ECONOMIC RESEARCH & CORPORATE DEVELOPMENT

The NewsLine

December 19, 2012

} MACROECONOMICS | FINANCIAL MARKETS | ECONOMIC POLICY | SECTORS

FINANCIAL MARKETS

Economic and financial market outlook 2013

Dr. Michael Heise
Phone +49.89.3800-16143
michael.heise@allianz.com

Dr. Rolf Schneider
Phone +49.69.263-57790
rolf.schneider@allianz.com

Allianz SE
https://www.allianz.com/economic-research/de

On the economic front, 2012 was a turbulent year. In mid-year the eurozone was staring a systemic crisis in the face. The economy slipped into recession and the global economy also sputtered. With growth of 2.3%, the world economy recorded the third lowest growth rate of the past ten years.

Taking stock of the financial markets at the end of this year, the picture is far more encouraging than in the real economy. Practically all asset classes – with the exception of cash – notched up significantly positive returns. Up among the leaders were German equities; in the year to date the DAX recorded an increase of almost 30%. But a portfolio with European or US equities also raked in more than 10%. Emerging market stock indices also saw double-digit increases. Exceptional returns were were also seen on longer-term corporate bonds. For medium-grade bonds (BBB, 7-10 years) European indices in some cases notched up gains of more than 20%, for longer-term top-grade corporate bonds (AAA, 7-10 years) gains were around 10%.

Even the longer-term government bonds of the “safe havens” Germany and USA generated a return of 7% and 5% respectively, thanks to a further decline in the yield level. With a broad portfolio of longer-term EMU government bonds, including a sizeable chunk of Italian and Spanish bonds, actually managed to generate a return of well over 10%.

Such a uniformly positive correlation of investment returns across various asset classes as this year is seldom. As a result, we think that a similarly uniform annual performance in 2013 is hardly to be expected, even if – as we deem likely – a moderate, largely inflation-free global economic recovery sets in.

Next year the world economy is likely to grow by 2.7% after 2.3% this year. For the USA we are penciling in a GDP increase of around 2%. In most emerging markets such as, for instance, China and Brazil, the economy will regain momentum. The eurozone will probably gradually crawl its way out of recession. But average growth in 2013 will be only marginal.

Growth rates in main economic regions
GDP, real % change over previous year

	2007	2008	2009	2010	2011	2012[1)]	2013[2)]
Industrialized countries	**2.5**	**-0.1**	**-3.8**	**2.6**	**1.3**	**1.1**	**1.3**
European Union	3.2	0.3	-4.3	2.1	1.6	-0.2	0.5
Euro area	3.0	0.3	-4.3	2.0	1.5	-0.4	0.2
USA	1.9	-0.3	-3.1	2.4	1.8	2.2	2.1
Japan	2.2	-1.0	-5.5	4.5	-0.8	1.7	0.9
Emerging markets	**8.3**	**5.5**	**1.3**	**7.4**	**6.1**	**4.5**	**5.3**
Asia	10.7	6.9	5.7	9.6	7.6	6.1	6.8
Latin America	5.9	4.2	-1.8	6.1	4.2	2.6	3.9
Central and Eastern Europe	7.4	4.4	-6.2	3.4	3.9	2.4	2.8
World	**4.2**	**1.5**	**-2.2**	**4.1**	**2.9**	**2.3**	**2.7**

1) estimate; 2) forecast.

Political risks still linger – not least the policy approach in countries with upcoming elections. This could trigger fluctuations on the financial markets, however we think it likely that the European debt crisis will no longer keep the markets on tenterhooks on the scale it has to date.

With the debt crisis gradually receding, flight into the "safe havens" of German and US government bonds is likely to ease, tending to push up yields in these markets. However, both the Fed and the ECB can be expected to stick with their ultra-loose policy stance, above all leaving key rates unchanged. With short-term rates close to zero, there is little room for a rise in yields on longer-term bonds. We expect yields on 10yr German and US government bonds to climb merely into a range of 2-2½%. Such an increase in yields would result in a slightly negative investment return.

Financial market forecasts

	12/18/2012	mid-2013	end-2013
3-month money market rate			
EMU	0.2	0.4	0.5
USA	0.3	0.3	0.3
10-year gov.bond yield			
EMU	1.4	1.6	2.0
USA	1.8	1.9	2.3
Exchange rate USD/EUR	1.32	1.25	1.25
Stock market index			
DAX	7654	7800	8200
Euro Stoxx 50	2644	2750	3000
Dow Jones	13351	13500	14000
S&P 500	1447	1480	1550

With the expected economic pickup, equities remain attractive. In addition, as a result of the investment plight, i.e. the shortage of low-risk investments with a decent return, riskier assets such as equities almost inevitably move more into focus if one wants to generate a sustained return above the rate of inflation. However, looking at the stock market outlook for 2013, it should be borne in mind that most stock markets rose strongly at the end of 2012 and experience shows that the trend in shares is not a one-way street upwards. All in all, we expect to see moderate increases of 5 to 10% in most stock indices in the course of 2013. On stock markets in the emerging markets, where performance in recent years has been subdued when measured against the buoyant economic growth, we see a potential return of more than 10%. Stock markets are, however, particularly susceptible to shocks. Individual risks are not predictable. In particular, an eye should be kept on:

- Fiscal cliff in the USA
- Geopolitical tensions in the Near and Middle East as well as between Japan and China.

Trends on other markets

	6 months	12 months
Emerging market equities	k	k
Risk premiums on emerging market bonds (relative to US Treasuries)	g	m
Risk premiums on top-grade corporate bonds (relative to government bonds)	g	m
Risk premiums on corporate bonds (relative to government bonds)	g	m
Commodities, energy	g	k
Commodities, non-energy	g	k

k: rising trend, g : unchanged, m: falling trend.

The risk premiums on European corporate bonds, and particularly on medium and low-grade paper, have fallen sharply in the course of 2012. In the USA they fell slightly. Against this backdrop, the potential for further declines is likely to be limited. Given the slight increase we are penciling in for German and US government bonds, corporate bond yields can be expected to drift sideways. The return on corporate bonds would be more or less in line with the coupon. The outlook for emerging market government bonds is similar. Risk premiums fell sharply in the course of 2012, curbing the prospects of further declines.

However, we do not expect to see a broad rise in the yield level here either, but rather with a sideways movement.

At the end of 2012 broad-based commodity price indices such as the CRB Index are more or less at the same level as at the start of the year. The same goes for crude oil prices. In the course of 2013 the economic pickup we expect to see could trigger rising commodity prices. The high liquidity in the financial sector, spawned by expansionary monetary policy, would also suggest this. On the other hand, commodity market price levels are fairly high when one considers the current economic situation. We therefore expect only a moderate upward trend in commodity prices in 2013.

In general, given the turmoil of recent years and unstable and shifting interactions between the markets, the uncertainties attached to the financial market outlook are considerable. Our moderately optimistic outlook has both upside and downside risks. Black swans can blow things off course at any time.

These assessments are, as always, subject to the disclaimer provided below.

ABOUT ALLIANZ

Together with its customers and sales partners, Allianz is one of the strongest financial communities. Around 78 million private and corporate customers rely on Allianz's knowledge, global reach, capital strength and solidity to help them make the most of financial opportunities and to avoid and safeguard themselves against risks.
In 2011, around 142,000 employees in some 70 countries achieved total revenue of 103.6 billion euros and an operating profit of 7.9 billion euros.
Benefits for our customers reached 86.5 billion euros. This business success with insurance, asset management and assistance services is based increasingly on customer demand for crisis-proof financial solutions for an ageing society and the challenges of climate change. Transparency and integrity are key components of sustainable corporate governance at Allianz SE.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

The statements contained herein may include statements of future expectations and other forward-looking statements that are based on management’s current views and assumptions and involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. In addition to statements which are forward-looking by reason of context, the words "may", "will", "should", "expects", "plans", "intends", "anticipates", "believes", "estimates", "predicts", "potential", or "continue" and similar expressions identify forward-looking statements. Actual results, performance or events may differ materially from those in such statements due to, without limitation, (i) general economic conditions, including in particular economic conditions in the Allianz Group’s core business and core markets, (ii) performance of financial markets, including emerging markets, and including market volatility, liquidity and credit events (iii) the frequency and severity of insured loss events, including from natural catastrophes and including the development of loss expenses, (iv) mortality and morbidity levels and trends, (v) persistency levels, (vi) the extent of credit defaults, (vii) interest rate levels, (viii) currency exchange rates including the Euro/U.S. Dollar exchange rate, (ix) changing levels of competition, (x) changes in laws and regulations, including monetary convergence and the European Monetary Union, (xi) changes in the policies of central banks and/or foreign governments, (xii) the impact of acquisitions, including related integration issues, (xiii) reorganization measures, and (xiv) general competitive factors, in each case on a local, regional, national and/or global basis. Many of these factors may be more likely to occur, or more pronounced, as a result of terrorist activities and their consequences. The company assumes no obligation to update any forward-looking statement.

NO DUTY TO UPDATE

The company assumes no obligation to update any information contained herein.