

# What to watch: Q3 earnings, the secret behind EU sovereign spread convergence and from tariff dividend to Supreme Court scrutiny

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## In summary

**Q3 earnings: Resilient profits powered by AI.** Despite rising tariffs and softening European demand, companies demonstrated remarkable resilience in the Q3 earnings season. US firms stood out as clear leaders – thanks to frontloading and foreign firms cutting their prices – with 82% beating estimates (revenues: +8.1% y/y and EPS: +16.8% y/y). Tech earnings soared +28.5% y/y and hyperscaler profits jumped +41.5% y/y, while capital expenditures surged to USD100bn, fueled by the AI boom, which has moved from a niche topic to the central focus in earnings calls across industries. Overall, expectations for Q4 remain moderate (with earnings growth forecast at +8% y/y) but full-year 2026 consensus estimates stand at a robust +13.8% y/y. Meanwhile, European companies lagged but outperformed subdued expectations, with EPS rising +6.2% y/y despite a -1.2% y/y revenue contraction. The boost in earnings was mostly led by the financial sector (+11.4% y/y) which helped to offset a decline of -11.2% y/y in consumer cyclicals. For Q4, the stronger euro, limited discretionary spending and sectoral headwinds will likely continue constraining growth (-1.8% y/y) and earnings (-2.7% y/y), but the outlook is turning optimistic for key industries in the region, with 2026 EPS growth revised up to +12.9% y/y from +12.6% y/y for the Stoxx-600.

**NGEU fund: The secret behind sovereign spread convergence.** France's risk premium recently surpassed Italy's, highlighting shifting dynamics in the Eurozone bond market. Since 2021, Eurozone government bond spreads have broadly converged, with the 10-year asset swap spread range narrowing from 250bps at the height of the pandemic to around 64bps. This reflects both improved fundamentals and the positive feedback loop between the NGEU fund and greater political stability in Southern Europe. NGEU disbursements (especially grants that reduce fiscal deficits) have supported growth and debt sustainability in Italy, Spain, Portugal and Greece. For instance, Italy's receipt of over EUR100bn more than France has supported the 170bps spread compression vs. Germany. Overall, we estimate that NGEU effects account for 30-50% of the recent spread narrowing. Yet, as NGEU inflows end in 2026 and political uncertainties rise ahead of key elections in 2027, sustaining convergence may require new EU-level initiatives, potentially through common debt for defence and strategic investment.

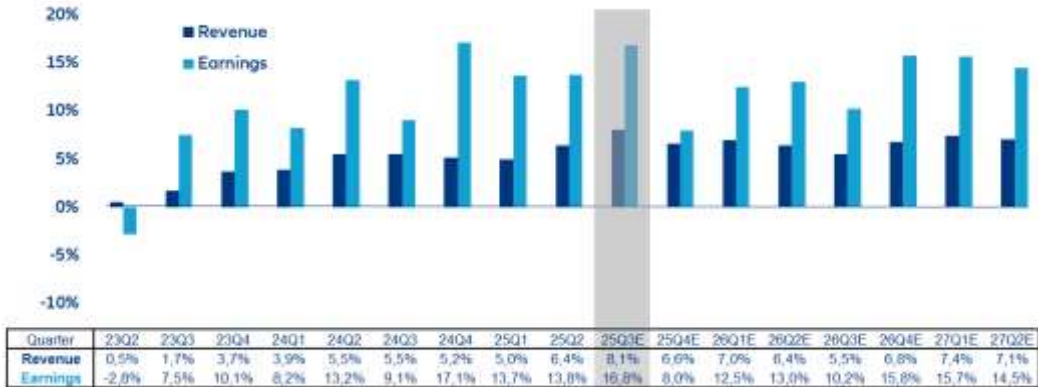
**Trade war: From tariff dividend to Supreme Court scrutiny.** The "tariff dividend" promised to US citizens – which could cost a whopping USD290bn, or 1% of GDP – is unlikely to represent a further easing of fiscal policy in the near term, since it is partially already embedded in the One Big Beautiful Bill. Funding an additional USD2000 per person with new customs revenues would imply an implausible +14pps increase in the US effective tariff rate, pushing it close to 30%. Much more important for the US outlook is the possibility that the Supreme Court strikes down the tariffs implemented with emergency powers. The lost customs receipts and potential refunds (USD220bn) could contribute to raise the fiscal deficit from -7% to -8% of GDP in 2026. Yields could still drop by 10-20bps from current levels, as lower inflation expectations from the removal of tariffs would outweigh the higher deficit. Global trade may face another period of volatility, with the US tariff rate ranging between 5-15% depending on the Supreme Court decision and how the US administration reacts. In the short term, Brazil, Bangladesh, India, China, Pakistan, Switzerland, South Africa, Vietnam and Indonesia could benefit from lower tariffs and frontloading. But ultimately, the US administration will have other options to raise tariffs again, such as sectoral investigations.

### Q3 earnings: Resilient profits powered by AI

Despite trade frictions and rising tariffs, as well as softening European demand, companies demonstrated remarkable resilience in the Q3 earnings season. Around 80% of companies have reported Q3 results so far, and over half have exceeded both sales and earnings expectations, with US companies standing out as clear leaders. Disciplined cost control and strategic agility have safeguarded margins and sustained growth amid ongoing policy uncertainty. Management sentiment also struck a notably more optimistic tone than in 2024, nearing the highs observed in late 2021 (Figure 3), suggesting that supply-chain challenges have largely faded and that tariff-related concerns were confined to the first half of the year.

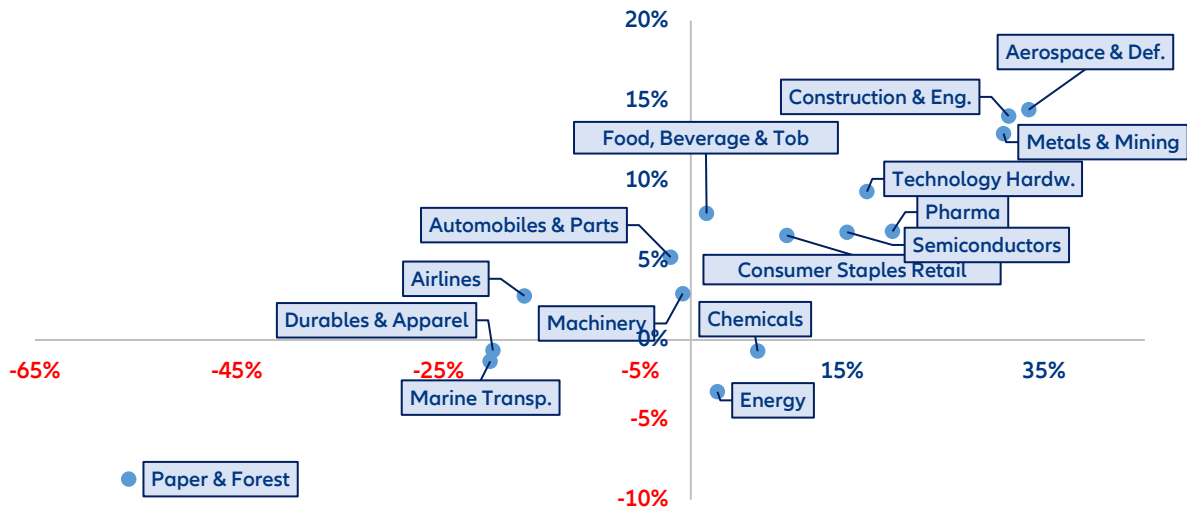
In the US, companies delivered robust double-digit earnings gains, widely beating forecasts and buoyed by the mega-cap tech AI boom. In Q3 2025, S&P 500 earnings growth accelerated to +16.8% y/y, extending the positive momentum from +13.8% y/y in Q2 (see Figure 1). With four consecutive quarters of double-digit earnings expansion, the S&P 500 is back at record earnings levels and on track for double-digit full-year earnings per share (EPS) growth. With reporting nearly complete, the index’s blended EPS growth far exceeds the ~+8.8% y/y expected at quarter-end as 82% of companies beat earnings estimates – well above the ~75% five-year average – marking one of the strongest quarters in recent years and confirming that US stocks can also deliver in a slowing growth environment. Tech remains the fastest-growing sector of the S&P 500, but the strength was broad-based: financials, industrials, real estate and materials all delivered EPS growth above +20%. In terms of earnings surprises, communication services, industrials, and healthcare led the pack, beating expectations by 12-15% this season. Top-line performance was also solid: Q3 revenues grew by +8.1% y/y in the US, significantly above the +5.7% expected at the start of earnings season, with a 78% beat rate. Within the index, all sectors delivered positive revenue growth in Q3, with energy lagging with a modest +1.1% y/y increase as softer prices weighed on top-line performance. Yet, when considering the entire listed universe (Figure 2), other sectors showed a y/y decline in revenues, notably paper & forest (-8.7%), marine transportation (-1.3%), and durables & apparel (-0.7%). The overall wide gap between revenue and EPS growth suggests that US companies are benefiting not only from healthy top-line demand and sustained pricing power, but also from improved operating efficiency, reflecting widespread margin improvement. The strongest margin gains came from financials, industrials and real estate; while healthcare, consumer staples and energy experienced some margin compression.

Figure 1: S&P 500 revenue and EPS growth rates (% y/y)



Sources: LSEG IBES, Allianz Research

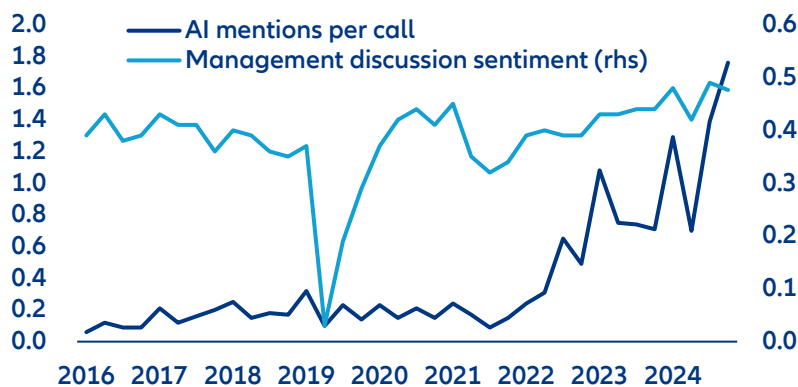
Figure 2: EPS (X axis) and revenue (Y axis) y/y growth rate in Q3 2025, North America



Sources: LSEG Refinitiv (average by sector as of 13 Nov, with 82% of American equities having released results), Allianz Research

**The continued surge in AI-driven investment and demand remains the center of attention, propelling large technology companies to deliver exceptional results.** The tech sector delivered the biggest jump in sales (+16.1% y/y) and earnings (+28.5%) within the S&P 500, supported by robust corporate spending on cloud services and AI infrastructure. Hyperscalers were standout performers, posting +41.5% y/y earnings growth in Q3, with sales up +21.7% y/y. Capital expenditures soared to USD100bn from roughly USD60bn in Q3 2024 (annualized USD400bn), underscoring the sector’s aggressive investment cycle in parallel to sustained profitability. But the AI boom is also visible outside tech, evolving from a niche topic to the central focus in investor meetings and corporate earnings calls across industries. Figure 3 shows that mentions of AI during earnings calls reached record highs in the latest quarter, reflecting its growing relevance to executive strategies and investor discussions. While tech firms remain the most vocal, sectors such as financials, consumer discretionary and energy are increasingly emphasizing AI’s role in enhancing efficiency, automation and risk management. This broad adoption underscores AI’s transformation into a key driver of productivity, profitability and long-term competitiveness as companies prepare for 2026. Nevertheless, concentration risk around AI is rising, keeping investors vigilant, with tough consequences when expectations are not met. Overall, while expectations for Q4 remain moderate (with earnings growth forecast at +8%) and full-year 2026 consensus estimates have been modestly trimmed (from +14.1% to +13.8%) US corporates remain on track to deliver another year of robust, double-digit earnings growth.

Figure 3: Mentions of artificial intelligence in corporate earnings calls and management sentiment index



Sources: Bloomberg, Allianz Research

**European companies underperformed US peers but results were better than expected.** With higher tariffs and a stronger euro weighing on international sales, Stoxx-600 revenues contracted for the second time this year (-1.2% y/y in Q3), see Figure 4. Marine transportation (-15.1% y/y), energy (-7.2%) and basic materials (-5.9%) faced the

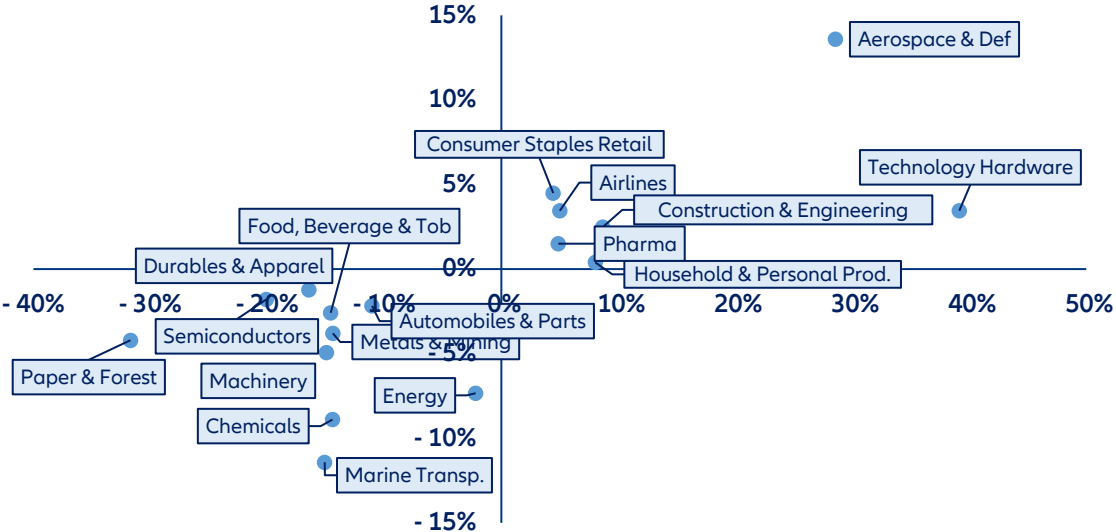
biggest drops, explained by lower shipping and commodity prices and weaker industrial demand, particularly affecting the chemicals, pulp & paper, and metals & mining sectors (Figure 5). Nevertheless, strategic management helped keep earnings resilient. With a +4.6% surprise level, earnings for the entire listed universe managed to remain on the positive territory (+0.3% y/y) in Q3. For the Stoxx-600 the surprise was even better. Based on the reports of 73% of companies, EPS growth, initially expected to be slightly negative, climbed to +6.2% y/y (see Figure 4), edging above Q2's +4.0% as more companies beat expectations. Sector leaders include financials (71% above expectations), tech (52%) and industrials (52%). Financials delivered the strongest earnings growth of the region at +11.4% y/y, with banks benefiting from still elevated interest rates that expanded net interest margins and boosted profits. Industrials on their side benefited from the increased spending in aerospace and defense. In contrast, consumer cyclicals (which includes apparel, consumer products, automobiles, and travel & leisure) posted the weakest earnings performance of the index, with EPS down -11.2% y/y representing a negative surprise of -5.6%, reflecting ongoing weakness in consumer confidence that continues to curb discretionary spending. Retailers and leisure companies reported a pullback in European consumer spending, while automakers struggled with weak demand and rising competition from China.

Figure 4: STOXX-600 revenue and EPS growth rates (% y/y)



Sources: LSEG IBES, Allianz Research

Figure 5: EPS (X axis) and revenue (Y axis) y/y growth rate in Q3 2025, Europe

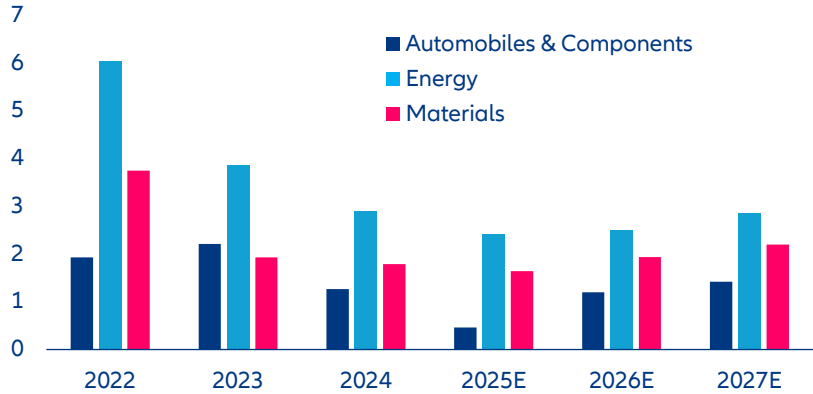


Sources: LSEG Refinitiv (average by sector as of 13 Nov, with 77% of European equities having released results), Allianz Research

The macroeconomic context (notably trade tensions), a stronger euro, weak discretionary spending and pressure on interest-sensitive sectors should continue to weigh on European earnings in Q4 and beyond. Consensus expectations point to a subdued growth environment through the first quarter of 2026, before a recovery in sales and earnings. Positively, mid-season revisions have turned slightly optimistic, with 2025 full-year earnings

growth now expected at -2.0% y/y compared to -2.9% at the start of the season, and 2026 growth revised up to +12.9% y/y from +12.6%. Most importantly, the 2026-27 outlook is also turning optimistic for key industries in the region, such as automobiles, energy and basic materials, whose deterioration over the past three years has reduced their combined contribution to Stoxx-600's earnings to just 12.6% (vs 32% in 2022). As seen in Figure 6, 2025 is expected to mark the trough for these sectors, with a notable EPS recovery anticipated in 2026 and 2027.

Figure 6: Historical and estimated EPS (EUR per share) for selected sectors in Europe

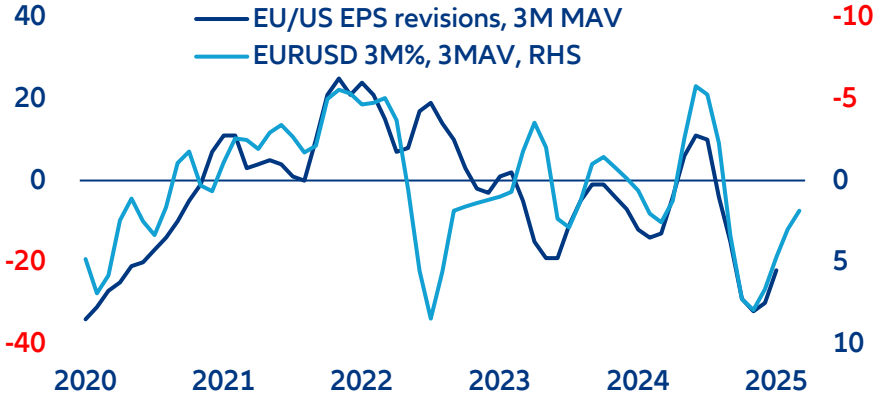


Sources: Bloomberg, Allianz Research

Figure 7: Relative earnings revision ratio Europe vs US and EURUSD exchange rate

**However, a factor that should not be overlooked is the evolution of the euro.** This is likely to continue to burden the European export-oriented equity market, though there are some signs that this headwind should fade soon (Figure 7). In case of no further euro appreciation, European companies can enter a level playing field with the US in 2026 – at least from an exchange rate perspective.

Figure 7: Europe vs US relative earnings revisions and EURUSD exchange rate



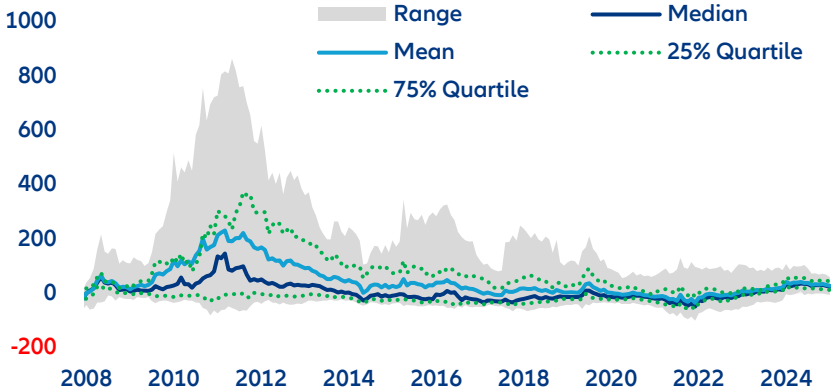
Sources: LSEG Datastream, Allianz Research

### NGEU fund: The secret behind sovereign spread convergence

France's risk premium recently surpassed Italy's, reinforcing an ongoing shift in the Eurozone government bond (EGB) market. Since 2021, risk premia in the EGB market have showed a trend toward convergence rather than divergence. The range of asset swap spreads (ASW) on 10-year EGBs, a common risk measure for government bonds, has shrunk from 250bps during at the peak of Covid-19 to 64bps (the ASW range even reached 900bps during the Euro crisis). The median now trades at 26bps and has converged to the mean, i.e. there is less dispersion among EGBs' risk premia and the distribution has become more symmetrical (Figure 8). At the same time, the EGB market has shifted from a three-tiered system of core (e.g. Germany, Netherlands), periphery (e.g. Italy, Spain, Portugal) and semi-core (e.g. France, Belgium) issuers to a two-tiered system of core and non-core issuers. In this new framework, France has joined Italy in the non-core segment, while Portugal and Spain, for instance, trade close

to core issuers. These shifts can be explained by differences in political stability and country-specific reforms, but also by the positive effects of the Next Generation EU program for southern European countries.

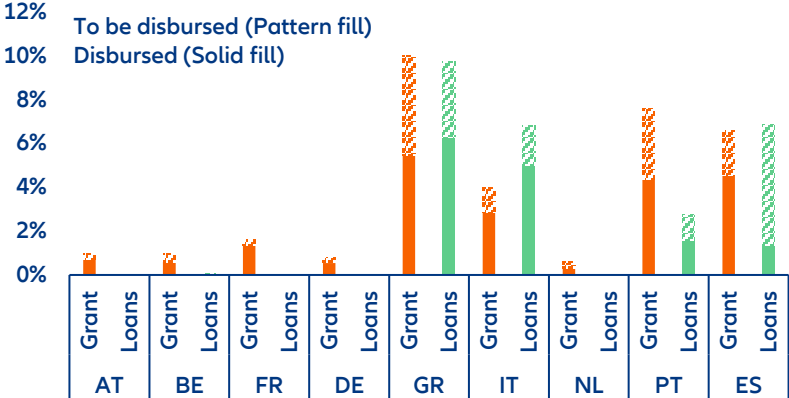
Figure 8: Asset swap spreads for Eurozone government bonds (10y)\* in bps



Sources: LSEG Workspace, Allianz Research. Note: includes Germany, France, Italy, Spain, Portugal, Netherlands, Belgium, Finland, Austria and Ireland. Greece is excluded as the country's government debt has a very long-weighted average maturity (18.7 years) and approximately 73% of its debt is held by official sector creditors.

**Launched in 2020, the NGEU program has had a notable influence on the fiscal positions and debt dynamics of Italy, Spain, Portugal and Greece, and contributed to their strong post-Covid recovery.** These economies were among the main beneficiaries of the Recovery and Resilience Facility (RRF, which includes EUR291bn in loans and EUR359bn in grants), given the redistribution mechanism that favoured countries most affected by the crisis (Figure 9). The impact on both the economic and fiscal outlook has been heterogeneous, reflecting differences in absorption capacity, project implementation and pre-existing fiscal conditions. Moreover, the performance-based disbursement mechanism means that funds are released only upon the satisfactory achievement of agreed milestones and targets. According to Eurostat accounting rules, grants reduce governments' net borrowing requirements as they finance additional public investment without increasing the deficit, while loans are recorded as (long-term) liabilities. Accordingly, many EU countries, especially those with favourable market access and low borrowing costs, chose not to apply for the loan component. This reflects both the limited financial advantage of RRF loans relative to sovereign borrowing conditions and a broader hesitation to expand public debt within an evolving and still fragile European fiscal-governance framework.

Figure 9: NGEU – RRF allocation and disbursement among a sample of countries (% of GDP)

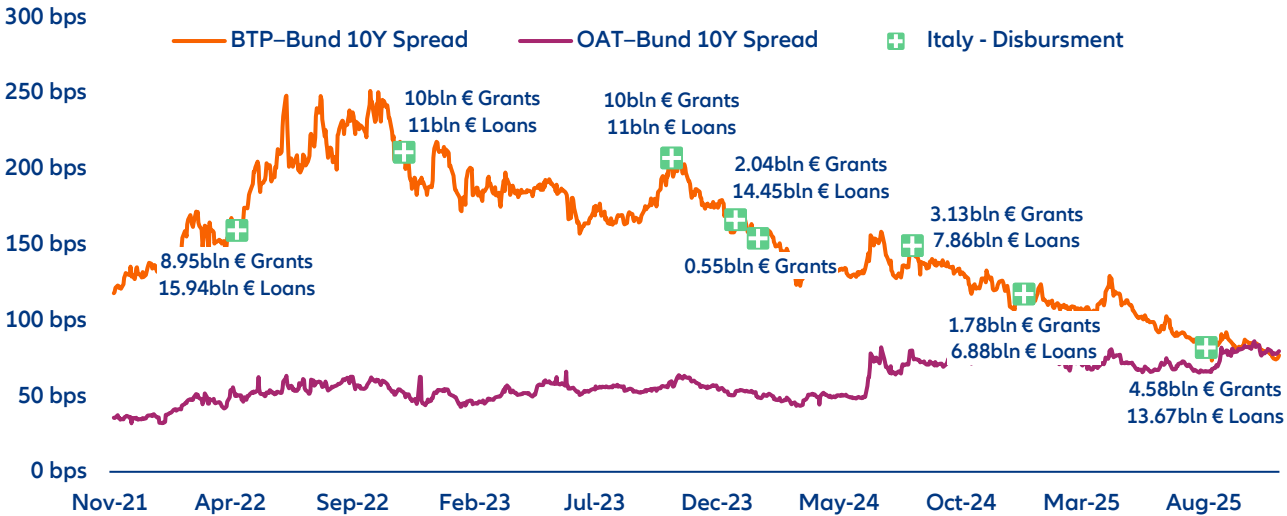


Sources: LSEG Datastream, European Commission, Allianz Research

**Taking on NGEU funding proved to be a winning strategy: from 2020 onwards, major NGEU disbursements coincide with periods of sovereign-spread narrowing.** The comparison of Italy and France is again revealing in this context (Figure 10). Since 2021, Italy has received EUR100bn more NGEU stimulus than France, improving its relative economic and fiscal position and spurring confidence in the country. Accordingly, its spread has contracted

by 170bps, while France’s spread increased by 40bps. The recent spread convergence of Italy and France is therefore not only due to differences in national politics but also has a European dimension.

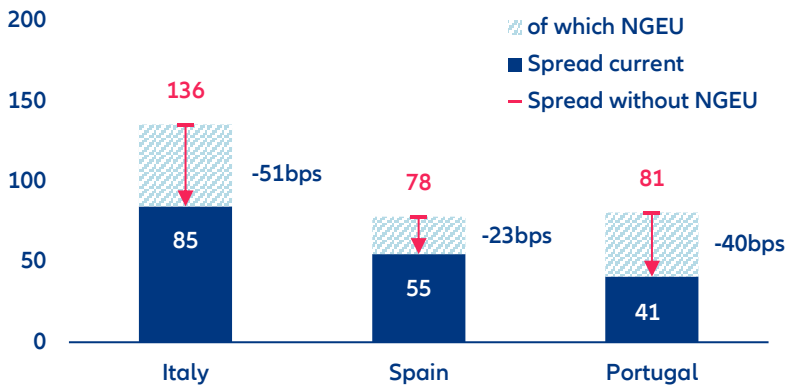
Figure 10: France and Italy – 10Y government spreads evolution and RRF disbursement



Sources: LSEG Datastream, European Commission, Allianz Research

This observation also applies to other big NGEU beneficiaries such as Spain (13.5% of 2021 GDP), Portugal (10.4% of 2021 GDP) and Greece (almost 20% of GDP). Their recent risk premia compression equally coincides with increasing NGEU stimulus. We estimate that since 2021, the growth effect alone amounts to a cumulative +1.0-1.2pp together with a strengthening of their fiscal positions. This improvement in fundamentals is responsible of 30% to 50% of the spread compression since 2021. Without the NGEU effect, the 10y spread (vs Bund) of Italy would currently be +51bps higher at 135bps, for Spain +23bps higher at 78bps and for Portugal +40bps higher at 81bps (Figure 11). This means that for every GDP percentage point in NGEU transfers, the 10-year spread (vs Bund) was compressed by 5bps for Italy, 4bps for Portugal and 2bps for Spain. Not only did NGEU lower the overall EGB spread level, but it also had a stronger effect where fundamentals were weakest and the risk premia were highest.

Figure 11: NGEU effect on risk premium (10y spread versus Bund), in bps



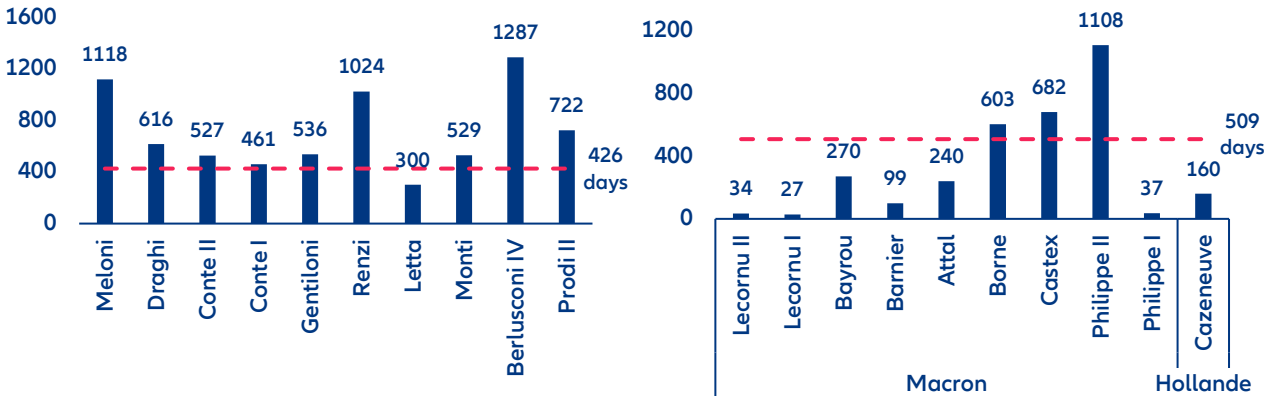
Source: LSEG Datastream, Allianz Research

\*Data as of end Q3 2025. Based on differences in fair spread model where the fiscal and economic variables have been shocked by inverse NGEU effect.

**Improved political stability in southern Europe is another key factor.** A stable political environment helps timely implementation and prevents political risk premiums from negating the positive NGEU effects. Italy provides a clear example: Since taking office in October 2022, the Meloni government has become the third longest-serving in the history of the Republic, far exceeding the average government duration of 426 days since 1948. It is projected to

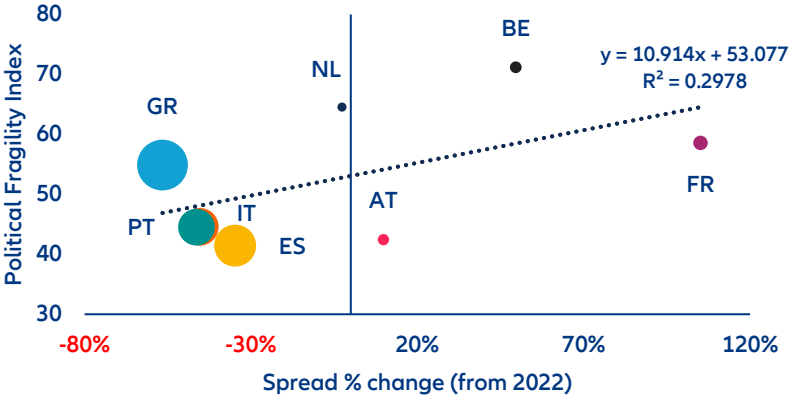
become the longest-lasting government, with possible large support in the 2027 election (Figure 12a). On the other hand, France being the only Eurozone country to see substantial spread widening is also a reflection of increasing political fragility. Since the establishment of the Fifth Republic in 1958, France has seen 48 governments, with an average duration of 509 days. Among the last ten governments, only three have lasted longer than the historical average (Figure 12b). The recent collapse of the Lecornu government following a no-confidence vote demonstrates the ongoing fragility, with an extremely fragmented National Assembly divided into three blocks of comparable electoral weight: the centrist alliance supporting President Macron, the left-wing NFP and the far-right RN. Our Political Fragility Index confirms that Mediterranean countries are currently benefiting from a virtuous combination of fiscal support, political stability and market confidence (Figure 13).

Figure 12a and 12b: Duration (in days) of the last ten Italian (left) and French (right) governments compared to the historical average (dashed line)



Sources: Italian Government Presidency of the Council of Ministers, French Government, Allianz Research

Figure 13: NGEU (% of 2021 GDP) (bubble size), Political Fragility Index, and % change in 10y government spread



Notes: Our Political Fragility Index is computed as  $PFI = 0.3 \cdot Dispersion + 0.3 \cdot Government\ weakness + 0.2 \cdot Disillusion + 0.2 \cdot Polarization$ . The index comprises four components: voting dispersion, voter disillusionment with traditional parties, ideological polarization and government weakness. The subcomponents derived respectively from the Laakso–Taagepera index, the share of votes not supporting government and traditional parties, and the average share of Eurosceptic, populist and extremist votes. For the classification of parties, we used the PopuList database. Sources: LSEG Datastream, European Commission, Politico.EU, Allianz Research.

**The NGEU will help to contain southern EGB spreads in 2026, but risks are slightly tilted to the upside.** We have previously highlighted that the mismatch between resources received and those actually spent implies that, even in the best-case scenario where countries fully absorb their allocations by end 2026 (a scenario that appears particularly challenging for countries such as Spain and Portugal, especially with respect to the loan component), the positive impact on growth is likely to extend beyond 2026. Overall, we see the compression effect of NGEU diminishing while southern EGB spreads are trading at the lower end of our fair value range. Therefore, we consider EGB spread risk in 2026 to be skewed to the upside, albeit only moderate in level.

**Will the convergence trend in EGB market prevail once the NGEU is depleted and no sizeable follow-up program is launched?** Fiscal vulnerabilities may re-emerge in 2027, particularly because NGEU grants are temporarily relieving pressure on fiscal deficits. Moreover, 2027 is a big electoral year in Southern Europe, with elections scheduled in Italy, Spain and Greece. This could alter the constructive political environment that was crucial to the successful roll-out of NGEU funds so far. To mitigate the risk of re-fragmentation, which would hurt capital market integration and monetary policy transmission, the EU could ramp up common debt issuance to finance defence and other large-scale strategic investment programmes. While issuing topic-related debt wrapped in different programs may be the most legible approach for markets (adding layers of complexity), the NGEU program has demonstrated the overall positive effects of such joint financing. The recent convergence in EGB spreads may indeed signal that markets are increasingly pricing a joint underlying EU risk factor, while exit risks are barely priced anymore.

## Trade war: From tariff dividend to Supreme Court scrutiny

**The “tariff dividend” promised to US citizens – which could cost a whopping 1% of GDP – is unlikely to represent a further easing of fiscal policy.** With US tariff policy facing scrutiny at the Supreme Court, President Trump announced on social media that “a dividend of at least \$2000 a person (not including high income people!) will be paid to everyone” from tariff revenues, prompting concerns about an increasing federal deficit amid already large fiscal imbalances. While worries about US fiscal unsustainability are indeed warranted (new customs receipts will not be enough to reduce the US deficit), the tariff dividend in itself is unlikely to add to the deficit. First of all, Treasury Secretary Bessent clarified that the tariff dividend was indeed already embedded in the OBBB Act – enacted during the summer – in the form of USD60bn in tax cuts for households<sup>1</sup>, kicking in from 2026. These tax cuts are, admittedly, much less than the USD 2000 cash handout per person announced by the President. Furthermore, if the President wanted to deliver further tax cuts for households (or direct cash handouts), he would need Congress approval, and it would likely take time to pass new legislation since the Republicans do not have a majority in the Senate. Besides, many Republicans would likely demand that new tax cuts be funded by a new source of revenues. Based on the assumption that 80% of active people (working or unemployed) would be eligible for the tariff dividend, the latter would cost US public finances close to USD290bn, or 1% of GDP (Table 1), which would be difficult to fund with new customs revenues. The effective tariff rate would need to increase by an implausibly high +14pps, pushing the total level to close to 30%. If the tariff dividend of USD 2000 were to pass unfunded, we estimate the measure would boost GDP growth by 0.5pp and inflation by 0.3pp (see Table 1 again).

Table 1: Cost of a potential “tariff dividend” and macro-economic impact (if measure not funded)

Impact of US tariff dividend	
Number of employed (million)	163 394
Number of unemployed (million)	7 384
Total active population excl 20% highest revenues (million)	143 453
<b>Cost of the tariff dividend (bn USD)</b>	<b>286.9</b>
<b>Cost of the tariff dividend (% of GDP)</b>	<b>1%</b>
Dividend as a share of revenue for lowest 20% (on average)	15%
Dividend as a share of revenue for middle 20% (on average)	5%
Average marginal propensity to consume (upper range)	45%
<b>Additional consumption over a year (bn USD)</b>	<b>129.1</b>
- in % of total consumption	0.6%
- contribution to gdp (pp)	0.5
- impact on inflation rate (pp)	0.3

Sources: Federal Reserve, Allianz Research

**Much more important for the US macroeconomic and fiscal outlook is the possibility that the Supreme Court strikes down the tariffs that were implemented using the International Emergency Economic Powers Act (IEEPA), with no easy options to recoup lost revenues in the short term.** What hangs in the balance are the tariffs imposed on imports from Canada, Mexico and China to address fentanyl and border security, and those on imports from the rest of the world to address trade deficits. On 28 May, the Court of International Trade had ordered the

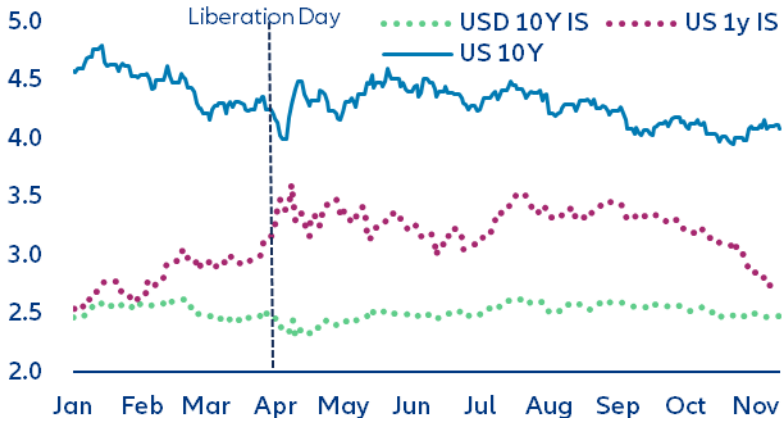
<sup>1</sup> “The \$2000 dividend could come in lots of forms, in lots of ways [...] you know, it could be just the tax decreases that we are seeing on the President’s agenda – you know, no tax on tips, no tax on overtime, no tax on Social Security, deductibility of auto loans” said Bessent.

removal of these tariffs, but the decision was appealed and the Supreme Court is set to provide the final ruling, possibly before the end of the year. Should it decide to strike down IEEPA-related tariffs, bilateral deals secured as part of that act could also be repealed (which, among other things, would reinstate tariffs applied on automotive imports from certain countries). While the White House has alternatives to raise tariffs again, a period of volatility and uncertainty might ensue. Additionally, the Supreme Court would also have to decide on the course of action to remove IEEPA-related tariffs, including whether the US would have to refund previously collected customs duties.

**If the Supreme Court strikes down the IEEPA tariffs, the fiscal deficit could rise to -8.0% of GDP in 2026.** Our interim federal fiscal deficit forecasts for 2025 and 2026 (calendar years) are -6.9% and -7.0% GDP, respectively. One of the key fiscal assumptions is that the effective tariff rate settles at around 15% from Q4 2025. But if the Supreme Court strikes down the IEEPA tariffs – which we estimate make up 70-80% of the extra customs receipts flowing to the Treasury – and orders refunds of collected duties, we estimate that the fiscal deficit would climb to -8.0% GDP in 2026. This is because the Treasury would be deprived of around USD110bn of IEEPA customs receipts, and, on top of that, would be compelled to refund another USD110bn to importers. Added to that, the OBBB Act will add USD110bn of tax cuts for households and corporates. Note that we have incorporated the growth-boosting effect of tariffs (+0.4pp GDP growth) This scenario is unlikely to materialize since the Trump administration would very likely use other means to replace the IEEPA tariffs. However, it is not certain that it would manage to recoup quickly as much of the customs receipts (see below), meaning that the US fiscal deficit in 2026 could hover between -7% and -8% GDP, depending on which tariff sections the White House triggers and how quickly it does so. Rather than letting the deficit swell, the US administration could also find new savings, either by cutting spending or raising other taxes, but that would be unpalatable politically. The broader point is that the US has come to rely on tariff revenues as a quasi-permanent source of fiscal support. That dependence makes it highly likely the administration will seek to preserve them, one way or another – and increases the chances that they persist under future administrations too.

**A partial removal of tariffs by US courts would push interest rates lower at the margin, as lower inflation expectations would outweigh the higher fiscal deficit.** If IEEPA tariffs were indeed struck down, markets would essentially roll back parts of the developments that followed “Liberation Day” (April 2), when tariffs were first introduced. Initially, markets reacted with a typical risk-off response, with investors moving into safe US government bonds, pushing yields down. Within a few days, however, this move was more than reversed: near-term inflation expectations rose sharply, pricing in the one-off effect of higher tariffs (Figure 14). This led to a delay in expected Fed cuts, which was the first driver to push interest rates up. The second driver stemmed from the de-dollarization trend, which not only weakened the dollar but also reduced overseas demand for US government bonds. This pushed 10-year yields higher relative to Fed pricing (OIS swap rates), as highlighted in the (inverse) swap spread in Figure 15, which can be interpreted as a risk premium of government bonds. Fiscal aspects overall played a minor role. The effect of higher revenues from tariffs can almost be neglected in comparison to the extremely large US deficit. Moreover, the additional revenues from tariffs on government balances were largely offset by increased expenditure stemming from the OBBB. Over the course of the year, the de-dollarization trend faded alongside inflation expectations, as actual inflation proved milder than initially feared and trade deals were implemented. Swap spreads normalized, and more Fed cuts were priced in again, also driven by a weakening labor market. Overall, this pushed 10-year yields below pre-“Liberation Day” levels (latest: 4.09% compared to 4.16% on 1 April; trading range since 1 April: 3.95%–4.60%).

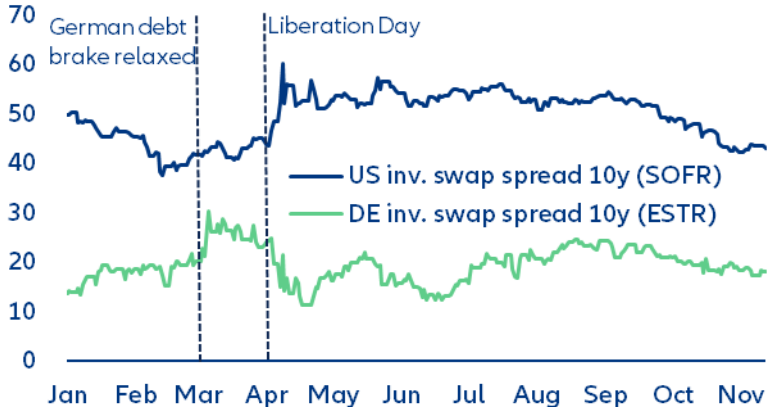
Figure 14: US 10y government bond yield, short- and long-term inflation expectations (inflation swaps), %



Sources: LSEG Datastream, Allianz Research

That said, a partial rollback of tariffs would likely lower near-term inflation expectations, giving the Fed more leeway to cut rates and focus on labor market weakness, thereby pushing yields down. However, uncertainty around alternative measures from the Trump administration could reignite the de-dollarization trend (yields up), potentially muting the overall effect. Depending on the exact court ruling, yields could drop by 10-20bps from current levels, but not more. Fiscal impacts – whether from tariffs or a potential tariff dividend – play a subordinate role.

Figure 15: Spread of 10y government bond yield over 10y OIS swaps (inverse swap spread), %



Sources: LSEG Datastream, Allianz Research

After a brief respite from uncertainty following recent deals and ongoing negotiations, global trade may face another period of volatility, with the US tariff rate ranging between 5-15% depending on the Supreme Court decision and how the US administration reacts. We estimate that trade deals that were reached in October (e.g. with China, South Korea etc.) brought down the US global tariff rate from 17% to 15%, while ongoing negotiations with Switzerland and India could potentially result in another -2pps reduction. But the outcome of the ongoing legal battle could bring another bout of volatility to global trade. If struck down, the Trump Administration would turn to other options to bring tariffs back up. First and most unlikely, the White House could take a more constrained attitude, leaving non-sector targeted tariffs at a Pre-Trump II level, only maintaining already concluded Section 232 investigations (on autos, steel, aluminum and copper), reducing the theoretical US global tariff rate to 5% (from the current 15%). Alternatively, the White House could take a more confrontational tone again by implementing Section 122 of the Commerce Act, introducing 15% bilateral tariffs for 150 days for countries with a “large and serious”

balance-of-payment deficit<sup>2</sup>. The phrasing leaves space for interpretation, allowing flexibility to impose tariffs on countries with trade deficits, which we estimate would bring the theoretical US global tariff rate to 15%, if no sectoral exemptions were implemented. Yet, if the White House would decide to maintain the same sectoral exemptions as in the current IEEPA reciprocal tariffs, the US global tariff rate be brought to 9%. Additionally, Section 338 of Commerce Act is also available in theory, allowing the White House to raise tariffs to up to 50% on countries presenting persistent discriminatory trade practices against the US. While tariffs under Section 338 do not have a time limit, the legal framework of applying them seems more questionable than Section 122.

**A regime where Section 122 replaces IEEPA tariffs would benefit Brazil, Bangladesh, India, China, Pakistan, Switzerland, South Africa, Vietnam and Indonesia the most.** We estimate that exporters from these markets could benefit from at least a -10pps cut in the average US tariff rate from current levels (especially if the same sectoral exemptions as for the IEEPA reciprocal tariffs remain in place). As Section 122 is by definition temporary (beyond 150 days, Congressional approval is needed), frontloading of shipments from these markets is likely to take place ahead of potentially further tariff hikes under other sections (see below). In contrast, under Section 122, Saudi Arabia, Mexico and Ecuador could face higher tariffs than current levels, as well as Taiwan, Norway, South Korea or the EU, in case no sectoral exemptions are put in place.

Table 2: US average import tariff by country

	US imports		Trade balance (2024)	US tariff rate					Maximum export losses (2026, USD bn)			
	USD bn (2024)	share of total (2024)		If the Supreme Court strikes down IEEPA tariffs (and sectoral tariffs remain in place)					If the Supreme Court strikes down IEEPA tariffs (and sectoral tariffs remain in place)			
				Pre-Trump II	Current	No immediate reaction from Trump Administration	Trump Administration applies Section 122, with sectoral exemptions (same as for IEEPA reciprocal tariffs)	Trump Administration applies Section 122, without sectoral exemptions	Current tariffs	No immediate reaction from Trump Administration	Trump Administration applies Section 122, with sectoral exemptions (same as for IEEPA reciprocal tariffs)	Trump Administration applies Section 122, without sectoral exemptions
Argentina	7	0%	2	0.7%	11%	6%	6%	6%	-1	0	0	0
Australia	17	1%	18	0.1%	12%	4%	4%	4%	-2	-1	-1	-1
Bangladesh	9	0%	-7	15.1%	35%	15%	15%	15%	-2	0	0	0
Brazil	44	1%	5	1.0%	32%	8%	8%	8%	-16	-4	-4	-4
Cambodia	13	0%	-13	6.5%	23%	7%	14%	15%	-3	0	-1	-1
Canada	422	13%	-74	0.1%	15%	4%	7%	16%	-74	-17	-36	-77
Chile	17	1%	1	0.0%	6%	1%	1%	1%	-1	0	0	0
China	463	14%	-319	13.0%	30%	14%	15%	16%	-66	-6	-11	-16
Colombia	18	1%	1	0.2%	14%	6%	6%	6%	-3	-1	-1	-1
Ecuador	9	0%	-2	0.4%	10%	1%	9%	16%	-1	0	-1	-2
EU	618	18%	-247	1.3%	13%	5%	10%	17%	-85	-24	-65	-112
Hong Kong	6	0%	22	1.4%	9%	2%	2%	2%	-1	0	0	0
India	91	3%	-49	2.4%	32%	5%	12%	17%	-32	-3	-10	-15
Indonesia	30	1%	-19	4.6%	24%	6%	14%	16%	-7	0	-3	-4
Japan	152	5%	-72	1.5%	13%	10%	12%	19%	-21	-16	-18	-31
Kenya	1	0%	0	0.3%	9%	1%	1%	1%	0	0	0	0
Malaysia	54	2%	-26	0.7%	13%	2%	7%	16%	-8	-1	-4	-9
Mexico	510	15%	-176	0.3%	5%	2%	7%	14%	-27	-11	-43	-81
New Zealand	6	0%	-1	1.1%	15%	2%	14%	16%	-1	0	-1	-1
Norway	7	0%	-2	0.6%	9%	2%	9%	16%	-1	0	-1	-1
Pakistan	5	0%	-3	9.7%	29%	10%	15%	15%	-1	0	0	0
Philippines	15	0%	-5	1.5%	13%	3%	9%	16%	-2	0	-1	-2
Saudi Arabia	13	0%	0	0.3%	4%	1%	6%	15%	-1	0	-1	-2
Singapore	44	1%	2	0.1%	10%	1%	1%	1%	-5	0	0	0
South Africa	15	0%	-9	0.4%	21%	6%	10%	18%	-3.6	-1.0	-1.7	-3.0
South Korea	135	4%	-70	0.2%	13%	9%	11%	19%	-21	-14	-18	-30
Switzerland	64	2%	-39	0.7%	25%	2%	10%	16%	-18	-1	-7	-11
Taiwan	119	4%	-76	1.2%	9%	3%	7%	17%	-11	-3	-8	-21
Thailand	66	2%	-48	1.4%	17%	4%	10%	16%	-12	-2	-7	-12
Türkiye	18	1%	-3	3.5%	19%	7%	15%	18%	-3	-1	-2	-3
UAE	8	0%	19	2.4%	21%	16%	16%	16%	-2	-1	-1	-1
UK	69	2%	11	0.9%	7%	4%	4%	4%	-5	-3	-3	-3
Vietnam	142	4%	-129	4.1%	22%	5%	11%	16%	-30	-1	-12	-19
<b>Global</b>	<b>3359</b>	<b>100%</b>	<b>-1295</b>	<b>2.5%</b>	<b>15%</b>	<b>5%</b>	<b>9%</b>	<b>15%</b>	<b>-549</b>	<b>-111</b>	<b>-263</b>	<b>-465</b>

Sources: various, Allianz Research

**Enacting Section 122 for 150 days would provide the Administration with more time to continue investigations under other Sections (232, 301), and potentially open new ones.** The Commerce Department’s investigations into pharmaceuticals and semiconductors will be concluded before the end of the year, giving President Trump until the end of Q1 2026 to make a decision on imposing tariffs on both sectors. Additional sectors under ongoing Section 232 investigations include critical minerals, robotics, drones, medical equipment, wind turbines, polysilicon and

<sup>2</sup> Earlier this year, lower courts concluded that rather than using IEEPA, which doesn’t mention tariffs at all, President Trump should have invoked Section 122 of the 1974 Trade Act, which explicitly outlines what powers Congress was willing to delegate to deal with balance of payments problems.

aircrafts. Other tariff options include Section 301 and Section 338 of the Commerce Act. Section 301, which has already been used to apply tariffs on Chinese shipbuilding and cranes, allows the Administration to impose tariff-based retaliation on foreign entities that violate trade agreements or disadvantage US commerce. However, this section comes with constraints as the investigation must review petitions, hold public hearings and issue findings before issuing recommendations. Currently seafood is under investigation under Section 301.

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

#### **FORWARD-LOOKING STATEMENTS**

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

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

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