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What to watch: Middle East conflict rattles markets, the fog of (trade) war and diverging rate paths across emerging markets

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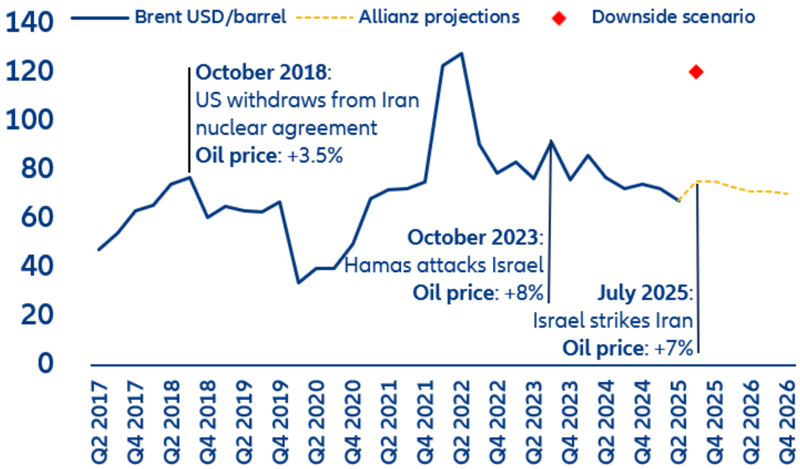
In summary

- **Israel-Iran escalation jolts oil markets, raising stagflation risks.** Brent crude prices jumped about 20% above early June levels due to fears of disruptions to oil flows. While Iran's exports are constrained by sanctions, the risk of broader regional escalation remains, particularly concerning the Strait of Hormuz, handling 20% of global oil and gas shipments. A prolonged blockage could push oil prices above 100 USD/bbl. Currently Brent is expected to remain between 70 USD/bbl and 80 USD/bbl, reflecting a moderate risk premium. Oil-consuming nations may release strategic reserves and OPEC producers could adjust capacity to stabilize markets. Financial markets have shown caution, with volatility in stock indexes, though major US and European markets recovered initial losses. Bond markets have been fairly stable but could see increased yields if tensions escalate further. Currency fluctuations were notable, particularly for the Israeli shekel and Iranian rial. The resolution timeline is uncertain, with a baseline scenario of contained military exchange and ongoing diplomatic efforts, though risks of more severe conflict persist.
- **The fog of (trade) war: Looking for evidence.** With the US effective tariff rate rising to 8% in May 2025, US importers already face increasing costs and deteriorating profitability. However, the rate should theoretically have been 13%, suggesting that frontloading, rerouting and substitution effects are at play. Even in May, frontloading in certain sectors seem to have continued (Taiwanese exports to the US were +63% above trend). Meanwhile Chinese exports to the US are collapsing but those to ASEAN and Latin America are accelerating. We estimate that rerouting through India and ASEAN covers around 40% of the shortfall in Chinese exports to the US. The share of Asia as a whole within US imports has been relatively stable (at around 40%) for most of the past decades: in the 2000s and early 2010s, China gained market share over other exporters in East Asia and is now conceding part of it to South and Southeast Asia.
- **No one-size-fits all: Emerging market central banks chart distinct easing courses.** 32 large emerging markets that account for more than 35% of global GDP will be easing monetary policy in the second half of 2025, supported by ongoing FX appreciation and receding inflation; 23 of them will continue easing well into 2026. But trade tensions, commodity price volatility and fragmentation in general mean that not everyone is marching in step with the Fed, expected to ease by 100bps by end-2026, as should Hong Kong, Chile and Middle Eastern countries. We identify four clusters: (i) those boldly leading the trend with an ambitious rate-cut path by end-2026, often coming from double-digit inflation (Mexico, Hungary, Argentina, Türkiye) but at risk of stalling should oil prices rise further and/or FX depreciation accelerate; (ii) those that were initially bolder but are less so now as inflation emerges again (Czechia, Kenya); (iii) laggards that will move ahead of the Fed (Poland, Romania), thanks to FX appreciation and moderating growth, leading to back-to-target inflation and (iv) those that will pursue moderate rate cuts (China, South Africa, Morocco, India, Indonesia, Philippines, Thailand, Taiwan, Malaysia, Vietnam) as they approach the end of their easing cycles and balance risks between inflation, growth and currency. Brazil remains the EM exception, continuing its own soon-to-end hiking cycle to fight inflation.

Israel-Iran escalation jolts oil markets, raising stagflation risks

The longstanding tensions between Israel and Iran escalated dramatically over the last week, sending tremors through global energy markets. Brent prices surged +20% above early June prices, reflecting a "geopolitical fear premium" as traders braced for potential disruptions in Middle East oil flows. This uptick mirrors the pattern seen in past geopolitical scares: During the June 2019 tanker attacks near the Strait of Hormuz, oil prices leapt about +4% in a day; the US strike on Iranian General Soleimani in January 2020 also pushed Brent up by close to +4%. In 2006, Israel's conflict with Hezbollah in Lebanon helped lift Brent close to a then-record 80 USD/bbl. Historical comparisons suggest that if the current confrontation remains limited – confined to rhetoric and proxy clashes without major supply disruption – oil prices may spike by 5-10%, with intraday surges if any incident occurs, but then stabilize. But absent actual supply loss, global spare capacity and high inventory buffers will help cap sustained increases, as seen in early 2020. Indeed, OPEC+ has recently announced significant increases in production and the oil market is also in a glut[1] in 2025.

Figure 1: Oil prices react to Middle East developments



Sources: LSGE Datastream, Allianz Research

A localized Iran-Israel conflict would not cut oil output significantly: Iran's exports are already constrained by sanctions and it produces "only" 5% of global oil. Yet the risk of broader regional escalation is non-trivial. Iran could threaten shipping in the Persian Gulf or encourage proxy attacks on Gulf oil infrastructure. Historical precedents illustrate the stakes: The 1973 Arab-Israeli War's oil embargo and the 1979 Iranian Revolution each removed about 5-10% of global oil supply and caused oil prices to double within months. Even the smaller 1990 Gulf War shock saw crude prices double from 18 USD/bbl to 36 USD/bbl in less than three months. A comparable supply disruption today could propel Brent well into triple digits.

All eyes on the Strait of Hormuz: the shipping chokepoint of 20% of the world's oil and gas. A blockage of the strait for a sustained period could send oil prices above 100 USD/bbl. In such a scenario, gas supplies would also be affected as Qatari and Gulf LNG tankers go through the Strait before reaching Asia, Europe and elsewhere. For now, the base case is less apocalyptic. The most likely scenario is that the crisis injects a persistent but moderate risk premium into prices. Brent could hover in an elevated range between 70 USD/bbl to 80 USD/bbl as long as tensions simmer. This reflects both precautionary stockpiling and speculative positioning against worst-case scenarios. Oil-consuming nations might respond by releasing strategic reserves to calm markets, while OPEC producers (notably Saudi Arabia) could further tap spare capacity. But OPEC's reaction may be cautious: Middle East producers enjoy higher revenues from geopolitical premiums and may prefer to keep the current status quo unless a true supply shortfall emerges.

[1] *See our previous report "What to watch: Drill, baby, drill no more, trade war ripple effects on Germany and Asian currencies leaving us a message?"*

Recent oil price fluctuations could slash US and European growth by less than -0.1pp, leaving unchanged our baseline scenario. A sustained oil price increase acts like a classic supply shock, boosting inflation while dampening growth (stagflationary pressure). The magnitudes, however, are moderate today compared to the 1970s due to improved energy efficiency and a smaller oil share in GDP. In 1973, oil comprised nearly half of global energy consumption; today it is about one-third. Consequently, a price shock now, while painful, tends to have milder effects on output and inflation than in the past. An increase of +10 USD/bbl as seen over the past week adds about +0.2pp to US inflation and shaves roughly -0.1pp off GDP growth. Europe faces a similar effect: every 10% oil price rise (in euro terms) lifts Eurozone inflation by about 0.1-0.2pp and European GDP would also be slashed by -0.1pp.

Financial markets have remained cautious, but volatility will continue. By the close of Friday 13 June, the S&P 500 had declined by -1.1%, while European stocks also moved on the downside (Stoxx Europe 600: -0.9%). Regional stock markets had more substantial reactions to the events as Dubai declined by 5% and Abu Dhabi by 3.5%. Those moves were accompanied by flight-to-haven dynamics with western government bond yields dropping and save haven currencies like the Swiss Franc gaining. Yet, by Monday 16 June, as a de-escalation seemed plausible, the initial risk-off market reaction was largely priced out again. Major US and European stock indexes had recovered almost all Friday losses. Under our current baseline scenario, the bond market including US and Eurozone 10Y yields are forecasted to remain in current levels. Further escalation, including the targeting of Iranian oil exporting infrastructure or a blockage of the Strait of Hormuz, could see government bond yields in the US and the Eurozone increase by 30 to 50bps as higher oil prices and subsequent inflation worries would trigger hawkish central bank responses. Major currency moves were felt in the region following the initial strikes, with the New Israeli Shekel lost 3.5% on initial moves but has since regained much of the decline. The Iranian rial lost around 10% following the initial strikes, erasing all the gains of the last few weeks following Iranian-US talks.

The timeline for resolving the current situation remains uncertain. Our baseline scenario (with a probability of 55%) considers a contained military exchange for a prolonged period without the targeting of energy exporting infrastructure in Iran, nor other military powers. Yet a downside scenario is still a possibility (30%) as Israeli leaders have signaled intentions to continue their current course of action. This would involve the active targeting of all types of energy infrastructure, the involvement of outside military powers and the closure of the Strait of Hormuz. In the background, an upside scenario is also considered (10%) as diplomatic efforts are still ongoing. Tehran signaled earlier on 16 June an intention to return to the negotiating table.

Table 1: Escalation scenarios of the Israel-Iran conflict

Upside scenario (10%)
Diplomacy succeeds

Description: *The war is short lived thanks to a settlement reached between Israel and Iran brokered by the White House. Energy markets return to levels pre-June 13th, and a normalization of relations between the West and Iran begins. It could include further positive ramifications in the region*

Channels of impact & magnitude of the shock
- *Oil prices: 66 USD/bbl*
- *EURUSD: stable at 1.15 year-end*
- *10y US and EZ gov. bond yields around current levels*
- *Economic impact: GDP, inflation*

	2025 GDP	2025 Inflation
Eurozone	1.2%	1.9%
US	1.6%	3.2%
China	4.5%	1.0%
World	2.5%	4.0%

Baseline scenario (55%)
Contained military exchange

Description: *Conflict mainly limited to Israel, Iran, Syria and Lebanon. Energy and transport infrastructure remain spared. The US, EU and UK pressure for de-escalation but remain ready to intervene if necessary. China works in the background to avoid the Strait of Hormuz blockage and risk supply disruption for oil.*

Channels of impact & magnitude of the shock
- *Oil prices: 75 USD/bbl*
- *EURUSD: stable at 1.15 year-end*
- *10y US and EZ gov. bond yields around current levels*
- *Economic impact: GDP, inflation*

	2025 GDP	2025 Inflation
Eurozone	1.2%	1.9%
US	1.6%	3.2%
China	4.5%	1.0%
World	2.5%	4.0%

Downside scenario (30%)
Full regional war with US, Europe, UK and Gulf military involvement

Description: *Israel target Iranian infrastructure and ports.*
Iran retaliates in the Gulf via proxies. The Strait of Hormuz is closed, and oil supply chain is disrupted globally. US, Europe, UK, Gulf countries intervene to secure trade routes and critical infrastructure.

Channels of impact
- *Oil prices: 120 USD/bbl*
- *USD appreciation by 10% vs the EUR*
- *10y US and EZ gov. bond yields increase by 30-50bp*
- *Economic impact: GDP, inflation*

	2025 GDP	2025 Inflation
Eurozone	0.4% (-0.8pp)	2.6% (+0.7pp)
US	0.7% (-0.9pp)	4.4% (+125pp)
China	3.41% (-1.1pp)	0.9%(+0.7pp)
World	1.7% (-0.8pp)	4.8% (+0.8pp)

* In brackets change from upside scenario

Note: 5% is left for the tail risk scenario
Sources: Allianz Research

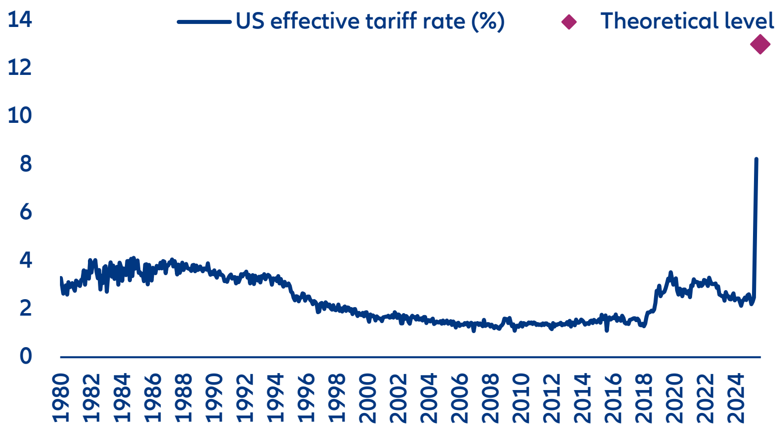
The economic impacts of the conflict in the region have been apparent since the escalation began. In Israel, the normalization that had begun since the start of the war in Gaza in October 2023 has now been brought to a halt.

Strikes are disrupting normal business activity, while defense spending is ramping up. Israel's public debt to GDP was projected to marginally fall to 67.7% in 2025 but the conflict will reverse that; the magnitude of the increase will depend on how long the ongoing exchanges last but it should lead to a deterioration of Israel's credit rating. In Egypt, energy scarcity has resurfaced as the shutdown of Israel's Leviathan gas field disrupted a crucial supply line. With high summer temperatures driving peak gas demand, Egypt now faces the prospect of purchasing emergency LNG supplies ahead of schedule. This comes at a time when LNG prices surged by +6.6% last Friday, leading to increased costs for both the public and private sectors, which are already grappling with a cost-of-living crisis and inflation at 16.8% as of May 2025, compounded by a challenging fiscal position of the sovereign. In the Gulf, higher oil prices (75USD/barrel in our current baseline scenario) will profit government coffers, especially in Bahrain, Kuwait and Saudi Arabia. But credit default swaps have risen since the airstrikes began on 13 June, pointing to higher debt costs both in the Gulf and in Israel.

The fog of (trade) war: Looking for evidence

US trade policies since January should in theory have brought the US global import tariff rate to 13%. But preliminary US customs data put the effective tariff rate at only 8% in May 2025. The US effective tariff rate has increased sharply in the past months from 2.5% in March to 5.6% in April and 8% in May (see Figure 2). However, this is still below the theoretical tariff rate of 13%, calculated based on all the tariff hikes announced and implemented by the Trump administration so far this year, and the 2024 structure of US imports. While some of the gap may be explained by the lack of some data for the moment[2], other phenomena are probably at play to explain the fog surrounding the ongoing trade war. Frontloading, rerouting and substitution effects are likely contributing to a milder shock to trade flows than initially anticipated: global trade in goods will still slow down significantly going forward, but a recession may be avoided – provided the trade war does not escalate further.

Figure 2: US import tariff rate (%)

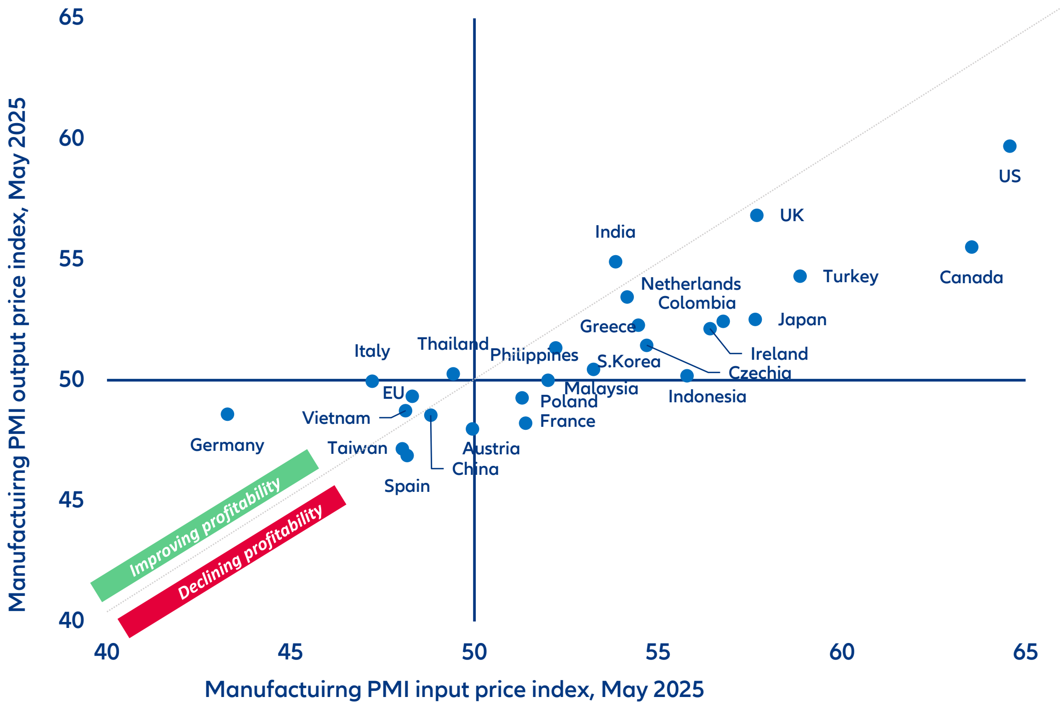


Sources: US Census Bureau, US Bureau of the Fiscal Service, Allianz Research

Even before the dust settles on tariffs, US importers are already starting to feel the impact through increasing costs – and deteriorating profitability. The input price index of the US manufacturing PMI has risen sharply in the past few months: From 56 on average in 2024, it reached 66 in March 2025 – the highest level since August 2022 – and stayed close to that high level in April and May 2025. This is much higher than for the Developed Markets group (at 57 in May) or the world overall (52 in May). In parallel, the output price index of the US manufacturing PMI did not increase as much: from 54 on average in 2024 to 59-60 between March and May 2025. This means that input prices are currently rising at a faster pace than output prices in the US, suggesting corporate profitability is likely to decline. While many other economies are also experiencing input prices rising faster than output prices, the situation is particularly more acute in the US (see Figure 3).

[2] The 8% effective import tariff rate is calculated based on duties collected in May, divided by the value of imports in April. It may be possible that US imports fell in May, thus potentially raising the effective import tariff rate beyond 8%, though it was most likely still some distance from the theoretical 13%. US advance import data for May will be published on 26 June.

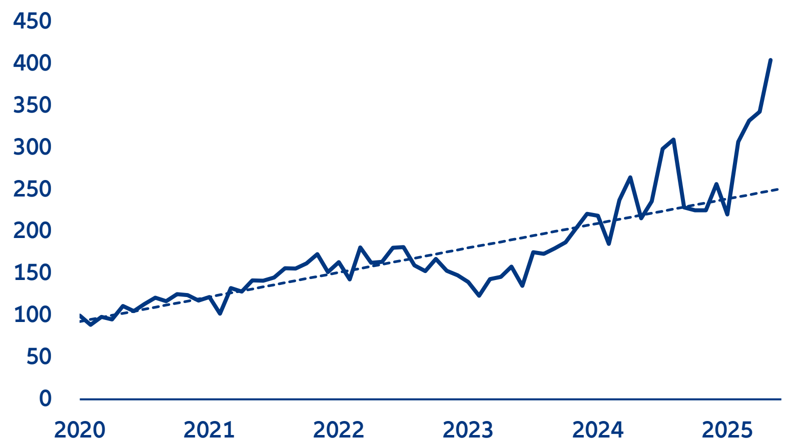
Figure 3: Manufacturing PMI, output and input price indices



Sources: S&P Global, Allianz Research

Frontloading seems to be continuing, especially in sectors such as electronics and pharmaceuticals, dampening the impact of the trade war on trade flows – for now. Total imports in the US were +14% above their 2020-2024 trend in Q1 2025. While the gap turned negative in April (-6%), exports from certain countries and sectors have remained on a very dynamic path in recent months, even after "Liberation Day" in early April. This is likely because a number of products are still exempt from the announced tariff hikes, mostly in the electronics and pharmaceuticals sectors. Notably, Taiwanese exports to the US still exceeded trend levels by +39% in April and +63% in May (see Figure 4). Based on the 2024 trade structure, we find that around 70% of Taiwanese exports to the US are exempt from "Liberation Day" tariff hikes.

Figure 4: Monthly exports from Taiwan to the US (January 2020 = 100)

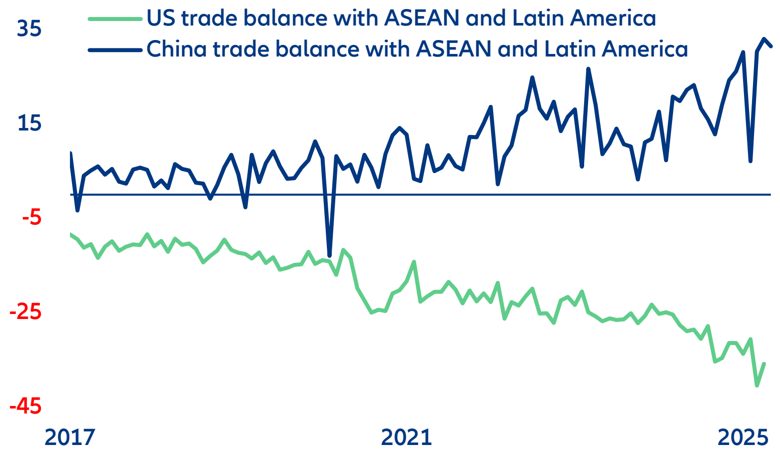


Sources: LSEG Datastream, Allianz Research

Companies are trying to mitigate the impact of the trade war by rerouting: China is exporting more to ASEAN and Latin America, which in turn are also exporting more to the US. In recent months, Chinese direct exports to the US experienced a sharp decline, falling by -21% y/y in April and -35% in May 2025 (compared with +5% y/y in Q1) – even though total Chinese exports continued to grow (+8% y/y in April and +5% y/y in May). Notably, Chinese exports to ASEAN, India and Latin America accelerated in April and May, respectively growing on average by +18%, +17% and 10% y/y. In the meantime, Vietnamese exports to the US grew by +34% y/y in April and +41% y/y in May (after +22% y/y in Q1). Similar outperformance can be observed in US-bound exports from Taiwan (+87% y/y in

May) or from Brazil (+11% y/y), suggesting that some rerouting of Chinese exports might be at play. As a result, China's trade surplus with ASEAN and Latin America increased to USD31.5bn in May 2025 (compared with USD19bn on average in 2024), while the US trade deficit with these regions widened further to USD36bn in April 2025 (compared with USD29bn on average in 2024) – see Figure 5.

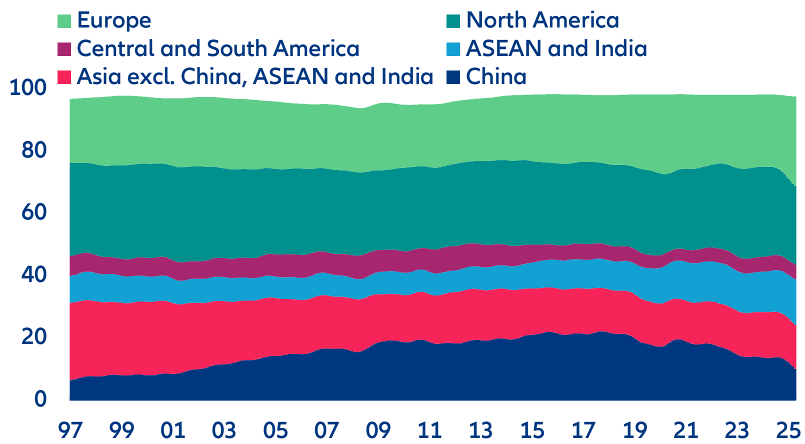
Figure 5: US and China trade balance with ASEAN and Latin America (USD bn)



Sources: USITC, China National Bureau of Statistics, Allianz Research

Rerouting and diversification are causing structural changes to US import sources as businesses are shifting away from direct imports from China and further bringing in third countries in emerging Asia and Latin America. Since Donald Trump took office in 2017, the share of US imports coming directly from China has seen a dramatic change in trend: After steadily rising from 7% at the end of 1999, it peaked around 22% in 2017, decreased to 13% by the end of 2024 and dropped to 9% in April 2025. In parallel, North American supply chains have further integrated, with Mexico becoming the US single largest trading partner in 2023 (and Canada the third-largest after China). Emerging Asia has also taken a rising position in supplying the US market: The share of ASEAN and India in US imports remained steady around 8% before 2015 and has been continuously rising to reach 13% at the end of 2024 and 17% in April 2025. The upshot is that the share of Asia as a whole within US imports has been relatively stable (at around 40%, see Figure 6) for most of the past decades. In the 2000s and early 2010s, China gained market share over other exporters in East Asia and is now conceding it to South and Southeast Asia.

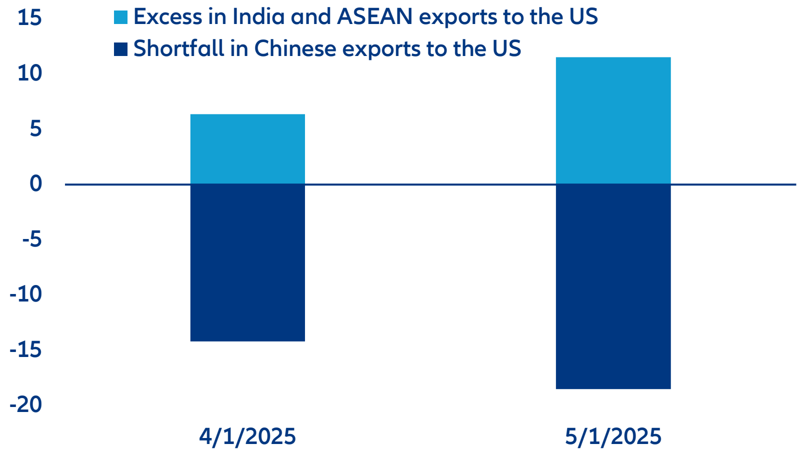
Figure 6: US import breakdown (%)



Sources: US Census Bureau, Allianz Research

We estimate that rerouting through India and ASEAN is currently probably covering around 40% of the shortfall in Chinese exports to the US. Exports to the US from India and ASEAN have been particularly strong since the beginning of 2025, clearly exceeding the trend of the past few years (2020-2024). Q1 was probably more related to companies frontloading shipments ahead of upcoming tariff hikes, and we observe that excess exports accelerated in April and May. For example, the excess in Vietnamese exports to the US stood at just +2% in Q1 2025 and increased to +15% in April (amounting to USD1.6bn) and +31% in May (USD3.2bn). The latter two months were likely supported by rerouting of Chinese shipments originally directly bound to the US as for most of that period after the "Liberation Day", US imports from China were subject to much higher tariff rates. Adding up the numbers for ASEAN and India, excess exports reached USD4bn in April and USD7bn in May. In parallel, Chinese exports to the US were -18% below their trend in Q1 2025, -30% in April (amounting to USD14bn) and -39% in May (USD18bn). This means that the excess in India and ASEAN exports to the US covered 30% of the shortfall of Chinese exports to the US in April and 39% in May (see Figure 7).

Figure 7: Excess and shortfall in exports to the US (USD bn)

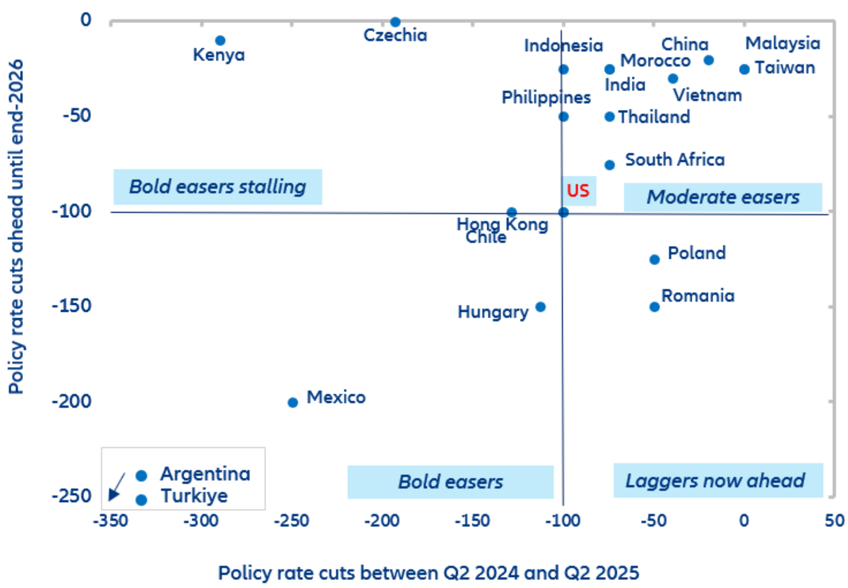


Sources: LSEG Datastream, Allianz Research

No one-size-fits-all: Emerging market central banks chart distinct easing courses

More than 30 large emerging markets that account for more than one-third of global GDP will be easing monetary policy, mostly in the second half of 2025. Beyond the Bank of Japan (BoJ) and the US Federal Reserve (Fed), a number of central banks in emerging markets also held policy meetings this week. With inflation mainly surprising on the downside and the benefit of an average 4.1% FX appreciation since the start of the year, they are well positioned to continue their respective easing cycles. But trade tensions and energy price volatility mean that not everyone is marching in step with the Fed, expected to ease by 100bp by end-2026. We identify four clusters of emerging markets: those that are leading the trend, laggards that are now ahead, bold easers that are now stalling and those that will remain cautious ahead.

Figure 8: Monetary policy easing across EMs relative to the Fed



Note: The graph excludes Brazil, Nigeria, Russia, Ghana and Venezuela.

Sources: LSGE Datastream, Allianz Research

Mexico, Chile and Hungary are boldly leading the trend. Higher levels of inflation forced several EMs, including Hungary and Mexico, to hike policy rates above 10% in 2023/24. Since the easing cycle begun in mid-2024, these EMs have maintained a more aggressive stance than the Fed and continue to plan a more aggressive approach to monetary policy. Currently the key interest rate in **Hungary** stands more than 1pp above the neutral rate and the easing cycle is delayed until spring 2026 – 150bps after the election and the aftermath of the expected fiscal easing. Inflation should decelerate to 3%, closer to the target. **Mexico**'s monetary policy has been among the most prudent in EMs since the start of the easing cycle. The central bank may revise its forward guidance to smaller cuts in the next 18 months but is still expected to deliver -200bps by end-2026. This comes amid weakening economic fundamentals in the context of the US trade war and contracting remittances (likely -2% in 2025, while remittances represent 3.5% of GDP and 6% of household consumption), with more than 2pps of distance between the estimated neutral rate and the policy rate, underscoring a still-restrictive monetary stance. In **Chile**, as core inflation moderates and copper-driven revenues stabilize fiscal prospects, the central bank is expected to ease between Q4 2025 and 2026 (-150bps in total). However, lingering uncertainty over the 2026 general elections might bring inflation back.

In **Argentina**, Milei's shock therapy has stabilized inflation faster than expected (219% in 2024; expected at 40% in 2025). On the other hand, doubts remain over the durability of reforms. The midterm legislative elections in four months will be a key test of political support for the libertarian experiment. Nevertheless, contained inflation means the central bank is likely to consider larger rate cuts in the future: we expect a decrease between -1200bps and -1400bps by late 2026, to 16%. In **Türkiye**, the central bank is coping with persistent cost-push inflation (labor costs, real exchange rate on the way up and poor harvests expected this year), narrowing corporate margins and intensifying political pressure to loosen policy. While the key rate was briefly lowered earlier in the year, effective tightening via elevated funding costs signals a cautious, backdoor approach to disinflation. Any premature easing risks reigniting lira volatility and undermining the fragile progress on inflation. We expect the Turkish central bank to lower the key rate by some -2000bps to 21% by the end of 2026, with the lira depreciating further to around TRY45 per USD by December.

The second category is laggards that are now ahead of the Fed, namely Poland and Romania. Inflationary pressures linked to expansionary fiscal policies and political uncertainties leading to currency volatility have kept central banks in Warsaw and Bucharest on hold for longer than previously forecasted. However, a successful taming of price pressures is positioning both nations to ease faster than the Fed moving forward. In **Poland**, strong wage growth and expansionary fiscal policy are expected to push inflation above 4% in 2025 before easing toward the upper end of the NBP target band (2.5% ±1pp) by end-2026. The NBP resumed easing in May 2025, lowering its policy rate to 5.25%, following weaker economic indicators. Further cuts are expected, with headline inflation slowing to +4.0% in May. In **Romania**, inflation remains elevated and persistent. The NBR is expected to hold its rate at 6.5% through 2025, with cuts likely only in 2026. Inflation rose again in May to 5.5%, staying well above the 2.5% ±1pp target range, and it is expected at 3.5% end 2026 by the end of 2026. Political uncertainty, currency pressures triggered by significant capital outflows after the first round of presidential elections and a looming credit-rate downgrade due to fiscal mismanagement are also limiting scope for easing. Romania thus shows one of the slowest rates cutting circles worldwide. However, since the start of the year, both Poland and Romania's currencies have appreciated by more than 10%.

Czechia and Kenya were leading the Fed but are now stalling as inflation is on the rise again. In **Czechia,** inflation returned to within the CNB target range after it cut its rate by 325bps between December 2023 and May 2025. Further easing is now unlikely as inflation is rising again – expected at 2% at end 2026 – and the current policy rate matches the estimated neutral rate, suggesting that the CNB's rate-cutting cycle may be nearing its end. In **Kenya,** inflation began climbing back up in the first half of 2025, reaching 4.1% in April and 3.8% in May 2025. The central bank cut by 25bps in June 2025, but higher inflation points to only one extra cut by the end of 2026.

The last category are the emerging markets that are still lagging the Fed, including South Africa and several Asian nations such as Thailand, Taiwan, Malaysia and China. South Africa has executed four 25bps reductions within the last 24 months – the latest in May 2025 – in response to growth challenges exacerbated by the trade war, the suspension of US aid funds and political uncertainty. In this context, we foresee the SARB continuing its easing cycle with one extra cut in 2025, ending the year at 7% and two more 25bps in 2026. South Africa's reserve bank is currently planning to lower its inflation target from the current 3-6% target to 3%. In **Thailand**, inflationary pressures are scarce (we expect 0.5% in 2025 and 0.6% in 2026), given soft domestic demand. The Bank of Thailand has delivered -75bps worth of policy rates since October 2024, and we expect -50bps further by the end of 2025 (and no change in 2026). In **Taiwan**, inflationary pressures are contained (we expect 1.4% in 2025 and 1.3% in 2026) and the trade war environment has not hit the economy sharply yet. The central bank has stayed put until now and we expect cautious easing going forward, with rate cuts worth -25bps in 2025 and -13bps in 2026. In **Malaysia**, inflation has been mild so far this year (year-to-date average at 1.5%). But Bank Negara Malaysia (BNM) will be wary of upside inflation risks (we expect 1.9% on average in 2025 and 2.2% in 2026) and pressure on the ringgit. We expect BNM to ease its monetary policy cautiously, with just one -25bps rate cut this year (and no change in 2026). In **Vietnam**, the State Bank of Vietnam (SBV) will try to find the balance between moderate inflation (3% in 2025 and 2.8% in 2026 likely, vs. central bank target of 4.5-5%), downside risks to economic growth and managing a controlled depreciation of the dong. In this context, we expect the SBV to cut policy rates by -50bps this year (and not change in 2026). In **China**, inflationary pressures remain weak (+0.2% expected in 2025), giving room for the PBOC to deliver further monetary easing. After -40bps since July 2024, we expect another -10bps cut in the seven-day reverse repo rate this year, and -20bps in 2026.

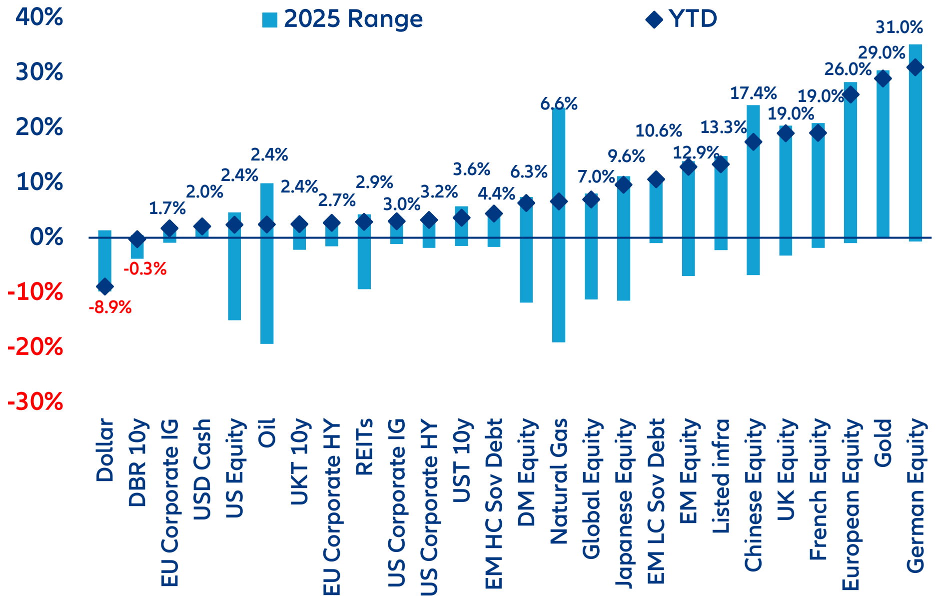
Some emerging markets are charting their own path but will still lag behind. Since the start of the easing cycle, emerging markets in Asia and Africa have mirrored the Fed's moves pushed by decreasing inflationary pressures, FX appreciations and limited fiscal pressure. However, growing inflation headwinds and global economic uncertainties amid the trade war and instability in commodity prices have been pushing central banks from Rabat to Jakarta to be more cautious in the next phase of easing.

In **Morocco**, inflation returned below 1% y/y in April after the surge during the month of Ramadan that brought CPI in February to 2.6%. After implementing three 25bps cuts over the past year, we do not foresee more cuts during the rest of 2025, and only one further 25bps cut in 2026. In **Indonesia** and the **Philippines,** inflation is expected to remain largely within the central bank target ranges of 1.5-3.5% (1.8% expected in 2025 and 2.8% in 2026) for the BI and 2-4% for the BSP. We expect a further -25bps worth of rate cuts in the rest of 2025 (and no change in 2026) in Indonesia, and another -25bps rate cut by the end of the year (and no change in 2026) in the Philippines. Indonesia's current policy rate is less than 1pp away from its estimated neutral rate, while Manila's rate continues 2pps above its estimated neutral rate, pointing to greater easing moving forward. In **India**, inflation has been sitting well within the central bank target band (4% +/-2pp) for most of the time since late-2023 and is expected to average 3.8% during calendar year 2025. The Reserve Bank of India (RBI) has started its easing cycle this year, already cutting its policy rate twice by a total of -100bps, -50bps in the latest board meeting in June. We expect no further rate cuts in the remainder of this year (and no change in 2026).

And Brazil continues with its own hiking cycle. Inflation showed signs of relief in May 2025, falling by 0.2pp to 5.3% y/y after having increased since April 2024. Growing fiscal and exchange rate pressures pushed Brazil to embark on a tightening cycle in October 2024 that brought interest rates to 15% today, around 10pps above inflation. With consumer credit growth slowing to below 7% year-on-year, rising problem loans – especially among small and medium-sized enterprises – and a deceleration in economic growth due to reduced fiscal spending, the BCB is expected to begin cutting policy rates in Q4 2025, with total reductions reaching 400bps by the end of 2026.

Continued easing should prove broadly supportive for EM assets. While portfolio inflows into EMs remain relatively subdued, they have shown a clear uptick compared to the previous year. We expect further improvements as the USD cycle turns weak and momentum in EM assets builds: EM stocks have outperformed developed market (DM) peers by 6.6pps, while local- and hard-currency sovereign bonds have delivered total returns of 10.6% and 4.4%, respectively. This strong performance should further encourage foreign inflows, particularly given persistent structural under-allocations to EM across global portfolios. Looking ahead, lower policy rates should continue to support domestic demand and corporate earnings, despite elevated geopolitical and trade uncertainty. Easing cycles also provide upside for equity valuations, with EM stocks still trading at roughly a 35% discount to DM peers, and nearly 45% relative to UK stocks. Continued monetary easing and a weaker dollar should support local currency performance, while resilient fundamentals and high carry continue to anchor hard currency debt. Overall, continued EM easing is expected to remain supportive for both EM bonds and equities, although a sharp reversal in FX trends or renewed dollar strength could pose risks, particularly for dollar-denominated EM equities and local currency bonds.

Figure 9: Global asset performance ytd



Sources: LSEG Datastream, Allianz Research

Note: Equity and EM local currency sovereign bond returns are shown in USD terms; Data as of Jun 17, 2025

Table 2: Main inflation and monetary indicators in selected emerging markets

Region		Inflation										Policy rate			
		Target	Latest	2025 Forecast	2026 Forecast	Gap	Trend	Rising/falling		Closer to the target		Latest	Last move (bps)	Exp. change in H2 2025 (bps)	Exp. change in 2026 (bps)
								-3 m	-6 m	-3 m	-6 m				
Latam	Brazil	3.0%	5.3%	5.0%	4.5%	2.3%		↑	↑	✗	✗	15.0%	+25	-50	-350
	Mexico	3.0%	4.4%	4.2%	3.9%	1.4%		↑	↓	✗	✓	8.5%	-50	-100	-100
	Chile	3.0%	4.4%	4.4%	2.9%	1.4%		↓	↑	✓	✗	5.0%	No change	-50	-50
	Colombia	3.0%	5.1%	5.0%	3.6%	2.1%		↓	↓	✓	✓	9.25%	-25	-50	-100
	Peru	2.0%	1.7%	1.9%	3.1%	-0.3%		↑	↓	✓	✗	4.5%	No change	-50	-25
	Argentina	5.0%	43.5%	40.0%	20.0%	38.5%		↓	↓	✓	✓	29.0%	-300	-700	-900
CEE	Czech Republic	2.0%	2.4%	2.7%	2.5%	0.4%		↓	↓	✓	✓	3.5%	-25	-50	0
	Poland	2.5%	4.3%	4.6%	3.8%	1.8%		↓	↓	✓	✓	5.25%	No change	-100	-75
	Hungary	3.0%	4.4%	4.7%	3.8%	1.4%		↓	↑	✓	✗	6.5%	No change	No change	-150
	Romania	2.5%	5.4%	3.6%	3.8%	2.9%		↑	↑	✗	✗	6.5%	No change	No change	-150
	Turkey	5.0%	35.4%	32.4%	18.8%	30.4%		↓	↓	✓	✓	46.0%	+350	-600	-1500
EM Asia	China	2.0%	-0.1%	0.2%	1.0%	-2.1%		↑	↓	✓	✗	1.4%	-10	-10	-20
	India	4.0%	2.8%	3.8%	4.2%	-1.2%		↓	↓	✗	✓	5.5%	-50	No change	No change
	Taiwan	2.0%	1.5%	1.4%	1.3%	-0.5%		↓	↓	✗	✗	2.0%	No change	-25	-13
	South Korea	2.0%	1.9%	1.8%	1.8%	-0.1%		↓	↑	✗	✓	2.5%	-25	-50	No change
	Malaysia		1.4%	1.9%	2.2%			↓	↓	✓	✓	3.0%	No change	-25	No change
	Indonesia	2.5%	1.6%	1.8%	2.8%	-0.9%		↑	↑	✓	✓	5.5%	-25	-50	No change
	Thailand	2.0%	-0.6%	0.5%	0.6%	-2.6%		↓	↓	✗	✗	1.8%	-25	-50	No change
	Philippines	3.0%	1.3%	1.9%	2.4%	-1.7%		↓	↓	✗	✗	6.0%	-25	-25	No change
	Vietnam	4.0%	3.2%	3.0%	2.8%	-0.8%		↑	↑	✓	✓	4.5%	No change	-50	No change
Africa	South Africa	4.5%	2.8%	3.3%	4.5%	-1.7%		↓	↑	✗	✓	7.25%	-25	-50	-50
	Egypt	7.0%	16.8%	15.0%	13.0%	9.8%		↑	↓	✗	✓	24.0%	-100	-325	-525
	Morocco	2.0%	0.7%	1.3%	2.1%	-1.3%		↓	↓	✗	✗	2.25%	-25	-25	-25
	Nigeria	7.5%	23.0%	19.9%	13.6%	15.5%		↓	↓	✓	✓	27.5%	No change	-325	-675
	Kenya	5.0%	3.8%	4.6%	6.0%	-1.2%		↑	↑	✓	✓	9.75%	-25	-10	0

Sources: LSGE Datastream, Allianz Research

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