

# Global Economics & Strategy

## How US elections, tariffs, China and geopolitical risk could shape global markets in 2025/2026

### Economics

#### Global

#### Five scenarios that could change markets

The Economics & Strategy Team at UBS has modelled five scenarios that could shape the outlook: (i) a US election Red Sweep; (ii) a Blue Sweep; (iii) a significant increase in global tariffs; (iv) a US recession; and (v) a 'no landing' scenario where central banks globally have eased prematurely. We also consider what kind of China stimulus would move the needle, and how a potential oil shock would affect inflation and central banks.

- Tariffs are the most impactful: a 60%/10% tariff on China/RoW would lower 2026 global GDP by 1pp and US GDP by ½ pp. Private demand falls by a multiple of GDP and corporate profits on average would fall by 6%. There are, however, also (perhaps surprisingly) tariff scenarios where US growth is positive.
- The US recession scenario generates the widest move in global policy rates: a few tenths of extra disinflation and weaker growth/employment allows central banks to become outright accommodative; we have six central banks returning to the lower bound (including the Fed, BoJ and BoC, but not the ECB or BoE).
- By contrast, the 'Central Banks eased too early' scenario generates much higher growth (and earnings) but comes with a complete reversal of the CB cuts priced into markets, leading to a correction in equity market valuations in '25.
- The Red and Blue sweep scenarios are remarkably similar, though a Republican administration would generate a few tenths extra growth in '26, but at the cost of nearly permanent 7% GDP deficits.

#### Equities: we lift our S&P target to 6400 in '25 and introduce a 6850 target for '26

In the baseline, earnings growth in '25 is around trend in the US and around zero in Europe. In a Blue Sweep scenario (higher corporate taxes), the RoW outperforms the US, but the opposite is true in a Red Sweep (more 'America-first' policies, tax cuts and reduced regulation). Under tariff and US recession scenarios, all markets are weak.

#### Fixed income: limited election impact on supply, but curves steeper in '25

The US elections only marginally affect 10y rates (the bleak fiscal does not get bleaker). We expect curve steepening as we drift back towards a pre-2013 paradigm. Euro rates do well in most scenarios, and bond-equity correlations turn positive in tariffs and premature easing scenarios. TIPS breakevens outperform in the non-recession scenarios.

#### FX: USD weakness; 'exceptional' no more

A Blue Sweep would see weakened demand for US assets adding to USD softness. A US recession would be most USD negative (and most positive for gold), while a Red Sweep would be most positive, even with substantial tariffs.

#### Credit: spreads stay tight in baseline and are tighter in Red than Blue Sweep

Large-scale tariffs would drive meaningful spread widening (US IG/HY spreads at 150/475bp); a recession would be shallow/short, with the Fed responding quickly (IG/HY spreads peak in Q3-25 at 195/650bp). A reacceleration of inflation would meaningfully reprice credit risk (US IG/HY peaks of 150/500).

#### EM: MSCI at 1255 by end '25; all eyes on China

Only the Blue Sweep scenario would generate similar returns for MSCI in '25 (+10%) as the baseline. All the others point to downside risk: Red Sweep (-2%), Premature Easing (-4%), Tariffs (-10%), and Recession (-10%).

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# UBS Forecasts (levels)

Figure 1: UBS baseline and scenario forecasts

Current baseline												
	4Q 24	2024	1Q 25	2Q 25	3Q 25	4Q 25	2025	1Q 26	2Q 26	3Q 26	4Q 26	2026
Global GDP %q/q saar	2.7	3.2	2.7	3.0	2.9	2.9	2.9	2.8	3.0	3.1	2.9	2.9
US GDP %q/q saar	1.2	2.6	1.3	1.6	1.6	1.7	1.6	1.6	1.7	1.7	1.7	1.7
Eurozone GDP %q/q saar	0.8	0.7	0.8	1.2	1.2	1.0	0.9	1.0	1.0	1.0	1.0	1.1
US CPI %y/y	2.7	2.9	2.1	2.4	2.5	2.4	2.4	2.4	2.4	2.4	2.4	2.4
Eurozone CPI %y/y	2.4	2.4	2.0	2.1	2.2	2.1	2.1	2.1	1.7	2.0	2.0	2.0
US policy rate % (top range)	4.50	4.50	4.00	3.50	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
Eurozone policy rate %	3.00	3.00	2.50	2.25	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
US 10y (bp)	400	400	395	390	385	380	380	390	400	420	440	440
Germany 10y (bp)	200	200	195	190	185	180	180	190	200	210	220	220
EURUSD	1.12	1.12	1.12	1.13	1.14	1.15	1.15	1.15	1.15	1.15	1.15	1.15
USDJPY	145	145	140	135	132	130	130	130	128	125	125	125
S&P 500	5,850	5,850	5,950	6,050	6,250	6,400	6,400	6,500	6,600	6,725	6,850	6,850
STOXX 600	540	540	550	540	545	550	550	560	560	565	575	575
US IG (bp)	95	95	90	95	95	95	95	90	95	105	105	105
US HY (bp)	325	325	300	325	325	325	325	300	325	350	350	350
MSCI EM	1,195	1,195	1,220	1,230	1,245	1,255	1,255	1,275	1,290	1,310	1,315	1,315
MSCI China	73	73	75	76	77	77	77	79	81	82	83	83
Gold	2,800	2,800	2,890	2,850	2,900	3,000	3,000	2,800	2,800	2,800	2,700	2,700
USDCNY	6.95	6.95	6.93	6.90	6.88	6.85	6.85	6.89	6.93	6.96	7.00	7.00
EM FX	100.5	100.5	100.6	100.8	100.9	101.5	101.5	100.8	100.5	100.3	100.5	100.5
Scenario 1: Red sweep												
	4Q 24	2024	1Q 25	2Q 25	3Q 25	4Q 25	2025	1Q 26	2Q 26	3Q 26	4Q 26	2026
Global GDP %q/q saar	2.7	3.2	2.7	3.0	2.9	2.2	2.8	2.0	2.7	3.1	2.9	2.5
US GDP %q/q saar	1.1	2.6	1.3	1.6	1.6	1.6	1.6	1.2	1.4	1.7	1.7	1.5
Eurozone GDP %q/q saar	0.8	0.7	0.8	1.2	1.2	1.1	0.9	1.0	1.0	0.9	0.9	1.0
US CPI %y/y	2.7	2.9	2.1	2.4	2.5	2.4	2.4	2.5	2.6	2.6	2.6	2.5
Eurozone CPI %y/y	2.4	2.4	2.0	2.1	2.3	2.2	2.1	2.1	1.7	1.9	1.9	1.9
US policy rate % (top range)	4.50	4.50	4.00	3.50	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
Eurozone policy rate %	3.00	3.00	2.50	2.25	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
US 10y (bp)	410	410	403	395	388	380	380	390	405	430	450	450
Germany 10y (bp)	220	220	190	190	180	180	180	180	190	200	210	210
EURUSD	1.09	1.09	1.09	1.09	1.09	1.09	1.09	1.08	1.08	1.08	1.08	1.08
USDJPY	148	148	148	148	148	148	148	145	145	145	145	145
S&P 500	5,850	5,850	6,175	6,150	6,250	6,375	6,375	6,400	6,575	6,650	6,775	6,775
STOXX 600	520	520	530	530	530	530	530	540	540	545	550	550
US IG (bp)	90	90	80	90	90	90	90	80	90	105	105	105
US HY (bp)	300	300	275	300	300	300	300	275	300	350	350	350
MSCI EM	1,135	1,135	1,125	1,115	1,115	1,115	1,115	1,120	1,130	1,140	1,145	1,145
MSCI China	70	70	69	69	69	69	69	69	69	70	70	70
Gold	2,700	2,700	2,650	2,600	2,700	2,800	2,800	2,900	2,900	2,950	2,950	2,950
USDCNY	7.20	7.20	7.30	7.40	7.50	7.50	7.50	7.48	7.45	7.43	7.40	7.40
EM FX	97.0	97.0	96.9	95.6	94.3	93.0	93.0	93.5	94.0	94.5	95.0	95.0
Scenario 2: Blue Sweep												
	4Q 24	2024	1Q 25	2Q 25	3Q 25	4Q 25	2025	1Q 26	2Q 26	3Q 26	4Q 26	2026
Global GDP %q/q saar	2.7	3.2	2.7	3.0	2.9	2.9	2.9	2.8	3.0	3.1	2.9	2.9
US GDP %q/q saar	1.2	2.6	1.3	1.6	1.6	1.7	1.6	1.5	1.6	1.6	1.6	1.6
Eurozone GDP %q/q saar	0.8	0.7	0.8	1.2	1.2	1.0	0.9	1.0	1.0	1.0	1.0	1.1
US CPI %y/y	2.7	2.9	2.1	2.4	2.5	2.4	2.4	2.4	2.4	2.4	2.4	2.4
Eurozone CPI %y/y	2.4	2.4	1.9	2.0	2.2	2.1	2.0	2.0	1.7	1.9	2.0	2.0
US policy rate % (top range)	4.50	4.50	4.00	3.50	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
Eurozone policy rate %	3.00	3.00	2.50	2.25	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
US 10y (bp)	405	405	395	390	385	380	380	388	395	413	430	430
Germany 10y (bp)	200	200	195	190	185	180	180	190	200	210	220	220
EURUSD	1.12	1.12	1.15	1.16	1.17	1.18	1.18	1.18	1.17	1.16	1.15	1.15
USDJPY	140	140	135	130	125	125	125	120	120	125	125	125
S&P 500	5,750	5,750	6,000	6,025	5,800	6,000	6,000	6,100	6,225	6,350	6,475	6,475
STOXX 600	550	550	560	560	565	570	570	585	585	590	600	600
US IG (bp)	95	95	95	105	105	105	105	95	95	105	105	105
US HY (bp)	325	325	325	350	350	350	350	325	325	350	350	350
MSCI EM	1,205	1,205	1,265	1,290	1,310	1,325	1,325	1,345	1,365	1,385	1,380	1,380
MSCI China	75	75	79	81	82	83	83	85	86	88	87	87
Gold	2,775	2,775	2,900	2,850	2,900	2,900	2,900	2,900	2,800	2,800	2,800	2,800
USDCNY	6.85	6.85	6.83	6.80	6.78	6.70	6.70	6.75	6.75	6.75	6.75	6.75
EM FX	102.5	102.5	102.9	103.3	103.6	104.0	104.0	103.8	103.5	103.3	103.0	103.0

Source: Bloomberg, UBS estimates. Note: a) Global GDP growth is based on countries which are included in the scenario analysis in current baseline. b) Except for GDP growth and inflation, all annual numbers are year-end. c) For GDP growth, quarterly data is qoq saar, yearly data is yoy. d) US policy rates indicate the upper end of the range. e) The GBI EM FX gauge is versus the USD (higher values = EM FX appreciation), rebased to 100 as on 8th Oct 2024.

Figure 2: UBS baseline and scenario forecasts (cont'd)

Scenario 3: Tariffs												
	4Q 24	2024	1Q 25	2Q 25	3Q 25	4Q 25	2025	1Q 26	2Q 26	3Q 26	4Q 26	2026
Global GDP %q/q saar	2.7	3.2	2.7	3.0	3.0	1.5	2.7	1.1	2.5	2.4	1.9	2.0
US GDP %q/q saar	1.2	2.6	1.3	1.6	1.6	1.8	1.6	1.0	0.7	0.7	0.3	1.1
Eurozone GDP %q/q saar	0.8	0.7	0.8	1.2	1.1	1.1	0.9	0.9	0.8	0.7	0.5	0.9
US CPI %y/y	2.7	2.9	2.1	2.4	2.5	2.7	2.4	3.0	3.3	3.5	3.4	3.2
Eurozone CPI %y/y	2.4	2.4	2.0	2.1	2.3	2.2	2.1	2.1	1.8	2.0	2.1	2.0
US policy rate % (top range)	4.50	4.50	4.00	3.50	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
Eurozone policy rate %	3.00	3.00	2.50	2.25	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
US 10y (bp)	400	400	400	400	400	400	400	390	380	395	410	410
Germany 10y (bp)	200	200	200	200	200	200	200	195	190	190	190	190
EURUSD	1.09	1.09	1.09	1.09	1.08	1.07	1.07	1.06	1.05	1.04	1.03	1.03
USDJPY	148	148	148	148	150	150	150	150	150	150	150	150
S&P 500	5,750	5,750	5,525	4,800	4,600	5,200	5,200	5,300	5,400	5,500	5,650	5,650
STOXX 600	520	520	520	440	420	450	450	460	460	450	450	450
US IG (bp)	90	90	95	125	160	150	150	140	150	165	155	155
US HY (bp)	300	300	325	400	500	475	475	450	475	525	500	500
MSCI EM	1,150	1,150	1,115	1,045	1,035	1,035	1,035	1,055	1,065	1,065	1,065	1,065
MSCI China	71	71	68	63	62	63	63	65	65	65	65	65
Gold	2,900	2,900	2,900	2,800	2,900	2,850	2,850	2,950	2,950	3,000	2,900	2,900
USDCNY	7.20	7.20	7.31	7.48	7.64	7.80	7.80	7.75	7.70	7.65	7.60	7.60
EM FX	98.0	98.0	96.0	94.0	90.0	86.0	86.0	86.0	86.0	85.0	85.0	85.0
Scenario 4: US Recession												
	4Q 24	2024	1Q 25	2Q 25	3Q 25	4Q 25	2025	1Q 26	2Q 26	3Q 26	4Q 26	2026
Global GDP %q/q saar	2.7	3.2	2.4	1.8	1.6	1.9	2.3	2.2	2.6	2.9	3.0	2.2
US GDP %q/q saar	1.1	2.6	0.8	-0.8	-1.3	-0.3	0.5	0.6	1.1	1.9	2.3	0.5
Eurozone GDP %q/q saar	0.8	0.7	0.8	0.7	0.7	0.1	0.7	0.1	0.4	0.6	1.0	0.4
US CPI %y/y	2.7	2.9	2.1	2.3	2.1	1.8	2.1	1.6	1.7	1.8	2.1	1.8
Eurozone CPI %y/y	2.4	2.4	1.9	1.9	2.0	1.9	1.9	1.9	1.7	2.0	2.1	1.9
US policy rate % (top range)	4.50	4.50	3.25	1.75	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50
Eurozone policy rate %	3.00	3.00	2.50	1.75	1.25	1.25	1.25	1.25	1.25	1.25	1.50	1.50
US 10y (bp)	400	400	350	300	275	250	250	263	275	288	300	300
Germany 10y (bp)	200	200	175	150	150	125	125	125	150	175	200	200
EURUSD	1.12	1.12	1.13	1.15	1.17	1.18	1.18	1.19	1.20	1.19	1.18	1.18
USDJPY	140	140	135	130	122	120	120	120	120	125	125	125
S&P 500	5,400	5,400	5,275	4,650	4,150	4,325	4,325	4,700	4,900	5,050	5,175	5,175
STOXX 600	500	500	490	460	410	460	460	500	520	530	540	540
US IG (bp)	105	105	120	140	195	170	170	150	135	120	110	110
US HY (bp)	350	350	400	475	650	575	575	500	450	400	375	375
MSCI EM	1,135	1,135	1,105	1,050	985	1,025	1,025	1,075	1,130	1,150	1,165	1,165
MSCI China	71	71	70	67	64	66	66	69	71	72	73	73
Gold	2,850	2,850	2,950	3,100	3,200	3,300	3,300	3,300	3,400	3,400	3,350	3,350
USDCNY	6.95	6.95	6.95	7.00	6.95	6.75	6.75	6.74	6.73	6.71	6.70	6.70
EM FX	100.5	100.5	101.0	95.0	96.0	100.0	100.0	100.5	101.0	101.5	102.5	102.5
Scenario 5: Central banks have eased prematurely												
	4Q 24	2024	1Q 25	2Q 25	3Q 25	4Q 25	2025	1Q 26	2Q 26	3Q 26	4Q 26	2026
Global GDP %q/q saar	3.2	3.2	3.9	4.1	3.8	3.4	3.6	3.2	3.3	3.3	2.9	3.4
US GDP %q/q saar	2.3	2.7	2.8	2.9	2.9	2.5	2.7	2.2	2.2	2.2	1.6	2.4
Eurozone GDP %q/q saar	1.4	0.8	2.8	2.8	2.3	1.8	2.0	1.6	1.4	1.2	1.0	1.7
US CPI %y/y	2.7	2.9	2.3	2.8	3.1	3.3	2.8	3.5	3.5	3.5	3.5	3.5
Eurozone CPI %y/y	2.6	2.4	2.2	2.3	2.6	2.6	2.4	2.5	2.2	2.4	2.5	2.4
US policy rate % (top range)	4.50	4.50	4.50	4.75	5.00	5.50	5.50	5.75	5.75	5.75	5.75	5.75
Eurozone policy rate %	3.25	3.25	3.25	3.50	3.75	4.00	4.00	4.00	4.00	4.00	4.00	4.00
US 10y (bp)	400	400	425	450	463	475	475	475	475	475	475	475
Germany 10y (bp)	200	200	225	250	275	275	275	275	275	250	250	250
EURUSD	1.12	1.12	1.12	1.11	1.10	1.09	1.09	1.08	1.07	1.06	1.05	1.05
USDJPY	145	145	145	145	145	148	148	152	155	155	155	155
S&P 500	5,650	5,650	5,600	5,400	5,350	5,400	5,400	5,450	5,500	5,650	5,700	5,700
STOXX 600	530	530	510	490	470	490	490	510	530	550	560	560
US IG (bp)	95	95	120	135	150	140	140	130	120	110	120	120
US HY (bp)	320	320	400	450	500	470	470	435	400	370	400	400
MSCI EM	1,160	1,160	1,125	1,095	1,070	1,115	1,115	1,145	1,180	1,205	1,225	1,225
MSCI China	73	73	71	70	68	71	71	72	74	75	76	76
Gold	2,525	2,525	2,450	2,300	2,300	2,200	2,200	2,200	2,150	2,025	2,025	2,025
USDCNY	6.95	6.95	7.06	7.18	7.29	7.40	7.40	7.40	7.40	7.40	7.40	7.40
EM FX	100.5	100.5	99.4	98.0	97.4	96.0	96.0	96.0	96.0	96.0	96.0	96.0

Source: Bloomberg, UBS estimates. Note: a) Global GDP growth is based on countries which are included in the scenario analysis in current baseline. b) Except for GDP growth and inflation, all annual numbers are year-end. c) For GDP growth, quarterly data is qoq saar, yearly data is yoy. d) US policy rates indicate the upper end of the range. e) The GBI EM FX gauge is versus the USD (higher values = EM FX appreciation), rebased to 100 as on 8th Oct 2024.

# UBS Forecasts (changes)

Figure 3: Baseline

	2024E*	1Q 25E	2Q 25E	3Q 25E	4Q 25E	2025E	1Q 26E	2Q 26E	3Q 26E	4Q 26E	2026E	Cumulative change
<b>Equity indices price change (%)</b>												
S&P 500	1.7%	1.7%	1.7%	3.3%	2.4%	9.4%	1.6%	1.5%	1.9%	1.9%	7.0%	19.1%
STOXX 600	4.5%	1.9%	-1.8%	0.9%	0.9%	1.9%	1.8%	0.0%	0.9%	1.8%	4.5%	11.3%
MSCI China	4.4%	2.2%	1.1%	1.1%	1.0%	5.5%	2.1%	2.1%	2.1%	0.5%	7.0%	17.8%
MSCI EM	3.4%	2.1%	0.8%	1.2%	0.8%	5.0%	1.6%	1.2%	1.6%	0.4%	4.8%	13.7%
<b>FX change (%)</b>												
EUR*	2.0%	0.0%	0.9%	0.9%	0.9%	2.7%	0.0%	0.0%	0.0%	0.0%	0.0%	4.7%
JPY*	2.2%	3.6%	3.7%	2.3%	1.5%	11.5%	0.0%	1.6%	2.4%	0.0%	4.0%	18.6%
CNY*	1.6%	0.4%	0.4%	0.4%	0.4%	1.5%	-0.5%	-0.5%	-0.5%	-0.5%	-2.1%	0.9%
Gold	6.8%	3.2%	-1.4%	1.8%	3.4%	7.1%	-6.7%	0.0%	0.0%	-3.6%	-10.0%	3.0%
EM FX*	0.5%	0.1%	0.1%	0.1%	0.6%	1.0%	-0.7%	-0.2%	-0.2%	0.2%	-1.0%	0.5%
<b>Yield change (bps)</b>												
US 10-year yield	-1.2	-5	-5	-5	-5	-20	10	10	20	20	60	39
Bund 10-year yield	-24	-5	-5	-5	-5	-20	10	10	10	10	40	-4.2
<b>Spread change (bps)</b>												
US IG spread	12	-5	5	0	0	0	-5	5	10	0	10	22
US HY spread	30	-25	25	0	0	0	-25	25	25	0	25	55

Source: Bloomberg, UBS estimates. Note: a) 2024E performance is for the rest of the year from 8th Oct 2024 close prices. b) \* currencies performance versus USD. c) The GBI EM FX gauge is versus the USD (higher values = EM FX appreciation).

Figure 4: Red sweep scenario

	2024E*	1Q 25E	2Q 25E	3Q 25E	4Q 25E	2025E	1Q 26E	2Q 26E	3Q 26E	4Q 26E	2026E	Cumulative change
<b>Equity indices price change (%)</b>												
S&P 500	1.7%	5.6%	-0.4%	1.6%	2.0%	9.0%	0.4%	2.7%	1.1%	1.9%	6.3%	17.8%
STOXX 600	0.7%	1.9%	0.0%	0.0%	0.0%	1.9%	1.9%	0.0%	0.9%	0.9%	3.8%	6.5%
MSCI China	-0.2%	-1.0%	-1.0%	0.0%	0.0%	-2.0%	0.5%	0.5%	0.5%	0.5%	2.0%	-0.3%
MSCI EM	-1.8%	-0.9%	-0.9%	0.0%	0.0%	-1.8%	0.4%	0.9%	0.9%	0.4%	2.7%	-1.0%
<b>FX change (%)</b>												
EUR*	-0.7%	0.0%	0.0%	0.0%	0.0%	0.0%	-0.9%	0.0%	0.0%	0.0%	-0.9%	-1.6%
JPY*	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	2.1%	0.0%	0.0%	0.0%	2.1%	2.2%
CNY*	-1.9%	-1.4%	-1.4%	-1.3%	0.0%	-4.0%	0.3%	0.3%	0.3%	0.3%	1.4%	-4.5%
Gold	3.0%	-1.9%	-1.9%	3.8%	3.7%	3.7%	3.6%	0.0%	1.7%	0.0%	5.4%	12.5%
EM FX*	-3.0%	-0.1%	-1.3%	-1.4%	-1.4%	-4.1%	0.5%	0.5%	0.5%	0.5%	2.2%	-5.0%
<b>Yield change (bps)</b>												
US 10-year yield	9	-8	-8	-8	-8	-30	10	15	25	20	70	49
Bund 10-year yield	-4.2	-30	0	-10	0	-40	0	10	10	10	30	-14
<b>Spread change (bps)</b>												
US IG spread	7	-10	10	0	0	0	-10	10	15	0	15	22
US HY spread	5	-25	25	0	0	0	-25	25	50	0	50	55

Source: Bloomberg, UBS estimates. Note: a) 2024E performance is for the rest of the year from 8th Oct 2024 close prices. b) \* currencies performance versus USD. c) The GBI EM FX gauge is versus the USD (higher values = EM FX appreciation).

Figure 5: Blue sweep scenario

	2024E*	1Q 25E	2Q 25E	3Q 25E	4Q 25E	2025E	1Q 26E	2Q 26E	3Q 26E	4Q 26E	2026E	Cumulative change
<b>Equity indices price change (%)</b>												
S&P 500	0.0%	4.3%	0.4%	-3.7%	3.4%	4.3%	1.7%	2.0%	2.0%	2.0%	7.9%	12.6%
STOXX 600	6.5%	1.8%	0.0%	0.9%	0.9%	3.6%	2.6%	0.0%	0.9%	1.7%	5.3%	16.1%
MSCI China	6.4%	5.5%	2.2%	1.3%	1.6%	11.0%	1.9%	1.9%	1.7%	-0.5%	5.0%	24.1%
MSCI EM	4.2%	5.0%	2.0%	1.6%	1.1%	10.0%	1.5%	1.5%	1.5%	-0.4%	4.2%	19.4%
<b>FX change (%)</b>												
EUR*	2.0%	2.7%	0.9%	0.9%	0.9%	5.4%	0.0%	-0.8%	-0.9%	-0.9%	-2.5%	4.7%
JPY*	5.9%	3.7%	3.8%	4.0%	0.0%	12.0%	4.2%	0.0%	-4.0%	0.0%	0.0%	18.6%
CNY*	3.1%	0.4%	0.4%	0.4%	1.1%	2.2%	-0.7%	0.0%	0.0%	0.0%	-0.7%	4.6%
Gold	5.8%	4.5%	-1.7%	1.8%	0.0%	4.5%	0.0%	-3.4%	0.0%	0.0%	-3.4%	6.8%
EM FX*	2.5%	0.4%	0.4%	0.4%	0.4%	1.5%	-0.2%	-0.2%	-0.2%	-0.2%	-1.0%	3.0%
<b>Yield change (bps)</b>												
US 10-year yield	3.8	-10	-5	-5	-5	-25	8	8	18	18	50	29
Bund 10-year yield	-24	-5	-5	-5	-5	-20	10	10	10	10	40	-4.2
<b>Spread change (bps)</b>												
US IG spread	12	0	10	0	0	10	-10	0	10	0	0	22
US HY spread	30	0	25	0	0	25	-25	0	25	0	0	55

Source: Bloomberg, UBS estimates. Note: a) 2024E performance is for the rest of the year from 8th Oct 2024 close prices. b) \* currencies performance versus USD. c) The GBI EM FX gauge is versus the USD (higher values = EM FX appreciation).

Figure 6: Tariffs scenario

	2024E*	1Q 25E	2Q 25E	3Q 25E	4Q 25E	2025E	1Q 26E	2Q 26E	3Q 26E	4Q 26E	2026E	Cumulative change
<b>Equity indices price change (%)</b>												
S&P 500	0.0%	-3.9%	-13.1%	-4.2%	13.0%	-9.6%	1.9%	1.9%	1.9%	2.7%	8.7%	-1.8%
STOXX 600	0.7%	0.0%	-15.4%	-4.5%	7.1%	-13.5%	2.2%	0.0%	-2.2%	0.0%	0.0%	-12.9%
MSCI China	1.3%	-5.0%	-7.0%	-1.0%	1.8%	-11.0%	2.0%	1.0%	0.0%	0.0%	3.0%	-7.1%
MSCI EM	-0.5%	-3.0%	-6.3%	-1.0%	0.0%	-10.0%	1.9%	0.9%	0.0%	0.0%	2.9%	-7.9%
<b>FX change (%)</b>												
EUR*	-0.7%	0.0%	0.0%	-0.9%	-0.9%	-1.8%	-0.9%	-0.9%	-1.0%	-1.0%	-3.7%	-6.2%
JPY*	0.1%	0.0%	0.0%	-1.3%	0.0%	-1.3%	0.0%	0.0%	0.0%	0.0%	0.0%	-1.2%
CNY*	-1.9%	-1.5%	-2.2%	-2.1%	-2.1%	-7.7%	0.6%	0.6%	0.7%	0.7%	2.6%	-7.1%
Gold	10.6%	0.0%	-3.4%	3.6%	-1.7%	-1.7%	3.5%	0.0%	1.7%	-3.3%	1.8%	10.6%
EM FX*	-2.0%	-2.0%	-2.1%	-4.3%	-4.4%	-12.2%	0.0%	0.0%	-1.2%	0.0%	-1.2%	-15.0%
<b>Yield change (bps)</b>												
US 10-year yield	-1.2	0	0	0	0	0	-10	-10	15	15	10	9
Bund 10-year yield	-24	0	0	0	0	0	-5	-5	0	0	-10	-34
<b>Spread change (bps)</b>												
US IG spread	7.0	5	30	35	-10	60	-10	10	15	-10	5.0	72
US HY spread	5.0	25	75	100	-25	175	-25	25	50	-25	25	205

Source: Bloomberg, UBS estimates. Note: a) 2024E performance is for the rest of the year from 8th Oct 2024 close prices. b) \* currencies performance versus USD. c) The GBI EM FX gauge is versus the USD (higher values = EM FX appreciation).

Figure 7: US recession scenario

	2024E*	1Q 25E	2Q 25E	3Q 25E	4Q 25E	2025E	1Q 26E	2Q 26E	3Q 26E	4Q 26E	2026E	Cumulative change
<b>Equity indices price change (%)</b>												
S&P 500	-6.1%	-2.3%	-11.8%	-10.8%	4.2%	-19.9%	8.7%	4.3%	3.1%	2.5%	19.7%	-10.0%
STOXX 600	-3.2%	-2.0%	-6.1%	-10.9%	12.2%	-8.0%	8.7%	4.0%	1.9%	1.9%	17.4%	4.5%
MSCI China	1.3%	-2.2%	-3.8%	-4.5%	2.9%	-7.5%	3.9%	3.9%	1.4%	1.3%	11.0%	4.0%
MSCI EM	-1.8%	-2.6%	-5.0%	-6.2%	4.1%	-9.7%	4.9%	5.1%	1.8%	1.3%	13.7%	0.8%
<b>FX change (%)</b>												
EUR*	2.0%	0.9%	1.8%	1.7%	0.9%	5.4%	0.8%	0.8%	-0.8%	-0.8%	0.0%	7.5%
JPY*	5.9%	3.7%	3.8%	6.6%	1.7%	16.7%	0.0%	0.0%	-4.0%	0.0%	-4.0%	18.6%
CNY*	1.6%	0.0%	-0.7%	0.7%	3.0%	3.0%	0.2%	0.2%	0.2%	0.2%	0.7%	5.4%
Gold	8.7%	3.5%	5.1%	3.2%	3.1%	15.8%	0.0%	3.0%	0.0%	-1.5%	1.5%	27.8%
EM FX*	0.5%	0.5%	-5.9%	1.1%	4.2%	-0.5%	0.5%	0.5%	0.5%	1.0%	2.5%	2.5%
<b>Yield change (bps)</b>												
US 10-year yield	-1.2	-50	-50	-25	-25	-150	13	13	13	13	50	-101
Bund 10-year yield	-24	-25	-25	0	-25	-75	0	25	25	25	75	-24
<b>Spread change (bps)</b>												
US IG spread	22	15	20	55	-25	65	-20	-15	-15	-10	-60	27
US HY spread	55	50	75	175	-75	225	-75	-50	-50	-25	-200	80

Source: Bloomberg, UBS estimates. Note: a) 2024E performance is for the rest of the year from 8th Oct 2024 close prices. b) \* currencies performance versus USD. c) The GBI EM FX gauge is versus the USD (higher values = EM FX appreciation).

Figure 8: Central banks have eased prematurely scenario

	2024E*	1Q 25E	2Q 25E	3Q 25E	4Q 25E	2025E	1Q 26E	2Q 26E	3Q 26E	4Q 26E	2026E	Cumulative change
<b>Equity indices price change (%)</b>												
S&P 500	-1.8%	-0.9%	-3.6%	-0.9%	0.9%	-4.4%	0.9%	0.9%	2.7%	0.9%	5.6%	-0.9%
STOXX 600	2.6%	-3.8%	-3.9%	-4.1%	4.3%	-7.5%	4.1%	3.9%	3.8%	1.8%	14.3%	8.4%
MSCI China	3.4%	-2.3%	-1.9%	-1.9%	3.1%	-3.0%	2.4%	2.4%	1.6%	1.4%	8.0%	8.3%
MSCI EM	0.3%	-3.0%	-2.7%	-2.3%	4.2%	-3.9%	2.7%	3.1%	2.1%	1.7%	9.9%	5.9%
<b>FX change (%)</b>												
EUR*	2.0%	0.0%	-0.9%	-0.9%	-0.9%	-2.7%	-0.9%	-0.9%	-0.9%	-0.9%	-3.7%	-4.4%
JPY*	2.2%	0.0%	0.0%	0.0%	-2.0%	-2.0%	-2.6%	-1.9%	0.0%	0.0%	-4.5%	-4.4%
CNY*	1.6%	-1.6%	-1.6%	-1.5%	-1.5%	-6.1%	0.0%	0.0%	0.0%	0.0%	0.0%	-4.6%
Gold	-3.7%	-3.0%	-6.1%	0.0%	-4.3%	-12.9%	0.0%	-2.3%	-5.8%	0.0%	-8.0%	-22.8%
EM FX*	0.5%	-1.1%	-1.4%	-0.6%	-1.4%	-4.5%	0.0%	0.0%	0.0%	0.0%	0.0%	-4.0%
<b>Yield change (bps)</b>												
US 10-year yield	-1.2	25	25	13	13	75	0	0	0	0	0	74
Bund 10-year yield	-24	25	25	25	0	75	0	0	-25	0	-25	26
<b>Spread change (bps)</b>												
US IG spread	12	25	15	15	-10	45	-10	-10	-10	10	-20	37
US HY spread	25	80	50	50	-30	150	-35	-35	-30	30	-70	105

Source: Bloomberg, UBS estimates. Note: a) 2024E performance is for the rest of the year from 8th Oct 2024 close prices. b) \* currencies performance versus USD. c) The GBI EM FX gauge is versus the USD (higher values = EM FX appreciation).

# Introduction

We normally publish our Global Markets Outlook in early November. However, the US elections (both presidential and legislative) are held on November 5 and their outcome is consequential enough for the global economy that we have pushed back the Outlook to allow time to process the results in our forecast. The purpose of this report is to discuss the potential implications of the US elections ahead of time, similar to the scenario analysis we always do in the Outlook, and we consider a number of non-election related scenarios as well. The aim is to capture a large range of possible outcomes for markets, both positive and negative. In particular, we have modelled the following:

- **US election - red sweep.** Former President Trump wins the presidency and Republicans win both houses of Congress (>50% of seats), though fall short of a filibuster-proof majority in the Senate (60 seats).
- **US election - blue sweep.** The obverse: Vice President Harris wins the presidency and Democrats win both House and Senate, again short of a filibuster-proof majority.
- **US recession.** In this scenario, we assess the mechanics of how the US economy might slip into recession. This risk should diminish over time, if the Fed manages to deliver the easing that is priced, but there are still ways in which the scenario could materialize.
- **Global tariffs.** This is essentially a Trump scenario where the tariffs that have been mentioned during the campaign (60% on China, 10% on the rest of the world) are fully implemented, and the rest of the world partially retaliates (see detail in next section). This is a much more extreme version of the tariffs that we have modelled in the red sweep scenario (where we assumed tariffs only for China and with exemptions).
- **Central banks (globally) eased too early.** The easing underway is occurring against a backdrop of labour markets remaining historically tight, with 63% of central banks still missing their inflation targets, and run rates of underlying core & services inflation above pre-pandemic levels for the majority of countries. We consider essentially a version of a 'no landing' scenario, where economic momentum is strong enough for inflation to get 'stuck' 50bp or more above central bank targets. We then assess how central banks would react.

We consider two additional scenarios, though not run as a full global modelling exercise:

- **China stimulus - what would change our view?** In Box 4, we discuss what kind of stimulus it would take to change our view. Our baseline for China is quite pessimistic, with the property market not recovering decisively before mid-2026, therefore weighing on household wealth, consumer sentiment, and spending (we have sub-4% consumption next year and only 4% real GDP growth). This baseline is arguably close to the 'worst case' we would normally model as a scenario in our Outlooks, especially if combined with the tariff scenarios discussed in this report. With property starts already down 70% from the peak, we did not view it as realistic or even useful to model something that was even worse. However, the question has now flipped to whether a materially better outcome is possible. [Recent announcements](#) are encouraging in that they are much more coordinated than before, even if the actual measures are more of the same, with no one measure making a decisive difference (with the possible exception of some measures to boost the equity market). The hope, and perhaps expectation, is that more stimulus will be announced, but it would have to be orders of magnitude greater than what we have seen so far. We discuss in the box what could change our mind.
- **Escalating tension in the Middle East.** With the conflict in the Middle East seemingly [spreading](#), and the risk of [possible attacks on oil facilities](#), we consider an oil spike scenario. This is something we have modelled in prior Outlooks (see [here](#), [here](#) and [here](#)). We discuss in Box 5 what impact an oil shock would have on our inflation forecasts, and how we believe central banks would react to it.

The assumptions behind these scenarios are discussed in much greater detail in the next section, which is then followed by a section showing how they affect our economic and asset class forecasts. We do not assign probabilities to any of these scenarios and UBS

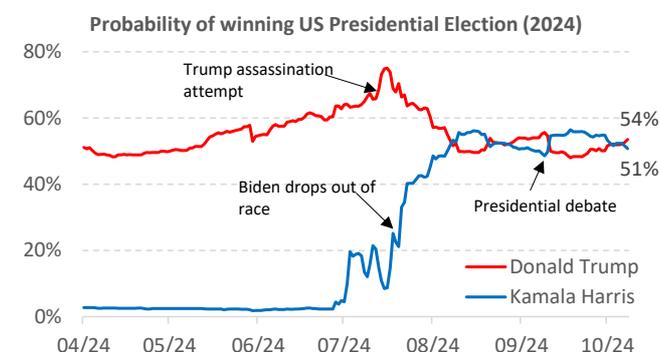
**We model 5 scenarios with a full set of accompanying market forecasts.**

**And we also consider China stimulus and the implications of tensions in the Middle East in two separate boxes.**

**We also assess if central banks would react differently to a transitory oil shock now than in the past.**

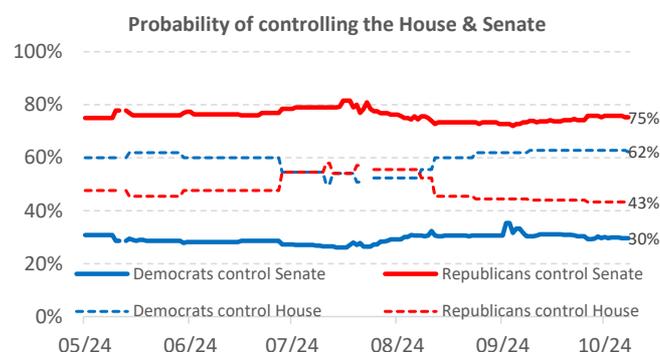
does not attempt to predict election outcomes. But for the US elections, at least, we can use bookmaker odds to help inform relative likelihoods. As Figure 1 and 2 below show, for instance, a red sweep is currently still considered a higher probability than a blue one, while the presidency remains a toss-up.

**Figure 9: Probability of winning US Presidential Election (leading bookmakers)**



Source: UBS Evidence Lab [Chart shows implied probability based on betting odds at leading bookmakers. Please note that UBS does not try to predict the outcome of elections. The sum of implied probabilities of the event outcomes will often exceed 100% as bookmakers and exchanges charge a premium for placing bets. The excess probability above of 100% can be thought of as the profit margin for bookmakers and more liquid bets will often have a smaller premium.]

**Figure 10: Probabilities for controlling House & Senate (leading bookmakers)**



Source: UBS Evidence Lab [Chart shows implied probability based on betting odds at leading bookmakers. Please note that UBS does not try to predict the outcome of elections. The sum of implied probabilities of the event outcomes will often exceed 100% as bookmakers and exchanges charge a premium for placing bets. The excess probability above of 100% can be thought of as the profit margin for bookmakers and more liquid bets will often have a smaller premium.]

Finally, all our modelling in this report is relative to a baseline, which is essentially our current set of forecasts. We will adapt that baseline after November 6, along the lines of what is discussed in this report, and depending of course on which scenario materializes. But it is worth highlighting a few key features of the current baseline:

First, we currently project global growth slowing from 3.2% in 2024 to 2.9% in both 2025 and 2026. Those growth rates are roughly 60bp below pre-pandemic trend growth, largely because we believe China will grow a few percentage points more slowly than before, on account of demographics and lower property sector growth contributions. Ex-China, the incremental slowing largely reflects the lags of past monetary policy tightening, and the drying up of consumer liquidity in the US, where we expect growth to slow in Q4/Q1 as spending converges down to income and the labour market [shows some renewed slowing](#). However, we have growth improving in roughly half of our country sample. With growth forecasts close to what we think is the current long-run trend, unemployment moves only modestly higher (0.2pp in DM and 0.5pp in EM ex-China), leaving labour markets still tight.

Second, headline inflation continues to decline—by a full percentage point globally in 2025 (from 3.8% to 2.8% as an annual average) and an additional 30bp in 2026, essentially back to pre-pandemic averages. The disinflation largely reflects an improvement in core inflation, as the remaining stickiness in services inflation is eliminated.

Third, central bank policy rates converge back to neutral (about 2½ % in DM and 4½ % in EM), on average, with most of the move occurring between now and end '25. The fed funds rate (3% by end '25E) remains somewhat above neutral as core PCE inflation touches 2%; towards the end of our horizon, however, the economy picks up momentum again.

For the US specifically, we currently assume a continuation of divided government with bipartisan support to extend most of the Trump tax cuts (except for incomes greater than \$400-450k), leaving the fiscal impulse (and growth implications) roughly neutral. The baseline does not assume major changes in regulation or any significant tariff increase but it includes a sharp slowdown in illegal immigration which both sides seem committed to bring about. Beyond that, however, we have not yet incorporated the specific new policies the candidates are campaigning on but will do so once we know the election outcome.

**All scenarios are compared with our baseline, which assumes a step-down in US growth in coming quarters and sub-par China growth, but is otherwise close to potential.**

**The baseline also assumes the residual stickiness in services inflation is eliminated in '25/'26.**

**And that policy rates on average converge back to neutral.**

**On US fiscal policy specifically, we have not yet incorporated any specific Trump or Harris proposals, but we have already reflected extension of the personal income tax cuts for which there is bipartisan support.**

## Description Scenarios

Below, we lay out our assumptions behind the various scenarios in more detail, before spelling out the economic and market implications.

### Scenario 1: Red Sweep

Joint control of the White House and the two houses of Congress determines the extent to which any political agenda is enacted. If President Trump wins and Republicans take over House and Senate, it would restore the Republican control of government from 8 years ago that ushered in the 2017 Tax Cuts and Jobs Act (TCJA).

Current polling suggests that the majority in a red sweep is likely to be slim, thereby restricting legislative efforts that require 60 votes in the Senate. However, tax, spending, and debt ceiling policies can be enacted with a simple Senate majority rule, if both the House and the Senate agree to use a budget process called "reconciliation". As in 2016, Republican majorities in the House and Senate would enable the party to enact its fiscal policy to a large extent.

Fiscal policy in 2025 is roughly baked in, as most of the spending and tax policies are already in place, based upon existing agreements between the parties. But beyond 2025, big changes loom: most of the tax cuts enacted under the Tax Cuts and Jobs Act in 2017 expire at the end of that year, with the exception of the corporate tax rate cut to 21%. Unless Congress and the next President act, a tax hike awaits most taxpayers, and the economy will experience significant fiscal drag.

According to the CBO, extending the 2017 provisions costs an [estimated](#) ~\$5 trillion over the 10-year budget horizon, taking interest payments on the higher debt into account. That leaves the deficit over 1pp of GDP wider annually on average relative to CBO's baseline in the 10-year window. That is, just preserving what is in place costs nearly \$5 trillion. And this estimate assumes the extension of elements of the original TCJA which were pay-fors, such as the elimination of personal tax exemptions and the cap on SALT deductions. The incentive to avoid hitting constituents with a tax hike is strong, but given the cost to maintain the status quo, the hurdle for any added stimulus is also high.<sup>(1)</sup> The debt outlook and deficit projections are already poor, and under any scenario would remain so. Inflating them by another \$5 trillion might be difficult for tax writing committees in Congress to stomach.

We do not assume that the Red Sweep would result in a simple extension of the of the TCJA, but we do assume the bulk of the TCJA would be extended and there would be a number of other modifications, which we detail in the below. In all, relative to the CBO baseline, we estimate the fiscal deficit would increase by \$4.4 trillion and run over 7% of GDP after 2028 — most of which would be the cost of maintaining the status quo — and this is not really "stimulus". An additional feature is a cut to corporate taxes estimated to cost about \$600bn over the 10-year window, which could be roughly fully funded by repealing the energy tax provisions in the Inflation Reduction Act (IRA). While many argue the IRA spending helps red states, Republicans in Congress have voted a remarkable 51 times to repeal it, and it is a central part of President Trump's platform. While not all of the IRA may be rolled back, most Republicans in Congress have voted for deep cuts already.

The other revenue item included in our deficit is tariffs. The challenge is estimating how much demand will fall in response to the increase in import prices (i.e. the tariffs). We estimate that since 2018/2019, the volume of US imports from China has dropped between 25% and 45% for items covered by the tariff increases, and the decline in China's market share in the US has greatly eroded tariff revenue.

For the much larger proposed tariffs in this episode (see our assumption in [Figure 12](#)), the incentive to substitute towards other goods/suppliers will be even stronger and

**A red sweep would put back in place the Republican control of government from 8 years ago.**

**Polling suggests slim majorities. Reconciliation likely the main tool for fiscal policy.**

**Unless Congress and the next President act, a large tax increase awaits most taxpayers in 2026.**

**The estimated cost of extending the tax cuts is nearly \$5 trillion, creating a big hurdle for any added ('real') stimulus.**

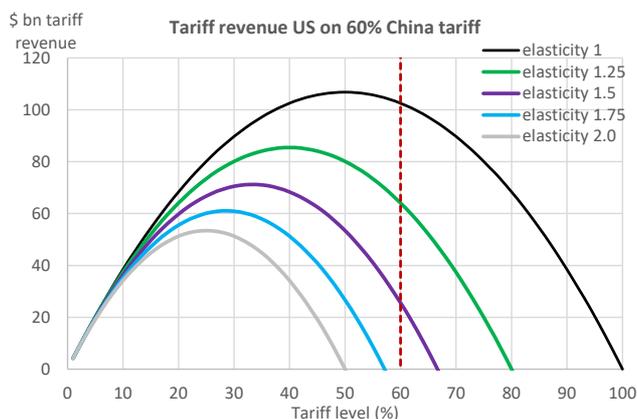
**Lowering the corporate income tax to 15% would cost roughly \$600bn over 10 years and could be funded by rolling back the energy tax provisions in the Inflation Reduction Act.**

**Tariff revenue will be highly sensitive to the size of the tariff on China and how much demand falls in response to it.**

<sup>1</sup> The tax increases would even affect the standard deduction, so taxes go up across the income distribution.

actual tariff revenue may greatly undershoot what the headline suggests.<sup>(2)</sup> [Figure 11](#) shows revenue raised for different tariff rates and demand elasticities. For instance, with demand elasticity of 2, as it seemed to be for large portions of tariffed goods in 2018/2019, a 60% tariff would imply a collapse in trade and no revenue collection at all (indeed, a tariff of 25% for that elasticity would be optimal). Alternatively, with an elasticity of 1, \$102bn could be raised annually (with the caveat that the ability to substitute away from goods increases over time), but the optimal tariff rate from a revenue perspective would be 50%. For the purpose of our fiscal calculations, we assume that with substitution effects the tariffs would raise ~\$375bn over the 10-year budget window.

**Figure 11: Tariff revenue is highly dependent on how much demand falls**



Source: UBS, Haver

**Figure 12: Assumptions on scope and timing for tariffs on China in the red wave scenario**

Tariff item	Starting date	Size of tariff	Imports affected (\$blns)	% of total imports
Tranche 1	01-Sep-25	60%	107	25%
Tranche 2	01-Jan-26	60%	107	25%
Tranche 3 - step 1	01-Mar-26	30%	107	12.5%
Tranche 3 - step 2	01-Jun-26	30%		12.5%
<b>Total</b>			<b>321</b>	<b>75%</b>

Source: UBS, Haver

Other policies could matter too, particularly regulation and immigration (we discuss tariffs in more detail later). We expect that on balance, a second Trump administration may favour deregulation compared to the current Biden administration, which businesses would likely perceive as a friendlier environment. As [Figure 14](#) shows, presidents have implemented "economically significant" regulations at an increasing pace over the years. "Economically significant" rules are regulations issued by executive branch agencies that meet the definition as given in [section 3\(f\)\(1\) of Executive Order 12866](#): "have an annual effect on the economy of \$100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or state, local, or tribal governments or communities."

**A second Trump presidency could be associated with significantly less regulation than a Harris administration, and might be perceived as more market friendly.**

Since 1980, the first three years of the Biden administration has delivered the highest average number of such rules per year (65.3) – with the pace picking up this year. The Trump administration was second, but many of the final year regulations enacted in 2020 pertained to the COVID-19 pandemic. Excluding 2020, the Trump administration implemented 39.3 per year, on average, well below the pace of the prior Obama administration (62.1) and a little below the Bush 41, Clinton, and Bush 43 administrations. This is potentially discounting part of a final year push that is increasingly apparent over time with the uptick in the pace of rules at the end of each line in the figure below. Counting regulations, regulatory costs, and the strength and direction of their cumulative economic impact is a difficult effort, and the actual macroeconomic impacts could be ambiguous. [Research by Richard Morgenstern](#), who served in the Environmental Protection Agency from the Reagan to Clinton administrations, found that when new environmental regulations were applied, some industries started shedding jobs but losses were offset by job creation in pollution abatement. With studies generally not suggesting a meaningful economic impact of the deregulation pursued during Trump's first term, we have not incorporated any specific growth uplift in our numbers.

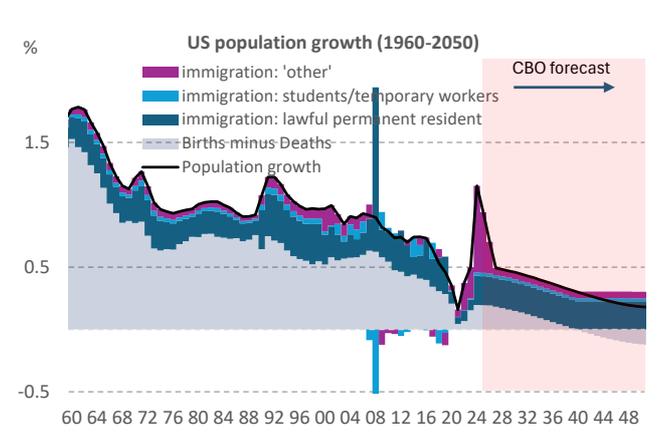
**Since the Reagan administration, the Biden administration has delivered the highest number of 'economically significant' regulations, while Trump's first term (excluding 2020) was in line with Bush 41, Clinton, and Bush 43.**

<sup>2</sup> We assume a 60% tariff but exclude a quarter of Chinese trade in the same way that Tranche 4B and other goods were excluded in 2018/2019. That would equate to a 45% weighted average increase in the import tariff from China.

By contrast, we expect that any shift in immigration could have a relatively large impact on our numbers. We did not model the [proposal for mass deportation](#), mainly because it is difficult to grasp the logistics. To deport 7 to 11 million people, say by school bus, would require 175K to 275K bus trips, some hundreds of miles, and in vehicles that go only 6 to 9 miles per gallon of gasoline. Plus, 7 million people would be equivalent to 4% of the labour force, and rank as the 17th most populous state in the nation, just behind Massachusetts. A population of 11 million would represent the 9th most populous state, larger than North Carolina and just behind Georgia.

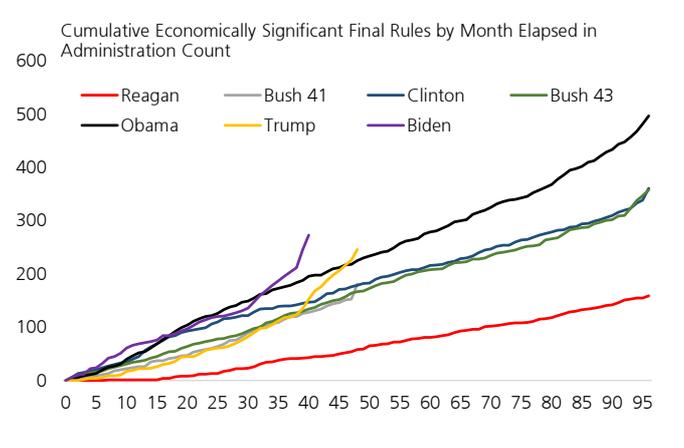
**The proposals on mass deportation (equivalent in size to deporting the population of New Jersey) strike us as unrealistic (logistically) and we have not incorporated them in our numbers.**

**Figure 13: Stopping the surge in 'other' (mostly illegal) immigration would reduce labour force growth by ½ pp**



Source: UBS, Haver, CBO

**Figure 14: Pre-pandemic, Trump administration enacted regulations on pace with Bush 41 and 43 and Clinton**



Source: Office of the Federal Register, Office of Information and Regulatory Affairs, The George Washington Regulatory Studies Center, UBS

However, we would assume under any outcome that US immigration is reformed. A bipartisan agreement reached this session of Congress appeared to have Republican support, and has now been supported by Vice President Harris. However, the severity of the restrictions at the border could matter. The US has in place guest and seasonal worker programs for specific industries, and the surge in net international migration appears to have helped ease nominal wage inflation. We estimate it lifted the civilian non-institutional population growth aged 16 and over from roughly 0.7% to 1.3% in 2023, in turn boosting potential GDP growth to 2.5%. We expect that impulse is already fading, but the extent to which it falls would depend in part on how much the next White House slows population growth.

**However, we do expect immigration to be curtailed, possibly reducing population growth by ½ pp relative to the peak in 2023.**

Finally, a word on the time frame and implementation risk. Congress will need to address the debt ceiling in 2025. If it spends too much time on other issues and not enough on writing new tax policy, it may simply delay and extend the current tax code a year, raising uncertainty for households and businesses into 2026.

## Box 1: Fiscal Policy Assumptions Under a Red Sweep

The core of Former President Trump's [plans](#) is the full extension of the expiring provisions from the 2017 Tax Cuts and Jobs Act (TCJA). The majority of these provisions pertains to the individual side of the tax code: fully extending the tax brackets in the TCJA, maintaining the more generous thresholds for the alternative minimum tax, and increasing the standard deduction. These provisions will likely reduce revenues ~\$4.4trn over the 10-year budget window. We also expect some 'pay fors' remain in the extension. The original TCJA included a \$10K cap on the State and Local Tax (SALT) deduction that people could apply to their federal tax returns. Despite Former President Trump recently [proposing](#) allowing the cap to expire at the end 2025, we assume [Republicans](#) increase it to \$20K for joint filers to remove the in-built 'marriage penalty'. This would increase revenues by \$1.1 trillion relative to removing the cap entirely, as would be the case if the provision expires.

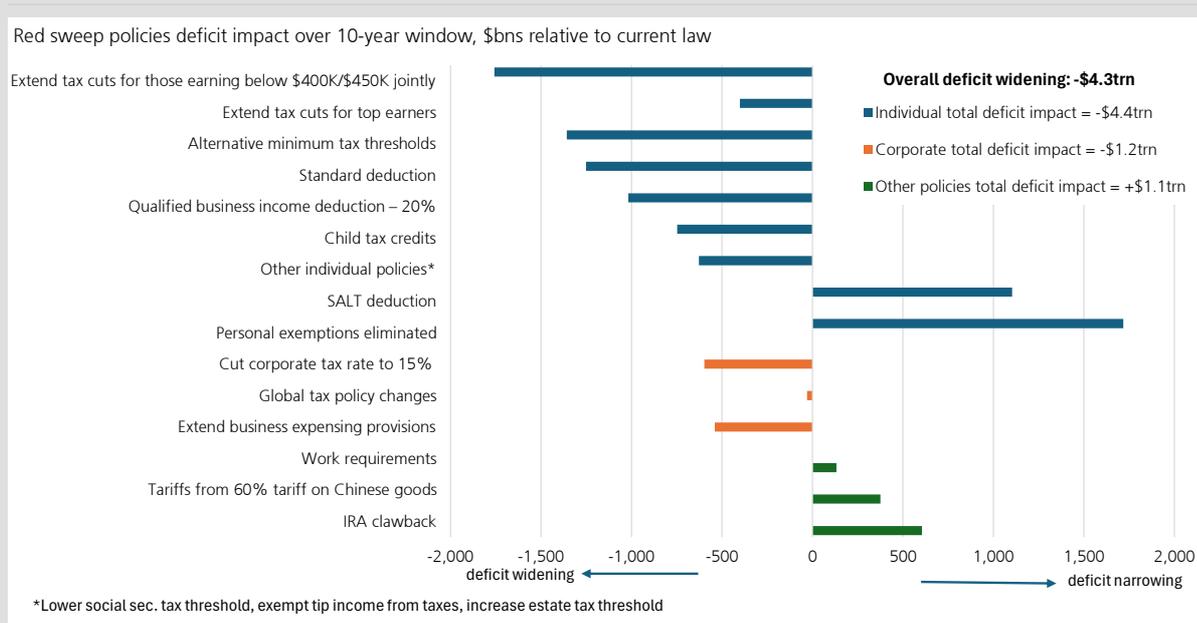
Other elements of the Trump campaign's fiscal plans, such as the tax exemption of tips and social security payments, are relatively inefficient from a policy perspective. It is unclear whether former President Trump wants to eliminate both income and payroll taxes from tip income, but [estimates](#) from the Yale budget lab found that such a policy would lower revenues by \$184bn over the 10-year budget window (if enacted from 2026 onwards). This estimate is static and does not account for behavioral shifts; with greater incentives to declare all income as tip income, it is probably a lower bound. Game-proofing the policy requires new definitions of income to regulate eligibility. Furthermore, it may not prove that beneficial for intended recipients; the Yale budget lab [estimates](#) that fewer than 3% of families would benefit from the income tax deduction for tips in 2026. Similarly, the proposal to exempt social security benefits is [estimated](#) by the CRFB to cost \$1.6-1.8trn over the 10-year window and it strains the sustainability of the social security system. We have [written](#) before about the exhaustion of the Old-Age and Survivors Insurance (OASI) trust fund moving into the budget window; this policy could bring it further forward by a year to 2032, and bring forward the Medicare Hospital Insurance (HI) trust fund exhaustion by six years to 2030.

On the corporate side, we assume that the corporate tax rate will be lowered to 15% in a second Trump term, reducing revenues ~\$600bn over the budget window. We further assume that several global taxation policies are allowed to expire — reverting to smaller deductions — but that business expensing provisions are extended.

Other potential plans in a second Trump presidency include the clawback of Inflation Reduction Act funding; the JCT [estimates](#) that scrapping the energy tax provisions in the bill could raise ~\$605bn in forgone spending over the 10-year budget window. The Republican party is [divided](#) over potentially repealing elements of the IRA given [evidence](#) that red states have on average benefited to a greater degree from the legislation. But with many Republicans and President Trump persistently [proposing](#) such rollbacks, we assume some elements will be cut. In the red wave scenario we further assume that 60% tariffs are enacted on 75% of Chinese goods imports, stopping short of taxing consumer goods which could prove more costly to tariff. We suppose that with substitution effects, the tariffs would raise ~\$375bn over the 10-year budget window.

Tallying it all up, the deficit would potentially widen \$4.4trn over the budget window relative to the CBO baseline where many current tax deductions would have expired. However, the vast majority of this spending is meant to keep the existing tax code in place rather than significantly cutting personal taxes, with the tip and social security proposals helping only at the margin. The corporate tax cut could potentially spur a little growth – Q4/Q4 growth could be ~0.2pp and ~0.1pp higher in 2026 and 2027, respectively, relative to baseline. However, combining this domestic tax policy mix with harsher China tariffs implies that deficit-widening relative to current law may not be all that stimulative for growth.

**Figure 15: Main fiscal measures assumed under a red sweep scenario**



Source: UBS, CRFB, Penn-Wharton, CBO, Tax Foundation

## Scenario 2: Blue Sweep

Vice President Harris revived the Democratic ticket to such an extent that, with the White House within distance, down-ballot momentum has boosted the odds of Democrats retaking the House of Representatives and potentially holding on to the Senate. An outcome we did not even address in our [election compendium](#) this summer is now a realistic possibility, even though odds of Democrats winning the Senate remain slim.

Although Vice President Harris has tried to stake out differences from President Biden on the campaign trail, much of her policy platform echoes the President's former proposals. In addition, some expected policies like expanding the child tax credit have a template from 2020 legislation, and remain popular among Democrats on Capitol Hill.

We describe our fiscal policy assumptions under a Blue Sweep scenario in the box below. We expect a Blue Sweep would likely result in more fiscal consolidation than a Red Sweep or gridlock. While we expect the upper marginal tax rates to rise, we also expect Vice President Harris to follow through on her pledge to freeze tax increases on households earning under \$450K a year. We also expect one relatively costly proposal to be enacted—the expansion of the child tax credit, a Democratic party policy priority. However, Democrats have also campaigned on, and proposed, taxes to help offset some of the costs. We expect the blue sweep agenda of higher corporate taxes, capital gains taxes, and taxes on high income households to cover more of the cost of other priorities than other potential political outcomes.

All tallied, the fiscal package would leave the deficit in 2027 1% of GDP lower than under a Red Sweep, though still ½ pp of GDP higher than in the CBO baseline where most provisions expire ([Figure 16](#)). It is thus less drastic than the CBO baseline but remains contractionary, costing a few extra tenths of growth compared to the Red Sweep scenario ([Figure 17](#)).

Much of the remaining policies of the Biden administration remain in place. We see some scope for compromise over the Vice President's proposed manufacturing tax credit, for example. We assume that immigration is curbed in this outcome, too. The Vice President and many Democrats appear to have supported the negotiated bipartisan immigration reform. The issue is important enough to both parties that some action seems likely, and if Congressional majorities are thin, some compromise would be needed. The White House could also use executive authority to address parts of the issue even without legislation. While a Harris administration may not clamp down in the same way as a Trump administration, one way or another, the flow of migrants over the southern border is a political problem and policies to slow that flow seem likely one way or another, in our view.

**The odds are still against Democrats winning the Senate but, compared to this summer, it is now at least a possibility.**

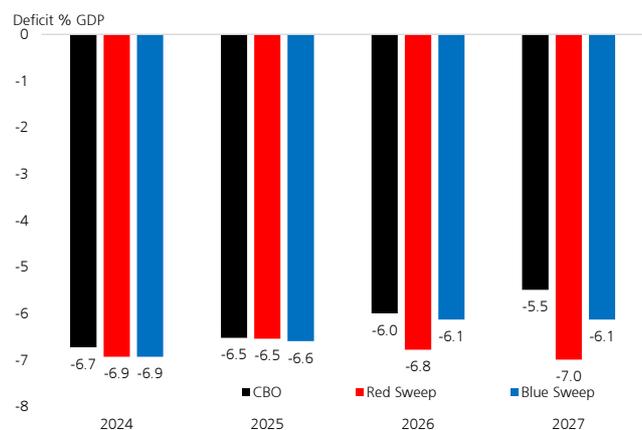
**Many of Harris' proposals echo those of President Biden.**

**The expansion of the child tax credit is the most expensive new proposal.**

**Compared to the Red Sweep scenario, Harris has more funding and fiscal deficits would be roughly 1% of GDP lower (though still high).**

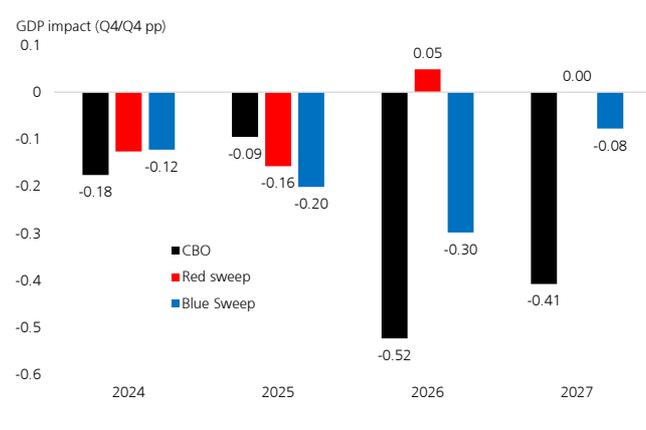
**We assume the flow of migrants is curbed, though perhaps through different and less aggressive means than under a Trump administration.**

**Figure 16: Fiscal deficits (red, blue, CBO)**



Source: UBS, CBO, Haver

**Figure 17: Growth impulse (red, blue, CBO)**



Source: UBS, CBO, Haver

## Box 2: Fiscal Policy Assumptions Under a Blue Sweep

Despite Vice President Harris' campaign proposal to raise taxes on upper income groups and corporations to fund more generous transfers to lower earners and families, we estimate that a Blue Sweep would still see the deficit widen ~\$1.8trn over the 10-year budget window relative to current law.

In the extension of the expiring TCJA provisions, the Harris campaign has proposed returning the top tax bracket to 39.6% for single filers' earnings over \$400K and joint filers' over \$450K, as was also proposed by the Biden administration. This policy could offset the widening from extending for other income groups by ~\$400bn over the budget window, meaning the total cost of bracket extension for all other groups would be ~\$1.7trn in lost revenues.

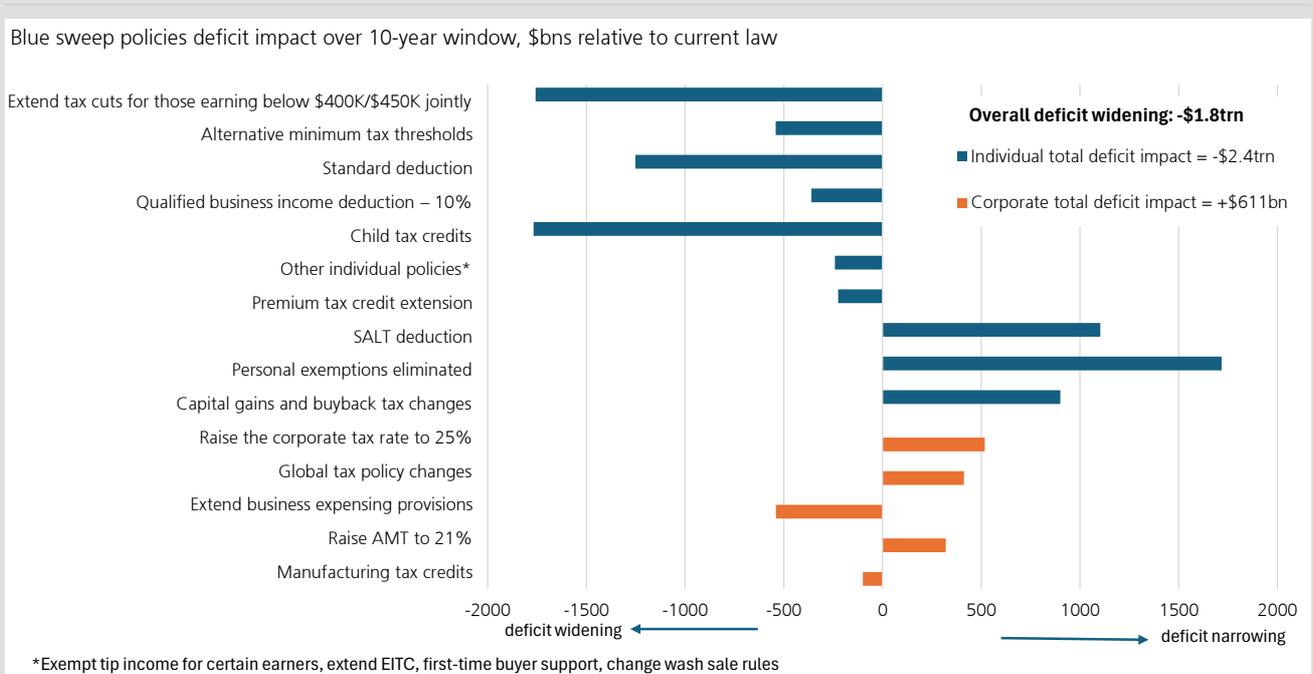
The Harris campaign has also put forward extending the generosity of child tax credits, going beyond the Biden administration's own proposals, increasing credits to \$3.6K for children under the age of five, to \$3K for children over five, raising the age of eligibility to 17, and making the credit fully refundable for households who do not earn enough to claim the deduction against their tax liability. The Penn-Wharton budget model [estimates](#) this would lower tax revenues by ~\$1.8trn over the budget window.

Other policies that would lower revenues are the extension of the changes to the Earned Income Tax Credit (EITC), which were made in the American Rescue Plan Act (ARPA), proposals to support first-time home buyers, and the extension of the premium tax credits in the ARPA and IRA. The Harris campaign has also proposed exempting tip income from taxes, although this policy is narrower in scope than in the Trump campaign platform and is aimed specifically at income tax deductions in specific leisure and hospitality industries, [estimated](#) to cost \$62bn over the 10-year window.

Offsetting these policies, the Harris campaign has proposed a 25% minimum tax for households with net wealth over \$100m, an increase in the ordinary capital gains tax rate from 20% to 28% for households making over \$1m, and an increase in the tax on buybacks to 4% from 1%. The Harris campaign also expects to raise revenues by upping the corporate tax rate to 28%, although we expect the increase could be limited to 25%. The alternative corporate minimum tax was repealed in the 2017 TCJA but was brought back by the Biden administration as part of the IRA and Vice President Harris has proposed raising it from 15% to 21%. On global tax policies, as in the Biden administration's 2025 FY budget, we expect that the tax rate for global intangible low-taxed income (GILTI) would be raised from 10.5% to 21%, with revisions to rules to allow tax to be calculated on a jurisdiction by jurisdiction basis. We also expect the reduced rate of tax for foreign derived intangible income (FDII) to be repealed.

Overall, despite a number of revenue raising proposals, the Harris campaign policies are likely to widen the deficit by ~\$2trn over the 10-year budget window. Balancing the tax hikes on upper incomes and corporations and tax cuts for the lower end of the income spectrum, we estimate Q4/Q4 growth would be ~0.3pp and ~0.1pp lower in 2026 and 2027, respectively, in the Blue Sweep scenario relative to our baseline.

**Figure 18: Main fiscal measures assumed under a blue sweep scenario**



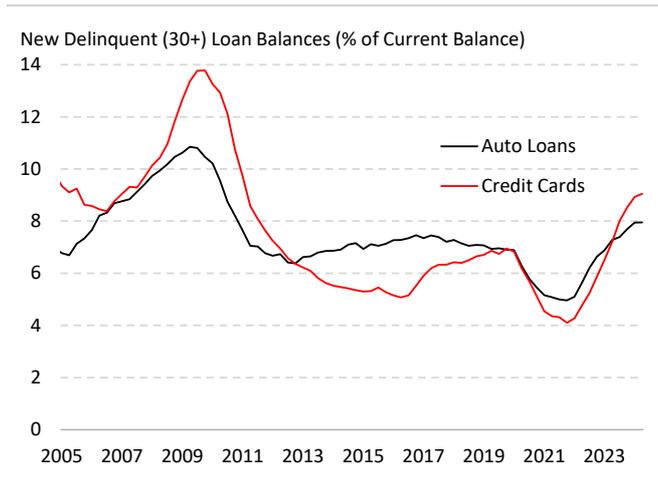
Source: UBS, CRFB, Penn-Wharton, CBO, Tax Foundation

## Scenario 3: US Recession

For all the good news on the economy, signs of household stress have spread. Credit card and auto loan delinquencies are near or above GFC levels (Figure 19). The highly liquid balance sheets have now completely evaporated for the bottom 80% of the income distribution (Figure 20). Even among the wealthy, the post-Covid spending spree may run out of steam. Fiscal policy may have pushed up the level of activity in the economy, but not necessarily the growth rate. If spending of upper income households simply levels out, a key support for growth would erode. Despite the appearance of resilience, with fiscal support in the rear view mirror, we think the expansion looks narrowly driven and vulnerable.

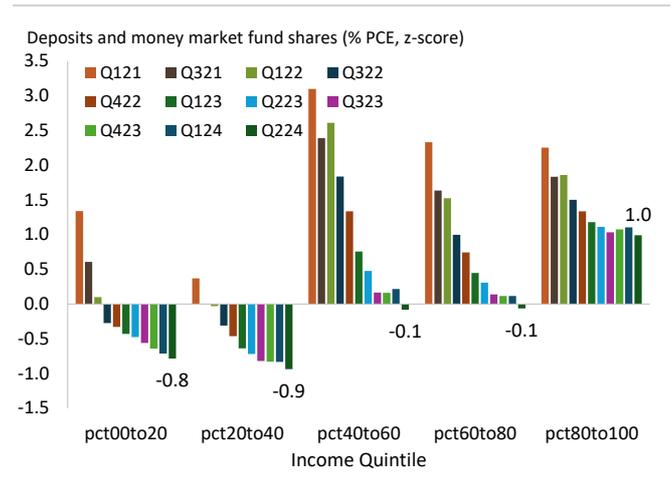
**There are signs of increasing distress at the bottom end of the income distribution.**

**Figure 19: Credit card and auto loan delinquencies are the highest since the end of the global financial crisis**



Source: Federal Reserve Bank of New York/Equifax, Haver, UBS

**Figure 20: The excess saving built up during the pandemic is gone except for the top quintile of the income distribution**



Source: BEA, Federal Reserve, Haver, UBS

At the moment, orders of capital goods look flat. Business surveys paint a mixed picture at best. Commercial real estate, multifamily construction, and even intellectual property investment have slowed sharply or are in contraction. Government current and capital expenditures are slowing, too (government spending and investment in H1-24 grew at half the pace of the four quarters ending in 2023Q3). The deceleration is expected to continue as federal budget caps bite and state and local government budgets come under increasing pressure. Plus, the heightened uncertainty surrounding tax policy with the looming expiration of the 2017 tax cuts could reasonably be expected to restrain business expansion plans, investment, and hiring.

**Business surveys look mixed at best, parts of investment and construction are slowing sharply, and slower government spending is starting to weigh on activity.**

A key feature of the US economy has been that the cyclical, interest-sensitive part of the economy has looked recessionary for a while. Our hard data recession model continues to show roughly half of the 16 lead indicators giving a recession signal (Figure 23), even if on average those leading indicators have improved YTD (Figure 24), and the recession probabilities have recently fallen somewhat (Figure 21). What has been unusual is that this weakness, thus far, has not managed to pull the economy as a whole into recession. We attribute that largely to the enormous fiscal stimulus during Covid, which bolstered household liquidity buffers, and allowed consumption, and demand, to remain unusually strong.

**The cyclical, interest-sensitive part of the economy has looked recessionary for a while, but strong consumption has broken the usual transmission link.**

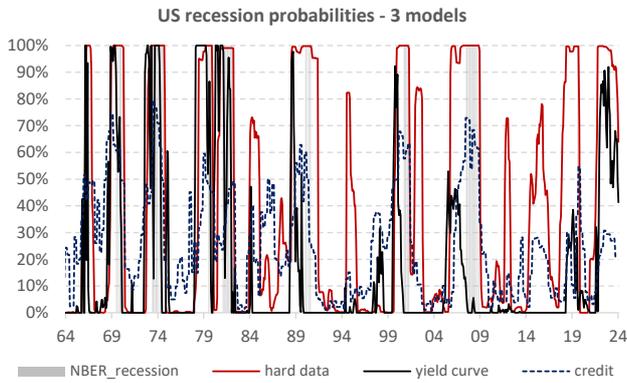
Under this scenario, however, we assume that consumer spending continues to slow and the already tepid business sector deteriorates further. Consumer inventories would rise, prompting a production pull-back and destocking of intermediate inputs. The nature of the consumer slowdown is one where liquidity constraints for lower income cohorts are increasingly binding, while upper income households' spending levels off (after taking three vacations in 2024, two are planned in 2025). The wave of relocations and associated activity ends. So-called revenge spending is over. After several years of rapid spending on goods, Americans simply need less "stuff."

**In this scenario that changes: consumer spending finally slows to the point of breaking corporate confidence about demand.**

The slowdown in consumer spending in 2024Q4 is followed by confirmation of that slowing in 2025Q1, and sets in train a vicious cycle. Businesses see their fears of slower demand validated and the retrenchment feeds upstream and across business sector activity. Business investment and expansion plans slow, and hiring follows, as firms seek to align plans with stalling economic growth. Without new jobs, the stream of layoffs has no outlet and payrolls start to contract. Less spending feeds into lower hiring which feeds into lower spending and rising precautionary saving. The negative feedback loop of recession sets in. As we show in [Figure 22](#), from peak to trough, the level of US GDP declines by roughly 1/2 pp, in line with other relatively mild US recessions in the past.

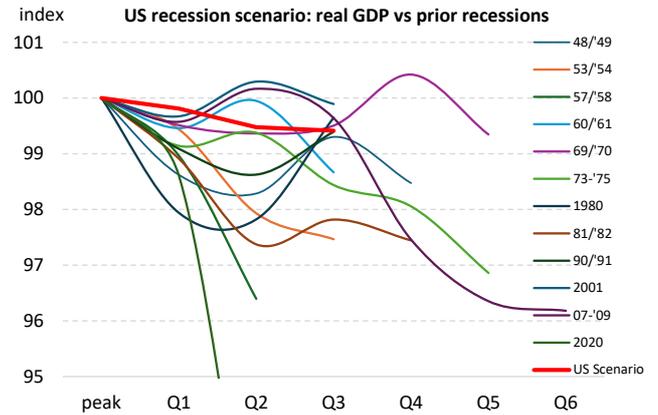
**Less spending feeds into lower hiring (negative payroll growth) which feeds into lower spending and rising precautionary savings.**

**Figure 21: Our three US recession models show a falling, but still elevated, recession probability**



Source: UBS, Haver

**Figure 22: Our assumed US recession scenario is reasonably mild relative to prior post WW-II recessions**

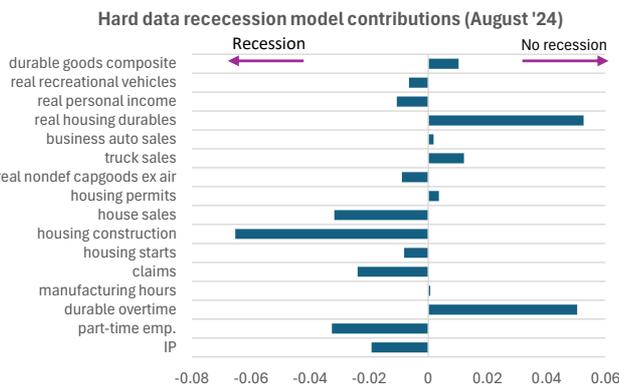


Source: UBS, Haver [Note: chart shows real GDP in index form for the recession quarters through to the trough (the last quarter before the recession ended.)]

In this scenario, the Fed's rate cuts are insufficient (because of monetary policy lags) or do not come fast enough to arrest the negative feedback loop setting in. But in response to the sharper-than-expected slowdown, and falling employment, the Fed shifts policy from removing excess restrictiveness to outright accommodation (rates well below "neutral"). Knowing QE and forward guidance are controversial and caused problems in the pandemic, the FOMC pushes the funds rate as low as it will go to prevent job loss and restart activity. The target range is taken back to the zero lower bound, prompting a subsequent resurgence in activity.

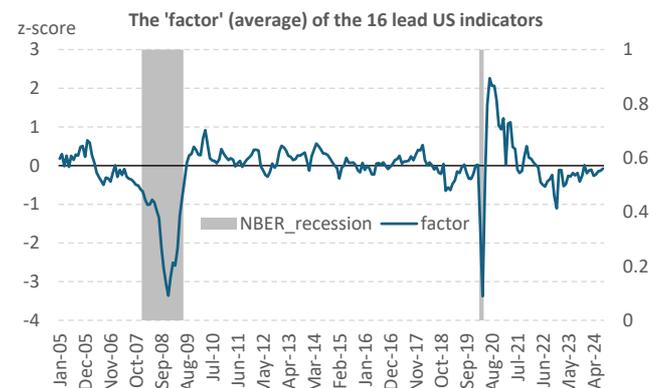
**The Fed, realizing that it needs to be outright accommodative rather than just less restrictive, takes the Fed funds rate back to the lower bound.**

**Figure 23: US hard data recession model - contributions**



Source: UBS, Haver

**Figure 24: On average, the 16 lead indicators for the US economy have been drifting back up toward their long-run average**



Source: UBS, Haver

## Scenario 4: Tariffs increase globally

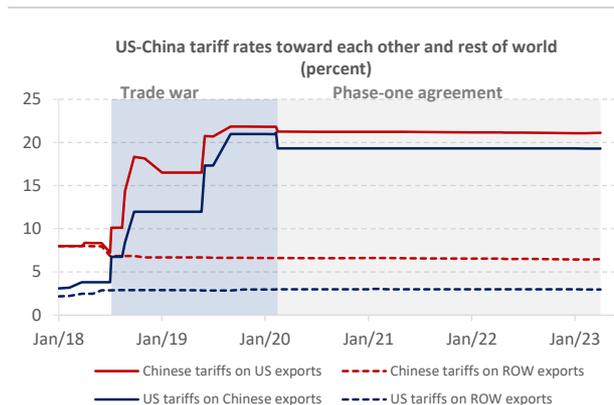
One of the most consequential proposals put forward by former President Trump is to increase the level of [US tariffs on China to 60%, and on the rest of the world to 10%](#). While it may be tempting to view this merely as an extension of the policies pursued in 2018-2020, the proposed tariffs are 5x larger in USD terms (tariff \* amount of trade involved – see [Figure 27](#)).<sup>(3)</sup> Moreover, a tariff on all trade partners – if implemented – would be much more difficult for everyone to circumvent. Even assuming that demand for tariffed goods falls 1 for 1 with the tariff (unit elasticity), as was roughly the case in the first 12 months with the 2018/2019 tariffs, US customs duties as a share of all US imports would revert to a level not seen since 1935 ([Figure 26](#)). And overall US imports would fall by 17% or so.<sup>(4)</sup>

**The proposed 60% tariff on China and 10% on the rest of the world, would be 5x larger than the tariff escalation in 2018/2019.**

The proposed tariff levels may be 'campaign numbers' but directionally this appears to be the policy thrust. We would expect any new tariffs on China (again under Section 301) to be phased in (as before), with a notice and comment period, and hearing, before implementation. Even if a second Trump administration moves quickly, additional tariffs on China would likely not be in place until the second half of 2025. The plan to impose a 10% tariff on all US imports could prove more complicated: absent new legislation, various authorities would need to be pieced together, and under some of these only temporary tariffs are allowed. Given competing priorities (immigration, regulation and an extension of the tax cuts), in our view this would likely be a '26 issue. It is also possible that the RoW tariffs end up being much narrower, given that the US trade imbalance is relatively concentrated on just a few countries.

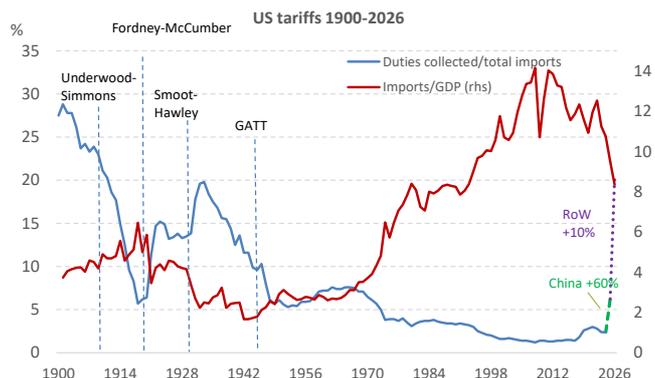
**Should such tariffs be implemented, we believe the legal process would make it unlikely that China tariffs are implemented before the second half of 2025 (we assume September) while RoW tariffs would be a 2026 event.**

**Figure 25: The tariff escalation in 2018/2019 was large.....**



Source: UBS, Haver, Peterson Institute

**Figure 26: ...but barely registers on this 100-year chart that also shows the newly proposed tariffs**



Source: UBS, Haver [Chart assumes imports decline with unit elasticity in response to the tariffs, so a 60% decline in imports from China and a 10% from the rest of the world.]

For the purpose of modelling this scenario, we have assumed a straight 60% tariff on China kicking in in Sep '25 and the 10% RoW tariff in Jan '26. We also assumed the tariffs would be announced a quarter before they go live, allowing the market to anticipate the tariffs before they kick in. We expect markets to be very sensitive to the timing of such tariff announcements. [Baker, Bloom and Davis \(2019\)](#) find that trade policy news caused nearly 40% of all jumps – defined as a change of plus or minus 2.5% – in the US stock market between January 2018 and August 2019. In the previous 117 years, trade drove only 0.6 percent of stock market jumps.

**Nearly 40% of all US stock market moves > 2.5% in 2018/2019 were driven by tariff announcements.**

3. The US weighted average tariff increased 2.8pp in 2018/2019, with the average tariff on China increasing 17.5pp and that on the rest of the world (mostly tariffs on steel, aluminium) 0.4pp. The retaliation by China lifted its weighted average tariff on the US by 15.6pp and its weighted average tariff on all trade by 1.4pp. By contrast, the 60% China and 10% RoW tariff would amount to a nearly 17pp increase in the US weighted average tariff on all trade, 5x greater than '18/'19.

4. For context, [the tariffs on electric vehicles, batteries, semiconductors and steel & aluminium](#) (ranging from 25% to 100%), [announced by the Biden administration in May](#), apply to roughly \$18bn in goods, or about 3½% of what is being proposed by Trump. We assume that Harris would keep in place most of the existing tariffs implemented under Trump 1, and would continue to apply export restrictions for technological inputs, in particular.

We have taken two approaches to modelling the impact of the tariffs. First, we have asked our economists for bottom-up estimates of the tariff impact. The drawback of this approach is that while it is one thing to calculate bilateral tariff impacts, it becomes incredibly complicated when multiple countries are involved, given the interlinkages in supply chains, multiple currencies, different pass-through and price flexibility in different countries, etc. It is unlikely that any individual analyst would be able to correctly internalize how all the moving parts would affect the country they cover. At the same time though, regional economists have the best sense of how local parameters would adjust.

The first approach to modelling the impact was to ask our economists; that gives us aggregated bottom-up estimates.

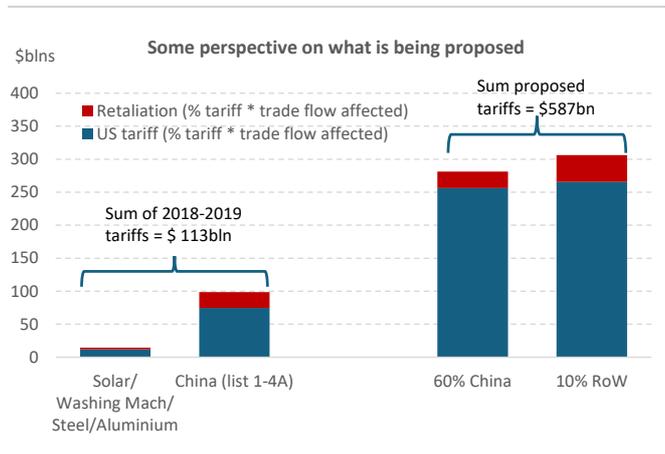
Second, we built a global model to analyse the effect of tariff policies on the joint equilibrium determination of output, inflation and exchange rate of trading partners. The model is complex (see the Box below for an intuitive explanation, and the Appendix for more detail) and involves numerous decisions about currency invoicing, exchange rate changes, supply chains, price flexibility, import substitution and margin absorption, for instance. We run a benchmark simulation off our preferred specification and parameter choices, but also run 16 alternative scenarios that emphasize a particular, a priori important dimension of the model to which results may be sensitive. The aim of the model is not to generate a point estimate of the impact of a tariff – that would be false precision given the sheer number of assumptions that go into it. Rather, the aim is to show outcome ranges, to give the reader a sense of plausible orders of magnitude, and to show what parameters/dimensions have the greatest impact. We then compare those outcome ranges to the bottom-up estimates.

The second approach was to build a global general equilibrium model that jointly determines output, inflation and exchange rates of trading partners.

One of the critical inputs into estimating the impact of the tariffs is how other countries might respond. Indeed, we can show with the global model how the absence of retaliation could lead to growth-increasing outcomes for the US (and very large ones if the US were to also use the tariff revenue to subsidize exporters so that they don't lose market share as the currency appreciates). In 2018/2019, there was near symmetric tit-for-tat by the EU, for instance, on the steel tariffs, and China responded symmetrically (with a 25% tariff of its own on the same dollar amount of goods) to List 1 and List 2 tariffs imposed by the US. For the later tariffs (List 3 and List 4A) China responded with lower tariffs, and it was also unable to match the goods covered by the US tariffs, as its imports from the US were just one third of the US imports from China (that imbalance persists today, as per [Figure 28](#)).

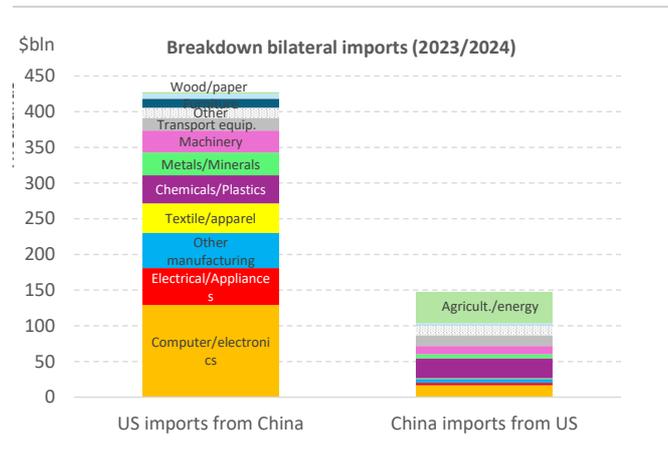
During 2018/2019, there was an attempt to match the US tariffs in retaliation, but this was constrained by the relative size of trade (China's imports from the US were only one third the size of US imports from China).

**Figure 27: Newly proposed tariffs compared to the 2018/2019 tariffs**



Source: UBS, Haver, [The US-China Trade war and Phase One Agreement](#) [Note that the retaliation assumption for the proposed tariffs is 15% by China and 3% for the rest of the World]

**Figure 28: Composition US vs China trade**



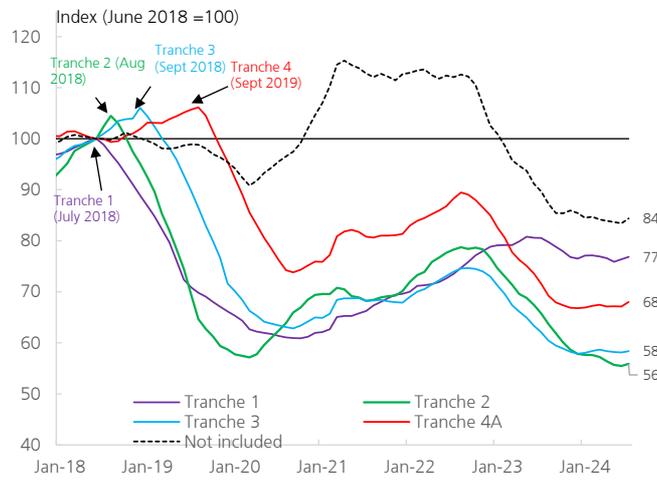
Source: UBS, Haver, US Census Bureau

We have asked our economists for the most likely response to the US tariffs, and summarize the results in [Figure 32](#). Perhaps surprisingly, the bottom-up expectation is that trade partners would raise their tariffs by only about a quarter of the US tariff: China would raise its tariff by 15½% compared to the US's 60%, and the rest of the world would on average (trade-weighted) lift duties on US imports by 2.7% compared to the 10% US tariff increase. This is in many cases because of a desire to 'maintain good relations with the US', or because imports from the US are small and there is an attempt

This time around, our economists guesstimate that, on average, tariffs would increase by only a quarter or so of the US tariff increase.

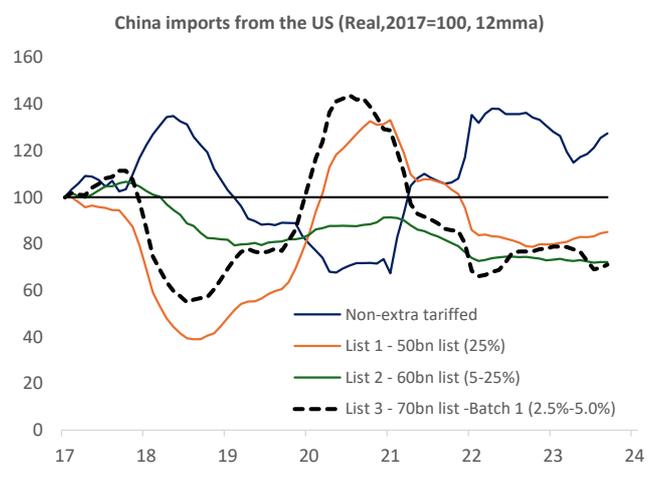
to be seen to be doing something while at the same time trying to de-escalate.<sup>5</sup> Because the dollar amount of imports from the US is smaller than the dollar amount of imports by the US from the RoW, the dollar amount of retaliation is also significantly smaller than the amount affected by US tariffs (Figure 27). It is possible, of course, that other ways are sought to retaliate (in 2018/2019 we assumed 'ad valorem equivalents' when estimating the retaliation), for instance a buyer strike on US imports, but we have not modelled that in what follows.

**Figure 29: Real US imports from China**



Source: UBS, Haver

**Figure 30: Real China imports from US**



Source: UBS, Haver

Finally, are there any other lessons from the 2018-2020 episode? Yes. Most of the literature finds that the [US bore +90% of the cost of its own import tariffs](#) (see also [here](#)), in so far as Chinese firms [did not lower their pre-tariff price](#) to preserve market share (and indeed the volume of imports fell sharply). However, the impact on inflation was muted as [costs were absorbed in profits rather than passed to consumers](#). With much larger tariffs the scope to do that is diminished.

The elasticity of imports relative to tariffs was found to increase over time as it takes time for firms to reorganize their supply chains. We show in [Figure 29](#) how much US imports from China declined in inflation-adjusted terms, and in [Figure 30](#) how much Chinese imports of US goods responded to their tariffs. On average, US imports of tariffed Chinese goods fell by 36%, while in market share terms ([Figure 31](#)), the decline was even larger. By contrast, China's imports of tariffed goods showed a resurgence in 2020-2021, largely in an attempt to (partially) abide by the [Phase One deal](#), it seems. There is little to [no evidence that tariffs had helped employment](#), as the higher cost of production and the cost of retaliatory tariffs outweighed the benefit to protected industries (e.g. [steel-consuming jobs vastly outnumber steel-producing jobs](#)).

The evidence on trade diversion is mixed (see [here](#), [here](#) and [here](#)), partly because it is difficult to measure (e.g. a product with a specific Chinese product code may have a different tariff code when sold by another country). Vietnam, Mexico, Taiwan, Canada and Korea have, however, [sharply increased their US market share](#). Some of that shift looks like China diverting exports to the US via third countries, though [half of the increase in imports from China are for consumption in Mexico, not re-exports](#). We believe the US is likely to invoke the 'sunset clause' in the USMCA in order to tighten rules of origin and minimum content requirements for manufactured goods.

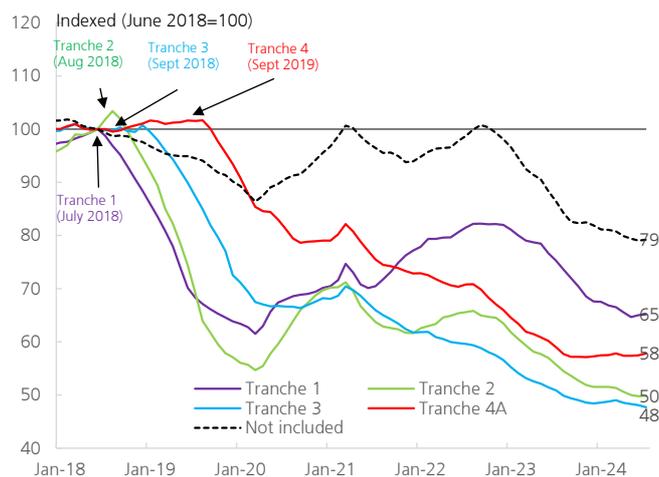
**Most of the literature suggests that the costs of the US tariffs in 2018/2019 were borne by the US, in that Chinese firms did not lower prices to preserve market share.**

**But the volume of imports from China (and its market share) fell sharply, by 22% in the first year, on average, and by 36% after 5 years).**

**We expect significantly more focus on 'rules of origin' to avoid tariff circumvention.**

<sup>5</sup> In the global model, by contrast, we have assumed the RoW adopts a 5% tariff, so equal to half of the US tariff, and China a 15% tariff].

**Figure 31: China's loss of market share in the US**



Source: UBS, Haver

**Figure 32: Retaliation assumption**

	US tariff	Retaliation	as % US tariff
Canada	10	0.1	1
Japan	10	none	
Australia	10	none	
New Zealand	10	none	
Switzerland	10	none	
Eurozone	10	3.0	30
UK	10	3.0	30
Korea	10	none	
Taiwan	10	none	
Hong Kong	10	none	
China	60	15.5	26
India	10	none	
Philippines	10	none	
Singapore	10	none	
Thailand	10	none	
Indonesia	10	none	
Malaysia	10	none	
Türkiye	10	none	
Poland	10	2.9	29
South Africa	10	none	
Brazil	10	none	
Mexico	10	10.0	100
<b>Trade-weighted average tariff</b>		4.0	26.7
<b>Trade-weighted average ex-China</b>		2.7	

Source: UBS

### Box 3: UBS Model for global tariff impact simulation

The global tariff model serves as a cross-check to the aggregation of country forecasts. It provides a global view of the joint equilibrium determination of the output, inflation, and exchange rates of trading partners. The model is run on a 3 country setting: US, China, and the rest of the world (ROW). The full description of the model is here ([link](#)), but the rough logic of the exercise is as follows:

Suppose we restrict ourselves to the US and China. The US imposes a 1% tariff on US imports from China, which are priced in RMB. Assume to begin with that the dollar appreciates (1-A)% so that import prices in dollars increase by A% (more on this below). Assume further that Chinese exporters absorb a fraction 1-B of the price increase in their margins, so the import prices would only increase by BA%. Even further, suppose importers in the US themselves absorb a fraction 1-C of the import price before passing on goods to final demand; the effective increase in the price of consumer imports is now CBA%.

On the production side, assume inputs are a share D of costs, with a fraction E of imports. Therefore, assuming other costs are held constant (wages in particular), marginal costs increase EDCBA%. But domestic producers absorb a fraction 1-F of the cost increase, passing on F to final consumers, so domestic prices increase FEDCBA%.

The US deflator is G% domestic price, (1-G)% import price, so the increase from the tariff is [GFED+(1-G)]CBA%.

US exporters sell abroad in dollars off the same marginal cost base as domestic producers; therefore, with the appreciation of the dollar, import prices in China increase [FEDCBA+(1-A)]%. Suppose China has the same share of imported costs as the US and same margin absorption, costs increase in China by FDE[FEDCBA+(1-A)]%, kicking off a second round of imported cost increases in the US.

Through monetary policy, nominal domestic demand is held steady. With unit demand elasticity, quantities change one-for-one with prices (negatively). Suppose that in the US, domestically produced goods' share of nominal output is H while US exports are a share I of China's nominal output. With the above iteration on prices landing with a J% increase in domestic prices and a K% increase in export prices, US GDP drops by (HJ+IK)%, with a similar calculation for China.

Now return to the very first assumption, the (1-A)% dollar appreciation. It is in fact not exogenous, but determined by balancing out the trade flows induced by the changes in the relative prices of exports and imports and demand for domestic and imported goods. It could well be that the combination of pass-throughs and demand shifts described above warrant a depreciation instead. In any case, the exchange rate adjustment kicks off another round in the whole convergence process towards equilibrium.

This chain of reasoning highlights the importance of several modelling choices. (i) how much domestic producers, importers and exporters absorb price changes in their margins; (ii) the invoicing denomination of exports; (iii) the degree of 'roundabout' pricing coming from the cross-border input network—shorthand for supply chains—as one firm's output price in country i is another's input cost in country j; (iv) elasticities of final demand (of consumers) and of demand for inputs (producers); (v) the degree of wage flexibility to offset tariff effects on marginal costs; (vi) the possibility of import substitution via a third country; (vii) the adjustment in general equilibrium of the exchange rate, which depends on (i-vi). The model accounts for all these features and is calibrated according to the latest academic research (much of which was inspired by the first Tariff war in '18-'19). The appendix describes the alternative scenarios that we run to test sensitivity to important modelling decisions.

## Scenario 5: Central Banks eased too early

Close to 70% of all the central banks under our coverage in DM and EM have now started lowering interest rates, despite the fact that [the monthly run-rate of inflation, especially in DM, is still running well above pre-pandemic levels \(Figure 33\)](#) and 63% of all central banks are still missing their inflation targets ([Figure 36](#)). [Figure 34](#) shows how, collectively, central banks are now easing at a historically fast pace, at least outside of recessions.

**Central bank easing has started despite still elevated run-rates of core inflation, and 63% of central banks missing their inflation targets.**

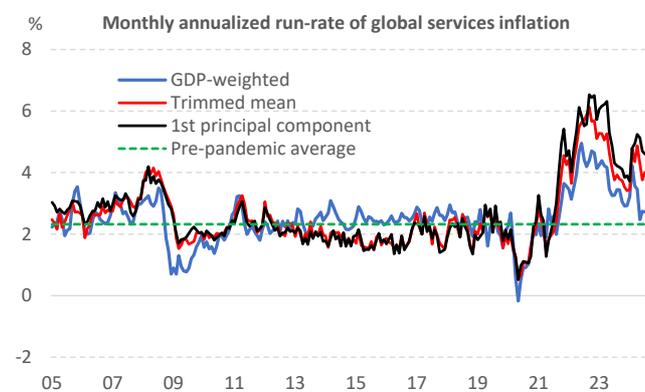
The logic of 'why cut now?' is that the level of interest rates is still restrictive (+real rates are rising as inflation recedes), labour markets are slackening, and the lags of monetary policy are long; so interest rates can start to converge back towards neutral levels, well before inflation has fully normalized. It is also consistent with the analysis done by [Bernanke and Blanchard](#) on the nature of the inflation shock: a perfect storm of supply shocks that should largely dissipate on their own, without much of a contribution from tight labour markets. Whereas last year a popular central bank narrative was that more labour market slack was necessary to bring inflation under control, the defence of easing is now partly to avoid undue labour market weakness.<sup>(6)</sup>

**The logic of the 'why cut now?' seems to be in part to ward off potential further slowing.**

All that said, we are not aware of prior episodes where this much easing was priced by markets when labour markets were still this tight ([Figure 35](#)). In terms of the cuts that are coming, it is still relatively early days in DM: Canada and Switzerland have each cut three times, but generally, we are into only the first or second cut. EM is more advanced, mirroring its better disinflation dynamics, with Hungary and Peru for instance already having cut more than 10x, and others such as the Czech Republic, Brazil, Chile, and Colombia having cut rates 6-8 times. Not everyone is cutting, of course: the Bank of Japan, Russia and Egypt have all hiked this year, and Brazil has started hikes again as well.

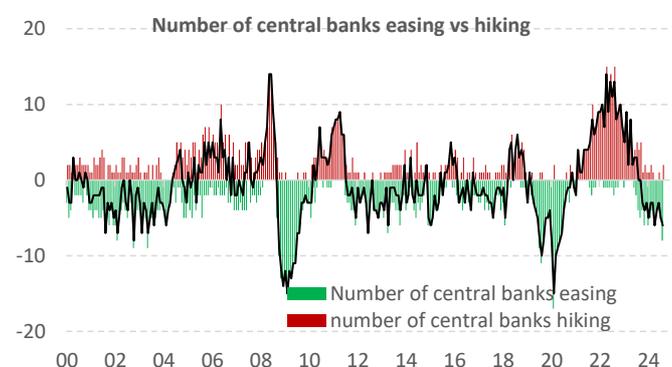
**The easing cycles are more advanced in EM than in DM.**

**Figure 33: The run-rate of monthly services inflation is still above pre-pandemic averages**



Source: UBS, Haver

**Figure 34: Central banks are easing at a historically fast pace (outside of recessions)**



Source: UBS, Haver

What we consider in this scenario is the possibility that the central banks are too premature in their easing. We are not in the 'sticky inflation' or the 'last mile is the hardest' camp when it comes to disinflation, or at least not in the sense that something is different in the inflation formation process compared to pre-pandemic. What is true though is that the service sector along with housing is the slowest to recover from inflation shocks, and those types of prices tend to be more vulnerable to wages, strong demand and tight labour markets. If central banks step on the accelerator too early, it is possible that services inflation, in particular, fails to normalize, leaving inflation stranded

**Although we are not in the 'sticky' inflation camp, premature easing could contribute to a slower 'last mile'.**

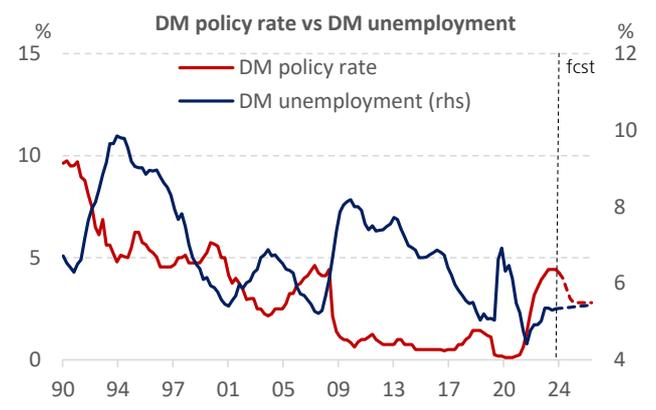
<sup>6</sup> Another narrative we've heard from ECB officials is that labour hoarding during the pandemic means that there are pockets of unproductive labour which will become more productive as the economy accelerates. That's a complicated story, however, as there are also plenty of sectors that still report labour shortages. It's possible that there is untapped productive capacity, but at this stage that's just a theory.

above central bank targets.

What would the mechanics of such a scenario be? Global growth outside of the Eurozone and China is already running a bit above its long-run average. It is not hard to imagine that, if the US does not slow as we forecast, and Eurozone consumption finally starts to take off (there has been a 3 standard deviation improvement in consumer confidence), or more stimulus from China is announced, that the global economy picks up momentum, pushing growth above trend. Wage growth would remain elevated, and unemployment perhaps declines again. For modelling purposes, we have mechanically assumed that inflation would get stuck 50bp above our baseline projection. The question we then posed ourselves was how central banks would react to that configuration of data. In many respects, this scenario is a bit like the 'no landing' debate from the Spring.

**This scenario is not dissimilar from the 'no landing' debate from the Spring.**

**Figure 35: Central banks are easing into a historically tight labour market**



Source: UBS, Haver

**Figure 36: 63% of central banks are still missing their inflation target**



Source: UBS, Haver

## Box 4: China Stimulus - What Would Change Our View?

China's government has recently announced [a set of easing measures](#) and [signalled more policy support](#). Investors now expect an imminent fiscal stimulus ranging from RMB 2 trillion to RMB 10+ trillion, or 1.6-8% of GDP. How much upside would the stimulus mean for China's growth?

Our [August 2024 baseline forecasts](#) already assumed the government would ease property policies further, including 10-20bps in rate cuts, expansion of the "white list" scheme, and funding for property destocking, and would implement a fiscal expansion of RMB 1-1.2 trillion in H2 2024. We thought these measures were needed to help ratchet up growth momentum for the rest of the year. We also assumed an augmented fiscal expansion of 1% of GDP in 2025, including RMB 1.5 trillion in special treasuries (vs RMB 1 trillion in 2024). Had the government not delivered as much fiscal support as we had assumed, we would have had to downgrade our GDP growth forecasts of 4.6% for 2024 and 4.0% for 2025 again. Concrete policies announced so far have been largely in line with our expectations, though the government has clearly signalled it is poised to do more.

If the government rolls out a much [larger stimulus package](#), most people expect a significant portion of it will address the local government financing gap and debt problems (including arrears to corporates), increase notably subsidies to the household sector or social spending, provide additional support to the corporates, and scale up substantially the funding for property destocking. Capital injections to state-owned banks are a likely part of the package. If the government announced a RMB 1.5-2 trillion (1.2-1.6% of 2023 GDP) fiscal stimulus soon and implemented most of it quickly, we could see this year's GDP growth reaching 4.8%. If these measures are also followed by an additional fiscal boost in 2025 of RMB2-3 trillion (1.5-2.3% of 2024 GDP), which would help stabilize the property market earlier than we currently project, China's GDP growth could potentially move higher to 4.5% in 2025, barring any [sharp tariff hike](#) or US recession. These figures do not include potential bank capital injections, which we think are important because they ensure that banks have adequate capital buffers and can continue to lend robustly, but do not contribute directly to growth.

How significant would this new stimulus package be? Compared with our baseline of late August (see [Figure 37](#)), it would mean fiscal support of an additional RMB 4-5 trillion for the rest of 2024 and for 2025, plus >RMB 1 trillion bank capital injection. These would mean an extra augmented fiscal expansion of around 0.5% in 2024 and about 1.5% in 2025, or total AFD expansion of 0.8-1.0% in 2024 and around 2.5% in 2025, respectively. Credit growth would accelerate to 8.6-8.8% for 2024 (from 8.3% in the current baseline forecast) and 8.8-9.0% in 2025 (from current 7.8%), with the credit impulse moving higher to -1.4% and +1.2% of GDP at the end of 2024 and 2025, respectively (from current -2.8% and -0.5%). In addition, we would expect more policy rate cuts to complement the fiscal package (perhaps 50bps more by end 2025 compared with 30bps more assumed currently). We would also continue to expect more credit support to property developers, greater funding for property inventory rundowns, and an acceleration of [structural and reform measures](#) to help boost consumer and corporate confidence.

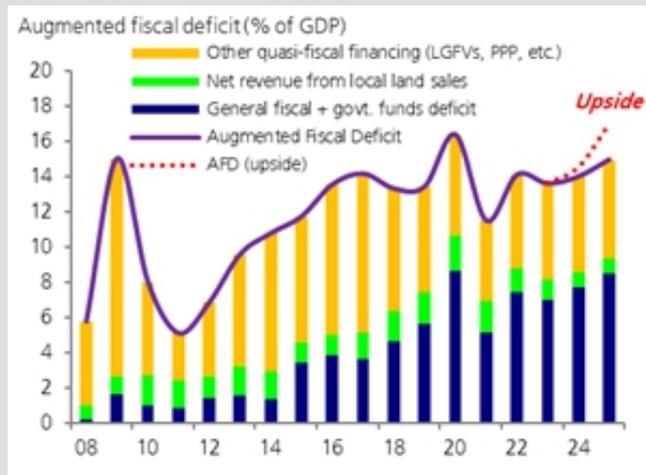
This stimulus would remain relatively modest compared with the response in 2008-09 ([Figure 38+Figure 39](#)), both in terms of the expansion of the augmented fiscal deficit and the boost to the credit impulse. While the overall size may be similar to the response in 2015-2016, and property easing measures may be cumulatively even bigger this time, there are some key differences to remember. Compared to the property downturn of 2015-2016, both property prices and home supply had risen sharply by 2021, all while fundamental demand had started to trend downward due to a declining population and slowing urbanization (see [property downgrade report](#)). In addition, cash subsidies in the shantytown renovation program were very effective in 2015-2016 but that is largely done. The current state of the property market is much more challenging, therefore a similar sized fiscal stimulus may have much less impact on the overall economy.

**Figure 37: Comparison of current baseline and upside scenario of China macro forecast**

	Current baseline forecast		Upside scenario	
	2024E	2025E	2024E	2025E
Real GDP growth (%)	4.6	4	4.8	4.5
Headline fiscal deficit (% of GDP)	3	3.0-3.5	3	3.5-4.0
Augmented fiscal expansion (% of GDP)	0.4	1	0.8-1.0	2.5
Credit growth (%)	8.3	7.8	8.8	9
Credit impulse (% of GDP)	-2.8	-0.5	-1.4	1.2
Policy rate cut (bp, 7-day repo)	30	30	30	50
USDCNY	7	7	6.9	6.8

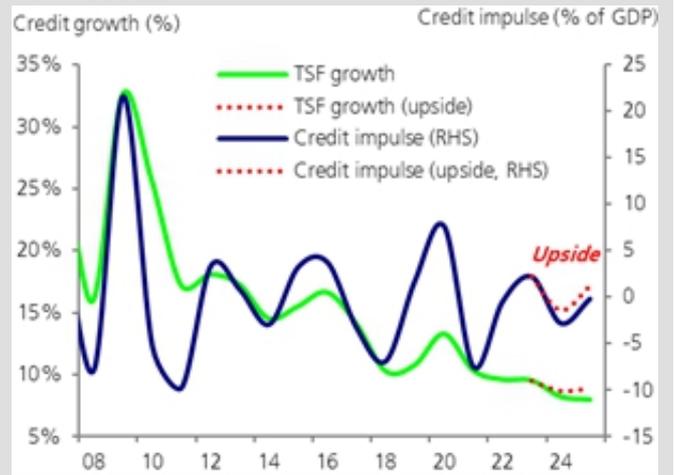
Source: UBS

Figure 38: China's augmented fiscal deficit 2008-2025E



Source: CEIC, Wind, UBS estimates

Figure 39: Credit impulse: 2008-2025E



Source: CEIC, Wind, UBS estimates

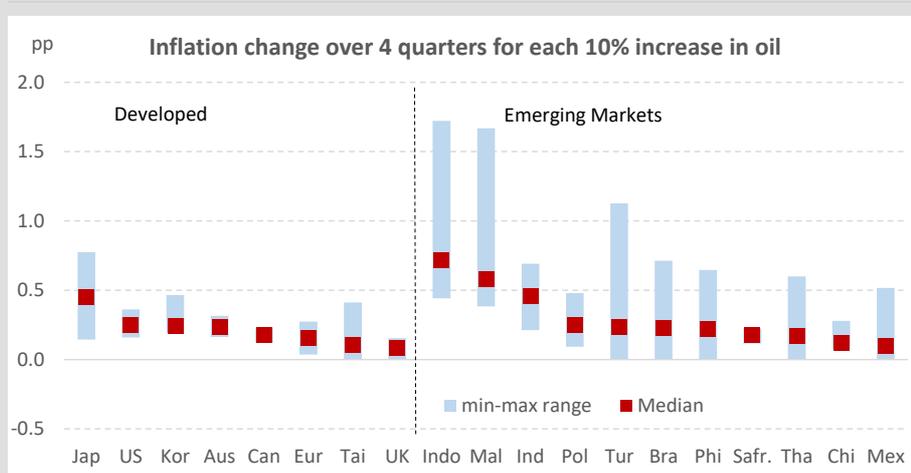
## Box 5: Impact of a possible geopolitical oil shock

With conflict in the Middle East spreading, and Iran oil facilities now explicitly a potential target, the risk of a spike in oil prices has increased. Iran produces ~3.3Mb/d of oil, roughly 3% of global oil supply. About half (~1.7Mb/d) is exported, with 90% handled by a single export terminal: Iran's Kharg Island.

[Should further escalation materialize, UBS's oil team expects Brent to rise further into the \\$80s, and possibly closer to \\$90/bbl.](#) Relative to the early September lows (\$68/bbl), that would imply an increase of about 32%. There are only 5 months since the early '70s when Brent increased by more. The most recent month (+54%) was August 1990, when, following Iraq's invasion of Kuwait, the UN passed an oil embargo on exports from both countries, removing 4Mb/d from oil markets (7% of global supply at the time). Looking at 2-month changes larger than 32%, we could identify 15 instances since the early '70s.

One factor potentially helping keeping oil prices in check is the current ample spare capacity within OPEC. Saudi Arabia and UAE alone have 4.5Mb/d of spare capacity that could be brought back to the market quickly. The US also has the buffer from the Strategic Petroleum Reserve (388mn bbls). The oil team currently still views the market as being near peak tightness, but has it moving to an overall surplus during 2025 (slowing oil demand and robust non-OPEC+ supply growth). The [bigger risk is perhaps a closing of the Strait of Hormuz](#) through which 20Mb/d of oil (incl. crude, condensate and oil products) transit, along with 20% of global LNG volumes. Blocking off the Strait should be a low probability event given the impact on Iran itself, but if it were to happen the oil team could see oil spiking to \$100/bbl.

**Figure 40: Inflation change over 4 quarters for each 10% increase in oil**



Source: UBS, Haver

We have modelled oil shocks in past Outlooks, and summarize the results from the last 4 outlooks in [Figure 40](#), which shows a min-max range in blue with the median estimate for each country. The numbers are presented as percentage point increases in inflation for each 10% increase in oil prices. On average, inflation in DM increases by 23bp for every 10% oil increase over the course of 4 quarters, while in EM it increases by 26bp. Thus, measuring from the recent low, an oil spike to \$100/bbl that remains at that level for a few quarters would add on between 105bp (DM) to 121bp (EM) to inflation. The range of estimate is wide because different countries have different levels of oil dependency, currencies can react differently (depreciation exacerbates the shock), and pass-through to consumer prices differs by country. But the inflation profile is generally one where a sharp increase in year 1 fully dissipates in year 2, as oil stabilizes at a higher level (implying zero inflation at that level) or recedes. For that reason, central banks have tended to look through oil shocks, especially of the 'supply shock' variety, and [ultimately all geopolitical shocks are contractionary](#).

The main question from a forecasting perspective is whether something may have changed in the central banks' reaction function. Andrea Maechler, deputy general manager of the BIS, [recently suggested that central banks could no longer afford to look through short-term swings in commodity prices](#) or shutdowns of oil refineries, as such shocks were becoming more frequent. She suggested monetary policy might need to adjust to keep inflation expectations anchored. We could imagine that, after having overplayed the 'transitory' argument during the pandemic, central banks will now be less sanguine about new shocks, especially as in the majority of cases, inflation has not yet returned to target. However, at this stage, we think that would mainly imply somewhat slower easing cycles – perhaps mixed in with a pause – rather than new hikes.

# Impact on Global Economy

In this section we present the simulations from our economists for the five main scenarios.

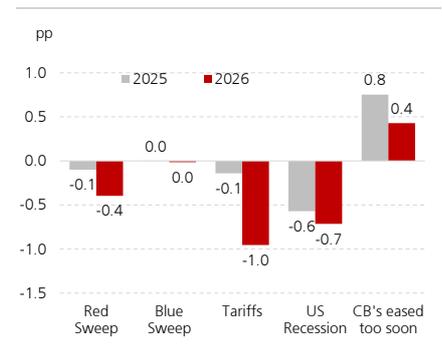
## Red sweep

In the red sweep scenario, growth in both DM (Figure 42) and EM (Figure 43) is a little weaker relative to the baseline, but mainly because of tariffs imposed on China that are phased in from September next year. Until that point, growth under the red sweep is almost indistinguishable from the baseline.

China's growth is 20bp lower in '25 and 100bp lower in '26; roughly half of the slowdown comes from a reduced contribution from net exports, the rest from the indirect impact on consumption and investment. These numbers include measures taken by the government (mainly fiscal policy) to mitigate the impact of the tariffs. Such measures would include tax rebates or relief to corporates, especially exporters, increased spending on social care, infrastructure, and measures to support employment. We do not project a significant increase in credit growth and would expect only modest interest rate cuts, in part because the PBC may worry about exacerbating currency weakness. As we mentioned in the prior section, we assume China's retaliation is modest, on average imposing a 15% tariff on US goods.

The weakness in China would be expected to spread to the region, particularly Hong Kong, which is a gateway for trade to/from China (though its domestic sectors, retail/hospitality/property, are also highly dependent on Chinese demand), Singapore (imports and exports combined are around 300% of GDP, so highly sensitive to a trade slowdown), Malaysia, Thailand and Korea. While ultimately these economies would likely benefit from trade diversion, as they did after 2018/2019, in the short run external demand weakness would dominate the outlook. Detailed charts for each country are shown at the end of this section.

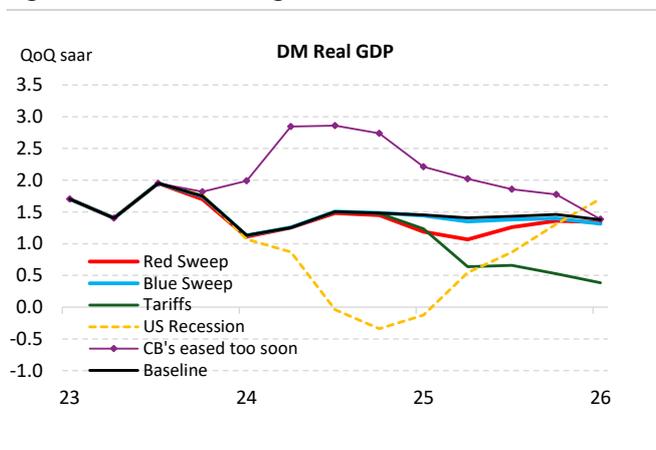
Figure 41: Global growth 'deltas' (vs baseline)



Source: UBS

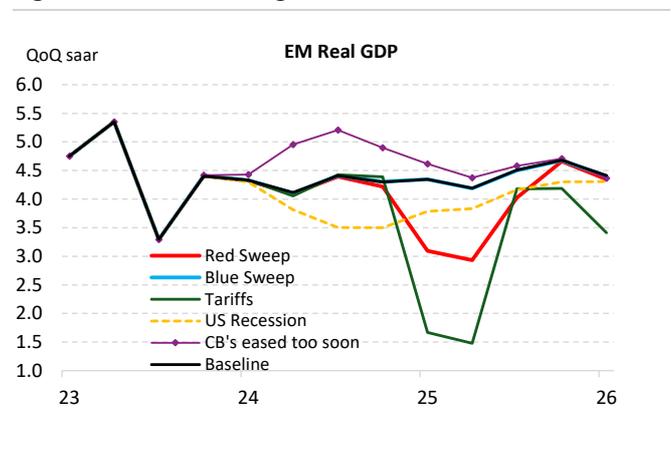
**In the Red Sweep scenario, global growth is mainly lower due to the China tariffs late '25, which also obscures (and offsets) potential new tax changes in '26.**

Figure 42: DM real GDP growth



Source: UBS, Haver

Figure 43: EM real GDP growth



Source: UBS, Haver

US GDP growth is just a few tenths weaker, in part because we assume the inflation pass-through to consumers is relatively contained (35-40bp increase), as importers have some ability to substitute away, and part of the trade is exempted from the tariffs.<sup>7</sup> Net exports also provide some modest offset to US growth, as imports slow faster than

<sup>7</sup> Since Chinese imports are roughly 2½% of US consumption expenditures, a 60% tariff on all imported goods from China would work out to roughly a 1.3pp boost to the US price level, assuming 100% pass-through. That is an upper bound, however, given that it is possible that not all items are covered (remember that tranche 4B, which included laptops, cell phones, toys and a large amount of consumer products, was never implemented) and pass-through is likely to depend on China's market share in specific product codes, and whether a given product is an intermediate, capital or consumer good. All tallied, we assume pass-through of roughly 30%, which would push core PCE prices 36bp above our baseline.

exports. Critically, the fact that China is assumed to only partially retaliate contains the damage for the US, though in our numbers we still lose 250,000 jobs relative to the baseline.

Why is there not more of a 'delta' in this scenario before the tariffs come online? Mainly because Congress would spend most of 2025 working on an extension of the TCJA tax cuts; any new fiscal measures would not kick in until 2026. Thus there is no fiscal impulse in '25 one way or the other. It is also unclear whether any of the changes in immigration (negative for growth) or regulation (potentially positive for growth; small business confidence would likely improve ) would move the needle on growth quickly enough.

Global inflation in this scenario is marginally lower than the baseline mainly because China's inflation falls more than US inflation increases. For the US that's the tariff impact, partially offset by modest currency appreciation, while for China it's mainly the impact of lower growth.

Our policy rate forecasts are little affected in this Red Sweep scenario, reflecting relatively limited growth and inflation deltas. The exceptions are in Asia, where Thailand, Indonesia and Malaysia add an extra quarter point cut to their easing trajectories.

## Blue sweep

The Blue Sweep scenario is almost identical, at a global level, to the baseline (Figure 41), in part because many policies of a Harris administration would be a continuation of the current one, and partly because the fiscal changes that we described in the prior section don't kick in before '26 (similar to our comments on the Red Sweep). We really have just marginally lower growth (a tenth) for the US in '26, on the somewhat greater fiscal consolidation we assume if the Democrats control both chambers of Congress.

The main message from this scenario is how similar it is to a baseline with divided government. Control of Congress would allow compositionally different fiscal policy, which will matter domestically and distributionally, but we do not identify anything that would materially change the growth outcomes. Cutting taxes for lower income groups who have a higher marginal propensity to consume is offset by taxes for higher income households and corporations. If that shift were neutral (cuts for lower income equal to hikes for higher income) it would yield higher net consumption, but given the (assumed) desire to lower the deficit and the overall mildly contractionary stance, there is no net growth benefit under the Blue Sweep vs our current baseline.

Deficits would be about 1% GDP lower than in the Red Sweep, and remain elevated (around -6% GDP). At the margin, that should translate to somewhat lower net issuance, and the 10y Treasury yield is 20bp lower by end '26 than in the Red Sweep scenario. But that is not quite an apples to apples comparison, as under the Red Sweep we also have somewhat higher inflation.

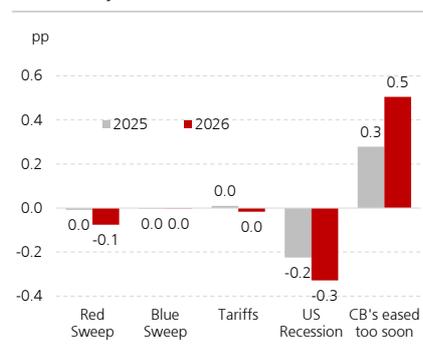
## Global Tariffs

As discussed in the description of the Global Tariff scenario (previous section) we should be wary of relying on point estimates of tariff impacts, given the myriad model choices that need to be made. The global model has many dimensions to play with, on price flexibility, exchange rate movement, currency invoicing, and retaliation to name just a few. We test dimensions one by one in our robustness exercises, but we could dream up many more combinations that would generate even greater outcome ranges. Also note that our model estimates reflect pure tariff shocks and do not assume any adverse confidence effects, which could significantly increase the estimates shown here.

One way to convey that uncertainty is by presenting our estimates along the lines of Figure 45 where we show the full min-max range of our global tariff model as grey bars, and then compare that to the bottom-up estimates by the economists (black dash) as well as our global model 'benchmark' (red dash). In addition, we show in blue squares which alternative scenario of the global model generated the most positive growth outcome, and which the most negative outcome (green triangles).

**US GDP growth is a few tenths lower under the Red Sweep, and we lose 250k in payrolls (vs baseline) while China's growth is a full pp lower in '26, despite substantial stimulus.**

**Figure 44: Global inflation deltas (vs baseline)**



Source: UBS

**In aggregate the Blue Sweep scenario is not notable different from our baseline of divided government**

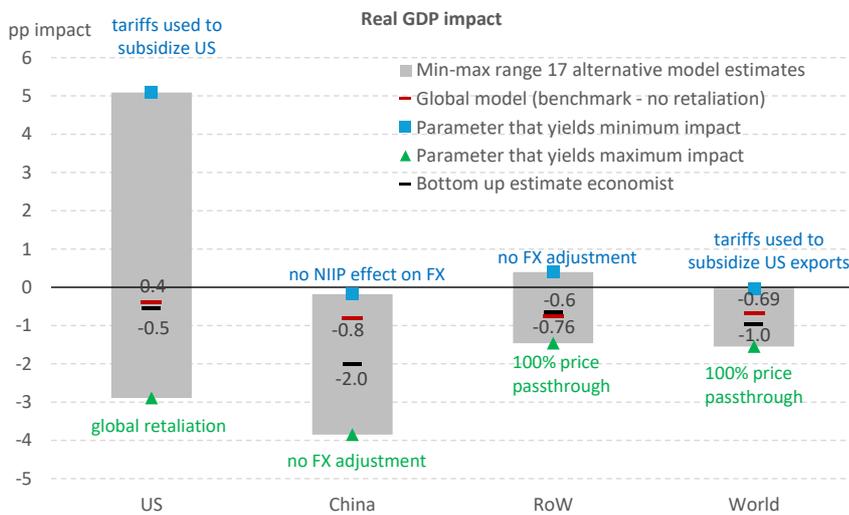
**A lot of uncertainty surrounds the tariff scenario as there are many margins that could affect the ultimate outcome**

As a first example, for the world as a whole, our regional economists have estimated that, in 2026, global growth would be 1pp lower due to the tariffs. That compares to a model range of -0.04pp to -1.51pp, and the model benchmark of -0.69pp. For those global estimates, the best possible outcome is one where the US uses its tariff revenue to subsidize its exporters, as that would neutralize the currency appreciation (about 3½% in the US) and offset the shift of resources out of the export sector to domestic production as firms step in to fill the gap of lost imports (the infamous Lerner Symmetry effect). The worst outcome is one where there is a 100% price pass-through; in the benchmark we assume 90% export price pass-through and 50% domestic and import price pass-through; but if we set all of those to 100% the transmission of the tariffs is maximized (hence the lowest GDP outcome).

**On GDP the bottom-up accounting from our regional economists suggests global growth 1pp lower due to the tariffs, with the model ranging from 0.04pp to 1.51pp lower growth.**

Figure 45 also shows that, for China, the bottom-up estimate from the economic team is substantially more severe than the global model's estimate (-2pp vs -0.8pp). For China, the min-max range is entirely defined by how much the currency (depreciation) is able to neutralize the higher import prices for US consumers (the labels for each parameters are explained in more detail in the appendix).

**Figure 45: Model based impact global tariffs vs bottom-up estimates – real GDP growth (change vs baseline in 2026)**



Source: UBS

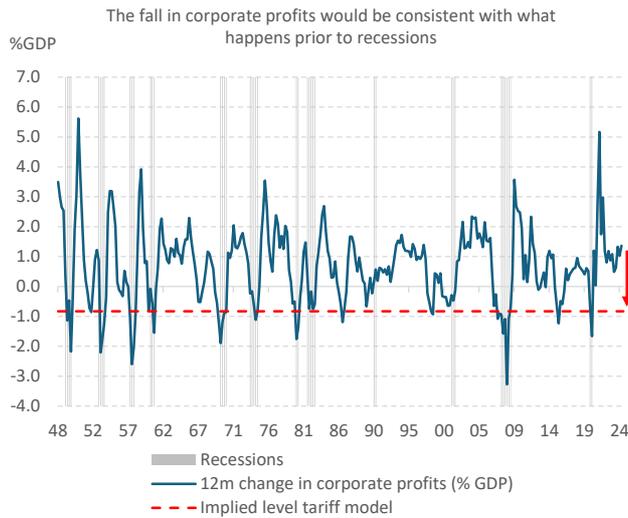
Let us focus for a moment on what the chart is showing for the US: a min-max range of nearly 8pp, from -2.1pp below the baseline to +5.1pp above it. Seemingly, at least according to the global model, there are states of the world where higher tariffs are actually good for US growth. As we show in Figure 40, that very high estimate is defined by an extreme outlier: when the US uses all the revenue to subsidize its exporters (essentially a large redistribution from importers to exporters). That is not the intent, as far as we are aware, but it serves to highlight how some policy choices (that seem absent in the current debate) could materially change the impact of tariffs on the economy. However, even the benchmark estimate and the bottom-up estimate from the US economics team do not seem particularly severe, with growth just ½ pp lower in '26. Not quite what you might expect based on reversing 100 years of trade liberalization. So what is going on?

**If tariffs are used to subsidize exports then higher tariffs could boost US growth**

It turns out that, for the US in particular, real GDP may not be the right way to think about the damage to the economy given that real imports collapse – mechanically boosting growth via net exports. The fall in private final domestic demand, for instance, is 3 times larger than the real GDP drop (-1.5pp below the baseline). To further put in context what would unfold, Figure 47 shows how the fall in real imports (roughly 12½%) compares to history; it would not be far off from what the US experienced during the Global Financial Crisis. That import collapse would disproportionately hurt US importers, as they are assumed to absorb 50% of the tariff in their profit margin. But even for the economy as a whole, profits would fall by more than 6% (but much more for importers), and the 12-month change in profits as a percent of GDP would look as it normally does just prior to recessions (Figure 46).

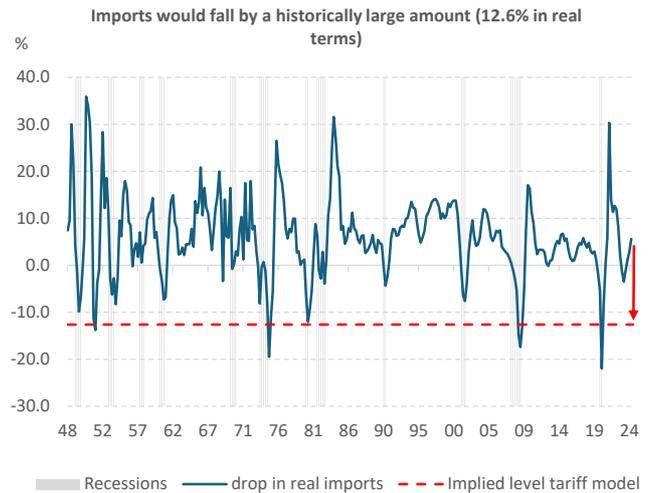
**However, the tariffs reduce private domestic demand (and consumption) in the US under almost all scenarios**

**Figure 46: The fall in profits would be consistent with what happens just before recessions**



Source: UBS, Haver

**Figure 47: Imports would fall by 12½% in real terms**



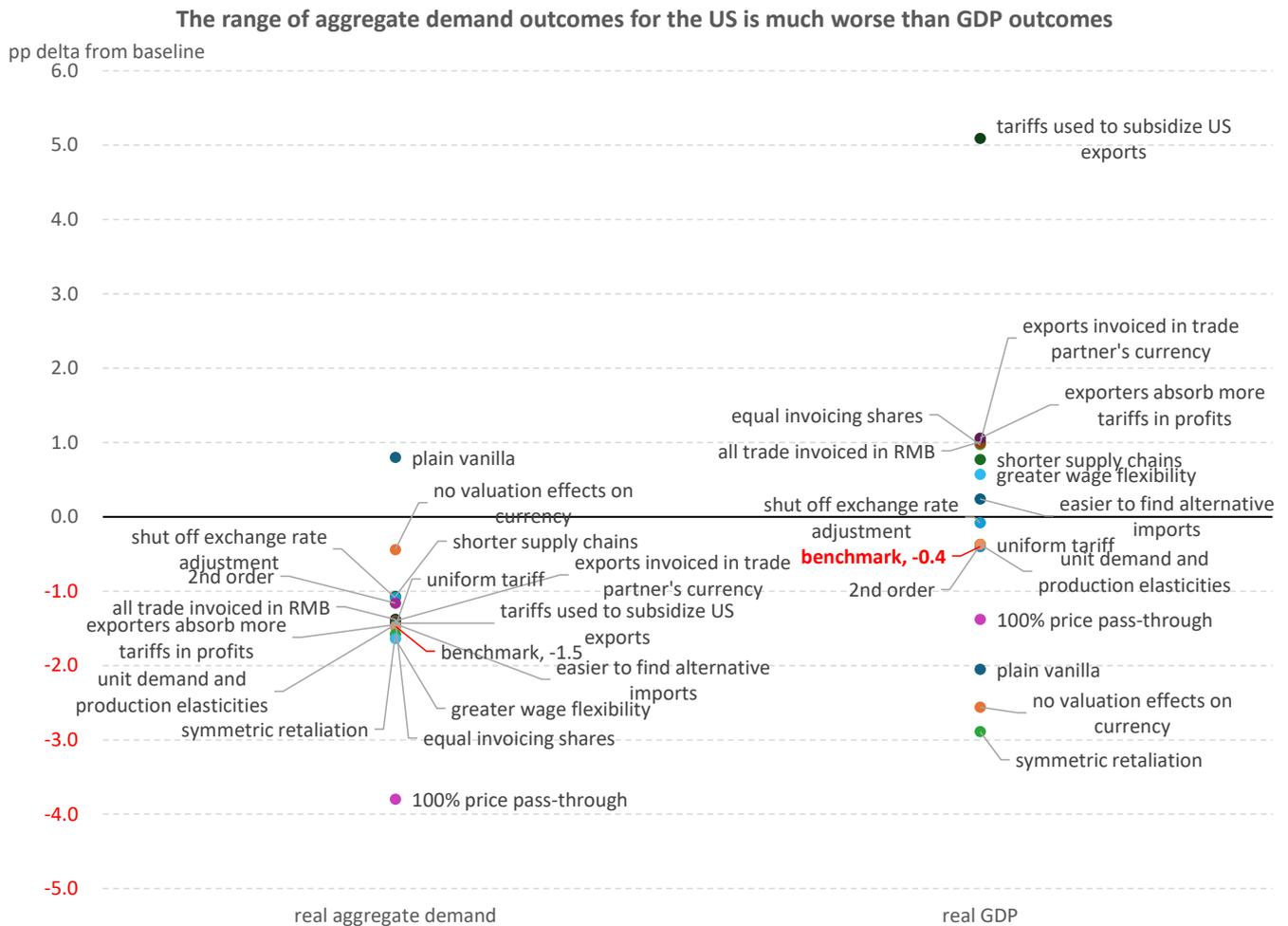
Source: UBS, Haver

One final point on the lowest growth estimate shown for the US in [Figure 45](#): symmetric retaliation. We estimate that anything less than one third retaliation (i.e. for every 10% US tariff the RoW does 3%) starts to generate positive outcomes for the US, but as you ratchet up the response of trade partners, the losses for the US mount quickly: in the case of full tit-for-tat tariffs, the model would see the real GDP hit as 6x larger than the benchmark simulation (which used a 50% retaliation assumption). These numbers are large, even with all the caveats about looking at output losses through a GDP rather than an aggregate demand lens ([Figure 48](#) gives a better sense of the range of output loss by putting the model estimates for aggregate demand and real GDP side by side for the US).

The issue of imports collapsing and flatterer real GDP outcomes also applies to other countries, but to a lesser extent. Our model for China has imports falling -4% in real terms and for the 'RoW' -2%. But with the above caveat on GDP accounting mechanics, a few points on the individual (bottom-up) country estimates: First, it is a sea of red. Every single country has lower growth in both '25 and '26. Most of Asia has a few negative quarters (Japan, Korea, Singapore, HK, Thailand, China and Malaysia), as do Brazil and Mexico. China's growth falls from 4% to 2%, despite the type of stimulus that we discussed under the Red Sweep scenario. Second, the least affected seems to be the Eurozone and countries in close proximity, such as Poland. For the Eurozone we have assumed only selective retaliation to the 10% tariff (about a third, focused on goods where the dependency on US supplies is lowest, thus minimizing the inflation impact on the consumer); monetary policy is unaffected but automatic stabilisers are allowed to work and the European Commission gives countries more time to reduce their deficits, resulting in a less restrictive fiscal stance in '26 than in the baseline. Third, unemployment follows an Okun's law type of relationship and is, globally, about ½ pp higher in 2026 than in the baseline.

**Under the full tariff scenario every single country has lower growth in both '25 and '26.**

**Figure 48: Aggregate demand outcomes in the global tariff model are much worse than GDP (which is boosted by a collapse in imports)**



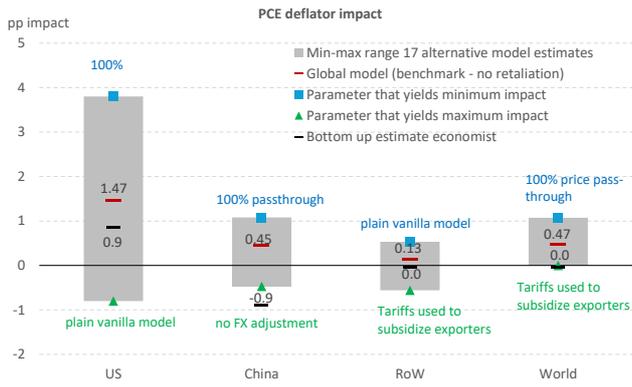
Source: UBS, Haver

The inflation impact of the tariff scenario is shown in [Figure 49](#). The format is similar to the earlier GDP chart, with min-max model ranges for inflation, and comparing to our bottom-up estimates and model benchmark. Note that for the world as a whole, the bottom-up estimate is that there is zero inflation impact from tariffs. That may be counterintuitive as most clients tend to think of them as 'stagflationary'. We believe that intuition is correct, but particularly for those imposing the tariffs and thus increasing their own import prices. [Figure 50](#) shows the individual country deltas for 2026, highlighting that it is the US, Mexico (full retaliation) and Turkey that have the largest inflation increases. In Turkey's case that is not because of retaliation but because of a slightly weaker currency assumption with reasonably high FX pass-through.

**Perhaps counterintuitively our bottom-up analysis finds the tariffs have no aggregate global impact on inflation — though country impacts vary widely.**

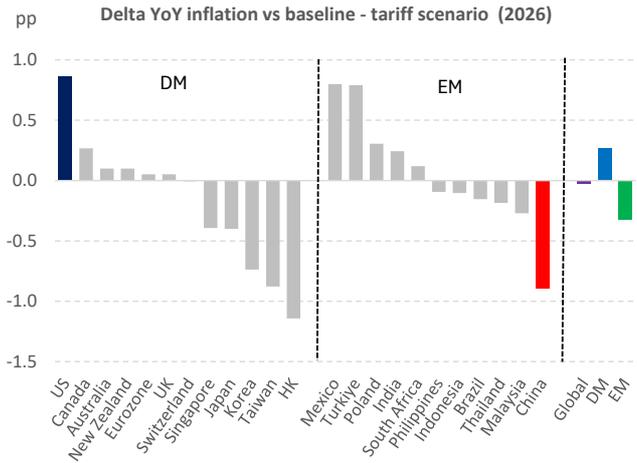
Both [Figure 49](#) and [Figure 50](#) drive home the complexity of the inflation dynamics. Whether or not inflation increases is a function of currency weakness, pass-through, retaliation and whether the US might attempt to lower its export prices with subsidies. The order of magnitude assumption for each country of these variables generates different outcomes. And a few of our economists also assumed an excess supply effect on inflation from weaker growth and possibly some trade redirection of Chinese goods. For the US, the inflation impact is much higher than under the Red Wave scenario, in part because with a global tariff it will not be possible to substitute towards non-tariffed goods (unless they are domestic).

**Figure 49: Model based impact global tariffs vs bottom up estimates – inflation**



Source: UBS, Haver

**Figure 50: Our bottom-up estimates suggest a wide range of possible inflation outcomes**

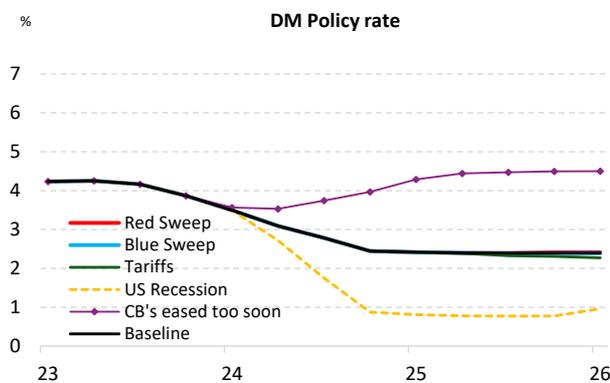


Source: UBS, Haver

Finally, and perhaps not surprisingly given the small variations in average global inflation, policy rates also don't move much (see [Figure 51](#) for DM in particular). But those averages hide a wide range of outcomes. The central banks that are assumed to pull back on easing relative to the baseline are Turkey, (+100bp by end '25), Mexico (+50bp, partly on MXN concerns), South Africa (+75bp) and Poland (+25bp). To be clear: these are not hikes but rather reduced cuts compared to our baseline, and we do not expect any outright tightening from any central bank under this scenario.

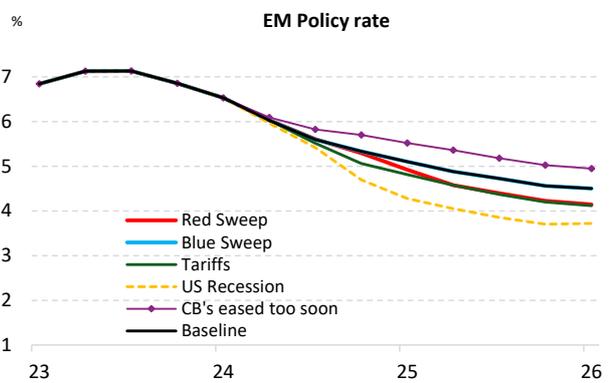
**Average central bank policy rates in the tariff scenario do not differ from the baseline.**

**Figure 51: DM policy rate average**



Source: UBS, Haver

**Figure 52: EM policy rate average**



Source: UBS, Haver

The central banks that would see lower policy rates in the tariff scenario compared to the baseline include: Canada (-75bp by end '26 vs baseline, as they have less inflation and weaker growth than the US), Japan (50bp less normalization because of the global growth weakness), Korea (-100bp vs baseline), Taiwan (-63bp), Thailand (-25bp), China (-75bp), and Indonesia, Malaysia and Brazil (all -50bp). As for the Fed, we expect it does not react. It will have completed its easing cycle by the time the tariffs kick in, and with inflation and growth moving in opposite directions (the classic stagflationary shock) it would try to look through the shock, even though from a dual mandate perspective, inflation (+90bp on core) increases by more than unemployment (+50bp).

**...but some central banks have lower policy rates to offset weaker GDP**

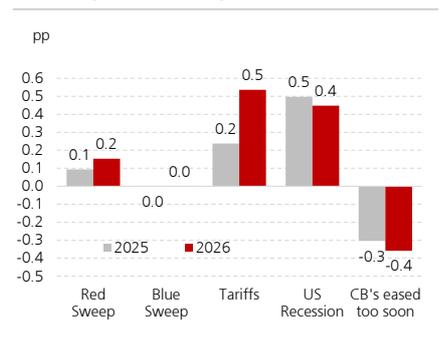
## US recession

US import growth runs about 5% annualized below our baseline for most of 2025, which is the main transmission channel to the rest of the world. The largest declines outside the US are in its largest trade partners (Canada, Mexico), as well as some of the large trade-oriented economies (Singapore, Malaysia) and Australia, New Zealand and Japan. These economies all have a beta of roughly 1 to the 1.1-1.2% fall in US growth vs the baseline. The profile of global growth largely mirrors the three negative quarters in the US (Q2-Q4 2025) but it takes until Q4-26 for quarterly global growth to recover to baseline levels.

What stands out for us, having modelled recession scenarios many times before, is how smooth/controlled all the forecast changes look. This is largely a function of the unusual nature of the recession: a gradual slide of consumption into negative territory, without the presence of major shocks.

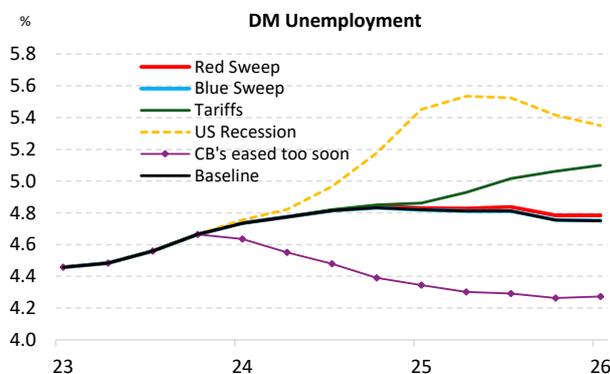
US unemployment drifts up to 5.5%, over a full percentage point above our baseline, and equivalent to over 2 million job losses. Unemployment gains in other countries largely mirror the GDP deltas. Global unemployment is roughly ½ pp above the baseline at 5.8% by the end of next year.

**Figure 53: Global unemployment deltas (vs baseline)**



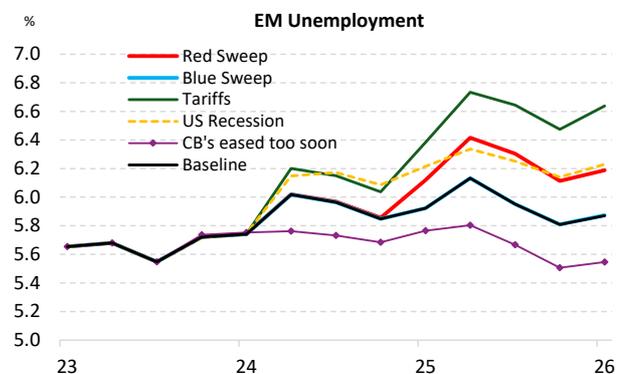
Source: UBS

**Figure 54: DM unemployment**



Source: UBS, Haver

**Figure 55: EM unemployment**



Source: UBS, Haver

Inflation on average is roughly 20-30bp lower in 2025/2026, both for headline and core, helping to eliminate the residual stickiness in underlying/service sector inflation. Weaker growth combined with lower commodity demand (and prices) is the main channel, though in some cases currency weakness offsets the downdraft.

In DM, every single major country sees inflation slipping below its target, with the exception of Australia, which is within its target range. The generalized disinflation enables central banks to extend their easing cycles by nearly 1 ½ pp in DM and by a bit less than 1pp in EM, moving policy generally into outright accommodative territory. Indeed, the projections in this scenario suggest a non-linearity, as policy rate cuts are 3-4x larger than the move lower in core inflation.

Canada follows the Fed down to the lower bound, as does Japan, where currency strength undoes much of the inflation progress made to date. Switzerland, Singapore and HK also bring policy rates back down to zero, or close to it. The ECB, by contrast, lands its policy rate at about 1½pp, consistent with inflation sitting only modestly below its 2% target (1.8% by end '26, though with an intra-year low of 1.6%). The data tests the 'r\* is higher' argument, but growth is not really weak enough (at 0.7% in '25 it sits roughly at this year's levels) to warrant pushing the accelerator too hard.

In EM, only Turkey's central bank is seen to marginally increase its policy rate vs the baseline, as global growth weakness leads to some currency depreciation and modest imported inflation. The numbers are very small though, relative to the high levels of inflation and policy rates (which continue to decline). Mexico, along with India, delivers the most easing relative to the baseline: roughly 175bp more.

**The US recession knocks a few tenths off other countries' inflation.**

**That helps push inflation slightly below target, enabling central banks to become outright accommodative (i.e. move below neutral).**

**Canada, Switzerland, HK and Singapore all follow the Fed down to the lower bound, and Japan abandons its policy normalization.**

**Mexico and India deliver the most additional easing in EM.**

## Central banks eased too early

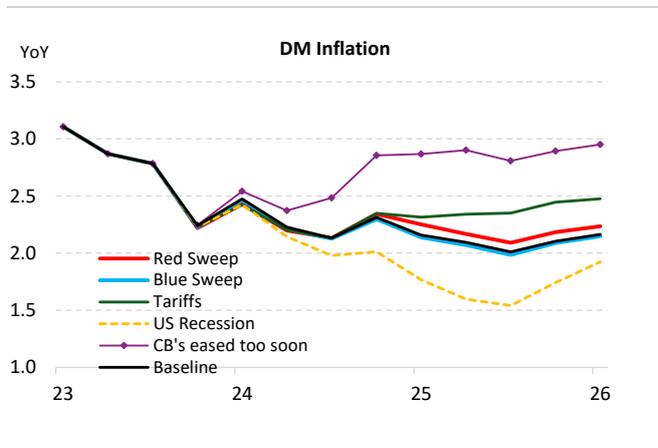
In this scenario, the easing currently underway by most central banks generates more momentum than expected, lifting global growth by about 80bp vs our baseline in '25 and 40bp in '26 (growth of 3.6 and 3.4%, respectively). Those would have been trend-like numbers pre-pandemic, but with China growing around 4-4 1/2 % (including in this scenario), that is a bit above potential.

US growth continues to run at around 2.7%, pushing unemployment back down into the mid 3% range, and adding 50bp to core inflation in '25 and 120bp in '26 (core CPI inflation fails to decline and continues to run around 3.4%, while core PCE inflation stays in the high 2s). The Fed is now missing its mandate on both sides again (unemployment below NAIUR and inflation above target) and is forced to abandon the easing cycle that was communicated in its most recent SEP. The FOMC reverses course and pushes the fed funds rate up to 5.5% by end '25 and 5.75% by end '26. This is the much feared 'no landing' scenario that was in vogue just a few months ago. Because of the lags of monetary policy, the growth outcomes in this scenario through end '26 are better than the baseline, by almost a full pp in '25 and about 70bp in '26. Sequentially, however, that momentum starts to erode decisively by the second half of '26.

**In this scenario, the global economy grows roughly 60bp above trend.**

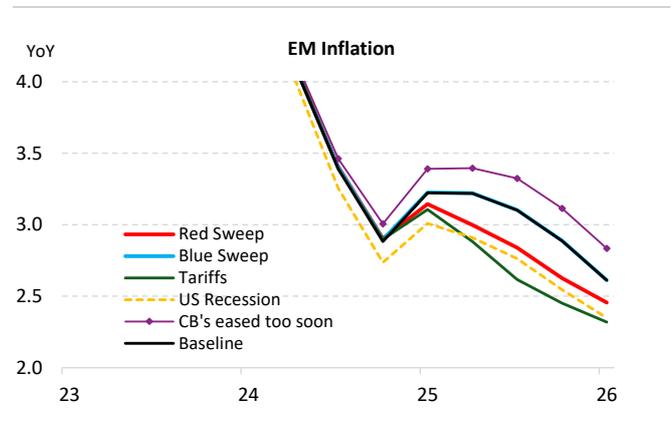
**Economies generally move into 'no landing' mode. Unemployment starts to edge lower again, core inflation fails to return to target, and DM central banks undo the tightening cycle that they just started**

**Figure 56: DM inflation**



Source: UBS, Haver

**Figure 57: EM inflation**



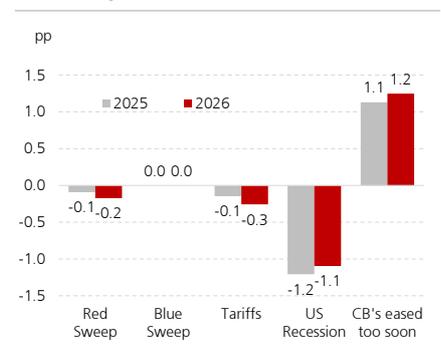
Source: UBS, Haver

Similar stories play out elsewhere as well. There is essentially no further labour market weakening, and unemployment actually declines 30-40bp vs our baseline. Global unemployment stays close to 5%, close to the early 2023 levels when central banks were still in full hiking mode, and DM unemployment in the low 4% range. Underlying inflation dynamics in DM show no real incremental improvement, though there is some mild disinflation in EM, in part because of the high levels from which Turkey's inflation rates are falling. For most others in EM though, core inflation shifts higher, and headline inflation largely mirrors it.

**DM central banks don't deliver any of the easing that is priced and shift policy rates higher by about 2x as much as EM central banks, on average.**

Policy rates, on average, are 110-120bp higher globally than in our baseline, with much larger increases in DM (2pp shift vs the baseline) than EM (about 40bp) as easing is priced out. The ECB goes back to where it started (a 4% policy rate), as do some others (Switzerland, UK); Canada, however, manages to land its policy rate around 3.5%, opening up a noticeable gap with the US. The BoJ delivers significantly more normalization, as inflation lands convincingly above the target (2.3% in '25) and pushes its policy rate up to 2%, about 4x more than currently priced. Because real rates don't move as much, debt dynamics are not adversely affected by the higher nominal policy rates. Some of the EM economies which already have higher rates (e.g. Brazil and Mexico) add about a percentage point more tightness vs the baseline, but lag the deltas of their DM counterparts. Policy responses in the larger, more closed economies (China, India) are generally more muted, in line with lower inflationary pressure, but the smaller more open economies (South Africa, Philippines, HK, Korea) all add at least a pp of additional tightening.

**Figure 58: Global policy rate deltas (vs baseline)**



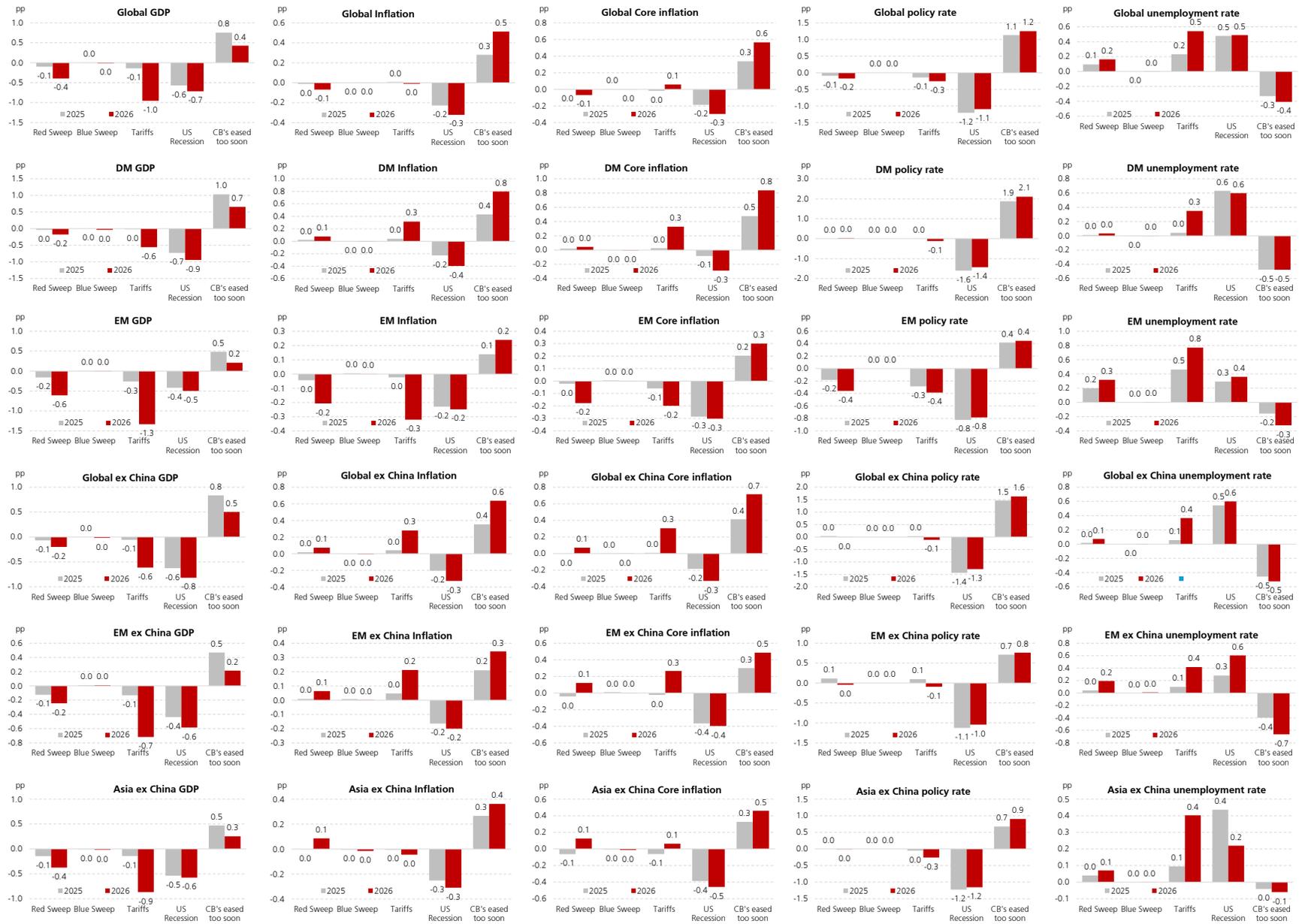
Source: UBS

Figure 59: Forecasts under different scenarios

Real GDP growth (YoY)				Headline inflation (YoY)				Core inflation (ex energy/food) (YoY)				Policy rate (end of period)				Unemployment (%)			
Global				Global				Global				Global				Global			
	2024	2025	2026		2024	2025	2026		2024	2025	2026		2024	2025	2026		2024	2025	2026
Red Sweep	3.2	2.8	2.5	Red Sweep	3.8	2.9	2.4	Red Sweep	3.9	3.1	2.5	Red Sweep	5.0	3.7	3.3	Red Sweep	5.2	5.4	5.4
Blue Sweep	3.2	2.9	2.9	Blue Sweep	3.8	2.9	2.5	Blue Sweep	3.9	3.1	2.6	Blue Sweep	5.0	3.8	3.5	Blue Sweep	5.2	5.3	5.3
Tariffs	3.2	2.7	2.0	Tariffs	3.8	2.9	2.5	Tariffs	3.9	3.1	2.7	Tariffs	5.0	3.6	3.2	Tariffs	5.2	5.6	5.8
US Recession	3.2	2.3	2.2	US Recession	3.8	2.6	2.2	US Recession	3.9	2.9	2.3	US Recession	5.0	2.6	2.4	US Recession	5.2	5.8	5.8
CB's eased too soon	3.2	3.6	3.4	CB's eased too soon	3.8	3.1	3.0	CB's eased too soon	3.9	3.4	3.2	CB's eased too soon	5.1	4.9	4.7	CB's eased too soon	5.1	5.0	4.9
Baseline	3.2	2.9	2.9	Baseline	3.8	2.9	2.5	Baseline	3.9	3.1	2.6	Baseline	5.0	3.8	3.5	Baseline	5.2	5.3	5.3
DM				DM				DM				DM				DM			
Red Sweep	1.6	1.4	1.3	Red Sweep	2.6	2.2	2.2	Red Sweep	3.0	2.5	2.2	Red Sweep	3.5	2.4	2.4	Red Sweep	4.7	4.8	4.8
Blue Sweep	1.6	1.4	1.4	Blue Sweep	2.6	2.2	2.1	Blue Sweep	3.0	2.5	2.1	Blue Sweep	3.5	2.4	2.4	Blue Sweep	4.7	4.8	4.8
Tariffs	1.6	1.4	0.9	Tariffs	2.6	2.2	2.4	Tariffs	3.0	2.5	2.5	Tariffs	3.5	2.4	2.3	Tariffs	4.7	4.9	5.1
US Recession	1.6	0.7	0.5	US Recession	2.6	2.0	1.7	US Recession	3.0	2.4	1.8	US Recession	3.5	0.8	1.0	US Recession	4.8	5.5	5.3
CB's eased too soon	1.7	2.5	2.1	CB's eased too soon	2.6	2.6	2.9	CB's eased too soon	3.0	3.0	3.0	CB's eased too soon	3.6	4.3	4.5	CB's eased too soon	4.6	4.3	4.3
Baseline	1.7	1.4	1.4	Baseline	2.6	2.2	2.1	Baseline	3.0	2.5	2.1	Baseline	3.5	2.4	2.4	Baseline	4.7	4.8	4.7
EM				EM				EM				EM				EM			
Red Sweep	4.7	4.1	3.8	Red Sweep	5.0	3.5	2.7	Red Sweep	4.7	3.6	2.9	Red Sweep	6.5	4.9	4.1	Red Sweep	5.7	6.1	6.2
Blue Sweep	4.7	4.3	4.4	Blue Sweep	5.0	3.5	2.9	Blue Sweep	4.7	3.7	3.0	Blue Sweep	6.5	5.1	4.5	Blue Sweep	5.7	5.9	5.9
Tariffs	4.7	4.0	3.1	Tariffs	5.0	3.5	2.6	Tariffs	4.7	3.6	2.8	Tariffs	6.5	4.8	4.1	Tariffs	5.7	6.4	6.6
US Recession	4.7	3.8	3.9	US Recession	5.0	3.3	2.7	US Recession	4.7	3.4	2.7	US Recession	6.5	4.3	3.7	US Recession	5.7	6.2	6.2
CB's eased too soon	4.7	4.7	4.6	CB's eased too soon	5.0	3.6	3.2	CB's eased too soon	4.7	3.9	3.3	CB's eased too soon	6.5	5.5	4.9	CB's eased too soon	5.8	5.8	5.5
Baseline	4.7	4.3	4.4	Baseline	5.0	3.5	2.9	Baseline	4.7	3.7	3.0	Baseline	6.5	5.1	4.5	Baseline	5.7	5.9	5.9
Global ex China				Global ex China				Global ex China				Global ex China				Global ex China			
Red Sweep	2.7	2.4	2.4	Red Sweep	4.9	3.7	3.2	Red Sweep	5.0	4.0	3.3	Red Sweep	6.0	4.5	4.1	Red Sweep	5.1	5.3	5.4
Blue Sweep	2.7	2.5	2.6	Blue Sweep	4.9	3.6	3.1	Blue Sweep	5.0	4.0	3.3	Blue Sweep	6.0	4.5	4.1	Blue Sweep	5.1	5.3	5.3
Tariffs	2.7	2.4	2.0	Tariffs	4.9	3.7	3.4	Tariffs	5.0	4.0	3.6	Tariffs	6.0	4.5	4.0	Tariffs	5.1	5.4	5.7
US Recession	2.7	1.9	1.8	US Recession	4.9	3.4	2.8	US Recession	5.0	3.8	2.9	US Recession	6.0	3.0	2.8	US Recession	5.2	5.9	5.9
CB's eased too soon	2.8	3.3	3.1	CB's eased too soon	4.9	4.0	3.7	CB's eased too soon	5.0	4.4	4.0	CB's eased too soon	6.0	5.9	5.7	CB's eased too soon	5.1	4.9	4.8
Baseline	2.7	2.5	2.6	Baseline	4.9	3.6	3.1	Baseline	5.0	4.0	3.3	Baseline	6.0	4.5	4.1	Baseline	5.1	5.3	5.3
EM ex China				EM ex China				EM ex China				EM ex China				EM ex China			
Red Sweep	4.7	4.4	4.5	Red Sweep	9.3	6.3	5.0	Red Sweep	8.7	6.7	5.5	Red Sweep	10.7	8.4	7.0	Red Sweep	6.4	6.9	7.1
Blue Sweep	4.7	4.5	4.8	Blue Sweep	9.3	6.3	5.0	Blue Sweep	8.7	6.8	5.4	Blue Sweep	10.7	8.2	7.1	Blue Sweep	6.4	6.9	6.9
Tariffs	4.7	4.4	4.0	Tariffs	9.3	6.3	5.2	Tariffs	8.7	6.7	5.7	Tariffs	10.7	8.3	7.0	Tariffs	6.4	7.0	7.3
US Recession	4.7	4.1	4.2	US Recession	9.3	6.1	4.8	US Recession	8.7	6.4	5.0	US Recession	10.7	7.1	6.0	US Recession	6.4	7.1	7.5
CB's eased too soon	4.7	5.0	5.0	CB's eased too soon	9.3	6.5	5.3	CB's eased too soon	8.7	7.1	5.9	CB's eased too soon	10.7	9.0	7.8	CB's eased too soon	6.4	6.5	6.2
Baseline	4.7	4.5	4.8	Baseline	9.3	6.3	5.0	Baseline	8.7	6.8	5.4	Baseline	10.7	8.2	7.1	Baseline	6.4	6.9	6.9
Asia ex China				Asia ex China				Asia ex China				Asia ex China				Asia ex China			
Red Sweep	4.2	4.3	4.0	Red Sweep	3.1	3.0	2.9	Red Sweep	2.6	2.7	2.8	Red Sweep	4.2	3.7	3.7	Red Sweep	3.4	3.3	3.4
Blue Sweep	4.2	4.4	4.4	Blue Sweep	3.1	3.0	2.8	Blue Sweep	2.6	2.8	2.7	Blue Sweep	4.2	3.7	3.7	Blue Sweep	3.4	3.3	3.4
Tariffs	4.2	4.3	3.5	Tariffs	3.1	3.0	2.8	Tariffs	2.6	2.7	2.7	Tariffs	4.2	3.7	3.5	Tariffs	3.4	3.4	3.8
US Recession	4.2	3.9	3.8	US Recession	3.1	2.8	2.6	US Recession	2.6	2.4	2.2	US Recession	4.2	2.5	2.6	US Recession	3.5	3.7	3.6
CB's eased too soon	4.2	4.9	4.6	CB's eased too soon	3.1	3.3	3.2	CB's eased too soon	2.6	3.1	3.1	CB's eased too soon	4.2	4.4	4.6	CB's eased too soon	3.5	3.3	3.3
Baseline	4.2	4.4	4.4	Baseline	3.1	3.0	2.9	Baseline	2.6	2.8	2.7	Baseline	4.2	3.7	3.7	Baseline	3.4	3.3	3.4

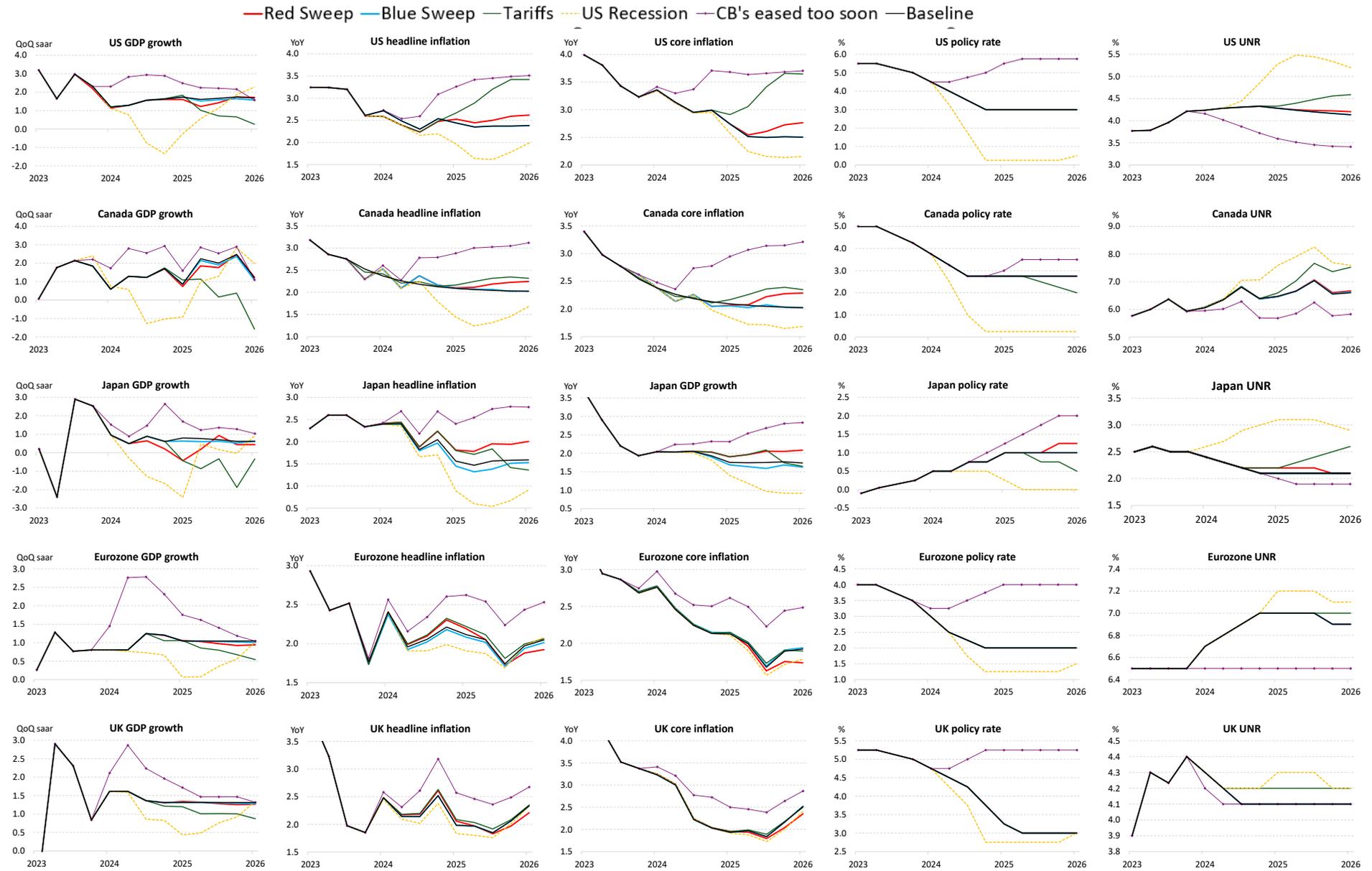
Source: UBS

Figure 60: Delta deviations against different scenarios



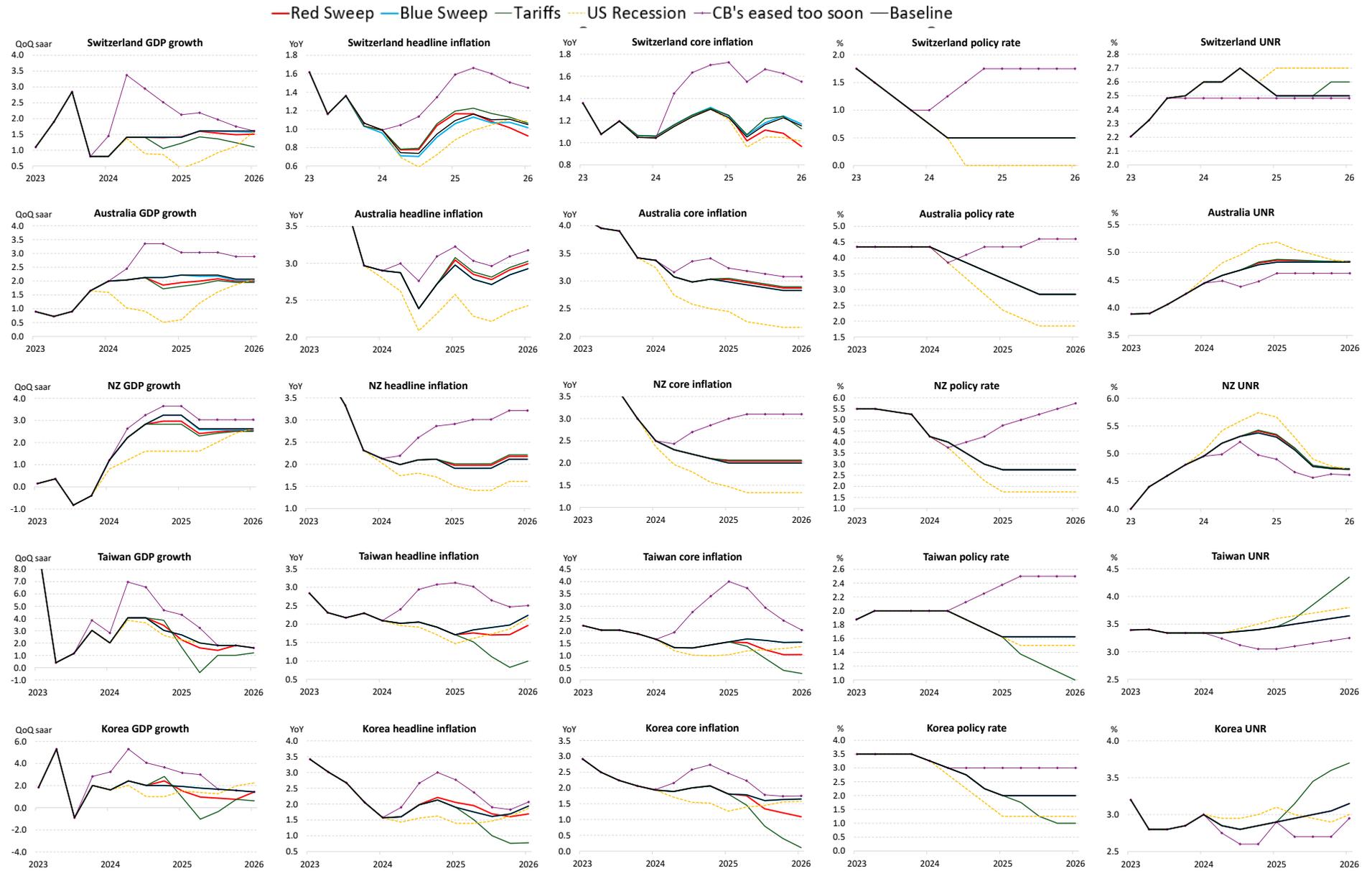
Source: UBS

Figure 61: Panel charts by countries



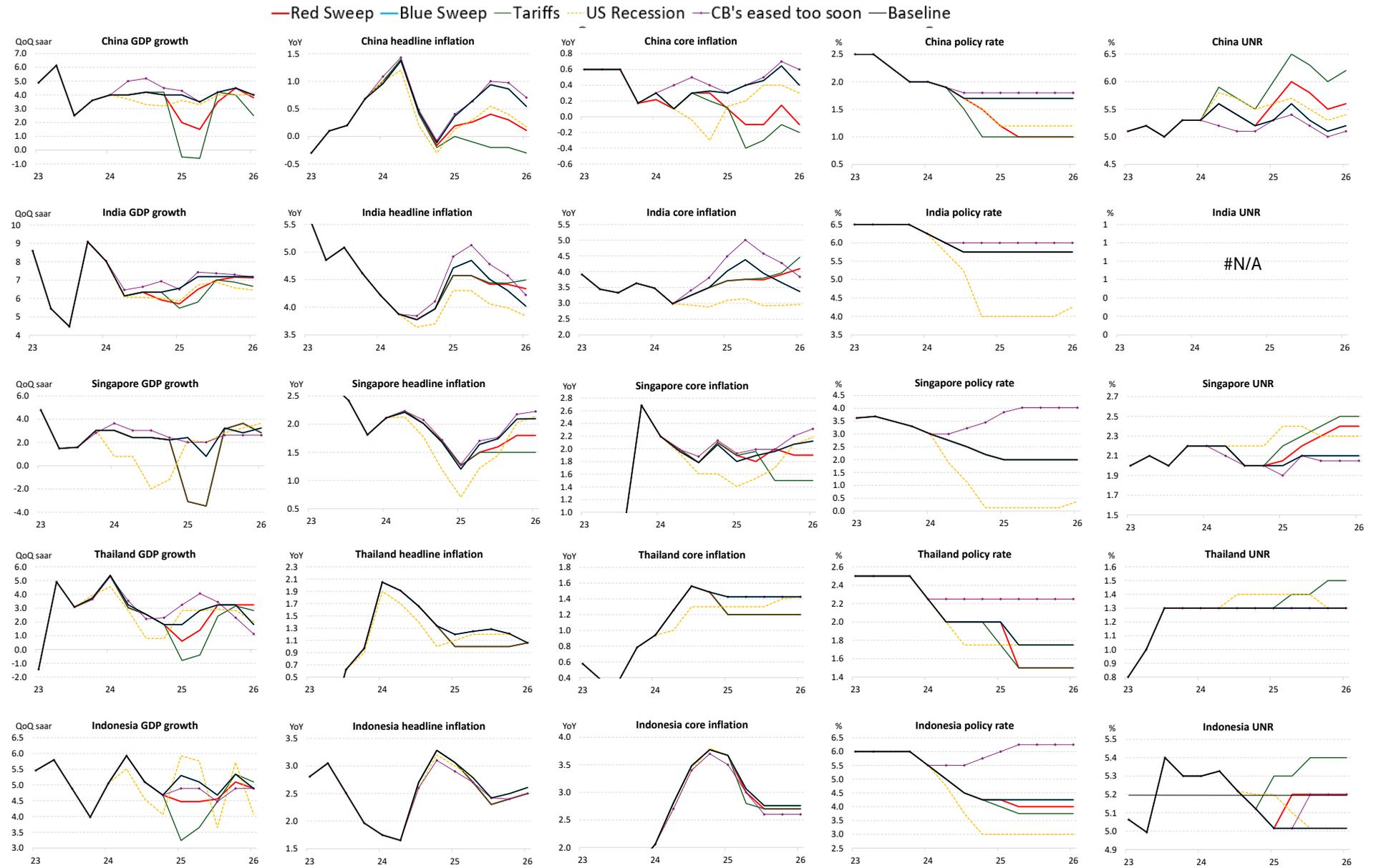
Source: UBS

Figure 62: Panel charts by countries



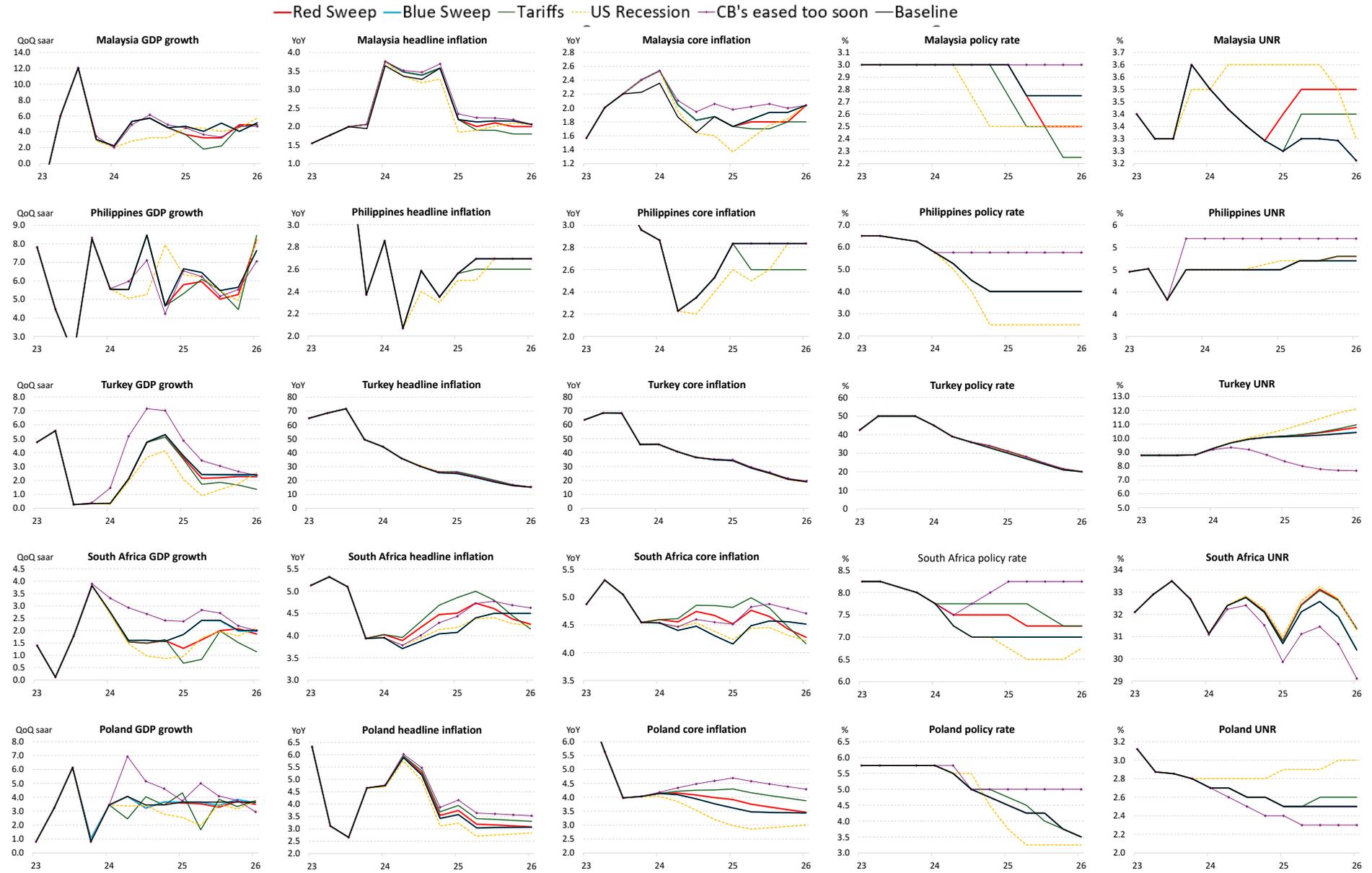
Source: UBS

Figure 63: Panel charts by countries



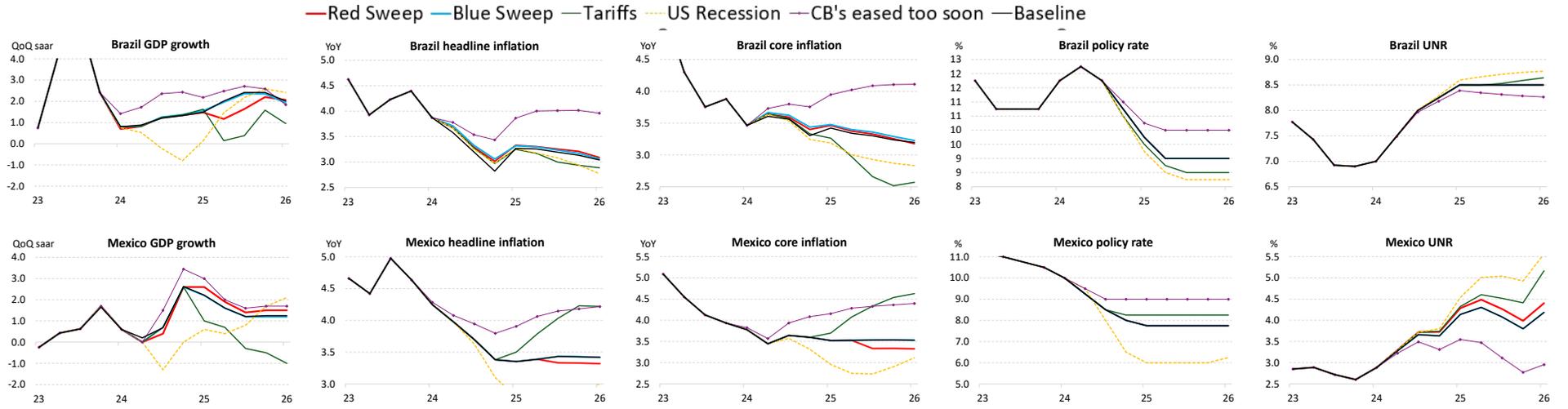
Source: UBS

Figure 64: Panel charts by countries



Source: UBS

Figure 65: Panel charts by countries

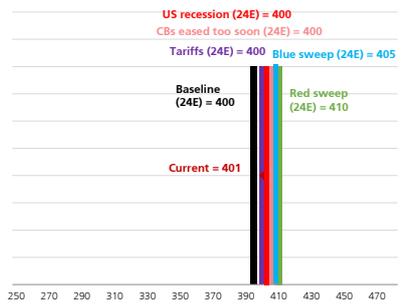


Source: UBS

## Key Asset Market Implications

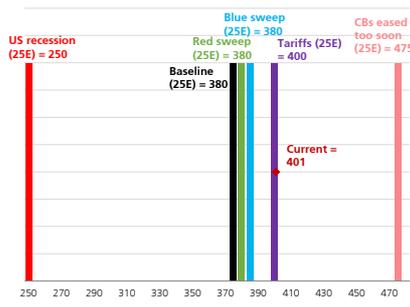
# UBS scenario forecasts

**Figure 66: US 10y yield 2024**



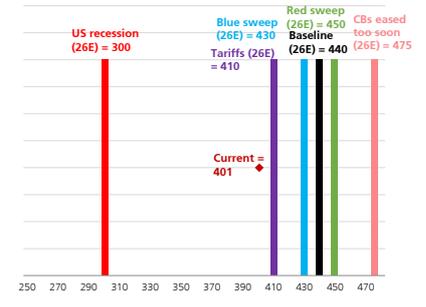
Source: Bloomberg, UBS

**Figure 67: US 10y yield 2025**



Source: Bloomberg, UBS

**Figure 68: US 10y yield 2026**



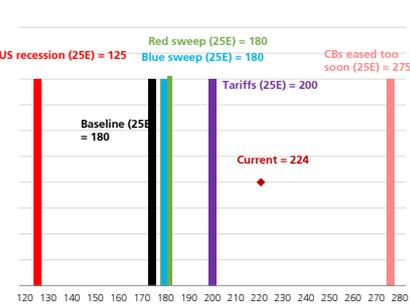
Source: Bloomberg, UBS

**Figure 69: Bund 10y yield 2024**



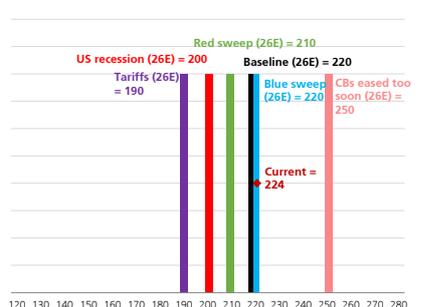
Source: Bloomberg, UBS

**Figure 70: Bund 10y yield 2025**



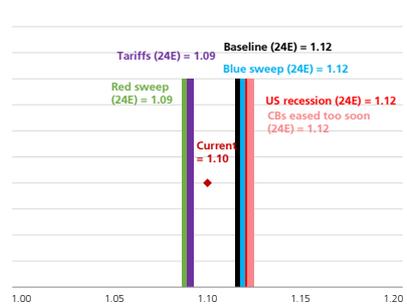
Source: Bloomberg, UBS

**Figure 71: Bund 10y yield 2026**



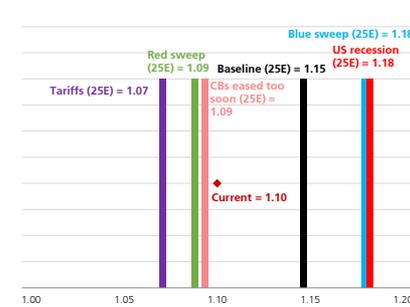
Source: Bloomberg, UBS

**Figure 72: EURUSD 2024**



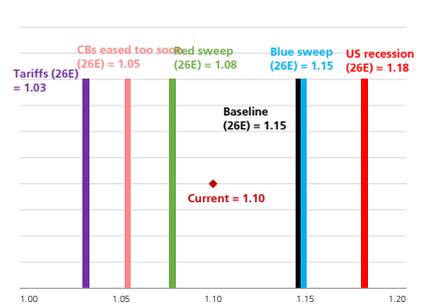
Source: Bloomberg, UBS

**Figure 73: EURUSD 2025**



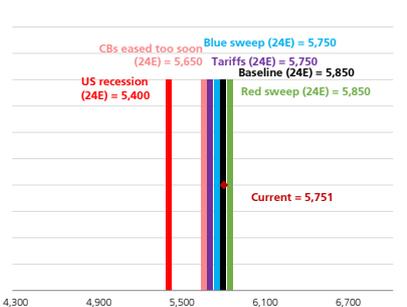
Source: Bloomberg, UBS

**Figure 74: EURUSD 2026**



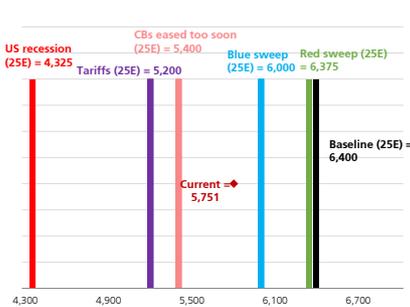
Source: Bloomberg, UBS

**Figure 75: S&P 500 2024**



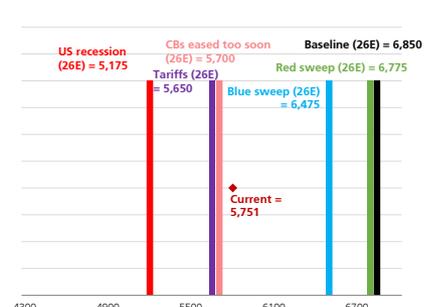
Source: Bloomberg, UBS

**Figure 76: S&P 500 2025**



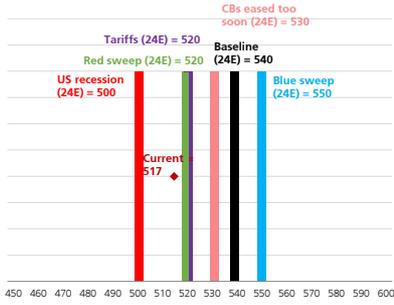
Source: Bloomberg, UBS

**Figure 77: S&P 500 2026**



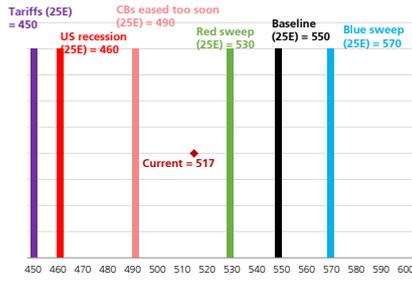
Source: Bloomberg, UBS

**Figure 78: Stoxx 600 2024**



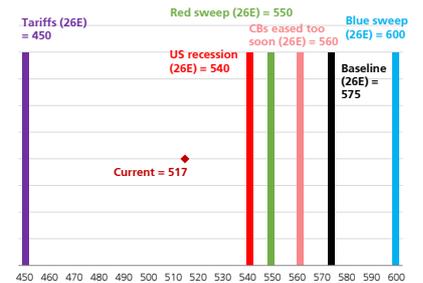
Source: Bloomberg, UBS

**Figure 79: Stoxx 600 2025**



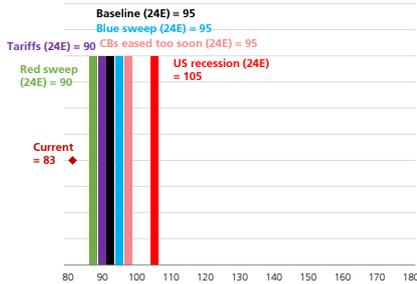
Source: Bloomberg, UBS

**Figure 80: Stoxx 600 2026**



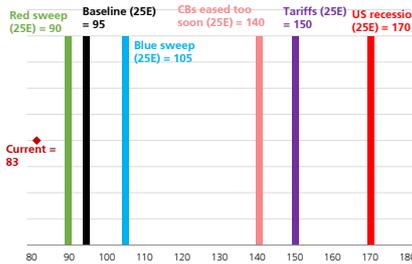
Source: Bloomberg, UBS

**Figure 81: US IG spreads 2024**



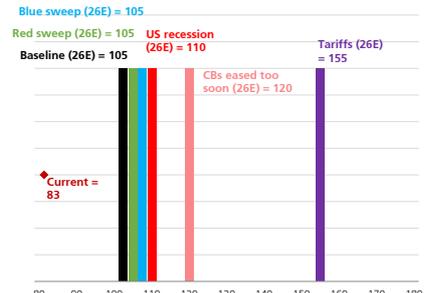
Source: Bloomberg, UBS

**Figure 82: US IG spreads 2025**



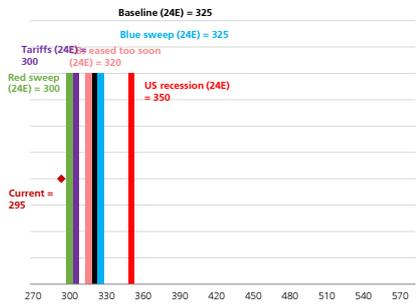
Source: Bloomberg, UBS

**Figure 83: US IG spreads 2026**



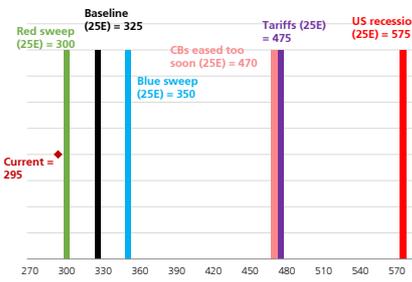
Source: Bloomberg, UBS

**Figure 84: US HY spreads 2024**



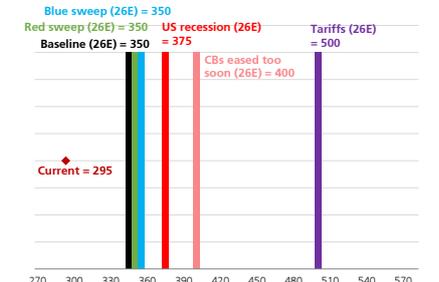
Source: Bloomberg, UBS

**Figure 85: US HY spreads 2025**



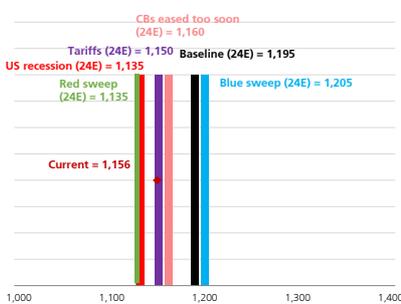
Source: Bloomberg, UBS

**Figure 86: US HY spreads 2026**



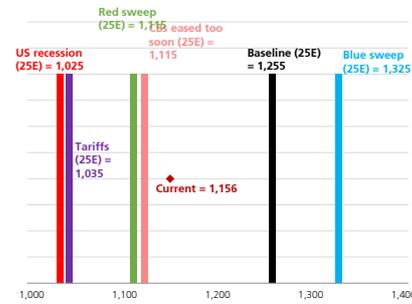
Source: Bloomberg, UBS

**Figure 87: MSCI EM 2024**



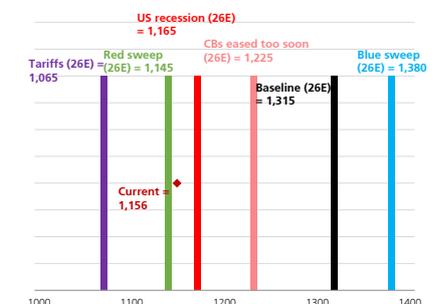
Source: Bloomberg, UBS

**Figure 88: MSCI EM 2025**



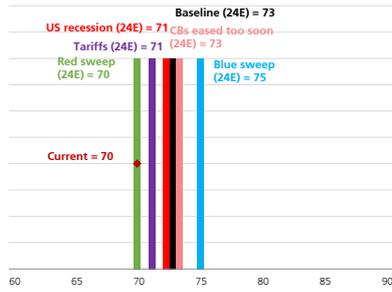
Source: Bloomberg, UBS

**Figure 89: MSCI EM 2026**



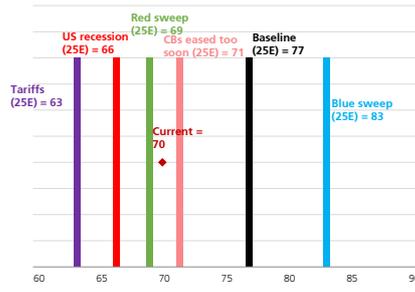
Source: Bloomberg, UBS

**Figure 90: MSCI China 2024**



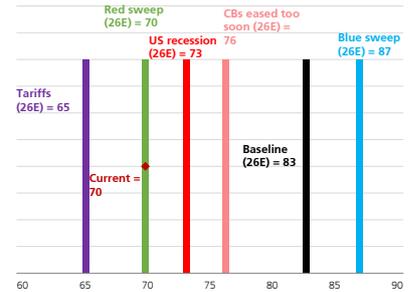
Source: Bloomberg, UBS

**Figure 91: MSCI China 2025**



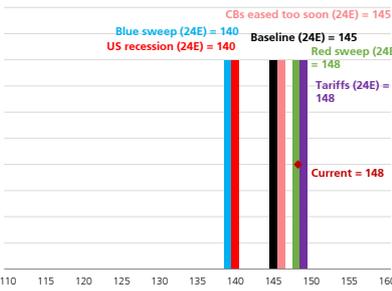
Source: Bloomberg, UBS

**Figure 92: MSCI China 2026**



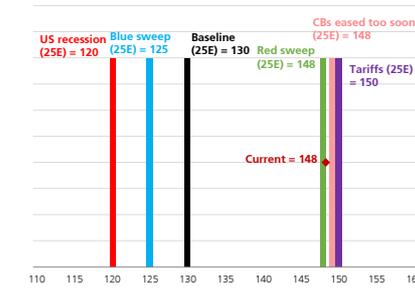
Source: Bloomberg, UBS

**Figure 93: USDJPY 2024**



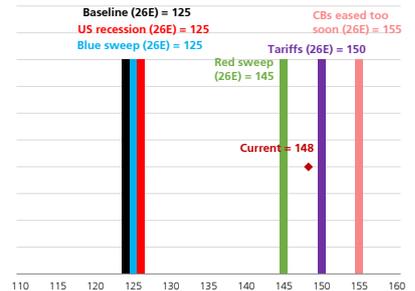
Source: Bloomberg, UBS

**Figure 94: USDJPY 2025**



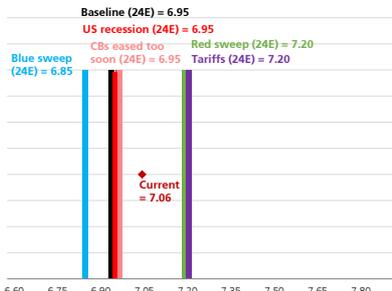
Source: Bloomberg, UBS

**Figure 95: USDJPY 2026**



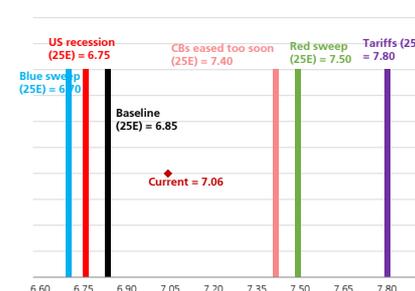
Source: Bloomberg, UBS

**Figure 96: USDCNY 2024**



Source: Bloomberg, UBS

**Figure 97: USDCNY 2025**



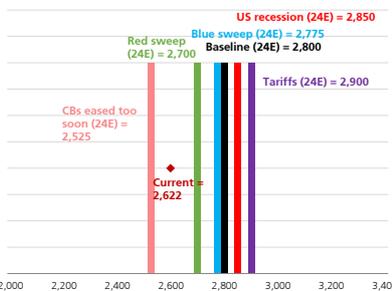
Source: Bloomberg, UBS

**Figure 98: USDCNY 2026**



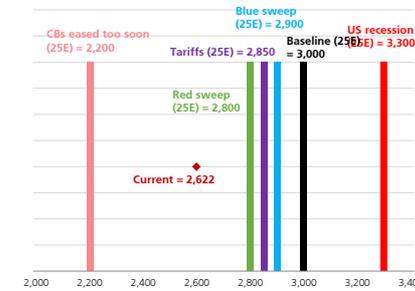
Source: Bloomberg, UBS

**Figure 99: Gold 2024**



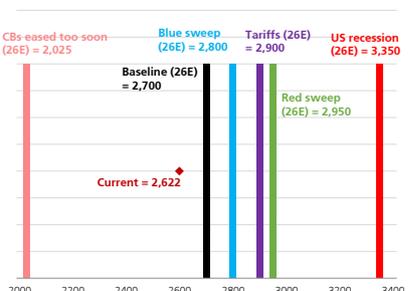
Source: Bloomberg, UBS

**Figure 100: Gold 2025**



Source: Bloomberg, UBS

**Figure 101: Gold 2026**



Source: Bloomberg, UBS

## Equity Strategy

### Key Messages

- In the baseline scenario, 2025 earnings growth is expected to be around trend for the US but around zero in Europe, where margin contraction eats up already low sales growth. Emerging markets are supported by possible China stimulus and USD weakness. Over the forecast horizon to 2026, earnings are notably better if the central banks ease too early, divergent (favouring the US) in a red sweep scenario, divergent (favouring RoW) in a blue sweep and notably weak everywhere in the US recession and Tariffs scenarios.
- Low bond yields and tight credit spreads are generally quite well reflected in current equity valuations. Productivity improvements from AI may support gains and justify more lofty US valuations, but in most scenarios, discount rates (10y Treasury yield + HY spread) are rising. This comes mainly from rising risk-free rates and risk-premia in the Tariffs and US recession scenarios. It comes from both rising risk-free rates and risk-premia in the Central Banks ease too early scenario. In all three scenarios, there are varying degrees of valuation downside to equities. We think this happens most significantly and earliest in the US recession scenario but most persistently in the tariffs scenario.
- By the end of 2026, only the more extreme Tariffs, US recession and Central Banks ease too early scenarios have lasting effects on equity performance. In the baseline, red and blue sweep scenarios, 2025 is somewhat turbulent and divergent dependent on the political outlook, but ultimately with less consequential effects in the longer-term equity market divergences than most might expect.

**The Baseline scenario delivers modest positive returns across markets. Expect higher returns favouring RoW from a Blue Sweep but the reverse for a Red Sweep. Tariffs and US Recession are scenarios with potentially significant negative effects on equity markets in '25, while, under Central Banks Ease Too Early, markets sell off in response to the higher rates regime (despite better earnings). Tariffs cause the most long-term damage outside the US.**

**Baseline** – A soft landing delivers modest sales growth globally but elevated margins constrain the transmission of this into anything above single-digit earnings growth per annum in most markets – China the possible exception depending on stimulus implementation.

**Modest but below-average equity returns as slow nominal growth and elevated margins hold back earnings growth. China and emerging markets outperform as China stimulus increases.**

Valuations already reflect low bond yields and credit spreads. As investors get more confident that rate cuts will stabilise growth, modest further valuation expansion is possible and would deliver positive but below-average returns for equity markets. Valuations increasingly need to be justified by productivity improvements that the Global Equity Strategy team believe will be forthcoming.

Superior US trend growth means the S&P 500 returns ~9% per annum reaching 6400 by the end of 2025. Europe rises more slowly (to SXXP at 550) as margins slowly recede and offset modest sales growth. Emerging markets are supported by continued Asia tech up-cycle (expected to start fading by end-2025) and Chinese stimulus efforts.

**Red sweep** – Relative to the baseline, US equities outperform versus European and emerging market equities. The catalyst is a more 'America-first' policy agenda supporting activity with the benefit of further tax cuts and winding back of regulations.

**The 'America First' strategy leaves the RoW stagnating. Emerging markets are the most vulnerable but Europe too suffers from more significant growth headwinds.**

The threat, and eventual implementation, of tariffs against China (and potentially more broadly) plus the clawback of IRA subsidies, cause more disruption in emerging markets and hence UBS forecasts a decline in 2025 with only a modest recovery in 2026. The disruption in Europe is more modest but enough to stop the index gaining any more than a few percent per annum.

**Blue sweep** – Higher taxes (corporations and buyback taxes) in the US drag on S&P 500 earnings and constrain US equities to only a modest advance in 2025 (to 6000) before returning to trend growth in 2026 and finishing the year at 6475.

**Although the US equity market underperforms, this is mostly due to the likely rise in corporation tax. For other markets, returns are best in this scenario as relative policy stability and a weaker USD allows for nascent recoveries to flourish.**

This is the best scenario for EM and European equity returns in our recent [research](#) given the lower risk premia compared to other scenarios – potentially 5%+ dividends per annum in Europe and more than 10% returns in emerging markets beginning late 2024 and into 2025 before slower growth in 2026.

The lower path of interest rates and consequently a weaker USD are key drivers of the emerging markets outperformance in this scenario.

**Tariffs** – The more disruptive implementation of tariffs against China and more broadly means all markets suffer negative returns in 2025 with the S&P 500 finishing the year at 5200 (-9%) but the European and emerging markets fall more and are down more than 10%. The US market is able to recover somewhat in 2026 but Europe and emerging markets continue to languish with more structural issues and ongoing trade tensions constraining competitiveness. One key element of the nature of this scenario is the redistribution effects of tariffs that cause significant rotations within equity markets.

**US recession** – This is the worst scenario for global equities. The downturn is worst in the US as it comes from a higher base of earnings and valuations. Emerging markets and Europe are better supported due to their exposure to the ongoing China stimulus and their own resilience after having already experienced significant slowdowns through the Covid years.

US equities fall up to 30% to a low of 4150 in 3Q25 on a mix of earnings weakness and valuation decline. Europe and emerging markets valuations also decline but earnings prove more resilient than the US given their lower starting point.

**Central banks have eased prematurely** – In this scenario, nominal GDP growth supports earnings in all markets, but rising interest rates and a potentially even more significant rise in bond yields cause equity valuations to decline materially.

This is especially the case in the US where valuations are already well ahead of where bond yields and credit spreads would imply. Europe declines in tandem with the US given its typically higher sensitivity to rising risk premia, but Europe has a stronger recovery as rising yields and the strong economic cycle support its more cyclical earnings outlook. Emerging markets are reasonably resilient, but as US yields continue to rise, are constrained by the rise of the USD.

**Not only do equity markets fall sharply in 2025, they struggle to recover in 2026 – particularly outside the US.**

**In this scenario we expect the most significant negative equity returns, including the S&P 500 down nearly 30%. In contrast to the Tariffs scenario, economies and global equity markets recover into 2026 on effective policy support.**

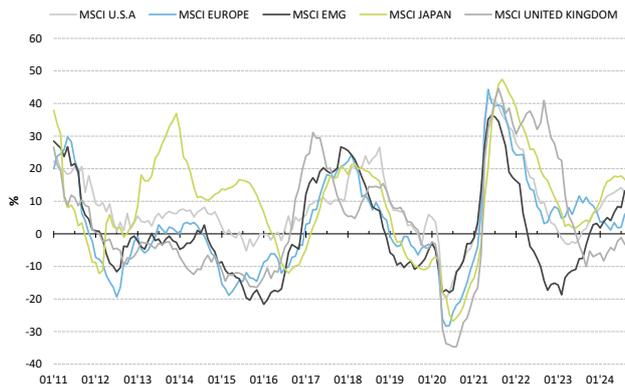
**Faster nominal growth is supportive of earnings growth, but rising bond yields and risk premia offset this, leaving equity markets faster growing but on lower valuations.**

**Figure 102: Index cumulative performance estimates in varying scenarios**

Scenario	Index	4Q 24	1Q 25	2Q 25	3Q 25	4Q 25	1Q 26	2Q 26	3Q 26	4Q 26
<b>Baseline</b>	S&P 500	2%	3%	5%	9%	11%	13%	15%	17%	19%
	Stoxx 600	5%	6%	5%	5%	6%	8%	8%	9%	11%
	MSCI Emerging Markets	3%	6%	6%	8%	9%	10%	12%	13%	14%
	MSCI China	4%	7%	8%	9%	10%	12%	15%	17%	18%
<b>Red sweep</b>	S&P 500	2%	7%	7%	9%	11%	11%	14%	16%	18%
	Stoxx 600	1%	3%	3%	3%	3%	5%	5%	5%	6%
	MSCI Emerging Markets	-2%	-3%	-4%	-4%	-4%	-3%	-2%	-1%	-1%
	MSCI China	0%	-1%	-2%	-2%	-2%	-2%	-1%	-1%	0%
<b>Blue sweep</b>	S&P 500	0%	4%	5%	1%	4%	6%	8%	10%	13%
	Stoxx 600	6%	8%	8%	9%	10%	13%	13%	14%	16%
	MSCI Emerging Markets	4%	9%	12%	13%	15%	16%	18%	20%	19%
	MSCI China	6%	12%	15%	16%	18%	20%	23%	25%	24%
<b>Tariffs</b>	S&P 500	0%	-4%	-17%	-20%	-10%	-8%	-6%	-4%	-2%
	Stoxx 600	1%	1%	-15%	-19%	-13%	-11%	-11%	-13%	-13%
	MSCI Emerging Markets	-1%	-4%	-10%	-10%	-10%	-9%	-8%	-8%	-8%
	MSCI China	1%	-4%	-10%	-11%	-10%	-8%	-7%	-7%	-7%
<b>US recession</b>	S&P 500	-6%	-8%	-19%	-28%	-25%	-18%	-15%	-12%	-10%
	Stoxx 600	-3%	-5%	-11%	-21%	-11%	-3%	1%	3%	5%
	MSCI Emerging Markets	-2%	-4%	-9%	-15%	-11%	-7%	-2%	-1%	1%
	MSCI China	1%	-1%	-5%	-9%	-6%	-3%	1%	3%	4%
<b>CBs ease too early</b>	S&P 500	-2%	-3%	-6%	-7%	-6%	-5%	-4%	-2%	-1%
	Stoxx 600	3%	-1%	-5%	-9%	-5%	-1%	3%	6%	8%
	MSCI Emerging Markets	0%	-3%	-5%	-7%	-4%	-1%	2%	4%	6%
	MSCI China	3%	1%	-1%	-3%	0%	3%	5%	7%	8%

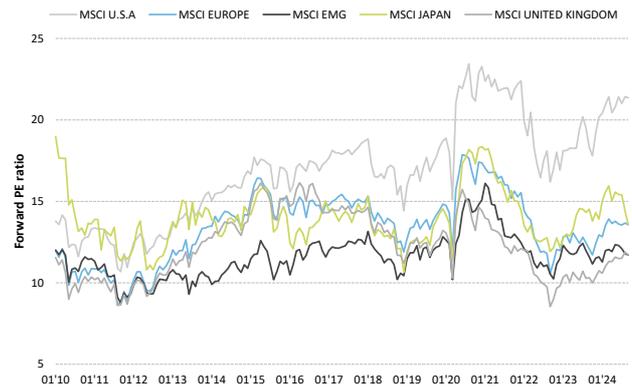
Source: UBS estimates

**Figure 103: Consensus forward earnings growth**



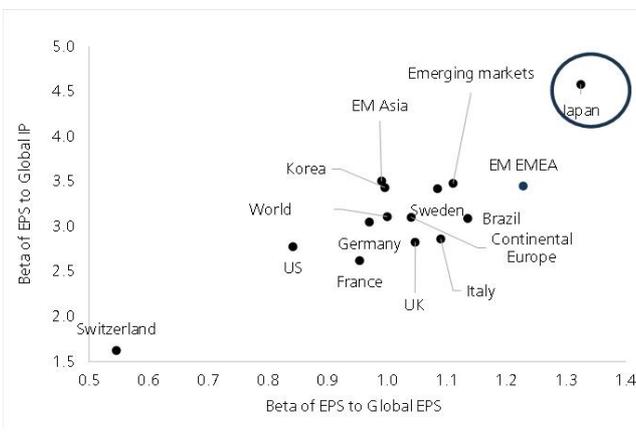
Source: UBS, Refinitiv

**Figure 104: Consensus Forward P/E Ratios**



Source: UBS, Refinitiv

**Figure 105: Operational leverage**



Source: UBS

**Figure 106: Sensitivity to trade war**

Aggregate Rank	Country/region	Beta of EPS to IP	Trade balance with US (% of GDP)	Gross exports to China	Rank of Beta of EPS to IP	Rank of Tr Bal with US	Rank of Exp to China	Avg Rank
1	Korea	3.47	3.03%	14.24%	2	1	1	1.3
2	EZ	3.12	1.22%	2.48%	3	4	6	4.3
3	Germany	3.06	2.67%	3.39%	5	2	5	4.0
2	Japan	4.56	1.76%	4.12%	1	3	4	2.7
5	Brazil	3.10	-0.20%	4.71%	4	7	3	4.7
6	Australia	2.66	-1.03%	11.07%	8	8	2	6.0
7	UK	2.82	0.28%	1.58%	6	6	7	6.3
8	India	2.14	1.22%	1.51%	9	5	8	7.3
9	US	2.77		1.05%	7	9	9	8.3

Source: UBS

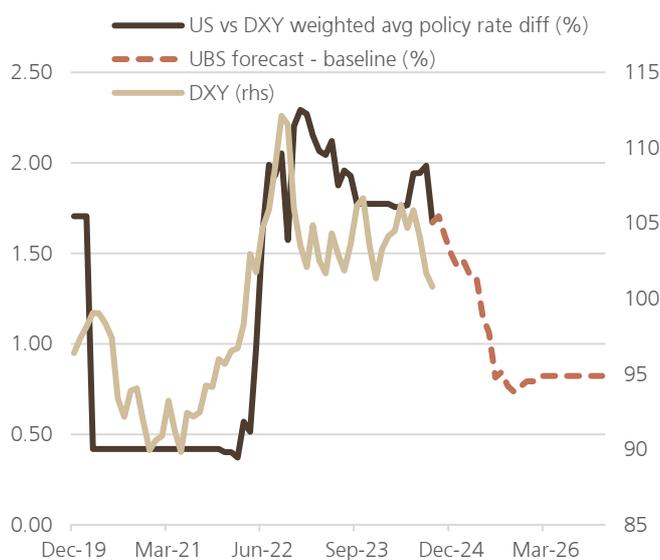
# FX Strategy

## Key Messages

- Our baseline is for moderate USD weakness, with Fed cuts undermining the US yield advantage and driving more hedging of US assets by non-US investors.
- A "blue sweep" would see weakened demand for US assets adding to USD softness. A US recession scenario would be the most USD negative.
- A red sweep featuring more fiscal stimulus (vs our baseline) would bolster the USD, and even more so if substantial tariffs are introduced.

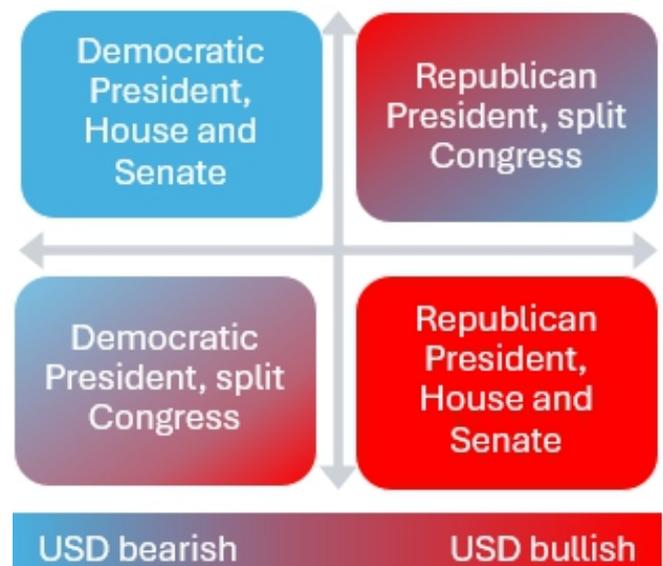
**Baseline:** This scenario sees US rates come lower in line with market pricing, as the US loses its "growth exceptionalism" premium. And while rates also move lower in the rest of G10 bar Japan, rates convergence happens nonetheless given US rates have further to fall from very restrictive levels compared to estimated long-term neutral rates. Indeed, US nominal rates could fall below some key G10 counterparts such as Australia and the UK. This would encourage diversification out of USD among asset managers as well as more USD hedging by overseas investors in the US, all of which would hurt the USD in an environment where "twin deficits" concerns could again matter as real interest rates fall. In this context, we see a weaker USD across the board, but in a controlled and unspectacular fashion against the currencies of countries or regions that also join in the rate cut cycle with some gusto. The key exception is Japan, where we see rates rising despite the cutting cycle in the rest of G10, which allows USDJPY to drop towards 130 and possibly below.

**Figure 107: In our baseline scenario, we expect the USD to weaken in line with its tightening rate advantage**



Source: Bloomberg, UBS

**Figure 108: A "red sweep" US election outcome is the key risk to our baseline call for moderate USD weakness**



Source: UBS

**Red Sweep:** This scenario allows for a) a clearer path towards rolling the expiring 2017 Trump tax cuts and b) an easier path to more controversial policies like tariffs. The resulting outcomes include the following possibilities: higher inflation, a higher Fed terminal rate and higher US real interest rates, based on the need for more term premia given the likeliest policy mix. In this situation, the USD gets wind in its sails once more, although the starting point of a US economy that is losing momentum still prevents an aggressive rally and instead simply takes crosses like EURUSD and USDJPY back towards levels and ranges that have prevailed for long periods of time over the past two years.

**Tariffs:** This scenario sees the most aggressive outcome in terms of the range of products and countries covered by new US tariffs. In that context, it also has the most dramatic potential impact in terms of higher US inflation and by extension higher US interest rates

as well. The loss of competitiveness in US markets would be felt broadly, which might dilute losses suffered at an individual level by exporting nations into the US market, but we would expect their currencies to fall against the USD nonetheless. We see the bigger impact coming through in 2026 after the market sees more clearly the contours of the tariff plan and its real impact on the economy. We do not expect a successful attempt to intervene against USD strength even if political noises are made in this direction.

**Blue Sweep:** This scenario allows for an extension of the status quo combined with market-unfriendly measures such as corporate and capital gains tax hikes as well income tax hikes for higher income individuals. If this leads to underperformance for US assets like equities, it could lead to a relative preference for foreign asset markets which could hurt the USD. Also, the market may fear more Fed rate cuts if the economy tends to a softer outcome in this environment, also pressuring the dollar.

**US recession:** This scenario in principle should be very USD negative by driving down US rates much further than the market is pricing in and creating still more forward rate differential compression and possibly leaving even more ex-US G10 countries with higher rates than the US than in our baseline scenario. This should see more defensive G10 currencies outperform the USD, with the likes of JPY and CHF also outperforming EUR as all G10 rates converge to very low levels. There is a risk in this situation that higher-beta G10 currencies like AUD or GBP actually underperform the USD.

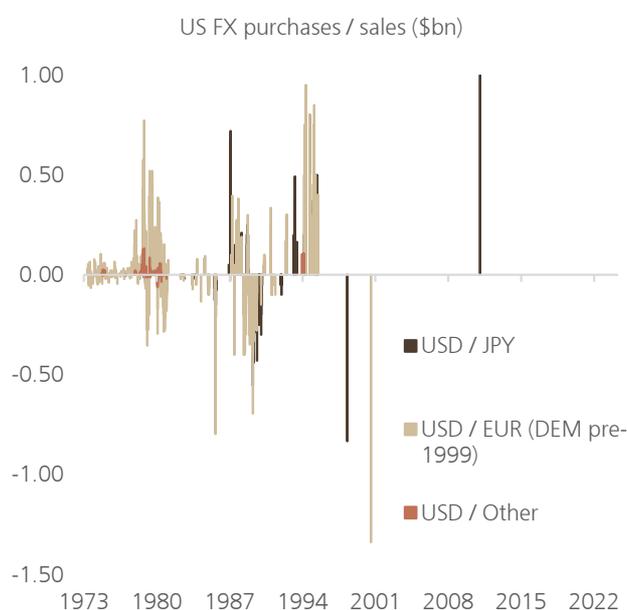
**Central banks eased too soon:** This scenario sees high rates of growth and inflation especially in the US, which reinforces once again the country's "exceptionalism" credentials. In this case, high real rates would once again attract global capital into US markets and the USD could rally to even higher levels on a broad basis than it did in 2024. But we suspect the fact that Japan would also have a freer hand to hike rates in this context would prevent USDJPY specifically moving back above 160 as it did this year. We would expect the US current account deficit to widen but the funding for this should be relatively easy to obtain through high interest rates. Again, there is a possibility that a Trump administration could try to push back against USD strength by threatening intervention, but we doubt this would be a successful strategy.

**Figure 109: Expected FX volatility around the US election date has picked up of late after a year-long decline**



Source: UBS

**Figure 110: US FX intervention has been extremely sporadic since the mid 90s and remains very unlikely**



Source: FRED, UBS

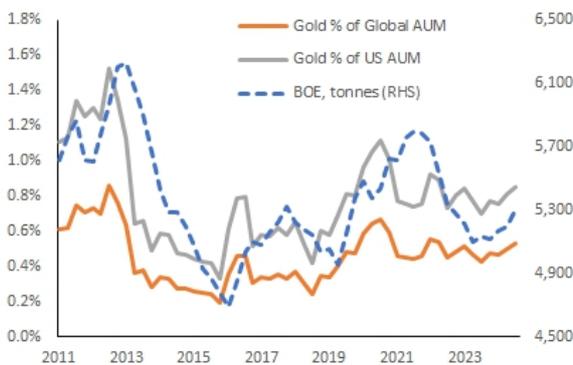
# Gold

## Key Messages

- We expect the market to rally strongly in 2025 and gold to reach \$3,000.
- The 'Central Banks eased prematurely' is most bearish for gold (higher rates, stronger USD), while a US recession would be most bullish.

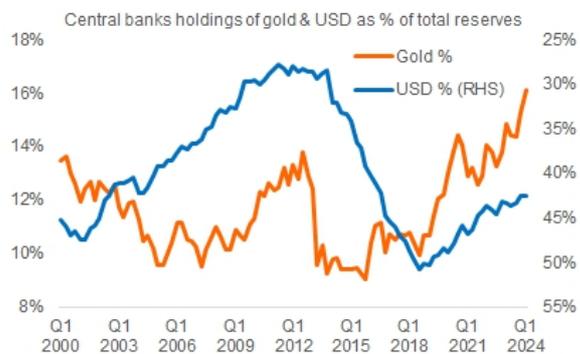
We are bullish on gold as our base case, expecting the market to rally strongly in 2025 to reach \$3,000. Strategic investor flows are likely to drive prices higher, in our view, incentivised by the lower cost of carry as the Fed cuts rates further. Investors are attracted to gold's safe haven and diversification properties in an environment of persistent macro uncertainty and heightened geopolitical risks. Despite gold's rally in 2024 and the strong bullish consensus, we don't think market positioning is crowded and there is space for gold allocations to grow over the next 12 months.

**Figure 111: Gold allocations have room to grow**



Source: Bloomberg, BOE, CFTC, Morningstar Inc., various funds, UBS. Note: value of gold held in Comex net longs and ETFs vs global/US funds' AUM.

**Figure 112: Central banks are diversifying into gold**



Source: IMF, WGC, UBS.

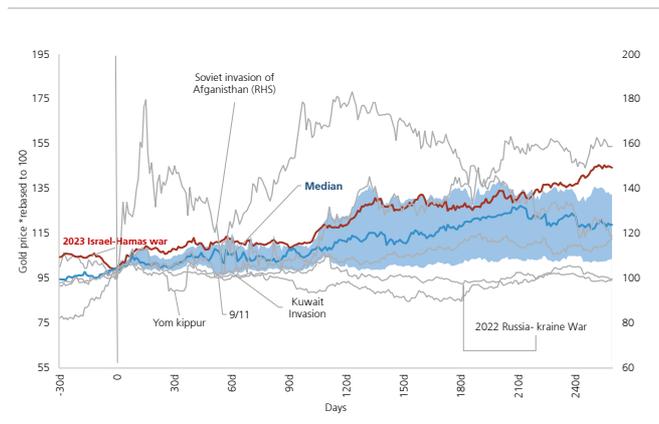
The official sector, which tends to buy physical gold bars, is likely to continue adding to reserves, for diversification purposes and amid geopolitical tensions and sanctions risks. Many central banks' gold reserves remain small as a percentage of total assets. Meanwhile, consumer demand for physical gold should stay resilient despite higher prices. Although volumes are likely to be dampened by gold's more expensive price tag, there should be offsetting factors, such as interest in gold as an alternative investment in markets such as China, and growing incomes in India.

Against a reasonably supportive fundamental demand backdrop, we expect supply to be broadly contained. Mine production does not respond quickly to higher prices and large hedging strategies are not popular with major producers as their shareholders are not keen on having their exposure to gold upside capped. While scrap supply should see some response to higher gold prices, we expect this to be contained given lower stocks and the anticipation of even higher gold prices holding back sales. The positive sentiment towards gold also suggests there is likely more willingness among retail consumers to hold on to existing gold stocks.

The impact of geopolitics on gold is not straightforward. Persistent geopolitical risks are likely part of the list of reasons investors would want to hold a core long position, but the direct price impact is less clear and difficult to isolate. History suggests there could be knee-jerk safe-haven flows into gold, but the price impact tends to fade over time (e.g. as it did following Russia's invasion of Ukraine) unless other macro factors such as real rates and the dollar also shift. A spike in oil prices that affects real rates through the impact on inflation and inflation expectations would have a more sustainable effect on gold prices than flight-to-safety flows alone. Looking at how gold has behaved on average during previous periods of conflict, the median reaction was around +5% early

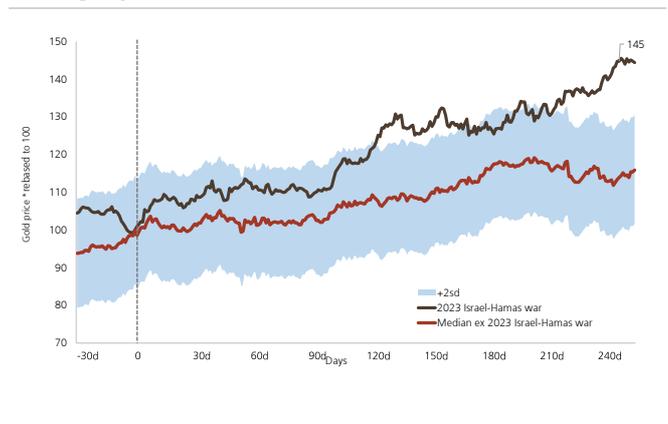
on. Given current spot prices, this implies making new highs through \$2,700 initially. As situations unfolded in the past, gold prices increased by as much as 20% on average over 3 quarters, which currently would imply a move beyond \$3,100.

**Figure 113: Gold prices following prior geopolitical events**



Source: UBS, Haver

**Figure 114: Price since start of Israel-Hamas war vs average other geopolitical events**



Source: UBS, Haver

Gold’s price move since the beginning of the 2023 Israel-Hamas war looks outsized, but we think this is because there have been other factors driving gold higher as well. Fed easing, the decline in real rates, weaker dollar, central bank buying, broadly resilient consumer demand and the lack of investor positioning have all contributed to gold’s strength over the past 12 months.

**Scenario 1: Red Sweep** – Stronger USD, higher rates albeit due to higher inflation, and stronger equities are likely to weigh on gold. There could be some offset from safe haven flows on the potential for a more volatile geopolitical landscape or perception of more uncertainty. However, in the medium term we expect gold to be higher relative to the base case and the Blue Sweep as concerns about the US fiscal deficit mount. There’s likely to be more uncertainty in gold’s reaction function under the Red Sweep scenario and more risks to our expectations. The market’s perception of the implications of this outcome on inflation and the Fed’s response will be crucial to how gold is traded.

**Scenario 2: Blue Sweep** – While initially lower than our base case, we expect gold prices to generally be higher under this scenario given a weaker dollar and the potential for more Fed cuts. Concerns about a wider fiscal deficit are likely to encourage some investor flows into gold over the medium to long term, though the widening is likely to be less than under a Red Sweep.

**Scenario 3: Tariffs** – Safe haven flows could initially push gold prices higher, but could then retrace as the US dollar strengthens. Higher tariff-induced inflation could compress real rates and support gold further out. Official sector gold buying might also be stronger as trade tensions rise. These cross-currents could keep gold within a broad range around historically elevated levels. With so many moving parts, we have the least conviction in our forecasts for this scenario and see risks to the downside.

**Scenario 4: US Recession** – The most bullish scenario for gold would be if the US fell into a recession. We expect strong investor flows as the Fed cuts policy rates aggressively and real rates fall sharply. A much weaker US dollar should also provide an additional boost for gold. Given current positioning, which we don’t think is crowded, there is plenty of scope for investors to build large gold positions.

**Scenario 5: Central banks have eased prematurely** – This is the most bearish scenario for gold given the likelihood of aggressive Fed rate hikes (relative to market pricing). It will be difficult for investors to hold positions in gold given the high cost of carry. The return of “US exceptionalism” and a stronger dollar should also weigh on prices. We would expect gold to fall alongside stocks, though outperforming on the way down. A potential upside risk under this scenario is if investors start to worry that Fed hikes are too aggressive and perceive them as a policy misstep.

## Rates Strategy

### Key Messages

- Impact of US elections on 10y rates limited in 2025 but important in higher inflation scenarios.
- Private sector to absorb more sovereign supply in US vs EUR in the coming years.
- We expect US curve steepening as we drift towards a pre-2013 paradigm.
- Euro rates do well in most scenarios but political uncertainty source of risk.
- Bond-equity correlations to turn positive again in tariffs and premature easing scenario.
- TIPS breakevens should perform well in non-recession scenarios.

### Higher US 10y rates in 2026 but not in 2025

The impact of the US elections on Treasury supply is likely to be limited in the near-term (contrary to commonly-held belief in markets, we think) in so far as it doesn't change the already bleak underlying fiscal deterioration over the longer-term. The baseline is for US marketable debt to more than double in the next decade, independent of the election outcome. After some near-term flattening, we expect [US curve steepening](#) as we drift to a pre-2013 paradigm. We believe that markets are most likely to focus on this question in higher-inflation environments with less anticipated support from the Fed. This could occur if central banks have misjudged inflation fundamentals and are cutting rates too soon, or if high tariffs worsen the inflation-growth mix. In a decelerating growth/inflation environment, meanwhile, natural demand for fixed income is likely to be sufficiently supportive to push concerns about government funding into 2026 or beyond. The run-off of the Fed's QE portfolios and the funding cycle driven by the debt ceiling is a possible source of [idiosyncratic volatility for rates](#) – particularly funding rates – in 2025. We see risks here focused in Q2.

### Risks skewed toward a steeper US curve

In 2025 we expect steepening pressures to return as the US curve reverts to its 2000-2012 relationship with front-end rates ([Figure 119](#)). Since 2013, the curve has been structurally flatter at all times, except when rates were extremely low. We attribute that flatness to QE and the prospect of QE given low inflation, and expect that a seemingly higher hurdle for future QE and supply will cause the curve to drift toward the pre-2013 paradigm.

### Curve flattening risks clearest in red sweep or if central banks have eased prematurely

Yield curve flattening is most likely in a red sweep. That seems clearest in a tariff scenario, where the Fed cuts more slowly but markets anticipate slower growth in 2026 and later. But without tariffs, a red sweep may also flatten the curve, if stronger risk-asset appreciation drives diversification flows toward duration, while the front end may still need to price a slower path of rate cuts.

Uncertainty also likely picks up substantially in the tariff scenario, however. That may mean higher rates volatility. But it also opens up the range of possible curve outcomes. For example, if higher inflation drives the stock-bond correlation positive ([Figure 118](#)) again, it would undermine diversification demand for treasuries. Note that this would have global significance. For example, in Europe the fall in inflation and restoration of 'risk-on/risk-off' dynamics was well timed to [mitigate the impact of political uncertainty and market volatility](#) through the middle of 2024.

### Inflation breakevens higher

Our projections for CPI across scenarios are above expectations embedded in TIPS ([Figure 117](#)). In addition, in most scenarios, a softer landing in growth and a benign outlook for risk are likely to be supportive for breakevens. TIPS have behaved largely according to the rule of thumb in which a Trump presidency (with or without a sweep of Congress) would be more inflationary. We tend to agree: our modelling of the red-wave

**US election is expected to have limited impact on US Treasury supply**

**Risk seen from misjudged inflation path and therefore easing too soon**

**Near term flat curve bias but we expect steepening pressures in 2025**

**Red sweep or policy mistake scenarios to push curve flatter**

tariff scenario does suggest inflation risk that is not captured in breakeven inflation. In most scenarios, the lower and stabler inflation path is likely to limit upside for TIPS breakevens. However, in our tariff and 'premature rate cut' scenarios, inflation assets may diversify for risk assets more effectively again, making them more attractive. Real rates will be mostly determined by nominal rates and higher inflation is likely to come hand-in-hand with higher real rates.

**Breakeven higher under Trump presidency**

**Euro rates do well in most scenarios but political uncertainty a source of risk**

We are constructive on European duration across scenarios, given downside risks to euro area growth, shifts in the ECB reaction function as inflation returns to target, and the re-emergence of core bonds as a hedge.

**Constructive on European duration across scenarios**

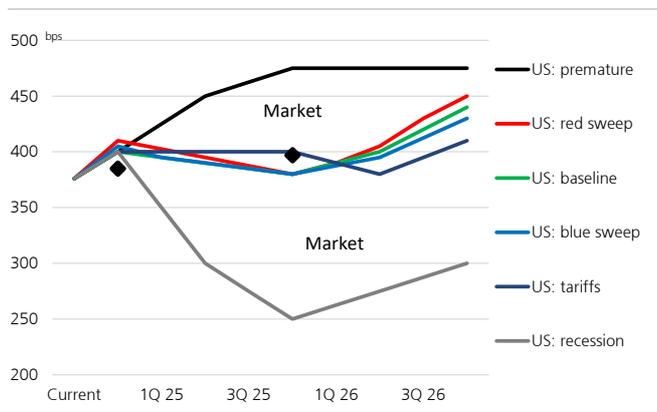
In a red sweep, weaker external demand from both China and US could be negatives for the European cycle. In a high-tariff scenario, the growth-inflation mix is likely to put downward pressure on European rates. In this case, European growth is likely to be slightly weaker, with little upward pressure on European inflation as weaker demand balances higher import prices. The US recession is relatively mild, so we see bund yields rising as growth recovers and the ECB starts hiking again at the end of 2026.

We broadly see the 10y Treasury-bund spread widening to around 200bp in 2025 and slightly further in 2026. Treasuries would outperform in a recession scenario, however. Conversely, we see downside in bunds only if inflation proves more resilient than expected, but in this case we do not expect markets to react to the theme until mid-2025.

**Treasury-bund spread to widen to around 200bp in 2025 and higher in 2026**

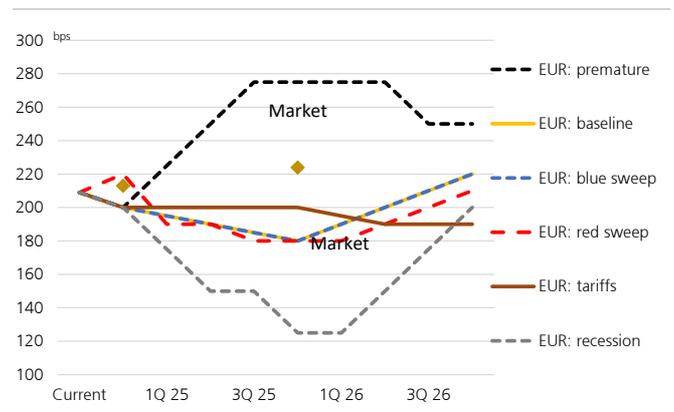
Politics is also a key source of risk in European rates, particularly in France where political uncertainty is a theme that will stretch well into 2025 and probably beyond, but the long maturity of France's debt, its diversified investor base, its large pool of domestic savings, and lower policy rates, should be sufficient to contain spreads overall.

**Figure 115: US 10y rates outlook in different scenarios**



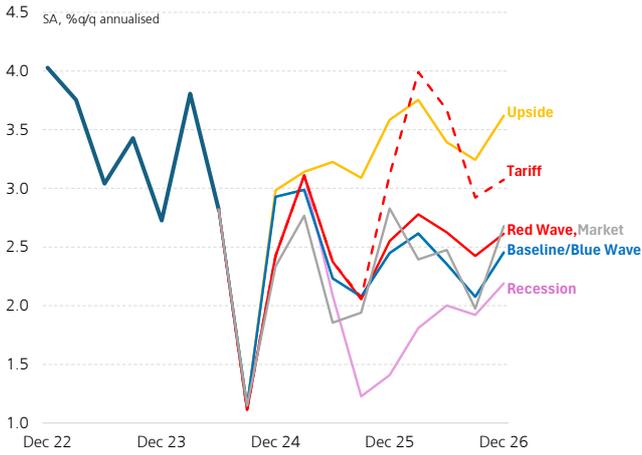
Source: Bloomberg, Haver, UBS

**Figure 116: German 10y rates outlook in different scenarios**



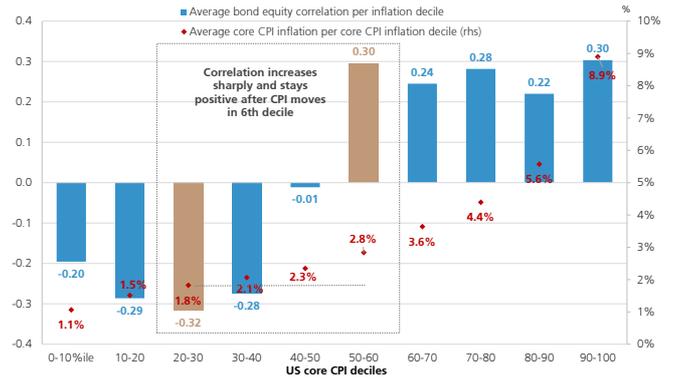
Source: Bloomberg, Haver, UBS

**Figure 117: Scenario paths for US CPI-U inflation compared to market-implied**



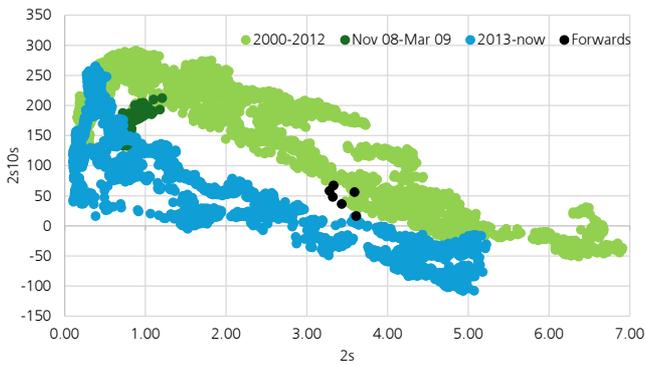
Source: Bloomberg, Haver, UBS

**Figure 118: Bond-equity correlations would turn positive again in the tariffs and premature easing scenario**



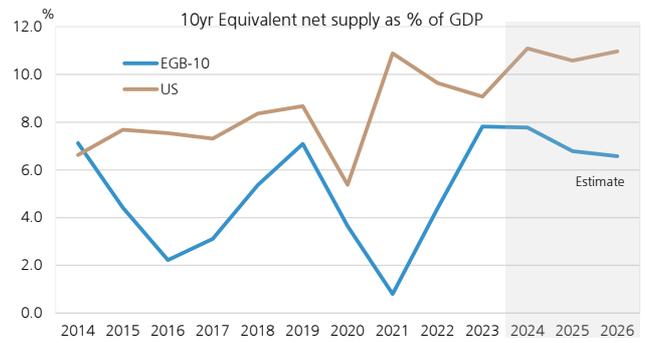
Source: Bloomberg, Datastream, Haver, UBS

**Figure 119: The US curve is returning to 2000-2012 patterns**



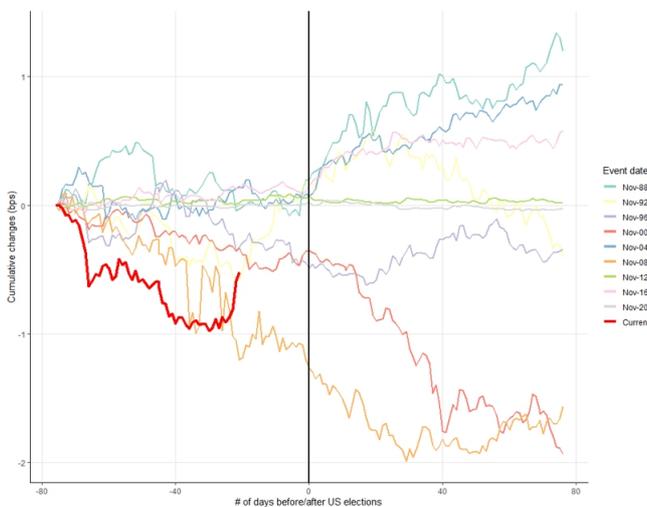
Source: Bloomberg, Haver, UBS

**Figure 120: Net sovereign issuance to private sector as % of GDP – private sector to absorb more in the US vs EUR in the coming years**



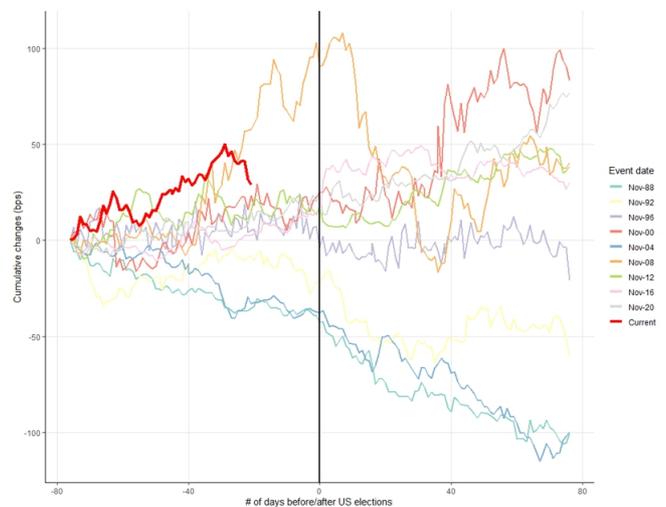
Source: Bloomberg, Haver, UBS

**Figure 121: US 2y rate performance around past US elections**



Source: Bloomberg and UBS.

**Figure 122: US 2s10s curve performance around past US elections**



Source: Bloomberg and UBS.

## Credit Strategy

### Key Messages

- We expect credit spreads to stay in a stubbornly tight range through 2025 as residual inflows from high yields and solid balance sheets provide a counterweight to lower growth. In our baseline, US credit should see equity-like total returns next year (9.0/6.4% HY/IG), while EU credit mirrors 2024's strong performance (7.5/4.7% HY/IG). We see limited long-run impacts in a blue or red sweep (barring tariff escalation).
- Large-scale tariffs and reaccelerating inflation are two non-recession tail risks that could drive a meaningful repricing in credit spreads. Tariffs would drive US IG underperformance vs US HY, and EU underperformance vs the US, as companies with non-US operations get hit the hardest. Both scenarios see US HY spreads peaking at 500bp in 2025, while EU HY peaks at 600bp on tariffs and 500bp on reflation.
- Our US recession scenario is shallow and short, with US IG/HY spreads peaking at 195/650bp in Q3 2025, while EU IG/HY spreads outperform with wides of 180/600bp. We would expect central banks to act swiftly and aggressively to any meaningful slowdown in growth, leading to a recovery beginning in Q4 next year.

**Our baseline:** our baseline is a [softish landing for global credit](#), with rangebound spreads in the US (IG 90-95, HY 300-325bp) through 2025 with the tightest levels seen in Q1 following the removal of US election uncertainty, lagged FOMO flows into US fixed income, and seasonal considerations. US real GDP growth proves resilient, but remains below 2% (1.6% in 2025, 1.7% in 2026), limiting further material tightening, particularly in lower-rated credit as (strong) growth matters more than (lower) rates. EU spreads are also range-bound in 2025 (IG 105-110, HY 325-350bp), but tighten marginally given wider starting valuations and easing concerns around EU growth risks (real GDP 1.0% in 2025, 1.1% in 2026). FY2025 excess returns in EU HY/IG (4.3, 1.3%) outperform US peers (3.3%, 1.0%), but FY25 total returns in US HY/IG (9.0%, 6.4%) best EU (7.5%, 4.5%) as we expect more aggressive rate cuts in the US (with the Fed Funds rate hitting 3% by Q325) and core inflation moving towards the Fed target (3.0% in 2025, 2.5% in 2026). Conversely, the ECB cuts to 2% by Q325 and holds there with headline inflation at target (2.1% in 2025, 2.0% in 2026).

**Red and Blue Sweeps:** in a Red sweep scenario we forecast moderately tighter tights for US spreads in Q1 (IG 80, HY 275bp) and a lower 2025 range (IG 80-90bp, HY 275-300bp) as deregulation and lower corporate tax rates create winners and losers, but on balance support corporate cash flows without triggering large moves in 2025 US growth, inflation or interest rates relative to our baseline. In Europe, we see spreads underperforming initially, but with negligible long-term impact on EU growth, inflation or policy rates, EU spreads remain in the same range as in our baseline (IG 105-110, HY 300-350bp). Conversely, in a Blue sweep scenario, we see a higher 2025 US spread range (IG 95-105, HY 325-350bp) on more regulation, higher future corporate tax rates, and on balance more losers than winners across key sectors per [our prior analysis \(e.g., tech, telecoms, banks\)](#). Here again, the US and EU growth, inflation and policy paths are stable next year. In Europe, spreads are largely immune and outperform marginally through 2025.

**Tariff scenario:** the first of three more interesting outcomes. Q1 25 sees slight widening as news starts to trickle out that more wide-ranging tariffs than initially expected are being considered, then a series of announcements about escalating tariffs begin in Q2 to widen US spreads throughout the year, as mid and end-25 IG/HY spreads hit 125/400bp and 150/475bp, respectively. US IG underperforms HY as the HY/IG spread ratio compresses from ~3.4:1 to 3.2:1 as larger multinational firms (which are typically IG rated) are more directly impacted from tariffs, whilst US growth proves resilient next year (1.6% in 2025, 1.1% in 2026) but core inflation rises (3.0% in 2025, 3.4% in 2026). EU spreads underperform the US, particularly in HY, as EU HY is more heavily weighted to basics and consumer cyclicals (~30% of the index) and EU growth softens marginally (real GDP 0.9% in 2025, 0.8% in 2026). EU IG/HY spreads reach 135/425 and 160/550bp, respectively, at mid and end-25, with the EU HY/IG ratio decompressing from ~3.1:1 to 3.4:1 (the reverse of the US).

**Lower rates and lower (though resilient) GDP growth in 2025 keep credit spreads in a stubbornly tight range in our baseline scenario. EU spreads should marginally outperform US counterparts, but US total returns are set for another strong year at 9.0/6.4% in HY/IG**

**Lower corporate tax rates and a weaker regulatory environment lead to a marginally tighter range in a red sweep, though ultimately a unified US government on either side of the political aisle does not have a meaningful impact on growth, inflation or global credit spreads**

**Large-scale tariffs would drive meaningful spread widening as corporate profits take a significant hit. HY/IG spread ratios would compress as multinationals are impacted most acutely, with US/EU IG peaks in Q3 2025 at 160/175bp, respectively**

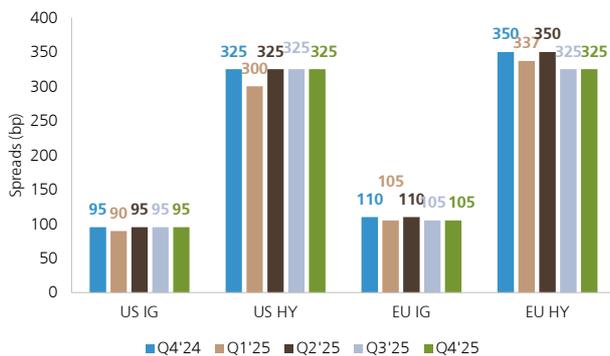
**US recession scenario:** this scenario is a shallow US recession by historical standards (e.g., real GDP growth 0.5% in 2025 and 2026, UE rate at end-25/26 at 5.3/5.2%) and quite short – starting in Q2 and ending in Q425. US/EU HY [default rates are also starting at low levels \(0.7%, 1.6%\)](#), in part as nominal earnings growth has remained solid; these factors should limit the cumulative defaults and drawdown in corporate earnings. Lastly, we see the Fed reacting quickly and cutting the FF rate to 0.25% by Q325 to support a recovery (and willingly employing credit facilities as needed to combat market dysfunction). We anticipate US spreads widening in the first three quarters, with IG/HY spreads peaking at 195/650bp in Q325. In comparison, EU IG/HY spreads outperform, peaking at 180/600bp in Q3 as the ECB also reacts aggressively (cutting to 1.25% by Q3), but the EU employment/growth shock is less severe (2025 real GDP 0.7%, 2026 0.4%). At end-25 US IG/HY and EU IG/HY spreads are beginning to recover to 170/575 and 150/500bp, respectively.

**We would expect a recession in the US to be shallow and short, with the Fed responding quickly and aggressively to any slowdown in growth. We see US IG/HY spreads peaking in Q32025 at 195/650bp, while EU IG/HY spreads peak at 180/600bp**

**Central banks eased prematurely:** in this outcome we see a material re-pricing in credit spreads in the first three quarters of 2025 on an inflation/policy shock, with US IG/HY spreads widening and peaking at 150/500bp as headline US inflation rises to 3.1% in Q325 – 3% is a key threshold for credit spread and rate correlations to flip positive. 10yr rates rise to the 4.5% and 4.75% context in mid and end-25, and the Fed stops cutting the FF rate at 4.5% and has to signal a first hike in Q225 to 4.75% (and 100bp in additional hikes through Q126). The silver lining is that US real GDP stays strong (2.7% in 2025, 2.4% in 2026) and core inflation also plateaus (3.5% for 2025, 3.7% for 2026), supporting a gradual recovery starting in Q4 with IG/HY spreads at end-25 at 140/470bp. In Europe we anticipate short-term spread volatility in H1, but EU spreads widen less through Q3 (peaking at 145/500bp). Ultimately EU inflation decouples from the US (headline 2.3% in 2025, 2.4% in 2026), while EU growth is stronger (2.0% in 2025, 1.7% in 2026), but EU IG outperforms HY as the HY/IG spread ratio decompresses from ~3.1:1 to 3.5:1 at end-25.

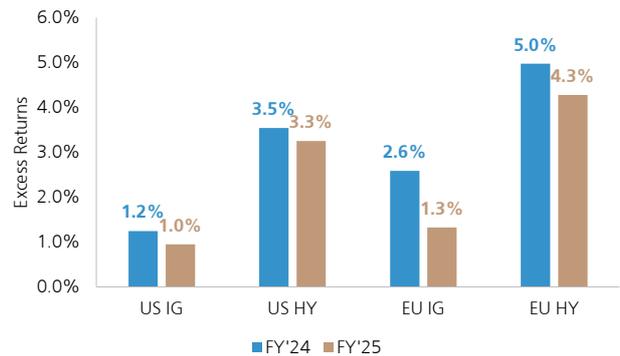
**A reacceleration in inflation above 3% would drive a meaningful repricing in credit risk, despite more robust GDP growth in this scenario. We would expect peak policy uncertainty in H2 2025, with a gradual recovery through 2026.**

**Figure 123: Quarterly spread forecasts for US and EU corporate bond markets through 2025**



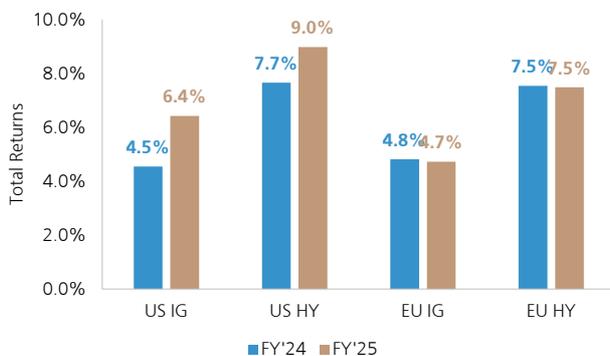
Source: Bloomberg Barclays Indices, UBS estimates

**Figure 124: Projected FY2024 and 2025 corporate bond market excess returns (in local currency)**



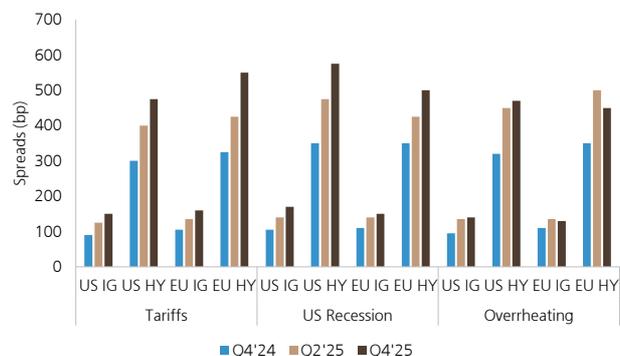
Source: Bloomberg Barclays Indices, UBS estimates

**Figure 125: Projected FY2024 and 2025 corporate bond market total returns (in local currency)**



Source: Bloomberg Barclays Indices, UBS estimates

**Figure 126: End-24 and end-25 credit spreads forecasts in alternate scenarios**



Source: Bloomberg Barclays Indices, UBS estimates

## Emerging markets

### Key Messages

- We expect ~10% equity, ~7% local debt and ~5% sovereign credit total returns in the baseline (no tariff) scenario.
- The size and texture of China's fiscal stimulus remains the most important upside risk for EM.
- USDCNY likely rises to 7.8 in a high tariff scenario; consider protection via 6m [USDCNH](#) or JPYCNH call options.

**Baseline views:** As discussed in "[Are these the late stages of EM underperformance](#)", a three-year regime of strong US growth and rates exceptionalism appears to be drawing to a close, presenting a lower bar for EM ahead. EM does not have particularly strong "pull factors" from growth, fiscal or reform dynamics, in general, but we expect that clean investor positioning should enable a modest recovery in net portfolio inflows after their longest dry spell in ~20y as growth differentials vs. the US improve. UBS expects MSCI EM ex China growth to ease from 4.1% in 2024 to 3.7% next year, a 40bp decline, while the US slows from 2.6 to 1.6% – a steeper 100bp decline. We see faster EM monetary transmission and improving real wage growth helping ASEAN and EMEA, on aggregate, hold up, driving MSCI EM ex China GDP growth differentials vs the US to the ~90th percentile of their post-GFC distribution.

We forecast MSCI EM at 1255 by end-25, making for ~10% total returns from current prices. We see China spearheading these gains, supported by valuation re-rating and improving RoEs; Malaysia, the Philippines, South Africa and Poland are other markets we like. We expect EM currencies on a GBI-weighted basis to appreciate ~1.5% against the USD into end-25 (lagging the EUR and JPY), making for 3-5% total returns (this benchmark has a 50% weight on EM Asia, so is more geographically diverse than MSCI EM). We see N. Asia offering greater risk/reward by region, supported by strong balance of payments (though supply-driven risks of higher oil need to be monitored), proximity to an improving JPY outlook, and potential shifts in local institutional/corporate FX hedging behaviour as the Fed validates market expectations by cutting to 3.25%. Among carry currencies, we continue to prefer the ZAR and TRY, particularly over the next 3-6m. With 10y USTs falling only moderately, towards 3.8%, and EM curves generally flat, we expect GBI EM total returns of 6-8% and EMBI total returns of 4-5%.

We see the balance of risks to these forecasts tilted to the downside, for 4 reasons:

1. Weak global trade, particularly outside of China. Chinese export volumes are currently growing at 14% y/y (3mma) while EM ex China is growing at 2.9%. China has more than offset its [declines in export share to the US with higher penetration into EM ex China](#) since the US-China trade conflict escalated in 2018/19).
2. Tight EM risk premia e.g. our EM Risk Appetite is near 15y highs, typically seen when the global manufacturing PMIs were ~5 points higher. This suggests that much of the good news around a US soft landing is priced / downside risks from tariffs are not being factored into EM assets, in general.
3. Historically weak carry in large parts of EM FX is only being repaired gradually, and is currently below what we estimate has historically been required to 'beat' the USD in a weak global trade environment.
4. Fiscal pressures are not only a US phenomenon. A key lesson of the past decade in EM (both before and after Covid) has been that EM growth has generally slowed faster than 10y bond yields have declined. UBS's expectations of slower nominal EM GDP growth in 2025 in large parts of LatAm and parts of Asia may contribute to a mild de-rating in EM ex China equities, and a modest widening in credit spreads.

Strong China fiscal stimulus, targeted at consumption, is likely the key upside risk.

**The Red Sweep and high tariff scenarios:** To differing degrees, these scenarios assume 1) a material escalation in the US-China trade conflict and 2) a deteriorated growth/inflation trade-off for US assets over the medium term, leading to a higher landing point for global risk premia. Recall that the 2018/19 effective tariff hike of ~15% on Chinese imports saw the CNH experience a peak-to-trough depreciation of 15% vs. the USD; a large subset of EM currencies (particularly outside Asia) fell even more; and MSCI EM lost ~22%, underperforming US equities. (Full-year moves were smaller e.g. MSCI EM fell 16% in 2018 and regained 15% in 2019.) In the high tariff scenario, proposed tariff increases could be 3x larger than in 2018/19. Our economists have estimated that this could hit China GDP growth by 200-250bp absent a large increase in stimulus, with consequences for China's commodity and overall import demand.

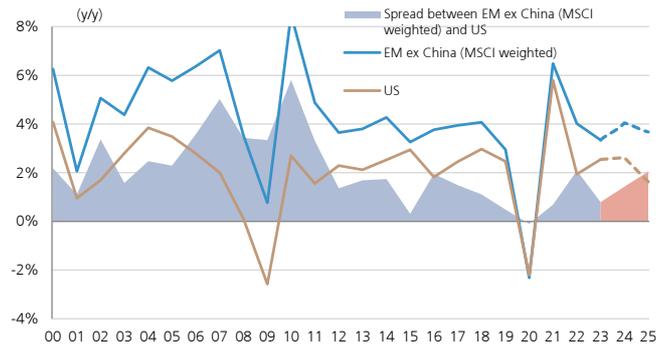
We forecast a 6% drop in the CNH and a 4% drop in MSCI EM through end-25 under the Red sweep scenario vs. the USD, extending to 10% and 11% drops, respectively, in the high tariffs scenario. Risks to these forecasts are likely tilted to even weaker EM performance; we have assumed that Fed easing (the Fed was hiking through most of 2018/19), lighter EM positioning and China's cheaper equity valuations plus seemingly tighter grip on capital outflows could help reduce the beta of EM assets to incremental tariff hikes vis-à-vis 2018/19. With signs that China has increasingly exported excess capacity to the rest of the world (particularly EM) in the years that followed Trump's first term, we are sceptical that EM ex China, on aggregate, will elegantly decouple even in the Red sweep scenario where tariffs are milder and concentrated solely on China. The good news is that current market pricing allows for hedging against these downside risks in EM FX at reasonable cost. For example 6m USDCNH digital call options with a strike at 7.4 cost ~10% of notional – in both of these scenarios, we would expect that strike to be hit by Q2.

**The Blue Sweep:** This is the friendliest scenario for EM assets in 2025, in our view. Gains would likely be front-loaded. Here, we see a US-specific hit to corporate earnings undermining US exceptionalism and providing the Fed with a clearer route towards reducing rates towards neutral absent a recession, with EM assets also benefiting from reduced tariff risk premia. We see ~10% price gains in MSCI EM in this scenario, and ~5% spot appreciation in the CNY vs. the USD. Carry-adjusted returns in other EM currencies would likely be higher.

**US recession:** In the "[US Recession Playbook for EM Investors](#)", we showed that a 'mild' US recession, characterised by a likely (temporary) widening in US HY spreads of up to 250bps over a 3m period, would likely see EM assets initially suffer, particularly among weaker balance sheet markets. High beta EM currencies, for instance, typically saw ~10% spot drawdowns, before later enjoying strong recoveries as the Fed eases and risk premia normalises from its initial shock. We've argued that EM's transit through the "left tail" of the dollar smile may be shorter, and less intense, than in previous cycles given the aforementioned considerations of positioning, limited EM external imbalances, and also as much weaker US growth could expose the dollar to greater selling pressure in the context of unusually bloated fiscal deficits, regardless of who wins the Presidency. We see MSCI EM falling ~10% through 2025 but strongly outperforming US equities (as the earnings sensitivity to US economy is lower for EMs, especially if China growth stabilises), and fully recouping losses in 2026 (but underperforming the US in recovery). EM FX likely holds up better, primarily thanks to the CNH and low-yielders such as TWD and THB.

**Central banks eased prematurely:** In this scenario, where the US experiences 'no landing', UBS sees US-global growth differentials falling the least of all 5 scenarios (exceptionalism returns!) and the Fed being forced to hike rates towards 5.75% by early 2026, some 275bp above current market pricing. With rates rising more than global growth, we assume a net negative impact to EM assets, particularly rates-sensitive sectors and low-yielders in FX. Higher yielders in FX and stocks with higher US exposure would likely outperform. We assume a 4-5% hit both to MSCI EM (primarily through the rates-valuations channel, while earnings growth could hold up) as well as the CNH vs. the USD.

**Figure 127: EM ex China vs US GDP growth differentials – towards 10y highs in 2025...**



Source: Haver, UBS estimates

**Figure 128: UBSe GDP vs consensus – improving growth differentials primarily a weaker US story**

	UBS 2025E (B) %	Bloomberg 2025 consensus (C) %	UBS deviation from consensus (B-C) bps
Taiwan	3.1	2.6	55
South Africa	2.1	1.7	41
Thailand	3.3	3.0	29
Malaysia	4.8	4.6	18
India	6.8	6.6	16
Philippines	6.2	6.0	15
Hungary	3.3	3.3	5
Singapore	2.5	2.5	3
Indonesia	5.1	5.1	1
Colombia	2.6	2.6	0
South Korea	2.1	2.2	-8
Chile	2.2	2.3	-12
US	1.6	1.8	-17
Poland	3.4	3.6	-19
Eurozone	0.9	1.3	-35
Turkey	2.6	3.0	-40
China	4.0	4.5	-50
Brazil	1.5	2.0	-53
Mexico	0.8	1.5	-74
<b>EM ex China (GBI weighted)</b>	<b>3.4</b>	<b>3.5</b>	<b>-4</b>
<b>EM ex China (MSCI weighted)</b>	<b>3.6</b>	<b>3.7</b>	<b>-3</b>

Source: Bloomberg, Haver, UBS estimates

**Figure 129: China and EM ex China export volumes – tariffs on China only hit US-China bilateral trade**



Source: Haver, UBS

**Figure 130: EM risk appetite index – EM assets already pricing a cyclical growth rebound**



Source: Bloomberg, Haver, Macrobond, UBS

**Figure 131: EM macro fundamentals vs 2018-19 average (before US-China tariffs gained intensity)**  
*Higher ERP in much of EM, but weaker trade, FX carry and fiscal balances suggest high bar to look through any new trade war escalation*

	Rates		Growth		Macro			Valuations			Risk premia		
	12m FX carry vs USD	10y real yield vs the US	IP growth, % y/y, 3mma	Export growth, % y/y, 3mma	Trade balance/GDP (3m, saar)	CA+FDI ex reinv. earnings+F&O (% of GDP)	Primary fiscal balance/GDP	Average 12m fwd P/E and Price to book (20y, RoE %ile)	REER (20y, %ile)	ERP	3m FX implied vol	5y CDS spread	
Brazil	6.3 (3.1)	7.0 (5.6)	4.0 (0.2)	-0.1 (2.6)	2.4 (2.1)	-0.6 (-0.6)	-2.3 (-1.4)	38 (73)	60 (38)	9 (36)	-0.1 (-0.6)	14.7 (14.2)	144 (177)
Chile	0.7 (0.0)	0.2 (1.6)	-4.3 (1.7)	5.4 (1.6)	6.7 (1.3)	-2.5 (-3.5)	-2.7 (-1.3)	9 (55)	43 (54)	12 (42)	5.3 (2.3)	12.9 (10.0)	53 (47)
China	-2.1 (0.9)	1.2 (1.0)	5.0 (6.0)	8.1 (6.0)	5.4 (2.8)	1.0 (-0.2)	-4.1 (-3.2)	23 (53)	13 (38)	45 (71)	6.4 (5.3)	6.8 (5.4)	62 (54)
Colombia	4.7 (2.1)	2.8 (2.6)	-2.4 (2.1)	1.9 (3.7)	-2.6 (-2.6)	0.4 (-2.2)	-2.7 (-0.2)	7 (36)	88 (56)	19 (35)	5.8 (2.5)	13.8 (11.6)	187 (106)
Czech	-0.9 (-1.3)	0.6 (-1.0)	-1.2 (1.8)	-1.8 (6.2)	7.9 (7.6)	0.4 (0.1)	-2.6 (0.5)	53 (46)	58 (27)	94 (54)	4.1 (5.6)	3.7 (3.7)	32 (41)
Hungary	1.6 (-2.2)	-1.3 (-0.5)	-4.5 (4.9)	-5.7 (4.7)	4.2 (3.8)	-0.9 (-1.4)	-0.9 (-1.0)	18 (59)	73 (54)	51 (30)	12.0 (7.8)	6.6 (4.9)	120 (84)
Indonesia	3.3 (5.0)	3.0 (3.8)	2.4 (4.1)	5.0 (0.5)	1.6 (-0.6)	0.7 (-0.3)	-0.8 (-0.3)	33 (54)	14 (30)	50 (40)	1.2 (-0.7)	8.1 (7.4)	69 (106)
Israel	-1.0 (-2.4)	-0.2 (0.5)	-1.1 (2.4)	-5.3 (-1.0)	-5.2 (-5.9)	3.1 (3.9)	-6.4 (-0.7)	66 (39)	86 (30)	63 (74)	4.0 (7.5)	11.6 (5.9)	169 (63)
India	2.5 (4.4)	1.2 (1.6)	5.2 (3.2)	-2.9 (5.5)	-7.5 (-6.5)	-0.7 (-1.0)	-1.2 (-0.5)	95 (47)	46 (11)	93 (70)	-2.6 (-1.8)	2.5 (6.6)	50 (110)
Korea	-1.8 (-1.3)	-0.1 (0.6)	3.6 (0.5)	10.8 (-1.4)	2.7 (3.1)	1.9 (3.1)	-1.1 (1.3)	18 (34)	15 (52)	21 (66)	9.2 (8.6)	9.6 (7.6)	32 (38)
Mexico	5.6 (5.8)	4.5 (3.4)	0.6 (-0.7)	2.6 (6.6)	-0.7 (-0.4)	-0.8 (-2.0)	-0.8 (0.5)	8 (38)	40 (25)	46 (19)	-0.4 (-0.6)	16.3 (11.9)	114 (118)
Malaysia	-1.1 (0.8)	0.2 (1.9)	4.2 (2.9)	9.1 (6.3)	6.2 (9.2)	1.1 (1.9)	-2.9 (-1.0)	25 (62)	18 (30)	31 (40)	3.4 (2.4)	7.0 (6.5)	38 (73)
Poland	1.5 (-0.7)	-0.6 (0.4)	1.5 (5.3)	-4.9 (8.5)	-0.5 (-0.5)	1.6 (-0.9)	-2.7 (0.5)	18 (43)	55 (38)	97 (28)	7.7 (6.1)	5.3 (4.7)	69 (62)
Thailand	-0.7 (-0.8)	-0.3 (1.0)	-1.0 (0.9)	7.3 (2.9)	0.1 (1.4)	2.4 (4.6)	0.1 (1.1)	52 (63)	25 (41)	85 (93)	3.5 (4.5)	9.9 (5.3)	36 (39)
Turkey	40.2 (17.2)	-11.5 (-0.5)	-2.7 (0.9)	2.2 (4.8)	-5.4 (-5.5)	-2.6 (0.2)	-2.6 (-0.1)	22 (24)	79 (42)	20 (27)	-6.1 (0.6)	14.2 (18.2)	275 (338)
Taiwan	-2.9 (-2.5)	-2.0 (-0.2)	14.0 (1.5)	14.5 (2.7)	5.8 (3.9)	10.7 (12.0)	-0.7 (2.0)	95 (49)	63 (51)	43 (45)	4.4 (6.3)	8.5 (4.8)	41 (17)
South Africa	3.3 (4.8)	5.9 (4.3)	-1.7 (0.3)	0.6 (1.5)	1.5 (0.4)	1.0 (-3.3)	1.8 (-1.0)	20 (55)	20 (16)	20 (50)	0.8 (-1.1)	13.5 (15.4)	179 (186)
<b>EM MSCI Weighted</b>	<b>-0.4 (0.9)</b>	<b>1.1 (1.4)</b>	<b>5.7 (3.0)</b>	<b>6.9 (3.8)</b>	<b>2.6 (1.5)</b>	<b>2.4 (2.2)</b>	<b>-2.0 (-0.7)</b>	<b>46 (50)</b>	<b>32 (37)</b>	<b>46 (60)</b>	<b>4.2 (4.0)</b>	<b>8.0 (7.0)</b>	<b>63 (69)</b>
<b>EM GBI Weighted</b>	<b>2.0 (2.3)</b>	<b>2.2 (2.3)</b>	<b>1.8 (2.5)</b>	<b>2.6 (4.5)</b>	<b>1.4 (1.2)</b>	<b>0.4 (-0.3)</b>	<b>-1.6 (-0.6)</b>	<b>34 (53)</b>	<b>37 (31)</b>	<b>52 (49)</b>	<b>2.6 (1.8)</b>	<b>9.2 (8.3)</b>	<b>84 (97)</b>

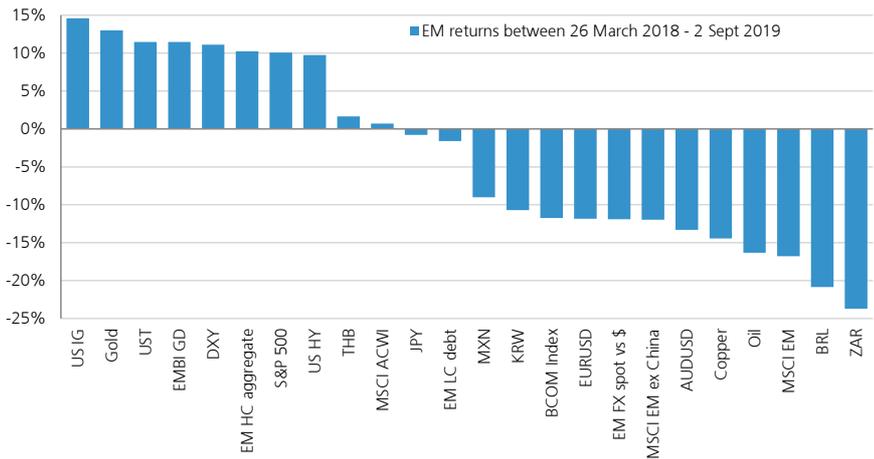
Source: Haver, Bloomberg, MSCI, IBES, Datastream, UBS. \*Numbers in the bracket represent average 2018-19 values. ERP denotes equity risk premia - higher values represent cheaper valuations vs. bonds. Real policy rates are calculated by deflating nominal policy rates with 6m sequential core annualized inflation.

**Figure 132: EM vs DM Price to Earnings ratio. On an index-weighted basis, MSCI EM valuations at the 91st percentile of its 20y distribution. A high bar for 10%+ price gains**



Source: MSCI, IBES, Datastream, UBS

**Figure 133: EM asset returns through US-China tariff escalation in 2018/19 (c.17% hike in tariffs)**  
**Debt would likely offer superior returns over equities in the US recession, Red Sweep, and tariff scenarios**



Source: Bloomberg, Macrobond, UBS. EM FX spot vs \$ is simple avg of 13 major EM ccys.

# Appendix – Tariff Model Description

As described in Box 3, the general equilibrium model of tariffs and trade requires taking a stand on several issues:

- the degree to which domestic producers, importers and exporters absorb price changes in their margins;
- the currencies in which exports are invoiced in each market;
- the degree of 'roundabout' pricing coming from the cross-border input network—shorthand for supply chains—as one firm's output price in country *i* is another's input cost in country *j*;
- the set of elasticities of demand for final goods (of consumers) and of demand for inputs (producers);
- the degree to which wages will adjust to offset tariff effects on marginal costs;
- the possibility of import substitution via a third country;
- the determination in general equilibrium of exchange rate pass-through, which depends on all preceding bullets.

The model accounts for all these features and is calibrated with results from recent academic research. We run the benchmark model and 16 other scenarios that each highlight the influence of a particular modelling choice. The full model is described in a piece to be published separately. [Figure 134](#) to [Figure 143](#) report the results for subsets of variables. The scenarios are the following:

## Benchmark

All margins and options are operating.

## Plain vanilla

Most basic three country model:

- domestic, export and import prices are fully flexible. In the benchmark, we assume varying degrees of pass-through, equivalently of absorption of price shocks into firms' margins.
- demand elasticities and production elasticities are unitary, implying constant expenditure and production shares. In the benchmark, we assume greater elasticities of demand (so that expenditure shares fall when prices rise – see below), and lower production elasticities (so that it is harder to replace an expensive input by cheaper labour).
- all trade flows are priced in USD (dollar-based Dominant Currency Pricing), same as in the benchmark.
- no valuation effects in exchange rates (see explanation below). The benchmark includes such effects.

The plain vanilla simulation is close to what would be the long run of the standard model, when all prices have adjusted to their desired levels, calibrated to standard textbook values (Cobb Douglas functions everywhere). The difference is that we stay within the Dominant Currency Pricing paradigm rather than the more traditional Mundell-Fleming world of Producer Currency Pricing.

## Symmetric retaliation

The benchmark assumes 60% and 10% tariffs on US imports from China and ROW, respectively, but the latter retaliate only mildly (15% Chinese tariffs and 5% ROW tariffs on imports from the US). In this scenario, they respond tit-for-tat, with tariffs in China and the ROW scaled to generate the same initial dollar amount of revenues as what the US taxes on them (ie, tariffs such that China tariff x Imports from US = US tariff x Imports from China, and same for ROW).

## Tariffs used to subsidize exports

What happens if import tariffs are used to subsidize exports, to counter the Lerner Symmetry effect (whereby resources are pulled out of the export sector towards extra domestic production needed to substitute for the loss of imports)? Here, subsidies are matched to the statutory tariff revenues (excluding the change in the tax base). Subsidies have large effects because they directly reduce marginal costs of firms and there are no costs to switching from domestic to export production (in this model).

### **Exporters absorb more tariffs in profits**

The benchmark simulation assumes export price pass-through of 0.9 (from the '18-'19 trade war literature, which shows that Chinese exporters passed on 90% of the tariffs). In this scenario, we test what happens when exporters pass-through only two thirds (in all countries), that is, when they absorb one third of tariffs in their margins.

### **No NIIP valuation effects on currency**

Roughly, the US owes 2xGDP debt in dollars, but holds close to 1.75xGDP of assets in other currencies. These large cross-currency claims imply valuation effects that dampen the adjustment of the exchange rate to trade flows. To see this, consider an increase in tariffs on US imports from China: demand for goods from China drops while demand for domestic goods increases, appreciating the dollar. But that appreciation lowers the return on US assets held in RMB while keeping unchanged its dollar-denominated debt, worsening the US's portfolio positioning and increasing the required payment flow to cover the valuation loss. This puts downward pressure on the dollar, offsetting the pure, trade balance induced appreciation. Research suggests valuation effects can swamp trade flow effects (Gourinchas Rey, 2007). In the benchmark, we calibrate the NIIP according to the ratios above, implying a given degree of exchange rate stickiness. In this scenario, we shut off valuation effects so that the exchange rate adjusts more flexibly to trade flows than in the benchmark.

### **Shut off exchange rate adjustment**

The opposite of the previous scenario: we parameterize the NIIP such that the exchange rate is much stickier (lower pass-through of tariff effects), enabling the price shocks to have greater real effects.

### **Unit demand and production elasticities**

The benchmark simulation has across-the-board demand elasticities of 2, and production elasticities less than 1 (inputs and labour are complements). In this scenario, all demand and production functions have unit elasticities (the standard textbook Cobb-Douglas world). Recall that an elasticity of  $x$  means a 1pct increase in relative price implies an  $x$  pct decrease in quantity, so the share moves by  $1-x$  pct. For  $x=1$  (Cobb-Douglas), the share is constant.

### **Exports invoiced in trade partner's currency**

The benchmark adopts the Dominant Currency Pricing paradigm: (almost) all flows priced in dollars. In contrast, Local Currency Pricing implies exports are priced in destination country currency. Producer Currency Pricing implies exports are priced in origin country currency. Export prices will react differently to a dollar appreciation under the different pricing regimes. Accordingly, so will import prices, hence demand for imported inputs, which feed back to marginal costs and final prices. In the latest academic work/research, DCP supersedes LCP, which itself had supplanted PCP (the traditional Mundell-Fleming framework). In this scenario, we assume Local Currency Pricing.

### **Easier to find alternative exports**

In the benchmark scenario, we impose demand elasticities of 2 everywhere (across goods and countries). In this scenario, we assume instead a higher elasticity of substitution between import varieties (easy to switch from a Chinese good to a ROW good), but lower substitution between import and domestic goods (harder to switch from an imported good to a domestic one).

### **All trade invoiced in RMB**

This scenario basically switches labels, assuming it is China, not the US, that benefits from Dominant Currency Pricing, which is the crucial asymmetric dimension in play. Given that most other parameters are symmetric (apart from some steady-state ratios, but they won't matter as much), it is roughly equivalent to assuming dollar DCP but China imposing the unilateral tariffs on imports from US.

### **Equal invoicing shares**

In the benchmark, all US-related bilateral flows are priced in dollars, but for flows between China and the ROW, we assume 50pct of trade is in dollars, with the rest split equally between the two regions (roughly consistent with the latest research). In this scenario, we dispense with the US's special privilege by imposing that invoicing is equally split across currencies (1/3 dollar, 1/3 yuan, 1/3 ROW currency).

### **Greater wage flexibility**

The model assumes wages are fixed, therefore implicitly limiting the horizon of the exercise to roughly a year. In this scenario, we assume wages adjust 50pct to their desired level. Price stickiness is unchanged.

### **100 pct price pass-through**

There are three layers of price stickiness: domestic prices, export prices, import prices. In the benchmark, we assume 90pct export price pass-through, 50pct domestic and import price pass-through. In the scenario, we assume 100pct pass-through for all margins, so that prices adjust immediately. Importantly, we still assume wages are fixed.

### **Shorter supply chains**

The cross-border input network magnifies shocks, as one firm's price in country  $i$  is another's marginal cost in country  $j$ . In this scenario, we shut down the network, as if trade and production were only for final goods consumption, to see the extent of the input network multiplier.

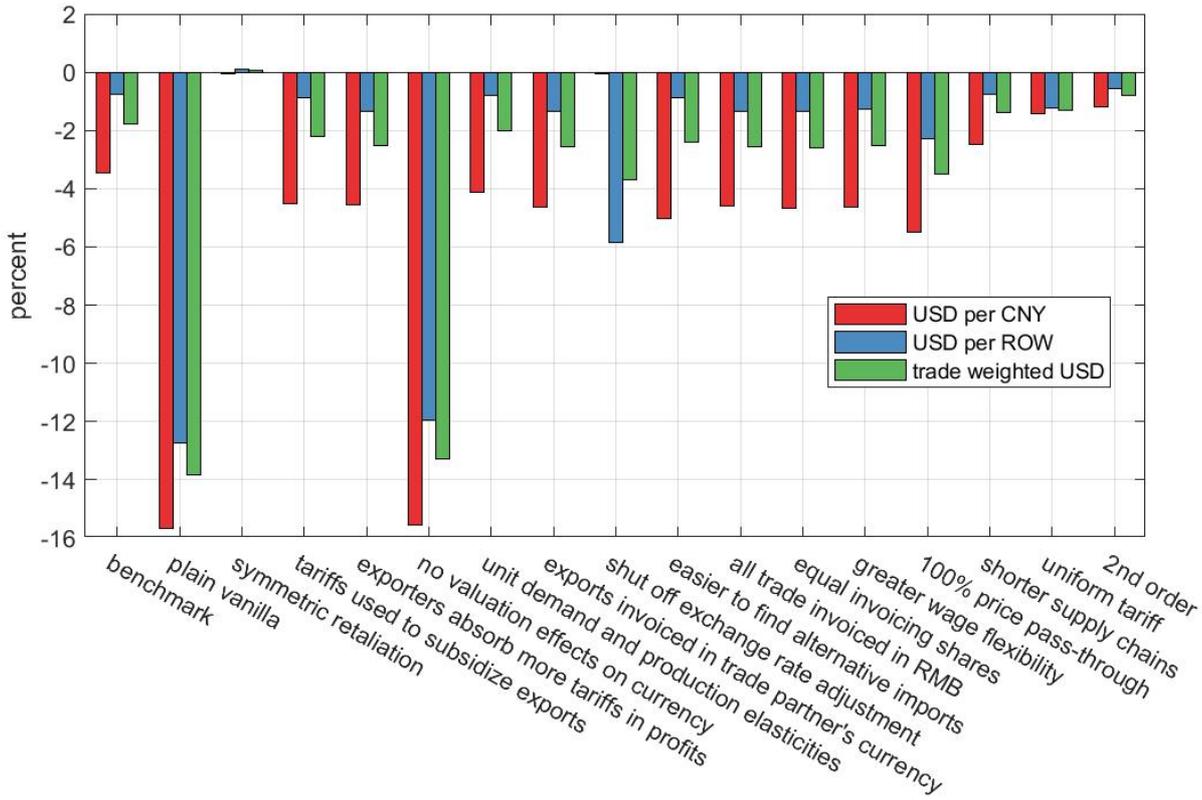
### **Uniform tariff**

This simulation is calibrated like the benchmark model, but instead of 60% + 10%, we have the equivalent uniform tariff (weighed by import shares, roughly 16%). The value of this scenario is to shut down import diversion, since all countries face the same US tariff barrier.

### **Second order**

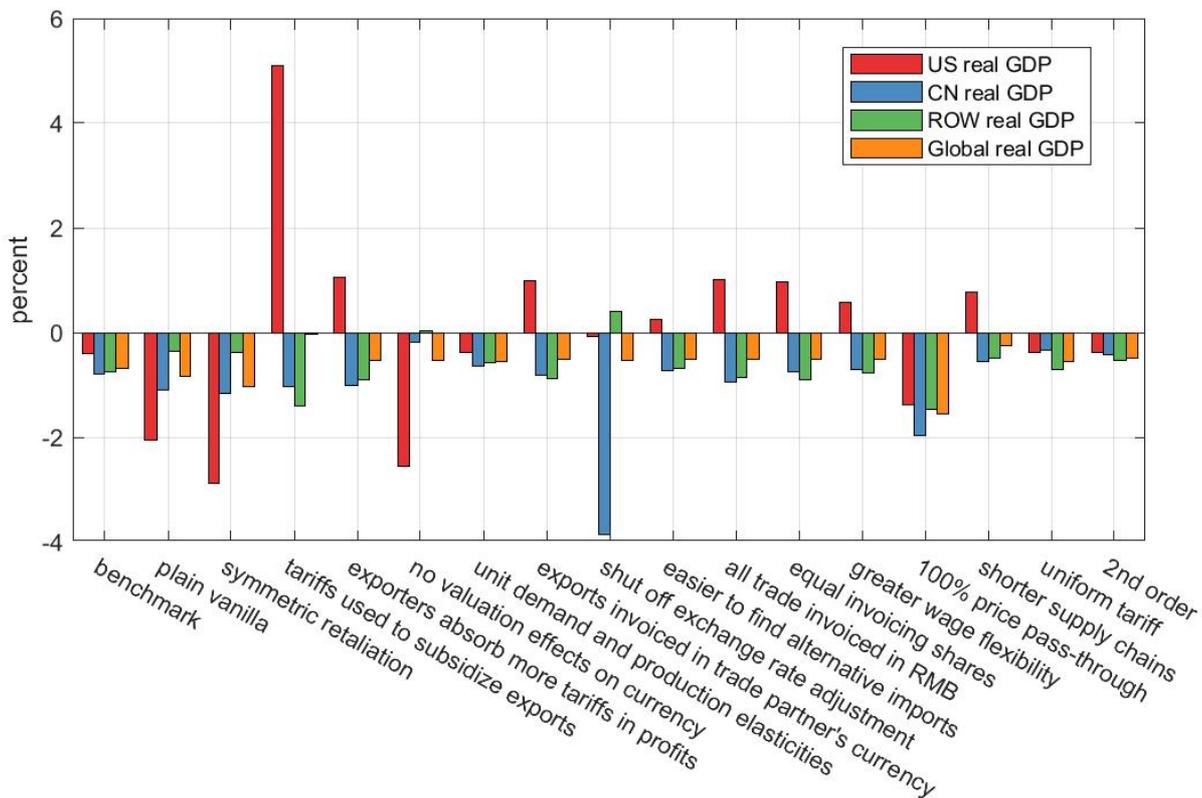
This reports the second order approximation of the benchmark model. It will essentially adjust for the second order effects on demand curves for final goods and inputs, since the rest of the model is close to linear (log linear for pricing equations).

**Figure 134: In the benchmark model with a 60pp increase in US tariff on goods imports from China and a 10pp increase on goods imports from the rest of the world, the trade-weighted USD appreciates 1 ¾ pct...**



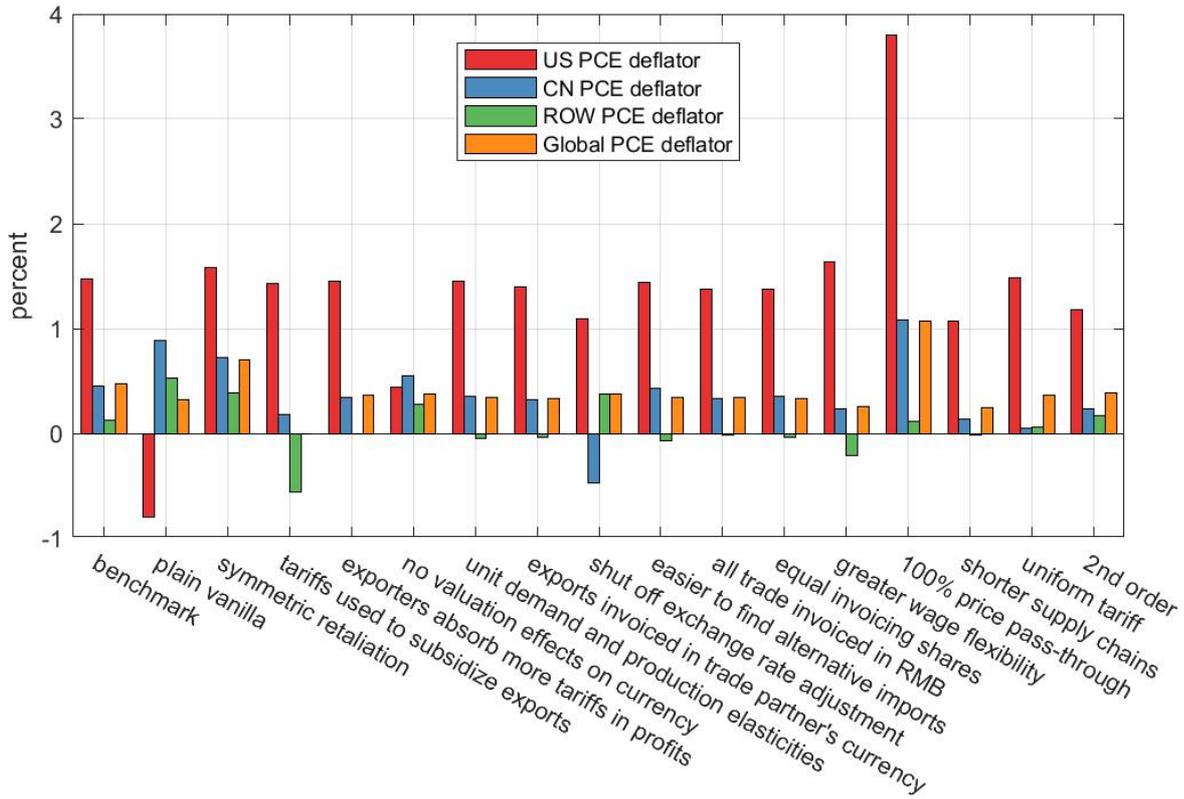
Source: UBS calculations

**Figure 135: ...Global GDP drops 70 bps...**



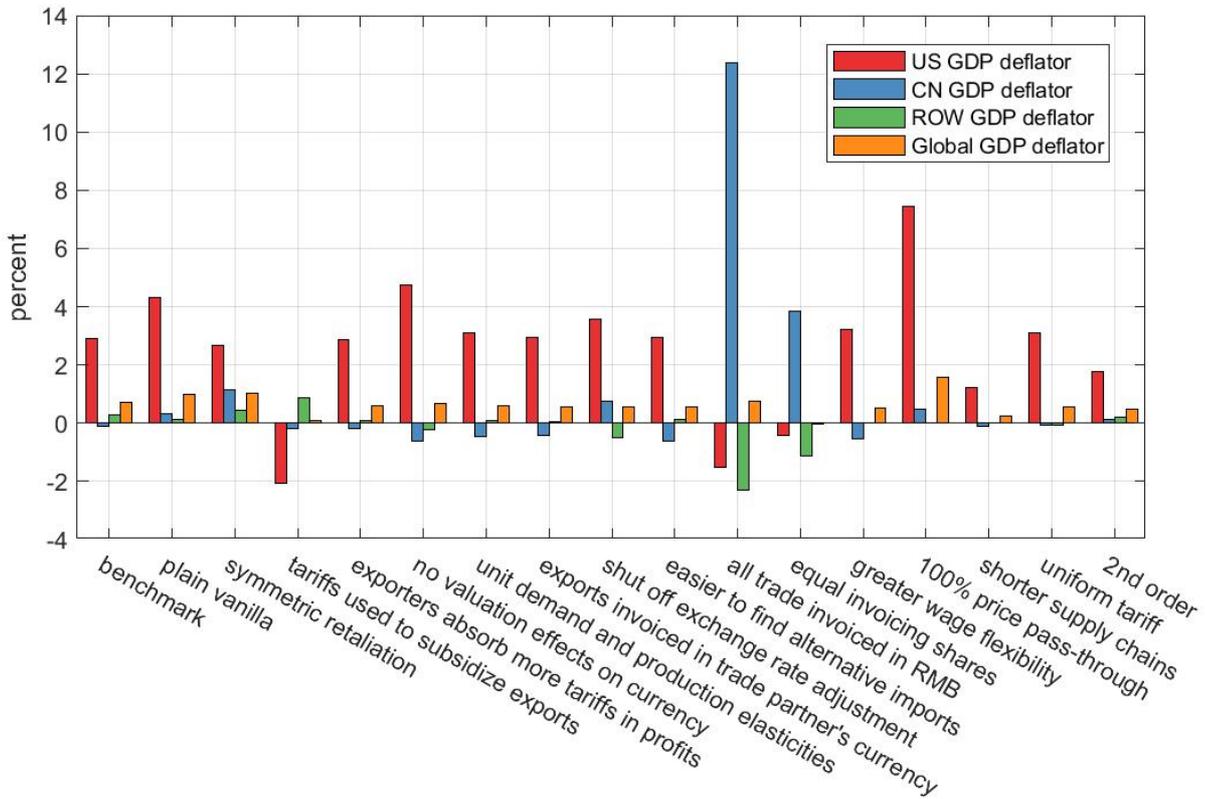
Source: UBS calculations

Figure 136: ...the global PCE deflator increases ~50 bps...



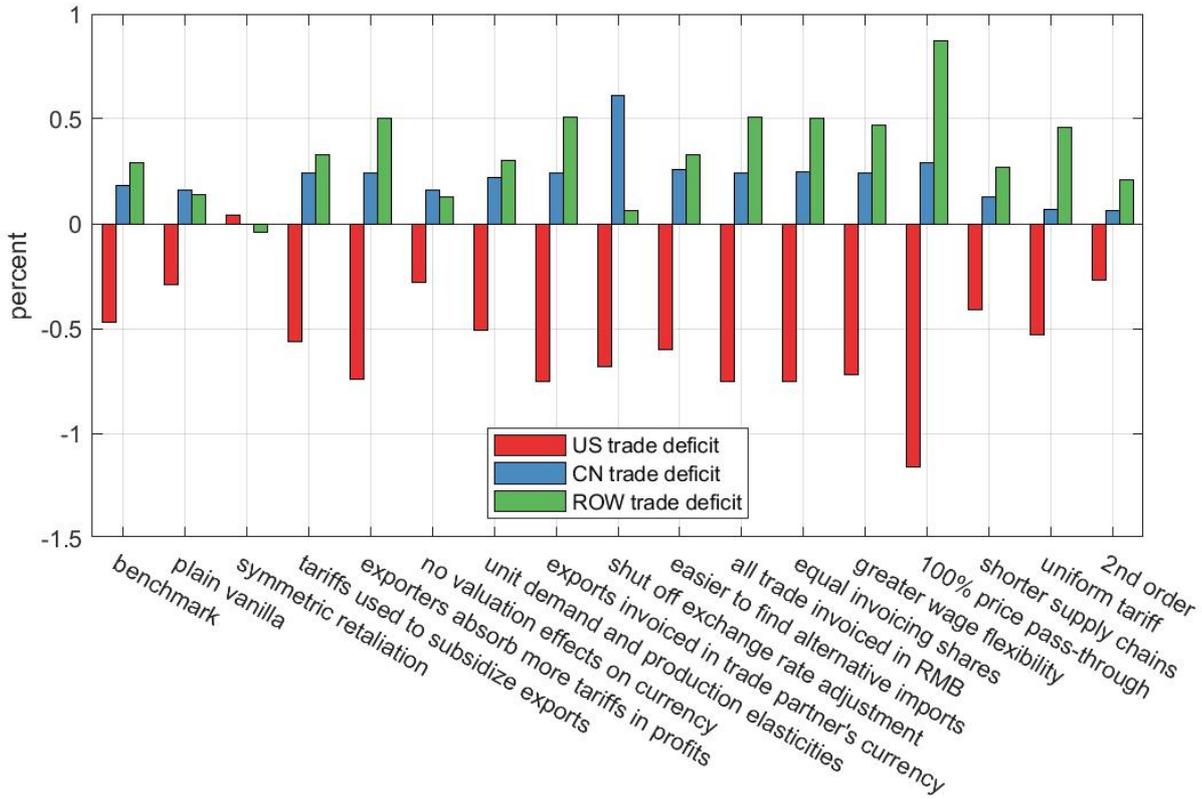
Source: UBS calculations

Figure 137: ...and the global GDP deflator increases ~30 bps...



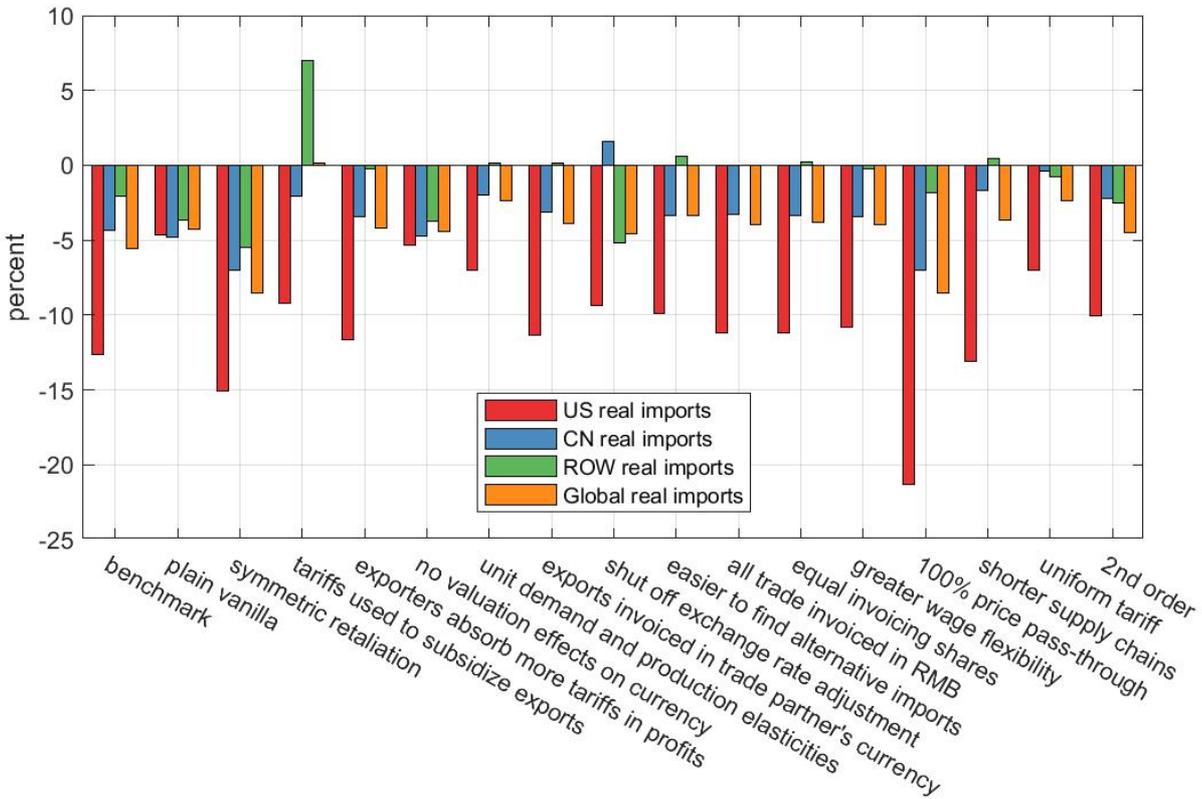
Source: UBS calculations

**Figure 138: ...the US trade deficit improves ~50 bps of GDP..**



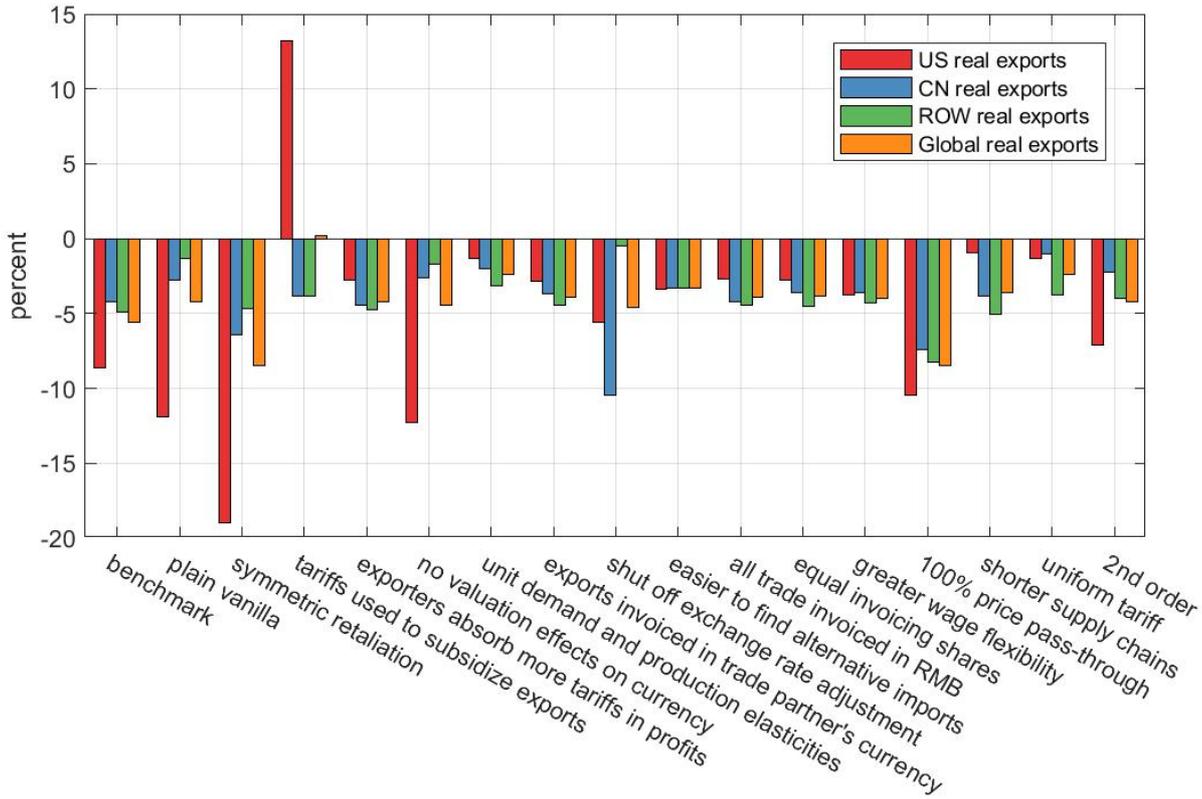
Source: UBS calculations

**Figure 139: ...as global real imports fall 4.3 pp of global GDP.**



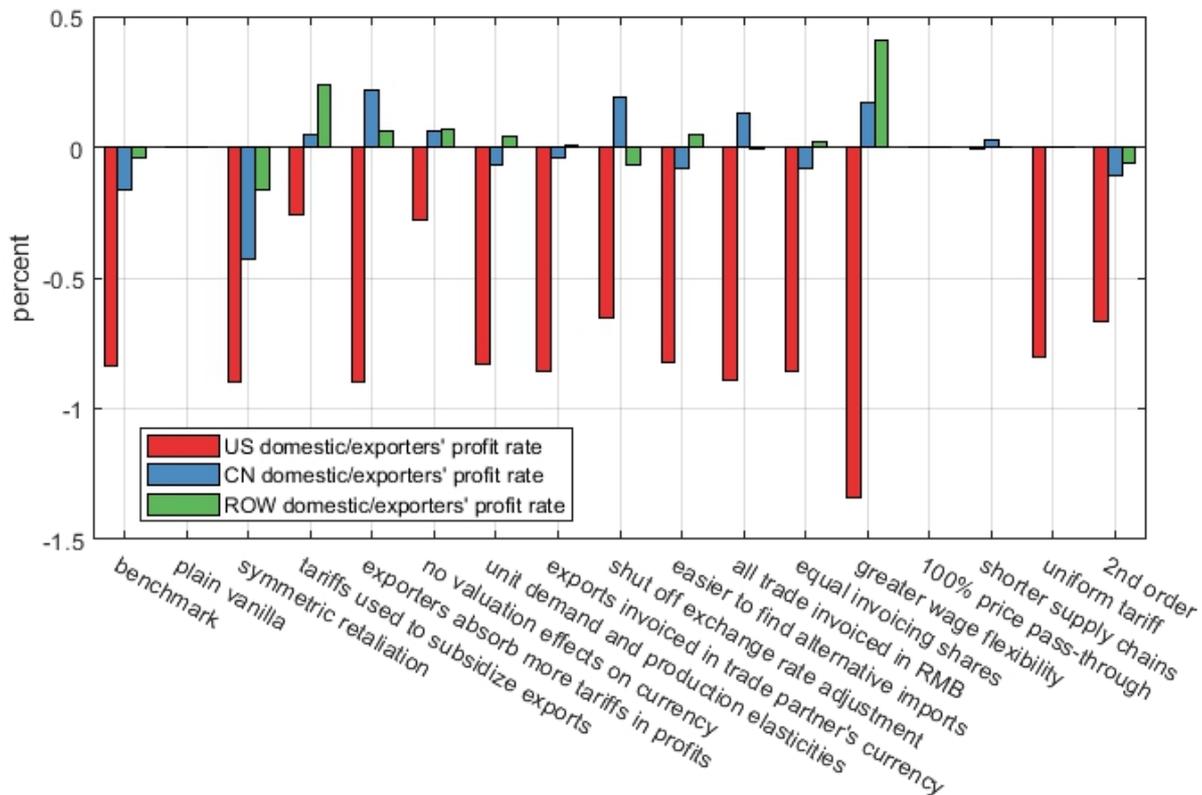
Source: UBS calculations

**Figure 140: ...and the US loses more exports than China and ROW**



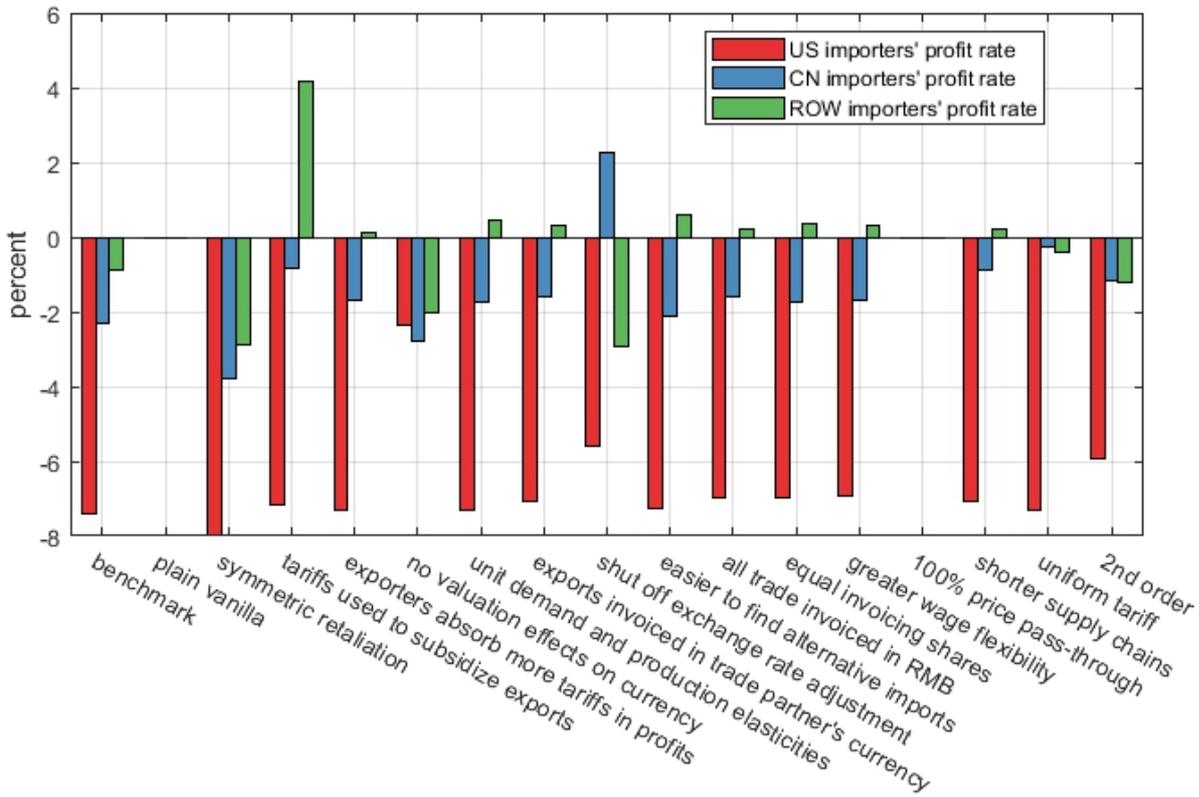
Source: UBS calculations

**Figure 141: Profits of domestic producers and exporters drop ~80bps of GDP, equivalent to a ~6.4pp decrease in corporate profits**



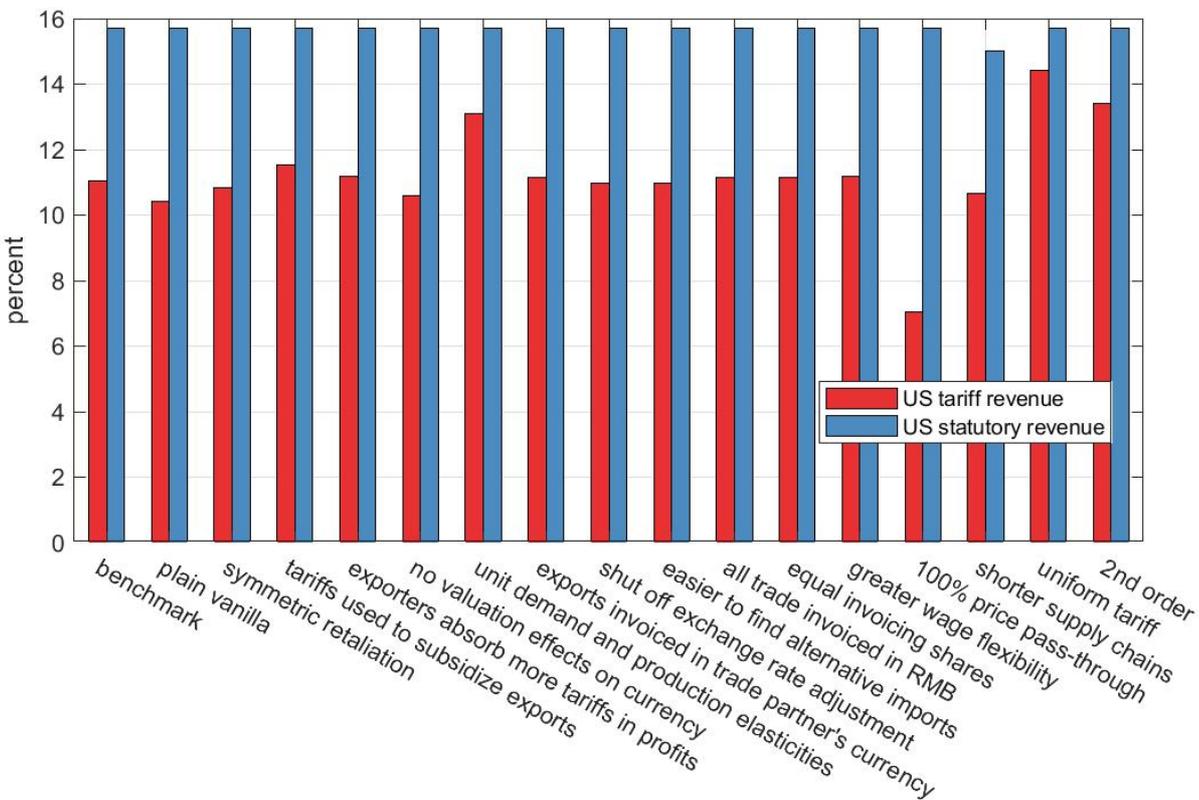
Source: UBS calculations. Note: Corporate profits in the National Income and Product Accounts are roughly 12.5% of GDP.

Figure 142: Importing firms see a ~8pp drop in profits relative to own sales...



Source: UBS calculations

Figure 143: ...as tariff revenues are redistributed to support aggregate demand, but with only 70% efficiency



Source: UBS calculations. Statutory revenues are computed keeping the tariff base constant (initial level of imports), while effective revenue includes the shrinking of the tax base as a response to higher tariffs (final level of imports).

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