

Economic outlook 2026-27: The Fog of War

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Executive Summary

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- **The war in the Middle East sets the stage. For the US and Europe, we expect lower growth, higher inflation, stronger fiscal pressure and a challenging situation for central banks.** Global GDP is expected at +2.6% in 2026 (revised down by -0.5pp), inflation at 3.2% in the US and 3.0% in the Eurozone this year (revised up by +0.7pp and +1.1pp, respectively) and trade growth at +1.5% in 2026 (revised down -0.5pp). Growth is expected to stay at +2.1% in the US and +0.8% in the Eurozone and deficits will remain elevated: -7% of GDP in the US and -3.0% in Europe, while higher debt-servicing costs limit room for support. Oil prices are expected to hover around 80 USD/bbl at end-2026 after reaching a record high in Q1 2026 on the back of geopolitical volatility. The Fed is expected to look through the inflation spike and remain on hold, with only one cut in early 2027. The ECB is likely to deliver a +25bps hike to anchor expectations, then pause as growth weakens. Both central banks will treat the shock as temporary in the baseline scenario, but prolonged energy pressures would trigger a more hawkish response.
- **The Gulf countries (GCC) and Asia remain most directly exposed while China should still grow by +4.6% in 2026.** Watch for triple-deficit economies facing recession risks while some commodity exporters benefit from diversification. Triple-deficit economies, combining fiscal, current account and energy deficits, are particularly vulnerable to capital outflows, higher inflation and recession. GCC economies face trade, tourism and real-estate risks despite high financial buffers and we have revised their growth forecast by -2.1pps. For Asia, the end-2025 growth tailwind of +0.2pp has been erased. Latam is relatively more insulated from the shock, with countries such as Argentina, Brazil and Mexico benefiting from their position as commodity exporters.
- **For corporates and consumers: a broad-based cost shock, on top of pre-existing vulnerabilities.** Higher energy, metals and fertilizer prices are creating a cost-push shock amid weak demand and elevated US tariffs, expected to hover around 10%. Energy producers and defense benefit, while energy-intensive, transport and consumer sectors face margin pressure. Tighter financial conditions and weaker demand are expected to push global insolvencies higher in 2026. Weakened consumer sentiment, labor markets and purchasing power in the context of high fuel and food prices are the main challenges ahead.
- **Capital markets: pricing in a geopolitical stagflation scare.** Since the outbreak of the Middle East conflict, investors have shifted decisively into a stagflationary risk off mode. Yield curves have risen and bear-flattened (front end: +50-90bps; long end: +40-70bps) as markets factor in a short term inflation spike and, as a consequence, hawkish reactions from central banks (expected end-of-year policy rates for the Fed and ECB rose 60bps

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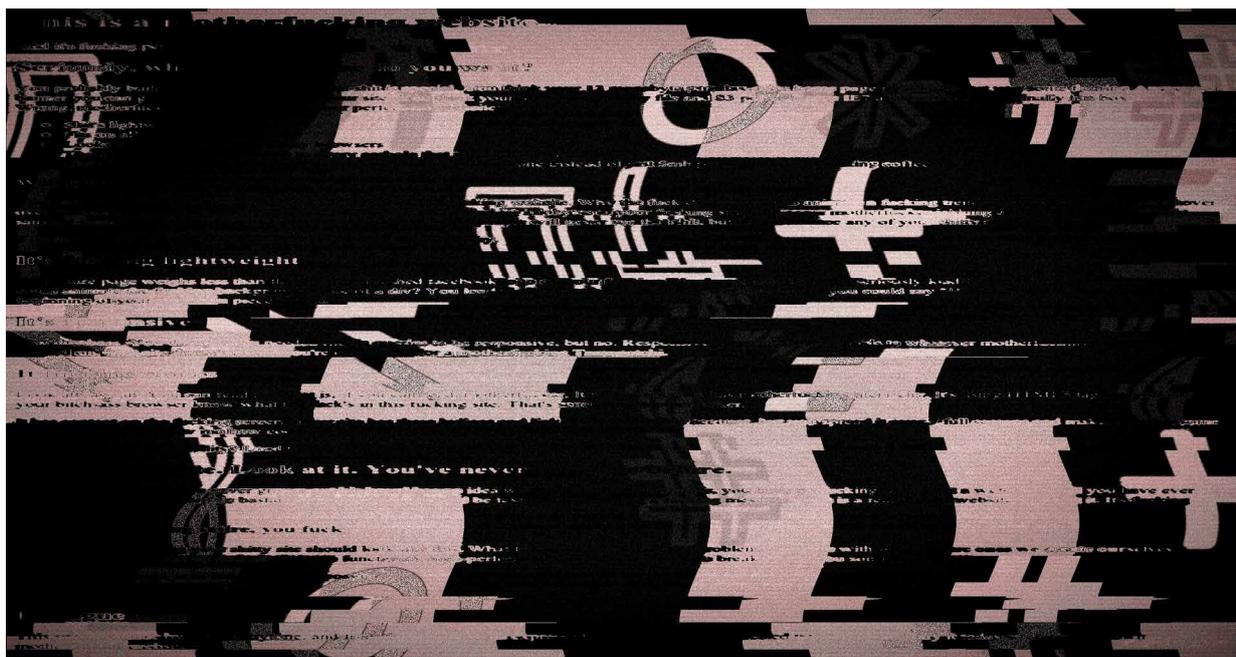
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and 90bps). At the same time, overseas demand appears to be softening as EM central banks draw down FX reserves to stabilize weakening currencies and finance elevated oil and gas imports. The growth scare is reflected in broad equity losses (US: -8%; Europe: -10%; EMs: -12%) and a pronounced flight to the ultimate safe asset: USD (trade weighted +2.5%) cash. Even gold has retreated (-13%), unwinding its earlier exceptional rally and facing selling pressure from countries tapping savings to pay for energy. Credit spreads have widened only modestly (+13bps for Euro IG; +26bps for HY), but broadly in line with previous geopolitical shocks. Importantly, markets still do not expect a structural regime shift: longer term inflation expectations remain well anchored (5y5y), and oil forwards for December are 30 USD below the current price. Our baseline scenario broadly aligns with this view: assuming the conflict and energy disruptions ease within three months, we expect a broad based asset market recovery as the year progresses (US 10y: 4.5%, DE: 2.8%, S&P500: +6%, Eurostoxx +5%). In the near term, however, further volatility and new market extremes remain likely.

- **It could get worse before it gets better: A worsening of the conflict would cause a stagflationary recession.** Mind the chain reaction. In our downside scenario, a prolonged closure of the Strait of Hormuz (>3 months) would magnify the economic shock, with oil rising temporarily to 180 USD/bbl and gas to 200 €/MWh before easing back to 85 USD/bbl and gas to 65 €/MWh towards the end of the year, given the demand-side destruction. The global economy would be pushed into a stagflationary regime, with the Eurozone falling into a technical recession (annual growth at +0.2%) and the US economy significantly slowing down for two years on second-round effects as a strong equity market correction would hit the consumer. Inflation would peak at 4.6% in the Eurozone and 4.9% in the US, forcing central banks into a more aggressive tightening response despite the economic slowdown (ECB: three hikes, Fed: two hikes). For capital markets, this implies a clear risk-off regime: higher yields (US 10y up to 5.7%, DE up to 3.7%), sharp equity corrections with a max drawdown of -30% in Europe and -25% in the US and materially wider credit spreads (Europe IG up to 150bps, HY 440bps), alongside a stronger USD and rising liquidity stress. In this scenario, nonlinear dynamics dominate, with consumer confidence shocks, forced deleveraging and private market stress amplifying the macro downturn.



Global outlook: Escalation risks in a fragmented world

The US-Israeli strikes on Iran will have implications for energy markets, shipping costs, inflation risks and financial conditions – but everything hinges on how long the conflict lasts and how far the escalation on critical energy infrastructure could go. Navigation through the Strait of Hormuz – critical for 25% of global hydrocarbon flows – and disruption of oil production in the Gulf remain the crucial transmission channels. In terms of the energy supply shock, the Middle East accounts for double Russia's share of oil, i.e. 20% of global supply, and a similar exposure for gas, i.e. 5% of global supply. We estimate that half of the oil supply from the Middle East can be covered through rerouting, additional supply from the US & Russia and a progressive release of strategic reserves. This is consistent with oil prices ranging between 80 to 100 USD/bbl. For now, gas prices have doubled but they were multiplied by five during the war in Ukraine, with the peak in oil prices above 130 USD/bbl at that time. In terms of country exposure, Europe is moderately exposed, with 7% of total oil imports from the Middle East and 4% of gas. In the emerging world, Asia is most

exposed as it imports more than 56% of its oil from the Middle East and more than 30% of its gas. Looking at energy vulnerability (price & supply), strategic reserves and coping mechanisms (fiscal and current balance), we identify one group of countries with high exposure and limited room to maneuver (high fiscal and current account deficits) – Egypt, Hungary, Kenya, Poland, Romania, Tunisia, Ethiopia, Jordan, Morocco, Pakistan and Bangladesh – and another group with high exposure but more leeway to counteract the shock – Chile, China, India, Philippines, Sri Lanka, Taiwan, Thailand and Turkey.

In our baseline scenario, energy price dynamics are a large but not sustained supply shock, with oil testing higher levels before gradually normalizing as de-escalation materializes and flows through the Strait of Hormuz return to normal progressively. Hence, we see energy prices coming down to 78 USD/ bbl by year-end from 90 USD/bbl in Q2, which means 2026 CPI inflation is forecast to rise to 3% in 2026 in the Eurozone (after 2.1% in 2025) and 3.2% in the US (after 2.7%). The hit

to GDP growth would range from -0.2pp in the US (to 2.1% in 2026) to -0.4pp in the Eurozone (to 0.8% in 2026). We believe central banks would mostly look through this temporary price shock, with the ECB and the BoE delivering modest 25bps rate hikes in April, and the Fed keeping rates steady. Overall, global GDP growth should reach +2.6% in 2026, from +3.1% prior to the conflict. If the Strait of Hormuz remains blocked for longer than three months, the impact will start to be recessionary. Inflation and central bank reactions will depend on the

length of the conflict and the reaction function of fiscal policy. In a prolonged conflict, we expect central banks to increase key rates more aggressively as markets will be testing their credibility after the 2022 episode (+75bps in the US, the UK and Eurozone by end-2026). In this scenario, GDP growth would take a large hit. The Eurozone would likely go through a technical recession, with annual GDP growth at +0.2% in 2026. The US economy would also take a hit, though more moderately thanks to partially offsetting effects in the mining sector. US GDP growth would drop to a meagre +1.5%.

Table 1: Real GDP growth forecasts, %

Growth (yearly %)	2023	2024	2025	2026f	2027f
Global	2.8	2.9	3.0	2.6	2.9
USA	2.9	2.8	2.1	2.1	2.2
Latin America	2.0	1.7	2.6	2.4	2.9
Brazil	3.2	3.0	2.6	1.9	2.5
UK	0.3	1.1	1.3	0.7	1.4
Eurozone	0.5	0.9	1.5	0.8	1.3
Germany	-0.7	-0.5	0.4	0.7	1.2
France	1.6	1.1	0.9	0.8	1.3
Italy	1.0	0.6	0.7	0.5	0.8
Spain	2.5	3.5	2.8	2.2	1.8
Central and Eastern Europe	1.4	2.2	2.2	2.6	2.7
Poland	0.1	3.0	3.6	3.7	2.6
Russia	3.9	4.3	1.0	1.7	2.0
Türkiye	5.0	3.5	3.6	3.5	4.0
Asia-Pacific	4.2	4.0	4.6	4.2	4.0
China	5.5	5.0	5.0	4.7	4.4
Japan	0.7	-0.2	1.2	1.2	1.0
India	6.8	7.3	7.5	6.4	6.5
Middle East	2.1	2.1	2.3	-1.0	4.0
Saudi Arabia	0.5	2.6	4.6	2.3	8.1
Africa	2.7	3.4	4.1	3.8	3.9
South Africa	0.8	0.5	1.3	1.4	1.6

Sources: national, Allianz Research

Table 2: Middle East conflict scenarios

		Feb 28th	Upside (15% probability): Short lived escalation with military exchange ***	Baseline (45% probability): Prolonged conflict with less than three months of global oil and gas disruption ***	Downside (35% probability): Long sustained escalation with prolonged disruption of global oil and gas supply ***
			2026	2026	2026
Description			Deescalation, Hormuz opens in April, no destruction of oil industry	A deal allowing for a progressive normalization of oil and gas trade in May. In between partial re-routing, additional production (US, Russia) and strategic reserves being tapped covers >50% of Hormuz gap in oil and gas; no material destruction of oil/gas industry.	Hormuz closed for more than three months. Oil, gas and other commodity supply shortages (fertilizers, helium) transmits to confidence & equity shock exacerbating downturn.
Oil Brent (USD/bbl), Q2 average / eoY 2026		73\$	70\$ / 70\$ (125\$)*	90\$ / 78\$ (\$140)*	130\$ / 85\$ (\$180)*
Gas prices, annual avg.		32€	35€ (80€)*	49€ (150€)*	65€ (200€)*
GDP					
	EZ	1.3%**	1.2%	0.8%	0.2%
	US	2.6%**	2.5%	2.1%	1.5%
Inflation					
	EZ	1.9%**	2.1%	3.0% (3.4%)*	3.9% (4.9%)*
	US	2.5%**	2.6%	3.2% (3.7%)*	4.0% (4.6%)*
EURUSD		1.18	1.19 (1.14)*	1.15 (1.11)*	1.12 (1.05)*
Monetary Policy					
	ECB	2.0	2.0	2.25	2.75
	Fed	3.75	3.5	3.75	4.25
10y					
	DE	2.6	2.6 (3.1)*	2.8 (3.3)*	3.1 (3.7)*
	US	4.0	4.3 (4.5)*	4.5 (4.8)*	5.0 (5.7)*
Equity market					
	EZ	6	9 (-10)*	5 (-10)*	-25 (-30)*
	US	1	10 (-10)*	6 (-10)*	-20 (-25)*
Credit spread					
	EZ IG	83	83 (100)*	95 (115)*	120 (150)*
	EZ HY	283	283 (320)*	320 (400)*	400 (440)*
	US IG	84	84 (100)*	95 (115)*	120 (140)*
EM HC spread		178	185 (200)*	200 (230)*	235 (280)*
Private Markets (Global)					
	Private EQ	6.7%	12.5%	10%	-10%
	Direct Lending	530	500	550	650-700
	Infra EQ	8.7%	9.8%	8.5%	5.5%
Insolvencies					
	EZ	+1.4%	+1.5%	+2.5%	+5.0%
	US	+5.7%	+6.4%	+9.3%	+13.5%

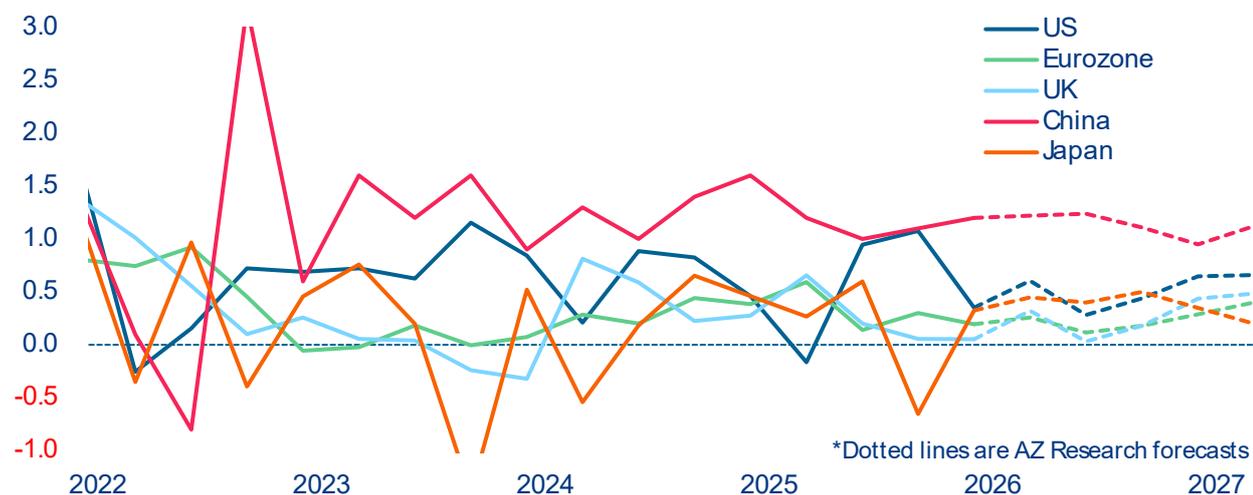
* max daily draw-down in brackets.

** macro forecast for 2026 before the start of the Iran war

*** probabilities add up to 95% with remaining upside and downside tail-risks (<5%) omitted

Sources: national, Allianz Research

Figure 1: Quarterly real GDP growth rates, q/q, %



Sources: national, Allianz Research

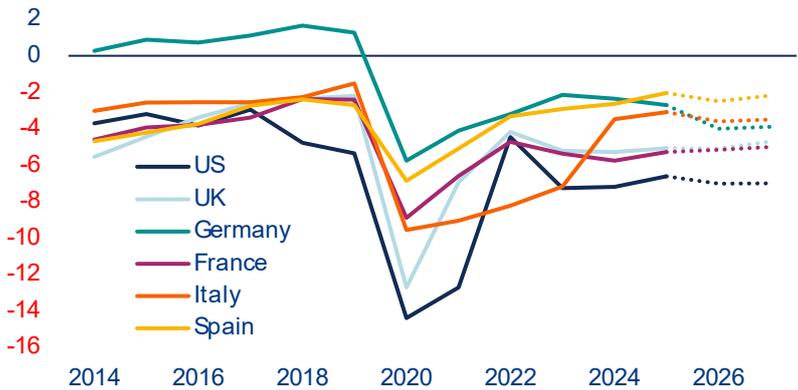
The 2026–2027 risk outlook should be read through the lens of a structural regime shift to a new global order, less rules-based and more power- and influence-driven. The efficiency-led paradigm anchored in free trade, comparative advantage and lean, cost-optimized supply chains is giving way to a system shaped by interventionism, geopolitics and strategic autonomy. Trade is increasingly weaponized via tariffs, export controls, sanctions, energy dependencies and control over strategic corridors while supply chains are diversified and, in many cases, duplicated. This transition is inherently inflationary, implies greater state involvement and is driving a reallocation of global capital toward strategic sectors. Crucially, volatility is no longer episodic but a structural feature of today's new global order. Geopolitical transmission channels, commodity-trade shocks and growth–inflation trade-offs are likely to generate more frequent and less predictable shocks. Market reactions are expected to be increasingly non-linear, with delayed repricing phases followed by abrupt adjustments, while traditional safe havens may prove less reliable in a fragmented geopolitical environment. This increases the need for a strong understanding of transmission mechanisms and second-round effects.

Within this evolving framework, the baseline scenario carries a 45% probability and the balance of risks is clearly skewed to the downside. A disorderly correction in AI-driven valuations could trigger broader equity repricing (with potential corrections of 25–30% in US equities), exposing leverage in private markets and amplifying recessionary dynamics. At the same time, persistently high fiscal deficits in major advanced economies risk morphing into confidence shocks, fueling FX and rate volatility, particularly in a context where macro aggregates remain resilient but micro-level stress is intensifying. In parallel, renewed de-dollarization pressures could act as a destabilizing amplifier, increase term premia and contribute to more volatile capital flows. Financial deregulation may support credit creation in the short term but at the cost of building medium-term vulnerabilities. Meanwhile, structural constraints such as tighter US immigration policies are likely to exacerbate labor shortages, reinforcing the shift toward capital-heavy, labor-light growth while capping potential output.

In this context, policy buffers and fiscal space will increasingly differentiate resilience to geopolitical and macro shocks. Overall, the transition toward modern mercantilism implies a more fragmented, state-driven and investment-heavy global economy, where the interaction between geopolitical competition, policy intervention and financial imbalances increases the likelihood of non-linear adjustments, and where the accumulation of risks intensifies the longer these dynamics persist.

Fiscal policy was already stretched before the Iran shock. Before the escalation of tensions, no major consolidation effort was on the horizon across advanced economies. Fiscal stances were broadly neutral at best, with most governments balancing post-pandemic spending legacies against moderating growth outlooks. The energy shock has since complicated the picture further, forcing some countries to contemplate targeted support measures while avoiding the broad-based subsidies deployed in 2022. Countries enter this period in somewhat better fiscal shape than during previous crises, having rebuilt modest buffers over 2023–2025, but the window for consolidation is narrowing. Slowing growth – amplified by higher energy costs and weakening consumer demand – will weigh on revenue dynamics and make deficit reduction harder to sustain. Adding to the strain, the trend reversal in interest rates will keep debt-servicing costs elevated. The combination of stagnating revenues, energy-related spending pressures and sticky borrowing costs leaves little room for maneuver – and makes any near-term improvement in debt ratios unlikely. In the US, new spending and tax refunds enacted in the One Big Beautiful Bill Act will more than offset tariff revenues, pushing up the federal deficit. In Europe, fiscal challenges look set to intensify into 2027, when major economies such as France, Italy, Spain and Greece, among others, head to the polls, likely on platforms favoring spending commitments over consolidation. Meanwhile, Germany's fiscal bazooka is slowly building momentum, with defense and special fund spending ramping up, though implementation remains gradual and the full economic impact will take time to feed through.

Figure 2: Fiscal deficit forecasts, % of GDP

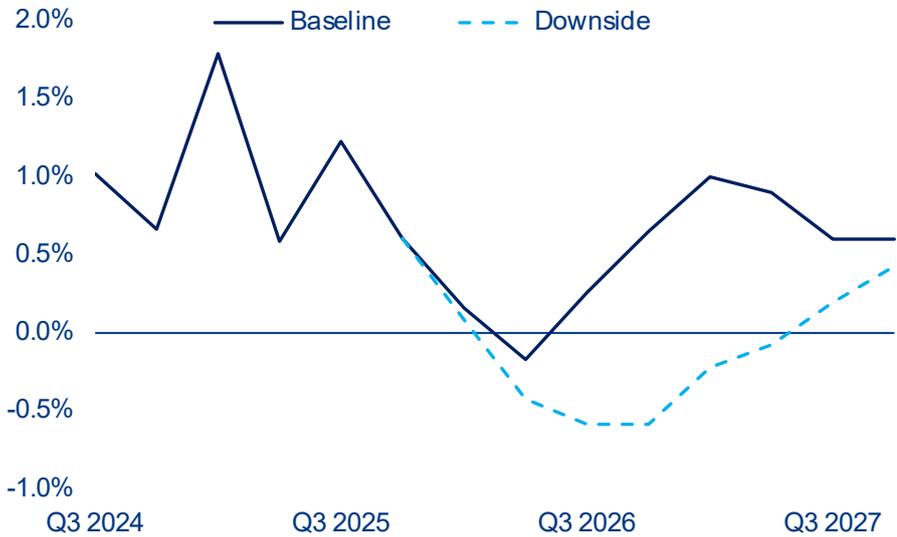


Sources: LSEG Datastream, Allianz Research

Global trade of goods is projected to decelerate to +1.5% in volume terms in 2026 – down from the +2% forecast before the Middle East conflict escalation. The revision reflects the conflict pass-through effects on energy markets, representing a sharp reversal from a stronger-than-expected 2025, when AI-related goods and frontloading ahead of US tariffs drove growth of trade in volume to +3.9%. A strong carry-over effect from late 2025 (+2.1%) provided some momentum into early 2026, but this tailwind is fading as trade volumes are likely to be impacted by the

escalation. In 2027, trade growth is expected to rebound to +2.7% assuming the Strait of Hormuz blockage has ended. However, in a downside scenario, the V-shaped recovery of the baseline would turn towards a U-shaped recovery as a prolonged closure of the Strait, global spillovers from higher energy prices through 2026/27 and reduced global trade would bring global trade growth to +0.5% in 2026, followed by a recession in 2027 with a decline to -0.9%.

Figure 3: Global trade forecast, quarterly path, %

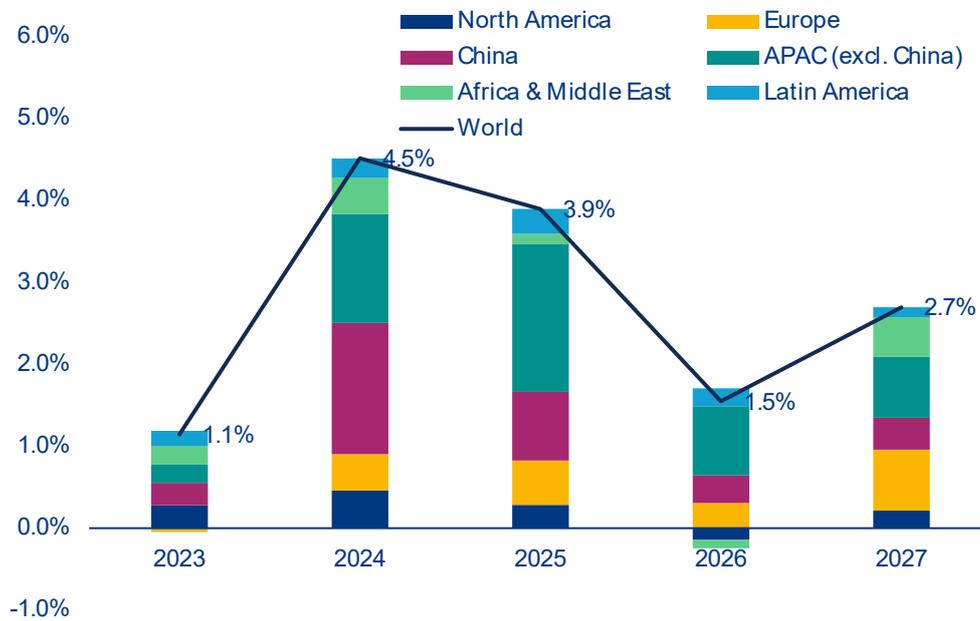


Sources: LSEG Datastream, Allianz Research

The most immediate drag on volumes comes from the physical blockage of the Strait of Hormuz. Trade flows through the Strait represent around 4% of global trade, but the effective disruption is more contained thanks to active rerouting. We estimate that around 1.9% of global trade flows are currently stranded or severely disrupted. In a downside scenario where circulation through the Strait is constrained for longer, we estimate the amount of strained global trade to increase to 2.9%. Currently, strained vessels are mainly oil and gas tankers, while bulk carriers and containerships unable to transit or load in the Gulf account for a residual to global trade. However the direct and growing drag compounds the broader cost channel, where higher bunker oil and jet-fuel prices are layering onto already-elevated trade war frictions. In nominal terms, growth is likely to outpace underlying volumes, as elevated energy costs – impacting both production and transportation – feed through into price increases across some sectors.

Slowdown of global trade will be felt across the board but geography continues to matter. Global trade growth in the Middle East will go to negative territory, last experienced in 2020, during the decline of oil demand due to the pandemic. Asia is expected to remain the main contributor to trade growth but with a much decelerated level of 1%, -0.8pp from the previous year. The region’s deep energy dependence makes it acutely exposed to the Iran shock: Trade growth for China, Singapore, South Korea and India is projected to be roughly halved, while Japan faces an outright contraction in trade volumes. Europe’s picture is uneven: Germany and France are expected to show tentative improvement, though Germany is set to remain in recessionary territory. The rest of the continent faces a broad-based slowdown. In the US, exports are also set to decelerate, constrained by the lingering drag of trade policy uncertainty and soft external demand for US products in key external markets including China, Mexico and Canada. Meanwhile, US imports will decline relative to 2025 as frontloading of shipments to the US market has largely run its course and elevated tariffs weigh on US demand for foreign products.

Figure 4: Regional contribution to global trade of goods, %



Sources: Oxford Economics, Allianz Research

In our view, a reopening of the Strait of Hormuz following a ceasefire would almost certainly be gradual rather than immediate as security risks tend to normalize far more slowly than physical disruptions.

Taking into account the tanker capacity of key emerging market exporters, initial commodity flows would likely recover to only 15–30% of normal levels (roughly 3–6 mn bpd of oil), contingent on the credibility of security guarantees, before scaling up cautiously. This would cover up to 60% of the current oil-supply gap of 10 mn bpd. Historical precedents reinforce this phased dynamic: During the 1980s Iran–Iraq war, throughput initially rebounded to around 20–30% within weeks, with full normalization taking several months due to the need

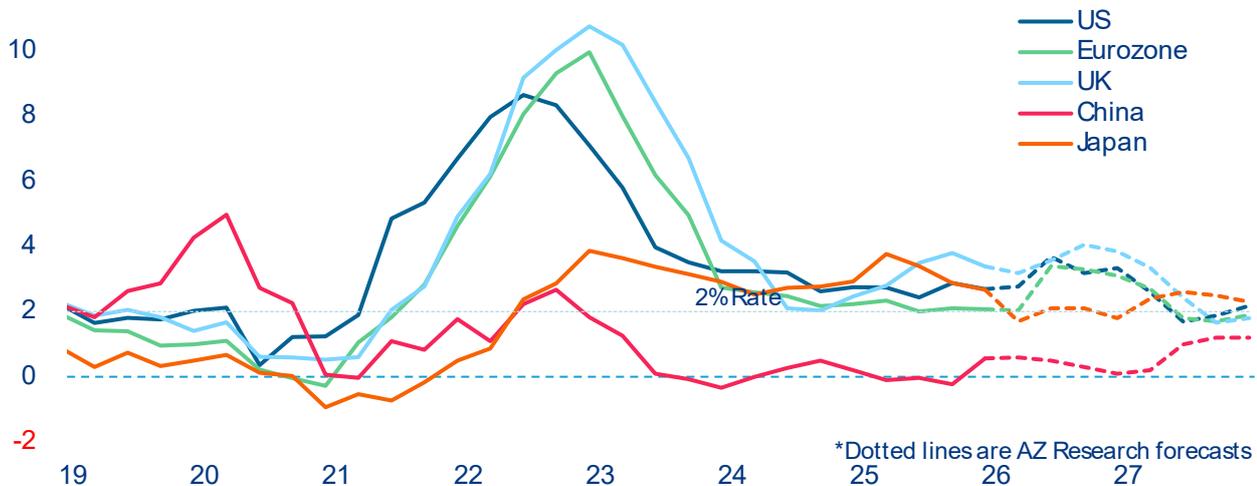
for naval escorts and mine clearance. Similarly, during the 2019 US–Iran tensions, partial flows resumed within days for insured vessels, but full confidence and capacity recovery took several weeks. Even in non-security scenarios, such as the six-day blockage of the Suez Canal by the ship Ever Given in 2021, normalization was not instantaneous: while limited traffic resumed quickly for small vessels, clearing the backlog and restoring full operational throughput still required around two weeks. Taken together, they suggest that even under favorable conditions, a post-ceasefire recovery in Hormuz would follow a cautious, step-wise trajectory rather than a rapid snapback.

Inflation and central banks: Price shock triggers reaction

Inflation is set to pick up significantly in Q2-Q3 2026, and start receding gradually thereafter amid soft economic growth and looser labor markets. The energy-price spike will push up inflation rates in March-May, with a rapid pass-through of higher oil prices onto retail gasoline prices. In the Eurozone, we expect headline CPI inflation to peak at +3.4% in Q2 2026 (after +2.0% in the previous quarter), and +3.7% in the US (after +2.8%). Because of higher wholesale gas prices in Europe feeding through into higher utility bills with a lag, we expect Eurozone inflation to recede a bit less rapidly than in the US. In the UK, inflation will peak later because of an expected sharp hike in the Ofgem utility price cap in July. Peak inflation will hit 4% in Q3. However, under our baseline assumption that energy prices will start drifting lower in Q2, inflation rates are expected to come down heading into 2027. Weaker economic activity will start bearing down on core inflationary pressures, limiting pass-through of higher fertilizer and transportation prices into consumer food and services

inflation. In 2027, we expect annual average inflation to be close or at central banks' 2% target (+2.3% in the UK, +2.1% in the US, +2% in the Eurozone). However, there are upside risks to our forecasts, if energy prices were to stay higher than we expect. Inflation expectations from the private sector (households and firms) may then start to drift higher, leading to second-round effects on wages on price settings. Ultimately though, higher inflation expectations and actual inflation would force central banks to react forcefully, bearing down on core inflation by end 2026-early 2027 through a weak labor market and demand. In all, we think the risk of de-anchoring inflation expectations and permanently higher actual inflation is moderate compared to 2022. The economic backdrop is much less conducive to such outcomes: GDP growth is lower, labor markets are looser, fiscal support more timid and monetary settings generally more neutral (vs deeply negative real interest rates in 2022). All this points to limited risks of persistent stagflationary outcomes.

Figure 5: Inflation forecasts, % y/y



Sources: LSEG Datastream, Allianz Research

US and Eurozone labor markets entered the energy shock from a position of relative resilience, but with less buffer than it may appear. US labor market conditions, though softening sharply since mid-2025 in terms of job creation, remain broadly resilient with a limited pick-up in the unemployment rate, while the Eurozone unemployment rate stands at a record low. However, labor markets on both sides of the Atlantic are weaker than in 2022 during the energy shock, particularly in the UK, with hiring intentions slowing, vacancy rates declining and wage growth moderating. Across developed markets, the energy shock now hits an already decelerating job machine. A deteriorating economic outlook, shaped by higher energy costs, weakening consumer spending and tightening financial conditions, risks amplifying what were already slowing employment intentions, particularly in energy-intensive and trade-exposed sectors. Adding a structural layer to the cyclical pressures, the global labor market was already undergoing a profound transformation ahead of this shock. AI adoption has accelerated across advanced economies, yet its impact on employment and productivity remains uneven and, for most countries, not yet visible in the aggregate data; only a handful of economies successfully converting broader AI diffusion into meaningful productivity gains. Yet, amid weak demographics and our baseline of a relatively short-lived spike in energy prices, we do not expect much of a rise in unemployment.

The Fed is expected to be on a prolonged hold as it looks through the energy price-induced spike in inflation. We expect only one 25bps cut in early 2027. The conflict in the Middle East poses a difficult dilemma for the Fed, with inflation set to pick up significantly amid higher energy prices while the labor market still looks fragile. With inflation now stuck above the 2% target for five years, the Fed clearly does not have the luxury to focus on labor market risks only. Inflation expectations are especially sensitive to energy (and food) prices and could risk de-anchoring if the Fed is perceived as too complacent with inflation risks. Encouragingly, early consumer surveys for March do not point to rising inflation expectations, but the Fed will have to live up to its anti-inflation credibility by keeping interest rates relatively elevated. We now expect the US central bank to remain on a prolonged hold, with no rate cut penciled in before early 2027 (-0.25bp rate cut in January 2027). We have long argued that the Fed will be limited in its ability to cut interest rates, and we were expecting only one rate cut in June prior to the conflict in the Middle East. The labor market is likely to remain weak through the summer as higher inflation eats into households' incomes and some corporates' profit margins, weighing on hiring. Thus, with the Fed staying on hold with still relatively elevated interest rates and a weaker economic backdrop, the risks of second-round effects on broader inflation, which could compound the initial energy price shock, should be much smaller than in 2022. We

Table 3: Inflation forecasts, yearly, %

Inflation (yearly %)	2023	2024	2025	2026f	2027f
Global	6.1	4.5	3.4	4.3	2.9
USA	4.1	3.0	2.7	3.2	2.1
Latin America	14.8	16.6	7.6	3.6	2.9
Brazil	4.6	4.4	5.0	4.5	3.3
UK	7.4	2.5	3.4	3.7	2.3
Eurozone	5.5	2.4	2.1	3.0	2.0
Germany	6.0	2.3	2.2	3.1	2.2
France	4.9	2.0	0.9	1.9	1.4
Italy	5.7	1.0	1.5	3.1	1.5
Spain	3.6	2.8	2.7	3.3	1.7
Central and Eastern Europe	11.2	3.9	5.0	4.2	3.1
Poland	11.6	3.8	3.8	3.3	2.5
Russia	5.9	8.4	8.7	7.8	7.0
Türkiye	53.4	60.0	35.2	28.0	19.5
Asia-Pacific	3.1	2.2	1.3	2.3	1.9
China	0.2	0.2	0.1	1.0	1.2
Japan	3.3	2.7	3.2	2.4	2.1
India	5.7	5.0	2.2	4.7	3.7
Middle East	16.5	10.7	12.7	18.7	10.0
Saudi Arabia	2.5	1.5	2.0	3.1	2.4
Africa	17.0	15.1	8.7	8.4	7.2
South Africa	5.9	4.5	3.2	4.5	3.5

Sources: national, Allianz Research

expect the Fed to remain quite hawkish through 2027 despite moderate growth, to ensure that inflation returns sustainably to target.

The ECB is likely to raise policy rates by 25bps as early as April but look through the subsequent inflation spike if the Middle East conflict is largely resolved by May as expected. The ECB has repeatedly stated that it will not adjust policy rates unless a significant shock occurs. With the war in Iran, such a shock has now clearly materialized. Inflation is expected to surge above 3%, up from the current target-level reading. This mechanically lowers the real interest rate and will prompt the ECB to deliver a hike at its next meeting on 30 April to keep long-term inflation expectations anchored. In our baseline outlook, in which the conflict is resolved and oil and gas price pressures ease by May, we expect the ECB to remain on hold and look through the temporary inflation spike. However, if the conflict persists longer than anticipated and oil prices remain elevated (downside

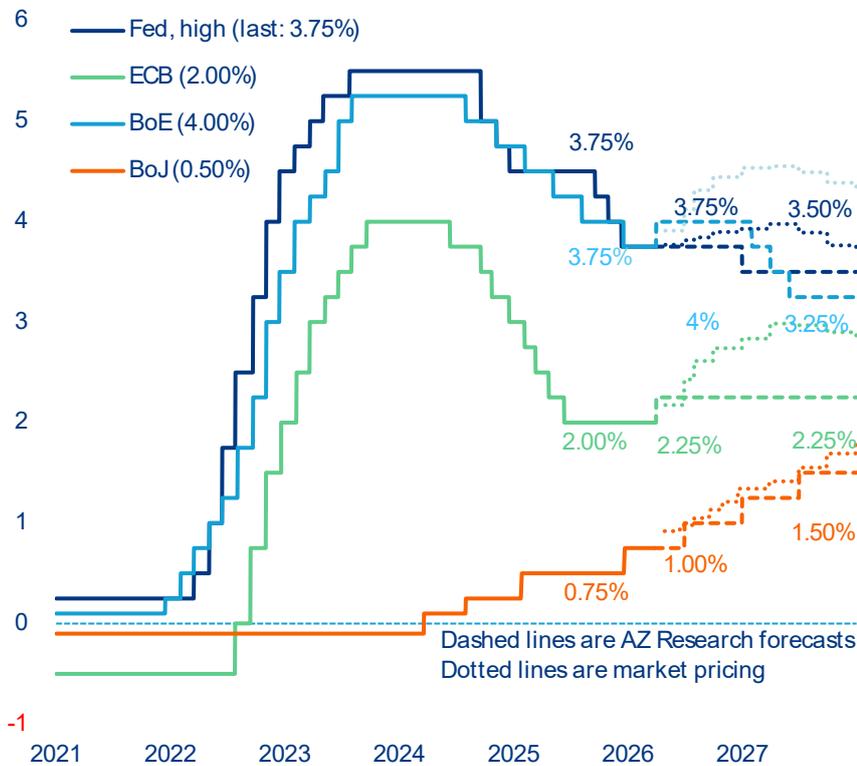
scenario), we would expect at least three consecutive rate hikes.

The Bank of England (BoE) is expected to hike interest rates by 25bps during the April meeting and keep a prolonged hold thereafter. The rate-cutting cycle is expected to resume in 2027. Against the backdrop of a loose labor market, moderating wage growth and fading GDP momentum, we expect the BoE not to over-react to short-term upward pressure on inflation. Nevertheless, with inflation persistently above target even prior the crisis in the Middle East, the BoE will have to hike interest rates by 25bps at its next meeting in April, to 4%, to signal its commitment to bring price pressures under control. Evidently, if measures of private-sector inflation expectations were to drift higher, the BoE would likely act by hiking rates further. In this scenario, we would expect the BoE to act swiftly by delivering at least 50bps of rate hikes. But the weaker economic backdrop than in 2022, including tighter fiscal and monetary conditions,

should prevent inflation expectations from de-anchoring if energy prices start to fall soon as we expect. Elevated energy prices will further weaken the economic backdrop and, ultimately, pull down core inflationary pressures, which will give room for the BoE to resume its rate cutting cycle in 2027. We look for a terminal rate at 3.25% by June 2027.

The Bank of Japan (BoJ) is likely to bring its policy rate to 1.5% by end-2027, from 0.75% currently. We expect the BOJ to hike by +25bps in Q2 2026 as underlying inflation remains elevated and this year's shunto delivered strong wage increases above 5% for the third consecutive year. Despite Japan's high dependency on energy imports, we expect the current escalation in the Middle East to generate limited short-term inflationary pressures (to 2.4% in 2026) as government energy subsidies and the price oil cap worth 1% of GDP should limit the impact on consumers. Looking forward, we continue to expect two more rate hikes by end-2027, bringing the policy rate to 1.5%.

Figure 6: Central bank forecasts, %



Sources: LSEG Datastream, Allianz Researchs



Developed markets: Stagflation returning

The US economy is expected to continue growing moderately (+2.1% in 2026, +2.2% in 2027) but to remain resilient to external headwinds. The Middle East crisis is expected to affect households' spending primarily as higher inflation will eat into real disposable income. With low household confidence and a meagre savings rate to begin with, any sustained high levels of gasoline prices would risk knocking consumer spending hard enough to provoke a substantial downturn of the economy. A partially mitigating factor is the expected increase drilling activity and higher earnings for workers in the oil patch. In our baseline scenario of gradually declining energy prices from Q2, we expect GDP to grow at the same moderate clip than last year, at +2.1%, thanks to supportive macro policy and dynamic AI capex. The credit cycle is picking up, with accelerating credit to consumers and businesses. With the Fed not expected to tighten policy in our scenario, support to the credit cycle should carry on, also helped by banking deregulation. Meanwhile, the OBBB Act is providing tax refunds to households. All this should limit further

consumer spending and non-AI capex deceleration. Finally, we still see dynamic AI capex this year despite elevated energy costs, given that natural gas prices – which matter more for electricity prices and therefore the data-center buildout – are unlikely to rise much in the US. Nevertheless, we expect AI capex euphoria to wane heading into 2027. Less supportive fiscal policy, still elevated interest rates and worsening demographics should cap US growth, which we expect at a meagre +2.2%.

Eurozone: 2022 stagflation fears re-emerge, but the region looks better equipped this time. The Eurozone stands among the most exposed regions to the Iran energy shock, given its structural dependence on imported oil and gas. The timing is particularly unwelcome: the bloc was emerging from a period of quiet resilience at the end of 2025, with Q4 growth holding up and a moderately constructive outlook for 2026 underpinned by the accelerating rollout of NGEU funds, early signs of recovery in manufacturing activity and

the anticipated boost from Germany's fiscal expansion. That relatively benign baseline has now been severely complicated. Rising energy prices are rekindling the stagflationary dynamics last seen in 2022. High energy import dependency remains a structural vulnerability, leaving the bloc disproportionately exposed to any sustained disruption in global oil and gas markets. Yet the situation is not a straight replay of 2022. Energy supply sources have diversified meaningfully over the past three years, with greater LNG import capacity, expanded renewables penetration and reduced reliance on any single supplier providing a degree of buffer that did not exist at the onset of the previous crisis. However, the capacity to absorb the shock varies considerably across member states, reflecting the uneven pace and ambition of energy diversification efforts, meaning the impact this time will be similarly asymmetric. Whether that buffer proves sufficient will depend heavily on the duration of the conflict and the extent to which Strait of Hormuz disruptions persist. In the baseline scenario, we expect GDP to grow below +1% this year (from +1.3% we were expecting before the Iran attacks) and to resume in 2027 as geopolitical tensions normalize.

Germany is expected to be more resilient than in 2022 as the decoupling from Russian gas was structural. GDP growth for 2026 is now expected to be +0.7%, a decrease of -0.3pp due to higher energy prices resulting from the conflict in the Middle East. Some of the external headwinds are cushioned by fiscal support: the special infrastructure fund adds +0.4pp to potential growth, though gradual spending uptake still limits the pass-through to economic growth. Defense adds +0.2pp and depreciation adds +0.2pp. However, these are offset by tariffs (-0.2pp) and energy prices (-0.3pp). Growth rebounds to +1.2% in 2027 as oil prices fall and fiscal spending boosts demand. However, the recovery remains fragile due to ongoing challenges such as weak exports, competition in key industries, tariff pressure, global fragmentation and weak consumer confidence due to continuously high uncertainty. Inflation is expected to rise to +3.1% in 2026 (+1pp), before easing to 2.2% in 2027. In a downside scenario involving prolonged energy shocks, growth would fall to +0.5% in 2026 (-0.5pp) and inflation would rise to +3.7% (+1.6pp). This would be accompanied by limited fiscal offset due to Germany's high energy dependence and the significant presence of energy-intensive industries.

In France, GDP is expected to grow sluggishly (+0.8%) as higher inflation saps the consumer recovery. With inflation expected to hover around +2.0% in 2026, from less than +0.9% in 2025, households' disposable income will take a hit. Sluggish wage growth (+2% in Q4 2025) and a loosening labor market are also key headwinds for the consumer. However, we continue to expect a favorable backdrop for business investment and exports. New orders in the manufacturing sector remain relatively well oriented according to the latest PMI survey (though those are concentrated in a handful of sectors such as transportation equipment). Meanwhile, we continue to expect dynamic digital investment as French corporates continue to take advantage of looser credit standards and lower funding costs. The ECB-induced moderate increase in short-term interest rates should have a marginal impact on business investment. After +0.8% GDP growth expected this year (from +0.9% in 2025), we expect an acceleration to +1.3% in 2027 amid lower energy costs and a recovery of consumer and residential spending.

Italy entered 2026 with a degree of quiet momentum, but the energy shock threatens to leave a mark once more. Q4 2025 growth came in better than expected (+0.3% q/q) and the Milano Cortina Winter Olympics are expected to have provided an additional demand boost in Q1 2026. The pre-shock outlook was moderately optimistic, with NGEU disbursements accelerating, German spillovers anticipated and the fiscal deficit narrowing to -3.1% of GDP in 2025. But that tailwind has now collided with a severe external shock. Italy's structurally high dependence on imported energy leaves households and energy-intensive industries among the most exposed in the Eurozone, with the inflation hit expected to be among the sharpest, compressing real incomes at precisely the moment domestic demand was meant to carry growth. Financial markets have taken notice: BTP spreads have widened more than those of any other major eurozone sovereign, reversing from their lowest levels since 2008. Compounding the cyclical pressure, NGEU grant revenues are set to taper sharply from 2027, removing a key fiscal buffer just as energy-related spending pressures build.

In Spain, the growth overperformance faces a stiff test. Spain has firmly cemented its position as the Eurozone's economic outperformer, posting above-consensus +0.8% q/q growth in Q4 2025, providing solid carry-over to 2026. Strong fundamentals and favorable market conditions even allowed Spain to renounce over EUR60bn of the loan component of its NGEU package (out of EUR80bn), a remarkable signal of fiscal confidence. We maintain our baseline forecasts of around +2.0% growth this year. Crucially, Spain enters the Iran energy shock better insulated than most Eurozone peers: a structural shift toward renewables has meaningfully reduced exposure to volatile fossil fuel prices, leaving households and industry less vulnerable to the energy pass-through now hammering peers such as Italy and Germany. The government has nonetheless responded with one of Europe's most ambitious crisis packages (a EUR5bn package across 80 measures including VAT cuts on fuel and electricity tax reductions of up to 60%).

The UK's growth momentum is expected to weaken substantially (+0.7% in 2026, after +1.3% in 2025) amid rising inflation and waning policy-induced boosts.

With rising energy prices expected to push inflation to +4% by Q3 2026, consumers' spending and business' investment are expected to take a hit as real disposable income and profit margins are impacted. Meanwhile, higher mortgage rates should further dampen residential investment, which was artificially boosted in 2025 amid anticipation of tax hikes on the property sector. With limited fiscal space, the government will likely stay pat over elevated energy prices, with marginal support measures announced, though it could cancel the fuel duty hike planned in September. While domestic demand is expected to cool substantially this year, we expect net

trade be less of a drag on GDP thanks to less dynamic imports. At +0.7% expected this year, GDP will grow well below its potential. Momentum should improve significantly in 2027 (GDP +1.4%) thanks to looser monetary conditions but tight fiscal policy and still elevated mortgage rates should cap the rebound. Japan's short term economic outlook remains broadly resilient, underpinned by continued fiscal stimulus and relatively robust public finances, despite rising external pressures. As the escalation in the Middle East weighs on the Japanese economy, we revise our forecast on the downside to +1.2% in 2026 (-0.2pp) and +1.0% in 2027. We expect government spending to remain a key buffer for the economy as Prime Minister Takaichi's supermajority will allow the current administration to maintain its fiscal stance, reinforcing Japan's policy continuity. Up to now, the Japanese government has announced fiscal support measures worth 1% of GDP (or USD41bn) on top of the 1.2% of GDP that was already in place before the conflict escalated. This is a higher support compared to what Europe did back in 2022. However, the external environment presents notable risks, with energy related price dynamics likely to persist.



Emerging markets: Triple deficit countries in focus

China's economic outlook remains resilient, supported by strong external demand and a lower exposure to the Iran crisis, despite challenges from soft domestic demand. We maintain our GDP growth forecasts at +4.6% in 2026 and +4.4% in 2027. While the Iran crisis will constitute a headwind to Chinese growth, the economy's energy mix and its ability to maintain its oil supply shield it compared to the rest of the APAC region. The economy has exceeded expectations since the beginning of the year, with strong external demand likely to remain a tailwind, bolstered by recent Supreme Court decision on the US tariffs. However, some concerns remain surrounding the domestic economy, where policy support is needed. The Two Sessions held the fiscal deficit steady while the policy focus remained heavily oriented toward industry, with a strong emphasis on AI-led investment and self-reliance. We forecast inflation at 1.0% in 2026 and 1.2% in 2027.

In the Middle East, the impacts of the conflict are reverberating across the entire economy of the region. Trade flows have contracted as the partial closure of the Strait of Hormuz imposes a hard physical constraint on the region's main commercial artery. Beyond the direct trade shock, the war is now feeding through into broader economic activity via several reinforcing channels. Tourism has collapsed, and an initial wave of expatriate departure, even if long lived, will add pressure on consumer spending, a meaningful hit given that foreign nationals account for over half the GCC total population. Cities like Dubai and Doha, whose growth models rest on services, retail and hospitality, are among the most exposed. On the supply side, Iranian strikes have disrupted activity on construction sites across the region – a sector that has been one of the primary engines of GCC growth over the past two decades and that underpins a vast, deeply interconnected real estate market.

For other emerging markets, the shock propagates globally through four main transmission channels. Even a short-lived interruption of less than two months could raise EM inflation by +0.8 to +1.0pp, prompting tighter policy responses, while growth effects would remain limited overall – though Gulf economies would be hit more severely.

Table 4: Exposure of EMs to Middle East crisis

Country	Exposure to the Middle East crisis						Market reaction since Feb 27		Coping mechanisms					
	Energy balance (% of GDP)	Strategic oil reserves (days of consumption)	Oil dependency (% primary energy)	Gas dependency (% primary energy)	Vulnerability to energy price shock	Vulnerability to ME supply shock	FX (% change vs USD)	Bond yields (bps)	Fiscal balance (% of GDP)	Current Account (% of GDP)	FX reserves (months of imports)	FX outlook	Central Bank stance (by mid-2026)	Risk of fiscal slippage throughout 2026
Argentina	0.6	NA	-8%	0%	Medium	Low	1.3	N/A	-1.5	-0.4	3.8	Neutral	On hold	Low
Bangladesh	-3.5	49	19%	8%	High	High	-0.5	36.0	-3.9	-0.9	4.9	Negative	On hold	High
Brazil	0.9	NA	-16%	2%	Low	Low	-2.3	60.0	-7.5	-2.3	12.1	Positive	Cautious easing	Medium
Chile	-4.4	25	46%	9%	High	Medium	-4.6	42.0	-0.6	-2.2	6.7	Negative	On hold	Low
China	-2.4	100	12%	3%	Medium	Medium	-0.7	42.0	-5.0	2.8	12.3	Neutral	On hold	Medium
Colombia	3.9	NA	-34%	4%	Low	Low	1.0	-38.0	-5.7	-2.6	9.6	Negative	Hike	Medium
Czechia	-2.4	117	28%	12%	High	Medium	-2.9	46.0	-2.1	0.4	9.3	Negative	On hold	Medium
Egypt	0.0	NA	8%	9%	Medium	High	-9.0	51.0	-10.7	-4.3	4.3	Negative	On hold	High
Hungary	-3.6	215	15%	20%	High	Medium	-5.1	106.0	-5.1	0.9	3.7	Negative	On hold	High
India	-3.7	30	13%	4%	High	Medium	-3.3	18.0	-1.8	-1.4	9.1	Neutral	On hold	Medium
Indonesia	1.1	20	15%	-3%	Low	Medium	-1.3	44.0	-2.7	-1.2	7.1	Negative	On hold	High
Kenya	-4.5	NA	16%	2%	High	High	-0.5	10.0	-5.6	-3.4	5.7	Negative	On hold	High
Malaysia	-0.4	NA	13%	-19%	Medium	Medium	-1.3	7.0	-3.6	1.8	5.3	Negative	On hold	High
Mexico	0.7	NA	2%	6%	Low	Low	-3.6	72.0	-4.1	-0.3	4.3	Neutral	Cautious easing	Medium
Morocco	-5.0	30	50%	15%	High	Medium	-2.1	29.0	-4.5	-1.5	7.4	Neutral	On hold	Medium
Nigeria	12.2	NA	-48%	-17%	Low	Low	-1.2	62.0	-3.7	3.6	12.0	Neutral	On hold	Medium
Pakistan	0.0	28	20%	7%	High	High	0.1	84.0	-4.1	-0.4	11.6	Negative	On hold	High
Peru	-0.5	NA	34%	-6%	High	Low	-3.1	44.0	-2.2	1.2	14.8	Negative	On hold	Low
Philippines	-4.2	60	36%	5%	High	Medium	-4.6	106.0	-0.3	-3.5	8.2	Negative	On hold	Medium
Poland	-2.1	121	35%	2%	High	Medium	-3.0	76.0	-6.3	-0.8	5.7	Negative	On hold	High
Romania	-1.7	92	28%	0%	High	Medium	-1.9	105.0	-6.2	-6.6	6.0	Neutral	On hold	High
South Africa	-2.3	NA	19%	1%	Medium	Low	-5.8	92.0	-5.6	-1.2	5.6	Negative	On hold	Low
Sri Lanka	-4.5	35	47%	4%	Medium	High	-1.2	14.0	-6.5	0.5	4.5	Negative	On hold	High
Taiwan	-5.1	80	28%	19%	Medium	High	-3.1	4.0	-0.2	13.1	15.9	Negative	On hold	Medium
Thailand	-7.8	60	35%	11%	High	High	-6.2	55.0	-2.5	1.3	8.9	Negative	On hold	Medium
Tunisia	-4.0	60	21%	22%	High	High	-1.6	NA	-6.0	-2.0	4.9	Negative	On hold	High
Türkiye	-3.6	94	7%	2%	High	Medium	-0.8	375	-0.7	-1.3	2.7	Neutral	Hike	Medium
Vietnam	-2.5	15	20%	2%	Medium	High	-1.1	8	-2.3	2.4	2.3	Negative	On hold	Medium

*in green central banks that were cutting before the conflict in the Middle East escalated

Sources: LSEG Datastream, Allianz Research

The shock is deeply asymmetric. A second tier of countries – including Chile, Hungary, India, the Philippines, Taiwan, Thailand and Türkiye – retains more policy space and access to private financing to absorb the pressure, while commodity exporters such as Azerbaijan, Brazil, Mexico and Nigeria may see partial offsetting gains from higher energy export revenues. In emerging Asia more broadly, growth is expected to remain resilient: the region has benefited from sustained AI-driven demand and largely outperformed in 2025, and while its exposure to the Hormuz closure is among the highest globally, the shock is expected to erode much of that upside rather than derail growth entirely. Central banks across emerging Asia, Latin America and Central and Eastern Europe are broadly expected to remain on hold, and several economies including Indonesia, Thailand, Czechia, or Mexico have put on hold their easing cycle. Brazil (mild easing) and Colombia (gradual hiking) are the main exceptions, driven by domestic election-cycle dynamics and diverging inflation trajectories.

The most immediate and universal spillover runs through energy prices. Asian economies are particularly exposed, sourcing 56% of their oil imports and 30% of their gas imports from the Middle East. If disruptions persist, the shock could shift from a price spike to a supply constraint: a prolonged disruption with oil prices doubling would require a 5% to 7% reduction in final energy consumption across energy-importing regions, amplifying the economic drag – though partial mitigation through substitution toward coal and renewables remains possible. In Central and Eastern Europe, higher oil and gas prices pass through relatively quickly into fuel costs and then more gradually into broader consumer prices, while household energy bills adjust more slowly where price caps or longer-term contracts remain in place. This comes at a delicate moment: in Poland and Hungary, the macro narrative had increasingly been one of disinflation, with rate cuts back on the table. The renewed energy shock risks interrupting or reversing that trend. In Latin America, rising oil prices complicate already cautious monetary stances, reinforcing the case for central banks to stay on hold for longer. Governments across all three regions will play an important role in shaping outcomes, with subsidies, tax measures and price controls able to soften the blow in the short term, but at the cost of greater fiscal strain.

Currency vulnerability amplifies the inflation shock in several exposed economies. In Central and Eastern

Europe, countries with weaker currencies face the risk that FX depreciation magnifies imported inflation and complicates the policy response. In Romania, already elevated inflation and deteriorated sentiment raise the danger of de-anchored expectations feeding further price pressures. Turkey is a specific case: a sharper depreciation of the lira could boost exports and widen profit margins for exporters, but would also entrench inflation regardless of the policy rate trajectory. In emerging Asia, currencies in Thailand, Pakistan, Indonesia and the Philippines have come under pressure since the escalation, adding a second layer of vulnerability on top of the direct energy shock. A closure of the Strait extending beyond three months would be particularly severe for economies carrying „triple deficits“ – fiscal, current account and energy – where higher import bills widen external positions while governments simultaneously face rising subsidy costs and financing pressures, forcing procyclical tightening. In this scenario, EM growth excluding China could fall to around +3.1%, implying a drag of at least -0.5pp. The most vulnerable countries in this group include Bangladesh, Egypt, Ethiopia, Jordan, Kenya, Morocco, Pakistan, Poland, Romania, Sri Lanka and Tunisia. For many of these economies, the external pressure is compounded by a distinct and underappreciated risk: their dependence on Gulf remittances. An extended conflict harming deeper economic activity could reduce remittance flows precisely when import bills are rising, creating a potential double squeeze on external accounts that could widen financing gaps and pressure foreign reserves – most acutely in countries with large share of population in the Gulf, in Nepal where GCC remittances represent 10% of GDP, as well as Sri Lanka (2.7%), Bangladesh (3.3%), Egypt (5.6%), Lebanon (13%) and Pakistan (4.7%).

The fertilizer price shock is a slower-moving but potentially severe transmission channel for agriculture-dependent economies. Countries with large farming sectors and limited fiscal space to absorb input cost increases – Kenya, Bangladesh, Indonesia, Pakistan and India among them – face the risk of sustained pressure on agricultural output and food inflation. Egypt and Jordan carry an additional exposure through tourism, as geographical proximity to the conflict is already weighing on arrival numbers. More broadly, countries such as Taiwan, Vietnam, Thailand, Pakistan, Bangladesh and Sri Lanka in Asia, and Egypt, Ethiopia, Kenya and Tunisia in Africa, would face acute price pressures spanning energy, critical materials and food.



Corporates navigating one crisis after another

The war in Iran is triggering a commodity shock beyond oil & gas that is sharply raising input costs across industries. The near-closure of the Strait of Hormuz has removed up to 20 mbpd of oil supply, equivalent to roughly one-fifth of global flows, marking the largest disruption on record. Brent crude has traded close to 120 USD/bbl and we expect prices to average 82 USD/bbl in 2026 (up from our previous forecast of 60 USD/bbl). The shock extends beyond energy: aluminum prices have risen to a four-year high, reflecting curtailed Gulf output and logistics bottlenecks. Fertilizer markets are similarly strained, with prices of nitrogen-based products like urea and ammonia up 30–40% amid disruptions to trade routes that account for roughly 30% of global supply. For corporates, this constitutes a textbook cost-push shock, with energy, metals and agricultural inputs rising simultaneously while pricing power remains constrained by rather weak demand from end markets.

In terms of sectors, the main winners are upstream companies, particularly non-Gulf producers with direct leverage to spot prices. Integrated oil majors would also benefit from short-term cash-flow uplift and stronger trading results, LNG exporters outside the Gulf could capture opportunistic margin increase in Europe and Asia, some refiners would be supported by firmer middle distillate cracks, while defense would also benefit from the current situation. The relative losers are airlines, which are not only contending with operational disruptions in the region but also facing higher jet fuel costs, with the crack exceeding USD 100/barrel, and limited ability to immediately pass these costs through to certain customer segments. Shipping companies (including cruise lines) are also facing higher fueling costs and are unable to increase freight rates as the market is in over-capacity. Other affected sectors include chemicals and petrochemical producers exposed to feedstock inflation and weaker downstream margins, gas-intensive European utilities sensitive to LNG repricing and political constraints on tariff adjustments and consumer discretionary sectors in energy-importing economies where temporary fuel inflation compresses real incomes and weighs on confidence.

On our watch list of the most impacted sectors we have fertilizers and helium. Fertilizers will primarily impact agriculture and food production, especially in emerging markets. In South Asia, Latam and Africa, reduced input availability could see lower yields from 5-30%, depending on crops and regions. This would drive food price inflation, increase import dependency, weaken food security and eventually spur political instability. This impacts downstream into the food industry, where higher input costs could compress margins. While fertilizer trade flows are partially rerouted through road and alternative suppliers, this adjustment is costly, sustaining elevated prices. In contrast, helium shortages represent a significant disruption in a highly concentrated supply chain, with Qatar accounting for roughly one-third of global helium supply but over two-third of supply in countries like China and South Korea. Although helium is critical for a number of sectors from pharmaceutical to semiconductors, it is too early to be alarmist as disruption risks are limited today. Indeed, the industry has a number of buffers. Firstly, it was in oversupply prior to the war, secondly, there is a significant volume in US storages (2-3 month of Qatari output), and third, US producers can ramp up production, especially if prices are attractive. Some alternatives like low-intensive and optimized energy process (Korea), ramp-up local production (China) or long-term contracts with a diversified panel of suppliers have been observed since 2022. USA holds here a critical role as potential stabilizer of supply imbalances in Middle East but such a role can't be taken for granted at the light of recent past tensions over US tariff. We also keep an eye on aluminium and sulfur whose exports to European industries like automotive, aircraft, construction and packaging could be impacted by a longer conflict.

Second-round macroeconomic effects could materialize through weaker demand, tighter financial conditions and rising recession risks. Higher energy prices and higher food prices could feed directly into inflation, dampening purchasing power and further depressing consumers' confidence. Business surveys across the US, Europe and Asia already indicate slowing activity, declining confidence and rising input costs, raising the risk of stagflation dynamics. As we expect central banks signaling tighter policy, it would also translate into increasing borrowing costs for corporates and households. This is reinforcing the demand slowdown, particularly in discretionary sectors such as

consumer goods, auto, tourism, restaurants but also in higher rate-sensitive industries like construction and real estate. The combination of cost inflation and weakening demand could also create a negative feedback loop for firms, with capex deferrals, hiring freezes and inventory adjustments.

In this context, business insolvencies are projected to keep on increasing by at least +5% globally in 2026.

Expectations were already on the upside prior to the conflict, despite a fourth annual rise in 2025 that pushed insolvencies 19% above pre-pandemic levels. The US and Asia were expected to record noticeable rises and Western Europe a modest increase, with most countries within the -3%/+3% range i.e. indicating a plateau at a (very) high level. We have revised our initial forecasts slightly up to factor in the immediate implications of the war for energy markets, shipping costs, inflation risks and financial conditions. At this stage, we expect business insolvencies to rise by +2.5% in the Eurozone in our baseline scenario for 2026 (+2.4pps from our pre-war estimation, from +1.5% in 2025) and to extend by +8.6% in the US (+4.9pps, from our pre-war estimation, from +6.9% in 2025) as a result of the combination of lower demand, higher costs and tighter financial conditions – with obvious pressure for the most vulnerable, including energy-intensive sectors such as transportation (shipping, aviation, road transport), the chemicals complex and metals industries, as well as companies with weak pricing power or thin margins, debt-heavy firms, businesses with structurally higher working capital requirements (e.g. agri-food distribution, machinery and transport, equipment, electronics, pharmaceuticals, construction) and businesses heavily reliant on consumer credit (automotive, tech, real estate). Yet, the risk is on the upside: the longer the duration of the Middle East conflict, the stronger the impact on the insolvency outlook. Our downside scenario, involving a prolonged energy shock and falling economic growth, has the potential to boost business insolvencies close to +5% and +7% y/y in the Eurozone and APAC, respectively, and above +13% y/y in the US.



Capital markets outlook: Ultimately a function of geopolitics

Capital markets began 2026 in a relatively orderly fashion despite an already heavy news flow, but volatility picked up significantly following the outbreak of the Middle East war. Markets were showing notable resilience despite multiple geopolitical shocks, from the US intervention in Venezuela and transatlantic tensions around Greenland to the legal question mark over US trade policy and the selection of a new Fed chair. Rates remained range-bound, central banks were seen near neutral with anchored inflation expectations, the USD showed mild softness, equities held up and credit spreads stayed contained. Private markets on the other hand already captured a lot of headlines without triggering a wider contagion. But the Middle East conflict has shifted markets toward an energy-driven stagflation scare. Higher oil prices pushed yields up, and expectations for a much more hawkish central bank stance emerged amid

lifted inflation expectations. The USD strengthened, equities sold off (notably in Europe and EM) and credit spreads widened, albeit only moderately. Markets have become highly headline-driven. Nevertheless, our baseline outlook remains cautiously optimistic, with limited energy disruption and market distortions until year-end, given a near-term resolution of the conflict. In the downside, prolonged conflict scenario, with persistently higher oil and gas prices, the adjustment could be more severe, with higher rates, weaker equities, wider spreads and a clearer slowdown in private markets.

Table 5: Capital market forecasts

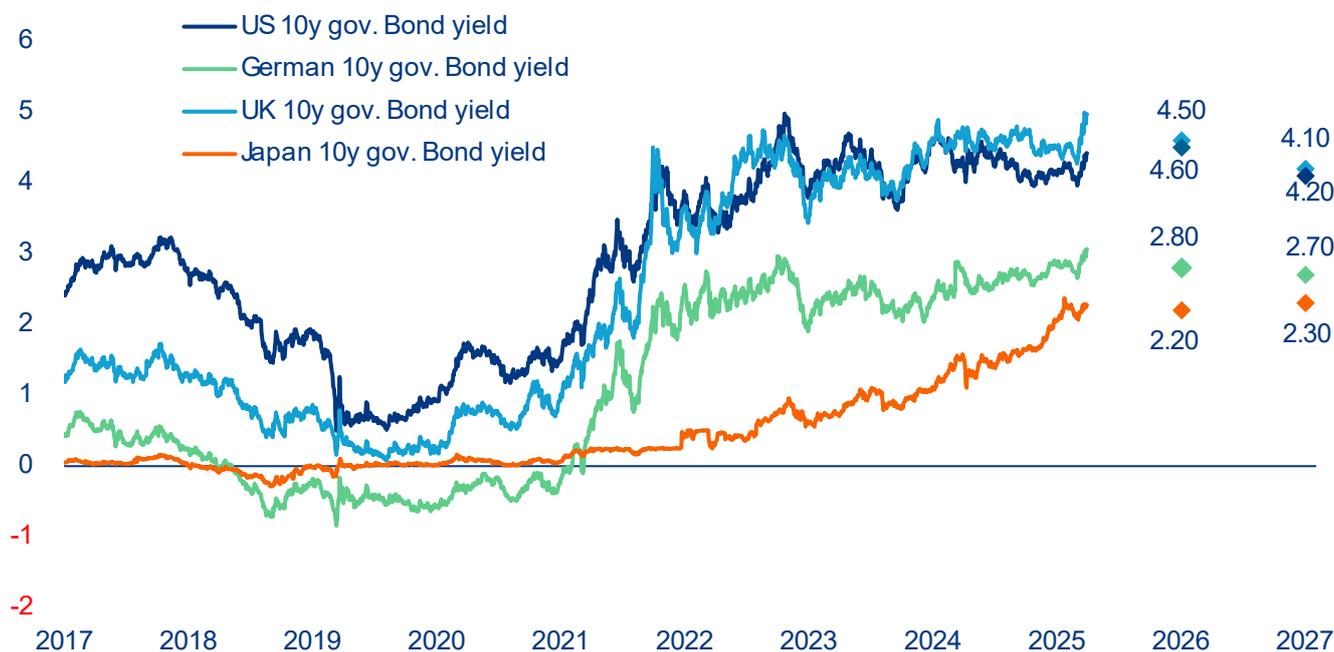
EMU	Last*	Unit	2023	2024	2025	2026f	2027f
Government Debt							
ECB deposit rate	2.00	%	4.00	3.00	2.00	2.25	2.25
10y yield (Bunds)	3.06	%	2.03	2.36	2.85	2.80	2.70
10y EUR swap rate	3.03	%	2.48	2.39	2.93	2.80	2.70
20y EUR swap rate	3.18	%	2.51	2.39	3.23	3.00	2.90
<i>Italy 10y sovereign spread</i>	94	bps	168	117	66	80	80
<i>France 10y sovereign spread</i>	72	bps	53	83	71	90	70
<i>Spain 10y sovereign spread</i>	53	bps	97	70	44	40	40
Corporate Debt							
Investment grade credit spreads	91	bps	135	101	78	95	90
High-yield credit spreads	309	bps	395	311	270	320	300
Equity							
Eurostoxx (total return p.a.)	-3 ytd	%	19	10	25	5	9
US							
Government Debt							
Fed Funds rate (high)	3.75	%	5.50	4.50	3.75	3.75	3.50
10y yield (Treasury)	4.42	%	3.87	4.57	4.16	4.50	4.10
Corporate Debt							
Investment grade credit spreads	88	bps	104	82	79	95	90
High-yield credit spreads	321	bps	334	292	281	330	320
Equity							
S&P 500 (total return p.a.)	-5 ytd	%	26	25	18	6	11
UK							
Government Debt							
BoE rate	3.75	%	5.25	4.75	3.75	4.00	3.25
10y yield sovereign (Gilt)	4.97	%	3.54	4.57	4.47	4.60	4.20
Corporate Debt							
Investment grade credit spreads	91	bps	134	91	80	115	105
High-yield credit spreads	462	bps	515	364	420	518	480
Equity							
FTSE 100 (total return p.a.)	1 ytd	%	8	10	26	7	8
Emerging Markets							
Government Debt							
Hard currency spread (vs USD)	185	bps	215	202	163	200	195
Local currency yield	6.29	%	6.19	6.39	5.87	6.30	6.00
Equity							
MSCI EM (total return p.a. in USD)	4 ytd	%	10	8	34	8	9
FX & Commodities							
EUR USD	1.15	\$ per €	1.10	1.04	1.17	1.15	1.17
Oil (Brent)	113	\$ per bl	78	75	61	78	72
Natural gas (Dutch TTF)	55	€ per MWh	32	49	28	40	30

Sources: LSEG Datastream, Allianz Research

With monetary policy expectations pivoting, global yield curves are giving a stagflationary signal. The shock on global energy markets has led to a complete pivot of monetary policy expectations. The dominating late-cycle easing bias has been replaced by a hawkish narrative focused on central banks hiking quickly to avoid the 2022 transitory-inflation mistake. Short-term yields rose sharply as investors priced in an energy-driven inflation shock, while long-term yields did not keep pace, producing a strong bear flattening move. This is a strong stagflationary signal where near-term inflation premium dominates while the growth drag caps ultra-long yields. In the Eurozone, the short-term rates sell-off was particularly strong, shadowing the price movement of oil and natural gas markets. With markets pricing almost three ECB hikes this year, we see some exaggeration here while the 10-year Bund trades at fair levels. In the US, the front end is repricing near-term inflation risk faster than the long end is absorbing growth deterioration. The 30-year Treasury continued its own logic, with the 10s30s sector behaving mostly as a

pure term-premium and fiscal risk asset. The UK saw the most violent repricing, with the biggest single-session jump in two-year Gilts since the Truss Mini Budget of September 2022. The rising yield volatility is not only due to investors adjusting their expectations but also a signal of growing liquidity stress. US Treasury repo markets had been fragile before the Iran war, transitioning from abundant to ample Fed reserves, with dealers reporting stressed episodes and growing concern about the market's capacity to absorb increasing Treasury issuance. Also in Europe, repo costs are rising as the ECB continues to drain excess liquidity via Quantitative Tightening, limiting arbitrage opportunities at short-dated maturities and putting upside pressure on funding rates. This liquidity stress is most visible in the front end of the EUR swap curve where Euribor vs. €STR spreads began to edge wider, a signal that the excess-liquidity buffer is thinner than markets had assumed. Therefore swap spreads in Europe are expected to continue narrowing.

Figure 7: Rates forecasts, %



Sources: LSEG Datastream, Allianz Research

The convergence trend among European government bond yields is being challenged. In the European government bonds (EGB) market, spreads versus the German Benchmark have been widening markedly. Italian BTPs have been punished more than French OATs as markets were digesting more supply, repricing Italy's strong exposure to natural gas risk and unwinding more leveraged carry positions. The dominating EGB convergence trend is now being challenged as markets reassess fiscal risk in the light of government measures to contain energy price pressure. However, the convergence trend could regain traction in case a common European program such as Next Generation EU (NGEU) is launched to face the looming energy crisis. ASW spreads are under widening pressure as risk aversion seems to dominate monetary policy positioning, meaning sovereign sell-offs outpaces swap rate repricing. We forecast the BTP–Bund spread at 80bps for 2026 and 2027. We see OAT–Bund rising to 90bps in 2026 in advance of the presidential elections before returning to 70bps in 2027.

The euro has given away some of its earlier gains after the outbreak of the Iran war, underscoring the US dollar's enduring role as a safe-haven asset. The EUR/USD exchange rate retreated from a high of 1.20 at the end of January to as low as 1.14 in March. Before the conflict, the dollar had been weighed down by policy uncertainty in the US, ranging from tariff disputes and government shutdowns to questions over the next Federal Reserve chair. As these issues became clearer – and as geopolitical risk in the Middle East materialized – global demand for the dollar revived. We expect dollar demand to remain firm through the year amid persistent geopolitical uncertainty, but a gradual softening

remains our base case over the longer horizon. The US administration is unlikely to become substantially more predictable, and periodic threats toward both allies and rivals cannot be excluded. As a result, global investors will continue their gradual efforts to diversify away from the dollar, insofar as viable alternatives are available.

Global equity markets enter Q1 2026 facing an outlook that is more asymmetric than valuations currently suggest. Earnings momentum remains present on both sides of the Atlantic, but the profit cycle is now increasingly vulnerable to a confidence shock that could flip revision trends rapidly and without much warning. The US market, pricing near-perfection at ~21.8x forward P/E, leaves no room for earnings disappointment – and on an equal-weighted basis the market screens even richer, with the S&P 500 EW P/E above its long-run average, implying that prices would need to fall by roughly 2% to revert to historical valuation norms before any earnings damage has even occurred. Europe's relative discount at ~15.7x is not yet a catalyst for outperformance, but it does provide meaningful cushion in a risk-off environment and continues to attract structural inflows from investors reducing concentrated US exposure. The broadening of market breadth beyond mega-cap technology, while encouraging, remains fragile and dependent on a macro backdrop that is now materially less certain than it appeared entering the year. In this context, the baseline scenario still supports modest positive returns, but the distribution of outcomes has widened considerably – and the tails are not symmetric.

Figure 8: Equity forecasts, index



Sources: LSEG Datastream, Allianz Research

The risk that dominates the equity outlook this quarter is not one that earnings models capture well.

It is a confidence shock, and confidence shocks compress multiples before they cut profits. In a contained deterioration scenario, markets drift lower as uncertainty suppresses capital-allocation decisions and PE multiples settle back toward long-run averages – a move that alone would represent a meaningful correction from current levels given where the S&P 500 is trading relative to its own history. Even so, expected EPS growth for 2026 remains positive, with the S&P 500 projected at 17.4% and the STOXX 600 at 13.8%, but Europe’s earnings base is structurally more exposed to a growth shock. In a severe scenario, the combination of multiple compression and an earnings revision cycle turning sharply negative could produce drawdowns of 20 to 25% in the US and approaching 30% in Europe, where energy sensitivity and cyclical sector exposure amplify the shock. If the ECB were to add another rate hike, it would further dampen valuation support in Europe and disproportionately pressure Eurozone earnings via higher discount rates and weaker confidence effects. Entry signals for adding equity risk remain unconfirmed – technicals are under stress without yet reaching a high-conviction contrarian point – and the appropriate posture is one of patience, selectivity across regions and sectors and a disciplined bias toward quality earnings over growth optionality for the duration of the quarter.

Global credit spreads have widened nearly 25% over the last three weeks, but absolute spreads remain at a tight level due to the historical tight levels pre-Iran-war. Stagflation concerns and higher equity and rates volatility keep the weight on credit spreads, and as the distribution of outcomes is clearly skewed to the downside, investors must take the tail scenario seriously. Against this backdrop, our baseline projects Euro and US IG spreads peaking at 115bps – a level consistent with the “Liberation Day” shock of April 2025 – before tightening to 95bps by year-end. In our downside scenario, where disruption proves more prolonged, IG spreads could reach 150bps. Euro high yield is expected to peak at 400bps in the base case, before recompressing to 320bps as risk appetite recovers through the second half of the year. And in downside scenario, HY spread can go up to 440bps, with limited recovery prospects.

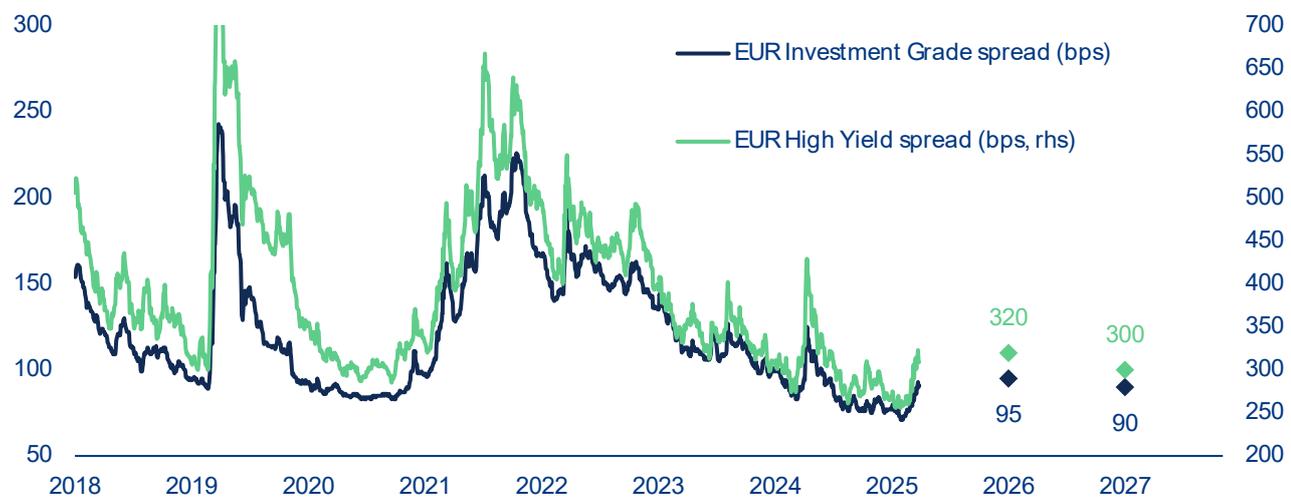
Investment grade spreads are enough to cover downside risk, but not yet attractive on an outright basis.

Combined downgrade and credit losses even in the stress year of 2022 amounted to roughly 30bps, well within the current ~90bps buffer – even counting in liquidity cost. But the entry point does not offer a compelling risk/reward as the room for further widening is larger than that for tightening. Within IG, financials are less attractive than non-financials: senior bank debt offers no meaningful spread pick-up over industrial

peers, yet carries higher sensitivity to macro and rate volatility. CDS became more attractive than cash bonds as investors actively hedge with CDS and the spread gap between cash bonds and CDX is narrowing. High yield is more exposed on multiple fronts: Fundamentals are more fragile, liquidity is thinner and the asset class has spread volatility under adverse events. While the relative value of HY versus IG has improved meaningfully and may appear attractive, we should bear in mind that in downturn HY/IG spread ratio can go even higher, as in 2020. It means if escalation continues

and stagflation fears prevails, HY spreads widening could accelerate compare to IG. Therefore we retain our negative HY view: at current spreads of ~300bps, there is barely enough cushion to absorb potential credit losses in a stress scenario, where annual credit loss rates can exceed 3%. This is not good timing for chasing yields, but with spreads widened more than 40bps, opportunities may occur – if spreads widen beyond average and downside risks diminish.

Figure 9: European credit spread forecasts, bps



Sources: LSEG Datastream, Allianz Research

Securitized credit is our preferred area of the market, offering resilience at low opportunity cost as collateral quality and structural protection layers remain solid.

Within the sector, covered bonds are attractive given a meaningful pick-up over unsecured bank debt at minimal additional risk. We prefer ABS most, where wider spreads and floating-rate structures provide both income and a natural hedge should inflation re-accelerate or rate cuts reverse.

Beyond the geopolitical shock, private credit concerns, software sell-off and oversupply by hyperscalers also put pressure on spreads.

The risk of forced selling into public credit markets adds a layer of spread vulnerability that is difficult to time but should not be ignored. Therefore we keep a cautious stance at this moment, preferring higher quality securitized and IG than HY and financials.

Emerging markets entered this geopolitical crisis on a strong footing, supporting a selective but still investable opportunity set.

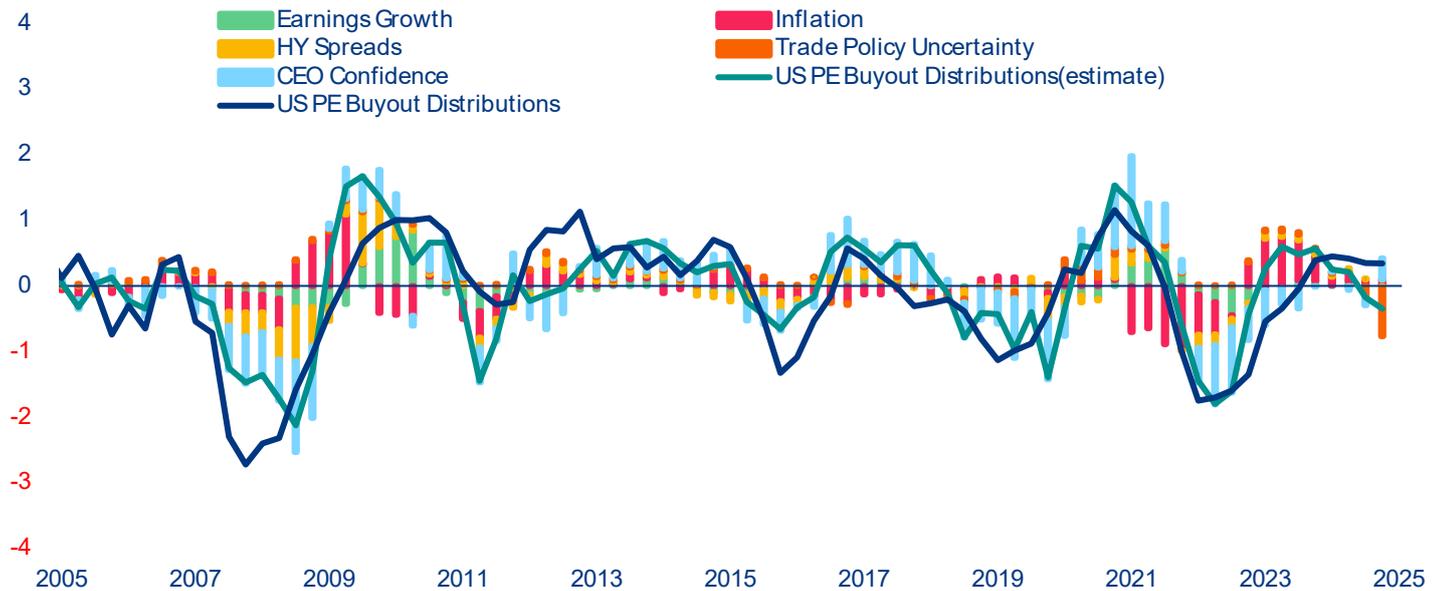
The Middle East escalation primarily represents an inflationary energy shock in the near term, with limited growth impact if disruptions remain contained. However, a prolonged impairment of energy flows through the Strait of Hormuz would materially increase cross country dispersion across EMs, driven by energy dependence, external balances and fiscal space. From an investment perspective, we expect repricing to take the form of a targeted energy risk premium rather than a systemic EM sell off. Vulnerabilities are most pronounced in sovereigns combining fiscal deficits, current account gaps and high energy import reliance, including Egypt and parts of Central and Eastern Europe, where higher energy prices would quickly translate into inflation pressure, currency weakness and wider spreads. By contrast, commodity exporters and structurally more resilient EMs such as Brazil, Mexico, Colombia and Indonesia benefit from positive or offsetting energy balances, stronger buffers

and greater policy flexibility. EM hard currency debt remains attractive on a selective basis, supported by still favorable carry and materially improved market access compared with past stress episodes, though caution is warranted toward the most energy exposed credit. At the same time, EM local-currency debt offers relative value, as elevated real yields and partial inflation repricing create opportunities in markets with credible policy frameworks, adequate reserves and anchored inflation expectations. Overall, we maintain a neutral to constructive stance on EM debt, with performance driven by country selection, resilience to energy shocks and disciplined risk management.

Private markets – Positioning through the fog. Over the past two decades, private markets have shown their portfolio value through a variety of returns, income streams and access to value-creation mechanisms that are not, traditionally, available in public markets. This structural case remains intact. However, the current economic climate, characterized by decelerating growth, persistent inflation and rates that are likely to remain elevated, is exerting significant pressure on commodity and freight markets. This creates meaningfully different conditions across sub-asset classes. The 2022 episode demonstrated the vulnerability of private markets as surging energy prices, hawkish central banks and rapid multiple compression resulted in the worst simultaneous equity and bond drawdown in a generation. Distributions froze, markdowns materialized and the denominator effect left allocators overexposed precisely when liquidity was scarce. The lesson is not to retreat, but to increase discrimination, favoring strategies with inflation linkage, contractual cash flows and secular demand drivers, while approaching segments dependent on exit multiples, cheap leverage and benign financing conditions with commensurate caution.

Private equity – value locked but distributions challenged. Private equity faces a distribution problem during this cycle that has yet to be resolved. Buyout funds currently hold a record USD3.8trn in unrealized value, holding periods have stretched toward seven years, and mid-market exits remain effectively frozen. As the chart illustrates, PE distributions are acutely sensitive to inflation spikes and trade policy uncertainty, the two shocks now hitting simultaneously, making the 2022 distribution collapse a direct and uncomfortable precedent for today's setup. The Iran shock has further compounded the pressure. Margin compression from higher energy and transport costs, elevated refinancing rates and weakening consumer spending are all bearing down on portfolio companies at once. Meanwhile, software-heavy portfolios remain exposed to AI-driven multiple compression that has yet to fully pass through to private marks. This necessitates patience and a discerning approach to selection. However, the fundamental case for this asset class remains sound. A resolution of the Middle East conflict would materially improve the exit backdrop, easing financing conditions, restoring M&A confidence and unlocking a substantial pipeline of mature assets that are ready to transact. In the long term, private equity continues to provide opportunities for value creation that are not available in public markets. Investors who are willing to tolerate near-term distribution delays are likely to receive positive returns as the cycle changes (Figure 10).

Figure 10: US private equity distributions breakdown (y/y change in Z-scores)

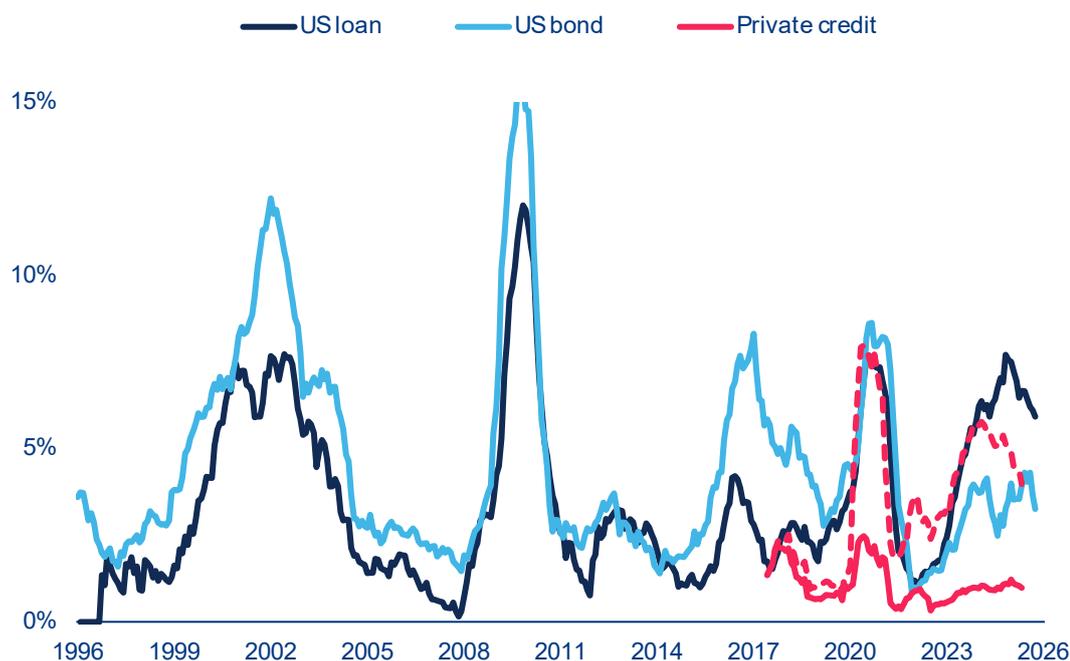


Sources: Pitchbook, Allianz Research

Private debt offers attractive carry, but investors should respect the tail risk. Private debt enters the current shock as one of the better-positioned private market sub-asset classes, but the margin for error is narrowing. The asset class's floating-rate structure provides a genuine income advantage as central banks adopt a hawkish stance. Additionally, middle-market direct lending spreads continue to command a significant premium over liquid credit. With this in mind, private credit default rates have remained structurally below those of public loans and bonds across every major cycle, including 2020. This is a track record reflecting both structural seniority and the hands-on lender oversight that public markets cannot replicate. However, this historical resilience should not lead to complacency. The current economic environment, characterized by stagflationary risk, poses significant challenges for leveraged borrowers on both sides of the Atlantic.

Margins are being compressed due to rising energy and input costs, and the cost of refinancing is increasing at a time when coverage ratios are deteriorating. PIK-paying loans currently account for approximately 13% of total BDC loan assets, maintaining a steady position close to recent highs. However, with approximately USD1.2trn in leveraged debt set to mature between 2027 and 2029, the upcoming refinancing challenge is substantial. With this in mind, direct lending still retains its appeal due to its income and seniority characteristics, but the current environment warrants a more defensive posture than at any point in the past two years. Vintage and sector selectivity are paramount, energy-intensive and over-levered borrowers should be avoided and allowing the stagflationary dynamic to play out is prudent (Figure 11).

Figure 11: US public and private credit default rates, %

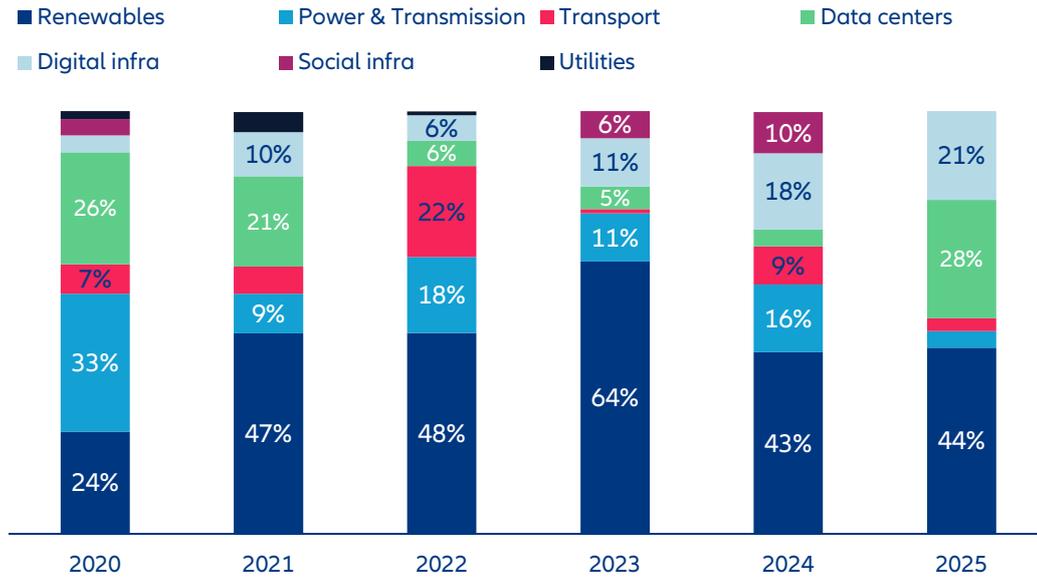


Source: Moodys, S&P Global Ratings. Private Credit: S&P Global Ratings. Dotted line includes distressed debt exchanges as default events.

Infrastructure – The structural winner. Infrastructure stands apart as the asset class best positioned to deliver resilient performance across a range of macro outcomes, and the Iran shock has only reinforced its investment case. Regulated tariffs, CPI-linked concession agreements and availability-based contracts provide precisely the inflation hedge allocators need when growth is slowing and price pressures are persistent. The fundraising composition tells its own story: data centers have surged from a negligible share of infrastructure capital in 2020 to 28% in 2025, reflecting the AI-driven electricity demand revolution now underway. US data centers consumed roughly 4% of national electricity

output in 2024, with demand projected to more than double by 2030. The Middle East escalation has further intensified urgency around energy security, reinforcing tailwinds that were already building across power generation, grid modernization and digital infrastructure. With cumulative global investment needs estimated at USD106trn through 2040, private capital is increasingly being called upon to fill the gap, and at current valuations power generation, grid services and data-center adjacencies continue to offer attractive entry points (Figure 12).

Figure 12: Infrastructure fundraising mix, %

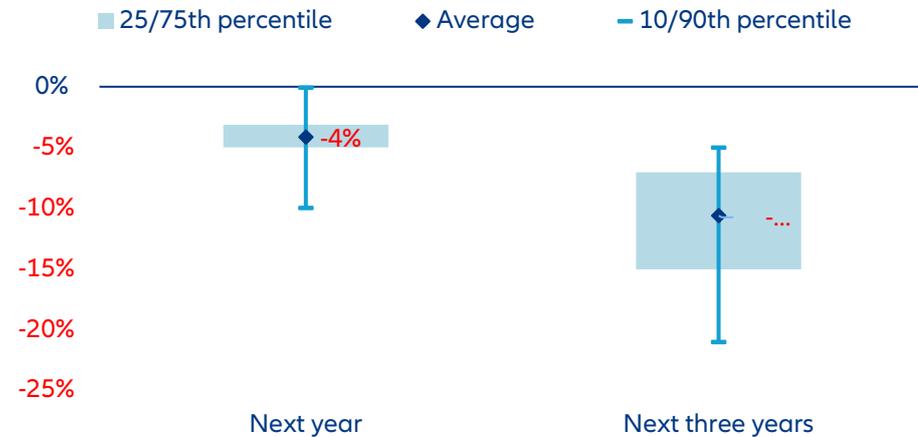


Sources: Infrastructure Investor, Allianz Research

Real estate – navigating the bifurcation. Real estate faces a confluence of pressures that makes the current conditions one of the most challenging in a decade. The Iran shock is adding a stagflationary layer, with slowing growth, persistent inflation and rates remaining higher for longer likely to compress valuations and strain refinancing conditions across the asset class. Well over USD1.5trn in commercial real estate loans will reach maturity by end-2026. The office sector faces a particularly uncomfortable combination of cyclical and structural headwinds. National vacancy rates remain near 20%, and while there are tentative signs of stabilization in prime space, the structural forces bearing down on demand are intensifying rather than easing.

Working from home has permanently reduced space requirements for many occupiers, and AI is now emerging as an additional and underappreciated headwind: while only 11% of US companies are actively cutting headcount today due to AI, corporate headcount is expected to contract by -4% over the next year and -11% over the next three years, a trajectory that points to a sustained softening in office demand beyond the current cyclical weakness. Beyond offices, the picture is more selective but more constructive: multifamily benefits from constrained supply and persistent affordability pressures; industrial and logistics are regaining supply-demand balance and data centers provide AI-driven structural demand largely uncorrelated with the broader cycle (Figure 13).

Figure 13: Expected headcount changes due to AI adoption, next one and three years, %



Sources: Goldman Sachs, Allianz Research



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The company assumes no obligation to update any information or forward-looking statement contained herein, save for any information required to be disclosed by law.

Allianz Trade is the trademark used to designate a range of services provided by Euler Hermes.