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Research

Global

Economics

World Outlook

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Navigating Trump 2.025

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The financial and geopolitical world changed dramatically overnight on November 5th with Trump's election victory and the Republican sweep in Congress. The outlook is now far from "business as usual" and this opens up a wider range of outcomes for the global economy and financial markets. These span from a potentially much more positive US outlook on the one hand, to a much more negative European outlook on the other. President-elect Trump has several potentially conflicting economic policy goals, and how he weights them in office will influence global growth and asset prices in 2025 and beyond.

If the primary focus of the new administration is boosting growth, there's every chance that this can be very positive for the US, with spillovers elsewhere across the globe. But that would likely require less of a focus on campaign promises like the deportation of undocumented immigrants and on tariffs. Mr Trump's unpredictability means we will only know in real-time the way he balances these priorities once in office.

The main downside risks are more likely to emerge if greater weight is put on aggressive trade and immigration policies. This could be more negative for growth and push up inflation. That would lead the Fed to cease the cutting cycle and possibly even contemplate restarting rate increases which would likely put upward pressure on bond yields. This would have implications for the US and even more so to the rest of the world. A maximalist Trump trade agenda and a Europe constrained to act because of fragmentation is a huge but realistic risk for the continent. The German election in February could become a pivotal event.

Our base case for 2025 is stronger US growth and inflation and a higher Fed terminal rate than previously expected with the opposite conditions for Europe. This is driven by the assumption of modest US tax cuts, a strong deregulation push, and more supportive financial conditions. On trade we assume a 10 percentage point increase in the tariff rate on imports from China in the first half of the year (ratcheting up a further 10pp in H2) and an equalisation of tariff rates on motor vehicles with Europe. The forecast also assumes a 5% universal baseline tariff, though that is more likely to be implemented late 2025/early 2026.

This report contains all our global economic and asset price forecasts for 2025 and into 2026, with a continuation of US exceptionalism the most likely path. Uncertainty is high and as we said at the top, business as usual is the least likely outcome.

Figure 1: List of Contributors

Overview	
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	David Folkerts-Landau
Economics	
United States	Matthew Luzzetti & Team
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Source: Deutsche Bank

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Overview

The financial and geopolitical world changed dramatically overnight on November 5th with Trump's election victory and the Republican sweep in Congress. The outlook is now far from "business as usual" and this opens up a wider range of outcomes for the global economy and financial markets. These span from a potentially much more positive US outlook on the one hand, to a much more negative European outlook on the other. President-elect Trump has several potentially conflicting economic policy goals, and how he weights them in office will influence global growth and asset prices in 2025 and beyond.

If the primary focus of the new administration is boosting growth, there's every chance that this can be very positive for the US, with spillovers elsewhere across the globe. But that would likely require less of a focus on campaign promises like the deportation of undocumented immigrants and on tariffs, which could represent a negative supply shock for the US economy, particularly if other countries retaliate against any tariffs. Mr Trump's unpredictability means we will only know in real-time the way he balances these priorities once in office.

The real upside scenario involves large tax cuts to stimulate business and household spending, which boost aggregate demand, alongside deregulation and Musk-inspired tech/AI-driven productivity gains to boost aggregate supply. If that came alongside light touch immigration and trade policies, that would ensure any inflation increases are more measured.

Figure 2: DB GDP growth forecasts

Real GDP (% YoY)		WO November 2024			Change versus June World Outlook		Bloomberg Consensus (22-Nov-24)		
World	2023	2024	2025	2026	2024	2025	2024	2025	2026
World	**3.5**	**3.2**	**3.1**	**3.1**	**Unch**	**Unch**	**3.1**	**3.1**	**3.1**
US	2.9	2.7	2.5	2.4	0.3	0.3	2.7	1.9	2.0
Euro Area	0.4	0.7	0.8	1.0	-0.2	-0.7	0.8	1.2	1.4
Germany	-0.3	-0.2	0.5	1.0	-0.5	-0.8	-0.1	0.7	1.3
UK	0.3	0.9	1.3	1.4	0.1	-0.1	0.9	1.4	1.5
Japan	1.7	-0.3	1.5	1.0	-0.7	Unch	-0.2	1.2	0.9
Australia	2.0	1.2	2.3	2.3	-0.1	0.4	1.2	2.0	2.5
Canada	1.2	1.1	2.1	2.3	-0.2	-0.1	1.1	1.8	2.1
China	5.2	4.9	4.8	4.6	-0.3	0.3	4.8	4.5	4.1
India	7.7	7.0	6.5	6.5	Unch	0.1	6.8	6.6	NA
South Korea	1.4	2.2	1.9	1.8	-0.3	-0.2	2.2	2.0	2.2
Russia	3.6	3.7	1.3	1.1	0.5	0.2	3.5	1.6	1.4
South Africa	0.7	1.1	2.1	1.5	0.2	Unch	1.0	1.7	2.0
Türkiye	5.1	2.9	2.6	4.7	-0.1	-1.2	3.0	2.8	3.7
Brazil	2.9	3.1	1.9	1.8	1.3	0.5	3.0	2.0	2.0
Mexico	3.2	1.4	0.8	1.8	-0.9	-1.0	1.5	1.3	2.0

Note: Previous forecast is as of World Outlook- June 2024. Forecasts will have been updated in the interim. Source : Bloomberg Finance LP, Deutsche Bank.

The main downside risks lie more into 2026, and are more likely to emerge if greater weight is put on aggressive trade and immigration policies. This would be more negative for growth and push up inflation. That would lead the Fed to cease the cutting cycle and possibly even contemplate restarting rate increases which would likely put upward pressure on bond yields. This would have implications for the US and even more so to the rest of the world.

So that's the range, but what's our base case?

Our US economists believe the most likely scenario is that modest tax cuts, a strong deregulation push, and more supportive financial conditions will produce faster US growth in 2025, which they now see at 2.5% (Q4/Q4) versus 2.2% previously. Beyond next year, adverse effects from the trade war and a more restrictive monetary policy setting reduce their growth estimates by a few tenths to 2.1% for 2026 (Q4/Q4). This policy mix will stall progress on inflation, with core PCE expected to remain at or above 2.5% over the next two years, leading the Fed to halt their rate cuts. We now see the fed funds rate at 4.375% by YE 2025 and above 4% through 2026, a modestly restrictive stance relative to our elevated estimates of neutral (3.75-4%).

Figure 3: DB CPI inflation forecasts

Headline CPI (% YOY)		WO November 2024			Change versus June World Outlook		Bloomberg Consensus (22-Nov-24)		
	2023	2024	2025	2026	2024	2025	2024	2025	2026
US	4.1	2.9	2.6	2.9	-0.1	0.1	2.9	2.3	2.4
Euro Area	5.4	2.4	1.9	1.9	Unch	Unch	2.4	2.0	2.0
Germany	6.0	2.5	2.4	2.4	0.1	0.1	2.4	2.1	2.0
UK	7.3	2.5	2.9	2.0	-0.1	0.9	2.5	2.3	2.1
Japan	3.3	2.6	2.5	2.0	Unch	Unch	2.5	2.0	1.8
Australia	5.3	3.2	2.9	2.5	-0.1	0.2	3.3	2.8	2.6
Canada	3.9	2.6	2.1	2.0	Unch	Unch	2.4	2.0	2.0
China	0.2	0.3	1.3	1.6	-0.2	-0.2	0.4	1.1	1.4
India	5.7	4.9	4.1	4.4	0.3	-0.5	4.7	4.3	NA
Russia	5.9	8.3	7.6	5.0	1.0	2.3	8.1	6.1	4.4
South Africa	5.9	4.5	4.2	4.7	-0.3	-0.4	4.6	4.2	4.5
Türkiye	53.9	60.0	33.0	21.2	0.9	2.2	58.7	29.9	18.9
Brazil	4.6	4.3	4.4	4.0	0.3	0.9	4.3	3.7	3.5
Mexico	5.5	4.8	4.3	3.4	NA	NA	4.7	3.8	3.7

Note: Germany inflation is as per the EU HICP measure. Previous forecast is as of World Outlook- June 2024. Forecasts will have been updated in the interim. Source : Bloomberg Finance LP, Deutsche Bank.

On trade, they expect the Trump administration to deliver on many campaign promises, but initially targeted and then incrementally implemented. They expect a 10 percentage point increase in the tariff rate on imports from China in the first half of the year (ratcheting up a further 10pp in H2) and an equalisation of tariff rates on motor vehicles with Europe. The forecast also assumes a 5% universal baseline tariff, though that is more likely to be implemented late 2025/early 2026.

For Europe, the Trump victory appears overwhelmingly negative at face value, but it could shake the continent into more positive policy action over the medium term. So again, that makes the range of outcomes fairly wide. For 2025, it's too early for the positive scenario to be considered and the economic performance gap to the US will likely widen. In light of this, our economists have downgraded their growth forecast (0.8% in 2025) while lowering their inflation and ECB terminal rate forecast (to 1.5% by YE 2025). US tariffs will reinforce Europe's competitiveness issues and increase the need for the EU to coalesce around its own strategic policy shift. A maximalist Trump trade agenda and a Europe constrained to act because of fragmentation is a huge but realistic risk for the continent.

With Germany at the heart of the competitiveness shock and less constrained by its balance sheet, the policy course followed by the next government in Berlin has the most leverage over the outlook for Europe. The prospects for a policy shift are rising but by no means certain, and will depend largely on the arithmetic of election result, likely to be held on 23 February 2025. However, any benefits here are more likely to be felt from 2026, meaning any policy accommodation will rest on the ECB's shoulders in 2025.

Staying with Europe, the war in Ukraine will likely see major developments in the next few months as both sides first vie for the strongest position they can achieve before Mr Trump lands in office. So escalation first before potential peace talks that could still have a wide range of outcomes. Chances of a ceasefire that reduces the uncertainty from the region are higher than in 2024, but an ongoing war and even escalation remain very possible.

Figure 4: DB GDP forecasts - quarterly profile

GDP Growth (%qoq)	Q4-23	Q1-24	Q2-24	Q3-24	Q4-24	Q1-25	Q2-25	Q3-25	Q4-25	Q1-26	Q2-26	Q3-26	Q4-26	2024 %q4/q4	2025 %q4/q4	2026 %q4/q4
World	**0.8**	**0.8**	**0.5**	**0.8**	**1.1**	**0.9**	**0.5**	**0.7**	**1.0**	**1.0**	**0.6**	**0.7**	**0.9**	**3.2**	**3.0**	**3.3**
US	0.8	0.4	0.7	0.7	0.5	0.5	0.6	0.7	0.7	0.6	0.5	0.5	0.4	2.4	2.5	2.1
Euro Area	0.1	0.3	0.2	0.4	0.1	0.3	0.2	0.2	0.2	0.3	0.3	0.3	0.3	1.0	0.8	1.2
Germany	-0.4	0.2	-0.3	0.1	0.2	0.1	0.3	0.2	0.2	0.2	0.3	0.0	0.1	0.3	0.8	0.6
UK	-0.3	0.7	0.5	0.1	0.3	0.3	0.4	0.3	0.4	0.2	0.4	0.4	0.4	1.6	1.5	1.3
Japan	0.1	-0.6	0.5	0.2	0.5	0.4	0.3	0.3	0.3	0.2	0.2	0.3	0.2	0.7	1.3	0.9
Australia	0.2	0.2	0.2	0.5	0.6	0.8	0.5	0.5	0.5	0.6	0.6	0.7	0.7	1.5	2.3	2.6
Canada	0.0	0.4	0.5	0.3	0.5	0.7	0.4	0.5	0.6	0.5	0.6	0.6	0.6	1.8	2.3	2.3
China	1.3	1.5	0.5	0.9	2.0	1.6	0.4	0.6	1.6	1.6	0.7	0.8	1.4	5.0	4.3	4.8
India	2.1	1.3	1.1	1.9	2.3	1.3	0.9	1.8	2.0	1.8	1.0	1.6	1.8	6.9	6.2	6.3
South Korea	0.5	1.3	-0.2	0.1	0.6	0.5	0.7	0.6	0.5	0.3	0.5	0.4	0.4	1.8	2.0	1.7
South Africa	0.4	0.0	0.4	0.7	0.7	0.5	0.5	0.4	0.4	0.4	0.3	0.4	0.6	1.8	1.7	1.6
Türkiye	1.2	1.4	0.1	-0.1	0.1	0.9	0.4	1.3	1.2	1.3	1.1	1.2	1.1	2.1	3.9	4.7
Brazil	0.0	0.6	0.4	0.7	0.4	0.3	0.4	0.4	0.3	0.6	0.6	0.5	0.4	2.7	1.4	2.2
Mexico	-0.1	0.1	0.2	1.0	0.4	0.2	-0.2	-0.3	0.1	0.7	0.6	1.1	1.0	1.7	-0.1	3.4

Note: Forecasts for Russia are excluded here. However, the annual forecasts are included in Figure 2. Source : Deutsche Bank

For China, our economists believe momentum has improved thanks to the recent expansionary macroeconomic policies. They expect 4.8% GDP growth in 2025, with the boost to domestic demand lifting CPI to a 1-1.5% range by mid-2025. They anticipate that significant fiscal stimulus will be announced in March 2025 alongside the annual budget. However, the sustainability of the recovery is dependent on the property sector's performance and the impact of US-China trade tensions. The large inventory of unsold housing continues to depress prices and is a risk, but our economists believe a muddle through is the most likely outcome. China's exports to the US account for only 3% of China GDP today, and the impact of tariff hikes in line with our base case will be mitigated by exchange rate adjustments and trade reorientation to non-US markets. Nevertheless, a severe global trade war would impact China given its export model.

For the UK, domestic and external headwinds are picking up heading into 2025. As such, our growth forecasts have edged lower to 1.3% for 2025 with the BoE now only cutting four times as inflation proves sticky.

For Japan, a domestically driven recovery is likely to be fuelled by wage growth exceeding inflation, with the latter remaining around 2%. This should encourage the BoJ to lift the policy rate to at least 1% in fiscal year 2025 (i.e., by Q1 2026).

The beacon of global growth in recent years has been India and although GDP is slowing, our economists still believe it will be at 6.5% in 2025 and 2026. This will likely require some monetary policy support (2 cuts in 2025), particularly with a backdrop of sustained fiscal consolidation, which on the upside may help bring a rating upgrade that's important for international inflows. The USA and China are India's two largest trading partners, so the path of any trade war will be a swing factor for India.

Figure 5: DB forecasts: Unemployment rates, budget deficits and public debt

Unemployment (%)	2023	2024	2025	2026
US	3.6	4.1	4.1	4.0
Euro Area	6.6	6.5	6.8	6.9
Germany	3.0	3.5	3.6	3.4
UK	3.8	4.2	4.5	4.1
Japan	2.6	2.5	2.4	2.3
Budget deficit (% GDP)	**2023**	**2024**	**2025**	**2026**
US	6.2	6.6	6.4	7.0
Euro Area	3.6	3.7	3.5	3.1
Germany	2.6	2.0	1.8	1.8
UK	4.5	4.5	3.8	3.2
Japan	6.2	6.2	4.5	3.6
China - official budget deficit	3.2	3.0	4.0	4.0
China - augmented fiscal deficit	8.6	8.0	9.5	9.0
India (Consolidated)	8.4	7.6	7.1	6.9
Government debt (% GDP)	**2023**	**2024**	**2025**	**2026**
US	96.2	97.4	101.9	102.7
Euro Area	87.4	89.9	90.7	91.2
Germany	62.9	63.1	63.8	64.3
UK	97.8	98.4	96.9	97.0
Japan	251.4	251.2	246.0	242.8
China - central government debt	23.8	26.2	29.9	32.5
China - augmented public debt	96.8	101.2	106.3	109.5
India	81.1	80.3	79.4	79.0

Note: German unemployment rate is as per ILO definition. Source : Deutsche Bank

In terms of asset prices, the 10yr UST yield should hit 4.75% in 2025 with 10yr Bunds at 2.50%. The curve in Europe should steepen significantly with a front-end rally. Conversely our strategists believe the front end of the JGB market is vulnerable. In FX the highlight is a EUR/USD move to parity in 2025, but with a high beta to the uncertain tariff regime, and then to the European policy response which may lift the single currency as we move into 2026. In EM bonds and FX, our strategists don't believe the impact of Trump has been priced in, but the idiosyncrasies will mean a diverse set of outcomes that we detail in the piece.

Our equity strategists have been consistently and successfully bullish over the last decade, and they remain confident for 2025 with an S&P 500 target of 7000 with gains seen in Europe too as they believe the risks are priced in. For credit, 2025 starts at incredibly tight levels and as such the most likely outcome is wider spreads, even if this will be within the breakevens for most parts of the market.

For all economies and asset classes, a more severe trade war scenario is the most obvious risk, whilst the return of the bond vigilantes in the face of ever-growing fiscal deficits is an alternative risk. On the former, our economists estimate that a 40pp cumulative rise in tariffs on imports from China and a 10% universal baseline tariff (versus 20pp for China and 5% for UBT in our baseline), would reduce global growth and create a notable inflation divergence. That would see US core PCE ending 2026 nearer to 3.5%, but with European inflation a bit lower unless, or until, fiscal spending ramps up.

So in a Trump 2.0 world, the base case is a continuation of US exceptionalism, but the exact path and the global impact is very dependent on how President-elect Trump prioritises his conflicting policy objectives. At the moment we believe the growth agenda will be the priority, but acknowledge the uncertainties are extremely high. As we said at the start, business as usual is the least likely outcome.

Figure 6: DB forecasts - Central bank rates and market variables

Central Bank rates	Q4-23	Q1-24	Q2-24	Q3-24	Q4-24	Q1-25	Q2-25	Q3-25	Q4-25	Q1-26	Q2-26	Q3-26	Q4-26
Fed Funds Rate	5.38	5.38	5.38	4.88	4.38	4.38	4.38	4.38	4.38	4.38	4.38	4.13	4.13
ECB Deposit Facility Rate	4.00	4.00	3.75	3.50	3.00	2.50	2.00	1.75	1.50	1.50	1.50	1.50	1.75
BoE Policy Rate	5.25	5.25	5.25	5.00	4.75	4.50	4.50	4.25	3.75	3.25	3.25	3.25	3.25
BoJ Policy Rate	-0.10	0.05	0.05	0.25	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.00	1.00
Financials and Oil	**Q4-23**	**Q1-24**	**Q2-24**	**Q3-24**	**Current**	**Q1-25**	**Q2-25**	**Q3-25**	**Q4-25**	**Q1-26**	**Q2-26**	**Q3-26**	**Q4-26**
10Yr US Treasury (spot)	3.9	4.2	4.4	3.8	4.4	4.8	4.8	4.7	4.7	NA	NA	NA	NA
10Yr German Bund (spot)	2.0	2.3	2.5	2.1	2.3	2.5	2.5	2.5	2.6	NA	NA	NA	NA
10Yr UK Gilt	3.5	3.9	4.2	4.0	4.4	4.3	4.3	4.2	4.2	NA	NA	NA	NA
S&P 500 (spot)	4770	5254	5460	5762	5949	6400	6600	6800	7000	NA	NA	NA	NA
STOXX 600 (spot)	479	513	511	523	505	550	565	575	590	NA	NA	NA	NA
US HY (spot)	323	299	309	295	258	300	300	360	360	NA	NA	NA	NA
US IG (spot)	99	90	94	89	78	92	92	110	110	NA	NA	NA	NA
EUR HY (spot)	381	347	359	345	314	355	355	380	380	NA	NA	NA	NA
EUR IG (spot)	138	114	120	117	106	115	115	120	120	NA	NA	NA	NA
EUR/USD (spot)	1.10	1.08	1.07	1.11	1.04	1.03	1.00	1.02	1.03	1.05	1.07	1.08	1.10
WTI (avg.)	78.5	76.9	80.6	75.3	74.3	68.0	63.0	60.0	58.0	NA	NA	NA	NA

Source : Deutsche Bank
Note that the shaded columns represent the forecasted numbers.
Current values are as of 11:30 am UK time. Date: 22nd November, 2024
While we aim to keep a consistent narrative in our views, there are examples where some analysts have slightly different views on either the timing or direction of moves.

Jim Reid and David Folkerts-Landau

United States

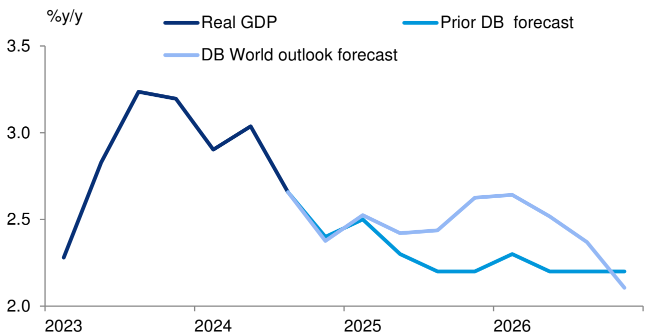
Summary: *The Republican sweep of the 2024 US election promises to bring transformative changes to the policy landscape. Details about the exact timing and parameters around these policies are highly uncertain. And shifts in fiscal and trade policy will provide crosscurrents to the growth outlook. We ultimately anticipate that modest tax cuts, a strong deregulation push, and more supportive financial conditions will produce faster growth in 2025, which we now see at 2.5% (Q4/Q4) versus 2.2% previously. Beyond next year, adverse effects from the trade war and a more restrictive monetary policy setting reduce our growth estimates modestly. This policy mix will stall progress on inflation, with core PCE expected to remain at or above 2.5% over the next two years, leading the Fed to undertake an extended pause. We now see the fed funds rate above 4% through 2026, a modestly restrictive stance relative to our elevated estimates of neutral (3.75-4%). Given the substantial policy uncertainties, we also detail how a more adverse trade scenario would impact our forecasts.*

We assume **a modest tax package legislated around mid-2025** including full extension of the TCJA along with a renewal of some business tax provisions (e.g., bonus depreciation) and an expansion of the child tax credit. In late 2025 or early 2026, we then anticipate a small cut to the corporate tax rate (to ~18%) and possibly an increase in the SALT deduction cap. The remaining campaign tax promises are not included in our forecast.

On trade, we expect the Trump administration to deliver on many campaign promises, though we expect an initial focus on more targeted tariffs. In particular, we expect a 10 percentage point increase in the tariff rate on imports from China in the first half of the year (ratcheting up a further 10pp in H2) and an equalization of tariff rates on motor vehicles with Europe. Our forecast also assumes a 5% universal baseline tariff, though that is more likely to be implemented late 2025/early 2026.

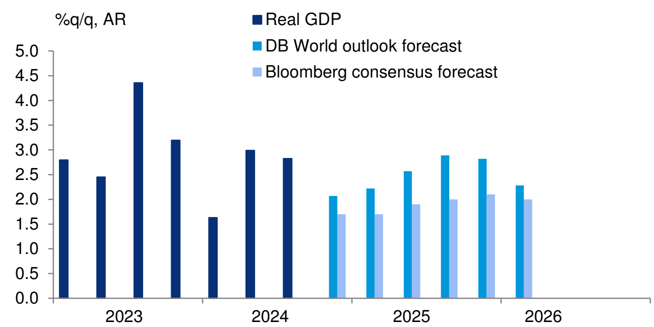
These policy shifts provide crosscurrents for growth. **Underlying growth momentum is solid**, particularly for the consumer, which has elevated wealth and savings and is supported by solid jobs and income growth. On the positive side, extension of the TCJA and modest additional tax cut measures, along with a deregulation push, positive confidence effects and an easing of financial conditions, will boost growth. However, the initiation of elements of a trade war counteracts some of these tailwinds. **On net, we now see 2025 growth closer to 2.5% from 2.2% previously (Q4/Q4)**. This upgrade is driven by private domestic demand categories, namely consumer spending and capex. Our growth forecast for 2026 faces the same crosscurrents, though we expect that the negatives will slightly dominate, as the impact of the trade war intensifies and monetary policy remains more restrictive as the Fed undertakes an extended pause in its cutting cycle. Our 2026 growth forecast falls mildly to 2.1% (Q4/Q4).

Figure 7: Significant upgrade to near-term growth outlook



Source : BEA, Haver Analytics, Deutsche Bank

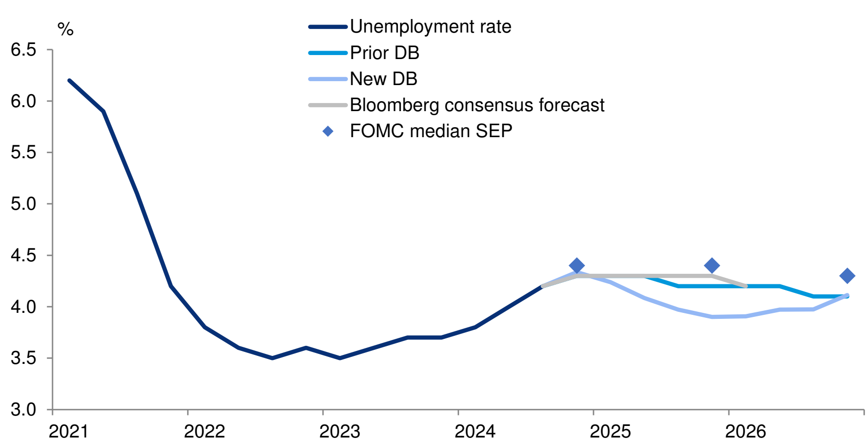
Figure 8: With growth expected to be meaningfully above consensus



Source : BEA, Haver Analytics, Bloomberg Finance LP, Deutsche Bank

Recent evidence of a diminution of downside risks to the labor market and a stronger tailwind to growth, at least in 2025, **lead to a lower unemployment profile across our forecast**. We now expect the unemployment rate to fall to 3.9% in 2025, in contrast to our prior forecast for it to remain above 4%. However, the labor market is not completely out of the woods in the near term, as resilient job gains continue to rely on low layoffs given soft hiring trends. An improvement in the latter, which we expect to become evident in the coming quarters, would fully alleviate concerns about recession risks.

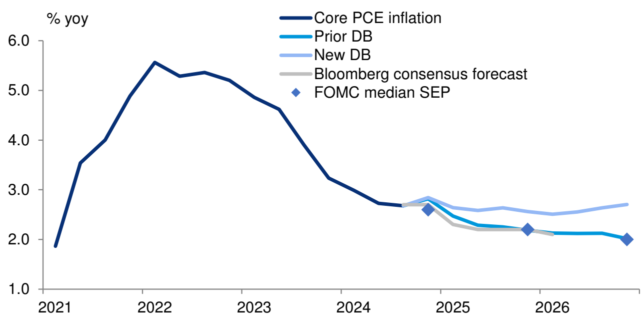
Figure 9: Unemployment rate now expected to decline modestly in 2025



Source :BLS, Haver Analytics, Bloomberg Finance LP, FOMC, Deutsche Bank

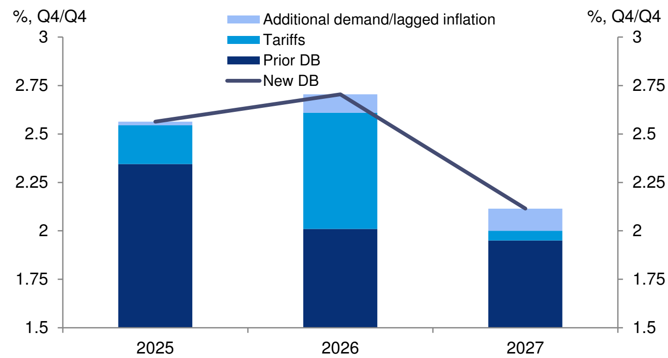
Against a backdrop of already slowing progress on inflation, **this policy mix will prove inflationary**. Core PCE inflation is revised higher due primarily to tariff effects and secondarily due to stronger demand and a somewhat tighter labor market. For 2025, our inflation forecast increases from 2.3% currently to 2.6% (Q4/Q4). Our inflation forecast rises by another 0.7 percentage points in 2026 to 2.7%, primarily driven by the impact of tariffs on inflation. Together these revisions would imply a stalling out in progress on the inflation front over the next two years. Outside of tariffs, shelter remains the most important driver of the inflation outlook. We have recently upgraded our forecast for this component given continued stickiness and research indicating there could be more price level catch up in the pipeline.

Figure 10: Inflation expected to remain sticky, more than 50bps above target



Source : BEA, Haver Analytics, Bloomberg Finance LP, FOMC, Deutsche Bank

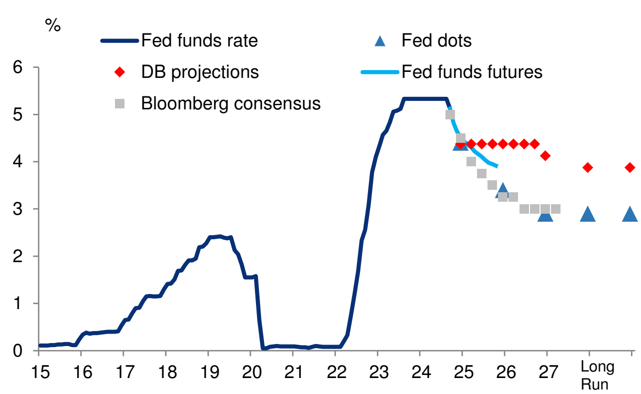
Figure 11: Inflation forecast revision mostly due to tariffs



Source : BEA, Haver Analytics, Deutsche Bank

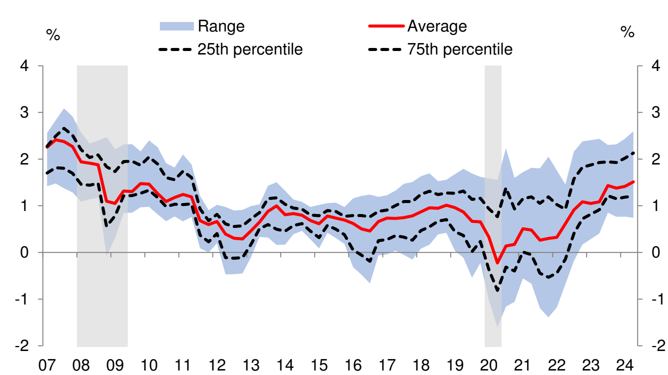
Our economic forecast revisions are hawkish for the Fed. While we maintain an expectation for a rate cut in December, we see heightened risks that the Fed skips a rate cut at that meeting. Thereafter, the case for cutting will fade, as growth remains resilient, downside risks to the labor market shrink, and inflation is stuck above 2.5%. **We anticipate the fed funds rate will end 2025 at 4.375%**, modestly above our estimates of neutral (3.75-4%). With an extended pause, it is plausible that two-sided risks to the Fed outlook reemerge next year (i.e., at some point they remove a cutting bias), particularly if inflation proves stickier prior to the tariffs, the labor market shows signs of reaccelerating, and especially if inflation expectations begin to more higher. We then anticipate the Fed would guide policy back towards a neutral rate of 3.75-4% over 2026 and 2027, as negative growth effects from tariffs become a headwind for private domestic demand and allow some modest reductions over time.

Figure 12: Fed expected to undertake extended pause above 4%



Source : FRB, Haver Analytcs, Bloomberg Finance LP, Deutsche Bank

Figure 13: R-star has risen meaningfully



Source : Deutsche Bank

With policy risks elevated it is prudent to consider alternative scenarios. **The most prominent risk to our baseline view is a more severe trade war.** If, instead, trade tensions continue ratcheting up in 2026, with a 40pp cumulative rise in tariffs on imports from China and a 10% universal baseline tariff (versus 20pp for China and 5% for UBT in our baseline), we anticipate growth would slip to around 1.75% in 2026 and 2027. However, inflation would be meaningfully higher, with core PCE ending 2026 near 3.5%. In this scenario we anticipate the Fed would hold rates steady at 4.3% as they attempt to look through the more significant price level shock and emphasize the rise in unemployment and weaker growth. But risks could rise that they need to raise rates further, especially if inflation expectations began to stir upwards.

Figure 14: Real GDP forecast and alternative scenario (Q4/Q4)

	2025	2026	2027
Prior DB forecast	2.2	2.2	2.2
DB World outlook forecast	2.5	2.1	2.1
Downside risk scenario	2.5	1.7	1.8

Note: The downside risk scenario is a more severe trade war. Source : Deutsche Bank

Figure 15: Core PCE (Q4/Q4)

	2025	2026	2027
Prior DB forecast	2.2	2.0	2.0
DB World outlook forecast	2.6	2.7	2.1
Downside risk scenario	2.6	3.5	2.1

Note: The downside risk scenario is a more severe trade war. Source : Deutsche Bank

A second downside risk would be a more aggressive approach to anti-immigration policies. According to a recent Brookings report, implementation of Trump's proposed immigration policies could dent growth by nearly 50bps (see here). Our own work found that the sharp rise in net immigration flows reduced core PCE inflation in 2023 by 25-50bps (see "How large was the inflation mitigation from immigration?"). A reversal of these immigration flows would therefore produce an adverse supply shock that would unwind this disinflationary impulse.

A final risk that we do not detail in depth is a return of the "bond market vigilantes", which push term premia and the long end of the curve materially higher as focus returns to elevated budget deficits and debt (we see budget deficits around 6.5% of GDP in 2025 and 7% in 2026). This risk would be amplified if the incoming Trump administration actively raised questions around Fed independence – this is not our baseline assumption. In this scenario, the long-end would need to build in more risk premia, which we expect would trigger a sharper tightening of financial conditions that could ultimately lead to a backtrack on fiscal or monetary initiatives.

There are also upside risks coming from a number of sources: (1) We and other economists have consistently underestimated growth momentum; (2) The incoming administration could place more emphasis on pro-growth tax and deregulation policies and less on trade policies; (3) If inflation does not pick up, the Fed could pursue a more accommodative stance; (4) There could be more lift to growth from channels that are difficult to quantify, including deregulation, confidence and financial conditions.

Needless to say, the economic outlook is particularly uncertain. We anticipate having to remain nimble as forecasters, adjusting our underlying assumptions as we gain greater clarity on the details around policy changes.

Matthew Luzzetti & Team

Euro Area

Summary: *A clear gap has opened in the relative performance of the US and European economies since the Ukraine invasion and energy shock in 2022. The policy stance of the incoming US Administration is likely to reinforce this gap in 2025 and in this World Outlook we are marking up growth, inflation and policy rates in the US in 2025 and marking them down in Europe.*

US tariffs will reinforce Europe's problem with weak competitiveness and increase the need for the EU to coalesce around its own strategic policy shift. Political fragmentation and high public debt are limiting factors in general. However, with Germany at the heart of the competitiveness shock and less constrained by its balance sheet, the policy course followed by the incoming government in Berlin has the most leverage over the outlook for Europe. The prospects for a policy shift are improving. However, the benefits are more likely to be felt from 2026, meaning the policy burden will rest on ECB shoulders in 2025.

Setting the scene: complex and vulnerable, but not without some hope

In our World Outlook twelve months ago we described the European economy as being in transition in 2024 but not reaching its new equilibrium.

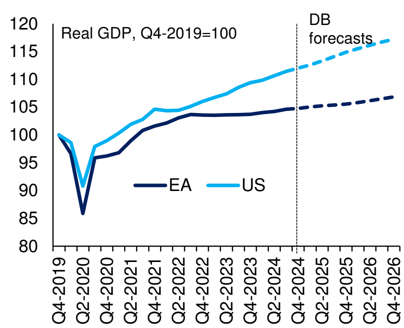
Cyclically, the dissipating supply shocks were expected to lift growth, reduce inflation and open the door to the normalisation of monetary policy. This has been broadly correct. Growth has been positive in 2024, an improvement after the stagnation of 2022-2023. However, the real income-driven consumption recovery has been slow to materialise. Growth has been largely export-led, and as such vulnerable to external shocks like US tariffs. Inflation has been declining more rapidly in recent months and the ECB is at least on course to removing policy restriction by mid-2025.

Structurally, there is a significant and growing challenge. The world is changing. More frictional geopolitics is exposing the vulnerability of the EU's trade-based economic model. Competitiveness has remained very weak despite gas prices returning to the pre-invasion level. 2024 was always going to be about the elections and how they define the new equilibrium for Europe and the path to it. The US election was going to reveal the extent to which the EU would need to change to achieve greater strategic autonomy in this more frictional world. The European elections were going to determine how easy or difficult it would be for that policy gap to be bridged by Europe.

Increasing political fragmentation within Europe and the need to consolidate public finances in the higher-debt member states complicates Europe's ability to coalesce around a new growth strategy to compete with the economic performance of the US. However, unlike the GFC/euro debt crisis and pandemic, the current shock (competitiveness) is centred on Germany, not the periphery. The first-best response should come from Berlin, where a leaner sovereign balance sheet and new government in early 2025 raise the potential for a constructive shift in strategy. What Brussels does with EU policy is not unimportant. The EU is ill-equipped for this more geopolitically frictional world and Mario Draghi has developed a roadmap to greater strategic autonomy. If Germany is underpinning its economic model, it will buy time for more challenged EU politics to work towards a new strategy.

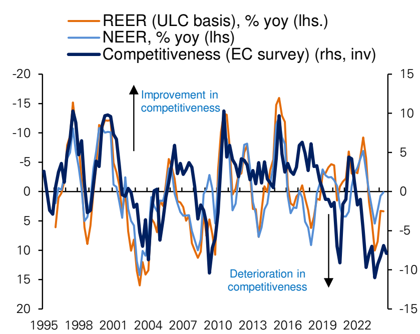
The prospects for stronger German policy are improving, but the benefits are not for 2025. Europe in 2025 is likely to be dominated by external events like US tariffs and the theme is likely to be US-EU "divergence". In this World Outlook we are marking up growth, inflation and policy rates in the US in 2025 and marking them down in Europe.

Figure 16: US-EU GDP divergence is set to grow in 2025



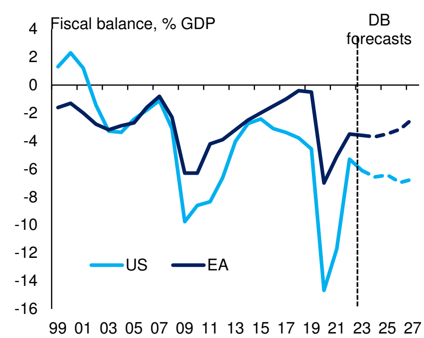
Source : Deutsche Bank, BEA, Eurostat, Haver Analytics LP

Figure 17: Europe is suffering from a competitiveness shock



Source : Deutsche Bank, ECB, Eurostat, Haver Analytics LP

Figure 18: Europe is consolidating public finances while the US goes the other way

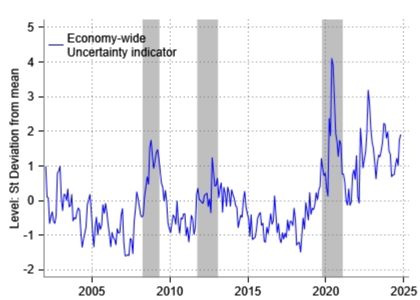


Source : Deutsche Bank, CBO, EC, Haver Analytics LP

Growth: Marked down, but avoiding recession

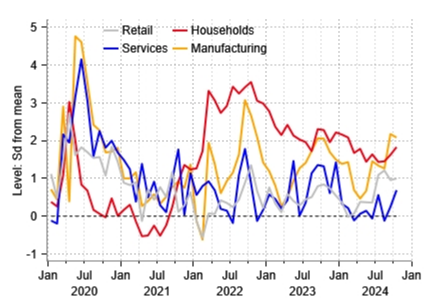
We have downgraded the euro area growth outlook. We now expect 0.7% in 2024 (-0.2pp), 0.8% in 2025 (-0.7pp) and 1.0% in 2026 (-0.2pp). In other words, we have downgraded growth from slightly above trend in our June WO update (1.2% average over 2024-2026) to slightly below trend now (0.8%).

Figure 19: Economic uncertainty has increased again lately. Is this the anticipation of tariffs?



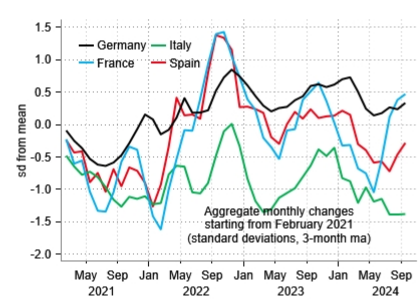
Source : Deutsche Bank, Macrobond

Figure 20: Higher uncertainty in the manufacturing sector say yes



Source : Deutsche Bank, Macrobond

Figure 21: Higher uncertainty in France implies different drivers (politics, budget), meaning a tariff shock remains possible



Source : Deutsche Bank, Macrobond

There is a lack of obvious growth drivers for 2025. Germany will continue to struggle with weak competitiveness. France is having to consolidate its public finances sharply. Italy is consolidating too. Having lent resilience to the economic cycle in 2022-2023 during the energy shock and sharp tightening of monetary policy, the labour market is softening. This will weigh on income and consumption.

Uncertainty is rising, which incentivises savings over consumption and investment.

To this weakening underlying picture we now add US tariffs. Our baseline assumption sees the Trump Administration applying 7.5% tariffs on autos and parts by mid-2025 and a 5% universal tariff by early 2026 (and 20% tariffs on China in two steps through 2025) with a threat of further increases. We previously estimated the cost to Europe of 10% universal tariffs at 0.5-0.9pp of GDP. Given a lower likely starting point for tariffs, we have scaled down the shock and are factoring a 0.3-0.4pp hit to GDP into our forecast, spread over 2025-2026.

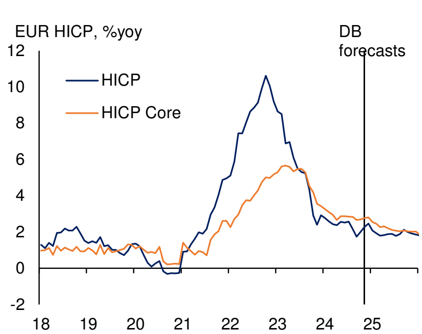
Inflation: Heading for a more persistent but moderate undershooting of the target

In our June WO we were expecting headline HICP inflation to average 2.4% in 2024, 2.0% in 2025 and 2.2% in 2026. The latter two forecasts had already declined 0.1pp to 1.9% and 2.1% prior to the US election. In this WO, we are reducing the 2026 forecast a further 0.2pp to 1.9%. In other words, inflation is expected to be a little below the ECB's 2% target on a more persistent basis.

The dominant inflation narrative through 2024 has been the 'long last mile' of disinflation. This reflected fast wage growth and sticky services inflation. More recently, the narrative switched to 'sprint finish' and HICP falling to target more rapidly. We are more confident that services inflation will turn down in early 2025. The inflation remains cost-push, not demand-pull. Wage growth is peaking and, given the hit to the economy from tariffs, unions are more likely to accept lower pay settlements in exchange for job guarantees.

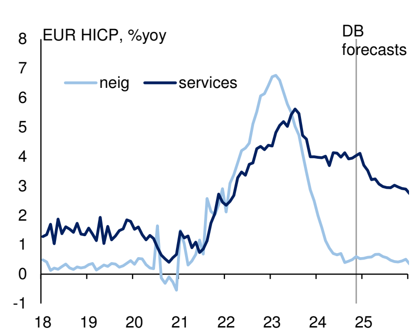
The new narrative is 'undershooting risk'. We are already expecting HICP to be below target from early 2025, six months before the ECB, and we have lowered the 2026 forecast to c.20bp 1.9%. This downgrade reflects weaker GDP growth weighing on services inflation via a higher unemployment rate and lower wage growth. US tariffs also play a role. Although a weaker euro exchange rate adds to goods inflation, we assume some imported disinflation from China via shorter delivery times. We expect the EU to implement safeguarding counter-tariffs on China, but we see a risk that China's excess capacity is disinflationary in general.

Figure 22: HICP inflation expected to be a little below the 2% target in 2025 and 2026



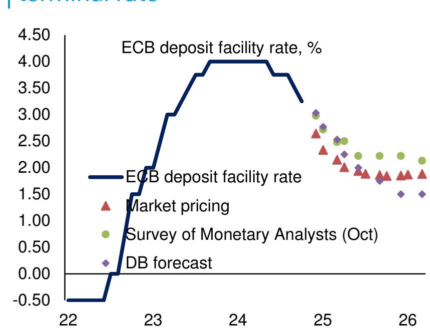
Source : Deutsche Bank, Eurostat, Haver Analytics LP

Figure 23: Core goods (NEIG) inflation is already low, services inflation expected to ease in 2025



Source : Deutsche Bank, Eurostat, Haver Analytics LP

Figure 24: We expect the ECB to cut to neutral by mid-2025 and below neutral by end-2025 with a 1.50% terminal rate



Source : Deutsche Bank, ECB, Bloomberg Finance LP

Monetary policy: In need to a mildly stimulative stance

We have lowered our ECB terminal rate forecast from 2.25% in mid-2025 to 1.50% at end-2025. We view neutral as 2.00-2.50%. In other words, we have cut the ECB view from a neutral policy stance to a mildly stimulative stance.

Our baseline has the ECB cutting in 25bp increments at the next five meetings until June 2025, followed by 25bp cuts in September and December 2025. 50bp steps are a close call. Policy rates are still well above neutral today. If upcoming data are weaker than expected, the ECB could cut by 50bp in December 2024. Alternatively, once services inflation slows meaningfully in Q1 and when the ECB captures more accurately the ramifications of the new US policy stance in the staff forecasts (more likely in March than December), there could be pressure on the ECB to cut in larger steps in early 2025.

Given the high degree of uncertainty around the tariffs (how much, when, the impact, the response, etc), we see the ECB terminal rate in a "landing zone" of 1.00-1.75% in 2025. In other words, we see some upside risk relative to our 1.50% baseline, but more downside risk.

The ECB terminal rate will depend on many things. One factor is fiscal policy (more below). Another is the impact of the tariffs on Germany. The less pessimistic argument, which is closer to our baseline, is that with competitiveness already very weak, tariffs might not have a big additional impact on the economy. The more pessimistic argument is that tariffs will be a tipping point and trigger a more disorderly adjustment by firms to the competitiveness challenge in terms of cutting employment and capex much more sharply.

A further factor is the path of oil prices. Geopolitical risk might push oil prices higher temporarily but if OPEC+ intends to build market share by increasing production and lowering the price, there could be a big drag on HICP inflation with echoes of US shale production in 2014.

Fiscal policy: Germany could take the edge off Europe's tightening stance

A key factor that will help determine the terminal rate is fiscal policy. Our baseline assumes consolidation in the euro area fiscal stance in 2025, dominated by France and Italy. Even accounting for NGEU spending, we expect the fiscal impulse to tighten by 0.7pp of GDP in 2025. This is a little tighter than assumed in our June WO.

The larger is the economic shock from tariffs, the higher is the likelihood of a more accommodative fiscal stance. The 4-year fiscal adjustments under the new EU fiscal rules mean there is scope to adjust the timing of consolidation. However, the most significant moving piece in the euro area fiscal stance will be what Germany decides to do.

The recent collapse of the government in Berlin and the bringing forward of the election to February 2025 from September 2025 opens the prospect of change. We expect the constitutional debt brake to be maintained by a probable CDU/CSU-SPD government. However, we expect a new off-balance sheet defence fund. Technically, this will allow the increase in defence spending since 2022 to be maintained, meaning the fiscal impulse won't tighten when the resources in the first defence fund are exhausted. We also see a decent chance of an off-balance sheet infrastructure fund (a competitiveness policy). However, both funds require the mainstream parties (including Greens, excluding FDP) to have a two-thirds majority of seats in the Federal parliament.

Much defence spending leaks out of Europe. Infrastructure spending, on the other hand, represents domestic stimulus. However, to target infrastructure spending appropriately requires time for planning. Even if an infrastructure fund was approved in 2025, the funds might not start hitting the economy until 2026. We assume the German fiscal stance rotates from a tightening of 0.3% of GDP in 2025 to an easing of 0.25% in 2026. This moderates the euro area fiscal stance from a tightening of 0.7pp of GDP in 2025 to a tightening of 0.2% in 2026 (about 15-20bp less tightening due to the German infrastructure fund). Hence, the pressure will remain on the ECB to ease the monetary stance in 2025.

Alternative scenario: Risks skewed to downside, initially

In the baseline scenario, we assume 7.5% auto/parts tariffs in H1-25 and 5% universal tariffs around the start of 2026. In an alternative scenario, we assume a further escalation of trade war with universal tariffs rising to 10-20% during 2026. In this scenario, the euro area GDP growth forecast would be largely unchanged at 0.8% in 2025 and slow to 0.5% in 2026 (0.5pp below baseline). The downside is limited by the assumption that further tariffs are more likely to galvanise Germany and the EU into a stronger strategic policy response to the competitiveness shock. This is likely to encompass fiscal and structural policy. The recent Draghi report on competitiveness is a guide to the EU response (more EU public goods like energy and defence; reforms of the Single Market and support for innovation; accelerated Capital Markets Union as a means to increase funding, etc).

There may be some initial growth benefits already by end-2026, but the main impact would likely be more visible from 2027 with GDP growth of c.1.5-2.0%. With a strong structural response, European trend growth could rise 0.25-0.50pp to 1.5%. Under the alternative scenario, HICP inflation is likely to be a little lower in 2026 (c.1.75%) and would probably remain below target in 2027 (1.8-1.9%) before the fiscal stimulus pushes growth enough to retighten the labour market and push wage growth and services inflation above baseline and HICP back above target. Further euro exchange rate weakness could limit the decline in inflation – although a strong structural response could be positive for the euro exchange rate. In this scenario, ECB policy rates could decline from 1.5% in 2025 to 1% in 2026 before retightening and returning to neutral in 2027.

Other risks

Maybe we are overstating the hit from tariffs. A shock that is anticipated could be less costly and uncertainty had already risen a lot ahead of the US election. Real income growth remains strong and may yet translate into a stronger recovery in consumption, especially if the uncertainty shock was anticipated and the labour market remains resilient. Our credit cycle indicators are rising too. If this continues, it could support stronger domestic demand. It speaks of the effective transmission of monetary policy.

On the downside, weaker growth could be destabilising for France and its need to rebalance its public finances. If labour hoarding fades, wage demands could unwind more rapidly. This could see services inflation slow more than expected and increase the risk of a chronic inflation undershoot.

Finally, the status of the conflict in Ukraine is uncertain. Trump 2.0 may press for a deal between Ukraine and Russia. Both sides are vying for the strongest position they can achieve before Mr Trump lands in office. So there could be escalation first before potential peace talks that could still have a wide range of outcomes. The chances of a ceasefire that reduces the uncertainty from the region are higher than in 2024. However, an ongoing war and even escalation remain very possible. Either way there is likely to be pressure on Europe to raise defence spending.

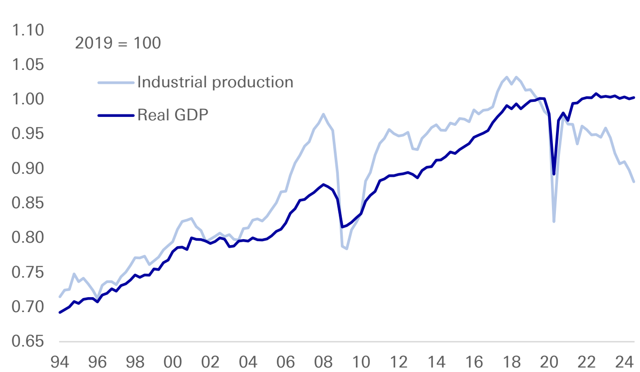
Mark Wall & Team

Germany

Summary: *Germany is looking back at another year of economic stagnation. The outlook for 2025 is only somewhat better: we expect the economy to grow by 0.5%. The window for a consumption rebound is closing as the labour market cools. Investment will likely remain anemic, as structural competitiveness problems risk being exacerbated by deteriorating global trade relations. More expansionary fiscal policy under the next government could offset the slump in private investment, but not before 2026. The unemployment rate is likely to rise only marginally to 6.3% next year, with a cooling labour market primarily being reflected in nominal wage growth slowing to about 3%. Headline inflation should average around 2.2% next year, whilst core inflation should decelerate to 2.5%.*

A structural stagnation beckons. The German economy most likely contracted slightly in 2024, for a second year in a row. This is not so much a cyclical recession as a structural stagnation that started well before the pandemic. Germany's economy is no larger today than in 2019, and its industry has contracted by 15% since 2017 in terms of production volumes. This is the most pronounced bout of economic weakness in German postwar history. The outlook for 2025 is only marginally better: we expect the economy to grow by 0.5% on the year. A meaningful recovery will most likely need to wait until 2026 and require more expansionary fiscal policy and effective supply side reforms under the next government.

Figure 25: The slump in German industry has resulted in structural stagnation



Source : Deutsche Bank, Haver Analytics

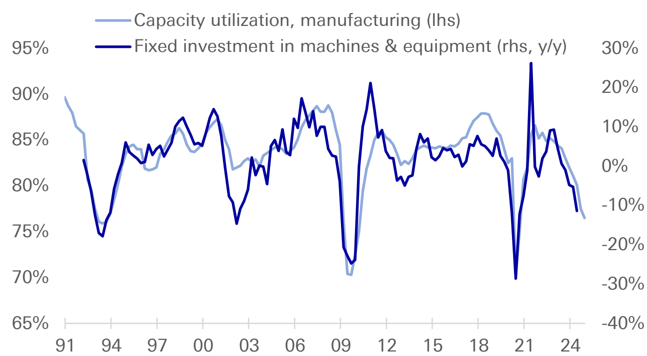
Figure 26: German consumers lack confidence despite solid income growth

Source : Deutsche Bank, Haver Analytics

Consumption is the only source of growth. As in much of Europe, German households have been reluctant to spend out of decent wage real income gains over the last year. For various reasons German households continue to lack confidence, and saving rates are likely to normalize only slowly. With real wage growth about to slow next year and layoffs in industry likely to continue, the window for a meaningful consumption rebound is closing. That said, private consumption is likely to be the main source of growth next year, and public consumption is also set to remain a gentle tail wind, even in the absence of fiscal policy changes.

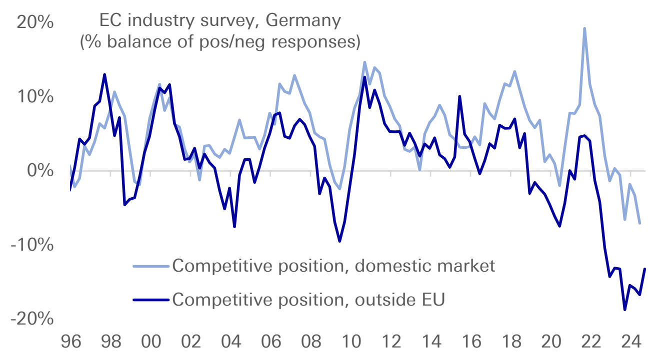
Investment spending will stagnate at best. A slump in private investment has been the main drag on growth in recent years. Residential investment has been in a cyclical recession, triggered by high financing and construction costs as well as by regulatory shocks. We expect only a gentle recovery in the second half of the year as these headwinds ease and pent-up demand materializes. Business investment however is unlikely to rebound next year, given that capacity utilization in manufacturing is yet to find a bottom.

Figure 27: The continued decline in industrial capacity utilization weighs on capex spending



Source : Deutsche Bank, Haver Analytics

Figure 28: German manufacturing is losing competitiveness abroad and increasingly at home



Source : Deutsche Bank, Haver Analytics

A brave new world for German exports. The prospect of higher US tariffs and the threat of a global trade war will not only weigh on business investment but further challenge German export competitiveness. German businesses no longer just see competitiveness problems in global markets, but also increasingly in the home market. These export headwinds will only strengthen incrementally and be partly offset by weaker import growth, but the times of export-led growth are over.

Fiscal cavalry not arriving before 2026. There is a decent chance that the next government will ease the constitutional debt brake to allow for more debt-financed infrastructure investment. There remains considerable political uncertainty around such a fiscal regime shift, however, and in any case the spending would only kick in from 2026 at the earliest. In the meantime, economic policy uncertainty is likely to remain high in the first half of the year, holding back private investment.

Cooling labour market weighs on wage growth. The German labour market is cooling noticeably. The registered unemployment rate is set to rise next year and could reach the pandemic peak of 6.4%. Yet the brunt of a cooling labour marker will likely be borne by wage growth. The most recent wage agreement in the metal industry points to unions losing bargaining power. There are not many wage rounds next year, however, and we still expect wage growth of 3.0%, down from about 5.5% this year.

Inflation to stabilize just above target. Slowing wage growth will contribute to a deceleration in core inflation to an annual average rate of 2.5% (national definition) in 2025. The bulk of this decline will come from services inflation, which we expect to slow from 3.8% this year to 3.0% next year. Notwithstanding this decline in core inflation, headline inflation is likely to stay at this year's average rate of 2.2% because of slowing energy price deflation.

Robin Winkler & Team

United Kingdom

Summary: *Domestic and external headwinds are picking up heading into 2025. We shave off nearly 0.4pp from our GDP growth projections between Q4-24 and Q4-26, with GDP growth hitting 0.9% this year (previous: 1%) next year reaching 1.3% (previous: 1.5%), before rising to 1.4% (previous: 1.6%) in 2026. The slowdown in growth will likely create some more slack in the economy – pushing unemployment higher, and wage growth lower over the next year or two. We see inflation picking up from 2.5% this year to 2.9% in 2025 given administrative tax changes, the national living wage (NLW) hike, and the pass-through of higher employer national insurance contributions (NICs). We still expect inflation to return to target in 2026. We see the Bank of England (BoE) cutting Bank Rate four times next year (previously, five), with only one rate cut now seen in H1-25. The risk is that the MPC continues at its current pace of quarterly rate cuts taking a more forward looking view on policy, given labour market weakness.*

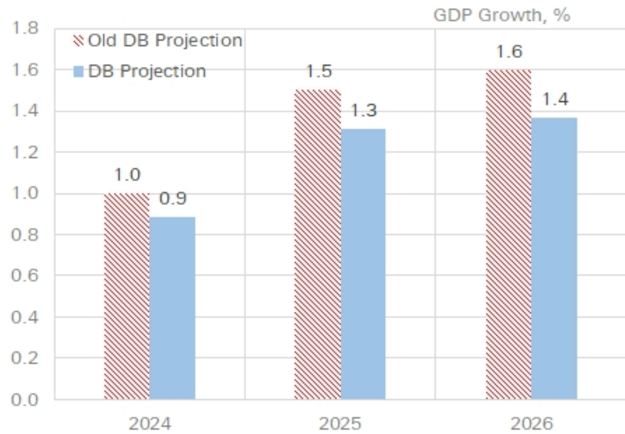
Public sector boom – but headwinds have gathered pace. On the positive side of the GDP ledger, fiscal stimulus is now expected to provide a material uplift to GDP, relative to our previous projections. Indeed, the recently delivered Autumn Budget was big - with historic spending increases and a historic increase in investment. Overall, we see government spending rising by 3% in real terms next year (previously: 1.5%, before settling at 1.5% in 2026).

What's the bad news? Relative to our previous growth update, big tax rises will hit private demand. With the Autumn Budget tax raising measures set to raise an additional GBP 25bn next year (relative to the Spring Budget forecasts), we expect household consumption and business investment growth to be trimmed. The rise in employer national insurance contributions (NICs) itself will hit private demand by a meaningful GBP 19bn in 2025/26 (gross), weighing on private spending. Higher taxation, higher inflation, lower employment, and lower wage growth will result in a smaller real disposable income growth uplift than we previously anticipated, and likely crowding out some business investment plans.

Externally, geopolitical risks have risen too. The spectre of a wider and deeper trade war looms over Europe, which will have important direct and indirect ramifications. A universal tariff of 10% met by equivalent retaliation could knock off around 0.4pp from UK GDP, ignoring any policy stimulus. The hit to continental Europe will also weigh on UK GDP via a weaker external backdrop. But given our baseline, we expect this to be slow moving, with the bulk of the trade war impact feeding through from 2026 onwards. There's plenty of uncertainty baked into our projections. Policy stimulus to cushion against any potential trade war escalation would soften the blow to demand. And there remains considerable uncertainty as to the scale and scope of any tariff increases directed either to Europe or indeed China – both of which will eventually feed through into the UK in varying degrees.

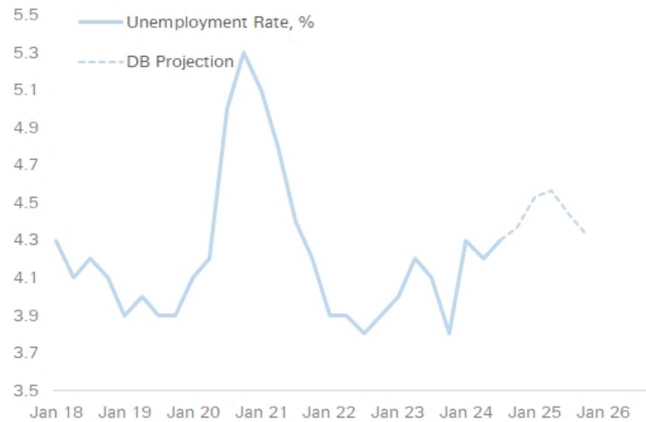
Altogether, we see GDP this year hitting 0.9% (previously: 1%), before touching 1.3% in 2025 (previously: 1.5%), and rising to 1.4% in 2026 (previously: 1.6%).

Figure 29: We've toned down our GDP projections across 2024-2026



Source : Deutsche Bank, Macrobond

Figure 30: We see the jobless rate rising faster and higher than the MPC – touching 4.6% in Q2-25



Source : Deutsche Bank, Macrobond

The labour market will likely weaken in 2025. We expect the labour market to loosen further over the coming quarters. Recruitment difficulties have eased meaningfully in recent months. Vacancies have fallen sizeably. And hiring intentions have come off too – as per recent business surveys. Upward pressure on corporate costs, via both the hefty hike in employer NICS and the increase to the National Living Wage (NLW) will trim payrolls. We expect the unemployment rate to rise to 4.6% by Q2-25, before slowly trending lower through the second half of next year. What about wages? Notwithstanding the near 7% increase to the NLW, private sector pay deals will likely narrow next year. Given the cooling labour market, and lower expected inflation this year (and next), we see private sector pay settlements trending closer to 3.75% in 2025.

Near-term price momentum to pick-up slightly, but inflation still on track to meet BoE's target in the medium-term. There are several moving parts to our inflation projection. First, recently announced tax administrative price changes in the Autumn Budget have added nearly 15bps to our CPI projections (that's on top of what we already projected in anticipation of some tax changes prior to the Budget). Second, we push through another 30bps into our 2025 CPI projections, owing to the increase in employer NICS, which will absorb a large chunk of our estimated price impact. We expect this to feed through from early next year, with the price adjustment likely to be complete by Q2-25. And third, we expect slightly reduced demand from tax rises to knock off 15bps from our CPI projections. Updating for recent market conditioning paths on energy, FX, and rates, this leaves our headline CPI projections roughly 30bps higher, relative to our previous forecasts.

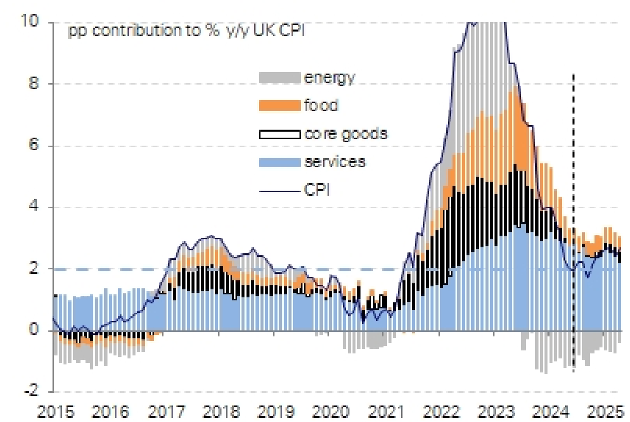
Where do we see CPI? We expect headline CPI to push to run closer to 2.9% y-o-y next year (from 2.5% this year). Lower wage settlements and higher unemployment, we expect, will push CPI back to 2% y-o-y in 2026.

The BoE will continue to cut rates – but the quantum and speed of rate cuts seems more uncertain now. Given the material changes to our CPI projections, we now see a slower dial down of restrictive policy in 2025. Instead, of five rate cuts in 2025, we now see a total of four rate cuts next year. And we now expect the easing cycle to be more backloaded.

We expect the MPC to push through only one rate cut in H1-25, taking Bank Rate to 4.5% in Feb-25. We expect the MPC to hit pause on any further rate cuts over the remainder of H1-25, given seasonal price changes through late Q1-25 and Q2-25 as a result of both the NLW hike and the increase in payroll tax via employer NICS. Thereafter, we expect the MPC to cut rates in Aug-25, Nov-25, and Dec-25 taking Bank Rate to 3.75% by year end. We expect two further rate cuts in 2026 (Feb, Mar), leaving our terminal Bank Rate projection of 3.25% unchanged. Indeed, we continue to think that the medium-term picture remains unchanged when it comes to inflation and the labour market, with a normalisation in price dynamics in the medium-term still our basecase – albeit with a slight bump through H1-25.

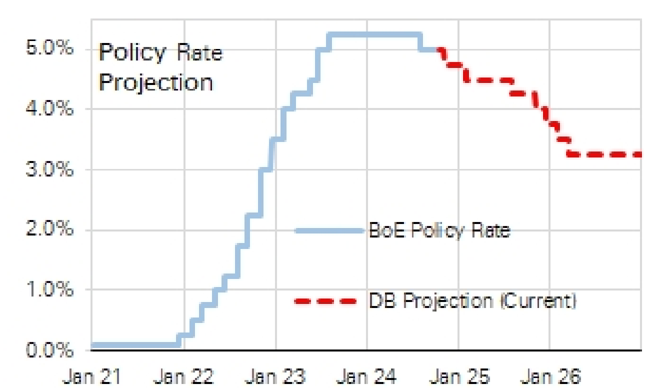
Risks abound, however. But the main risk we see heading into 2025 is that the MPC continues on a gradual easing cycle, delivering quarterly rate cuts at a quarterly pace in spite of big upward price adjustments. Why would the MPC do this? Simply, because the MPC may start to put more stock in the labour market data, where unemployment is expected to rise further and wages slow potentially by more than the MPC anticipates, allowing the BoE to take a more forward-looking path on policy. Incoming survey data will tell us more about how corporates are likely to behave in lieu of big tax changes and how this will impact the real economy.

Figure 31: Headline CPI expected to be stickier given announced tax changes, but expected to converge to target in 2026



Source : Deutsche Bank, Haver Analytics LP

Figure 32: Bank Rate path points to gradual and more backloaded dial down of restrictive policy –



Source : Deutsche Bank, Macrobond

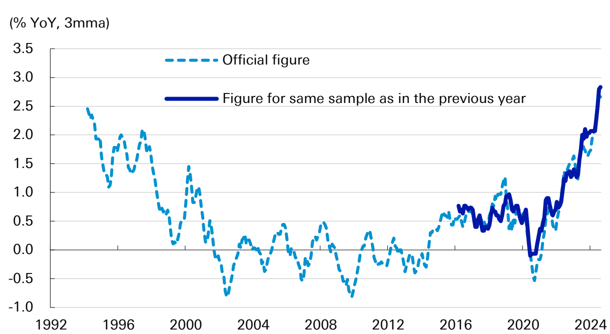
Sanjay Raja

Japan

Summary: *Over the next two years, we anticipate a domestically driven recovery in the Japanese economy, fueled by wage growth exceeding inflation. Based on currently available information, we believe uncertainties surrounding overseas economies will not materially impact Japan. Inflation, excluding the effects of government stimulus packages, should remain around 2%. In this context, we reiterate our forecast of a Bank of Japan (BoJ) policy rate hike to at least 1% in fiscal year 2025 (i.e., by Q1 2026). However, the uncertain political landscape, both domestically and internationally, could influence BoJ monetary policy.*

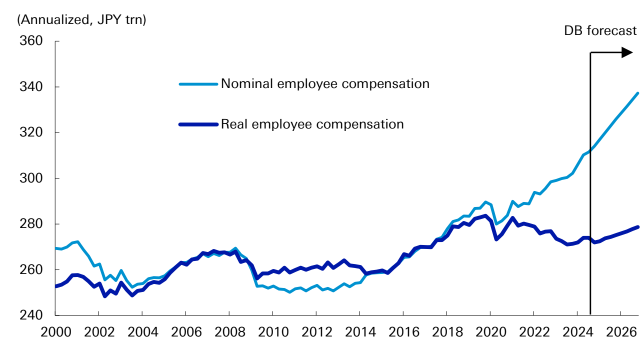
Growth Outlook: We have revised our 2024 growth forecast downward from 0.4% in our June World Outlook to -0.3%. This revision is primarily attributable to weaker-than-expected overseas demand. Our previous assumption of a 0.4 percentage point positive contribution from external demand has been adjusted to a negative 0.2 percentage point contribution, reflecting higher-than-anticipated import growth and lower-than-expected export growth. Our domestic demand forecast remains largely unchanged. It should be noted that the government's retroactive downward revision of past public investment data in GDP statistics, announced on 1 July, mechanically lowered our 2024 forecast by 0.2 percentage points. Excluding this technical adjustment, our domestic demand forecast has actually improved since June. We anticipate above-potential growth in 2025-2026.

Figure 33: Scheduled cash earnings (base salary) for full-timers



Note: Establishments with 5 employees or more.
Sources: MHLW, Deutsche Securities

Figure 34: Compensation of employees



Sources: Cabinet Office, Deutsche Securities

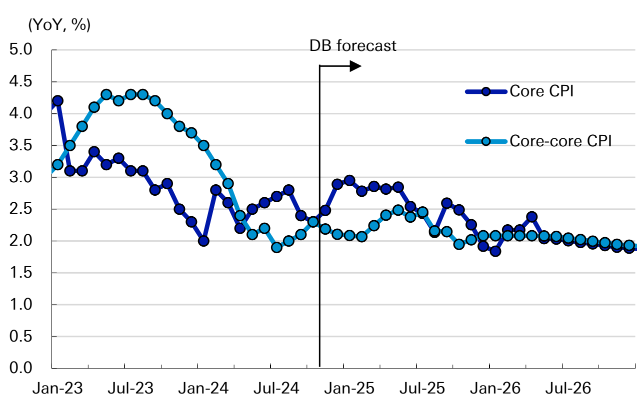
Underpinning the upward trend in domestic demand is accelerating wage growth. The Monthly Labor Survey indicates that scheduled cash earnings (base salary) are rising by approximately 3%, consistent with the results of this year's shuntō spring wage negotiations. This growth exceeds the inflation rate, signifying an upward trend in real employee compensation. We expect next year's shuntō negotiations to yield similar wage increases, thereby sustaining the upward trajectory of real employee compensation and supporting consumption.

A key factor for overseas economies will be US fiscal and tariff policy. Our US economic research team anticipates an expansionary fiscal policy coupled with tariff levels lower than those threatened by Mr. Trump prior to the election. We believe the positive effects of increased US fiscal spending will offset the negative impact of higher tariffs, resulting in a limited net effect on the Japanese economy.

Inflation Outlook: Energy prices are expected to remain volatile due to government economic policies. We anticipate the government will extend its gasoline subsidies in December, albeit at a reduced level. These subsidies currently reduce CPI inflation by 0.26 percentage points, but we estimate the revised measure will have a negative 0.09 percentage point impact. We also expect the government to reinstate subsidies for electricity and gas in Q1 2025, which will lower CPI inflation by 0.33 percentage points during that period.

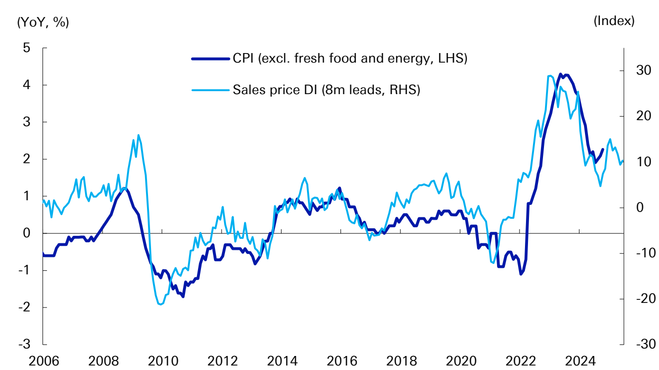
Core-core CPI inflation (excluding fresh food and energy, which are unaffected by these factors) should remain stable at approximately 2% YoY. We have revised our 2024 core-core CPI forecast upward from 2.2% to 2.4%, while our outlook for 2025-2026 remains unchanged. Although our figures remain above consensus, the likelihood of inflation aligning with our forecast is increasing. The Japan Finance Corporation's sales price DI, a leading indicator for core-core inflation, suggests continued steady core-core inflation of around 2%. Corporations remain inclined to raise prices in anticipation of wage increases next year. If tariffs align with our projections, inflation next year should be close to the BoJ's price stability target.

Figure 35: Inflation outlook



Sources: MIC, Deutsche Securities

Figure 36: CPI and SME inflation expectation



Sources: Haver Analytics, JFC, Deutsche Securities

Fiscal and Monetary Policy Outlook: Since assuming office in October, Prime Minister Shigeru Ishiba has shifted from his previous emphasis on fiscal consolidation to a more expansionary fiscal stance. This shift has intensified following the recent general election, which resulted in the LDP-Komeito coalition losing its majority in the Lower House and consequently increased the political influence of the Democratic Party for the People (DPP), a proponent of expansionary fiscal policy.

This year's supplementary budget is expected to be ¥13.9 trillion, slightly exceeding last year's ¥13 trillion. Consequently, we estimate the general government fiscal deficit-to-GDP ratio in FY2024 will be almost the same as in FY2023. We anticipate a gradual decrease in the fiscal deficit-to-GDP ratio in 2025–2026. However, we have not incorporated the substantial spending increase advocated by the DPP, given the uncertainty surrounding its scale and timing. Should the government proceed with the proposed increase in the income tax threshold, it would forgo approximately ¥7.6 trillion (1.2% of GDP) in annual tax revenue. Furthermore, the reduction in gasoline taxes will decrease revenues by an additional ¥1.5 trillion

(0.2% of GDP).

Regarding monetary policy, we maintain our view that the BoJ will raise its policy rate approximately every six months, reaching at least 1%. This projection remains more hawkish than the market's implied forecast based on overnight index swap (OIS) rates. Our June World Outlook predicted a July rate hike, which, while likely surprising to many market participants, proved accurate. We anticipate the next rate hike (from 0.25% to 0.5%) will occur in December. While the subsequent tightening pace remains uncertain, we project further increases in Q3 2025 (from 0.5% to 0.75%) and Q1 2026 (from 0.75% to 1%). The BoJ is likely to proceed cautiously, given its lack of experience with rates above 0.5% for approximately thirty years, and the need to assess the impact of its actions over at least a six-month period.

Risk Factors: We acknowledge heightened risks to our forecasts. The Trump administration's tariff policy could prove more aggressive than we assume, increasing downside risks to the Japanese economy and potentially hindering the BoJ's ability to raise rates. Conversely, we see a growing possibility of more expansionary fiscal policy by the Japanese government, which could elevate the terminal rate for the BoJ's rate hikes and influence the pace of its Japanese government bond (JGB) purchases. Furthermore, the domestic political outlook could become further complicated depending on the upcoming budget deliberations and the Upper House election expected in July 2025. This political instability could constrain the BoJ's ability to adjust policy. A delay in rate hikes due to political factors could exacerbate yen depreciation. Therefore, the BoJ will have to maintain close communication with the government and carefully assess the appropriate timing for rate adjustments.

Kentaro Koyama

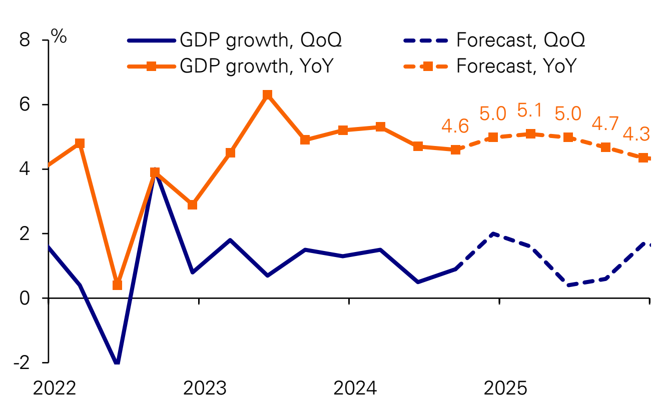
China

Summary: *China's growth has improved following the implementation of expansionary macroeconomic policies. The sustainability of this recovery depends on the property sector's performance and the impact of US-China trade tensions. We forecast real GDP growth of 4.8% in 2025 and 4.6% in 2026, assuming a "muddle through" scenario in the property market with slow price declines and modest sales increases, and phased US tariff hikes capped at 20% with mitigated impact due to trade flow reorientation. Expansionary policies, including direct fiscal spending, local government debt swaps, monetary easing, and bank recapitalization, are expected to boost domestic demand and lift CPI inflation to 1-1.5% range by mid-2025. Key downside risks include further property market deterioration and a more severe trade war.*

China's economic growth has regained momentum since September, thanks to government policies aimed at boosting domestic demand. However, two key uncertainties cloud the outlook: the persistent property sector downturn and the potential escalation of US-China trade tensions. The economic trajectory for 2025 and beyond hinges on developments in these two areas.

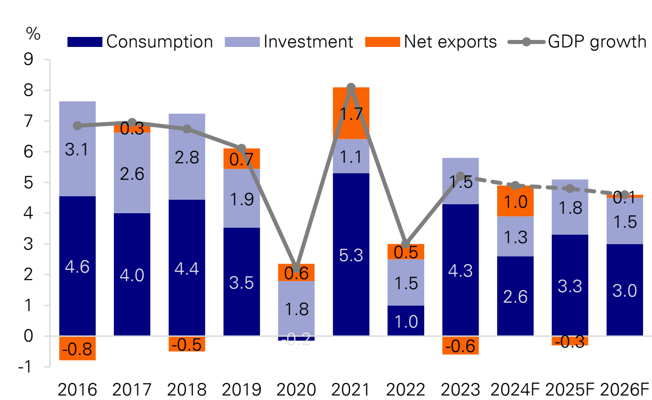
Our baseline forecast - assuming a property sector that muddles through and limited US tariff hikes - is an average annual growth of 4.8% and 4.6% for China in 2025 and 2026, respectively. Quarterly growth is expected to slow to 4.3% in Q4 2025 from above 5% in Q1 2025, and rebound thereafter assuming no further tariff increases in 2026 and beyond. Domestic demand is expected to strengthen on the back of fiscal expansion and a confidence recovery, while the contribution from external demand is expected turn negative again. As a result of stronger domestic consumption and investment, we expect China's CPI inflation will rebound to 1% - 1.5% by mid-2025.

Figure 37: We forecast China's real GDP to growth by 4.8% in 2025



Source : Deutsche Bank. NBS

Figure 38: Domestic demand is expected to strengthen while external demand weakens



Source : Deutsche Bank, NBS

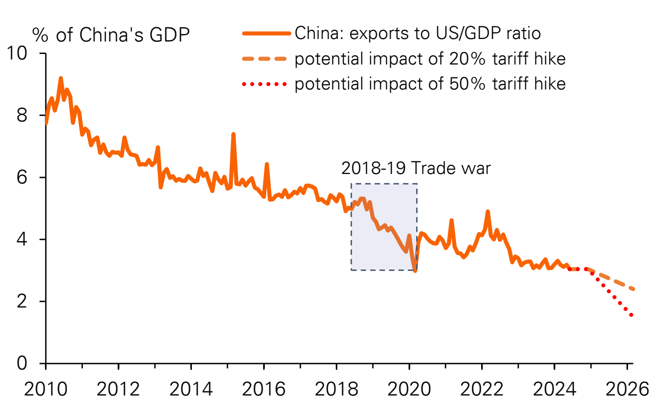
The property market downturn, now in its fifth year, shows tentative signs of recovery, with sales rebounding sharply in the past two months in both new and secondary home markets. However, the large inventory of unsold housing continues to depress prices, raising concerns about the sustainability of this recovery. While uncertainties remain very high, we think the most likely outcome is a "muddle through" scenario for 2025, with prices continuing to fall, albeit at a slower pace, and new home sales rising modestly, thanks to improved housing affordability and government policy support, including through downpayment and mortgage rate cuts, housing inventory purchases, and urban renewal projects.

Renewed US-China trade tensions under a second Trump administration pose another significant risk. Our baseline projection assumes phased US tariff hikes on Chinese goods: 10% in the first half of 2025 and another 10% in the second half. This gradual approach aims to minimize disruptions to US growth and inflation. We estimate the negative impact on China to be mild at no more than 0.5% of GDP. This is because exports to the US accounts for only 3% of China GDP today, and the impact of tariff hikes will be mitigated by exchange rate adjustments and trade reorientation to non-US markets.

We anticipate significant fiscal stimulus will be announced in March 2025 alongside the annual budget and a 4.5% growth target for 2025. This stimulus package could include direct government spending (1.5% of GDP) financed through higher deficit and special bonds; bank recapitalization (1% of GDP); and further support for the property sector. The already announced local government debt swaps (5% of GDP over three years) will also provide relief to local governments. Monetary easing will also continue, though rate cuts will likely be limited to around 20bps to avoid sharp Renminbi devaluation. Instead the PBOC is likely to utilize tools such as reserve requirement ratio (RRR) cuts, government bond purchases, and structural lending facilities.

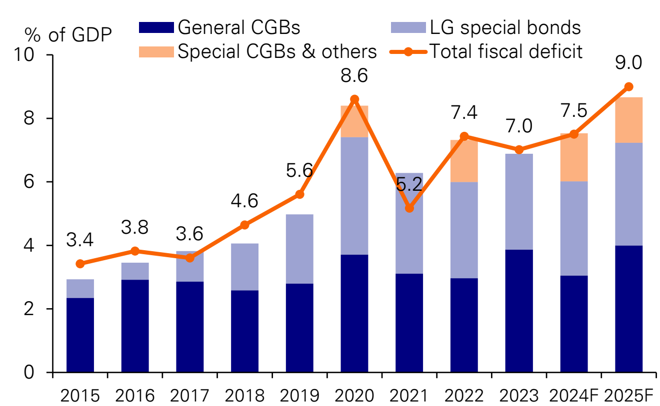
A key downside risk to our forecast is a severe US trade war. If US hikes tariffs by 50% on China and 10-20% on rest of the world, China's growth could fall to around 4% in 2026. Another downside risk could emerge from further deterioration in China's property market without sufficient policy intervention. Upside risks to our outlook include a higher-than-expected government growth target of 5%, coupled with more aggressive policy support.

Figure 39: Trade war could hit China's exports to the US again which is only 3% of GDP as of today



Source : Deutsche Bank Research, IMF

Figure 40: Fiscal stimulus has begun in Q4, we expect more stimulus in 2025



Source : Deutsche Bank Research, MOF

Yi Xiong

India

Summary: *We expect growth to moderate further to 6.5% in 2025 and 2026, which would necessitate some monetary policy support, particularly against the backdrop of sustained fiscal consolidation. We are forecasting CPI inflation to average 4.1% in 2025 vs. 4.9% in 2024 and 5.7% in 2023. Based on this growth-inflation mix, we expect one 25bps rate cut in April'25, followed by another 25bps cut in Aug'25, but if growth concerns escalate, then the rate cutting cycle could start from Feb'25. We expect the central government to lower the fiscal deficit below 4.5% of GDP in FY26 (4.4% of GDP), which may result in a sovereign ratings upgrade. We expect the rupee to be in the range of 85-86.50 in 2025, with the RBI proactively managing FX volatility.*

Growth outlook: We forecast real GDP growth to moderate further to 6.5%yoy in 2025 and 2026, from a 7%yoy likely outturn in 2024 and 7.7%yoy growth in 2023. In terms of fiscal years, **we are projecting real GDP growth to moderate to 6.5%yoy in FY26 and FY27, from a 6.8-6.9% likely outturn in FY25 and 8.2%yoy growth in FY24.** Indeed, growth momentum has already moderated in 2024, in line with our expectations, and continued global uncertainty along with moderation in urban consumption demand is likely to exert downside pressure on growth, absent policy support. Recent high frequency growth indicators (PMI, car sales, GST collection, industrial production, credit growth, corporate earnings data etc.) have shown some moderation in momentum. To maintain a sustained growth of 6.5-7.0% over the next 12-24 months, some monetary easing may be warranted, particularly as the central government is likely to continue with its fiscal consolidation agenda.

The prospect of higher tariffs under Trump 2.0 is negative for global growth on the margin, in our view, and with **India's beta to global growth at around 0.50,** we see downside risks to growth for India, led by global factors, apart from domestic issues which are already indicating a slowdown in growth momentum.

The USA and China are India's two largest trading partners. In FY24, China (USD118.4bn) surpassed the USA (USD118.3bn) marginally in terms of bilateral trade to become the largest trading partner of India. Previously, the USA was India’s top trading partner in FY22 and FY23. India runs a trade surplus with the USA (USD37bn in FY24; +1.0% of GDP), while having a sizable trade deficit with China (USD85bn in FY24; -2.4% of GDP). USA is India's biggest export partner with a 17.7% share in total exports. Increased tariffs on India's exports under Trump 2.0 could slow down the exports momentum and prove to be a drag on growth. Going forward, there is a non-trivial risk that global growth momentum slows down further and along with that global trade flows also soften due to persistent geopolitical concerns and potential tariff wars. **We already have a below-consensus growth forecast of 6.5%yoy for FY26** (consensus at 6.7%; RBI at 7.1%), which factors in some of these external risks.

Inflation outlook: We are forecasting CPI inflation to average 4.1% in 2025 vs. 4.9% in 2024 and 5.7% in 2023. In fiscal year terms, **CPI inflation is likely to moderate to 4.3%yoy in FY26, from a likely 4.6%yoy average in FY25.** The **CPI diffusion index** shows that most of the current inflation pressure is related to food inflation. Indeed, only 27% of CPI items have an inflation rate above 5% currently vs. 31% in the pre-Covid period (was 60%+ in FY23). And 10% of core CPI items have an inflation rate above 5% currently, lower than 16% pre-Covid (was 63%+ in FY23).

The likelihood of increased tariffs across the world under Trump 2.0 carries with it rising inflationary risks through the imported channel, but in India's case, the inflation dynamic is governed mostly by domestic factors and therefore risks of a sharp spike remain low. Indeed, during Trump 1.0, India's inflation remained below 4% most of the time, despite tariff wars and geo-fragmentation. Therefore, it is the domestic food price dynamic which will determine whether we get upside surprise to inflation or not in India rather than Trump 2.0 policies. On the positive side, if oil prices come off further in Trump 2.0, that could help Indian authorities to cut local pump prices of petrol and diesel, which could then help the inflation trajectory to drift lower than our baseline estimates.

Monetary policy outlook: The Trump victory could bring about increased volatility in global financial markets, and therefore monetary authorities in India will likely have to ensure that rate cuts at any point do not give rise to domestic financial stability risks. Given the evolving global macro backdrop, a generally conservative RBI will, in our view, cut rates only by a cumulative 50bps in 2025, to guard against potential financial stability risks. **In our base case we now factor in 50bps of cumulative rate cut in 2025, though the effective rate cut could turn out to be 75bps,** with the central bank at some stage likely allowing short term rates to settle closer to the SDF rate, which is 25bps lower than the repo rate. We now expect one 25bps rate cut in Apr'25, followed by another 25bps cut in Aug'25, but if growth concerns escalate after the release of the Jul-Sep'24 GDP data on 29 Nov, then the rate cutting cycle could start from Feb'25.

Fiscal outlook: We expect the central government to lower the fiscal deficit for FY25 to 4.8% of GDP, below the Budget Estimate of 4.9% of GDP, and then **set a target lower than 4.5% of GDP (4.4% of GDP) in FY26.** This will likely open up room for a sovereign ratings upgrade in 2025. General government debt is likely to fall below 80% of GDP in FY26. High economic growth and fiscal consolidation could lead to sustained improvement in India’s debt/GDP over the medium-term. **We think it is possible for India to lower its debt/GDP to below 75% of GDP by FY31.** But the faster fiscal consolidation path would, in our view, necessitate some monetary policy easing to maintain growth between 6.5-7.0% on a sustained basis.

Rupee outlook: We were always of the view that the Rupee will maintain a depreciating bias vs. the USD, despite an expectedly large BOP surplus in 2024 due to India's inclusion in global bond index. **We have a similar view for 2025 as well, expecting rupee to be broadly in the 85.0-86.50 range,** with possible intermittent undershooting and overshooting, with the RBI continuing with its proactive FX intervention strategy to manage unnecessary volatility. **The Trump victory has not changed this baseline view,** though the RBI may have to decide how much FX reserves to use at what point of time, to maintain a gradual depreciating range for the rupee. This could become particularly important if other currencies such as the CNY are depreciating at a rapid pace vs. the USD within a short period of time.

As far as capital flows are concerned, there could be inter-temporal volatility led by potential tariff wars or increased geopolitical tensions, but there could be a positive side as well, particularly if the Trump 2.0 administration can help end the various wars, leading to a further lowering of global oil prices. This could provide comfort to India's already strong BOP position (current account deficit is likely to average 1.1-1.2% of GDP in 2025 and 2026) and may turn out to be a helpful offset against the depreciation pressure on the rupee.

Kaushik Das

Rates

The US election resulted in a unified Republican government, which we interpret as leading to net fiscal easing, regulatory reforms, across-the-board tariffs, and tighter immigration controls. These policy shifts have significant implications for global interest rates. Considering the likely policy response in Europe and Japan, we anticipate higher long-term interest rates in the US, lower short-term rates and a steeper yield curve in Europe, and higher short-term rates in Japan. More specifically, our forecast anticipates a peak of ~4.75% for the 10-year US Treasury yield and ~2.50% for the 10-year German Bund yield in 2025.

In the US, the assumed policy mix should result in a combination of a positive demand shock (net fiscal easing), a positive supply shock (regulatory reforms) and a negative supply shock (tariffs and immigration controls). The impact on US growth and inflation will depend on the timing and scale of the various policy levers. For the purpose of our forecast, we assume that these policies will raise the nominal neutral rate to approximately 4% and lead the Fed to remain above neutral for longer. Moreover, term premia should rise further as the market reassesses inflation risks and increased supply. Taken together, these factors support our forecast of a 10-year US Treasury yield peaking around 4.75%.

Higher US tariffs represent a negative demand shock for the eurozone, lowering both growth and inflation. The ECB will have to bear the brunt of the policy easing in response to the imposition of US tariffs, at least until there are immediate prospects of a fiscal response in Europe. The USD-EUR neutral real interest rate (r*) spread has averaged 100bp, with a peak above 200bp during the Reagan/Volcker period. We assume that the divergence in fiscal policies, combined with the impact of US tariffs, justifies for now a mid-1980s r* differential of approximately 200bp, implying a nominal neutral rate in Europe of around 2%. We expect the ECB to ease 50bp below neutral, to 1.5%. In practice, the extent of easing will depend on the degree to which Europe, and Germany in particular, utilises its fiscal policy space. Recent political developments suggest that some fiscal easing appears increasingly probable, although the impact on growth, inflation and, consequently, the ECB, is unlikely to be felt in 2025. Finally, we assume that term premia will also recover in Europe, but a little less so than in the US. Taken together, we expect the 10-year German Bund yield to peak around 2.5% and a significantly steeper EUR yield curve.

The outcome of the US election reinforces our view that the BoJ will raise interest rates substantially more than is currently priced in. Wage growth in Japan is on track to be consistent with above-target inflation for three consecutive years. The BoJ's policy rate remains well below even the most conservative estimates of neutral. Current coalition discussions appear likely to result in new fiscal stimulus. Further yen depreciation will probably exacerbate the cost-of-living issue, which contributed to the ruling LDP's loss in the recent parliamentary elections. Lastly, the new US administration may pressure Japan to prevent further yen depreciation. Collectively, these factors suggest increasing pressure on the BoJ to raise rates.

There are several risks to our forecast. First and foremost, our macro assumptions reflect current political realities, but are at odds with a more normative view. More specifically, given the current economic backdrop and deficit levels, there is limited economic rationale for further fiscal stimulus in the US. On the other hand, there are very strong arguments for Germany, in particular, to utilise its fiscal policy space to address structural challenges to its business model. Furthermore, our analysis indicates that US tariffs are likely to be inflationary. A key lesson from this year's elections is that inflation is highly unpopular and a problem for incumbents globally. Second, China has already established a framework for additional fiscal easing, including policies to support domestic consumption and recapitalise banks. The magnitude of the easing remains unclear, but the imposition of US tariffs will probably lead to more aggressive fiscal stimulus. Lastly, the US election could result in a material shift in the Ukraine and Middle East conflicts, significantly impacting energy prices.

The tension between what is expected to happen and what “should” happen partially informs our forecast. However, we remain alert to signals that the normative view is becoming more probable, to the impact of China’s policy response to US tariffs, and to any further geopolitical developments that could impact energy prices. If the facts change (as they undoubtedly will), ... we will change our views.

Francis Yared, Matthew Raskin, Ioannis Sokos

FX

The starting point as we look into 2025 is a dollar that has been *very* high for a *very* long time. It's been more than 20% expensive on a PPP basis for two years now and has eschewed the normal 'boom then bust' dynamics seen in recent decades. That's a function of US exceptionalism. The return of Trump with a more unified team opens up even further upside for the dollar, potentially taking it to unprecedented levels. On the other side of the equation, the other major regions (Euro-zone, China, Japan) seem to have their own challenges that aren't getting any better. How does this backdrop shape our forecasts? Our year-ahead outlook embeds a dollar overshoot back to its Volcker-era record highs, but with a significant risk of an even further overshoot depending on the policy mix and speed with which it is delivered in coming months. Our forecasts anticipate the brunt of the dollar trade-weighted appreciation to be borne by European currencies. There is significant uncertainty with regard to USD/CNY moves but we expect authorities to allow some CNY weakness as it balances the need to preserve export share in face of tariffs versus risking capital outflows.

Starting with **EUR/USD**, we see a combination of central bank repricing and additional safe-haven dollar risk premium as driving the cross towards parity next year. How much the euro weakens will largely depend on the policy mix that is delivered by the Trump administration, the speed of implementation as well as the policy response from other countries. On the central bank front, our expectation is that the market should be pricing an ECB terminal rate of at least 1.5% and a Fed terminal rate above 4%, which would leave a gap of 250bps compared to current market pricing of closer to 180bps. On the risk premium front, we see very little tariff risk or fiscal easing priced in to the dollar or indeed broader markets. The market is likely to be sensitive to perceptions of US policy sequencing (fiscal spending versus tariffs) over the next few months, with an emphasis on demand-side policy first likely to support high-beta currencies over the low-yielders and vice versa in the event of tariffs. Either way the dollar should hold up as a high-yielder, and we would expect the euro to underperform in both a risk-on carry-friendly scenario and a risk-off tariff-driven environment. Our forecast embeds a fiscal easing assumption of 0.5% - 1% GDP delivered in a budget bill by the middle of next year. Our forecast also embeds tariffs but less aggressive in scale compared to the 10-20% and 60% tariffs discussed for Europe and China respectively. A more aggressive policy mix would likely lead to a EUR/USD drop below 1.00. Our FX profile then assumes a gradual recovery in EUR/USD by the end of the year potentially embedding a fiscal policy reaction in Europe (especially Germany), the potential resolution of the Russia - Ukraine war as well as some modest release of dollar risk premium. Our forecasts for next year are clouded by high uncertainty however and we are likely to make significant revisions as we gain more clarity on the policy mix.

The **yen** has experienced huge depreciation in recent years, and while that may now be facing an end, we don't see it reversing meaningfully anytime soon. The Japan story is historic - sustained inflation (core CPI accelerating now, wages at multi-decade highs), and the BoJ has been hiking. But there are impediments in translating this into yen strength. One is how small the interest rates moves are relative to what's already happened in the US - there's still plenty of carry to be earned by using yen as a funder. Japan investors recognise this - they've been buying foreign bonds this year, even as USD/JPY and hedging costs are elevated, while outbound FDI is around record highs. And the US outlook we've discussed only adds to the appeal. Further, stronger yen typically results from weaker US equities, which seems unlikely absent a US growth slowdown (high valuations notwithstanding). Another challenge is that the BoJ risks being too slow to move - it talks of staying accommodative, despite inflation annualising at 3% lately. And the loss of LDP's majority means some reliance on other parties who prefer loose BoJ policy. A behind-the-curve central bank is generally going to be bad for a currency, and may already be reflected somewhat with USD/JPY overshooting rate spreads. All that said, yen is extremely cheap, and the vast foreign asset pile could be brought home to some degree in coming years. Plus the BoJ could at some point try to catch up more forcefully to the inflation pulse. For that reason it's more a profile of yen holding around current levels into mid-2025, before some modest strengthening beyond that.

Over in **EM FX**, we see the market taking an overly optimistic view on the Trump policy mix. First, while many currencies in Lat Am and CEEMEA enjoy a closer relationship to equities than rate differentials, higher US rates for longer presents a challenge when it comes to already strained fiscal outlooks. Fiscal dominance concerns may become an increasing headwind going forward. Second, the implications of US tariffs for global goods trade could be far reaching. Small, open, manufacturing centric economies like in the CEE region, as well as Asia, are vulnerable in that respect. Third, idiosyncratic risks to bilateral and security relationships like for Poland and Mexico are not being reflected in market pricing. Overall, we expect EM performance to shift over the course of 2025 from being dominated by fear/anticipation of large policy shifts in the US to being more differentiated - in favor of those with higher real rates, a stronger fiscal trajectory and lower sensitivity to global trade - as we get more clarity on policy details.

George Saravelos, Tim Baker, Oliver Harvey

Credit

US credit spreads are likely to start 2025 at exceptionally tight levels. $IG spreads of 78bps are the lowest since May'98, while $HY spreads of 258bps are the lowest since May'07. Expensive valuations do not presage a near-term selloff. **But credit investors will need 4 macro ingredients to hold if spreads are to stay this tight next year.** These factors are: 1) Low US recession odds, 2) Undeployed investor cash, 3) Low rate volatility & 4) Low inflation, or a Fed willing to run easy monetary policy despite above-target inflation, such as in 2021.

The good news for $-credit is that the first two factors are currently in place. On 1), we believe US recession odds are only around 10% through the 1H'25, at the lowest levels since 2021. Strong corporate profit growth, easing financial conditions, and falling bank loan delinquencies all provide a strong vote of confidence in the US cycle. And on 2), there is room for animal spirits to rise further. $HY manager cash balances are near average levels, while the use of margin debt to buy US stocks on leverage (a classic bubble signal) is only amazingly 0.2 standard deviations above average (Y/Y), despite this year's roaring equity market rally. We are unlikely to see major spread widening to start next year, nor are we likely to see any material downgrade or default risk for much of 2025 as well.

But factors 3) & 4) are likely to disappoint. Simply put, a hawkish Fed pivot is near. The risk of an over-heating US cycle is under-priced, as recent Fed cuts are starting to kick off a credit cycle, while the removal of election uncertainty plus future pro-growth policies from a Trump administration could easily boost employment and inflation above expectations. This will damage credit technicals, especially in higher duration & fixed-rate markets. Higher rates will subtract from total returns and reduce inflows, at the same time that pent-up animal spirits front-load 2025 M&A & LBO supply.

And contrary to expectations, this hawkish Fed pivot may have some staying power. There is far too much cash & equity in the US private sector to allow for any meaningful Fed cuts from here, without engendering financial stability and inflation worries. Global credit investors may need to brace themselves for a world where the terminal Fed Funds rate is higher (4%+) and where a positively sloping Treasury curve emerges on top of that higher terminal rate. That could bring a substantial amount of rate volatility, as investors try to assess fair-value Treasury and credit yields in real-time. For $IG investors, the big surprise in 2025 could be much lower inflows than predicted. And for $-spec grade investors, next year may provide a dawning realization that leveraged issuers will be unable to refinance their existing debt more cheaply over the next few years ahead.

Hence, we believe $-credit spreads will gradually widen next year. $IG spreads should hit 92bps by mid'25 (+14bps) & 110bps (+32bps) by YE'25. $HY spreads should trade at 300bps (+42bps) & 360bps (+102bps), while $Lev Loan spreads should reside at 420bps (+12bps) & 450bp (+42bps) by mid'25 & YE'25 respectively. We project $spec-grade default rates to decline from 4.7% to 4.4% by mid'25, before rising again to 4.6% by YE'25. **Higher rates and strong growth will lead shorter-duration and higher-carry markets to outperform.** We prefer $HY over $IG and $Lev Loans over $HY. But the shock of higher terminal rates will eventually seep into weaker fundamentals during the 2H'25. Vulnerabilities are highest in 1) BDCs & Private Credit, given a record-high share of PIK (paid-in-kind) loans waiting for Fed cuts that are unlikely to materialize, 2) the underperforming software sector within $-Lev Loans, & 3) $HY CCCs, which are 43% non-cyclical, and which would rather have more Fed cuts than more US growth next year.

In Europe, €-credit spreads start 2025 at fairly cheap valuations vs. $-credit. However, this additional risk premium in €-credit won't disappear overnight. Weak growth, geopolitical uncertainties, and a hawkish Fed will all prove to be relevant headwinds to start next year. Regarding growth, European cyclical profit margins continue to compress, as elevated staffing levels, high wages, and mediocre domestic & Chinese demand strains balance sheets. German Industrial confidence has also collapsed; pre-election German manufacturing employment expectations are at GFC and COVID levels. On the geopolitical front, German & French political volatility will persist through at least early 2025, while the prospect of an incoming Trump administration applying tariffs to European Autos and Chinese exports could further hurt cyclicals. Lastly, the potential double-whammy of Trump tariffs + a hawkish Fed could beget substantial EUR/USD weakening from current levels. If so, the odds of an "ECB put" via a 50bp cut could be lower than credit investors anticipate. It is too early to overweight € vs. $-credit to start 2025.

But if Europe can "weather the storm", €-credit markets should face a relatively more positive backdrop later in the year. While investor sentiment is rightfully bearish on German manufacturing, this is not yet infecting the broader Eurozone economy. Europe ex-German manufacturing hiring expectations are still healthy, while the European service sector is still producing solid results. The European banks are also quietly emerging as an "unsung hero". Despite very weak GDP growth and a plethora of exogenous geopolitical shocks, more profitable and better capitalized banks are starting to ease lending standards & increase loan growth. Lastly, the ECB is still likely to proceed with consistent 25bp cuts through the 1H'25. Absent any growth fears, this will support credit technically, via inflows from both domestic & global accounts. But ECB cuts will also matter fundamentally; ~75% of European business debt is borrowed from banks via floating-rate instruments. European coverage ratios should improve quickly from here.

Hence, we expect €IG spreads to hit 115bps (+9bps) by mid'25 and 120bps (+14bps) by YE'25. For €HY, spreads should trade at 355bps (+41bps) & 380bps (+66bps), while €Lev-Loan spreads should trade at 460bps (+11bps) & 480bps (+31bps) by mid'25 & YE'25 respectively. We project €spec-grade default rates to decline from 3.6% to 3.3% by mid'25, before falling further to 3.1% by YE'25. **€-credit will face a more challenging first half;** we prefer the more technically supported €IG and the less cyclical €Lev Loan markets over the more cyclical and expensive €HY market to start next year. **But in the 2H'25, all €-credit markets will produce solid carry and outperform $-credit**, as European growth & geopolitical concerns fade. To be clear, this will still not be a volatility-free zone; a hawkish Fed will still reverberate across the globe, while better European growth and the potential for extra German fiscal spending in 2026 could further steepen global yield curves and hurt real estate valuations.

But if steeper global yield curves are the end result of next year's "terminal tantrum", Europe has a key advantage over the US. European corporates and households are far more likely to borrow at shorter-maturities than US corporates & households.

Steve Caprio, Cem Keltek, Karthik Nagalingam

Equities

The Outlook For Equities in 2025: What's Still To Come

Equities have risen strongly, naturally raising questions about their drivers and valuations. The S&P 500 has risen in a steep trend channel (23.7% annual rate) from its late 2022 low, on track for two years in a row of 20%+ increases, a run that has happened only 3 times in the last 100 years. The presidential election has so far not had a discernible impact on the trajectory, round-tripping from the mid-October highs. We attribute the duration and strength of the rally to low expectations and positioning for the cycle in the face of rapid interest rate hikes, leading to an unprecedented 14 months of positive macro data surprises; while the economic backdrop turned out to be very robust, with the current combination of low unemployment and strong GDP growth seen only 6% of the time historically; a cross asset inflows boom as excess cash accumulated around the pandemic freed up households to allocate larger shares of new savings to bonds and equities; and higher multiples driven by a number of factors discussed below.

We remain constructive on the cycle: what's still to come? Consumer spending continues to grow solidly in its trend channel, though spending on services relative to goods looks to have overshot, with a rotation back to goods in the cards at some point. While attention has focused on late cycle indicators such as the labor market and delinquencies, several early cycle indicators have been turning up. We see various aspects of the cycle still to come, including a move from de- to re-stocking; a pickup in capex outside Tech; a manufacturing recovery; rises in consumer and corporate confidence; a recovery in capital markets and M&A activity; a pickup in loan growth; and rest of the world growth. With macro growth already strong, can it pick up? Disaggregating US GDP into stable growth and cyclical components, cyclical GDP is 15% below where it typically rises to in recoveries. A productivity boom may have already begun, with growth over the last 6 quarters at an annual rate of 2.6%, well above the norm of 1.5%. With potential policy changes by the incoming administration having both positive and negative implications for growth, sequencing will be key. In the last Trump term, tax cuts and deregulation came first (2017), tariff escalations came later (2018-2019). For now, our working assumption is a similar timing. But we expect growth to remain the priority. Over several rounds of the last trade war, escalations saw equity selloffs which then prompted de-escalations, especially after declines of -10%, with the S&P 500 in a wide volatile range.

Robust steady earnings growth to continue. S&P 500 EPS is on track to rise 11% in 2024 to $253, in line with typical growth outside recessions. Like our house economics view, we see steady robust momentum continuing into 2025, with EPS growth of 11.6% to $282. Alternatively, if global growth picks up to the upper end of its historical range, earnings growth could rise to 17%, taking S&P 500 EPS to $295.

What's driving multiples higher? At 23-24x, the S&P 500 trailing P/E multiple is not only well above the historical average of 15.3x but also the 10x-20x range that prevailed historically. Valuations are high across a variety of metrics, not just for certain sectors and stocks but across the board with median company valuations near record highs. A historical comparison of valuations though requires the same of the potential drivers. Payout ratios have been running around 80% over the last decade, significantly above the tight range of 50%-60% they were in for several decades. Inflation returning to 2% would put it well below the historical long-run average of 3%. Earnings growth over the last decade has run at 9%, well above the long-run trend rate of 6.5%. The frequency of large (10%+) declines in earnings has dropped significantly in the last 3 decades. Each of these shifts is individually powerful and combined can have dramatic impacts on fair value multiples. We expect multiples to sustain if not push slightly higher against the backdrop of a robust demand-supply balance for equities.

Setting a year-end 2025 target for the S&P 500 of 7000. From a demand-supply perspective, the rally over the last 2 years reflected a combination of rising positioning, large inflows and strong buybacks. Looking forward, equity positioning is already near the top of its long-run band with little room for further upside. We see robust equity (and bond) inflows continuing, boosted by strong risk appetite, though are factoring in some slowing in the pace. We see S&P 500 buybacks rising from an annual run rate of $1.1 trillion currently to about $1.3 trillion next year, rising in line with earnings. We see the demand-supply backdrop for US equities remaining solid even with conservative assumptions, pushing the S&P 500 to around 7000 next year. This would still leave it well within the uptrend channel in place post-GFC (6000-7500 for end 2025).

At the sector level, we continue to maintain a cyclical tilt. We remain neutral MCG & Tech with derating advanced but growth slowing; remain overweight the Financials where a multitude of tailwinds are converging; remain overweight Consumer Cyclicals and Materials with the broader cycle still having plenty of legs; remain neutral the Industrials as mega-trends look priced in; neutral Energy as they remain at the mercy of oil prices; across defensives we remain neutral Utilities and Real Estate, and underweight Healthcare, Staples and Telecom.

Across regions. In Europe, in our reading, a variety of economic, political and geopolitical headwinds are already priced in but while we see plenty of upside, it is likely not enough to outperform the US, and we are neutral; we are neutral EM where consensus expectations for next year are high but falling; we view the risk-reward on Japanese equities as poor with prospects tied to the yen which is already at the bottom of its 3 decade range and remain underweight.

Figure 41: S&P 500 and Stoxx 600 forecasts

	Current	Q1 2025	Q2 2025	Q3 2025	Q4 2025
S&P 500	5949	6400	6600	6800	7000
Stoxx 600	503	550	565	575	590

Source : Deutsche Bank

Bankim Chadha, Parag Thatte, Maximilian Uleer

Emerging Markets

EM as an asset class typically responds most to; a) rate differentials vs DM (which often define boundary conditions for central banks); b) bond-equity correlation in core markets (EM does best in higher equities/lower rates risk regime, and the poorest in lower equities/higher rates); c) core rates vol; d) USD liquidity conditions; and e) idiosyncratic factors like political cycles. For much of 2024, the positive beta from DM equities, and the buffer from positive real rates (in many parts) helped EM stay relatively resilient, even in the face of a stronger dollar, higher vol, and multiple left-field outcomes on elections, and inspite of China largely keeping to its incrementalist approach to policy stimulus. EM equities are up 7% on the year, though underperforming DM; EM blended local yield is, if anything, tighter vs USTs than at the start of the year; and EMFX hasn't lost any more ground vs the dollar than DM FX (though with significantly more differentiation).

We think 2025 will bring with it a more negative tilt on the distribution of expected returns for EM, mostly driven by spillover from a regime shift in policy the US, but likely also fatter tails predicated on the sequencing and speed of that shift. EM is negatively exposed to threats of disruption/shifts in global trade from increased use of tariffs (Asia, CEE, Mexico more than others); to potential disruptions/delays to its easing cycles (as US monetary conditions tighten) and its spillover into local institutional dynamics (relationship between governments and central banks, for example); and to a potential reconfiguration in geo-strategic relationship between US and rest of the world. Conversely though, spillovers from positive adjustments to both demand (fiscal) and supply (deregulation) functions in the US should benefit EM economies; as might also the prospect of reduced risk premium on key geopolitical issues which impact EM directly (Middle East, Russia-Ukraine) and indirectly (commodities).

Trump 2.0 is not in the price in EM, in our view. Our prior is that the reaction function for markets and policy in EM will be dominated by fear of increased tariffs and tighter monetary conditions before (and if) they get to know otherwise. And which will likely keep correlations relatively high, till better visibility on the timing/ sequencing/quantum of policy shifts executed by the incoming administration helps differentiate relatively in favour of EM with better real rate buffers, lower dependence on global capital (and therefore beta to higher core term premium), and greater self-reliance on domestic demand vs global trade. Central bank preferences – as they balance financial/FX stability risks versus growth fears - will become key to this differentiation.

These policy trade offs will likely be most acute for Asia, which stands in the eye of the storm with some of the biggest trade surpluses with the US. The response from individual central banks – likely to be more sensitive to bilateral USD FX for managing expectations and inflation pass through, and the RMB cross to manage TWI/competitiveness considerations – will drive both relative FX and rates performance. China's policy response will be a key anchor for the region, both on whether/where it draws a 'line in the sand' on FX, and if it shifts from a reactive/ passive approach towards fiscal support (aiming to underwrite the growth downside) to a more proactive mode (shifting the balance to the upside). The tails are fatter, we would argue, versus Trump 1.0, more so on the poorer side, because of the risk that tariffs ended up being a) legislated rather than transactional; and b) multilateral rather than just bilateral; and which could present China policy with a more challenging trade off between risking export downside (if it lets RMB strengthen vs TWI) vs potentially de-stabilizing capital outflows (if it lets RMB weaken vs USD). We see North Asia FX (RMB, KRW) underperforming South Asia (SGD, PHP, IDR), and as a corollary a higher probability of rate cut expectations being pared back in North (Korea) vs South (Thailand). While RBI might still allow a step adjustment in INR with an eye on the CNH cross, its larger degrees of freedom on policy beta keeps us positive on India fixed income.

LatAM will face similar policy trade offs as it weighs stronger dollar and higher USD funding costs in response to US policy shifts, though likely of a smaller magnitude. We expect the overall impact of trade frictions and uncertainty to primarily delay, rather than disrupt, ongoing cycles. Mexico is the most exposed in the region to policy headlines, but we believe both migration concerns and US interests favour negotiations within the USMCA framework. Brazil is the outlier in the region, where local dynamics continue to be more binding, and reluctance to deliver more than a fraction of the required fiscal adjustment will likely push policy rates higher. We favour BRL, COP and MXN in that order, though again wary of high correlation till we get better visibility on US policy shifts. We like rates in both Mexico (front end) as the economy slows and the deficit shrinks there, and Peru (duration); and for the Brazil curve to bear flatten.

CEEMEA is a more heterogenous mix within EM between markets with a strong growth/trade/rates exposure (CEE), higher EM beta (South Africa), and more idiosyncrasies (Israel, Türkiye, Egypt). Concerns about FX spillover have kept central banks in CEE relatively hawkish in their communication, but that puts them behind the curve in our opinion to the outlook on weaker European growth and a lower terminal rate for the ECB. We see most of CEE underperforming the EUR, and favour receivers across CEE (up to 5 years). Local policy dynamics continue to dominate the appeal for Türkiye assets – with CBT expected to start easing by December, more disinflation ahead, and which makes us favour the belly of the curve (and the currency). We remain constructive on the domestic reform story in South Africa; but with support from a stronger FX to helping the disinflation momentum now at risk from increased global volatility, we can expect SARB to become more cautious.

Sameer Goel & Team

Crude Oil

Crude oil is underperforming our current quarter forecast, substantially because of China demand weakness that is now at least fulfilling reduced expectations, and possibly going beyond the lowered thresholds of ~+200 kb/d yoy in 2024 and 2025.

In addition we remain of the view that 2025 fundamentals look poor as we expect the OPEC+ supply ramp up to proceed eventually after its many delays. Since at least May, it has been apparent that OPEC's cycle of discipline had been nearing maturity. Coordinated, group-wide quota cuts have become more difficult to achieve, recent cuts have either been intended to be temporary or non-binding, and market share losses have become significant by OPEC core to OPEC exempt countries, and by OPEC to non-OPEC (*Risk of higher OPEC+ supply*).

Also weighing on our expectations are the likely oil-friendly policy measures under President-elect Trump, assumed to be promulgated by the appointment of an 'energy czar', replacing the position of 'climate czar' under President Biden. There are at least two degrees of latitude for this official: the expansion of leasing programs for federal lands, and the rollback of revisions to fiscal terms of the Federal Oil and Gas Leasing Program under the 2022 Inflation Reduction Act.

We continue to think the biggest wildcard on US oil policy will be the re-emergence or not of a 'maximum pressure' approach to Iran, whereby the existing relaxation of oil sanctions since 2022 under President Biden means that the direction of the possible supply swing is entirely to the downside (*Iran sanctions may figure anew*). We have incorporated a 'weak' assumption of 500 kb/d of supply tightening, phased in over January-Sep 2025, without which our modeled surplus would be significantly wider, and Brent prices possibly below USD 55/bbl at end-25. A public statement by the future US ambassador to the UN has indicated tightening as likely, although there is uncertainty around implementation.

In combination with the fundamental surplus emerging next quarter, and anchoring to a Brent price of USD 77/bbl for the fourth quarter leads us to lower our 2025 forecast by -6% to 66/bbl, down from USD 70/bbl. The updated year-end 2025 target is Brent USD 62/bbl, down from USD 68/bbl.

Michael Hsueh

Appendix 1

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*Other information available upon request

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