IV Outlook

1 Economic conditions

1.1 Global economic trends

In 2020, the COVID-19 pandemic plunged the global economy into the deepest recession since the end of the Second World War. Global economic output contracted by more than 3 percent in 2020.

Even in mid-2021, coronavirus is continuing to have a dominant effect on the current economic situation and on expectations for the remainder of the year. Progress with worldwide vaccination campaigns in the year to date has stabilized the health emergency and consequently also helped economic activity to start returning to normal.

The global economy is expected to continue its recovery in the remaining months of 2021, with growth predicted at 5.8 percent. Nevertheless, there is still a risk that the vaccination program cannot deliver a sufficient level of protection, as a consequence of which the COVID-19 pandemic could weigh on the economy and society at large for a much longer period.

There is significant but temporary upward pressure on consumer prices this year. Inflation rates are likely to remain at an elevated level in key national economies over the remainder of 2021, although central banks view this as only a short-term phenomenon.

1.2 Trends in the USA

While the changeover in the White House at the beginning of 2021 led to more intensive international dialog, the trade disputes between the United States, China, and Europe have not been eliminated. In the absence of a lasting solution, there is still a risk that countries will impose protectionist measures, delivering a further blow to world trade already weakened by the impact of the COVID-19 pandemic. This would adversely affect the global economy and hit the heavily export-dependent German economy particularly hard.

As a result of the vast fiscal stimulus package, US economic output is likely to rise by 6.7 percent in 2021. The recovery will probably be driven mainly by consumer spending.

1.3 Trends in the eurozone

The eurozone’s economic rebound began in spring 2021, with economic growth having been held back in the first quarter of the year due to the containment measures. The situation should continue to normalize over the course of the year and the economy is likely to kick into gear with the help of rising vaccination rates and warmer weather. Following a 6.5 percent contraction in GDP in 2020, economic growth of 4.0 percent is projected for 2021 as a whole.

Upward pressure on consumer prices is likely to remain until the end of 2021. However, the effect of the year-on-year increases in energy prices should diminish over the course of 2021. The reopening of the economy and strong demand are predicted to push up prices for goods and services in the second half of the year. While the inflation rate in 2020 was low at just 0.3 percent, consumer prices are expected to rise by an average of 2.3 percent in 2021.

1.4 Trends in Germany

The lockdown imposed due to the third wave of COVID-19 caused the economy as a whole to contract in the first quarter of 2021.

However, a vigorous recovery began in spring 2021, bolstered by progress in the vaccine campaign. An economic growth rate of 2.7 percent is projected for 2021.

The average rate of inflation in Germany for 2021 will be markedly higher than in the previous year at 3.0 percent (2020: 0.4 percent). The main reasons are the end of the temporary reduction in VAT, higher energy prices, and rises in prices for goods and services as a result of the reopening process and the recovery of demand. Strong inflationary pressure is not expected to persist in Germany either over the longer term.

1.5 Trends in the financial sector

The continued bounce-back of the global economy in 2021 and the resulting upward pressure on consumer prices led to rising yields in the capital markets in the first half of the year. However, they have recently stagnated. In the view of the central banks, this inflationary pressure is only temporary, although ongoing success with vaccination programs combined with a boom in private-sector demand and support from government investment programs may exert further upward pressure on prices.

In its latest decision of July 8, 2021, the ECB formulated an inflation target of 2 percent but will temporarily tolerate a higher or lower level. This gives the central bank the flexibility to continue with its expansionary monetary policy and asset purchase programs in the bond market.

Against this backdrop, nominal interest rates are expected to remain at their comparatively low level in the second half of 2021. This will be accompanied by a relatively flat yield curve and will prevent any significant increase in margins in interest-related business.

In the last few years, the ECB's expansionary approach combined with its asset purchase programs largely prevented structural problems in some EMU member countries from becoming apparent in the capital markets. The fiscal stimulus measures introduced to tackle the fallout from the COVID-19 pandemic have resulted in a sharp increase in the need to obtain funding in the capital markets. There is a risk that yields could rise further at the long end if a potentially more restrictive approach to the asset purchase programs is taken.

Because of the expansionary monetary policy pursued by central banks and the fiscal policy measures implemented in many countries, it is reasonable to assume that there will be a global economic recovery, which should also help to stabilize financial performance in the financial sector. However, it is still not possible to rule out potential negative effects from the COVID-19 pandemic on businesses and consumers – such as higher debt – in the second half of 2021, which in turn could have an adverse impact on the financial sector.

The uncertain political and economic trends outlined above could spill over and have an adverse effect on the economic position of the financial sector. Relevant information on macroeconomic risk factors can be found in the risk report (chapter VI.3).

2 Financial performance

The forecasts below are based on the outcome of the DZ BANK Group's projection process. Forecasting uncertainty, particularly as a result of the macroeconomic conditions described above, may lead to deviations from the underlying assumptions.

Profit before taxes is likely to rise sharply in 2021 compared with 2020; the increase in the second half of the year will be far smaller than in the first half. The predicted encouraging financial performance will primarily be driven by positive trends in the operating business, such as those emerging in the UMH and DZ BANK – CICB operating segments, and by the capital markets' recovery from COVID-19-related price falls, which will have a positive impact on the R+V operating segment, for example.

In 2022, profit before taxes is forecast to be lower than in 2021. This will essentially be because the positive non-recurring items in 2021 – some of which are attributable to the pandemic – will not be repeated.

Net interest income including income from long-term equity investments is predicted to be unchanged year on year in 2021 in view of the healthy performance of the operating business despite persistently low interest rates.

Economic conditions in the eurozone, which continue to be heavily influenced by the COVID-19 pandemic, coupled with a yield curve that remains relatively flat, 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 expected to be significantly higher in 2021 than in 2020 thanks to 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.

Gains and losses on trading activities are anticipated to deteriorate markedly in 2021 owing to negative IFRS-related valuation effects. Positive impetus is particularly likely to come from customer-driven capital markets business in the DZ BANK – CICB operating segment.

The 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 improve significantly this year, partly due to the inclusion in the prior-year figure of negative non-recurring items.

Other gains and losses on valuation of financial instruments are expected to improve sharply year on year to a substantial net gain in 2021, mainly due to positive effects of measuring securities from government issuers in European periphery countries in the DZ HYP operating segment and measuring guarantee commitments for investment products in the UMH operating segment. Moreover, the negative effects that impacted on DVB operating segment in 2020 will not be repeated.

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 2021 is expected to be well above the 2020 figure. This is because of the projected significant improvement in gains and losses on investments held by insurance companies, although premiums earned are likely to decline slightly.

From the current perspective, the severe weather event referred to as Bernd, a loss event that occurred in July 2021, will have limited financial implications (see also note 53 in the notes to the consolidated financial statements). Further exceptional events in financial and capital markets, loss events, and changes in underwriting practices may adversely affect the level of net income expected to be earned from insurance business.

Expenses for **loss allowances** are likely to fall considerably in 2021 compared with their elevated level in 2020, which had been influenced by the potential impact of COVID-19 on the real economy.

The effects of economic conditions, which continue to be 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 2021, **administrative expenses** are expected to rise moderately year on year. This will predominantly be due to growth-related increases in general and administrative expenses in selected operating segments, higher contributions to protection schemes, and the effects of the acquisition of a majority stake in ZBI Partnerschaftsholding GmbH by the UMH operating segment.

Other net operating income is anticipated to be substantially lower in 2021 than in 2020, partly because of the impact of positive non-recurring items in the prior-year period.

The DZ BANK Group is likely to see a slight year-on-year improvement in its **cost/income ratio** in 2021.

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 rise substantially year on year in 2021 in view of the expected significant increase in profit before taxes.

3 Liquidity and capital adequacy

The DZ BANK Group is assuming that it can continue to maintain an appropriate level of **liquidity adequacy** in the second half of 2021. Further information on liquidity adequacy can be found in the risk report (chapter VI).

As matters currently stand, the DZ BANK Group's **capital adequacy** will continue to be assured for the second half of 2021 from both economic and regulatory perspectives; 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 the risk report (chapter VI).