

Scenario Analysis 2020

Recovery – Recession – Stagnation

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Executive Summary

Scenario 1


Recovery: Mild recovery towards potential global real GDP growth

 Equities

 Credit riskless government bonds

Scenario 2


Recession: Negative spillover effects intensify


 Credit riskless government bonds

 Risk assets

Scenario 3

Secular Stagnation: Ongoing growth below potential

 Bonds

 Equities

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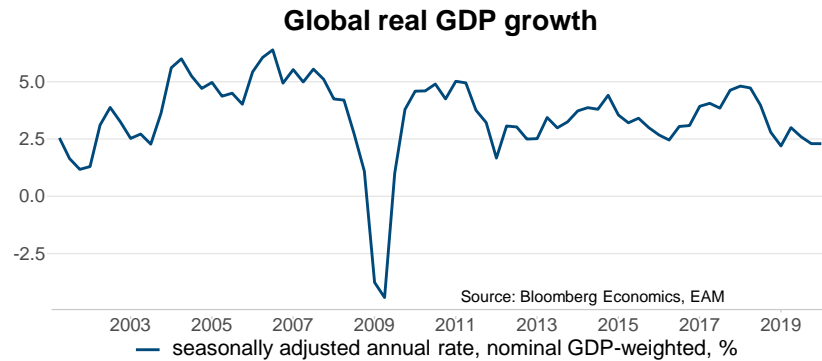
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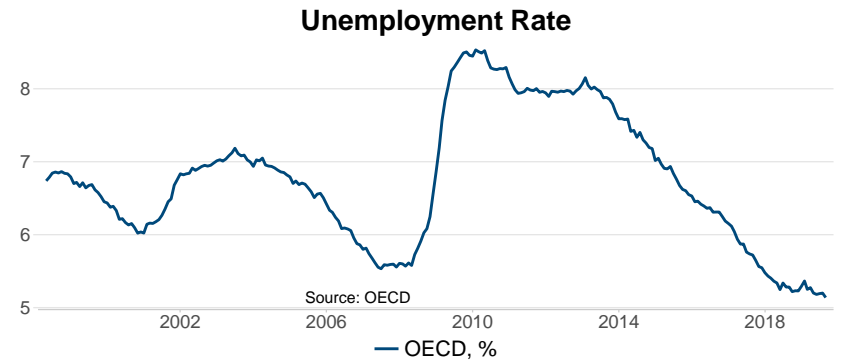
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Current Environment (1/3)

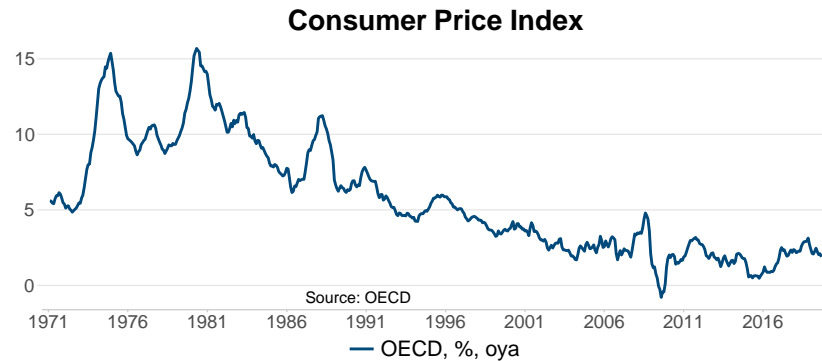
Global real GDP growth below potential
Only weak stabilisation signs



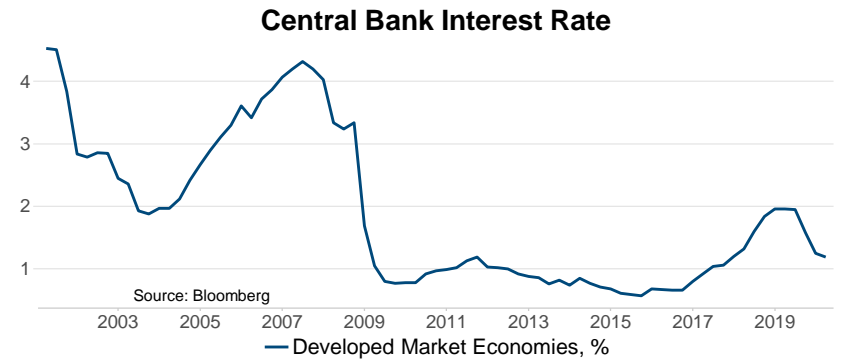
Strong labour market
Negative spillover effects - falling employment growth



Low inflation
Falling price indicators



More easy monetary policies
Falling effectivity

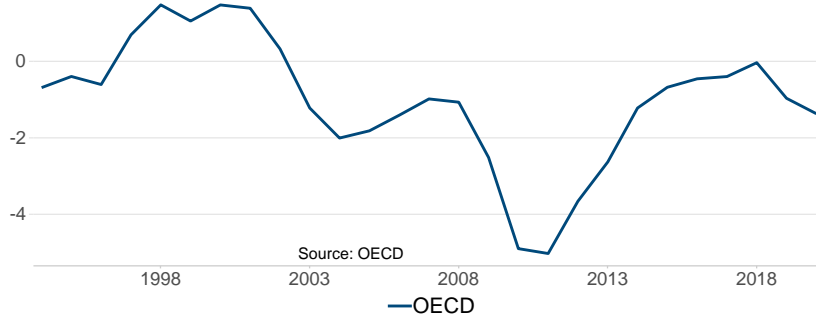


Current Environment (2/3)

Fiscal stance is mildly expansionary

Pressure for much higher government budget deficits

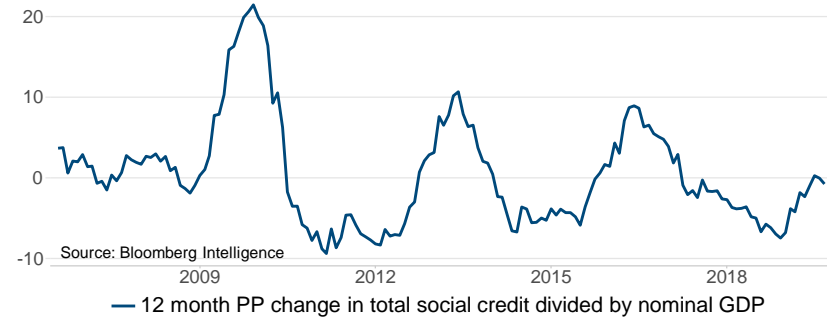
Cyclically Adjusted Gov't Primary Balance, % Potential GDP



Neutral credit environment

Mildly positive credit impulse in China

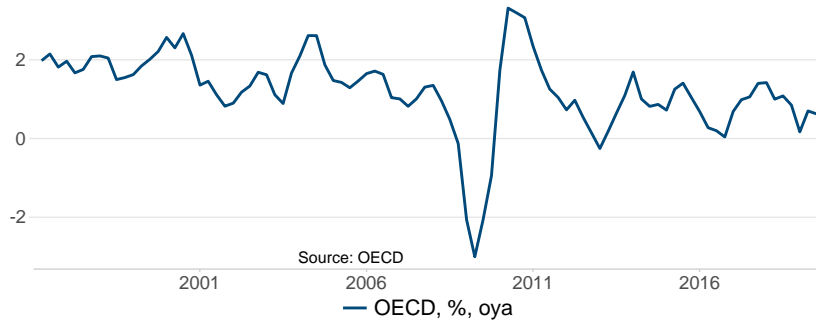
China Credit Impulse



Increase in unit labour costs growth

Wage growth above productivity growth

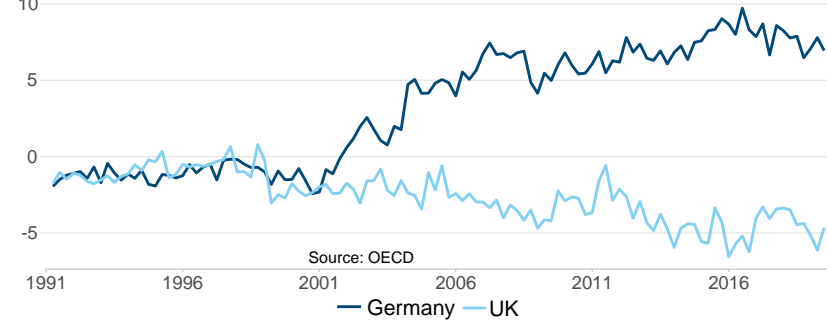
Labor Productivity



Elevated current account surplus in Germany

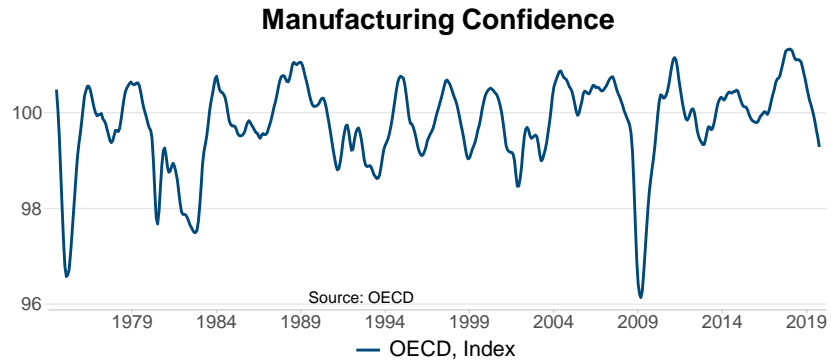
Elevated current account deficit in the UK

Current Account Balance, % GDP

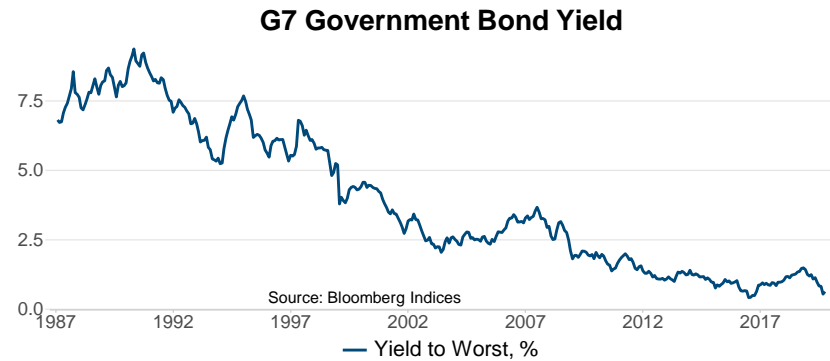


Current Environment (3/3)

High politics-induced uncertainty
Downturn in manufacturing confidence



Very low interest rate level
Equilibrium valuations have increased



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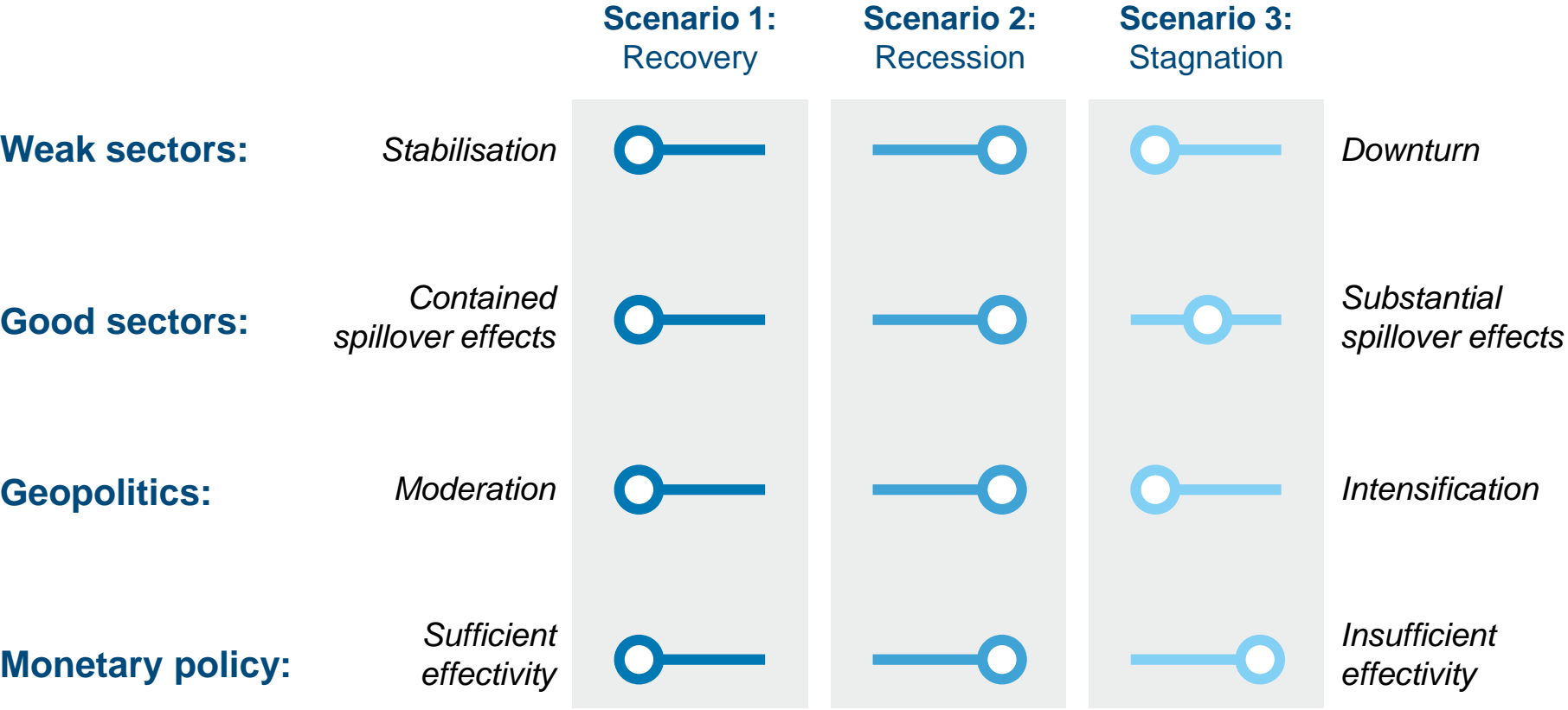
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Four Parameters

...which are determining the three scenarios



Scenario 1: Recovery

Global real GDP growth around potential



- **Growth:**
 1. Stabilisation in industrial production
 2. Negative spillover effects remain subdued
- **Labour Market:**

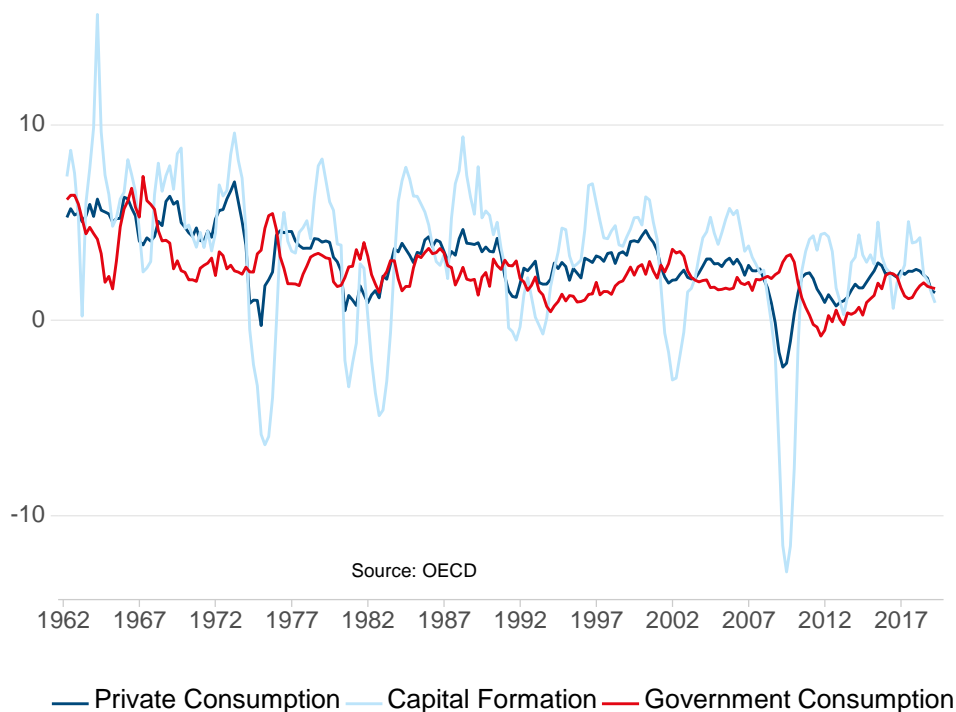
Unemployment rates remain low
- **Inflation:**

Stabilisation at a low level
- **Monetary policy:**

Monetary policy easing is effective
- **Fiscal policy:**

Mild expansionary fiscal policy is sufficient

Consumption and Investment, %, oya



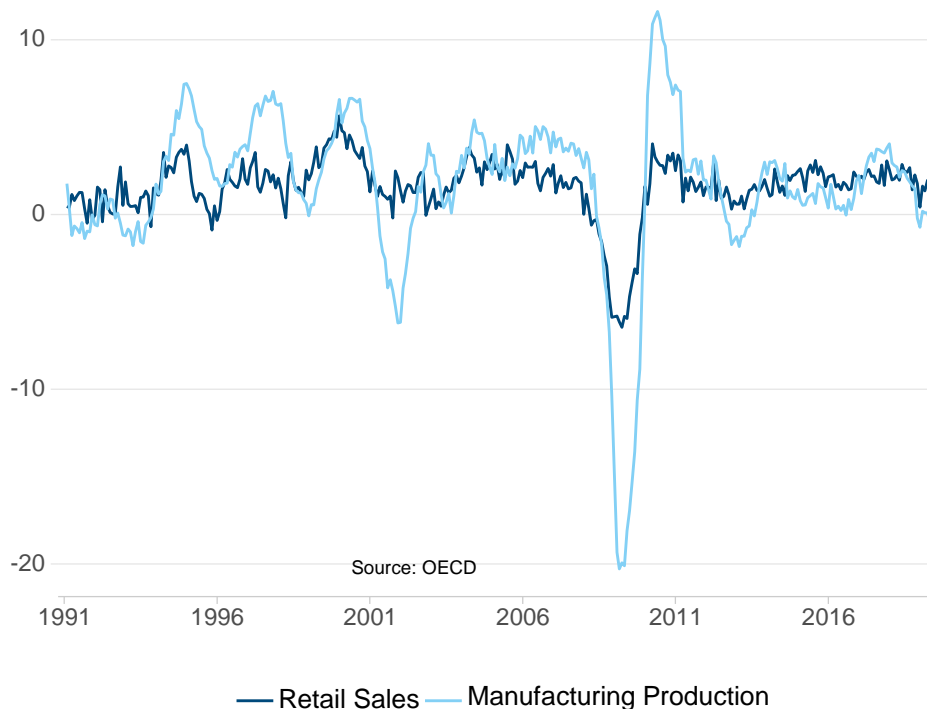
Scenario 1: Recovery

Probability: 50%



- **Credit environment:**
Credit lending standards turn mildly expansionary
- **Competitiveness:**
Stabilisation in increased unit labour cost growth
- **External Sector:**
No external adjustment pressures
- **Politics:**
Mini-deal between the US and China (truce), no hard Brexit
- **Financial Market:**
Recovery in profit growth dominates increase in interest rates

Retail Sales and Manufacturing, %, oya



Scenario 2: Recession

Continuation of the downturn

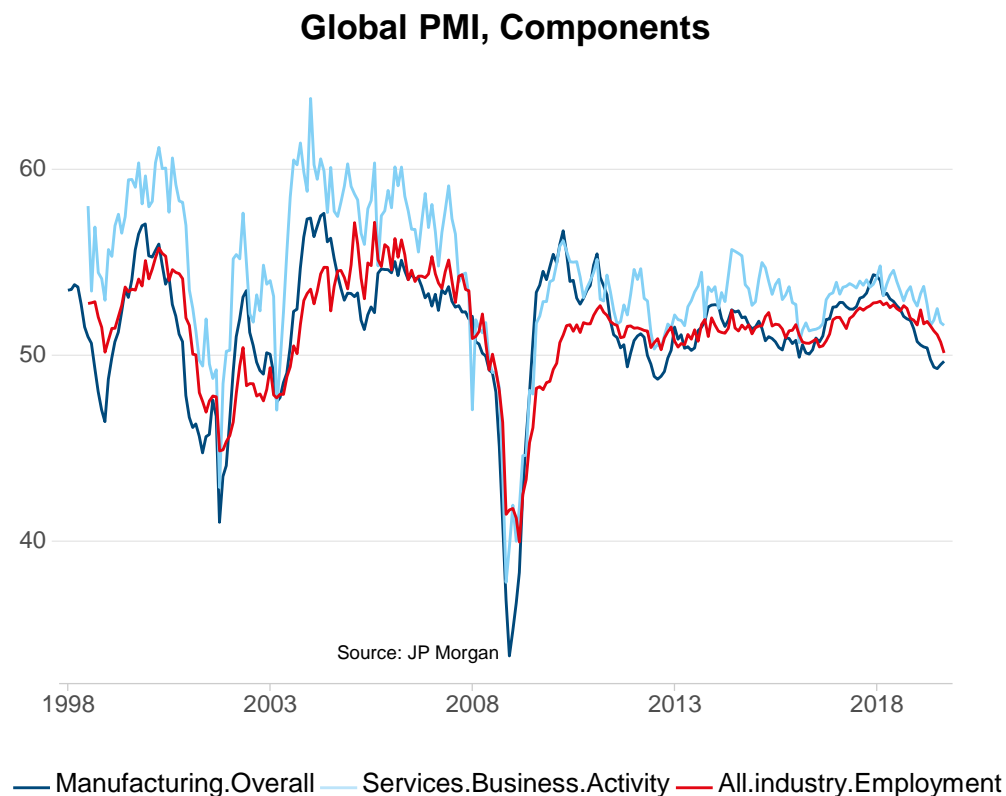


- **Growth:**
 1. Contraction in industrial production and corporate investment spending
 2. Negative spillover effects on employment / consumption / services / company profits
- **Labour Market:**

Ongoing fall in employment growth / increase in unemployment rates
- **Inflation:** Disinflation
- **Monetary policy:**

Monetary policy is not able to prevent downturn
- **Fiscal policy:**

Necessary increase in government spending does not take place



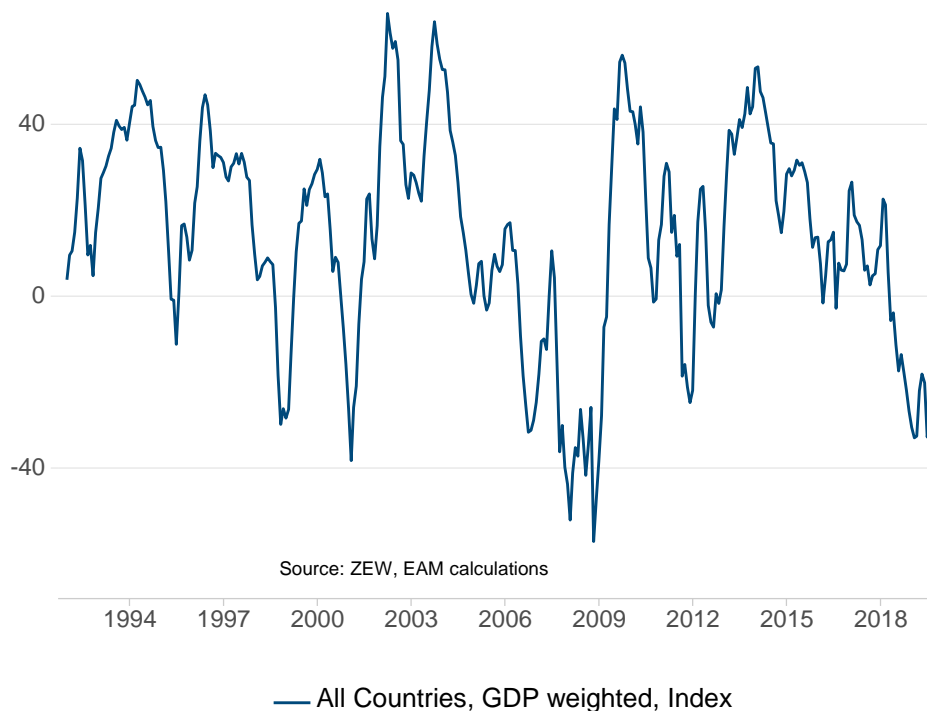
Scenario 2: Recession

Probability: 25%



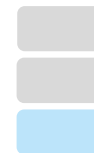
- **Credit environment:**
Credit lending standards turn restrictive
- **Competitiveness:**
Significant increase in unit labour cost growth leads to contraction in company profits
- **External Sector:**
Adjustment of external imbalances (falling imports in current account deficit countries, falling exports in current account surplus countries)
- **Politics:**
Conflict between the US and China intensifies (trade, technology, currency, finance)
- **Financial Market:**
Falling interest rates are not able to compensate for earnings contraction

ZEW Expectations of Economic Growth



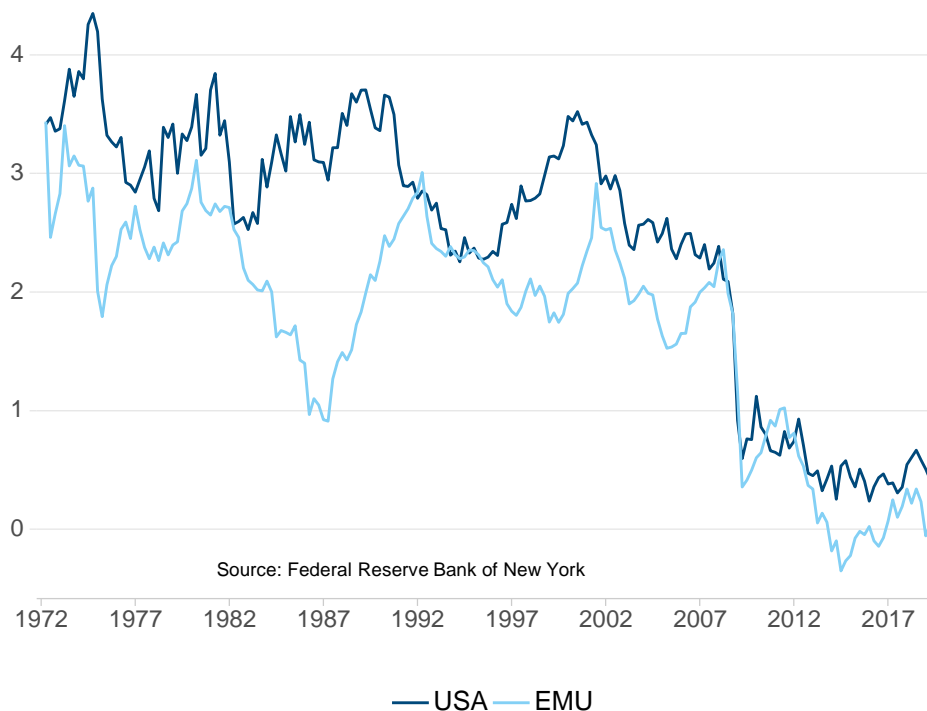
Scenario 3: Secular Stagnation

Ongoing low GDP growth



- **Growth:**
Global economic growth remains below potential for a long time
- **Labour Market:**
Elevated unemployment rates for a long time
- **Inflation:**
Inflation rates remain below the central bank target
- **Monetary policy:**
Policy rates reach the effective lower bound
- **Fiscal policy:**
Necessary substantial increase in government spending does not take place

Natural Real Rate of Interest, %

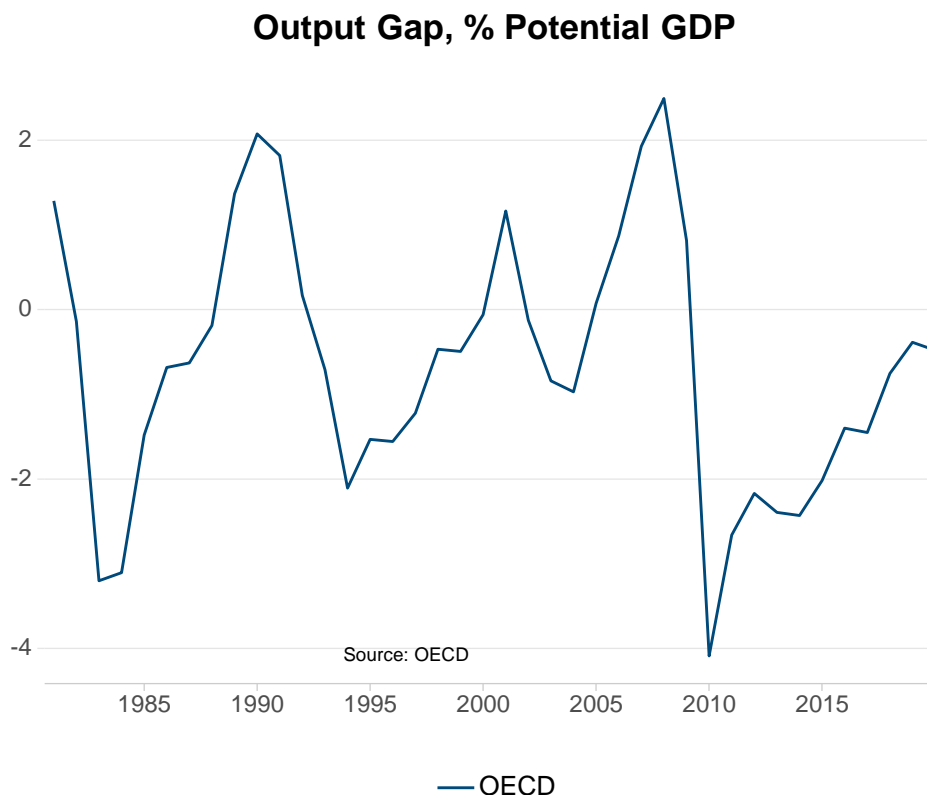


Scenario 3: Secular Stagnation

Probability: 25%



- **Credit environment:**
Credit lending standards stay restrictive
- **Competitiveness:**
Ongoing low productivity growth and profit margins
- **External Sector:**
Countries with elevated current account surpluses export secular stagnation
- **Politics:**
Globalisation in retreat
- **Financial Market:**
 1. Ongoing very low interest rate level
 2. Equilibrium valuations have increased
 3. Subdued expected returns



Performance Estimates 2020

By asset class and scenario

Scenario 1: Recovery

Scenario 2: Recession

Scenario 3: Stagnation

Global equities	4.0%	US treasuries	5.0%	China government bonds (LC)	4.5%
Global corporate bonds HY	3.0%	China government bonds (LC)	4.5%	US treasuries	3.5%
EM corporate bonds (HC)	2.5%	Global ESG bonds	3.5%	EM government bonds (LC)	3.0%
EM government bonds (HC)	2.0%	German government bonds	2.5%	German government bonds	2.5%
EM government bonds (LC)	1.0%	Euro government bonds	2.0%	Euro government bonds	2.0%
China government bonds (LC)	-0.5%	Euro corporate bonds IG	0.0%	Global corporate bonds HY	2.0%
Global ESG bonds	-1.0%	EM government bonds (LC)	-1.5%	Global ESG bonds	2.0%
US treasuries	-1.5%	EM corporate bonds (HC)	-3.0%	EM government bonds (HC)	1.0%
Euro corporate bonds IG	-2.0%	Global corporate bonds HY	-4.5%	EM corporate bonds (HC)	0.5%
Euro government bonds	-3.5%	EM government bonds (HC)	-5.0%	Euro corporate bonds IG	0.0%
German government bonds	-4.0%	Global equities	-12.5%	Global equities	-2.0%



List of indices employed: see slide 39. Methodology description: see slide 40. Performance estimates rounded in 0.5% intervals.

Yield Estimates 2020

By asset class and scenario

Asset class	Index*	Current yield**	Estimated yield change		
			Recovery	Recession	Stagnation
US treasuries	LUATTREH	1.7%	+0.5%	-0.5%	-0.3%
German government bonds	BCEG1T	-0.4%	+0.4%	-0.4%	-0.4%
Euro government bonds	LEEGTREU	-0.1%	+0.4%	-0.3%	-0.3%
Euro corporate bonds IG	LECP TREU	0.4%	+0.5%	+0.1%	+0.1%
Global corporate bonds HY	LG30TREH	6.1%	+0.8%	+2.8%	+1.1%
EM government bonds (HC)	BSSUSIEH	5.8%	+0.5%	+1.4%	+0.6%
EM corporate bonds (HC)	BEHPSIEH	4.7%	+0.6%	+1.8%	+0.9%
EM government bonds (LC)	EMLCTRUU	3.9%	+0.5%	+0.8%	+0.2%
China government bonds (LC)	LACHTRUU	3.1%	+0.6%	-0.2%	-0.2%
Global ESG bonds	EGAM TREU	1.2%	+0.5%	-0.5%	-0.1%

HY: high yield, IG: investment grade, HC: hard currency, LC: local currency

*List of indices employed: see slide 40, **As of October 2019

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Methodology

Technical background

Set-up:

- Eleven asset classes
- Three scenarios
- Method: Dynamic Simulation (“dynsim” package in R)

Five step process to simulate:

1. Download and prepare the data
(detrending, taking differences, ...)
2. Estimate the linear model using the core R function
“lm”
3. Set up values for simulation scenarios
4. Simulate these scenarios based on the estimated
model using the “dynsim” function
5. Calculate the return of the simulation results

Literature:

- Dynamic Simulations of Autoregressive Relationships in R with dynsim
- Christopher Gandrud, Laron Williams, Guy Whitten
- <https://cran.r-project.org/web/packages/dynsim/vignettes/dynsim-overview.pdf>

Methodology

Employed index universe

Asset class	Ticker	Index name
US treasuries	LUATTREH	Bloomberg Barclays US Aggregate Total Treasury Value Hedged EUR
German government bonds	BCEG1T	Bloomberg Barclays Germany Govt All Bonds Total Return
Euro government bonds	LEEGTREU	Bloomberg Barclays Euro Agg Government Total Return Index Value Unhedged EUR
Euro corporate bonds IG	LECP TREU	Bloomberg Barclays Euro Aggregate Corporate Total Return Index Value Unhedged EU
Global corporate bonds HY	LG30TREH	Bloomberg Barclays Global High Yield Total Return Index Value Hedged EUR
EM government bonds (HC)	BSSUSIEH	Bloomberg Barclays Emerging Markets Sovereigns Since Inception Return Hedged EUR
EM corporate bonds (HC)	BEHPSIEH	Bloomberg Barclays EM Hard Currency Agg Corp Since Inception Return Hedged EUR
EM government bonds (LC)	EMLCTRUU	Bloomberg Barclays EM Local Currency Government TR Index Unhedged USD
China government bonds (LC)	LACHTRUU	Bloomberg Barclays China Aggregate TR Index
Global ESG bonds	EGAMTREU	Bloomberg Barclays MSCI Global Agg ESG Weighted Total Return Index Unhedged EUR
Global equities	MSDEWIN	MSCI World Net Total Return EUR Index

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