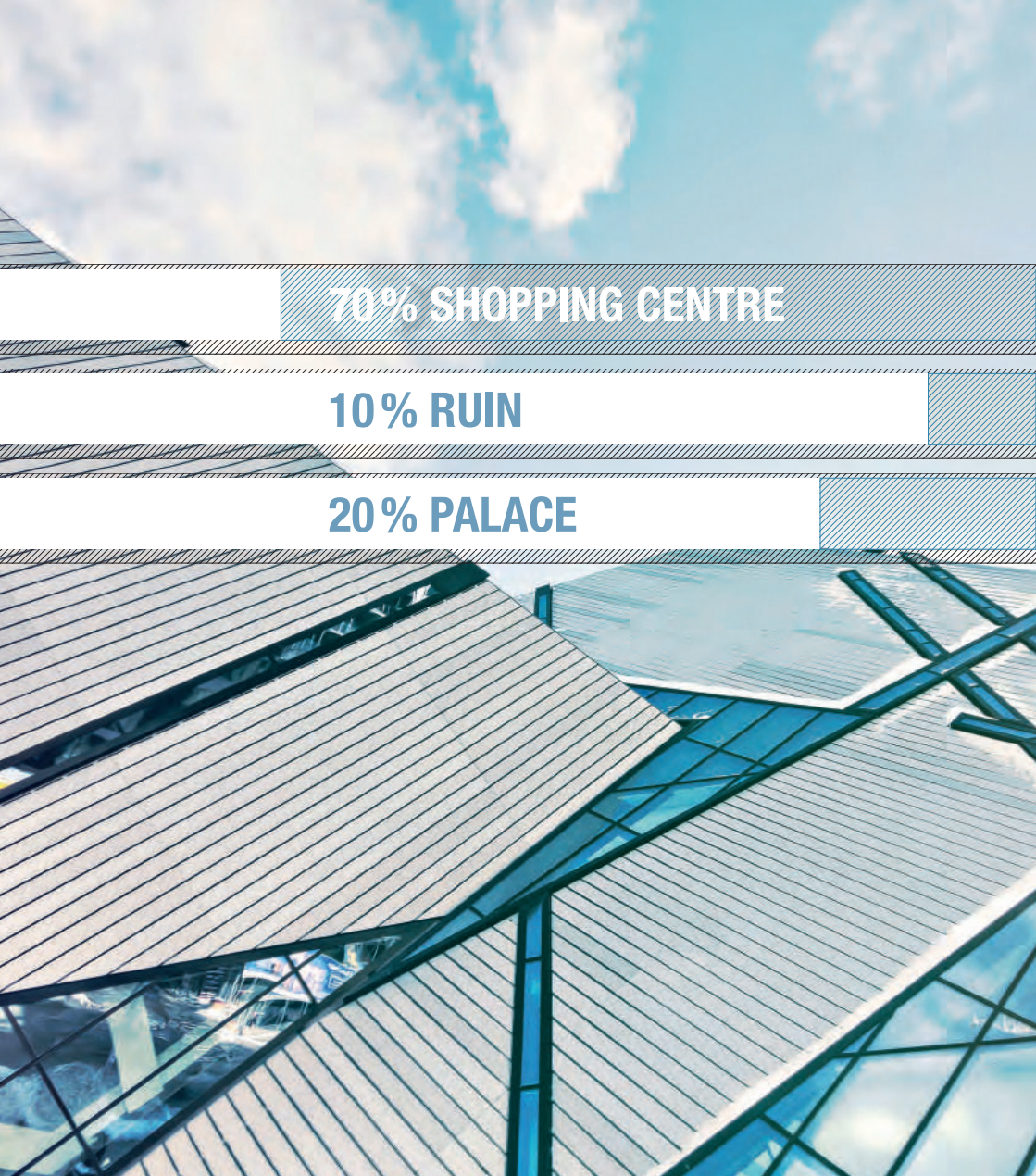


Shopping Centre
Nothing Comes for Free

Helaba Research
November 2017

Helaba


70% SHOPPING CENTRE
10% RUIN
20% PALACE

EDITORIAL

Consumers‘ and investors‘ wallets are wide open – more than they have been for a long time. But beware: in a positive mood, people are less critical and easily seduced by peripheral cues. The fact that many goods and asset classes have become expensive is quickly overlooked.

It applies for both the shopping centre and the capital markets: Nothing comes for free



Dr. Gertrud R. Traud
Chief Economist /
Head of Research

Dear readers,

Architects equipped with imagination and contemporary concepts possess magic powers: with their buildings they create silent contemporary witnesses that are useful and evoke **emotions**.

Baseline scenario "shopping centre" – nothing comes for free!

We have also let ourselves be inspired by buildings for the 2018 annual outlook. The symbol of the economic situation and the capital markets is the shopping centre in our baseline scenario (70 % probability). For economists it is actually a very clear choice. After all, shopping centres are nothing more than market places where supply and demand meet.

As places for consumption, shopping centres impressively reflect the most significant component of gross domestic product (GDP) – **private consumption**. With a share of between 50 % and 70 %, it significantly determines economic development in

most countries. In doing so, the economy runs smoothly and consumers can enjoy a diverse range thanks to globalisation.

Consumers and investors are currently in a **buying mood**. But beware: scientific studies have shown that people are less critical and attentive in a positive mood. They are taken in by the perfectly designed atmosphere in the shopping centre.

Inflation is back

In the process, they do not even realise that many prices have already increased in 2017. We should know that a good economic situation is not for free: its price is inflation.

What is the situation in different **countries**? We have compared and evaluated: Reading this is for free, so don't hesitate.

As in every year, we provide you with an overview of the different **asset classes**. The mood in the capital markets is very similar to that in the shopping centre. That is why you should not just go shopping with open eyes in 2018, but also check the prices when investing in assets. More caution is appropriate due to the high valuations – after all, nothing comes for free, either!

Information about our alternative scenarios “ruin” (10 %) and “palace” (20 %) can be found at the end of the brochure.

This publication represents a summary of the most important subjects and findings of the 2018 annual outlook. This document as well as the complete version (only in German) can be found at:
http://volkswirtschaft.helaba.de

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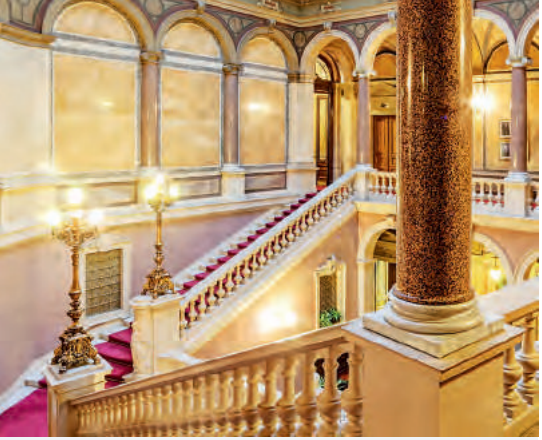
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Baseline scenario

Shopping centre – Nothing Comes for Free (70 %)

Customers and investors are in a buying mood. However, in the meantime, many goods and asset classes have become expensive. In our baseline scenario, "shopping centre", we therefore advise against impulse buys. We attribute a 70 % probability to this scenario.

In 2018, the **global economy** will grow as dynamically as in the previous year, at a rate of 3.4 %. Sharply increasing growth rates, as currently promised by many economic indicators will, however, not be realised.

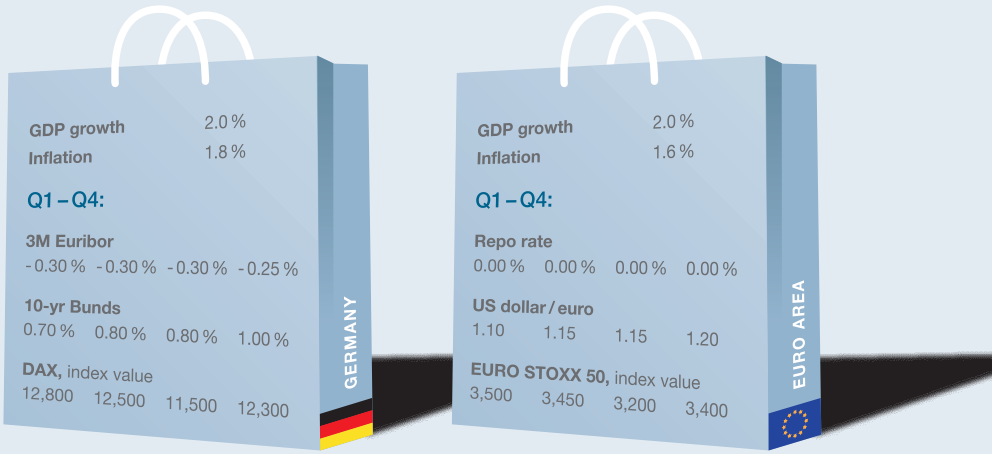
For the **USA**, a slight acceleration of the annual average from 2.2 % to 2.5 % emerges. Here, we have assumed moderate tax cuts. The **unpredictability** of future trade policy under President Trump, however, has an impact on the investment climate.

The **euro area** and **Germany** will not be able to sustain their fast pace from 2017. Consumers are increasingly becoming aware of higher inflation. In order to follow a path of sustainably higher growth, a growth-oriented economic policy is required that counteracts both demographic development as well as the neglected infrastructure. In some regions of Europe, populism, protectionism and **separatism** are proving to be damaging to growth.

There will be reduced stimulus from **Asia** in 2018 compared to 2017. After a phase of additional economic policy stimulus, China is returning to a path of slower structural growth. Indebtedness, in particular of state-owned enterprises, has increased dramatically. The Chinese property market remains a stability risk. A persistently high **debt ratio** in industrialised countries and debt financing in emerging economies that has increased significantly in recent years will be a burden in 2018.

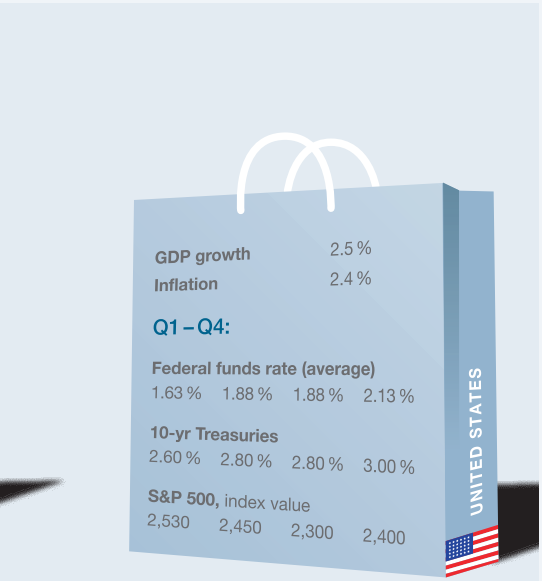
> Contrary to speculation, the Phillips curve is not dead

Selected Forecasts 2018



Source: Helaba Research

In many industrialised countries, **inflation rates** returned to around the 2 % mark in 2017. Shortages in the labour market favour wage growth. This is particularly pronounced in Eastern Europe, where strong wage growth can already be observed due to a lack of skilled workers. The tide also appears to be turning in the USA and Germany. Whilst the rise in inflation so far is mainly attributed to higher energy prices, increasing **core rates** are also to be expected in 2018. In the USA, the inflation rate will be significantly above 2 % in 2018; in the euro area and Germany it will edge towards the ECB's inflation target of 2 %. Complaints about "undesirably low" inflation rates, therefore, are not justified any longer.



Less expansive monetary policy

In industrialised countries, some central banks return to focusing on interest rate increases. The **US Federal Reserve** will continue to normalise its monetary policy. By the end of 2018 we are expecting an increase in the Fed funds rate in the range from 2.00 % to 2.25 %. In addition, the Fed is planning to reduce its securities portfolio by 10 % by the end of 2018.

The **ECB** is not yet that far ahead, but is also likely to react to the improved economic environment. At the start of 2018 it will scale back its purchasing programme from €60 billion per month to €30 billion per month. In September 2018 the monetary spending spree is likely to come to an end. However, this does not mean that the ECB will cease to be a source of demand in the bond market. It will

merely freeze its portfolio of securities at around €2.6 trillion and will replace maturing interest-bearing securities with new ones.

In the euro area, the turnaround of interest rates will only happen in 2019. We expect that the ECB will reduce the deposit rate from -0.4 % to -0.2 % in spring. This penalty payment has become a considerable burden for banks, insurers and – not least – private investors. During 2019, Mario Draghi will increase the **key rate** (repo rate) from zero to 0.25 %.

In 2018, the **euro-dollar exchange rate** is likely to move initially in the lower end of the 1.10 to 1.20 USD range. With a looming turnaround of interest rates by the ECB, the euro will once again appreciate to 1.20 USD later in the year.

Deceptive tranquillity, careless investors

Investors have let themselves be **lulled into complacency by monetary policy**. They have been able to observe that political risks have not led to uncertainty in the financial markets, irrespectively of whether those risks ultimately materialised. By historical standards, this is very unusual.

But it is not just political cycles that are now being declared obsolete by many people. The economic cycle seems to have become obsolete. This distortion of perception is not new. The longer an economic upswing lasts, the **more secure market participants feel**. Experts' growth forecasts barely differ from each other. All are in agreement that economic activity will keep running. Financial market participants also evidently do not currently see any requirement to hedge. The implied volatility of equity and bond markets is at an historic low. The market participants last had a similar feeling of security in summer 2007.

The extreme easing of monetary policy has led to a – partly considerable – **valuation expansion** in recent years among shares, bonds and real estate. The result is that traditional investments are similarly expensive.

Losses on bonds

How should investors position themselves in this environment? With **bonds**, valuation issues increasingly arise due to higher inflation rates. It is not very likely that investors resign

themselves to lasting real losses in assets' value. During the course of 2018, we are expecting an increase in yields of 10-year German government bonds of up to 1 %. There is a threat of losses. The first choice for new investments should therefore be short- and medium-term maturities.

Equity investors have also become markedly careless. The historically low implied share volatility illustrates that risks are currently estimated to be very low by the majority of market participants. With a price/earnings ratio of about 14, the **valuation** of the DAX is already moving above the long-standing normal band.

By contrast, a considerable risk of setbacks is inherent in the combination of high valuations and increased risk appetite, especially since the **economic sentiment** has probably reached its peak. Using realistic assumptions for earnings growth gives a range for the **DAX** of 10,500 to 13,500 points. Because shares are frequently exaggerating, it could also temporarily exceed these levels. **Real estates** have now become equally highly valued. However, they can retain their relative attraction despite alluring yields in the bond market.

As the earnings potential of popular asset classes is limited overall, no larger deviations from the strategic neutral values are necessary for 2018.



Everything good is already included!



Bond markets: Out of crisis mode

German government bonds are not slow sellers thanks to their high quality, but at the same time they are not attractive due to their low yields. In light of the good economic environment, bond yields are likely to tend to rise over the coming year. Pressure comes from the US bond market in particular.

As expected, the very low yield level of German bonds did not allow any jump in earnings this year. The nominal investment conditions have at least improved. The average annual yield of **10-year German government bonds** climbed from around 0.1 % to approximately 0.4 % in 2017. A continuation of this trend is to be expected for 2018. At the end of the year, yield is likely to be at around 1 %.

The basis for increasing yields is formed by **normalising inflation** – deflation ceased to be an issue a long time ago. In the euro area, consumer prices are likely to increase by around 1½ % for the second year in a row in 2018. In comparison, yield growth lags behind considerably, leading to significant real financial losses. Whether many investors (apart from the European Central Bank) are prepared to buy on these unfavourable terms is doubtful.

ECB delays interest rate turnaround

In addition, there is the fact that an extremely enthusiastic purchaser – the **ECB** – will now scale back its activities. At the start of 2018, it will cut back its purchase programme of 60 billion euro per month to 30 billion euro per month. The Asset Purchase Program is likely to come to an end in September 2018, which however does not mean that the ECB will

disappear as a good customer in the bond market. It will merely freeze its portfolio of securities at around 2.6 trillion euro and replace maturing interest-bearing securities with new ones.

The **US Federal Reserve** is one step ahead. It has already begun to gradually scale back its balance sheet total. For US bonds this means a noticeable change in framework conditions, particularly as the Fed is likely to drive key rates towards 2 % in 2018. Out-of-date bonds and bonds repackaged by issuers are once again freely available on the shop shelf. However, it will probably not be so easy to find new investors, particularly as inflation is being increasingly felt in the USA. In tow behind higher key rates, we therefore expect an increase in yield of **10-year US Treasuries** to around 3 %.

Draghi under pressure

The subject of an interest rate turnaround is likely to continue to preoccupy investors, especially if the purchase programme is terminated and Mario Draghi's final year in office approaches. The question that arises is whether he will pull the **interest lever** himself, or whether the President of the ECB will leave this job to his successor from November 2019. We suspect the former. In spring 2019 the negative deposit rate is likely to be raised – by the end of the year, the "penalty interest" should finally fall away. For the first time since 2015, the refinancing rate is likely to show a positive value once again. Higher yields in expectation of a change in monetary policy in the euro area would alleviate the investment crisis and thereby remove the burden from the demand side of the bond market. On the supply side, the prospect of higher interest rates could increase the pressure for reform in the euro area.

Equities: Only high-priced products left on the shelf

The US stock indices leapt from one record high to the next over the last twelve months. This inevitably raises the question of whether investors have not already been too generous with premature praise, given deregulation and tax cuts.

Expectation bubble with regard to US shares?

Only in the final stage of the new economy boom from 1998 to 2000, US shares were **valued** higher. Even under the assumption that, due to tax reforms, the net results of companies increase more significantly than currently forecast the P/E ratio of the S&P 500 still lies noticeably above the historic average of 15. In any event, the valuation expansion is non-typical for a period of increasing key rates. With the Fed now gradually reducing its balance sheet, the rally in the US stock market faces the threat of running out of fuel.

DAX with unfavourable risk-reward profile

Equity investors have also become downright **careless** in Germany, too. The historically weak implied share volatility, therefore, shows that exchange risks are currently perceived as being very low by the majority of market participants. With a P/E ratio of around 14, the valuation of the DAX is already moving above the long-term normal band. On the basis of key figures such as the share price/cash flow ratio, the overvaluation is even more pronounced.



In our baseline scenario, the fair **valuation** for the DAX lies in the P/E ratio band between 10.5 and 13. Using realistic assumptions for earnings growth, the possible spread for the DAX extends from 10,500 to 13,500 points. At a share price level above 13,000 points, the risks outweigh the upside potential by far.

People rarely get the timing perfect for buying and selling shares. In extreme cases, things may even turn out opposite to the old trading rule "buy low, sell high". **Equity-based saving** is a good way to minimise such "timing mistakes" – nothing more, but also nothing less!



Gold belongs to the shopping list

With high growth dynamics, moderate inflation and continued loose monetary policy, classic risk investments gained strongly in 2017. The relative valuation of gold has thus become more attractive. In addition, the inflation of asset prices is likely to significantly raise financial investors' **hedging requirement** in the form of physical gold.

Both **central banks** and **sovereign wealth funds** are also turning to gold. As a result of massive indebtedness, unconventional monetary policy and decreasing political predictability, US government bonds no longer have the unqualified status of "risk-free investments".

Apart from that, **political risks** have largely been disregarded by the financial markets. Uncertainty in Europe has decreased for now, but the structural problems persist and are only temporarily concealed by positive economic influences. However, history shows that in times of economic upheaval, the countries with the largest gold reserves are not in the weakest position.

Meanwhile, the **US real yield** continues to hover around the zero line. Even in the case of rising to slightly higher levels it is expected to give a boost to the gold price as well in 2018. A more pronounced increase in nominal yields would eventually be compensated by correspondingly higher inflation rates.

With regard to the **technical market analysis**, gold seems to have moved into a decisive phase after years of consolidation. The medium-term downward trend dating back to 2011 was most recently exceeded, meaning that a potential turning point has arisen. In 2018, therefore, the yellow metal could pursue a new sustainable upward trend. Technically, there would be **scope for a further increase**. In 2018, the price of gold is likely to rise above 1,400 US dollars per ounce.

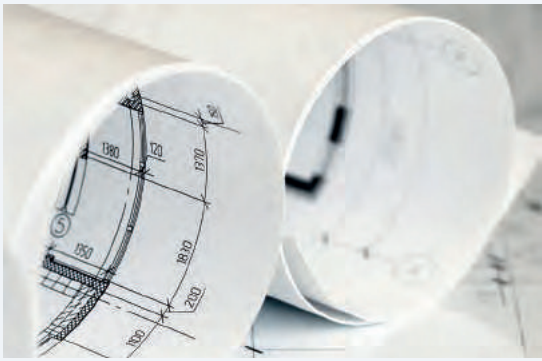
Real estate: No more bargains on offer

Many investors would like to invest their abundant liquidity in real estate. However, in many cases their shopping experience will be disappointing in 2018. Bargains have not been on offer for a long time and quality property has mostly sold out. Who wants to buy less valuable properties with higher risks?

The **property cycle** is in a mature stage. But an end to the upward trend is not looming in 2018 because the general conditions will remain positive. However, over-valuations can already be observed in many markets. Property values continue to increase – in Germany both in the residential market and the commercial sector. The market participants are still not euphoric and the granting of credit is largely inconspicuous. The likely largest risk for property lies in a significant increase in interest rates.

German open-ended real estate funds are likely to achieve a performance of around 2½ % in 2018. In light of the still very low yields in the bond market, this form of investment remains relatively attractive.

Prices of **German residential property** will continue to grow in 2018 – primarily in metropolitan areas. Financing terms remain very favourable and the population is growing. An increasing demand for living space is faced with supply that is only increasing at a moderate rate. Measures taken by a new German government to support the building of residential property are not likely to change this. Demand for around 400,000 homes is likely to be up against approximately 320,000 property completions.



US dollar and Swiss franc



In 2018, monetary policy will initially support the US dollar. Whilst the ECB will for the time being move away from its extremely expansive course only very hesitantly, the Federal Reserve will gradually reduce its easy policy and continue the cycle of interest rate hikes. The short-term **US yield advantage** that has reached a long-time high in comparison with European bonds will increase further still in 2018.

Beyond tax measures such as incentives to repatriate foreign profits, the Trump government will barely support the greenback. On the basis of its **protectionist nature**, the government has no interest in a currency that is too strong. Despite the devaluation in 2017, the US currency continues to be expensive in the long term – in particular in relation to the euro. In addition, in Europe the long-term need for the adaptation of monetary policy continues to grow in the euro area. The first **interest rate hikes by the ECB** are probably not due in 2018, but in the first half of 2019. A looming interest rate turnaround is likely to strengthen the euro during 2018. We therefore expect that the **euro-dollar exchange rate in 2018** will initially be at the lower end of a range from **1.10 to 1.20**. Later in the year, the euro will likely once again climb towards **1.20**.

The downward trend of the Swiss franc will not continue. The interest rate differences with regard to the euro will instead support the franc. In the long term, the Swiss currency continues to be over-valued, but not at such an extreme level. The **euro-franc exchange rate** will barely carry on its increase in 2018 and, after temporary setbacks, trade **at 1.15**.


Forecasts 2018
GDP 1.5 %
GDP 2.5 %
GDP 2.2 %
GDP 3.5 %
GDP 1.8 %
GDP 1.0 %
GDP 2.0 %


GDP 3.3 %
GDP 2.0 %
GDP 1.8 %
GDP 2.0 %
GDP 6.5 %
GDP 1.2 %
GDP 2.8 %
GDP 3.0 %
GDP 3.5 %
GDP 2.5 %

Germany: Crowds in the shopping centres

German economic growth in 2017 at a calendar-adjusted rate of 2,5 % topped the previous year's high figure of 1.9 %. Even if the strong momentum doesn't quite hold, at 2 % the GDP increase for 2018 is likely to be brisk. Only in 2019 growth will move closer to the potential at 1.7 %.

The expansion model will only change gradually. **Private consumer expenditure** is likely to continue to make a significant contribution to economic growth in 2018, with rising real incomes and higher levels of employment – despite inflation running at 1.8 %.

A boom in investment should not be expected in Germany. The contribution to growth made by gross investments will change very little, yet its composition will. **Investment in equipment will gain momentum**. Companies are likely to ease off on their restraint as the general conditions for capital formation have improved.

In contrast, the momentum of construction investment is likely to decrease a little in 2018. Nevertheless, demand for homes will remain high in light of a favourable labour market, rising incomes and migration to and within Germany. The unusually favourable financing conditions will make construction decisions easier. The sector will benefit from the resources provided for municipal infrastructure and the increasingly improved financial position of local authorities.

It is expected that **foreign trade** will also **not make a positive contribution to growth in 2018**. The favourable domestic economy will cause imports to increase more quickly than exports.



France: Reforms in the economic upturn



In recent years, France has grown significantly more slowly than Germany. This gap is likely to narrow. Gross domestic product is expected to grow by 1.8 % in 2018, only two-tenths less than in Germany.

Despite the brightening economic situation, private consumption grew considerably more weakly than in the previous year with only a 1 % increase in 2017. In real terms, private households were left with less in their pocket as a result of **higher inflation**. Higher employment and barely higher wages were unable to compensate for this. Not all consumer wishes will come true in 2018: at 1½ %, this component will grow just below average.

Investment in equipment should generate positive stimulus in 2018. **Increased margins** and **improved capacity utilisation** underline this conclusion. After years of decline, French construction investment has increased by presumably more than 3 % in 2017. The momentum is currently coming from both non-residential and residential construction. The marked **increase in building permits** signals a lasting upturn.

International competitiveness remains the weakness of the French economy; foreign trade will hold back growth in 2018, too. The planned reforms by the new president are likely to bring about an improvement here in the medium term.

The **Maastricht criterion** of a deficit no greater than 3 % of GDP has not been met by France since 2007. The new government is determined to achieve this from 2017 onwards.

Italy: Major renovations still to be carried out



Italy is also in an upturn – but it is only a weak one. Since the launch of the euro, with the exception of the year 2000, the country has never been able to reach the momentum of the euro area. Nothing is likely to change in this respect for the time being. Although **consumer prices** grew more strongly in 2017 than in the previous year, private consumption expenditure, at an estimated 1½%, grew by the same rate as gross domestic product. This was financed by a **decreased savings rate**. Furthermore, employment is growing. Despite the limited financing capacity of many Italians, the consumer climate is friendly, meaning that a growth in consumption is expected in 2018 similar to that of the previous year. Despite the somewhat more favourable economic situation, the government has little scope for election gifts.

Corporate earnings will remain under pressure in 2018 as a result of stagnating productivity and slight increases in labour costs. However, industrial capacity utilisation in Italy has grown considerably above the long-standing average. Since the business environment is also positive in the other sectors, **capital formation** is likely to **increase moderately**. Construction activity should increase for the third year in a row in 2018. Conversely, slightly negative effects will again result from foreign trade.

Because the standard of living can only be raised by continuously increasing productivity, the reform process should be reinforced. Despite the huge problems, no quick pace of reform is expected before the upcoming parliamentary elections, which will take place no later than May 2018. It is rather unlikely that there will be subsequent political change.

Spain: Conflict among Spaniards

In 2017, Spain achieved economic growth of more than 3 % for the third time in a row, thereby surpassing the pre-crisis level at the start of 2008. Our growth forecast of 2.8 % for 2018 assumes that the **Catalonia conflict** can be resolved swiftly. If this is not the case, a deduction of at least half a percentage point should be expected. The strong momentum of recent years was a counter-movement against both of the previous recessions, as well as the result of improved competitiveness.

In 2017, the Spanish inflation rate climbed from negative territory to 2 %. This is above-average when compared with the whole euro area and is a burden on the budgets of private households. Despite this, consumer momentum has only slightly decreased. Continuously increasing employment continues to generate a stimulus. In addition, wage rises are somewhat higher. The number of people unemployed is falling significantly and the **consumer climate is friendly**. Little is likely to change in this regard in 2018. Public consumption expenditure will continue to grow only moderately. In 2017, the public deficit was still above the 3 % that is actually permitted.

Spanish investment is growing pleasingly. The **property crisis has been overcome**, prices are increasing again. With low mortgage interest rates, investment in residential construction is rising. Investment in equipment has been growing since 2013. On the basis of increased competitiveness and the economic upswing, the companies' optimism towards the future seems justified. In contrast to other European countries, Spain also benefits from **foreign trade**.





Sweden: 2018 with less shine

The Swedish economy once again grew strongly by 3.1 % in 2017. In 2018, the country, which has a high level of exports, will continue to expand its economy, even if the growth rate will be lower at 2.5 %.

Monetary and fiscal policy, which continues to be supportive to growth, as well as house prices that have been increasing rapidly for years, ensure numerous visits to department stores. The indebtedness of private households now amounts to around 180 % of disposable income. Measures such as the reduction of the lending limit for loans have so far shown no sustainable effect to counteract this trend.

Fiscal policy as a crucial factor

In 2018, growth stimulus is likely to come from the continuing **expansive fiscal policy**. The budget plan concentrates on the creation of new jobs, which in particular creates the prerequisite for increased consumer spending in light of the high admission quota of migrants. In addition, tax cuts are planned and money is to be invested in health services and the education system.

Despite **increasing inflation** and strong growth figures, the Swedish central bank continues to adhere to its expansive monetary policy. The Riksbank will also orientate at the ECB in future in order to avoid a significant appreciation of the Swedish krona and deflationary tendencies.

The **Swedish central bank** will probably leave the key rate at -0.5 % until autumn 2018 to ensure that the Swedish economy can remain on its export track.

United Kingdom: Agreement on the negotiation bazaar?

Brexit hovers above everything in the United Kingdom. The economic consequences of the referendum have so far been paid mainly by consumers, as the devaluation of the pound makes imports more expensive and puts a strain on real incomes. Since there are also limitations on credit-financed consumption, private consumption will only grow by 1 % in 2018. The considerable uncertainty associated with Brexit will increasingly impair investments by companies, meaning that gross domestic product is likely to grow by 1 % in 2018 – a slower rate than the previous year (1.5 %).

The Bank of England will remain calm after the most recent **interest rate rise** and could leave its key rate at 0.5 %, especially as growth is slowing down. Inflation will eventually reach its peak and will once again fall towards the 2 % mark over the course of 2018.

The very sluggish Brexit negotiations overlap with the economic situation and monetary policy. The free trade agreement beyond the Single Market that Britain desires cannot be negotiated in its entirety in the time remaining. Due to its relative size alone, the United Kingdom is more strongly dependent on an agreement being reached than the EU.

Over the course of the year, **pressure on Prime Minister May** to reach a compromise will increase. An agreement could include a relatively free trade in goods, restricted trade for services and limited freedom of movement for workers. Despite all the problems and risks, a deal still seems to be the most likely solution – by 2019 at the latest.



USA: “Retail Apocalypse” Now?

For some time now in the USA there has been a controversial discussion about **“the death of malls”** and the bankruptcies of major retailers (“Retail Apocalypse”), despite a brilliant sentiment in the economy and **growth in private consumption** which come close to that of the boom years in the late 90s. It seems contradictory that retailers are starving whilst households are spending money generously. The background is the meteoric rise of online retailing, which comes along with a radical structural change – meaning that excess capacity is shut down. In addition, the proportion of consumer expenditure spent on services is increasing.

Contrary to often-heard horror stories, household indebtedness currently gives no cause for concern. In light of the strained labour market, wages should generally increase, and employment will continue to rise – albeit less dynamically than in previous years. Consumption remains on track. In addition, there is now a **noticeable recovery in investments** that is not just limited to the mining and energy sectors.

Supported by monetary and fiscal policy

The US economy is likely to register **growth of around 2.5 %** in 2018, following growth of about 2 % in 2017, taking into account a slight stimulus from tax cuts and increased government spending. Monetary policy will not hinder economic growth. Even if – as expected – the Fed increases the **target range by the end of 2018 to between 2.00 % and 2.25 %**, real interest rates (less inflation) will remain at almost zero.



China: The party is always right



At the conference of the Communist Party of China, party leader Xi rose to the Olympus: in the party constitution, he is now on the same level as Mao. Overall, 2017 was a successful year for the Chinese leadership, while, in 2015 and 2016, it did not always look very bright from an economic policy perspective. Among other things, Xi has benefitted from a weaker position of the USA as a global leader under Donald Trump.

Tail wind from the industrial cycle

From an economic perspective, the situation has also improved. This is based on a massive financial policy stimulus and **increased lending** initiated by the government. This partly reflects an upward movement in the industrial cycle that can be observed globally. However, considerable risks like the high levels of indebtedness of state-owned enterprises and a potential bubble in the property market, persist. This is a drawback of Xi's policy: when in doubt he opts for stability and against risky reforms, however necessary they may be.

Short-term stability – medium-term risks

We therefore maintain our estimate that China will head for **medium-term trend growth of around 5 %** each year. The slow pace of reforms increases the likelihood of the "China crash", feared by many observers for years. The efforts by the government to stimulate demand in the short term at any cost increase stability risks in the medium term. For **2018** we anticipate **growth of 6.5 %** (2017: 6.8 %), as the government, with regard to economic policy, probably will take gradually its foot off the accelerator.



Financial market forecasts

	Changes since year end	current*	Forecast horizon at end … Q1/2018	Q2/2018	Q3/2018	Q4/2018
	in basis points	interest rate in %				
ECB deposit facility rate	0	-0.40	-0.40	-0.40	-0.40	-0.40
Repo rate	0	0.00	0.00	0.00	0.00	0.00
Overnight rate Eonia	-3	-0.36	-0.35	-0.35	-0.35	-0.35
3M Euribor	-1	-0.33	-0.30	-0.30	-0.30	-0.25
6M Euribor	-6	-0.28	-0.25	-0.25	-0.25	-0.20
12M Euribor	-11	-0.19	-0.20	-0.20	-0.15	-0.10
2-yr Bunds	2	-0.75	-0.70	-0.60	-0.60	-0.50
5-yr Bunds	18	-0.35	-0.30	-0.20	-0.20	0.00
10-yr Bunds	17	0.38	0.70	0.80	0.80	1.00
2-yr swap rate	-4	-0.20	-0.20	-0.10	-0.10	0.00
5-yr swap rate	12	0.20	0.25	0.35	0.35	0.50
10-yr swap rate	18	0.84	1.10	1.15	1.15	1.30
30-yr swap rate	32	1.56	1.70	1.75	1.75	1.85
Federal funds rate**	50	1.13	1.63	1.88	1.88	2.13
3M USD Libor	41	1.41	1.90	2.15	2.15	2.40
10-yr US-Treasuries	-10	2.34	2.60	2.80	2.80	3.00
	in local currency, %	index				
DAX	14.8	13,183	12,800	12,500	11,500	12,300
EURO STOXX 50	9.8	3,613	3,500	3,450	3,200	3,400
Dow Jones	18.7	23,462	23,000	22,500	21,000	22,000
S&P 500	15.4	2,585	2,530	2,450	2,300	2,400
Nikkei 225	19.6	22,869	22,000	21,500	20,000	21,000
	%	price in $				
Brent crude $/bbl	12.5	64	60	62	59	60
Gold $/oz	10.9	1,284	1,360	1,370	1,400	1,420

* 09.11.2017 ** target range, average Sources: Bloomberg, Helaba Research

Currency forecasts

	Performance year to date	current*	Forecast horizon at end … Q1/2018	Q2/2018	Q3/2018	Q4/2018
vs. Euro	**vs. Euro, %**	**exchange rate**				
US dollar	-9.7	1.16	1.10	1.15	1.15	1.20
Japanese yen	-6.9	132	127	125	125	128
British pound	-3.6	0.89	0.85	0.90	0.90	0.85
Swiss franc	-7.3	1.16	1.12	1.15	1.17	1.15
Canadian dollar	-4.3	1.48	1.44	1.50	1.47	1.51
Australian dollar	-3.7	1.52	1.47	1.49	1.47	1.50
Swedish krona	-1.8	9.75	9.50	9.40	9.20	9.00
Norwegian krone	-4.0	9.47	9.10	9.00	8.90	8.80
Chinese yuan	-5.0	7.72	7.48	7.88	7.88	8.16
vs. US-Dollar	**vs. USD, %**	**exchange rate**				
Japanese yen	3.1	113	115	109	109	107
Swiss franc	2.5	0.99	1.02	1.00	1.02	0.96
Canadian dollar	6.0	1.27	1.31	1.30	1.28	1.26
Swedish krona	8.7	8.38	8.64	8.17	8.00	7.50
Norwegian krone	6.2	8.13	8.27	7.83	7.74	7.33
Chinese yuan	4.6	6.64	6.80	6.85	6.85	6.80
US-Dollar vs. …	**vs. USD, %**	**exchange rate**				
British pound	6.5	1.31	1.29	1.28	1.28	1.41
Australian dollar	6.5	0.77	0.75	0.77	0.78	0.80

* 09.11.2017

Sources: Bloomberg, Helaba Research

Gross domestic product, inflation, budget deficit

	Gross domestic product real change, % yoy				Consumer prices Change, % yoy				Budget deficit % of GDP			
	2016	2017e	2018f	2019f	2016	2017e	2018f	2019f	2016	2017e	2018f	2019f
Euro area	**1.8**	**2.3**	**2.0**	**1.7**	**0.2**	**1.5**	**1.6**	**1.7**	**-1.5**	**-1.2**	**-1.0**	**-0.9**
Germany	1.9	2.5	2.0	1.7	0.5	1.7	1.8	2.0	0.8	0.8	0.7	0.6
France	1.1	1.8	1.8	1.6	0.3	1.2	1.4	1.6	-3.4	-3.0	-2.8	-2.7
Italy	1.1	1.6	1.5	1.3	-0.1	1.4	1.3	1.4	-2.5	-2.3	-2.1	-2.1
Spain	3.3	3.1	2.8	2.2	-0.3	2.0	1.6	1.7	-4.5	-3.3	-2.4	-1.7
Netherlands	2.1	3.3	2.3	2.1	0.1	1.3	1.5	1.7	0.4	0.6	0.5	0.7
Austria	1.5	2.8	2.2	2.0	0.9	2.2	2.2	2.1	-1.6	-1.2	-1.1	-1.0
Greece	-0.2	1.2	2.0	2.0	0.0	1.2	1.0	1.5	0.5	-1.2	-0.5	-0.8
Portugal	1.5	2.4	2.0	1.8	0.6	1.5	1.4	1.5	-2.0	-1.5	-1.4	-1.4
Ireland	5.1	4.0	3.5	3.0	-0.2	0.3	1.2	1.5	-0.6	-0.3	-0.2	0.0
Great Britain	**1.8**	**1.5**	**1.0**	**1.4**	**0.6**	**2.7**	**2.4**	**2.0**	**-2.9**	**-2.5**	**-2.5**	**-2.5**
Switzerland	**1.4**	**0.7**	**1.5**	**1.3**	**-0.4**	**0.5**	**0.7**	**1.2**	**0.1**	**-0.1**	**-0.1**	**0.0**
Sweden	**3.3**	**3.1**	**2.5**	**2.4**	**1.0**	**1.7**	**1.8**	**1.8**	**0.9**	**0.8**	**0.7**	**0.6**
Norway	**1.1**	**1.9**	**2.2**	**2.0**	**3.6**	**2.2**	**2.2**	**2.0**	**3.0**	**4.2**	**3.8**	**3.6**
Poland	**2.9**	**4.1**	**3.5**	**3.3**	**-0.6**	**1.9**	**2.4**	**2.3**	**-2.5**	**-2.0**	**-2.2**	**-2.3**
Hungary	**2.2**	**3.7**	**3.3**	**2.5**	**0.4**	**2.4**	**3.0**	**2.7**	**-1.9**	**-2.3**	**-2.5**	**-2.3**
Czech Republic	**2.6**	**4.5**	**3.0**	**2.8**	**0.7**	**2.5**	**2.3**	**2.2**	**0.7**	**1.0**	**0.7**	**0.5**
Russia	**-0.2**	**1.9**	**1.8**	**1.7**	**7.0**	**3.8**	**4.0**	**4.7**	**-3.4**	**-2.1**	**-1.3**	**-1.1**
United States	**1.5**	**2.2**	**2.5**	**2.0**	**1.3**	**2.1**	**2.4**	**2.5**	**-3.9**	**-3.9**	**-5.0**	**-4.7**
Japan	**1.0**	**1.6**	**1.2**	**1.0**	**-0.1**	**0.4**	**0.6**	**1.0**	**-4.6**	**-4.5**	**-5.0**	**-5.3**
Asia ex Japan	**5.4**	**5.3**	**5.0**	**5.2**	**2.7**	**2.4**	**2.6**	**3.0**	**-3.0**	**-3.1**	**-3.5**	**-3.4**
China	6.7	6.8	6.5	6.3	2.1	1.5	2.0	2.2	-3.7	-4.0	-4.5	-4.5
India	7.1	6.7	7.2	7.5	4.9	3.3	4.4	4.8	-3.5	-3.2	-3.2	-3.0
Latin America	**-0.7**	**1.2**	**2.0**	**2.2**	**19.5**	**19.0**	**19.5**	**17.0**	**-4.9**	**-4.2**	**-3.0**	**-2.0**
Brazil	-3.6	0.7	2.0	2.3	8.7	3.0	3.5	4.2	-6.4	-8.0	-7.0	-5.7
World	**2.9**	**3.4**	**3.4**	**3.3**	**3.6**	**3.9**	**4.1**	**4.0**	–	–	–	–

GDP growth working day adjusted if available; e=estimate, f=forecast

Sources: EIU, Macrobond, Datastream, Helaba Research



Alternative scenario

Ruin (10 %)

In our negative alternative scenario "ruin", structural weaknesses pave the way to a global downturn. Distribution conflicts increase. Politics react with protectionism; globalisation and international trade are pushed back. Investment activity suffers under economic and political uncertainty. Under threat of job losses, households reduce their consumption.

Due to its export quota of almost 50 %, **Germany** is particularly strongly affected by the global economic downturn. Investment activity is also encumbered by this. Germany slides into a recession.

The downward trend extends to the **European Union**, meaning that the unresolved structural problems of the currency union once again emerge with force. In this environment, the conversion of the European institutions into a community of competition fails.

Investors are looking for security and flee from risk assets into the "safe haven" of treasuries and government bonds. During this process, 10-year **US treasuries** fall to 1 %, whilst yields on 10-year **German government bonds** plunge towards the -1 % mark.

Gold and the **US dollar**, in these times of high uncertainty, live up to their reputation as crisis-proof currencies. Gold once again approaches its old peak of over 1,900 US dollars per ounce. The euro-dollar exchange rate falls to 0.90.

The now highly valued **real estate market** proves to be vulnerable to corrections. Risk aversion rises rapidly and causes significant valuation discounts on shares. The **DAX** crashes towards the 8,000-point mark.



Alternative scenario

Palace (20 %)

In our positive alternative scenario "palace", the global economy reaches an impressive level of growth. Brisk trade and investment activities, as well as progress in productivity, open up new possibilities. In this environment, the conversion of the European Union into a community of competition is successful.

China and **Russia** generate crucial growth stimulus in 2018. The People's Republic of China tackles its excess capacity in heavy industry and launches a new investment cycle. Both European and Russian companies and consumers benefit from the abolition of sanctions against Russia.

Among the **industrialised countries**, the USA leads growth with almost 4 %. **Germany** benefits from stronger global trade and achieves a rate of expansion of around 3 %. Progress in productivity makes Europeans competitive on the global markets. All of the countries in the **euro area** grow strongly.

As a result of high growth levels, **inflation** increases significantly above the central banks' stated goal of 2 %. The **Fed** and **ECB** accelerate the pace of normalisation.

The ECB initiates the turnaround of interest rates already in 2018. The **bond market** experiences massive losses. 10-year US treasuries climb to 4 % and 10-year German government bonds approach the 2 % mark. The **euro-dollar** exchange rate reaches 1.30.

Corporate earnings grow strongly and the **DAX** exceeds the threshold of 15,000 points. **Real estate** loses its relative attraction in light of increasing interest rates. However, this effect is compensated by the considerably better situation on the rental markets.

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„A NEW CITY IS BUILT BY THOSE WHO DARE TO DREAM IT.“

DANILO DOLCI (1924–1997)

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