

# Global Outlook 2025

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# Assumptions Overboard

In 2025, investors will need to question many long-held assumptions about the global economic and investing landscape. After decades of globalization, multilateralism, and relative geopolitical stability, the outlook has shifted. In developed economy elections around the world in 2024—from France to the United Kingdom to Japan to the United States—voters demanded change, as the lingering squeeze from prior years' inflation ignited a desire to punish incumbents. In each country, the circumstances beyond inflation differ and the policy consequences will diverge. But change is in the air, with meaningful economic and market implications across each major economy.

- In the United States, significant policy changes could materially affect global growth, US inflation, and corporate profitability.
- China will be at the center of the storm and is likely to respond to US protectionism with asymmetrical retaliatory measures and substantial fiscal and monetary stimulus.
- The Eurozone is likely to be tested by US trade policy, fiscal pressure from higher defense spending, and the potential security threat from an emboldened Russia.
- Japan will struggle to balance the benefits of positive inflation against voter anger over cost-of-living increases and the desire to stabilize the yen.
- The geopolitical backdrop is likely to shift meaningfully as the United States retrenches from multilateralism and diminishes its commitments to mutual defense treaty partners.
- The changing global backdrop could significantly affect prices across asset classes, with elevated dispersion within them. Investors will therefore need to reevaluate likely winners and losers across countries, sectors, and companies.

# United States

Historically, I have believed that investors should avoid overemphasizing US elections and focus instead on the fundamentals of individual assets. After all, in past elections, the economic divergences between candidates were relatively modest, with the choice being either a center-right or center-left candidate. In this election, the situation changed. With the re-election of Donald Trump to a second term along with a Republican majority in the House of Representatives and Senate, and a conservative majority on the Supreme Court, the new administration's ability to enact significant changes is likely underestimated by investors. Five market-moving policy areas that warrant investor attention are sequenced below, based on when I believe changes are most likely to be implemented.

## Deregulation

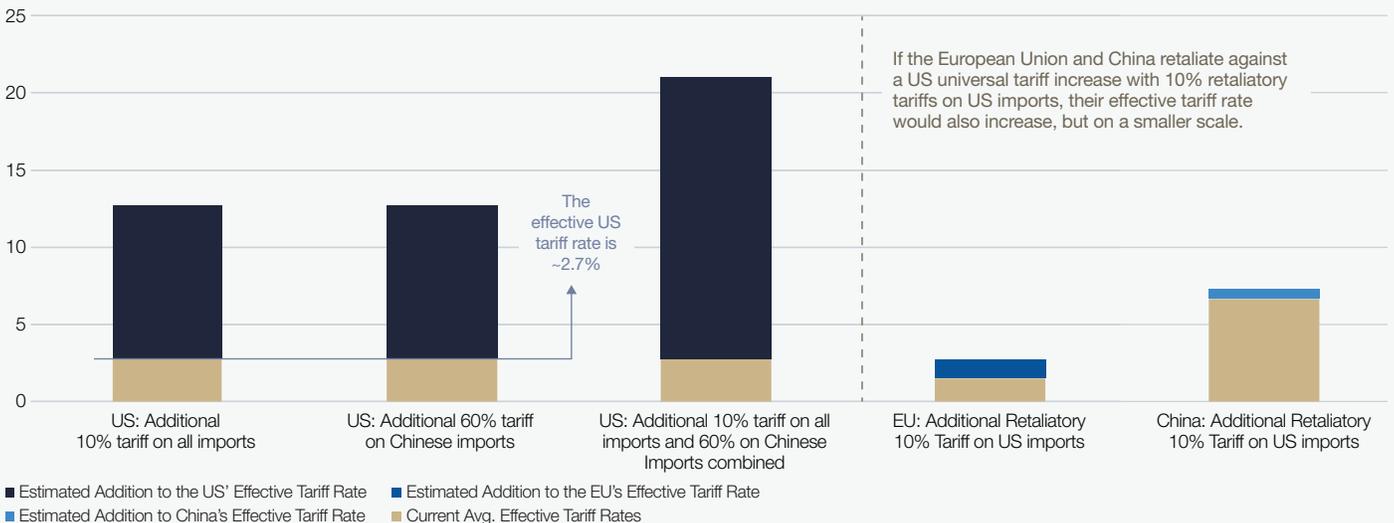
The Trump campaign stridently advocated for sharply reducing regulation of the US economy across sectors. I expect the most material deregulatory moves to occur in the energy and financial services sectors. For energy companies, we are likely to see increased exploration and production of fossil fuel on government land as well as looser environmental constraints on production in general. While increased fossil fuel production is likely to reduce commodity prices (due to greater supply), I also expect increased permitting of liquefied natural gas (LNG) and other energy exports to raise demand for US commodity production.

Financial services deregulation was a less prominent topic on the campaign trail given ongoing voter antagonism toward the industry, but I expect significant changes here as well. Efforts to increase bank capital requirements and regulatory oversight of large banks under the Basel III Endgame will likely be derailed, benefiting banks with over \$100 billion of assets. I also expect long-standing Republican antipathy toward the Consumer Financial Protection Bureau (CFPB) to culminate in a significant curtailment of its authority or even its outright elimination. The most significant regulations imposed by the CFPB relate to non-sufficient fund (NSF) charges on demand deposit accounts—penalties imposed when customers attempt to withdraw funds beyond those available in their account—and more recently, proposed limits on late fees for credit card payments. The NSF regulations reduced bank revenue by over \$5 billion per year and the credit card late fee proposals could reduce revenue by an additional \$4.5 billion per year.

Exhibit 1.

### Trump's Proposed Tariff Increases Could Incite Retaliation ...

Effective Tariff Rates under Trump's Proposals (%)

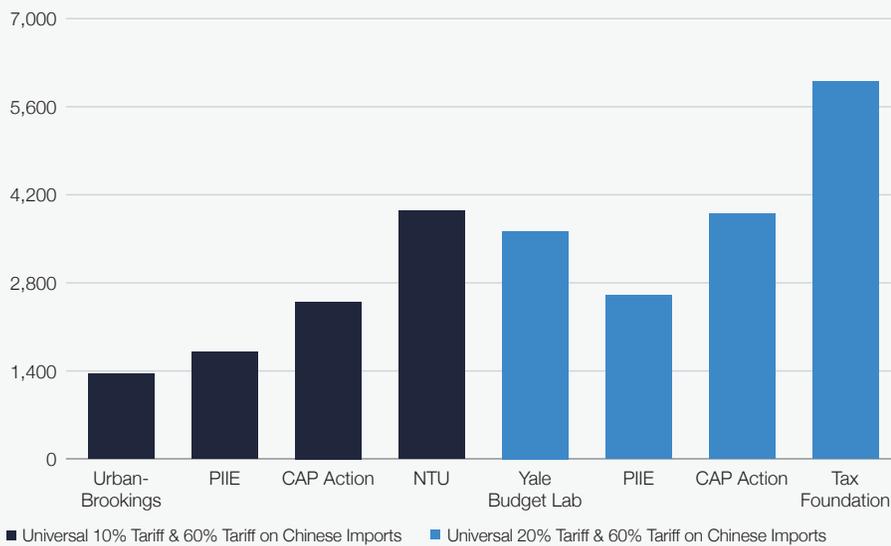


As of December 2024. Source: Lazard, World Bank. Calculations assume no exemptions and tit-for-tat retaliatory actions by trade partners on US imports. Trade data based on estimates from the World Bank as of 2022 assuming that the United States's share of Chinese imports is 16.5%, the EU's share of US imports is 11.8%, and China's share of US imports is 6.6%.

Exhibit 2.

... And Cost the Average American Household Thousands of Dollars

Cost to Avg. US Household (US\$)



As of December 2024. Source: Center for American Progress (CAP) Action, National Taxpayers Union (NTU), The Peterson Institute for International Economics (PIIE), Tax Foundation, Urban-Brookings, Yale Budget Lab

How and when would such policy changes be enacted? Energy deregulation could be accomplished through executive orders that could be implemented in days or weeks while efforts to increase bank capital requirements could likely be ended without legislation. The changes to the CFPB would likely take longer to accomplish as part of fiscal legislation that could take months to pass and enact.

## The Impact of Tariffs

As early as the 1980s, Donald Trump advocated using tariffs to reduce the United States's bilateral trade deficit with other countries. During his first term, he imposed 10%–25% tariffs on ~\$380 billion of Chinese goods from mid-2018 to late-2019 before reaching a “Phase One” trade deal with China. During the 2024 campaign, Trump asserted that he would impose a 60% tariff on imports from China and a 10%–20% tariff on all other imports into the United States. More recently, Trump has said that he might impose a 25% tariff on Mexico and Canada despite the terms of the United States-Mexico-Canada Agreement, an agreement negotiated by Trump’s administration in 2020. If the United States were to implement a global 10% tariff and a 60%

tariff on China, the weighted average US tariff would rise from ~3% to ~20% on all imports (Exhibit 1), a level not seen since the early 1940s. According to the Peterson Institute for International Economics (PIIE), one of the more respected institutions weighing the potential impact of Trump’s tariff proposals, this could end up costing the average US household approximately \$1,700 per year (Exhibit 2).

There are multiple legal authorities that Trump can use to impose these tariffs without the involvement of Congress, including Section 232 of the Trade Expansion Act of 1962, Section 301 of the Trade Act of 1974, the International Emergency Economic Powers Act (IEEPA), Section 122 of the Trade Act of 1974, Section 338 of the Tariff Act of 1930, and others. The process for each of these legal authorities varies, but typically an investigation is required before tariffs can be implemented. This means that a newly inaugurated President Trump could declare that tariffs will be implemented, but it could take months before they are actually applied.

I believe strongly that investors should brace themselves for tariffs to be announced early in the new administration. I do not expect the tariffs to start at 60%

against China or 20% against others, but a staged escalation of tariffs appears likely, with rates differing based on the availability of substitutes from other countries. For example, in the case of textiles from China, the tariff could be over 100% to encourage companies to buy from other countries that are more aligned with the United States. In contrast, certain rare earths that are difficult to source outside of China might face much lower tariffs given their importance to the production of a range of products from electric vehicles to wind energy infrastructure.

Over time, however, I believe investors should consider full implementation of the 60% tariff against China and a 10% global tariff as a possible bear case scenario. If these tariffs come to fruition, the macroeconomic implications are material with US GDP being reduced as much as 100 basis points (bps) and US inflation increasing by 100 bps or more. Eurozone GDP could fall as much as 100 bps under a 10% tariff scenario and China’s GDP could slow by as much as 300 bps, with a 60% tariff, assuming no offsetting fiscal stimulus policies. The other major macro implication of tariffs is likely to be a stronger US dollar. The US dollar has already strengthened meaningfully since Trump won the election, but it could appreciate even further in 2025 as the disparate impact of tariffs drives wider interest rate differentials, which then affect foreign exchange rates.

Looking at more micro considerations, tariffs also could disrupt corporate supply chains and meaningfully affect sales volume and profit margins. Consumer discretionary companies are most vulnerable as the elasticity of demand is highest for these products, potentially translating into lower sales volume and reduced profit margins on each unit sold. Other sectors that could be harmed are tech hardware and industrial companies that have substantial content from overseas. The sectors that would be most immune to tariffs are energy, financial services, utilities, and real estate as most have few if any imports that would be subject to tariffs.



## Immigration and Economic Growth

Immigration was another critical issue that drove voters to support Trump. Trump pledged the largest deportation of undocumented workers in US history. Deportations could be announced on the first day of Trump's presidency with time then required to implement the order. The Pew Research Center estimates there are approximately 11 million unauthorized immigrants in the United States, about 3.3% of the population, based on the 2022 American Community Survey. Deporting such large numbers of people is likely impossible from a logistical perspective, but ejecting even one million people could have meaningful economic implications. The PIIIE has estimated that deporting 1.3 million workers (comparable to a 1956 deportation exercise led by President Eisenhower) would raise US inflation by over 50 bps and lower US GDP by over 70 bps in 2026 (Exhibit 3), with the effects being most notable in a range of industries from construction to meat packing.

Looking beyond immediate executive orders, I expect significant increases in funding for immigration law enforcement and

deportations. The American Immigration Council has estimated that deporting one million immigrants annually would cost ~\$88 billion per year while a one-time mass deportation could cost around \$315 billion.<sup>1</sup> Such large expenditures would require legislation for the incremental funding which could take months. These figures do not account for the sizable reduction in US GDP that would result from a sharp reduction in the working population and consumer base.

## The Path of Tax Reform

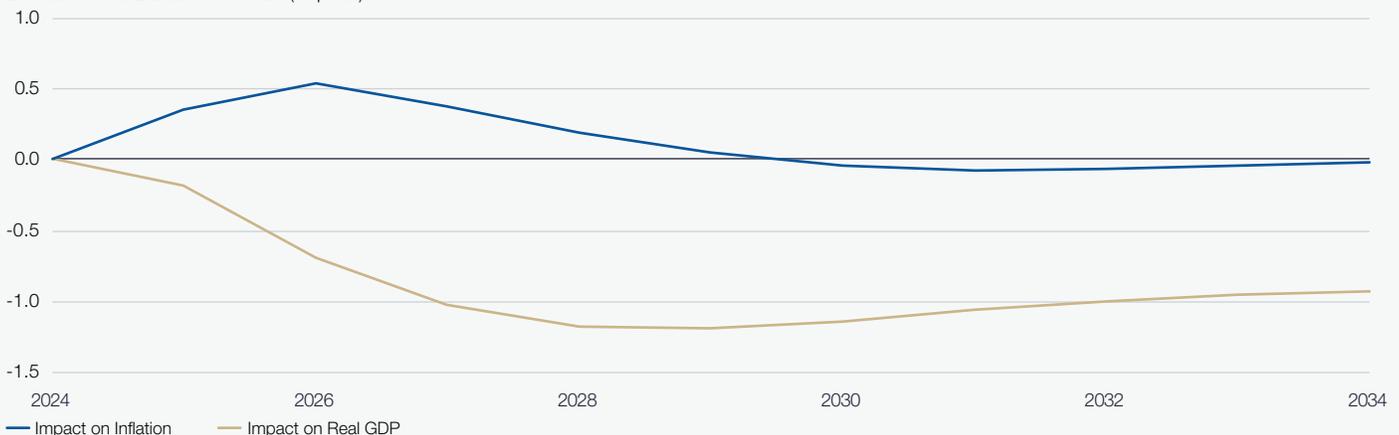
One likely tax policy change is a reduction in the statutory tax rate for corporations, which Trump has proposed cutting from 21% to 15%. The proposed reduction would be unlikely to lift the growth rate of the national economy by a noticeable amount, but it could raise S&P 500 earnings by about 400 bps. I expect this legislation to be passed in 2025.

Personal tax rates are unlikely to change meaningfully under a second Trump administration, as Trump's primary pledge was to make the current rates permanent, rather than allowing current

Exhibit 3.

### Trump's Proposed 1.3 Million Deportations Are Likely to Increase Inflation and Slow GDP Growth

Deviation from Baseline Forecast (% point)



As of 26 September 2024 Source: Warwick J. McKibbin, The Peterson Institute for International Economics

rates to expire and then increase at the end of 2025. Trump proposed numerous other tax breaks for consumers, ranging from eliminating the tax on tips to allowing a tax deduction for interest on auto loans to ending taxes on Social Security benefits. The first two proposals would have little impact on consumption and economic growth as only 2% of Americans work in jobs where tips constitute a meaningful portion of their income and making interest expense on auto loans tax-deductible would benefit only the ~10% of Americans with sufficient income to itemize tax deductions each year. The final proposal related to Social Security benefits is unlikely to pass Congress, as it would accelerate the insolvency of the Social Security Trust Fund.

## Federal Reserve Independence

During his first term and the recent campaign, Trump said the president should have input into monetary policy decisions. He also suggested he could fire Fed Chair Jay Powell from his position. Fortunately, Trump has subsequently walked back some of these comments. I believe investors should focus on May 2026, when Jay Powell's term as Fed Chair ends. In the months leading up to that date, I would expect President Trump to nominate a successor who will then have to win Senate confirmation. To the extent the nominee is a political ideologue or lacks credibility as an independent chair, the market reaction could be very negative given the already-high debt-to-GDP ratio of the US federal government and the ongoing large fiscal deficits that are likely in the years ahead.

Against this backdrop, decisions by the Fed Open Market Committee (FOMC) over the next year are likely to be heavily scrutinized for signs of political bias. Markets are currently pricing in two 25 bps rate cuts by the middle of 2025 versus six 25 bps cuts that were expected in the same period as recently as September 2024. The less dovish outlook has largely been driven by higher inflation expectations with inflation breakevens indicating that inflation is likely to average ~2.4% per annum over the next five years up from an expectation of ~1.9% in mid-September (Exhibit 4).

Given the recent stabilization of inflation at rates still above the Fed's target and the rising market expectations for future price increases, the Fed can easily justify pausing further rate cuts even before Trump takes office. If President Trump implements tariffs and immigration controls, I would expect the FOMC to stop easing policy until it can assess the impact of such policies on inflation. This decision would likely lead to increased tension with the White House.

Exhibit 4.

### Inflation Expectations Have Risen Meaningfully

US Five-Year Breakevens Imply Inflation of ~2.4% after the Next 12 Months

Implied Inflation Rate (% YoY)



As of 3 December 2024 Source: Bloomberg

# China

China faces significant challenges entering 2025. The ongoing real estate crisis has shattered consumer confidence while a potential trade war with the United States could trigger the worst growth slowdown in decades. The central government in China has attempted to address the economic malaise more aggressively in recent months, but it has still failed to deliver sufficient fiscal stimulus or to attack the underlying structural problems that led to the current lethargy. Investor expectations have been raised and dashed more than once in China in recent years, and 2025 may prove to be no different. China's economic and market outlook might largely depend on the speed and magnitude of government reforms. Unfortunately, I am not optimistic that the government will deliver what is needed to secure robust growth in the future. Instead, I expect sporadic intervention that temporarily excites investors but then fails to create the social safety net needed to invigorate consumption, transition local and provincial government funding models away from dependence on property sales, and more generally rebalance the Chinese economy away from excessive saving and investment toward a consumption-driven model.

## Real Estate Crisis

China's real estate crisis persisted through 2024. At its peak, real estate contributed as much as 25% to 30% of China's GDP before the government initiated efforts to deleverage and shrink the sector. Since the "Three Red Lines" policy was introduced in August 2020, a substantial majority of the largest privately owned property developers have defaulted on their debts. Home prices have also declined with prices for previously occupied housing down 27%–36% as of October across Tier 1, 2, and 3 cities (Exhibit 5). Given that the typical Chinese household has about 60% of its assets invested in residential real estate, the hit to consumer confidence has been severe (Exhibit 6).

The good news is that housing starts have declined over 60% from a peak of approximately 1.7 billion square meters per year to about 650 million. This decline in starts implies that completions should decline by a similar percentage in the next year or two relative to the prior peak, narrowing the gap between supply and demand and putting a floor under home prices.

Exhibit 5.

**Home Prices in China Have Fallen Materially**  
 50-City Secondary Housing Price Index by City Tiers  
 Beike Secondary Housing Price Index, Q1-18 = 100

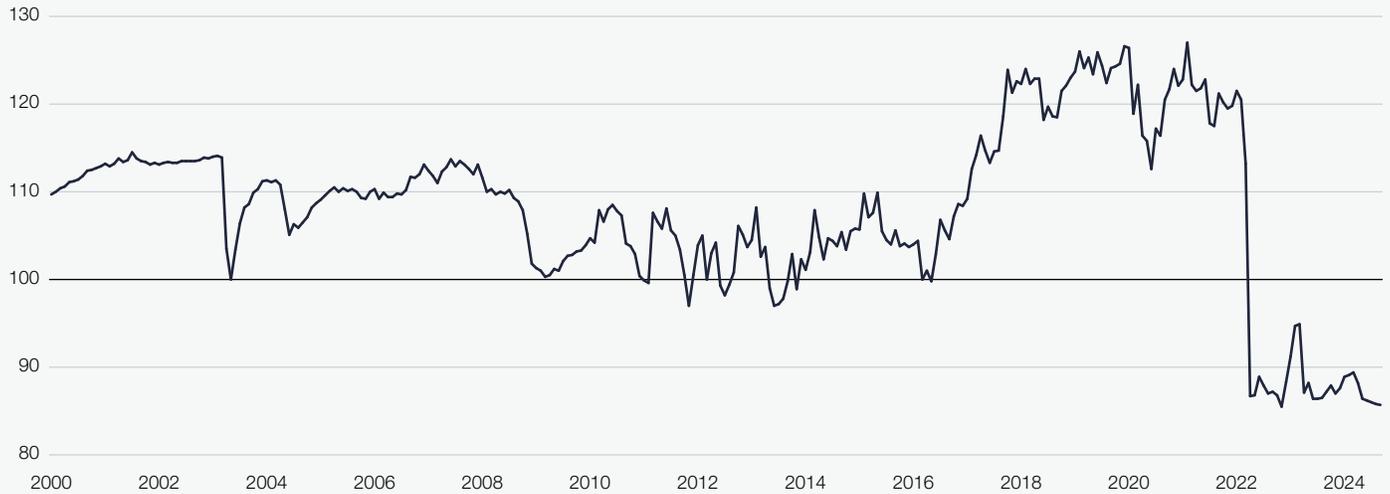


As of October 2024. Source: Lazard, Beike, Morgan Stanley.

Exhibit 6.

### Chinese Consumer Confidence Remains Near Record Low Levels

Survey of Chinese Consumer Confidence (Greater than 100 = Optimistic)

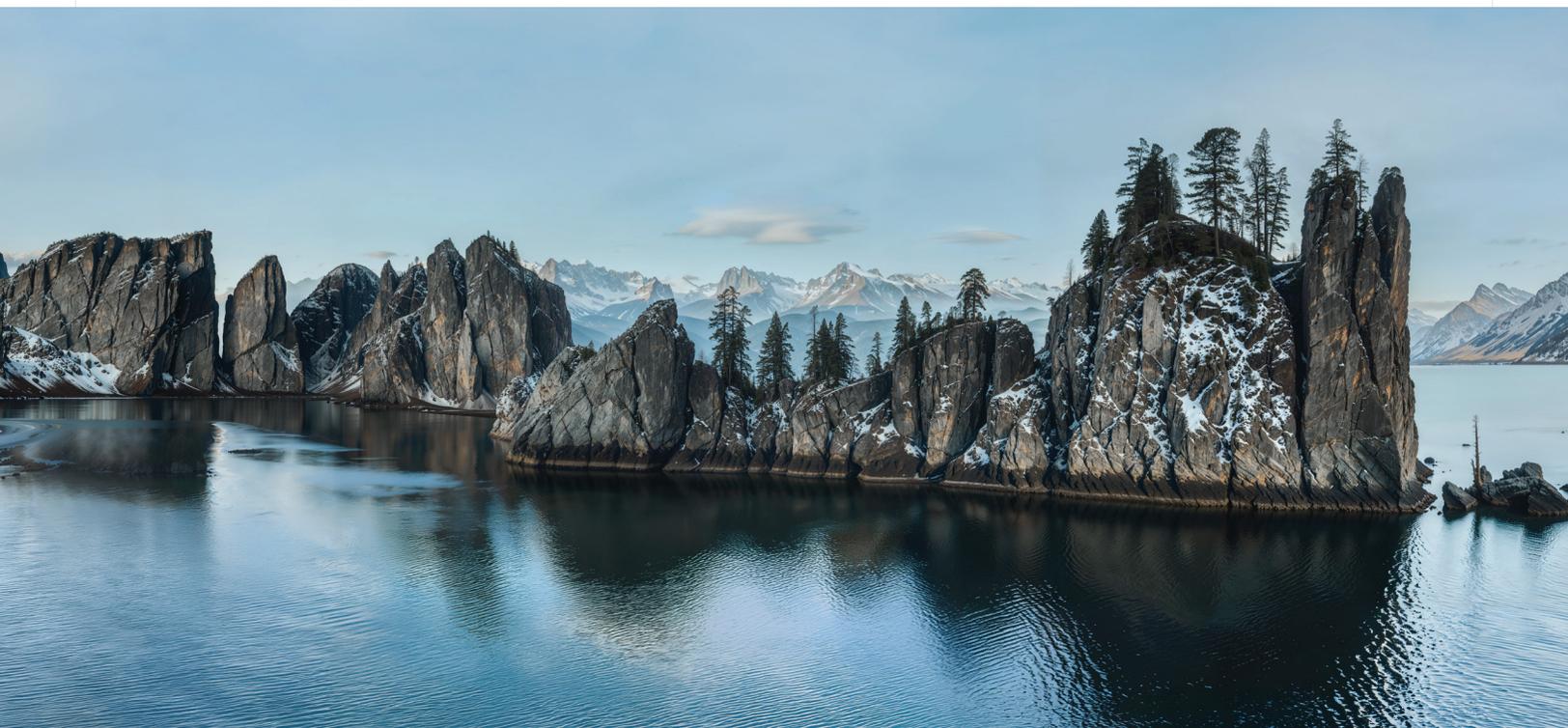


As of September 2024 Source: Bloomberg, Chinese National Bureau of Statistics

## Government Stimulus

Over the last two years, the Chinese government has announced dozens of measures to try to lift growth, but the policies have not materially lifted consumer confidence or domestic demand. These efforts accelerated in late 2024 but still disappointed markets. Thus far, the measures have been primarily focused on monetary policy stimulus, including reductions in interest rates, lower downpayment requirements for home purchases, and funding to finance share repurchases by companies. The most recent announcement was an RMB10 trillion package for the resolution of local government debt. While the package size was at the high end of expectations, the multiplier effect of debt resolution is very low given that it basically reflects moving off-balance-sheet debt onto the balance sheets of local governments which lowers the interest rate on that debt.

In 2025, I expect China to attack the economic malaise more aggressively after its belated recognition that consumer psychology had become dangerously negative, at the risk of creating a Japan 2.0 scenario. I also expect the government to respond to the imposition of tariffs on Chinese exports by the United States. The most likely first steps from the Chinese government are a) consumer trade-in and subsidy funding to incentivize durable goods purchases, b) funding to regional and provincial governments to buy excess housing inventory and reduce downward pressure on home prices, and c) capital injections into the major banks to facilitate riskier lending against public equity repurchases and other highly risk-weighted assets.



## Economic Imbalances Remain Unresolved

Even if China launches fiscal stimulus to increase domestic demand, I believe the underlying economic imbalances that have been evident for decades will remain unresolved. The most pernicious problem in China is the imbalance between savings and consumption in the household sector, which is exacerbated by a shrinking, aging population. In large part due to the absence of a resilient social safety net, Chinese households have one of the highest savings rates in the world as a percentage of income for fear of outliving their savings. Unfortunately for elderly people in China, coverage from the Old-Age Insurance System is woefully inadequate in rural areas and for urban workers who are not in skilled positions, a group that counts about 549 million among its numbers. As of 2023, retired urban salaried workers could receive an average monthly pension benefit equal to about \$461. Their less fortunate urban unsalaried and rural worker peers received only \$25 per month or less. With such low retirement allowances, it is no surprise that workers save so much of their current income. Given the sharp decline in previously occupied home prices, we should assume that workers will save even more going forward to try to repair their balance sheets.

To sustainably accelerate growth, I believe China will need a significant expansion and improvement of pension benefits, along with a range of other structural reforms such as changing the local government funding model to be less reliant on property sales. To date, there is little evidence of an appetite for major changes, but one recent change was a very good start. In September of 2024, the government announced widespread increases to the retirement age: from 60 to 63 for men, from 55 to 58 for white-collar women, and from 50 to 55 for blue-collar women. Given that life expectancy has increased from only ~45 years when the previous retirement age was set to ~78 years today, the increase was long overdue. This should incrementally help address the savings problem even if it is unlikely to be a popular policy change.

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Their less fortunate urban unsalaried and rural worker peers received only **\$25** per month or less.

## Trade Policy

Turning to the impact of US trade policy, as with Europe, I suspect China has developed a clear plan to retaliate if the United States imposes tariffs on Chinese goods. The challenge for China is its trade surplus. In 2023, China ran a trade surplus of nearly \$280 billion with the United States, which means imposing tariffs on imports from the United States would fall far short of the impact of US taxes on Chinese exports.<sup>2</sup> Moreover, China would be far better served by shifting its purchases of US agricultural products to other countries such as Brazil to punish American businesses for imposing tariffs. As a result, I expect China's response to be multi-faceted and to include import substitution, measures that complicate operations for US companies operating in China, and restrictions on exports of key components or inputs to the United States to hamstring US productivity and competitiveness.

Alongside retaliation against the United States, Chinese companies will seek alternative export markets to unload excess supplies of goods that are no longer in demand given the US tariffs. This could lead to additional trade tensions with other countries, first and foremost with those in the European Union.

More aggressive rate cuts in Europe combined with less easing in the United States will likely lead to a weaker euro, which could lead to higher inflation for imported goods into the region.

Before the US election, there were signs that the Eurozone economy might be poised to improve. Wage gains began to exceed inflation in 2024 in most countries, the European Central Bank (ECB) began cutting interest rates, and consumer confidence was grinding higher. Unfortunately, the US election might derail this budding optimism as Europe faces the likelihood of a trade conflict with the United States, more pressure to materially increase defense spending, and internal political uncertainty due to German elections and an unstable French government. Taking these considerations into account, the Eurozone appears at risk of enduring another year of relative economic stagnation.

## Trade Conflict with the United States

The United States is likely to try to “divide and conquer” when negotiating with the European Union, prioritizing favorable deals with countries with smaller trade surpluses and penalizing countries with large surpluses such as Germany.

It is unlikely the European Union will sit idly by while the United States imposes tariffs. I believe Brussels has already crafted a retaliation plan targeting specific US exports to the region. I also anticipate that European leaders will try to preempt some US tariffs by offering to buy more US LNG or other commodities to reduce the bilateral trade deficit. Finally, European leaders should seek to maintain a united front in negotiations with the United States given the fact that the US economy is nearly double the size of the Eurozone’s.

Despite Europe’s efforts to limit the fallout from US trade policies, the prospects for meaningful tariffs being imposed early in 2025 on European exports to the United States has meaningfully dimmed the Eurozone outlook on three fronts. First, Exports to the United States are likely to decline. In 2022, exports from the Eurozone to the United States represented about 15% of total exports or 3.7% of Eurozone GDP. A 10% tariff could meaningfully depress demand for some of these exports. Assuming the 10% tariff is part of a global tariff regime with few exceptions, the impact might be less negative, but it is not yet clear what exceptions there might be to the idea of a global tariff or the sequencing of tariff implementation. Second, US tariffs would likely lead to a decline in private sector investment within Europe as companies become less confident in their ability to export products to the United States. Finally, Europe might become a dumping ground for exports from China if the United States imposes a 60% tariff on imports from China. With US demand for Chinese goods likely to decline substantially, China will have to find new customers for the excess supplies that cannot be absorbed domestically. In 2024, the European Union imposed tariffs on imports of Chinese electric vehicles (EVs), but I would expect more protections for European industry in 2025 in response to increased instances of products being sold below production cost into the European Union.

## Monetary Policy Implications

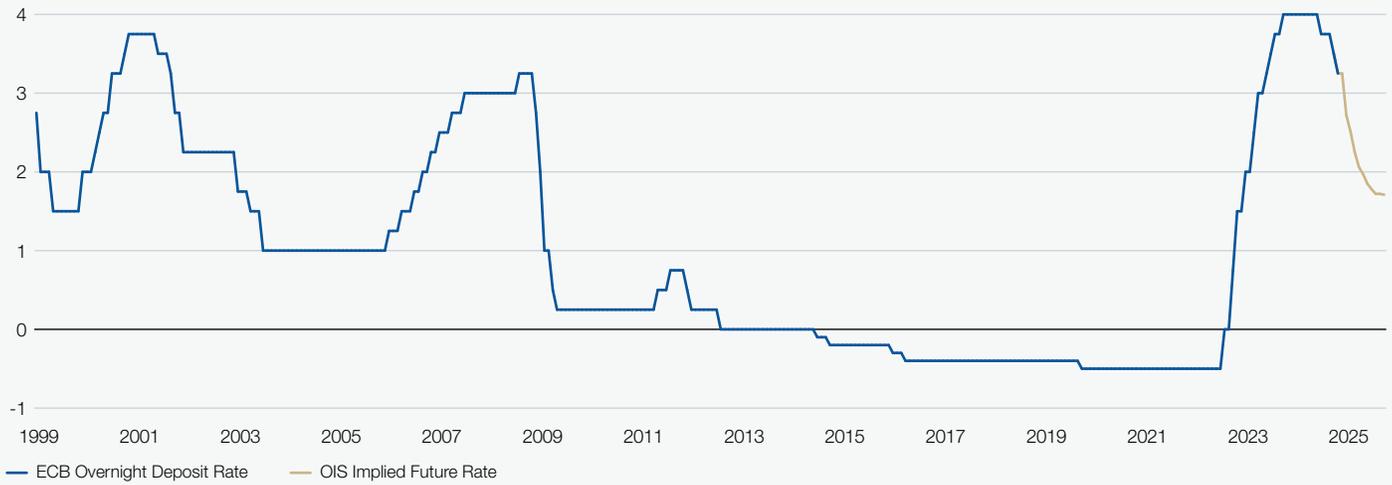
The ECB is likely to respond to trade and growth challenges by cutting rates more aggressively in 2025. Markets currently expect ~141 bps of rate reductions by the end of June taking the ECB’s target rate to approximately 2.0% (Exhibit 7).

I believe the ECB could end up lowering rates materially further depending on the severity of a potential trade war. More aggressive rate cuts in Europe combined with less easing in the United States will likely lead to a weaker euro, which could lead to higher inflation for imported goods into the region. Perversely, as I expect will be the case globally, US tariffs aimed at reducing the US trade deficit will likely strengthen the US dollar, which makes US exports more expensive and imports into the United States cheaper, offsetting much of the impact of tariffs on the trade deficit.

Exhibit 7.

### The ECB Is Likely to Cut Rates Aggressively in 2025 Markets Suggest ~141 bps of Additional Cuts through June 2025

Implied Eurozone Deposit Rate through September 2025 (%)



As of 3 December 2024. Source: Bloomberg

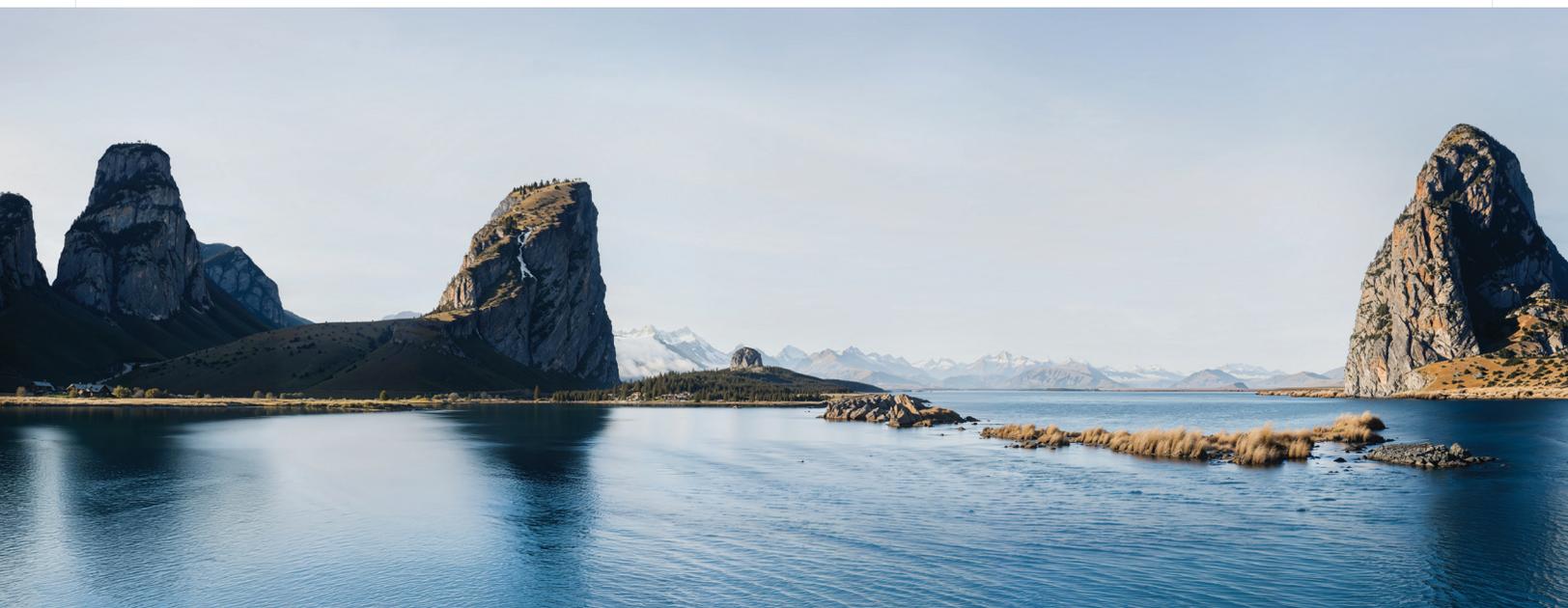
## National Security Considerations Increase in Importance

These trade-related pressures will likely be further aggravated by US pressure for European nations to significantly increase defense spending in the face of an emboldened Russia and a less-committed United States. As of 2024, it is expected that 23 of 32 members of the North Atlantic Treaty Organization (NATO) will fulfill the minimum standard of spending 2% of GDP on defense. The most significant laggards include Spain at 1.3% of GDP, Belgium at 1.3%, Italy at 1.5%, and Portugal at 1.6%.<sup>3</sup> According to former National Security Advisor John Bolton, Trump seriously considered withdrawing the United States from NATO during his first term but was convinced not to do so. Since then, Congress included a provision in the National Defense Authorization Act of 2024 that explicitly bars the US president from withdrawing from NATO without support from two-thirds of the US Senate. However, that does not mean a US president could not effectively undermine

NATO by verbally indicating he would not comply with Article V, which is a collective defense clause stating that an attack on one NATO member is an attack against all.

Given the president-elect's commitment to ending the war in Ukraine "within 24 hours" of taking office, NATO partners will also have to contemplate their options for supporting Ukraine if the US commitment ends or is significantly reduced. While it would not be easy, Europe can fiscally support Ukraine, but it cannot provide military equipment like the United States can given the absence of a meaningful military-industrial complex. In this regard, again, Europe will likely be forced to increase spending on military needs potentially at the cost of less funding for social programs and the green transition or larger budget deficits.

The combination of trade conflict and additional fiscal pressures from defense spending are likely to challenge some European countries more than others, adding to tensions within the economic union.



The Japanese economy has been through a wrenching change over recent years. In 2025, my key questions relate to the impact of a new governing coalition, the sustainability of inflation and wage increases, how changes in the takeover code and corporate governance in Japan might affect M&A activity, and where Japan fits in global supply chain shifts to derisk from China.

## Electoral Upheaval

Japan was not immune to electoral upheaval in 2024. The Liberal Democratic Party (LDP) under the leadership of then newly named Prime Minister Shigeru Ishiba suffered an unexpectedly severe defeat in elections in November. The LDP and its partner Komeito won only 215 seats in Japan's House of Representatives, versus the 288 they held before the election and the 233 seats required to have a simple majority.

The LDP and Komeito are currently working to form a new governing coalition including other parties. While major policy changes appear unlikely, many investors expect less fiscally conservative policies from the next government alongside a relatively dovish trajectory from the Bank of Japan (BoJ).

## Sustainability of Inflation and Wage Increases

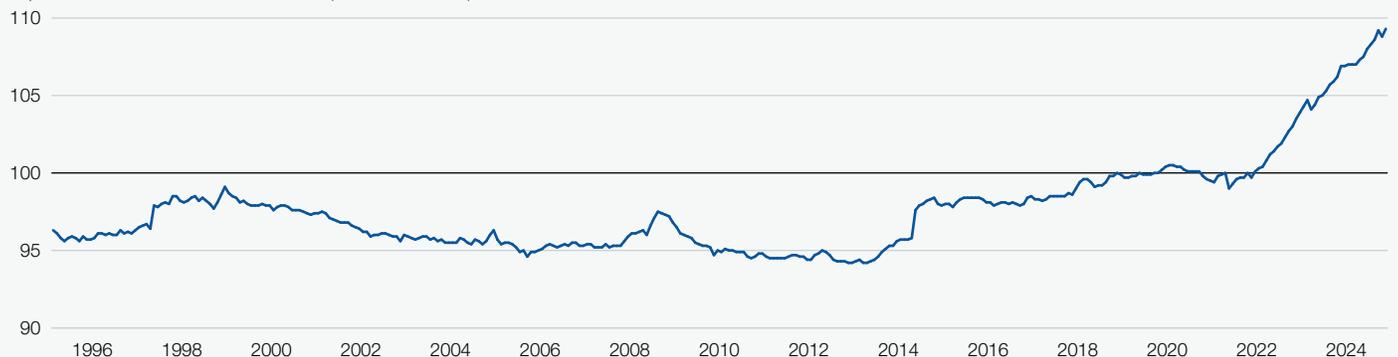
From January 1995 to December of 2021, the Japanese Consumer Price Index (CPI) rose from a level of 96.3 to 100.3, suggesting a cumulative price increase of only 4.2% over a 27-year period or an annualized inflation rate of only 0.15%. Since the end of 2021, the CPI has increased by 9% or an annualized rate of 3.17% (Exhibit 8). While a 3% inflation rate might not sound so shocking to most Western observers, after over three decades of basically no inflation, Japanese consumers have seen their world turned upside down. Making matters worse, for the first two years of this much higher inflation regime, wages in Japan did not keep up with prices, which meant lower purchasing power. Only in 2024 did wage agreements finally exceed inflation levels, which should bode well for purchasing power entering 2025.

While the outcome of the coalition formation talks could meaningfully affect policy and growth rates in Japan, my operating assumption is that policy will be changed only on the margins. Japan is likely to continue posting CPI inflation figures around 2%, which should continue to reaffirm the normalization of inflation expectations after decades of undesirably low price increases and outright deflation. To the extent I am correct, I would also expect another year of sizable wage gains for Japanese workers given the extreme tightness of the labor market. The quarterly Tankan survey shows that labor shortages are at their worst levels since 1991, which should encourage businesses to raise wages and increase investment in productivity-enhancing innovation (Exhibit 9).

Exhibit 8.

### After Decades of Price Stability, Inflation Took Off in Late 2021

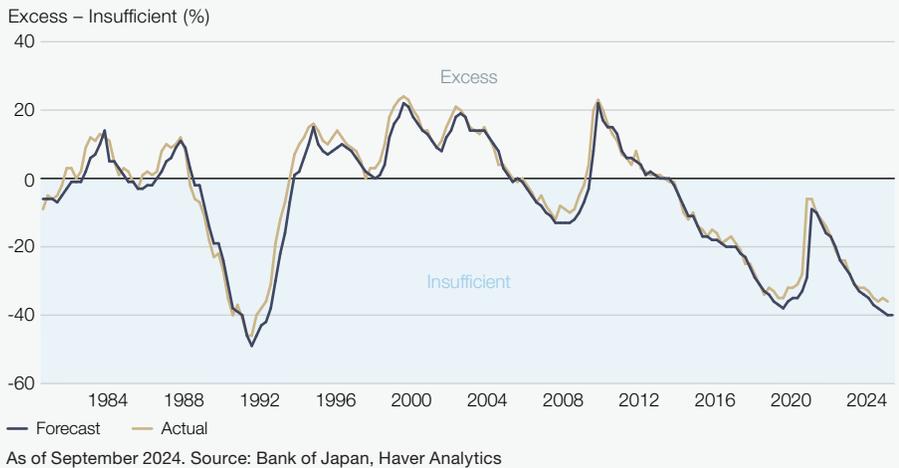
Japan General Consumer Price Index (SA, 2020 = 100)



As of October 2024. Source: Haver Analytics, Japan Ministry of Internal Affairs and Communications

Exhibit 9.

### Japan's Labor Market Remains Extremely Tight



## A New Era for Corporate Dealmaking?

The other big news of 2024 in Japan was the unsolicited takeover bid for Seven & i by the Canadian convenience store operator Alimentation Couche Tarde. Typically, a single takeover attempt is not newsworthy, but I believe this unfolding story is important as it highlights the impact of changes in recent years to Japan's takeover code and corporate governance practices. In years past, an unsolicited bid from a foreign company would likely have been dismissed out of hand, but in this case, the target was required to seriously consider the bid and incorporate shareholder interests into the decision-making process. The outcome of the saga remains unclear,

but whatever the result, I believe this bid could signal a new era of increased acquisition activity in Japan, including hostile takeovers that would have not even been considered in the past.

If we are at the dawn of a new era in which shareholders are more appropriately considered in corporate boardrooms, that could also bode well for a meaningful shift in asset allocation that could benefit both companies and consumers. Entering 2024, currency and bank deposits accounted for over 52% of Japanese household financial assets while equities accounted for only ~13% (Exhibit 10). If Japanese consumers realize a) that their bank deposits that earn 0% interest are actually returning a negative 2% real return and b) that they

could be earning a positive return from investing in equities that have significant upside potential from better management practices and optionality around takeovers, we could see a significant reallocation of capital toward riskier assets in Japan.

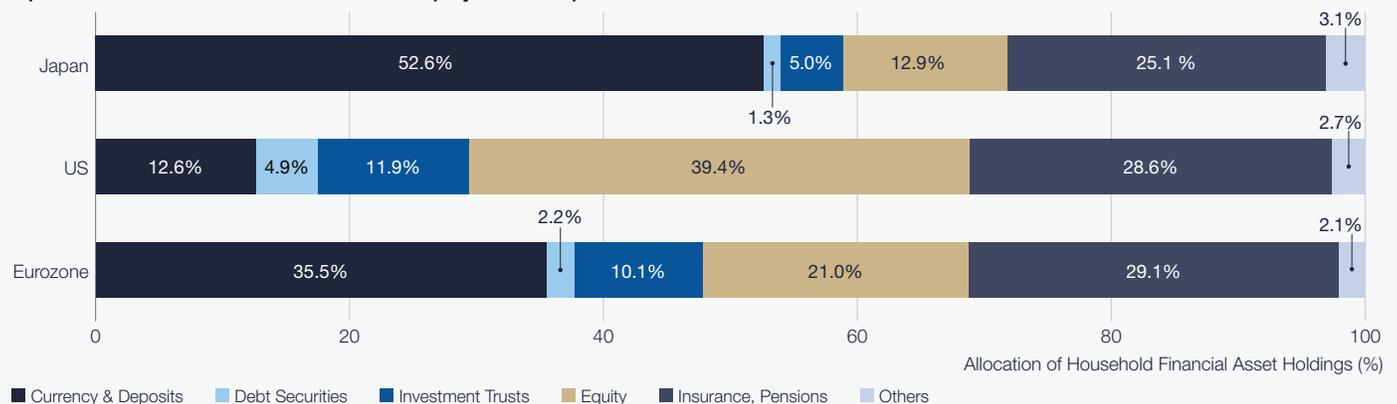
## Changing Role in Global Supply Chains

Finally, another positive facet of the outlook for Japan is its ability to play a strategic role in de-risking global technology supply chains relative to Greater China. Japan has long had the technical know-how and skilled labor force to produce semiconductors. The challenge has been the cost of production. In a world where Western governments are eager to identify and develop alternatives to China and Taiwan, Japan is well positioned to win a greater share of this market. Japan could be a target of US protectionism given that it had a \$71 billion trade surplus with the United States in 2023 but ranks #5 on the list of bilateral US deficits. This could keep Japan somewhat insulated from US pressure. I would also expect Japan to try to "get in front of" US trade protection by offering additional investment in US facilities and other potential deals.

Overall, Japan is not immune to the global uncertainty likely to be unleashed by the US election, but it might be less vulnerable than some of its peers. Assuming no radical change in policy from Japan's new coalition government, Japan could continue to offer an uncorrelated equity market opportunity in 2025 for investors.

Exhibit 10.

### Japanese Households Have Much Lower Equity Ownership than Global Peers



# Geopolitical Shifts

Taken together, the geopolitical outlook is much less predictable and hence introduces significant risk to investors and corporate executives making capital commitment decisions.

After decades of globalization, multilateralism, and relative geopolitical stability, I believe the elections of 2024, most importantly in the United States, have shifted the narrative. The United States is unlikely to continue supporting Ukraine in its defense against Russian aggression, and the US commitment to NATO is increasingly uncertain. In the Middle East, the United States is likely to stand resolutely behind Israel and is likely to reassume a “maximum pressure” campaign against Iran, risking further escalation of conflict in the region. Finally, in a world where US foreign policy is more transactional in nature, China might perceive a window of opportunity to test the US commitment to Taiwan’s sovereignty. Taken together, the geopolitical outlook is much less predictable and hence introduces significant risk to investors and corporate executives making capital commitment decisions. The following issues will be top of mind in this new era.

## Aid to Ukraine

Trump campaigned on a pledge to end the war in Ukraine within 24 hours. While such a pledge might be impossible to fulfill, the message was clear that US aid to Ukraine is likely to end. The implications of a sharp reduction or elimination of US aid would mean some combination of increased European funding to Ukraine and/or President Volodymyr Zelensky being forced to negotiate a cessation of hostilities with Russia from a further weakened position.

## The Future of NATO

Through his first term, Trump was a skeptic regarding the value of NATO to the United States. He railed against the failure of other NATO members to satisfy their minimum 2% of GDP funding for defense spending which gradually led to materially higher spending across the organization. Any diminishment of the US commitment to NATO could have significant consequences for stability in Europe.

## Middle East Policy

US policy toward Israel is unlikely to change materially with the new administration. The Trump administration will likely put less pressure on Israel on humanitarian grounds related to its operations in Gaza, the West Bank, and Lebanon, but this change is on the margin given how permissive the Biden administration was on such matters. The more meaningful change will relate to Iran where I expect a resumption of the “Maximum Pressure” campaign that significantly curtailed Iran’s ability to export energy products and participate in global commerce. The Biden administration turned a blind eye to Iran’s energy exports hoping that the supplies would reduce inflation by compensating for reduced global purchases of Russian energy after the Ukraine invasion. Reimposition and enforcement of tougher US sanctions against Iran and a more permissive approach to Israeli military action against Iran could raise the risk that the regional conflict expands to disrupt the flow of energy products out of the Persian Gulf.

## China-Taiwan Policy

US policy toward China is likely to be less predictable going forward in part because of divergent views within the new administration. There is commonality across key players as it relates to trade policy with China, but views on Taiwan differ. Several Trump appointees are traditional China hawks with strong commitments to Taiwan’s sovereignty. However, Trump himself has voiced doubts about whether and why the United States could or would protect Taiwan in a conflict with China. Such doubts on the US side of the Pacific could incentivize China to push the envelope in terms of applying pressure on Taiwan whether through military or other means to see how far it could go without a US response.

# Investment Implications

Put simply, my preference remains to be more exposed to intermediate-duration and higher-quality borrowers rather than reaching for yield in riskier areas, such as the high yield market or leveraged loans, given the outsized risk of an unexpected downturn.

Over the last three years, much of the macroeconomic discussion followed a predictable pattern. It began with inflation, which then connected to monetary policy, which then led to contemplation of recession risk and the probability of a soft landing. Through most of 2024, fears related to inflation and recession faded substantially and attention shifted to elections, with the US decision looming largest over the economic outlook. In 2025, as is evident from the entirety of this outlook, I expect the macro discussion to shift substantially toward the effects of the president-elect's policies.

The biggest challenge from a market perspective lies in quantifying the independent effects of potential policy changes and then attempting to understand how these countervailing impacts will interact. For example, economists can estimate the inflationary and growth impacts of increased tariffs, but even these estimates are subject to large error bands. Several questions remain unanswered: When will tariffs be applied? Will they be applied all at once, or gradually over time? Which items will they be applied to? Will they be applied uniformly? If not, what will the nuances be?

Predicting the customer responses to policy changes is also imprecise. For example, if one million undocumented immigrants were deported in 2025, what might that mean to wage growth by sector? How will compensation increases resulting from deportations affect broader price levels? Even more difficult to forecast is the impact of broad price-level increases on wage demands in sectors that are not directly impacted by deportations. Finally, there is the complexity of measuring the impact that deregulation and lower tax rates could have on the "animal spirits," or psychology of all market participants.

I am elaborating on complexity because I want to emphasize the importance of humility in forecasting the impact of potentially significant policy changes on the economy and markets.

With that cautionary note in mind, my base case expectation is that inflation will increase moderately in 2025 due to tariffs and modest increases in consumption driven by wealth effects and optimism around perceptions of a more growth-oriented economic agenda. In 2026, I expect further increases in inflationary pressure as immigration policies and tariffs accumulate. With this backdrop, I see the US 10-Year Treasury yield moving back toward 5% and the fed funds rate staying at or above 4%. While it might be tempting for investors to extend duration in their portfolios if the 10-year Treasury reaches a 5% yield again, I would caution against any excessive reallocation. This is because the shifting policy backdrop could lead to a sustained grind higher in US government financing costs as key policy changes reignite inflation and budget deficits remain elevated. To the extent Fed independence is also called into question against a backdrop of elevated inflation and deficits, rates could rise sharply.

With trade and immigration policy depressing growth and raising inflation, while deregulation and tax policy increase corporate profitability, I would expect credit spreads to remain tight as recession risk appears low. However, if I am wrong, the accumulated uncertainty created by so much change and an escalating global trade war could at some point negatively impact investor psychology, leading to wider credit spreads and perceptions of increased recession risk. Put simply, my preference remains to be more exposed to intermediate-duration and higher-quality borrowers rather than reaching for yield in riskier areas, such as the high yield market or leveraged loans, given the outsized risk of an unexpected downturn.

For US equities, the initial response to the US election was positive as investors focused on the obvious tailwinds to profitability: lower corporate tax rates and less regulation. However, I expect much more dispersion within the equity market when the reality of a much-less-friendly trade environment sets in. Some companies, such as those in the financial services and energy sectors, will be less vulnerable to tariffs while others, such as those in the consumer discretionary arena, will be much more susceptible. After another year of narrow leadership in the S&P 500 Index, I expect a shift in leadership in the market and potentially a meaningful rotation of capital. To put a finer point on the narrowness, in 2024, the S&P 500 Index rose 26.8% through 25 November, but the median stock was only up 16.8% with only 167 stocks beating the overall Index return.



Within the US equity market, investors might want to examine the opportunity in small cap stocks. After years of underperformance, the sector has been reinvigorated post-election on the back of optimism that smaller companies could benefit from deregulation and lower corporate tax rates, while also being less vulnerable to the negative consequences of a global trade war. That said, I would argue in favor of a strategy that takes quality into account, given how many small companies consistently lose money and given that the cost of debt financing is likely to be higher for longer than previously expected, due to the inflationary impact of US trade and immigration policies.

In the immediate aftermath of the US election, non-US equities initially underperformed US peers. However, 2025 could present an excellent opportunity to add capital in non-US markets as investors recalibrate assumptions regarding the relative winners and losers from the reshaping of global supply chains against an evolving geopolitical backdrop. In three of the last five quarters, foreign direct investment into China has been negative, and I expect to see more capital being redirected away from China in the years ahead. The main beneficiaries are likely to be other emerging economies for everyday goods, while production of strategic and national security-related goods will increasingly shift back to developed economies. With record-high valuation discounts for non-US versus US equities, I believe investors would be well-served by taking another look at which companies are best positioned to benefit from this changing landscape.

Looking beyond geography, I continue to believe the two most transformational economic themes in our lifetimes will be the advent of artificial intelligence (AI) and the energy transition. Investors are fully engaged in the AI trade but are increasingly discarding shares related to clean energy. I believe a great investment opportunity could be in the making, as climate change continues unabated and the profit opportunity from investing in both mitigation and adaptation grows. In the case of AI, the most attractive near-term opportunity might still be in the market leaders, but I believe it will increasingly shift to the companies that effectively deploy AI into their operations in a way that generates meaningful returns on investment.

# In Summary

The year ahead is going to present new challenges as well as new opportunities. Recognizing and anticipating the seismic shifts that are likely to occur can make a significant difference in whether and to what degree investors and companies can capitalize on disruption. The pendulum swing away from globalization, multilateralism, and relative geopolitical stability is likely underappreciated. Our goal is to ensure that we provide as much insight as possible to help each of you assess these changes and apply them to your objectives throughout the year.

## About the Author

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Ronald Temple is the Chief Market Strategist for Lazard's Financial Advisory and Asset Management businesses. In this role, Ron provides macroeconomic and market perspectives to Lazard's investment teams on a firmwide basis and works closely with Lazard's Geopolitical Advisory group to assess economic and market implications of key geopolitical issues globally. Ron also advises clients of Lazard's Asset Management businesses regarding macroeconomic and market considerations that are important to achieving their objectives.



# Important Information

## Notes

- 1 [Mass Deportation: Devastating Costs to America, Its Budget and Economy](#), American Immigration Council, October 2024
- 2 [U.S. International Trade in Goods and Services](#), United States Bureau of Economic Analysis, February 2024
- 3 [Defence Expenditure of NATO Countries \(2014-2024\)](#), NATO, June 2024

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