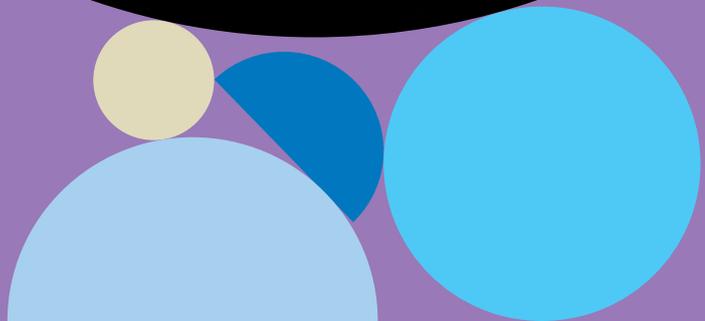


Economic and Market Outlook 2025



A state of flux



Overview

As 2024 draws to a close the Great Normalisation (as we had termed it) of falling inflation, progressive cuts in policy rates and trend-like global growth, is now in doubt. The US election outcome signals a new direction. President-elect Trump has a mandate for change and a desire to make it happen quickly. Election pledges are being bolstered by the proposal of loyal hard-liners to key cabinet positions, as the rest of the world takes note with some trepidation. While the President-elect's intent appears clear, and Congress is likely to be supportive, it is perhaps the financial markets that will ultimately provide the checks and constraints on an ambitious political agenda. From both an economic and financial market perspective, the global 2025 outlook is best characterised as being in a state of flux.

There is no doubt that the commanding victory of President Trump will influence the shape of the year ahead. The tough rhetoric has already created shockwaves and to some extent is having the desired effect.

The focus on US trade deficits and threat of penal tariffs has prompted a reaction from some key global figures, with the ECB president talking of the need to buy more US goods, the Canadian prime minister flying to Florida for an audience with Trump, and policy makers in China showing a desire for dialogue. With their respective territories being particularly vulnerable given relatively weak domestic economies that are ill-equipped for a barrage of trade restrictions, this may be no surprise and suggests no appetite for an all-out trade war.

At this point, we see a world of compromise and deal-making ahead to mitigate the worst effects of tariffs and perhaps even establish more symbiotic relationships. For example, Europe's need for cheaper and more secure liquified natural gas (LNG) as well as increasing military spending are potential ways to reduce the trade surplus with the US, while securing energy and defence capabilities that are needed anyway.

As we have pointed out many times, however, while tariffs are at best a blunt weapon in economic combat, they are also a direct tax on the domestic electorate. An electorate, in the case of the US, that has just voted for a president who pledged to banish inflation and bring down the cost of living. In addition, stimulative taxation plans and fiscal largesse in an economy already running notably above potential growth are likely to contradict

that pledge and cause the Fed to have to alter course in a bid to still meet its inflation mandate. This would be painful for borrowers, both consumer and business, that were banking on lower funding costs ahead.

Of course, timing is critical, and it may be that election promises can be delivered upon without proving inflationary. If not, it could ultimately be the financial markets that temper policy desires. The dollar and Treasury yields have already sent a warning shot across the bow of policy makers, with yields rising and the greenback jumping. As James Carville, Bill Clinton's advisor, famously said about reincarnation—he would choose to come back as the bond market because 'You can intimidate everybody'. We would add—even a US President! With the US deficit high and rising, and more now being spent on interest payments than defence spending, rising bond yields in the face of higher inflation and an overheating economy would be a concern.

The potential consequences of rising corporate defaults, a faltering housing market and, perhaps most alarming of all for a president who quotes equity performance as a measure of success, a falling stock market would be unacceptable. Consequently, just as financial markets have curbed the policy ambitions of more populist parties in Europe and elsewhere, this is also likely to hold true in the US.

While it is easy to be sceptical of the impact of many policies, the incoming president is certainly shaking things up, and there are many positives that can be hoped for. More balanced global trade, fairer defence

spending, lower taxes, easing the costs of doing business, and a more efficient US government are hard to argue against. If implemented skilfully these policies could extend both the US and even the global expansion, though it is very clear that America comes first. With that, however, also comes the likelihood of fractious trade and geopolitical relationships, and less willingness to enter into multilateral treaties on critical global topics, such as climate change.

In aggregate we see the macro outlook as now skewed more towards US growth, but with a higher risk of inflation, while the other two largest trading blocks of China and Europe will have added headwinds that lower their growth potential in the year ahead.

Prospects for financial markets are tilted towards equity markets and the US markets in particular, given better growth and a favourable tax and merger and acquisitions environment. What is abundantly clear despite our relatively sanguine view is that whether it is geopolitics, economic fortunes or financial market returns, risks are high as we enter a world order in a state of flux.



Guy Miller

Chief Market Strategist & Economist

Contents

Global	4
US	6
UK	8
Eurozone	10
Germany	12
Switzerland	14
Japan and South Korea	16
Mainland China, Hong Kong and Taiwan	18
ASEAN and India	20
Australia	22
LatAm ex Brazil	24
Brazil	26
Contacts	28
Additional products on zurich.com/msme	29

Global

Outlook

- Global growth should hold up, but the outlook is increasingly bifurcated and vulnerable to trade disruptions
- Inflation likely to ratchet lower, but at a slow pace with more pronounced regional divergences
- Central bank policy easing set to continue at a gradual and cautious pace

Implications

- Limited downside for US and global government bond yields over the coming year, amid elevated volatility
- Credit markets to notably underperform stocks, with limited upside amid challenging headwinds
- Upside potential greatest for stocks, with supportive policy favouring the US markets

Risks

- Global trade war results in recession taking hold
- Fed rate hike disrupts lending market and monetary policy in other regions
- Credit spreads widen sharply and stocks drop as risk of a hard landing or rate hikes emerges

A shifting trajectory for the global economy

The macro backdrop is in flux. Prior to the US election, the outlook for the global economy was one of normalisation, with further declines in inflation, rates and yields, trend-like global growth and smaller divergences across regions. This included slowing US growth and modestly improving dynamics in Europe and China, with emerging markets (EM) benefitting from an accelerated rate cutting cycle and a weaker dollar. The outcome of the US election is instead likely to amplify divergences. US growth is set to pick up as fiscal measures are expanded, while elevated uncertainty around tariffs and the future world trade environment will weigh on sentiment and activity elsewhere. Stickier US inflation and reduced scope for Fed rate cuts, in combination with the stronger dollar environment, will weigh on the global rate cutting cycle, with negative implications for emerging markets in particular.

Tariffs to rise, but a global trade war is not expected

The resulting trajectory for global growth will critically depend on the eventual path for tariffs. Proposed tariffs (60% on all

imports from China and 10% elsewhere) are not expected to be implemented, as this would imply a return to a 1930s US and global tariff environment, with retaliation and huge disruptions on global supply chains and trade, a likely surge in consumer and producer prices, and a very painful contraction in global economic activity.

Instead, we expect tariffs to primarily be used as a blunt negotiation tool. Even so, some tariffs are still likely to be raised, and the sheer uncertainty around the future trade environment will have a negative impact on business investment and activity in many regions. Disruptions are, moreover, happening against a backdrop of a fractious geopolitical environment and vulnerabilities in the manufacturing and real estate sectors, which could amplify the negative impact.

As a result, we now expect global growth to weaken modestly in 2025 to a below trend pace, with large growth divergences set to persist or widen. We do not anticipate a global recession, however, with policy easing in Europe and support measures in China providing some offsets.

Inflation diverges alongside growth

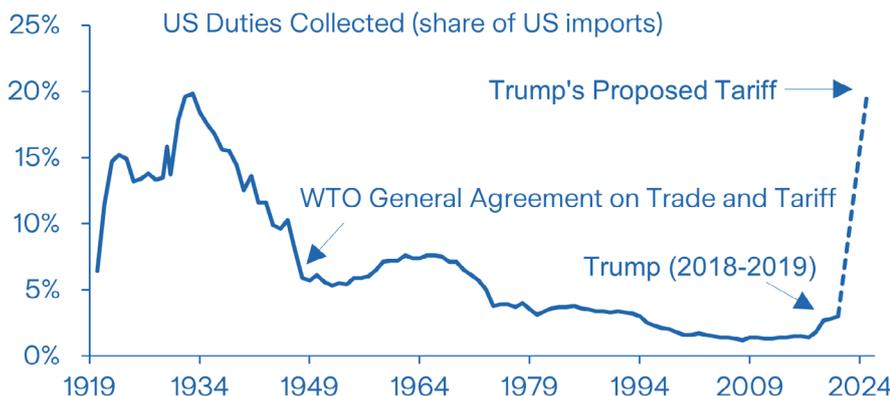
Inflation is close to target in most countries, but is yet to be vanquished given persistent services price pressures. While the near-term trajectory continues to be one of easing inflation in most regions, the medium-term outlook has become more uncertain. Stronger growth, the potential for tariffs to ratchet higher, and more restrictions on immigration add to upside risk for US inflation, though a stronger dollar and the potential for lower energy costs provide some offset. In the absence of large scale and broad-based stimulus, China's economy is set to remain under pressure, and we suspect this will continue to weigh on global commodity and producer prices, alongside world export prices. For Europe, the inflation outlook remains broadly unchanged, with price pressures set to remain contained given subdued growth, weak demand, and normalising wage pressures.

We maintain our view that inflation remains well anchored, given inflation targeting central banks that have both the ability and the willingness to respond should inflation rebound, either by delaying rate cuts or even hiking rates. A recent example is Brazil, where the central bank has rapidly switched from cutting rates to hiking rates due to robust growth amid fiscal easing and a rebound in inflation and inflation expectations. While we do not anticipate other central banks will need to follow suit, this provides an example of how policy should be expected to respond should inflation pick up more materially.

Government bond yields are set to remain volatile on political, geopolitical and tariff uncertainty

Government bond markets were volatile in 2024, predominantly driven by large fluctuations in the policy rate outlook, with inflation data and recession concerns key drivers of volatility. This volatility has translated to large fluctuations at the longer end of the yield curve, though as we had anticipated, yields remained below last year's high.

A compromise solution is expected on trade, but the stakes are high



Note: Dotted line assumes 60% tariff on China and 10% on the rest, import units fall 1 for 1 with the tariff.

Source: ZIG, US ITC, UBS

Going forward, we expect the Treasury market to remain volatile as the US election has injected further uncertainty around tariffs, geopolitics, sticky inflation, and the path of Fed rate cuts. Looking through the volatility, we now anticipate US rates and yields to remain higher for longer compared to pre-election, given the prospect of both stronger US growth and stickier inflation. That said, these assets have not lost their safe-haven properties, with the geopolitical environment likely to keep demand in place and yields capped, and we see Treasury yields modestly lower over the coming year, but likely remaining above 4%.

By contrast, the weaker growth and inflation outlook for Europe, alongside falling policy rates, should keep European yields in check, with modest downside to Bund and gilt yields while Swiss yields have already approached the zero bound, with limited further downside near term. In Japan, the JGB market is expected to remain volatile, with the stronger dollar and a less dovish Fed likely to put pressure on the BoJ to tighten policy further.

Elsewhere, we see a broadly benign environment for European sovereign spreads through 2025. Valuations are unexciting, however, with limited further spread compression likely. This stability is aided by continued ECB easing and reasonable fiscal trajectories in many member states. France is a significant exception. We see the risks skewed towards further increases in OAT bond yields given the unstable political situation.

Credit: Another brick in the (maturity) wall
Credit valuations are the tightest in decades and we expect spreads to widen in 2025, albeit modestly. That said, H1 2025 could still see spreads holding in around current levels, with most of the spread widening likely coming through in the latter half of next year. While we see little upside to our credit spread forecast, there are notable downside risks which would be realised if there is a full-scale global trade war, an inflation outburst or the rate cut path gets recalibrated upward.

The spread widening is likely to be driven by tight spreads and weaker supply/demand technicals rather than by a sharp deterioration of fundamentals. Supply/demand technicals for credit appear set to weaken as we expect increased supply from companies that have not issued enough in the last two years as well as from a modest deleveraging by stronger companies. In this elevated supply backdrop, a steeper government bond yield curve and lower yields are likely to diminish demand from rates investors. On fundamentals, default rates for speculative grade credit should decline modestly but still remain above historical averages. Investment grade companies are likely to see a modest

releveraging as animal spirits will probably return given tight credit valuations and a low risk of a recession. While the perceived situation of the banking sector has improved notably since March 2023, the smaller banks in the US and some lenders in Europe are likely to face pressures from their exposure to commercial real estate.

Within global credit, we remain negative on global High Yield spreads across the US, Europe and China. Companies will need to scale the proverbial wall of maturities, especially in European High Yield, and we see a challenging environment for smaller companies while China's High Yield property sector is still likely to see double-digit default rates. Within Investment Grade credit, European and Japanese credit offer better value, while the US, UK and China offer poorer risk reward. Within credit the front end of the curve should generally benefit from better valuations and the easing of monetary policy. We also believe several parts of non-corporate credit such as US CLOs, US ABS and European covered bonds offer value while US municipal bonds are likely to remain volatile.

Equities are again favoured in what is likely to be a choppy year for returns

As the current year draws to a close, global equity investors have cause for cheer. The broad-based fall in policy rates and trend-like economic growth, pushed most markets to substantial double-digit gains, making equities the best performing asset class in 2024. The US equity markets continued their domination, with US exceptionalism most apparent in the technology sector. The mega-cap players extended their reach and market valuations and continue to invest in their future via huge R&D commitments.

Although it had seemed likely that a new year would bring a broadening of returns, driven by further rate cuts, a softer dollar

and increased investor focus on relative valuations, the Trump-twist appears to have derailed this narrative. In contrast, an agenda of favourable taxation policies, combined with a lighter regulatory touch, are potent shifts that are expected to keep US equity markets in vogue. While we see a much more modest tariff policy than rhetoric would imply, the incoming President's transactional approach to global trade is likely to boost the sale of US products, from defence equipment and technology, to energy and, specifically, LNG shipments. Consequently, we see the US equity markets as continuing to perform well on both a total and relative return basis. That noted, valuations are very high, implying that investor expectations are elevated, offering little room for disappointment. In addition, the ability for the mega tech companies to surprise positively in terms of earnings and margin growth will be reduced in the coming year. This, in combination with our view of a year of flux and volatility, will create opportunities for other equity markets to have their moments to shine, albeit in a transitory fashion.

Chinese stocks should have another bout of gains as Chinese policy makers are forced to provide even more stimulus. Japanese equities have a tailwind from the structural shift in corporate practices towards shareholder-friendly policies, although we are cautious given the potential for the yen to appreciate sharply from currently very low levels. Opportunities elsewhere are less obvious, but in a year where we see both economic and market volatility as key themes, investors need to be primed and prepped to take advantage of opportunities as they present themselves. Net, net, another year of equity gains beckons.

US stocks are expensive, but the wind remains in their sails



Source: Bloomberg

US

Outlook

- The economic cycle will be extended by the expected fiscal measures
- In an environment of above-trend growth most of the announced policies will be inflationary
- The Fed will proceed cautiously given slower progress towards its inflation target

Implications

- Bond yields remain elevated as investors worry about inflation and the fiscal deficit
- Multi decade tight credit spreads limit upside – we prefer stocks instead
- Equities remain attractive, but the margin for error is shrinking given high valuations

Risks

- Significant tariffs and an extended trade war weigh on the growth outlook
- Worries around the fiscal deficit trigger a bond market rout
- The Fed hikes rates as inflation reaccelerates substantially

Households keep spending

The US economy continues to grow at a solid pace above its estimated long-term trend rate, with GDP 2.7% higher in Q3 than a year ago. While the manufacturing sector has been under pressure for most of 2024, services activity continues to hold up. Consumer spending remains the key driver of growth as households keep their wallets open despite mediocre consumer sentiment. Higher costs of living continue to weigh on consumers' mood despite the recent slowdown in inflation, which is one reason for Donald Trump's election victory. Thanks to very long duration mortgages, many households have been shielded against rising interest rates so debt service levels have not risen materially in recent quarters. At the same time, the labour market is holding up well despite a pickup in unemployment. At 4.1% in October, the unemployment rate remains low while solid wage growth has lifted households' real income.

The Fed weakens the labour market without a lot of damage

Some aspects of the labour market have weakened in recent months, but little is pointing at a significant deterioration in the coming months. The quits rate, which tracks the number of employees voluntarily leaving their employer, has fallen below pre-Covid levels, indicating that people have become less certain about quickly finding a new job. This is confirmed by the Conference Board's labour market differential, which measures households' perception of how difficult it is to find a new job versus the risk of losing their current one.

Finally, this pattern also shows up when comparing initial jobless claims to continuing claims. The continuously low number of the first statistic shows that the risk of losing a job remains very low while the significant rise of the latter is an indication of the increased difficulty of finding a new job once you're out of work. Overall, these figures show that the Fed managed to ease the very tight employment situation by causing

firms to significantly reduce the number of job openings without creating substantial damage to the labour market.

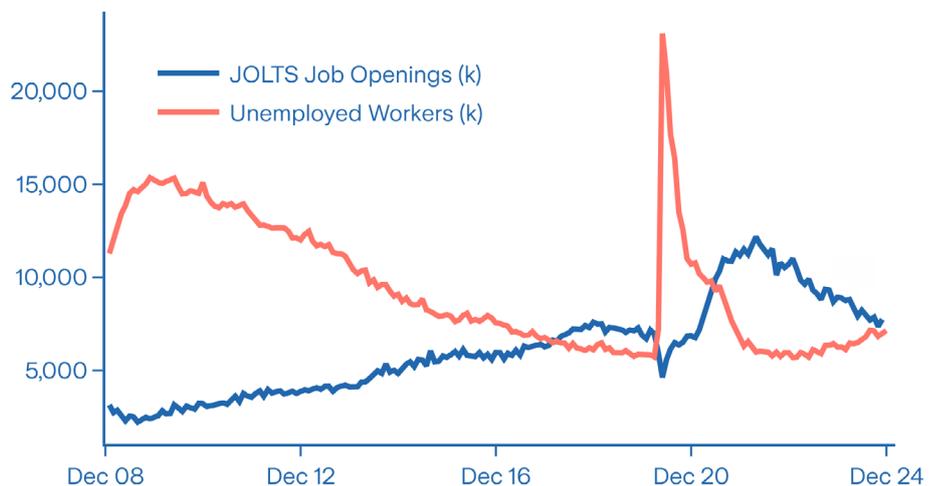
Although it is a politically sensitive topic, the US economy did benefit from high immigration in the past as it helped to ease pressure in the labour market and kept wage growth in check, not least in the lower income sectors like agriculture and hospitality. Given the strong voter mandate, a stricter approach to immigration is to be expected. While this will have an impact on job and wage growth, we don't expect a massive disruption, particularly given that labour market tension has eased as mentioned above. Longer term, it is crucial that the US finds the right balance when it comes to regulating immigration as positive demographics have been a major advantage for the US compared to other developed economies.

The business cycle gets extended

Very often, the economy would start to slow further at this stage in the cycle because households and firms become more reluctant

to spend as restrictive monetary policy keeps weighing on budgets. However, the Republicans' clean sweep in the election, which handed them the presidency as well as both chambers in Congress, is likely to extend the current cycle. A major risk to growth in 2025 and beyond had been the potential end of the Tax Cuts and Jobs Act (TCJA), which is scheduled to expire in 2025. Given the broad-based tax benefits to both corporates and households, even the prospect of it not being fully extended could have weighed on the growth outlook. With a Republican majority in both chambers of Congress the full extension of the TCJA is all but certain. Although the economic impact of the TCJA extension is expected to be more modest than after the initial implementation, it will still support growth. In addition, there is now at least the potential for modest corporate tax cuts, which would improve market sentiment and support greater business investment should the materialise.

The US labour market is back in balance



Source: Bloomberg

Most of the announced policy measures will be inflationary

While the expected fiscal stimulus will support growth and makes a severe slowdown or even a recession less likely in the coming quarters, the positive growth effects have to be weighed against the impact of rising tariffs, higher real yields, and a potentially tighter labour market if the Trump administration significantly restricts the number of migrants entering the US. While we don't expect the government to implement all of the tariffs announced during the campaign, some will be enacted. Higher import costs and uncertainty around future trade policies are likely to weigh on the growth outlook. As companies will try to pre-empt expected tariffs, we could even see a pickup in imported goods in the coming months. This would temporarily weigh on the reported growth numbers (and the trade balance).

A significant fall in inflation has allowed the Fed and other central banks to kick off the monetary easing cycle. Given that growth is still above trend and most of the announced policies are inflationary, the Fed will have to proceed more cautiously but is still expected to cut rates further in the coming months. While the inflation target has come within reach, inflation has not been fully beaten as there remain pockets of elevated price pressure, particularly in the services sector.

Bond yields rise in anticipation of inflationary policies

Higher tariffs will have a direct impact on inflation, but will not necessarily be a reason to worry for the Fed. The one-off pickup in prices disappears after a year and the tariffs would weigh on demand. However, if the expected tariffs are combined with a fiscal stimulus of lower taxes at a time when inflation rates remain above target, it will affect the Fed's monetary policy path such that fewer rate cuts are expected in 2025 than would be without the announced policy measures. Although not our base case, strong economic growth in combination with a healthy labour market and re-accelerating inflation could even trigger a rate hike, a scenario that would be disruptive for financial markets.

The rising interest rate gap between Treasury yields and other bond markets has already strengthened the US dollar to the highest level in two years. While a stronger dollar will help to keep inflation rates in check, it tends to widen the trade deficit and is usually not the best investment environment for emerging markets.

Treasury yields have risen in the aftermath of the election in anticipation of inflationary policies under the Trump administration. This will partially undermine the growth impulse of the fiscal stimulus and further increase the government's debt service costs. The fiscal deficit will remain at unsustainably high levels, raising the risk premium that investors will ask to hold US government bonds. The growing supply of Treasury bonds and notes is increasing the risk of a mismatch between Treasury supply and demand which could trigger weak bond auctions, and in turn lead to higher volatility in the bond market.

Credit is set to notably underperform stocks

US credit markets are at a valuation level that is the most expensive in decades despite notable uncertainty ahead. While Investment Grade credit spread is back to levels last seen in the late nineties, High Yield credit spread is back to pre-financial crisis levels. It would be very unusual for spreads to tighten notably from here, even in an elongated economic cycle, as spreads are at record lows, including on a leverage-adjusted basis. We expect spreads to widen in all scenarios, but also think the widening will be back-end loaded in 2025.

The headwinds to credit are more likely to come from supply/demand technicals rather than a collapse in fundamentals, despite risks to the latter having increased. Although default rates are expected to decline while remaining sticky and above average, the weakest borrowers in the CCC segment remain vulnerable. The perceived situation of the US banking sector has improved, but our outlook on several small banks still remains cautious given their huge exposure to commercial real estate. While recession odds have fallen for 2025, the greater risk at this point, given the tight spreads, lies in the path of interest rates.

In non-corporate credit, we still see value in US CLOs and ABS, while US municipals are likely to remain volatile. That said, optimism around commercial real estate would likely be contingent on rates moving lower, meaning that a re-emergence of inflation would pose asymmetric risks regardless of a better growth environment next year.

An attractive environment for stocks, but expectations are high

Rising bond yields have not been a major headwind for equities in recent months, but they increase the risk of a setback, particularly given high equity valuations. Performance of US stocks in 2024 has been very good, with technology stocks and the Magnificent 7 in particular strong drivers of the market. Expectations are high, which does not leave a lot of room for error. Nevertheless, the economic environment remains benign for stocks and the Republicans' election victory has triggered investors' animal spirits, lifting companies' earnings and margin prospects, although potentially at the price of higher inflation. This could result in US equities returning low double digit gains in 2025.

Many of the announced policies aim at improving the prospect of domestic industries, which is likely to benefit smaller companies as well. These prospects are being reflected in the Russell 2000's outperformance since the election. This provides a basis for a continuation and broadening of the stock market rally. The downside risks should not be underestimated, however, as higher interest rates and reaccelerating inflation rates could disproportionately weigh on smaller capitalised firms.

The election result triggered a small-cap rally



Note: Indexed Series, January 2024 = 100

Source: Bloomberg

UK

Outlook

- Fiscal stimulus will support growth, particularly in the first half of 2025
- Policy measures are inflationary and a potential drag on employment
- The Bank of England will keep to a gradual pace of cutting rates

Implications

- Gilt yields are expected to moderate as inflation falls and the BoE lowers rates
- Sterling credit to underperform European credit
- UK equities are inexpensive and are supported by falling interest rates

Risks

- Inflation reaccelerates markedly, holding the BoE back from further policy easing
- The positive fiscal impulse is much weaker than expected with growth slowing substantially
- Investors worry about fiscal sustainability, triggering a bond market rout

Economic momentum has slowed at the end of 2024

In the first two quarters of 2024, the economy recovered from the mild recession at the end of 2023 before slowing down again entering the second half of the year. Private sector firms have become more cautious as business activity slowed down in the final months of 2024. New order growth and business confidence weakened as companies face a more uncertain outlook with services holding up better than manufacturing. Some firms are delaying their investment decisions in response to worsening domestic business conditions and geopolitical uncertainty. Input costs remain an issue and companies have signalled more modest hiring intentions. Business sentiment has taken a hit following the announcement of the Autumn Budget as the planned increase in employers' National Insurance contribution will weigh on corporate earnings.

The combination of weak demand and rising payroll costs led to a marginal decline in private sector employment in November.

The unemployment rate remained in a broad range between 4 and 4.5% but was generally a bit higher than in 2023. While labour force participation has picked up recently, the employment situation is weakening although the measured unemployment rate has been showing large erratic swings for over a year now, due to sampling issues, so monthly changes should always be taken with a pinch of salt. Other job market surveys confirm the picture of a more moderate slowdown.

Consumer spending is supported by solid growth in real income

The softening employment situation has helped to reduce wage pressure, with growth in weekly earnings (ex bonus) slowing to 4.8% YoY in the third quarter from a peak of almost 8% in 2023. While still elevated, the substantial fall has given the Bank of England more room to manoeuvre. The combination of a healthy labour market, solid wage growth and falling inflation has lifted households' real incomes, which has supported consumer spending. Consumer sentiment has improved further but remains

below pre-Covid levels. Real wage growth is expected to remain solid in the coming months, supported by a still robust labour market and further falls in inflation rates.

The housing market continues to recover

While real income growth should continue to support consumer spending, higher interest costs will create some headwinds as many households will have to refinance their mortgages at higher rates, which will weigh on disposable income. The housing market has seen notable improvement in 2024 and is expected to continue to do so. In addition to the steady trend higher in mortgage approvals, the latest Royal Institution of Chartered Surveyors' (RICS) survey of real estate agents for October showed further improvements in agreed and expected sales. One reason why sales expectations have jumped significantly is likely that the thresholds at which stamp duty must be paid are set to fall next spring, which creates an incentive to bring forward property transactions. While the effect could reverse later in 2025, increased activity is likely to keep supporting house prices in the coming months.

The Autumn Budget provides additional fiscal stimulus

Given the healthy employment situation and the housing market recovery, the economic outlook was already decent before Chancellor Reeves announced the Autumn Budget, but the fiscal expansion will provide an additional stimulus from the government side. The Autumn Budget has a number of expansionary elements that are expected to provide an impetus to growth in the first half of 2025. Departmental spending will be notably higher than enshrined in the Spring Budget. The Office for Budget Responsibility (OBR) revised up its forecast for the cyclically adjusted primary deficit by 1.1% of GDP in the current fiscal year, significantly raising the fiscal impulse in the coming quarters. A large part of the change is driven by public sector pay that will provide a substantial boost to

Real income growth supports consumer spending



Source: Bloomberg

consumer spending. In addition, the savings rate, which has been rising continuously in recent quarters, is likely to stabilise, further supporting household spending.

Trade uncertainty will weigh on the growth outlook

The boost to growth is likely to fade in the second half of the year, however, when growth in disposable income is moderating and the additional stimulus from government spending is fading. At the same time, although interest rates are expected to recede over the course of the year, many households will still have to refinance their mortgages at a higher rate, potentially weighing on consumer spending. Finally, increasing trade tensions between the US and Europe, following Donald Trump's election victory are also expected to weigh on growth in the second half of 2025. Although the UK is unlikely to be the Trumps administration's main target, it will nevertheless be impacted by the threat of new tariffs and the lingering trade uncertainty in the Eurozone.

The BoE will only gradually ease its policy as fiscal measures are inflationary

The positive growth impact of the new budget will also lead to firmer inflation rates in the near term through different channels. The increase in the employers' National Insurance Contributions will at least partially be passed through to prices, directly

affecting consumers. In addition, increases in vehicle excise duty and the introduction of VAT on private school fees are likely to push up on services inflation, which is still elevated. Furthermore, the increase in the National Living Wage will push up wage growth and raise service companies' costs, particularly in the hospitality sector, which accounts for a substantial part of the services CPI basket.

We still expect overall wage growth and inflation to fall further in 2025, but it will happen more slowly than without the expansionary budget. With core inflation ticking up to 3.3% YoY in October, the Bank of England will have to keep a close eye on any potential second-round effects of the announced fiscal stimulus and passthrough of the planned increase in employers' National Insurance contribution. Given this environment the BoE is expected to proceed gradually to further ease its policy in the months ahead. This was emphasised by several members of the Monetary Policy Committee in recent weeks.

Gilt yields have risen substantially in the aftermath of the budget announcement, although a large part of the pickup has since disappeared. Worries concerning the outlook for government debt and a more expansionary fiscal policy, as well as its impact on inflation and monetary policy, have contributed to the rise. While the higher risk premium is unlikely to disappear completely

in the near term, we expect gilt yields to fall back over the course of the year as inflation rates are receding. The yield curve has been largely flat in recent months but is expected to steepen going forward as the BoE will gradually cut rates in 2025.

Sterling credit to underperform European credit

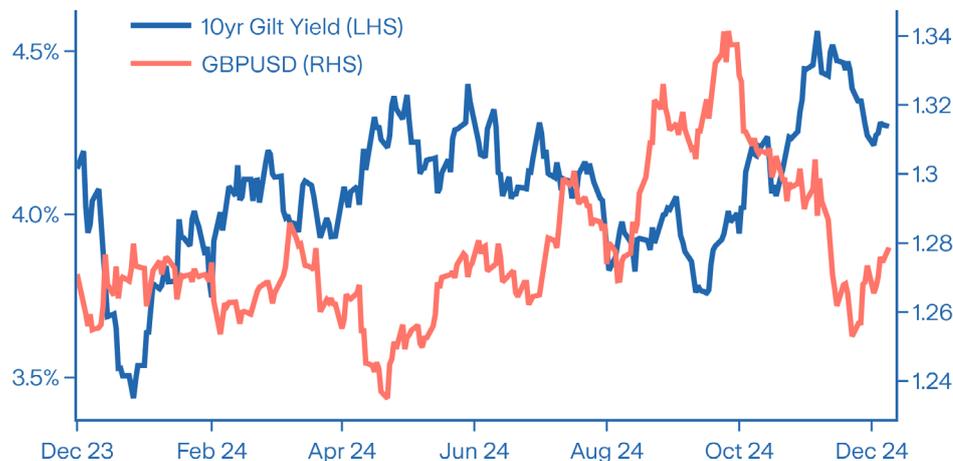
We find little value in sterling credit as spreads have tightened and remain near historic tightness on a quality adjusted basis. Sterling Financial credit is also offering little value after the spread compression seen during last two years. Given the lower quality and a tendency for higher rates volatility, we think spreads are likely to widen in line with global credit. In sterling ABS, auto ABS arrears will probably plateau, and interest rate cuts are likely to be critical for credit card ABS and residential mortgage-backed securities (RMBS). While credit cards performance is steady in the latest data, arrears for RMBS will take some time to improve. All in all, we find European credit more appealing than sterling credit.

A benign environment for stocks

With an estimated price-to-earnings ratio of around 12 at the end of 2024, the British stock market remains inexpensive. The valuation discount to other markets and particularly to the US can in large parts be explained by a different sectoral composition as the FTSE 100 mostly lacks large technology companies, which provided a stellar performance in 2024. This is unlikely to change materially in 2025 although the decent growth outlook and expected monetary policy easing will provide a benign environment for stocks and could lead to a broadening out to other sectors and regions.

Smaller capitalised companies have predominantly lagged their larger peers through most of 2024. The gap has not materially narrowed in the aftermath of the Autumn Budget as domestic firms may benefit more from the fiscal stimulus but will also feel the impact of the rise in the employers' National Insurance Contributions. Sterling strengthened significantly against the US dollar in the first nine months of 2024, proving an additional headwind to UK stocks. This has reverted since the Republicans' clear election victory in the US, however, and sterling is now below its level a year ago, potentially providing some additional support to British stocks in the coming months.

Sterling weakens despite a pickup in gilt yields



Source: Bloomberg

Eurozone

Outlook

- Eurozone economy to grow below trend in 2025, with Spain driving growth while Germany lags
- Trade tensions, political uncertainty and fiscal consolidation weigh on the growth and investment outlook
- Real wages are increasing as inflation falls, and lower policy rates are encouraging credit demand

Implications

- Bond yields to tread water while French debt is highly vulnerable to political risks
- Credit offers better value in Investment Grade with High Yield maturity walls a key risk
- Equity markets to deliver small positive returns, but expect significant sectoral divergences

Risks

- Uncertainty around US-EU relations, with scenarios of improved co-operation vs. one of highly penal tariffs
- Downside risks from lower business investment and higher unemployment amid uncertainty
- Upside risk from fiscal spending, including from German or EU-wide defense and infrastructure spending

Here we go again

Overall economic growth in the Eurozone was disappointing this year. 2025 looks set for more of the same: positive, but below-trend growth. We expect 0.8% Eurozone GDP growth next year, below consensus but similar to 2024 levels. There are nuances within this. Labour markets are still strong, inflation has fallen back to the 2% target, and there are individual success stories among member states. The ECB continues to cut interest rates, and lending data finally show a pickup in credit demand from both corporates and households. Yet, there are significant offsets. Weak business investment and industrial production look likely to continue next year. The incoming US administration has threatened significant tariffs, at a time when the US has become a more important export destination for Eurozone firms. Aggregate Eurozone fiscal policy is set to contract in 2025, with the possible exception of Germany.

We need fundamental change in Europe. The economic model, and the welfare state afforded by it, are under threat. Productivity stagnation, an aging population, over-regulation, high energy prices and a less friendly world for trade all hurt the Eurozone. It needs to find an entrepreneurial zeal for the future, rather than managed decline. Currently, this is a slow-motion decay. The problem is recognised, but the answer appears to be to wait-and-see. We need to see drastic decisions on further single market integration, fiscal co-operation and EU-wide investment. We do expect progress here in 2025, but such changes would likely only impact the economy from 2026 onwards. There are clearly also scenarios where a lack of ambition and unity at an EU level leads to continued disappointment.

The leaders and the laggards

One consistent theme of the Eurozone economy since the Covid pandemic has been an inversion of the rankings in the growth trajectories among the largest economies. We think this will continue through 2025. From 2019 Q3 to 2024 Q3

the Spanish economy has grown 7% in real terms, while Germany has not grown at all. Spain leads the pack in terms of GDP growth, while Italy (5.1%) and France (3.5%) sit closer to the Eurozone average of 4.6% real growth over the same period.

The reasons behind this are varied, and are likely to persist for the time being. The relatively higher portion of services in these economies compared to Germany has mitigated some of the impact of the energy price shock and the international competitive disadvantages. Higher immigration has played an important factor, particularly in Spain, which has seen its population increase by 3% from 2018 to the most recent figures in 2023, with the immigrant population up almost 33% in that time. Yet, some rankings have not changed. Fiscal policy has been considerably easier in Spain, Italy and France than in Germany. Spain and Italy have also received additional help from the EU's Covid recovery fund. This programme will run at least through to 2026, and possibly beyond.

There are offsets to further divergences in the economic outlook. Despite higher growth numbers in some countries, there is little evidence of much-needed increased productivity. Fiscal consolidation is expected across Italy, France and Spain. France stands out as particularly vulnerable to fiscal pressure, and Prime Minister Barnier faces the daunting task of slashing the budget deficit while leading a minority government. It is likely that the government will face a no-confidence vote at the end of 2024, and more through 2025. New elections remain a distinct possibility from the second half of the year, or earlier if Macron resigns. In Germany, as discussed in our separate section, the fiscal pressures are in the opposite direction.

The good news

There are three key areas contributing to economic growth next year. These are real wage growth, lower inflation, and rising credit demand. At an aggregate Eurozone level, unemployment is at a historic low of 6.3%. While job vacancies and employment growth

slowed over 2023, real wage growth is rising. Lost purchasing power since the Covid pandemic is being regained. This, combined with higher-than-average savings levels, poses upside risks to consumption.

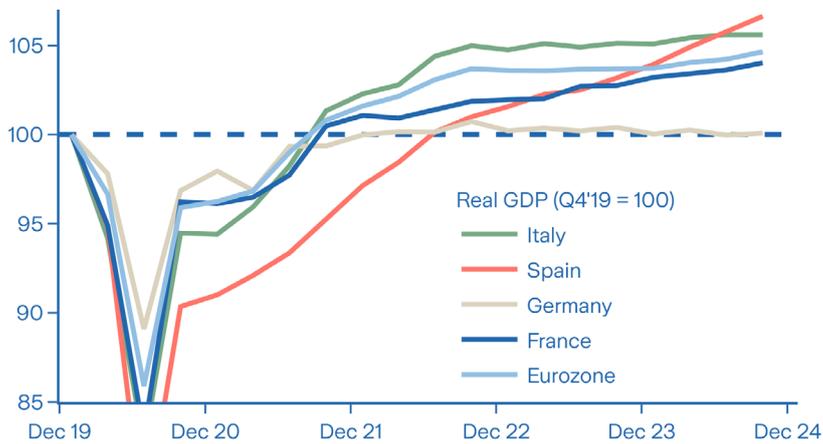
The fall in inflation is a welcome development for both households and companies. While there are concerns around service inflation, which continues to run around 4% YoY, the headline inflation measure is now comfortably around 2%. It is expected to remain so throughout 2025. This has allowed the ECB to cut interest rates, which is having the desired impact. The bank lending survey is showing a pickup in mortgage demands from individuals, while enterprise loan demand is back to neutral territory for the first time in two years.

The fog of wars

During campaigning, Trump spoke of implementing a 10-20% universal import tariff. While this is considerably lower than the 60% touted for Chinese imports, it still represents a significant risk to the Eurozone economy. The EU's goods trade surplus vis-à-vis the US was just under USD 200bn in 2023. The imbalance is reduced by around a third when services are included, where the US has an underappreciated trade surplus with the EU. Focusing on goods tariffs, Germany and Italy are most at risk, as are the machinery, transport and chemical sectors. Estimates of the impacts are varied and depend on the specific form of tariffs. Nevertheless they are clearly negative, ranging from smaller impacts of -0.3% of GDP, to -1.5% or more in a harsh scenario. The Euro exchange rate is reacting to these concerns, although at current levels it does not pose a meaningful inflationary threat for the ECB.

We see tariffs as likely, but in a less aggressive form than discussed on the campaign trail. The European political environment has changed compared to Trump's first term in ways that may improve relations. Relationships with Trump at the top political level may be better now than during Trump's first term. There is a vacuum in EU leadership, but there has also been a general rightward shift and a growing appreciation

Growth laggards from the sovereign debt crisis are now leaders



Source: Bloomberg

in some Eurozone quarters for the US's techno-optimism amid European productivity stagnation. The new European Commission may be less aggressive in regulating and fining US technology firms. There are also 'quick-wins' for Europe to reduce the goods imbalance, for example through purchasing US LNG, where Trump is expected to lift export-restrictions.

There is also increased uncertainty regarding the Russia-Ukraine war and broader geopolitical physical conflicts. Trump pledged to end the war immediately, and both Vladimir Putin and Volodymyr Zelenskyy have signalled openness to negotiations. The specifics of a ceasefire, and the cost to Ukraine and partners in Europe, are unclear. Any deal is likely to be met by a continued ramp up of defence spending and co-ordination among NATO and European states. We ultimately see this as a source of longer-term upside inflationary (and growth) risks through large fiscal spending, real resource competition and possible supply shocks.

It isn't always easy to ease monetary policy

The ECB's job has gotten more difficult. We see the ECB continuing to cut interest rates through 2025 to around 2%. However, we see much more balance to the risks from that point on. Weak domestic growth, which argues in favour of lower rates, must be matched up against the potential inflationary impact of global trade wars and geopolitical resource competition. This argument is playing out publicly between members of the ECB's governing committee, with some convinced of the need to lower rates to encourage investment while others are wary about resurgent inflation.

Further complexity stems from the increased risk of inflationary shocks and the possibility that it would not take much for economic actors to revise up their expectations of price rises again. The near-term risks appear skewed to an undesirable combination of slower growth and higher inflation. In the medium and long-term, there is also a higher chance of larger fiscal stimulus from both the EU and member states related to defence and infrastructure. This could boost both growth and inflation from a domestic perspective.

Clip your coupon

We see little value in European sovereign bonds next year. Investors should receive coupon returns, but not considerable capital

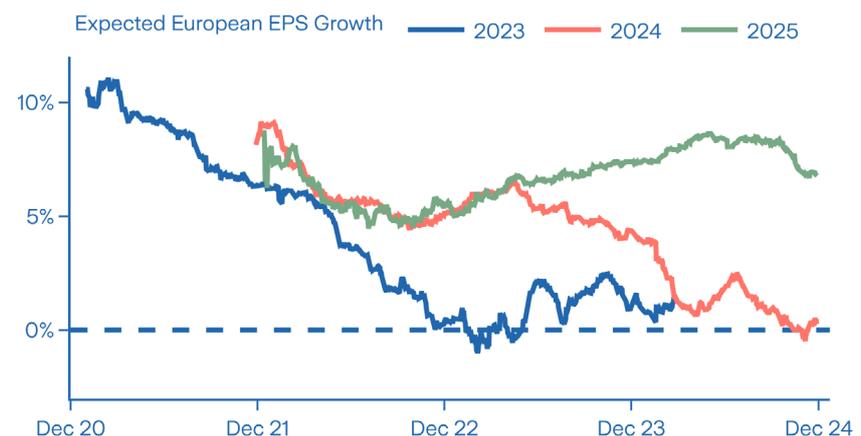
appreciation from lower yields. Bond yields incorporate significant expectations of ECB easing, limiting their scope to move lower in our base case. While there are scenarios when they do fall, including a combination of surprisingly weak growth and inflation, we equally see scenarios where they rise from greater pricing of inflationary pressures. Long-term market-implied inflation expectations embedded in bond prices continue to look too low for us, with inflation expected to average less than 2% over the next 10 years.

Sovereign bond spreads should largely be well-behaved, helped by ECB easing. However, valuations are increasingly expensive. Germany's potential fiscal expansion could weigh on Bunds, through higher growth expectations and higher bond supply. We remain most concerned for French OATs, and see the risks of yields moving higher than other countries. 2025 will be a difficult year for President Macron and for Michel Barnier's minority government should it survive this December. The market is looking for budget responsibility, and the risks are skewed towards disappointment.

Credit: IG stands out in value

European Investment Grade credit is our top pick within global credit markets, while High Yield is highly vulnerable given the looming maturity walls and poor funding seen amongst CCC issuers in 2024.

2025 earnings growth estimates look unrealistic



Source: Bloomberg

While valuation of European credit has been at a discount since the energy crisis of 2022, the better quality alongside ECB rate cuts make us comfortable. Sectors such as autos are largely discounting risks and could drive upside if fears around the trade war dissipate or if considerable Chinese stimulus is announced. We remain cautious on High Yield and the supply patterns in H1 '25 need to be keenly watched as the maturity wall remains a significant concern. European covered bonds appear cheap on a quality and risk adjusted basis, especially versus bank bonds. While technicals could remain weak for some time, we think there is value from investors wishing to protect against global uncertainties.

Equity markets

Eurozone equity market returns considerably lagged the US this year. It's difficult to see a European-specific catalyst that will lead to a catch-up in 2025. There remains a fundamental problem that Eurozone equity indices on average represent older firms with less exposure to leading-edge technology, specialising more broadly in 'middle' technologies. We continue to see a high number of successful EU-founded businesses listing on US capital markets, exacerbating this trend. Earnings growth has also been disappointing since 2022. Current consensus earnings growth expectations of around 7% for the Euro Stoxx 600 next year represent a significant acceleration from 2023 and 2024. The risks to this forecast are skewed to the downside.

There are likely to be significant sectoral divergences. In our view, 2025 will be a year for continued momentum in established themes. The defence sector can continue to benefit from geopolitical tensions, restocking needs, and the possibility of even greater government spending on defence. While a Ukrainian ceasefire may seem to lead to a drop in immediate demand, the ongoing surge in security-adjacent spending from NATO members will be unaffected. Meanwhile, areas highly exposed to global markets, such as many parts of the consumer discretionary sector, are threatened by trade tensions and evidence of demand shifting towards non-EU producers. The market has been rightly moving to price these themes, but we do not think they have fully played out.

Germany

Outlook

- German economic growth is likely to stagnate for the sixth consecutive year
- The challenge to Germany's export model is rippling through the economy
- Real wage growth continues, but expect smaller negotiated pay increases amid rising unemployment

Implications

- German equity market to exhibit sectoral dispersion from ongoing structural rebalancing
- German Bunds to tread water as economic weakness is offset by rising inflation and fiscal premium
- New Chancellor to decide on defense spending and reforms to unlock growth for Germany and the EU

Risks

- Trade threats from the new US administration, but relations may be better than under Angela Merkel
- Accelerating pace of job losses in the manufacturing sector leads to a larger economic downturn
- Supermajority required in the Bundestag to reform and loosen the debt-brake

Stuck in neutral

Germany's economy hasn't grown for five years. 2025 doesn't look any easier. We forecast continued stagnation in economic growth, which is below the market consensus. The German economy continues to suffer from a relatively high exposure to manufacturing (~20% of Gross Value Add, but falling). Leading indicators suggest a high degree of pessimism from businesses and consumers, all consistent with further economic difficulty. Germany's trade deficit with the United States will be under scrutiny, and exports to China have already fallen considerably in recent years. The nation continues to suffer from structural competitiveness issues, and the near-term risks are overwhelming skewed towards more negative economic outcomes.

There are positives. The labour market remains strong, and there has been growth in professional services employment as part of a rebalancing. The ECB's policy easing will help, but rates are not expected to return to pre-2020 levels. New elections in February will bring a change of government, hopefully with a clear mandate and the ability to form a stable centrist coalition. We think the incoming government is likely to foster a better relationship with the US and Donald Trump than Angela Merkel did. Germany's fiscal fundamentals remain enviable, and we expect they will be loosened to some extent. However, the numbers being discussed currently are underwhelming, and we think more will be required at both the German and European level. Supply-side reforms will be favoured by the CDU, currently being framed as *Agenda 2030* in a reference to Gerhard Schröder's *Agenda 2010*. These are ultimately necessary, and can help a turnaround driven by innovation and entrepreneurship. It is, however, not a short-term cure, and will likely see a continued longer-term and painful shift in sectors and industrial specialisations. It is also not a risk-free exercise and may bring further discontent with mainstream political parties.

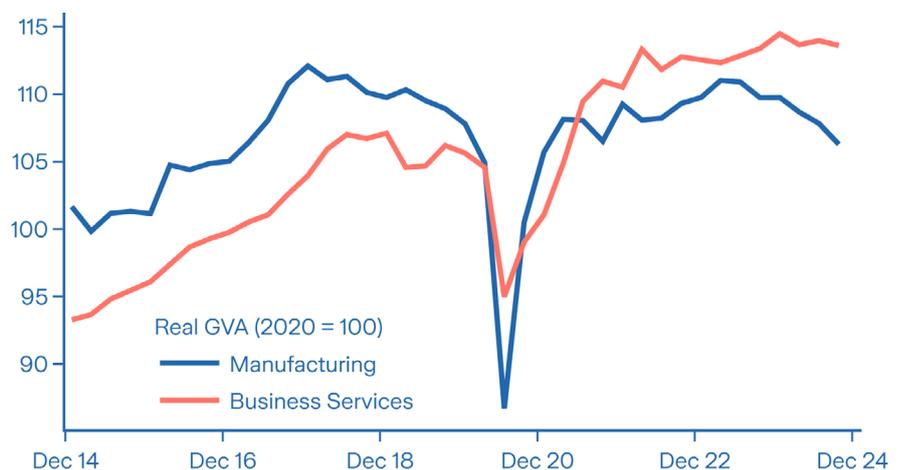
Industrial woes

The difficulty facing the German economy is primarily one of manufacturing weakness. One way of measuring this is through the lens of Gross Value Added (GVA) sectoral analysis. German manufacturing is now 2.4% lower in real terms than in 2019, with construction down more than 20%. By contrast, broad service sectors are around 4% higher and public sector-adjacent areas are more than 7% larger. German industry is suffering from competitiveness issues coming both from an international energy-cost disadvantage and declining product relevance in key export markets. There has been some good news insofar as Germany's terms of trade (import compared to export prices) has fully unwound the negative shock following Russia's invasion of Ukraine. However, the above issues are proving to be increasingly structural, and we do not predict a meaningful rebound in German industrial activity next year.

The new US administration presents short-term downside risks to German industry

through threats of tariffs. The relative importance of Germany's trading partners has changed in recent years. The US and China have both long been important trading partners. Since the Covid-pandemic, however, their relative importance has shifted significantly. Whereas German exports to the US are up 3% in real terms since 2019 until Q3 of 2024, exports to China have fallen by more than 40% over the same period. This higher dependency on American markets, while simultaneously maintaining a goods surplus with the US, puts Germany firmly at risk from protectionist measures by the Trump administration. We see scope for compromise through a combination of US natural gas and military-hardware purchases. It is also possible that Germany's decreased reliance on China combined with the US administration's long-standing concerns, will lead to incremental increases in European protectionist measures against newly-competitive Chinese imports.

The German manufacturing sector is dragging down growth



Source: Bloomberg

Employment and wage growth

The German labour market has been resilient so far, but is weakening. Germany's internationally-comparable unemployment measure has risen to 3.5% from lows of 2.9% in 2023. Overall employment growth has slowed considerably and has turned negative in the second half of 2024. There are three points to be made here. Firstly, the overall strength in employment figures masks significant underlying compositional changes. Secondly, there is reason to expect unemployment to grow at a quicker pace from here, particularly within manufacturing. Thirdly, negotiated wage growth is likely to slow notably from 2025 onward as discussions move from significant pay hikes to job security.

Within the details of German employment figures there is clear evidence of changing sectoral composition. From 2018 to the most recent data at end-2023, the regular labour force subject to social security taxes has increased by 2.3mn people. Over a quarter (26.3%) have joined health and social work services. Another third are working in broad professional services, including IT and knowledge based work. Growth in this category is particularly encouraging. On the other hand, manufacturing, which makes up 19.4% of employment, has lost 55,000 workers despite this labour force growth. We expect job losses in this sector will increase from here. Labour hoarding behaviour has been evident since the Covid and Ukraine crises. With backlog work and new orders falling, we are increasingly seeing firms announcing job cuts. This has already fed into a decrease in negotiated pay settlements compared to recent years. One of the largest unions, IG Metall, recently agreed to pay increases of around 2% and 3% for 2025 and 2026 respectively, half as much as in the previous two years.

Early elections are welcome

Barring any last minute political manoeuvring, Germany will hold early elections on February 23 next year. They were originally planned for September, but brought forward as Chancellor Olaf Scholz fired the debt-averse Finance Minister, Christian Lindner, and collapsed the governing coalition. In our view, the earlier elections can be held, the better. The 'traffic-light' coalition was mired in infighting, unable to agree on policy, and unsuitable for Germany's difficult economic situation. Current polls put the centre-right CDU/CSU firmly in the lead. This can change, however, and there are risks around the surging popularity of polarising parties, as well as around more complicated Bundestag arithmetic for any incoming government. Nevertheless, the central case sees Friedrich Merz as Germany's next Chancellor, likely in a coalition with the SPD or the Greens as the junior partner.

Every little bit helps

It appears likely that the new government will reform the constitutional debt brake and allow for additional fiscal easing. This brake

limits Germany structural budget to 0.35% of GDP (~15bn EUR). We expect a change that exempts specific forms of spending (i.e. investment and/or defense) from the calculation, or that enshrines additional spending facilities in the constitution. The SPD and the Greens are vocally supportive of this, while the CDU are more circumspect. Merz has signalled a willingness to negotiate. This is a positive for Germany, which can benefit immensely from its substantial fiscal space during this slow-moving crisis. But the expected loosening should not be overstated. The numbers being discussed are underwhelming in an international context. 1% of GDP in additional annual spending would amount to around 40bn EUR. The CDU also remains a fundamentally conservative German party, sceptical of the benefits of Keynesian fiscal expansion.

Boring Bunds

We do not see significant value in German Bunds. Yield levels are low across the curve and reflect considerable expectations of ECB easing through next year. While it is possible that in a scenario of weak growth and falling inflation yields will fall further, there needs to be a considerable move to compensate for the highly inverted bond curve between the current ECB rate and 10yr Bunds. We also think that the inflation expectations embedded in the price of these bonds does not adequately reflect future risk. The market currently prices that inflation in Germany will average below 2% over the next 10 years. While this is possible, there are reasons to believe that inflationary pressures will be persistently higher than they were in the pre-2020 era. There is also a recent history of extremely high inflation that was unforeseen by the market beforehand, which should underscore the need for adequate risk premium compensation. It currently does not.

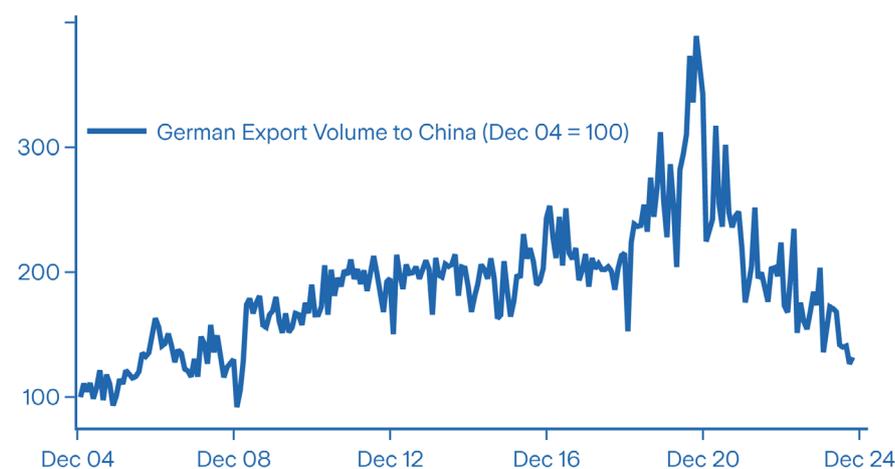
We do not foresee bond market concerns in response to German fiscal easing. Germany's AAA rating is unlikely to be impacted by the

proposed fiscal loosening. Its debt-to-GDP remains around 62%, compared to France's 112% and new stimulus is highly unlikely to lead to concerns around a persistently increasing debt trajectory. It is also likely that investors and rating agencies will welcome the positive growth impacts of unlocked government spending, compared favourably against the current economic stagnation. However, we do expect the German yield curve to steepen, particularly when looking at long-dated 30yr bonds. The difference in yield between 10yr and 30yr bonds remains too low in our view.

The counter-intuitive DAX strength

The German DAX Index has been one of the top performing European equity indices year-to-date, delivering around 16% to the end of November. This is in spite of the domestic economic stagnation. This contrasts sharply with the French CAC, which is negative on the year. This move speaks to the diversified nature of Germany's public equity index, as well as significant sectoral divergences. In a similar vein to the broader Euro Stoxx Index, defense-related names and financial stocks have performed strongly. By contrast, certain areas of the consumer discretionary and industrial sectors have struggled. This has been driven by longer-running structural issues, including falling demand from China, energy affordability, and geopolitical tensions. The threat of Trump tariffs has also weighed on areas that are particularly exposed to the US. Looking forward, we expect further momentum behind the divergent performances next year, with index support from defense-adjacent industries depending on the scale of future EU and NATO spending proposals. The macro environment for financials is becoming less of a tailwind as the ECB continues to lower interest rates. Ultimately, while positive returns are expected in the year ahead from German stocks, performance is likely to be modest and patchy.

German exports to China have fallen considerably



Note: Indexed Series, November 2004 = 100

Source: Bloomberg

Switzerland

Outlook

- The economy continues to expand, but at a moderate pace
- Inflation remains benign as disinflation broadens out
- The SNB maintains its dovish stance, with further policy easing expected

Implications

- Bond yields set to remain low given weak inflation and policy easing
- The Swiss franc should stay in demand amid strong fundamentals

Risks

- A global trade war disrupting Swiss manufacturing and trade
- Deteriorating geopolitics triggering a sharp further appreciation of the Swiss franc

Economic resilience set to remain in place

As expected, economic activity has been resilient, with underlying (sport-event adjusted) GDP estimated to have grown by close to 1% in the first three quarters of 2024 (annualised rate), continuing to outperform its European peers. Divergences are large however. The manufacturing sector is still weak, though a nascent recovery has gained traction following contraction over the past two years, while services continue to expand but at a more moderate pace. Private consumption has been a driver of growth over the past year, amid still solid labour markets, healthy household finances, and falling borrowing costs, with solid demographics adding to positive dynamics. By contrast, business investment and exports have been under pressure given the challenging global trade environment and elevated uncertainty. Credit provisioning also appears to have been weak, following last year's banking sector issues.

Looking forward, economic resilience is expected to remain in place, despite a more fractured global trade and geopolitical environment. This reflects the robust underlying economic fundamentals in Switzerland, with a highly diversified economy and range of trading partners, differentiated and price inelastic exports, and strong household finances. SNB rate cuts should also support the economy, with capex spending and construction investment set to benefit. Inflation is moreover benign and government finances are in good shape, with government debt below 40% of GDP. Should global conditions deteriorate more significantly, there is space for policy easing and broader economic support to prevent a sharper deterioration.

While the economy is set to remain resilient, upside to growth from the current level is limited given elevated uncertainty and disruptive geopolitics and politics, alongside weak demand among key trading partners. We expect underlying GDP growth at around 1.2% in 2024 and a similar pace in 2025, which leaves it well below the longer-term

average of 1.8% in both years. This should allow spare capacity to continue to build up, also in the tighter services part of the economy, and continue to restrain wage and price pressures.

Switzerland is exposed to a more fractured global trade environment

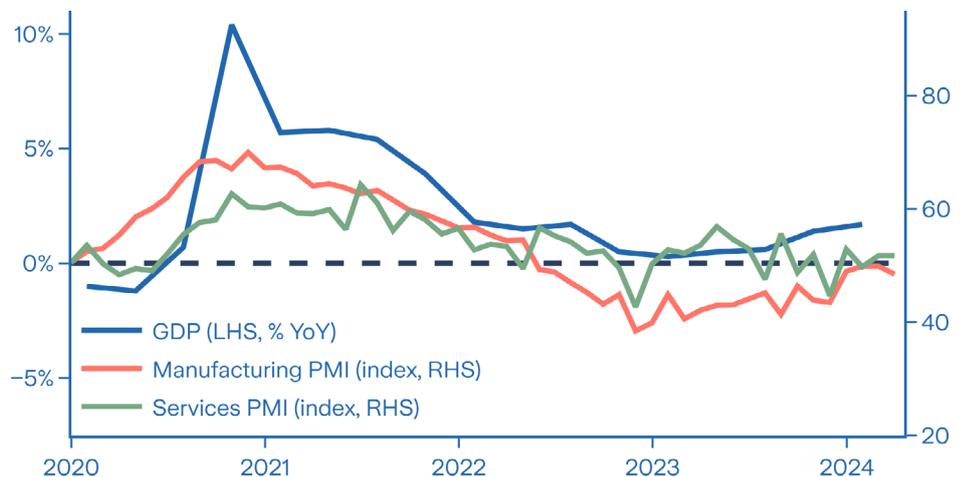
As a small open economy that is highly integrated into the global trading system and with the US, the Eurozone and China as key trade partners, Switzerland is exposed to disruptions in the global trade environment, such as tariffs or restrictions. Exports to the US amounted to around 7% of Swiss GDP over the past year, which is the second largest share among the G10 economies, with only Canada ranking higher. Highly differentiated goods make up a large share of exports to the US, however, pharma and medical equipment in particular, which are relatively price inelastic and insensitive to disruptions. This has underpinned the strong export performance and steady rise in the trade surplus over the past decades, despite an appreciation trend in the franc. As a result,

we anticipate Switzerland to be able to navigate the more challenging global trade environment relatively well.

Inflation surprises to the downside as disinflation pressures broaden out

Inflation has surprised to the downside in 2024, with a broadening out of disinflationary pressures. Headline CPI fell to 0.6% YoY in October, with core CPI at 1%. Imported consumer goods are deeply deflationary, tracking at -3% YoY currently, while services inflation and domestically driven price pressures are still close to 2%. CPI excluding rents is, however, also in deflationary territory, at -0.1% YoY, and domestic producer prices are falling at a pace of -3%. The strong franc has clearly contained inflation, helping to insulate Switzerland from global price pressures, but domestic price and wage pressures have also been much more benign compared to the rest of the Europe. Looking forward, we expect inflation to edge down further, helped by a cut in regulated electricity prices in early 2025, favourable base effects (reflecting last year's VAT hike

Stable but subdued growth following the manufacturing recovery



Source: Bloomberg

and rent increases), and the potential for a decline in the regulated reference rate for rent contracts. A strong franc should remain disinflationary, both by limiting import price pressure, but also by constraining domestic cost pressures given the need to remain competitive in export markets. We therefore see annual CPI averaging 0.7% in 2025, but risk is to the downside.

The benign inflation outlook hinges on wage growth remaining contained. While Swiss wage data are patchy, the quarterly nominal wage growth index averaged 1.1% in the first three quarters of the year, down from 1.8% in 2023, which leaves it consistent with the longer-term trend in inflation of well below 1%. Looking forward, we see downside risk to wage growth, given a weakening in the labour market and reduced labour shortages. This is visible both in the recent rebound in unemployment, which has increased from 1.9% to 2.6% over the past year, and the extended uptake of short-term work within the manufacturing sector. Household's assessment of job security has also been deteriorating over the past few months, though it is still at a historically favourable level.

The SNB turns dovish, with further easing expected

The SNB was the first G10 central bank to cut rates in 2024, and its policy stance has turned increasingly dovish over the course of the year. The inflation forecast for 2025, for example, was lowered to 0.6% in the September meeting, down from 1.9% only twelve months earlier. Concerns around persistent inflation have clearly been replaced by concerns around the strong currency and the potential for inflation to slide back into negative territory. Given this, we expect the SNB to continue to cut rates in late 2024 and early 2025, taking the policy

rate from the currently level of 1% to 0.5%. Risk to the rate outlook is to the downside, given elevated geopolitical risk and a fractured global trade environment, which are likely to underpin strong demand for safe-haven assets, including the Swiss franc.

SNB direct interventions in the FX market appear to have been limited so far this year, with rate cuts the primary tool to counter FX strength. Looking forward, however, the SNB continues to stress that it remains willing to be active in the foreign exchange market, and we anticipate it to step in should it be needed to counter currency strength.

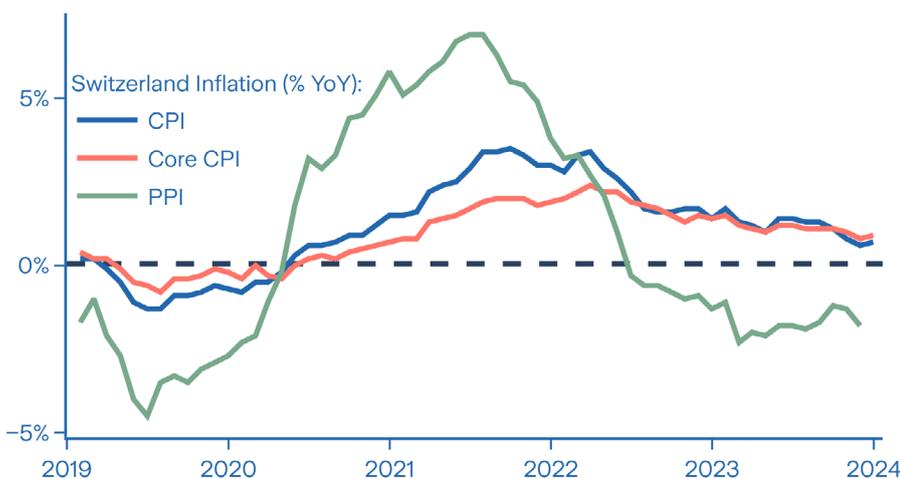
The Swiss franc will remain in demand given strong underlying fundamentals

The Swiss franc has been a key driver of SNB policy over the past year. As the real exchange rate strengthened significantly in early 2024, back to a level last seen in 2015 when the cap on the franc was removed, the SNB surprised markets by stepping back from its hawkish positioning and pivoting towards rate cuts and a dovish outlook, also shifting its positioning on FX interventions—emphasising the need to weaken the franc, rather than strengthening the franc as was the case during the post-Covid, high inflation period. While the real exchange rate has come off its recent highs, it remains strongly valued and remains a constraint on the economy and policy. And although the dovish SNB stance limits upside to the currency, we expect the Swiss franc to remain in demand, given solid fundamentals, with a current account above 7% of GDP and a steadily rising trade balance towards the rest of the world—up by 70% compared to the pre-Covid level (in USD terms). Safe-haven demand for the Swiss franc is also likely to remain a tailwind, given a fraught geopolitical backdrop.

Swiss government bond yields are expected to remain stable

Swiss government bond yields have fallen more than anticipated in 2024, with the 10yr yield currently trading below 20bps and the 2yr yield below 10bps. The move lower has been driven by downside inflation surprises and the dovish SNB pivot, amplified by the strong currency and firm safe-haven demand. Swiss yields have decoupled from other markets, with the spread vs Bunds, gilts and Treasuries at multi-decade lows. The relative outperformance can partly be explained by the more benign inflation backdrop, lower policy rates, a strong fiscal position, and tight demand/supply dynamics in the government debt market. However, Switzerland is a highly open economy, with economic and financial links to Europe and the rest of the world, and there are limits to how far yields can decouple. Going forward, we therefore suspect spreads will narrow, particular relative to Bunds and gilts.

Disinflationary pressures broaden



Source: Bloomberg

Japan and South Korea

Outlook

- Consumption, capital investment and exports should support our benign outlook for Japan's economy
- Wage growth is expected to remain solid, though slightly softer than last year
- South Korea's economic growth is likely to soften, with further rate cuts by Bank of Korea in the offing

Implications

- Bank of Japan's policy rates have further room to rise
- Corporate governance reform will remain a topic, supporting investors' interest in Japan's equity market
- The speed toward fiscal consolidation is likely to slow amid the less stable political constellation

Risks

- Political turmoil may erupt as PM Ishiba's government is perceived as vulnerable
- Wild swings of the USDJPY rate could cause headwinds for financial assets
- Trade frictions with China may escalate

Consumption is expected to pick up in 2025

As penalties imposed on the auto manufacturers for alleged regulatory breaches will subside, auto production and consumption patterns should stabilise in 2025, helping private durable goods consumption to improve gradually. Services consumption is expected to remain firm. Basic wage income should continue to rise, supporting consumer confidence. As labour shortages are likely to prevail, real wage growth is expected to rise further. Early indications for the 'shunto' spring wage negotiation round suggest that wage growth will be roughly in line with last year's outcome, enabling rising real disposable income amid falling inflation.

Corporate capital investment should continue to grow

We expect corporate capex to continue growing along the long-term stable path that was interrupted by Covid.

Digital transformation, decarbonisation and labour shortages, particularly for specialised construction workers, remain the core reasons for firms to expand capital investment. Corporate capex plans remain supportive for growth, according to the Tankan corporate survey, underpinned by high corporate profit growth.

Export growth is likely to pick up steam again

In 2024, auto exports suffered from irregularities in certification testing, which hit overall exports as auto exports account for about a quarter of total exports. We expect auto exports to continue to normalise in 2025, in line with the recent trend. Semiconductor related exports should continue to be a driving force. Semiconductor equipment exports to China are expected to remain firm, even if the Trump administration's increase in tariffs on China's exports to the US indirectly hit Japanese exports to China as well. However,

Japan should benefit from China's domestic stimulus measures, compensating for some of the Trump tariff induced trade frictions.

Foreign tourist boom likely to prevail

Former PM Abe had initiated policies to spur a steady rise of foreign tourists to Japan, before the Covid bust caused a complete collapse in 2020 and 2021. However, as of Q4 2024, the latest surge in tourists has already exceeded the prior record of foreign visitor arrivals while the cheap yen has enabled a spending boom. In 2019, pre-Covid, foreign tourists spent about 5tn JPY, comparatively we expect spending to reach 9tn JPY in 2025. The number of accommodation industry employees has also exceeded the pre-Covid record high, with a surge of foreign employees, mainly from ASEAN nations.

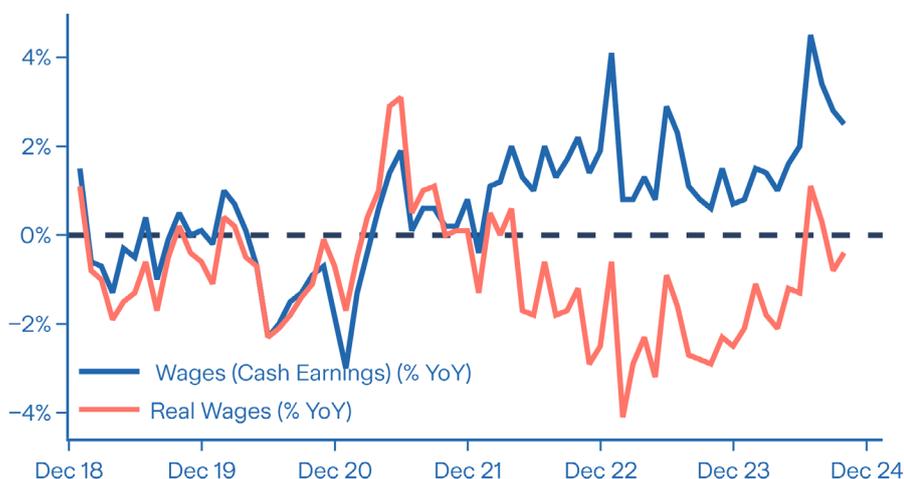
Inflation is likely to slow somewhat

While there are various measures of core inflation in Japan, we prefer to focus on the so called 'core-core' definition, which excludes fresh food and energy. We envisage a slowdown from 2.4% in 2024 to 2.1% in 2025. While services inflation is likely to rise, goods inflation is expected moderate amid softer import price rises. Meanwhile, we also expect wage growth to recede somewhat, even if preliminary requests by the labour unions suggest that wage hikes in 2025 could be in line with the 2024 outcome. However, wage growth is tied to inflation in the prior year, which was lower in 2024 compared to 2023. We think headline wage hikes will be lower than the 5.1% achieved in 2024 while the so called 'base up', which excludes seniority based wage increases, should come in 30bps below the 2024 3.6% hike.

The monetary policy normalisation process is expected to continue smoothly

2024 was characterised by the end of NIRP and QQE with YCC. For beginners, NIRP stands for 'Negative Interest Rate Policy', QQE for 'Quantitative and Qualitative Monetary Easing' and YCC for 'Yield Curve

Real wages are still struggling to move into positive territory



Source: Ministry of Internal Affairs and Communication, Bloomberg

Control'. Retrospectively, monetary policy normalisation went relatively smoothly and is expected to continue. We believe another policy rate hike of 25bps is in the offing for January 2025, even though some market participants think that recent comments by the Bank of Japan could be interpreted as favouring a 25bp hike already in December 2024, followed by another 25bp hike in May 2025. It remains to be seen whether a further 25bp hike will follow at the September meeting, but the path towards 1.5% in 2026 seems reasonable. Meanwhile, the reduction of JGB holdings is progressing smoothly, targeting JPY 3tn by Q1 2026. ETF and J-REIT holding reductions are likely to be considered later, but not in 2025.

Fiscal policy is likely to be complicated amid the current political constellation

In the latest elections, PM Ishida lost the majority of parliamentary seats held by the LDP and Komeito coalition and will now have to cooperate with the opposition DPP, a party requesting income tax cuts that will result in higher fiscal deficits.

The DPP cannot be regarded as a ruling coalition partner, but as a party whose policy targets need to be considered by the LDP/ Komeito minority government. The DPP has entered into discussions about an increase in the basic income tax deduction, which equates to a permanent tax cut. This would delay the swing of the Primary Balance from deficit to surplus by about two years, with a negative impact on the debt management targets intended to reduce Japan's debt-to-GDP ratio. Eventually, the reduction of this ratio will proceed anyway as long as the current inflation regime is maintained, but the process may take longer and needs to be considered at risk of being delayed.

Japanese credit offers relative value despite low spreads

We are positive on Japanese credit for 2025 both from a flight-to-safety perspective and relative valuations on a rating-adjusted basis. As global credit spreads tightened to historically tight levels in many segments through 2024, most notably in the US, Japanese credit spreads have lagged the rally. While spreads levels are low given the very high quality of Japanese corporates, we think global investors can add exposure as part of a barbell risk strategy along with European credit while underweighting US credit. Japan should also fare better than other parts of the global credit market with respect to the impending trade war, although risks and uncertainties still remain.

Constructive outlook for Japan's equity market

At the start of December 2024, Japanese equities are hovering around the same level as at the start of March, following a 15% rally in the first two months of the year. However, this masks a very volatile Topix index move in between, including a 25% drop between mid-July and early August amid a dissolution of the yen-carry trade, which was followed by a 'V'-shaped recovery. Following this volatile phase, Japanese equities lost some of their lustre, impacted by political turbulence

as the LDP/Komeito lost their absolute majority in the Lower House elections and are now ruling as a minority government, dependent on whether the opposition party DPP agrees to its policies. The outcome was preceded by some turmoil during the LDP leadership election, which was finally won by PM Ishiba. Furthermore, foreign investors were somewhat disappointed as Japanese equities underperformed major markets in USD denominated terms.

Going forward, the Bank of Japan's policy normalisation should benefit heavy-weight financials while a pickup in China's stimulus policy is likely to support China-exposed companies in Japan. As is the case for some European nations, targeting a 2% defence expense ratio to GDP should spur related sectors. Finally, Japan's economy is closely bound to the area of 'AI (artificial intelligence)' via many of its IT related companies, which is likely to remain in favour over the coming year.

Corporate governance reform is highly likely to continue and will remain a major motivation for foreign investors to increase their holdings of Japanese stocks as corporate leaders need to do more to avoid a delisting from major equity indices. Consequently, we see a strong relative performance for Japanese stocks over the year ahead.

Solid, but uninspiring outlook for South Korea's economy

Our 2025 outlook for South Korea's economy is solid, but uninspiring, with softer consumption trends and a lower growth contribution from net exports. The ageing population remains a structural impediment for private consumption, which is likely to remain sluggish in 2025, with slowing employment growth, high household debt and softer real wage income growth being impediments. New business formation continues to slow while many small family-owned business closures are likely to intensify and drag on consumption, though the situation is better for those households linked to the AI boom. However, many households are more linked

to enterprises exposed to cyclical products like petrochemicals and autos, which have a more sluggish outlook.

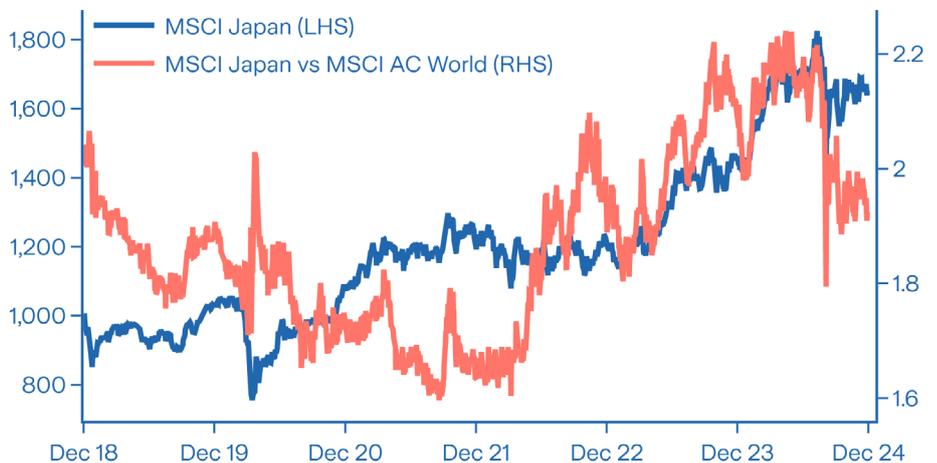
While the tech cycle is already peaking, potential higher tariffs imposed by the US Trump administration would result in headwinds to South Korea's export performance, both for those goods exported directly to the US as well as intermediate goods used as inputs for goods China exports to the US. The US trade deficit versus South Korea ranks eighth among individual countries, with large trade deficits in autos, auto parts, EV batteries, smartphones, monitors and DRAM.

The Bank of Korea cut its policy rate by 25bps in October and again in November 2024. Following a pause, we see two further rate cuts in 2025, as both the CPI and core CPI are expected to remain below 2%. Meanwhile, fiscal policy is expected to remain prudent, targeting a fiscal deficit of about 1% in 2025. A supplementary budget is only likely in case of an unforeseen shock to economy. Fiscal policy may become looser in 2026 and 2027, when by-elections and presidential elections are due.

Although the worst performing Asian equity market in 2024, the outlook for 2025 is more benign

South Korea's equity market had performed well until July 2024 but has lost steam since then, and even registered a negative performance going in to December, as heavyweight Samsung Electronics was shunned by investors. Now in early December, Korea's equity market was become the worst performing Asian market in 2024, down more than 7%, with the tech-heavy Kosdaq index losing more than 20%. Both domestic and foreign investors have taken a cautious stance, which should limit further significant downside as the earnings outlook for 2025 remains favourable while the 'Value-up' program to improve corporate governance should attract renewed attention into 2025.

MSCI Japan in absolute terms and relative to global equities



Source: MSCI, Bloomberg

Mainland China, Hong Kong and Taiwan

Outlook

- China's economic growth is expected to slow notably compared to the prior two years, but should remain decent
- Exports, the main growth driver in 2024, will suffer headwinds from potential Trump tariffs
- The property market remains in a multi-year consolidation phase, but should start to stabilise

Implications

- Policy rates are expected to be cut further while fiscal policy support should be stepped up
- China is likely to diversify its exports further amid higher US tariffs
- Currently undervalued and under-owned, Chinese equities are expected to perform well in the upcoming year

Risks

- The property market fails to stabilise, and home prices fall further
- Tensions with the Trump administration could be worse than consensus is expecting
- Deflationary pressures may intensify

The wise Year of the Snake

According to the Chinese zodiac, following the year of the Dragon, 2025 will be the year of the Wood Snake, starting on January 29. Those born in the year of the snake are believed to face particular challenges in career and finances in 2025, requiring optimism and adaptability to overcome setbacks and achieve success. Accordingly, we suspect China's authorities will be able to handle challenges when focussing on renewal, transformation, and growth.

Following major obstacles, China's policy makers appear to now recognise and be appropriately responding to the severe challenges China's economy is facing amid the ongoing property market collapse, dwindling consumer confidence and difficult future US trade policy. Authorities started to act in a more forceful manner around the National Day holidays in early October, stimulating the economy in the fourth quarter of the year and helping to improve consumer and investor confidence. While the policy moves were encouraging, more needs to be done into 2025 and beyond.

We still feel comfortable with our real GDP growth forecast of 4.9% for 2024, which we have consistently maintained throughout the year despite severe headwinds and far more volatile consensus forecasts. It will be interesting to see whether the government will stick to its 'around' 5% growth target for 2025, which will be discussed during the December Economic Work Conference, though it will only be officially announced during the National People's Congress in spring 2025. Our real GDP forecast for 2025 stands at around 4.2%, which is below consensus, as we take into account the tougher trade environment that will arise amid the US tariffs that are likely to be implemented under President Trump. China's economy will keep transforming from the 9%-10% growth range seen earlier this century to a more modest trajectory of 3 to 3½% into the next decade. Instead of targeting excessive

growth rates, it will be more important for China to focus on the quality of growth in order to avoid the typical 'mid-income trap'.

The consumption outlook is slowly improving

As in most economies, consumption largely depends on household income, consumer confidence and overall labour market conditions. These three components were a drag on consumption in 2024, as growth was driven largely by the favourable export performance in 2024. We believe that consumer conditions should start to stabilise in 2025. Based on non-official private wage statistics, wage growth fell to a record low in 2024, if the steep drop following the outbreak of Covid is excluded. Various employees in the private sector as well as civil servants have suffered from wage cuts or wage payment delays. Labour market conditions have been particularly severe in non-manufacturing sectors, which includes services and construction, while the manufacturing sector has benefitted

from China's strong export performance. We believe a shift between these categories has started already and should enable somewhat better wage growth in 2025, particularly as policy makers have realised that improving labour market conditions and wage growth are important to avoid further dissatisfaction among citizens.

The property market will continue to be a drag in 2025

The property market downturn is already in its fourth year, and is likely to remain a drag for the rest of the decade. However, the degree of the drag on overall growth appears to be stabilising and is unlikely to intensify in 2025. The government has taken a series of measures to help stabilising the housing downturn, even though, retrospectively, these measures can be described as somewhat piecemeal and should have been implemented even more vigorously. To no surprise, both President Xi and Vice-Premier He have called for further policy efforts. Some of the measures are already showing

China's property sector remains vulnerable



Source: Bloomberg

a positive impact, as home sales have finally started to improve recently, though it is too early to argue that it is a major turnaround as the recent optimism of home buyers may fade again if no follow-up measures will be implemented. House prices, particularly secondary home prices, keep falling, and are likely to continue falling into 2025, though at a slower pace. An improvement may primarily become visible in tier-1 cities, while lower tier cities are likely to continue to struggle for many years.

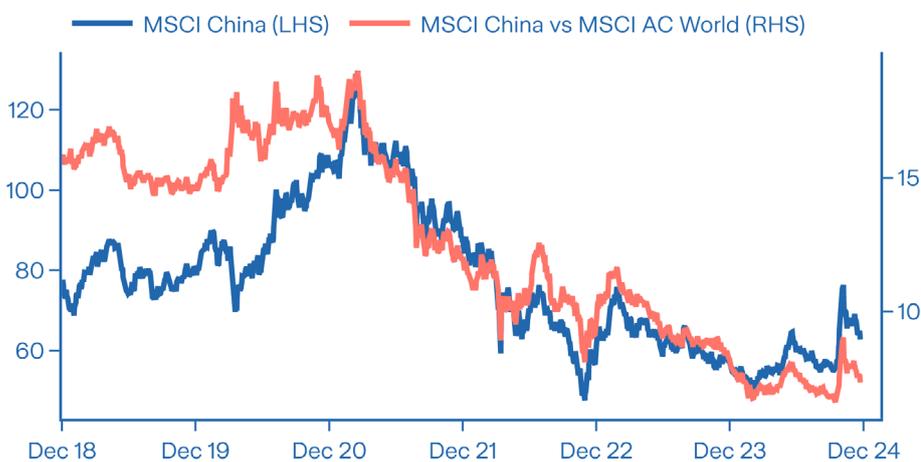
Infrastructure and manufacturing investment are expected to remain solid

As we do not expect China's export performance to deteriorate significantly in 2025, despite tariff proposals, manufacturing investment growth will remain firm, though slightly lower than in 2024 amid tariff risks. Meanwhile, fiscal stimulus will benefit strong infrastructure investment, as has already become visible in Q4 2024. On the contrary, property investment will keep suffering, as lower land sales by local governments will keep the drag on property investment intact, with difficult financing conditions for the major property developers prevailing.

We expect a mixed export performance in 2025 amid US tariff hikes

Our forecast for China's exports in 2025 hinges on the degree of US tariff hikes under President Trump. We do not believe that the pre-announced tariff hikes on imports from China by 60% will be fully implemented immediately after President Trump takes office on January 20, but may be scaled back to somewhere between 20% and 40% and may only be implemented over the course of the year. We also need to take into account that China's exports to the US only make up about 15% of China's total exports. It is therefore possible that much of the expected decrease in exports to the US could be made up for by higher exports to other destinations amid strong price competitiveness and strong demand for electric vehicles and solar panels that are 'Made in China'. Our base case assumes that the net export contribution to China's overall GDP growth will be around zero in 2025.

MSCI China, and relative to global equities



Source: MSCI, Bloomberg

Fiscal and monetary policy are likely to support growth

Falling tax and land sales income by a series of local governments resulted in increased additional fee collection and public salary payment delays in 2024. In addition, local government officials were cautious in starting new investment projects amid a desire to avoid anti-corruption investigations, resulting in a fiscal tightening. We expect this trend to reverse in 2025, resulting in a more supportive fiscal impulse for growth. We also anticipate that the fiscal deficit target for 2025 and both the local and central government special bond issuance quotas will be raised. Monetary policy will remain expansive, and we expect more policy rate and RRR cuts, alleviating financing pressures for both corporates and households, and enabling a turnaround of the credit impulse so that it improves and finally moves back into positive territory.

We maintain a cautiously optimistic outlook for China equities

Last year, our more optimistic 2024 outlook for Chinese equities turned out to be right. China's 'H'-share performance ranks closely behind the equity markets of the US and Taiwan as of the time of writing. Our equity market outlook for China remains constructive as we believe China equities remain attractively valued and are still under-owned by global investors. China's policy turnaround at the start of Q4 2024 has attracted the attention of both local and global investors, though the euphoria has faded somewhat due to disappointingly slow policy implementation. We believe there is further upside potential in 2025 unless trade issues with the US escalate. We also note increasing buyback potential for domestic 'A'-shares.

Chinese IG credit offers little value while HY property defaults are likely to continue

Chinese Investment Grade credit is likely to see spread widening as spreads are tight relative to the US on a historical basis while the prospect of a looming trade war with the US and growth risks stemming from a weak property sector are downside

risks. We anticipate that Chinese credit will also be impacted by the generic widening of global credit spreads that we expect in 2025. Chinese High Yield valuations are also not cheap in our view, and the property sector is likely to remain under pressure, with probable double-digit default rates. A key risk for Chinese and Asian credit in general arises from fund outflows, which is a distinct possibility next year as the rhetoric around a US-China trade war picks up.

Hong Kong's 2025 growth contribution is shifting towards improving consumption

Private consumption was the main drag on Hong Kong's economy in 2024. Consumer patterns changed as people flocked to Shenzhen to benefit from lower prices for goods and services in neighbouring mainland China and easy train connections. Net exports were the main growth driver while capex benefitted from easing financial conditions. For 2025, we believe growth contribution patterns will change significantly. Net exports are expected to be a drag following the implementation of higher tariffs on Chinese goods in line with prior threats from US President Trump. As a centre for international finance and a major hub for mainland China trade, Hong Kong will suffer accordingly. Consumer confidence is likely to improve, however, following a turnaround in property prices, which fell in 2024 but are now in the process of increasing again. Meanwhile, fiscal policy is likely to move from expansion to a more sustainable path, with a focus on greater efficiency.

Taiwan's growth outlook for 2025 should remain brisk, but less dynamic than last year

Benefitting from the progress in AI, Taiwan experienced solid growth in 2024. Thriving exports ignited a strong capex boom and boosted private income. The latter benefitted from high bonus payments in the tech sector, but also from rising equity and property prices. We expect GDP to have grown in the 4½ - 5% range in 2024. It will be challenging for the economy to maintain such a strong growth path in 2025, but even if growth were to slow down somewhat, it is expected to remain solid as long as political tensions do not escalate. An even more expansive fiscal policy is expected to make up for some of the slower growth in other GDP components. Export growth is likely to soften in the event that US tariff hikes are implemented for Taiwan exports, but even if that were not the case, Taiwan is highly likely to suffer as a supplier of parts to Mainland China, where tariffs may be hiked by up to 60% by the Trump administration in the most pessimistic scenario. Despite the overheated housing market, inflationary pressures appear to be contained, with the CBC, Taiwan's central bank, sticking to its more hawkish stance, at least in 2025. The booming equity market may require a consolidation phase before edging higher.

ASEAN and India

Outlook

- Growth is expected to be steady, but tariff uncertainties loom
- Underlying inflation is expected to remain weak despite volatile headline inflation
- Central banks are likely to cut rates further, but the pace will depend on external conditions

Implications

- Equity performance is likely to be dampened by uncertainty around global growth and rates
- Bond yields should come down further, driven by potential rate cuts
- Depreciation pressure on local currencies will continue amid the USD strength

Risks

- A prolonged period of a strong USD could significantly delay ASEAN's ability to cut rates
- Intense tariff war with direct tariffs on ASEAN could considerably drag on growth
- Increased risk-off sentiment could lead to fund outflows and put pressure on currencies

Growth momentum builds, but tariff uncertainties loom

Regional growth gained traction in 2024, driven by a recovery in manufacturing and exports. Trade-reliant economies such as Vietnam, Singapore, and Malaysia exceeded growth expectations in recent quarters while rate cuts in Indonesia, Thailand, and the Philippines have begun to ease financial conditions, setting the stage for further support in 2025. India's growth was exceptionally strong in H1 2024 but the pace has eased in H2. We think growth will continue to normalise towards trend growth in 2025.

While momentum builds, the 2025 outlook is overshadowed by uncertainty surrounding potential US tariffs. Vietnam, Malaysia, and Singapore are particularly vulnerable to reduced exports. However, the impact will only be visible towards the end of the year. India, with its domestically driven economy, is likely to face minimal impact from tariffs.

Interest rate trajectory to be shaped by external conditions

Inflation across ASEAN remained benign at 2-4% in 2024. India saw a surge in headline inflation in October due to volatile food components, but core inflation remains below the central bank's target. Inflation is expected to remain modest in the coming year, paving the way for central banks to deliver further rate cuts. Indonesia and the Philippines have room to cut rates by 75-100bps, while India is expected to reduce its policy rate by 50bps. Elsewhere in ASEAN, monetary policy is expected to stay stable or ease slightly.

That said, there remains high uncertainty around rate expectations as the pace and magnitude of policy easing will be significantly influenced by external factors. In recent months, regional currencies have depreciated by 2-4% amid a stronger USD, delaying further rate cuts. The risk of prolonged USD strength looms amid uncertainty around US tariffs while the

potential impact of fiscal policy on US inflation is likely to complicate the Fed's rate-cutting plans, clouding the rate outlook in the region.

Direct US tariffs will weigh on exports, but the impact remains unclear

The scale and timing of potential US tariffs under Trump 2.0 remain ambiguous. Even in a worst-case scenario of 60% tariffs on China and 10-20% tariffs on the rest of the world, legal procedures and implementation would take time, likely driving frontloaded trade and boosting exports in early 2025.

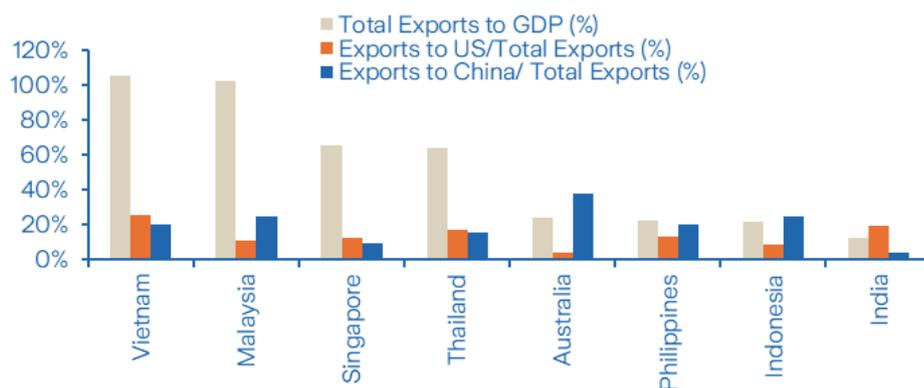
Overall, direct tariffs on ASEAN would pressure export volumes. However, some of the negative effects will be absorbed in the margins of exporters and importers, as seen in the last round of tariffs in 2018. A stronger USD could partially mitigate the impact by improving terms of trade for the region. That said, countries like Vietnam, with its ballooning surplus and heavy reliance on US exports (between 20-30% of total exports), appear particularly vulnerable to tariff threats.

ASEAN's vulnerability and potential shifts in trade dynamics with China

A 60% US tariff on Chinese products would impact ASEAN's intermediary goods exports to China, and slower growth in China would weigh on ASEAN exports catering to China's end use demand. Singapore, Malaysia and Thailand are particularly vulnerable due to their strong ties to China's domestic economy. However, an offsetting factor could be China's increased efforts in stimulating domestic consumption, which could be beneficial for these countries.

Moreover, trade dynamics between China and ASEAN will potentially be affected as China further redirects its excess exports to ASEAN markets. Malaysia has recently imposed a 10% excise tax on some low-value imports from China. Indonesia has banned Temu, a Chinese e-commerce platform, amid concerns about the negative impact on local businesses. Trade frictions are likely to intensify, although ASEAN might have lower bargaining power compared to the US or Europe to impose hefty tariffs on Chinese products.

Several ASEAN countries are highly exposed to global trade



Source: WTO, World Bank

Strategic positioning of ASEAN and India to attract global FDIs

Despite near-term challenges, ASEAN continues to solidify its position as a premier destination for FDIs. Post-pandemic, FDI inflows into ASEAN have nearly doubled, with Singapore capturing 70%. Vietnam and Indonesia have also seen notable gains. Looking ahead, the distribution of ASEAN's FDI inflows may hinge on tariff structures within the region. Higher tariffs on Vietnam compared to its ASEAN peers could redistribute investments to other countries across the bloc.

Meanwhile, India is well-placed to benefit from supply chain diversions, supported by its neutral tariff stance and close US ties. However, recent trends show disappointing FDI inflows, highlighting India's limited manufacturing capability but strategic developments, such as Apple's establishment of production facilities, signal incremental progress in bolstering its industrial capacity.

Malaysia: Growth to be supported by fiscal spending and capex

Growth is expected to moderate slightly in 2025 from a stronger-than-expected 2024. Malaysia's fiscal policy balances consolidation with growth support. The government aims to reduce the fiscal deficit from 4.3% of GDP in 2024 to 3.8% in 2025 while increasing spending by 4.2% YoY with higher minimum wages, in part funded by lower fuel subsidies for high income households.

Investment prospects are strong, with high-tech FDI inflows in sectors such as data centres. The Johor-Singapore Special Economic Zone is likely to position Johor as

a regional manufacturing hub, leveraging its proximity to Singapore. Monetary policy is expected to remain steady, with Bank Negara Malaysia likely holding rates at 3%.

Indonesia: Continuity amid leadership transition

Indonesia's new cabinet is signalling policy continuity, with key figures such as Finance Minister Sri Mulyani Indrawati retained from the previous administration. This reassures investors of Indonesia's ongoing commitment to fiscal prudence. Longer term, Prabowo's goal is to raise trend growth to 8% through increased fiscal spending. However, Indonesia's commitment to fiscal discipline may constrain these plans while raising trend growth will also require significant structural reforms, which continue to face political resistance.

All told, we expect growth to remain steady at around 5% in 2025 and external risks persist, with the IDR vulnerable to USD volatility and rapid shifts in foreign capital flows. This will limit Bank Indonesia's flexibility to cut rates during the year. We are currently pencilling in a 100bp rate cut by the central bank in 2025.

India: Growth to return to trend

India's economy surged in early 2024, driven by pre-election spending and public investments, but growth is expected to stabilise around trend growth of 6.5% in 2025. This will keep India in its spot as the fastest-growing major economy and on track to become the fourth largest by GDP at market prices by 2030.

Despite the BJP's loss of a majority in 2024 and the formation of a coalition government, policy continuity persists. The FY25 budget targets a deficit reduction from 5.8% of

GDP in FY24 to 4.9% in FY25, supported by stronger tax revenues and RBI dividends. Capital investments, which accounts for 4.3% of GDP, and labour market support have been priorities, ensuring that fiscal discipline does not hinder growth. While inflationary pressures persist due to adverse weather and volatile oil prices, stable core inflation provides room for the RBI to cut rates by 50bps in 2025.

Bond yields set to ease with rate cuts

The US election triggered a sell-off in EM bonds, but ASEAN and India were largely resilient. Indonesia has seen the largest yield widening in the region, given its sensitivity to foreign investor sentiment. In the short-term, we think Indonesia's 10yr yields might continue to face pressure, driven by risk aversion, higher Fed rate expectations, and FX depreciation concerns.

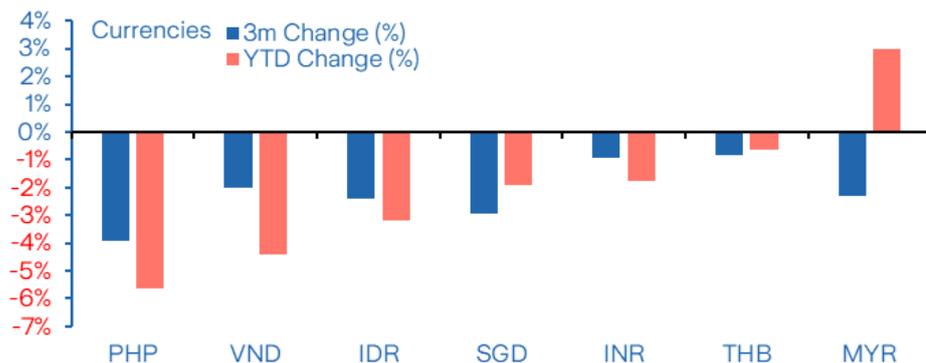
Overall, however, we think ASEAN and India should see nominal long-term yields on a downward trend throughout 2025 as central banks continue to deliver rate cuts, though at a measured pace influenced by external uncertainty. We expect yield curves to steepen further, particularly in Indonesia, the Philippines, and India, where there is the most room for monetary easing.

Equites: Headwinds ahead

In 2025, we think tariff concerns and a stronger USD will continue to dampen investor appetite for ASEAN equities. In such a risk-off environment, Malaysia may offer a defensive tilt, while Indonesia's equity market could be vulnerable to a stronger USD. Vietnam is more exposed to tariff risks. However, the impact of tariffs may turn out to be less severe than feared. With more targeted measures towards China rather than universal tariffs, ASEAN could further capture market share in the manufacturing sector, driving investor interest back to the region. As sentiment improves, attractive valuations and light positioning could present tactical opportunities relative to other markets.

For India, its stock market has emerged as the standout performer in Asia. The relative weakness of China has further redirected fund flows towards India. However, in the short term, concerns over stretched valuations and waning investor optimism may temper performance in 2025. That said, India's earnings growth continues to outperform many emerging markets, and its stocks deliver one of the highest returns on equity in the region. These solid fundamentals should continue to underpin India's equity performance over the medium to long term.

Currency headwinds remain the key concerns for the region



Source: Bloomberg

Australia

Outlook

- Growth is expected to return to trend, with a consumption recovery more pronounced
- Inflation will ease further and potentially fall back to the RBA's target range
- Interest rates are expected to fall, but the rate-cutting cycle will be rather shallow

Implications

- Bond yields will be volatile amid uncertainty around the impact of US tariffs on inflation
- Equity markets are expected to post another year of decent gains, supported by the financial sector
- The AUD is likely to appreciate further, but the level remains low by historical standards

Risks

- Inflation reaccelerates, leading to further rate hikes
- Further rate increases tip the economy into a recession
- China's severe slowdown weighs on Australia's commodity and mining sector

Growth: the fog is slowly lifting

In 2024, Australia experienced a significant growth slowdown, primarily driven by weak consumer spending due to decade-high mortgage rates and elevated inflation. Nevertheless, a resilient labour market and strong immigration flows have prevented growth from slipping into contractionary territory. Looking ahead, growth is expected to return to trend in 2025. Easing inflation, rate cuts, and supportive fiscal policies should create a more favourable environment for households and businesses.

While uncertainty surrounding potential US tariffs on China and the rest of the world could lead to tighter financial conditions as markets price in higher bond yields and inflation expectations, we believe the spillover effects on Australia's economy will be relatively modest. These effects are likely to manifest mainly through a further slowdown in China due to tariffs.

Improved private consumption and robust public demand to bolster growth

2024 has been a tough year for Australian consumers. Household balance sheets have been under considerable pressure, with a significant drop in household saving rates from the all-time high during the Covid era to almost zero. In 2025, these pressures are expected to ease as growth in real household income has improved and moved back into positive territory, driven by lower inflation and higher wages. Additionally, falling mortgage rates and increased disposable income from recent tax cuts will provide further relief, while rising home prices create positive wealth effects. Rising consumer confidence, shown in recent consumer surveys, suggests households are becoming less pessimistic and potentially more inclined to spend in the coming year.

From the public demand perspective, government spending and public capital expenditure have been key drivers for growth in 2024, offsetting the pronounced

weaknesses in private consumption. The share of public spending and investment in GDP has risen from just over 20% before Covid to nearly 30% recently. Tax cuts, energy rebates, and increased wages for the public sector are among the key measures boosting fiscal expenditure. We expect fiscal policy to remain expansionary in 2025, thanks to favourable budget positions coupled with strong pre-election spending.

A mixed outlook for business investment

Private investment experienced a modest recovery in 2024, constrained by high inflation, a tight labour market, and elevated interest rates. With rate cuts expected in 2025, private investment should see further support. Residential investment is also likely to gain momentum on the back of lower funding costs and strong housing demand.

That said, business confidence and capex intention surveys suggest firms are cautious about boosting capital expenditure in the coming year. Persistently high construction costs and tight labour conditions continue

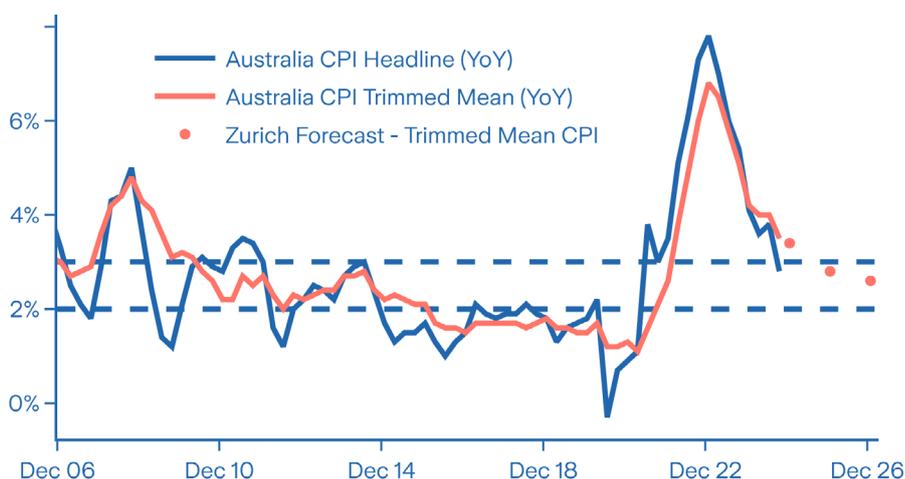
to weigh on sentiment. In the mining sector, weaker demand from China has eroded profitability, suggesting limited investment growth in this area for 2025.

The rate-cutting cycle is expected to be shallow

Headline inflation decreased from 3.6% to 2.8% YoY in Q3, partly due to government cost-of-living relief measures. However, the trimmed mean, a measure of underlying inflation, has only moderated from 3.8% to 3.6% YoY, remaining above the Reserve Bank of Australia's (RBA) target range.

Although inflation has been more persistent than initially expected, its downward trajectory is intact, and the pressure on underlying inflation is continuing to ease. Sticky components of core inflation, such as services and rents, are showing signs of moderation. Wage growth appears to have peaked given a gradual loosening of the labour market, as indicated by a gradual rising unemployment rate and declining job vacancies.

Core inflation should return to the RBA's target range by end of 2025



Source: ZIG, Bloomberg

While inflation is broadly decreasing in the short term, we suspect the levels of inflation in this cycle will remain structurally higher than pre-pandemic levels due to a tight labour market and global trade fragmentation exerting upward pressure on input costs. Rents are expected to stay elevated amid persistent supply shortages and robust housing demand. The RBA has adopted a more cautious approach compared to the Fed and ECB. We expect the RBA will deliver a 75bp rate cut in total, starting early next year and bringing its policy rate to around 3.6% by the end of 2025.

The pace of increase in house prices should moderate

Following a 7% increase in 2023, house prices have risen another 5% YTD despite elevated mortgage rates. A significant uptick in net migration has boosted demand, while persistent supply shortages exacerbate the imbalance and put upward pressure on prices. However, recent trends suggest that the pace of house price increases has stalled. In major cities like Sydney, prices are beginning to fall, and leading indicators, such as the sales-to-listing ratio, are also showing signs of moderation. Affordability remains a key concern for the housing market in 2025 and is expected to temper the pace at which house prices rise further.

Nevertheless, anticipated rate cuts in 2025 are likely to provide renewed support for the housing market as historically house prices have been highly sensitive to falling rates. While building approvals are improving, they remain significantly lower than long-term averages, suggesting that the issue of housing shortages will not be resolved any time soon.

The spillover impact of proposed US tariffs on Australia is limited

Australia is expected to be largely unaffected by US tariffs given its current bilateral trade surplus with the US. Notably, Australia was exempted from the steel and aluminium tariffs in 2018, and even comprehensive US import tariffs would likely have a limited direct impact as the US accounts for only around 4% of Australia's exports. The primary channel through which Australia may feel the impact is via China. China accounts for around 40% of Australia's total exports, predominantly through commodities.

While China's property crisis has significantly reduced demand for Australian commodities used in the construction sector, China's focus on boosting its manufacturing capability and infrastructure has offset some of this weakness. However, if tariffs significantly hinder China's growth, the spillover effects on Australia's exports and mining investment could be noticeable.

Despite this, exports only account for 25% of Australia's total GDP, so the knock-on effects on overall economic growth are unlikely to be catastrophic. Australia's reduced dependence on China's economic growth in recent years and the diminishing role of mining investment in driving GDP also provide some insulation.

Bond yields are expected to decline in anticipation of potential rate cuts

Bond yields have risen notably towards the end of 2024, mirroring the increase in yields across global markets. With rate cuts on the horizon, 10yr bond yields are expected to decline and trade within the range of 3.8%–4% by the end of 2025. A steepening yield curve is anticipated, with front-end yields falling more quickly in response to monetary policy easing while the longer-end reflecting a more normalising economic conditions.

Nevertheless, uncertainty persists, particularly regarding the potential impact of the US tariff war on global growth and inflation expectations. This could drive continued volatility in bond yields throughout the year given that 10yr Australia government securities have been tracking 10yr US Treasury closely.

The AUD is expected to strengthen further

The AUD has appreciated by 4.5% YTD reaching 0.65 USD/AUD, yet its valuation remains attractive relative to the historical average level of 0.8 USD/AUD. Several factors support further appreciation of the AUD in the medium term. First, the RBA's higher interest rates relative to other central banks provide a positive carry and should support inflows into the currency. Second, given its cyclical nature, the AUD has the potential to rebound further as global growth improves with looser global

financial conditions. However, the upside potential for the AUD will be likely capped given subdued demand for commodities from China and global growth uncertainty amid proposed US tariffs. Hence, we expect the AUD to remain relatively weak, hovering around 0.7 USD/AUD by the end of 2025.

Equities: sector divergence remains

The ASX200 has risen around 10% YTD with the outlook for banks improving significantly. Since 2022, rapid rate increases and fierce competition among banks prevented them from passing on the increase in funding rates to end customers, putting pressure on profit margins. However, the tide has turned. With funding rates now expected to fall probably faster than lending rates, banks' profit margins should improve, and a better growth outlook is likely to support loan growth.

In contrast, the commodity sector continues to face challenges from China's ongoing weakness. That said, any upside surprises from Chinese stimulus measures could act as a catalyst for this sector in 2025.

Overall, we think Australian equities are in good shape and expect similar returns in the coming year of close to 10%, primarily benefiting from the outperformance of the financial sector.

Mind the gap



Source: Bloomberg

LatAm ex Brazil

Outlook

- LatAm growth prospects to be negatively impacted by renewed global trade tensions
- In Mexico, the domestic political situation leads to additional uncertainty
- A modest weakening in growth in Chile, but policy easing provides some support

Implications

- Valuations to remain discounted compared to developed markets
- Stock markets to stay volatile due to external risk, but monetary easing cycle provides some support

Risks

- US trade tensions create elevated uncertainty, disrupting conditions more than anticipated
- Commodity prices fall sharply amid trade disruptions and weak global growth
- In Mexico, domestic reforms and US trade talks amplify pressure on financial markets

Chile: The central bank addresses inflation and growth weakness

The Central Bank of Chile has reduced the policy rate by 600bps since the beginning of the easing cycle. Inflation maintained a downward trend during the first half of the year, but accelerated in July due to volatile components, particularly increases in electricity rates. This reacceleration caused inflation to remain above the upper limit of the inflation target range. Although the economy has recovered, helped by consumption and the external sector, its expansion was smaller than anticipated in the beginning of the year, mainly due to a drop in investment.

In Q3, GDP grew by 2.3% YoY, with a notable recovery in manufacturing and trade. From a spending perspective, domestic demand remains weak, showing a -1.5% QoQ decline, with slowing consumption and reduced inventories. By contrast, investment increased after four quarters of decline. Going forward, we expect domestic demand to improve modestly, given policy easing.

The fiscal balance remains vulnerable. Following a surplus of 1.1% of GDP in 2022, a deficit of -2.4% was recorded in 2023. We anticipate the fiscal balance will continue to deteriorate to around -2.5% of GDP in 2025 as government expenditures rise and tax revenues contract, given a subdued growth backdrop.

Local assets declined and became very volatile in response to the US election outcome, as this has generated uncertainty about how potential measures will affect global trade. A slowdown in global economic activity would reduce demand for commodities and copper in particular. Before the election, the external sector in Chile benefited from copper prices at attractive levels, leading to a trade balance surplus. This resulted in better tax collection and improved terms of trade, boosting economic activity in Chile. Domestically, a more stable political environment led to local assets showing gains for much of the year.

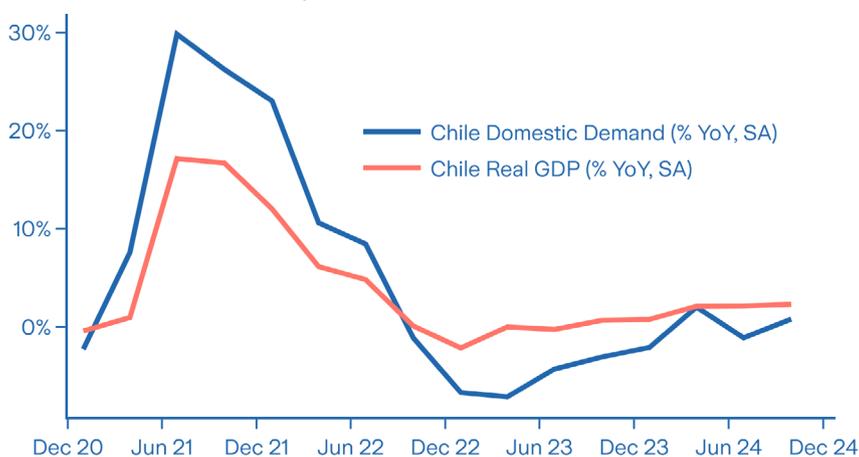
Our view on the local stock market is neutral. We believe Chile has gradually moved past its most complex political moments since the 2022 plebiscite vote. While profit estimates for local companies this year suggest growth for most, the average shows a decrease due to the weak performance of a few companies. However, profits are expected to grow in the coming years, driven by a low comparison base and a reasonable economic outlook. Regarding crucial raw materials like cellulose and lithium, prices remain low, but we anticipate a medium-term rebound driven by structural demand prospects.

Mexico: Financial markets face volatility due to political and trade uncertainties

In the first half of 2024, driven by household consumption and investment, economic growth was evident. However, in the second half of the year, several events increased the risk in Mexico's economy and financial markets. Notably, Claudia Sheinbaum's overwhelming electoral victory introduced several reforms to the Mexican State and continued the policies of former President Manuel Lopez-Obrador. Following the US election in early November the internal scenario worsened, with potential trade tariffs and stricter controls on migratory flow increasing tensions between the two countries. Consequently, both the exchange rate and the stock market have experienced high volatility and declines in the second half of the year.

Since the beginning of the easing cycle in 2024, Banxico has cut rates by 100bps. In the last meeting in November, central bank officials expressed concern about the economic outlook, which will be affected by the US election outcome. This should act as a factor to slow down inflation, providing room for the easing cycle to continue. While inflation has remained above the target range (2.0% - 4.0%), and rising to 4.8% YoY in

Domestic demand should improve in Chile



Source: Central Bank of Chile

October (up from 4.6% the previous month), volatile components, particularly food prices, explain much of the increase. Core inflation showed declines, with core services falling to the lowest level since November 2021, reflecting slowing domestic demand.

Despite policy easing, we maintain a negative outlook for the Mexican stock market and expect volatility to continue, influenced by both the internal fears of potential reforms and external pressure by the US government on the trade relationship.

Argentina: Striving for economic stability during a recession and inflation control efforts

With the economy in recession since 2023 and GDP growth projected to contract by -3.5% in 2024, Argentina is experiencing a significant economic downturn. Inflation has however decreased for the seventh consecutive month, with a 2.7% MoM rise in the CPI in October, down from 3.5% in September and 25% at the end of 2023, and year-on-year inflation was 193%, down from 209% the previous month. The government aims to maintain a zero fiscal deficit, a challenging task especially with the elimination of the PAIS tax (tax on the purchase of foreign currency) at the end of 2024. By 2025, despite a greater drop in revenue, other resources are projected to offset the loss, paving the way for fiscal sustainability. Additionally, the Central Bank of the Argentine Republic (BCRA) will cease financing the Treasury through monetary issuance as the debt is not expected to grow further.

The Argentine government has announced the beginning of 'phase two' of its economic plan, aimed at maintaining a stable 'broad money supply'. As inflation decreases and economic activity recovers, the demand for pesos is expected to increase, aligning the parallel exchange rate with the official exchange rate. However, the government's successful tax amnesty has led to a surge in USD private deposits. This, along with the strong demand for local corporate debt issuance in international markets and the positive outlook for the energy trade balance—driven by the exploitation of the Vaca Muerta Oil and Gas fields—has bolstered market confidence. As a result, Argentina's EMBI sovereign risk index has dropped by approximately 1,200bps in 2024, and the Merval Stock Index has reached a record high in current dollar terms. While these developments are encouraging, it is clear the Argentine economy still faces several challenges. In this context, all eyes will be on President Milei's ability to reach a new agreement with the IMF and to regain access to international debt markets. More

importantly, the administration will face mid-term elections next year, which will test its ability to govern for the second half of its mandate.

The LatAm stock market has declined due to political and geopolitical uncertainty

The MSCI LatAm Index has underperformed compared to developed and emerging economies and decoupled from the strong performance of the North American stock market, with a fall of nearly -16.7% (in US dollars) as of the end of October 2024. This decline is attributed to heightened political uncertainty in the region and expectations of a challenging global geopolitical scenario. In addition, the underperformance can be attributed to the average depreciation of LatAm currencies, volatile interest rates in the United States, and corrections in raw material prices. The primary detractors were the stock markets of Mexico, Chile, and Brazil.

As of October's close, the region was trading at 8.8x P/E forward, 1.2 deviations below its historical average, positioning it as one of the most discounted regions globally, both in comparison to its own history and to major markets. By contrast, on the corporate level, most companies have reported solid results with profits exceeding market expectations, supporting valuations. While this, along with an attractive dividend yield and the inflow of cash as portfolio diversification begins, should boost the region's returns, we believe that in the short term markets will adopt a more cautious stance given Donald Trump's election victory, which could lead to altered trade relationships amongst major trading partners, along with geopolitical risks and uncertainty around the China growth outlook.

Nonetheless, the fundamentals are clear, and considering the discount in valuations many

of these risks appear to be well accounted for. The rate cut cycles in Chile and Mexico should also mitigate the effect of regional uncertainty.

The Mexican stock market has underperformed compared to other emerging market indices, impacted by uncertainty surrounding the reformist waves announced by the Mexican government. Additionally, there is a heightened perception of risk due to the US elections and their potential impact on the T-MEC free trade agreement (between the US, Mexico and Canada). The Mexican peso has been the most depreciated currency in the region, with increasing volatility following Claudia Sheinbaum's victory in early June. Despite these challenges, equity valuation prospects remain positive, keeping the Mexican market attractive. However, the high exposure and dependence on the US, coupled with a less favorable policy environment for fixed income assets, may undermine economic activity and the value of local assets.

The Chilean stock market has exhibited the strongest performance in the region, supported by the central bank's maintenance of the easing cycle. Institutionally, there has been a gradual exit from the most complex and radical political policies, which has provided stability. The strong equity performance has also been driven by corporate results that have exceeded market expectations. Despite recent declines, the prices of key raw materials, particularly copper and lithium, have remained attractive. We nonetheless maintain a neutral view on the Chilean stock market near term, given risk around trade and global growth, with implications for commodity prices.

Due to high volatility and risk LatAm stock markets are declining



Source: Bloomberg (Note: Indexed to 100 on December 31, 2023)

Brazil

Outlook

- While growth is expected to slow from 2023-2024 levels, it will still lead the region
- Fiscal expansion and above target inflation will drive Selic rate hikes through 2025
- Monetary policy is decoupling from the rest of the world

Implications

- Financial assets will face pressure in 2025; selectivity is key
- Fiscal policy and geopolitical tensions are key risk drivers in financial markets
- The stock market is undervalued; finance sectors are expected to perform better

Risks

- The rate hiking cycle could be more aggressive and slow consumption more than expected
- Commodity prices fall on weaker global growth
- A faster deterioration in the fiscal deficit than is currently expected

Slowing growth in 2025, but from a strong level

Driven by private consumption and investment, GDP growth was revised up at the end of Q2, demonstrating greater dynamism, and was followed by strong activity in Q3. Notably, projections at the beginning of the year estimated annual growth for 2024 in the range of 1.5-2.0%. Recent forecasts indicate a growth of around 3.0% for 2024. However, high and rising interest rates, a constrained government sector, and weakening external demand are likely to slow economic activity down, and we anticipate growth of 2.0% in 2025. The Central Bank of Brazil is expected to continue its rate hike cycle in 2025.

Solid economic activity amid rising public debt

We expect private consumption and investment to be the main drivers of growth, accompanied by government

income transfers and a labour market that has remained healthy. At the end of Q3, the unemployment rate in Brazil fell to a new low of 6.4%, driven by an increase in employment and a slight decrease in labour force participation. We are also anticipating the reform of indirect taxes, which should improve the business environment through tax simplification and boost productivity. Notwithstanding the above, the primary deficit and public debt will continue to show increases, with the fiscal outlook remaining in investor focus.

Fiscal measures boost growth

Driven by private consumption, Q2 GDP grew 3.3% YoY, surpassing the market consensus of 2.7% and paving the way for the Central Bank to resume the rate hike cycle. This was followed by an equally solid GDP expansion in Q3, with GDP up 4% YoY. Consumption was fuelled by government income transfers, which have helped Luiz

Inácio da Silva's government maintain popularity. These transfers have been increasing and other measures adopted this year, such as the minimum wage increase in January, continue to boost demand amid tight financial conditions. However, this also heightens fiscal uncertainty, and contributes to inflationary pressures. Concerns around the fiscal stance has increased more recently following the long-awaited announcement of fiscal spending cuts, which underwhelmed compared to market expectations, and triggered a repricing of the rates outlook.

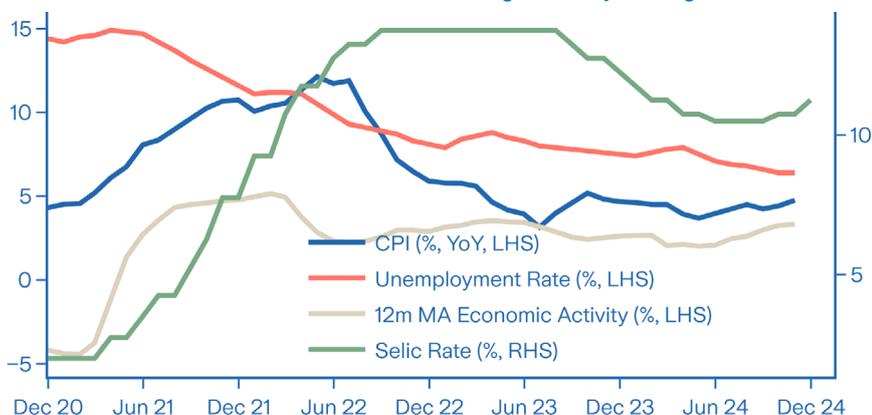
A resilient labour market fuels the economy amid rate hikes

The labour market remains resilient, significantly contributing to the positive dynamics of Brazilian economic activity, which has prompted the central bank to resume the cycle of Selic rate hikes. Unemployment reached historic lows at the end of Q3, standing at 6.4% (down from 6.6% in August), driven by an increase in employment and a slight decrease in the labour market participation rate. Employment has been rising for 11 consecutive months, despite a slowdown last month. Inflation-adjusted real wages fell by 0.3% MoM in September, although they remain strongly positive at 3.5% YoY. Despite a 0.3% decline in total labour income at the end of Q3, year-on-year growth was 7.2%. The strength of labour income explains the robust household consumption despite the high-interest rate environment.

The Central Bank resumes the rate hike cycle to address inflationary pressures

Based on strong growth in Q2, the central bank paused the rate cut cycle in June and subsequently began hiking in September. At the latest meeting in November, the bank raised the Selic rate by 50bps, bringing it to 11.25%, with the aim of controlling inflation.

The Central Bank resumes rate hikes amid a strong economy and high inflation



Source: Bloomberg

This decision was made in a context of healthy economic growth, a strong labour market, a positive output gap, and rising and unanchored inflation expectations, all of which justified a more restrictive monetary policy.

Inflation has remained high, driven mainly by expansionary fiscal measures that have boosted domestic demand, as well as increases in volatile components affected by supply factors. The central bank indicated that if inflation expectations continue to deteriorate, the monetary policy tightening cycle could be prolonged. We now expect rate hikes to continue through 2025, with the Selic rate peaking at around 13.5%. We see a resumption of the easing cycle after that, as growth is expected to slow.

Neutral stance amid continued rate hikes and fiscal uncertainty

From the perspective of fixed-income assets, we maintain a neutral outlook in the current economic scenario. The central bank is expected to continue its rate hiking cycle throughout 2025. This outlook is set against a backdrop of ongoing fiscal administration concerns, which continue to generate uncertainty among investors. As a result, interest rates remain elevated, with rates and yields nearing the peak levels observed in 2022. While the rising trajectory of policy rates has been largely anticipated, the persistent fiscal uncertainty necessitates a cautious approach to fixed-income assets moving forward. The 10-year Credit Default Swap (CDS) has similarly shown high volatility and an upward trend.

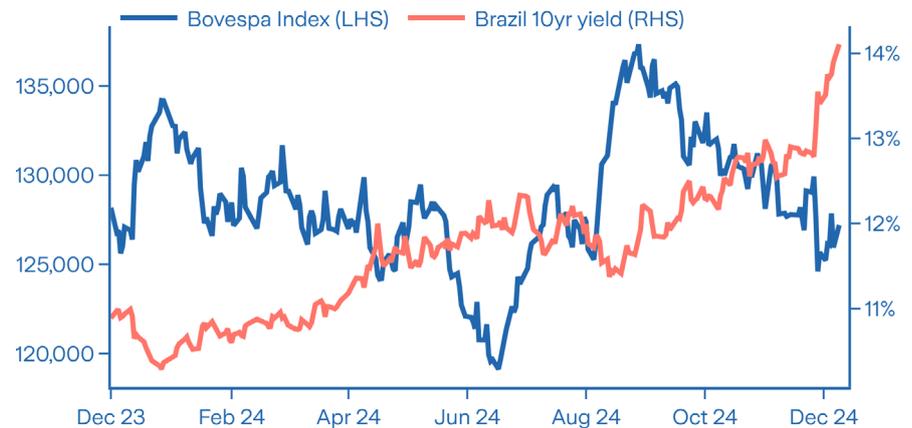
Discounted valuations and solid earnings are positive for stocks

The outlook for the Brazilian stock market is neutral. On the positive side, valuations are still discounted compared to emerging and developed markets. Corporate earnings are expected to remain solid, though a more aggressive rate hiking cycle would be a headwind. Furthermore, the high dividend yield and the redirection of flows from other emerging markets should positively impact foreign investment. On the negative side, fiscal uncertainty and the rising rates environment will be a headwind. Externally, uncertainty surrounding the policies of the incoming Trump administration could moreover affect commodity prices, potentially increasing risk and volatility in the Brazilian stock market.

Policy divergence will be supportive for Brazilian markets

We expect the Fed to continue to cut rates in 2025, helping to alleviate external risks and support the equity and fixed income markets in Brazil. Higher dividend yields and carry should attract flows to local assets, reinforcing currency appreciation and reducing the inflationary impact of currency fluctuations. Latin America, and Brazil in particular, is additionally gaining structural relevance. Stock markets benefit as a vehicles for gaining exposure to commodities, supporting both equity and currency markets. However, we must acknowledge that the level of risk remains high and fiscal uncertainty persists, adding further risk and volatility to local financial markets.

Interest rates on 10yr government debt rise while the stock market remains volatile



Source: Bloomberg

Contacts



Guy Miller

Chief Market Strategist & Economist
guy.miller@zurich.com



Charlotta Groth

Head of Macroeconomics
charlotta.groth@zurich.com



Puneet Sharma

Head of Market Strategies
puneet.sharma@zurich.com



Thomas Liebi

Head of US and UK Market Strategy & Economics
thomas.liebi@zurich.com



Ross Hutchison

Head of Eurozone Market Strategy & Economics
ross.hutchison@zurich.com



Håkan Hedström

Head of Asian Market Strategy & Economics
hokan.hedstroem@zurich.com



Ha Nguyen

Market Strategist & Economist Asia Pacific
ha.nguyen@zurich.com



Diego Ignacio Valda

Head of LatAm Market Strategy & Economics
diego.valda@zurich.com

Additional products on zurich.com/msme



Weekly Macro & Market View

Interpretation and opinion on the very latest regional economic and financial market developments and data releases.



Topical Thoughts

Periodic articles and papers on a variety of issues that are deemed to be significant, challenging conventional wisdom and detailing implications.



Monthly Investment Insights

Focuses on specific issues that are shaping the Group's investment stance over the short to medium term.



Quarterly Inflation Focus

Zurich's view on both global inflation trends and individual countries' inflation prospects.

For those short of time, view our video vignettes that give a short, sharp take on the key global developments, and how they may change the business landscape, developments and data releases.

Videos

Key points

An accompaniment to our Monthly Investment Insights publication, giving 3 key points for the month ahead in 3 minutes.



Podcasts

Topical Thoughts

For those interested in a deep-dive from the subject matter experts, podcasts are available to accompany some of our publications.



Following the US election, Zurich's Market Strategy & Macroeconomics team look at the implications on the key regions of the US, Eurozone and China. What does a Republican clean sweep mean for tariffs, trade, growth and inflation in the year ahead, and how will the central banks respond to a profound shift in US fiscal policy.

Economic and market implications of the US election outcome on the US, Eurozone and China

Thomas Liebi, Håkan Hedström, Ross Hutchison, Guy Miller
34:31



Disclaimer and cautionary statement

This publication has been prepared by Zurich Insurance Group Ltd and the opinions expressed therein are those of Zurich Insurance Group Ltd as of the date of writing and are subject to change without notice.

This publication has been produced solely for informational purposes. The analysis contained and opinions expressed herein are based on numerous assumptions concerning anticipated results that are inherently subject to significant economic, competitive, and other uncertainties and contingencies. Different assumptions could result in materially different conclusions. All information contained in this publication have been compiled and obtained from sources believed to be reliable and credible but no representation or warranty, express or implied, is made by Zurich Insurance Group Ltd or any of its subsidiaries (the 'Group') as to their accuracy or completeness.

Opinions expressed and analyses contained herein might differ from or be contrary to those expressed by other Group functions or contained in other documents of the Group, as a result of using different assumptions and/or criteria.

The Group may buy, sell, cover or otherwise change the nature, form or amount of its investments, including any investments identified in this publication, without further notice for any reason.

This publication is not intended to be legal, underwriting, financial investment or any other type of professional advice. No content in this publication constitutes a recommendation that any particular investment, security, transaction or investment strategy is suitable for any specific person. The content in this publication is not designed to meet any one's personal situation. The Group hereby disclaims any duty to update any information in this publication.

Persons requiring advice should consult an independent adviser (the Group does not provide investment or personalized advice).

The Group disclaims any and all liability whatsoever resulting from the use of or reliance upon publication. Certain statements in this publication are forward-looking statements, including, but not limited to, statements that are predictions of or indicate future events, trends, plans, developments or objectives. Undue reliance should not be placed on such statements because, by their nature, they are subject to known and unknown risks and uncertainties and can be affected by other factors that could cause actual results, developments and plans and objectives to differ materially from those expressed or implied in the forward-looking statements.

The subject matter of this publication is also not tied to any specific insurance product nor will it ensure coverage under any insurance policy.

This publication may not be reproduced either in whole, or in part, without prior written permission of Zurich Insurance Group Ltd, Mythenquai 2, 8002 Zurich, Switzerland. Neither Zurich Insurance Group Ltd nor any of its subsidiaries accept liability for any loss arising from the use or distribution of publication. This publication is for distribution only under such circumstances as may be permitted by applicable law and regulations. This publication does not constitute an offer or an invitation for the sale or purchase of securities in any jurisdiction.