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What to watch: Fed preview, AI bubble risks for US households and a softening tone on tariffs – for now

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In summary

Fed: Nearing the end of the road for rate cuts? After several weeks of mixed messages and internal disagreement, Federal Reserve officials now appear aligned on delivering a 25bps rate cut at the next meeting on 10 December. With the unemployment rate likely to rise a little further through Q1 2026 and persistently weak job creation, we expect another 25bps cut in the first half of 2026 (most likely in March) as the Fed continues to prioritize labor market risks. However, sticky core inflation and strengthening underlying growth momentum – generated by loosening fiscal and financial conditions as well strong AI-related capex – should eventually keep the Fed on a prolonged hold, with the Federal Feds funds rate expected to settle at our long-standing view of 3.5% (upper bound). Our financial conditions indices show that 'risky' financial conditions (credit spreads, equity markets) are particularly loose in 2025 relative to historical averages. Historically, financial conditions have helped to predict near-term future economic activity and they signal an increasing growth-boosting impulse in the quarters ahead.

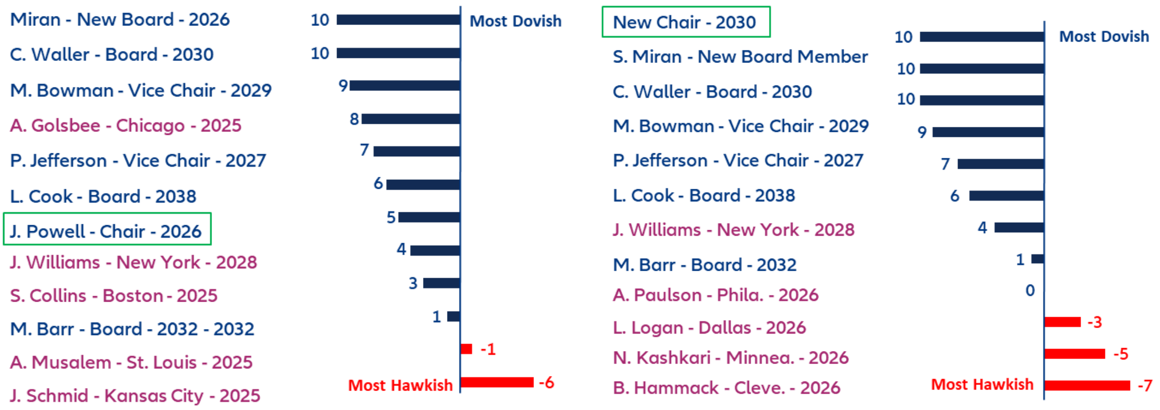
US households: On the front line of an AI stock market correction. US households have significantly benefited from the AI-driven stock market surge, with the S&P 500 rising 74% over the past three years, largely powered by a small group of AI stocks. Because households hold 65% of their financial savings in equities, pensions and mutual funds, their gross financial assets rose nearly +28% (USD30.6trn). This heavy exposure to equities likely boosted confidence and spending during the rally but it also creates vulnerability: A market correction could quickly reverse sentiment and in turn weigh on GDP. Economic fragility is worsened by the increasingly k-shaped structure of the US economy, with the top 10% of households owning 87% of total assets invested in corporate equities and mutual fund shares, and 67% of total net wealth, while driving about half of retail spending. In our baseline scenario, we expect a short-lived 15% correction in the S&P500 in early 2027, driven by earnings misses, to shave -0.2pp off annual GDP growth. In a downside scenario mounting fundamental concerns about the AI business case, triggered by more significant earnings misses of US chipmakers and cloud providers, would result in a -25% correction. This would wipe out USD16trn in household wealth – equivalent to an almost -8% drop in total net worth – and reduce US GDP growth by -1.6pp, sending the economy into recession.

Trade war: A softening tone on tariffs – for now. The effective US tariff rate likely remained around 11-12% in October, still at the highest level since the 1940s, and the lag in tariff implementation is likely to push it up to 14% at most by year-end. Our proprietary indicator confirms a visible softening in the tone of US trade policy in the past month, especially in favor of many Asian countries. In contrast, roadblocks seem to remain when it comes to the EU. In this context, global trade will likely continue to show resilience through the end of 2025 and beginning of 2026, with annual growth now expected at +3.5% and +1.3%, respectively, with potential upside on this latter number as uncertainty persists. Half of the upward revision in our forecast for 2025 (+0.7pp) is due to a more contained trade war impact than initially expected, while the rest is explained by the boost in global services, as well as the AI boom triggering higher exports of both goods and services.

Fed: Nearing the end of the road for rate cuts?

After several weeks of mixed messages and internal disagreement, Federal Reserve officials now appear aligned on delivering a 25bps rate cut at the 10 December FOMC meeting. The minutes from the October meeting were unusually blunt, noting that "many" participants preferred leaving rates unchanged for the rest of the year, while only "several" supported another cut in December. Through November, several voting members and regional Fed presidents – including S. Collins, A. Goolsbee, A. Musalem and J. Schmid – publicly voiced skepticism or outright opposition to a near-term cut. Other governors, such as M. Barr and P. Jefferson, also struck a cautious tone, urging a slower pace of easing. The debate intensified when FOMC Vice Chair J. Williams surprised markets by signaling support for a "near-term" rate cut, highlighting an unusually divided committee. By most accounts, the FOMC had split into two equal camps: six favoring a hold and six backing a December cut – a rare occurrence in the committee's history. However, by late November, the odds of a rate cut appeared to rise. In our assessment, voting members moved towards consensus to avoid the highly awkward optics of a tie vote – especially given that the Chair does not hold a casting vote. A deadlock would have risked sending confusing and potentially damaging signals about the Fed's communication and internal cohesion. In fact, the shifting composition of the FOMC in 2026 – with a new Chair coming in May and rotating new regional Fed governors – points towards increasing dispersion of views in coming months: the new Chair will likely be very dovish, but some new incoming Fed governors – mostly notably B. Hammack and N. Kashkari – hold hawkish views.

Figure 1: FOMC composition: 2025 (left) versus expected in 2026 (right)

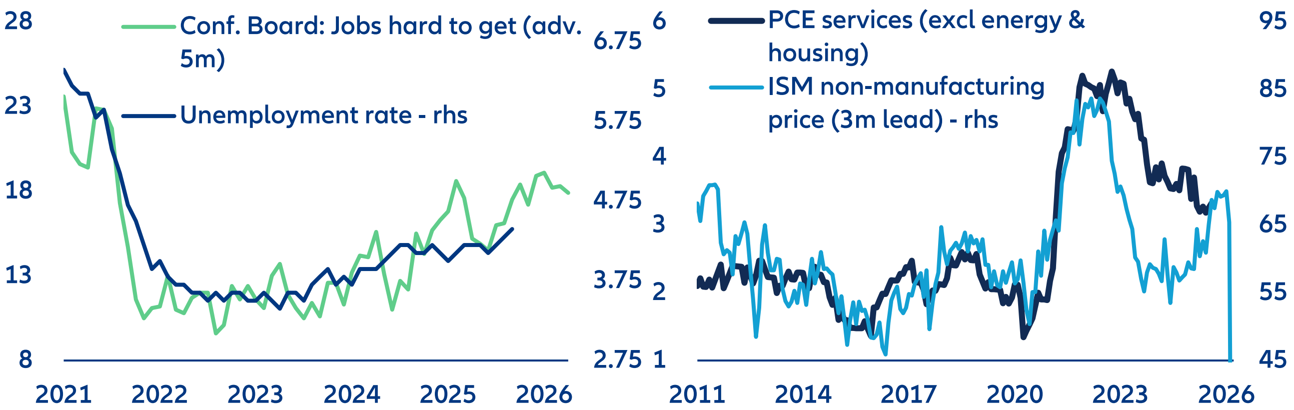


Sources: ICT Market Research, Fred, Allianz Research

Notes: A score ranging from 10 (most dovish) to -10 (most hawkish) is assigned to each of the FOMC's 12 voting members, based on the ICT Market Research classification. Names highlighted in purple are regional Fed governors and names highlighted in blue are Fed Board members. Dates shown next to the names indicate the end of their tenure as voting member in the FOMC. We assume that L. Cook remains a Fed Board member and that current Chair Powell leaves the Fed in May and is replaced by a dovish Chair. The median score in 2025 is 5.5 with a standard deviation of 4.8, against an expected median score of 5.0 in 2026 and a standard deviation of 6.2.

We believe a further modest increase in the unemployment rate will push the FOMC towards another rate cut – likely in March. From that point on, however, sticky inflation and good underlying growth momentum should keep policymakers on hold and shift their focus back toward inflation risks. The softening of labor demand since the summer has been central to the Fed's decision to ease policy pre-emptively, despite persistent inflationary pressures. Hiring has been weighed down by a combination of policy uncertainty, tariff-driven pressure on profit margins and subdued demand across non-tech sectors. Notably, production in non-ICT industries accounted for less than half of GDP growth in the first half of 2025, even though these sectors represent roughly 93% of the economy. At the same time, weak labor force growth – partly a consequence of tighter immigration policies – has helped keep the unemployment rate from rising more meaningfully. Still, we expect some additional upward drift as labor demand remains soft in the near term – recently confirmed by weak ADP employment figures for November (-31K). Indicators such as the Conference Board's "Jobs Hard to Get" index point to the unemployment rate rising toward 4.7–4.8% by March (up from 4.4% in September), before leveling off (Figure 2, left). Looking further ahead, the monetary and fiscal easing embedded in the One Big Beautiful Bill package should begin to revive labor demand through 2026, as well as very loose financial conditions (see below). In this environment, we expect the FOMC to increasingly refocus on inflation persistence. Business surveys continue to highlight persistent stickiness to key components of core inflation, underscoring the challenge the Fed faces in its transition away from a growth-supportive stance (Figure 2, right). Though measures of input costs have eased in some business surveys, partly thanks to lower oil prices, these surveys still indicate output prices above the 2% Fed target for the next months. In all, we maintain our long-standing view that the Fed will keep interest rates at 3.5% from Q1 or Q2 2025, higher than market pricing. At that point, the Fed Funds rate could stand 75bps below the Taylor rule-prescribed level, increasing inflationary risks[1].

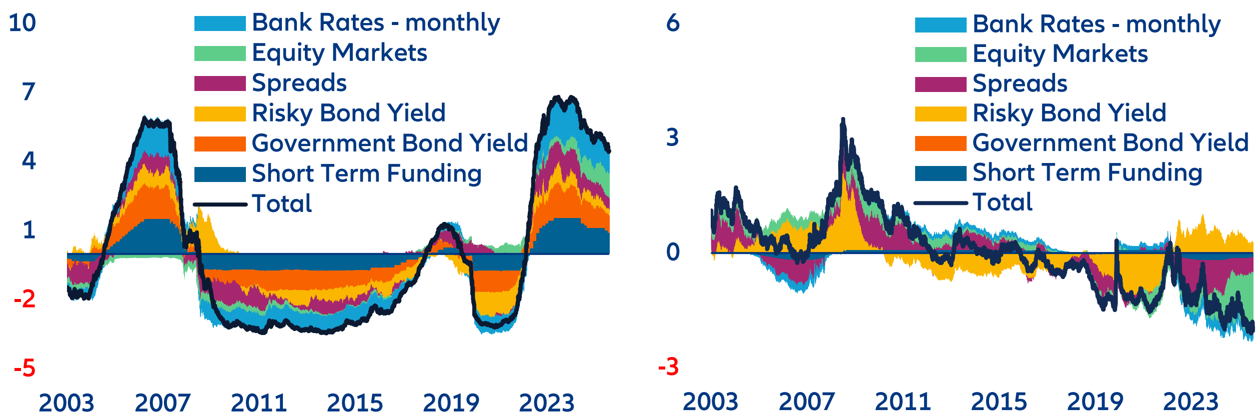
Figure 2: Unemployment rate (left) ; PCE services (excluding energy & housing) inflation (right)



Sources: LSGE Datastream, Allianz Research

Financial conditions are very loose, signaling increasing growth support for early 2026. Monetary policy influences the economy through financial conditions: market interest rates, credit spreads, equity prices etc. We replicate the financial conditions indices (FCI) built by the BIS[2] in a recent paper to assess how much Fed monetary policy easing has impacted growth so far and what could be expected in the few months ahead. One advantage of this approach is that financial conditions are summarized into two components: the Safe Yield Factor, which gives an higher weight to the general level of safe interest rates (such as government bond yields and money market rates) and the Risk Factor, which gives a higher weight to broader financial risks (such as credit spreads and equity market conditions). The two factors are shown in Figure 3.

Figure 3: Safe Yield Factor (left) and Risk Factor (right)



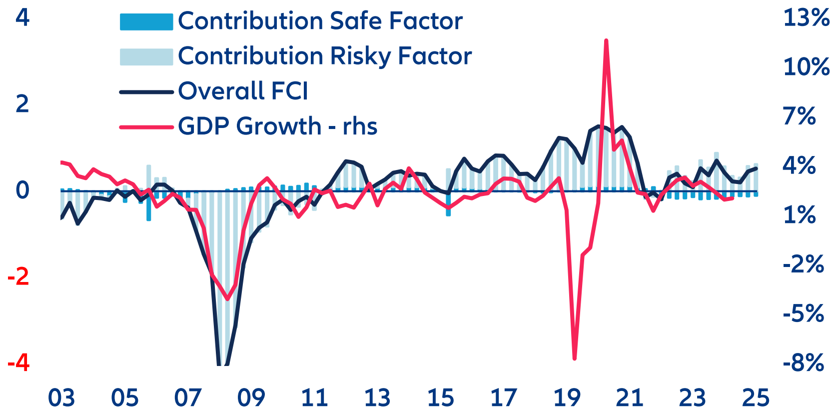
Sources: LSGE Datastream, Bloomberg, BIS, Allianz Research

Monetary policy transmits through both factors, though the transmission is evidently much stronger in the Safe Yield Factor since the Fed can stir safe yields more easily (particularly at the short end). It is noteworthy that the Risk Factor has loosened considerably since the Covid-19 crisis: in fact, "risky" financial conditions have never been so

[1] *See our report: [What to Watch 23 October 2025](#).*
[2] *Financial conditions and the macroeconomy: a two-facto view, BIS Working Papers No 1272, 16 June 2025.*

loose in our sample starting in the early 2000s. The loosening has been driven mostly by equity markets and credit spreads. Financial conditions today can also help to predict future economic activity. We find that current loose financial conditions are expected to increasingly support GDP growth in the quarters ahead (Figure 4). Risky conditions have historically had a much stronger impact than safe conditions.

Figure 4: US GDP growth (% year-on-year) and financial conditions near-term growth-impulse (standard-deviations)



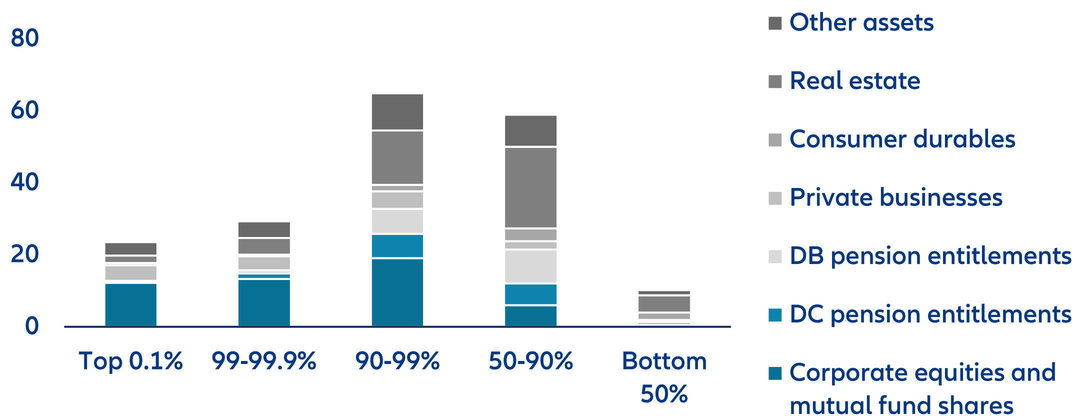
Sources: LSGE Datastream, BIS, Allianz Research

US households: On the front line of an AI stock market correction

US households profited strongly from the AI-fueled stock market rally, thanks to their significant exposure to equities. But this may prove to be a vulnerability should markets correct. The S&P500 increased by 74% between the end of 2022 and Q3 2025 – with 75 AI stocks driving 70% of the rise. With US households' significant exposure to equities – 31% of their financial savings are held in corporate equities, 25% in pension funds (defined benefits and defined contribution entitlements) and 10% in mutual fund shares – their gross financial assets grew by almost 28% or around USD31trn, and total US household net wealth by 22% during the same period. But this notable exposure – a combined 65% of financial savings, around 6pps above the long-term average, and 26ppt higher than in Europe – is a double-edged sword. When markets rally, consumers feel more confident and are likely to increase spending. In fact, the AI-induced equities rally was likely a key driver of the resilience in US consumption growth over the past three years. But when markets correct, consumers are likely to tighten their belts. The resulting retreat in spending can topple the US economy as household consumption is typically the most important driver of US GDP growth.

The increasingly unbalanced, K-shaped structure of the US economy is adding to economic fragility while leaving the broader economy more exposed to shocks and bouts of heightened volatility. The majority of the asset classes mentioned above is concentrated among the top 10% of US households: collectively, they own 87% of the total private wealth invested in corporate equities and mutual fund shares (Figure 5).

Figure 5: Shares of wealth (in %) by wealth percentile groups, 2025Q

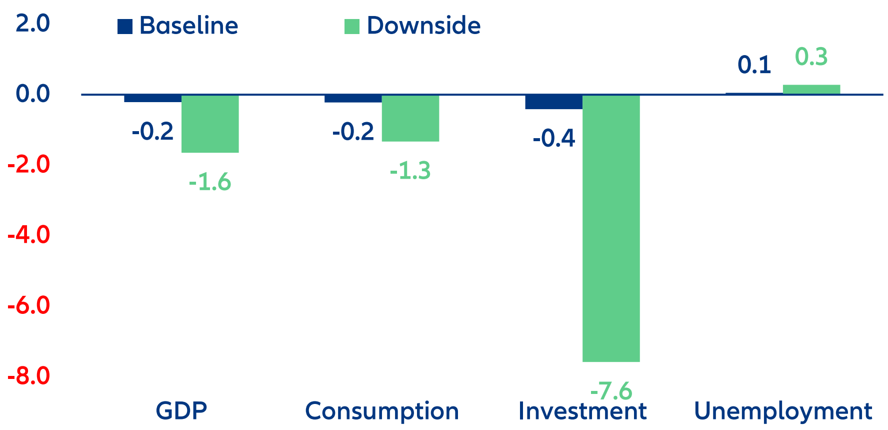


Sources: The Federal Reserve, Allianz Research.

In addition, more than half (56%) of total defined contribution pension entitlements are held by the richest 10% of households. Overall, the top wealth decile holds 67% of total net household wealth. Moreover, US GDP growth has been increasingly powered by high-income consumers – with the top 10% of earners accounting for roughly half of US retail spending in Q2 2025 – and the dominance of mega-cap corporations, leaving fewer households and sectors carrying a disproportionate share of economic momentum. This concentration also creates fragility as momentum rests on markets and affluent consumers while lower-income households and smaller firms lack meaningful buffers. Any significant market downturn could rapidly erode high-income consumption and corporate confidence, amplifying negative economic outcomes.

If the AI equity bubble bursts, it would weigh on US economic growth and heighten recession risks. For now, our AI bubble risk monitor[3] suggests rising but still manageable bubble pressures. While overall we do not dismiss the profound impact that AI will have on economies, the real risk is that markets may have priced in decades of growth overnight, leaving valuations vulnerable if adoption proves slower than expected. Therefore – following a period of markets switching back and forth between FOMO and fear-off mode – we eventually expect an earnings miss in early 2027 to trigger a -15% correction in the S&P500. Given that the set-back will not be triggered by fundamental concerns about the viability of the AI business case but rather exuberant expectations, it would be followed by a swift V-shaped recovery completed over a time horizon of six to nine months. Such a correction would lead to a -4.6% drop in total US household net wealth. The overall drag on annual GDP would tally up to -0.2pp (Figure 6).

Figure 6 : Impact of a correction in the S&P500 on the real economy (in pp)



Sources: Oxford Economics, Allianz Research

In a downside scenario, if earnings misses of US chipmakers and cloud providers[4] prove more substantial, raising fundamental concerns about the AI business case, the resulting -25% S&P500 correction could eliminate USD16trn in household wealth, equivalent to an almost -8% drop in total net worth, leading to a prolonged period of weaker confidence and spending. The resulting erosion in wealth and sentiment, together with a collapse in AI investment, would push the US economy into a recession in 2027 despite substantial monetary easing. With equity markets taking up to two years to recover in this scenario, the drag on economic activity would be substantial: US GDP growth in 2027 would be -1.6pps lower relative to the baseline. The most severe impact would be visible in investment as the bubble would also trigger an abrupt reversal in total business investment. Household consumption would be severely affected because of weak sentiment and negative wealth effects inducing households to hold back spending (Figure 6).

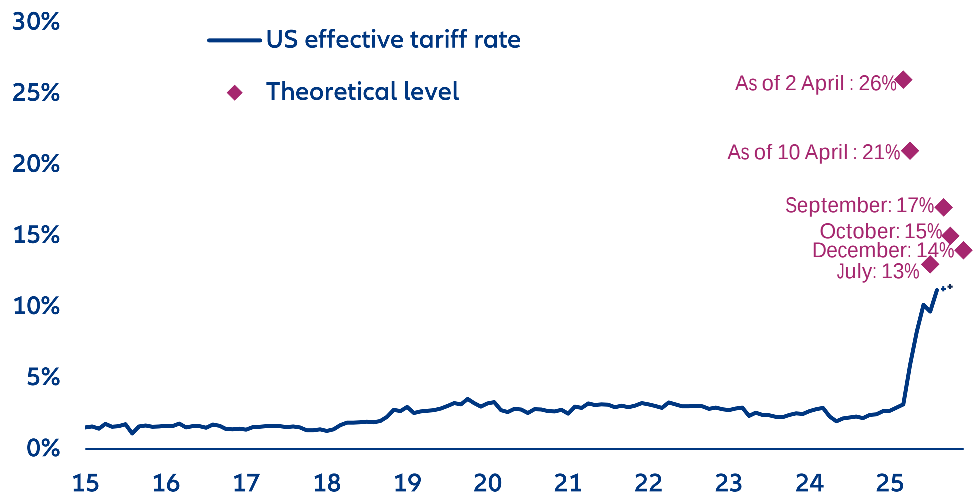
Trade war: A softening tone on tariffs – for now

The effective US tariff rate likely remained around 11-12% in October, still at the highest level since the 1940s. There is likely limited room for further upside going forward: We estimate it could reach at most 14% by year-end. Data on collected duties in USD terms are already available until October, but imports data are not yet

[3] *See our report: [What to Watch 28 November 2025](#).*
[4] *See our report on the risks of circular deals in AI: [What to Watch 31 October 2025](#).*

available to calculate the actual tariff rate. Judging from available survey data (e.g. the imports index of the ISM manufacturing survey) and taking into account the trend in the past few months, the effective US tariff rate is likely to have only marginally creeped up in September and October, from the 11.2% reported for August. In comparison, we had estimated a theoretical tariff rate of 17% in September and 15% in October, with the gap likely explained by continued mitigation strategies from firms[5]. This gap is likely to continue to decline until the end of the year as corporate adaptative behaviors run their course. Moreover, a number of recent changes in US trade policy have further lowered our estimate of the theoretical tariff rate to 14%. Most importantly, the list of goods that are exempt from US reciprocal tariffs has been expanded further, mainly including more food products. This is a clear sign of US tariff policy softening as the US consumer starts to feel the effects: US inflation stood at 3% in September (with categories such as coffee and beef seeing the fastest acceleration since the beginning of the year) as companies seem to be passing on the higher costs. We estimate that inflation likely rose further to 3.2% in October. In November, the White House issued a new executive order that reduced food tariffs across the board.

Figure 7: Effective vs. theoretical US tariff rates



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

The Latin American region remains best positioned against US trade policy, particularly after the review of restrictions imposed on Central America, Argentina and Brazil. Commodity-dependent countries have turned trade tensions to their advantage by filling supply gaps and increasing their market share – particularly in Asia. In the case of Brazil, for example, US tariffs were imposed despite a likely USD10bn US trade surplus in 2025, equivalent to 0.4% of Brazil's GDP – leading to an increase of 0.1pp this year compared to 2024. However, Brazil's overall trade balance remains well in surplus at 2.8% of GDP in 2025, according to our forecasts. The November carve-out on Brazilian tariffs brought them from an average of 40% to 25%, cutting export losses by USD6bn in 2026. Soybean exports contribute 2.5pps of GDP in 2025 and almost 75% of sales this year are to the Chinese market. At the same time, agrochemical inputs and processed goods remain among the Brazilian goods subject to US tariffs, with potentially significant effects on upstream value chains and investments in labor-intensive sectors that need long-term certainties, while giving vertically integrated producers the opportunity to take advantage of regional synergies. Argentina is also expected to benefit from an increase in the quota of meat that can be imported by the US, with the share of beef directed towards the US likely to increase from 3% to 11%, albeit still subject to the 10% flat tariff. However, again in this case, 69% of the meat exported from Argentina in the first nine months of the year went to China, equivalent to around 480,000 tons or USD2.6bn in the full year (0.4pp of GDP).

Beyond Latin America, our proprietary indicator confirms a visible softening in the tone of US trade policy in the past month, especially in favor of many Asian countries. In contrast, roadblocks seem to remain when it comes to the EU. We construct a US bilateral relationships tone tracker, accounting for US trade partners constituting 95% of US imports, based on tone scores from the GDELT Project (Global Database of Events, Language, and Tone).

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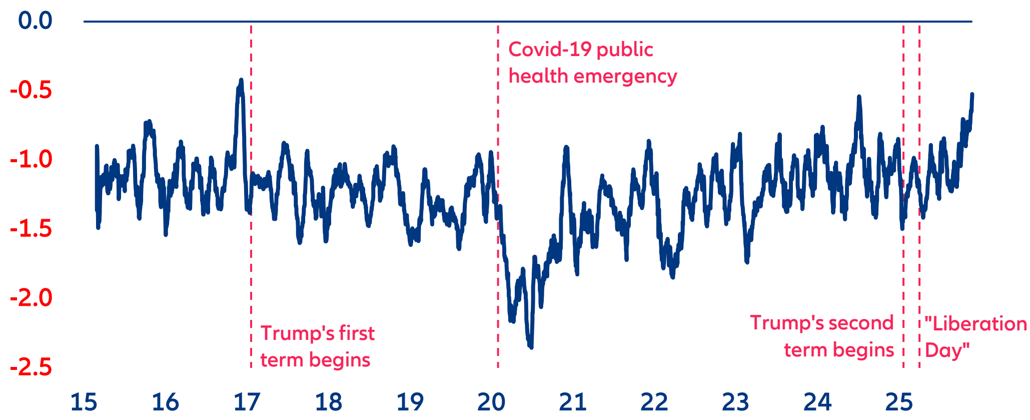
[5] *See our report: [What to Watch 5 September 2025](#).*

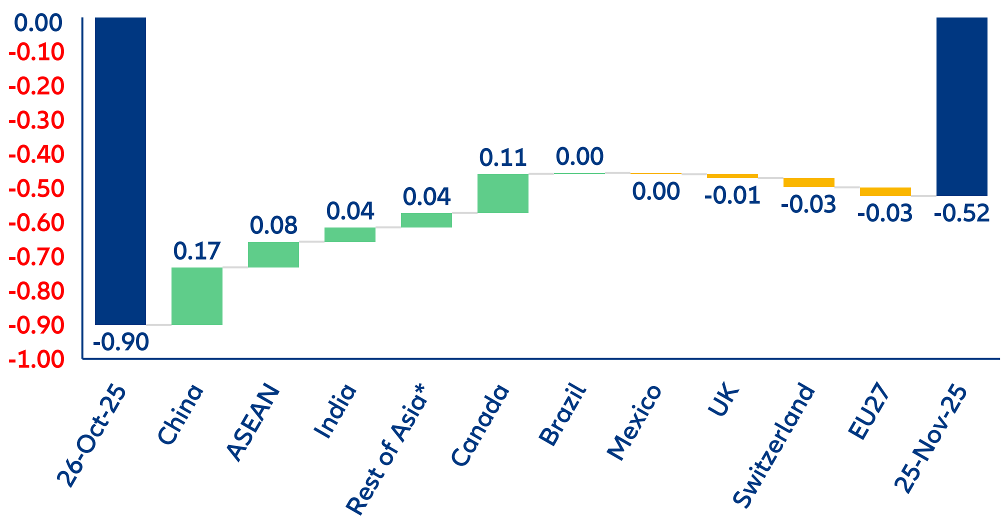
These tone scores derive from an LLM-based sentiment analysis performed on daily events where the US addresses or takes actions against other countries. We then calculate a weighted average to get a global aggregate. Our tone tracker significantly increased between the end of October and the end of November (latest data available, see Figure 8), reaching the highest level since late-2016. The breakdown by countries shows that it is particularly the tone towards Asia (China, ASEAN, India, Japan and South Korea) that has recently eased, but it stayed unchanged for other trade partners and even worsened for Europe (EU27, Switzerland and the UK) – see Figure 9. Recent media articles reporting the possibility that the Trump administration may not end up applying higher tariffs on semiconductors imports, despite an ongoing Section 232 investigation, would indeed be particularly supportive for Asian exporters. The Trump administration seems to be willing to minimize the cost of the trade war for the domestic economy, providing relief to US inflation and households, and trying to avoid derailing the AI boom.

Figure 8: US bilateral relationship tone tracker (pt)



Sources: GDELT, Allianz Research

Figure 9: US bilateral relationship tone tracker – change over the past month and contributions (pt)

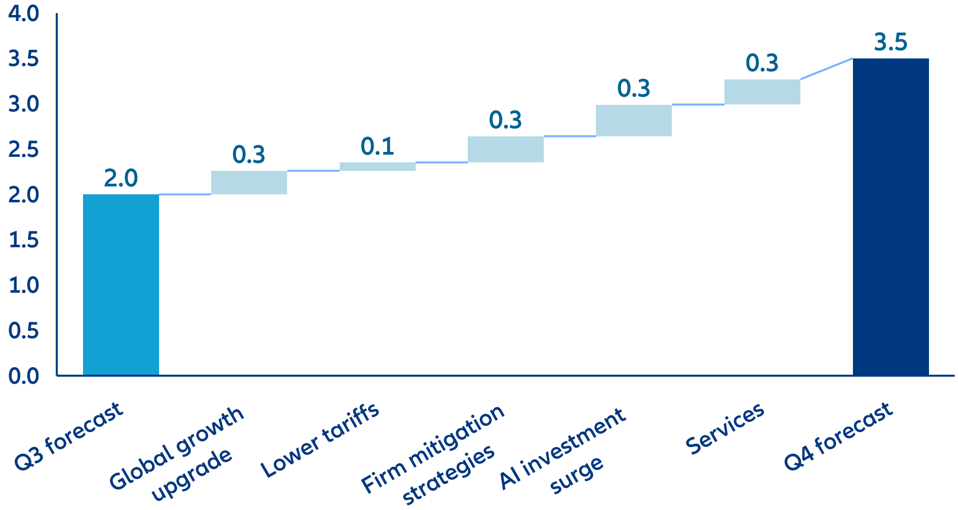


** Japan, South Korea, Taiwan*

Sources: GDELT, Allianz Research

In this context, global trade will likely continue to show resilience through the end of 2025 and beginning of 2026, with annual growth respectively at +3.5% and +1.3%, and potential upside on the latter number as uncertainty persists. We have revised significantly on the upside our forecast for 2025 by +1.5pp (see Figure 10). The deals and softening in US trade policy over the past few months explain 0.1pp of the revision. Additionally, companies across the globe demonstrated great flexibility against the tariffs this year, through frontloading earlier in 2025, as well as rerouting and trade diversification, which began shifting some well-established supply chains, mitigating the negative impact from the trade war – explaining another 0.3pp of our upwards revision. With more resilient trade in goods than previously expected, trade in services has also been supported, contributing another 0.3pp. The continued outperformance of AI-related sectors and the resilience of the global economy have also lifted global trade this year more than we had forecast. Going into 2026, softer trade growth will likely be driven by a slowdown of Asian exports, in particular from Taiwan, Thailand, Indonesia, Vietnam and China. Yet, ongoing negotiations of free-trade agreements, including those with the EU, India, ASEAN and the UAE, as well as the implementation of already signed ones (such as the EU-MERCOSUR), could provide upside risks to trade growth in 2026, and in the long-term could contribute to shifting the shape of global trade in the future. The year ahead will not be without surprises, with the Supreme Court decision on the use of the International Emergency Economic Powers Act to impose tariffs still pending. With tariffs likely to be overturned by the Supreme Court, the White House may resort to other tools, such as Section 338 or Section 122, which should keep tariffs at an elevated level. In parallel, ongoing Section 232 investigations could result in the introduction of tariffs on new products.

Figure 10: Global trade growth forecast reviewed on the upside for 2025 (% and pp)



Source: Allianz Research

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