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What to watch: Germany hat es geschafft, US consumer (still) holding strong and why markets are not buying the “America First” pledges this time

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In summary

Germany: Unleashing defense and infrastructure spending. A two-thirds majority in the Bundestag has exempted defense spending from the normal budget, allowing new debt above 1% of GDP, and established a special infrastructure fund of EUR500bn to address decades of underinvestment (capital stock -10pps over the last decade). Defense spending will be front-loaded but infrastructure projects are likely to take time. The stimulus could boost private investment by up to +5.9% cumulatively over the 12-year life of the infrastructure fund, although structural reforms are needed to fully realize potential growth. Debt-financed fiscal spending is expected to add +0.3% to GDP in 2025, with growth expanding to +1.7% in 2026 and +2.1% in 2027. But risks such as inflation and capacity constraints remain, and the debt-to-GDP ratio is projected to exceed 72% by 2037 from 62.8% currently. Capital markets had already priced in this week's vote and are now charging roughly 30bps higher interest rates for Germany. Considering the upside on growth and inflation, the resulting additional debt-servicing costs for Germany should be manageable (0.1-0.2% of GDP, ceteris paribus).

Can the American consumer hold up? The US economy looks to be weakening rapidly amid trade tensions, policy uncertainty and risks of higher inflation. The plunging sentiment of the American consumer is signaling substantial spending retrenchment in Q2 2025. The extent of potential damage hinges on three factors: household incomes, balance sheets and stock-market-related wealth effects. On the positive side, government transfers and stronger wage growth for low-income households are supporting household income. Moreover, balance sheets are solid overall, with a healthy net lending position of 2-3% of GDP. Breaking down US GDP growth by terms of trade, bond spreads and the stock market, we find a q/q drop of -0.7pp in GDP growth at end-Q1. Of this, the negative wealth effects caused by lower stock prices appear to have driven -0.6pp (roughly two-thirds), with the remaining third explained by tariff-induced deteriorating terms of trade. We expect US GDP to flatline in H1 2025 and grow by a lackluster +1.6% in 2025, should trade tensions wane by mid-year.

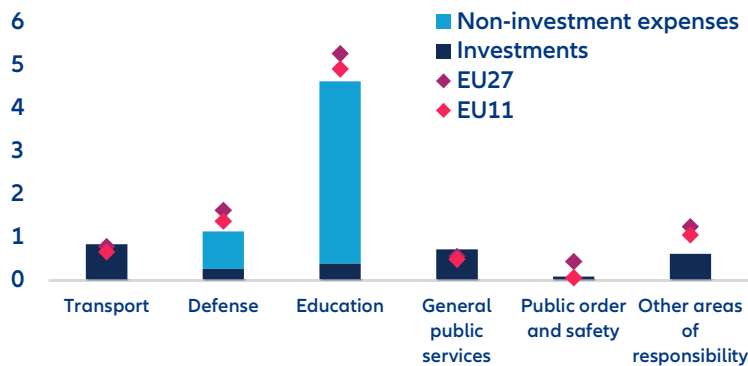
“America First” for factories, last on Wall Street? Trump's emphasis on reshoring production and bolstering US manufacturing and tech sovereignty has pushed corporates to immediately pledge big spending in the US over the next few years. Tech and semiconductor giants Apple and TSMC moved first, followed by pharmaceutical companies Amgen, Merck and Eli Lilly, with plans to build giant plants in the US. Overall, investment announcements should surpass the USD1trn threshold, equivalent to around to 3% of US GDP. However, equity investors are worried about higher operational costs eating into margins – US reshoring indices are down -10% since Trump's inauguration – and portfolio investment flows indicate a clear shift of capital away from US equities (-41% in US ETFs ytd) toward Europe (+97%) and emerging markets, now perceived as less at risk from economic stagflation and policy-driven uncertainties. This divergence suggests that although investors remain confident in America's real economy, they remain cautious about the short-term policy outlook.

Germany: Unleashing defense and infrastructure spending

In this week's special session, the Bundestag passed amendments to the Basic Law on the topics of defense, infrastructure and climate neutrality that can pull Germany out of the economic doldrums. The Bundestag found a two-thirds majority to exempt defense spending – including civil protection and defense, cybersecurity, intelligence and support for states attacked in violation of international law – from the normal budget in excess of 1% of GDP, allowing the federal government to take on new debt. In addition, the Bundestag decided to add a special fund of EUR500bn to the constitution for additional investments in infrastructure and to achieve climate neutrality by 2045. Only if 10% of the normal federal budget is spent on investments can the special fund be used for additional investments. EUR100bn of the fund will be used for the Climate and Transformation Fund (KTF) and another EUR100bn will be available to the federal states for investment in their infrastructure, especially heating networks and other energy-related networks.

The fiscal spending is a leap in the right direction as Germany urgently needs to rebuild its public infrastructure after years of neglect, while particularly increasing and stabilizing future-oriented spending. Over the past decade, Germany's capital stock has declined by -10pps. Underinvestment has been most severe in public infrastructure – railways, highways and waterways – with a peak loss of -EUR22bn in 2023, aggravating the situation. Key areas of future-oriented spending, such as transportation infrastructure, education and defense, currently account for just under 25% of public budgets at the federal, state and local levels. Their share of GDP has remained relatively stable over the past decades but are still below the EU average (7.3% of GDP in 2023 vs. 10.5%), especially in the case of defense and education (Figure 1). Even with the fiscal package, Germany faces the challenge of accelerating infrastructure development as capacity constraints and tight labor markets will slow implementation. On the positive side, the public investment push could also stimulate private sector investment by up to +5.9% cumulatively over the 12-year life of the infrastructure fund, provided the fiscal package is accompanied by structural reforms, such as tax reforms or a reduction of red tape.

Figure 1: Future-oriented public spending in Germany is lower than the EU average

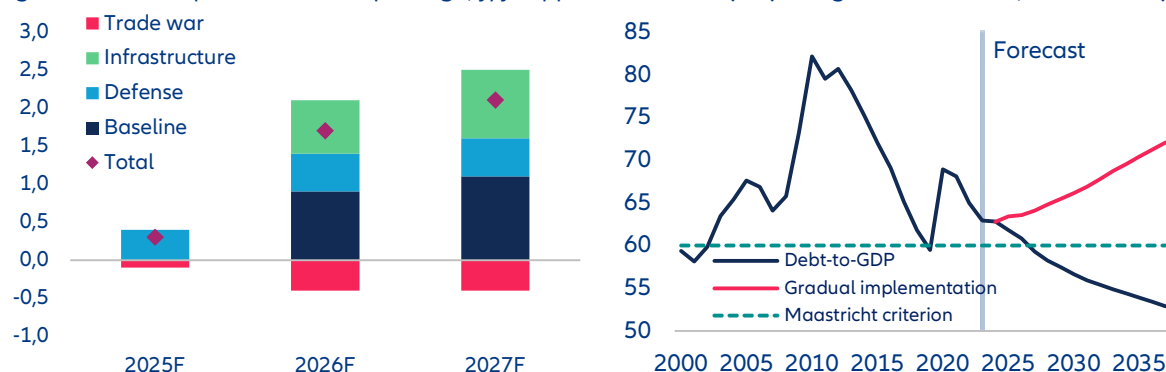


Sources: Eurostat, Allianz Research. Note: EU11 are the 11 European founding states.

While defense spending is likely to be frontloaded, the implementation of infrastructure projects will take time, though it will still add to the upside of the German GDP forecast. We have used the lower bound of the multipliers for infrastructure and defense as the ramp-up of infrastructure will take time and defense spending tends to have a more modest impact, with some of the funds going to imported equipment rather than domestic production. Assuming a gradual implementation of an additional 2% of GDP of debt-financed fiscal spending¹, GDP could rise by +0.3% in 2025 (from a stagnation baseline), +1.7% in 2026 (from +0.9%) and +2.1% in 2027 (from +1.1%) (Figure 2, left). But debt-financed fiscal spending is also likely to increase other risks, such as wage growth and inflation, as capacity constraints limit output growth. With a gradual implementation, the debt-to-GDP ratio would reach just over 72% by 2037 (Figure 2, right).

¹ With defense spending reaching 3% of GDP by 2025 and infrastructure spending only starting to materialize from 2026 due to the longer timelines of projects, while factoring in the 25% reciprocal aluminum and auto tariffs from the US that took effect 12 March 2025.

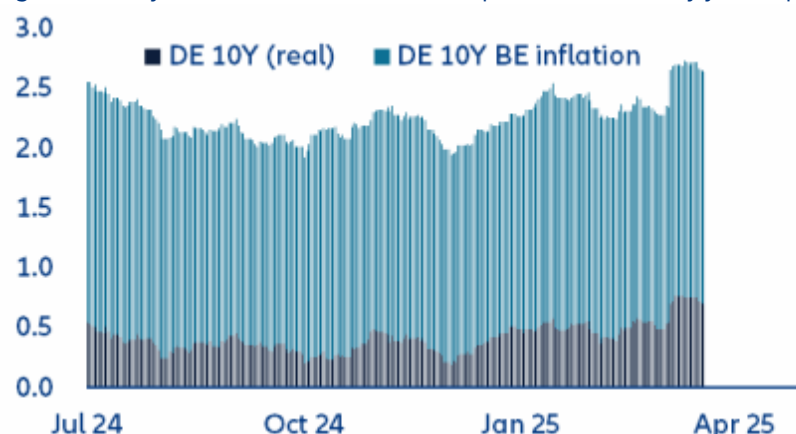
Figure 2: Growth upside from fiscal package, y/y in pp and total in % (left) and government debt, in % of GDP (right)



Sources: LSEG Datastream, NATO, Oxford Economics, Allianz Research. Note: We assume a gradual implementation approach.

Markets had already largely priced in the Bundestag vote beforehand. Markets did not react much to Tuesday's vote, maintaining the reaction seen in the first two days after the announcement on 4 March. Overall, the yield curve has shifted up by roughly 20-30bps (2y 15bps, 10y 30bps, 30y 30bps). The move was driven by higher real rates (17bps) and to a slightly lesser extent by higher inflation expectations (14bps, Figure 3). The German stock index (DAX) has risen by +5%, pushing ytd gains to 17%. The euro has appreciated by 3.0% to 1.09 against the USD. Overall, the market reaction reflects our view and we do not see any further increase in yields based on this event.

Figure 3: Real yields and breakeven inflation pushed German 10y yields up after the announcement, %



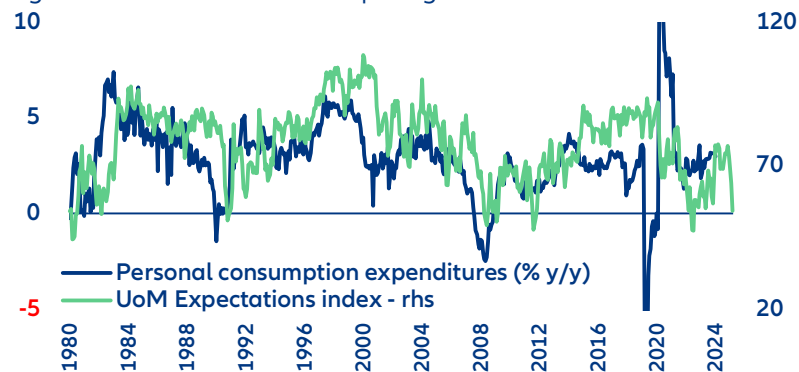
Sources: Bloomberg, Allianz Research.

Higher interest rate charges translate to roughly 0.1-0.2% of GDP of additional fiscal deficit over the long run, which should be manageable. If we assume that debt costs rose by 30bps over the long run, this would translate to EUR8bn of additional interest costs per year, given the current debt stock of EUR2.6trn. This is the equivalent of 0.19% of GDP of additional deficit. This number might be the better indicator to look at because a) it will take time until the additional interest costs transmit to the entire debt stock due to the average maturity of debt and b) the total debt stock will gradually rise (in general but also due to the additional spending) but so does nominal GDP, given the higher economic growth and inflation trajectory, ceteris paribus. All in all, 0.1-0.2% of GDP of additional deficit due to higher interest costs seems manageable for Germany. Therefore, this effect on its own does not have an impact on our interest rate forecast. The main point of penciling in higher interest rates is rather the increase in inflation expectations as opposed to higher debt issuance.

Can the American consumer hold up?

Plunging consumer confidence in the US signals an abrupt stalling of consumer spending in Q2 2025, raising the risk of a recession. After stellar growth for the past three years (+2.4% on average 2022-2024), the tide has turned quickly for the US economy amid abrupt tariff hikes and soaring policy uncertainty. While the latest high-frequency hard data (e.g. unemployment claims, electricity loads, railroad traffic) do not point to a noticeable weakening of growth momentum yet, forward-looking indicators linked to household confidence have deteriorated sharply amid concerns over job prospects and rising inflation expectations. For instance, the University of Michigan (UoM) Consumer Sentiment Index dipped sharply in February and March (Figure 4). Given the tight link between consumer confidence and consumer spending, consumer spending looks likely to slow down rapidly – if not pull-back – at the end of Q1 2025 and through Q2 2025. Considering the outsized weight of consumer spending in the US economy (around 70% of GDP), weakening household spending is almost certain to lead to a substantial weakening of US growth – or even a recession.

Figure 4: US households' consumption growth & confidence

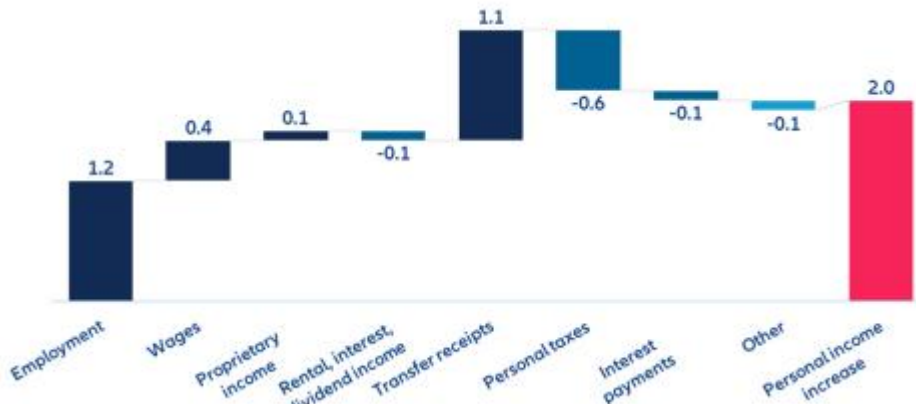


Sources: University of Michigan, Allianz Research

Three factors will shape the outlook: households' disposable income, finances and the strength of stock market-driven negative wealth effects. Deteriorating sentiment has not always led to a corresponding sharp pullback of consumer spending. For instance, inflation sent the UoM survey plunging in July 2022 but consumer spending still held up. Other consumer surveys such as the Conference Board's also plunged in a few instances but without a corresponding pull-back in consumer spending. For 2025, much will depend on the direction of the Trump administration's trade policy in the coming weeks: a further escalation of trade tensions could prompt US households to increase precautionary savings and substantially cut back on spending. High inflation and high interest-rate fatigue are factors of risk that could amplify the consumer downturn. But households' disposable income and solid balance sheets could counterbalance these forces, despite some stock market-driven negative wealth effects.

Household income is being supported by government transfers and stronger wage growth for low-income households. Figure 5 breaks down the components of the rise in real disposable income between Q4 2023 and Q4 2024, which increased by a decent +2%. The largest drivers were employment (+1.2pp contribution) and real transfer receipts (+1.1pp), while real wages contributed only modestly (+0.4pp). Structural labor shortages – which will probably amplify as tight immigration policy intensifies – could limit the extent to which businesses are ready to shed their employees, providing a buffer to households' income. But government transfers are arguably a more potent force. Thus far, the administration's efforts to cut back on federal spending has been limited to funding for government agencies. The bulk of federal spending – namely entitlement programs such as Social Security and Medicare/Medicaid – remains on auto-pilot and should continue to support households' income in 2025. Against this backdrop, the real wage growth of low-income households (1st decile of the income distribution) has picked up pace in recent quarters, after already outperforming high-income (9th decile) wage growth since the pandemic (Figure 6). The fact that working low-income households have seen stronger earnings growth could limit the downside to consumption spending.

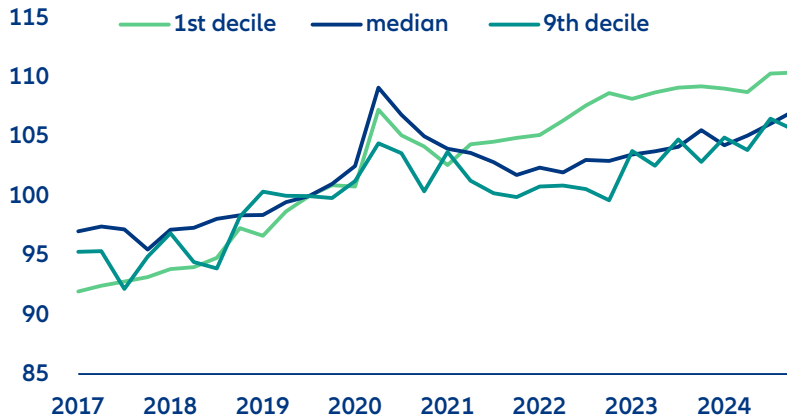
Figure 5: Households' real disposable income growth breakdown (% y/y Q4-2024).



Sources: LSGE Workspace, Allianz Research

Note: proprietary income is the income derived from production for households that own their business.

Figure 6: Real wage according to income distribution (indexed, 2020-Q1 = 100)

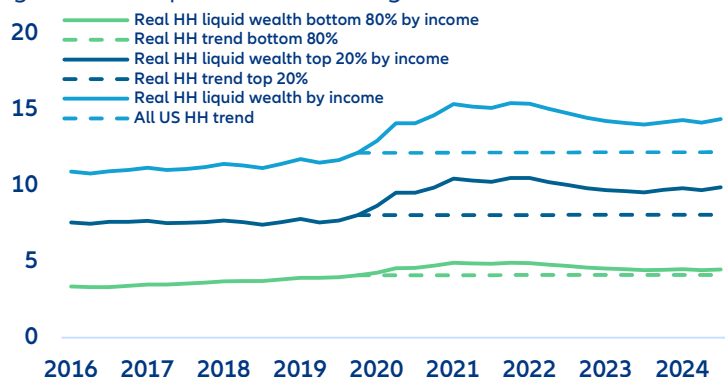


Sources: BLS, Allianz Research

Despite some pockets of vulnerability, households still have solid balance sheets overall. US households have accumulated large cash holdings and liquid wealth, an important buffer that can be easily spent amidst potential job losses. Real liquid wealth was close to 25% above its pre-pandemic trend in Q3 2024. While this was largely driven by higher-income households, the bottom 20% of the income distribution had liquid wealth nearly 10% above the pre-pandemic trend (Figure 7). In this environment of elevated cash buffers, overall loan delinquencies have remained muted. Delinquencies have risen the most for consumer credit (both 30 days+ and 90 days+), auto credit (30 days+) and, to a lesser extent, the “other” category². A factor that has helped keep mortgage delinquencies low is the prevalence of fixed-interest rates for this type of products. Total debt payments were standing at a moderate 11.3% of disposable income in Q4 2024 – still below the pre-pandemic level. Households’ overall balance sheet strength is also corroborated by the segment’s substantial net lending surplus, which has hovered around 2-3% GDP over the past two years. This means that, in aggregate, US households have a large ability to self-finance, and means that they would be more resilient to a tightening of credit conditions.

² The “other” category includes Consumer finance (sales financing, personal loans) and Retail (clothing, grocery, department stores, home furnishings, gas, etc) loans.

Figure 7: Real liquid wealth according to income distribution

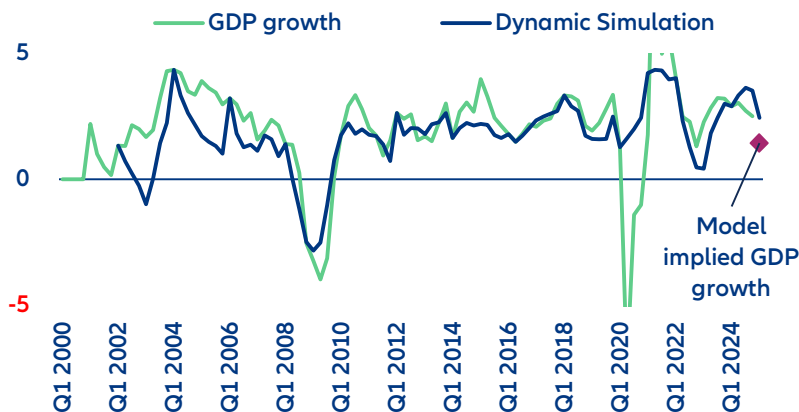


Sources: NY Fed, Allianz Research

On the other hand, negative wealth effects from the sharp correction in US stock markets could cause a -0.6pp hit to annual GDP. The interaction between the economy and the stock market is complex, with both feeding into each other. Negative stock prices lead to lower GDP growth mostly through so-called “wealth effects” whereby households feel less wealthy and, consequently, cut back on spending. Using a model that breaks down US GDP growth by three drivers (terms of trade, bond spreads and the stock market,³ see Figure 8), we find a q/q drop of -0.7pp (the equivalent of -1.1pp y/y) in US GDP growth at the end of Q1 – a significant hit. Of this, the negative wealth effects caused by lower stock prices appear to have driven -0.6pp (roughly two-thirds), with the remaining third explained by tariff-induced deteriorating terms of trade (-0.3pp).

In all, we expect US GDP to flatline in the first half of 2025 and grow by a lackluster +1.6% for the full-year 2025. Households’ income and balance sheets should soften the blow on consumption spending from tariff hikes and depressed sentiment. Nevertheless, if trade tensions do not wane by mid-year, the consumer may cut back on spending more sharply than expected.

Figure 8: GDP growth explained by the terms of trade, spread term and stock market (% y/y)



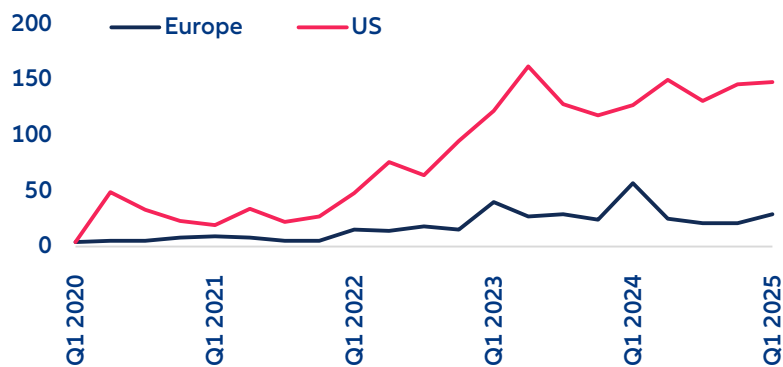
Source: Allianz Research

³ The model-generated “dynamic” simulation is restarted every two years. This means that every two years we look at the model-generated GDP growth path based on the exogenous explanatory variables (terms of trade, etc) and the model-generated GDP lag. It shows that the model yields a good fit overall. To analyze Q1 2025 GDP, we use the change in spreads between the week of 9 March and Q4 2024; for terms of trade, we assume that the price of exports increased in line with the past couple of quarters, while for the price of imports we pencil in a 5.5pps rise based on our assessment of the rise in the US effective tariff rate between Q4 2024 and Q1 2025. Although strictly speaking the price of imports is computed by national statistical offices pre-tariff payments, nevertheless the steep tariff hikes still mean a significant negative import price shock for the economy, which will drag on growth.

“America first” for factories, last on Wall Street?

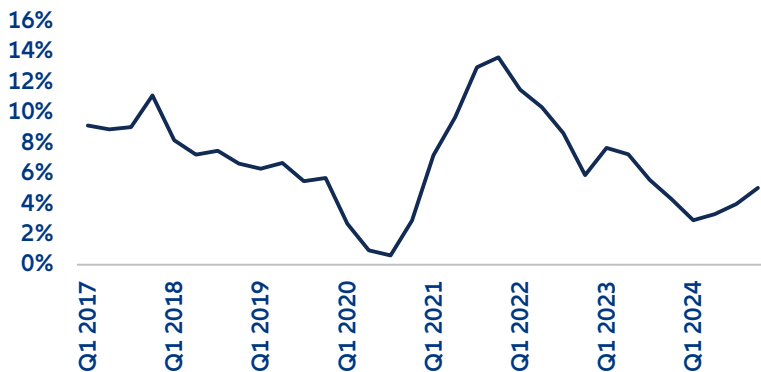
Corporates are pre-emptively moving (back) to the US. President Trump’s second term began with a clear message: reshoring production and tightening import controls to bolster US manufacturing and technological sovereignty. Within weeks of taking office, the administration introduced a series of targeted tariffs, notably imposing 20% duties on selected technology goods from China and a potential 25% tariff on pharmaceutical and chip imports, as well as increased scrutiny of foreign takeovers in strategic industries, justified as necessary for national security, economic independence and job creation. Companies that previously relied heavily on overseas production, notably in Asia, are now incentivized – or even compelled – to ramp up US-based manufacturing and investment. In response, business strategies have shifted swiftly, with both American and foreign companies accelerating investment initiatives across the US. Many firms have cited tariffs explicitly when unveiling substantial expansions, indicating a direct link between policy announcements and their decision-making (Figure 9). From a broader perspective, foreign direct investments (FDIs) in the US have been recovering since late 2024 but it remains to be seen if recent announcements will initiate wider inflows (Figure 10).

Figure 9: Mentions of "reshoring" in earnings results and investor meetings in the US and Europe



Sources: Bloomberg Intelligence, Allianz Research

Figure 10: Foreign direct investment (FDI) inflows into the US (y/y%)



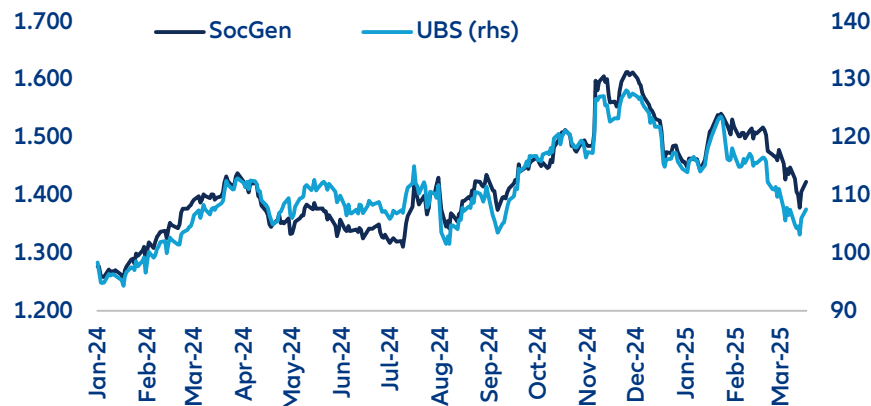
Sources: LSEG Datastream, Allianz Research

Tech and pharmaceutical companies have acted fast, promising billion-dollar investments. Tech giants have been the most visible movers following Trump’s inauguration. Apple set the tone with a four-year USD500bn investment pledge on 24 February, which includes plans to construct a large factory in Texas, in collaboration with Taiwan’s Foxconn, specifically targeting advanced AI server equipment previously manufactured in China. The firm explicitly cited the newly imposed 10% tariffs on China-assembled technology products as a catalyst for shifting substantial manufacturing stateside. Taiwan Semiconductor Manufacturing Company (TSMC), the world’s largest semiconductor factory, also unveiled a USD100bn investment to build five new semiconductor fabrication plants in

the US. This comes at a time when the Trump administration is hinting at cutting back on the CHIPS Act funds – for which TSMC is one of the largest recipients. Japan’s SoftBank Group also committed USD100bn to support US AI and tech ventures. At the same time, investment in infrastructure, particularly for data centers, has also surged as companies anticipate rising domestic demand, partly due to Trump’s tightening export controls on advanced computing technologies. The pharmaceutical industry is the other major sector with large investment announcements. US pharmaceuticals have quickly moved to ramp up domestic production to mitigate potential disruption from the administration’s proposed 25% tariff on imported medicines. Eli Lilly announced the largest pharmaceutical expansion investment in US history to build four large-scale plants: USD27bn, more than double what it has allocated for domestic manufacturing since 2020. Amgen similarly announced it will build a new drug substance plant in North Carolina (USD1bn), a move that was just replicated by Merck, which is also opening a new USD1bn vaccine production facility in the same state, with further investments totaling USD8bn through 2028. On the transport sector side, CMA-CGM has just revealed a USD20bn investment plan to increase its shipping capacity in the US, with funds to be allocated on both logistics and supply-chain capabilities over the next four years.

The stock market's reaction has been mixed, underscoring cautious scrutiny over rising operational costs. While investors cheered the announcements from Apple (+1.2%), SoftBank (+3%), Eli Lilly (+1.5%) and Merck (flat), TSMC's shares dipped approximately -2% on concerns about significantly higher manufacturing costs in the US compared to Taiwan. This indicates investor unease about the potential impact on margins from higher operational costs in the US, despite the long-term strategic benefits. Wages are significantly higher compared to regions like Asia, making manufacturing more expensive in the US. Companies may also face a shortage of workers with the specialized skills needed for certain industries, and the economy has more complex regulatory requirements and relatively higher corporate taxes, which could further increase operational complexities and reduce efficiencies. Against this backdrop, US reshoring indices have fallen by -10% since Trump's inauguration (Figure 11).

Figure 11: US reshoring stock indices



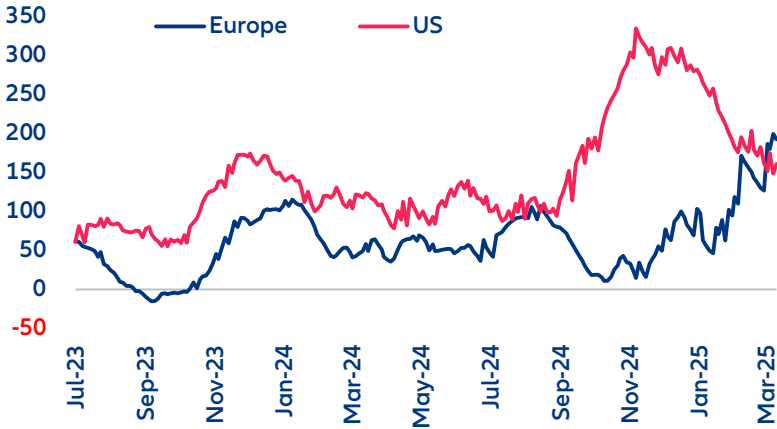
Sources: Bloomberg, Allianz Research.

*Note: Both indices aim to track the stock market performance of US companies that would benefit from activities being brought back to the US in key industries such as semiconductors, IT, defense and pharmaceuticals and general manufacturing.

FDI “IN” but portfolio investments “OUT”? Current US policies might attract FDI but portfolio investment flows indicate a clear shift of capital away from US equities toward European and emerging markets, which currently offer more attractive valuations, better growth potential and lower perceived macroeconomic risks. As shown in Figure 12, since the start of the year, capital allocation in American Exchange Traded Funds (ETFs) has declined by -41%, whereas European ETFs have seen a significant increase of +97%. Furthermore, recent investment surveys indicate that institutional investors, who were previously overweight US assets, are rapidly readjusting allocations (Figure 13). The underlying causes for this capital migration are to be found in investor concerns about the trajectory of the US economy, particularly fears of stagflation. This trend is also reflected in recent market performance data, showing the S&P 500 lagging behind European indices, which have experienced notable gains since the beginning of 2025. Europe's relatively stable monetary policy outlook and recent economic resilience make it an appealing alternative to investors concerned about potential interest rate fluctuations or policy mistakes in the US. Emerging market economies, particularly in Asia and Latin America, have also attracted interest thanks to their improved economic fundamentals, attractive valuations and lower relative risk profiles amid current global uncertainties.

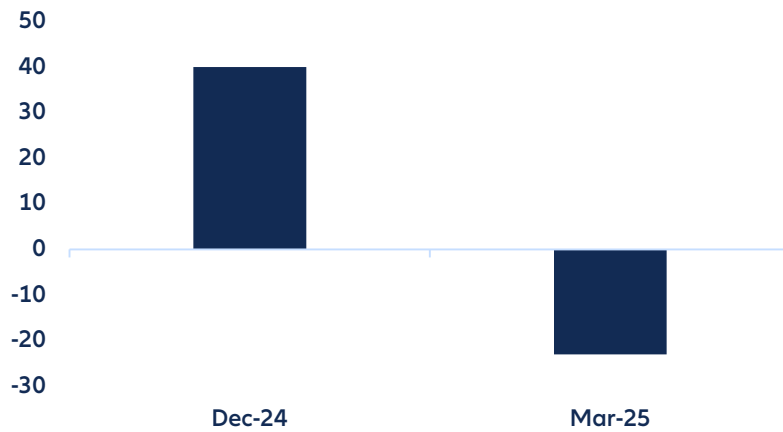
Markets such as Hong Kong and Japan have indeed benefited from renewed investor interest due to improving corporate earnings outlooks and relative political stability compared to previous years. The new landscape clearly shows that while FDI is getting a boost from the new administration's policies, the US stock market is not experiencing the same level of investor interest.

Figure 12: Net inflow to largest ETFs in the US and Europe (rolling quarterly, USD bn)



Sources: Bloomberg, Macrobond, Allianz Research

Figure 13: Net percentage of fund managers overweight US equities



Sources: BoA, Allianz Research

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

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