IV Outlook

1 Economic conditions

1.1 Global economic trends

The COVID-19 pandemic pushed the global economy into recession. The economic output data available for the first quarter of 2020 gives an impression of the severity of the crisis. The collapse of the economy in 2020 is likely to be on an unprecedented scale, especially in Europe, where significant restrictions were imposed on some areas of economic activity as early as mid-March. However, the economic impact of COVID-19 on the United States and other major economies is also huge.

Many countries outside South East Asia began easing their lockdown measures in May 2020. However, the still considerable risk of infection means that economic activity can pick up only gradually. There is deep-seated uncertainty, and fears about a second wave remain high. The fallout is expected to carry on into 2021.

In addition to the COVID-19 pandemic, the global economy continues to face other risks. These include the trade dispute between the United States and China, which has flared up again. Another risk is posed by the negotiations between the United Kingdom and the EU on the agreement about their post-Brexit relationship, which have made barely any progress despite the tight timeframe.

The forecast for global economic output in 2020 is a contraction of just over 4 percent. The recovery anticipated for 2021 will result in growth of around 5 percent. The price of crude oil remains low due to persistently weak demand. Consequently, inflation rates are likely to be extremely low this year and only slightly higher in 2021.

1.2 Trends in the USA

The restrictions on economic activity and public life resulting from the COVID-19 pandemic drove the US economy into recession. Economic output is likely to contract by approximately 5.5 percent this year. In the first quarter of 2020, US GDP shrank by 4.8 percent on an annualized basis. The economic collapse was even greater in the second quarter. Unemployment rose sharply. The significant decline in consumer spending is taking its toll on economic output. The government support measures cannot take effect fast enough to prevent this. At the same time, the European economy's massive slump is weighing heavily on US exports. After all, a fifth of US exports are destined for EU countries thanks to the close trade relationships.

Next year is likely to see strong economic growth of around 4 percent fueled by robust consumer spending and the recovery of exports and of corporate capital expenditure.

Inflation has fallen almost to zero owing to the weakness of the economy. Energy prices are the primary brake on inflation, but prices for other goods are also having the same effect. Although the inflation rate is unlikely to remain close to zero for long, the weak economy leaves no room for significant price increases. The average rate of inflation for 2020 in the United States is predicted to be 0.8 percent, rising to 1.8 percent in 2021.

1.3 Trends in the eurozone

The eurozone has also slipped into recession. In the period January to March 2020, GDP fell by 3.6 percent compared with the previous quarter. From mid-March onward, the lockdowns imposed in order to contain the COVID-19 pandemic led to the collapse of consumer spending and capital expenditure in all EMU member states. Exports and imports were also scaled back massively.

However, the degree of collapse varied among the large member states because they imposed different levels of economic and social restrictions. The contraction of GDP compared with the previous quarter was greater in France, Italy, and Spain than in Germany and the Netherlands.

Most countries did not begin to ease the lockdown until during the course of May 2020. Only since June has there been a gradual resumption of international travel. The decrease in the eurozone's economic output was therefore very pronounced in the second quarter of 2020.

Economic growth in the eurozone is expected to stage a moderate recovery in the second half of this year. Provided that there is no new spike in the number of coronavirus cases and a return to lockdown is avoided, confidence among consumers and companies should gradually return. The fiscal stimulus measures at country level and the EU's programs will also help the economy to rebound. But there will be no return to 'normality'. Economic growth in the third and fourth quarters of 2020 will be insufficient to compensate for the decline in the first half of the year. Overall, therefore, the eurozone's economic output in 2020 is likely to be down by more than 9 percent compared with 2019. In 2021, GDP is expected to return to growth of almost 6 percent.

In spring 2020, inflation in the eurozone fell sharply yet again due not only to the sharp drop in the oil price but also to the crisis created by COVID-19. The inflation rate of the Harmonised Index of Consumer Prices (HVPI) dropped close to zero in the eurozone in April and May 2020. This trend is unlikely to be reversed in the months ahead. An average inflation rate of 0.3 percent is projected for 2020. However, there are no signs of the risk of deflationary tendencies. For 2021, an inflation rate of 1.4 percent is predicted.

1.4 Trends in Germany

The German economy was also in recession in the middle of 2020. However, economic activity looks to have reached its nadir in April 2020 when strict restrictions were in place, and German companies are now more positive about the future again. The easing of the lockdown measures imposed to contain COVID-19 means that many companies' prospects look brighter again. It is too early to sound the all-clear, but the hard-hit service and retail sectors are offering a first glimmer of hope. Nevertheless, economic output slumped in the second quarter of 2020 following a 2.2 percent GDP decrease in the first three months of the year. Consumer spending, expenditure on capital equipment – mainly machinery, equipment, and vehicles – and the export of goods declined significantly in the first quarter. Construction investment and current spending by the government provided some stability, preventing an even stronger contraction of GDP. Overall, the expectation is that sentiment will continue to gradually improve in the coming months as the lockdown is lifted in phases and most sectors start reopening for business.

The economic stimulus package agreed upon by Germany's ruling coalition on June 3, 2020 has a substantial volume equating to almost 4 percent of GDP and should provide a significant boost to the economy. The additional impetus for GDP is estimated to be roughly three-quarters of a percentage point for 2020 and around one-quarter of a percentage point for 2021. Lower rates of excise duty will stimulate consumer spending in the second half of this year. Bigger purchases will be made, some of which will certainly be brought forward from 2021. This will have some repercussions in the first quarter of next year. However, the net effect of lowering VAT should be very positive and may increase consumer spending by around 1 percentage point.

The anticipated fall in prices will also cause the inflation rate to go down in the second half of 2020. From July onward, it is likely to hover between minus 1 and minus 2 percent, but will therefore be higher in the second half of 2021 (between 2.5 and 3.5 percent) due to the low level of prices this year. Capital expenditure by companies and the government will also be higher than previously estimated due to the tax measures and the subsidies for capital investment by local governments.

Overall, GDP is projected to contract by 5.9 percent this year before returning to growth of 5.1 percent in 2021. The average inflation rate for 2020 is expected to be around zero, rising to just under 2 percent in 2021.

1.5 Trends in the financial sector

The global outbreak of the COVID-19 pandemic in March 2020 is presenting the financial sector with huge challenges.

As well as sharp price falls in international financial markets, the stability of the global financial markets is being challenged by sweeping economic and social restrictions introduced to stop the spread of the pandemic. Monetary, fiscal, and economic policy measures taken by central banks and governments worldwide enabled the capital markets to recover, at least to some extent, but it is impossible to fully assess whether these measures are having their intended impact on the real economy because of the current recession affecting large parts of the global economy.

One of the objectives of the public-sector support measures is to encourage lending to businesses and to households in order to protect their liquidity and encourage capital expenditure and consumer spending. However, it is possible that potential rises in companies' and individuals' debt levels as a result of these measures could have an adverse impact on the financial sector's financial performance, even though the financial sector is considered to be far more stable than at the time of the 2008/2009 financial crisis due to the various regulatory requirements that have been introduced.

The macroeconomic situation outlined above increases the already considerable pressure in terms of both adjustment and costs caused by the need to comply with regulatory reforms and to implement structural change in response to growing competitive pressures.

The presence of competitors with approaches based on the use of data and technology are presenting the financial sector with the challenge of scrutinizing its existing business models, adapting them as required, and having to substantially improve its efficiency by digitalizing business and IT processes. The corresponding capital investment is initially likely to push up costs in the industry before the anticipated profitability gains can be realized.

As before, efforts to address the challenges described above are being made more difficult by the persistently low nominal interest rates in the eurozone, which are still accompanied by a relatively flat yield curve. This situation is likely to prevent any significant increase in margins in interest-related business and continues to weigh heavily on the business models in asset management and insurance as well.

The uncertainty surrounding political and economic developments, some of which is the result of COVID-19, could have an adverse effect on the economic position of the financial sector. Further information on overarching risk factors can be found in section 4.2 of the opportunity and risk report.

2 Financial performance

The forecasts below are based on the outcome of the DZ BANK Group's projection and planning process. Increased forecasting uncertainty, particularly as a result of the COVID-19 pandemic, may lead to deviations from the underlying assumptions.

In view of the economic conditions resulting from the COVID-19 pandemic, **profit before taxes** is likely to fall sharply in 2020 and be below the originally budgeted figure of around €1.5 billion. Profit before taxes of €1 billion is unlikely to be achieved in 2020 as a whole. Positive trends in the operating business, such as those emerging in the DZ BANK – CICB and UMH operating segments, will be nowhere near enough to compensate for the fallout from COVID-19.

Profit before taxes is expected to be better in 2021 than in 2020 although, from the current perspective, achieving a profit before taxes that is within the long-term target range of €1.5 billion to €2.0 billion appears improbable.

Net interest income including **income from long-term equity investments** is predicted to be a little higher in 2020 than in 2019.

Assuming that interest rates remain low, net interest income in 2021 is expected to be at a similarly high level to 2020.

The economic conditions, which are heavily influenced by the COVID-19 pandemic, coupled with a yield curve that remains flat and with low rates of interest, may lead to falls in income, especially in relation to the interest-rate-sensitive business models within the DZ BANK Group.

Net fee and commission income is projected to be slightly higher in 2020 than in 2019.

Once again, net fee and commission income will make a very hefty positive contribution to the earnings of the DZ BANK Group in 2021 thanks to growth, especially in the UMH, DZ BANK – CICB, and DZ PRIVATBANK operating segments.

Any lasting uncertainty in capital and financial markets could have a negative impact on confidence and sentiment among retail and institutional investors, thereby depressing net fee and commission income.

In all probability, net gains under **gains and losses on trading activities** will rise sharply in 2020 compared with 2019.

According to the planning for 2021, gains and losses on trading activities will deteriorate significantly compared with 2020. Positive impetus is particularly likely to come from customer-driven capital markets business in the DZ BANK – CICB operating segment.

The primary prerequisite for a steady level of net gains under gains and losses on trading activities is considered to be a stable financial and capital markets environment.

Gains and losses on investments will deteriorate significantly this year due to the inclusion in the prior-year figure of positive non-recurring items.

From the current perspective, gains and losses on investments will improve significantly in 2021 because no further adverse impact of write-downs on the carrying amounts of investments are expected.

Other gains and losses on valuation of financial instruments are expected to deteriorate sharply year on year to a net loss in 2020, mainly due to the effects of measuring securities from government issuers in European periphery countries and measuring guarantee commitments for investment products.

In 2021, however, other gains and losses on valuation of financial instruments are forecast to improve substantially to a net gain.

Volatility in capital markets and especially the widening of credit spreads on securities from the aforementioned issuers could have a negative impact on the forecast gains and losses.

Net income from insurance business in 2020 is expected to be well below the 2019 figure. The reason for this is the predicted sharp year-on-year decline in gains and losses on investments held by insurance companies, which will not be offset by the growth-related increase in premiums earned.

In 2021, net income from insurance business is currently expected to see a strong recovery and is therefore likely to be much higher than in 2020.

Exceptional events in financial and capital markets, changes in underwriting practices, or potential changes in the regulatory requirements faced by insurers may adversely affect the level of net income expected to be earned from insurance business.

Expenses for **loss allowances** are likely to rise considerably in 2020 compared with their level in 2019 owing to the predicted impact of COVID-19 on the real economy. At present, expenses for loss allowances in the second half of this year are anticipated to be in line with the planning.

Expenses for loss allowances are expected to remain at a high level in 2021, especially in the DZ BANK – CICB, DVB, and TeamBank operating segments.

The effects of the economic conditions shaped by the COVID-19 pandemic on the credit markets relevant to the DZ BANK Group could have a detrimental impact on loss allowances.

In 2020, **administrative expenses** are expected to hold steady year on year.

The planning for 2021 assumes a small rise in administrative expenses compared with 2020. The aim is for growth-related increases in administrative expenses in selected operating segments to be offset by savings.

Other net operating income is expected to be substantially lower in 2020 than in 2019 as a result of the prior-year figure having been boosted by positive non-recurring items and will probably remain at a greatly reduced level in 2021.

The **cost/income ratio** for the DZ BANK Group is likely to deteriorate sharply in 2020 as a result of the predicted year-on-year decrease in income and an unchanged level of expenses.

In 2021, the cost/income ratio should then improve noticeably in line with the anticipated increase in income.

One of the main strategic aims is to reduce the cost/income ratio over the long term by rigorously managing costs in all operating segments on the one hand and by accelerating growth in their operating business on the other.

Regulatory RORAC, the risk-adjusted performance measure based on regulatory risk capital, will probably fall substantially year on year in 2020 but rise substantially in 2021.

3 Liquidity and capital adequacy

The DZ BANK Group is assuming that it can continue to maintain an appropriate level of **liquidity adequacy** during the remainder of 2020 and in 2021. Further information on liquidity adequacy can be found in section 5 of the opportunity and risk report.

As matters currently stand, the DZ BANK Group's **capital adequacy** is assured for 2020 and 2021; that is to say, it will continue to have at its disposal the available internal capital necessary to cover the risks associated with the finance business and other risks arising from the group's business operations. Further information on capital adequacy can be found in section 6 of the opportunity and risk report.