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What to watch: Higher taxes for French corporates, all eyes on Germany at Paris motor show and understanding China's big move

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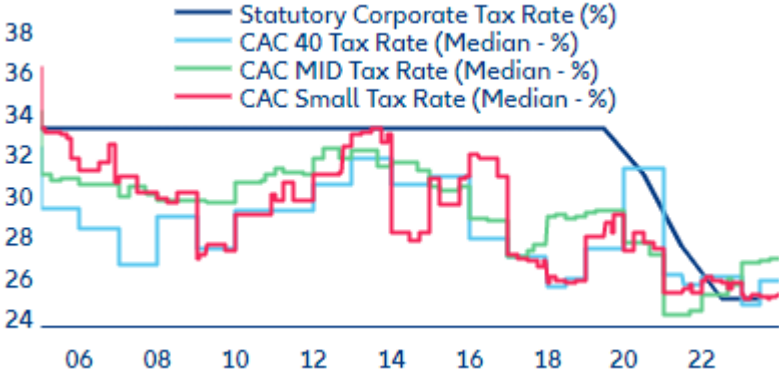
In summary

- **France's higher corporate taxes: The bark is worse than the bite.** The French government's new budget plan introduces a tiered corporate tax structure that raises the statutory corporate tax rate for businesses with turnovers exceeding EUR1bn. We expect earnings for large-cap companies (40% of CAC 40 companies are concerned) to reduce by only -2% in 2025 and -1.2% in 2026 as a result of the new tax regime (many of these companies are less exposed to France). Small- and mid-sized companies which generate more of their revenues locally are likely to face a larger hit: -3.5% in 2025 and -2.5% in 2026 for CAC Mid companies (5% of companies in scope) and -3.8% in 2025 and -4.4% in 2026 for CAC Small companies (5% of companies in scope). Overall, forecasts for earnings growth for CAC 40 companies remains robust, with EPS estimates likely to timidly adjust downward to 7% for 2025 and 8% for 2026, in line with our French equity market forecasts (6%).
- **Paris motor show: Schadenfreude for German car makers.** Global car sales are stalling, especially in Europe and Germany's automotive sector is struggling the most. Major automakers have already reported sales declines between -3% to -13% for Q3 2024, highlighting the need to revisit the export-driven business model oriented towards traditional internal combustion engines. While electric vehicle sales (EV) were the silver lining everywhere else (+22% from January to September 2024 vs. Jan-Sept 2023), they fell by 32% in Germany over the same period. With the EU CO2 penalty looming, German automakers could face as much as EUR16bn in fines if they do not step up the pace of their EV transition.
- **China: Big move policies have yet to deliver.** The Chinese economy is still in dire need of policy support. Q3 GDP data released today shows a slowdown to +4.6% y/y, from +4.7% in Q2, a far cry from the official growth target of "around +5%" for 2024, while consumer and activity data also confirm the gloomy outlook. The PBOC's super package boosted Chinese equity markets but improved economic fundamentals are yet to be seen. For this, fiscal policy needs to do the heavy lifting to break the negative confidence feedback loops, help stabilize real estate prices, sustainably restore confidence and anchor long-term growth expectations. The yet-to-be-announced full scale of the fiscal stimulus, hopefully focusing further on consumers and the property market, would ensure China achieves the official growth target for 2024, and potentially boost 2025 growth by up to +0.4pp, though the long-term trend of economic slowdown cannot be avoided.

France’s higher corporate taxes: the bark is worse than the bite

After dropping to 25% in 2022 (from 33% before the pandemic), France’s statutory corporate tax rate is reversing course. In recent years, the effective tax rate for French companies mirrored the downward trajectory of the statutory corporate tax rate, decreasing from 33% to ~25%. But with its finances under pressure, the new government plans to hike tax rates to 30.15% for companies with turnover between EUR1bn and EUR3bn, and to 35.3% for those with a turnover exceeding EUR3bn. These increases are intended to be temporary, with a planned halving of rates by 2026 and a full elimination by 2027 (Figure 1 and Table 1).

Figure 1: France’s statutory corporate tax rate and CAC 40 / Mid and Small median effective tax rate (in %)



Sources: LSEG Datastream, Allianz Research

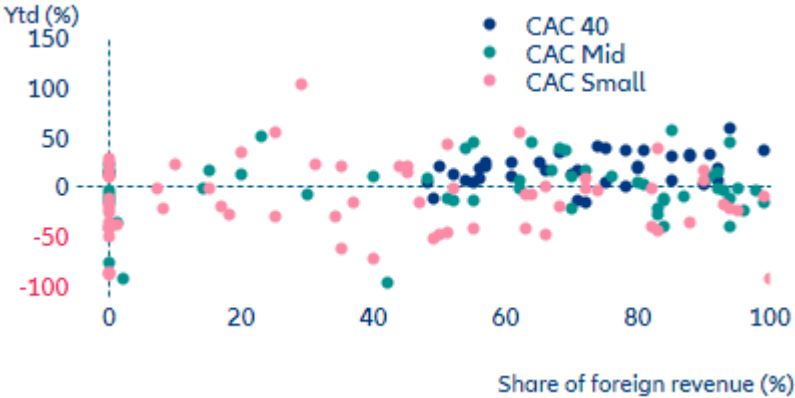
Table 1: France’s new corporate tax rate by turnover (in %)

Turnover (in EUR bn)	2024	2025	2026
<1	25,0	25,0	25,0
1-3	25,0	30,2	27,6
>3	25,0	35,3	31,5

Source: Allianz Research

Our estimates suggest that the tax hikes will have a limited impact on French equity markets as the biggest taxpayers in France are mid- and small-cap companies that typically do not generate more than EUR1bn in turnover. The effect on earnings will vary greatly depending on how much tax each company pays in France, which is implicitly linked to domestic revenue exposure. For CAC 40 companies – which generate only about 10-20% of their revenues from French operations – the impact on net profit is estimated to be approximately 2.0% in 2025 and 1.2% in 2026 when considering only their French business segments. The picture changes significantly when we look at mid-cap and small-cap companies, which have a higher dependence on domestic revenues – 45% for CAC Mid companies and up to 65% for CAC Small companies (Figure 2). Nevertheless, their earnings are unlikely to be hit hard by the new tax rates on an aggregate basis since these companies typically do not generate more than EUR1bn in annual turnover – the threshold at which the increased tax rates begin to apply. Therefore, higher domestic exposure does not directly translate into a higher tax burden for these smaller firms. In fact, considering projected revenues for the end of 2024, about 90% of the CAC 40 companies will be affected by the new tax regime to varying degrees, while only 46% of the CAC MID companies and 5% of the CAC Small companies will be impacted.

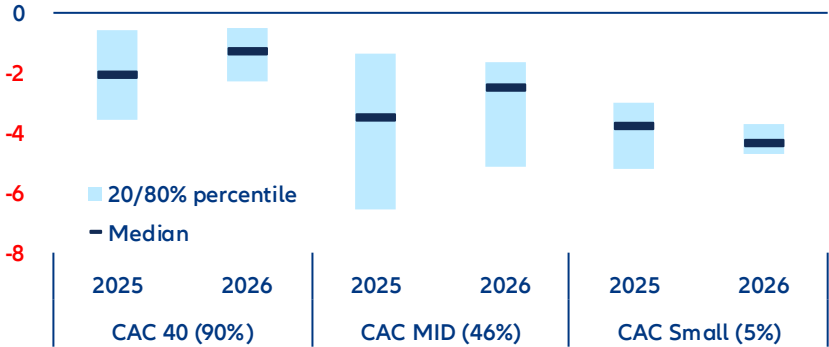
Figure 2: Share of foreign revenue and year-to-date performance (in %)



Sources: LSEG Datastream, Allianz Research

The new tax regime is likely to cut CAC 40 companies’ earnings by -2% in 2025, and then by just -1% in 2026. For qualifying companies in the CAC MID (46%), the average impact is projected at -3.5% in 2025 and -2.5% in 2026. Smaller companies (5% of the CAC Small index) are expected to see a -3.8% impact in 2025, increasing to -4.4% in 2026 (Figure 3). Our study confirms that smaller companies will be more heavily affected (if they have more than 1bn turnover) by the new tax system and that the overall decreasing impact on the aggregate equity market indices based on company sizes is the result of reduced domestic exposure. Notably, the variance in impact is greatest among mid-cap companies, reflecting the wide range of domestic exposure within this segment, which spans from 0% to 100% depending on the company.

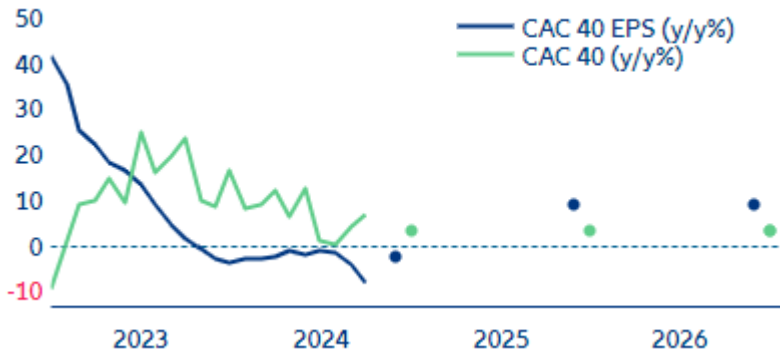
Figure 3: Expected impact of the new tax regime on French equity markets (in %)



Sources: LSEG Datastream, Allianz Research*
 Note: In parentheses the percentage of companies that are affected to the new tax

Meanwhile, the anticipated revenue and earnings recovery in 2025 will be mildly challenged. However, the current EPS growth forecast of around 9% y/y for the CAC 40 in both 2025 and 2026 provides enough cushion to absorb the tax impact. After factoring in the tax changes, EPS growth estimates would likely be adjusted to approximately 7% for 2025 and 8% for 2026. This adjustment aligns with the market reaction we observed following the budget release, where large-cap indices saw a moderate correction of around 1-2%. Given our 6% forecast for French equity markets in 2025 and 2026, we believe the new tax rate will have a minimal impact on market pricing and will not play a significant role in shaping return expectations for those years (Figure 4).

Figure 4: CAC 40 EPS growth and performance projections

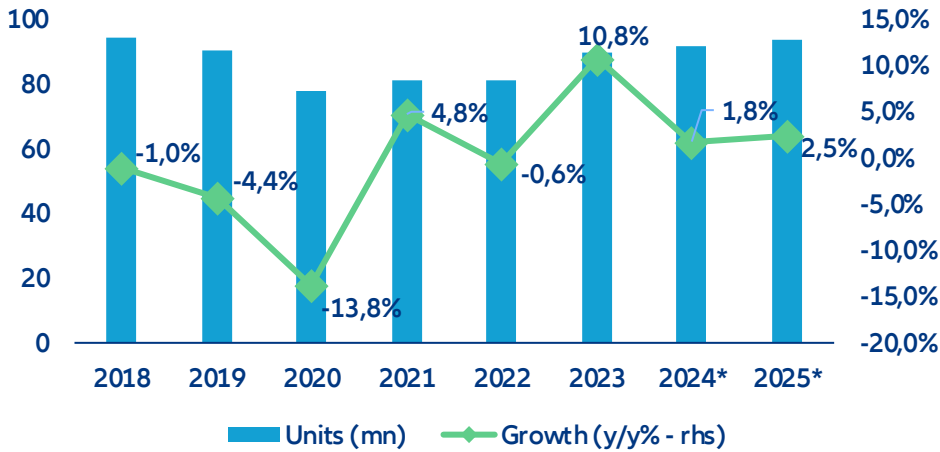


Sources: LSEG Datastream, Allianz Research
 Note: Dots represent market expectations (for EPS) and our own forecasts (for the CAC 40).

Paris motor show: Schadenfreude for German car makers

Global car sales are stalling as post-pandemic pent-up demand peters out, especially in the US and Europe, with consumers squeezed by high fuel prices and tight credit conditions. While the Paris Global Auto show started this week with the motto “let’s celebrate”, there is little to celebrate in 2024 for the European auto sector. As of August 2024, new light vehicle sales in the US were down -1.1% y/y, -5% in China and as much as -18.3% in Europe. We expect the year to end with global car sales in up about +2% but this is a significant deceleration from the +10.8% growth seen in 2023 (Figure 5). Total sales for light vehicles are forecasted to reach around 91.4mn units by year-end.

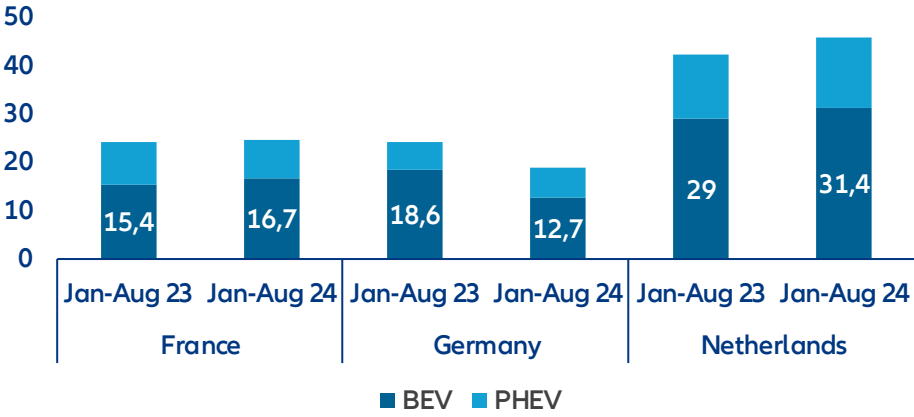
Figure 5: Global car sales



Sources: Moody’s, Allianz Research

Electric vehicle (EVs) sales are the only silver lining – except in Germany. From January to September 2024, sales of battery-electric vehicles (BEV) and plug-in hybrid vehicles (PHEV) increased by +22% compared to the same period in 2023. Nevertheless, there are huge differences among markets: China accounted for over 62% of total volumes, while North America represented 11% and Europe 19%. Furthermore, EV growth is also slowing in some key markets like the US and Europe, where demand has softened due to reduced subsidies, high upfront costs and still limited charging infrastructure. EV sales are even declining in Germany (Figure 6), where the market is facing stagnation as the demand for traditional ICE cars is declining sharply but EVs are still to gain enough traction to offset the overall decline. Moreover, the scale-back of subsidies for EV purchases is also hurting the market: Since 2024, EVs priced above EUR45,000 have been excluded from subsidies while cheaper versions have seen their subsidies scaled down.

Figure 6: EU car registrations by power source (% of total)



Sources: ACEA, Allianz Research

Declining EV sales highlight how the German auto industry needs to revisit its business model, especially in a context of rising protectionism and trade barriers, and geopolitical tensions. Although the current earning season has not delivered its final word, major German automakers have already reported sales declines between -3% to -13% for Q3 2024, highlighting the industry’s struggles. Over the last 20 years, the epicentre of the global automotive industry has moved East towards Asia, and more specifically China. Initially Germany was able to capitalize on this growing market opportunity by maintaining and expanding its export-driven model. Despite global changes, the country’s automotive production thrived from 2000 to 2017, largely due to its dual strategy of actively globalizing production and sales, and dominating the premium segment. As a result, it is estimated that approximately 75% of cars produced in Germany in 2023 were exported, showcasing the strength of its business model¹. Nevertheless, the global push towards EVs poses significant challenges, particularly for Germany, which has been a leader in ICE vehicles. The emergence of EVs has opened the market to new incumbents, mostly from China, where German manufacturers face significant pressure as their premium ICE segment is slowing sharply. Rising protectionism and trade barriers, particularly in key export markets like the US, and potential conflicts with China threaten Germany’s export-dependent automotive sector. US protectionism towards Chinese EVs also means further competition from Chinese firms in European markets. Moreover, the EU’s increased tariffs on Chinese battery EVs (now ranging from 9% to 36.3%), will not fully cancel out the price edge of Chinese EVs against European and German one. Against this backdrop, the German automotive industry needs to navigate the shift towards electric vehicles effectively to retain its leadership and competitive edge. This means building a stronger supply chain for batteries and semis but also investing in software development and advanced driver assistance systems (ADAS). Germany’s auto sector will also need to leverage its premium segment advantage, where customers are more willing to pay for advanced technologies, by investing in product design, brand and customer experience to trump new incumbents, besides reconsidering its strategy for the Chinese market that is younger and more tech-oriented.

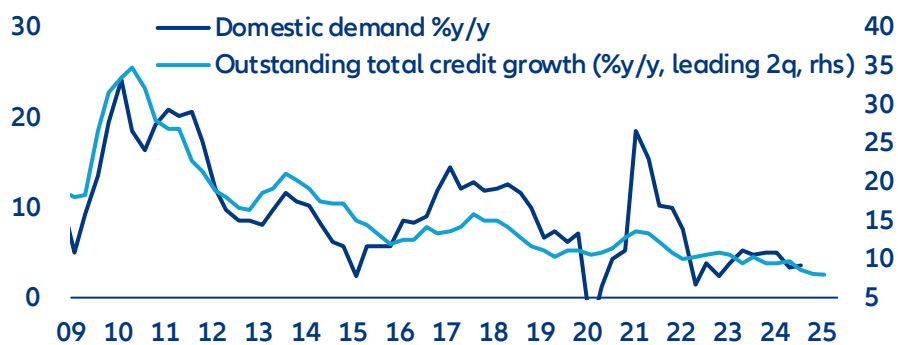
At the same time, the EU CO2 penalty is another cloud on the horizon, which could cost German automakers as much as EUR16bn in fines. As part of the “Fit for 55” package unveiled in 2021, European car manufacturers must respect strict standards on CO2 emissions by 2025. But with the full switch to EVs still lagging, the automotive sector has pushed back on both the 2025 target and the 2035 100% emissions reduction target. Indeed, without heavy investments in building charging infrastructure, reduced energy costs and greater consumer acceptance, the zero-emission transition will remain highly challenging and could trigger multibillion-euro fines, which would lead to unnecessary production cuts, job losses and a weakened European supply and value chain. In this context, there is mounting political pressure, notably from France and Germany, on the Commission to postpone its 2025 CO2 target or review its sanctions policy, even though the automotive industry itself is not yet presenting a united front.

¹ Die Automobilindustrie im Jahr 2024, IW-Report

China: Big move policies have yet to deliver

The Chinese economy is still in dire need of policy support. Recent data releases continue to point to an economic slowdown (Figure 7) in China. Consumer-related data from the week-long National Day holiday (1-7 October) show that while tourism travel has risen (domestic touristic visits were up by +5.9% y/y and +10.2% compared to 2019), tourism revenue per head remained -2.1% below the 2019 National Day holiday level. In September, outstanding credit growth was roughly unchanged at a low level (+8.0% y/y compared with +8.1% in August and +9.3% at the end of 2023) and inflation failed to rebound (+0.4% y/y in September, from +0.6% in August). Even exports, one of the very few bright spots, disappointed in September – slowing to +2.4% y/y from +8.7% the previous month, potentially due to disruptions caused by typhoons. Further activity data for September released today point to slightly improved, but still soft industrial production, retail sales and investment. Q3 GDP data were published as well and show a slowdown to +4.6% y/y, from +4.7% in Q2, a far cry from the official growth target of “around +5%” for 2024.

Figure 7: Domestic demand and outstanding total credit growth (%y/y)



Sources: national sources, LSEG Datastream, Allianz Research

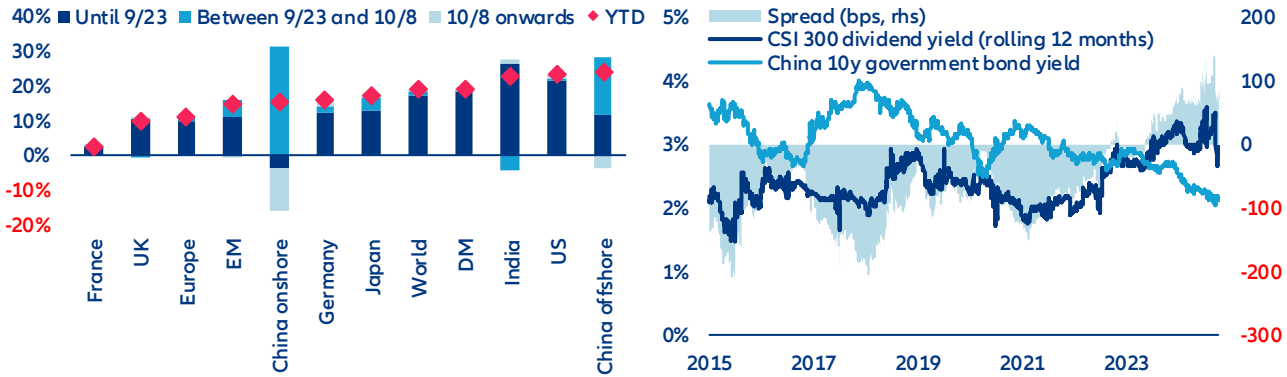
Against this backdrop, policy support is turning more aggressive to put the economy on the right path in Q4.

Stepped up monetary easing provided a significant confidence boost to Chinese equity markets after years of underperformance, but the rally needs improved economic fundamentals to last. China's onshore and offshore equity markets soared more than 25% in the two weeks following the PBOC's announcement of a super package of accommodative measures² on 24 September (Figure 8). The RMB500bn swap facility dedicated to equity investment is the key differentiator in this round of stimulus, encouraging institutional investors to engage in leveraged investments by borrowing cheap government bonds. The 10-year government bond yield has been consistently declining from its peak of 4.0% in early 2018 to 2.1% recently, while the dividend yield of the broad-based equity market index has been steadily increasing (Figure 8). The equity dividend yield surpassed the government bond yield in mid-2023 and the spread has continued to widen since then. The limited downside risk of equities, given their very low valuations, along with a RMB300bn refinancing facility established to support companies with share buybacks and the PBOC's pledge to provide further liquidity, have reinforced market confidence and sparked a buying frenzy. With eye-watering gains in just a couple of days, retail investors are also rushing into the market and increasing their stock positions. However, these rapid increases need to be justified by improving growth prospects, which are not yet in sight. Indeed, we think the PBOC's super package on its own is insufficient to prop up the real economy: So far this year, monetary easing has not been very successful in reversing the slowdown in credit and domestic demand. Observers have thus been awaiting fiscal policies to step in and provide additional support. However, with authorities refraining from detailing amounts and measures of the full fiscal package, markets have been trading on heightened volatility. Both the onshore and offshore markets have since corrected, with the onshore market experiencing a decline of nearly -10% (Figure 9). Equity markets are likely to remain volatile in the coming weeks as investor sentiment cools down and the focus shifts back to economic fundamentals and corporate earnings, both of which remain weak and require time to recover³.

² The super package entailed cutting policy rates, providing additional liquidity to the banking system, expanding measures for the real estate sector and setting up facilities to prop up the stock market (see What to Watch, 27 September 2024 for more details).

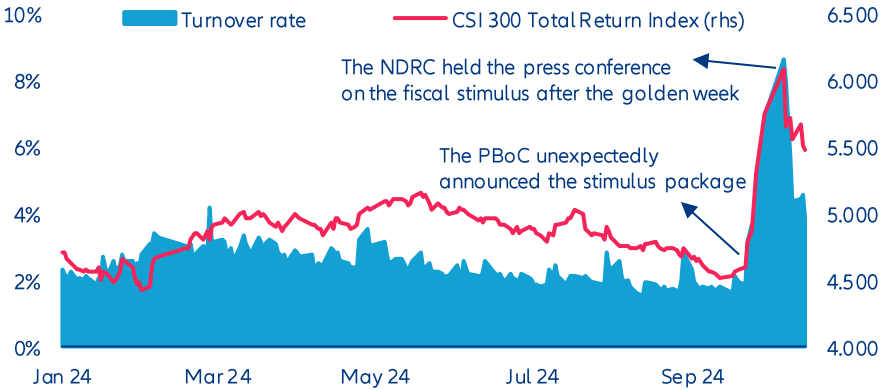
³ See our report [2024_09_06-what_to_watch.pdf \(allianz.com\)](#).

Figure 8: Total returns of global stock markets by region (left) and stock dividend yield and government bond yield in China (right)



Sources: LSEG Datastream, Wind, Allianz Research
 Notes: The data for the graph on the lefthand side is as of Oct 15, 2024.

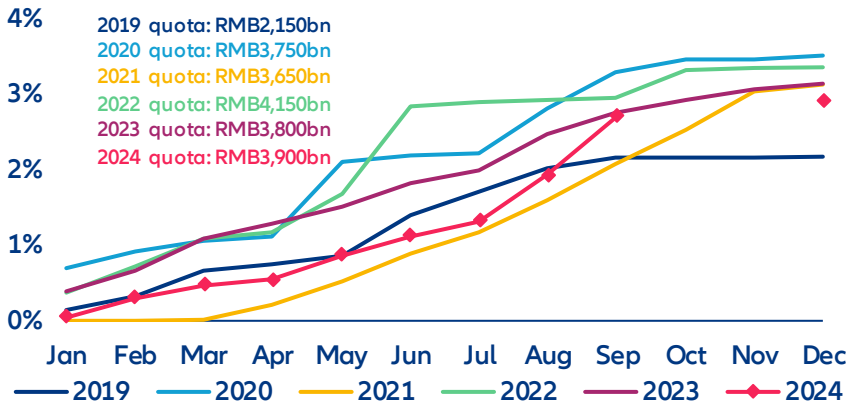
Figure 9: Total return index and turnover rate of China’s onshore stock market



Sources: LSEG Datastream, Wind, Allianz Research

Fiscal policy needs to do the heavy lifting for the real economy and markets to recover sustainably. Authorities have clearly increased efforts, but details of the stimulus are still lacking. Fiscal easing is necessary to break the negative confidence feedback loops, help stabilize real estate prices, sustainably restore confidence and anchor long-term growth expectations. In the past weeks, authorities have made it clear that they are focused on supporting growth and that government spending will accelerate. Local governments are required to complete their full-year quota for special bond issuance by the end of October, and an acceleration is already clearly visible (Figure 10). Additionally, on 12 October, the Ministry of Finance committed that RMB2.3trn worth of unused funds from local government special bonds would be spent by the end of the year. We also expect a larger fiscal deficit target and an enlarged quota for ultra-long-term central government special bonds (adding RMB1-2trn) to be approved at the Standing Committee meeting of the National People’s Congress in late-October/early-November. But details of what the fiscal stimulus would target are still lacking, with expectations focused on supporting households and the property market.

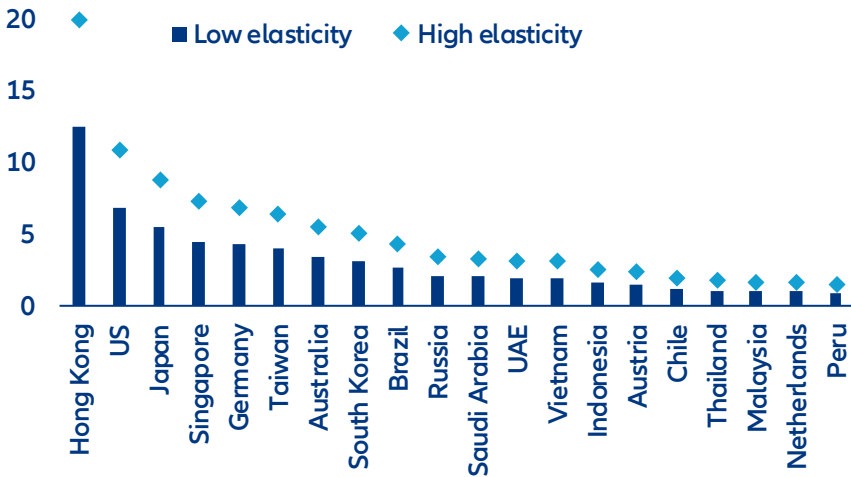
Figure 10: Local government special bond issuance (% of nominal GDP)



Sources: national sources, LSEG Datastream, Allianz Research

The delivery of fiscal stimulus would ensure China achieves the official growth target for 2024, and potentially boost 2025 growth by up to +0.4pp. That said, the long-term trend of economic slowdown cannot be avoided. Our latest GDP growth forecast for 2024 stands at +5%, in line with the official target, as we already assumed increased policy support to take place in Q4. That said, we expected a stimulus of smaller intensity, on the basis of a less acute economic slowdown in Q3. We have thus adjusted our quarterly GDP profile and expect a stronger rebound in Q4 to lead to a larger carryover effect for 2025. Assuming that policy easing will continue into 2025, we thus find that GDP growth next year could be boosted by up to +0.4pp, from our previous forecast of +4.3%. Depending on the design of the stimulus, higher domestic demand would translate into different elasticities of imports. We estimate that China’s fiscal stimulus would lead to between USD72-115bn of additional imports in 2025, with Hong Kong, the US, Japan, Singapore and Germany set to benefit the most (Figure 11).

Figure 11: Additional export gains by countries in 2025 (USD bn), depending on China’s elasticity of imports



Source: Allianz Research

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