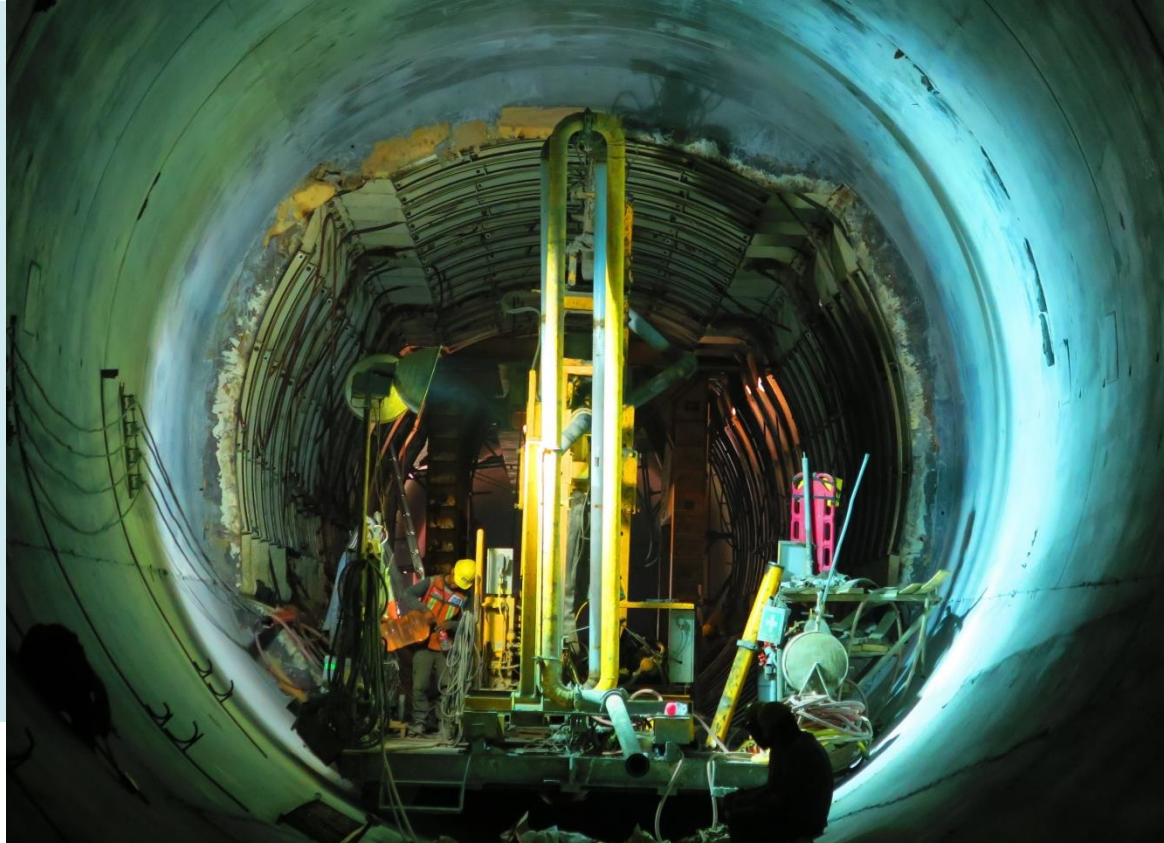


CLOSING THE LOOP IN 2019

Economic Research Department
Global Economic Outlook
Q4 2018



GLOBAL GROWTH: WEATHERING RISKS



Real GDP growth, %

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

* Weights in global GDP at market price, 2017

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

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

- 1. Self-correcting mechanisms:** US fiscal and monetary fuses to preserve the economic circuit from systemic unsustainability
- 2. Fine-tuning policy tools:** Fueling demand in the short-term and repairing supply in the medium-term will be the leitmotiv of China and Europe
- 3. Technical inspection:** The market will continue to differentiate defective emerging economies from sound ones

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

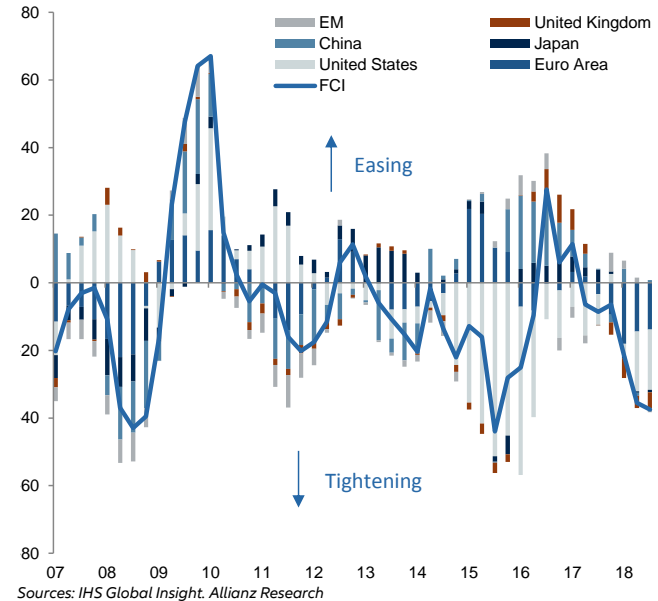
Inflation and interest rates: The peak of inflation is behind us in advanced economies but there are rising price pressures in the emerging markets post currency depreciation. We expect US 10Y interest rate to be at 3.0% at the end of 2019 and 2.8% at the end of 2020

GLOBAL RISKS: MULTIPLE PERTURBATIONS IN 2019-20



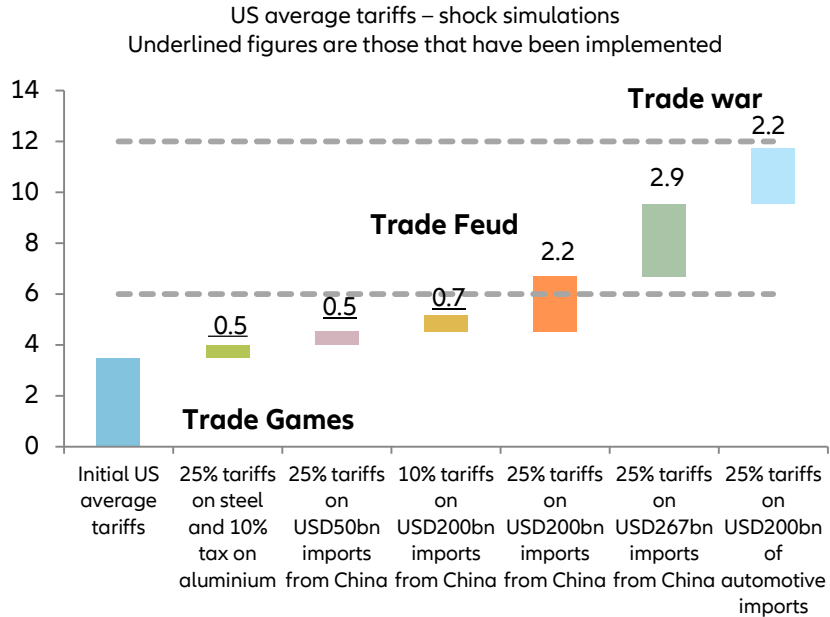
The political and economic risk landscape remains crowded with potential recession triggers. Uncertainty is unlikely to escalate further, but expect it to linger. Visible impact could still increase as the negative effect kicks in with a lag

World monetary and financial conditions (level)



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

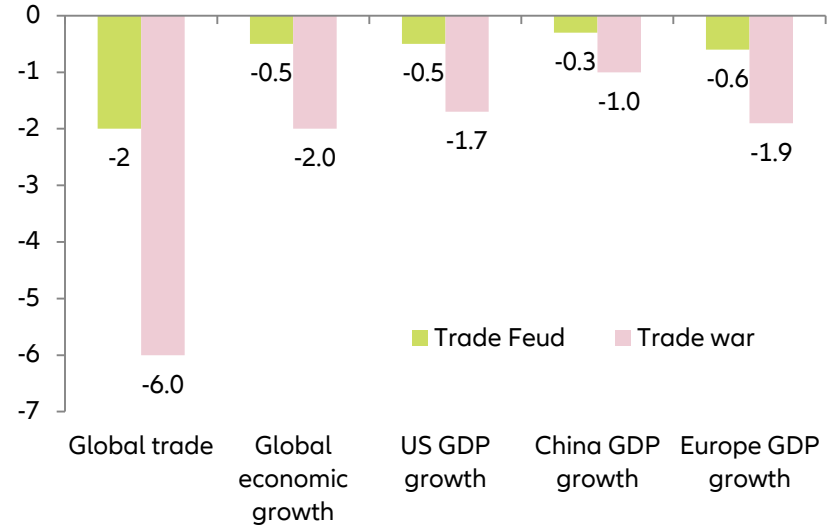
PROTECTIONISM: UNSTABLE EQUILIBRIUM



Sources: IHS Global Insight, Allianz Research

US average tariff rose to 5.2% in 2017, it could cross the 6% trade feud threshold in 2018 if the US implements 25% tariffs on USD200bn imports from China

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

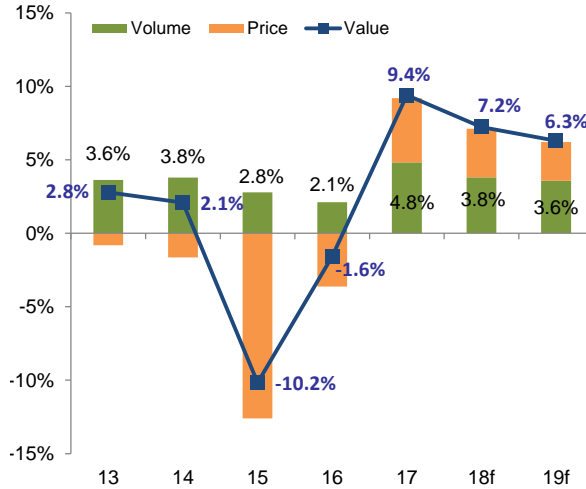


Sources: IHS Global Insight, Allianz Research

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

GLOBAL TRADE: LOOKING FOR A NEW EQUILIBRIUM

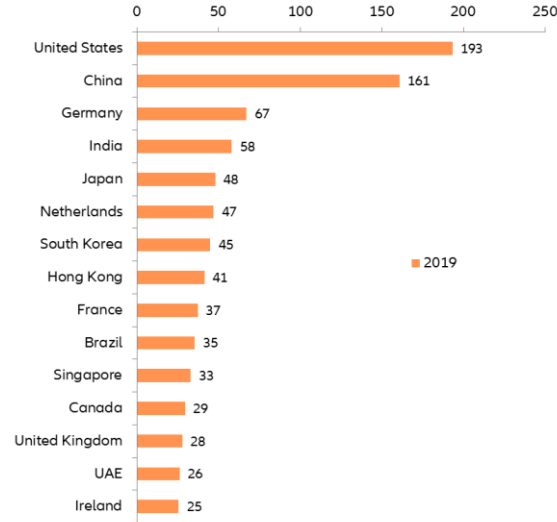
Global trade in goods and services



Sources: IHS, Datastream, Allianz Research

Global trade growth to slow in line with global demand

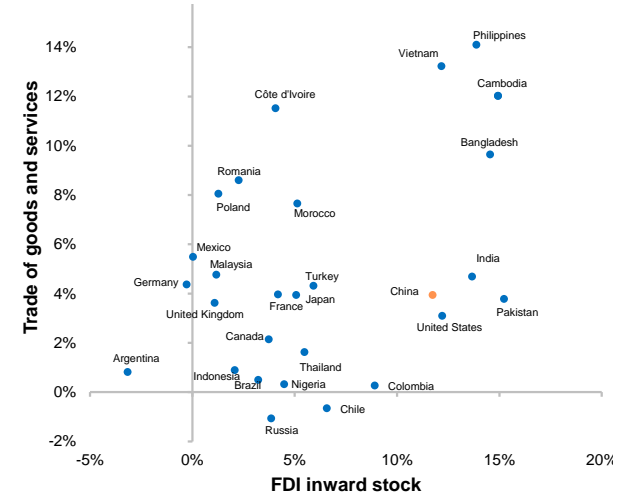
Additional import needs by country in 2019 (Goods & Services, in USD bn)



Source: Euler Hermes

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

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



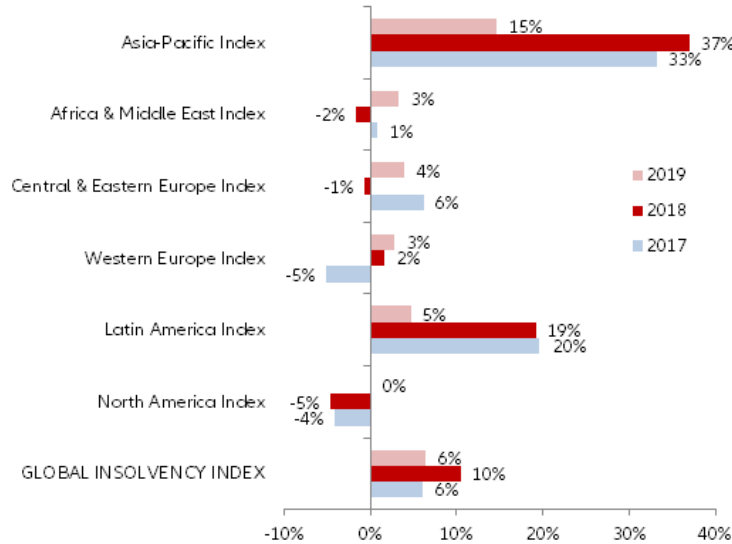
Source: Euler Hermes

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

GLOBAL INSOLVENCIES: ON THE UPSIDE

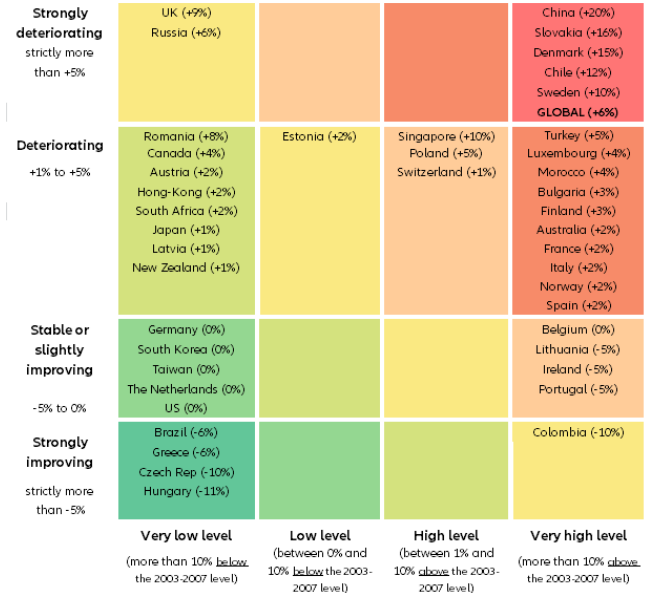


EH Global and Regional Insolvency Indices (yearly changes in %)



Sources: National statistics, Euler Hermes, Allianz Research

Insolvency Heat Map 2019



Sources: IHS Global Insight, Allianz Research

We expect our Global Insolvency Index to keep on increasing in 2019 (+6% after +10% in 2018). 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

**FISCAL AND MONETARY FUSES
TO PRESERVE THE US FROM
DEBT UNSUSTAINABILITY**

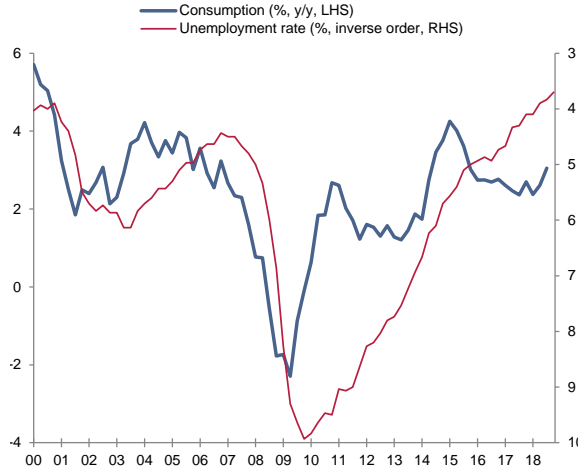
01



US ECONOMY: GROWTH ENGINE IS ROARING BUT...

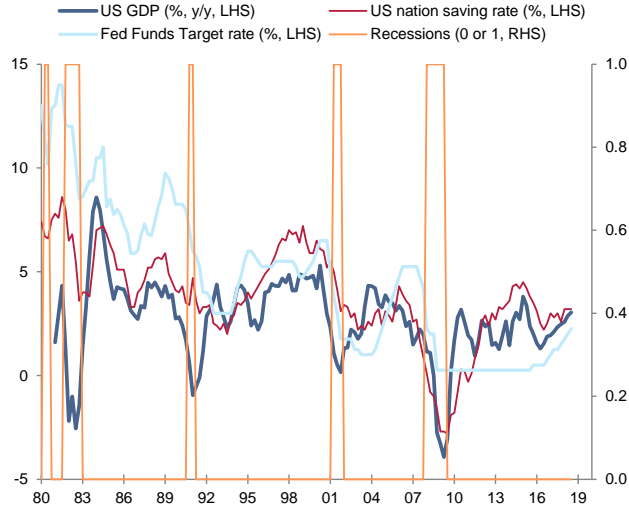


US labor markets and household consumption



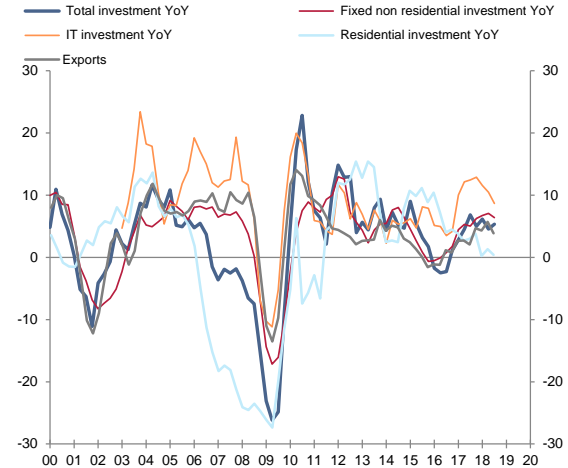
Sources: IHS Global Insight. Allianz Research

US economic circuit signals end of the cycle



Sources: IHS Global Insight. Allianz Research

US investment and exports (% y/y)



Sources: IHS Global Insight. Allianz Research

Solid employment growth provides a strong boost to household confidence and stronger consumption

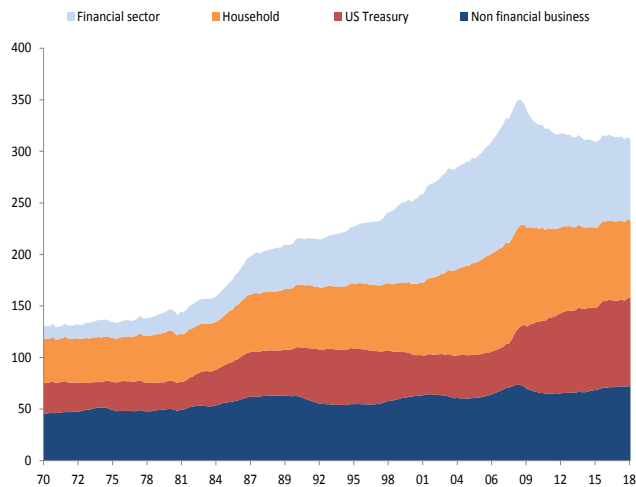
The fed funds rate looks set to rise above the US nation's saving rate from Q4 2019 onwards. In these territories, the probability of a recession becomes non negligible

Investment is showing signs of weakening amid higher interest rates, less supportive external conditions and deteriorating corporate credit quality

US DEBT: LOCALIZING THE MALFUNCTIONS



Debt of US economic sectors (as % of GDP)

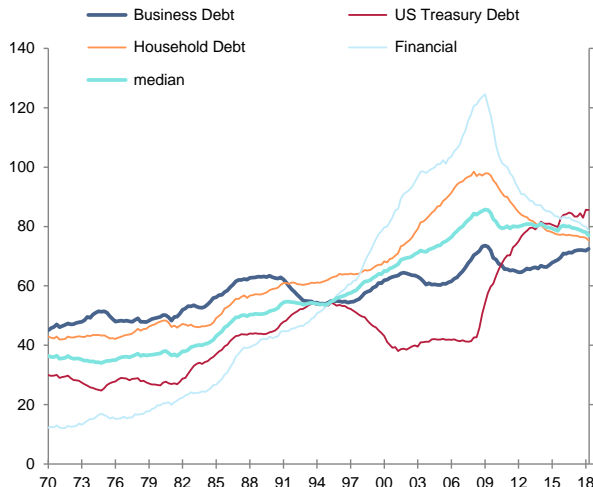


Sources: IHS Global Insight. Allianz Research

Looking at total US debt aggregated across all sectors, the deleveraging mode is still on, suggesting that the systemic risk is not implicated for now

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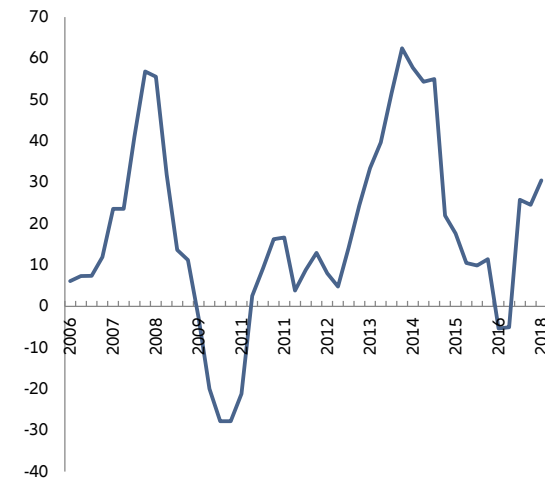
US non financial debt (% of GDP)



Sources: IHS Global Insight. Allianz Research

Deviations from the long-term growth trend of debt is traditionally a good indicator for the nature of an upcoming crisis. Today, public debt and corporate debt are at risk

US net issuance of risky business debt (leveraged loans and high yield or unrated bonds, USD bn)



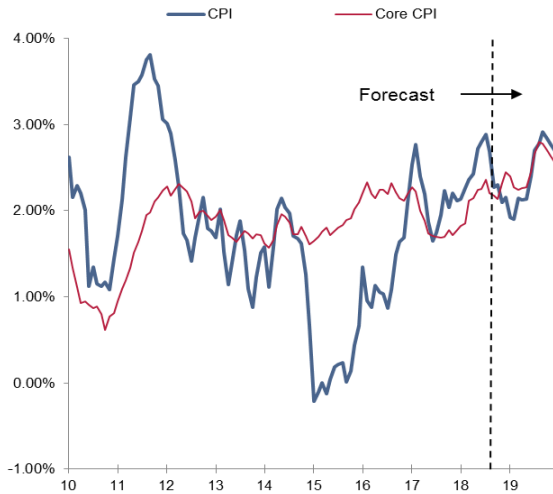
Sources: Fed, Allianz Research

The share of high yield bonds has been flat since 2015 at around one third (below the 2009 peak of 45%). But the share of the lowest invest grade level (BBB) has reached a record high of 35% in Q2 2018

US POLICY: FUSES AGAINST FURTHER DEBT INFLATING



US CPI (% y/y)



Sources: IHS Global Insight, Allianz Research

Circuit breaker #1: The Fed will hike interest rates twice in 2019 as inflation remains stuck above 2%

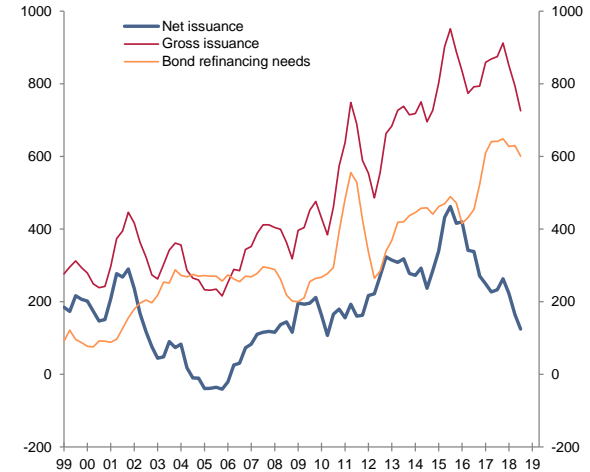
History of US government shutdowns

- 2013 (President Barack Obama): Oct. 1 to Oct. 17 - 16 days
- 1995-1996 (President Bill Clinton): December 5, 1995, to January 6, 1996, - 21 days
- 1995 (President Bill Clinton): Nov. 13 to 19 - 5 days
- 1990 (President George H.W. Bush): October 5 to 9 - 3 days
- 1987 (President Ronald Reagan): December 18 to December 20 - 1 day
- 1986 (President Ronald Reagan): October 16 to October 18 - 1 day
- 1984 (President Ronald Reagan): October 3 to October 5 - 1 day
- 1984 (President Ronald Reagan): September 30 to October 3 - 2 days
- 1983 (President Ronald Reagan): November 10 to November 14 - 3 days
- 1982 (President Ronald Reagan): December 17 to December 21 - 3 days
- 1982 (President Ronald Reagan): September 30 to October 2 - 1 day
- 1981 (President Ronald Reagan): November 20 to November 23 - 2 days
- 1979 (President Jimmy Carter): September 30 to October 12 - 11 days
- 1978 (President Jimmy Carter): September 30 to October 18 - 18 days
- 1977 (President Jimmy Carter): November 30 to December 9 - 8 days
- 1977 (President Jimmy Carter): October 31 to November 9 - 8 days
- 1977 (President Jimmy Carter): September 30 to October 13 - 12 days
- 1976 (President Gerald Ford): September 30 to October 11 - 10 days

Sources: Wikipedia, Allianz Research

Circuit breaker #2: A government shutdown is possible in Q4 2019. It will trigger a significant tightening of monetary and financial conditions

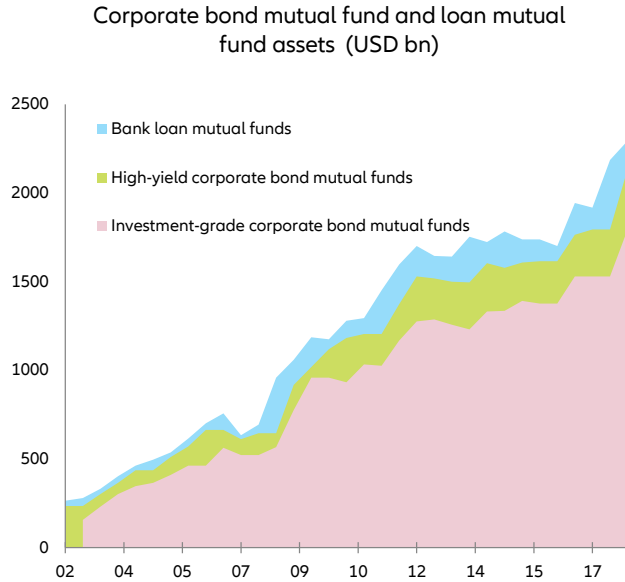
Nonfinancial companies' debt issuance in the US



Sources: IHS, Allianz Research

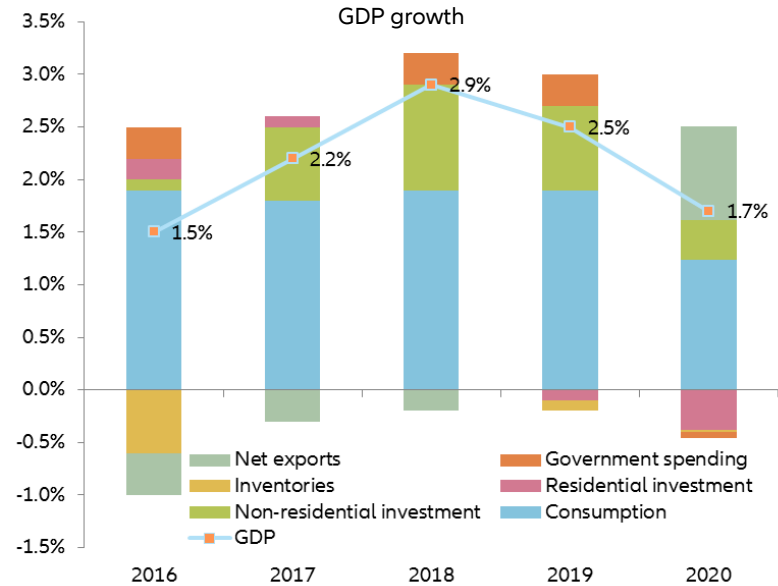
Record high refinancing needs will make tightening credit conditions painful for US non-financial companies

US SCENARIO: A MORE ABRUPT ADJUSTMENT IN 2020



Sources: Fed, Allianz Research

A rush to redeem shares of mutual funds could exacerbate losses of relatively illiquid types of assets. Negative wealth effects will hurt consumption prospects



Sources: Fed, Allianz Research

A technical recession is possible as early as 1H20. US growth slowdown will start in 2019 amid diluting impact of the fiscal stimulus and tightening credit conditions

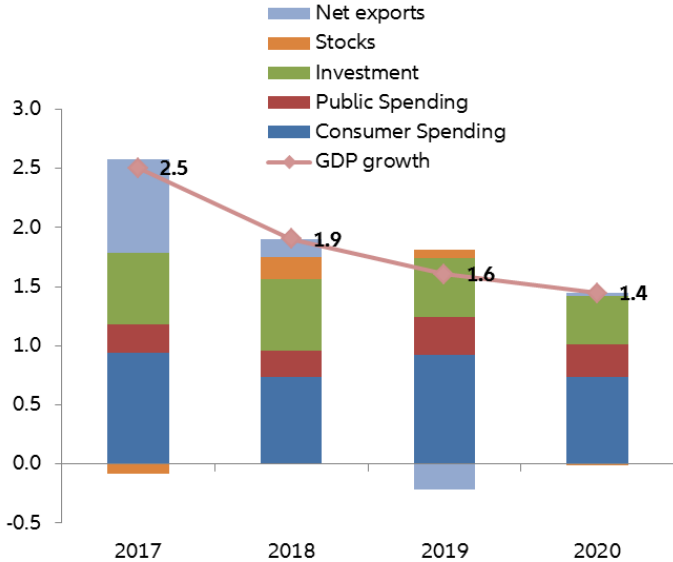
**EUROZONE AND CHINA: FUELING
DEMAND IN THE SHORT-TERM
AND REPAIRING SUPPLY OVER
THE MEDIUM-TERM**

02



EUROZONE TO NAVIGATE STORMY WATERS

GDP growth (%) & components (pp)

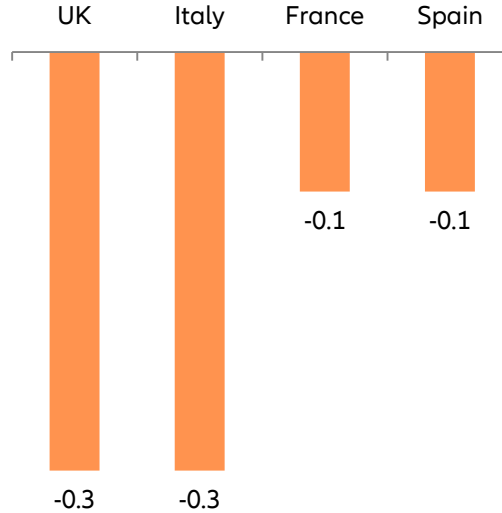


Sources: Eurostat, Allianz Research

In 2019 GDP growth will be above potential for the 5th consecutive year but momentum continues to fade as external pressures rise and monetary and financial conditions become tighter

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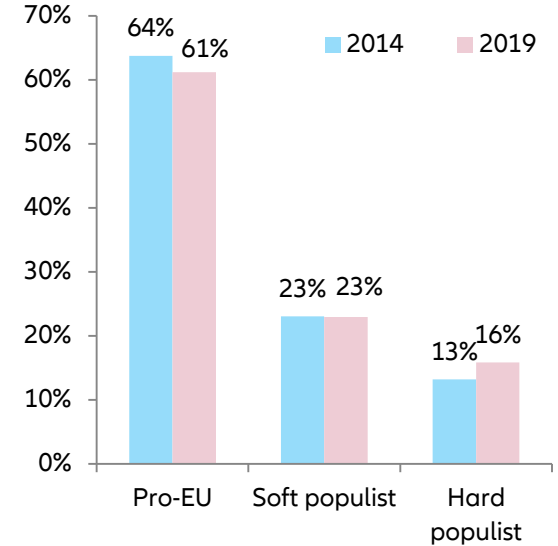
Uncertainty impact on real GDP growth (pp, 2018)



Source: Allianz Research

We don't expect downside risks to materialize (no Brexit deal, Italian crisis) but the high uncertainty "put" has weighed on economic growth in 2018

EU Parliament seat distribution (2014 vs estimates for 2019)

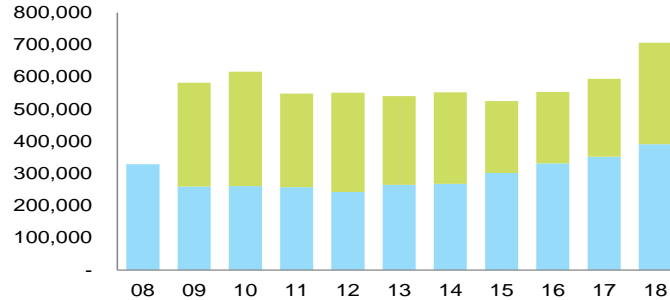


Sources: National sources, Allianz Research

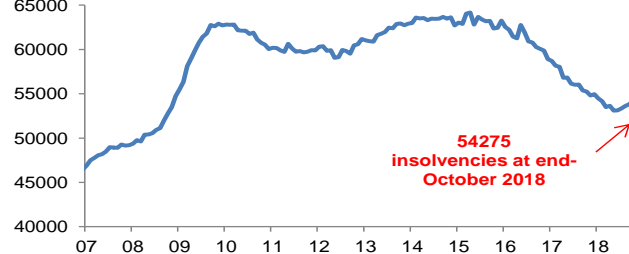
A Grand Coalition of mainstream parties is likely; high risk of polarization in the EU political landscape. Higher hard populist support could create noise and make procedures longer

EUROZONE CORPORATES: STILL RESILIENT...

France: Business creations



France: Business insolvencies

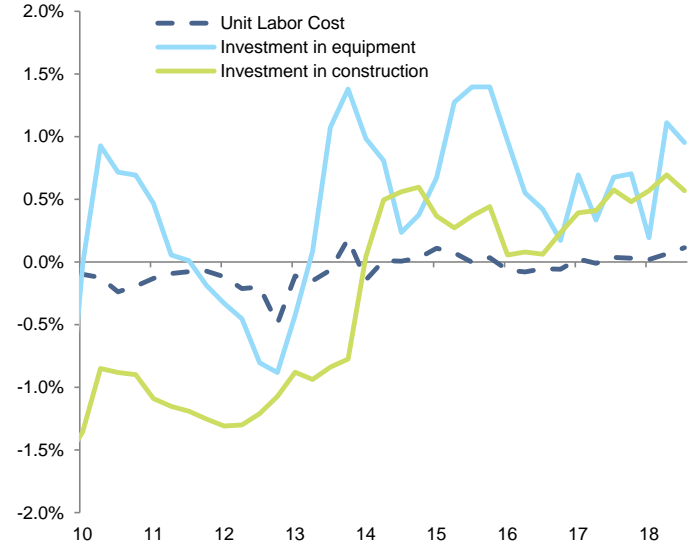


Sources: IHS Global Insight, Allianz Research

France: Creative destruction in the making. Corporate creations increased by +11% in 2018 and should continue to the upward trend. At the same time, business insolvencies rose by +2.2% from the May trough to October

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Spain: Unit labor costs (ULC) and investment growth (% y/y)

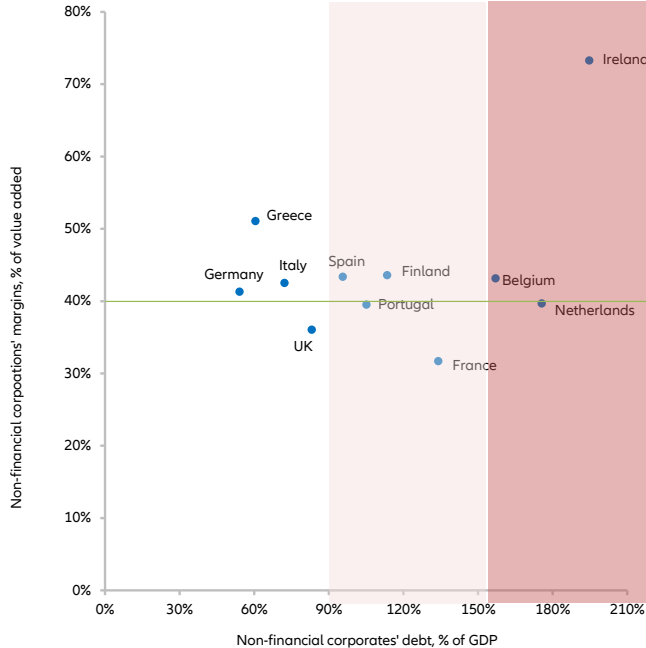


Sources: IHS, Allianz Research

Spain: Resilience partly explained by corporate dynamism. Historically high profit shares (>43% of GVA) and subdued ULC growth allows companies to invest. Reforms such as giving priority to company-level wage agreements (2012) controlled the wage increases despite employment gains

EUROZONE CORPORATES: ...BUT FEWER BUFFERS

Corporate debt vs profitability



Sources: BIS, Eurostat, Allianz Research

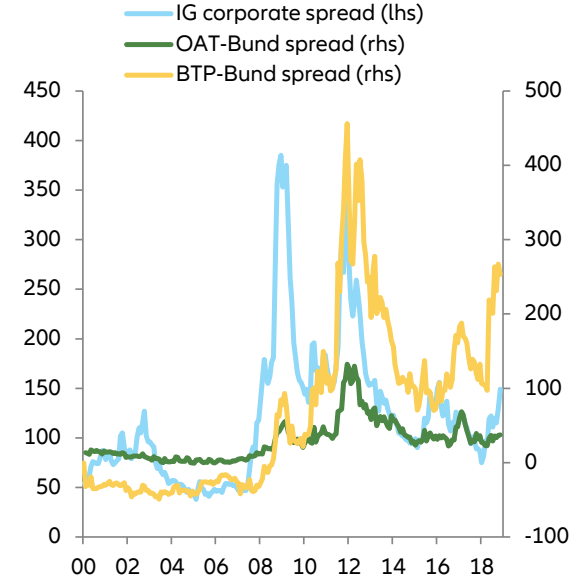
ECB Bank Lending Survey

	Cost of funds and balance sheet constraints	
	Q2 2018	Q3 2018
Eurozone	-3	3
Germany	0	0
Spain	-10	0
France	0	0
Italy	-10	10
Netherlands	0	0

Note: The net percentages for the questions relating to contributing factors are defined as the difference between the percentage of banks reporting that the given factor contributed to a tightening and the percentage reporting that it contributed to an easing

Sources: ECB, Allianz Research

Corporate vs sovereign spreads (bp)

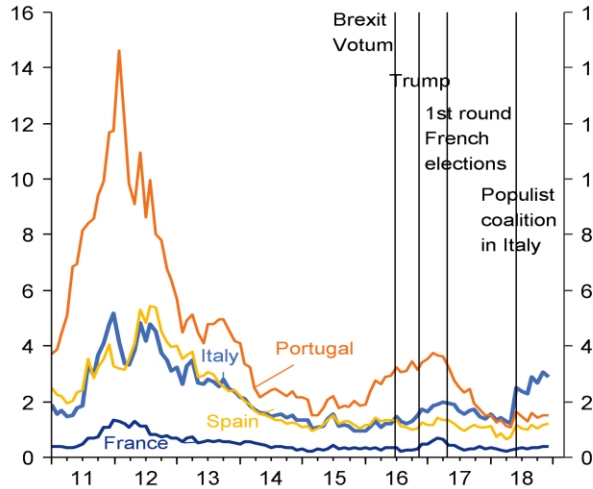


Sources: Bloomberg, Allianz Research

The Eurozone investment cycle has been boosted by credit growth. Tighter financial conditions will make banks more risk adverse while market conditions could remain volatile as the ECB starts to normalize monetary policy

EUROZONE: POLICY-MIX TO TAME UNCERTAINTY

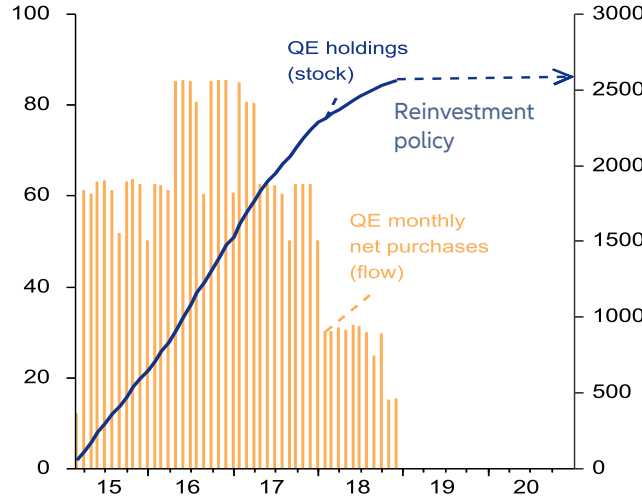
Spreads between 10-yr gov't bonds over German Bunds



Sources: IHS Global Insight, Allianz Research

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

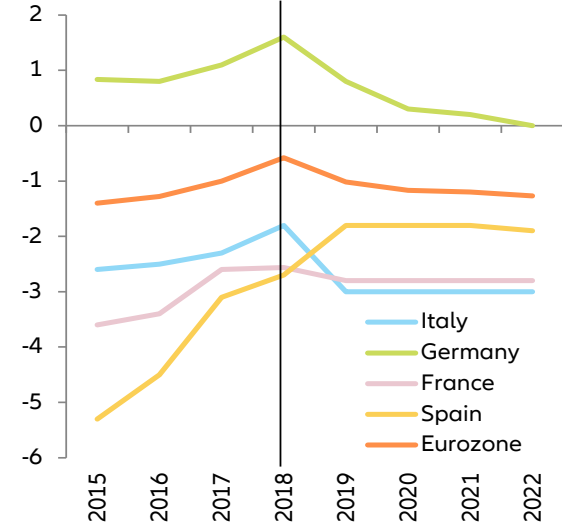
ECB QE stock and flows (EURbn)



Sources: IHS Global Insight, Allianz Research

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

Fiscal balance (% of GDP)



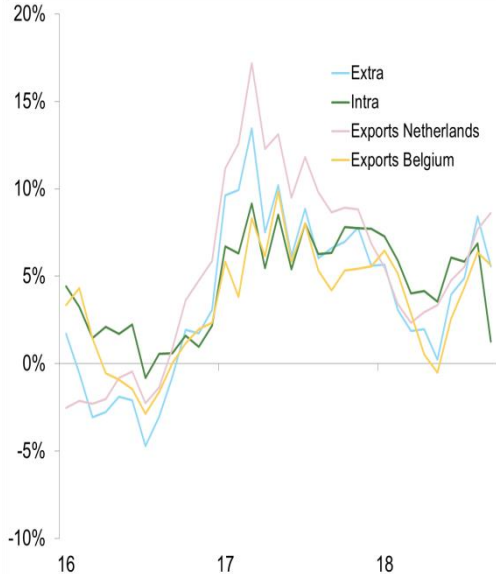
Sources: IHS Global Insight, Allianz Research

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

EUROZONE: EXTERNAL PRESSURES TO STAY UNDER CONTROL



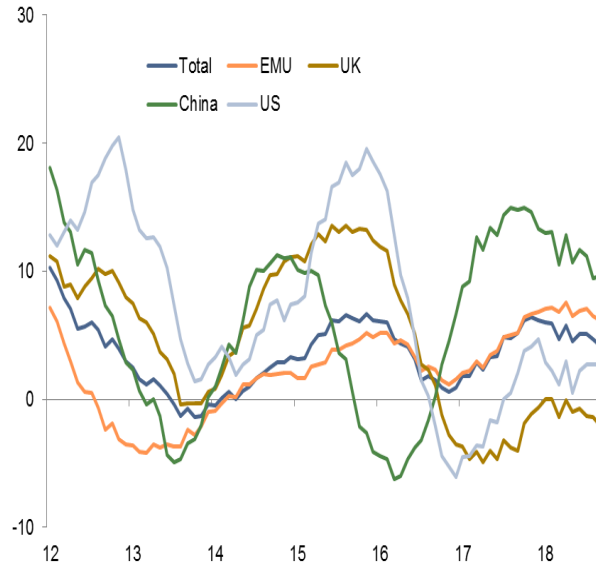
Intra and extra EU exports, Dutch and Belgian exports, 3M yoy



Sources: Eurostat, National sources, Allianz Research

Intra-EU exports are acting as a buffer for lower extra-EU demand...

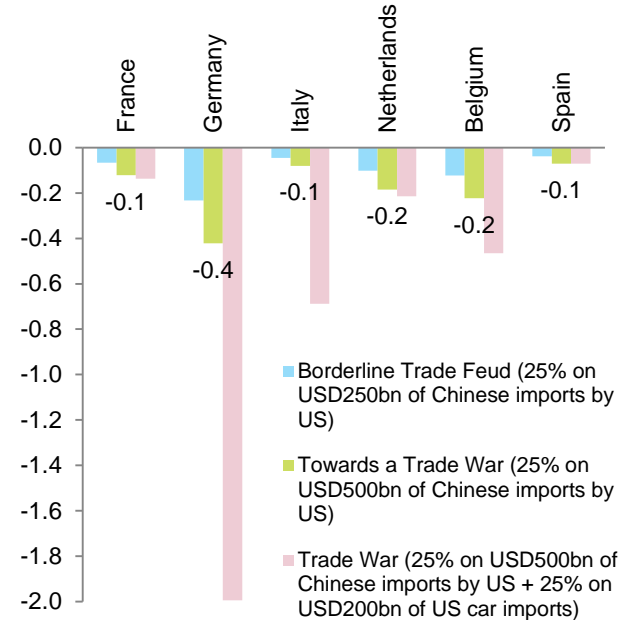
Germany: Nominal exports, 12m moving average, percentage change over previous year



Sources: National sources, Allianz Research

...as well as a stabilizer for German exports

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



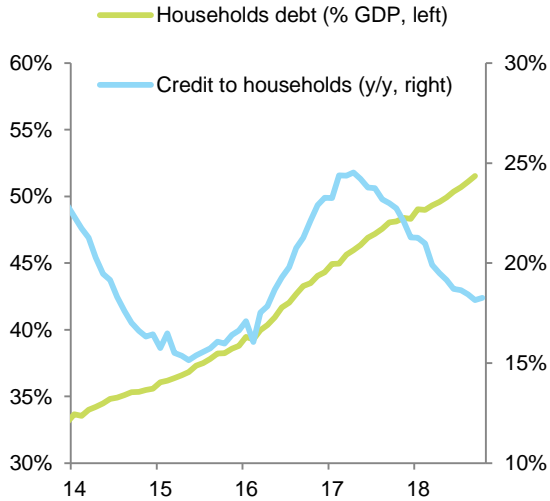
Sources: Chelem, National sources, Allianz Research

The trade dispute has shaved off around -0.2pp of annual German GDP growth

CHINA: BETTING (BOLDLY) ON HOUSEHOLDS

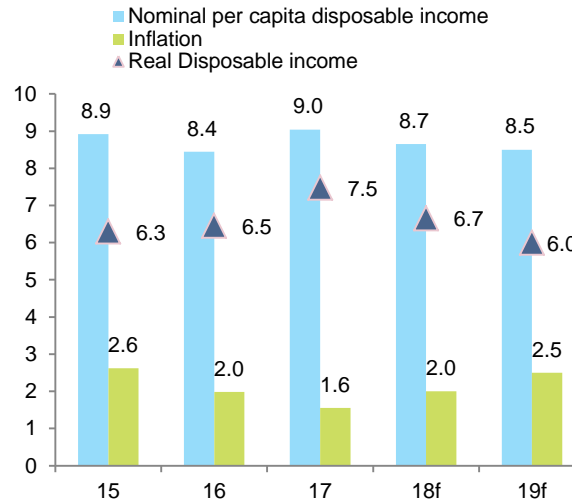


Household debt vs. credit to households



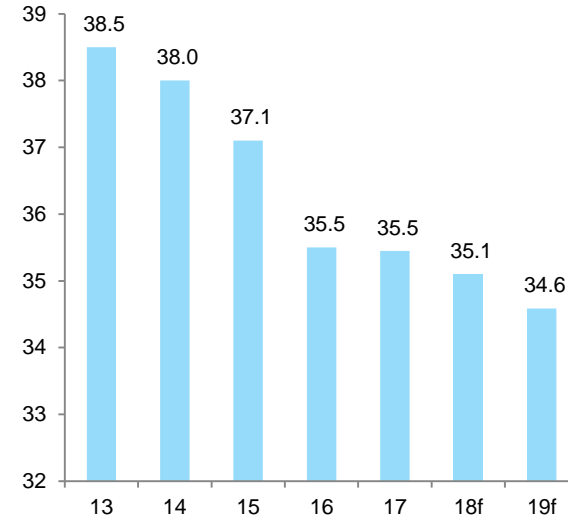
Sources: IMF, Allianz Research

Income growth



Sources: IMF, Allianz Research

Households Saving (% Disposable income)



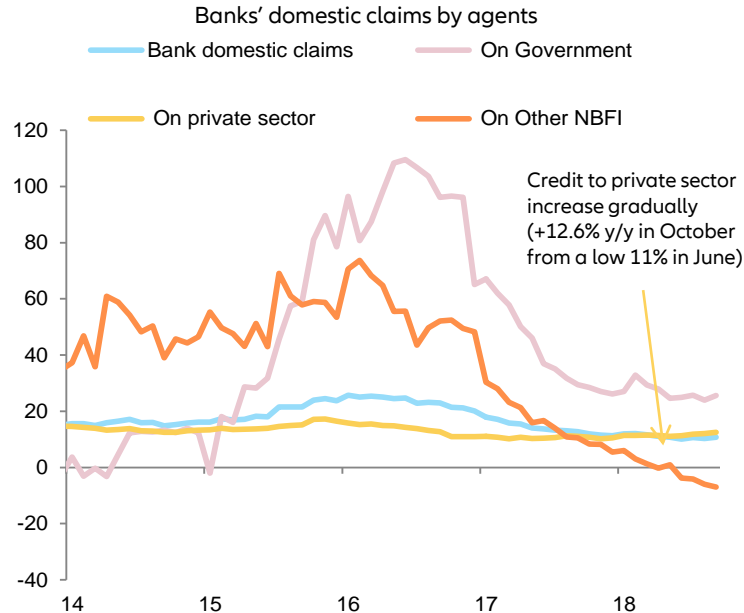
Sources: IMF, Allianz Research

Driver #1: Strong credit growth

Driver #2: Positive income growth

Driver #3: Declining savings rate

CHINA: PRIORITIZING BETTER CAPITAL ALLOCATION



Sources: IHS, Allianz Research

Overall credit growth is stable. By segments, the private sector is the one benefitting from current monetary easing

Financial sector indicators

	2017	Last	
Loan to deposit ratio	70.6	73.6	●
Bank NPL ratio	1.7	1.9	●
Urban banks	1.5	1.7	●
Rural banks	3.2	4.2	●
SOE	1.5	1.5	●
Shadow Banking Flows (% GDP)	4.3	-1.9	●
Non-Financial corporations debt (% GDP)	160.3	164.1	●

N.B: loan to deposit and NPL ratios figures stop end Q3 2018, shadow banking flows take into account trust, entrusted loans and undiscounted bank acceptances over October 2017-September 2018, Non-financial corporations debt is based on BIS figures which end Q1 2018.

Sources: WIND, IHS, BIS, Allianz Research

Prudence is justified by the fact that the financial system is still under stress and room for maneuver is increasingly limited

CHINA: FINE-TUNING SHOCK ABSORBERS

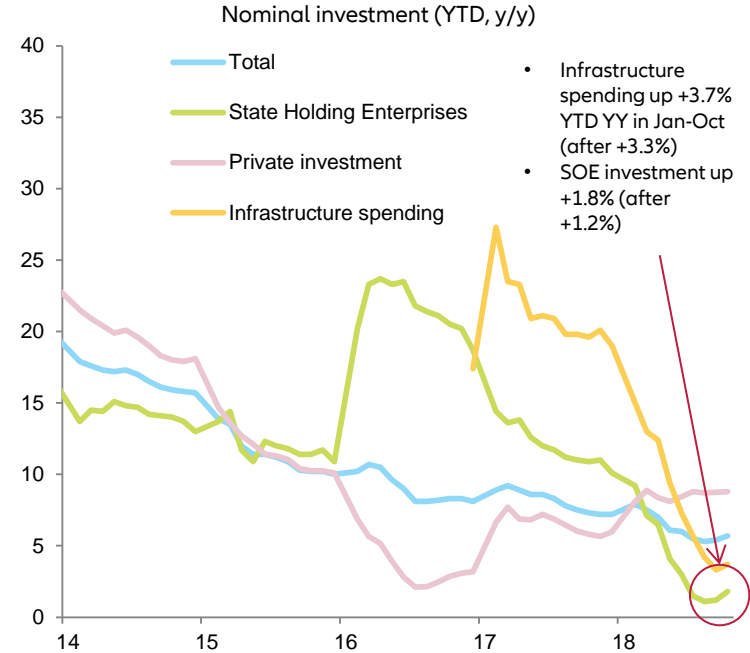
How much RMB depreciation is required to make up for the US tariff shock?

A static approach (USD bn)

10% tariff on USD imports from China	Cost	25% tariff on USD imports from China	Cost	RMB depreciation	Cost Absorption
50	5	50	12.5	-2%	-10
100	10	100	25.0	-4%	-20
150	15	150	37.5	-6%	-30
200	20	200	50.0	-8%	-40
250	25	250	62.5	-10%	-50
300	30	300	75.0	-12%	-60
350	35	350	87.5	-14%	-70
400	40	400	100.0	-16%	-80
450	45	450	112.5	-18%	-90
500	50	500	125.0	-20%	-100

*Bold figures indicate where we are end Q4. 10% on USD200bn imports and 25% on USD50bn imports from China have been enacted. RMB depreciated by -10% since March
Sources: IHS, Allianz Research*

A 10% RMB depreciation would help absorb a cost increase of USD 50 bn. More should be expected if the US raises tariffs further

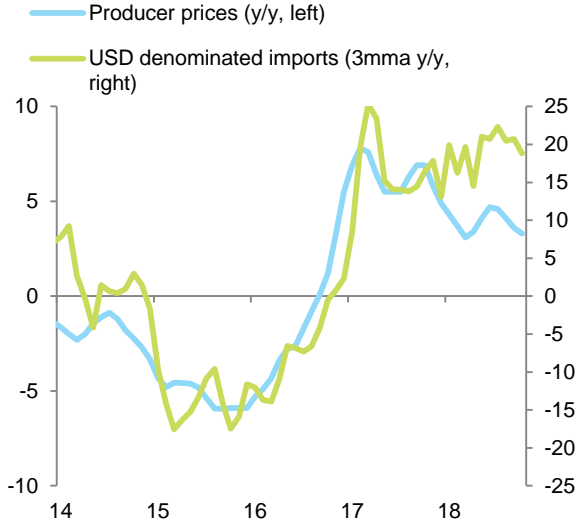


Sources: IHS, Allianz Research

Fiscal stimulus is bearing fruit: Infrastructure and SOE investment are starting to pick up

CHINA: OPENING UP WISELY

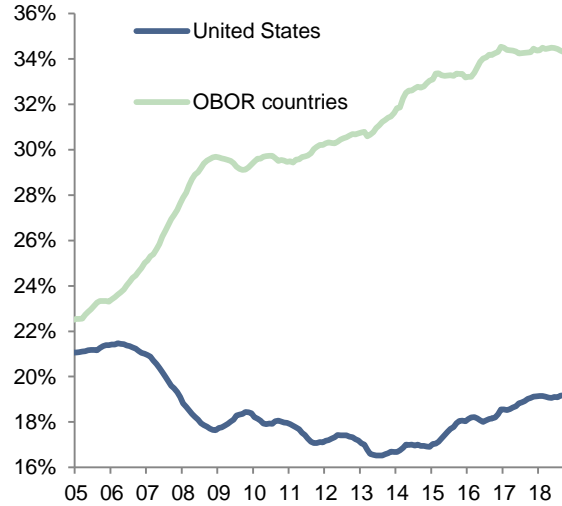
USD denominated imports and producer prices



Sources: IHS, Allianz Research

Tariff cut: China's tariff cuts help support import growth and absorb higher inputs cost due to oil prices and RMB depreciation

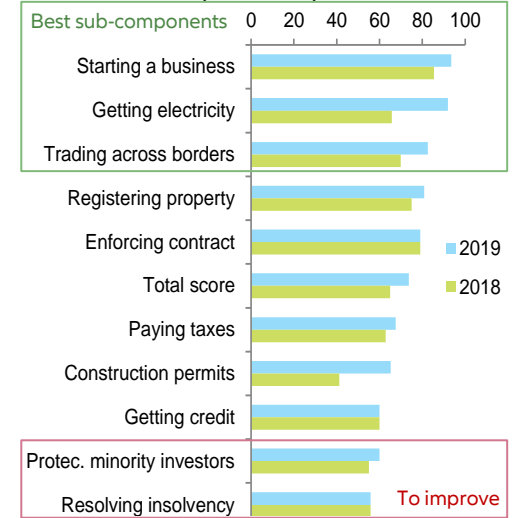
Share of US and BRI exports in total USD denominated exports



Sources: IHS, Allianz Research

Partnerships: Accelerating partnerships helps diversify trade opportunities. The Belt and Road Initiative is the core strategy for now. Watch out for partnership in Asia (RCEP) and Europe

Ease of doing business - score and subcomponents (100 = best)



Sources: WB, Allianz Research

Reforms: Business-friendly reforms will be important to attract much-needed investment. Investor protection and insolvency resolution remain key problems

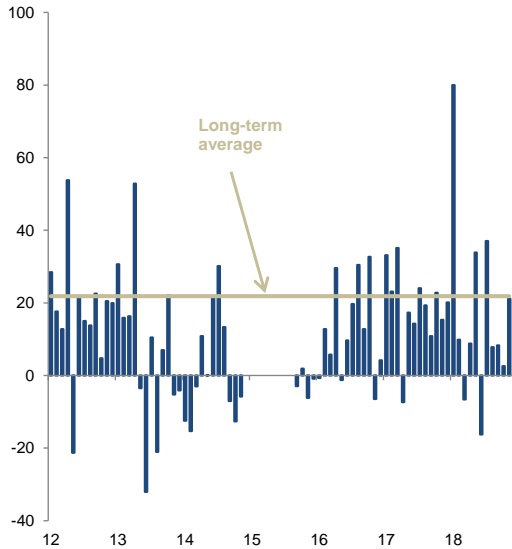
**EMERGING ECONOMIES :
TECHNICAL INSPECTION BY THE
MARKET TO CONTINUE**

03



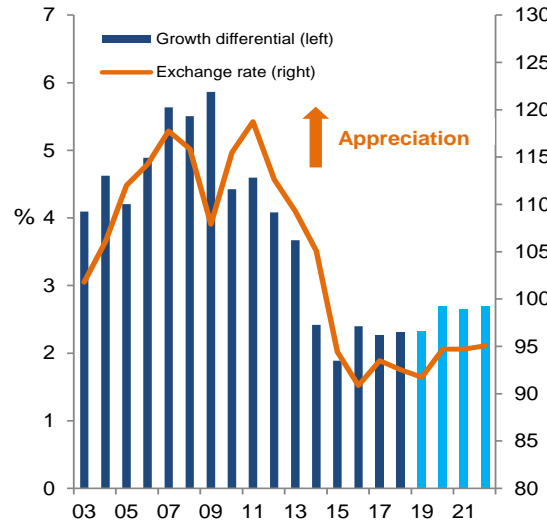
EMERGING MARKETS: RESILIENCE AMID VOLATILITY

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



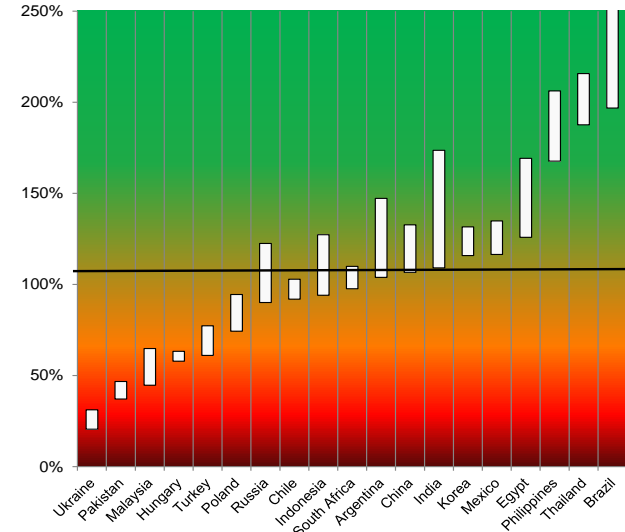
Sources: IHS Global Insight, Allianz Research

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



Sources: IHS Global Insight, Allianz Research

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



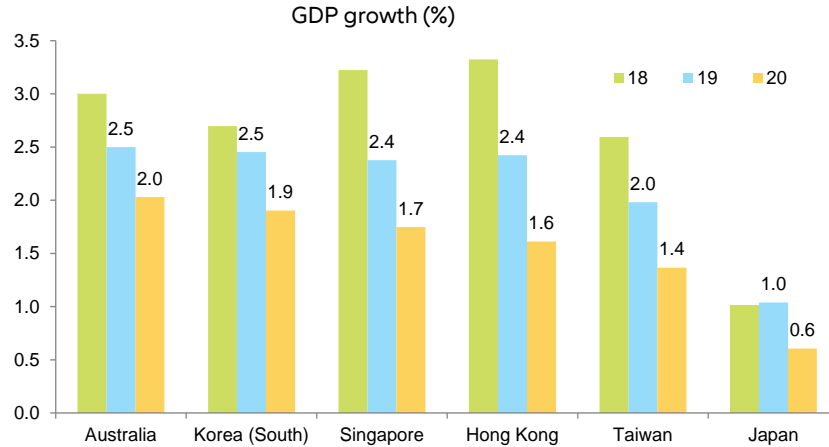
Sources: IHS Global Insight, Allianz Research

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

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

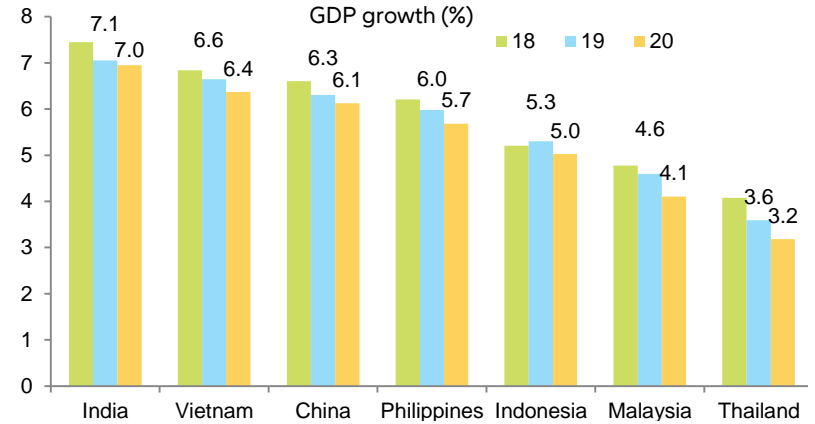
In case of adverse shocks, several Emerging Markets may face liquidity crises, adversely impacting the entire EM asset class

ASIA-PACIFIC: KEEPING THE SYSTEM RUNNING



Advanced Economies: Adjusting to slower global demand

- Economic growth is set to slow to in line with slower global trade especially for trade related economies (South Korea, Singapore, Hong Kong and Taiwan)
- Policymakers will use fiscal leeway's to support economic growth next year. Apart from Japan, public finances are generally sound in all markets
- High households debt (e.g. in Australia, South Korea, New Zealand), tighter global financing conditions and trade uncertainties (with a large potential impact on Singapore, Taiwan and Hong Kong) are the big ticket items that corporates and the private sector should keep in mind for 2019



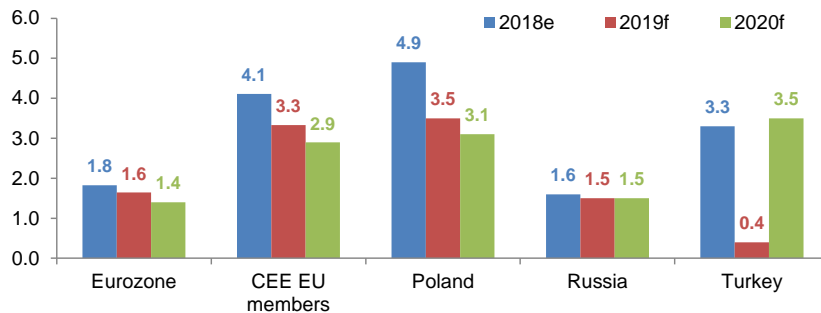
Emerging Economies: High tides for high flyers

- Emerging Markets in the region will continue to grow above global growth on average benefitting from (i) resilient growth in China, (ii) trade diversion as corporates look for cheap alternative hubs of production (Vietnam, India, Indonesia and Philippines, e.g.) and (iii) supportive fiscal policy (Thailand). Yet tightening of monetary conditions and weaker global demand will lead to a growth deceleration
- Main risks stem from continued pressures on the currency of markets with twin deficits (India, Indonesia and Philippines), overheating risks (Vietnam and Philippines) and the outcome of elections in India, Indonesia and Thailand

EASTERN EUROPE: HEADING AWAY FROM OVERHEATING



Real GDP growth

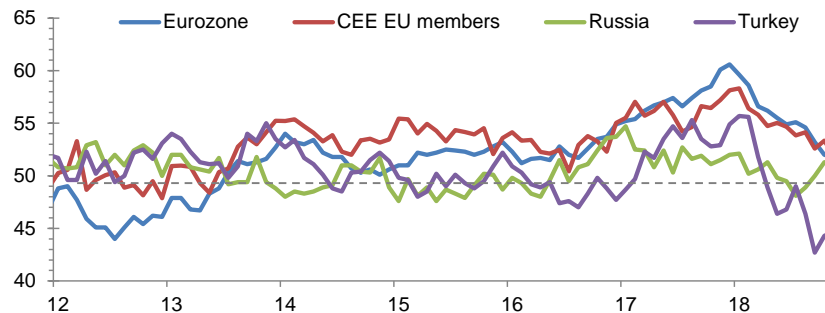


Sources: National statistics, IHS Markit, Allianz Research

CEE EU members

- Economic growth is forecast to moderate in line with the slow-down in the Eurozone. That said, robust domestic demand thanks to good absorption of EU investment funds and much improved labor markets provide some cushion against external shocks.
- Overheating concerns are fading as inflation has remained in check and strong wage growth is gradually retreating
- Fed (and ECB) tightening and contagion risks are limited as surpluses or small deficits on the current and fiscal accounts as well as sufficient room for monetary tightening should help tame currency and inflationary risks
- A key risk to growth is currently a potential sharp decline in global demand for automotive products

Manufacturing PMI



Sources: IHS Markit, Allianz Research

Russia

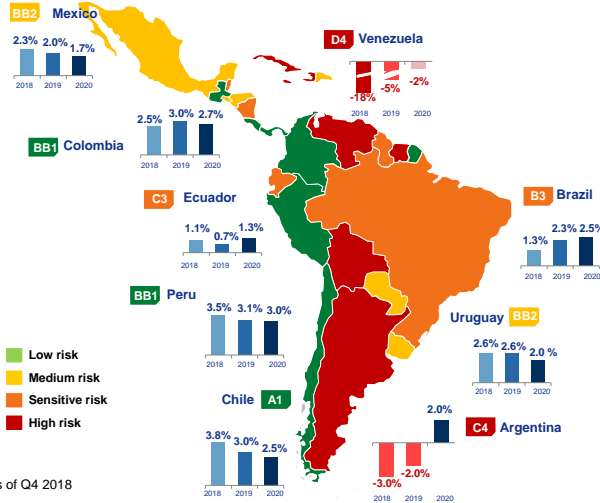
- Growth will be limited to around +1.5% in the next years as new US sanctions affecting investment activity
- The main risk is low oil prices for a sustained period, but fiscal buffers and credible monetary policy (prioritizing financial stability over growth) should help avoid a recession until 2020

Turkey

- Sharp monetary tightening in September has calmed financial markets, for now
- But the currency crisis is taking its toll on the economy: industrial output and retail sales are contracting sharply – supporting our forecast of a hard landing in 2019 – while...
- ...the tradable sector is re-balancing as sharp TRY depreciation has led to declining imports while supporting exports.

LATAM: POLICY RISK & END OF MONETARY EASING

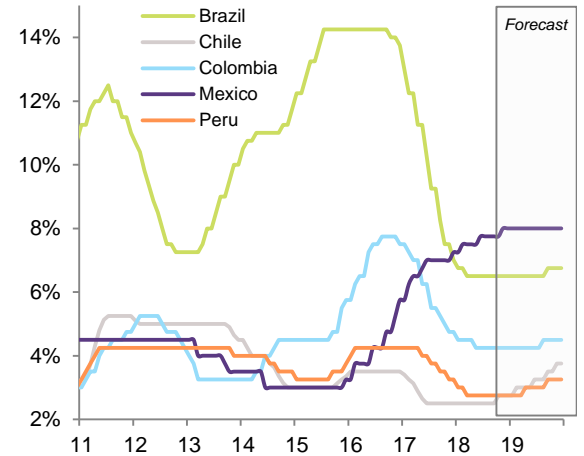
Country risk and economic growth



Latin America vulnerability scorecard: not all in the same boat

2019 forecasts		Argentina	Brazil	Mexico	Colombia	Chile
External vulnerabilities and debt rollover risk	Current account balance	-1.49%	-0.8%	-1.9%	-2.7%	-0.7%
	External debt (% GDP)	27%	14%	36%	31%	45%
	% of foreign-denominated debt (2017)	51%	18%	25%	27%	40%
	Reserve adequacy (Aug 18)	Adequate	High	Adequate	Adequate	Low
Cycle management	Real interest rate (Aug 18, policy rate - CPI inflation)	11.3%	2.0%	3.1%	1.0%	-0.2%
	Real GDP growth	-2.0%	2.3%	2.0%	3.0%	3.0%
Fiscal risk	Fiscal deficit	-2.6%	-6.7%	-2.5%	-2.1%	-0.9%
	Public debt	80%	88%	54%	48%	25%
Policy uncertainty risk	Probability of policy mistakes	Moderate	High	High	Low	Low

Policy rates in inflation-targeting economies



Sources: IHS, IMF, Euler Hermes, Allianz Research

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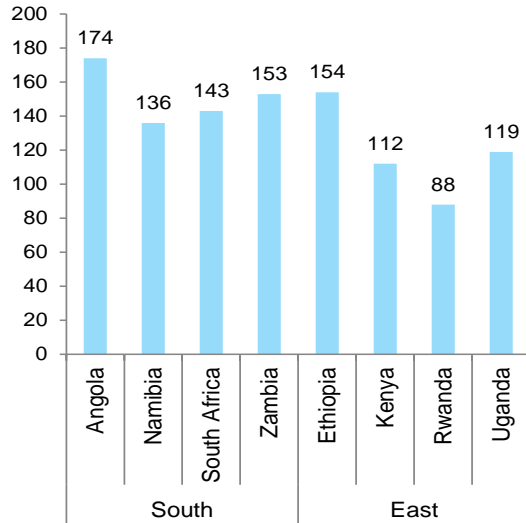
Sources: IHS, Euler Hermes, Allianz Research

Latin America's activity decelerated (+1.5%, *excluding Venezuela*) in 2018 as Argentina sank into recession. Going forward we expect a gradual acceleration to +2% in 2019, +2.4% in 2020. Recovery still slow, and late cycle dynamics will exacerbate divergence. Two stories:

- Financial conditions will be less favorable for corporates** as monetary policy gradually shifts to tightening mode
- B.A.M's future contingent on policy risk:** Brazil, instability of policy platform + pension reform outlook challenging; Mexico: policy choices contradicting pro-business stance; Argentina: severe austerity could fuel social discontent, mind elections in October 2019

AFRICA, MIDDLE EAST: THE RESOURCE CURSE

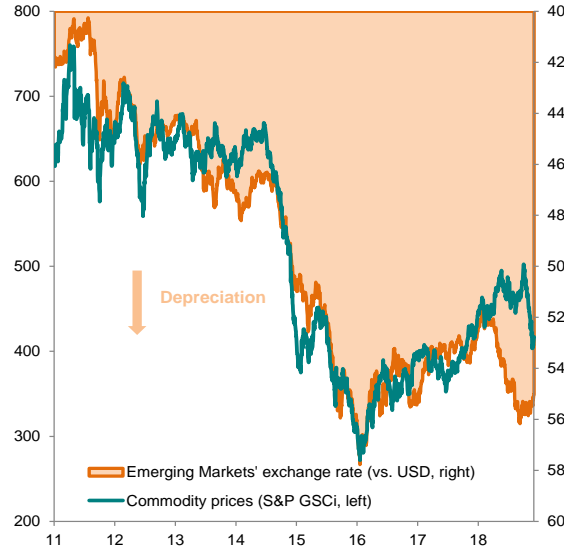
Africa: Trading across borders ranking in the Doing Business survey, South vs. East



Sources: IHS Global Insight, Allianz Research

Barriers to trade are inhibiting growth in the Southern part of the Africa. Reforms and openness are driving it in East Africa

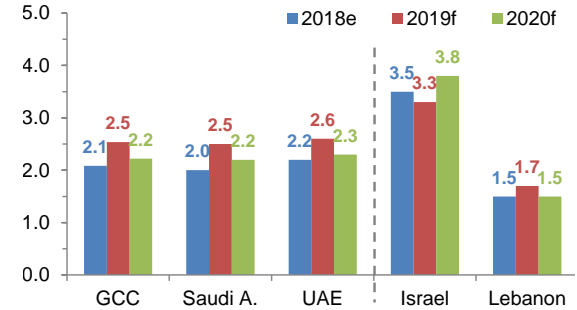
Commodity prices vs. EM exchange rates



Sources: IHS Global Insight, Allianz Research

As commodity started to decrease, Middle East and Africa are exposed to renewed exchange rate pressure (e.g. the Nigerian Naira on the black market exchange rate)

Real GDP growth



Sources: National statistics, IHS Markit, Allianz Research

GCC

- Growth will pick up in 2019 due to higher oil output, fiscal stimulus and a robust non-oil sector. Slowdown in 2020 as oil prices fall
- Main risks are oil price shocks, oil output cuts, and deteriorating geopolitical tension

Israel

- Growth eases slightly in 2019 in line with global economy. The coming online of a new natural gas field will boost growth in 2020

Lebanon

- Growth will remain subdued as policy uncertainty (still no government after May elections) and political risk in general drag on

THANK YOU!

Economic research Department
Q4 2018

