Group Investment Strategy
December 2024

The Compass 2025

In a Nutshell

2024 has been a historic election year, with over two billion people casting votes globally. The results have often been surprising, yet democracy has shown remarkable resilience. As we look to 2025, the full impact of electoral shifts will become clearer. Among the most significant developments will be the return of Donald Trump to the White House – a pivotal moment that will undoubtedly shape the global economy.

The Compass 2025, prepared by the newly formed Group Investment Strategy team, offers a comprehensive view of our economic forecasts and their main financial implications. Trump 2.0 will only be one of the many stories of 2025 that we will explore.

Next year, geopolitical tensions are expected to intensify, protectionism to rise and industrial policies to become more intrusive. However, this environment will also present significant opportunities for positive change. Europe, for example, may finally address its existential challenges, as it always shifts gears in times of real need. The different forces that are shaping the new global economy will lead to diverging patterns in domestic growth and inflation on the two sides of the Atlantic. As a result, monetary easing will proceed at a different pace in the US and the eurozone.

Our outlook for 2025 is thus marked by cautious optimism: a macro environment characterised by lower interest rates and positive economic growth will support risk appetite, as the tightening cycle has replenished central banks' toolboxes, creating room for bold action if needed. This is good news for equity and bond returns in 2025, but it will not necessarily translate into an all-clear for global markets. US equities will probably show the highest potential in the coming quarters, despite high market concentration and elevated valuations, but opportunities will also arise in other regions. Bonds will be in demand given their still-attractive carry, with rate cuts being well priced into government and corporate bonds.

We hope you find our insights valuable, and we wish you a successful 2025.

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What World?

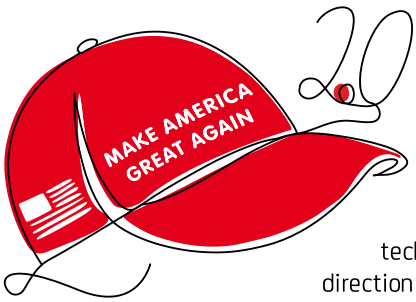
Welcome to Trump 2.0

By Edoardo Campanella, Chief Editor, *The Compass 2025*

Every four years, immediately after the US presidential election, the National Intelligence Council (NIC) publishes its *Global Trends* report – a bold foresight effort to help the incoming administration envision what the world could look like two decades out. The report's aim is not to make crystal-ball predictions but rather to identify the key structural forces shaping the future.

President-elect Donald Trump will receive the new issue of the report before Inauguration Day on 20 January. The report will look at the world in 2045. In 2008, when Barack Obama became president, the NIC released *Global Trends 2025: A Transformed World*. As 2024 draws to a close, we think it is worthwhile to reflect on what the NIC predicted two decades ago to gain some insight into what 2025 might hold in store.

The key prediction was that "The international system – as constructed following WWII – will be almost unrecognisable by 2025". The US-led unipolar order was expected to be replaced by a multipolar world – chaotic, unstable and ripe for conflict. The NIC was right in many respects. The Pax Americana is crumbling. New power centres are emerging, military conflicts are on the rise and the world is being divided along geopolitical lines. A second cold war appears to be looming.



Mr. Trump's first term catalysed some of the structural trends the NIC identified almost a decade earlier. He turned his back on the global liberal order, embracing isolationism and protectionism. Ultimately, **Trump 1.0** was a presidency of disruption and discontinuity. **Trump 2.0** will undoubtedly shape 2025, but this time, Mr. Trump is expected to be a president of continuity. Like it or not, we already live in a Trumpian world, one characterised by rampant protectionism, wide-ranging industrial policies and rising geopolitical tensions.

During his second term, Mr. Trump will likely accelerate some of these dynamics through outright transactionalism and unilateralism. However, compared to his first term, he could also be a president of restraint – this is our hope, at least. Today's world is far more dangerous than in 2016. With two major conflicts underway, in Ukraine and the Middle East, and increasingly strained relations with China, there is less room for miscalculation.

Trump 2.0 will probably be a less-inflationary presidency than many fear. Take his electoral statements seriously but not literally. Mr. Trump has his sights set on 2026 (midterm elections) rather than on 2028 (presidential elections). If he adopts policies that are too inflationary, he will likely pay the price in 2026 by losing Congress. After making some symbolic decisions related to targeted tariffs, immigration and taxes in the first months of his presidency, to follow through on campaign promises, he is likely to try and shift attention away from economic promises and towards identity issues.

Trump 2.0 will probably be a less-inflationary presidency than many fear

Given the uncertainty and risk associated with Mr. Trump's economic agenda, the Fed will likely be more cautious than it would have been if Kamala Harris had won. It will likely use the first half of next year to cut rates towards 4%, when there will not yet be any visible impact from Mr. Trump's policies. Although the ECB and the BoE will likely continue towards neutral territory, a less-dovish Fed might make them more hesitant.

Like central banks, the rest of the world will have to adapt to the shifts and shocks triggered by Mr. Trump's return to the White House. The EU will face a critical choice in 2025: whether to step up and become a true geopolitical superpower, with a cohesive industrial and defence strategy, or to continue drifting in a world of rival blocs and a less-engaged US. In 2008, the NIC regarded the latter scenario as more likely. The other big challenge for Europe will be to stick to its climate change commitments despite a probable setback on this front caused by the incoming Trump administration.

Similarly, China will have to decide whether to upgrade its growth model away from exports and investment and towards private consumption. With Mr. Trump in the White House, the world will be even less willing to absorb China's overcapacity, particularly regarding electric vehicles, solar panels and batteries, and this could lead to an intensification of current trade tensions.

The 2008 NIC report barely mentioned artificial intelligence (AI). Back then, AI was still a nascent technology. In 2025, AI will continue to shape the direction of stock markets, possibly leading to market stress due to the high concentration of tech stocks. Given the centrality of chips to the development of AI, Mr. Trump's ambiguous attitude towards defending Taiwan's status could be another source of volatility for tech stocks.

In its 2008 report, the NIC missed the shale-oil revolution in the US, which was to reshape the oil market around five years later. The report claimed that, by 2025, the world would enter a post-oil economy – as supply was not expected to keep up with demand. In reality, and despite rising demand, the oil market is dealing with an oversupply problem, which could be exacerbated by Mr. Trump's support for the US oil industry. However, a global shift towards electrification is making the global economy less oil-intensive and relatively more metal-intensive. If trade tensions escalate between the US and China (which controls a large supply of key metals), we might see a new type of energy shock in 2025 – one centred around metals rather than oil.

What the NIC did not predict in 2008 was the polarisation of US politics. This is a trend that will likely last beyond 2025.

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Trump 2.0 will cloud the global outlook

Global growth remains stuck in low gear, with limited prospects of improvement in the near term, while the outcome of the US presidential election adds to already-high geopolitical uncertainty.

Although we assume that only parts of US President-elect Donald Trump's agenda will be implemented, fresh tariffs are likely to weigh on global manufacturing as they dampen trade, affect sentiment and cloud the outlook for capex. China is unlikely to remain passive to the imposition of US tariffs, and, in a context of rising trade tensions, the eurozone will face headwinds due to its large manufacturing sector. Tariffs, rising tensions between the US and China and increased geoeconomic fragmentation are also likely to cause trade diversion away from the US and throw sand in the gears of global supply chains. **Global trade**, which has posted a tentative recovery this year, is unlikely to show further progress in 2025.

In this context of rising trade barriers, slightly-above-potential growth in the US, fuelled by even-more-expansionary fiscal policy, is unlikely to benefit the rest of the world much. For the eurozone, the situation will be further complicated by the ongoing process of fiscal consolidation and the lack of a clear strategic direction on the industrial front at the continental level. In China, stimulus measures will probably prove sufficient to preserve financial stability and mitigate the risk of outright deflation but are unlikely to fuel private consumption meaningfully and steer the country away from its trajectory of structurally weaker growth. All in all, despite weakness in manufacturing, the services sector will likely help **global GDP** growth to stabilise at just above 3%.

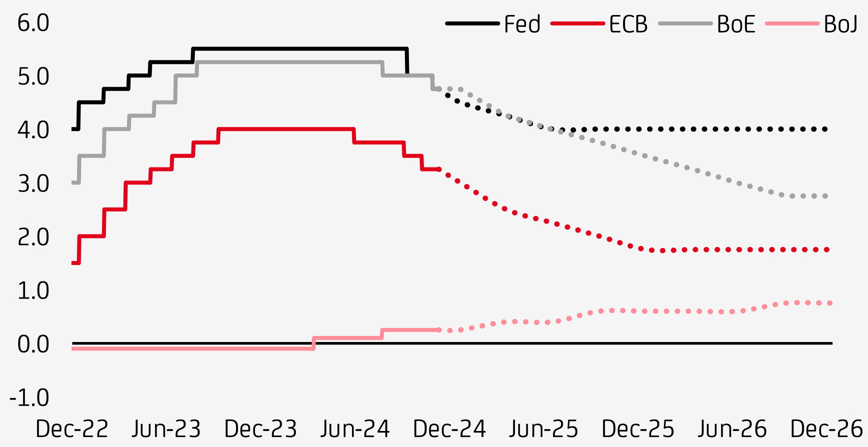
The Trump presidency might also have meaningful implications for the war in Ukraine and the outlook in the Middle East.

- The most likely scenario is **territorial losses** for Ukraine and a smaller Ukraine moving closer to Europe, although an agreement to end the war is unlikely to be reached soon.
- In the Middle East, the risk of an **escalation of tensions** between Israel and Iran has probably increased. At current levels of production, thanks to US drilling, the oil market is likely to be oversupplied next year, and this will help cap the risk premium and will likely force OPEC+ to prolong output curbs again in 2025. We expect the Brent price to hover in the USD 75-80/bbl range over the forecast horizon if no major shock hits.

Absent a major energy shock, **inflation** in the developed world will likely continue to approach central banks' targets, and we generally expect further progress as service-price inflation slows amid easing wage pressure while core-good-price inflation remains low. However, the US is likely to buck this trend. We now expect US inflation to pick up somewhat as a result of the trade, fiscal and immigration policies of the Trump administration, although the timing and extent of policy changes remain highly uncertain. This will likely lead to divergence in monetary policy between the US and the eurozone, with the Fed now expected to stop rate cuts while interest rates are in restrictive territory and the ECB likely being forced to bring rates slightly below a neutral level. The BoJ, by contrast, will have more room to gradually tighten its monetary stance.

CHART 2.1: MONETARY EASING TO CONTINUE IN MOST JURISDICTIONS

POLICY RATES, %



Source: Bloomberg, UniCredit Group Investment Strategy
Observation period: Dec 2022-Dec 2026

The Fed will remain in restrictive territory; the ECB will move below neutral

Downside risks to our growth forecasts currently prevail, primarily because we have assumed a partial and staggered phasing-in of US tariffs and no escalation of tensions in the Middle East. If we are wrong about the former, the resulting effects on trade, confidence, capex and labour markets would be significantly larger than currently projected. If tensions in the Middle East were to increase, oil prices would jump, likely well beyond USD 100/bbl, particularly if there is a disruption in the Strait of Hormuz. Such a shock would affect the eurozone much more than the US, triggering further divergence between the two economies.

1

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CONTINUED GROWTH IN CEE AMID FISCAL CONSOLIDATION AND EXTERNAL HEADWINDS

1 LOOSER FISCAL POLICY IN THE US TO KEEP GROWTH ABOVE TREND

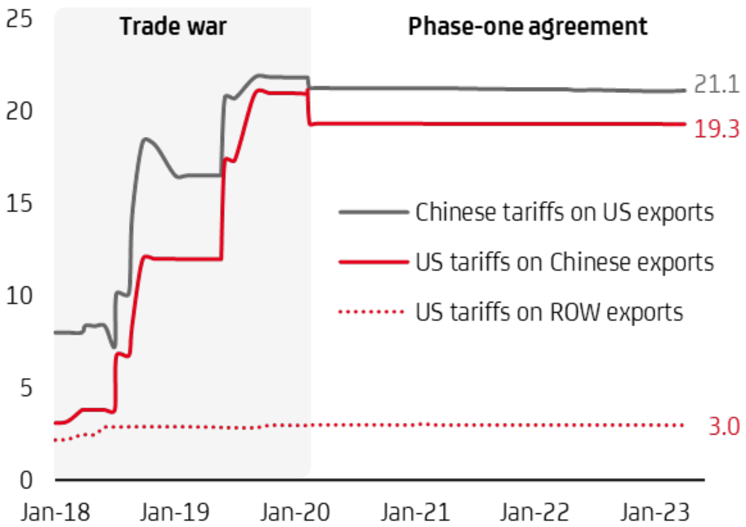
With Mr. Trump in the White House and Republicans in control of both chambers of Congress, we expect the net effect of tax cuts, looser regulation, higher tariffs and tighter immigration to result in slightly-above-trend growth over the next two years (2.1% in 2025 and 2.3% in 2026). However, much will depend on the timing, size and substance of policy changes, and these are highly uncertain.

In the near term, the economy should have decent momentum. Real GDP grew at an annualised rate of around 3% in 2Q24 and 3Q24. However, the strength of **personal consumption** has in part been due to a decline in the savings rate, while the labour market has cooled. The latter is likely to continue to gradually cool around the turn of the year, and there remains a risk that consumption growth could shift downward more abruptly to reflect slower income growth.

Beyond the very near term, the US outlook will be shaped by Mr. Trump's policies. We judge that the upward effects on GDP growth from looser fiscal policy (worth around 1.5-2% of GDP, mainly comprising tax cuts) and reduced regulation would offset downward effects from higher tariffs and tighter immigration (including the expected deportation of some unauthorised immigrants). This assumes a partial implementation of Mr. Trump's **election pledges** with respect to tariffs and mass deportation, meaning that risks to GDP growth will be skewed to the downside should Mr. Trump implement his agenda in full. The implementation of tariffs may begin in spring 2025, with a fiscal package following in the autumn.

CHART 2.2: FRESH TARIFFS ARE IN THE PIPELINE

US-CHINA TARIFF RATES TOWARD EACH OTHER AND REST OF WORLD, %



Source: PIIE, UniCredit Group Investment Strategy; observation period: 2018-2023

The 1.5-2% of GDP of fiscal loosening we have assumed is in addition to a full extension of the individual tax cuts contained in the **2017 Tax Cuts and Jobs Act** (TCJA), which would otherwise expire at the end of 2025. Such an extension would not directly provide a boost to GDP, since it would act as a sizeable drag in the absence of an extension. If our forecast horizon were longer than two years, we would expect growth to slow to below trend, as the temporary boost from looser fiscal policy fades and turns into a drag, along with lagged effects on the economy of restrictive-for-longer monetary policy.

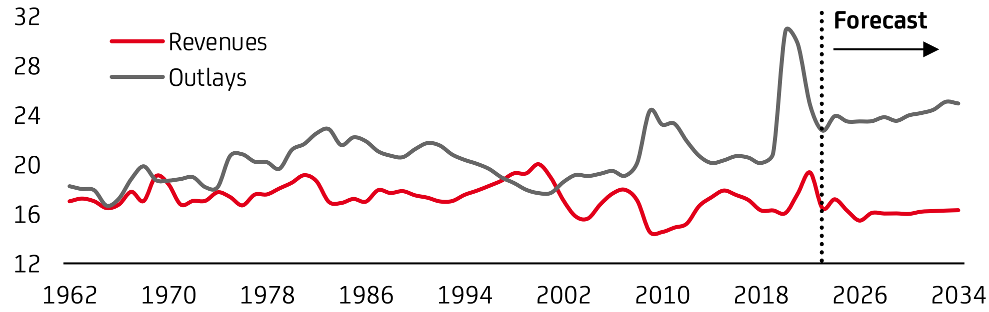
The rollout of tariffs may begin in spring 2025, with a fiscal package following in the autumn. Regulatory rule rewriting will move slowly

Higher tariffs, tighter migration and slightly-above-trend growth (when the economy starts from essentially zero spare capacity) will likely put upward pressure on consumer prices, leaving **inflation above target**, at 2.3%, next year and at 2.5% in 2026. The Fed will have to take notice after cutting rates by 25bp at its December meeting. Since it will take a few months for Mr. Trump's policies to be announced and implemented, and then for these to work their way through to the economy, we think the Fed will keep cutting rates in 1H25 but probably at a slower pace of 25bp per quarter. **The Fed** will probably enter a **wait-and-see** holding period beyond mid-2025, as prospects for above-target inflation and slightly-above-trend growth would require a higher trajectory for rates than otherwise. This would leave the target range for the federal funds rate at 3.75-4.00% through 2026, somewhat above where we expect the longer-run neutral rate to end up (close to or slightly above 3%). We expect quantitative tightening (QT) to stop in spring 2025, but the exact timing of this will be determined by the development of money-market rates and other measures of liquidity (to assess when reserves are no longer abundant but ample).

See our Top 2025 Story
Public debt: US vs. eurozone

CHART 2.3: WIDENING US BUDGET DEFICIT

FEDERAL GOVERNMENT REVENUES AND OUTLAYS, % OF GDP



Note: The forecast for outlays is from the Congressional Budget Office (CBO). The forecast for revenues is UniCredit's forecast based on the CBO's projection + full extension of TCJA + additional tax cuts costing 1.5% of GDP

Source: CBO, UniCredit Group Investment Strategy; observation period: 1962-2034

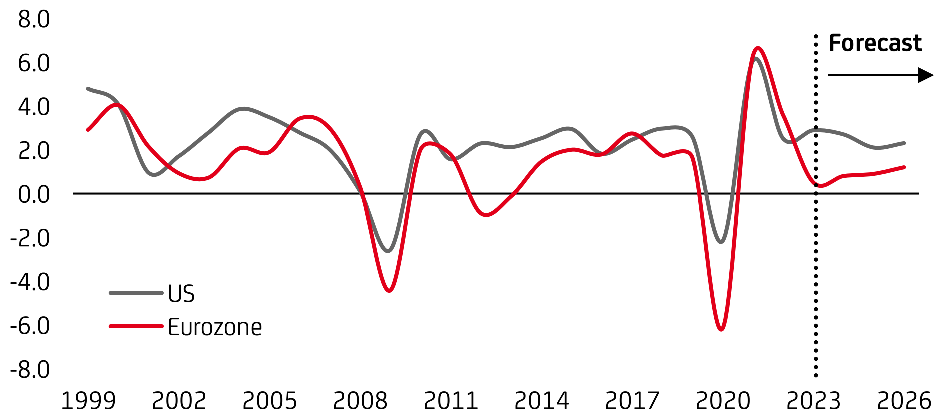
2

SLUGGISH ECONOMIC GROWTH IN THE EUROZONE

The eurozone is likely to remain trapped in a low-growth environment, continuing to meaningfully underperform the US in terms of economic activity, partly as a result of Mr. Trump's policies. We forecast that eurozone GDP will expand by 0.9% in 2025, only marginally above 0.8% growth expected for this year, with Germany, France and Italy expected to grow slightly less than the eurozone as a whole. In 2026, the recovery is likely to gain some traction, with activity in the eurozone set to rise at a pace broadly in line with potential.

CHART 2.4: A WIDE GROWTH GAP BETWEEN THE US AND THE EUROZONE

ANNUAL GDP GROWTH, %



Source: Eurostat, UniCredit Group Investment Strategy; observation period: 1999-2026

Two main factors will support activity.

1. A moderate acceleration in private consumption as real wages return towards pre-pandemic levels. However, elevated economic uncertainty and a weakening labour market are likely to prevent any material decline in the savings ratio from its currently high level.
2. The normalisation of monetary policy should support the construction sector and bring relief to capex at a time of reduced visibility regarding the outlook for external demand.

In **Germany**, where house prices have declined by more than 10% since the ECB started to hike rates, looser monetary policy but also strong demand for living space due to a rising population argue for a turnaround in the housing sector.

Italy is likely to buck the improving trend in residential investment as generous incentives related to building renovation are scaled back. How rapid and intense the effect will be is, in our view, one of the unknowns in Italy's growth outlook. However, the country remains well-positioned to benefit from the implementation of the National Recovery and Resilience Plan (NRRP). While only 30% of the Next

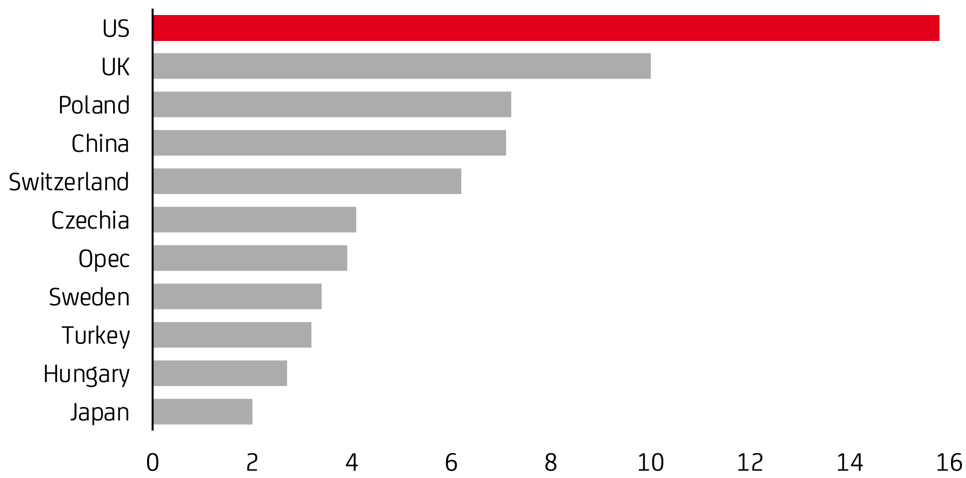
Generation EU (NGEU) resources allocated to Italy have been spent so far, we remain confident that expenditure will accelerate in the coming quarters as the bulk of the investment projects has already started. Therefore, the growth impulse is likely to increase significantly, especially next year.

External trade in the eurozone will probably go from providing a boost to growth to acting as a drag, largely due to higher expected tariffs in the US, its main export market, which accounts for almost 16% of total extra-eurozone merchandise trade. During the second Trump administration, and when one considers an extreme scenario based on Mr. Trump's campaign promises, tariffs on US imports from the EU might increase to 10% from a current average of 3%. Among the largest eurozone countries, Germany is likely to be the most exposed to the risks posed by higher tariffs, as the quantity of goods it exports to the US amounts to almost 4% of national GDP, followed by Italy (3.2%) and France (1.6%).

> External trade in the eurozone will probably go from providing a boost to growth to acting as a drag

CHART 2.5: THE US IS THE EUROZONE'S MAIN EXPORT MARKET

EUROZONE EXPORTS TO MAIN TRADING PARTNERS, % OF EXTRA-EUROZONE EXPORTS, GOODS



Source: Eurostat, UniCredit Group Investment Strategy; observation period: 2023

See our Top 2025 Story
Electric vehicles in Europe

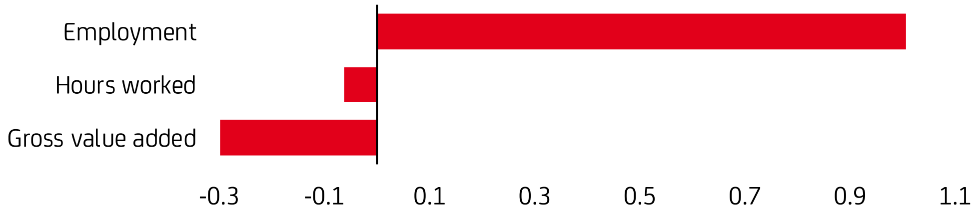
The **auto sector**, a likely target of protectionist measures in the US, will probably remain under pressure amid high uncertainty, fierce Chinese competition and structural problems facing German auto companies.

Fiscal policy (excluding NGEU) is likely to be restrictive to the order of 0.3-0.5% of GDP, and this will likely be driven especially by fiscal tightening in **France**. A wildcard is the possibility of a more-expansionary fiscal policy in Germany after snap elections are held in February. The CDU/CSU, which clearly leads in opinion polls, with a vote share of more than 30%, still seems inclined to maintain the debt brake. However, given the rising likelihood that Mr. Trump will put pressure on **Germany** to ramp up military spending, and the need to modernise Germany's infrastructure, a softening of the debt brake and/or the introduction of a shadow budget to finance spending on defence, energy transition, etc. could be a compromise after the elections. However, this would need a two-thirds majority in both the Bundestag and the Bundesrat. More-expansionary fiscal policy in Germany would be good news for the country and for Europe if it raises the likelihood that there will be a joint effort to increase investment in critical areas, such as defence and the twin transition, at a time when the political outlook remains fraught with uncertainty. France is in the spotlight here. One of the main risks it faces is a scenario in which the French parliament is dissolved again next June (i.e. the earliest this could happen), thereby increasing political instability and placing pressure on President Emmanuel Macron to step down. Fearing a victory by far-right leader Marine Le Pen in the next presidential election, markets could become increasingly nervous, and downward pressure on the sovereign credit rating might intensify. Under such circumstances, France's rating might decline towards single A.

Following significant **labour hoarding** over the last two years, new hiring is likely to weaken as firms in the eurozone see profit growth slow after a post-pandemic boom. This will increase downside risks to the labour market, although a downturn is unlikely as companies seem more reluctant to let staff go than in previous cycles amid unfavourable demographic trends.

CHART 2.6: SIGNIFICANT LABOUR HOARDING IN INDUSTRY

INDUSTRY (4Q19-2Q24, % CHANGE)



Source: Eurostat, UniCredit Group Investment Strategy; observation period: 4Q19-2Q24

Disinflation in the eurozone is on track, and headline inflation will probably settle in line with, or slightly below, the ECB's 2% target over the course of 2025. Service-price inflation has remained around 4% for a year, but a slowdown is looming. In our forecasts, service prices will drive the final leg of core-price slowdown as wage growth eases more decisively next year. In general, eurozone firms experience weaker pricing power and are forced to absorb a larger share of their labour costs into their profit margins. Leading indicators suggest that disinflationary impulses from goods and food prices are fading, although pressure is likely to remain weak into next year.

Rising risks to the employment outlook and fast disinflation make it likely that **the ECB** will abandon its restrictive monetary stance soon. We expect 25bp cuts at consecutive meetings until March, when the deposit rate is likely to reach 2.50%, a level that a majority of the Governing Council (GC) seem to regard as broadly neutral. The pace of easing might slow thereafter, reverting to a quarterly pace of cuts. Given our expectations that US tariffs will weigh on eurozone economic activity throughout next year and that inflation will hover around the ECB's 2% goal, we have added one final 25bp cut to our projection for easing, with the deposit rate now seen reaching a **terminal level of 1.75%** in December 2025. In our view, this would be slightly below a neutral level for the policy rate. In general, when dealing with the spillover from the outcome of the US election, the ECB will have to calibrate its policy response based on the evolution of financial conditions in the eurozone. In this respect, two factors will play a particularly important role in shaping the thinking of the GC: the EUR and the long end of yield curves in the euro area. If the EUR were to weaken significantly, the ECB would have less scope to cut rates below neutral, while upward pressure on long-term yields induced by a possible sell-off in USTs would argue for faster and deeper ECB rate cuts. We think that interest rates will remain unchanged in 2026, as inflation will probably fluctuate around 2% if no major shock to commodity prices occurs.

TIME TO RISE TO THE CHALLENGE

In his recent report on Europe's competitiveness, former Italian Prime Minister **Mario Draghi** warned that, without a change of mindset, the EU faces the risk of a "slow agony". A second Trump administration might spur Europe to tackle some of its persistent structural issues head-on, from its innovation gap and lack of cross-border infrastructure to its incomplete single market and inadequate governance structure. However, the continental political context does not seem too conducive to this kind of change as strategic priorities differ among EU member states and as Eurosceptic forces are gaining ground. Trump 2.0 might exacerbate these dynamics, further dividing the EU and boosting illiberal democracies in eastern Europe. Moreover, if Europe can no longer take for granted the US security umbrella under Mr. Trump, then national governments will face a difficult trade-off when it comes to allocating portions of national budgets for defence or for social programs. Since the end of the Cold War, government spending on social programs has increased dramatically, whereas spending on defence has remained roughly flat. Reversing the trend will be politically costly.

3

CHINA'S WOES ARE SET TO CONTINUE

In 2025, trade tensions between China and the US will likely intensify. On the campaign trail, Mr. Trump reiterated his intention to put a 60% tariff on all US imports from China, even vowing to impose a 100% duty if Beijing tried to undermine the international role of the USD. In order to contain domestic inflationary pressure ahead of the midterm elections, Mr. Trump will probably limit himself to **targeted measures** in selected industries, at least in the first few months of his presidency.

China's exports to the US as % of total

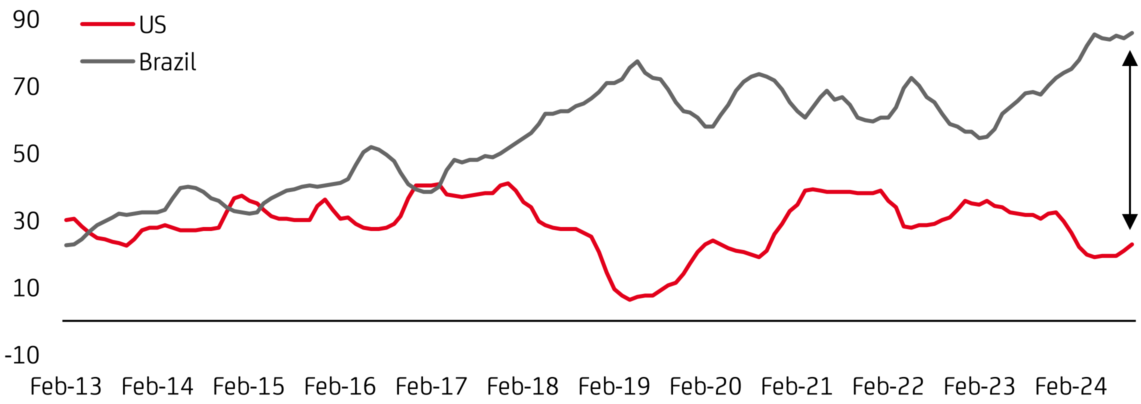
14.3%
2024

18.2%
2017

This will allow him to preserve domestic political support and to build leverage for possible negotiations with China down the road. For this reason, the consequences for China's growth are likely to be limited. In general, since Mr. Trump's first presidency, the US has gradually become a less important export destination for China, with China's exports to the US falling from around 18% to about 14%. Moreover, **the PBoC** is likely to support China's export sector by letting the CNY depreciate – also thanks to contained domestic inflationary pressure. Even without an escalation in trade tensions, and to compensate for anaemic domestic demand, we expect USD-CNY to move towards 7.30-7.35 next year. If the US imposes 60% tariffs and if Beijing decides to sharply depreciate its own currency to offset the impact of these tariffs, USD-CNY will likely rally further, probably even well beyond the 7.40 handle, depending on how many sectors are targeted by the Trump administration. That said, China is unlikely to remain passive. As it did during the first Trump presidency, it will likely adopt retaliatory measures, and research has shown that it will probably adopt politically targeted measures. In 2018, China's **retaliatory tariffs** were carefully selected to target goods produced in counties where Republicans have traditionally enjoyed strong support. One clear example is in agricultural products, such as soybeans, where China has reduced its exposure to the US while increasing its dependence on Brazil.

CHART 2.7: TARIFFS LEAD TO TRADE DIVERSION

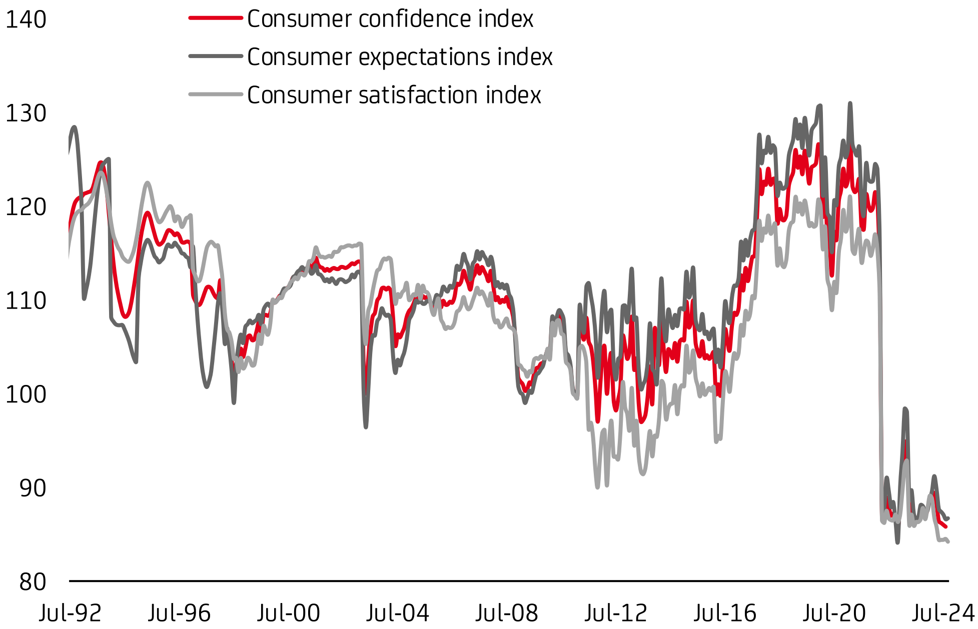
CHINA'S SOYBEAN IMPORTS (MN/TONS, 12M CUMULATED)



Source: Bloomberg, UniCredit Group Investment Strategy; observation period: Feb 2013-Feb 2024

Increased challenges to China's exports are likely to expose weakness in domestic demand amid a lack of bold consumption-enhancing measures. This strengthens our conviction that structural deceleration in China's economic growth will continue, with GDP set to expand by 4.5% in 2025 and by 4.2% in 2026, from 4.8% this year. Two main factors will likely weigh on the Chinese economy. First, the rebalancing of the country's growth model away from real estate and heavy industry and towards high-value-added and more-strategic manufacturing (i.e. electric vehicles, high technology, batteries, etc.) is still under way. Second, **consumer confidence** remains at rock bottom, primarily because Chinese household wealth tends to be tied to the value of homes, which has fallen in recent years, in a context of rising unemployment and a weak social safety net.

CHART 2.8: CHINESE CONSUMERS ARE PESSIMISTIC



Source: NBS, UniCredit Group Investment Strategy; observation period: Jul 1992-Jul 2024

Since a revitalisation of private consumption would require boosting the real-estate sector, which would delay a structural transformation of the economy, we expect Beijing to keep adopting policy measures aimed at stimulating the supply side of the economy more than the demand side (through, for example, monetary measures aimed at providing credit to firms and small cash handouts for low-income households). This is because China's financial system is mainly geared toward the supply side of the economy. Credit is directed through businesses, state-owned enterprises, local governments and the central government to infrastructure, property and manufacturing. In turn, this leads to elevated output from companies that then heavily compete on prices. Bold consumption-boosting measures would require reforms, such as the introduction of a Western-style welfare state, to address persistently low consumer spending as a proportion of GDP and a high savings ratio. We think this is unlikely to happen anytime soon.

In turn, demand-supply imbalances at home will remain a source of deflationary pressure domestically, with CPI inflation likely to remain below 1.0% in 2025. China's **excess capacity** will need to be absorbed abroad (so called Second China Shock), with all the trade tensions associated with this. In order to keep supporting the economy, we expect the PBoC to announce further reductions to the 14-day reverse repo rate, the required reserve ratio and the seven-day reverse repurchase rate.

China's demand-supply imbalances will remain a source of deflationary pressure domestically

DEALING WITH THE SECOND CHINA SHOCK

The world is facing a **new export boom** from China. During the First China Shock, which took place between 2003 and 2015, Beijing's global export shares jumped from less than 5% to about 12%. Then, they declined until the outbreak of the pandemic and now they are close to 15% - a historic high. There are interesting differences between the two shocks.

The First China Shock was about the export of cheap, low-quality and low-value-added goods. Now, instead, China is exporting technologically advanced goods, such as EVs, batteries or solar panels that are of higher quality and more affordable than what Western companies can produce. The other interesting difference between the two shocks is that the first one related to forced technology transfers from the West to China. Now, it's the West that should try to get access to China's know-how, particularly in the field of green technologies.

A pragmatic solution to the problem would be to attract Chinese companies in Europe and the US. This way, the negative employment consequences of China's competition would be mitigated as Chinese companies would rely on the local labour force and would comply with local labour regulations. At the same time, it would be possible to enforce technological controls on their products, for example when it comes to the use of data in EVs. In the 1980s, trade tensions between Japan and the US eased when Japanese companies moved part of their production to the US.

However, in the current geopolitical context, this is something that is unlikely to happen. Unlike China, Japan was not seen as a hegemonic rival. At the same time, trust between Beijing and the West is at rock bottom. The incoming Trump administration is unlikely to adopt policies aimed at rebuilding trust with Beijing that would facilitate the absorption of its excess capacity. The **trust issue** is what will prevent an easy resolution of the Second China Shock. Overcapacity in green technologies should be welcomed globally because it could accelerate the decarbonisation process at the lowest cost. Europe and the US would not need to regain competitiveness in the production of solar panels, for example, but could specialise in their true comparative advantages. But without trust, national security concerns related to overdependence on a single supplier will have the upper hand over economic efficiency and green transition arguments.

4 UK ECONOMIC GROWTH TO PICK UP MODESTLY

In the UK, we forecast real GDP will grow by 1.2% next year and by 1.4% in 2026, after growing by 0.9% this year. Near-term growth is likely to remain subdued, but an easing of the fiscal consolidation announced in the Autumn Budget, along with less restrictive monetary policy, will help to support a moderate pickup in growth. Headline inflation will likely stay close to, but slightly above, the 2% target next year before falling slightly below target in 2026.

UK Autumn Budget (GBP, average per year)

c. 40bn in higher taxes

c. 70bn in higher spending

The BoE is likely to hold the bank rate steady at 4.75% in December, since, at its November meeting, the Monetary Policy Committee repeated that most members favour a "gradual approach" (likely meaning one 25bp cut per quarter). For next year, we expect a total of 125bp of cuts, taking the bank rate to 3.50% by the end of next year. This is less than we previously expected, since the smaller tightening of fiscal policy will favour a more gradual reduction in monetary-policy restriction. In 2026, the BoE is likely to return the bank rate to a neutral level, which we estimate to be around 2.75%.

Office for Budget Responsibility stated

"One of the largest fiscal loosenings of any fiscal event in recent decades"

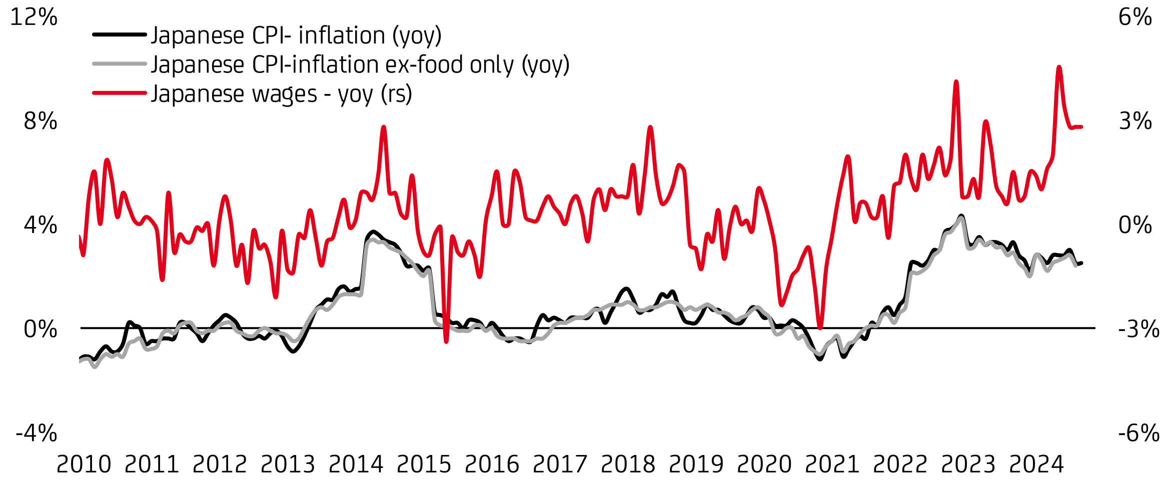
5

BOJ MONETARY POLICY TO KEEP DIVERGING

The Japanese economy is expected to regain momentum next year, with GDP growth accelerating to around 1% from 0.1% in 2024. Stronger growth is expected to come primarily from private consumption as real-wage growth strengthens. Consumer spending will also benefit from a stronger JPY, and this could alleviate inflationary pressure.

The BoJ will probably continue to diverge from the central banks of other developed countries and remain on a normalisation path. Wages are still growing strongly, although off the peak of 4.5% Y/Y reached in June, while inflation remains above the central bank's 2% target, leaving real rates clearly in negative territory. BoJ tightening will likely remain gradual in 2025 and will largely depend on the outlook for economic growth, on whether wage and inflation pressures soften further and on the future trajectory of the JPY. Additional weakness of the JPY, stemming from a protracted political impasse after the general election held in October, might well have an impact on BoJ policy. Overall, we expect the BoJ's official policy rate to be raised from the current 0.25% to 0.65% by 4Q25 and to 0.75% by 4Q26.

CHART 2.9: ADDITIONAL BOJ POLICY NORMALISATION LIES AHEAD



Source: Bloomberg, UniCredit Investment Strategy; observation period: 2010-24

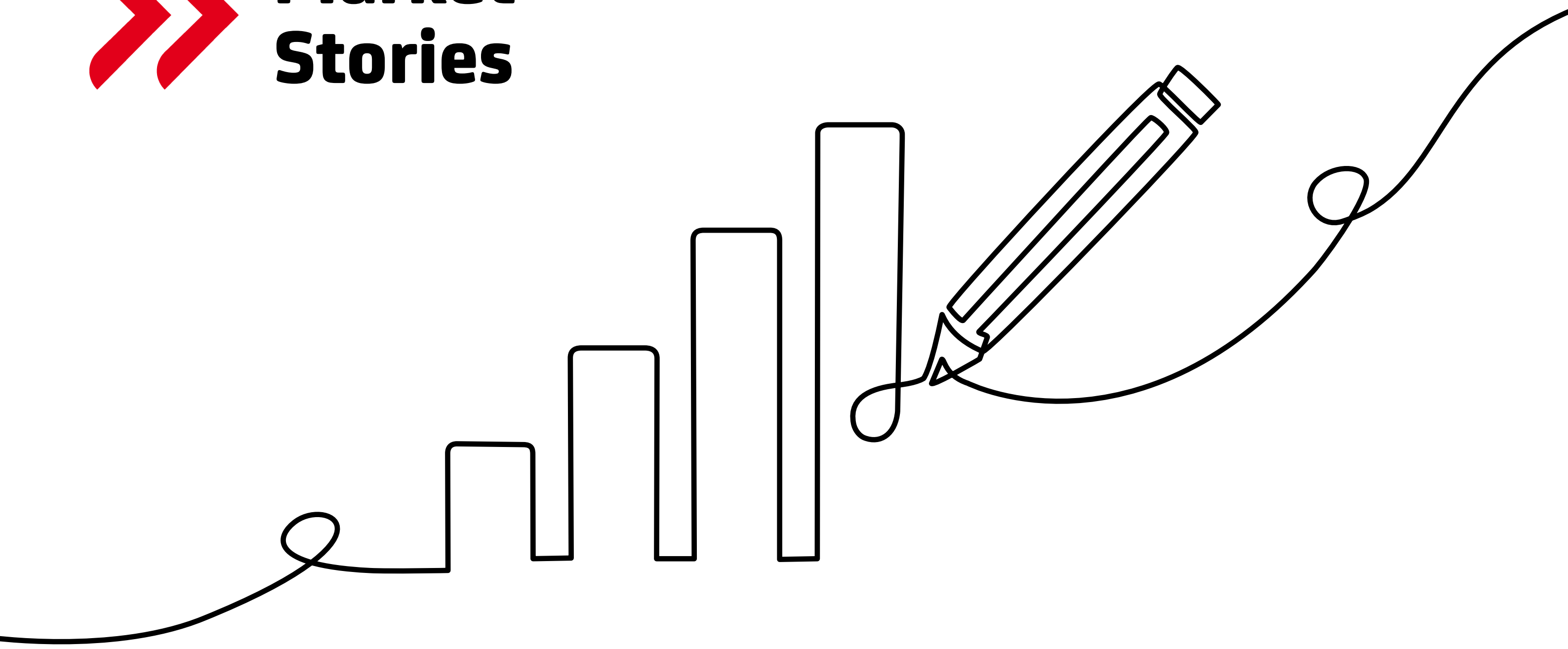
6

CONTINUED GROWTH IN CEE AMID FISCAL CONSOLIDATION AND EXTERNAL HEADWINDS

Headwinds to global trade due to tariffs will likely weigh on demand for CEE exports, given CEE economies' integration into the supply chains of euro-area manufacturing. Consequently, net exports will probably continue to pose a drag on growth in 2025. Meanwhile, private consumption will likely continue to drive growth, but its contribution could ease, with slower real-wage growth and smaller fiscal support to households due to government plans for fiscal consolidation. Monetary policy will continue to ease, supporting domestic demand. **Election cycles** imply some divergence across countries. Countries with elections on the horizon (Poland and Czechia in 2025 and Hungary in 2026) will be more prone to risks associated with fiscal slippage, and this might also narrow the scope for rate cuts by central banks. However, countries such as Romania, Slovakia and Turkey, could deliver more-sizable fiscal tightening. Contribution from investment will rise, especially if public investment picks up with a higher disbursement of Recovery and Resilience Facility and regular EU funds from the 2021-27 EU budget. Consequently, GDP growth could accelerate to 2.7% in 2025 (from 2.0% this year) in EU-CEE, while, in Turkey, it could ease from 3% to 2.7% next year. More-protracted weakness in net exports could affect domestic demand in CEE through labour-market conditions and consumer sentiment.

Disinflation will resume in 2025 after stalling in 4Q24. Slower wage growth and a benign trend in imported inflation will support the downside trend. Meanwhile, fiscal measures (rollback of price caps, tax hikes) imply upside pressure on administrative prices. Higher US yields could lead to currency weakness, risking a narrowing of the scope for monetary easing.

Market Stories



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Stay constructive

The macroeconomic backdrop seems to support risk appetite in 2025. We expect moderate global economic growth and inflation no longer running hot but often converging towards central-bank targets, allowing easier monetary policy. The tightening cycle has replenished central banks' toolboxes, creating room for bold action in case of need. We expect to see conditions that are conducive to solid earnings growth, lingering demand for carry and a recovery in valuations in underperforming market segments.

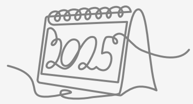
This will be good news for equity and bond returns in 2025, but it will not necessarily translate into an all-clear for global markets. The global recovery in risk appetite is mature, and this year's double-digit returns across large swathes of the stock market have lifted valuations. Credit spreads have been tightening materially, while risk-free curves are already pricing in sizable cuts to official rates. US equities anticipate market-friendly impulses from US President-elect Donald Trump. Conversely, the new administration's agenda poses some risk to USTs, the global benchmark for bond markets, and might add to geopolitical and trade tensions, with potentially large spillovers outside the US. Hence, portfolio construction needs to be adjusted accordingly.

While the low-hanging fruit has been picked, solid returns can still be harvested in equities and bonds by investors with a more-selective approach. Economic and political uncertainty will lead to different risk-reward prospects across regions. US equities will probably offer the highest potential for the coming quarters, but opportunities will also arise in other regions. Bonds will be in demand given their diversification benefit and still-attractive carry. Macroeconomic and geopolitical uncertainty will continue to sustain demand for precious metals, while industrial metals will await better economic-growth prospects.

Bonds

TREASURIES AND BUNDS TO TRADE SIDEWAYS AS RATE CUTS ARE ALREADY PRICED IN

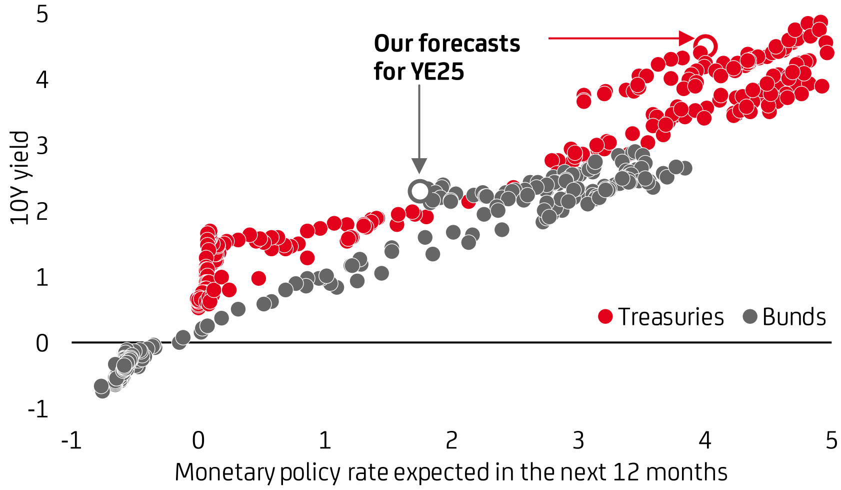
With the outlook for policy rates in the US and the eurozone trending downward, investors are focused on where policy rates will settle at the end of this monetary easing cycle and on how long it will take for central banks to achieve a neutral monetary-policy stance. Regarding the first point, as discussed in our Top 2025 Stories, a key question remains: has the elusive neutral rate risen in recent years, and how will it be influenced by the second Trump presidency? The pace of rate cuts will largely depend on growth and inflation dynamics as central banks are set to reiterate their data-dependency mantra. Policy-rate cuts do not automatically translate into lower 10Y yields, which, in turn, are also affected by other factors, such as bond supply dynamics. Also, geopolitical risks might represent a wildcard, as they could either boost demand for govies, which are regarded as safe-haven assets, or lead to reaccelerating inflation and, possibly, less-dovish central banks.



See our Top 2025 Story
Public debt: US vs. eurozone

CHART 3.1: POLICY RATES AND THEIR IMPACT ON LONGER-DATED YIELDS

Each point indicates the past relationship between the depo/fed funds rate expected by markets in the following 12 months and the 10Y Bund/UST yield. **The correlation is significant and positive**



Source: Bloomberg, UniCredit Group Investment Strategy; weekly data from 15-Nov-19 to 15-Nov-24.

Assuming monetary easing will progress as we expect in both the eurozone and the US, we believe **long-dated yields** of eurozone government bonds and Treasuries have little room to decline from their current levels. Rate cuts by the Fed and the ECB are widely priced in, and bond supply is set to weigh on the longer end of the curve. Ongoing quantitative tightening by the ECB will amplify the burden on investors to absorb the supply of eurozone government bonds, while UST supply is set to remain abundant to finance Mr. Trump's ambitious agenda. With respect to the **10Y UST yield**, we have pencilled in a range of **4.40-4.60%** for the end of 2025, 40-60bp higher than the terminal rate. We expect the **10Y Bund yield** to remain in a range between **2.20% and 2.40%** by the end of 2025, 45-65bp above our projected depo rate by the end of next year. The 10Y UST-Bund spread is set to widen further. Carry will be the key engine of UST and Bund performance. Yield curves are set to steepen in the US and the eurozone, although they will likely remain flatter than their pre-pandemic levels due to elevated policy rates (still in restrictive territory in the US).

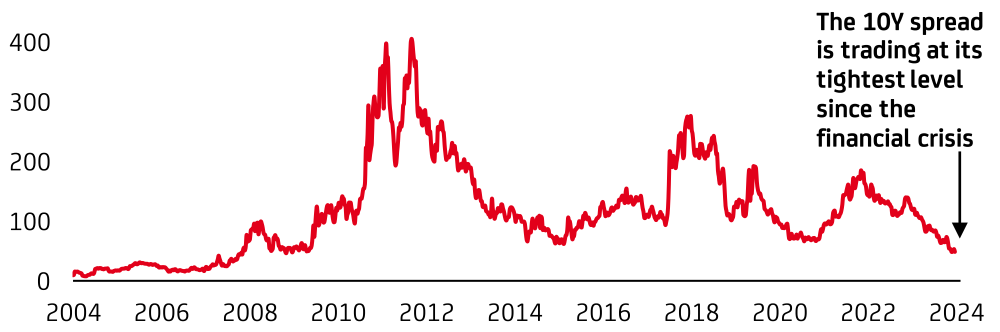
BTPS WILL LIKELY REMAIN IN A SWEET SPOT

With Bunds likely to show contained performance, savvy investors will seek more lucrative opportunities. Such an attitude would be in alignment with this year's resurgence in carry trades. Strong interest in peripheral government bonds has tightened yield spreads relative to Bunds, supported by ongoing disinflation, declining volatility, favourable fiscal outlooks, better-than-average growth rates and, especially in Italy, a stable political picture. France stands out as an exception, burdened by weakening macroeconomic fundamentals and political uncertainty.

We expect demand for Italian government bonds to remain sustained in 2025, bolstered by a stable political environment and ongoing fiscal consolidation. We see the 10Y yield **spread** between Italian and German bonds in the **120-140bp range**, as positive factors will partly be offset by heavy issuance, mostly due to maturing bonds. On the other hand, the outlook for French government bonds appears grim, primarily due to political instability and rating risks. While tactical buying may occur, investor concerns will keep the 10Y OAT-Bund yield spread at around 70bp. **We prefer BTPs to OATs**, as the former offer a more attractive entry point and a natural buffer if yields rise. Additionally, that 50% of all French government debt is held by foreign investors (compared to just 25% for Italy) is also relevant as foreign investors are often more sensitive to price fluctuations and shifts in a country's economic fundamentals.

CHART 3.2: BTP OUTPERFORMANCE VS. OATS

10Y BTP-OAT SPREAD

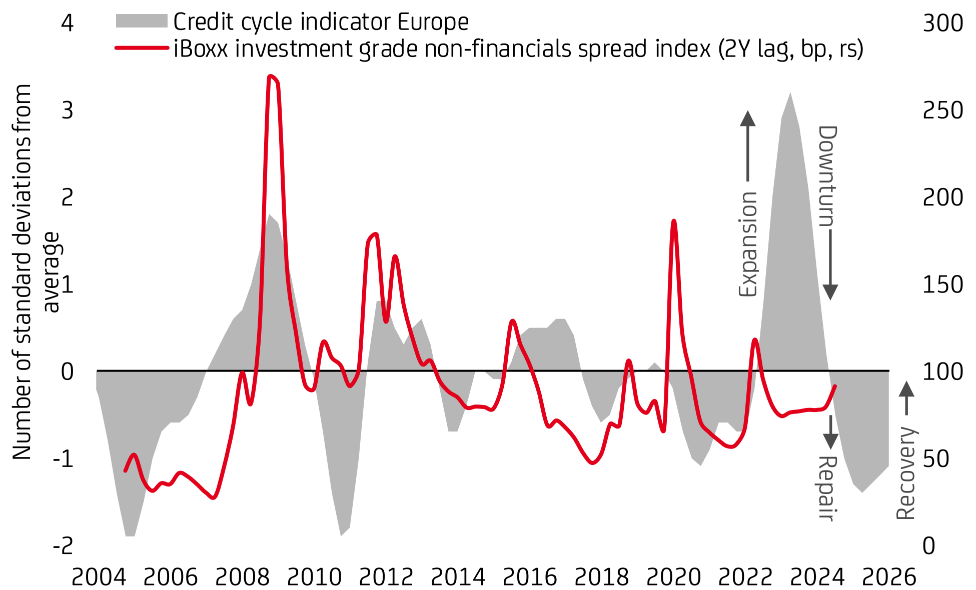


Source: Bloomberg, UniCredit Group Investment Strategy; weekly data from 20-Nov-04 to 15-Nov-24.

CARRY TRADES TO DRIVE 2025 GAINS FOR EUROPEAN CREDIT

Carry trade is set to be the name of the game for credit markets. The promising performance expected for European non-financials credit is fuelled by moderate macroeconomic growth in the eurozone and a credit cycle that is firmly in recovery mode. This is illustrated in Chart 3.3, which shows the credit cycle phases represented as units of standard deviation from the long-term average (represented as 0). We are seeing signs of moderately accelerating credit growth alongside conservative financial strategies from corporates, all while appetite for risk remains robust amid rising asset valuations.

CHART 3.3: RECOVERING CREDIT CYCLE TO SUPPORT EUROZONE CREDIT



Source: S&P Global, UniCredit Group Investment Strategy; monthly data from Dec-04 to Sep-24.

Cyclical credit is poised to gain from a gradual uptick in economic growth, and the likelihood of credit events, such as defaults, is expected to decrease. Many corporates are sitting on healthy cash reserves, which bodes well for debt service. As economic growth picks up, we anticipate a moderate rise in capital expenditure, along with a **boost in M&A activity**. Coupled with rising bond redemptions in 2025-26, these factors point to another year of strong new bond supply next year. Taking into account the overall supportive economic outlook, this influx, combined with a lack of reinvestment by the ECB, should be neutral for credit risk premiums.

Investors should pay close attention to the **automotive sector**, where structural challenges related to electric vehicles and tariffs warrant a cautious approach, especially to longer-dated bonds. Bank credit is also set to remain in good shape next year. While net interest income is expected to moderate, European banks are still likely to enjoy solid profitability in 2025, with a consensus return on common equity hovering around 11%. Declining interest rates will support asset quality, particularly in commercial real estate lending. We anticipate that banks' 2025 cost of credit will remain manageable.

2025 will be another year of strong bond supply

In terms of spreads, we think the iBoxx Investment-Grade Non-Financials Index will tighten to 80bp, the iBoxx Non-Financials Hybrid Index to 180bp, and the iBoxx High-Yield Non-Financials Index to 270bp by the end of 2025. Decent carry in this environment will be a crucial driver of total returns and is projected to be between 3% for the iBoxx Investment-Grade Non-Financials Index and 6% for the iBoxx High-Yield Non-Financials Index, thereby keeping pace with this year's performance.

A continuation of the contained rate volatility environment could also favour lower-rated (primarily BB rated) corporate bonds. Selectively adding fundamentally solid high-yield names to portfolios can provide value, thanks to their enticing carry opportunities, while investors should remain mindful of associated idiosyncratic risks. With investor concerns regarding the economic outlook diminishing and the ECB likely to ease policy in 2025, **extending maturity** to benefit from higher credit spreads could be an effective strategy to enhance performance.

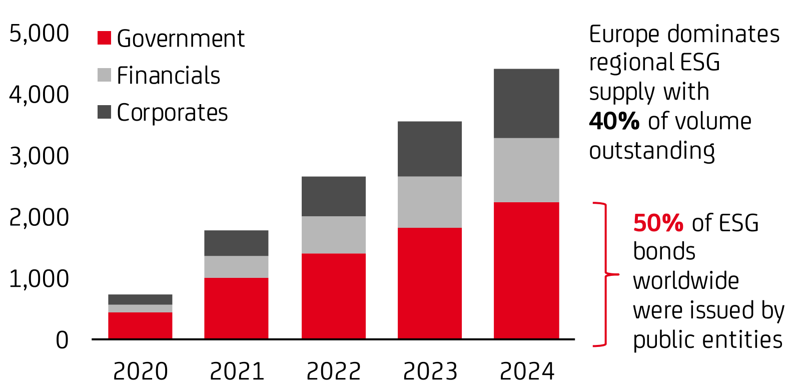
NAVIGATING THE ESG BOND MARKET IN 2025

In 2025, we anticipate that investors in environmental, social and governance (ESG) bonds will continue to capitalise on the supportive landscape for ESG investing that began toward the end of 2023. Our research indicates that **"greeniums"**, the price premiums associated with green and other ESG-bond classes compared to standard bonds, have nearly vanished since 3Q23. This shift enables investors to engage in ethical and environmental investment strategies without the higher costs that characterised the boom in ESG-bond volumes that started in 2019.

Several factors have contributed to this retreat of ESG-bond pricing to parity with standard bonds. **1.** Cooler demand has arisen from uncertainty surrounding EU regulation of green assets, particularly in the context of the Sustainable Finance Disclosure Regulation's fund classification. **2.** Following commodity price hikes linked to the Ukraine conflict, there has been a notable uptick in interest in "brown" energy assets. **3.** The broader bond market has seen high demand, as investors flock to long-dated bonds in anticipation of declining interest rates.

Furthermore, the ongoing-robust supply of **ESG bonds** plays a significant role in this pricing dynamic. Contrary to what one might expect from a dwindling price premium, we have seen steady growth in ESG-bond issuance throughout 2024. New bonds from debut ESG issuers are expanding the range of available bond classes, industry sectors and issuers. Companies and governments are motivated to issue ESG bonds for reasons beyond just seeking better pricing. They are increasingly focused on meeting sustainability targets, preparing for stricter environmental regulations and engaging in "virtue signalling" to stakeholders. Amid further growth of the ESG market, expected monetary easing is likely to stimulate even more green investment, ensuring that the ESG-bond market remains vibrant.

CHART 3.4: ESG BONDS OUTSTANDING WORLDWIDE
(USD BN)



Source: Bloomberg, UniCredit Group Investment Strategy; yearly data from 2020 to 2024.

Equities

ANOTHER YEAR OF SOLID EQUITY PERFORMANCE AHEAD

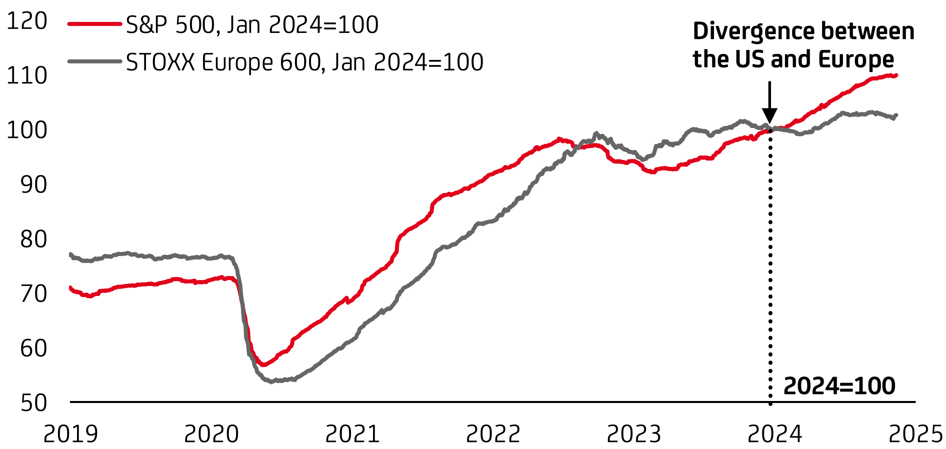
The equity market outlook for 2025 remains optimistic, pointing to appealing opportunities, with a solid focus on fundamentals and sector dynamics driving growth. After an impressive 2024, when the US stock market has soared (S&P 500 +25% until mid-November, STOXX Europe 600 +7%, Nikkei +15%, MSCI EM +10%), we anticipate another solid **average gain of around 10%** next year. While short-term news cycles often bring their share of reasons to worry – ranging from geopolitical tensions to disappointing earnings in the tech sector – it is essential to maintain a long-term perspective focused on fundamentals.

After navigating an initial slowdown next year, the global economic outlook is set to improve towards the end of 2025 and this should positively impact corporate profits and stock markets alike. The technology sector, particularly due to the rise of artificial intelligence, is poised to be a significant and independent driver of growth. Barring possible episodes of stock volatility, we expect valuations to gradually normalise, primarily supported by a trend toward lower central-bank rates.

Tech sector poised for another strong performance; US stock market exceptionalism to continue

We believe the US stock market will start 2025 with the strongest fundamentals. We project that the US economy will pull off a "soft landing", with growth accelerating in 2026, while the economy in Europe will start to recover only gradually. The economic environment in China is likely to deteriorate further, while GDP in Japan will accelerate only modestly. As a result, we expect profit margins to remain highest in the US, albeit slightly lower, and we think the divergence in corporate earnings growth between the US and Europe that we have observed this year will continue in 2025. Additional fiscal stimulus, tax cuts and deregulation efforts, which will be facilitated by the Republican majority in Congress, are likely to support US earnings growth.

CHART 3.5: STRONG US EARNINGS GROWTH TO CONTINUE
12M FORWARD EPS ESTIMATE



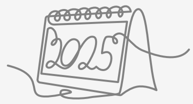
Source: Bloomberg, UniCredit Group Investment Strategy; daily data from 1-Jan-19 to 15-Nov-24.

Based on these forecasts, our year-end targets for 2025 range from +8% for Europe to +15% for the US. Japanese and Chinese companies are projected to show growth potential similar to Europe, each at +8%. Thus, we see the highest stock-market potential in the US, followed by Europe and Japan. While China's markets may exhibit some tactical catch-up potential, this will be limited by Mr. Trump's victory in the presidential election and the resulting uncertainty surrounding tariffs.

With economic growth likely to accelerate during 2025, the appeal of cyclical sectors will probably rise, making **small- and mid-cap** companies attractive relative to large caps. In relative terms, this could temper the momentum of technology stocks, whose robust earnings growth is already reflected in high valuations.

VALUATIONS AND US MARKET CONCENTRATION ARE MANAGEABLE

Market concentration will remain a critical concern, especially as it pertains to the "Magnificent Seven," which comprise about 30% of the S&P 500. Historically, sustaining high sales growth and profitability over extended periods has been challenging. However, if our predictions about the US economy and the Fed hold true, we could see a shift in stock-market favourites, allowing for a recovery among the broader S&P 500. Companies in sectors such as financials, consumer discretionary and industrials (whose weighting taken together is equal to that of the IT sector in the S&P 500) could emerge as market leaders.

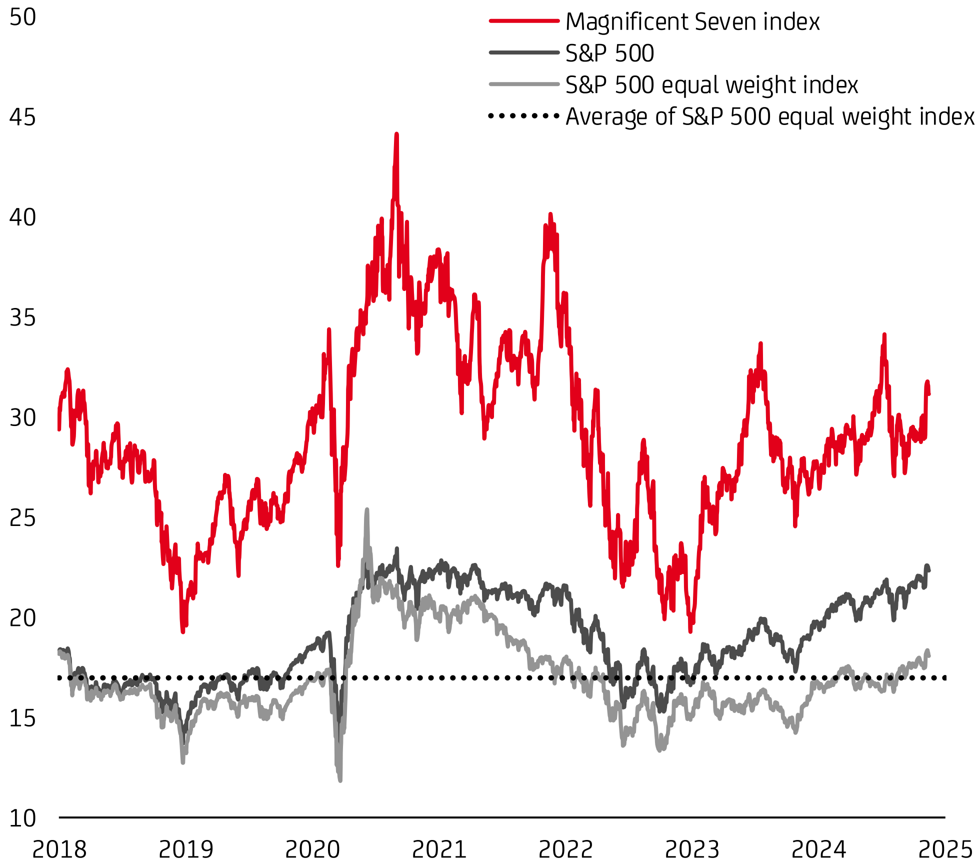


See our Top 2025 Story
There is no AI bubble

Although US valuations, with an average price/earnings (P/E) ratio of 22, are above historical averages, this can largely be attributed to the **Magnificent Seven**'s expected high earnings growth of nearly 40% in 2025. This situation differs from the dot-com bubble of 2000, when the leading companies at the time had an average P/E ratio of 52. However, as market concentration has increased, it may be important to diversify and reduce the risks linked to the IT sector. The equally weighted S&P 500 index may better reflect reasonable valuations across the broader market. With the anticipated trend to lower interest rates and improving economic momentum, we believe the equally weighted S&P 500 could outperform. In particular, companies outside the (partly pricey) large-cap segment that are strongly focused on the US domestic economy are likely to benefit from the measures planned by the incoming Trump administration.

CHART 3.6: US VALUATIONS ARE STRETCHED BUT NOT EXCESSIVE

P/E RATIO



Source: Bloomberg, UniCredit Group Investment Strategy; daily data from 1-Jan-18 to 15-Nov-24.

Commodities

ENERGY COMMODITIES: BRENT AND TTF PRICES TO STABILISE

OPEC+ is navigating a challenging landscape as it grapples with its current production limits with members eager to normalise output and lift the existing curbs of 2.2mb/d. Looking at 2025, with robust oil supply from North America (which could benefit from the support to the industry pledged by the incoming Trump administration) and a sluggish global demand outlook, OPEC+ may find itself compelled to extend its current production cuts throughout the year. Even maintaining present production levels could lead to a slight surplus in the global oil market.

If geopolitical tensions in the Middle East do not escalate into a broader regional conflict, we expect OPEC+ to seek to stabilise the Brent price at around **USD 75/bbl**. By 2026, as demand begins to improve, OPEC+ is likely to start injecting oil supply back into the market, with Brent prices likely moving toward USD 80/bbl. On the other hand, if OPEC+ opts to increase supply at its annual meeting in December by 180kb/d each month, the Brent price could decrease to around **USD 60/bbl** or below in 2025.

OPEC+ will struggle to lift production, given ongoing problems of oversupply

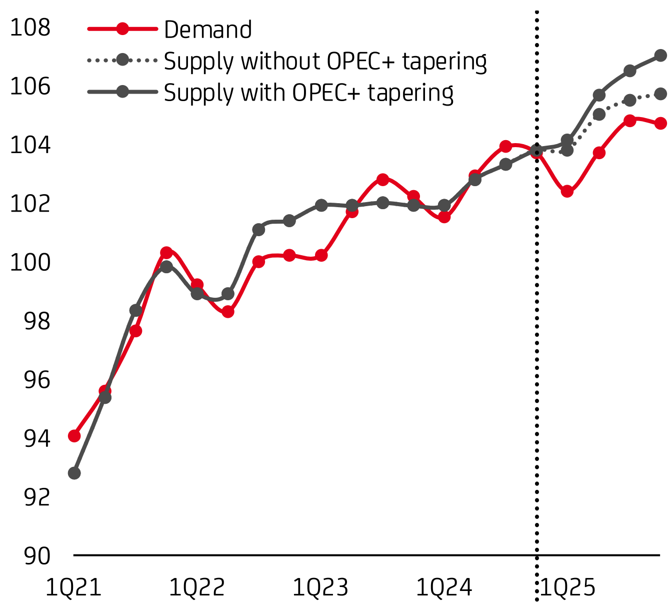
In contrast, a widening conflict in the Middle East could drive the Brent price beyond USD 100/bbl. If oil fields or refining facilities in Iran or Saudi Arabia were to be targeted, or if there were a temporary blockade of the Strait of Hormuz, through which approximately 20% of global oil supply flows, Brent prices could surge past **USD 130/bbl**. Such a spike would likely persist until there were clear indications of a full restoration of global oil supply.

Thanks to a mild-winter carryover effect, Europe's gas storage hit 90% of capacity by mid-August. Demand is stabilising at low levels, likely due to structural changes caused by energy-efficiency gains, fuel diversification away from gas and binding climate targets. In industrial sectors, part of this weakness stems from permanent output losses in energy-intensive industries, which are struggling to compete globally due to TTF prices remaining above pre-Ukraine-war levels. We expect TTF prices to remain within the **EUR 40-45/MWh** range throughout the winter.

Europe has effectively reduced its dependence on Russian gas through supply diversification. Currently, domestic production accounts for about 45% of European supply, followed by LNG imports (35%) and piped gas (20%). But **gas supply is tight**. A 20% increase in heating demand could create a shortfall of around 20bcm, necessitating more LNG imports, creating upward price pressure. Temporary outages could disrupt gas balances, especially if the coming winter is colder than average. Despite diversification efforts, Europe still relies on Russian gas and LNG for about 12.5% of its total consumption. An escalation of the Russia-Ukraine conflict would likely push TTF prices towards **EUR 100/MWh**.

CHART 3.7. OVERSUPPLIED OIL MARKET

MB/D



Source: International Energy Agency, UniCredit Group Investment Strategy; quarterly data from 1Q21 to 4Q25.

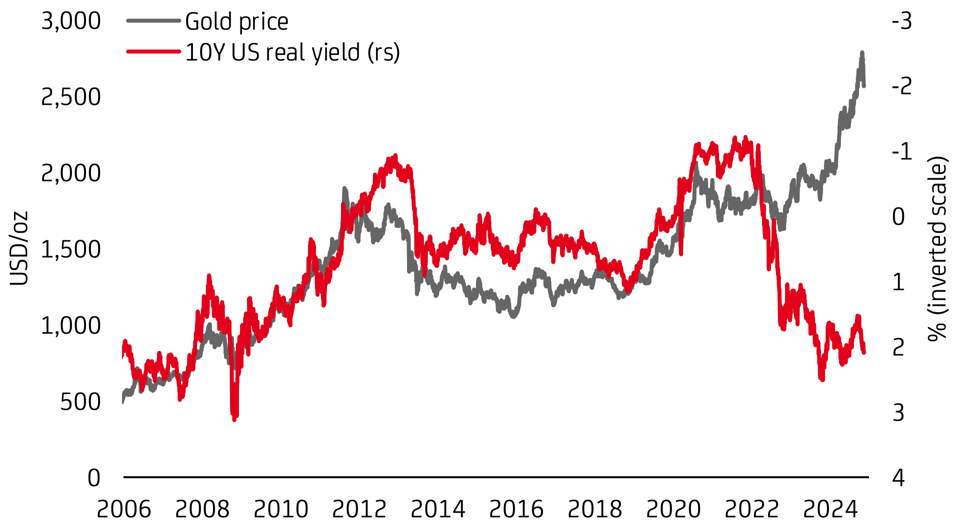
INDUSTRIAL METALS HAVE ROOM TO REBOUND, WHILE THE GOLD RUSH IS PROBABLY OVER

Global manufacturing activity has deteriorated in recent quarters, negatively impacting demand for industrial metals this year. While sluggish demand could persist into early 2025, central bank easing cycles should generally support industrial recovery and foster capital spending, thus leading to stronger demand for industrial metals. Nevertheless, much of the performance of industrial metals over the course of next year will depend on how economic activity in Europe and China, and thus global growth, develops amid the threat of US import tariffs under the Trump administration and possible retaliation measures.

China will play a particularly important role, as **aluminium** and **copper** should benefit from the country's industrial upgrade programs and investment in power grids, while **iron-ore** prices could come under pressure as China increasingly focuses on reducing overcapacity in the real-estate sector. Over the longer term, demand for industrial metals is likely to benefit from the global transition to net-zero climate emissions, while new supply will be constrained by factors that make mining companies vulnerable to ESG risks.

In a year marked by soaring stock markets, gold has emerged as a standout performer; its price has reached impressive highs of around **USD 2,750 per ounce**. This remarkable rise has taken many analysts by surprise, particularly those who relied on historical drivers to forecast gold prices. As a non-interest-bearing asset, gold tends to become more appealing when interest rates, especially real rates, decline. It also serves as a reliable safe haven during periods of high inflation and heightened market volatility. However, in recent years, the gold price has defied expectations, holding steady despite rising real rates, easing inflation risks and a robust equity market.

CHART 3.8: THE SHINING PERFORMANCE OF GOLD THIS YEAR



Source: Bloomberg, UniCredit Group Investment Strategy; daily data from 4-Jan-06 to 15-Nov-24.

What is behind this unexpected decoupling? Key factors are geopolitical uncertainty and growing concerns about the US's fiscal position. The potential for renewed geopolitical tensions, even hints of a second cold war has led investors, including central banks and private investors, to seek alternatives to the USD, the world's dominant reserve currency, and this has increased gold purchases. While gold's stellar performance may invite some profit-taking as the year draws to a close, ongoing demand for hedging, along with declining bond yields and a softer USD, should help cushion any potential downside. However, barring any escalation in geopolitical tensions or sudden spikes in inflation, gold may face limited upside in the near future.

FX

TRUMP 2.0 BODES WELL FOR THE US DOLLAR

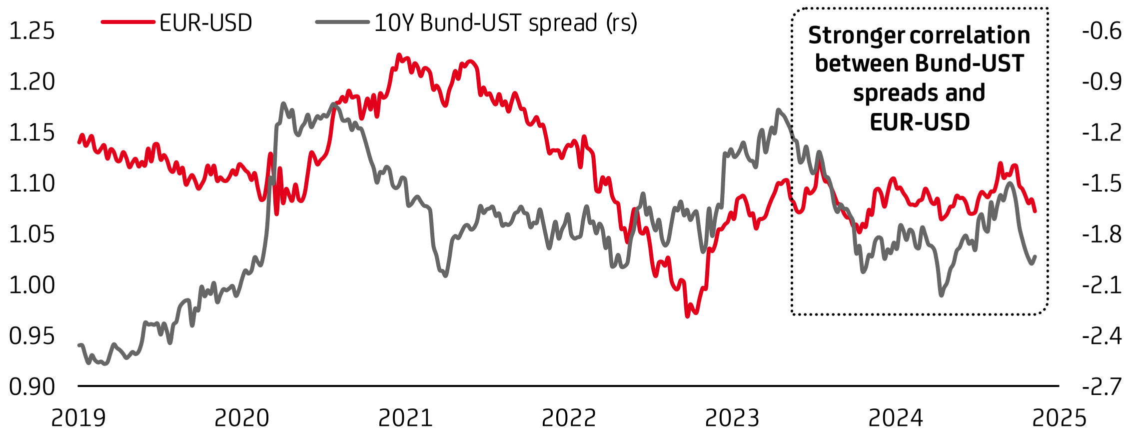
We expect the **USD to shine in 2025**. The Trump presidency is likely to lead to higher inflation, a more-cautious stance by the Fed, more trade tensions with China and Europe and more isolationist US foreign policy, which all point to strong demand for the greenback.

Against this backdrop, Mr. Trump's stated hopes for a weaker currency will be difficult to realise. Equity inflows, higher yields at home and the USD's role as a safe-haven currency if global risk aversion escalates would also support the USD. The degree to which Mr. Trump's proposals are implemented and the timing of this will determine the intensity of the appreciation of the US unit relative to other currencies.

EUR-USD
to stay above parity

EUR-USD will likely slide further, but the pair's decline will probably be limited to **above parity**, given that market expectations surrounding the Fed's and the ECB's rate-cutting trajectories are not far from ours. The USD has already rallied as investors rode part of the "Trump trade" in the weeks immediately after the US election. Concerns about **fiscal indiscipline** in the US will likely limit EUR-USD downside as well and might weigh on the US unit in the coming years. A more-intense fall (EUR-USD hit a low of 0.9536 in late September 2022) would probably require interest-rate differentials moving much more in favour of the USD, while a return much beyond 2024's highs of close to 1.12 would require sharp improvement in the eurozone's economic outlook compared to the US, an even less likely scenario next year. We thus expect the US Dollar Index (DXY) to climb back to around 108/109. This index represents a weighted average of the six major exchange rates (EUR, JPY, GBP, CHF, SEK and CAD) against the USD.

CHART 3.9: A WIDE UST-BUND SPREAD IS LIKELY TO KEEP EUR-USD SUBDUED



Source: Bloomberg, UniCredit Group Investment Strategy; daily data from 1-Jan-19 to 15-Nov-24.

Japan's recent general election has left the country's political landscape in a stalemate, and this may weigh on the JPY in the short term. Still, we expect the BoJ to continue its tightening measures, which could narrow yield spreads between the US and Japan, but not strongly enough to drag **USD-JPY** much below 150 in 2025. EUR-JPY will probably slide below 155 given the weaker euro.

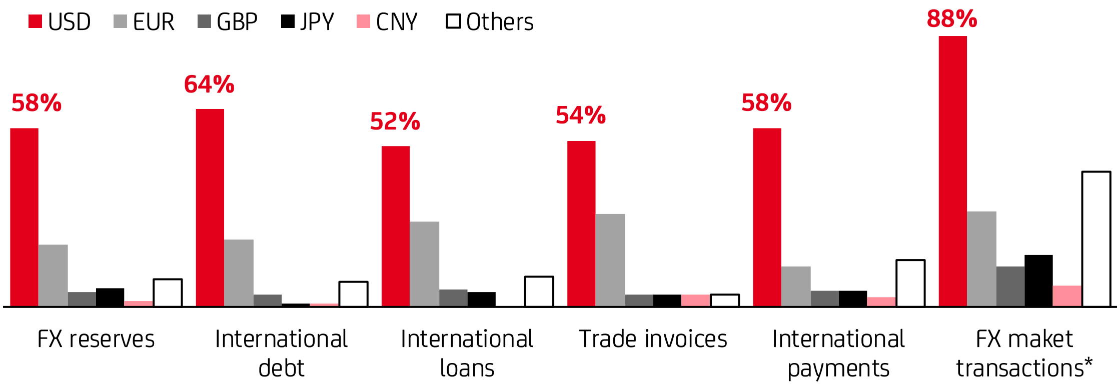
In the UK, the **GBP** is likely to encounter headwinds, primarily against the USD, from further easing measures, which we still anticipate will be made by the BoE in 2025. In November, BoE Governor Andrew Bailey warned that the bank could not cut rates too quickly or by too much. We project rates will fall from the current 4.75% to 3.50% next year and then to 2.75% by 2026 in response to a deteriorating UK economy. This is likely to be further complicated by stringent fiscal policies outlined in the 2025 budget. EUR-GBP will remain around 0.82.

USD LEADERSHIP NOT AT RISK

The recent gold rush has been partly fueled by the central banks of emerging economies, which have sought to reduce their USD exposure. The expanded BRICS+ group, which includes Egypt, Ethiopia, Iran and the UAE, is actively working to diminish the USD's role in the international financial system while promoting the wider use of the CNY. Despite the group's diverse interests, the shared goal of challenging the USD unites them.

In the short term, the **USD's international status** is unlikely to be significantly threatened. History shows that global reserve currencies exhibit inertia; their rise often aligns with the ascendance of their issuing powers, but their decline does not necessarily follow suit. Even as Pax Americana wanes, the US will continue to be the leading global power, with the USD maintaining supremacy in the international monetary system. The US dollar remains by far the most used currency regarding FX reserves, international payments, world debt and foreign trade invoices. The EUR makes up about 20% of global reserves, while the CNY trails with just 2% (SWIFT data show that only 2.2% of global payments are conducted in renminbi).

CHART 3.10: THE USD HAS NO RIVALS AT PRESENT



*Sum of FX is 200%.
Source: Bloomberg, Bank for International Settlements, IMF, SWIFT and UniCredit Group Investment Strategy; observation period: 2023-2024

That Beijing keeps strict capital controls on the CNY, which is not fully convertible, undermines international aspirations for the currency. A recent Carnegie Endowment for International Peace report indicates that, while China aims to internationalise the CNY, it has no ambition for it to replace the USD, which would require a fundamental transformation of its economic model, including financial market depth, capital-account liberalisation, a floating exchange rate and reduced state intervention. Moreover, China would need to run substantial current-account deficits and lower private savings to supply its currency globally. Although China's leadership aspires to shift from an investment-driven model to one centered on private consumption, such a transition will take time.

Over a relatively long-term horizon, the possible ascendance of the CNY would likely lead to the formation of a **multipolar international monetary system**, rather than to global hegemony. Against this backdrop, the EUR and the CNY could act as regional anchors in Europe and Asia, representing a means of diversifying away from the USD.

Aside from geopolitical factors, other drivers could undermine the dominance of the USD. **Innovations** in payment technology and settlements could reduce the use of the USD as a third "vehicle currency". Digital central-bank currencies could also reduce the USD's role as a "third counterpart" by reducing settlement times and integrating messaging and payments. Moreover, **loose fiscal policy** in the US might force rating agencies to downgrade the country's credit rating, which would erode investor confidence in the greenback.

What If We Are Wrong?

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Forecasting is ultimately a probabilistic exercise, but many factors can compromise our baseline scenario. In the following, we will focus on the two risk factors that are of greatest concern to us: a sharp deterioration in the geopolitical environment and a more hawkish Fed. We will explore both their macro and market implications.

What if the “axis of upheaval” becomes emboldened?

Geopolitical risk has been the most destabilising factor for the global economy since the Covid pandemic. In our baseline scenario, we assume an escalation of tensions between the West and China and some resolution of conflicts in Ukraine and the Middle East through the intervention of the Trump administration – potentially with bitter consequences for both the Ukrainians and the Palestinians. But our greatest source of concern is represented by how the so-called “axis of upheaval”, an expression coined in a *Foreign Affairs* article, might evolve in the future. This axis includes four states – **Iran, North Korea, Russia and China** – that are converging on a shared purpose of overturning the principles, rules and institutions that underlie the Western liberal order. Although not a formal bloc, these states have increasingly coordinated their economic, military and diplomatic efforts to minimise the impact of Western foreign policy tools.

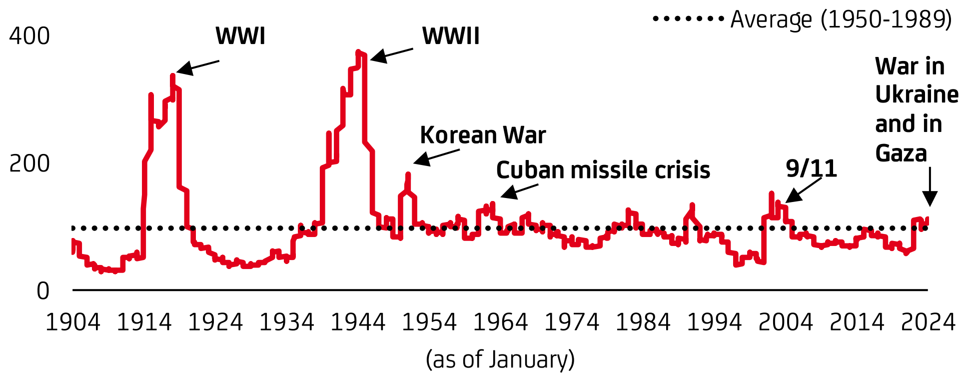
Immediately before the outbreak of the war in Ukraine in 2022, China and Russia announced a "no limits" partnership, and Beijing has since provided economic support to Moscow, buying sanctioned oil while increasingly supplying dual-use components covered by Western export controls. Iran is supporting Russia's war in Ukraine by providing drone technologies, while North Korea has sent ballistic missiles and soldiers to Russia for support in the Ukraine conflict. With respect to other bilateral interactions, China is also a key importer of sanctioned Iranian oil, and Moscow is now Iran's largest source of foreign investment. In addition, China, Iran and Russia have held combined naval exercises over the last three years. The list of interactions goes on.

What might happen next year? There is a risk that interaction between these four actors will intensify in scale and scope. So far, collaboration among these countries has mostly been bilateral. **Trilateral and quadrilateral action** could increase their capacity for disruption. The most visible consequences of an emboldened axis of this sort could become evident in existing conflicts. The war in Ukraine might drag on, and Russia might gain further territory. Iran might respond more aggressively to the likely attacks by Israel, and the war in the Middle East might become more regional, possibly interrupting oil and LNG supplies. We do not expect China to become directly involved in any of these conflicts, but we think it could orchestrate them from behind the scenes, especially if tensions with the West rise following the re-election of Mr. Trump. Ultimately, the outcome of these conflicts could also have serious consequences for Taiwan's future status.

This does not imply that there will be a large-scale conflict between the West and this axis. The major risk is that the more these revisionist powers challenge the Western liberal order, the more fractures in the international system will appear, making a **second cold war** more likely, with the emergence of distinct economic and ideological blocs. Chart 4.1 shows that geopolitical tensions are already at levels above the cold war average. The IMF estimates that trade between economies in politically distant blocs has declined more than trade between those within blocs. Foreign direct investment is also fragmenting along geopolitical lines, and supply chains are lengthening.

CHART 4.1 GEOPOLITICAL TENSIONS ABOVE COLD WAR AVERAGE

GEOPOLITICAL RISK INDEX (12M-MA)



Source: Matteo Iacoviello, UniCredit Group Investment Strategy

An emboldened "axis of upheaval" would widen these fractures, undermining efficiency gains and economies of scale that have arisen through trade specialisation and raising prices for consumers. The IMF estimates that, in a situation in which two exclusive geopolitical blocs arise, one centred around the US and Europe and the other around China and Russia, there would be a long-run reduction in real GDP of about 2.5% and a short-run reduction of around 5% globally. Of course, it is unlikely that a deterioration in diplomatic relations would occur rapidly enough to trigger such losses in 2025, but there could be an acceleration in the fragmentation process.

The implications for financial markets would be **more volatility**, with higher interest rates likely, as supply shocks might increase inflation despite weaker growth prospects amid less-efficient trade specialisation, longer value chains and a compression of supply. Traditional safe-haven assets, such as gold and the USD, would likely perform well in such an environment, while emerging-market assets might be exposed to higher volatility and vulnerability to sudden shifts in the balance of risks. Besides the adverse impact of deglobalisation on global-growth prospects, higher inflation and increased geopolitical risk assessments could also weigh on consumer confidence over the long term, especially in developed economies with ageing populations.

What if the Fed hikes?

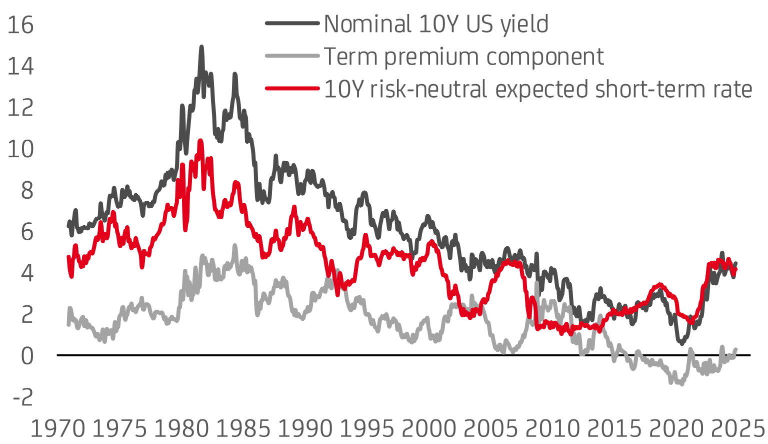
In our baseline scenario, we expect the Fed to reduce the fed funds target range by a further 50bp in 1H25 to 3.75-4.00% and to keep it at this level through 2026. In our upside risk scenario, we assume interest rates will go up again from 2H25. This could be driven by **larger fiscal stimulus** provided by the Trump administration, possibly of around 5% of GDP compared to 2% in our baseline, to be announced at the beginning of 2H25 and with formal approval by Congress in the autumn. Measures could include greater tax cuts than currently assumed, for example a broader corporate-tax reduction, lower capital-gains tax and an increase in tax-deduction limits. Such additional stimulus could raise the level of real GDP by around 1.5% cumulatively over two years and increase inflation by around 0.3-0.4pp in each year. Since this would raise both growth and inflation, and growth would be above trend, the Fed will not ignore it. As this stimulus would not be announced until 2H25, we stick to our estimate of a 50bp reduction in the fed funds target range to 3.75-4.00% in 1H25. Thereafter, as this level is not very restrictive, the Fed would likely have to increase rates, probably by 100-150bp. In a context of higher tariffs, higher growth in the US would probably not have major spillover effects for the eurozone. Therefore, we continue to assume that the ECB would carry on reducing interest rates, but probably by slightly less, to 2.00%, to take into account the likely depreciation of the euro.

What additional fiscal measures could be implemented?

What is in store for US assets under this scenario? With inflation consistently above target, even higher growth than that anticipated in our baseline scenario and Fed tightening likely, we could see a **significant shift in the rates landscape**. This would push long-term yields to new multi-year highs. In such a situation, the 10Y UST yield crossing the 5% mark, the peak seen in 2023, becomes highly plausible. The expected long-term key-rate outlook (the red line in Chart 4.2), currently at around 4.15%, could easily rise towards 4.5%, and persistent budget deficits, which would fuel concerns about the US's debt sustainability, would also likely drive up the term premium (the additional yield investors demand over the risk-free rate for holding longer-dated maturities). According to Fed estimates, the term premium on the 10Y maturity now stands at 0.30% (the grey line in Chart 4.2).

While we are far from the days of the 1970s and early 1980s, when bond vigilantes pushed the term premium as high as 5.3% due to high inflation and rising deficits, it does not require an ultra-libertarian outlook to imagine the term premium increasing to at least 1%. This would bring the 10Y US yield towards 5.5%, with the risk skewed toward an even higher term premium. A 6% yield on **10Y USTs** no longer seems unrealistic. Longer periods of high rates could also weigh on equities, making the equity risk premium far less attractive. **Gold** might perform relatively well, supported by high inflation and, more importantly, by lingering fears of potential debt monetisation. Meanwhile, the **USD** could strengthen, supported by a widening yield spread between the US and other economies. However, if concerns about debt sustainability arise, the US dollar might lose some of its appeal. Additionally, if we approach the symbolic parity level in the EUR-USD exchange rate, corporate America is likely to push back, and Mr. Trump may attempt **to talk down the USD**.

CHART 4.2 THE RISK IS SKEWED TOWARDS A HIGHER TERM PREMIUM



Note: Time series according to a no-arbitrage term structure model by New York Fed economists Tobias Adrian, Richard Crump, and Emanuel Moench.

Source: Bloomberg, UniCredit Group Investment Strategy; reporting date: 15 Nov 2024

In summary, there are numerous moving parts, making the 2025 financial market outlook far less rosy than in the past two years. In an extreme scenario like that of 2022, this risk setup suggests there is no place to hide aside from money-market instruments, floating-rate securities and gold – which ended 2022 broadly unchanged while most major bond and stock markets experienced double-digit losses.

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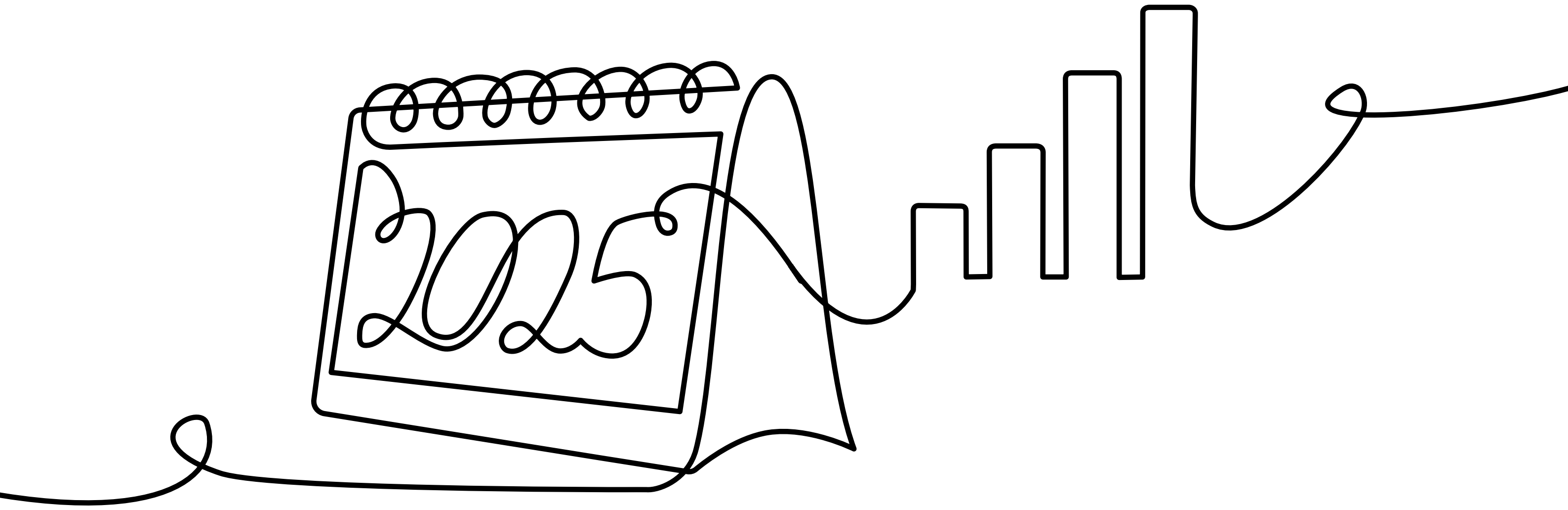

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1. Looser fiscal policy in the US vs. the eurozone – why it matters for markets

2. Europe's auto sector under pressure from China, but the race has just started

3. There is no AI bubble

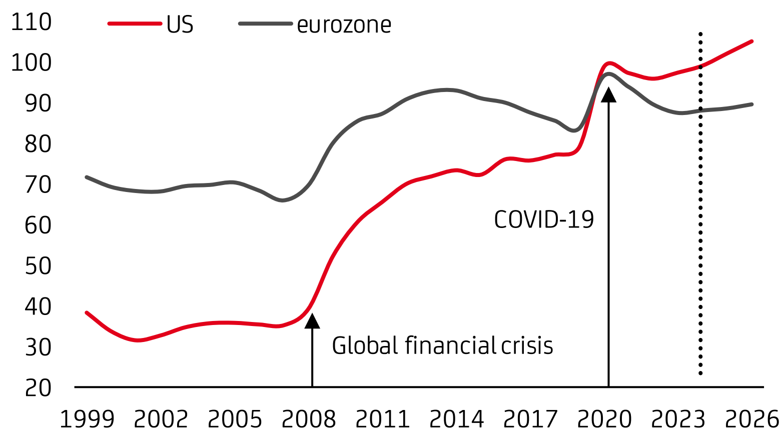
1 Looser fiscal policy in the US vs. the eurozone – why it matters for markets

Fiscal policy is likely to increasingly accentuate the post-pandemic divergence between the US and the eurozone. In the US, the public debt/GDP ratio has risen to record-high levels, whereas in the eurozone it has declined slightly while remaining close to its average level since the global financial crisis.

In the US, Mr. Trump's fiscal pledges are projected to cost **more than USD 9tn** over the next ten years (excluding the effects of higher tariff revenues), according to the Committee for a Responsible Federal Budget (CRFB). This includes an extension of the individual tax cuts enacted in the 2017 Tax Cuts and Jobs Act (worth roughly USD 4-5tn) that are due to expire at the end of 2025. Given that this extension was already part of our previous baseline, the additional fiscal stimulus would thus amount to around a cumulative USD 4-5tn, or about 1.5-2.0% of US GDP per year, implying a strong and protracted expansion of fiscal policy over the next decade.

The eurozone is likely to experience a paradigm shift in fiscal policy from next year, as 2025 will mark the first year in which **the new European economic governance framework** takes effect. This means that for highly indebted countries, new fiscal rules will require prolonged fiscal adjustment to place debt/GDP ratios on a sustainably downward trend. For example, in Italy and France, which are among the most indebted large eurozone countries, fiscal consolidation is expected to amount to 0.5pp and 0.7pp of GDP, respectively, on average, in 2025-31. For the eurozone as a whole, where about half of countries still have a public debt/GDP ratio of below 60%, the change in the structural primary balance is expected to amount to around 0.3-0.4pp of GDP, on average.

CHART 5.1 US PUBLIC DEBT AT RECORD-HIGH LEVELS
PUBLIC DEBT (% OF GDP)



Note: CBO public debt figures refer only to gross federal debt held by the public, excluding debt held by federal trust funds and other government accounts.

Source: Congressional Budget Office, Eurostat, UniCredit Group Investment Strategy, observation period: 1999-2026

This divergence in fiscal policy between the US and the EU is reflected in their expected future debt trajectories. Under unchanged policies, public debt is expected to increase by around 20pp of GDP in the US and by less than 10pp in the eurozone by the end of the next decade. According to announced fiscal plans, this gap is likely to widen significantly. The CRFB forecasts that the US's debt/GDP ratio may well increase to above 140% by 2035, while fiscal adjustment will probably deliver a mild decline in the eurozone's debt/GDP ratio. This implies that fiscal and monetary-policy goals will be aligned in the euro area, as they will translate into mutually supportive stances. In contrast, US fiscal policy is likely to be working at odds with the Fed's intention to move interest rates to more neutral levels.

R-star refers to the real rate of interest that equates demand for investment with demand for savings and is neither expansionary nor contractionary when an economy is at full employment. Therefore, r-star moves over time, and its value can differ in the short run (in response to shocks and the business cycle) from what it is in the long run.

WHAT IMPLICATIONS WOULD SUCH TRENDS IN FISCAL POLICY HAVE ON THE REAL NEUTRAL RATE OF INTEREST, OR R-STAR, ON EACH SIDE OF THE ATLANTIC?

The consensus view, also among central bankers, is that global r-star might have moved up (or is likely to move up) somewhat in the aftermath of the pandemic and the Russia-Ukraine conflict, due to strong fiscal stimulus, investment needs for the green transition and defence, and increasing global economic fragmentation. Mr. Trump's policies for additional fiscal stimulus (supporting investment through stronger aggregate demand, while raising issuance) together with geopolitical uncertainty and tariffs (which could reduce global current account imbalances and former Fed Chair Ben Bernanke's **"global savings glut"** of foreign demand for treasuries, particularly from China), and banking deregulation (which might reduce the demand for safe, liquid assets), would tend to push up r-star somewhat.

In the eurozone, the prospect of prolonged mildly restrictive fiscal policy could put downward pressure on r-star by restraining aggregate demand, which would have negative effects on investment. However, we would expect such pressure to be largely offset by increasing pressure on member states, particularly after Mr. Trump's victory in the presidential election, to increase public spending to effectively address the economic and social consequences of lingering conflicts, the latest geopolitical shifts and the loss of competitiveness of the eurozone's industrial sector globally. Holding on to the status-quo may jeopardise the eurozone's ability to preserve its economic and socioeconomic model in the long term, as former ECB President Mario Draghi recently stated. The main challenge will be to forge consensus on the appropriate instruments to finance these strategic goals.

> Holding on to the status-quo may jeopardise the eurozone's ability to preserve its economic and socioeconomic model

If we focus on our forecast horizon, the implications of a higher r-star support our expectation that the Fed will stop cutting rates sooner than we previously anticipated and that a fed funds rate of 4% will probably still be restrictive but not very restrictive (particularly if inflation expectations move higher, which would lower the real fed funds rate). In turn, we expect that the ECB will stick to its plan of abandoning its restrictive stance relatively soon and then gradually adopt a moderately accommodative stance. The short-term divergence of r-star in the US and the eurozone may be challenged over time because highly integrated financial markets mean that the long-run r-star could be more of a global than a regional concept.

For markets, high deficits in the US create the risk of **term-premium repricing**, resulting in a steeper curve. The IMF estimates (April 2024 Fiscal Monitor) that a 1pp increase in the US primary deficit will lead to an increase of 11bp in the term premium. This is probably a lower bound given that investors are probably more concerned about US debt sustainability than the IMF's estimation sample were, and the share of price-insensitive investors in USTs, including foreign-reserve managers and the Fed, has dropped to only 35%.

One factor that may (partly) offset the difference in the fiscal outlooks of the US and the eurozone is that the Fed is expected to stop shrinking its balance sheet early next year, while the ECB is expected to step this up by fully disinvesting its pandemic emergency purchase program (PEPP). On balance, however, the different fiscal outlooks and their implications for r-star point to wide yield spreads, possibly also at the long end. In addition, we see the risk of **bouts of volatility** in the US relative to the eurozone, as the US debt-limit mechanism has proven ineffective at containing debt growth, and this will leave the role of imposing fiscal discipline on the government to the market.

Another question is whether heavy issuance will only affect USTs or whether it will also lead to a weaker USD to provide investors some risk compensation. We think a significant decline in the USD's value is unlikely because:

1. the USD continues to play a major role in international trade;
2. the USD represents over 50% of foreign reserve allocation worldwide and
3. the role of foreign investors in absorbing USD-denominated debt has fallen over time, and these have been replaced by domestic investors.

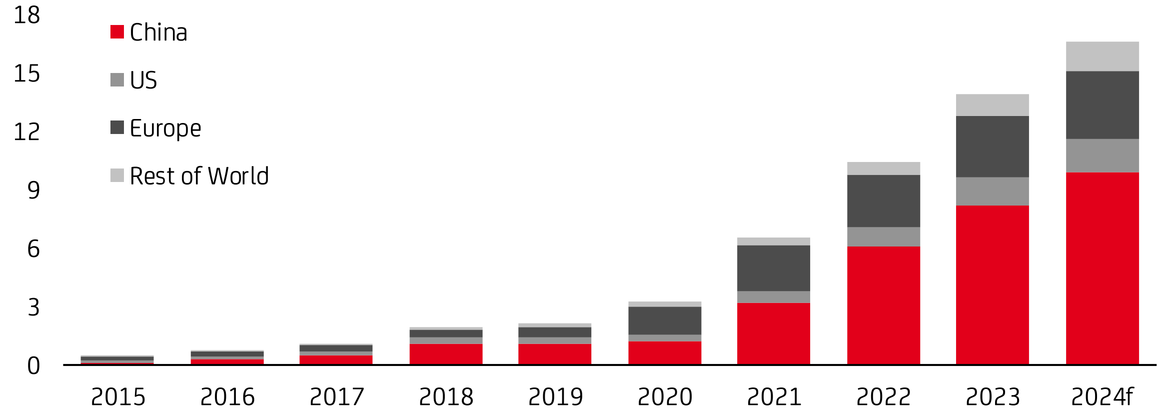
2 Europe's auto sector under pressure from China, but the race has just started

Driven by massive technological change, such as the shift to green technologies and the rising importance of connectivity, the global auto industry is currently undergoing its most profound transformation ever. **Global sales of electric vehicles** (EVs) are likely to exceed 16mn units in 2024, a new record high (see chart 5.2). Chinese car manufacturers have taken the lead by selling nearly 10mn EVs, which would equal a global market share of about 60%. In contrast, legacy automakers in Europe have been losing ground. They are expected to sell only about 3.5mn EVs this year, a global market share of around 20%.

We expect the European car industry to sputter on in 2025-26, given that it faces substantial structural challenges. This is especially true for **German carmakers**. Among these challenges are the need to reduce production costs, as Chinese manufacturers benefit from lower labour costs, economies of scale and government subsidies; having to partly shift away from the expensive premium segment and toward offering more affordable EV models; having to catch up with regard to software and connectivity; and dealing with the global dominance of Chinese battery producers. Furthermore, the global shift towards the adoption of EVs is likely to put under pressure auto suppliers in Germany and in CEE, where automakers have specialised in producing internal combustion engines (ICEs). We note that EV motors only require about **20 parts**, compared to the more than 2,000 parts that make up ICEs. Finally, higher US tariffs, especially on autos, given President-elect Trump's focus on German cars, will probably dampen the positive impact coming from lower inflation rates and additional rate cuts by central banks.

CHART 5.2: CHINESE CAR PRODUCERS IN THE PASSING LANE

GLOBAL PASSENGER EV SALES (IN MN), BY MARKET/REGION OF AUTOMAKER HEADQUARTER



Source: BNEF, Bundesbank, UniCredit Group Investment Strategy

However, we think there will also be **glimmers of hope** for the European car industry in 2025-26. First of all, the negative impact of higher US tariffs will be dampened by the fact that many German auto manufacturers are located in the US and can produce and sell their products directly there (German-owned affiliates in the US purchase autos and car parts worth about EUR 150bn per year compared to only EUR 34bn in exports from Germany to the US). Furthermore, the flexibility of

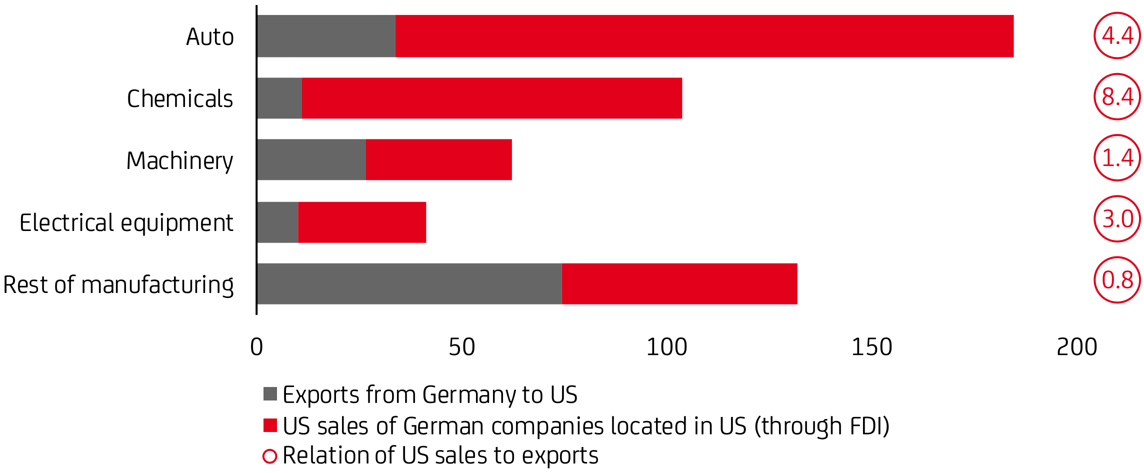
Corporate Germany, with its social partnership between labour unions and employers' associations, should not be underestimated. In the past few decades, times of crisis, such as the period after German reunification in the 1990s and the global financial crisis in 2008-09, have been overcome by making compromises. Examples are cuts in labour costs in exchange for job guarantees and the reduction of working hours. Also on a positive note, German car producers have caught up quickly in the field of electric/hybrid propulsion technology and have in the meantime filed more patents than their competitors. Furthermore, recently introduced EU tariffs on Chinese brands are likely to reduce the price gap between Chinese EVs and their European competitors, although there is a risk that Chinese policymakers could retaliate and hamper sales of EU cars in China. While we do not expect any escalation in tariffs between the EU and China, Chinese brands are likely to increase local production in the EU for European markets to avoid import tariffs. Protectionist EU trade measures may also support the nearshoring of automotive production, which could be particularly relevant for CEE economies, as they aim to attract foreign direct investment through lower labour costs and corporate taxes.

The flexibility of Corporate Germany should not be underestimated

Beyond 2025-26, our long-term outlook for European car manufacturers is constructive. While Chinese brands currently have a strong competitive edge, they also face problems, such as substantial overcapacity in production facilities. Coordinated EU-level policies supporting labour automation and the development of recharging infrastructure may also help ease supply and demand constraints. Finally, the **technological race** in the global auto market is far from over but has barely started. New massive technological change is still to come and will decide the winners and losers. Examples are the rapid evolution of battery technology and range improvement; advancements in connectivity, IoT (internet of things) and AI (artificial intelligence); the rise of autonomous vehicles; and even greater efforts towards achieving sustainability by increasing the longevity of auto parts.

CHART 5.3: AUTO SALES IN US EXCEEDING EXPORTS FROM GERMANY

IN EUR BN (2022; LATEST AVAILABLE DATA)



Source: BNEF, Bundesbank, UniCredit Group Investment Strategy

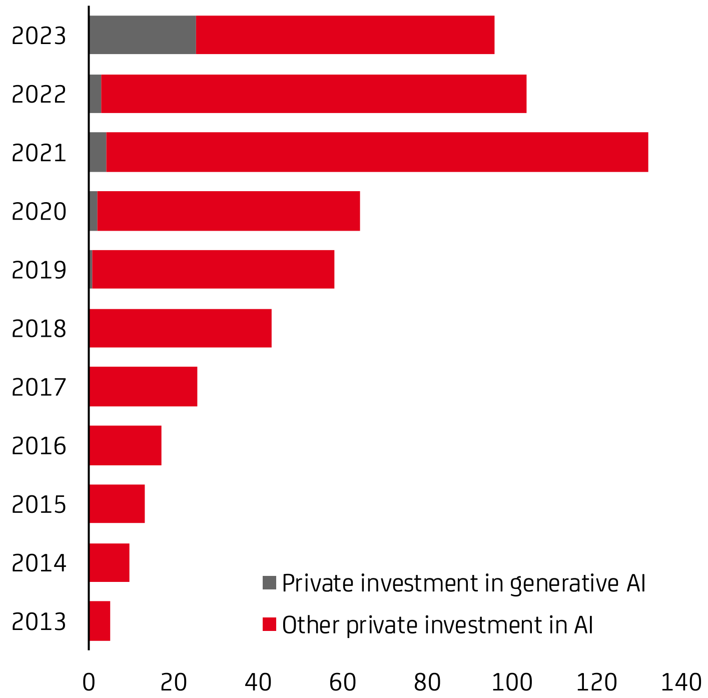
3 There is no AI bubble

The emergence of ChatGPT in November 2022 was a manifestation of the immense potential of AI. Recent years have seen a rapid development of new AI applications (in areas as diverse as marketing, pharmaceuticals, health care, risk management, and product and service development) and massive private investment in AI, which averaged USD 110bn per year from 2021 to 2023, including, in particular, rapid growth of generative AI.

Large milestone technology innovations that give rise to production methods important enough to have a protracted aggregate impact are called **general-purpose technologies**. In the past, the emergence of new general-purpose technologies, such as the introduction of electricity in the 1920s or information technology in the 1990s, first led to investment increasing by 3-4% of GDP, with labour productivity increasing five or six years later. History also suggests that as new technologies evolve, they improve and become less costly. In the case of AI, for instance, the current high energy requirements could be reduced by technological advancements.

In recent months, there has been growing concern that spending on AI investments will exceed returns for both AI model developers and users, thereby limiting the future potential for AI stocks. We think such concerns are not well founded, as rising demand for generative AI products remains unchecked and large US companies such as Amazon, Microsoft, Alphabet, Meta Platforms and Nvidia will be among the biggest beneficiaries as enterprises shift more tasks to the cloud.

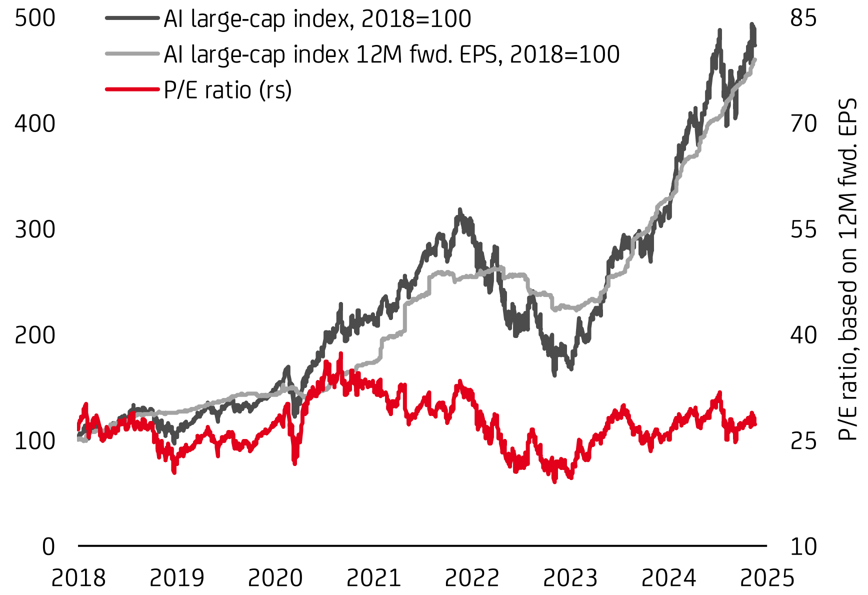
CHART 5.4: PRIVATE AI INVESTMENTS IN USD BN



Source: Stanford University 2024 AI Index Report

To better visualise the strong developments in large AI companies, we created an **AI large-cap index**, which contains the above-mentioned companies, weighted by their market capitalisation. The index development shows that the underlying earnings story of the large AI companies is intact. Since 2018, the index has gained 375% and earnings based on 12M forward EPS have increased by 350% (compared to only 80% for the S&P 500), while estimates are for a further 45% increase over the next 12 months. The five companies earned an aggregate net income of around USD 100bn in 3Q24. These numbers certainly justify the current P/E ratio of 27 for our AI index and highlight the enormous difference to earlier bubbles, such as the dotcom bubble of the early 2000s, when the largest technology leaders at the time were trading almost twice as high at a P/E ratio of 52, or the Japanese financial bubble of 1989, when the average P/E ratio peaked at 67. It is also worth mentioning that some of the companies that are currently dominant in the AI era are unusual in that they were also among the top companies in the last technology wave, the dotcom bubble. Their scale and **high profitability** have put them in a unique position to develop new and investment-intensive technologies related to AI. However,

CHART 5.5: AI LARGE-CAP INDEX IS WELL SUPPORTED BY UNDERLYING EARNINGS GROWTH



Source: Bloomberg, UniCredit Group Investment Strategy

although the valuations are currently not excessive, they have the potential to increase volatility, which also affects the overall market due to the high market concentration in this segment.

One hindrance to AI-related profit growth will increasingly be its **demand for already scarce resources**. The chief constraint comes from AI's energy demands. US utilities are already struggling with the surge in energy required to run AI programs and data centres, which the International Energy Agency expects will account for 5-6% of total power generation in the US and Europe by 2026, compared to close to 4% in 2022. AI development is also stressing some regional water supplies for cooling equipment and is expected to lead to a surge in electronic waste. This is leading to a deterioration in the ESG profiles of the pioneers in this area, which could result in regulatory and investor blowback in the future. Societal and climate-related concerns could also cause users to eventually curtail their use of AI applications and consequently put in doubt more-optimistic growth projections.

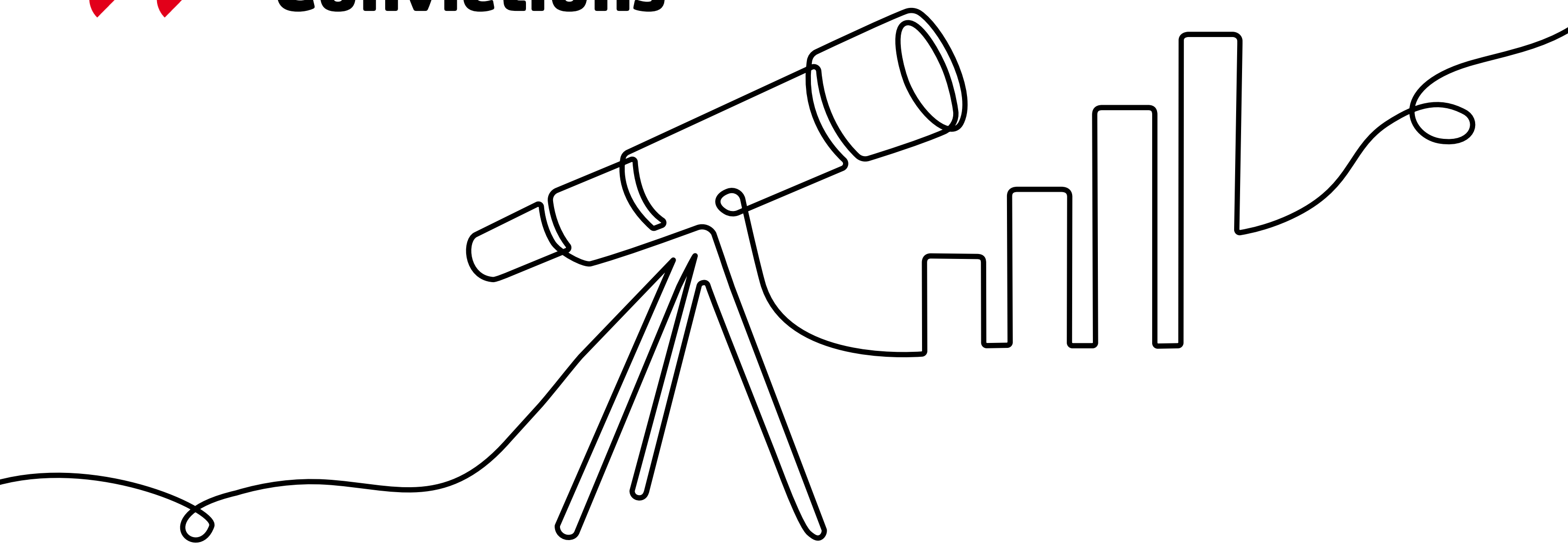
Given the central importance of semiconductors in the development of AI, President-elect Trump's ambiguous attitude towards defending **Taiwan's political status** could be a source of volatility for tech stocks – as was the case last summer when he downplayed the strategic importance of the island by saying: "Taiwan is 9,500 miles away (from the US). It's 68 miles away from China." These few words were enough to trigger a sizable sell-off for stocks related to chips makers.

Another hinderance to the growth of AI technology could stem from its **general acceptance** by society, particularly in terms of its potential threat to jobs. Politicians will closely observe the development and impact of AI and will evaluate both opportunities and threats when considering the future regulation of AI. As technological advances in generative AI and its use are very recent, findings at the micro or industry level mainly capture the impact on early adopters and those working on specialist tasks and likely indicate short-term effects. The long-run impact of AI on macro-level productivity growth will depend on the extent of its use and its successful integration into business processes. We do not think a meaningful wider adoption of AI by non-tech companies will happen in the short term but rather in five to ten years' time. Several economists doubt the long-term positive impact on productivity as they are sceptical about the extent to which work will be cost-effective to automate.

We have a more bullish view on AI

We have a more bullish view and think AI is a transformative technology with wide-ranging applications and the ability to increasingly accelerate revenue streams for companies active in the field. It will primarily increase the efficiency of existing work processes by automating tasks or by making workers who perform these tasks more productive. This has the potential to make businesses more efficient and profitable, leading to additional earnings momentum for the wider stock market over the next decade. In our view, this technology megatrend justifies the current valuations of AI companies. However, as the technology evolves, so will the winners and losers in the industry – and today's leaders (particularly in semiconductor hardware) might not be the leaders of the future.

Investment Convictions



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The CIOs' view

Every economic cycle is different, but certain patterns tend to repeat themselves over time. With large parts of the economy still exhibiting late-cycle characteristics, such as restrictive monetary policy and tight labour markets, the traditional four-stage economic cycle would suggest a recession were to follow. However, the broader economic picture supports our view that the global economy will grow moderately in 2025 and start to accelerate from 2026, with corporate earnings rising, demand for credit increasing and monetary policy shifting towards neutral territory.

Historically, such an environment of moderate growth, easing inflation and falling policy rates, especially when accompanied by dynamic technological innovation, has usually led to positive equity-market performance and generally favourable conditions for bonds. Therefore, our prevailing outlook for 2025 is cautious optimism. A good deal of caution seems to be warranted, as various elements, including structural transformations in the economy and lingering external factors, make the market outlook less certain.

While the potential return on cash deposits should drop as interest rates fall, the economic cycle encourages us to remain selective and prudent in our investment allocation, following strategies that can enhance portfolio resilience by cautiously favouring assets of superior quality and liquidity across all asset classes. However, we are also prepared to take advantage of selected opportunities that arise when market volatility leads to valuations that exceed or fail to meet fundamentals.

Asset allocation

OUR INVESTMENT VIEW ON ASSET CLASSES

	UNDERWEIGHT	NEUTRAL	OVERWEIGHT
GLOBAL EQUITIES		●	
US EQUITIES		●	
EUROPE EQUITIES	●		
PACIFIC EQUITIES (DEVELOPED MARKETS[1])			●
EMERGING MARKET EQUITIES		●	
GLOBAL BONDS			●
EMU GOVERNMENT BONDS		●	
NON-EMU GOVERNMENT BONDS		●	
EURO INVESTMENT-GRADE CORPORATE BONDS			●
HIGH-YIELD CORPORATE BONDS	●		
EMERGING MARKET BONDS (HARD CURRENCY)			●
EMERGING MARKET BONDS (LOCAL CURRENCY)			●
MONEY MARKETS	●		
ALTERNATIVES		●	
COMMODITIES		●	
OIL		●	
GOLD		●	

1. Developed Markets (Australia, Japan, Hong Kong, New Zealand, Singapore)

Our views on the major asset classes in detail

GLOBAL EQUITIES

The macroeconomic environment is expected to remain positive for risky assets over the coming quarters. Receding inflation risks are allowing major central banks to ease monetary policy in a context of moderate global economic growth. Improved earnings growth is paving the way for attractive return prospects for global equities. Regional and sectoral sensitivity to the potential fallout from political and geopolitical developments might increase volatility and require some differentiation in investment views within the asset class. However, we do not expect the market to come under lasting pressure and reiterate our constructive view on global equities.

US EQUITIES

The US economy has proven more resilient than expected in 2024 and the positive momentum will extend into 2025, albeit the fundamental drivers of consumption will start to soften. We do not expect a hard landing but rather decent GDP growth in 2025 and a reacceleration in 2026. US equities are likely to enjoy the prospect of more market-friendly policies and a better risk-reward balance compared to other regions, which are relatively more exposed to geopolitical tensions and the risk of tariffs. Equity valuations have expanded and probably have limited upside from here. Concentration risk in large-cap US indices warrants monitoring.

EUROPE EQUITIES

The global equity environment is likely to offer some support, but domestic drivers are unlikely to provide tailwind. GDP growth is expected to remain below potential over the next two years, with downside risks prevailing due to trade tensions and geopolitical uncertainty. A benign inflation outlook will allow the ECB's policy to turn neutral. Depressed equity valuations and soft earnings-growth expectations could offer attractive entry points, while single-name and sector selection is becoming even more important.

PACIFIC EQUITIES (DEVELOPED MARKETS[1])

Japan continues to experience medium- and long-term structural changes. We expect Japanese GDP growth to gain momentum next year while the BoJ should continue to normalise its monetary policy, raising rates gradually. Developments in rate differentials seem set to support a moderate recovery of the JPY against the USD and the EUR, which may pose a headwind to export earnings but could help domestic sentiment over time. Positioning on the JPY is more balanced than it was in the past, which should limit volatility. Pacific equities feature cheap valuations and offer diversification benefits within a global equity portfolio.

EMERGING MARKET EQUITIES

Moderate global growth and the risk of increased trade barriers warrant some caution with respect to emerging market (EM) equities. China's structural GDP growth slowdown is set to continue, with expectations of a sizable fiscally induced reacceleration in growth being scaled down. Fiscal and monetary-policy measures might dampen financial risks and help fuel a recovery given the significant underperformance over the past few years and low valuations. We continue to stress the need for a selective approach to EM by country and sector.

1. Developed Markets (Australia, Japan, Hong Kong, New Zealand, Singapore)

UNDERWEIGHT NEUTRAL OVERWEIGHT

GLOBAL BONDS

Global bond yields continue to trade at attractive levels. Reduced inflationary risks and the prospect of further rate cuts by major Western central banks should be supportive factors. Moreover, when looking past the inflationary shock, there are signs that high-grade fixed income has regained its diversification benefit with respect to equity exposure, and correlations between bonds and equities might drop further as market attention shifts from inflation to economic growth. Forward curves already project a significant repricing of short-term rates and might be capping bond returns, which we see as being mostly driven by carry. Developments in US bond markets might pose a headwind to the asset class.

EMU GOVERNMENT BONDS

Significant progress has been made in containing inflation in the eurozone, and GDP growth has been rather modest in recent quarters. Recovery is likely to remain shallow, which should allow the ECB to further loosen its monetary policy, thus contributing to a positive environment for EGBs and some steepening of the yield curve.

NON-EMU GOVERNMENT BONDS

Economic growth has been surprising to the upside in the US and is set to remain resilient, albeit slowing. Inflation risks have been mostly reined in. Markets project some normalisation in official rate levels over the coming quarters, which creates a positive environment and might fuel some curve steepening. Attractive yield levels and the hedge-like behaviour of US Treasuries in the event of a sharper-than-expected economic slowdown or rising market tensions will likely contribute to fuelling demand. However, if funding and/or inflation risks were to increase in the US, longer-dated bonds would be affected.

EURO INVESTMENT-GRADE CORPORATE BONDS

The credit fundamentals of European investment-grade (IG) corporates are supported by healthy balance sheets. Leverage is below its long-term average; earnings have been higher than expected and cash balances remain ample. The credit cycle is moving into its recovery phase, during which corporates tend to continue to focus on cash-preserving financial policies, which may provide an additional tailwind. However, credit risk premiums have modest room to tighten further in the coming months, with carry likely being the key source of total return.

HIGH-YIELD CORPORATE BONDS

A gradual recovery in economic growth in 2025 should support high-yield (HY) corporate bonds. However, their spreads are at the narrower end of their historical range and issuers will have to refinance a large portion of their total debt over the next two years. Moreover, the low liquidity of HY bonds makes them less appealing in the current phase of the economic cycle.

EMERGING MARKET BONDS (HARD CURRENCY)

Attractive bond yield levels and projected carry-based returns can make EM hard-currency bonds an important addition to a diversified portfolio. Global monetary impulses are likely to provide some tailwind, while the fundamental support from a weakening USD will likely peter out over the coming quarters.

EMERGING MARKET BONDS (LOCAL CURRENCY)

The global decline in inflation has paved the way for countries around the world to adjust monetary policy, helping to create a better environment for fixed-income investment. EM local-currency bonds still offer attractive yields, albeit less than they offered a few quarters ago. Geopolitical tensions and tariffs might create some headwind.

MONEY MARKETS

Major Western central banks have kicked off their easing cycles and are expected to progressively take official rates to more-neutral territory. While short-dated, high-grade exposure remains a potential safety valve given lingering risk, return prospects have deteriorated in recent months and reinvestment risks have increased. We think that other fixed-income segments offer more-attractive returns.

ALTERNATIVES

The diversification potential of this asset class remains its key characteristic. Despite inflation risks having eased, real assets represent a hedge against a sharp reacceleration of price pressure (not our baseline scenario).

COMMODITIES

OIL

Given the abundant oil supply in North America and a rather weak demand outlook that may force OPEC+ to again reconsider the withdrawal of its output curbs next year, the Brent price is likely to fluctuate around recent levels until the end of 2025. A wider conflict in the Middle East would likely push prices higher, while a significant de-escalation and a noticeable global economic softening (not our base case) may put downward pressure on crude prices.

GOLD

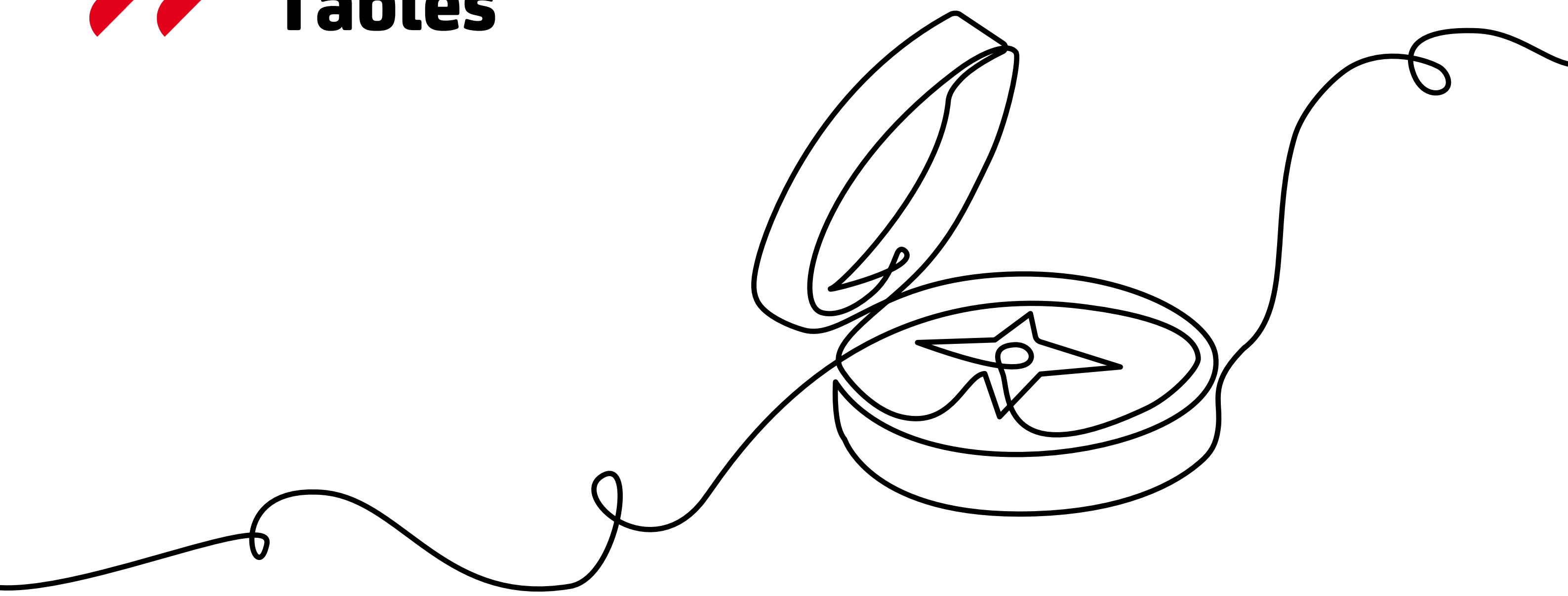
After this year's rally, which was boosted by central-bank and private-investor demand, the risk of profit-taking has increased. Lingering geopolitical uncertainty will likely continue to contribute to demand for gold. Lower bond yields and a somewhat weaker USD should limit the downward potential of gold prices. However, barring a significant escalation in tensions, a spike in inflation or a sharp correction in global equity prices, gold might have limited upside potential from its current level.

CURRENCIES

EUR-USD

EUR-USD is likely to weaken further, but not below parity. Concerns about the lack of fiscal discipline in the US should limit the downward trend of the EUR-USD, but the weaker economic outlook in the eurozone limit its appreciation potential.

Forecast Tables



UNICREDIT FORECASTS

GDP, CPI AND BUDGET BALANCE FORECASTS

	Real GDP (% Y/Y)			Consumer prices (% Y/Y)			Budget balance (% of GDP)		
	2024	2025	2026	2024	2025	2026	2024	2025	2026
Global	**3.2**	**3.2**	**3.3**						
US	**2.7**	**2.1**	**2.3**	**2.9**	**2.3**	**2.5**	**-7.6**	**-8.0**	**-8.6**
Eurozone	**0.8**	**0.9**	**1.2**	**2.4**	**1.9**	**1.9**	**-3.6**	**-3.2**	**-2.8**
Germany	-0.2*	0.7*	1.2*	2.2	1.5	1.7	-2.0	-2.0	-2.0
France	1.1	0.7	1.2	2.0	1.0	1.2	-6.1	-5.4	-4.2
Italy	0.5	0.8	1.0	1.0	1.5	1.6	-4.0	-3.6	-3.0
Spain	3.0	1.8	1.9	3.0	1.8	2.0	-3.9	-3.0	-2.5
UK	**0.9**	**1.2**	**1.4**	**2.5**	**1.9**	**2.0**	**-4.3**	**-4.0**	**-3.8**
China	**4.8**	**4.5**	**4.2**	**0.6**	**0.9**	**1.8**	**-7.4**	**-7.6**	**-7.7**
Japan	**0.1**	**1.0**	**0.9**	**2.4**	**1.8**	**1.9**	**-6.9**	**-3.1**	**2.0**
India	**7.0**	**6.5**	**6.5**	**4.4**	**4.1**	**4.1**	**-2.4**	**-2.1**	**-2.2**

*Non-WDA figures. Adjusted for working days: -0.1% (2024), 0.8% (2025) and 1.0% (2026)
Source: UniCredit Group Investment Strategy

CENTRAL BANKS WATCH

	4Q24	1Q25	2Q25	3Q25	4Q25	1Q26	2Q26	3Q26	4Q26
Fed	4.50	4.25	4.00	4.00	4.00	4.00	4.00	4.00	4.00
ECB	3.00	2.50	2.25	2.00	1.75	1.75	1.75	1.75	1.75
BOE	4.75	4.25	4.00	3.75	3.50	3.25	3.00	2.75	2.75
BoJ	0.25	0.35	0.45	0.55	0.65	0.75	0.75	0.75	0.75
Riksbank	2.50	2.25	2.00	2.00	2.00	2.00	2.00	2.00	2.00
Norges Bank	4.50	4.25	4.00	3.75	3.50	3.25	3.25	3.25	3.25

Note: Figures are end-of-period
Source: UniCredit Group Investment Strategy

INTEREST RATE AND YIELD FORECASTS

	15.11.24	1Q25	2Q25	3Q25	4Q25
Eurozone					
Depo rate	3.25	2.50	2.25	2.00	1.75
3M Euribor	3.00	2.43	2.20	1.95	1.75
2Y Schatz	2.12	2.10	2.00	1.90	1.80
10Y Bund	2.36	2.30	2.30	2.30	2.30
2Y EUR swap	2.22	2.20	2.10	2.05	1.95
10Y EUR swap	2.30	2.30	2.30	2.35	2.35
10Y Bund-swap spread	-6	0	0	5	5
2Y BTP	2.58	2.55	2.45	2.40	2.30
10Y BTP	3.55	3.60	3.60	3.60	3.60
10Y BTP-Bund spread	120	130	130	130	130
US					
Fed fund rate	4.75	4.25	4.00	4.00	4.00
3M OIS SOFR	4.49	4.14	3.90	3.90	3.90
2Y UST	4.30	4.25	4.20	4.10	4.00
10Y UST	4.44	4.50	4.50	4.50	4.50
10Y UST-Bund spread	208	220	220	220	220

FX FORECASTS

	15.11.24	1Q25	2Q25	3Q25	4Q25
EUR-USD	1.06	1.05	1.04	1.03	1.02
USD-JPY	155	154	152	150	149
EUR-JPY	164	162	158	155	152
GBP-USD	1.26	1.27	1.26	1.25	1.24
EUR-GBP	0.84	0.83	0.83	0.82	0.82
USD-CNY	7.24	7.30	7.33	7.30	7.28
EUR-CNY	7.65	7.67	7.62	7.52	7.43

Source: Bloomberg, UniCredit Group Investment Strategy

RISKY ASSETS FORECASTS

	Closing 15.11.24	Mid-2025	End-2025
Oil			
Brent USD/bbl.	71	75	78
Equities			
Euro STOXX 50	4,795	5,075	5,200
STOXX Europe 600	503	530	545
DAX	19,211	20,000	21,000
MSCI Italy	89	93	97
S&P 500	5,871	6,400	6,800
Nasdaq 100	20,394	22,000	23,500
Credit			
iBoxx Non-Financials Senior	96	85	80
iBoxx Banks Senior	93	90	85
iBoxx High Yield NFI	302	280	270

Source: Bloomberg, S&P Global, UniCredit Group Investment Strategy

For detailed forecast tables click the following links: Economics; FI, FX.

DEVELOPMENT OF SELECTED FINANCIAL MARKET INDICES

from to	**15.11.23 15.11.24**	15.11.19 15.11.20	13.11.20 15.11.21	15.11.21 15.11.22	15.11.22 15.11.23	15.11.23 15.11.24	15.11.19 15.11.24	**01.01.24 15.11.24**
Stock market indices (total return, in %)								
MSCI World (in USD)	**27.2**	14.1	29.9	-15.3	13.5	27.2	79.8	**19.1**
MSCI Emerging Markets (in USD)	**13.7**	16.9	10.9	-22.9	5.6	13.7	19.1	**8.8**
MSCI US (in USD)	**32.5**	19.8	33.0	-15.2	14.8	32.5	104.0	**24.6**
MSCI Europe (in EUR)	**14.8**	-3.5	30.2	-6.9	8.2	14.8	43.8	**8.1**
MSCI AC Asia Pacific (in USD)	**16.4**	16.1	11.0	-20.7	7.0	16.4	26.4	**10.2**
STOXX Europe 600 (in EUR)	**15.2**	-2.2	30.2	-8.3	8.1	15.2	43.9	**8.3**
DAX 40 (Germany, in EUR)	**21.7**	-0.8	23.5	-11.0	9.5	21.7	45.1	**14.7**
MSCI Italy (in EUR)	**24.7**	-12.3	34.7	-5.9	25.2	24.7	71.8	**19.1**
ATX (Austria, in EUR)	**14.9**	-22.6	65.3	-13.1	6.8	14.9	35.2	**8.8**
SMI (Switzerland, in CHF)	**12.8**	6.0	22.9	-9.4	0.2	12.8	31.6	**7.8**
S&P 500 (US, in USD)	**32.0**	18.0	32.5	-13.4	14.7	32.0	103.7	**24.6**
Nikkei (Japan, in JPY)	**17.7**	11.9	19.3	-3.9	22.3	17.7	82.7	**17.4**
CSI 300 (China, in Yuan)	**14.5**	27.0	2.3	-19.1	-4.3	14.5	14.9	**19.1**
Bond market indices (total return, in %)								
US government bonds 10Y (in USD)	**4.1**	11.9	-3.9	-15.8	-2.4	4.1	-7.1	**-1.1**
US government bonds (ICE BofA , in USD)	**5.0**	7.8	-2.9	-12.7	-0.4	5.0	-3.8	**0.7**
US corporate bonds (ICE BofA A-BBB, in USD)	**9.2**	8.8	0.6	-16.2	3.4	9.2	4.3	**3.1**
German Bunds 10Y (in EUR)	**4.4**	2.2	-2.4	-18.2	-1.5	4.4	-15.6	**-0.3**
EUR government bonds 1Y-10Y (iBOXX, in EUR)	**6.3**	3.8	-2.0	-16.8	-1.1	6.3	-10.7	**1.6**
EUR corporate bonds 1Y-10Y (iBOXX, in EUR)	**7.9**	2.0	0.0	-14.3	3.8	7.9	-1.8	**4.2**
Bond yields (change in basis points = 0.01 percentage points)								
US government bonds 10Y (in USD)	**-2**	-95	73	221	75	-2	260	**58**
US government bonds (ICE BofA , in USD)	**-27**	-115	58	293	62	-27	261	**29**
US corporate bonds (ICE BofA A-BBB, in USD)	**-64**	-98	32	327	41	-64	227	**10**
German Bunds 10Y (in EUR)	**-20**	-20	30	234	50	-20	269	**35**
EUR government bonds 1Y-10Y (iBOXX, in EUR)	**-40**	-37	28	247	60	-40	252	**17**
EUR corporate bonds 1Y-10Y (iBOXX, in EUR)	**-88**	-20	16	350	12	-88	266	**-19**
Spreads on government bonds (credit spreads, change in basis points)								
US corporate bonds (ICE BofA US Corporate Master)	**-41**	8	-30	57	-26	-41	-32	**-24**
US corporate bonds (ICE BofA US High Yield)	**-130**	55	-153	154	-75	-130	-134	**-62**
Euro corporate bonds (ICE BofA Euro Corporate AAA-A)	**-39**	-3	2	73	-30	-39	5	**-31**
Euro corporate bonds (ICE BofA Euro High Yield)	**-129**	45	-78	180	-69	-129	-45	**-77**
Money market rates (change in basis points)								
Libor (USD, 3 months)	**-77**	-168	-6	449	98	-77	295	**-74**
Euribor (EUR, 3 months)	**-100**	-12	-5	236	220	-100	340	**-91**
Euro exchange rates (change in %)								
US dollar (EUR-USD)	**-2.5**	7.4	-3.1	-9.1	4.5	-2.5	-4.1	**-4.2**
British pound (EUR-GBP)	**-4.6**	4.7	-5.0	2.7	-0.3	-4.6	-2.6	**-4.0**
Swiss franc (EUR-SFR)	**-2.7**	-0.6	-2.5	-7.1	-1.5	-2.7	-14.1	**1.4**
Japanese yen (EUR-JPY)	**0.2**	3.7	5.2	11.1	12.8	0.2	37.0	**5.1**
Commodities (change in %)								
Commodity Index (GSCI, in USD)	**28.4**	24.6	-2.0	-5.2	10.0	28.4	65.8	**23.7**
Industrial metals (GSCI, in USD)	**10.5**	12.8	34.7	-5.3	-10.1	10.5	41.3	**6.4**
Gold (in USD per fine ounce)	**29.8**	28.7	-1.7	-4.9	10.6	29.8	75.4	**24.6**
Crude oil (Brent, in USD per barrel)	**-11.7**	-31.5	91.7	14.4	-13.6	-11.7	13.9	**-7.1**

Please note: Past values and forecasts are not a reliable indicator of future performance. Indices cannot be purchased and therefore do not include costs. When investing in securities, costs are incurred which reduce the performance. The return on investments in foreign currencies may also rise or fall as a result of currency fluctuations. So-called synthetic bonds are calculated to reflect the performance of government bonds in a fixed maturity range. In each case, the most "suitable" real federal bond at the relevant time is used as a reference for the yield opportunity of the synthetic bond. The development of the expected yield to maturity is shown under the following conditions: servicing of interest payments and redemption in accordance with the terms and conditions and holding until maturity. In this respect, it is a yield opportunity. The yield opportunities reflect the different risk assessments of the investors for the respective products or countries (higher yield opportunity=higher risk assessment). The synthetic bonds cannot be purchased and therefore do not include any costs. In the case of currencies and commodities, acquisition and/or custody costs incurred are not included.
Source: Refinitiv Datastream.

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MARKETING COMMUNICATION

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