2020-21: DEFENDING GROWTH AT ALL COSTS

Economic, Capital Markets and Industry Research

Global Economic Outlook

as of January 2020

EULER HERMES

Allianz

LESSONS LEARNED FROM 2019

1. **US-China rivalry escalated at a rapid pace**
   The US average import tariff increased from 3.5% in 2018 to close to 8% in 2019. **Lessons learned**: a continuation of very high uncertainty, at least until the 2020 election. While tariffs shaved -0.2pp off global GDP growth, we estimate the annual cost of uncertainty at -0.3pp of global GDP growth. China has prioritized economic transformation over stabilization, with measured stimulus. **Lessons learned**: The global economy will have to rely less on Chinese policy action to support growth.

2. **Environmental focused regulations had global repercussions**
   The regulatory shock in the automotive sector has almost pushed Germany into recession and had global repercussions. Major climate events (fires in the US, Brazil and Australia) occur at more frequent pace. Concomitantly, the new European Commission announced a Green Deal that will include a Just Transition Mechanism worth EUR100bn. **Lessons learned:** The implementation of new green and ESG policies has started to bite companies, with further adjustments to be seen and new initiatives to support energy transition.

3. **(Geo)political and social risk has soared**
   Increasing inequality over the past decade and high fiscal pressures on households have resulted in outbreaks of social crisis in several countries. Unexpected protests escalated across regions, such as Hong Kong, several countries in Latam (Chile, Colombia), and France. Geopolitical tensions also prevailed in the Middle East, particularly between Saudi Arabia and Iran. **Lessons learned:** A more reactive and redistributive fiscal policy is to be expected to respond to growing social tension. The pace of structural reforms will slow down amid growing reform fatigue.

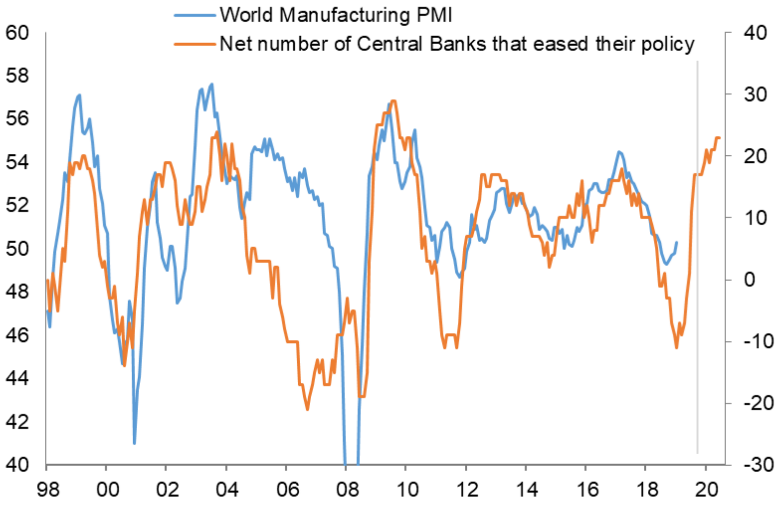
4. **Monetary policy has come to the rescue and helped avoid a broad-based recession**
   Monetary policy's reaction to the external shock was swift and sizeable in 2019. The number of central banks initiating a monetary policy easing has reached a record high since 2009. Both the Fed and the ECB did not hesitate to increase the use of unconventional monetary policy tools to inject liquidity while cutting interest rates further. **Lessons learned**: The protracted usage of unconventional monetary policy tools has pushed interest rates into negative territory. Efficiency is put to the test.

KEY TICKET ITEMS FOR 2020

1. **Global economic growth** to remain muted in 2021-21 after bottoming out at the turn of 2019
2. **US-China trade tensions** should not escalate, nor de-escalate much further in 2020
3. **The US** to further explore higher public and corporate debt when face with electoral uncertainty
4. **The global economy cannot rely on a new Chinese bazooka** stimulus
5. **Eurozone growth below potential** at +1.0% and +1.3% in 2020-21 respectively
6. **Monetary policy is the safety net** for growth and markets. Mind negative spillovers
7. **Persistently high social discontent** will call for fiscal policies to become more redistributive
8. **Domestic sectors** will continue to outperform
9. **(Unusually) low volatility** and correlation between asset classes for longer
10. **A -4% depreciation of the Dollar** depreciation is expected to support Emerging Markets assets

BUSINESS CONFIDENCE IS IMPROVING FROM LOW LEVELS THANKS TO MONETARY EASING

World Manufacturing PMI vs net number of Central Banks cutting rates, 10-month lag

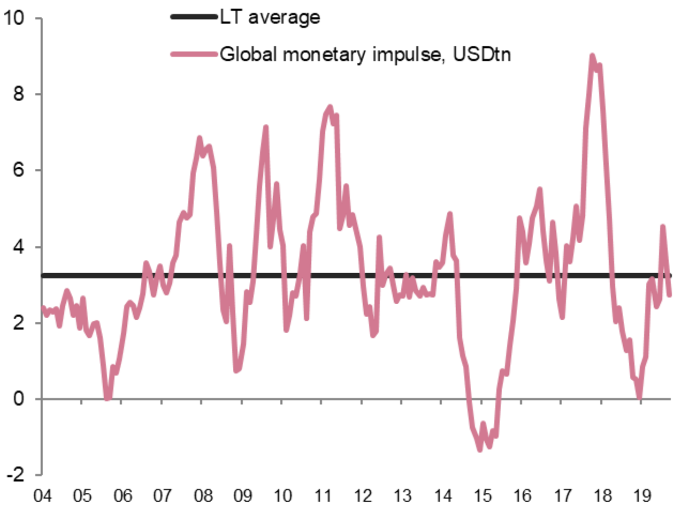


Sources: Markit, Bloomberg, Euler Hermes, Allianz Research

The cycle of monetary policy easing continued in Q4 2019 which should boost activity in H1 2020. We expect one rate cut in March 2020 in the US and one by the ECB in April.

Global M2

(incl. Eurozone, China, United States, Japan, South Korea, Australia)

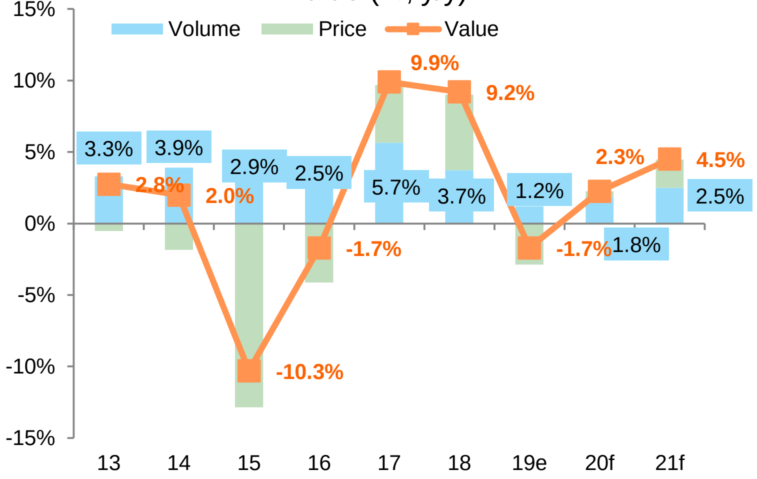


Sources: Bloomberg, Euler Hermes, Allianz Research

Global monetary impulse rebounded above LT average in October 2019, but more needs to be done to boost growth above its current levels.

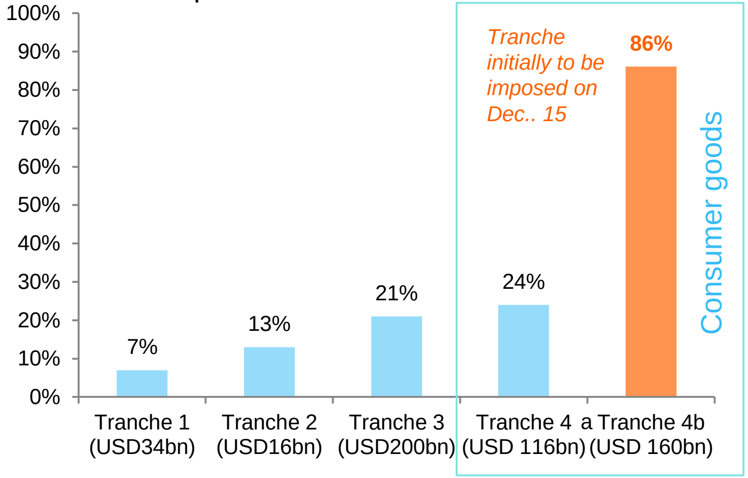
GLOBAL TRADE: DON'T SELL THE BEAR'S SKIN BEFORE KILLING IT

World trade in goods and services, growth in volume and value (%, y/y)



Sources: IHS, Euler Hermes, Allianz Research

Share of Total U.S. imports coming from China, comparison between tariff tranches



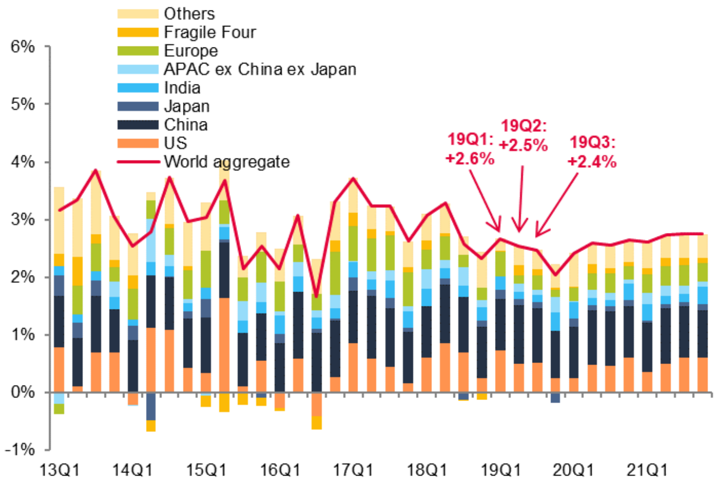
Sources: Bloomberg, Euler Hermes, Allianz Research

Trade growth could bottom out but not significantly accelerate in 2020 (+1.8%), in 2021 higher demand should lift trade (+2.5%) amid a lasting trade feud but no significant U.S.-China escalation.

U.S.-China mini-deal not a game changer, only superficial. But tariff escalation unlikely: (i) 86% of goods in tranche 4b come from China (i.e. no substitution possible); (ii) consumer goods would see biggest increases in tariff coverage; (iii) 2020 US election

GLOBAL GROWTH RECOVERING BUT CAPPED BY UNCERTAINTY

World GDP, quarterly growth, y/y



Sources: National sources, Euler Hermes, Allianz Research

The trough in global growth is expected in Q4 2019 due to the US, China and Japan, followed by moderate growth in the absence of a fiscal and monetary bazooka

World GDP, annual growth

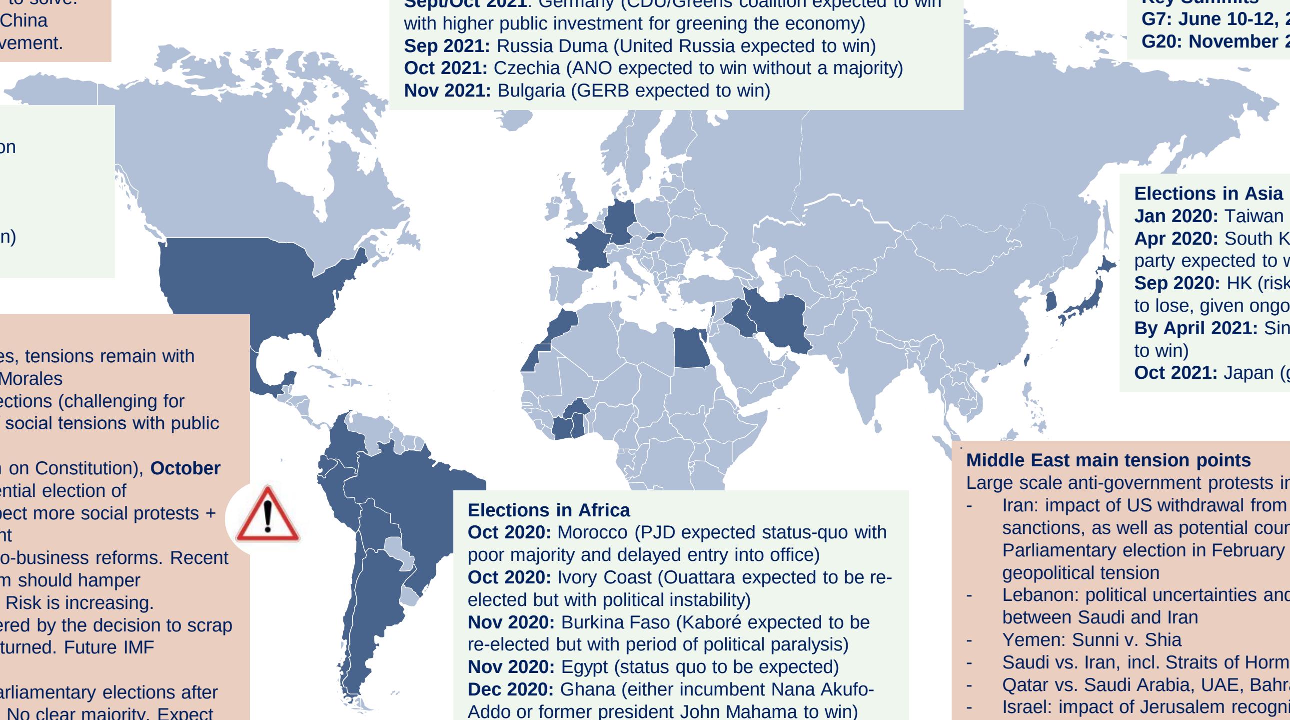
	2016	2017	2018	2019	2020	2021
World GDP growth	**2.7**	**3.3**	**3.1**	**2.5**	**2.4**	**2.8**
United States	1.6	2.4	2.9	2.3	1.6	2.0
Latin America	**-1.1**	**1.0**	**1.0**	**0.0**	**1.1**	**2.0**
Brazil	-3.3	1.3	1.3	1.1	2.0	2.5
United Kingdom	1.9	1.8	1.4	1.2	1.0	1.6
Eurozone members	**1.7**	**2.7**	**1.9**	**1.2**	**1.0**	**1.3**
Germany	2.1	2.8	1.5	0.6	0.6	1.1
France	1.0	2.4	1.7	1.2	1.2	1.4
Italy	1.4	1.8	0.7	0.1	0.4	0.8
Spain	3.0	2.9	2.4	2.0	1.6	1.4
Russia	0.3	1.6	2.3	1.1	1.3	1.5
Turkey	3.2	7.5	2.8	0.1	2.3	3.5
Asia	**5.0**	**5.3**	**4.9**	**4.4**	**4.4**	**4.6**
China	6.7	6.9	6.6	6.2	5.9	5.8
Japan	0.6	1.9	0.8	0.8	0.9	1.6
India	8.1	7.1	6.8	5.2	6.0	6.2
Middle East	**4.9**	**1.2**	**1.1**	**0.5**	**2.1**	**3.1**
Saudi Arabia	1.7	-0.7	2.4	0.4	1.2	2.0
Africa	**1.2**	**3.2**	**2.7**	**1.9**	**1.8**	**2.7**
South Africa	0.6	1.4	0.8	0.3	0.0	0.7

** Weights in global GDP at market price, 2019*
NB: The revisions refer to the changes in our forecasts since the last quarter
Fiscal year for India

Sources: National sources, Euler Hermes, Allianz Research

Global GDP growth should go back to 2016 levels in 2021 supported by very accommodative monetary policies and higher fiscal support, notably from China and the US

GLOBAL POLITICAL LANDSCAPE



Trade tensions China/US
Trade feud: Phase 1-deal not a game changer, phase 2 issues much harder to solve. No significant U.S.-China escalation or improvement.

November 03, 2020
US presidential election
Predicted outcome:
55% Democrats win
45% Republicans win
(Trump re-election)

Latin America unrests
- **Bolivia:** high risk for companies, tensions remain with clashes between pro and anti Morales
- **Brazil: October 2020** local elections (challenging for Bolsonaro's new party), risk of social tensions with public sector reform
- **Chile: April 2020** (referendum on Constitution), **October 2020** (local elections and potential election of constitutional convention). Expect more social protests + uncertain business environment
- **Colombia:** protests against pro-business reforms. Recent constitutional blow to tax reform should hamper confidence and delay reforms. Risk is increasing.
- **Ecuador:** mass protests triggered by the decision to scrap fuel subsidies, which was overturned. Future IMF disbursements at risk
- **Peru (January 2020):** early parliamentary elections after President dissolved Congress. No clear majority. Expect delay in reforms + policy instability

Elections in Europe
Feb 2020: Slovakia (Smer-SD expected to win), Italian regional election in Emilia Romagna and Calabria
Dec 2020: Romania (Liberals expected to win)
Sept/Oct 2021: Germany (CDU/Greens coalition expected to win with higher public investment for greening the economy)
Sep 2021: Russia Duma (United Russia expected to win)
Oct 2021: Czechia (ANO expected to win without a majority)
Nov 2021: Bulgaria (GERB expected to win)

Key Summits
G7: June 10-12, 2020
G20: November 21-22, 2020

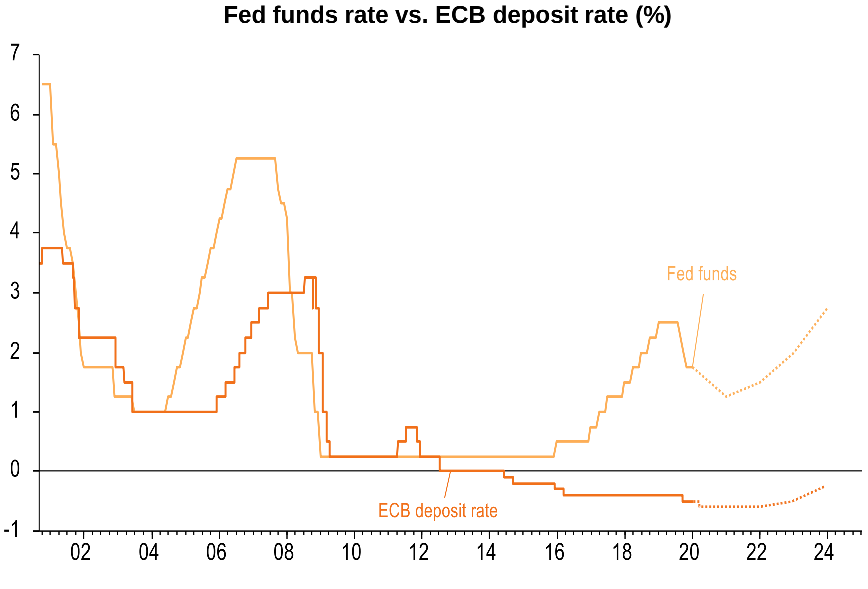
Elections in Asia
Jan 2020: Taiwan (Tsai expected to be re-elected)
Apr 2020: South Korea (governing Democratic party expected to win)
Sep 2020: HK (risk for governing pro-Beijing parties to lose, given ongoing pro-democracy protests)
By April 2021: Singapore (governing PAP expected to win)
Oct 2021: Japan (governing LDP expected to win)

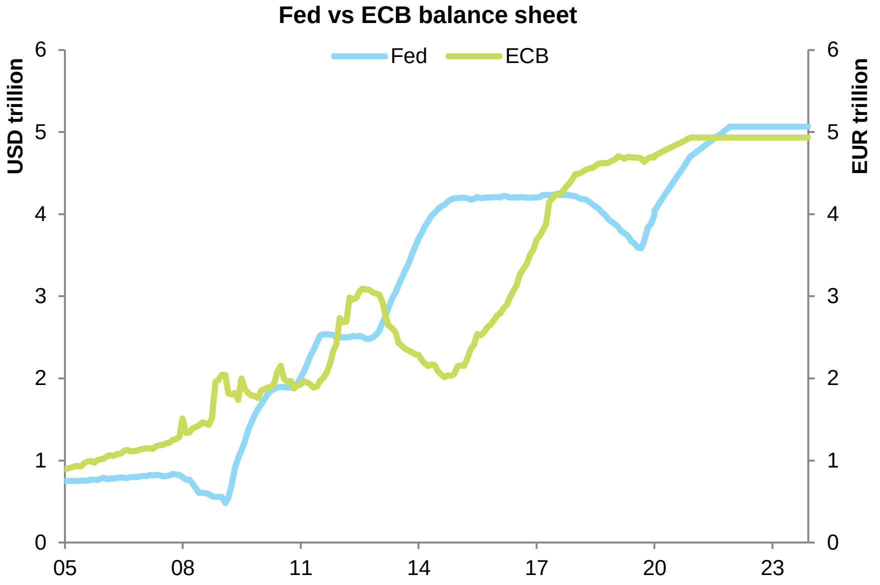
Elections in Africa
Oct 2020: Morocco (PJD expected status-quo with poor majority and delayed entry into office)
Oct 2020: Ivory Coast (Ouattara expected to be re-elected but with political instability)
Nov 2020: Burkina Faso (Kaboré expected to be re-elected but with period of political paralysis)
Nov 2020: Egypt (status quo to be expected)
Dec 2020: Ghana (either incumbent Nana Akufo-Addo or former president John Mahama to win)

Middle East main tension points
Large scale anti-government protests in **Lebanon**, **Iraq** and **Iran**
- Iran: impact of US withdrawal from JCPOA and new US sanctions, as well as potential counter measures. Parliamentary election in February as a potential source of geopolitical tension
- Lebanon: political uncertainties and potential new proxy war between Saudi and Iran
- Yemen: Sunni v. Shia
- Saudi vs. Iran, incl. Straits of Hormuz, revisited
- Qatar vs. Saudi Arabia, UAE, Bahrain, Egypt (blockade)
- Israel: impact of Jerusalem recognition by the US
- Turkey: US sanctions

Source: Euler Hermes, Allianz Research

MONETARY POLICY WILL REMAIN THE SAFETY NET FOR GROWTH AND MARKETS





Sources: IHS, Allianz Research

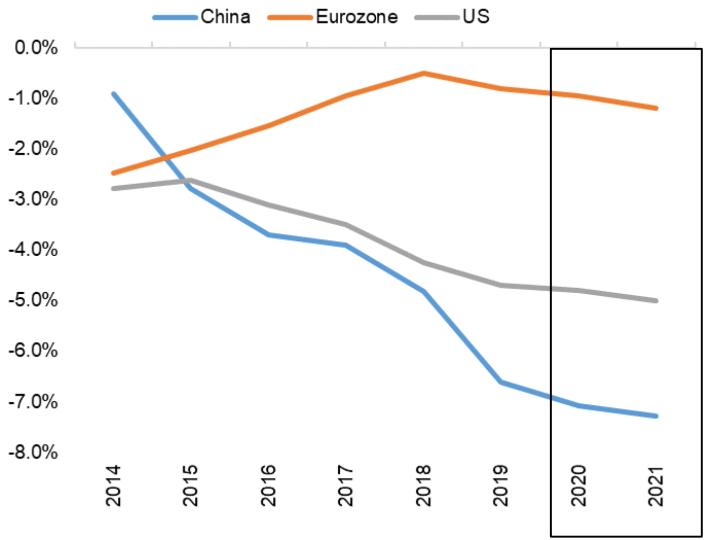
LIMITED UPSIDE POTENTIAL FROM FISCAL POLICY

Taxes – companies vs households (OECD average)

Sources: OECD, Euler Hermes, Allianz Research

There is a higher potential to support households (and consumption) given the trends in corporate vs personal income taxes since the last crisis and rise in social tensions

Fiscal balance, % of GDP

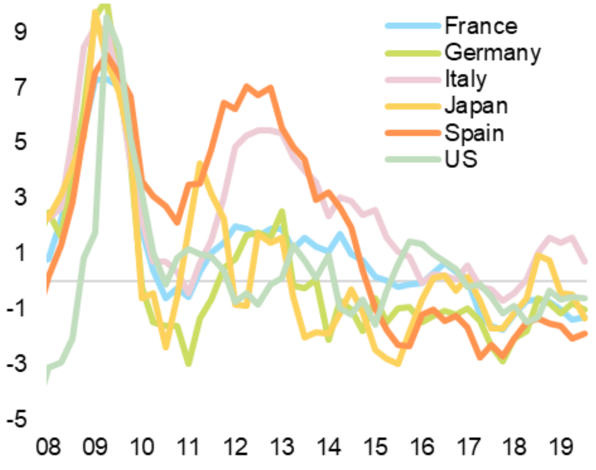


Sources: National sources, Euler Hermes, Allianz Research

Most fiscal stimulus will come under the form of higher social and infrastructure spending. Europe announced EUR100bn allocated for the Green Deal (0.8% of GDP). The fiscal impulse will be more positive in 2021 as the US will spend more and China will maintain its efforts of stabilization.

WHAT DOES IT MEAN FOR COMPANIES? MORE LEVERAGE, WEAKER PROFITABILITY

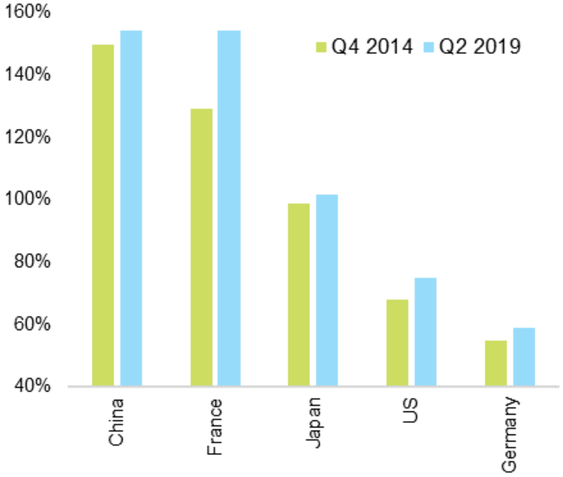
Bank interest rates – growth differential, %



Sources: Euler Hermes, Allianz Research

In the short-term, the fall in interest rate growth differential has opened the door for more sustainable debt financing…

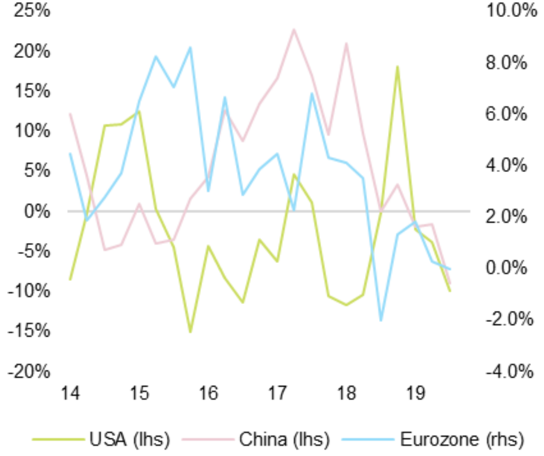
Non-financial corporations' debt (NFC), % of GDP, Q2 2019



Sources: BIS, Euler Hermes, Allianz Research

…but over the medium-term, credit risks remain elevated given the high corporate debt levels

Company profits, y/y

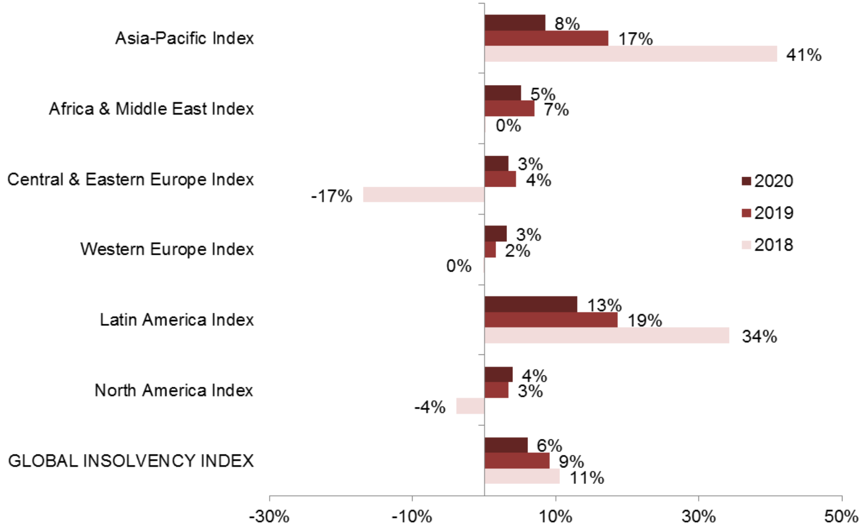


Sources: Euler Hermes, Allianz Research

Below long-term average corporate margins and too limited pricing power given the prolonged weakness of demand, increase liquidity risk for companies in the medium run

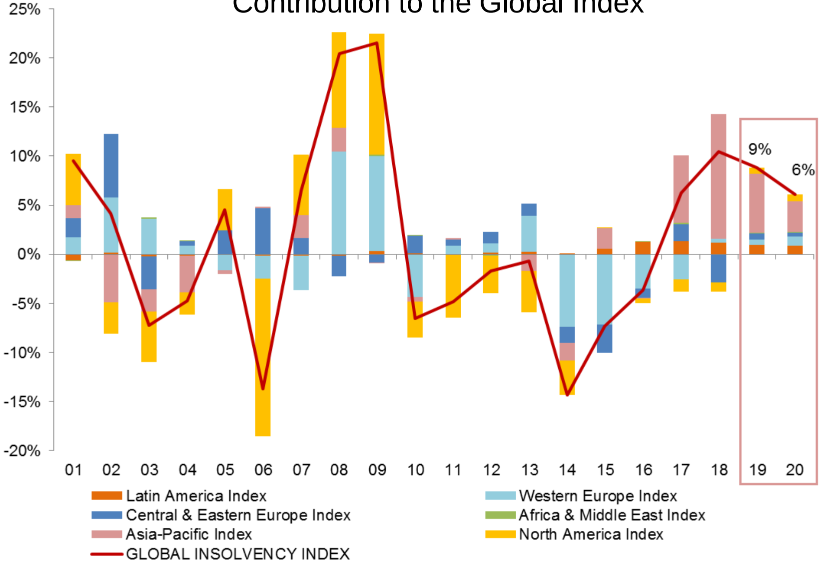
GLOBAL INSOLVENCIES: ON THE RISE

EH Global and Regional Insolvency Indices
Yearly changes in %



Sources: national statistics, Euler Hermes, Allianz Research

EH regional Insolvency Indices
Contribution to the Global Index



Sources: national statistics, Euler Hermes , Allianz Research

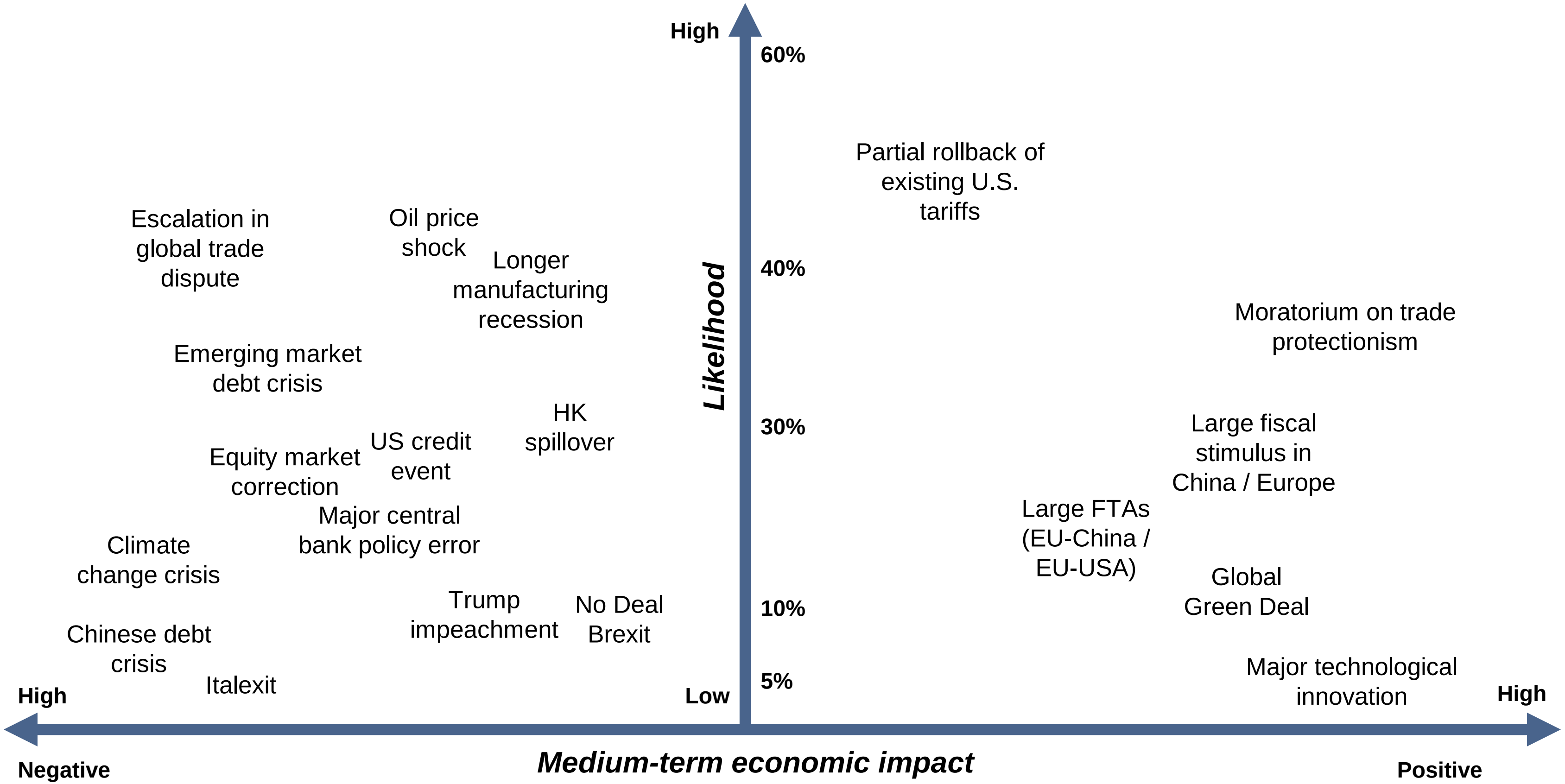
The upside trend in global insolvencies, as measured by our Global Insolvency Index, is confirmed for 2019 (+9%) with still a noticeable increase in Asia and Latam. We expect this trend to continue in 2020, for the 4th consecutive year, mainly due to the prolonged weakness of demand. The easing of global monetary and financial conditions will contribute to limit the pace of the increase, but the rise will remain broad-based with a rise across all regions and a majority of countries (4 out of 5).

WHAT DOES IT MEAN FOR MARKETS? AN OVERVIEW

		2020	2021
EMU			
	Policy rate (deposit rate)	-0.6	-0.6
	10y Bund	-0.1	0.1
	10y Swap	0.2	0.3
	Corporate IG spread (bp)	100	105
	MSCI EMU (TR, % p.a.)	3.1	4.8
USA			
	Policy rate	1.25	1.50
	10y UST	1.9	2.3
	Corporate IG spread (bp)	120	130
	MSCI USA (TR, % p.a.)	2.1	2.0

Source: Allianz Research

GLOBAL ECONOMY: DOWNSIDE AND UPSIDE RISKS

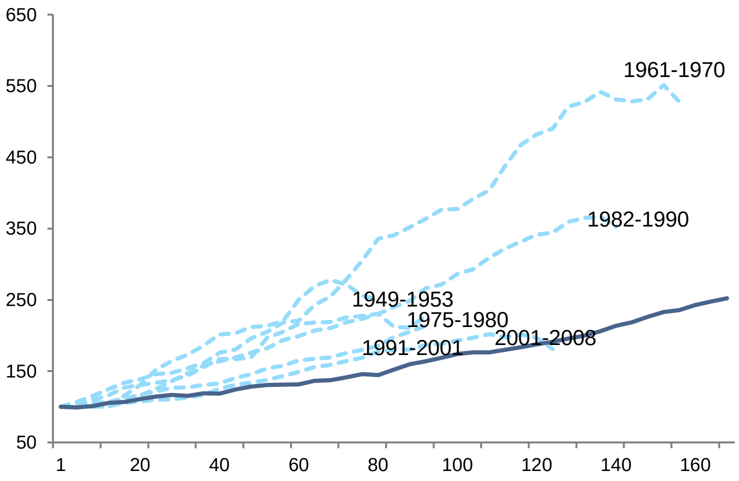


UNITED STATES

01

US: PROVING MORE RESILIENT

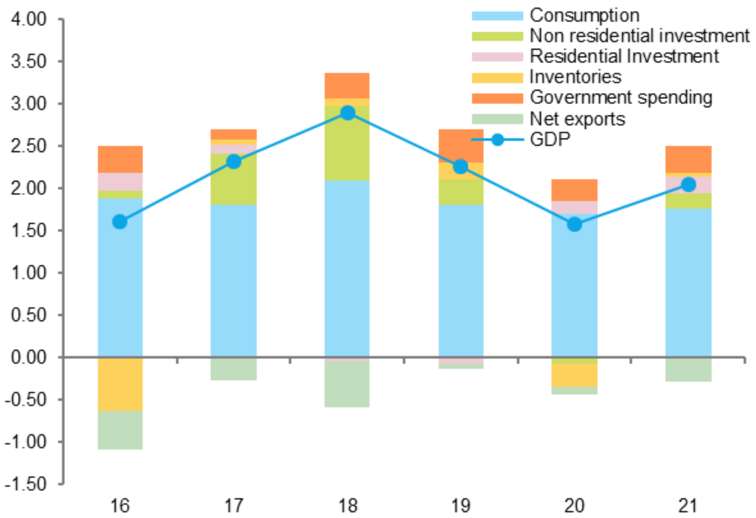
US Real GDP index



Sources: Bloomberg, Euler Hermes, Allianz Research

We are now in the longest cycle of expansion in the US. This is also the slowest, suggesting stronger footing for this cycle. We expect 2% of growth in 2021 compared with 1.6% in 2020 and 2.3% in 2019

Contribution to growth (pp)

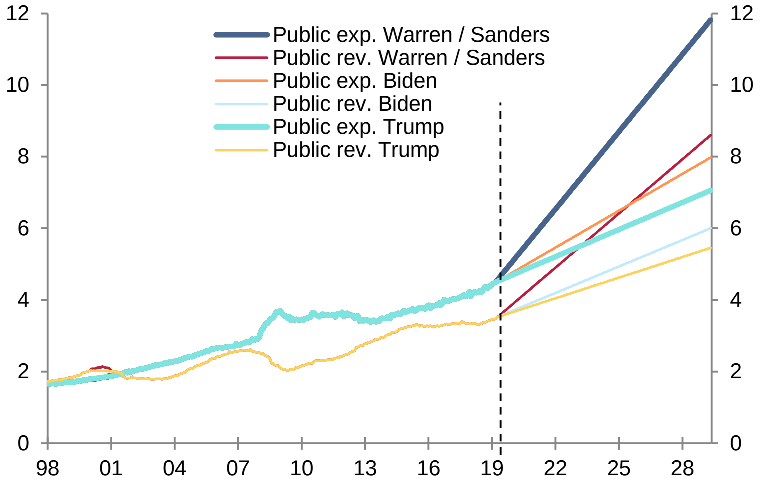


Sources: Bloomberg, Euler Hermes, Allianz Research

The labor market proved more resilient than expected and the monetary policy turned more expansionary than initially thought. This reduced the probability of recession in H1 2020.

US: FISCAL SUPPORT TO INCREASE AFTER THE ELECTIONS

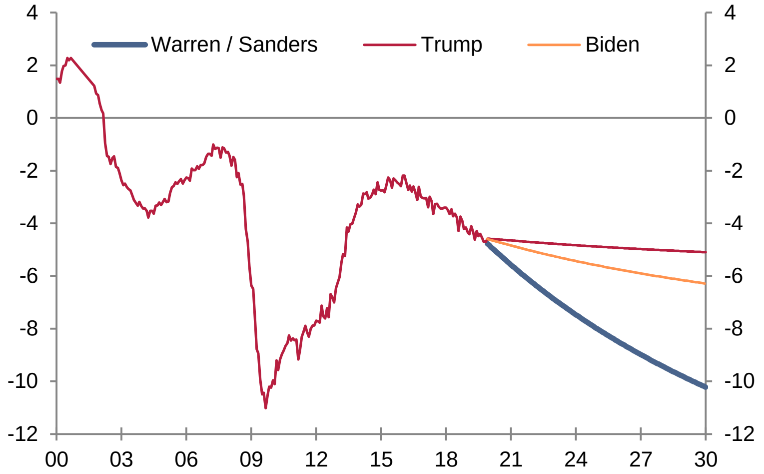
Long-term fiscal projections (USD trillion)



Sources: Bloomberg, Euler Hermes, Allianz Research

Biden is much less aggressive in terms of tax hikes for companies and wealthy people. He only intends to rise this amount of tax by USD 3.4 trillion compared with USD 30 trillion for Warren and Sanders

Long-term projections on fiscal deficit (% of GDP)

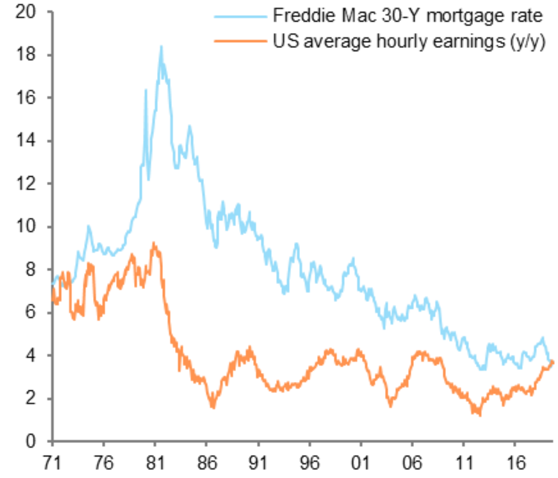


Sources: Bloomberg, Euler Hermes, Allianz Research

A too liberal approach of fiscal approach would endanger the US debt sustainability. We expect a Democrat win (55% probability), albeit with a trajectory close to Biden's proposal as any new US Democrat President would have to compose with the Congress

US: GROWTH WILL BE INCREASINGLY DOMESTIC DRIVEN

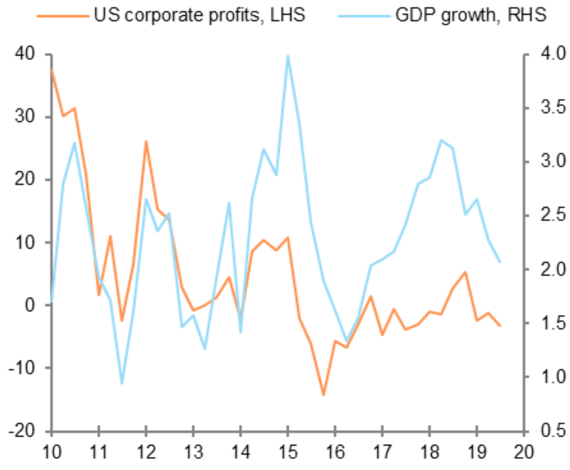
30-year mortgage rates vs average hourly earnings growth



Sources: Bloomberg, Euler Hermes, Allianz Research

The Fed will explore lower levels of unemployment rates. This will boost wage growth and contribute via low interest rates to stronger demand in residential investment

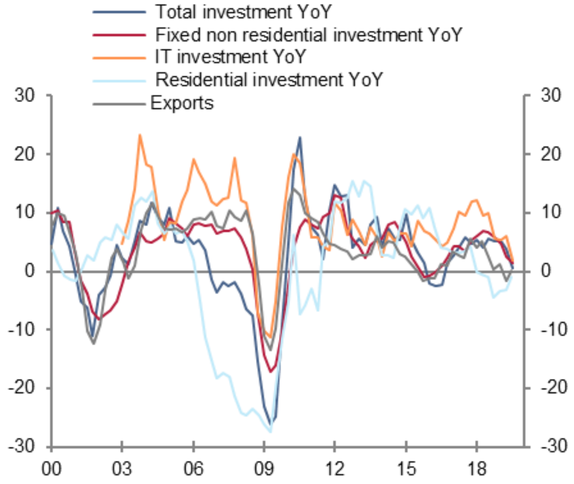
US profits and GDP growth (%, y/y)



Sources: Bloomberg, Euler Hermes, Allianz Research

The global shock on trade impairs profits of US large companies, which have large exposure to foreign demand

Investment in the US (%, y/y)

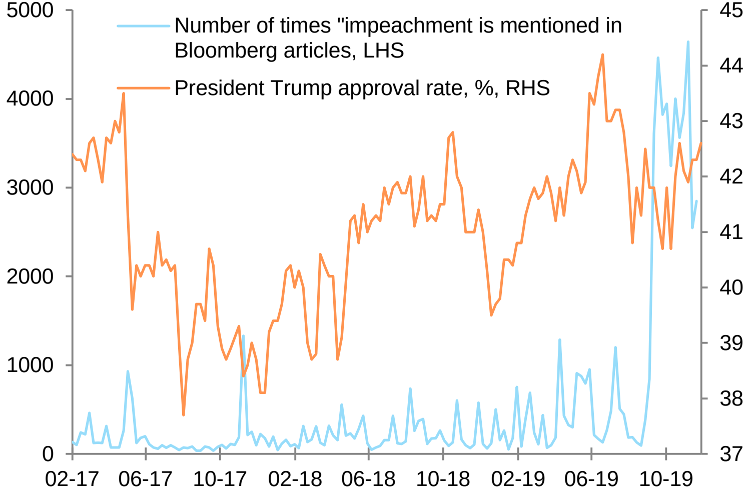


Sources: Bloomberg, Euler Hermes, Allianz Research

US investment, except residential investment, is badly oriented, even if the stabilization of external conditions will bring some support

US: THE TRUMP FACTOR TO BE AT WORK

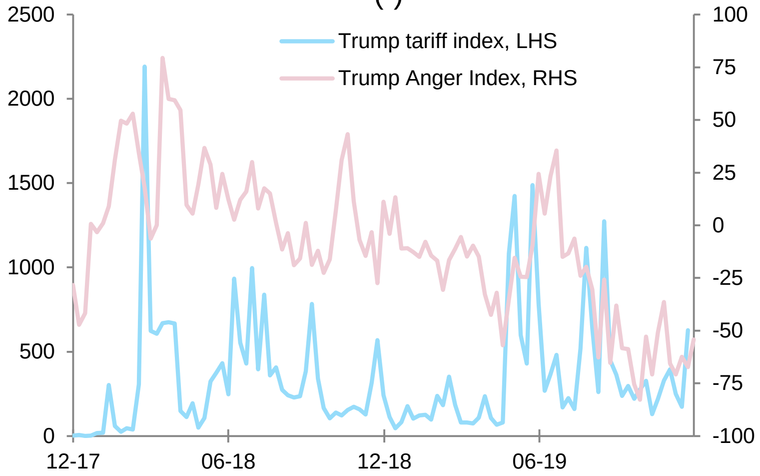
Impeachment and President Trump's popularity



Sources: HIS, Bloomberg, Allianz Research

The impeachment procedure does not seem to have any influence on President Trump's approval rate for now. However, it can open Pandora's box by increasing Trump's Anger Index

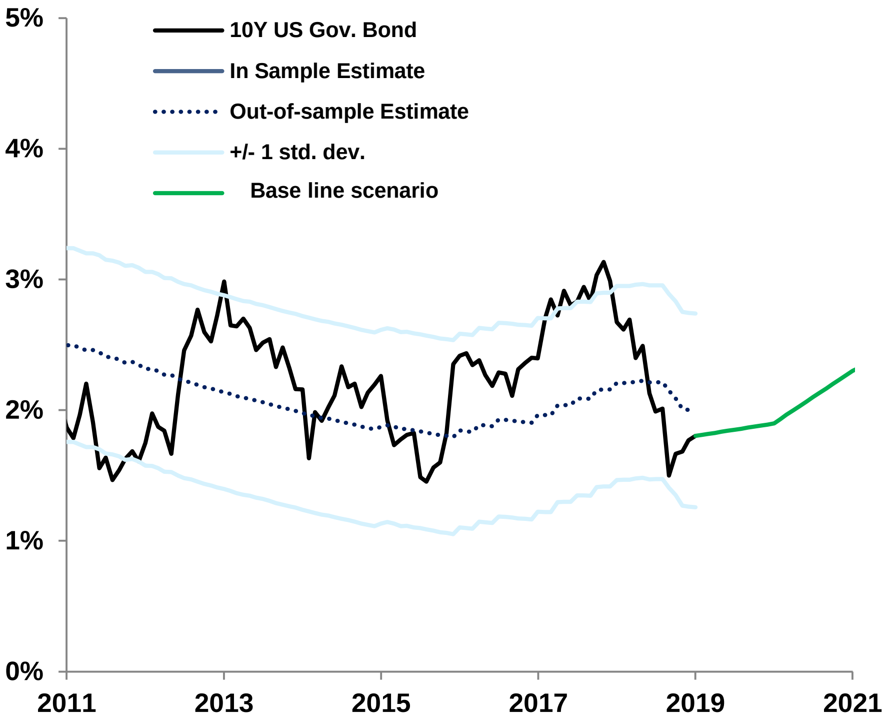
Trump Anger index is constructed in function of S&P performance (-), USD appreciation (+) and the approval rate (-)



Sources: HIS, Bloomberg, Allianz Research

Times of higher anger correspond with more frequent tariffs threats triggering a strong correction in equity markets

US 10Y YIELDS: A CAUTIOUS NORMALIZATION



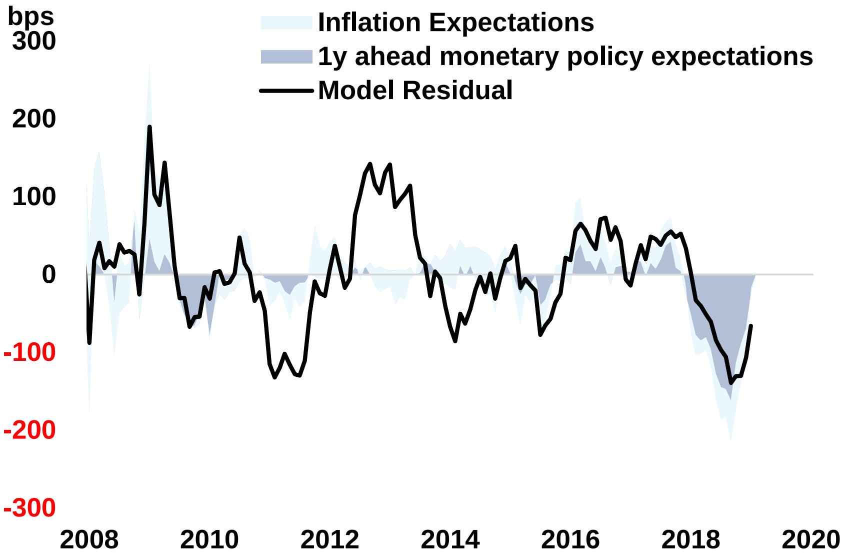
Sources: Refinitiv, Allianz Research

- Our base line scenario shows a continuous climb from current levels to a fundamental upper-range of 2.3% at the end of 2021.
- At 2.3% by the end of 2021 long-term UST yields will be between fair value and slightly overvalued.
- 10y UST yields are expected to remain roaming below our fundamental fair value estimate (1.9%) before the 2020 elections to be followed by long slow climb on the back of subdued future but positive economic optimism and reanchored inflation expectations.
- The base line path finishes the forecasting timeframe 2021 with a steeper yield curve that should however reverse in afterwards.

Model's standard deviation: 50 - 60bps

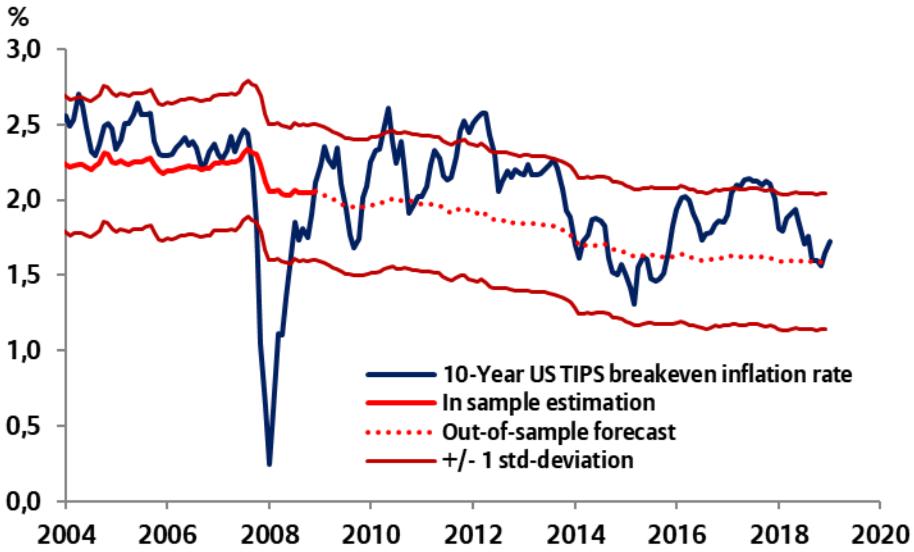
US 10Y YIELDS: CENTRAL BANK IN THE DRIVING SEAT

12m changes in valuation components (bps)



Sources: Refinitiv, Allianz Research

Market – based Inflation Expectations

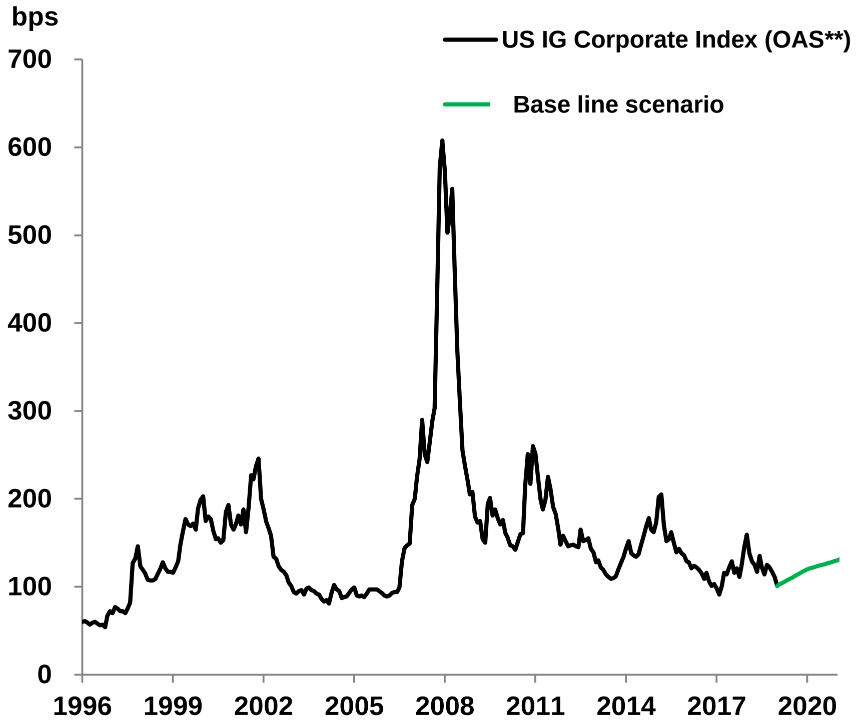


Sources: Refinitiv, Allianz Research

Since the beginning of 2015 changes in UST long-term yields (represented by our fundamental model residual), can be explained by a mix between changes in inflation expectations and changes in monetary policy expectations. Currently, changes in monetary policy expectations are of upmost importance in the determination of long-term UST yields.

Our proprietary model of market-based inflation expectations shows that the upside potential of inflation expectations is limited (50bps). As current fundamental inflation valuations show that at 1.6% long-term inflation expectations are correctly priced-in, if were markets to start discounting a sizeable fiscal stimulus (reflation), the upside potential in the inflation component of long-term US yields would be capped at ~2%.

US IG: POSTPONING THE CREDIT RERISKING



Sources: Refinitiv, Allianz Research

- US investment grade corporates are expected to remain anchored around current levels (100-120bps) in 2020 as a combination of a dovish Fed and the proximity of the US presidential elections should not grant a free ticket for markets to take strong positions.

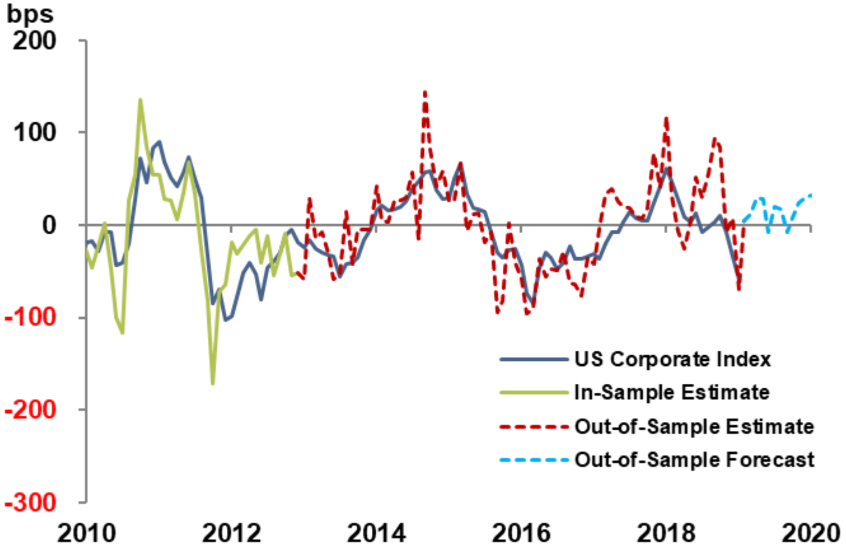
- The slow structural widening in investment grade corporate spreads within the 2020/2021 time span is fueled by the beginning of a mild corporate risk repricing as a direct consequence of the implied shift of the ongoing discussion on corporate debt sustainability.

- Importantly, our base linescenario is based on the empirical fact that the Fed stops hiking when credit spreads are rapidly widening.

** **Index**: ICE Bank Of America United States Corporate Index
IG: Investment grade ; **OAS:** Option Adjusted Sprea

US IG: UNDERESTIMATING CORPORATE CREDIT RISK

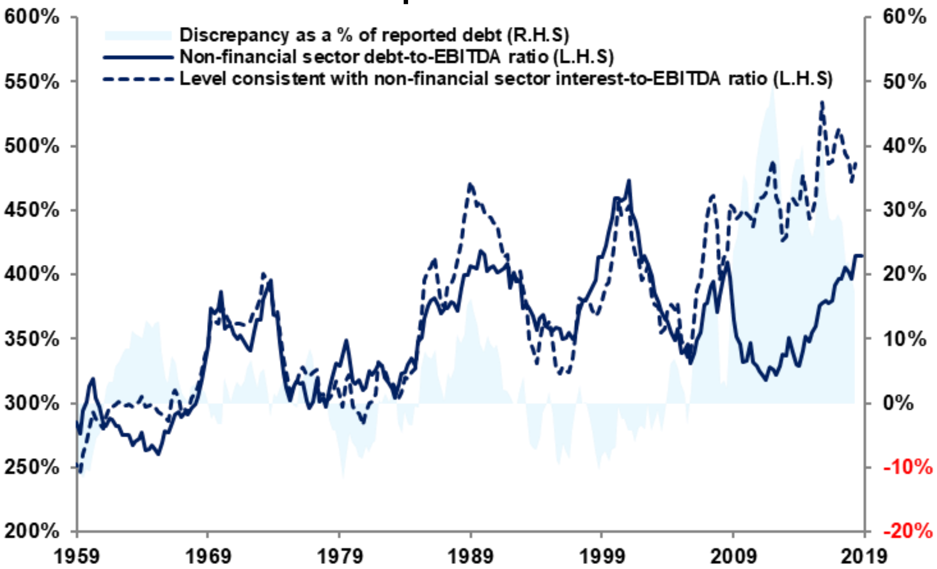
12m changes in spreads model



Sources: Bloomberg, Allianz Research

Our proprietary corporate spreads model shows no much room for narrower spreads in 2020 and extremely muted widening forces over the forecasting period. The combination of the muted widening potential with the Fed's prescribed hiking path limits the fundamental implied re-risking of corporate spreads in the 2020-2023 timespan.

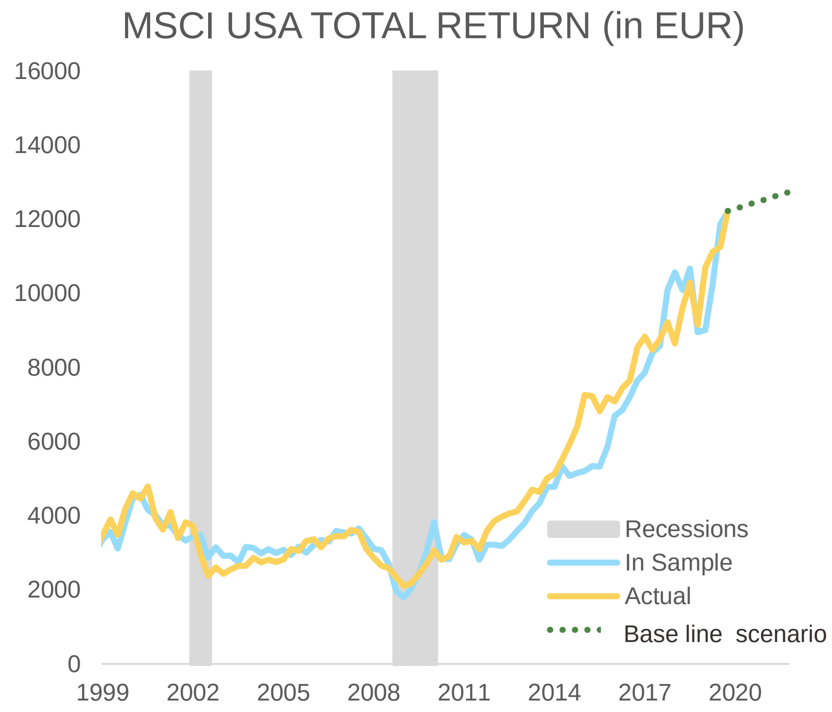
Underestimated US corporate credit risk



Sources: Bloomberg, Allianz Research

By looking at the US corporate debt level consistent with the current interest to EBITDA ratio it is clear that US corporate debt is being massively underestimated. This non-negligible imbalance may well be a source of extreme downside risk beyond 2023 with no clear sign of a circuit break mechanism that would alleviate this US credit event.

MSCI USA: PLEASE DON'T STOP THE MUSIC

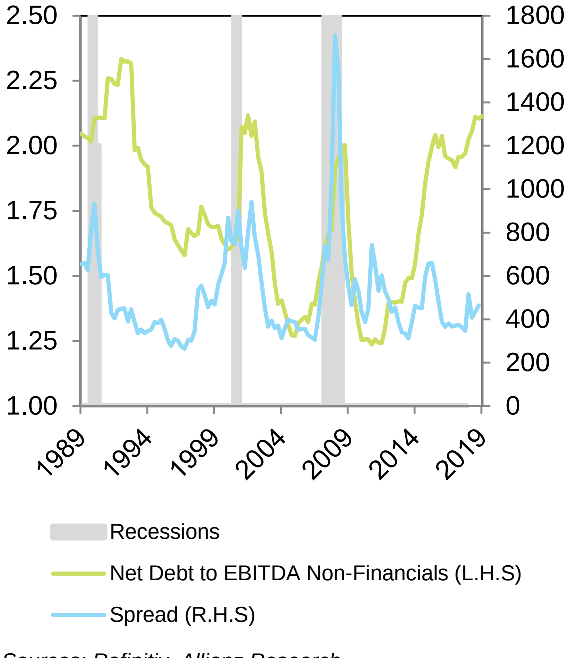


- Trade war remains unsolved and investors temperamental on trade news
- Mini-cycle: earnings growth forecasts will likely to be revised down
- Equities further fueled by share buybacks and financed by cheap debt
- Yield hunting attracts more investors
- The sugar rush from the fiscal stimulus fades away
- The volatility may occur within a year
- Democrat president might reverse Tax Cuts and Jobs Act of 2017

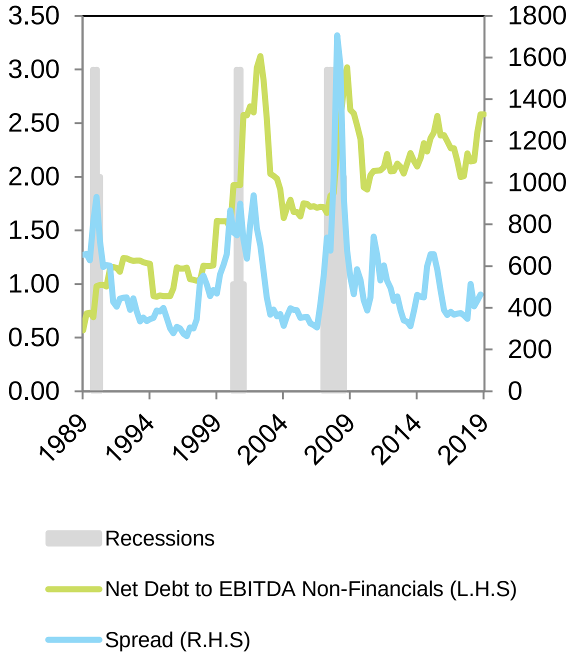
Sources: Refinitiv, Allianz Research

CHEAP DEBT AND SHARE BUYBACKS – FUEL FOR THE MARKET

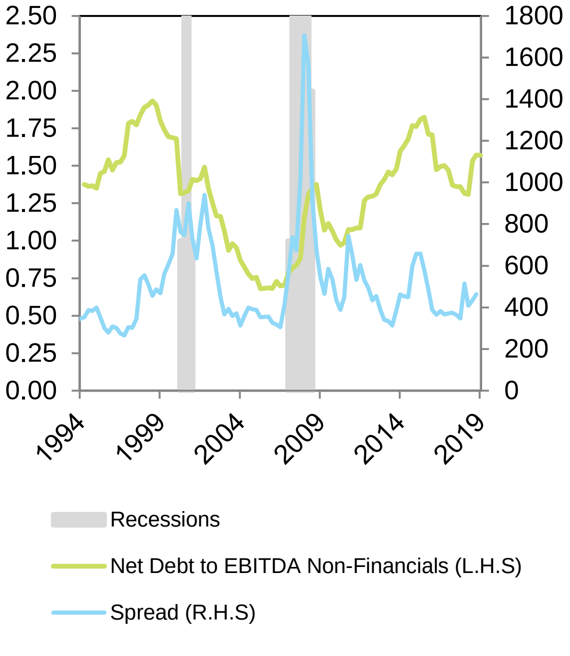
USA: Net Debt to EBITDA



EMU: Net Debt To EBITDA

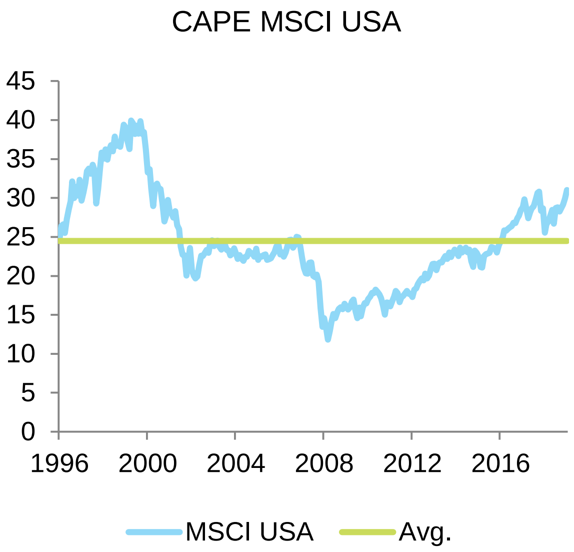


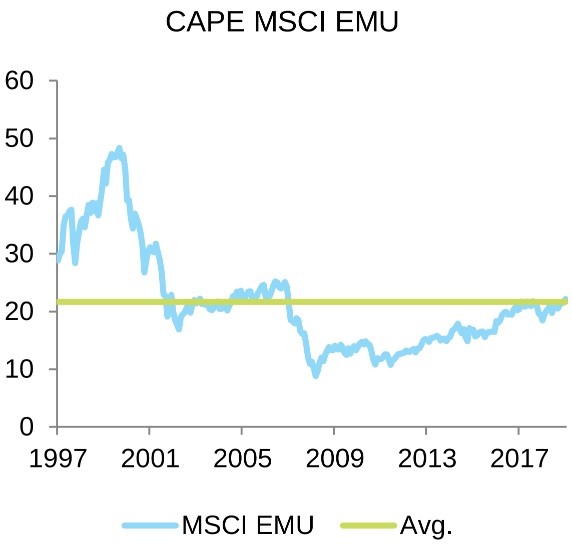
EM: Net Debt to EBITDA

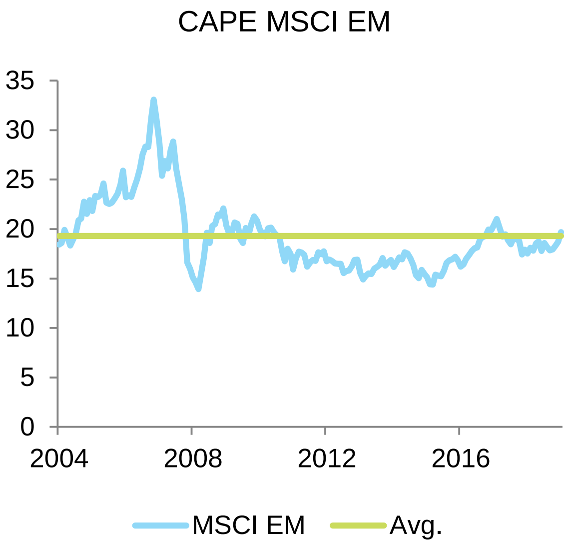


Sources: Refinitiv, Allianz Research

VALUATIONS: STRETCHED IN THE US







High valuations in the US restrains the growth potential. Valuations are inflated by the technology sector. The EMU and EM are fairly valued based on the long-time average of the Cyclically Adjusted Price/Earnings ratio.

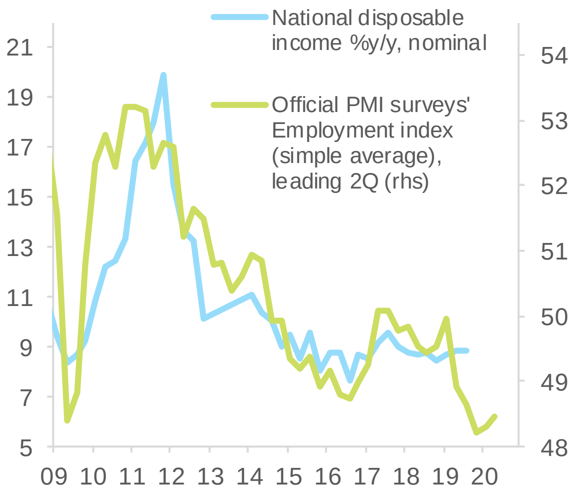
Sources: Refinitiv, Allianz Research

CHINA

02

CHINA: THE SLOWDOWN CONTINUES

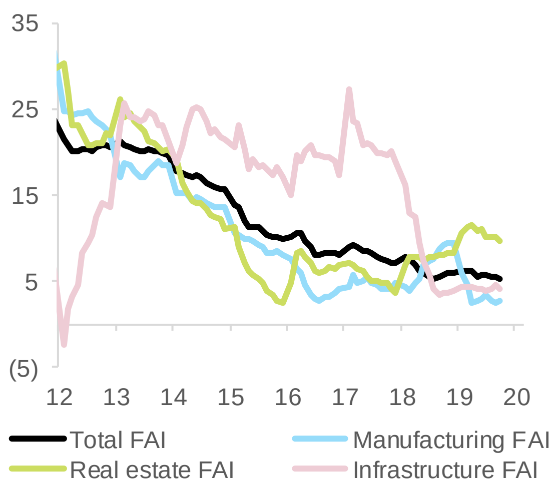
Household income, PMI employment index



Source: National Statistics, Euler Hermes, Allianz Research

Private consumption may not perform as well as in 2019 going forward, as the labour market has deteriorated and the support of past fiscal reforms peters out.

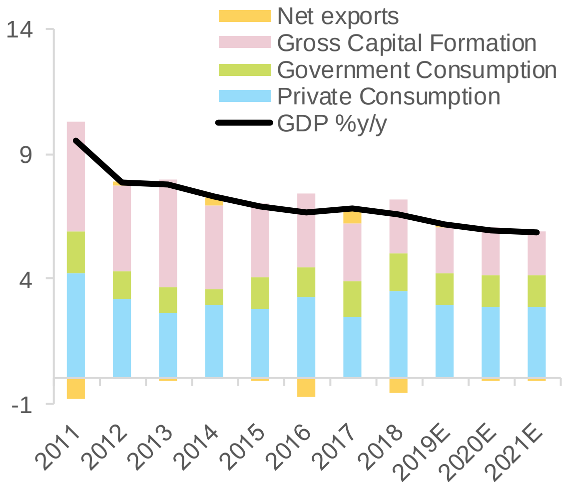
Fixed Asset Investment, nominal ytd %y/y



Source: Wind, Euler Hermes, Allianz Research

Investment slowed in 2019. The real estate sector has been the bright spot, while investment in infrastructure and manufacturing slowed.

GDP growth & breakdown of contributions

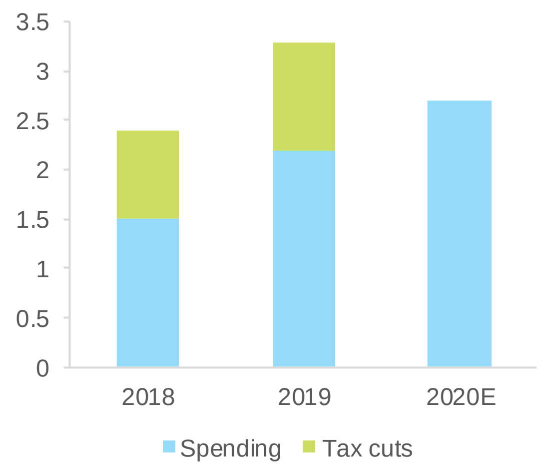


Source: National Statistics, Euler Hermes, Allianz Research

Trade tensions, the global slowdown and weak business sentiment mean that China will continue to slow. We expect GDP to grow by 6.2% in 2019, 5.9% in 2020 and 5.8% in 2021.

CHINA: FURTHER POLICY EASING TO COME, IN A MEASURED WAY

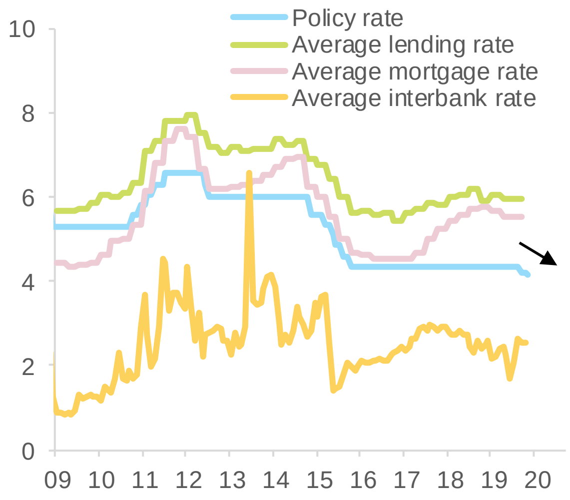
Size of fiscal stimulus package (% of GDP)



Source: Euler Hermes, Allianz Research

Fiscal easing will continue in 2020, mostly through infrastructure. We expect 2.7% of GDP of fiscal support in 2020, vs. 5.7% in total over 2018-2019.

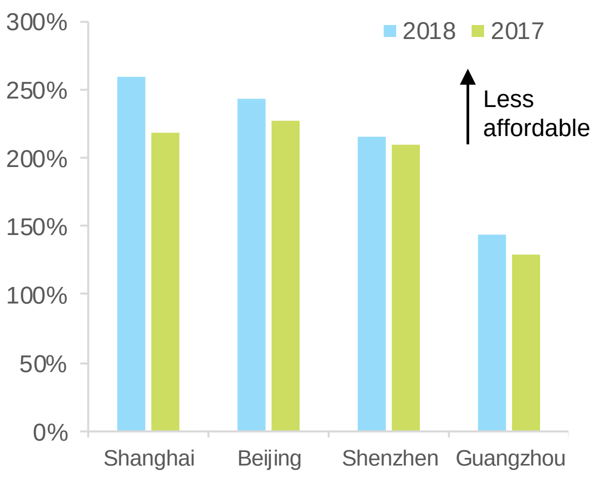
Interest rates (%)



Source: Datastream, Euler Hermes, Allianz Research

On the monetary side, the PBOC should continue easing, in a prudent way. In 2020, we expect the policy rate to be cut by 30bp, and the Reserve Requirement Ratios by 150bp.

Housing affordability (cost as % of income)

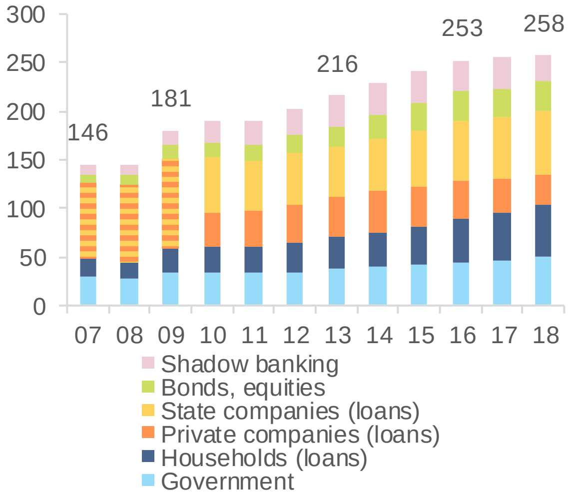


Source: Bloomberg, Euler Hermes, Allianz Research

The housing sector may not be used as a cyclical stabiliser this time. Housing and construction policies are unlikely to be loosened, as authorities are more concerned with housing affordability.

CHINA: HIGH DEBT AND FINANCIAL STABILITY RISKS DETER FROM AGGRESSIVE STIMULUS

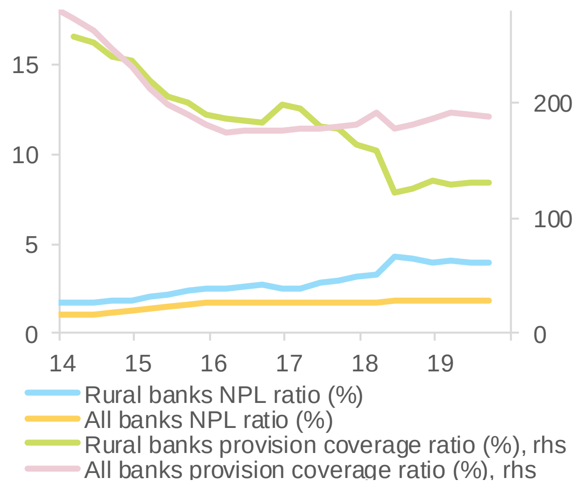
Breakdown of total debt (as % of GDP)



Source: National statistics, Euler Hermes, Allianz Research

China's total debt stands at c.260% of GDP, which is similar to the US and the Eurozone.

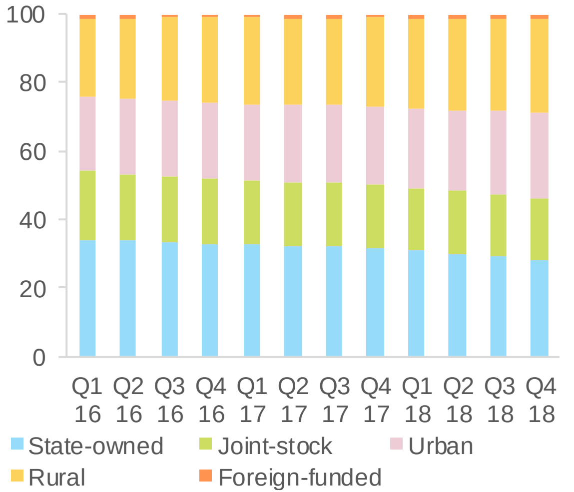
Banks' NPL and provision coverage ratios



Sources: Wind, Euler Hermes, Allianz Research

Several bailouts this year have raised concerns on banking sector stability, in particular for smaller (city-level and rural) banks.

SME loan balance breakdown by bank type



Sources: Wind, Euler Hermes, Allianz Research

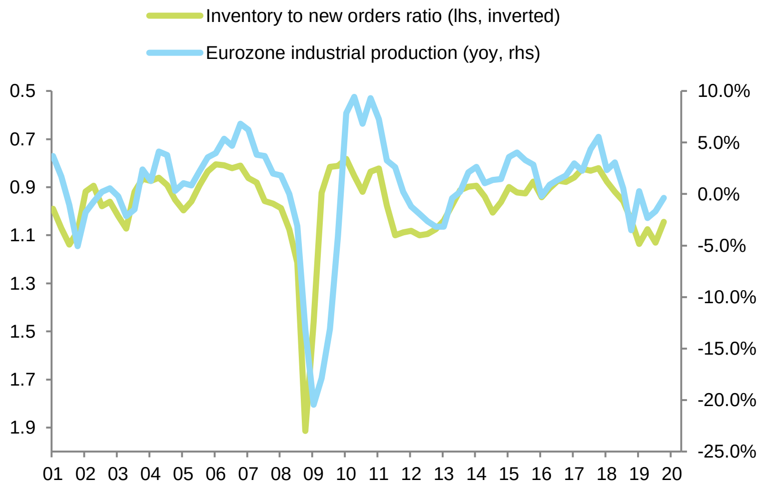
The share of SME loan balance provided by urban and rural banks went up from 43% at the end of 2015 to 52% at the end of 2018.

EUROZONE

03

EUROZONE: GREEN SHOOTS ON THE SUPPLY SIDE AND RESILIENCE ON THE DEMAND SIDE

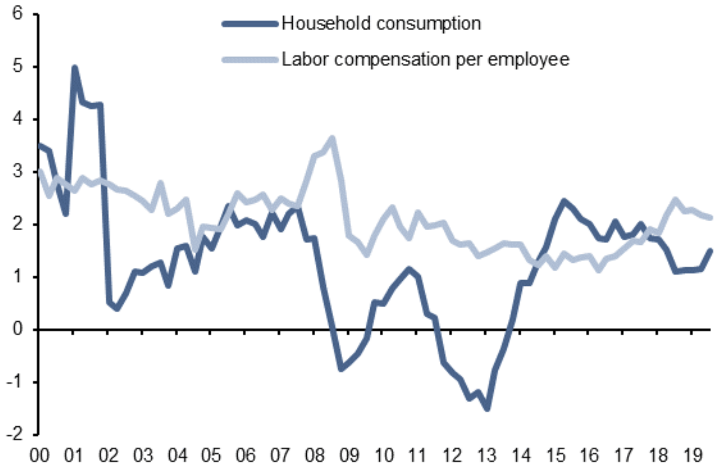
Inventory to new orders vs industrial production, 1Q lead



Sources: Refinitiv, Euler Hermes, Allianz Research

The high levels of inventories started to correct in Q3 and should continue to do so in Q4. This should support a pick-up in industrial production in Q1 2020

Household consumption & wage growth, yoy

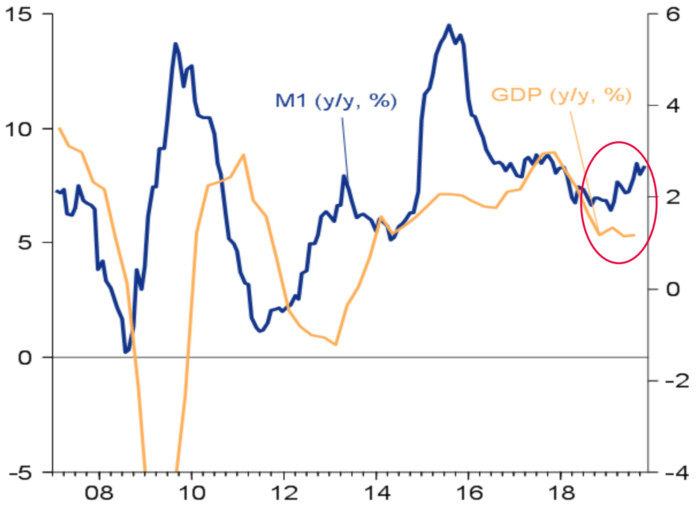


Sources: Refinitiv, Euler Hermes, Allianz Research

While employment growth has clearly slowed down in most Eurozone countries in 2019, it remains clearly positive. Household consumption should be also propped up by still solid wage growth.

EUROZONE: MONETARY POLICY HELPED STABILIZE, FISCAL POLICY SHOULD TAKE THE BATON

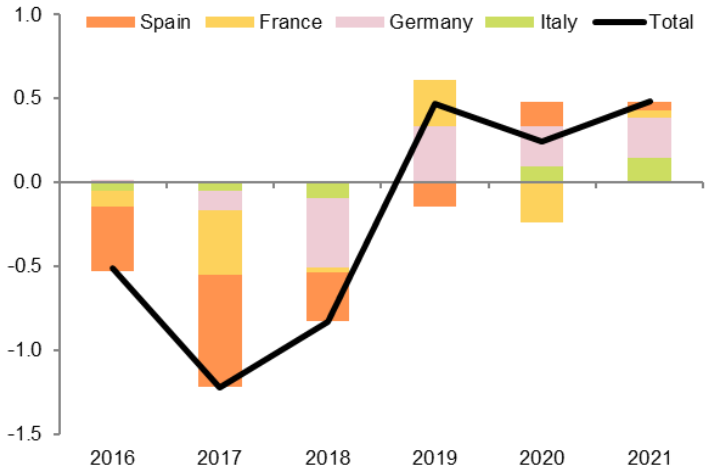
M1 & Eurozone real GDP growth (y/y, %), 2 quarters lead



Sources: Refinitiv, Euler Hermes, Allianz Research

M1 – the inflation-adjusted money supply suggests that an uptick in Eurozone GDP growth is around the corner. We expect the ECB to continue to ease policy in 2020 with one additional rate cut to be implemented in H1, continue QE until end-2020 and remain on hold in 2021.

Fiscal impulse, pp of real GDP growth



Sources: Refinitiv, Euler Hermes, Allianz Research

The policy mix in the Eurozone remains very supportive. Since 2019 fiscal policy is providing some tailwind and will continue to do so in 2020/21

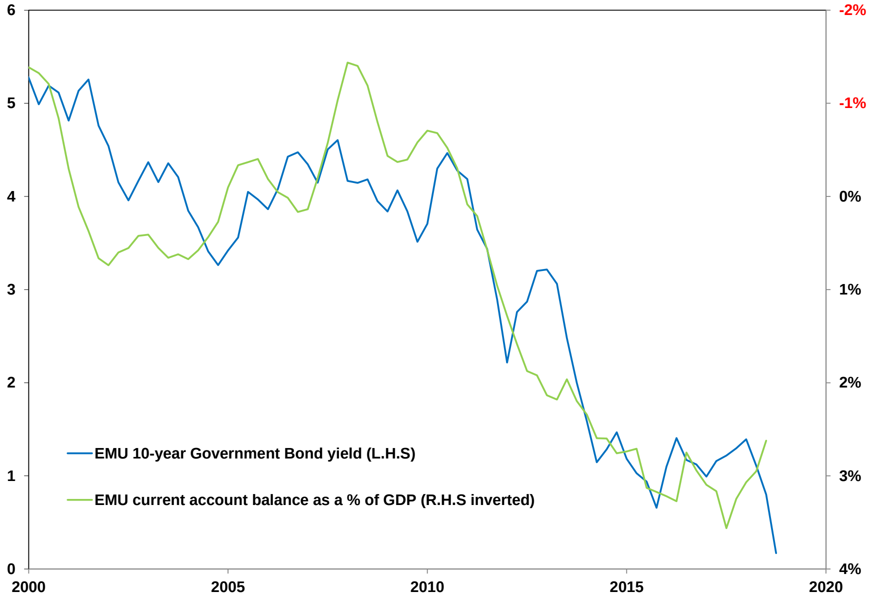
THE GREEN DEAL: LIMITED UPSIDE

EU Commission nnounced policy	Sectors	Time frame	Potential impact
Review Emissions Trading Directive	All	Expect 2020s	Eur 4.3bn for each Eur 1/t resulting CO2 price increase on incremental purchased credits
End fuel tax exemptions	Airlines, shipping	Likely 2020s	+15% fuel cost increase for each Eur 0.1/l fuel tax
Extend carbon trading to marine	Shipping	Likely 2020s	Eur 215bn to 2030
Reduce Co2 allocations to airlines	Airlines	Expect 2020s	Eur 7bn to 2030
Revision Energy Taxation Directive	Energy	Expect 2020s	Eur 1.1bn for 1%
Reduce auto emissions from 95g/km to nil	Automotive, energy	2030s	
Assess inclusion of road transport in EU ETS	Road transport	Possible mid 2020s	Eur 157bn to 2030
Smart mobility strategy	Automotive, road transport, energy	2020	EV targets, infrastructure upgrade
Energy Efficiency and Renewable Energy Directive	Energy, retail, construction, industrials	Expect early 2020s	Further renewables targets upgrade
Green ICT sector	Telecommunications, IT services	Possible late 2020s	Tightening obsolescence and recycling; energy consumption and efficiency mandates
Renovation wave initiative	Construction	H1 2021 tbc	Rising demand for construction
EU ETS Innovation Fund	IT, industrials, energy		
Review all agriculture and forestry legislation	Agrifood, pulp&paper		
Review air, water, chemicals legislation	Chemicals, industrials		
Resubmit Eurovignette for heavy trucks	Road transport		
Facilitate smart integration	Energy, industrials		
EU wide plan to close emissions ambitions gap		Potentially 2021	
Industrial strategy	Industrials, machinery, energy, metals	March 2020	
Construction productionsregulations revision	Construction, metals		
Circular economy	All		
State aid review	Energy, industrials	Likely 2020s	Greater distinction/bonus malus rules
strongly negative	Neutral to negative	TBC	
Negative	Positive		

Sources: EU, Allianz Research calculations

- ✓ The new European green deal: wide ranging and ambitious full decarbonisation 2050, -50-55% 2030
- ✓ Strongest impact of incremental measures: Transport, energy; strong likelihood of EU ETS tightening/reform
- ✓ Carbon border tax: Controversial measure, in silage with new industrial policy, positive for industrials, metals, energy intensives, potential for wide ranging secondary impact

EUROZONE: TOO MUCH SAVINGS, NOT ENOUGH PUBLIC SPENDING

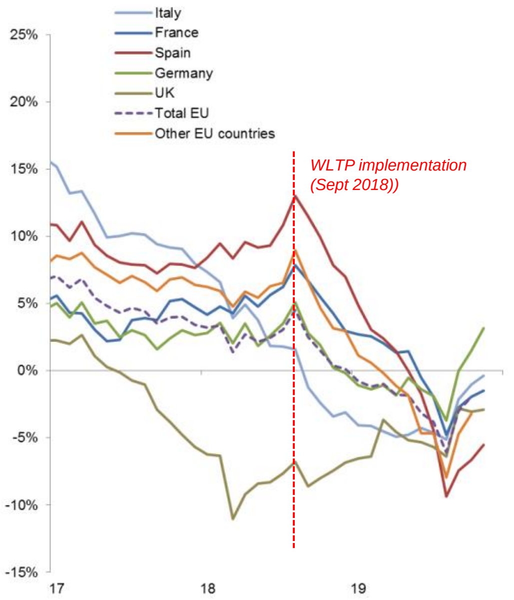


Source: Refinitiv, Allianz Research

Monetary policy is not the only, nor the major force pushing interest rates down. Excess savings are in the driving seat.

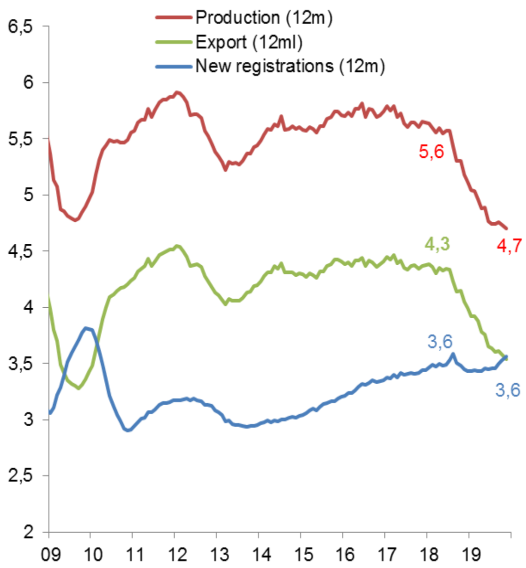
AUTOMOTIVE SECTOR: FRAGILE AND UNEVEN RECOVERY FROM REGULATORY CONSTRAINTS

New passenger cars registrations cumulative 12 months (y/y change)



Sources: national sources, IHS, Allianz/Euler Hermes Research

German market and industry (in millions of vehicles)

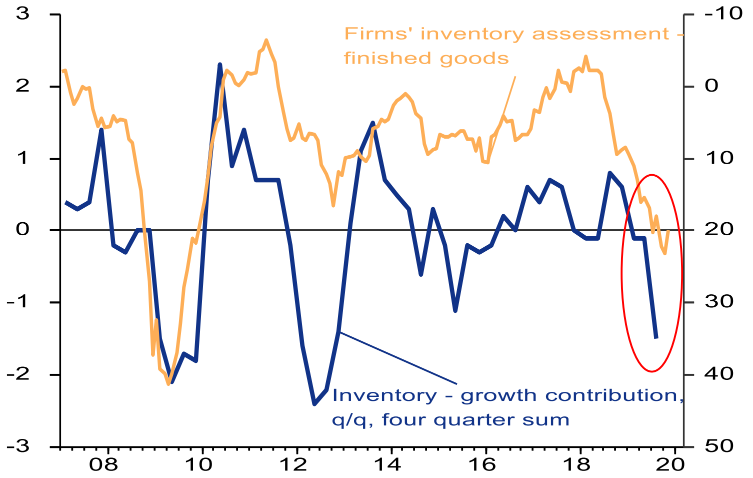


Sources: VDA, IHS, Allianz/Euler Hermes Research

- As expected, 2019 has been chaotic for monthly sales due to the implementation of the WLTP in Sept 2018 which created a strong basis effect
- 2019 will ended almost stable thanks to the German market (+4% expected) while some markets are struggling to recover (Spain, UK)
- Yet, the German industry has been strongly impacted, with a extended loss in volume of production and exports
- 2020 will remain challenging, with a small decline in new registrations (-1%) due to a prolonged ‘wait-and-see’ attitude of the demand - despite a faster rolling out of new vehicles, notably low-emitting ones, and aggressive price competition ahead of the CO_2 emission requirements for 2021
- We expect a better outlook for 2021 (+1% in new registrations) when the European EV will take off more significantly4

GERMANY: INVENTORY HEADWINDS TO ABATE, BUT PRODUCTION REBOUND NOT IN THE CARDS

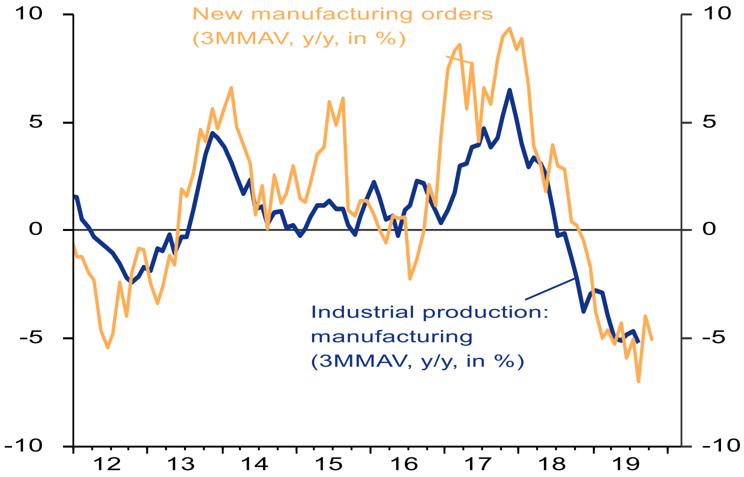
Firms' inventory assessment vs. quarterly GDP growth contribution of inventory (four quarter sum)



Sources: Refinitiv, Euler Hermes, Allianz Research

Following a notable inventory correction over the past year, the worst is probably behind us. Going forward we expect the negative growth impact from stocks to fade.

New manufacturing orders & industrial production (3MMAV, y/y, in %)

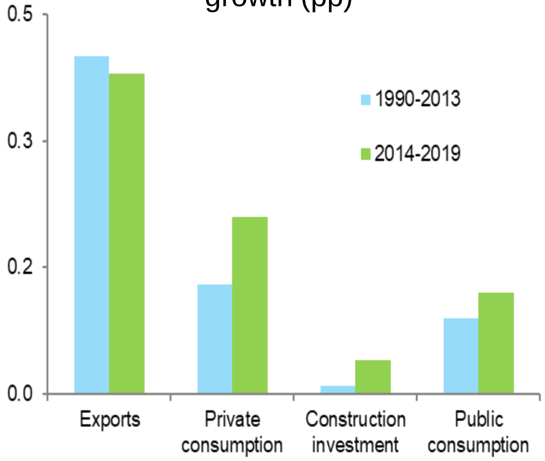


Sources: Refinitiv, Euler Hermes, Allianz Research

A marked restart in production is not in the cards looking at incoming order activity. Instead we only expect a moderate industrial recovery.

GERMANY: CONSUMPTION TO SAVE THE DAY IN 2020, BUT INVESTMENT SET TO DECLINE

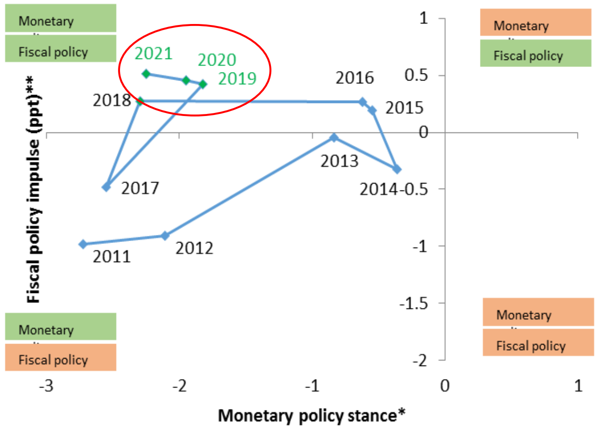
Average contributions to quarterly GDP growth (pp)



Sources: Refinitiv, Euler Hermes, Allianz Research

Domestic demand has become much more important to German GDP growth in recent years, in particular private consumption.

Fiscal & monetary policy mix

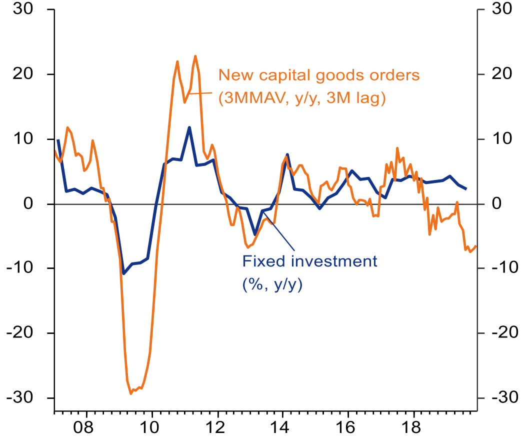


real policy rate minus r estimated by HLW-Model;
**change in structural primary balance

Sources: AMECO, Euler Hermes, Allianz Research

A big fiscal stimulus package is unlikely unless the economic outlook deteriorates further, but German domestic demand will benefit from a very supportive policy mix.

New capital good orders (3MMAV, y/y, 3M lag) vs. fixed investment (%, y/y)

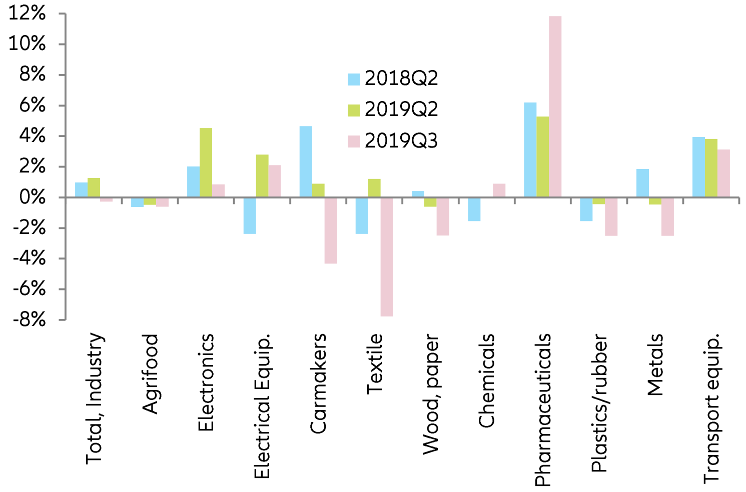


Sources: Refinitiv, Euler Hermes, Allianz Research

Fixed investment growth looks set to cool notably given the weak GDP growth outlook, subdued capacity utilization rates and lingering elevated uncertainty.

FRANCE: INTERMEDIATE GROWTH MEANS WINNERS AND LOSERS

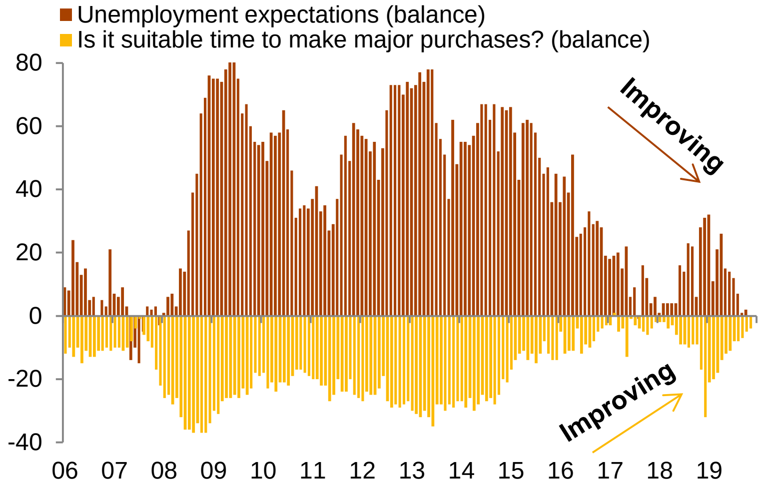
France: Manufacturing production, y/y change



Sources: Bloomberg, Allianz Research

French manufacturing sector entered later into recession mode, but destocking into the car supply chain is now triggering a deterioration of the output. Pharmaceuticals and transport equipment still in growing mode.

France: Household confidence, durable goods spending

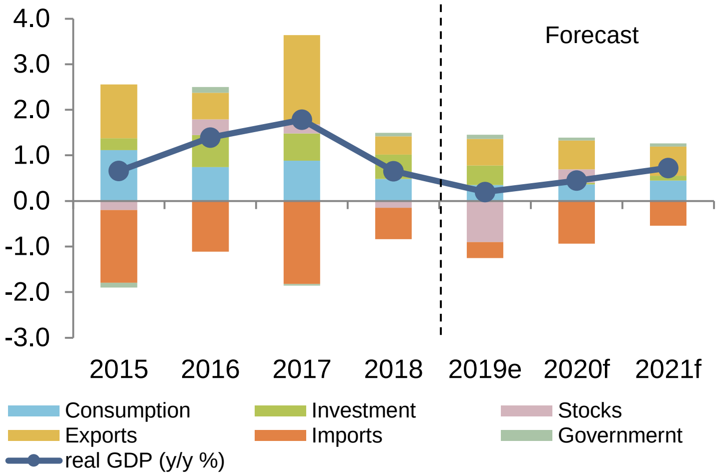


Sources: Insee, IHS Global Insight, Allianz Research

The consumer will save the day, but no free lunch: Durable goods (construction, household equipment) will be among winners. But consumer spending will continue to experience a glass ceiling as a result of the impact of the pension reform on household saving behavior.

ITALY: SLOW RECOVERY WITH LINGERING POLITICAL RISK

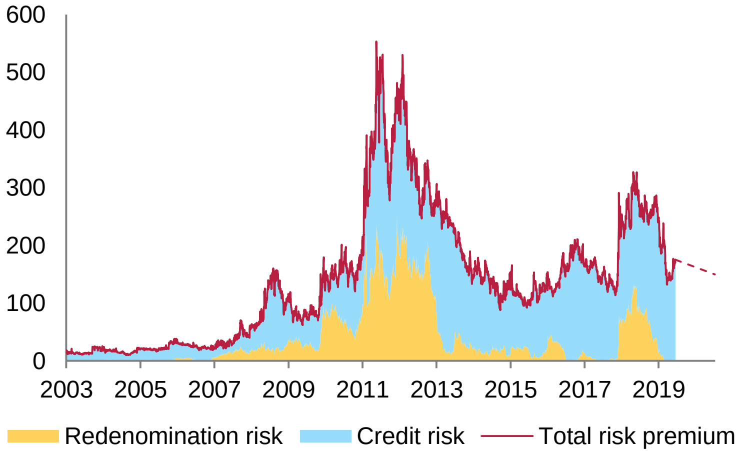
Real GDP and components



Sources Refinitiv, Allianz Research

Italy will show the same growth pattern as euro area, however less dynamic, with consumption being a backbone of growth and investment with weaker momentum.

10yr Italian sovereign yields vs German Bund, in bp

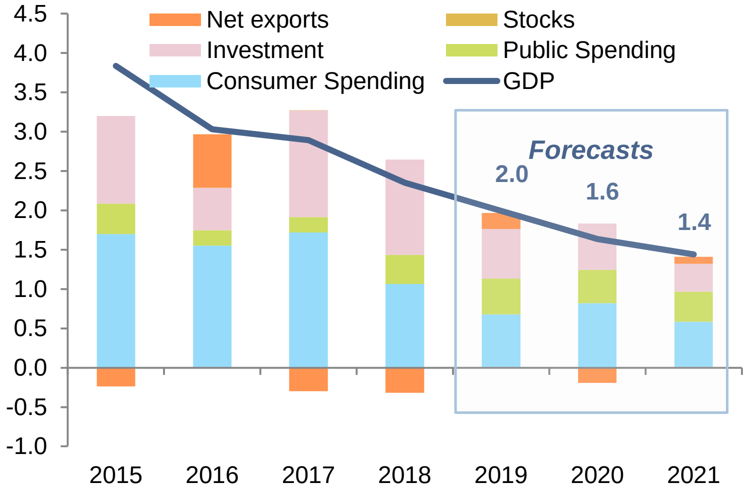


Sources Refinitiv, Allianz Research

With new coalition, redenomination risk has been entirely priced out. If government succeeds in reestablishing some fiscal credibility, credit risk premium should also narrow, especially in QE context.

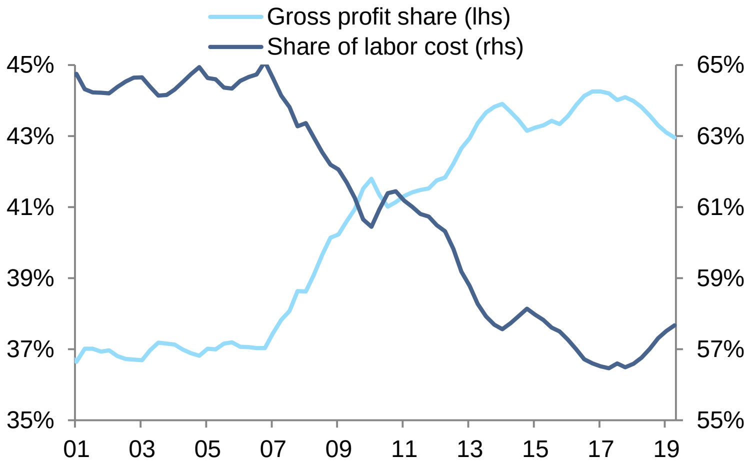
SPAIN: CONSUMPTION STABILIZING, EXPORTS SLOWING, COMPANY MARGINS DOWN

GDP growth and components



Sources: IHS, Euler Hermes, Allianz Research

NFC Profit & labor costs, share of Gross Value Added (GVA)



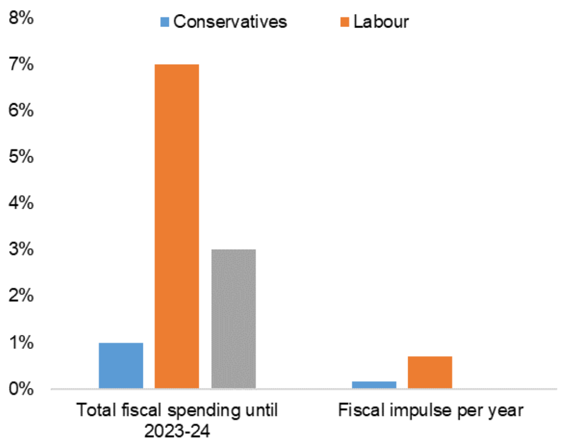
Sources: IHS, Euler Hermes, Allianz Research

Higher labor costs => lower competitiveness => slower exports. Stable but slow consumption, slowing investment. Political fragmentation mean no structural reforms; social spending as a quick win.

(-) Savings ratio increasing; (-) Job growth is slowing. (+) Higher wages should be a buffer for consumption. Companies pass it on margins, that are steadily decreasing (43% of GVA, vs. peak of 44.2%); still higher than Eurozone average.

UNITED KINGDOM: BREXIT SHOULD BE DONE IN 2020, BUT MIND THE "NO TRADE DEAL" RISK

Fiscal spending by party, % of GDP



Sources: Manifestos, Euler Hermes, Allianz Research

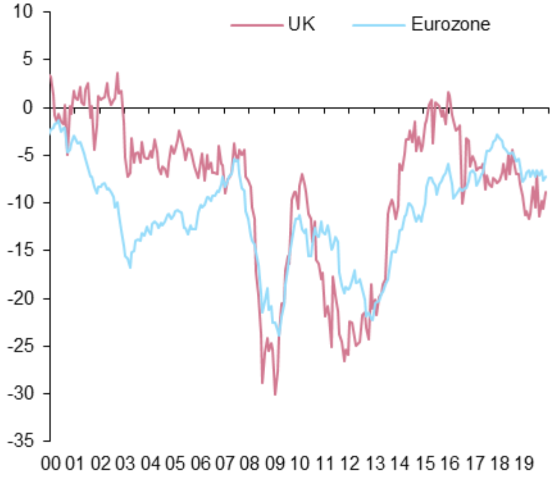
The impact on GDP growth is positive for all parties. We estimate GDP growth at 1.8% in 2021 for Labor led coalition and 1.6% for Conservatives majority

Inventory to orders ratio

Sources: Markit, Euler Hermes, Allianz Research

55% of UK firms reported that Brexit was one of their top three sources of uncertainty in November. The stock absorption will continue to be a drag on growth

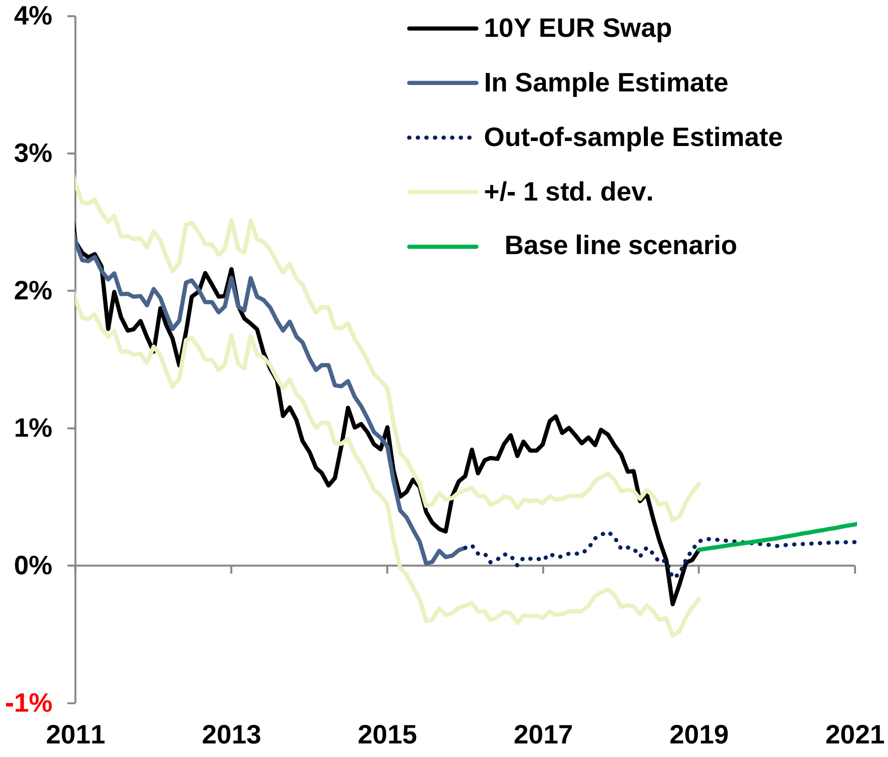
Consumer confidence



Sources: Eurostat, Euler Hermes, Allianz Research

Consumer confidence remains weak despite pledge of fiscal spending through tax cuts that have helped the index improve in the past elections.

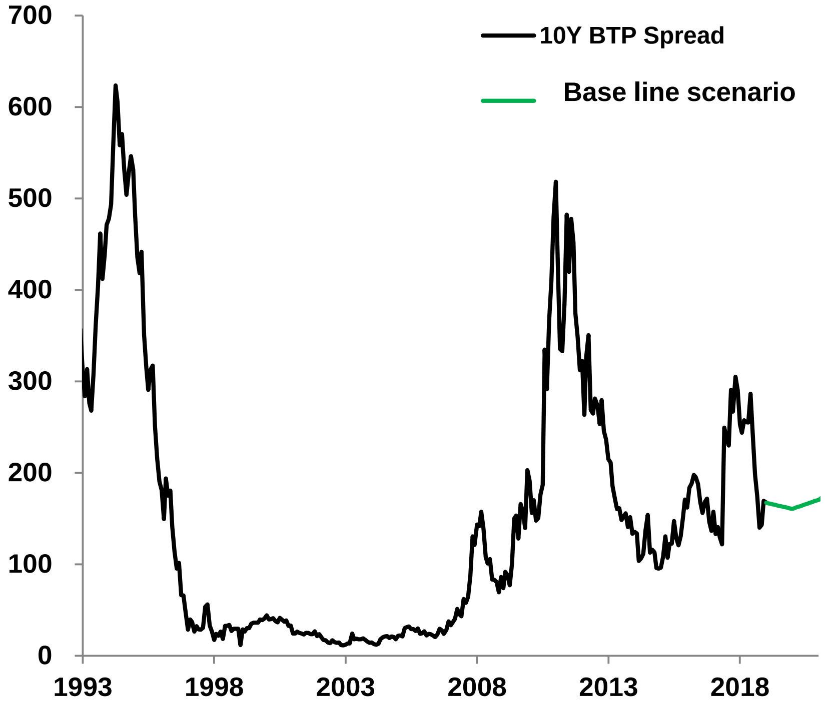
EUR 10Y SWAP: UNDER THE ECB'S WATCH



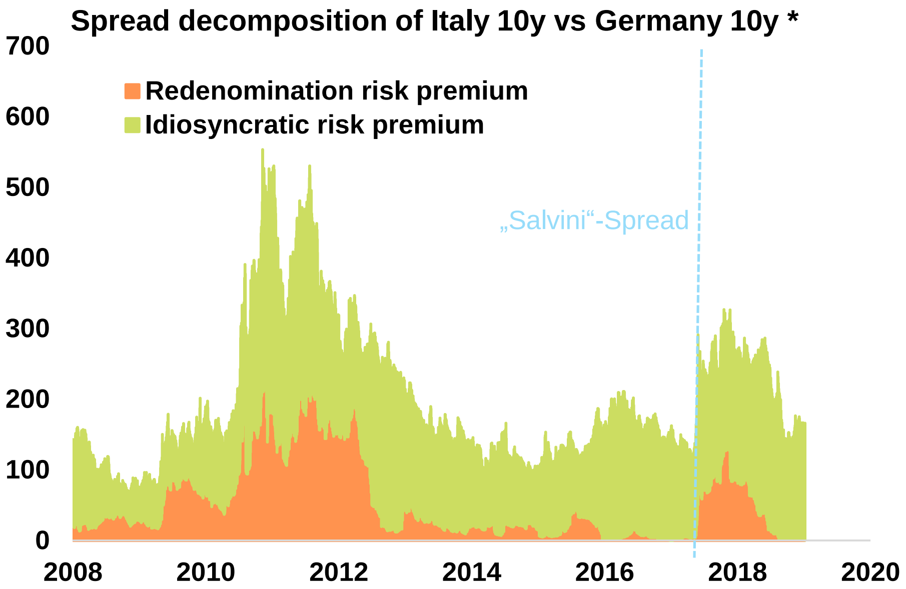
Sources: Refinitiv, Allianz Research

- The base line scenario shows a continuous climb from current levels to a comfortable 0.3% at the end of 2021.
- 10y EUR swaps are expected to remain close to our fundamental fair value estimate (0.2%).
- On the inflation side, inflation expectations are not expected to shows signs of a clear repricing over the forecasting period as underlying inflation is not expected to substantially accelerate.
- The EMU rates prospect implies a slight fundamental yield overvaluation at the end of the forecasting period.

10Y BTP: LOCKED-IN BY THE ECB



Sources: Refinitiv, Allianz Research



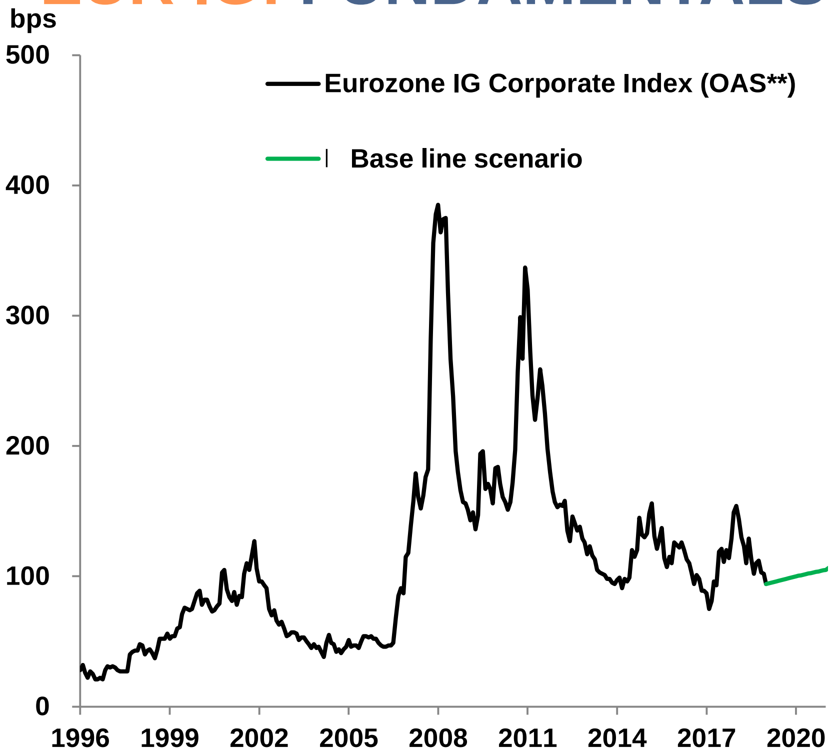
Sources: Refinitiv, Allianz Research

A spread level significantly over 200bp would require repricing of redenomination risk which can either be triggered by political activism or emergence of doubts over robustness euro area architecture.

BTPs are only expected to enter in such a described situation in our global recession scenario.

* Using variance decomposition of BTP yield movements in systemic part (explained by decoupling from Germany) and idiosyncratic part

EUR IG: FUNDAMENTALS HAVE NO POWER

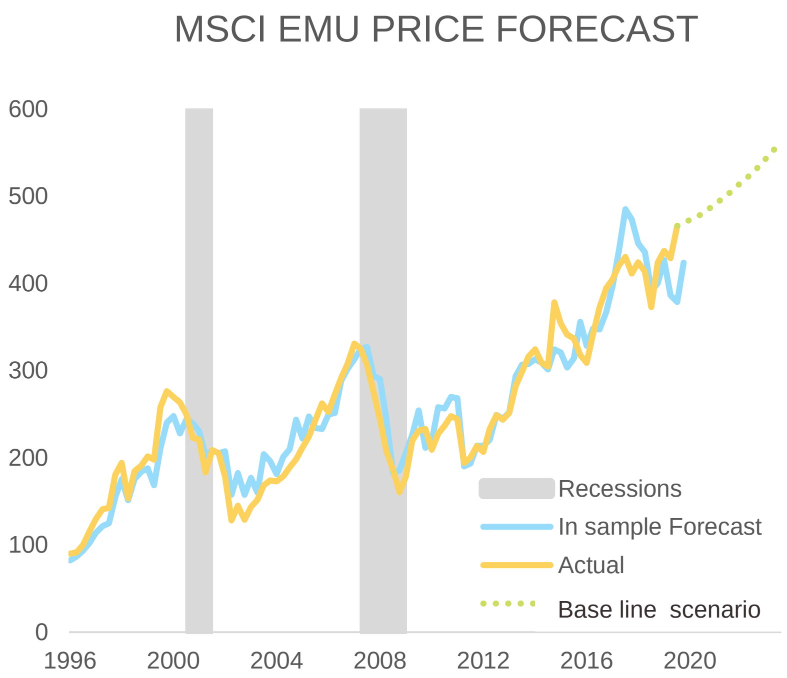


Sources: Refinitiv, Allianz Research

- EUR investment grade corporates are expected to remain anchored at current levels in 2020 as the ECB market presence should not grant a free ticket for markets to take strong positions.
- Importantly, the ECB market presence is expected to keep equity volatility anchored at current levels until the end of the forecasting period which is a key input for corporate spread widening.
- The slow but steady increase (~105bps) should reflect the anticipation of the ECB's market withdrawal.

** **Index**: ICE Bank Of America Euro Corporate Index
IG: Investment grade ; **OAS:** Option Adjusted Spread

EMU EQUITIES: TIME FOR THE COMEBACK



- Low valuations leave some room for European equities to catch up
- No trade tensions between the US and Europe
- Stable growth across the region and mild earnings recovery
- German economy recovers after almost technical recession and lifts European equity market
- Diminished risk of the hard Brexit brings back the confidence
- The volatility may occur within the year

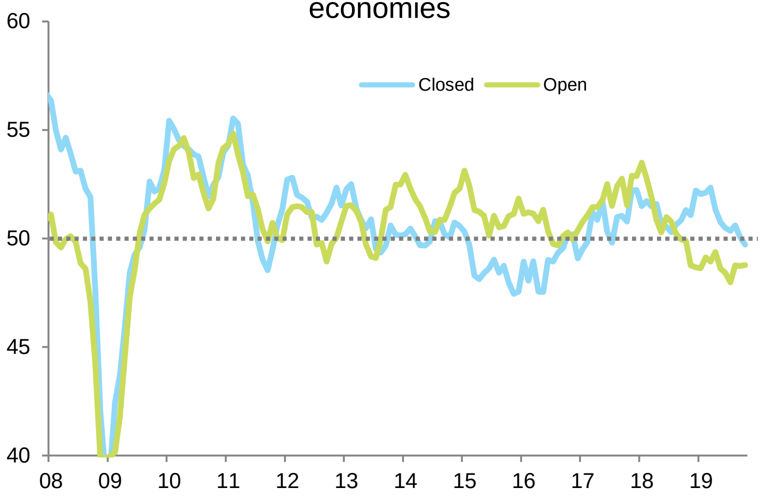
Sources: Refinitiv, Allianz Research

EMERGING MARKETS

04

EMERGING MARKETS: GROWTH SHOULD STABILIZE

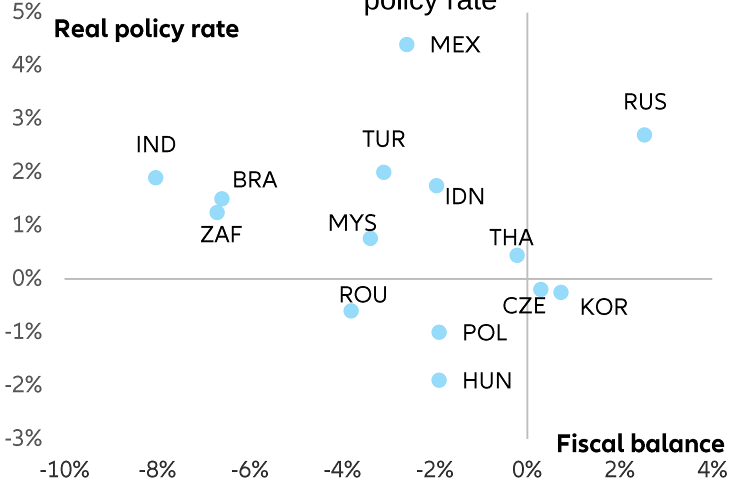
Emerging Markets: Manufacturing PMI, open vs. closed economies



Sources: Bloomberg, Allianz Research

The growth fatigue is broadening in Emerging Markets: open economies still hit by the protectionism wave, but quite closed economies such as India, Russia and South Africa also disappointed.

Emerging Markets: fiscal balance (% of GDP) vs. real policy rate

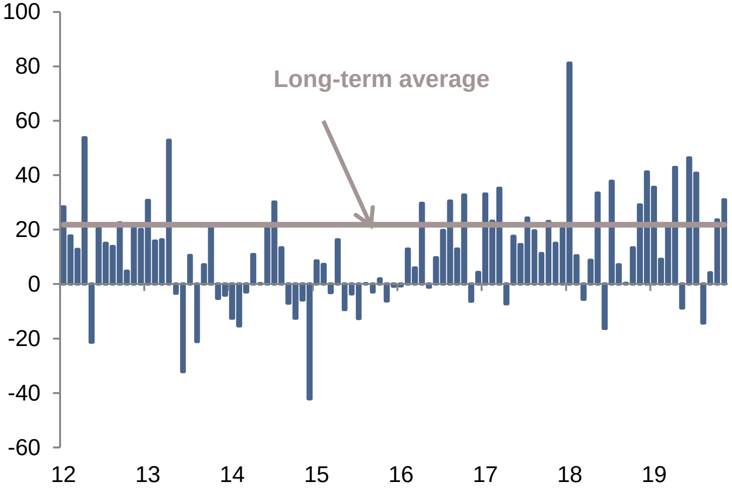


Sources: IHS Global Insight, Allianz Research

Key Emerging Markets, such as EM Asia and EM Europe still have a leeway to ease. Positive surprises could come from Brazil, Russia, Eastern Europe. Bad surprises could come from trade hubs (HK, Singapore, Taiwan), Mexico, Colombia, Saudi Arabia and Middle East. Weak spots prevailing: Argentina, Turkey, South Africa.

EMERGING MARKETS: MIND THE BAD CHOLESTEROL

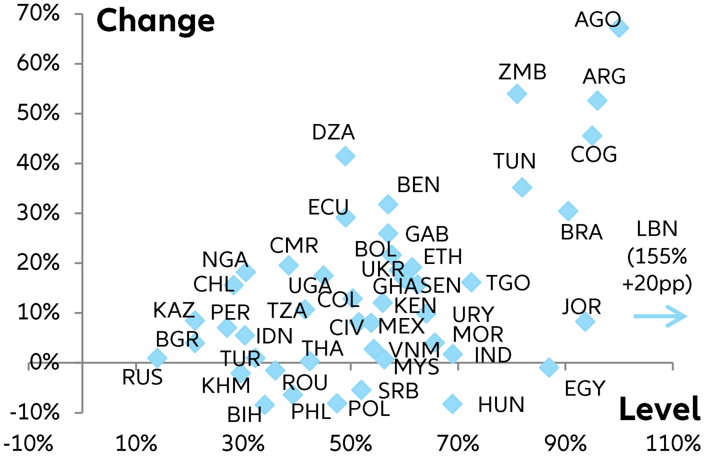
Emerging Markets (excl. China and Russia): Net capital flows, USD bn



Sources: IHS Global Insight, Allianz Research

Capital flows are fickle. Their recovery is somewhat subdued, but push (low rates in advanced economies) and pull (higher yields in emerging markets) are financing a strong pipe of primary issuance in high-yield EM and frontier markets.

Public debt in % of GDP in EMs: level vs. change (between 2013 and 2019)

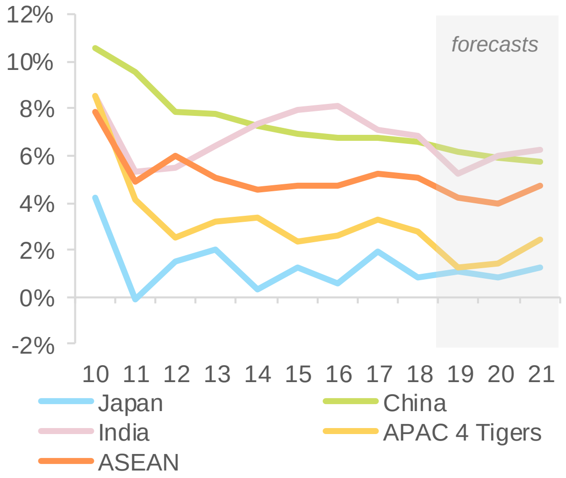


Sources: IHS Global Insight, Allianz Research

The current yield seeking environment is conducive to too much debt accumulation in countries with low domestic savings, so unable to repay at the end with a higher likelihood.

ASIA: MORE SLOWDOWN INTO 2020, WITH POLICY BUFFERS IN PLACE

Real GDP growth



Source: National Statistics, Euler Hermes, Allianz Research

We expect Asia-Pacific GDP growth at 4.3% in 2019, 4.2% in 2020 and 4.5% in 2021.

Monetary policy leeway

	Inflation Target	Inflation 2019 Q3	Inflation latest month	Policy rate	Monetary policy leeway
Australia	2%-3%	1.7%	1.7%	0.75%	
China	3.0%	2.9%	4.5%	4.20%	
India	4.0%	3.5%	4.6%	5.15%	
Indonesia	3.5% +/-1%	3.4%	3.0%	5.00%	
Japan	2.0%	0.3%	0.2%	-0.10%	
Malaysia*	-	1.3%	1.1%	3.00%	
New Zealand	1%-3%	1.5%	1.5%	1.00%	
Philippines	3% +/-1%	1.7%	1.3%	4.00%	
South Korea	2.0%	0.0%	0.0%	1.25%	
Taiwan*	-	0.4%	0.6%	1.38%	
Thailand	2.5% +/-1.5%	0.6%	0.2%	1.25%	
Vietnam*	-	2.2%	3.5%	6.00%	

* no explicit inflation targeting framework

Light red when policy rate < latest inflation, green otherwise

Source: National Statistics, Euler Hermes, Allianz Research

There are policy buffers in place. Central banks are in easing mode, as inflationary pressures in most countries are relatively subdued.

Fiscal policy leeway

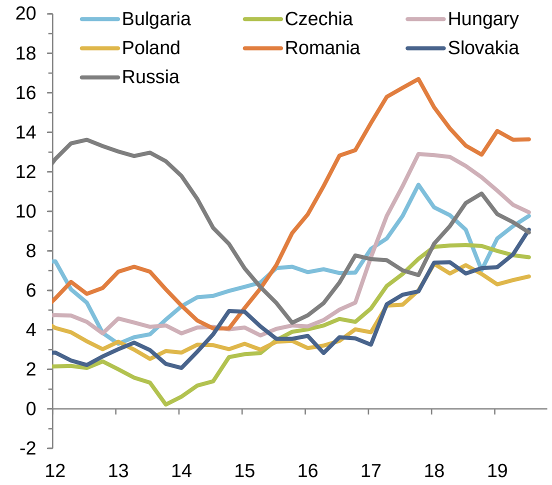
2019E	Fiscal balance % of GDP	Public debt % of GDP	Fiscal leeway
Australia	-0.7%	42%	
China	-6.6%	56%	
Hong Kong	-0.3%	0%	
India	-8.0%	69%	
Indonesia	-2.0%	30%	
Japan	-3.0%	238%	
Malaysia	-3.4%	56%	
New Zealand	0.1%	30%	
Philippines	-1.1%	39%	
Singapore	3.2%	114%	
South Korea	0.7%	40%	
Taiwan	-1.3%	34%	
Thailand	-1.1%	42%	
Vietnam	-4.5%	54%	
Light red	if < -3%	if > 50%	

Source: National Statistics, Euler Hermes, Allianz Research

On the fiscal side, China, India, Japan, the Philippines and South Korea will implement relatively large support. More is needed in countries that have much fiscal leeway, such as Singapore, Indonesia, Taiwan and Thailand.

EMERGING EUROPE : FISCAL POLICY CAN SUPPORT BUT WATCH FOR PRICE PRESSURES

Nominal wage growth (%; 4-qtr mov. avg.)



Sources: National statistics, Eurostat, Allianz Research

Wage growth has peaked in most economies (but still rising in Slovakia and Bulgaria).

Yet it remains elevated, reflecting labor shortages in most countries.

It affects corporate margins as firms can pass on the rising costs only partly to consumers (CPI inflation remains moderate).

Monetary policy leeway

	Inflation target	Inflation Q3 2019	Inflation latest month	Policy rate	Monetary policy leeway
Poland	2.5%	2.7%	2.5%	1.50%	
Czechia	2.0%	2.8%	3.1%	2.00%	
Romania	2.5%	3.8%	3.8%	2.50%	
Hungary	3.0%	3.3%	3.4%	0.90%	
Slovakia*	2.0%	2.9%	2.9%	0.00%	
Croatia	-	0.9%	0.6%	2.50%	
Bulgaria**	2.0%	2.7%	2.4%	0.00%	
Russia	4.0%	4.3%	3.5%	6.25%	
Turkey	5.0%	13.6%	10.6%	12.00%	

* Slovakia is a Eurozone member, thus monetary policy is set by the ECB.

** Bulgaria has currency board with a peg to the EUR, thus it follows the monetary policy of the ECB.

Sources: National statistics, IHS Markit, Allianz Research

Monetary policy is already loose in many countries.

Inflationary pressures remain present in some countries (Czechia, Romania, Hungary, Slovakia).

Russia and **Turkey** likely to cut rates further in Q1 2020 but will need to watch currency volatility.

Fiscal policy leeway, 2019f

	Fiscal balance % of GDP	Public debt % of GDP	Fiscal policy leeway
Poland	-1.9%	47.5%	
Czechia	0.3%	32.0%	
Romania	-3.8%	36.0%	
Hungary	-2.0%	69.0%	
Slovakia	-1.2%	48.0%	
Croatia	0.1%	71.5%	
Bulgaria	0.9%	21.0%	
Russia	2.5%	14.0%	
Turkey	-3.1%	32.3%	
Orange	if <-3%	if >50%	

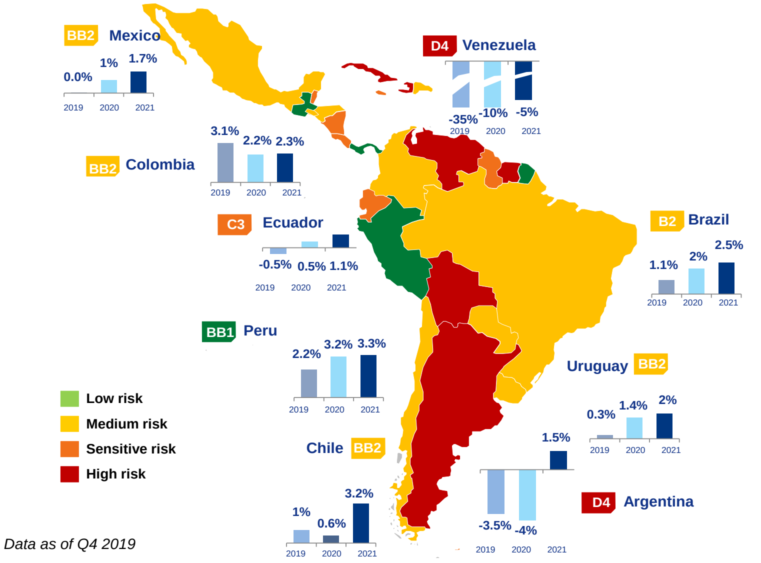
Sources: Eurostat, IHS Markit, Allianz Research

Most countries have fiscal policy leeway.

Most of them have already announced or are implementing some fiscal stimulus measures such as rises in public sector wages and social benefits.

Caution is warranted in Romania, Hungary, Croatia and Turkey.

LATAM: POLITICAL RISK AND A STALLING REFORM MOMENTUM LIMIT GROWTH ACCELERATION



Sources: IMF WEO, Euler Hermes, Allianz Research

After stalling in 2019 (+0.6% exc. Venezuela), LatAm will miss the 2% threshold of growth in 2020 (+1.3%) for the 7th straight year. In 2021, GDP growth should accelerate to a modest +2.2%.

Monetary and fiscal policy leeway

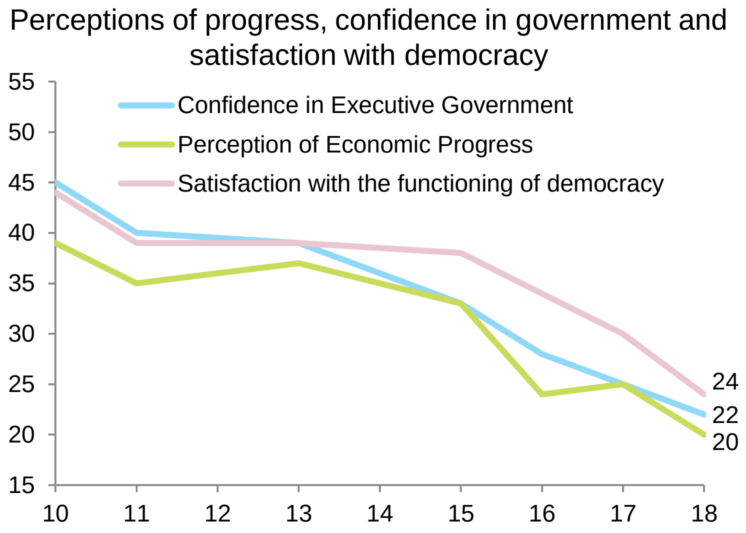
	Inflation target	Inflation Q3 2019	Inflation latest month	Policy rate	Monetary policy leeway
Argentina	30.0%	53.3%	51.4%	58.00%	
Brazil	4.5%	3.2%	3.3%	4.50%	
Chile	3.0%	2.2%	2.7%	1.75%	
Colombia	3.0%	3.8%	3.9%	4.25%	
Mexico	3.0%	3.3%	3.0%	7.50%	
Peru	2.0%	2.0%	1.9%	2.25%	

	Fiscal balance (% GDP)	Public debt (% GDP)	Fiscal policy leeway
Argentina	-4.0%	96.0%	
Brazil	-6.7%	90.6%	
Chile	-2.5%	28.2%	
Colombia	-1.7%	50.4%	
Mexico	-2.6%	53.8%	
Peru	-1.5%	27.0%	
Light red	if <-3%	if >50%	

Sources: IMF WEO, Euler Hermes, Allianz Research

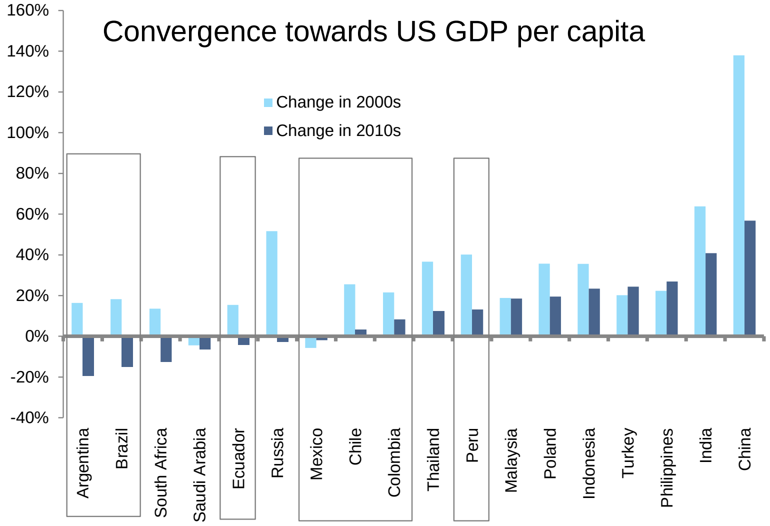
Most central banks have already eased monetary policy. Few countries have fiscal leeway: Chile will increase social spending next year. Hot spots for 2020: Colombia and Mexico. Brazil's risk picture improving but window for reform is narrowing.

LATAM: REDISTRIBUTION AND POLITICAL REFORMS NEEDED TO RESPOND TO PROTESTS



Sources: Latinobarometro, Euler Hermes, Allianz Research

Confidence in political institutions, satisfaction with democracy and perception of progress have almost halved since 2010. This is one clear pattern that could explain renewed social demands and protests.

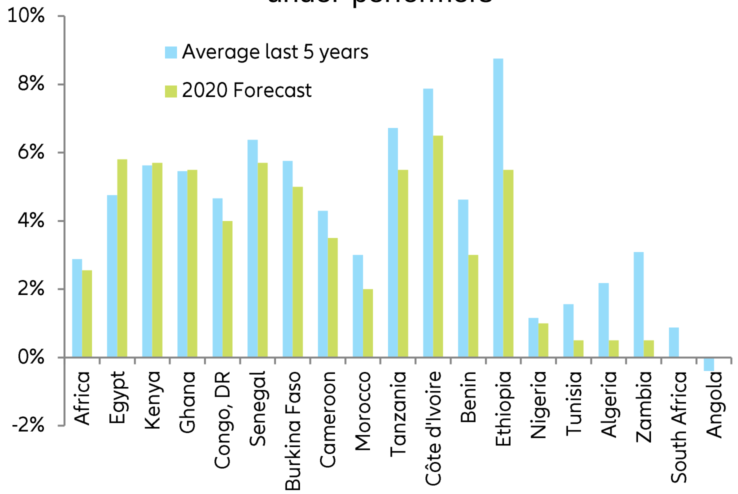


Sources: IMF; Euler Hermes, Allianz Research

Lost decade: in the 2010s see that Latin American countries have either lagged the U.S. per capita growth or converged at a much slower rate compared to the 2000s and compared to other main EM.

AFRICA: NO COUNTRY FOR OLD MEN

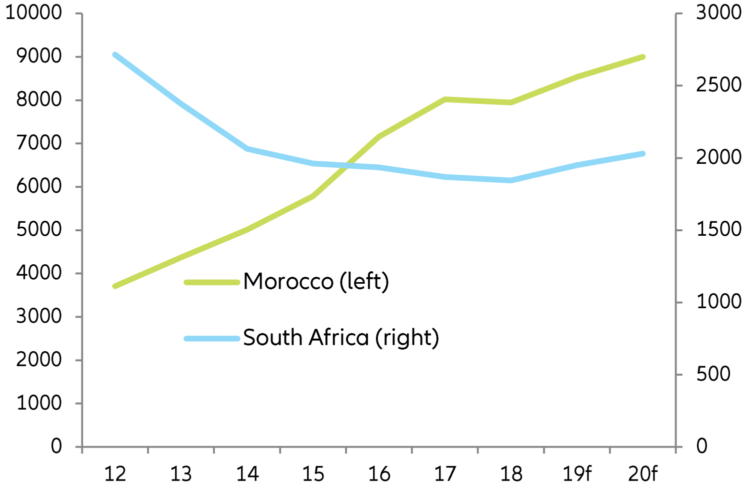
Africa: Growth ranking from over-performers to under-performers



Sources: IHS Global Insight, Allianz Research

Growth is disappointing in many countries in Africa from those exhibiting a deceleration from a high to an intermediate level to those where growth disappeared almost completely

Morocco and South Africa: Insolvencies



Sources: StatSSA, Inforisk, Allianz Research

Low growth is the way for a deterioration of the payment behavior, as shown particularly in Morocco (+7% in 2019 and +5% in 2020) and South Africa (+6% and +4%).

US-IRAN: PARTIAL DÉTENTE, REGIONAL INSTABILITIES

Lasting de-escalation (but not necessarily conflict resolution) (5%)

Oil price:
- Average oil price of 62 USD/bbl (Brent) in 2020

Iran actions:
- No further direct retaliatory actions against the US
- Continued moderate non-compliance with JCPOA, but no acceleration
- Moderate actions by Iran proxies against US allies in the region

US actions:
- No further US sanctions
- No further US attacks

Elsewhere in the Middle East:
- Iraq: US and NATO remain on site, maintaining the status quo
- Syria: increasing influence of Russia and Turkey
- Israel and Lebanon: no impact

Global capital markets:
- Some ST volatility (already seen); no LT impact

Intensified but controlled confrontation (60%)

Oil price:
- Average oil price of 66 USD/bbl (Brent) in 2020

Iran actions:
- Further retaliatory actions against targets with links to the US, most likely through proxies in the region
- Acceleration of non-compliance with JCPOA
- Attacks against oil infrastructure and shipping of GCC states

US actions:
- US sanctions stepped up in 2020, but with limited or no impact as existing sanctions already pose maximum impact
- “Proportionate” retaliation in the event of attacks on US assets

Elsewhere in the Middle East:
- Iraq: US + NATO possibly forced out; greater influence of Iran; resurgences of IS possible
- Syria: increasing influence of Russia and Turkey
- Israel and Lebanon: no impact

Global capital markets:
- Some ST volatility; no LT impact

Full-fledged war (35%)

Oil price:
- Average oil price of 80 USD/bbl (Brent) in the 12 months following the outbreak

Iran actions:
- Further direct retaliatory actions against US targets, possibly also outside the region
- Acceleration of non-compliance with JCPOA
- Attacks against oil infrastructure and shipping of GCC states
- Blocking of Strait of Hormuz

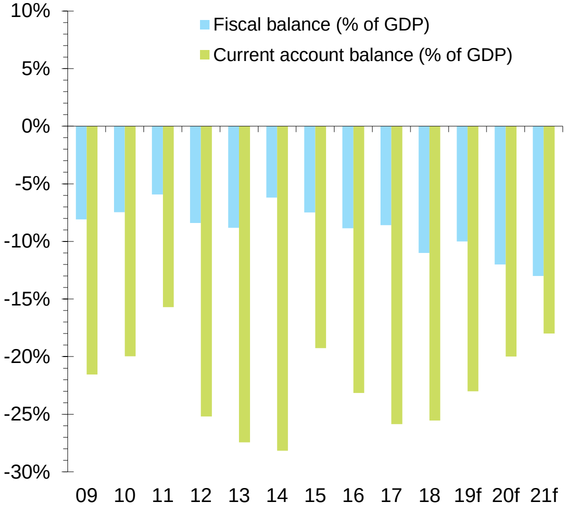
US actions:
- US sanctions stepped up in 2020, but with limited or no impact as existing sanctions already pose maximum impact
- Attacks on Iranian soil

Elsewhere in the Middle East:
- Iraq and Syria: US and NATO forced out; greater influence of Iran, Russia and Turkey; resurgences of IS possible
- Lebanon: increased political instability
- Israel: Hamas, Islamic Jihad and Hezbollah will join in a war against Israel

Global capital markets:
- ST volatility. Significant LT impact on MSCI only if oil prices remain at 80 USD/bbl for longer. Gold price to be likely winner.

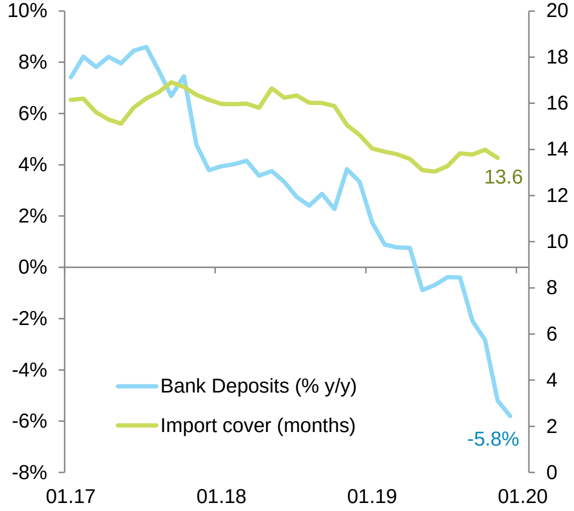
LEBANON: RISK OF CAPITAL CONTROLS AND DEFAULT
SAUDI ARABIA: GROWTH TO REMAIN SUBDUED IN 2020-2021

Lebanon: History of huge twin deficits



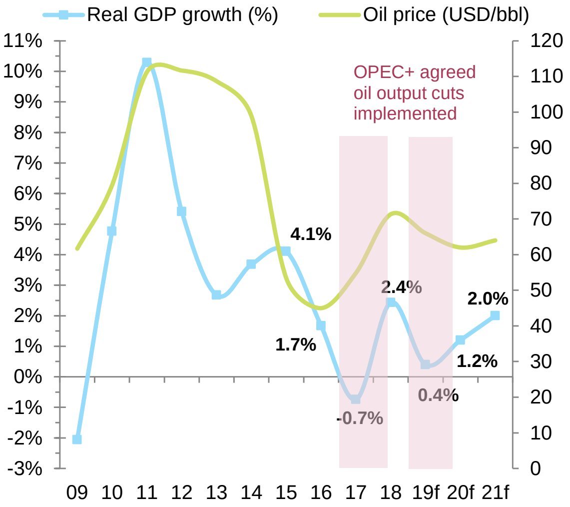
Sources: IHS Markit, IMF, Allianz Research

Lebanon: Bank deposits and FX reserves down



Sources: Byblos Bank, IMF, Allianz Research

Saudi Arabia: Oil still determines growth



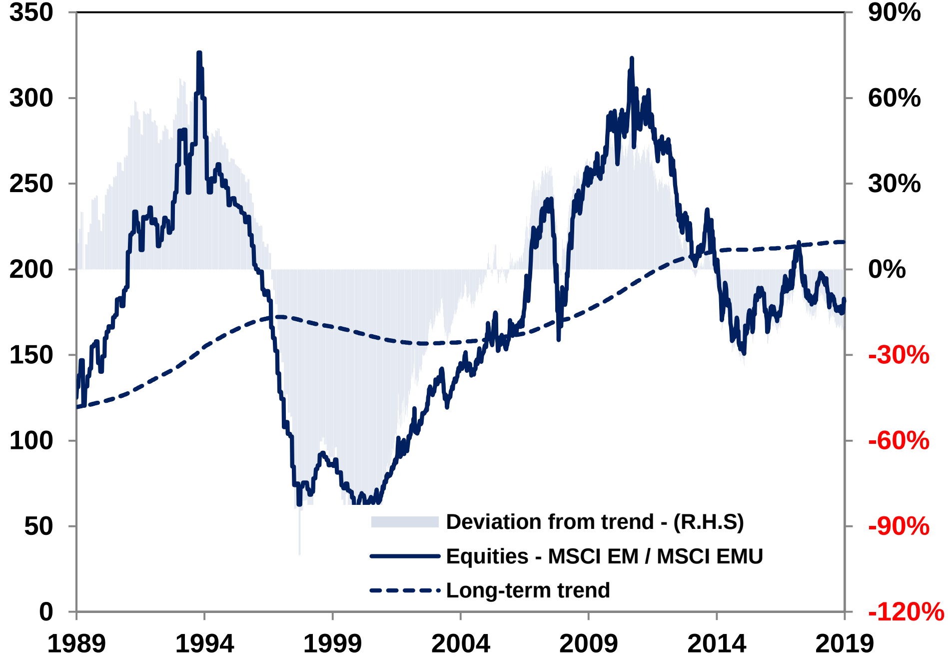
Sources: IHS Markit, National statistics, Allianz Research

- Unsustainably high twin deficits have made Lebanon highly dependent on capital inflows (remittances from expats and aid flows mainly from Gulf region).
- This financing model is now at risk...
- …as confidence in both the fragile political system and the banking system is unravelling rapidly.
- The risks of stepped-up USD shortages, LBP devaluation, liquidity stress in the banking sector (bank runs), shortages of basic goods, non-payment risks for imports, and of a debt restructuring have risen.
- “Soft” capital controls introduced by Lebanese Banking Association (such as restrictions on transfers abroad, caps on USD withdrawals).

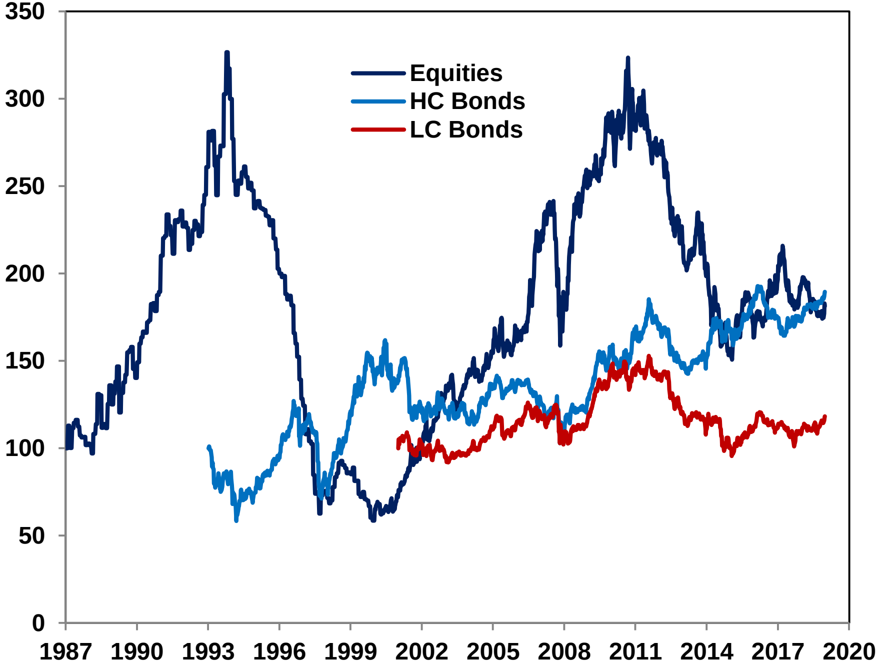
- Recession in H1 2019.
- Monetary easing (in line with US Fed) and heavy fiscal stimulus is underway.
- Yet, annual GDP growth to remain weak as long as the “OPEC+ agreed oil output cuts” remain in place (agreed until March 2020; we expect an extension at least until end-2020).

EM EQ: EM EQUITIES HAVE DISAPPOINTED FOR A LONG TIME

EM equities vs EMU equities: relative total return in common currency terms (unhedged)

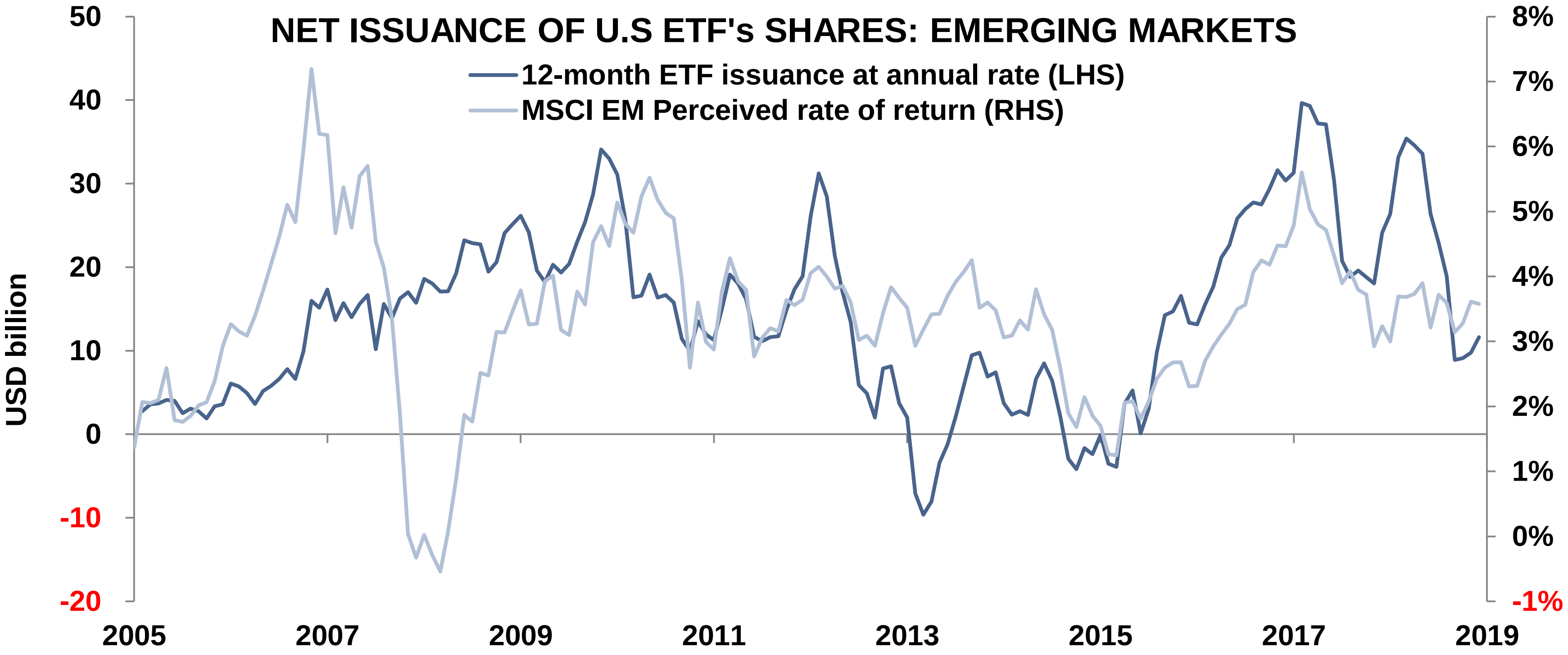


EM vs EMU: Equities and Bonds relative unhedged total return



Sources: Refinitiv, Allianz Research

INVESTMENT FLOWS & RETURNS: A CHICKEN AND EGG PROBLEM?



Sources: Refinitiv, Allianz Research

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