Climbing the wall of worries

Allianz Research

20 June 2023

Un homme grimpant sur le flanc d'une montagne photo – Photo Désert d'hisma Gratuite sur Unsplash

Global Macro & Corporate Outlook 2023-24

Climbing the wall of worries

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1	Muddle-through ahead	• Some larger economies slipped into recession earlier this year amid a difficult global economic outlook. While some of the resilience comes from the labor market, with companies hoarding labor despite the fall in margins, this can't last for too long. • We expect a soft landing in 2023 +(2.5%) before a timid recovery starting in mid-2024 (+2.3%).
2	More hawkish central banks amid sticky core inflation will turn real interest rates positive	• In the US, inflation is expected to decelerate to 3.1% in Q4 2023 and 1.9% in Q4 2024. In Germany, it is expected to reach 3.1% and 2.5% respectively, against 3.8% and 2.7% in the UK. • Central banks are likely to decelerate their hiking cycles throughout the summer but not pivot before spring 2024. In July and September, we expect two additional rate hikes from both the Fed and ECB, leading to terminal rates of 5.75% and 4.0%, respectively. The Bank of England is likely to be the last to pause.
3	Fiscal policy: from supportive to restrictive in 2024 as rising interest rates reduce flexibility	• In the US, the debt-ceiling agreement limits the degree of fiscal policy tightening. We expect a negative general government fiscal impulse amounting to 0.7% of GDP in 2024 and forecast a broadening fiscal deficit to -7.8% of GDP (from -7.3% in 2023) amid a weaker economy induced by Fed policies and interest payments rising above 4% of GDP. • In Europe, the fiscal stance lingers near peak levels. However, the cyclical impact of a more restrictive fiscal policy won't be substantial. Shrinkage in fiscal space may necessitate challenging policy compromises as governments strive to address key structural issues arising from the recent crisis, including green economy transitions and crucial pension and tax reforms.
4	Market outlook dependent on confidence in financial stability & policy path	• Expectations of heightened monetary policy and stronger-than-anticipated economic resilience present short-term upside risks for both short and long-term yields, while euphoric equity markets are heading towards challenges. • Overall, we timid upside risk for long-term yields with the 10-year UST ending at around 3.8% by the end of 2023 to drop to 3.3% in 2024, and similar patterns for the 10-year Bund. Despite their strong performance so far, equity markets should see downward pressures in the next few months finishing at an average 7% total return performance.
5	What could go wrong?	• Prepare for a very politically charged 2024, with elections upcoming in the US, EU, UK, Austria, Russia, Poland, Romania, South Africa, Taiwan, India, Mexico etc. • The risk of further bank failures remains as efforts to reassure investors falter. • Higher-for-longer inflation also increases the risk of a policy mistake by central banks. • A cold winter could bring back the specter of gas rationing in Europe, raising recession risks until mid-2024.

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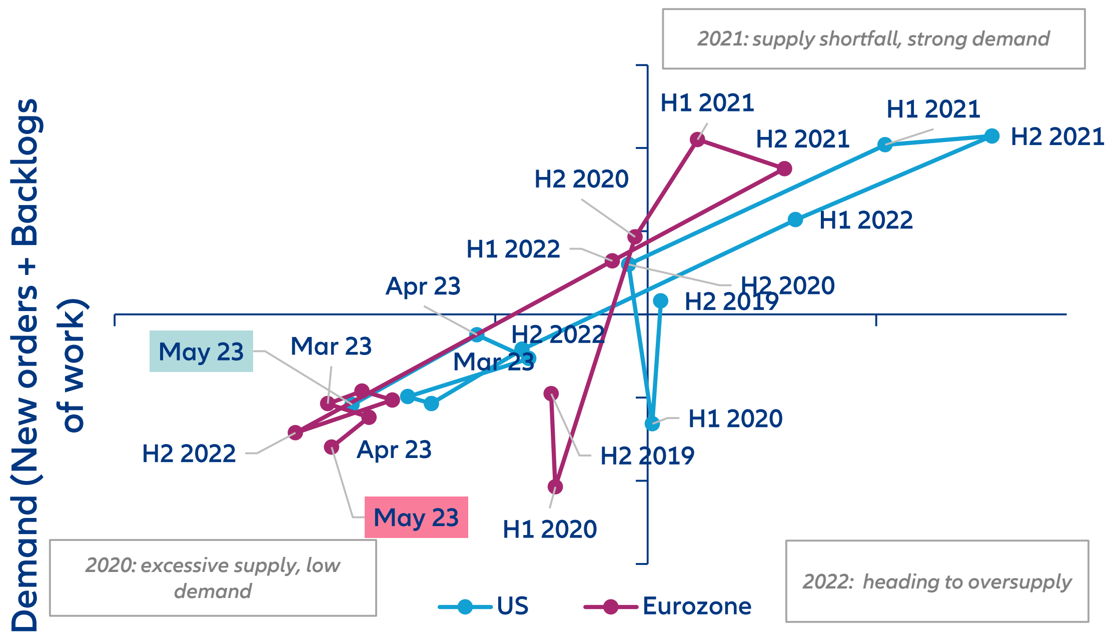
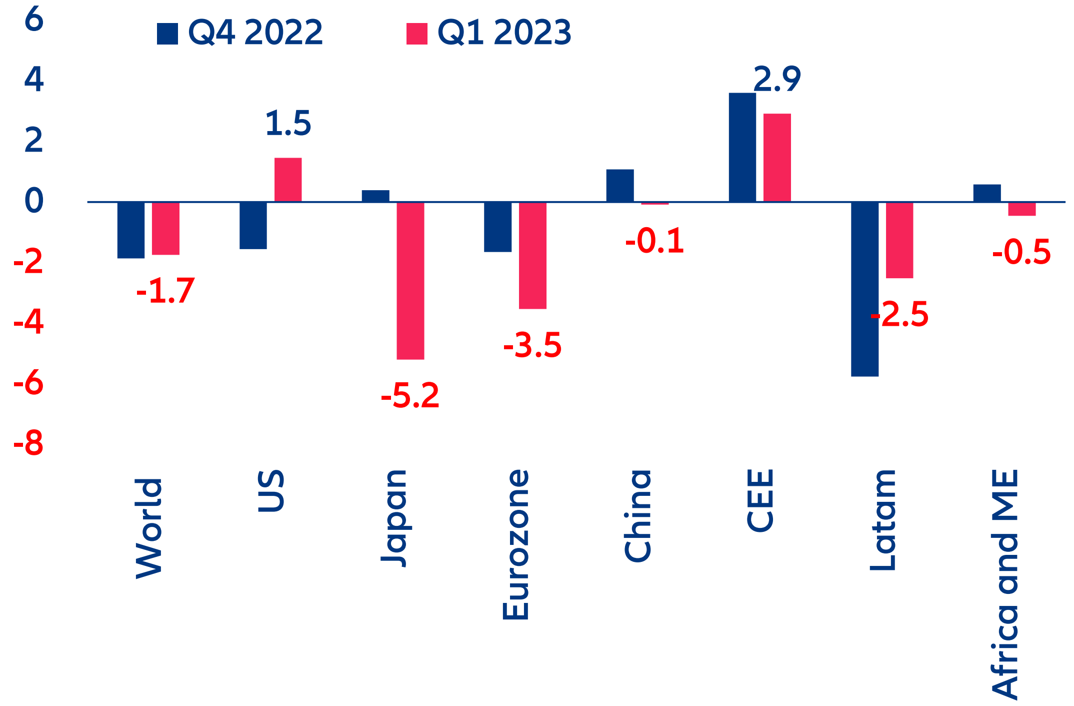
Pockets of recession confirmed

"Manufacturing supply-demand clock"



Real imports of goods

q/q%



Sources: S&P Global PMI, Allianz Research

Sources: Refinitiv (as of 13 June 2023), Allianz Research

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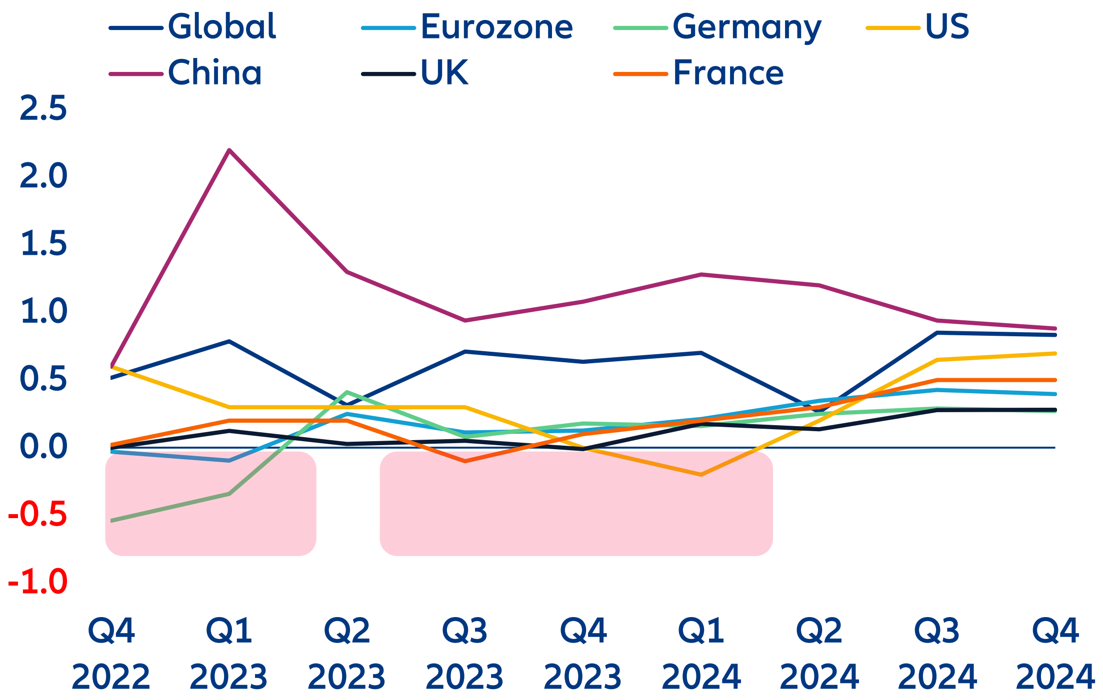
The global economy should bottom-out in mid-2024

Global real GDP growth (%)

Growth (yearly %)	2021	2022	2023f	2024f
Global	**6.0**	**3.0**	**2.5**	**2.3**
USA	**6.0**	**2.1**	**1.5**	**0.7**
Latin America	**6.8**	**3.7**	**1.6**	**1.7**
Brazil	5.3	3.0	2.1	1.2
UK	**7.6**	**4.1**	**0.2**	**0.5**
Eurozone	**5.4**	**3.5**	**0.5**	**1.0**
Germany	2.6	1.9	-0.1	0.8
France	6.8	2.6	0.6	0.9
Italy	7.0	3.8	1.1	0.7
Spain	5.5	5.5	2.0	1.6
Russia	5.6	-2.1	1.0	1.4
Turkey	11.4	5.6	3.3	3.8
Central and Eastern Europe	**6.2**	**4.1**	**1.2**	**2.8**
Poland	6.9	5.1	1.5	2.7
Asia-Pacific	**6.4**	**3.2**	**4.5**	**4.1**
China	8.5	3.0	5.8	4.5
Japan	2.2	1.0	1.3	1.1
Middle East	**4.1**	**6.7**	**2.7**	**2.6**
Saudi Arabia	3.9	8.7	3.8	2.9
Africa	**5.8**	**3.7**	**3.2**	**3.6**
South Africa	4.9	2.0	0.7	1.4

Sources: Refinitiv Datastream, Allianz Research

Real GDP growth (q/q %)



Sources: Refinitiv Datastream, Allianz Research

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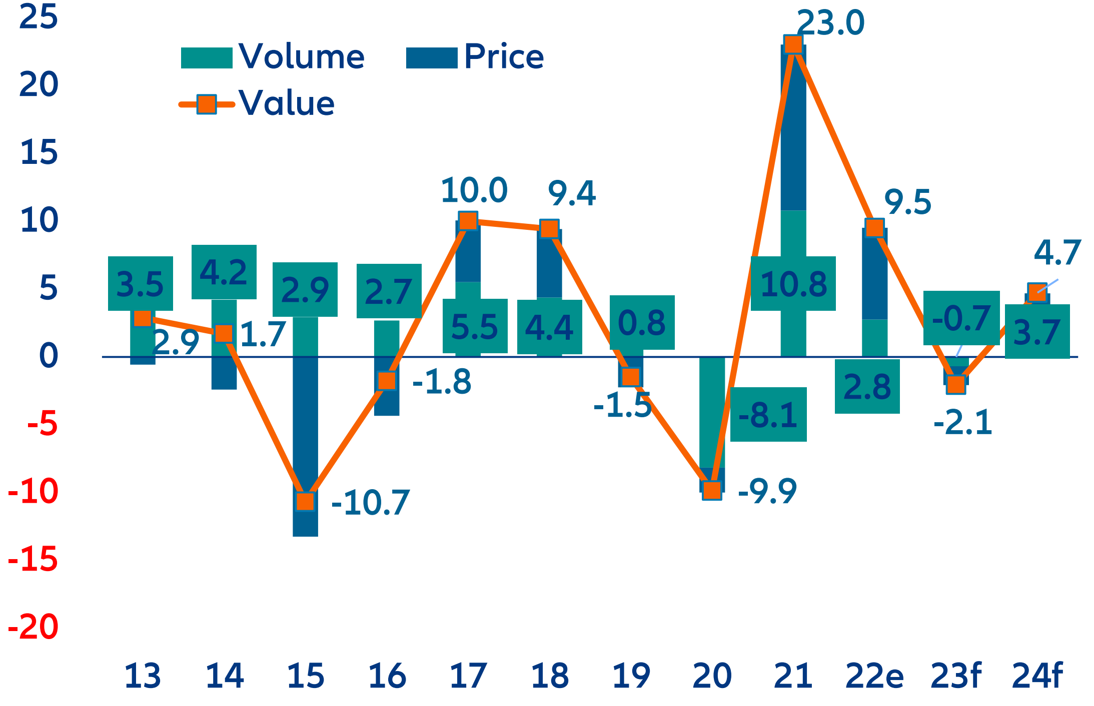
Broad-based global trade recession

Global trade in goods and services

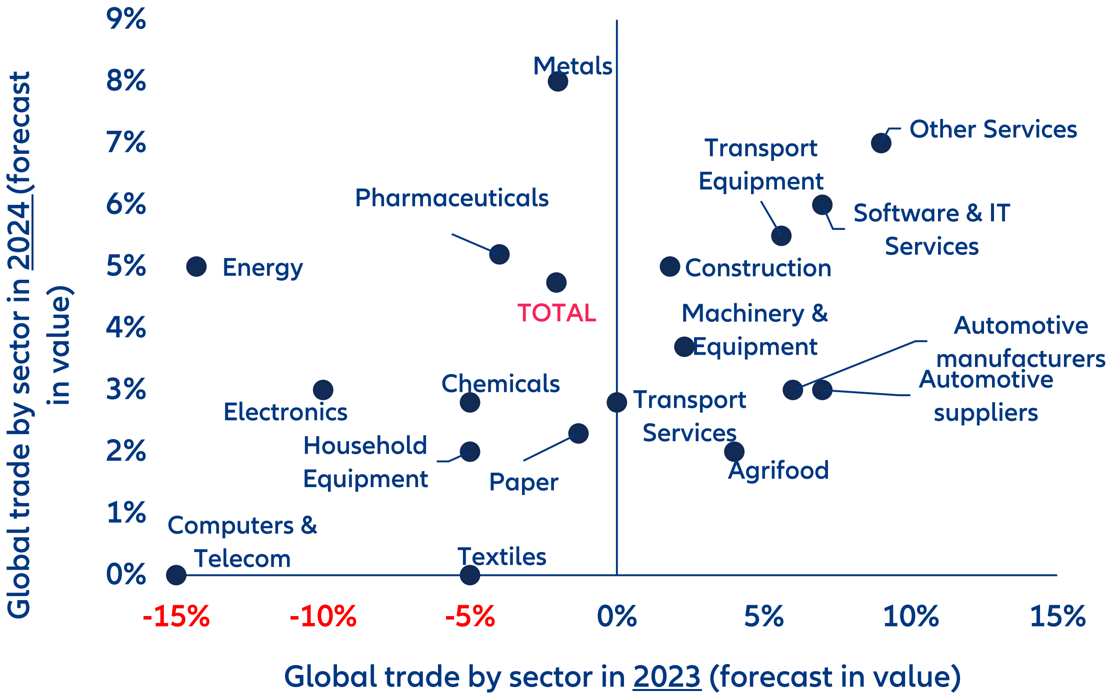
y/y %



Sources: Refinitiv Datastream, Allianz Research

Global trade by sector

y/y %



Sources: national authorities, Refinitiv Datastream, Allianz Research

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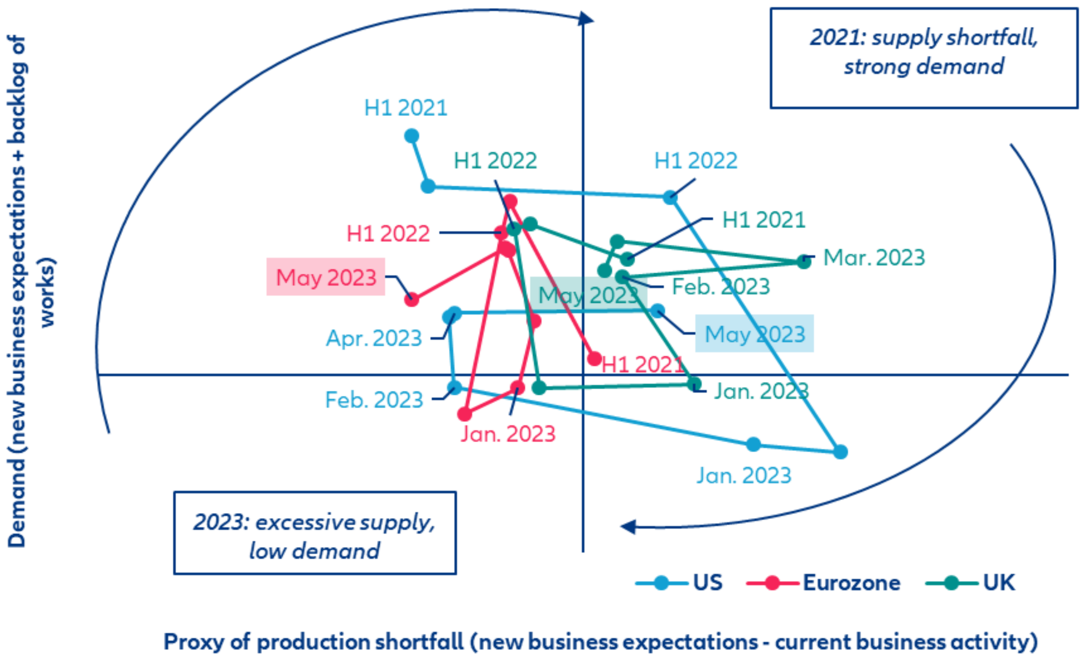
Services boost to fade after the summer

The services cycle in the US and the UK is still strong

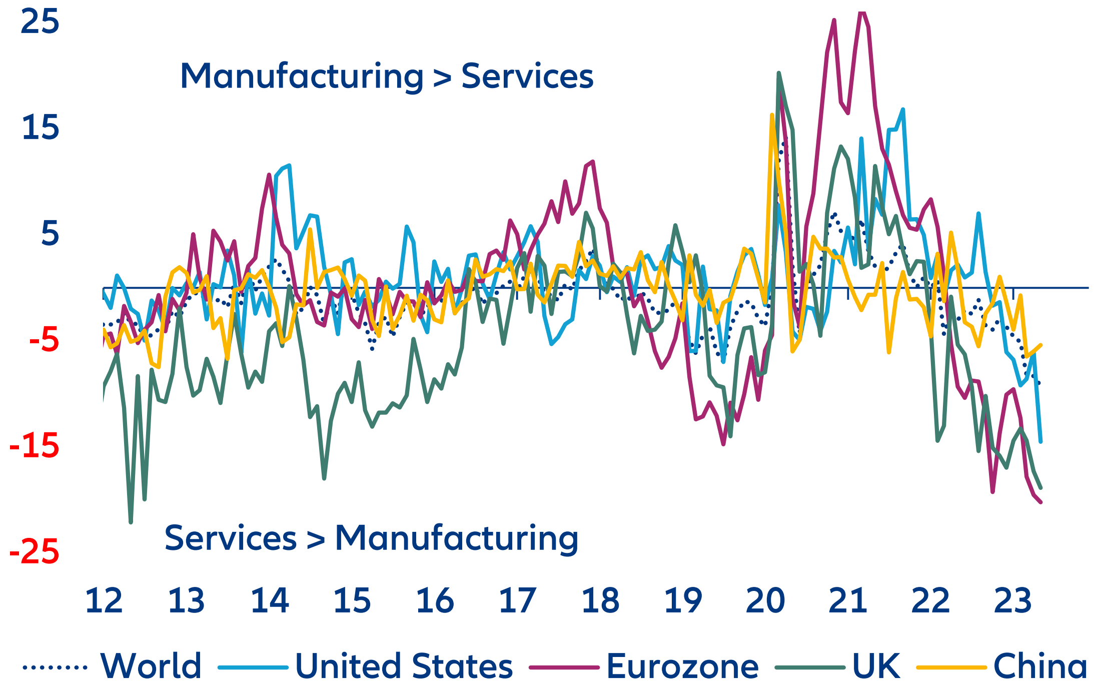
Services PMI sub-components



Sources: Refinitiv Datastream, Allianz Research

Demand for services continues to outpace that for goods

Manufacturing vs Services PMI



Sources: Refinitiv Datastream, Allianz Research

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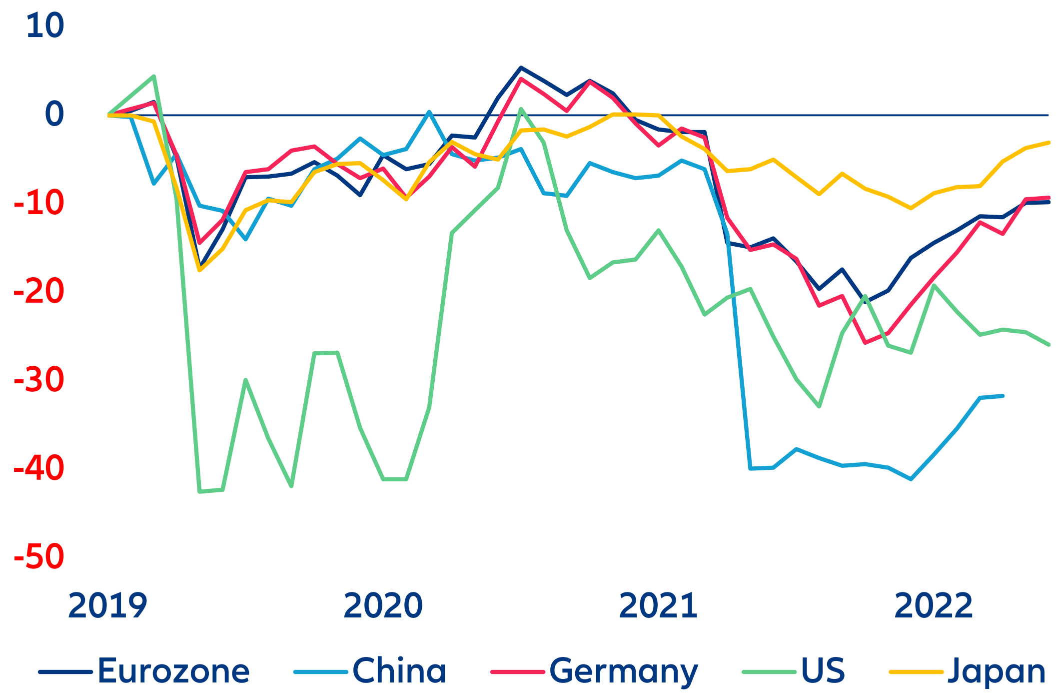
Consumer resilience tested

Consumer confidence remains depressed

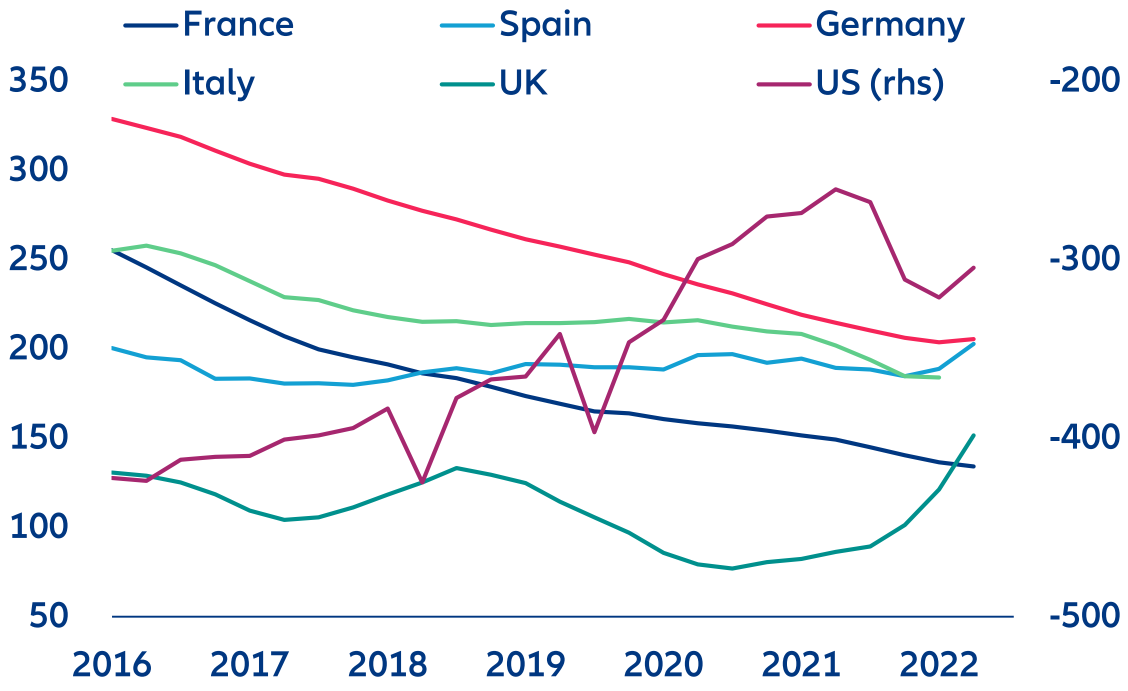
(points vs Dec 2019)



Sources: Refinitiv Datastream, Allianz Research

The transmission of monetary policy is slow

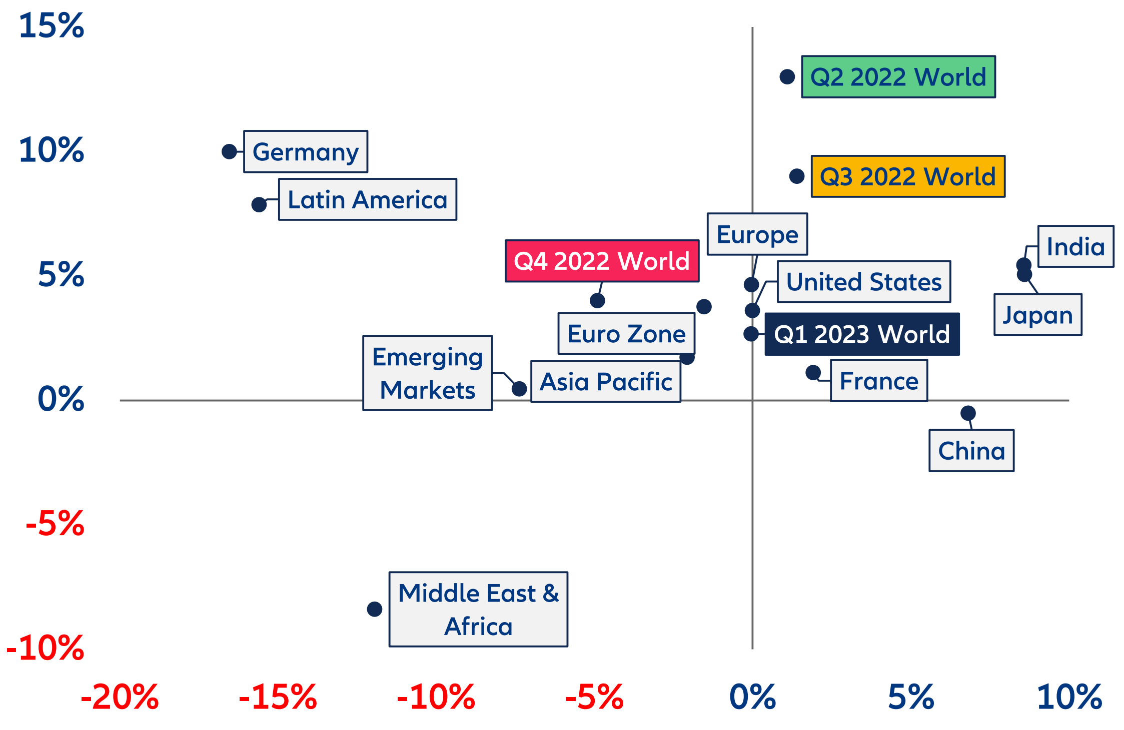
Effective interest rate differential (paid on debt – received on assets, bps)



Sources: Refinitiv Datastream, Allianz Research

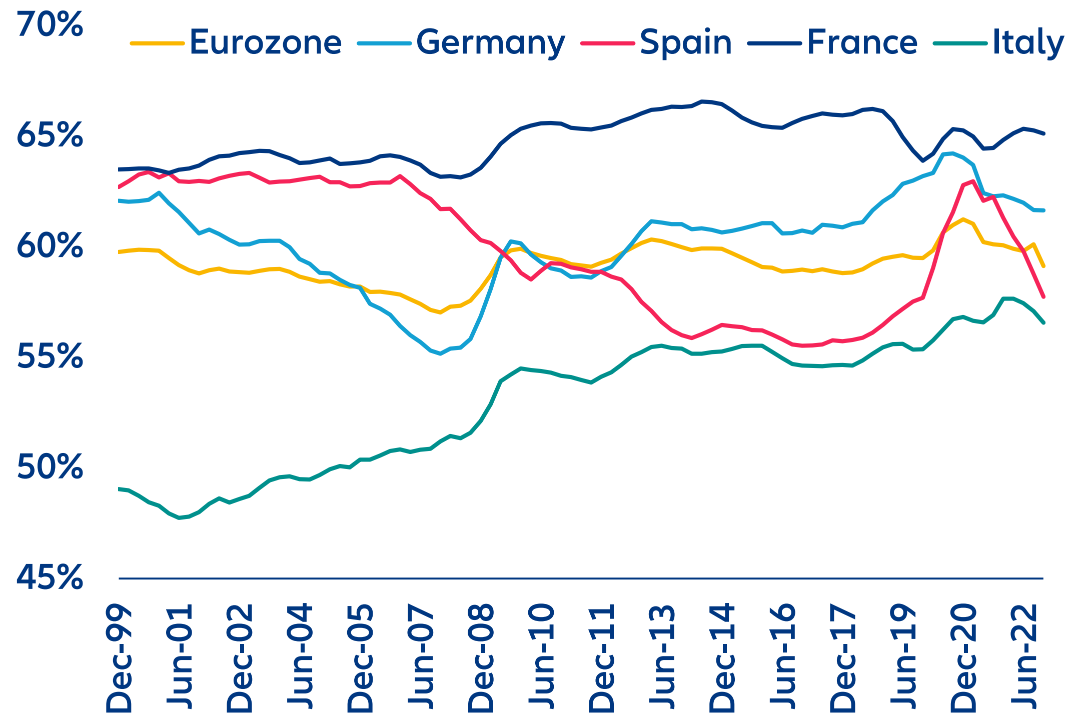
Hoarding labor vs. fall in margins cannot last forever

Q1 2023: Revenue vs EPS growth (y/y%)



Sources: Refinitiv (as of 12 June 2023), Allianz Research

Wages % of gross value added



Sources: Refinitiv Datastream, Allianz Research

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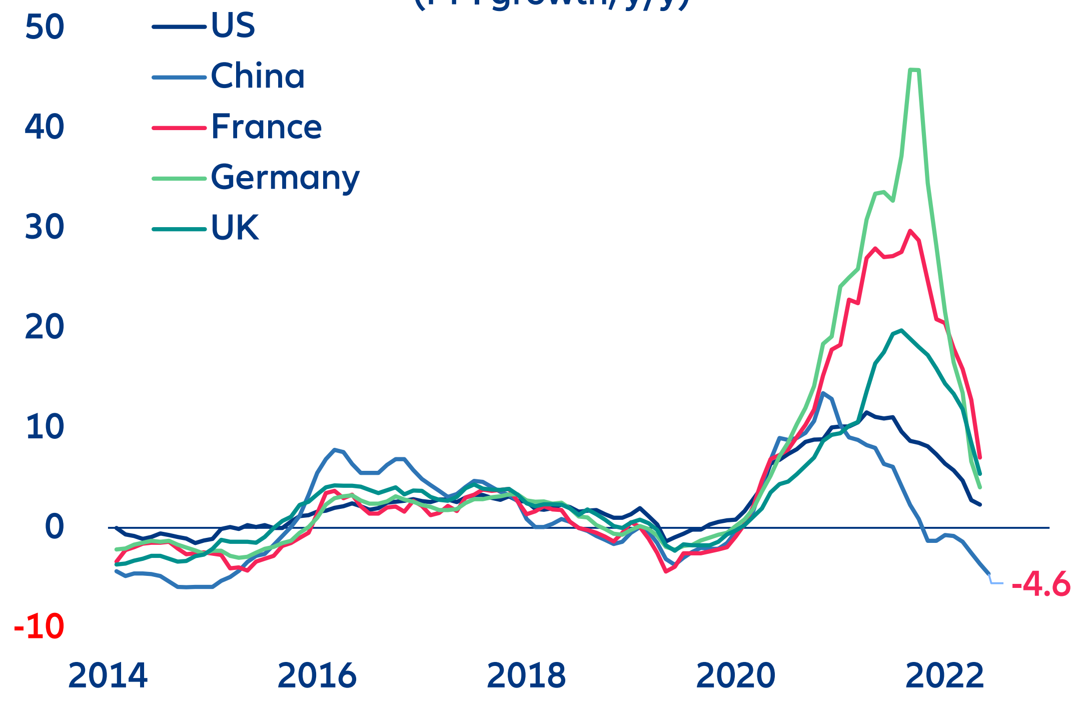
Cost deflation on its way

China is exporting deflation and factory gates fell at the fastest pace in 7 years

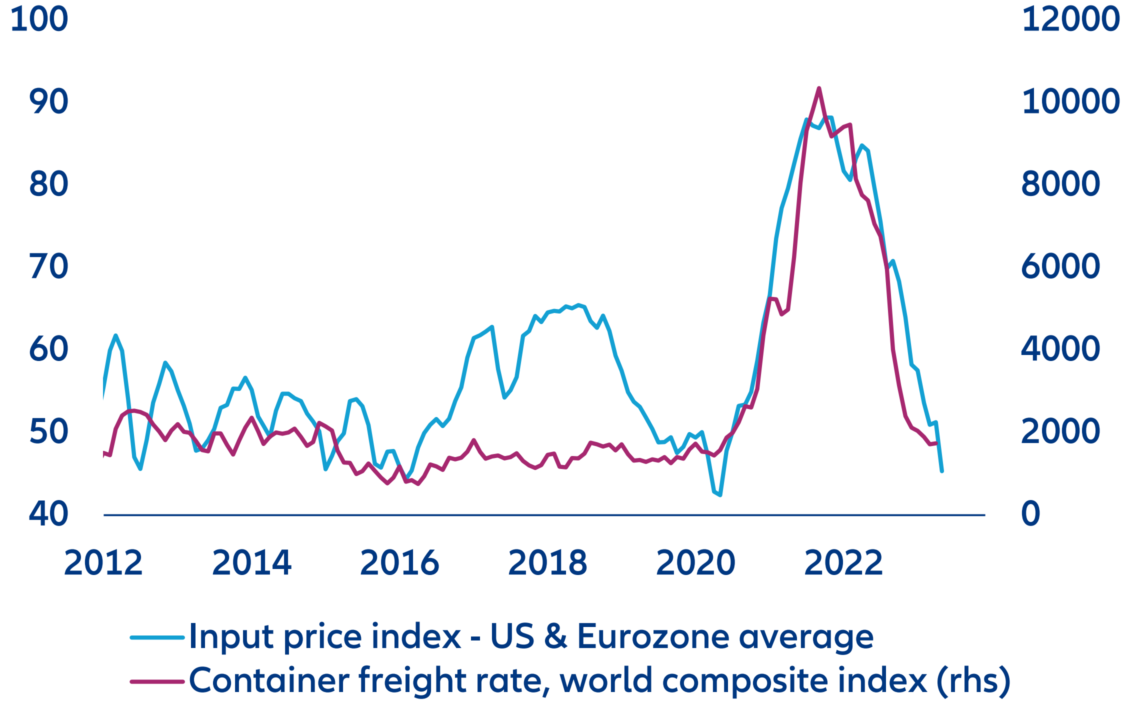
(PPI growth, y/y)



Sources: Refinitiv Datastream, Allianz Research

Transportation costs are normalizing

Input prices vs container freight rates

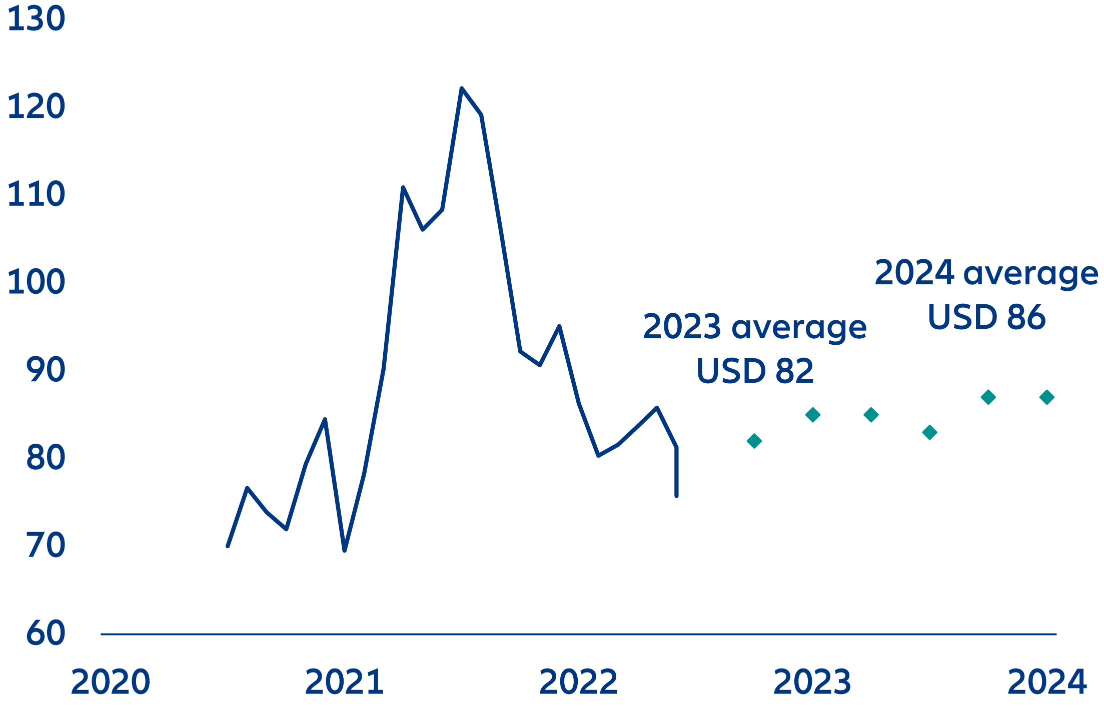


Sources: Refinitiv Datastream, Allianz Research

Energy prices: expensive but not accelerating

Oil prices should increase by end-2023 in response to persistent demand and supply uncertainties

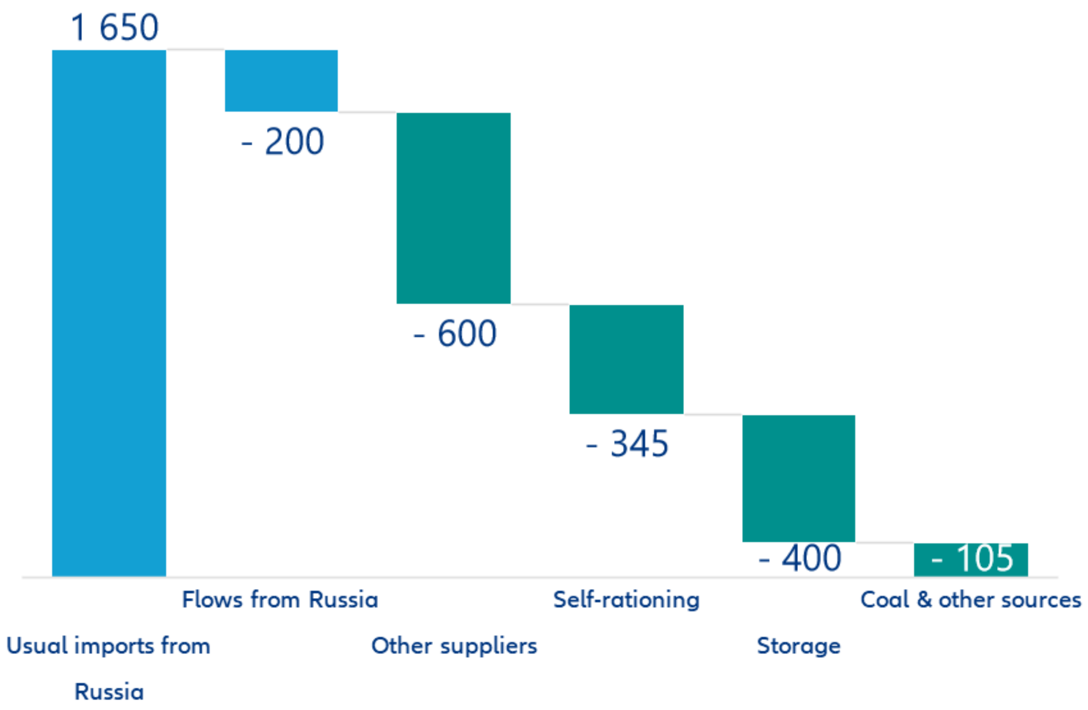
(USD/bbl)



Sources: ENTSO-G, Allianz Research

Europe decreasing its gas consumption by about -10% and gas storage levels are at 70%

Gas substitution in Europe (TWh)



Sources: Refinitiv Datastream, Allianz Research

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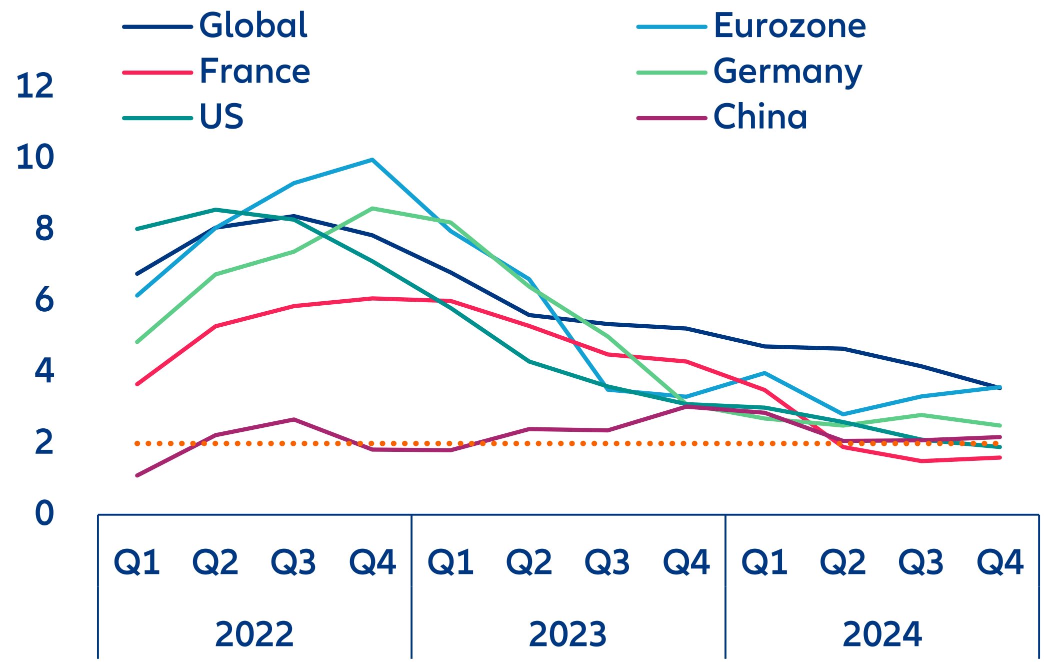
The disinflation gains traction globally and will push real wage growth in positive territory

Headline inflation will get closer to 2% only towards end of 2024

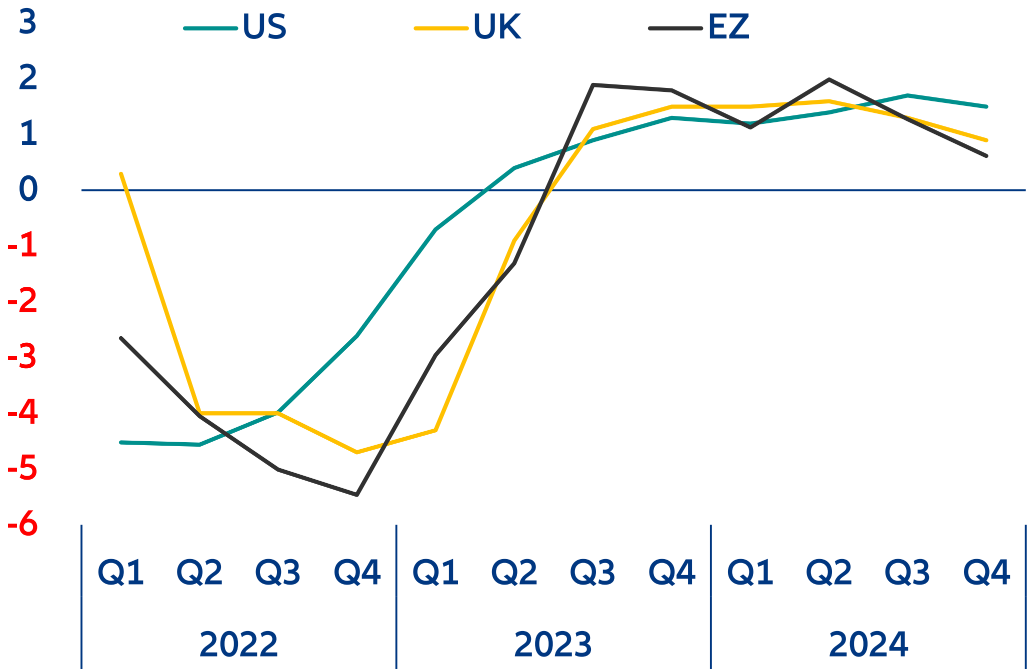
(y/y %)



Sources: Refinitiv Datastream, Allianz Research

Positive real wage growth by Q3 2024

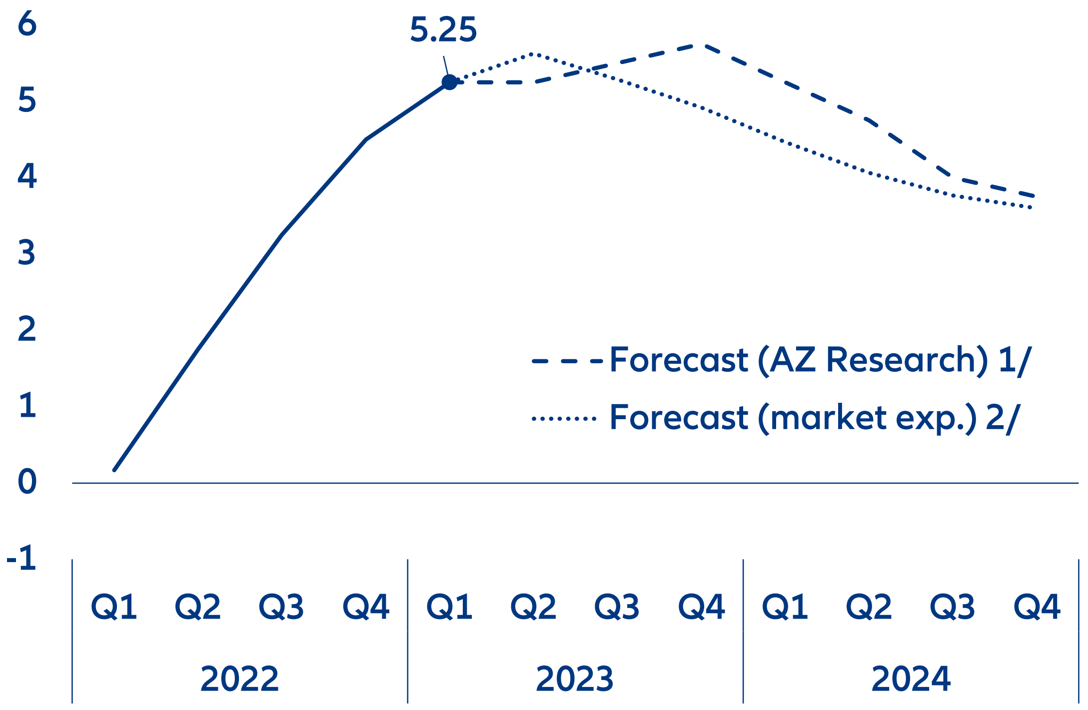
(y/y%)



Sources: Refinitiv Datastream, Allianz Research

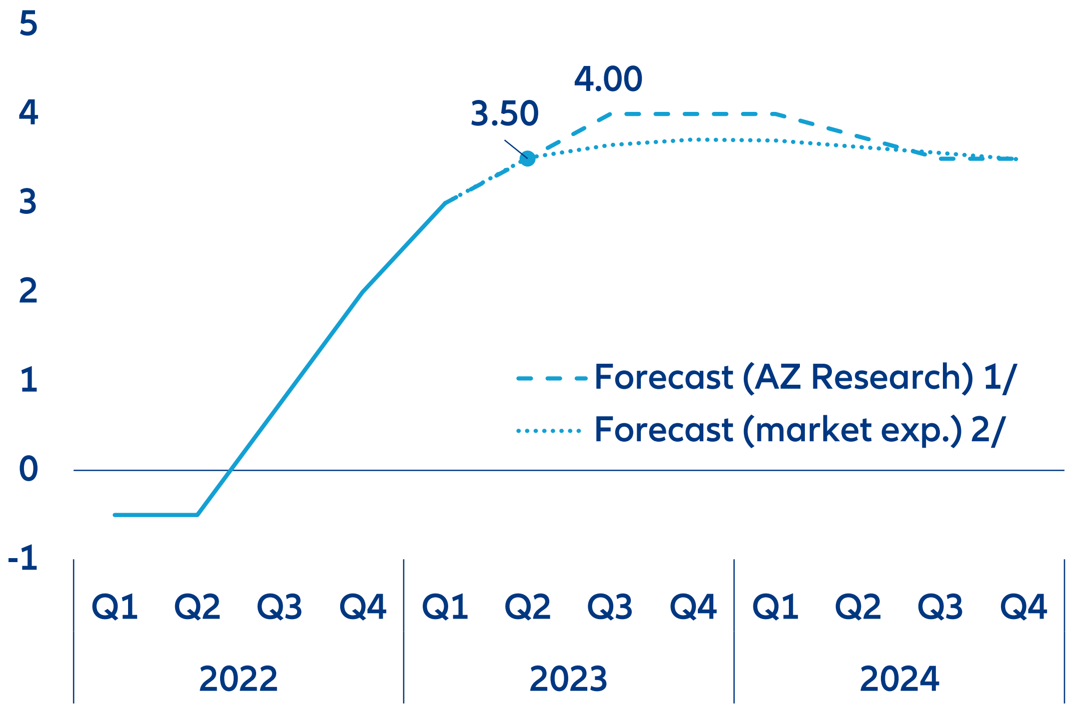
Resilient activity and limited financial stability concerns mean tight(er) monetary policy for longer

US: Policy rate forecast and market expectations
(%)



Sources: Refinitiv Datastream, Allianz Research

EZ: Policy rate forecast and market expectations
(%)



Sources: Refinitiv Datastream, Allianz Research

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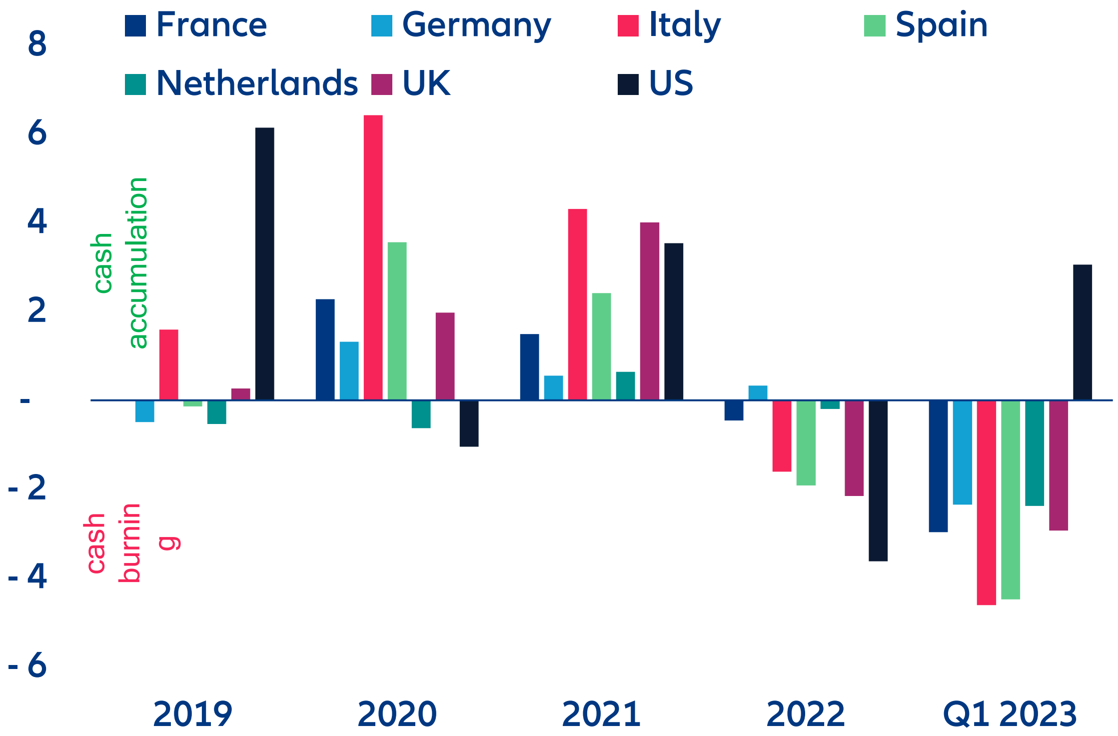
Peak in monetary policy transmission in late Fall

Cash buffers have been waning since H1 2022, except in the US where new loans are falling

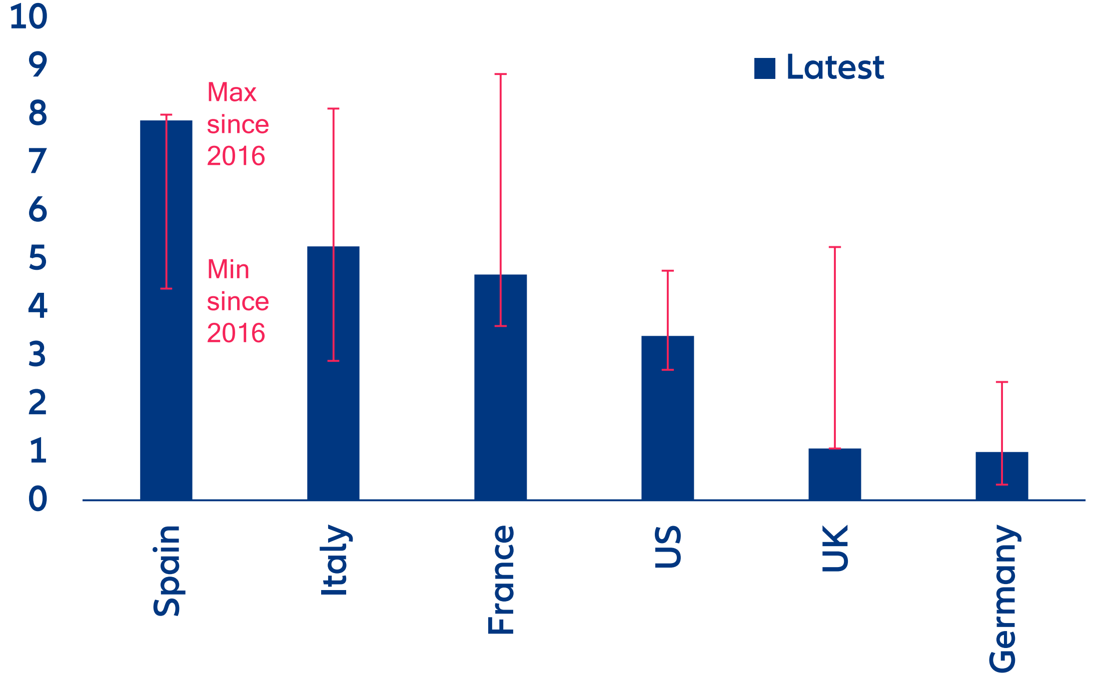
Cash-burning index, selected countries



Sources: ECB, Refinitiv, Allianz Research

The transmission of monetary policy is more visible in countries where banks are more fragile

Net interest payments (paid on debt – received on assets, % of GOS)



Sources: Refinitiv Datastream, Allianz Research

Note: Higher bound is the max since 2016 and the lower bound is the min. Please note that for the US we take into account net operating surplus.

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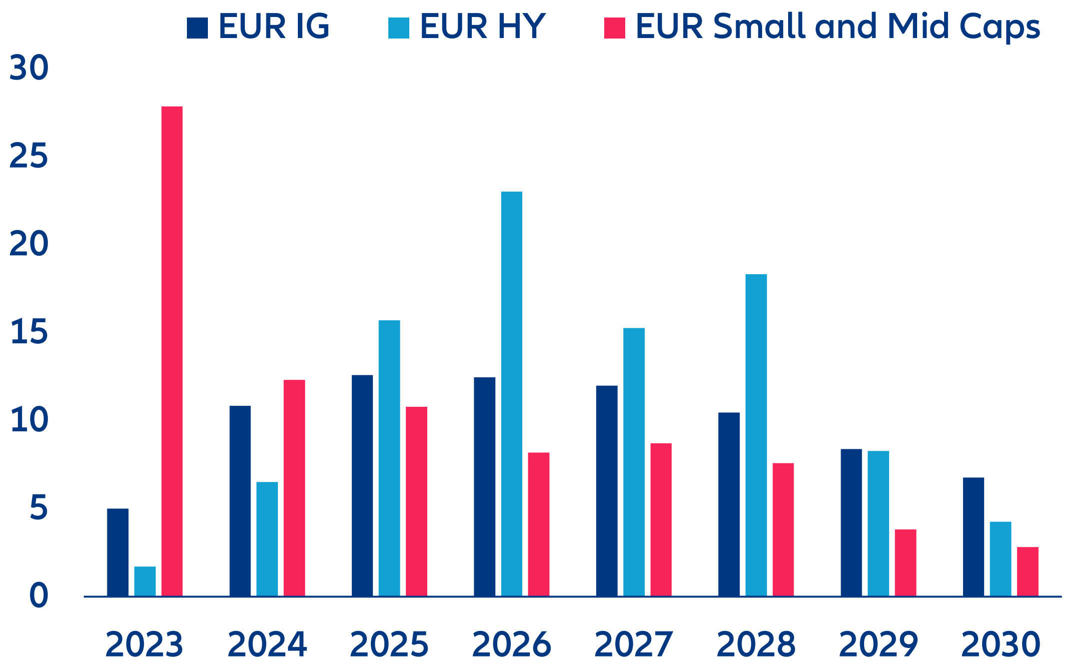
Wall of (corporate) debt repayments by 2026

Corporate debt maturities in Europe by 2030

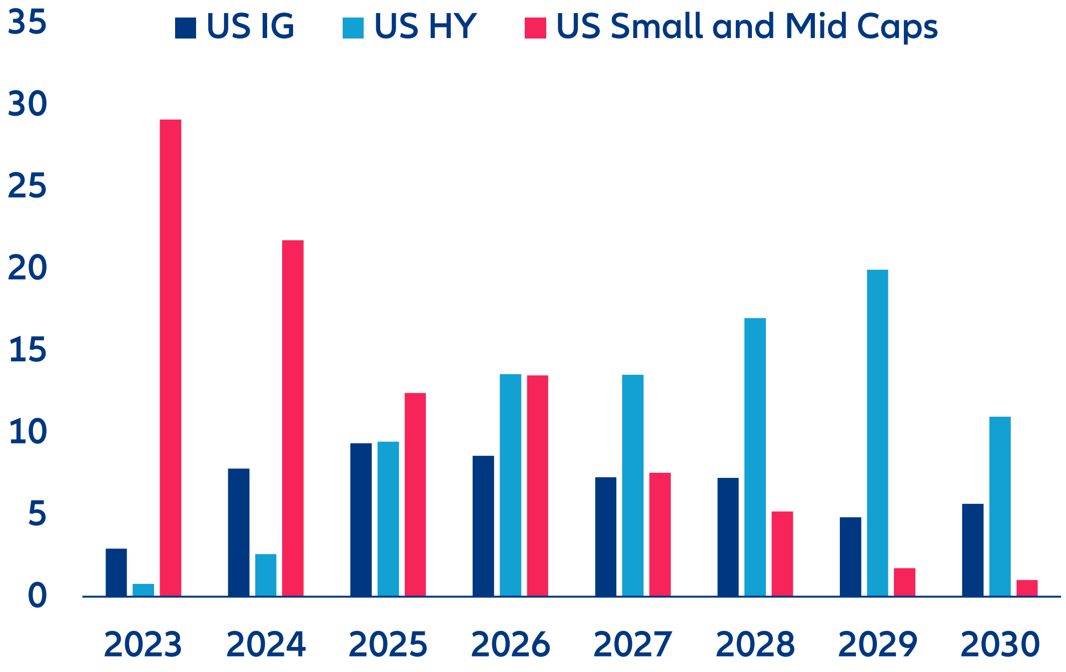
% of total



Sources: Refinitiv Eikon, Allianz Research

Corporate debt maturities in the US by 2030

% of total

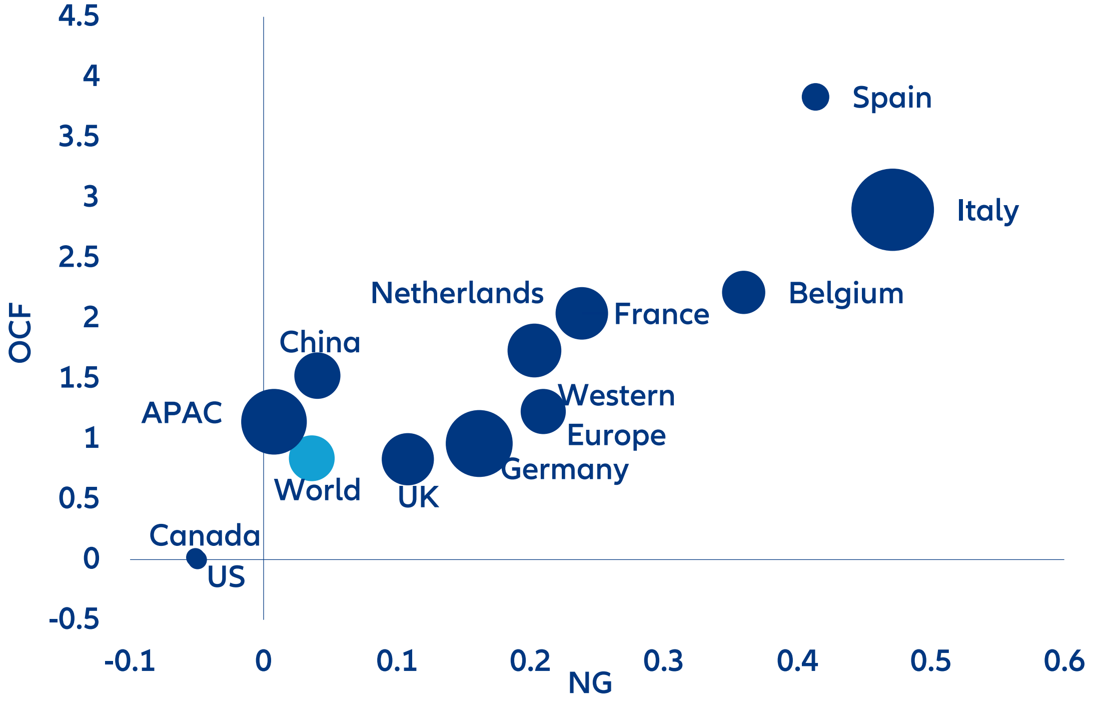


Sources: Refinitiv Eikon, Allianz Research

Debt vulnerability: Transport and construction most exposed

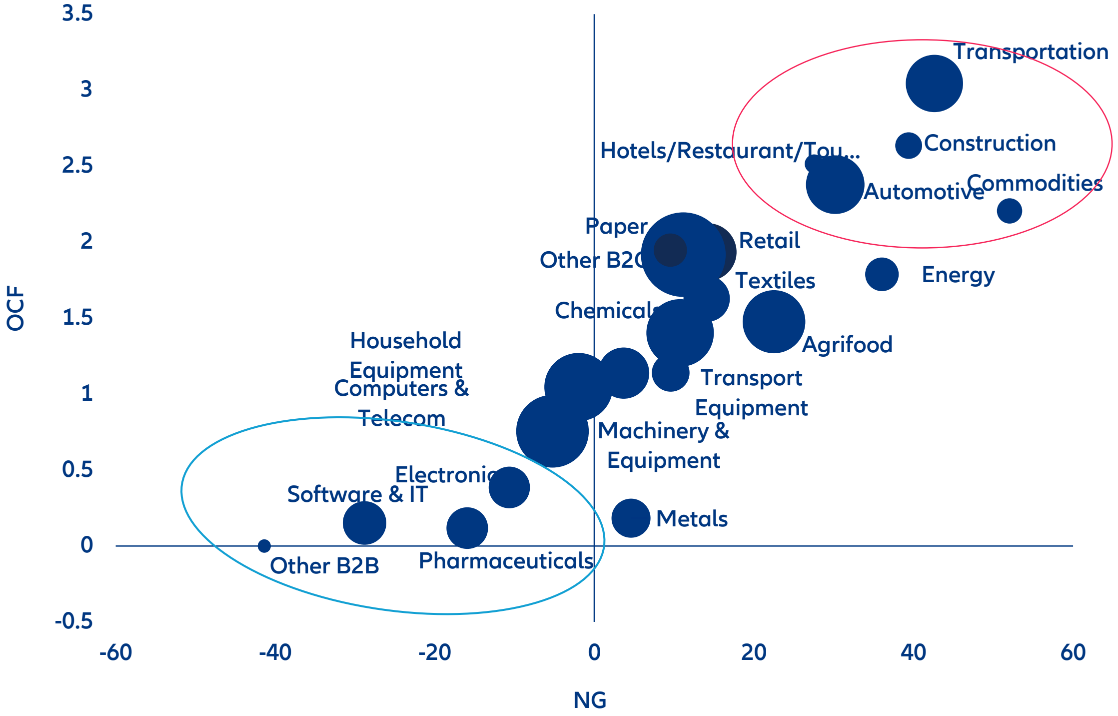
Net gearing (x-axis), operating cash flow coefficient (y-axis) and interest expense coverage (bubble)

By country, median figure for 2022



Sources: Refinitiv Eikon, Allianz Research

By global sector, median figure for 2022



Sources: Refinitiv Eikon, Allianz Research

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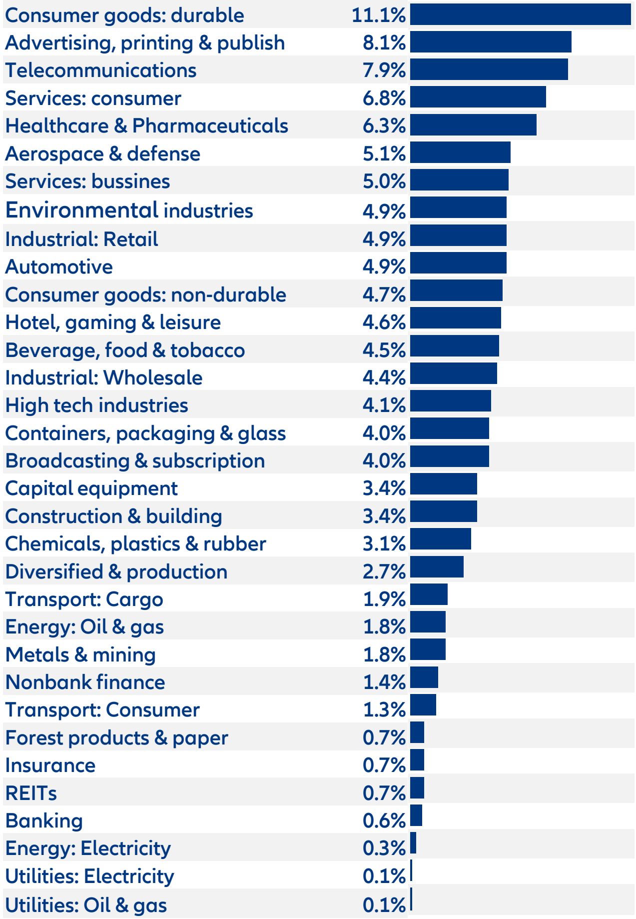
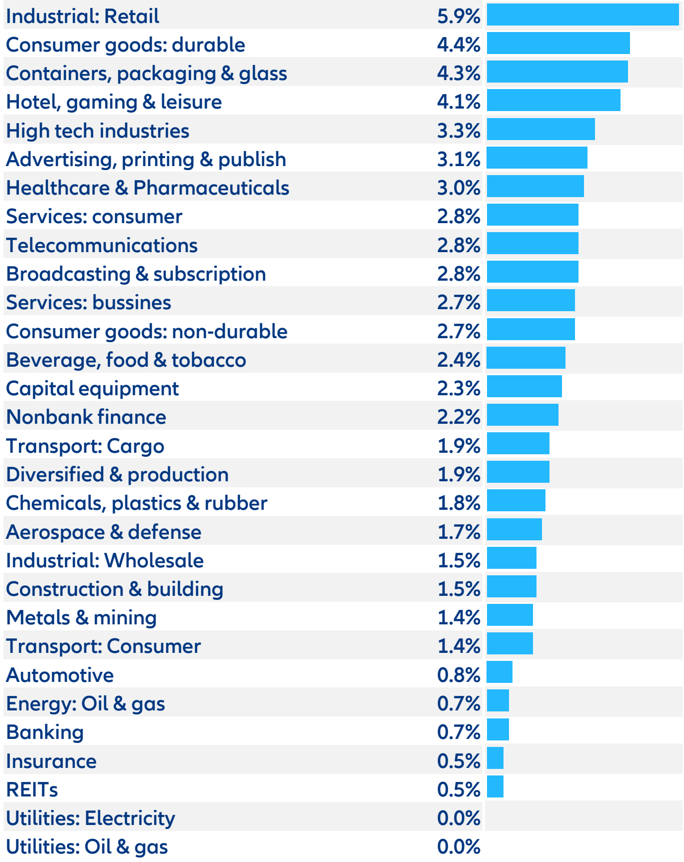
Consumer industries expected to have the highest default rate in the short term

US - 1Y default rate forecasts by sector



Sources: Moody's Investors service, Allianz Research

Eurozone - 1Y default rate forecasts by sector



Sources: Moody's Investors service, Allianz Research

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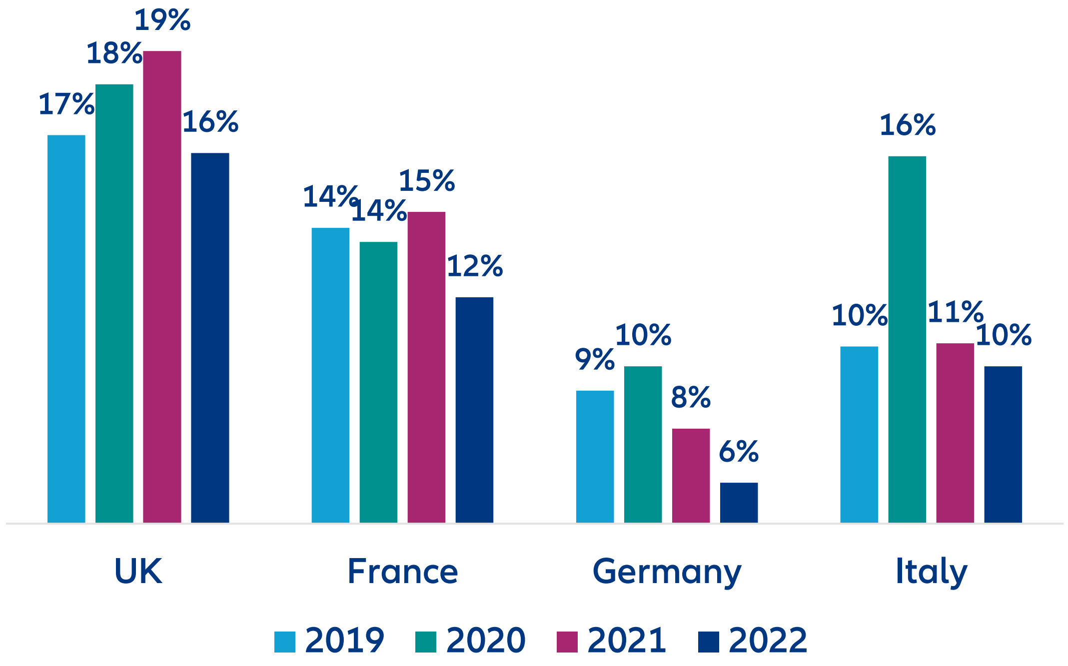
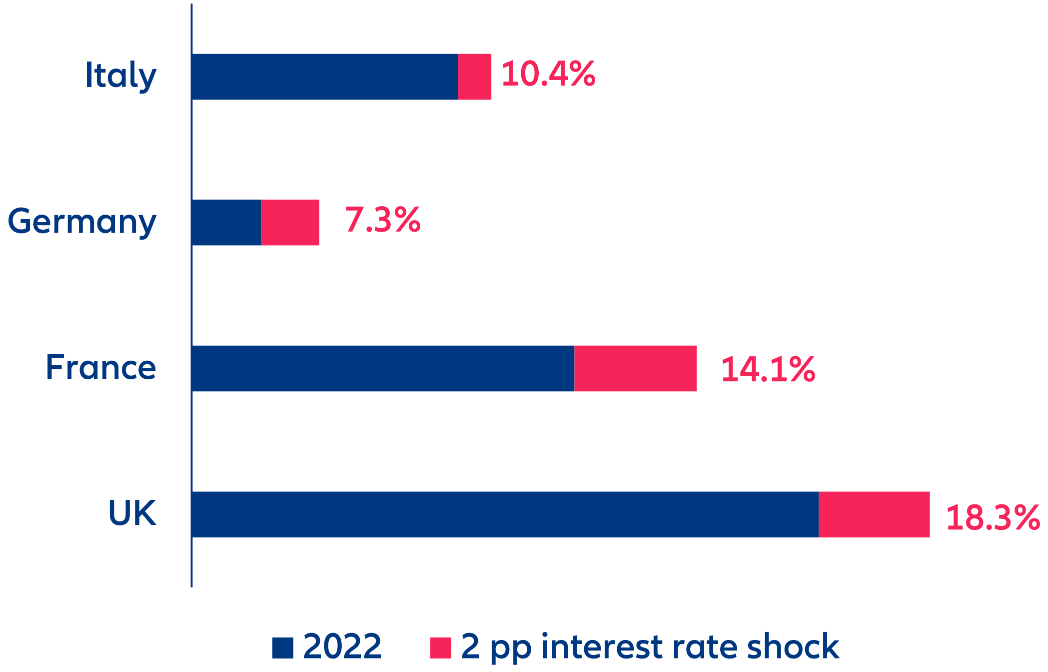
SMEs at risk could increase going forward

Share of fragile SMEs



Source: Allianz Research

Interest rate shock to increase vulnerabilities among SMEs



Source: Allianz Research

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The bounce back in insolvencies is spreading across sectors and to large firms

Europe: Q1 2023 business bankruptcies

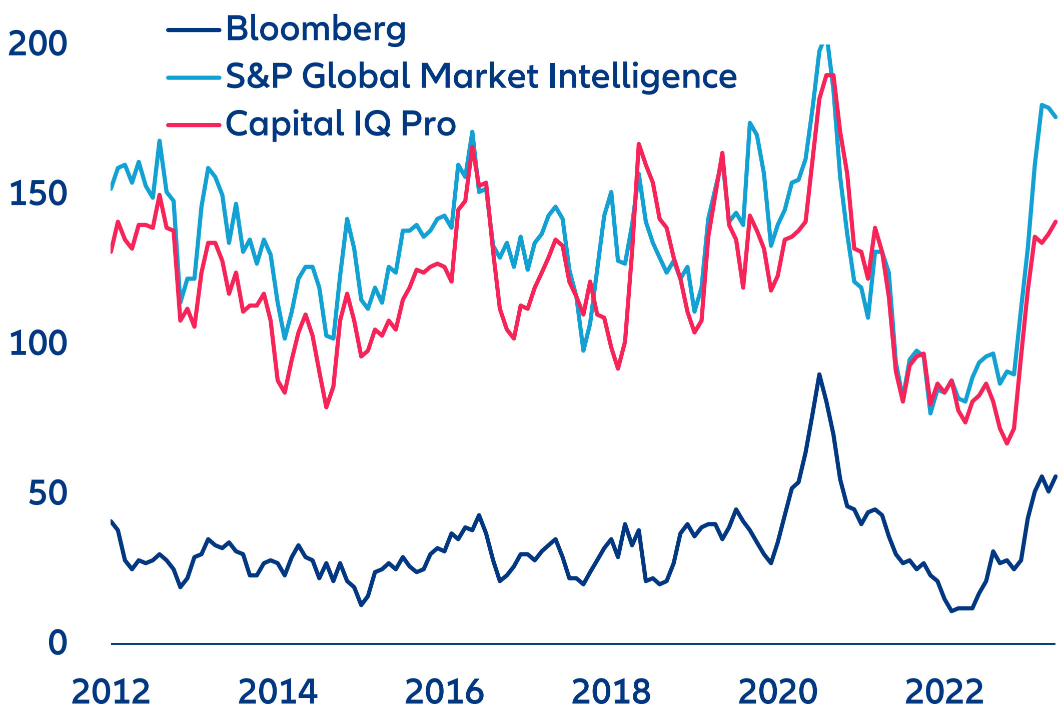
selected countries, y/y change in % *

	Industry	Construction	Trade	Transport & storage	Accommod. & food service activities	Information & communic.	Finance, insurance, real estate, B2B activities	Education, human health and social work activities
Belgium	10	24	1	-4	21	-11	7	18
Bulgaria	-19	14	-6	-29	-7	69	-2	-42
Croatia	-27	-8	-13	1	-18	-5	-20	-25
Denmark	-4	29	4	-5	17	-32	-28	-35
France	63	43	43	30	61	51	37	35
Germany	13	11	33	3	14	27	8	26
Hungary	144	227	264	115	337	324	252	308
Iceland	250	191	216	350	123	227	122	225
Italy	4	-15	-2	-16	-25	23	8	5
Lithuania	10	-28	60	-52	28	-31	4	-29
Luxembourg	-20	111	4	38	124	-45	4	-33
Netherlands	175	16	79	111	187	50	26	-21
Norway	25	31	67	7	104	17	27	38
Poland	62	-12	146	-86	80	-29	92	100
Portugal	15	73	26	12	-3	0	11	48
Romania	3	5	4	-4	-15	0	-17	-22
Slovakia	5	-7	-5	25	33	0	-7	-40
Slovenia	13	9	-42	0	73	0	17	-62
Spain	5	-14	19	70	35	-8	17	69
UK	19	1	35	8	44	-12	-4	21

(*) non seasonally adjusted numbers; underligned figures indicate a higher number compared to 2019 average; German figures refer to Dec 2022/Feb 2023 period

Sources: National sources, Eurostat, Allianz Research

US: Insolvencies of large firms*, monthly monitoring



(*) Bloomberg: Firms with USD50mn+ in liabilities; S&P Global Market Intelligence and Capital IQ Pro: Firms with public debt where either assets or liabilities are greater than or equal to USD 2mn, or private companies where either assets or liabilities are greater than or equal to USD 10mn

Source: Allianz Research

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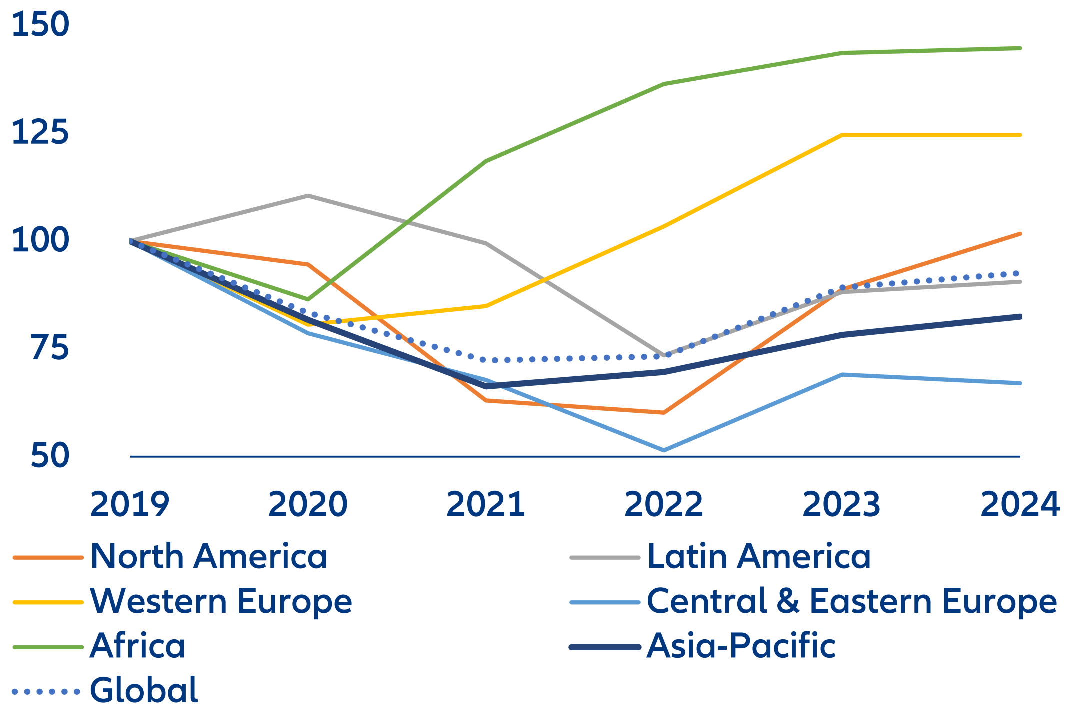
The return of credit risk: +21% increase in business insolvencies globally

Western Europe soon back to pre-pandemic levels

Global and regional insolvency indices*, yearly level, basis 100 in 2019



(*) not seasonally adjusted
Sources: National statistics, Allianz Research

The rebound is picking up speed

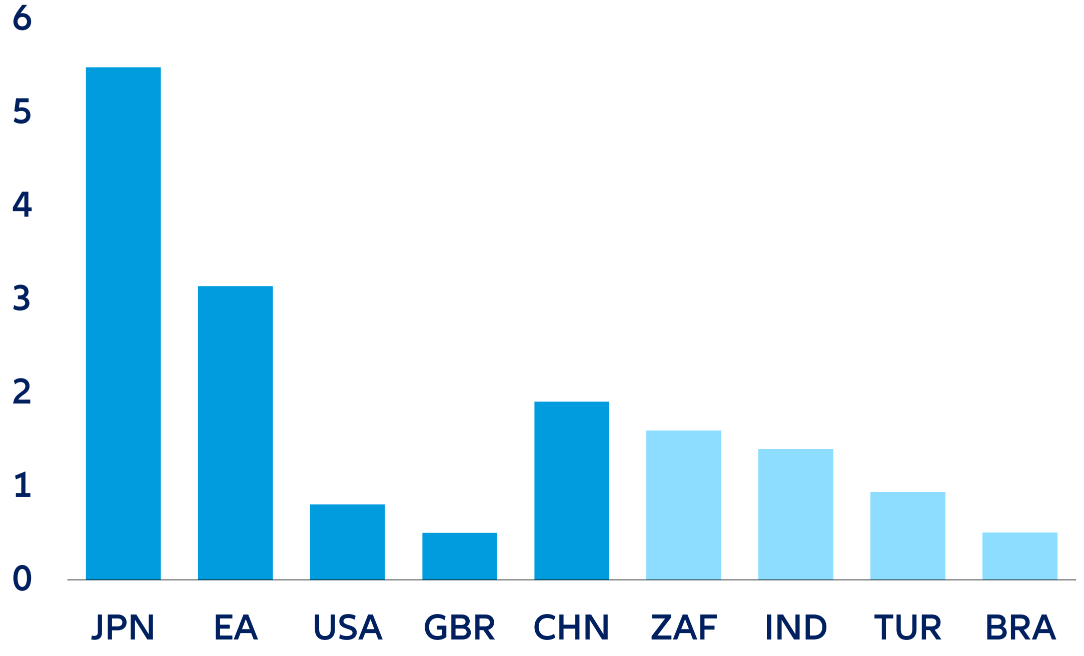
June update (selected countries*)

Country	Latest data point: Date	Latest data point: y/y change in %: 3 months	Latest data point: y/y change in %: 6 months	Latest data point: y/y change in %: 12 months	Latest data point: y/y change in %: Year to date	Annual figures and forecasts: Yearly number: 2022	Annual figures and forecasts: Yearly number: 2023	Annual figures and forecasts: Yearly number: 2024	Annual figures and forecasts: Yearly change in %: 2022	Annual figures and forecasts: Yearly change in %: 2023	Annual figures and forecasts: Yearly change in %: 2024	Annual figures and forecasts: Comparison with 2019 level: 2022	Annual figures and forecasts: Comparison with 2019 level: 2023	Annual figures and forecasts: Comparison with 2019 level: 2024
U.S.	2023 Q1	33%	22%	10%	33%	13 436	20 000	23 000	-6%	49%	15%	-41%	-12%	1%
Canada	04-23	29%	34%	35%	33%	2 621	3 350	3 450	35%	28%	3%	-5%	22%	26%
Brazil	04-23	14%	4%	-1%	18%	1 857	2 400	2 650	-5%	29%	10%	-36%	-17%	-8%
Germany	02-23	20%	19%	8%	20%	14 590	17 800	18 900	4%	22%	6%	-22%	-5%	1%
United Kingdom	04-23	6%	13%	26%	7%	24 614	28 500	31 100	51%	16%	9%	11%	29%	41%
France	04-23	36%	42%	48%	40%	41 887	59 000	57 000	49%	41%	-3%	-19%	15%	11%
Italy	05-23	2%	-3%	-11%	2%	7 164	8 250	9 800	-20%	15%	19%	-36%	-26%	-12%
Spain	04-23	-39%	-8%	12%	-30%	6 187	7 300	6 900	21%	18%	-5%	49%	75%	66%
Netherlands	05-23	42%	54%	40%	54%	2 145	3 270	3 530	18%	52%	8%	-43%	-14%	-7%
Switzerland	12-22	26%	26%	33%	33%	6 796	7 100	6 800	33%	4%	-4%	13%	18%	13%
Sweden	04-23	18%	26%	16%	26%	7 189	8 100	7 800	6%	13%	-4%	-6%	6%	2%
Belgium	04-23	12%	15%	30%	15%	9 265	9 960	10 200	42%	8%	2%	-13%	-6%	-4%
Ireland	2023 Q1	22%	23%	36%	22%	530	670	790	32%	26%	18%	-7%	18%	39%
Norway	04-23	30%	27%	23%	35%	3 713	4 330	4 750	12%	17%	10%	-26%	-14%	-5%
Austria	2023 Q1	22%	13%	39%	22%	4 770	5 310	5 510	57%	11%	4%	-5%	6%	10%
Denmark	05-23	12%	26%	39%	28%	2 834	3 300	3 000	30%	16%	-9%	9%	27%	16%
Finland	05-23	10%	23%	21%	26%	2 995	3 300	3 350	7%	10%	2%	0%	10%	12%
Russia	03-23	-46%	-41%	-25%	-46%	9 055	9 300	12 100	-12%	3%	30%	-27%	-25%	-2%
Poland	05-23	114%	137%	74%	128%	2 625	3 700	3 500	20%	41%	-5%	169%	279%	258%
China	05-23	-10%	-16%	-10%	-14%	7 528	7 600	8 100	-13%	1%	7%	-36%	-36%	-32%
Japan	05-23	33%	28%	19%	30%	6 428	7 230	7 620	7%	12%	5%	-23%	-14%	-9%
India	2023 Q1	6%	18%	42%	6%	1 237	1 650	1 750	53%	33%	6%	-36%	-14%	-9%
South Korea	04-23	3%	9%	-8%	12%	149	190	210	-19%	28%	11%	-64%	-54%	-49%
Australia	04-23	52%	47%	52%	47%	4 940	5 950	6 300	45%	20%	6%	-23%	-7%	-2%
Singapore	04-23	-16%	-15%	-3%	-14%	215	220	225	13%	2%	2%	-25%	-23%	-22%
Hong Kong	04-23	76%	15%	25%	47%	303	305	295	1%	1%	-3%	24%	25%	21%
New Zealand	05-23	42%	44%	32%	36%	1 652	1 970	2 100	12%	19%	7%	-13%	3%	10%
South Africa	04-23	-8%	-4%	-2%	-13%	1 907	1 980	2 050	-1%	4%	4%	-7%	-3%	0%

(*) not seasonally adjusted
Sources: National statistics, Allianz Research

Corporate losses could wipe out several years of bank profits & cause fiscal burden

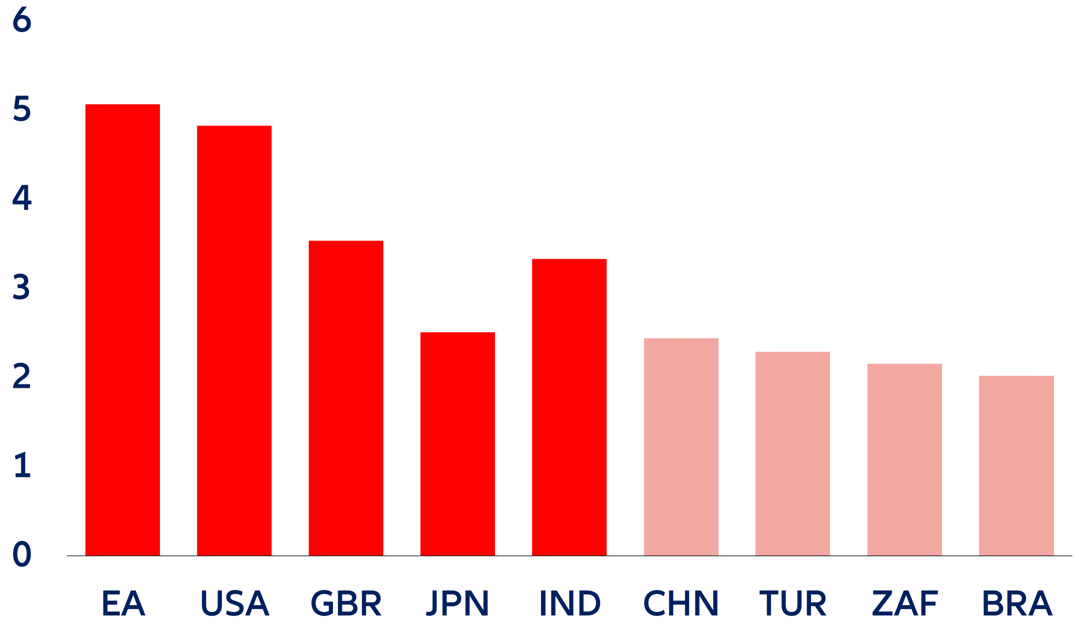
Net bank losses equivalent to number of years of profits



Sources: Refinitiv Datastream, Allianz Research. Note: capital buffers are preserved, and does not include additional impact of net change in corporate credit risk weights and lost interest income from corporate lending; comprises only public credit guarantees for corporate lending by banks, which cover mostly new lending, and many credit guarantee programs have not been fully exhausted (assumption: two-thirds usage rate); we assume a corporate default rate increase of 6.1 percentage points in 2023, with the government absorbing 90 percent of losses covered by guarantees.

Fiscal deficits from government exposure to corporates

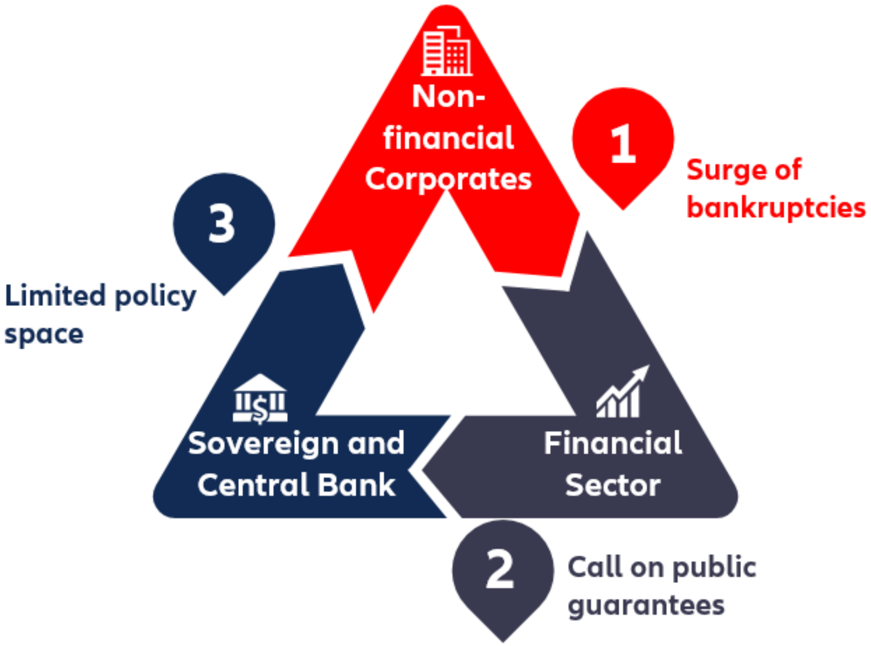
(% of GDP)



Sources: Refinitiv Datastream, Allianz Research. Note: does not include impact of deteriorating fiscal deficit and government debt stock on funding cost (and debt sustainability); comprises only public credit guarantees for corporate lending by banks, which cover mostly new lending, and many credit guarantee programs have not been fully exhausted (assumption: two-thirds usage rate); we assume a corporate default rate increase of 6.1 percentage points in 2023, with the government absorbing 90 percent of losses covered by guarantees; governments also incur corporate income tax losses of 30 and 25 percent of GDP (ex post shock) in advanced and emerging economies, respectively.

Doom-loop revisited

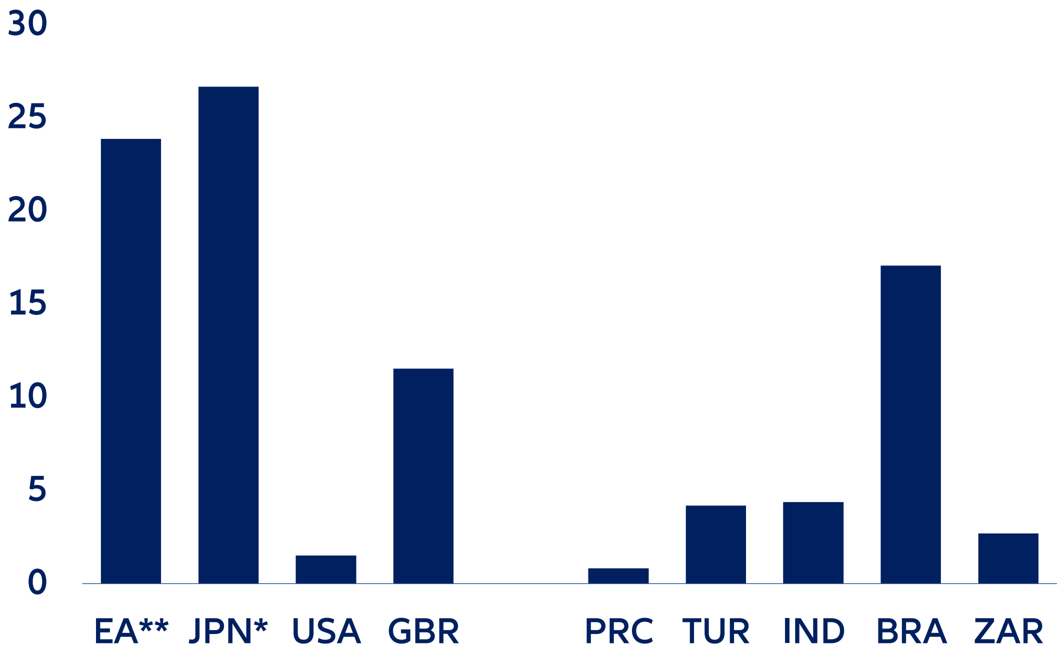
Corporate-bank-sovereign nexus



Source: Allianz Research

Sovereign exposure to private non-financial corporate debt via guarantees & CB asset purchases

(% of GDP)



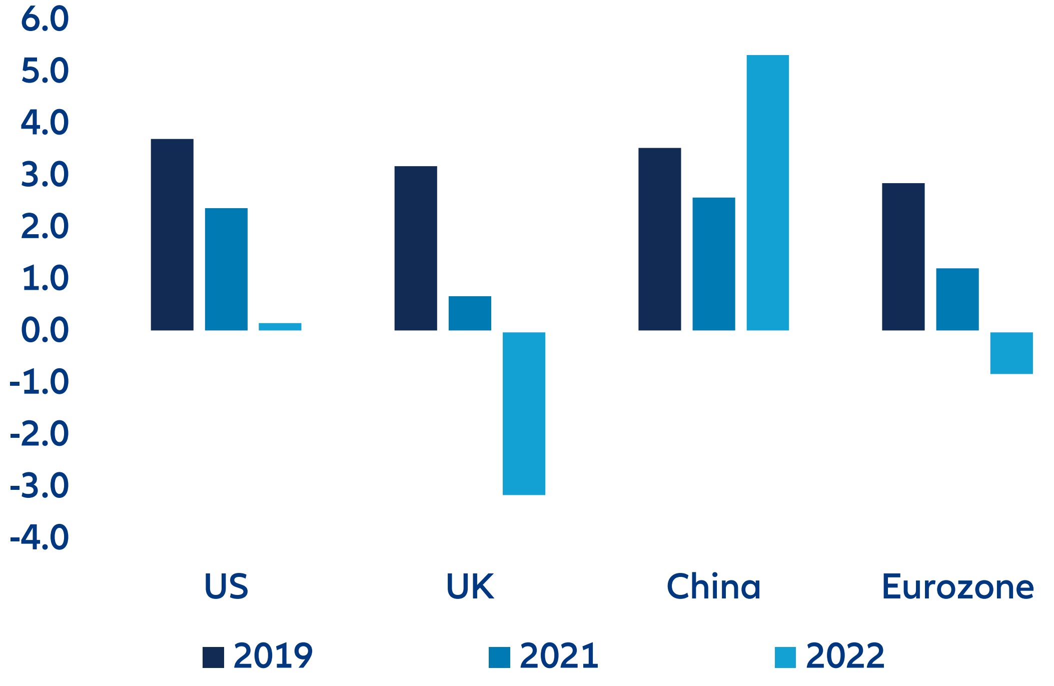
Sources: Refinitiv Datastream, IMF Fiscal Monitor (April 2021), Allianz Research.
Notes: */ includes stocks and ETFs; **/ weighted average of Germany, France, and Italy.

Allianz

Fiscal consolidation risks on the horizon

Credit intensity is decreasing in terms of growth…

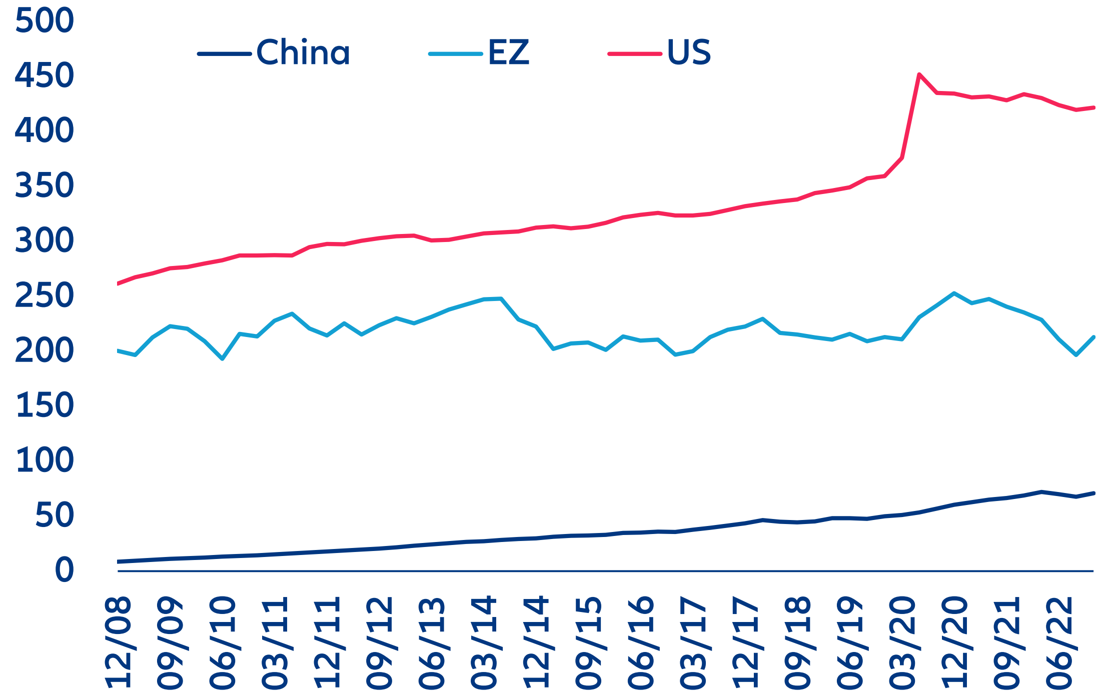
Private sector credit intensity, y/y



Sources: BIS, Allianz Research

…and employment

Unit of public and private debt per employed people (USD '000)



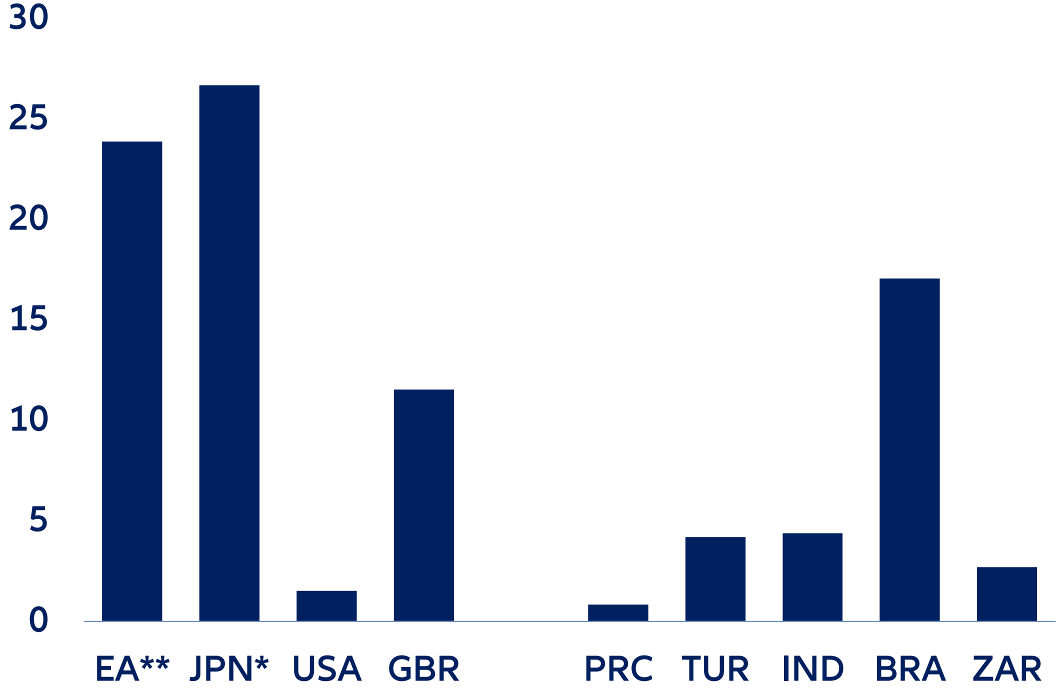
Sources: BIS, Allianz Research

Allianz

Risk of twin deficits and impending fiscal tightening

Direct exposures & contingent liabilities of governments to NFCs

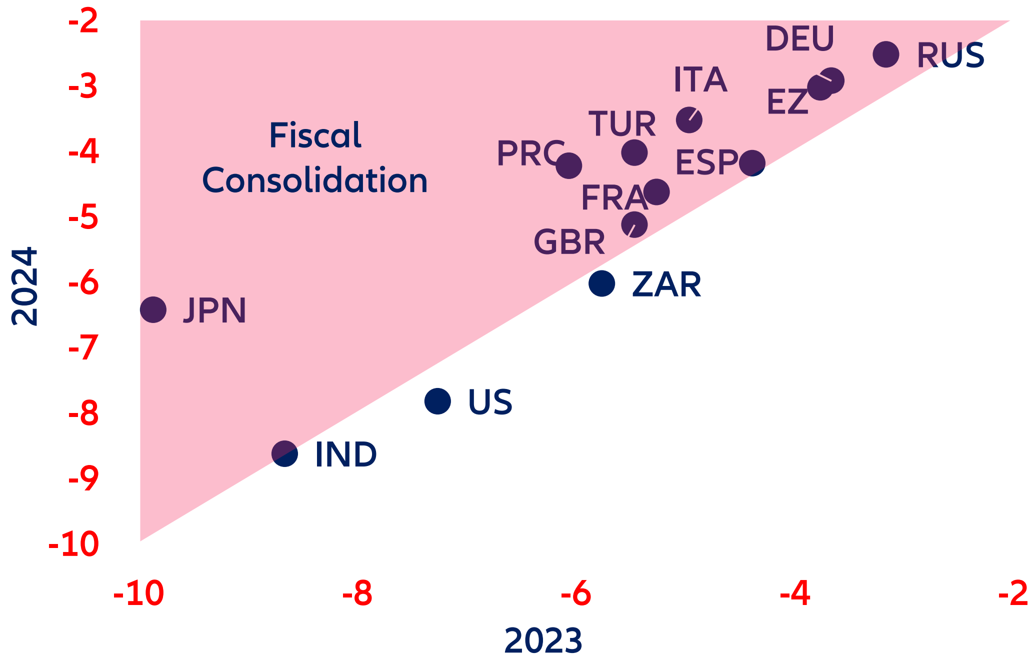
(% of GDP, end-Q1 2023)



Sources: Refinitiv Datastream, Allianz Research

Change of fiscal deficit (2023 vs. 2024)

(% of GDP)



Sources: Refinitiv Datastream, IMF Fiscal Monitor (April 2021), Allianz Research. Note: 1/ comprises public credit guarantees for corporate lending by banks and asset purchases with significant corporate risk. The actual materialization of guarantees will depend on loan losses in excess of current provisions (net of collateral value) and the loss sharing by governments (usually about 80%); */ includes stocks and ETFs; **/ weighted average of Germany, France, and Italy.

Politically charged next two years: 75% of global GDP will be under close scrutiny

United-States
Next key dates: Nov 2024, 5 - Presidential elections
Our expectations: *Whoever wins the Presidential election, we think that fiscal policy will be tightened substantially in 2025 amid large and growing fiscal imbalances.*

Mexico
Next key dates: July 2024 - Presidential elections
Our expectations: *Due to President AMLO's consistently high approval ratings and strong political influence, the Morena candidate is expected to be the favoured winner.*

Ecuador
Next key dates: Aug 2023, 20 & Oct 2023, 15 - Presidential elections
Our expectations: *President Lasso mentioned that he has "no plans to run" in the elections and widespread dissatisfaction with his administration is likely to drive a shift to the left. In particular, the hard-left populist movement Correísta appears well placed to make a strong showing, given the recent regional elections.*

Poland
Next key dates:
Nov 2023 – Legislative elections
Our expectations: *Outcome will be a close call with some pre-election noise. We expect the ruling PiS-led government to win narrowly. Relations between the EU and Poland will remain strained.*

United Kingdom
Next key dates:
Jan 2025 – General elections
Our expectations: *Hung parliament likely post elections.*

Peru
Our expectations: *After anti-government protests faded, proposals to bring forward general elections (due by 2026) will most likely not go through.*

Argentina
Next key dates: October 2023, 22 - Presidential elections
Our expectations: *President Alberto Fernández declined to run for a new term. While most polls show a lead for the ruling coalition, not all of them show the same advantage, and some highlight the rising voting intentions for the libertarian party.*

Austria
Next key dates:
2024 – General elections
Our expectations: *Expect an increasing shift to the right, with issues around migration.*

European elections
Next key dates:
June 2024 - Parliament
Our expectations: Expect *the center right to lead the polls.*

Senegal
Next key dates: Feb 2024 - General elections
Our expectations: *Unprecedented social unrest after most prominent opponent's 2-year jail sentencing.*

South Africa
2024 - General elections
Our expectations: *Given the current structural crisis significantly affecting the political course of the African National Congress and economic challenges, the road to next year's elections will be all uphill.*

Russia
Next key dates: 2024 – Presidential elections
Our expectations: *A harsh official crackdown on dissent and protests could discourage people from taking action but the costs of war could eventually lead to a groundswell of discontent that spreads beyond the usual opposition circles.*

Türkiye
Next key dates: 2024 March – Local elections
Our expectations: *Expect recently reelected Recep Tayyip Erdogan to continue dominate Turkish politics and remain in power until 2028, and potentially beyond (despite current constitutional hinders).*

Taiwan
Next key dates: 2024 January, 13 – Presidential elections
Our expectations: *Expect noise around National Day (10 Oct), given current military exercises in the South China Sea. China will also be celebrating its National Day in October.*

South Korea
Next key dates: 2024 April, 10 – Legislative elections
Our expectations: *The ruling conservative party's minority in the National Assembly, dominated by the opposition, will keep law-making confrontational.*

India
Next key dates: 2023 October, 14 - General elections
Our expectations: *Low risk of political instability. The ruling party could potentially intensify its Hindu nationalist agenda in 2023 in the run-up to the general election, sparking intermittent religious and communal clashes*

Indonesia
Next key dates: 2024 February, 14 – Presidential elections
Our expectations: *Expect Ganjar Pranowo, the governor of Central Java, to succeed Jokowi in 2024 and to maintain the big tent strategy, which will include drafting politicians from rival parties into the next administration.*

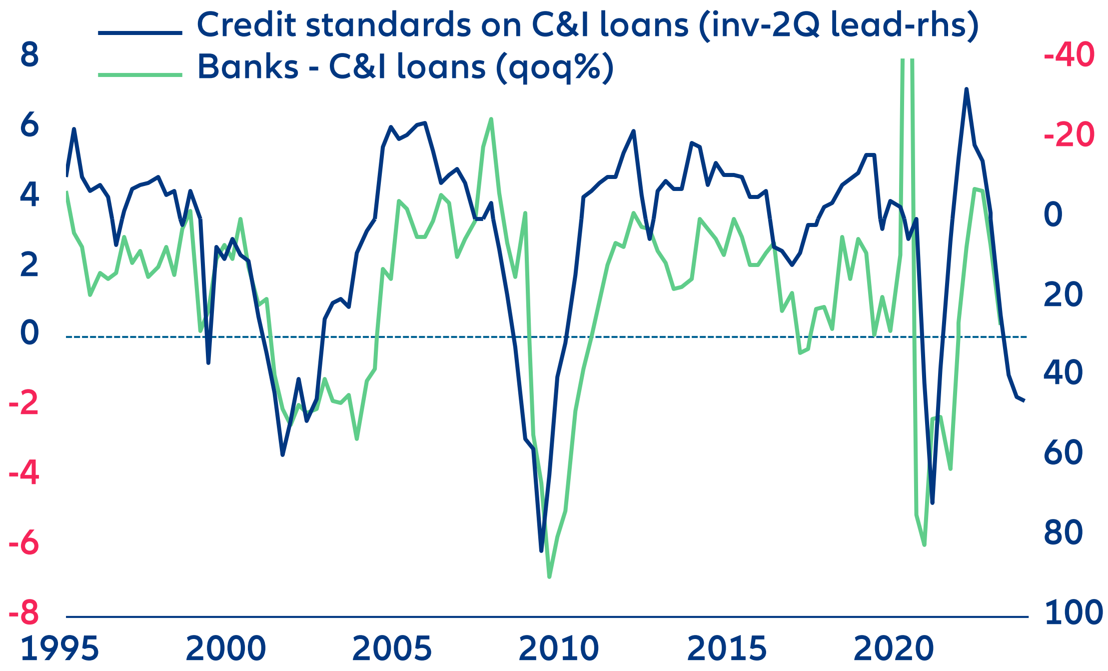
Sources: Allianz Research, Economist Intelligence Unit

Regional outlook 2023-24

Allianz

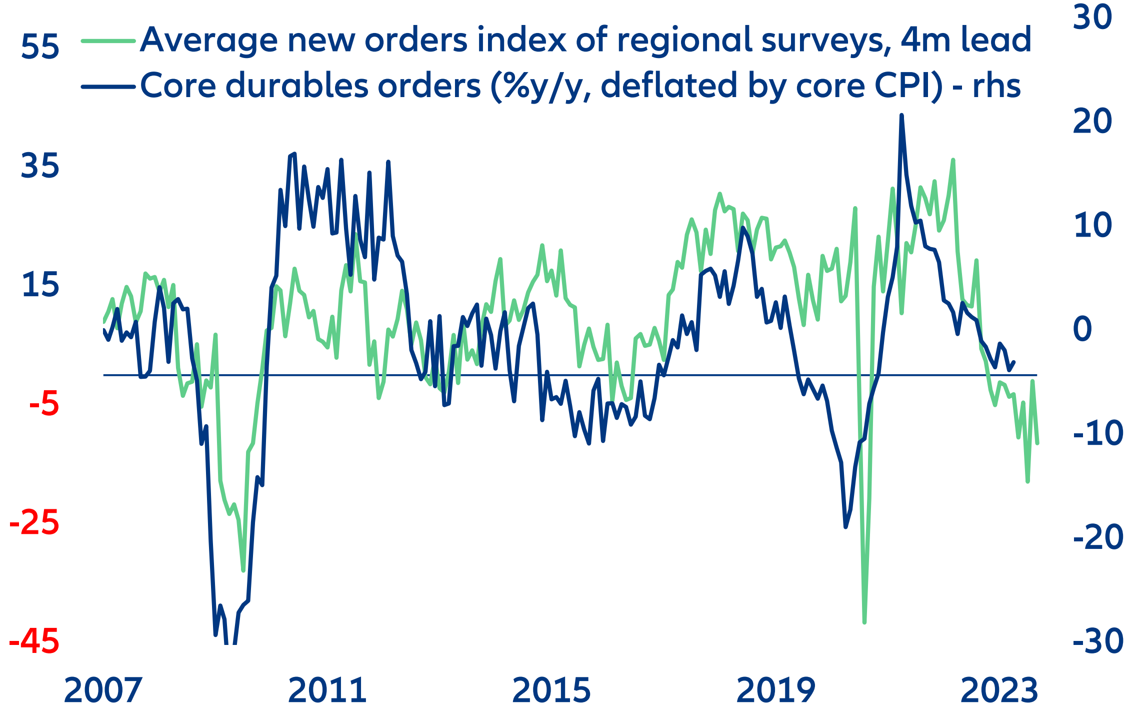
A soft patch ahead

The supply of credit for corporates is set for a rapid pull-back



Sources: Refinitiv Datastream, Allianz Research

Capex intentions are weak

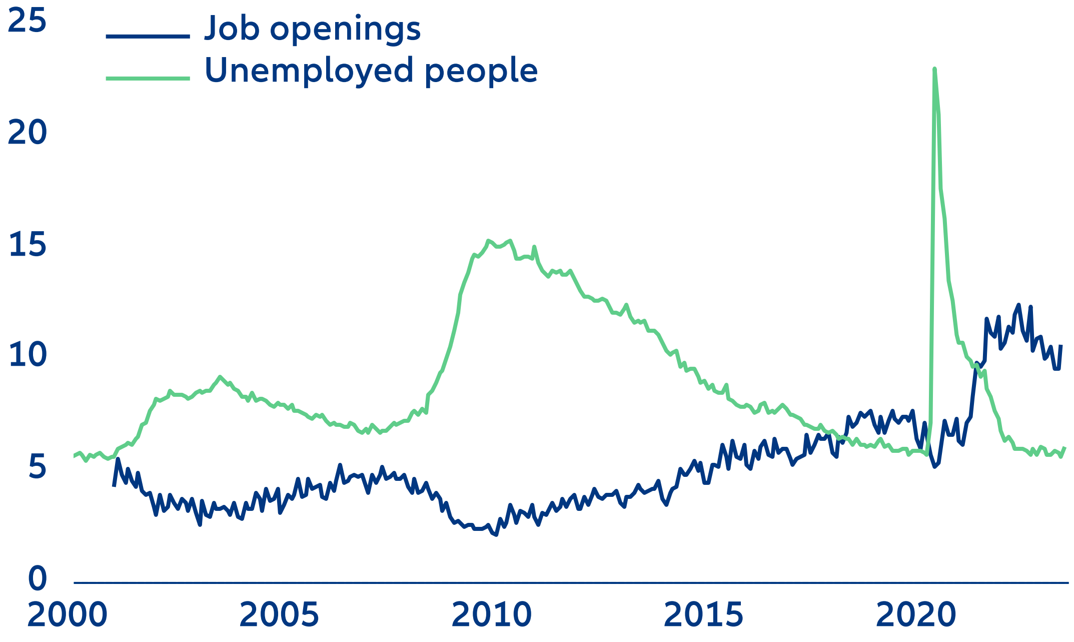


Sources: Refinitiv Datastream, Allianz Research

Allianz

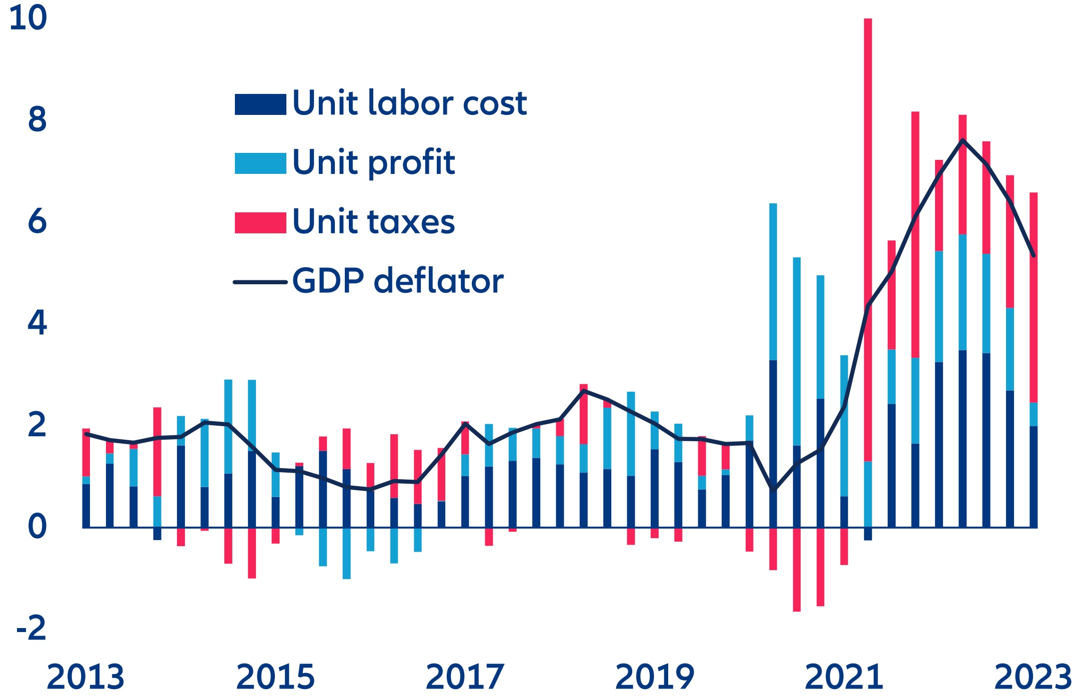
Softish landing followed by a recovery in mid-2024

Acute labor shortages should limit the rise of unemployment



Sources: Refinitiv Datastream, Allianz Research

Corporates start to ease on their margins rather than lay off their staff (% year-on-year)

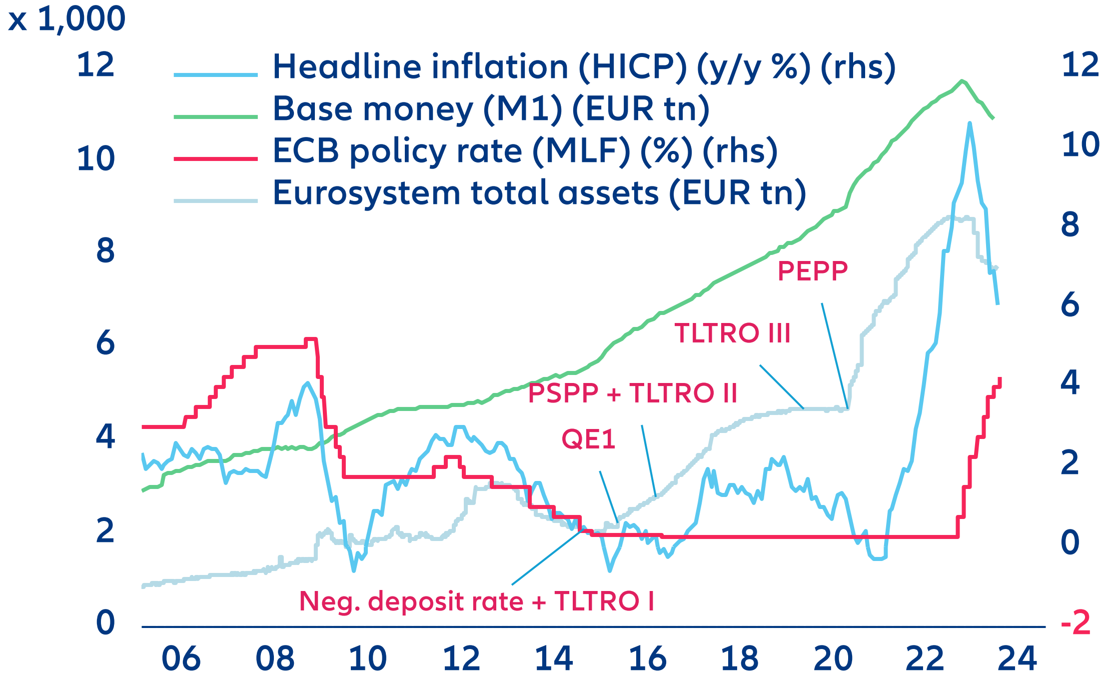


Sources: Refinitiv Datastream, Allianz Research

Allianz

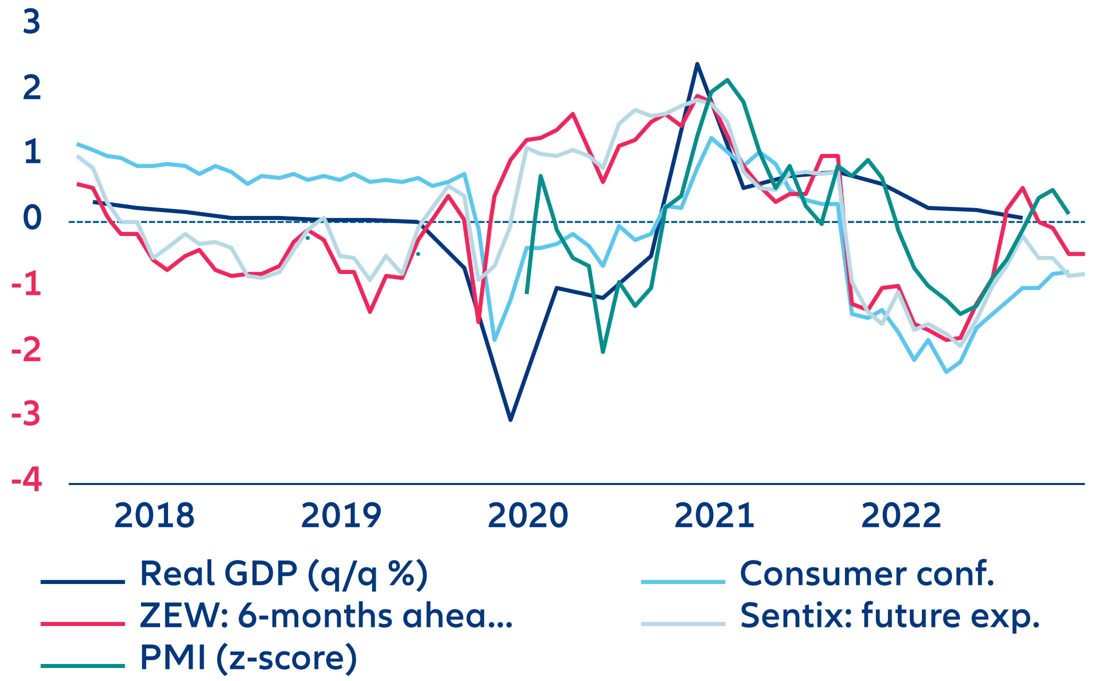
Significant tightening as economy muddles through

ECB balance sheet, inflation and policy rate



Sources: Refinitiv Datastream, Allianz Research

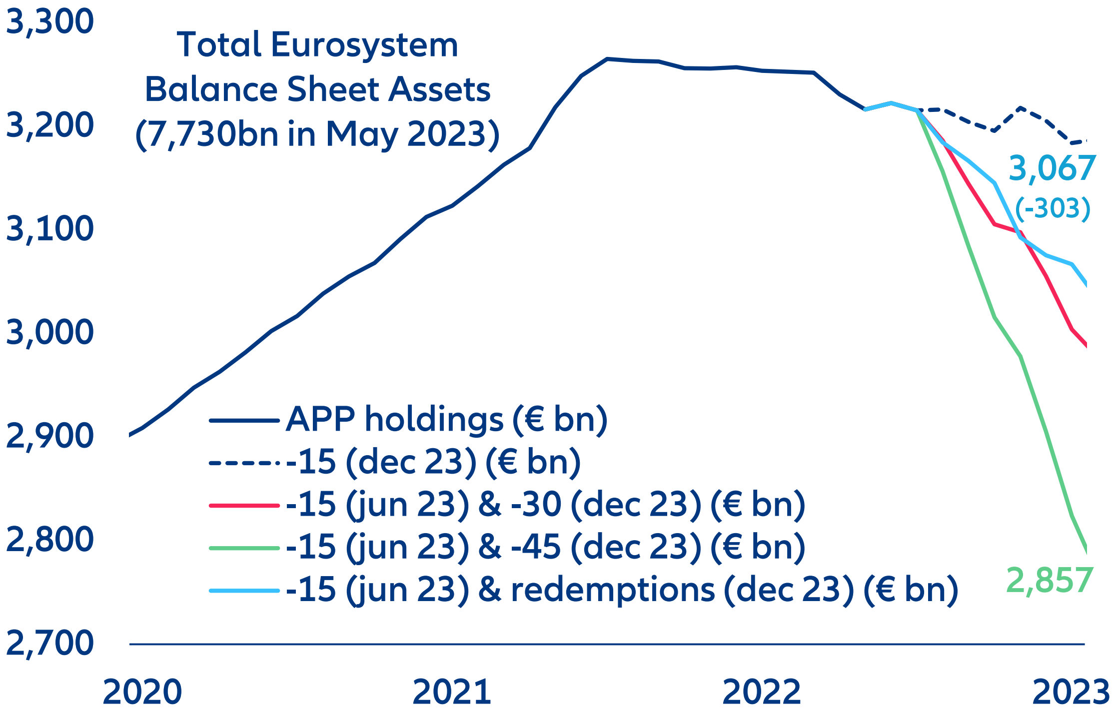
Eurozone: GDP, consumer sentiment and business confidence



Sources: Refinitiv Datastream, Allianz Research

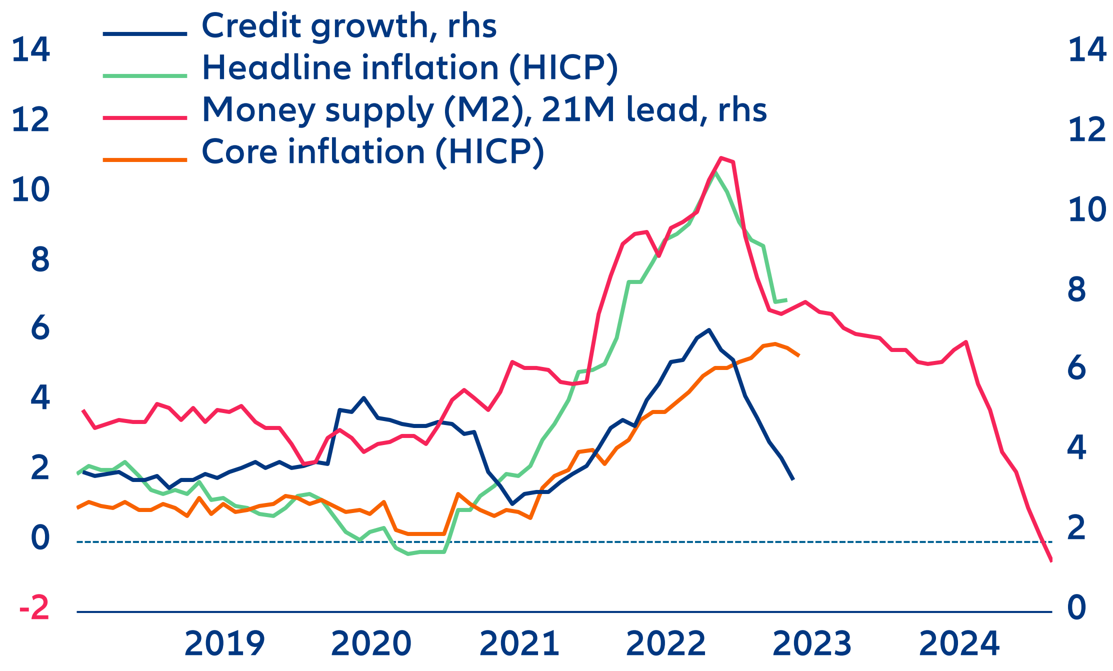
Collapse of money supply due to QT should support the normalization of inflation

Eurosystem: Evolution of legacy asset purchase program (PSPP) (EUR bn)



Sources: Refinitiv Datastream, Allianz Research

Eurozone: Credit, money and inflation

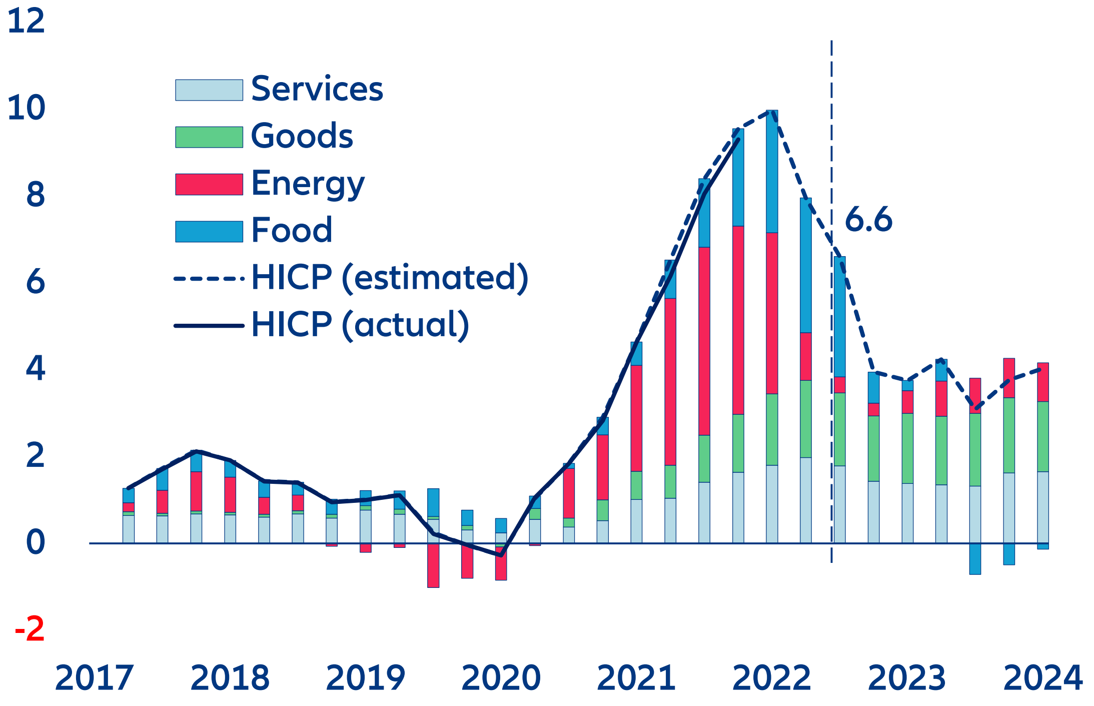


Sources: Refinitiv Datastream, Allianz Research

Allianz

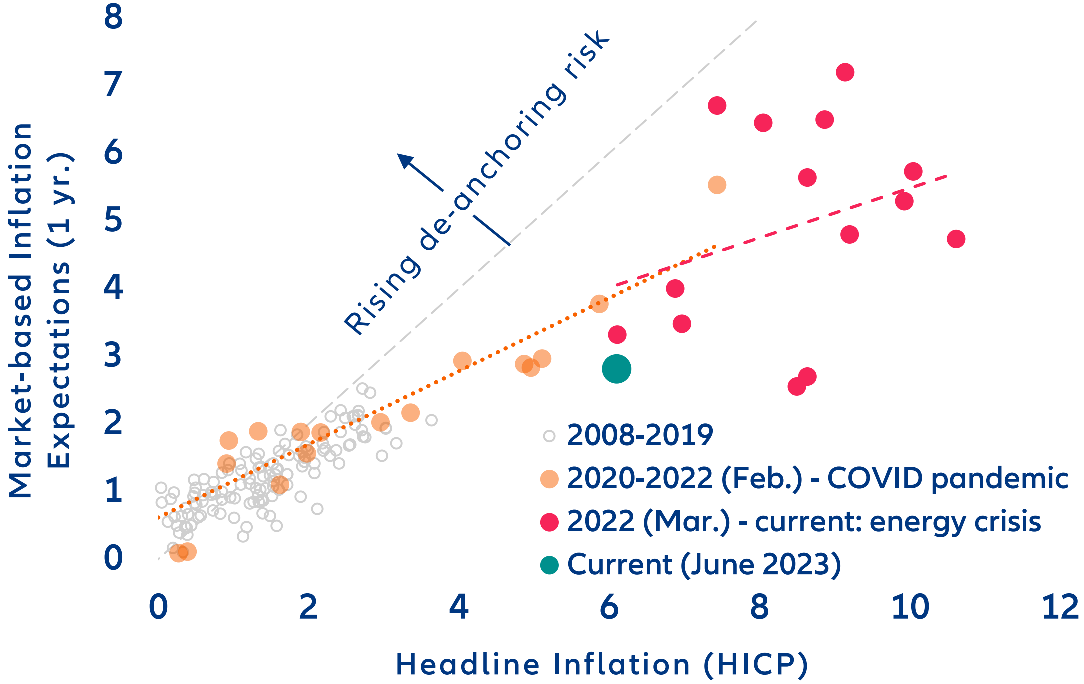
Sticky core inflation in the Eurozone but no de-anchoring of inflation expectations

Eurozone: Inflation components*
(y/y %)



Sources: Refinitiv Datastream, Allianz Research.
* Note: avg. contribution in pp based on quarterly y/y%, component model, June 2023.

Eurozone: Inflation and inflation expectations
(y/y %)

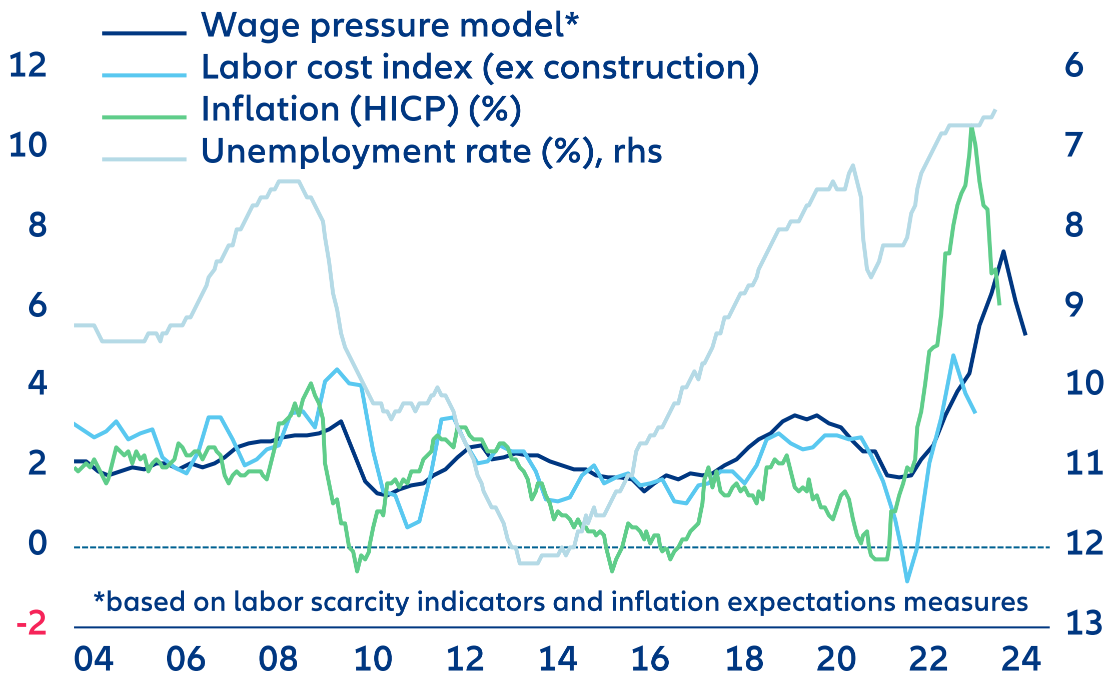


Sources: Refinitiv Datastream, Allianz Research

Allianz

Tight labor market will keep wage pressures high

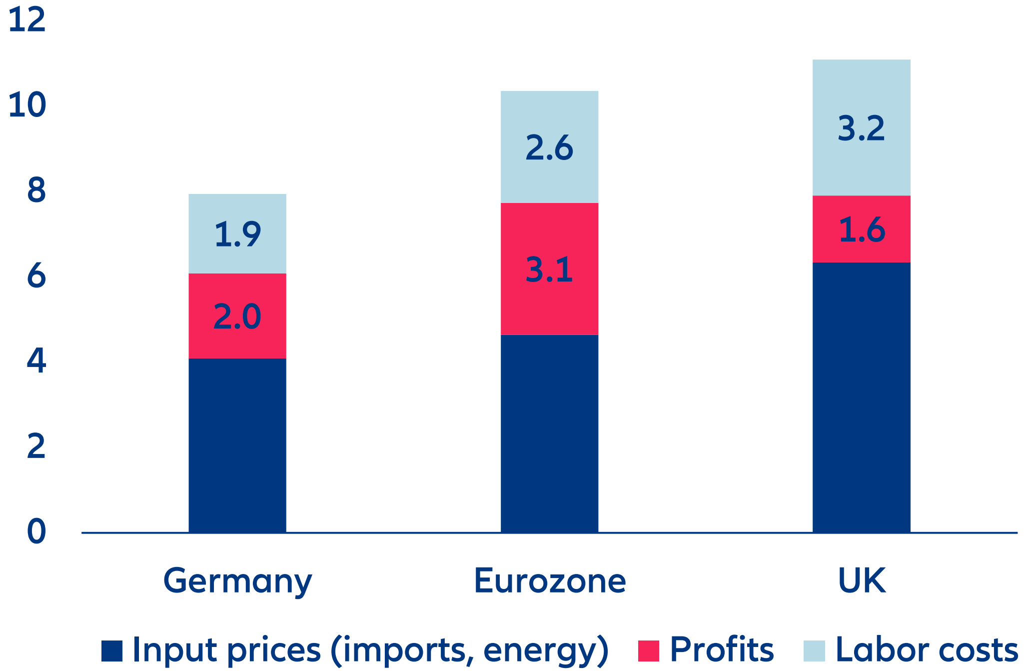
Eurozone: Labor market & inflation



Sources: Refinitiv Datastream, Allianz Research

Wage growth will continue to keep core inflation sticky

contribution to GDP deflator, %

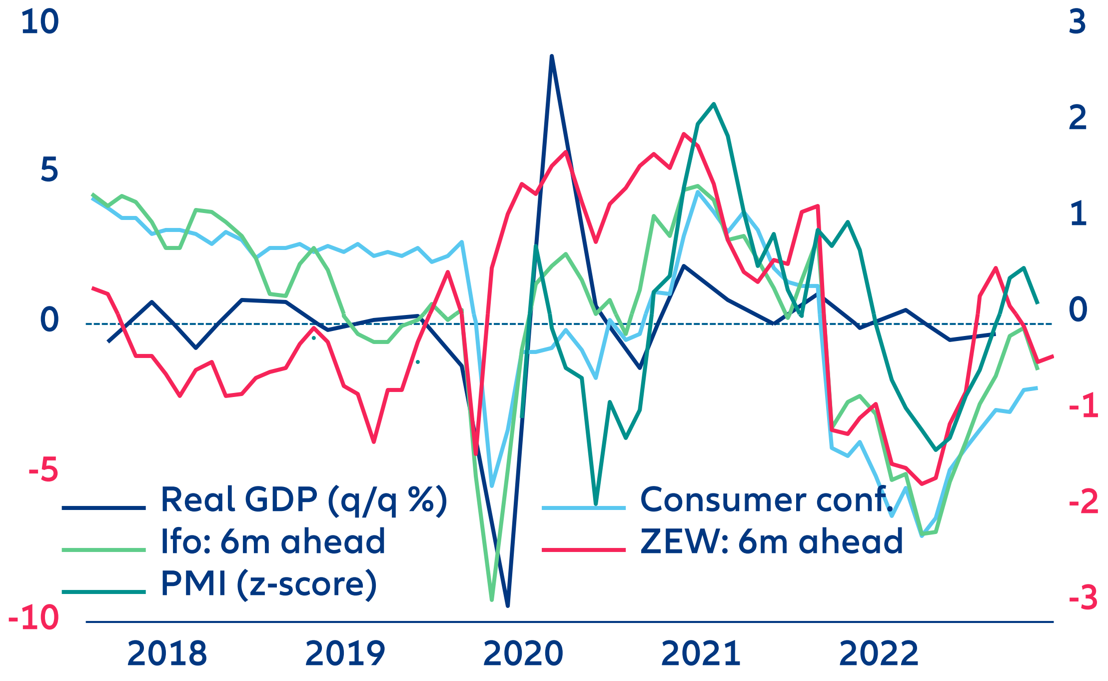


Sources: Refinitiv Datastream, ECB, Allianz Research

Allianz

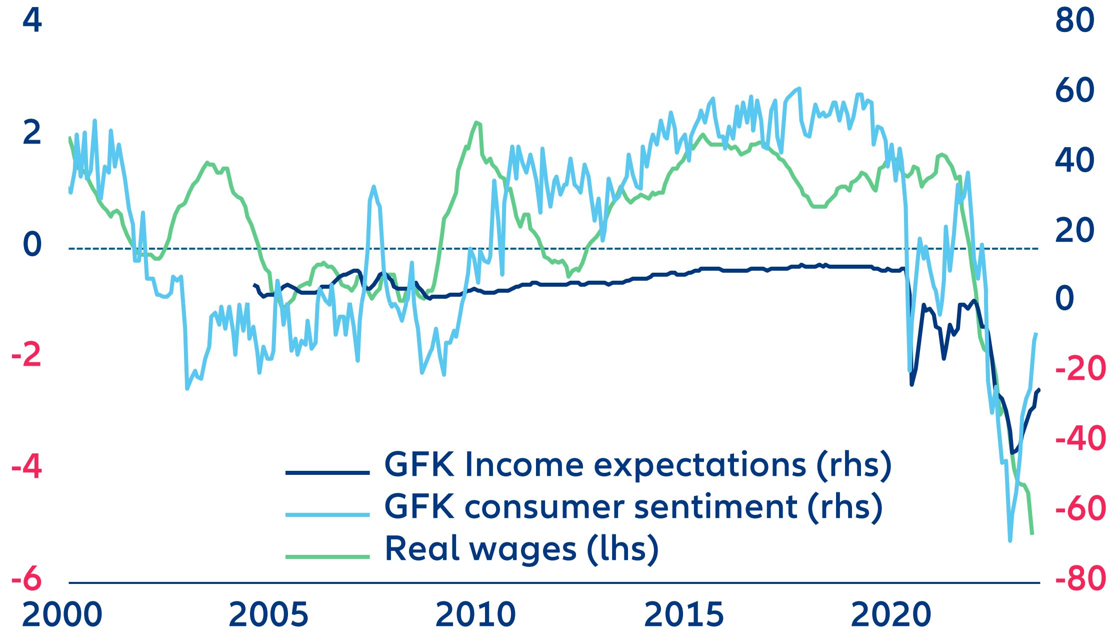
Stagnation as expectations deteriorate and real wages decline

Germany: GDP growth and sentiment



Sources: Refinitiv Datastream, Allianz Research

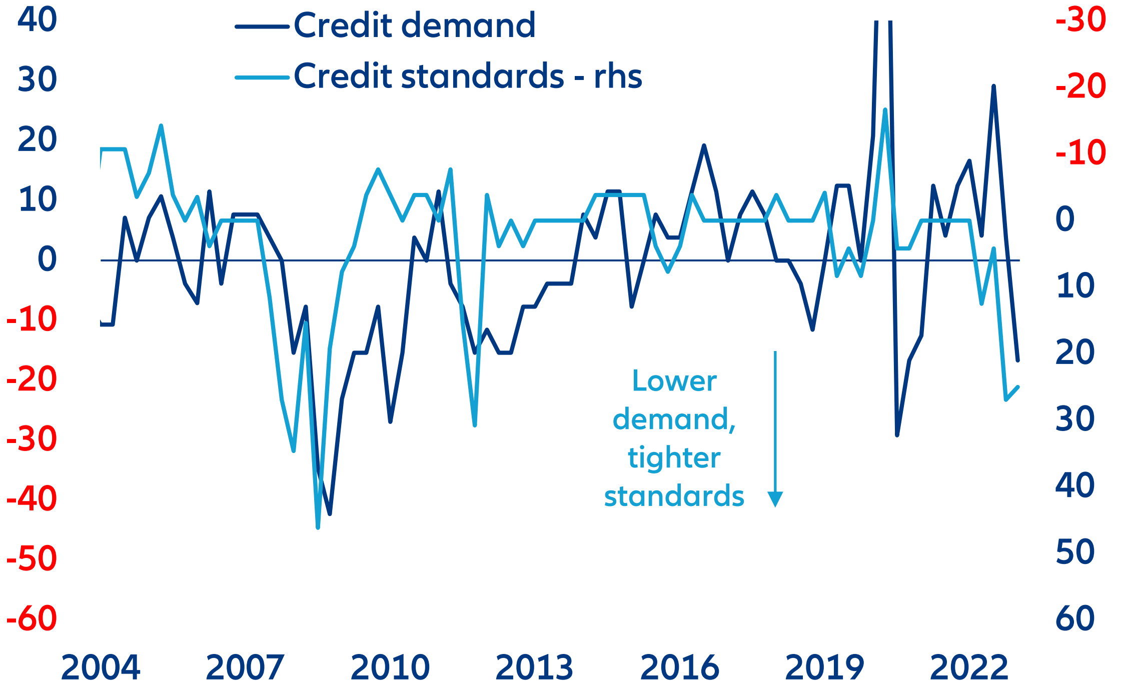
Germany: Consumer confidence and real wages



Sources: Refinitiv Datastream, Allianz Research

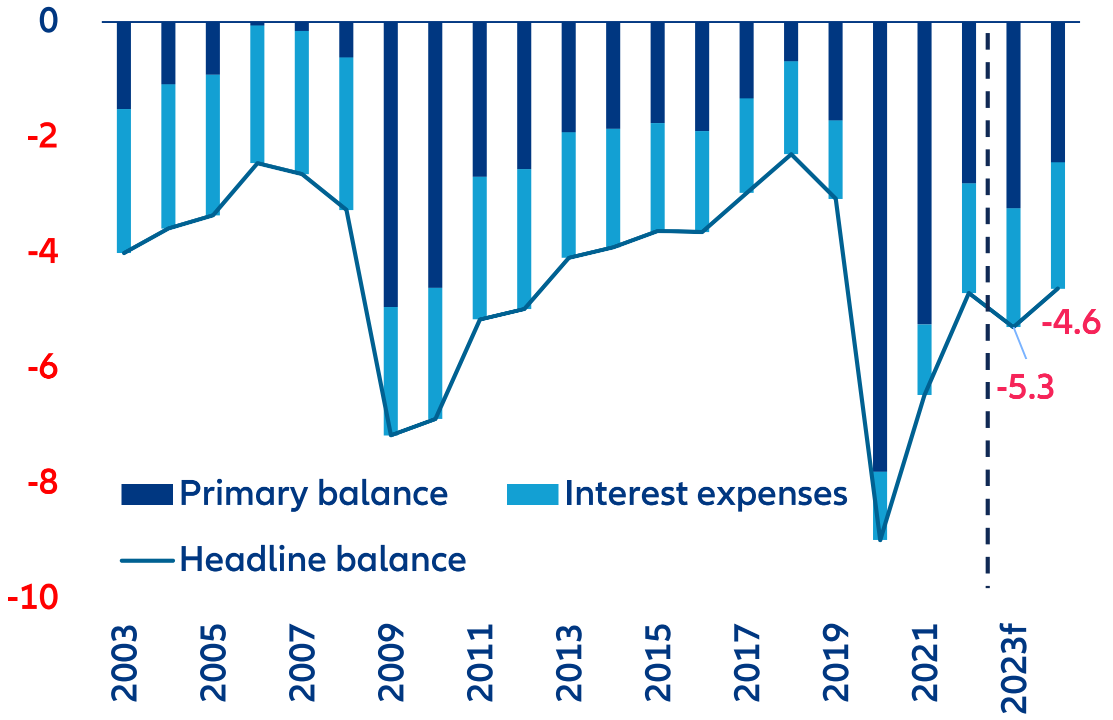
Lackluster growth to carry on in 2024 as financing conditions and fiscal policy tighten

Credit supply & demand for corporate loans are down



Sources: Refinitiv Datastream, Allianz Research

Support measures set to unwind in 2024 as fiscal imbalances are large



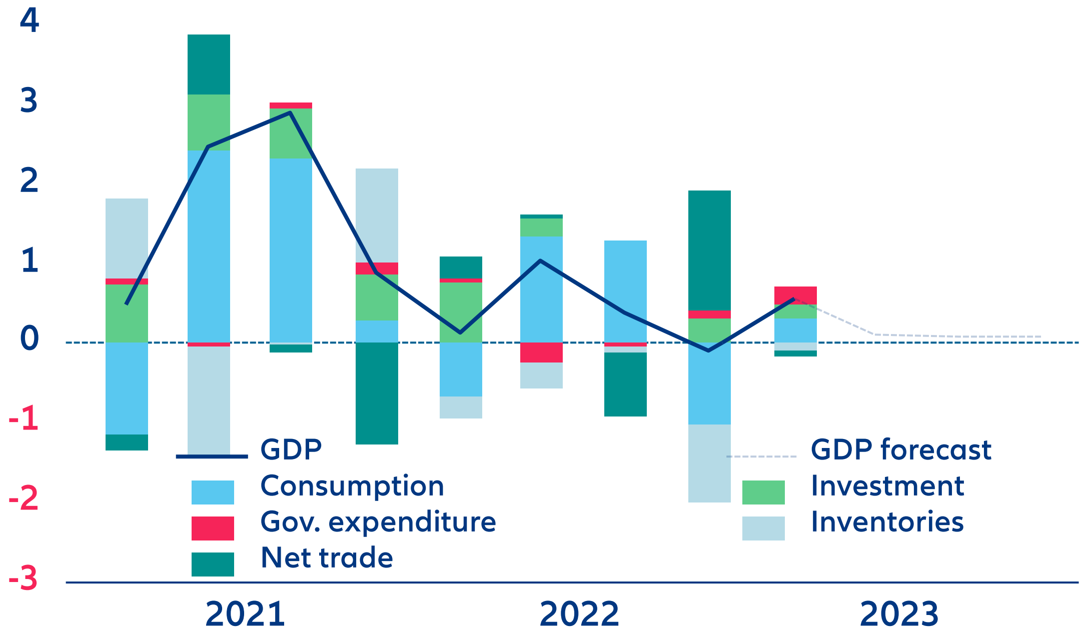
Sources: Refinitiv Datastream, Allianz Research

Allianz

Solid growth in Q1 to provide a cushion to multiple challenges

GDP expanded solidly in Q1 (+0.6% q/q vs EZ at -0.1%), with investment being supportive…

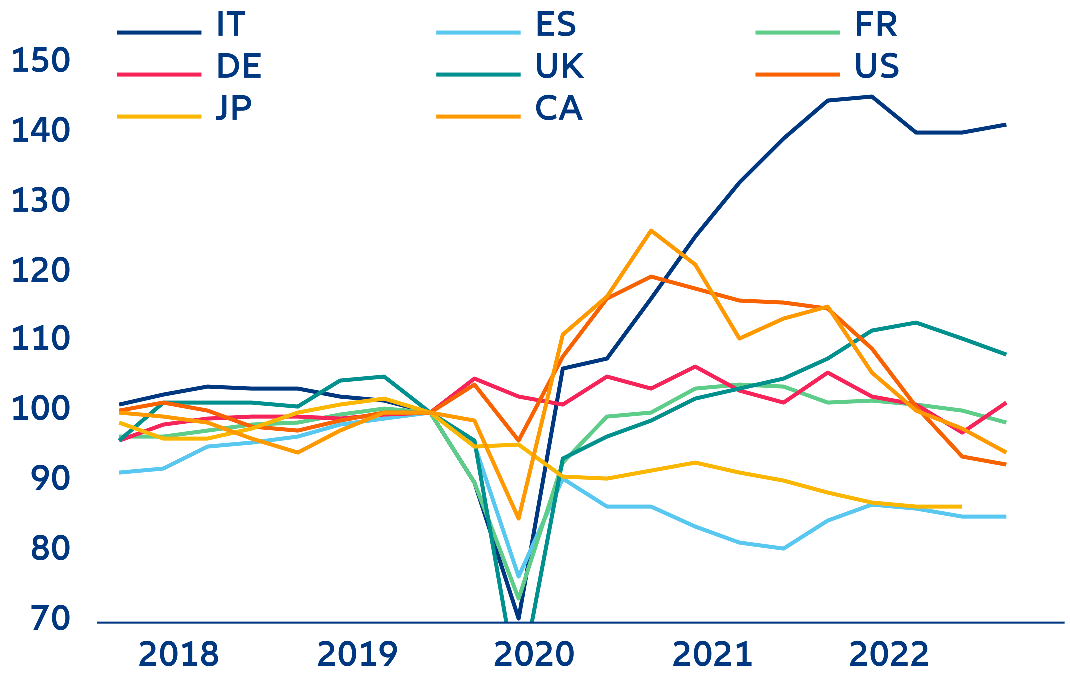
GDP contribution (%, ppts)



Sources: Refinitiv Datastream, Allianz Research

…thanks also to strong housing activity – not only linked to the "superbonus" tax credit

(2019=100)



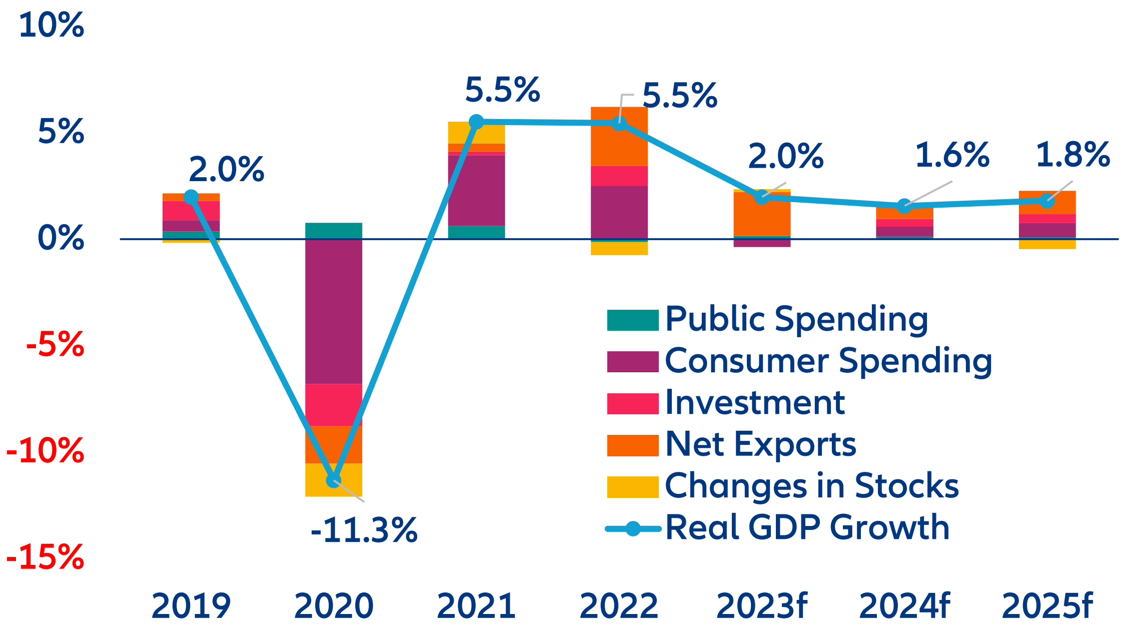
Sources: Refinitiv Datastream, Allianz Research

Allianz

Tourism renaissance and real wage positive growth could support private consumption in H2

External demand and investment have contributed to the surprisingly positive Q1 figures

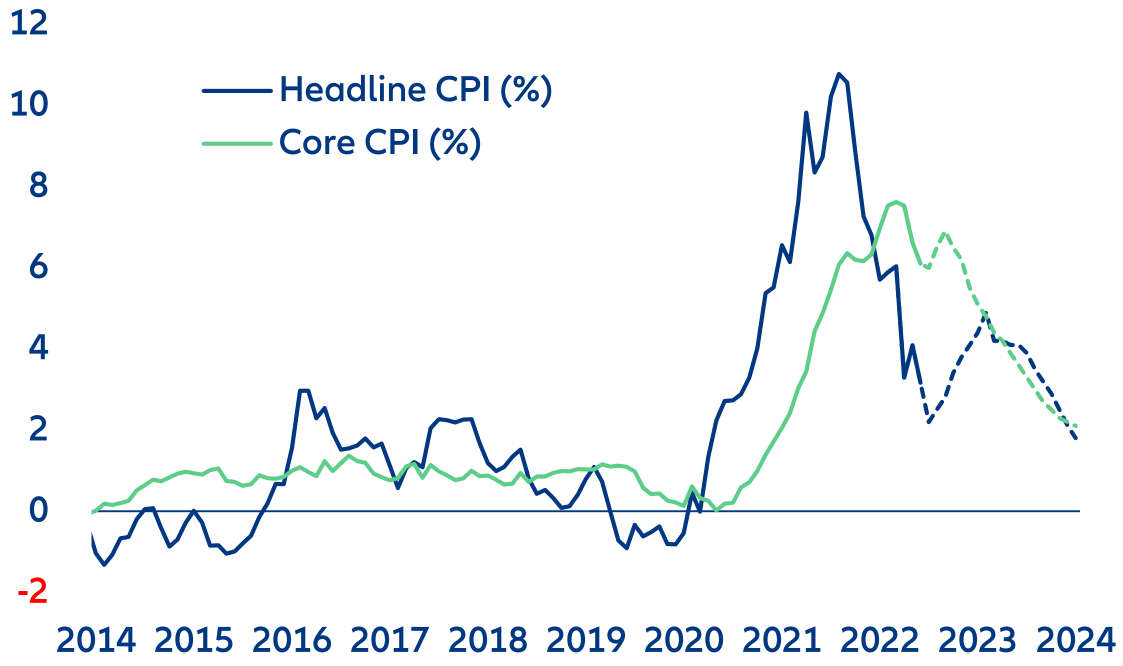
GDP growth and components



Sources: INE, Datastream, Allianz Research.

Rapid fall in inflation (3.5% in 2023-24) coupled with wage growth at +4.3% should boost private consumption

Headline and core CPI



Sources: INE, Datastream, Allianz Research.

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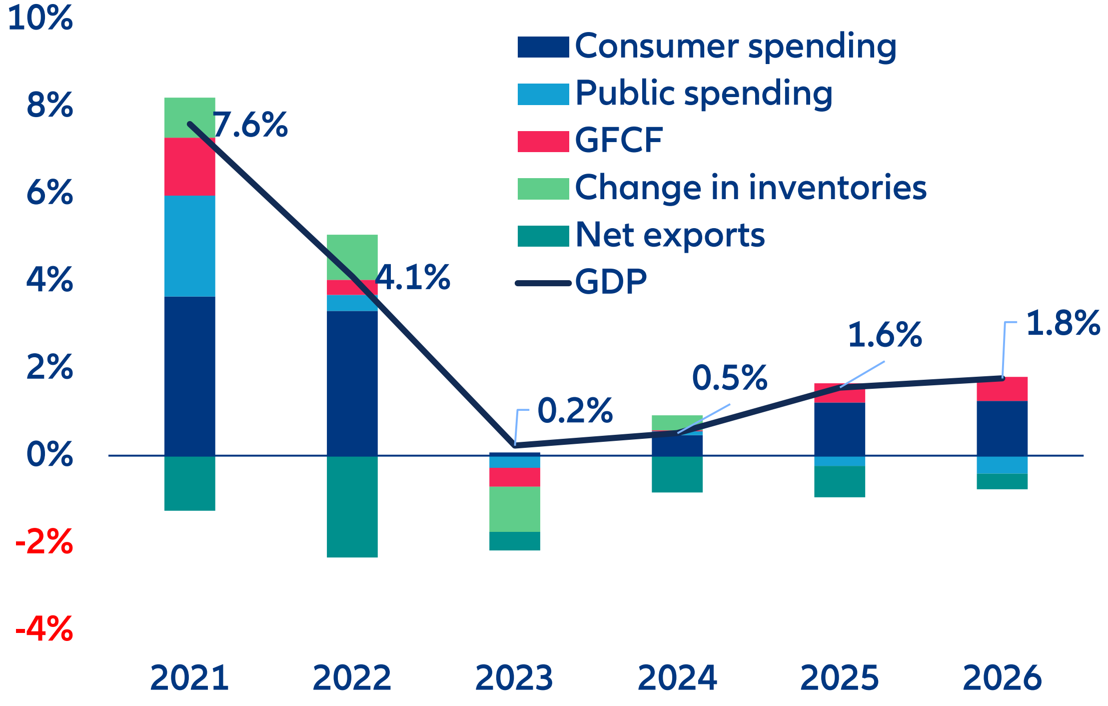
Testing resilience ahead of 2024 general elections

The recovery is expected to be visible in 2025

GDP growth and contribution by component



Sources: Refinitiv Datastream, Allianz Research

Stress in 2023 and reversal in 2024-25

AZ Research 2023 – 2026 UK market forecasts

year-end figures	Last	Unit	2021	2022	2023f	2024f
Inflation rate		%	2.5	7.9	6.5	3.0
Government Debt						
Policy rate	4.50	%	0.25	3.50	5.5	4.5
10y yield sovereign (Gilt)	4.12	%	1.0	3.7	4.0	3.5
Corporate Debt						
Investment grade credit	172	bps	115	192	180	170
High-yield credit	593	bps	390	663	625	575
Equity						
FTSE 100 (total return p.a.)	2.5 ytd	%	18.4	5	3	7
FX						
EURGBP	0.857	£ per €	0.840	0.887	0.90	0.88

Sources: Refinitiv Datastream, Allianz Research

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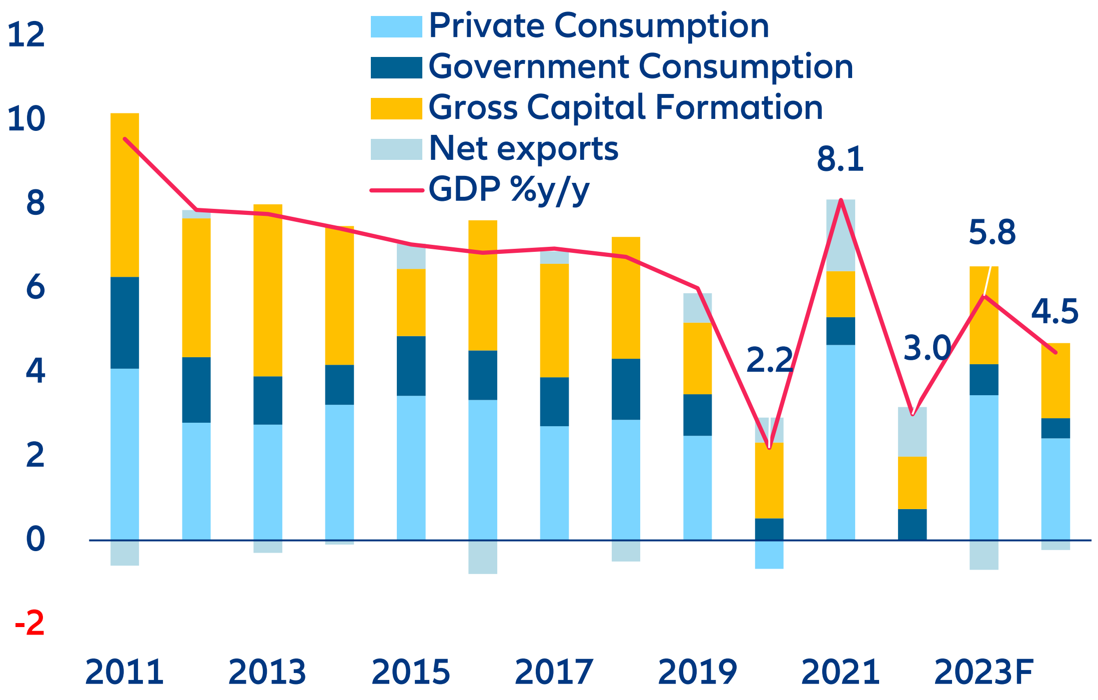
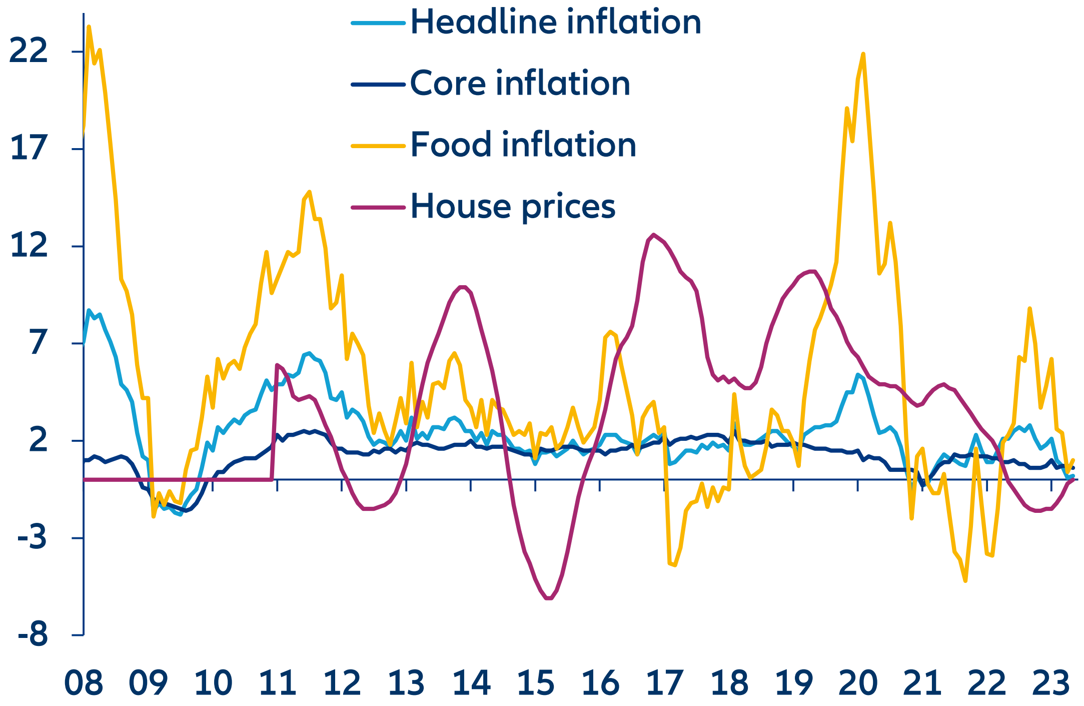
A consumer-led (timid) recovery

Stronger Q1 growth led to a (one-shot) upside revision for 2023



Sources: Official sources, Allianz Research

Inflation remains low as initial reopening effects begin to fade (prices y/y %)



Sources: Refinitiv Datastream, Allianz Research

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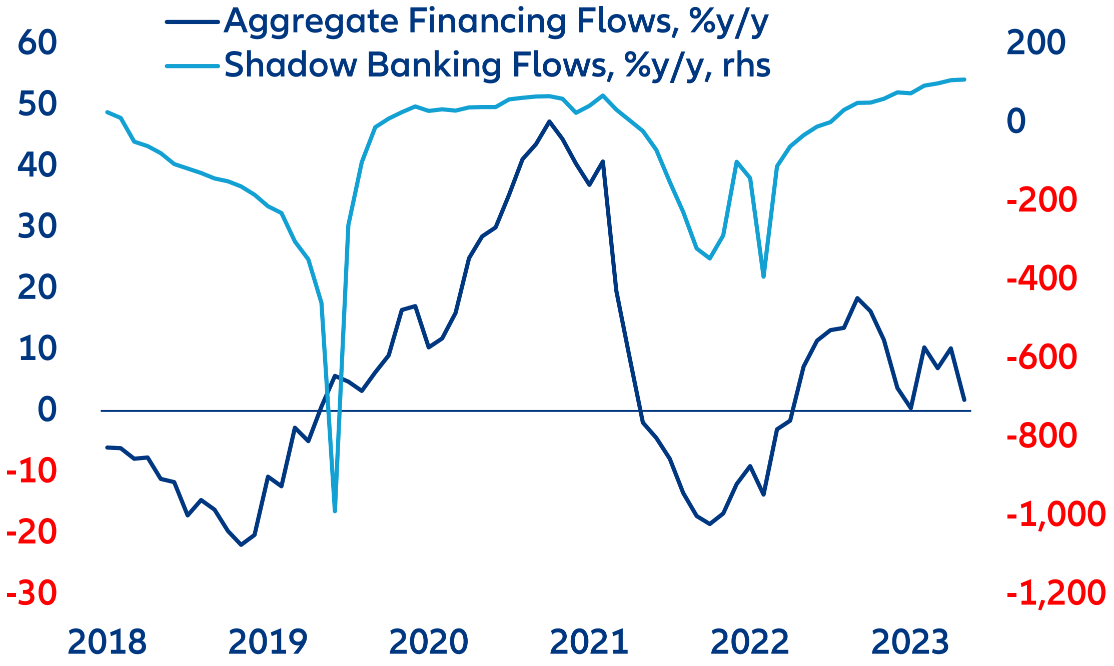
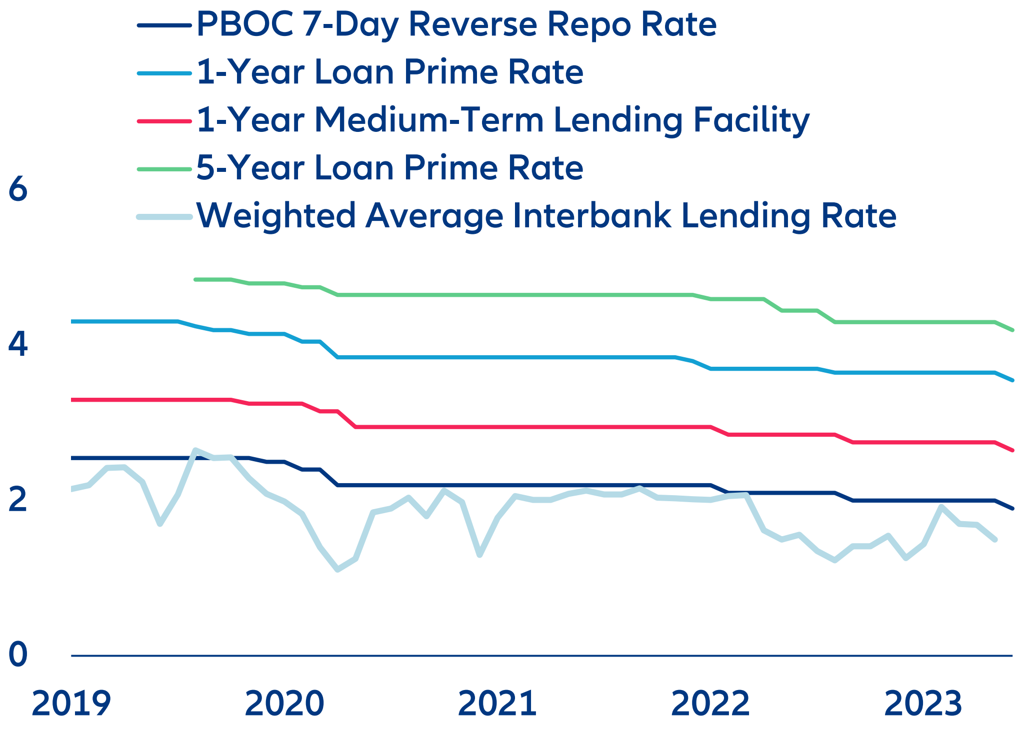
Further monetary easing against the weak recovery

Broad credit growth slowed sharply in May and has now reversed almost all its reopening recovery while shadow banking is increasing



Sources: National Bureau of Statistics of China, Allianz Research

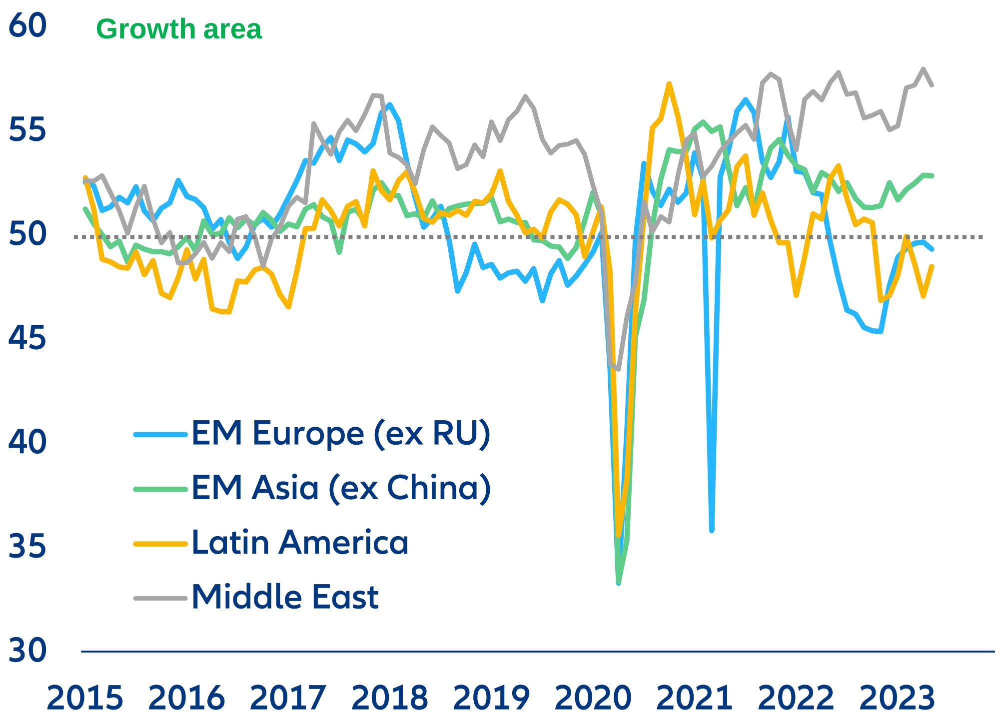
Higher likelihood of further key rate cuts in 2023



Sources: official sources, Allianz Research

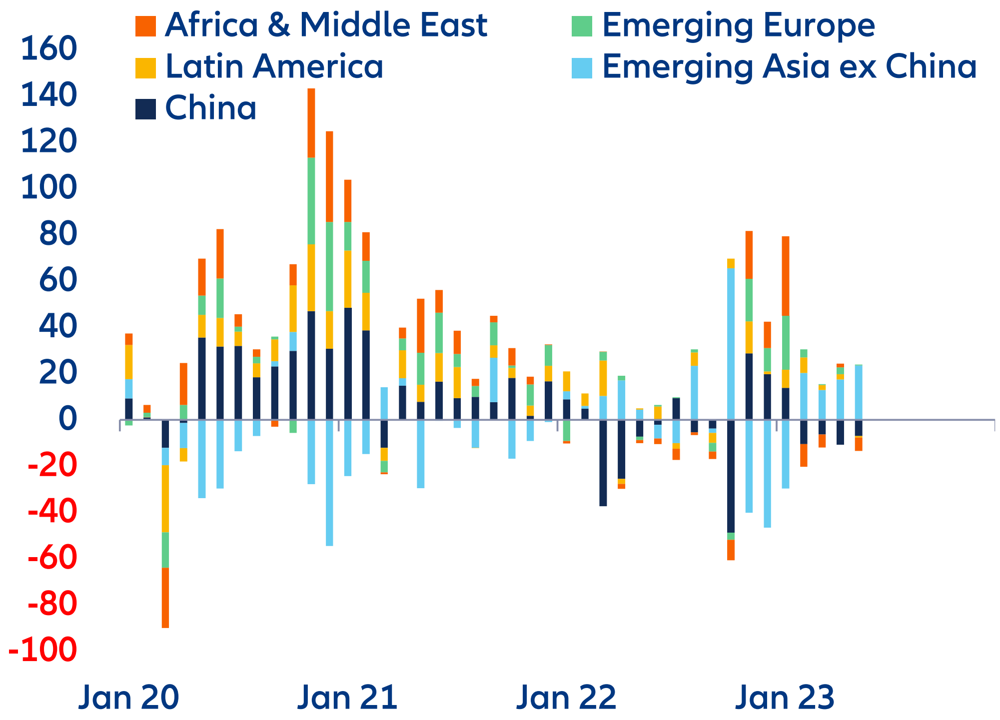
Continued regional divergence with regards to output outlook and capital flows

Composite regional manufacturing PMIs



Sources: Refinitiv Datastream, national statistics, Allianz Research

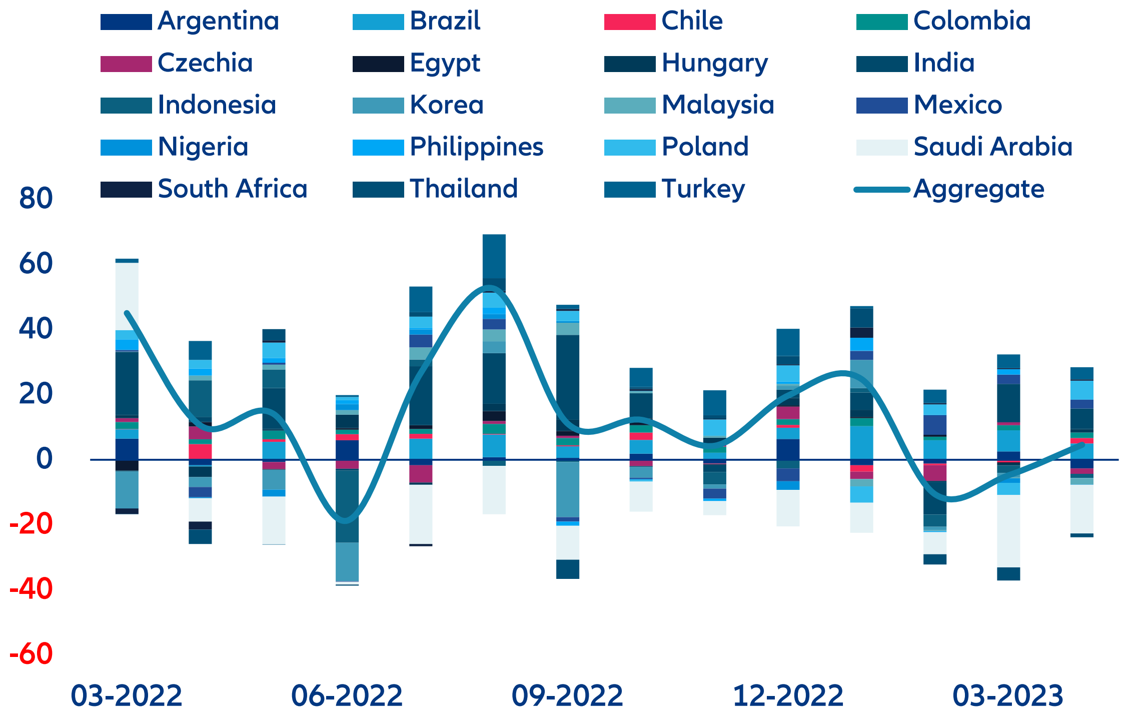
Net capital flows to EMs by region (USD bn)



Sources: IIF, Refinitiv Datastream, national statistics, Allianz Research

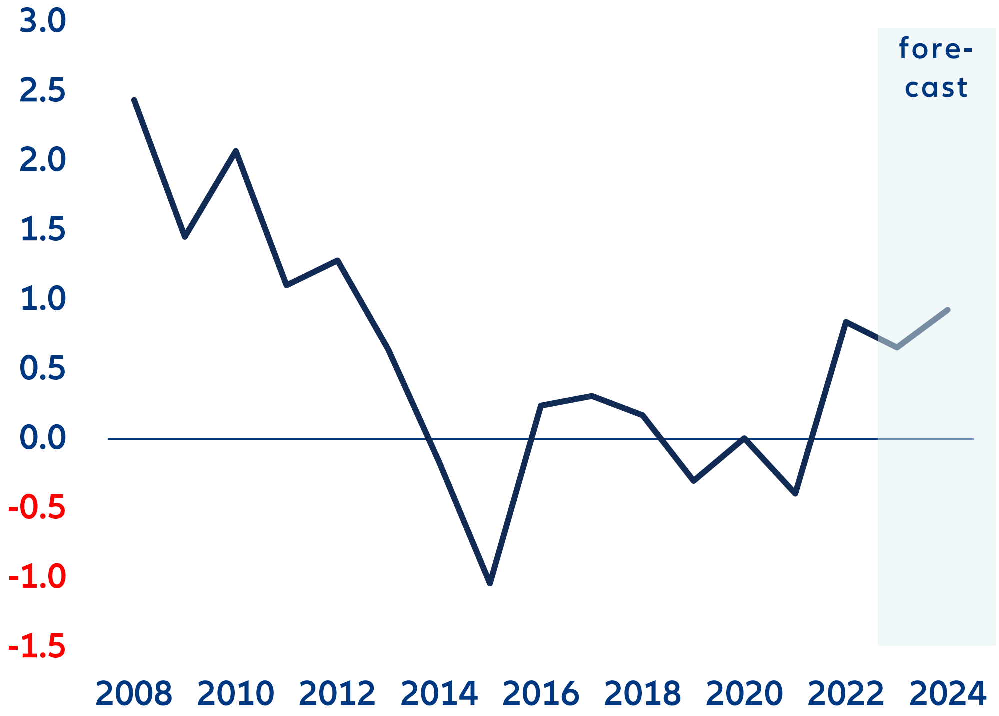
EMs economic catch-up awaits investment, while trade and demand from AEs stagnate

Estimated net capital flows to selected EMs
(USD bn)



Sources: IIF, Allianz Research

GDP growth differential (pp) between EMs excl. China and AEs plus China



Sources: Refinitiv Datastream, national statistics, Allianz Research

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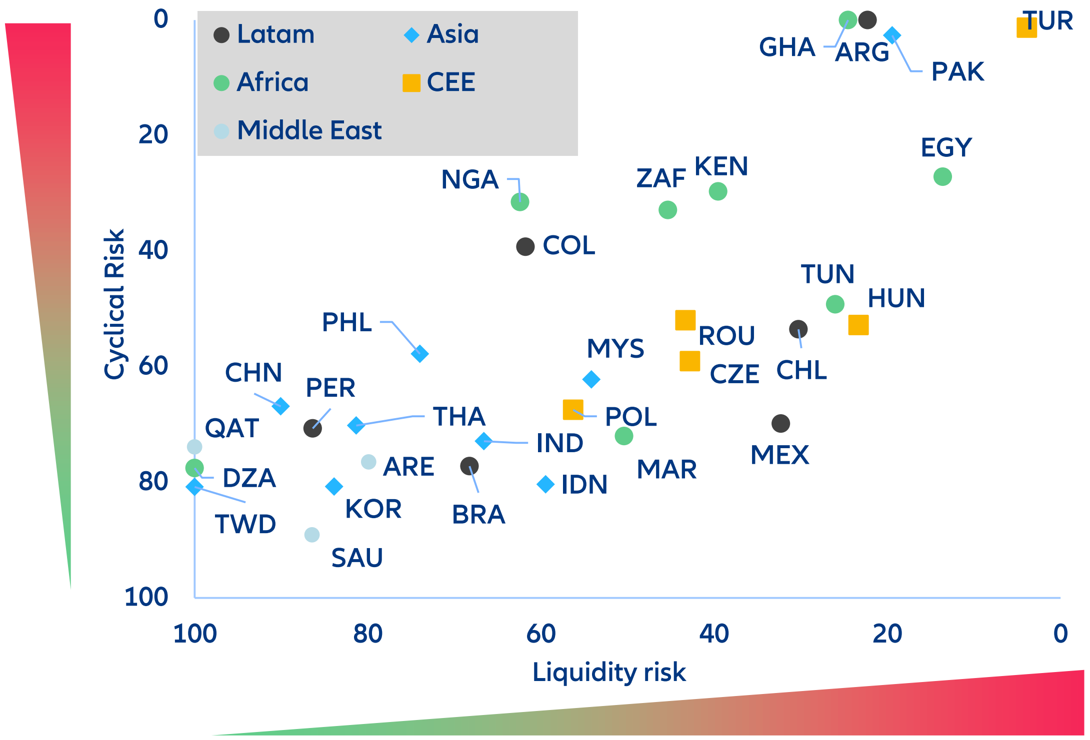
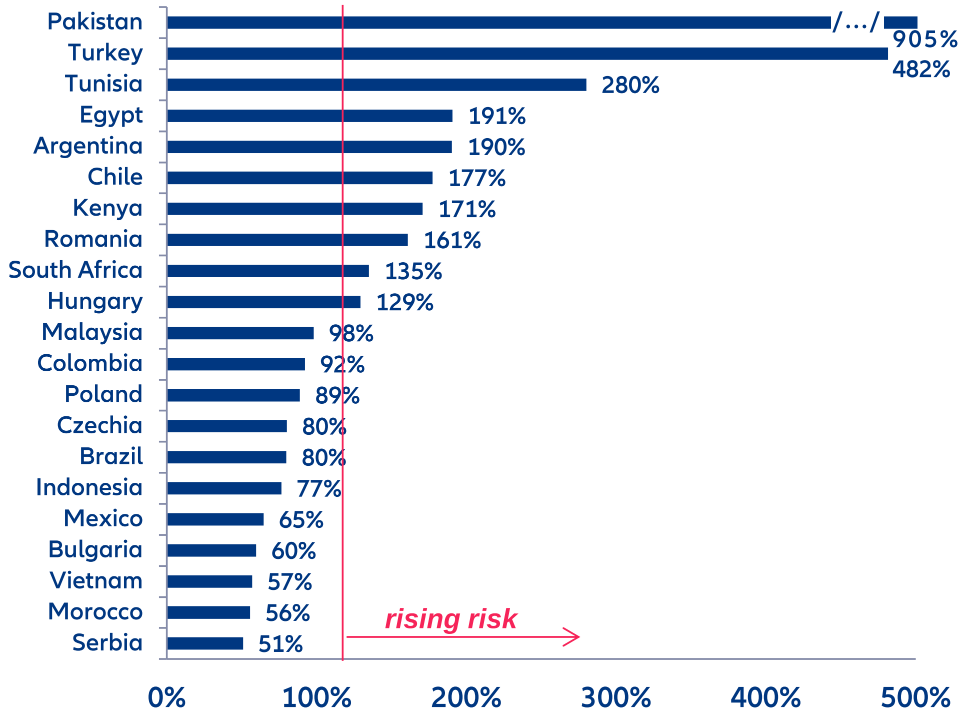
EMs face increased risk due to global financial tightening and BoP shocks

Vulnerabilities to external shocks



Sources: Refinitiv Datastream, Allianz Research. To calculate the score for each risk, we aggregate the individual scores (from 0 (bad) to 100 (good)) of a set of variables. Liquidity risk comprises a set of variables (e.g. BoP) that points to vulnerabilities in the medium term, while cyclical points to short term problems (e.g. market volatility).

Gross external financing requirements (% of FX reserves)



Sources: Refinitiv, national statistics, Allianz Research

Note: Gross external financing requirement = current account balance + maturing external debt repayments in the next 12 months.

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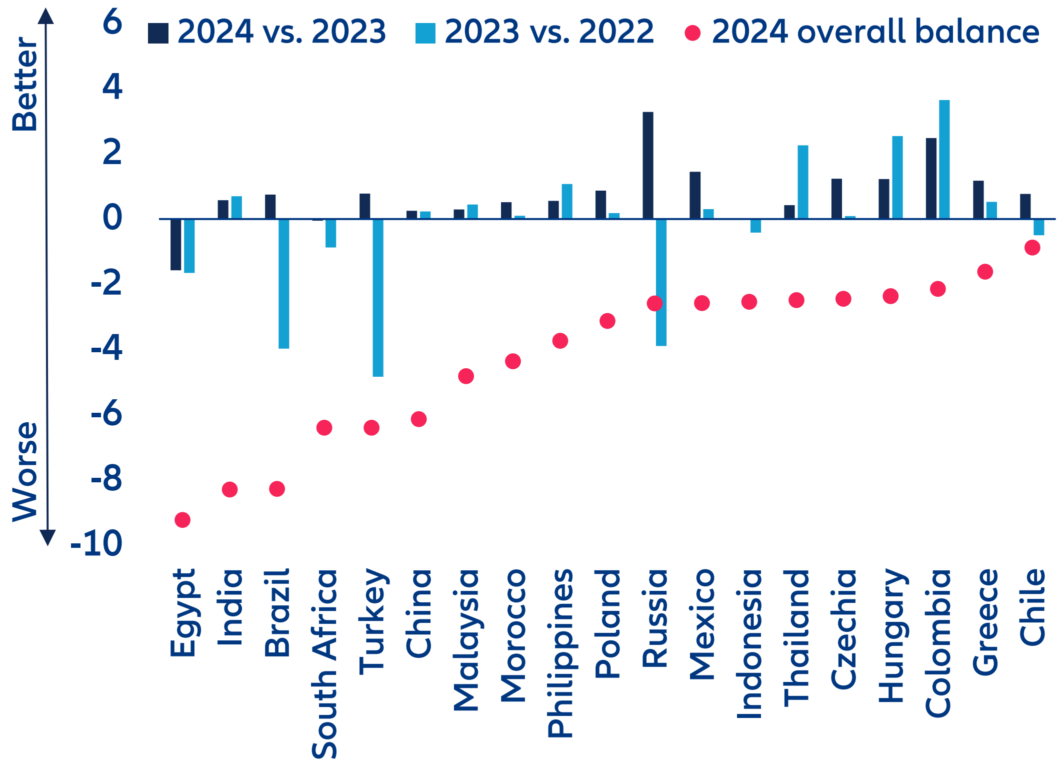
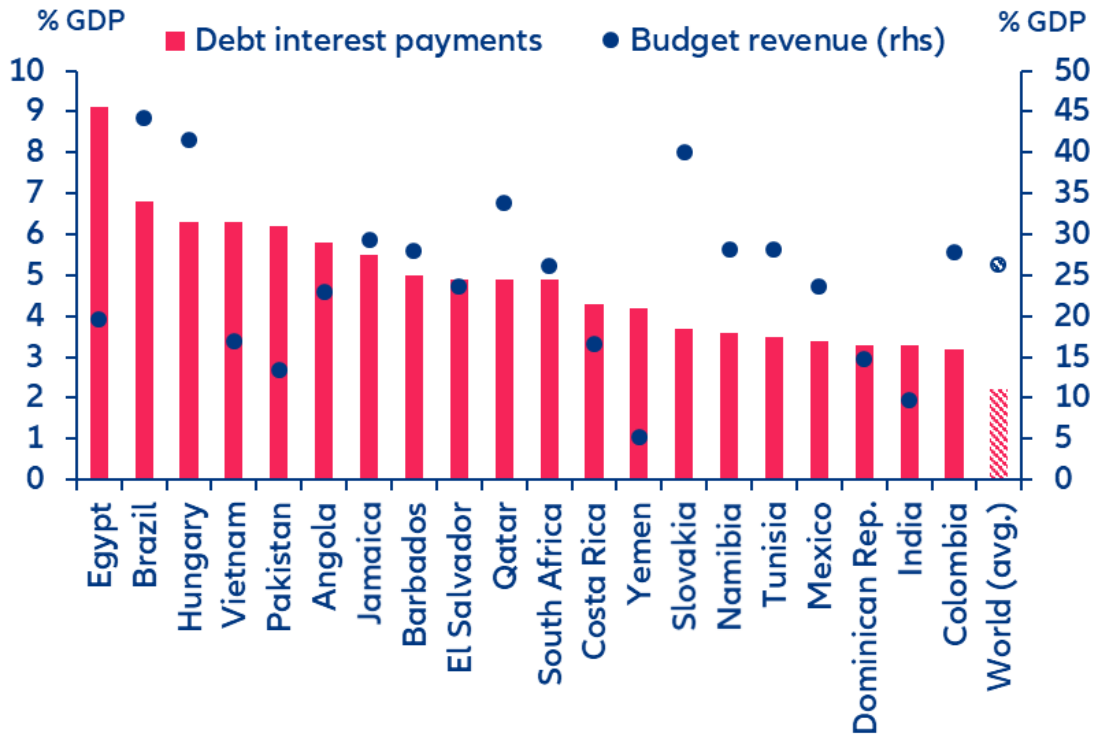
Tough decisions ahead in the EMs space due to costlier refinancing and politics

Cyclically adjusted fiscal balance (% of GDP) and annual changes (pp of GDP)



Sources: IMF, Allianz Research

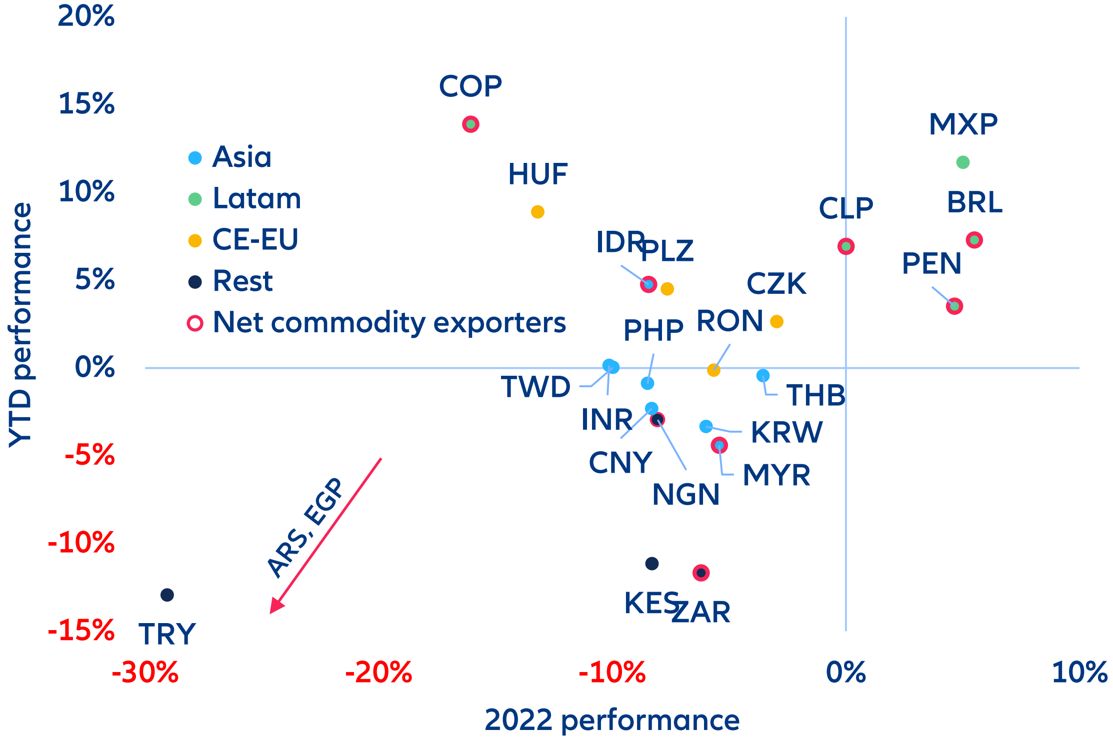
EMs with debt interest payments ≥ 3% of GDP in 2023



Sources: EIU, Allianz Research
Note: Debt interest payments due in 2023 (forecast), budget revenue as of end-2022 (estimate).

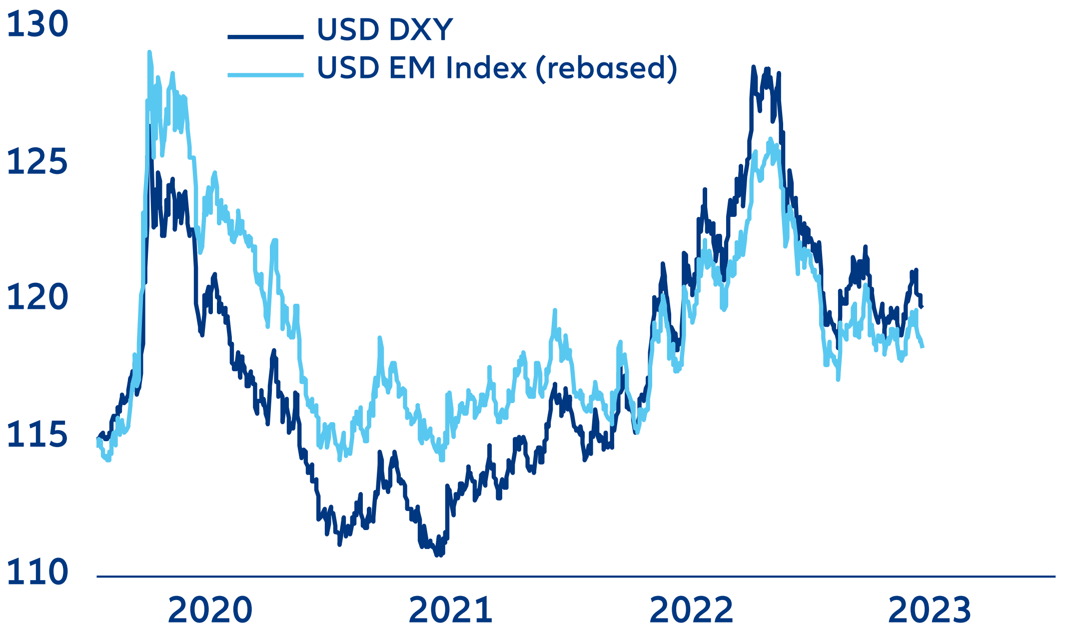
FX resilience: will the driver change from commodities to regional clusters?

EM currencies performance



Sources: Refinitiv, Allianz Research.

The USD has strengthened less vs. EM currencies



Sources: Refinitiv Datastream, Allianz Research.
Note: USD EM Index is rebased to have the same starting value as the USD DXY.

Allianz

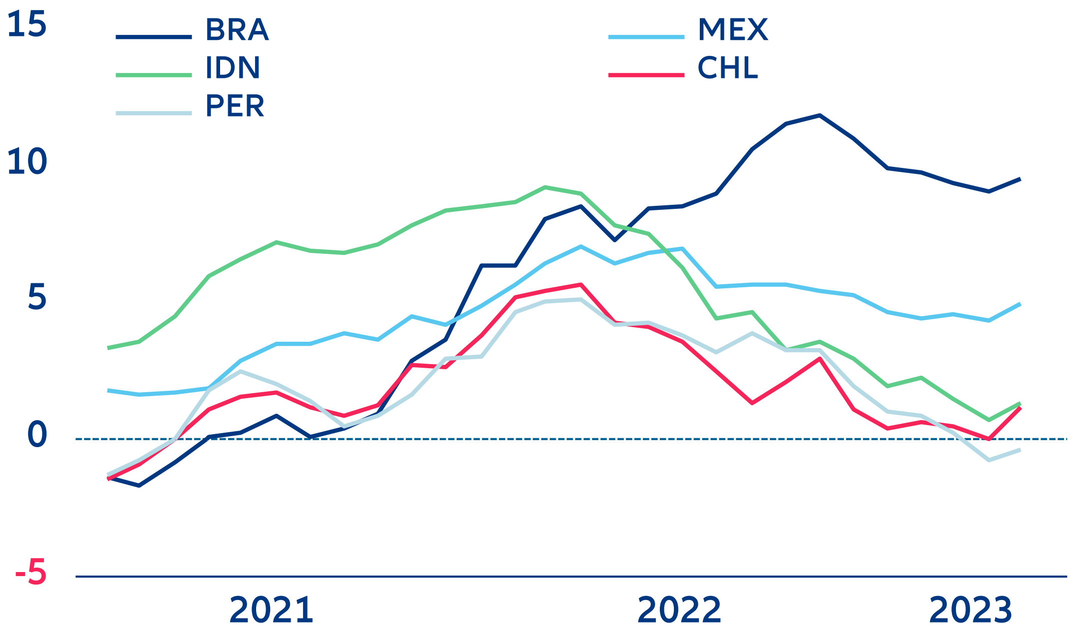
Less space than previously for rate cuts but higher growth and FX resilience

Divergent monetary policy dynamics to create opportunities

		Interest rate	Implied interest rates from markets		
		Latest	Q3 2023	End-2023	Q2 2024
Latin America	Brazil	13.75	13.50	12.50	10.00
	Chile	11.25	10.60	9.00	6.50
	Mexico	11.25	11.25	11.00	9.75
	Colombia	13.25	13.25	12.75	10.75
Asia	South Korea	3.50	3.50	3.50	3.25
	Malaysia	3.00	3.00	3.00	3.00
	Taiwan	1.88	1.75	1.75	1.75
	Philippines	6.75	5.75	6.00	4.25
	Thailand	2.00	2.00	2.00	2.00
	India	6.50	6.75	6.50	6.25
Eastern Europe	Czech Republic	7.00	6.50	6.25	5.75
	Poland	6.75	6.50	6.00	6.00
	Romania	7.00	7.00	7.00	7.00
	Hungary	13.00	11.50	10.00	7.25
Africa	South Africa	8.25	8.50	8.75	8.75
	Morocco	3.00	3.00	3.00	3.50

Sources: Bloomberg, Allianz Research

Real interest rate differential of selected countries



Sources: Refinitiv Datastream, Allianz Research

Market Outlook 2023-24

Allianz

The H1 2023 market optimism will be challenged until year-end

Capital markets: Eurozone and US

year-end figures

year-end figures	Last	Unit	2021	2022	2023f	2024f
EMU			2021	2022	2023f	2024f
Government Debt						
Policy rate (ECB deposit rate)	3.50	%	-0.50	2.00	4.00	3.50
Policy Rate (MRO)	4.00	%	0.00	2.50	4.50	4.00
10y yield (Bunds)	2.51	%	-0.2	2.6	2.50	2.20
10y EUR swap rate	3.03	%	0.3	3.1	2.80	2.50
Italy 10y sovereign spread	164	bps	136	213	190	170
France 10y sovereign spread	52	bps	37	55	40	30
Spain 10y sovereign spread	94	bps	77	109	100	90
Corporate Debt						
Investment grade credit spreads	158	bps	98	166	170	140
High-yield credit spreads	430	bps	331	494	500	425
Equity						
Eurostoxx (total return p.a.)	15.1 ytd	%	23.4	-12	9	7

US			2021	2022	2023f	2024f
Government Debt						
Policy rate (upper)	5.25	%	0.25	4.50	5.75	3.75
10y yield (Treasuries)	3.72	%	1.5	3.83	3.80	3.30
Corporate Debt						
Investment grade credit spreads	137	bps	98	138	150	130
High-yield credit spreads	421	bps	310	479	475	430
Equity						
S&P 500 (total return p.a.)	16.2 ytd	%	28.7	-18	6	9

Sources: Refinitiv Datastream, Allianz Research

Capital markets: UK, emerging markets, FX

year-end figures

year-end figures	Last	Unit	2021	2022	2023f	2024f
UK			2021	2022	2023f	2024f
Government Debt						
Policy rate	4.50	%	0.25	3.50	5.50	4.50
10y yield sovereign (Gilt)	4.38	%	1.0	3.7	4.00	3.50
Corporate Debt						
Investment grade credit spreads	168	bps	115	192	180	170
High-yield credit spreads	544	bps	390	663	625	575
Equity						
FTSE 100 (total return p.a.)	4.5 ytd	%	18.4	5	3	7

Emerging Markets			2021	2022	2023f	2024f
Government Debt						
Hard currency spread (vs USD)	276	bps	295	270	320	280
Local currency yield	6.3	%	5.72	6.50	6.4	5.8
Equity						
MSCI EM (total return p.a. in USD)	8.3 ytd	%	-2.2	-19.7	5	6

Others			2021	2022	2023f	2024f
Foreign Exchange						
EURUSD	1.091	$ per €	1.137	1.067	1.10	1.15
Commodities						
Oil Brent*	76	$ per Bbl	78	85	82	86
Natural Gas Dutch TTF*	42	€ per MWh	69	74	50	43

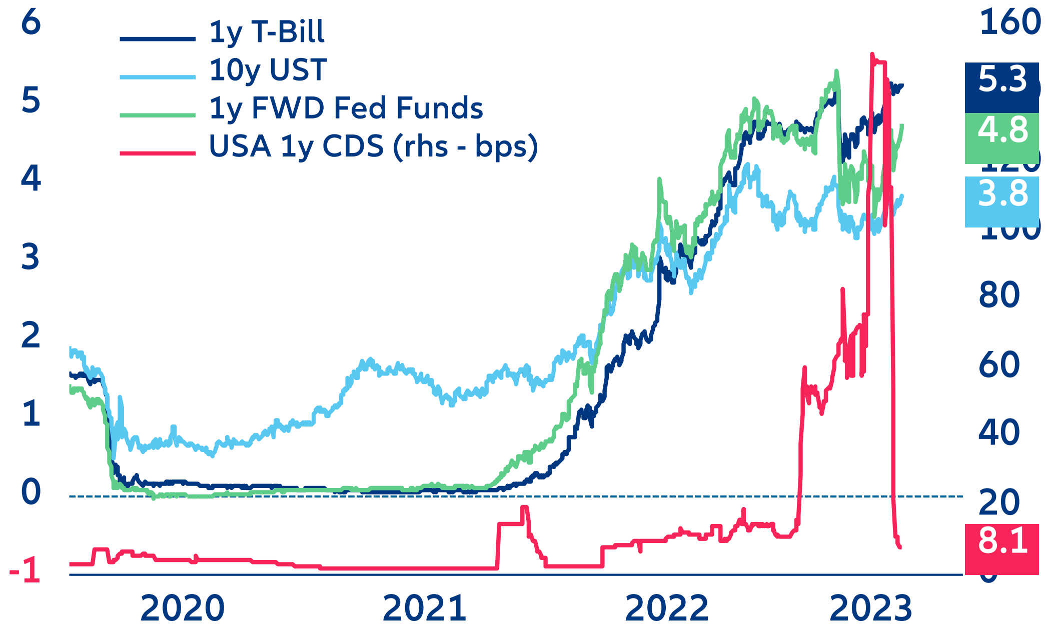
*yearly averages

Sources: Refinitiv Datastream, Allianz Research

Allianz

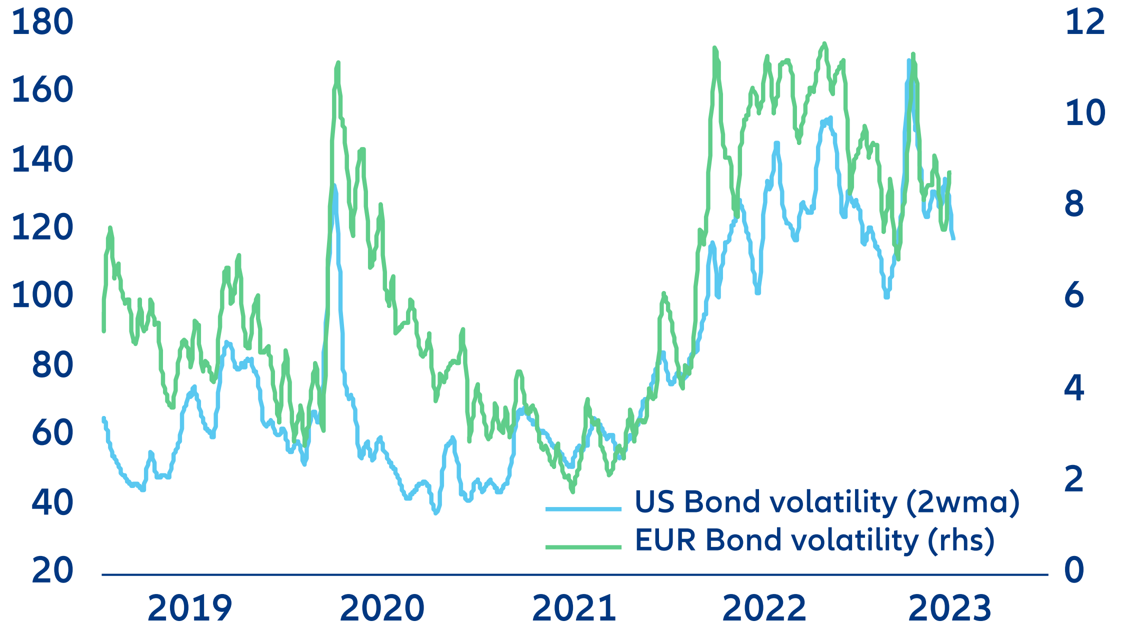
Markets breathe after the debt ceiling impasse, but market volatility will remain high

The debt ceiling premium has almost disappeared, leaving room for a "more hawkish" future



Sources: Refinitiv Datastream, Allianz Research.

Market volatility remains high



Sources: Refinitiv Datastream, CISS, Allianz Research

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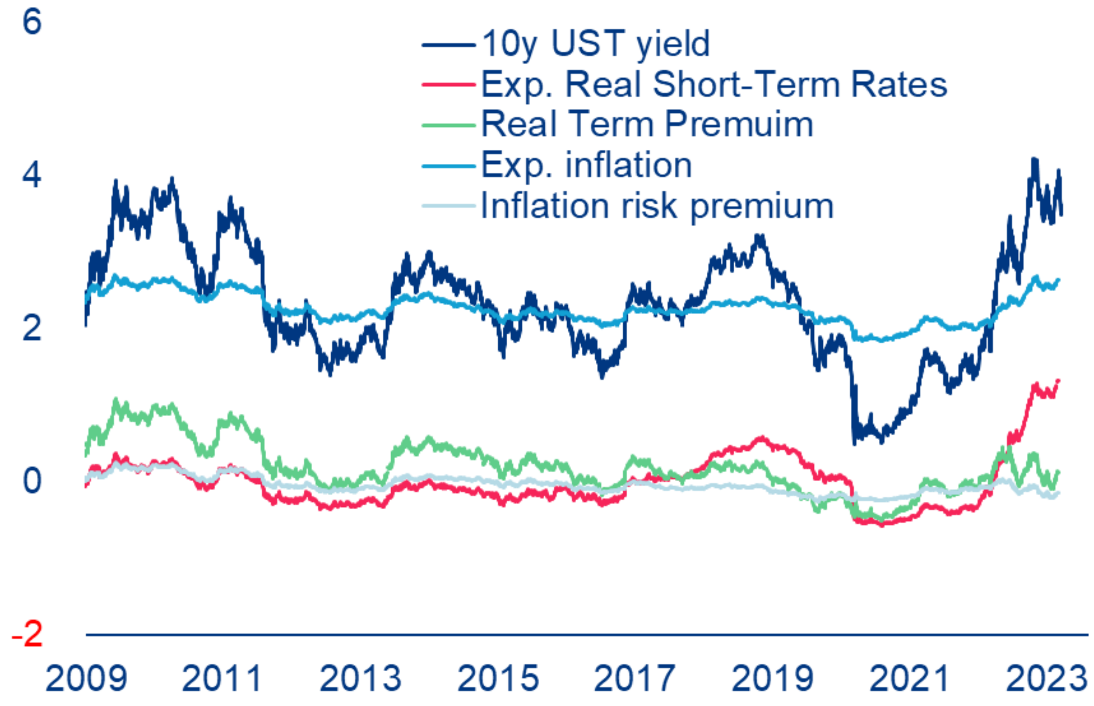
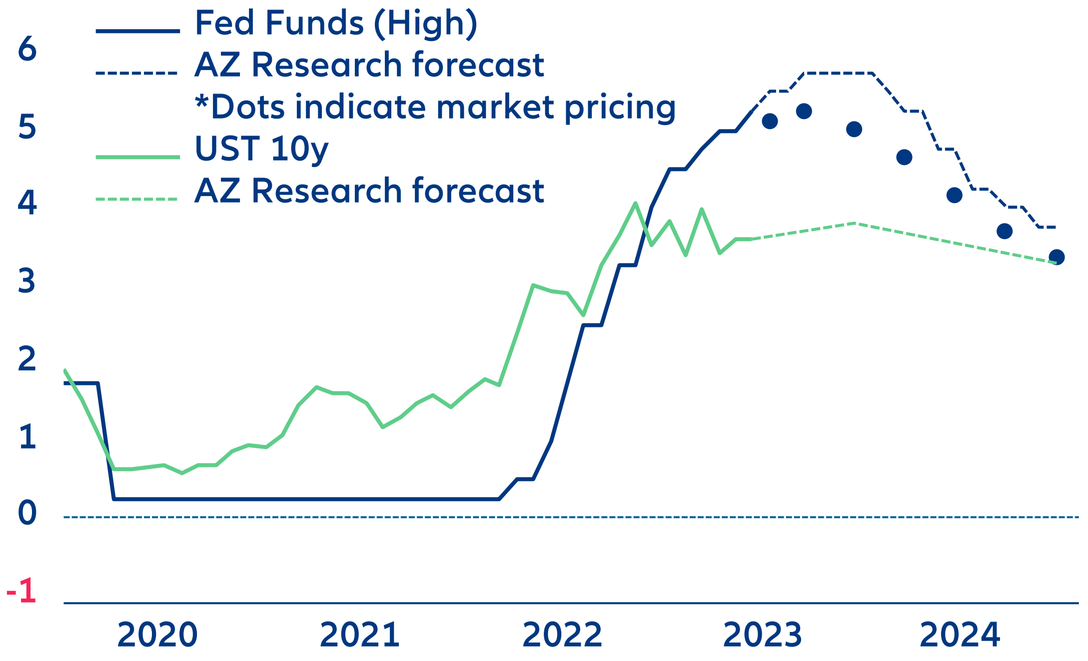
The short-end of the curve will continue to be the biggest driver of long-term yields in H2 2023

Short-term rates continue to drive the long-end of the curve



Sources: Refinitiv Datastream, Allianz Research
Note: based on D'Amico et al. (2019)

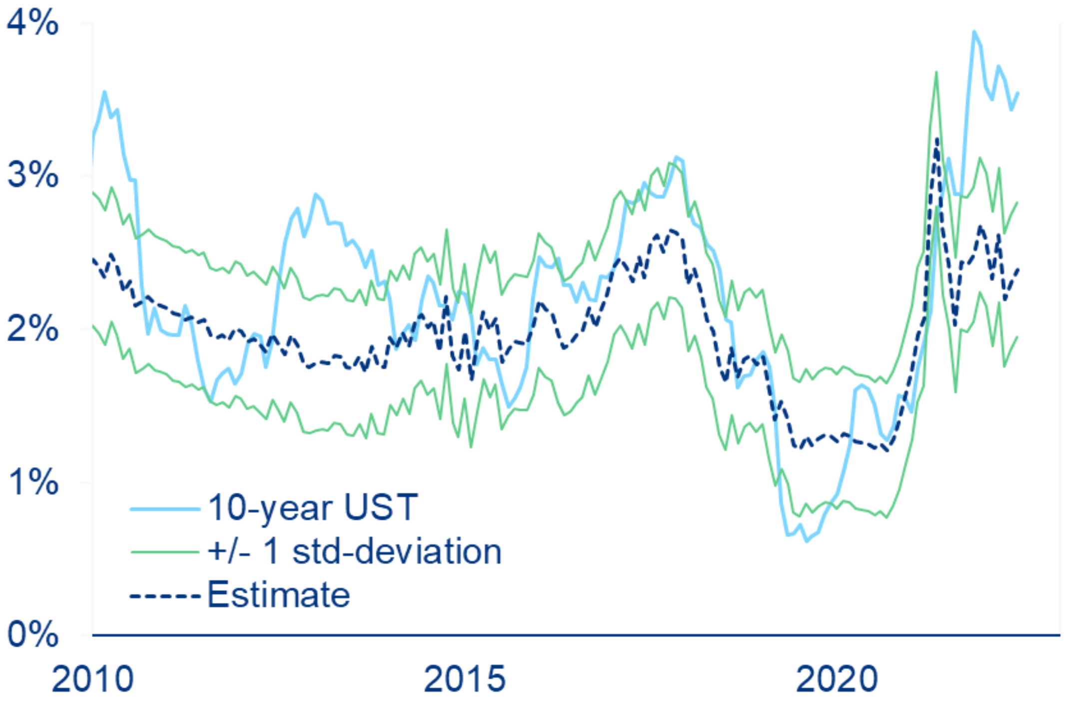
Short-term upside risks for long-term yields followed by a slow down-trending motion in 2024



Sources: Refinitiv Datastream, Allianz Research

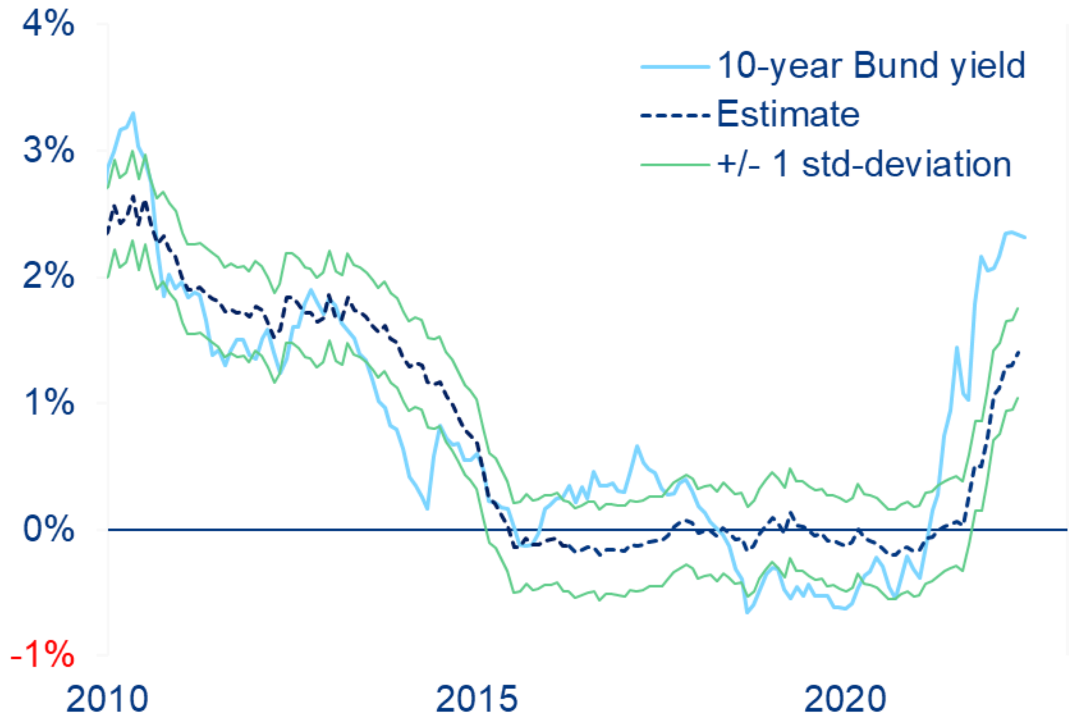
The fair-value gravity of the long-end of the yield curve should pull yields down in the mid run

The fair value of the long-end of the UST curve remains anchored at 2 to 3%



Sources: Refinitiv Datastream, Allianz Research.
Note: model based on FED policy rate and cyclically-adjusted FED policy rate

Despite increasing the fair value of the long-end of the Bund curve remains between 1 to 2%



Sources: Refinitiv Datastream, Allianz Research
Note: model based on 10y JGBs, ECB policy rate, cyclically-adjusted ECB policy rate and cyclically adjusted ECB QE

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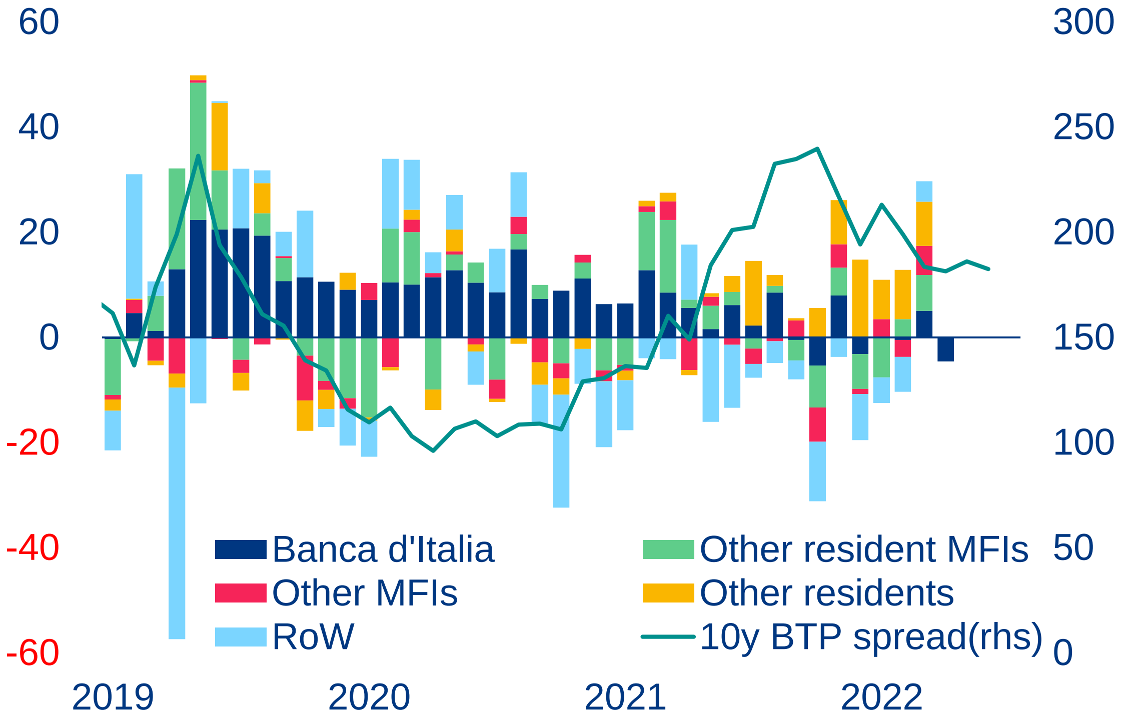
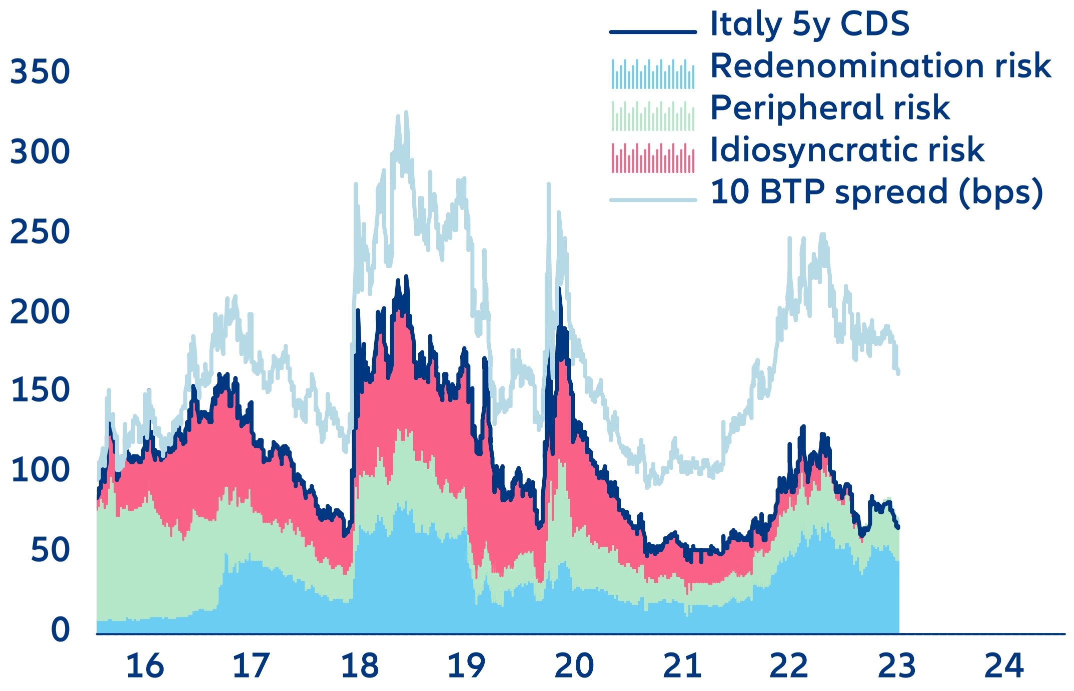
Peripheral spreads should remain contained as private investors cover for the ECB's departure

Italian sovereign debt ownership changes
(m/m EUR Bn)



Sources: Refinitiv Datastream, Allianz Research.
RoW: Rest of the world

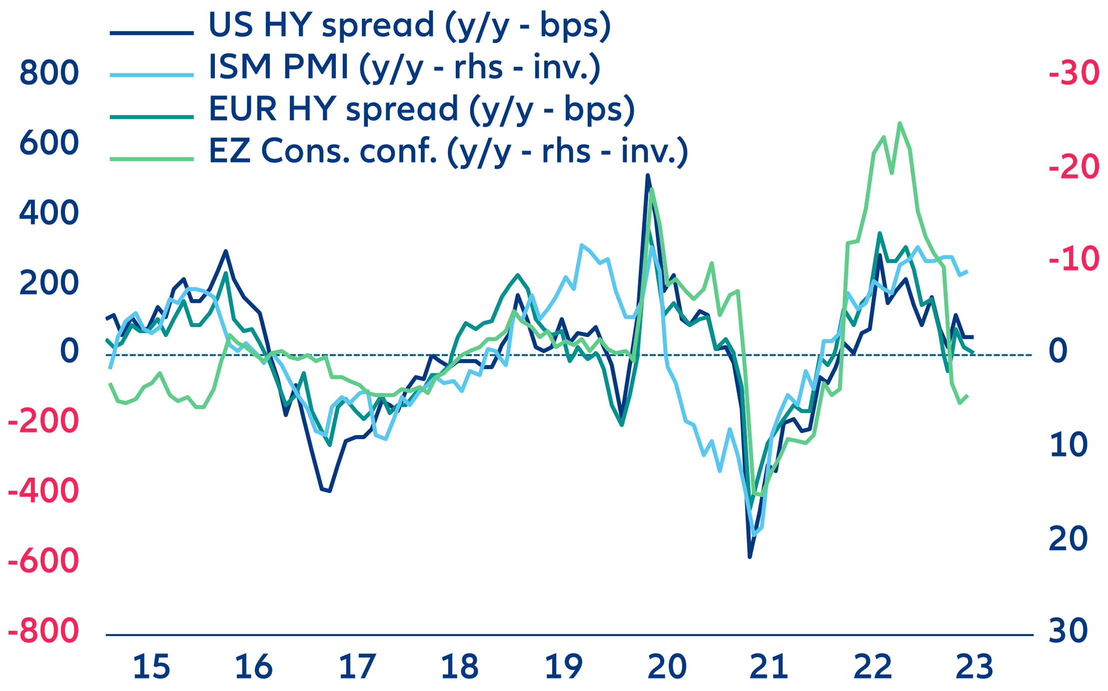
Volatility in peripheral spreads will be higher due to the loss of a permanent demand actor (ECB)



Sources: Refinitiv Datastream, Allianz Research
Note: based on Marcello Minenna et al. (2020)

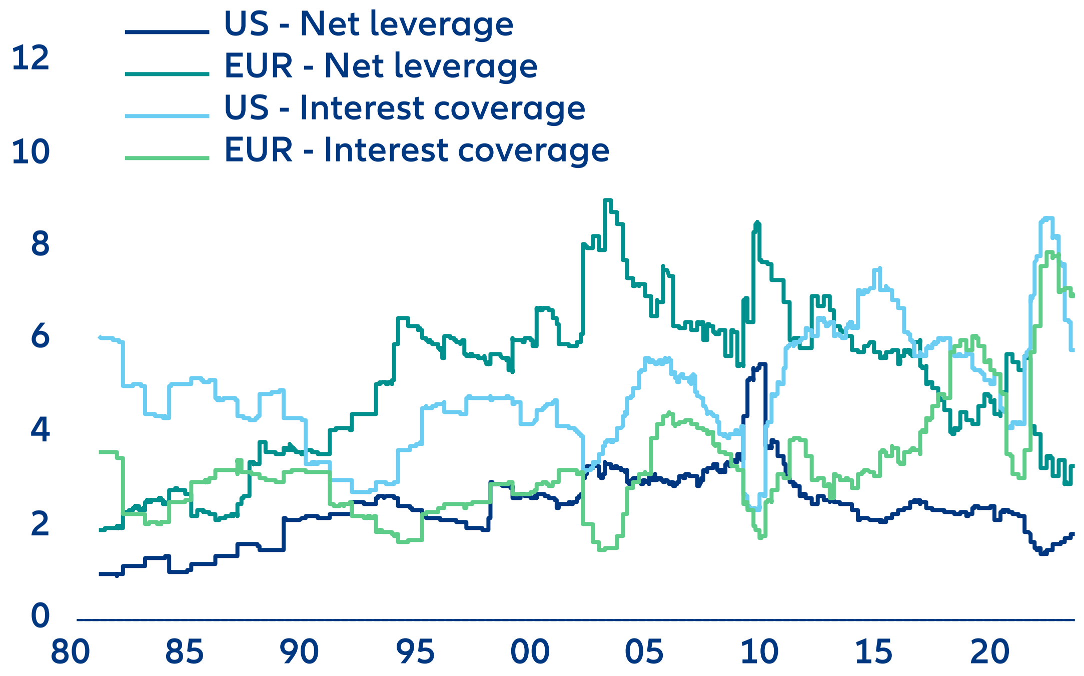
Credit market imbalances remain high and continue to call for a cautious approach

US credit remains detached from macro fundamentals



Sources: Refinitiv Datastream, Allianz Research.

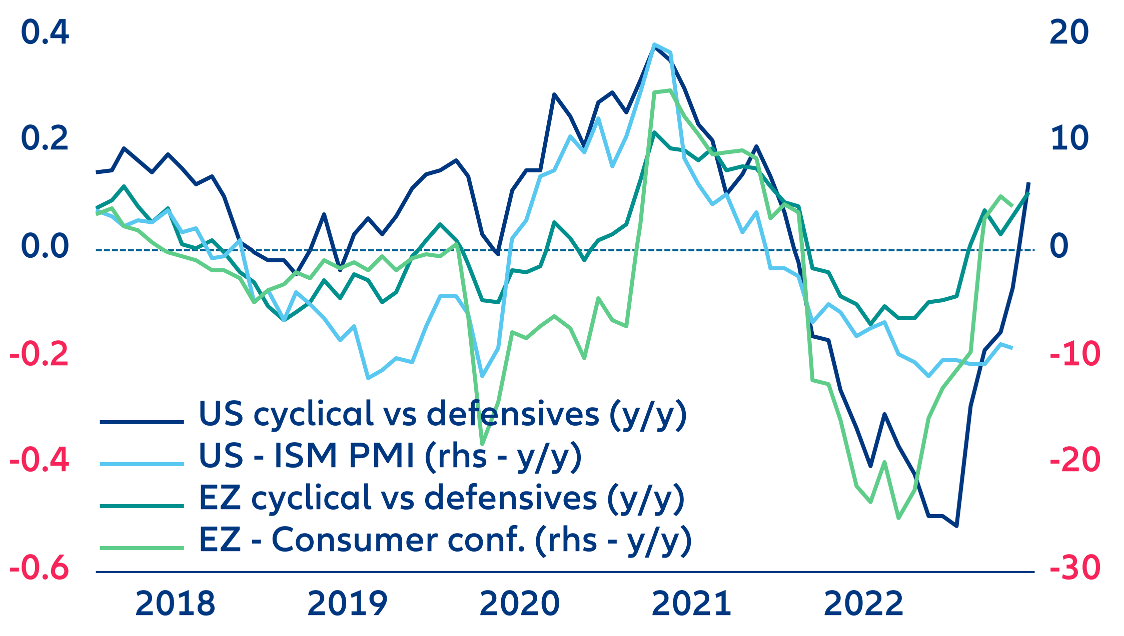
European issuers seem to be in a slightly better position



Sources: Refinitiv Datastream, Allianz Research

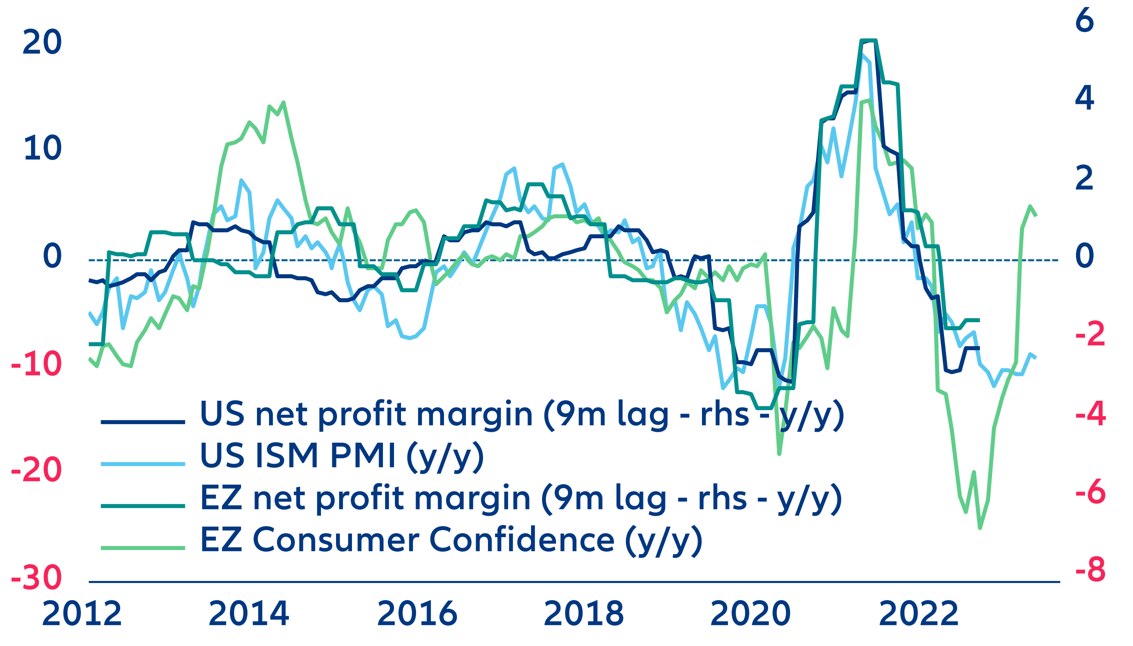
The sustainability of the year-to- date equity rally will continue to be challenged

The rush for risk continues to be inconsistent with the economic outlook



Sources: Refinitiv Datastream, Allianz Research.

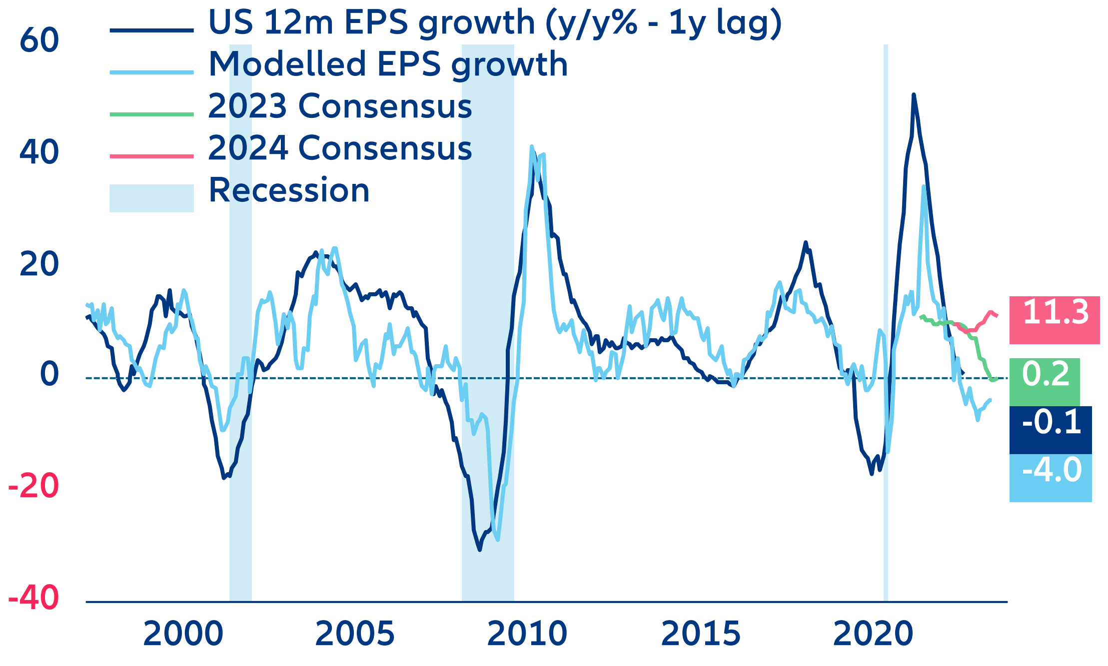
Companies' profit margins are bound to suffer before rebounding in 2024



Sources: Refinitiv Datastream, Allianz Research

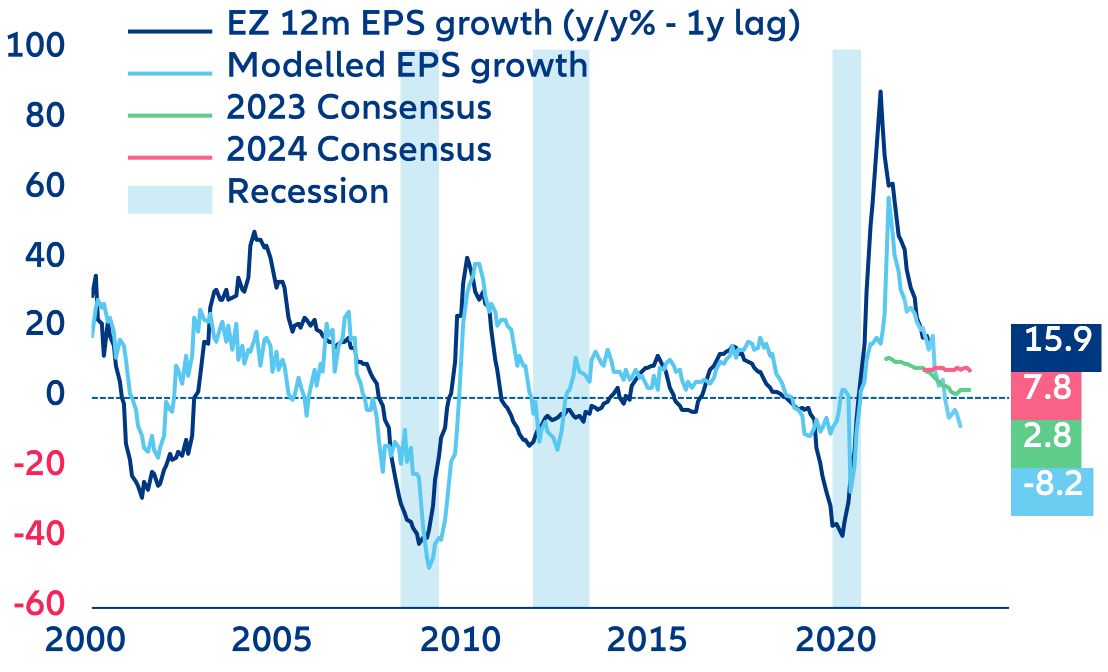
Companies' top and bottom lines will have a challenging 2023

US EPS growth model vs consensus



Sources: Refinitiv Datastream, Allianz Research.

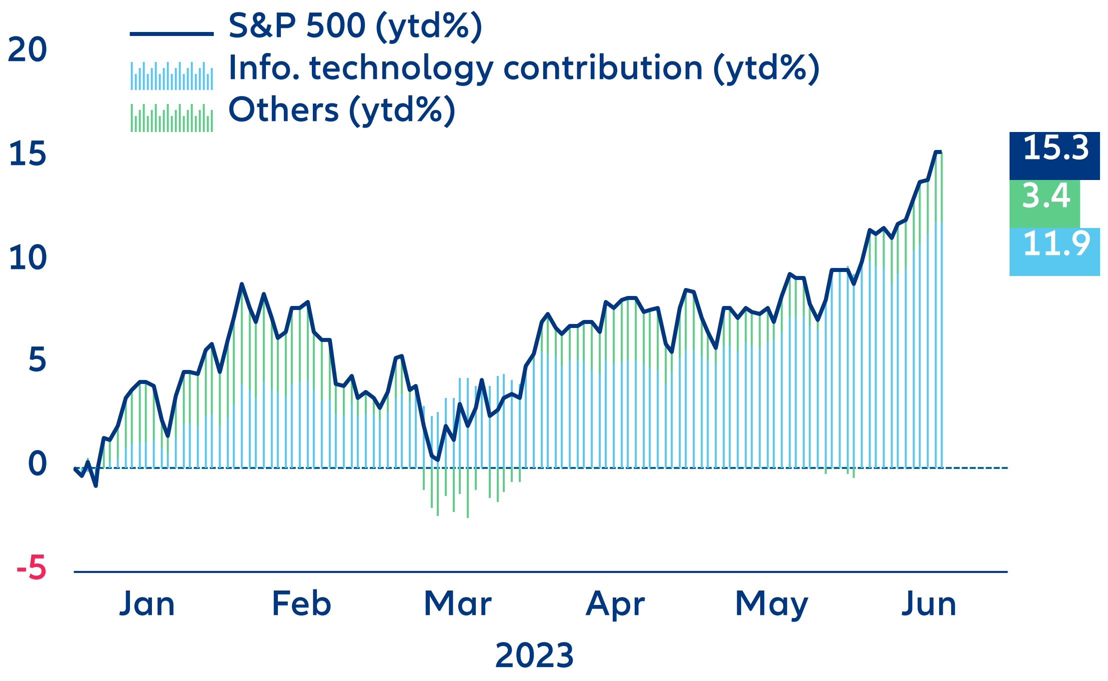
Eurozone EPS growth model vs consensus



Sources: Refinitiv Datastream, Allianz Research

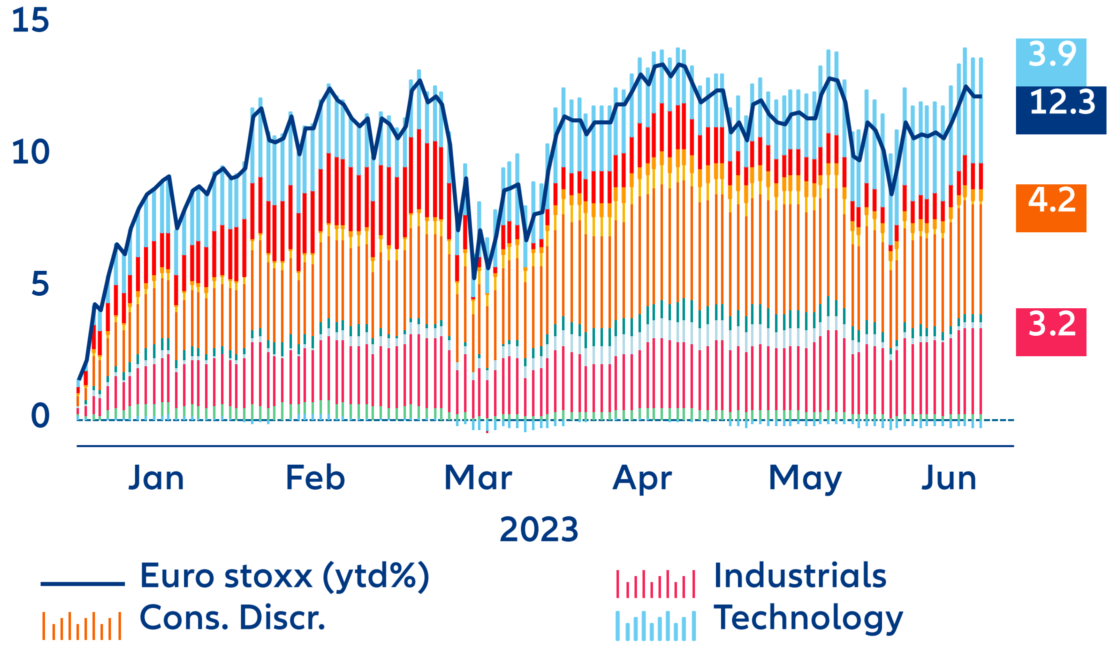
Concentration risk is much higher in US equity markets than in the Eurozone

S&P 500 year-to-date performance (%)



Sources: Refinitiv Datastream, Allianz Research.

Euro Stoxx year-to-date performance (%)



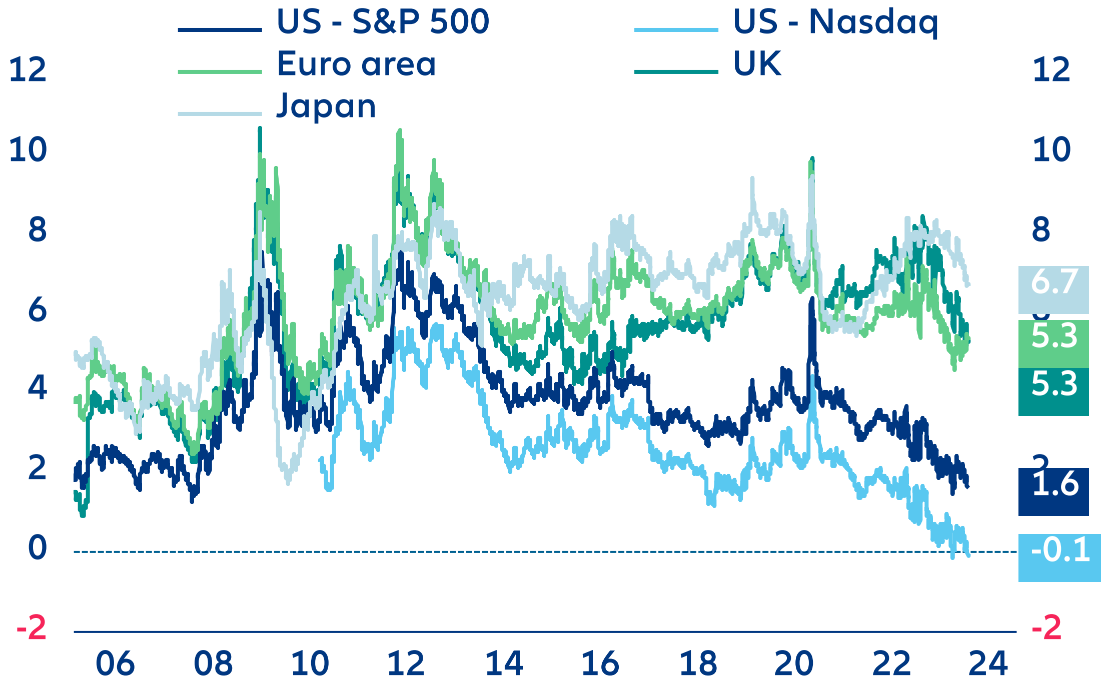
Sources: Refinitiv Datastream, Allianz Research

Allianz

The return of high-quality fixed income assets still has some legs

Little compensation over FI for taking US EQ risk

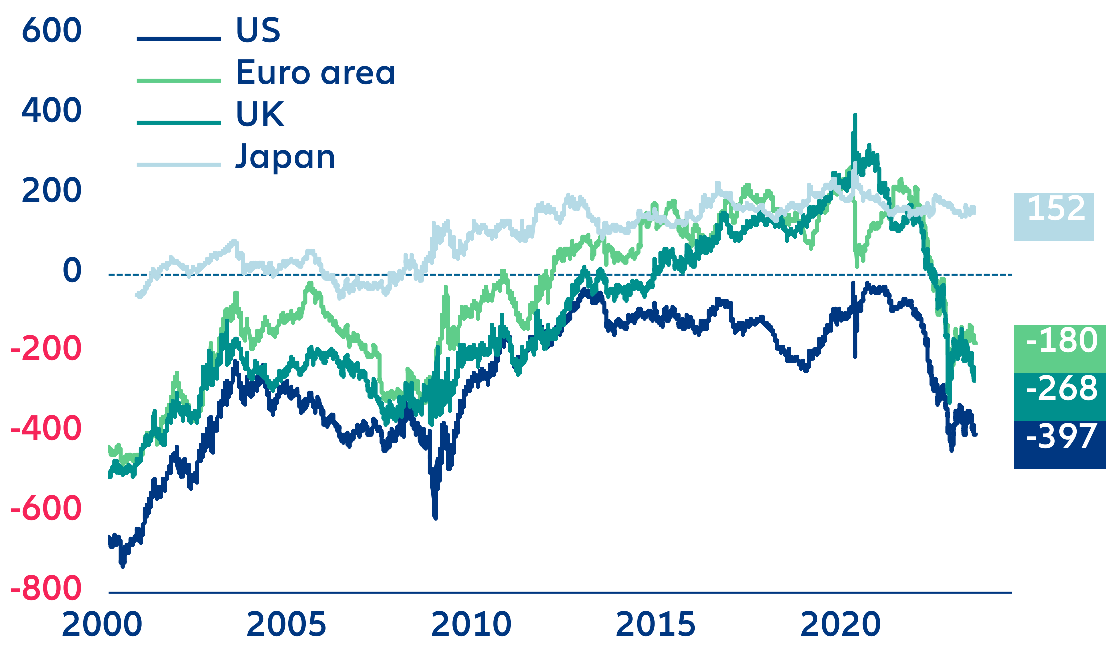
Equity Risk Premium (%)



Sources: Refinitiv Datastream, Allianz Research.

Equity dividend vs corporate investment grade yields

(bps)

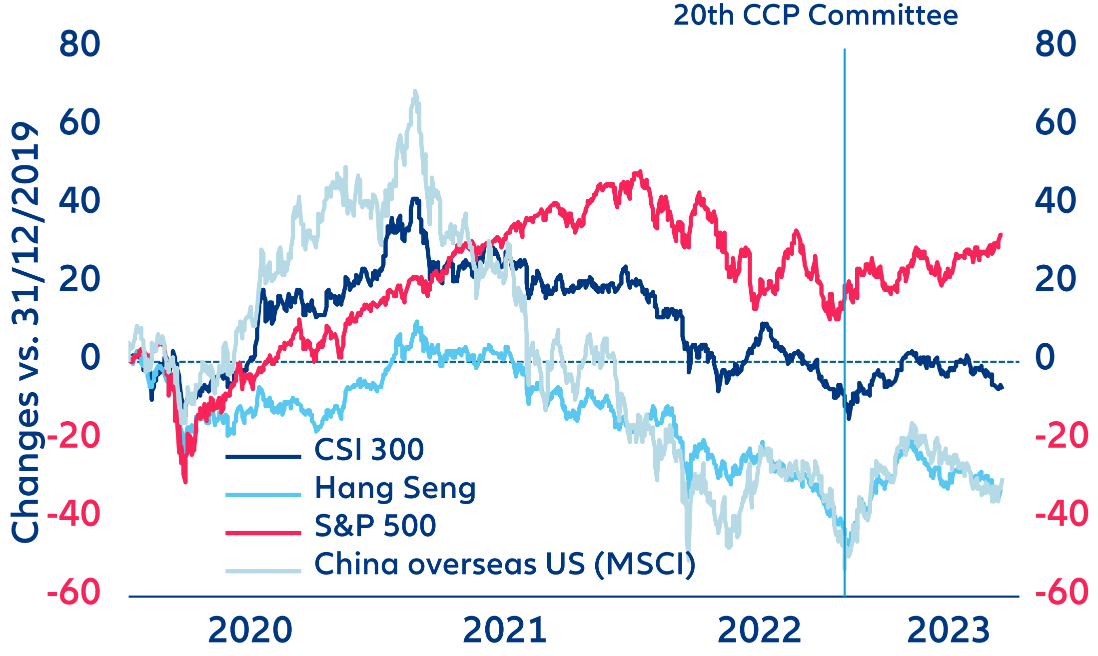


Sources: Refinitiv Datastream, Allianz Research

Allianz

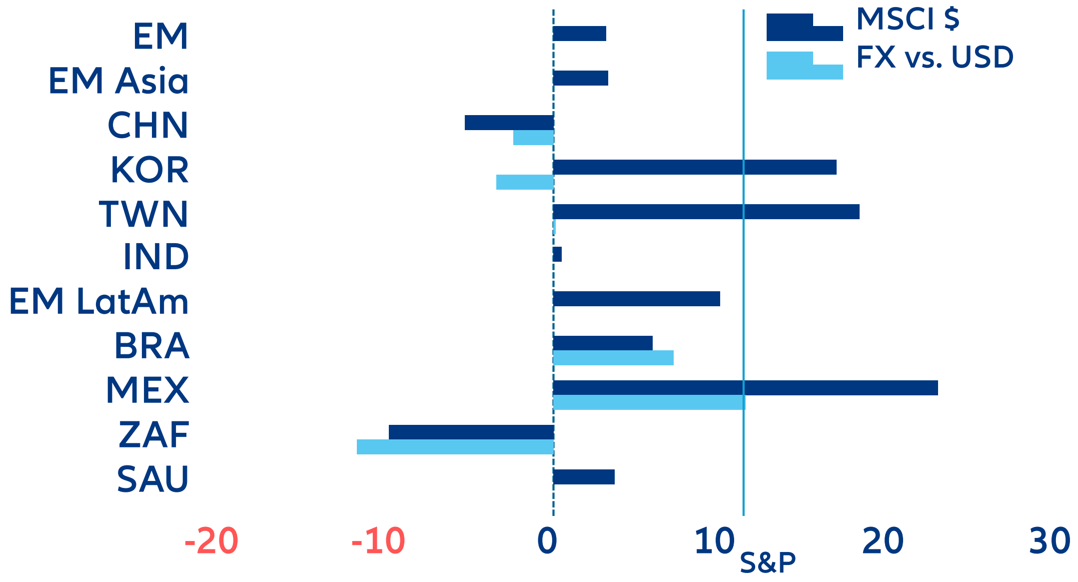
Precaution warranted in China, more room to go in EM ex-China

Geopolitics dampen any reopening optimism



Sources: Refinitiv Datastream, Allianz Research.

Growth vs. value yet to kick in: so far, correlations with US is what has driven performance



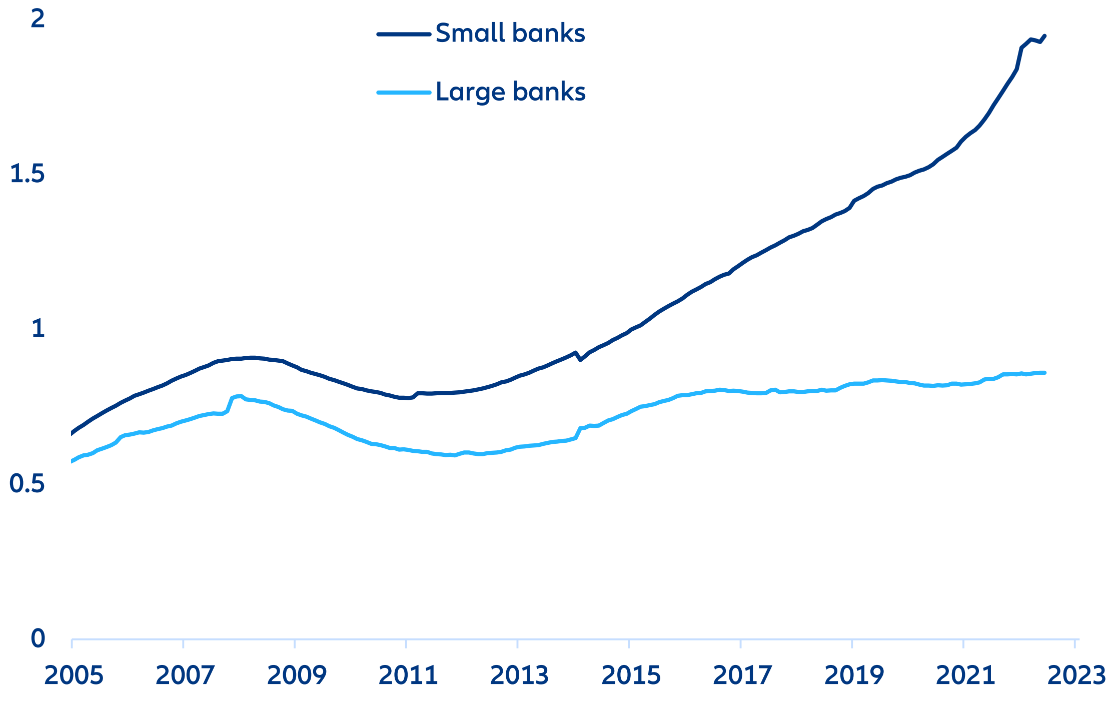
Sources: Refinitiv Datastream, Allianz Research

Allianz

Even after Fed rapid action, CRE remains a major concern for US regional banks

Small banks doubled CRE exposure since 2015

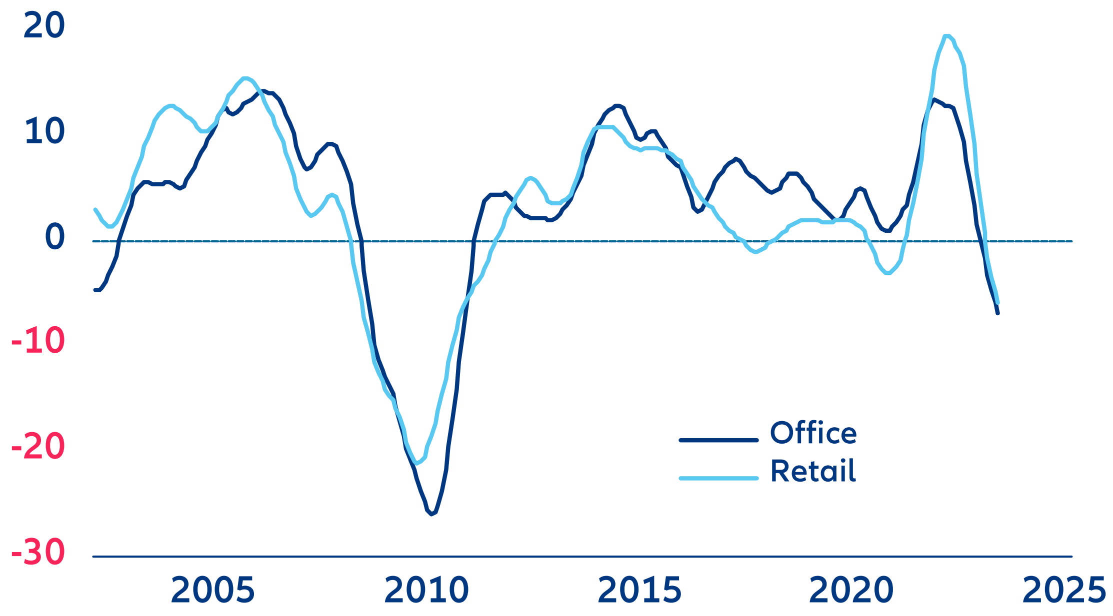
CRE lending, USD trn



Sources: US Fed, Refinitiv Datastream, Allianz Research.

As valuations fall and cost of debt rises

YoY Prices



Sources: Real Capital Analytics, Refinitiv Datastream, Allianz Research