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Allianz Research

# The great **balancing act**

Global Economic Outlook 2024-2026

# Executive Summary

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- **Steady (not stellar) global growth ahead at +2.8% until 2026, in line with the long-term average.** The US economy is slowing but will remain the main support to the global economy in 2024. Momentum is gradually building in Europe, though Germany will remain the exception, with the economy only exiting recession by the end of 2024. Domestic demand continues to slow in China as policy easing can only partly compensate for the headwinds brought on by the continued real estate crisis.
- **Recession risks in the US are rising but the economy is still within the range of a soft landing.** Strong household and corporate finances, a rising trend in manufacturing investment and the technology sector support this view. However, US consumption is expected to slow further next year, in line with the slowdown of earnings growth. In Europe, leading indicators still show recession risks but are improving from low levels.
- **It's austerity time (again).** The fiscal consolidation ahead will be the big elephant in the room as it will represent a drag on GDP growth of around -0.3pp on average until 2027 in both the US and Europe. Tax hikes, mainly on corporates, are more likely than spending cuts. In addition, quantitative tightening (QT) will transfer more than 3pps of debt/GDP per year to investors in Europe.
- **Inflation should reach the 2% target in H1 2025, allowing for a strong(er) easing cycle ahead.** Inflation surprised on the downside during the summer and we expect sticky services inflation to soften slowly, driven by decelerating wages, while energy and goods will continue to drag inflation down. Oil prices should remain below 80 USD/bbl in 2025-26 in the absence of a stronger recovery in demand and no supply shock. Gradual central bank easing should continue until terminal rates are reached next year, with the Fed cutting down to 3.5%, the ECB to 2.25% and the BoE to 3.0%. Emerging market central banks will cautiously proceed with their easing cycles as portfolio inflows should pick up again on more favorable interest rate differentials.
- **Real wage growth revives consumers' purchasing power, but excess savings continue to build up in Eurozone countries amid subpar confidence.** Consumer spending has favored services over goods, but services sales in volume have started to slow amid high inflation. Some durable goods are likely to be replaced in the next quarters, especially in Europe, in line with the replacement cycle. Nominal wage growth is set to normalize by 2025 in line with the cooling down of labor markets once some corporates (mainly in food, auto, materials and machinery & equipment) reduce labor hoarding.

- **Restocking has started and is likely to be a tailwind for the global trade recovery.** H1 confirmed the exit from 1.5 years of trade recession, and we expect the recovery to be more sustained going forward, along with the rebound in consumption. Overall, we expect global trade to increase by around +3% in 2025-26 in volume terms, but to remain below the long-term average.
- **Corporates are recovering by digging into inventories.** In Q2, revenues and earnings growth were fueled by corporate destocking. The Europe-US divide persists; despite a slight improvement in corporates' financials in Q2, Eurozone fixed capital investment fell to 7% below pre-pandemic levels and far behind peers such as the US and the UK. Major insolvencies continued to accelerate, mainly in retail, construction and services. Overall, we expect business insolvencies to rise by +10% in 2024 and by +1% in 2025.
- **Capital markets remain under the spell of central banks.** Markets are now pricing a strong policy rate-cutting cycle for most Western central banks, dragging long-term government bond yields lower. This provides some tailwind to riskier investments, with government bond spreads in Southern Europe narrowing further. As we see slightly less easing by the Fed and the ECB compared to market pricing, we do not expect long-term yields to fall below current levels in the near term.
- **Risky assets at the mercy of political uncertainty.** After a relatively weak Q2 earnings season, which has partially deflated some market imbalances (e.g. AI boom), market participants have quickly lowered expectations for corporates' growth capabilities. Nevertheless, decent single-digit earnings and revenue growth, paired with declining financing rates, should help maintain a decent single-digit return profile over the next three years. However, still elevated (geo)political uncertainty will keep investors awake as periods of heightened volatility are to be expected.
- **Geopolitical tensions pose downside risks to our scenario.** A potential surge in US protectionism if Donald Trump wins the US elections is the largest risk, along with high political uncertainty in major European countries (France, Germany, Belgium, Netherlands) as well as the ongoing conflicts in Russia-Ukraine and the Middle East, and tensions in the South-China-Sea and with Taiwan. Overall, our downside scenario translates to -1.5pp lower global growth and +1pp higher inflation, which would keep interest rates higher for longer.



# Steady (not stellar) global growth ahead

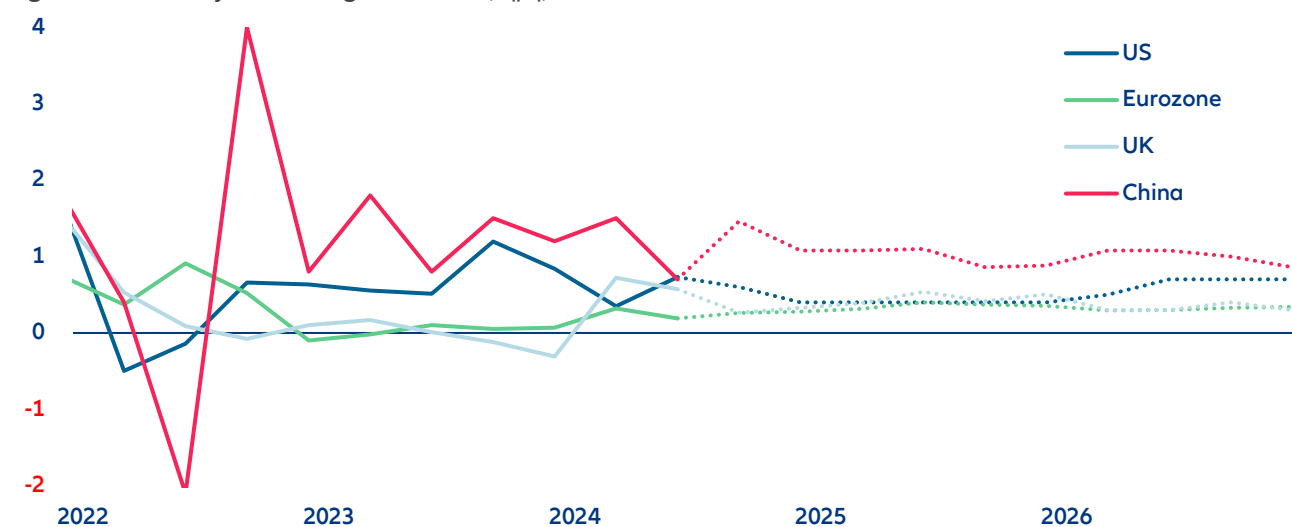
**We expect global growth at +2.8% until 2026, in line with its long-term average.** The US economy is slowing but will remain the main support to the global economy in 2024. We expect US growth to reach +1.7% in 2025, followed by a rebound to +2.2% in 2026, in line with its potential, thanks to a pick-up in domestic demand as monetary and financial conditions become more accommodative. Momentum is gradually building in Europe, and we expect growth to increase to +1.4% in 2025-26, slightly above potential. However, Germany will remain in recession for a second year in a row, with growth expected to bottom out in late 2024, supported by the recovery in global trade and easing monetary and financial conditions finally driving up domestic demand. The Chinese economy remains in a slowdown amidst a real estate crisis that weighs on private sector confidence. Policymakers are sensing the urgency to step up support and further monetary easing along with accelerating fiscal spending in the coming quarters should bring China's GDP growth close to the official target of "around +5%" in 2024, and it should remain above +4% in 2025-26.

**Recession risks in the US are rising but the economy is still within the range of a soft landing, helped by strong household finances, a rising trend in manufacturing investment and the technology sector.** However, US consumption is expected to slow further next year, in line with the slowdown of wage growth. Households have been ready to use their savings over the past year, pushing the saving ratio to levels as low as those seen during the 2000s. However, it is not expected to fall further, alongside with less supportive fiscal policy. In Europe, the economic momentum is improving, mainly thanks to net trade and public consumption, but leading indicators reflect ongoing weakness in domestic demand.

**Table 1:** Global real GDP growth, %

Growth (yearly %)	2022	2023	2024f	2025f	2026f
<b>Global</b>	<b>3.1</b>	<b>2.7</b>	<b>2.8</b>	<b>2.8</b>	<b>2.8</b>
<b>USA</b>	<b>1.9</b>	<b>2.5</b>	<b>2.6</b>	<b>1.7</b>	<b>2.2</b>
<b>Latin America</b>	<b>3.9</b>	<b>1.9</b>	<b>1.9</b>	<b>2.7</b>	<b>2.6</b>
Brazil	3.1	2.9	2.3	2.4	2.0
<b>UK</b>	<b>4.4</b>	<b>0.1</b>	<b>1.2</b>	<b>1.8</b>	<b>1.3</b>
<b>Eurozone</b>	<b>3.5</b>	<b>0.5</b>	<b>0.8</b>	<b>1.4</b>	<b>1.4</b>
Germany	1.7	-0.1	-0.1	0.7	1.1
France	2.6	1.1	1.1	1.4	1.2
Italy	4.2	1.0	0.8	1.2	0.9
Spain	5.8	2.5	2.7	2.0	2.0
<b>Central and Eastern Europe</b>	<b>1.1</b>	<b>1.1</b>	<b>2.4</b>	<b>3.3</b>	<b>3.3</b>
Poland	5.9	0.1	3.0	3.8	3.6
Russia	-1.3	3.7	3.9	2.2	1.6
Türkiye	5.5	4.5	4.0	4.1	4.0
<b>Asia-Pacific</b>	<b>3.2</b>	<b>4.3</b>	<b>4.2</b>	<b>4.0</b>	<b>3.8</b>
China	3.0	5.3	5.0	4.3	4.0
Japan	1.2	1.8	0.0	1.2	1.0
India	6.5	7.8	7.0	6.4	6.4
<b>Middle East</b>	<b>6.1</b>	<b>1.3</b>	<b>1.9</b>	<b>3.4</b>	<b>3.5</b>
Saudi Arabia	7.5	-0.8	1.4	4.3	4.1
<b>Africa</b>	<b>3.9</b>	<b>3.0</b>	<b>3.3</b>	<b>3.6</b>	<b>3.6</b>
South Africa	1.9	0.7	1.2	1.7	2.0

Sources: national, Allianz Research

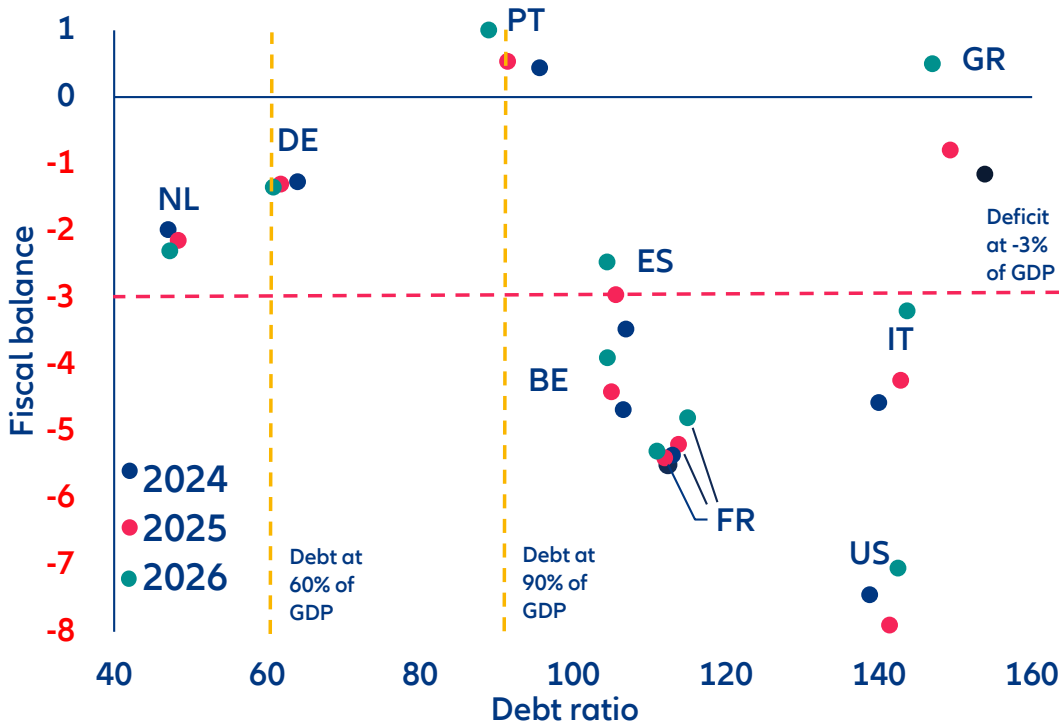
**Figure 1:** Quarterly real GDP growth rates, q/q, %

Sources: national, Allianz Research

**Fiscal policy: it's austerity time (again).** In Europe, reformed fiscal rules will soon be tested by policymakers and financial markets. Overall, the outlook remains a moderate fiscal consolidation in 2025-2026, but major Eurozone economies such as France, Italy and Belgium would need to undertake greater efforts to reduce their deficit and debt-to-GDP ratios. Indeed, these economies (out of seven EU countries) are now back in the spotlight for having breached the 3% fiscal deficit anchor rule and are required to present to the European Commission their country-specific adjustment plans. This would require a fiscal consolidation of around 0.5% of GDP per year for a seven-year period, which means a negative impact of -0.3pp on GDP growth every year. Governments will likely prioritize increasing their revenues. For example, France may do so by increasing taxes on corporates while in Italy this could be achieved through speeding up the planned privatization scheme (1% of GDP over three years).

Moreover, a little more than two years are now left for EU countries to receive and spend what is left of the EUR750bn in loans and grants offered by the Next Generation EU funds. Only one-third of this sum has been disbursed so far, in parallel with the fulfillment of milestones and targets, and even less has been invested. The catch-up in spending will be crucial to somewhat alleviate fiscal pressure and boost public investment, which are estimated, together with private efforts, to amount to EUR800bn per year to improve European competitiveness, according to the recently published Draghi report.

Figure 2: Fiscal balances and debt ratios, %



Sources: LSEG Datastream, Allianz Research.

Note: dotted lines represent debt and deficit thresholds settled by the reformed EU fiscal rules, and they don't apply for UK and US.

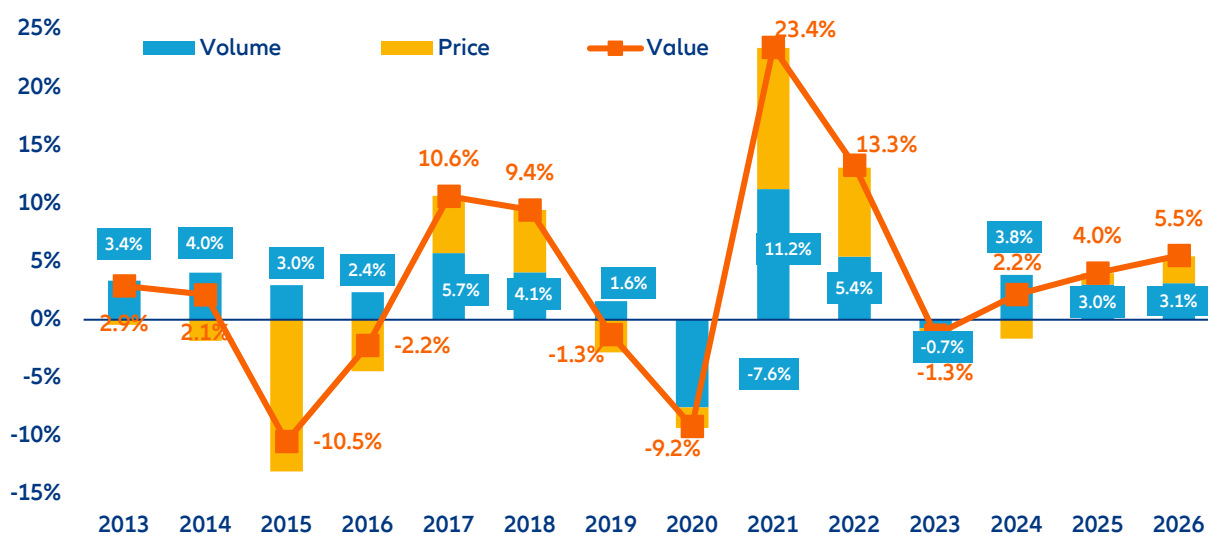
**In the US, the General Government (GG) public deficit should be lower in 2024 than in 2023 (at -7.5% of GDP vs -7.9%).** State & local (S&L) governments are largely behind the reduction, given their strong fiscal rules of targeting balanced budgets. We expect the GG fiscal stance to remain restrictive in 2025 (to the tune of 0.5% GDP), driven again by S&L governments. At the federal level, no major legislative changes are expected under our scenario of policy continuity, with the odds of a divided government being high. The GG public deficit should rise again (to -7.9% GDP) because of a slowing economy weighing on tax collections. In 2026, we are penciling in only a partial extension of Trump's 2017 personal tax cuts. Under this scenario, the fiscal stance should become very restrictive, to the tune of 1% of GDP at the federal level.

**The global trade recovery is ongoing and restocking will further support the outlook.** We expect global trade to grow by +3.8% in volume terms in 2024, followed by +3.0% in 2025 and +3.1% in 2026. After a year and a half in recession, global trade in goods has recovered by +0.9% y/y in the first half of 2024. Momentum in the latter months is particularly positive on the back of resilience in household consumption in advanced economies and as retailers look to restock ahead of the holiday season and potential uncertainties affecting global trade routes. Looking ahead, we anticipate a sustained recovery, driven by restocking from companies and households renewing purchases of durable goods while reducing services expenditures.

However, exporters' profitability remains pressured by soaring global sea freight rates. As of early September, shipping rates have surged +79% YTD and +184% y/y, now at approximately 46% of 2021's peak. Freight prices are expected to decline after the Western holiday season as frontloading activities conclude and US tariffs on China take effect. Nonetheless, global sea freight rates will stay elevated as long as the Gaza conflict persists and until the Red Sea situation stabilizes.

**Risks to our scenario remain tilted to the downside.** The upcoming US elections could trigger a surge in protectionism if Donald Trump wins, while political uncertainty looms in major European nations due to the current political fragmentation and the rise of extremist parties (France, Germany, Belgium, the Netherlands). The ongoing conflicts (Russia-Ukraine, Middle East, South China Sea, Taiwan) further exacerbate these risks. The key economic threats to our outlook include: (i) China's real estate crisis, which could potentially drag growth below +4% by depressing further domestic demand and (ii) a sluggish recovery in Eurozone demand, compounded by rising savings rates. Additionally, declining productivity amid stable workforce levels signals potential layoffs if consumer demand falters. Overall, our downside scenario – marked by fiscal slippage and escalating geopolitical tensions – could slash global growth by 1.5pp and boost inflation by 1pp, maintaining elevated interest rates for an extended period.

**Figure 3:** Global trade of goods and services, annual growth



Sources: CPB, Allianz Research



## Inflation should reach the 2% target in H1 2025, allowing for a strong(er) easing cycle ahead

**Inflation has recently surprised on the downside particularly in the US and Eurozone, largely driven by lower energy costs and still subdued goods inflation.**

However, core inflation remains elevated in many regions, with the latest readings close to or above 3% due to persistent service sector price pressures. On a positive note, initial signs of easing in service prices have emerged, with forward-looking indicators, such as purchasing managers' indices for output prices, returning to or even dropping below pre-Covid levels in many countries. As wage growth is expected to decelerate with easing global labor market pressures, decelerating service price pressures may continue. We expect inflation targets to be met by 2025, though potential hurdles remain. Volatility in oil prices, for instance, persists; after briefly dipping below 70 USD/bbl in September, prices are expected to rise again above 80 USD/bbl by year-end before moderating in 2025-26. Additionally, electricity prices in Europe have recently rebounded, posing short-term risks to headline inflation. Meanwhile, China remains an outlier, still grappling with inflation rates below 1% though signs of a gradual rise are evident. Overall, inflation rates globally are expected to further normalize toward central bank targets in 2025.

**The labor market has loosened significantly in the US, helping to push down wage growth. In Europe, labor markets remain tight, helping households to continue to push for high pay hikes. But recent data point to softening.** The US labor market has almost fully normalized from the pandemic-induced distortions. The

private quit rate has even dropped below its 2019 (pre-pandemic) level. Although the rising unemployment rate is more driven by strong labor supply rather than too weak labor demand – with no evidence of broad-based layoffs – a looser labor market means slower wage growth should continue. We expect the unemployment rate to increase to 4.8% by Q1 2025, and wage growth (as measured by the Employment Cost Index) to cool down from +3.8% in 2024 to +3.3% in 2025. In Europe, labor markets have not quite loosened as much as in the US, partly because of lower market flexibility and partly because of acute labor shortages (e.g. in Germany and the UK). In this environment, wage growth has cooled less rapidly than in the US, though there are cross-country specificities. Spain and Italy, for instance, are seeing less rapid softening than France and the UK. Nevertheless, the slight increase in unemployment that we expect, and much lower inflation, should continue to push wage growth lower. It should normalize by mid-2025 in most countries.



**Table 2:** Inflation forecasts, yearly, %

Inflation (yearly %)	2022	2023	2024f	2025f	2026f
<b>Global</b>	<b>8.2</b>	<b>6.1</b>	<b>5.4</b>	<b>3.7</b>	<b>3.2</b>
<b>USA</b>	<b>8.0</b>	<b>4.1</b>	<b>2.9</b>	<b>2.2</b>	<b>2.2</b>
<b>Latin America</b>	<b>14.0</b>	<b>14.4</b>	<b>16.7</b>	<b>9.8</b>	<b>5.9</b>
Brazil	9.3	4.6	4.1	3.0	3.5
<b>UK</b>	<b>9.1</b>	<b>7.3</b>	<b>2.7</b>	<b>2.0</b>	<b>2.1</b>
<b>Eurozone</b>	<b>8.4</b>	<b>5.4</b>	<b>2.4</b>	<b>2.0</b>	<b>2.0</b>
Germany	6.9	5.9	2.2	2.1	1.9
France	5.2	4.9	2.2	1.7	1.8
Italy	8.2	5.6	1.2	2.0	2.0
Spain	8.4	3.5	3.0	2.2	1.9
<b>Central and Eastern Europe</b>	<b>9.1</b>	<b>11.0</b>	<b>3.8</b>	<b>4.1</b>	<b>3.4</b>
Poland	14.4	11.4	3.8	4.5	3.6
Russia	13.8	5.9	8.2	6.0	4.4
Türkiye	72.3	53.9	59.3	25.4	17.3
<b>Asia-Pacific</b>	<b>3.9</b>	<b>3.0</b>	<b>1.9</b>	<b>2.2</b>	<b>2.3</b>
China	2.0	0.2	0.4	1.3	1.8
Japan	2.5	3.3	2.5	2.1	1.6
India	6.7	5.7	4.5	4.4	4.4
<b>Middle East</b>	<b>13.9</b>	<b>10.7</b>	<b>12.5</b>	<b>5.1</b>	<b>4.8</b>
Saudi Arabia	2.5	2.3	1.9	2.0	2.0
<b>Africa</b>	<b>14.2</b>	<b>18.2</b>	<b>19.0</b>	<b>11.1</b>	<b>6.1</b>
South Africa	6.9	5.9	4.5	4.5	4.0

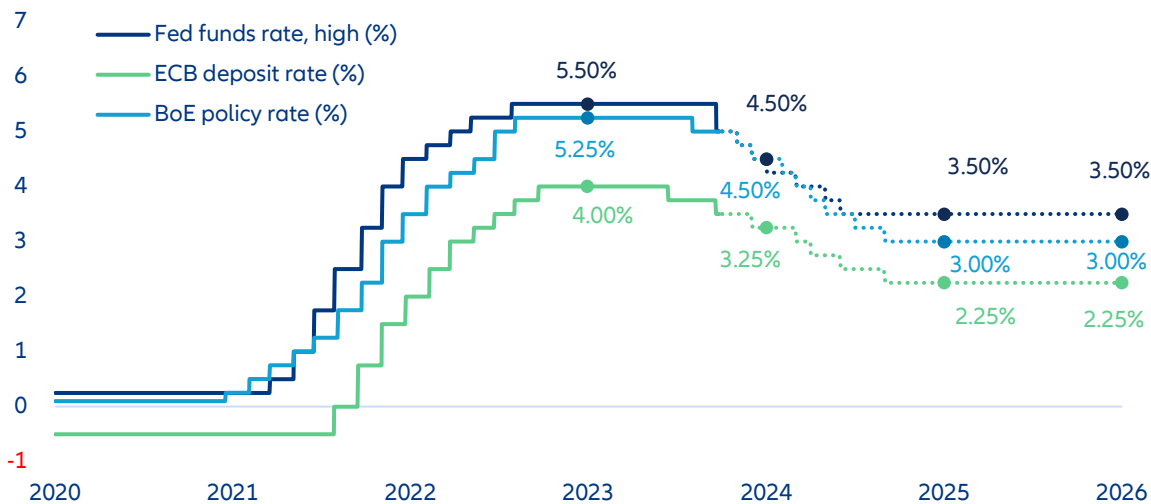
Sources: national, Allianz Research

**The Fed has kicked off its loosening cycle with a jumbo 50bps interest rate cut. However, we expect back-to-back 25bps rate cuts in each subsequent meeting through June 2025 amid a resilient economy.**

The softening labor market, lower inflation and a fear of being “behind the curve” (i.e. too restrictive for too long) prompted the Fed to opt for a 50bps interest rate cut during its September meeting. This is an insurance cut against the risk of a weakening economy. However, the Fed has acknowledged the strength of the economy and this 50bps rate cut is a way to keep it growing. Besides, the labor market is not as weak as it appears at first glance. In this environment, the reality of a resilient, albeit cooling, economy will reassert itself to FOMC policymakers. The Fed will have to carefully balance the risk of reheating the economy and over-easing financial conditions. That is why we expect a more balanced approach in the next FOMC

meetings, with back-to-back 25bps interest rate cuts at each one through June 2025. This would bring the Fed funds rate (upper range) down to 3.5% by then<sup>1</sup>.

<sup>1</sup> This is close to our estimate of the neutral interest rate, which is probably much higher than during the 2010s because of i) higher inflation volatility, ii) larger government deficits and iii) solid private sector balance sheets.

**Figure 4: Monetary policy forecasts**

Sources: LSEG Datastream, Allianz Research  
 Note: Dots show Allianz forecasts.

**The ECB started its easing cycle earlier but more gradually than the Fed, with two 25bps cuts in June and September.** It is likely to continue a gradual easing approach. With the inflation rate dropping to 2.2% y/y in August, loosening the highly restrictive stance is well justified. However, with record low unemployment, still strong wage growth and sticky core inflation, the ECB is not in a rush and will likely continue a careful, data-dependent approach. We therefore expect policymakers in Frankfurt to follow a gradual cutting cycle, reaching a terminal rate of 2.25% in September 2025. Meanwhile, quantitative tightening has accelerated, as already announced by the ECB in December last year, from an average monthly roll-off of EUR28bn to around EUR35bn since July. From January 2025 onwards, the average monthly run-off will again increase to around EUR40bn per month. This dynamic contrasts with the Fed, which limited its monthly run-off in treasuries in June from USD60bn to USD25bn.

**The Bank of England (BoE) is expected to move in lockstep with the Fed, delivering cautious 25bps rate cuts in each meeting from November.** With an economy displaying solid momentum, inflation set to pick up again in coming months, and financial conditions loosening (e.g. in the housing market), the BoE is in no rush to loosen policy. A steady loosening from the Fed and the ECB and

a drop back in inflation expected by the spring of 2025 should give the BoE enough confidence to cut rates by 25bps in each meeting through August 2025, which would bring the bank rate to 3%.



## The US economy enters a soft landing

**The US economy is braced for a managed slowdown heading into 2025.** Incoming data through the end of Q3 2024 shows that the US economy is still growing at a strong pace. We expect sequential growth to start to soften from Q4 2024 and heading into 2025. Several tailwinds that have supported the economy in 2023 and 2024 are indeed fading rapidly. Immigration flows have been cut down at the Southwest border, reducing the boost to labor supply. Meanwhile, corporates' hiring intentions are weak and signal very tepid private job creations by end 2024-early 2025. Households have also depleted most of their "excess" pandemic savings. Real household liquid wealth for the bottom 80% of households has dipped below its pre-pandemic trend in 2024, while credit card delinquencies continue to increase fast. Lastly, more restrictive fiscal policy should start to weigh on demand. Nevertheless, we expect the economic slowdown to be manageable, given the strength of corporates and households' balance sheets, the economy's solid supply

dynamics and improved credit conditions. The Fed's easing should limit downside risks to the economy, for instance in the case where the weakening labor market were to spill over to negative confidence effects and depressed spending. In all, we see US growth cooling down from +2.6% this year to +1.7% in 2025. In 2026, US growth should step up to +2.2% amid lower Fed interest rates feeding through to the real economy. The upside to growth in 2026 would be limited by a much more restrictive fiscal stance amid the expiration of some personal tax cuts. However, the outcome of the election creates considerable uncertainties to our forecasts. Should Trump secure a second term and increase of trade tariffs from 2.5% to 4.5% – which looks more likely than his campaign pledge of 10% – this would cut US growth by -0.5pp in 2025 compared to the baseline scenario. It would also increase inflation by +1.6pp to 3.5%, putting the Fed easing cycle on hold, with rates stalling at 4.5% in 2025<sup>2</sup>.

<sup>2</sup> See our report: [Trumponomics: the sequel \(allianz.com\)](https://www.allianz.com/en/insights/trump-economics)

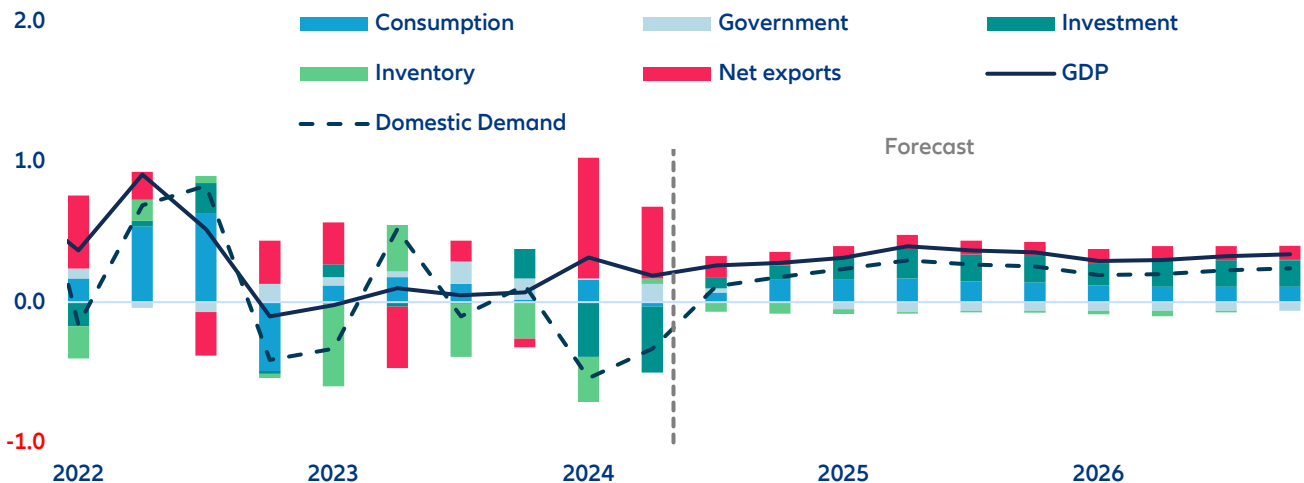
# Economic momentum is improving in Europe, but Germany remains the sick man

**Eurozone growth is set to strengthen, driven by a rebound in investment and consumption.** The Eurozone exited its stagnation phase of 2023, posting positive growth in the first two quarters of this year at +0.3% and +0.2% q/q. However, this growth was largely fueled by net exports, while domestic demand, particularly investment, contracted. Looking ahead, we expect economic activity to accelerate and slightly exceed potential growth, supported by a rebound in consumption and investment as real wages rise and easing monetary policy lowers credit costs. Additionally, a global trade recovery could provide further support, while government spending is expected to act as a drag due to fiscal tightening. However, with only 35% of NGEU funds disbursed and even less effectively spent, accelerating spending could provide an additional boost to activity in the coming quarters.

**Germany is currently navigating a challenging landscape marked by both cyclical and increasingly structural issues.** Companies are facing declining competitiveness, not only in international markets but

increasingly also domestically. The planned budget cuts for 2025 – along with uncertainties over the years to come and particularly regarding financing the green transformation – add further strains. Adhering strictly to the debt-brake policy presents an additional challenge as low government debt and interest payments may hinder investments and potentially prolong recession risks. As economic and political uncertainty rises even further in Germany, particularly with elections on the horizon, revitalizing the economy will require more than the government’s current strategies. We anticipate a second year of recession with -0.1% in 2024, followed by modest growth of just +0.7% in 2025 and +1.1% in 2026, supported by lower borrowing costs resulting from declining interest rates.

Figure 5: Eurozone growth contributions, %



Sources: Eurostat, Allianz Research

**In France, the economy has proved resilient despite the rise in political uncertainty since the dissolution of the National Assembly in July.** Policy uncertainty has receded while financial conditions have not tightened. Meanwhile, fiscal policy is looser than it would have been absent the dissolution. We expect GDP growth to step up from +1.1% in 2024 to +1.4% in 2025, helped by the ECB-induced loosening of credit conditions. Fiscal policy will become tighter but not particularly tight as it will be challenging to pass significant fiscal-consolidation measures in Parliament.

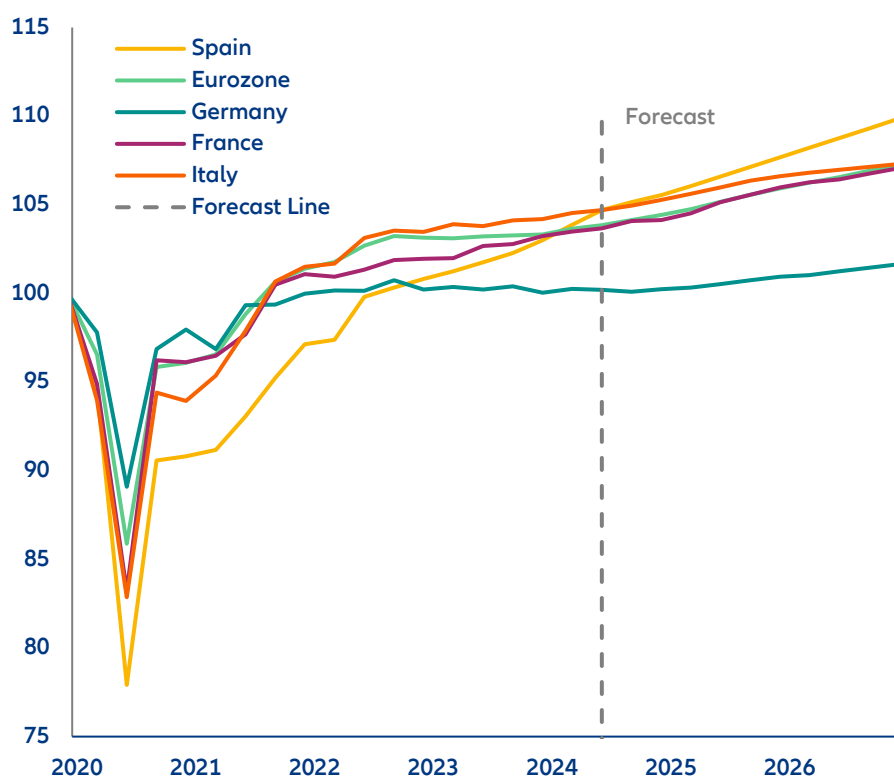
In Italy, a steady and moderate pace of growth (+0.2% q/q in Q2) means we see the economy expanding by +0.8% in 2024, before speeding up to +1.2% in 2025. This should be driven by the positive effects of monetary policy easing and a boost to investment from the NGEU, which will make up for the normalization of construction boosted by the Superbonus tax credit scheme in 2021-2023. Despite Italy's inflation rate being one of the lowest in the Eurozone, private consumption has not resumed yet, with the savings rate surpassing pre-pandemic levels. Also, fiscal challenges will continue to weigh on the outlook as the new EU rules will require significant consolidation efforts.

**Spain will remain the Eurozone's outperformer.** After posting a strong +0.8% quarterly growth rate in Q2, we expect GDP to grow by +2.7% this year. However, the underlying drivers of growth remain volatile; consumption

and investment have almost recovered to end-2019 levels, while activity is already 4.7% above pre-pandemic levels, thanks to strong positive contributions from net trade. Disposable income is recovering but at the same time savings are increasing, providing only little hopes of a swift rebound in private spending. On the other hand, tourism activity has experienced a record season, supporting Spain's trade balance.

**The UK's growth momentum should continue to be solid heading into 2025.** The UK posted solid quarterly growth rates in H1 2024, buoyed by the early signs of a recovery in residential investment and strong public spending. We expect the recovery of the housing market to continue through 2025. Mortgage approvals are almost back to their pre-pandemic levels and real house prices are accelerating. Lower inflation, still elevated wage growth and a tight labor market should increasingly support household spending. We expect the fiscal stance to be slightly expansionary in 2025, with tax hikes partially funding increased public spending on infrastructure, for example, which has a strong GDP impact. Nevertheless, tax hikes announced in the upcoming budget may weigh on consumer confidence. Meanwhile, exports should recover heading into 2025, helped by stronger growth in the Eurozone.

**Figure 6:** Eurozone real GDP, index 100=2019 Q4



Sources: national, Allianz Research

# Emerging markets' growth above pre-pandemic average

**China: stronger policy easing will only cushion the economic slowdown.** While the Chinese economy started 2024 with an encouraging quarter, subsequent data have been mostly disappointing. Exports have been one of the very few bright spots throughout the year as manufacturers benefit from recovering global demand and remain competitive by cutting export prices. Business confidence indices thus paint a mixed picture, with manufacturing companies more exposed to external demand faring better. Domestically, the crisis in the real estate sector continues, with construction activity still in sharp decline, inventories not depleting fast enough and most gauges of housing prices in slight decline. In this context, household confidence remains well below pre-crisis levels and private consumption spending is stuttering. Monetary and fiscal policy measures so far this year have been insufficient to reverse the downward trends. Authorities are now probably sensing the urgency to step up policy easing in order to restore private sector confidence and ultimately ensure a sustainable recovery in domestic demand. On the monetary side, the PBOC delivered a larger-than-expected package of accommodative measures on 24 September and is likely to cut policy rates twice more in 2025, while also increasing liquidity availability for banks. Easier and cheaper funding conditions are insufficient on their own to reverse the downwards trend in private sector credit, but they provide favorable conditions for stepping up fiscal spending. On this front, we expect government bond issuance to accelerate in coming quarters. Overall, we expect China's GDP growth in 2024 to end up close to the official target of "around +5%", with risks clearly on the downside. Thereafter, we expect a slowdown to +4.3% in 2025 and +4.0% in 2026. In the long run, we estimate that China's potential growth will average +3.9% over 2025-2040, compared with +7.0% over 2011-2020.

**Conditions have improved for emerging market economies, but divergences remain.** We expect GDP growth for emerging market economies (excluding China) overall above the pre-pandemic average at +3.6% in 2024 and +3.9% in both 2025 and 2026. South and Southeast Asia in particular should outperform, supported by robust exports and easing domestic conditions. Africa and the Middle East are likely to see higher growth rates in the coming years, Emerging Europe is gradually recovering, while Latin America delivers more of a mixed picture. Divergence in monetary policies is also evident there, with Brazil expected to hike the policy rate, diverging from the global trend of monetary easing. The pace of policy rate cuts is likely to pick up in Emerging Asia, while it has slowed in Emerging Europe as inflation there is expected to remain above central bank targets. Against overall benign conditions for growth, idiosyncratic vulnerabilities and geopolitical risks could cloud the outlook for certain emerging market economies: the ongoing war in Ukraine and the Middle East, social tensions in Argentina, potential balance-of-payment crises in Romania and Türkiye and tensions around the Taiwan Strait and the South China Sea.

**Table 3: Key drivers and challenges for emerging market economies**

<b>Emerging Asia, excluding China</b>	<ul style="list-style-type: none"> <li>• We expect the Asia-Pacific region to grow by +4.2% in 2024 (after +4.3% in 2023), followed by +4.0% in 2025 and +3.8% in 2026. South and Southeast Asia will continue outperform, with India growing by +6.4% and ASEAN by +4.5% in 2025-2026. Tailwinds include robust exports and easing domestic conditions.</li> <li>• Inflation fell back to or below central bank targets in most of the region, due to past monetary policy tightening and falling food prices. We forecast inflation for Emerging Asia (excluding China) overall at 4.1% in 2024 (after 5.5% in 2023), 3.6% in 2025 and 3.2% in 2026.</li> <li>• Lower inflation and the Fed's pivot allow for monetary easing in Emerging Asia. The Philippines has kicked off policy rate cuts in August, and more are likely to follow suit before the end of 2024. We expect between 50-150bps of cuts in the main economies of Emerging Asia (excl. China) by the end of 2025.</li> <li>• Main geopolitical risks in the region are around the Taiwan Strait and the South China Sea. Economies also need to affirm themselves amidst the US-China rivalry.</li> </ul>
<b>Emerging Europe</b>	<ul style="list-style-type: none"> <li>• Regional growth is forecast +3.3% in 2024 and around +3% in both 2025 and 2026. While growth in Russia is set to slow, economic activity is gradually recovering in CEE, driven mainly by domestic demand and fiscal stimulus.</li> <li>• Inflation is forecast to remain above central bank targets in most economies until end-2025, due to fiscal stimulus and strong wage growth. In Türkiye, however, inflation will remain well into double digits until 2026. This will keep the regional average at around 16% in 2024, 9% in 2025 and 6% in 2026.</li> <li>• The pace of monetary easing has slowed and policy rates are expected to remain above pre-pandemic levels. Fiscal policy is forecast to remain loose, putting public finances at risk in the medium term.</li> <li>• Key risks include the ongoing war in Ukraine, potential balance-of-payment crises in Romania and Türkiye and continued economic weakness in Western Europe.</li> </ul>
<b>Latin America</b>	<ul style="list-style-type: none"> <li>• After a +1.9% expansion in 2023, we expect moderate regional growth of +2% this year, surpassing the decade's average of +1%. Chile and Peru will lead, driven by mining and services, along with Costa Rica and the Dominican Republic. Mexico and Brazil will see growth matching OECD averages due to labor market resilience, infrastructure investments and household spending. Argentina faces negative growth from fiscal measures, though its long-term credibility will improve. In 2025, fiscal spending in Chile will rise and Mexico's growth may slow, depending on US election outcomes.</li> <li>• Supportive monetary policies, commodity prices and investor confidence have stabilized inflation and exchange rates. Brazil's central bank is expected to take a different approach to extend its exchange rate gains, attract foreign investment and address concerns about its independence. Mexico, Colombia and Chile are likely to continue their easing cycles into 2025.</li> <li>• The region benefits from geopolitical isolation and supply-chain reconfigurations, though risks such as resource nationalism and social tensions persist. Social risks are declining, but Argentina may see continued protests, mostly confined to large cities and the public sector.</li> </ul>
<b>Africa and the Middle East</b>	<ul style="list-style-type: none"> <li>• Both Africa and the Middle East are projected to experience growth increases compared to 2023. Africa is expected to grow by +3.3% in 2024 and +3.6% in 2025. With relatively lower oil prices, the Middle East is forecasted to grow by +1.9% in 2024 and +3.4% in 2025.</li> <li>• Inflation is decelerating across the board, albeit at varying rates. Gulf Cooperation Council (GCC) countries are expected to stabilize at +2.1% in 2024 and +2% in 2025. However, inflation remains high in non-GCC Middle Eastern nations, averaging 13.7% in 2024 and 13.4% in 2025. In Africa, inflation is projected at 19% in 2024, decreasing to 11% in 2025.</li> <li>• Central banks in the region are aligning with major global economies in terms of monetary easing. Gulf economies have quickly followed the Fed's lead, reducing rates. Selected African and non-GCC economies have also begun easing, although many remain cautious.</li> <li>• Ongoing conflict in the Middle East poses a significant threat to regional stability. As the conflict continues, neighboring countries are experiencing economic slowdowns, and the risk of further escalation remains a concern.</li> </ul>

Source: Allianz Research





# Corporates in cyclical sectors to make a comeback in 2025

**Corporate earnings have been showing signs of recovery, with global revenues growing by +3.5% y/y in Q2.** However, the Europe-US divide persists as European companies experienced a slight revenue decline of -0.7% y/y, while US and Asia-Pacific firms reported growth of +4.5% y/y. Despite this, a notable 58% of global corporations exceeded revenue expectations, with 59% of European firms also beating forecasts, suggesting that the momentum is getting stronger. Profitability trends further highlight this recovery as global earnings rose by +14.7% y/y. US companies led again in the scoreboard as earnings growth hit +10% y/y, with 69% surpassing market expectations. European firms saw a decline of -2.5%, but a majority of firms still managed to beat expectations. This recovery is being driven partly by sectors such as technology, which are outperforming others that are struggling due to supply-chain and geopolitical challenges. The earnings outlook remains cautiously optimistic, bolstered by economic resilience and the ongoing easing of monetary policy across the globe.

**The strategic drawdown of inventories is also a significant factor contributing to the corporate recovery.** This has allowed corporates to generate revenues, post better profits in a context of still high input costs and improved their working capital requirements (WCR). Indeed, in Q2 2024, global WCR showed a slight decline compared to the previous quarter, mostly thanks to the decrease in inventories, while shifts in payment behaviors were relatively modest. Nevertheless, while some sectors such as computers and telecom, household equipment and chemicals reported substantial quarterly reductions in WCR, others such as construction, energy and tourism saw some increases. Also, destocking has played a crucial role in stabilizing the cash cycle in sectors such as agrifood, automotive, chemicals and electronics, while elevated inventory levels in energy, construction and pharmaceuticals are still adding upward pressure on WCR.

**Despite the still weak economic context, two drivers will continue to lift capital expenditures: decarbonization and GenAI.** Inflationary pressures, higher-for-longer interest rates and geopolitical uncertainties have made companies cautious with large capital outlays, focusing on cash preservation and operational efficiency instead. However, looking ahead, there are some sectors that will

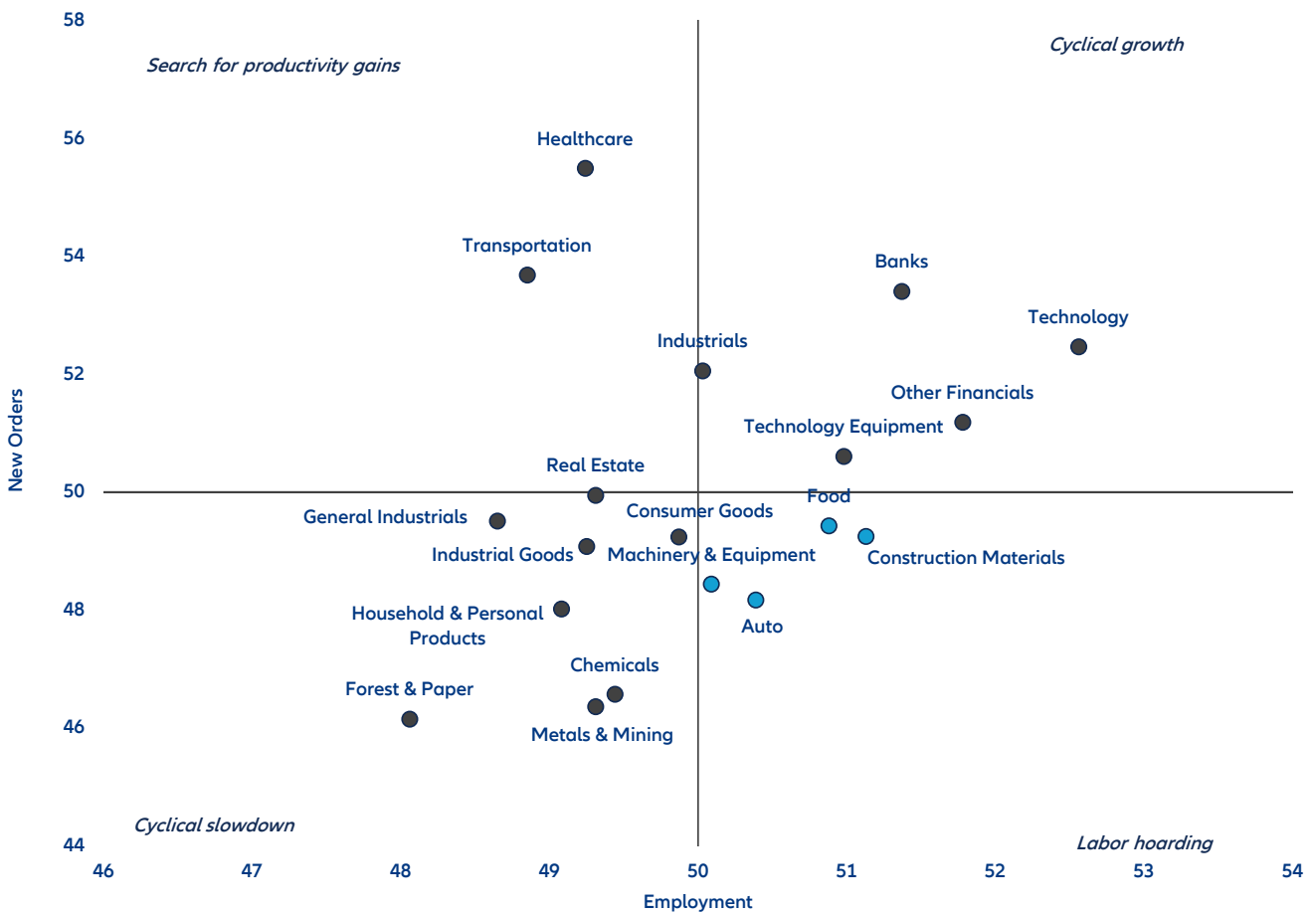
not stop investing as they are in a race against time to decarbonize their businesses and that of their customers. Such is the case for transport equipment, transportation, automobiles, metals & mining and energy. In this regard, we expect European firms to take the lead as they face stricter environmental regulations. In parallel, the rapid and growing adoption of generative artificial intelligence (GenAI) has also triggered capital investments in sectors such as technology and semiconductors, which indeed have registered the largest y/y increases in capex so far in 2024 (+38%), versus an all-industries average of +8%. In this area, we expect companies in Asia and the US – particularly tech giants and pharmaceuticals – to invest heavily in research & development, data centres, cloud compounding and AI, while on this regard, we expect European firms to allocate relatively less cash. Overall, we believe rate cuts will play a role in boosting capex financing. Yet, by geography, the outlook for investments in the coming year should be mixed. While we expect businesses in most advanced economies to prioritize efficiency improvements and digitalization, companies in emerging markets are likely to focus on building capacity to meet growing demand.

**Firms remain mindful of leverage and cautious about potential productivity gains. In a context of cautious cash allocation, corporates are deleveraging and making efforts to stabilize debt levels to improve their financial health.** This deleveraging is reflected in a more disciplined approach to balance sheet management as firms aim to mitigate the risks associated with high interest rates and heightened economic and political uncertainty. As a consequence, non-financial corporates' outstanding loans grew a meagre +0.9% y/y in the UK, decreased by -1% in the US and was almost stable in the Eurozone (-0.1% y/y). Furthermore, companies are holding onto their workforces despite efforts to enhance productivity, even in sectors facing profitability challenges such as automotive (see Figure 7). Indeed, despite many corporates going through restructuring and seeking more integration of technology and especially AI, this labor hoarding reflects a strategic choice to retain talent in anticipation of future growth but also perhaps some reservations regarding the actual productivity benefits of automation technologies.

**Against this still challenging backdrop, business insolvencies have not yet peaked and North America is leading the rise.** Canada, the Netherlands, Russia and Singapore are leading the rise in their respective regions. Exceptions are mainly to be found among emerging markets, such as Hungary, South Africa, Chile and India. In the US, Q2 2024 saw a +38% y/y increase in bankruptcies, prolonging the trend that began in mid-2022. Alternative sources confirm this upward trend for Q3, with the number of insolvencies of large firms remaining above pre-pandemic levels. Western Europe is also experiencing a prolonged rise in insolvencies, with the Netherlands, Sweden, Austria, Ireland and Germany posting the largest increases year to date. Denmark and the UK, however, are seeing a softening trend. In Asia, excluding China and India, countries such as Singapore, South Korea and New Zealand are witnessing strong upward momentum in insolvencies. Overall, most advanced economies are surpassing pre-pandemic levels of business insolvencies,

particularly in Western Europe and North America. In that context, a noticeable or strong increase in insolvencies is expected in one out of two countries for 2024, with two out of three countries projected to end the year with cumulated insolvencies above pre-pandemic levels. North America is expected to lead the rise (round +30%), followed by Western Europe (+13%) and Asia (+3% excluding China). Globally, insolvencies are expected to accelerate by at least +10%. Looking ahead, a moderate global increase is anticipated in 2025, driven primarily by North America and China. Other regions should see a slowdown in insolvencies as economic activity and financing conditions improve. However, this trend reversal will be limited and, in essence, primarily due to the strong rebound from 2021-2024 and return to high insolvency levels.

**Figure 7:** New orders vs employment (Manufacturing PMI index), above 50 = expansion; below 50 = contraction



Sources: S&P Markit, Allianz Research

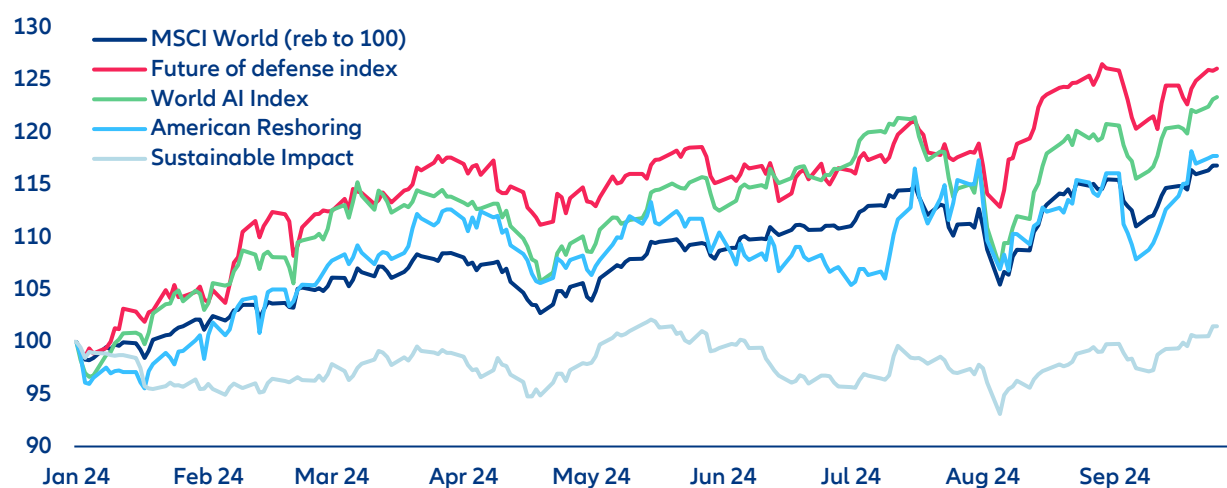
# Capital markets outlook: Getting ready for the mid-to-late cycle

## Q3 2024 has introduced significant structural changes that will shape market dynamics going forward.

Throughout this quarter, global equity and fixed-income markets have been buoyed by the growing anticipation of accelerated policy rate cuts, with market participants embracing the “soft landing” narrative. This trend began over the summer with the Bank of England and the ECB, and was amplified in September when the US Federal Reserve implemented a substantial 50bps cut. Despite this expected policy easing, markets still anticipate that terminal rates will remain relatively high from a historical standpoint, signaling an end to the ultra-low yield curve environment of the past decade. Even with a clear policy direction emerging, investors will continue to react quickly to each economic data release, pricing in a wide range of

possible outcomes and keeping market volatility elevated – especially as they seem poised to cut their losses short. Moving forward, investors will need to adapt to this persistent market uncertainty in the near term. However, as policy cuts continue and the soft-landing narrative is confirmed, the favorable market environment is likely to persist for most markets, particularly for riskier assets. Nonetheless, diversification will remain key as global trends that have driven markets upward in recent years are expected to cool down. In this environment it would be too temporary to go all-in, especially during a mid- to late-cycle environment (Figure 8).

**Figure 8:** Global equity market trends (rebased to 100)



Sources: LSEG Datastream, Allianz Research

**Table 4:** Capital market forecasts

<b>EMU</b>	<b>Last*</b>	<b>Unit</b>	<b>2023</b>	<b>2024f</b>	<b>2025f</b>	<b>2026f</b>
<b>Government Debt</b>						
ECB deposit rate	3.50	%	4.00	3.25	2.25	2.25
10y yield (Bunds)	2.17	%	2.03	2.30	2.20	2.20
10y EUR swap rate	2.40	%	2.48	2.60	2.50	2.50
20y EUR swap rate	2.48	%	2.51	2.70	2.70	2.70
<i>Italy 10y sovereign spread</i>	131	bps	168	130	120	100
<i>France 10y sovereign spread</i>	80	bps	53	70	50	40
<i>Spain 10y sovereign spread</i>	79	bps	97	70	60	50
<b>Corporate Debt</b>						
Investment grade credit spreads	114	bps	135	120	110	100
High-yield credit spreads	347	bps	395	360	350	340
<b>Equity</b>						
Eurostoxx (total return p.a.)	13 ytd	%	19	10	8	7
<b>US</b>						
<b>Government Debt</b>						
Fed Funds rate (high)	5.00	%	5.50	4.50	3.50	3.50
10y yield (Treasuries)	3.79	%	3.87	3.90	3.70	3.70
<b>Corporate Debt</b>						
Investment grade credit spreads	92	bps	104	100	90	85
High-yield credit spreads	314	bps	334	330	320	310
<b>Equity</b>						
S&P 500 (total return p.a.)	22 ytd	%	26	13	8	9
<b>UK</b>						
<b>Government Debt</b>						
BoE rate	5.00	%	5.25	4.50	3.00	3.00
10y yield sovereign (Gilt)	4.01	%	3.54	3.80	3.60	3.50
<b>Corporate Debt</b>						
Investment grade credit spreads	114	bps	134	120	120	110
High-yield credit spreads	416	bps	515	440	410	410
<b>Equity</b>						
FTSE 100 (total return p.a.)	10 ytd	%	8	7	8	7
<b>Emerging Markets</b>						
<b>Government Debt</b>						
Hard currency spread (vs USD)	198	bps	215	220	220	210
Local currency yield	6.10	%	6.19	6.3	5.9	5.8
<b>Equity</b>						
MSCI EM (total return p.a. in USD)	16 ytd	%	10	7	7	8
<b>Others</b>						
EUR USD	1.12	\$ per €	1.10	1.10	1.10	1.11

Sources: LSEG Datastream, Bloomberg, Allianz Research

Notes : Year end figures

\*as of 26 Sep.2024

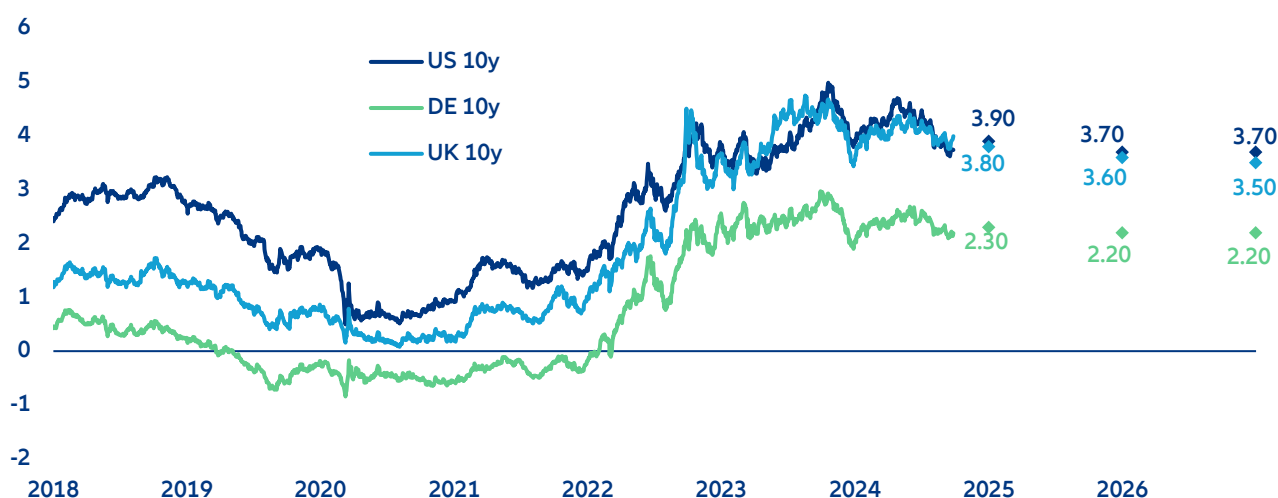
**Long-term interest rates are heavily influenced by expected central bank terminal rates, which declined during the summer amid progress on disinflation.** Unlike foreign exchange markets, which are driven by short-term policy rate expectations, 10y rates are co-moving with market expectations of terminal rates. For the Fed, these have dropped from over 4% earlier this year to below 3% now, while for the ECB, terminal rates fell from above 2.5% to around 2%. In lockstep, 10y US yields have moved from 4.5% since July to below 3.7% recently. As market expectations for terminal policy rates are now slightly below our forecasts of 3.5% for the Fed and 2.25% for the ECB, we expect a mild upward adjustment in government bond yields towards year-end. Beyond this correction, we foresee largely stable 10y yields in 2025 and 2026 (Figure 9). Two forces continue to counterbalance each other: Lower policy rates as well as normalizing inflation expectations should push yields down, while the large “net-net issuance” of government bonds could exert upward pressure on yields<sup>3</sup>.

**With falling policy rates, yield curves will continue to steepen, but the German curve will only adjust gradually in this cycle for several reasons.** First, this easing cycle takes place against the backdrop of a soft landing, not a hard landing like previous cycles. As a result, the ECB’s terminal rate is expected to settle at neutral levels (around 2%) rather than in full easing mode (around 0%) which should limit the short end of the German curve (2y rates)

from falling too low. Second, the German debt brake, a new factor compared to previous cycles, significantly limits German debt issuance and economic growth. These drivers keep the long end of the German curve suppressed (10y). Therefore, the German yield curve is unlikely to steepen as much as in previous periods, provided the soft-landing scenario continues.

**European government bond spreads should gradually narrow, with the exception of France where we expect spreads to remain around current levels.** While the formation of a new government in France is positive news, the next challenge lies in agreeing on a new fiscal budget and meeting EU demands to reduce the excessive deficit. Rating agencies will be closely monitoring the outcome. As a result, we do not expect the French-German yield spread to fall significantly by year-end, bringing it closer to Spanish levels despite a two-notch rating difference. However, over the next two years, we anticipate improvements in France’s political and fiscal landscape, which could gradually reduce spreads. Elsewhere in Europe, spreads should benefit from lower fragmentation risks, easing monetary conditions and Germany’s declining investment appeal due to weak growth and structural issues.

**Figure 9:** 10y government bond yield forecasts, %



Sources: LSEG Datastream, Allianz Research

<sup>3</sup> “Net-net issuance” refers to the combined effect of net bond issuance – gross issuance after redemptions, which directly results from fiscal deficits – being amplified by quantitative tightening (QT). Through QT, central banks release additional bonds into the market, further increasing the supply.

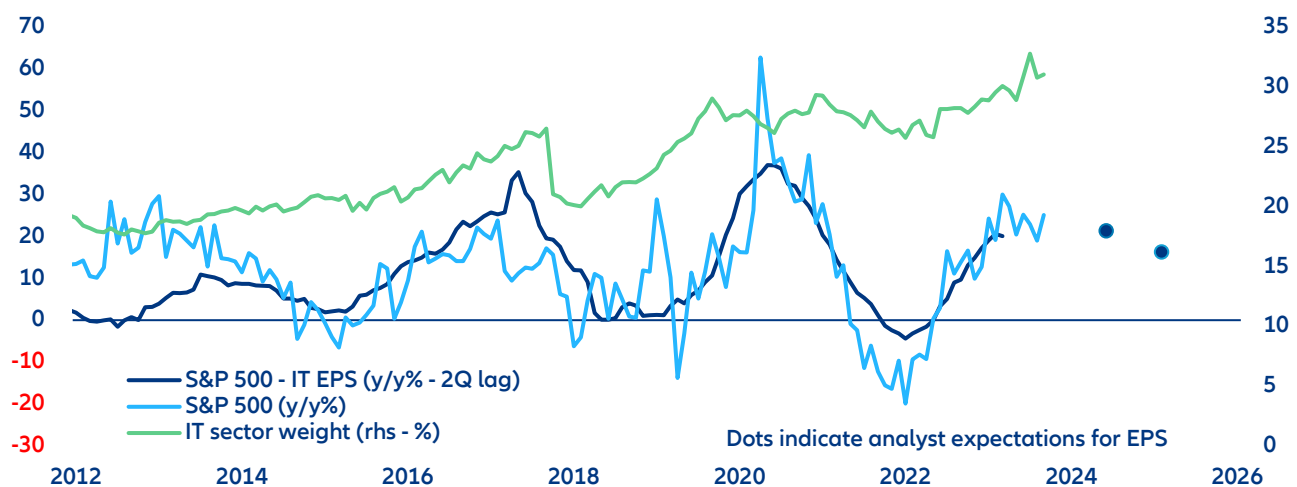
**The EUR is expected to remain largely stable against the USD, hovering around the 1.10 level.** The prospect of a more dovish Fed compared to the ECB gave a tailwind to the euro during the summer months despite elevated geopolitical risks, which usually serve as a boost to the dollar. Going forward, we expect the EURUSD to stay largely stable as we see the short-term real interest rate differential staying put in our outlook. While the US dollar seems overvalued globally, this is mainly due to unusually weak Asian currencies, especially the Japanese yen and Chinese yuan. In contrast, the euro is fairly valued from a real effective exchange rate perspective. As the Fed continues its easing cycle, narrowing real interest rate differentials should support other currencies, particularly the yen. However, any rate hikes by the Bank of Japan are likely to be cautious following the significant volatility experienced after their last hike in July<sup>4</sup>.

**Equity markets: entering the mid-to-late cycle phase. In Q3 2024, equity markets found steady support as global interest-rate cuts took effect across the globe.** This marked a structural change in market dynamics that were mainly driven by mixed economic data and shifting interest-rate expectations for the first half of the year. In the third quarter, the clearer outlook on disinflation and growth prospects has been fostering a more favorable environment for equities. During this period European and Japanese stocks have been notable for their attractive valuations and positive earnings revisions. US equities, on the other hand, have showed robust but decelerating

earnings growth in key sectors, typical of a mid-to-late cycle economic phase (Figure 10).

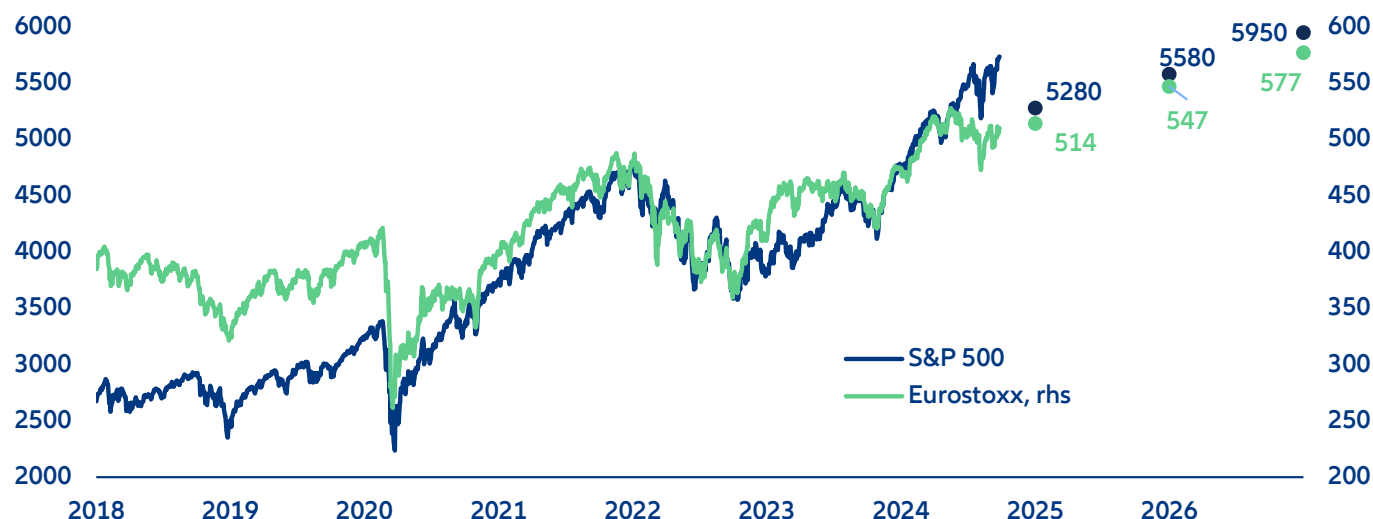
**Global market trends, such as AI, defense, and American reshoring, are beginning to slow, signaling a period of consolidation for these sectors.** Historically, few companies or sectors maintain consistent double-digit growth, as evidenced by the projected technology sector earnings slowdown over the next two years. In this environment, it is key for investors to diversify across geographies and sectors, with expected yearly returns in developed markets likely to stay within the 7-10% range. Additionally, market concentration risk has surged, with companies like the “Magnificent 7” in the US and “Granolas” in Europe driving most returns. This leaves markets vulnerable to underperformance if key sectors or companies face negative news. Passive investors are particularly exposed, as they are passively overweight in these overvalued assets. However, on the flip side, lower yields have historically led to upward revisions in valuations for these companies. Lastly, slowing economic growth, political uncertainty, and unclear fiscal policies create a challenging environment for risky assets. This “three-way trilemma” may dampen risk appetite, with heightened market volatility expected, especially with the upcoming US elections. A fundamentals-driven approach and broad diversification will be key to navigating this turbulence (Figure 11).

**Figure 10:** S&P 500 IT and IT weight in the S&P 500



Sources: IBES, LSEG Datastream, Allianz Research

<sup>4</sup> The BOJ raised its policy rate from 0-0.1% to a larger than expected 0.25% on 31st July 2024 causing high volatility in capital markets.

**Figure 11** Equity market forecasts (in local currency)

Sources: LSEG Datastream, Allianz Research

**Corporate credit markets remain the alternative.**

Corporate credit markets continued to benefit from declining inflation and the ongoing rate cuts through Q3 2024. In contrast to H1 2024, when rising rates and uncertain economic data kept fixed-income investors on edge, Q3 seems to have presented better opportunities. Both investment-grade and, to a lesser extent, high-yield corporate bonds have continued to be attractive to investors, translating into lower spreads due to improved growth visibility and a more favorable interest rate environment. In this regard, the influx of capital into money-market funds during the earlier months, as the Fed had raised rates, has continuously shifted toward these fixed-income assets, aligning with the stabilizing economic outlook.

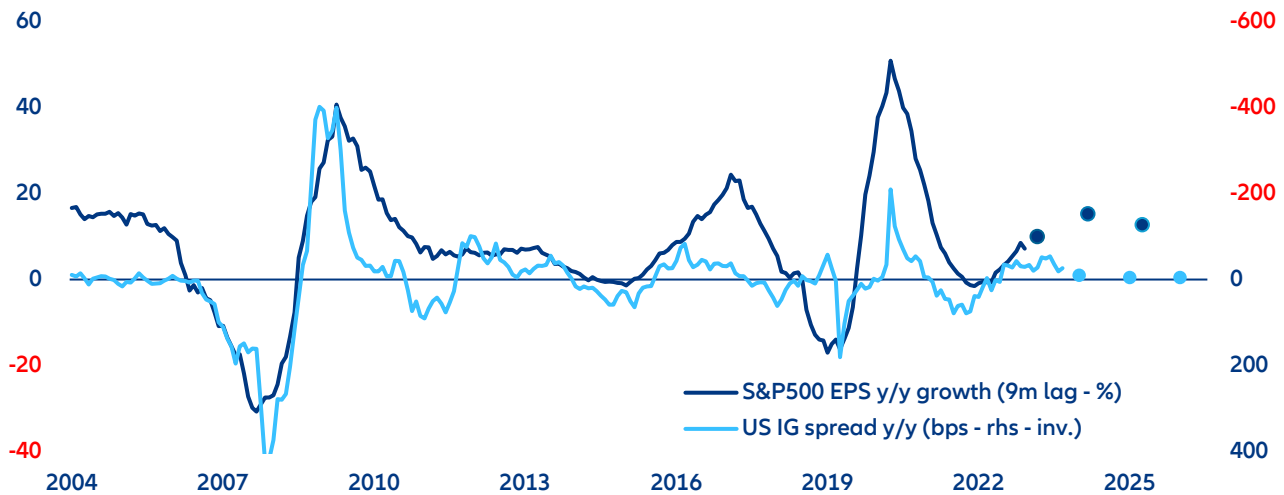
**The ongoing inflow of capital into corporate credit has kept corporate spreads stable, weakening the traditional link between equity markets and corporate spreads.** As a result, the sharp downturn in equity markets in early August did not significantly impact corporate credit markets. Furthermore, continuous upward revisions in credit ratings – especially in Europe – have improved the rating composition of reference credit indices, which supports expectations for slightly higher ratings and generally lower spreads in the mid-run (Figure X). Despite this positive momentum and earnings forecasts suggesting some potential for further spread compression, the need for refinancing at higher costs and worsening debt-

servicing ratios are likely to keep corporate spreads range-bound through 2025 and 2026. We expect spreads to trade in a range of 100/130bps for US and EUR investment grade (IG) and 330/360bps for high yield (HY). However, while the overall outlook remains stable, an analysis of corporate spreads indicates that equity-market volatility could drive occasional widening of spreads in the near future and especially ahead of the US elections.

**A basket of mixed factors, including weaker-than-expected US labor market data and rising certainty around Fed rate cuts, has contributed to heightened volatility in EM sovereign debt since early August.**

The EM hard currency spread initially widened due to recession fears in the US, but later tightened as the Fed adopted a more dovish stance. Although falling yields and a weakening USD have driven up the total returns on EM local currency debt, the year-to-date performance still lags behind that of other asset classes. With the US easing cycle kicked off by a strong 50bps cut, which creates more room for EM central banks to follow suit, we expect increased capital inflows into EM markets as EM rates benefit from a rebound in risk appetite. Nevertheless, the resurgence of inflation in some EM economies, alongside external and internal political uncertainties – such as the US election results and Mexico's judicial reform – are likely to put upward pressure on spreads and add to ongoing market volatility.

**Figure 12:** US IG spreads and S&P 500 earnings



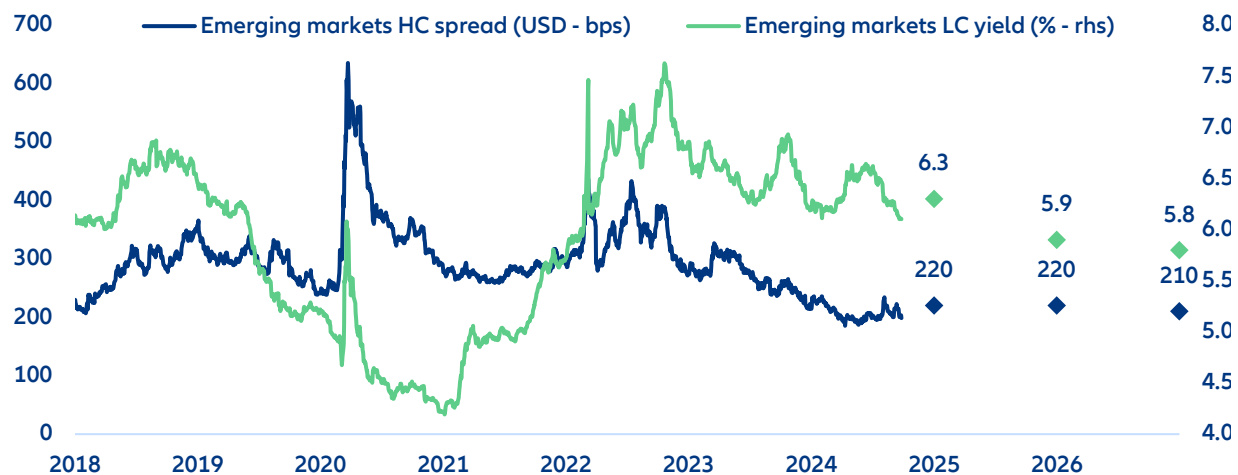
Sources: LSEG Datastream, Allianz Research

**Following a volatile summer, the EM hard currency spread has returned to its end-of-July levels, but we remain cautious about further spread tightening.** Fiscal and political risks in Latin America (LATAM), which have been key contributors to the widening of the hard currency spread this year, remain areas to watch. While the Fed’s easing provides a tailwind for yields to fall, we maintain a cautious stance on further spread tightening, given that spreads are already compressed compared to the long-term average. We expect the hard currency spread to moderately widen to 220bps by the end of the year.

by negative FX returns over the past year, but we expect further appreciation of EM currencies as real exchange rates in most EM countries remain undervalued and the US easing cycle unfolds. Emerging Asian economies, which carry the most weight in the local currency index, are mostly on track or below their inflation targets, positioning them for future rate cuts. Additionally, lower debt-servicing costs, driven by a weaker US dollar, will improve credit conditions for EM economies. We expect yields to moderately pick up to 6.3% before further declining into 2025 and 2026 (Figure 13).

**The tide has turned for the EM local currency debt, with yields falling and EM currencies strengthening against the US dollar.** The total return has been weighed down

**Figure 13:** Allianz Research forecasts for EM sovereign spreads and yields



Sources: Bloomberg, Allianz Research  
 Notes: JP Morgan indexes. HC = Hard Currency. LC = Local Currency. Sov = Sovereign.



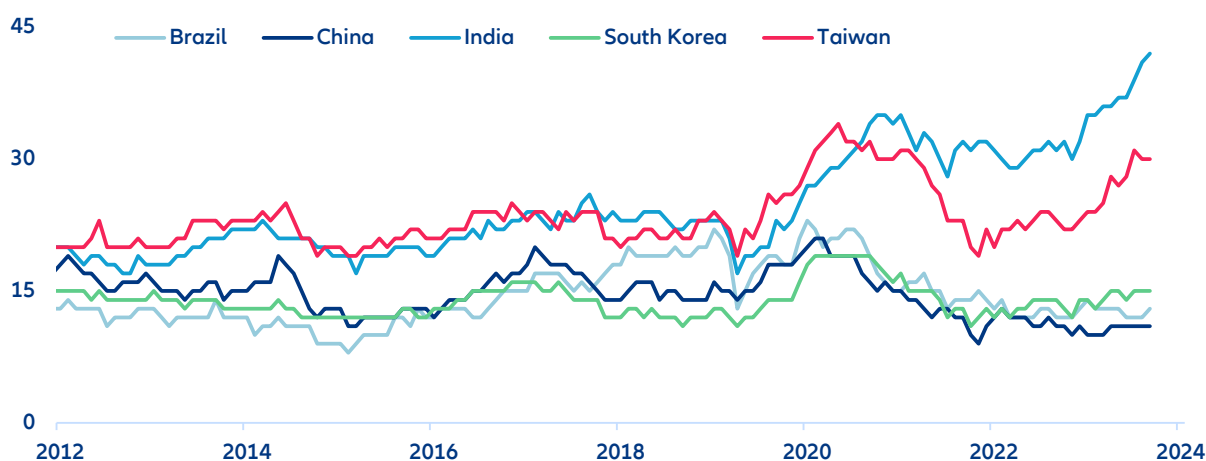
**EM equities have delivered a decent total return year to date, though still underperforming DM equities.** Looking ahead, the start of the easing cycle in the US will provide some cyclical tailwinds to EM equities: First, lower policy rates in the US will enhance investor appetite for riskier assets such as EM equities. Second, the USD weakening further against EM currencies should give an additional boost to total returns for overseas investors. Third, with EM economies following suite with rate cuts, albeit at a comparatively slower pace, we should see improving equity valuations that are already attractive relative to DM equities on an aggregate level.

**Despite these favorable dynamics, we maintain a neutral stance on EM equities due to persistent regional headwinds, particularly in some of the largest components in the index.** China, the largest component of the EM equity index, continues to face significant challenges, having delivered quarters of disappointing earnings results. The country's economy remains weighed down by the property crisis, subdued domestic demand and weak consumer sentiment. While exports have been the supporting factor in recent quarters as the government continues to focus on promoting advanced manufacturing, notably electric vehicles, batteries and solar panels, geopolitical risks and overcapacity issues continue to weigh on growth and earnings prospects. While the PBoC has unveiled a larger-than-expected stimulus package following the recent Fed cut and the ongoing domestic economic downturn, and fiscal support is expected to increase in the near term, the government's ongoing crackdown on key sectors, including tech and

finance, under the "common prosperity" agenda, keeps posing risk for investors and counteracting the recovery effort. We remain cautious on the outlook even though the valuation has fallen to a favorable level. India and Taiwan have continued to outperform their EM peers, each now accounting for nearly one-fifth of the index. However, it is noteworthy that the returns have been mainly driven by valuations instead of earnings. The cyclically adjusted price-to-earnings (CAPE) ratios for both countries have climbed to (almost) decade-high levels. In particular, India's CAPE ratio reached 42 by the end of August, compared to 36 in the US (Figure 14). The country has seen much lower foreign capital inflows this year as investors become increasingly concerned about the sustainability of high valuations, especially amid lagging earnings growth. We expect a moderate correction in EM equities by year-end, which sets the stage for a total return of 6% in 2024.

**Private assets: promising opportunities ahead.** Global private equity fundraising had a strong start in 2024, with nearly USD300bn raised in the first half of the year. Buyout funds dominated, securing 85% of new capital, while growth funds lagged behind, mirroring trends in traded markets. However, despite this surge in funding, operational closing times are lengthening across the board. Much like in traded equities, there are concerns that the fundraising momentum may slow in the near term. While a potential shift in monetary policy could increase available capital in the second half, a cautious risk appetite may persist due to slowing economic growth and the cooling of the AI boom.

**Figure 14:** Cyclically adjusted PE ratios for selected EM equity indexes



Sources: Barclays, Allianz Research. Notes: Equity markets of the selected regions are proxied by region-specific indices published by MSCI; China (24.4%), India (19.9%), Taiwan (18.8%), South Korea (11.7%) and Brazil (4.5%) are the top five weighted economies in the MSCI EM Index as of 30 August.

In private debt, Q2 fundraising rebounded, bringing the total to USD91bn in the first half of the year, suggesting that 2024's total could match last year's figure of USD215bn. Although rate cuts could potentially reduce the appeal of private debt (which typically offers floating rates and could see less income), expectations of higher long-term interest rates should sustain private debt's attractiveness as an alternative income strategy (Figure 15).

Overall, falling interest rates and an economic slowdown could create a favorable environment for skilled asset pickers, with opportunities likely to emerge at attractive discounts, particularly in private equity. In this landscape, selectivity will be crucial, and well-diversified illiquid asset portfolios are expected to continue outperforming their liquid counterparts in the coming years.

**Still elevated interest rates have kept the real estate sector in a still troubled state in 2024, but we are seeing positive signs as easing cycles in major economies begin.**

Cooling inflation and rising real wages are enhancing consumers' purchasing power, while at the same time allowing central banks to move forward with monetary easing, reducing borrowing costs. The 10-year mortgage rate in the Eurozone has continued to drift downward from its recent peak in November last year. This downward trend, combined with a net easing in credit standards reported by banks, has created a more favorable financing environment, leading to gradual recovery in housing loan demand. We expect the momentum to persist, supported by rising consumer confidence and continued rate declines.

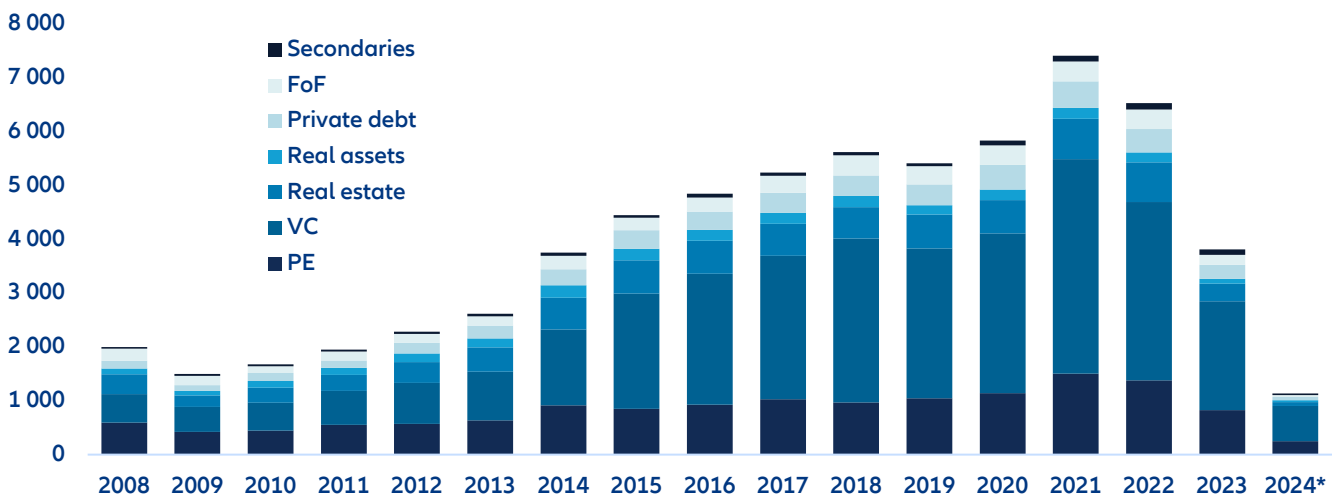
**On the other hand, supply will remain constrained in the short run, putting upward pressure on housing prices.**

Construction output in Europe remains subdued, with limited new supply expected in the near term, particularly in countries such as Germany and the Netherlands, where housing – especially social housing – remains a structural challenge. The number of completed apartments is well below government targets and is expected to decrease further due to persistent lack of orders and declining building permits. Despite these headwinds, there are encouraging signs for builders and developers: construction costs have been cooling and construction confidence indicators have stabilized. We expect supply to remain tight in the short run but anticipate it will gradually catch up as prices bottom out and costs continue to stabilize.

**We expect a moderate recovery across Europe, with regional divergence in pace and scope.**

In France, we anticipate the latest recovery, with housing prices expected to bottom out only by the end of 2024, resulting in a -4.5% decline for the year. This will be followed by modest price growth of around +1% and +2% in 2025 and 2026, respectively. In Southern Europe, markets such as Italy and Spain, which have shown more resilience, are expected to struggle to maintain momentum, with nominal price increases of around +1% in 2025 and +1.5% in 2026. Conversely, Germany and the Netherlands, having already experienced significant adjustments, are expected to see a quicker turnaround, with prices forecasted to grow by more than +2% annually in 2025 and 2026. The UK is projected to be the fastest-growing market in the coming years, with nominal price growth exceeding +2.5% during the same period, reflecting a more robust recovery.

Figure 15: Private assets fundraising



Sources: Pitchbook, Allianz Research (\*as of June 2024)

A photograph showing a group of diverse hands stacked on top of each other, resting on a tree trunk. The hands are of various skin tones and are positioned in a way that suggests unity and teamwork. The background is a lush green forest with sunlight filtering through the trees. The text "Our team" is overlaid on the image, with "Our" in white and "team" in yellow.

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