ECONOMIC RESEARCH

Working Paper 181

December 22, 2014

MACROECONOMICS | FINANCIAL MARKETS | ECONOMIC POLICY | SECTORS

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2015: Financial market and economic outlook

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2015: Financial market and economic outlook

The development of the financial markets at the end of this year is proving to be something of an emotional roller coaster, especially as far as the stock markets are concerned. In the period between mid-October and early December, key European share indices gained more than 10%. The DAX, for example, soared by as much as 16%. This was then followed by a sharp downturn. The DAX tumbled by around 8% within the space of less than two weeks, but has since rebounded strongly.

The real economy has been spared such ups and downs. In the main, the hard economic data have been a source of disappointment in recent months. Economic growth in the euro area and in Germany in the second and third quarters of the year can be described as anemic at best. Concerns that a renewed recession was lurking on the horizon started to be voiced. And even those who were reluctant to subscribe to this skeptical outlook took their growth forecasts for 2015 down a notch. Forecasts of economic growth of 1% or less for next year started to become increasingly common. In early December, the European Central Bank also corrected its GDP outlook for the euro area in 2015, bringing it down from 1.6% to 1.0%. The German Bundesbank actually sliced its 2015 growth outlook for Germany in half: from 2.0% to 1.0%.

In this sort of environment, the debate as to whether share price developments have any real economic basis at all these days perpetually flares up. The fact that the downward trend in commodity prices stems from a global demand slump that could plunge commodity-exporting countries into financial difficulties is one of the scenarios cited as evidence that the stock markets have sometimes sent out excessively positive signals. The further drop in yields on the bond market is also argued to point towards a weak economy, if not even to deflationary trends. So is the positive trend on the stock markets being fueled solely by the abundant liquidity being unleashed by the central banks? Is the weaker market development a hint that a major correction is imminent?

There is no doubt that the financial markets are currently under the spell of the central banks. Their actions and, in particular, the expectations that they are creating are one of the main drivers behind the development in high-risk investment forms, a category that naturally includes shares. The unconventional monetary policy pursued by the world's major central banks has at times appeared to be dictating the pace of the market. The speculation surrounding large-scale bond purchases by the ECB at the start of next year was one of the main reasons behind the upswing on the stock markets. On the other hand, there are a number of factors likely to put a damper on the demand for shares that are not related to either monetary policy or the economy. The new regulatory requirements, which call for greater capital backing for high-risk forms of investment, mean that institutional investors are investing less in equities. What is more, many investors are still likely to prefer to pursue a risk-averse approach given their experience of the financial crisis. The price-to-earnings ratios of most European stock markets, for example, remain at a normal or indeed low level, giving the lie to talk of excessive valuation.

In our view, however, monetary policy impetus - regardless of how unconventional it may be – does not in the long run provide the basis for an ongoing upward trend in equity indices unless it goes hand-in-hand with a real economic upswing. So the question is: is the price slump on the oil market the result of a global economic slowdown or is it, quite the contrary, a key source of impetus that will help the economy gain momentum?

Crude oil – prices expected to edge up after marked downward correction

Oil prices have been headed in pretty much only one direction for months now – downwards. At the moment, Brent oil costs around 45% a barrel less, in US dollar terms, than it did at the start of the year. Compared with its 2014 high, reached in mid-June, it is down by almost 50%. In order to be able to make a relatively reliable assumption regarding how oil prices will develop next year, it is important to first of all identify possible causes of the sustained drop in prices. We believe that the downward spiral is largely due to supply factors and has not been triggered by a global demand slump, although the fact that growth has fallen short of expectations, especially in the emerging markets, is likely to have played a role. This view is confirmed by the recent figures released by the International Energy Agency. In the first three quarters of this year, the global demand for oil charted a moderate increase, rising by 0.8% year-on-year. The scale of this increase is consistent with the subdued expansion of the global economy overall. Global oil supply growth, on the other hand, was fairly sizeable in comparison, coming in at 1.8% during the same period. Since the first three months of 2014, the supply on the global oil markets has been ahead of demand, with excess supply of 0.5 million barrels a day in the third quarter. By way of comparison: last year's oil market was, on average, dominated by a demand surplus on exactly the same scale. The supply growth has been fueled, among other factors, by the increased production of shale oil in the US and a sharp rise in production in Libya. In addition to actual supply and demand developments, there is no doubt that changes in risk assessments on the supply side have also contributed to the most recent oil price correction. Concerns regarding possible supply restrictions placed on Russian oil and gas, as well as fears of production downtime due to the rise of the IS terrorist militia are likely to have resulted in at least a temporary risk premium being applied to oil prices in the first half of 2014.

Although a further slide in oil prices to well below 60 US dollars a barrel cannot be ruled out in the short term, we expect the oil price to stabilize at its current level of 60 US dollars a barrel for the time being, before starting to pick up again as 2015 progresses. In our view, the extent of the current correction is somewhat exaggerated, particularly given the supply and demand situation on the oil market. There is no doubt that OPEC's failure to act has also contributed to this "undershooting" of recent weeks, after the Organization failed to agree to cut output volumes at its November meeting. The fact that the production of shale oil in the US, for example, is no longer profitable if the oil price falls below a certain level also suggests that oil prices will soon start to climb back up. The logic behind this is that, if the oil price dips to below this "break-even" price, production is no longer profitable, investments are no longer made in additional production facilities, or existing facilities are taken out of operation, reducing the global oil supply and forcing the oil price back up. Various studies do, in fact, conclude that the current price level is edging closer to this "break-even" oil price, if it has not undershot it already. In our economic forecast for 2015, we have assumed an average Brent oil price of 70 US dollars a barrel (2014: just under 100 US dollars a barrel).

Upward forces to dominate the global economy

The rate of global economic expansion remained moderate in the third quarter of this year. Although the US economy achieved growth that was well above-average, as in the quarter before, economic output in the euro area was once again only a whisker above the level seen in the previous quarter. The Japanese economy also remained a drag. Following the VAT hike, the Japanese economy has not yet managed to find a way back to the growth path. Although real gross domestic product did not contract by quite as much as it did in the second quarter, the drop of 0.5% was still considerable. Among the

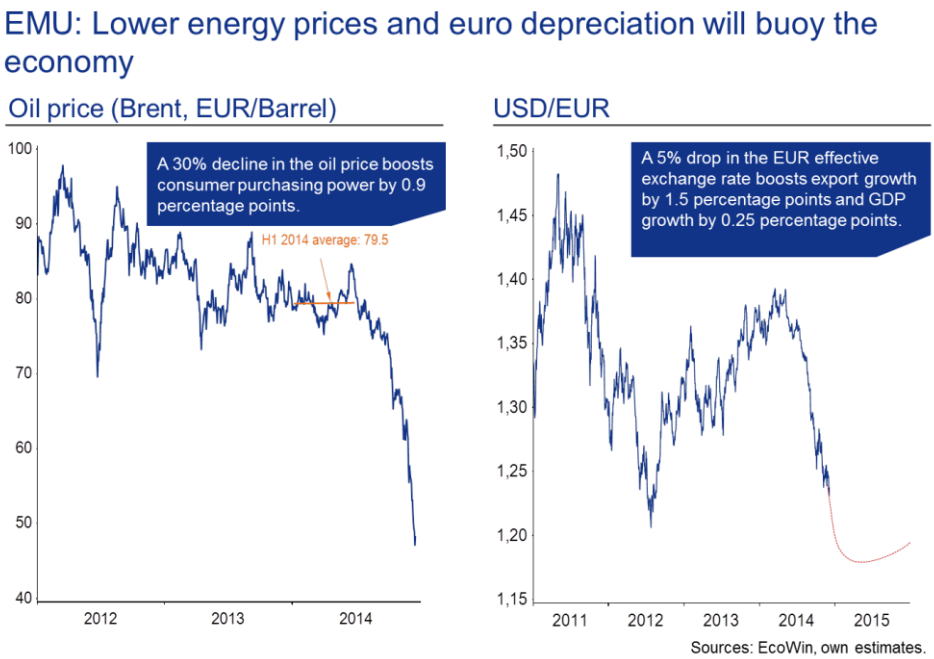
emerging markets, the Brazilian economy stabilized after a decline in economic output in the first six months of the year, contributing to a firmer trend. Economic momentum in China proved stable.

The fact that the global economy has stuck firmly to only a moderate growth path to date is reflected in global industrial production, which also showed only modest expansion in the middle quarters of this year with an annualized growth rate of only 1.5-2%. The outlook for this quarter, however, looks rosier. By way of example, global industrial production had already made marked gains in September, putting it 0.6% up on the level for the entire third quarter. Another positive factor is that the world's large economies and the euro area managed to at least maintain the increased production level in October. And in the US, the expansion in manufacturing output accelerated appreciably in November.

Over the coming months, the unexpectedly drastic slide in oil prices is likely to provide an important shot in the arm for the global economy. As oil consumers make the most of their increased purchasing power and spending in the oil-producing countries is only partially curbed in response to lower oil revenue, global demand is likely to be bolstered on balance. Whereas net oil imports to the US have been falling steadily in recent years due to the increase in domestic production, the euro area will experience considerable relief when it comes to its oil import bills. All in all, we expect global economic growth to accelerate to 3.0% next year (2014: 2.5%).

Strong economic impetus in the euro area

The eurozone economy showed extremely subdued expansion in the course of 2014, with business and consumer surveys failing to reveal any signs of a decisive change for the better to the end. Nevertheless, we believe that the economic cards are now being reshuffled. In euro terms, oil prices are currently around 30% lower than in the first half of 2014. The trade-weighted external value of the euro is down by approx. 5% compared with the first six months of 2014. The former serves to reduce production costs and boost consumer purchasing power. Based on the econometrically estimated elasticities, consumer purchasing power in the euro area will rise by 0.9 percentage points as a result. The positive impact of the oil price slump on gross domestic product is expected to come in at around half a percentage point. In addition, the slide in the value of the euro by around 5% is likely to stimulate export growth by around 1.5 percentage points, adding a quarter of a percentage point to GDP growth in the process. Taken together, these factors are therefore estimated to add 0.75 percentage points to economic growth in the course of 2015, at least if the current oil price and exchange rate remain roughly as they are for some time. Some of this impact was already factored in to our economic forecast, but not all. As a result, we have made a slight upward revision to our forecast for economic growth in the euro area and Germany. Looking at 2015 on average, we now predict economic growth of 1.3% (previously 1.2%) for the euro area and 1.6% (previously 1.4%) for Germany.



The drop in oil prices is likely to improve the terms of trade, although this will be somewhat counteracted by the depreciation of the euro. Experience has shown that such improvements tend to have a positive impact on the profit margins of companies with domestic production facilities. The more favorable terms of trade and rising sales levels that are expected to come on the back of the economic recovery are expected to prompt an appreciable acceleration in corporate profit growth in 2015.

Brighter financial market outlook despite ongoing risks

We believe that the economic impetus provided by the drop in the oil prices will have a positive impact on the financial market outlook in the long run. Nevertheless, the abrupt slide in oil prices also creates short-term market risks. Concerns regarding financing difficulties faced by crude oil-exporting countries, for example, have pushed up the risk premiums on bonds issued by these countries. Corporate bonds with low credit ratings have also seen their prices slashed as a result of the uncertainty. Although the problems faced by some countries will not be solved overnight due to a failure to take action in the past, we believe that the risk of conflagration is low. The positive aspects of the oil price slump will increasingly gain the upper hand on the markets.

2015 is unlikely to see any fundamental shift in the low interest rate policies pursued by the world's major central banks, even if the US Fed implements an interest rate turnaround – as is on the cards in the middle of the year. As we move into the latter part of 2015, the European Central Bank could then also follow suit, implementing a slight interest rate correction. In one conceivable scenario, the ECB could abandon the negative deposit rate due to the false incentives that it entails and, in the process, also lift the main refinancing rate. The ECB is, however, likely to remain keen to anchor inflation expectations, which will limit the extent to which it can change course. This means that risk-free or low-risk investment forms will continue to generate returns close to zero and even suffer value losses in real terms as the inflation rate in the euro area starts edging back towards the 1% mark in the course of next year.

Returns on fixed-income securities, which hit all-time lows in the eurozone at the end of 2014, are likely to have increased considerably before 2015 is out – we expect the yield on ten-year German government bonds to come in at 1.5%. The development pattern, however, is difficult to forecast. The renewed drop in yields seen over the past few months is largely due to expectations of a large-scale ECB bond-purchasing program. If the ECB were really to announce a government bond purchasing program worth EUR 1000 billion at the start of next year, the extremely low yields would remain with us for some time. Even then, however, the economic upturn and slight increase in inflation would probably result, slowly but surely, in higher yields later on in 2015. Long-term interest rates in the US also showed at least a moderate increase in spite of the bond-purchasing program.

The more favorable real economic conditions – increased purchasing power and improved price competitiveness – which are expected to have a positive impact on corporate profits, will create upside potential for the European stock markets in 2015. Given the level that has already been reached, however, the upward trend will not be one long one-way street, and we can expect to see occasional, albeit presumably limited, setbacks. Factors that could put a spoke in the wheel include: political uncertainty in heavily indebted EMU countries, geopolitical conflicts, disappointed monetary policy expectations. All in all, given the current subdued price level, we believe that upside potential of 10% - 15% is a realistic prospect for the European stock market indices in the course of next year. Smaller European markets that need to catch up could even see more substantial gains.

	as of December 15, 2014	End June 2015	End December 2015
Interest rates (in %)			
EMU-3m money market rate	0.1	0.1	0.3
German-10yr government bond yield	0.6	1.0	1.5
US-3m money market rate	0.2	0.6	1.2
US-10yr government bond yield	2.1	2.8	3.0
Stocks			
DAX	9,334	10,500	11,000
Euro Stoxx 50	2,983	3,250	3,400
S&P 500	1,990	2,080	2,120
Exchange rate			
USD/EUR	1.24	1.19	1.2

Germany: Economic indicators and forecasts*

		2013				2014				2015						
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2013	2014f	2015f
GDP real		-0.4	0.8	0.3	0.4	0.8	-0.1	0.1	0.1	0.5	0.6	0.4	0.4	0.1	1.5	1.6
Private consumption		0.2	0.6	0.3	-0.3	0.5	0.1	0.7	0.5	0.5	0.4	0.3	0.3	0.8	1.2	1.9
Government spending		0.0	0.0	0.6	-0.1	0.2	0.4	0.6	0.2	0.3	0.3	0.3	0.3	0.7	1.1	1.3
Investment in machinery/equipment		-4.0	2.8	-0.6	2.6	1.7	0.4	-2.3	1.2	1.2	1.5	1.0	1.0	-2.4	3.6	3.2
Construction		-2.8	3.0	1.8	0.7	4.2	-3.9	-0.3	1.5	1.2	1.0	0.8	0.8	-0.1	3.6	2.9
Domestic demand		-0.2	0.7	0.7	0.0	0.9	-0.2	-0.2	0.3	0.5	0.4	0.3	0.3	0.7	1.3	1.4
Exports		0.7	1.4	0.7	1.7	-0.2	1.2	1.9	0.3	1.0	1.5	1.3	1.2	1.6	3.8	4.9
Imports		1.2	1.3	1.7	0.7	-0.1	1.1	1.7	0.8	1.2	1.2	1.2	1.0	3.1	3.6	5.0
Industrial production (excl. construction)**)		0.5	1.4	0.6	0.6	0.6	-0.6	-0.3	1.2	0.7	0.7	0.4	0.4	0.4	1.6	2.2
Unemployment rate (EU def.)	%	5.3	5.3	5.2	5.1	5.1	5.0	4.9	4.9	4.9	4.9	4.9	4.9	5.2	5.0	4.9
Unemployment rate (nat. def.	%	6.9	6.9	6.8	6.9	6.8	6.7	6.7	6.6	6.6	6.6	6.6	6.6	6.9	6.7	6.6
Employed persons (national (	y-o-y	0.6	0.6	0.6	0.5	0.7	0.8	0.8	0.9	0.7	0.6	0.4	0.3	0.6	0.8	0.5
Consumer prices	y-o-y	1.5	1.5	1.6	1.3	1.2	1.1	0.8	0.6	0.6	0.7	1.0	1.5	1.5	0.9	0.9
Current account balance	EUR bn	47.1	48.5	44.5	50.4	51.5	51.2	58.2	57.0	56.0	55.0	54.0	53.0	189.2	217.9	218.0
	% of GDP													6.7	7.5	7.3
Budget balance	EUR bn													4.2	20.4	14.7
(Maastricht-definition)	% of GDP													0.1	0.7	0.5

*) Quarterly figures: percentage change over previous period, seasonally and working day adjusted, except where noted, yearly figures: percentage change, not working day adjusted. **) Yearly average working day adjusted. f = forecast.

Euro area: Economic indicators and forecasts*

		2013				2014				2015						
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2013	2014f	2015f
GDP real		-0.4	0.3	0.2	0.2	0.3	0.1	0.2	0.1	0.4	0.4	0.3	0.3	-0.4	0.9	1.3
Private consumption		-0.2	0.1	0.1	0.1	0.2	0.3	0.5	0.0	0.4	0.4	0.2	0.2	-0.6	0.9	1.2
Government spending		0.0	0.2	0.2	0.3	0.1	0.3	0.3	0.1	0.3	0.3	0.2	0.3	0.2	0.9	1.1
Investment		-2.3	0.6	0.6	0.7	0.3	-0.6	-0.2	0.4	0.7	0.8	0.6	0.6	-2.4	0.8	1.8
Exports		0.3	1.8	0.7	0.8	0.4	1.4	0.8	0.9	1.2	1.0	0.9	0.8	2.1	3.5	4.1
Imports		0.0	1.4	1.6	0.2	0.4	1.3	1.2	0.9	1.2	1.2	0.9	0.9	1.2	3.5	4.5
Unemployment rate	%	12.0	12.0	12.0	11.9	11.8	11.6	11.5	11.4	11.3	11.1	10.9	10.8	12.0	11.6	11.0
Consumer prices	y-o-y	1.9	1.4	1.3	0.8	0.7	0.6	0.4	0.2	0.0	0.3	0.5	1.1	1.4	0.5	0.5
Current account balance	EUR bn, nsa	47.0	58.8	40.9	50.7	59.3	59.9	75.7	60.0	65.0	65.0	65.0	60.0	197.4	254.9	255.0
	% of GDP													2.0	2.5	2.5
Budget balance	% of GDP													-2.9	-2.5	-2.0
3m money market rate**)	%	0.2	0.2	0.2	0.3	0.3	0.2	0.1	0.1	0.1	0.1	0.1	0.3	0.2	0.2	0.1
10yr gov. bond yield***)	%	1.3	1.7	1.8	1.9	1.6	1.3	0.9	0.7	0.7	1.0	1.2	1.5	1.6	1.3	1.0

*) Quarterly values: percentage change over previous period, seasonally adjusted, except where noted; annual GDP not adjusted; foreign trade incl. intra-trade.
) End of quarter, yearly average. *) Germany as benchmark; end of quarter, yearly average. f = forecast.

USA: Economic indicators and forecasts*

		2013				2014				2015						
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2013	2014f	2015f
GDP real		2.7	1.8	4.5	3.5	-2.1	4.6	3.9	2.2	2.6	2.5	2.6	2.6	2.2	2.3	2.8
Private consumption		3.6	1.8	2.0	3.7	1.2	2.5	2.2	3.2	3.1	2.6	2.7	2.4	2.4	2.3	2.8
Fixed investment		2.7	4.9	6.6	6.3	0.2	9.5	6.2	6.1	4.9	6.1	6.5	6.5	4.7	5.3	6.1
Inventory change	USD bn	33.4	43.4	95.6	81.8	35.2	84.8	79	60	62	66	68	69	63.6	64.8	66.3
Government spending		-3.9	0.2	0.2	-3.8	-0.8	1.7	4.2	-0.8	-0.2	0.0	0.0	0.0	-2.0	-0.1	0.4
Gross domestic demand		2.7	2.2	3.7	2.4	-0.5	4.7	3.0	2.4	2.8	2.8	2.9	2.7	1.9	2.3	2.9
Exports		-0.8	6.3	5.1	10.0	-9.2	11.0	4.9	3.7	2.8	3.2	3.4	5.1	3.0	3.2	4.0
Imports		-0.2	8.5	0.6	1.3	2.2	11.3	-0.7	5.1	4.5	4.9	4.9	5.1	1.1	3.7	4.5
Net exports	USD bn	-427.2	-446.0	-424.6	-384.0	-447.2	-460.4	-431.0	-443.5	-456.9	-471.0	-484.2	-490.2	-420.5	-445.5	-475.6
Industrial production		4.2	1.9	2.5	4.9	3.9	5.7	4.0	5.6	3.7	4.2	3.9	3.7	2.9	4.2	4.3
Unemployment rate	%	7.7	7.5	7.2	7.0	6.7	6.2	6.1	5.8	5.8	5.7	5.6	5.5	7.4	6.2	5.6
Consumer prices		1.2	0.4	2.2	1.1	1.9	3.0	1.1	-0.7	0.9	2.3	3.0	2.3	1.5	1.6	1.4
		-105.5	-106.1	-101.3	-87.3	-102.1	-98.4	-100.3	-107	-108	-114	-118	-123	-400	-408	-464
Current account balance	USD bn	-2.6	-2.6	-2.4	-2.0	-2.4	-2.3	-2.3	-2.4	-2.4	-2.5	-2.6	-2.7	-2.4	-2.3	-2.5
	% of GDP													-680	-483	-480
Federal budget	FY, USD bn													-4.1	-2.8	-2.7
3-month money market rate *	%	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.3	0.4	0.6	0.9	1.2	0.3	0.2	0.7
10-year treasury yield **)	%	1.9	2.5	2.6	3.0	2.7	2.5	2.5	2.3	2.7	2.8	2.9	3.0	2.3	2.5	2.8
Exchange rate **)	USD per EUR	1.28	1.31	1.35	1.38	1.38	1.37	1.26	1.23	1.18	1.19	1.19	1.20	1.33	1.33	1.19

*) Percent change over previous period, seasonally adjusted annual rates, except where noted. **) End of quarter, yearly average. f = forecast.

Growth rates in main economic regions

GDP, real % change over previous year

	2009	2010	2011	2012	2013	2014[1)]	2015[1)]
Industrialized countries	**-3.7**	**2.6**	**1.4**	**1.1**	**1.2**	**1.6**	**2.1**
European Union	-4.5	2.0	1.7	-0.3	0.1	1.4	1.7
Euro area	-4.4	1.9	-0.7	-0.4	0.9	1.3	1.3
USA	-2.8	2.5	1.6	2.3	2.2	2.3	2.8
Japan	-5.5	4.7	-0.5	1.4	1.5	0.2	1.2
Emerging markets	**1.5**	**7.5**	**6.1**	**4.5**	**4.5**	**4.2**	**4.5**
Asia	5.9	9.5	7.5	6.1	6.2	6.2	6.2
Latin America	-1.6	6.0	4.2	2.7	2.4	1.2	2.4
Central and Eastern Europe	-6.1	3.4	3.9	2.1	1.4	1.2	1.3
World	**-2.1**	**4.1**	**2.9**	**2.3**	**2.4**	**2.5**	**3.0**

1) forecast.

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

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