

What to watch: Quarterly country and sector risk update, term premia and investment promises as trade war currency

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In summary

Quarterly country and sector risk ratings: Pharma in the spotlight. Country risk ratings saw modest improvement this quarter, with four emerging markets – Armenia, Ecuador, Montenegro and Uzbekistan – upgraded on the back of stronger GDP growth, greater political stability and healthier fiscal positions. Overall, 56% of our country risk ratings are ‘low’ or ‘medium’ (+5pps more compared to the pre-pandemic period). Sector risk ratings also improved slightly in net terms for the first time since early 2024, reflecting cautious optimism despite **persistent global headwinds** such as soft demand, high financing costs and trade uncertainty. However, the pharmaceuticals sector stands out with downgrades in the US and India to medium risk, driven by the 100% tariff on branded drugs imports to the US, effective from 1 October, as well as President Trump’s new order to reduce drug prices in the US. In the chemicals sector, the UK and Uruguay joined the cluster of 15 already rated at sensitive risk as demand for basic chemicals remains subdued. We also downgraded metals in Canada, retail in Switzerland and automotive in France from medium to sensitive risk. Overall, there are still fewer low-risk sectors (9%) than before the pandemic (15% in Q4 2019).

What term premia tell us about political and fiscal risk. Rising 30y yields have become a sustained trend in the bond markets of developed economies, primarily driven by higher risk premia (term premium) rather than changes in expected terminal policy rates. Recent developments in the US, France and Japan have added to this momentum. Since the start of President Trump’s second mandate, the term premium has become a gauge of institutional and fiscal credibility. The ongoing government shutdown in the US may have a limited impact on the trajectory of public finances, but it comes at the cost of institutional credibility. Meanwhile, Japan’s term premium has been rising due to fiscal concerns and higher inflation risk **following the elections**, but it should stabilize in the absence of any new political shocks. France and Italy are following contrasting fiscal and political trajectories: Italy’s improving fiscal situation is driving convergence in long-term term premiums with France, which is facing rising fiscal risks amid **enduring political uncertainty**.

Investment promises as trade war currency: Big numbers, bigger questions. Investment pledges are increasingly being used as a bargaining chip in the **current trade war**, with lower tariffs offered in exchange for substantial investment commitments and other concessions. After a marked slowdown in FDI in the US (USD160bn in 2024, 40% below the last decade’s average), recent trade deals promise a total of USD5.6trn, with more than 85% concentrated in the next four years, including USD600bn from the EU and USD1trn from Japan. If these are fully realized, FDI in the US could reach an unprecedented USD1.5trn annually in 2026–2028, equivalent to 6% of US GDP. USD1trn in annual inflows could boost US GDP growth by +0.5pp to +2pp annually, raise inflation by up to +0.8pp and create up to 15mn jobs over the investment period. But only 9% of the EU’s pledge is currently backed by firms, revealing a significant discrepancy from actual commitments. Moreover, diverting capital abroad could result in long-term costs for the economies involved, with EU GDP growth potentially being reduced by up to -0.3pp annually, in addition to losses related to tariffs, which challenges the credibility of these pledges. Indeed, markets remain sceptical, viewing them more as political signals rather than concrete commitments.

Solid economic growth, a stabilization in the political environment and sound fiscal performance resulted in country risk upgrades for four emerging markets in Q3 2025: Armenia, Ecuador, Montenegro and Uzbekistan. The positive trend continues for small to medium-sized emerging markets, which are managing to ride out the current uncertainty, thanks to resilient domestic markets, their relative distance from trade policy turmoil and their smaller role on the geopolitical stage. **Ecuador** is an excellent example. Economic growth prospects strengthened in the first half of 2025 as hydropower availability normalized and the operating environment improved. Output in agriculture and fisheries is rising along with more diversified demand across Asia and Europe. Rebuilding reserves and firmer balance-of-payments dynamics, greater policy predictability under a more governable political environment, constructive engagement with the US and the IMF and a gradual pivot toward non-oil FX earners support a stronger and more resilient near-term growth outlook. That said, elevated non-performing loans, softer retail momentum, security risks and social tensions remain important watchpoints. From a firmer footing, **Uzbekistan's** economic growth is also staying strong, driven by favorable demographics, high gold prices and the depreciation of the local currency, which has benefited remittance flows from Russia – now accounting for around 10% of GDP.

Despite upgrades to overall ratings, sub-ratings show a mixed picture of opportunities and risks in 2026. Several countries confirm an upward trend in terms of demand and economic growth, with commercial risk showing signs of improvement in **Argentina, Germany, Greece, Italy, Mexico, Panama** and **Peru**. At the same time, the fiscal framework of others is deteriorating, particularly in **Indonesia** and **Mexico** – partly due to contingent liabilities – and in the **UK**. Looking ahead to 2026, the global country risk landscape should see a moderate improvement but persistent divergence between advanced and emerging economies. While many emerging markets are expected to maintain resilience, thanks to the pick-up in domestic demand driven by monetary easing and more fiscal support, advanced economies face slower growth momentum and mounting fiscal pressures as high public debt and election-related spending weigh on medium-term sustainability. Rising geopolitical risk and the ongoing trade war triggering not only significant rises in US import tariffs and retaliation but also a shift in supply chains – will continue to shape credit risk profiles, with Asia likely to remain the most stable region and Africa, Latin America and parts of Europe showing higher dispersion. Overall, global risk ratings are expected to deliver a mixed picture, reflecting a fragile balance between softening external pressures and uneven structural reform progress across regions.

4 COUNTRIES WITH UPGRADED RATINGS

- ARMENIA: D3 > C3
- ECUADOR: C4 > C3
- MONTENEGRO: D1 > C3
- UZBEKISTAN: D3 > C2

Legend:

- Low risk (Green)
- Medium risk (Yellow)
- Sensitive risk (Orange)
- High risk (Red)
- Improved rating (Upward arrow)
- Deteriorated rating (Downward arrow)

Source: Allioniz Trade, as of 30 September 2025

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Meanwhile, sector risk ratings improved in net terms for the first time since Q2 2024, but this outcome results from a limited number of changes compared to past quarters, and from a long-term perspective. With nine upgrades (compared to 12 in Q1) and only eight downgrades (16 in Q1), the limited and nearly balanced shifts in the risk environment reflect the complex mix of short-term challenges – soft global demand, the delayed impact of trade war, persistently high financing costs and high uncertainty – and potential tailwinds. Upgrades occurred mainly in Latin America (5) and Asia (3) and were spread across sectors, mainly moving from sensitive to medium level of risk. They include construction in Malaysia and Uruguay, machinery equipment in Chile, transportation in South Korea and metals and household equipment in Uruguay. Agrifood in Spain and transport equipment in Japan both stand out with an upgrade to low risk, while metals exited the high level of risk.

Tariff policies are putting the pharmaceuticals sector under pressure in the US and India. At a global level the sector shows the lowest risk of all, but it faced the highest number of downgrades (3) this quarter, taking the risk level from low to medium in the US and India. After signing an executive order in May directing drugmakers to voluntarily lower US prescription drug prices, US President Trump announced a 100% tariff on branded pharmaceutical imports effective from 1 October. While generics were excluded and dominate prescriptions in the US by volume (around 90% of prescriptions filled), the pharma sector will still feel the pinch since branded drugs account for most of drug-spending in the US, given their higher prices. The US represents the biggest single revenue source for most pharmaceutical companies, with European players making 45% of their top line on average in the US. Nevertheless, an exception should limit the impact for a large group of companies as President Trump also indicated that the 100% tariff will not apply if the company is actively building a manufacturing plant in the US. The pharma sector has already announced capex plans in the US totalling USD436bn, of which USD179bn has been pledged by European firms and USD257bn by American players (60% of their facilities are abroad). Exceptions will also apply for companies that promise to significantly reduce drug prices. For example, Pfizer recently secured a three-year waiver from import tariffs after agreeing to sell its drugs to Medicaid patients at a much lower price on a website launched by the Trump administration (TrumpRx), on top of pledging to invest USD70bn. Meanwhile, the US accounts for 30% of India's exports and the country's sizable exposure to the generics market will put the local pharmaceutical sector at risk if the Trump administration's plan to reduce drug prices moves forward.

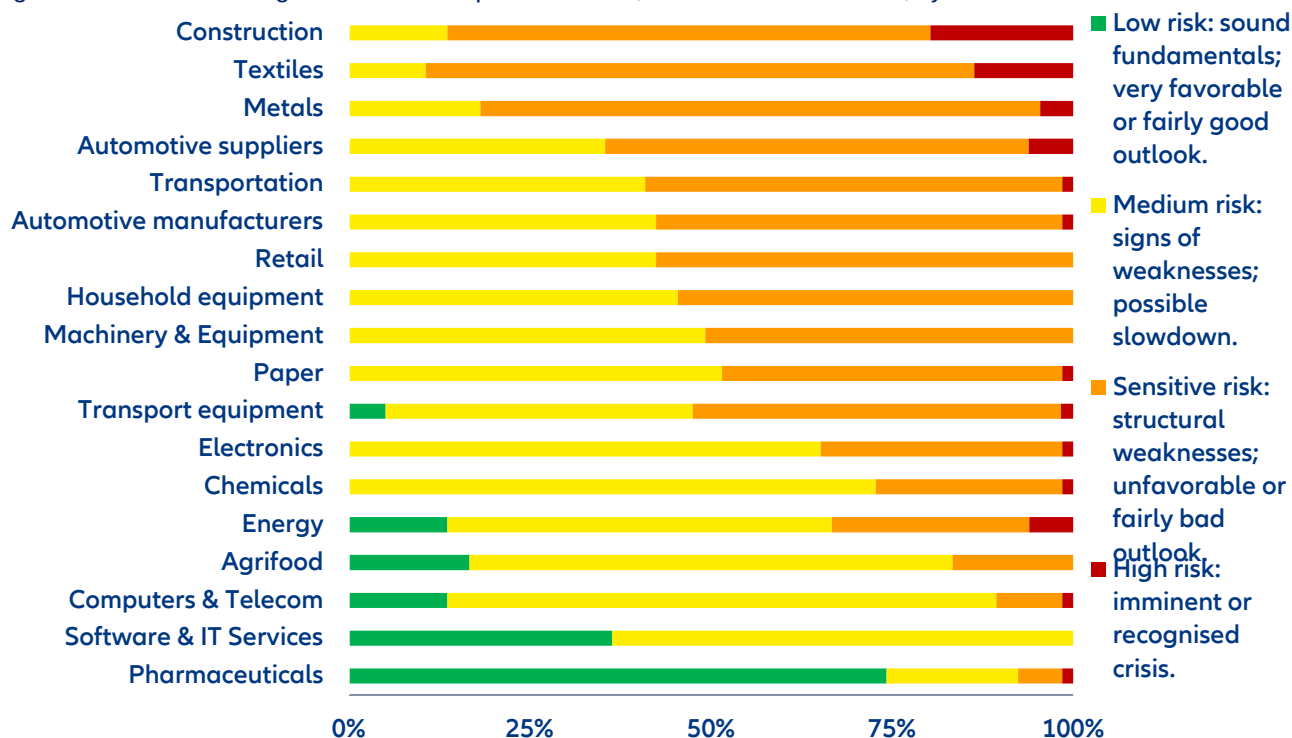
In the chemicals sector, two additional countries (UK and Uruguay) have joined the cluster of 15 already rated at sensitive risk as demand for basic chemicals remains subdued. We also downgraded metals in Canada, retail in Switzerland and automotive in France from medium to sensitive risk. For the latter, which follows similar downgrades in Germany, Mexico, Japan and South Korea in the previous quarter, the downgrade reflects the current issues – and the boom in insolvencies – plaguing smaller firms of the sector, notably specific auto suppliers, dealers, retailers and repairers more exposed to regional demand weakness and transition challenges. Overall, those adjustments led to a broadly stable global picture of ratings, with a small majority of sectors (54%) on the positive side (either low or medium risk). Yet, sector ratings are mostly either medium (45% i.e. stable q/q) or sensitive risk (43% i.e. stable q/q) across all regions. The overall risk dispersion is noticeable between the comparatively safest region (Asia) and the riskiest (Latin America, and to a lesser extent Central and Eastern Europe). Overall, there are still fewer low-risk sectors (9%) than before the pandemic (15% in Q4 2019).

Tables 1 and 2: Q3 2025 changes (downgrades and upgrades) in sector risk ratings

WORSE RISK RATINGS (DOWNGRADES)				BETTER RISK RATINGS (UPGRADES)			
Sector	Country	Q2 2025 rating	Q3 2025 rating	Sector	Country	Q2 2025 rating	Q3 2025 rating
Auto. manufacturers	France	2 (medium)	3 (sensitive)	Agrifood	Spain	2 (medium)	1 (low)
Chemicals	UK	2 (medium)	3 (sensitive)	Construction	Malaysia	3 (sensitive)	2 (medium)
Chemicals	Uruguay	2 (medium)	3 (sensitive)	Construction	Uruguay	3 (sensitive)	2 (medium)
Metals	Canada	2 (medium)	3 (sensitive)	Household Equipment	Uruguay	3 (sensitive)	2 (medium)
Pharmaceuticals	US	1 (low)	2 (medium)	Machinery & equipment	Chile	3 (sensitive)	2 (medium)
Pharmaceuticals	India	1 (low)	2 (medium)	Metals	Uruguay	3 (sensitive)	2 (medium)
Pharmaceuticals	Colombia	3 (sensitive)	4 (high)	Metals	Panama	4 (high)	3 (sensitive)
Retail	Switzerland	2 (medium)	3 (sensitive)	Transport	South Korea	3 (sensitive)	2 (medium)
				Transport equipment	Japan	2 (medium)	1 (low)

Source: Allianz Research, based on the [Sector Risk Methodology](#) and the [Q3 2025 Sector Risk Map](#)

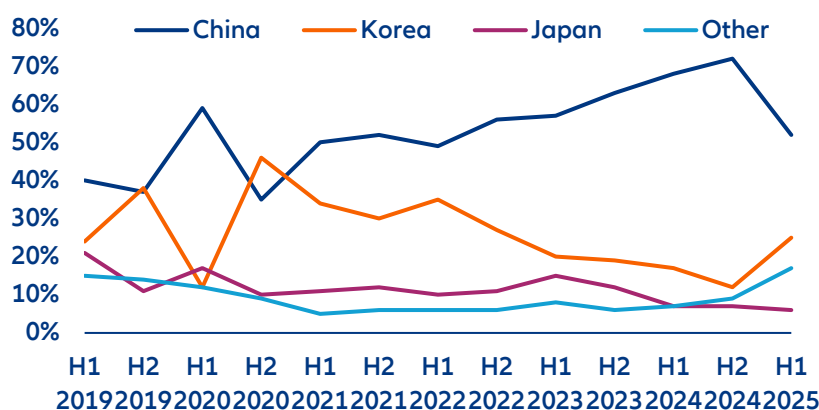
Figure 2: Sector risk ratings as of end of September 2025, in number of countries, by level of risk



Source: Allianz Research, based on the [Sector Risk Methodology](#) and the [Q3 2025 Sector Risk Map](#)

Looking ahead, the transportation equipment sector will be on the watchlist as fees on Chinese ships or operated by Chinese companies come into effect in the US mid-October. To counter China's dominance in global shipping (55% market share) and bolster US shipbuilding, the US administration will start imposing fees on vessels built in China and/or operated by Chinese shipping companies as of 14 October. Ranging from USD14 to USD50 per net ton and per US voyage, the fees will increase in April 2026 and continue increasing gradually until April 2028, when they will remain fixed. From a shipbuilding perspective, the situation represents a significant opportunity for South Korean and Japanese shipyards (which together have a global market share of 41%) as long as they have sufficient absorption capacity, given that the US shipbuilding industry is relatively almost inexistent. In the first half of the year, China's share of newbuilding contracting declined from 72% to 52%, while South Korea gained 13% of market share (Figure 3). From a ship liners perspective, the situation represents a financial burden, with fees translating to an estimated extra cost of USD3-8mn per voyage for Chinese carriers and USD1.2-2.5mn for non-Chinese carriers. While this could be passed on to the consumer, some carriers have already announced that they will fully absorb it.

Figure 3: New building contracting by shipbuilding country, share of CGT

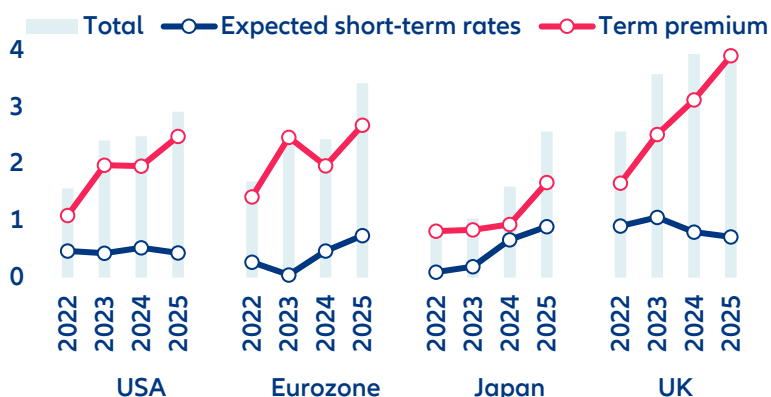


Sources: Clarkson Shipping Intelligence, Allianz Research

What term premia tell us about political and fiscal risk

30y yields have reached record highs. Through all the macro-volatility of the past three years, one trend has remained unbroken: rising yields at the very long end (30y and more) of the curve in developed markets. The yield on 30y Japanese government bonds (JGB) has now reached a historic peak, while 30y Gilts, US Treasuries and Bunds are all trading at multi-decade highs. This rise in yields largely exceeds what changing expectations for the terminal policy rate would suggest. Since 2022, only 15–35% of the 30y yield increase can be explained by interest-rate expectations; the rest is due to a higher risk premium (term premium) that investors demand for holding such long-term debt securities (Figure 4).

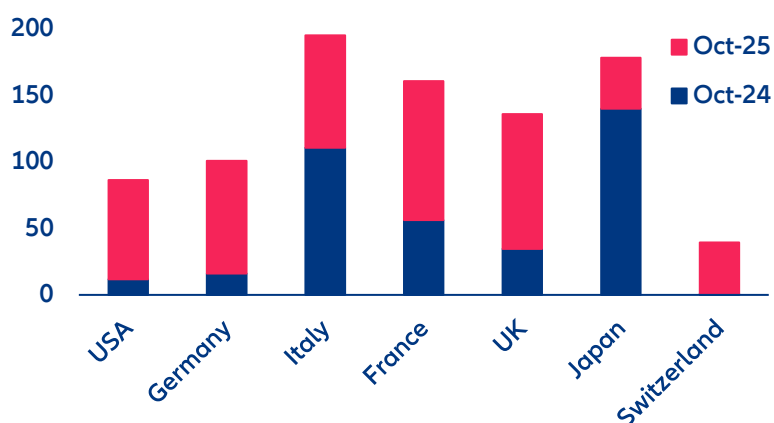
Figure 4: Decomposition of rise in 30y yields since 2022, cumulative in pp



Sources: LSEG Datastream, Allianz Research. Notes: Based on Abrahams et al. (2016).

In recent months, the term premium has also become a gauge of institutional and fiscal credibility. The term premium traditionally bundles two identifiable risks: 1) uncertainty about the neutral rate (real term premium), which is related to the perceived growth potential of the economy, 2) uncertainty about future inflation (inflation risk premium). Trump's second term brought about a series of political uncertainties that translated into higher global term premium in 2025 (Figure 5). This perceived political risk has thus become the marginal driver of 30y term premia in developed markets. Europe has been most affected by this repricing. The term premium for 30y bonds rose by +105bps in France, +85bps in Italy, +84bps in Germany and +101bps in the UK). For Japan the increase remained with +38bps while for the US itself the 30y term premium rose by +75bps.

Figure 5: In Trump's second term, global 30y term premia have been repriced

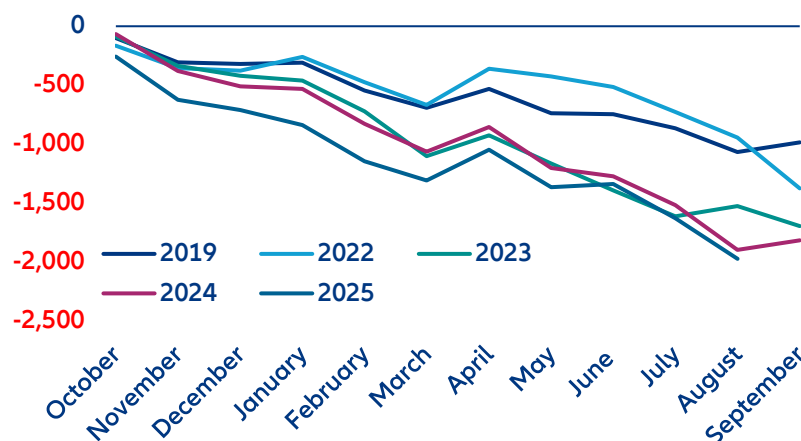


Sources: LSEG Datastream, Allianz Research

In the US, the ongoing government shutdown may have a limited impact on the trajectory of public finances but it comes with a cost to institutional credibility, adding upside pressure on 30y Treasuries. During shutdowns, agencies funded by annual appropriations (i.e. funding granted by Congress) must halt non-essential services until new legislation passes, but programs funded by mandatory spending – like Social Security and Medicare – continue,

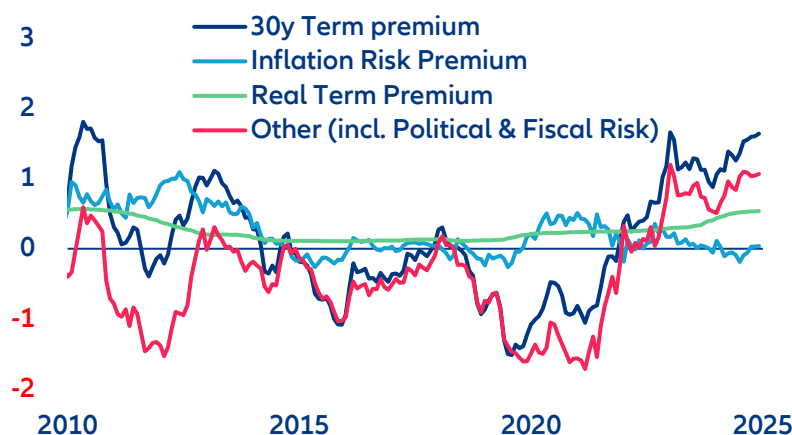
and the Treasury still services its debt. Overall, three-quarters of federal spending typically continue as normal and we do not expect the shutdown to slow down federal spending significantly. Despite the DOGE and sharply higher tariff collections, federal deficits show no signs of narrowing (Figure 6). In 2026, we expect tariff revenues to roughly pay for the One Big Beautiful Bill tax cuts, but rising interest expenses will push the total federal deficit to -7.3% GDP in 2026 (after -6.9% in 2025) and -7.5% in 2027. However, the cost in terms of institutional credibility and political risk will be most visible on the 30y maturity of US government debt, where the fiscal and political risk component is already the main driver of the term premium (Figure 7). This keeps an underlying upside pressure on 30y Treasuries, supporting the steepening trend at the long end of the US curve.

Figure 6: US federal government deficit, fiscal years in USD bn



Sources: LSEG Datastream, Allianz Research

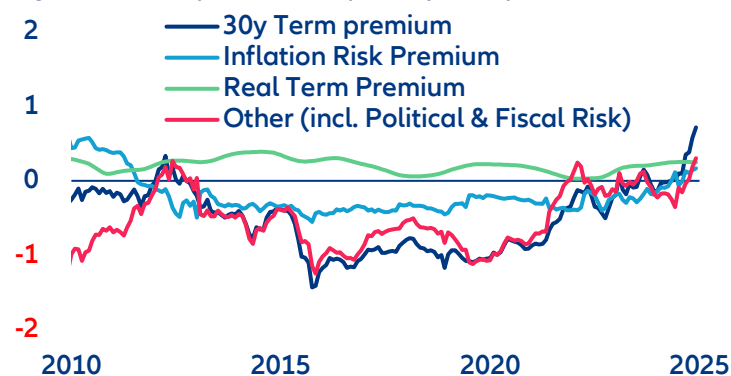
Figure 7: Decomposition of US 30y term premium



Sources: LSEG Datastream, Allianz Research. Notes: Based on Abrahams et al. (2016).

Meanwhile, Japan's term premium is rising due to fiscal concerns and higher inflation risk. The recent election of Sanae Takaishi as head of the ruling Liberal Democratic Party (LDP) has increased fears of a revival of Abenomics, i.e. fiscal stimulus combined with a cautious approach to monetary tightening. Pledges such as tax cuts and cash handouts could deepen the primary fiscal deficit by +1pp each year, adding +3pp to Japan's debt-to-GDP ratio by 2027. In response, the yield on 30y Japanese government bond (JGB) surged by +13bps, reaching historical highs, while the yield curve steepened sharply. Once again, the driving force is the term premium. However, unlike in the US, where the term premium reflects fiscal and political risk, the Japanese 30y term premium reflects fiscal and inflation risk (Figure 8).

Figure 8: Decomposition of Japan 30y term premium

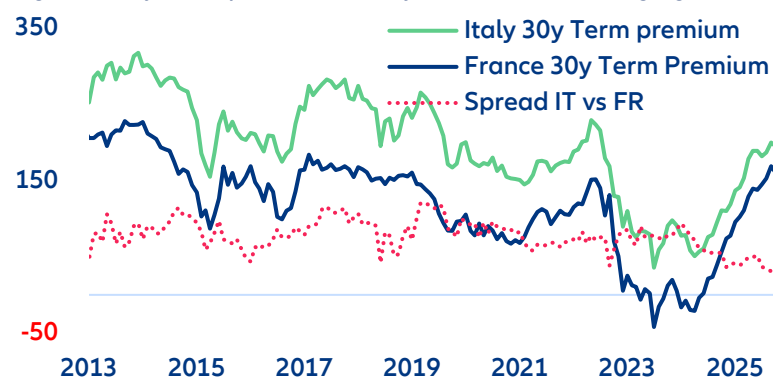


Sources: LSEG Datastream, Allianz Research. Notes: Based on Abrahams et al. (2016).

Political uncertainty in France has pushed the 30y term premium to converge towards that of Italy, with the spread reaching its lowest level since the introduction of the euro. Political gridlocks in France mean that the deficit is unlikely to fall below 5% of GDP before 2028. Following the surprise resignation of Prime Minister Lecornu on Monday, France finds itself dealing with yet another political crisis. We continue to attach a 50% probability that the country will manage to pass a watered-down budget or, as a close equivalent, a Special Law to push down the headline deficit slightly from -5.4/5.5% of GDP this year to around -5.2% of GDP next year. However, there is a 40% chance of President Macron calling for snap elections before the end of this year. Under such a scenario, uncertainty over the budget and the deficit would likely pressure growth in the next couple of quarters as business investment would take another hit. GDP growth could be closer to +0.6% in 2026, against +1% in our baseline scenario of a watered-down budget or Special Law. Lower growth, as well as probably a watered-down budget passed by the new government following the elections, would likely keep the deficit high in 2026, at around -5.5% of GDP.

Meanwhile, in Italy, the recently approved draft budget projects that the public deficit will reach -3% of GDP already in 2025 (down from -3.3% of GDP in the last official forecast and -3.6% of GDP in our projection), before declining further to -2.8% of GDP in 2026 and -2.6% of GDP in 2027. Italy could therefore exit the Excessive Deficit Procedure as early as next year, ahead of schedule. Government revenues have outperformed expectations despite a weakening economic outlook. The government has revised its growth forecasts to +0.5% for 2025, +0.7% for 2026 and +0.8% for 2027, in line with our updated outlook. Looking ahead, the end of NGEU inflows, which have played a crucial role in supporting growth and easing fiscal constraints, in 2026 will pose a challenge in 2027, an election year, when campaign promises could further strain public finances. The planned measures amount to around 0.7% of GDP (approximately EUR16.5bn per year) and are allocated to cuts in personal income tax (IRPEF), healthcare, birth-rate support, competitiveness and investments. These resources are expected to come from EUR10bn in unspecified spending cuts and EUR6.5bn in additional revenues. The tax burden is expected to remain high at 42.8% in 2025 as tax cuts will largely be offset by increases in other taxes. Furthermore, interest payments will remain high, at around 3.9% of GDP, representing a significant structural constraint on Italy's medium-term fiscal outlook.

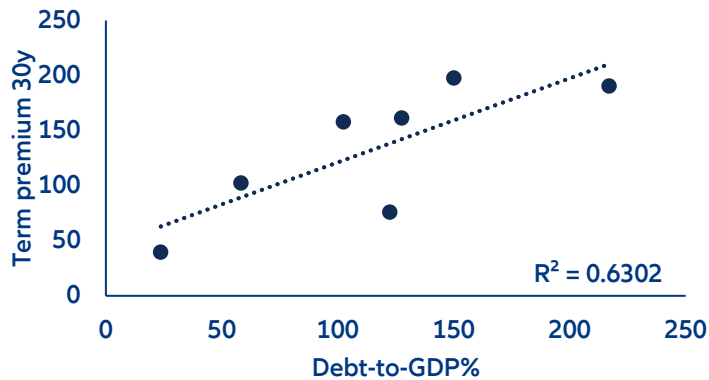
Figure 9: 30y Term premium of Italy and France converging as fiscal risks diverge



Sources: LSEG Datastream, Allianz Research. Notes: Based on Abrahams et al. (2016).

How far can the repricing of 30y term premia go from here? Fundamentally, the higher the debt level of a sovereign, the higher the 30y term premium as fiscal strength is its main determinant (Figure 10). The repricing of political risk under Trump's second term leaves European term premia overstretched while that of the US still has room to the upside. Japan's term premium now seems fairly priced. For the US curve, we still see a risk of higher 30y yields and a further steepening of the curve, while in Europe and Japan, the term-premium-driven rally on the 30y yield should come to an end unless new political risks emerge.

Figure 10: The higher the debt, the higher the 30y term premium

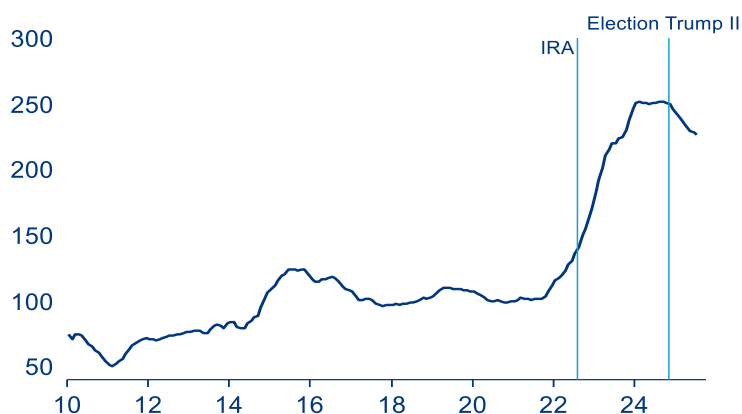


Sources: LSEG Datastream, Allianz Research

Investment promises as trade war currency: Big numbers, bigger questions

US tariffs are increasingly being used as a bargaining chip, with lower rates offered in exchange for substantial investment commitments and other concessions. The "America First Investment Policy" considers Foreign Direct Investment (FDI) as a strategic asset for building domestic production capacity, securing critical supply chains, creating jobs and strengthening US independence in strategic sectors such as semiconductors, energy, defense, critical minerals and pharmaceuticals. To encourage investment, the administration has introduced incentives such as bonus depreciation and R&D tax relief, as well as business-friendly regulatory policies, and has maintained a low corporate tax rate of 21% under the One Big Beautiful Bill. Although the size of the US market is a strong pull factor, high labor costs, skill and labor shortages, an unpredictable tariff agenda, as well as the potential enactment of Section 899 which permits retaliatory taxation, could deter investors. And uncertainty bites hard: Investments in new US plant construction have already stalled since President Trump's re-election (Figure 11).

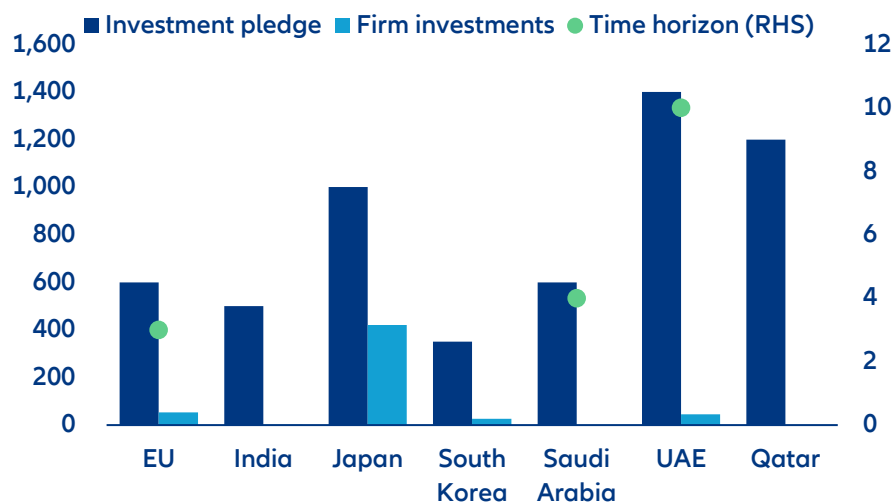
Figure 11: Plant construction in the US, three-month moving average 2022 = 100



Sources: LSEG Datastream, Allianz Research. Notes: US plant construction investments are calculated as total private construction spending price adjusted by the PPI for intermediate demand "materials and components for construction".

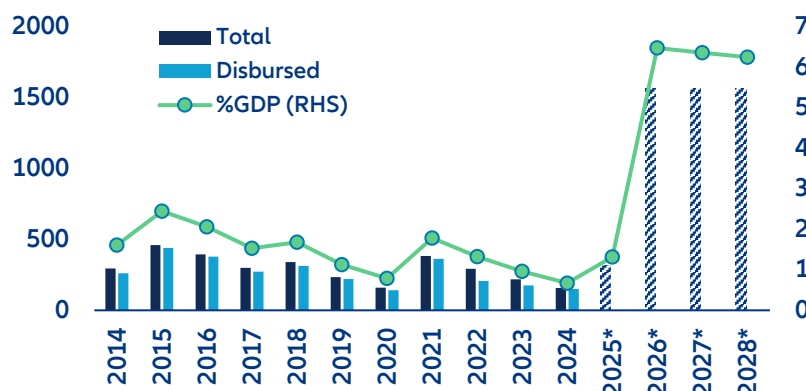
After a marked slowdown in FDI recent years, the full rollout of investments pledged so far could lift annual inflows to unprecedented levels of roughly USD1.5trn per year through 2028. According to BEA data, new FDI inflows totaled USD151bn in 2024, down from USD176bn in 2023 and well below the average of the last decade of USD277bn. Almost 95% of this capital (around USD143bn) came from the acquisition of existing US companies, while only USD6bn went towards establishing new businesses and less than USD2bn towards expanding existing ones. This composition highlights that recent inflows have been driven more by ownership transfers than by the creation of new productive capacity. Against this backdrop, the new wave of investment pledges represents a significant increase. In its trade deal with the US, the EU pledged USD600bn over the next three years (3% of its nominal GDP in 2024), which resulted in a reduction of tariffs on its exports from the initially threatened 30% to a cap of 15%. Japan committed USD1trn, while South Korea, Saudi Arabia, the UAE, Qatar and India followed with promises ranging from USD450bn to USD1.4trn (Figure 12). Assuming these pledges are realized with an average execution period of four years, FDI inflows could already start rising in late 2025, reaching around USD400 bn by year-end. From 2026 onward, the full rollout of pledged investments would lift annual inflows to unprecedented levels of roughly USD 1.5trn per year through 2028 (Figure 13). This would imply an increase in FDI from about 0.7% to more than 6% of US GDP – an exceptional jump that would far exceed historical norms.

Figure 12: Pledged FDI to the US from trade deals and private firms, in USD bn and time horizon (where available)



Sources: The White House, Allianz Research

Figure 13: US pledged vs. actual FDI, in USD bn and % GDP



Sources: BEA, Allianz Research. Notes: Dashed bars assume pledged investments from trade deals are spread evenly across 2026–2028. For 2025, only one-third of the annual amount is allocated (reflecting implementation in the last four months). The remaining two-thirds of the 2025 amount are redistributed equally across 2026–2028, on top of their baseline annual pledges. On the right: Only deals over USD20bn shown. For the percentage of GDP, only investment pledges are included.

A foreign investment wave of this scale could reshape the US economy. Assuming the majority of these inflows materialize as greenfield projects in technology, manufacturing, pharmaceuticals and energy, the macroeconomic effects would be profound. We estimate that sustained capital inflows of USD1trn per year from 2026 to 2028 would result in an additional +2pp of GDP growth in 2026, followed by +0.8pp to +1.5pp in 2027 and +0.5pp to +1.0pp in 2028, leaving the level of US GDP roughly 5% to 7% higher by 2030. The long-term effects would be structural rather than cyclical as the inflows would expand the capital stock, raise productivity and permanently lift potential output. Inflation would likely rise modestly in the short term due to higher demand for building material and intermediate inputs in manufacturing. We estimate a CPI increase of around +0.5pp to 0.8pp during 2026–27, followed by a moderation as new capacity and productivity gains ease supply constraints and stabilize prices. Employment gains would be equally significant: over the three-year period, the investment boom could generate 10-15mn jobs. Sustained capital inflow from abroad would strengthen the USD, while equity markets, supported by higher profit expectations and improved sentiment, would likely re-rate upward.

However, there is a striking difference between state-level commitments and the extent to which corporates follow through on them. For example, Japan's USD1trn pledge is matched by only USD420bn in company announcements, representing a 58% shortfall; South Korea's USD450bn is backed by just USD26bn, representing a 94% shortfall, and in the EU, the headline figure of USD600bn contrasts with only around USD53bn from firms, representing a 91% gap (Figure 11). Large national commitments from the Gulf economies have yet to be matched by identifiable corporate plans. Many of these announcements may therefore function more as political signals than as concrete investment programs and could ultimately be scaled down, implemented slowly or abandoned altogether. Moreover, diverting capital towards the US will also create significant opportunity costs for other countries as funds used abroad could otherwise have supported domestic priorities. In the long term, this burden could be more damaging than tariffs as it could hinder structural economic transformation. For example, if EU investments in the US were to nearly double between 2026 and 2028 due to trade deal commitments, the resulting capital outflows could reduce EU GDP growth by between -0.1pp and -0.3pp, in addition to the estimated annual drag of -0.3pp already expected from tariffs.

Against this backdrop, investors remain skeptical that the ambitious pledges will fully translate into action. Furthermore, in practice, it is highly unlikely that the US economy would have enough labor and skills to fill in new factories and support new industrial capacities. Increasingly tight immigration policy is likely to magnify these challenges. This disbelief has left US growth expectations, equity valuations and the dollar below levels implied by such an investment wave.

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

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