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What to watch: Liberation Day – When an unprecedented tariff salvo plunged the world into a (temporary?) full-fledged trade war

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In summary

On 9 April, the US import tariff rate will hit its highest level since the 1890s at 20.6%. Some retaliated, others negotiated. The environment will remain fluid, increasing the cost of uncertainty. The 10% universal minimum tariff and record tariff rates on 50 countries announced on 2 April exceeded analysts' expectations. Chinese goods are now facing a 59% tariff, while Vietnam, Thailand, Indonesia, Taiwan and India face tariffs soaring from 18.5-40.4pps. Meanwhile, the UK, Singapore, UAE and Saudi Arabia will see modest increases (between +3.4-5.6pps). The EU faces a +20pps tariff rise (average tariff to 13.3% after sectorial exclusions). Bilateral deals could lower this to 11.8% by Q4 2025. China announced +34pps tariffs on all US imports: this could cause a USD64bn annual export loss. A reciprocal retaliation from the EU on all US imports excl. LNG could result in an annual export loss of USD26bn. Israel, Vietnam, India, and Thailand, Vietnam to name a few opted for (resp.) cutting tariffs, seeking a trade agreement or increasing imports. Like a fog of war, it is unclear what the final tariff landscape will look like, but the cost of uncertainty is high as tariff arbitrage is now off the table for most companies – until the dust settles.

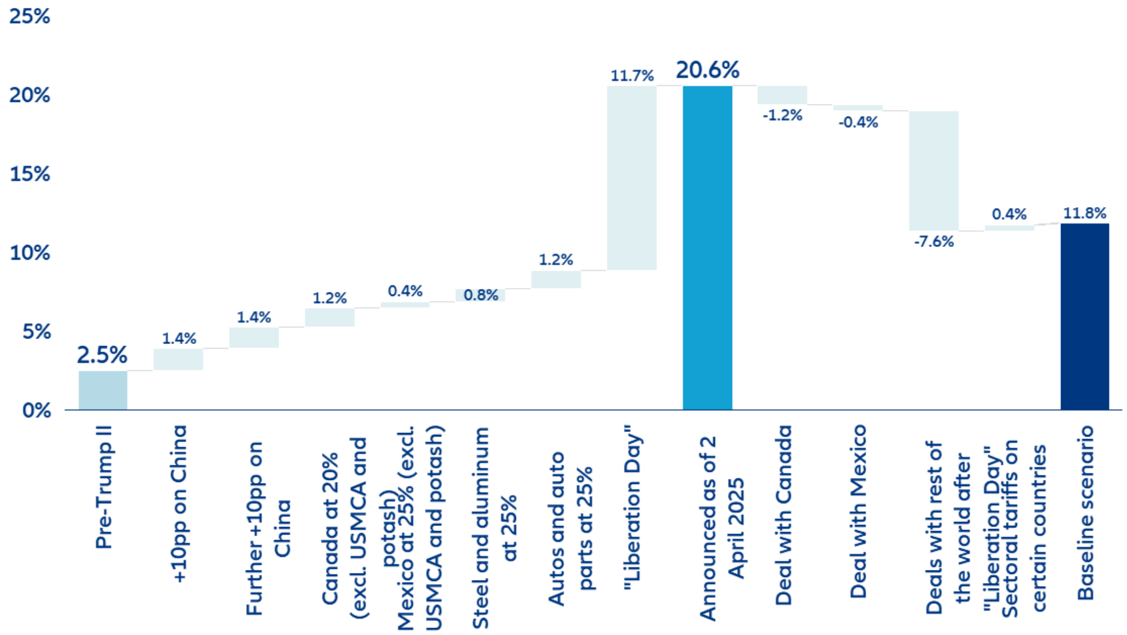
Global GDP growth will slump to a mere +1.9%, the lowest level since 2008; global trade of goods to enter a recession (-0.5% in volume). With US inflation to peak at 4.3% by summer, central banks are in a pickle. US corporates have stockpiled enough for about six months of total consumer demand. However, two-thirds of the rise in import costs will be passed on to the consumer. US inflation is expected to peak at 4.3% by summer, tying the Fed's hands until October (rate at 4% by end-2025 and 2.75% by mid-2026). The US recession is expected to stay mild (cumulative decline of -0.5% Q1-Q3), with a weak +0.8% in 2025. **Europe** cannot escape lower growth due to higher trade restrictions and a weaker US economy, despite the German fiscal stimulus and higher defense spending. We cut forecasts to +0.8% in 2025 and +1.5% in 2026. The **ECB** is likely to bring rates down to 1.5%, -50bps more than expected. **China** is set to enhance policy support with at least RMB800bn in additional fiscal stimulus (i.e. 0.6% of GDP) which should keep growth afloat (+4.6% in 2025, +4.2% in 2026).

With a US recession looming ahead, government bond yields and stock markets have reacted strongly and will continue to fall. Capital markets started to price in a recession, with global stock indices dropping by around 2-6% on the first day – even if an actual recession would tank stocks by at least 10pps more and credit spreads would have to widen further. The USD fell by 1.8% against the EUR and most other currencies on the first day, which, taken together with the stock market reaction highlights that markets expect US companies to suffer the most from Liberation Day. Government bond yields also dropped as recession fears outweighed inflation risks. With a US recession now being our baseline and lower terminal rates for the ECB and the Fed than current market pricing, government bond yields and stock indices could fall further. However, the exact timing is hard to predict as volatility will remain high amid forthcoming trade deals and counter-tariffs.

Liberation Day: a temporary full-fledged trade war?

On 2 April, US president Donald Trump announced "reciprocal" tariffs that exceeded expectations, with products imported from China set to be taxed at a staggering 59%. The Liberation Day announcements included a universal minimum tariff of 10%, taking effect on 5 April at 12:01 a.m. EDT.[1] President Trump also decided to impose an individualized reciprocal higher tariff on over 50 countries with which the US has the largest trade deficits[2] and which explain 98% of the US trade deficit for goods (Figure 1). The EU will face additional tariffs of 20pps, bringing the total US average tariff on EU imported goods to 13.3% (Figure 2) after considering sectorial exclusions (e.g. semiconductors, pharmaceuticals, copper, minerals). The top five hardest countries are Vietnam (+40.4pps to 44.5%), Thailand (+29.4pps to 30.2%), Indonesia (+28.1pps to 33.3%), Taiwan (+26.4pps to 28.3%) and China (+26.3pps to 59.3%). The least impacted are Ecuador (+5.6pps to 6.2%), the UK (+5.6pps to 9.3%), Singapore (+4.9pps to 5.4%), UAE (+4.9pps to 7.2%) and Saudi Arabia (+3.4pps to 4%). All these tariff hikes will bring the US global import tariff rate to 20.6% (Figure 1). In our baseline scenario, we assume that it could decline to 11.8% by Q4 2025, taking into account bilateral deals that would partially reverse the tariff hikes from Liberation Day, while certain countries' sectors would be targeted with tariff hikes that had been excluded on Liberation Day (e.g. pharmaceuticals in China and India, etc.).

Figure 1: US global import tariff (trade-weighted average)



Source: Allianz Research

Figure 2: Tariff change for largest exporting economies to the US

	US imports		US tariff rate				Maximum export losses in the baseline scenario			
	USD bn (2024)	share of total	Pre-Trump II	Before "Liberation Day"	"Liberation Day" (tariff hikes and accounting for sectoral exclusions)	Baseline scenario (accounting for deals to partly reverse "Liberation Day" by year-end but also certain sectoral tariff hikes)	2025 (USD bn)	2026 (USD bn)	2025 (share of exporters' 2024 GDP)	2026 (share of exporters' 2024 GDP)
Argentina	7	0%	0.7%	3.1%	9.1%	9.1%	-1	-1	-0.1%	-0.2%
Australia	17	1%	0.1%	1.9%	9.9%	9.9%	-1	-2	-0.1%	-0.1%
Bangladesh	9	0%	15.1%	15.4%	52.0%	25.3%	-2	-1	-0.5%	-0.2%
Brazil	44	1%	1.0%	4.4%	11.2%	11.2%	-4	-5	-0.2%	-0.3%
Cambodia	13	0%	6.5%	6.6%	48.4%	15.5%	-4	-1	-10.6%	-4.1%
Canada	422	14%	0.1%	10.4%	10.4%	1.6%	-27	-7	-1.2%	-0.3%
Chile	17	1%	0.0%	4.3%	12.5%	12.5%	-2	-3	-0.5%	-0.7%
China	463	14%	13.0%	33.0%	59.3%	43.0%	-164	-161	-0.8%	-0.8%
Colombia	18	1%	0.2%	5.2%	13.4%	13.4%	-2	-3	-0.6%	-0.8%
Ecuador	9	0%	0.4%	0.6%	6.2%	6.2%	0	-1	-0.4%	-0.6%
EU	618	21%	1.3%	3.8%	13.3%	7.9%	-55	-48	-0.3%	-0.2%
Hong Kong	6	0%	1.4%	1.4%	27.3%	8.7%	-1	-1	-0.2%	-0.1%
India	91	3%	2.4%	3.9%	22.4%	13.9%	-14	-12	-0.3%	-0.3%
Indonesia	30	1%	4.6%	5.0%	33.3%	14.0%	-6	-3	-0.4%	-0.2%
Japan	152	5%	1.5%	8.9%	20.6%	13.8%	-22	-22	-0.4%	-0.4%
Kenya	1	0%	0.3%	0.4%	10.3%	10.3%	0	0	-0.1%	-0.1%
Malaysia	54	1%	0.7%	1.0%	17.1%	7.7%	-6	-4	-1.3%	-0.9%
Mexico	510	15%	0.3%	3.7%	3.7%	0.9%	-11	-4	-0.8%	-0.3%
New Zealand	6	0%	1.1%	1.4%	10.5%	10.5%	0	-1	-0.2%	-0.2%
Norway	7	0%	0.6%	1.4%	8.5%	6.2%	0	0	-0.1%	-0.1%
Pakistan	5	0%	9.7%	10.0%	38.4%	19.8%	-1	-1	-0.3%	-0.2%
Philippines	15	0%	1.5%	1.7%	14.6%	9.2%	-1	-1	-0.3%	-0.3%
Saudi Arabia	13	1%	0.3%	0.5%	4.0%	4.0%	0	-1	0.0%	-0.1%
Singapore	44	1%	0.1%	0.5%	5.4%	5.4%	-2	-3	-0.5%	-0.6%
South Africa	15	0%	0.4%	3.9%	18.5%	8.7%	-2	-1	-0.5%	-0.4%
South Korea	135	4%	0.2%	8.0%	22.0%	13.6%	-22	-21	-1.1%	-1.0%
Switzerland	64	2%	0.7%	1.4%	19.8%	7.3%	-8	-5	-0.9%	-0.5%
Taiwan	119	3%	1.2%	2.1%	28.3%	10.1%	-22	-12	-2.4%	-1.4%
Thailand	66	2%	1.4%	2.2%	30.2%	9.0%	-12	-6	-2.0%	-0.9%
Türkiye	18	1%	3.5%	4.8%	12.6%	12.6%	-1	-2	-0.1%	-0.2%
UAE	8	0%	2.4%	2.5%	7.2%	7.2%	0	0	-0.1%	-0.1%
UK	69	2%	0.9%	3.6%	9.3%	9.3%	-5	-7	-0.1%	-0.2%
Vietnam	142	4%	4.1%	4.5%	44.5%	12.9%	-37	-15	-7.9%	-3.1%
Global	**3359**	**100%**	**2.5%**	**8.7%**	**20.6%**	**11.8%**	**-440**	**-354**	**-0.4%**	**-0.3%**

Source: Allianz Research

These moves will take the effective import-weighted tariff rate to 20.6%, a level last seen in the 1890s (vs 9% previously) and could push global trade into a recession. Global export losses are expected to reach USD440bn in 2025 and USD354bn in 2026. A recession in global trade of goods is expected in volume terms (-0.5% in 2025) while total trade in goods and services should rise by +1% in 2025 (-1.4pp) and +1.3% in 2026 (-1.1pp), in volume terms, down from close to +3% expected in Q4 2024. As the predominant supplier to the US, China faces export losses of USD164bn in 2025 or 0.8% of total GDP. The highest losses are expected in the computers & telecom sector (USD25bn), followed by machinery & equipment (USD22.6bn) and household equipment/home appliances (USD20.1bn). Other significant sectors at risk include textiles, apparel footwear (USD15.6bn), electronics (USD10.8bn) and chemicals, plastics & rubber (USD9.8bn). The EU is next in line, with USD62bn in expected export losses, and within the regional bloc Germany is most exposed, with potential export losses amounting to USD17bn. Unsurprisingly, the export losses would be concentrated in machinery & equipment (USD3.1bn) and automotive manufacturers (USD2.6bn). Vietnam emerges as the second most exposed single country after China. In Vietnam, the sectors that will face the biggest losses are textiles, apparel & footwear (USD6.5bn), followed closely by computers & telecom (USD5.7bn) and machinery & equipment (USD3.8bn). Taiwan, South Korea and Japan are next in line, each with potential maximum export losses of USD22bn. For Taiwan, the computers & telecom sector alone accounts for USD5.8bn of potential losses, while electronics (excluding semis) accounts for USD2.5bn and machinery & equipment adds USD2bn. South Korea's main export losses are primarily in automotive manufacturers (USD5.8bn), machinery & equipment (USD2.8bn) and electronics (USD1.6bn). Japan's export losses will mostly be felt in automotive manufacturers (USD6.9bn), machinery & equipment (USD5.1bn) and automotive suppliers

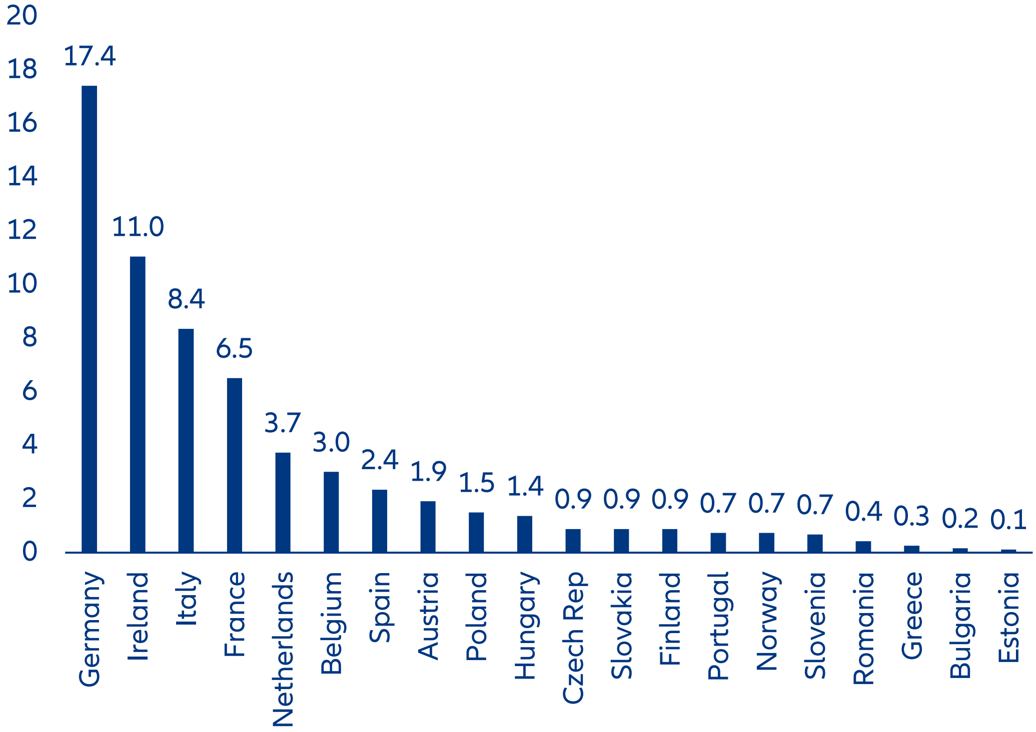
(USD1.2bn). Overall, we expect rerouting is likely to continue, but new trade hubs are likely to emerge, notably in Latin America and the Middle East. Southeast Asia will remain attractive in the long run if countries manage to strike deals with the US and depreciate their currencies to compensate for part of the tariff increases. We do expect some bilateral deals to be signed by year-end, which would bring the US average import tariff down to 11.8% in Q4 2025, though this would still be the highest level since the 1940s.

Figure 3: Top 50 US imports/exports by Country / Sector (excl. Pharma and Semiconductors for imports)

Country	Sector	Exports in USD bn to/from US	Maximum export losses in baseline scenario
China	Computers & Telecom	70.2	25.0
China	Machinery & Equipment	63.5	22.6
China	Household Equipment - Home appliances	56.6	20.1
China	Textiles - Apparel & Footwear	43.8	15.6
China	Electronics	30.3	10.8
China	Chemicals - Plastics & Rubber	27.4	9.8
US	Agrifood - Agriculture & farming	22.3	8.8
Canada	Energy - Oil & gas upstream activities	126.6	8.1
US	Energy - Oil & gas	19.3	7.6
Japan	Automotive manufacturers	47.4	6.9
China	Textiles - Textile	18.8	6.7
Viet Nam	Textiles - Apparel & Footwear	24.8	6.5
US	Pharmaceuticals	15.6	6.1
Taiwan	Computers & Telecom	31.9	5.8
China	Household Equipment - Other	16.3	5.8
Republic of Korea	Automotive manufacturers	34.8	5.8
Viet Nam	Computers & Telecom	21.5	5.7
US	Machinery & Equipment	14.1	5.6
China	Automotive suppliers	14.6	5.2
China	Metals - Metal works & Engineering	14.4	5.1
Japan	Machinery & Equipment	34.7	5.1
China	Construction - Building Materials	11.1	3.9
China	Automotive manufacturers	10.9	3.9
Viet Nam	Machinery & Equipment	14.3	3.8
US	Electronics	8.8	3.5
Viet Nam	Household Equipment - Home appliances	12.9	3.4
US	Chemicals - Plastics & Rubber	8.5	3.4
Canada	Automotive manufacturers	50.2	3.2
Germany	Machinery & Equipment	35.5	3.1
US	Automotive manufacturers	7.5	3.0
US	Chemicals - Industrial & Other	7.4	2.9
Republic of Korea	Machinery & Equipment	16.8	2.8
US	Agrifood - Food & Beverages manufacturing	6.7	2.7
Germany	Automotive manufacturers	29.7	2.6
Taiwan	Electronics	13.4	2.5
Canada	Metals - Mining, Casting & Processing	37.6	2.4
Mexico	Automotive manufacturers	111.4	2.4
US	Metals - Mining, Casting & Processing	5.8	2.3
Canada	Agrifood - Food & Beverages manufacturing	32.6	2.1
Taiwan	Machinery & Equipment	11.2	2.0
Canada	Machinery & Equipment	26.4	1.7
Malaysia	Electronics	12.9	1.5
US	Household Equipment - Other	3.8	1.5
US	Construction - Building Materials	3.7	1.5
Canada	Chemicals - Plastics & Rubber	20.8	1.3
Italy	Machinery & Equipment	13.7	1.2
Mexico	Machinery & Equipment	51.5	1.1
US	Paper - Manufacturing	2.4	0.9
Canada	Construction - Building Materials	14.3	0.9
US	Computers & Telecom	2.3	0.9

Source: Allianz Research

Figure 4: Maximum export losses in the baseline scenario (USDbn), top 20 EU countries



Source: Allianz Research

For now, Europe has not yet announced any additional retaliatory measures to the ones published on 11 March[1]. However, reciprocal retaliation from the EU on all US imports excluding LNG would amount to an estimated USD26bn of export losses for the US. Pharmaceuticals stands as the foremost sector at risk in the US, with exports amounting to USD61.4bn and a potential maximum export loss of USD 7.54bn. Machinery & equipment, with exports valued at USD27.1bn, is positioned for a potential export loss of USD3.3bn. With exports totaling USD16bn and a potential maximum export loss of USD 1.96bn, the chemicals, plastics & rubber sector would be third hardest hit by EU retaliation.

China has instead announced +34pp additional tariffs on all US imports, effective on 10 April. These levies would cause annual export losses amounting to USD64bn, causing US imports to fall by -0.2pp annually. The impact is expected to be most substantial for the US agriculture sector, specifically for soybean, wheat and corn exporters, as well as for the US pharmaceutical and energy industries. We estimate that the agrifood sector could face about USD22.3bn export losses and the oil & gas industry up to USD19.3bn, while pharma and machinery & equipment could lose respectively USD15.6bn and USD14.1bn (see Figure 3). On top of the tariff hike, China's Ministry of Commerce also announced retaliation in the form of non-tariff measures, including an export ban on seven rare earth minerals used in high-tech products. The retaliation also includes the addition of 11 US firms to the "unreliable entities" list, including several drone manufacturers, barring them from doing business in China. Finally, the Ministry also announced new investigations into US regarding medical imagining equipment.

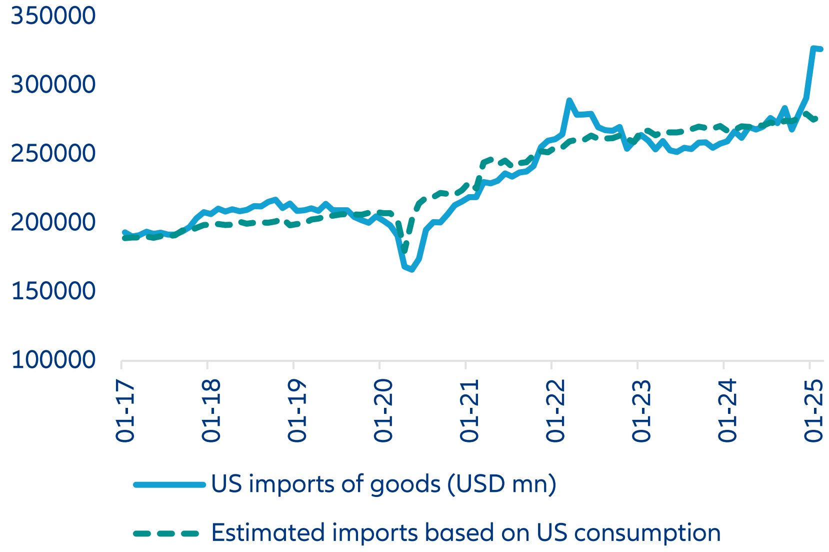
Most Southeast and East Asian countries have avoided retaliation so far, instead announcing a willingness to negotiate, either with lower tariffs or higher imports from the US. Others had already lowered tariffs on US imports beforehand. Israel falls in the second category, having lowered tariffs on all US imports to zero just a few days prior. Under the Liberation Day announcements, it will face a +17pps increase in tariffs. Together with Israel, India has been the most active in offering a deal to the White House. Earlier in March, India had already lowered tariffs on some US imports such as high-end motorcycles and bourbon, and had dropped a tax on digital services. Now facing a +27% tariff, India has hinted at lowering tariffs on USD23bn of other imports, with the goal of reaching a trade agreement with the US by autumn 2025. The Ministry of Commerce in Thailand has indicated plans to

[1] https://ec.europa.eu/commission/presscorner/detail/en/ip_25_740

increase imports of US products, including agricultural goods like corn and soybeans, as well as energy products such as crude oil and natural gas. Additionally, discussions are underway to reduce tariffs on specific US goods to help balance the trade relationship. Vietnam had proactively reduced import duties on several US products on 26 March to mitigate potential trade tensions, including liquefied natural gas (LNG) and automobiles. Additionally, Vietnam moved to approve Starlink services, aiming to strengthen economic ties with the US.

US corporates should be able to cope over the next few months on the back of generally solid balance sheets and stockpiling, enough for about six months of consumer demand. However, we expect around two-thirds of them to pass on the costs of increased tariffs on to consumers and clients, though this will vary by sector. Companies have already turned to several strategies to mitigate the financial impacts of tariffs, including frontloading imports, exploring alternative sourcing options and selling products without certain components or with cheaper materials to reduce tariff impacts. US ports have reported surges in cargo volumes and our estimates suggest that corporates stockpiled enough to meet about six months of consumer demand over December, January and February (Figure 5). Moreover, several companies have already announced investments totaling close to USD1trn to (re)locate production to the US to mitigate tariff exposure, despite potential challenges such as higher labor costs[3]. Nevertheless, about two-thirds of companies are likely to pass on the higher costs from tariffs to consumers. Businesses with strong brand recognition and market positioning, such as luxury brands or certain tech companies, are better equipped to do so without significant loss of market share, while business with low margins, such as retail, will have no choice.

Figure 5: US imports much higher than warranted



Sources: LSEG Workspace, Allianz Research

We now expect the US economy to slip into a recession through Q3 2025. We now expect weak GDP growth of +0.8% this year. GDP is expected to have contracted (mildly) as early as Q1 2025, but this is explained by a negative contribution from net trade rather than weakening domestic demand. However, we forecast Q2 and Q3 GDP to register negative growth on the back of declining consumer and investment spending. From Q1 to Q3, we expect GDP to decline by a cumulative -0.5%. Ramped-up industrial subsidies and fiscal spending – funded by new customs receipts – should prevent a deeper recession, though negative wealth effects and prolonged high uncertainty could amplify the downturn. The timing of when new industrial subsidies will be effectively disbursed is uncertain. They will probably come in the second half of 2025, meaning they will support activity in the latter part of the year and in 2026. Activity in 2026 will be further supported by tax cuts, the Fed loosening monetary policy and the unwinding of some tariffs on foreign partners. We are penciling in +2.3% growth in 2026.

But the Fed will have to wait till October to provide support because of spiking inflation. US inflation is expected to peak at close to +4.5% by the summer, pushed up by goods and food prices. Inflation should eventually recede as weak demand starts to pull down prices and wage growth. In annual average terms, we see CPI inflation at 3.8% in 2025 and 1.8% in 2026. The Fed will look through the tariff-induced spike in inflation: loosening too quickly would risk triggering a wage-price spiral in an environment of already high inflation and early signs of de-anchoring inflation expectations by households. By October, the Fed will start to cut and accelerate through 2026. We see the Fed Fund rate (upper bound) at 4% in end-2025 and 2.75% in end-2026.

Europe will be hit less but cannot escape lower growth due to higher trade restrictions and a weaker US economy, despite the German fiscal stimulus and higher defense spending. In 2024, the Eurozone exported goods worth EUR531bn to the US, equivalent to 3.5% of Eurozone GDP, making it by far the most important trading partner. As these goods now become significantly more expensive in the US due to tariffs, demand will most certainly drop, negatively impacting GDP growth in the Eurozone. The fiscal stimulus from Germany and higher defense spending in general throughout Europe can only partially compensate for this. Notably, Germany will also be hit most by the US tariffs as it is the biggest export nation in Europe. Given the higher-than-expected tariffs, we have cut our GDP growth forecasts for the Eurozone by -0.3pp to +0.8% in 2025 and by -0.1pp to +1.5% in 2026. Inflation risks are also tilted to the downside as lower demand from the US and global overcapacities in the rest of the world, as well as lower energy prices will have a negative effect on the prices of domestic and imported goods (with the exception of the US, where we expect counter-tariffs by the EU). Therefore, we have lowered our inflation forecast by -0.2pp and -0.1pp to 1.9% both in 2025 and 2026. As economic output will remain below potential and downside risks to inflation emerge, we expect the ECB to cut its policy rate below neutral to 1.5% by the end of 2025 (50bps lower than the initial forecast).

China will further step up policy support (at least RMB800bn of additional fiscal stimulus) to make up for the higher-than-expected tariff hikes. We keep our GDP growth forecasts for China at +4.6% in 2025 and +4.2% in 2026 for now based on: better-than-expected economic activity data in Q1, expectations of further policy easing and the possibility to very partially mitigate higher tariffs with a weaker CNY. Prior to Liberation Day, risks to our GDP growth forecast in 2025 were probably on the upside: despite still fragile fundamentals, activity data had surprised positively at the turn of the year and the credit impulse had been recovering, thanks to policy easing and signs of private sector confidence bottoming out. A large fiscal package (RMB2.9tn) had already been announced in early-March to underpin the official GDP growth target maintained at "around 5%", but we believe that the door was left open to step up policy support further, should economic headwinds call for it. We estimate that around RMB800bn of additional fiscal stimulus is likely needed to help mitigate the drag on GDP growth from higher tariff rates from the US (currently at nearly 60% and potentially around 45% after a deal is struck, vs. 25% in our original contained trade war scenario). Finally, another possible mitigation tool for Chinese policymakers is to allow for the CNY to depreciate. Although there are very early signs suggesting that the PBOC is considering this (the onshore mid-rate was fixed 0.14% weaker vs. the USD on 3 April, the largest daily adjustment since December), we continue to believe that a significant weakening of the CNY is not Chinese policymakers' preferred option as it may also dent domestic confidence.

In the downside scenario, should the US maintain its average import tariff at 20.6% until the end of 2026, the US recession would be prolonged until early 2026. In this scenario, US GDP growth is projected to slow significantly to +0.4% in 2025 and +1.5% in 2026, compared to baseline expectations of +0.8% and +2.3%, respectively. This deceleration would be driven by persistently high tariffs weighing on trade volumes and economic expansion. Inflation in the US is anticipated to rise even more in the downside scenario, reaching 4.2% in 2025 and 2% in 2026, suggesting ongoing price pressures despite weaker growth. China's GDP growth would be reduced to +4.5% in 2025 and +3.8% in 2026, down from baseline projections of +4.6% and +4.2%, respectively, as policy stimulus would struggle compensate for the prolonged high level of tariffs. Inflation would increase to 0.5% in 2025 and 0.8% in 2026 amid cautious consumer demand and external pressures. Meanwhile, the Eurozone would see a modest growth deceleration, with GDP growth forecasted at +0.7% in 2025 and +1.1% in 2026, slightly below baseline expectations of +0.8% and +1.5%, respectively. Inflation would remain relatively stable, with a minor decrease to 1.9% in 2025 and 1.7% in 2026, indicating limited pressures despite economic uncertainties.

Markets expect the US to suffer the most

Government bond yields fell globally and in the US, implying more recession than inflation risks. US 10y rates dropped by more than 15bps to below 4% since the tariff announcements and similar moves across the world (eg. German 10y falling below 2.6%) show that recession risks outweigh inflation concerns, even in the US. This is particularly evident when looking at inflation-linked bonds, which showed that lower inflation expectations were the main driver of lower nominal yields while real yields also fell. Meanwhile, markets have priced in more central bank easing and are now expecting four cuts by the Fed and three cuts by the ECB until year-end. As our revised outlook on Fed and ECB terminal rates is now slightly lower than market pricing, we also see room for 10y yields to fall a bit further from current levels. However, volatility will remain high as we expect a multitude of countermeasures and trade deals down the road, which will keep markets busy pricing in new scenarios.

The sell-off in risk markets was even more pronounced, with the US leading the downturn. The strong reaction of equity markets across the globe was astonishing but in the end looks justified as US tariffs came in significantly higher than expected. On the first day, the Japanese Topix index lost -3.1%, the Hang Seng -1.5%, Euro Stoxx 50 -3.6% and the S&P 500 -4.8%. Adding the currency move, with the USD weakening most across the globe, it is more than evident that markets are punishing US companies most (the USD lost -1.8% against the EUR and 1.6% on a trade-weighted basis against a basket of currencies on the first day). With a US recession now our baseline scenario, there is even more downside to equities. The historic average recession downside in the S&P 500 has been around 25% (of which 8.6% from earnings and 16.4% from valuation adjustment in PE). We believe investors will to some degree look through the current uncertainty but nevertheless, we see additional temporary downside risk of around 9% for the S&P 500, approaching the 5000 level. Until year-end, we see reasonable upside from current levels as tariff negotiations start, a severe earnings recession is avoided and sentiment normalizes again (from e.g. VIX above average 28). In the meantime, Liberation Day also impacted credit markets, as visible in CDS spreads, which widened 7bps (5bps) for investment grade in the US (Europe) and 27bps (19bps) for high yield.

Emerging market spreads widened, particularly in Asia. Though emerging Asia will bear the brunt of the higher-than-expected tariffs (accounting for 20 out of the 56 countries listed), notably China and Vietnam, emerging markets overall demonstrated greater resilience compared to US credit in the lead-up to the announcement. This resilience is reflected in the spread of the Emerging Markets Bond Index Global (EMBIG), which widened by 17bps, while US corporate spreads widened by 30bps when adjusted for credit quality. This indicates that emerging markets have managed to maintain a relatively stable outlook despite the external pressures.

The enduring uncertainty is likely to constrain private equity exits and increase scrutiny over private debt. Tariffs will likely impact private equity exits by constraining market liquidity and dampening investor confidence, besides introducing additional costs and uncertainty, making it more challenging for firms to achieve favorable valuations during exit events (ie. IPOs or secondary sales). This uncertainty will effectively put a lid on exit activity, limiting the ability of private equity firms to realize returns on their investments. However, the expected acceleration in Fed rate cuts by the second half of the year should foster more accommodative market conditions, potentially revitalizing investor sentiment and creating a more conducive environment for private equity exits. This trend will not be limited to the US; Europe's reaction to the tariffs is also expected to trigger market uncertainty, further limiting activity across the region. Private debt will also be affected as the potential pricing of a US recession later in the year will likely lead to heightened scrutiny in lending conditions as lenders brace for the possibility of higher default rates, particularly for floating rate instruments. However, even in this more bearish scenario, private credit should retain its relative attractiveness due to its structurally lower loss rates and high expected total returns, which continue to provide a compelling argument for remaining positive on the asset class. Nonetheless, deal-making is anticipated to decelerate, even if overall market appetite for private credit remains robust throughout this volatile cycle.

These assessments are, as always, subject to the disclaimer provided below.

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The statements contained herein may include prospects, statements of future expectations and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties. Actual results, performance or events may differ materially from those expressed or implied in such forward-looking statements.

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