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The last hike

Allianz Research

4 October 2023

Executive summary

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1 Ultra long political year, recession (mostly) avoided, inflation (mostly) circumscribed

- **Muddle-through economics** in the making due to normalizing consumption and wait-and-see mode in a very electoral year. **Consumer** demand will remain soft amid negative wealth effects and increasing precautionary savings. **Corporates** are navigating decelerating revenue growth and a wage pinch. **Global trade** to rebound timidly but global south affected by muted northern and eastern engines of growth.
- **Inflation** is pushed down by lower demand, inventory gluts and China. Wavelets from higher and more volatile energy and wage pressures to stay.

2 Toxic policy mix in the short-run, and return of dirigisme in the medium-term

- **Monetary policy** to pivot mid- or late 2024 everywhere as the job is done and recession-avoidance persists. Much higher for much longer would trigger recession as the credit channel is impaired and a repayment wall looms ahead.
- **All ayes on fiscal.** A fiscal cliff is expected in 2024 after some largesse. Market discipline (debt burden) will continue to play a role but beware of dirigisme in a cold war II environment favoring costly industrial policies.

3 Markets: between a micro rock and a macro hard place

- With the policy rates peaking there is little upside left for **long-term rates.** But with the supply-demand picture looking less favorable in 2024 we do not expect big downward shifts to occur either.
- **Equities** will continue to buy into the fundamentals resilience narrative while downplaying the still-high macroeconomic uncertainty; we expect positive total returns for the next three years.
- **Corporate credit** will remain tight despite some short-term volatility as corporate balance sheet resilience and the limited pass-through effect from higher financing costs will not spook investor appetite.
- **Emerging market** carry will remain strong, but country selectivity will continue to be a key performance factor moving forward.

4 What could go wrong?

- Downside (risks include: (i) recession if rates remain much higher for much longer because of tail tightening — or if the ECB throws in the towel too early, spooking markets with a confirmed stagflationary recession; (ii) a fiercer hunt for weaker links (peripherals and high yield); (iii) a reshuffled Ukraine and China stance under Trump II; and (iv) increased polarization and populism around sustainability issues.

Global Macro & Corporate Outlook 2023-2025

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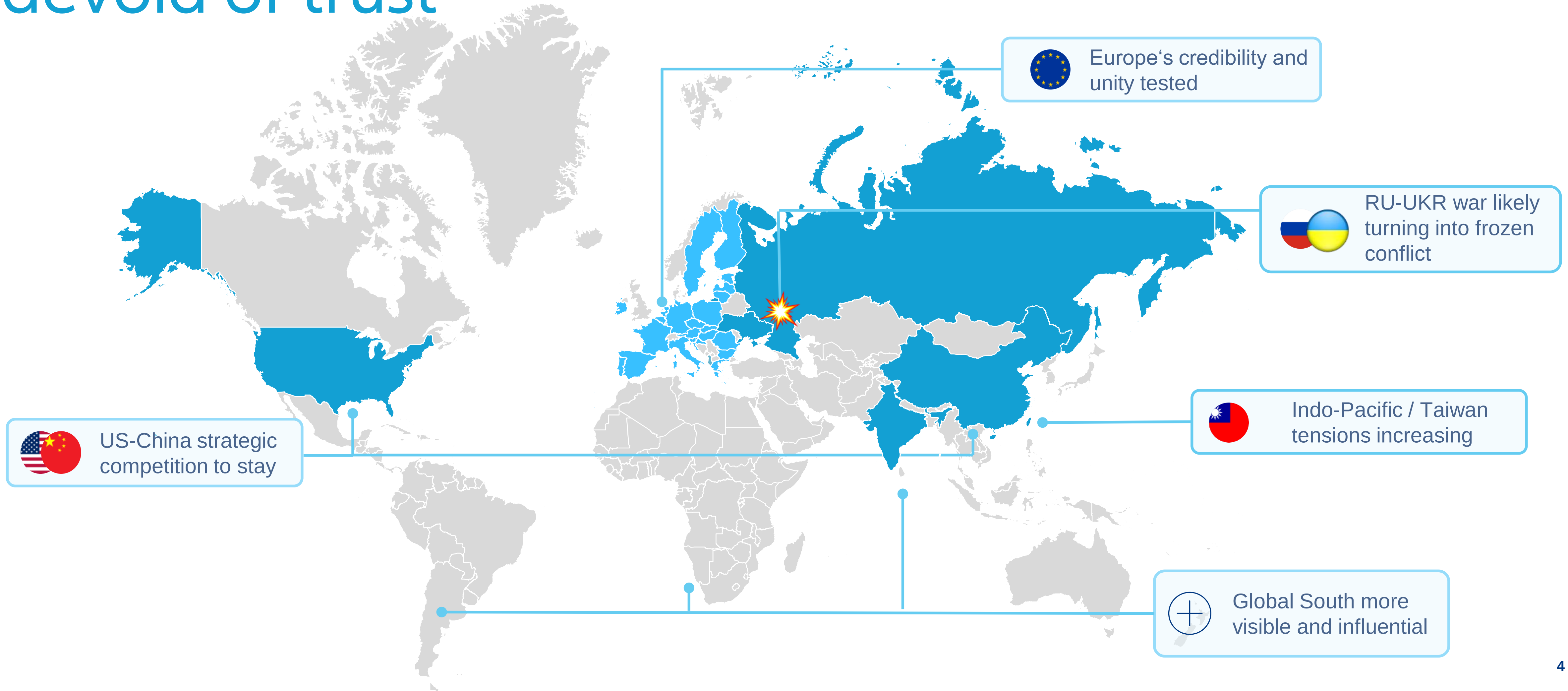
Geopolitics increasingly polarized and devoid of trust



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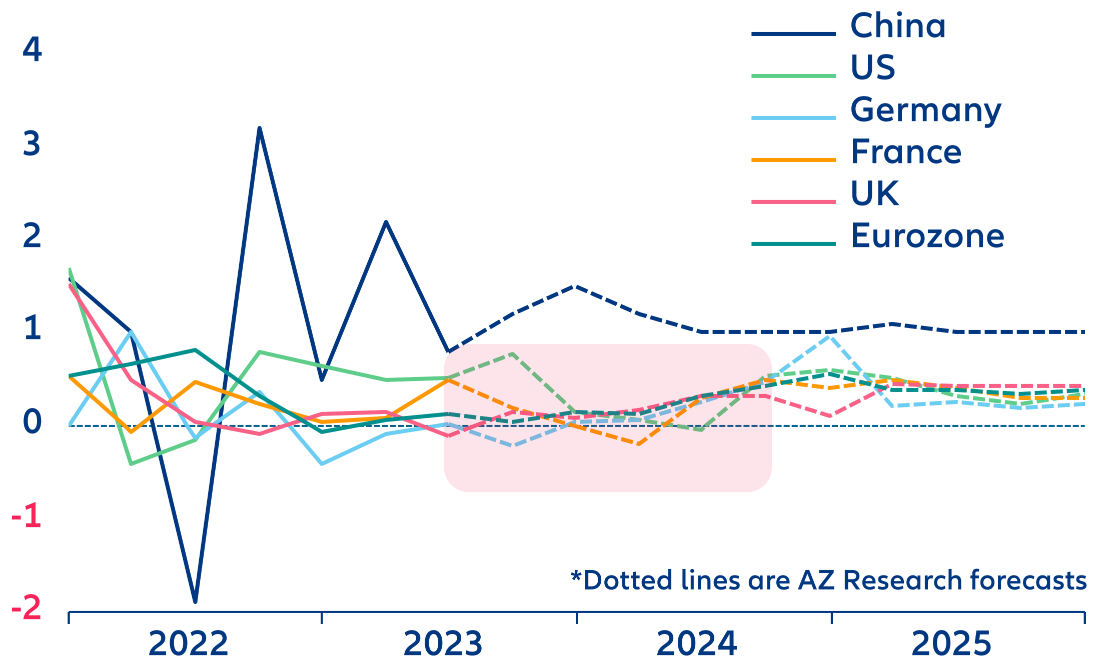
Sidestepping the recession

Global real GDP growth (%)

Growth (yearly %)	2021	2022	2023f	2024f	2025f
Global	**6.1**	**3.0**	**2.7**	**2.4**	**2.7**
USA	**6.0**	**2.1**	**2.2**	**1.1**	**1.7**
Latin America	**6.8**	**3.6**	**2.1**	**1.7**	**2.6**
Brazil	5.3	3.0	3.1	1.3	1.9
UK	**7.6**	**4.1**	**0.3**	**0.6**	**1.5**
Eurozone	**5.4**	**3.4**	**0.6**	**0.9**	**1.7**
Germany	3.1	1.9	-0.3	0.7	1.6
France	6.4	2.5	0.9	0.7	1.6
Italy	7.0	3.8	0.7	0.5	1.5
Spain	5.5	5.5	2.2	1.5	1.8
Russia	5.6	-2.1	2.1	1.9	1.5
Turkey	11.4	5.5	4.0	2.9	3.9
Central and Eastern Europe	**5.9**	**0.8**	**0.7**	**2.8**	**3.2**
Poland	6.9	5.1	-0.2	2.8	3.5
Asia-Pacific	**6.4**	**3.2**	**4.4**	**4.1**	**3.9**
China	8.5	3.0	5.3	4.7	4.2
Japan	2.3	1.0	2.3	1.3	1.2
India	8.9	6.7	6.5	6.1	6.2
Middle East	**4.2**	**6.7**	**2.3**	**2.5**	**2.6**
Saudi Arabia	3.9	8.7	1.5	1.8	3.0
Africa	**5.7**	**3.7**	**3.2**	**3.6**	**4.1**
South Africa	4.7	1.9	0.7	1.4	1.6

Subdued growth for the next two years

Quarterly real growth rates (q/q %)



Sources: LSEG Datastream, Allianz Research

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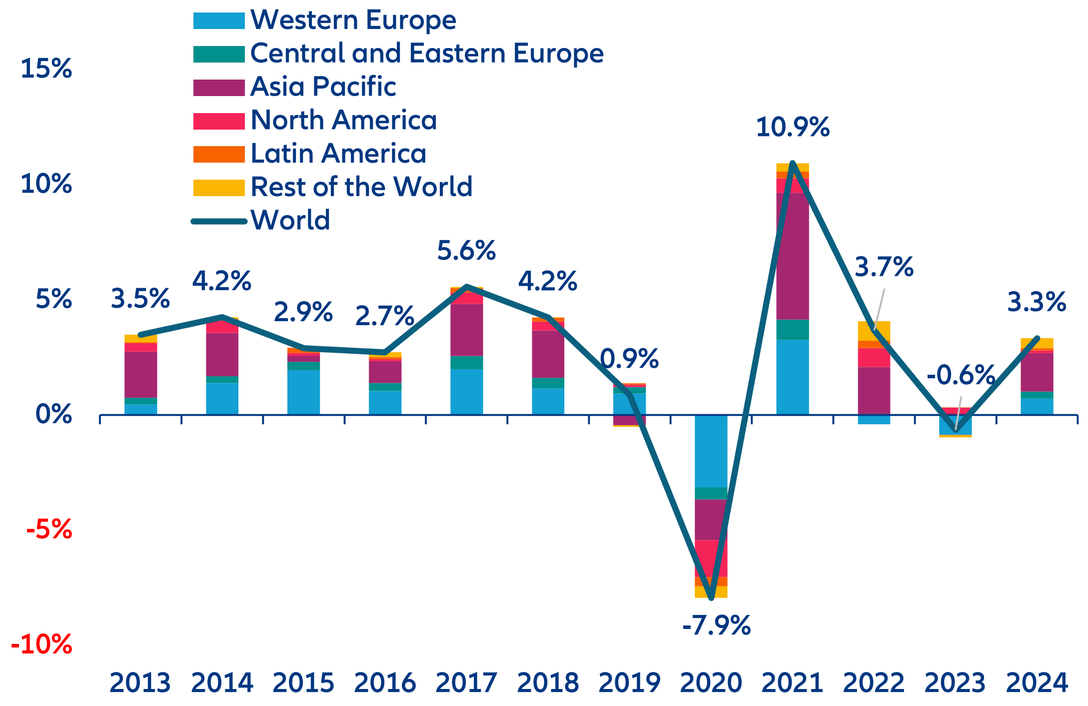
Timid rebound in global trade in 2024

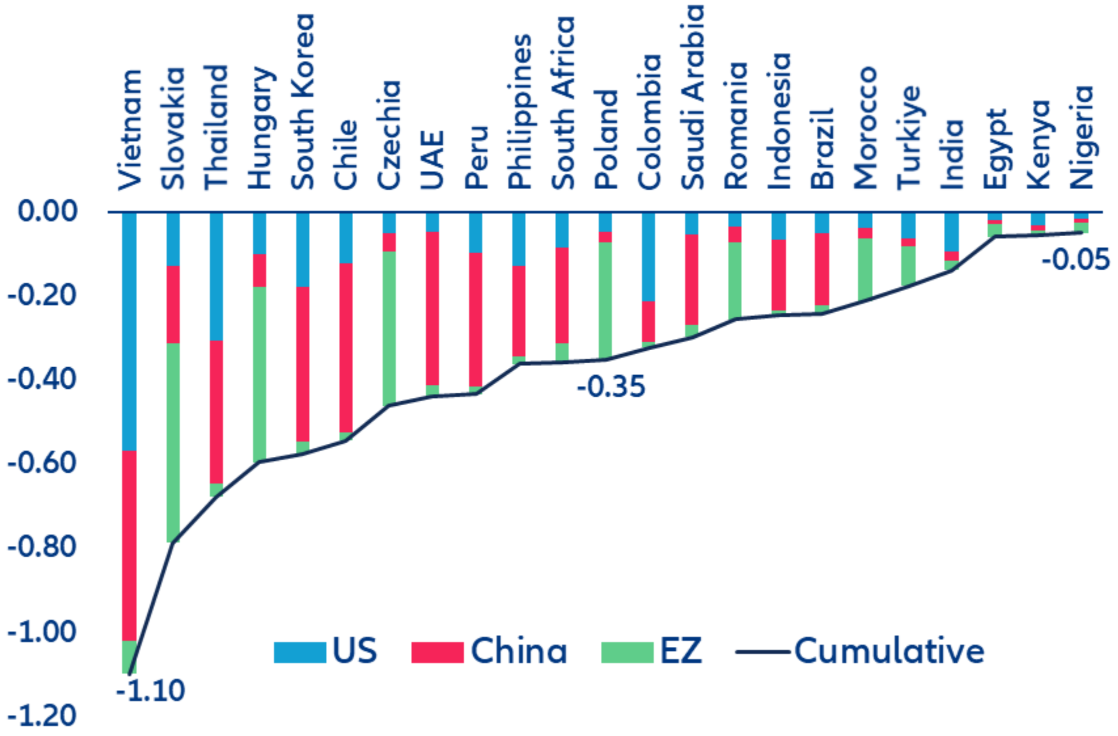
Europe to rebound after two years of trade recession

Volume trade of goods and services, y/y



Sources: LSEG Datastream, Allianz Research

Demand shock: cost to GDP in pp in 2023-24 due to lower import growth in the US, China and Eurozone



Sources: UNCTADstat, Allianz Research

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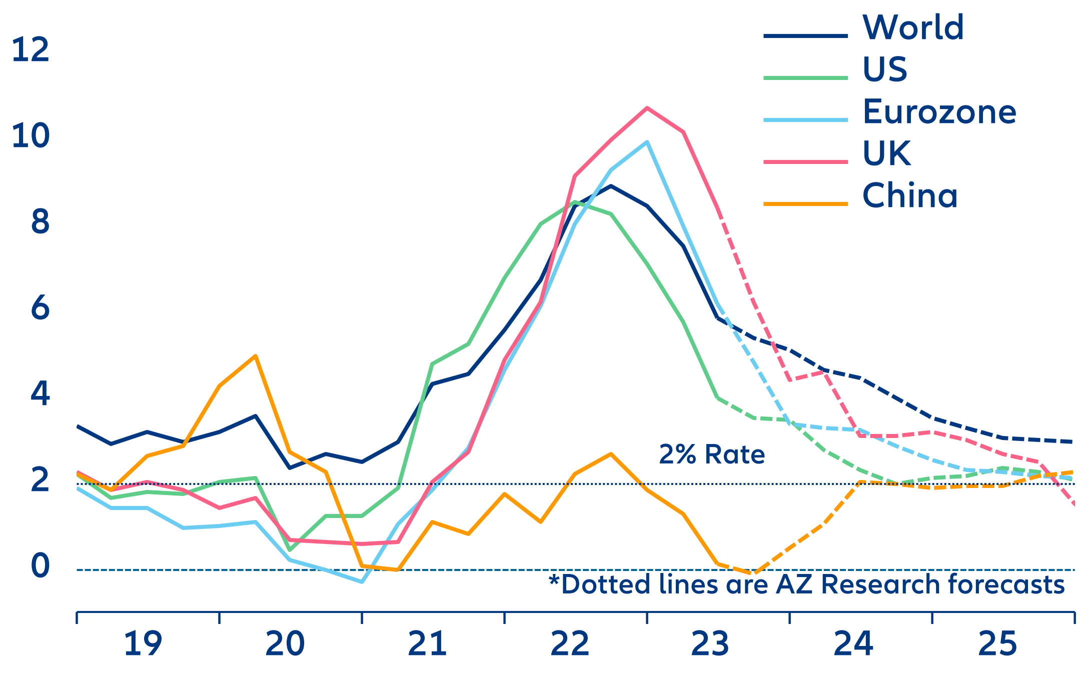
Bumpy (dis)inflation

Inflation forecasts, %

Inflation (yearly %)	2021	2022	2023f	2024f	2025f
Global	**4.3**	**8.4**	**6.3**	**4.3**	**3.4**
USA	**4.7**	**8.0**	**4.2**	**2.3**	**2.2**
Latin America	**13.9**	**14.9**	**22.0**	**11.8**	**7.5**
Brazil	8.3	9.3	5.1	4.2	3.5
UK	**2.6**	**9.1**	**7.0**	**3.5**	**2.0**
Eurozone	**2.6**	**8.4**	**5.6**	**3.0**	**2.2**
Germany	3.1	6.9	6.0	2.8	2.4
France	1.6	5.2	5.3	2.6	2.0
Italy	1.9	8.2	6.2	2.5	2.2
Spain	3.1	8.4	3.7	3.7	2.2
Russia	6.7	13.8	5.5	5.6	4.0
Turkey	19.6	72.3	54.0	38.5	17.4
Central and Eastern Europe	**8.1**	**9.1**	**12.0**	**6.2**	**3.9**
Poland	5.1	14.4	12.3	6.2	4.0
Asia-Pacific	**1.7**	**3.7**	**2.6**	**2.6**	**2.4**
China	0.9	2.0	0.4	1.7	1.9
Japan	-0.2	2.5	3.1	1.8	1.0
India	5.1	6.7	6.4	5.3	4.5
Middle East	**15.8**	**10.3**	**7.7**	**5.6**	**5.1**
Saudi Arabia	3.1	2.5	2.8	2.8	2.0
Africa	**12.4**	**16.1**	**19.7**	**14.6**	**9.7**
South Africa	4.6	6.9	5.2	4.2	4.5

No return to 2% before 2025

Quarterly inflation rates, y/y%



Sources: LSEG Datastream, Allianz Research

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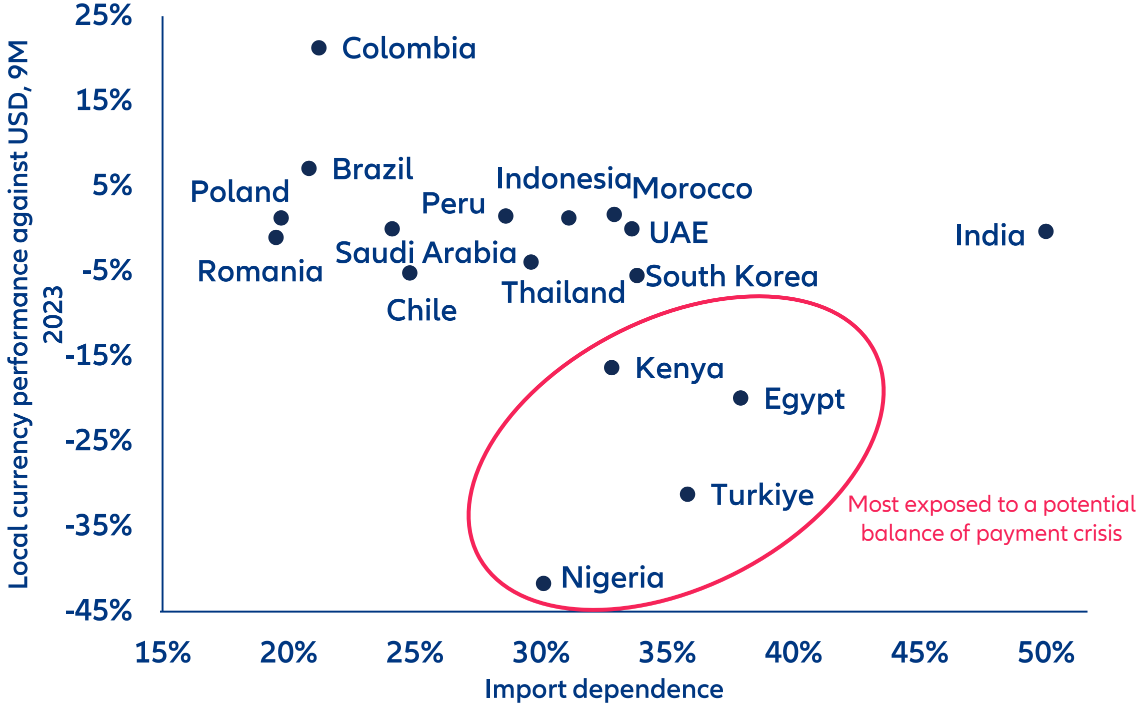
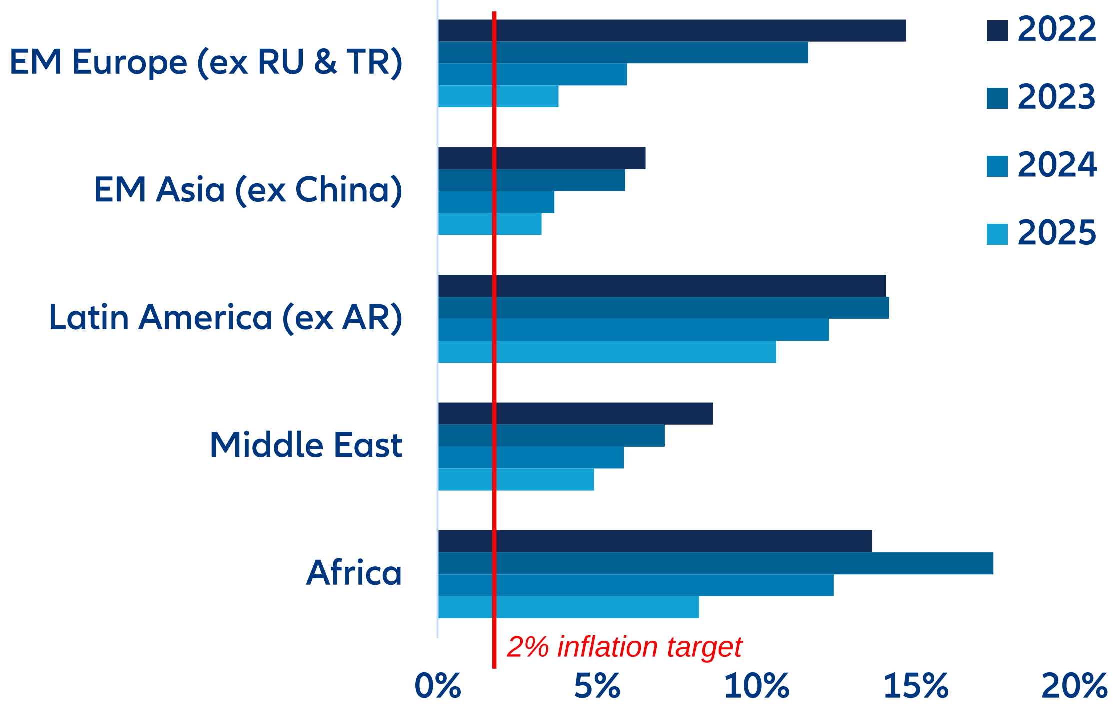
Inflation outlook in emerging markets is challenged by strong USD and higher commodity prices

Supply shock: import dependence on commodities and exchange rate variation, selected countries



Sources: Refinitiv, UNCTADstat, Allianz Research.
NB: Chart shows the four most affected countries of the regions Emerging Europe, Latin America, Emerging Asia and Africa, as well as Saudi Arabia and the UAE.

Consumer price inflation will continue to retreat in all regions but remain above central bank targets



Sources: Refinitiv Datastream, Allianz Research
NB: Russia, Turkey and Argentina excluded from this chart as they are currently idiosyncratic cases with a heavy regional weight that would distort the regional comparison.

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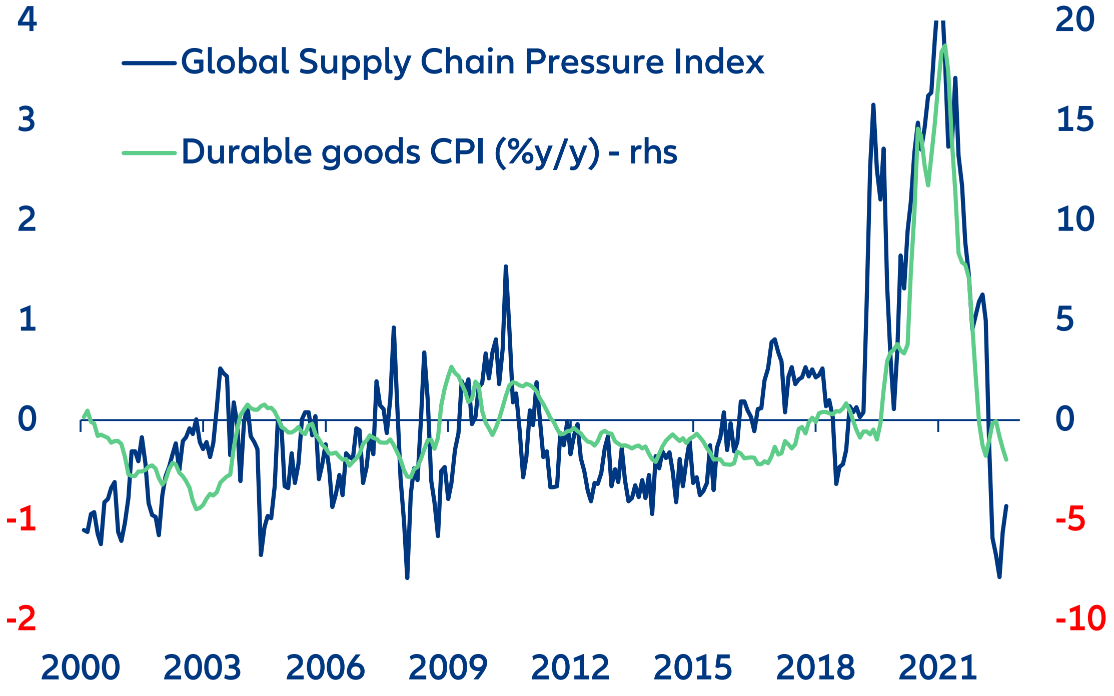
Inventory glut pushes goods inflation down

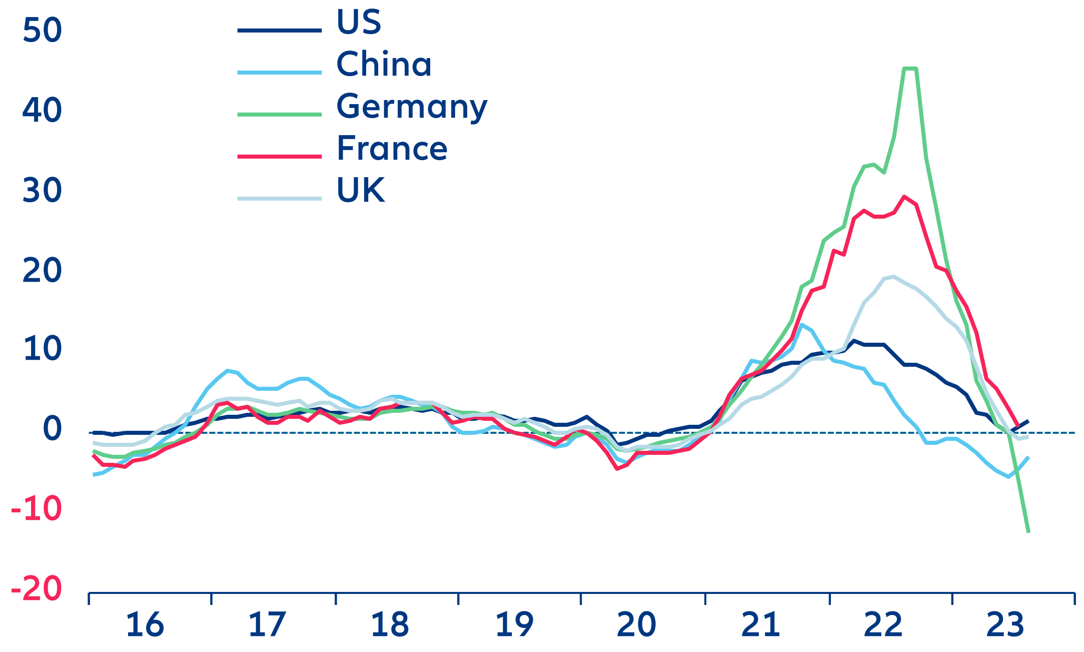
In the US, goods inflation is back to pre-pandemic norm amid the unwinding of supply shortages



Sources: LSEG Datastream, Allianz Research

Producer price deflation, notably in China and Germany

Producer price index, y/y %

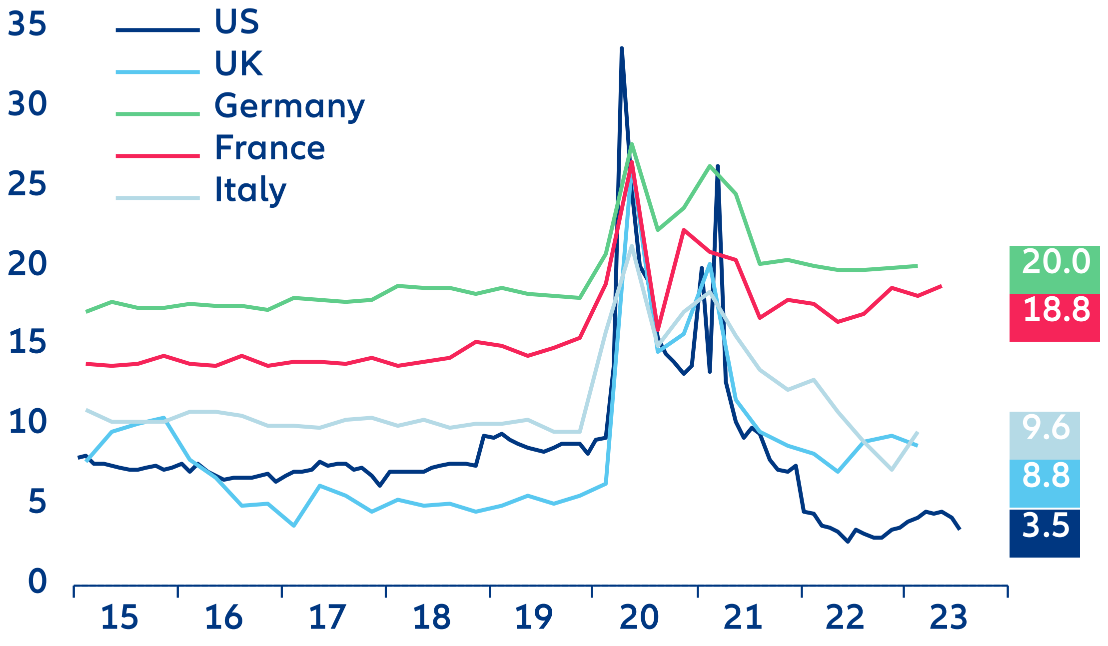


Sources: LSEG Datastream, Allianz Research

Consumers: Softer demand

Precautionary savings are higher in the Eurozone while excess savings stand at close to 4% of GDP

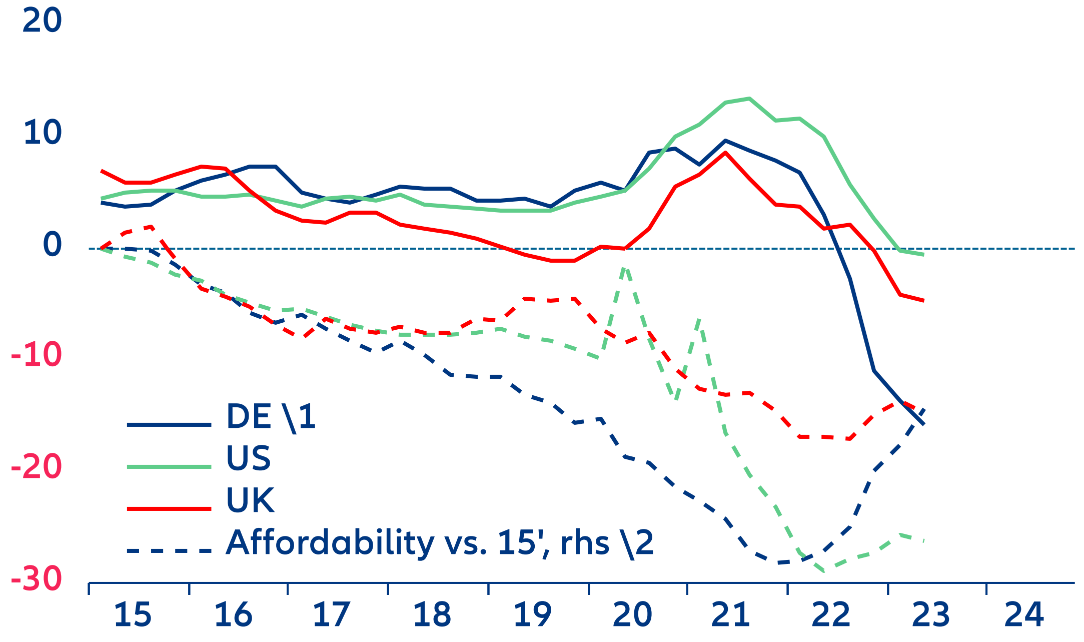
Gross saving rate, % of disposable income



Sources: LSEG Datastream, Allianz Research

Housing prices are adjusting; affordability has not improved as much

Real house price index growth, y/y%



Sources: LSEG Datastream, BIS, Allianz Research. Notes: \1 Germany used instead of the EZ as the most representative example of the housing prices correction; \2 based on price-to-income ratios; the drops would be deeper after taking adding mortgage costs; \3 Real house prices as provided by the BIS

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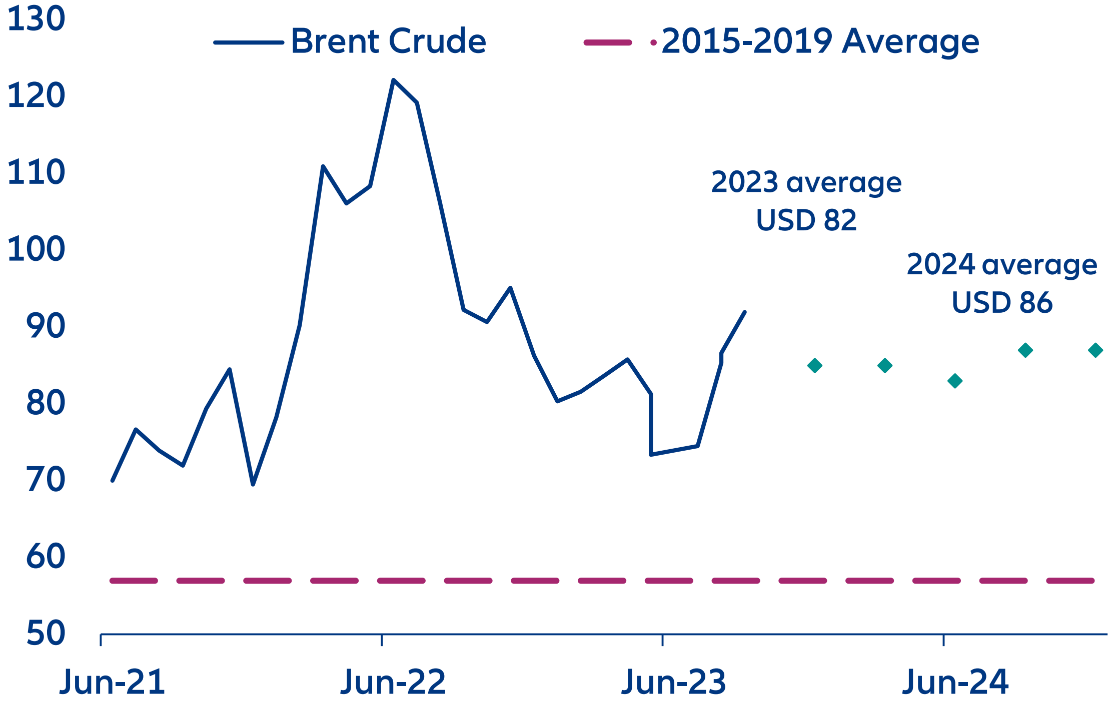
No additional relief from energy prices

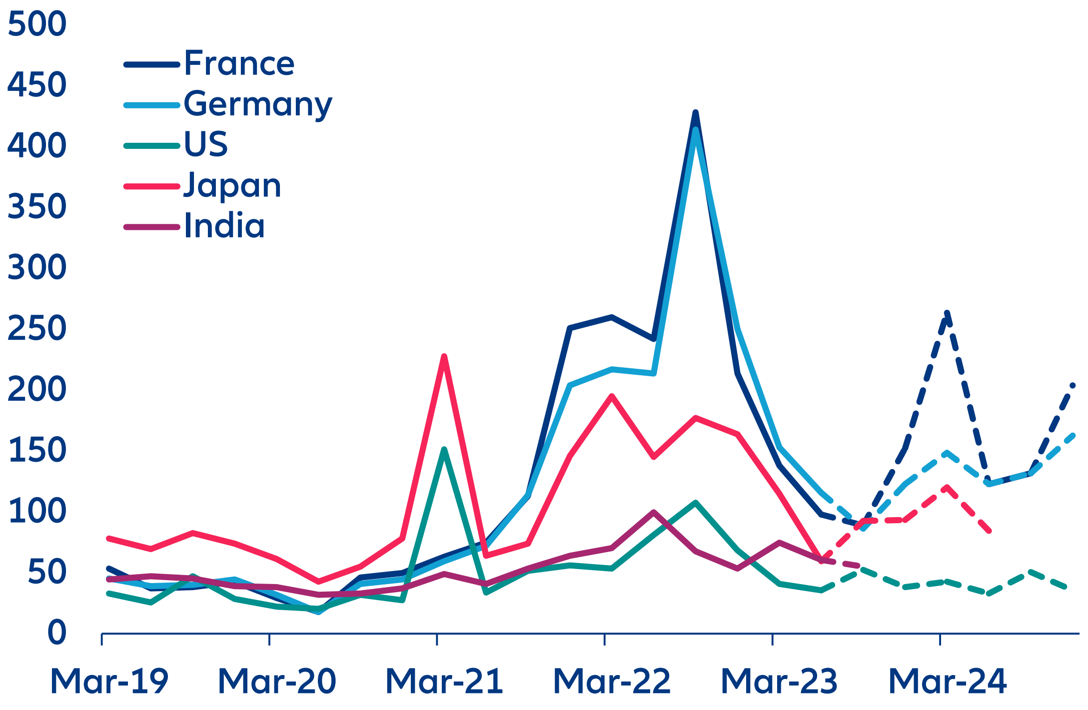
Oil to remain expensive

Brent prices, USD/bbl



Sources: LSEG Datastream, Allianz Research

Wholesale future electricity prices should not decrease much in 2024 in Europe



Sources: LSEG Datastream, Allianz Research

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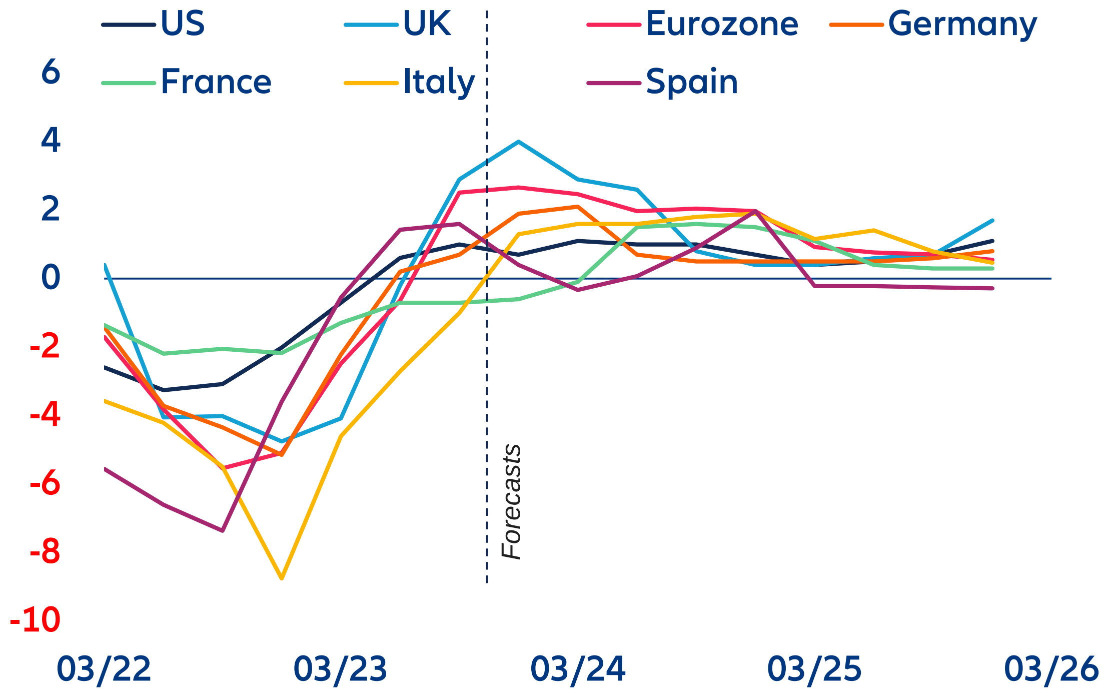
A wage pinch, but no price spiral

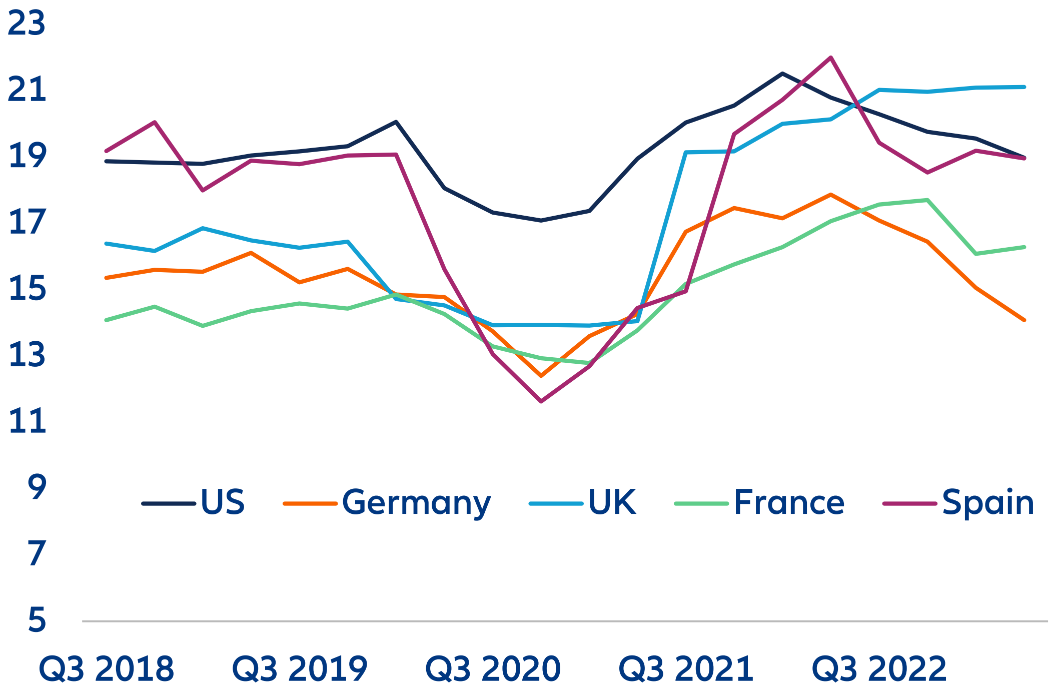
Positive real wages will not compensate for 2022 losses, except in the UK, y/y %



Sources: LSEG Datastream, Allianz Research

Corporates are feeling the higher cost of labor

Quarterly EBITDA margin (%)



Listed corporates

Sources: Bloomberg, Allianz Research

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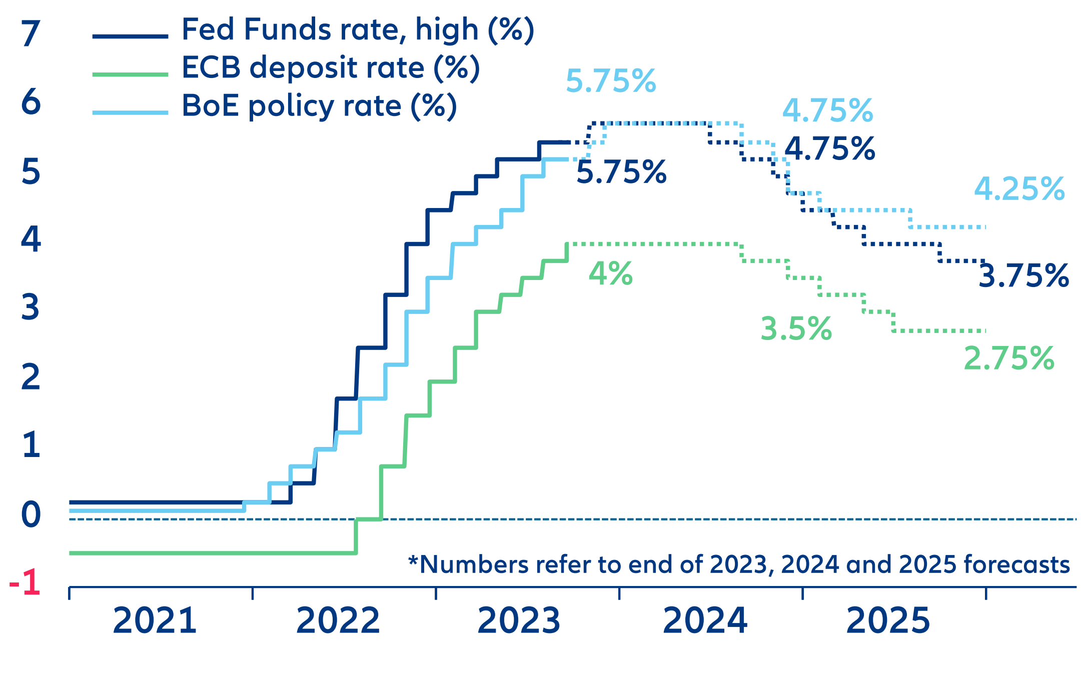
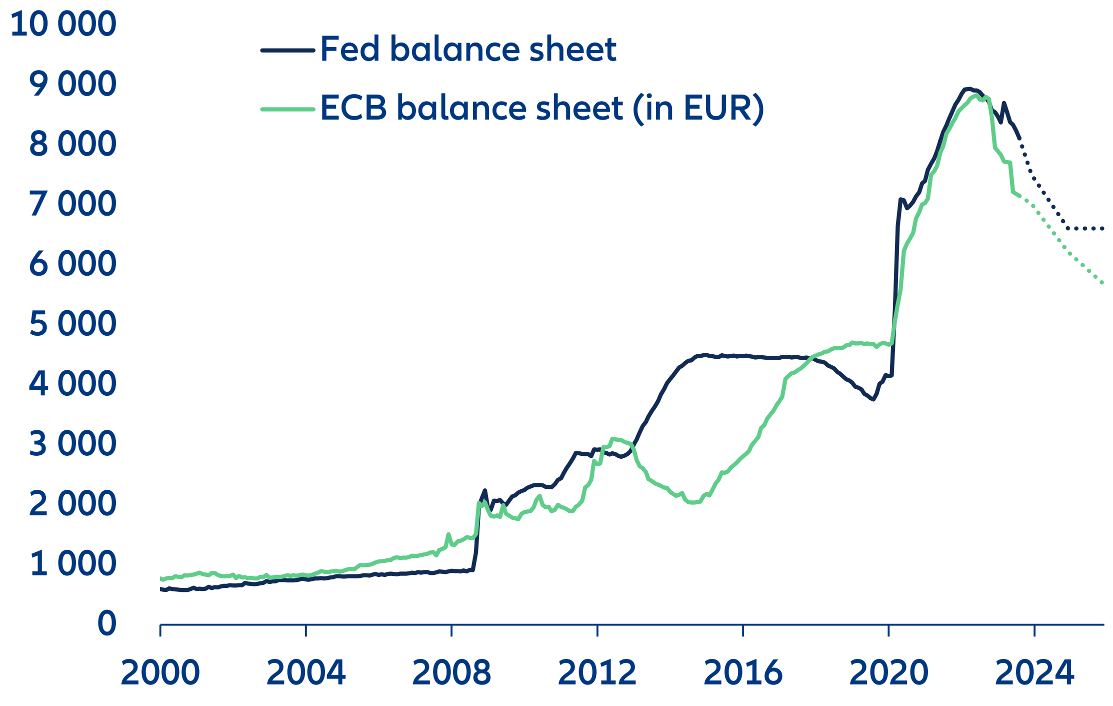
Timid pivots in interest rates to start mid-2024

Central banks will start cutting rates in H2 2024 amid weak growth and ongoing disinflation



Sources: LSEG Datastream, Bloomberg, Allianz Research

Quantitative tightening will continue in the Eurozone whereas the Fed is expected to stop in mid-2024



Sources: LSEG Datastream, Allianz Research

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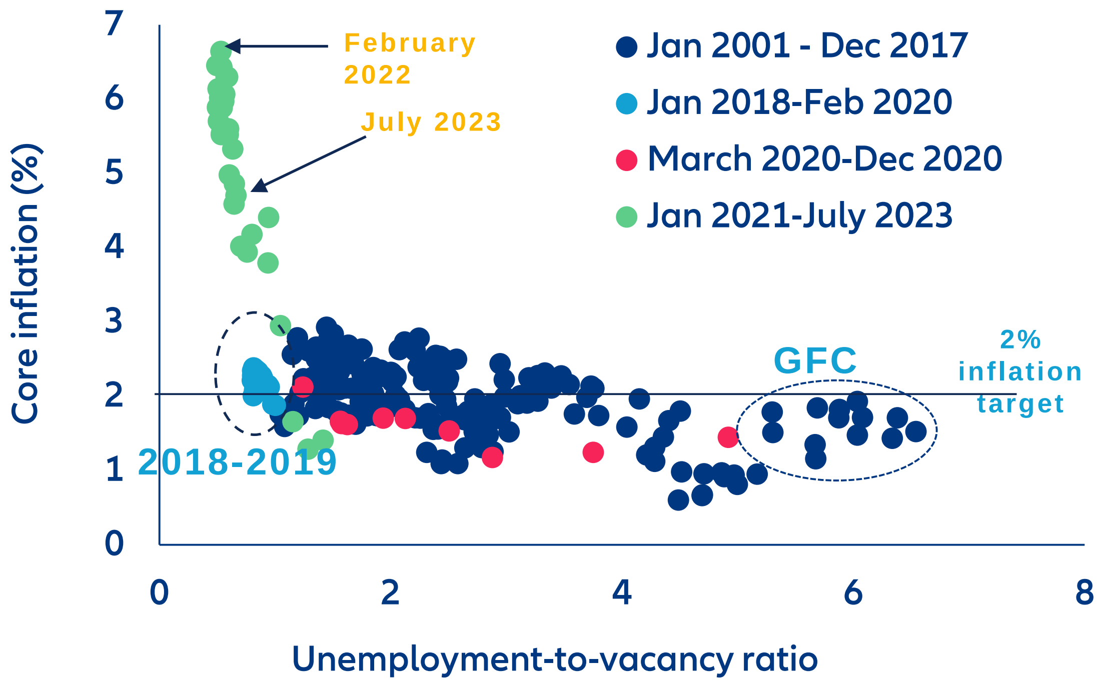
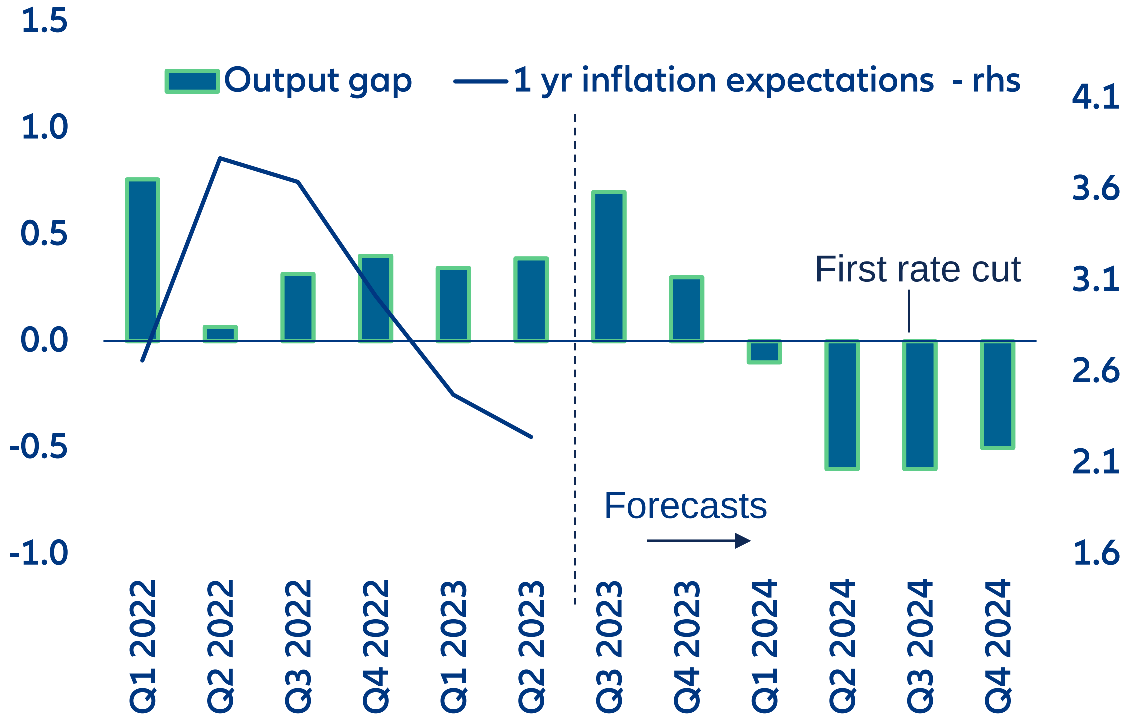
Ingredients in place for the Fed to cut by Q3 2024, but monetary settings will remain tight

The labor market is gradually easing back towards the 2018-19 pattern, compatible with 2% inflation...



Sources: LSEG Datastream, Bloomberg, Allianz Research

...while inflation expectations are low and the output gap is expected to widen sharply



Sources: LSEG Datastream, Allianz Research

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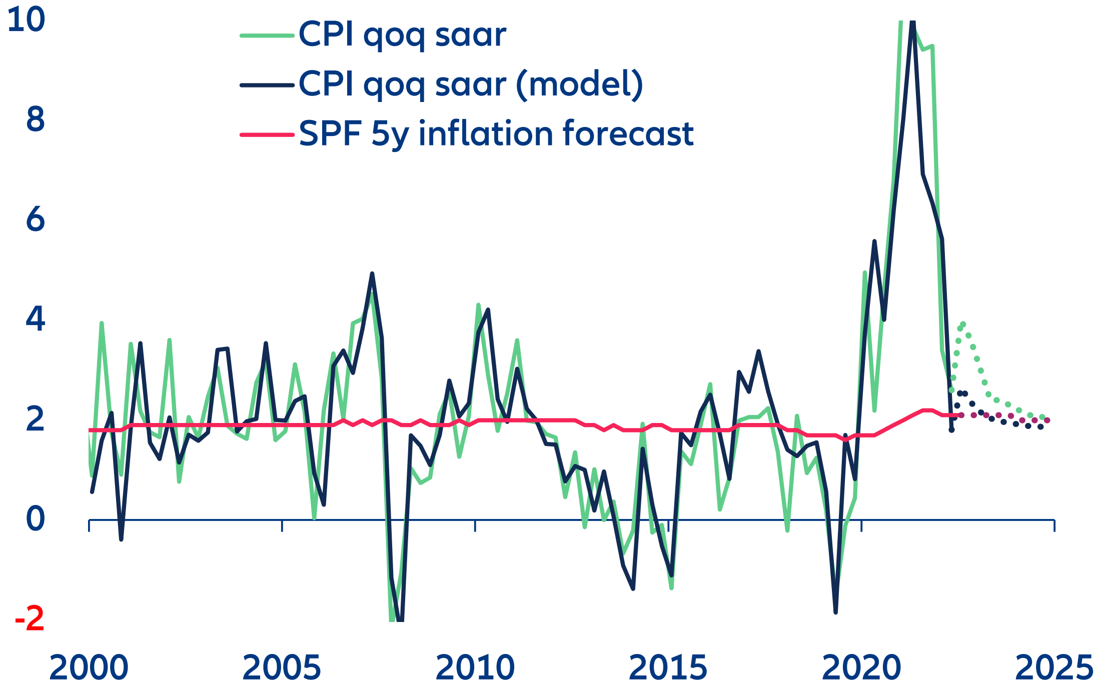
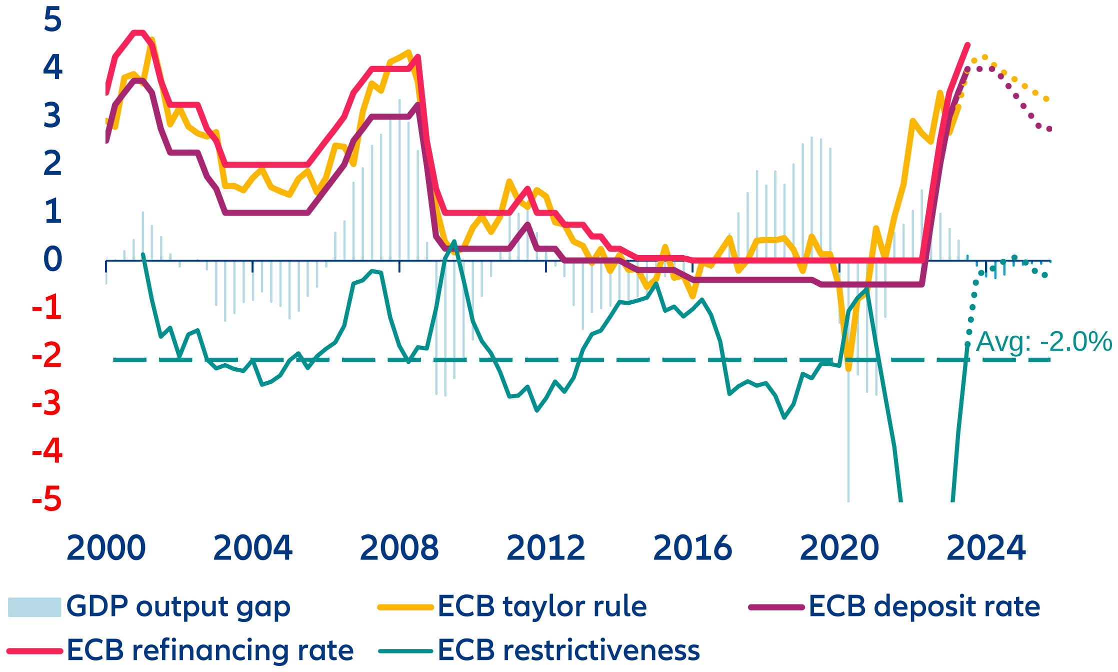
The ECB will need to avoid a hard landing in 2024

Phillips curve model shows disinflation due to anchored expectations and fading of supply shocks



Sources: LSEG Datastream, Bloomberg, Allianz Research
Notes: Phillips curve inflation model using output gap, inflation expectations, oil price growth, global supply chain index and lagged inflation as input.
SPF refers to survey of professional forecasters.

To achieve a soft landing the ECB will need to release the brakes slightly in 2024

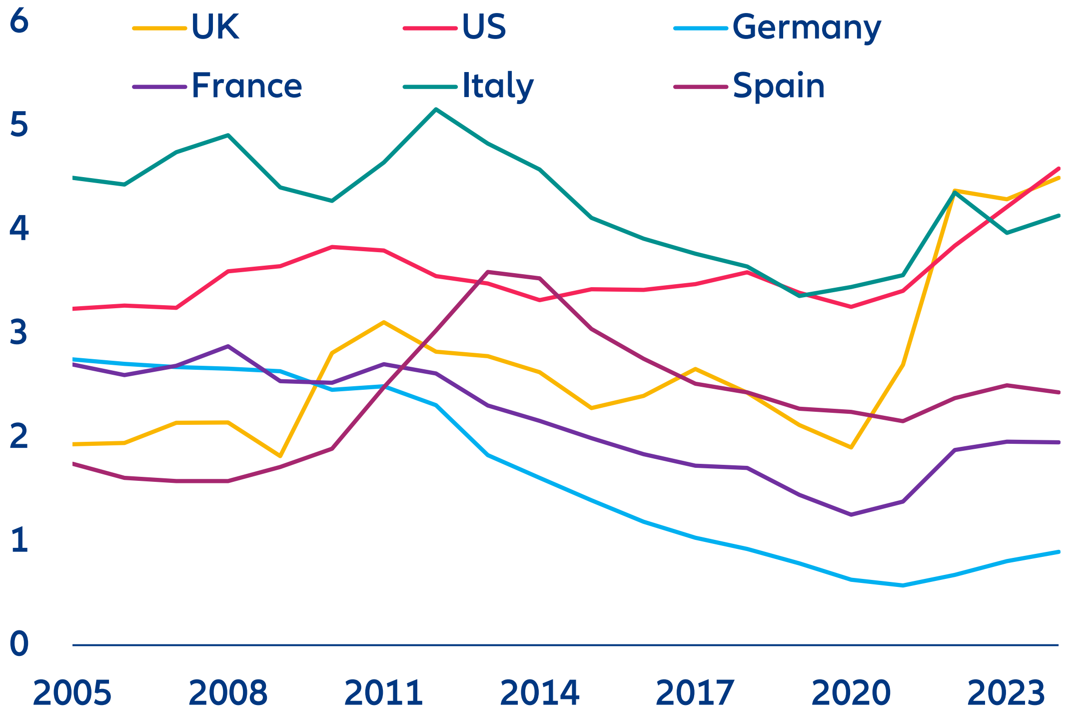


Sources: LSEG Datastream, Allianz Research
Notes: ECB restrictiveness is defined as the real policy rate minus the Laubach Williams estimate of the neutral real policy rate. The real policy rate equals the refinancing rate (from 2014 the deposit rate) minus inflation

Mildly restrictive policy mix

Fiscal consolidation is needed as real interest rates will reach their highest levels since 2006

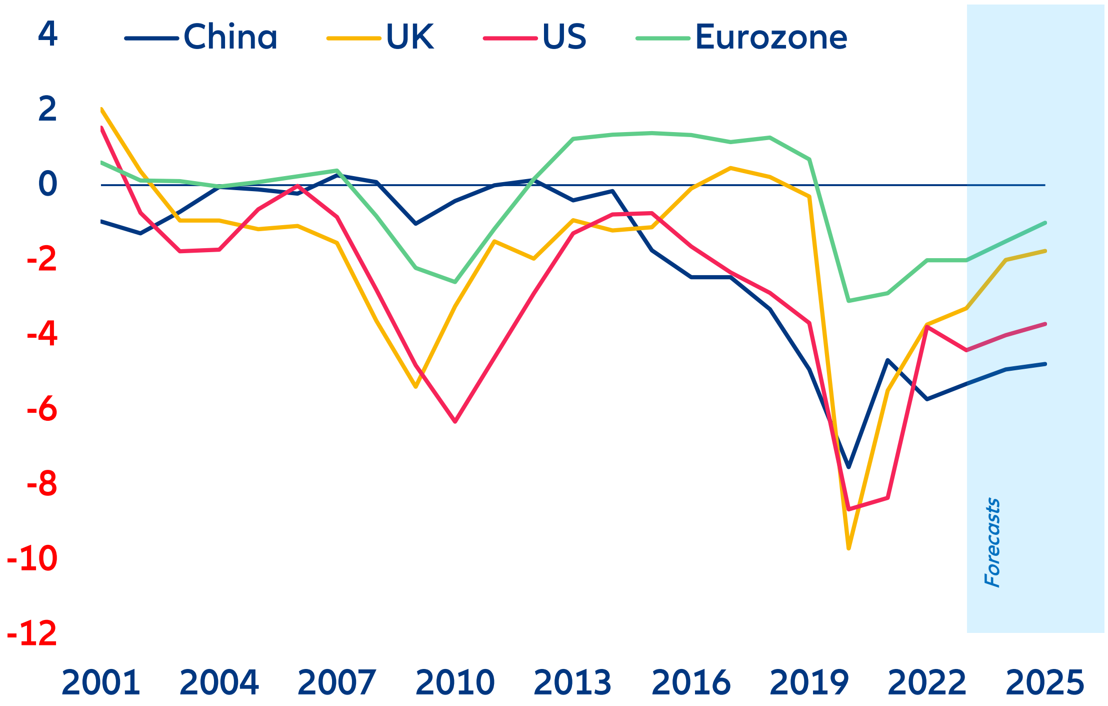
(government interest expenditures, % of GDP)



Sources: Refinitiv Datastream, Allianz Research

The politicized environment calls for moderate adjustments

(cyclically adjusted primary balance, % of GDP)

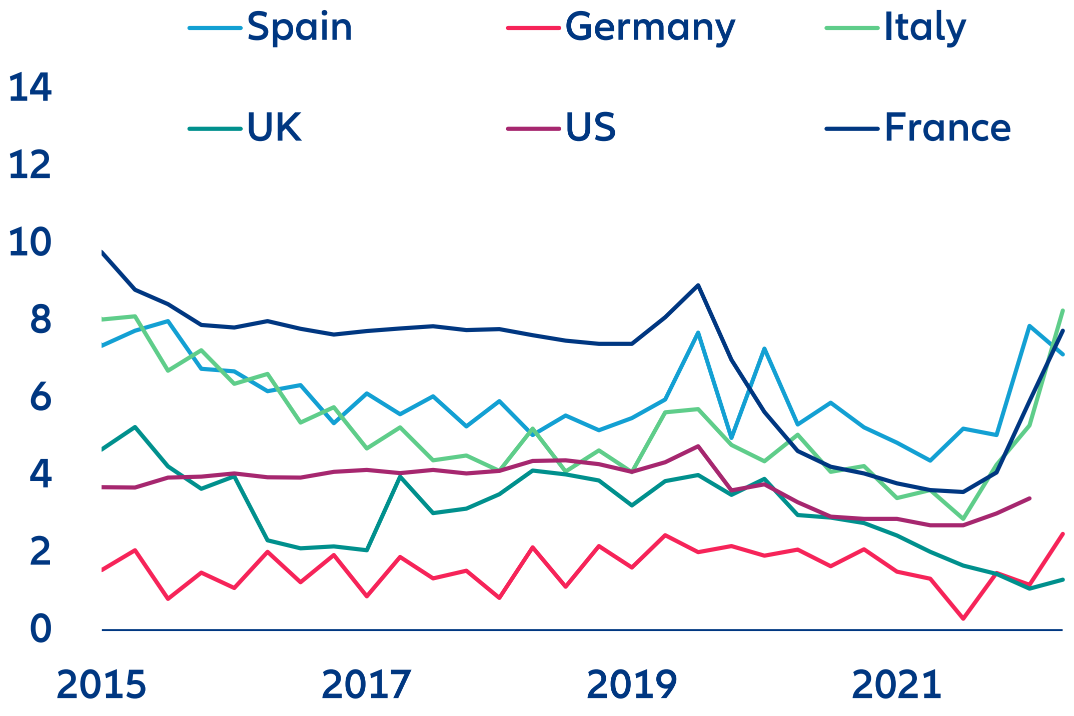


Sources: Refinitiv Datastream, IMF, Allianz Research

Net deceleration of credit in the economy

The debt-repayment wall can prove more challenging for European corporates given their exposure to banks

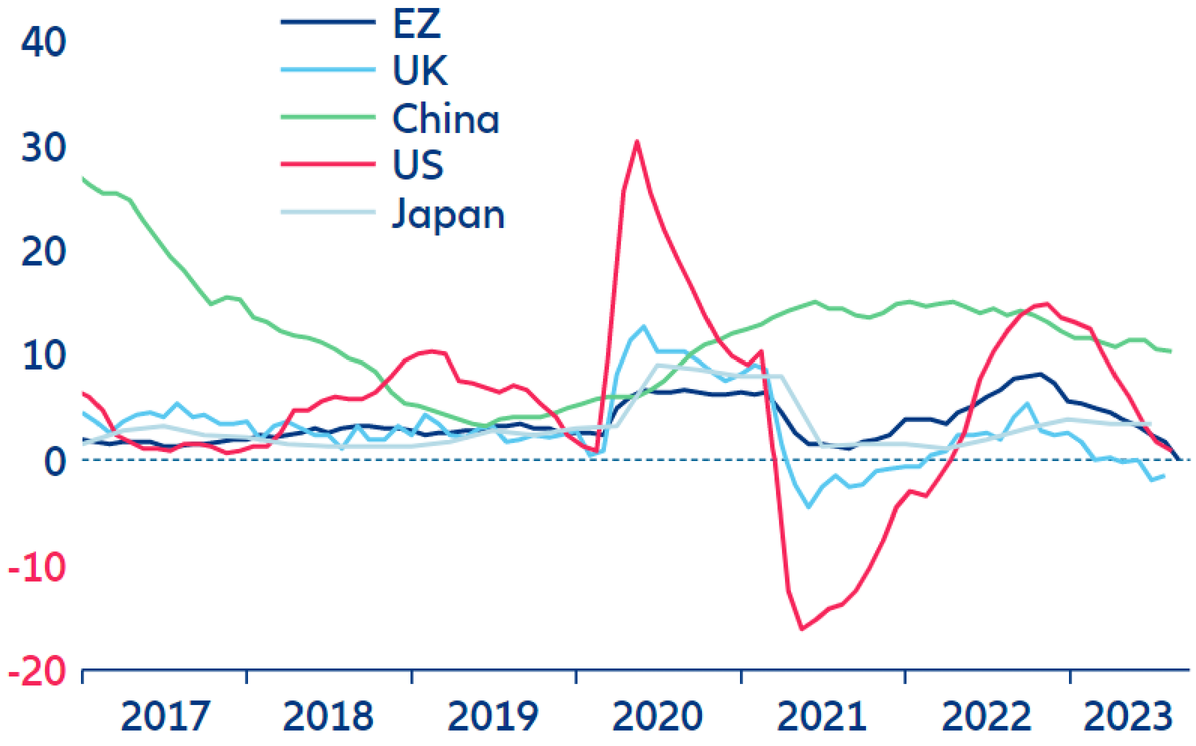
Net interest payments (paid – received), % of GOS



Sources: LSEG Refinitiv, Allianz Research

Higher interest rates start to bite with credit to non-financial corporates slowing down fast

Total loans to NFC, % y/y



Sources: LSEG Refinitiv, Allianz Research

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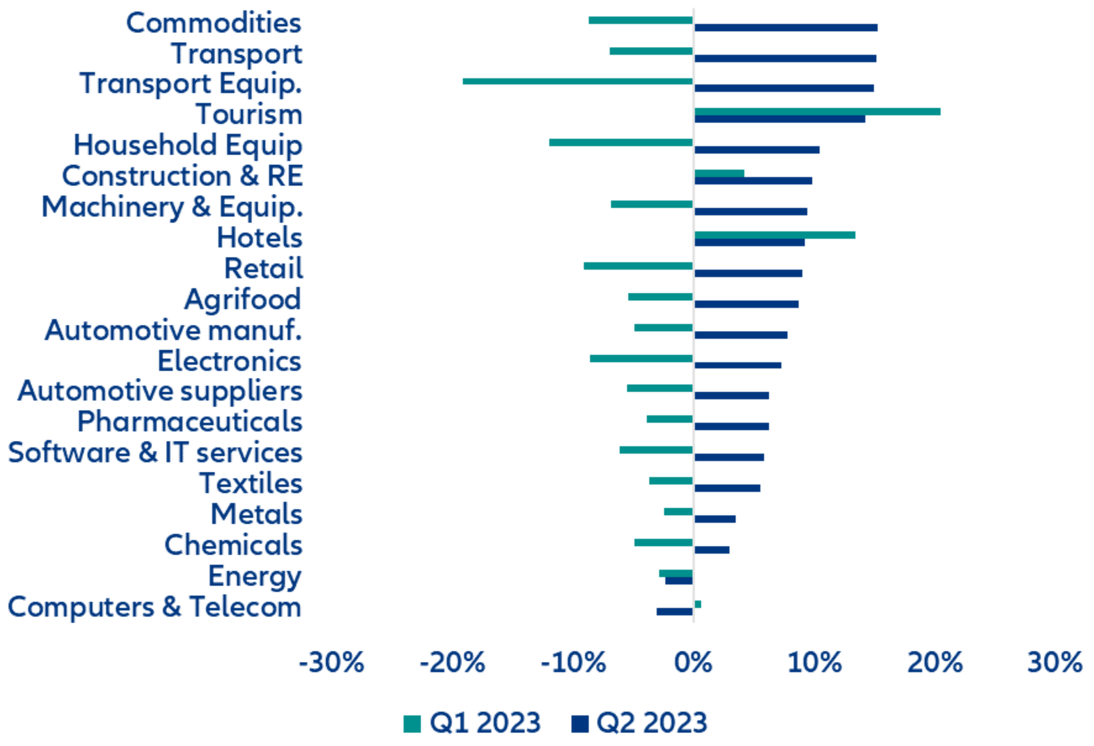
Corporates feeling the pinch from higher costs & lower revenue growth

Unfavorable expense momentum…

(q/q change in operating expenses, %)

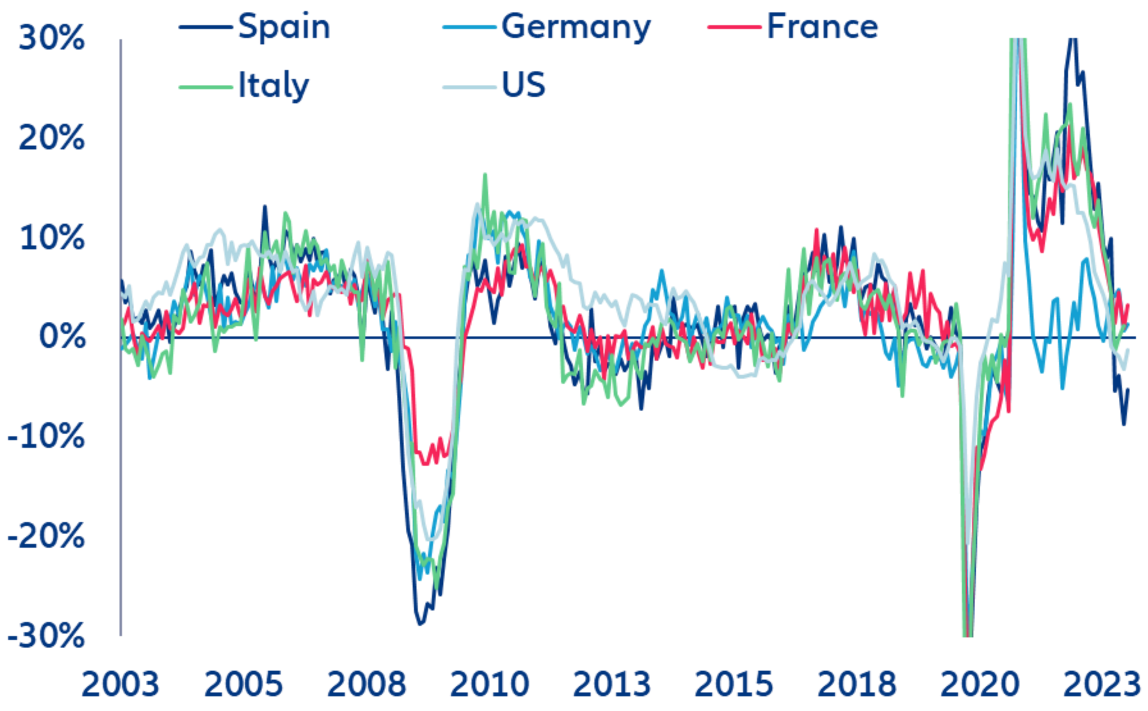


Sample of 23,000 listed global corporates

Sources: Refinitiv Datastream, Allianz Research

…alongside turnover slump

(industrial turnover, y/y)



Sources: Refinitiv Datastream, IMF, Allianz Research

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Business insolvencies: Normalizing at a high speed

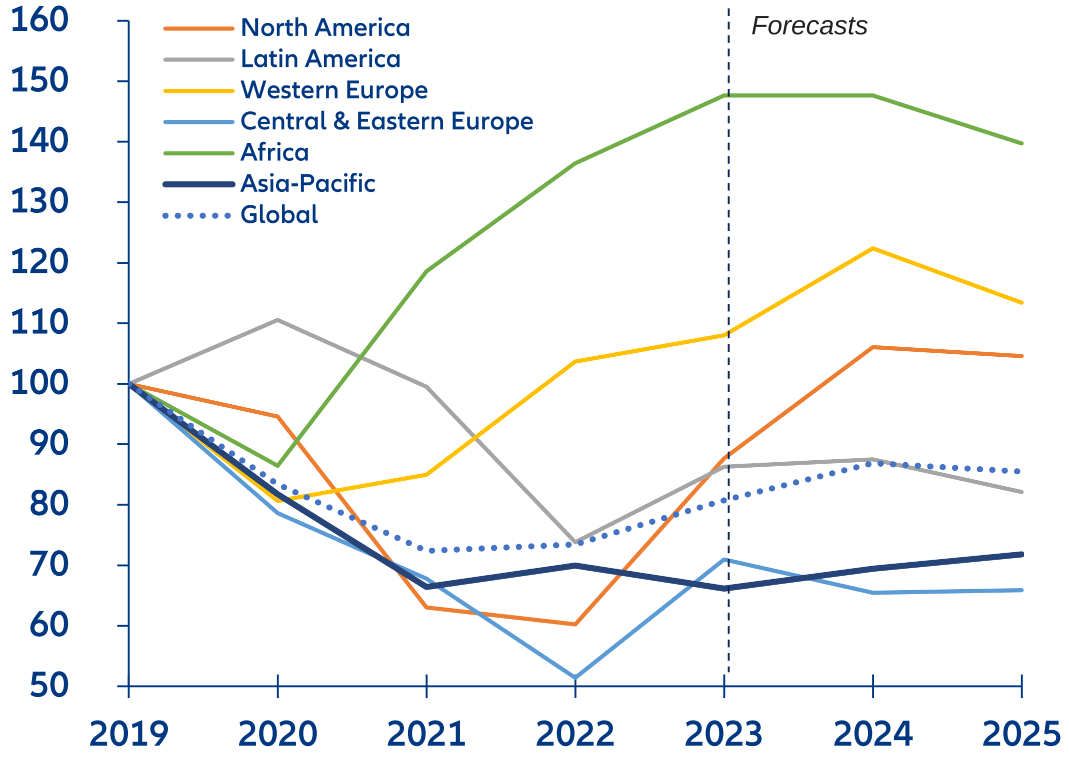
North America and Europe are leading the global rebound, selected countries

Cumulative change over 2023 and 2024	Very low level (more than -20%)	Low level (-20% to -5%)	High level (-5% to +20%)	Very high level (+20% and more)
Strongly increasing (+30% and more)		Brazil Estonia Italy Japan	Netherlands US	Ireland Poland South Korea
Noticeably increasing (+15% to +30%)	Chile Turkey	Lithuania	Australia France Germany Luxembourg New Zealand Norway Portugal	Canada Finland Hungary UK Sweden
Increasing (0% to +15%)	India Latvia	Colombia Czechia Slovakia	Austria Belgium Bulgaria Switzerland Romania	Denmark Morocco Spain
Decreasing	China Russia Singapore	South Africa	Taiwan	Hong-Kong

2024 expected level compared to 2019

Sources: national sources, Allianz Research

Still higher levels to expect in most countries and regions in 2024, index 100 = 2019



Provisional forecasts
Sources: national sources, Allianz Research

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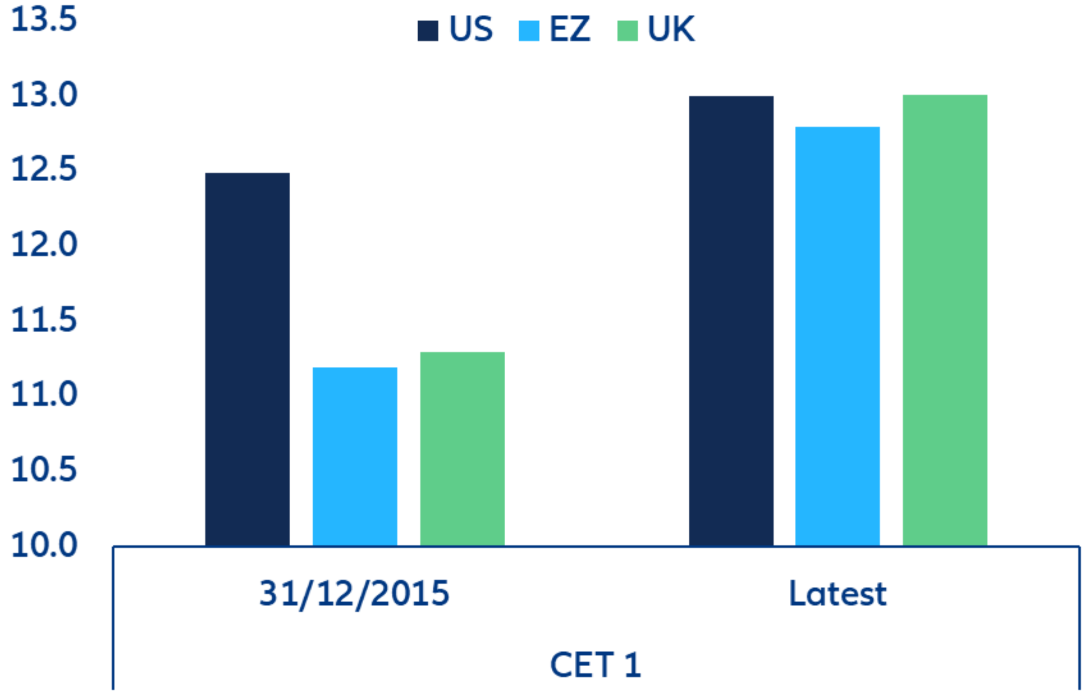
Banks are better prepared to absorb shocks, still face increasing pressures

Banks are better capitalized compared to 2015 and able to absorb shocks…

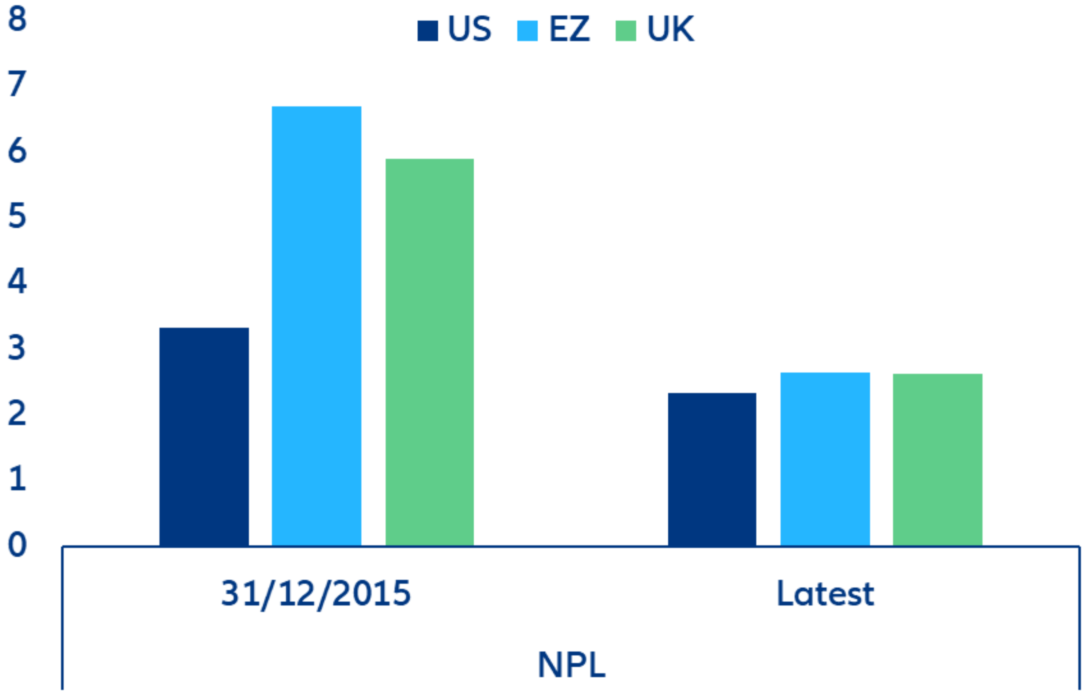
Tier 1 capital ratio (%)



Sources: LSEG Refinitiv, Allianz Research. Note Note: The figures refer to G-SIB= global, systemically important banks.

…but fears of a corporate-bank doom loop can re-emerge if asset quality deteriorates

Non-performing loan ratio (%)



Sources: LSEG Refinitiv, Allianz Research

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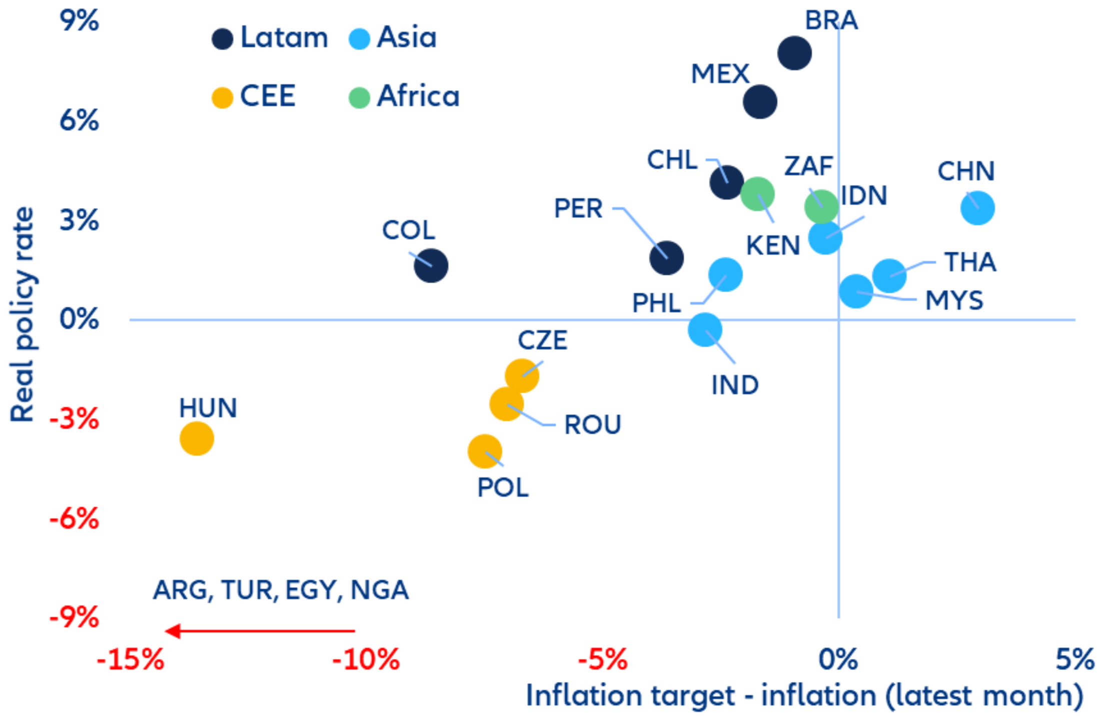
Prolonged high AE rates to stall EM policy normalization; risks of politics-induced errors grow

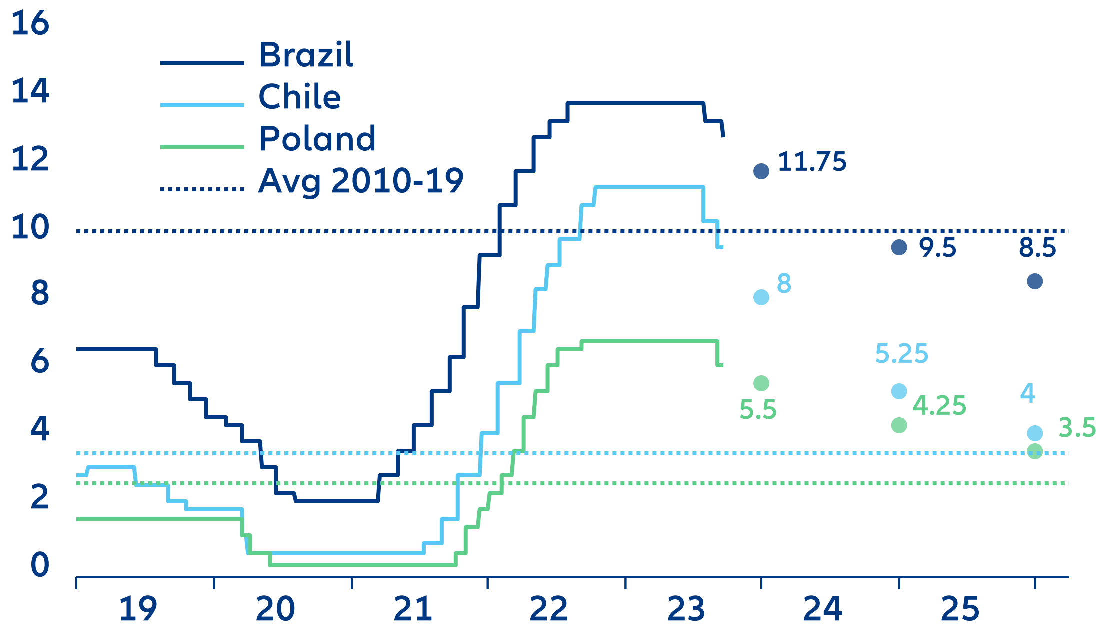
Widespread positive real policy rates (excl. Eastern Europe) as a sign of effective fight against inflation



Sources: LSEG Datastream, Allianz Research. Bubbles = GDP.

Policy normalization has started but few will manage to cut as quickly as desired considering weak growth

central bank policy rates in selected EMs



Sources: LSEG Datastream, Allianz Research. Notes: \1 A selection of CBs that are "ahead of the curve" in terms of cuts; \2 Dots represent AZ forecasts for year-end; \3 for EM-Asia we expect a milder and delayed normalization, mirroring the patterns with the hikes.

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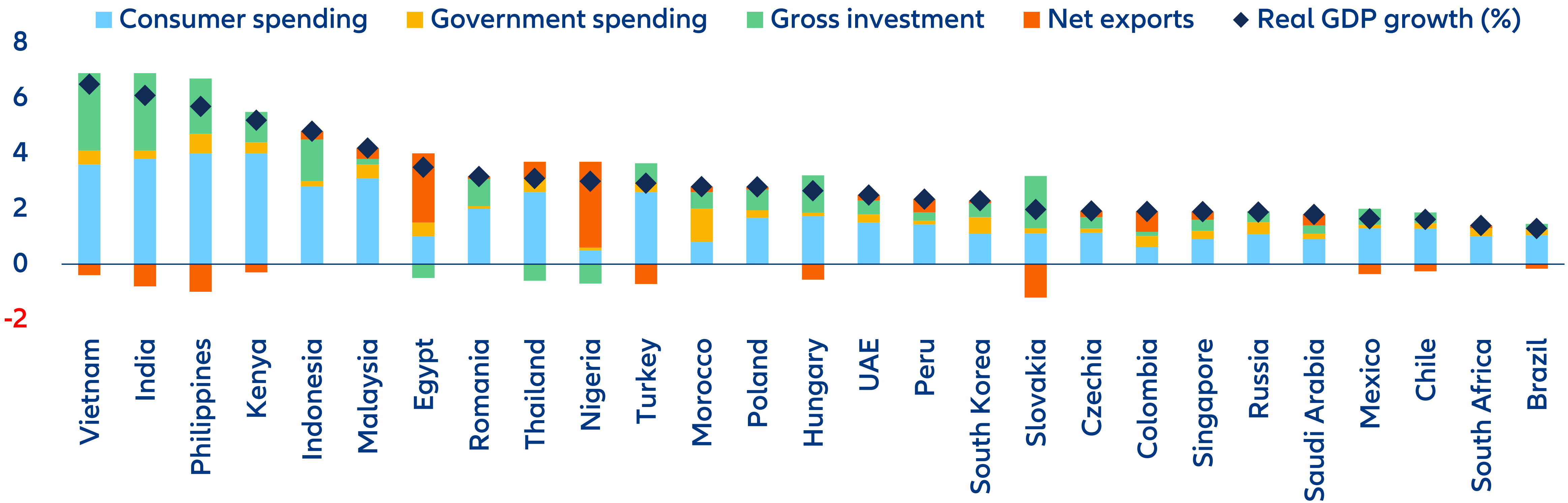
Most emerging markets are also confronting weak domestic demand

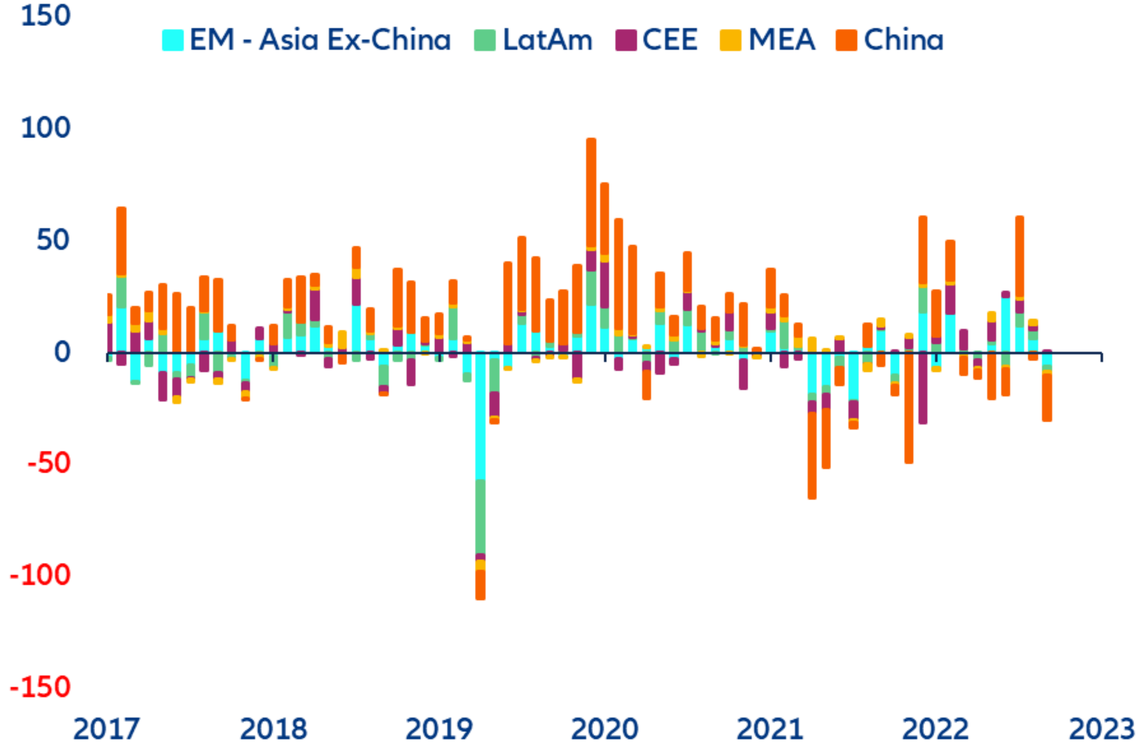
Real GDP growth contributions, 2024, pp



Sources: Allianz Research

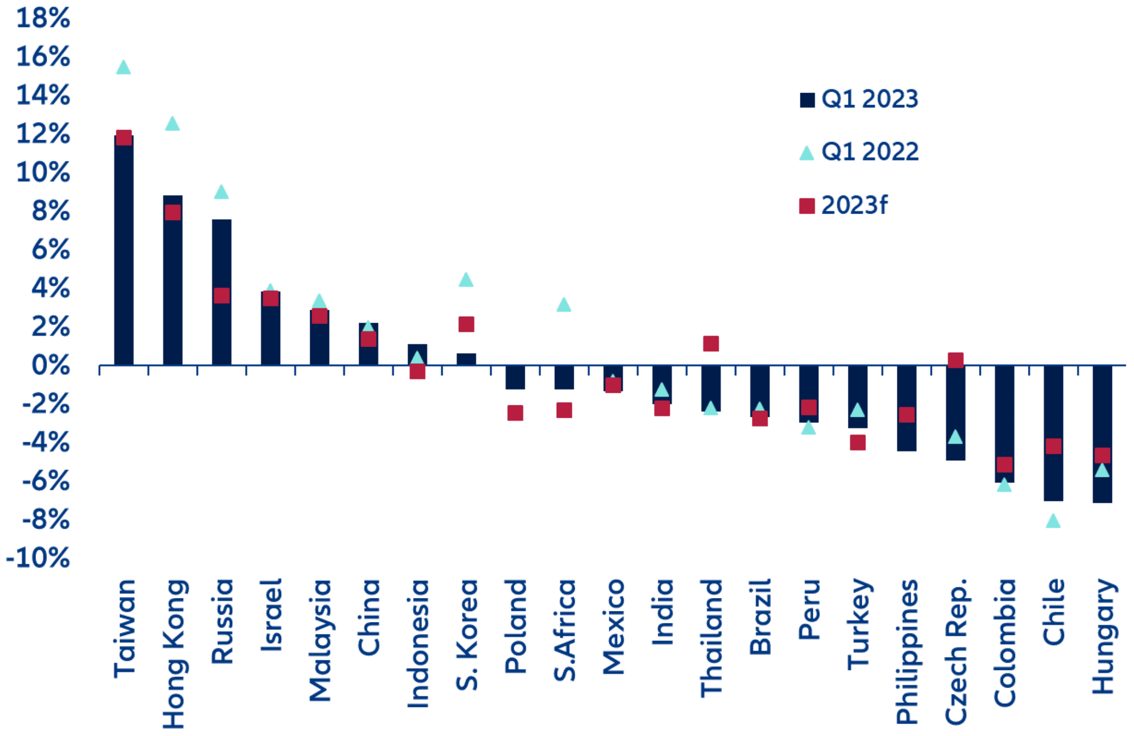
Portfolio flow pressures are likely to continue in EMs, but imbalances are set to improve

Exposure to sentiment swings in China is particularly pronounced in Asia, portfolio flows (USD bn)



Sources: IIF, Allianz Research

Current account adjustments are taking place, Asia remains in a favorable position, % GDP



Sources: Refinitiv, Allianz Research

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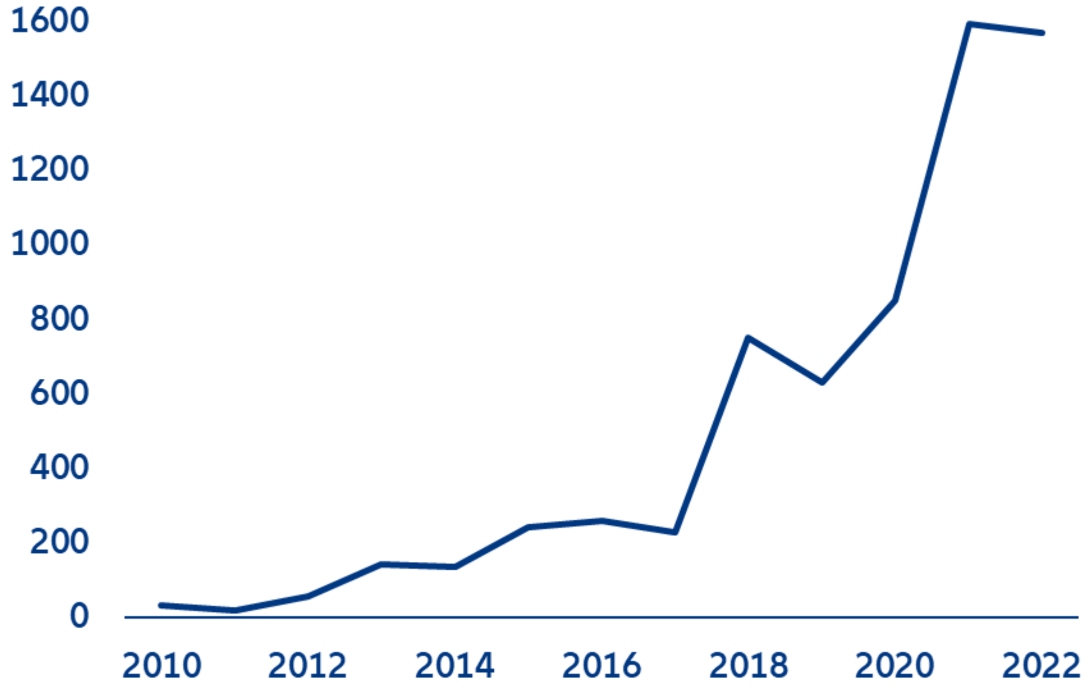
Industrial policy: from passé to fashionable again, but beware the strings attached

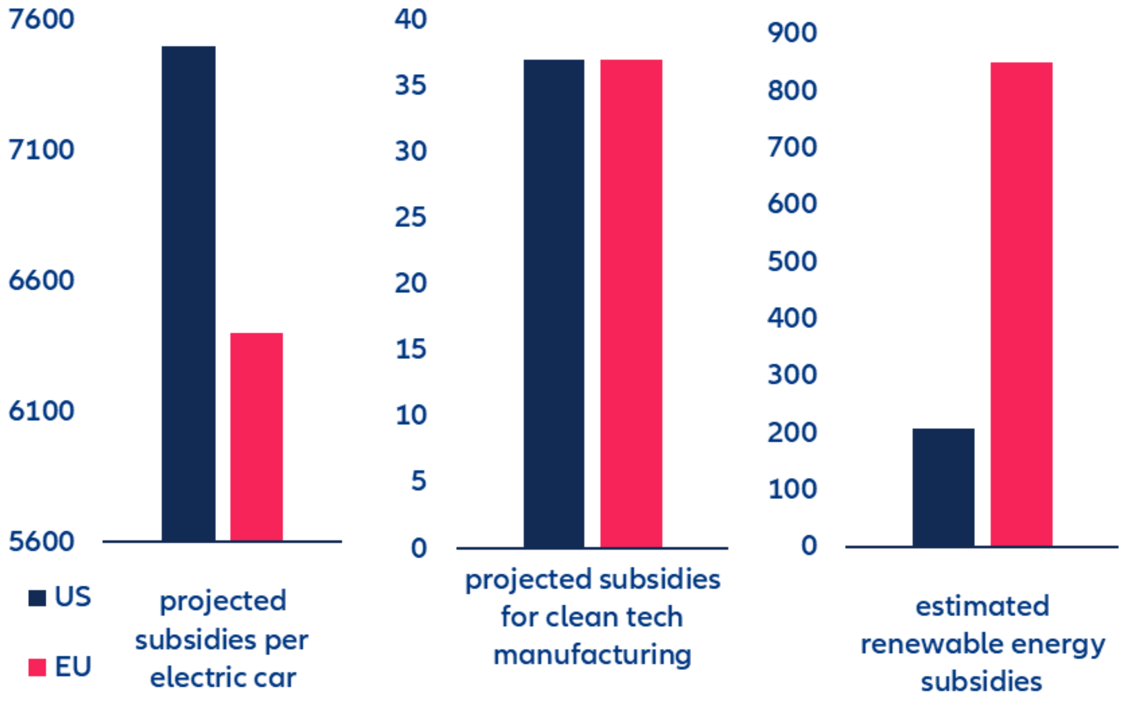
Global industrial policy interventions on the rise



Sources: Juhasz, Lane and Rodrik (2023), Allianz Research, Note: Juhasz, Lane and Rodrik (2023) apply a large natural language model to classify policy descriptions from the GTA database

Green subsidy levels in the US versus EU are similar in size but very different in implementation

(2022-2031, in USD (left) and bn USD (center and right))



Sources: National Sources, Allianz Research

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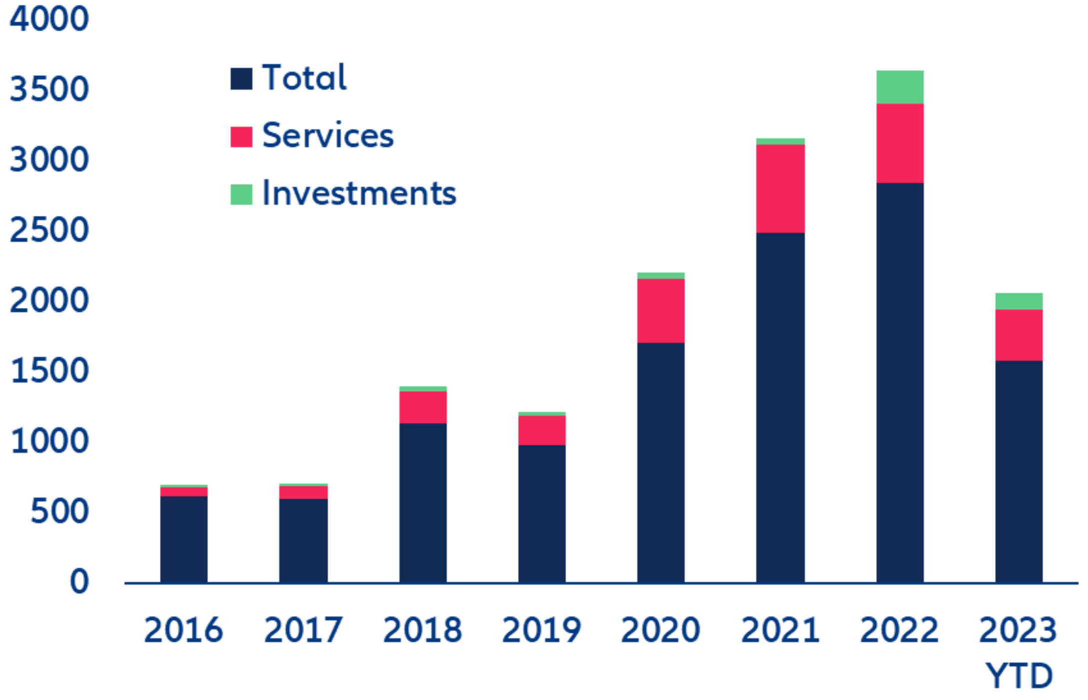
Protectionism going forward ?

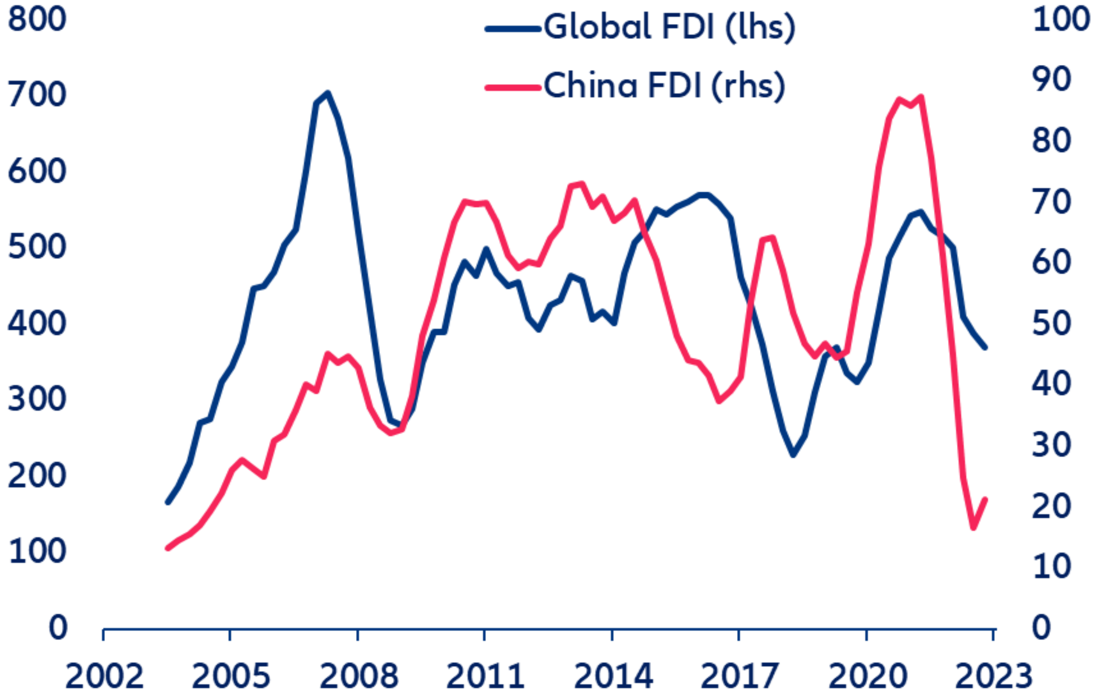
Rising trade restrictions worlwide



Sources: Global Trade Alert as of Aug. 2023, IMF, Allianz Research

Global FDIs sharply dropping

(4 quarter average, USD Bn)



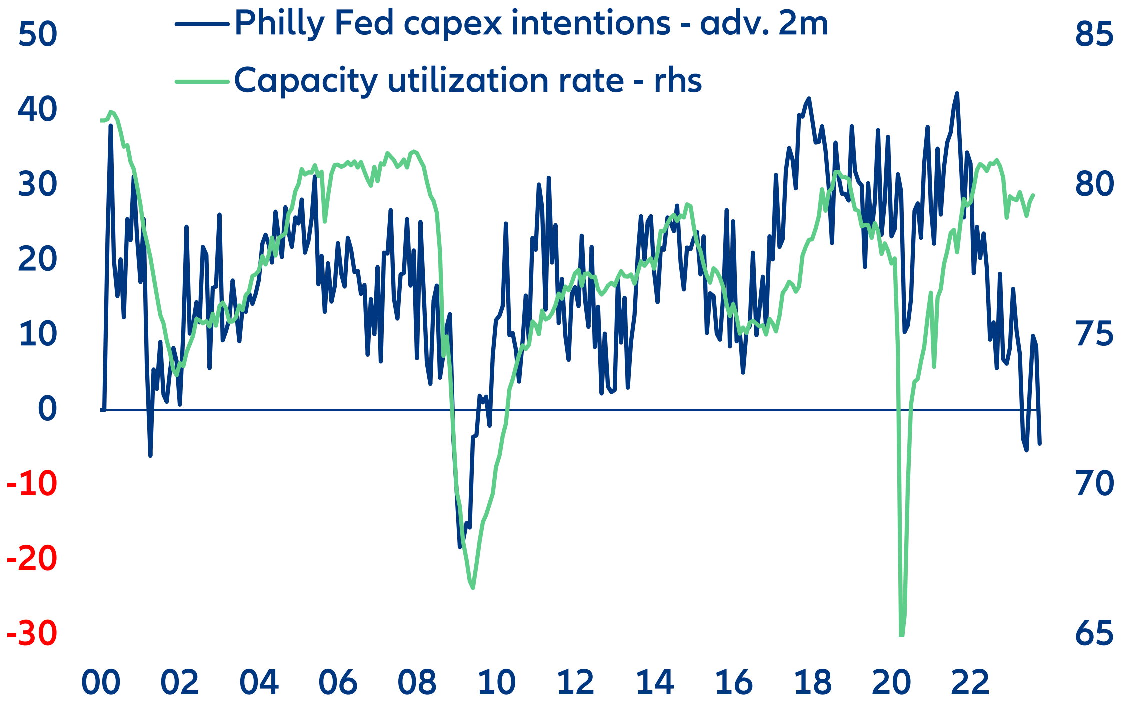
Sources: LSEG Refinitiv, Allianz Research

Regional outlooks 2023-2025

Allianz

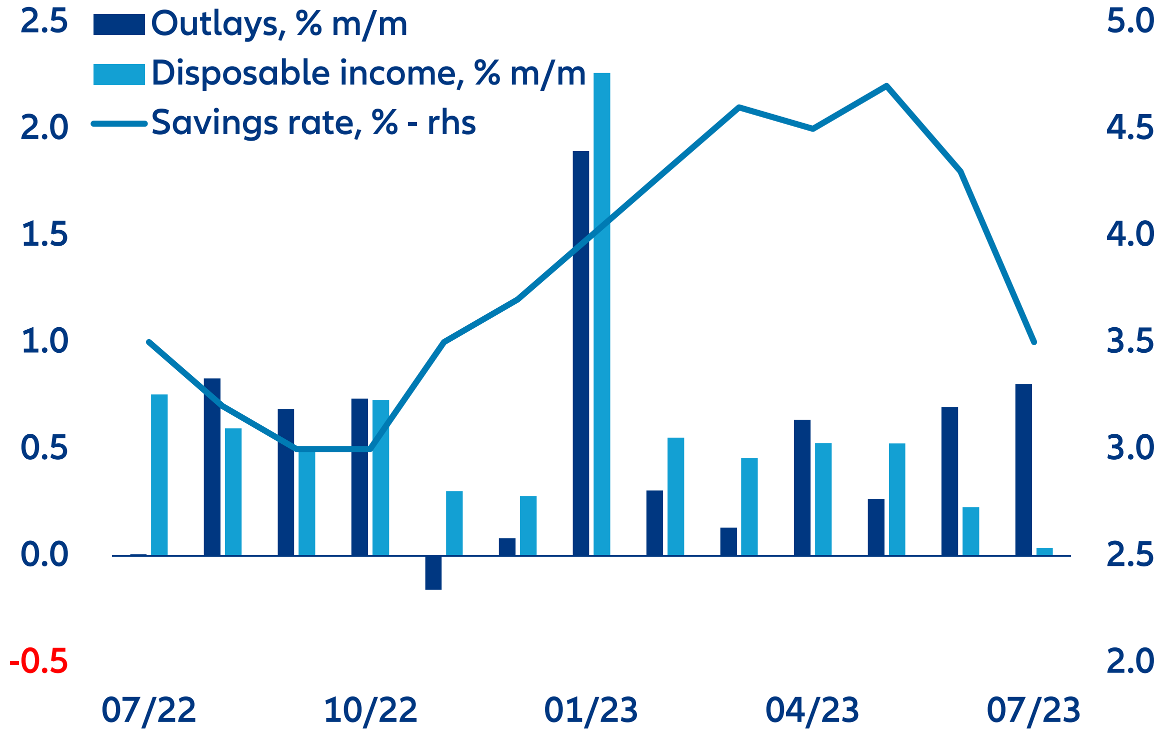
US heading towards lackluster growth

Muted capex intentions signal struggling manufacturing sector ahead



Sources: Refinitiv Datastream, Allianz Research

Household income is slowing while the savings rate is already low, meaning softer consumption ahead



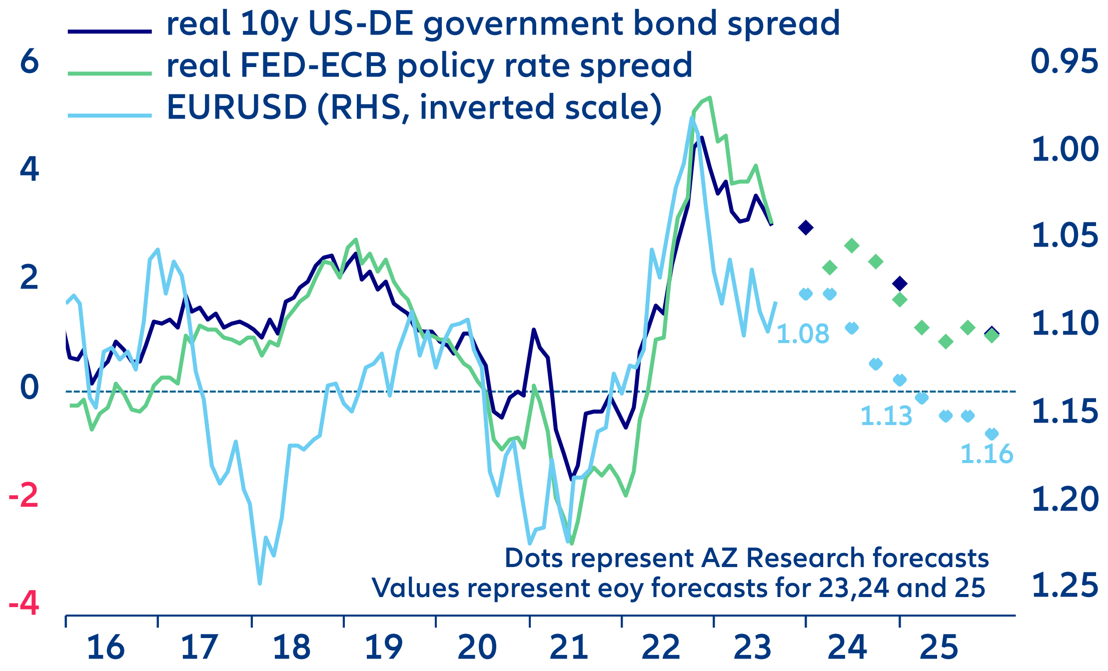
Sources: Refinitiv Datastream, Allianz Research

Allianz

The USD tends to appreciate on average after the presidential elections

USD to remain strong in the short-run but valuations suggest weakness in the mid-run

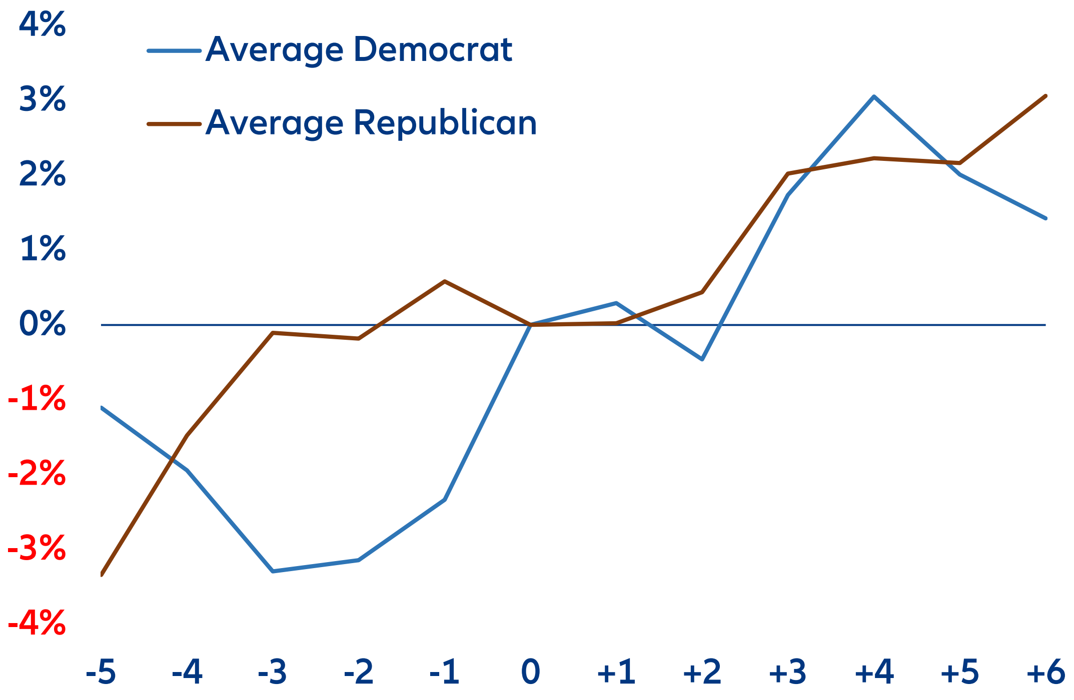
Real transatlantic spread and EURUSD (inverted)



Sources: LSEG Datastream, Allianz Research

Markets anticipate the 'election effect' in the case of Republican victory

USD performance 6 months before and after the elections take place

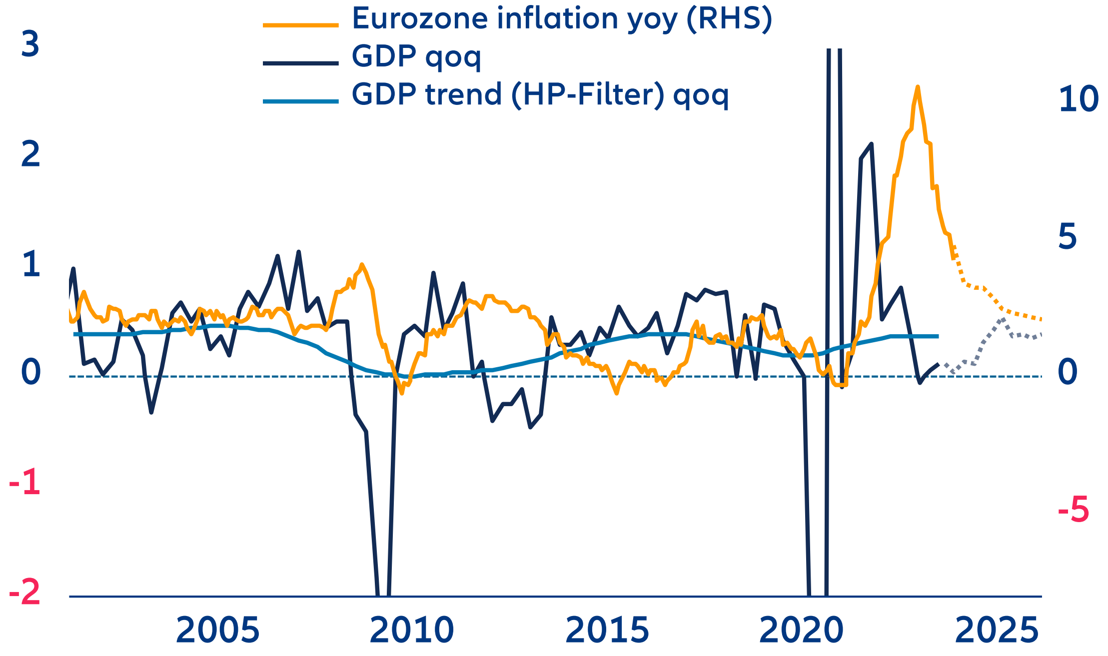


Sources: LSEG Datastream, Allianz Research

Allianz

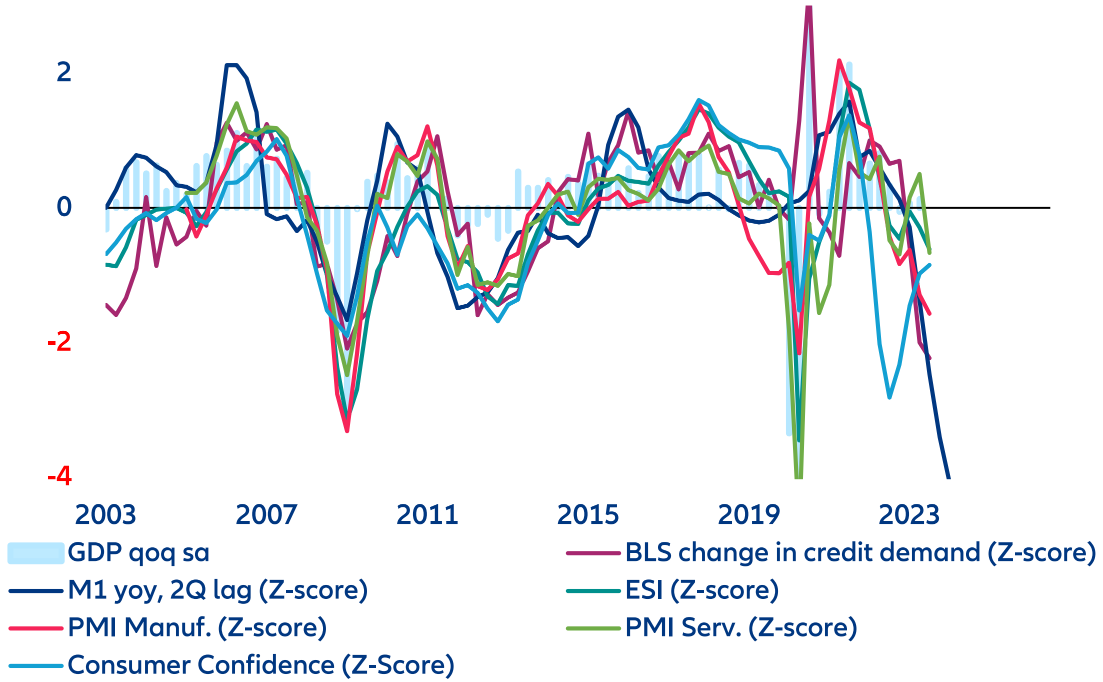
Eurozone in stag(dis)flation but significant downside risks loom

Eurozone growth has been below trend since Q4 2022



Sources: Datastream, Ameco, Allianz Research

High downside risks and uncertainty amid elevated dispersion



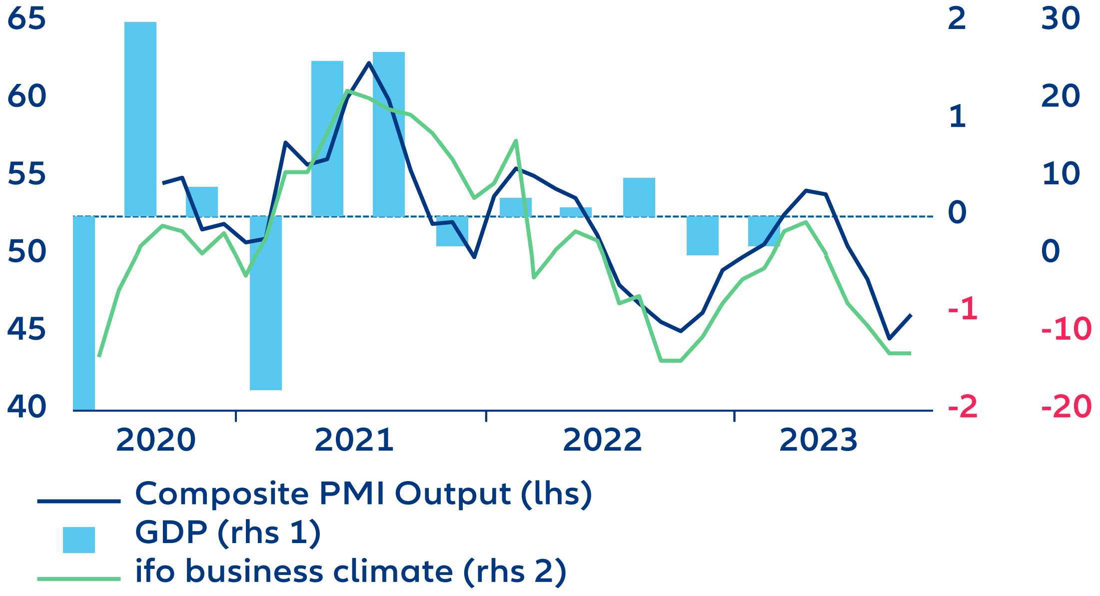
Sources: Datastream, Ameco, Allianz Research

Allianz

German economy set for recession

GDP, Composite PMI output, ifo business climate

(q/q % and Index)



Sources: Refinitiv Datastream, Allianz Research

Strengthening Germany as place to innovate, invest and create high-value jobs despite…

…cyclical challenges

- Slowing global demand
- Export specialization of highly cyclical goods (e.g. cars, machinery, chemicals)
- Lopsided global growth in services
- US industry and Chinese economy slowdown
- Inventory correction

…structural headwinds

- Shortage of skilled workers
- Energy costs and green transformation
- Red tape and tax burdens
- Digitalization, AI and automation
- Political uncertainty

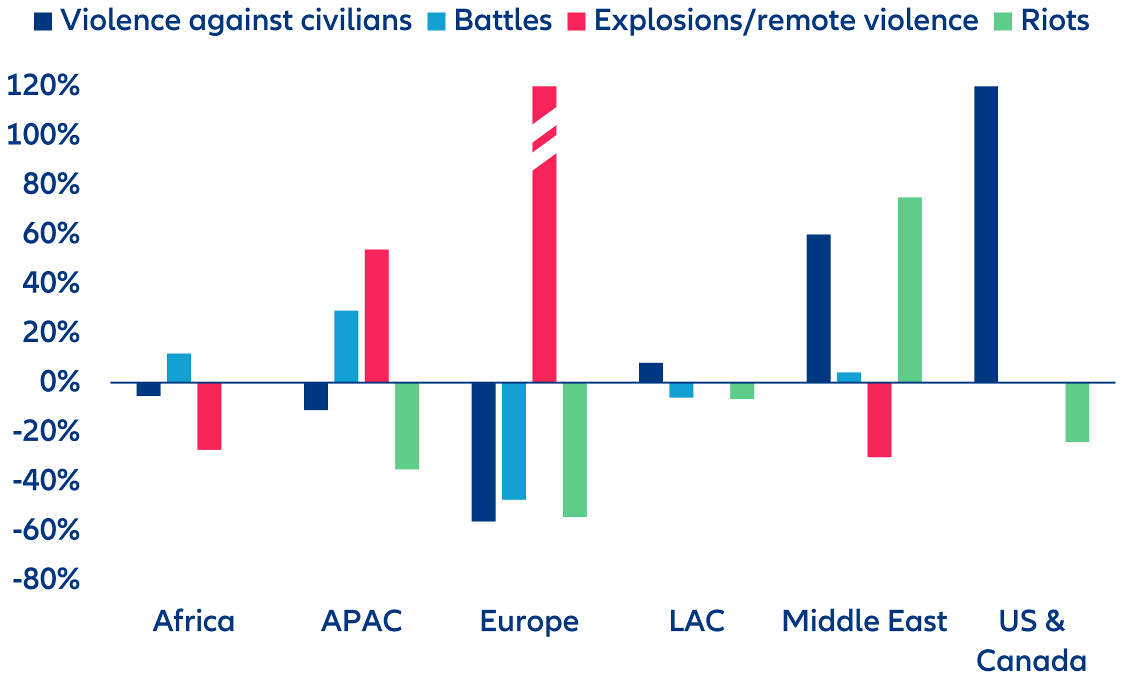
10-Punkte Wirtschaftsplan – what next?

- end policy uncertainty esp. future energy policy
- fewer and simpler regulations , less red tape
- faster planning and approval procedure s
- tax and pension reforms
- tackle skilled labor shortage

Allianz

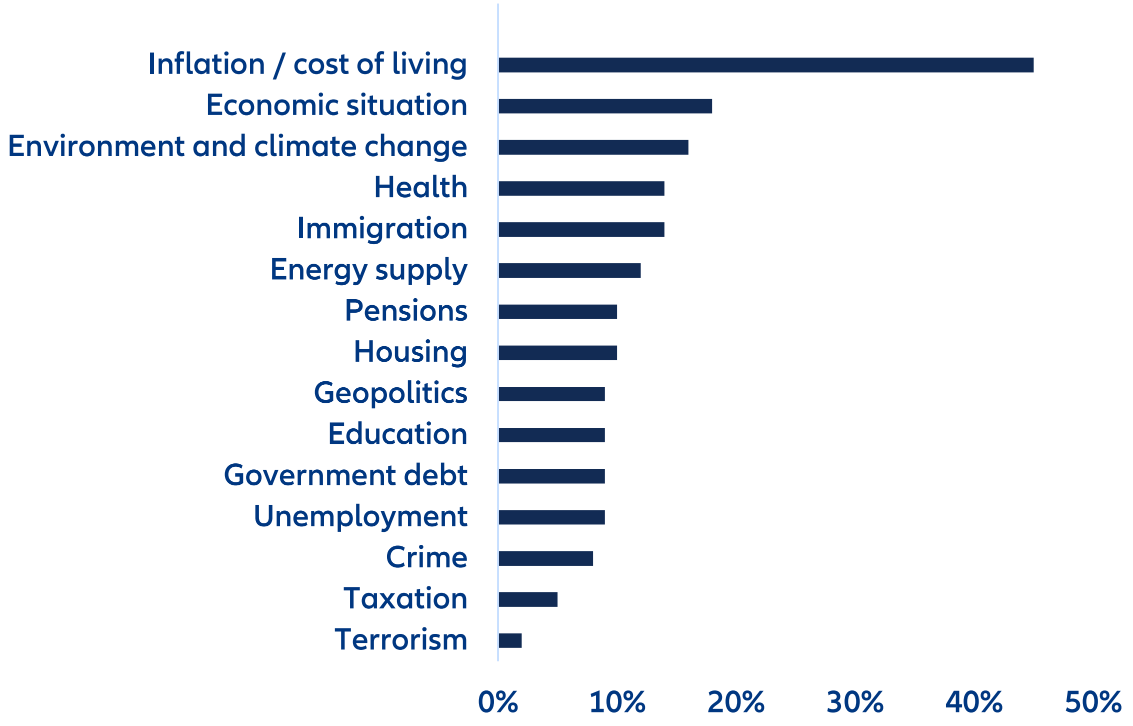
Rising political violence and social risk

Frequency of political violence events by type and region in 2023-ytd, change vs 2019-2022 average (%)



Sources: ACLED, Allianz Research

Most pressing issues facing EU countries (%)

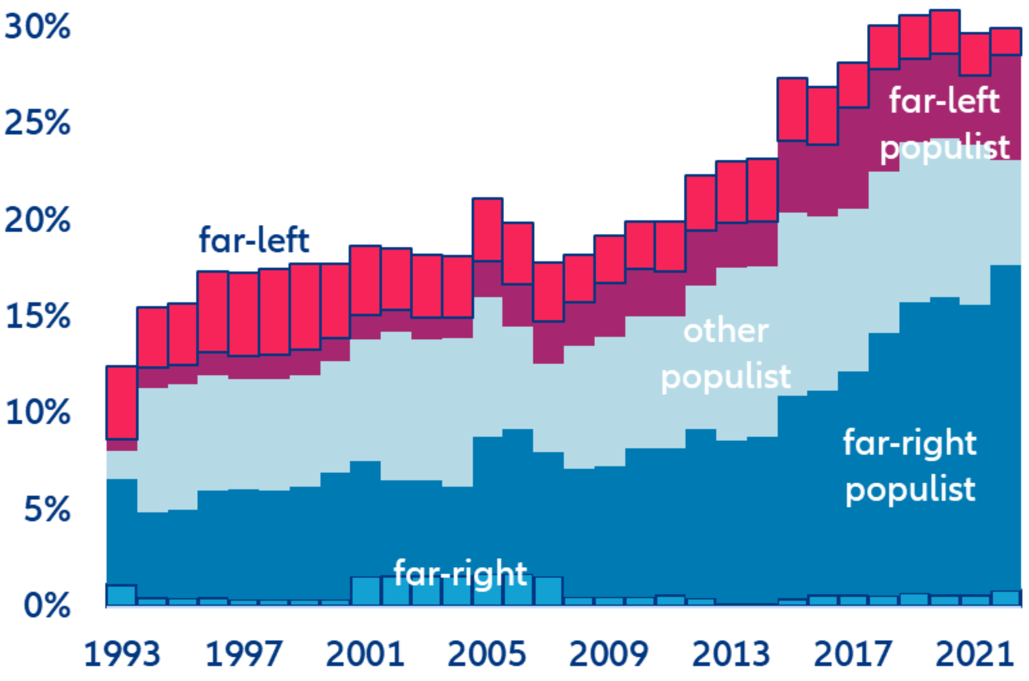


Sources: EU Standard Barometer Sprind 2023, Allianz Research

Allianz

The last thing the EU needs are illusory solutions

European populist parties have more than doubled their vote share in the last 30 years



Sources: Party classification from The PopuList 3.0, Vote share data from ParlGov and World Bank, Allianz Research

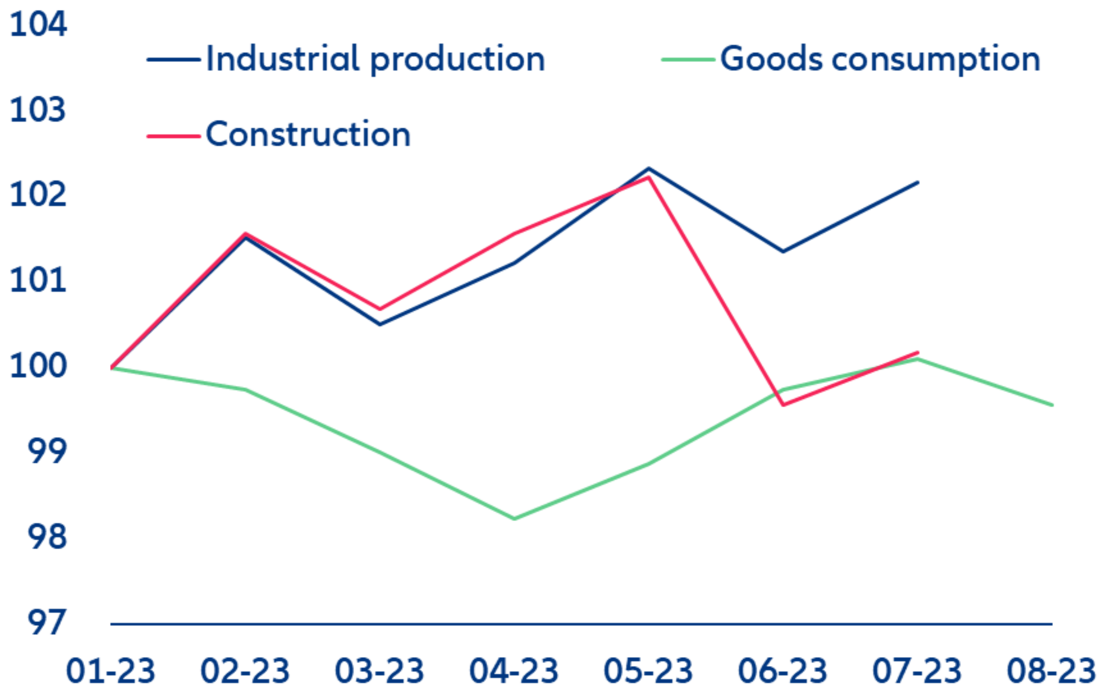
Correlation between the populist vote shares in Europe and economic policy uncertainty

Sources: Party classification from The PopuList 3.0, Vote share data from ParlGov and World Bank, Baker, Bloom, Davis (2016), Allianz Research

Allianz

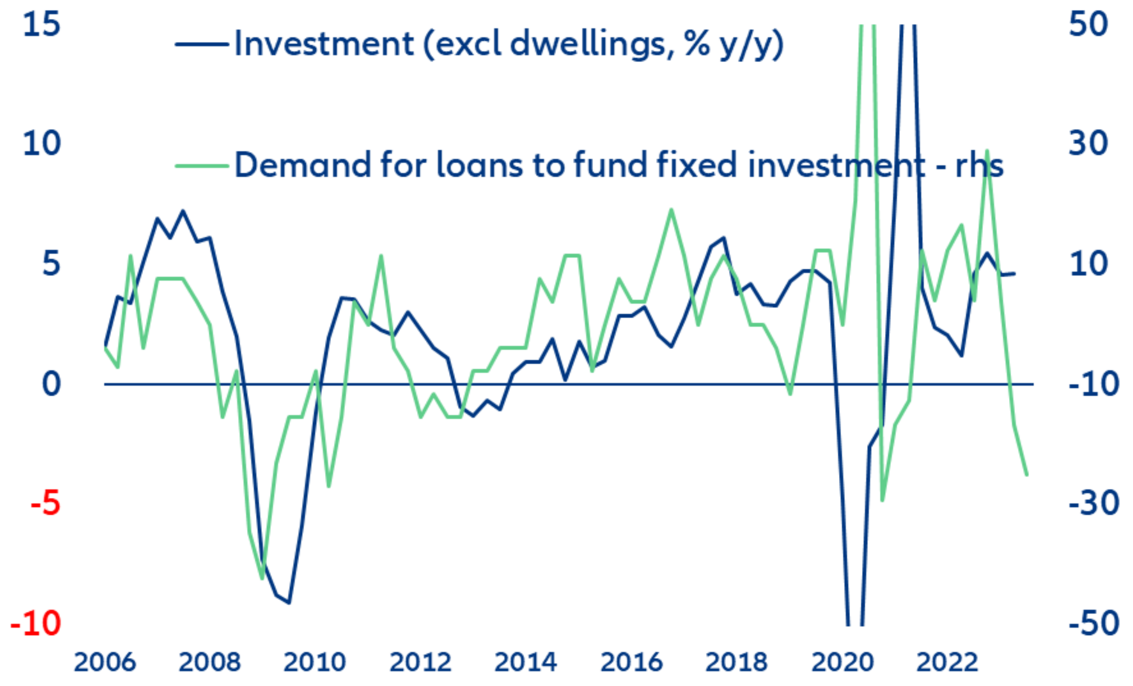
France : Few growth boosters in sight

Household (goods) consumption struggling to recover (Index, January 2023 = 100)



Sources: Refinitiv Datastream, Allianz Research

Business investment braced for a slowdown amid lower credit demand

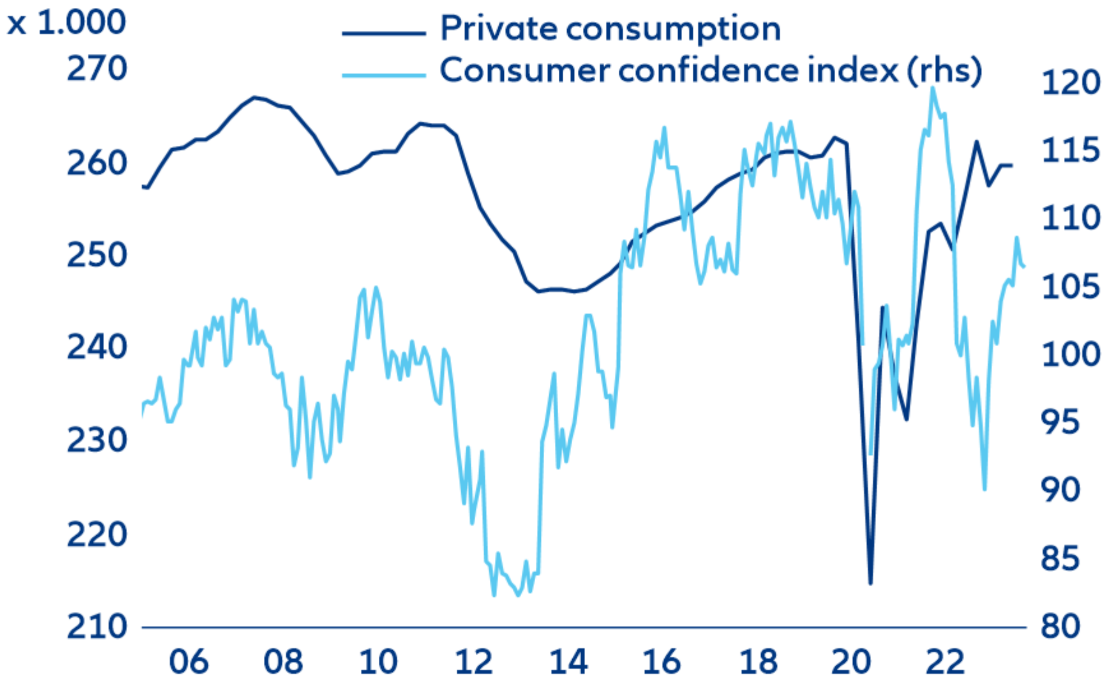


Sources: Refinitiv Datastream, Allianz Research

Allianz

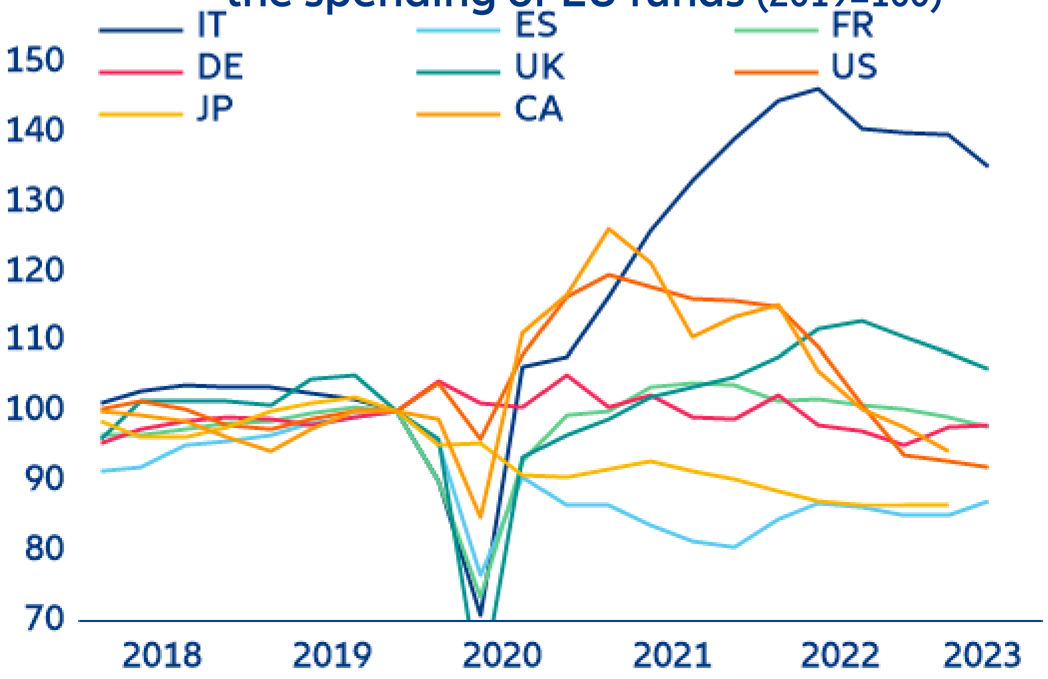
Italy: Engines of recent resilience to step back

Private consumption to slow down as households feel the impact of rising interest rates



Sources: Refinitiv Datastream, Allianz Research

Strong construction activity – linked to tax credit scheme – should normalize and not be fully offset by the spending of EU funds (2019=100)



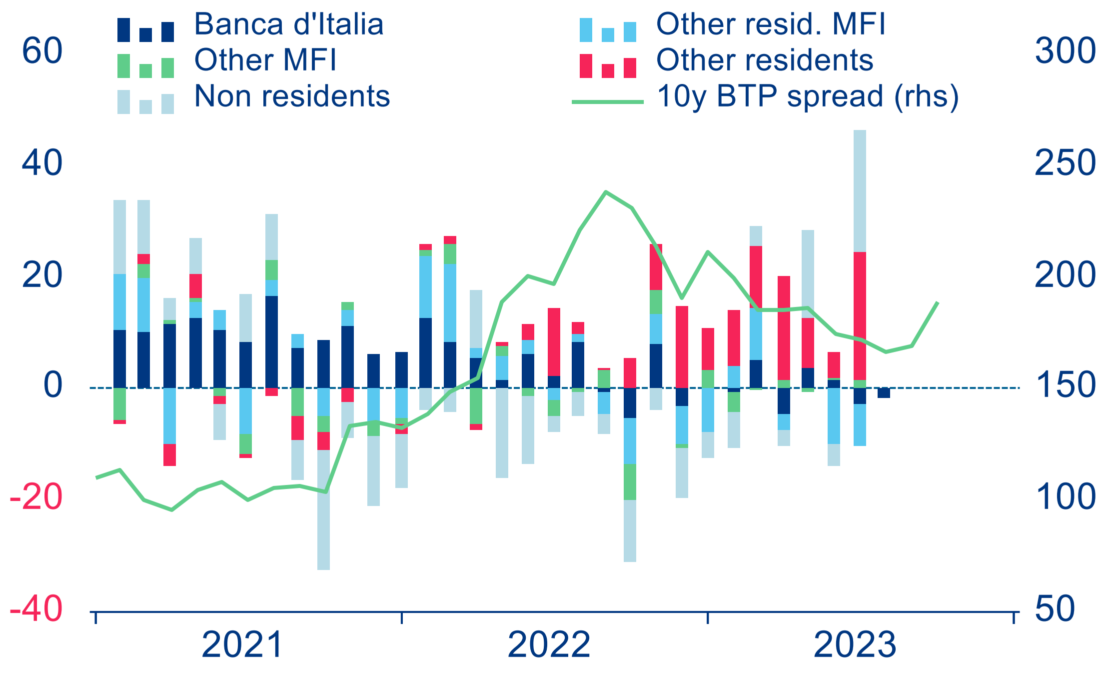
Sources: Refinitiv Datastream, Allianz Research

Allianz

Italy: Still good appetite for BTPs

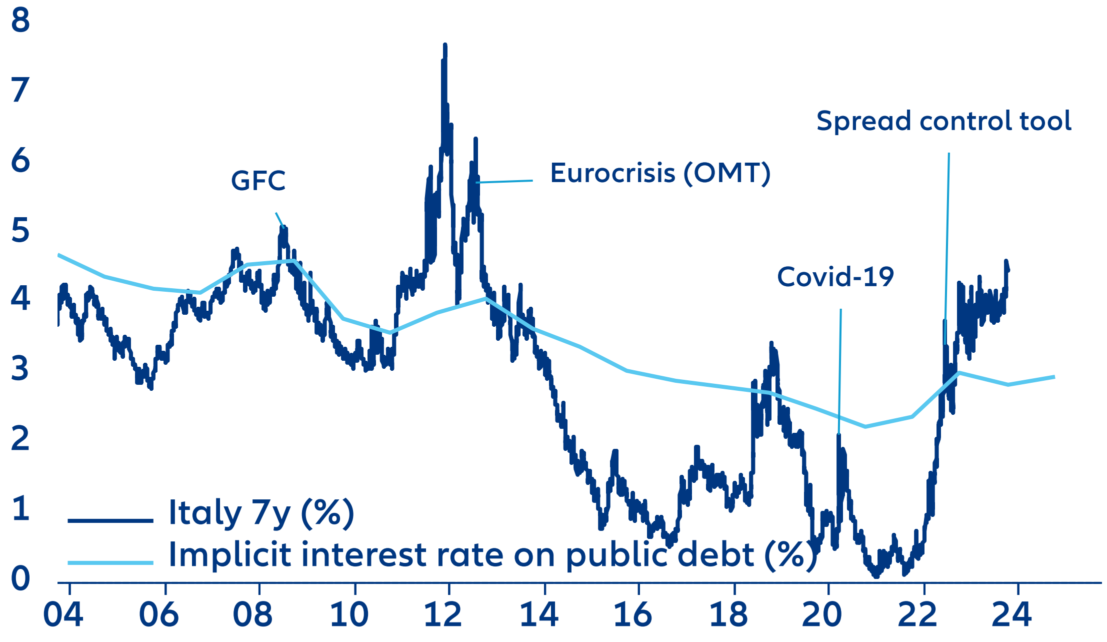
Retailers and foreign investors have taken over the ECB and are keeping Italian sovereign

Monthly Italian government bond flows (EUR bn)



Sources: Refinitiv Datastream, Allianz Research

Rollover risks remain under control so far

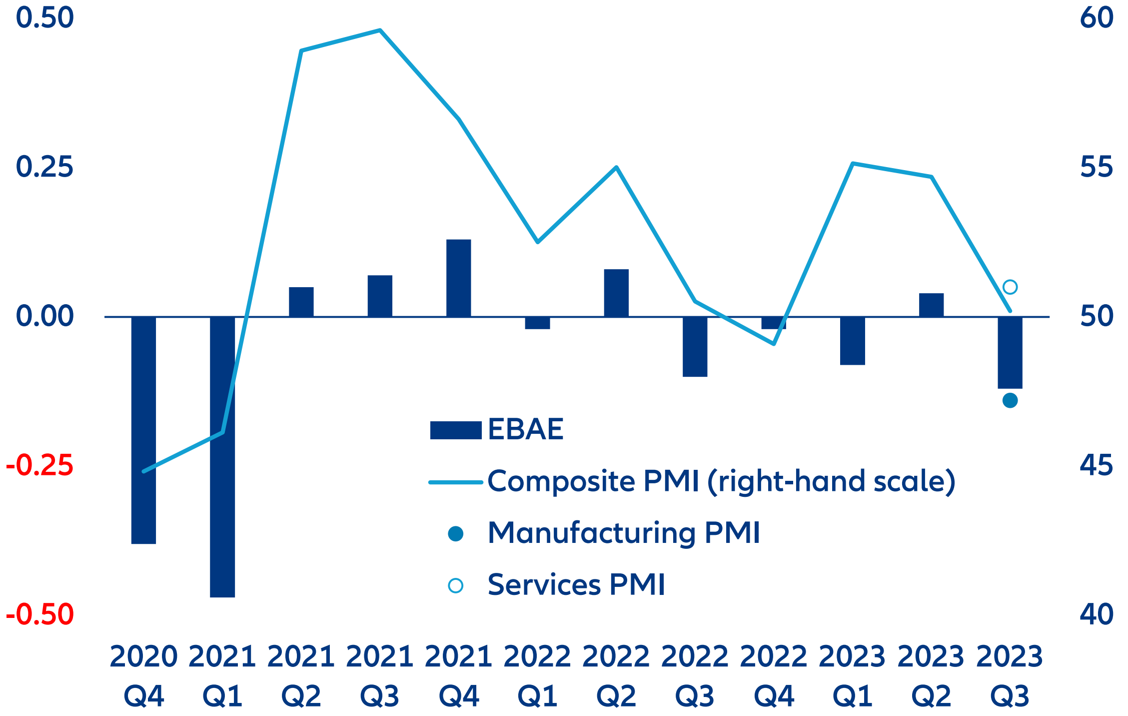


Sources: Refinitiv Datastream, Allianz Research

Allianz

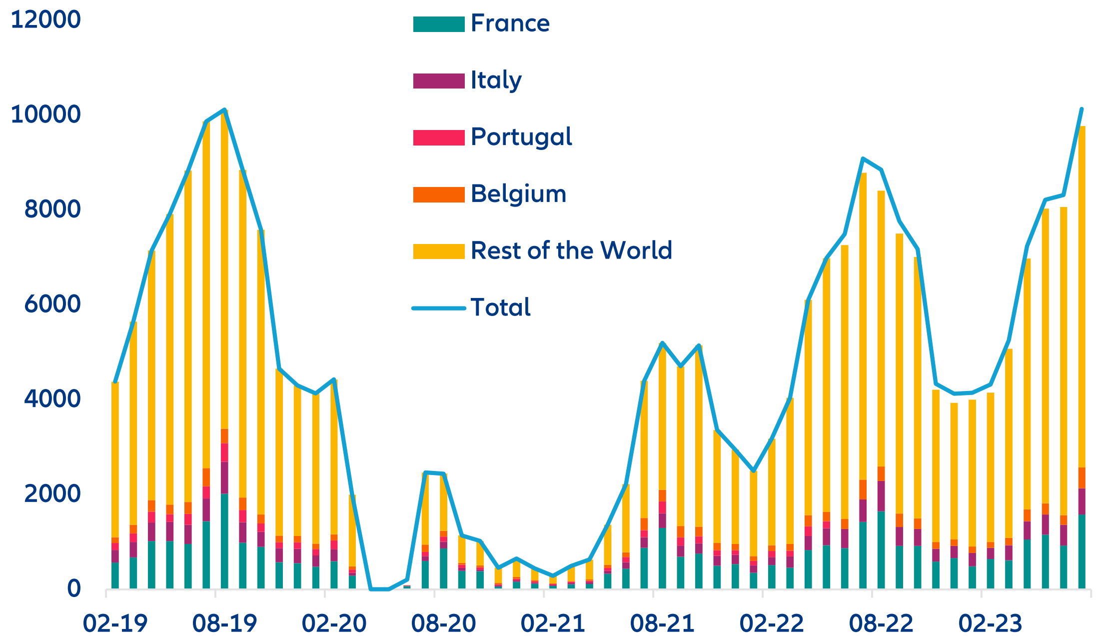
Spain : A two-sided story

Leading economic indicators suggest that economic growth may have decelerated slightly in Q3 2023



Sources: Bank of Spain, Datastream, Allianz Research. *EBAE corresponds to the Banco de España Business Activity Survey indicator

But strong tourism should continue to boost growth



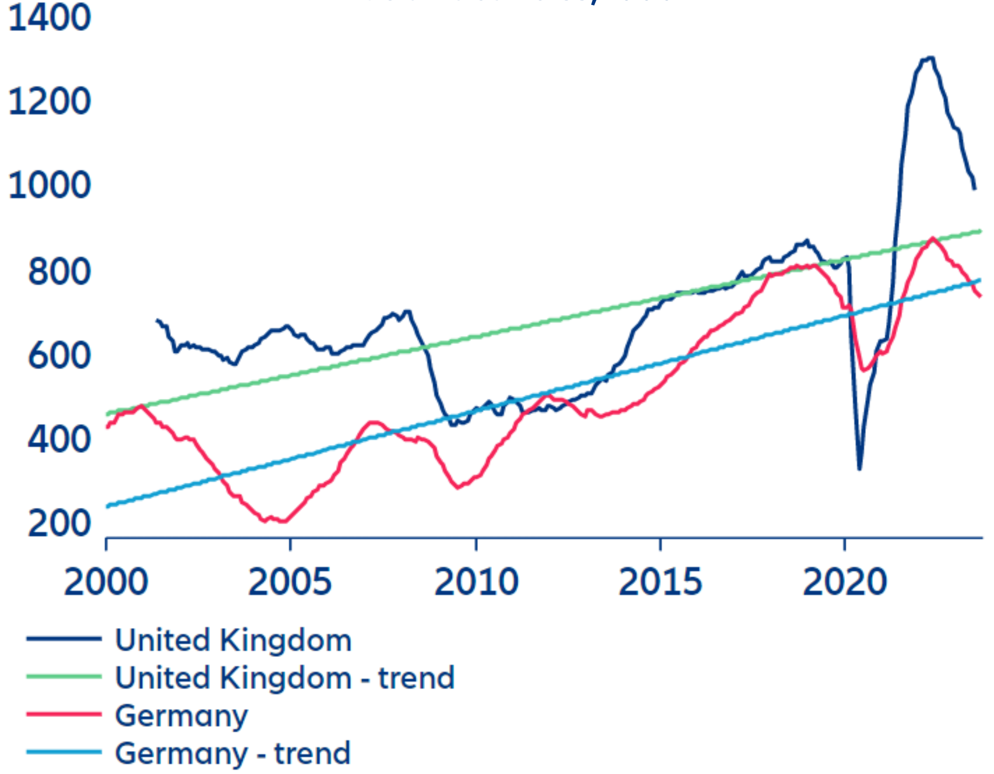
Sources: Refinitiv Datastream, Allianz Research

Allianz

UK: A long-lasting supply shock

Labor market remains tight despite recent rebalancing

Job vacancies, '000

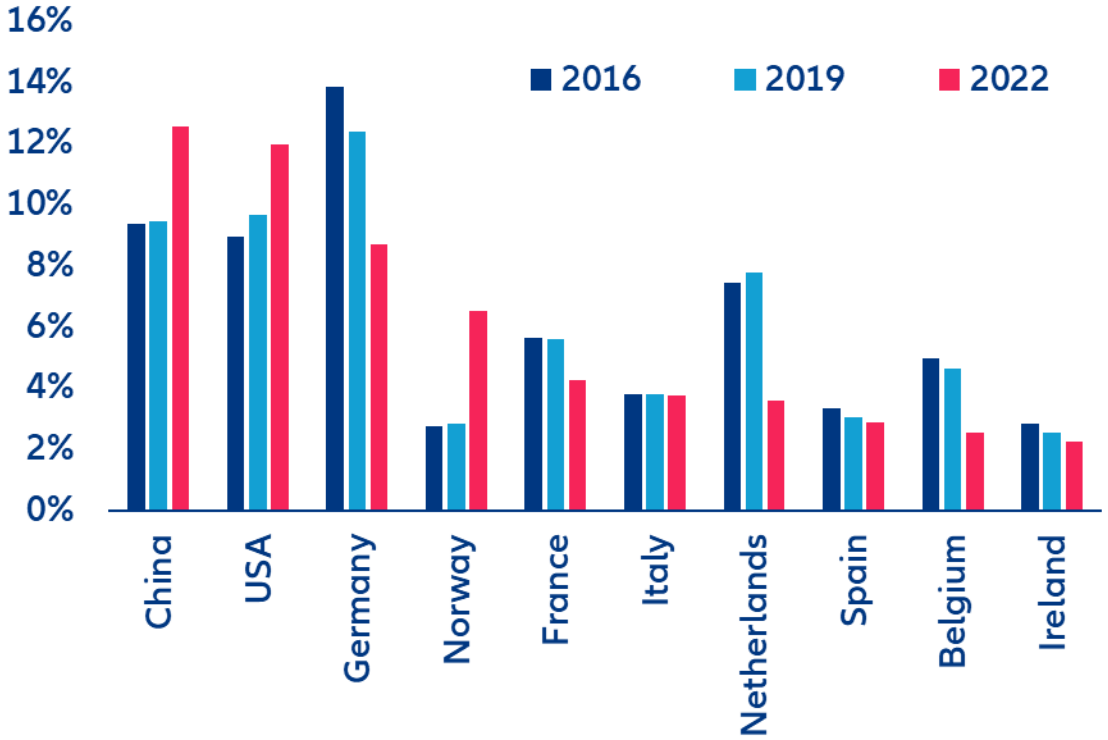


Sources: LSEG Datastream, Allianz Trade

Dependency on imports from outside the EU is up

(+6pps from US and China combined since 2016, -13pps from EU)

Imports by origin, % of total

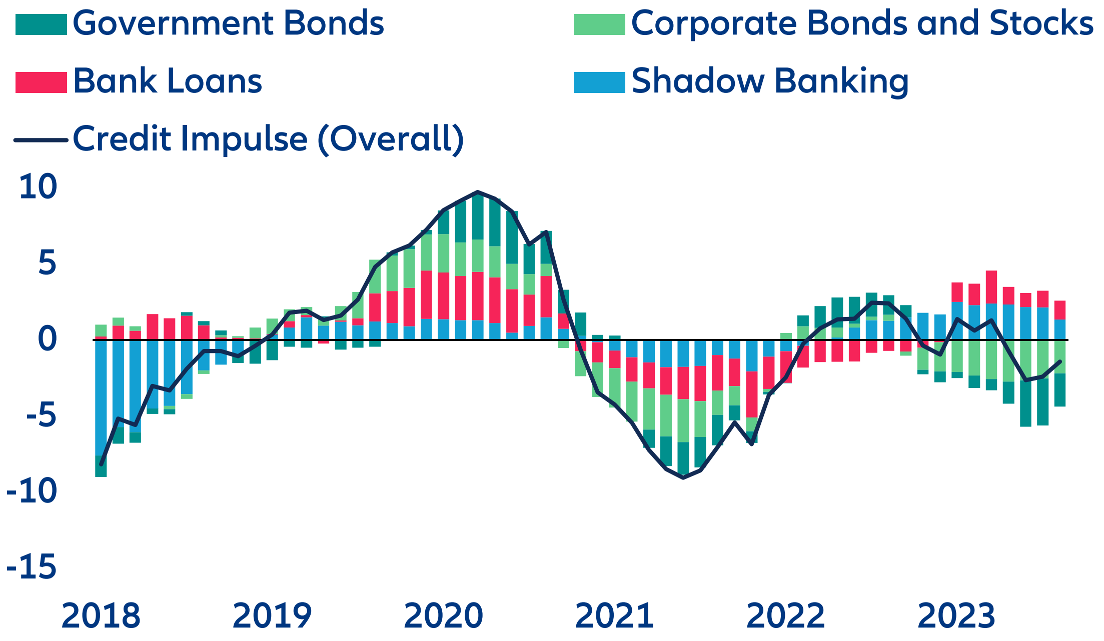


Sources: LSEG Datastream, Allianz Research

Allianz

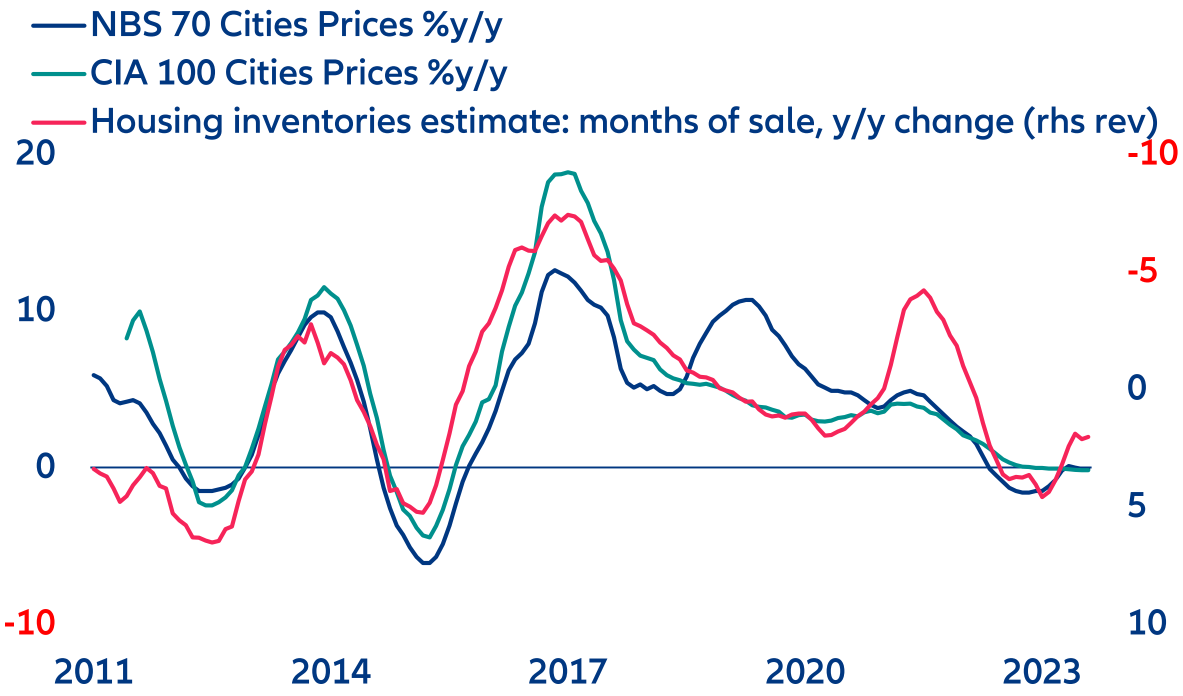
China: It's all about policy

Monetary policy is far too restrictive, which warrants further easing by year-end, % y/y



Sources: national, Refinitiv, Allianz Research

Housing indicators point to a stabilization at low levels, % y/y

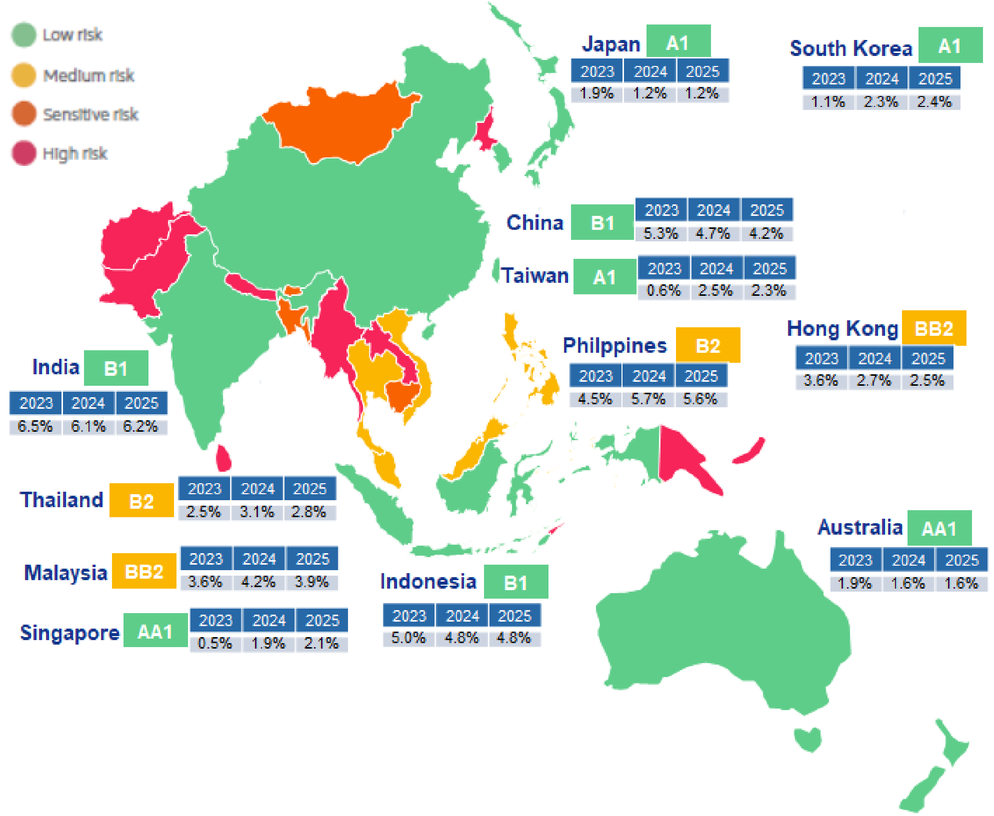


Sources: Official Sources, Allianz Research

Allianz

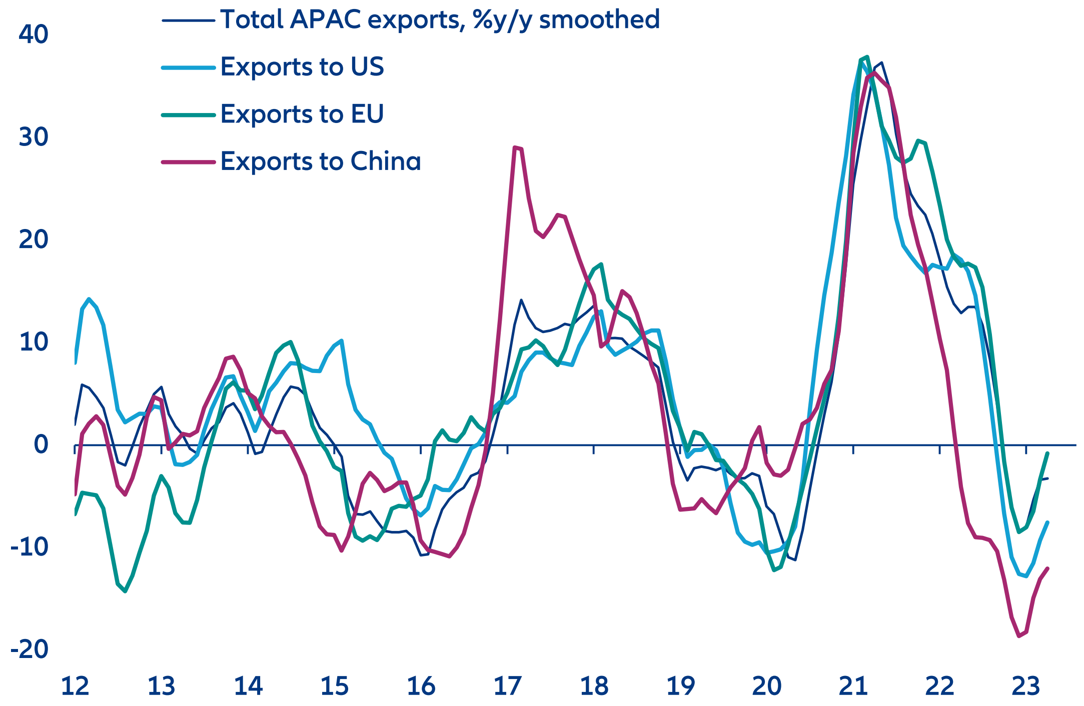
APAC: Weak global trade performance will jeopardize regional growth

GDP growth and short-term country risk as of Q3 2023



Sources: Allianz Research.

Exports are bottoming-out

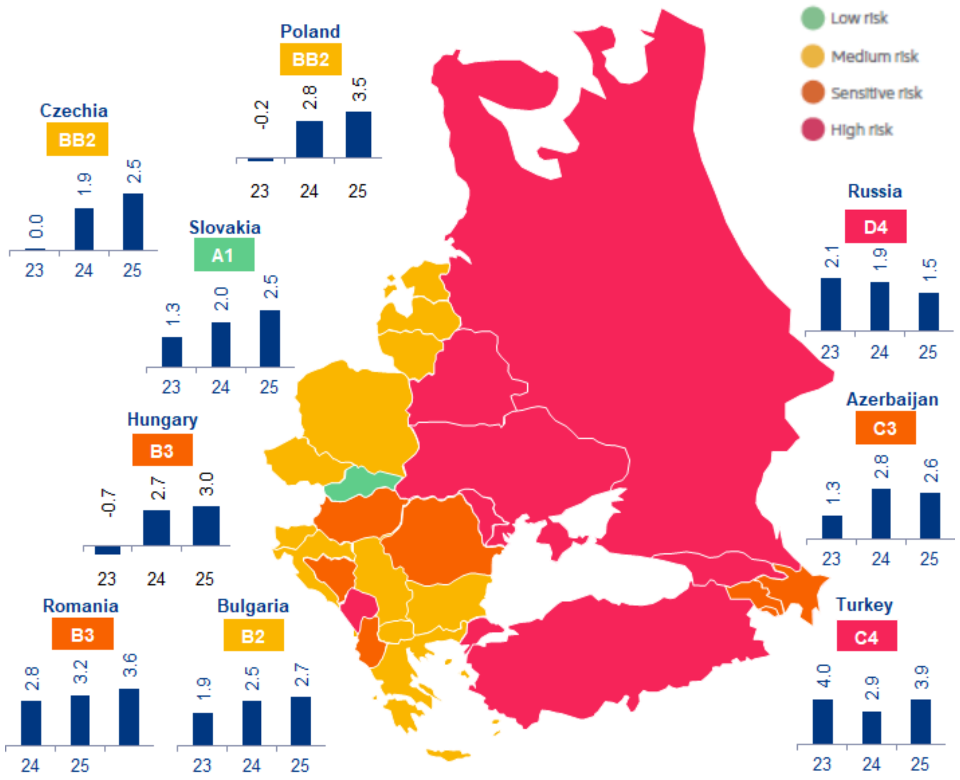


Sources: IMF, Allianz Research.

Allianz

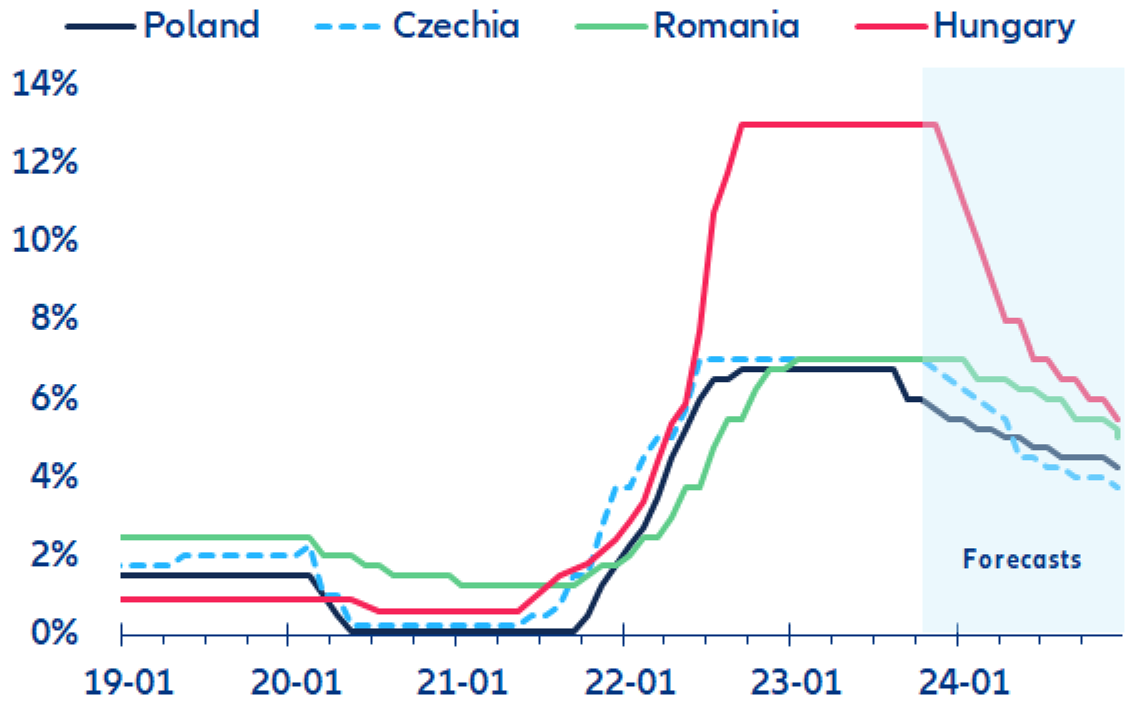
Emerging Europe: Growth will gradually recover in 2024-2025, supported by monetary easing

GDP growth and short-term country risk as of Q3 2023



Sources: Allianz Research.

As inflation is retreating, CEE central banks will cut rates to support growth



Sources: Refinitiv, Allianz Research.

Africa & Middle East: Growth moderates amid persisting external and social pressures

Inflation and political instability in Africa keep weighing on growth

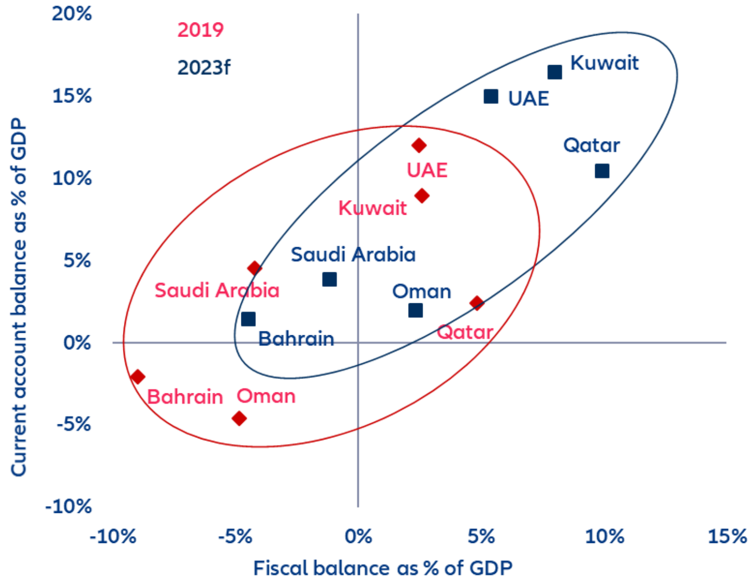
	GDP growth (pps)		Inflation (pps)	
	2023	2024	2023	2024
Africa	3.2	3.6	19.7	14.6
Algeria	2.4	1.8	9.0	4.8
Angola	2.6	3.5	12.0	10.5
Côte d'Ivoire	6.5	6.4	4.3	3.2
Egypt	2.8	3.5	40.0	32.0
Ghana	2.5	3.0	43.0	22.0
Kenya	4.4	5.2	7.5	5.5
Morocco	2.6	2.8	6.4	3.0
Mozambique	5.0	7.0	7.4	6.5
Nigeria	2.4	3.0	22.5	17.0
Senegal	5.5	8.0	8.0	4.0
South Africa	0.7	1.4	5.2	4.2
Tunisia	0.9	1.8	9.5	8.0

Source: Allianz Research

Country risk map, short-term ratings

Source: Allianz Research

Fiscal and current account improve in Kuwait, Oman, Qatar and UAE

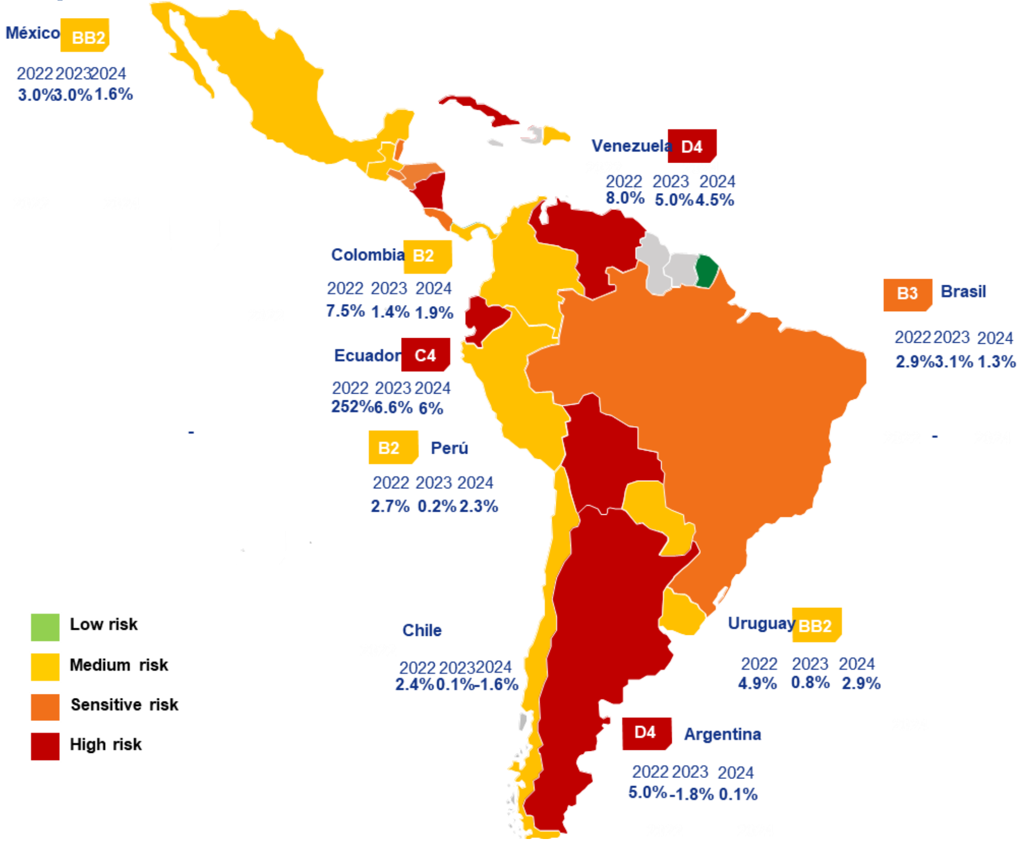


Sources: Refinitiv, EIU, Allianz Research

Allianz

LatAm: Growth divergence, monetary policy to gradually ease further

Outperformance of Brazil and Mexico to reduce



Sources: Allianz Research

Fiscal consolidation remains Brazil's main challenge; Chile and Colombia more exposed to external shocks

		Brazil	Colombia	Chile	Mexico	Peru
Fiscal	Fiscal balance/ GDP	-8,8%	-4,0%	-1,8%	-4,1%	-2,0%
Inflationary risk	CPI	5,1%	11,8%	7,9%	6,0%	6,5%
Competitiveness	REER (deviation from the average of past 5	6,3%	4,3%	2,3%	24,7%	6,5%
Growth	GDP (2023)	3,1%	1,4%	0,1%	3,0%	0,2%
	Domestic Credit Growth	3,0%	1,3%	2,4%	2,3%	7,0%
External Sector Ratios	External Debt/GDP	48,7%	62,0%	69,0%	52,0%	43,0%
	External Debt/ Exports	181,4%	333,2%	218,2%	88,7%	135,3%
	Public Debt/ GDP	88,4%	57,2%	36,6%	57,7%	33,0%
	ST External debt (USD bn)	78,9	19,4	45	53,4	10,6
	FX reserves (USD bn)	345,48	58,11	40,68	206,60	71,91
	CA/GDP	-2,9%	-5,1%	-9,0%	-0,9%	-4,5%
	Import Cover	12,16	8,20	6,02	4,00	14,31

Sources: Allianz Research . Note that the data for fiscal balance/GDP, CPI and GDP correspond to our forecasts for 2023.

Capital Markets Outlook

2023-2025

Allianz

Markets to navigate the policy-heavy environment

Capital Markets: Eurozone and US

year-end figures

year-end figures	Last	Unit				
EMU			**2022**	**2023f**	**2024f**	**2025f**
Government Debt						
ECB deposit rate	4.00	%	2.0	4.00	3.50	2.75
10y yield (Bunds)	2.97	%	2.6	2.6	2.5	2.4
10y EUR swap rate	3.33	%	3.1	3.0	2.9	2.8
Italy 10y sovereign spread	195	bps	214	170	150	140
France 10y sovereign spread	57	bps	54.4	60	40	40
Spain 10y sovereign spread	110	bps	109	110	80	70
Corporate Debt						
Investment grade credit spreads	151	bps	166	160	140	130
High-yield credit spreads	432	bps	494	475	425	375
Equity						
Eurostoxx (total return p.a.)	10.2 ytd	%	-12	9	7	8

US			**2022**	**2023f**	**2024f**	**2025f**
Government Debt						
Fed Funds rate (high)	5.50	%	4.5	5.75	4.75	3.75
10y yield (Treasuries)	4.58	%	3.8	4.2	3.9	3.6
Corporate Debt						
Investment grade credit spreads	123	bps	138	130	120	110
High-yield credit spreads	409	bps	479	400	375	350
Equity						
S&P 500 (total return p.a.)	13.4 ytd	%	-18	13	9	11

Capital Markets: UK, Emerging Markets, FX

year-end figures

UK			**2022**	**2023f**	**2024f**	**2025f**
Government Debt						
BoE rate	5.25	%	3.5	5.75	4.75	4.25
10y yield sovereign (Gilt)	4.49	%	3.7	4.4	4.2	4.0
Corporate Debt						
Investment grade credit spreads	158	bps	192	170	150	140
High-yield credit spreads	569	bps	663	600	550	500
Equity						
FTSE 100 (total return p.a.)	5.4 ytd	%	4.7	3	7	7

Emerging Markets			**2022**	**2023f**	**2024f**	**2025f**
Government Debt						
Hard currency spread (vs USD)	243	bps	273	275	270	260
Local currency yield	6.6	%	7	6.6	6.0	5.5
Equity						
MSCI EM (total return p.a. in USD)	1.2 ytd	%	-20	2	5	12

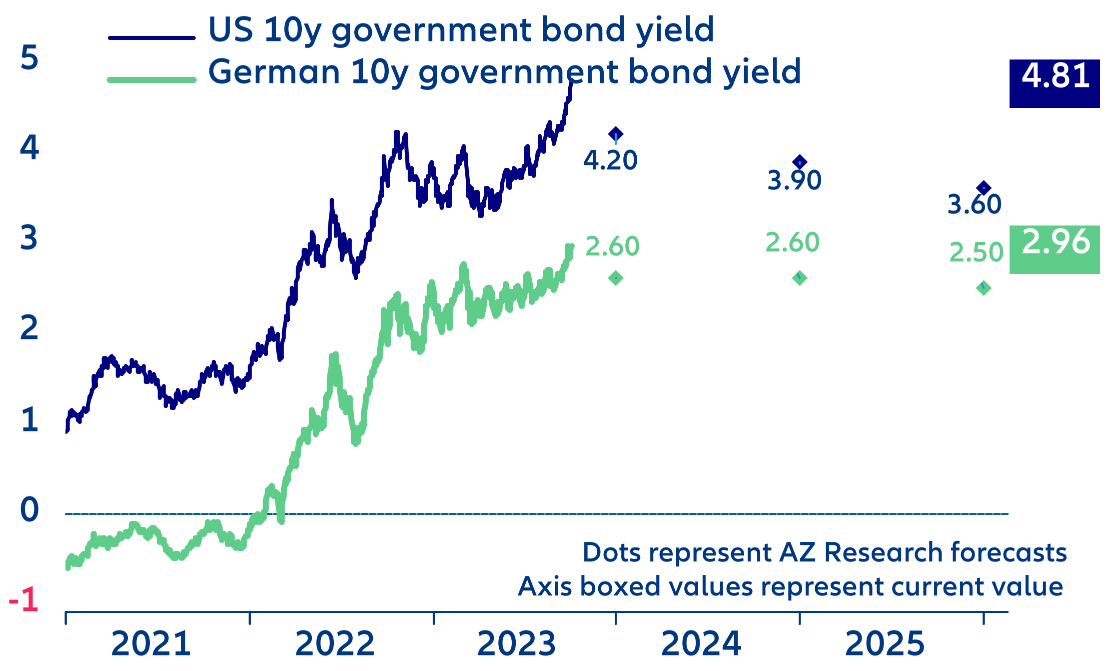
Others			**2022**	**2023f**	**2024f**	**2025f**
EUR USD	1.06	$ per €	1.07	1.08	1.13	1.16

Sources: LSEG Datastream, Bloomberg, Allianz Research

Allianz

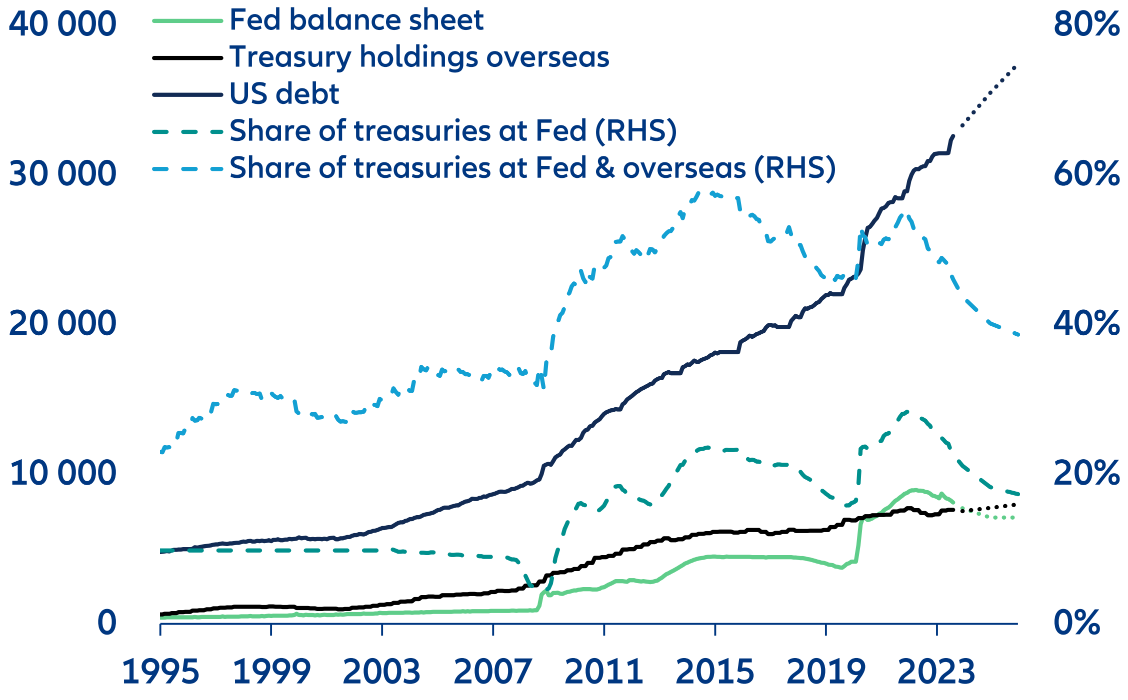
Long-term yields should start edging lower as policy peaks

Sovereign bond yields will fall on lower policy rates and easing inflation expectations



Sources: LSEG Datastream, Bloomberg, Allianz Research

But high net supply, quantitative tightening and subdued foreign demand limit yield compression



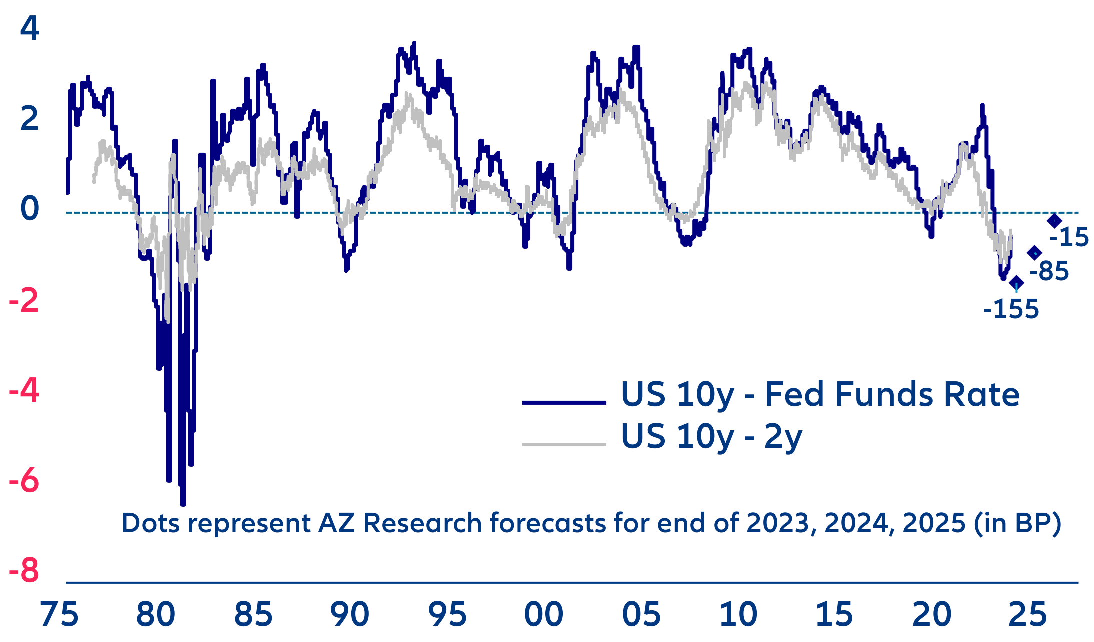
Sources: LSEG Datastream, Bloomberg, Allianz Research

Notes: Estimate before 2003

Allianz

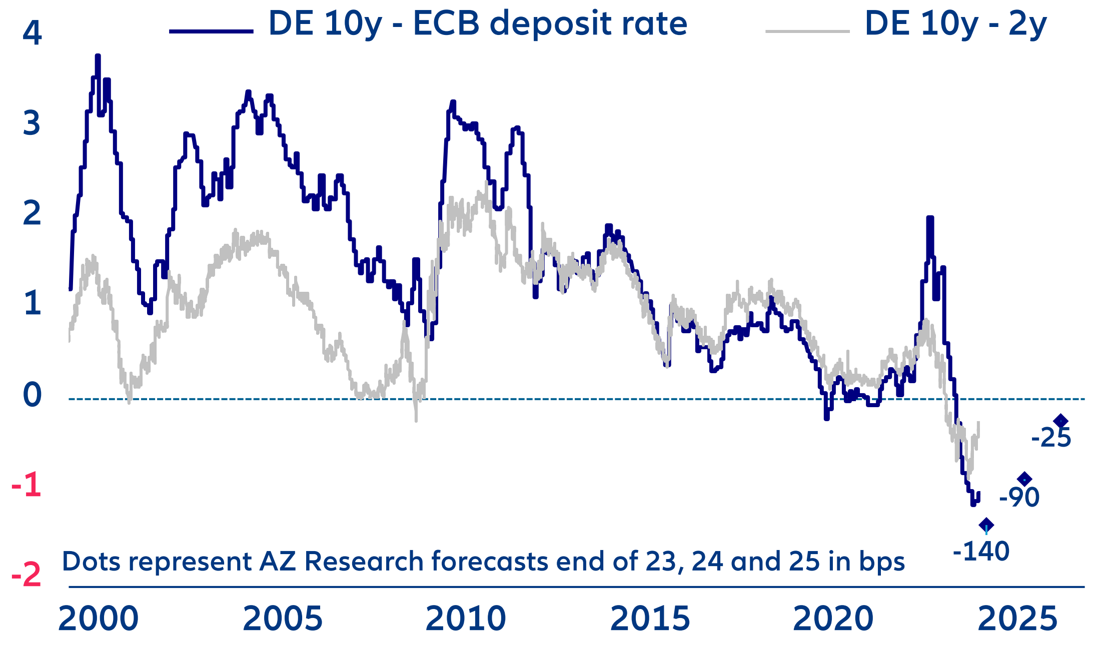
Yield curves will stay inverted for a while but will bull steepen in 2024

US yield curve will remain inverted for a long time – a pattern last seen in the oil price shock of the 1980s



Sources: Datastream, Allianz Research

Similar pattern for the German yield curve though it will likely stay inverted for even longer

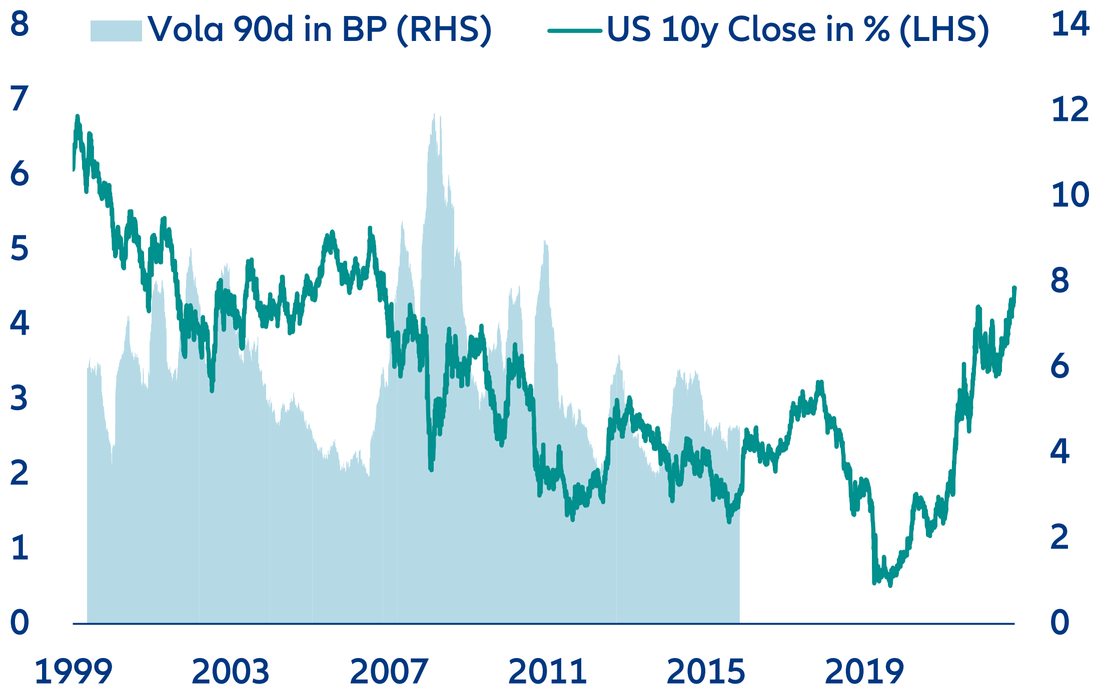


Sources: Datastream, Allianz Research

Allianz

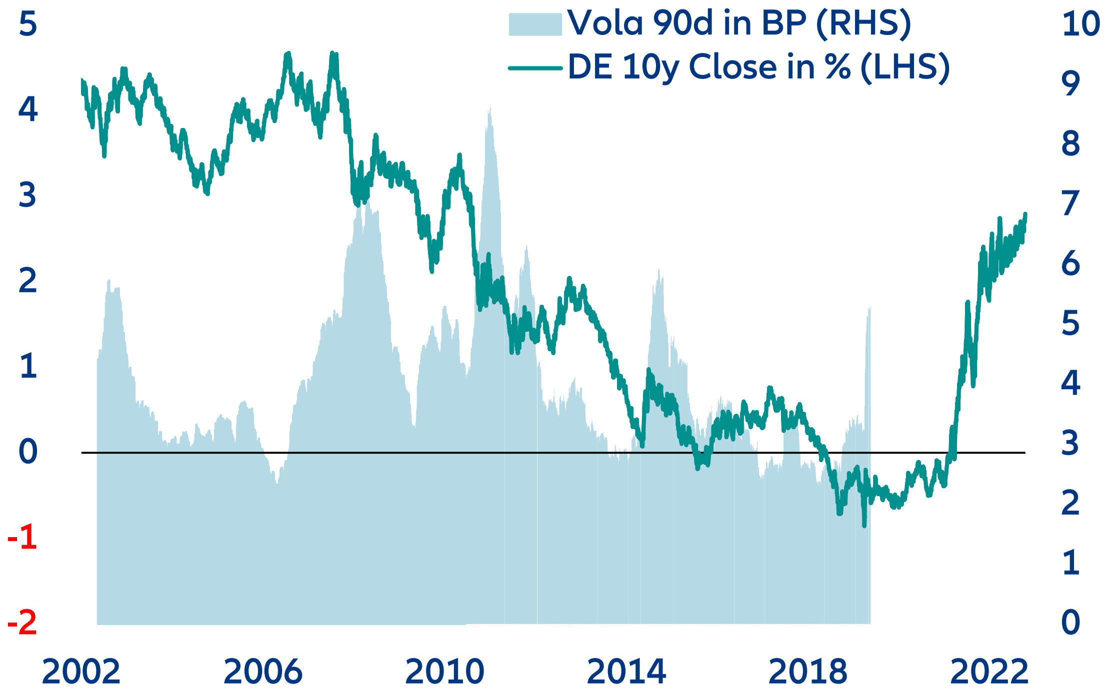
Volatility in bond markets to remain elevated until investors are certain that inflation is under control

90-day rolling volatility of daily changes in the US 10y yield at upper end of historical range



Sources: LSEG Datastream, Allianz Research

Volatility in the German 10y bund yield even higher from a historical perspective

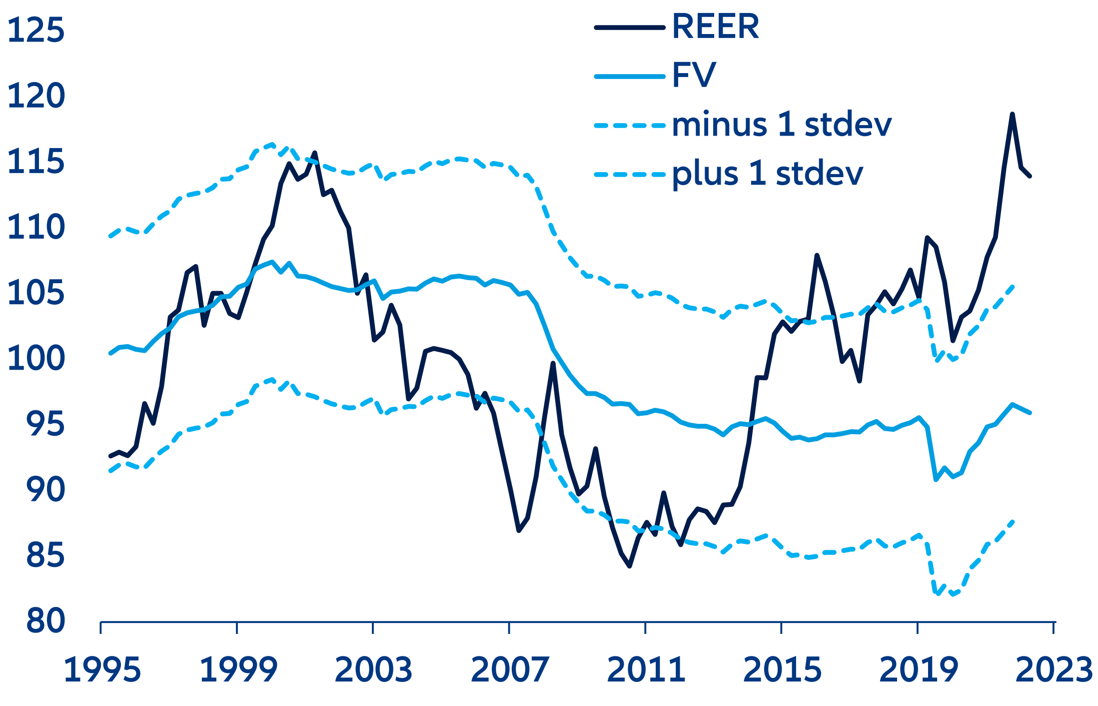


Sources: LSEG Datastream, Allianz Research

Allianz

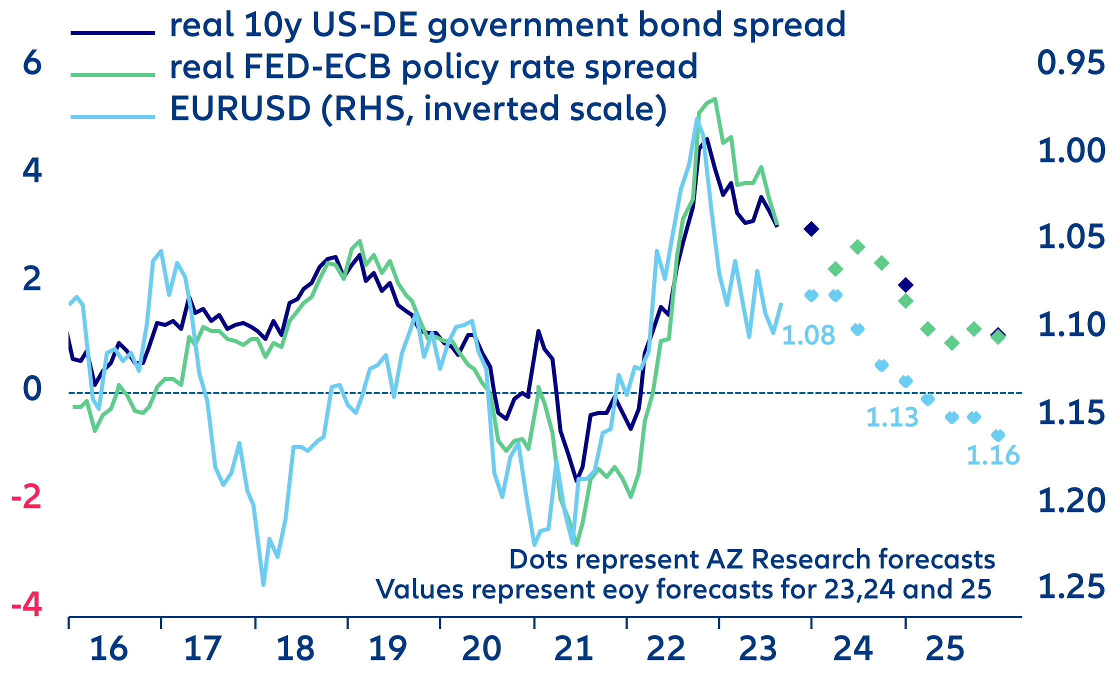
USD to remain strong in the short-run but valuations suggest weakness in the mid-run

Valuation shows that the USD is very overvalued



Sources Datastream, Allianz Research. Fair value (FV) is based on the Behavioral Equilibrium Exchange Rate Model (BEER).

Real transatlantic spread and EURUSD (inverted)

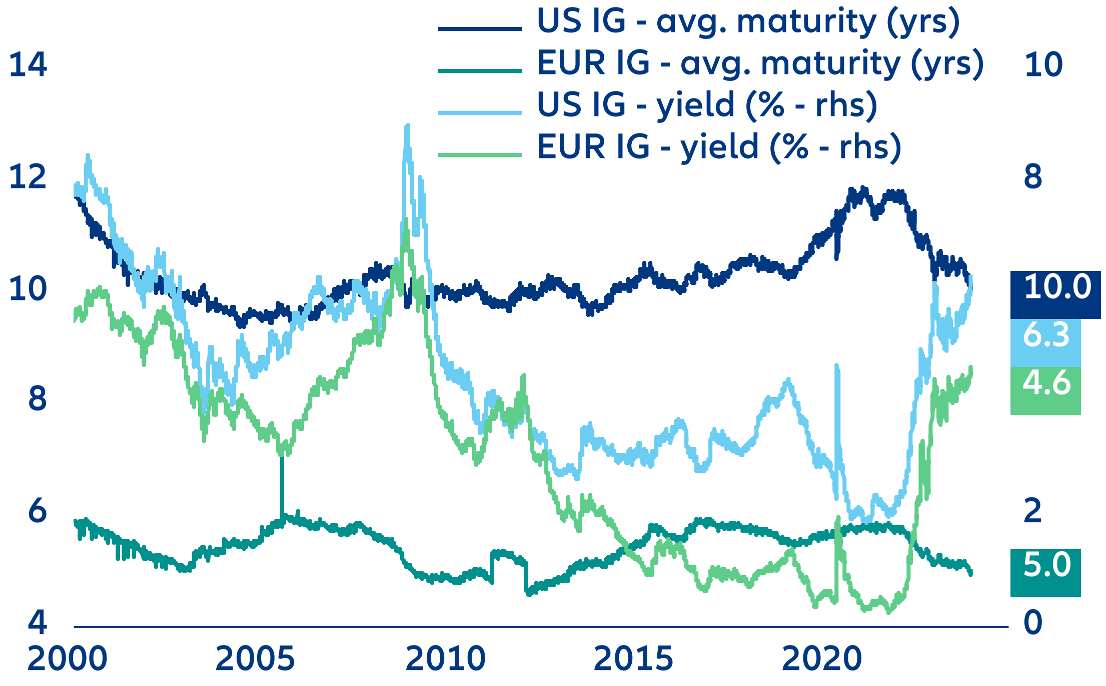


Sources: LSEG Datastream, Allianz Research

Allianz

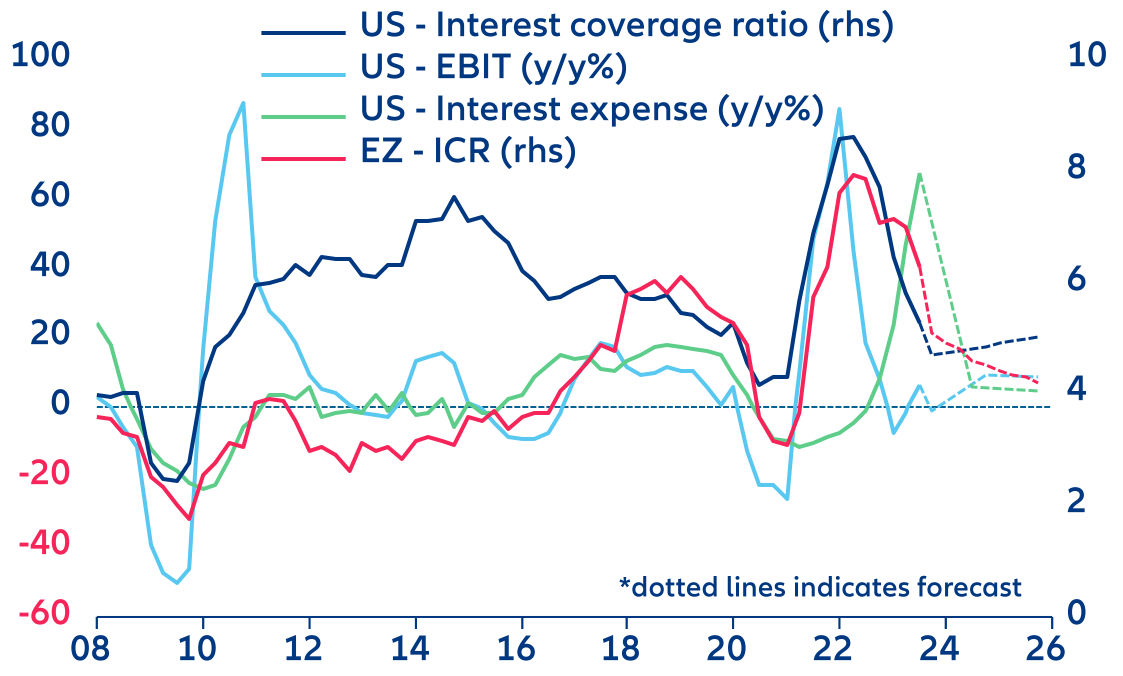
Corporate debt servicing will remain under pressure but will not break the market

Lower-shorter issuance and limited redemptions should prevent a full pass-through effect of higher rates



Sources: LSEG Datastream, Allianz Research

Earnings to outpace the growing interest burden in the US but might not do so in the EZ

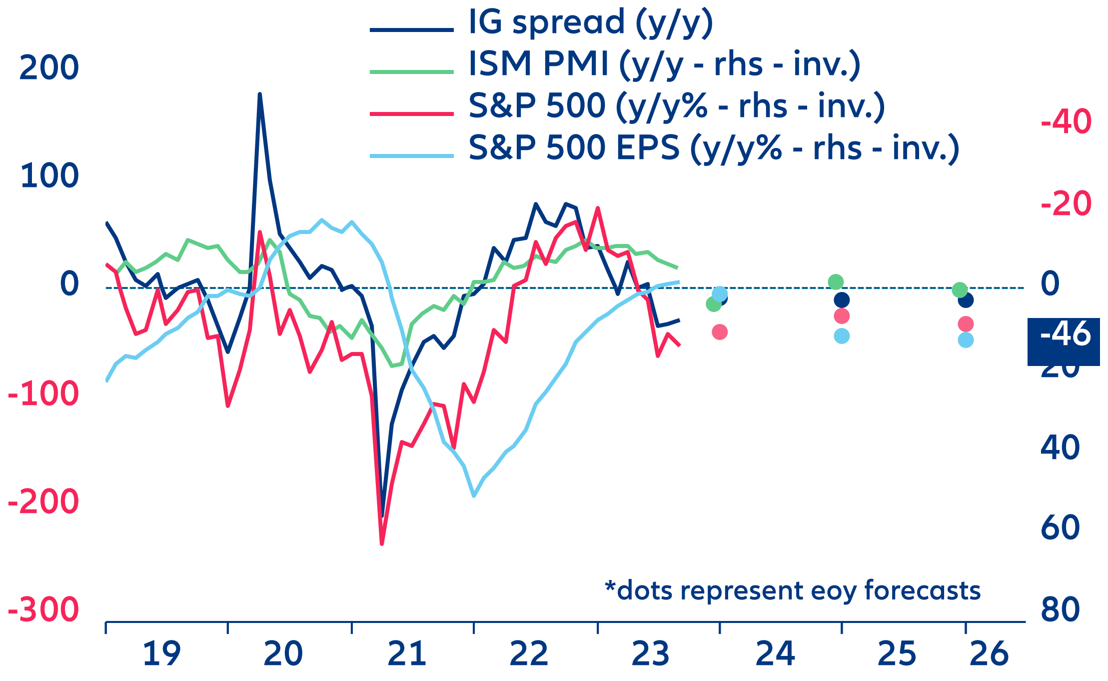


Sources: LSEG Datastream, Allianz Research
Note: ICR: Interest Coverage Ratio (EBIT/Interest expense)

Allianz

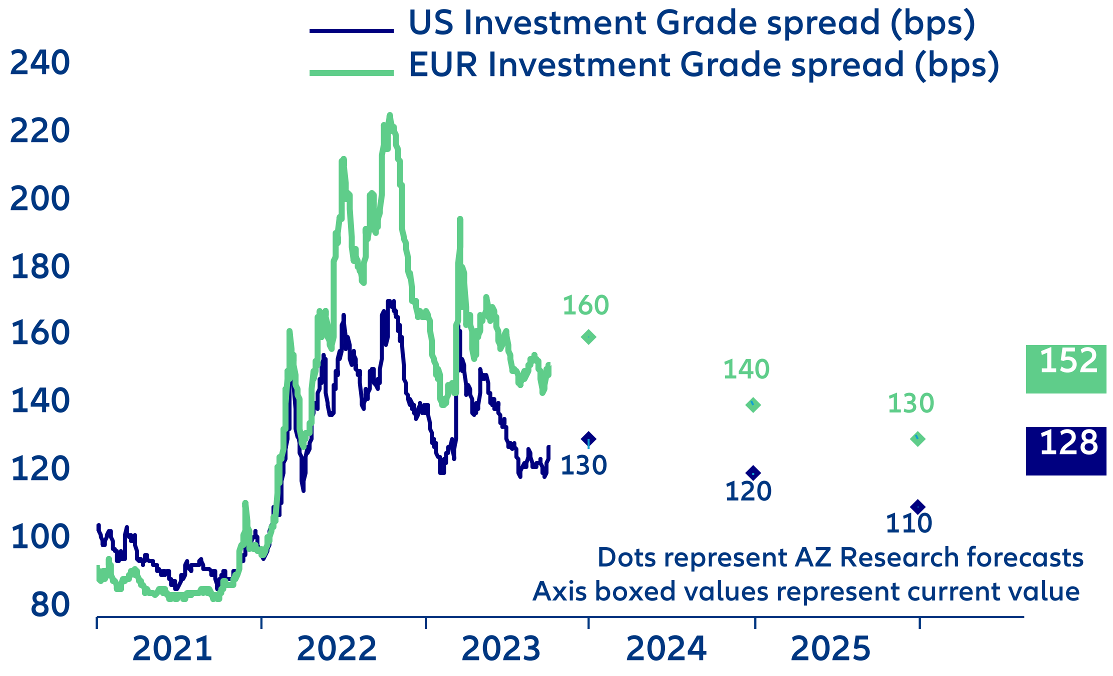
Credit remains tight given current macroeconomic conditions but should still be resilient in the mid-run

Short-term cyclical risks point towards a mild widening but relatively strong balance sheets …



Sources: LSEG Datastream, Allianz Research
Note: IG – Investment Grade

… and still resilient debt servicing capacity should cap the widening short and keep inflows stable

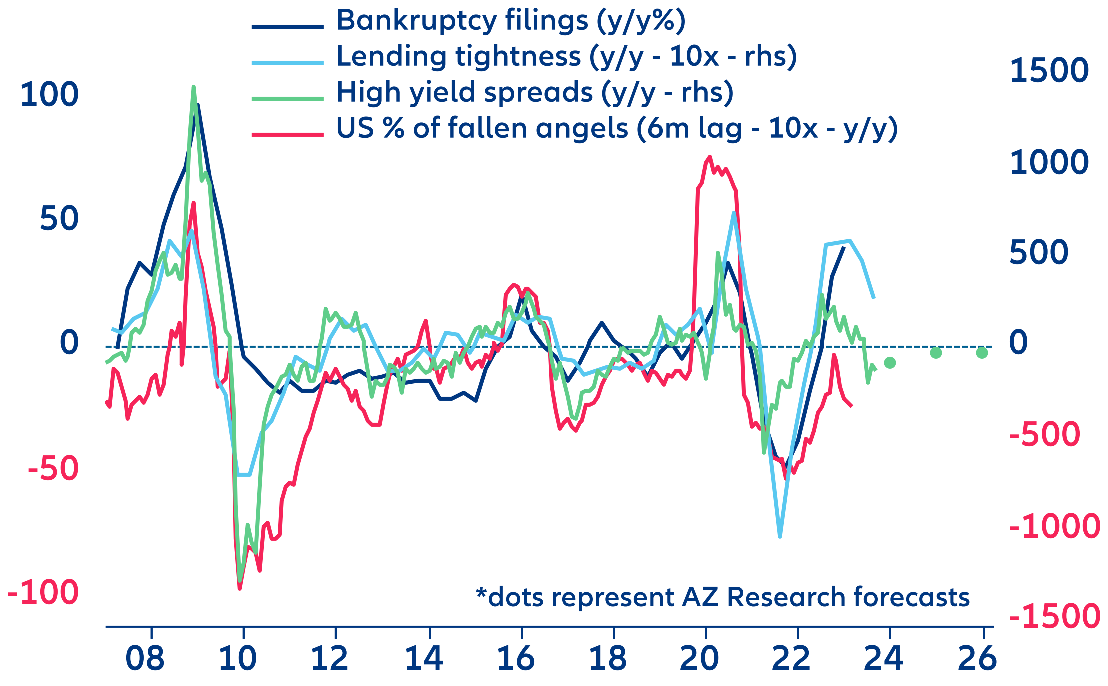


Sources: LSEG Datastream, Allianz Research

Allianz

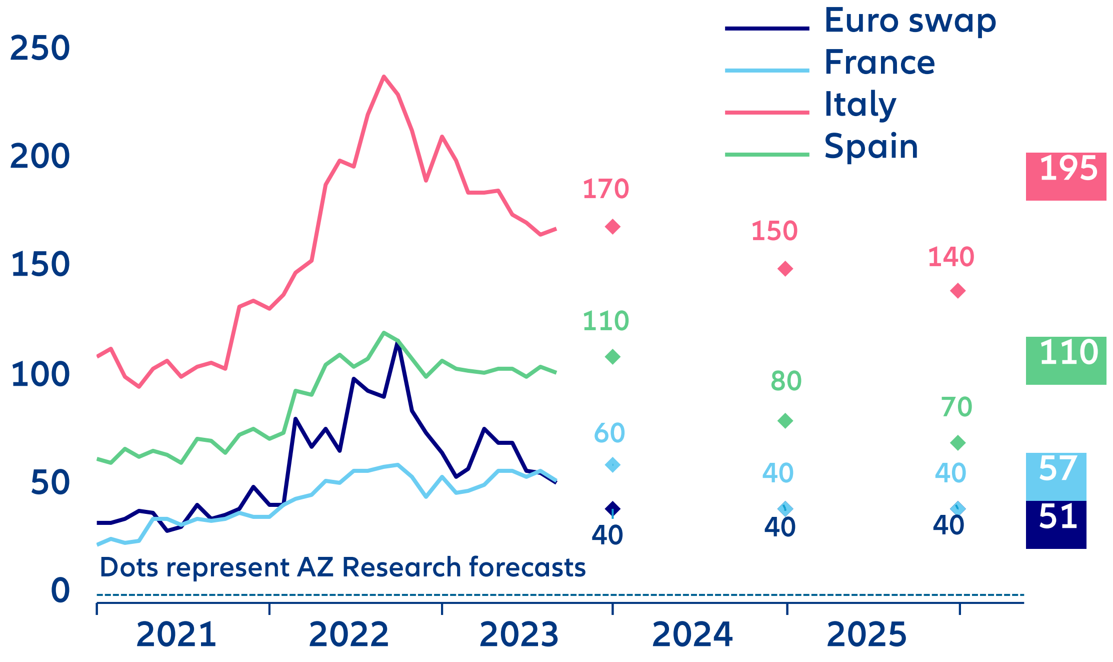
In a higher-for-longer environment the weak links will continue to face elevated headwinds

Rising defaults, higher rates and a crowded market add short-term risks to the weak links in high-yield corporates



Sources: LSEG Datastream, Allianz Research

Eurozone periphery spreads versus Germany to remain stable amid ECB support tools (e.g. TPI)



Sources: LSEG Datastream, Allianz Research
Notes: TPI refers to the Transmission Protection Instrument introduced by the ECB in July 2022 in order to keep government bonds spreads from widening amid policy tightening.

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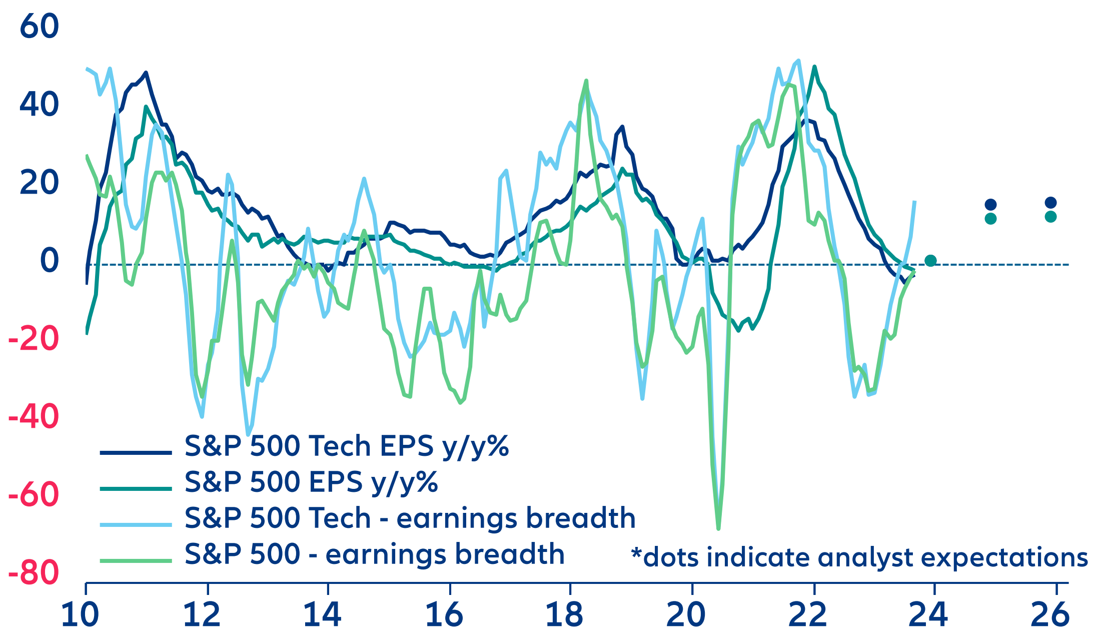
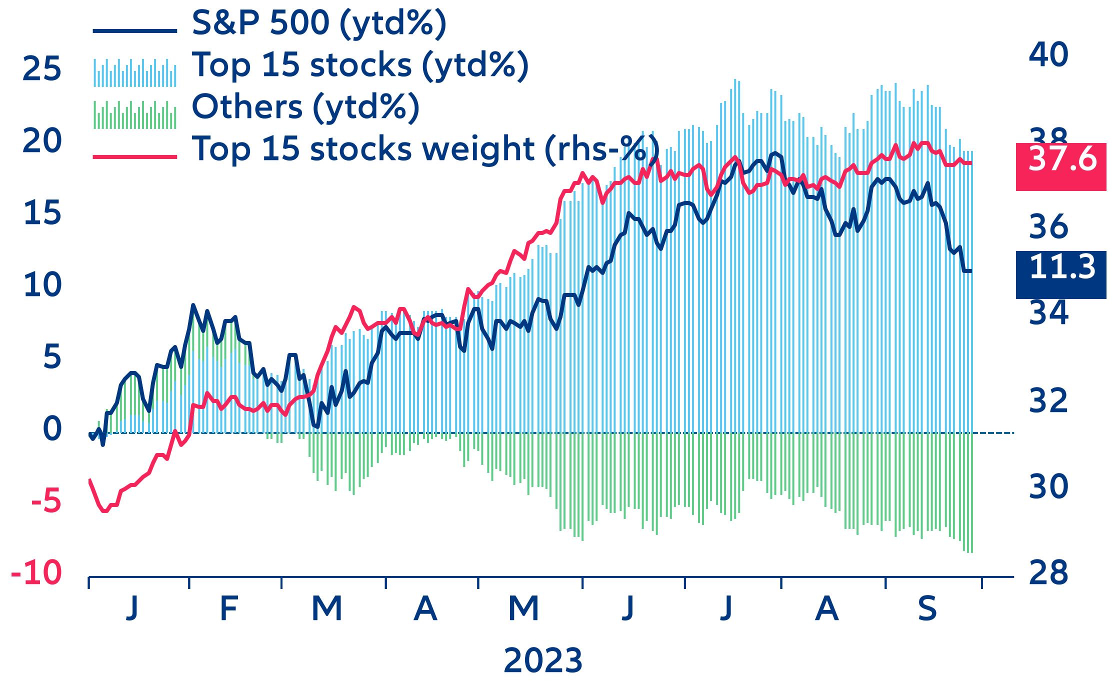
Concentration risk remains high and performance will depend on a handful of tech companies

Tech earnings are set to remain strong but leave global markets at the mercy of a few companies



Sources: LSEG Datastream, Bloomberg, Allianz Research
Note: Earnings breadth = (# of earnings revisions up - # of earnings revisions down) / total # of earnings revisions

The overperformance of the top companies hides the underperformance of the rest of the market



Sources: LSEG Datastream, Bloomberg, Allianz Research

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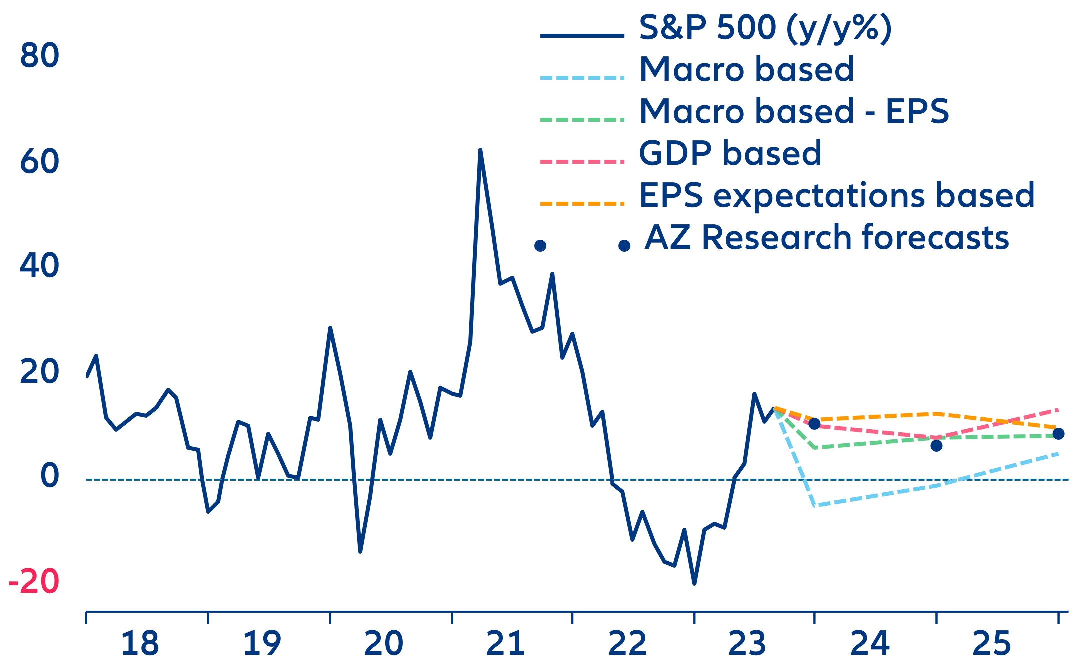
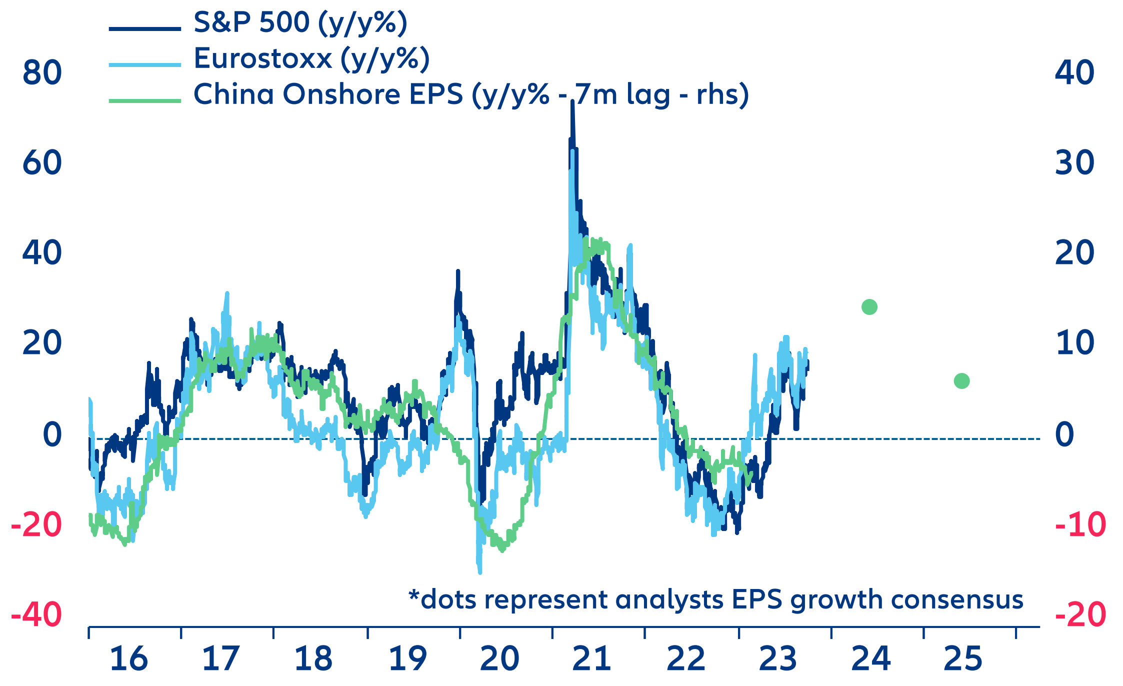
Macro and fundamentals suggest diverging paths for equity markets moving forward

Macro indicators suggest downside risks for equities but fundamentals yield a more positive outlook



Sources: LSEG Datastream, Bloomberg, Allianz Research
Note: EPS – Earnings per share

China's economic resilience will remain crucial for the fundamentals resilience story



Sources: LSEG Datastream, Bloomberg, Allianz Research

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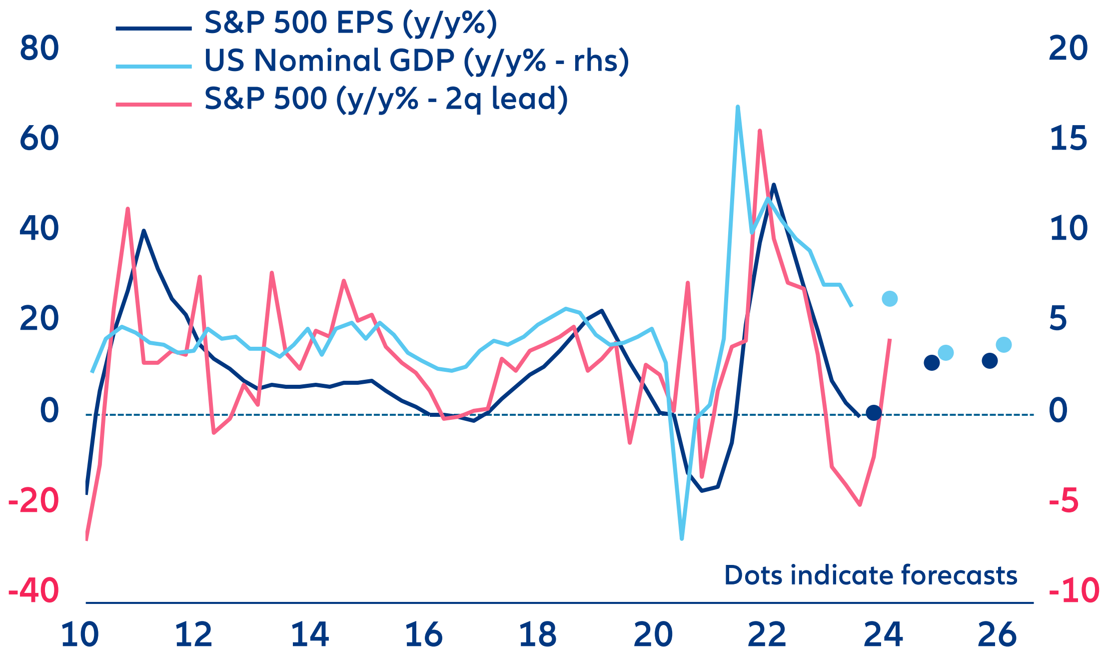
Balance sheet resilience should keep markets afloat until the economy reaccelerates

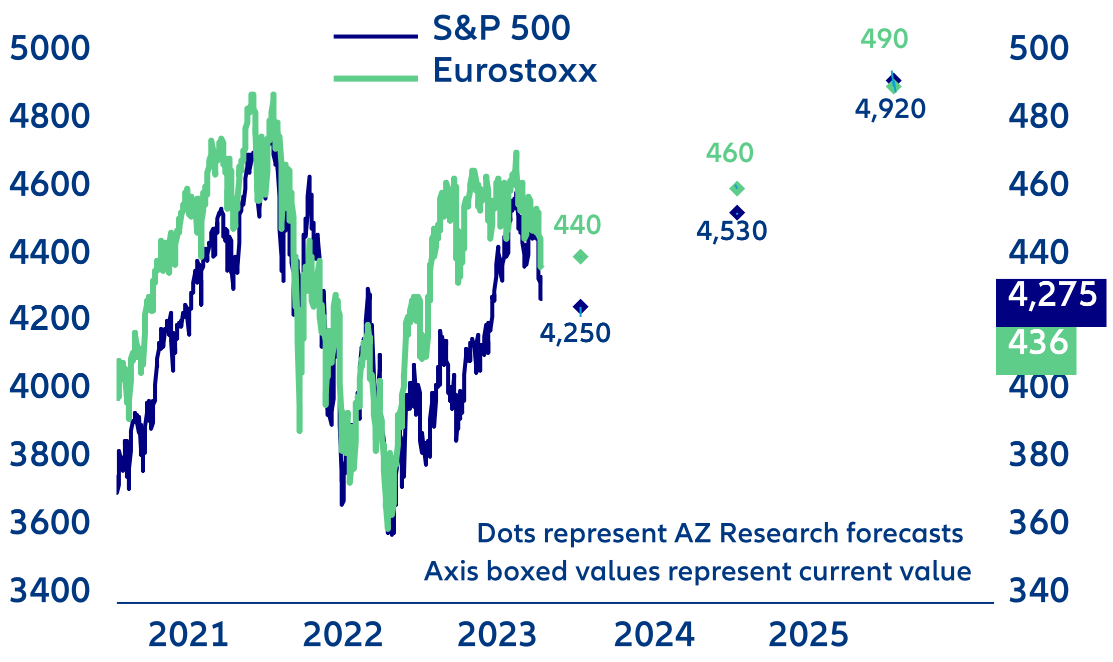
Resilient earnings should keep equity markets performing positively in the next three years

US Equity markets and GDP (y/y%)



Sources: LSEG Datastream, Bloomberg, Allianz Research

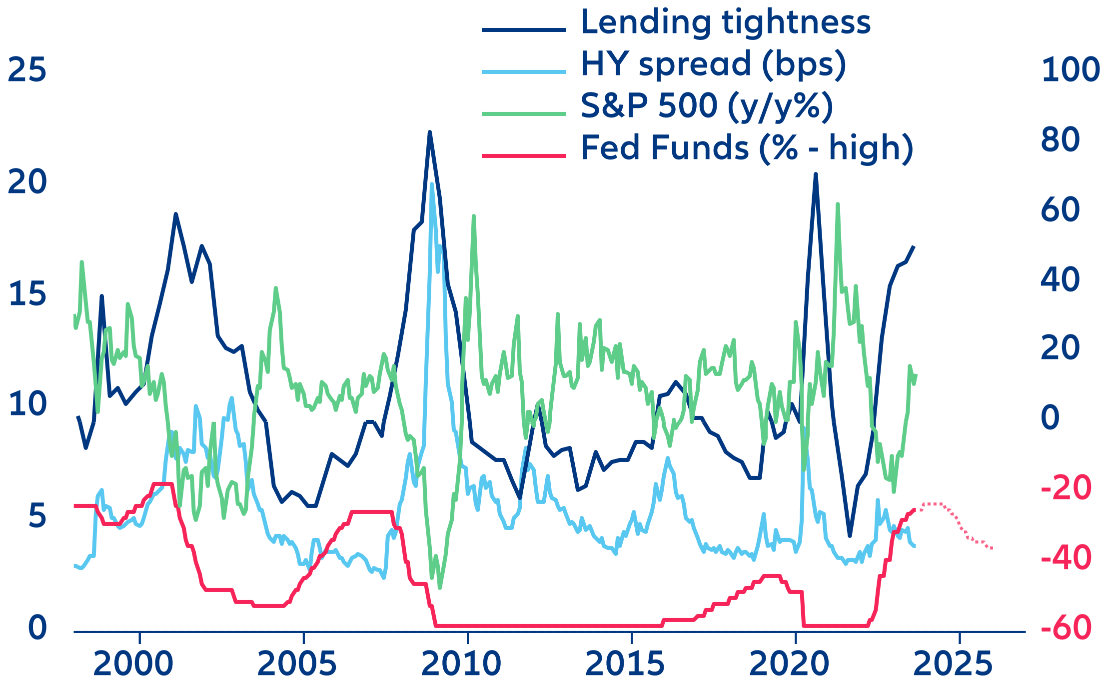
Our scenario suggest ~10% returns for US equities and 8% for European equities



Sources: LSEG Datastream, Allianz Research

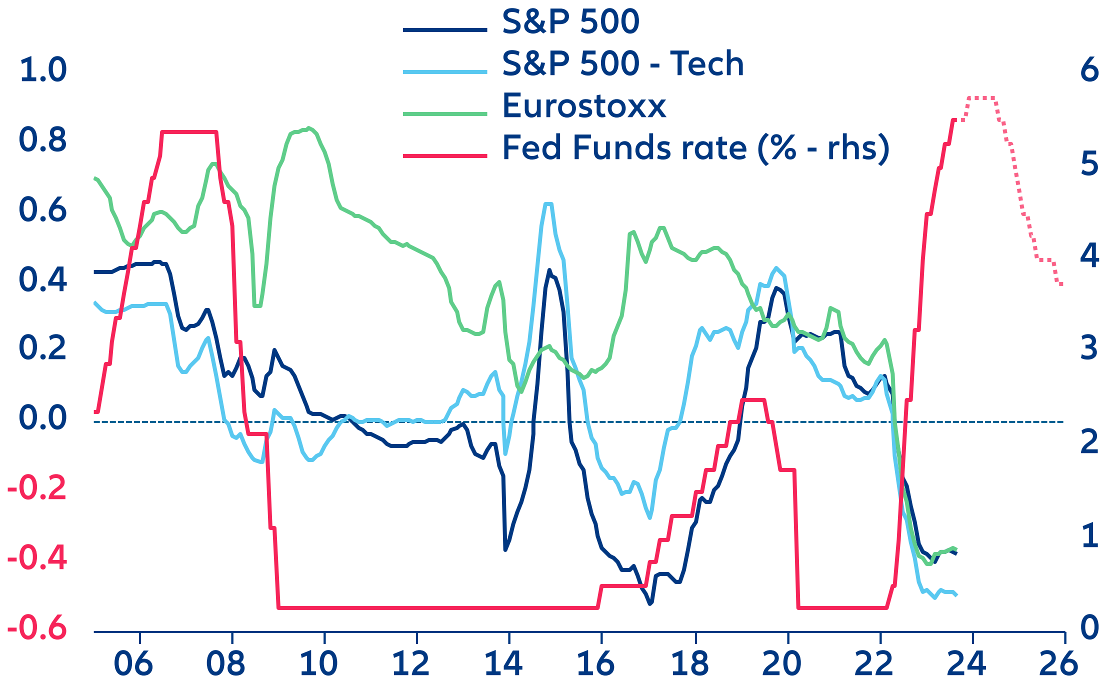
A much higher for much longer scenario could rapidly derail an already fragile market equilibrium

The financial conditions tightness vs market positioning conundrum is already overstretched



Sources: LSEG Datastream, Allianz Research

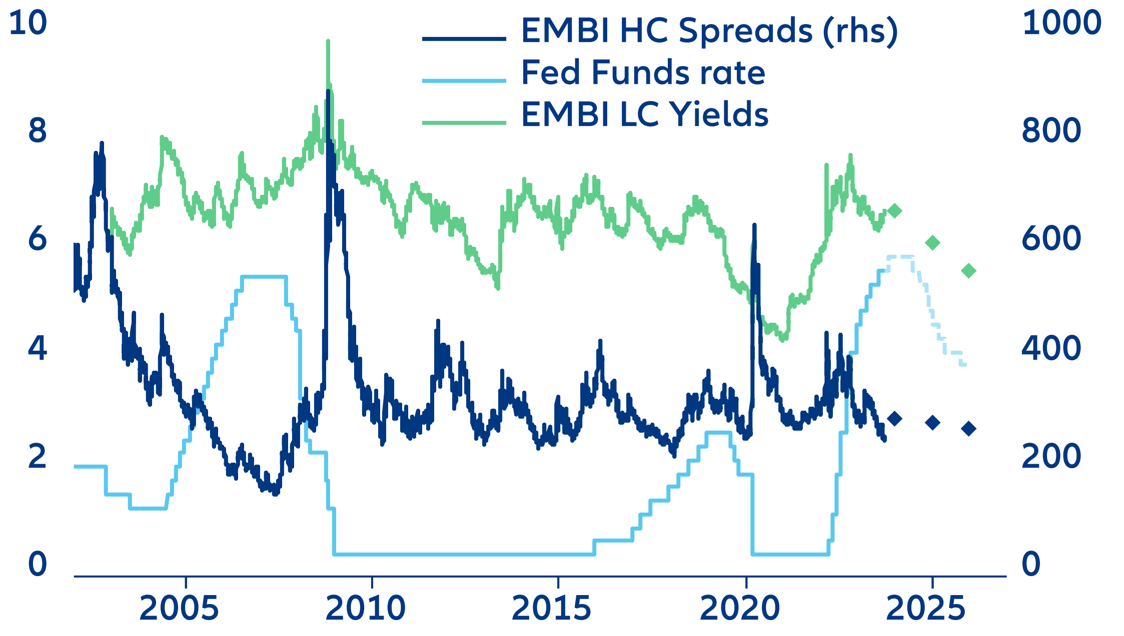
The equity market leaders belong to one of the sectors most sensitive to interest rates



Sources: LSEG Datastream, Allianz Research

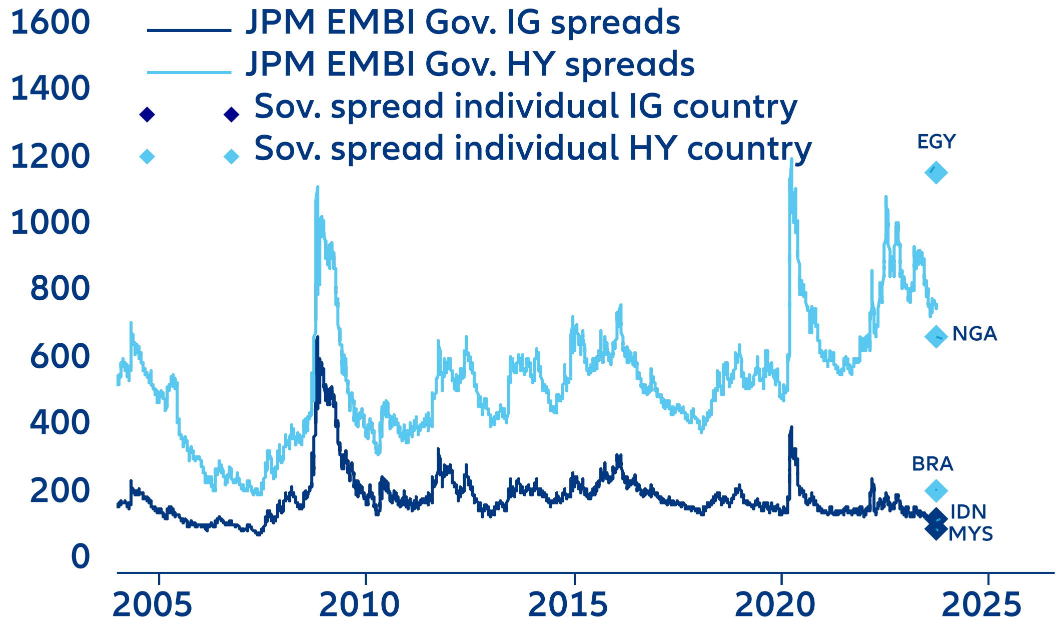
Peak EM momentum? Only in certain in areas of the market as selectivity prevailed

Appetite for high returns may be underestimating the challenges...



Sources: Bloomberg, LSEG Datastream, Allianz Research. Note: The EMBI HC spreads represent the JPM EMBI Gov Diversified ex-CCC. The EMBI LC yields represnt the GBI EM Global Diversified.

... but markets have drawn clear distinctions across the rating spectrum \1



Sources: Bloomberg, Allianz Research. Notes: \1 Within the HY environment we have included one of the good stories: the case of Brazil, fueled by the shift of global commodities markets and responsible monetary policy. Other countries within the HY environment are not included to keep the axis readable.

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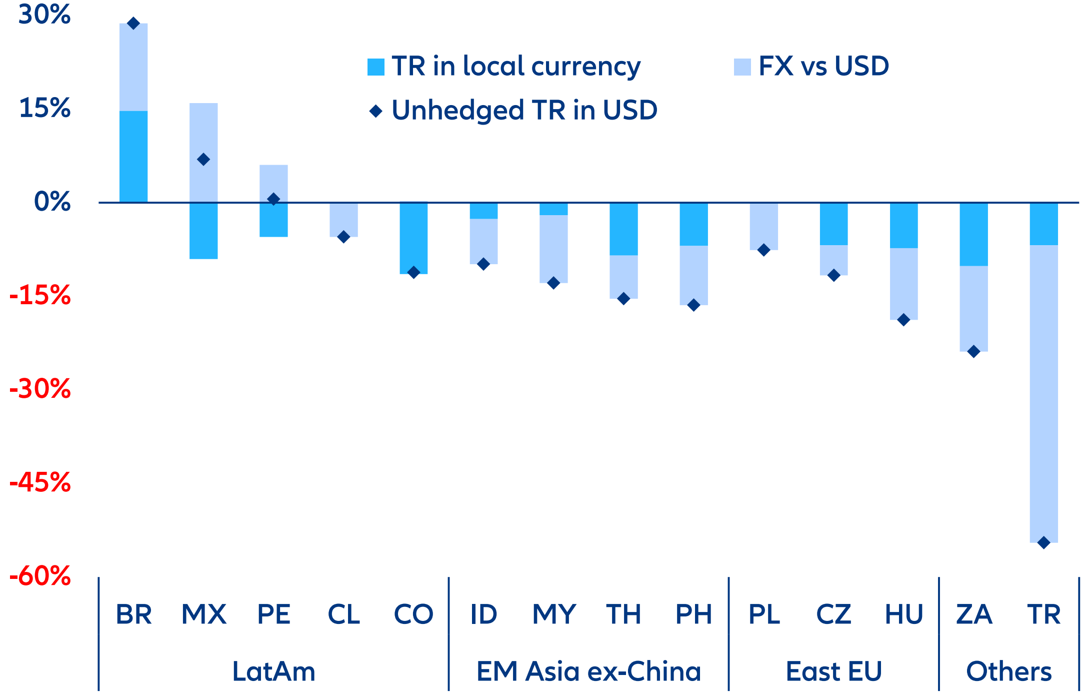
EM resilience stories: commodities shock and central banks drive regional success

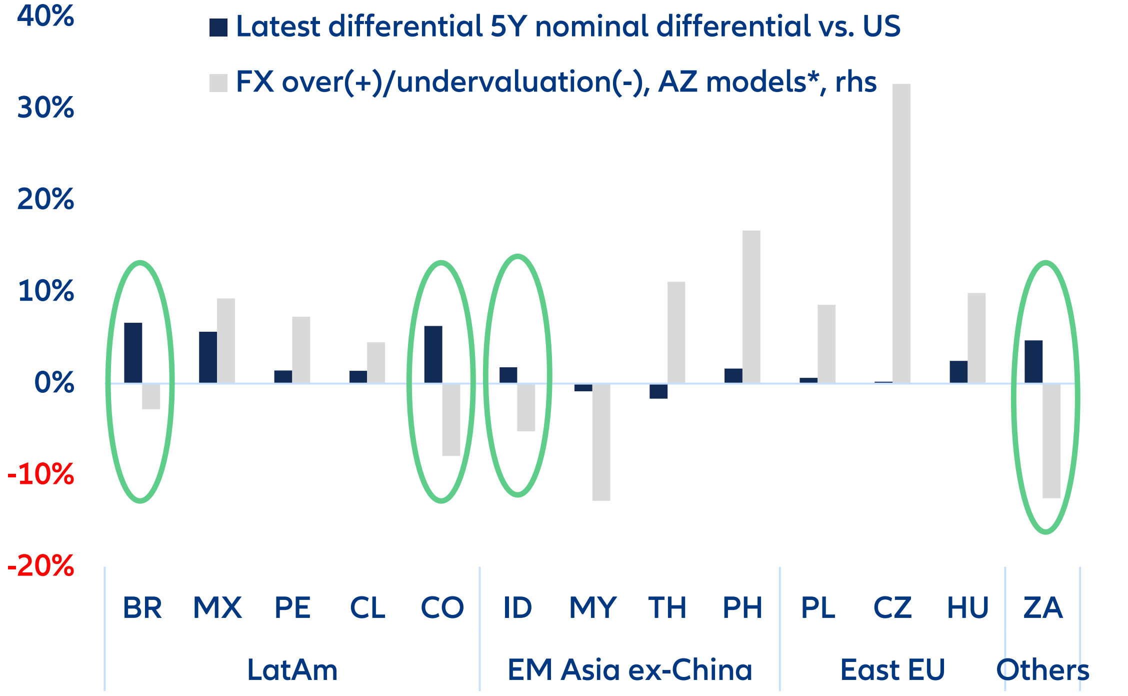
CB response and FX strength helped LatAm local bond markets to navigate market turmoil...

Local currency sovereigns performance since 2022



Sources: LSEG Datastream, Allianz Research. For the local currency bonds, BofA indexes across all maturities have been used.

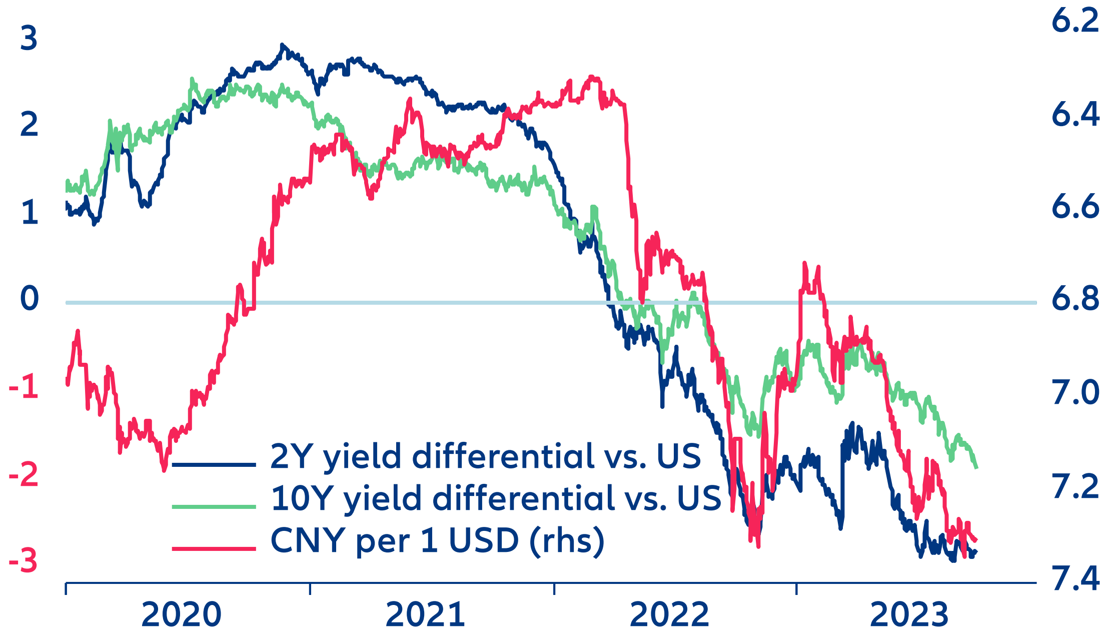
... a situation that could continue given the still above-average nominal yield differentials and FX valuations*



Sources: LSEG Datastream, Allianz Research. * PPP, BEER, FEER models (trade-weighted based). For every currency, models with larger errors are penalized. In green circles those with a positive differential vs. the US and whose currency is undervalued. Nevertheless, the results our models also show USD overvalued.

China bonds and equities show divergent fundamentals, but both face geopolitical concerns

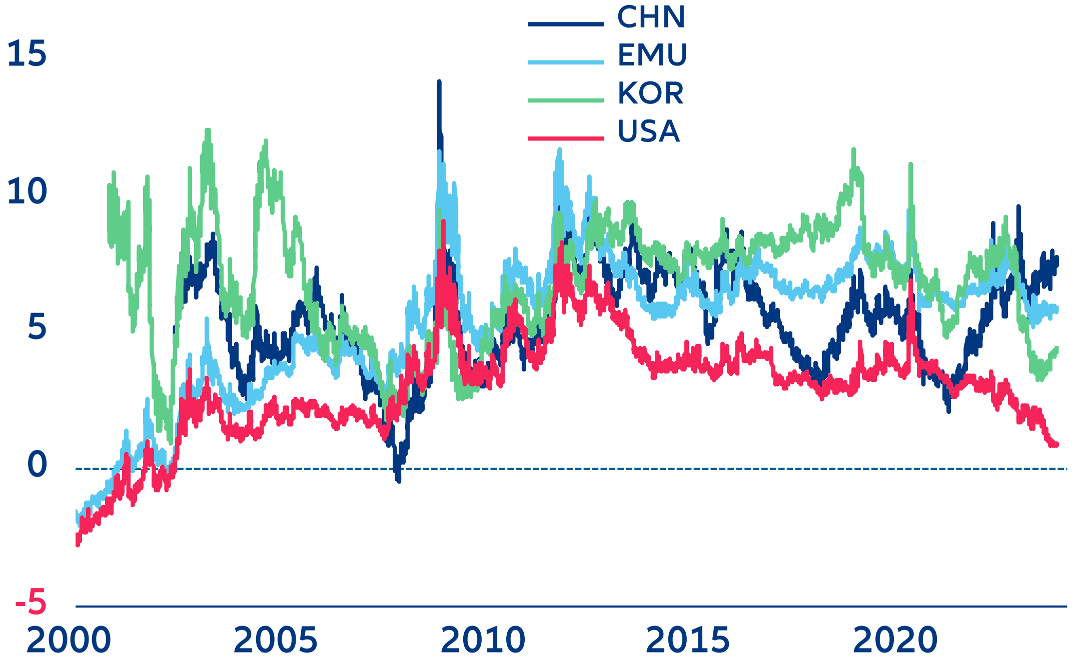
China's local currency bonds lose appeal with a weaker CNY, highlighting divergent monetary stance



Sources: LSEG Datastream, Allianz Research. A negative differential indicates US bond yield is higher.

Good fundamentals don't assure the Chinese equities comeback, weighed by investability concerns

Equity risk premium of Chinese over major selected benchmarks



Sources: LSEG Datastream, Allianz Research. S&P used for the US, MSCIs for the rest. 10Y local yields used.

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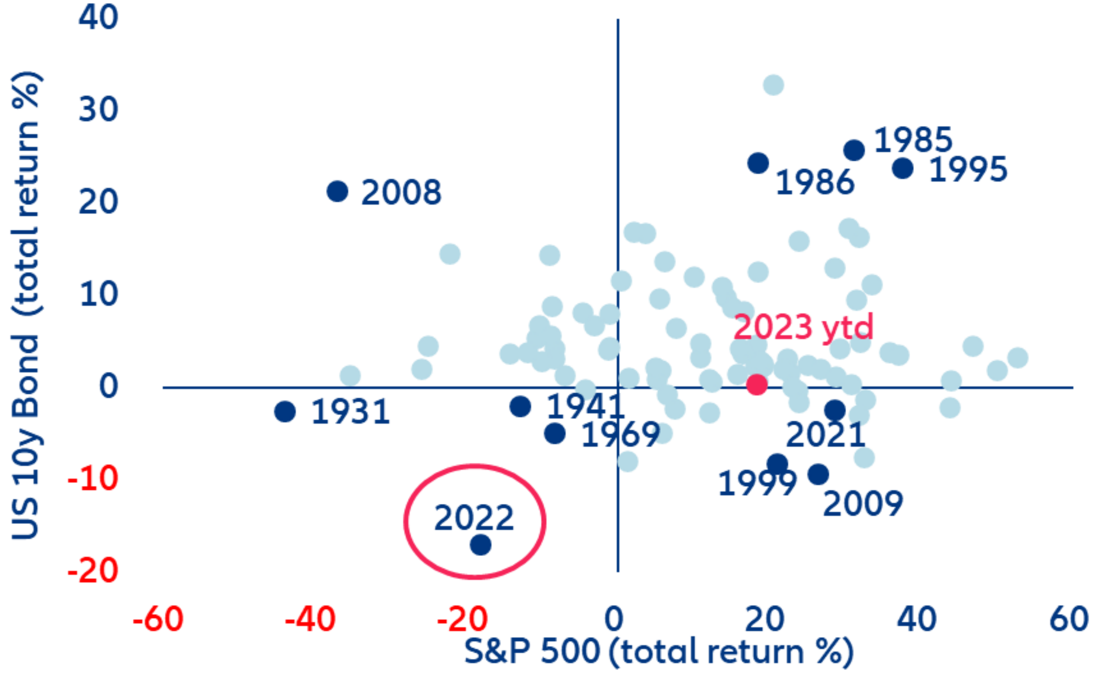
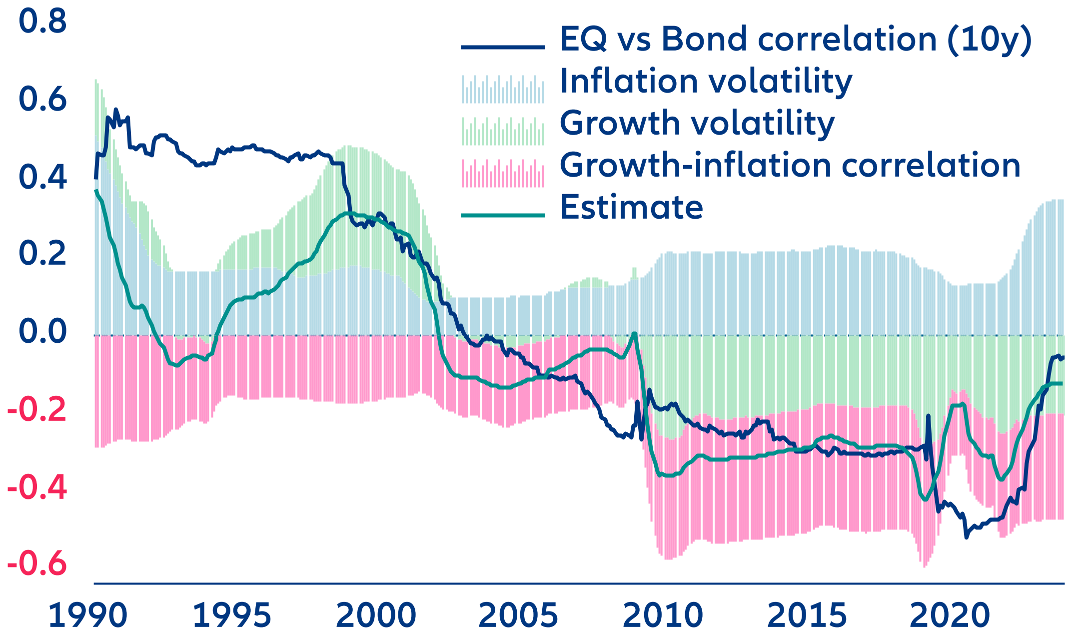
Diversification, a comeback to the post 2000s era or a structural shift?

The simultaneous equity-fixed income underperformance in 2022 will remain engraved in market sentiment…



Sources: LSEG Datastream, Allianz Research

… but declining growth-inflation uncertainty and a comeback of demand-driven dynamics should bring diversification back



Sources: LSEG Datastream, AQR, Allianz Research

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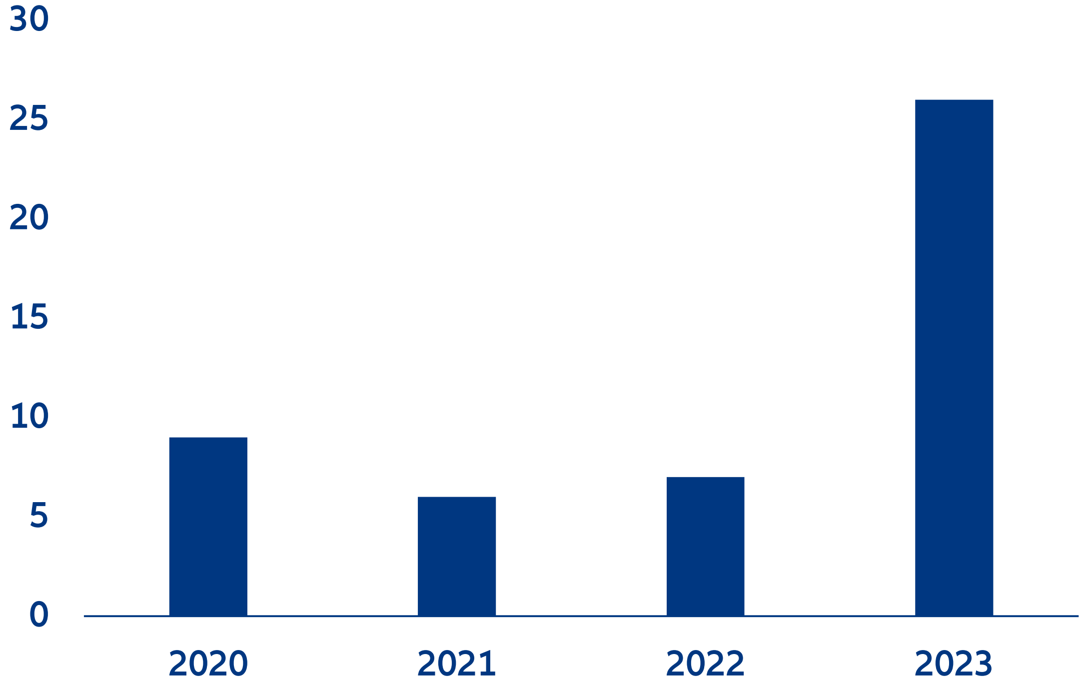
The ESG market rush is decelerating as sustainable investing becomes ever more politicized

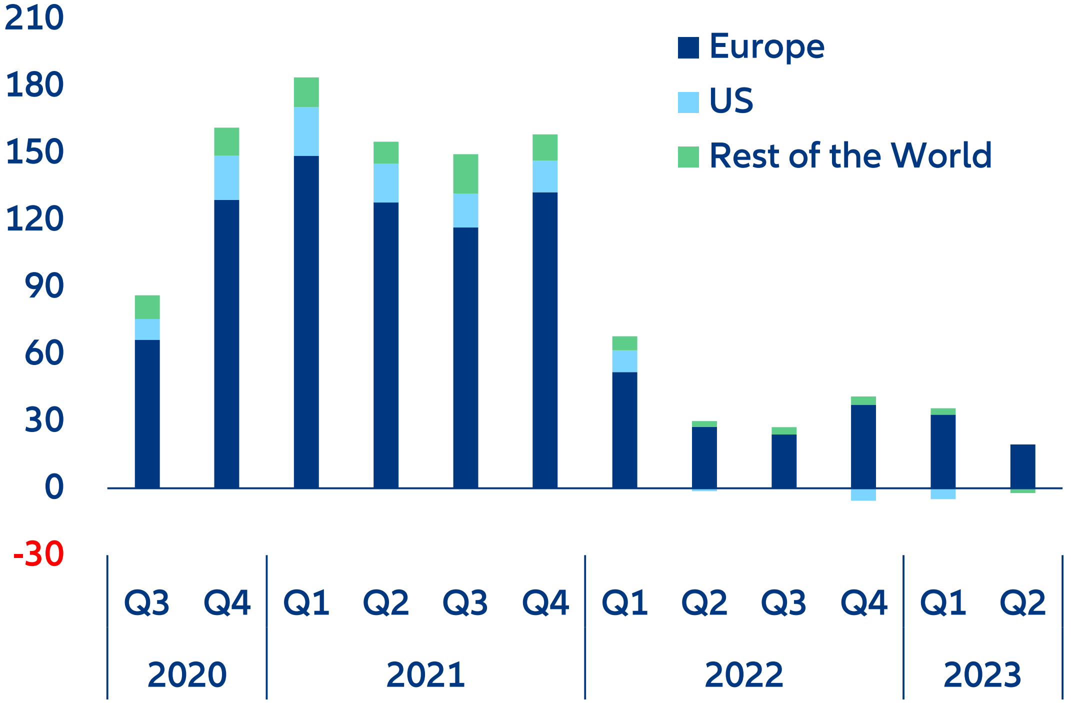
ESG investment fund liquidations increase in 2023

Sustainable fund closures in first eight months of each year



Sources: Morningstar, Bloomberg, Allianz Research

ESG fund flows are decelerating and even turning into outflows (q/q - USD Bn)



Sources: Morningstar, Allianz Research