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# Schroedinger's tariffs

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## In Summary

- **The US Supreme Court dismantled the most cost-effective tariff instrument, but not the new tariff regime overall.** The ruling against using the International Emergency Economic Powers Act (IEEPA) for "Liberation Day" tariffs invalidates around USD60bn in duties, as well as the fentanyl-emergency tariffs imposed on China, Mexico and Canada worth an additional USD40bn. While this halves the effective US tariff rate to around 5%, half of the 2025 tariffs still remain in place via Section 301 (on industrial machinery, electrical equipment etc.) and Section 232 (on steel and aluminum).
- **For companies, the ruling renews trade uncertainty as the stop-and-go policy will prevail and complicate inventory management, and the respite may likely be temporary.** President Trump has reaffirmed plans for a 10% universal tariff floor, with Section 122 allowing tariffs of up to 15% for 150 days, alongside expanded Section 301 probes and the theoretical use of Section 338 (up to 50% tariffs). A renewed stockpiling cycle is likely to keep US WCR at their 2025 highs (>60 days), led by automotive manufacturers and household equipment, the two sectors most exposed to tariff escalation and supply-chain front-loading, as well as retail and chemicals, reflecting precautionary inventory builds and longer input sourcing cycles. So far, only half of the tariff costs have been passed through to consumers as of December 2025 and the peak impact is expected around Q1 2027 (+1pp CPI) for an average expected tariff of 10% by then under Section 122, factoring in sectorial exclusions.
- **Uncannily, the Global South and China now emerge as the biggest winners. Reactions from across the globe point to partner countries asking for clarification and forward visibility, including when it comes to recently-negotiated trade agreements.** Tariff relief is concentrated across large emerging exporters including Indonesia (-18pp), Brazil (-17pp), China (-15pp) and Vietnam (-15pp), South Africa, Türkiye and India. The biggest tariff winners under a Section 122 regime with sector exemptions are also concentrated in high-exposure emerging exporters led by Brazil (-17pp), and China, while developed markets see more limited relief (EU and UK -3pp and Japan -1pp) and a handful of partners such as Saudi Arabia and Mexico would face marginal tariff increases (+2pp).
- **Fiscal and market spillovers are material but disinflation dominates the near-term outlook.** IEEPA alone generated close to 60% of incremental receipts (USD180bn of USD240bn in 2025). Refund liabilities could amount to USD120bn (~0.5% of GDP), widening the fiscal deficit toward 7.5% of GDP, though repayments would unfold slowly via customs litigation. Macro spillovers tilt modestly disinflationary (-0.1pp to 2.3% US inflation in 2026). US 10y Treasury yields could fall 10-20bps and remain below the 4% threshold for longer. However, fiscal dominance risk as well as oil price inflation risks should prevent a substantial yield decrease. EUR/USD is likely to remain broadly stable, anchored at 1.19. A tariff unwind may add +0.5pp to growth and ~+1% to earnings, modest versus ~16% 2026 EPS growth and high valuations, leaving equity upside capped and volatility elevated if tariffs return via other tools. For private equity and private credit, trade policy uncertainty introduces material risk at a critical juncture for distribution recovery and credit pricing.

**The US Supreme Court has struck down the administration's most cost-effective tariff instrument, which accounted for 60% of all US tariff revenue so far.** In a 6–3 decision, the US Supreme Court ruled on 20 February that the International Emergency Economic Powers Act (IEEPA) does not provide legal authority for the reciprocal tariffs announced on “Liberation Day”, worth USD60bn of custom receipts<sup>1</sup>. The Supreme Court ruling also invalidates the fentanyl-emergency tariffs imposed on China, Mexico and Canada under IEEPA authority. While smaller than the reciprocal tariff pool, these country-specific measures account for USD40bn.

**What remains in place? First, Section 301 applying 25% tariffs on the industrial and technological core of US imports from China, which were tariffed during the first Trump Administration.** The regime spans over USD370bn of goods, roughly half of current US imports from China, and is concentrated in manufacturing supply chains rather than basic consumer staples. High-exposure categories include industrial machinery (machine tools, pumps, robotics), electrical equipment (transformers, motors, switchgear) and electronics inputs such as printed circuit boards, networking hardware and storage components. Automotive parts – including engines and transmission systems – alongside chemicals, plastics and fabricated metals form another major tranche, reflecting their role in downstream US production. Coverage at a lower tariff rate extends into manufactured consumer goods, notably furniture, lighting, tools and selected appliances, though large retail electronics such as smartphones and many laptops were structurally excluded or delayed. Higher tariffs onto strategic sectors targeted during the Biden Administration also remain, including those on electric vehicles, lithium-ion batteries, solar cells, semiconductors and critical minerals.

**Second, Section 232 tariffs enacted over the last 12 months remain concentrated on upstream industrial inputs deemed critical to national security.** The regime is anchored in steel (50% tariffs covering flat-rolled products, pipes and structural sections) and aluminum (50% across unwrought and semi-fabricated products), alongside expanded derivative goods such as fasteners, stampings and fabricated metal components designed to prevent circumvention. While Section 232 investigations into autos and auto parts authorize tariffs of up to 25%, broad automotive duties have largely been avoided through negotiated arrangements with key partners, including the EU, Japan, the UK, South Korea, Canada and Mexico, leaving autos a contingent rather than systemic pillar of the regime. Lumber and trucks also remain under Section 232 tariffs.

**The Supreme Court ruling removes the legal backbone of recent US tariff arrangements but does not void trade agreements already in place.** By invalidating IEEPA-based tariffs, the Court neutralizes the instrument that underpinned the reciprocal tariff regime affecting partners such as Europe, Japan and the UK, effectively stripping tariff concessions and exemptions of their operational enforcement mechanism. However, formal trade agreements and sectoral frameworks negotiated under separate legal authorities, including quota arrangements and tariff provisions anchored in other statutes, remain fully in force, leaving the broader trade architecture intact even as the tariff leverage embedded within it is materially weakened.

**The overall US average tariff has halved to 5% but this respite will only be temporary.** Overall, the goods CPI index (most exposed to tariffs as services were not targeted) increased from -0.1% year-on-year (y/y) in January 2025 to +1.4% in December 2025. Non-electric cookware & tableware, dishes and flatware and photographic equipment have seen the fastest price increases. As of December 2025, we estimate that only about half of the additional tariff costs has been passed through onto consumer prices, pushing the tariff contribution to US headline inflation from 0pp to +0.3pp. This means the peak impact of a US average tariff of 10% is still looming, likely in Q1 2027 (+1pp)<sup>2</sup>. Following the Supreme Court ruling, President Trump reaffirmed the political commitment to a 10% universal tariff floor on imports but did not announce a finalized legal implementation mechanism. Replacement pathways, most likely Section 122 of the Trade Act of 1974, which allows the implantation of tariffs of up to 15% for 150 days, without Congressional extension, provided action is justified by large and serious balance-of-payments deficits and applied on a non-discriminatory basis. In addition, expanded sectoral investigations under Section 301 would be opened, and Section 338 of Commerce Act is also available in theory, allowing the White House to raise tariffs to up to 50% on countries presenting persistent discriminatory trade practices against the US. While tariffs under Section 338 do not have a time limit, the legal framework of applying them seems more questionable than Section 122.

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<sup>1</sup> See our report [Q3 earnings, the secret behind EU sovereign spread convergence and from tariff dividend to Supreme Court scrutiny](#)

<sup>2</sup> See our report [High prices, thin buffers: America's affordability crisis persists](#).

Table 1: Legal alternatives for tariffs

Instrument	Policy Objective	Who Investigates	Max Tariff	Duration	Prior Use
<b>Section 301 (Trade Act 1974)</b>	Address unfair trade practices / IP violations	USTR (investigation required)	No statutory cap	Typically 4 years (renewable)	Used since 2018 (China tariffs, still active)
<b>Section 232 (Trade Expansion Act 1962)</b>	Protect national security / industrial base	Commerce Dept (270-day review)	No statutory cap	Indefinite unless modified	Frequently used (steel, aluminum, autos investigation)
<b>Section 201 (Trade Act 1974)</b>	Temporary relief from import surges	USITC (120–150 days)	Limited (cannot exceed 50% increase over existing duty)	Up to 4 years (extendable to 8)	Used in 2018 (solar panels)
<b>Section 122 (Trade Act 1974)</b>	Correct serious balance-of-payments deficits	Presidential action (no investigation)	15%	150 days	Never used for tariffs
<b>Section 338 (Tariff Act 1930)</b>	Counter discrimination against US commerce	Presidential proclamation	Up to 50%	No explicit time limit	Never used

Sources: various, Allianz Research

**Who benefits most from the removal of the IEEPA tariffs?** The largest beneficiaries include Bangladesh (-20pps to 15%), Pakistan (-19pps to 10%), Indonesia (-18pps to 6%), Brazil (-17pps to 8%) and Cambodia (-16pps to 7%), alongside China (-15pps to 14%) and Vietnam (-15pps to 5%). South Africa (-15pps to 6%), Türkiye (-12pps to 7%) and India (-12pps to 5%) will also enjoy lower tariffs, reinforcing the broad-based easing across Asia, LatAm and select EMEA exporters. Developed markets benefit as well, albeit to a lesser degree: Canada (-11pps to 4%) and the EU (-8pps to 5%) post meaningful declines, while Japan (-3pps to 10%) and South Korea (-4pps to 9%) see more limited relief.

Table 2: US import tariffs for main trade partners

	Pre-Trump II	Current	The Supreme Court strikes down IEEPA tariffs. No immediate reaction from Trump Administration	Trump Administration applies Section 122, with sectoral exemptions (same as for IEEPA reciprocal tariffs)	Trump Administration applies Section 122, without sectoral exemptions
Argentina	1%	11%	6%	6%	6%
Australia	0%	12%	4%	4%	4%
Bangladesh	15%	35%	15%	15%	15%
Brazil	1%	25%	8%	8%	8%
Cambodia	6%	23%	7%	14%	15%
Canada	0%	15%	4%	7%	16%
Chile	0%	6%	1%	1%	1%
China	13%	29%	14%	15%	16%
Colombia	0%	14%	6%	6%	6%
Ecuador	0%	10%	1%	9%	16%
EU	1%	13%	5%	10%	17%
Hang Kong	1%	9%	2%	2%	2%
India	2%	17%	5%	12%	17%
Indonesia	5%	24%	6%	14%	16%
Japan	2%	13%	10%	12%	19%
Kenya	0%	9%	1%	1%	1%
Malaysia	1%	9%	2%	7%	16%
Mexico	0%	5%	2%	7%	14%
New Zealand	1%	15%	2%	14%	16%
Norway	1%	9%	2%	9%	16%
Pakistan	10%	29%	10%	15%	15%
Philippines	2%	10%	3%	9%	16%
Saudi Arabia	0%	4%	1%	6%	15%
Singapore	0%	9%	1%	1%	1%
South Africa	0%	21%	6%	10%	18%
South Korea	0%	13%	9%	11%	19%
Switzerland	1%	10%	2%	10%	16%
Taiwan	1%	8%	3%	7%	17%
Thailand	1%	15%	4%	10%	16%
Türkiye	3%	19%	7%	15%	18%
UAE	2%	21%	16%	16%	16%
UK	1%	7%	4%	4%	4%
Vietnam	4%	20%	5%	11%	16%
<b>Global</b>	<b>3%</b>	<b>10%</b>	<b>5%</b>	<b>9%</b>	<b>15%</b>

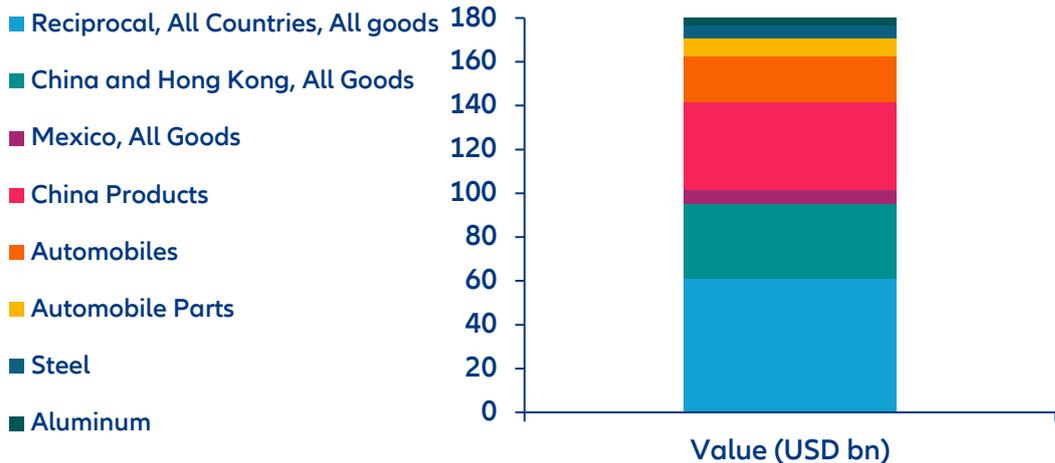
Sources: various, Allianz Research

**A regime where Section 122 replaces IEEPA tariffs would benefit Brazil, Bangladesh, India, China, Pakistan, Switzerland, South Africa, Vietnam and Indonesia the most.** We estimate that exporters from these markets could benefit from at least a -10pps cut in the average US tariff rate from current levels (especially if the same sectoral exemptions as for the IEEPA reciprocal tariffs remain in place). As Section 122 is by definition temporary (beyond 150 days, Congressional approval is needed), frontloading of shipments from these markets is likely to take place ahead of potentially further tariff hikes under other sections. In contrast, under Section 122, Saudi Arabia, Mexico and Ecuador could face higher tariffs than current levels, as well as Taiwan, Norway, South Korea or the EU, in case no sectoral exemptions are put in place.

**A renewed precautionary stockpiling window is opening for US corporates, pushing Working Capital Requirements (WCR) towards new cyclical highs.** Tariff frontloading added roughly +0.4-0.6pp to US real GDP growth at peak quarterly impact during the immediate post-announcement phase of the reciprocal tariff regime in 2025. In trade-flow terms, goods imports surged temporarily, with some monthly prints running 10–15% above the baseline trend during the most acute frontloading phases. The effect was particularly visible in containerized freight, electronics, machinery and durable consumer goods, sectors where tariff pass-through risk is highest and inventory holding costs are manageable. US WCR increased by more than 35 days over a year in Q3 2025 to more than 60 days, led by automotive manufacturers and household equipment, the two sectors most exposed to tariff escalation and supply-chain front-loading. Retail and chemicals also recorded sizeable increases, reflecting precautionary inventory builds and longer input sourcing cycles. By contrast, upstream suppliers show the mirror effect: automotive suppliers, metals and machinery & equipment saw WCR compression, pointing to inventory drawdowns and weaker downstream order visibility. Electronics and pharmaceuticals posted only modest increases, suggesting more balanced inventory dynamics.

**Tariffs had become a fiscal pillar. Refund risk is real but operationally slow.** Since “Liberation Day”, US customs duties have surged to USD240bn, roughly USD180bn higher than over the same period in 2024. On an effective-rate basis, tariffs rose to 10% in December 2025 from just 2.5% one year before. Approximately 9pps of that increase stemmed directly from IEEPA-linked measures, including reciprocal tariffs and targeted duties on Brazil, Canada, China, India and Mexico. Indeed, IEEPA accounted for close to 60% of incremental tariff receipts under the post-2 April regime. If duties are deemed retroactively unlawful, reimbursement liabilities could reach USD120bn (0.5% of GDP), bringing the US fiscal deficit to -7.5% of GDP. However, implementation is unlikely to be immediate. The Court may leave refund adjudication to lower courts, and importers would likely need to file claims through customs procedures, implying a lengthy and administratively complex repayment process, that could even take years.

Figure 1: Total tax receipts from higher US average import tariffs in 2025, USDbn

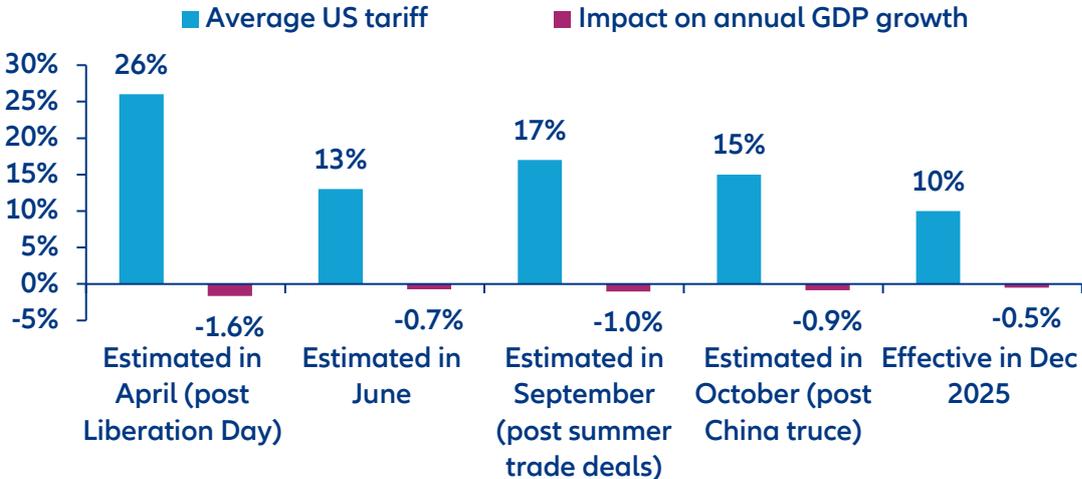


Sources: various, Allianz Research

**Inflation and rates dynamics tilt modestly disinflationary.** In principle, the removal of IEEPA tariffs is significant, given their large share in overall US duties and, critically, their concentration in consumer goods, making them more directly CPI-sensitive than remaining sectoral tariffs outside autos under Section 232. The extent to which the ruling translates into outright price declines or higher firms’ margins remains to be seen. On balance, the decision constitutes a downside risk to one-year CPI and a bearish catalyst for front-end real yields. We see a downside risk on Treasury yields of 10–20bps in the near term as the disinflation impulse dominates fiscal-supply concerns. That

said, policy uncertainty around alternative tariff instruments and the risk of renewed trade weaponization could rekindle de-dollarization pressures and place upward pressure on yields, partially offsetting the initial rally.

Figure 2: Impact of US import tariffs on GDP growth



Sources: various, Allianz Research

**The EUR/USD exchange rate is expected to see little movement despite rising uncertainty.** Delays or revisions in the EU-US trade agreement are unlikely to cause significant fluctuations as the currency pair is not in the eye of this “tariff storm”.

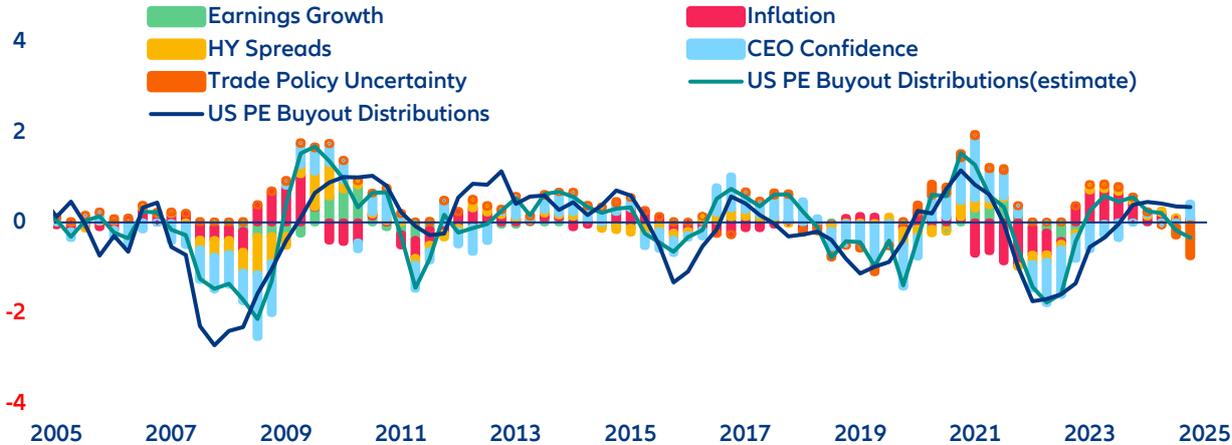
**For US rates markets, the disinflationary narrative will be strengthened.** Together with some Iran-related flight-to-safety flows, we could see 10y US treasuries dipping below the 4% yield threshold. However, a mild boost for US growth, fiscal risks related to tariffs and inflation risks related to a potential oil-price shock should prevent a substantial move below that level. We expect the US 10Y-2Y spread to remain around 60bps, with a long end range trading around 4% and a data-responsive volatile short end still repricing the Fed's reaction function, not recession risk. The Fed's position on tariffs so far was to look through the one-off price effect and focus on the underlying headwind to demand. If these price effects are now less pronounced, and if unemployment remains contained, some FOMC members might become less inclined to cut policy rates in the months to come. We see the biggest risk on the liquidity side. If the Treasury needs to increase debt issuance to cover refunds and compensate for missing tariff income, this could further drain liquidity as the absorption capacities of intermediaries in the US Treasury market are already tight. This makes the market more exposed to short-term rate volatility, which can quickly spill over to risky assets.

**Risk assets in public markets reacted in a measured way, which appears reasonable. Near-term upside may quickly give way to downside from uncertainty, until lower rates or visible higher US growth offer support. Mid-term the reintroduction of similar tariff levels would largely restore conditions, resulting primarily in increased volatility.** The S&P 500 advanced by 0.7%; with the technology sector leading these gains, the impact of the tariff rejection appears minimal. In Europe, the increase of c.0.9% after the announcement was similar but on Monday Morning Asia already registered a more negative stance with Nikkei and CSI c.1.1% lower. Market participants seem to have anticipated alternative measures from the Trump administration to reinstate tariffs, thereby maintaining the status quo. In the short term, potential upside from disinflation, lower interest rates and higher growth may be tempered by uncertainty pending the establishment of a stable tariff framework to inform capital expenditure. We estimate that a +0.5% growth boost could lift earnings temporarily by c.1% but compared to 2026 consensus expectations of +16% for the S&P 500 and high price/earnings ratios, this would translate into little equity price stimulus. Likewise, at high valuations, a decline in bond yields would need to be material to push equities more notably higher. On the flip side, uncertainty can produce a significant market effect, as seen on “Liberation Day”, and depending on subsequent policy directions, more pronounced volatility could return. As growth and valuations are much more dependent on the AI-induced economic impulse, we believe investors’ conviction in technology will

be more decisive for equity markets. Among risk assets, investment grade corporate bonds appear better positioned to manage this uncertainty: they provide both credit spread exposure and interest rate sensitivity. Although spreads remain compressed, the asset class is comparatively well-suited to current conditions. Conversely, emerging market equities may exhibit heightened volatility, given their pronounced sensitivity to tariffs and robust year-to-date performance, which suggests a more selective approach is warranted, e.g. tilted towards technology with less price-sensitivity.

**For private equity, the Supreme Court's review of tariff constitutionality introduces material uncertainty into portfolio management and exit timing at a critical moment for distribution recovery.** Our baseline forecast anticipates distribution growth of 5% in 2026 and 1% in 2027, predicated on moderating trade tensions and stable policy conditions. However, the current situation facing private equity sponsors is particularly complex for software-heavy portfolios, where newly proposed tariffs would compound existing challenges around artificial intelligence-driven business model transformation. For holdings deployed at elevated revenue multiples, such as the 2020-21 vintages, the intersection of trade policy volatility and technology disruption creates difficult strategic decisions where margin forecasts, competitive positioning, and cost structure assumptions all face meaningful revision risk simultaneously. Along these lines and as outlined in our recent research<sup>3</sup>, trade policy uncertainty has become one key factor influencing exit market conditions and buyer willingness to commit capital (Figure 3). In the event of adverse scenarios where sustained trade conflict escalates, possibly ending in fiscal-dominance dynamics, distribution growth could compress to -3% in 2026 before recovering to 1% in 2027. This would turn the anticipated recovery into contraction and keep financing costs structurally elevated precisely when sponsors require improved conditions to monetize portfolios, generate cash returns to limited partners and position for successor fund raises on the strength of demonstrated distribution discipline.

Figure 3: US PE distributions y/y change decomposition (Z-scoring)



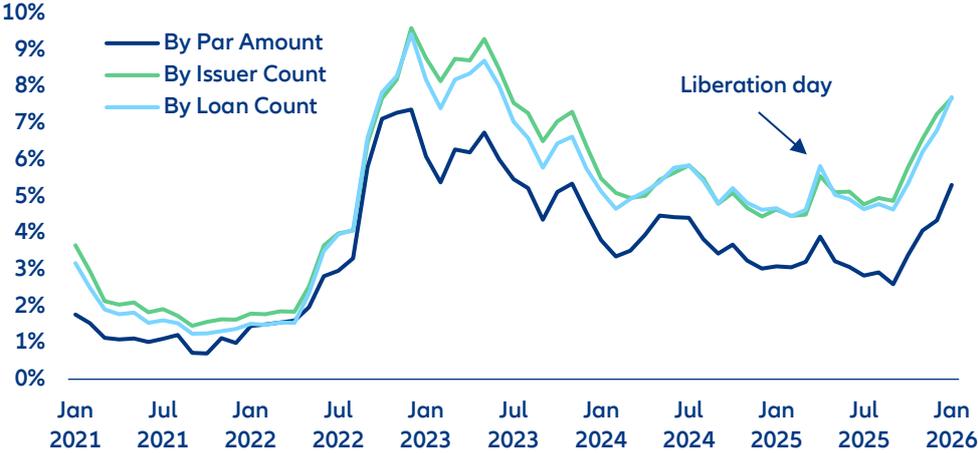
Sources: Pitchbook, LSEG Datastream, Allianz Research

**For private credit, the tariffs review introduces material uncertainty precisely when spreads at 450-550bps may inadequately price emerging risks across portfolio segments.** Tariff implementation would directly pressure margins for companies with significant manufacturing exposure, cross-border supply chains or international-dependent sourcing, affecting substantial portions of private credit portfolios where approximately 40% of borrowers already carry negative free cash flow with limited cushion to absorb additional cost-structure shocks. The compounding concern involves the possibility of fiscal-dominance dynamics that would imply persistent elevated financing costs regardless of near-term policy actions and prevent the refinancing relief that current spread levels appear to assume. This risk is most evident where tariff exposure intersects with business model uncertainty, particularly in software portfolios, which represent the largest sector concentration in BDC holdings at approximately 17%. Companies navigating AI disruption face triple uncertainty around revenue durability, margin sustainability and refinancing conditions. The fragility of current pricing became evident during “Liberation Day” in

<sup>3</sup> See our report [Private equity in transition: from distribution drought to selective recovery](#).

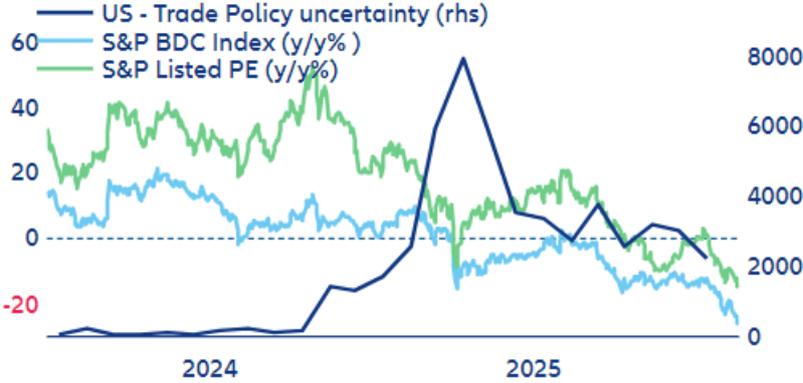
April 2025, when the leveraged loan distressed ratio spiked to 3.90% from 3.51% before moderating through summer, demonstrating how quickly credit stress responds to trade policy volatility. Our baseline scenario continues to anticipate spreads hovering in the 450-550bps range as markets digest moderate tariff implementation and stable credit conditions, but a sustained trade conflict or fiscal dominance shock could push spreads back above 600bps fairly quickly, materially tightening credit availability and creating renewed pressure on covenant compliance and NAV pricing (Figures 4 & 5).

Figure 4: Morningstar LSTA LL Index – distressed ratios



Sources: Pitchbook, Allianz Research

Figure 5: Trade policy uncertainty vs Listed Private Equity and BDCs



Sources: LSEG Datastream, Allianz Research

These assessments are, as always, subject to the disclaimer provided below.

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