GRAND REOPENING: NEW OPPORTUNITIES, OLD RISKS

Allianz Research

June 9, 2021

EULER HERMES

Allianz

EXECUTIVE SUMMARY

Message #1: Vaccine security to shape Grand Reopening. While advanced economies delivered on immunization campaigns, vaccine hesitancy and second generation vaccines are first-order priorities. In the meantime, under-vaccination in Asia and in Emerging Markets may cause desynchronized growth paths.

Message #2: Multi--faceted recovery – High-pressure economics in the US, low pressure economics in Europe. We expect global GDP to grow by +5.5% in 2021, with the US being a clear outperformer. In Europe, the return to pre-crisis levels will take an extra six months and to the pre-crisis growth trend an extra four years – if it happens.

Message #3: Revenge spending is happening but residual savings to amount to EUR500bn in Europe, and USD1trn in the US. Consumption will lead the recovery but hoarding behaviors remain for precautionary reasons, complicating policy choices down the road.

Message #4: Inflation, what inflation? Bottlenecks in terms of supply (raw materials, transportation capacity, workers) will likely keep cost inflation at a five-year high until the end of 2021. Companies' pricing power remains limited, notably in Europe. Households' purchasing power will be under pressure as the employment gap (4 million jobs in the Eurozone and 10 million in the US) will keep wage inflation in check. No monetary inflation as velocity of money is at a record low.

Message #5: Markets' risk-on music keeps on playing but mind endogenous financial instabilities. We adjusted on the upside our forecasts for most asset classes to reflect the grand reopening and strong policy mix support but the risk and magnitude of a correction have increased in the meantime, reflecting growing imbalances.

Message #6: Faustian pact between expansionary fiscal and monetary policies to stay. We expect central banks to be patient before hiking rates in 2023 (some exceptions: Norway, New Zealand, the UK by September 2022). Total global debt has increased by more than USD24trn between Q4 2019 and Q4 2020, including USD12trn of public debt and USD12trn of private debt. Emerging Markets are more exposed to a sudden shift in market sentiment, imposing a disorderly adjustment of currencies and debt.

Message #7: Political crossroads ahead for Europe but no repeat of 2012 crisis in 2022. In the Eurozone, the Next Generation EU fund and the ECB will support the recovery and keep financial stress at bay while German-French elections may create policy surprises. Yet, watch out for heterogeneity.

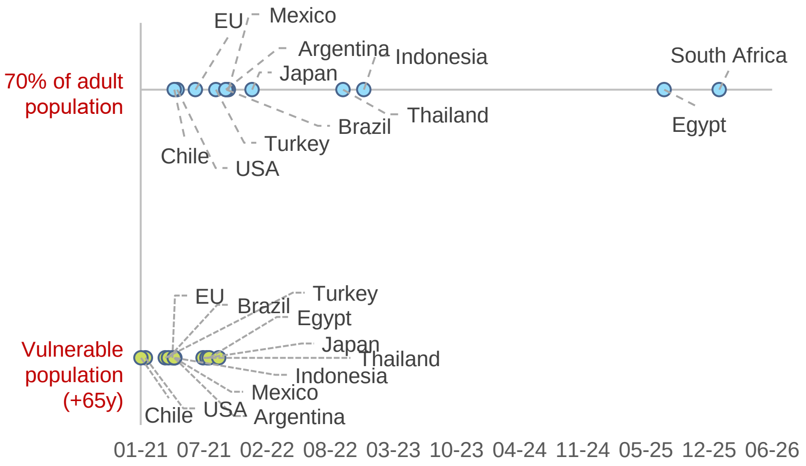
Message #8: Credit risk under control. The insolvency puzzle continues as corporate debt increased to new highs but cash on balance sheet did too, and liquidity support to firms continue into 2022. European non-financial companies have to increase on average their margin by 1.5 pp in order to make their debt sustainable

Message #9: Green is the new black of industrial policy. The transition towards a cleaner model of growth will require the definition of a real new industrial consisting of generating new fiscal resources, subsiding transition, protecting domestic producers and investing in infrastructure.

Message #10: Political risk is still there amid a new US paternalism and tactical multilateralism. US-China rivalry became US+Europe v. China as President Biden ties back with Europe. US protectionism upgraded.

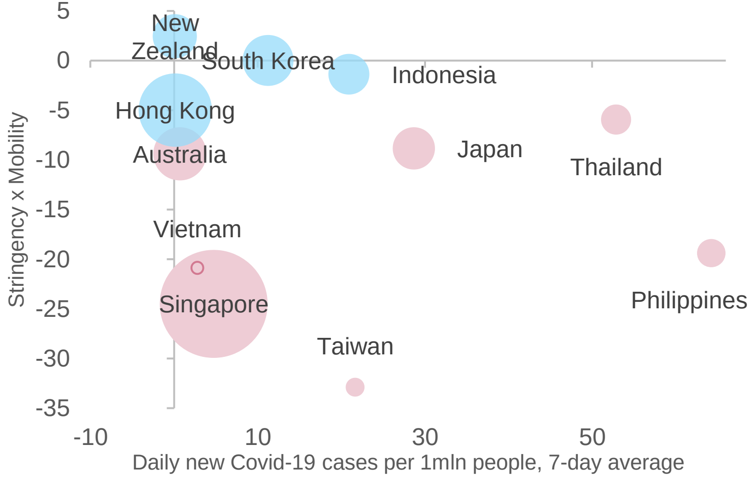
MESSAGE #1: VACCINES SECURITY MATTERS

Expected date of herd immunity
(at current vaccination speed)



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

Asia relapse: Sanitary situation vs. stringency & mobility impact, as of end of May (bubble size = vaccine doses administered as % of population; pink bubbles where stringency increased over past month)



Sources: Our World in Data, University of Oxford, Google, Allianz Research

Most countries should reach herd immunity (1st dose) by the summer, but demand-side hurdles will be more and more visible. Advanced economies seem overall closer to 'normality', while EMs are still likely to remain 'closed' due to the supply gap in vaccines.

Ultimately, vaccination is likely to determine the pace of the return-to-normal. APAC is a case in point: many economies had managed the pandemic well in 2020, but they recently had to implement restrictions again amidst new outbreaks and low vaccination rates.

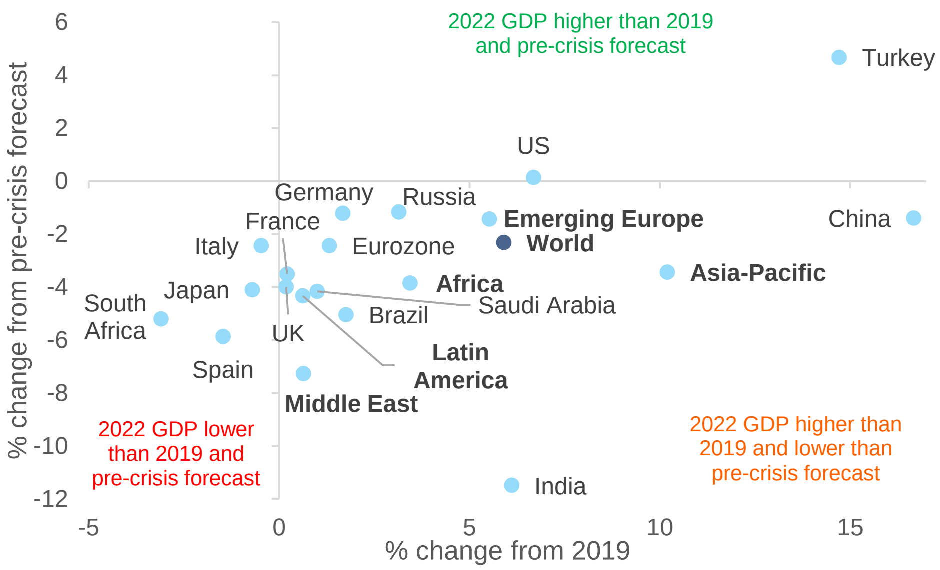
MESSAGE #2: MULTI-FACETED RECOVERY

Real GDP growth forecasts

	2019	2020	2021	2022
World GDP growth	**2.4**	**-3.5**	**5.5**	**4.1**
United States	2.2	-3.5	6.3	4.0
Latin America	**0.2**	**-7.1**	**5.2**	**2.9**
Brazil	1.4	-4.4	3.8	2.5
United Kingdom	1.4	-9.9	6.0	4.9
Eurozone members	**1.3**	**-6.5**	**4.2**	**4.2**
Germany	0.6	-5.1	3.4	3.8
France	1.5	-8.2	5.4	3.6
Italy	0.3	-8.9	4.4	4.6
Spain	2.0	-10.8	5.1	5.3
Russia	2.0	-3.1	3.1	3.2
Turkey	0.9	1.8	8.3	4.1
Asia-Pacific	**4.1**	**-1.1**	**6.3**	**4.8**
China	6.0	2.3	8.2	5.4
Japan	0.3	-4.9	2.5	1.9
India	4.1	-7.5	7.9	6.4
Middle East	**0.0**	**-5.0**	**2.8**	**3.0**
Saudi Arabia	0.3	-4.1	2.4	2.9
Africa	**1.7**	**-2.8**	**2.7**	**3.5**
South Africa	0.3	-7.0	2.2	1.9

NB: fiscal year for India

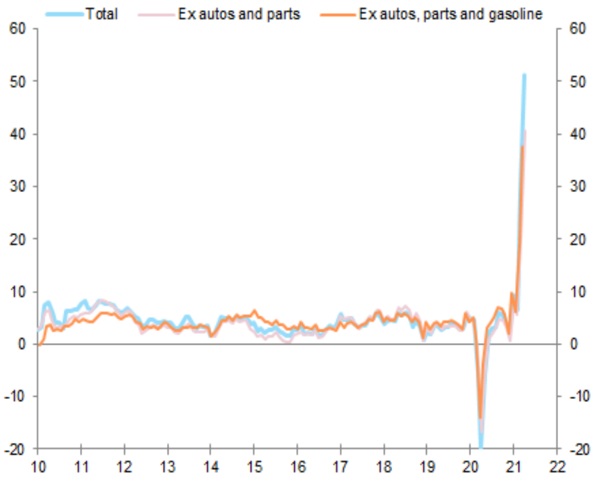
2022 GDP, compared to 2019 and to pre-crisis forecast



Sources: various, Allianz Research

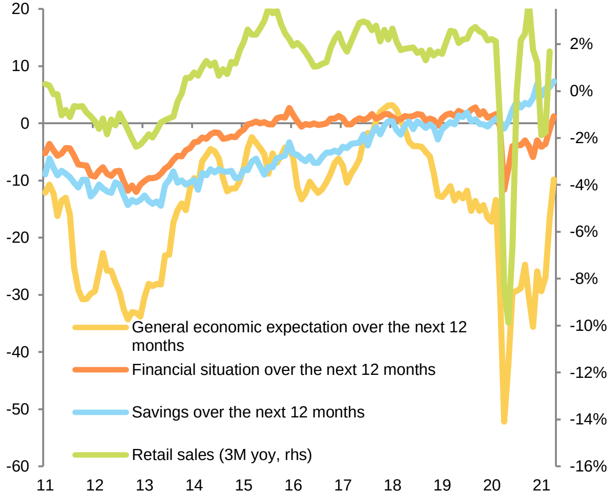
MESSAGE #3: REVENGE SPENDING TO ABSORB ONLY PART OF RESIDUAL SAVINGS

US retail sales (%, y/y)



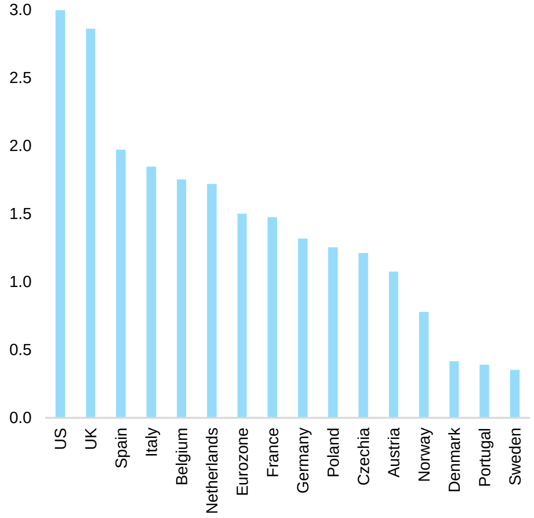
Sources: US Census Bureau, Allianz Research

Eurozone consumer confidence vs retail sales growth



Sources: US Census Bureau, Allianz Research

Catch-up consumption expected in 2021, % of GDP



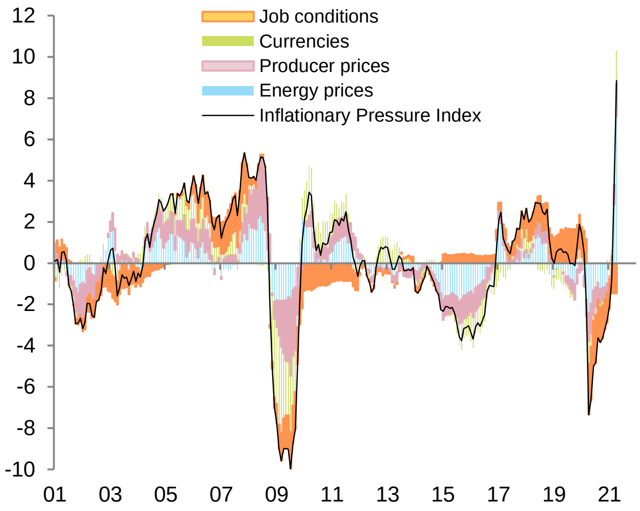
Sources: Eurostat, Euler Hermes, Allianz Research

Demand-supportive policies more than offset the lack of automatic stabilizers in the short-term. Household consumption is expected to grow by +7.8% y/y in 2021 vs -3.8% y/y in 2020.

Consumer confidence in the Eurozone is close to pre-crisis levels. The glut of household savings could generate a consumption boom of EUR170bn in 2021. Looking at individual countries, we estimate pent-up consumption could reach 3% of GDP in the US and the UK in 2021, and around 1.5% in most European countries. Nevertheless, roughly EUR500bn of Covid-19 residual savings will still remain at the Eurozone level at end-2021.

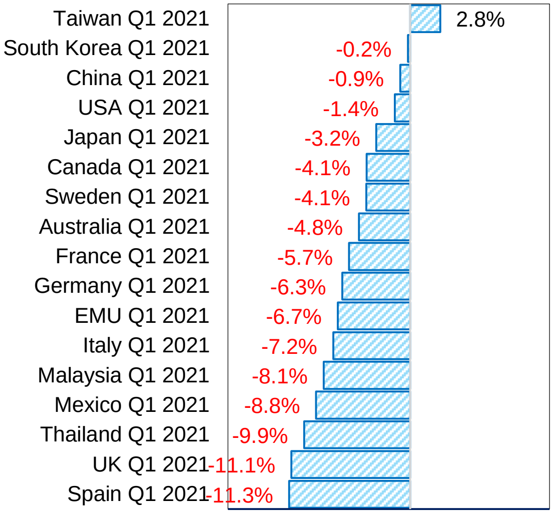
MESSAGE #4: CYCLICAL INFLATION IS HIGH, STRUCTURAL ONE CONTAINED

Global inflationary pressure index



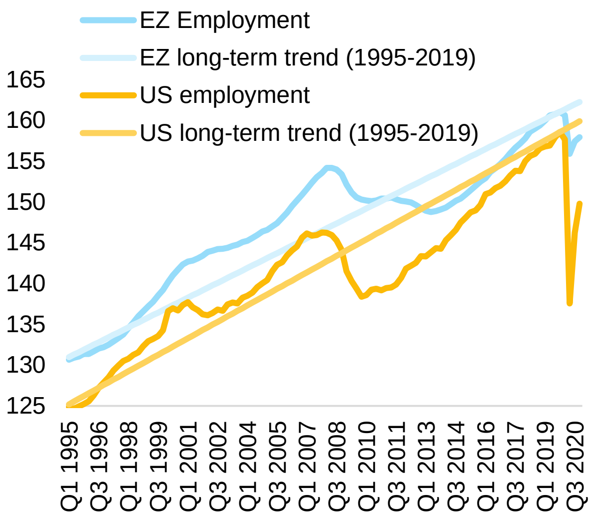
Sources: IHS, Euler Hermes, Allianz Research

Perceived output gap (latest available)



Sources: Refinitiv, Allianz Research

Employment (in million), Eurozone vs US



Sources: Refinitiv, Allianz Research

Inflationary pressures are at record high levels. The good news: they are mainly driven by energy prices and USD appreciation, which should prove temporary.

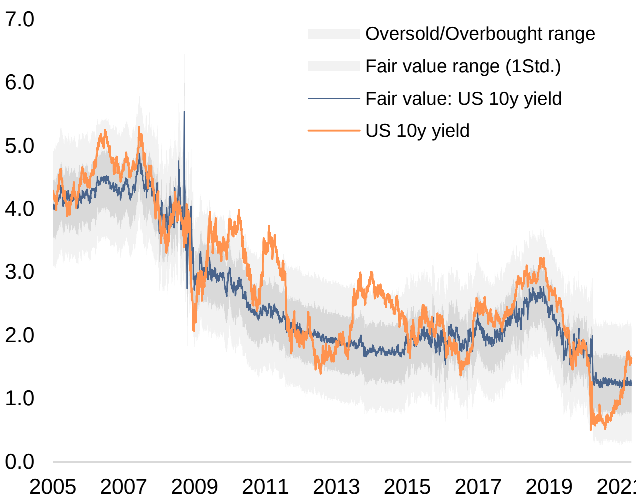
That being said, negative output gaps should keep wage pressure in check. The Covid-19 pandemic has widened output gaps almost everywhere.

Despite the extension of generous furlough schemes, employment compared to the long-term average is lower by around 4 million jobs in the Eurozone and 7 million in the US, which should keep economy-wide wage growth in check.

MESSAGE #4B: MARKETS UNIMPRESSED BY INFLATION EXPECTATIONS

US 10y yield at the upper fair value range

(yield in %)

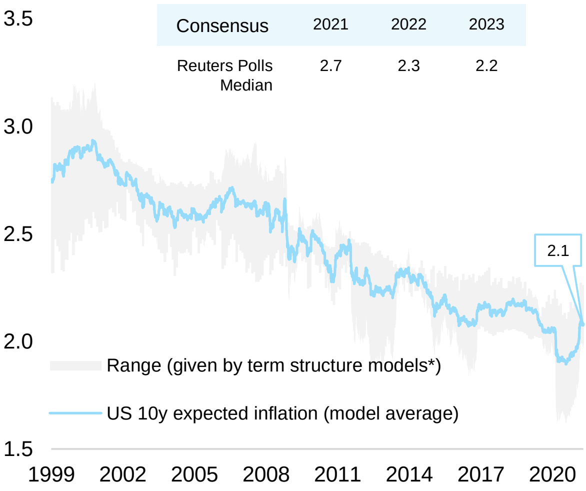


Sources: Refinitiv, Allianz Research

The US 10y yield has reached the upper range of our fair value range and have built up a short-term buffer against bad news. There is a 14% probability for an overshoot to 2%, but his would be temporary, being clearly in the oversold range.

No shift in long-term inflation expectations

(yearly inflation in %)

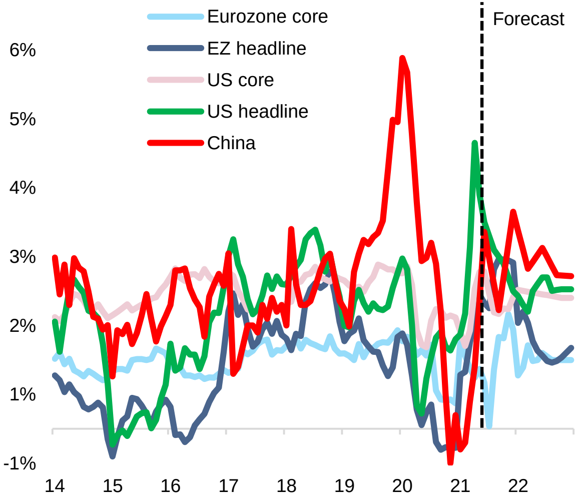


Sources: Refinitiv, Allianz Research

** D'Amico, Kim & Wei (2018), Adrian, Crump & Moench (2013), Christensen, Lopez & Rudebusch (2010) and proprietary Allianz Research Model*

While the breakeven rise is mainly due to tight market conditions (TIPS liquidity premium), LT expectations have returned to pre-crisis levels and don't indicate a inflation regime shift, in line with consensus.

Inflation forecasts by region



Sources: Refinitiv, Allianz Research

A return to 2% inflation mark is expected in most advanced economies in early 2022 when the demand-supply mismatch should normalize.

MESSAGE #5: THE MUSIC KEEPS ON PLAYING BUT MIND ENDOGENOUS INSTABILITIES

Sovereign: Despite the recent increase in long-term sovereign yields our forecasts maintain the raising path described at the beginning of the year. Nonetheless, starting levels have been adjusted to reflect the market anchor.

Corporate Credit: Spreads have been slightly adjusted lower as credit markets are passively range trading and we expect this to continue in 2021, leaving 2022 for some timid, but larger consolidation.

Equity: Equity market performance has been increased for 2021 as market participants are frontloading 2022 earnings into 2021, pricing a better-than-initially-expected 2021. Despite the revision, the high earnings expectations paired with slowly dissipating monetary and fiscal policies by year-end/early 2022 are setting the path for increased market volatility.

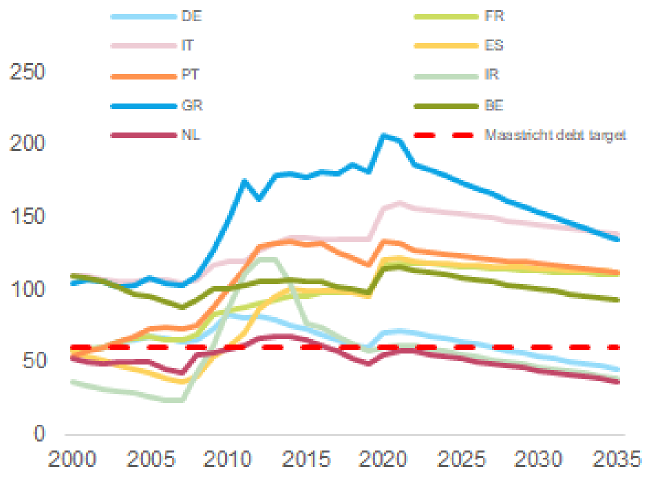
Emerging Market Fixed Income: Acknowledging the deviation between forecasts and the current figures in hard currency spreads, we stick to them as most of the risks remain in the horizon.

year-end figures	Last Value (01.06.2021)	Unit	Old Scenario		New Scenario	
EMU			**2021**	**2022**	**2021**	**2022**
Rates						
Policy rates (depo)	-0.50	%	-0.50	-0.50	-0.50	-0.50
10y yield "risk-free" sovereign (Bunds)	-0.2	%	-0.5	-0.3	-0.3	-0.1
10y Swap Rate	0.1	%	-0.2	0.0	0.0	0.2
Italy 10y sovereign spread	108	bps	80	100	90	90
France 10y sovereign spread	35	bps	20	30	20	30
Spain 10y sovereign spread	65	bps	50	60	55	60
Corporate Spreads						
Investment grade credit spreads	86	bps	110	120	100	120
High yield credit spreads	299	bps	475	450	375	450
Equity						
MSCI EMU: total return p.a.	15.4 (ytd)	%	6.0	6.0	11.0	6.0
US			**2021**	**2022**	**2021**	**2022**
Rates						
Policy rates (mid-rate)	0.125	%	0.125	0.125	0.125	0.125
10y yield "risk-free" sovereign (Treasuries)	1.62	%	1.5	1.8	1.5	1.8
Corporate Spreads						
Investment grade credit spreads	91	bps	110	110	100	110
High yield credit spreads	333	bps	450	425	400	425
Equity						
MSCI USA: total return p.a. in USD	11.7 (ytd)	%	1.7	6.0	8.0	6.0
FX			**2021**	**2022**	**2021**	**2022**
USD - EUR	1.22	%	1.22	1.19	1.22	1.19
Emerging Markets			**2021**	**2022**	**2021**	**2022**
Rates						
Hard Currency Spread (vs USD)	267	bps	310	350	310	350
Local Currency Yield	4.6	%	4.8	5.3	4.8	5.3
Equity						
MSCI EM: total return p.a. in USD	8.5 (ytd)	%	2.8	7.0	9.0	7.0

Sources: Refinitiv, Allianz Research

MESSAGE #6: FISCAL IMPULSE TO STAY

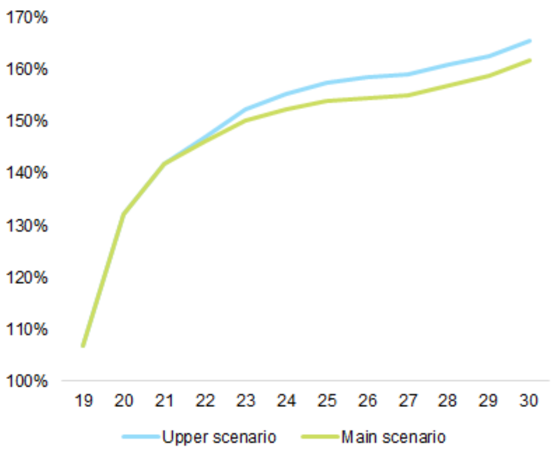
Eurozone public debt (% GDP)



Sources: Refinitiv, Allianz Research.

We still see EZ heavyweights France, Italy and Spain boast debt ratios close to or notably above 100% of GDP in 2035. In contrast, Germany, Ireland and the Netherlands cement their position as low-debt countries by pushing debt notably below the 60% Maastricht target by 2035.

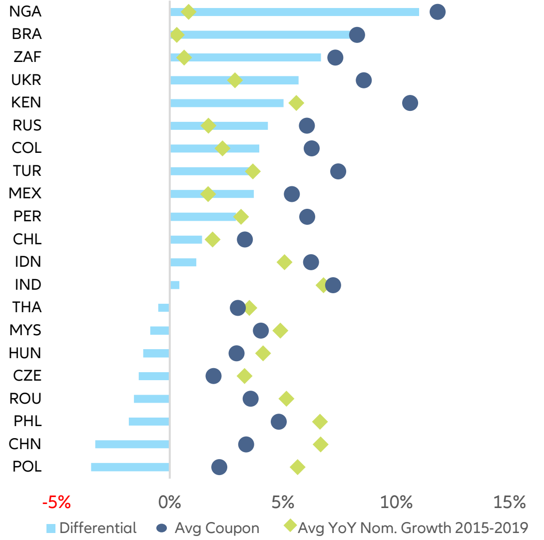
US public debt (% GDP)



Sources: Refinitiv, Allianz Research.

US public debt is expected at close to 160% of GDP at the horizon of 2030. The sustainability of US public debt won't be at risk as the spread r-g is expected to remain pretty low alongside cooperative monetary policy and resilient growth

EMs: Differential between past economic growth and current cost of debt*



* A positive differential indicates future debt sustainability risks.
Sources: Refinitiv, Allianz Research.

Nigeria, Brazil, South Africa, Ukraine and Kenya face high debt rollover risks in the medium term.

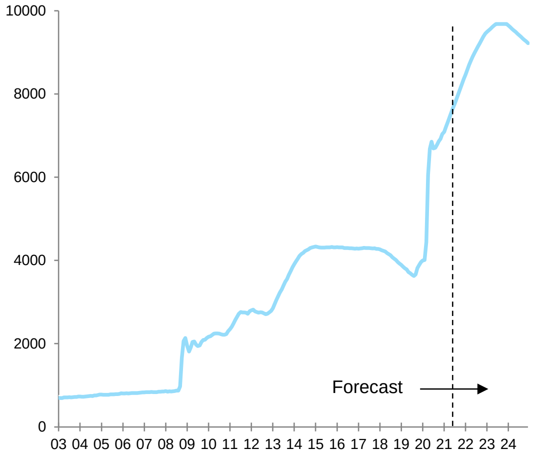
MESSAGE #6B: MONETARY POLICY FOR JOBS

EM: Expected number of policy rate hikes until mid-2022 (sorted by region)

Country	Expected number of rate hikes	Country	Expected number of rate hikes
China	1	Brazil	3
India	1	Mexico	2
Indonesia	1	Argentina	2
Thailand	0	Colombia	2
Philippines	0	Chile	2
Malaysia	0	Peru	2
Russia	2	Nigeria	3
Poland	2	South Africa	3
Romania	3	Egypt	2
Czechia	3	Algeria	3
Hungary	1	Morocco	1
Ukraine	2	Kenya	2

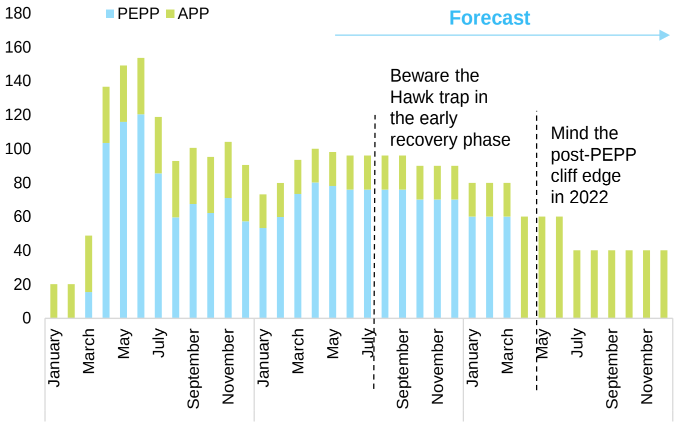
Sources: National statistics, Allianz Research

Fed's balance sheet (USD bn)



Sources: Fed, Allianz Research

ECB Public sector asset purchases under PEPP & PSPP (EUR bn)



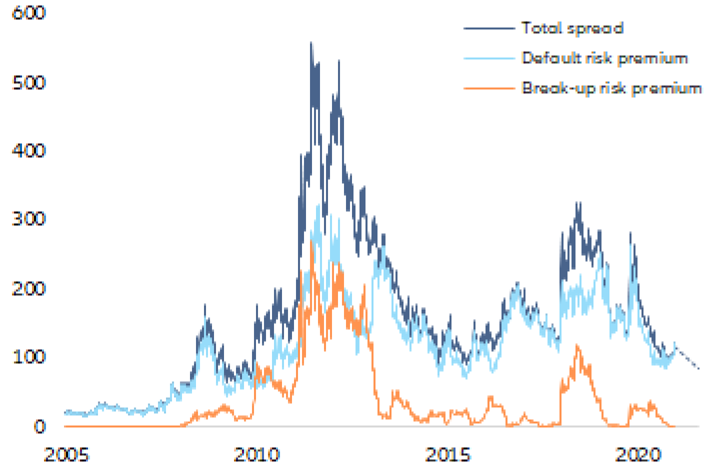
Sources: Refinitiv, ECB, Allianz Research

We expect some EMs to gradually tighten their monetary policies to fight imported inflation (eg. Brazil, Romania, Czechia, South Africa and Nigeria likely to hike three times by mid-2022).

In the US, we think the Fed is at ease with a temporary overheating of the economy. It will envisage an operation twist with less MBS and more USTs from Q2 22 and then gradually reduce securities purchases from USD120bn per month to 0 in H2 23. The ECB will soon have to manage the balancing act of a "dovish tapering" while avoiding a hawk trap in Q3 (i.e. pre-committing to a lower PEPP pace in the early recovery phase) and prepare markets for a life after PEPP, which includes navigating the looming cliff edge in March 2022.

MESSAGE #7: HOT FALL BUT NO 2012 FOR EUROPE

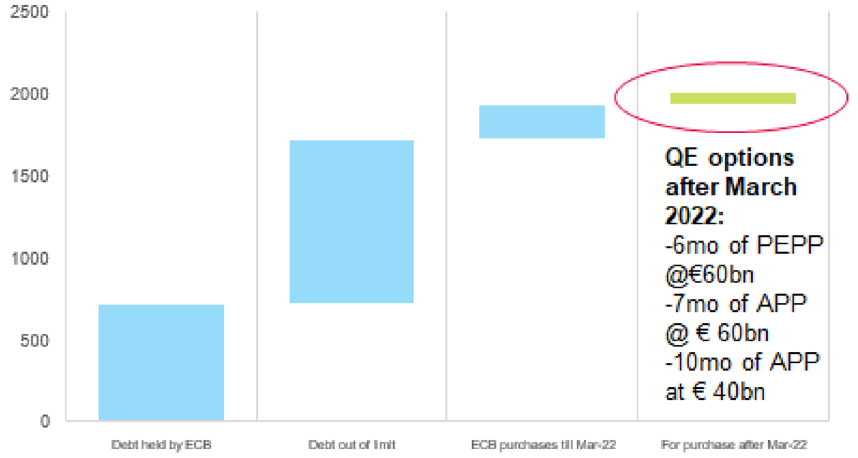
Italy: Tapering rumors weigh on spread, but risk is capped (10y spread in bp)



Sources: Refinitiv, Allianz Research

Tapering rumors weighed on BTP, but “Italexit” risk has vanished. Italy being firmly anchored in Eurozone acts as a cap on spreads, widening as opportunity. Systemic risks only occur if political uncertainty rises. Currently, low political risk (Draghi put), but watch 2023 elections.

Germany: Public sector debt outstanding

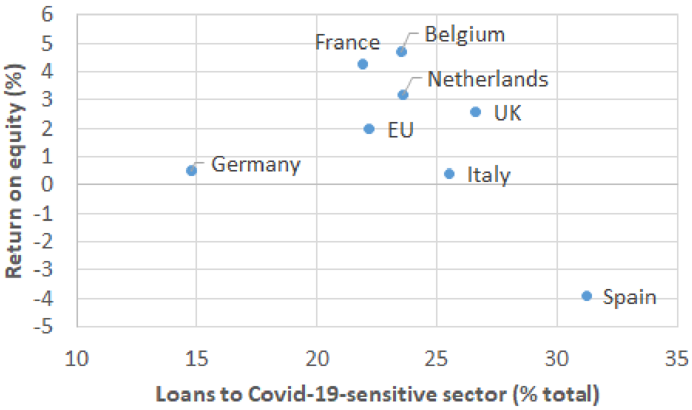


Sources: Refinitiv, ECB, Allianz Research

The ECB will continue to "close spreads" in the coming quarters via PEPP and after March 2022 via APP. It will run increasingly into German debt limits, but the ECB has another trick up its sleeve: the strategy review- We are looking for PEPP’s features to be rolled over to APP, in particular the flexibility around how much is spent in which jurisdiction.

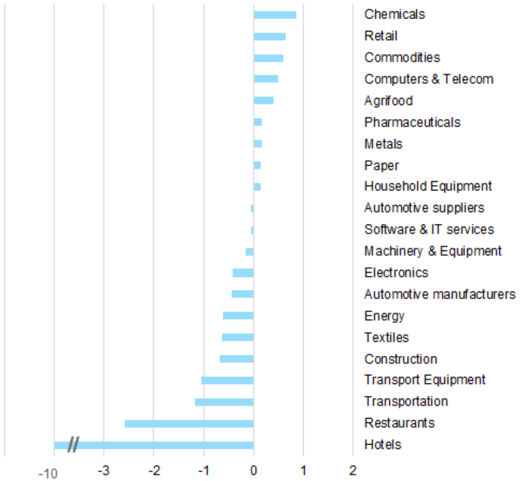
MESSAGE #8: CREDIT RISK UNDER CONTROL

Eurozone banks' exposure to Covid-19 sectors vs. return on equity (%) – as of Dec. 2020



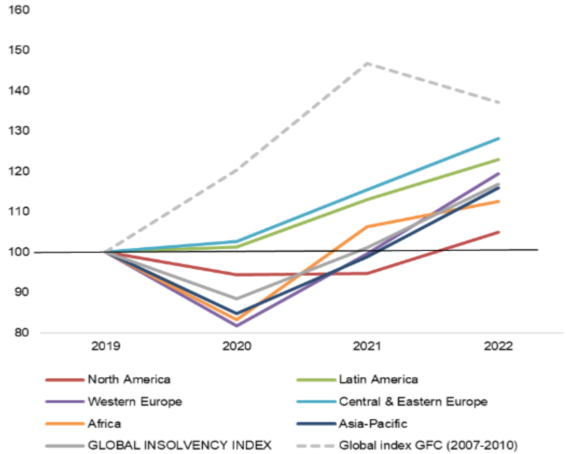
Sources: EBA, Refinitiv, Allianz Research

Changes in EBITDA margin between FY2019 and FY2020, by sector at the global scale



Sources: Refinitiv, Allianz Research

Euler Hermes Insolvency Index, yearly level, base 100 in 2019



Sources: National sources, Euler Hermes, Allianz Research

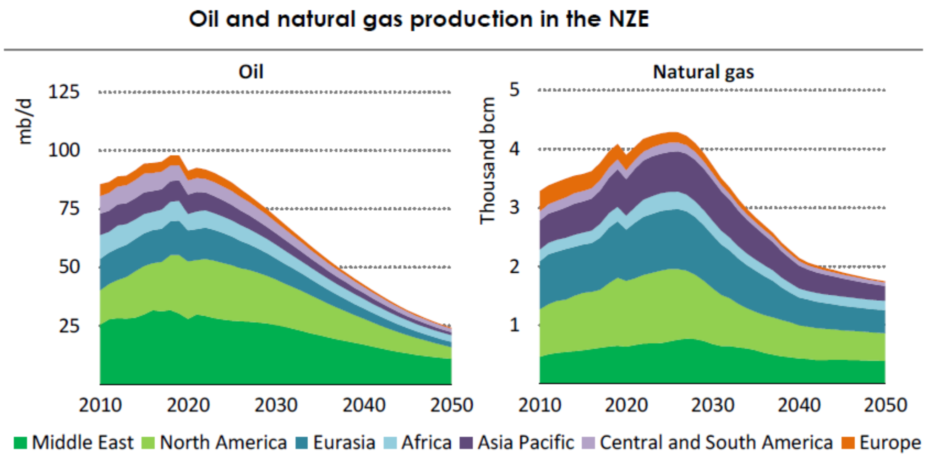
The expected delay in insolvencies will be headwinds to Eurozone banks. Deeply depressed profitability rates in key economies (Germany, Italy and Spain) will make it harder to rebuild capital cushions amid a still expected rise in NPLs. Tightening credit standards on the rise.

The sectorial asymmetry of the shock led to wide heterogeneity across sectors in terms of revenue and profits, with sharper drops in margin for sectors facing the harshest social and mobility restrictions.

The comeback of insolvencies will be both asymmetric, due to the multi-speed economic recovery, and gradual, due to a delicate but pragmatic phasing-out of support measures.

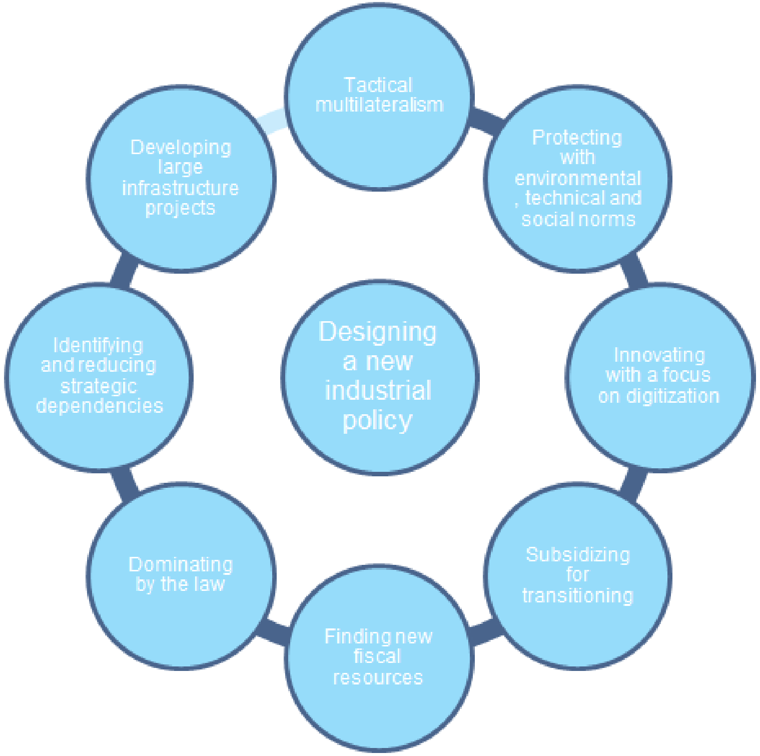
MESSAGE #9: NET ZERO POLICY WILL REQUIRE PROGRESSIVENSS AND A NEW INDUSTRIAL POLICY

Fossil assets will get stranded as fossil prices fall and become insufficient to recover OPEX. OPEC will increase its market oil share from 34% to 52% due to low extraction costs

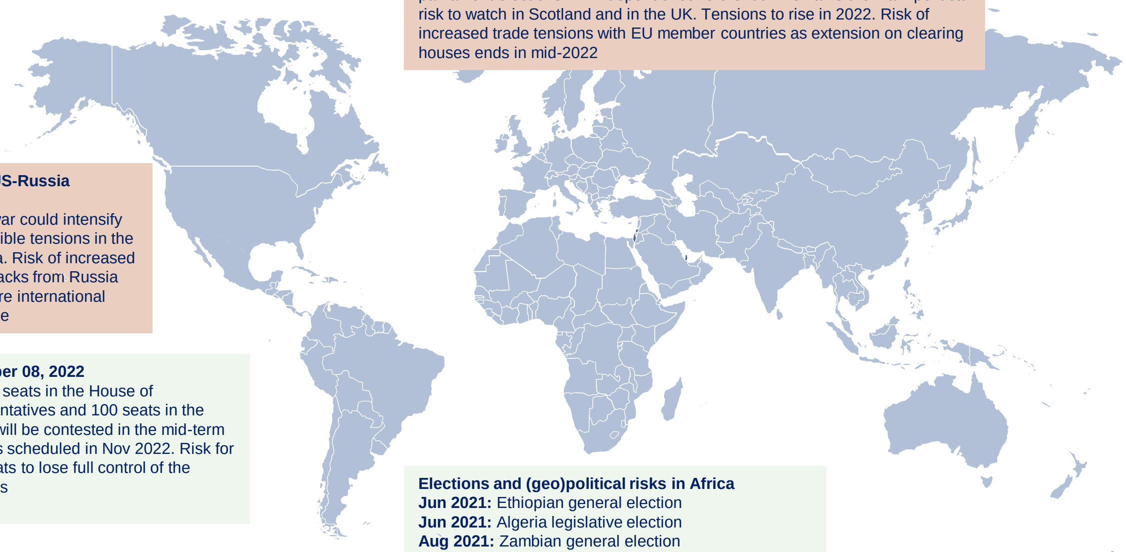


No new oil and natural gas fields are required beyond those already approved for development. Supply is increasingly concentrated in a few major producing countries

Designing new industrial policies started across the board



MESSAGE #10: POLITICAL RISK RELOADED



United Kingdom:
The SNP was short one seat to gain the majority at the May 2021 Scottish parliament elections. An independence referendum remains the main political risk to watch in Scotland and in the UK. Tensions to rise in 2022. Risk of increased trade tensions with EU member countries as extension on clearing houses ends in mid-2022

Elections in Europe
Sep 2021: German federal elections (The Green party is high in the polls and should confront the CDU/CSU party to determine who is going to replace Angela Merkel)
Apr 2022: French presidential elections (Emmanuel Macron and Marine Le Pen are expected to face off at the second round of the elections)

US-China and US-Russia tensions
Economic cold war could intensify with China. Possible tensions in the South-China Sea. Risk of increased cyber threats/attacks from Russia with possibly more international sanctions to come

November 08, 2022
US: 435 seats in the House of Representatives and 100 seats in the Senate will be contested in the mid-term elections scheduled in Nov 2022. Risk for Democrats to lose full control of the Congress

Latin America (geo)political risks to watch and elections to come
Brazil: protests to impeach Bolsonaro and general election in Oct 2022
Peru: general election run-off between the populist candidate P.Castillo and K. Fujimori in June 2022. Policy discontinuity if Castillo is elected
Colombia: Fiscal reform dilution and social unrest

Elections and (geo)political risks in Africa
Jun 2021: Ethiopian general election
Jun 2021: Algeria legislative election
Aug 2021: Zambian general election
Dec 2021: Gambian presidential election
Dec 2021: Libyan presidential election
General risks: vaccine shortages lead to a prolonged sanitary crisis with renewed waves and new virus variants. Risk of social unrest fueled by increased poverty and youth unemployment

Asia-Pacific (geo)political risks to watch and elections to come
Hong Kong: legislative election scheduled in Dec 2021. and Chief Executive election in Mar 2022. New protests are possible
Taiwan: cross-strait relations still tense, with possible interventionism of the U.S.
Japan: general election in Oct 2021
India: presidential and state elections in 2022
South-Korea: presidential election in Mar 2022
Philippines: general election in May 2022
China: long-term trend of isolation of China on the international stage could continue. Australia, India, Japan and Taiwan have been putting policies in place. Tensions in South-China Sea could increase.
Other elections: next Australian federal election before 2022, Myanmar presidential general election in 2022

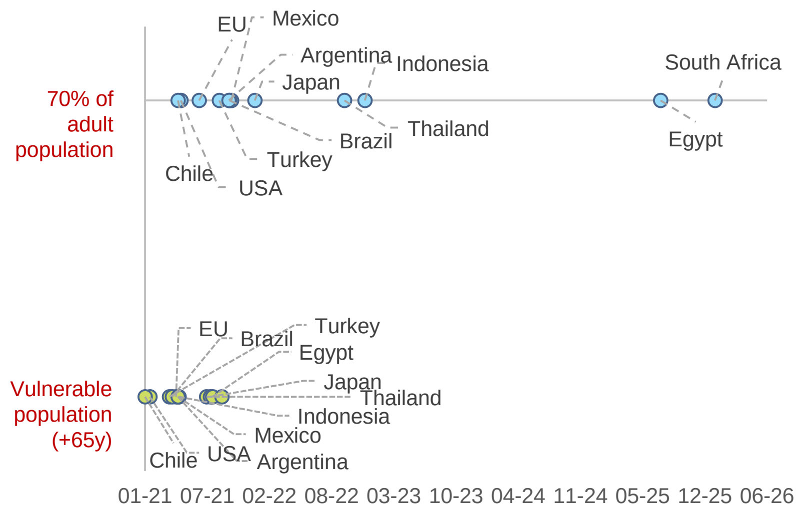
Middle East main elections and tension points
Iran: presidential election scheduled in Jun 2021. Hard-liner Judiciary Chief Ebrahim Raisi is seen as the clear frontrunner to success the moderate President Rouhani. Possible heightened tensions with Israel and Saudi-Arabia. Tensions in the strait of Hormuz.
Lebanon: general election scheduled for May 2022. Political uncertainties and potential new proxy war between Saudi and Iran. The economic crisis could deepen should Lebanon not restore international creditors trust
Yemen: civil war
Israel: resurgence of tensions between Palestinians and Israelis in the occupied territories

Source: Euler Hermes, Allianz Research

APPENDIX 1 – MACROECONOMIC OUTLOOK

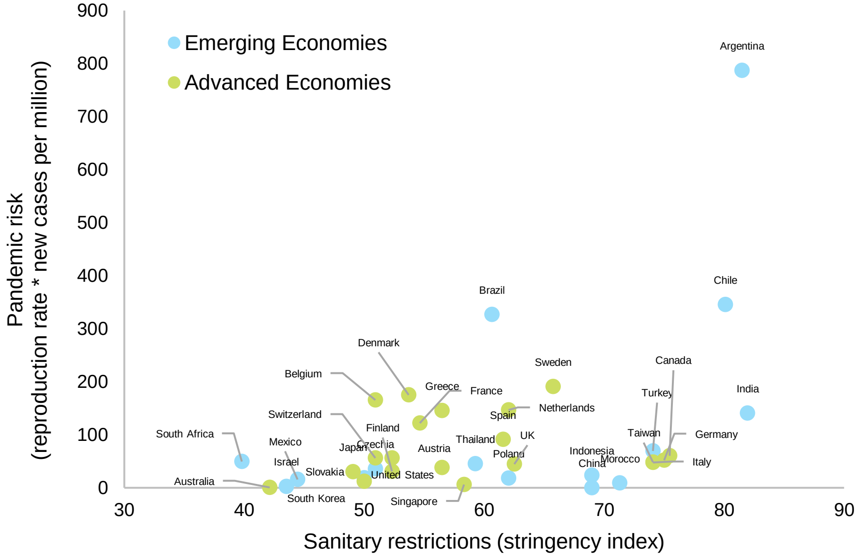
COVID-19: CLOSER TO 'NORMALITY' IN ADVANCED ECONOMIES

Expected date of herd immunity
(at current vaccination speed)



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

Pandemic risk vs sanitary restrictions



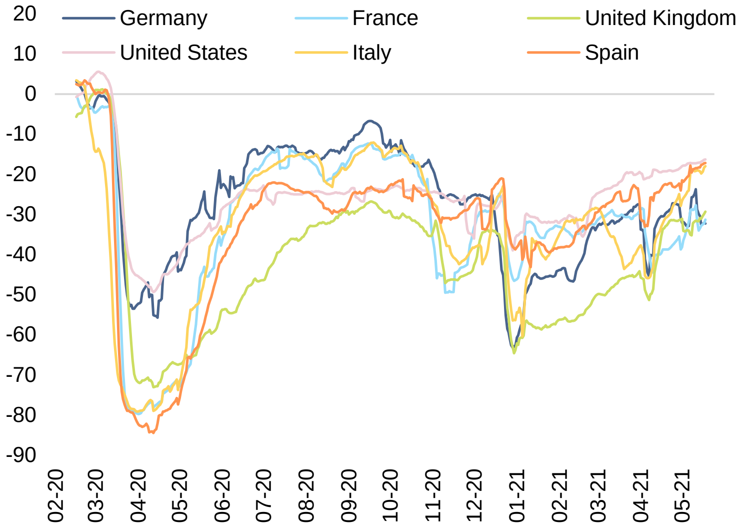
Sources: Our World in Data, Euler Hermes, Allianz Research

Most countries are expected to reach herd immunity (first dose) by summer but demand-side hurdles will become more and more visible. Emerging Markets still likely to remain 'closed' given the supply gap in terms of vaccination.

Emerging Markets lagging in opening as pandemic situation remains challenging. Diversion among advanced economies with some remaining cautious despite improving pandemic data while others open more quickly.

GLOBAL DEMAND: FROM K-SHAPE TO V-SHAPE

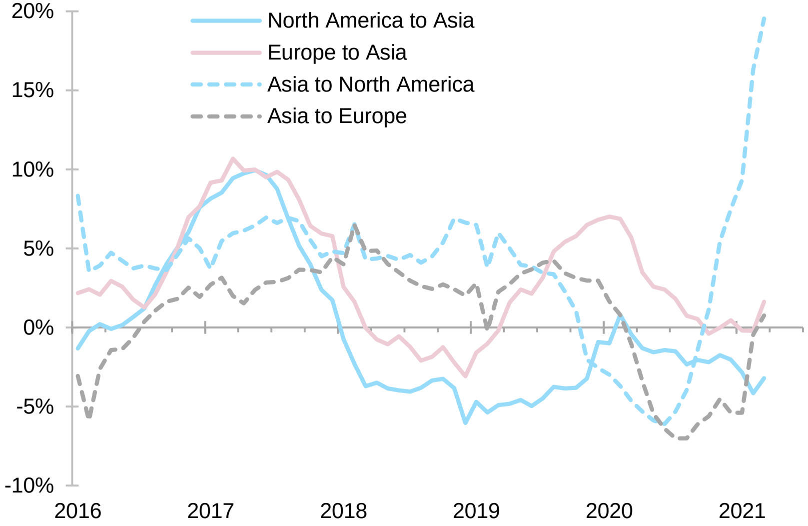
Mobility data, level compared to pre-crisis



Sources: various, Euler Hermes, Allianz Research

Mobility has picked up strongly over the course of May and should continue to recover significantly in June amid greater re-openings in most European countries.

Container traffic volumes
(12m/12m)

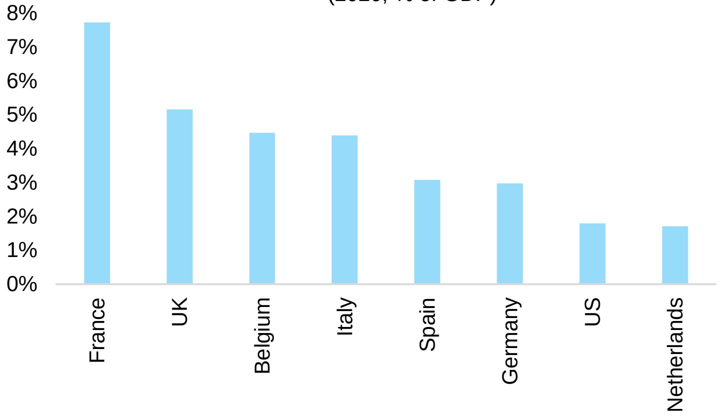


Sources: Bloomberg, Euler Hermes, Allianz Research

The US is indeed the driving force of the recovery, but this is also capturing a lot of the global transportation capacity, with container prices at a record 5-year high.

GLOBAL INVESTMENT:
GREEN LIGHT FOR A STRONG CYCLE

Increase in non-financial corporates' total deposits,
(2020, % of GDP)



Sources: national, Euler Hermes, Allianz Research

Corporates' excess cash positions accumulated in 2020 remain generous in most European countries, at above 3% of GDP.

Baseline forecast of business investment growth
(current LCU)

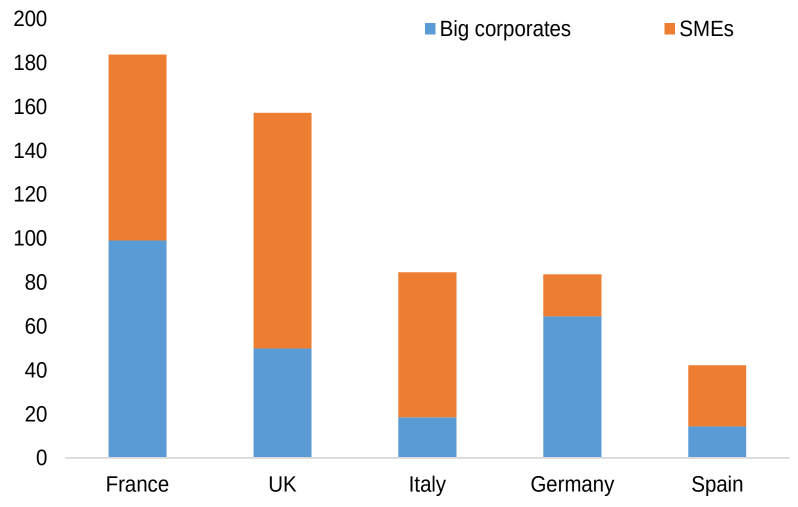
Business investment y/y change	France	Germany	US	UK
2020	-3.6%	-5.1%	-2.9%	-13.9%
2021	6.1%	6.3%	9.8%	11.8%
2022	5.2%	5.7%	8.4%	8.9%
2023	4.3%	3.6%	7.2%	3.3%
2024	4.5%	4.4%	4.3%	4.5%

Sources: national, Euler Hermes, Allianz Research

In the short run, a demand catch-up and the reduction in spare capacities will drive a business investment recovery. However, it could take up to four years to return to long-term growth trends: credit conditions during the recovery phase may be tighter and excessive levels of corporate debt could limit companies' ability to borrow once state-support schemes are phased out.

GLOBAL INVESTMENT: CASH-RICH SECTORS TO HAVE MORE ACTIVE POLICES

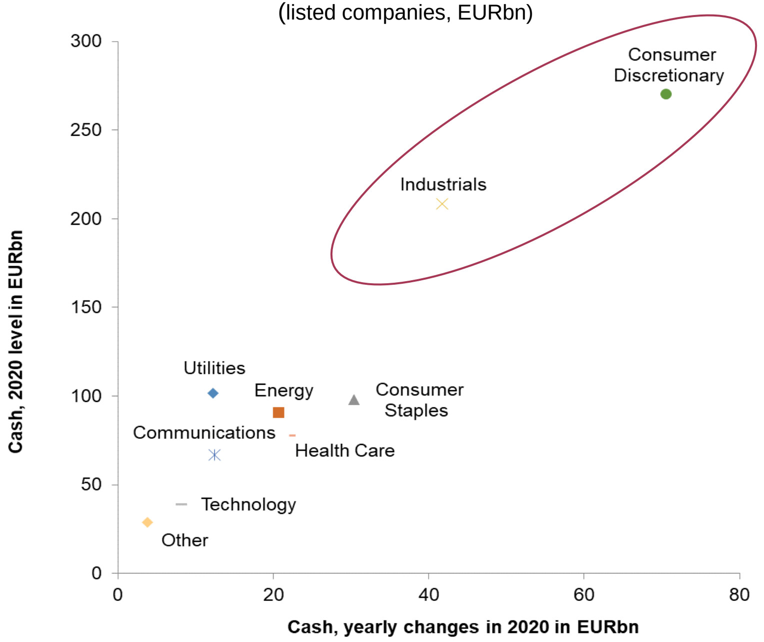
Increase in cash positions in 2020 by size of company
(bn LCU)



NB: Cash of SMEs is the difference between total cash position of NFCs and cash of listed companies.

Sources: Bloomberg, ECB, BoE, Euler Hermes, Allianz Research

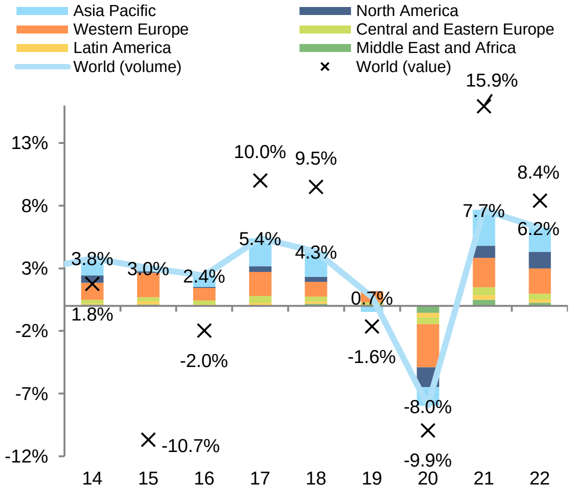
Cash-hoarding by sectors in main European countries*
(listed companies, EURbn)



**) Selected countries: Germany, France, Italy, Spain, Belgium and the Netherlands*
Sources: Bloomberg, Euler Hermes, Allianz Research

GLOBAL TRADE: STRONG MOMENTUM DESPITE SHORT-TERM HURDLES DUE TO BOTTLENECKS

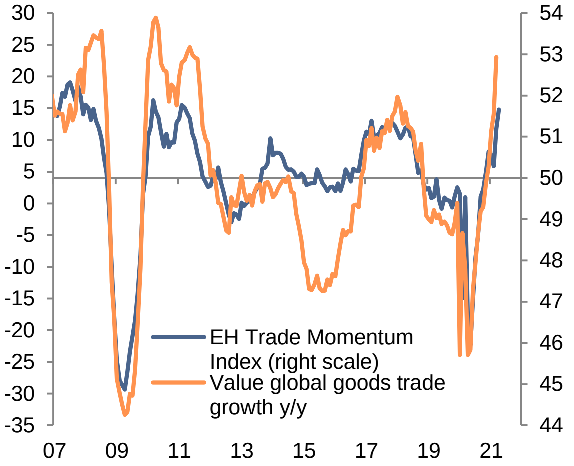
Global trade in goods and services, %y/y



Sources: IHS, IMF, Euler Hermes Allianz Research

We expect global trade to grow by +7.7% in volume in 2021, and by +15.9% in value terms, likely driven by robust exports from APAC and strong imports in the US, Europe and China.

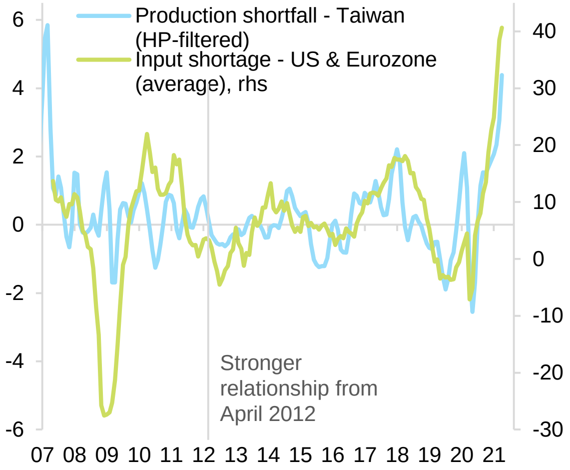
Global trade in goods & leading indicator



Sources: CPB, Allianz Research

Such a strong pace of growth for full-year 2021 is partly ensured by favorable base effects and a stronger-than-expected momentum in the first months of the year. However, there are short-term risks.

Taiwan production shortfall vs. US & Eurozone input shortage

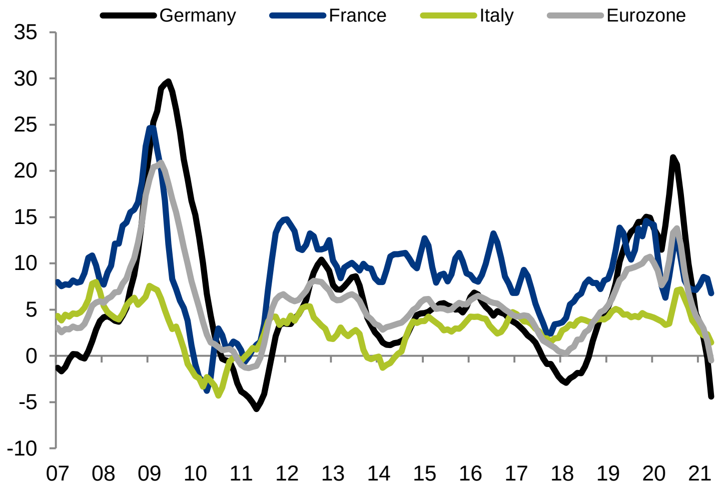


Sources: IHS, AGI, Allianz Research

The global supply-demand imbalance could be exacerbated in Q2 and the summer, given the new Covid-19 outbreak in Taiwan – on which the world has become increasingly dependent in the electronics sector.

GLOBAL SUPPLY: BOTTLENECKS CAN LAST UNTIL YEAR-END

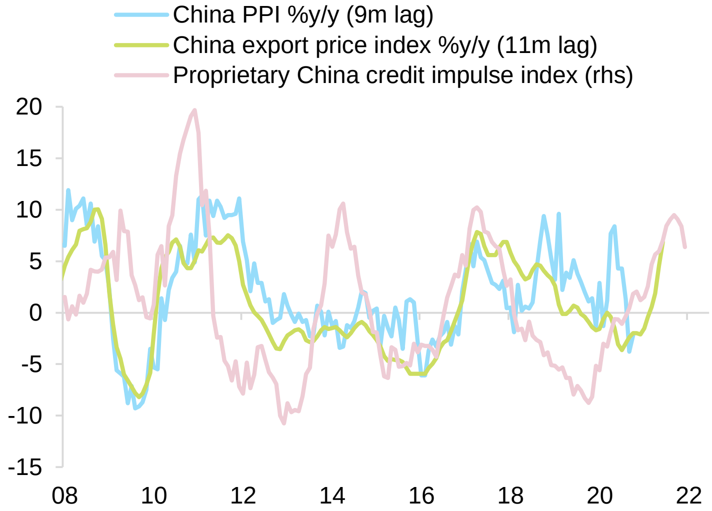
Assessment of stock levels, manufacturing
(balance of opinion)



Sources: Eurostat, Euler Hermes, Allianz Research

Companies operate at very low levels of inventories. Longer transportation times could mean that companies will use 'just in case' management of stocks in 2021-22 rather than the usual 'just in time'.

China credit impulse and price indices

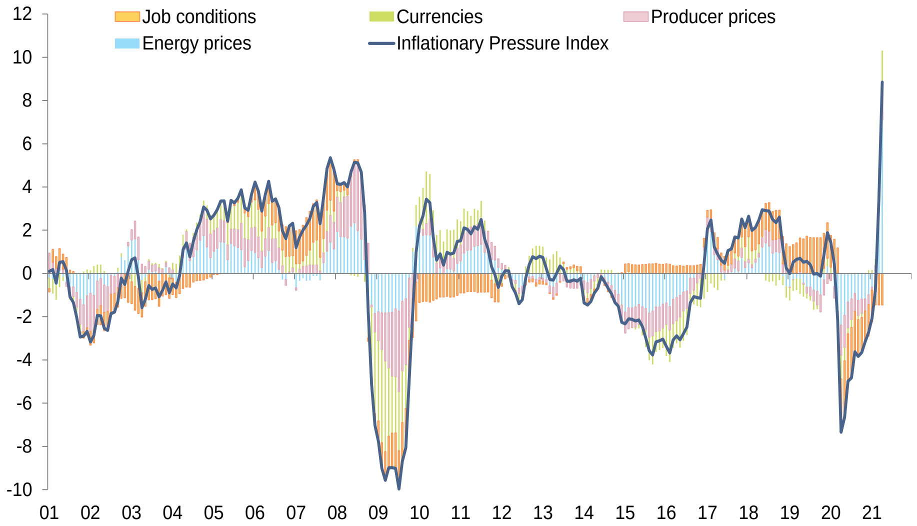


Sources: national, Euler Hermes, Allianz Research

Credit impulse has a 9-month lead over PPI prices and 11 months on export prices. Hence, we should start to see a deceleration in price in T4 2021.

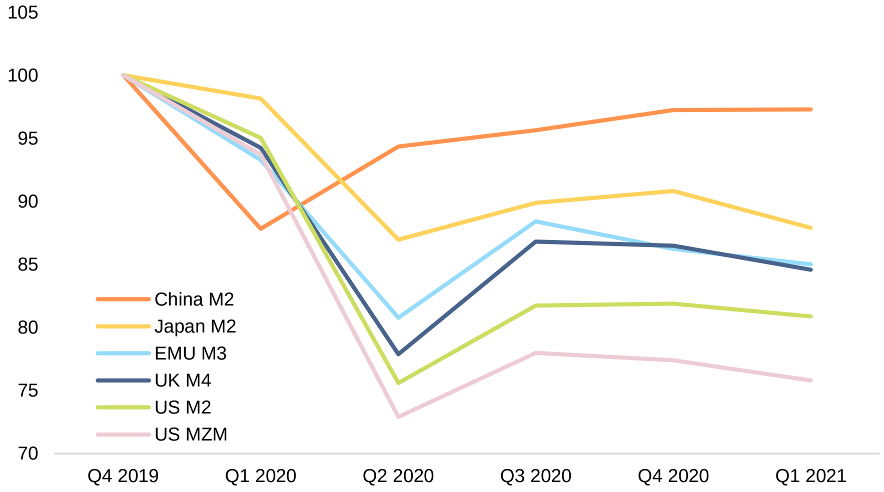
INFLATION: THE CYCLICAL PART IS HIGH, THE STRUCTURAL ONE REMAINS CONTAINED

Global inflationary pressure index



Sources: IHS, Euler Hermes, Allianz Research

Income money velocity (100 = Q4 2019)



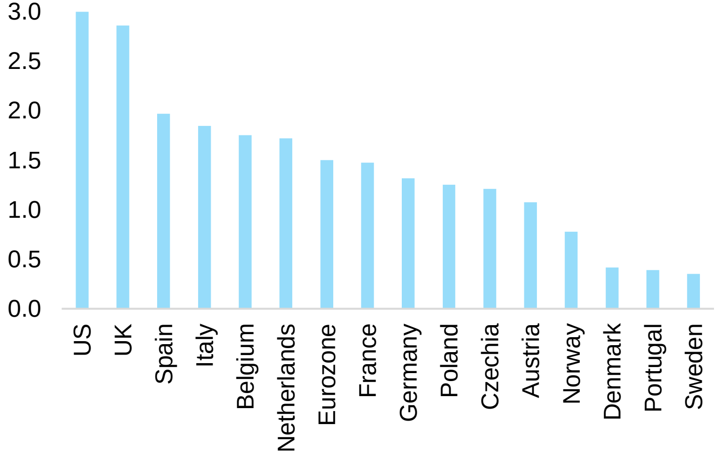
Sources: Refinitiv, Allianz Research

Inflationary pressures are at record high levels. The good news: they are mainly driven by energy prices and USD appreciation which should prove temporary.

Usually forgotten in the inflation equation, velocity is as important as the amount of money. Surprisingly, the money velocity in the US is the one that recovered less since pre-crisis levels. Or, put differently, a recovery in money velocity could push inflationary pressures.

INFLATION: SWITCHING FROM EXCESS SUPPLY TO EXCESS DEMAND WITH BOTLENECKS

Catch-up consumption expected in 2021, % of GDP



Sources: Eurostat, Allianz Research

Pent-up consumption in 2021 could reach 3% of GDP in US/UK and 1.5% in most European countries in 2021. However residual savings at end-2021 will remain 40% above pre-crisis levels and will need to be directed into productive growth

Real GDP growth

		US (q/q)	**China** (y/y)	**Euro area** (q/q)	**UK** (q/q)
2019 average		0.6%	6.0%	0.2%	0.3%
2021	Q1	1.6%	18.3%	-0.6%	-1.5%
	Q2	2.2%	7.3%	1.8%	4.0%
	Q3	1.7%	4.8%	2.0%	2.5%
	Q4	1.5%	3.9%	1.0%	0.5%
2022	Q1	0.6%	4.3%	0.8%	1.1%
	Q2	0.6%	5.1%	0.8%	0.5%
	Q3	0.5%	6.1%	0.7%	0.8%
	Q4	0.9%	5.9%	0.6%	1.1%

A strong rebound in GDP growth is expected, much above potential, but this should be temporary. Europe will return to low pressure once it reaches pre-crisis levels in Q1 2022

INFLATION: LIVING WITH HIGHER INFLATION MEANS LOWER MARGINS AND PURCHASING POWER

Assessment of shortages and selling price expectations by firms, by sector (Europe)

	Shortage in factor of production - compared to pre covid levels (*)		Selling price expectations (**)
	Labor	Material, equipment & space	
Wood & related	4	25	61
Paper & related	1	18	61
Basic metals	2	8	51
Furniture	0	22	47
Rubber/plastics	0	32	43
Coke and refined products	-2	19	40
Fabricated metal products	3	17	37
Electrical equipment	8	27	36
Textiles	4	5	35
Machinery/equipment	-1	14	32
Chemicals	-1	16	30
Other non-metallic mineral	1	7	30
Food	-4	-1	24
Motor vehicles	-2	30	18
Computer/electronic	-2	22	17
Leather	3	3	14
Repair/installation	-4	10	13
Other manufacturing	-12	-8	13
Construction	24	3	11
Beverages	-2	-4	10
Pharmaceuticals	-6	-9	4
Wearing	-2	1	4
Other transport equipment	-7	-10	4
Printing	0	6	3

(*) Q2'21 vs. to Q4'19 levels; (**) As of May 2021 surveys
Sources: Eurostat, Euler Hermes, Allianz Research

Input shortages are particularly acute in the automotive and computer/electronic sectors (semiconductors!). Surveys find that selling prices could rise in Europe going forward, alleviating some pressure from cost inflation.

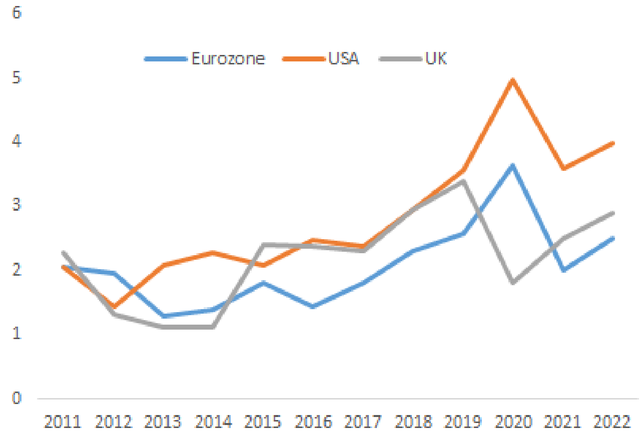
European companies' pricing power

	Eurozone Pricing Power	Risk on profitability due to input prices
Electricity	✗	🟡
Pharmaceuticals	✗	🟢
Computers	✓	🟢
Consumer Electronics	✓	🟢
Food & non-alcoholic beverages	✓	🟡
Tobacco	✗	🟡
Wines from grapes	✗	🟡
Automobile	✗	🟡
Household Appliances	✗	🔴
Diesel/Petrol	✓	🟡
Textile	✓	🟡
Printed media	✗	🔴
Cleaning products	✗	🟡
Air transport	✓	🟡
Postal services	✗	🟡
Telephone services	✗	🟡
Restaurants, cafés and the like	✓	🟡
Accommodation services	✗	🟡

Sources: Allianz Research

Indeed, the rise in input prices is not being transferred onto output prices. We find that European companies in particular are most at risk, having limited pricing power for now.

Nominal wage growth (%)

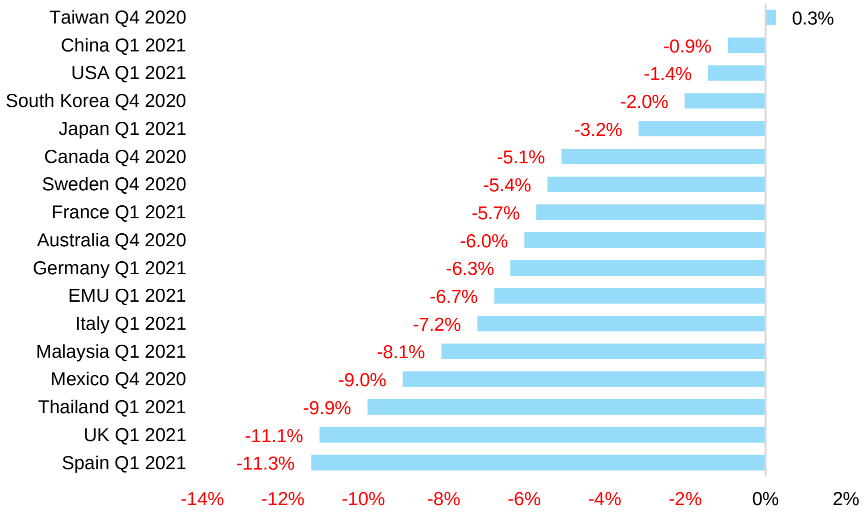


Sources: Allianz Research

Wages are likely to rise in those sectors that face labor shortages. However we don't expect a blanket boost with total wages galloping out of control.

INFLATION: NEGATIVE OUTPUT GAPS WILL KEEP WAGE PRESSURE IN CHECK

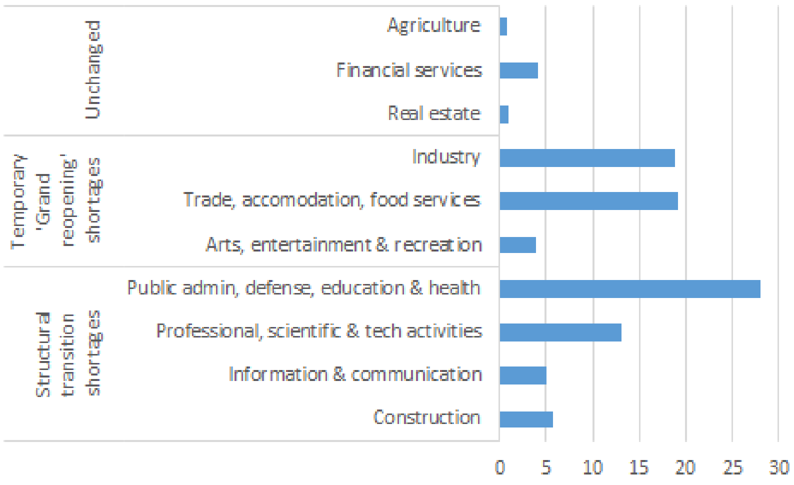
Perceived output gap (latest available)



Sources: Refinitiv, Allianz Research

Covid-19 has not helped close the gap between countries, but rather widened it. While the UK had to deal with Brexit and Covid-19 almost at the same time, others have suffered more due to sector composition (Spain, Thailand).

Sectoral wages in Europe (% total)

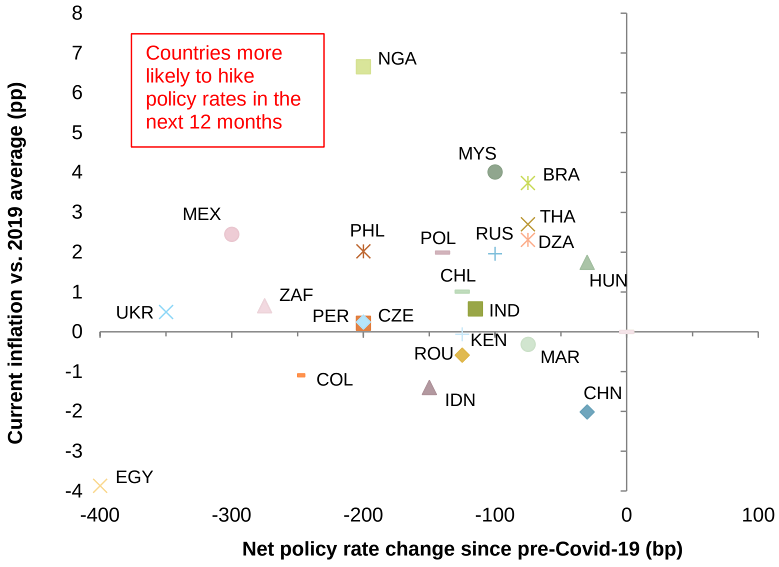


Sources: Refinitiv, Allianz Research

Structural shortages have been exacerbated by the crisis, particularly in growth sectors that underpin the digital & green transition. Construction should receive some tailwind from public investment plans (incl. when powered by NGEU).

INFLATION: GRADUAL MONETARY TIGHTENING IN THE EMERGING MARKETS

EM: Inflationary and monetary policy pressures



Sources: National statistics, Allianz Research

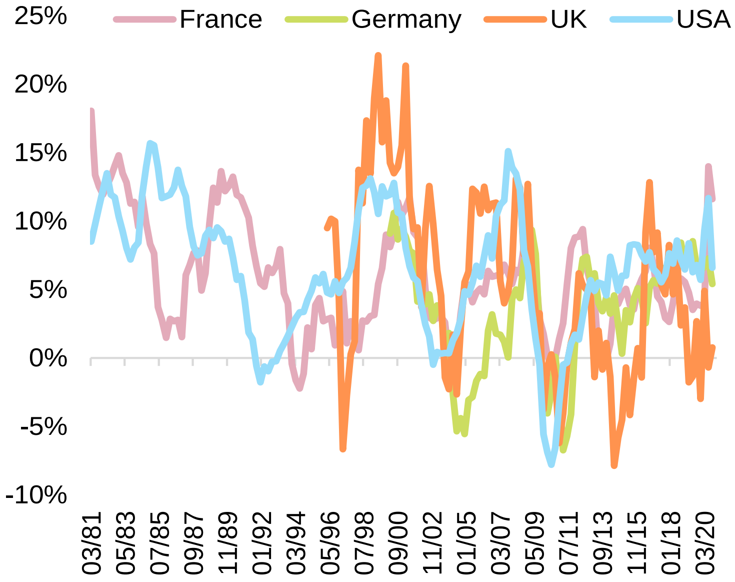
EM: Expected number of policy rate hikes until mid-2022 (sorted by region)

Country	Expected number of rate hikes	Country	Expected number of rate hikes
China	1	Brazil	3
India	1	Mexico	2
Indonesia	1	Argentina	2
Thailand	0	Colombia	2
Philippines	0	Chile	2
Malaysia	0	Peru	2
Russia	2	Nigeria	3
Poland	2	South Africa	3
Romania	3	Egypt	2
Czechia	3	Algeria	3
Hungary	1	Morocco	1
Ukraine	2	Kenya	2

Sources: Allianz Research forecasts

CORPORATES: ABSORBING COVID-19 DEBT REQUIRES AMBITIOUS FISCAL REFORMS

Annual change in NFC debt – annual change in NFC margins



Sources: Euler Hermes, Allianz Research

Most companies across advanced economies have less buffers as their debt levels increased faster compared to their margins over the past decade.

What is needed to absorb Covid-19 corporate debt?

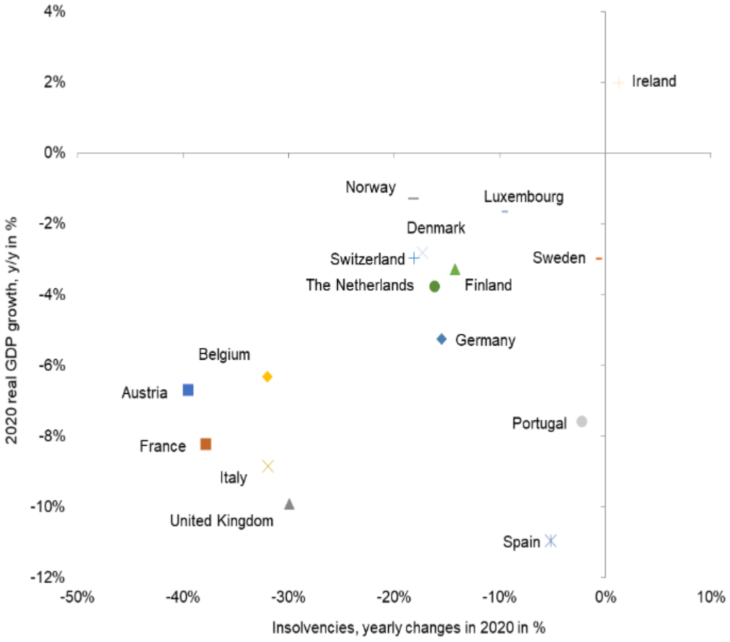
	Increase in debt in 2020, pp of GDP	Increase needed in gross operating surplus, %	Change in operating surplus (EURmn)	Increase in margins needed (pp)	LT annual average increase in margins	Maximum historical annual increase	Year of maximum annual increase
Germany	5.0	2.7	19	1.0	0.0	1.8	(2006)
France	14.3	7.7	27	2.4	0.0	1.8	(2019)
UK	6.3	3.4	15	1.2	-0.2	1.4	(1996)
Belgium	9.4	5.1	5	2.1	0.2	2.4	(2010)
Netherlands	3.9	2.1	4	0.9	0.1	1.7	(2005)
Italy	8.6	4.6	15	2.0	-0.4	1.8	(2016)
Spain	10.0	5.4	13	2.2	0.1	1.6	(2007)

Sources: Bank of France, BIS (until Q3 for Belgium and Netherlands), Euler Hermes, Allianz Research

If nothing is done, and supposing stable interest expenditures, Covid-19 corporate debt can be absorbed only in 5 years time in most European countries. Hence, boosting corporates' self-financing capacity through fiscal reforms could improve debt sustainability and avoid a premature deleveraging process.

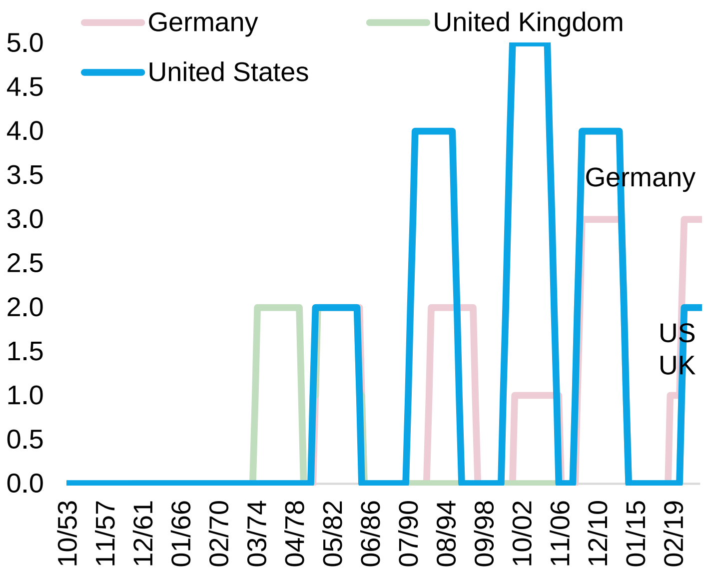
INSOLVENCIES: 1 OUT OF 2 COMPANIES IN WESTERN EUROPE SAVED BY THE STATES

2020 GDP growth and insolvencies in Western Europe



Sources: National sources, Euler Hermes, Allianz Research

5-year cumulated number of quarters during which GDP growth is below average by two standard deviations

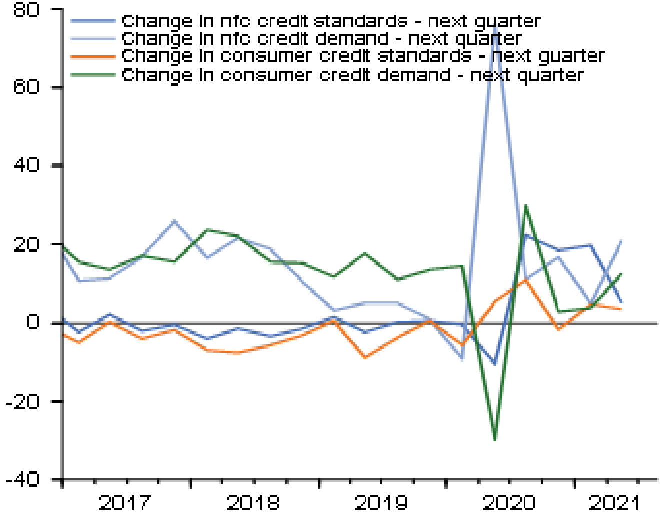


Sources: national, Allianz Research

Frequency and severity of economic shocks increased over time.

BANKS: THE RISK OF CRUNCHING THE RECOVERY

ECB Eurozone bank lending survey

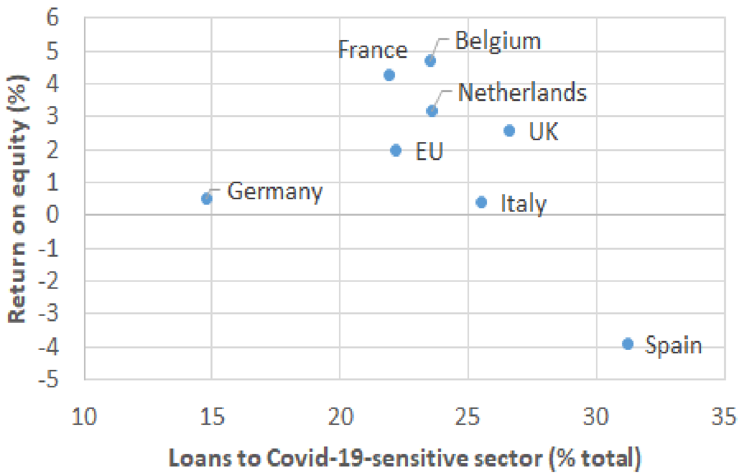


Sources: Refinitiv, Allianz Research

*Note: *Jan – Mar 2021*

Eurozone banks have helped cushion the Covid-19 shock to the economy by providing record amounts of liquidity. Just as the economy is getting ready to rebound and credit demand is strengthening, credit standards for the private sector are tightening.

Banks' exposure to Covid-19 sensitive sectors vs. return on equity (%) - as of Dec 2020

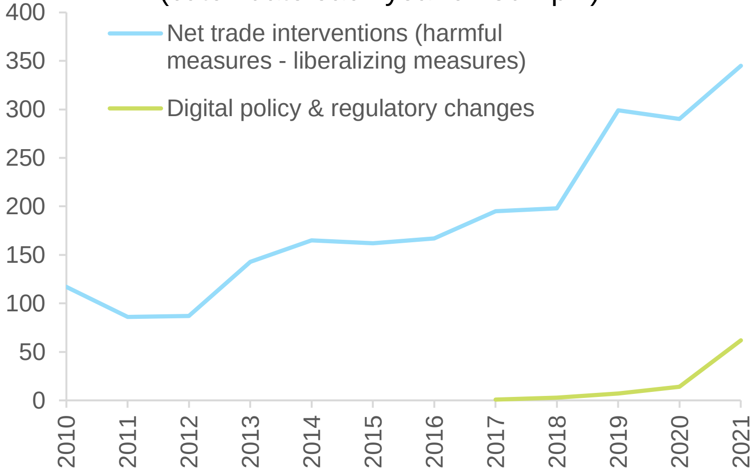


Sources: EBA, Refinitiv, Allianz Research

The expected delay in insolvencies will pose headwinds to Eurozone banks. Deeply depressed profitability rates in key economies (Germany, Italy and Spain) will make it harder to rebuild capital cushions amid a still expected rise in NPLs.

GLOBAL UNCERTAINTY: CONTINUED PROTECTIONISM VS. MULTILATERALISM 2.0

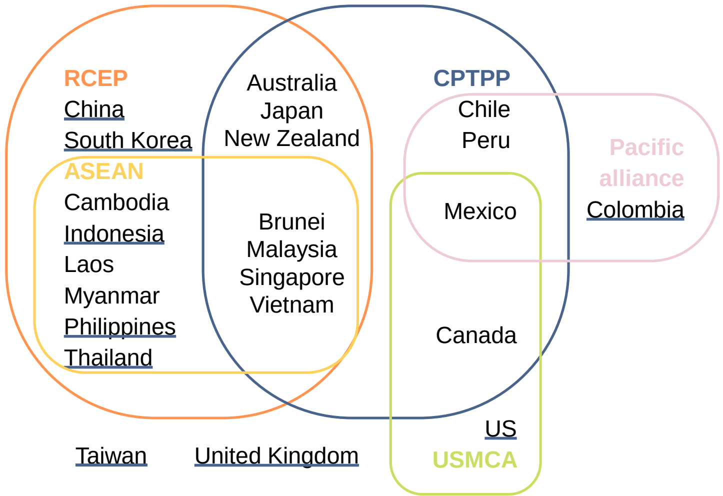
Measures restraining trade
(cutoff date each year on 30 April)



Sources: Global Trade Alert, Allianz Research

Protectionist measures are still being implemented in 2021, with the US being the most active and China and Germany the most targeted (in net terms). Regulation affecting digital commerce is also becoming increasingly apparent.

Multilateral free trade agreements (underlined: interest in joining CPTPP)



Sources: official resources, Allianz Research

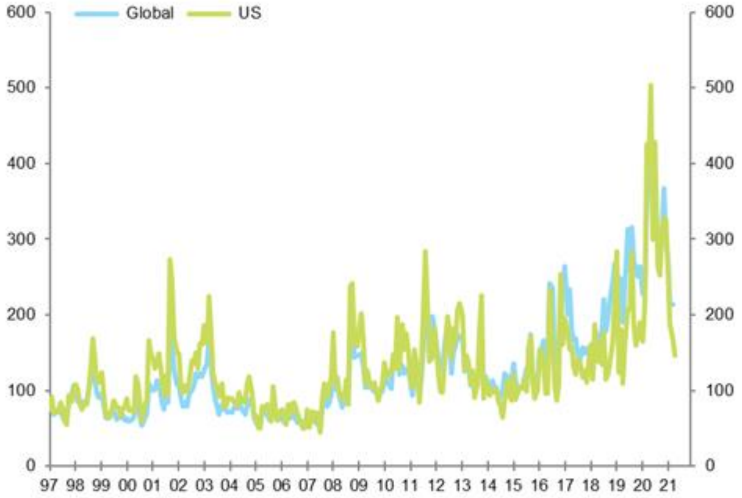
A revival and acceleration of multilateralism may be on the cards, particularly in the Pacific region: increased incentives for economies to join and conclude free trade agreements as the US reengages in global policies.

GLOBAL UNCERTAINTY: A NEW US PATERNALISM UNTIL THE MID-TERM ELECTIONS IN 2022?

Towards a leadership by the law

- “A family approach” by adopting a **multilateral strategy** with a comeback to international organizations and a leading role in international discussions
- “Educating” by **sanctioning in the short-term** but opening the door to improvements of relations over the long-term with Russia and China
- “Protecting” by **continuing the America First Policy** initiated by Barack Obama and reinforced by Donald Trump
- “Making the law” by imposing **new norms at the level of digital, tax and environment policy** (a diplomacy aiming at establishing leadership by the law)

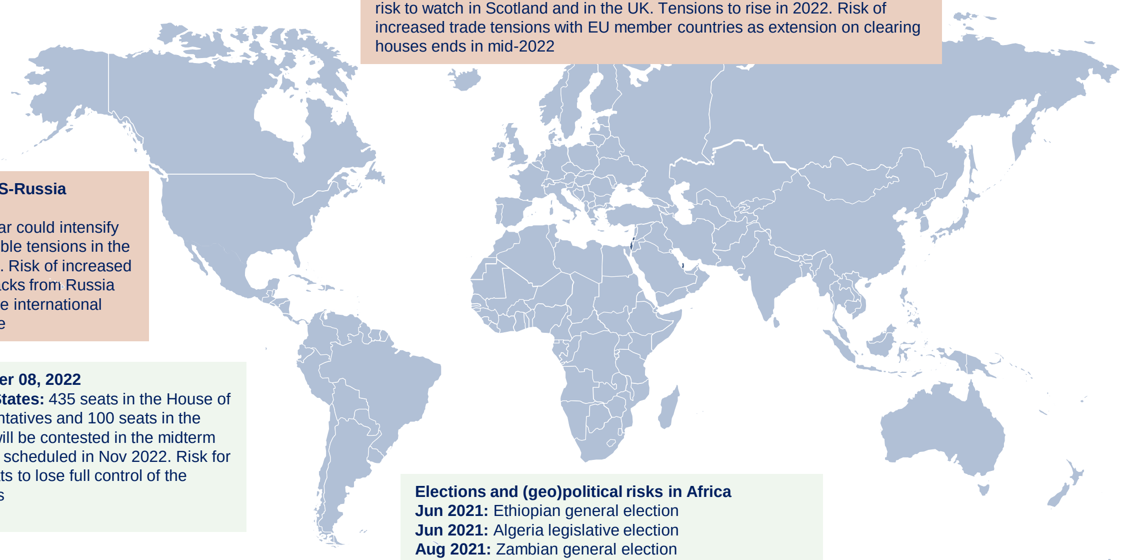
Economic Policy Uncertainty index



Sources: EPU, Allianz Research

Biden's administration, until recent events in the Middle East, had contributed to attenuate global political risk. Tactical multilateralism is the new leitmotiv of international relations, which is less confrontational though this does not mean lower protectionism.

POLITICAL RISK IS NOT FULLY DEAD



UK:
The SNP was short one seat to gain the majority at the May 2021 Scottish parliament elections. An independence referendum remains the main political risk to watch in Scotland and in the UK. Tensions to rise in 2022. Risk of increased trade tensions with EU member countries as extension on clearing houses ends in mid-2022

Elections in Europe
Sep 2021: German federal elections (The Green party is high in the polls and should confront the CDU/CSU party to determine who is going to replace Angela Merkel)
Apr 2022: French presidential elections (Emmanuel Macron and Marine Le Pen are expected to confront at the second round of the elections)

US-China and US-Russia tensions
Economic cold war could intensify with China. Possible tensions in the South-China Sea. Risk of increased cyber threats/attacks from Russia with possibly more international sanctions to come

November 08, 2022
United-States: 435 seats in the House of Representatives and 100 seats in the Senate will be contested in the midterm elections scheduled in Nov 2022. Risk for Democrats to lose full control of the Congress

Latin America (geo)political risks to watch and elections to come
Brazil: protests to impeach Bolsonaro and general election in Oct 2022
Peru: general election run-off between the populist candidate P.Castillo and K. Fujimori in Jun 2022. Policy discontinuity if Castillo is elected
Mexico: midterm elections, legislative and local elections in Jun 2021
Colombia: Fiscal reform dilution and social unrest

Elections and (geo)political risks in Africa
Jun 2021: Ethiopian general election
Jun 2021: Algeria legislative election
Aug 2021: Zambian general election
Dec 2021: Gambian presidential election
Dec 2021: Libyan presidential election
General risks: vaccine shortages lead to a prolonged sanitary crisis with renewed waves and new virus variants. Risk of social unrest fueled by increased poverty and youth unemployment

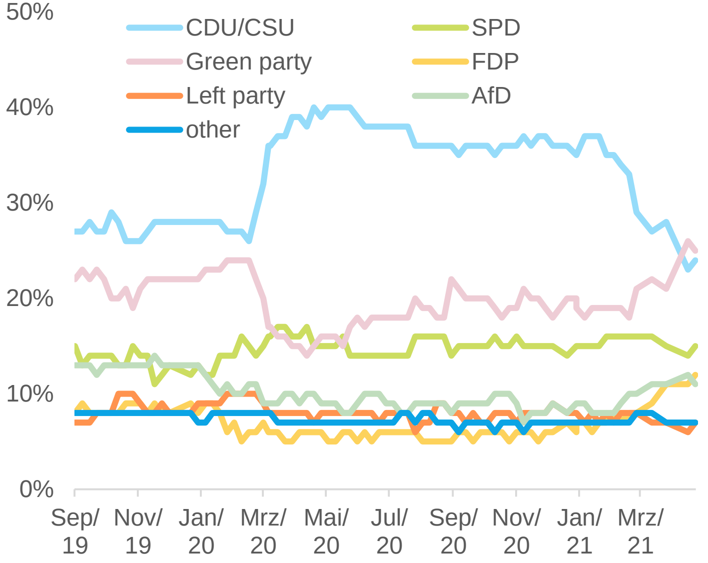
Asia-Pacific (geo)political risks to watch and elections to come
Hong Kong: legislative election scheduled in Dec 2021. and Chief Executive election in Mar 2022. New protests are possible
Taiwan: cross-strait relations still tense, with possible interventionism of the U.S.
Japan: general election in Oct 2021
India: presidential and state elections in 2022
South-Korea: presidential election in Mar 2022
Philippines: general election in May 2022
China: long-term trend of isolation of China on the international stage could continue. Australia, India, Japan and Taiwan have been putting policies in place. Tensions in South-China Sea could increase.
Other elections: next Australian federal election before 2022, Myanmar presidential general election in 2022

Middle East main elections and tension points
Iran: presidential election scheduled in Jun 2021. Hard-liner Judiciary Chief Ebrahim Raisi is seen as the clear frontrunner to success the moderate President Rouhani. Possible heightened tensions with Israel and Saudi-Arabia. Tensions in the strait of Hormuz.
Lebanon: general election scheduled for May 2022. Political uncertainties and potential new proxy war between Saudi and Iran. The economic crisis could deepen should Lebanon not restore international creditors trust
Yemen: civil war
Israel: resurgence of tensions between Palestinians and Israelis in the occupied territories

Source: Euler Hermes, Allianz Research

GERMAN ELECTIONS: EVOLUTION, NO REVOLUTION

Germany: Election poll (%)



Source: Infratest Dimpa

What could a Black-Green coalition (baseline scenario) entail?

Fiscal policy

- Temporary suspension & stretched interpretation of debt brake provides some room for tax cuts for low-income earners & SMEs as well as more public investment (+EUR20bn/year in green, digital & education) while allowing return to the 'green zero' by 2023.
- Possibly higher taxes for top-earners, but no wealth tax

Environment

- Step-up in regulation – above all green – with a focus on targets i.e. acceleration of coal exit, e-vehicle targets etc. combined with incentives & subsidies to accelerate the transition & reduce the adjustment pain for the private sector.
- Phase out of brown subsidies with CO2 price increasingly market-based.

Europe

- No overhaul of EU fiscal rules, but rather prolonged suspension until 2023.
- Acceleration of EU carbon border tax & push for more EU integration (i.e. banking, capital market & defense union).

Source: Allianz Research

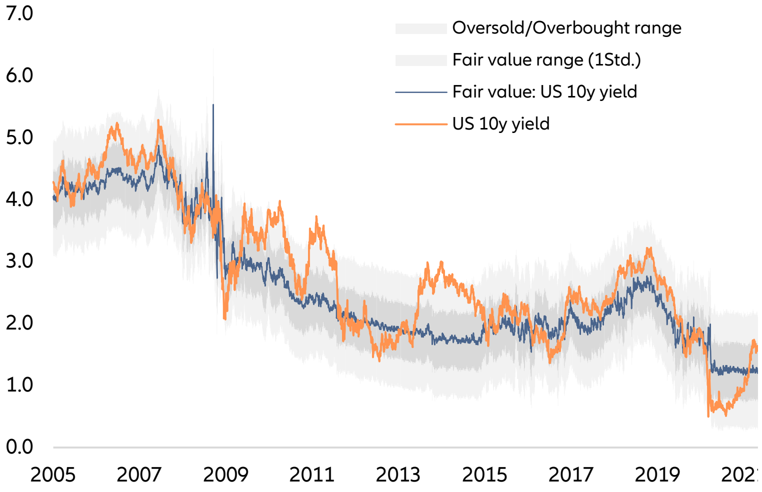
Current election polls suggest three feasible coalitions to emerge from the September vote, with the Green Party a key member in all of them: 1) CDU/CSU & Green Party (plus the FDP), 2) CDU, SPD & Green Party, 3) Green Party, SPD & FDP. Approaching the election date, we expect the governing CDU/CSU to receive more support in polls, with progress on the vaccination front and an improvement in the outlook.

Agreeing on a coalition contract will prove challenging as positions on a number of key topics are far apart between the CDU/CSU and the Green Party (the most likely scenario). Even under the pragmatic leadership of Baerbock and Laschet a deal could take several months to be sealed, as agreement will require deviating from party lines.

APPENDIX 2 – CAPITAL MARKETS OUTLOOK

US INFLATION: THE EXPECTATION PUZZLE

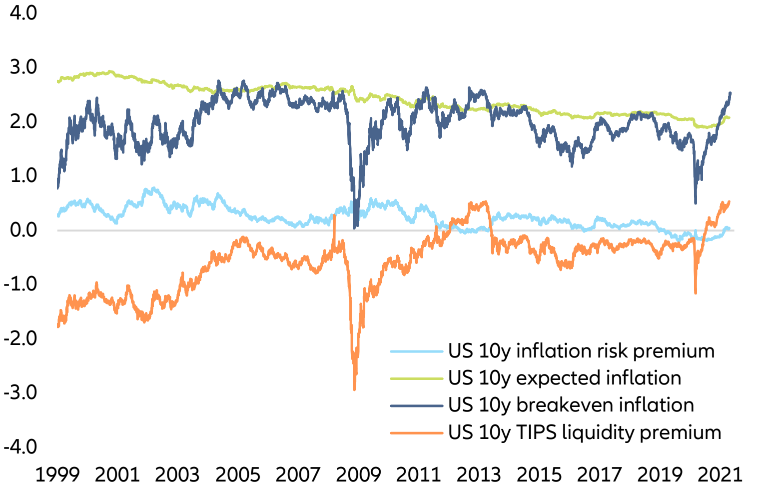
US 10y yield at the upper fair value range
(yield in %)



Sources: Refinitiv, Allianz Research

US 10y yield has reached the upper range of our fair value range. There is a 14% probability for an overshoot to 2% until the year end. This would be temporary being clearly in the oversold range.

Rising breakeven don't mean higher inflation expectations
(decomposition of breakeven, in %)

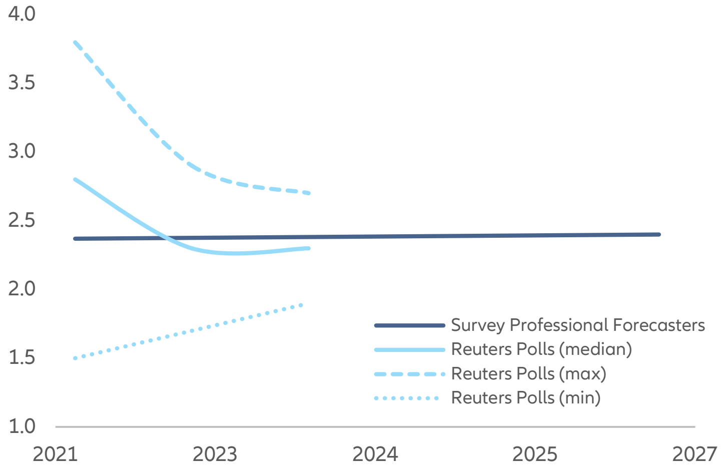


Sources: Refinitiv, Allianz Research after D'Amico, Kim & Wei (2018)

A seeming paradox: High inflation discount (breakeven) with negative real yield suggesting subdued economic outlook. Most of breakeven rise due to tight market conditions (TIPS liquidity premium). Uncertainty about future inflation (inflation risk premium) priced in. Expectations recovered to pre-crisis level.

US INFLATION: THE EXPECTATION PUZZLE (II)

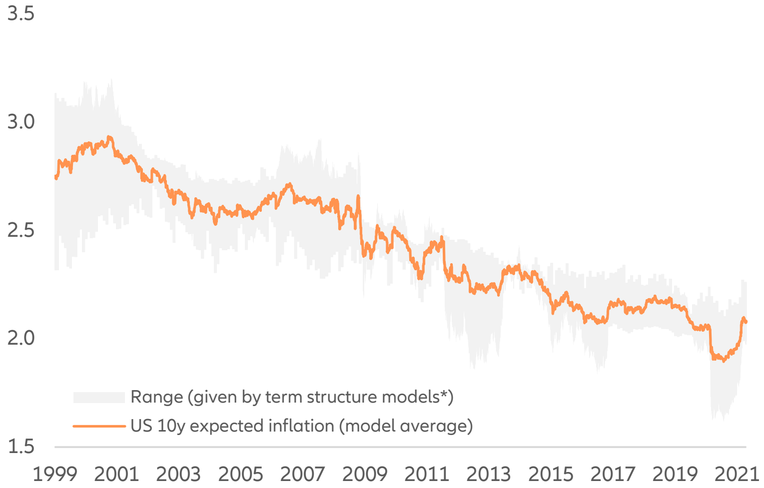
Inflation surveys show contained inflation fears
(Consumer Price Index, in %)



Sources: Thomson Reuters Eikon, Refinitiv, Allianz Research

Surveys among professional forecasters show high uncertainty about short-term inflation dynamics. Long-term expectations remain anchored at levels in line with the average inflation target of the Fed.

Term structure models indicate no shift in long-term expectations ...yet?

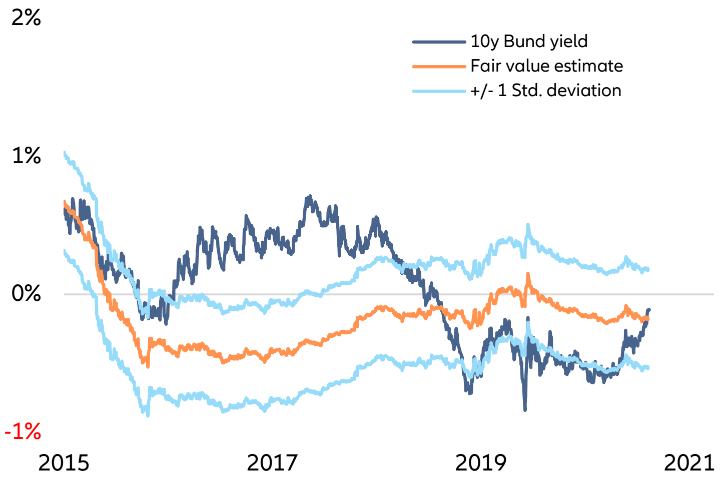


Sources: Refinitiv, Allianz Research

*after Adrian, Crump & Moench (2013), D'Amico, Kim & Wei (2018), Christensen, Lopez & Rudebusch (2010) and proprietary Allianz Research model

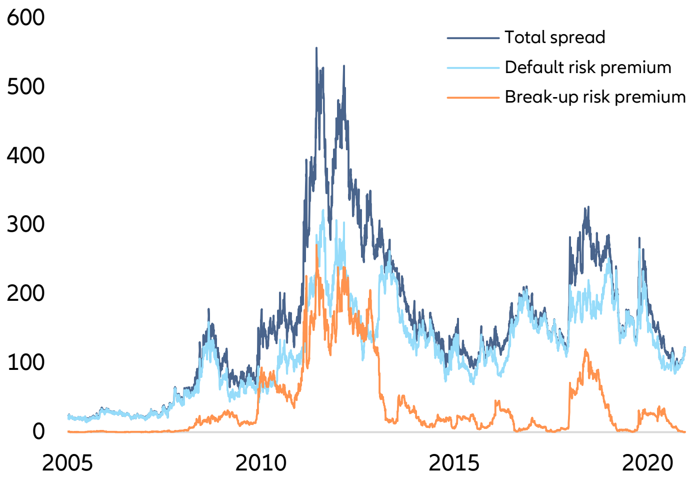
EURO SOVEREIGNS : TAPERING RUMOURS

10y Bund: Catch-up to fair value
(10y yield in %)



Sources: Refinitiv, Allianz Research

Italy: Tapering rumors weigh on spread, but risk is capped
(10y spread in bp)



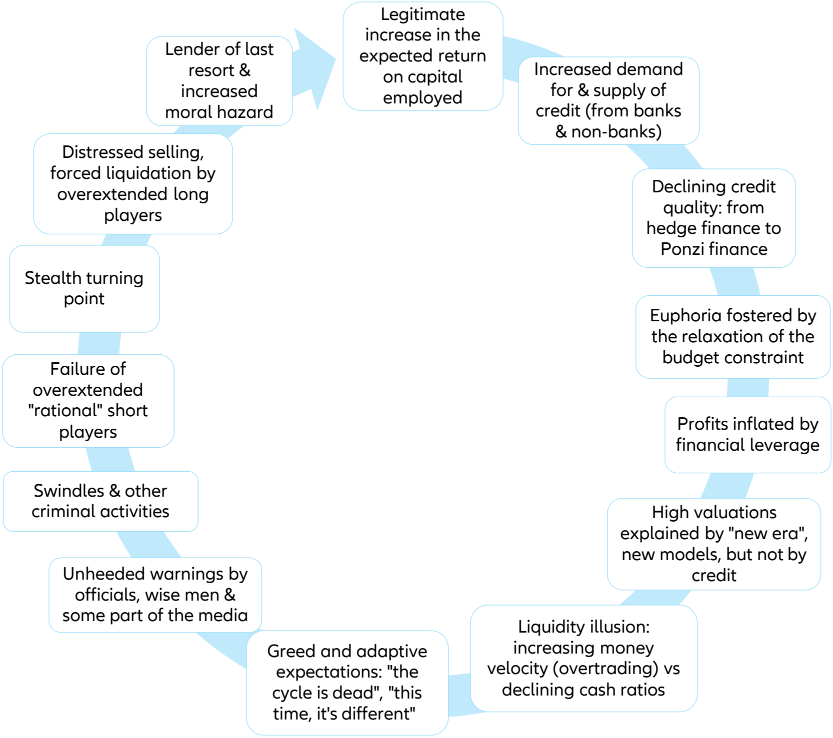
Sources: Refinitiv, Allianz Research

10y Bund has caught up to fair value due to economic momentum, spillover from US yields and strong speculative position on tapering rumors. Switch into positive territory is possible (18% probability), but we would not consider it sustainable.

Tapering rumors weigh on BTP, but "Italexit" risk has almost vanished with new European fiscal integration. Italy being firmly anchored in Euro area acts as a cap on spreads, widening as opportunity. Political risk currently low, but watch 2023 elections.

THIS TIME IS DIFFERENT: IT'S PAST MIDNIGHT

Minsky – Kindleberger Market Cycle Clock



Sources: Adapted from Charles Kindleberger's Manias, Panics and Crashes a history of financial crises, 1978, Allianz Research

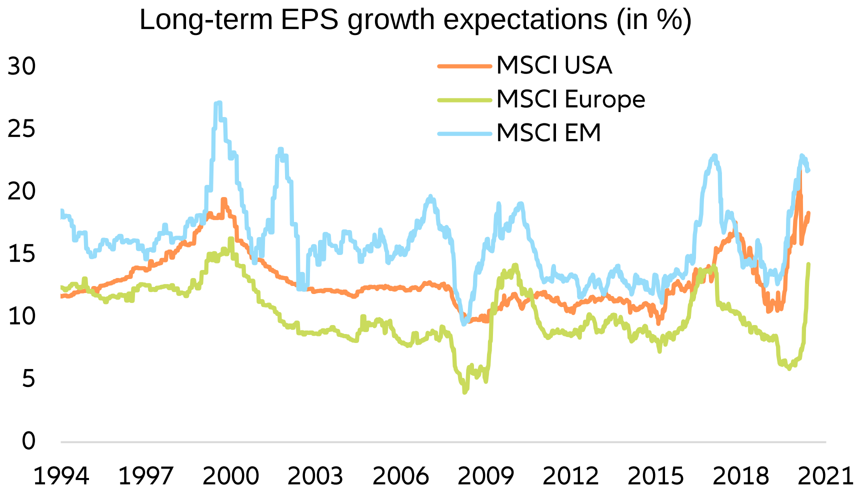
The recent post-Covid-19 market frothiness has sparked claims of a structural change in the functioning of capital markets.

However, this situation is not really new! Despite having to concede that the tools, outreach and amplification of the equity rally have structurally changed by the extensive use of social networks and other online platforms, most of the recent equity rally's characteristics are common in a "late" equity cycle stage.

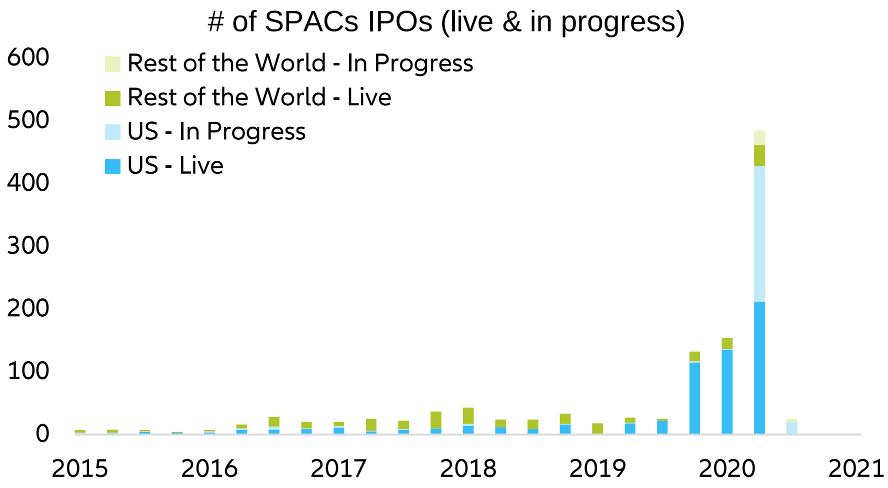
These include a reliance on leveraged investing to quickly multiply gains, signs of market manipulation/fraud starting to appear and, Fear of Missing Out (FOMO) effect leading to overtrading, some isolated market bubbles burst, etc.

Nonetheless, despite the amounting signs of a late-late capital markets cycle, the active monetary and fiscal policy intervention remains an unconditional put protection and should still sustain the current market rally for as long as the policy tailwinds remain in place. Nonetheless, and due to the market fragility, a premature exit from policy support may spook markets quickly although it is not our base case.

EQUITY MARKETS: RED FLAGS (I)



Sources: IBES, Refinitiv, Allianz Research



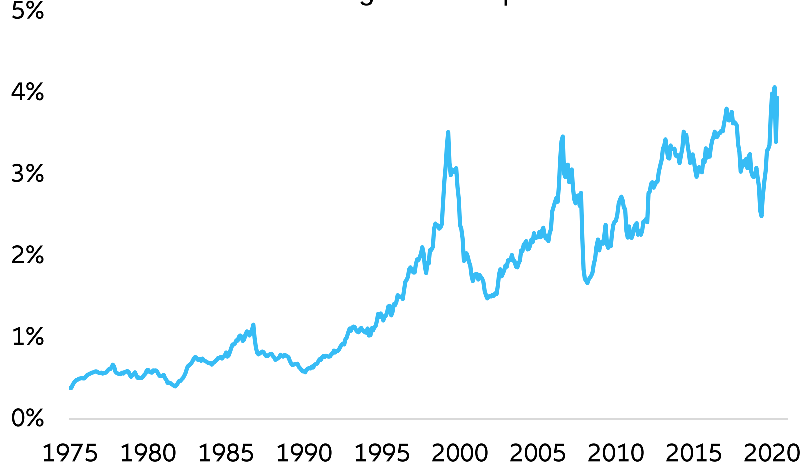
Sources: Eikon Refinitiv, Allianz Research

Looking at both fundamental valuation metrics both in realized and expectations terms, equity markets look extremely expensive. In this context, both the US and EMs are on the extreme frothy side (even considering the latest US revision), with market consensus aiming for earnings long-term growth rates last seen in 2000 for the US and close to all-time highs for EMs. Despite lagging, the Eurozone has now joined its peers with earnings expectations substantially rising.

Some overtraded equity buckets (e.g., SPAC IPOs) have already burst. This comes after a substantial acceleration in both volumes and prices of this “new” financial instrument, which has led to a substantial market correction once the embedded market frothiness has slowly disappeared. As of today, more than 60% of the SPAC mergers that have been announced since the start of the year are now trading below the IPO price of their SPAC.

EQUITY MARKETS: RED FLAGS (II)

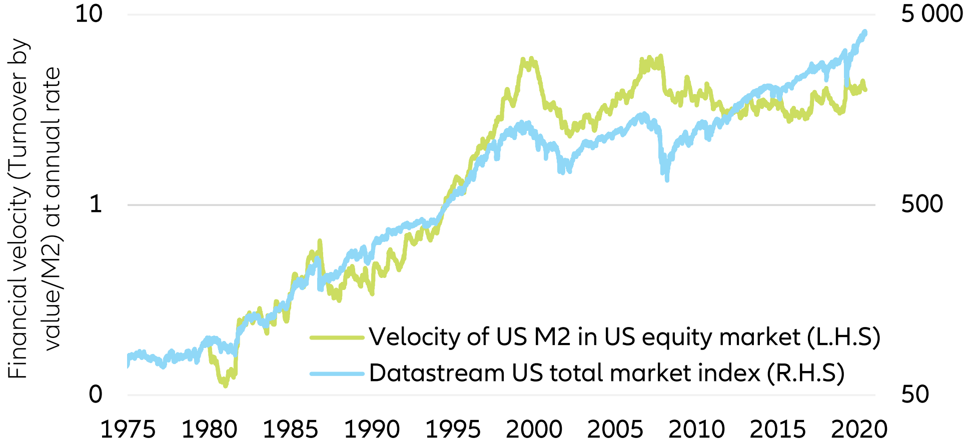
Ratio of US margin debt to personal income



Sources: Refinitiv, Allianz Research

Another signal of the recent market frothiness and overtrading can be found in the increasing amount of margin debt and deposits in US clearing houses, triggered by the rapid increase in options trading volumes since March 2020. At this point, things start to take a systemic flavor and although we maintain that, at current levels, there is enough public and private liquidity in the market to absorb the increased trading volumes, it is an overtrading red flag.

Financial velocity of money



Sources: Refinitiv, Allianz Research

Another clear red flag that combines overtrading with increased moral hazard is the rapid increase in money velocity within financial markets. This increase is relevant as it shows that the recent equity rally has, partly, occurred thanks to the market's unconditional trust in the central banks' unconditional put protection, which has led to a rapid increase in financial money velocity. This red flag is particularly important as it is not the quantity of money but its circulation that causes asset prices to rise or fall and historical experience shows us that central banks do not control the velocity of money, especially in capital markets.

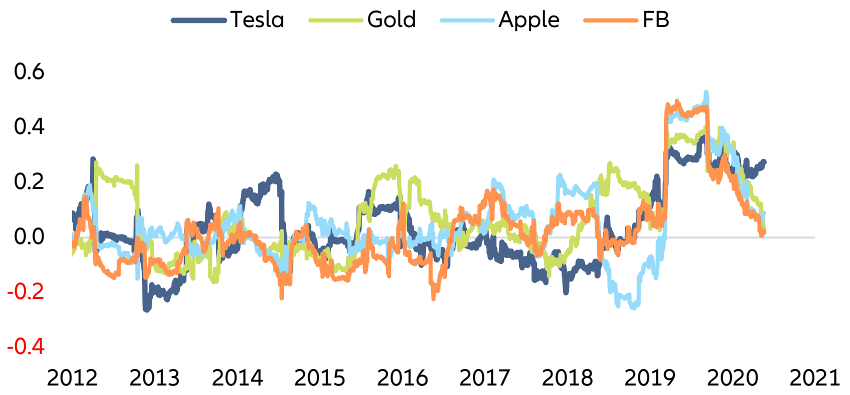
CRYPTOCURRENCIES: A RED FLAG?

Cryptocurrencies market capitalization

Sources: coinmarketcap.com, Allianz Research.

In early Q1 2021, the aggregated market cap of cryptocurrencies sky-rocketed above USD2trn just to lose more than USD500bn in a matter of days. It must be conceded that cryptocurrencies are no strangers to such sharp movements but the natural question that arises is where did this money go? Although the answer in this “new” investment is not straightforward, it confirms the recent market exuberance, overtrading and irrationality.

Bitcoin correlations with certain stocks (and Gold)

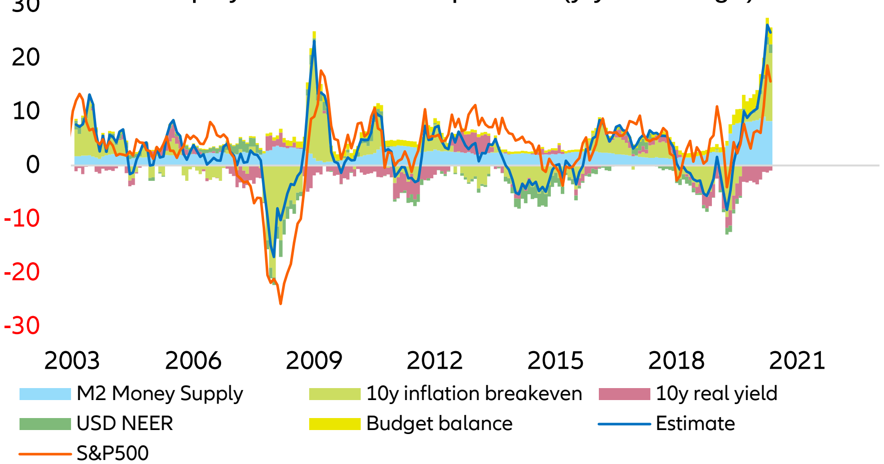


Sources: Refinitiv, Allianz Research. Correlations are computed using a 6M rolling correlation on daily changes

Volatility has been structural feature of cryptocurrencies since their initial launch. For some time, they were said to be a reserve asset like gold. However, the price correction that occurred while inflation uncertainty was climbing does not support this theory. On the other hand, since 2019, there has been a structurally sustained correlation between Bitcoin and meme stocks (e.g. Tesla, GME, AMC, etc).

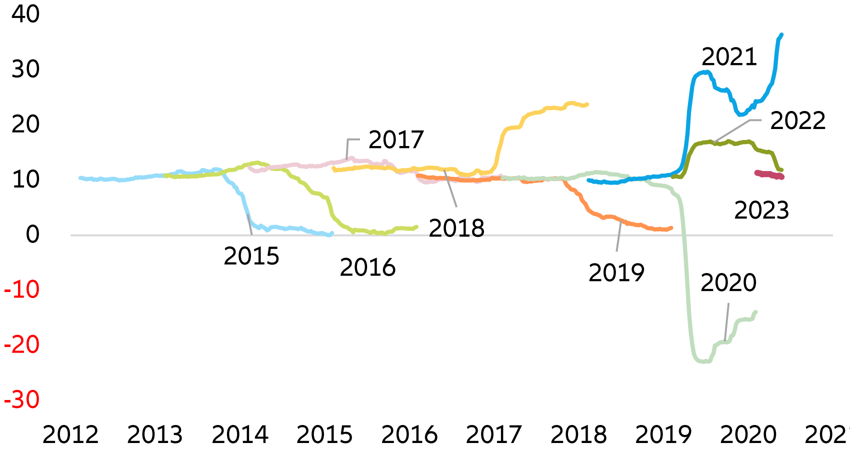
US EQUITY: CONTINUOUS POLICY DEPENDENCE

US equity markets decomposition (y/y % change)



Sources: Refinitiv, Allianz Research

S&P500 EPS growth expectations (in %)



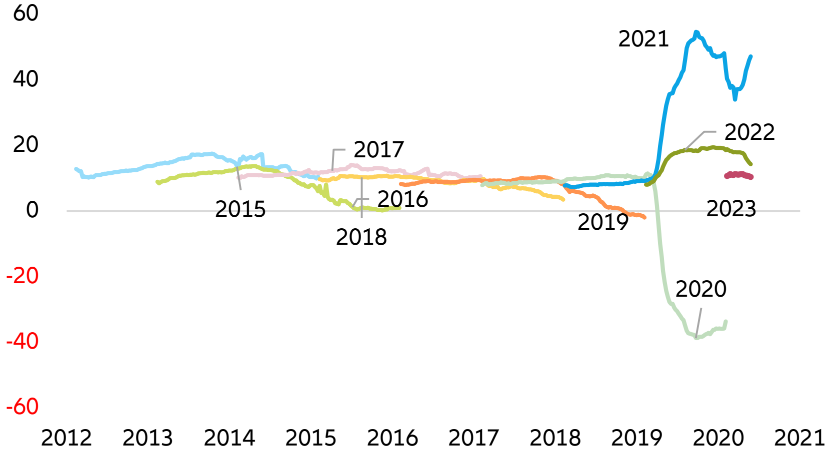
Sources: Refinitiv, Allianz Research

But not everything is lost! In this fragile market context, our equity decomposition model shows that both monetary and fiscal policy are currently acting as a backstop against a market correction, and we do not have any reason to believe that this will change in 2021. Because of the recursive active intervention of this two exogenous forces, we believe US equity markets will post high single digit returns (~7 to 8%) in 2021, allowing for some sector rotation and consolidation towards defensive/quality stocks.

Despite the great 2021 and due to the frontloading of earnings growth from 2022 into 2021, we expect 2022 to be the consolidation year in which equity markets slowly but sturdily start reconverging towards fundamentals, posting returns close to their long-term averages (~5 to 6%). In this regard, we do not expect 2022 to be free of volatility as the current market dependence on exogenous tailwinds should start fading away, with companies underlying growth engines having to take over.

EMU & EM EQUITY: NOT AS STRECHED AS US EQ

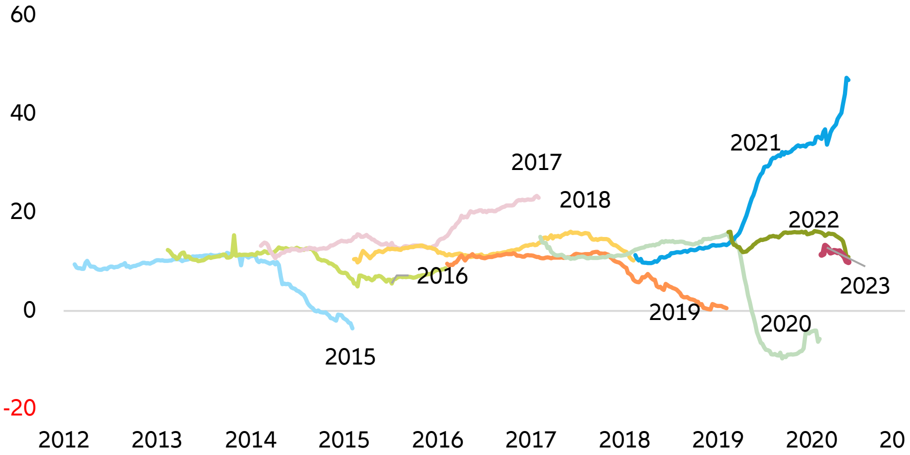
MSCI EMU EPS growth expectations (in %)



Sources: IBES, Refinitiv, Allianz Research

A lot of commonalities can be found in equity markets across the globe. Our decomposition for EMU equities also shows (although to a lesser extent) a high dependence to both monetary and fiscal policy and the frontloading of EPS growth into 2021. Nonetheless, fundamental valuations and sector entropy revels that the EMU is not that overstretched and there is still some pockets of value within the universe. Because of that we envisage a close to ~10% equity performance in 2021 and 5 to 6% in 2022.

MSCI EM EPS growth expectations (in %)

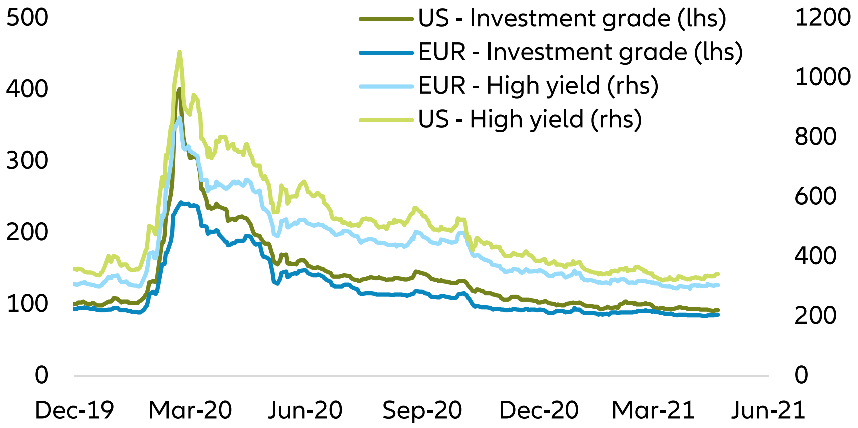


Sources: IBES, Refinitiv, Allianz Research

As unusual as it may sound, EM equities are currently depicting the middle ground. This is specially the case since EM equity markets are quite overstretched in terms of fundamental valuations: not as acute as in the US but higher than in the EMU. Additionally, the direct effect between policy and equity markets is not straightforward in EM markets as the effect that foreign capital has on performance is quite abrupt. Because of this we believe EM equities will post decent middle ground returns (~8 to 9%) in 2021 while consolidating around 7% in 2022.

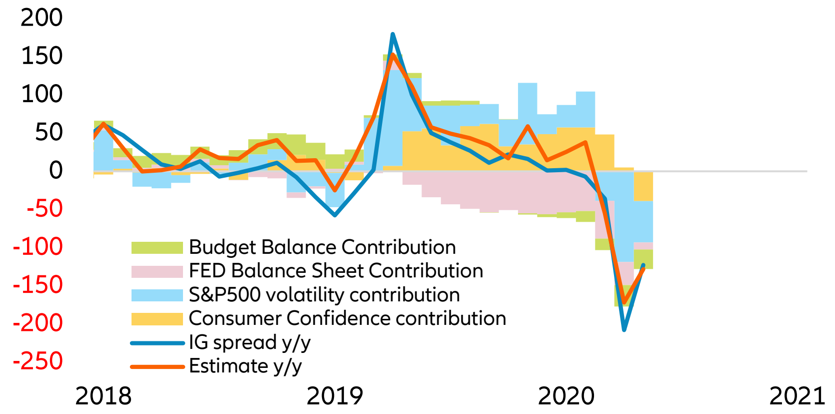
CORPORATE CREDIT: A FRAGILE EQUILIBRIUM

IG & HY corporate spreads (in bps)



Sources: BofA, Refinitiv, Allianz Research

US yoy change in IG corporate spreads decomposition (in bps)



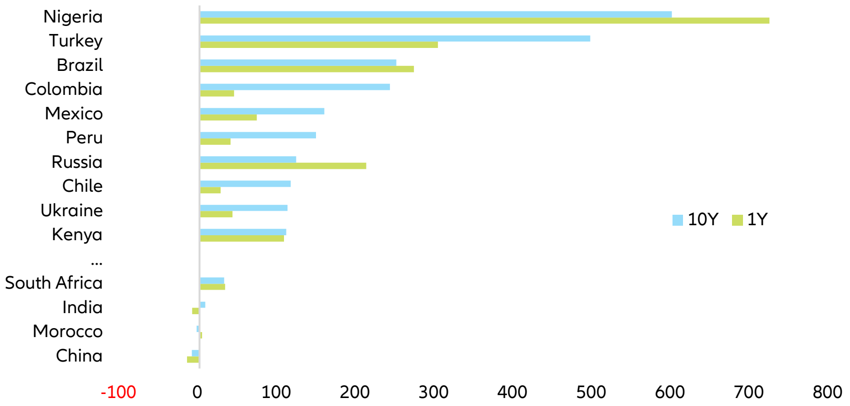
Sources: BofA, Refinitiv, Allianz Research, computed using 5y rolling coefficients

Normally, equities and credit spreads are two sides of the same coin. Nonetheless, this structural relationship seems to have broken as credit markets have set an effective floor around 90bps and ~330bps for IG and HY respectively. This diverges from the equity story as the recent equity rally should have led to tighter spreads rather than unchanged. But why is this the case? We believe credit markets are more cautious than equity markets and hesitate to bring spreads to historical lows, signaling that the probability of experiencing wider spreads outpaces that of tighter spreads.

Additionally, our decomposition of credit spreads clearly shows that central banks have managed to keep an anchor on them. Nonetheless, and under the assumption that economies will, at some point, start stabilizing rather than continuously accelerating, we expect spreads to timidly widen due to extreme tight valuations and delayed insolvencies/defaults. The same logic applies to EUR credit, which currently depicts a similar pattern. All in all, we expect IG spreads to range trade in 2021 around 100bps but to start a timid widening trend in 2022 at a 20 to 30bps pace.

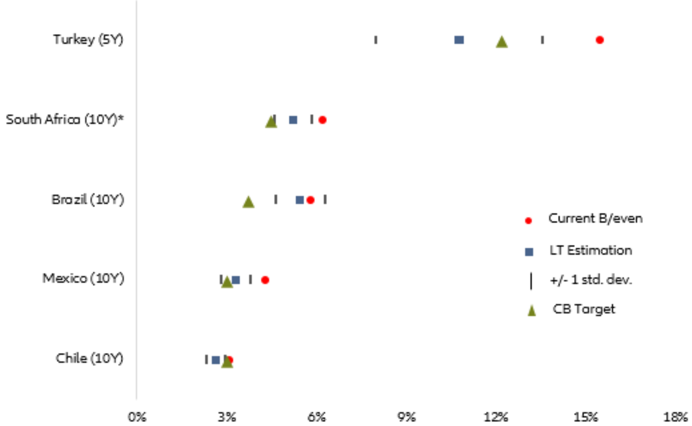
EM: TAPER TANTRUM & INFLATIONARY PRESSURES

Increase in Sovereign Bond Yields (LC) in 2021



Sources: Refinitiv, BofA, Allianz Research

EM Breakeven Inflation Estimations

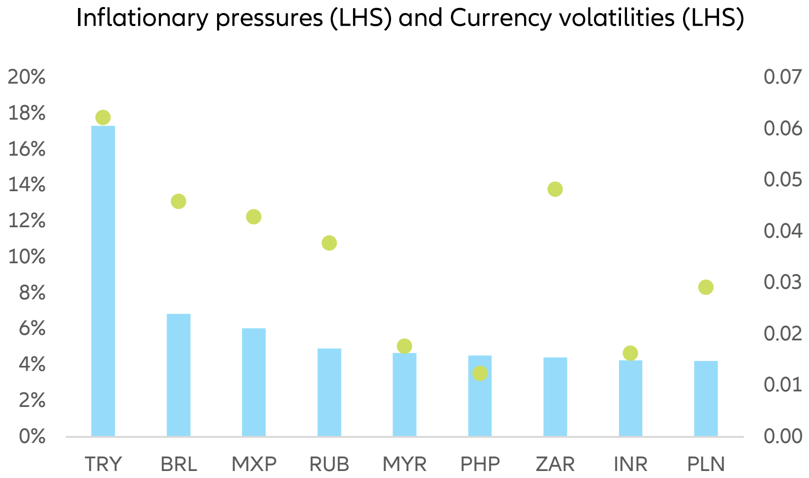


Sources: Refinitiv, BofA, Allianz Research; Inflation Target for the Central Bank of Turkey has been revised to 12.2% to adjust to reality, the aim is conversion to 5% in 2023.

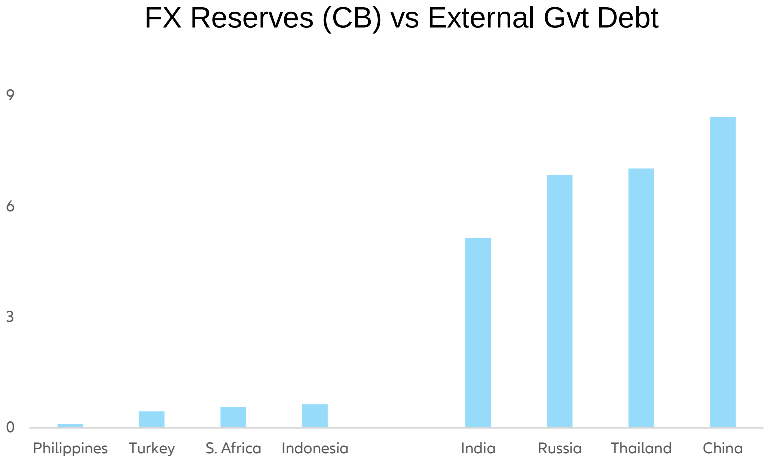
Movements in the US markets have repercussions elsewhere, and especially in the Emerging Markets, where a mix of a taper tantrum, inflationary pressures and political tensions (the latter two used to go hand-in-hand) endanger the relative calm after QE and successive measures were implemented to deal with the Covid-19 shock.

Inflationary pressures are not new in Emerging Markets, but tackling them at the expense of harming the Covid-19 recovery could become a problem. One of the indicators to look at are the inflation breakeven rates build from Inflation Linkers, which currently are above the CB Targets (and also above the our estimations for the long-term). The pressures on central banks have two different directions: inflation and the need to support the economy.

EM: REPERCUSSIONS ON CURRENCIES



Source: Refinitiv, Allianz Research. Pressures measured with April'21 YoY CPI change

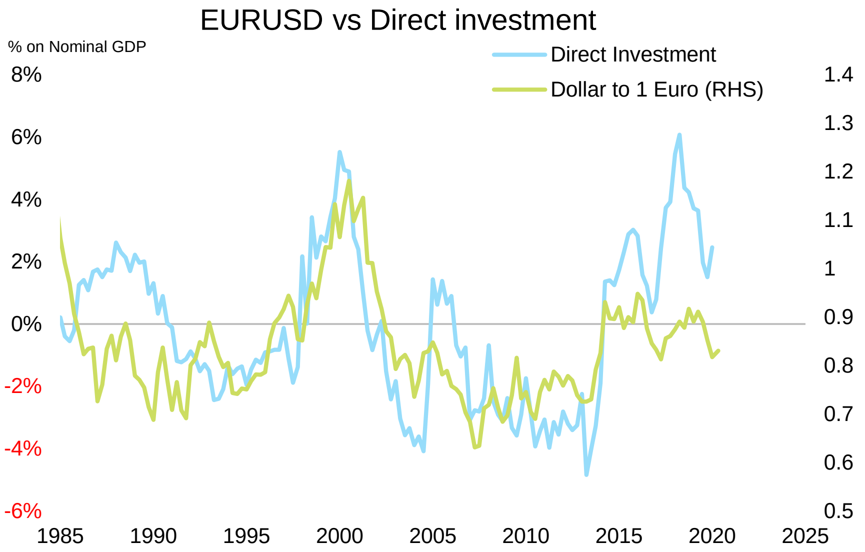


Sources: Refinitiv, Allianz Research.

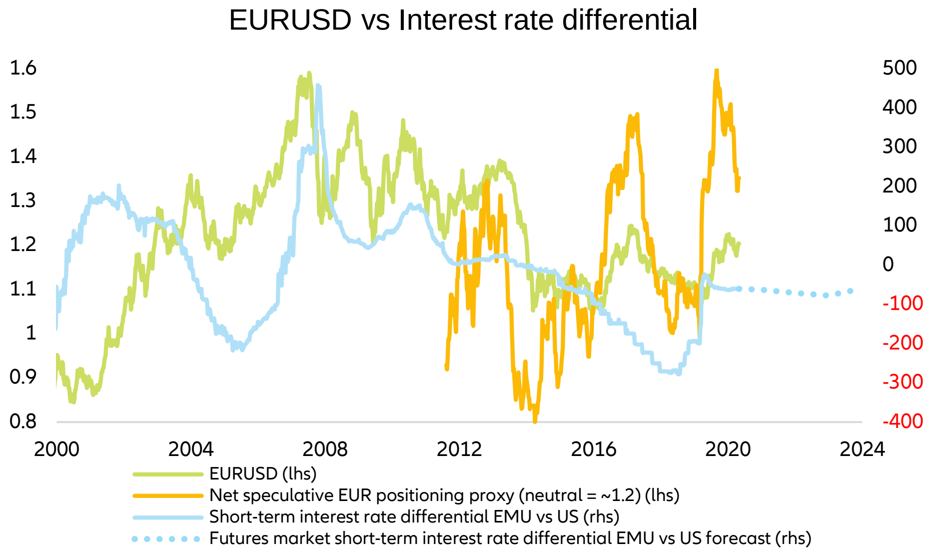
But inflation does not come alone. Some currencies, which already experienced a tough 2020, could suffer as a result of it, even before taking into account the likelihood of a policy mistake with the current environment.

Would a severe depreciation endanger debt repayments? On the other hand, will some countries induce the FX hoardings to avoid appreciations? Both answers seem to be affirmative, although the latter is clearer. As an example, we have the recent increase in the required FX reserves ratio on deposits in China.

EURUSD: WILL THE TREND HOLD?



Sources: Refinitiv, Allianz Research



Sources: CFTC, Refinitiv, Allianz Research

The uncertainty around the US economic recovery in Q2 and Q3 2020 consolidated the divestment pattern, in terms of direct investment, that started in early 2019, reflecting in a sharp USD depreciation. As of 2021, this depreciation pattern has now reversed, with the USD appreciating vs the EUR on the back of faster-than-expected US economic growth. But is this appreciation trend here to stay?

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

APPENDIX 3 – MEDIUM-TERM TRENDS

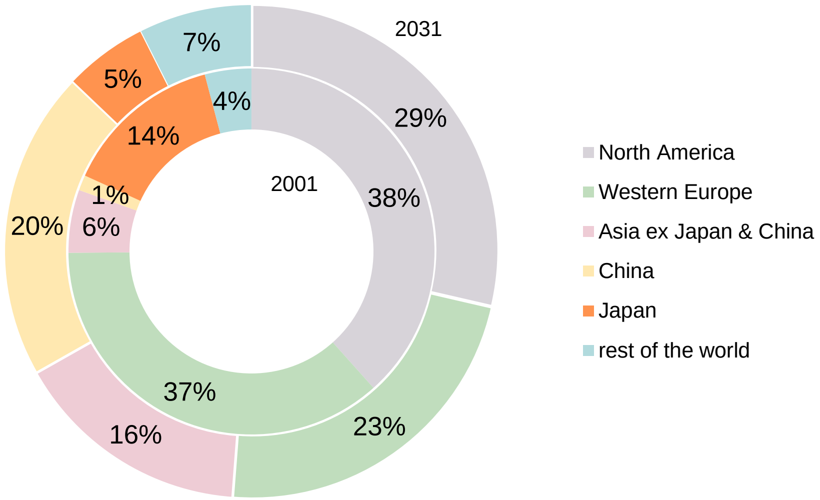
GLOBAL RIVALRY: CHINA'S RISE CREATES TENSIONS

World economic center of gravity

Blue dots: 1998 to 2019. Orange dots: 2020, 2025 and 2030 on current forecasts. Green dots: 2020, 2025 and 2030 on Q4 2019 forecasts. Grey dots: geographic center of gravity of the U.S., Germany, India, China and Japan.

Allianz Research

Total gross written premium*, by region in %

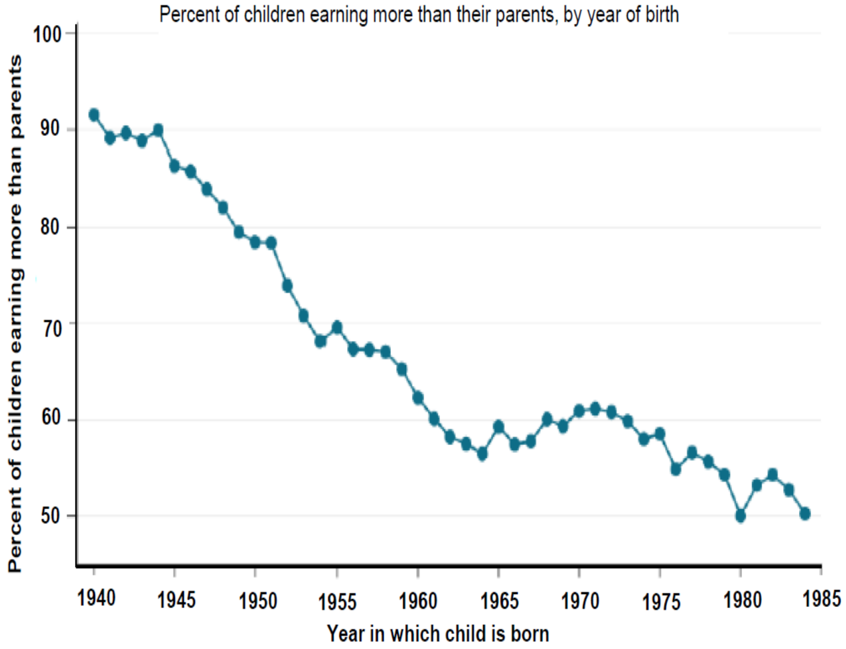


*W/o health; the conversion into EUR is based on 2020 exchange rates.

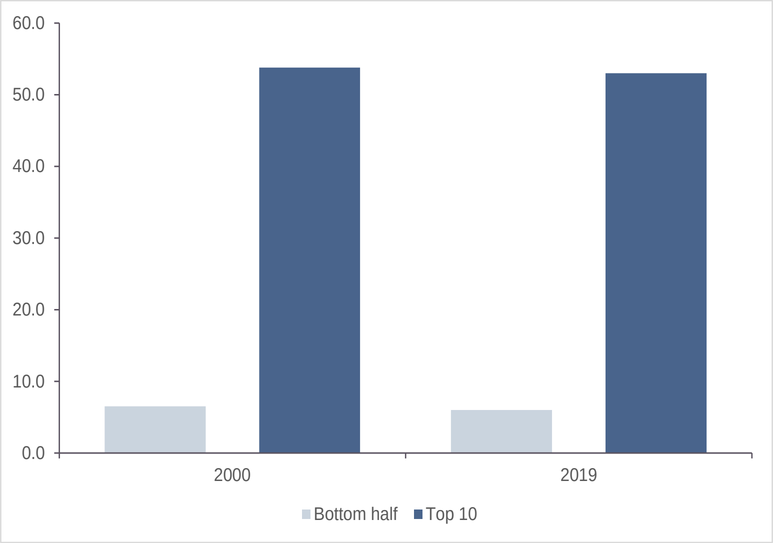
Source: Allianz Research.

SOCIAL INEQUALITY: NO BETTER TOMORROW

The end of the Amercian dream



Share of bottom half and top 10 of population in net financial assets*

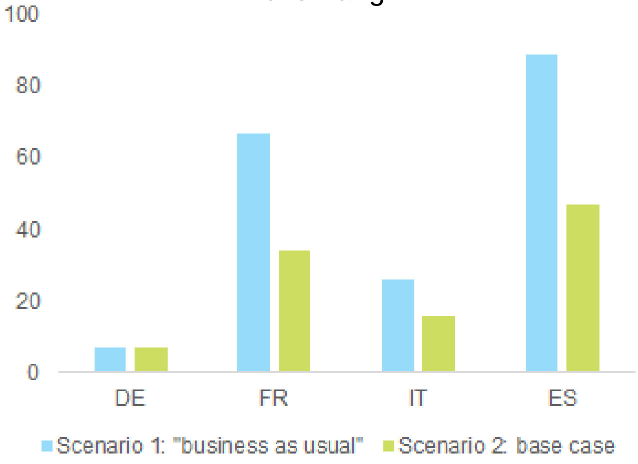


*Unweighted average of 53 countries.

Source: Allianz Research.

PUBLIC DEBT: LOW RATES WILL NOT BE ENOUGH TO ENSURE DEBT SUSTAINABILITY

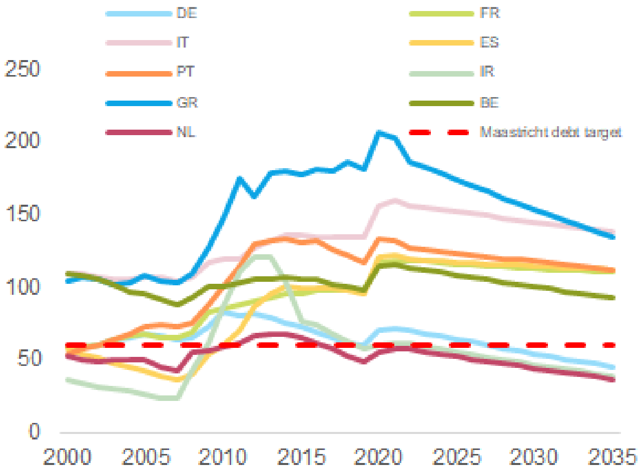
Number of years need to eliminate the Covid-19 debt overhang



Sources: Refinitiv, Allianz Research.

A return to fiscal “business as usual” with regards to nominal GDP growth & primary balance in line with the average of the past 20 years will not allow a swift reduction in public debt ratios.

Public debt (% GDP)

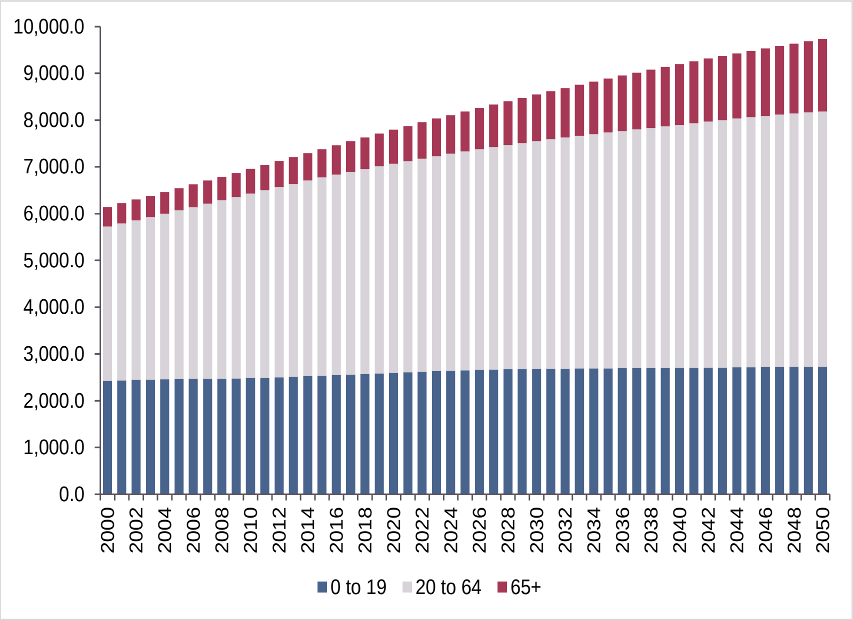


Sources: Refinitiv, Allianz Research.

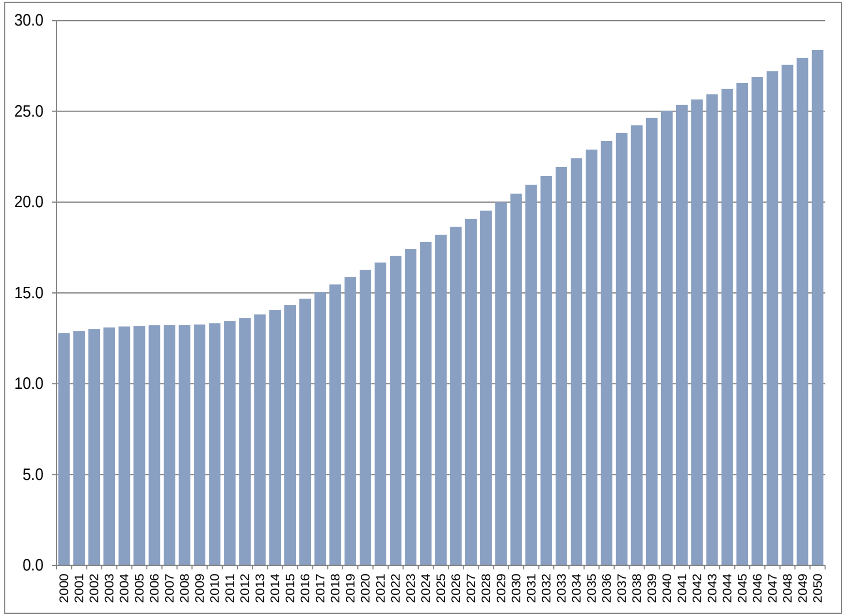
In our baseline scenario, we still see EZ heavyweights France, Italy and Spain boasting debt ratios close to or notably above 100% of GDP in 2035. In contrast, Germany, Ireland and the Netherlands would cement their position as low-debt countries by pushing debt notably below the 60% Maastricht target by 2035.

DEMOGRAPHY: GROWING OLD

World population by age groups, millions



Global old age dependency ratio in %*

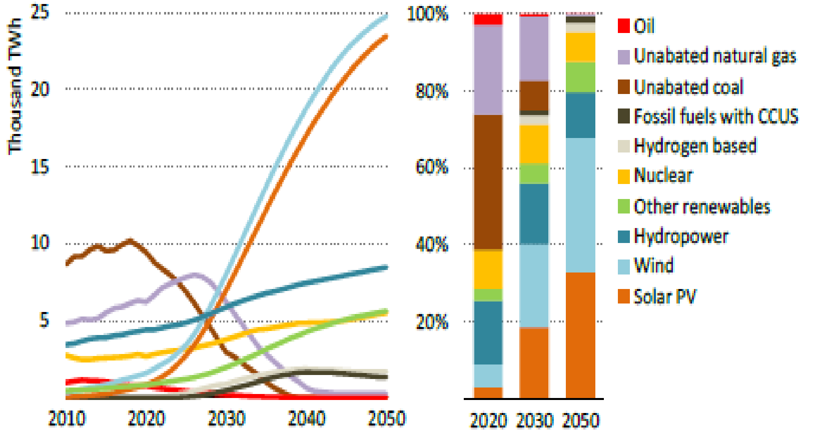


*Share of 65+ in percentage of working population (20-64).

Source: United Nations, Allianz Research.

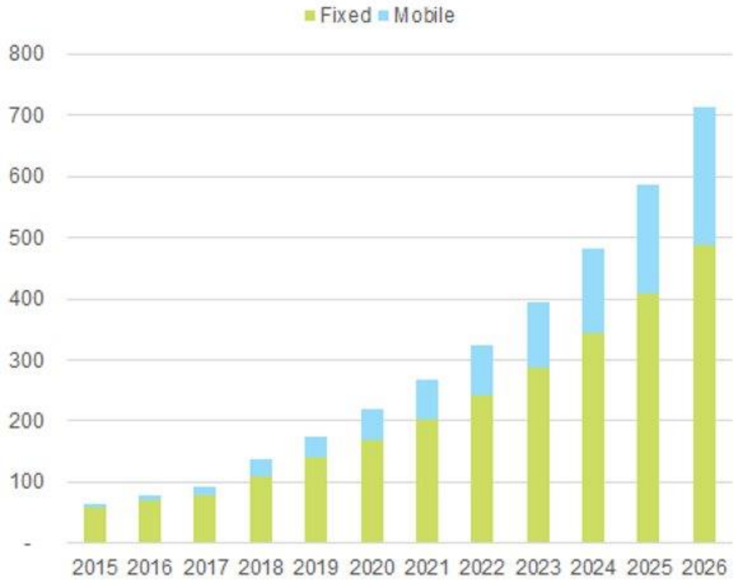
TECHNOLOGY: THE GREAT TRANSFORMATION I

Global electricity generation by source in the Net-Zero-Economy



Solar and wind power race ahead, raising the share of renewables in total generation from 29% in 2020 to nearly 90% in 2050, complemented by nuclear, hydrogen and CCUS

Global data traffic

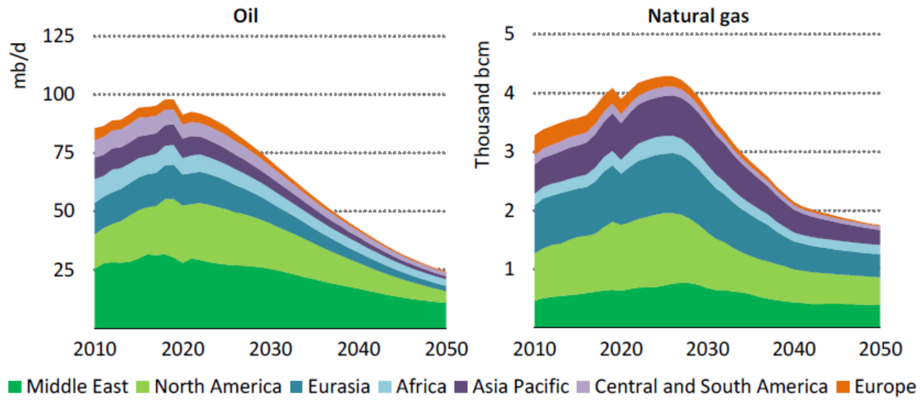


Source: IEA, McKinsey Global Institute.

TECHNOLOGY: THE GREAT TRANSFORMATION II

Fossil assets will get stranded as fossil prices fall and become insufficient to recover OPEX. OPEC will increase its market oil share from 34% to 52% due to low extraction costs

Figure 3.3 ▷ Oil and natural gas production in the NZE



No new oil and natural gas fields are required beyond those already approved for development. Supply is increasingly concentrated in a few major producing countries

Fossil prices will fall in the Net Zero Emissions scenario (NZE)

Table 2.1 ▷ Fossil fuel prices in the NZE

Real terms (USD 2019)	2010	2020	2030	2040	2050
IEA crude oil (USD/barrel)	91	37	35	28	24
Natural gas (USD/MBtu)					
United States	5.1	2.1	1.9	2.0	2.0
European Union	8.7	2.0	3.8	3.8	3.5
China	7.8	5.7	5.2	4.8	4.6
Japan	12.9	5.7	4.4	4.2	4.1
Steam coal (USD/tonne)					
United States	60	45	24	24	22
European Union	108	56	51	48	43
Japan	125	75	57	53	49
Coastal China	135	81	60	54	50

Notes: MBtu = million British thermal units. The IEA crude oil prices are a weighted average import price among IEA member countries. Natural gas prices are weighted averages expressed on a gross calorific-value basis. US natural gas prices reflect the wholesale price prevailing on the domestic market. The European Union and China gas prices reflect a balance of pipeline and liquefied natural gas (LNG) imports, while Japan gas prices solely reflect LNG imports. LNG prices used are those at the customs border, prior to regasification. Steam coal prices are weighted averages adjusted to 6 000 kilocalories per kilogramme. US steam coal prices reflect mine-mouth price plus transport and handling cost. Coastal China steam coal price reflects a balance of imports and domestic sales, while the European Union and Japanese steam coal prices are solely for imports.

Source: IEA

AFTER COVID-19: A CHANGED RISK LANDSCAPE

Dramatic acceleration of secular trends leads to changes in awareness and behavior of economic actors

State	Companies	Households
Return of the **strong state** actively shaping the economy and society according to its ideas and concepts	Today's companies are **“purpose-driven”** contributing to societal well-being by providing solutions to the societal problems facing their customers	**Digital mindset**: Customer expect innovative, fast, simple, and personalized offerings **Resilient mindset**: Customer aspire healthy, mental, and financial well-being

Consequences for insurers: from a pure product logic to a more service-oriented business model

More intrusive, conduct-oriented regulation (**value for money**) and more **Private-Public-Partnerships** to address systemic risks	Risk solutions to protect the value of the company (brand & reputation) require **joint and holistic strategies** for managing and preventing risks e.g. with regard to the **pivot to sustainability** or **data integrity**	Redefining **customer engagement** to create new products and services with customer-centric data ("value co-creation") by building **ecosystems** e.g. health journeys or mobility services

THREE MAJOR CHALLENGES THE FINANCIAL SERVICES SECTOR IS FACED WITH

1. **The Faustian Pact: The Covid19 crisis unprecedented policy mix response**
   - Unintended consequences on financial markets, wealth inequalities, indebtedness which will call for action
   - Tailwind for financial services institutions such as banks and asset managers
   - Beware, however, of regulatory backlash, command economy, and artificial growth drivers
   - Challenges for an FS sector deeply reshuffled and vulnerable: unplugging support and normalizing

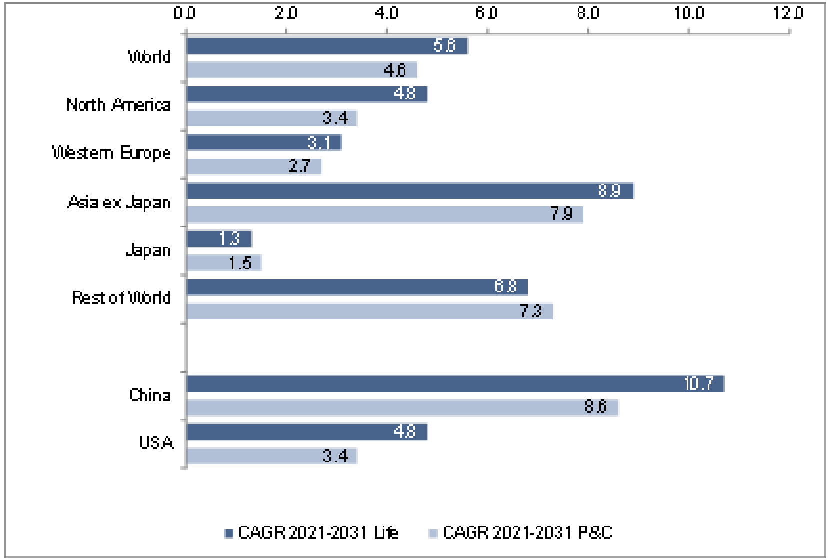
2. **Home bias reloaded: In the aftermath of any crisis, home bias becomes an issue for the financial sector**
   - Difficult time for globalized financial services, looking for scale, aiming at seamless service
   - Protectionist backdrop against which this crisis (Brexit, US-China rivalry e.g.) unfolded
   - Multi-speed recovery (high pressure economics in the US v. low pressure economics in Europe)
   - Subdued M&A and consolidation and an essential need to create value and proximity remain

3. **Impact is the name of the game: Stakeholder capitalism is on everybody's mind**
   - Impact finance, investment and insurance = the next big balance sheet transformation
   - Net-zero economy, the fight for equity, stronger governance will only come through the financial sector
   - Great reputational risk to miss our date with history as trust will not be immune to our inaction

 9-Jun-21

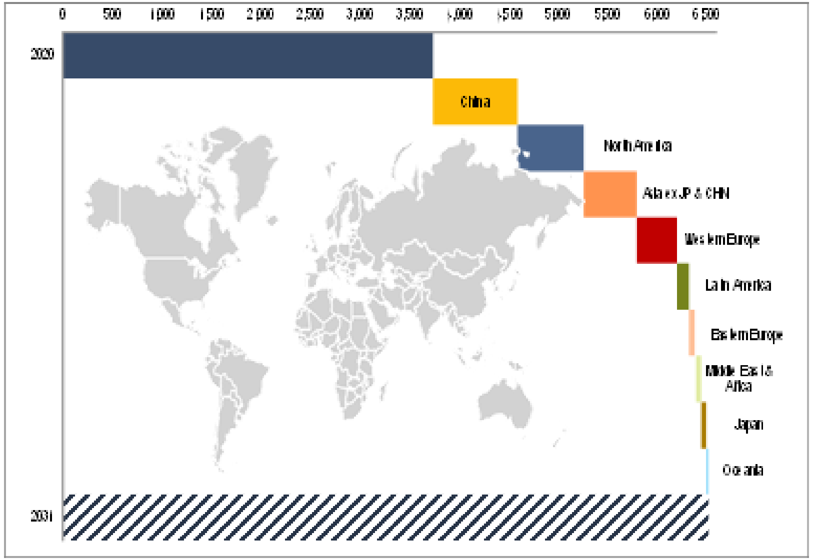
INSURANCE OUTLOOK: GOLDEN 2020S (IN SHANGHAI)

Gross Written Premium* growth, CAGR 2021 -2031 by region in %



*W/o health; the conversion into EUR is based on 2020 exchange rates.

Gross Written Premium* growth, by region in EUR



*W/o health; the conversion into EUR is based on 2020 exchange rates.

Source: Allianz Research.

THANK YOU

Allianz Research Team

9 June 2021

EULER HERMES

Allianz