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What to watch: China's trade war defense, bond markets riding the storm and US labor market during a recession

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In summary

Trade war: Can China play defense? The US administration's latest exemptions on products such as laptops, tablets and smartphones will bring some relief to Asian exporters but the tariff rate on China remains at an eye-watering 103% (-27pps). To mitigate the impact, Chinese companies can consider rerouting through neighboring countries or deflecting to other export markets. While in theory, there is capacity to reroute up to 64% of Chinese exports usually bound to the US, it would put strains on other Asian ports, global supply chains and maritime shipping. Over the next three years, trade diversification could see imports from China rise by up to +6% annually in the EU, the UK, Vietnam, Taiwan, Malaysia, Indonesia, Mexico, Singapore, Saudi Arabia and Nigeria. But ultimately US companies in the electronics, household equipment and textiles sectors cannot do without China's manufacturing given critical dependencies. While geopolitical concerns may spare companies in the electronics sector, those in textiles may not be so lucky and could face a hit on margins.

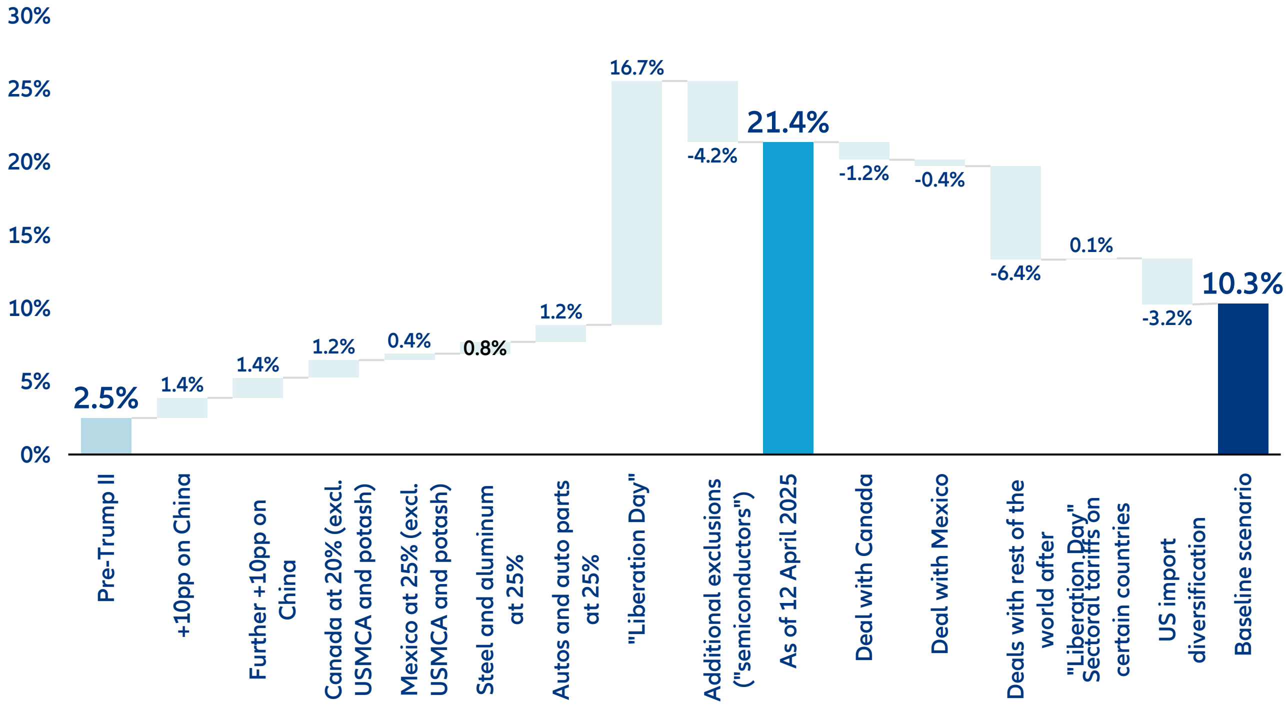
Bond markets are riding the storm. Tariff hikes triggered a historic bond market repricing: US yields surged (30-year up by +46bps in one week), the USD depreciated and German yields fell, signaling a possible shift in global investment away from US assets. While who is selling remains speculative, institutional investors from countries in the crosshairs of Trump's foreign policy (notably China) do have an incentive. Looking ahead, despite volatility, we continue to see the US 10-year yield stabilizing around 4.0% by the end of 2025, driven by monetary easing and weak economic growth. The EUR/USD exchange rate is also still likely to move towards 1.12 by year-end as capital flows rebalance and real interest rate differentials narrow. The ECB is poised to cut policy rates by 25bps in each of its upcoming meetings, down to 1.5% by September 2025, moving into accommodative territory as inflation will fall below target and a negative output gap persists.

The US job market: how much can it weaken? The US labor market has held up despite mounting economic headwinds, and forward-looking indicators suggest this resilience should continue in Q2 2025. The job vacancy rate will be the first to signal a recession (expected in Q2-Q3) but we do not expect large layoffs. The US economy faces a unique combination of supply constraints (more than conventionally thought) and increasingly tight immigration policy. Hence, companies are more likely to hoard scarce labor compared to previous recessionary episodes, preventing a surge in unemployment. Additionally, record profits offer a buffer to bear the tariffs for now. Nevertheless, we expect the unemployment rate to peak at 5% by Q1 2026. But the DOGE-driven federal layoffs are not likely to shake up the labor market: even if dismissed or quitting federal employees do not find another job (but stay in the labor force), this alone would push up the unemployment rate by just +0.3pp in 2025. The steady deterioration of the labor market is a reason why we expect the Fed to accelerate rate cuts in end 2025-early 2026 after a tariff-induced inflation spike in the summer.

Trade war: Can China play defense?

Deciphering the trade war: additional exemptions reduce the US global import tariff rate by -4.2pps to 21.4% and the US import tariff rate on China by -27pps to 103%. On 11 April, the White House published an extension to the list of goods that are exempted from the "Liberation Day" tariff hikes to include products such as laptops, tablets and smartphones. As a result, the exemption now applies to 32% of US imports, instead of 24% previously, bringing the US global import tariff to 21.4% instead of 25.5% previously (see Figure 1). Asian exporters in particular benefit from the change: 70% of US imports from Taiwan are now exempt from the latest tariff hikes (vs. 18% initially), 45% for Thailand (vs. 18% initially), 39% for Vietnam (vs. 12% initially), 58% for Malaysia (vs. 33% initially), 48% for the Philippines (vs. 23% initially) and 44% for China (vs. 23% initially). That said, we estimate that the US effective import tariff rate on China still stands at an eye-watering 103%, lowered by -27pps thanks to the additional exemptions but still much higher than before 2 April (see Table 1). In our baseline scenario, a deal between the US and China may be reached later this year, but ultimately the US import tariff rate on China will stand +60pps higher than before the second Trump administration came into power.

Figure 1: US global effective import tariff rate (weighted average, %)



Sources: various, Allianz Research.

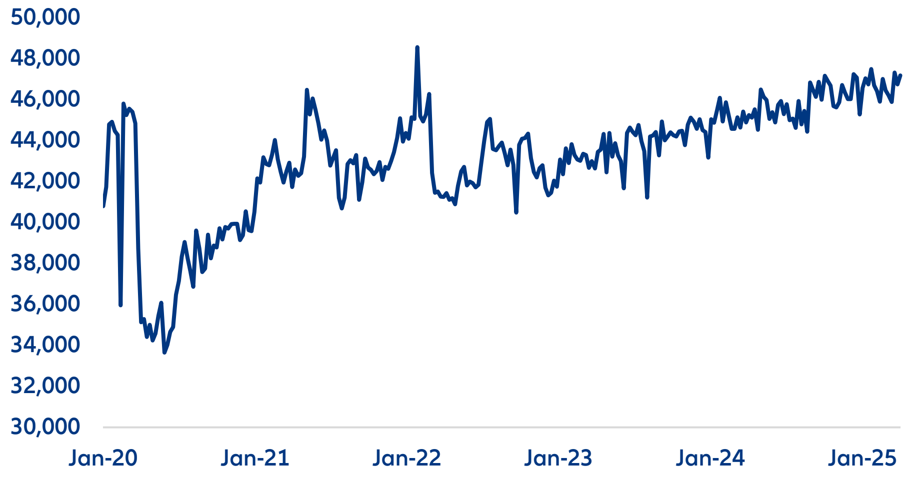
Table 1: US tariff rates

	US imports		US tariff rate				
	USD bn (2024)	share of total (2024)	Pre-Trump II	Before "Liberation Day"	"Liberation Day" (tariff hikes and accounting for sectoral exclusions), as of 10 April	"Liberation Day" (tariff hikes and accounting for sectoral exclusions), as of 12 April	Baseline scenario (accounting for deals to partly reverse "Liberation Day" by year-end but also certain sectoral tariff hikes and US import diversification)
Argentina	7	0%	0.7%	3.1%	8.8%	8.8%	3.1%
Australia	17	1%	0.1%	1.9%	9.9%	9.9%	9.9%
Bangladesh	9	0%	15.1%	15.4%	25.3%	25.3%	25.3%
Brazil	44	1%	1.0%	4.4%	10.9%	10.9%	4.4%
Cambodia	13	0%	6.5%	6.6%	15.0%	15.0%	15.0%
Canada	422	13%	0.1%	10.4%	10.4%	10.4%	1.6%
Chile	17	1%	0.0%	4.3%	12.5%	12.5%	12.5%
China	463	14%	13.0%	33.0%	129.7%	102.7%	73.0%
Colombia	18	1%	0.2%	5.2%	13.4%	13.4%	13.4%
Ecuador	9	0%	0.4%	0.6%	6.2%	6.2%	6.2%
EU	618	18%	1.3%	3.8%	9.2%	9.1%	3.8%
Hong Kong	6	0%	1.4%	1.4%	98.1%	97.8%	61.4%
India	91	3%	2.4%	3.9%	11.0%	10.1%	6.8%
Indonesia	30	1%	4.6%	5.0%	13.8%	13.4%	13.8%
Japan	152	5%	1.5%	8.9%	13.8%	13.4%	8.9%
Kenya	1	0%	0.3%	0.4%	10.4%	10.4%	10.4%
Malaysia	54	2%	0.7%	1.0%	7.7%	5.3%	7.7%
Mexico	510	15%	0.3%	3.7%	3.7%	3.7%	0.9%
New Zealand	6	0%	1.1%	1.4%	10.4%	10.3%	10.4%
Norway	7	0%	0.6%	1.4%	6.1%	6.0%	6.1%
Pakistan	5	0%	9.7%	10.0%	19.9%	19.9%	19.9%
Philippines	15	0%	1.5%	1.7%	9.4%	6.9%	9.4%
Saudi Arabia	13	0%	0.3%	0.5%	3.9%	3.9%	3.9%
Singapore	44	1%	0.1%	0.5%	5.4%	4.5%	5.4%
South Africa	15	0%	0.4%	3.9%	8.8%	8.8%	8.8%
South Korea	135	4%	0.2%	8.0%	13.6%	12.5%	8.0%
Switzerland	64	2%	0.7%	1.4%	7.4%	7.4%	7.4%
Taiwan	119	4%	1.2%	2.1%	10.4%	5.1%	2.1%
Thailand	66	2%	1.4%	2.2%	10.4%	7.7%	2.2%
Türkiye	18	1%	3.5%	4.8%	12.8%	12.7%	12.8%
UAE	8	0%	2.4%	2.5%	7.4%	7.4%	7.4%
UK	69	2%	0.9%	3.6%	9.2%	9.1%	3.6%
Vietnam	142	4%	4.1%	4.5%	13.2%	10.5%	4.5%
Global	**3359**	**100%**	**2.5%**	**8.7%**	**25.5%**	**21.4%**	**10.3%**

Sources: various, Allianz Research.

To mitigate the impact, Chinese companies could resort to rerouting up to 64% of exports through other Asian countries that face lower US tariff rates. But that would put ports at capacity and likely heighten the vulnerability of global supply chains and maritime shipping. Trade rerouting means that Chinese companies would be relying more heavily on neighboring countries for the transformation, assembly or transport of goods that are partially or even predominantly manufactured in China. By doing so, these products can be re-exported to the US under the origin of a different lower-tariff nation. Rerouting Chinese exports is feasible on a tactical level, particularly for high-margin, low-volume goods (e.g. certain home appliances and electronics, robotics etc.). However, as a large-scale strategy, rerouting faces logistical and geopolitical limitations, including constrained seaport capacity and growing scrutiny from US regulators. From a logistical standpoint, port capacity among China's regional peers poses the main challenge. Across the top ten Asian exporting countries excluding China (see Figure 2), weekly port calls have steadily increased since the end of the pandemic, reaching approximately 47,200 last week – just 3% below the mid-2022 peak of 48,600. This suggests a remaining capacity of roughly 1,400 weekly port calls that could, in theory, be used for rerouted Chinese exports. This available capacity covers about 64% of the volume China typically ships to the US, while 54% of the value of Chinese exports to the US are facing tariff hikes. Thus, in theory, ports in the rest of Asia could absorb rerouting from China. However, this would put them at capacity and potentially strain global supply chains and maritime shipping. Moreover, if regions like Europe also pivot away from US markets and encourage deeper trade ties with Asia-Pacific nations, this would ramp up the pressure on already congested regional ports.

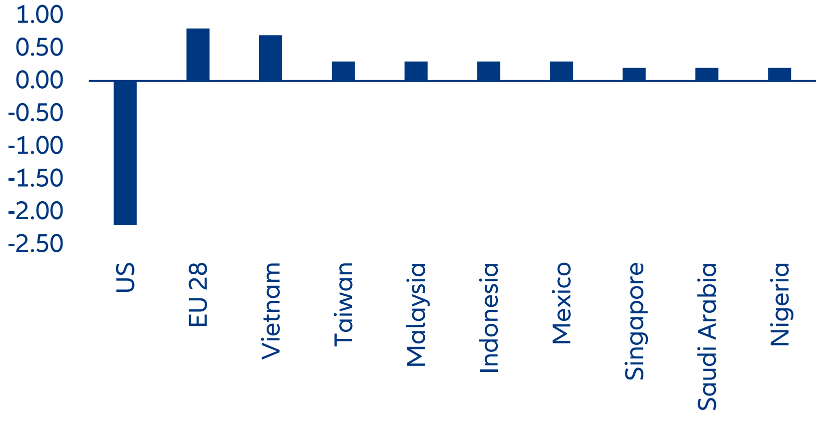
Figure 2: Number of port callings at China's top 10 trade partners within Asia, weekly data



Sources: Bloomberg, Allianz Research: Countries considered: Vietnam, Thailand, Taiwan, South Korea, Singapore, Malaysia, Japan, Indonesia, India and Hong Kong.

Another strategy could be trade diversification to other export markets. The EU, the UK, Vietnam, Taiwan, Malaysia, Indonesia, Mexico, Singapore, Saudi Arabia and Nigeria are the most likely to absorb Chinese exports not bound to the US anymore. Assuming that this trade deflection across three years, imports from China in these countries could rise by up to +6% annually. Emerging markets undergoing rapid industrialization and urbanization can generate demand for Chinese machinery, infrastructure materials and consumer goods. Additionally, China's manufacturing strength, competitive pricing and supply-chain resilience make it a preferred partner for trade and infrastructure & technology projects. The experience of the US-China trade war under the first Trump administration is instructive. In the three years between 2017 and 2019, the share of Chinese exports to the US fell by -2.2pps to 16.8%. This is a clear negative break from the long-term trend that preceded the first trade war, when the share of Chinese exports to the US changed by just -1.4pps over the 18 years from 2000 to 2017. Conversely, a positive break has been observed for the EU28, Vietnam, Taiwan, Malaysia, Indonesia, Mexico, Singapore, Saudi Arabia and Nigeria. The share of Chinese exports to these destinations clearly rose faster during 2017-2019 (+3.3pps to 34%) than across 2000-2017 (+4.3pps to 29.7%). Assuming that losses to China's exports to the US due to the trade war could reach up to USD234bn, and that this amount is deflected towards the aforementioned markets across three years, their imports from China would rise by up to an annualized +6%.

Figure 3: Change in China's export share during the first US-China trade war, 2017-2019 (pps)

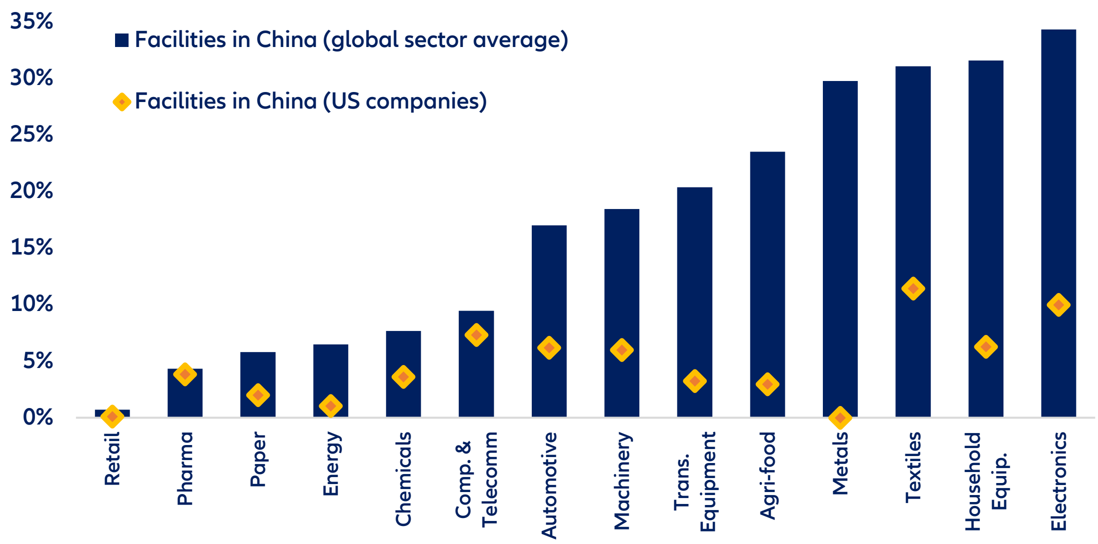


Sources: ITC, Allianz Research.

The world (including the US) cannot do without China's manufacturing. Although China's role as the "world's factory" has evolved, given some diversification to other Asian nations, China's concentration of manufacturing facilities continues to underpin its central role in global trade and supply chains. When examining the proportion of production facilities located in China by sector, globally, (Figure 4), it is clear that electronics (35%), household equipment (32%) and textiles (31%) have the most deeply established roots in the country's industrial landscape. Indeed, these three industries remain heavily reliant on China for manufacturing, with a significant share of their global supply chains rooted in Chinese production hubs. This means that these are the sectors whose goods will become more expensive in the US in the context of the new higher tariffs as, in parallel, the proportion of production facilities located in the US is only 6%, 3% and 9%, respectively. At the same time, if American consumers are unwilling to pay higher prices, and China is unable to secure alternative trading partners to offset lost US demand, the country may face overproduction in electronics, household appliances and textiles in the coming quarters, while it rightsizes production levels.

When examining the supply chains of American companies, no sector in the US has (on average) more than 12% of its production facilities located in China. This means that at the aggregate level, the risk of US production shortfalls is relatively contained, but individual sectors or companies could be more at risk. However, electronics and textiles are, once again, the most fragile sectors, with US businesses having respectively 10% and 11% of their facilities located in China, meaning that one tenth of both finished goods and components for local production are coming from China. Therefore, in the context of the current bilateral trade war, US companies in these sectors could face more expensive or disrupted access to key inputs. On a case-by-case basis, some big US companies – such as Appel and Intel – are publicly known to be vulnerable to Chinese production or demand. This explains the latest decision by the Trump administration to exempt phones, computers and chips from the Liberation Day tariffs. Apple has nearly 11% of its facilities in China (29% in the US), with its main supplier Hon Hai (33% of Apple's COGS) being Chinese. For Intel, although only 6% of its suppliers are based in China, this country accounts for almost 30% of total revenues. Strategically, both Apple and Intel should be protected as they are key for the US tech leadership, innovation and defense, as well as crucial for job creation. Textiles & apparel remains therefore the sole sector with high exposure to Chinese production that has so far not been protected from the trade war. Companies in this sector will struggle to source domestically at competitive prices, meaning that US manufacturers will have to find alternative suppliers quickly or face margin deterioration.

Figure 4: % of production facilities located in China, by sector (global average) and US companies' average



Sources: Bloomberg, Allianz Research. For global sector average we have selected the 20 largest companies (market capitalization) by sector

Bond markets are riding the storm

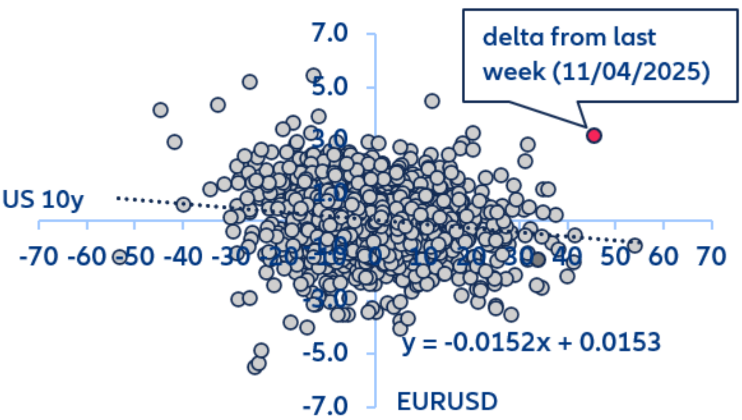
Liberation Day triggered a historic bond market repricing. The sweeping tariffs announced on 2 April and subsequent back and forth on temporary halts and counter-tariffs delivered a seismic shock to global capital markets, with bond markets bearing the brunt. The US 30-year Treasury yield surged by 46bps over the week – its sharpest weekly rise in more than two decades. Meanwhile, the 10-year Treasury-Bund yield spread widened by an unprecedented 50bps. This sharp divergence marked a complete reversal of the rapid narrowing seen only weeks earlier, when Germany's surprise fiscal U-turn had sent Bund yields soaring relative to US Treasuries (Figure 5).

Figure 5: Transatlantic government bond spread, bps

Sources: Bloomberg, Allianz Research

Divesting from the US is the most likely driver behind the sell-off. Several theories are circulating to explain the dramatic moves in US yields, with some more plausible than others. One trigger could be the lagged reaction of markets switching from safe-haven demand to fundamental drivers. As often happens during episodes of geopolitical or policy uncertainty, after Liberation Day investors initially flocked to safe-haven assets like US Treasuries and the dollar. However, as the implications of the policy shift became clearer, attention turned to its inflationary consequences. Tariffs are expected to fuel inflation, potentially delaying the Federal Reserve's ability to cut rates. Markets quickly adjusted their expectations, driving a reassessment of the future path of monetary policy and lifting yields, particularly at the long end of the curve. However, a more structural and perhaps more concerning explanation is gaining traction: a wave of global divestment from US Treasuries and the US in general. This is supported by the rare occurrence of rising US yields alongside a weakening dollar (Figure 6). Ordinarily, higher yields attract foreign capital and strengthen the currency. The fact that the opposite occurred suggests that major holders were not only selling Treasuries but also converting the proceeds into other currencies – possibly reallocating to European markets. This theory is corroborated by falling yields in Europe, especially in Germany, and by the behavior of swap spreads. In the US, swap spreads narrowed, indicating Treasuries were becoming cheaper relative to compounded central bank expectations (swap rates). In contrast, German spreads widened, pointing to increased demand and rising valuations for Bunds (Figure 7).

Figure 6: Weekly change in US 10y yields and EURUSD exchange rate, bps, %



Sources: LSEG Datastream, Allianz Research
Notes: Each point is a weekly observation. Data goes back to 01/01/2000.

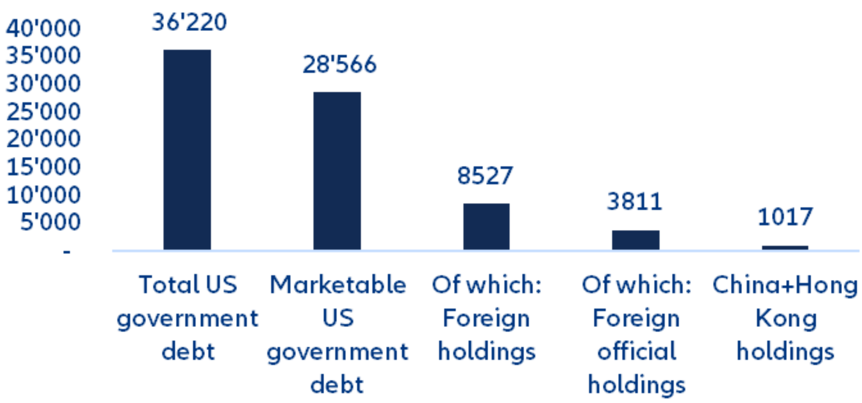
Institutional investors from countries in the crosshairs of Trump's foreign policy have an incentive to sell their US holdings. The question of who is selling remains speculative as institutional holdings data or balance of payments are published with long lags or not at all. Still, market rumors have pointed to China and large pension funds in Canada and Denmark. For China, the combination of heightened geopolitical tensions with the US and the precedent set by the freezing of Russian assets after the attack on Ukraine offer a strong incentive to reduce exposure to US assets. That said, without hard data, these claims remain anecdotal though consistent with observed market behavior. Initial signs of a lack of interest in US assets can also be seen from retail investors. Non-US domiciled investors have stopped buying US equity ETFs in February and have turned into modest sellers of US bond funds since March.

Figure 7: Swap spreads (10y swap – 10y government bond yield), bps

Sources: Bloomberg, Allianz Research

Concerns about further reductions in overseas holdings of US Treasuries are valid but may be overstated. As of January, China held USD760bn in Treasuries, roughly 2.6% of the USD29trn in marketable US government debt (Figure 8, Hong Kong owns another USD255trn). While meaningful, this share has declined steadily in recent years. Moreover, the market has previously absorbed much larger shifts in demand. For example, in April 2020 during the height of the pandemic, the Federal Reserve purchased USD911bn in Treasuries in a single month, demonstrating that large-scale shifts in demand and supply are possible and that the Fed would have the power to intervene if financial stability were at risk.

Figure 8: Total US government debt and foreign holdings, USD bn



Sources: US Treasury, Allianz Research
Notes: Foreign holdings are from January 2025, total debt from March 2025

The bond market turmoil has made the US administration think twice. The speed and scale of the move in bond markets have clearly caught the attention of US policymakers. With memories of the UK's 2022 "Truss moment" still fresh, the risk of a similar crisis of confidence in the US Treasury market is being taken seriously. In response to the turmoil, the Trump administration announced a 90-day pause on the newly imposed tariffs. President Trump acknowledged the decision had been prompted by market concerns, saying, "people were getting yippy [...] a little bit afraid" adding "The bond market is very tricky" reflecting an unusually candid recognition of financial market sensitivities. Going forward, this supports the optimistic view that the worst of the trade war could be behind us.

Volatility ahead but looking through the noise we expect lower rates as central bank easing continues. The path forward will depend heavily on the next steps from the US administration. Should the government resume its tariff push or adopt additional measures seen as inflationary or fiscally unsound, bond markets may again respond sharply. Yet once the current volatility subsides, we expect fundamentals to reassert themselves. Rising US yields enhance the relative attractiveness of Treasuries, particularly for long-duration investors seeking liquid, high-quality assets. Despite recent selling, the US Treasury market remains unparalleled in terms of size and depth and these characteristics provide a natural buffer against sustained outflows. Our base case remains unchanged: we see the US 10-year yield stabilizing around 4.0% by the end of 2025, supported by strong easing of monetary policy, as we expect the Fed to cut the policy rate down to 2.75% starting at the end of 2025. In FX markets, we continue to forecast the EUR/USD exchange rate to move towards 1.12 by year-end, as capital flows rebalance and real interest rate differentials narrow.

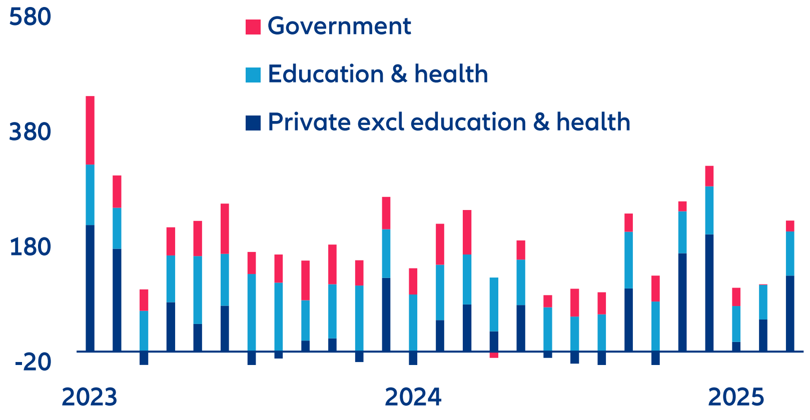
The ECB is set to continue its easing cycle below neutral, given economic headwinds and disinflation forces. At its next meeting on 17 April, the ECB is expected to lower the deposit rate again by 25bps to 2.25%. Inflation concerns have moved to the background with headline inflation having eased to 2.2% y/y and core inflation to 2.4% in March, the latter being at a three-year-low. Also looking into the details, concerns have dissipated. Services inflation fell, wage growth is coming down and leading indicators from Purchasing Manager Surveys (PMIs) show easing price pressures ahead. Most importantly, due to the aggressive trade war, disinflation forces should gain further traction and push inflation well below the target of 2% soon. Oil prices fell 13% ytd while the Euro gained 4% ytd. Overcapacities in China on reduced demand from the US will intensify and lead to downward price pressures outside of China due to imported deflation. At the same time, we expect another year of weak economic growth (2025: +0.8%) below potential, thereby widening the negative output gap. Therefore, the ECB will be forced to move monetary policy to accommodative territory. ECB staff have estimated the neutral nominal rate at 1.75%-2.25%. Given the additional economic headwinds, we expect the ECB to continue cutting the policy rate down to 1.5% by September 2025. Meanwhile, quantitative tightening is set to continue, with the ECB not reinvesting any maturing bonds in its APP and PEPP program, leading to a reduction of bond holdings by roughly EUR40bn per month. Risks are high and asymmetric to the downside. The German-induced fiscal boost will not be able to outweigh the headwinds from intensifying trade frictions coming from the US. But the ECB retains considerable leeway to contain widening Eurozone spreads in the event of financial stress. The most likely first response would be a halt to quantitative tightening, which would lower the net-net issuance of Eurozone government bonds by around EUR480bn annually – far exceeding the currently debated increase in debt financed defense spending (EUR140bn annually, which would raise EU-wide defense spending from 2.2% to 3% of GDP).

US labor market: how much can it weaken?

The US labor market has been holding up well despite mounting economic headwinds, including a sharp rise in policy uncertainty. The bumper 228,000 rise in non-farm payrolls in March suggests that the US labor market remains solid. Private payrolls excluding education & heath (the most cyclical component of labor) led the way (Figure 9), particularly in the services sector (notably retail trade and transportation & warehousing), though manufacturing employment barely rose. The unemployment rate ticked up only marginally at 4.2%. Total government payrolls increased by +19,000, a bit below the recent average. Within the government, federal government payrolls only declined by -4,000, despite the DOGE-led push to dismiss federal employees. This resilience presumably reflects some of the legal pushback against the firing of probationary employees. The Challenger job cut announcements for March and the weekly initial jobless claims through end-March corroborate the resilience of the US labor market until recently[1].

[1] The Challenger job cut announcements for the private sector pulled back in March. It increased sharply for the government sector but did not translate into actual job losses because of the legal push back against the firing of probationary employees.

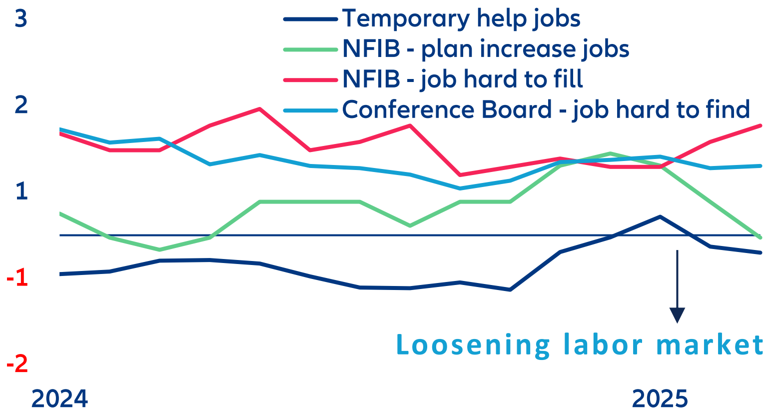
Figure 9: Non-farm payrolls breakdown (000s jobs, monthly)



Sources: LSGE Workspace, Allianz Research

Forward-looking indicators suggest this resilience is likely to continue in Q2 2025. We look at four variables to predict labor market outcomes for the next three months: the NFIB survey on the share of companies that plan to increase employment and the share reporting difficulty in filling a job position; the Conference Board survey of how easy it is for households to find a job and the growth of temporary help jobs from the non-farm payrolls establishment survey (Figure 10). Historically, these four variables have tended to detect momentum in the US labor market for the next couple of months. While they are currently sending mixed signals, overall they do not point to a deterioration of the labor market in the next couple of months. For comparison, in the last two US recessions (2020 and 2008[2]), we look at three core data: employment growth, the unemployment rate, and the job vacancy rate (Figure 11). To capture underlying momentum and cut through the noise, the data are expressed in 6m/6m % change (employment) and 6m/6m %-pt change (unemployment rate and job vacancy rate). What can be inferred from the two prior recessions is that the job vacancy rate deteriorated the first. During the 2008 recession, even four months after the start of the recession the unemployment rate and employment growth did not deteriorate markedly[3].

Figure 10: Forward-looking indicators of the US labor market (z-score)



Sources: LSGE Workspace, Allianz Research

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[2] We estimate that the 2008 recession started in March 2008 rather in December 2007 as declared by the NBER because before March 2008 most of the activity data did not point to a recession.

[3] We look at three core variables: employment growth, the unemployment rate and the job vacancy rate (Figure X3). To capture underlying momentum and cut through the noise, the data are expressed in 6m/6m % change (employment) and 6m/6m pp change (unemployment rate and job vacancy rate).

Figure 11: Labor market indicators under previous US recessions (z-score)

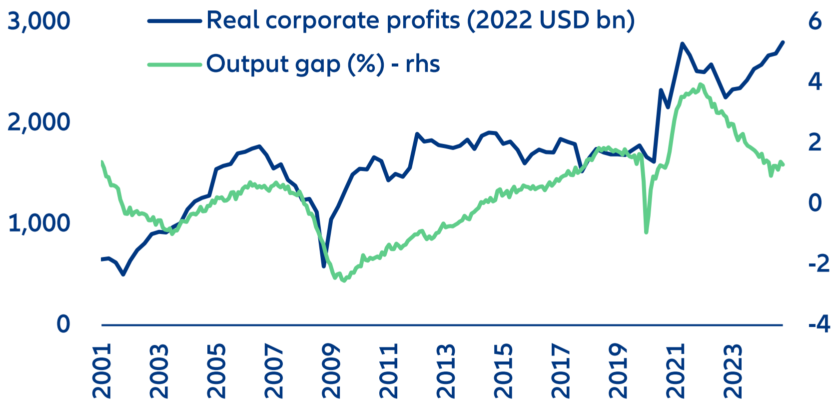
		-4	-3	-2	-1	Crisis	1	2	3	4	Feb 25	Mar 25
2008	Employment	0.0	-0.1	0.0	-0.2	-0.2	-0.4	-0.3	-0.4	-0.4	0.0	0.2
	Unemployment rate (-)	-0.1	-0.2	-0.3	-0.1	-0.3	-0.2	-0.3	-0.4	-0.6	-0.1	-0.2
	Job vacancy rate	-0.4	-0.1	0.0	-0.8	-0.5	-1.3	-0.5	-1.3	-0.8	0.1	
2020	Employment	0.1	-0.1	-0.2	-1.3	-7.8	-6.7	-5.0	-4.6	-2.6		
	Unemployment rate (-)	-0.1	-0.1	-0.1	-0.6	-7.5	-6.5	-5.0	-4.5	-2.7		
	Job vacancy rate	-0.8	0.0	-0.3	-2.0	-2.2	-0.5	-0.5	0.2	1.3		

Sources: LSGE Workspace, Allianz Research
Note: employment growth is expressed in % 6m/6m change and job vacancy rate/unemployment rate in 6m/6m pp change.

Despite the inflationary effects of steep tariff hikes and persistently high policy uncertainty, we do not expect large layoffs as US companies are still enjoying healthy profits and also facing elevated labor shortages. Nevertheless, we expect the unemployment rate to rise, peaking at 5% by Q1-2026. Alongside the relatively solid state of US households' balance sheets and income[4], the limited deterioration of the labor market in the next couple of months is another factor of resilience. First, the level of spare capacity in the US economy remains very limited. In fact, our in-house output gap – which is constructed based on survey measures such as the industrial capacity utilization or quite rate – is still in largely positive territory (Figure 12), and more elevated that alternative output gap estimates This indicates that firms are more supply-constrained than conventionally thought and, this environment, more likely to retain their employees, particularly as tight immigration policy is increasing the scarcity of labor. In fact, working hours per employee have steadily decreased since the aftermath of the Covid-19 crisis, which points to a strategy of adapting hours rather than headcounts to changing economic circumstances. Second, corporate profits (in inflation-adjusted terms) are high (Figure 12). US corporates, in aggregate, have buffers to navigate through the tariffs and will probably favor temporary lower profits rather than mass layoffs. Meanwhile, the DOGE-driven federal layoffs are not likely to shake up the labor market. Layoffs of non-probationary employees in agencies like the Department of Education and USAID will start to show in the data in coming months. In October alone, the employment report will likely capture the impact of 75,000 federal employees who chose deferred resignation. In total, we would expect federal employment to decline by close to 200,000 this year – more than 10% of annual employment gains. But even in an extreme scenario where dismissed or quitting federal employees do not find another job (but stay in the labor force), the unemployment rate would increase by just +0.3pp in 2025.

Figure 12: Output gap & real corporate profits

[4] *See Allianz | What to watch I March 20, 2025*



Sources: LSGE Workspace, Allianz Research

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

FORWARD-LOOKING STATEMENTS

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

Such deviations may arise due to, without limitation, (i) changes of the general economic conditions and competitive situation, particularly in the Allianz Group's core business and core markets, (ii) performance of financial markets (particularly market volatility, liquidity and credit events), (iii) frequency and severity of insured loss events, including from natural catastrophes, and the development of loss expenses, (iv) mortality and morbidity levels and trends, (v) persistency levels, (vi) particularly in the banking business, the extent of credit defaults, (vii) interest rate levels, (viii) currency exchange rates including the EUR/USD exchange rate, (ix) changes in laws and regulations, including tax regulations, (x) the impact of acquisitions, including related integration issues, and reorganization measures, and (xi) general competitive factors, in each case on a local, regional, national and/or global basis. Many of these factors may be more likely to occur, or more pronounced, as a result of terrorist activities and their consequences.

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The company assumes no obligation to update any information or forward-looking statement contained herein, save for any information required to be disclosed by law.