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What to watch: The cost of uncertainty in Germany, the finishing touch of the Chinese stimulus and all eyes on Brazil while this COP is in Baku

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In summary

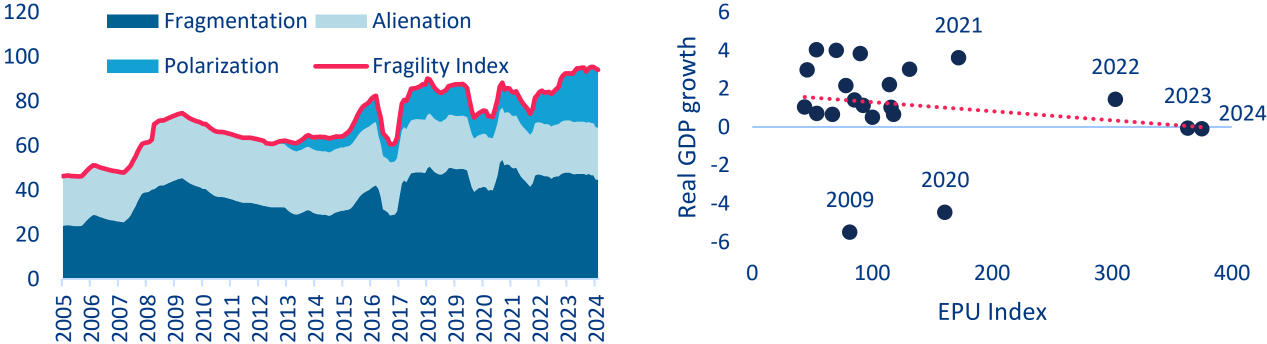
- Germany: what's next? Snap elections are set for 23 February 2025 but Germany urgently needs greater stability and reduced uncertainty to ward off economic stagnation. The upcoming elections and the threat of a trade war with an increasingly protectionist US could halve projected GDP growth in 2025 to just +0.4%. While a CDU-led grand coalition is currently expected by mid-2025, it will face similar challenges as its predecessors. The next German government must implement substantial structural reforms to improve economic prospects and tackle low productivity, employing a combined strategy of increased spending alongside competitiveness-focused reforms, although significant fiscal loosening seems unlikely even after the elections. To address pressing budget gaps and invest in the green transformation, infrastructure and innovation, Germany needs a comprehensive Agenda 2030 that unites political and industrial stakeholders. Additionally, demographic reforms and tax changes are essential for boosting competitiveness. In an increasingly fragmented world, Germany needs to transform its economic model, embracing more European solutions.
- **China's fiscal stimulus that wasn't.** China finally announced its long-awaited fiscal package (RMB10trn over five years), which raises the local government debt ceiling by RMB2trn per year over 2024-2026 and allocates RMB800bn per year over five years out of the annual local government special bond issuance quotas. Bullish bets are unwinding as markets were disappointed by the lack of measures to boost short-term growth. We think the plan is sensible, aimed at reducing the structural risks of a fiscal/financial crisis, but for markets to regain confidence, the government will need to send clearer signals and take bolder steps to revitalize the economy, including a stronger focus on consumption. We continue to expect GDP growth at +4.6% in 2025 and +4.2%, in 2026. Looking ahead, more policies could still be announced by next spring – but consumers should not hold their breath.
- Brazil is burning: The interplay of climate change and deforestation, and the path forward for forest resilience. With COP29 underway in Baku, Azerbaijan, the pressure is mounting to meet global climate commitments on time. Many observers were worried about the low expectations for this COP and anticipating a much better vintage with COP30 in Brazil. But this is for another reason that Brazil is on everyone's mind this week: it is facing one of the worst years on record for wildfires, with nearly 40mn hectares of land burned, which is significantly higher than the 30mn hectare annual average of the last decade. Rising temperatures (+1.2°C in 2019 compared to the 1950–1979 average) and three decades of persistent droughts have accelerated the spread of fires. Additionally, deforestation driven by agricultural expansion, particularly soybean cultivation, has further exacerbated the crisis. Between 2013 and 2020 alone, soybean-related deforestation reached 5.17mn hectares, highlighting the urgent need for sustainable land-use policies and climate adaptation measures to mitigate wildfire risks and protect Brazil's ecosystems.

Germany: what's next?

General elections are fixed for 23 February 2025. On 6 November 2024, the German government coalition collapsed due to disagreements over the 2025 budget and broader economic policies. Former Finance Minister Lindner advocated for upholding the debt brake by freezing social spending and implementing tax cuts while scaling back Germany's climate goals. In contrast, Chancellor Scholz supported an emergency suspension of the debt brake, citing the war in Ukraine as a reason to avoid cuts to social benefits and allow for increased defense spending. SPD and the Greens will govern as a minority government until Chancellor Scholz calls a confidence vote on 16 December, which he is likely to lose, leading to snap elections on 23 February 2025, as agreed upon by the main parties.

The ongoing uncertainty could prolong Germany's economic stagnation, with GDP growth likely to be halved in 2025. The core issue lies in the political fragility that has doubled over the past two decades due to increasing polarization and fragmentation (Figure 1, left). This increased uncertainty is already exerting significant pressure on the economy. Furthermore, economic policy is likely to remain stagnant until a new coalition is formed following the snap elections in February 2023. Until then, we might witness selective agreements on critical issues at best, such as necessary support for Ukraine. But Germany urgently requires greater stability to regain its economic footing. Consumer confidence remains fragile (-0.11 in October) and has not fully recovered from diminished purchasing power caused by high inflation. If economic uncertainty rises to the levels seen after previous shocks (snap elections in 2005 and the first trade war)[1], consumer confidence could fall by an additional -0.2 points, pushing it deeper into negative territory. This has clear implications for real growth: such a 90-point increase in uncertainty would reduce economic growth by -0.4pps (Figure 1, right), effectively halving GDP growth in 2025 from the current forecast of +0.8% to just +0.4%. However, a new government that responds swiftly and effectively to upcoming challenges could reverse this trend, reducing economic uncertainty and fostering higher consumer confidence and economic growth.

Figure 1: Political fragility index (left) and economic policy uncertainty and real GDP growth, in % (right)



Sources: National polls, EiQCC, Allianz Research (left) and LSEG Workstream, Allianz Research (right). Notes: Fragmentation is the share of the two largest traditional parties, the number of parties >10%. Alienation is the share of far-right, far-left and populist parties based on EiQCC from Cambridge University, Polarization is the share of non-voters at latest elections, possibility and impact of referenda based on voting polls. The fragility index is a composite of the fragmentation, polarization and alienation subindices.

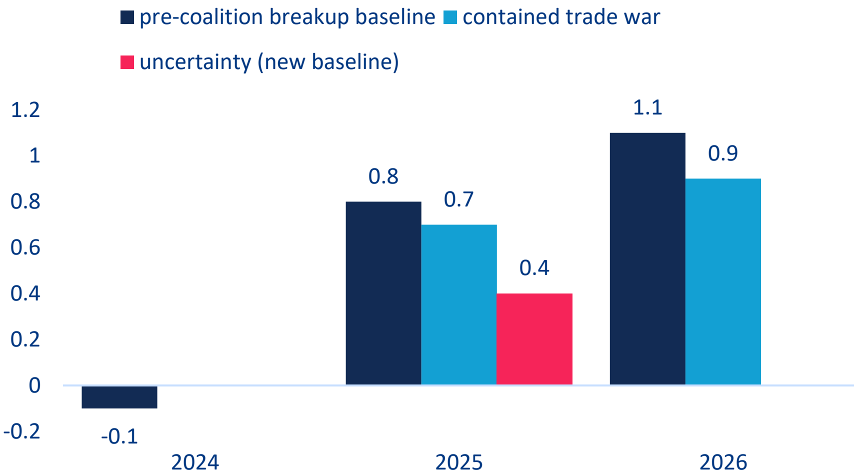
At the same time, a new trade war with the US could threaten Germany's core business model. The re-election of Trump in the US only heightens concerns. Germany is particularly vulnerable to a resurgence of trade tensions or direct tariff increases, given that the US has become its most important trade partner. The share of German exports to the US rose from 8% in 2013 to 10% in 2023. Additionally, the trade balance with the US has increased by a third

[1] *We take the sum of the increase in economic policy uncertainty from two historical events: 1) the announcement of the confidence vote of Gerhard Schröder in June 2005 followed by snap elections until the cabinet of Angela Merkel was established in November 2005 and 2) the first trade war when Trump imposed tariffs on steel (25%) and aluminum (19%) also on the EU and the EU retaliated until they were lifted in October 2021.*

over the past decade, reaching USD9bn in July 2024, and has nearly tripled over the last 20 years. A contained trade war could result in a loss of -USD1bn in exports for Germany in 2025 and -USD7bn in 2026, which would reduce its already modest growth by -0.1pps in 2025 and -0.2pps in 2026. Germany's manufacturing and export-driven business model is under increasing pressure from global fragmentation and rising protectionism, intensified competition from abroad – particularly from China – and declining productivity at home, further exacerbated by the energy crisis stemming from Russia's actions.

The German economy is in need of reorientation, but a significant transformation will not be easy. By mid-2025, Germany is expected to have a CDU-led grand coalition government in place, which may prove to be more stable and functional than the outgoing administration. However, it will still face similar constraints and challenges, particularly given the more protectionist stance of the US administration. Expectations for an immediate easing of fiscal policy are unlikely as the budget for 2025 will probably only be finalized by mid-2025 when the new government takes office. Under the interim budget regime, existing programs can continue, but no new policies requiring additional funding can be introduced. Consequently, any economic support initiatives will likely have to wait until the new budget for 2025 is approved. As a result, fiscal policy is expected to become even more restrictive in 2025, leading to continued weak growth. For 2024, we forecast -0.1%, followed by a growth rate of +0.4% in 2025 (adjusted baseline after uncertainty stemming from elections and a contained trade war from the US) and +0.9% in 2026 (Figure 2).

Figure 2: Projected real GDP growth under contained trade war and uncertainty scenarios, in %



Sources: Allianz Research

The next German government urgently needs to implement substantial structural reforms to enhance the **country's economic prospects and address low productivity, currently projected at a potential growth rate of just** +0.4%. Two main strategies emerge: Germany can either spend its way out of stagnation while ensuring structural financing for transitions or adopt a bootstrap approach similar to 2005, focusing on reforms to boost competitiveness. The most effective path likely involves a combination of both strategies. There is broad consensus that relaxing the debt brake could benefit Germany. While the conservatives have indicated some flexibility for reform, significant loosening of fiscal spending seems unlikely. Any reforms post-election are expected to be modest and still tighter than EU fiscal rules require. A slightly higher structural deficit ceiling of 0.5-1% of GDP could provide some room for investment spending, keeping debt still around 60% of GDP. However, this alone will not suffice; meaningful structural reforms are essential for sustainable growth.

Ultimately, Germany needs a comprehensive Agenda 2030 that unites political and industrial stakeholders. With a budget gap of EUR12-28bn in 2025 (0.2-0.4% of GDP) and a projected shortfall of EUR135bn from 2026 to 2028, significant investment expansion is crucial. To facilitate the green transformation, Germany must think European and invest at least EUR838bn in components and infrastructure by 2035. Additionally, up to EUR600bn is needed over the next decade to halt the infrastructure decline. To maintain economic competitiveness, Germany must

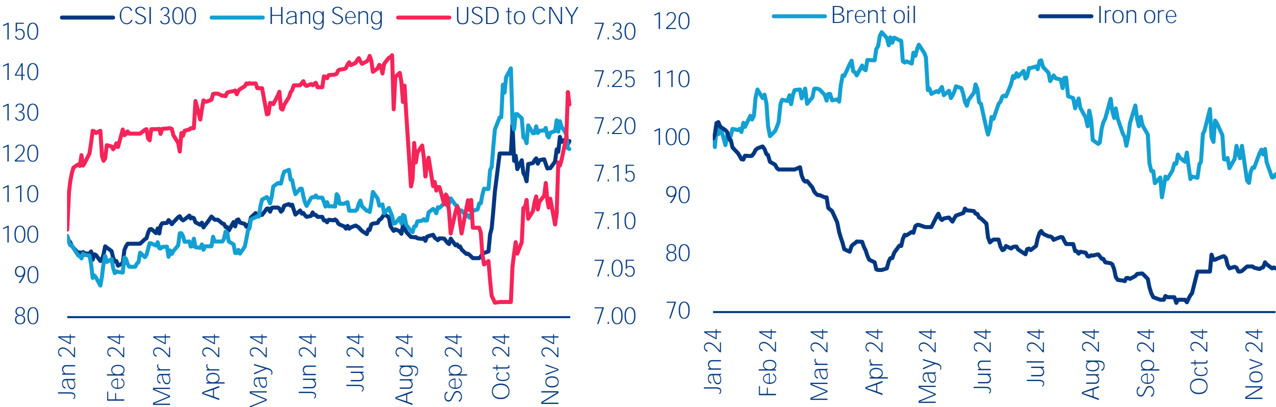
double its innovation investments to 6% of GDP (currently at 3.1%), particularly in future technologies. Demographic changes also necessitate reforms, including gradually raising the retirement age to 68 and increasing labor force participation among women while reducing part-time employment rates. Additionally, an annual inflow of 200,000 skilled workers is needed where Germany stands in competition with other countries. Tax reform is also critical for enhancing competitiveness. The effective personal tax rate was comparably high at 29% in 2023, with the progressive income tax system offering minimal incentives for low- and middle-income earners to work more. Corporate taxes are similarly high at nearly 30%. Proposed reforms should simplify personal income tax, lower the corporate tax rate to 25% and standardize VAT at 16.5%, while not to forget eliminating red tape. Overall, Germany must adopt a more European perspective as many challenges can be better addressed collectively at the European level. In an increasingly fragmented world, future prosperity must stem from within Europe rather than beyond its borders. This shift will require transforming Germany's economic model, which has relied on globalization. To lead this change, Germany must rally a coalition of the willing and create a compelling vision for Europe's future.

China's fiscal stimulus that wasn't

China finally announced its long-awaited fiscal package, which amounts to RMB10trn over five years and focuses on local government debt. More than a month after the PBoC announced its super package to revive the flagging economy, the Standing Committee of the National People's Congress has revealed some details about the size and scope of the fiscal package. In essence, it is a five-year swap plan to bring part of local government implicit debt on the balance sheet, amounting to RMB10trn. More specifically, the plan raises the local government debt ceiling by RMB2trn per year over 2024-2025-2026 and allocates RMB800bn per year over five years (2024-2028) out of the annual local government special bond issuance quotas. While this plan roughly meets previous market and media expectations, there was no approval of an additional issuance quota for ultra-long central government special bonds, which could focus more on short-term growth stimulus.

Bullish bets are unwinding as markets were disappointed by the lack of measures to boost short-term growth. China's equity market initially saw a significant rally following the PBoC's monetary stimulus in end September[2], moving from one of the worst-performing to one of the best-performing markets within a month as sentiment lifted on the expectations of the government's pro-growth pivot. However, constant delays, the lack of details and limited measures to revive consumption quickly have eroded this momentum. The onshore and offshore markets have corrected by -3.2% and -6.6% since their recent peaks, respectively, while the Chinese yuan has depreciated by -2.9% against the USD since early October in the context of expected higher-for-longer rates in the US and weakening exports under the next Trump administration. Assets closely tied to China's domestic demand, such as oil and iron ore prices, continue to face downwards pressure (Figure 3).

Figure 3: Year-to-date performance of Chinese equities, currency (left) and commodities closely linked to Chinese demand (right)



Sources: LSEG Datastream, Allianz Research. Note: Data is as of 13 November 2024. Equity and commodity price indexes are rebased to 01 January 2024 = 100.

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[2] *See our report [What to Watch: Higher taxes for French corporates, all eyes on Germany at Paris Motor Show and understanding China's big move.](#)*

A communication mishap more than a shortcoming in policymaking. **Shortly after the PBOC's super package** was announced, expectations for a strong growth-focused fiscal stimulus built up, in part on the back of hints provided by policymakers. The actual fiscal package did not deliver on this front, but from a macroeconomic perspective, we think it is a sensible plan aimed at resolving a structural issue. After a previous round of debt swaps in 2015-2018, local government finances have come under renewed pressure in the 2020s. Stimulus measures against the Covid-19 pandemic led to a rebound in local government debt (amounting to RMB40.7trn at the end of 2023, out of which RMB14.3trn is implicit) and the ongoing real estate crisis is denting fiscal revenues. According to the Minister of Finance, the debt swap plan will bring down implicit local government debt to RMB2.3trn by 2028 and reduce debt-servicing costs over 2024-2028 by RMB600bn, i.e. 0.5% of 2024E nominal GDP – a negligible saving over five years. The intent is not so much about additional fiscal spending to directly stimulate the economy but rather resolving the structural risk of a fiscal/financial crisis. Ultimately, healthy public finances will be supportive to growth.

Easing measures announced since the end of September should be sufficient to support a moderate improvement in economic momentum in the coming months, but they will not prevent a slowdown in 2025-2026. Data released this morning show industrial production slightly slowing but investment stabilizing and retail sales recovering a little stronger than expected. This suggests that the bout of particularly disappointing hard data since the summer may be behind us for now, thanks to supportive policies in the monetary, housing and fiscal spaces (see Figure 4). Most notably, the 2024 annual quota for local government special bonds has been 99.9% achieved at the beginning of November (vs. 65% at the end of August) and RMB3.2trn (i.e. 1.7% of 2024E nominal GDP) worth of unused funds were committed to be spent by the end of the year. Such measures will likely be sufficient to bring 2024 GDP growth close to the "around +5%" official target and provide a stronger carryover into 2025 than previously expected. Still, we expect an overall slowdown in the coming two years, with GDP growth reaching +4.6% in 2025 and +4.2% in 2026.

Figure 4: Main easing measures announced since the end of September 2024, and our expectations

Monetary policy	
Policy rates	-20bps to the 7-day reverse repo rate -30bps to the medium-term lending facility rates About -20-25bps in loan prime rates and deposit rates *Looking forward: in 2025, two policy rate cuts of -10bps each*
Liquidity	-50bps to the reserve requirement ratio for banks, unleashing RMB1trn of long-term liquidity *Looking forward: another -25-50bps cut in 2024; two cuts of -25bps each in 2025*
Housing policy	
Interest rates	-50bps reduction for existing mortgages on average, lowering interest payments by RMB150bn for 150mn people (estimated to amount to 0.3% of projected 2024 household consumption expenditure, or 0.1% of projected GDP)
Down payment	Minimum down payment requirement cut to 15% for all types of purchases
Housing inventories	Commercial banks can use 100% of the RMB300bn relending loan facility to finance loans to state-owned enterprises that acquire unsold apartments *Looking forward: funding from local government special bonds will likely be used to buy unused lands and housing inventories*
Fiscal policy	
Local government funding	Commitment to spend RMB2.3trn worth of unused funds from local government special bonds, by the end of the year Debt swap program to bring implicit debt on-balance amounts to RMB10trn over five years (2024-2028). It is expected to reduce local government debt-servicing costs over this period by RMB600bn (i.e. 0.5% of 2024E nominal GDP).

Central government funding	No announcement for now *Looking forward: we expect a larger fiscal deficit target in 2025 and an enlarged quota for ultra-long-term central government special bonds (adding RMB1-2trn)*

Sources: national sources, Allianz Research

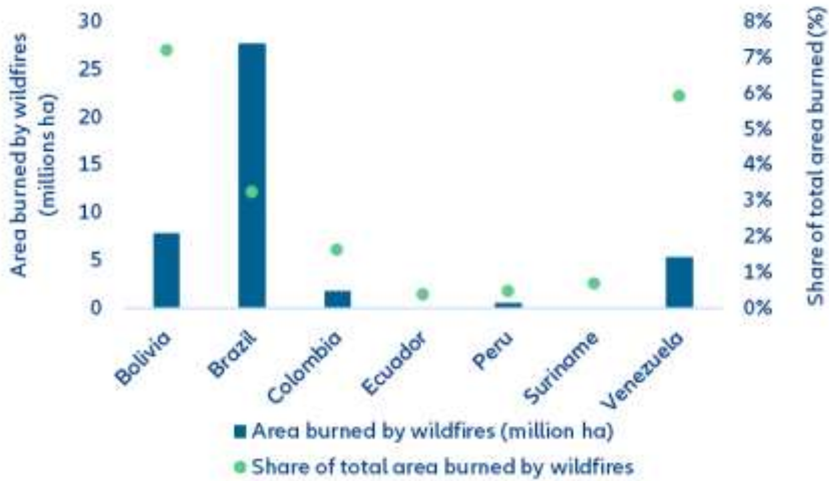
For markets to regain confidence, the government will need to send clearer signals and take bolder steps to revitalize the economy, including a stronger focus on stimulating consumption. China will face mounting challenges as Trump returns for a second term. The economy has been largely driven by exports in recent years and the additional tariffs are likely to bite. Additionally, weak domestic demand and persistent deflationary pressures continue to weigh on economic growth and corporate earnings, underscoring the urgent need for more targeted support for consumption, which the government has been hesitant to embrace, with little indication of imminent change.

More policies could still be announced by next spring – but consumers should not hold their breath. Headwinds are building and we expect the policy mix to remain accommodative to cushion downside pressures. Some forward guidance was provided last week, hinting that authorities were working on future support towards bank recapitalization (through central government special bonds), the property sector (through local government special bonds to buy land and housing inventories) and household consumption (through consumer trade-in and equipment upgrade programs). However, the past month of policy announcements suggests that measures focused on households and the consumer are still not at the top of the list. The next events to watch will be the Central Economic Work Conference in the second half of December (for policy direction) and the Two Sessions in March 2025 (for specific numbers).

Brazil is burning: The interplay of climate change and deforestation, and the path forward for forest resilience

Wildfires are an increasingly significant climate threat worldwide, affecting not only ecosystems but also biodiversity, economies and communities. Figure 5 underscores the profound impact of wildfires across several South American countries, especially those with rich biodiversity and ecosystems like the Amazon rainforest. Spanning multiple nations, the Amazon serves as a crucial carbon sink and plays a vital role in regulating the global climate system. This makes its vulnerability to wildfires particularly alarming. Brazil is notably affected, with an average of nearly 30mn hectares burned annually over the period 2012–2023 – around 4% of the total area. This extensive burning endangers Brazil's ecosystems, leading to habitat loss, biodiversity decline and diminished carbon-sequestration capacity. Bolivia has also been significantly affected by wildfires, with considerable burning relative to its size, while other countries, including Venezuela and Colombia, are seeing smaller but still impactful wildfire damage.

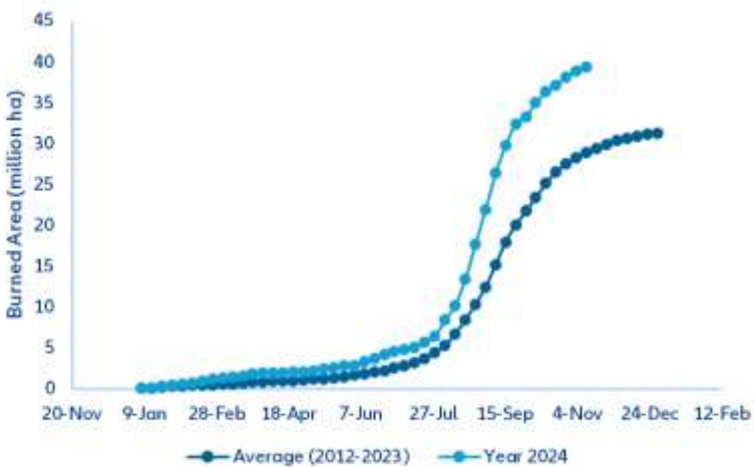
Figure 5: Wildfires in South America for the period 2012-2023 (average)



Sources: Our world in data, Allianz Research

Wildfires are on the rise across Brazil's major biomes. In the first ten months of 2024, the number of fire outbreaks surpassed those recorded during the same period in 2023, with a +51% increase in the Amazon, a nearly +70% rise in the Cerrado and an astonishing surge of over +600% in the Pantanal[3]. These sharp increases highlight a troubling trend for Brazil's ecosystems, which are crucial for biodiversity and climate regulation. October brought particularly alarming statistics: Fire activity in the Amazon was over 11% higher than the average for the past five years, while the Pantanal experienced an increase of more than 35% above its five-year average. In contrast, the Cerrado recorded fire occurrences 20% below the average, which may reflect regional variations in climate and land-use factors or successful fire-management efforts. Figure 6 compares the cumulative burned area in Brazil for 2024 with the average from 2012 to 2023. It reveals a substantial increase this year, with 2024 diverging sharply from the historical average starting around July. By mid-September, the burned area in 2024 significantly exceeded the previous years' average, reaching over 35mn hectares, compared to about 30mn hectares for the average. This widening gap suggests an intensification of wildfire occurrences in 2024, likely driven by worsening climate conditions, deforestation and land-use changes.

Figure 6: Average share of land burned and share of tree cover loss (2012-2023)



Sources: GWIS, Allianz Research

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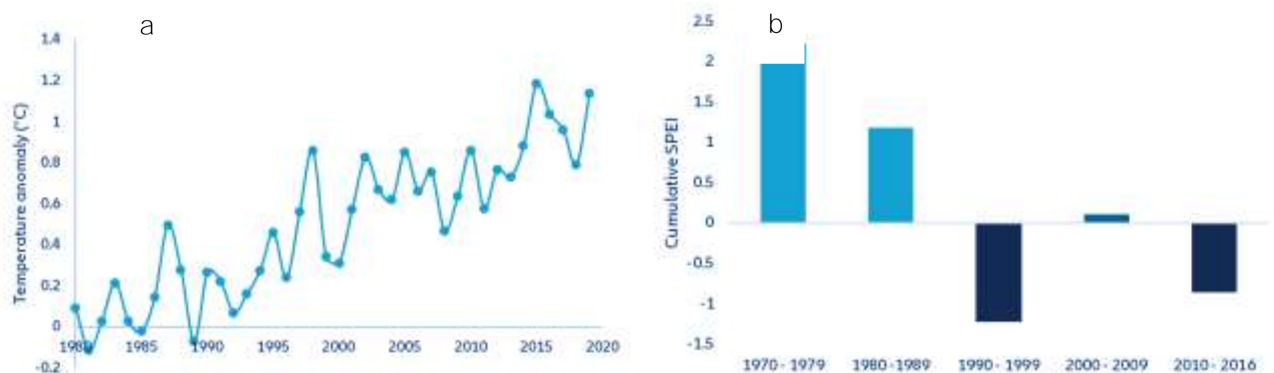
[3] Wildfires continue to rise in Brazil's main biomes in 2024 | WWF Brasil

The primary driver behind the unprecedented surge in wildfires in Brazil is the changing climate. During drought conditions, vegetation such as grasses and trees lose essential moisture, becoming highly flammable and significantly increasing wildfire risk. Drought not only makes ignition more likely but also accelerates fire spread, creating a volatile environment where fires can grow rapidly out of control. Furthermore, unusually high temperatures intensify drought conditions, creating even drier landscapes that fuel more extreme and unmanageable fires. Brazil is particularly vulnerable to these climate impacts, with temperatures consistently on the rise. As shown in Figure 7a, Brazil's average temperature anomaly has reached approximately +1.2°C above the 1950–1979 baseline. This warming trend contributes to more frequent and severe heatwaves, exacerbating the wildfire risk. For example, in August 2024, Brazil experienced temperatures as high as 39°C, significantly above normal levels. In some parts of Central Brazil (Centro-Oeste), temperatures soared up to 7°C above the seasonal average, pushing ecosystems and communities to their limits[4]. These extreme temperatures coincide with chronic drought conditions, as illustrated in Figure 7b. The standardized precipitation and evapotranspiration index (SPEI) reveals frequent and intense drought periods in Brazil from 1990 to 2016. This pattern of prolonged dryness and high temperatures creates a feedback loop that weakens ecosystems, depletes soil moisture and leaves vegetation vulnerable to ignition. With each additional dry and hot season, Brazil's natural landscapes, including vital biomes like the Amazon and Cerrado, become more prone to fire. This cycle not only threatens biodiversity and ecosystem stability but also reduces the climate-regulating capacity of these biomes. Finally, the influence of climate change on Brazil's wildfire risk is further intensified by the periodic occurrence of El Niño events. El Niño, a climate phenomenon characterized by warmer-than-average sea surface temperatures in the Pacific Ocean, disrupts weather patterns globally and often brings hotter and drier conditions to Brazil. During El Niño years, Brazil experiences reduced rainfall and extended dry spells, which exacerbate drought conditions and increase wildfire risk. This is particularly concerning when combined with already rising temperatures.

Figure 7: Evolution of climate in Brazil: a) Temperature anomaly for the period 1980 – 2019 compared to average 1950 – 1979, b) Evolution of the Standardized Precipitation Evapotranspiration Index for the period 1970 – 2016



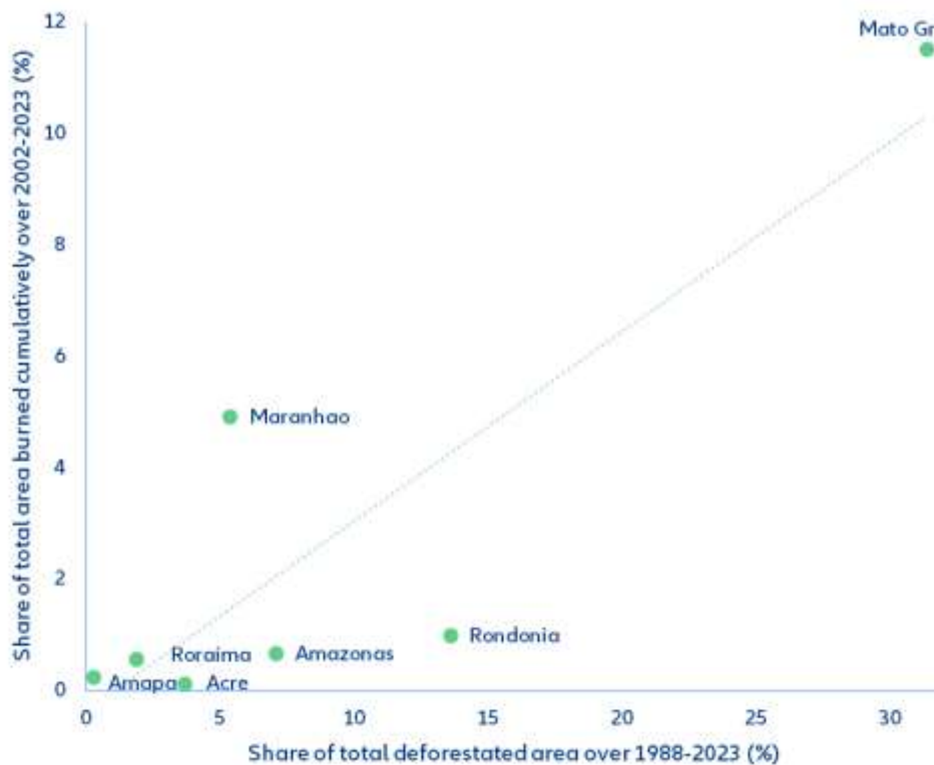
Sources: Copernicus, JRC Data Catalogue, Allianz Research

The second driver of wildfires in Brazil is the relentless deforestation occurring across vast areas of the Amazon rainforest and other key ecosystems. As forests are cleared for agricultural expansion, cattle ranching and infrastructure projects, the exposed land becomes more vulnerable to fire. Deforestation strips away the natural canopy that retains moisture in the soil and air, creating drier and more flammable conditions[5]. Without dense vegetation to trap humidity, these areas are more susceptible to ignition, particularly during Brazil's dry season. The interplay between deforestation and fire risk creates a dangerous feedback loop: as deforested land becomes more prone to wildfires, these fires further degrade nearby forests, pushing the landscape toward even greater vulnerability. The scale of deforestation in Brazil has been accelerating, particularly since 2012, with some regions witnessing alarming rates of forest loss. States like Pará and Mato Grosso, major centers of agricultural and cattle ranching activities, have seen deforestation claiming over 30% of their total forest area between 1988 and 2023 (Figure 8). Figure 8 illustrates a strong correlation between deforestation rates from 1988 to 2023 and the proportion of total area burned by state. Mato Grosso stands out, displaying the highest levels of wildfire exposure

[4] *Extreme heat and fires linked to climate change in Brazil | Climate Central*
[5] *Interactions among Amazon land use, forests and climate: prospects for a near-term forest tipping point - PMC*

alongside the most extensive deforestation activity. This trend underscores how areas with significant forest loss, like Mato Grosso, are particularly vulnerable to wildfires as the degradation of natural landscapes creates conditions that increase fire frequency and intensity. In 2019, Brazil experienced a +39% increase in wildfires compared to previous years, largely driven by heightened deforestation. The fires generated massive amounts of fine particles (PM2.5), leading to serious public health impacts. Exposure to these particles contributed to an estimated 3,400 additional deaths due to respiratory and cardiovascular issues, indicating the broader social and health consequences of deforestation-fueled wildfires[6].

Figure 8: Deforestation of the Amazon rainforest in Brazil for the period 1988 – 2023 by state



Sources: Statista, Allianz Research

Agriculture is the primary driver of deforestation in Brazil, with beef production and soybean cultivation leading the way[7]. In 2020 alone, beef production was responsible for 949,000 hectares of deforested land, while soybean cultivation accounted for an additional 417,000 hectares. Soybeans, once processed into soy oil, play a significant role in Brazil's biodiesel industry, comprising 70% of the country's biodiesel supply. This reliance on soy-based biodiesel aligns with Brazil's National Biofuels Policy (RenovaBio), a strategic initiative aimed at reducing greenhouse gas emissions and supporting the country's climate commitments. However, the expansion of these agricultural activities, while beneficial for biofuel production, poses a serious threat to Brazil's forests, underscoring the complex balance between economic development and environmental preservation in meeting climate goals. Since 2013, soybean production in Brazil has surged, increasing from 80mn tons to 120mn tons. Although deforestation rates have stabilized since 2017, the cumulative deforestation attributed to soy cultivation between 2013 and 2020 still reached a substantial 5.17mn hectares (Figure 9). This trend is further illustrated in Figure 10, which shows a nearly linear relationship between land-use change and soybean trade. Mato Grosso stands out as the state with the highest volume of soybean trade, corresponding to extensive land-use changes and, as discussed in Figure 8, the highest wildfire activity. This correlation highlights how the expansion of soybean cultivation

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[6] Large Air Quality and Public Health Impacts due to Amazonian Deforestation Fires in 2019 - Butt - 2021 - GeoHealth - Wiley Online Library

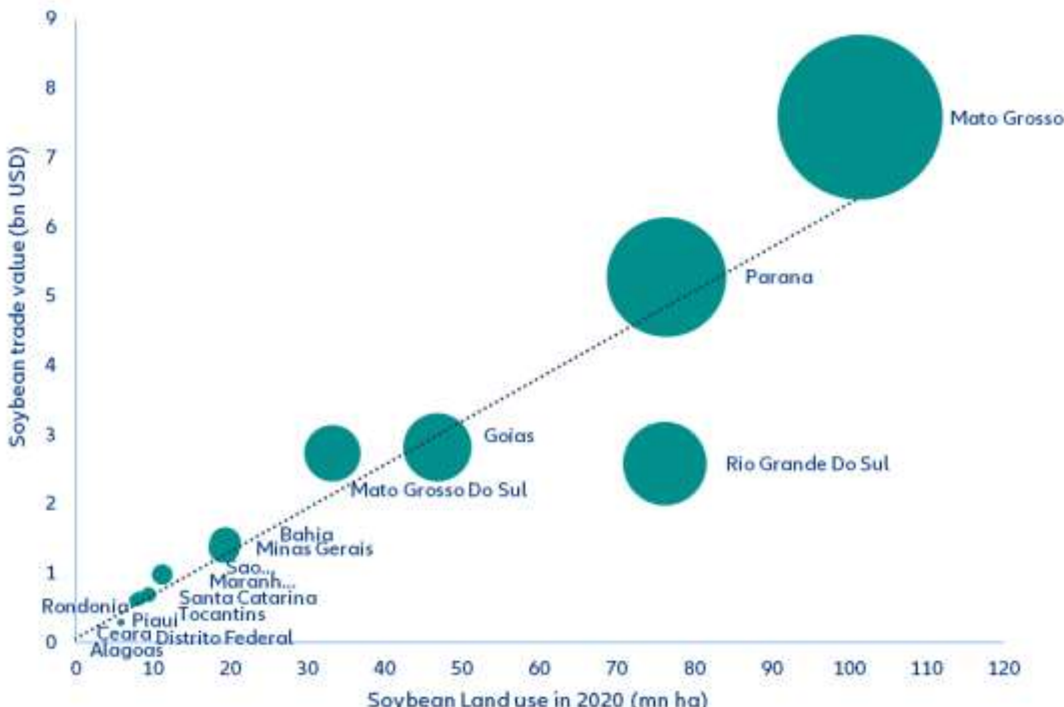
[7] The deforestation effects of trade and agricultural productivity in Brazil - ScienceDirect

contributes not only to significant deforestation but also to increased wildfire risks, particularly in regions heavily engaged in agricultural trade. The findings highlight the environmental costs associated with agricultural growth, emphasizing the need for sustainable practices to mitigate impacts on Brazil's forests and ecosystems.

Figure 9: Trend in soybean cultivation and associated deforestation

Sources: Trase, Allianz Research

Figure 10: Soybean trade and associated land-use



Sources: Trase, Allianz Research

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