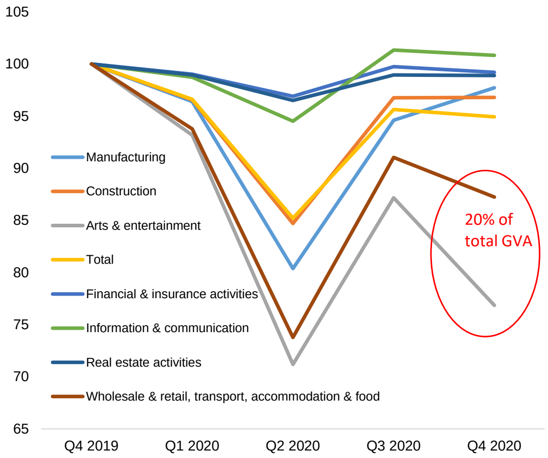
RACE TO THE POST COVID-19 RECOVERY: 7 OBSTACLES TO OVERCOME

Allianz Research

1 April 2021

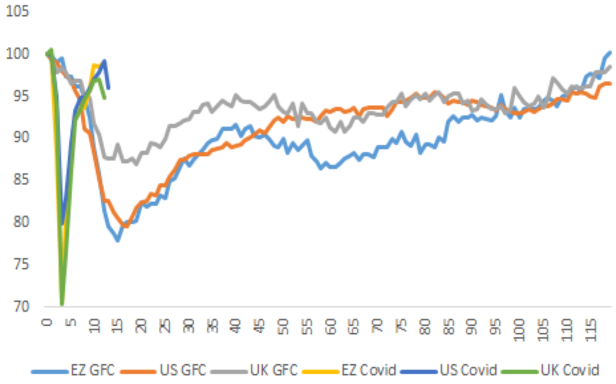
GLOBAL: K-SKAPE RECOVERY PREVAILS

Eurozone gross value added by sector, Index: 100 = Q4 2019



Sources: Refinitiv, Allianz Research

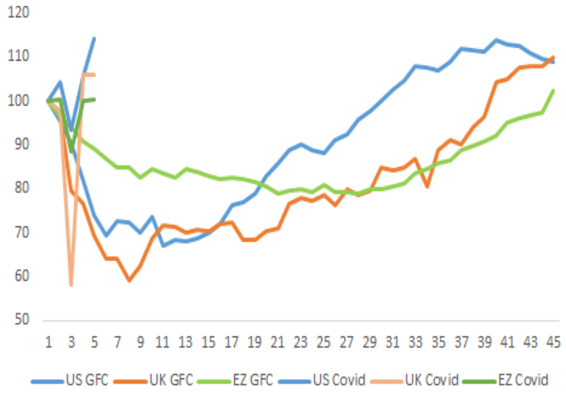
Manufacturing production, Index: 100 = pre-crisis output level (in months)



Notes: GFC (Global Financial Crisis 2007-09); GVA (Gross value added).

Sources: Eurostat, Allianz Research

Residential investment, Index: 100 = pre-crisis output level (in quarters)



Notes: GFC (Global Financial Crisis 2007-09); GVA (Gross value added).

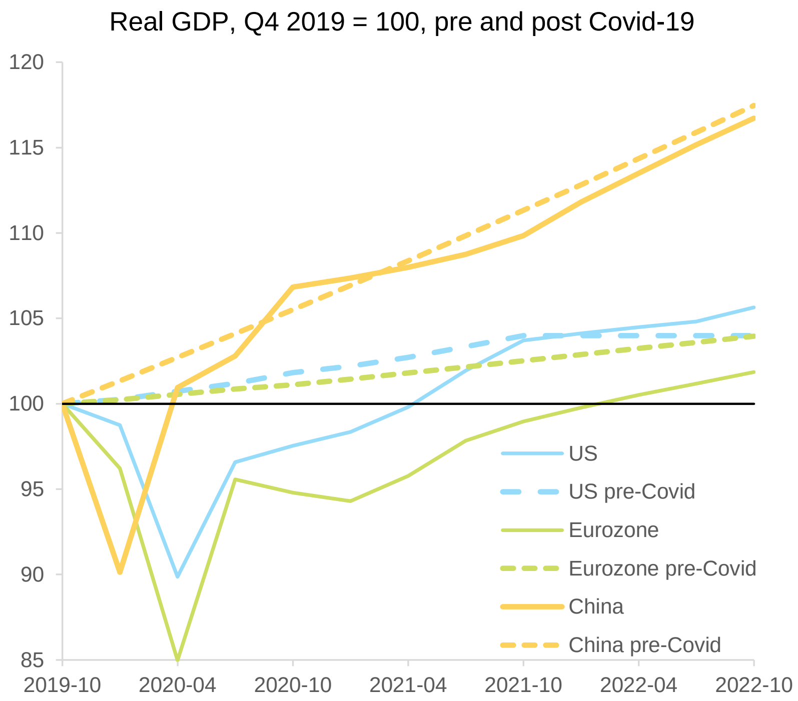
Sources: Eurostat, Allianz Research

80% of the economy is growing at a reasonably good speed while Covid-sensitive sectors remain in the doldrums.

The manufacturing recovery has been V-shaped but shows signs of weakness due to growing supply chain tensions.

Savings have been directed into the residential housing market. The boom should remain strong in the US.

GLOBAL: MULTI-SPEED BUMPY RECOVERY



Sources: national statistics, Allianz Research

	2019	2020	2021	2022
World GDP growth	**2.4**	**-3.6**	**5.1**	**4.0**
United States	2.2	-3.5	5.3	3.8
Latin America	**0.2**	**-7.1**	**3.9**	**2.9**
Brazil	1.4	-4.4	2.8	2.3
United Kingdom	1.4	-9.9	3.7	5.9
Eurozone members	**1.3**	**-6.6**	**4.0**	**4.0**
Germany	0.6	-5.3	3.4	3.8
France	1.5	-8.2	5.4	3.6
Italy	0.3	-8.9	4.1	4.0
Spain	2.0	-11.0	4.8	5.7
Russia	2.0	-3.1	2.5	3.0
Turkey	0.9	1.8	6.6	4.1
Asia-Pacific	**4.1**	**-1.1**	**6.6**	**4.7**
China	6.0	2.3	8.2	5.4
Japan	0.3	-4.9	2.8	1.9
India	4.1	-7.5	10.7	6.4
Middle East	**0.1**	**-5.2**	**2.8**	**2.2**
Saudi Arabia	0.3	-4.1	2.5	2.3
Africa	**1.7**	**-3.2**	**2.4**	**3.4**
South Africa	0.3	-7.1	1.9	2.1

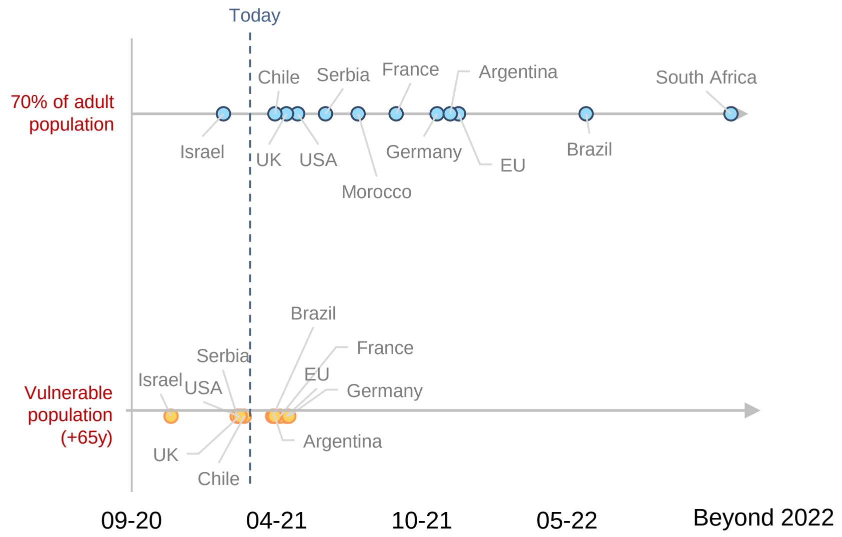
** Weights in global GDP at market price*

NB: fiscal year for India

Sources: national, Allianz Research

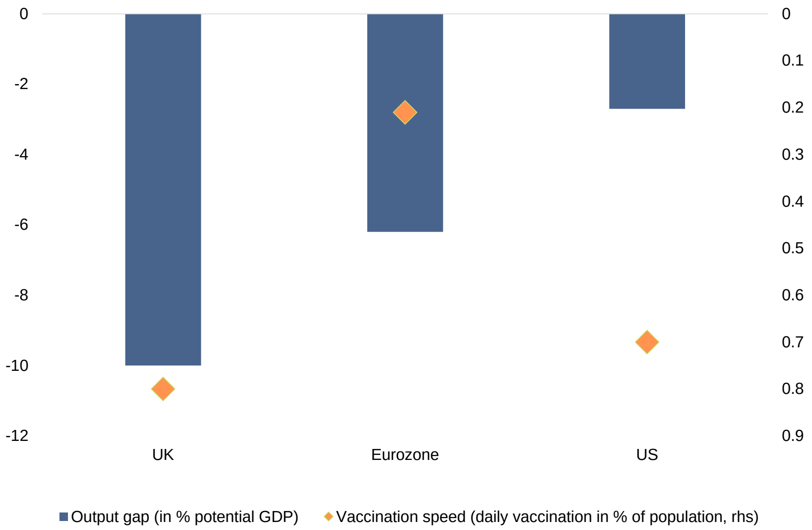
OBSTACLE 1: FORMULA 1 RACE ON VACCINATION

Expected date of herd immunity
(at current vaccination speed)



Sources: Our World in Data, Duke University, Allianz Research

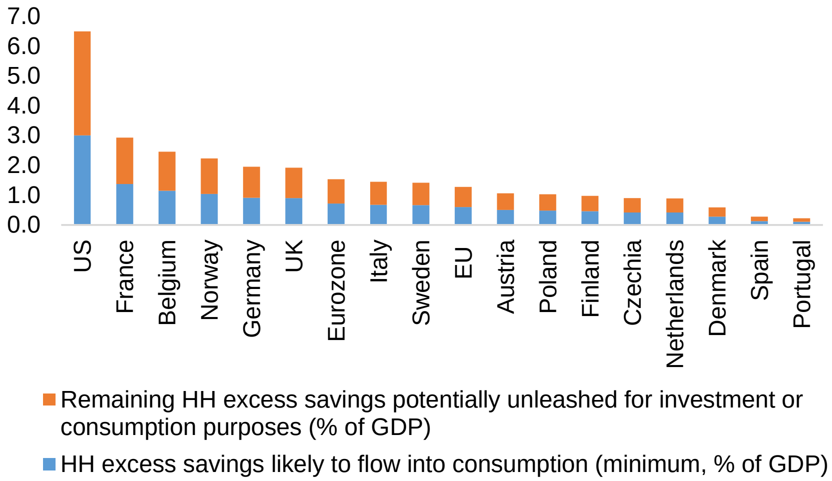
Estimate growth output gap vs. vaccination speed



Sources: Our World in Data, Allianz Research

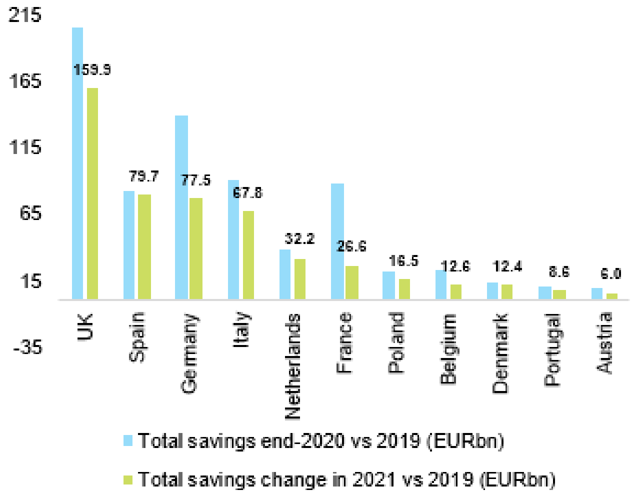
OBSTACLE 2: EXCESS SAVINGS AT AROUND 40% ABOVE PRE-CRISIS LEVELS AT END-2021

European & US household savings, % of GDP, usage 2021



Sources: Fred, Eurostat, Allianz Research

Excess savings in Europe, bn EUR

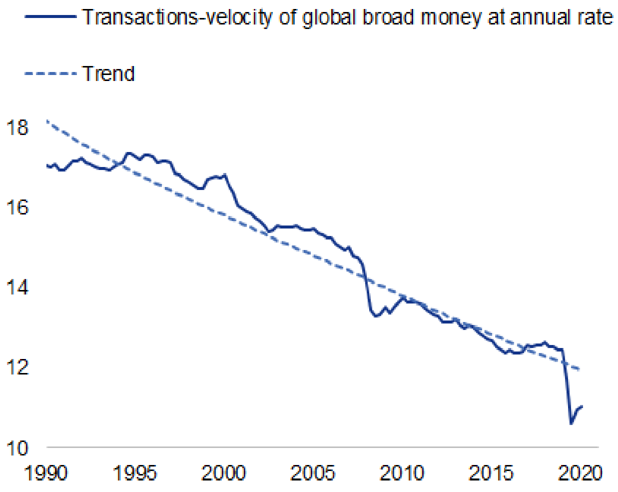


Sources: Eurostat, Allianz Research

In the US, we expect the savings rate to normalize at around 7% (compared with 20.5% in January 2021) of gross disposable income at the horizon of end-2022. In 2020, Eurozone household savings increased by EUR530bn or +40% compared to pre-pandemic levels. Out of this, we expect EUR180bn to be unleashed in 2021 in the Eurozone or 1.5% of GDP. Overall, at end-2021, we expect Eurozone savings to remain 37% still above pre-pandemic levels (or close to EUR350bn, 2.9% of GDP).

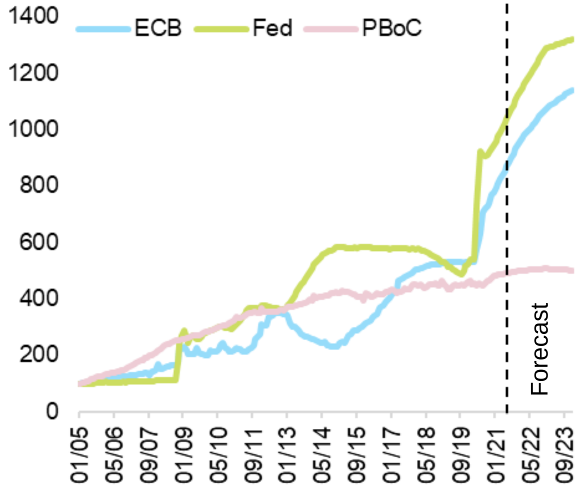
OBSTACLE 3: HIGH RISK OF POLICY MISTAKES WHEN PHASING-OUT ASSISTANCE MECHANISMS

Global speed of money circulation



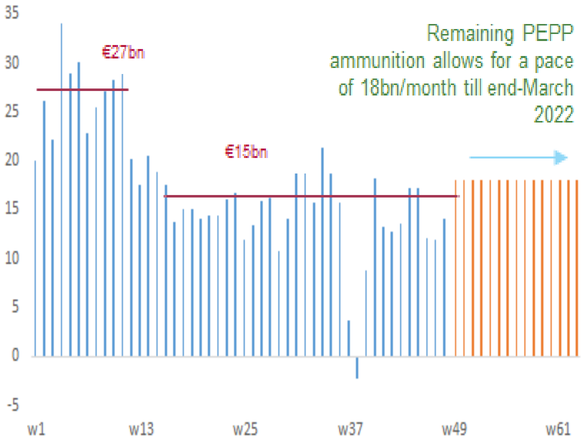
Sources: various, Allianz Research

Central banks' balance sheets (Index Jan 2005 = 100)



Sources: Refinitiv, Allianz Research

ECB: Weekly PEPP purchases (EUR bn)



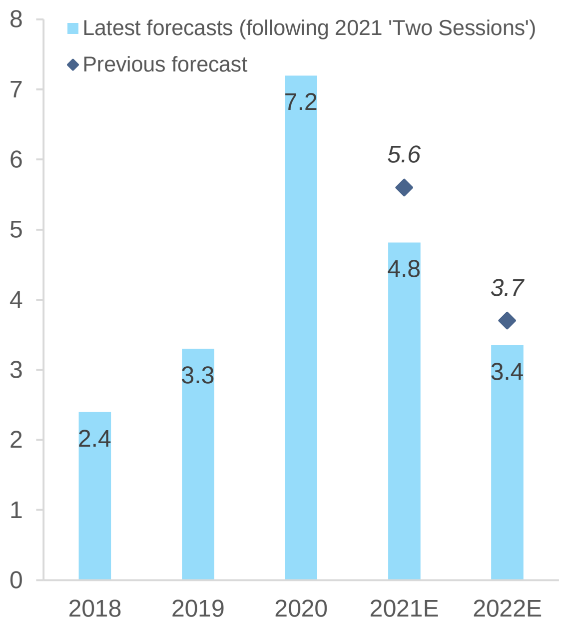
Sources: Refinitiv, ECB, Allianz Research

The propensity to hold idle money balances has increased with the pandemic. Private agents have hoarded money rather than spent it, similarly to 2008-09.

The Fed will start to gradually taper the pace of asset purchases as early as H2 2022. Meanwhile the ECB remains committed to preserving favorable financial conditions. Implicit yield curve control will however require stepped-up PEPP purchases in Q2&Q3 when US-EZ economic divergence may be most pronounced, fueling calls for another PEPP increase.

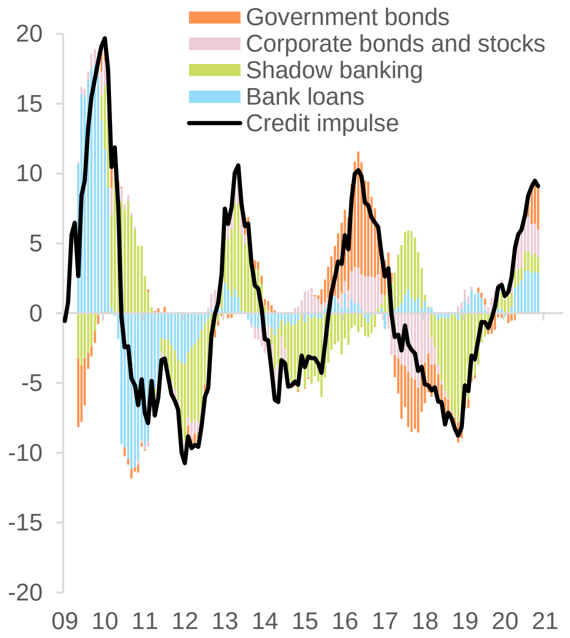
CHINA'S POLICY TIGHTENING: FIRST TO NORMALIZE?

Fiscal stimulus (% of GDP)



Sources: national statistics, Allianz Research

Proprietary credit impulse index



Sources: national statistics, Allianz Research

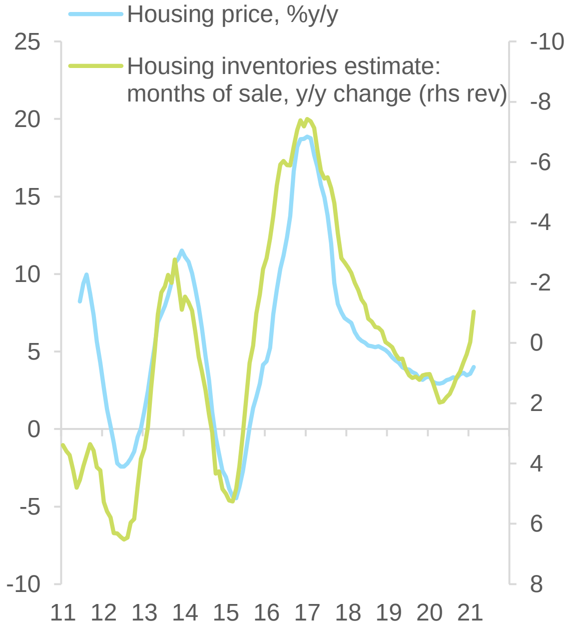
Comparison of monetary easing episodes in China, based on our proprietary credit impulse index

	2008-09 Great Financial Crisis (GFC)	**2012** Eurozone sovereign debt & China real estate cooling	**2015-16** China stock market collapse & RMB scares	**2020** Covid-19 crisis
Date of shock	September 2008	May 2012	June 2015	January 2020
Date of start of monetary easing	January 2009	May 2012	June 2015	January 2020
Date of peak of monetary easing	January 2010	May 2013	May 2016	October 2020
Duration of monetary easing	**12 months**	**12 months**	**11 months**	**9 months**
Intensity of monetary easing, compared to GFC	**100%**	**100%**	**72%**	**41%**

Sources: national statistics, Allianz Research

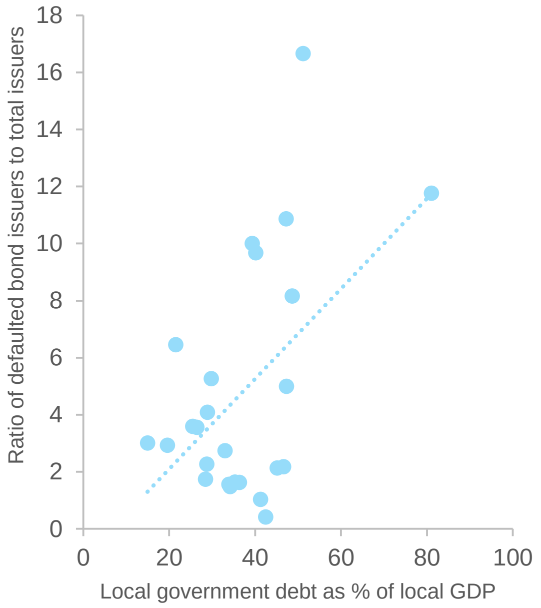
CHINA'S TIGHTENING: NOT BE A WALK IN THE PARK

Real estate sector: prices and inventories (right-hand scale inverted)



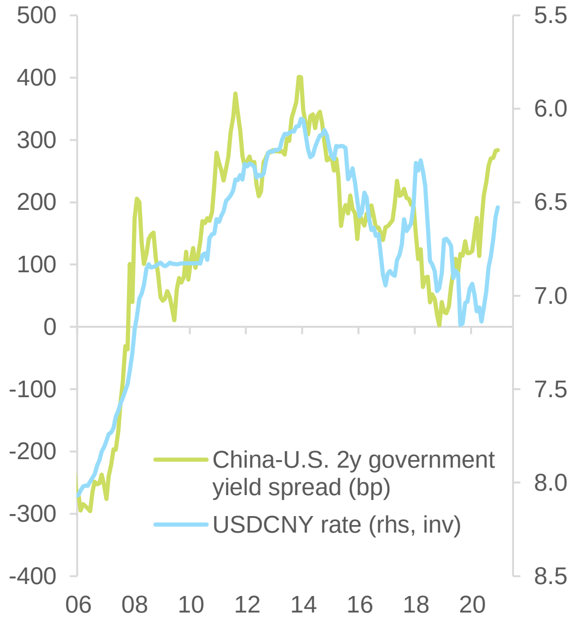
Sources: national statistics, Allianz Research

By province: 2019 provincial debt-to-GDP ratio vs. Corporate bond default ratio



Sources: Wind, Allianz Research

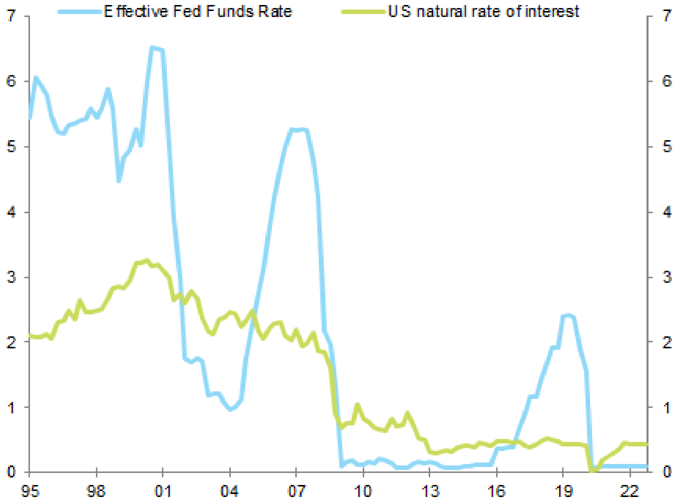
USDCNY and Government yield spread



Sources: Refinitiv, Allianz Research

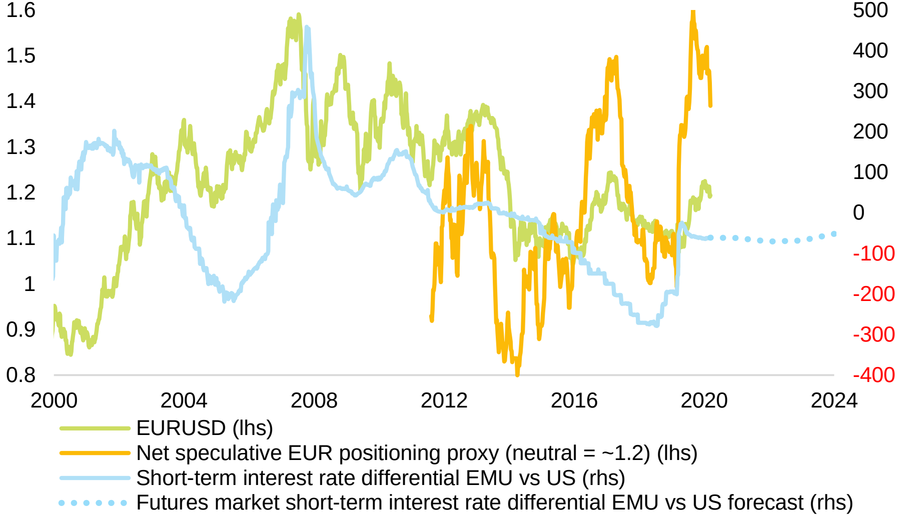
US: THE FED WILL KEEP A COOL HEAD

US: Fed Funds target rate (%)



Sources: Refinitiv, Allianz Research.

EURUSD vs Interest rate differential



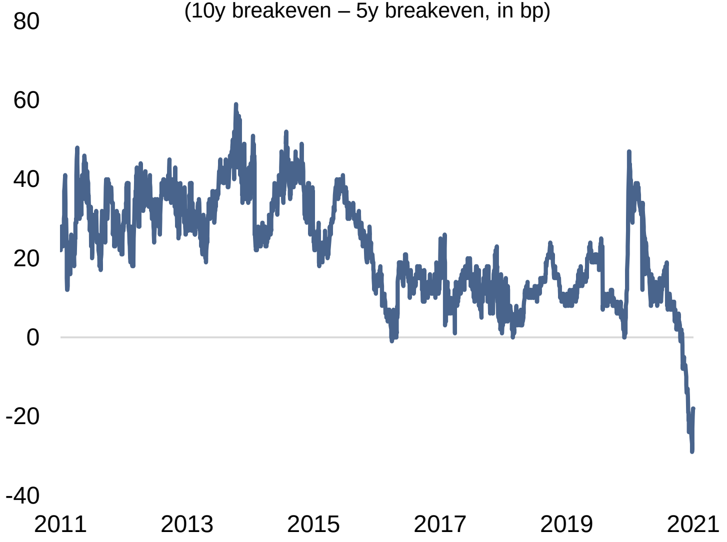
Sources: CFTC, Refinitiv, Allianz Research

When considering the level of the natural level of interest (below which the FFR becomes inflationary), the US monetary policy can be deemed as being only moderately accommodative, allowing the Fed to wait and see before really considering the case of tapering (starting in H2 2022) and a rate hike (H2 2023)

Speculative positioning show that, tactically, investors are betting on the dollar. Looking at the market implied interest rate differential it is quite revealing that money markets have yet to buy the USD appreciating story as they still price in a flat interest rate differential until 2024. We still believe in a range trading EURUSD for 2021 (1.22 with upside volatility pockets) with a mild structural appreciation of the USD in 2022 to 2024.

US YIELDS: WHAT IS REALLY PRICED IN?

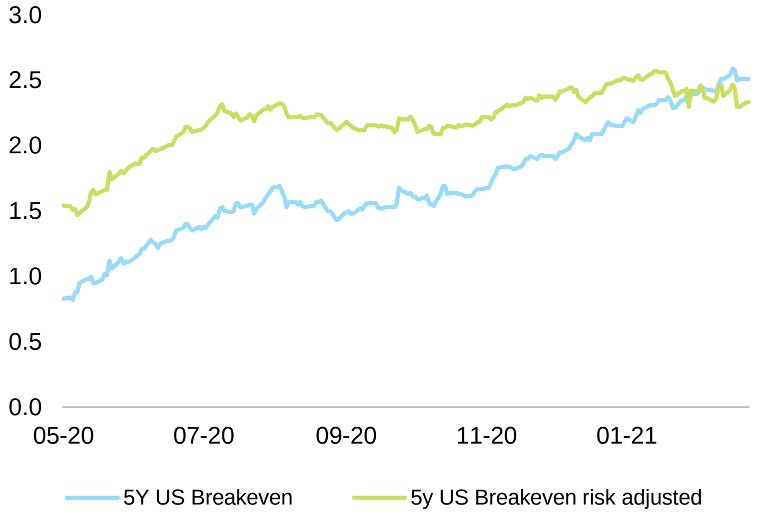
US Inflation curve strongly inverted
(10y breakeven – 5y breakeven, in bp)



Sources: Refinitiv, Allianz Research

US 5y breakeven trade 30bp over US 10y breakeven. Markets thus price no new inflation regime but temporary effects.

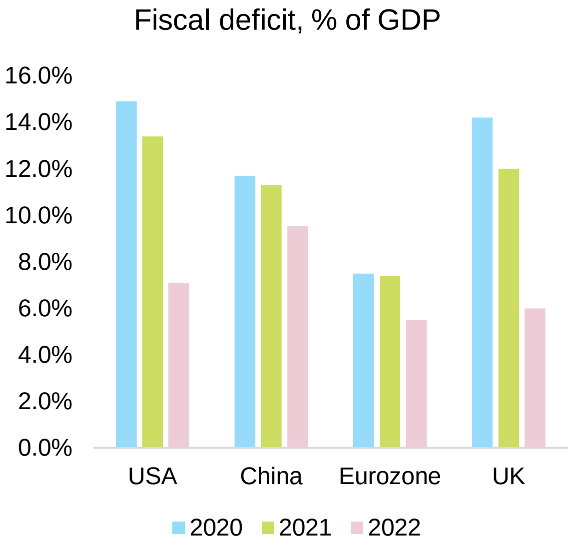
Uncertainty not expectations are repriced
(US 5Y breakeven rates, in %)



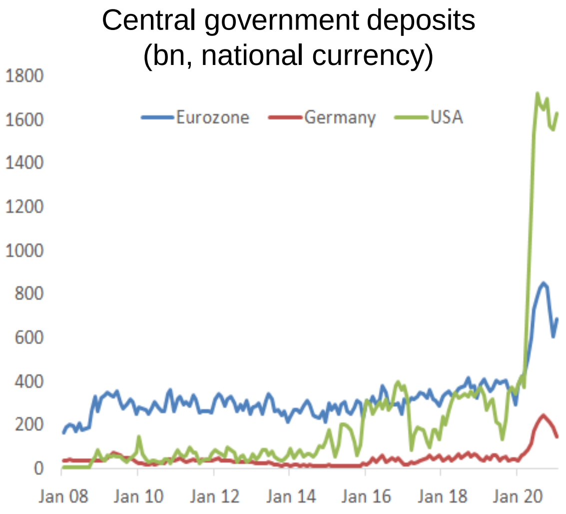
Sources: Refinitiv, Allianz Research

When adjusting breakeven rates for the uncertainty component (term premium) one sees that inflation expectation peaked in February. Recent rise in breakeven is due to a repricing of uncertainty mainly about Fed policy timeline (tapering).

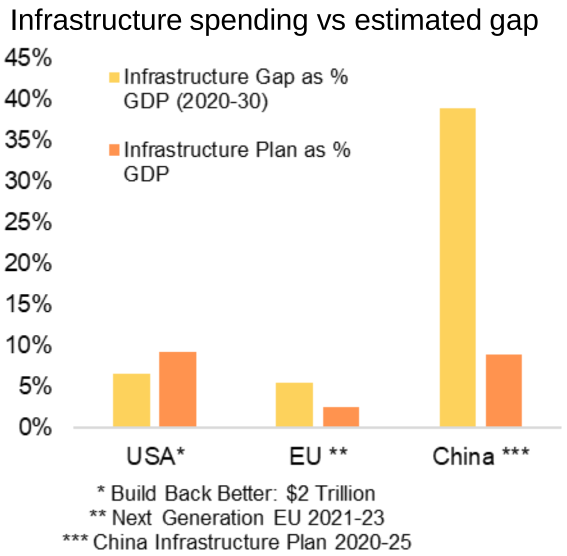
OBSTACLE 4: CROWDING-IN VS. CROWDING-OUT EFFECTS ON INVESTMENT ARE NOT YET RESOLVED



Sources: various, Allianz Research



Sources: Eurostat, Allianz Research



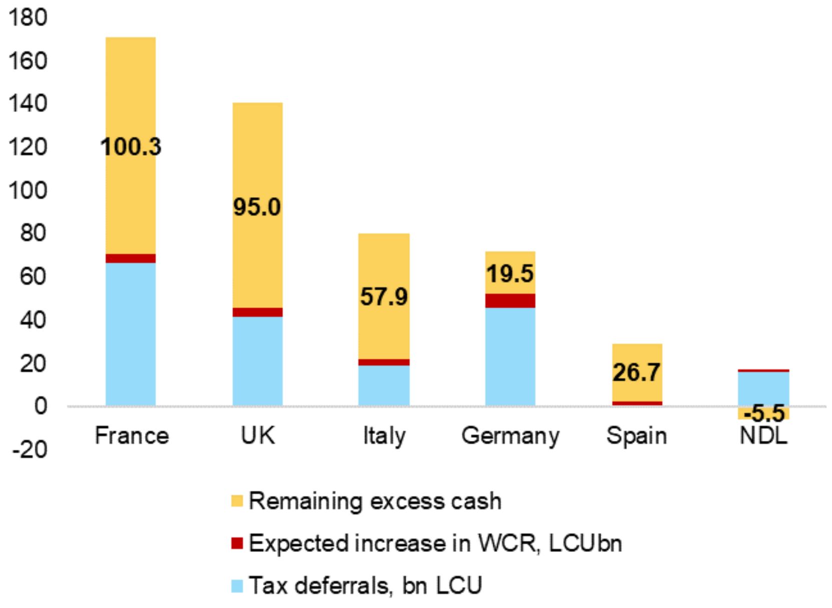
Sources: various, Allianz Research

Most countries have adopted record high fiscal stimuli which are expected to continue into 2021-22. As significant funds remain unspent - Eurozone governments have amassed excess deposits of 3% of GDP – these could provide additional stimulus in 2021.

The US will spend the double compared to their infrastructure needs (i.e. USD2tn). Europe allocates 1.7% of GDP for infrastructure spending, less than one third compared to the estimated gap.

CORPORATE SAVINGS: UNEVENLY DISTRIBUTED AMONG COUNTRIES AND SECTORS

Increase of working capital requirements and tax deferrals vs. NFC "excess cash", bn LCU, as of Feb 2021



Sources: various, Euler Hermes, Allianz Research

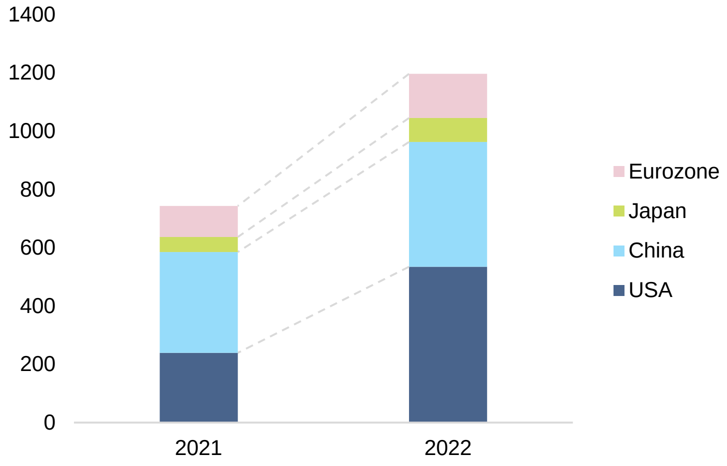
Expected investment recovery due to cyclical demand recovery

	Germany	France	Italy	UK	USA
Capacity utilization gap to normal end 2020 (pp)	-5.0	-7.5	-3.6	-9.4	-2.4
Average capacity utilization 2008-2019	77%	84%	75%	80%	77%
Business investment to demand elasticity	0.006	0.008	0.012	0.017	0.010
Business investment gains from demand normalization					
%	**3.1%**	**6.0%**	**4.4%**	**17.2%**	**2.5%**
bn LCU	1.5	2.4	1.1	1.9	272

Sources: various, Euler Hermes, Allianz Research

CORPORATE DEBT: REDEMPTIONS & HIGHER INTEREST CHARGES TO REDUCE CASH FLOW IN 2022

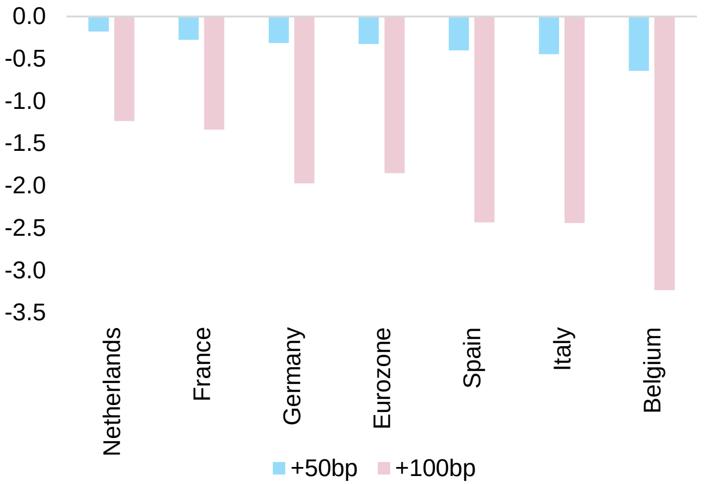
Redemptions of corporate bonds issued by NFC
(in USD bn)



Sources: Refinitiv, Allianz Research

Corporate bonds redemptions will increase by more than 70% in 2022 – and double in the US.

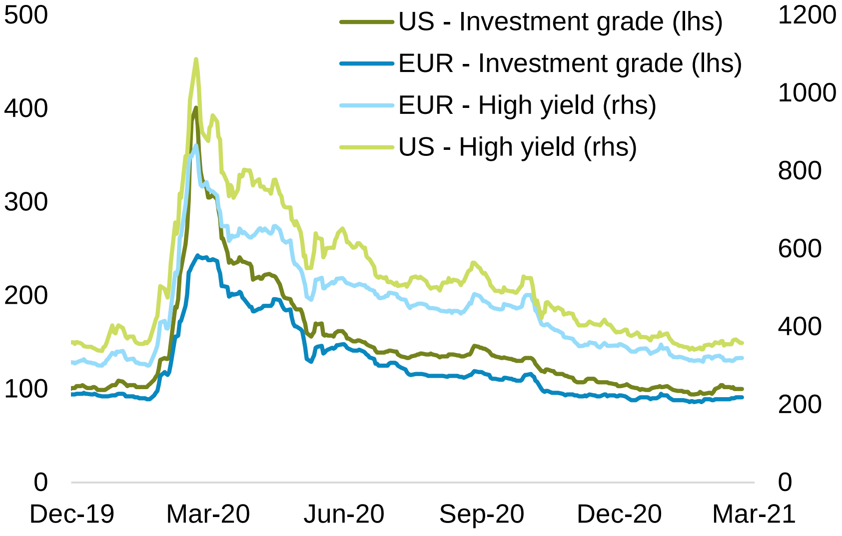
Increase in NFC interest payments,
impact on margins, pp



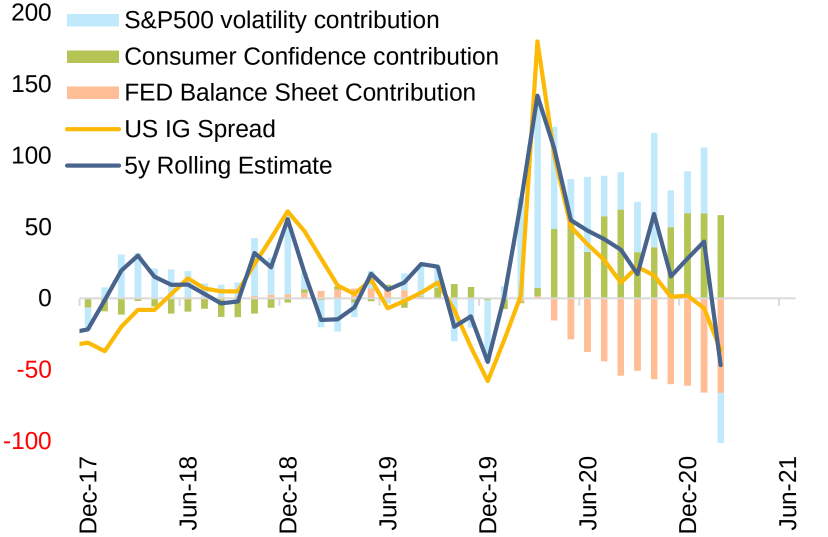
Sources: ECB, Allianz Research

A rise of at least +50bp per year in bank interest rates would be equivalent to an increase of EUR15bn in the Eurozone or +0.8pp of the operating surplus to close to 4%. In terms of impact on margins, it would go to -2pp in 2023.

CORPORATE CREDIT: QE DEPENDENT



Sources: BofA, Refinitiv, Allianz Research



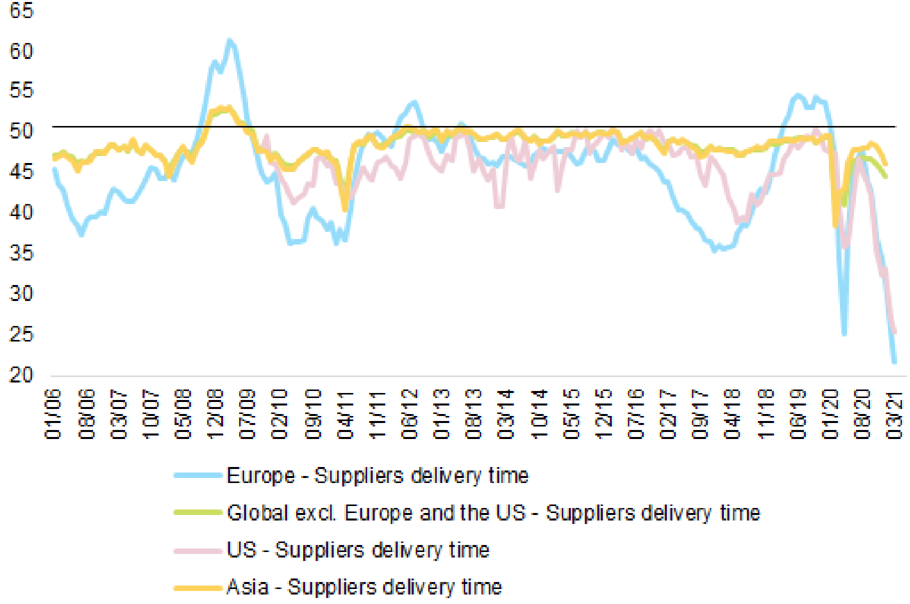
Sources: BofA, Refinitiv, Allianz Research, computed using 5y rolling coefficients

Due to historically tight valuations, the probability of experiencing higher spreads in the near future far outpaces the probability of experiencing tighter spreads. With that in mind, we still expect central banks to be unable to withdraw their current support should widening pressures come into place due to spikes in market volatility.

With central banks keeping an anchor on spreads, we expect investment grade spreads to timidly widen due to a deteriorated economic outlook but to remain close to current levels with QE compensating for extra volatility and sentiment deterioration. The same logic applies to EUR IG corporates, which currently depict a similar pattern.

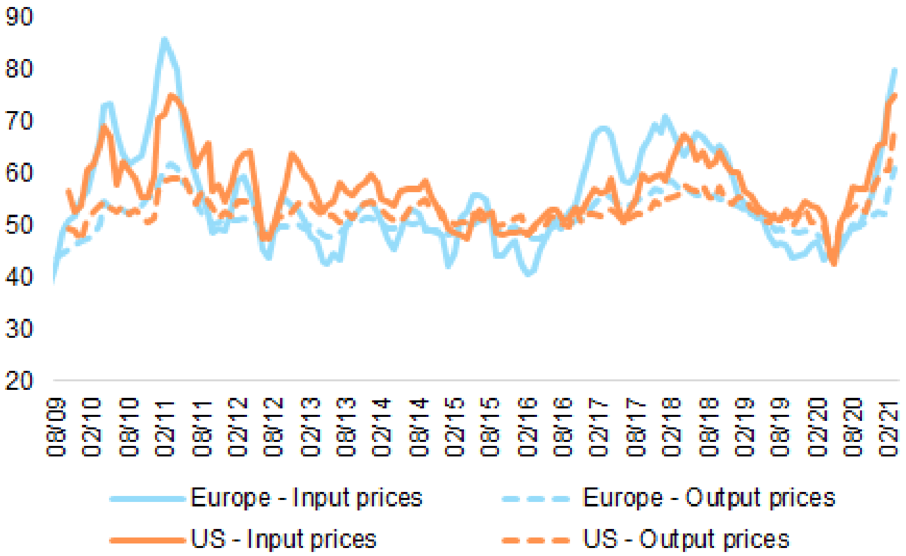
OBSTACLE 5: BOTTLENECKS IN THE GLOBAL SUPPLY CHAIN BACK TO PANDEMIC PEAKS (I)

Suppliers' delivery times (below 50 = disruption)



Sources: Markit, Allianz Research

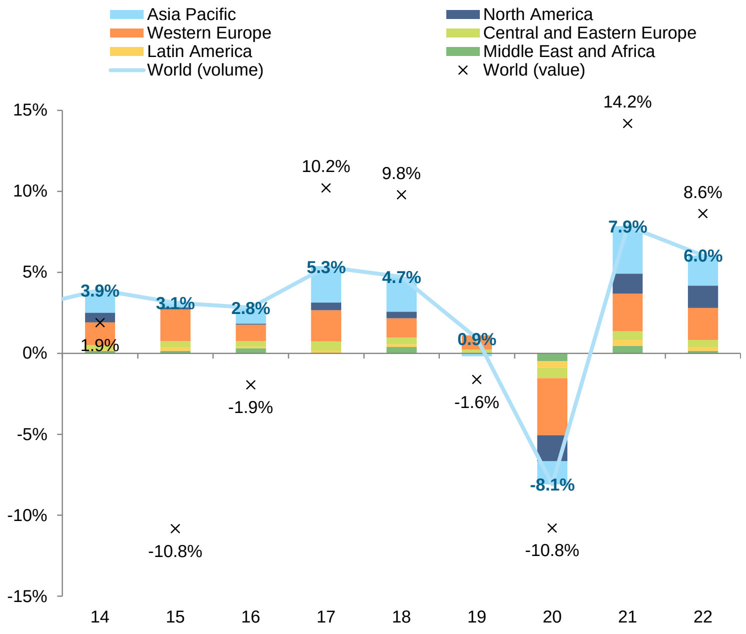
Manufacturing sector – input vs output price index (above 50 = rising)



Sources: Markit, Allianz Research

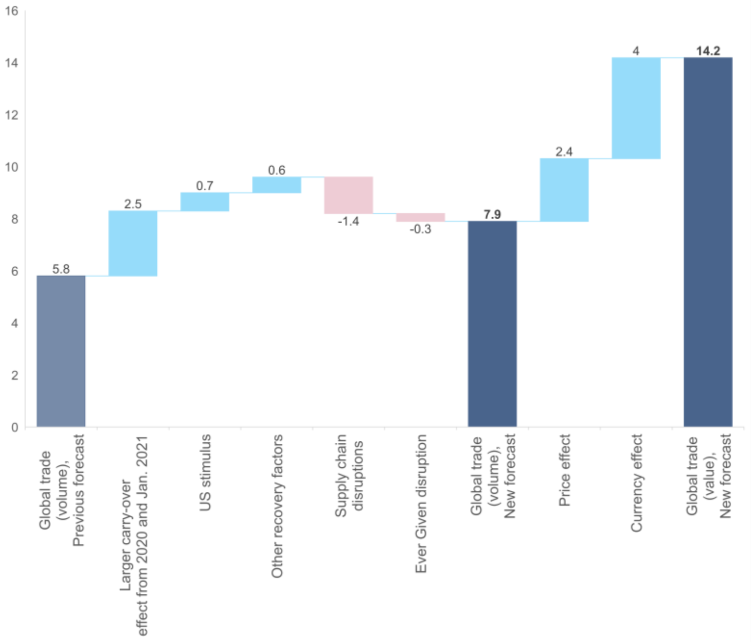
OBSTACLE 5: BOTTLENECKS IN THE GLOBAL SUPPLY CHAIN BACK TO PANDEMIC PEAKS (II)

Global trade growth, goods and services, %y/y



Sources: IHS Markit, Euler Hermes, Allianz Research

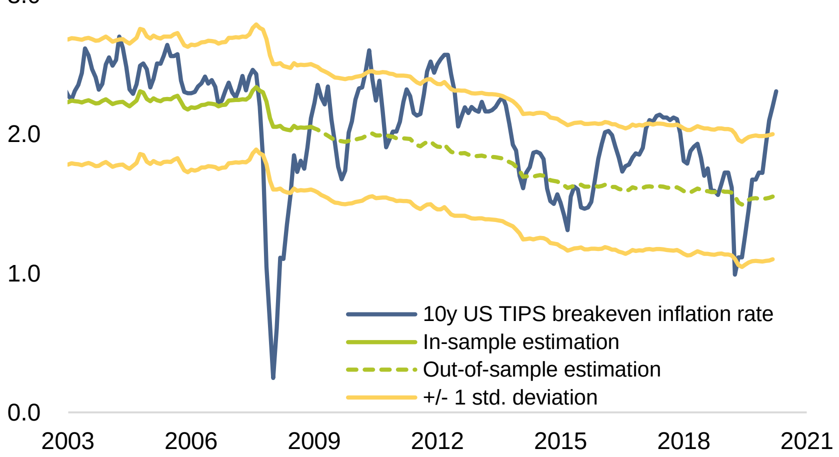
2021 global trade growth forecast, %y/y



Sources: IHS Markit, Euler Hermes, Allianz Research

OBSTACLE 6: TEMPORARY OVERSHOOT OF INFLATION (I)

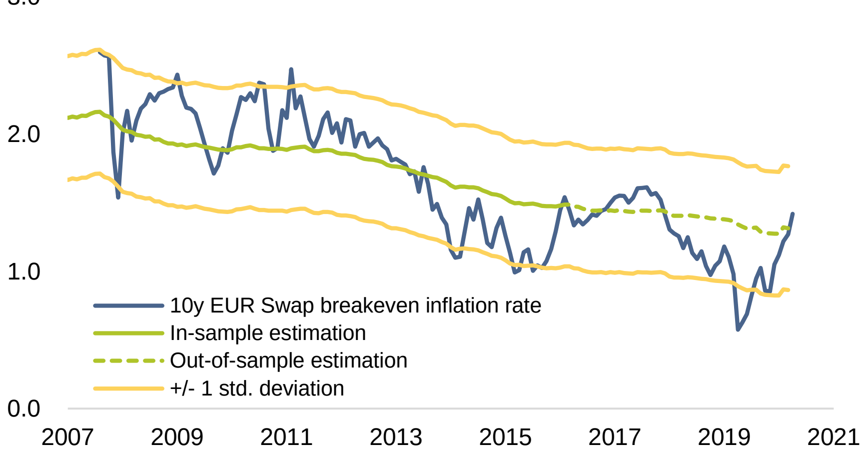
US 10y breakeven inflation rate (in %)



Sources: Refinitiv, Allianz Research

US long-term market-based inflation expectations remain above the +1 standard deviation level inferred by our valuation model. This substantial deviation from fair value (~1.6%) is to be expected as the Federal Reserve remains committed to the average inflation targeting strategy allowing for a temporary inflation overshoot. Nonetheless, we remain skeptical when it comes to the underlying structural nature of this inflation repricing. Consequently, we believe US long-term inflation expectations to have little upside potential left.

EUR 10y breakeven inflation rate (in %)

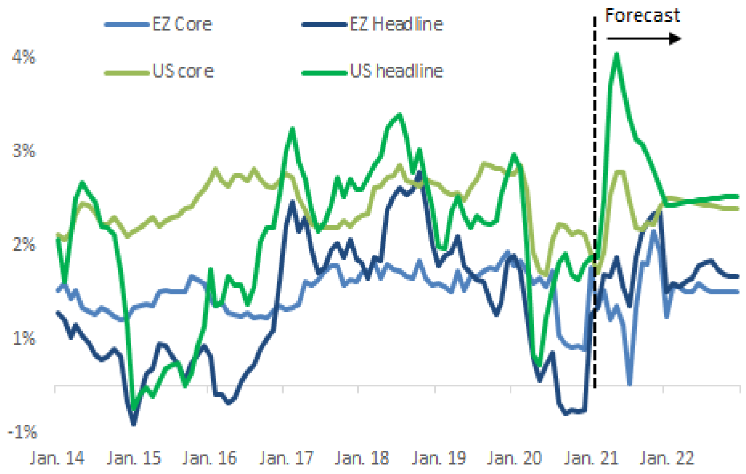


Sources: Refinitiv, Allianz Research

In the case of the Eurozone, our proprietary model shows that long-term market-based inflation expectations have re-converged towards fair value (1.3%). With the upper bound of our model at ~1.8%, we still believe that 10y EUR inflation breakeven rates can rise by 20 to 30bps allowing the current reflationary rotation a little more room to maneuver and facilitating the continuation of the recent over performance of EUR equity vs US equity.

OBSTACLE 6: TEMPORARY OVERSHOOT OF INFLATION (II)

US vs. Eurozone headline inflation (%)



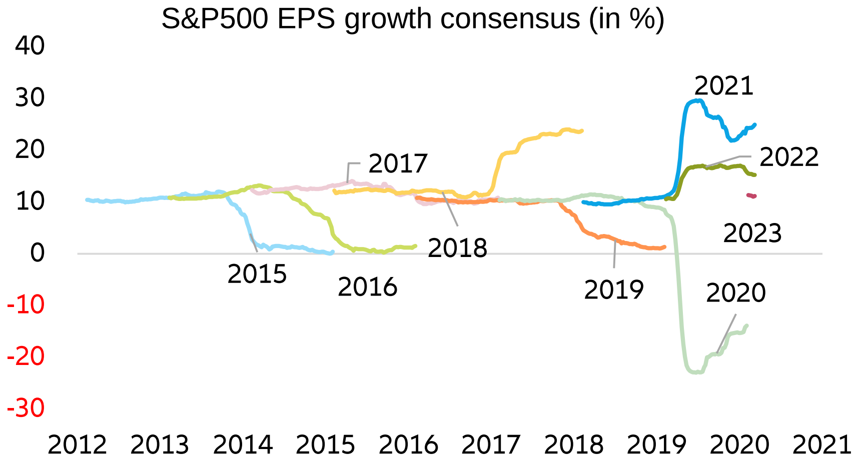
Sources: Refinitiv, Allianz Research

Inflation will temporarily overshoot in 2021 – reaching 3.5%y/y in the US and rising close to 2%y/y in the Eurozone – propped up by the input price bonanza and the reopening of the economy. But we forecast Eurozone inflation to stabilize with 1.2% in 2022 after 1.3% in 2021. In the US we expect inflation to moderate to 2% in 2022 after 2.5% in 2021.

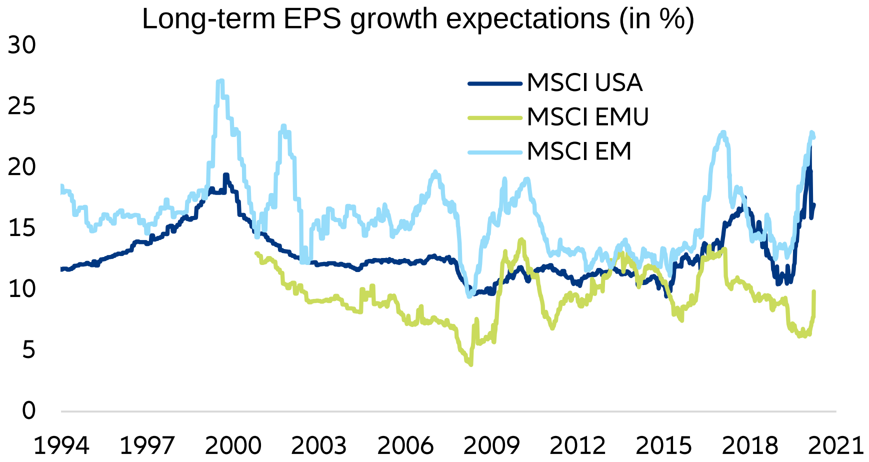
	Reflation (temporary, relative)	Stagflation (structural, generalized)
Lockdown economics	**Demand**: Pent up demand but uncertainty (and demographics) keep precautionary savings high	Fast riding demand creates pervasive price acceleration, and negative real growth shock
	Supply: Higher commodity prices / transportation costs are temporary and indenting firms' profitability with limited pass-through to household inflation	Supply side shock becomes structural on the back of protectionism 2.0. or exogenous CO2 price shock
	Wage increase subdued by high unemployment, firms' search for productivity	Political rise in (minimum) wage for essential workers
Stimuli	**Fiscal**: Impulse support closing large output gaps (income support, firms' liquidity bridge, long-term investments)	Debt monetization become permanent, with risks of high debt burden-low productivity trap
	Monetary: tamed inflation expectations, lower interest rates, liquidity injections to preserve monetary and financial conditions and support credit increase	Prevailing zombification, overheating on the mortgage market, monetary inflation
	Markets: Asset price reflation includes steeper yield curve & bond volatility, strong equity markets. Time to normalize, no credit crisis	Central Banks deemed impotent, behind the curve, unable to tighten because of financial instability

Sources: various, Allianz Research

OBSTACLE 7: NOT PUTTING AN END TO THE SWEET MUSIC OF MARKET'S REFLATION



Sources: IBES, Refinitiv, Allianz Research



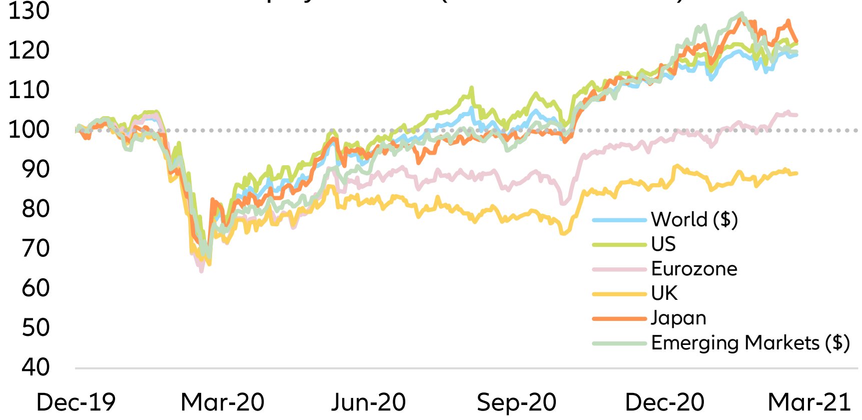
Sources: IBES, Refinitiv, Allianz Research

Some equity markets remain extremely optimistic (i.e. U.S. and EMs). In this regard, Q4 earnings showed a mixed bag of outcomes with some of the equity rally leaders (Facebook, Google, etc), showing that their underlying growth engines are losing some steam. This has led market participants to front load the initial optimism in 2021 but to reprice worse than initially expected 2022 earnings growth.

From a long-term EPS growth perspective, the U.S. and EMs are on the extremely expensive side (even taking into account the latest US revision), with the market consensus aiming for earnings growth rates last seen in 2000 for the U.S. and close to all-time highs for EMs. On the other hand, the Eurozone does not look overbought in terms of earnings expectations but rather cheap adding to the premise that EUR equity markets look relatively cheap both from a fundamental and market composition perspective.

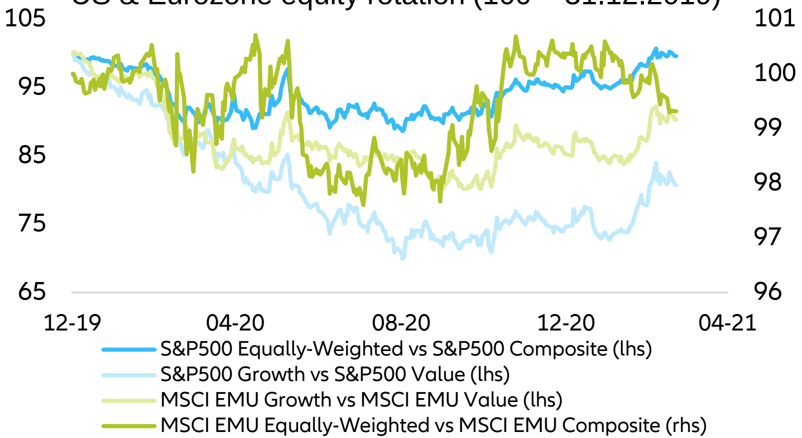
OBSTACLE 7: NOT PUTTING AN END TO THE SWEET MUSIC OF MARKET’S REFLATION

Global equity markets (100 = 31.12.2019)



Sources: Refinitiv, Allianz Research

US & Eurozone equity rotation (100 = 31.12.2019)



Sources: Refinitiv, Allianz Research

The combination of extremely accommodative monetary and fiscal policy paired with renewed investor and economic sentiment was and remains to be blamed for the persisting equity rally. With these two equity market tailwinds still in place, equity markets continue their climb towards new all-time highs, leaving behind the “V” part of the market recovery story. Nonetheless, it is worth noting, that despite equity markets climbing in a linear fashion, the underlying sectors driving the rally have been changing along the journey.

At the beginning of the rally, “stay at home” friendly sectors (e.g. technology and telecommunications) were in the driving seat. Later in the year and due to a combination of the US elections result and the rollout of the first Covid19 vaccines, the “back to normal / reflation” friendly sectors like energy and financials took the baton and led the rally. This sector rebalancing becomes obvious when looking at the growth vs value relative performance and at the equally weighted vs market value weighted indices.

EMERGING MARKETS: NEXT CRISIS HOTSPOT?

MSCI $ Indexes Top performers since 2010

2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021(YTD)
ARG 70,1%	IDN 4,%	TUR 60,5%	ARG 63,7%	IDN 24,1%	HUN 33,1%	BRA 61,3%	ARG 72,3%	PER -0,3%	RUS 41,%	KOR 42,6%	CHL 13,7%
THA 50,8%	MYS -2,9%	PHL 43,9%	TWN 6,6%	PHL 23,7%	RUS 0,%	PER 53,8%	POL 52,2%	BRA -3,9%	TWN 31,5%	TWN 37,2%	TWN 9,8%
PER 49,2%	PHL -3,2%	POL 32,1%	MYS 4,2%	IND 21,9%	ARG -1,2%	RUS 48,9%	CHN 51,1%	RUS -5,3%	COL 25,9%	CHN 27,3%	ZAF 9,4%
CHL 41,8%	THA -5,6%	COL 31,6%	KOR 3,1%	ARG 17,3%	IND -7,4%	HUN 32,3%	KOR 45,5%	THA -8,%	BRA 22,1%	EM 15,8%	IND 6,9%
COL 40,8%	COL -7,1%	THA 30,9%	CHN 0,4%	TUR 16,7%	KOR -7,9%	COL 23,9%	CHL 39,8%	CZE -8,4%	CHN 20,9%	IND 14,1%	CZE 4,7%
MYS 32,5%	CZE -11,3%	MEX 27,1%	POL -1,7%	THA 13,3%	PHL -8,1%	THA 23,%	HUN 36,9%	HUN -8,5%	HUN 16,3%	ARG 12,3%	THA 2,8%
IDN 31,2%	KOR -12,8%	IND 23,9%	MEX -2,%	PER 9,2%	CHN -10,%	ZAF 15,1%	IND 36,8%	IND -8,8%	EM 15,4%	MYS 0,%	EM 2,5%
ZAF 30,7%	MEX -13,5%	KOR 20,2%	RUS -2,6%	TWN 6,9%	TWN -14,4%	IDN 14,8%	EM 34,3%	MYS -8,9%	KOR 10,4%	MEX -4,%	CHN 1,9%
PHL 30,3%	ZAF -17,3%	CHN 19,%	PHL -4,3%	CHN 4,7%	MEX -16,%	TWN 14,8%	TUR 34,3%	IDN -11,2%	PHL 9,2%	PHL -4,7%	RUS 1,9%
MEX 26,%	CHN -20,3%	HUN 18,7%	EM -5,%	ZAF 2,5%	EM -17,%	CHL 13,2%	PER 33,5%	TWN -11,8%	MEX 8,%	ZAF -5,7%	MEX 1,7%
KOR 25,3%	EM -20,4%	PER 15,5%	IND -5,3%	EM -4,6%	CHL -18,9%	EM 8,6%	ZAF 33,1%	COL -13,9%	ZAF 7,4%	CZE -6,2%	KOR -0,2%
IND 19,4%	RUS -20,9%	EM 15,1%	ZAF -8,8%	CZE -7,9%	IDN -21,%	KOR 7,%	THA 30,9%	POL -14,5%	TUR 7,3%	CHL -8,3%	HUN -0,7%
TUR 18,4%	CHL -22,1%	ZAF 14,8%	HUN -9,%	MEX -10,2%	CZE -21,9%	ARG 3,9%	CZE 29,4%	EM -16,6%	IDN 6,7%	PER -9,5%	ARG -2,8%
TWN 18,3%	TWN -23,3%	TWN 13,4%	CZE -14,9%	KOR -12,6%	MYS -22,4%	CHN -1,4%	TWN 23,8%	MEX -17,4%	THA 6,6%	TUR -9,9%	IDN -3,%
RUS 17,2%	PER -23,9%	MYS 10,8%	THA -16,9%	MYS -13,4%	THA -25,5%	POL -2,2%	PHL 23,3%	PHL -17,4%	IND 6,1%	IDN -10,6%	MYS -5,2%
EM 16,4%	BRA -24,9%	RUS 9,6%	BRA -18,7%	CHL -14,5%	POL -27,2%	IND -2,8%	IDN 22,%	CHN -20,4%	PER 1,1%	POL -11,8%	POL -7,%
POL 12,6%	POL -32,6%	CHL 5,6%	CHL -23,%	POL -16,8%	ZAF -27,2%	MYS -6,7%	MYS 21,1%	CHL -21,%	CZE -0,1%	HUN -11,8%	PER -8,8%
BRA 3,8%	HUN -34,7%	IDN 2,4%	COL -23,7%	BRA -17,4%	PER -32,5%	PHL -7,7%	BRA 21,%	KOR -22,6%	MYS -5,2%	THA -13,9%	BRA -10,9%
CHN 2,3%	TUR -36,8%	CZE -3,1%	IDN -25,%	COL -22,3%	TUR -33,6%	CZE -9,6%	COL 13,8%	ZAF -26,5%	POL -8,2%	RUS -17,1%	PHL -11,1%
CZE -7,4%	IND -38,%	BRA -3,5%	TUR -28,1%	HUN -29,6%	BRA -43,4%	TUR -10,5%	MEX 13,6%	TUR -43,6%	CHL -18,6%	BRA -20,9%	COL -14,6%
HUN -10,7%	ARG -42,6%	ARG -38,9%	PER -31,%	RUS -48,5%	COL -43,9%	MEX -10,7%	RUS 0,3%	ARG -51,7%	ARG -22,6%	COL -22,9%	TUR -17,%

China, Taiwan & S. Korea – The trend was broken in February. Chinese equities are in a downward trend, the YTD in the CSI 300 is negative (more financial weighted). Taiwanese equities continue the rally.

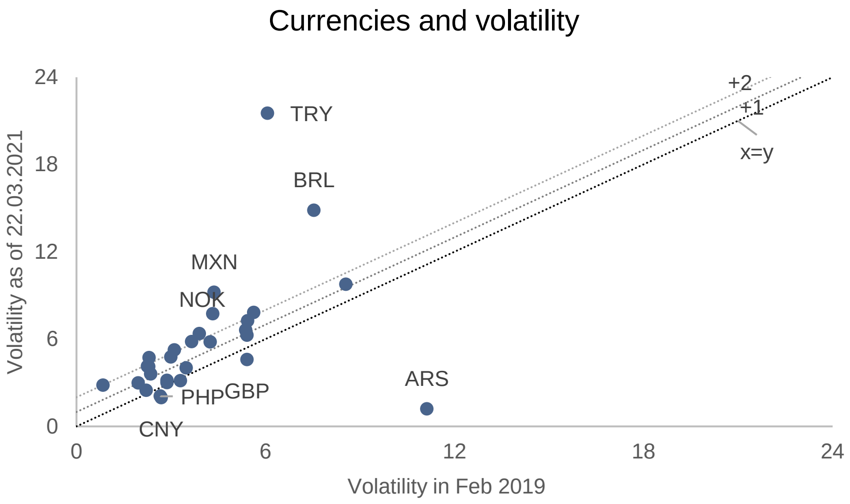
Rest of APAC – Especially good performance of India.

LatAm – Chile is the exception in a so far negative year. There is room for improvement, as the current standpoint is low, but the risks are still high (political, medical, financial).

Turkey – The latest developments in the Central Bank had huge impact in equities as well - besides the currency losses. Especially hit was the financial sector. Companies elsewhere with interests in Turkey have also felt the impact.

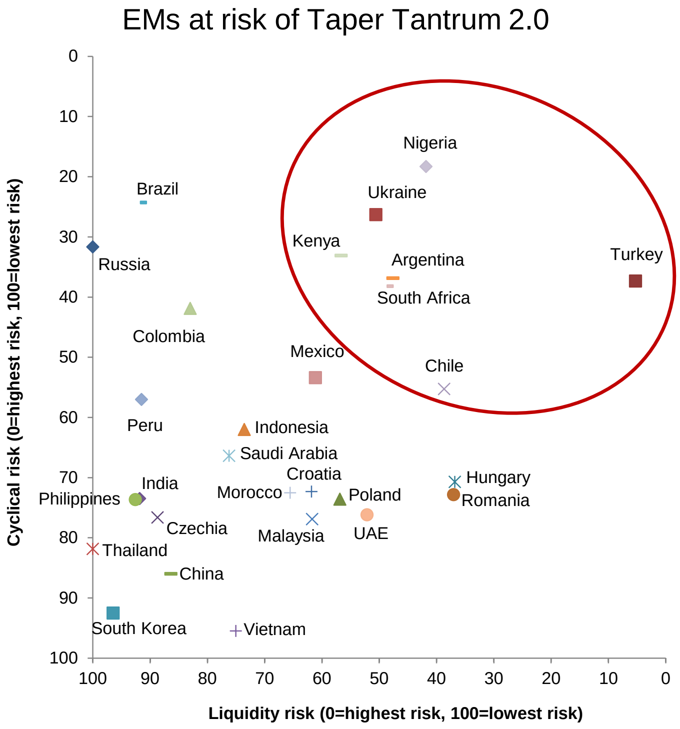
Sources:Refinitiv, Allianz Research

EMERGING MARKETS: HIGH CURRENCY VOLATILITY IN 2021-2022



Sources: Refinitiv, Allianz Research; Largest moves from a selection of currencies

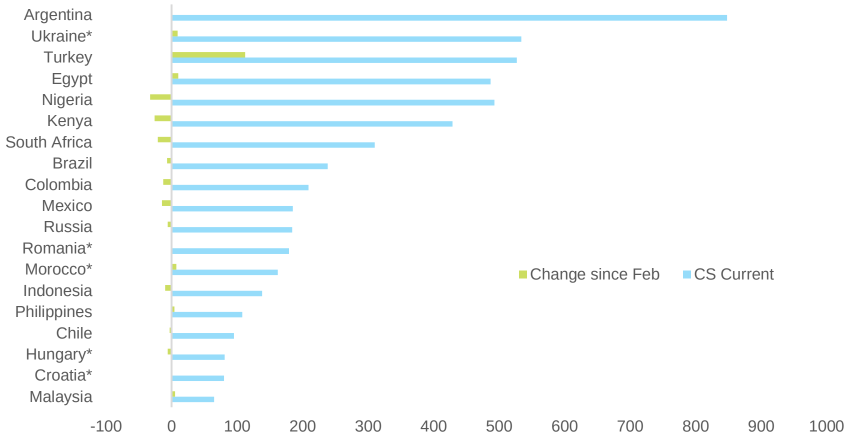
Comparing FX market volatility across currencies, it is easily observable that the initial Covid19 instability has yet to fully disappear with most currencies currently experiencing higher volatility than in 2019. Some APAC currencies are the exceptions to the norm showing slightly lower volatility levels. From a valuation perspective and except some APAC currencies, EM currencies remain fairly attractive but are bound to high volatility episodes.



Sources: Allianz Research

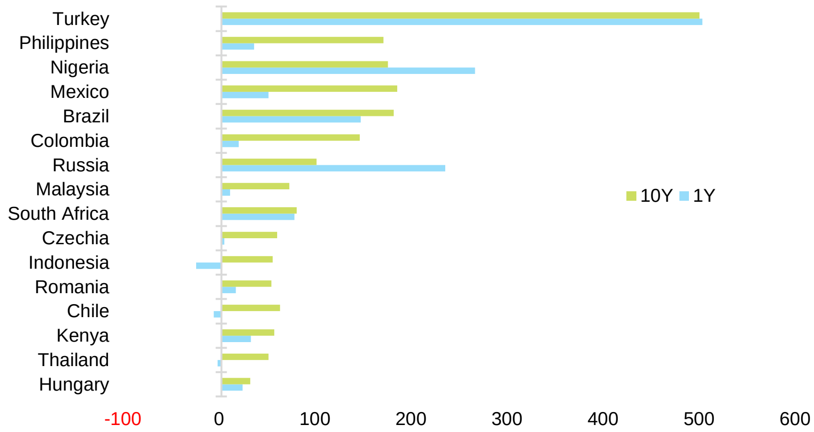
EMERGING MARKETS: SOVEREIGN SPREADS

EM Hard Currency ASW spreads (bps)



*Sources: Refinitiv, BofA, Allianz Research; Hard Currency for the * is calculated with Euro denominated Bonds.*

EM Local Yield Bonds – Changes (bps) since 01.02.2021

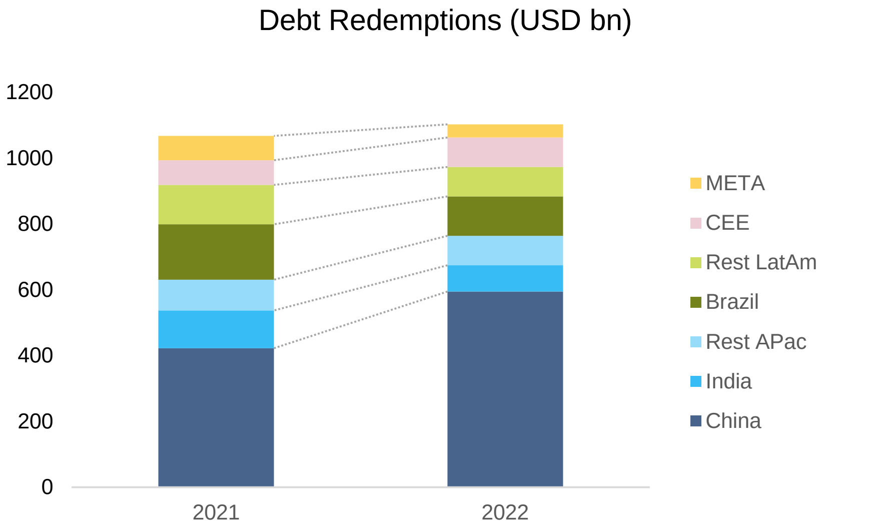


Sources: Refinitiv, BofA, Allianz Research; UKR is calculated with the 3Y instead of the 10Y; ARG with the 7Y.

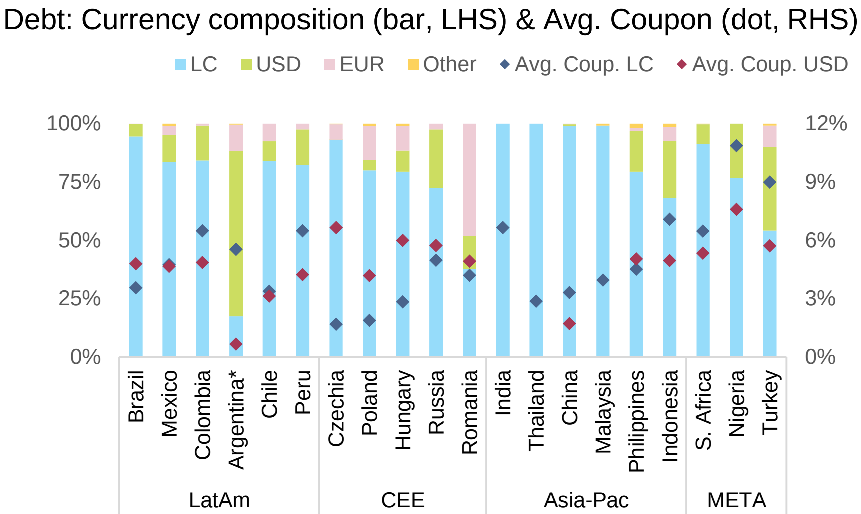
The recent developments in US sovereign debt market, the EM have experienced interest rates increases but the spread has not widened much – yet. Although EM bond indexes display historically low spreads, the particular situation in each of the countries is different. On the worrying side, - and besides Argentina – African countries, Turkey and Malaysia are above the 400 bps barrier, with Brazil spreads widening.

The Local Currency Environment has experienced an increase in interest rates that, in some cases, are higher than a year ago. Following developments on Turkey Central Bank, the LC curve has shifted abruptly. Taking into account the short-maturity of its local currency debt, instability and sudden monetary policy movements could endanger its debt sustainability.

EMERGING MARKETS: TOUGH DEBT SCHEDULE



Sources: Refinitiv, Allianz Research. Argentina defaulted ~50bn USD outstanding bonds in 2020. The countries covered and regional aggrupation is the same as in the RHS graph.*



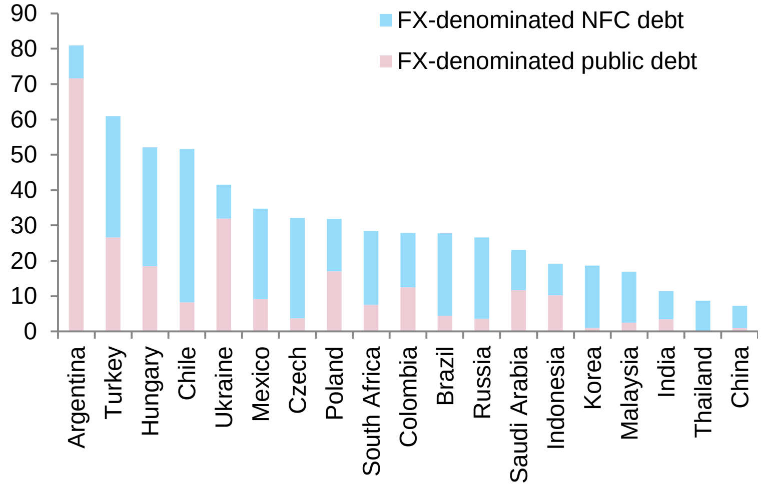
Sources: Refinitiv, Allianz Research. Argentina defaulted ~50bn USD outstanding bonds in 2020.*

The burden of sovereign debt redemptions in the coming years for EM will be considerable. Brazil is both by size and short maturity one of the key countries to look at. Around 1000bn (USD) of Chinese bonds will mature between 2021 and 2022. Apart from Brazil; the short maturities for Turkey, Romania and Poland could bring some stress.

When taking into account the high interests currently paid, the high share of foreign currency debt, and the volatility in the currency, Turkey may face some risks during the coming two years. However, its position in terms of debt to tax revenue is relatively good. If they are able to control the currency risk, they could manage to refinance themselves and extend the maturity.

EMERGING MARKETS: CORPORATE DEBT ALSO POSE RISKS IN 2022

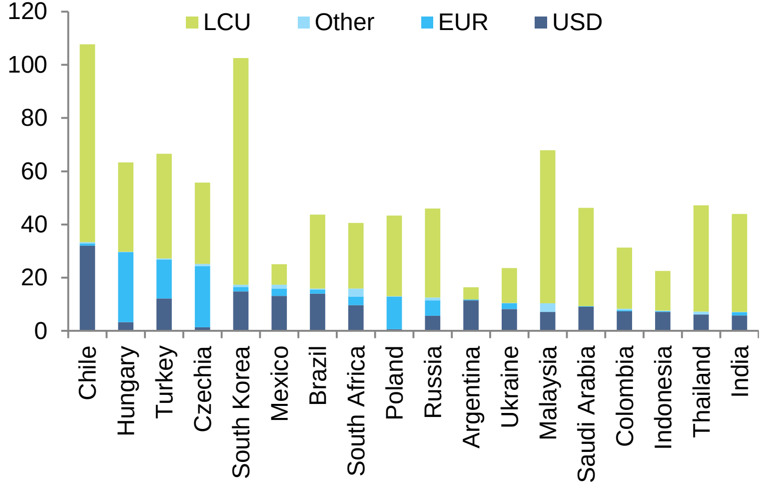
Foreign exchange-denominated sovereign and NFC debt (% of GDP), Q4 2020, selected EM



Sources: National statistics, IIF, Allianz Research

Argentina has the highest share of FX-denominated debt to GDP (81%). And most of that is sovereign debt.

Currency breakdown of NFC debt (% of GDP), Q4 2020, selected EM



Sources: National statistics, IIF, Allianz Research

Chile has the highest FX-denominated debt of NFCs in relation to GDP (43%).

GLOBAL: OUR KEY MAIN TAKEAWAYS FOR 2021-22

Recovery obstacle 1: Formula 1 race on vaccination. Herd immunity as soon as May in the US, while Europe will need till fall. Vaccination remains slow in the emerging markets with only 20% of the total population expected to be vaccinated in 2021. Reopening will remain heterogeneous.

Recovery obstacle 2: Excess savings will still hover around 40% above pre-crisis levels at end-2021. Fading fear factor is a positive for future consumer spending: we expect +1.5% of GDP in Europe and more than +3% in the US in 2021 by end-2021.

Recovery obstacle 3: Phasing out assistance mechanisms is not a zero-sum game and the risk of policy mistakes remains high. Compared to the US super stimulus (USD1.9tn, 9% of GDP), Europe's fiscal response should prove moderate and delayed, given its focus on the supply side. In China, fiscal targets imply a clear withdrawal of policy support in 2021.

Recovery obstacle 4: Crowding-in vs. crowding-out effects on investment are not yet resolved. The success of massive public investment programs, mainly in the US depend on reducing execution risks, on tax policies and on whether governments can channel excess savings to productive projects and boost private sector investment.

Recovery obstacle 5: Bottlenecks in the global supply chain are as high as during the peak of the pandemic and should push global trade into a borderline recession in Q2 with the global supply chain disruptions to cut global trade growth in volume by -1.7pp in 2021 (vs. +0.7pp from the Biden super stimulus).

Recovery obstacle 6: Temporary overshoot of inflation. This is likely to be driven by temporary base effects (e.g. reopening of the services sector, rising commodity prices, supply shortages). We don't expect central banks to stage a policy U-turn as a reaction to inflation temporarily overshooting in the US at 3.5% by mid-2021 and hitting the 2% target for a few months in the Eurozone.

Recovery obstacle 7: Not putting an end to the sweet music of market's reflation. We see a widening divergence between asset prices and their underlying value. Amplified by various investment management techniques (ETFs, risk-parity) that put asset allocation on automatic pilot, this divergence is a vulnerability. Risks for capital markets remain on the downside.

THANK YOU

Allianz Research

1 April 2021

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