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What to watch: The cost of a weaker dollar, tariff turbulence ahead for the travel industry and chip war reloaded

Ludovic Subran
Chief Economist
ludovic.subran@allianz.com

Maxime Darmet
Senior Economist for UK, US and France
maxime.darmet@allianz-trade.com

Guillaume Dejean
Sector Advisor
guillaume.dejean@allianz-trade.com

Bjoern Griesbach
Senior Investment Strategist & Eurozone Economist
bjoern.griesbach@allianz.com

Maria Latorre
Sector Advisor
maria.latorre@allianz-trade.com

In summary

President Trump gets a weaker dollar, but it comes at a cost. The USD has fallen 10% since Donald Trump's inauguration, albeit due to investor distrust following erratic trade measures and attacks on Fed independence rather than deliberate policy moves. Despite mounting concerns, many investors will be forced to stay in US markets as there is no alternative to move the massive net international investment balance of USD28trn anywhere else. Yet, if even a fraction of these assets were leaving the US, it would lead to even larger distortions in exchange rates and global asset prices. Foreign exchange market volatility is therefore likely to remain elevated amid the news flow, but fundamentals suggest that the EUR/USD exchange rate may stabilize around 1.12 by year-end, with an asymmetric risk towards higher levels. Long-term valuations metrics would see the dollar weaken mostly against Asian currencies while European ones look fairly valued against the dollar.

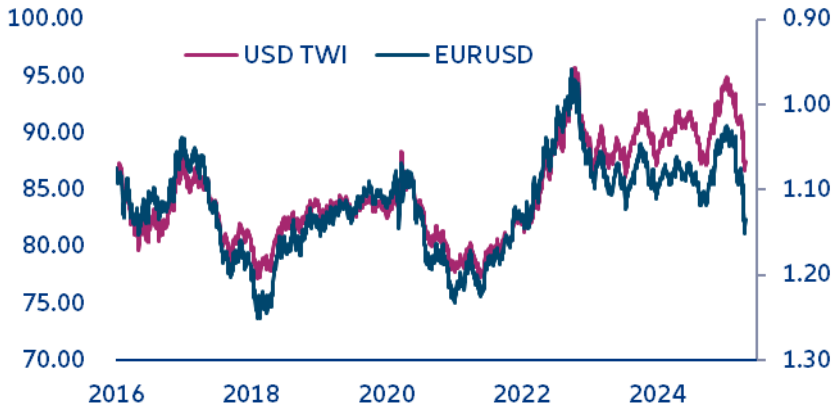
Turbulence ahead: Tariffs will send aircraft costs soaring while grounding travel demand. President Trump's renewed tariff push is casting fresh clouds over the airline industry, threatening to derail its fragile post-pandemic recovery. After strong revenue rebounds in 2023 (+23% y/y) and 2024 (+7%), airlines now face soaring aircraft costs (+16%) and limited supply, with deliveries still 10% below pre-pandemic levels and a record 17,000-plane backlog further worsening delays. The new tariffs threaten to make Boeing and Airbus's complex supply-chains more expensive, with both having production facilities in the US and more than half of suppliers located abroad. At the same time, US-bound tourism – a key revenue driver – is cooling, with a -17% y/y drop from Western Europe in March and early Q1 airline load factors falling to 78% (from 84%). North American airlines now project the weakest 2025 revenue growth globally (+1% y/y) and are already reporting a -10% q/q decline in Q1 revenues. However, cooling jet fuel prices (-22% y/y) should cushion some of the blow.

Chip on the shoulder: A defensive but counterproductive move from the US. With AI-related revenues set to record +30% CAGR over the next decade, reaching USD1.6trn by 2032, the US administration is pulling out all the stops to secure its leadership position in that segment, especially following the breakout success of China's Deepseek. New chip restrictions will bar US companies from selling chips specifically designed for China. But this defensive move could backfire in the short run as large US semiconductor companies are heavily exposed to China (30% of their revenue for the top 10) and will have to tame rising concerns toward the slow returns of huge AI investments. Moreover, US isolationist policy could accelerate public investments for semiconductors in China, paving the way for an innovative and cheaper ecosystem that could be favored over that of the US in the future.

President Trump gets a weaker dollar, but at a high cost

One of Trump's strongest scores in his first 100 days may be delivering on his promise to weaken the US dollar. As Trump's second term reaches the 100 day mark on 30 April, one campaign pledge has been achieved with surprising success: the delivery of a weaker dollar. Indeed, the trade-weighted USD index dropped to the lowest level since 2022 this week and is down 10% since Trump's inauguration. The EURUSD exchange rate surpassed 1.15 at one point, making the euro appreciate against the dollar by 11% since the beginning of the year (Figure 1). A weaker dollar has been one of Trump's main policy goals and was vividly debated after the so-called Mar-a-Lago accord policy paper.

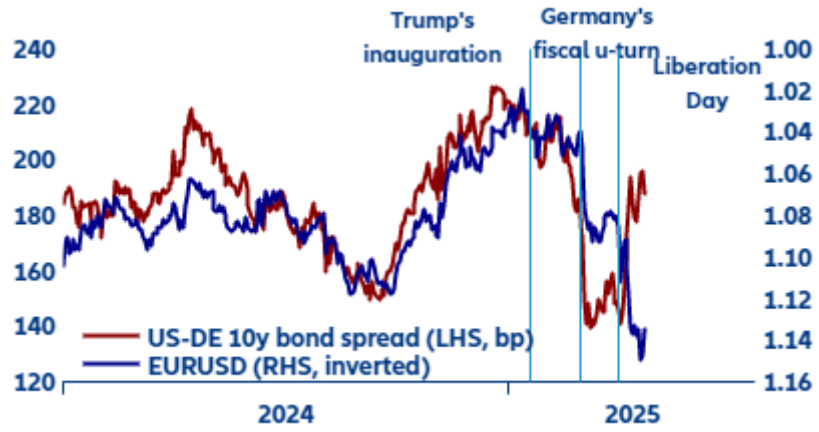
Figure 1: Trade-weighted Dollar index (LHS) and EURUSD (RHS, inverted)



Sources: LSEG Datastream, Allianz Research

However, the dollar sell-off has been driven by a loss of trust in US policy, with investors turning their back on America's economy. The loss in USD value has largely been driven by capital outflows (or less inflows) from the US as a whole as investors lost confidence in the US economy following erratic and aggressive policy measures. The full-blown trade war initiated on Liberation Day three weeks ago and, more recently, an attack on the Fed's independence have scared both domestic and foreign investors, causing the dollar to depreciate. Normally a currency is largely driven by interest rate differentials. When US interest rates rise compared to other markets, the dollar rises in value as it becomes more attractive to invest in and vice versa. Since the extensive tariff announcements of 2 April, that pattern has been broken, whether you look at long-term interest rate differentials or short-term expectations on the divergence of central bank policy rates (Figure 2). Investors dumped the USD even though it became more attractive amid rising yields. This indicates that investors are selling US bonds and equities and swapping the proceeds to other currencies, in particular the euro. Initial data publications show that Japanese pension funds and European retail investors have reduced their interest in US assets.

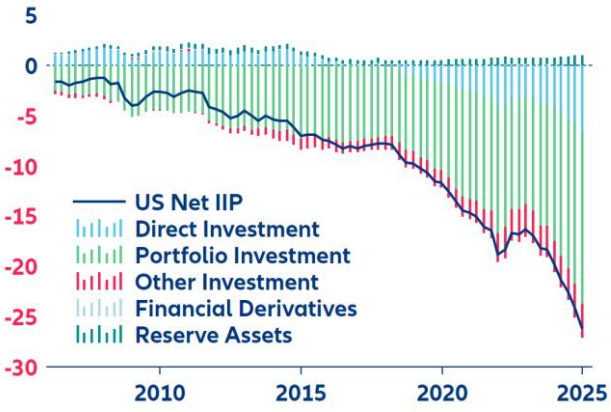
Figure 2: EURUSD decouples from interest rate differentials, %



Sources: LSEG Datastream, Allianz Research

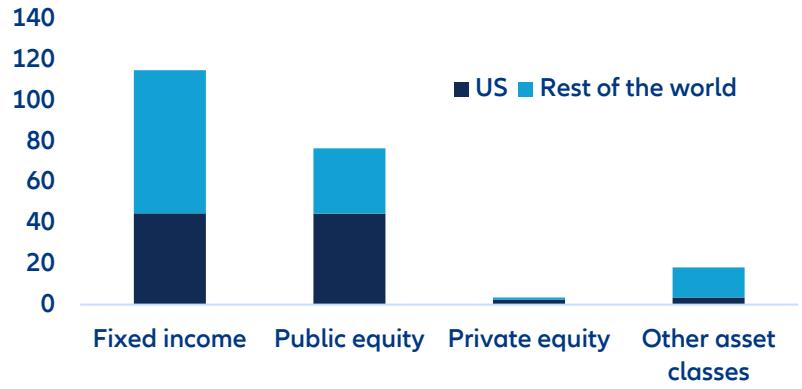
But overseas investors have a problem: they are highly exposed to the US but have few alternatives to move elsewhere. Decades of high US trade deficits were counterbalanced by an equal amount of capital flows to the US from overseas investors. The resulting net international investment position (NIIP) stood at a staggering USD26trn as of Q4 2024 (Figure 3), equivalent to around 85% of US GDP or around a third of the entire US capital stock. Therefore, a lot is at stake for the US and the USD even if only a fraction of these funds were to be moved outside of the US again. As a reversal in the US trade deficit still looks like farfetched (despite tariffs and an already weaker dollar), the valve that would equate capital outflows and trade deficits would be a further weakening of the dollar – at least initially. However, investors face one obstacle in moving substantial funds from the US anywhere else: TINA (there is no alternative). Figure 4 shows that the US dominates at the global investment portfolio in all relevant asset classes. 39% (USD45trn) of all fixed income products and 58% (USD44trn) of all listed stocks are US domiciled. No other market outside the US has the depth to fill the void. If overseas investors would stop putting their funds in the US (amid ongoing trade deficits) or worse, if they were to move just a fraction of the USD26trn outside of the US, this would lead to huge distortions in financial markets. US equity prices (bond yields) would drop (rise) and the opposite would happen in Europe or other markets that investors would shift their funds to, while the USD would strongly depreciate and could easily reach levels around 1.20-1.40 against the euro. However, these price moves would quickly lead to levels beyond any reasonable acceptance in terms of valuations for investors. As a result, market forces, would stop any further outflows before they actually took place.

Figure 3: Net international investment position (NIIP) of the US, trillion USD



Sources: LSEG Datastream, Allianz Research

Figure 4: Global free-float adjusted market portfolio (2023), trillion USD

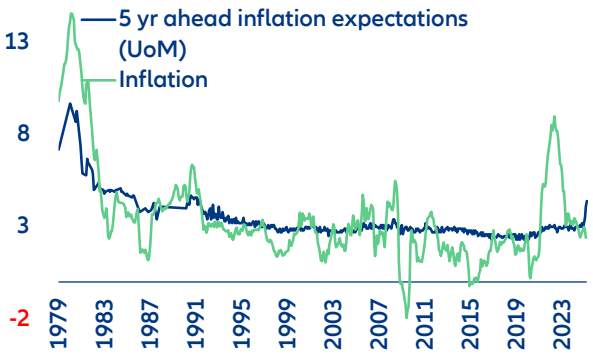


Sources: MSCI, Allianz Research

The latest round of USD depreciation has been reinforced by Trump's attack against the Fed's independence – a cornerstone of trust in the global reserve currency. Last week, President Trump lashed out at Powell, blaming him for being "too late and wrong" on interest rates and adding that "his termination cannot come fast enough". However, after the negative market reaction, he backtracked this week, saying he has "no intention" of firing Powell, whose term as the Fed Chair ends in May 2026. Such political pressure on the Fed to ease monetary policy has not been seen since the 1970s when A. Burns was leading the institution, though it was less explicit and occurred mostly behind closed doors. Recent economic research suggests that increased political pressure on the Fed (which intensified sharply during the Nixon presidency) and weakened de facto independence in the 1960s and 1970s was a major cause of the spike in inflation seen during the period – potentially even more than other shocks such as the oil price spike or the break-up of the Bretton-Woods monetary system. Economic conditions in the US today do not warrant an easing of monetary policy: While headwinds have intensified, threatening a pick-up in unemployment, the outlook for inflation has deteriorated on the back of sharp tariff hikes. Though a tariff-induced rise in prices would generally be seen as a one-off increase in the price level, the fact that households' medium-term inflation expectations have shot up recently signals a risk of de-anchoring of expectations relative to the Fed's 2% target that the Board cannot ignore (Figure 5). Therefore, interest rates cuts in the short term are not warranted. Any political pressure to do so apparently undermines the confidence investors have in the USD, which explains them shying away from the greenback. Ultimately, we do not expect the President to fire Powell but he will pick a new Fed Chair after Powell's term in the position expires in May 2026. With Board member A. Kugler's term expiring in January 2026, the balance of votes would remain relatively hawkish in the 12-voting-member FOMC but the Fed's perceived credibility would be marginally reduced because of Trump's two appointees, which would be moderately negative for the USD and US Treasuries[1].

Figure 5: US inflation and medium-term inflation expectations (%)

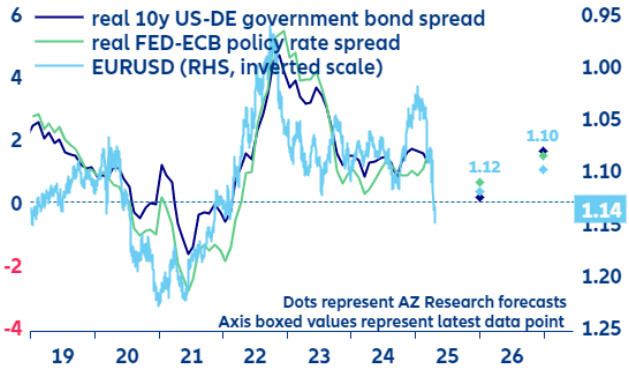
[1] *However, if the Supreme Court grants Trump the authority to fire the Chair, a second scenario could see the appointment of a Chair aligned with Trump (and the replacement of A. Kruger from January 2026) but he would remain isolated at the FOMC. This scenario would be more negative for the USD and US Treasuries, but short-term rates would likely fall in anticipation of monetary easing. The worst-case scenario would occur if Trump were to fire other Board members in an all-out war against the Fed. Though the Senate might vote down overly political picks, the implications for financial markets would be very negative as the Fed would be perceived as much less independent. The term premium on US Treasuries would rise sharply.*



Sources: LSGE Workspace, University of Michigan, Allianz Research

We expect ongoing volatility but maintain our year-end forecast of 1.12 for the EURUSD exchange rate as markets seem to keep any overly aggressive US policy move in check, giving room again to fundamental factors driving the exchange rate. The past weeks have shown that Trump delivers on aggressive policy measures, but also backpedals if markets react strongly (eg. announcing a 90-day pause on tariffs or withdrawing his threat on removing Fed chair Powell from office). While such back-and-forth policy moves will continue and lead to high volatility, it is worth looking through the noise and reverting to fundamental drivers of the exchange rate. The expected interest rate differential, based on our forecasts for inflation, policy rates and long-term yields for the Eurozone and the US, suggests the EURUSD exchange rate should reach 1.12 at the end of this year and 1.10 in 2026, with a large confidence interval given the large amount of uncertainty (Figure 6).

Figure 6: EURUSD and real interest rate differentials, %

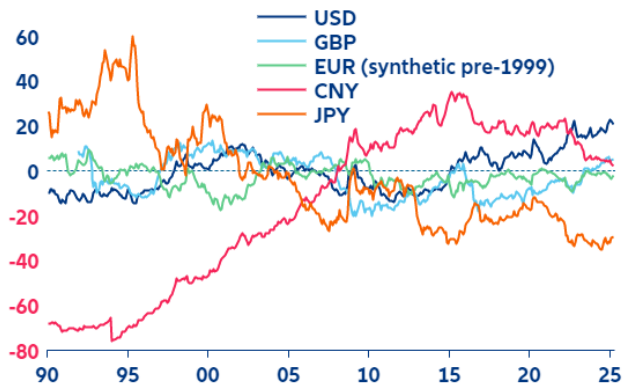


Sources: LSEG Datastream, Allianz Research
Notes: Dots refer to Allianz Research forecasts.

Longer-term valuation measures see the USD overvalued, but with inherent structural limitations these measures offer only a rough guidance. Looking at the real effective exchange rate (REER), the dollar is currently 20% above its long-term average value. On the flip side, the Japanese yen looks undervalued from that perspective, while the euro, the British pound and the Chinese yuan look fair valued. However, it is important to note that the REER level is based on arbitrary CPI index levels. The only way to interpret it is by looking at relative moves over time and, thus, deviations from its long-term average, as shown in Figure 7. An alternative way to compare the levels of exchange rates is to look at the price of goods in different countries and how much they deviate from each other when converted to one currency (typically the USD). The most famous example is the Big Mac Index as it compares a standardized product whose production costs are largely domestically driven. In the US, the Big Mac cost USD5.79 at the beginning of the year compared to USD5.95 in the Eurozone and USD5.73 in UK. It is the most expensive in Switzerland at USD7.99 and fairly cheap in China (USD3.52) and Japan (USD3.11), implying again an overvaluation of the dollar against Asian currencies but not so much against Europe. This pattern has been broadly stable over the past decade (Figure 8). A similar conclusion arises when using a broader consumer basket, for example when looking at the purchasing-power-parity-implied exchange rates (PPP). However, while the Big Mac Index and

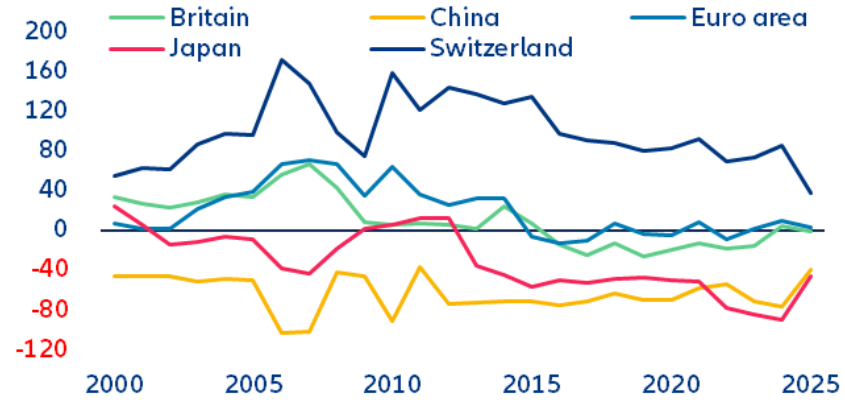
broader PPP-based measures offer a simple way to assess currency misalignment in currencies, they have important limitations. These approaches ignore structural differences such as productivity, labor costs and consumption patterns across countries. They also assume identical goods and services baskets, which often isn't the case, especially in emerging markets. As a result, PPP measures can provide a rough, long-term guide, but not a definitive benchmark or a fair value for a currency.

Figure 7: Real effective exchange rate deviations from long-term average, %



Sources: LSEG Datastream, Allianz Research
Notes: Real effective exchange rates deviations from 20y moving average.

Figure 8: Big Mac Index deviation from US, %



Sources: LSEG Datastream, Allianz Research

Turbulence ahead: Tariffs will send aircraft costs soaring while grounding travel demand

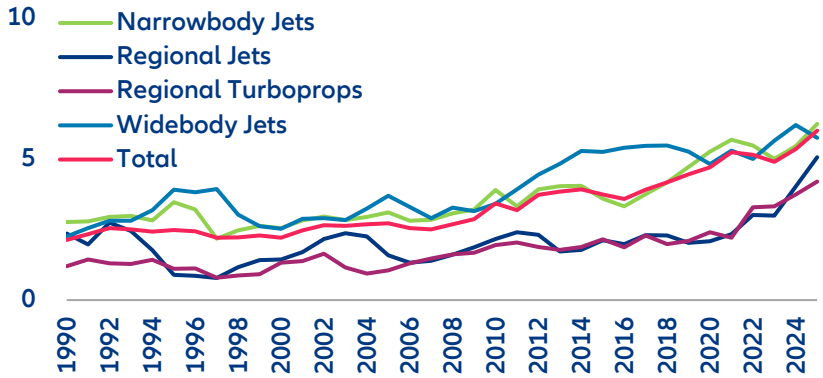
Cloudy skies for airlines. Following a pandemic that devastated the tourism industry and left airlines with profit losses for three consecutive years, the sector now faces another turbulent period, triggered by rising tariffs that risk inflating aircraft costs (exacerbating existing production challenges), and potentially dampening inbound tourism to the US. Certainly, the current trade war has brought to a halt the financial rebound that airlines enjoyed in 2023-2024 (when revenues jumped by +23% and +7% y/y, respectively, and bottom lines went positive). Among all current headwinds, the most worrying is the limited capacity. While the sector's capacity, measured by ATK[2], grew by

[2] *ATK, or available ton kilometers, is a capacity measure that combines both passenger and cargo capacity. It is calculated by multiplying the capacity for the transport of passengers and cargo (converted to tons) by the distance flown.*

around +21% y/y in 2022 and 2023, in 2024 global ATK went up only by +8% and it should remain capped at around +5% this year.

Aircraft and key component manufacturers are still struggling to return to pre-pandemic production levels, hindering deliveries. In 2024, the two biggest plane-makers – Boeing and Airbus – delivered only 90% of what they used to provide to the market. With demand for new planes soaring, the global order backlog reached an unprecedented 17,000 aircraft at the end of 2024, making it very difficult for the duopoly to meet demand and increasing the aircraft delivery times to levels never seen in history (Figure 9), particularly for narrowbody (short-haul) and widebody (long-haul) planes.

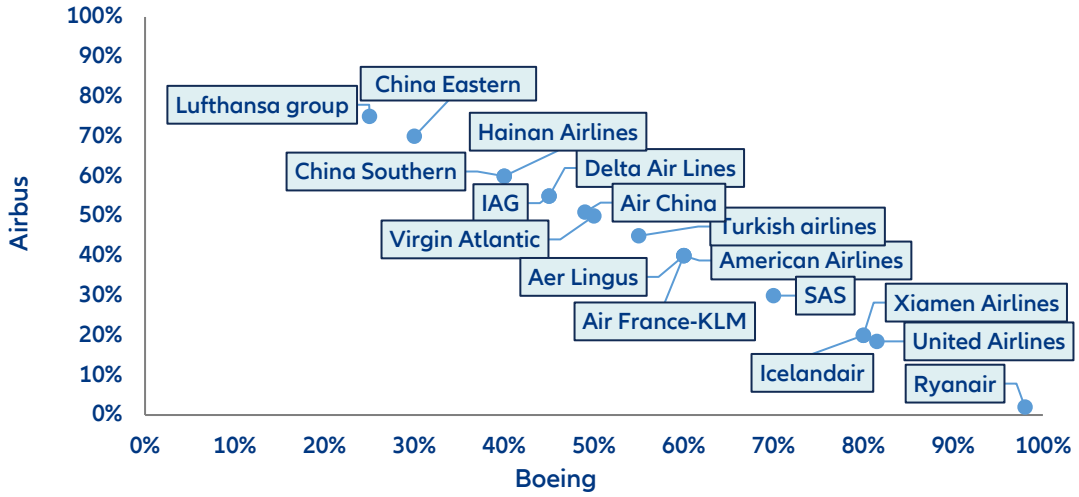
Figure 9: Aircraft average delivery times in years, by the year of delivery



Source: IATA, Cirium, Allianz Research

The current trade war is expected to exacerbate the ongoing disruptions in global supply chains, as well as specific issues at the manufacturer level, making airplanes more expensive. Although Boeing's supply chain is less complex and vast than that of Airbus (345 vs 2,398 suppliers), 54% of Boeing's suppliers are located abroad. This will roughly translate into more than half of the company's production costs being at least 10% more expensive once higher tariffs come into effect (with Safran being the main non-US supplier). For Airbus, the US is the largest single country supplier (2,000 suppliers across 40 states), with key manufacturing facilities in Alabama, Mississippi and Florida. As a result, it will also face higher tariffs on the components it needs to build jets there. Aircraft have become +16% more expensive in the past five years and prices should continue to increase by around +20% by 2030. These tariff-induced price increases could shift market dynamics in favor of Airbus as airlines might turn to the European player as a more affordable and reliable option. Additionally, governments such as China, which recently instructed its airlines to halt Boeing deliveries, may influence other governments to follow suit (nearly 8% of Boeing's client base is located in China). However, for Airbus to capture a greater share of the global market and reduce its vulnerability, it must not only invest decisively and at scale, but also adopt a strategically forward-thinking approach to supplier selection.

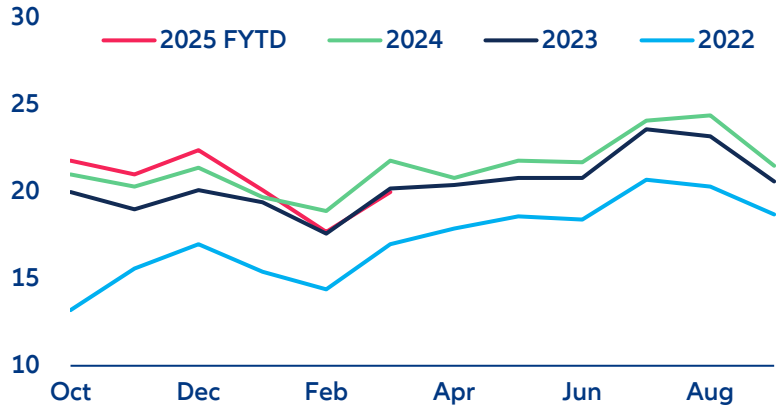
Figure 10: Airlines' fleet exposure to Boeing vs Airbus aircraft supply



Sources: Bloomberg Intelligence, Company filings, Allianz Research.

The flight path of US tourism is also shifting and should weigh on airlines highly exposed to this market. The US ranks third globally in international tourism, after France and Spain. Last year, the country received over 72mn international visitors (+9% y/y). This surge contributed to a record-breaking USD215bn (+14% y/y) in tourism receipts, making this sector (and all sub-industries related to leisure services) important for the US economy. Therefore, inflationary fears and uncertainties related to the deterioration of diplomatic relations with neighboring countries could leave a dent in tourism. Indeed, Canada and Mexico represent 52% (37mn) of total tourists visiting the US yearly, and according to the US Customs and Border Protection (Figure 11), the number of visitors crossing the northern and southern borders already decreased by -6% y/y in February and by -8% in March.

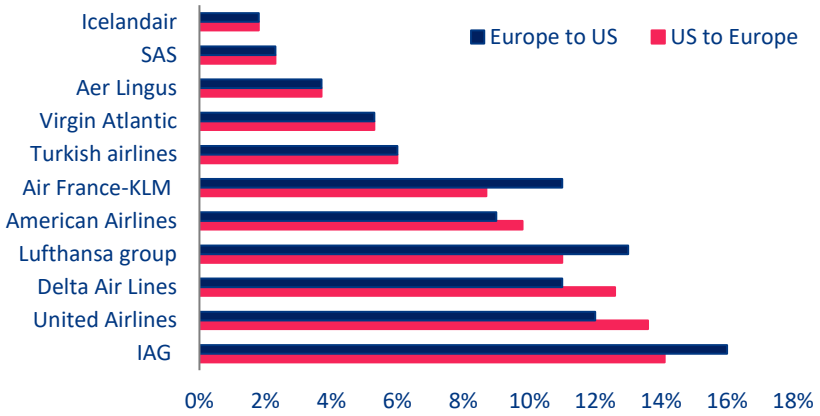
Figure 11: US arrivals by month, through northern and southern borders, all transportation means



Sources: US Customs and Border Protection, Allianz Research.

Although American airlines will be more affected, transatlantic carriers should also brace for a booking slowdown to the US. By air-passenger volume, North America as a region is key for the airlines industry as it represents around 23% of global market share, just after Asia-Pacific (36%) and Europe (27%). Therefore, a slowdown in tourism will impact not only American and regional carriers like Air Canada and Aeroméxico, but also all airline groups with revenue exposure to the US market, albeit to a lesser extent. This includes British Airways (IAG) and Lufthansa, European firms that have a market share of seats on the transatlantic route ranging between 12%-15% (Figure 12). Another concern is that transatlantic tourism represents a key profit driver for airlines as long-haul routes typically carry a higher share of first-class and business travelers, segments that generate the highest margins. Recent data from the National Travel and Tourism Office (NTTO) showed that US inbound tourism from Western Europe fell by -17% y/y in March and -7% y/y in the first three months of 2025, with Germany (-28% y/y) and Spain (-25% y/y) registering the biggest drops last month.

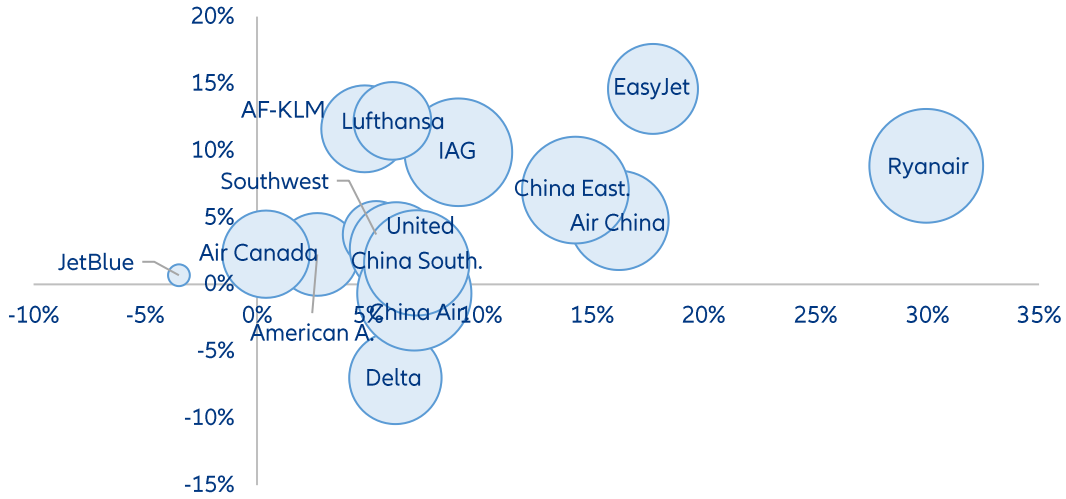
Figure 12: Market share of seats in the US <> Europe route, by airline



Sources: Bloomberg, Company data, Allianz Research.

Early Q1 2025 results underscore the declining demand for US travel, with North American carriers heading for the weakest revenue growth in 2025. Load factors[3] for airlines flying within and to the US are currently at around 78% on average, while prior to Trump's tariff announcements they were around 84%. For major US airlines, this has represented a revenue decline of -10% q/q, on average, for the January-March period. As shown in Figure 13, North American carriers are projected to post the weakest revenue growth among global peers in 2025, with only a +1% y/y increase. In comparison, European airlines are expected to see average top-line growth of +10%, while Chinese carriers are forecast to grow by +3%. Admittedly, the outlook is challenging, and turbulence lies ahead, but this is far from a crash landing. Airlines today operate with stronger margins – the average EBITDA margin stands at 11% for US carriers, 16% for European ones and 20% for Chinese ones – thanks in large part to a significant drop in jet fuel prices (-22% y/y and -56% below the peak observed in mid-2022). Kerosene prices are a major driver for airlines' earnings as fuel represents their largest operating cost (29% of total) so cheaper fuel is a tailwind that compensates for declines in revenue.

Figure 13: y/y revenue growth in 2024 (X axis), revenue growth expected for 2025 (Y axis) and current EBITDA margin of each airline (bubble size)



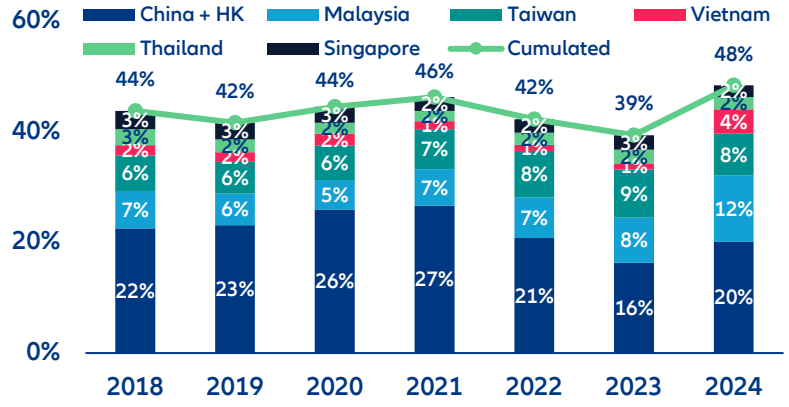
Sources: Bloomberg, Allianz Research

[3] *Load factor is a metric used by the airline industry to measure the percentage of available seating capacity filled with passengers. Airlines with high load factors sell most of their available seats. The higher the load factor, the more an airline can spread its fixed costs among passengers.*

Chip on the shoulder: A defensive but counterproductive move from the US

Following the breakout success of China's Deepseek, the US administration is implementing additional restrictions on semiconductor exports to secure its position in the global AI race. The White House recently announced a series of new curbs on semiconductor exports to China and Hong Kong, notably forbidding US companies Nvidia and AMD from selling chips specifically dedicated to the Chinese market. Under the Biden administration, US companies were already restricted from selling their best-performing chips to China. Nevertheless, China still managed to make a decisive leap forward in AI technology, relying on less powerful "light" chips (eg. Nvidia's H20) to build a low-cost, open-source language learning model (v3 and r1 models) to compete with the much costlier versions built by large US tech companies (OpenAI, Meta, Amazon). The new regulatory tightening is another attempt by the US to isolate China in the ongoing AI leadership race and secure its technology edge. Despite some tangible results, illustrated by a substantial decline of chip import volumes since the application of restrictions (down -22% over 2022-2024 vs. 2019-2021), China has always been the second-largest buyer of US semiconductors, and ranks first if Hong Kong is included (20% of US exports of semiconductors and other electronics in 2024). In fact, Chinese purchases of US chips actually increased last year (market share up by +4%) and global demand for chips was also higher in Q1 2025 (well above consensus earnings delivered by both Asian chip-maker TSMC and SK Hynix) as some companies likely stockpiled in anticipation of the tougher stance under Trump.

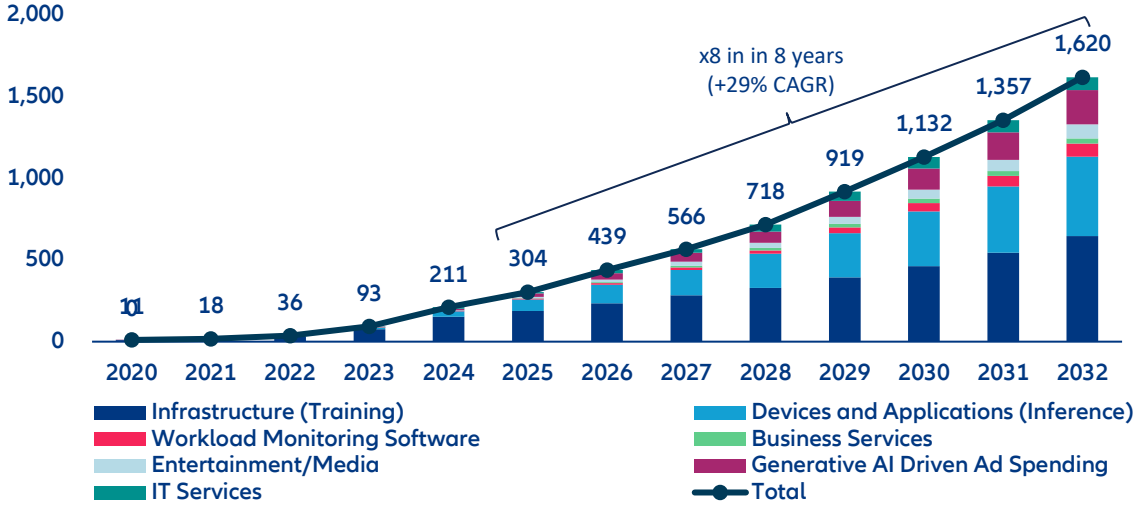
Figure 14: Annual US exports of semiconductors and other electronic components (country breakdown)



Sources: US International Trade Administration (ITA), Allianz Research

Loopholes have weakened the effects of existing restrictions. The US has a long history of imposing tech-related trade restrictions on China, but the AI race has only intensified competition. The AI industry is expected to become the main driver of global growth in the future, with expected revenue to reach USD1.6trn by 2032. Against this backdrop, the pivotal role of semiconductors has placed the industry in the spotlight amid the current standoff between the US and China. The US has a clear technology edge in the AI economy, thanks notably to strong private investment capacities but also a powerful corporate and education ecosystem promoting innovation and entrepreneurship. Yet, restrictions imposed to protect this technology edge have been weakened by loopholes mostly resulting from the looser regulatory frameworks of US trade partners, and notably an absence of restrictions on end-user or third-party transfer of technology items to China. Moreover, the US administration lacks capital resources to identify the final destination of products traded and to control direct and indirect exchanges of US technology abroad, and there is no penalty procedure applied in case of a violation of US restrictions. In this context, a full ban seems to be the only option to fully block China's access to US chips.

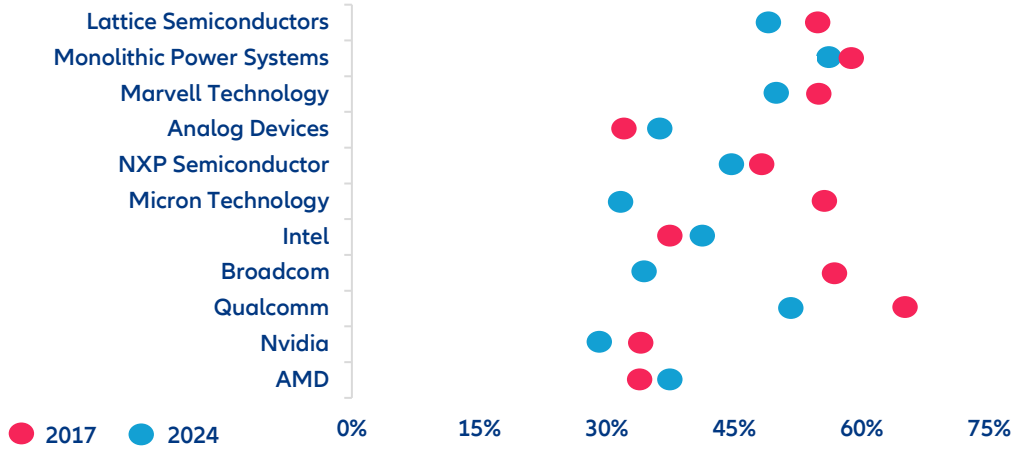
Figure 15: Estimated revenue to be generated by AI industry, breakdown by application



Sources: Bloomberg intelligence, Allianz Research

However, US companies will also pay the price. Nvidia and AMD have said that new restrictions will imply huge losses of USD5.5bn and USD800mn (6.5% and 14.6% of 2024 annual EBITDA, respectively) if applied as the existing inventory of chips designed specifically for China cannot be re-routed to other regions. In fact, China still accounts for as much as a third of revenue for some companies, even if the share overall has reduced since Trump's first mandate, as the country remains the world's biggest manufacturing hub of consumer electronics. For such companies, losing access to China would be very painful, at least as long as no alternative is found to offset that potential loss of revenue.

Figure 16: Revenue exposure to China of main US semiconductor companies

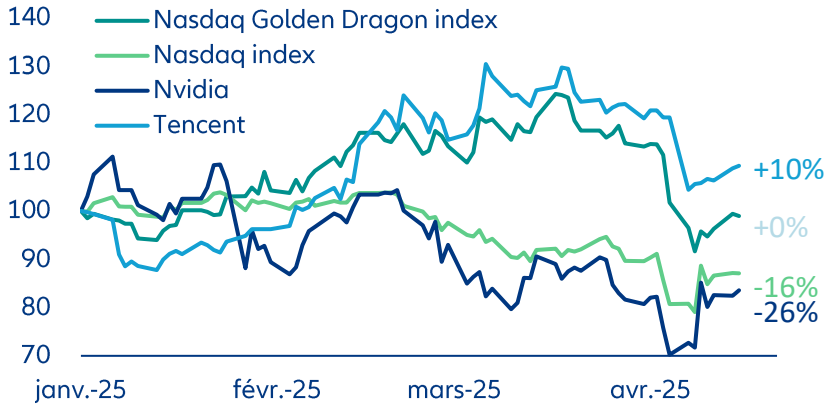


Sources: Corporate filings, Bloomberg, Allianz Research

Ultimately, an outright ban on chip sales to China is a counterproductive move. The new restrictions – and the looming risk of specific tariffs on semiconductors – add to the pressure on US tech companies that are already struggling with tariff-related recession risks and scrutiny from domestic regulators over alleged monopoly practices (Google and Meta are both currently facing non-compliance investigation processes). Since mid-February, the US tech sector has seen a strong sell-off, with the Nasdaq Index down -30% as investors fear a severe drop in revenue and profitability, with a recession looming. With earnings guidance likely to be revised down over the next few months, US tech companies urgently need to convince investors that the short-term turmoil is only cyclical, mostly dependent on temporary unfavorable external factors, and not structural. This would imply controlling costs imposed by new tariffs and finding new sources of revenue that are not dependent on China but also demonstrating that huge investments made in AI technology are not in vain. Investors have been relatively complacent so far but

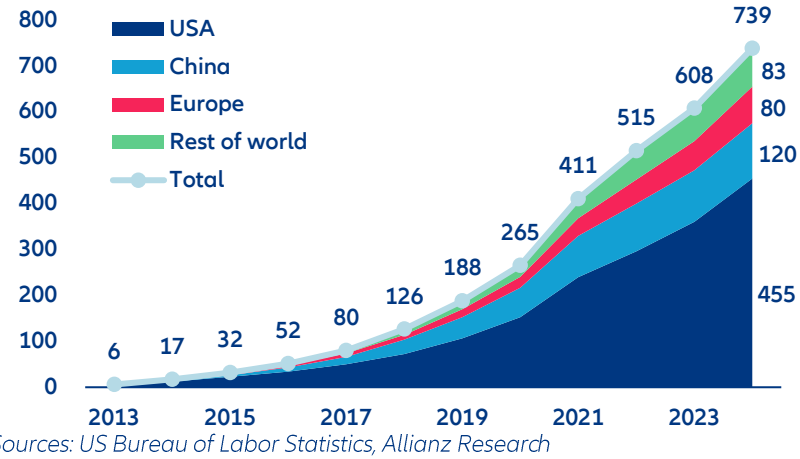
amid the radical change of economic conditions, technology companies urgently need to deliver first tangible results to cool down ongoing nervousness. In contrast, the skies are looking clearer for China's tech industry. Large corporates like Huawei and Tencent are already developing their own cutting-edge AI-linked chips that are expected to be incorporated in AI-capable laptops, mobiles and also automobile software systems. In fact, the US's isolationist approach could even backfire if it sparks an acceleration of public investment into AI technology in China to build up a strong domestic ecosystem far less reliant on US chips but also cheaper. Even though it could take some years for China to narrow fully the technology gap with the US, the gradual emancipation of China and its ability to build-up a reliable and innovative counter-model (as seen in the electric vehicle industry) might reshuffle cards and dent the US's dominant position. Indeed, some emerging economies might in the near future favor Chinese technology over that of the US to develop their own AI infrastructure.

Figure 17: Year-to-date performance of equity index and share price



Sources: LSEG Workspace, Allianz Research

Figure 18: AI private investments (cumulative amount in USD bn, 2013-2024)



Sources: US Bureau of Labor Statistics, Allianz Research

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

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