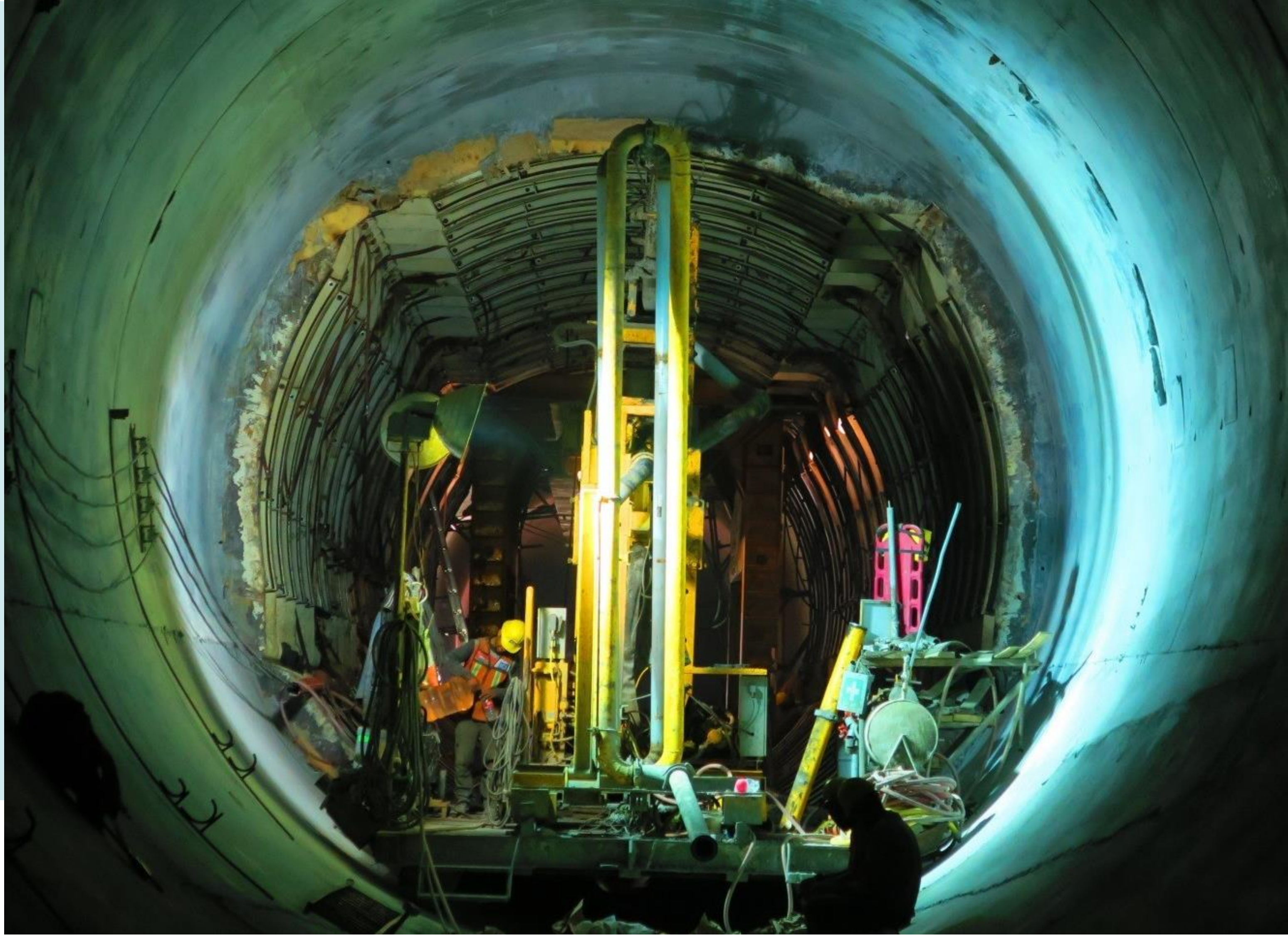
CLOSING THE LOOP IN 2019



- Economic Research Department
- Global Economic Outlook
- 1Q19

EULER HERMES

Allianz

GLOBAL GROWTH: WEATHERING RISKS

Real GDP growth, %

	2017	2018		2019		2020
		Latest forecast	Revision (pps)	Latest forecast	Revision (pps)	Latest forecast
World GDP growth	**3.2**	**3.1**	**-0.1**	**3.0**	**-0.1**	**2.7**
United States	2.2	2.9	=	2.5	=	1.7
Latin America	**1.1**	**0.8**	**-0.1**	**1.9**	**=**	**2.4**
Brazil	1.0	1.3	=	2.3	-0.2	2.5
United Kingdom	1.7	1.3	-0.1	1.2	-0.1	1.0
Eurozone members	**2.5**	**1.9**	**-0.2**	**1.5**	**-0.3**	**1.4**
Germany	2.5	1.5	-0.6	1.7	-0.2	1.6
France	2.3	1.5	=	1.2	-0.7	1.5
Italy	1.6	1.0	-0.2	0.6	-0.2	0.4
Spain	3.0	2.5	-0.2	2.1	-0.3	1.9
Russia	1.5	1.6	=	1.5	=	1.5
Turkey	7.4	3.3	=	0.4	=	3.5
Asia	**5.2**	**5.1**	**=**	**4.8**	**-0.2**	**4.6**
China	6.9	6.6	=	6.3	=	6.1
Japan	1.9	1.0	=	1.0	=	0.6
India	6.7	7.4	-0.2	7.1	-0.3	7.0
Middle East	**1.2**	**1.9**	**-0.6**	**2.0**	**-0.7**	**2.1**
Saudi Arabia	-0.9	2.0	-0.1	2.5	=	0.0
Africa	**3.0**	**2.3**	**-0.8**	**2.8**	**-0.5**	**2.8**
South Africa	1.3	0.7	=	1.0	-0.3	1.0

** Weights in global GDP at market price, 2017*

NB: The revisions refer to the changes in our forecasts since the last quarter
Fiscal year for India

Global growth to remain on a healthy trajectory despite the multiplication of risks:

1. **Self-correcting mechanisms:** US fiscal and monetary fuses to preserve the economic circuit from systemic unsustainability

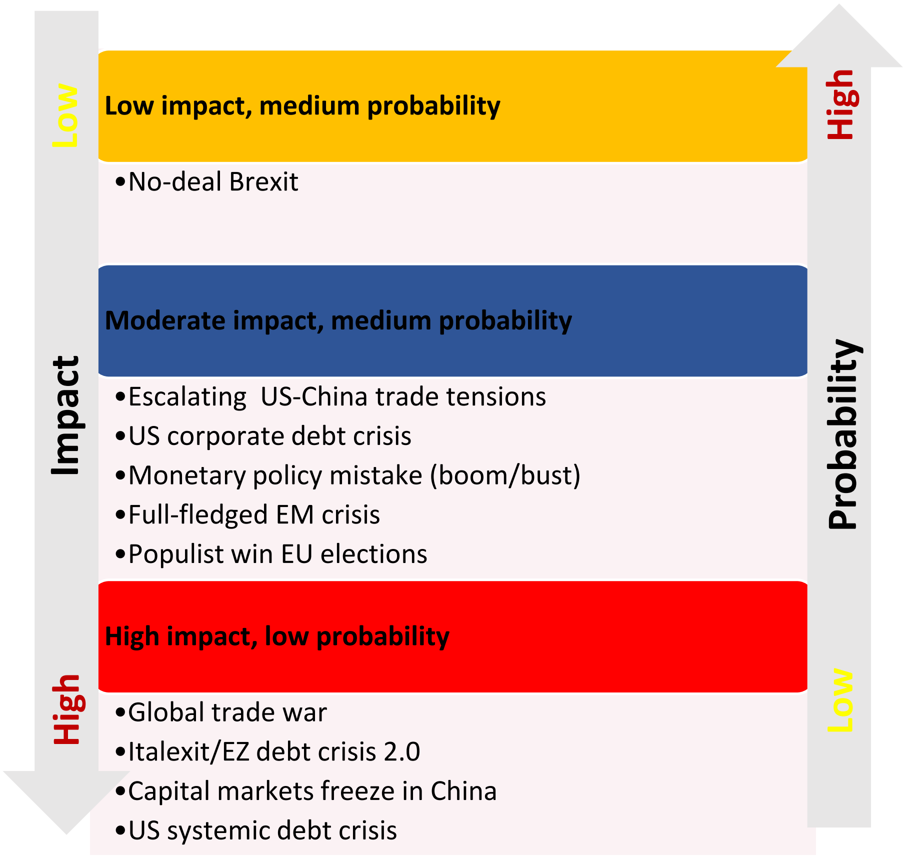
2. **Fine-tuning policy tools:** Fueling demand in the short-term and repairing supply in the medium-term will be the leitmotiv of China and Europe

3. **Technical inspection:** The market will continue to differentiate defective emerging economies from sound ones

Macro assumptions: Brent oil prices at 69 USD/bbl in 2019; 65 USD/bbl in 2020. EUR/USD at 1.17 at the end of 2019, 1.24 end 2020; emerging currencies to stabilize in H1 2019

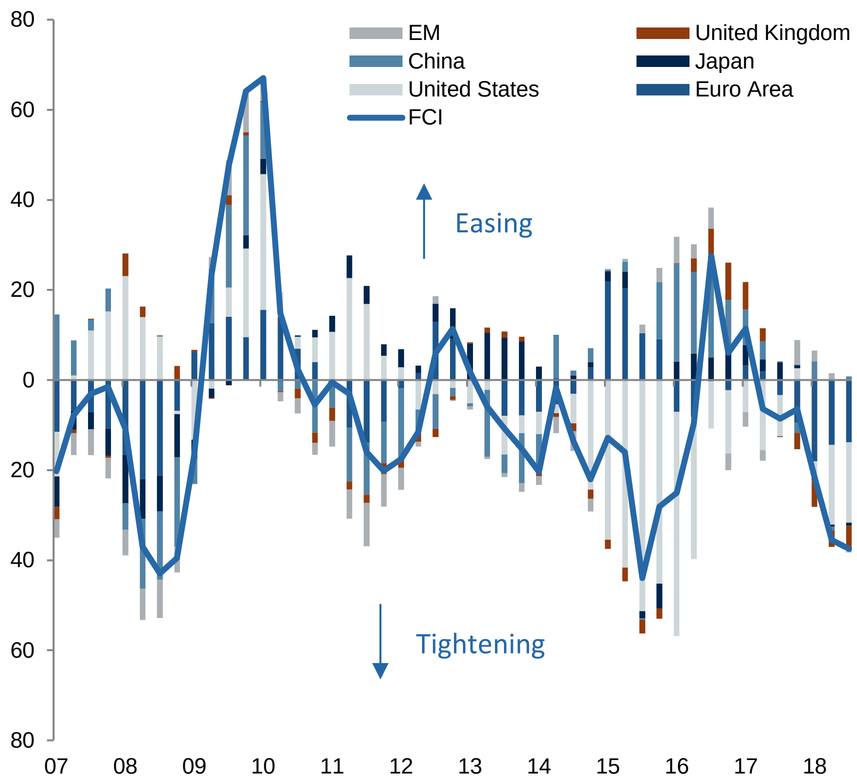
Inflation and interest rates: The peak of inflation is behind us in advanced economies but there are rising price pressures in the emerging markets post currency depreciation. We expect US 10Y interest rate to be at 3.0% at the end of 2019 and 2.8% at the end of 2020

GLOBAL RISKS: MULTIPLE PERTURBATIONS IN 2019-20



The political and economic risk landscape remains crowded with potential recession triggers. Uncertainty is unlikely to escalate further, but expect it to linger. Visible impact could still increase as the negative effect kicks in with a lag

World monetary and financial conditions (level)

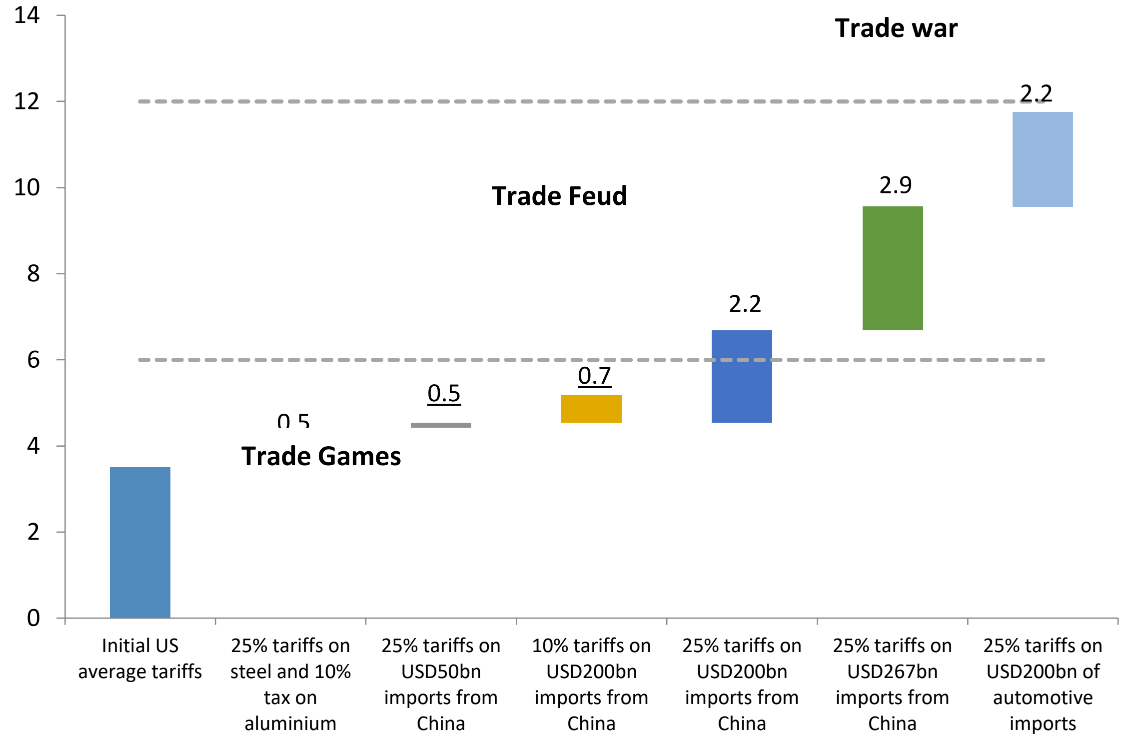


Sources: IHS Global Insight. Allianz Research

The multiplication of uncertainty sources has contributed, beside the normalization of monetary policies in developed markets, to a significant tightening of world credit conditions, pointing toward a deceleration of growth

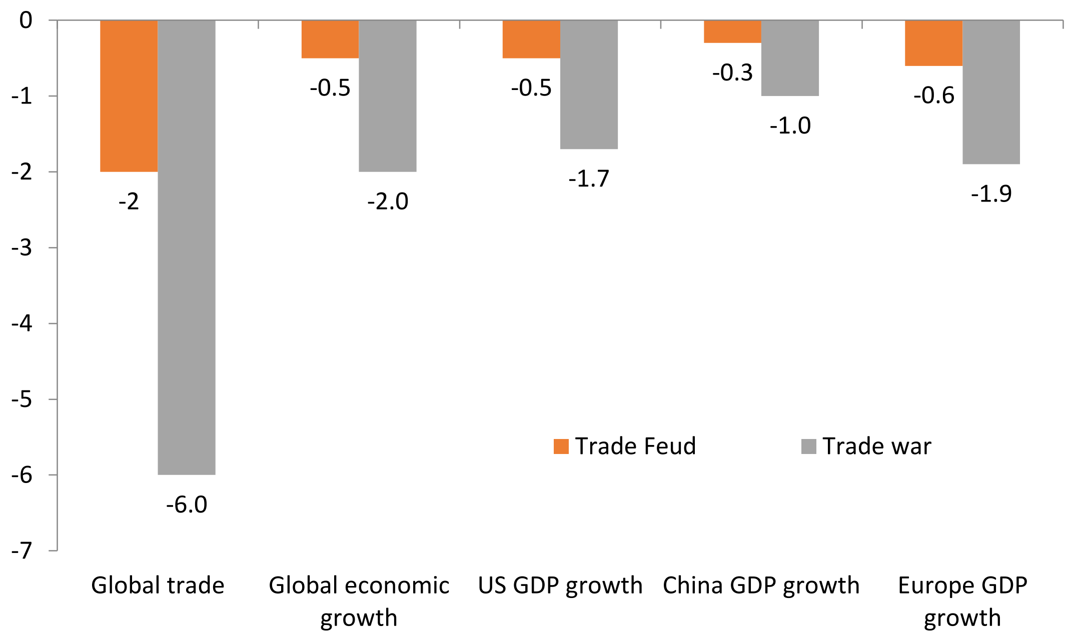
PROTECTIONISM: UNSTABLE EQUILIBRIUM

US average tariffs – shock simulations
Underlined figures are those that have been implemented



Sources: IHS Global Insight. Allianz Research

What does that mean for the global economy? 2-year impact (pp)



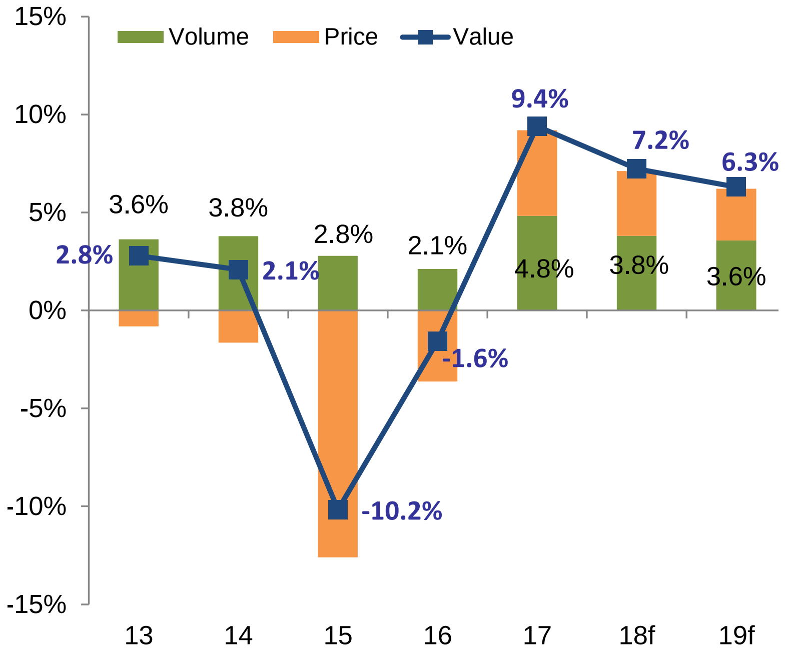
Sources: IHS Global Insight. Allianz Research

US average tariff rose to 5.2% in 2018, it could cross the 6% trade feud threshold in 2019 if the US implements 25% tariffs on USD200bn imports from China

Further escalation to a trade feud scenario could cost half a percentage point of GDP growth; a trade war would cost two percentage points of GDP and a global recession

GLOBAL TRADE: LOOKING FOR A NEW EQUILIBRIUM

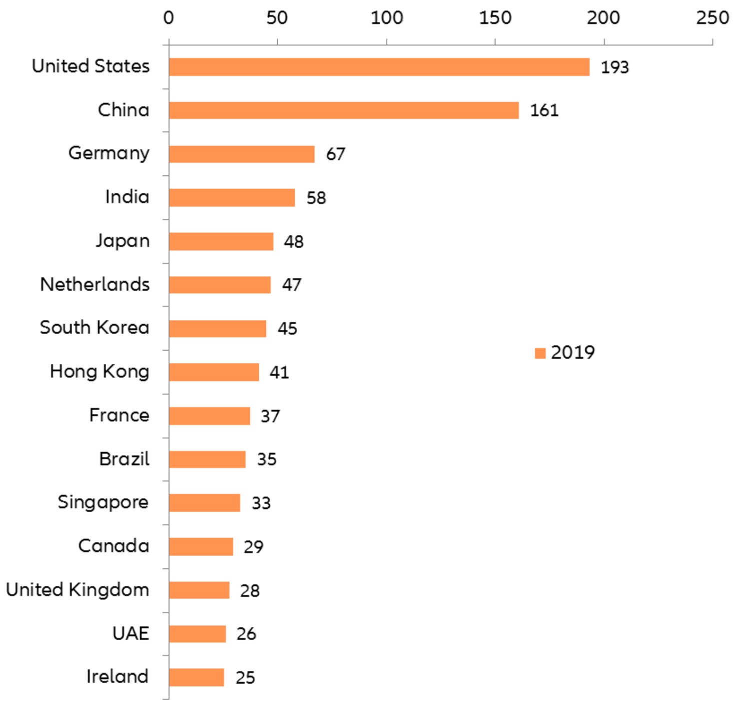
Global trade in goods and services



Sources: IHS, Datastream, Allianz Research

Global trade growth to slow in line with global demand

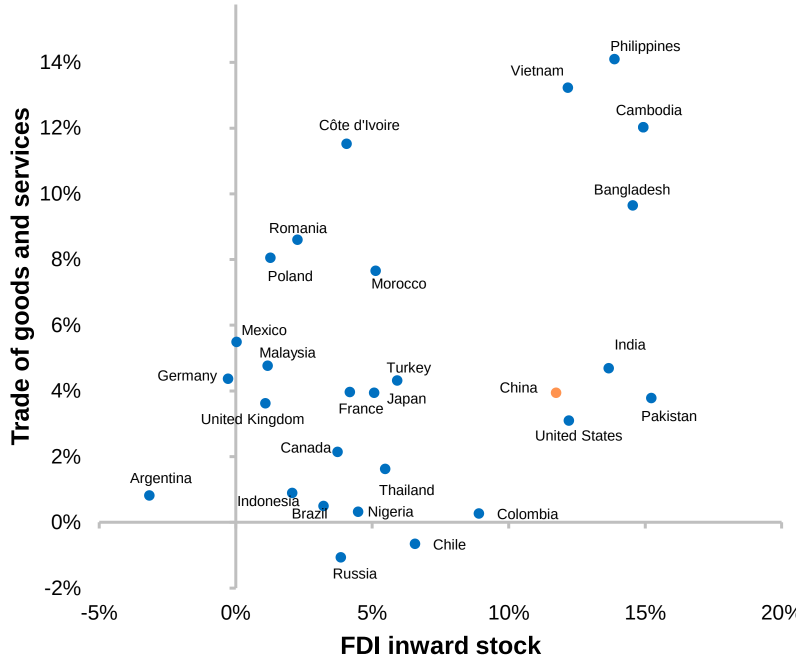
Additional import needs by country in 2019 (Goods & Services, in USD bn)



Source: Euler Hermes

The US, the Eurozone and increasingly also China will act as a key driver for trade growth in the short-run

FDI inward stock vs. trade in goods and Services (growth average over 2014-2017)

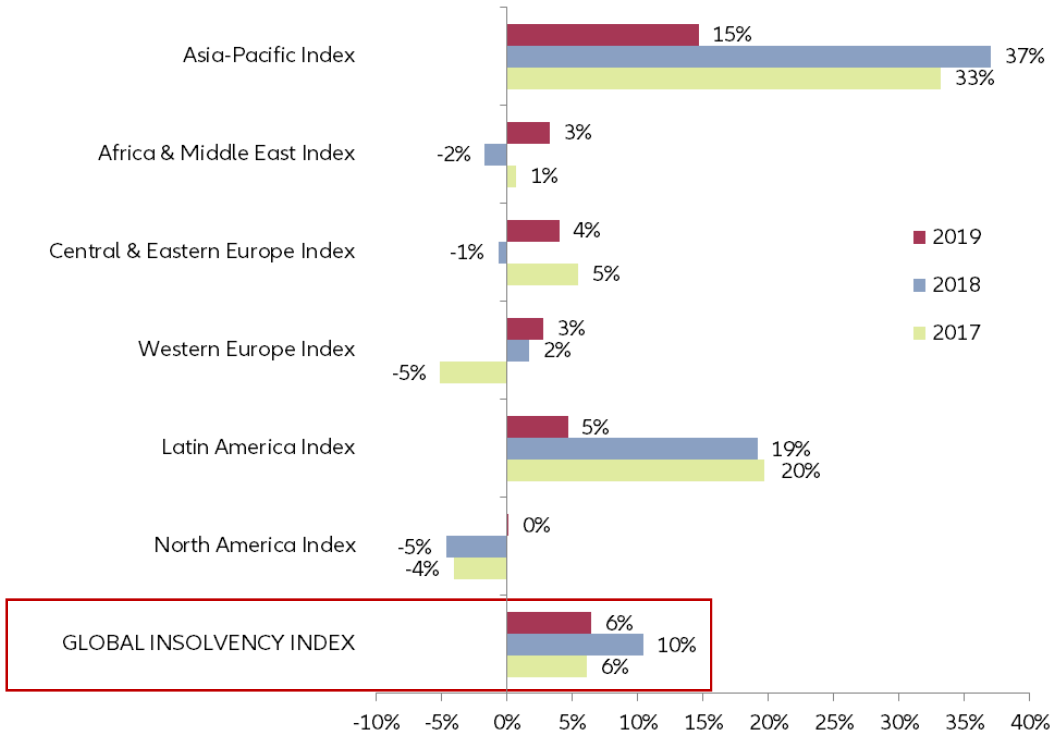


Source: Euler Hermes

Trade diversion has already started and could disrupt supply chains. Asian pivot stands to benefit the most

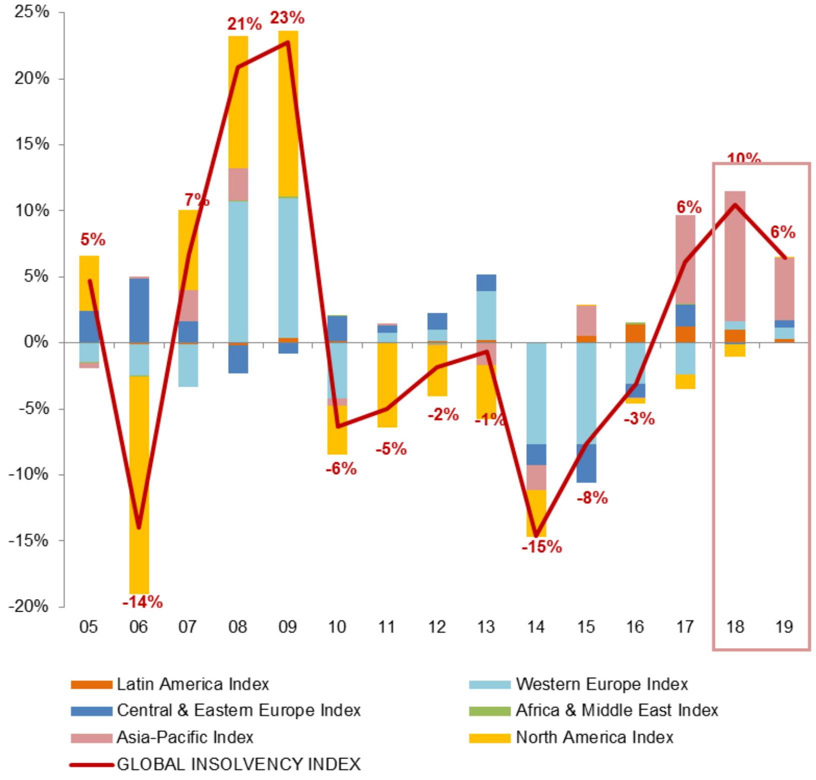
GLOBAL INSOLVENCIES: (+6% IN 2019 AFTER +10% IN 2018)

EH Global and Regional Insolvency Indices
(yearly changes in %)



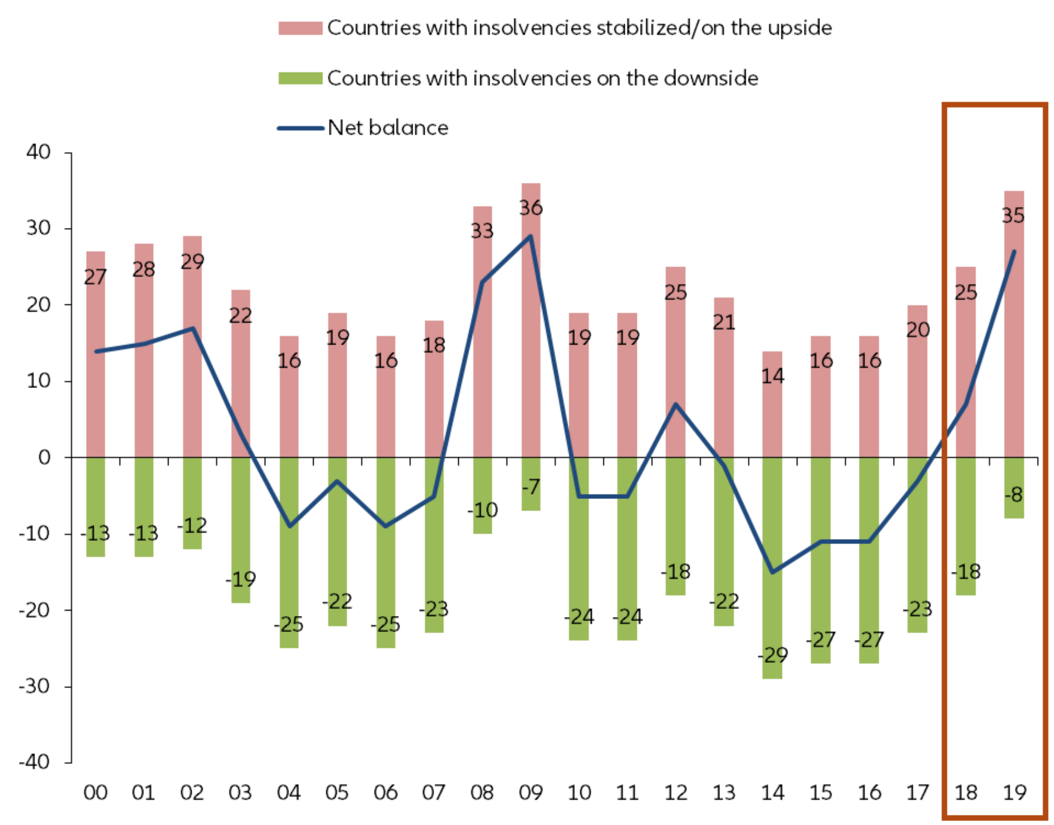
Sources: National statistics, Euler Hermes, Allianz Research

EH Regional Insolvency Indices
(contribution to the Global Insolvency Index)



At a global level, the upward trend in business insolvencies continued in 2018 (+10% y/y), mainly due to the surge in China (+60%) and, to a lesser extent, an increase in Western Europe (+2%). In 2019, business failures are set to rise for the third consecutive year (+6% y/y). The softening economic momentum, coupled by the global tightening of financing conditions, will drive up insolvencies in a majority of countries, with Asia remaining the main contributor to the deterioration.

GLOBAL INSOLVENCIES: ON THE UPSIDE



Sources: National statistics, Euler Hermes, Allianz Research

Insolvency Heat Map 2019

	Very low level (more than 10% below the 2003-2007 level)	**Low level** (between 0% and 10% below the 2003-2007 level)	**High level** (between 1% and 10% above the 2003-2007 level)	**Very high level** (more than 10% above the 2003-2007 level)
Strongly deteriorating strictly more than +5%	UK (+9%) Russia (+6%)			China (+20%) Slovakia (+16%) Denmark (+15%) Chile (+12%) Sweden (+10%) **GLOBAL (+6%)**
Deteriorating +1% to +5%	Canada (+4%) Romania (+3%) Austria (+2%) Hong-Kong (+2%) South Africa (+2%) Japan (+1%) Latvia (+1%) New Zealand (+1%)	Estonia (+2%)	Poland (+5%) Singapore (+3%) Switzerland (+1%)	Turkey (+5%) Luxembourg (+4%) Morocco (+4%) Bulgaria (+3%) Finland (+3%) Australia (+2%) France (+2%) Italy (+2%) Norway (+2%) Spain (+2%)
Stable or slightly improving -5% to 0%	Germany (0%) South Korea (0%) Taiwan (0%) The Netherlands (0%) US (0%)			Belgium (0%) Lithuania (-5%) Ireland (-5%) Portugal (-5%)
Strongly improving strictly more than -5%	Brazil (-6%) Greece (-6%) Czech Rep (-10%) Hungary (-11%)			Colombia (-10%)

Sources: National statistics, Euler Hermes, Allianz Research

We expect 2 out of 3 countries to post an increase in insolvencies in 2019, and 1 out of 2 countries to register more insolvencies than over the 2003-2007 period

INSOLVENCIES IN: THE REST OF THE WORLD

NORTH AMERICA (+0% in 2019):
On the road to plateau

A new low in the **US** in 2018 reflecting the robust performance of the economy and the positive impact on businesses of the massive fiscal stimulus. In 2019, the cooling down of the economy and the gradual tightening of credit conditions, should lead to a stabilization in business insolvencies (0%) - with a risk of trend reversal in case of prolonged shutdown.

CENTRAL AND EASTERN EUROPE (+4% in 2019): Diverging trends

Improvement in **Hungary** (from -18% in 2018 to -11% in 2019) and the **Czech Republic** (respectively -17% and -10%).

Deterioration in **Russia** (-9% and +6%), where growth will be limited by the US sanctions affecting investment activity, and in **Romania** (-3% and +3%)

LATIN AMERICA (+5% in 2019):
Trend reversal in Brazil

The continued increase in Latin America will result from the trend in **Chile** (+13% anticipated in 2019) which is only gradually weakening since the new Insolvency law boosted insolvencies in 2014.
The gradual acceleration of the economy expected in 2019 should contribute to a trend reversal in insolvencies in **Colombia** (from +25% to -10%) and in **Brazil** (-6% in 2019) where insolvencies struggled to diminish in 2018 from the 10 years high reached in 2017.

ASIA (+15% in 2019):
A persistent boost from China

A double digit growth in **China**: +20% in 2019 (after a +60% in 2018 according to the available non-official data and a +74% official pickup in 2017). Key factor#1: the on-going softening and adjustments of the economy. Key factor#2: the increasing inclination to use insolvency procedures, in particular by the authorities, in order to clean the 'zombie' state-owned enterprises

A quasi stabilisation in **South Korea** (from -6% in 2018 to 0% in 2019), **Japan** (respectively -2% and +1%), **Hong-Kong** (-10% and +2%)

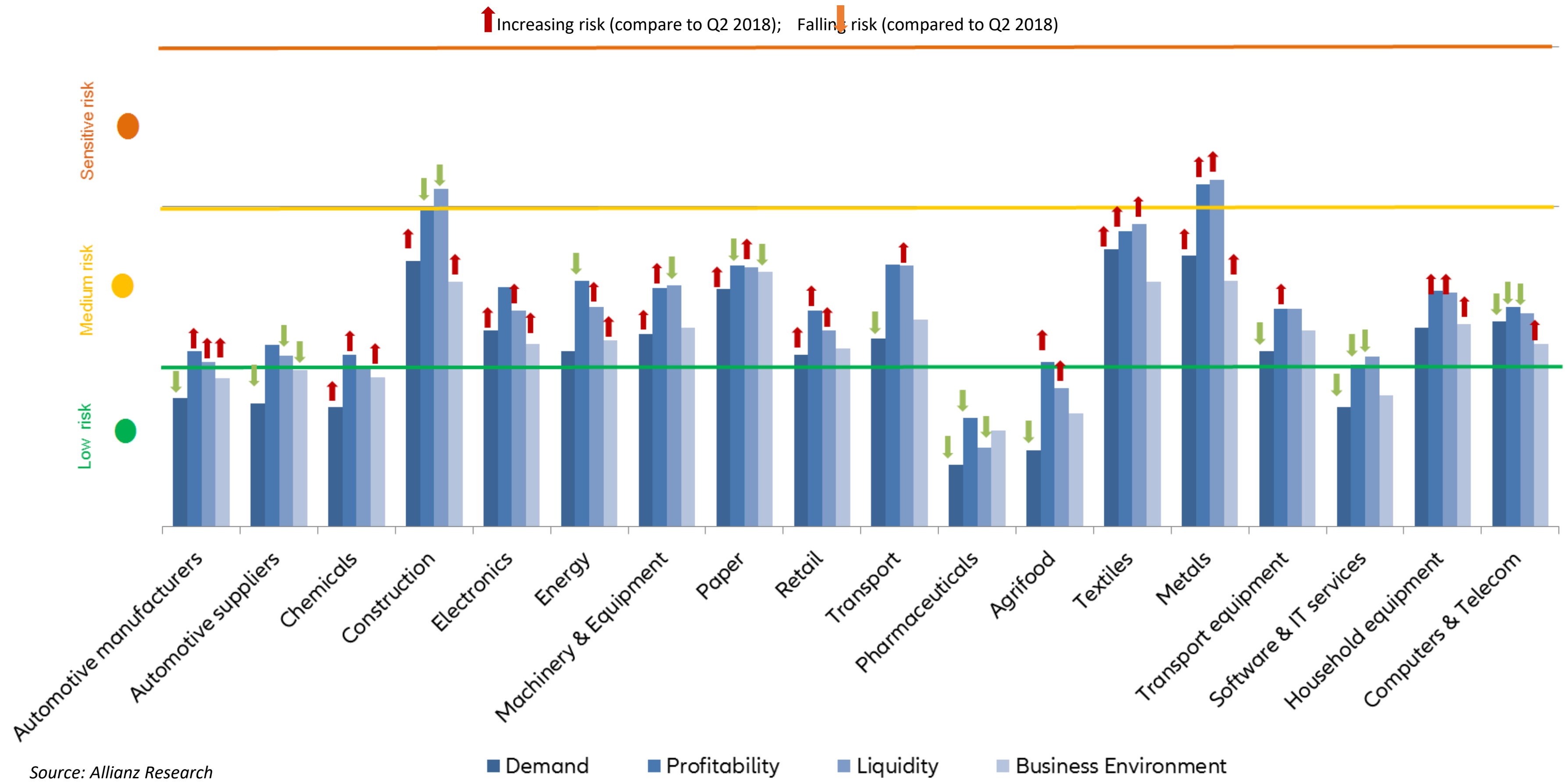
An increase in **Australia** (+3% in 2019 after +2% in 2018), **New-Zealand** (respectively +6% and +1%) and, from a low level, **Singapore** (+10%).

A 'mechanical' increase in **India** in 2018 due to the gradual implementation of the new Insolvency law established end of 2016 for the whole country.

RETAIL & HOUSEHOLD EQUIPMENT SHOW DETERIORATING FUNDAMENTALS

A majority of consumer, metal and energy-related sectors posted a deterioration in demand, profitability and liquidity

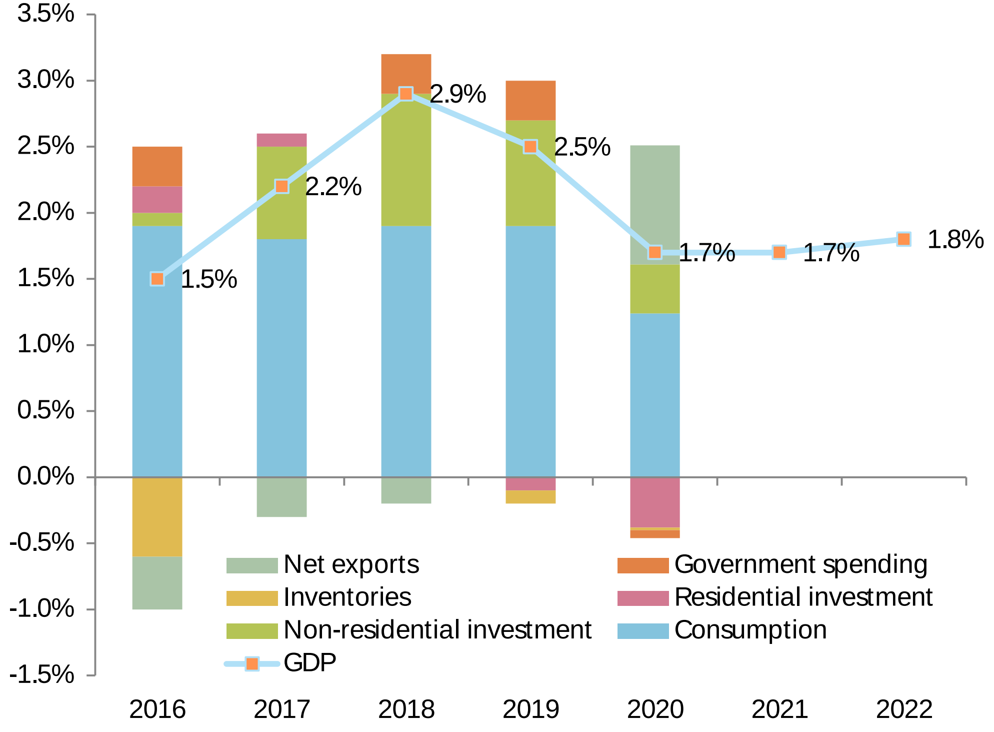
Changes in sector risk subcomponents by sector in Q3 2018



Source: Allianz Research

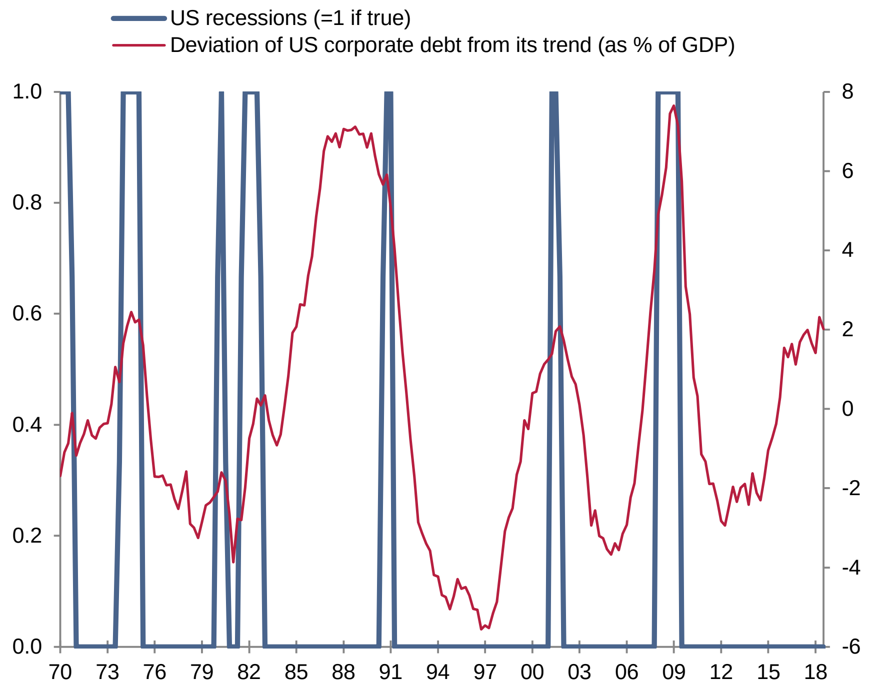
US: POSSIBLE TECHNICAL RECESSION IN 1H20

US GDP growth scenario (% y/y)



A technical recession is possible as early as H1 2020. US growth slowdown will start in 2019 amid diluting impact of the fiscal stimulus, tightening credit conditions and political uncertainty.

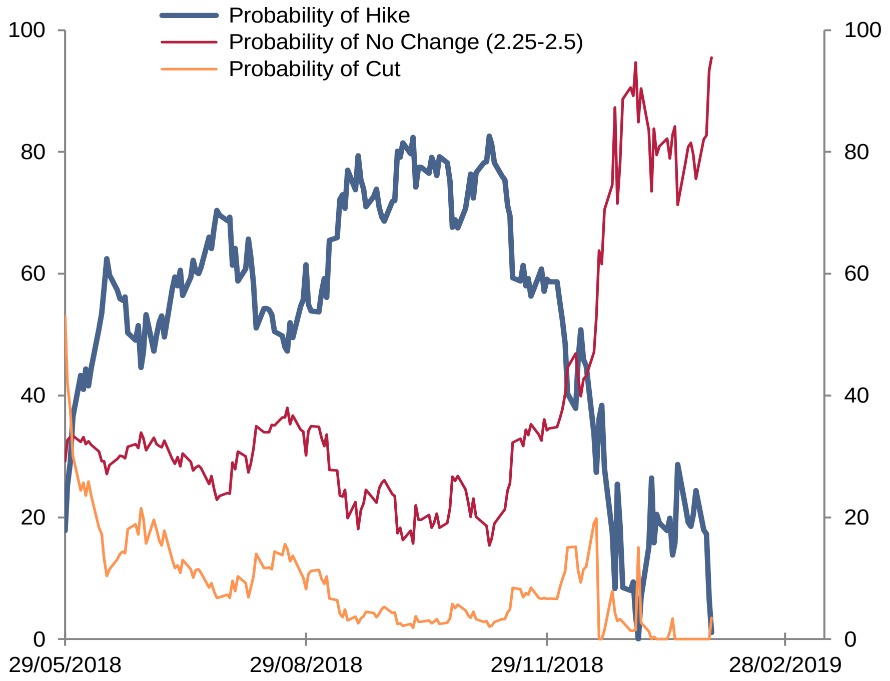
US nonfinancial corporate debt
(as % of GDP, deviation from trend)



The risk has been rightfully located in the US nonfinancial corporate sector debt. Significant deviations from its trend generally precede recessions

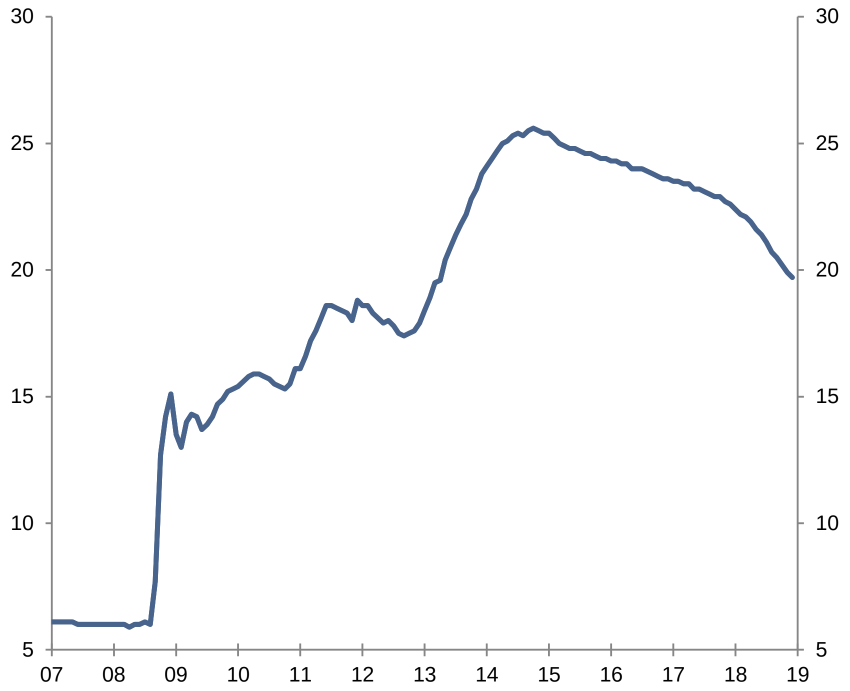
THE FED: CHECKING-IN OR CHECKING-OUT?

Probability of the Fed's rate decision for June 2019 FOMC meeting



Sources: Bloomberg. Allianz Research

Size of the Fed's balance sheet (as % of GDP)



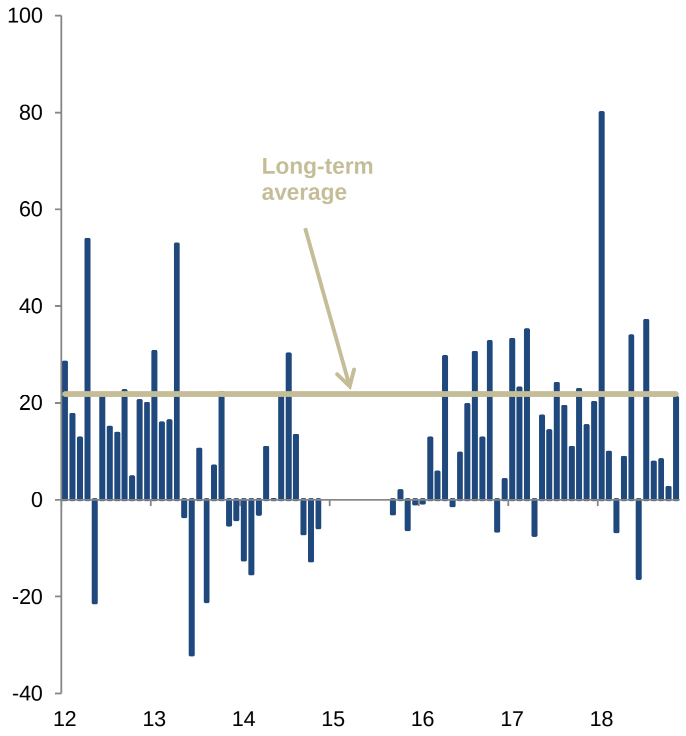
Sources: Bloomberg, Allianz Research

Since November 2018, the Fed has significantly softened the stance of its communication on the back of deteriorating macro-economic conditions and tightening financial conditions. We now expect only one hike at best in 2019.

The Fed balance sheet's size has declined at a monthly pace of USD 50 bn. Powell said that a completed normalization could take place sooner than expected as an ample reserve regime was probably required, suggesting a larger Fed's balance sheet than prior to crisis.

EMERGING MARKETS: HEADWINDS AND TAILWINDS

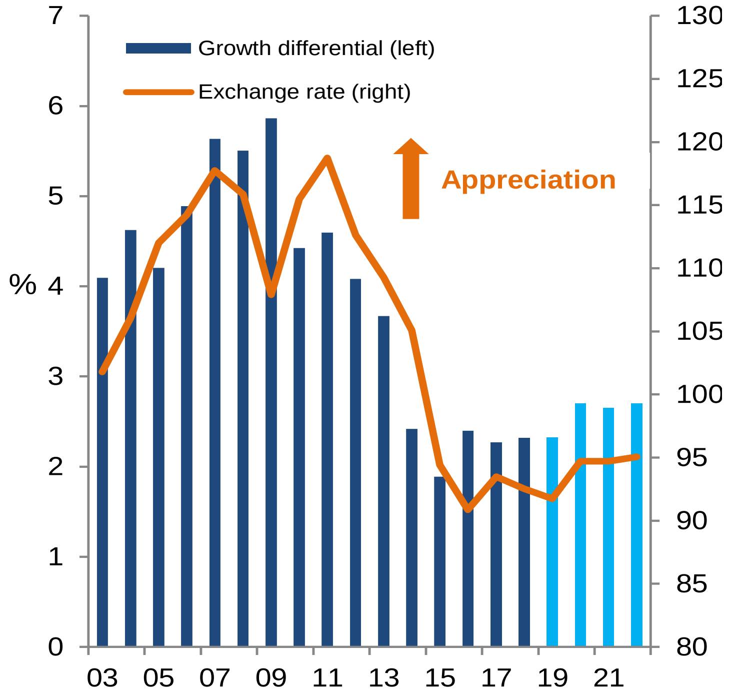
Capital flows to Emerging Markets (excl. China and Russia), USD bn



Sources: IHS Global Insight, Allianz Research

Capital flows to Emerging Markets to prove fickle, but attractiveness to remain and reignite capital inflows in periods of lower risk-aversion

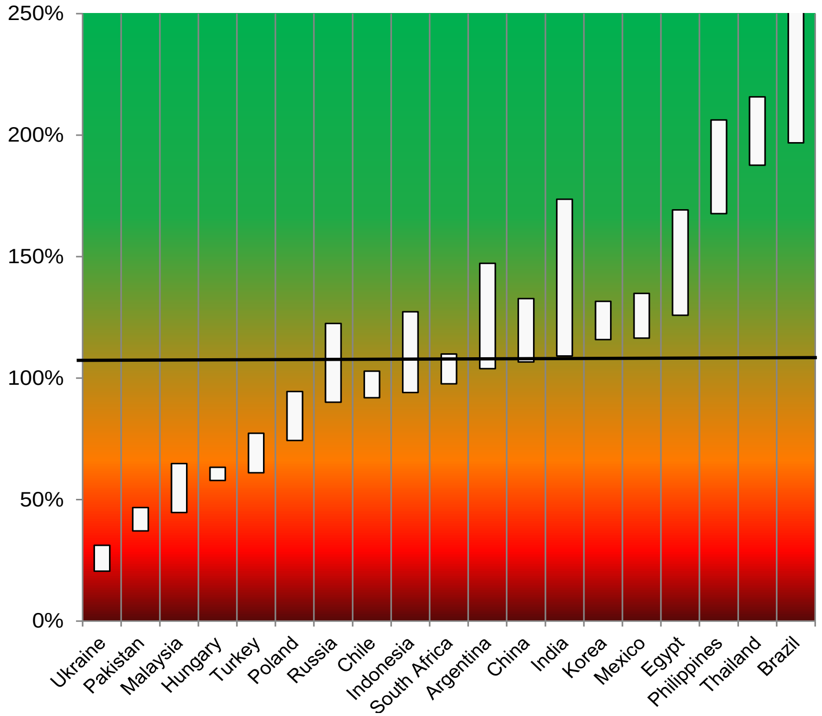
Growth differentials between Advanced Economies and Emerging Markets vs. exchange rates



Sources: IHS Global Insight, Allianz Research

In a scenario where US growth decelerates progressively, US monetary policy tightening would ease with Emerging Markets standing to benefit

Foreign reserve adequacy: FX reserves in % of liquidity potential needs



Sources: IHS Global Insight, Allianz Research

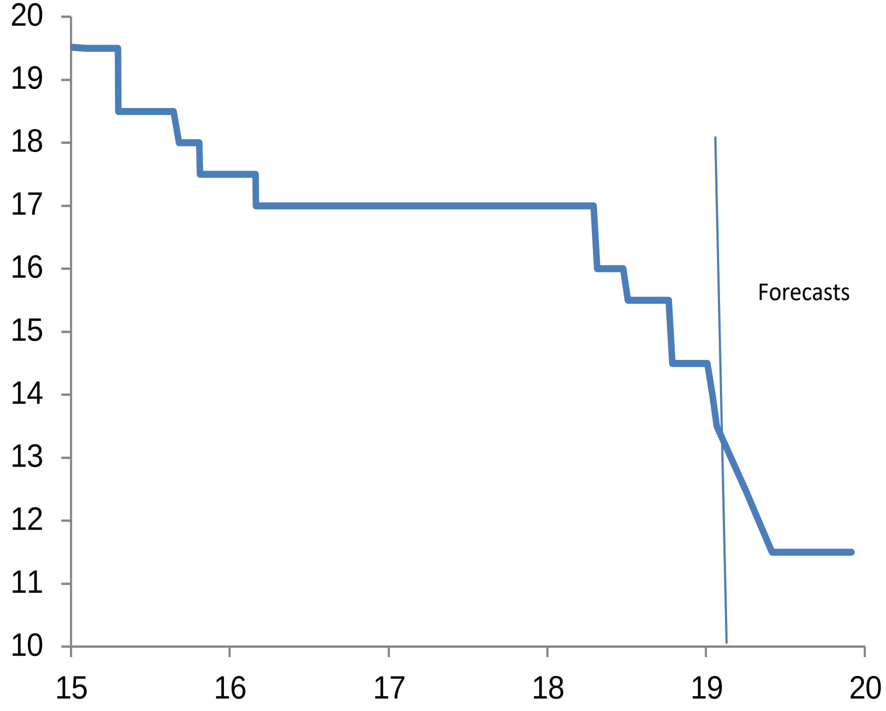
In case of adverse shocks, several Emerging Markets may face liquidity crises, adversely impacting the entire EM asset class

CHINA: POWERFUL STABILIZATION AT WORK

	2018e	2019f	2020f	2021f	2022f
Real GDP growth and contributions	6.6	6.3	6.1	5.9	5.7
Total domestic demand	7.0	6.7	6.1	5.8	5.6
Final consumption expenditure	5.0	3.9	3.6	3.5	3.4
Gross capital formation	2.0	2.1	2.0	2.0	1.8
Net exports	-0.4	-0.4	0.0	0.1	0.1
Assumptions					
Consumer Inflation	2.1	2.5	2.3	2.1	2.2
RMB/USD (end year)	6.9	7.0	7.1	6.9	6.7
Policy rate (end year)	4.35	4.10	4.10	4.00	4.00

Sources: IHS Global Insight. Allianz Research

RRR for large financial institutions



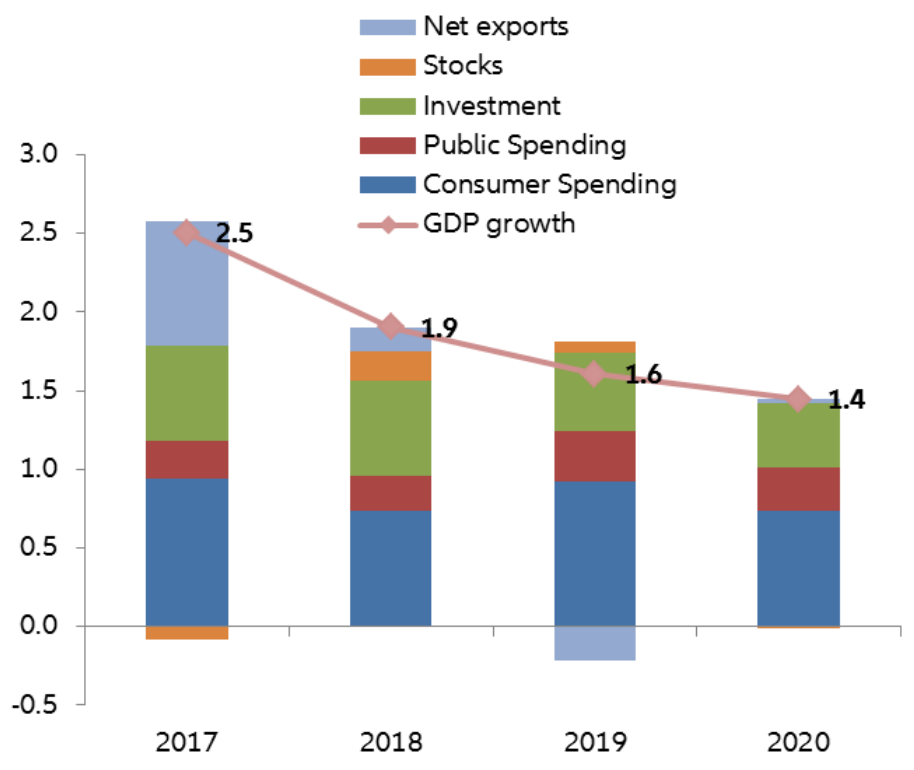
Sources: IHS, Allianz Research

- RMB2tn tax cuts (over 2018-19) to households and business to support private consumption and investment.
- Infrastructure investment to pick up speed to +7% in 2019 (from +3.8% in 2018)

The authorities are stepping financing measures to support growth with RRR cuts (five since last year), increased liquidity injection (RMB1.16tn in the third week of January), support for corporate bond issuance, targeted lending measures to the private sector .

EUROZONE: MIND THE FRENCH - GERMAN ENGINE

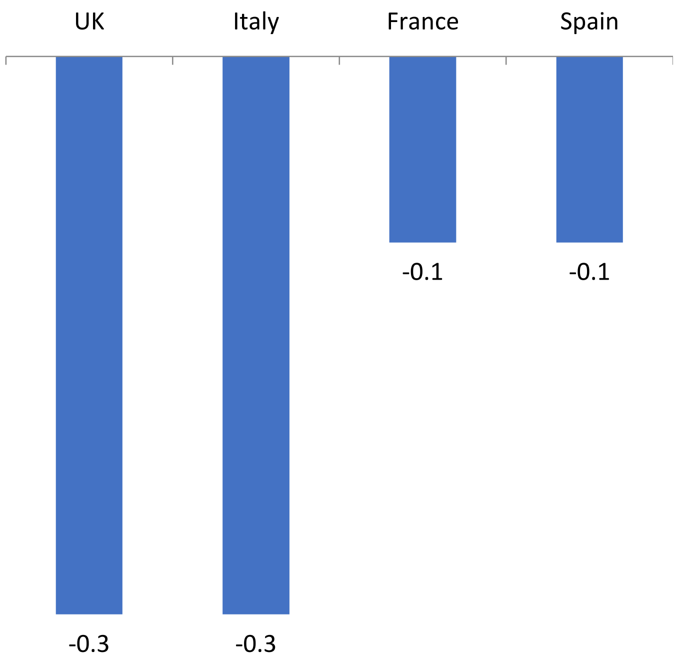
GDP growth (%) & components (pp)



Sources: Eurostat, Allianz Research

In 2019 GDP growth above potential for 5th consecutive year but momentum continues to fade as external pressures rise

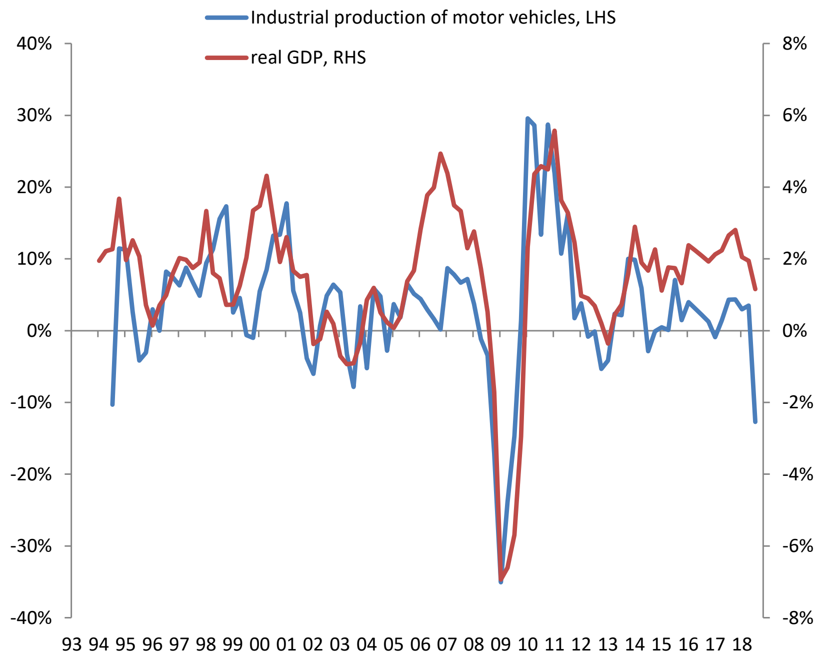
Uncertainty impact on real GDP growth (pp, 2018)



Source: Allianz Research

The high uncertainty "put" has weighed on economic growth in 2018

German industrial production and GDP growth (%, y/y)



Sources: Chelem, National sources, Allianz Research

The strength of German auto sector will be decisive in German and European economic cycles.

EUROPE: (YELLOW) LIFE VESTS

Most recent election outcome

Eurobarometer 2018

UK – Brexit: Deal or no deal?

AVG real GDP growth 2016-19	1.6%
Unemployment rate (2018)	4.1%
% of votes received by largest political party	42.3%
Support for main populist party	1.8%
% population with negative view of non-EU immigration	29%
% population with negative view of the EU	27%

European Union – Strong populist faring in EU elections, impact on EU/EZ reform?

AVG real GDP growth 2016-19	2.0%
Unemployment rate (2018)	7.0%
% population with negative view of non-EU immigration	53%
% population with negative view of the EU	20%

France – Yellow vests slow reforms

AVG real GDP growth 2016-19	1.6%
Unemployment rate (2018)	9.1%
% of votes received by largest political party	53.4%
Support for main populist party	13.2%
% population with negative view of non-EU immigration	54%
% population with negative view of the EU	27%

Italy – Populist coalition in power

AVG real GDP growth 2016-19	1.1%
Unemployment rate (2018)	10.7%
% of votes received by largest party	25.6%
Support for main populist party	25.6%
% population with negative view of non-EU immigration	66%
% population with negative view of the EU	27%

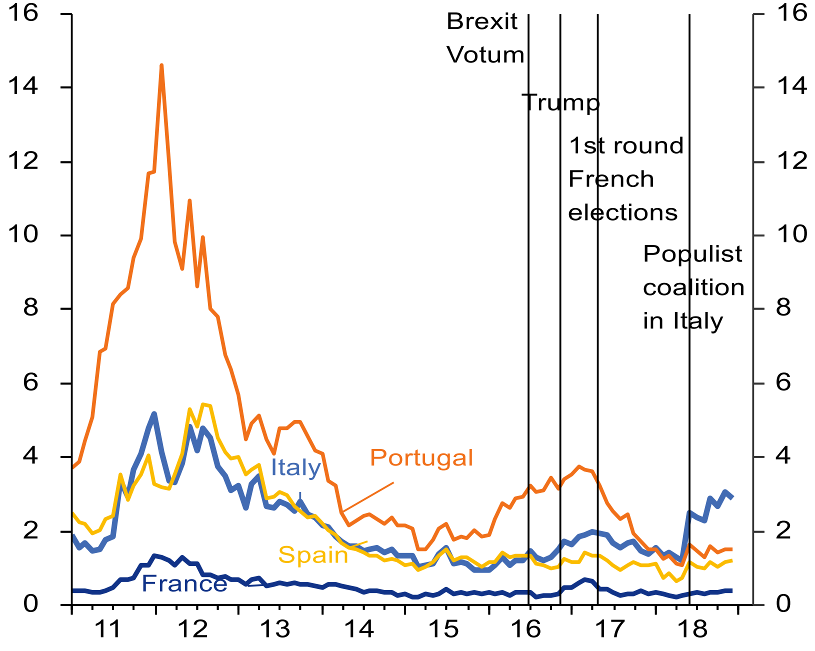
Germany – Merkel era to end, early elections?

AVG real GDP growth 2016-19	2.0%
Unemployment rate (2018)	3.6%
% of votes received by largest political party	32.9%
Support for main populist party	12.6%
% population with negative view of non-EU immigration	53%
% population with negative view of the EU	15%

Sources: Thomson Reuters Datastream, EU Commission, Allianz Research.

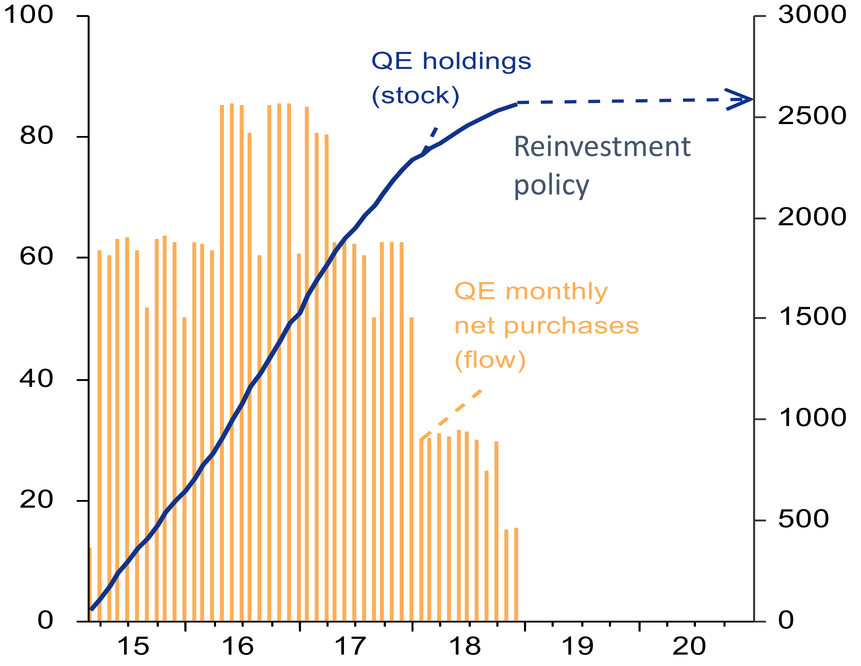
EUROZONE: TOWARD MORE REDISTRIBUTION

Spreads between 10-yr govt bonds over German Bunds



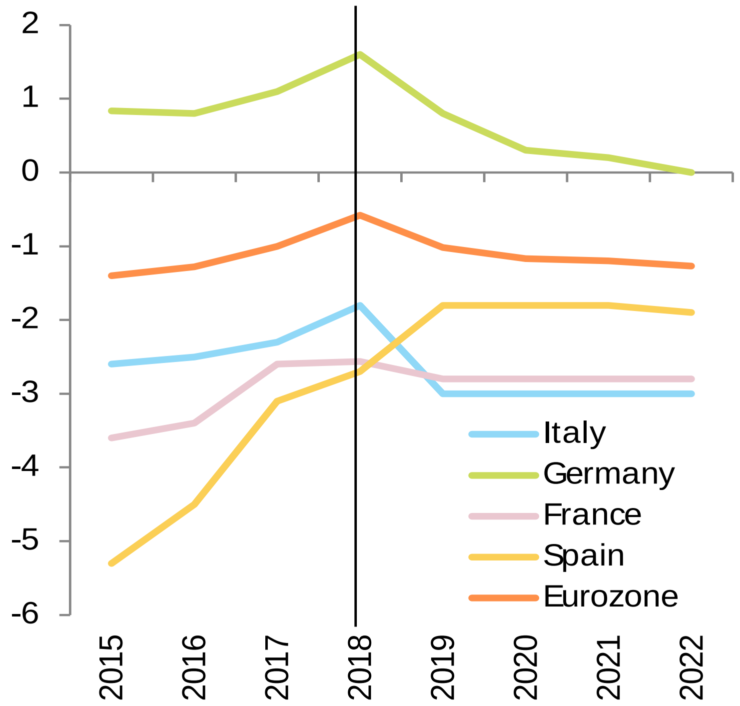
Sources: IHS Global Insight. Allianz Research

ECB QE stock and flows (EURbn)



Sources: IHS Global Insight. Allianz Research

Fiscal balance (% of GDP)



Sources: IHS Global Insight. Allianz Research

The ultra-expansive monetary policy has served as a buffer in times of elevated political uncertainty, drowning out market concerns while supporting risk appetite

As the ECB takes a first step towards normalizing its policy by ending monthly QE net purchases come Jan 2019, market discipline will start to return. But the re-investment of maturing principal until at least early 2021 will act as a safety-net

In times of past-the-peak economic growth and waning liquidity, we expect fiscal policy to step up its game to address lingering political discontent – at least in Eurozone countries where fiscal room for maneuver allows for it

BREXIT: NAVIGATING THE UNCERTAINTY

November 25

EU Council agreed on the draft Brexit deal

January 15

UK Parliament rejected the Brexit deal

January 29

Two amendments to the Brexit bill voted

(avoid no-deal, renegotiation of the Irish backstop)

February 14

A new vote planned for the Brexit deal 2.0 post renegotiation with the EU

(Simple majority needed)

End-February

Deadline for delaying Art. 50 beyond 29 March 2019

(Simple majority needed)

11-14 February

11-14 March or 25-28 March

EU Parliament ratifies the Withdrawal Agreement

(Simple majority needed)

21-22 March

European Summit

PROBABILITY FOR A LAST-MINUTE AGREEMENT

UNITED KINGDOM: COST OF UNCERTAINTY & POLITICAL SCENARIOS

The impact of uncertainty on real GDP growth is estimated at -0.3pp per year:

1. **Lower sterling** which could fall below 1.1 vs the EUR at the peak of the tensions. This in turn weighs on households' real purchasing power and company margins.
2. **Falling investment** (4 consecutive quarters of falls for the first time since 2009).
3. **Lower net migration** from the EU which triggers labor market shortages and puts upside pressures on wages (+3.3% y/y).
4. **Real estate prices** are adjusting downwards which creates negative wealth effects and impact consumer confidence and limits private consumption.
5. **Contingency stockpiling** by companies since Q3 2018 which will pose downside risks in 2019 given the weakness of domestic demand.
6. **Deteriorating attractiveness** with total M&A deals falling by 60% to GBP42.4bn on average. Several EU companies switch from a UK supplier to an EU supplier which in turn feeds into higher insolvencies in the UK market: +9% in 2019 after +12% in 2018
7. Worsening business and consumer confidence coupled with higher risk aversion trigger a **deterioration in loan availability by banks**

Political scenarios in 2019

No change in political leadership
(high probability)

- Theresa May survived several confidence votes (and has 1-year immunity from her Party). She seems determined to stay in power as long as needed and to save her party.

Second referendum *(medium probability)*

- 2/3 majority in Parliament in favor
- 3 to 4 months need to organize it
- Polls show: 56% for *Bremain* should the question be asked

General elections *(medium probability)*

- Theresa May decides to resign after several unsuccessful attempts to ratify the Brexit deal. Another Conservative leader takes over and has 14 days to win Parliament support but fails which triggers general elections (25 days latter)
- Labor and Conservatives are hand in hand in the polls

The UK revokes unilaterally Article 50
(low probability)

UNITED KINGDOM: BREXIT SCENARIOS & IMPACT

	2016	2017	2018	2019			2020	2021		
	Pro-Brexit vote in June	EU exit negotiations with EU	EU exit negotiations with EU	Last-minute agreement by March, July or December 2019 (extension of Art 50) (70%)	No agreement, disorderly Brexit, WTO rules (25%)	Stay in the EU (5%)	Transition deal	Soft Brexit (55%)	Limited FTA (40%)	Hard Brexit (5%)
Real GDP (y/y)	1.8%	1.7%	1.3%	1.2%	-1.0%	1.8%	1.0%	1.5%	0.5%	-0.5%
Real private consumption (y/y)	3.1%	1.8%	1.5%	1.5%	-1.0%	2.1%	1.1%	1.6%	0.8%	-0.6%
Real business investment (y/y)	-0.2%	1.6%	0.2%	1.2%	-4.0%	2.6%	1.1%	1.4%	-4.0%	-3.0%
Real total exports (y/y)	1.0%	5.4%	1.5%	2.0%	-5.0%	2.0%	1.8%	1.7%	-2.5%	-4.0%
Real total imports (y/y)	3.3%	3.2%	0.9%	2.5%	-6.0%	3.0%	2.3%	2.2%	-3.0%	-5.0%
Inflation (CPI, y/y)	0.9%	2.7%	2.4%	2.3%	3.5%	2.0%	2.2%	2.1%	2.7%	3.0%
BoE benchmark interest rate	0.25%	0.50%	0.75%	1.00%	0.75%	1.00%	1.25%	1.50%	1.25%	1.25%
GBP/EUR (eop)	1.17	1.12	1.09 - 1.12	1.15 - 1.20	0.84 - 0.87	1.20 - 1.25	1.15-1.20	1.15 - 1.20	0.97 - 0.98	0.79 - 0.81
Business insolvencies (y/y)	0.0%	-3.0%	12.0%	9.0%	20.0%	2.0%	6.0%	1.0%	4.0%	6.0%

NB:

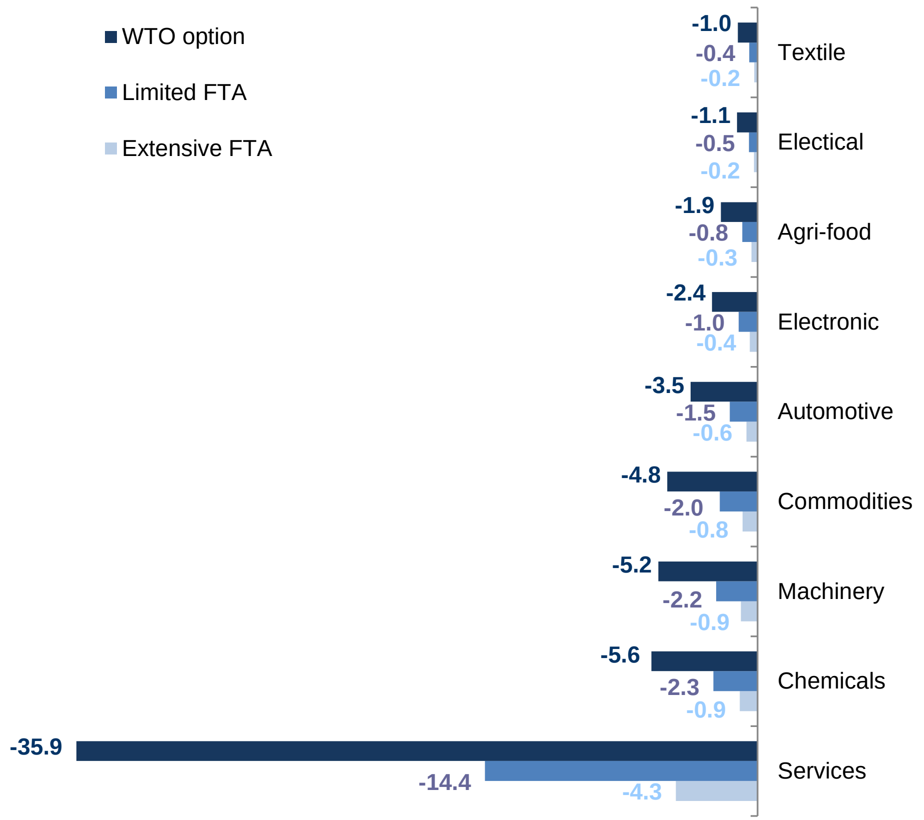
Soft Brexit = Norway / Switzerland type of trade agreement
Limited FTA = CETA-type of trade agreement
Hard Brexit = WTO, Most Favored Nation principle will apply (equiv. to more than 5% weighted average on goods, 20% to 30% additional costs for trade in services)

Sources: IHS Global Insight, ONS, Eurostat, Bloomberg, Allianz Research

NO BREXIT DEAL: WHICH POSSIBLE TARIFFS?

TOP 20 sectors	WTO tariffs (%)	Imports from UK (USDbn)	Share of EU imports in total imports from UK
Parts of nuclear reactors, boilers, machinery, and mechanical appliances	1.8	31.8	15.3%
Vehicles other than railway or tramway rolling	6.2	26.4	12.7%
of which Motor cars	*10.0*	*19.6*	
Mineral fuels, oils	0.8	24.2	11.7%
Electrical machinery	2.4	15.6	7.5%
Pharmaceuticals	0.0	12.3	5.9%
Plastics	5.9	8.0	3.9%
Optical, photographic, cinematographic instruments	1.4	7.5	3.6%
Organic chemicals	4.5	5.8	2.8%
Aircraft	3.0	4.6	2.2%
Chemical products	5.5	4.2	2.0%
Natural or cultured pearls and stones	0.6	4.0	1.9%
Iron and steel	0.3	3.6	1.7%
Beverages	4.3	3.6	1.7%
Total		**151.6**	**73%**

Potential export losses (EUR bn)



MULTILATERALISM: IS THERE A PILOT IN THE PLANE?

A less efficient coordination of policies means deeper and long-lasting impacts of any global crisis

US reducing its supply of world public goods

Coordination of economic policy

- Controlling and criticizing IMF
- Criticizing WTO and opting for protectionism
- Exiting United Nation Human Rights Council
- Reducing spending for UN

Environment policy

- Withdrawal from Paris Agreement
- Supporting energy sector

Military cooperation

- Claiming higher military spending to NATO members
- Bargaining trade advantages against military protection (Japan, South Korea)
- Blurring the lines between old friends and foes

Know-How transfers

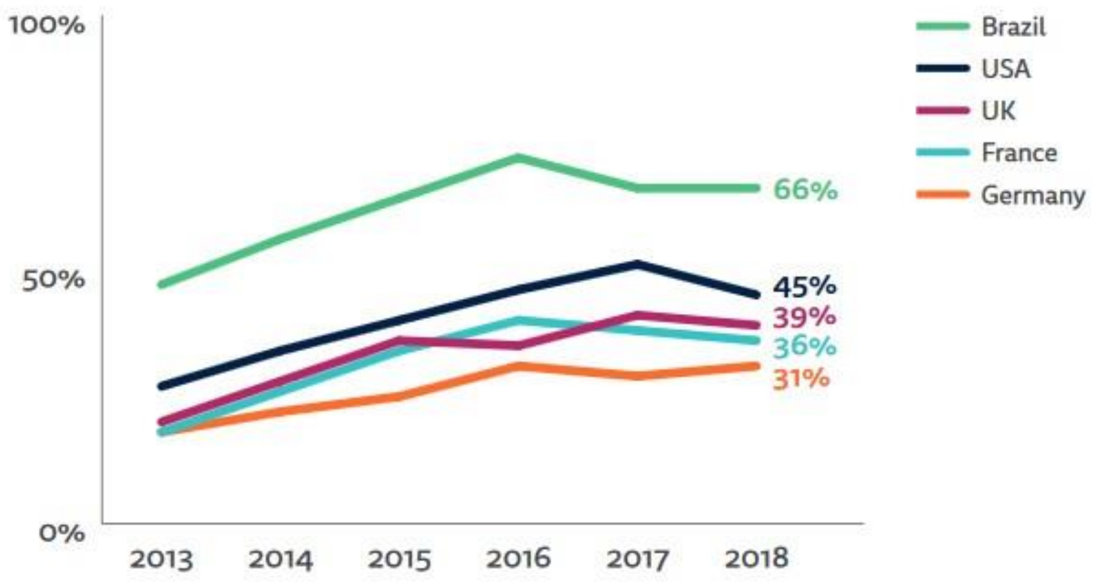
- Limiting inward and sensitive outward FDI
- Stricter control of data and intellectual property
- Stricter control of immigration

Thucydides' trap (Allison, 2017) : US and China destined to be rival? Mind the impact on Europe and Emerging Markets

US	China
Capitalism	State capitalism
Maintain leading position in technology	Move up the value chain (Made in 2025)
US security dominance and economic influence	Expansionary foreign policy (South China Sea, Taiwan, Africa)
America first	Belt and Road initiative
Maintain reserve currency role	RMB internationalization
Largest Economy by now	The second largest economy
In the situation of a Thucydides trap, where a rising power challenges the hegemonic rule of a regime in place, the situation was solved **with war** 12 out of the 16 times throughout history.	

SOCIAL MEDIA: ALGORITHMS NURTURING POPULISM

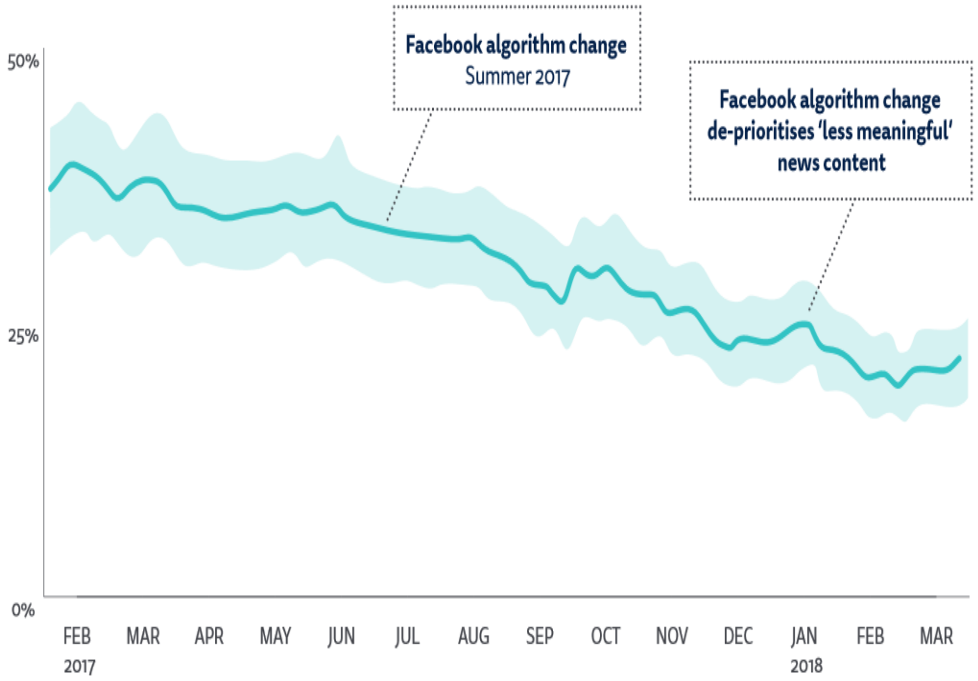
Proportion that used social media as a source of news in the last week



Sources: IHS Global Insight. Allianz Research

A large percentage of citizen now use social media as their main source of information. It fosters the phenomenon of fake news and exposes the public opinion to potential manipulation (Russia Internet Research Agency, Cambridge Analytica…)

Proportion of referrals to news websites from Facebook



Sources: Reuters, Parsely

Facebook changed its algorithms post US elections in order to gave the priority to friends, neighbors and groups to the detriment of pages. It reduces the access to both reliable and unreliable information providers and accentuates the polarization of opinion (confirmation bias).