Navigating Cross-Border Challenges in a Volatile World: A Strategic Approach

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With deep dedication.
Deutsche Bank

IMPORTANT NOTICE

Executive summary

- The world is changing with sharpening focus on the composition, strength and alignment of different geopolitical blocs. The US and China may be decoupling as economic and security risks are reassessed
- Tariffs continue to drive risk sentiment, with de-escalation (including legality question marks) seeing a reversal of the sharp April sell-off in risk assets, and reduced fears of an imminent economic slowdown
- New downside economic and financial risk drivers have come into focus:
  - US fiscal crisis a new theme amid USD weakness and rising risk/term premia as debt sustainability in focus (new tax bill, Moody's downgrade, uncertainty over tariff revenues)
  - Trade war extends to capital highlighted given legislation that may allow taxation of US investments of foreign countries
  - Ongoing disturbances to rules-based system of governance/liberal order elevate tail risks, with weaponisation of USD swap lines (Fed independence being challenged), and risk of forcibly extending debt maturities of foreign investors
- Existing risk drivers remain with a high probability:
  - Key economic themes are high market volatility, US growth slowdown, higher inflation and fiscal deficits, weakening USD dominance, with rising sovereign term premia increasing downside risks to corporate borrowing costs/default outlook
  - Geopolitical and regulatory themes are dominated by tariffs (plus new risk of a capital tax), sanctions and regulatory divergence, as well as escalating conflicts (Middle East, Russia/Ukraine, India/Pakistan and growing China dominance)
  - Technological themes in focus remain AI and cyber security, and impacts from tariffs (e.g., sourcing of tech services)
- The rise of the Global South as a major economic and demographic force presents new opportunities, accompanied by its increasing influence on geopolitical alignments

The new reality: A world in disarray

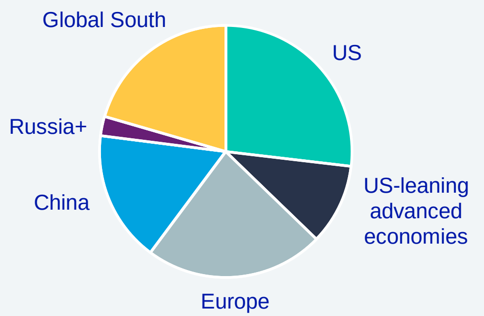
Decline of US hegemony and rise of multipolarity

- US hegemony is eroding – driven both by the growing challenge from China, and by the US' own retreat from its leadership role
- National security concerns and economic dependencies between the world's two largest economies are being reassessed
- The commitment to free and open trade which connected the world is at risk
- Europe is shifting towards greater military autonomy as its long-standing strategic alliance with the US is brought into question
- Dividing the world into four blocs by nominal economic size, we find a roughly even split

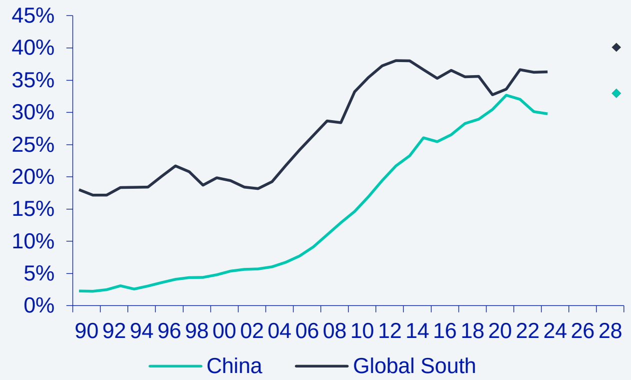
The shifting geopolitical landscape

- For the past few decades, the world has focused on the extraordinary rise of China but unlike China's steady rise over the past four decades, the Global South's economic fortunes have been less consistent
- But as some of the foundational conditions underlying China's one-way rise get challenged, there is likely to be greater focus on alternative global growth engines
- There are already tentative signs of a rotation from China to the Global South
- The Global South is set to become a larger share of the global economy, as China's share stabilizes
- Even as FDI into China has collapsed, investment into the Global South has held up better

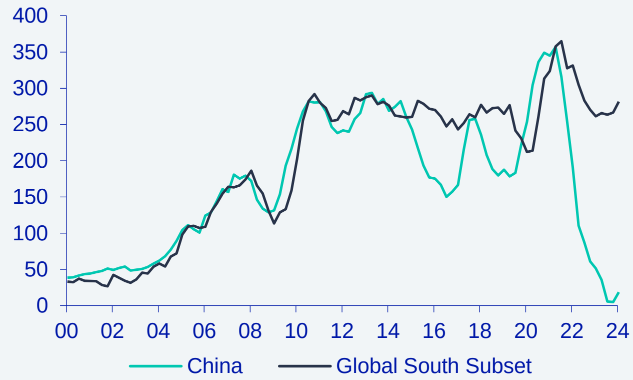
The US-bloc, Europe, the China-Russia bloc, and the Global South (share of nominal GDP, 2024)



Nominal GDP as % advanced economies[(a)]



Inward direct investment (annual, flow, US$bn)[(b)]



Against this backdrop of change, greater attention needs to be paid to the world's fourth and crucial bloc: the Global South

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(a) Note: Dots are IMF forecasts for end-2029; Source: Deutsche Bank, Haver Analytics
(b) Source: Deutsche Bank, Haver Analytics

The World's fourth bloc: Global South

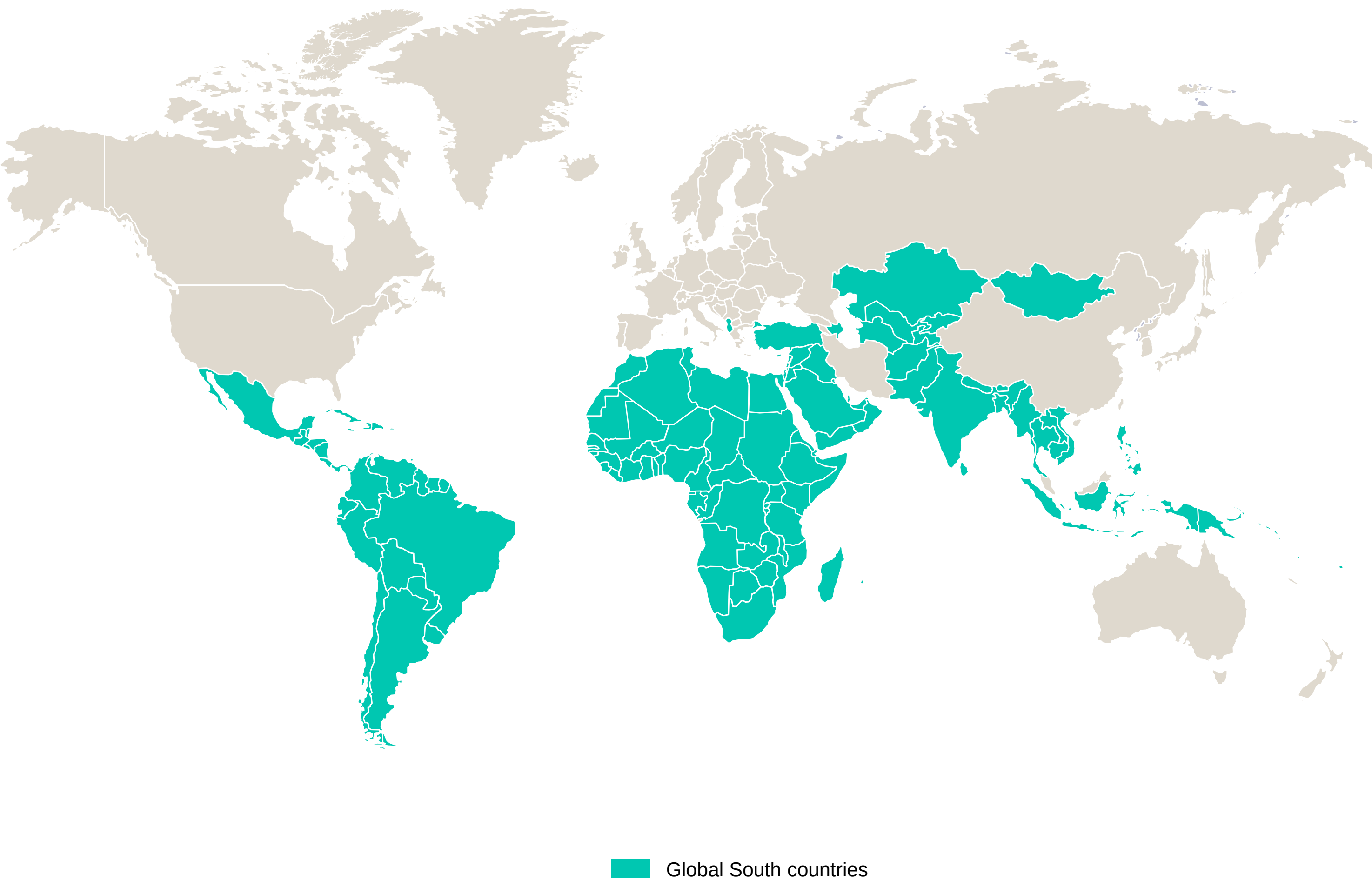
The Global South is a "Rest of the World" measure of 130+ countries, after excluding US, Europe, Other Advanced Economies, and a China-Russia bloc

The scale and significance of the bloc:

1. Almost two-thirds of the world's working age population lives in the Global South
2. Produce more than 40% of the world's energy and key transition metals
3. Makes up around 20% of the world's nominal GDP, but this rises to close to 35% on a PPP-adjusted GDP basis
4. The Global South is very integrated into the global economy across trade and investment flows
5. Makes up 18% of military spending

While manufacturing hubs develop, Global South has a growing middle class consumer market and an important manufacturing sector

Key countries are India, Indonesia, Brazil and Saudi Arabia due to its large size



The Global South presents significant opportunities for growth, offering access to large and growing consumer markets and emerging as new manufacturing hubs. But unlocking this potential requires a nuanced understanding of global dynamics and strategic risk management

Emerging risk themes: Economic and financial

Economic and financial		Actions	Direction
Market volatility/ financial conditions	– Market and financial conditions highly responsive to economic data releases and policy announcements – "Trump trades" have been unwound with US equities selling off sharply in response to elevated uncertainty – High levels of volatility, exacerbated by low liquidity, likely to persist – Appetite for HY / Leveraged assets remains solid, risks to U/W pipeline if financial conditions worsen	– Systemic U/W pipeline risk effectively managed via hedging; risk to effectiveness of hedges if market dislocate – Regular market risk stress testing on multiple scenarios – High volume of margins calls monitored (stress shortfall contained) – Daily monitoring of operations stability in place due to volatility – Increased scrutiny on upcoming pipeline concentrations	↑
Inflation /rates and fiscal deficits	– Upside risk to US inflation/rates from Trump policies – US debt sustainability in focus (policy uncertainty, US bill to extend tax cuts, raise debt ceiling, Moody's rating cut) – USD weaker/LT Treasury yields higher amid rise in risk/term premia – LT Govt debt auctions in focus (lower subscription in eg, US, Japan) – Sovereign spreads in Europe have generally tightened, though increase in European defence spending will pressure deficits	– Market risk stress tests run around Japan auctions – Positive ytd total return in SLR; HTC bond investment strategy to provide stable carry income without exposure to MtM volatility – Review vulnerable credit portfolios if US and European inflation and / or rate expectations materially increase – Mature Rep Risk framework around defence transactions	↑
Sector specific risks	– CRE: Market indicators stabilizing, though risk of elevated CLPs on valuation/appraisal updates; higher LT rates a concern as increases cap rates, debt service costs, and impacts property values – Autos: Earnings outlook subdued, European incumbents facing high competition from China, EV roll out is challenging – Private credit: High rates pressuring private credit borrowers, risk mitigants yet to be tested in a severe downturn	– CRE: Focus on mgmt of upcoming maturities/refi risk, selective new origination at low LTV; stress tests performed on portfolio – Auto: High quality portfolio, deep dive reviews to identify higher vulnerability clients with proactive additions to Watchlist – Private credit: Conservatively structured portfolio to well rated obligors.	↔
Germany/ US growth	– Fears of imminent global downturn subsided – 2025 German economic outlook weak but impact of fiscal expansion expected to provide significant boost from 2026 – US growth forecasts revised lower, albeit data in Apr/May have been broadly resilient – Rising sovereign term premia increase downside risks to corporate funding costs/default outlook in US	– German portfolio under enhanced monitoring; credit quality stable – Focus on Midcaps, with increase in WL/WRM (sub-sector thresholds established for higher risk sectors) – Industry limits to support expansion in A&D (Defence & infrastructure) – Higher macro sensitivity US portfolios (CRE, LDCM) tightly managed (no material deterioration observed from tariffs)	↔

↑ Increased probability/severity of risk in next 24 months vs previous emerging risk assessment

↔ Probability/severity of risk unchanged

↓ Probability/severity of risk reduced; opportunity increasing

Emerging risk themes: Economic and financial (cont)/Geopolitical and regulatory (1)

Economic and financial(cont)		Actions	Direction
Weakening USD dominance/ US fiscal crisis	– De-dollarisation theme has emerged, with USD weakening and Treasuries selling off/curve steepening amid rise in term premia – US debt sustainability in focus (US tax bill to extend tax cuts, raise debt ceiling, Moody's rating cut), volatility around UST auctions – Fiscal concerns not new, but compounded amid exceptional policy uncertainty, and indications of reducing demand to hold US assets	– Implicitly managed through country risk appetite, ratings – Colleterial tightly managed in event of debt ceiling concerns to mitigate risk – Extensive monitoring of events – New market risk scenarios being developed around de-dollarisation and market dislocation	NEW

Geopolitical and regulatory		Actions	Direction
Tariffs	– Massive risk-off period following 'Liberation day' announcement, followed by rapid recovery on 90-day suspension/de-escalation – Uncertainty very high (US court blocked, then temporary reprieve) – Risk of proposed tariffs on EU exports leading to deterioration in credit portfolio quality – 2nd order impacts on growth, inflation and rates are likely (growth forecasts revised lower globally); Business confidence shaken	– Deep dive reviews showed contained high/elevated risk exposure; tariff CLP overlay, vulnerable clients added WL/ downgraded – Industry appetite levels recalibrated; new amber levels – Assess potential supply chain risks (based on geographical sources) – Elevated uncertainty in operations (refer p.9)	↑
Regulatory divergence/ Reg risk	– US/UK governments committed to easing regulatory burdens, incl for banks; EU taking a more conservative approach (eg, ESG) – US Treasury recommends international standards only be adopted if in nation's best interest – Increase in info requests impacts day-to-day risk management	– Continued advocation for regulatory alignment and easing of EU-specific burdens – Maintain strong support for capital markets union in EU with substantial benefits – Continued close engagement with regulatory authorities – Ad-hoc adjustment to capital risk appetite	↔
Sanctions	– Potential sanctions and retaliatory sanctions related to US Foreign Policy and China is a key emerging risk – Russia sanctions circumvention risks in focus where entities conducting such activity may also be banked by correspondent banking clients – Iran sanctions circumvention risks through correspondent banking – Risk of diverging sanction regimes, complicating compliance	– Establish EU/US-China Oversight Group – Multiple Financial Crime Intelligence Unit (FCIU) projects to identify transactional exposure linked with sanctions circumvention re Russia/Iran – Risk related to guarantees in higher risk industries under review – Active monitoring given heightened scrutiny around country-of- origin rules and possible attempts to bypass trade restrictions	↔

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Emerging risk themes: Geopolitical/Regulatory (continued)

Geopolitical and regulatory		Actions	Direction
Russia hybrid warfare	– Significantly increased adaptability and strength of (dis)information campaigns weaken Western governance/ create pretext for conflict – Utilization of flexible, supposedly deniable proxy forces – Cyber attacks increase in frequency and sophistication – Clandestine measures (eg targeting undersea cables and other critical infrastructure) cause disruption for affected economies – Prospects of peace in the near term increasingly unlikely	– Tight restrictions and controls must be maintained once Ukraine conflict ends – Cyber focused operational resilience scenario performed alongside increased security monitoring and vulnerability remediation – Lack of predictability on clandestine/proxy measures; Risk management will likely be reactive in these instances, active concentration risk management is key	⟷
ESG stop	– Positive short-term implications for high carbon intensity sectors but medium-to-long term transition risks will increase – Renewables and other low carbon sectors and technologies likely to see reduced investment – Physical climate risks increase in frequency & intensity in the l/t – Growing risk of a highly disruptive 'disorderly transition' – Increased oil supply may drive prices lower	– Comprehensive climate materiality assessment concludes that risks are contained in the short-to-medium term – Critical to maintain decarbonization framework to position for inevitable ramp up of global transition efforts, significant opportunities from transition financing – Ongoing review of physical risk concentrations and insurance – Exposure to oil producing countries concentrated on top rated Saudi, UAE. Oil and Gas portfolio high quality	⟷
Trump administration targets key client	– Risk of idiosyncratic defaults if the US administration decides to target specific clients for sanctions, export controls, other measures – Second order impacts on supply chains possible if impacted clients play a significant role	– Impossible to accurately predict which clients may be affected – Maintenance of disciplined counterparty concentration risk framework (guidance appetite grid, hedge requirements) is key to manage idiosyncratic risks – Developed framework to identify higher risk clients	⟷
Trump administration targets non-US companies	– Trump administration may increase enforcement actions against non-US companies perceived to act contrary to its priorities – Where public enforcement cases gain momentum this could encourage private plaintiffs to allege damages – In current focus is ESG and perceived antitrust violations stemming from climate initiatives such as net zero	– Develop framework to identify potential targets for US actions (eg, well developed ESG/DEI agenda); continuous monitoring of US administration priorities and policies	⟷

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Emerging risk themes: Geopolitical/Regulatory (continued)

Geopolitical and regulatory		Actions	Direction
Trade war extends to capital	– Section 899 of the tax bill that passed the House aims to deter 'unfair foreign taxes' – Proposal may allow taxation of US investments of foreign countries of up to 20%, providing a new means of leverage ('capital war') – Fixed income investments unlikely to be affected, though the legislation could impact foreign direct investment	– Plays into broader unpredictable US policy and de-dollarisation theme – Deep dive review of implication of Section 899 underway	NEW
USD Swap lines/debt maturities extended	– Traditional rules-based system of governance and liberal order continually challenges under Trump administration – Tail risks of direct intervention, including (i) appointing a new Fed governing board and weaponisation of Fed swap lines, and (ii) forcibly extending debt maturities for foreign investors – Risk to global systemic stability (ability to access US currency in stress) and could raise cost of USD funding	– Reduce USD funding imbalance (lower cross currency funding swap needs) – Extend the term profile of USD swaps (reducing ST roll-over risk) – Deep dive review of implications of a range of scenarios underway	NEW
Critical minerals	– Risk of China export ban on rare earth materials – High dependency on China could lead to possible supply chain disruptions, including across auto and defence – Nexus with other risks, including tariffs (eg, as a retaliatory measure) and US aggression in Greenland	– Industry appetite levels recalibrated: limited capacity for Autos, Retail, M&M, Chemical; new amber levels for high-risk sub sectors	NEW
Middle East India/ Pakistan	– Israel has targeted Iran's nuclear sites and military commanders in a major attack, as well as strikes and ground operations in Gaza, increasing the risks of regional escalation – India/Pakistan tensions: US-brokered ceasefire over Kashmir has temporarily halted hostilities, but unresolved tensions remain	– Extensive reviews of regional exposures conducted since the conflict started; de minimis credit exposure to weaker surrounding countries (Lebanon, Iran, Syria)	↑

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Emerging risk themes: Technological

Technological		Actions	Direction
AI and cyber security threats	– Cyberattacks and Deepfake Theft incidences/impacts continue – Rapid breakthroughs in AI continue to lower the entry barriers for malicious elements to attack through sophisticated technologies – Reduced US administration support towards cybersecurity (eg, federal employee headcount reduction) – Challenges attracting tech talent to finance industry	– Cyber operational resilience scenarios, increased monitoring and remediation (diversifying methods for detecting vulnerabilities) – Technology and cyber defence out of tolerance/under remediation – Tariffs could impact sourcing of tech services (see below) – 2025+ roadmap for Digital Operational Resilience Act (DORA)	
AI regulation outpaced / war of technology	– Governance around AI will likely not keep pace with ongoing advancements (US expected to take a free-market approach) – EU AI act sets benchmark for European firms – Disruptive potential (as well as opportunity) is increasing, with loss of competitiveness a key risk – Secondary impacts on power, water and land resources; energy availability may be a constraint in the near-term	– Target state requires strengthened framework and policy, moving beyond current use-cases approach – Develop operational resilience capabilities – Managed roll-out of internal AI-driven capabilities to improve efficiency and decision making	
Digital asset growth	– Trump administration is keen to position digital assets as a strategic reserve asset; regulatory framework still developing – Two government held crypto funds are established, a strategic Bitcoin reserve and a US digital asset stockpile – Reports major US banks plan to issue joint stablecoins – Concerns around valuations, volatility, transparency, and environmental impacts; LT risks of disintermediation	– Expect more business opportunities as digital assets become mainstream; risk to build market share as currently lags peers	
Continuation of tariff risk from page 6			
Tariff risk to tech and cyber	– Tariffs may impact sourcing of tech goods and services (particularly US vendors), albeit not observed to date – Potential risks include hardware supply chain disruption, sharp increase in vendor operating costs, or in a tail risk, US government restricting export of technology	– Assessing potential actions, including acceleration of '25&26 procurement, and acceleration of cyber risk projects, with risks to be closely monitored	

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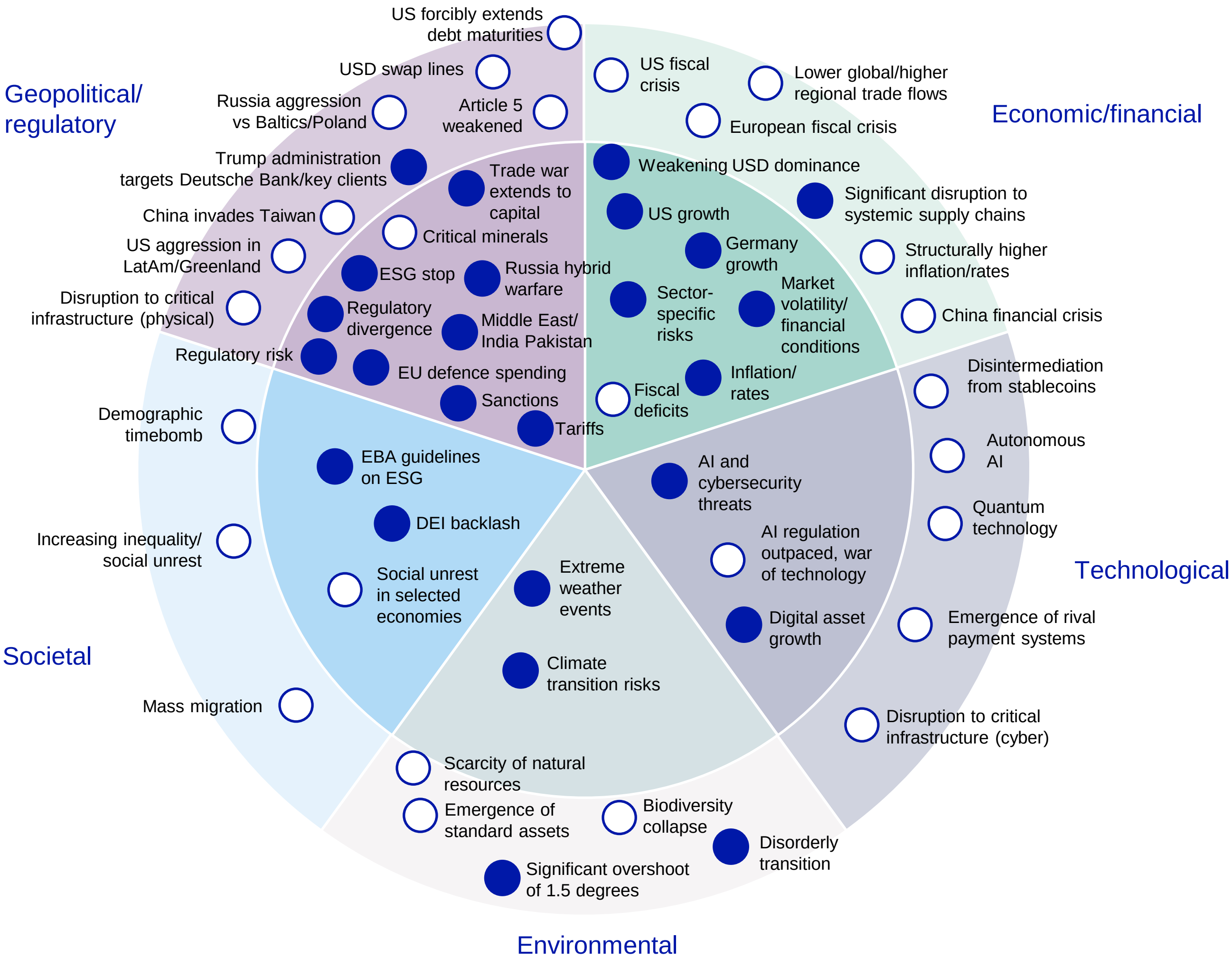
Emerging risk themes



Short-to-Medium term trends

Items on long-term radar

● Risk under review/managed under specific framework

○ Emerging trend not under regular review or managed under specific framework

Higher probability themes

- Economic/financial
  US growth slowdown, market volatility/gapping events, fiscal deficits, inflation, weakening USD dominance
- Geopolitical/Regulatory
  Unpredictable US policy (overarching theme), Tariffs, Sanctions, Regulatory divergence, Middle East/India Pakistan
- Societal
  DEI backlash, EBA guidelines on ESG
- Technological
  AI and cyber security threats, AI regulation outpaced – war of technology

Risk reducing themes/opportunities

- Economic/financial
  Germany growth outlook
- Geopolitical/Regulatory
  ESG stop, EU defence spending
- Environmental
  Climate transition risks
- Technological
  Digital asset growth

New themes

- Geopolitical/Regulatory: Trump targets key clients, trade war extends to capital, Critical minerals
- New LT risks: USD swap lines, US fiscal crisis, US forcibly extends debt maturities, Disintermediation from stablecoins