GLOBAL STRATEGY UPDATE Q2 2025 | CROSS-ASSET

Trump's tariffs are determining the outlook

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Note: Information on past performance is not a reliable indicator of future performance.

For the time being, there is little 'light at the end of the tunnel' in the trade war, but sentiment is certainly under great strain.

The exact economic impact of US tariffs remains to be seen. The level of the tariffs on imports to the US announced by Donald Trump and already implemented came as a surprise to the financial markets, as did their global scope. The result was an abrupt initial revaluation in almost all asset classes. Trump's erratic and unpredictable actions also make it difficult to assess the markets. In any case, they were shaken by uncertainty in a surprise attack, as an intervention of this dimension in the world economy by one person was completely new. A process has been triggered whose further course is difficult to predict. Open questions range from the passing on of tariffs to US consumers, to the shifting of supply chains, to the countermeasures of the US's trading partners. Only the coming weeks and months will bring more clarity about how consumers, companies and governments will react to the US tariffs. Uncertainty will therefore remain high, unless there is a U-turn in US trade policy, which we do not expect. Rather, the coming weeks and months should be characterised by a mixed news and data situation. We do not expect any relief or a significant countermovement in the markets to the recent massive shifts as long as irritations remain a possibility, leading to erratic and even escalatory action. In our view, the uncertainty that has arisen, which has led to comparable highs in volatility with the financial crisis and pandemic, will only slowly subside in the financial markets.

US – Economy and interest rates

The tariffs recently announced by US President Trump will be imposed across the world and have caused a real shock to the capital markets. The import-weighted average tariff rate is now over 20%, with the new import tariffs for the most important import trading partners ranging from 20% for the EU to 104% for China. The tariffs had been expected neither by market participants nor in this amount, which is based only on the trade deficit data. They are not reciprocal tariffs, because such would consist of a compensatory countervailing duty as well as compensation for the disadvantage from other trade barriers.

The outlook for the global economy, including the US economy, has become bleak, as the latest developments in the financial markets clearly show. Rising inflation rates are to be expected in the US due to the massive increase in the cost of imports, which will be accompanied by a decline in private consumption and a drop in corporate investment. The labor market will also come under pressure, as companies are unlikely to create or fill a large number of new positions, which will be accompanied by a wave of layoffs in the public sector. Given the likelihood of or already implemented countervailing tariffs, US exporters will find it difficult to succeed in international markets, while imports to the US will decline significantly due to sharp price increases. We estimate that the additional upward price pressure in the US economy will be slightly above 2%. However, we also expect energy prices to fall due to a global economic slowdown. We expect the further development of housing costs in the United States to have a similar dampening effect on inflation. We have therefore adjusted our forecasts accordingly and now expect an inflation rate of 3.3% for 2025 and 2.6% for 2026, with economic growth remaining unchanged at below potential at 1.4%.

At the meeting of the FOMC, the Federal Reserve's key interest rate-setting committee, which ended in mid-March, key rates were left unchanged. At the press conference, Fed Chair Powell emphasized that the Fed is waiting for more clarity before making further adjustments. We expect three further key rate cuts from June onwards due to slowing growth. Expectations on the capital market have shifted massively. At the beginning of the year, the market had almost entirely discounted the possibility of interest rate cuts, but now almost four rate cuts of 25bp each are expected this year. If the capital market assumes that the Fed will lower its key rates, this implies that the FOMC will view the tariff-induced inflation as essentially temporary. Otherwise, rate cuts during a period of sharply rising inflation would be inconsistent with the central bank's target of 2% inflation.

Eurozone – Economy and interest rates

We expect the tariff shock announced by the US to have far-reaching negative consequences for all EU countries. At the industry level, the machinery, pharmaceutical and automotive sectors in Europe are particularly exposed. For the time being, however, the pharmaceutical industry is exempt from US tariffs, which is at least good news given its significant importance for the EU. Among the large Eurozone countries, US exports play a particularly important role for Germany and Italy. We expect sentiment indicators, especially in manufacturing, to weaken noticeably in the course of the second quarter. We therefore expect the Eurozone economy to largely stagnate in the second quarter.

At the level of GDP components, we forecast the largest negative effect from weaker exports and a dampening effect on investment. Due to the unexpectedly harsh nature of the US's tariff policy, we have lowered our GDP forecasts for the Eurozone for 2025 to 0.5% (previously 1.0%) and for 2026 to 0.9% (previously 1.5%). We expect the EU to react moderately to the sharp US tariffs for the time being, in order to avoid a further escalation. It is possible that the EU, like other economic areas that have been hit hard, will decide on fiscal support packages for export industries in order to cushion the expected shock to foreign trade.

In view of these dramatic developments, we expect the ECB to make the next interest rate cut of 25 basis points at its meeting on April 18. The downside risks to the economy have increased unexpectedly sharply as a result of the hefty US tariffs. This would mean that the ECB would move more quickly towards a neutral interest rate level of around 2% in view of the uncertain environment. In light of recent developments, the downside risks to the interest rate outlook have increased noticeably. It now remains to be seen how the ECB Governing Council assesses the increased risks to the outlook. The ECB economists will not provide updated forecasts for growth and inflation until the meeting at the end of June.

Impact on asset classes

US and German government bonds

Yields of US government bonds likely face upward pressure over the medium term

After a noticeable increase at the beginning of the year, yields on US government bonds have fallen sharply since mid-January, with the announcement of the new US tariffs ultimately making a significant contribution to this. Since the beginning of the year, sentiment among purchasing managers and consumers has deteriorated materially. Massive economic concerns due to the new tariffs are currently the dominating force on the financial market. We expect a marked cooling of the US economy this year and think that the US market has discounted this accordingly. We therefore expect US government bonds to move sideways in a volatile manner in the coming months, with a further downside risk for yields in the event of a further escalation of the trade war, possibly coupled with a global recession.

Expect US dollar strength versus the Euro

After trading fairly in line with their US equivalents for months, German yields were able to decouple at the beginning of March. Planned economic stimulus packages and a massive increase in defense spending in the eurozone led to a peak yield increase of over 0.5% for 10-year German government bonds. Subsequently, however, yields fell again due to the increased downside risks to the global economy. We expect the upcoming US tariffs to dampen growth in the eurozone and expect German government bond yields to trend sideways for the rest of the year.

Sub-Sovereigns and Agencies (SSA)

Safe-haven flows, but also high volume on the primary market foreseeable

For the time being, SSA bonds are benefiting from investors' flight to safe havens. While Bund spreads have picked up again slightly after their lows in March, ASW spreads are narrowing at a high level. On the supply side, however, substantial primary market supply is to be expected, which was already at an above-average level in the first quarter of 2025.

In principle, the lower yield environment is helping the strained budgetary situation in many Eurozone countries. However, lower financing costs and possible additional customs revenues are being clouded by persistent economic risks. These risks could intensify if the trade conflict drags on.

EU and states mobilize public funds for economic recovery and armaments

This means that there is no prospect of a sustainable consolidation of public finances. On the contrary, new economic stimulus packages could be back on the table – with the corresponding additional funding volume. The armaments program “EU ReARM” with up to EUR 800bn (EU White Paper, 19.3.2025) and the German “special fund” infrastructure of over EUR 500bn over twelve years (approved on 18 and 21.3.2025, respectively), each with exceptions to the debt rules, have already been specified.

Rating agencies: further downgrades possible

While rating agencies are relatively relaxed about Germany's deficit spending plans, the situation in France or even the Eurozone periphery is much more differentiated in terms of credit risk. A significant narrowing of the ASW spreads therefore seems unlikely.

Financials & Covered Bonds

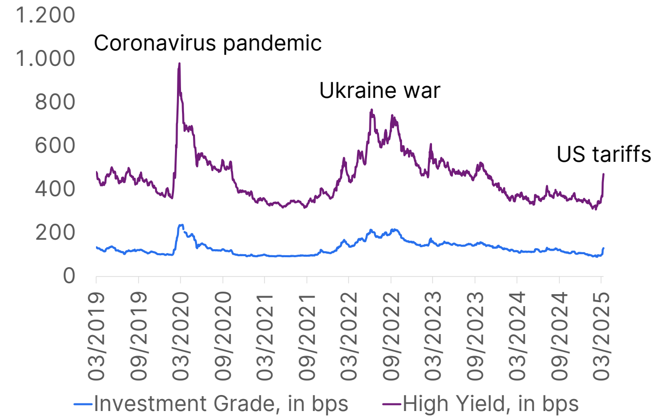
The tariff shock triggered by President Trump last week could also have medium-term effects on the European banking market. The negative impact on the European economy could intensify the already rising risk costs for banks and possibly also increase them in the long term. It should be noted here that we are starting from historically low levels of non-performing loans and that there may be a not insignificant delay between the start of the tariffs and the deterioration in the credit quality of European bank loans.

Another negative factor could be the risk of sharper interest rate cuts by the ECB. These would reduce the profitability of European banks in the long term. After the announcement of the tariffs, senior bank bonds reacted with a widening of the asset swap spreads, which can be attributed to the beginning of the pricing of the aforementioned risks at the banks. Meanwhile, the credit risk premiums of the covered bond spreads remained stable. In the medium term, a further widening of the senior spreads can be assumed, while the covered bonds show only limited potential for a spread widening.

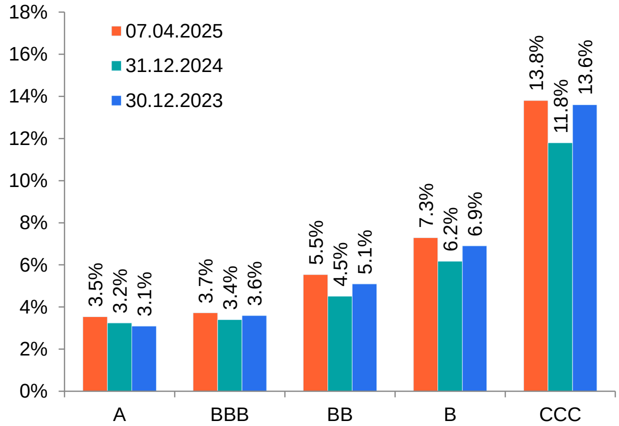
EUR Corporate Bonds

After the corporate bond market held up relatively well in the first few months of the year, US President Trump's hard-line trade policy has sent shockwaves through the financial market since the beginning of April. The corporate bond market has not been spared either. Since then, we have observed significant upward pressure on risk premiums. However, these are well below the levels seen at the beginning of the pandemic in March 2020 and after the outbreak of the war in Ukraine in February 2022.

IG segment with significantly lower spread widening
Ø Spread development vs. government bonds, in bps



Currently, yields have increased in all rating categories
Ø Yields by rating category



Source: Market data provider, Erste Group Research (own calculations)

Due to the unexpected extent of the US tariffs, the correspondingly harsh reaction of the financial markets and the potential negative economic impact, investors are focusing on differentiation by creditworthiness. Therefore, we prefer investment grade corporate bonds (IG) for the time being. In an uncertain market environment, these are more stable than the high yield segment (HY). Spreads in the IG segment have widened by 20bp since the announcement of the US tariffs, compared with 80bp for HYs.

Within the IG segment, telecommunications and utilities companies, which have a strong presence in the corporate bond market as predominantly regionally oriented industries with an index weighting of around 28%, are known as critical infrastructure and tend to be less volatile than cyclical sectors in turbulent times.

The ECB's monetary policy undoubtedly remains an important driver for the credit market. Further interest rate cuts should support issuers' credit metrics. Interest coverage ratios have so far remained relatively stable in both the IG and HY segments. However, the uncertainty surrounding the impact of US trade policy poses risks and will keep volatility in spreads at an elevated level.

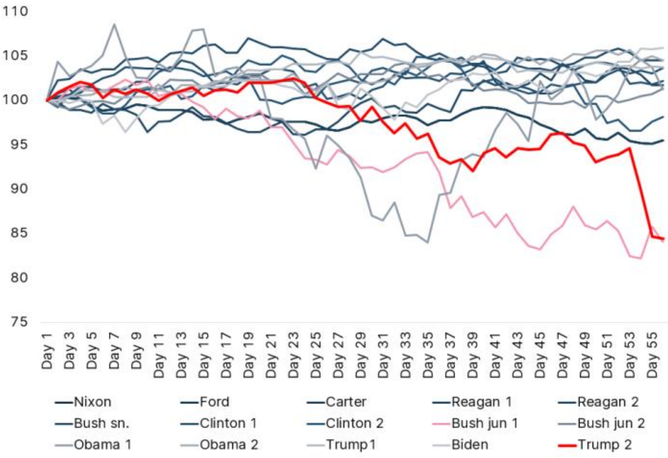
Equities

The new US tariffs, which were significantly higher than expected by the market, had a strongly negative impact on all global stock markets. Donald Trump's erratic policies are causing a high level of uncertainty. Since Donald Trump's inauguration on January 20, the S&P 500 has fallen by a total of

-15% since Donald Trump's inauguration. This is one of the worst performances by a US president since 1974, on a par with George Bush Jr. who became US president when the dot.com bubble burst.

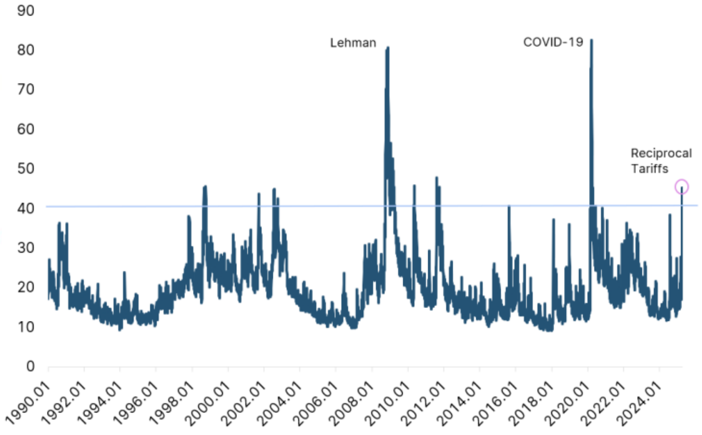
The US stock market already showed signs of weakness in February and March due to poorer economic data in the USA, among other things. The announcement of the new US tariffs on April 2 at 22:00 then led to panic selling on the international stock exchanges. In the following three trading days, the S&P 500 lost a total of -11%, the Stoxx 600 -12% and the Nikkei 225 -13%.

S&P 500 Performance since US-President Inauguration
Since 1974, rebased to 100, USD



Source: LSEG, Erste Group Research

VIX Index at the highest level since COVID-19 Pandemic
Index Points



Source: FactSet, Erste Group Research

Example Apple: New tariffs cost around USD 36bn p.a.
The new US tariffs published on April 2 hit Apple hard. Since then, the share price has fallen by -23%. The new US tariffs on imports from China will amount to 84%. Therefore, the tariff rate on Chinese imports into the US now totals 104%. However, Apple has so far had exemptions from most tariffs during the first Trump presidency. The company has around 80% of its production capacity in China. Around 90% of iPhones, 55% of Macs and 80% of iPads are produced in China. The remaining production capacity is located in Vietnam (iPads/Apple Watch), India (iPhones) and Malaysia (Macs). Product imports from these countries are also subject to high new tariffs of 46% (Vietnam), 26% (India) and 24% (Malaysia). Importantly for Apple, India has iPhone production capacity to meet around 50% of US iPhone demand. We assume that Apple will expand capacity in India.

Looking at Apple's global sales, the group generated USD 167 bn in sales in the US in FY 2024. (42% of global sales). Around 72% of this is attributable to products (especially iPhones) and 28% to services. According to our calculations, the additional approx. 60% customs costs for all imports from South East Asia to the USA will burden the group with approx. USD 36bn p.a.. If US selling prices remain unchanged, the gross margin would decline from 47% to 38% and Apple's annual profit would fall by around -33% y/y. However, we expect Apple to raise US iPhone prices slightly for the first time since 2017. Apple has kept the price of the basic iPhone Pro constant at USD 1,000 (excl. tax) for the last seven years in order to maintain or slightly increase its market share of around 57%.

We consider the probability that Apple will relocate production to the US due to the tariffs to be very low. The cost advantages and economies of scale of the IT clusters in South East Asia continue to exist despite the high tariffs. Apple CEO Tim Cook said at a conference at the end of 2017 before the first Trump tariffs that China was one of the few places where Apple could reliably find employees. These employees are able to operate the state-of-the-art machines used to manufacture Apple products. “In the US, you could have a meeting of tooling engineers and I'm not sure we could fill the room,” Tim Cook said. “In China, you could fill several soccer fields.” Moving production to the US is therefore very unlikely as it would significantly increase production costs. We assume that Apple will supply the US market partly from India, as the customs duties there are significantly lower than in China. Apple has the capacity to supply around 50% of US iPhone demand in India.

Equity Outlook

Positive factors

- The price slump has pushed technical indicators in the USA such as the number of stocks above their 50-day line (07.04.: 7%), the put/call ratio (03.04.: 1.02) and the VIX index (07.04.: high: 60 pts. / close: 45 pts.) to strongly oversold levels.

- Yields on 10Y Japanese government bonds are showing a technical bottom after the sharp fall within a week from 1.6% to 1.1%. In addition, the safe haven flows from USD into CHF also indicate a technical stabilization of risk aversion.

- NASDAQ stocks are showing initial relative strength to the market. This is often a good sign that investors are becoming less risk averse. The important comparison here is the year 2009 when the S&P reached new lows while the NASDAQ remained above the 2008 lows.

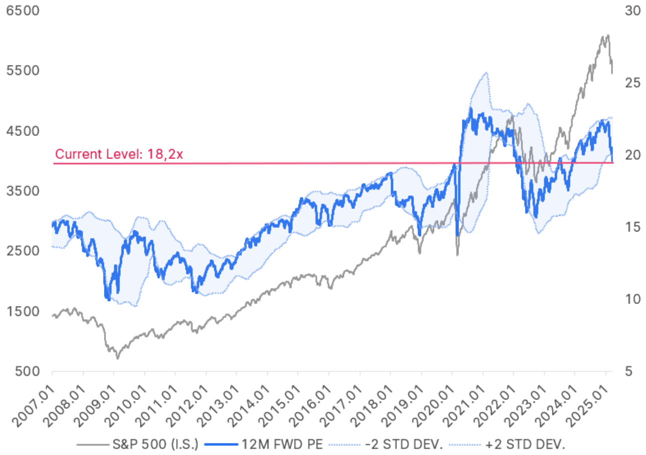
Negative factors

- The valuation of the S&P 500 is high by historical standards for a bottom. At 18.2x, the 12-month P/E ratio of the S&P 500 is only slightly below the 10-year average (18.3x). In the low of the ten significant corrections, the P/E ratio averaged the much lower level of 13x.

- We expect consensus earnings forecasts for 2025 to decline due to falling margins of global corporations as a result of tariffs. Global earnings growth is still expected to be +7.5% this year and +6.9% in 2026. However, companies' margins will be squeezed if costs cannot be passed on 1:1 to customers. We assume that this will only be possible for a small proportion of companies.

- While the tariff dispute between the USA and China is already in its second round, the EU's countermeasures to the 20% tariffs are still unclear. This and the expected backlash from Donald Trump will cause uncertainty on the European stock market. However, we do not expect the EU to tax US tech companies as a countermeasure. They could pass on the cost increases to European customers due to their monopoly positions.

S&P 500: 12M FWD P/E
USD



Source: FactSet, Erste Group Research

S&P 500: Oversold, but P/E at a high level
Significant Index-Corrections since 1980

	Drawdown		12M FWD PE		VIX Index		Perf. after Low		
Period	Loss	Days	Start	End	Start	End	+1M	+3M	+6M
13.02.1980 - 27.03.1980	**-17%**	43					7%	18%	28%
28.11.1980 - 12.08.1982	**-27%**	622					18%	36%	44%
25.08.1987 - 04.12.1987	**-34%**	101					14%	19%	19%
16.07.1990 - 11.10.1990	**-20%**	87			17	34	6%	7%	28%
17.07.1998 - 31.08.1998	**-19%**	45			16	44	6%	22%	29%
24.03.2000 - 09.10.2002	**-49%**	929	26	14	23	42	15%	19%	11%
09.10.2007 - 09.03.2009	**-57%**	517	15	10	16	50	27%	39%	53%
20.09.2018 - 24.12.2018	**-20%**	95	17	14	12	36	12%	19%	25%
19.02.2020 - 23.03.2020	**-34%**	33	19	13	14	62	25%	40%	45%
03.01.2022 - 12.10.2022	**-25%**	282	22	15	17	34	12%	11%	14%
Average	*-30%*		*20*	*13*	*16*	*43*	*14%*	*23%*	*30%*
Median	*-26%*		*19*	*14*	*16*	*42*	*13%*	*19%*	*28%*
19.02.2025 - 07.04.2025	**-18%**	**44**	**22**	**18**	**15**	**45**			

Source: FactSet, Erste Group Research
Note: 12M Forward Price Earnings Ratio and VIX-Index only available since shown Periods.

Based on the assumption that the US economy will weaken but not go into recession, we expect the equity markets to bottom out in Q2 and a slight recovery over the course of the quarter is possible. In the course of the reporting season, which starts on Friday, April 11, investors will once again focus on corporate earnings performance. Earnings growth of +7.0% y/y is forecast for the S&P 500 in 1Q25e and +10% y/y for 2025e. Management statements on margin development after the tariffs and the demand situation of the US consumer will be decisive for investors. We assume that the sales and earnings guidance for 2025 will be reduced, but that the year-on-year change in US earnings will remain slightly positive and that the tariffs will still slightly affect the 2026 forecasts due to the one-off base effect.

US-dollar

The euro was able to strengthen significantly against the US dollar in light of the changed economic outlook for the eurozone and the new US tariffs. We think that increased volatility will accompany the interest rate and currency markets in the coming months. We have adjusted our forecasts to take into account the possibility of a marked economic downturn in the US with rising inflation expectations, and the positive growth effect of defense and economic stimulus programs in the eurozone together with the narrowing interest rate differential to the US dollar. We think that the euro will remain in a volatile sideways phase against the US dollar in the near future, although we still expect a slight appreciation of the euro.

Gold

The gold price rose by +5.0% in EUR terms in March. It once again reached a new record high. The steady demand from global central banks is an important factor that will have a positive impact on the gold price in the long term. Investment demand from investors has also risen sharply. In recent weeks, gold ETFs in North America in particular have seen significant inflows. Assets managed by gold ETFs have now risen to USD 332 billion. The ongoing geopolitical uncertainties, the trade conflicts in the US and the slowdown in US economic growth are favoring rising demand for gold. We therefore expect the price of gold to continue to rise in April.

Forecasts[1]

GDP	2023	2024	2025	2026
Eurozone	0.4	0.9	0.5	0.9
US	2.9	2.8	1.4	1.4

Inflation	2023	2024	2025	2026
Eurozone	5.5	2.4	2.0	2.1
US	4.1	3.0	3.3	2.6

Interest rates	current	Jun.25	Sep.25	Dec.25	Mar.26
ECB MRR	2.65	2.15	2.15	2.15	2.15
ECB Deposit Rate	2.50	2.00	2.00	2.00	2.00
3M Euribor	2.30	1.97	1.98	1.99	2.01
Germany Govt. 10Y	2.57	2.50	2.50	2.50	2.50
Swap 10Y	2.56	2.50	2.60	2.70	2.70

Interest rates	current	Jun.25	Sep.25	Dec.25	Mar.26
Fed Funds Target Rate*	4.33	4.13	3.88	3.63	3.38
3M SOFR	4.21	4.08	3.83	3.58	3.33
US Govt. 10Y	4.36	4.00	3.80	3.80	3.80
EURUSD	1.10	1.12	1.10	1.11	1.11

*Mid of target range

Source: Market data provider, Erste Group Research

[1] By regulations we are obliged to issue the following statement: Forecasts are no reliable indicator of future performance

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