Outlook: Energy, trade, and financial shockwaves

AZR Scenario_Q22022
Allianz Research

March 18, 2022

Economic Outlook

Ceasefire (Probability 5%)

Ceasefire & search for a diplomatic solution amid persistent sanctions

Russia

- GDP growth: +2.5% in both 2022 and 2023
- Inflation (aop): +7.5% in 2022, +4.5% in 2023
- FX controls (forced RUB buying by companies) remains in place.
- Capital controls on specific FDI flows possible (retaliation for new sanctions).
- No sovereign default in 2022-2023.

Eurozone

- GDP growth: +3.8% in 2022,+2.3% in 2023
- Inflation: +3.8% in 2022, +1.8% in 2023.
- Policy: ECB sticks to hawkish pivot – QE ends in Q3, first rate hike in Dec., +50pts in 2022.
- Insolvencies: +16% in 2022; +13% in 2023

Energy prices normalization

- Natural gas price (TTF: €/MWh): average 75 in 2022, 45 in 2023.
- Oil price (Brent: $/bbl): average 79 in 2022, 72 in 2023.

Conflict Escalation (Probability 55%)

Escalation trigger: more extensive sanctions (financial & trade, excl. energy)

Russia

- GDP growth: -8% in 2022, -3% in 2023
- Inflation (aop): 28% in 2022, 20% in 2023
- Intensified FX and capital controls.
- Sovereign default possible in 2022-2023

Eurozone

- GDP growth: +2.6% in 2022, +1.6% in 2023
- Inflation: +5.5% in 2022, +2.5% in 2023
- Policy: ECB scales down policy normalization plans with QE continuing throughout 2022 to backstop expansive fiscal policy, +50bp hike in 2023
- Insolvencies (additional increase): +2.8/3.8 pp in 2022; +1.7/2.3 pp in 2023

Energy prices elevated

- Natural gas price (TTF: €/MWh): avg. 90 in 2022, 70 in 2023
- Oil price (Brent: $/bbl): avg. 93 in 2022, 85 in 2023

Black-out (Probability 35%)*

Harsh sanctions freeze economic & financial relations between Russia & the West

Russia

- GDP growth: -16% in 2022, -6% in 2023
- Inflation (aop): 40% in 2022, 25% in 2023
- Full-fledged FX and capital controls
- Near-term sovereign default very likely

Eurozone

- GDP growth: +1.5% in 2022, -1.2% in 2023
- Inflation: +6.5% in 2022, +4.0% in 2023
- Policy: ECB remains in crisis-mode throughout the forecast horizon, PEPP revived to “close spread”, no rate hikes
- Insolvencies (additional increase): +7.2/9.8 pp in 2022; +18.0/24.8 pp in 2023.

Energy crisis

- **Natural gas price** (TTF: €/MWh): avg. 140 in 2022, 110 in 2023
- **Oil price** (Brent: $/bbl): avg. 120 in 2022, 100 in 2023

**Note: We reserve a 5% probability for tail risk scenarios (i.e. direct military confrontation between Russia and NATO etc.)*

Source: Allianz Research

Forecasts: Slowflation vs. Stagflation

GDP growth forecasts

	Conflict Escalation (55%)						Blackout (35%)			
	2020	2021	2022f	*Revision from pre-war*	2023f	*Revision from pre-war*	2022f	*Revision from pre-war*	2023f	*Revision from pre-war*
Global	**-3.4**	**5.9**	**3.3**	***-0.8***	**2.8**	***-0.4***	**2.4**	***-1.7***	**-0.3**	***-3.5***
USA	**-3.5**	**5.7**	**3.3**	***-0.6***	**2.6**	***-0.2***	**2.3**	***-1.6***	**-0.6**	***-3.4***
Latin America	**-6.9**	**6.5**	**1.7**	***-0.7***	**2.0**	***-0.6***	**1.2**	***-1.2***	**1.6**	***-1.0***
Brazil	-4.1	4.8	0.2	*-0.4*	0.9	*-0.3*	-0.3	*-0.9*	0.4	*-0.8*
Eurozone	**-6.5**	**5.2**	**2.6**	***-1.2***	**1.6**	***-0.7***	**1.5**	***-2.3***	**-1.2**	***-3.5***
Germany	-4.9	2.9	1.8	*-1.4*	1.6	*-0.8*	0.9	*-2.3*	-1.4	*-3.8*
France	-8.0	7.0	3.0	*-1.0*	1.5	*-0.4*	1.9	*-2.1*	-1.2	*-3.1*
Italy	-8.9	6.5	2.6	*-1.4*	1.2	*-0.9*	1.4	*-2.6*	-1.4	*-3.5*
Spain	-10.8	5.0	3.9	*-1.6*	1.9	*-1.4*	1.7	*-3.8*	-1.0	*-4.3*
UK	-9.9	7.1	3.2	*-1.2*	2.0	*-0.6*	1.4	*-3.0*	-0.8	*-3.4*
Russia	-2.7	4.7	-8.0	*-11.0*	-3.0	*-5.5*	-16.0	*-19.0*	-6.0	*-8.5*
Turkey	1.8	11.0	1.4	*-0.1*	3.9	*-0.3*	1.0	*-0.5*	1.4	*-2.8*
Asia-Pacific	**-1.0**	**6.1**	**4.6**	***-0.1***	**4.5**	***-0.2***	**3.7**	***-1.0***	**0.9**	***-3.8***
China	2.3	8.1	4.9	*-0.3*	5.0	*0.0*	4.2	*-1.0*	1.8	*-3.2*
Japan	-4.7	1.7	2.2	*-0.3*	1.8	*0.2*	1.2	*-1.3*	-0.6	*-2.2*
India	-7.3	8.9	7.5	*0.4*	6.9	*0.0*	5.9	*-1.2*	0.9	*-6.0*
Middle East	**-4.5**	**3.3**	**4.5**	***0.6***	**2.7**	***0.2***	**4.7**	***0.8***	**2.9**	***0.4***
Saudi Arabia	-4.1	3.3	5.6	*0.9*	2.7	*0.3*	5.9	*1.2*	3.0	*0.6*
Africa	**-2.6**	**3.1**	**3.4**	***-0.2***	**2.7**	***-0.3***	**2.5**	***-1.1***	**2.3**	***-0.7***
South Africa	-6.4	4.6	2.0	*-0.1*	1.5	*-0.1*	2.0	*-0.1*	1.5	*-0.1*

Source: Allianz Research

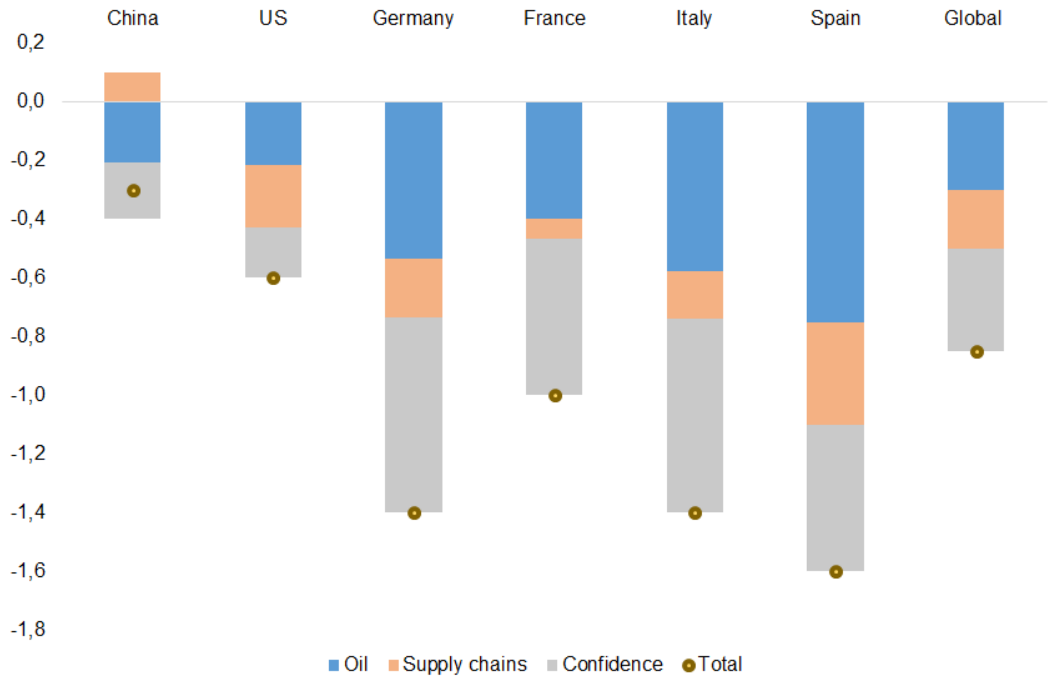
Inflation forecasts

	Conflict Escalation (55%)					Blackout (35%)			
	2021	2022f	*Revision from pre-war*	2023f	*Revision from pre-war*	2022f	*Revision from pre-war*	2023f	*Revision from pre-war*
Global	**3.3**	**6.0**	***1.9***	**3.3**	***0.9***	**7.0**	***3.0***	**5.4**	***3.0***
USA	**4.7**	**6.1**	***1.3***	**2.5**	***0.5***	**7.0**	***2.2***	**5.0**	***3.0***
Latin America	**12.0**	**10.6**	***1.3***	**6.8**	***2.0***	**13.5**	***4.2***	**10.6**	***5.8***
Brazil	8.3	7.7	*1.7*	4.0	*0.5*	10.1	*4.1*	7.5	*4.0*
Eurozone	**2.6**	**5.5**	***1.7***	**2.5**	***0.7***	**6.5**	***2.7***	**4.0**	***2.2***
Germany	3.2	6.0	*2.2*	3.2	*1.2*	6.8	*3.0*	4.3	*2.3*
France	2.0	4.3	*1.0*	2.6	*0.5*	5.9	*2.6*	3.6	*1.5*
Italy	2.0	5.2	*1.6*	2.2	*0.7*	6.1	*2.5*	3.7	*2.2*
Spain	3.1	5.0	*1.1*	2.2	*0.8*	6.3	*2.4*	4.1	*2.7*
UK	2.6	7.5	*2.0*	3.5	*1.0*	7.8	*2.3*	4.8	*2.3*
Russia	6.7	28.0	*21.5*	20.0	*15.8*	40.0	*33.5*	25.0	*20.8*
Turkey	19.4	51.7	*32.2*	19.0	*5.2*	57.0	*37.5*	22.0	*8.2*
Asia-Pacific	**1.6**	**3.1**	***0.2***	**2.6**	***0.2***	**3.6**	***0.7***	**4.6**	***2.2***
China	0.9	2.6	*0.1*	2.2	*0.2*	3.1	*0.6*	4.5	*2.5*
Japan	-0.2	1.1	*0.3*	1.1	*0.2*	1.3	*0.5*	1.7	*0.8*
India	5.4	5.6	*0.4*	5.2	*0.3*	6.6	*1.4*	8.3	*3.4*
Middle East	**12.2**	**12.9**	***4.7***	**9.4**	***4.7***	**13.5**	***5.3***	**9.9**	***5.2***
Saudi Arabia	3.1	2.1	*0.4*	2.4	*0.9*	2.5	*0.8*	2.9	*1.4*
Africa	**4.5**	**9.2**	***0.5***	**7.5**	***0.6***	**12.3**	***3.6***	**8.9**	***2.0***
South Africa	5.2	6.5	*0.7*	4.6	*0.3*	7.0	*1.2*	5.2	*0.9*

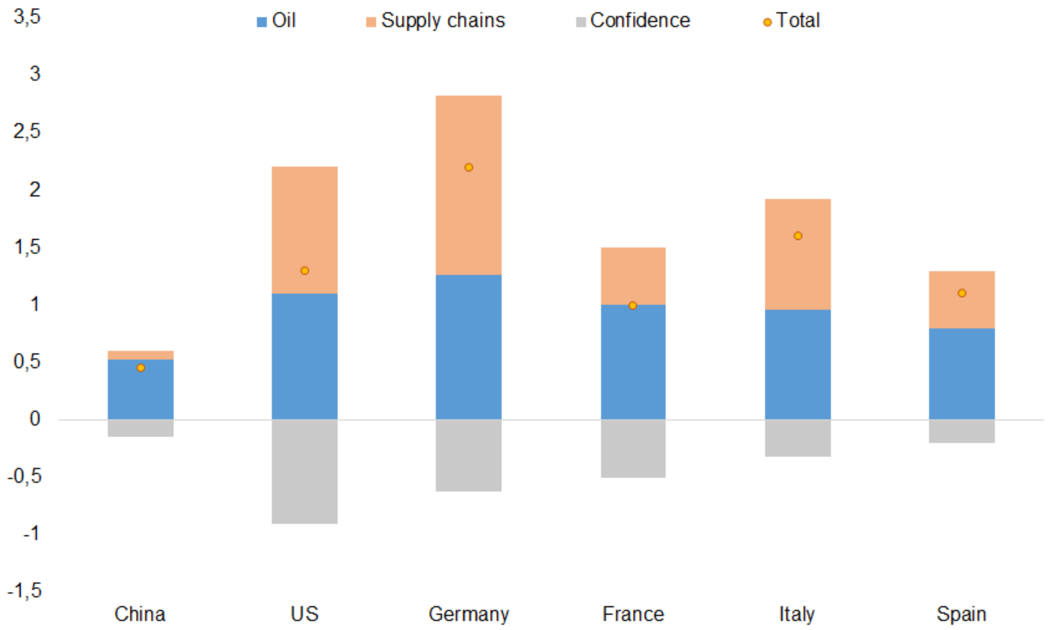
Source: Allianz Research

Trifecta on growth: oil, confidence and supply chain shocks

Breakdown of 2022 GDP growth forecasts revisions (pp)



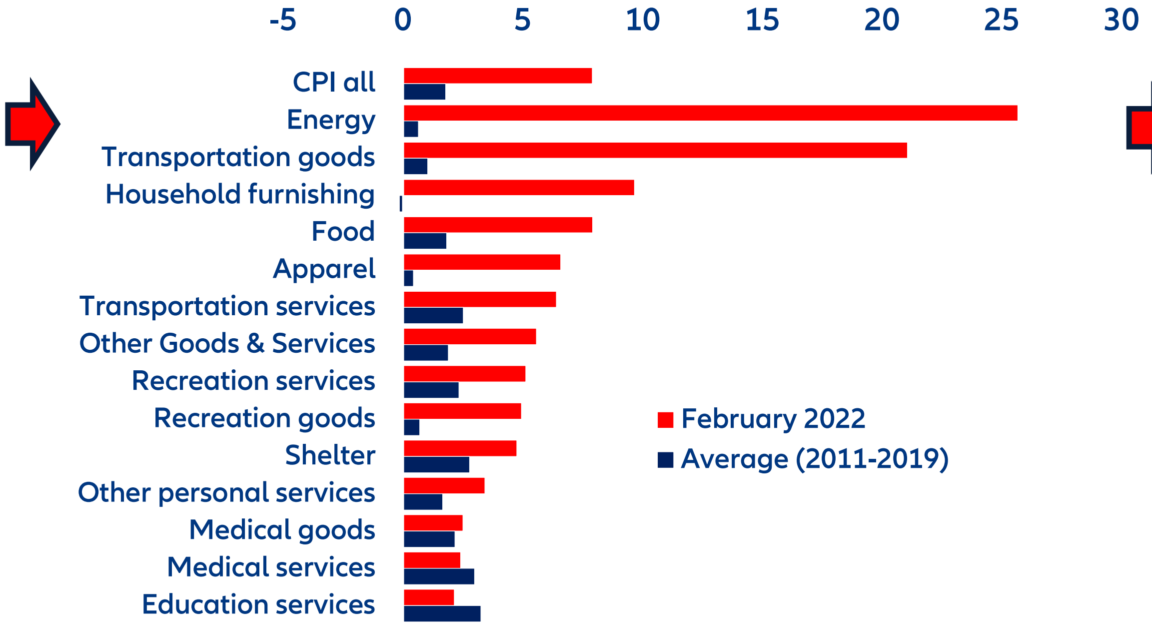
Breakdown of 2022 inflation forecasts revisions (pp)



Note: the supply-chains factor includes impacts from both the Russia-Ukraine crisis, and the Covid-19 outbreaks in China.
Source: Allianz Research

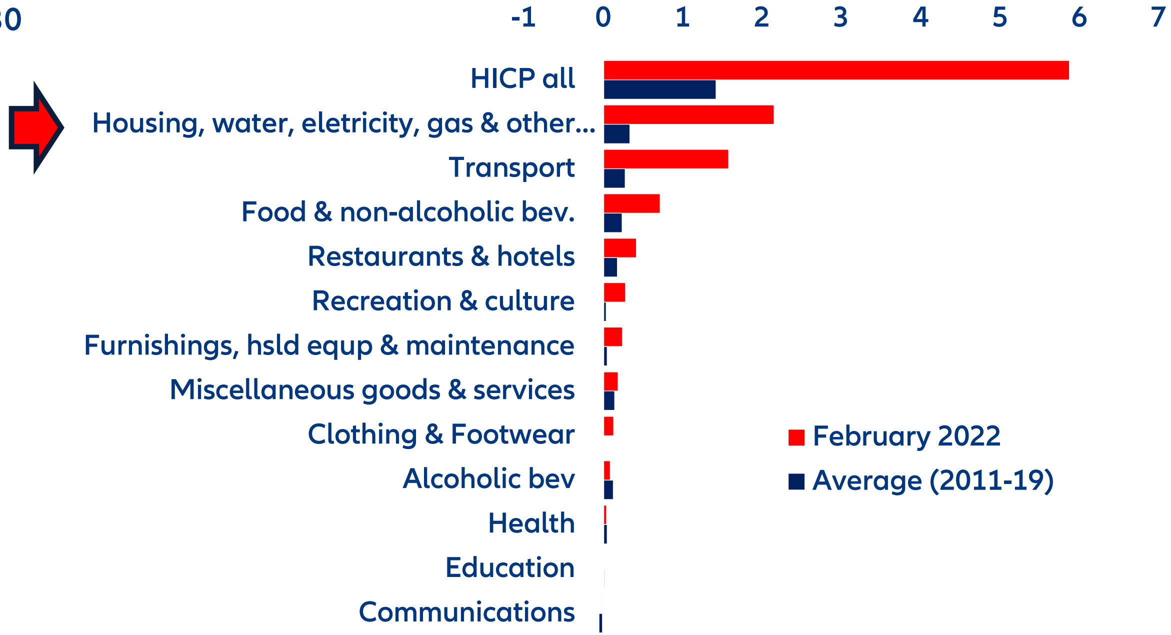
Energy and reopening driving inflation

US CPI Breakdown (y/y% change)



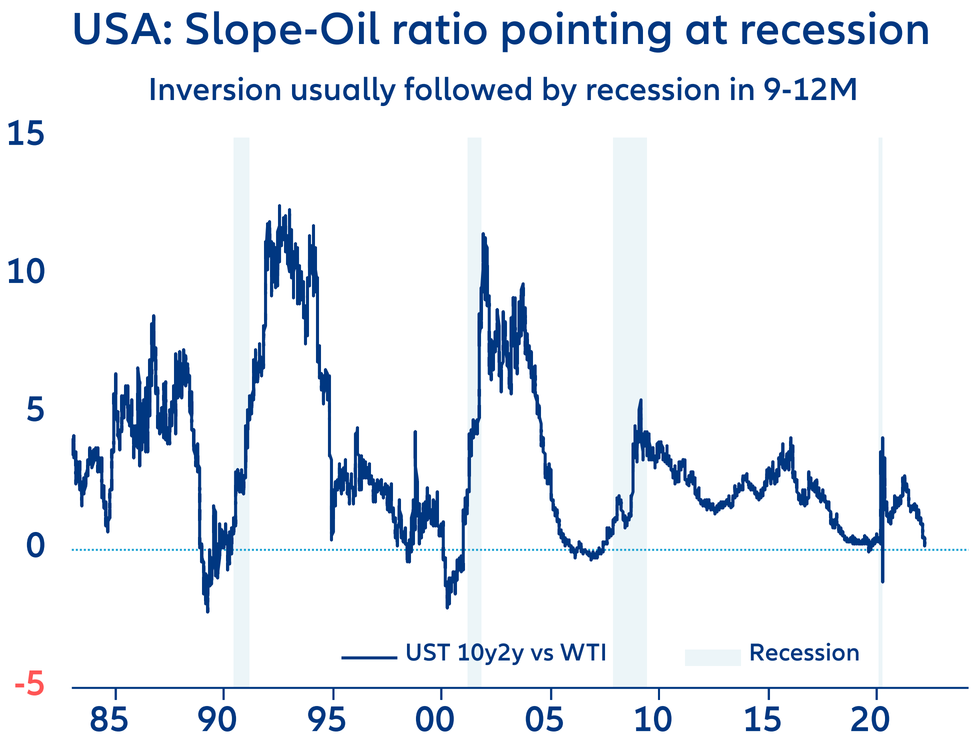
Sources: Refinitiv, Allianz Research

Eurozone HICP Breakdown (y/y% change)

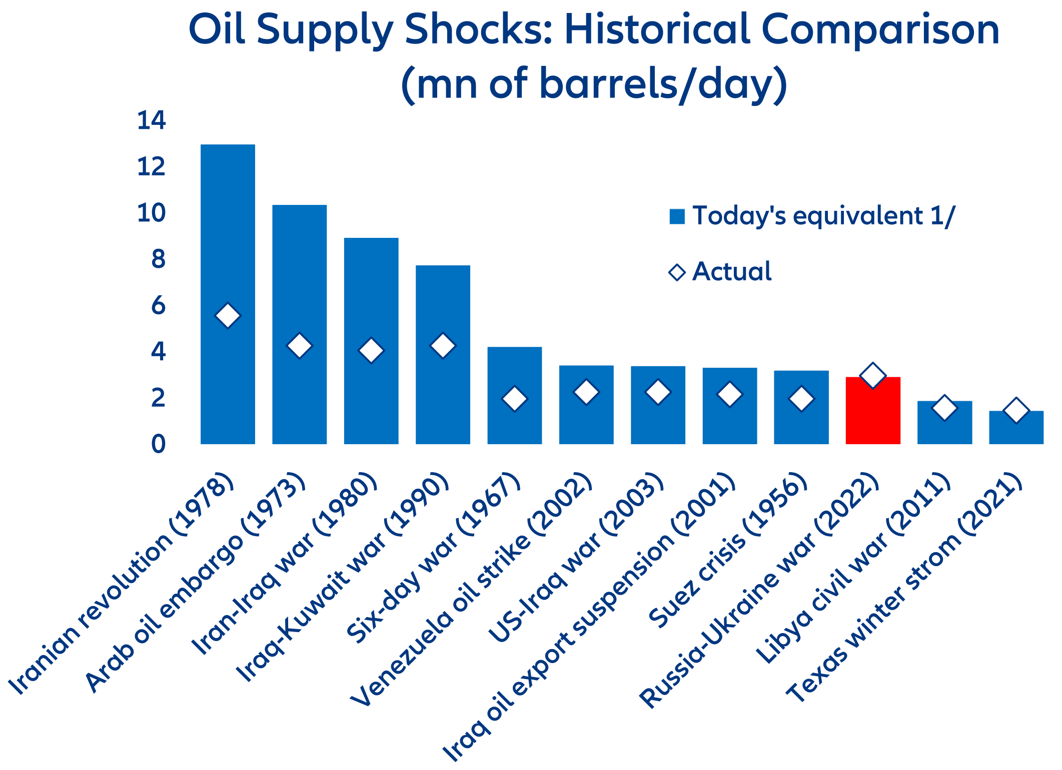


Sources: Refinitiv, Allianz Research

Hard landing over the medium term?



Source: Refinitiv Datastream; Allianz Research

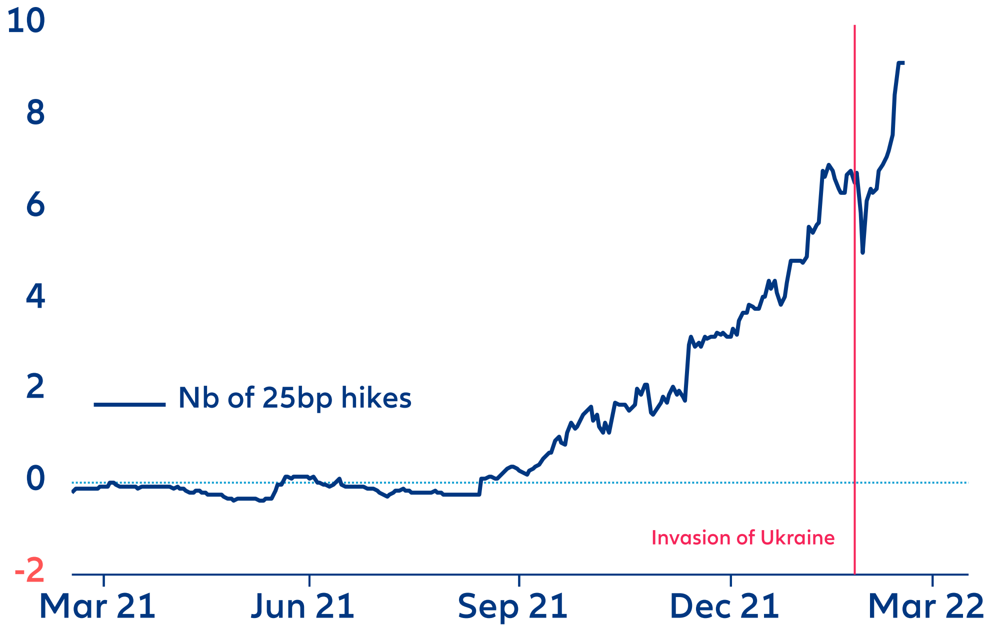


Sources: Enerdata, IEA, Our World In Data, Allianz Research.
Note: 1/ adjusted for changes in the share of oil in the global energy mix and the energy intensity of production and consumption.

Central banks prioritize inflation for now

USA: Policy Rate Outlook

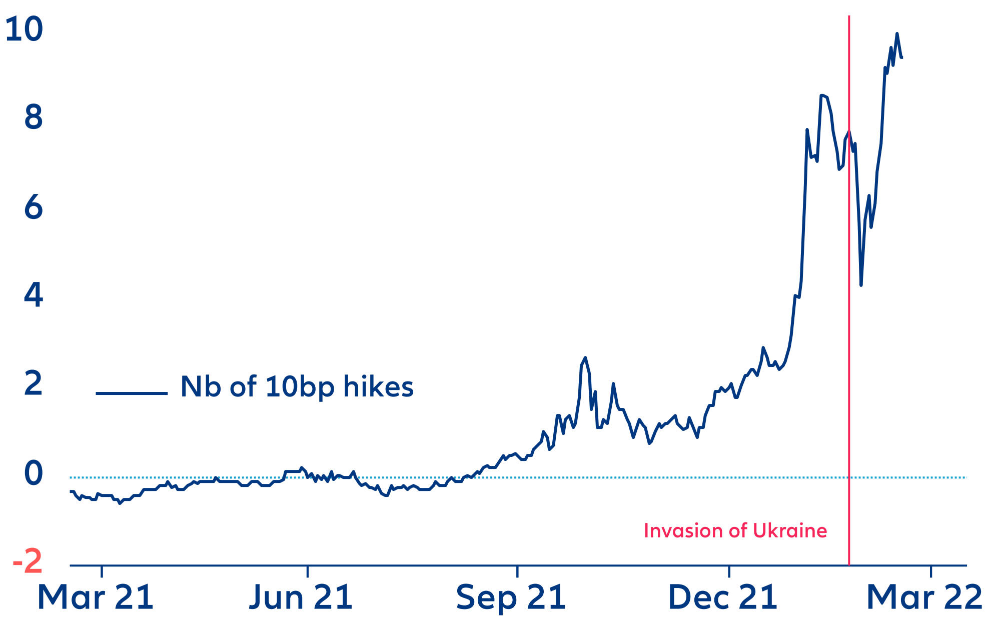
next 12M, based on EuroDollar Futures



Source: Refinitiv Datastream; Allianz Research

EUROZONE: Policy Rate Outlook

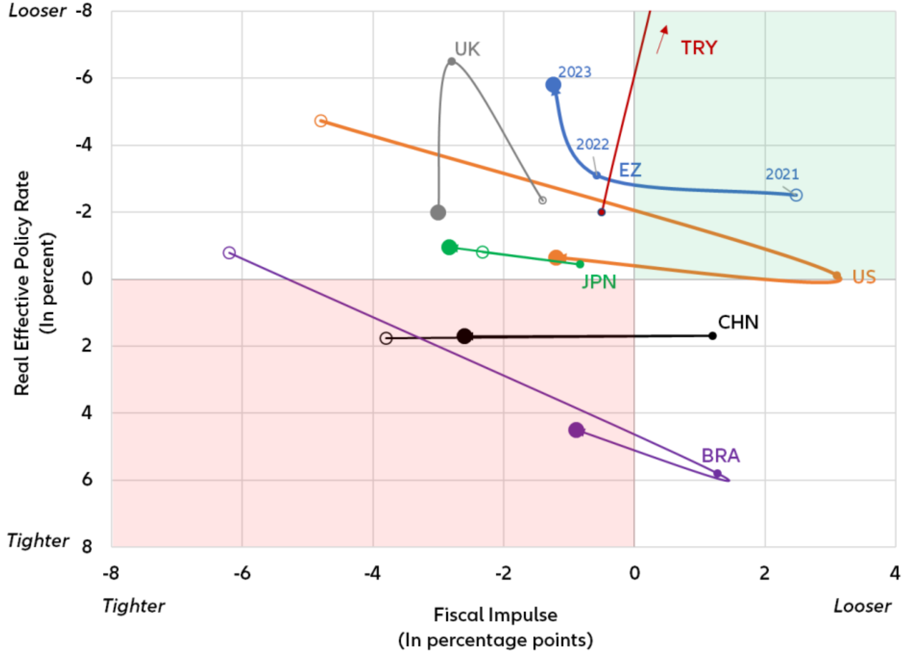
next 12M, based on OIS Forward Swaps



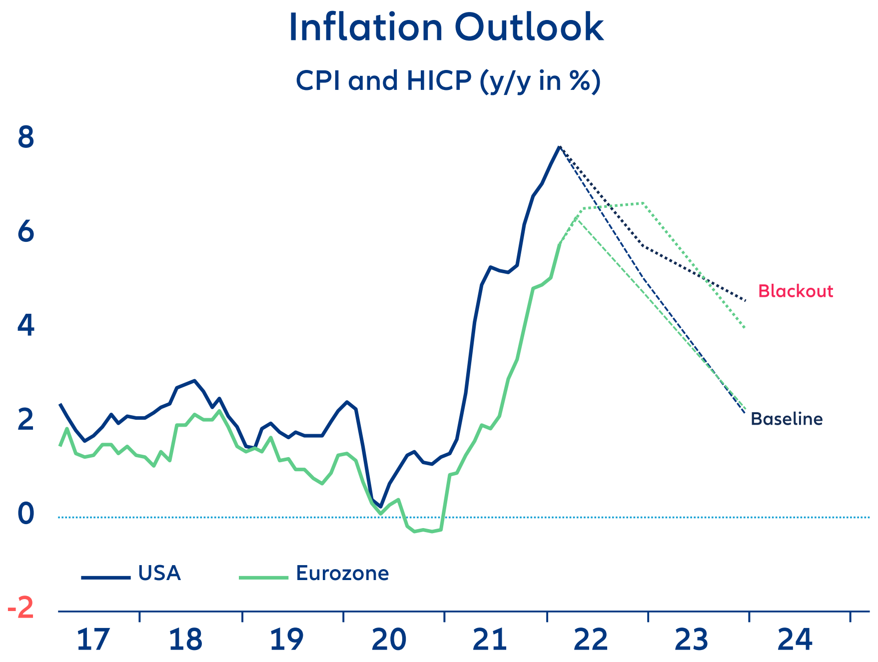
Source: Refinitiv Datastream; Allianz Research

Markets expect central banks to prioritize inflation over growth in the short term. Positioning for a close end of the escalation phase with return to their pre-crisis short-term policy rate outlook. Within the next 12 months, 9 hikes of 10bps are again priced in in the Eurozone and 8 hikes of 25bps the US.

Energy prices delay fiscal adjustment



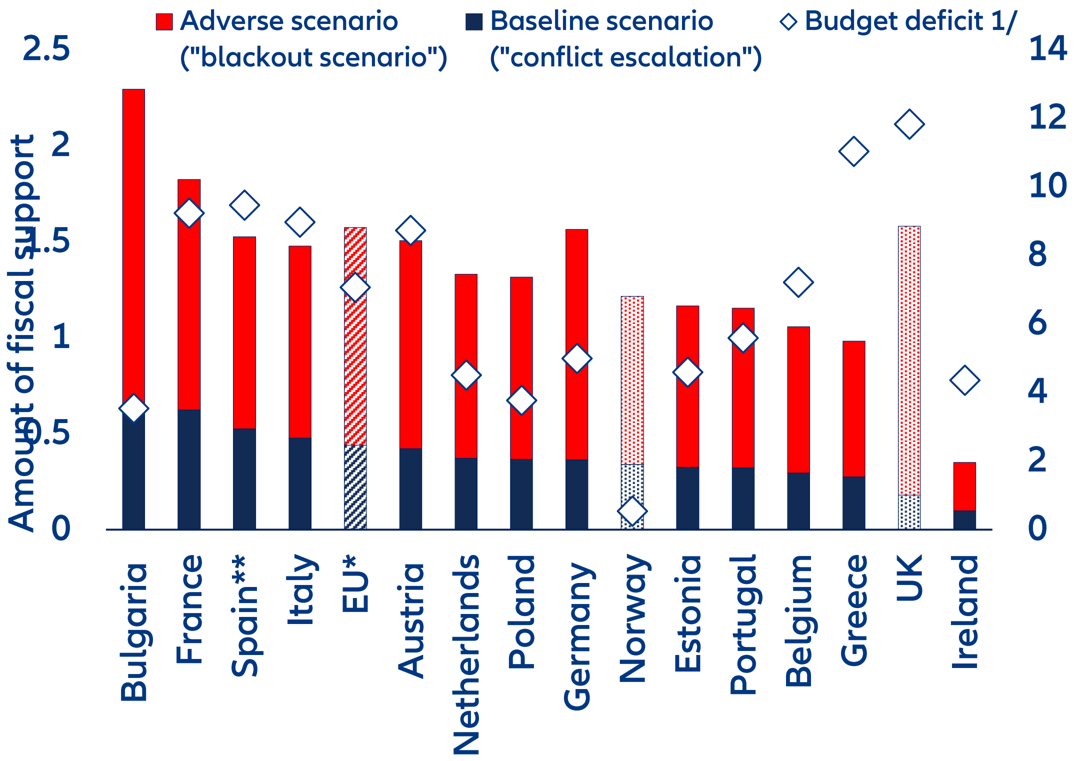
Source: Allianz Research.



Source: Refinitiv Datastream; Allianz Research

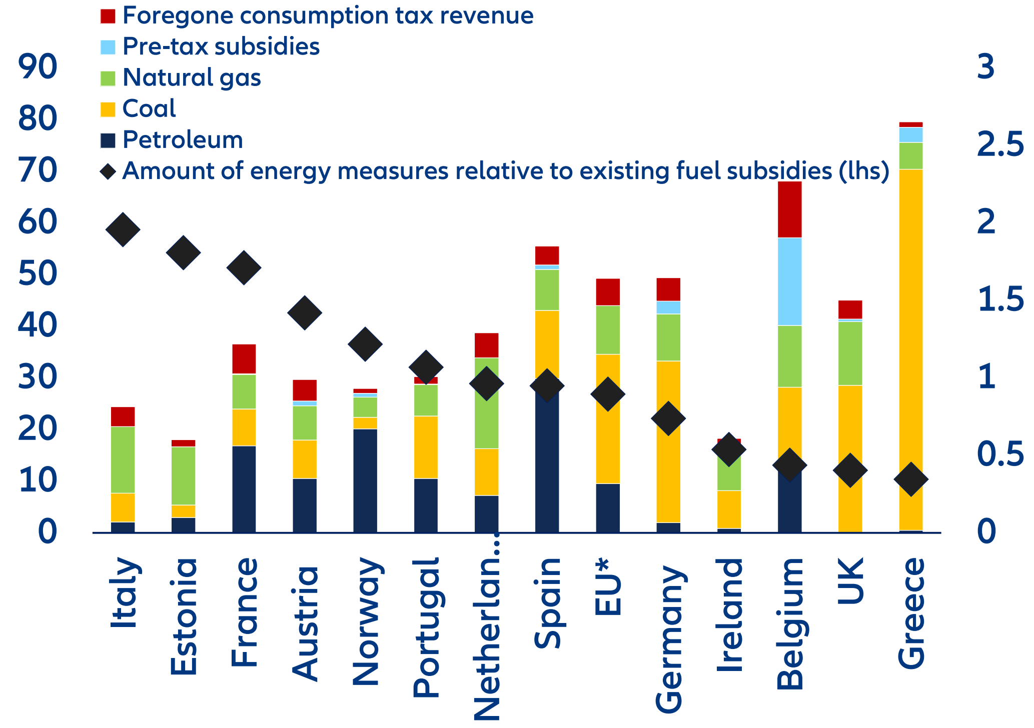
Fiscal support of at least ~0.6% of GDP

Additional fiscal support and budget deficits (% of GDP)



Source: Allianz Research

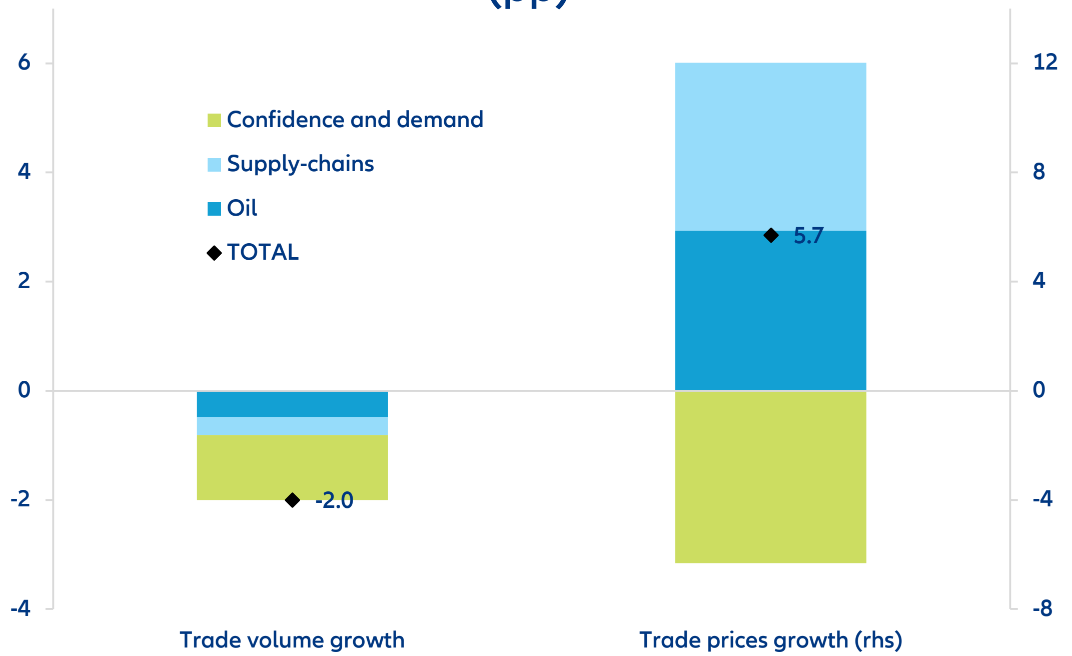
Announced and expected fiscal support to mitigate energy inflation



Source: Allianz Research

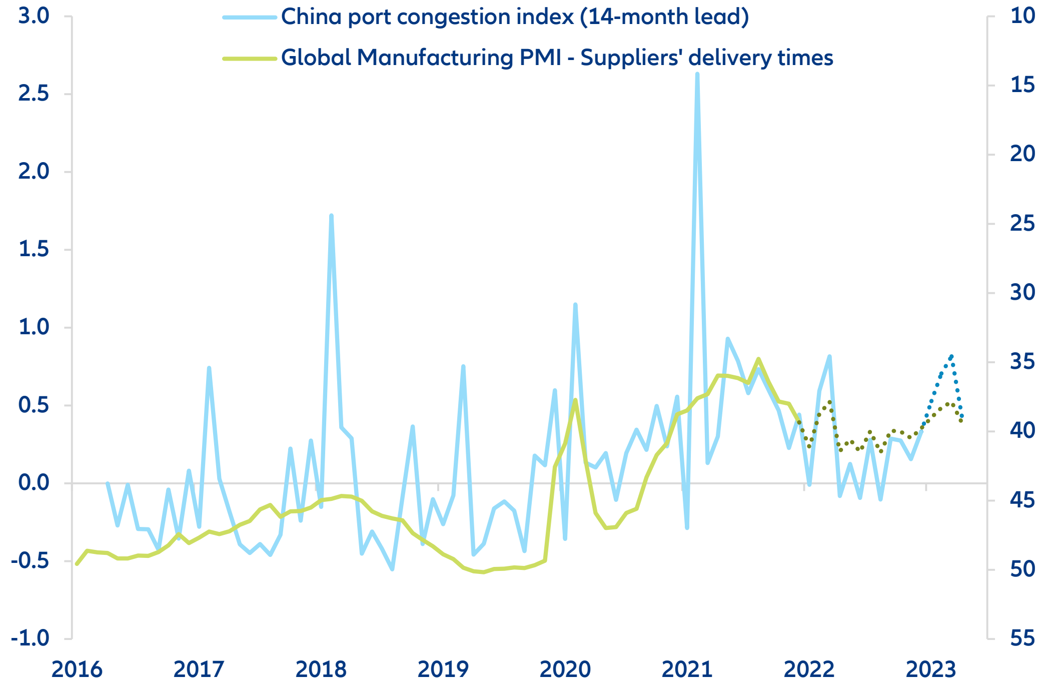
Supply chain bottlenecks prolonged

Breakdown of 2022 trade growth forecast revisions (pp)



Source: Allianz Research

China port congestion and global delivery times



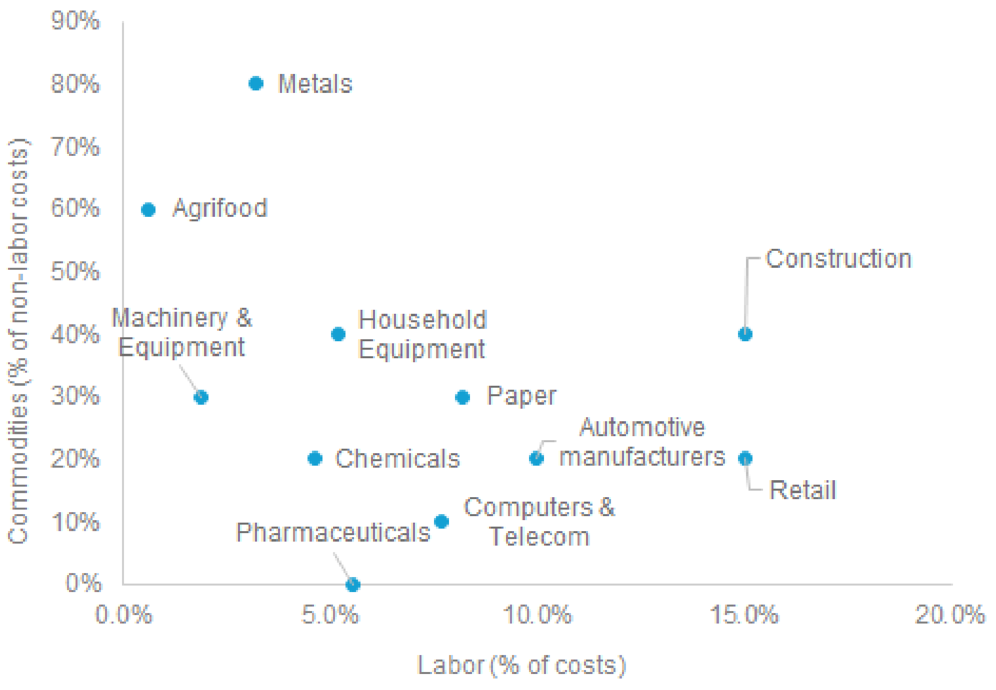
Sources: UNCTAD AIS database, IHS Markit, Allianz Research

Higher oil prices, the confidence and demand shock and extended supply-chain bottlenecks lead to sizeable revisions in global trade forecasts. We now expect global trade to grow in 2022 by +4.0% in volume terms (vs. +6.0% previously) and +10.9% in value terms (vs. +7.2% previously).

The invasion of Ukraine is leading to bottlenecks in supply-chains at the (European) regional level, while Covid-19 outbreaks in China could have broader global repercussions. Suppliers' delivery times should remain relatively elevated for longer, but below the 2021 peaks.

Corporate sector affected by the war

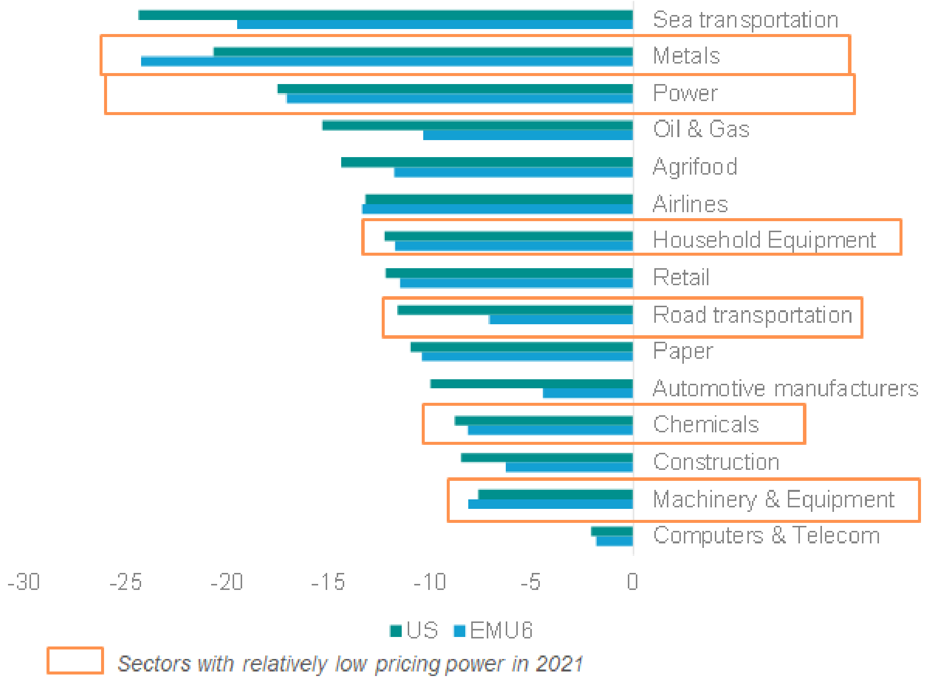
Labor costs coupled with commodity costs



Sources: Refinitiv, Allianz Research

Some sectors are labor intensive and commodity "light" (e.g. Retail), others are labor light and commodity "intensive" (e.g. Metals) some require both (e.g. Construction)

Profitability decrease if commodity prices remain at current levels (EBITDA, pp)

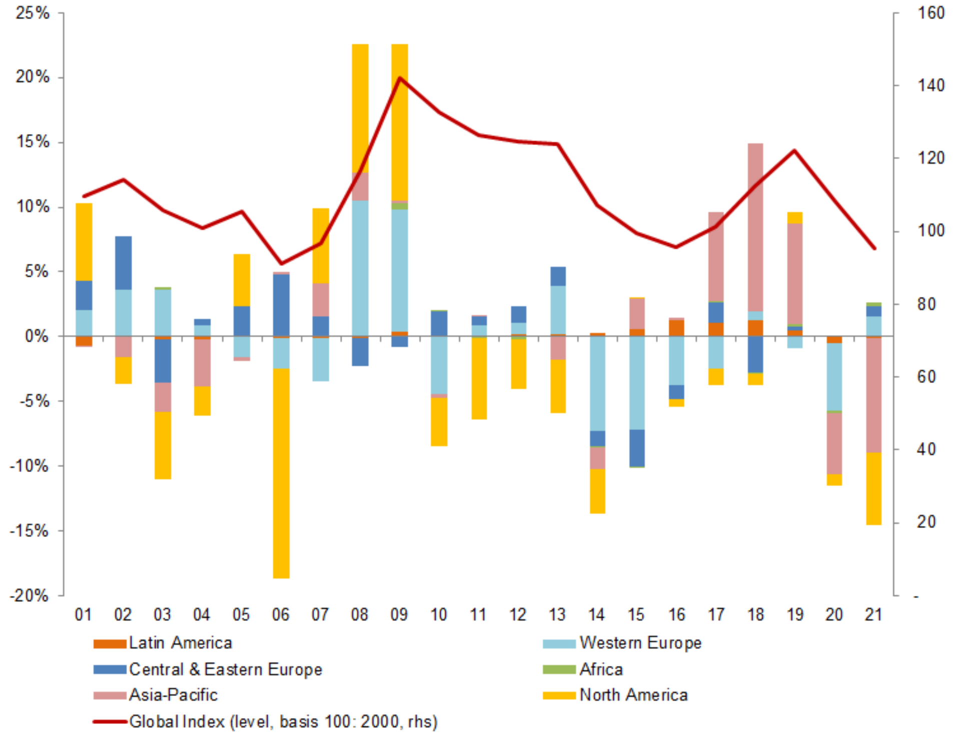


Source: Bloomberg, Allianz Research

If commodities remain at current levels, Metals and Power are most at risk of a profitability squeeze since they have low pricing power and are commodity "intensive".

Insolvencies & State support measures

Global and regional insolvency indices*



Source: Allianz Research. Note: (*) Indices are the weighted sum of national indices, each country being weighted by the share of its GDP within the countries used in the sample.

Business insolvencies forecasts* (selected countries)

					Conflict Escalation		Black-out	
number of cases, thousands		2019	2020	2021	2022f	2023f	2022f	2023f
US		22.7	21.6	14.3	15.3	18	16.6	23.2
Germany		18.7	15.8	14	14.6	16.1	15.3	18.2
Italy		10.5	7.2	8.5	9.2	10.7	9.6	12.1
UK		22.1	15.7	16.2	20.8	22.2	22.5	27.6
China		11.8	12.0	8.7	8.7	9.6	9.1	12.1
France	*without support measures*	51.4	32.0	28.2	37.4	51.0	38.8	57.6
	with support measures				31.0	42.0		

Source: Allianz Research. Note: (*) without additional support measures.

Adverse scenario to add potentially +5/10pp (2022) and +15/25pp (2023) at a global level

Capital Markets Outlook

Capital Markets: forecasts 2022-23

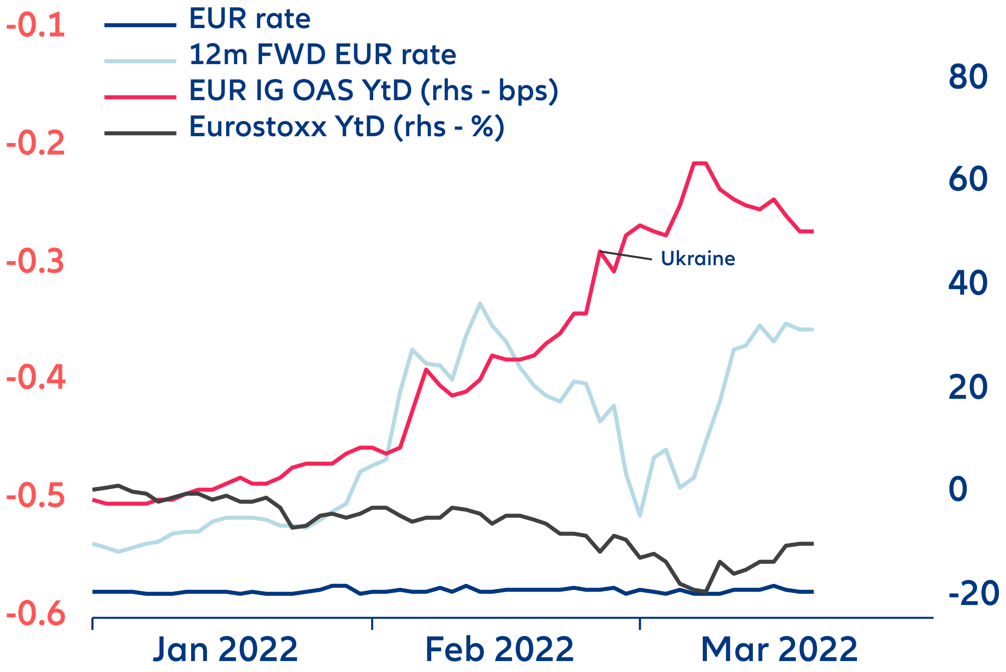
year-end figures	Last value (16.03.2022)	Unit		Conflict Escalation (50%)		Black-out (35%)	
EMU			**2021**	**2022f**	**2023f**	**2022f**	**2023f**
Government Debt							
Policy rate (ECB deposit rate)	**-0.5**	%	-0.5	**-0.5**	**0.0**	-0.5	-0.5
10y yield (Bunds)	**0.40**	%	-0.18	**0.15**	**0.50**	-0.35	-0.10
10y swap rate	**1.03**	%	0.28	**0.55**	**0.80**	0.25	0.4
Italy 10y sov. spread	**151**	bps	136	**160**	**175**	135	150
France 10y sov. spread	**46**	bps	37	**40**	**45**	35	40
Spain 10y sov. spread	**95**	bps	77	**80**	**90**	70	85
Corporate Debt							
Investment grade credit spreads	**152**	bps	98	**120**	**125**	180	165
High-yield credit spreads	**458**	bps	331	**400**	**420**	650	525
Equity							
Eurostoxx (total return p.a.)	**-9.9 (ytd)**	%	20.4	**3**	**6**	-13	4

US			**2021**	**2022f**	**2023f**	**2022f**	**2023f**
Government Debt							
Policy rate (mid-rate)	**0.375**	%	0.125	**1.625**	**2.625**	0.125	0.125
10y yield (Treasuries)	**2.19**	%	1.50	**1.90**	**2.30**	1.20	1.50
Corporate Debt							
Investment grade credit spreads	**146**	bps	98	**115**	**120**	175	160
High-yield credit spreads	**396**	bps	310	**390**	**415**	600	500
Equity							
S&P 500 (total return p.a.)	**-8.6 (ytd)**	%	26.9	**4**	**7**	-11	5

Emerging Markets			**2021**	**2022f**	**2023f**	**2022f**	**2023f**
Government Debt							
Hard currency spread (vs USD)	**402**	bps	295	**360**	**375**	470	430
Local currency yield	**6.2**	%	5.7	**6.7**	**6.5**	8.2	7.0
Equity							
MSCI EM: total return p.a. in USD	**-12.0 (ytd)**	%	-4.6	**0**	**4**	-14	3

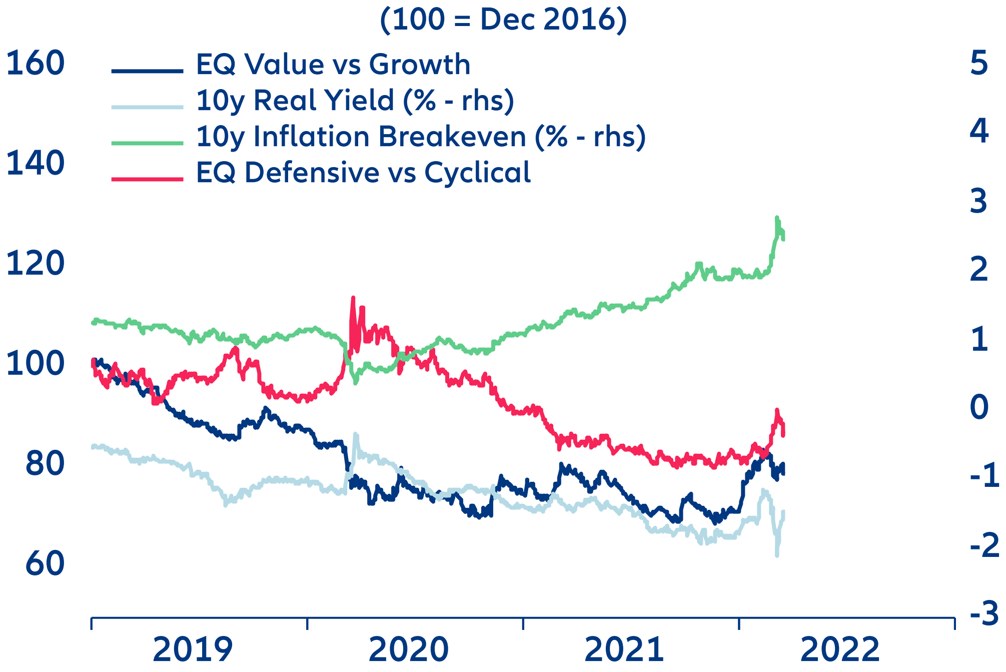
Capital markets changing regimes

EUR risky assets vs monetary policy



Source: Refinitiv Datastream; Allianz Research (as of 3/17/2022)

EMU EQ styles vs 10y yields breakdown

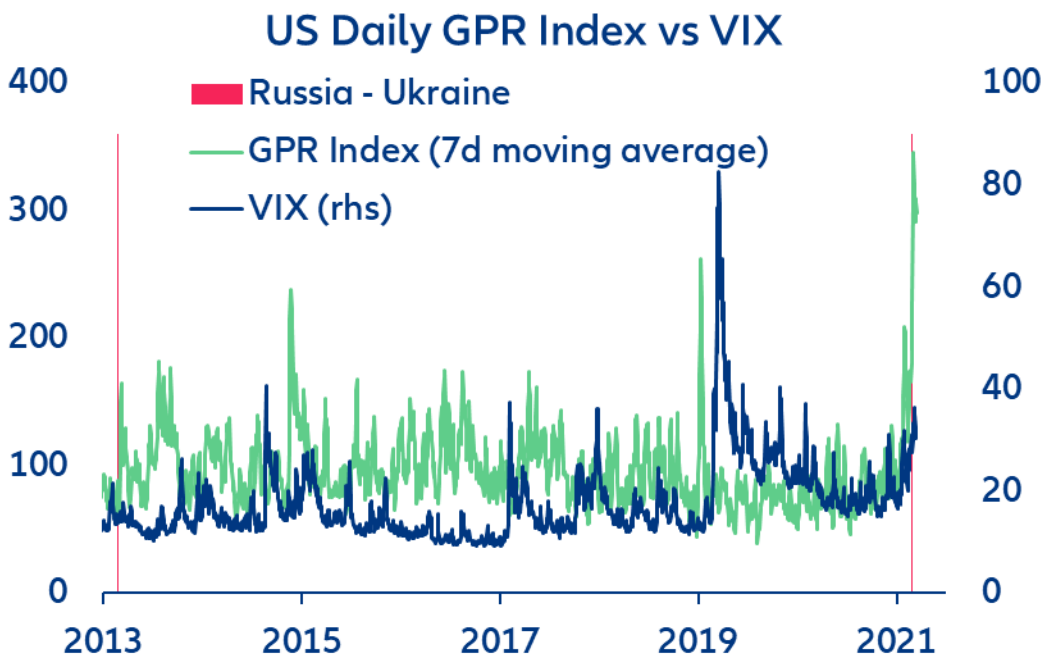


Source: Refinitiv Datastream; Allianz Research (as of 3/17/2022)

Since Q4 2021 and mostly in 2022, markets have already experienced two structural shifts in market sentiment and positioning

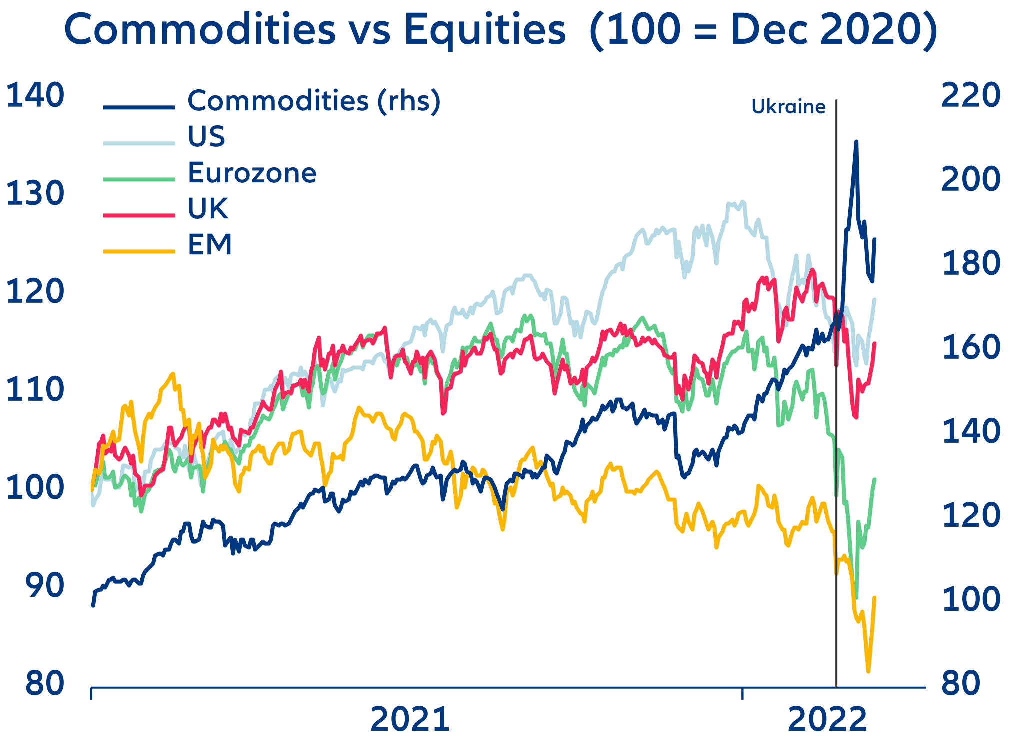
Initially, markets repositioned for a faster than expected monetary policy normalization which managed to de-rail markets from their sticky post-Covid structural bull-run

Capital markets are nervous



Note: Geopolitical Risk Index: Caldara, Dario and Matteo Iacoviello, Board of Governors of the Federal Reserve
Sources: Refinitiv, Allianz Research

The invasion of Ukraine has exacerbated downside pressures in capital markets but has yet to trigger dislocations commonly associated with financial crises

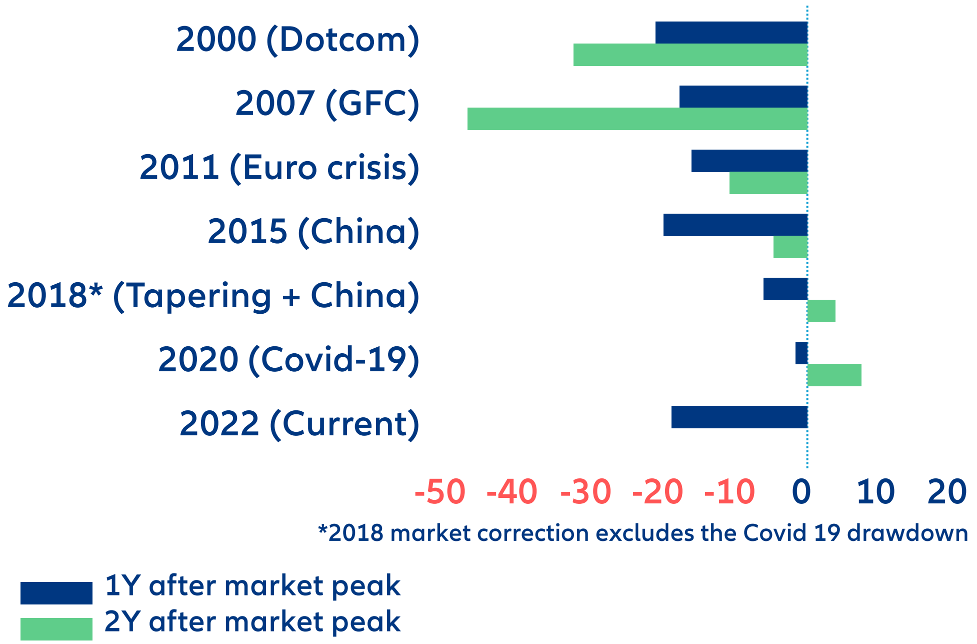


Source: Refinitiv Datastream; Allianz Research (as of 3/17/2022)

Since Q4 2021, markets have already experienced a significant deterioration in market sentiment

EQ sell-off consistent with history

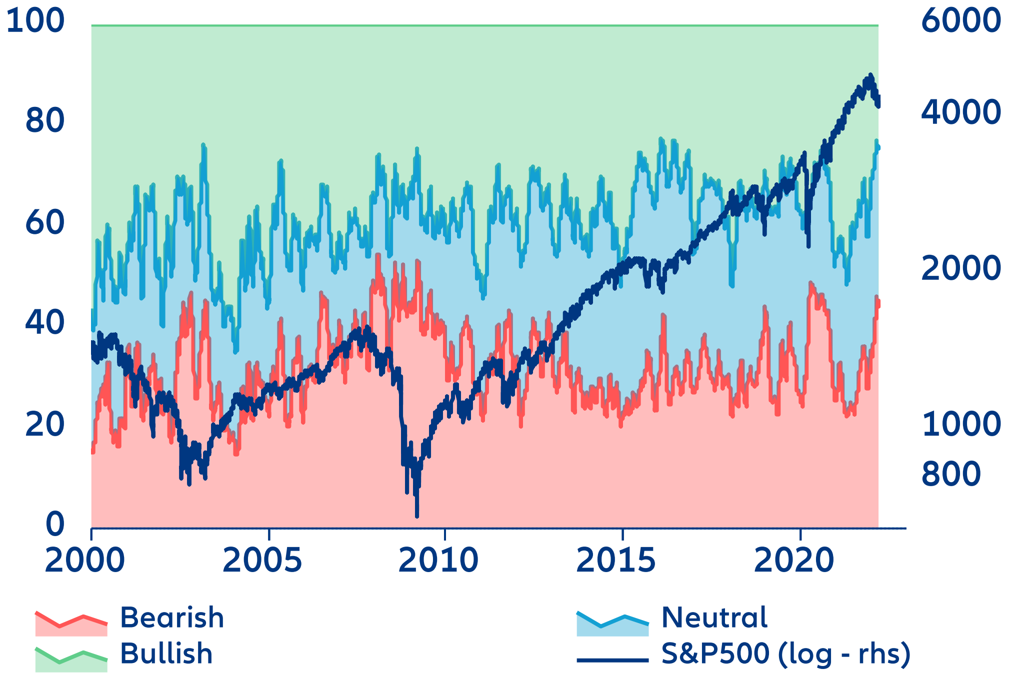
Euro stoxx corrections from market peak



Source: Refinitiv Datastream; Allianz Research (as of 3/17/2022)

The peak-to-date performance of equities has been similar to those experienced during other historical market sell-offs

US Investor sentiment vs S&P500



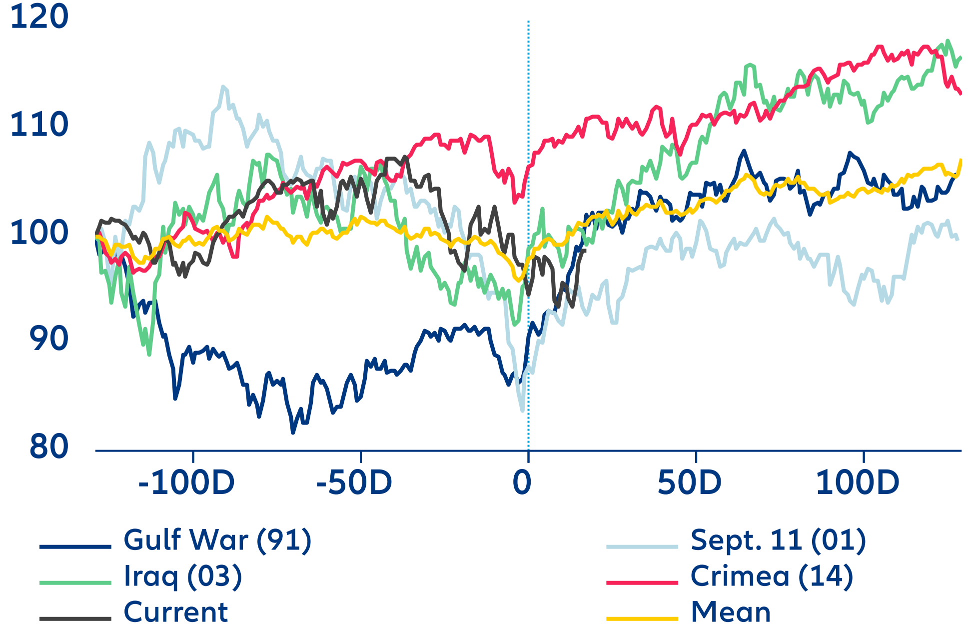
Source: Refinitiv Datastream; AAII; Allianz Research (as of 3/17/2022)

Aggregated market sentiment has rapidly shifted with market participants turning as bearish as were at the onset of the COVID-19 crisis and during the global financial crisis (GFC)

Markets rebound after wars

US Equities vs War periods

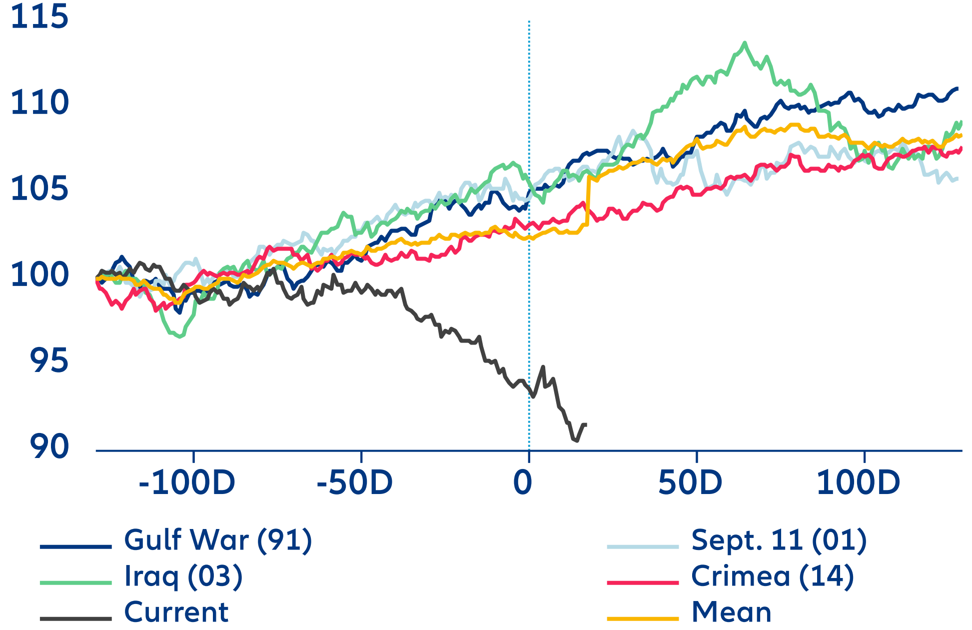
100 = - 120 days



Source: Refinitiv Datastream; Allianz Research (as of 3/17/2022)

US IG Corporate vs War periods

100 = -120 days

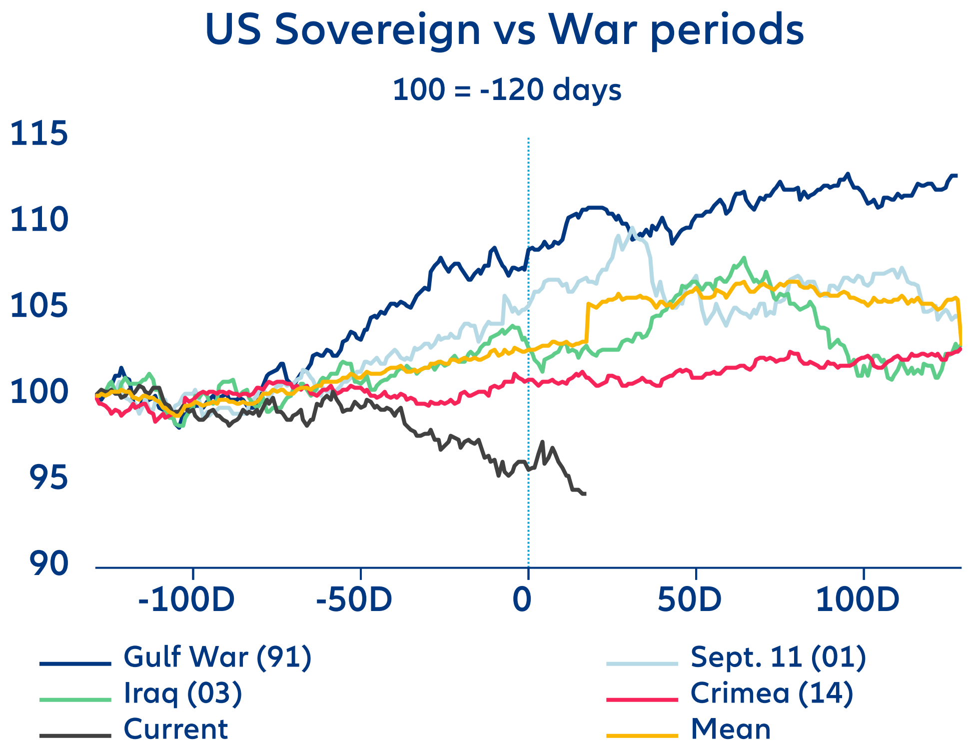


Source: Refinitiv Datastream; Allianz Research (as of 3/17/2022)

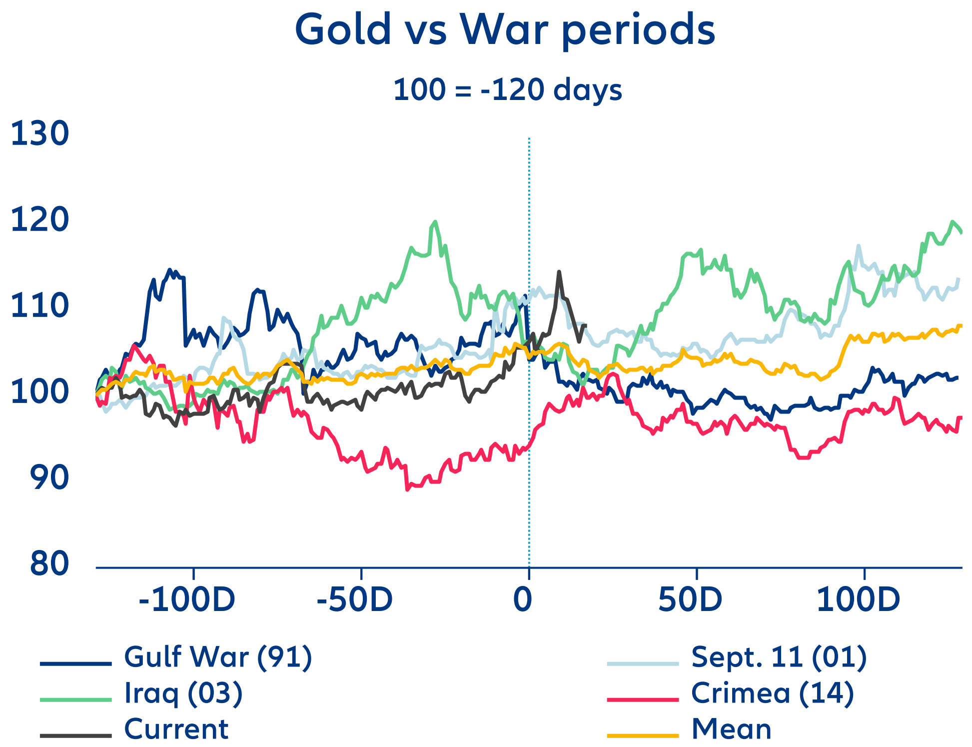
Historically, publicly-traded assets do not underperform during times of war or geopolitical conflict

Over the last 30 years, after each crisis, all asset classes recorded a mildly positive return performance over a three-month period

Markets positioned for stagflation



Source: Refinitiv Datastream; Allianz Research (as of 3/17/2022)

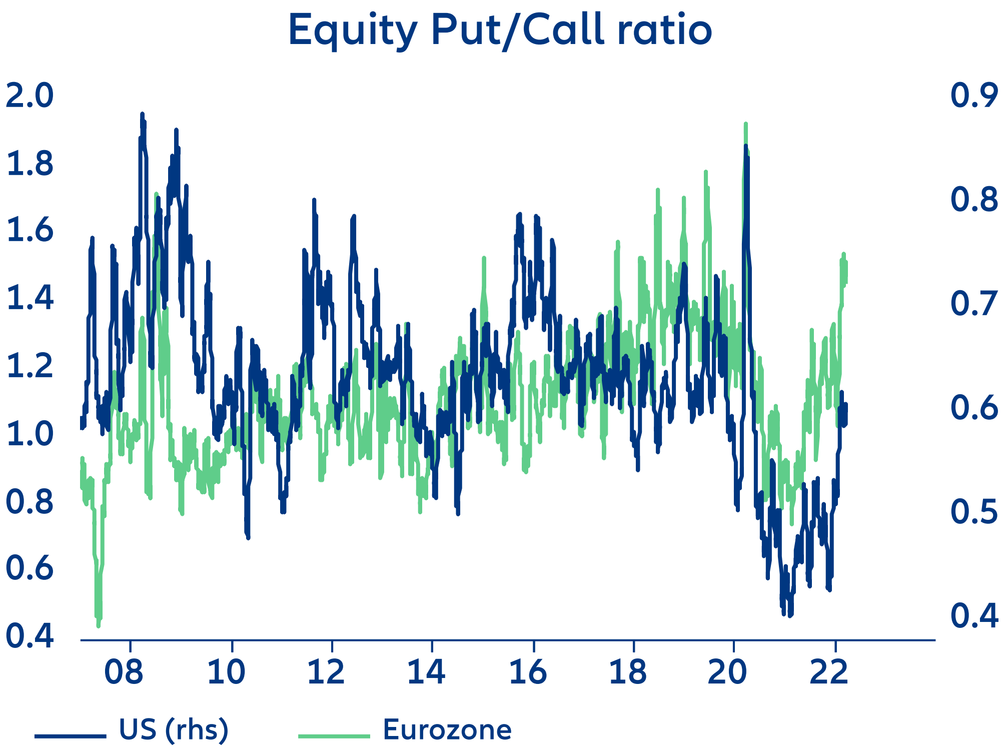


Source: Refinitiv Datastream; Allianz Research (as of 3/17/2022)

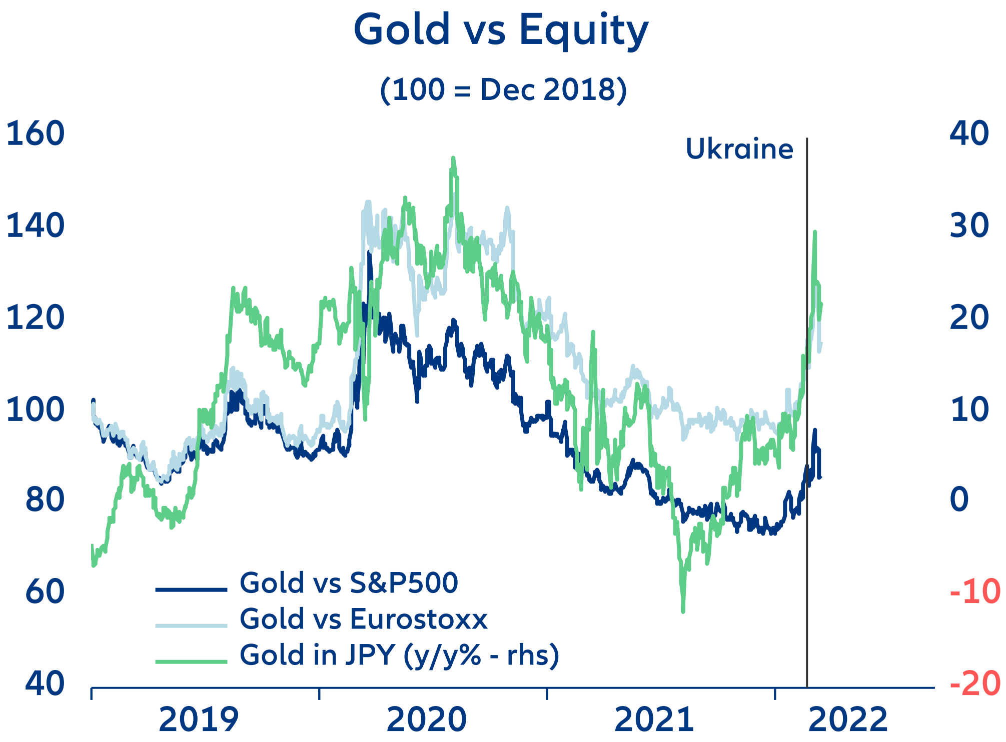
The current market correction at the time of conflict seems far more abrupt, especially for risky assets.

This suggests that this time things might be different as the stagflationary environment creates a double-edged sword for risky assets

A hard to hedge market correction



Source: Refinitiv Datastream; Allianz Research (as of 3/17/2022)

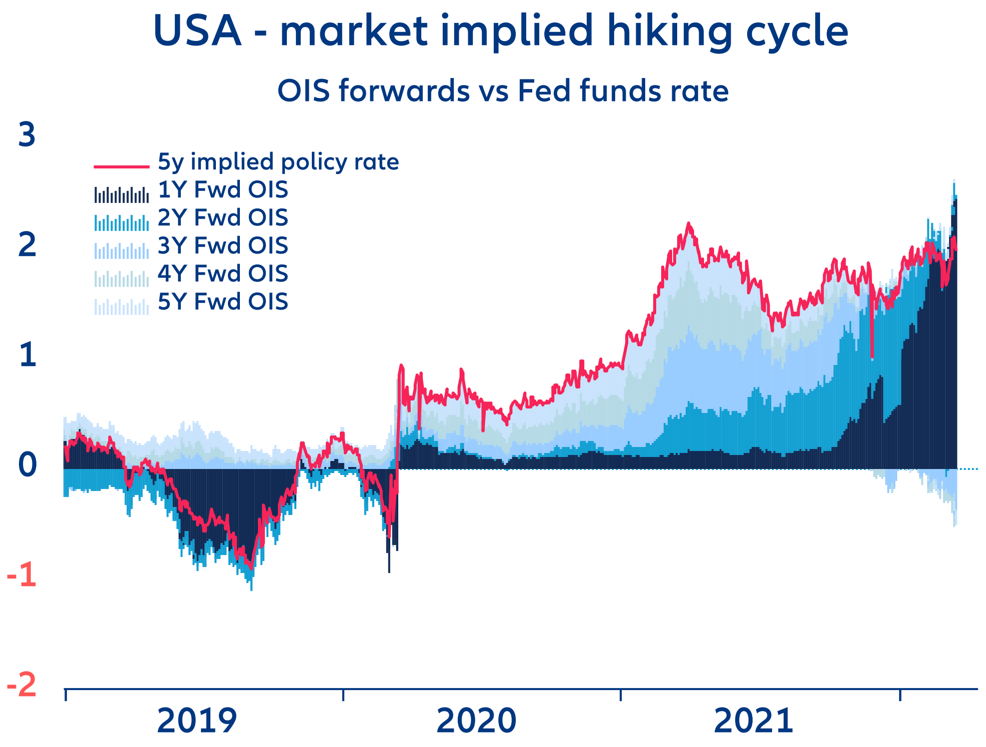


Source: Refinitiv Datastream; Allianz Research (as of 3/17/2022)

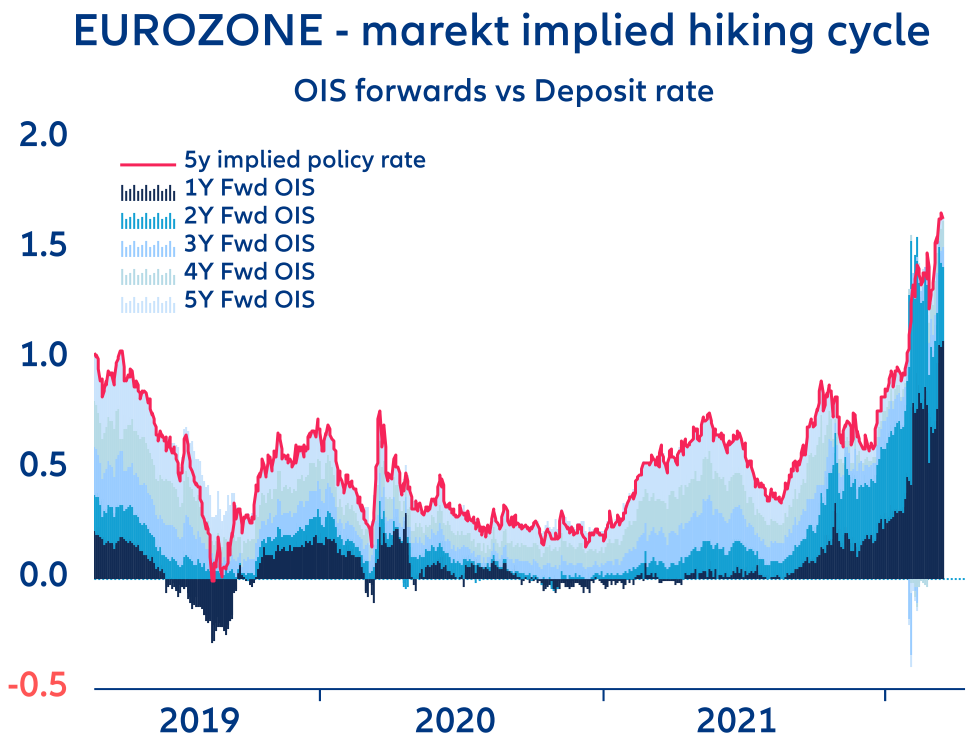
High uncertainty has also impacted market liquidity and hedging strategies. market participants have increased their put protection as depicted by the rapid increase in the put to call ratios

This increase in aggregated hedging has been far more pronounced in Europe than in the US

Frontloaded and shallow hiking cycle



Source: Refinitiv Datastream; Allianz Research

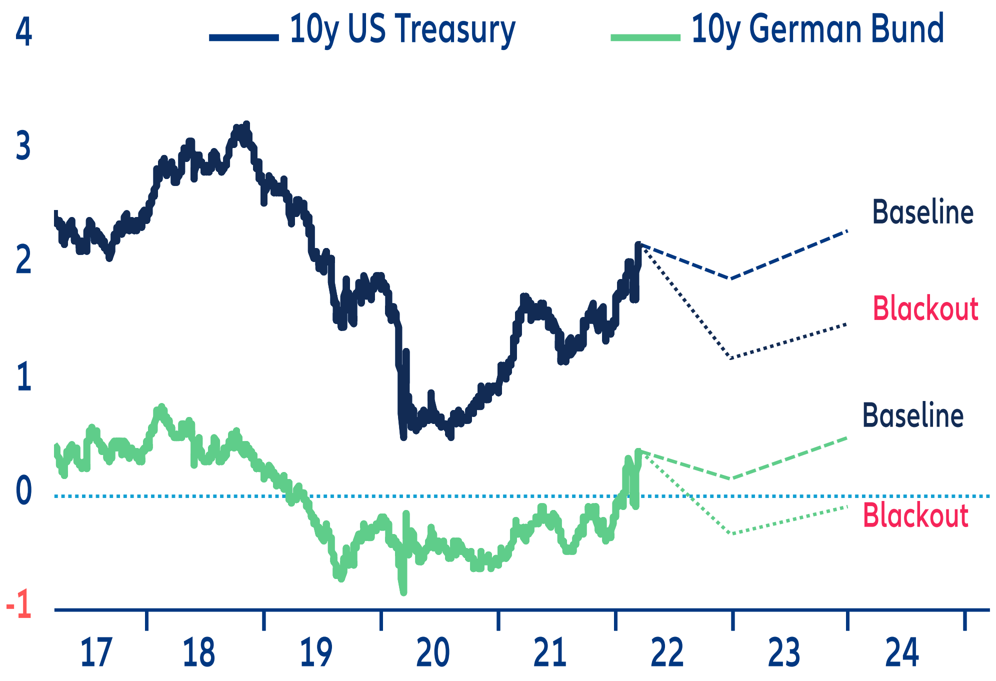


Source: Refinitiv Datastream; Allianz Research

Heavily frontloaded forward term structure with hiking cycles entirely priced within the next 18 months. Two main reasons: (i) weakening upside spiral between oil price and inflation expectations and (ii) rising recession fears as higher rates will affect already slowing growth.

Sovereigns in stagflation mood

US & Germany: 10y yield outlook

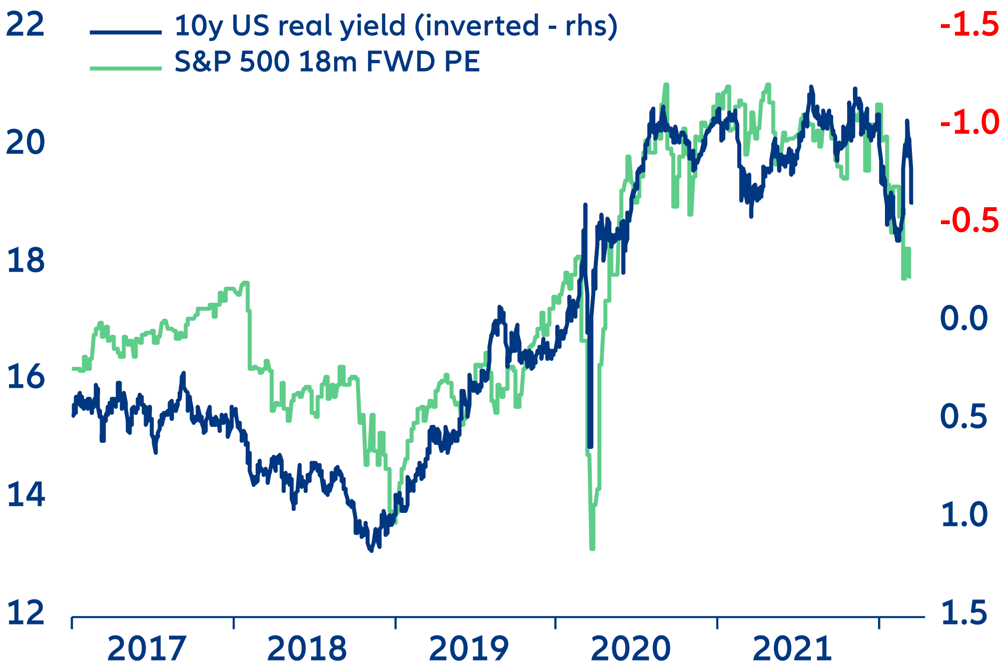


*percentage deviation from filtered trend (Kalman)
Sources: Refinitiv Datastream, Allianz Research

- Generally, little upside from expected nominal short-term rates given the already ambitious market pricing and (re-)anchoring inflation expectations.
- Baseline: 10y US Treasuries around 2% in 2022 and 2.3% in 2023, 10y German Bunds at 0.15% and 0.5%
- Term premium upside by QT contained by reduced inflation risk premium and safe haven demand
- Blackout: 10y US Treasuries at 1.2% in 2022 and 1.5% in 2023, 10y German Bund at -0.35% in 2022 and -0.1% in 2023.
- Recession risks materialize. Sharp downside adjustment of expected nominal short-term rates, lower term premium due to safe haven flows and reduced QT

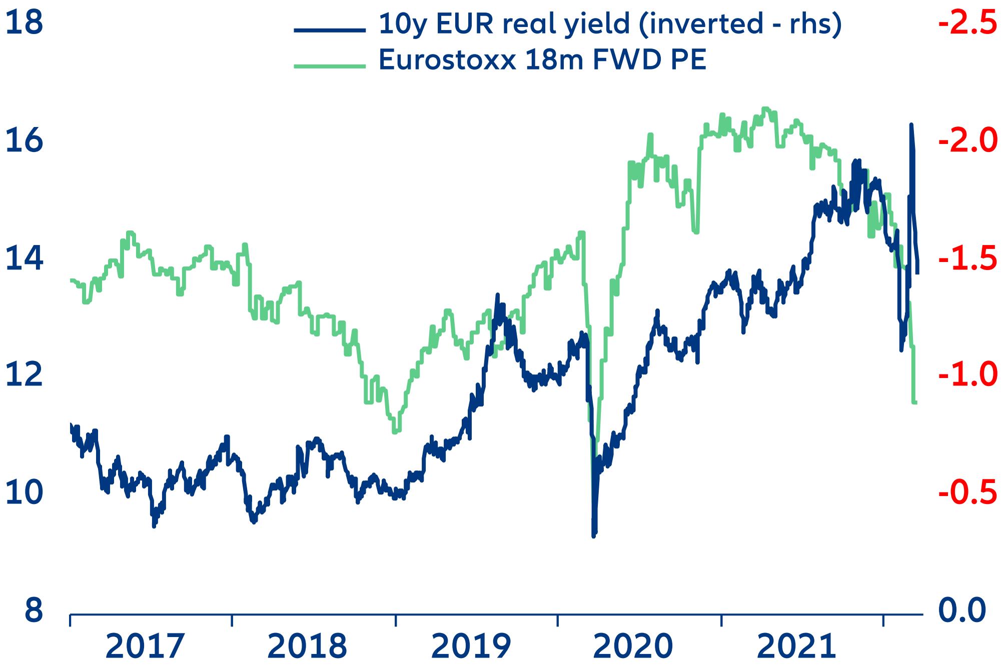
Equities are central bank dependent

S&P 500 valuations vs real yields



Source: Refinitiv Datastream; Allianz Research (as of 3/17/2022)

Eurostoxx valuations vs real yields

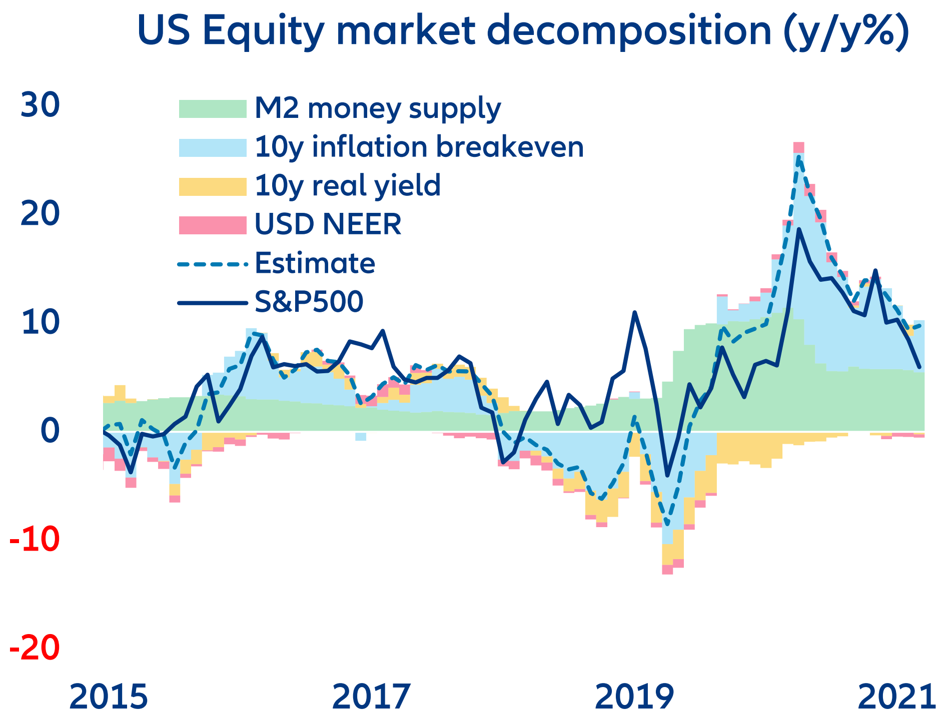


Source: Refinitiv Datastream; Allianz Research (as of 3/16/2022)

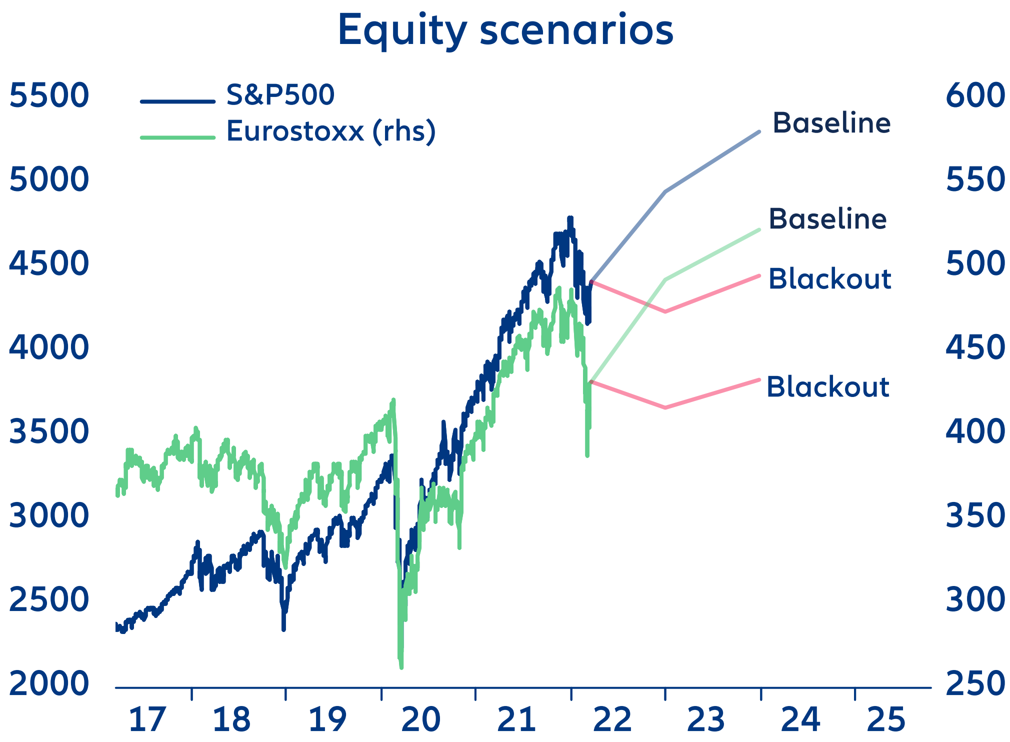
The expected decline in real yields should stabilize equity markets as long as the global economy does not end up in a full-fledged recessionary environment

Monetary and fiscal policy will remain a key determinant of future market behavior

Equities will end the year almost flat



Source: Refinitiv, Allianz Research



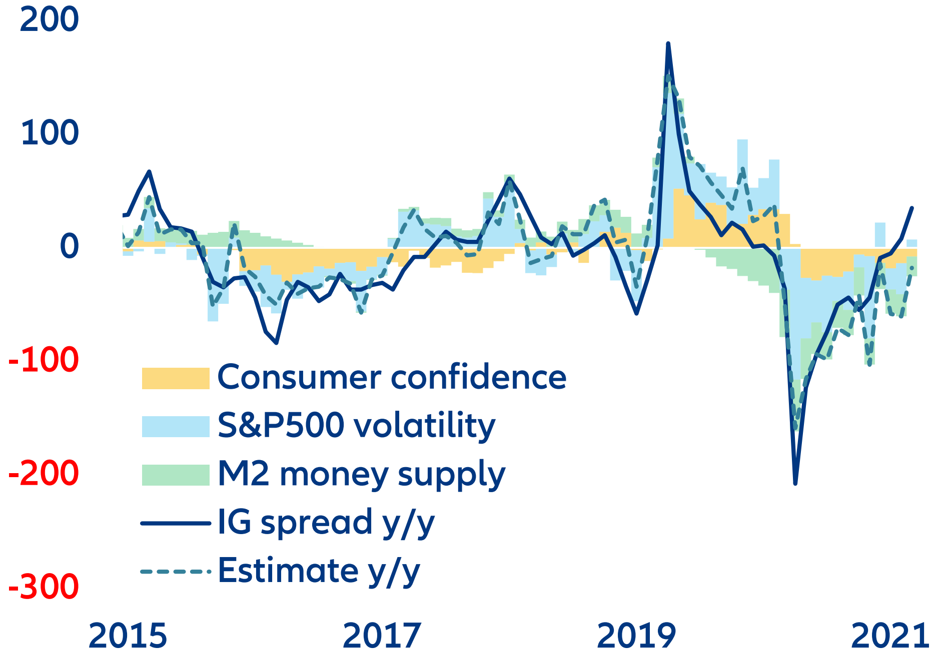
Source: Refinitiv Datastream; Allianz Research (as of 3/17/2022)

The effective balance between changes in the monetary stance and inflation expectations will be the key determinant of future returns as it will signal if the economy will manage to avoid stagflation

Our central scenario depicts extremely muted positive yearly total returns for equity markets while our adverse scenario shows a double-digit contraction

Credit spreads are set to compress

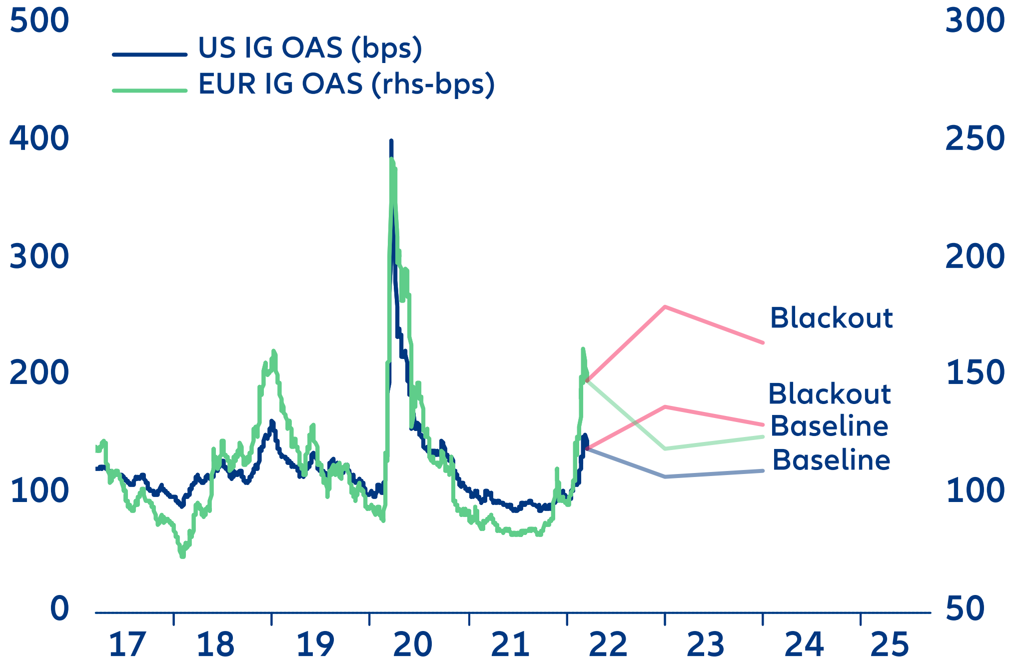
US IG credit spread decomposition (y/y)



Source: Refinitiv, Allianz Research

The fine balance between policy moves and short-term equity volatility should manage to compensate for a deteriorating consumer confidence keeping corporate spreads on a leash

Investment Grade spread scenarios (bps)

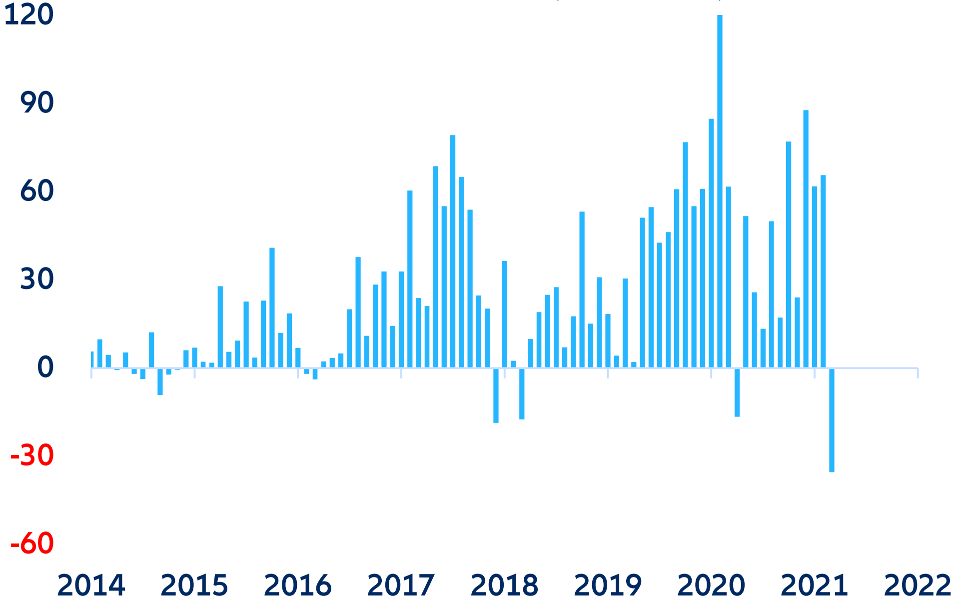


Source: Refinitiv Datastream; Allianz Research (as of 3/17/2022)

Within our baseline scenario, the recent widening of corporate spreads is likely to slow and even revert as markets reprice the possibility of extended monetary and fiscal policy support

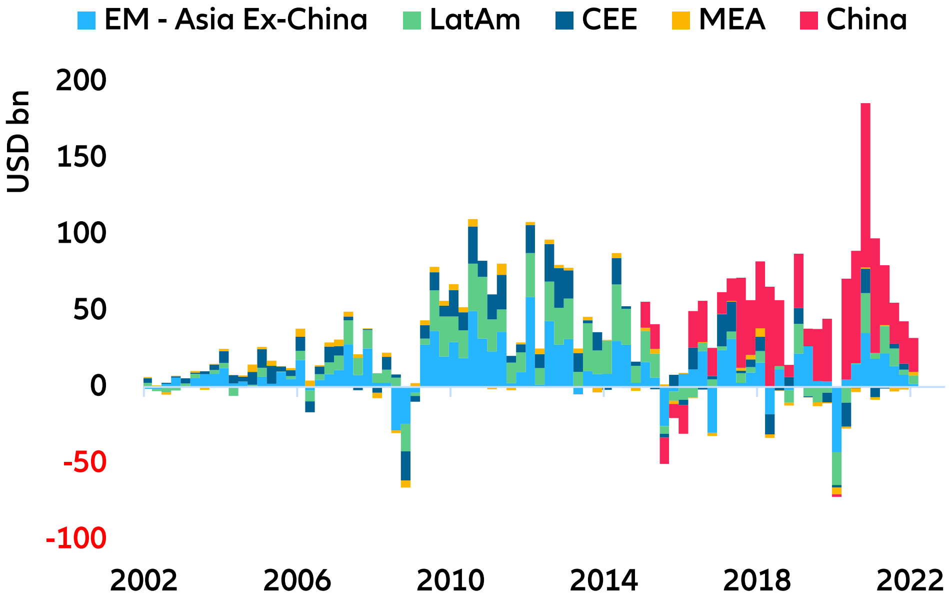
Emerging markets capital flows

Monthly changes in foreign holdings of Chinese treasureis (CNY,bn)



Sources: Bloomberg , Allianz Research

Quarterly capital flows from/to EM, by region



Sources: IIF, Allianz Research

Tensions in the US-China relationship worsen, which has been felt in the Chinese stocks but it will be interesting to know whether it extends to the bond market.

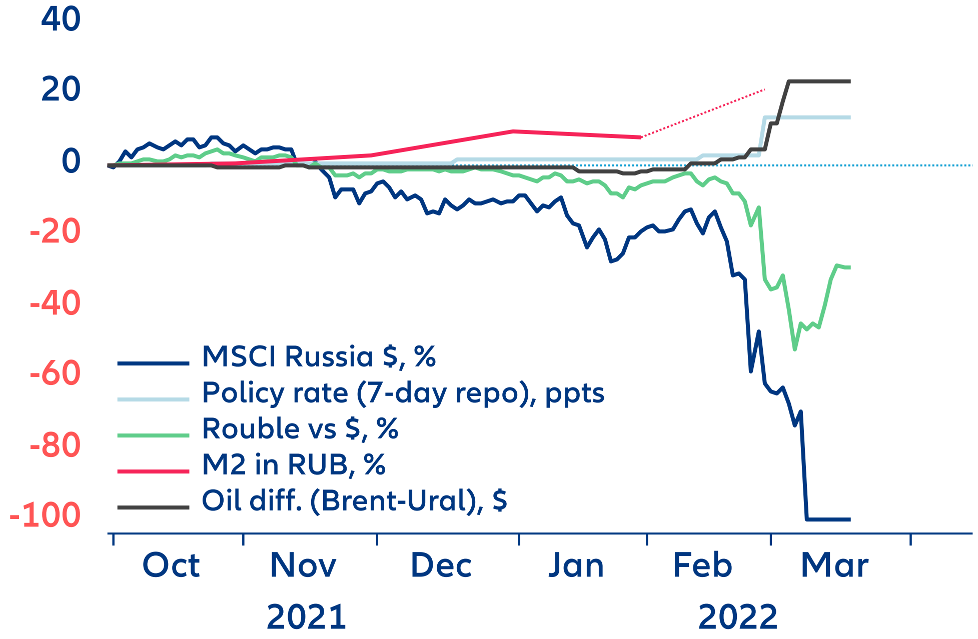
Vulnerabilities, Fed rate hikes and contagion tantrum will make of 2022 a tough year for EM capital flows.

Regional Outlook

Russian economy after sanctions

Russian Economy after sanctions

Cumm. change since 30/09/21



Source: Refinitiv Datastream; Allianz Research (as of 3/17/2022)

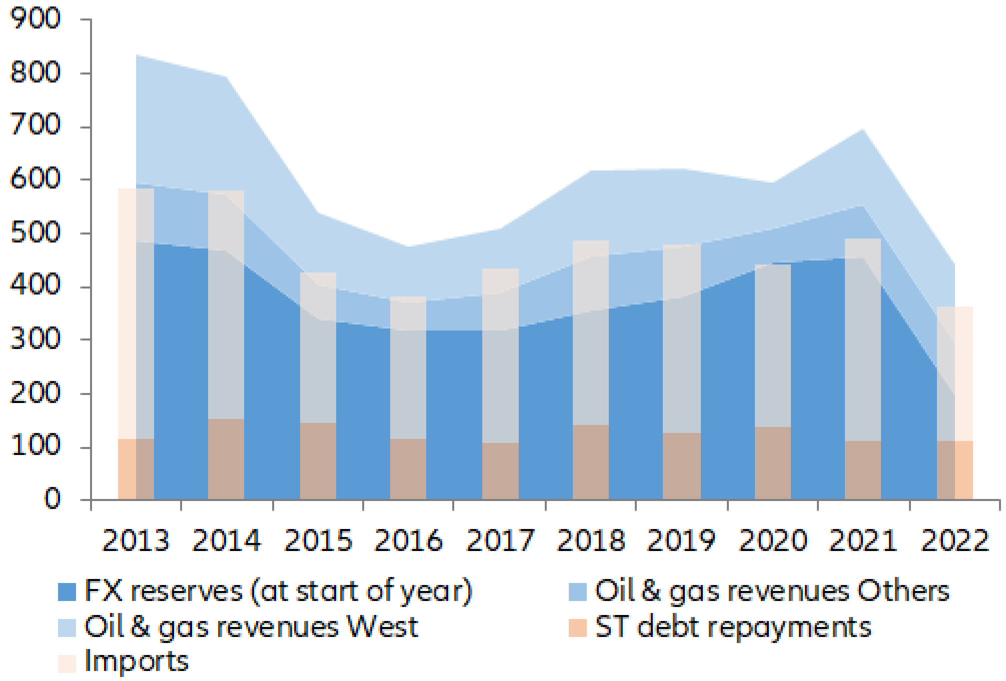
The M2 figure for February is estimated based on daily operations by the CBR. Official value expected by 31/03.

Impact & Policy Measures

- Ruble depreciates by more than 40%
- CBR raises interest rates from 9.5% to 20%
- Run on Russian banks, M2 surges by 12.5%
- ECB warns of Sberbank Europe default
- Russian companies must cede 80% of their FX revenues
- Foreigners banned from selling securities on the Moscow exchange

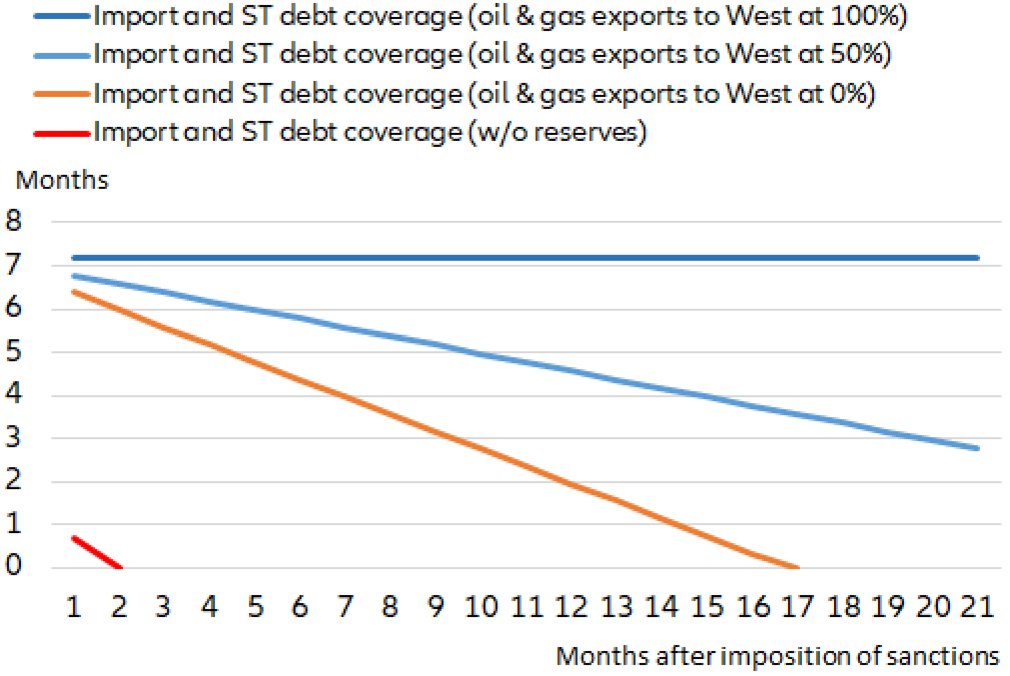
How long can Russia survive sanctions?

FX reserves and income vs. FX needs (USD bn)



Sources: Refinitiv, Central Bank of Russia, Allianz Research estimates

Import and ST external debt (public and private) coverage under various export scenarios



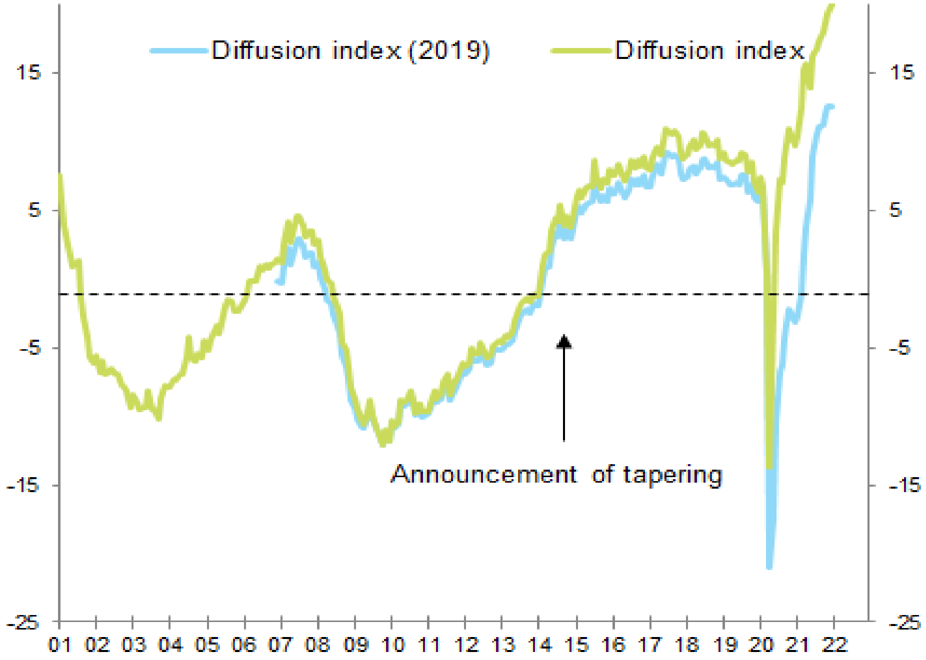
Sources: Refinitiv, Central Bank of Russia, Allianz Research

Without oil & gas revenues from the West, usable FX reserves (excl. frozen reserves) and FX income will barely cover FX needs in 2022.

Unless the West stops importing oil & gas, it is virtually impossible for Russia to become bankrupt.

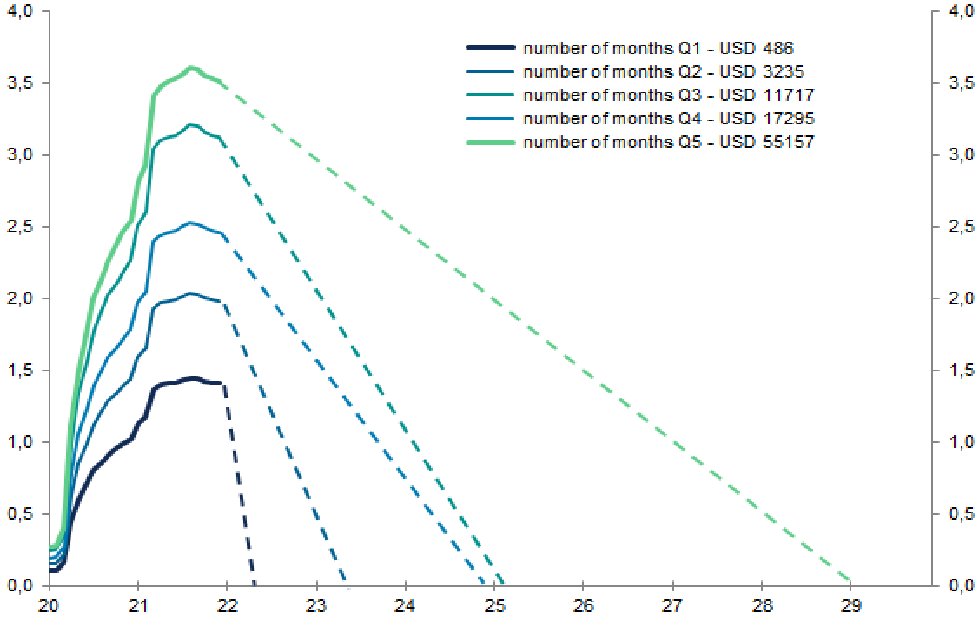
The war is not a macro game changer

US job market diffusion index



Sources: Refinitiv, Allianz Research

US households excess saving (as number of months to withstand current inflationary shock, per quintiles)



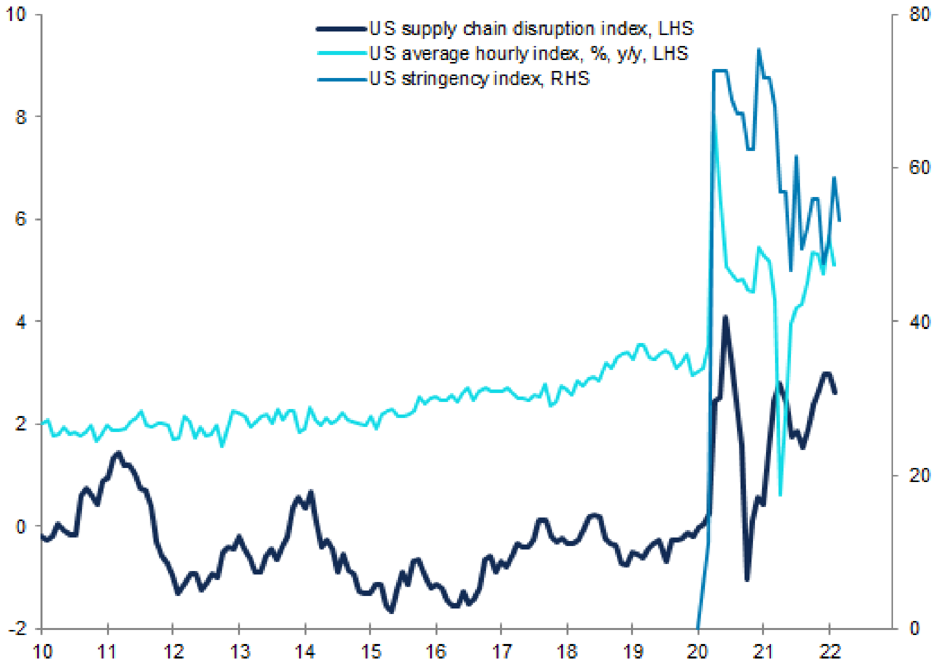
Sources: national sources, Allianz Research

Our US job market diffusion index (measuring the normalized distance to maximum value of 10 different indicators) shows that the US job market has rarely been as tight and strong as today. Recor high job openings mirror an important albeit temporary lack of job supply after the big resignation

The excess saving of the lowest incomes (Q1) has been already depleted in this beginning of 2022, contributing to make them return to the job market quicker compared with other categories. However, the rest of the population has much more leeway to absorb any inflationary shock

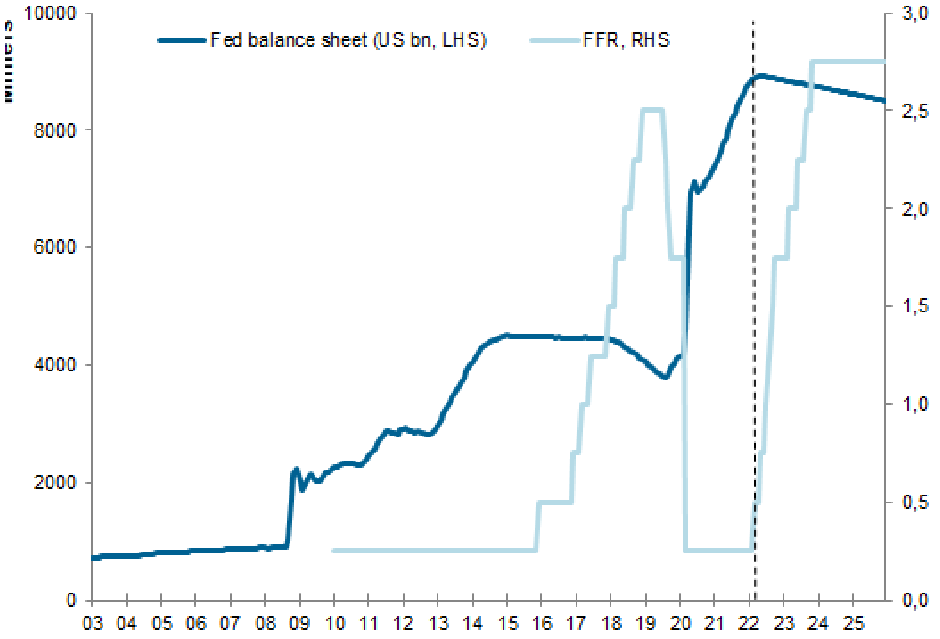
The Fed cannot afford high inflation risks

Explanatory factors of inflationary persistence



Sources: Refinitiv, Allianz Research

The Fed to hike six times the FFR in 2022 (%)



Sources: national sources, Allianz Research

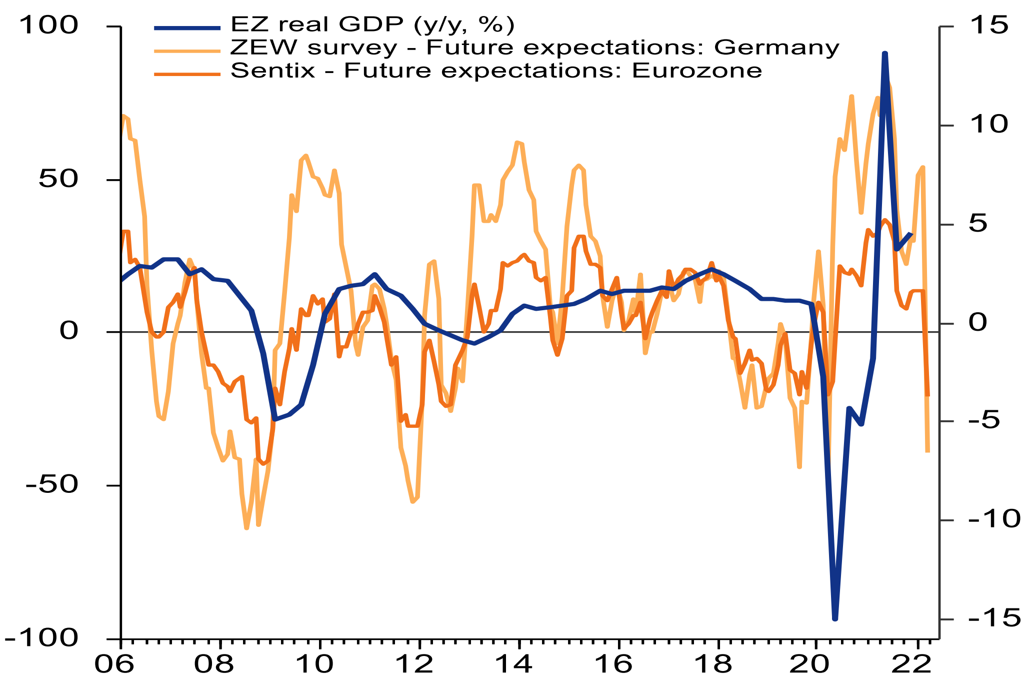
Critical variables, such as the stringency index (the higher the lower the free circulation of factors of production, the level of disruption in supply chains (thwarting any matching between supply and demand) and salaries take a longer than expected time to normalize.

We have revised on the downside our GDP growth scenario to 3.3% y/y in 2022 and on the upside for inflation to 6.1% y/y. The Fed thinks that the US economy is solid enough to envisage 6 hikes in 2022 (we see only five hikes post March decision to hike) and 4 in 2023 (like us). Its dual mandate today gives the priority to prices stabilization

EUROZONE

Sharp blow to the recovery pace

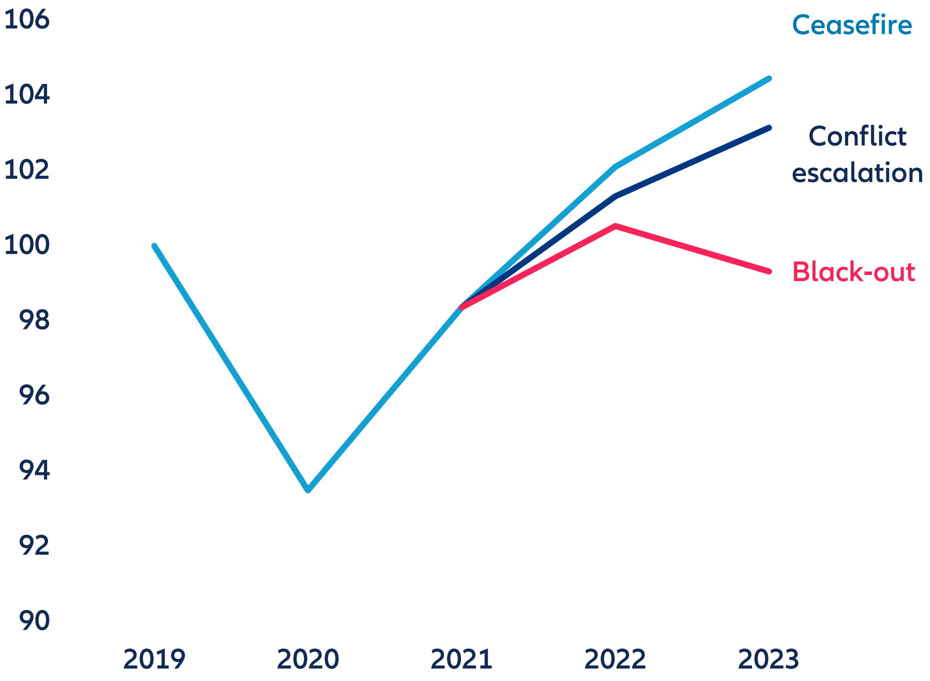
Eurozone real GDP (Y/Y, %) vs. ZEW and Sentix survey



Sources: Refinitiv, Allianz Research

Confidence survey suggests the war in Ukraine will pose a major headwind to the Eurozone recovery.

Eurozone: Real GDP under different scenarios

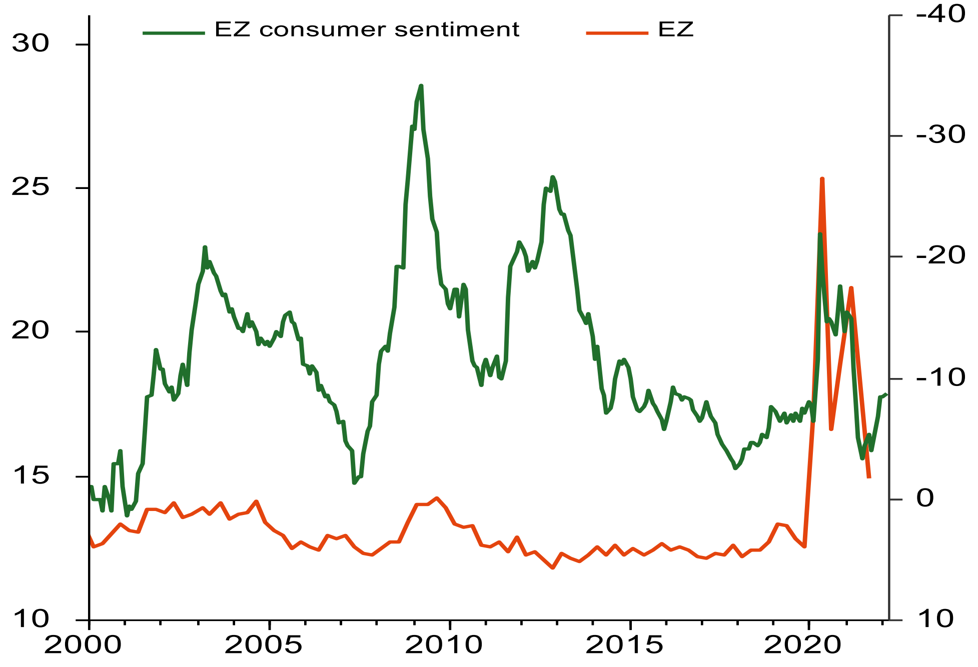


Sources: Refinitiv, Allianz Research

In our base case “Conflict escalation” we expect GDP growth to slow to 2.6% in 2022 and 1.6% in 2023. In our downside scenario “Black-out” the Eurozone economy will slip into a sharp recession in H2 2022.

Consumer under pressure

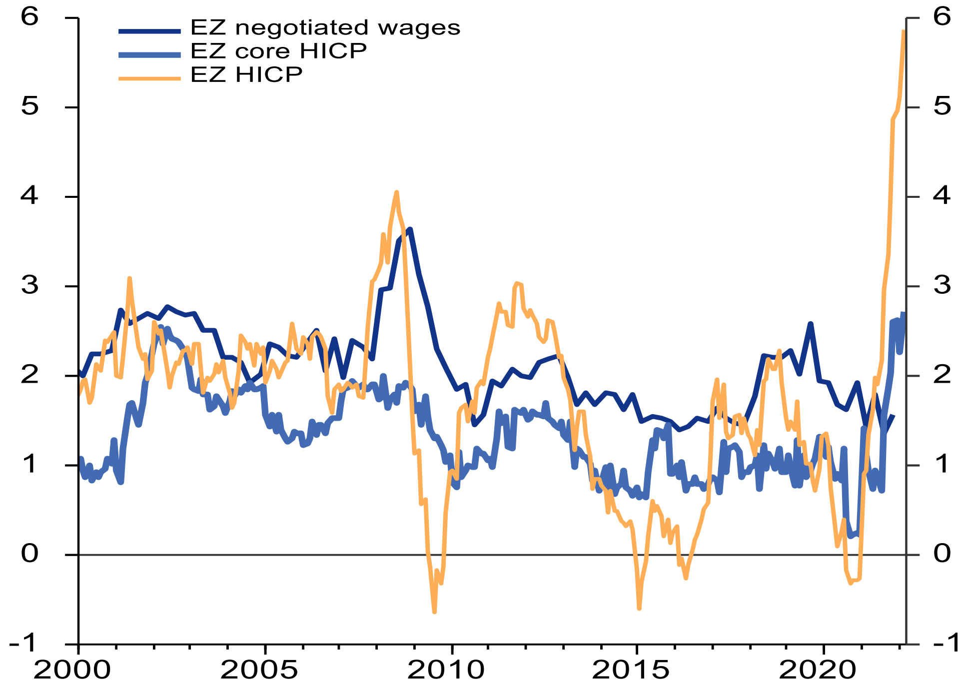
Eurozone: Gross household savings rate (rhs, inverted axis) vs. consumer confidence (lhs)



Sources: Refinitiv, Allianz Research

Excess savings were expected to power the recovery across the Eurozone. Elevated uncertainty will see consumers cut back on consumption plans instead.

Eurozone: Negotiated wages & inflation (y/y, in %)

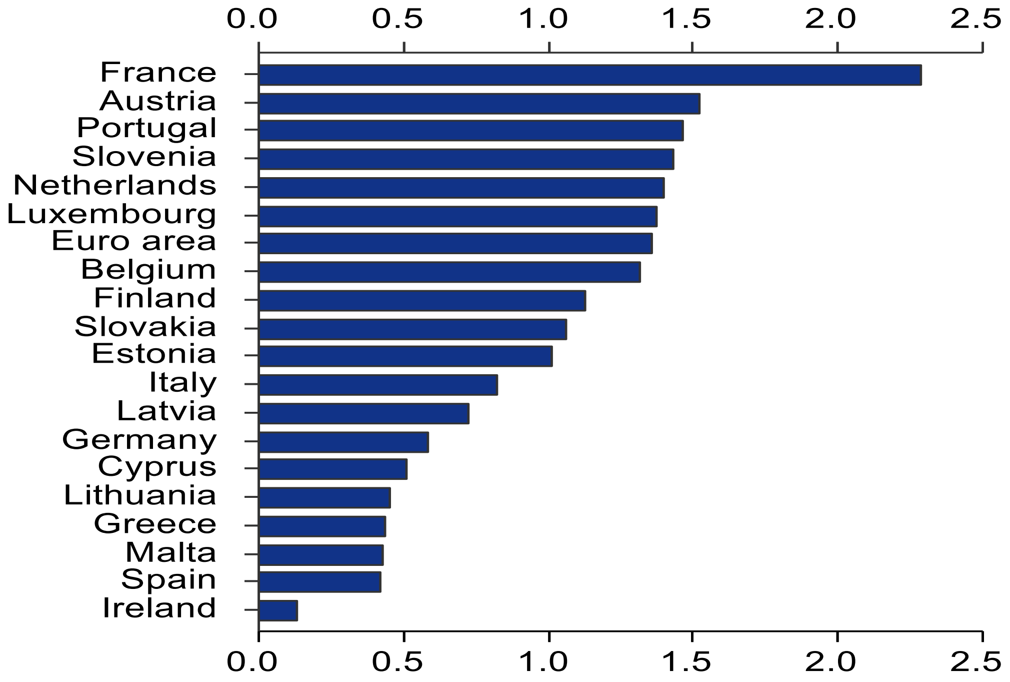


Sources: Refinitiv, Allianz Research

With wage growth unlikely to make up for the surge in inflation – as unions could restrain their wage demands in exchange for job security - , the hit to household purchasing power will weigh on consumption prospects.

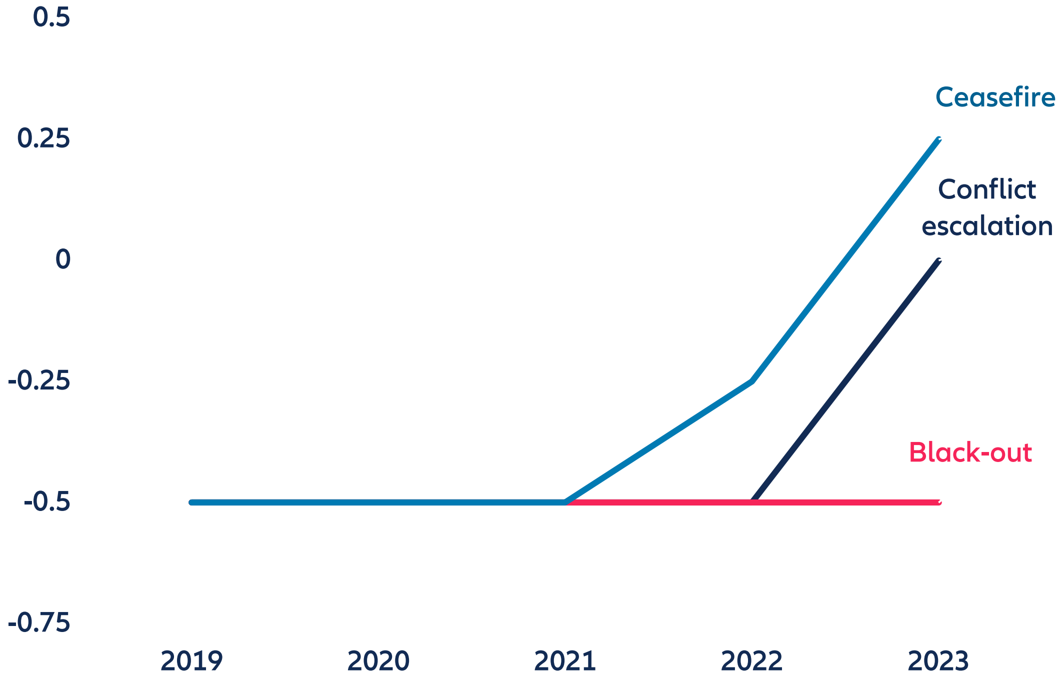
ECB to err on the cautious side

Eurozone household one-year inflation expectations, Net balances, Z-scored, February 2022



Sources: Refinitiv, Allianz Research

ECB deposit rate (%)



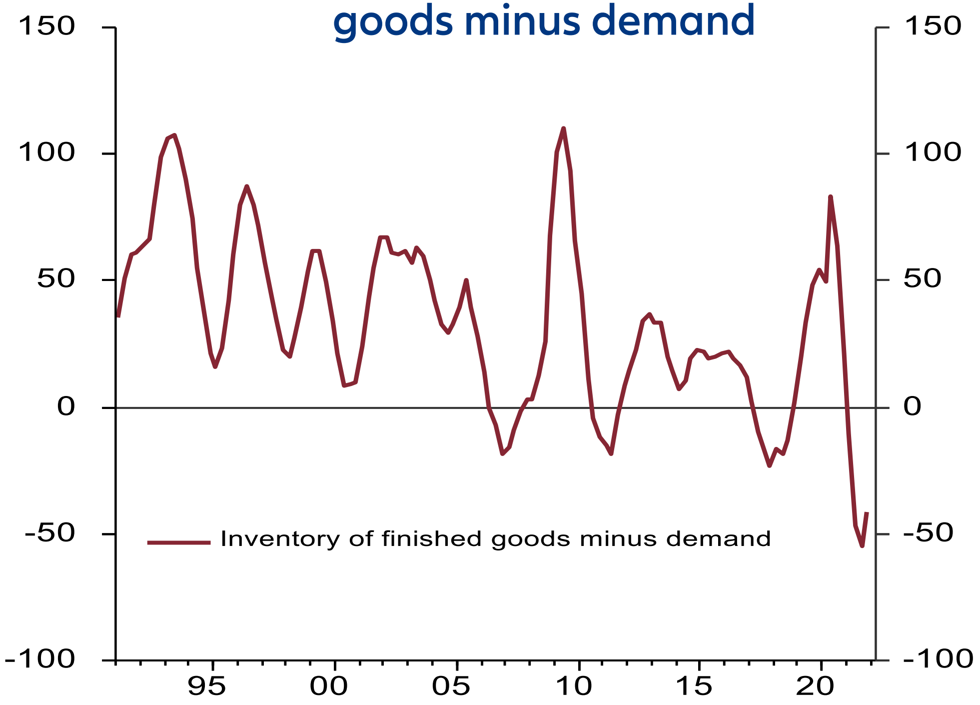
Sources: Refinitiv, Allianz Research

The ECB can afford to remain in wait-and-see mode for now as survey-based household inflation expectations across the Eurozone remain moderate.

We only expect QE to be concluded by end-2022. A first 25bp rate hike will take place in Q1 2023 (previously expected in December) with an a second one following in June 2023.

Fiscal to the rescue

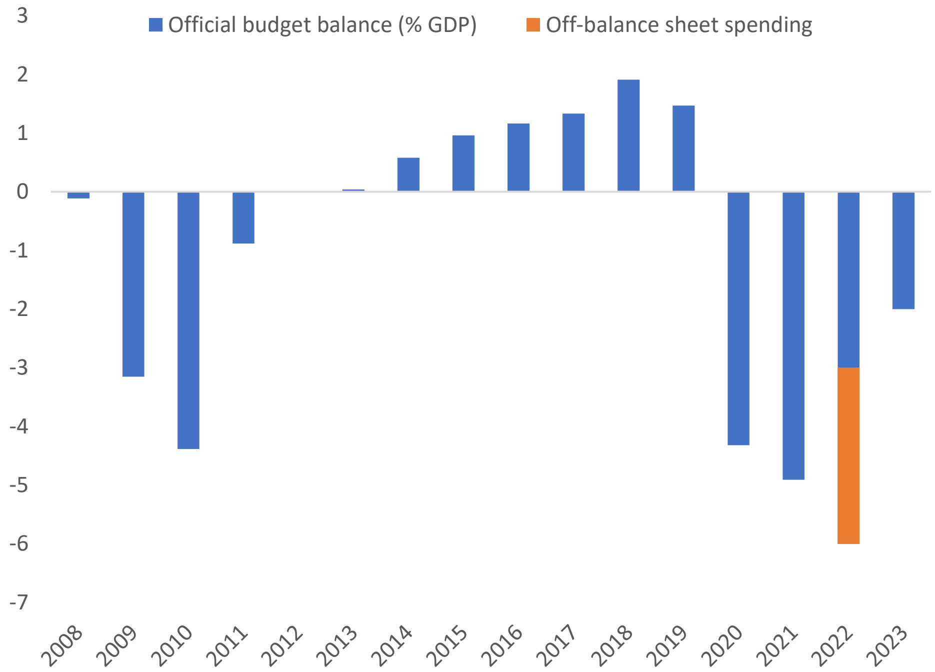
Germany: Intermediate goods – inventory of finished goods minus demand



Sources: Refinitiv, Allianz Research

Just as signs emerged at the turn of 2021-22 that supply chain bottlenecks are easing, the war in Ukraine plus China's tightening of sanitary restrictions will weigh on the industrial recovery in Germany.

Germany: Budget balance (% GDP)

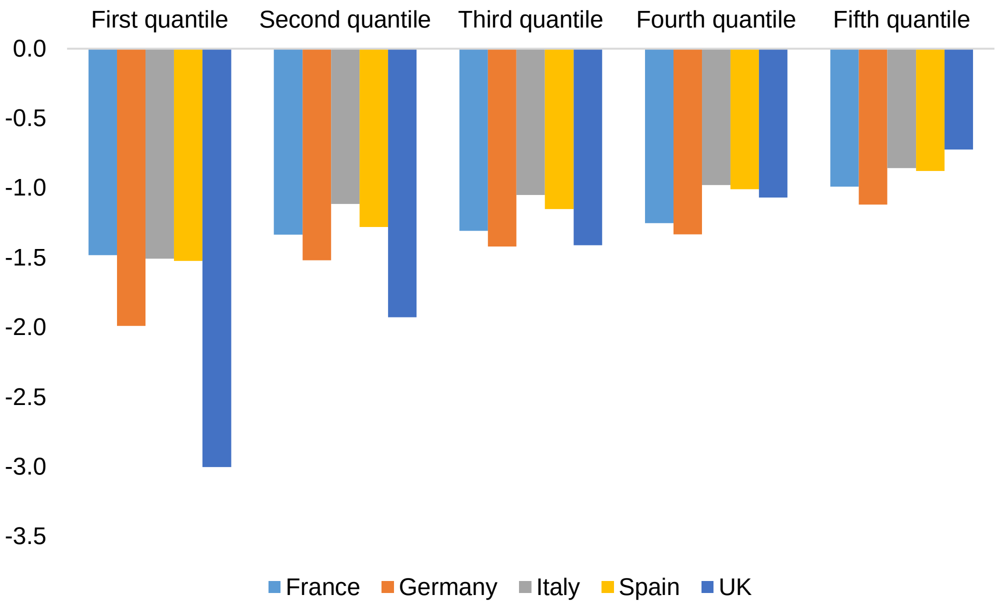


Sources: Refinitiv, Allianz Research

Fiscal policy is returning to emergency mode with the deficit rising to 6% when factoring in off-balance sheet spending on greening the economy and defense.

Purchasing power is key, notably in an electoral period

Estimated energy cost in 2022 (total increase of +30%), pp of disposable income



Sources: Eurostat, ONS, Allianz Research

Low-income households bear the brunt of the rise in oil and gas prices

- Despite France's limited dependency on Russian gas, **confidence channel and high inflation** will dampen economic outlook. We cut our **GDP forecast (-1pp) to 3%** in 2022 (-0.4pp) to 1.5% in 2023.

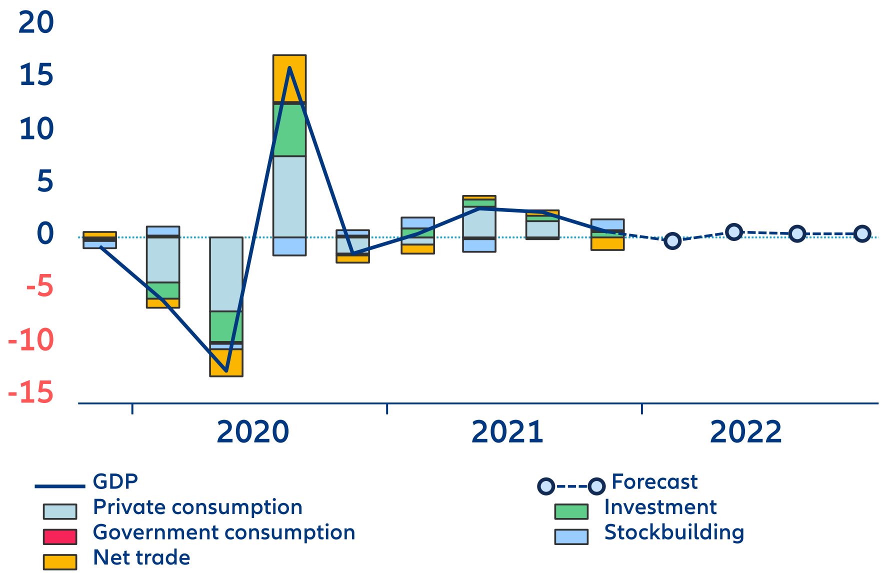
- We revised our (HICP) **inflation forecast up to 4.2%** in 2022 and to 2.6% in 2023.

- **Fiscal measures** to curb the impact of rising energy prices have already reached more than **1% of GDP** (EUR27bn). In 2022, budget deficit is expected to hover around -7% GDP for another year.

- **War in Ukraine** increased E. Macron's chances of being re-elected in a context of "search for stability". Macron scores 30% in 1st-round voting intentions followed by 17% for M. Le Pen, the far right candidate.

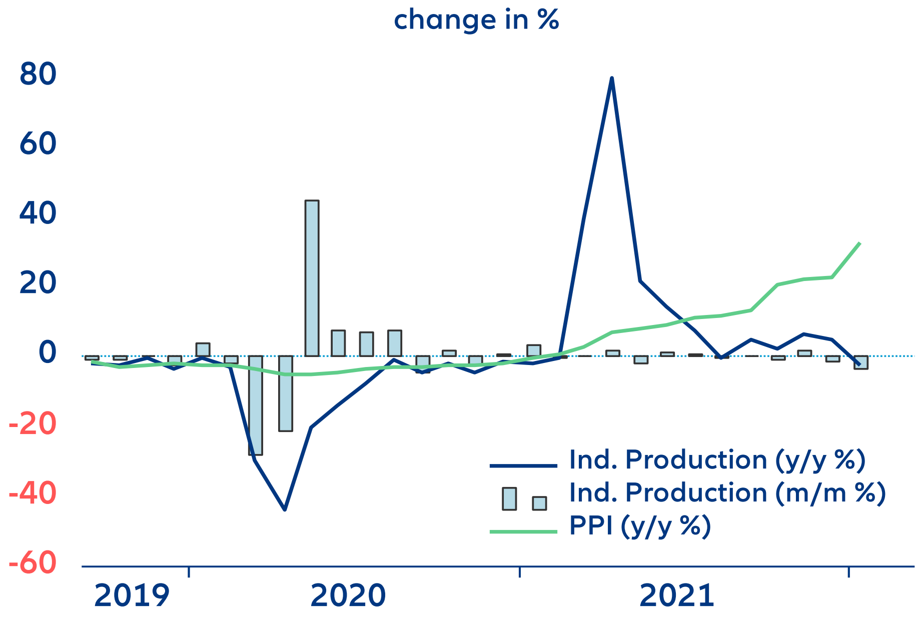
Manufacturing sector, already under pressure

Contributions to quarterly GDP growth



Source: Refinitiv Datastream; Allianz Research

Industrial production and production prices



Source: Refinitiv Datastream; Allianz Research

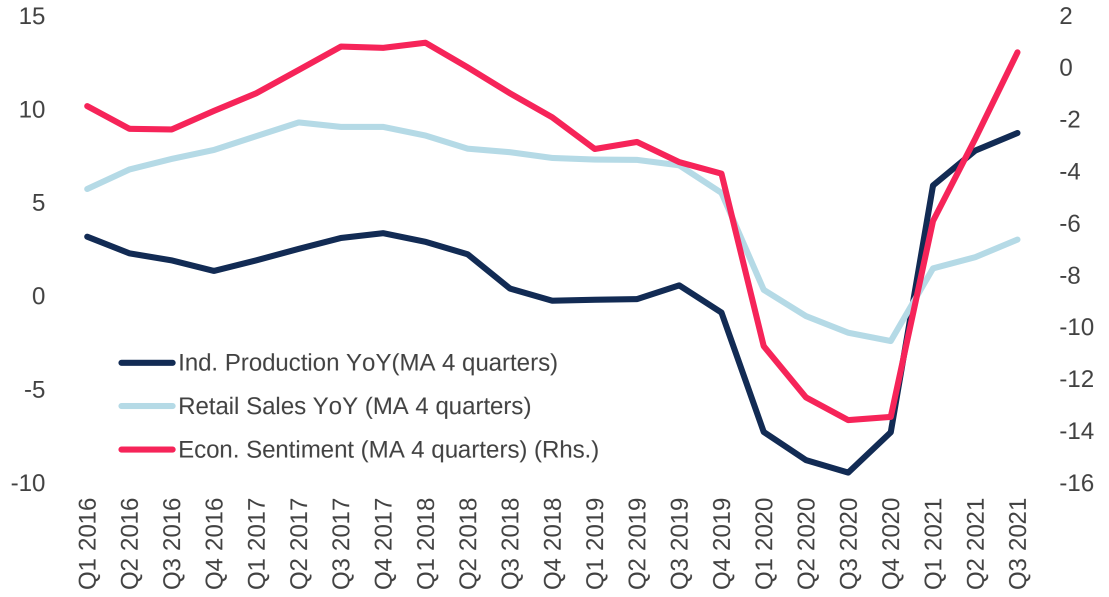
Weak start into the year with growth likely to turn negative (-0.3% q/q) in Q1. Private consumption affected by the energy shock despite fiscal cushioning. Annual growth expected at 2.6% after 4.5% pre-crisis.

Industrial production under pressure even before Ukraine crisis. Grim lookout for Q1 as just when supply chain disruptions started easing, the energy and commodity price channel is taking over.

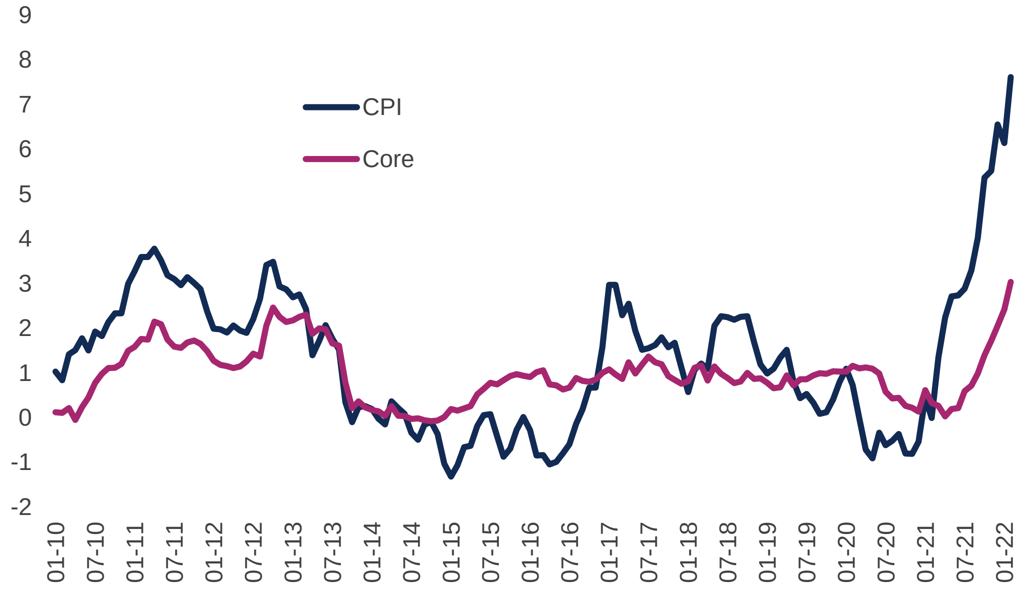
SPAIN

Russia-Ukraine conflict undermines the economic recovery

Economic recovery was on track in the beginning of the year



Inflation to stay high for a while



Economic sentiment reached the highest level in February 2022 in 20 years. However, economic uncertainties related to the crisis pose risks to recovery. We expect growth to reach 3.9% from 5.4% pre-crisis.

We increased our inflation forecasts by +1.1 pp to 5% in 2022. Higher inflation will negatively the purchasing power of households and reduce the momentum of private consumption.

Visible squeeze of incomes

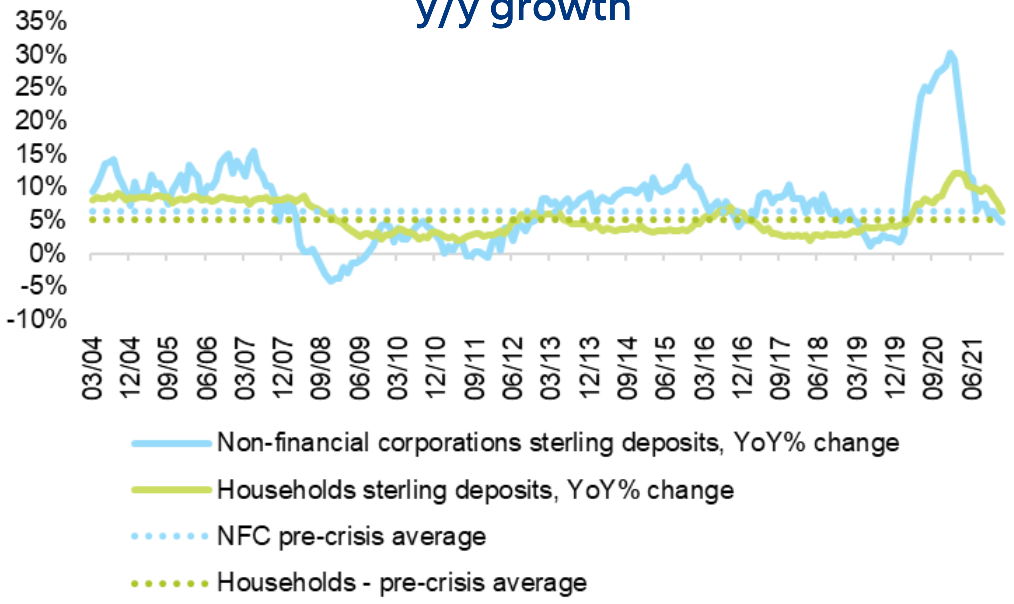
UK	2020	2021	2022	2023
GDP	**-9.4%**	**7.5%**	**3.2%**	**2.0%**
Consumer Spending	*-10.5%*	*6.1%*	*5.0%*	*1.7%*
Public Spending	*-5.4%*	*14.5%*	*5.0%*	*2.0%*
Investment	*-8.9%*	*6.6%*	*-2.1%*	*2.8%*
Stocks	*-0.9%*	*0.8%*	*-0.4%*	*0.4%*
Exports	*-13.9%*	*-1.1%*	*4.0%*	*2.8%*
Imports	*-15.9%*	*3.0%*	*4.5%*	*3.9%*
Net exports	*0.8%*	*-1.2%*	*-0.2%*	*-0.4%*
Current account (% of GDP)	-4.7%	-2.7%	-4.2%	-3.9%
Employment	-0.8%	-0.5%	0.8%	1.0%
Unemployment rate	5.1%	4.5%	4.3%	4.5%
Wages	1.8%	5.7%	4.0%	3.6%
Inflation	**1.8%**	**2.6%**	**7.5%**	**3.5%**
BoE rate	**0.10%**	**0.25%**	**1.00%**	**1.50%**
Fiscal balance (% of GDP)	-16.9%	-10.9%	-8.0%	-5.0%
Public debt (% of GDP)	104.0%	108.0%	107.5%	106.0%

*Change over the period, unless otherwise indicated: * contribution to GDP growth*

*** mds de £*

Sources: ONS, Allianz Research

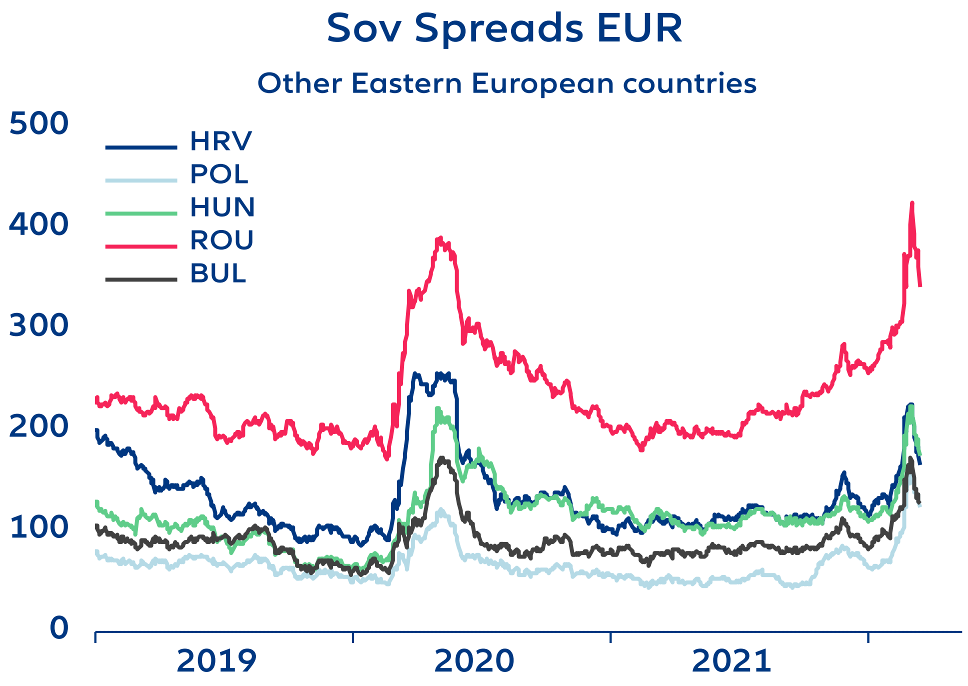
Cash from non-financial corporates and households, y/y growth



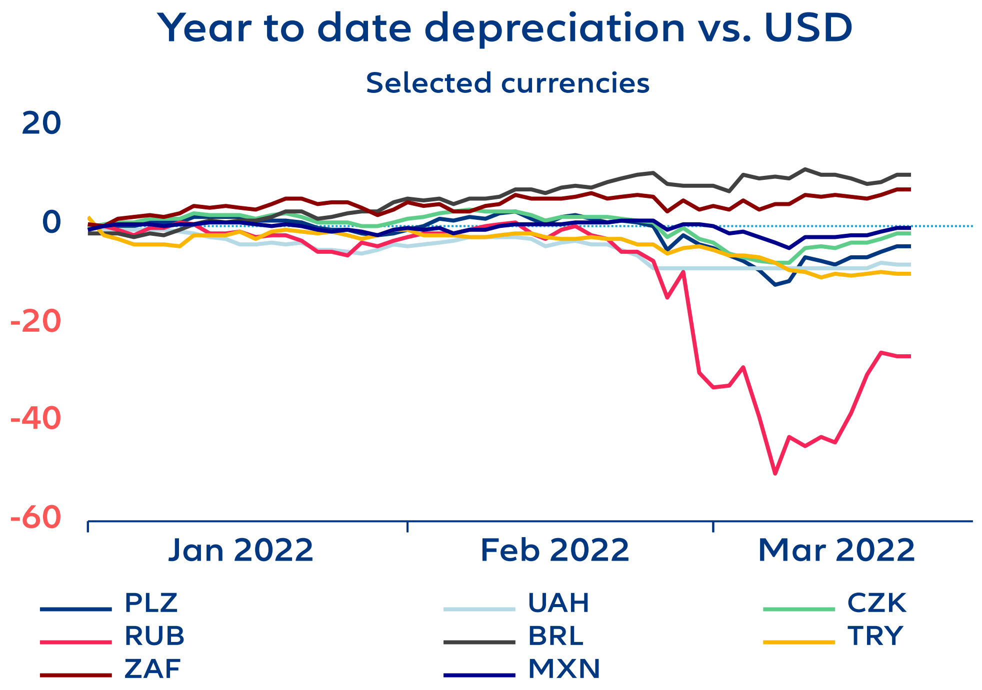
Sources: ONS, Allianz Research

The UK government should announce support measures within the Spring Statement. Potential measures could include (I) Increase military spending by 0.5pp of GDP to 2.5%; (ii) Protect purchasing power (e.g. remove the 5% VAT rate on energy bills, reduce fuel duty); (iii) Extent Recovery Loan Schemes beyond June 2022

Substantial contagion risk to emerging markets



Source: Refinitiv Datastream; Allianz Research (as of 3/17/2022)



Source: Refinitiv Datastream; Allianz Research (as of 3/17/2022)

EUR spreads of Eastern European countries, which have been widening in the previous weeks, among the most sensitive. Similar levels as Covid shock are observed.

Eastern European currencies, EUR-centric, will suffer if the regional instability continues. However, high commodity prices have supported LatAm currencies.

Emerging markets most exposed

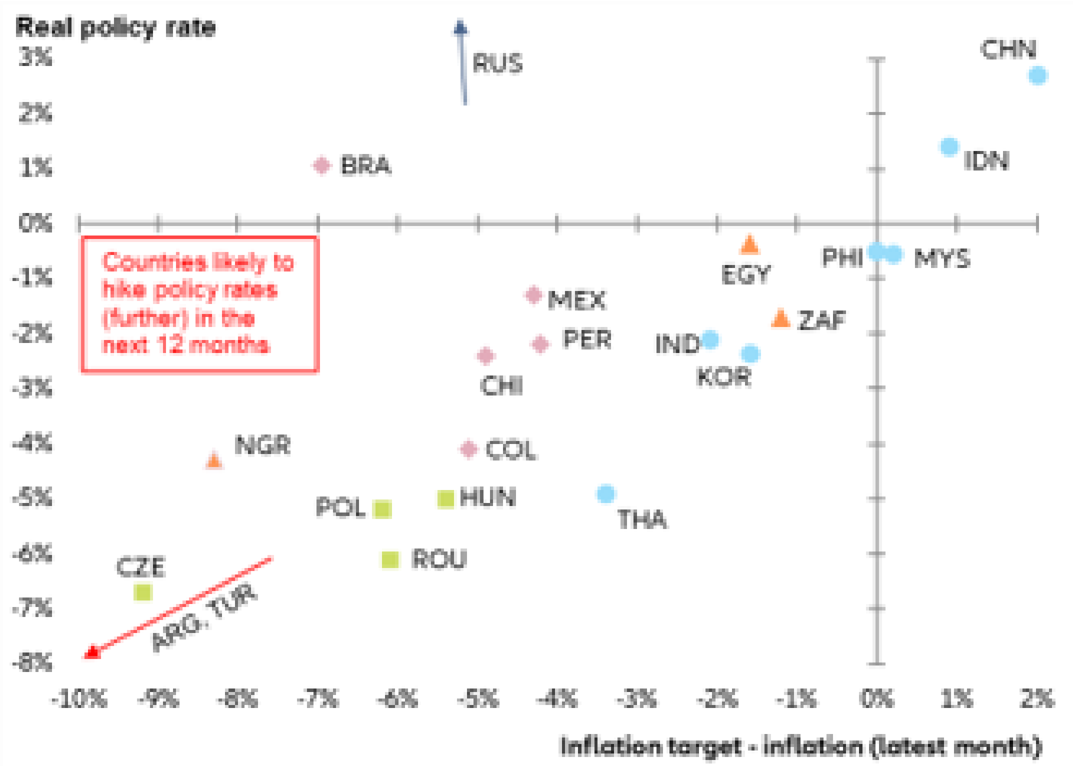
Emerging Markets impacted by RU-UA war through various channels

Export channel		Import channel		Energy and commodities channel						Current account	
Exports of goods to Russia (% of country's GDP)		Imports of goods from Russia (% of country's GDP)		Natural gas imports from Russia (% of country's total primary energy usage)		Russian energy, metals and agrifood inputs used in countries' output (% of GDP)		Net exports in energy, metals and agrifood (% of GDP), bottom 10 countries		Current account deficit (% of GDP), major EMs	
Belarus	21.8	Belarus	27.4	Hungary	36.0	Bulgaria	8.9	Tunisia	-11.9	Algeria	-10.9
Lithuania	7.8	Kyrgyzstan	17.0	Czechia	19.8	Lithuania	5.2	Morocco	-8.8	Romania	-7.1
Latvia	6.3	Armenia	11.8	Romania	13.7	Hungary	2.3	South Korea	-6.6	Colombia	-5.7
Armenia	5.4	Tajikistan	11.4	Poland	10.6	Poland	1.9	Viet Nam	-6.4	Kenya	-5.5
Kyrgyzstan	3.1	Mongolia	10.5	Latvia	0.3	Latvia	1.5	Taiwan	-6.3	Tunisia	-5.5
Estonia	3.0	Kazakhstan	7.8	Slovakia	0.2	Kazakhstan	1.3	Slovakia	-6.2	Egypt	-5.1
Kazakhstan	2.9	Uzbekistan	6.8	Lithuania	0.1	Turkey	1.3	Slovenia	-6.1	Chile	-3.5
Georgia	2.8	Georgia	5.6	Bulgaria	0.1	Estonia	1.1	Croatia	-6.1	Turkey	-3.0
Uzbekistan	2.0	Lithuania	5.2	Turkey	0.1	Romania	0.8	Philippines	-6.1	Peru	-2.8
Slovenia	1.8	Moldova	5.1	Estonia	0.0	Morocco	0.6	Panama	-5.9	Thailand	-2.2

Financial channel						Social risk		Policy room to maneuver			
Stock of FDI in country by Russia (% of country's GDP)		Currency depreciation (LCU vs EUR, % YTD), major EMs		Sovereign bonds: change in spread YTD (bp), major EMs		Imports of food and fuel (% of country's GDP)		Public debt sustainability risk score (0 = high risk; 100 = low risk)		Real policy interest rate (%), major EMs	
Belarus	6.6	Russia	-41.9	Russia	7526	Cape Verde	18.5	Egypt	11.0	Turkey	-40.7
Latvia	5.1	Belarus	-19.9	Ukraine	4701	Mauritania	17.9	Ghana	15.5	Argentina	-8.2
Tajikistan	4.8	Kazakhstan	-13.8	Argentina	1872	Belarus	17.6	Jordan	19.9	Czechia	-6.7
Moldova	4.5	Turkey	-6.5	Egypt	848	Belize	16.9	Tunisia	20.4	Romania	-6.1
Bulgaria	4.2	Ukraine	-5.4	Nigeria	658	Tajikistan	16.2	Mozambique	21.2	Poland	-6.0
Serbia	3.7	Poland	-4.3	Kenya	643	Maldives	16.1	Malawi	21.6	Algeria	-5.4
Belize	3.4	Hungary	-3.4	Turkey	625	Honduras	15.7	El Salvador	25.2	Hungary	-5.0
Dominica	3.4	Argentina	-2.2	Romania	378	Mozambique	15.3	Costa Rica	25.3	Thailand	-4.9
Bosnia & H.	2.6	Czechia	-1.1	Colombia	350	Jordan	13.0	Mauritius	25.8	Nigeria	-4.2
Kazakhstan	2.5	Romania	0.0	South Africa	307	Lithuania	12.3	Turkey	29.4	Colombia	-4.1

Sources: various, Allianz Research

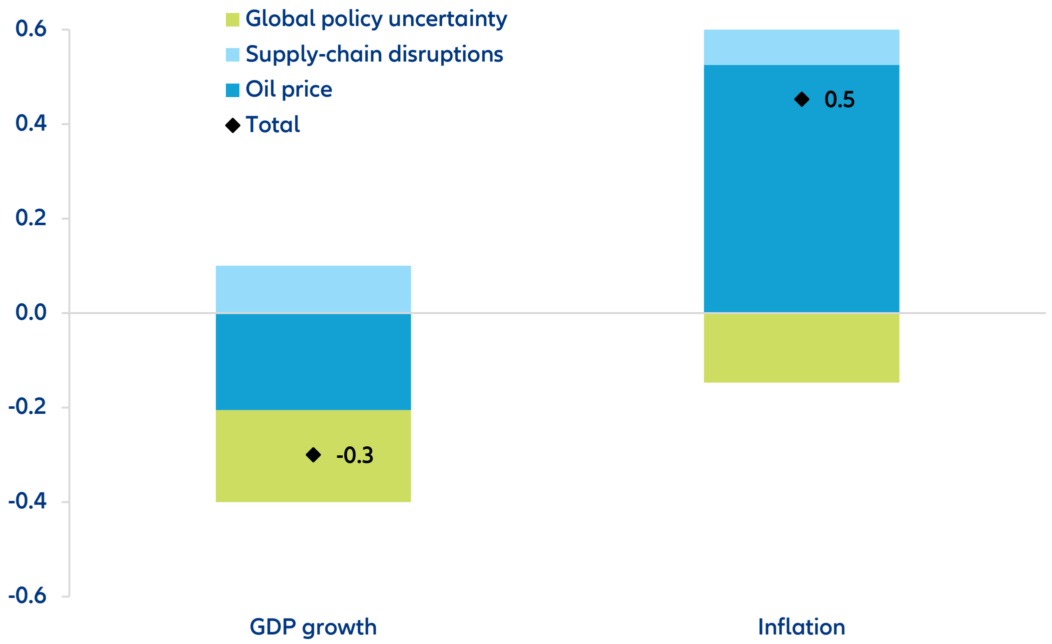
Real policy rate vs inflation trend



Sources: various, Allianz Research

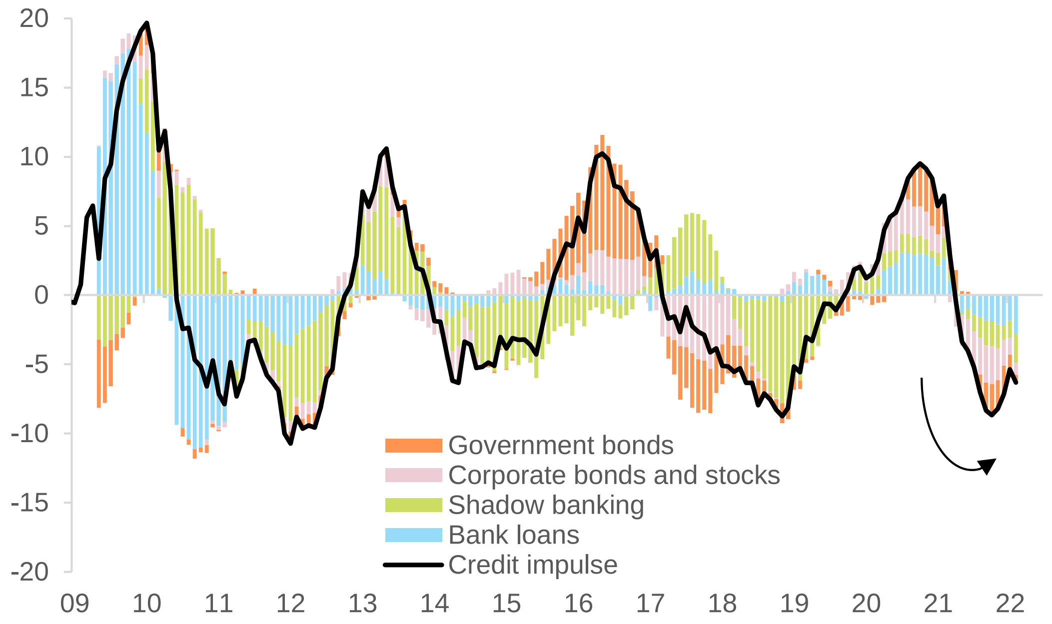
More pressure but there is policy leeway

Cumulative impact after 4 quarters over GDP growth and inflation %y/y



Sources: Allianz Research

China credit impulse and breakdown



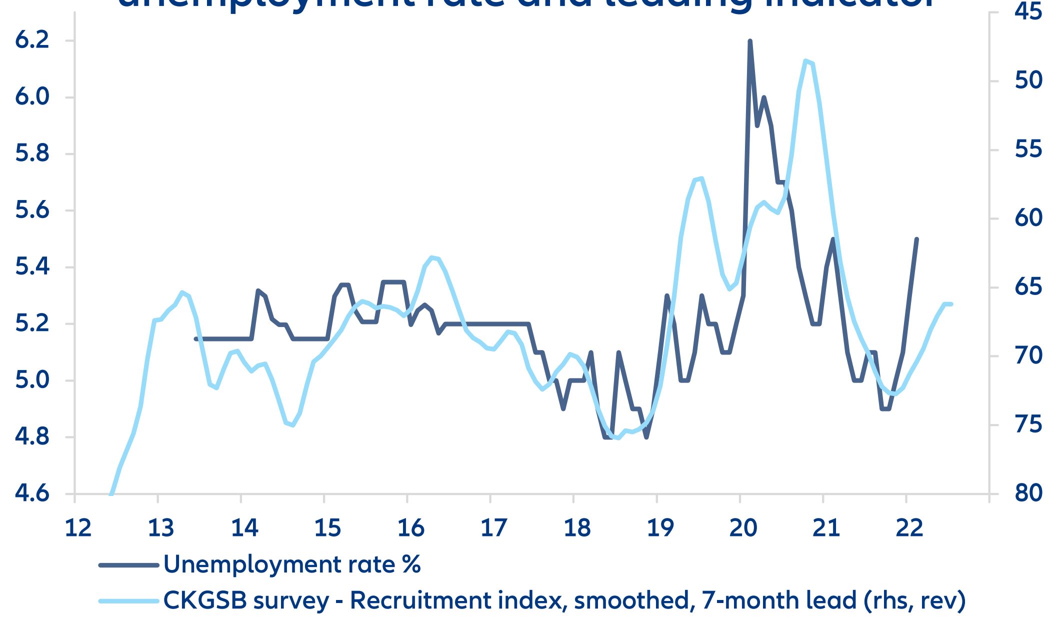
Sources: national sources, Allianz Research

External downwards pressures on the Chinese economy come mostly from global policy uncertainty and commodity prices channels. Domestically, downside risks come from the Covid-19 situation in a context where authorities maintain a zero-Covid policy. On the positive, policy support is likely to increase.

The policy mix is already in easing mode but at least one more cut in policy rate (-10bp) and RRR (-50bp) is likely, along with additional public investment of ~3% of GDP. GDP is likely to grow by +4.9% in 2022 (after +8.1% in 2021 and instead of +5.2% previously expected) and +5.0% in 2023 (unchanged).

Policies to drive the stabilization again

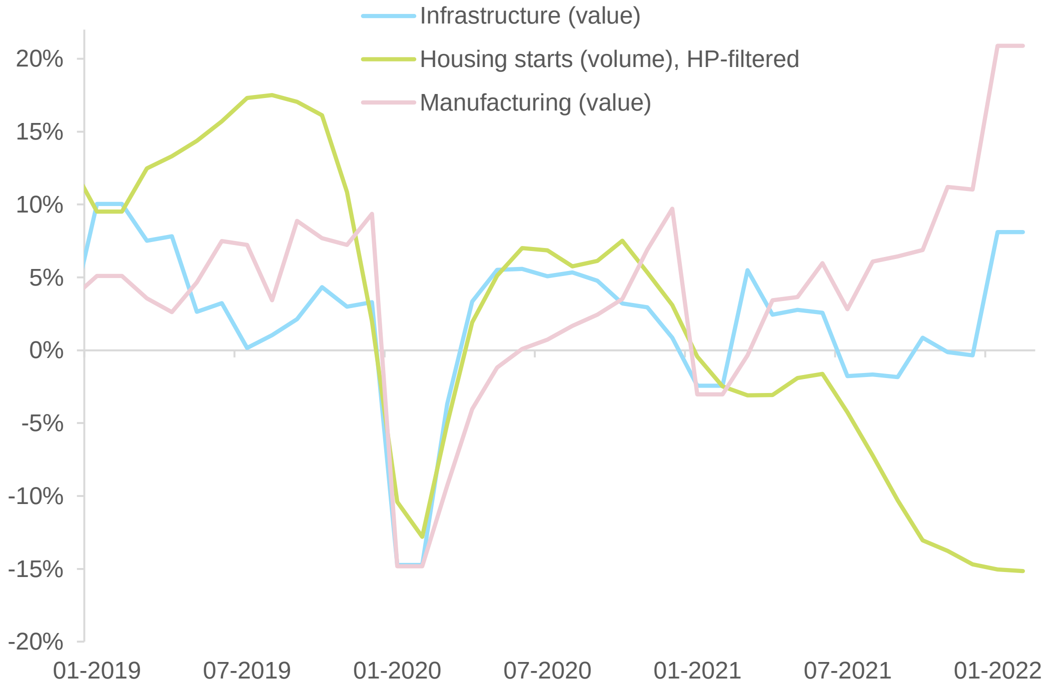
China labor market: unemployment rate and leading indicator



Sources: national sources, Allianz Research

The labor market is starting to see the impact of the economic slowdown, with unemployment rate coming back to the highest level since February 2021. Leading indicators suggest a stabilization but zero-Covid policy context is likely to keep a lid on normalization of household confidence and spending.

Investment growth (%) *

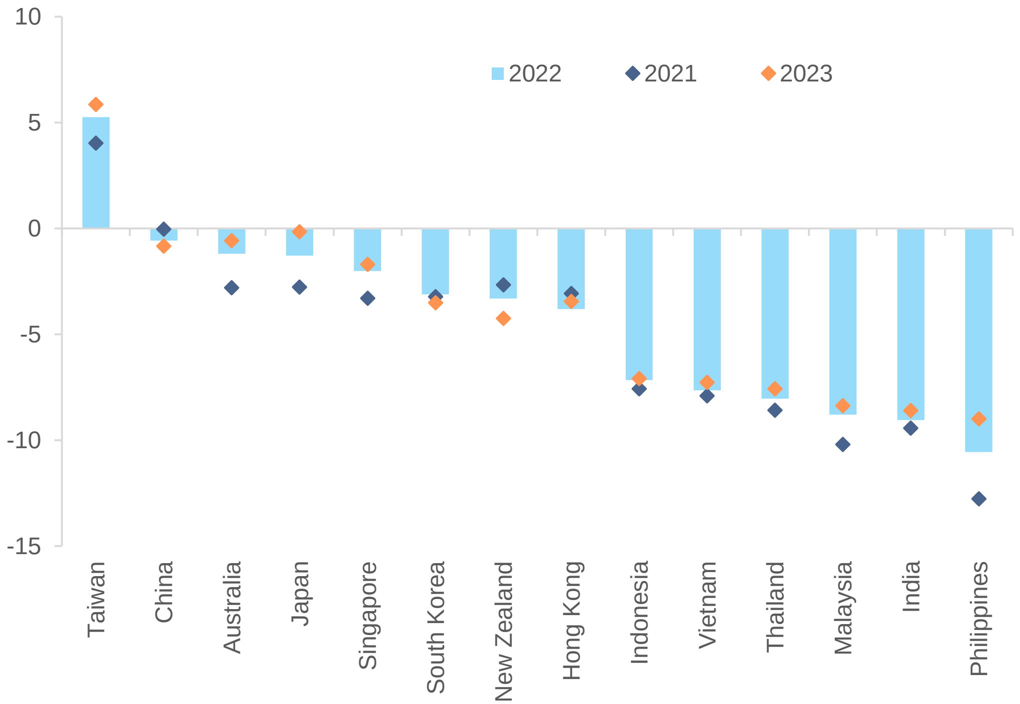


* 2-year CAGR until December 2021, y/y growth rate after
Sources: national sources, Allianz Research

Real estate will continue to be a drag, even if the pace of deterioration is stabilizing. The bright spots of 2022 should be manufacturing and infrastructure investment. The former is comparatively more at risk (being closely linked to exports), while the latter is supported by the easing policy mix.

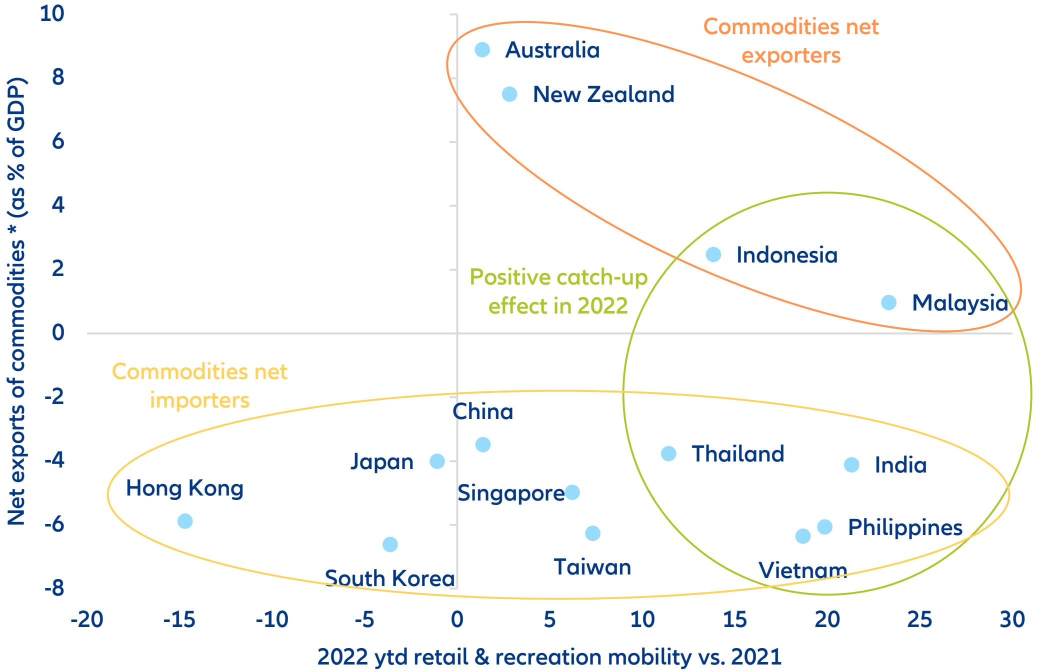
Some catch-up in 2022, despite risks

Real GDP, distance to pre-pandemic trend GDP



Sources: national sources, Allianz Research

Commodities prices vs. (post-)Covid impacts

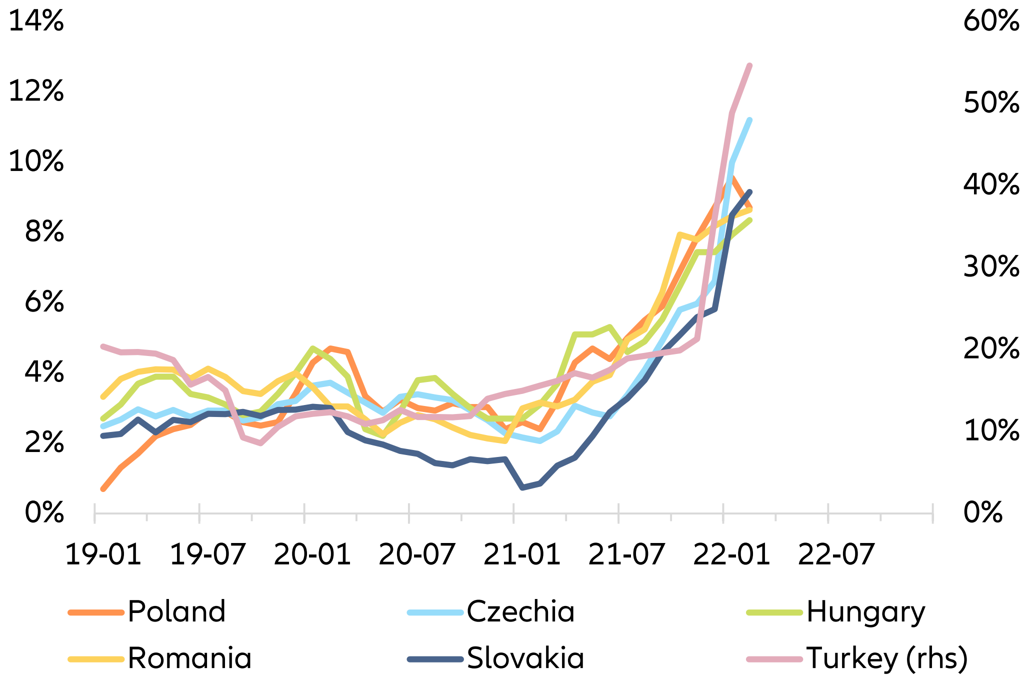


* Taking into account the overall trade balance for energy, metals and agrifood.
Sources: Google, TradeMap, Allianz Research

We expect Asia-Pacific GDP to grow by +4.6% in 2022 (after +6.1% in 2021) and +4.5% in 2023. Several economies in South and Southeast Asia should benefit from a catch-up effect in 2022, after weathering the pandemic with comparatively more difficulty in 2020-2021 (and as omicron is having a softer-than-expected impact). As net exporters of commodities, Indonesia and Malaysia are likely to benefit from the environment of higher commodities prices resulting from the invasion of Ukraine, while it could be a headwind for Pakistan, Vietnam, the Philippines, India and Thailand.

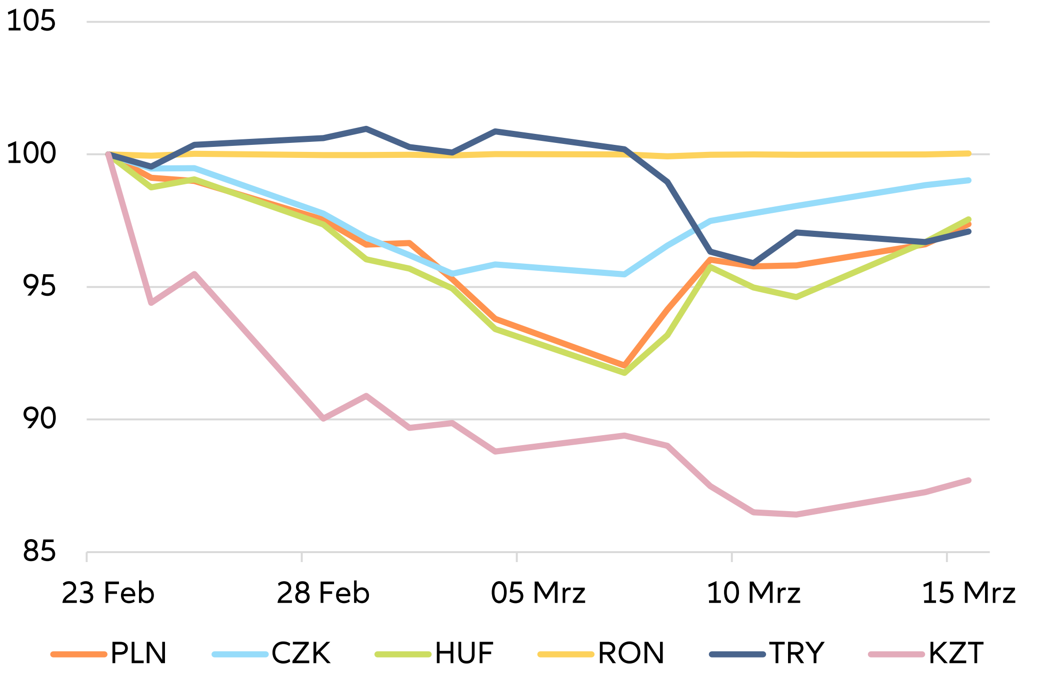
Inflationary pressures on the rise

Inflation (% y/y)



Sources: National statistics, Refinitiv, Allianz Research

Exchange rates (23 February = 100)



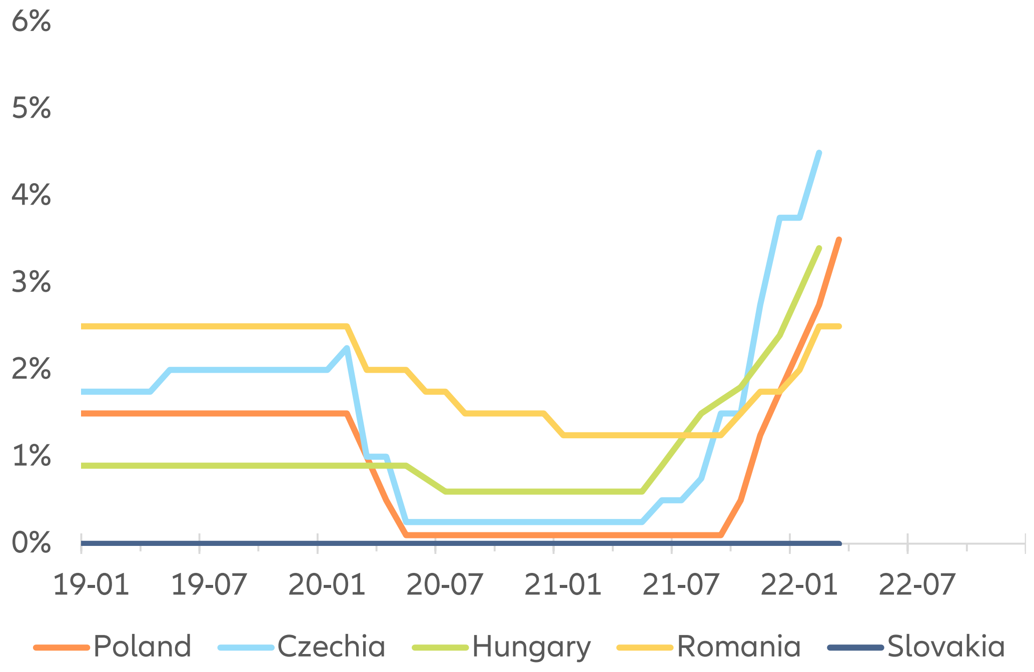
Sources: Refinitiv, Allianz Research

Inflation has continued to surge towards double digits in Q1, mainly driven by rising energy and food prices. Supply chain disruption will add to the problems in the next months. Turkey is an idiosyncratic risk which, however, will also be aggravated by the war in Ukraine.

Emerging European currencies have taken a hit, especially in CIS countries. In CEE-EU, currencies have recovered somewhat after the initial shock.

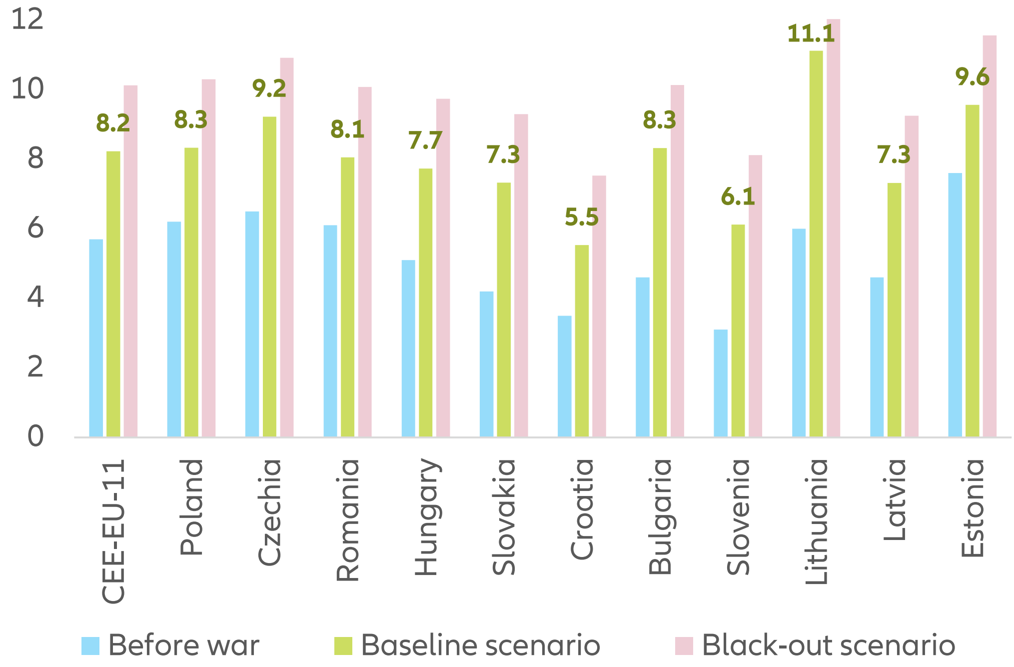
Central Banks will need to do more

Monetary policy rates



Sources: National statistics, Refinitiv, Allianz Research

Inflation forecasts 2022 (%, aop), various scenarios



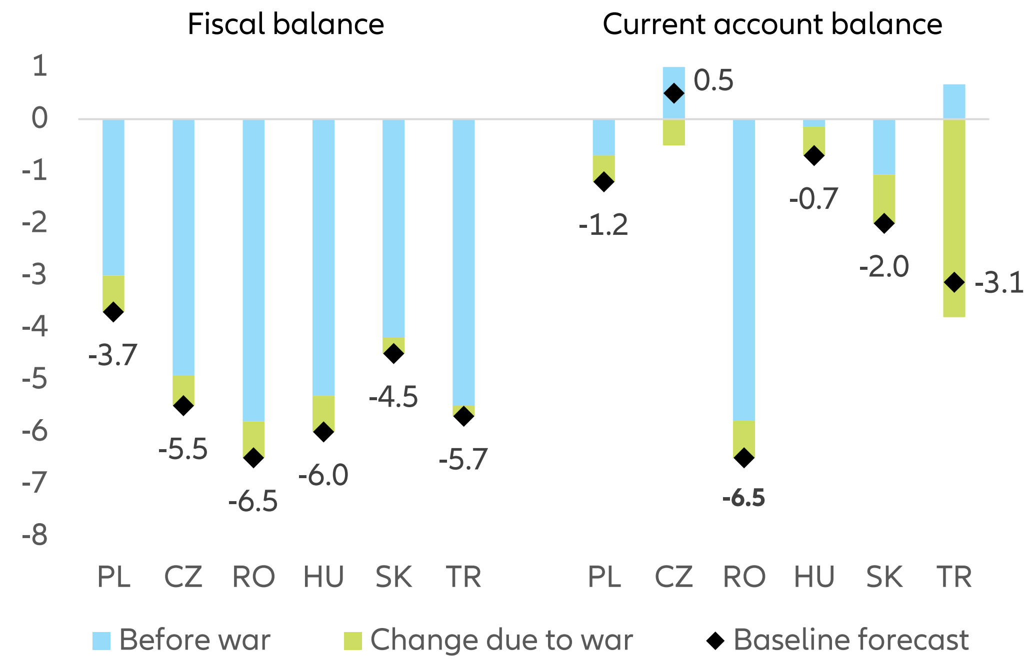
Sources: National statistics, Refinitiv, Allianz Research

Monetary tighteing has continued to trail the price rises and real policy rates are still well in the negative (between -5% and -7% in CEE). More tightening will be required to rein in second round effects (e.g. the wage-price loop) and to achieve a gradual normalization of prices in H2.

We have lifted our full-year 2022 average inflation forecasts for CEE-EU-11 markedly:
- Baseline: by 2.5pp to an average 8.2% in the region;
- Black-out: by 4.4pp to an average 10.1% in the region.

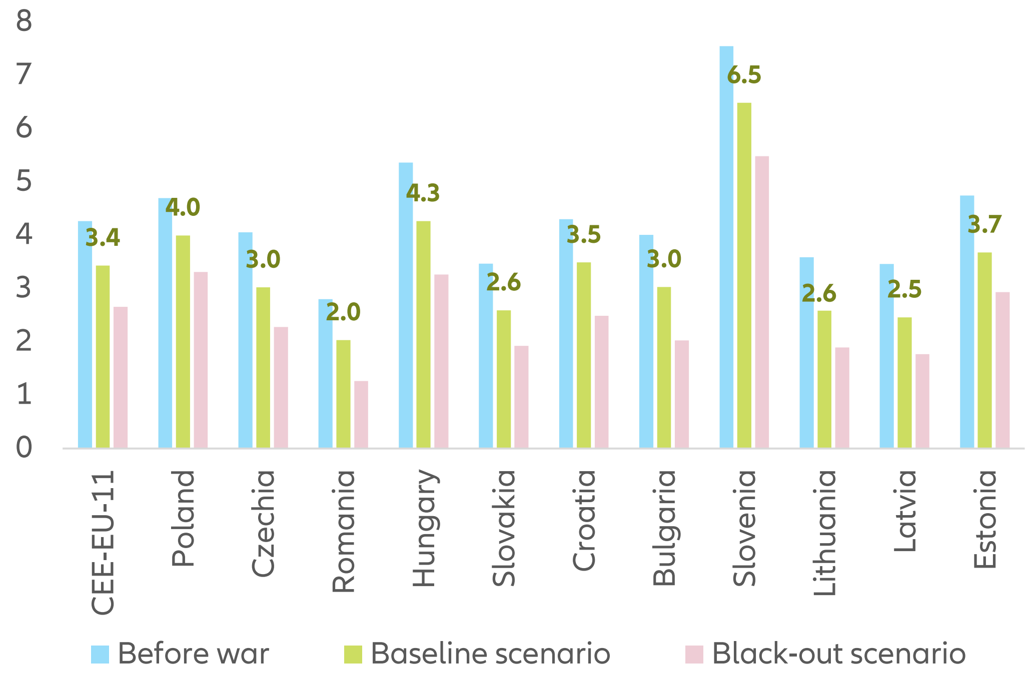
Rising imbalances and lower growth

Fiscal and current account balances (% of GDP), 2022f



Sources: National statistics, Refinitiv, Allianz Research

GDP growth forecasts 2022 (%), various scenarios



Sources: National statistics, Refinitiv, Allianz Research

Massive stimulus during Covid-19 pandemic and increased spreads after start of war limit fiscal leeway, for now. Current account balances will deteriorate due to higher energy prices.

We have lowered our full-year 2022 real GDP growth forecasts for CEE-EU-11 markedly:
- Baseline: by -0.8pp to an average 3.4% in the region;
- Black-out: by -1.6pp to an average 2.7% in the region.

Oil and gas exporters to benefit

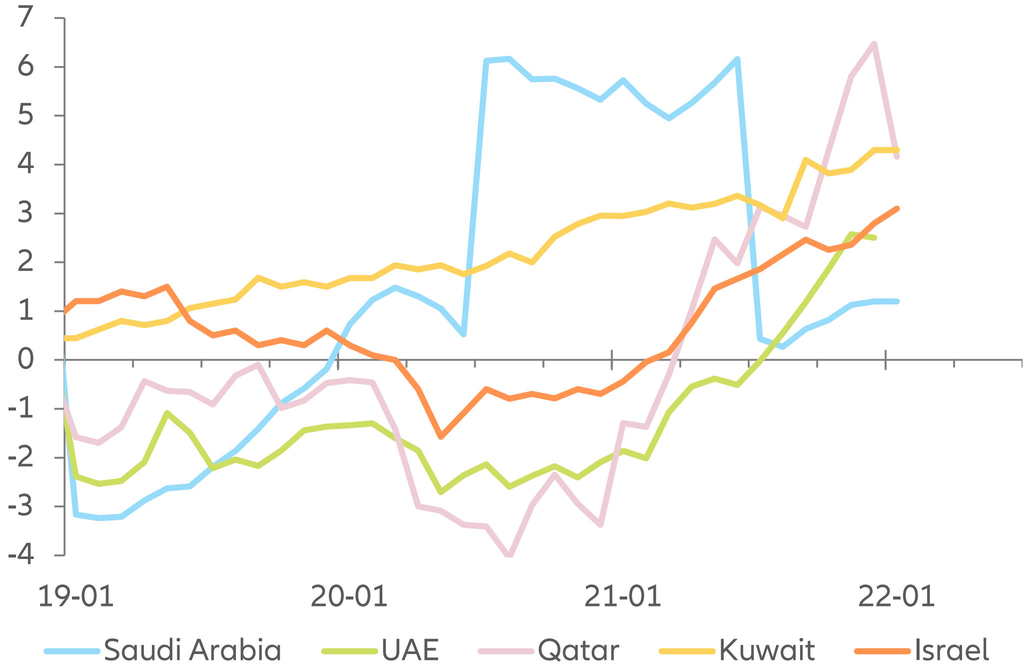
Real GDP growth (%)

	2020	2021	2022	2023
Middle East	**-4.5**	**3.3**	**4.5**	**2.7**
GCC	***-4.9***	***3.0***	***4.9***	***2.9***
Saudi A.	-4.1	3.3	5.6	2.7
UAE	-6.1	3.0	4.0	3.5
Qatar	-3.6	2.5	4.4	2.8
Kuwait	-8.9	2.2	5.7	2.7
Oman	-2.8	2.3	3.2	2.5
Bahrain	-5.1	2.2	3.2	2.2
Non-GCC	***-3.9***	***3.8***	***3.9***	***2.5***
Iran	3.4	2.6	2.5	2.0
Israel	-2.2	8.1	5.7	2.8
Iraq	-15.7	4.0	6.0	3.5
Lebanon	-25.0	-11.0	-1.0	3.0
Jordan	-1.6	2.2	2.4	2.0

Sources: National statistics, Refinitiv, Allianz Research

We have lifted the regional growth forecast to +4.5% in 2022 from +3.9% at end-2021. Higher oil and gas prices will also widen current account surpluses and support fiscal consolidation, and even provide some fiscal leeway.

Consumer price inflation (% y/y)

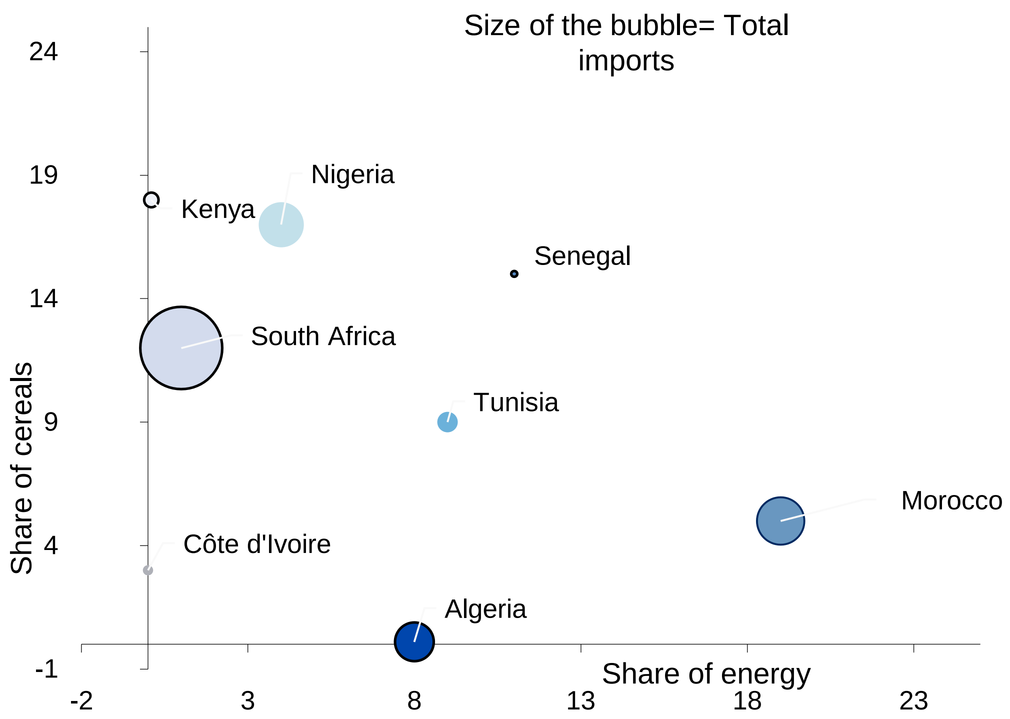


Sources: Refinitiv, Allianz Research

Consumer prices in the GCC and Israel have left deflationary territory in 2021 and we expect inflation to remain positive until end-2022. Yet, price growth will be slower than in Emerging Europe and Latin America, for example.

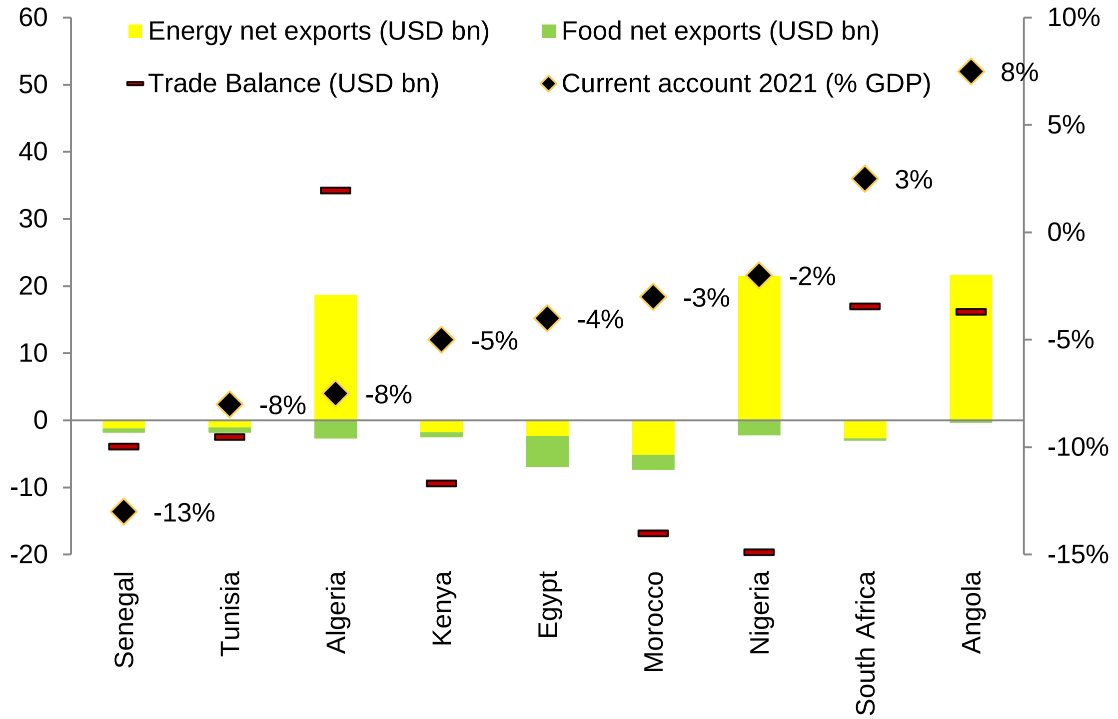
Tailwinds for net commodity exporters

Share of energy and food imports from Russia/Ukraine (%)



Sources: Trade Map, Allianz Research

Net trade (USD bn) and current account (% GDP)



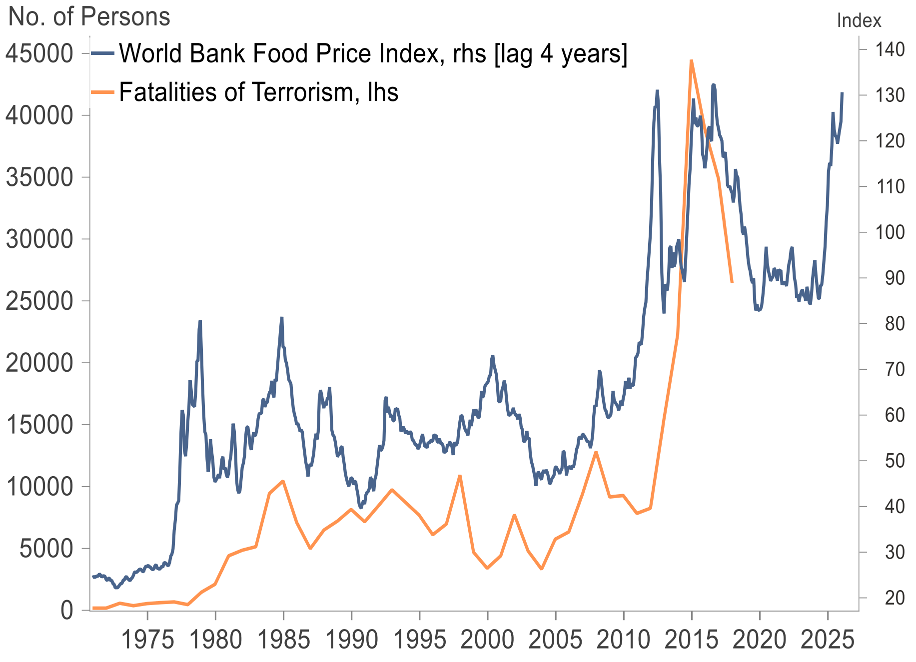
Sources: Trade Map, IMF, Allianz Research

North African countries are highly dependent on cereal imports from Russia and Ukraine.

Net energy exporters (Algeria, Nigeria, Angola) will see an improvement of their current accounts in 2022.

Rising food insecurity and social risk

Food inflation and rise of terrorism



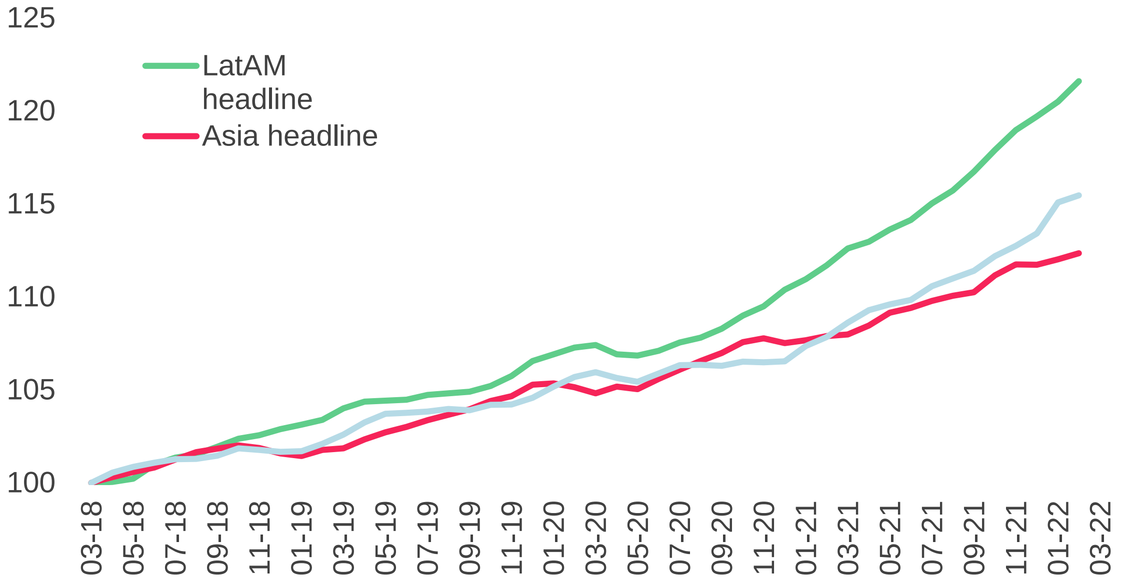
Sources: Macrobond, Our World in Data, Allianz Research

Food price hikes before the war had already fueled inflation to double digits.

- Muted economic recovery in 2021 (3.1%) to be followed with **slowdown of growth** to 2.5% in 2022 and to 2.3%.
- **Price and demand tailwinds** and new market opportunities for **oil and commodity exporters** (Algeria, Nigeria, Libya, South Africa, Namibia)
- **Food security at risk** due to high dependence on imports from Ukraine and Russia (Morocco, Tunisia, Egypt and Mozambique).
- **Tourism revenues will shrink** (Tunisia, Seychelles, Tanzania, Egypt), together with exports to Europe (Morocco, Tunisia).
- **Social risk on the rise as inflation bites**. International community (UN, IMF, WB) to step in for support to avoid another Arab spring.

Monetary tightening to further slow growth

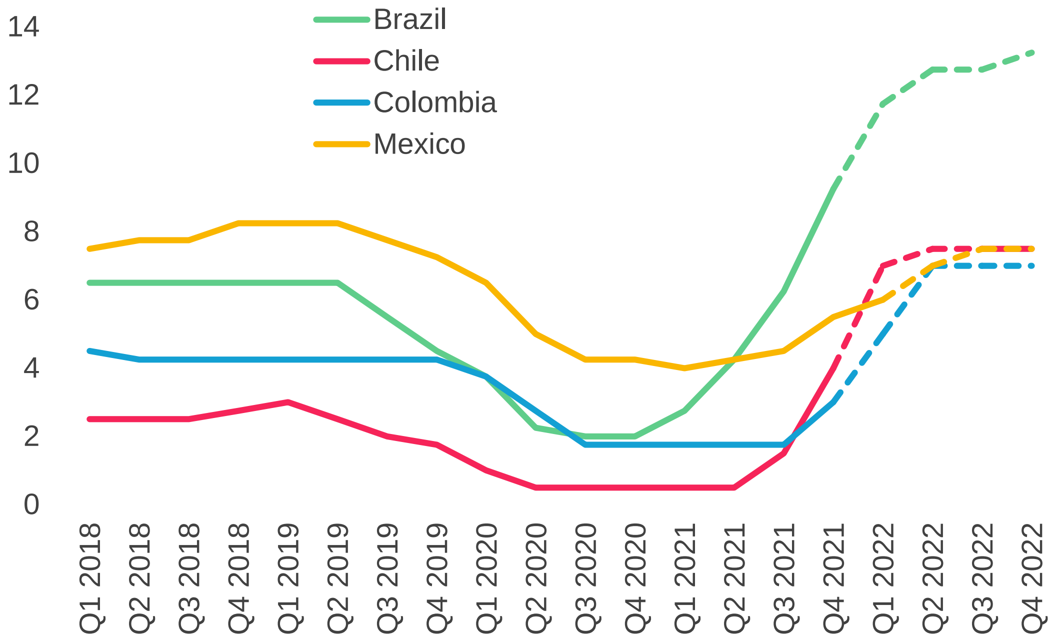
Inflation is particularly high in LatAM



Sources: Refinitiv, Allianz Research.
Note: LaTAM includes: Brazil, Mexico, Chile, Colombia and Peru. Asia: India, Indonesia, Taiwan, Malaysia, Thailand Hong Kong, South Korea and Philippines. EMEA: Israel, South Arica, Hungary, Czech Republic and Poland.

High commodity prices and suplly shortages have raised global inflation. In LaTAM, soaring food prices are partly driven surge. Food prices make up about a quarter of the average consumption basket. The ongoing conflict adds fuel to the fire. We revised our inflation forecast upwards +1.3 bps to 10,6% in 2022.

Central Banks will keep tightening

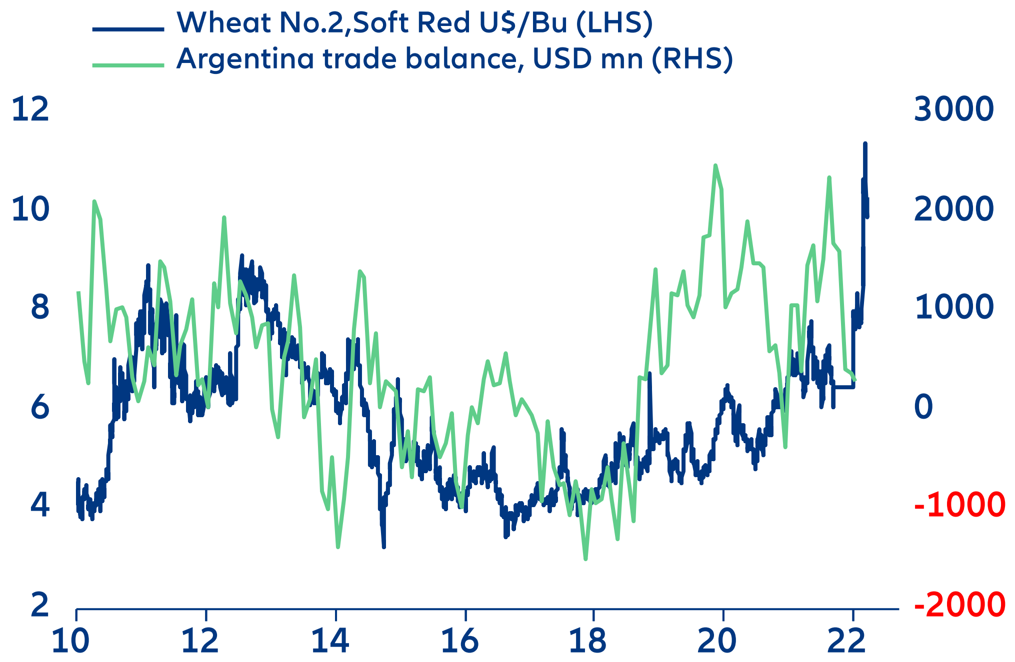


Sources: Refinitiv, Allianz Research.
Note: Dashed line corresponds to markets' forecasts.

CBs in the region have already significantly tightened financial conditions and will need to do more to fight inflation. High and increasing rates will put additional brake on a fragile economic growth. We have lowered our growth forecast fro the region by -0.7 bps to 1.7% in 2022.

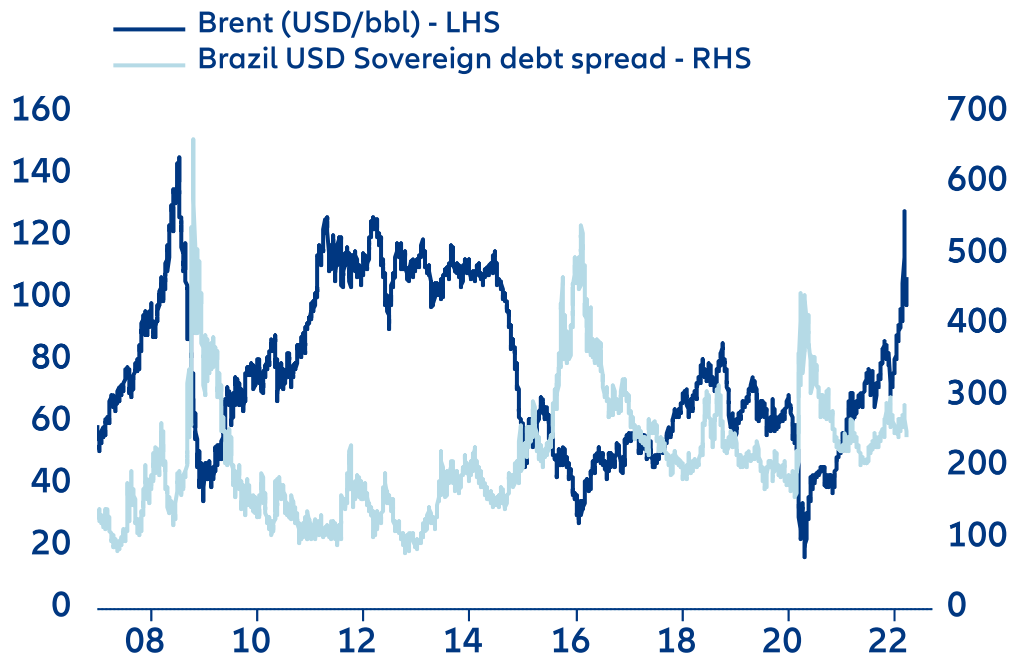
Opportunities from diverted trade flows

Argentina trade balance vs. Wheat prices



Source: Refinitiv Datastream; Allianz Research (as of 3/17/2022)

Brazil spreads vs. Oil price



Source: Refinitiv Datastream; Allianz Research (as of 3/17/2022)

Diverted trade flows from Russia are likely to support the trade balance of other commodities exporters; also, any exclusion of Russian assets would leave the door open to rebalancing of important indexes (and linked products). Yet, capital outflows from EMs is likely in a context of "flight to safety".

Thank you!