THE BIG SWITCH: REWIRING THE WORLD?

Economic Research Department

Global Economic Outlook

Q1 2019

EULER HERMES

Allianz

EXECUTIVE SUMMARY: THREE BIG SWITCHES

Three policy switches to keep in mind in 2019-20: two happened, one to come?

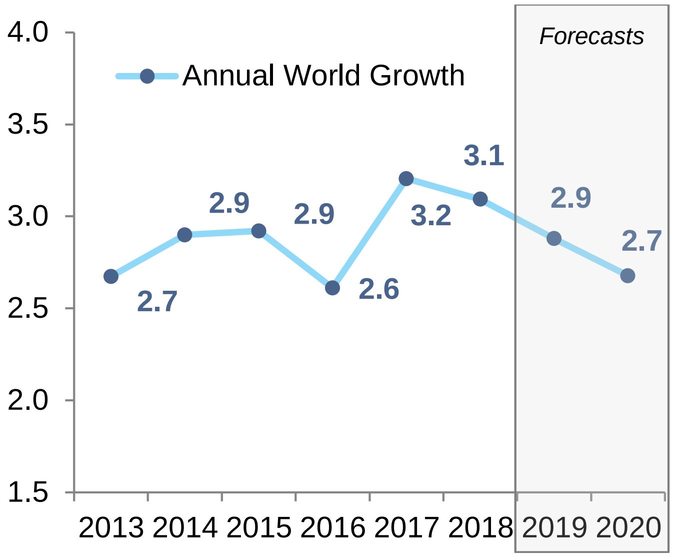
1. **The US-China switch.** Waning positive effects of the 2017-18 US fiscal stimulus offset only in part by a Chinese super bazooka stimulus.
2. **The policy switch.** The average stance of monetary policies observed at a global level will switch from being restrictive to being expansionary. Fiscal impulse will come from China, the Eurozone and the US in 2019.
3. **The uncertainty switch.** We expect positive outcomes in ongoing trade negotiations to contribute to stabilize global trade at 2.5% in volume terms after a trough in Q1 19. We also expect prolonged Brexit limbos, and contained political risks.

Two technical upheavals to create bumpy growth path

1. **Eurozone softer-than-soft patch** in Q3 18 – Q1 19
2. Upcoming : **US debt ceiling** issue to negatively impact investment in H1 20

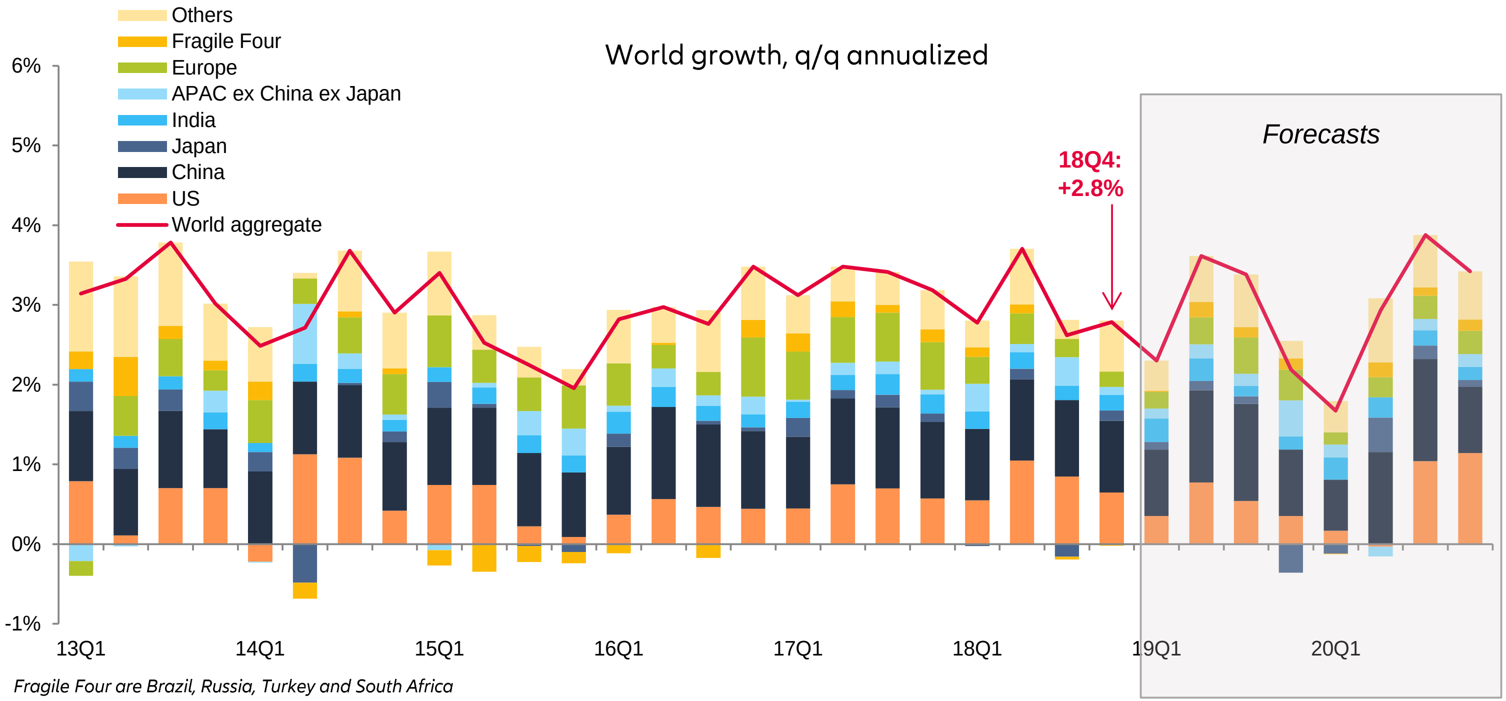
One question: Are we already **back to a 2015-2016 muddle-through scenario** after a US-made artefact of growth?

Global growth: Back to 2015-16?



Sources: Euler Hermes, Allianz Research

GLOBAL GROWTH: BUMPY ROAD AHEAD

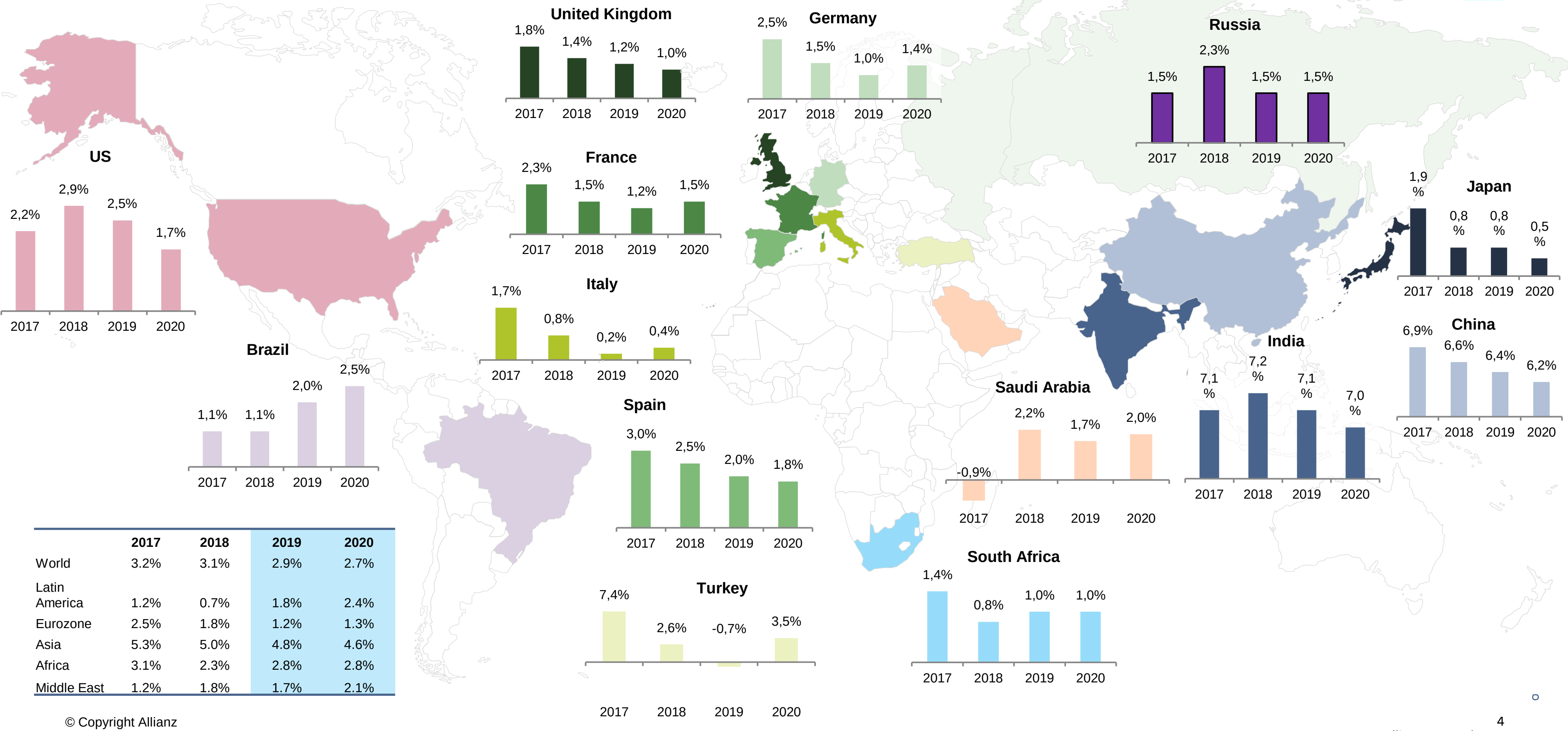


Fragile Four are Brazil, Russia, Turkey and South Africa

Sources: Bloomberg, Euler Hermes, Allianz Research

China's and the US fiscal stimulus will allow escaping the soft patch of Q3 18 – Q1 19. The recovery should be short-lived because of a negative shock occurring in the US with a maximum impact to be felt in Q1 20. The recovery of H2 20 will embody a normalization of growth in the US, the succession of stop and go maintaining developed economies below potential

GROWTH: COUNTRY FORECASTS

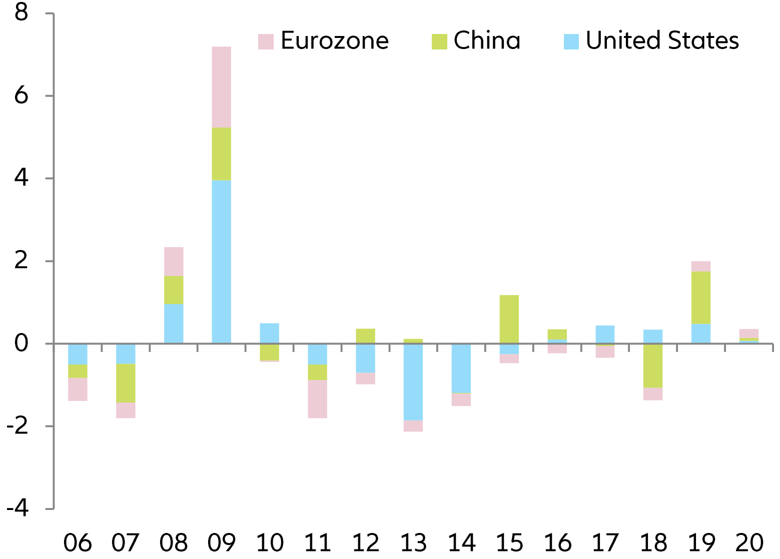


	2017	2018	2019	2020
World	3.2%	3.1%	2.9%	2.7%
Latin America	1.2%	0.7%	1.8%	2.4%
Eurozone	2.5%	1.8%	1.2%	1.3%
Asia	5.3%	5.0%	4.8%	4.6%
Africa	3.1%	2.3%	2.8%	2.8%
Middle East	1.2%	1.8%	1.7%	2.1%

Source: Allianz Research

POLICY SUPPORT: EASING OF THE GLOBAL POLICY MIX

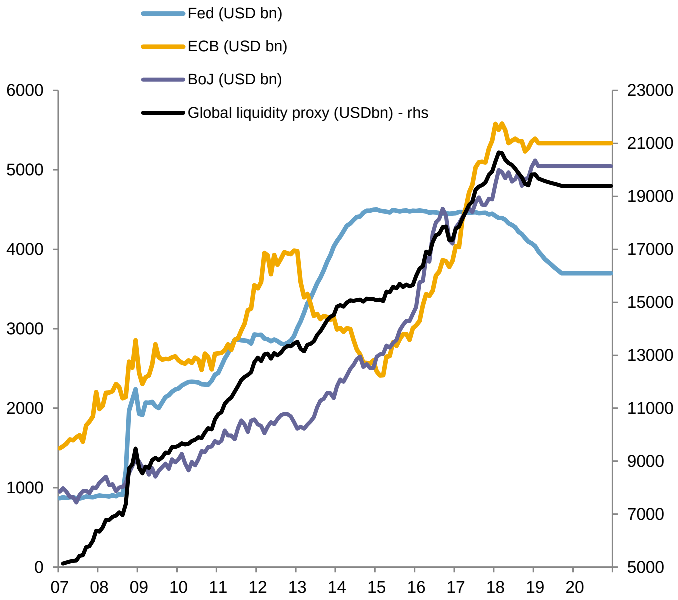
Impact of fiscal stimulus on world growth (pp)



Sources: Euler Hermes, Allianz Research

In 2019, all three regions are aligning their fiscal support but the US is passing the baton to China

Central banks' balance sheet policy



Sources: Euler Hermes, Allianz Research

Major central banks have decided to be patient in normalizing their monetary policy to ensure that world growth will be on a stronger footing

POLITICAL RISK AND HURDLES

December 10
WTO deadline: Unless US. stops blocking appointments to the WTOs appellate body, the trade body will lose the minimum 3 judge quorum needed to issue rulings

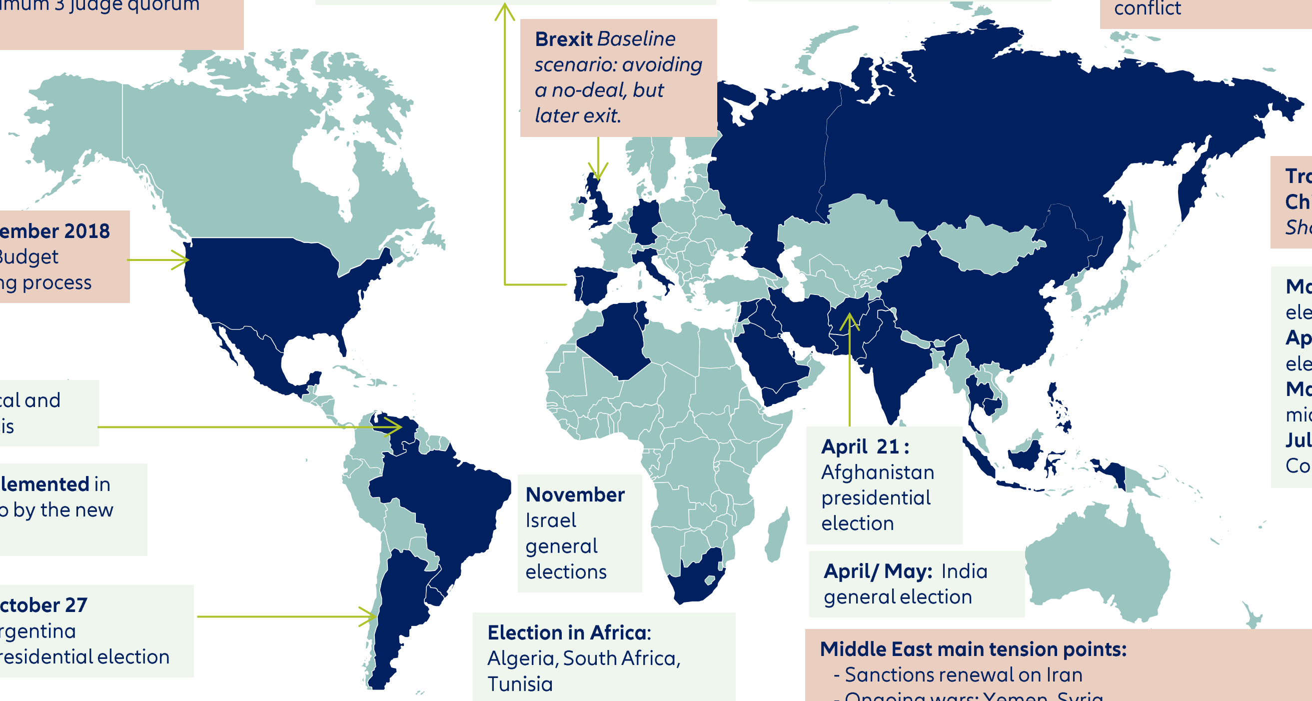
May 23-26
EU Parliament elections

April and October
Spain and Portugal general elections

Elections in Europe:
March : Ukraine
April : Finland
June : Denmark
November/October: Poland

Russia/Ukraine
Political instability could rekindle the conflict

Brexit *Baseline scenario: avoiding a no-deal, but later exit.*



Trade tensions China/US
Should ease this year

November 2018
US Budget voting process

March: Thailand general elections
April: Indonesia general election
May: Philippines midterm election
July: Japanese House of Councilors election

Venezuela political and humanitarian crisis

First policies implemented in Brazil and Mexico by the new administrations

November
Israel general elections

April 21 :
Afghanistan presidential election

April/ May: India general election

October 27
Argentina presidential election

Election in Africa:
Algeria, South Africa, Tunisia

Middle East main tension points:
- Sanctions renewal on Iran
- Ongoing wars: Yemen, Syria
- Qatar v. Saudi Arabia, UAE, Bahrain, Egypt (blockade)

NB: In Italic our baseline assumptions

Source: Allianz Research

US-CHINA BEYOND TRADE: LOWER SUPPLY OF GLOBAL PUBLIC GOODS. EUROPE AT THE CROSSROADS

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

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

Regulatory void
Supporting energy sector. Withdrawal from Paris Agreement
Deregulation of financial sector
New rules for pharma?

A shrinking benevolent hegemon?

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

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

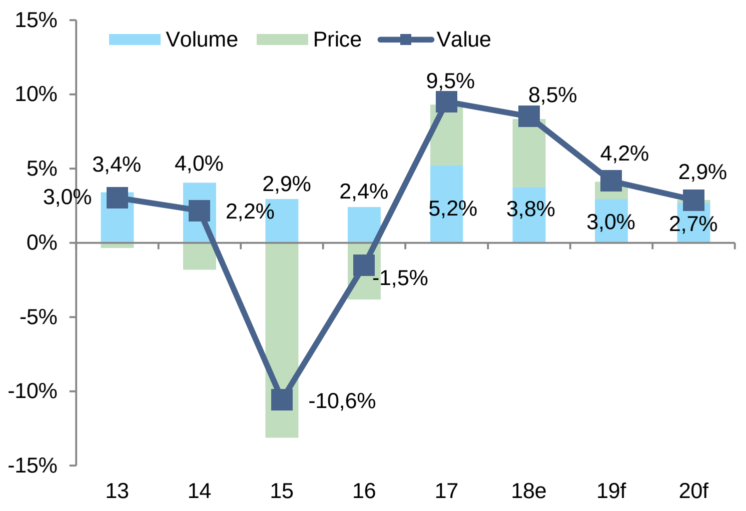
Thucydides' trap (Allison, 2017) : US and China destined to be rival?

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

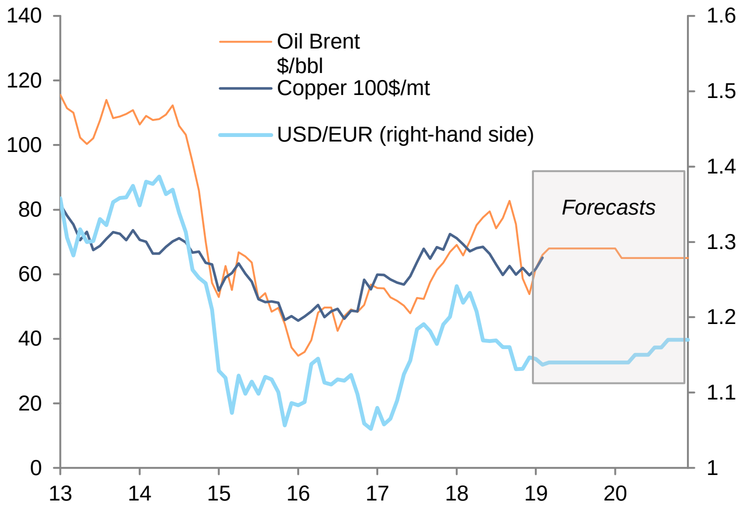
In the situation of a Thucydides trap, where a rising power challenges the hegemonic rule of a regime in place, the situation was solved **with war** 12 out of the 16 times throughout history.

GLOBAL TRADE: A VALUE ADJUSTMENT

Global Trade of goods and services



Commodity prices and USD/EUR exchange rate



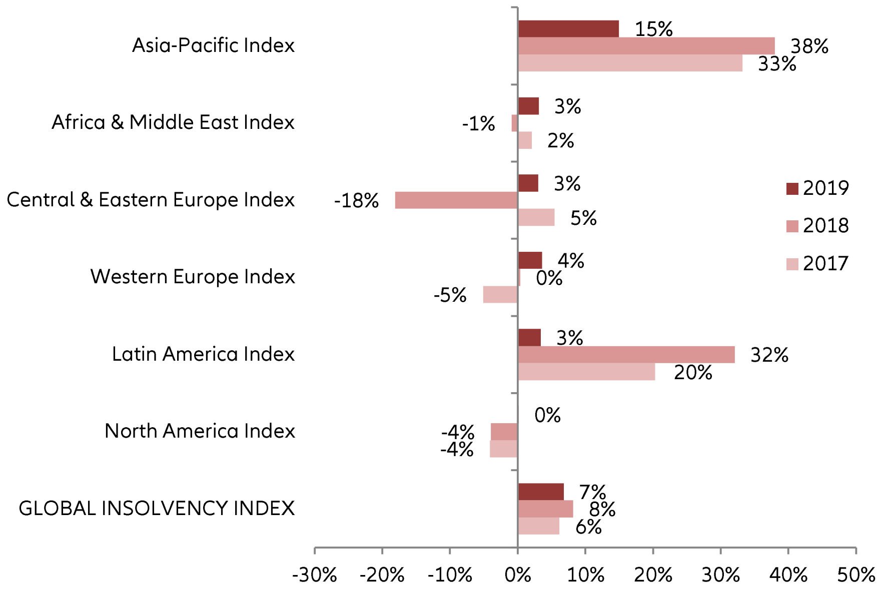
Sources: Euler Hermes, Allianz Research

Sources: IHS, Euler Hermes Estimates

Global trade is expected to pick up in H2 19 as trade tensions should diminish while, China's economic stimulus, coupled with the residual impact of the US stimulus, is expected to start producing positive effects. The recovery of commodity prices and global activity should not be strong and rapid enough to avoid a global trade deceleration at +3.0% in 2019 compared with 3.8% in 2018. Indeed, a rapid deceleration of economic activity in the US as early as Q4 19 is expected to pursue the decelerating trend of global trade in 2020 being expected at 2.7% y/y.

GLOBAL INSOLVENCIES: ON THE UPSIDE, AS EXPECTED

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



Sources: National statistics, Euler Hermes, Allianz Research

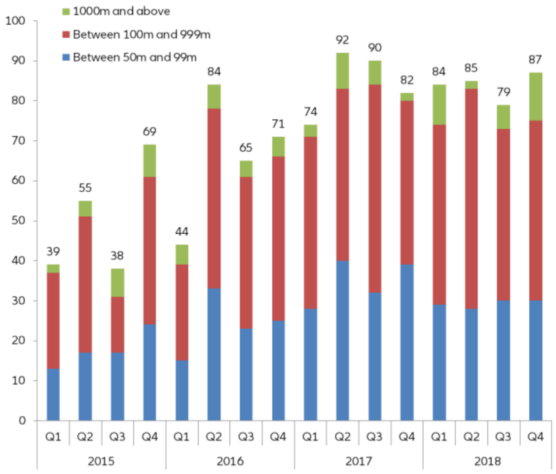
Insolvency Heat Map 2019

	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%)		Poland (+5%)	China (+20%) Slovakia (+16%) Denmark (+15%) Chile (+10%) Sweden (+10%) **GLOBAL (+7%)**
Deteriorating +1% to +5%	Canada (+4%) Romania (+3%) Austria (+2%) Hong-Kong (+2%) South Africa (+2%) Japan (+1%) Latvia (+1%) New Zealand (+1%)	Estonia (+3%)	Singapore (+2%) Switzerland (+1%)	Turkey (+5%) Spain (+5%) Luxembourg (+4%) Morocco (+3%) Bulgaria (+3%) Finland (+3%) Australia (+2%) Italy +2%) Norway (+2%) France (+2%)
Stable or slightly improving -5% to 0%	Germany (0%) South Korea (0%) Russia (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%)

We expect our Global Insolvency Index to keep on increasing in 2019 (+7% after +8% in 2018), with a deceleration in Asia, a stabilization in the US and a rebound in Europe. We expect 2 out of 3 countries to post an increase in insolvencies, and 1 out of 2 countries to register in 2019 more insolvencies than over the 2003-2007 period

MAJOR INSOLVENCIES: RETAIL AND CONSTRUCTION

Number of major insolvencies*
(by size of turnover in million of EUR)



(*) Companies with a turnover exceeding EUR50m
Source: Euler Hermes

Major insolvencies* by sector and by region (number of insolvencies)

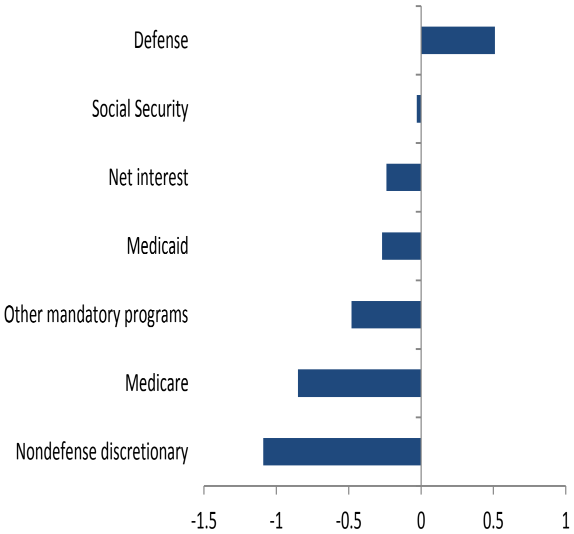
	Africa/Middle East and Latin America	North America	Central & Eastern Europe	Asia Pacific	Western Europe	TOTAL
Pharmaceuticals	-	-	-	-	1	1
Transport equipment	-	-	-	-	3	3
Electronics	-	-	-	2	3	5
Paper	-	-	-	1	4	5
Commodities	-	-	1	3	3	7
Chemicals	-	1	1	4	2	8
Computers & Telecom	1	-	-	6	1	8
Textile	1	1	1	3	3	9
Automotive	-	-	4	1	7	12
Household equipment	-	3	2	3	9	17
Transportation	-	3	4	1	9	17
Machinery/Equipment	-	-	6	4	11	21
Metals	-	1	-	10	10	21
Energy	-	8	7	7	2	24
Services	-	3	5	6	18	32
Agrifood	-	-	7	12	15	34
Retail	3	15	4	5	24	51
Construction	-	3	17	23	17	60
Total	5	38	59	91	142	335

(*) Companies with a turnover exceeding EUR50m
Source: Euler Hermes

2018 posted 335 major insolvencies (-3 cases), with a cumulative turnover of EUR158bn (+40%). This rise in severity comes from the biggest top failures with a turnover exceeding EUR100m : +10 cases in number (30) , with a cumulative turnover increasing by 87% to EUR100bn). **Hot spots** continued to be **Construction** (60 major insolvencies) , notably in Asia (+11 cases to 23), and **Retail** (51 cases), notably in Western Europe (24) – which remains the region with the highest ,number of major insolvencies. **Asia** is in second place with a noticeable rebound in Agrifood (+7 cases) as well as in Energy and Computer/Telecom (both +6). Retail in the US registered 15 new major insolvencies despite the already impressive list of 34 cases over 2015-2017.

US: WHITE HOUSE ASKS FOR LOWER SOCIAL SPENDING

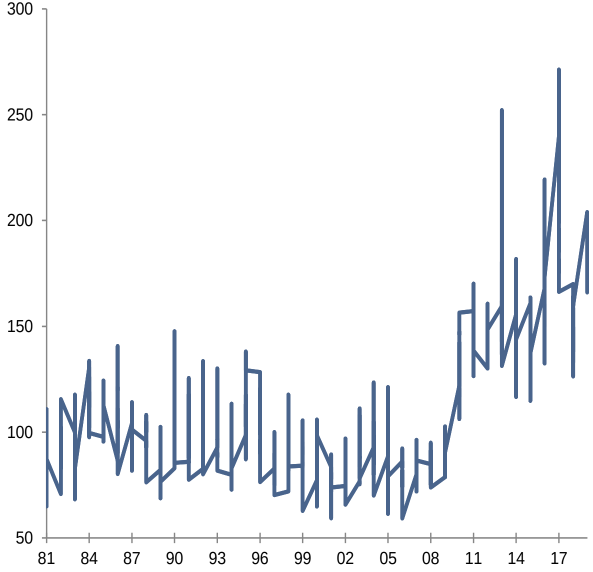
Proposed spending changes (USD trillion) in White House new budget



Sources: Euler Hermes, Allianz Research

In 2017, the Trump administration saw USD 488 bn of deficit for FY 2019. Now it expects USD 1.1 trillion, requiring some restrictive adjustments.

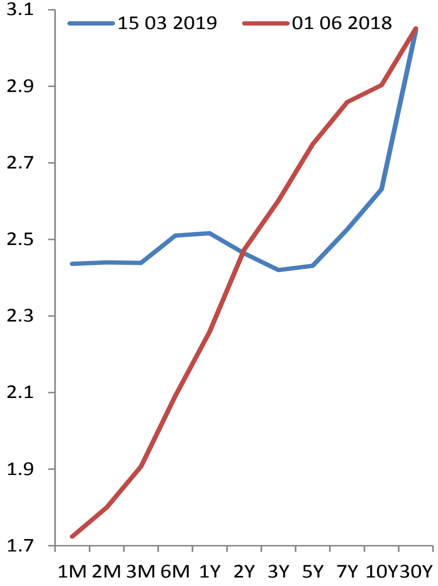
Partisanship index in the US Congress



Sources: Euler Hermes, Allianz Research

Partisan approaches of budgetary issues will trigger new blockages during the year in particular prior to 2020 Presidential elections

US yield curve (%)

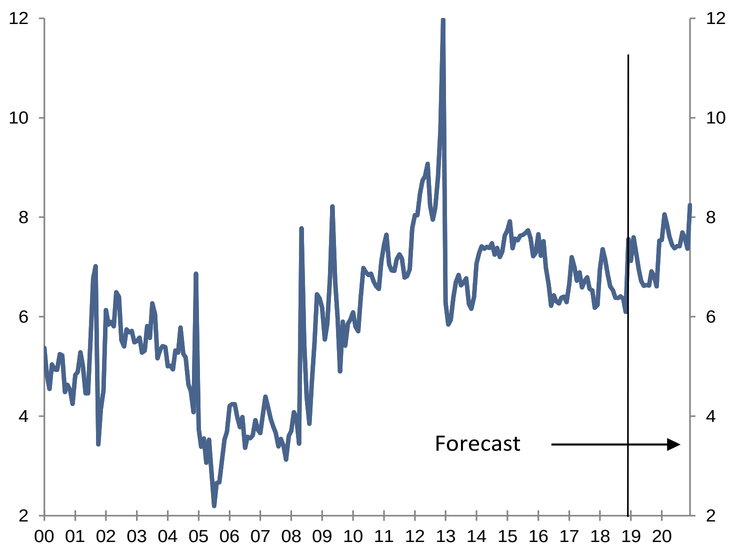


Sources: Euler Hermes, Allianz Research

The market has already priced in a phase of particularly high uncertainty in H2 19 (6M – 1Y bump of the yield curve) alongside mounting economic difficulties (flattening of the yield curve)

US: POLITICAL UNCERTAINTY TO HAMPER CONSUMPTION AND INVESTMENT

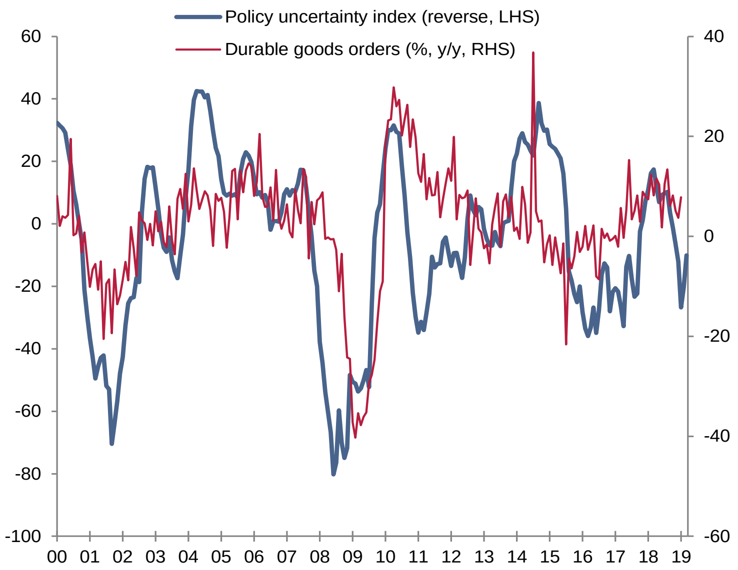
US household saving rate (as % of disposable income)



Sources: Euler Hermes, Allianz Research

Excessive borrowing and expected adjustments threatening social safety nets will induce Ricardian comportments

Non residential investment and political uncertainty

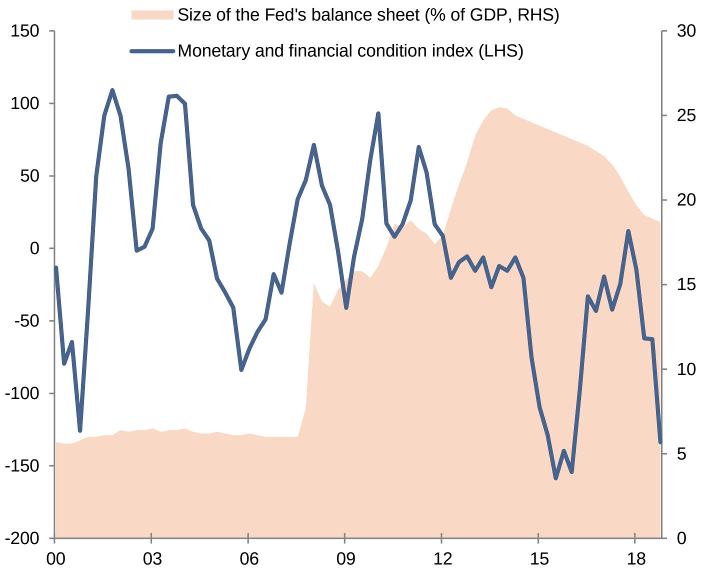


Sources: Euler Hermes, Allianz Research

Non residential investment will suffer from high uncertainty in the orientation of economic policy

US: THE FED HAS ALREADY COME TO THE RESCUE

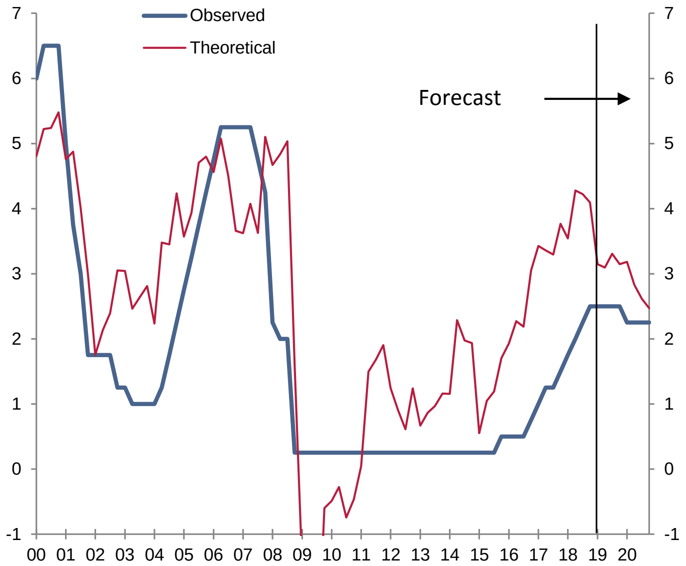
Liquidity conditions in the US



Sources: Euler Hermes, Allianz Research

The Fed already announced that it will not go back to initial balance sheet size. As monetary and financial conditions strongly tightened, the quantitative role of the Fed matters

Fed Funds target rate (%)

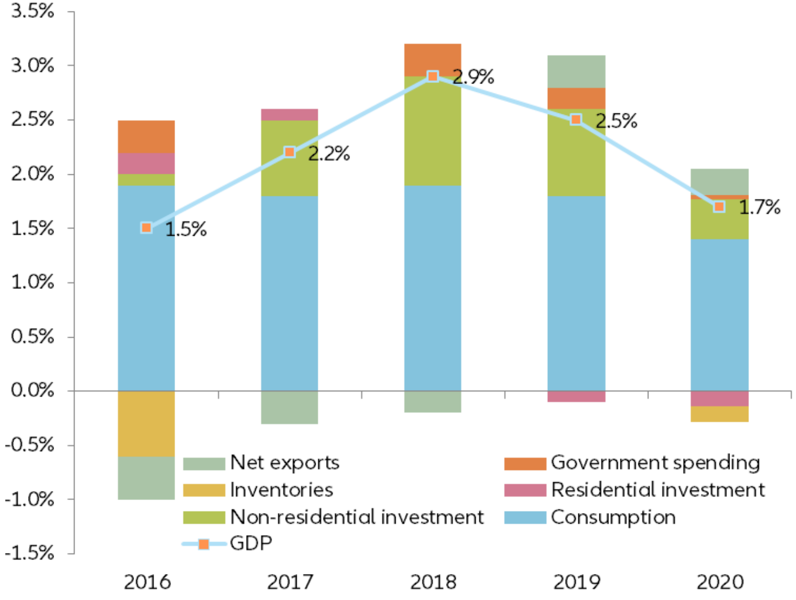


Sources: Euler Hermes, Allianz Research

The Fed has adopted a much more dovish stance of communication in terms of rate policy as Chairman Powell sees as being unlikely any further rate hike in 2019. We expect a cut in Q1 20.

US: LOWER GROWTH TO CHALLENGE THE CREDIT MARKET

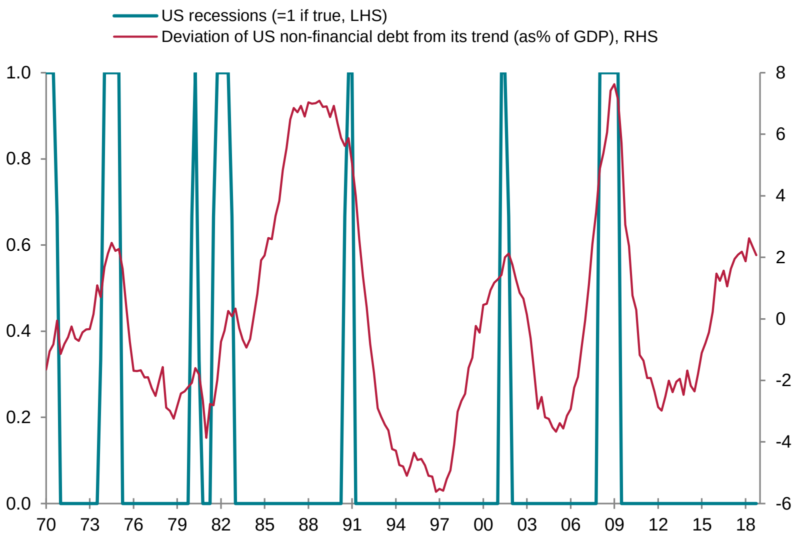
Contribution to US GDP growth (pp)



Sources: Euler Hermes, Allianz Research

Disorderly negotiations of the budget will represent a significant shock of uncertainty in H2 19, which will hamper the US investment cycle and erode consumers' confidence

US Corporate debt and probability of recession

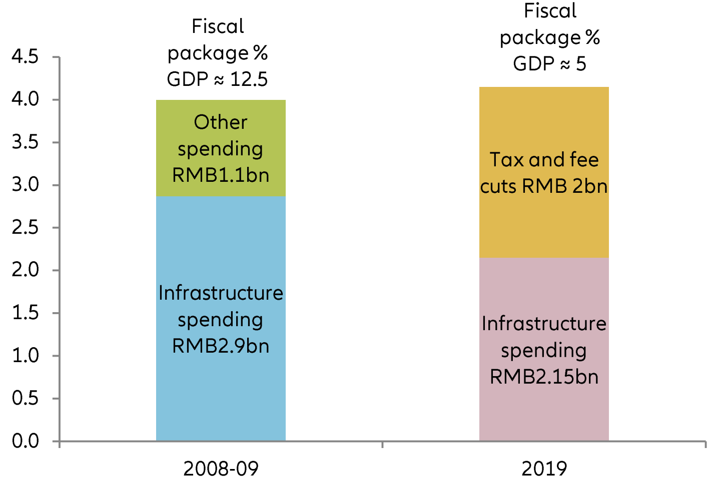


Sources: Euler Hermes, Allianz Research

Lower growth could be a trigger for stress in the credit market as corporate debt of non-financial companies has significantly deviated from its trend

CHINA: A POWERFUL AND TARGETED STIMULUS

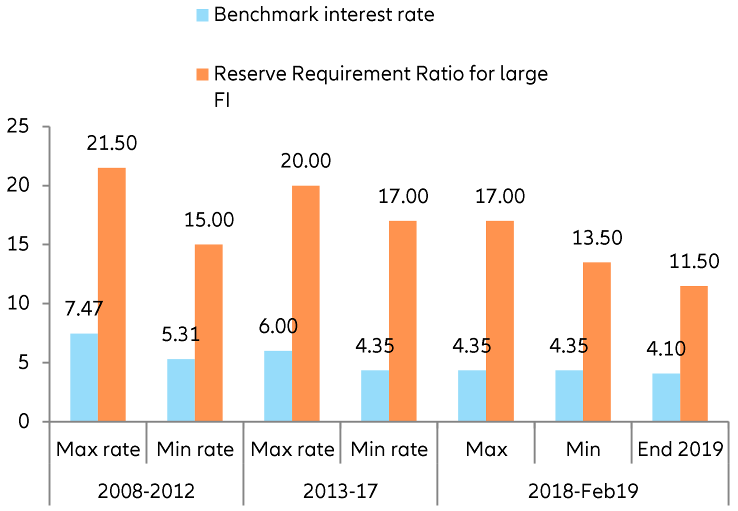
Fiscal package (RMB tn)



Sources: Euler Hermes, Allianz Research

China's top legislature announced a significant fiscal package of RMB4.15tn (5% GDP), including tax and fee cuts (RMB2tn) and infrastructure spending (RMB2.15tn).

Policy rate and Reserve Requirement Ratio

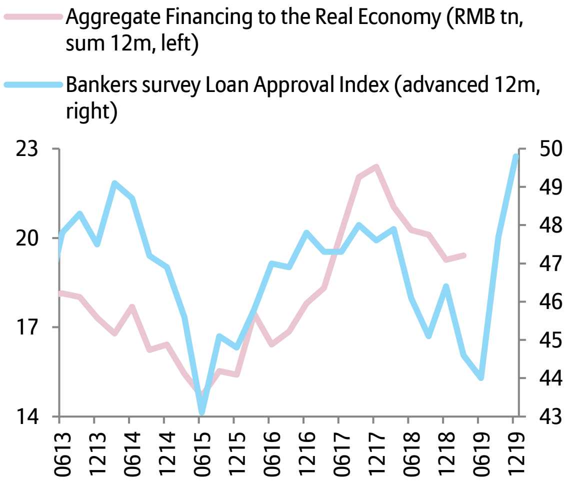


Sources: WIND, Euler Hermes, Allianz Research

A targeted and quite innovative monetary stimulus is at work. It is composed of both cuts in RRR, and non-traditional measures to increase lending to small and micro-businesses by 30% in 2019. Expect 200bp in RRR for the remainder of the year

CHINA: TANGIBLE EFFECTS OF THE STIMULUS ARE BUILDING UP

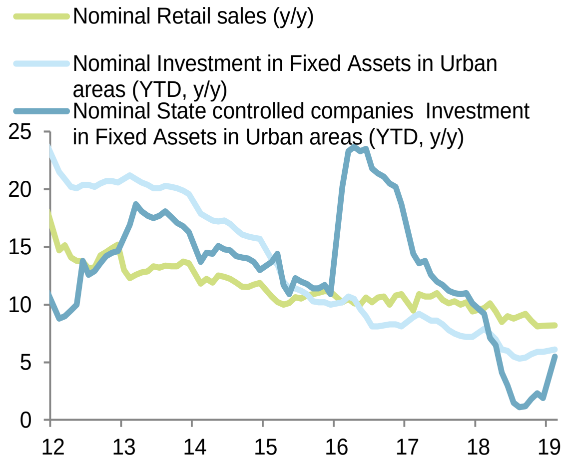
Financing conditions



Sources: IHS, Allianz Research

Credit conditions: bankers survey suggest a pick up of credit in the coming months.

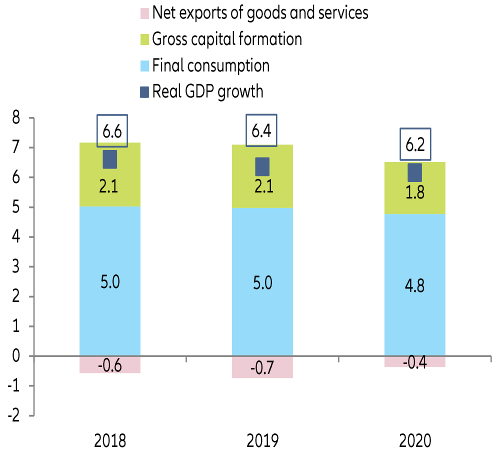
Demand indicators



Sources: IHS, Allianz Research

Demand: investment picks up speed as SOEs investment recovers and credit conditions improve. Consumer demand growth stabilizes on the back of tax cuts

GDP growth and sub-components



Sources: IHS, Allianz Research

We revised our forecasts by +0.1pp for both 2019 and 2020. We expect a modest acceleration from Q2 onwards. Domestic demand will be main driver

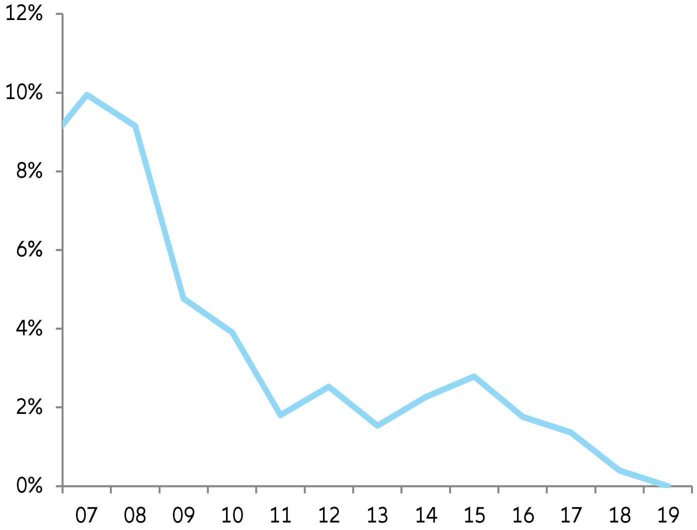
CHINA TO THE WORLD: LIMITED PASS THROUGH

China's demand for foreign goods trackers

*Include data from US, Germany, France, United Kingdom,, Switzerland, South Korea, Japan, Taiwan, Brazil and Italy; ** Tourist arrivals in Hong Kong, South Korea and Japan

Sources: IHS, Euler Hermes, Allianz Research

Current account balance (% GDP)



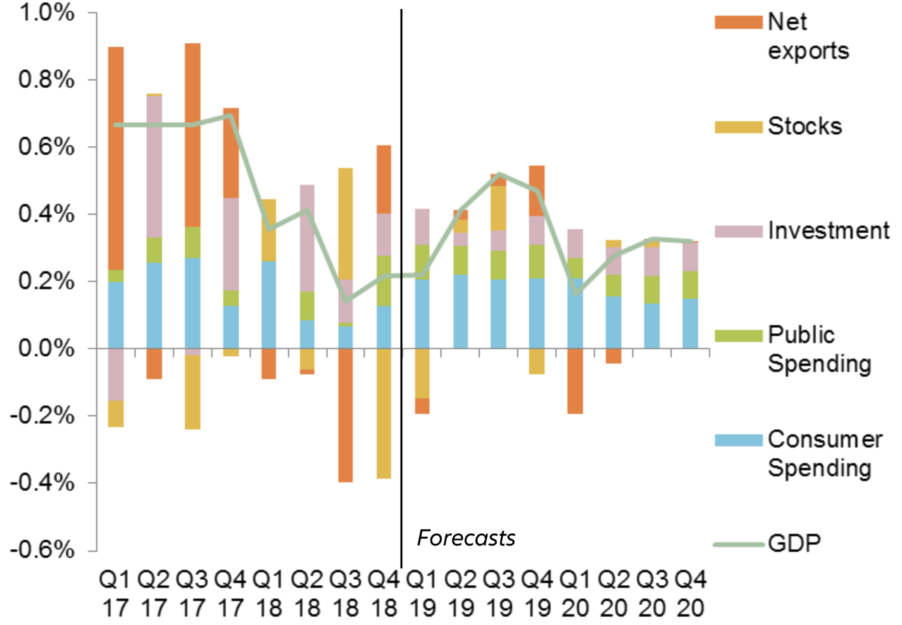
Sources: IHS, Euler Hermes, Allianz Research

Demand: the Chinese consumer will be the main driver and the global trade boost will likely be limited. Commodity exporters to benefit less than 2016 stimulus

Financing: not have strong pass-through either because of the deterioration of the current account balance. It continued to shrink to 0.4% GDP in 2018 (from 10% in 2007) and we expect it be neutral in 2019.

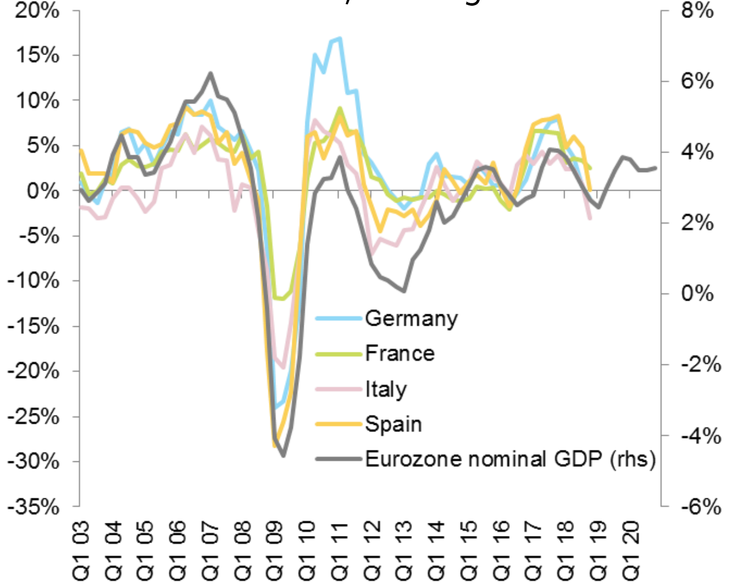
EUROZONE: TEMPORARY CATCH-UP IN H2

GDP by component (pp)



Sources: Eurostat, Allianz Research

Turnover (Industry) vs. Eurozone nominal GDP, annual growth



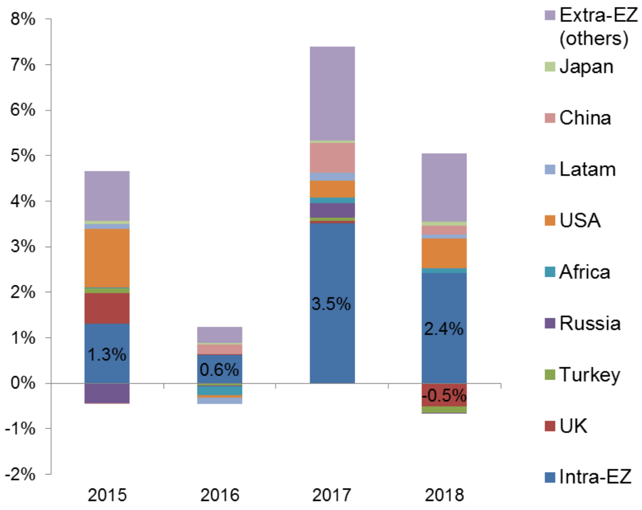
Sources: IHS Global Insight, Allianz Research

Starting in Q2 with the consumer, then in Q3 with trade, and Q4 2018and Q1 2019 are a low point for the Eurozone. Short-lived recovery in H2 2019 (positive political development and Chinese stimulus, interrupted by US slowdown early 2020).

Decelerating revenue growth should continue but not return to 2014 lows.

EUROZONE: TRADE BETWEEN A ROCK AND A HARD PLACE

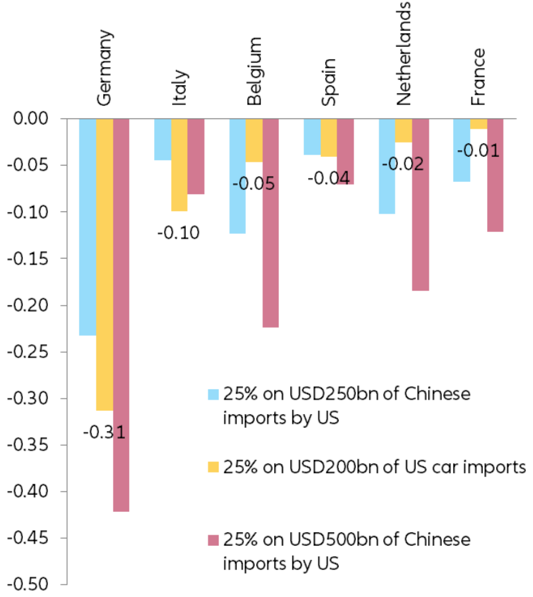
EZ exports by destination, annual growth and contributions



Sources: Eurostat, Allianz Research

The UK should not be a negative contributor to Eurozone exports in 2019

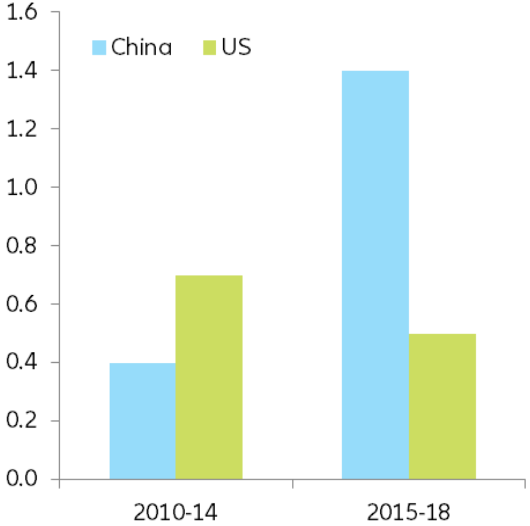
Export losses from US-China trade dispute (secondary and tertiary round effects), pp



Sources: Chelem, National sources, Allianz Research

Higher domestic difficulties in the US should divert President Trump's administration away from renewed protectionism

Elasticity between China and US real GDP growth (y/y) and the Eurozone

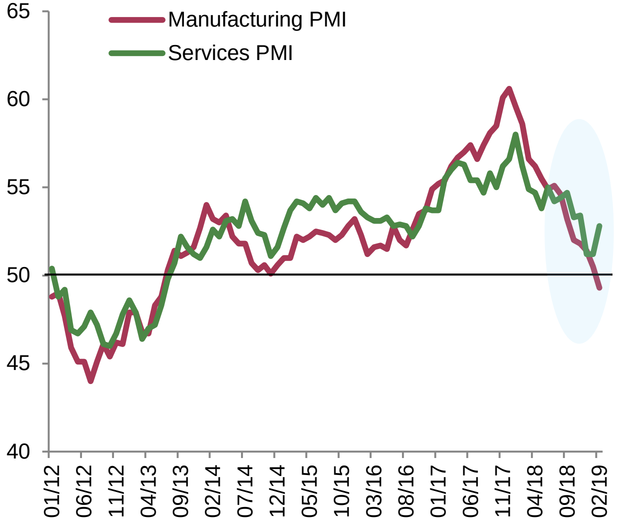


Sources: Allianz Research

China's stimulus should provide tailwind to Eurozone export growth in H2 2019

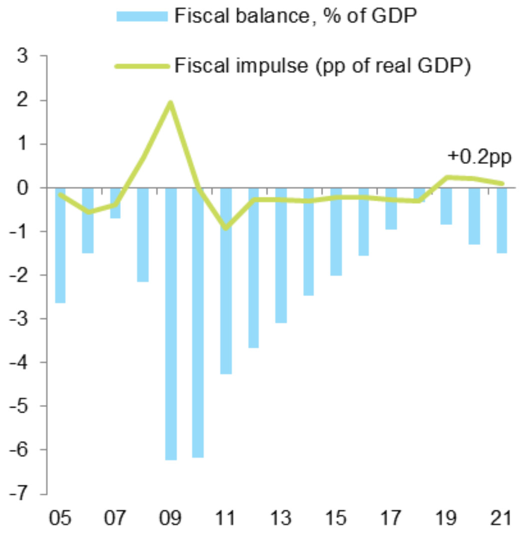
EUROZONE: TAILWINDS TO DOMESTIC DEMAND

PMIs Manufacturing & Services



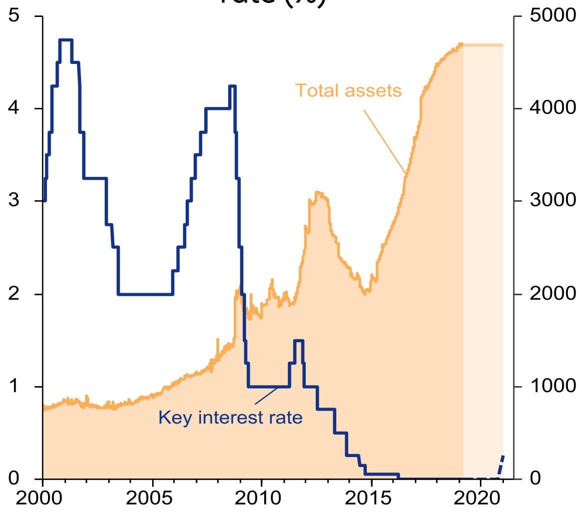
Sources: Markit, Allianz Research

Eurozone fiscal balance



Sources: Eurostat, Allianz Research

Total assets (EUR billion) vs. ECB key rate (%)



Sources: Eurostat, Allianz Research

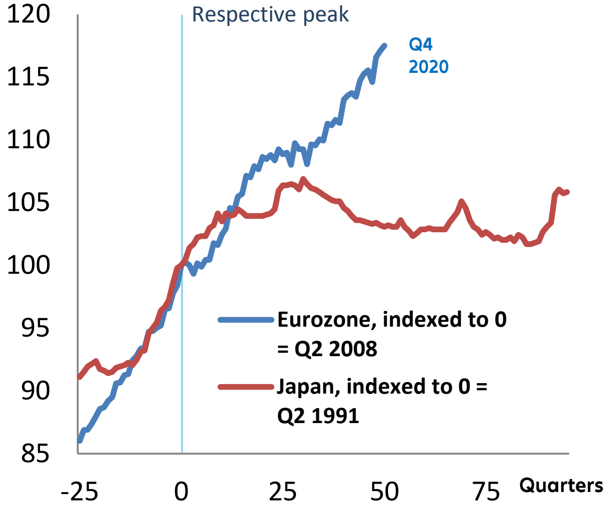
Service sector stays resilient in spite of manufacturing sector turbulences (car and export shocks).

Fiscal policy: The region will benefit from a positive fiscal impulse in 2019, for the first time in 10 years

Monetary policy: ECB to start quantitative tightening in H2 2020. New TLTRO announcement to provide needed liquidity to weakest Eurozone banks.

EUROZONE: THE SPECTER OF JAPANIFICATION

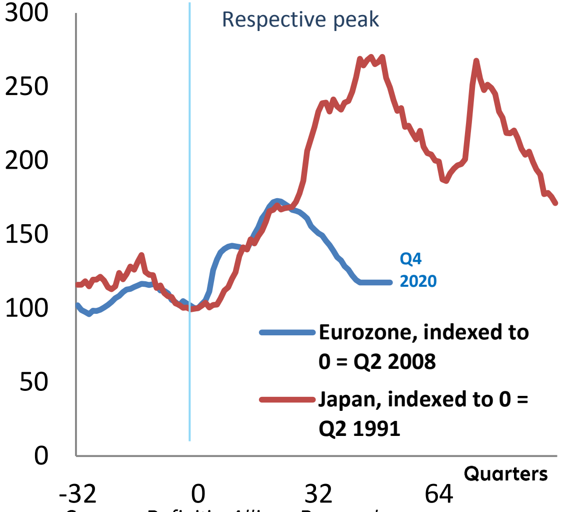
Headline inflation, Index: 100 = peak



Sources: Refinitiv, Allianz Research

Inflation in the Eurozone is clearly more dynamic compared to Japan in the period post the burst of the asset price bubble in 1991. While core inflation remains stuck at 1%, the threat of deflation appears to be off the table.

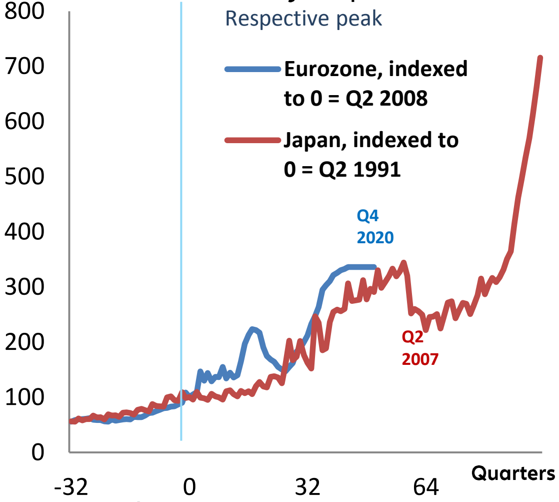
Unemployment, Index: 100 = cycle peak



Sources: Refinitiv, Allianz Research

The sharp decline in the Eurozone unemployment rate close to pre-crisis levels as well as the closure of the output gap are positive developments, that suggest domestic demand will support the economy in the short-medium term.

Central banks' balance sheets, Index: 100 = cycle peak

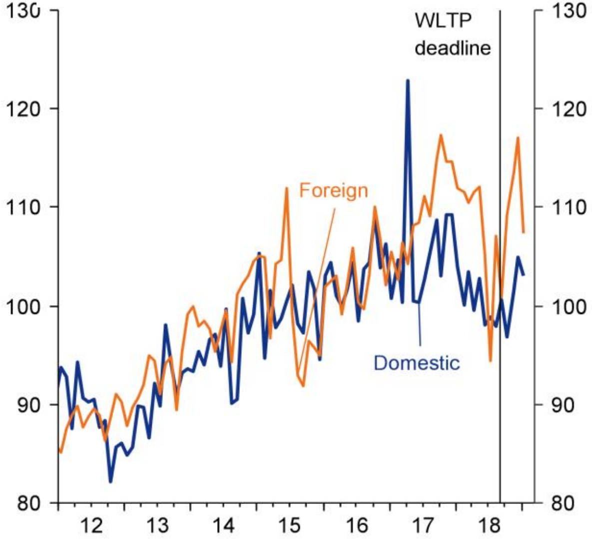


Sources: Refinitiv, Allianz Research

Japanification risk continues to linger: In the event of an economic shock the Eurozone may become reliant on unconventional monetary policy support. Key interest rate could then stay lower in the Eurozone for much longer than we currently expect.

GERMANY: BUMPY ROAD AHEAD FOR THE CAR SECTOR

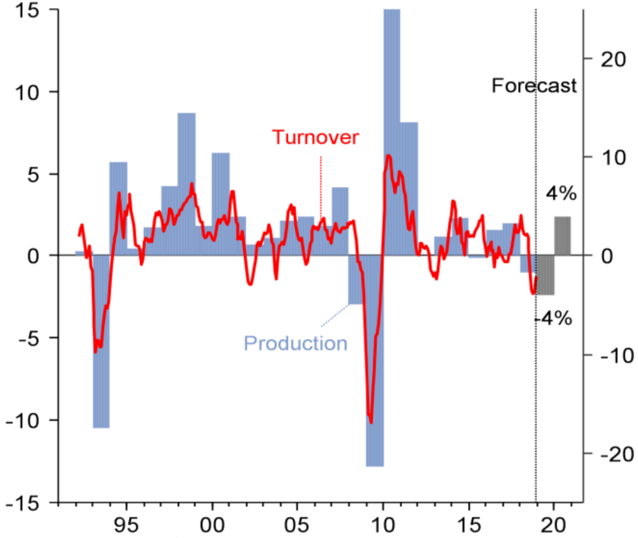
New motor vehicle orders – foreign & domestic (Index: 2015 = 100)



Sources: Refinitiv, Allianz Research

Carmakers' struggled to meet requirements under the WLTP emissions test procedure. Orders and domestic sales are encouraging signs, but data remained mixed and…

Turnover (y/y, in%, lhs) vs. production of motor vehicles (y/y, in %, rhs)

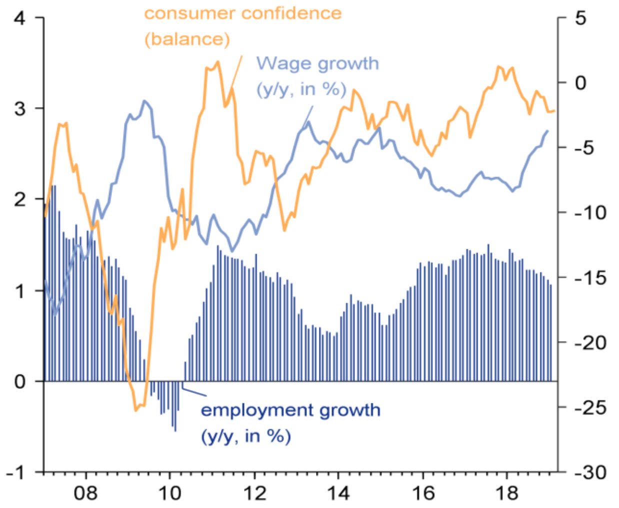


Sources: Refinitiv, Allianz Research

…a v-shaped recovery is excluded. Stocks accumulated in 2018 have to be reined in, while foreign demand - notably from China – will take time to materialize.

GERMANY: CONSUMERS TO SAVE THE DAY

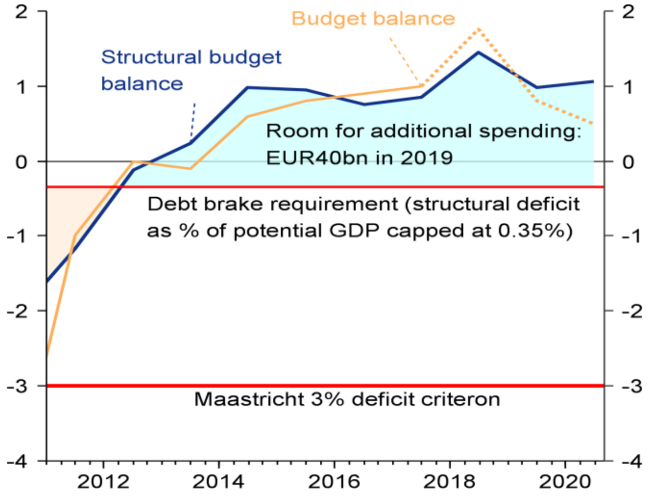
Wage growth (y/y, in %, lhs) & employment growth (y/y, in %, lhs) vs. consumer confidence (balances, rhs)



Sources: Refinitiv, Allianz Research

Robust wage growth and higher fiscal spending aimed at propping up private consumption. Mind the savings rate (17.7%).

German budget balance & structural budget balance as % of GDP

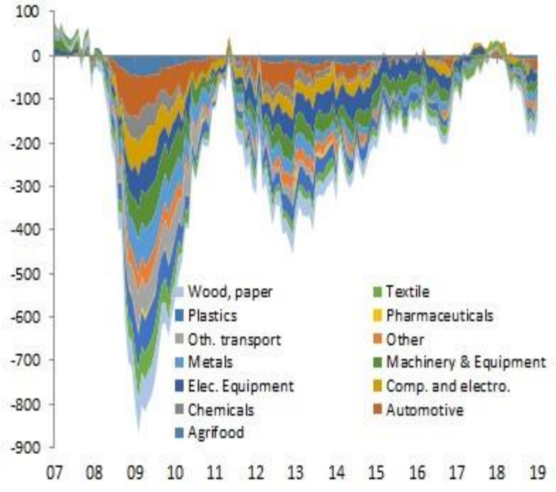


Sources: Refinitiv, Allianz Research

Higher transfers and lower tax & contribution rates to social security funds) will add 0.2-0.3ppt to GDP growth in 2019-20. An additional EUR40bn are available in 2019 to boost growth without violating the fiscal rules.

FRANCE: DEMAND IS NOT BACK FOR NOW

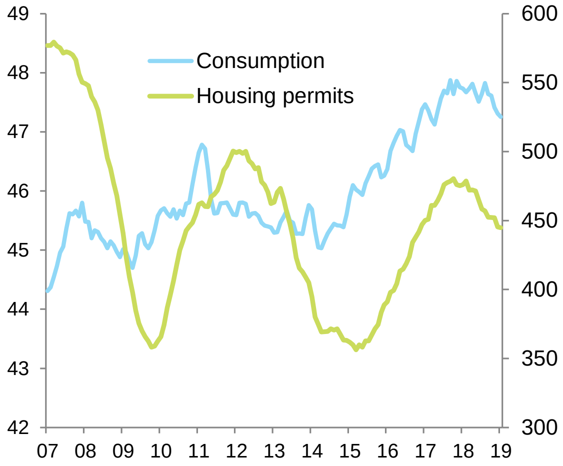
France: Business confidence, order books cumulative balance of opinions



Sources: INSEE, Allianz Research

Fighting for +1% growth in 2019 (as in 2015-16): Order books point to a subdued growth in 2019.

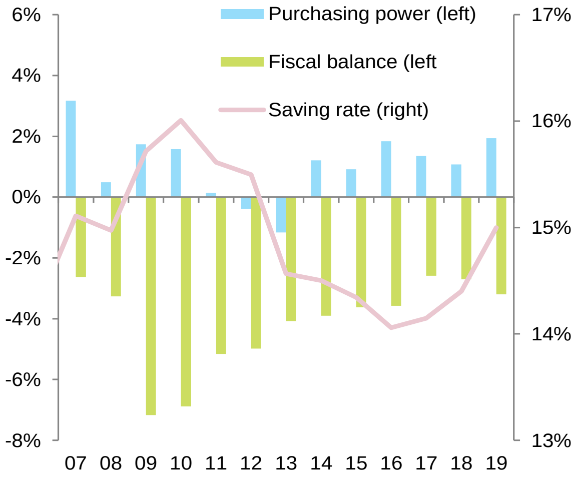
France: Consumption in goods (volume, EUR bn) vs. Housing starts (thousands, 12-months sum)



Sources: IHS Global Insight, Allianz Research

Consumption is still in slow motion in January (Food, auto and textile are affected the most). The construction cycle went wrong and is still deteriorating.

France: Purchasing power growth, fiscal balance in % of GDP and saving rate

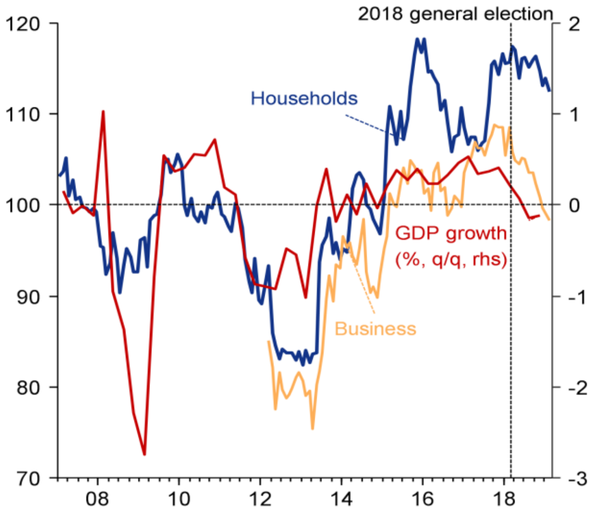


Sources: IHS Global Insight, Allianz Research

Low inflation (+1.3% in 2019) and a fiscal stimulus should drive a consumer-driven recovery from Q2, but with subdued fiscal multipliers as a result of higher saving rates.

ITALY: BUDGET TENSIONS WILL RESURFACE IN 2019

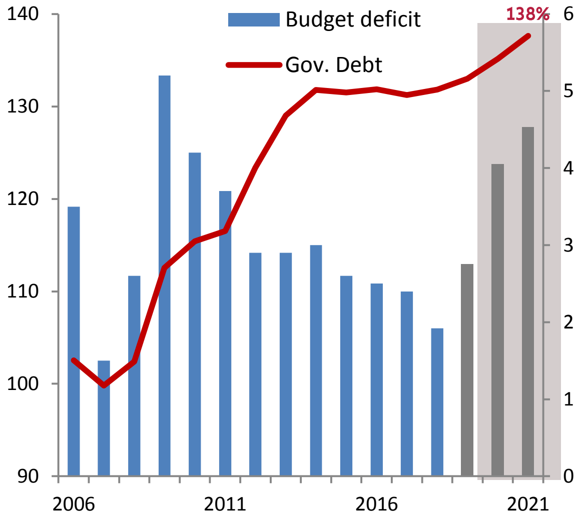
Italy: Household & business confidence vs. real GDP (q/q, %, rhs)



Sources: Refinitiv, Allianz Research

The Italian economy slipped into recession in H2 2018.

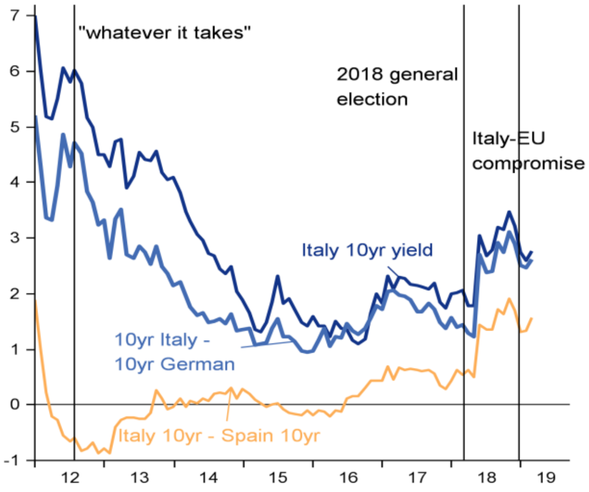
Italian public debt (% GDP, lhs) and budget deficit (% of GDP, rhs)



Sources: Refinitiv, Allianz Research

The expansionary 2019 fiscal measures together with weaker nominal growth and higher interest rates will push the budget deficit towards 3%.

Italian 10yr government bond yields, risk premia vs German & Spanish 10yr bonds

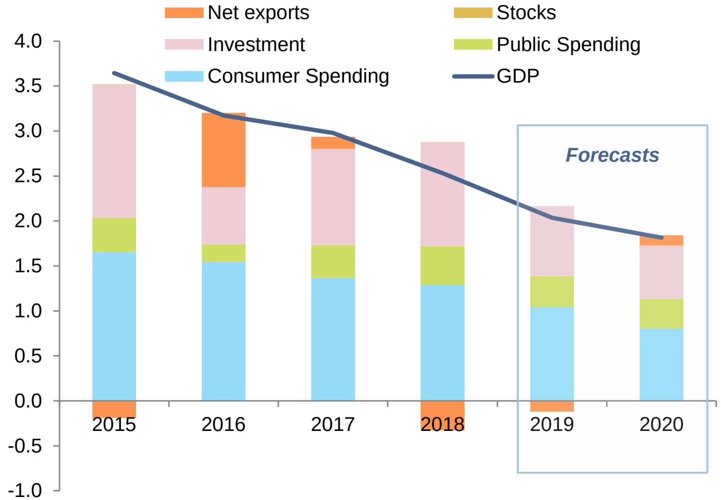


Sources: Refinitiv, Allianz Research

Expect budget tensions to reemerge before fall when the 2020 budget draft is due. Lack of agreement on fiscal savings to reign in the deficit could trigger the coalition's breakdown.

SPAIN: SOFT LANDING (+2% IN 2019, +1.8% IN 2020)

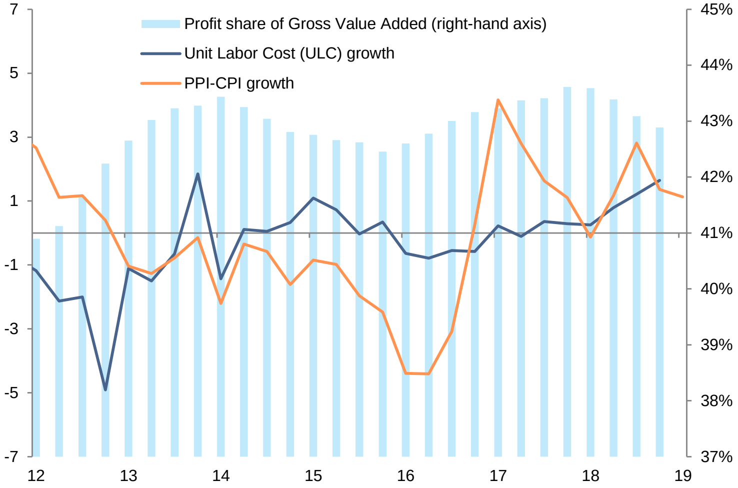
GDP growth (y/y, %) and contributions (in pp)



Sources: IHS, Euler Hermes, Allianz Research

Spain continued on a soft landing trajectory. As unemployment went back to end-2008 levels (14.5% in Q4 2018), consumption (and intra Eurozone trade) helped Spain stay on a soft landing trajectory. Going forward, positive levers will start to wane.

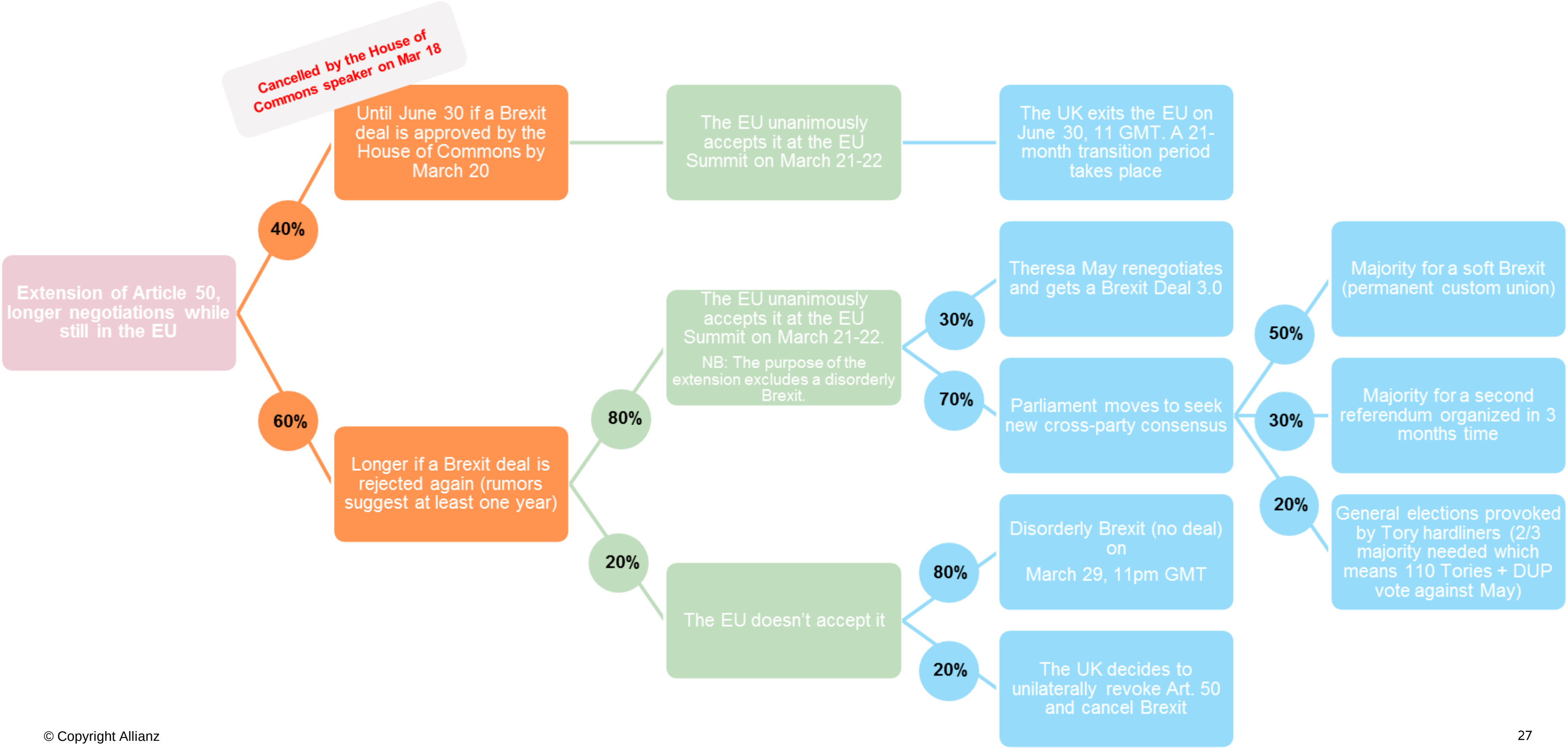
Profit margins as a share of gross value added, unit labor cost (ULC) and PPI-CPI growth (y/y, %)



Sources: IHS, Euler Hermes, Allianz Research

Indeed, Spain decided on a **re-normalization of its competitiveness**: ULC are accelerating at the fastest rate in 4 years and back to early 2012 levels. This will indent profit margins along with higher PPI.

UNITED KINGDOM: BREXIT ME…LATER (IF YOU CAN)



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	Extension of Art 50 followed by agreement towards a Soft Brexit (70%)	No agreement, disorderly Brexit, WTO rules (25%)	Stay in the EU (5%)	Transition period	Soft Brexit (55%)	Limited FTA (40%)	Hard Brexit (5%)
Real GDP (y/y)	1.8%	1.8%	1.4%	1.2%	-1.0%	1.8%	1.0%	1.5%	0.5%	-0.5%
Real private consumption (y/y)	3.1%	2.1%	1.7%	1.7%	-1.0%	2.1%	1.5%	1.6%	0.8%	-0.6%
Real business investment (y/y)	-0.2%	1.5%	-0.9%	-1.5%	-4.0%	2.6%	0.6%	1.4%	-4.0%	-3.0%
Real total exports (y/y)	1.0%	5.6%	0.2%	1.3%	-5.0%	2.0%	1.4%	1.7%	-2.5%	-4.0%
Real total imports (y/y)	3.3%	3.5%	0.8%	2.2%	-6.0%	3.0%	1.8%	2.2%	-3.0%	-5.0%
Inflation (CPI, y/y)	0.9%	2.7%	2.5%	2.2%	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	1.13	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%	10.0%	9.0%	20.0%	2.0%	6.0%	1.0%	4.0%	6.0%

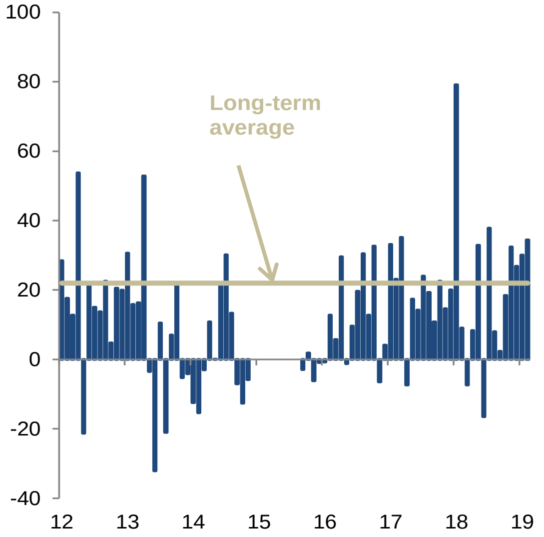
NB:

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

EMERGING MARKETS: TURN IT ON

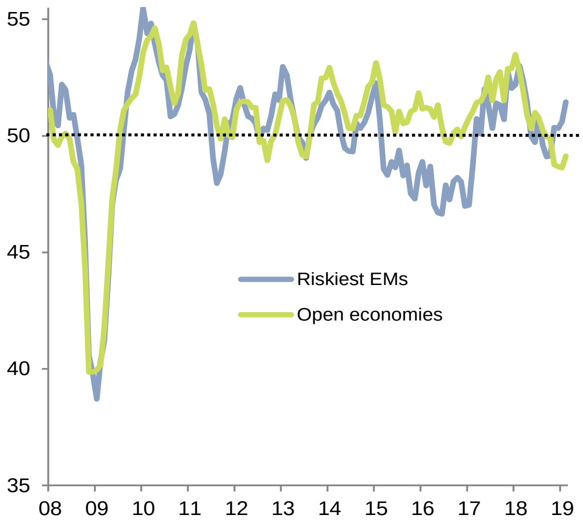
Capital flows to Emerging Markets (excl. China and Russia), USD bn



Sources: IHS Global Insight, Allianz Research

Switch #1: Dovish monetary policy in Advanced Economies pushed higher and more persistent capital flows in Emerging Markets.

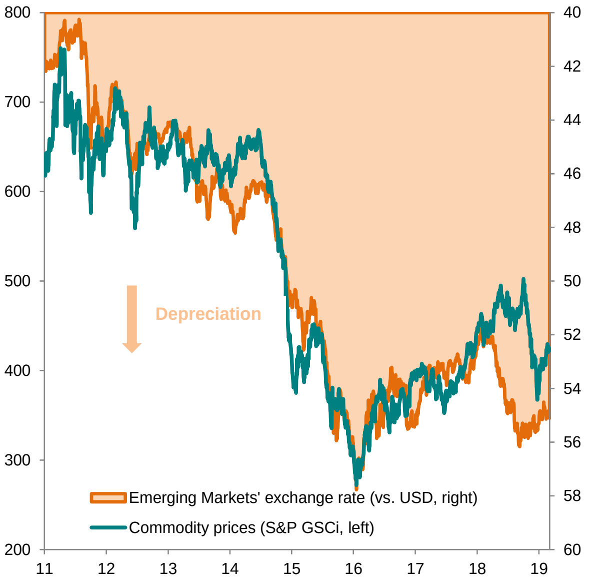
Emerging Markets: Aggregate manufacturing PMI in riskiest EMs (with inflation and/or deficits) vs. open economies



Riskiest EMs are Brazil, Mexico, South Africa and Turkey
Sources: IHS Global Insight, Allianz Research

Switch #2: The Chinese stimulus is expected to trigger some growth impact in Emerging Markets, this time more balanced between commodity and consumer goods suppliers, albeit not visible yet.

Commodity prices vs. EM exchange rates



Sources: IHS Global Insight, Allianz Research

Switch #3: The end of trade uncertainties should support commodity prices and favor a slight appreciation of EM FX (+3/4%)

COUNTRY RISK: WATCHLIST OF COUNTRIES PARTICULARLY VULNERABLE TO A (SHARP) GLOBAL SLOWDOWN

Most vulnerable			More vulnerable		
Euler Hermes Country Rating	Country	Channels of vulnerability	Euler Hermes Country Rating	Country	Channels of vulnerability
	Americas			*Americas*	
C4	Argentina*	(1) + (3a)	C3	Ecuador	(3a) + (3b)
	Europe		B3	Trinidad and Tobago	(3b)
B2	Cyprus	(1)		*Europe*	
C3	Turkey	(1)	B2	Croatia	(2)
	Middle East & Africa		A2	Italy	(2)
C3	Bahrain	(3b)	B2	Romania*	(1) + (2)
B3	Jordan*	(1) + (2)		*Asia-Pacific*	
C4	Tunisia*	(1) + (2)	C3	Vietnam	(2)
				Middle East & Africa	
			C3	Algeria*	(1) + (3b)
			C3	Cameroon*	(1) + (3a) + (3b)
			C3	Ethiopia	(1) + (3a)
			BB2	Oman	(1) + (3b)
			B3	South Africa*	(1) + (3a)
			D3	Zambia*	(1) + (3a)

NB: (1) External financing channel; (2) Trade channel; (3a) Non-fuel commodity prices channel; (3b) Energy prices channel. Excludes vulnerable countries with GDP below USD20bn or Euler Hermes Country Rating D4. Countries with an * were downgraded in 2018 or Q1 2019; yet they remain vulnerable.

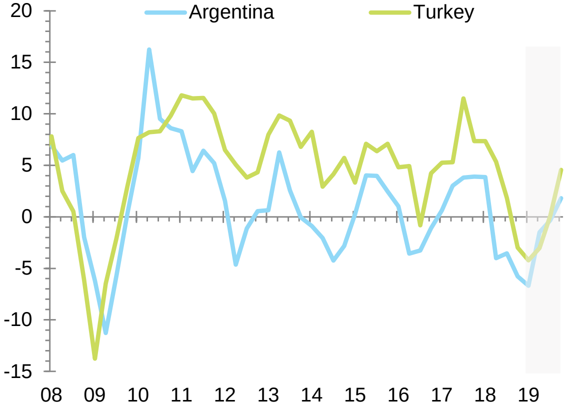
Sources: National statistics, World Bank, IMF, IHS Markit, Euler Hermes

NB:
In our baseline scenario we forecast a soft landing of the global economy, translating in a moderation of global GDP growth from +3.1% in 2018 to +2.9% in 2019 and +2.7% in 2020.
Should the global growth deceleration be stronger by -0.5pp (-1.0pp) or more than in the baseline scenario, then the slowdown can be considered to be sharp (particularly sharp).

- We have identified 6 countries as most vulnerable and another 12 countries as more vulnerable to a (sharp) global slowdown.
- Included are 2 Advanced Economies (Cyprus, Italy) and several larger EM (Argentina, Turkey, Algeria, South Africa, Romania).
- 10 of the 18 identified economies are major commodity exporters.
- Non-commodity exporting EM have rebalanced better and improved policies better than commodity exporters after the 2008-2009 global financial crisis. Hence they are, as a whole, less vulnerable to a (sharp) global slowdown than a decade ago.

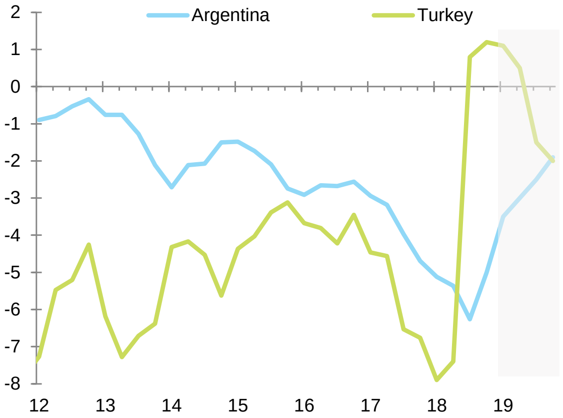
ARGENTINA VS TURKEY: RECESSION AND REBALANCING

Real GDP growth (% y/y)



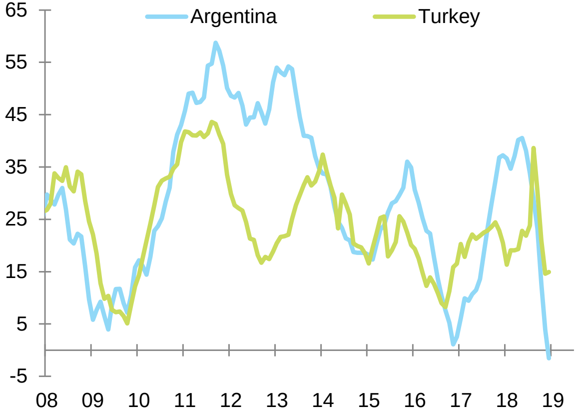
Sources: National statistics, IHS Markit, Allianz Research

Current account balance as % of GDP



Sources: National statistics, IHS Markit, Allianz Research

Private sector credit growth (% y/y)



Sources: National statistics, IHS Markit, Allianz Research

Argentina

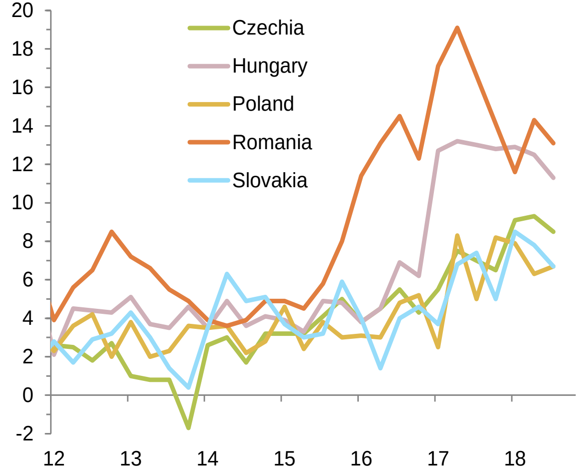
- After two quarters of contraction, the **recession** should spill over Q1, but Q2 growth should be positive. Credit growth turned negative in Dec.
- Argentina is slowly **rebalancing**: the trade deficit turned into a surplus
- **FX reserves** are being managed more carefully they stand at USD66.5bn after the second IMF disbursement, i.e. USD20bn > last Sept's trough.
- More effort is needed on **inflation** which is still high (~50%)
- Argentina achieved **IMF primary deficit target** of -2.7% in 2018 (after -3.8% in 2017) and is on the right track to reach primary balance in 2019.

Turkey

- The **recession** will continue to deepen as the contraction in industrial output and retail sales is still accelerating – supporting our forecast of a hard landing in 2019.
- The tradable sector is **rebalancing** rapidly: the current account deficit is narrowing quickly as imports decline and exports rise.
- **Inflation** has fallen to below 20% but remains elevated.
- **Credit growth** has fallen to 15% y/y at end-2018 but new easing measures pose a risk of reversal of that downtrend.
- **Fiscal tightening** plans – with a focus on rebalancing and not growth – look promising but need resolute implementation.

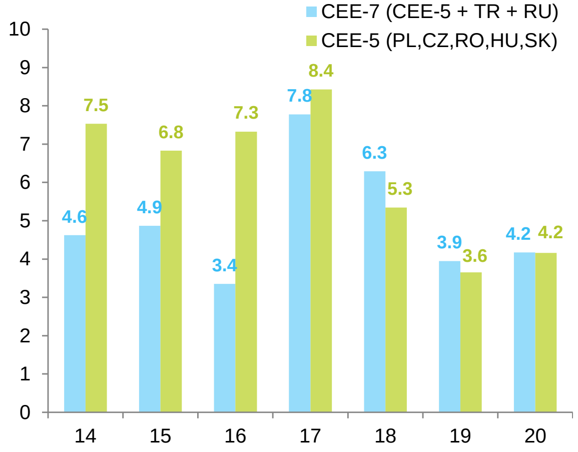
EMERGING EUROPE: PREPARING THE LANDING

Wage growth (% y/y)



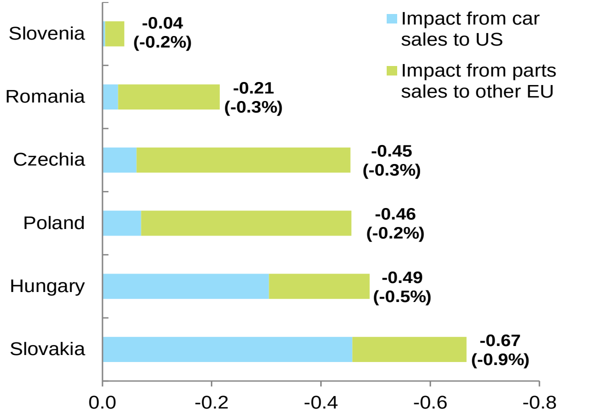
Sources: Eurostat, Allianz Research

Exports (goods and services) volume growth (%)



Sources: National sources, Allianz Research

Annual automotive export losses due to a 25% US tariff on imports from the EU; EUR bn (% of total exports)



Sources: ITC, Allianz Research

The Emerging European region as a whole will experience a cyclical downswing in 2019 (+1.7% growth) followed by a moderate rebound in 2020 (+2.5%).

Factors contributing to the downswing:

- Previously overheating economies are cooling/ rebalancing. Rapid wage growth has begun to retreat.
- Strong (EU-funded) investment growth is leveling off.
- Slower import demand from Western Europe dents exports.
- Growth in Russia will ease (sanctions, lower oil prices).

Mitigating factors:

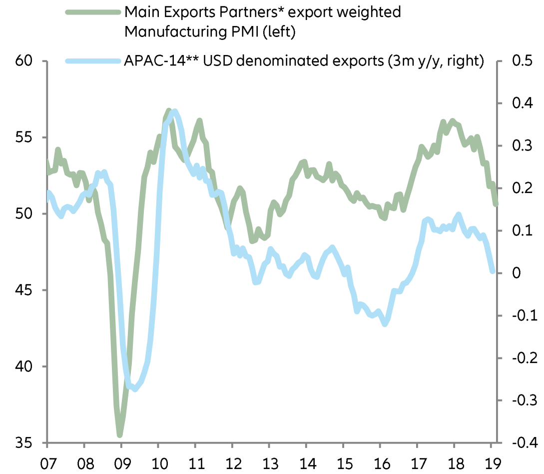
- Easing price pressures (in part due to retreating wages) have brought inflation back to target ranges.
- Hence accommodative monetary policy stance to continue in most countries.

Downside risk:

- A 25% US tariff on automotive imports from the EU would have an impact on auto exporters in CEE, though it seems to be manageable.
- Slovakia would be most affected, losing -EUR670mn in auto exports (-0.9% of total exports).

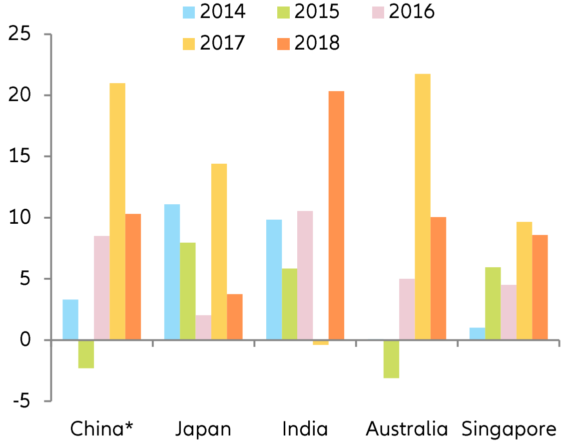
ASIA: SELF-SUSTAINED MODEL OF GROWTH?

Export cycle indicators



** China, United States, Eurozone, Japan and South Korea*
*** China, Japan, India, South Korea, Australia, New Zealand, Hong Kong, Taiwan, ASEAN-6*
Sources: IHS Global Insight, Allianz Research

Corporates profits growth



**Industrial sector only*
Sources: IHS Global Insight, Allianz Research

Policy scorecard

	Gen. Gov balance % GDP	Gen. Gov debt % GDP	Fiscal leeway	Inflation Q4 2018
Australia	-1.4%	41%		1.9
China	-4.1%	50%		1.9
Hong Kong	3.6%	0%		2.5
Indonesia	-2.2%	30%		3.1
Japan	-3.7%	238%		0.5
Korea (South)	2.3%	40%		1.4
Malaysia	-2.7%	55%		-0.1
New Zealand	0.8%	30%		1.9
Philippines	-1.0%	40%		5.2
Singapore	2.3%	113%		0.4
Taiwan	-1.9%	34%		0.1
Thailand	-0.6%	42%		0.5
India	-6.6%	70%		2.1
Orange	when below -3%	when above 50%		when above 2% for AE* 4% for EM*

**AE stands for advanced economies, EM for emerging markets*
Sources: IHS Global Insight, Allianz Research

Exports won’t help that much in the near term. We expect them to pick up speed from Q2 onwards as China stimulus start to have an impact

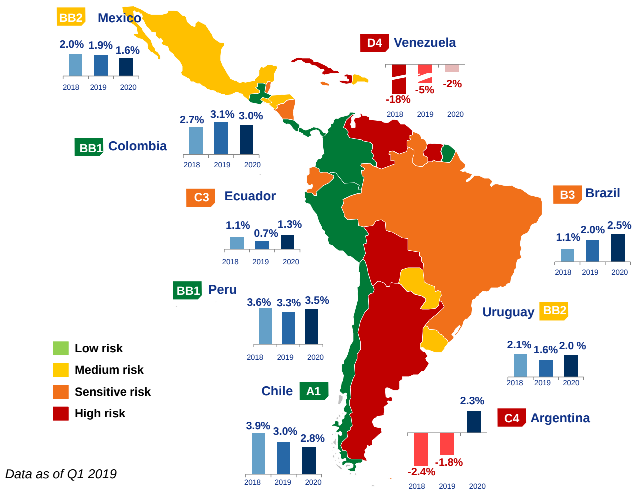
Corporates financial strength is relatively solid. Confidence will be key to for them to spend on capex.

Policymakers will likely support growth aggressively

- Using fiscal policy for Asia-Pacific advanced economies.
- Using policy rate cuts for Emerging Asia.

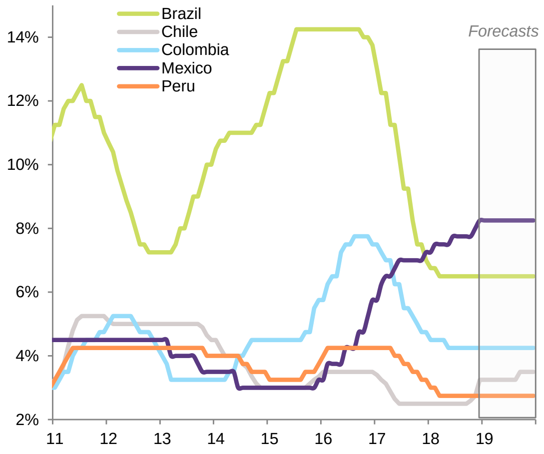
LATAM : MONETARY RELIEF, BUT INCOMING REALITY CHECK

Country risk and economic growth



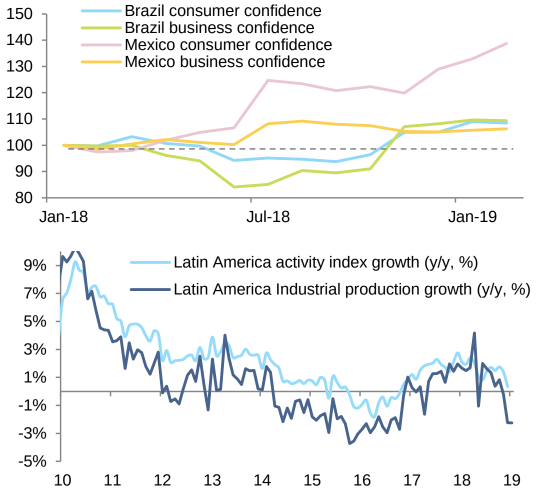
Sources: IHS, IMF, Euler Hermes, Allianz Research

Policy rates in inflation-targeting economies



Sources: IHS, Euler Hermes, Allianz Research

Soft data vs. Hard data



Sources: IHS, Bloomberg, Euler Hermes, Allianz Research

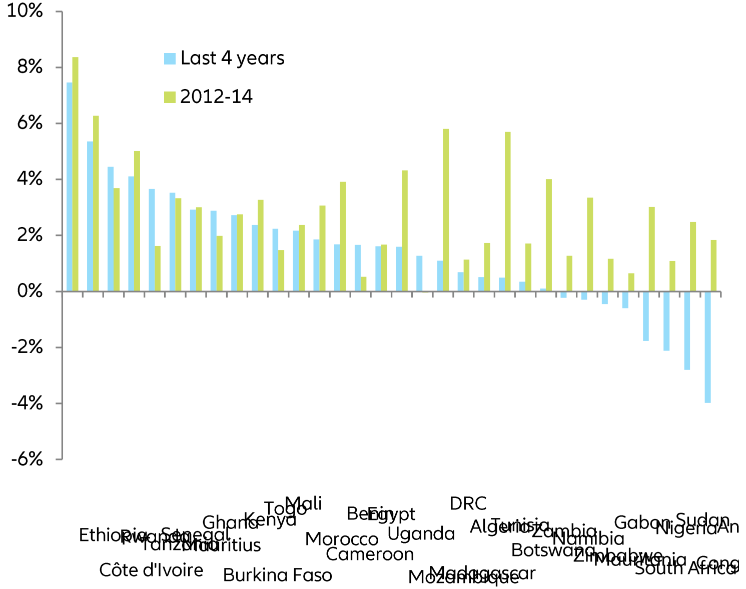
Growth will slightly accelerate (+1.4% in 2018, +1.9% in 2019, +2.4 in 2020). In **Argentina**, a reelection of Macri is still the baseline, but not a done deal. The rebalancing is not over and will continue to be painful for the real economy.

Policy commitments and the Fed's big switch have favored optimism by providing a monetary relief: better sentiment, neutral investor opinion, lower yields, stronger currencies. Central banks could pause or postpone tightening.

Mind the reality checks: In **Brazil** we see better internal demand, but the pension reform is likely to disappoint, putting pressure on borrowing costs. **Mexico**'s growth should be capped despite a better consumer outlook, as investors are wary of nationalistic policies.

AFRICA: CLIFF-HANGERS

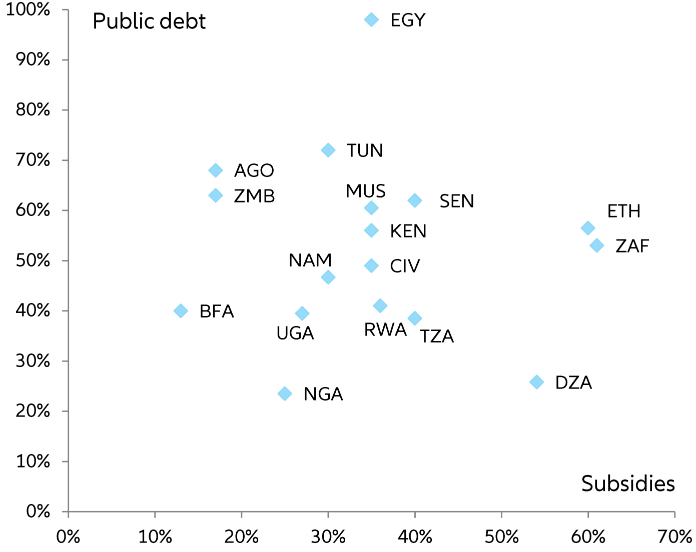
Africa: Growth per capita, last 4 years vs. 2012-14 period



Sources: IHS Global Insight, Allianz Research

Growth asymmetries observed during the last 4 years should still prevail in the next two years. From Ethiopia to Morocco, growth was not affected compared to 2012-14. Growth accelerations (e.g. Mali and Madagascar) improved the country risk. Income pressures have been deteriorating it (from Cameroon to Angola).

Africa: Subsidies (% of public spending) vs. public debt (% of GDP)

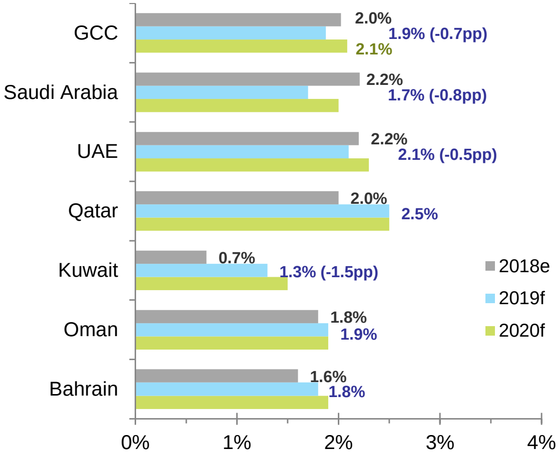


Sources: IHS Global Insight, Allianz Research

Low for long commodity prices is putting pressures on public finance. Fiscal consolidation is materializing and improving country risk in some areas (e.g. East Africa). Countries with high subsidies will be the more challenged, as subsidies cut can exacerbate protests (e.g. Southern & North Africa).

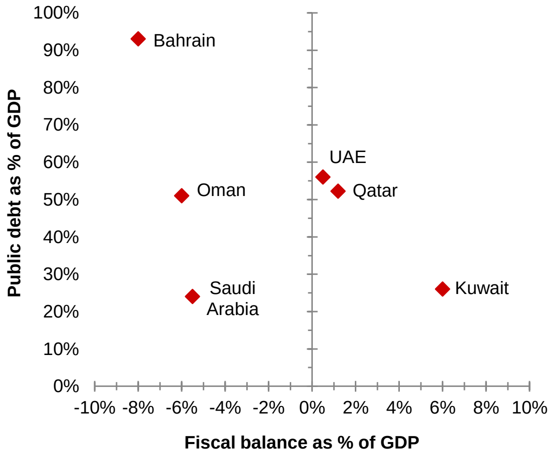
MIDDLE-EAST : MORE TIME TO REFORM

GDP growth (revisions for 2019 in brackets)



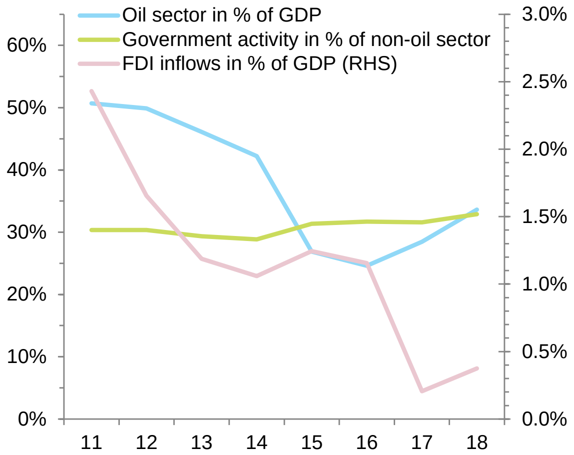
Sources: Nat. statistics, IMF, Allianz Research forecasts

Public finances (2019 forecasts)



Sources: Nat. statistics, IMF, Allianz Research forecasts

Saudi Arabia: Reliance on oil sector and state-funded activity



Sources: National statistics, Allianz Research forecasts

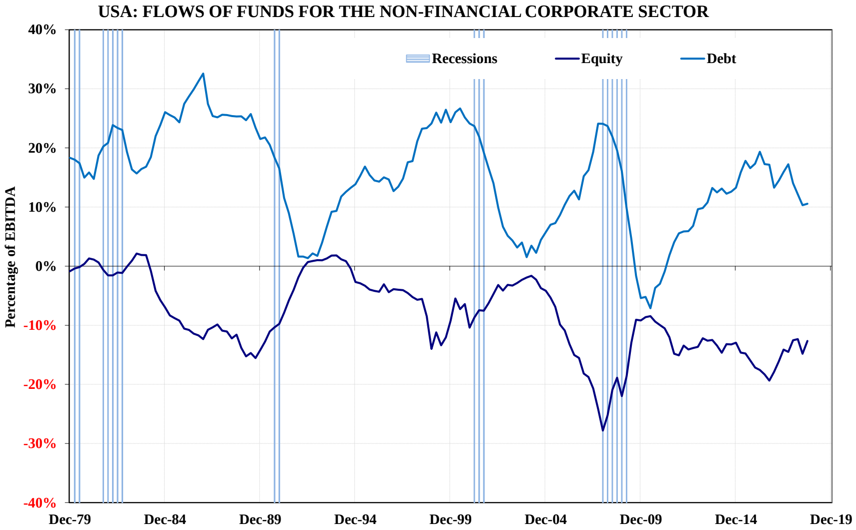
The GCC's growth outlook for 2019 has been markedly revised downwards (-0.7pp to +1.9%) reflecting the OPEC+ decision to cut oil production quotas to stabilize oil prices.

Saudi Arabia, Kuwait and the UAE particularly affected.

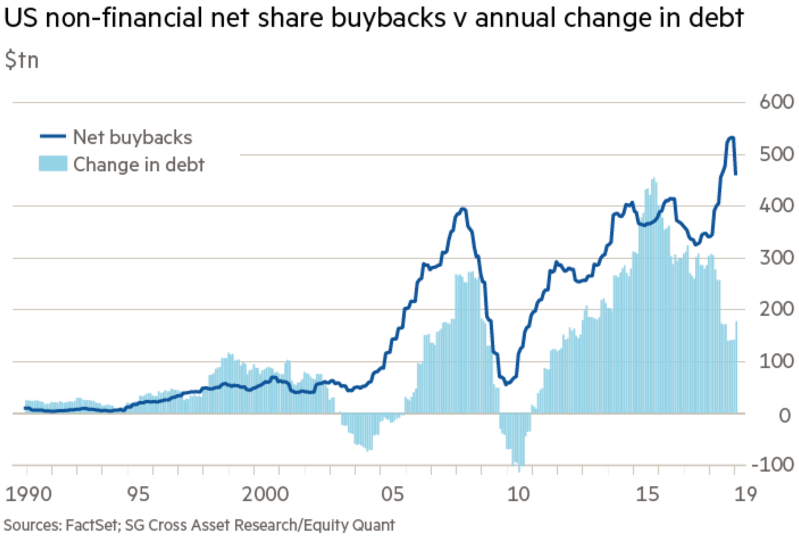
Fiscal reform/consolidation has been put on hold in the GCC, mostly. A 5% VAT was scheduled for 2018 but imposed only in Saudi Arabia and the UAE at the time. Bahrain followed in Jan. 2019 as requested by financial aid program from fellow GCC members. Oman (Sep. 2019?), Qatar (>=2020) and Kuwait (2021) will follow later. Meanwhile, Saudi has embarked on heavy fiscal stimulus in 2019, causing the deficit to rise again.

The Saudi reform program **Vision 2030**, unveiled 2016, aims at moving economy away form reliance on oil revenues and public sector activity. Private sector shall be boosted with help of FDI inflows. So far, little if any has been achieved. FDI inflows have been jeopardized by Saudi Arabia's worsened reputation over the war in Yemen and the murder of dissident journalist Khashoggi.

BORROWING BINGE: RECORD PACE OF SHARE BUYBACKS



Source: Allianz Research

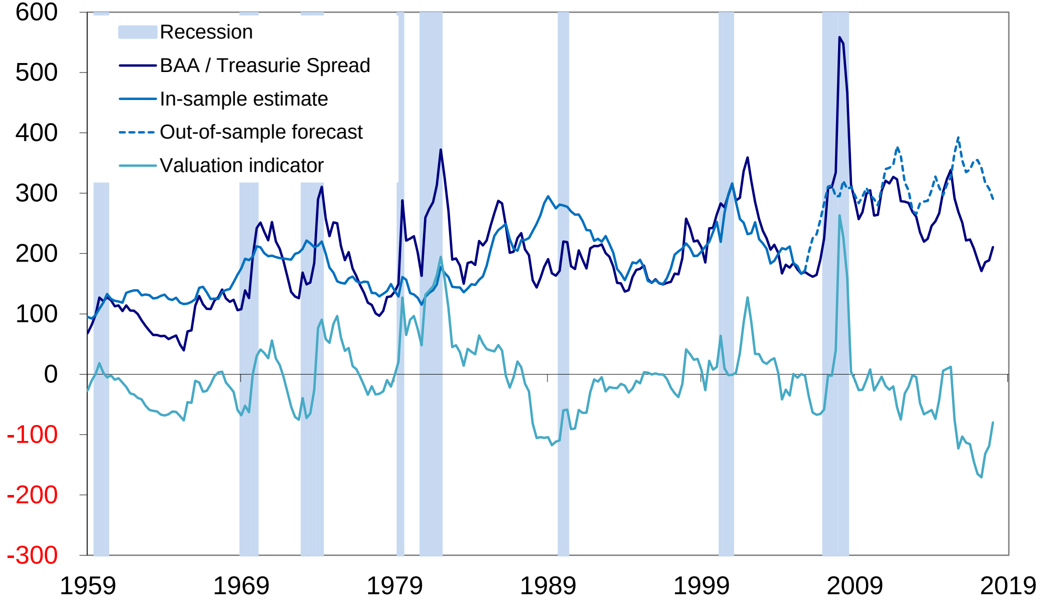


- Since 2009, companies have taken advantage of low-interest rates and strong demand from bond investors hunting for yield.
- To a large extent, share buybacks - a major driver of the bull market - have been funded by corporate debt.
- The equity and corporate markets are very much linked to each other.

More recently, at a time when the headwind of rising interest rates slowed down debt issuance, the one-off tailwind of Trump's corporate tax reform has supported share buybacks. Unless credit picks up again, buybacks should fall.

CREDIT SPREAD: TOO LOW RISK PREMIUM

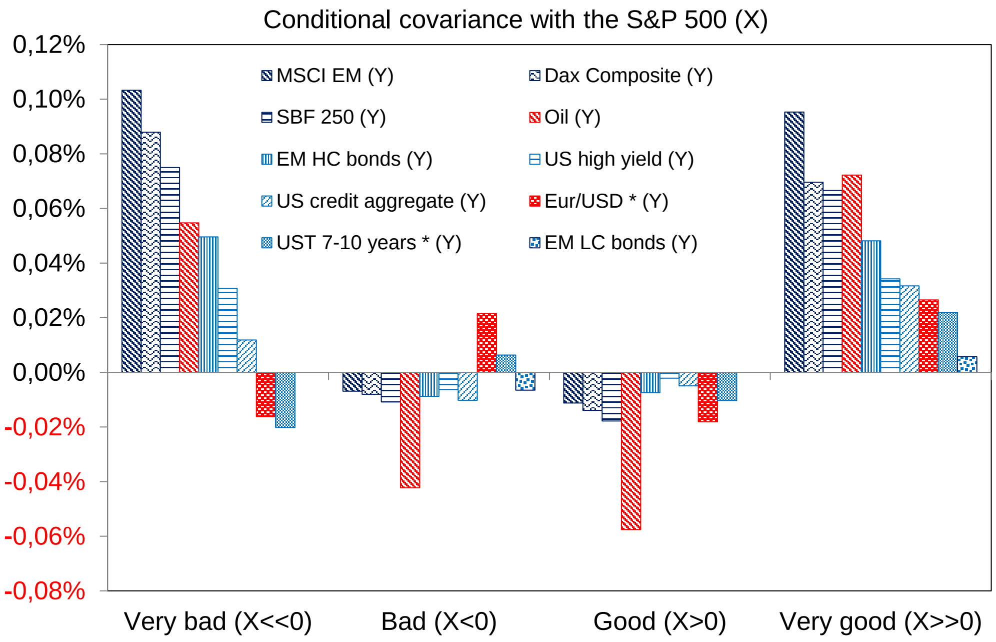
USA: Estimate of the BAA/Treasuries spread
based on adjusted non-financial sector debt-to-EBIDTA ratio



Source: Allianz Research

- The Trump Administration's fiscal stimulus has boosted EBITDA in the US over the past couple of years. Corporate debt is likely to be significantly underestimated (by about 30%).
- The higher the debt-to-EBITDA ratio, the higher the spread between the BAA yield and the US Treasuries yield.
- Current spreads do not account for the true level of corporate debt.

DIVERSIFICATION: CAN'T HELP IN BAD TIMES



Source: Allianz Research

- The potential for co-movements between asset classes depends on the magnitude of the returns posted by the key asset classes. In the presence of large negative returns in key asset classes, diversification brings very limited benefits.
- The overvaluation of US equities and corporate bonds threatens all risky asset classes with contagion, even if some of the latter are not so overvalued.

THANK YOU!

Economic research Department

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EULER HERMES

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