April 15, 2025

Kroll Cost of Capital Inputs Updated to Reflect Heightened Uncertainty in Global Economy

Executive Summary

Kroll regularly reviews fluctuations in global economic and financial market conditions that may warrant changes to our equity risk premium (ERP) and accompanying risk-free rate recommendations. The risk-free rate and ERP are key inputs used to calculate the cost of equity capital in the context of the Capital Asset Pricing Model (CAPM) and other models used to develop discount rates. We also update country risk data on a quarterly basis for 175+ countries using various models.

Based on recent economic indicators and financial market conditions, **the Kroll Recommended U.S. ERP is increased from 5.0% to 5.5%** when developing USD-denominated discount rates as of April 15, 2025, and thereafter, until further guidance is issued. This is matched with the higher of a U.S. normalized risk-free rate of 3.5% or the spot 20-year U.S. Treasury yield as of the valuation date.

The Kroll Recommended Eurozone ERP is being reaffirmed in the range of 5.5% to 6.0% when developing EUR-denominated discount rates as of April 15, 2025, and thereafter, until further guidance is issued. However, we now believe that an ERP towards the ***higher*** **end of the range (i.e., closer to a 6.0% ERP)** is likely more appropriate. This is matched with the higher of a German normalized risk-free rate of 2.5% or the spot 15-year German government bond yield as of the valuation date.

Incremental country risk adjustments for other Eurozone countries with a sovereign debt rating below AAA may be appropriate. Please note that this information does not supersede Germany's IDW (Institut der Wirtschaftsprüfer) guidance for projects that will be reviewed by German auditors or regulators.

We will continue to monitor economic and geopolitical events that may change our guidance in the coming months. We may also issue in the future a more detailed report on the rationale for the change in ERP recommendations.

Background

Recently, uncertainty has risen materially for the global economy, which is leading economists and market participants to rethink their expectations for the remainder of 2025. There are three major sources of downside risks and uncertainty that support our decision to increase our ERP recommendations as of April 15, 2025.

First, and foremost, the uncertainty in the current international trade environment, and further escalation in trade conflicts, are likely to continue disrupting the global economy and global financial markets in 2025. On April 2, 2025 the U.S. Administration announced plans to impose a baseline 10% tariff on imports from most countries, and tariffs far in excess of 10% for countries with which the U.S. has a goods trade deficit. This comes at the heels of other previously announced or imposed tariffs that were already in effect (e.g., steel and aluminum, automobiles and auto parts, etc.). One week later (April 9th), the U.S. Administration instituted a 90-day "pause" on excess reciprocal tariffs, while still leaving in place the 10% baseline tariffs for most countries, except for China, which saw tariffs raised to 125%. Notably, this tariff was later raised to 145%, with China retaliating with a 125% tariff on certain U.S. goods. For perspective, China is the third largest supplier of goods to the U.S., after Mexico and Canada, but the largest U.S. trade deficit (in goods) is with China.[1]

Almost daily, there are announcements of possible new tariffs or exceptions followed by a reprieve or delay in effective dates for some of them. The uncertainty created by the scope, magnitude, and timing of these tariffs, along with the possible ensuing retaliation by U.S. trading partners may disrupt global trade and potentially lead to higher inflation and/or an economic slowdown in the U.S. and other countries. Businesses are starting to delay M&A and capital expenditure/expansion plans, as they wait for the tariff situation to become less ambiguous. Consumer confidence has dropped significantly in light of these developments. A scenario of stagflation or even recession has been resurrected by several economists for the U.S. economy. Real growth forecasts for other countries and regions are also being downgraded.

Financial markets in the U.S. and elsewhere are already reeling from this uncertainty, creating significant volatility for bonds and equities. Even if the U.S. Administration is successful in negotiating new trade agreements with the rest of the world, we believe that supply chain disruptions, manufacturing relocations, and other business decisions (e.g., potential price increases) in response to the new tariff environment will lead to heightened equity risk for some time.

Second, there is heightened uncertainty about budget policies, potential tax cuts, increased government spending and a related rise in budget deficits, not just in the U.S. but elsewhere (e.g., Germany), which could place upward pressure on long-term interest rates and disrupt global financial markets. The U.S. dollar is still the world's reserve currency, but the current trade uncertainty is challenging the U.S. dollar status and leading to greater volatility in exchange rates and long-term interest rates.

[1] Based on 2024 full year data. See "U.S. International Trade in Goods and Services" releases by the U.S. Census Bureau and the U.S. Bureau of Economic Analysis. At the time of writing, the latest report was released on April 3, 2025 and can be found here (see Part C): https://www.bea.gov/sites/default/files/2025-04/trad0225.pdf.

The negative impact on markets from higher long-term interest rates could be mitigated if real growth accelerates materially due to the additional fiscal spending measures.

Finally, there are other global geopolitical events warranting close watch including, but not limited to, a reignition of the ongoing conflicts in the Middle East, an unsatisfactory resolution of the Russia-Ukraine war, and a potential withdrawal of the U.S. from NATO.

The combination of these risks is already causing significant upheaval in global financial markets, with heightened volatility likely to persist in the coming months.

Volatility of Current Spot Yields on Government Bonds

As investors attempt to predict the pace and magnitude of future rate cuts by major central banks, we continue to observe high levels of volatility in the spot yields of government bonds of major economies. The uncertainty created by policies from the new U.S. administration could add further volatility to bond markets in 2025. Long-term bonds yields may continue to fluctuate considerably in the near- to medium-term before stabilizing. During these periods, valuation professionals may need to consider using a moving average of spot yields to mitigate the impact of this volatility on their valuation analyses (e.g., weekly or monthly averages).

We will continue to closely monitor the situation and publish new guidance when appropriate. Please contact our support team with any questions: costofcapital.support@kroll.com.

Kroll Cost of Capital Inputs

Data as of April 15, 2025

	U.S. (in USD)	Eurozone ** (in EUR)	U.K. †† (in GBP)	Canada †† (in CAD)	Australia †† (in AUD)
Normalized Risk-Free Rate	Higher of 3.5% or Spot*	Higher of 2.5% or Spot†	Higher of 4.0% or Spot‡	Higher of 3.5% or Spot§	Higher of 3.5% or Spot#
Kroll Recommended Equity Risk Premium	5.5% *	5.5% to 6.0%†	n/a	n/a	n/a

* We recommend using the spot 20-year U.S. Treasury yield as the proxy for the risk-free rate, if the prevailing yield as of the valuation date is higher than our U.S. normalized risk-free rate of 3.5%. This guidance is effective when developing USD-denominated discount rates as of June 16, 2022, and thereafter. Based on current economic indicators and financial market conditions, the Kroll Recommended U.S. ERP is 5.5% when developing USD-denominated discount rates as of April 15, 2025, and thereafter.

† We recommend using the spot 15-year German government bond yield as the proxy for the risk-free rate, if the prevailing yield as of the valuation date is higher than our German normalized risk-free rate of 2.5%. This guidance is effective when developing EUR-denominated discount rates as of March 31, 2024, and thereafter. Based on current economic and financial market conditions, the Kroll Recommended Eurozone ERP remains in the range of 5.5% to 6.0%, and we believe that an ERP towards the higher end of the range (i.e., closer to 6.0%) is likely more appropriate when developing EUR-denominated discount rates as of April 15, 2025, and thereafter.

‡ We recommend using the spot 20-year U.K. Gilt yield as the proxy for the risk-free rate, if the prevailing yield as of the valuation date is higher than our U.K. normalized risk-free rate of 4.0%. This guidance is effective when developing GBP-denominated discount rates as of October 18, 2022, and thereafter.

§ We recommend using the spot Government of Canada Benchmark Long-Term Bond yield as the proxy for the risk-free rate, if the prevailing yield as of the valuation date is higher than our Canada normalized risk-free rate of 3.5%. This guidance is effective when developing CAD-denominated discount rates as of October 18, 2022, and thereafter.

We recommend using the spot 10-year Australia Commonwealth Government bond yield as the proxy for the risk-free rate, if the prevailing yield as of the valuation date is higher than our Australia normalized risk-free rate of 3.5%. This guidance is effective when developing AUD-denominated discount rates as of October 31, 2022, and thereafter.

** German normalized risk-free rate and Eurozone equity risk premium (ERP) for use in EUR-denominated discount rates from a German investor perspective. Additional country risk adjustments may be warranted when estimating discount rates for other countries in the Eurozone.

†† Although currently we do not have an official Kroll Recommended ERP for the U.K., Canada and Australia, historical and other forward-looking ERP information for these countries is available in the International Cost of Capital Inputs dataset within the Cost of Capital Navigator.