



Allianz Research | 23 January 2025

# What to watch: The playbook of Trumponomics; diverging central banks and China's slippery trade surplus in the year of the snake

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## In summary

This week we look at three critical issues:

- President Trump signed a flurry of executive orders on his first day as the new President of the US, including a withdrawal from the Paris Accords and the WHO. But cracking down on unauthorized and legal immigration topped the agenda. We expect the number of deportations per year to reach 500,000, which could stall US population growth, pushing the economy's potential growth below +2% by 2026. The President will likely announce tariff hikes on 1 February against China and potentially the EU, Mexico, and Canada. Executive orders were also signed to boost oil & gas production and unravel green-friendly policies, especially for electric vehicles. Overall, some policies could be inconsistent with each other, such as maintaining high growth while reducing inflation. Ultimately, the success of Trumponomics will mostly hinge on the administration's ability to substantially reduce the public deficit, which would lead to lower inflation and lower interest rates.
- **Central banks: Red light, green light.** The coming days will be packed with central bank decisions, but not everyone is driving in the same direction. The Bank of Japan will be on the starting block on Friday, likely raising its policy rate by 25bps to 0.50%. The Fed meeting follows on 29 January, and we expect a pause in its easing cycle (Fed Funds rate target in the 4.25-4.5% bound) after three consecutive rate cuts in end-2024 amid persistent core inflationary pressures. With policies likely to keep inflation above target, and political pressure on the Fed to favor growth, we still see little scope for further decreases this year. We still expect only one last 25bps rate cut in March, which will keep the Fed Funds rate in the 4-4.25% bound for the rest of the year. In contrast, the ECB (30 January) is set to continue its easing cycle this year, lowering the deposit rate again by 25bps to 2.75% as economic headwinds persist. We expect 25bps cuts at each of the following meetings, reaching a terminal rate of 2.0% by June 2025. Lastly, the Bank of England is likely to cut the bank rate by 25bps on 06 February, and to cut in one of every two meetings until Q3 2025 as it balances weak economic activity and sticky inflation.
- **China: A slippery trade surplus in the year of the snake.** China ended the year of the dragon with a fiery trade surplus of nearly USD1trn, boosted by exports to the US at the end of the year ahead of the looming trade war. But the year of the snake will be more slippery, with President Trump warning of setting 10% tariffs against China as soon as 1 February. While details are still lacking, we estimate that China's export losses would range between USD22bn and USD57bn over 2025-2026 in a contained trade war scenario. Weaker export prices and currency may partly mitigate the impact, though we expect a milder CNY depreciation this time around (2.6% in 2025 vs. 10% in 2018) as Chinese authorities worry about confidence effects and the risk of capital flight. The USDCNY rate is unlikely to exceed 7.50 in 2025.

## The playbook of Trumponomics

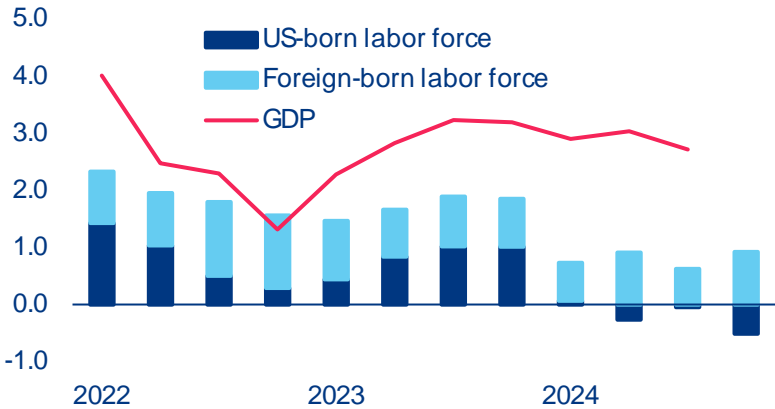
The new Trump administration’s top priority is cracking down on immigration (unauthorized and legal). We expect deportations to reach 500,000 per year, which could stall US population growth (0.2%), pushing the economy’s potential growth below +2%. President Trump signed off on a flurry of executive orders on his first day as the new President of the US, including a withdrawal from the Paris Accords and the WHO. But a swift crackdown on both unauthorized and legal immigration topped the President’s agenda, with around 10 executive orders, including declaring a national emergency at the border, further limiting asylum claims at the border, the requirement for asylum seekers to stay in Mexico while their claims are processed, ending the right to birthright citizenship, resuming construction of the border wall and sending troops to the border. In the short-term, immigration inflows at the border will likely drop sharply, though they were already decreasing significantly since the signing of an executive order by former President Biden in June 2024. However, the deportation of undocumented immigrants from other parts of the US (“interior deportations”) have been less than 50,000 per year since 2021, down from the record highs seen during the Obama administration (250,000 per year). Under the new Trump administration, we expect interior deportations to pick up sharply to 500,000 per year. The goal of 1mn floated by several members of the Trump administration looks very hard to achieve, given logistical and administrative hurdles. If the Trump administration proceeds with tighter legal immigration policies in the coming months, US population growth could slow down from 3.4mn last year to 1.5mn this year, and close to 0.5mn by 2027 (Table 1). That would weigh significantly on the growth of the labor force, which has been powered up almost entirely by foreign-born people in recent years, while the growth of US-born people has stalled (Figure 1). Labor force growth is one of the two key drivers of GDP growth along with productivity growth. In this context, under much tighter immigration policies, US potential growth is likely to drop below +2% by 2026.

Table 1: US population growth forecasts under President Trump

q4/q4, millions	2023	2024	2025	2026	2027
Legal immigration	0.9	0.9	0.7	0.5	0.5
Net unauthorized ex interior removals	2.5	2.0	0.5	0.1	0.0
Interior removals	0.0	0.1	0.3	0.4	0.5
Net foreign-born	3.4	2.8	0.9	0.2	0.0
Natural change	0.6	0.6	0.6	0.6	0.6
<b>Net total change</b>	<b>4.0</b>	<b>3.4</b>	<b>1.5</b>	<b>0.8</b>	<b>0.6</b>
<b>Net (%y/y)</b>	<b>1.2</b>	<b>1.0</b>	<b>0.4</b>	<b>0.2</b>	<b>0.2</b>
<b>If interior removals rise to one million:</b>					
Net foreign-born	3.4	2.8	0.9	-0.4	-0.5
<b>Net total change</b>	<b>4.0</b>	<b>3.4</b>	<b>1.5</b>	<b>0.2</b>	<b>0.1</b>
<b>Net (%y/y)</b>	<b>1.2</b>	<b>1.0</b>	<b>0.4</b>	<b>0.1</b>	<b>0.0</b>

Sources: Capital Economics, BLS, DHS, Allianz Research

Figure 1: US GDP and labor force growth (% year-on-year)



Sources: LSGE Workspace, Allianz Research

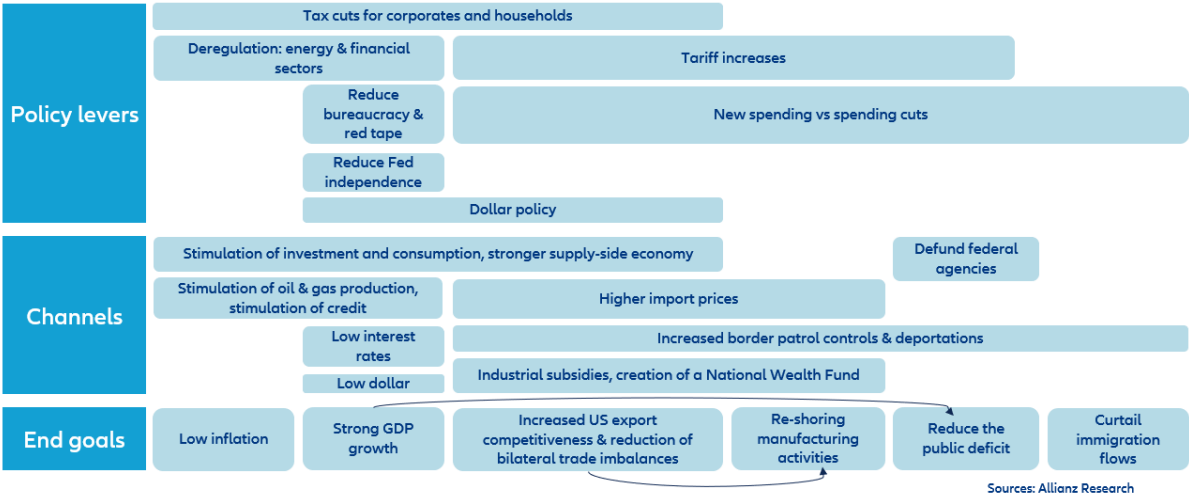
**On trade policy, the President will likely announce tariff hikes on 1 February against China and potentially the EU, Mexico and Canada, but the scope of goods targeted remains uncertain.** The White House released a memorandum which directs the Secretary of Commerce to investigate the US’s “large and persistent trade deficits in goods” as well as to “recommend appropriate measures, such as global supplemental tariffs”. President Trump said his administration was considering a 10% tariff on Chinese products by 1 February. On the EU, President Trump insisted on the unbalanced trade relationship in the automotive sector, so these goods are likely to be targeted with higher tariffs. On Mexico and Canada, President Trump is still threatening to impose 25% tariffs, but his threats could be watered down faced with the prospect of harmful supply-chain disruptions in North America. The creation of an *External Revenue Service* (ERS) to collect customs receipts highlights that the Trump administration intends on making these sources of revenues permanent.

**On deregulation and energy policy, President Trump re-affirmed his commitments: boosting oil & gas production and unraveling green-friendly policies. The deregulation agenda will also benefit artificial intelligence.** President Trump declared a national energy state of emergency to support oil & gas production. This allows easier access to drilling permits and the reversal of several bans on drilling. It also confirmed an intent to unravel the green-friendly policies implemented by the former Biden government, notably as regards the development of the electric vehicle (EV) industry on US soil and the suspension of wind permit issuance on federal lands. For now, President Trump has ended the federal fund allocation to EV charging stations, which the former administration aimed to double by 2030 (500,000 compared to 203,000 currently). Other key policies implemented by Biden, such as the incentive policy on new EV purchases and/or leasing (up to USD7500 subsidy), but also federal rules enforced to curb carbon emissions (the Environment Protection Agency enacted a tail-pipe curb rule, California has also enacted its own target to have 100% carbon-neutral new registrations as soon as 2035) could also be scrapped. With only 8% of market share in 2024 (slightly up from 7.9% in 2023), the US EV segment is relatively underdeveloped and trails behind that of Europe and China. President Trump also revoked the "Safe, Secure, and Trustworthy Development and Use of AI" executive order that had been put in place by the Biden administration, and unveiled an AI-focused initiative called "Stargate" that will involve several tech companies. The joint venture will invest an initial USD100bn of private capital (and up to USD500bn over the next four years) to fund AI infrastructure. The project aims to support the "re-industrialization of the United States," generating 100,000 jobs, as well as providing strategic capabilities to "protect the national security of America and its allies." This is mostly a grand statement of pre-existing plans, but it highlights the increasing policy focus on AI.

**The new administration has ambitious goals to boost GDP growth while taming excessive inflation but some policies could be inconsistent with each other.** Tax cuts are aimed at stimulating investment and consumption, which in turn will support GDP growth. At the same time, tariff increases will bring new customs receipts, helping to fund new industrial subsidies and support US export competitiveness and re-shoring. The dollar policy, floated by

several advisers to Trump as well as Vice-President Vance on the campaign trail, could serve the same purpose by weakening the dollar against foreign currencies. Finally, lower energy prices spurred by deregulation of the energy sector, as well as the boost to the supply side of the economy via tax cuts (increased labor supply and investment) are aimed at pushing down inflation. However, several policy goals could become inconsistent with each other. For instance, pressure on the Fed to decrease interest rates could re-ignite inflationary pressures. The drastic curtailing of immigration flows will weigh on US potential GDP growth, as highlighted above. Tax cuts could boost more the demand side of the economy more (aggregate spending) rather than the supply side, again pushing up inflation. The reduction of the public deficit also looks hard to achieve in the absence of substantial savings, even if growth settled at a high +3% per annum, as we have shown in a previous report<sup>1</sup>. The Trump administration is unlikely to reduce the deficit significantly without reducing welfare spending drastically (and/or increasing taxation). The defunding of federal agencies will be nowhere near enough to balance the budget. In addition, customs receipts will probably be far from enough to fill in the holes: if all additional duties go to deficit reduction, 1% GDP of deficit reduction (USD290bn) would require the US effective tariff rate to raise from the current 2.7% to 13%. Under this scenario, US GDP growth would likely be affected very negatively – with supply-chain disruptions at the borders with Canada and Mexico – challenging the goals of strong GDP growth and low inflation.

Figure 2: Trumponomics playbook



Source: Allianz Research. Note: The bottom row summarizes the policy goals of the Trump administration, while the top row shows the policy levers that could be used and the middle row the channels from which the policy levers achieve the goals.

**In all, the success of Trumponomics will mostly hinge on the ability of the Trump administration to substantially reduce the public deficit.** A large, sustained reduction of the public deficit will likely lead to lower inflation and lower interest rates. The dollar could also depreciate, thanks to lower interest rates, helping to support US export competitiveness. Meanwhile, the reduction of the public deficit (as well as a weaker dollar) will likely narrow the US trade deficit by curtailing import demand. Admittedly, under this scenario, the administration will likely have to give up on its strong GDP growth assumption – at least in the short term.

### Central banks: Red light, green light

The coming days will be packed with central bank decisions, but not everyone is driving in the same direction. The Bank of Japan will be on the starting block on Friday, likely raising its policy rate by 25bps to 0.50%. As of Wednesday morning, overnight-indexed swaps indicated an over 90% probability of a rate hike, up from around 40% at the end of December 2024. The focus will not only be on the immediate rate hike but also on the BoJ’s guidance regarding future policy tightening. The central bank delivered two rate hikes last year (+35bps to 0.25%) and we expect two others this year (+50bps to 0.75%) and another next year (+25bps to 1% by 2026-end). In his

<sup>1</sup> Allianz | What to watch | November 28, 2024

December press conference, Governor Ueda highlighted that the annual *shunto* wage negotiations and US policies could play a pivotal role in determining the BoJ's future rate path. On the former, recent data suggest wage dynamics are likely to remain solid this year (a survey by the Japan Chamber of Commerce and Industry released at the end of 2024 shows around half of SMEs asked plan to raise wages) and on the latter, US policies are likely to support USD strength. Over the past week, the JPY has appreciated by 1.6% against the USD as markets price in the imminent policy rate hike, but JPY weakness remains a concern for the BoJ, especially as it could fuel inflationary pressures. In its Outlook Report to be published on Friday, the BoJ is likely to revise inflation projections upwards. We expect the headline to average 2.2% in 2025 (after likely 2.7% in 2024) and 1.9% in 2026. GDP growth is likely to recover to +1.2% in 2025 (after likely -0.3% in 2024) and +1.1% in 2026.

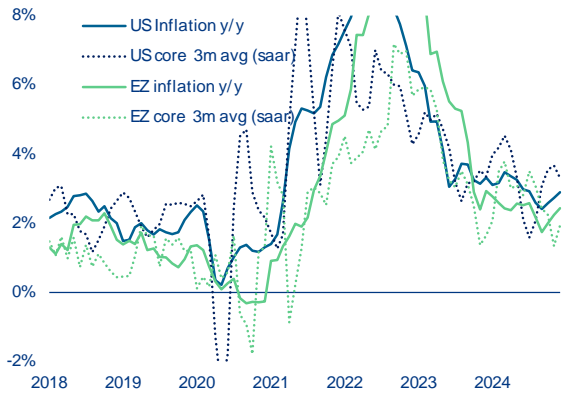
**The Fed meeting follows on 29 January, and we expect a pause in its easing cycle amid persistent core inflationary pressures.** The Fed is likely to keep the Fed Funds rate target in the 4.25-4.5% bound after three consecutive interest rate cuts from September-December 2024. US economic activity has remained strong since then, while the labor market has stopped loosening. Against this backdrop, disinflation progress has been moderate or has even reversed on some metrics. Forward-looking indicators such as the December ISM non-manufacturing survey are pointing to risks that services inflation could be re-accelerating in the next couple of months. Meanwhile, goods inflation remains soft, indicating that US importers are not pre-empting upcoming tariff hikes just yet. We maintain our view that if the labor market does not soften further, core inflation will likely not return to the Fed's 2% target. Historically, core inflation has hovered around 2% when the vacancy-to-unemployed ratio steadied at 0.8, which corresponds to an unemployment rate of around 5%<sup>2</sup>. At 4.1 in December, the unemployment rate is still too high to allow core inflation to return to 2% sustainably. The timing and the scope of future macro policies under the new Trump administration will also affect inflation and, consequently, the trajectory of interest rates. For now, we expect tariff and immigration policies to keep inflation higher than 2%, while the Fed is likely to face political pressure to favor growth over a strict stance against inflation. Consequently, we still see little scope for the Fed to decrease interest rates further this year. We still expect only one last 25bps rate cut in March, which will keep the Fed Funds rate in the 4-4.25% bound for the rest of the year.

**In contrast, the ECB is set to continue its easing cycle this year as economic headwinds persist.** At its next meeting on 30 January, the ECB is expected to lower the deposit rate again by 25bps to 2.75%. Policymakers have repeatedly emphasized that macroeconomic risks are now linked to slowing growth rather than inflation. Recent surveys, including Purchasing Managers' Indices (PMIs), indicate an ongoing contraction in manufacturing and sluggish growth in services. The impact of still-high energy prices, uncertainty and the lagged effects of earlier monetary tightening continue to weigh on activity. Risks to growth remain tilted to the downside, particularly as potential trade frictions with the incoming US administration and global geopolitical uncertainties could dampen Eurozone exports and investment. The outlook is further clouded by fiscal and political developments in major European economies such as Germany and France. Meanwhile, inflation concerns have moved to the background even as headline inflation rose for three consecutive months to 2.4% y/y in December. However, this increase is largely due to base effects and energy prices. Core inflation remained steady at 2.7% y/y but shows signs of improvement, with the three-month annualized sequential rate below the ECB's target (1.9%). With base effects becoming more favorable, inflation should move back towards the target in the coming months. Our monetary policy forecast for the Eurozone therefore remains unchanged, with 25bps cuts likely at each of the following meetings, reaching a terminal rate of 2.0% by June 2025.

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<sup>2</sup> To express the vacancy-to-unemployment ratio in terms of the unemployment rate, a stable Beveridge curve is required, which fits the data, including until recently.

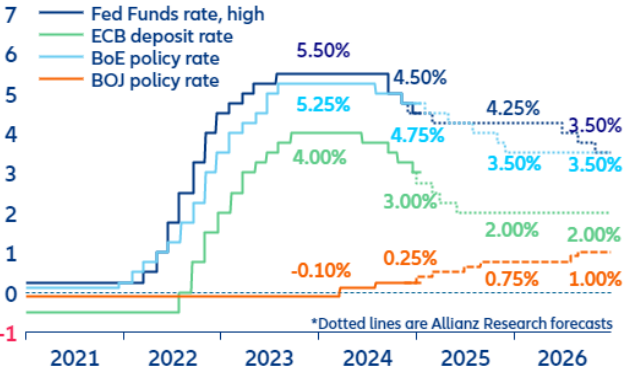
Figure 3: Eurozone and US inflation, headline y/y and 3m avg m/m, %



Sources: LSEG Workspace, Allianz Research. Note: Dotted lines show three-month average m/m seasonally adjusted annualized rate (saar) inflation rates.

**The Bank of England is likely to cut the bank rate by 25bps on 06 February, and to cut in one of every two meetings until Q3 2025 as it balances weak economic activity and sticky inflation.** Despite elevated wage growth reported in November, forward-looking data already suggest that core inflation and wage growth will pull back in the next six to 12 months. Meanwhile, the UK economy likely did not grow at all in the second half of 2024, with the latest hard data coming out very weak at the end of 2024. Against this backdrop, we still expect the BoE to cut the bank rate by 25bps at its next meeting in February, and then to cut in one of every two meetings through Q3. We then expect back-to-back 25bps rate cuts in the November and December meetings. In all, the bank rate should reach 3.5% by December 2025, in line with our expectations for headline inflation to remain elevated (between 2.5% and 3%) through the end of the summer, but core inflation to weaken substantially from the spring. That will give the BoE confidence that underlying inflationary pressures are abating and that more needs to be done to offset the drag on the economy from tight financial conditions and fiscal policy.

Figure 4: Monetary policy rates and Allianz Research forecasts, %

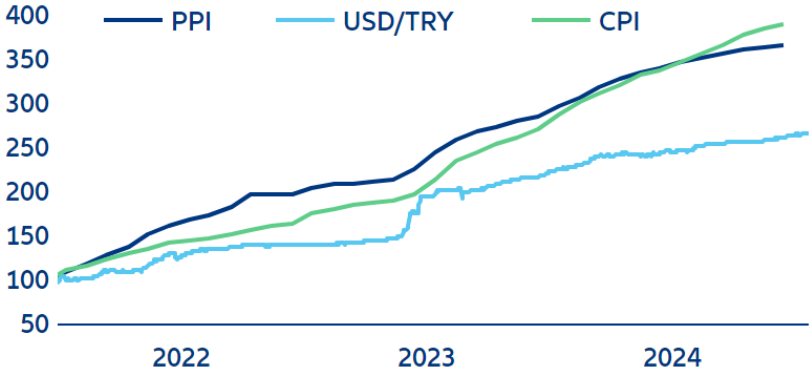


Sources: LSEG Workspace, Allianz Research

**Divergent objectives can complicate things in emerging markets, for example in Türkiye.** The December inflation print came in lower than expected, supported by declining unprocessed food prices and moderation in domestic demand. Food inflation decreased significantly to 1.3% from 5.1% monthly, while services inflation also slowed to 1.1% from 1.6%. Seasonal trends and limited wage increases suggest manageable inflation risks, with Q1 expected to see the highest inflation of the year. Our baseline scenario remains that of continuity in policy predictability, little government interference and further improvement of the sovereign profile. The central bank is continuing its focus on controlling loan growth, reducing caps for commercial and FX loans while slightly increasing the loan cap for SMEs. Following a 250bps rate cut in December, the central bank delivered another 250bps rate cut on Thursday,

in line with the implied rate, amid currency volatility concerns. This gradual reduction strategy may contribute to a 30pp policy rate by year-end, while the currency may depreciate by approximately 20% against the USD, reaching TRY45 per USD. The appreciation of the real exchange rate has eroded corporate profit margins, particularly for exporters, as well as overall competitiveness, potentially increasing corporate insolvency risks in 2025.

Figure 5: Consumer and producer price index vs exchange rate, index: 01/01/2022 = 100

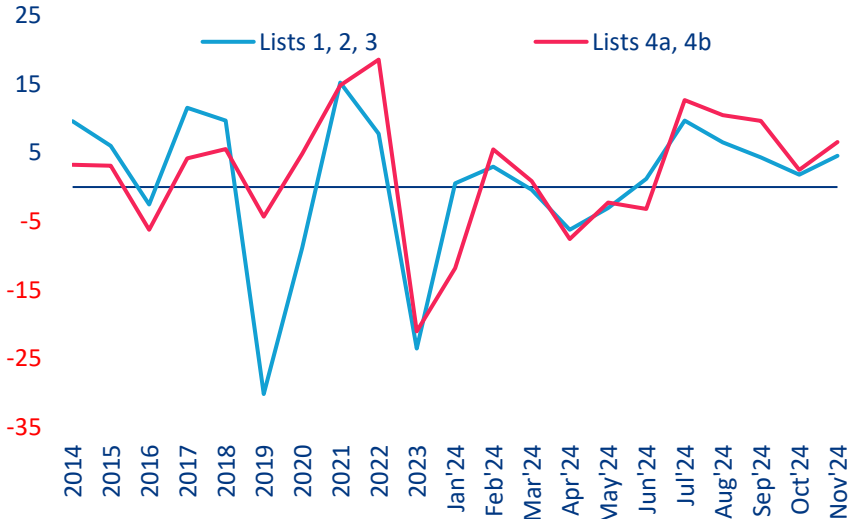


Sources: TurkStat, LSEG Datastream, Allianz Research

### China: A slippery trade surplus in the year of the snake

Closing the year of the dragon on a fiery note, China’s trade surplus reached a record high of nearly USD1tn in 2024. The credit goes to strong export growth combined with weak imports in the context of Chinese manufacturers’ competitiveness and still soft domestic demand. Additionally, the end of the year was supported by frontloading of shipments ahead of a probable renewed trade war in 2025. The December trade surplus exceeded the USD100bn mark for the first time on record, with exports rising by a strong +10.7% y/y (compared with +5.9% for 2024 as a whole). In particular, Chinese shipments to the US outperformed in December, rising by +15.6% y/y (compared with +4.9% for 2024 as a whole), and goods that currently face lower tariffs or none at all were especially popular, growing on average by +8.4% y/y between July and November, compared to +5.4% for the other goods (Figure 6).

Figure 6: US imports from China, %/y



Note: Lists of US imports from China that were targeted during the first Trump administration: List 1 (machinery, electronics, industrial goods) with current tariff rate at 25%, List 2 (chemicals, plastics, semiconductors) at 25%, List 3 (consumer goods, furniture, textile) at 25%, List 4a (footwear, clothing, kitchenware) at 7.5% and List 4b (smartphones, laptops, toys) at 0%.  
Sources: ITC, USTR, Allianz Research

**But the year of the snake could be slippery.** The benefits of frontloading will only last until higher tariff rates are implemented. While we initially expected this in Q2, President Trump’s recent comments suggest that they might come as soon as 1 February. More reassuringly, though, the scale of tariff hikes seems close to our baseline scenario of a “contained trade war”: Trump has warned of setting 10% tariffs against China, much less than the 60% suggested on the campaign trail. It remains unclear at this stage if he means a 10% terminal tariff rate for all goods currently under that rate, or a blanket additional 10pps on tariff rate for all goods. The US trade-weighted average tariff rate on China would rise to 17.1% in the former case and 23.4% in the latter, compared with around 13% currently and 19.5% in the assumptions of our baseline scenario. Under these different possibilities, we estimate that Chinese export losses over 2025-2026 would range between USD22.4bn and USD56.9bn (Table 2), with a hit to GDP of -0.1pp in 2025 and -0.2pp to -0.3pp in 2026.

Table 2: Economic impact of US trade policy scenarios on China

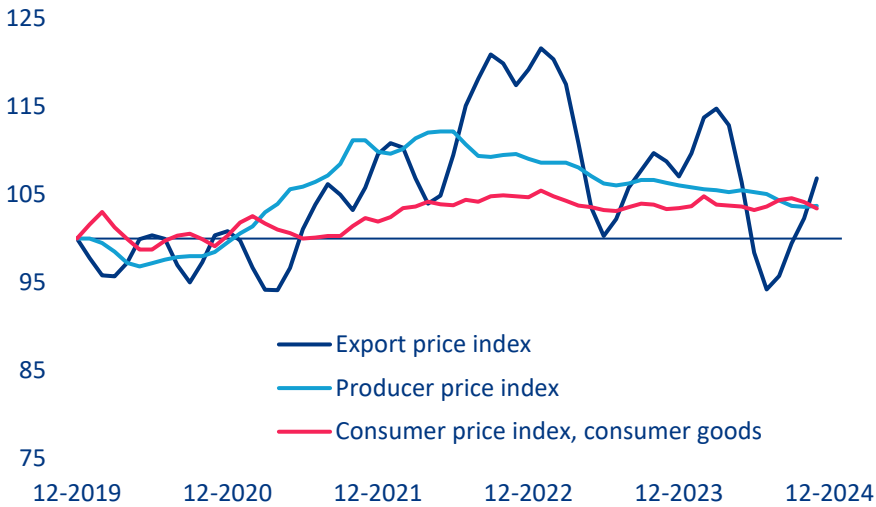
	Our baseline “contained trade war” scenario	10% terminal tariff rate on goods currently under that rate	Additional 10pp on tariff rate for all goods	Our downside “full-fledged trade war” scenario
Trade-weighted average tariff rate	19.5%	17.1%	23.4%	38.7%
Export losses in 2025-2026	USD34.4bn	USD22.4bn	USD56.9bn	USD125.3bn
Hit to exports*	-0.1pp in 2025, -0.8pp in 2026	-0.1pp in 2025, -0.5pp in 2026	-0.2pp in 2025 -1.3pp in 2026	-0.4pp in 2025, -2.9pp in 2026
Hit to GDP*	-0.1pp in 2025, -0.2pp in 2026	-0.1pp in 2025 -0.1pp in 2026	-0.1pp in 2025 -0.3pp in 2026	-0.3pp in 2025, -0.7pp in 2026

\* Percentage change relative to projected level  
Sources: Oxford Economics, Allianz Research

**Weaker export prices and currency may partly mitigate the impact of the trade war...** Since 2023, Chinese export prices have been more volatile than in the previous decade. Large sequential declines in the first half of 2023 (-17% between January and June) were followed by a trend of increases until March 2024 (+14% between June 2023 and March 2024), another bout of price cuts (-17% between March and July 2024) and, lately, some recovery (+13% between July and November 2024) – see Figure 7. This probably reflects the fact that exporters have been actively using price adjustments to remain competitive and secure market share. They can also turn to cutting export prices to try and mitigate the impact of higher tariff rates, especially as some room for maneuver has been built in the past few months. Additionally, a weaker currency could also help mitigate the impact of the trade war. The Chinese yuan (CNY) depreciated by around 10% against the US dollar (USD) when tariff hikes were implemented between April and October 2018, when the US trade-weighted average tariff rate on China rose by 12.6pps. This time, we estimate that an around 7% depreciation would match the tariff hikes under our baseline “contained trade war” scenario (and around 20% in our downside “full-fledged trade war” scenario). Since the end of September 2024 (when expectations clearly shifted towards Trump’s victory), the CNY has depreciated by 3.6% against the USD, as of 22 January. Either markets have not fully priced in the extent of likely upcoming tariff hikes and/or Chinese authorities are trying to prevent a fast and meaningful depreciation of the CNY.



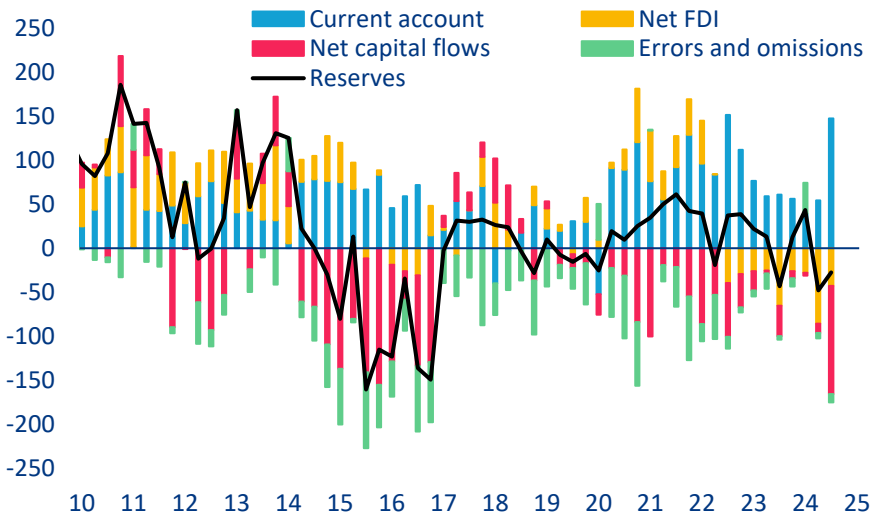
Figure 7: China price indices, December 2019 = 100



Sources: national sources, LSEG Datastream, Allianz Research

**...but Chinese authorities will likely fight against a strong depreciation to curtail confidence effects and the risk of capital flight.** Even though China’s trade and current account balances have been strong since 2020, official FX reserves did not rise significantly during that period (Figure 8). Instead, capital outflows have risen, probably because of several reasons, including divestments from foreign investors, rising outwards FDI from China and foreign assets accumulation by state banks. While such a situation is manageable from a balance of payments perspective (a country with a current account surplus and managed exchange rate should have capital outflows by definition), the risk is that a strong CNY depreciation leads to capital flights from domestic residents – as it did during 2015-2016. Capital outflows have been rising again through 2024 and to prevent large US tariff hikes creating expectations of a substantial fall in the CNY, Chinese authorities will likely manage the path and extent of upcoming CNY depreciation. They are already doing so: the daily USDCNY central parity rate has been fixed on the stronger end since the beginning of the year and the CNY is among the outperforming currencies (with the CFETS RMB Index rising by +2.7% since the end of September 2024). In our baseline “contained trade war” scenario, the USDCNY rate is unlikely to exceed 7.5, implying at most a 2.6% depreciation over 2025 (or less than 7% since the end of September 2024).

Figure 8: China’s balance of payments, USD bn



Sources: national sources, LSEG Datastream, Allianz Research

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

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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.

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