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# Trumponomics: the sequel

Trade, fiscal and monetary policy implications  
of a second Trump presidency

# Executive Summary

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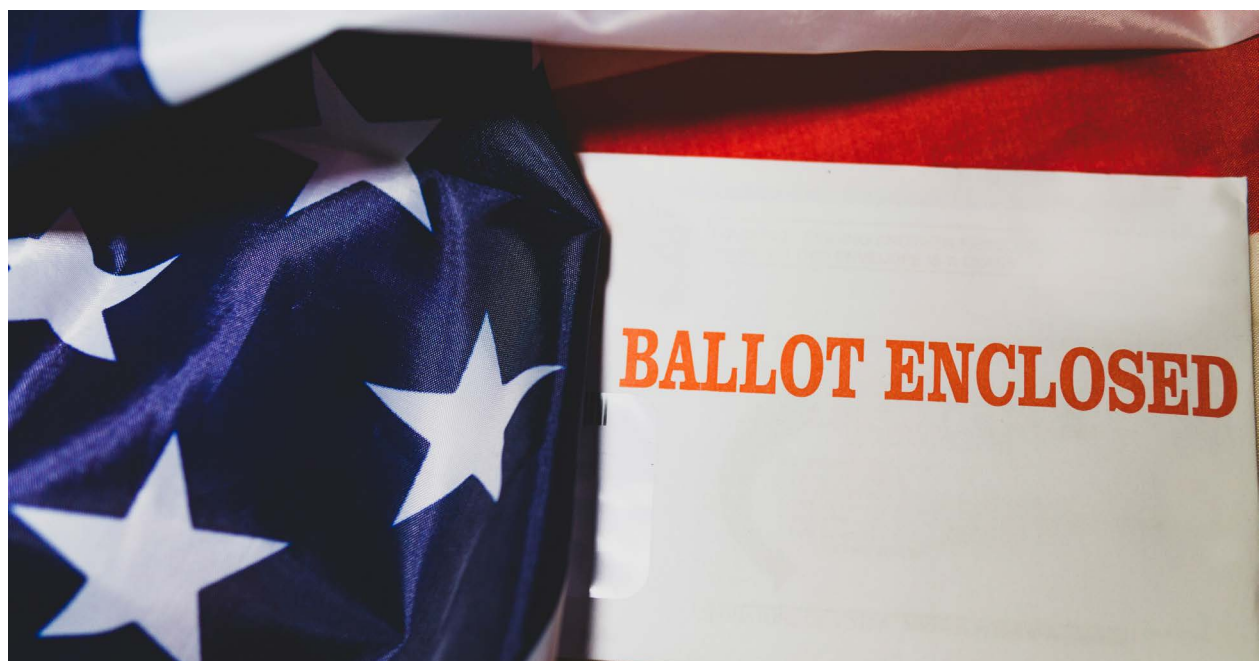
- **Whoever wins the White House in November will be confronted with a changing US economy.** While the US has remained remarkably resilient despite rising interest rates and global uncertainty, it has become more prone to inflation volatility, given a larger exposure to frequent supply shocks and structural labor shortages. Against this backdrop, demand-boosting policies (such as tax cuts) or supply-hurting policies (tariff hikes) could re-ignite inflation faster and push up interest rates. Social tensions and fiscal trade-offs also raise concerns about the future of fiscal policy. On the other hand, the roll-out of artificial intelligence (AI) is likely to boost productivity and GDP growth, and the US's energy net-exporter status provide additional room to manoeuvre.
- **In this report, we look at what the return of President Trump could mean for growth, inflation and capital markets, as well as trade, fiscal and industrial policies.** So far, several of Trump's campaign pledges have raised far-reaching questions especially for the transatlantic partnership: from the resolution of the war in Ukraine, to the US exiting (again) the Paris Accord, to an escalation of the US-China Cold War. Narrowing down on economic policy-making, we analyzed three fault lines: (i) the return of trade war, with the alleged plan to increase tariff rates to 10% and unleash industrial subsidies to re-shore production in the US; (ii) the fiscal bazooka that could ensue after the elections, given the 2017-2019 playbook, and the return of dirigisme everywhere and (iii) the conduct of a credible monetary policy. Given the many stagflationary risks (even a boom-bust pattern) stemming from increased protectionism, fiscal profligacy and interventionism, we expect a pragmatic policy approach, supported by a scenario of a divided Congress and Republican Party.
- **First, tariff increases are likely to be more moderate and targeted than pledged, though still substantial.** We think record-high tariffs would hurt the US economy more than in 2018-19: President Trump's pledge to crack down on trade diversion and tariff evasion would be inflationary. In our baseline scenario, we expect that Trump would increase the US effective average tariff rate from 2.5% currently to around 4.3% – i.e. not 10% but still the highest level since the mid-1970s – and crack down severely on tariff evasion. In addition, we estimate that the crackdown on tariff evasion through stepped-up customs checks at the borders would push up short-term inflation by +0.6pp by lengthening suppliers' delivery times, although a stronger USD that we would expect could mitigate this effect. Trump would likely recycle additional customs duties into industrial subsidies to support the economy. This scenario could knock off -0.5pp and -0.2pp from US and global economic growth in the first year, respectively. In our downside scenario (a near-full implementation of campaign pledges), the effective tariff could go up to 12%, the highest

level since the early 1940s. In this case, the cost to US and global GDP would be much larger, at -1.4pp and -0.6pp, respectively. However, in both cases we would expect Trump to target goods that are not critical for the US economy, equivalent to 55% of imported Chinese goods and 70% of EU goods. China's textiles sector and the US transportation equipment sector would be the hardest hit. The administration is also likely to play cautiously on fiscal policy.

- **Second, the administration is likely to play it cautiously on fiscal policy.** A Trump 2.0 presidency would inherit very large fiscal deficits from the Biden administration and rising interest expenses. Another round of large, deficit-financed tax cuts (or increased spending) could thus re-ignite inflation and heighten concerns about the sustainability of US public finances in bond markets. Besides, it is unlikely that fiscal hawks among the Republicans would sign off on large tax cuts or new spending, given the poor state of US public finances. Finally, the Trump administration may itself recognize that as long as public deficits remain large, it will be challenging to significantly reduce the trade deficit. In this context, we would expect the Trump administration to fund its fiscal pledges with increased customs receipts and the repealing of some of President Biden's policies. Overall, the fiscal stance could be slightly loosened in the first year of a Trump presidency but turn neutral in the later years.
- **Also note that some of Biden's green subsidies would likely be repealed and replaced;** we would expect new broad-based subsidies for production and tax credits for investment. The subsidies are likely to be targeted towards technological sectors and supply-chain strengthening (esp. raw materials, rare earths), chemicals and minerals, but also steel and autos. Under a fiscally responsible Trump administration, we would expect non-green industrial subsidies to be boosted by around USD55bn per year (0.2% of GDP).
- **Last, against this backdrop, we would expect the Federal Reserve to be forced to pause its easing cycle in 2025 and the US 10-year yield to stay above 4%.** Equity markets would likely undergo a downward adjustment due to the short-term impact of increased rates on valuations. A short-term spike in inflation would prompt the Fed to err on the side of caution. The policy rate and Treasury yields would remain above 4%, and equity markets would be hit. Though a significant market downturn is unlikely, risks will accumulate. More plausibly, markets may experience a period of lateral movement throughout 2025. Looking ahead to 2026 and 2027, policies favoring domestic priorities, along with an expected shift towards more accommodative monetary policy by the Fed, are likely to positively influence US corporations as a whole. This could lead to US markets outperforming international counterparts, with expected annual returns of 8-10%. On the FX market, the stretched valuation of the dollar suggests there would be limited scope for appreciation for the USD (+2.5%).







# A pivotal election

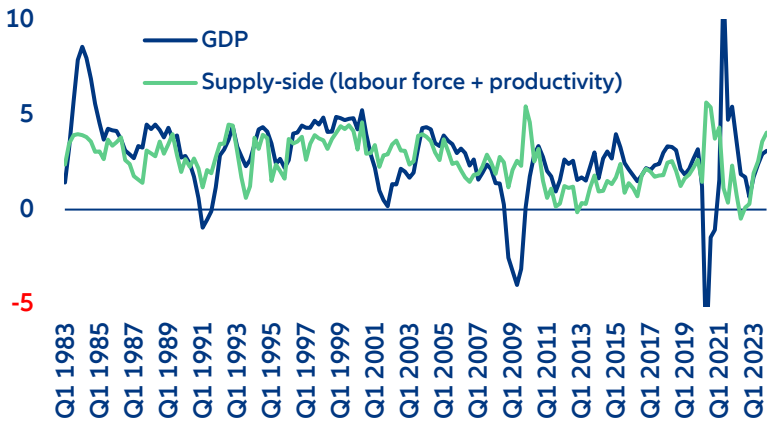
**Whoever wins the White House in November will be confronted with a changing US economy.** Global uncertainty has been on the rise, standing above its long-term trend and global economic growth is moderating as a consequence of the aggressive monetary tightening. Yet, the US economy has remained remarkably resilient despite the sharp increase in interest rates. The unemployment rate has been hovering below 4% since early 2022 while GDP growth picked up momentum in 2023 (Figure 1). Notably, the supply-side of the economy – measured by the sum of labor productivity growth and labor force growth – has improved dramatically over the past two years (Figure 1 again). In particular, the prime-age participation rate has reached historically high levels as an increasing share of 25-54-year-olds have flocked into the labor market.

**Looking ahead, the US economy will be i) more prone to inflation volatility, given a larger exposure to frequent supply shocks, and ii) increasingly shaped by the deployment of AI.** Corporates have higher pricing power in an economy running structurally closer to maximum capacity amid elevated labor shortages (Figure 2), while the risks of supply shocks are increasing in a context of global fracturing, volatile geopolitics, de-risking and

climate-related extreme weather events. Against this backdrop, demand-boosting policies (such as tax cuts) or supply-hurting policies (tariff hikes) could re-ignite inflation faster and push up interest rates. However, the roll-out of artificial intelligence (AI) is likely to boost US potential GDP growth by stimulating productivity growth. GDP growth may thus step up under the next presidency, whoever wins the White House. This could make things easier to deliver on some fiscal pledges (though the state of US public finances will remain poor), while some policies which are growth-hurting in the short term (such as large tariff hikes) may prove to be less acutely felt, though it is likely to be more visible at the end of this decade or in the 2030s. Against this backdrop, demand-boosting policies (such as tax cuts) or supply-hurting policies (tariff hikes) could re-ignite inflation faster and push up interest rates. But even if Congress were to switch to the Grand Old Party in the next legislature, this does not mean Trump would have free rein to set policy amid deep divisions within

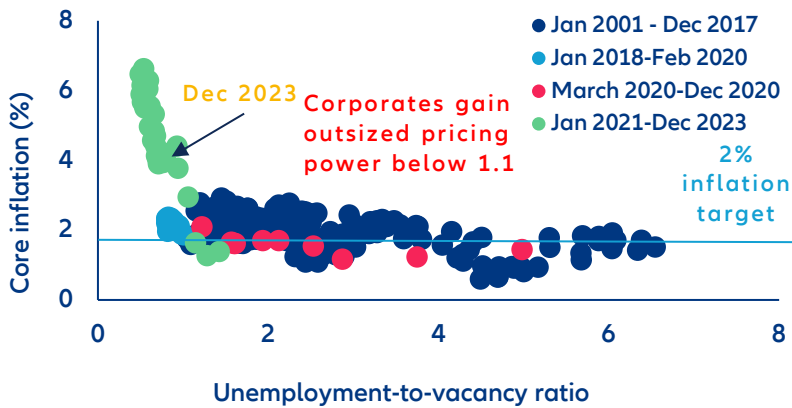


**Figure 1: US GDP & supply-side growth, % y/y**



Sources: LSEG Datastream, Allianz Research

**Figure 2: US non-linear Phillips curve: core inflation (% y/y) & unemployment-to-vacancy ratio**



Sources: LSEG Datastream, Allianz Research

In this report, we look at what a Trump 2.0 presidency could mean in terms of US and world GDP and inflation, trade, fiscal policy, industrial policy, corporates and capital market developments. On the campaign trail, several of Trump’s policy pledges have raised questions about the future of US sustainability engagements and US-China relations, besides trade policy, with a plan to increase tariff rates to 10% and unleash industrial subsidies to re-shore production in the US. However, given the likely stagflationary consequences of tough trade policy, weak public finances and possible opposition from within the Republican Party, as well as checks and balances in Congress, we would expect a second Trump presidency to take a more pragmatic policy approach. Tariff

increases are likely to be more moderate and targeted than pledged – though they would still be increased substantially – while we would expect the administration to play cautiously on fiscal policy, all the more so because of fiscal conservatism amongst Republicans in Congress.<sup>1</sup> And while some of Biden’s green subsidies would likely be repealed and replaced, we would expect new broad-based subsidies for production and tax credits for investment (conditional on domestic content requirements) in the technological sectors, for supply-chain strengthening (esp. raw material, rare earths) and to chemicals and minerals, but also steel and autos.

<sup>1</sup> It is rare for one party to have filibuster-proof majority of 60 seats in the Senate that would allow a free rein to set policy. And while executive orders and reconciliation bills in the Senate are likely to be used to pass laws with only a simple majority, the President would need Congress approval for bills to increase defense spending, fund new industrial subsidies or modify immigration legislation, for example.

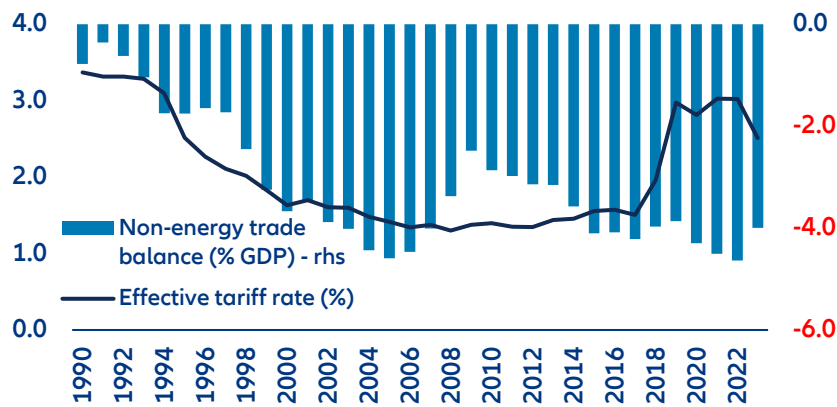


# Trade policy: Not a full-fledged trade war?

**Trump's first term marked a decisive turning point in US trade policy, doubling the effective US tariff rate to 3%. While some tariffs have been reduced since then, the Biden administration not only extended most trade barriers but even stepped up protectionist measures.** During Trump's first term, the effective US tariff rate doubled during from around 1.5% to 3%. However, the former administration fell far short of its goal to reduce the US goods trade deficit (Figure 3). By types of products (Figure 4), the US trade deficit increased notably for consumer goods excluding automotive & food (-USD125bn

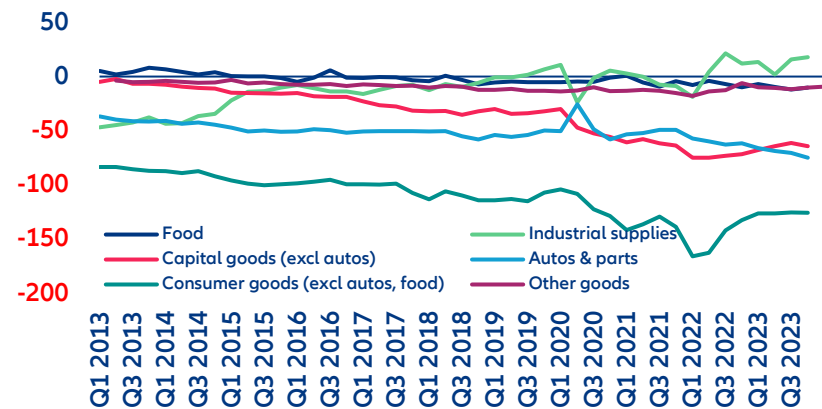
at the end of 2023), capital goods excluding automotive (-USD65bn) and automotive & parts (-USD75bn). The only area where the US did better is in industrial supplies, with a surplus posted since Q2 2022. And while the Biden administration reduced some tariffs (the effective tariff rate dropped to 2.5% last year), it not only extended most of the trade barriers imposed by Trump but also stepped up protectionist measures by unleashing new industrial subsidies to promote domestic firms over foreign competitors through the IRA and the CHIPS Act.

**Figure 3: US non-energy goods trade balance & effective tariff rate**



Sources: LSEG Datastream, Allianz Research

**Figure 4: US goods trade balance in main categories (USD bn, annualized)**



Sources: LSEG Datastream, Allianz Research

**If re-elected, Trump has pledged to implement a 10% across-the-board tariff rate on all trading partners but the specifics are still unclear.** To be determined are whether all goods – including duty-free ones (generally small shipments) and critical goods – will be taxed, and how a universal tariff would interact with existing US trade agreements (including the USMCA with Mexico and Canada).

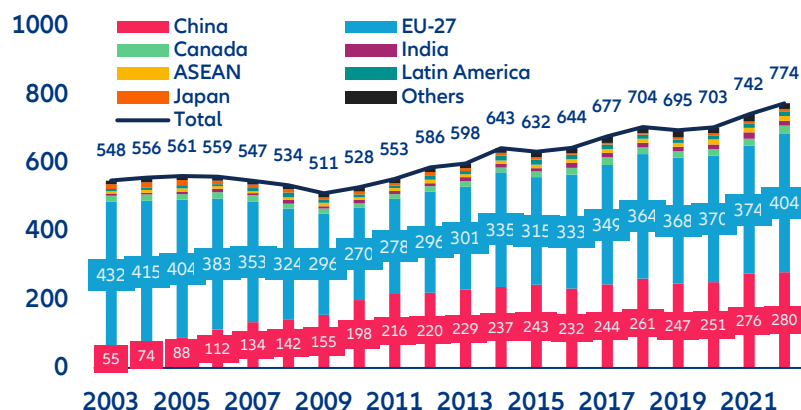
**Trump has also vowed to levy a 60% tariff on all Chinese imports, but the US’s high dependence on Chinese goods makes this unlikely: Close to half of total US imports from China are critical dependencies<sup>2</sup> (Figures 5 & 6).** On the campaign trail, Trump has pledged to “completely

eliminate dependence on China in all critical areas”, to revoke its Most Favored Nation trade status and impose a 60% tariff on all Chinese imports, as well as to “adopt a four-year plan to phase out all Chinese imports of essential goods – everything from electronics to steel to pharmaceuticals”. However, phasing out imports from China is nearly impossible in the short term. In 2022, the US imported close to USD565bn worth of goods from China, out of which close to 50% (USD250bn) were critical dependencies (Figure 7), primarily in the computers and telecom, electronics, household equipment, textiles and chemicals sectors. Targeting these products with higher tariffs would induce significant substitution costs and efficiency losses.

<sup>2</sup> See our recent report [China: keeping the Dragon awake](#) for a detailed analysis and classification of critical dependencies.

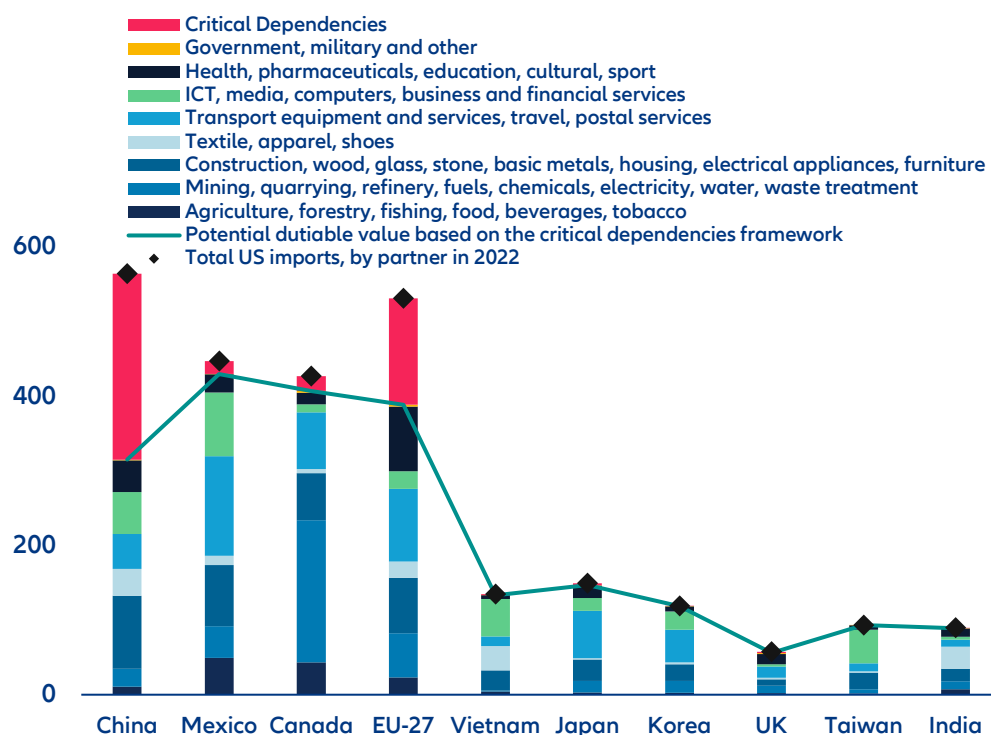


**Figure 5:** Number of US critical dependencies imported from its main trading partners



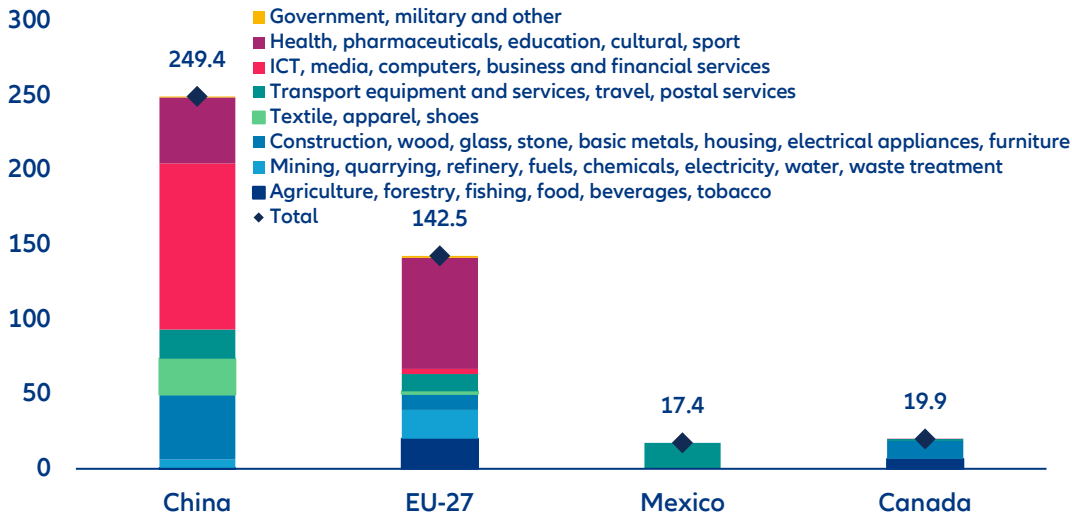
Sources: ITC, Allianz Research

**Figure 6:** Estimates of potentially targetable US imports, by partner and sector (USD bn)



Sources: ITC, Allianz Research

**Figure 7:** Value of critical dependencies imported by the US in 2022, by partner and sector (USD bn)



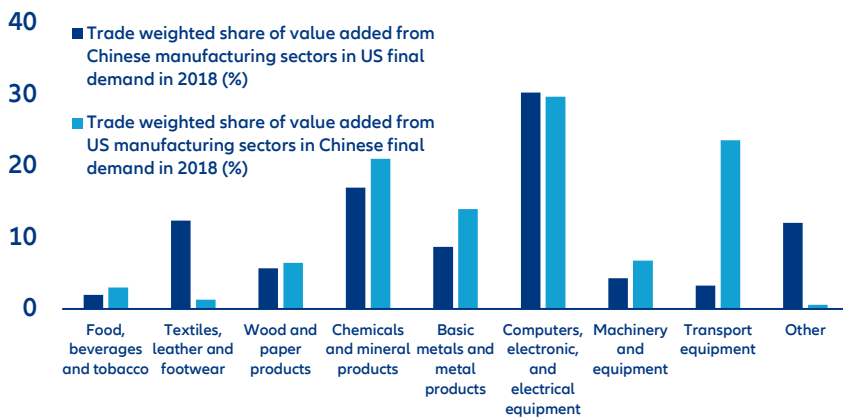
Sources: ITC, Allianz Research

**If US protectionist policies targeted at China escalate into a trade war, China’s textiles sector and the US transport equipment sector would be hit the hardest.**

The role of globalized supply chains has never been more important than it is today. To understand the impact of tariffs on foreign exporters via the reduction in demand, we look at the sectoral exposure of China to foreign final demand in the US, and vice versa, weighted by the share of imports from the source country. We find that exporters in the US would suffer more in net terms, with the largest

losses felt by the transport equipment industry, followed by metals and chemicals. From China’s perspective, the largest losses will be felt in the textile industry, followed by computers and electronics (Figure 8). This is consistent with our estimates of the potential value of targeted goods based on the critical dependencies’ framework: the lower the concentration of critical dependencies in a particular sector, the higher the likelihood that it will be hit the most.

**Figure 8:** Trade-weighted share of value added in final demand, % of total



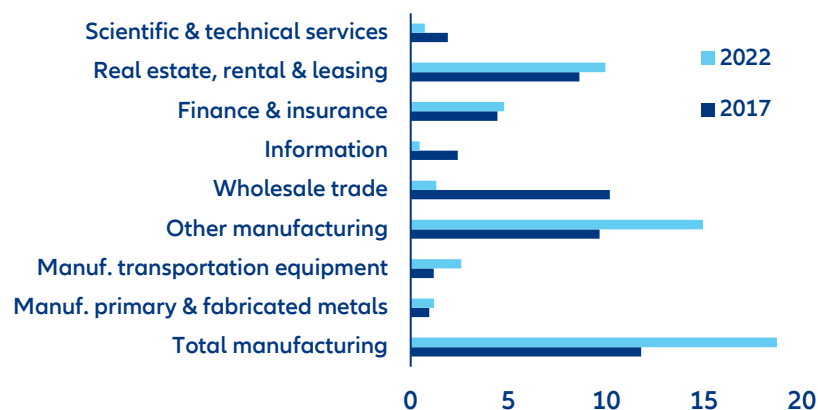
Sources: OECD, Allianz Research

**In this context, we think a 25% tariff on Chinese goods followed by a deal is the more likely scenario.** With China likely uninterested in a trade war while trying to revive its weak economy, we would expect Trump to escalate tariffs against China (and China to retaliate). But negotiations would likely follow through 2025, leading to the signing of a revamped “Phase I” type agreement (similar in what Trump signed in end-2019) aimed at boosting US exports to China (notably for agriculture products). Trump is also likely to face stiff opposition in Congress – including from Republicans – against pushing the limits of tariff hikes too far amid legitimate concerns about the sizeable negative impact of a full-blown trade war on the US economy.

**Likewise, we think the USMCA would be preserved in exchange of stepped up customs checks at the border to crack down on tariff evasion and trade diversion.** Trump would likely face stiff opposition in Congress and from businesses to tear the USMCA apart – a free trade agreement he already revamped from the NAFTA when he was President. However, we think Trump would extract concessions from Mexico to help the US crack downs forcefully on trade diversion and tariff evasion (see Box 1).

**Besides trade policy, Trump would also continue tightening restrictions on inbound foreign investment, especially in critical sectors.** On the campaign trail, Trump has emphasized his goal to “stop US companies from pouring investments into China and stop China from buying up America<sup>3</sup>”. The stock of Chinese capital investments in the US manufacturing sector has indeed increased since 2017 (Figure 9), although the overall stock has declined (Figure 10). Should he be elected for a second term, we would expect a tightening of restrictions on foreign investment from China in critical sectors – e.g. infrastructure (airports, ports), chip plants, energy, raw materials, food, biopharmaceuticals, steel.. In addition, we would expect a further tightening of restrictions on outbound investment to China and an expansion of the scope of export controls, particularly in biopharmaceuticals, where China is highly dependent on US intellectual property), biotech materials, technical information and laboratory equipment, which US companies supply in significant quantities to Chinese facilities, or even agricultural products (e.g., seeds). Note that among major economies, US economic security measures are already restrictive in many aspects (Table 1).

**Figure 9:** Foreign Direct Investment in the US from China, selected sectors (historical cost basis, USD bn)

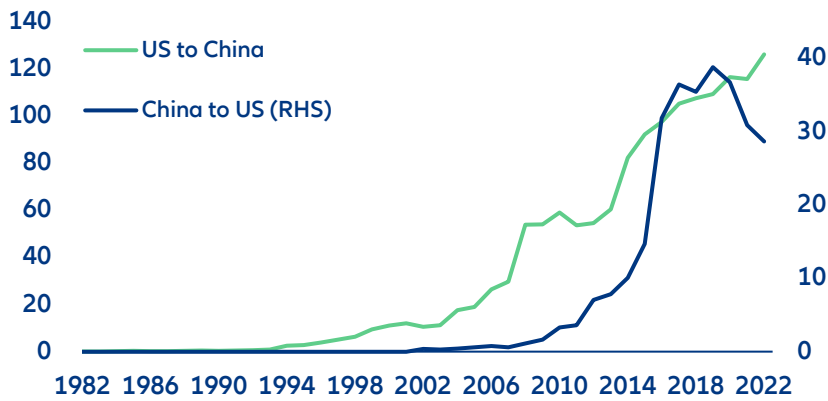


Sources: US Bureau of Economic Analysis (BEA), Allianz Research. Note that we used the „ultimate beneficial owner“ (UBO) country database, which takes into account the fact that foreign investors channel funds destined for the United States through subsidiaries they set up in financial centres. We only considered sectors for which information was available in both periods. Other manufacturing is the residual of total manufacturing minus transport equipment and primary and fabricated metals.

<sup>3</sup> See e.g. <https://www.foxnews.com/politics/trump-rolls-out-2024-trade-policy-tax-china-build-up-america-reward-us-producers>



**Figure 10:** Direct Investment (USD bn)



Sources: US Bureau of Economic Analysis (BEA), Allianz Research

**Table 1:** Economic security measures currently in place and under discussion

	China	US	EU	UK	Japan	Australia	South-Korea
Inbound investment screening	Strong	Strong	Moderate	Moderate	Moderate	Moderate	Moderate
Outbound investment screening	Moderate	Under discussion	None	None	Weak*	None	Weak*
Export controls	Strong	Strong	Moderate	Moderate	Moderate	Moderate	Moderate
Procurement restrictions	Strong	Strong	Moderate	Moderate	Moderate	Moderate	Moderate
Sanctions	Strong	Strong	Moderate	Moderate	Moderate	Moderate	Moderate
Anti-coercion policy	None	Under discussion	Under discussion	None	None	None	None
Supply-chain resilience policies	Moderate	Strong	Moderate	Moderate	Strong	Moderate	Strong
Data protection and cybersecurity	Moderate	Moderate	Strong	Strong	Strong	Moderate	Strong
Institutionalization	None	None	None	Weak	Strong	None	Moderate
Industrial strategy	Strong	Strong	Moderate	Moderate	Strong	Moderate	Strong

Strong	Strong
Moderate	Moderate
Weak	Weak
Under discussion	Under discussion
None	None

Sources: Metrics, Allianz Research. NB: \* Minor restrictions in place for foreign banks, weapons manufacturing, and narcotics, but they are residuals of processes of economic opening and not full-fledged policies to screen outbound investments

**Overall, a stronger return to protectionism would entail losses for economies that are dragged into a trade war.** Applied tariff rates currently faced by economies exporting to the US – accounting for the share of duty-free imports – are broadly in line with the most favored nation (MFN) rates for most economies, except for China and India (Table 1). To calculate the effects of stronger protectionism, we outline two scenarios:

**a. A baseline scenario:** Tariffs on all goods that are not critical dependencies imported from China are increased to 25%, and to 5% on the other large trading partners (EU, South Korea and Japan). Mexico and Canada are exempted from tariff increases.

**b. A downside scenario:** Tariffs on China are increased to 60% and tariffs on other countries are increased to 10% on all goods that are not critical dependencies. In this case, even Canada and Mexico are targeted.

**Based on our assumptions, the trade-weighted average effective tariff rate faced by exporters to the US would rise to 4.3% and 11.9% in the baseline and downside scenarios, respectively, the highest levels since the mid-1970s and the early 1940s.** That would be a significant deviation from the current level of 2.5%. In response, we assume the large trading partners of the US impose equivalent tariffs on the same share of imported goods from the US. For instance, if US targets 50% of total imports from China with a tariff rate of 60%, we expect China to retaliate with a tariff of 60% on 50% of total imports from the US.

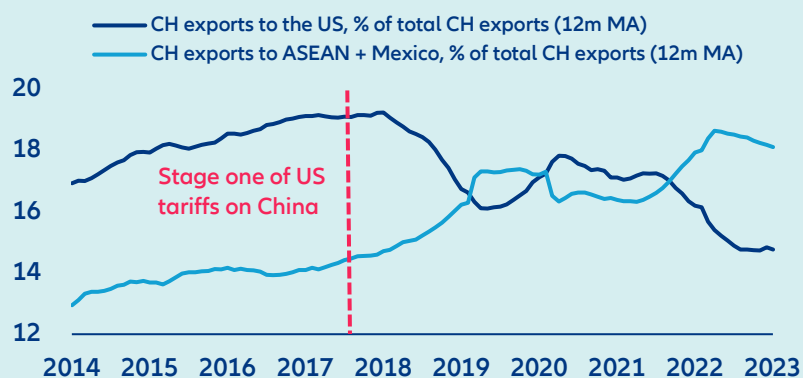
**On top of the rise import duties, we assume that Trump steps up customs checks at US borders to crackdown on trade diversion and tariff evasion, which would push up US inflation by +0.6pp on its own.** That would amount to sizeable shock that would hurt households' disposable income (see Box 1).

## Box 1: Trump 2.0. will crack down on trade diversion and mis-invoicing

**In his campaign, Trump has been very vocal about trade diversion**, i.e. the rerouting of shipments via third countries not affected by tariffs (hence the universal tariff on washing machines imposed during his first term in 2018). He has pledged to impose "strong protections" to avoid "circumventing restrictions by passing goods through conduit countries". Avoiding trade diversion is also one of the rationales for imposing a universal tariff.

**There is mounting evidence that Chinese exporters have established transshipment routes to the US via Southeast Asia and Mexico to evade tariffs.** Since the trade war began, the decline in the share of Chinese exports going to the US has been almost perfectly offset by an increase in the share going to these countries (Figure 11). They in turn have recorded a similarly large jump in their exports to the US.

**Figure 11:** Share of Chinese exports by destination, % of total Chinese exports, 12 month moving average

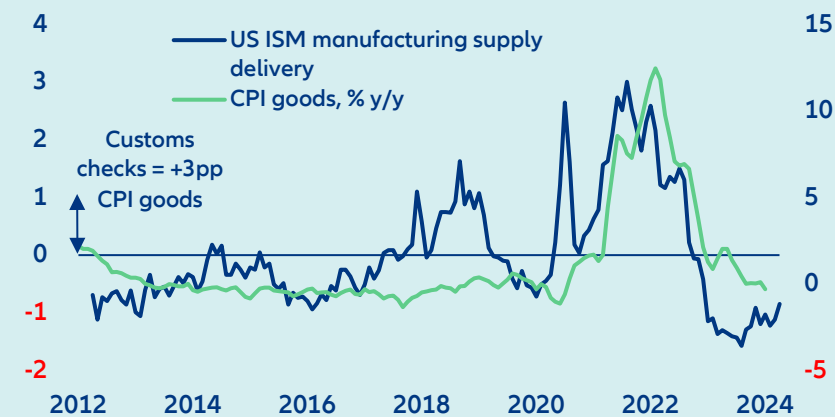


Sources: LSEG Datastream, Allianz Research

**Besides, there is also strong evidence of mis-invoicing of Chinese imported goods into the US.** Since 2020, Chinese data on exports to the US have shown larger shipments than US data on imports from China (the opposite was true prior to 2020). Chinese firms have little incentive to misreport the destination of their exports to the Chinese authorities since it would lower the VAT rebates they get and not help to evade the tariffs, which are enforced on the US side. On the other hand, US importers have incentives for understating the value of inward shipments. Therefore, the gap between Chinese and US data is indicative of trade mis-invoicing.

**We estimate that stepped up customs checks will push up US inflation by 0.6pp. We think it is likely that Trump follows through on this promise and orders US customs to step up checks of inward shipments.** That would amount to a sizeable negative supply shock for the US economy by increasing supply delivery times, creating temporary shortages and ultimately pushing up prices. We quantify the inflation impact by first scaling up the import content of goods purchased in the US (around 30%) by the combined share of Mexico and main Asian trading partners (excl. China and Japan) in US goods imports (28%). We assume that all US importers importing goods from these countries would report increased delivery times, which would translate into an increase of the net percentage of respondents in the ISM manufacturing survey on delivery times by 1.1 standard deviation, ie about +3pp goods inflation according to recent relationship (Figure 12), or about 0.6pp headline inflation.

**Figure 12:** Supply-chain disruptions indicators (z-score)



Sources: LSGE Datastream, Allianz Research



**Table 2:** Tariff rates (%) faced by countries exporting to the US: applied, MFN, baseline, downside scenario, an indicator for FTA in force and the estimated share of imported goods that may be targeted

	Applied tariff rate	MFN rates	Baseline scenario	Downside scenario	FTA in force	Estimated share of goods targeted
China	12.82	1.02	25.00	60		55%
Mexico	0.01	0.01	0.01	(10)	FTA	94%
Canada	0.00	0.00	0.00	(10)	FTA	91%
Japan	0.79	0.79	5.00	10		95%
European Union	0.56	0.56	5.00	10		68%
Vietnam	1.67	1.67	5.00	10		99%
South Korea	0.00	0.00	5.00	10	FTA	98%
Taiwan	0.45	0.45	5.00	10		97%
India	1.60	1.03	5.00	10		98%
United Kingdom	0.35	0.35	5.00	10		86%

Sources: WTO, Allianz Research

**The US and the world stand to lose from a trade war in the short-term.** For the US we use the increase in tariff rates under the two scenarios as one-off shocks, while allowing for the use of additional tariff revenues recycled into government spending (0.2% of GDP in the baseline scenario vs 1.1% of GDP in the downside scenario). We also add an exogenous one-off 0.6pp inflation shock in the US to account for disruptions of US supply chains (see Box 2 again). We simulate the economic impact of this dual shock (trade war + US supply-chain disruptions) using the 'Global Economic Model' developed by Oxford Economics.

**The results show that US GDP growth in the first year would be knocked off by -0.5pp in the baseline scenario alone, a number that could increase to -1.4pp in the downside scenario.** Tariff hikes depress exports and sentiment, while the rise in inflation induced by supply-chain disruptions and tariff increases (+0.6pp inflation) hurts US households' disposable income. The impact of the 'dual' shock on inflation would fade after the first year as a large negative output gap would open up

and disinflationary pressures start to build, weighing on inflation dynamics. The Fed would start to resume policy easing, helping US GDP to recover from the second year onward, although it will remain depressed relative to its pre-shock trend.

**Under the baseline scenario, the US' trading partners would see their GDP growth hit by -0.1 to -0.3pp.** Other countries stand to lose less than the US since they only impose new tariffs on US (while the US imposes tariffs on the others). Mexico and Canada would be hit despite not being involved in the trade war because of their high exposure to the US economy. Overall, the dual shocks would knock off global GDP growth modestly, by -0.2pp and increase global inflation by a small +0.1pp in the first year under the baseline scenario. In the downside scenario where Mexico and Canada are involved in the trade war, the negative impact would be very large: their GDP could be up to -2.4% below their trend after two to three years.

**Table 2:** Economic impact on selected economies of a dual (tariff + US supply chain disruptions) shock, under the baseline and downside scenarios

Baseline Scenario								
% change relative to projected level, unless otherwise indicated	US			% change relative to projected level, unless otherwise indicated	EU			
	GDP	Exports	Inflation (pp)		GDP	Exports	Inflation (pp)	
2025	-0.5	-0.3	0.6	2025	-0.1	-0.2	0.0	
2026	-0.3	-0.8	0.0	2026	-0.2	-0.5	-0.1	
2027	-0.2	-1.0	0.0	2027	-0.3	-0.7	0.0	
China				Canada				
	GDP	Exports	Inflation (pp)		GDP	Exports	Inflation (pp)	
2025	-0.1	-0.4	0.1	2025	-0.2	-0.5	0.0	
2026	-0.3	-1.0	-0.1	2026	-0.4	-1.1	-0.1	
2027	-0.3	-1.3	0.1	2027	-0.2	-1.2	0.1	
Mexico				World				
	GDP	Exports	Inflation (pp)		GDP	Exports	Inflation (pp)	
2025	-0.2	-0.7	0.0	2025	-0.2		0.1	
2026	-0.3	-1.4	-0.1	2026	-0.2		-0.1	
2027	-0.3	-1.6	-0.1	2027	-0.2		0.1	
Japan								
	GDP	Exports	Inflation (pp)		GDP	Exports	Inflation (pp)	
2025	-0.1	-0.3	0.0					
2026	-0.2	-0.8	-0.1					
2027	-0.2	-1.1	0.0					
Downside Scenario								
% change relative to projected level, unless otherwise indicated	US			% change relative to projected level, unless otherwise indicated	EU			
	GDP	Exports	Inflation (pp)		GDP	Exports	Inflation (pp)	
2025	-1.4	-1.2	1.2	2025	-0.3	-0.5	-0.1	
2026	-1.3	-3.4	-0.1	2026	-0.8	-1.7	-0.4	
2027	-1.0	-4.8	0.3	2027	-1.0	-2.7	0.2	
China				Canada				
	GDP	Exports	Inflation (pp)		GDP	Exports	Inflation (pp)	
2025	-0.5	-1.4	0.3	2025	-1.5	-1.8	1.6	
2026	-1.1	-3.7	-0.3	2026	-2.4	-4.2	-0.1	
2027	-1.4	-5.2	0.3	2027	-1.9	-5.7	0.3	
Mexico				World				
	GDP	Exports	Inflation (pp)		GDP	Exports	Inflation (pp)	
2025	-1.0	-2.7	0.3	2025	-0.6		0.2	
2026	-2.2	-6.5	-0.5	2026	-0.9		-0.4	
2027	-2.4	-9.0	-0.4	2027	-1.0		0.2	
Japan								
	GDP	Exports	Inflation (pp)		GDP	Exports	Inflation (pp)	
2025	-0.3	-1.0	0.0					
2026	-0.7	-2.9	-0.4					
2027	-0.9	-4.4	0.0					

Sources: Oxford Economics, Allianz Research

**It is challenging for the US to reduce its trade deficit significantly as long as it runs large fiscal deficits.**

The simulations of the model indicate that the US trade deficit would narrow by a tiny -0.1pp of GDP under the baseline scenario, even after three years (-0.4pp under the downside scenario). But these results are to be taken with a pinch of salt: the ambitious industrial policy set out by Trump is another lever that could help to reduce the trade deficit. But more fundamentally, we are skeptical that the

US can substantially reduce its trade deficit while running large fiscal deficits. The trade balance is a subcomponent of the current account, which is the difference between aggregate savings and investment. The US's current account is deeply negative because of large fiscal deficits more than offsetting the private sector's financial balances surplus. This is another reason why a second Trump presidency could mean cautiousness on fiscal policy.

## Box 2: Tariff hikes and the economy: why they are growth-hurting, at least in the short-term

**Tariff increases can work, in theory.** If the bulk of the tariff increases are borne by exporters, domestic prices will not increase by much. Additionally, if tariff policy is crafted with a well-designed industrial policy, the end purpose of supporting foreign firms and increasing domestic production can work. This is even more likely to be the case now that firms are paying greater attention to political risks and embracing the benefits of supply-chain diversification – industrial subsidies and high tariffs can nudge them to relocate into the US, which is the biggest market for most products. Surveys indeed indicate that an increasing number of firms are considering moving capacity outside of China. Besides, US manufacturing possesses several tailwinds such as low electricity costs.

**But highly integrated and complex cross-border supply-chains, corporate pricing power, retaliation by trading partners, increased uncertainty and trade diversion make tariff hikes a growth-hurting policy.** US supply chains are highly integrated in the global economy. They rely on a large chunk of imported intermediate inputs, which are often re-exported across the border. This is particularly the case at the US-Canada border, where the upstream supply chains of the auto industry are deeply interconnected. Tariff hikes would thus inflict significant drag on US supply chains. Besides, it is evident that the US is heavily reliant on foreign inputs and products, which cannot be easily replaced by domestic firms: tariff hikes will not spur US domestic production in many sectors, at least in the short term. Moreover, evidence suggests that increased import duties are mostly passed through into higher prices to the final consumer rather than being borne by the exporter or the importer. This is even more likely to be the case in a US economy, which operates near full capacity (Figure 4 again). Furthermore, retaliation by trading partners – which we already assume in our simulations – could be stepped up via other measures than tariffs, magnifying the drag on the US economy. For instance, during Trump's first term, China instructed its state-run companies to cut back purchases of US agricultural products. Finally, trade diversion and mis-voicing of shipments – that Trump has pledged to tackle – mitigate the benefits of tariff hikes for US-based firms competing against foreign ones.

**In addition, the net impact of the trade war on the domestic economy in the US will depend on how the tariff revenues are re-used in practice, on industrial policy and exchange rate fluctuations.** If, for instance, tariff revenues are recycled into the economy through higher government spending as we assume in our scenarios, the drag on the US economy would be more limited relative to a situation wherein the tariffs are used to reduce the fiscal deficit. In addition, the loss of competitiveness of imported products can be mitigated if the US dollar strengthens against foreign currencies. On the other hand, a stronger US dollar may help limit the impact on prices in the US.







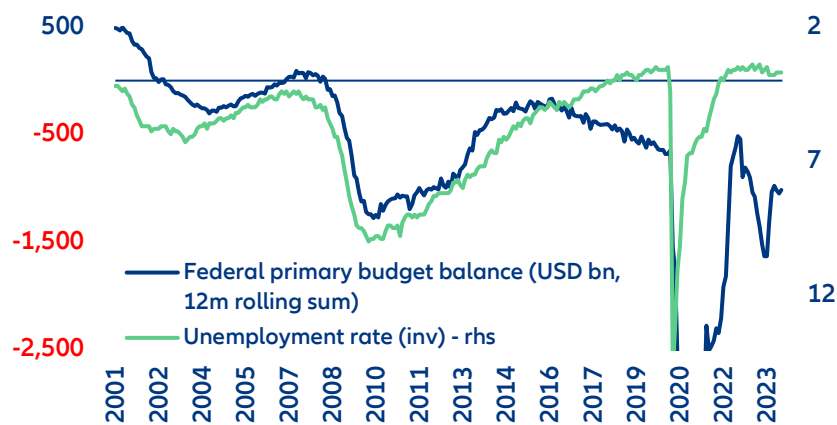
# Fiscal policy: playing cautiously

**The federal deficit widened under Trump 1.0 despite low unemployment and a strong economy (Figure 13).**

The federal outlays-to-GDP ratio increased by 0.5pp between Q1 2017 and Q4 2019, while the federal receipts-to-GDP ratio declined by 0.9pp over the same time span. Tax receipts were dragged down by the implementation of the Tax Cuts and Jobs Act, which included reduced statutory tax rates and increased deductions (effectively

shrinking the tax base). The effective federal personal tax rate declined by -1.3pp between 2016 and 2019 while the effective federal corporate tax rate declined by -2.8pps. The TCJA tax cuts are set to expire as scheduled at the end of 2025 so if Trump wins a second term he is likely to make it a priority to extend them. That would deprive the federal budget of around 1% of GDP of new windfalls.

**Figure 13:** Subsidies in USD bn and % share of green subsidies



Sources: LSGE Datastream, Allianz Research

**A Trump 2.0 presidency would inherit very large fiscal deficits from the Biden administration, rising interest expenses and an economy probably more prone to bouts of inflation.** Another round of large, deficit-financed tax cuts (or increased spending) could thus re-ignite inflation and heighten concerns about the sustainability of US public finances in bond markets. As a cautionary tale, Liz Truss lasted only 50 days as UK Prime Minister in 2022 after bond and currency markets reacted adversely to her plans for big deficit-financed tax cuts.

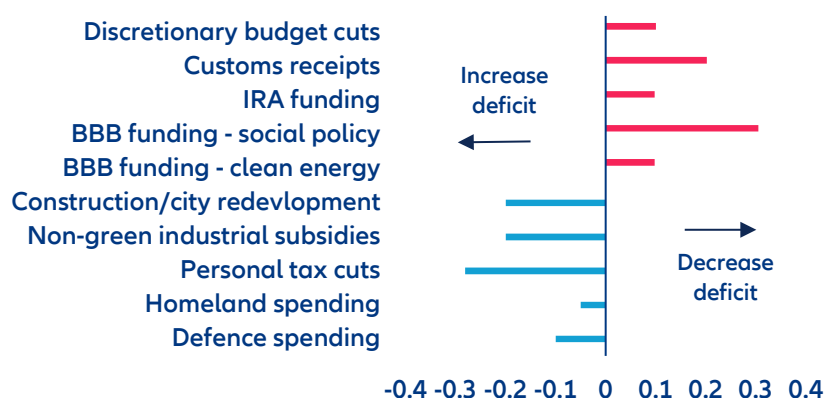
**In this context, we would expect Trump to fund his fiscal pledges with increased customs receipts and the repealing of some of Biden's policies.** Our baseline assumption that the effective US tariff rate would increase to 4.3% (from 2.5% currently) would raise 0.2% GDP of new receipts. The repeal of parts of Biden's flagship Acts – the Build Back Better Act (BBB) and the IRA – could yield 0.1% to 0.3% of annual savings relative to what was budgeted by the Biden Administration. On new spending and tax cuts, Trump has said revenue raised by the tariffs would be used to increase support to domestic companies: 0.2% of GDP of non-green industrial subsidies could be unleashed from the direct recycling of higher customs receipts. Additional funding for the Homeland and Defence departments are also core pledges. Trump has proposed various construction projects, including city redevelopment, notably in Washington DC, and continuing the border wall construction with Mexico. Finally, we would assume that he would enact moderate personal tax cuts for households (through tax deductions, for instance)<sup>4</sup>.

**Nevertheless, in a downside scenario in which Trump unleashes a full-blown trade war (causing substantial economic damage) and still delivers larger tax cuts, the**

**risk of a fiscal crisis would loom large.** In the alternative downside scenario, where the effective tariff rate would rise to 12%, that would amount to 1.1% of GDP of new receipts – but probably much less after taking account into the large negative effects on the economy. While there is no precise threshold of the deficit or the debt beyond which bonds markets starts to panic, in an environment of large budget deficits and trade war-induced lower growth, the absence of credible commitment to put public finances on a sustainable footing would trigger a fiscal crisis. Eventually, that would force the Trump administration to back down and to undertake a painful fiscal adjustment to restore confidence.

**In this environment, we think Trump would play cautiously on fiscal policy, all the more so because of fiscal conservatism amongst Republicans in Congress.** Overall, the fiscal stance could be slightly loosened in the first year of a Trump presidency, but neutral in the outer years. He has already backed down on his promise to slash the statutory corporate tax rate plan down to 15% (from 21%), though he has also committed to “dramatically” lower taxes for American workers and families. Furthermore, Trump would need the backing of both Houses of Congress for passing new tax cuts (he would need only a simple majority in the Senate for passing the law via reconciliation). We doubt that the fiscally responsible Republicans would sign off on large tax cuts or new spending, given the poor state of US public finances. In this context, we would expect the fiscal stance to be slightly loosened in a first year of a second Trump presidency thanks to additional customs receipts being recycled into the economy. In the outer years, we would expect deficit-increasing measures to be offset by deficit-reducing ones, as illustrated in Figure 14.

**Figure 14:** Potential tax & spending changes under Trump 2.0, before feedback effects (% GDP)



Sources: LSGE Datastream, Allianz Research.

<sup>4</sup> For instance, Trump vowed to support homeschooling families, proposing that 529 education savings accounts could be utilized for homeschooling expenses up to EUR10,000 annually per child without taxation.



# Industrial policy: unleashing non-green subsidies

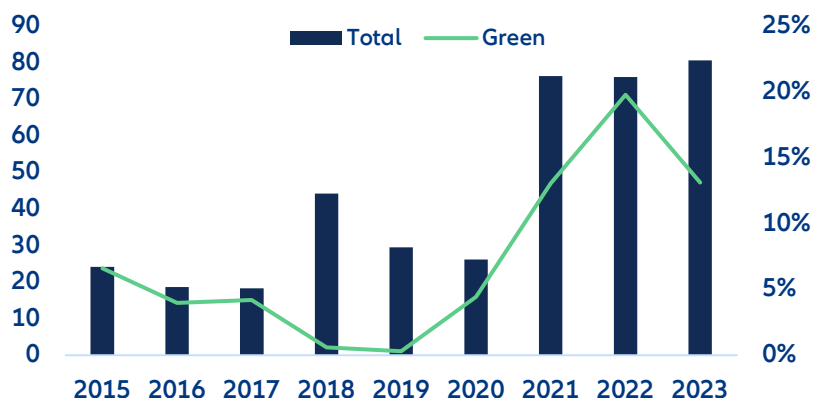
**Industrial policy is back in style.** While industrial policy is not new in the US, the current administration has emphasized it as a key pillar, committing over USD805bn to subsidize semiconductor manufacturing, research, climate initiatives and infrastructure projects. This renewed focus on industrial policy reflects a shift towards targeted investments to achieve various policy objectives – notably to accelerate the de-risking from China and compete with China on high-end manufacturing products. Recent

initiatives such as the IRA and CHIPS Act have spurred growth in specific sectors such as computer/electronics/electrical manufacturing, creating an estimated 200-250k new jobs<sup>5</sup>. However, this only represents a modest 2% increase in overall manufacturing employment. Total subsidies have quadrupled between 2015 and 2023, and the share of subsidies that are classified as green has increased to 15% on average across 2021-2023 (Figure 15).

<sup>5</sup> Goldman Sachs, "Activist Industrial and Trade Policy: Here to Stay", December 2023.



**Figure 15:** Subsidies in USD bn (left) and % share of green subsidies (right)

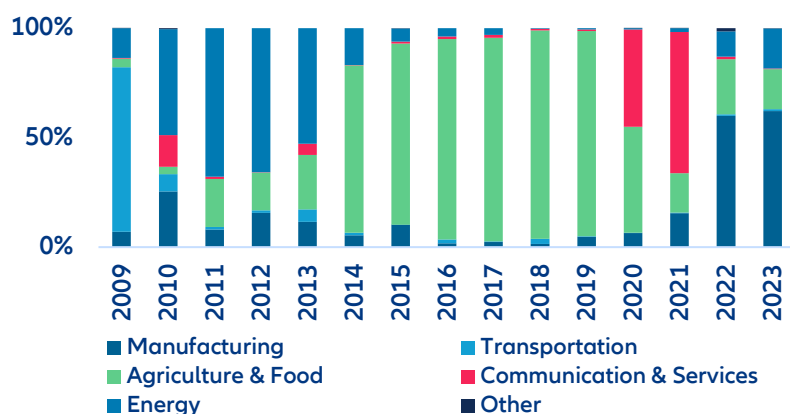


Sources: Global Trade Alert, Allianz Research; Research Notes: Classified as green means that the question “Is the corporate subsidy related to the environment or Low-Carbon Emitting Technology?” is answered with “yes”. The analysis does not include corporate subsidies that (1) affect almost all sectors as classified by GTA, (2) related to public health concerns (including COVID-19), (3) linked to the invasion of Ukraine. Bailouts and financial institutions are not considered. The total amount of subsidies that spread across several years has been equally divided across granted years if no other information was available. GTA corporate subsidies database has been enriched for 2022 and 2023 using the GTA latest state act section.

Subsidies are shifting towards different sectors. Attention has shifted from transport, energy and agriculture & food to communication & services, and more recently to manufacturing. In the last two years, more than 60% of subsidies went into manufacturing, with the other big chunks going to agriculture & food and energy (Figure

16). But only 8% of subsidies spent in manufacturing was classified as green in 2023. Around half of those spent on projects in transport or energy were classified as green, but the amounts in the latter were much smaller overall.

**Figure 16:** Subsidies by sector in % of total subsidies

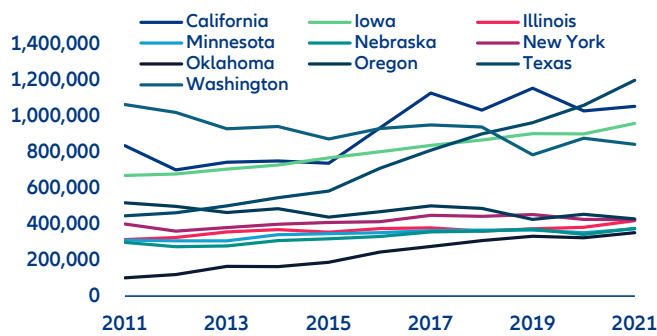


Sources: Global Trade Alerts, Allianz Research; Research Notes: The analysis does not include corporate subsidies that (1) affect almost all sectors as classified by GTA, (2) related to public health concerns (including Covid-19), (3) linked to the invasion of Ukraine. Bailouts and financial institutions are not considered. The total amount of subsidies that spread across several years has been equally divided across granted years if no other information was available. GTA corporate subsidies database has been enriched for 2022 and 2023 using the GTA latest state act section.

**Whoever wins the election, the turn towards more active industrial policy will continue.** Trump’s “Strategic National Manufacturing Initiative”(SNMI) would mean ramped up, across-the-board industrial subsidies and a cut-back on green subsidies. Trump’s SNMI to relocate manufacturing production into the US is made up of two pillars: trade policy (increase in tariffs) and industrial policy (increase in subsidies). Should he win a second term, we would expect the CHIPS Act subsidies to be maintained in full as they garner broad political consensus, although, surprisingly, Trump has accused the funds of being “directed to foreign countries”<sup>6</sup>. However, green subsidies to be slashed, particularly the subsidy of up to USD7,500 for electric vehicle purchases. We would expect new broad-based subsidies for production and tax credits for investment (conditional on domestic content requirements) in the technological sectors, supply-chains strengthening (esp. raw material, rare earths), chemicals and minerals, but also steel and autos to be pushed through. We estimate that, under a fiscally responsible Trump, non-green industrial subsidies could plausibly be boosted by around USD55bn per year (0.2% of GDP).

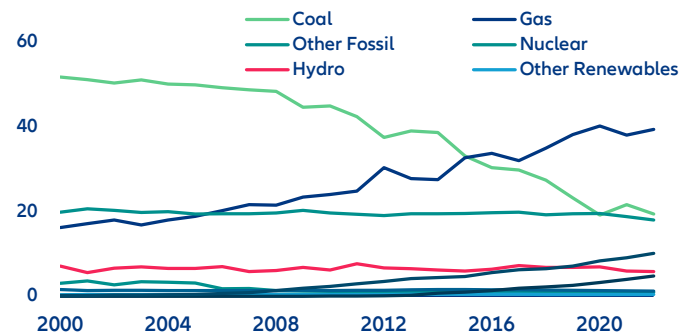
**However, the transition towards renewables is not likely to be derailed.** In several areas, GOP-leaning states have been at the vanguard of the climate transition: they have installed 35% more renewable capacity than Democrat-leaning states since 2012. Indeed, Texas alone has been responsible for one-quarter of the increase in the US’s renewable capacity over this period (Figure 17). In the context, we would expect coal production to remain depressed and renewable production to continue gaining momentum (Box 3). Also, most of the IRA funding and positive spillovers to private investments actually benefit Red States. Moreover, the IRA is a Trump-compatible protectionist policy. Therefore, it is possible that Trump would cap IRA tax credits and subsidies (wind, solar, battery) rather than fully repeal them.

**Figure 17:** Renewable energy production, top 10 state producers, Bn Btu



Sources: US EIA, Allianz Research

**Figure 18:** US electricity production mix, share in total by type



Sources: Ember, Allianz Research

<sup>6</sup> He could have meant that the profits made by subsidy-recipient foreign companies are paid out to foreign shareholders.

**The US is facing structural hurdles to re-industrialize and the SNMI may not be targeted enough.** Biden's IRA and CHIPS Act have spurred a sharp rise in plant investments over the past two years, which are likely to be followed through by equipment investments. However, chipmaking, electronics and green industries make up only a small part of total US manufacturing. The US faces numerous structural headwinds that will be hard to overcome, notably a shortage of labor, the high cost of labor and weak public finances, besides excessive red tape. Against this backdrop, low electricity costs,

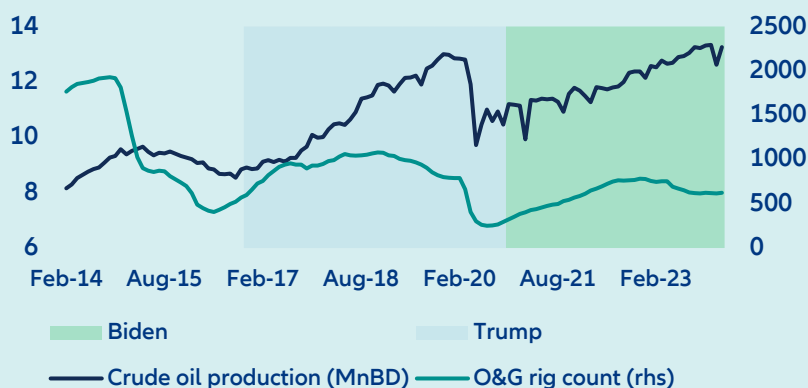
high potential GDP growth relative to peer countries and strong private sector balance sheets are tailwinds. In order to yield benefits, industrial policy must avoid the risk of targeting too many objectives. In that respect, Trump's ambitious SNMI may disappoint when set against its numerous goals and the reality that the US does not have a competitive advantage in many sectors (creating manufacturing jobs, supporting large swathes of sectors against foreign competition, re-shoring highly integrated supply-chains, etc), or even fail (see Box 3, on the automotive industry)

### Box 3: Corporate winners and losers from a potential Trump 2.0 administration

#### Oil & gas: The most obvious winner?

**Oil & gas would benefit the most, but only marginally.** On the campaign trail back in 2020, Joe Biden said "I would transition from the oil industry". Yet, four years later, after massive inflation on fuel prices and in the midst of a war in Ukraine, the US has hit a new record for crude oil production (Figure 19) and has become the biggest LNG export partner for Europe. Nevertheless, a second Trump administration would prioritize oil & gas production by increasing lease programs in the Gulf of Mexico, removing restrictions on oil & gas developments in Alaska, increasing the number of drilling permits and promoting the creation of new LNG export terminals. However, the consequent increase in production would be marginal. Indeed, factors related to demand and price fluctuations have constantly proved to be weigh more on production than policy. For instance, we would expect coal production to continue its structural decline as it is replaced by cheaper sources of electricity generation such as renewables. On the demand side, a future Trump administration could prolong higher oil demand by opposing EVs and supporting oil & gas consumption through regulatory changes and incentives such as abandoning environment regulations and climate targets. Importantly, the focus of a future Trump administration would likely prioritize energy independence and economic considerations over environmental goals.

**Figure 19:** US crude oil production & rig count



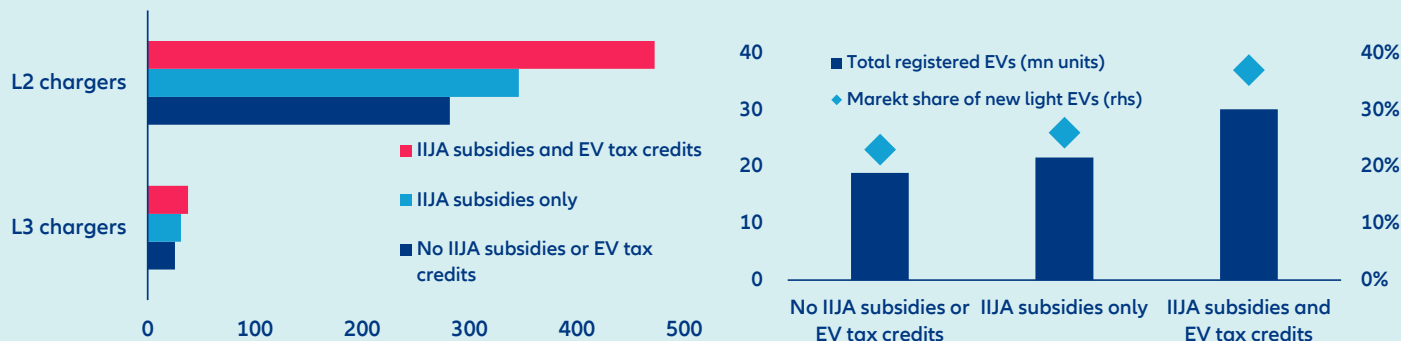
Sources: EIA, Baker Hughes, Allianz Research

### US auto industry: Less competitive?

**While Biden and Trump both aim to foster local auto manufacturing base and recapture jobs from abroad, there is a significant discrepancy in their visions for the industry's future.** The Biden administration has been actively promoting EV adoption, with a goal of capturing two-thirds of new car sales by 2032. Conversely, Trump vehemently opposes the EV transition, claiming it would decimate the US auto industry and lead to a 40% job loss. Though the claim on job losses is not totally ungrounded given the more automated production process and reduced labor need, major automakers such as Ford have pledged to retrain their workforces to manufacture EV parts, thereby mitigating job losses.

**The domestic auto sector is poised to face a decline in competitiveness under a potential second Trump presidency in an increasingly EV-embracing world.** The EV segment will receive about USD21.7bn in total subsidies under the current government, including USD7.5bn for EV charging stations from the Infrastructure Investment and Jobs Act (IIJA) and USD14.2bn for EV purchases between 2022 and 2031 from the Inflation Reduction Act (IRA). According to the Congressional Budget Office (CBO), the combined effect of direct incentives of up to USD7,500 in tax credits per eligible EV and the increasing supply of EV chargers is estimated to increase EV registrations and the market share of new light EVs by 59.3% and 14pps, respectively (Figures 20 & 21). The policies will also lead to an almost nine-fold increase in the number of EV chargers compared to the end of 2022, significantly surpassing the nearly six-fold increase that would occur without both policies. If Trump secures a second term, we anticipate a shift in government support within the automotive sector, redirecting subsidies from EVs to traditional ICE vehicles. The withdrawal of support from EVs would not only have a tangible environmental impact due to the slower adoption of EVs in the world's second-largest auto market, but also undermine the competitiveness of US auto makers in an increasingly EV-embracing world.

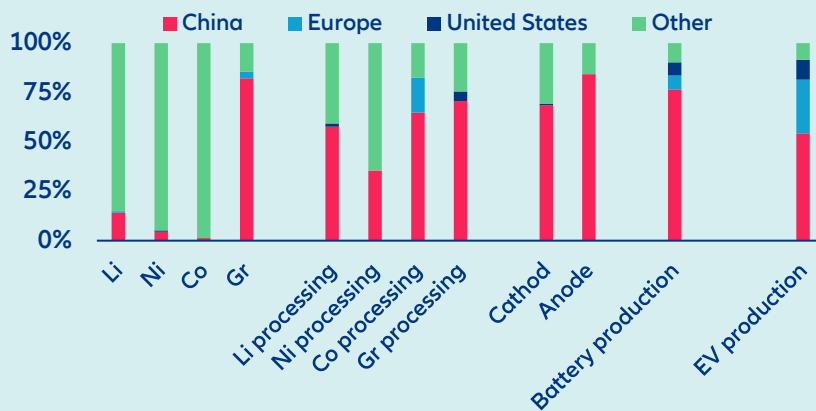
**Figure 20 & 21:** Impact of current industrial policies on the EV sector



Sources: CBO, Allianz Research

**Besides his opposition to the EV transition, Trump also pledged to move the entire auto supply chain back to the US.** This appears economically nonviable, given the significant share of imported car parts and insufficient capacity to manufacture all parts domestically. For the EV segment, this seems even more improbable due to the lack of critical material supplies, refinery infrastructure and battery production in the US (Figure 22). Relocating even parts of the supply chain would be expensive, translating to even higher costs to produce EVs in the US, where most domestic automakers have already been struggling to cut costs and become profitable in their EV businesses. Additionally, the potential imposition of higher tariffs on imported car parts would come at the cost of domestic consumers' utility as they push up prices of new cars, likely spilling over to the prices of used cars as well, with reduced demand for expensive new vehicles. Consequently, this would lead to lower auto production and subsequent job cuts, which is precisely the opposite of what Trump promised.

**Figure 22:** Geographical distribution of the global EV battery supply chain

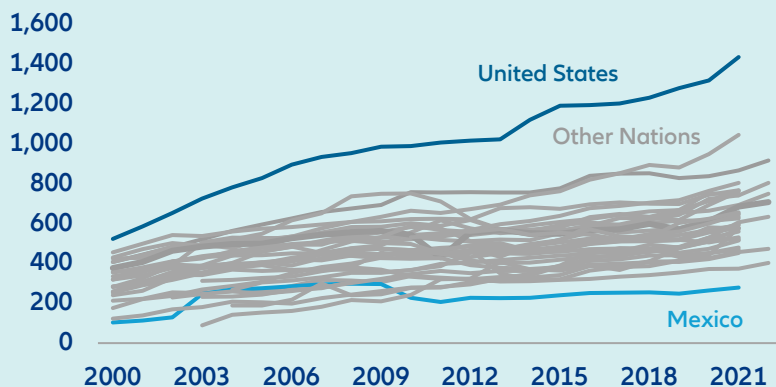


Sources: IEA, Allianz Research

### Big Pharma: Same target, different weapons

**Despite the discrepancies between Democrats and Republicans, both agree on one thing: prescription drug prices must go down.** Yet, they diverge on how to address the problem. For decades, Americans have been paying some of the highest prices in the world for prescription drugs. Per year, a US citizen spends USD 1,432 on medicines, which is 2.3x more than the average of OECD nations. Just across the border, Mexico's per capita spending is 2.2x less than the peer group (Figure 23). While Democrats advocated for implementing the Affordable Care Act in 2010 (ACA, also known as Obamacare<sup>7</sup>), Republicans later employed the American Patients First (APF) policy and the Most Favored Nation (MFN) order. All managed to improve the health system from different directions, but none achieved a sustained and material improvement in terms of prescription-drug prices.

**Figure 23:** Pharmaceutical spending per capita (US \$) in OECD countries



Sources: OECD, Allianz Research

**The burden of disease is explained by two factors: higher prescription-drug dependency and higher national prices.** The US has one of the world's highest rates of people diagnosed with a lifelong condition<sup>8</sup>: 31% of US adults have two or more chronic conditions (a rate almost twice as high as that of France), while 43% of Americans are considered obese (vs. an average of 25% for the OCDE), resulting in a high rate of people with diabetes and hypertension, the two most common diseases in the country. These diseases require life-long treatment, pushing up demand for medicines year after year. At the same time, while governments in other countries directly negotiate prices, access to and distribution of medicines with pharmaceutical companies, the US government does not. As a result, Americans are paying the high cost of R&D that pharmaceutical firms cannot transmit elsewhere. In other words, prescription drugs are more expensive in the US because they are cheaper in other countries.

<sup>7</sup> Obamacare: Created with the main goal of reducing the number of uninsured Americans and helping low-income households afford healthcare.

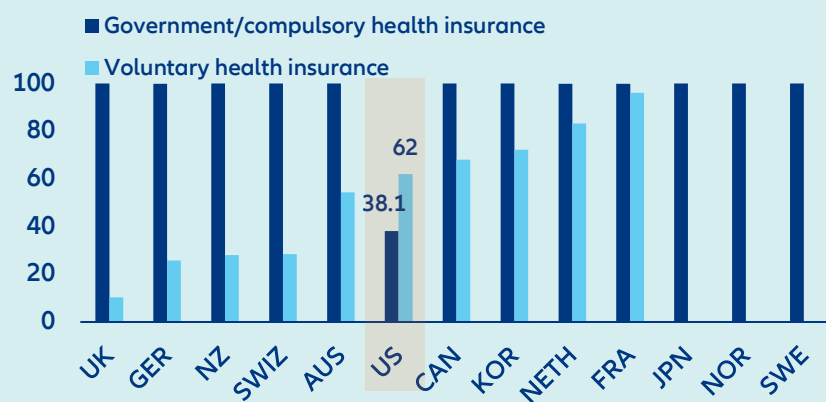
<sup>8</sup> A life-long or chronic condition is an illness that cannot be cured, so the patient must live with it forever or for a long period of their life. Yet, the illness can be controlled through drugs or medical treatments. Examples include diabetes, heart disease, high blood pressure, epilepsy, asthma, arthritis, Alzheimer's, chronic depression and anxiety.



**Joe Biden's IRA also aims to target the issue of high prices of prescription drugs.** But a second Trump term could challenge this. From February to August 2024, Medicare<sup>9</sup> will be negotiating with pharmaceutical companies the price of 10 expensive and highly used drugs<sup>10</sup> for the first time, with new lower prices being applicable from January 2026 (if Medicare manages to haggle hard). Further negotiations will follow next year in order to cover a full list of 30 drugs, with the potential to save Medicare USD98.5bn over a decade. Although the savings resulting from these negotiations will only benefit Medicare part D adherents, which is only around 15% of the US population (50mn people), the negotiations have popular support, which will make it challenging for Trump to repeal the act.

**But even in a scenario of prescription-drug prices going down, Americans will continue paying more out of their pockets than anywhere else as the government's sickness insurance system is precarious.** As Figure 24 shows, all high-income countries except the US guarantee a public health insurance to all their residents. Moreover, people in other countries also benefit from affordable private insurance options. In France, for instance, almost the entire population enjoys both private and public insurance.

**Figure 24:** Percentage of total population with health insurance coverage, high-income countries

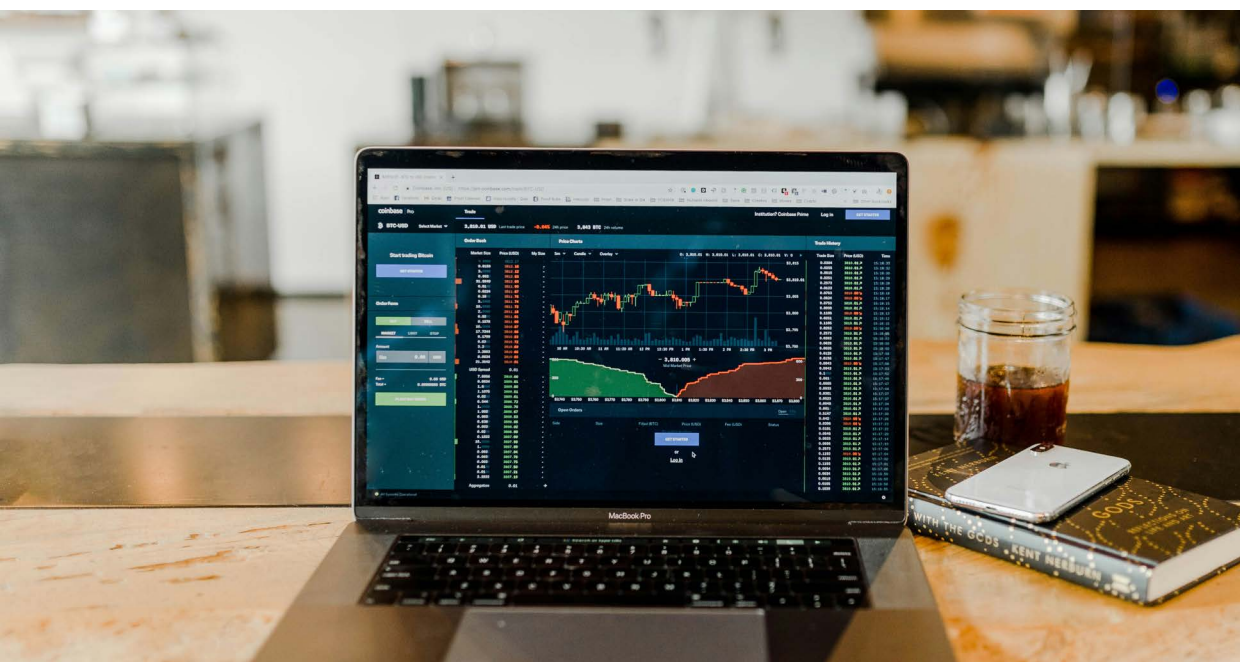


Source: OECD Health Statistics, Allianz Research

**In this context, Obama's ACA has indeed been helpful to the US health system, but Republicans will surely try to repeal it again.** Every year Obamacare becomes more popular. In 2023, 16.3mn Americans signed up for health insurance plans through the ACA's marketplaces, up from only 8mn in 2014. Moreover, for 2024, a record 21.3mn Americans have enrolled for coverage. This growing popularity will make it even harder for Trump to try to again repeal and replace the ACA if he is elected to a second term. For the moment, Trump does not have a clear and defined plan to replace Obamacare and drug prices are not at the center of his campaign. However, he has recently reiterated his discontent with Big Pharma. Based on Trump's previous actions during his presidency, it is highly possible that his policies could continue to focus on reducing prescription drug prices and promoting domestic manufacturing of pharmaceuticals. But the power of US Big Pharma is undeniable. In 2023, the 10 largest US pharmaceutical companies made USD447bn of revenues (from USD377bn in 2020). At the same time, they managed to create Covid-19 vaccines in record time to serve not only US citizens but the entire world, preventing more than 18.5mn hospitalizations and 3.2mn deaths in the US alone. Without a doubt, Big Pharma's negotiating power is too high and any policy that goes against their local pricing power will have to be strategically well designed and argued.

<sup>9</sup> Medicare is a US federal health insurance program for people aged 65 and older, though it also covers some younger individuals with disabilities or specific medical conditions. It is composed of several parts (from A to D, D being the prescription drug coverage). Medicaid is another government program designed to provide healthcare access to lower-income people of every age.

<sup>10</sup> Initial drug negotiation list: Eliquis (blood thinner), Jardiance (diabetes), Xarelto (blood thinner), Januvia (diabetes), Farxiga (diabetes), Entresto (heart failure), Embrel (rheumatoid arthritis), Imbruvica (blood cancer), Stelara (psoriasis and Crohn's disease) and NovoLog/Fiasp (diabetes).



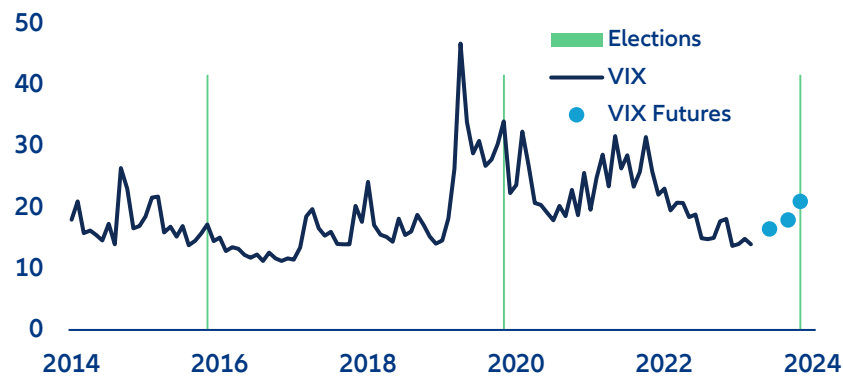
# Capital Markets: higher for longer

**Under our baseline scenario, the Fed would err slightly on the side of caution in 2025 because of the short-term rise in US inflation.** The return to “neutral” monetary policy and lower interest rates would be pushed back to 2026. In the first year, the lower growth-higher inflation nexus would force the Fed to sit on the sidelines, challenging current projections of rate cuts. Rather than pursuing monetary policy normalization, the Fed would keep its policy rate above 4%. Normalization would resume in 2026 as the inflation shock would fade, prompting the Fed to support the economy.

**With a higher-for-longer Fed and a likely rebound in inflation expectations, US 10-year rates would follow suit and stay above 4% until at least 2025.** The impact on inflation rates could elevate inflation expectations once more, and these are a key determinant of long-

term interest rates. Coupled with the Fed pausing its normalization path in 2025, this could lead to a rebound in 10-year rates both in the US and globally. Rather than a gradual decrease to 3.6% by the end of 2025, we would expect them to remain approximately 40bps higher, at around 4%.

**2024 and 2025 would not be easy years for risky assets.** Historical trends suggest that regardless of the 2024 election outcome, if central banks maintain stability and the economy demonstrates resilience, US equities and corporate credit markets are likely to finish the year in the green. However, this does not guarantee a seamless journey, as evidenced by the significant adjustments in the VIX futures. These adjustments suggest that equity markets are anticipated to experience heightened volatility around the elections period (Figure 25).

**Figure 25: VIX during elections**

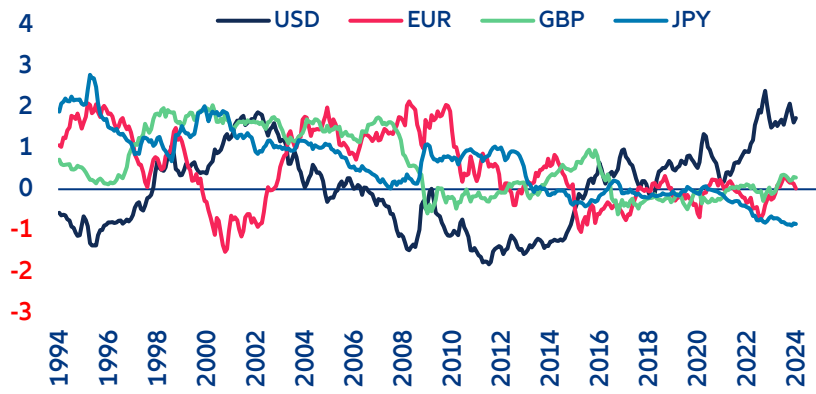
Source: LSGE Datastream, Allianz Research

**With the Fed maintaining interest rates higher than initially anticipated for longer, equity markets are likely to undergo a downward adjustment due to the short-term impact on valuations, particularly because of the ongoing high sensitivity to interest-rate changes.**

However, a significant market downturn is unlikely; instead, markets may experience a period of lateral movement throughout 2025. Looking ahead to 2026 and 2027, policies favoring domestic priorities, along with an expected shift towards more accommodative monetary policy, are likely to positively influence US corporations as a whole. This could lead to US markets outperforming international counterparts, with expected annual returns of 8-10%. Credit markets are likely to follow a similar trajectory, with financing costs that exceed expectations in 2025 causing a temporary widening of corporate spreads. This could set the stage for a substantial narrowing of spreads in 2026 and 2027. The global reshoring theme under Trump would likely benefit specific sectors such as defense, freight, industrials, infrastructure and other sectors bound to receive a "local" push. However, defense and bank stocks will be the long-term beneficiaries above all, while international stocks, especially Chinese and emerging market ones, may struggle the most. Especially in the case of defense stocks, the likely shift towards spending more on defense will generate a structural push for the sector, while for banks the embedded dovishness coming with a Trump victory and the aversion towards banking regulation may provide some tailwinds. On the other side of the coin, sectors such as clean energy and companies with lots of internationally sourced earnings are set to suffer due to both the increase in tariffs and the deprioritization of climate change objectives.

**The US dollar would appreciate only marginally, given very stretched valuations.** The 2016 elections sparked a significant appreciation of the USD, which reached its highest level since 2003. This surge was primarily supported by: i) a significant monetary policy differential with other major economies, particularly the Eurozone, which had recently initiated its monetary easing policy; ii) a favorable business cycle in the US, characterized by full employment, unlike its main trading partners and iii) a massive fiscal stimulus package centered on infrastructure spending and tax cuts promised by Trump during his campaign. However, things are different today. The US dollar is already at historically high levels (Figure 26) and we do not expect a new large fiscal plan under a second Trump administration. Consequently, we would expect a modest appreciation of the USD in 2025 (+2.5%), though the USD will remain relatively strong for a while.

Figure 26: Real Effective Exchange Rate (REER), deviation from long term average (in stdv)



Sources: BIS, Refinitiv, Allianz Research







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