

POLITICAL WORRIES, FLAT LINING GROWTH, ILLIBERAL CYCLE

Economic Research Department
Global Economic Outlook
Q3 2019



KEY MESSAGES

- In 2019-20, overactive policy makers, especially superdovish central bankers, and a new fiscal impulse (U.S., China and Europe, to a lesser extent) **will help avoid a global recession, but flat-lining growth – with activity bottoming out in Q1 2020 – will be the norm.**
- **This time around, expect more volatile markets and fickle capital flows**, as our fragmented world has entered an “Illiberal Cycle”. This also means volatile commodity prices (~70\$/bbl for oil), currencies (3-5% depreciation on average) and capital flows for emerging markets.
- **To exit these limbos, 2 upside possibilities** (electoral bifurcation in the U.S. and moratorium on protectionism, or sizeable fiscal response from Europe), **and 2 downside risks** (credit event from a zombie corporate in the U.S., full-fledged U.S.-China trade war).
- What it means for markets: **Superdovish central banks will keep bond yields at very low levels:** 10YR Bund at -0.4% at end-2020 and 10YR U.S. yield at 1.7%. Higher volatility from U.S.-China trade conflict will keep the USD strong (1.10 end-2019 and 1.12 end-2020 for EUR/USD).
- What it means for companies: **Global Insolvency Index should increase by +8% (in 2019 and 2020)**

NO BIG R IN 2020

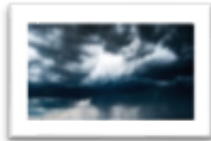
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BACK TO SCHOOL: WALL OF (POLITICAL) WORRIES



TRADE WAR

- No further significant escalation but U.S. average tariff hovering around 9%
- High volatility in policy announcements to continue



ECONOMIC SLOWDOWN, RECESSION

- No full-fledged global recession
- Soft landing of the economy: after +3.1% in 2018, +2.5% in 2019, +2.4% in 2020



ITALIAN FISCAL POLICY

- The new governing coalition in Italy takes away, at least temporarily, the risk of a strong confrontation with the EU as the fiscal deficit is likely to be kept under control



USA 2020 ELECTION

- Additional volatility, in the US, on the back of the start of the campaign: trade policies, financial vulnerabilities, the fragile emerging markets and high valuations will create more volatility.



HONG-KONG PROTESTS

- Borderline recession, economic outlook revised downwards
- Gradual normalization ahead



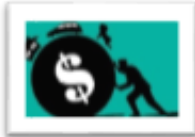
EARNINGS RECESSION

- Strong correction post Q4 2018
- Since end of Q1, 12-month forward EPS gradually recovering (despite May + August disruptions)



GLOBAL BOND YIELDS

- Lower for longer: end of period forecasts: Bund -0.6% 2019, -0.4% 2020. 10-year U.S. 1.6% 2019, 1.7% 2020



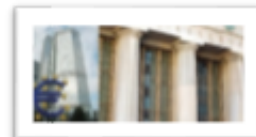
NEGATIVE DEBT PILE

- Further vulnerabilities due to superdovishness of central banks
- Increasing risks for corporates in U.S., Eurozone & China (SOEs)



BREXIT

- Last minute extension of Article 50 will further delay Brexit and avoid a no-deal on Oct 31st

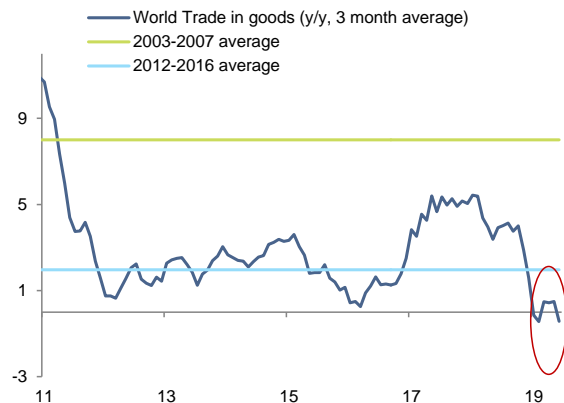


CENTRAL BANK AMMO

- More central bank easing
- Diminishing returns to policy mix

ON TOP OF POCKETS OF RECESSIONS IN H1

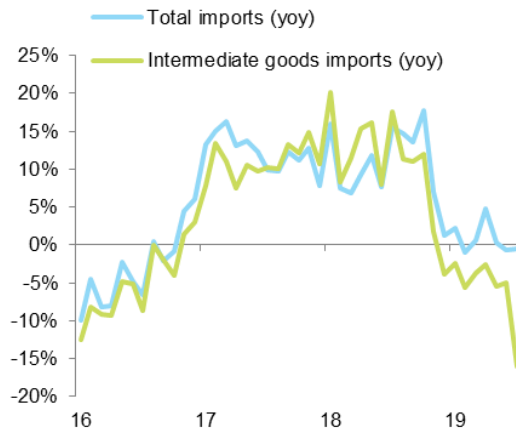
World trade growth (merchandise trade, y/y, %)



Sources: CPB, Euler Hermes, Allianz Research

After contracting in Q4 2018, goods trade contracted in Q1 2019 by -0.3% q/q and in Q2 by -0.7% q/q. It is the first time since 2009 that we have 3 negative quarters. On a year on year basis, growth is now well below average.

Global import growth (proxy based on US, Japan, Germany, China, South Korea), yoy



Sources: CPB, Euler Hermes, Allianz Research

Difficulties of the car and electronic sectors have translated into lower demand for intermediate goods globally.

Global industrial production growth (y/y, %)



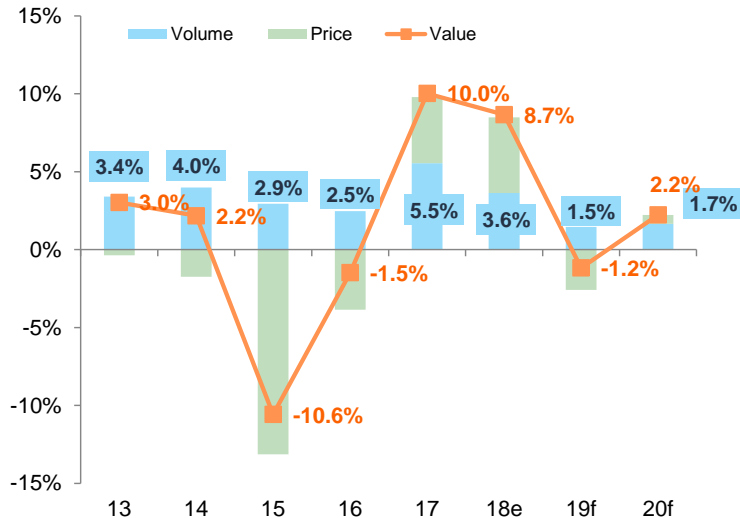
Sources: Allianz Research

Global industrial production has contracted as well on the back of unusually high inventories. We expect it to reach a trough in Q4 2019 (-0.2% y/y in September).

SUBDUED TRADE TO CONTINUE



Global Trade of goods and services (% , y/y)

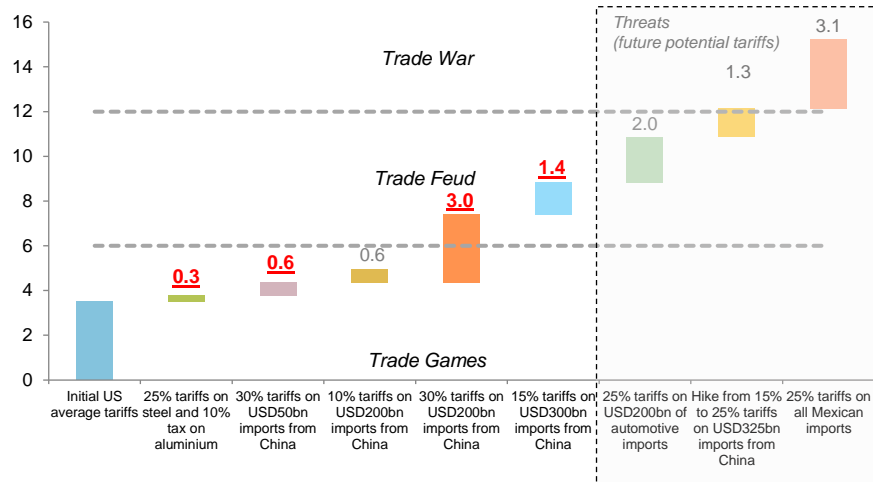


Sources: Euler Hermes, Allianz Research

Global trade of goods and services should grow at its lowest pace since 2009 in volume terms as it was strongly hit by the escalation in the trade war. The outlook for 2020 shows no significant improvement, as we do not see a comprehensive FTA between US and China as likely

Average US import tariff (%)

In red, tariffs that are implemented or that have been announced for the end of the year, and their impact on the US average import tariff



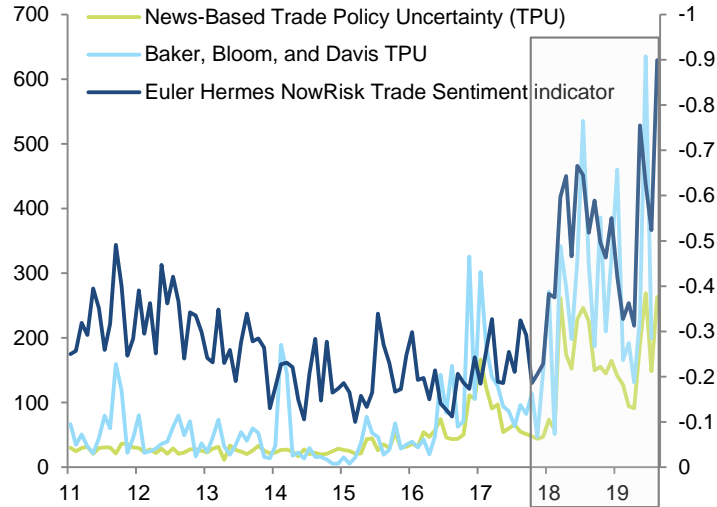
Source: WTO, Euler Hermes, Allianz Research

The average U.S. tariff increased from 7.6% to 8% on September 1st, and should reach 9% by December 15th. While further tariff escalation to a trade war is not our baseline scenario, as it would damage the U.S. domestic economy, we expect the average U.S. tariff to remain around present levels (~9%) well into 2020.

AND TRADE VOLATILITY TO INCREASE



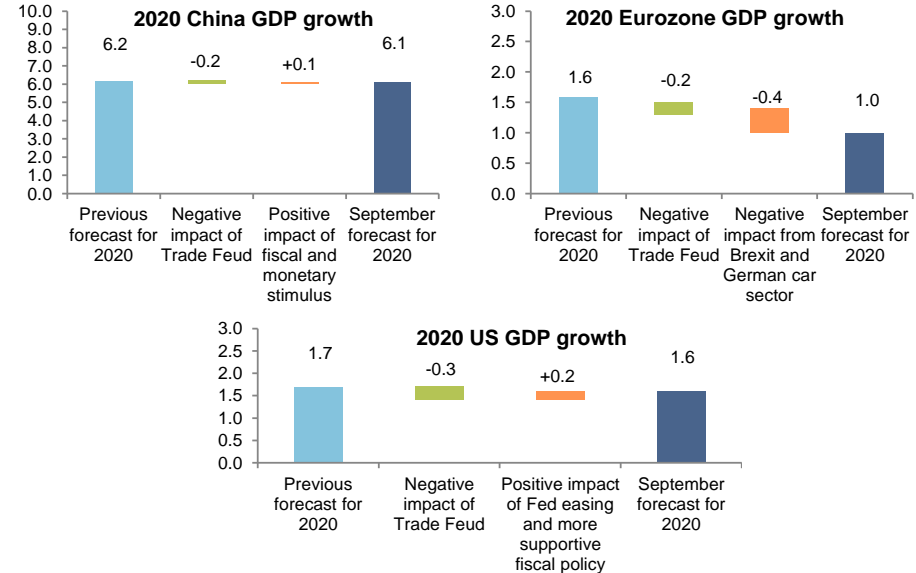
Trade Policy Uncertainty and EH Now Risk Trade sentiment indicator (inverted scale)



Sources: Federal Reserve, Euler Hermes, Allianz Research

Our EH trade sentiment indicator shows record high trade uncertainty, bound to continue. Along with tariffs, this should cause a drop in GDP growth of -0.5pp over 2019-2020, which is reflected in our forecasts revision (from +2.7% in 2019 and 2020 to +2.5% and +2.4%).

Impact of trade tensions on 2020 forecasts

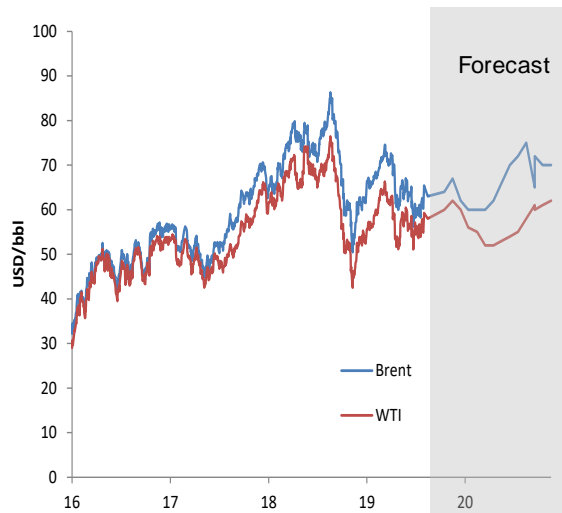


Lessons learned: (i) Uncertainty costs more to growth than tariffs. (ii) The Trade Feud accelerated China's trade opening to the RoW (iii) and failed to reduce the U.S. trade deficit; (iv) U.S. CPI should not be immune to tariffs anymore; (v) investment is taking a hit. Attention can turn to Europe in November (10% tariffs on cars) which would cost -0.1pp to annual real GDP growth.

OIL PRICE SPIKE: A SIZEABLE DOWNSIDE RISK, BUT WITH LOW PROBABILITY



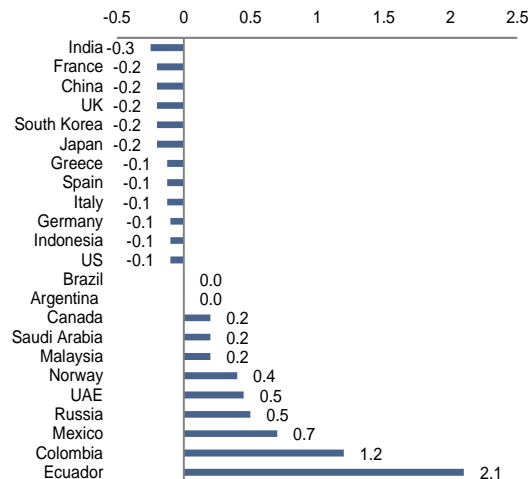
Oil price scenario



Sources: Allianz Research

Demand weakness competes with risk of supply disruption. Our central forecast is for an average Brent crude price of USD 66/bbl 2019e. There is upside risk in case of protracted Saudi supply loss, beyond 30 days. High case USD 68/bbl.

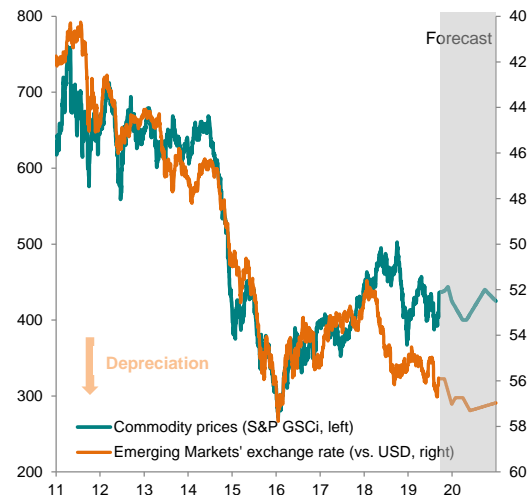
Impact on GDP growth after 1 year from a permanent increase in oil price of USD10bbl



Sources: IHS Markit, Allianz Research

Higher oil prices would have a negative impact on oil importers (India, China, France) but favor oil exporters. Besides the oil sector, beneficiaries would be renewable energy/power generation, construction in oil exporting countries, while consumer-oriented sectors would be hit.

Commodity prices vs. Emerging Markets exchange rate



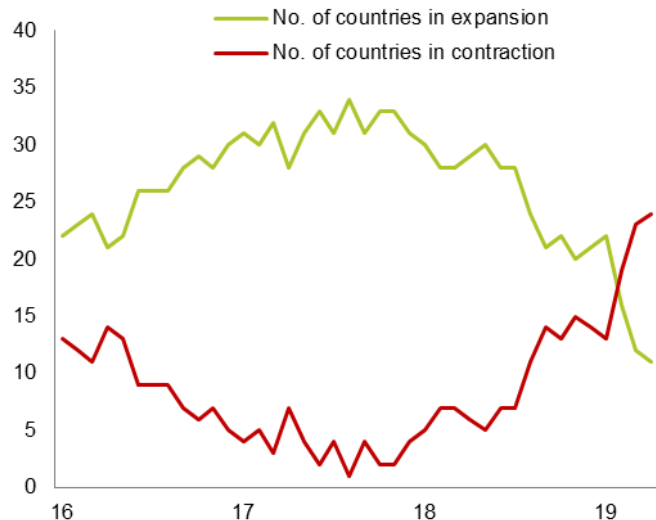
Sources: Bloomberg, Allianz Research

No contagion to other commodities (metals, food) of the oil price spike and an unwinding of the current pressure before year-end mean an environment that will not change for EM currencies: A moderate bumpy trend decline ahead.

GROWTH TO BOTTOM OUT IN Q1 2020



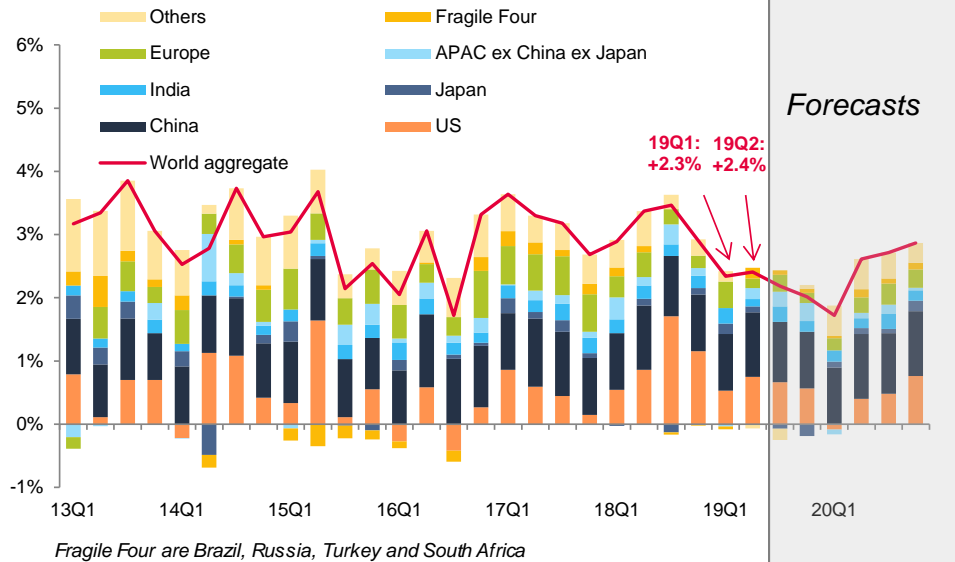
Manufacturing PMI indices being above or below 50



Sources: Markit, Allianz Research

Recession (two quarters of contraction) or borderline ones (one quarter of contraction) were already seen in Germany, Italy, the UK, South Korea, Singapore, Hong Kong, Turkey, Brazil, Mexico, Argentina and South Africa.

World growth, q/q annualized



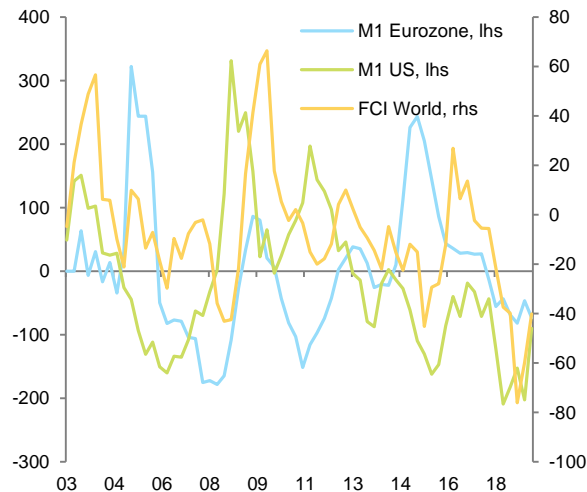
Fragile Four are Brazil, Russia, Turkey and South Africa

Sources: Bloomberg, Allianz Research

Global growth to weaken again during the next quarters. No global recession ahead, but again quarters of negative growth, mainly in the US, the UK, Japan, South Korea, Russia and Asian export hubs. The recovery thereafter should remain subdued. Overall, with 9 quarters below +3%, Q4 18 - Q4 20 will be the longest slow growth period since 1991-93.

GLOBAL FINANCIAL CONDITIONS: LESS, BUT STILL TIGHT

Financial and Monetary conditions for the US, the Eurozone and the World

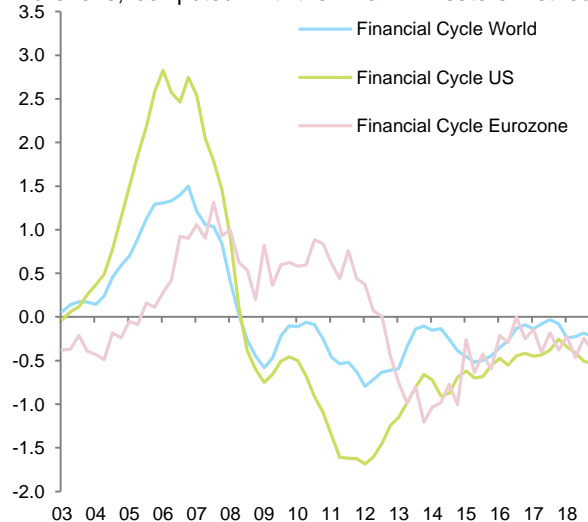


Sources: Bloomberg, Euler Hermes, DataInsight

Financial and monetary conditions remain in tightening mode, even if to a lower extent since Q2 2019. Going forward, the superdovish Central Banks should help ease financial conditions from current tight levels

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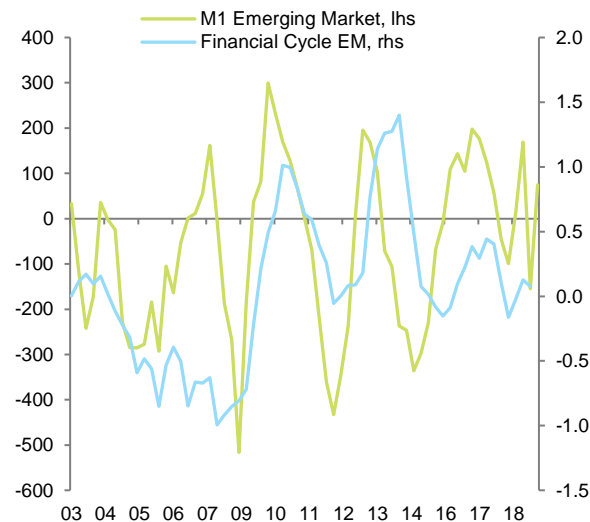
Financial Cycles of the World, the US and the Eurozone, computed with the Allianz Investors Method



Sources: Data Insight, Euler Hermes, Bloomberg, Allianz Global Investors (Financial cycle is calculated as the average z-score of private non-financial debt/GDP - credit gap - and real house prices relative to trend).

Financial cycles remain in contraction, even if less than in 2012-15, suggesting a moderate negative impact on activity

Financial cycle and M1 in Emerging Markets



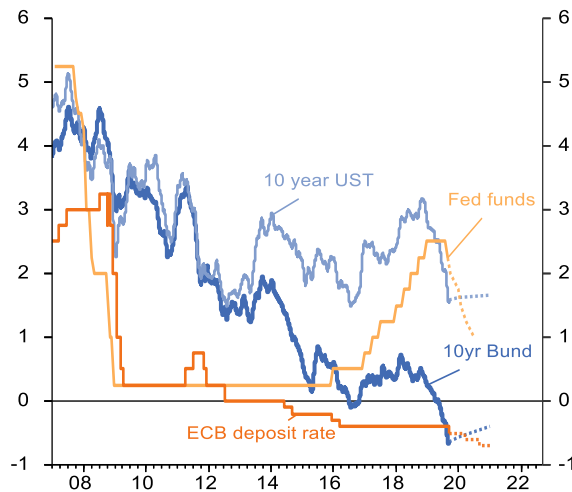
Sources: Bloomberg, Euler Hermes, Allianz Investors, IHS

Emerging markets are suffering from tighter financial conditions in the advanced economies (notably in the US) while credit flows and the housing market remain in distress. Going forward, some easiness is likely

CENTRAL BANKS SAVED THE DAY – AT A HIGH PRICE



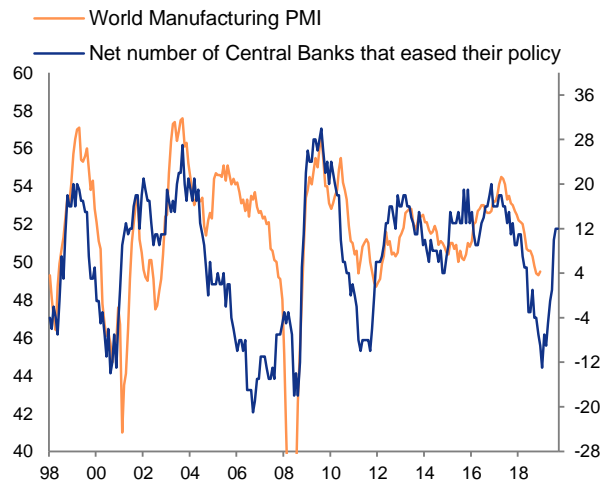
Key interest rates, %



Sources: Markit, Allianz Research

A new wave of monetary policy easing will take place: we expect three rate cuts by the Fed in 2020 and two more by the ECB in addition to more QE (EUR30bn per month starting in April 2020)

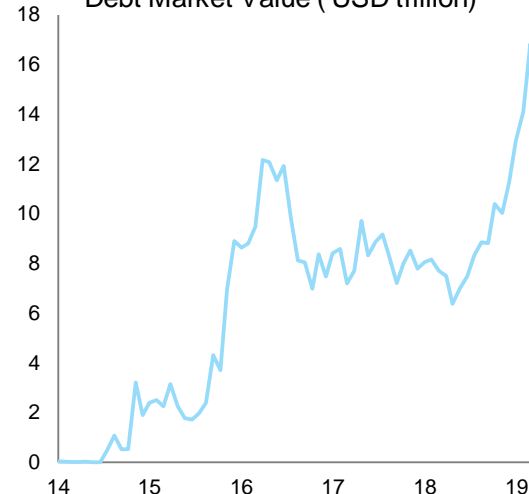
Manufacturing PMI vs monetary policy easing



Sources: Bloomberg, Allianz Research

Global monetary easing should help boost business confidence in early 2020 and avoid a full-fledged global recession

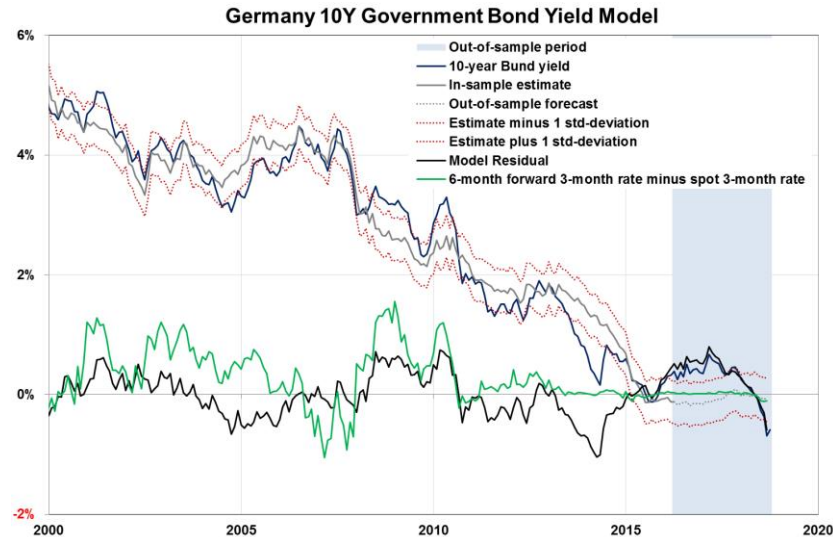
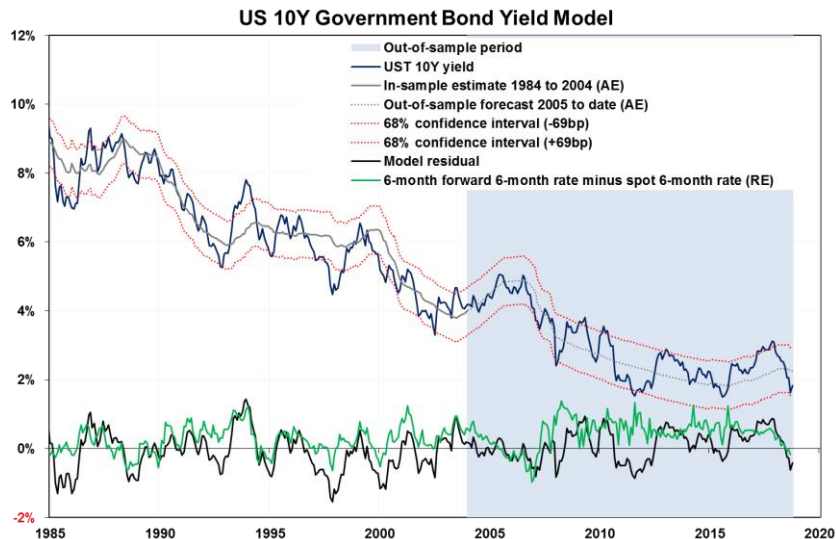
Bloomberg Barclays Global Negative Yielding Debt Market Value (USD trillion)



Sources: IHS, Allianz Research

There are growing doubts expressed on the benefits of negative yields. In a context of too high debt, whatever interest rates, necessity to repay weighs on consumption and investment

MONETARY EASING: A LOT ALREADY PRICED IN



Sources: Bloomberg, Allianz Research

Sources: Bloomberg, Allianz Research

US and German long-term government yields have declined and reached the lower-band of our proprietary model indicating that in the current market environment it is hard to buy duration at a reasonable price.

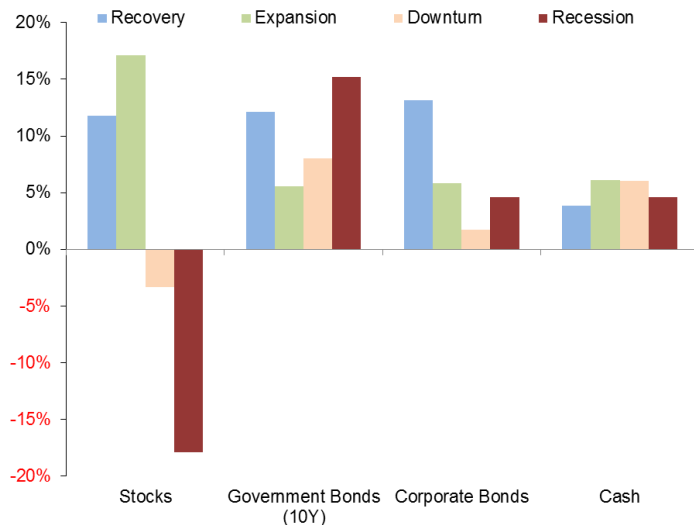
Our proprietary Long-Term government bond yield models have, so far, remained robust as shown by their out-of-sample performance. In addition, it looks like the residual of our proprietary model (the unexplained part of the model) can be explained by expected short-term changes in short term rates (rational expectations about monetary policy).

All in all, adaptive expectations (as defined by our proprietary smoothing, grey lines above) seem to keep rational expectations (expected short term changes in short term rates, green lines above) on a leash.

GLOBAL MARKETS: LESS DIRECTIONALITY



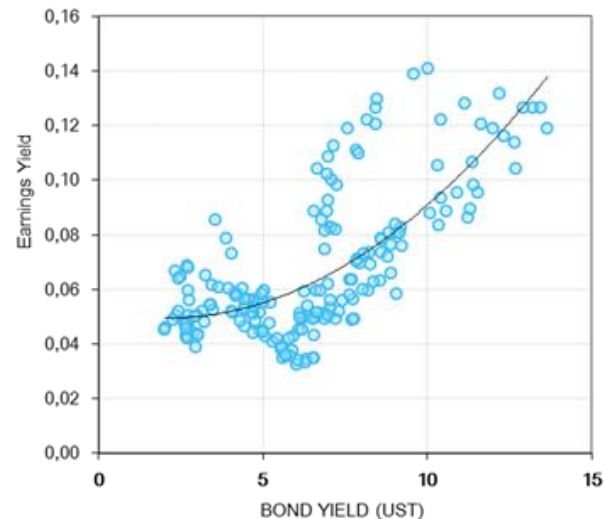
US - Historical Asset Class Performance
(annual absolute return - historical average)



Sources: Bloomberg, Allianz Research

Historically, fixed income assets have been the outperformers in late-late cycle environments. A severe economic downturn (recession) would lead equity markets to a double digit downward correction.

US: Earnings yield and US Treasuries (1973–2019)

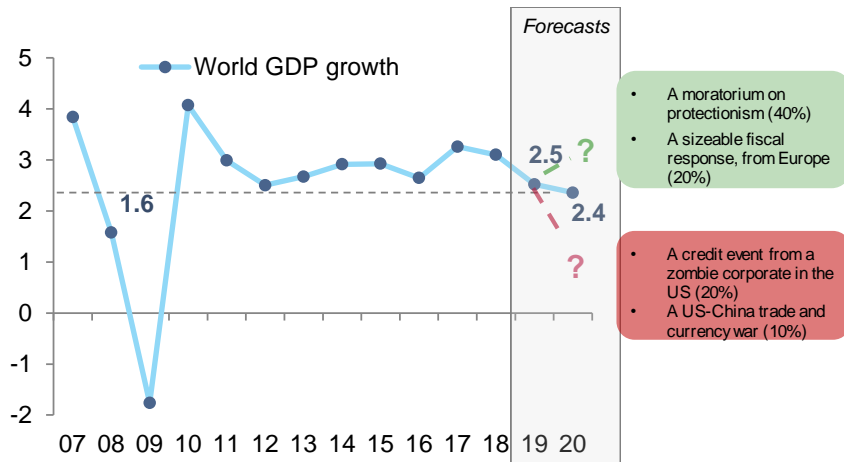


Sources: Bloomberg, Allianz Research

Falling interest rates have been accompanied by falling earnings yields in the US over the last 46 years. Extremely low interest rates link to pessimistic (real as well as nominal) growth expectations and increasing earnings yield. Trend nominal GDP growth and long-term nominal interest rates are closely linked together.

2020: NO BIG R BUT GROWTH LIMBOS

Annual GDP growth (y/y, %) and risk factors



Sources: IHS, EulerHermès, Allianz Research

Annual GDP growth and forecasts (y/y, %)

	2016	2017	2018	2019	2020
World GDP growth	2.6	3.3	3.1	2.5	2.4
United States	1.6	2.4	2.9	2.4	1.6
Latin America	-1.2	0.9	0.9	0.4	1.1
Brazil	-3.3	1.1	1.1	1.0	1.8
United Kingdom	1.8	1.8	1.4	1.2	0.8
Eurozone members	1.7	2.6	1.9	1.1	1.0
Germany	2.1	2.8	1.5	0.6	0.6
France	1.0	2.4	1.7	1.2	1.2
Italy	1.2	1.8	0.7	0.2	0.4
Spain	3.2	3.0	2.6	2.1	1.7
Russia	0.3	1.6	2.3	0.7	1.1
Turkey	3.2	7.5	2.8	-0.2	2.3
Asia	5.0	5.3	4.9	4.5	4.3
China	6.7	6.9	6.6	6.2	6.1
Japan	0.6	1.9	0.8	0.9	0.4
India	8.1	7.1	6.8	5.3	5.8
Middle East	4.7	1.3	1.6	0.8	2.1
Saudi Arabia	1.7	-0.7	2.4	1.2	1.2
Africa	1.2	3.2	2.7	1.9	1.9
South Africa	0.6	1.4	0.8	0.5	0.0

* Weights in global GDP at market price, 2018

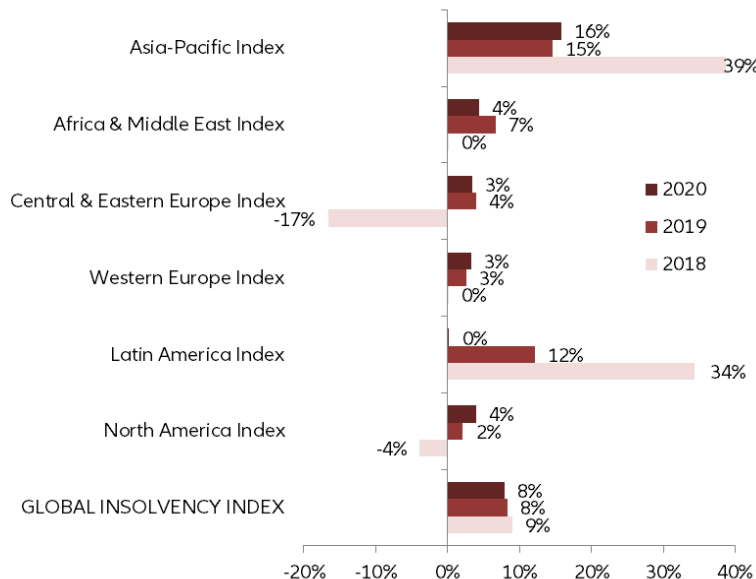
NB: The revisions refer to the changes in our forecasts since the last quarter
Fiscal year for India

Sources: IHS, EulerHermès, Allianz Research

To exit the 2015-2016 limbos, we see two upside possibilities, and two downside risks. Risk factors: potential positive developments include: an electoral bifurcation in the US in 2020 and a moratorium on protectionism (40% v. 60% for more of the same) but less business-friendliness; and a sizeable fiscal response, from Europe, taking the baton from the US (20%). These would call for rapid normalization by Central Banks to avoid exuberance. On the negative side: a credit event from a zombie corporate in the US for instance (20%); a major policy and a full-fledged US-China trade and currency war (10%) will trigger a recession.

GLOBAL INSOLVENCIES: ON THE UPSIDE, AS EXPECTED

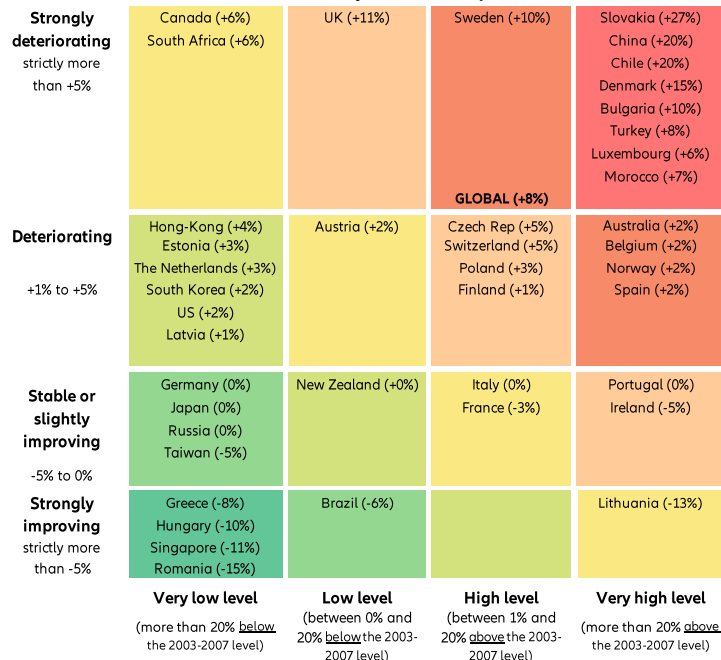
EH Global and Regional Insolvency Indices (yearly changes in %)



Sources: National statistics, Euler Hermes, Allianz Research

We expect 2 out of 3 countries to register an increase in corporate insolvencies in 2019 and almost 3 out of 5 countries to end 2019 with more insolvencies than posted annually before the 2008-2009 global crisis. The upside trend would remain broad-based in 2020. Our Global Insolvency Index is forecasted to increase by +8%, both in 2019 and 2020, with a still noticeable increase in Asia (+15% in 2019 and +16% in 2020), a rebound in Western Europe (+3%) and a trend reversal in North America (respectively +2% and +4%).

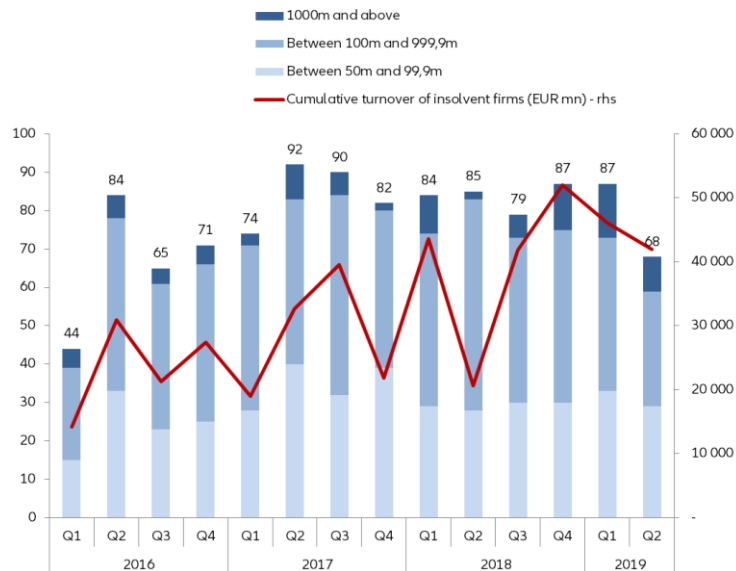
Insolvency Heat Map 2019



Sources: National statistics, Euler Hermes, Allianz Research

MAJOR INSOLVENCIES: HIGH FREQUENCY AND SEVERITY

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



Source: EulerHermès, (*) Companies with a turnover exceeding EUR50m

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

	H1 2019					TOTAL	FY 2018
	Africa Middle East and Latin America	Central & Eastern Europe	North America	Asia Pacific	Western Europe		
Electronics	-	-	-	1	-	1	5
Transport equipment	-	1	-	-	-	1	3
Commodities	-	-	-	2	-	2	7
Machinery/Equipment	-	1	-	1	-	2	21
Pharmaceuticals	-	1	2	-	-	3	1
Computers & Telecom	-	-	3	1	-	4	8
Automotive	-	2	-	-	4	6	12
Paper	-	-	2	-	4	6	5
Chemicals	-	-	1	5	1	7	8
Household equipment	-	-	1	3	3	7	17
Transportation	-	1	3	1	2	7	17
Textile	-	-	2	2	4	8	9
Energy	1	1	7	1	1	10	24
Agrifood	-	2	1	7	4	14	34
Services	-	1	1	5	8	15	32
Metals	-	1	-	6	9	16	21
Construction	-	2	1	10	7	20	60
Retail	-	2	7	2	13	24	51
Total	1	15	31	47	61	155	335

Source: EulerHermès, (*) Companies with a turnover exceeding EUR50m

H1 2019 monitoring points to a lower number of major insolvencies (-14 cases from H1 2018). Based on their financials, these insolvent companies represented a higher combined turnover of EUR88.2bn (+37% or +EUR23.9bn vs H1 2018), suggesting a worsening severity of global insolvencies, which could have serious effects on providers along supply chains. Asia and North America both experienced an increase in major insolvencies (+4 and +13 cases, respectively, compared to H1 2018), while both Central & Eastern Europe and Western Europe recorded less (-13 and -16 cases, respectively). At the same time, Western Europe remained the main contributor to the global level of major insolvencies. Retail (24 insolvencies), Construction (20) and Metals (16) were the most affected sectors in terms of the number of insolvencies for this period. Metals (+7), along with Paper (+5), posted the strongest rise in insolvencies, while Machinery & Equipment (-10) saw a noticeable decline compared to H1 2018.

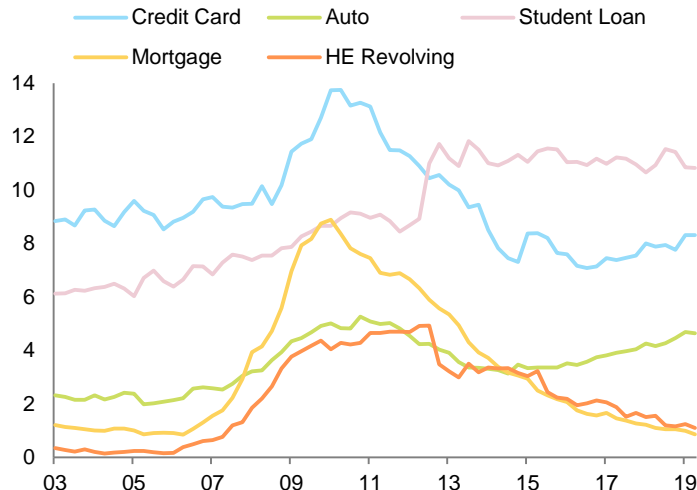
THE US AND WESTERN EUROPE

02

US: CONSUMER FATIGUE TO PROGRESSIVELY APPEAR



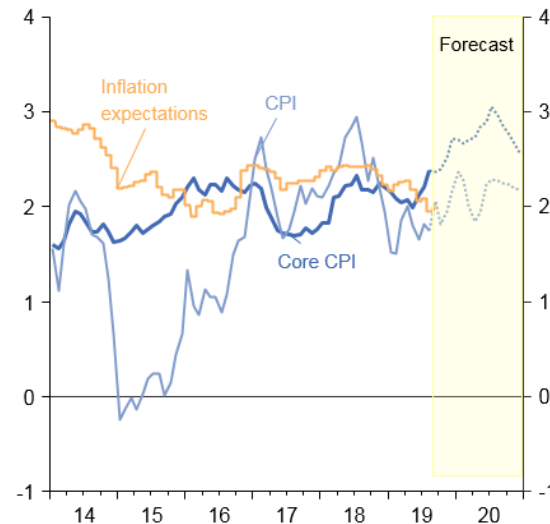
Percent of Balance 90+ Days Delinquent by Loan Type



Source: Bloomberg, Allianz Research

Credit deterioration in the consumer credit segments (autos, student loans, credit card) points towards lower momentum in the coming months.

CPI and core CPI (yoy, %)



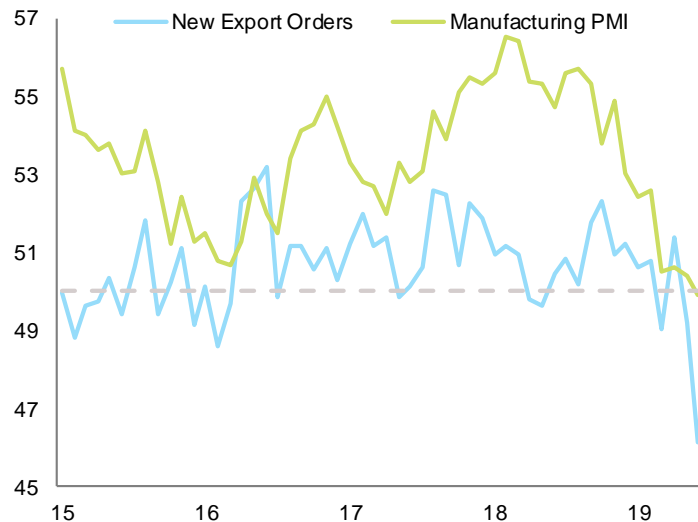
Source: Bloomberg, Allianz Research

Household consumption is expected to decelerate at 1.4% y/y in 2020 compared with 1.9% y/y in 2019. Some erosion of real purchasing power will come from higher core CPI price items post implementation of tariffs on consumer goods imported from China.

US: TRADE SHOCK TO BE VISIBLE IN H1 2020



ISM Manufacturing PMI & Manufacturing New Export Orders



Source: Markit data, Allianz Research

New export orders of the ISM manufacturing PMI index are at their lowest value since Sept 2009. The deterioration of external demand weighs on manufacturing activity and progressively spreads to the rest of the economy.

Wholesale inventories and goods imports (% y/y)

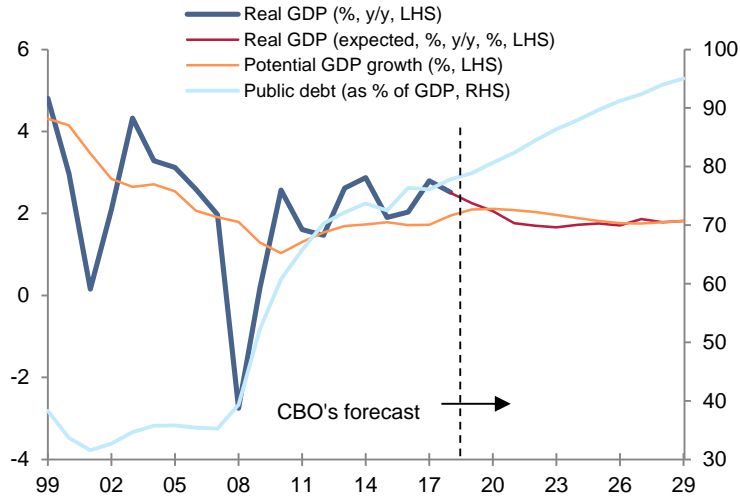


Source: Markit data, Allianz Research

Imports are a good advanced indicator of inventories. Front-loading activities before real implementations of tariffs have been at work and nurtured inventories. In the coming months (6 months lag), inventories are expected to contribute much less to growth

US: RECESSION AVOIDED BUT LIMITED CAPACITY TO GROW

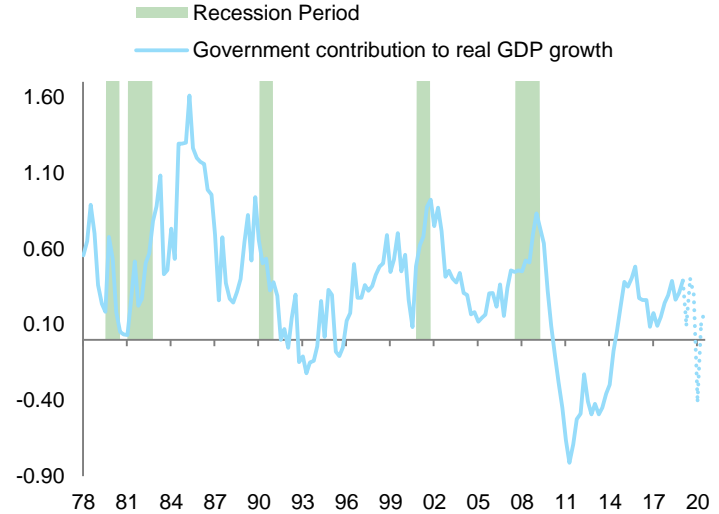
US public debt and GDP growth



Sources: Bloomberg, Allianz Research

The potential of growth has been unresponsive to the recent stimulus, pointing towards limited capacity to stabilize debt. Fed independence is at risk. Tools of economic policy will be less powerful in the future.

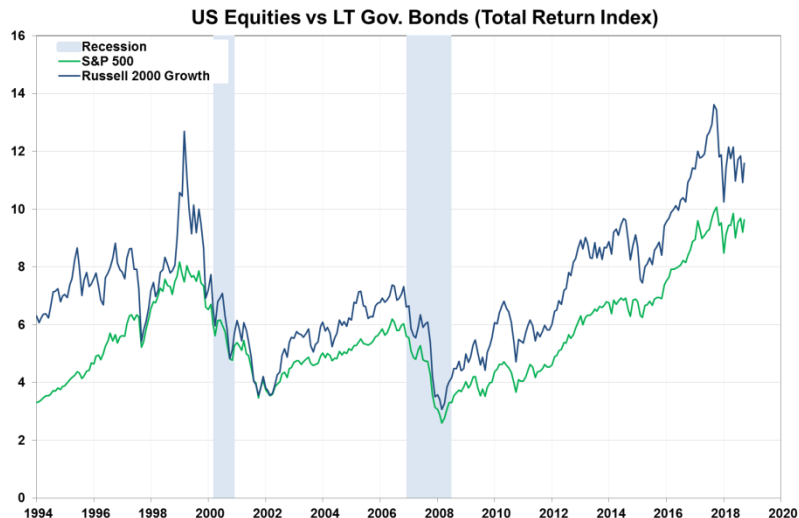
Public expenditures' contribution to growth (pp)



Sources: National sources, Allianz Research

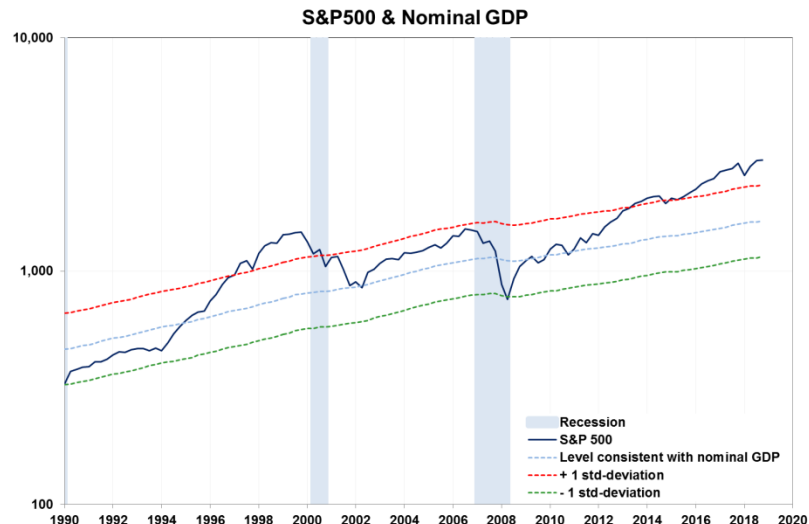
We don't expect a radical re-orientation of fiscal policy now thanks to a bi-partisan agreement on debt, which will generate USD150bn more of fiscal spending over the two coming years. However the contribution to growth of fiscal spending is expected to gradually weaken because of fiscal constraints

US: HIGHER VULNERABILITIES IN THE EQUITY MARKET



Sources: Refinitiv, Allianz Research

Small caps growth stocks tend to exhibit a more cyclical behavior than the large caps stocks. While the relative performance of the S&P 500 has been flat since October 2018, that of the Russell 2000 growth has seemingly peaked in August 2018. The divergence in the behavior of large and small caps is reminiscent of the one observed in 2000.



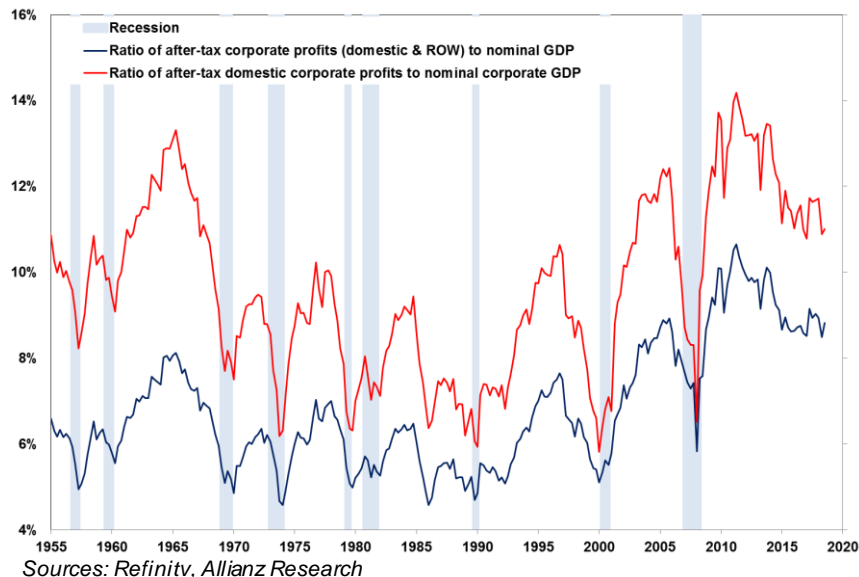
Sources: Refinitiv, Allianz Research

As the S&P500 stands well above fair value, the distribution of outcomes is skewed (less than 8% chance to see a higher S&P500).

US: CORPORATE PROFITABILITY WILL REACH A TROUGH IN H2 2020



S&P 500 profits

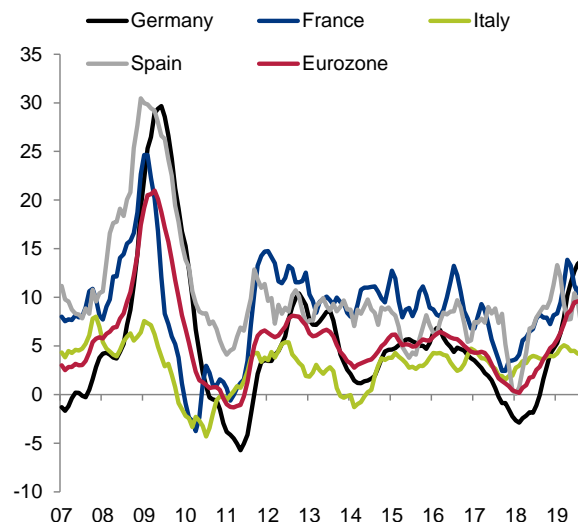


- The S&P 500 reported profits account for only about 1/6 of total corporate profits. The share of after-tax corporate profits in corporate GDP has peaked in Q1 2012 and, from Q4 2014 onwards, they have started to fall.
- The increased negative contribution of employees' compensation, the consumption of fixed capital, interest payments, and the turn-around in the contribution of taxes on corporate income, from negative to positive, are the key changes observed since 2014. Without these tax cuts, profits would have barely grown since 2014, and as a share of GDP, their recession would have been more pronounced.

EUROPE: RESILIENT DOMESTIC SECTORS



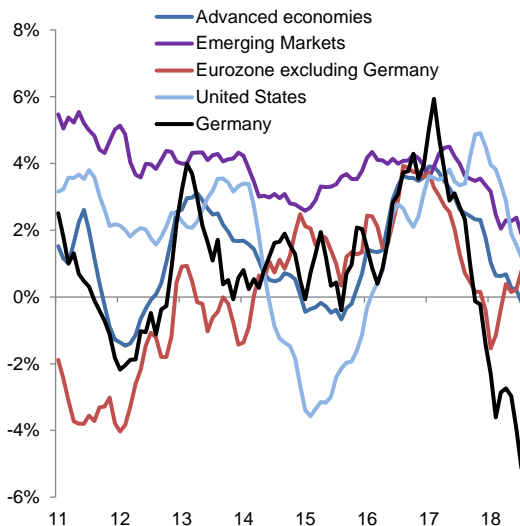
Assessment of stocks by companies in the industrial sector, balance of opinion



Sources: Eurostat, Allianz Research

Company inventories remain at unusually high levels, notably in Germany...

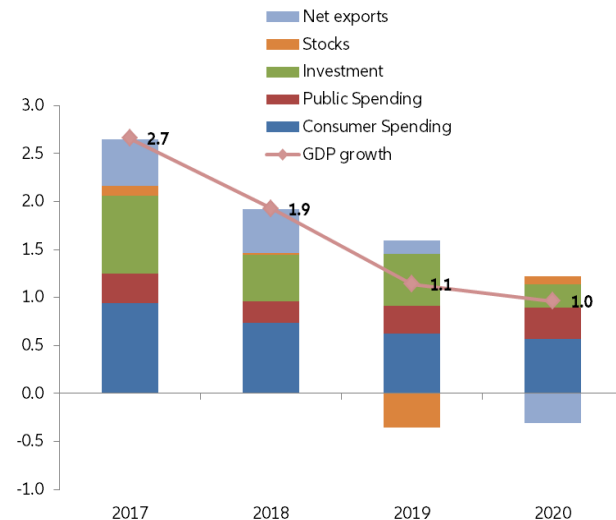
Industrial production, 3M yoy



Sources: Eurostat, Allianz Research

...which calls for further downside adjustment in production: we expect a trough in Q3-Q4

Real Eurozone GDP growth, contribution by component

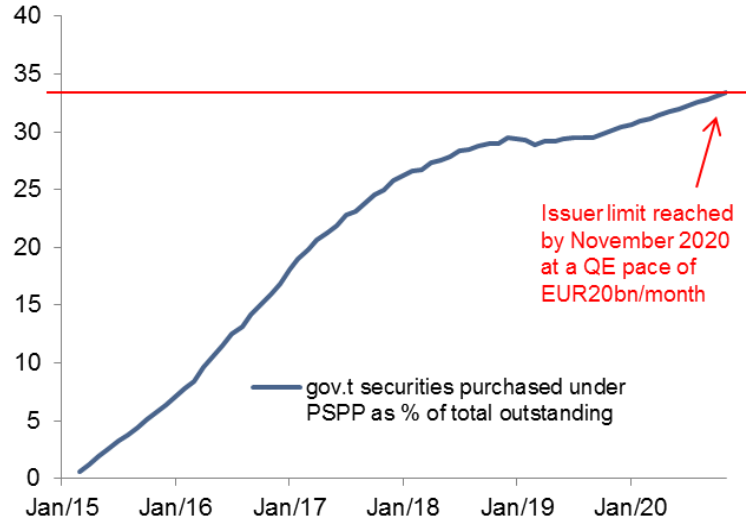


Sources: IHS Data Insight, Allianz Research

Consumer spending growth should remain broadly stable in 2020

EUROPE: EXPECT YET MORE ECB DOVISHNESS IN 2020

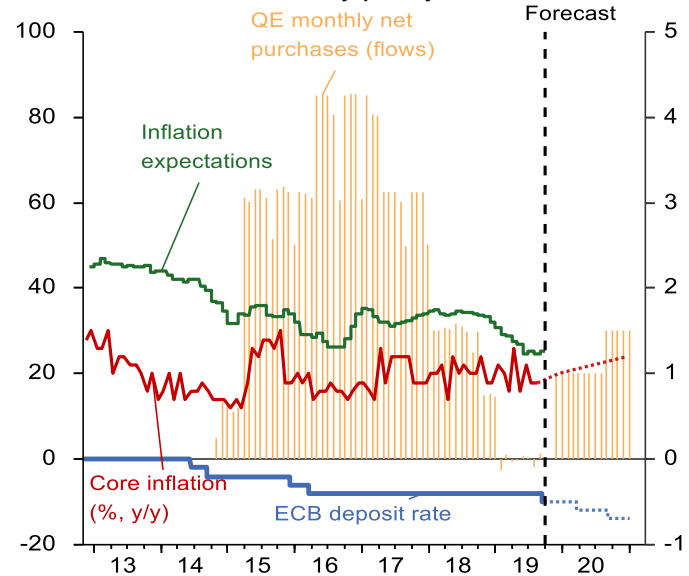
German government securities purchased under PSPP as % of total outstanding



Sources: Refinitiv, Allianz Research

The ECB announced a super-dovish stimulus package in September but we think it will further up the stimulus doses in 2020 with inflation to remain notably below target and the Fed further easing its policy. To ensure the implementability of its QE program the issuer limit will have to be raised from 33% to 50% by mid-2020.

ECB monetary policy outlook



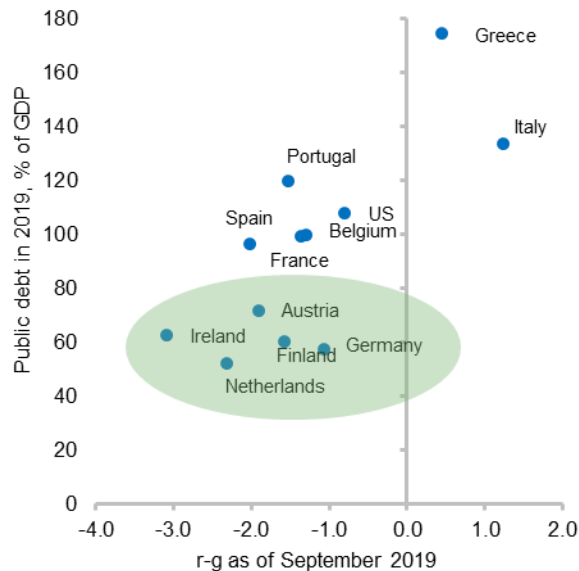
Sources: Refinitiv, Allianz Research

The ECB will further lower the deposit rate by another 10bps in March and September to a low of -0.7% while monthly QE purchases will be increased to EUR30bn as early as April 2020.

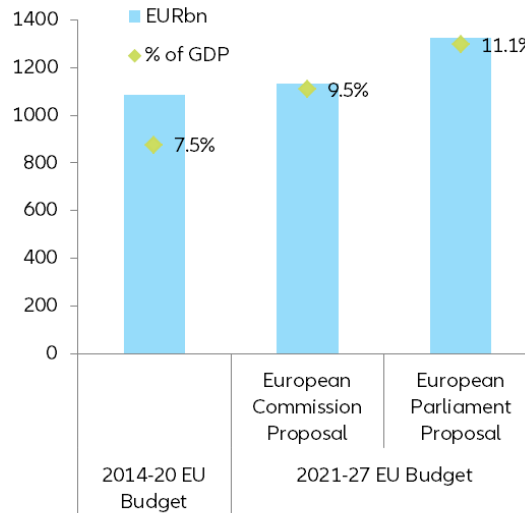
EUROPE: MORE FISCAL SPENDING NEEDED



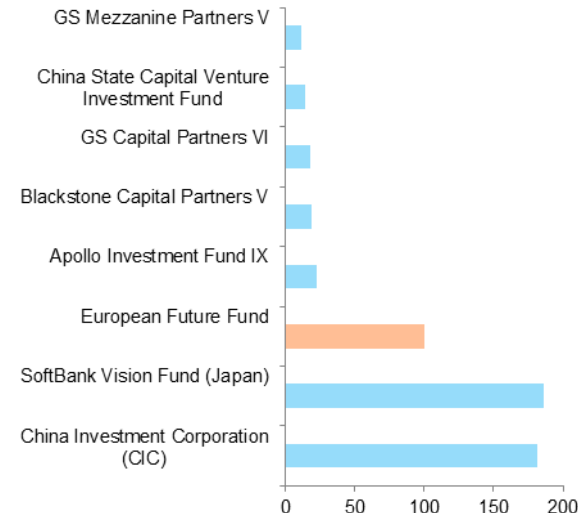
Public debt vs r-g



EU Budget (Multiannual Financial Framework)



Capital funds, EURbn



Sources: *The Economist*, Allianz Research

Negative r-g creates some space for more public spending but the room to maneuver of the States are limited

Sources: *EU Commission*, Allianz Research

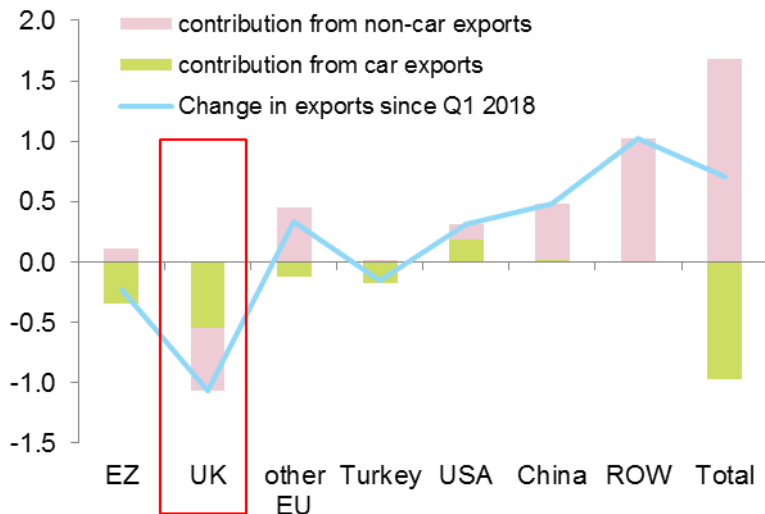
The next EU Budget should reach between 9.5% and 11% of GDP, in addition to Invest_EU (EUR650bn by 2027, i.e. 5.4% of GDP)

Sources: *The Economist*, Allianz Research

A European Future Fund of at least EUR100bn is likely in 2020-21 which will aim to invest directly in the equity of European champions (probably in ITC, agri-food, aeronautics, machinery) in order to cope with competition from abroad

GERMANY: FLIRTING WITH RECESSION, BUT NOT COMMITTING YET

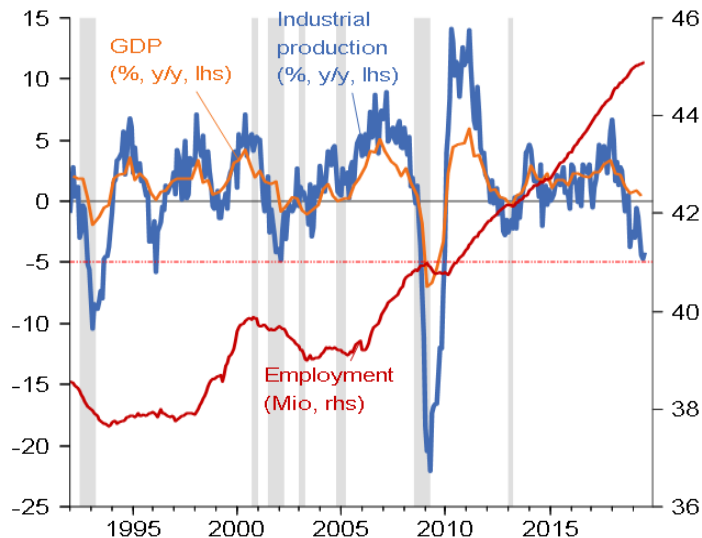
Change in nominal exports since Q1 2018 (%) & contributions from car and non-car exports



Sources: Refinitiv, Allianz Research

German export weakness is mostly about cars and Brexit. Meanwhile the trade tensions appear to play a less important role with overall German export growth – in particular when disregarding cars - still positive compared to Q1 2018.

GDP, industrial production, employment & recession bands



Sources: Refinitiv, Allianz Research

Germany has experienced four comparable industrial setbacks of which three ended in a recession. What's different this time: consumption is structurally boosted with 3 million jobs added over the past 6 years. Thanks to *Kurzarbeit* & skilled-labor shortages, employment will remain resilient in 2020.

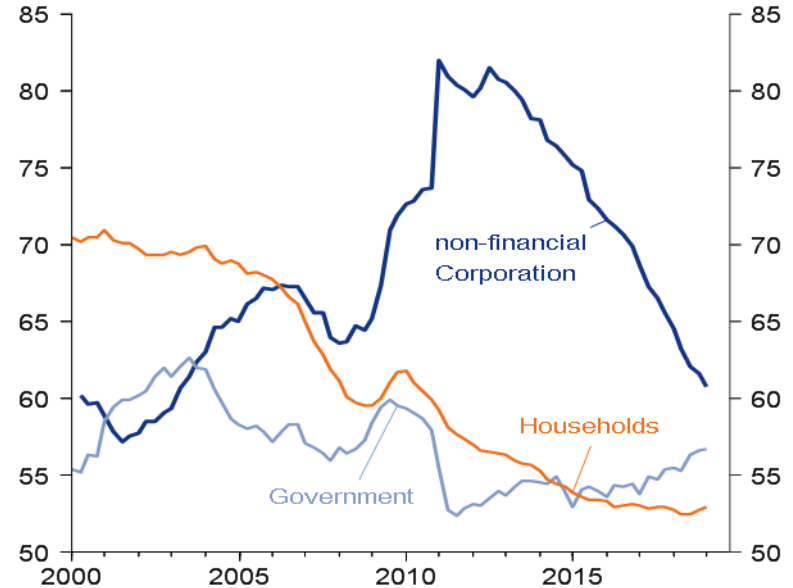
GERMANY: DON'T WAIT FOR A FISCAL BAZOOKA!

Fiscal wish list - in compliance with German debt brake

Fiscal impulse	Objective	Impact & implementation
Infrastructure investment (EUR4bn)	Boost potential growth with focus on green, digital	<ul style="list-style-type: none"> High fiscal multiplier (1.5) likely delayed implementation due to bottlenecks in construction sector
Lower taxes & social contributions (EUR4bn)	Tackle short-term demand lack & boost potential growth	<ul style="list-style-type: none"> Fiscal multiplier of 0.7 Immediate implementation High uncertainty may see households chose to save rather than spend
Cash for clunkers (e-cars) / temp. reduction in VAT (EUR4bn)	Tackle short-term demand lack	<ul style="list-style-type: none"> Fiscal multiplier of 0.6-0.7 Immediate implementation politically controversial due to recent car scandals Require a certain degree of legal and regulatory certain.

To maximize the impact of its room for maneuver under the *Schuldenbremse* (about EUR 12bn in 2020, +0.2pp of GDP growth) Germany should follow a multi-pronged approach aimed at boosting short-term demand as well as potential growth.

German sectoral debt (% GDP)

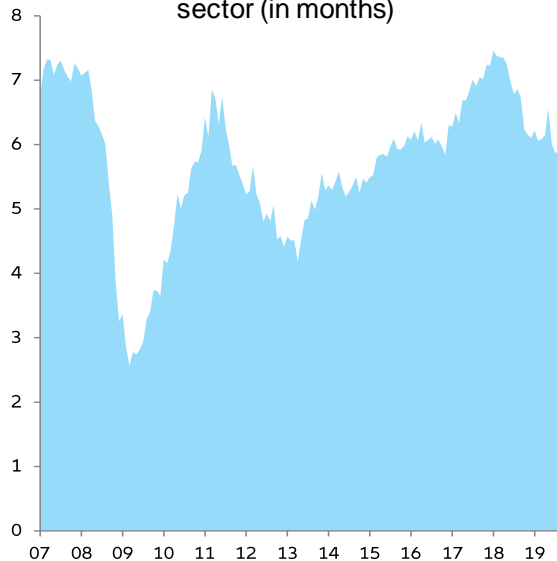


Sources: Refinitiv, Allianz Research

Even without much support from the government, the private sector is in good shape to weather an economic downturn given low indebtedness & high savings amassed during recent years.

FRANCE: RESILIENT HOUSEHOLD SPENDING

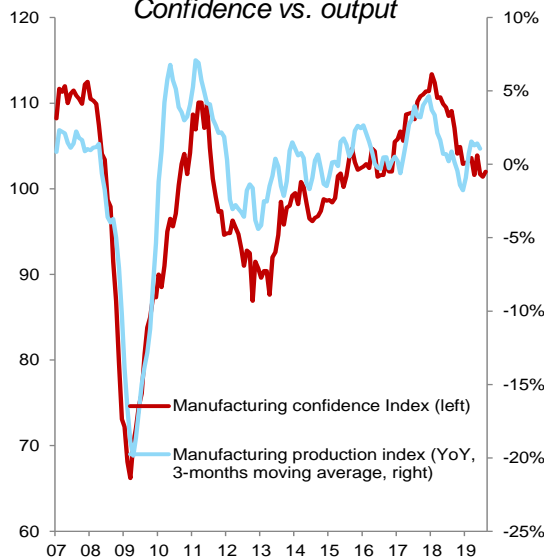
France: Order books in the manufacturing sector (in months)



Source: Allianz Research

France is exposed to the downturn experienced elsewhere (e.g. French suppliers of the car industry), with lowering order books (including foreign ones).

France : Manufacturing sector
Confidence vs. output



Sources: IHS Global Insight, Allianz Research

French corporates have increased both their output and inventories in H1 2019. Manufacturing production should slowdown more markedly.

France: % of households able to buy a home in the next two years



Source: Insee

However, higher purchasing power growth (+2.5% in 2019) and low interest rates are providing a stimulus to residential investment acting as a buffer and limiting the growth downturn.

ITALY: REDUCED RISK OF BUDGET TENSIONS, BUT DEBT DYNAMICS REMAIN A PROBLEM



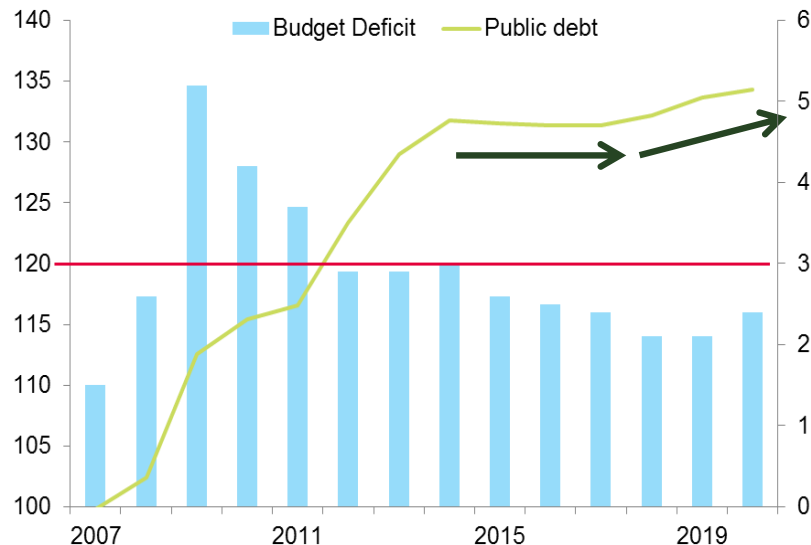
Italian 10yr government bond yield vs Germany & real GDP growth (q/q, %, inverted axis)



Sources: Refinitiv, Allianz Research

Italian 10-yr yields fall to the lowest level since H1 2018 with markets relieved about the M5S-PD coalition taking over. Reduced uncertainty will boost 2020 growth prospects with GDP accelerating to 0.4% in 2020.

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



Sources: Refinitiv, Allianz Research

We expect the government to comply with the 3% deficit criterion, but despite a more prudent fiscal stance, debt dynamics remain a problem with debt as % of GDP remaining on an upward trajectory.

BREXIT: A PYRRHIC DEAL?

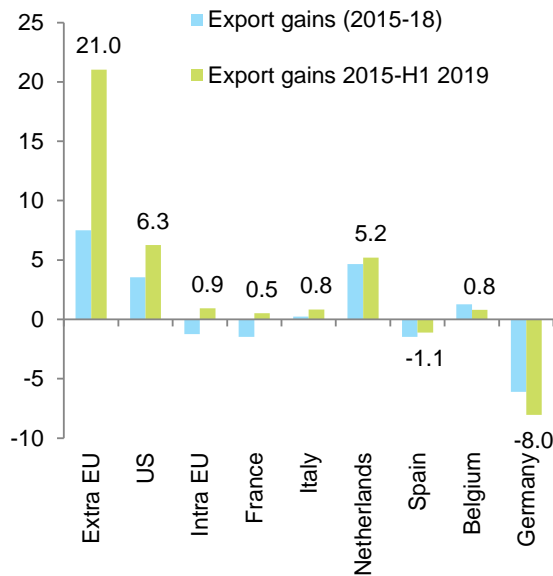


Cost of Brexit fears so far

Indicator	Prior Brexit referendum	Latest	Change
Real GDP growth, %	2.3	1.2	-1.1
Markets			
Stock market (FTSE index, all)	3 584	3 953	10%
Gilts rates, %	1.8	1.1	-0.7
Sterling (REER index)	115.7	96.9	-16%
Labor market			
Migrants EU, number of persons	122 000	97 000	-20.5%
Migrants extra-EU, number of persons	450 500	440 000	-2.3%
Wage growth, %	2.4	4.0	1.6
Consumers			
Consumer confidence, balance of opinion	3.1	-12.6	-15.7
Savings rate, %	10.2	4.4	-5.8
Consumer credit growth, %	7.6	3.5	-4.1
Private consumption, %	2.6	1.7	-0.9
Companies			
Business investment, %	3.7	-1.1	-4.8
Business confidence (Composite PMI)	56.8	50.2	-6.6
Turnover Services, 3M yoy	2.0	3.6	1.6
Turnover Manufacturing, 3M yoy	2.2	-0.9	-3.1
Margins, % of value added	40.7	37.7	-3.0
Inward FDI, GBPbn	199	24	-88%
Business insolvencies, cases	19 824	23 433	18%

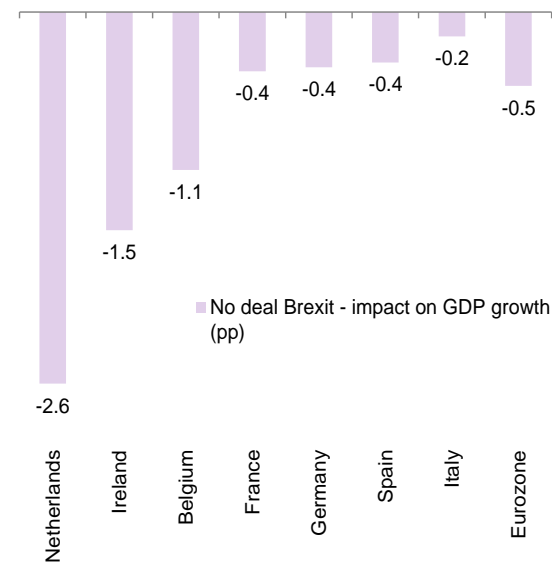
Sources: National sources, Allianz Research

Export gains to the UK by origin, EURbn



Sources: Eurostat, Allianz Research

Impact of 'no deal' Brexit, pp of real GDP growth per year



Sources: ITC, World Bank, Allianz Research

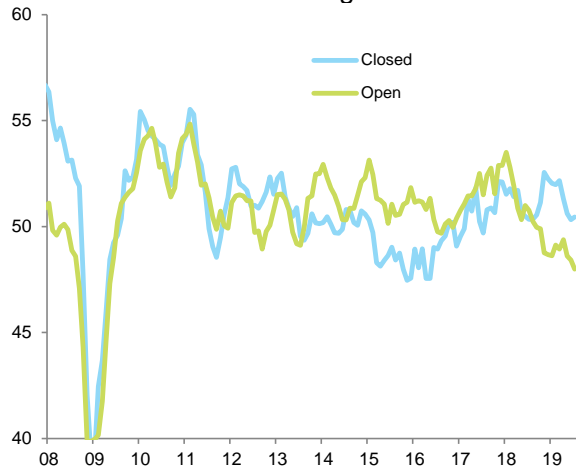
The trade flows between the UK and the EU have been reinforced by the contingency stockpiling. A no deal would push the Netherlands, Belgium and Germany into recession.

EMERGING MARKETS

03

EMERGING MARKETS: FEELING THE SQUEEZE

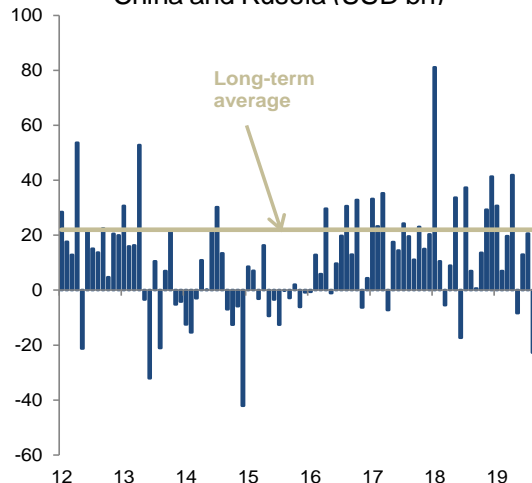
Emerging Markets: Aggregate Manufacturing PMI



Sources: Bloomberg, Allianz Research

Activity: EM PMIs broadly deteriorated but with the strongest pace in open economies. The gap between open and closed economies is typically observable during strong downturns.

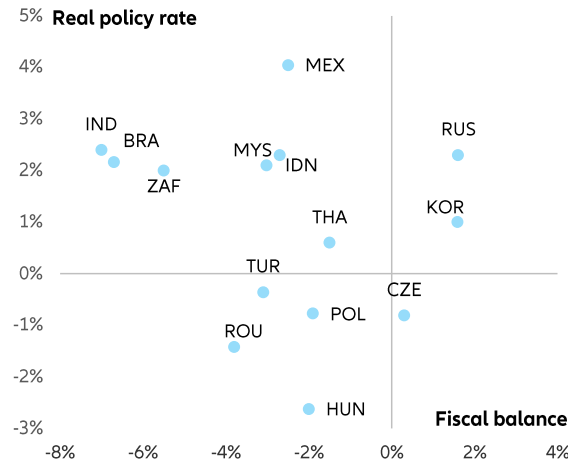
Net capital flows to Emerging Markets excl. China and Russia (USD bn)



Sources: IHS Data Insight, Allianz Research

Capital outflows are again materializing and are aligned with the two last bouts of protectionists moves from the US (May and August)

Emerging Markets: Fiscal balance in % of GDP vs. real monetary policy rate

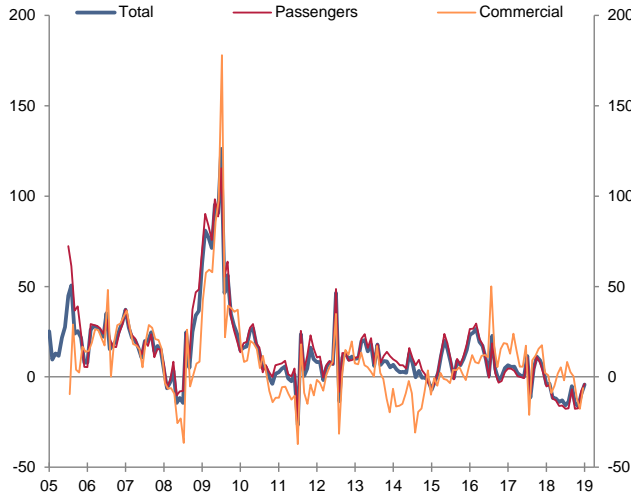


Sources: Bloomberg, Allianz Research

Buffers: Emerging Markets have more leeway to ease their monetary policy. Exceptions: India, Brazil and South Africa for fiscal policy. In Eastern Europe, monetary policy easing would have to come through unconventional measures.

CHINA: PRUDENT CONSUMER AMID NEGATIVE EXTERNAL FORCES

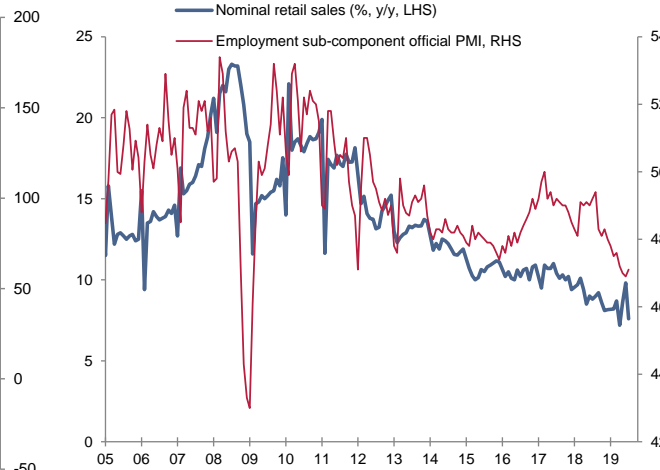
Car sales in China (% y/y)



Sources: IHS, Allianz Research

The fiscal stimulus did not bear fruit for the private sector yet

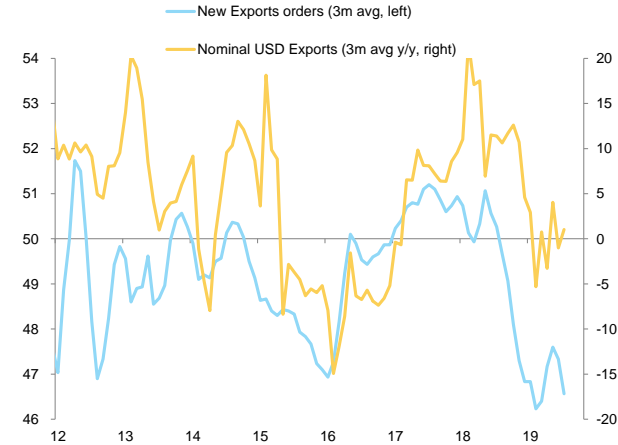
Employment conditions and retail sales



Sources: IHS, Allianz Research

The consumer remains worried about deteriorating job market prospects

Nominal exports and export orders in China



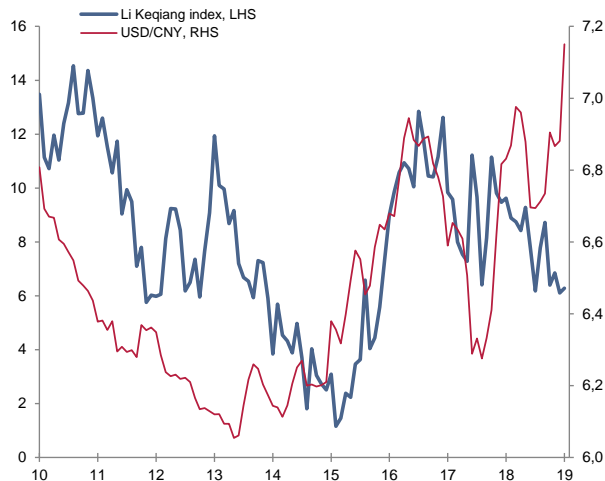
Sources: IHS, Allianz Research

New export orders suggest weak export performance going forward

CHINA: SHOCK ABSORBERS AT PLAY



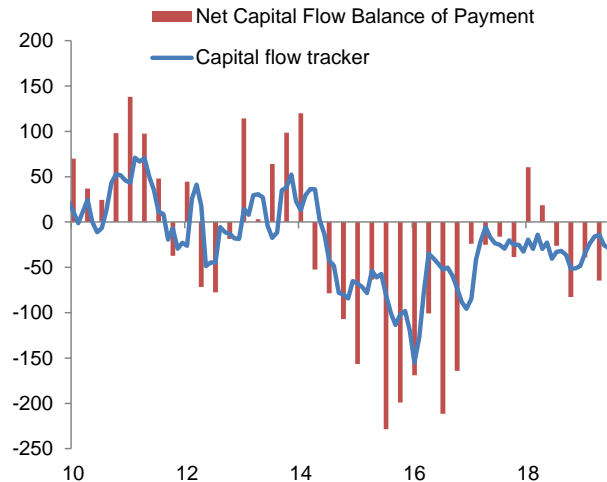
Li Keqiang Index and USD/CNY



Sources: Bloomberg, Allianz Research

The RMB should depreciate further alongside trade dispute = 7.23 for CNY/USD in a 1-year horizon...

Capital flows in China (USD bn)



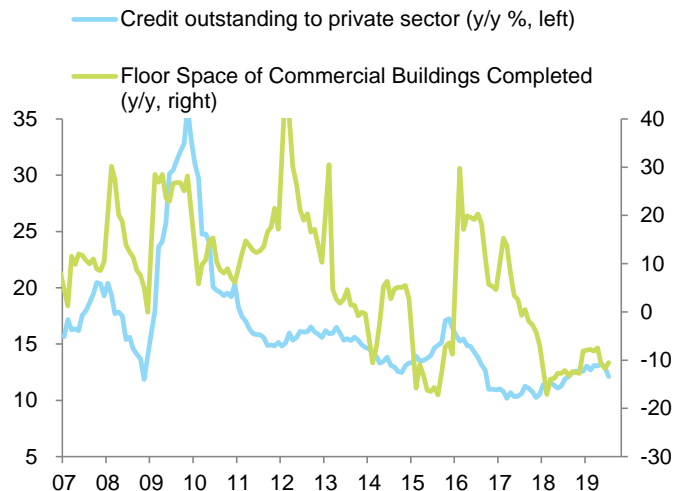
Sources: Bloomberg, Allianz Research

Stricter capital controls will allow avoiding disorderly adjustments like in 2015 - 2016

CHINA: ADDITIONAL MONETARY AND FISCAL SUPPORT EXPECTED



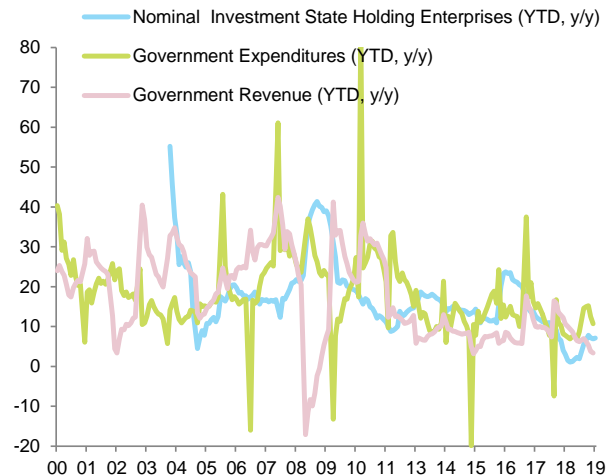
Credit to private sector



Sources: Bloomberg, Allianz Research

The PBOC is likely to implement three cuts in RRR, new cuts in the medium-term lending facility (TMLF) rate and in the loan prime rate (LPR).

Chinese government accounts (% y/y)



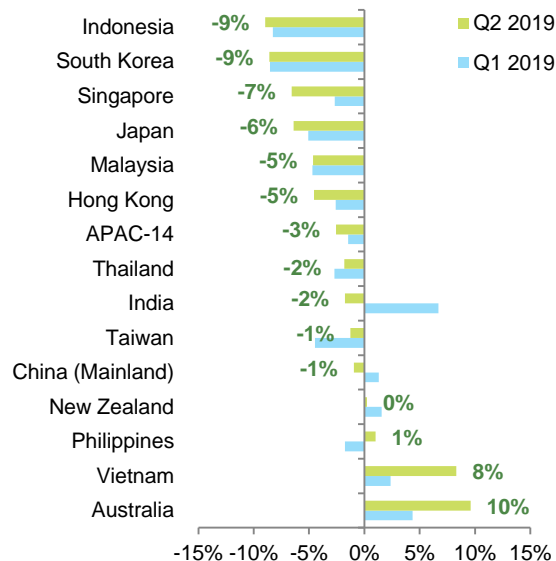
Sources: Bloomberg, Allianz Research

Policymakers could increase quotas for special bonds to allow for higher bond issuances for local governments to allow for higher infrastructure spending. We expect around 2% of GDP more in late 2019 – early 2020. The private sector will slowly positively respond.

ASIA: TRADE RECESSION AFFECTS INDUSTRIAL ACTIVITY AND CURRENCIES



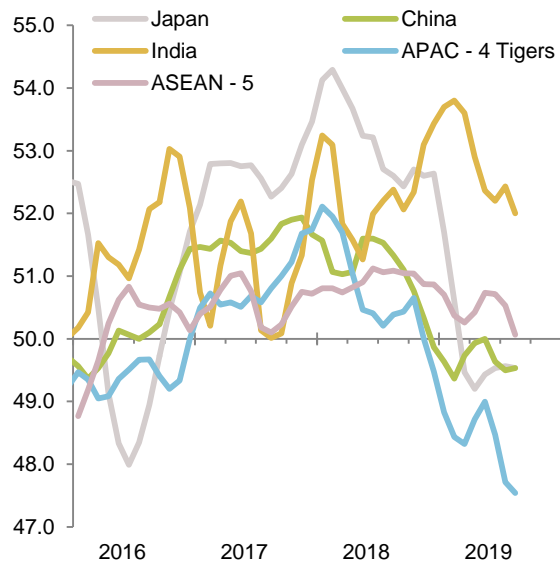
USD-denominated export growth (% y/y)



Sources: IHS Markit, Allianz Research

Open economies with strong trade links to China have experienced significant export losses in early 2019. Vietnam is a beneficiary from the US-China trade feud, with firms shifting production. Australian exports bolstered by strong commodity prices

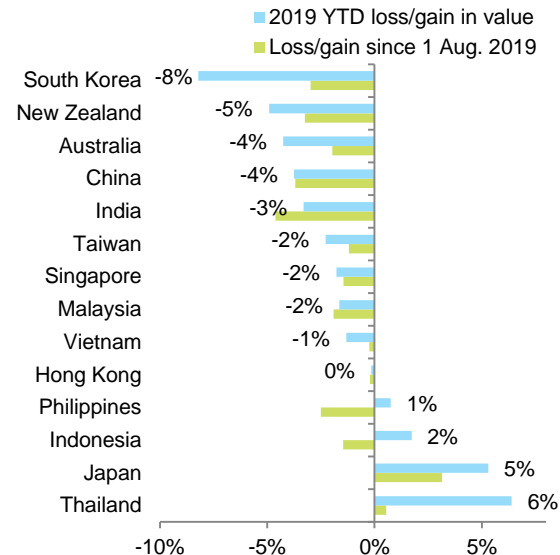
Manufacturing PMI (3-month moving average)



Sources: IHS Markit, Allianz Research

The industrial output cycle follows the trade cycle.

Exchange rates vs. USD



Sources: IHS Markit, Allianz Research

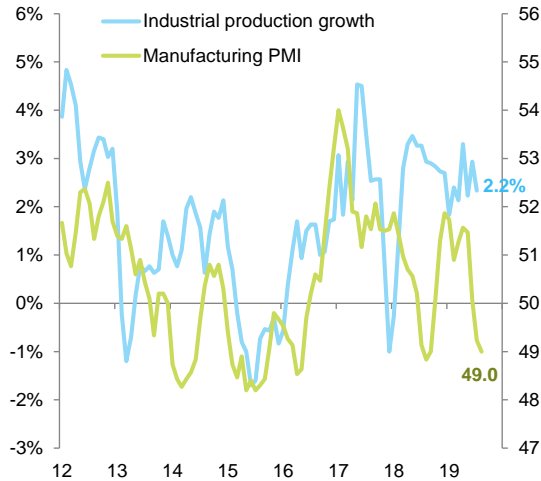
Exchange rate pressures were moderate in H1 2019 (except for South Korea where the economy unexpectedly shrank in Q1...but have markedly picked up in August as weak trade data were published and “political noise” intensified.

RUSSIA: CLOSE TO RECESSION

TURKEY: BOTTOMED OUT - RISKS REMAIN



Russia: Industrial production growth (y/y) and Manufacturing PMI (3-mth moving averages)



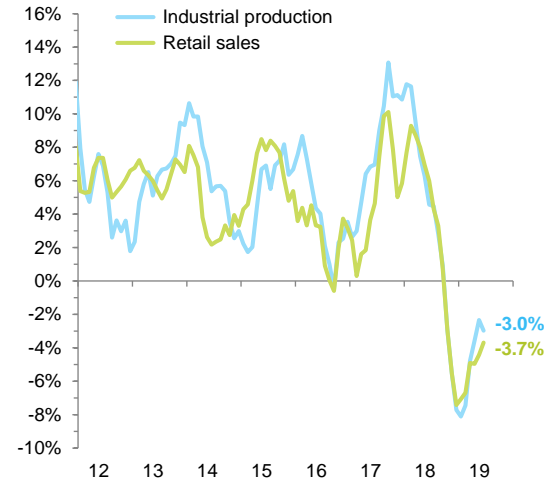
Sources: National statistics, IMF, IHS, Allianz Research

Russia: Retail sales growth (y/y) and consumer confidence index (quarterly averages)



Source: National statistics, IHS Markit, Allianz Research

Turkey: Industrial production and retail sales growth (y/y, 3-mth moving averages)



Source: National statistics, IHS Markit, Allianz Research

Russia's GDP growth disappointed in H1 2019 (+0.7% y/y), owing to both subdued domestic demand and exports, the latter due to oil output cuts agreed with OPEC. This pattern is to continue broadly amid global uncertainties and stepped-up financial sanctions.

Growth forecasts: +0.7% in 2019 and +1.1% in 2020.

Solid macro fundamentals continue to provide buffers: fiscal and current account surpluses, low debt levels, moderate inflation that allows for more monetary easing.

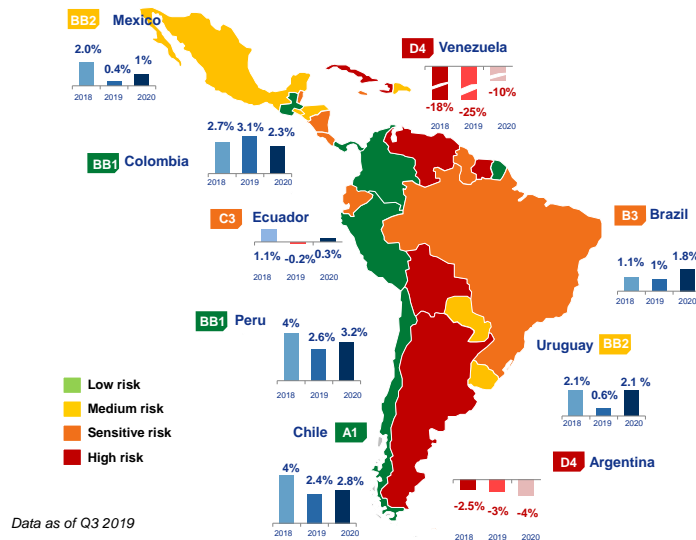
But insolvency risk for corporates and (small) banks remains elevated.

Turkey's GDP growth is forecast at -0.2% in 2019 and +2.3% in 2020. Rebalancing of external sector continues though current account to remain in (small) deficit. Fundamental weaknesses will remain (high unemployment and inflation, exchange rate vulnerability, low FX reserves, high external debt).

LATIN AMERICA: SLIPPERY SLOPE

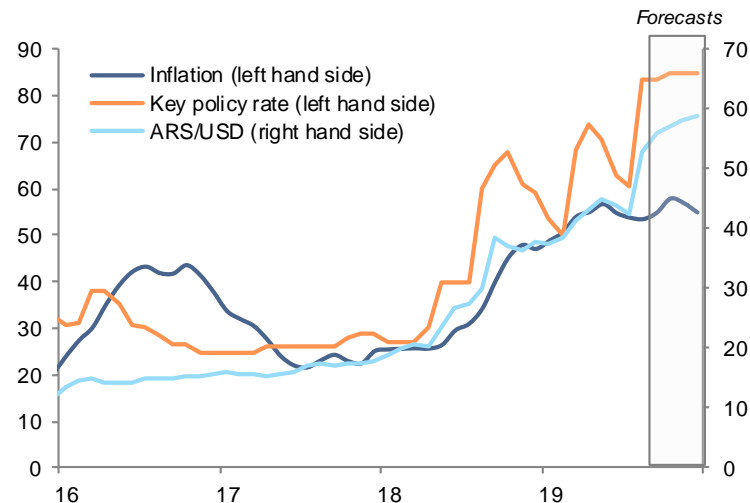


Country risk and economic growth in Latin America



Sources: IMF, IHS, Euler Hermes, Allianz Research

Inflation, policy rate and exchange rate in Argentina



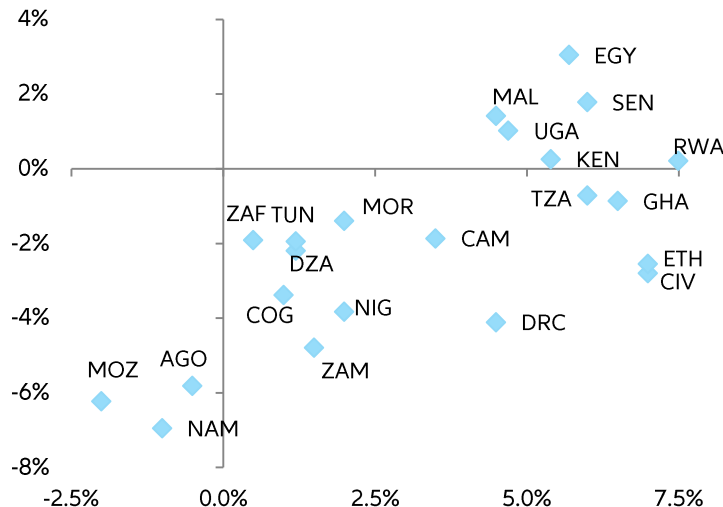
Sources: IHS, BCRA, Euler Hermes, Allianz Research

No sizable recovery in sight: 0.8% growth 2019, +1.3% in 2020 (exc. Venezuela), after +1.4% in 2018. Features of illiberal cycle: monetary easing, prioritization of household purchasing power and interventionism amid political risk. Brazil's growth should be moderately boosted by watered-down pension reform and privatizations. Low-growth regime in Mexico and policy uncertainty driving off investment. Argentina's default and predicted election result = additional year of economic contraction in 2020, and heightened political risk for companies. Higher risk of financial contagion Colombia + Costa Rica (twin deficits)

AFRICA: THE GOOD, THE BAD, AND THE UGLY



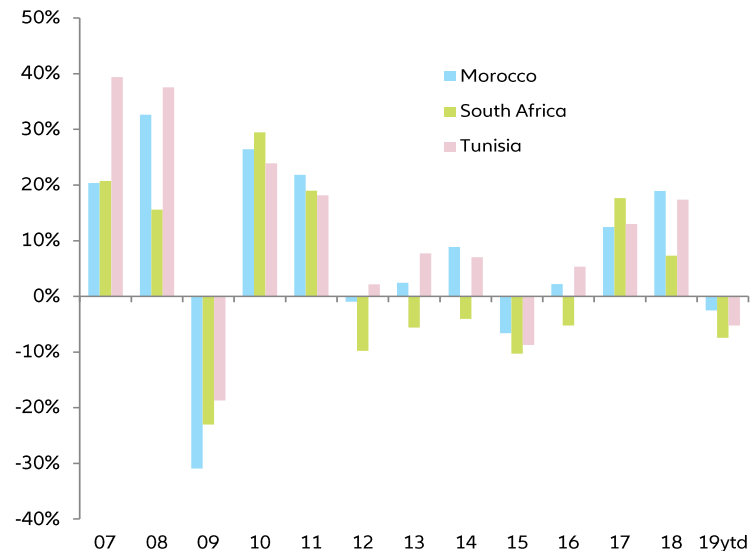
Africa: 2019 GDP growth level vs growth change compared to 2012-14 period



Source: Allianz Research

African growth underperformance is widening (+1.9% in 2019 and 2020). Large economies (Nigeria, South Africa, Algeria) and export hubs (Morocco, Tunisia) are underperforming visibly. Over-performers (from Egypt to Ghana) are not affected by the downturn.

Export dynamics: Morocco, Tunisia and South Africa (y/y)



Source: IHS Global Insight

African Export hubs are suffering from a visible downturn in their exports change, as sizeable as in 2015 despite lower price deflation (~stronger volume impact)

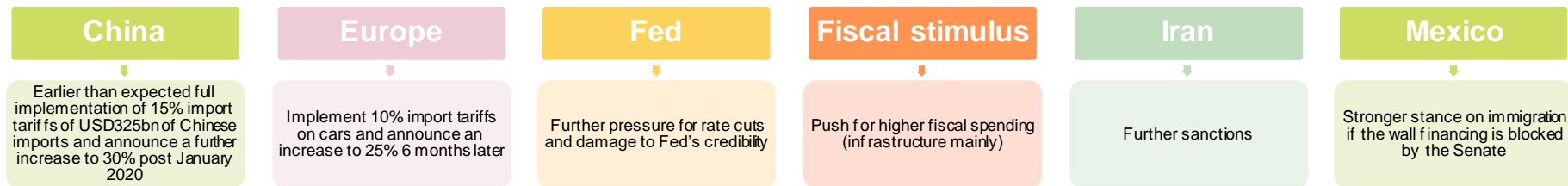
THANK YOU!

Economic Research Department
Q3 2019



US: SIDE EFFECTS FROM THE IMPEACHMENT?

Impeachment procedure: what could be Trump's reaction function?
(by order of likelihood)



Source: Allianz Research

6 key steps in the impeachment process:

- ✓ Impeachment resolution: **ongoing**
- ✓ Investigation: **likely**
- ✓ House vote on impeachment: **likely**
- ✓ Trial: **likely**
- ✗ Senate vote: **unlikely**
- ✗ Removal: **unlikely**

Only two Presidents have been impeached before, Andrew Johnson in 1868, and Bill Clinton in 1998-1999. The latter has been impeached in Oct 1998, had his trial in Jan 1999 and was impeached in Dec 1998.