

What to watch: Steady rates and shifting seats for the Fed, US-EU trade on the rocks and reading between the (market) lines

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In summary

Fed: Steady rates, shifting seats. Amid sticky price pressures and lingering uncertainty on the effect of tariffs on inflation, the FOMC is expected to keep interest rates unchanged next week. For now, US firms have absorbed the impact on margins thanks to robust profits so far, while using up their pre-tariff stock. However, some price increases are emerging (e.g. apparel, audio and video equipment, toys) as business surveys and depleting inventories still suggest that output prices will rise in the coming months. We expect the FOMC to remain cautious for the rest of the year, with the first rate cut expected in December. With new FOMC appointees in 2026, increasing pressure on the Fed to lower interest rates should be expected. But new hawks from the regional Feds should ensure a balance between doves and hawks overall. Going forward, the Fed's communication will become increasingly blurry, potentially leading to increased volatility of US assets and inflation.

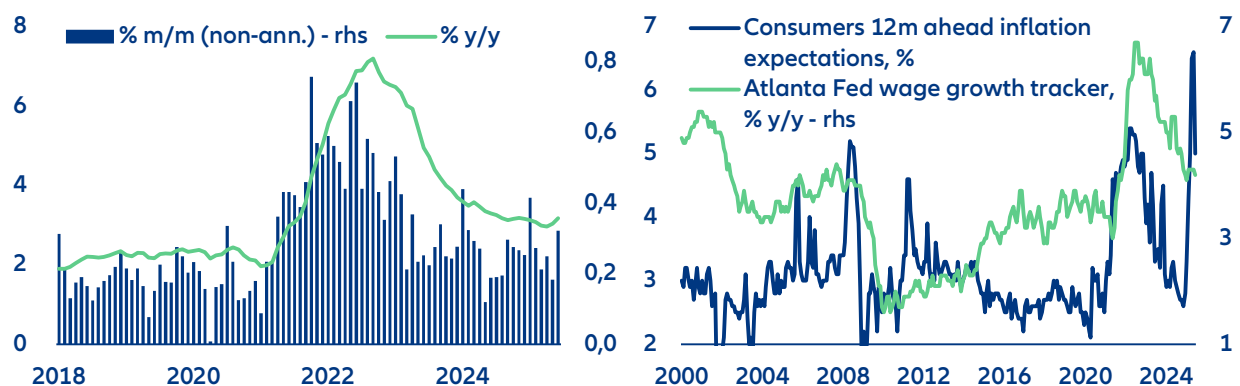
US-EU trade on the rocks. If no additional agreements are reached by 1 August, the average US import tariff will increase to 20%, causing significant economic damage. Though a few deals have recently been reached, notably with Japan (reducing the tariff rate from 21% to 13%), the administration has also escalated tensions elsewhere, such as with the +30pps tariff hike on Mexico and the +25pps tariff on previously exempt sectors, including pharmaceuticals and semiconductors. The EU could face tariff increases of +15pps from the 1.3% tariff before the trade war (with a downside of +30pps). In this context, the EU could lose USD53bn in exports to the US. Germany, Ireland, Italy and France would be most affected. EU GDP growth could shrink by -0.3pp annually and up to 250,000 EU jobs could be lost, raising the EU unemployment rate by +0.2pp. Additionally, a strong euro (EURUSD at 1.15 in 2025 v. 1.08 in 2024) entails an additional 5% drop in EU exports to the US (equivalent to a 1% increase in US tariffs). Lastly, if talks collapse, the EU is prepared to retaliate with tariffs on a total of USD93bn in US imports to match the 30% US tariffs, which could worsen the trade outlook for European exporters. To mitigate the impact, the EU will have to accelerate trade deals covering 25% of export losses with the US, boost intra-EU trade by 1.1% and promote strategic autonomy.

Pricing soft, hedging hard: Reading between the market lines. Equity markets are pricing in an exceptionally optimistic soft landing of the US economy, even outpacing the goldilocks eras of the 1990s and early 2000s. The current post-tightening equity rally is the strongest since at least the 1960s. But gold prices echo the stagflationary hard landings of the 1970s, signaling systemic tail risks and economic uncertainty. This divergence shows that the current momentum in equity markets has limited upside as underlying economic and geopolitical risks could quickly derail the optimistic market pricing. Against that background, we confirm our cautious equity market outlook that sees no further gains in equity markets from current levels until year-end.

Fed: Steady rates, shifting seats

The FOMC is expected to maintain its “wait and see” approach at next week’s meeting amid sticky price pressures and lingering uncertainty on the inflation effect of tariffs. The FOMC should keep the Fed Funds target in the 4.25-4.5% bound at its next meeting on 30 July, a level it has been stuck at since December 2024. Data continue to point to a softening yet resilient economy despite disruptive macro policies and elevated policy uncertainty. June retail sales rose a solid +0.6% m/m – reversing most of the -0.9% drop in May – and increases were broad-based across most categories. However, the backdrop of household consumption remains weak, with real personal consumption expenditures flat since end-2024. Moreover, the retail sales data pointed to two areas of increasing weakness: furniture and electronics retail sales, which both edged down following slightly larger declines in May, suggesting tariffs are beginning to weigh on spending in those areas. On the price front, inflation and wage growth remain sticky. While the uptick in the June CPI to +2.7% y/y was driven by energy prices, the trimmed-mean CPI – which excludes the more volatile 16% of items – did also pick back up to +3.2% (Figure 1, left), pointing to persistent underlying price pressures. Meanwhile, wage growth has not shown any clear signs of easing, with the Atlanta Fed wage growth tracker, for instance, remaining stuck in the 4.1-4.3% pace since November 2024 (Figure 2, right). Short-term inflation expectations from households have pulled back but remain high, indicating a persistent risk of a wage-price loop. Against this backdrop, while the price effect of the tariffs appears limited so far, it is increasingly tangible. Meanwhile, tariff policy remains very volatile despite recent new deals with Japan and the EU. This uncertainty, as indicated by FOMC members (including the Chair), continues to keep the Fed on the sidelines as it awaits more clarity. As long as the economy remains resilient and the effect of tariff on inflation are not clear, we think the FOMC will remain cautious. The latest “dot plot” showed that the two three-cut doves are very much in the minority, with seven people no cuts this year and ten with only one or two cuts. It will take a good deal of persuasion to move the needle toward more rapid monetary easing.

Figure 1: Trimmed-mean CPI inflation (left); consumer inflation expectations & wage growth (right)



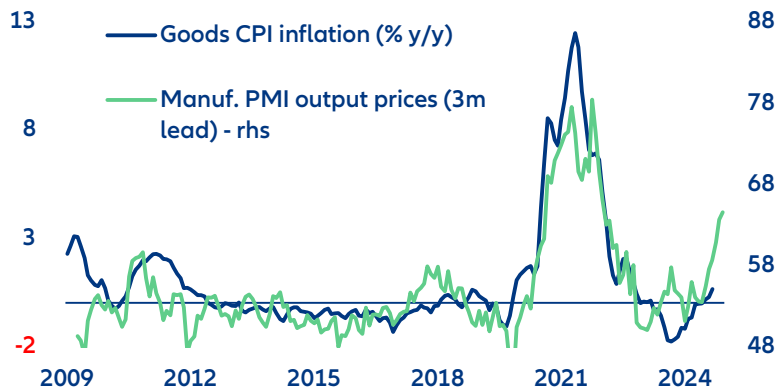
Sources: LSGE Datastream, university of Michigan, Atlanta Fed, Allianz Research

For now, US firms are absorbing the costs of tariffs into their margins and relying on clearing inventories. Business surveys continue to point to transmission to consumer prices in the months ahead. With core goods prices increasing a modest +0.2% m/m in June (after +0.0% in May), the price effect of steep tariff hikes is little visible in the macro data, although pockets of price pressures are starting to emerge in video & audio equipment, apparel, toys and furniture. Nevertheless, goods prices are rising faster than last year, with the year-on-year increase picking up to +0.6% in June (+0.3pp relative to May) – its highest pace since July 2023. Surveys suggest that firms are mostly absorbing tariff costs onto their margins instead of increasing prices – for now. For example, a recent KPMG survey¹ of 300 large US corporations found that more than half (58%) reported that tariffs have reduced their gross margins; around a third of firms said tariffs had cut margins by 1-5%, while a quarter reported a reduction of 6-10%. Fortunately, profit margins are historically high, at 9.2% of gross output in Q1 2025 according to BEA data, against 7.1% on average over the past 15 years. Nevertheless, muted price transmission is unlikely to continue for too long.

¹ [New Data Shows US Businesses Already Experiencing Impacts from Tariffs: More Price Increases and Customer Pushback Expected](#)

Business surveys such as the PMI indicate that output prices are increasingly rising and will transmit to prices before long² (Figure 2). Meanwhile, manufacturing, wholesale and retail inventories point to July-September as the most likely window for firms to start to pass on the costs of higher tariffs to consumers after their inventories are depleted. We still expect about two-third of tariff hikes to be eventually transmitted to the consumer, though potentially more slowly than initially expected.

Figure 2: PMI output prices and goods CPI inflation



Sources: LSGE Datastream, Allianz Research

Doves will be on the rise in the FOMC in 2026 as new members are coming in. However, regional Fed governors will add hawks to the mix, making communication over monetary policy increasingly blurry, and potentially increasing volatility of US assets. We continue to expect 100bps of cumulative rate cuts between December 2025 and mid-2026. Political pressure on the Fed to lower interest rates, and criticism against its Chair Jerome Powell, remains high. The top contenders to succeed Powell as Board Chair are Kevin Hassett, Kevin Warsch and current Board member Christopher Wallers, though Treasury Secretary Scott Bessent also remains a possibility. A new appointee will likely join the Fed Chair in January 2026, replacing Adriana Kugler whose term is expiring. A first pick could be designated as the “new” Chair before Powell’s term as Chair effectively ends in May 2026. Diverging opinions within the FOMC on interest rate policy could thus start to emerge as early as January between a “shadow Chair” and Powell. In May 2026, Powell may decide to remain a board member (his term expires in 2028) to be able to challenge the new Chair, which the Trump administration is trying to avoid by seeking to oust him through legal means³. If Powell decides to step down in May, President Trump will be able to designate a second board member as a replacement (or the actual Chair if not already done in January). Figure 3 classifies the 12-voting FOMC members currently (left) and expected in 2026 (right). Members are ranked on a scale from -10 (most hawkish) to +10 (most dovish). The voting FOMC members comprises the seven Fed board members (including its Chair), who are permanent voters, and five regional Fed presidents who change on a rotating basis. Currently, the average score of the FOMC is +4 and the median score +5, with Waller the most dovish member and Schmid the most hawkish. In 2026, if Powell steps down, and Warsch and Hasselt step in (both ranked at +10 as they would likely be loyal to President Trump), the average and median scores would remain at +4 and +5, respectively. This is because the new doves Warsch and Hassett would be offset by new hawks Logan, Hammack and Kashkari from the Feds of Dallas, Cleveland and Minneapolis, respectively. However, if the equilibrium point of the FOMC remains broadly unchanged, diverging views would increase, with a standard deviation increasing from 4.7 to 5.9.

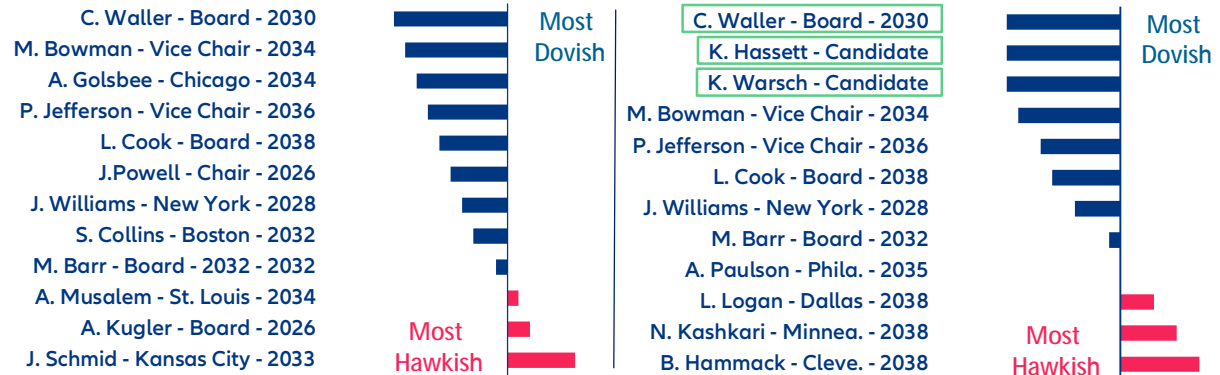
What does this mean for US monetary policy? First, while pressure on the Fed to decrease interest rates will step up further in 2026, there will still be strong pushback within the FOMC against too loose monetary policy (unless the economy weakness substantially and/or inflation drops). Second, the Fed may become less of a consensus-driven central bank, which will blur its communication and weaken the predictive power of policy direction. Public disagreement and conflicting messages between the next Chair (dove) and FOMC hawks may undermine the Fed’s credibility credentials, potentially leading to higher inflation expectations, actual inflation and interest rate

² See also the NY Fed Regional Business Survey and the Richmond Fed/Duke CFO Survey.

³ Cf. [the accusations put forward against Powell surrounding renovations at the Eccles Building and 1951 Constitution Avenue](#).

volatility. In all, we continue to expect the bulk of interest rates interventions in the first half of 2026 as inflation gradually cools toward the target and the economy remains soft but resilient – partly helped by looser fiscal policy (amid the passage of the One Big Beautiful Bill⁴), including new industrial subsidies. We expect the Fed funds target to settle at 3.25-3.5% by mid-2026.

Figure 3: FOMC members current composition (left) and expected in 2026 (right)



Sources: ITC Market Research, Allianz Research

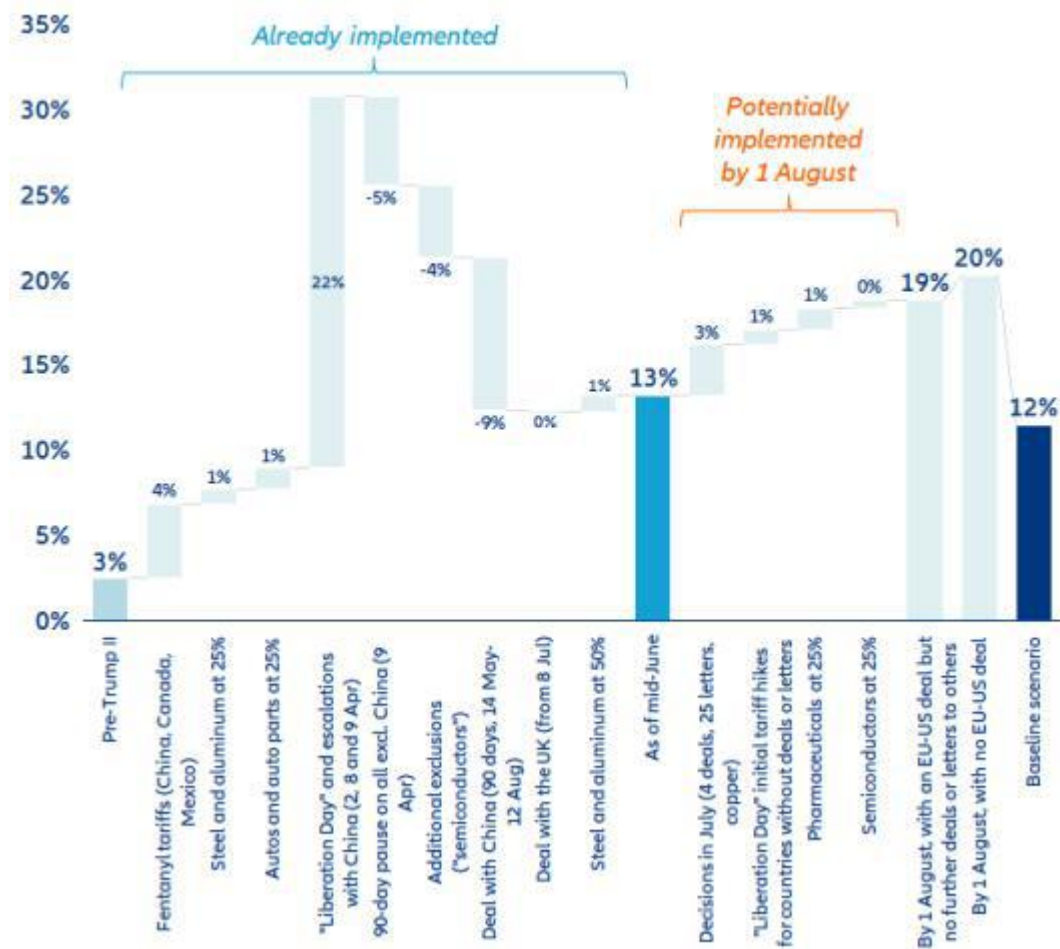
Note: names in a square are potential new Fed (and FOMC) Chair. We assume Powell steps down from his Fed board position after May 2026.

US-EU trade on the rocks

If no further deals are reached before 1 August and tariff threats are acted upon, the US global average import tariff will reach 20%, lower than the almost 30% implied by the initial “Liberation Day” hikes but still substantially higher than 2.5% at end-2024. Over the past two weeks, the Trump administration has issued further trade policy tightening and threats. Mexico could face +30pps instead of the +25pps that has been in place since March (with the same exemption on USMCA-compliant exports). President Trump also said 25% tariffs on imports of pharmaceuticals and semiconductors, which were previously exempted from “Liberation Day”, could be implemented as soon as 1 August. Now, the last mile is on to secure trade deals or extensions before deadlines (1 August for most, 12 August for China). Australia, Chile, Colombia, India, Singapore, Switzerland, Taiwan, Türkiye and the UAE are the remaining large trade partners (together representing 10% of US imports) that are still to either receive a tariff letter or make a deal. Earlier this month, the EU received a tariff letter revising the “reciprocal” tariff to +30pps from the initial +20pps, but recent developments have increased the likelihood of a deal at +15pps (and potentially also a reduced tariff rate on autos and auto parts). This would take the US global average import tariff to 19% by 1 August (instead of 20%).

⁴ Allianz | What to watch | July 11, 2025

Figure 4: US average import tariff



Sources: various, Allianz Research

On a positive note, the US did make deals with Japan, Indonesia and the Philippines, partially reversing previously planned tariff hikes. The truce with China may be extended beyond 12 August. An initial tariff letter earlier in July put the "reciprocal" tariff hike on Japan at +25pps (compared with +24pps on "Liberation Day"). This has been lowered to +15pps after a deal was reached on 22 July. Tariffs on US imports of Japanese autos and auto parts will also be lowered to 15% (from 27.5%). All this should cut the US average import tariff rate applied on Japan to 13%, lower than 21% without the deal, but much higher than 1.5% in 2024. Comments from officials also suggest that the US-Japan deal will include a USD550bn package of Japanese investments and loans benefiting the US (in pharmaceuticals and semiconductors), more Japanese market access given to US autos and rice and a potential joint gas pipeline venture in Alaska. Precise details are still lacking for the moment. Regarding Indonesia, President Trump said US goods will enter Indonesia with no tariffs, and that Indonesia will buy 50 Boeing jets as part of the broader trade agreement. The +19pps "reciprocal" tariff agreed upon is lower than the +32pps that was threatened in the tariff letter Indonesia received previously. Accounting for exclusions, the effective US tariff rate on Indonesia would thus be 24% instead of 34%. The Philippines will also face a +19pps "reciprocal" tariff, which is roughly in line with previous announcements (+20pps in the tariff letter earlier this month, +17pps in the original 'Liberation Day' announcement). This means the effective US tariff rate on the Philippines, accounting for sectoral exemptions, could increase to 12%, compared to 7% in June and less than 2% in 2024. As Indonesia and the Philippines account for only 1% of US imports, the impact on the US global tariff rate is minimal.

Table 1: US average import tariff by country

	US imports		US tariff rate										Maximum export losses	
	USD bn (2024)	share of total (2024)	Pre-Trump II	Before "Liberation Day" *	After "Liberation Day" and related decisions **	With deals found in May (China and UK)	With steel and aluminum at 50%	Decisions in July and likely deal with the EU ***	By 1 August, if no further deals or letters ^	By 1 August, if no further deals or letters and higher basic tariff ^^	By 1 August, adding pharma and semiconductors at 25%	Baseline scenario	2025 (USD bn)	2025 (share of exporters' 2024 GDP)
Argentina	7	0%	0.7%	3%	9%	9%	11%	11%	11%	17%	17%	8%	-1	-0.1%
Australia	17	1%	0.1%	2%	10%	10%	12%	12%	12%	20%	22%	8%	-2	-0.1%
Bangladesh	9	0%	15.1%	15%	25%	25%	25%	50%	50%	50%	50%	33%	-2	-0.3%
Brazil	44	1%	1.0%	4%	11%	11%	14%	40%	40%	40%	40%	24%	-9	-0.5%
Cambodia	13	0%	6.5%	7%	15%	15%	15%	37%	37%	37%	42%	22%	-2	-6.8%
Canada	422	13%	0.1%	10%	10%	10%	12%	15%	15%	15%	15%	9%	-43	-1.9%
Chile	17	1%	0.0%	4%	13%	13%	13%	27%	27%	36%	36%	23%	-4	-1.0%
China	463	14%	13.0%	33%	103%	39%	39%	39%	39%	39%	40%	39%	-111	-0.5%
Colombia	18	1%	0.2%	5%	13%	13%	14%	14%	14%	23%	23%	10%	-2	-0.7%
Ecuador	9	0%	0.4%	1%	6%	6%	6%	6%	6%	12%	12%	4%	-1	-0.5%
EU	618	18%	1.3%	4%	9%	9%	10%	12%	12%	12%	16%	8%	-53	-0.3%
Hong Kong	6	0%	1.4%	1%	94%	9%	9%	9%	9%	9%	9%	9%	-1	-0.2%
India	91	3%	2.4%	4%	10%	10%	11%	11%	23%	23%	27%	14%	-12	-0.3%
Indonesia	30	1%	4.6%	5%	13%	13%	14%	24%	24%	24%	24%	15%	-3	-0.2%
Japan	152	5%	1.5%	10%	14%	14%	15%	13%	13%	13%	15%	12%	-16	-0.3%
Kenya	1	0%	0.3%	0%	8%	8%	9%	9%	9%	17%	21%	5%	0	-0.1%
Malaysia	54	2%	0.7%	1%	5%	5%	6%	15%	15%	15%	22%	8%	-5	-1.1%
Mexico	510	15%	0.3%	4%	4%	4%	4%	5%	5%	5%	5%	4%	-18	-1.3%
New Zealand	6	0%	1.1%	1%	10%	10%	11%	11%	11%	20%	20%	6%	-1	-0.2%
Norway	7	0%	0.6%	1%	6%	6%	7%	7%	9%	9%	10%	6%	0	-0.1%
Pakistan	5	0%	9.7%	10%	20%	20%	20%	20%	39%	39%	39%	24%	-1	-0.2%
Philippines	15	0%	1.5%	2%	7%	7%	7%	12%	12%	12%	15%	7%	-1	-0.2%
Saudi Arabia	13	0%	0.3%	1%	4%	4%	4%	4%	4%	8%	8%	3%	-1	-0.1%
Singapore	44	1%	0.1%	0%	5%	5%	5%	5%	10%	14%	20%	5%	-4	-0.9%
South Africa	15	0%	0.4%	4%	9%	9%	11%	21%	21%	21%	21%	14%	-2	-0.5%
South Korea	135	4%	0.2%	8%	13%	13%	14%	21%	21%	21%	22%	15%	-19	-0.9%
Switzerland	64	2%	0.7%	1%	7%	7%	8%	8%	20%	20%	27%	11%	-8	-0.8%
Taiwan	119	4%	1.2%	2%	5%	5%	6%	7%	13%	13%	16%	8%	-9	-1.0%
Thailand	66	2%	1.4%	2%	8%	8%	9%	25%	25%	25%	28%	14%	-9	-1.4%
Türkiye	18	1%	3.5%	5%	13%	13%	15%	15%	15%	23%	23%	11%	-2	-0.2%
UAE	8	0%	2.4%	8%	13%	13%	21%	22%	22%	27%	27%	20%	-1	-0.3%
UK	69	2%	0.9%	4%	9%	6%	7%	7%	7%	7%	10%	7%	-5	-0.1%
Vietnam	142	4%	4.1%	4%	11%	11%	11%	22%	22%	22%	24%	14%	-15	-3.1%
Global	3359	100%	2.5%	9%	21%	12%	13%	16%	17%	17%	19%	12%	-360	-0.3%

* Before "Liberation Day": accounts for tariff hikes on US imports from China, Canada and Mexico, as well as US imports of steel, aluminum, autos and auto parts

** After "Liberation Day" and related decisions: accounts for tariff changes in the first half of April, i.e. +10pps basic hike on all countries, a higher hike on China (also accounting for rounds of retaliations), and considering sectoral exclusions

*** Decisions in July and likely deal with the EU: actual deals with Vietnam, Indonesia, Japan and the Philippines, tariff letters sent to 25 countries (including Brazil, Canada, Malaysia, South Africa, South Korea, Thailand, etc.), tariffs on US imports of copper. In the likely deal with the EU, we assume 'reciprocal' tariff of +15pps, and the tariff rate on autos and auto parts cut to 15%.

^ By 1 August, if no further deals or letters: assuming that an EU-US deal is reached, and that countries that did not reach a deal with the US nor receive any tariff letter would face the tariff hike announced on 2 April ("Liberation Day") ^^ By 1 August, if no further deals or letters and higher basic tariff: instead of the +10pps basic tariff hike announced in April, apply +20pps (as President Trump mentioned in an interview on 10 July)

Sources: various, Allianz Research

Deal or no deal, the consequences will have a substantial impact on the EU. The EU remains committed to securing a deal before the 1 August deadline, despite tensions over tariff levels and exemptions with the US. While the EU is pushing for a 10% universal tariff rate with broader exemptions, the US is reportedly demanding a 15% minimum rate with limited carve-outs and improved market access for American companies. But with a population of 450mn and US exports of goods and services to the EU reaching USD900bn in 2024, the EU stands as the largest single destination for US exports, which should give it considerably more leverage in trade talks than smaller US trade partners. With a tariff increase of +15pps, EU exports to the US could be cut by -8.6% in 2025, resulting in losses of USD53bn. Germany would face the largest annual export losses, followed by Ireland, Italy and France. Ireland's GDP growth would be most affected, with a decline of -1.6pps, due to its strong US export-orientation. Some small, open Eastern European countries, such as Slovakia, Slovenia and Hungary, would also face significant growth losses due to their importance in the auto supply chain. Belgium could lose -0.4pps, followed by Germany, Italy, Netherlands and Austria, which could each see growth reduced by -0.3pps, while France might experience a decline of -0.2pps. European GDP growth could be cut by up to -0.3pps annually. Additionally, a strong euro (EURUSD at 1.15 in 2025 compared to 1.08 in 2024), which means an appreciation of the EUR against the USD of +6.3%, entails an additional 5% drop in EU exports to the US which is equivalent to a 1% increase in US tariffs. Additionally, a strong euro (EURUSD at 1.15 in 2025 v. 1.08 in 2024) entails an additional 5% drop in EU exports to the US (equivalent to a 1% increase in US tariffs).

Compounding the tariffs on auto and machinery & equipment, the tariffs on pharmaceuticals could also be a huge blow for Europe. The potential 15% tariff would inflict losses across several of the bloc's most export-intensive sectors (Table 2). Within the pharmaceuticals sector, Ireland alone ships almost USD47bn of drugs to the US and could face an estimated export loss of USD4bn. Germany faces USD26.5bn of pharma exports at risk (USD2.3bn export loss), the Netherlands USD11.7bn (USD1bn export loss), Belgium USD7.1bn (with an export loss of USD0.6bn) and Denmark USD6.2bn (USD0.5bn). Beyond pharmaceuticals, machinery and automotive emerge as the most severely impacted, especially in Germany. In the machinery and equipment sector, Germany exports USD35.5bn to the US and is at risk of losing USD3bn; Italy stands to lose USD1.2bn on exports valued at USD13.7bn and France risks losing USD0.7bn on USD7.8bn of machinery shipments. In the automotive sector, German OEMs export USD29.7bn, with USD2.5bn at stake, while Slovakia and Italy each export roughly USD6.6bn, risking USD0.6bn. Other critical sectors are also at risk, including chemicals, plastics, rubber, transport equipment, automotive suppliers, agrifood, textiles, metals, and electronics, each facing losses in the USD0.4-0.6bn range. The breadth and depth of exposure underscore why the EU has launched contingency measures and rolled out retaliatory fee proposals on US exports.

Table 2: 25 most exposed European sectors

Country	Sector	Trade Value in USD Bn	Max Export loss USD Bn
Ireland	Pharmaceuticals	46.9	4.0
Germany	Machinery & Equipment	35.5	3.0
Germany	Automotive manufacturers	29.7	2.5
Germany	Pharmaceuticals	26.5	2.3
Italy	Machinery & Equipment	13.7	1.2
Netherlands	Pharmaceuticals	11.7	1.0
Ireland	Chemicals - Industrial & Other	10.7	0.9
Italy	Pharmaceuticals	9.6	0.8
France	Transport Equipment	8.1	0.7
France	Machinery & Equipment	7.8	0.7
Ireland	Chemicals - Plastics & Rubber	7.4	0.6
Italy	Agrifood - Food & Beverages manufacturing	7.1	0.6
Belgium	Pharmaceuticals	7.1	0.6
Italy	Textiles - Apparel & Footwear	6.7	0.6
Slovakia	Automotive manufacturers	6.6	0.6
Germany	Metals - Mining, Casting & Processing	6.5	0.6
France	Agrifood - Food & Beverages manufacturing	6.5	0.6
Germany	Chemicals - Plastics & Rubber	6.3	0.5
Denmark	Pharmaceuticals	6.2	0.5
Italy	Automotive manufacturers	6.1	0.5
Germany	Transport Equipment	5.9	0.5
France	Pharmaceuticals	5.9	0.5
Germany	Automotive suppliers	5.4	0.5
Germany	Chemicals - Industrial & Other	4.7	0.4
Sweden	Automotive manufacturers	4.3	0.4

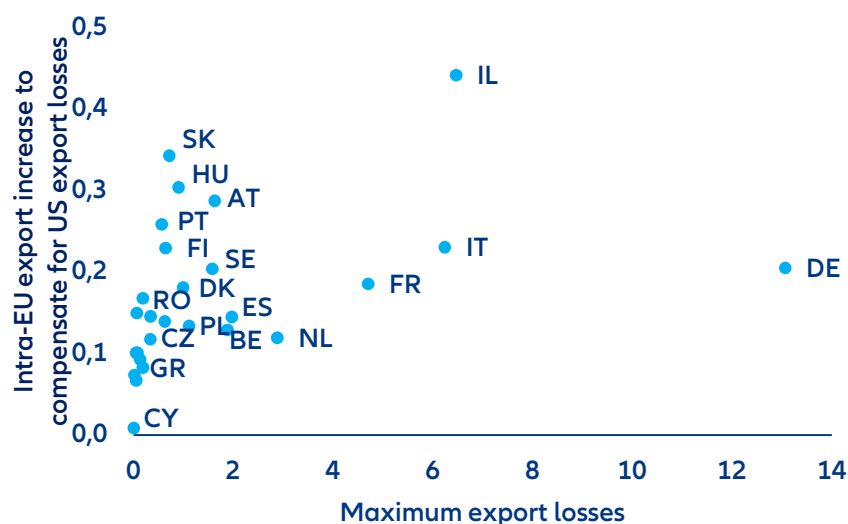
Sources: various, Allianz Research. Notes: Includes sectors with maximum export losses above USD500mn.

EU jobs could also come under pressure. While the overall impact of trade cost increases on EU exports may appear manageable, the concentration of losses in a few countries and sectors raises concerns. Employment exposure to

US tariffs is broadly distributed across the EU, but Ireland stands out due to its strong export orientation towards the US, particularly in pharma, chemicals, agrifood and transport equipment, sectors with both high export value added and significant employment shares. Slovakia is the second most exposed, with high value added in exports to the US in the motor vehicle and machinery sectors, while Estonia is notably exposed in computers, electronics and opticals. In total, approximately 1.1mn jobs in the EU27 are vulnerable to the impact of higher US tariffs, particularly in Ireland's pharma sector, Slovakia's automotive industry, Hungary's auto and machinery sectors and Germany's machinery industry. Overall, we estimate that increased trade costs up to 15% tariffs with the US, if sustained, could result in the loss of 50,000 up to 250,000 jobs across the EU27, driven by declines in value added embedded in exports to the US. This means that the European unemployment rate could increase by up to +0.2pp.

The EU is simultaneously preparing to act quickly if a deal with the US fails or looks too one-sided. First of all, certain EU sectors could prove resilient to US tariff hikes, particularly those producing goods where demand elasticity to price changes is limited and for which EU countries are currently notable providers of the US market – for example luxury-related products (leathers and furs, silk, cosmetics, beverages and spirits). Additionally, the EU can implement retaliatory tariffs on up to EUR21bn of politically sensitive US imports (e.g. soybeans, poultry, motorcycles) starting August 6, backed by a larger EUR72bn contingency package including aircraft, autos, machinery, farm produce, spirits and food, pending EU council approval if US tariffs of 30% are imposed from August. To make countermeasures clearer, simpler and stronger, the EU currently works on merging the two lists into a single one. The EU is also considering non-goods measures, such as new taxes on US tech firms, investment curbs, and market access restrictions, but reaching Council agreement may be challenging. But the EU can also accelerate trade diversification, deepening ties with other world regions like Mercosur, India, ASEAN, Australia and Africa. For the EU, the export gains due to a potential FTA look most favorable with Mercosur, followed by India and ASEAN, which together could bring USD14bn additional exports annually if an FTA is implemented. Including also FTAs with Malaysia, Thailand, the Philippines and Indonesia, these FTAs could compensate for about a quarter of annual lost EU27 exports to the US. Leveraging the Single Market itself by harmonizing regulations, removing licensing and infrastructure bottlenecks and enhancing labor and capital mobility emerges as arguably the strongest lever of all. Within-EU exports have increased by +4pp from 57% to 61% between 2013 to 2024, making up more than two-thirds of EU countries' exports and becoming ever more important. To offset 15% in US tariffs, the EU would need to boost its intra-EU trade in goods and services by +1.1%, based on 2024 trade figures. Looking at individual EU members, this would mean a boost of intra-EU trade in goods and services by +0.4% for Ireland to +0.2% for Germany and Italy annually (Figure 5). On top of the tariff increases a higher USD/EUR exchange rate of 1.15 would necessitate an additional +0.1pp rise in intra-EU trade to compensate. Moreover, the EU can enhance strategic autonomy by reshoring supply chains, fostering green and digital industries and using targeted industrial policy and carbon border measures to support exposed sectors such as autos and agrifood.

Figure 5: Intra-EU export increase relative to own intra-EU exports in goods and services (in %) needed to compensate for maximum EU27-US export losses (in USDbn), in 2025



Sources: UNComtrade, Eurostat, Allianz Research

Pricing soft, hedging hard: Reading between the market lines

Equity markets are pricing in a Goldilocks soft landing scenario for the US economy. Economists remain divided on whether the Fed is overtightening or if the US economy is following a perfect soft-landing path, where slowing inflation coincides with solid growth and a solid labor market. But equity markets seem to have taken a clear stance. Compared to all two-year performance paths following the conclusion of past Fed tightening cycles, the current post-tightening equity rally is the strongest since the 1960s. Being far above the average of previous soft-landing episodes the S&P 500 currently even overshoots the “Goldilocks” landings of the 1990s and early 2000s (Table 3). Since the last Fed hike in June 2023, the S&P500 has gained 37%. But this optimistic market pricing is all but steady. The announcement of “Liberation Day” prompted the S&P 500 to plunge heavily, almost touching bear-market and hard landing territory (-19% peak-to-trough), before rebounding back to new all-time-highs once tariff threats deescalated (Figure 6). This suggests that the underlying equilibrium remains fragile and can easily be tipped by geopolitical risks.

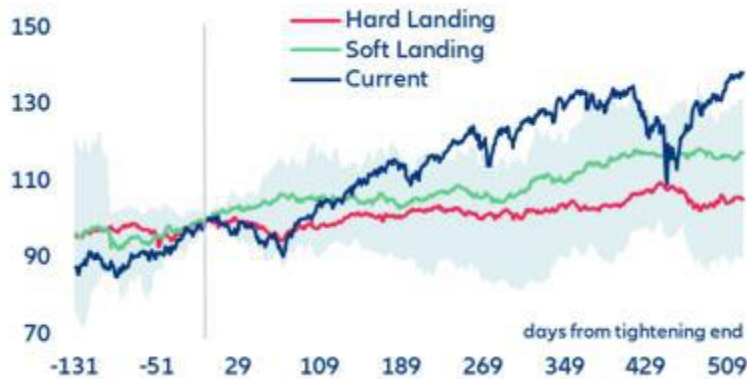
Table 3: US monetary policy tightening since 1965 and landing type

Fed tightening cycle	Landing type
1965-1966	Soft
1967-1969	Soft
1972-1974	Hard
1977-1980	Hard
1980-1981	Hard
1983-1984	Soft
1988-1989	Soft
1993-1995	Soft
1999-2000	Soft
2004-2006	Hard
2015-2019	Hard

Based on: Blinder, Alan S. 2023. “Landings, Soft and Hard: The Federal Reserve, 1965–2022.” *Journal of Economic Perspectives* 37 (1): 101–20.

Source: Allianz Research

Figure 6: S&P 500 before and after monetary tightening ends
(End of tightening = 100)

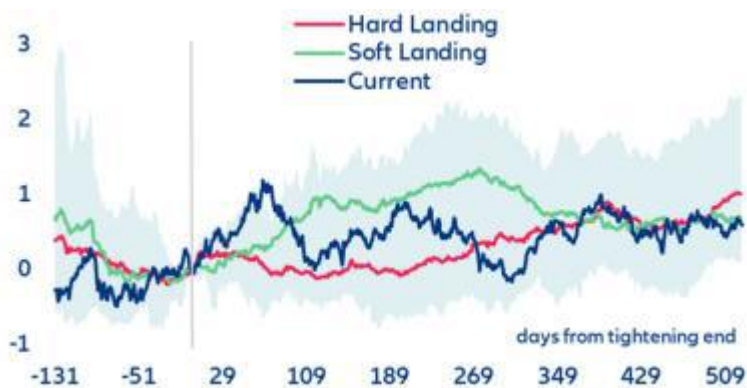


Sources: LSEG Workspace, Allianz Research

Notes: Shaded area covers range of outcomes since 1965.

On the other hand, the bond market is sending ambiguous messages. 10-year US Treasury yields have been moving between historical averages for hard and soft landings (Figure 7). After an optimistic start, the US 10-year yield has not returned to soft-landing territory since “Liberation Day”. In contrast, the slope of the US yield curve is very clearly in soft-landing territory, and has steepened more than in all previous soft-landing phases (Figure 8). So while the level of the US yield curve offers little guidance, the slope seems strongly supportive of a soft-landing scenario. But there is a warning sign again: The bulk of the steepening is due to the increased term premium at the long end of the curve. Since the term premium embodies the risk components of the yield (not growth or inflation expectations) the slope’s soft-landing signal is somehow mitigated.

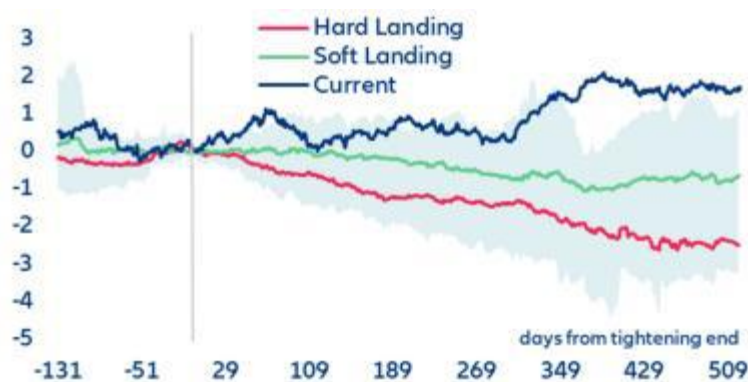
Figure 7: Changes of US 10y yield before and after monetary tightening ends
(End of tightening = 0, changes in pp)



Sources: LSEG Workspace, Allianz Research

Notes: Shaded area covers range of outcomes since 1965.

Figure 8: Changes of US 3M-10Y yield spread (slope) before and after monetary tightening ends
(End of tightening = 0, changes in pp)

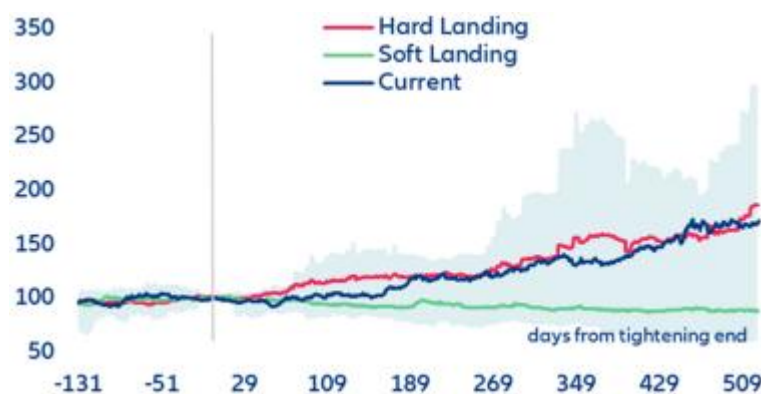


Sources: LSEG Workspace, Allianz Research

Notes: Shaded area covers range of outcomes since 1965.

Gold prices are sending a pessimistic signal, echoing the stagflationary hard landing of the 1970s. But given geopolitical trends, this time could be different. Gold tells a different and more worrying story. While equity investors are betting on a euphoric soft-landing scenario and bond investors are still trying to make up their minds, gold is the only major asset class firmly in hard-landing territory. While its performance path hasn't yet reached the severe hard-landing episodes of the stagflationary 1970s (Figure 9), this suggests that a significant amount of capital is hedging against economic tail risks or inflation fears against the background of an extremely high fiscal deficit (in fact the highest in recent history outside recessions). However, there is also another explanation. After western nations froze Russian currency reserves following the invasion of Ukraine, several other central banks started to slowly diversify away from US treasuries, Bunds and the like, and put their reserves in something that no one else can take hold off: gold. So unlike in the hard-landing episodes of the 1970s, the current hard landing rally of gold also has a strong geopolitical component.

Figure 9: Gold prices before and after US monetary tightening ends
(End of tightening = 100)



Sources: LSEG Workspace, Allianz Research

The coexistence of hard- and soft-landing narratives underscores the elevated uncertainty of the current cycle, reinforcing our cautious, risk-off stance. For now, the powerful momentum of US equities remains the predominant force, drowning out most divergent signals. However, this momentum is more fragile than it appears. Gold and segments of the bond market serve as a reminder that underlying hard landing risks have not disappeared. Betting on rising growth and falling inflation has become a crowded trade and the upside potential is thin. Consequently, if the scenarios were to converge it is rather likely to happen on the negative side triggered by faltering growth, resurgent inflation or a geopolitical shock. We therefore reiterate our cautious risk-off view, with limited equity

upside from here, and expect bond yields to remain range-bound or slightly lower in safe-haven markets – particularly German Bunds.

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

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