IV Outlook

1 Economic conditions

1.1 Global economic trends

Persistently high inflation and the jump in interest rates are weighing on the global economic outlook. Although consumer prices have now probably peaked in most countries and inflation rates are expected to come down again, inflation is currently still very high in many areas. This is holding back consumer spending and curbing the inclination to make purchases. Moreover, the rapid interest-rate increases have swiftly become reflected in banks' new lending business, which has led to a slowdown in mortgage finance in particular. However, high interest rates are weighing not only on investment in construction, which is simultaneously being hit by sharply rising costs, but also on companies' spending on capital equipment.

The recovery from the economic slump triggered by the war in Ukraine, the energy crisis, and the ensuing mild winter recession in the eurozone is struggling to gain traction in this environment. In the United States, on the other hand, a recession is probably yet to come. A further unexpected rise in interest rates would put additional pressure on the economy, as would further escalation of the war in Ukraine or a renewed flare-up of the energy crisis.

The risk of new protectionist measures in trade relations between the United States, Europe, and China has increased, as can be seen from the debate surrounding the US Inflation Reduction Act. Geopolitical tensions, such as over the position of Taiwan, may prompt a further escalation of trade disputes. This would adversely affect the global economy and hit the heavily export-dependent German economy particularly hard.

For certain products, high energy prices will take quite some time to filter through the various production stages before reaching end customers, so inflation rates are likely to decline only gradually. High core inflation, fueled by healthy wage increases in various industries and regions, is the greatest cause for concern. This means that, despite their projected downward trajectory, average inflation rates for 2023 as a whole are expected to remain far above the target levels of many central banks.

1.2 Trends in the USA

The US economy has so far proved resilient in the face of recessionary risks. The service sector in particular has been boosted by strong post-pandemic demand in recent months, which has supported economic growth. The labor market has also remained robust. However, key indicators continue to signal that the economy is heading toward a recession. High interest rates and still significantly elevated inflation are key factors that point to a looming economic downturn. Consumers are likely to become increasingly reluctant to spend and companies will scale back their investment activities. DZ BANK now expects the US economy to slip into a mild recession over the course of the second half of 2023. For 2023 as a whole, DZ BANK predicts that economic output will grow by just 0.8 percent and that inflation will slow to a rate of 4.4 percent. The labor market is currently a major source of risk. Unless it weakens noticeably in the coming months, the US Federal Reserve will be forced to take more decisive action in order to prevent even greater upward wage pressure. Such an intervention would further increase the likelihood of a recession. Turmoil in the banking sector also remains a risk factor for the US economy. Concerns about the financial industry have abated somewhat in recent months, but heightened risks in this sector cannot be ruled out.

1.3 Trends in the eurozone

The eurozone's gross domestic product (GDP) shrank slightly in the first quarter. It was the second consecutive quarter of negative growth, which means that the eurozone economy experienced a mild winter recession.

Consumer spending declined in the period January to March due to high inflation. Capital expenditure increased slightly and the trade balance showed positive growth indications, but only because imports fell more strongly than exports. The threat of severe supply shortages in the energy sector did not materialize. However, the war in Ukraine and the sanctions imposed against Russia continue to cause uncertainty and thus remain a drag on Europe's economy.

Conditions in the industrial sector are particularly challenging. Order book buffers are declining as new order levels dwindle. In light of weak demand at an international level and high interest rates, the outlook for the industrial and construction sectors remains gloomy. This coincides with a recent slowdown in the recovery of consumer confidence. In particular, consumers' inclination to make major purchases is still very limited. Despite this weak macroeconomic picture, positive stimulus is expected to come from the still robust conditions in the labor market, which are keeping household incomes supported. The tourism and leisure sector, meanwhile, is likely to enjoy a continuing boost from post-pandemic catch-up effects.

All in all, the prospects for economic growth in the eurozone remain subdued. Challenging conditions in the industrial sector and for foreign trade will put a damper on growth in the coming quarters. However, the positive situation in the service sector and stable labor market conditions will provide some support for the economy. Consumers should slowly regain their appetite for spending as inflationary pressures gradually diminish. For the current year, DZ BANK predicts growth at a rate of 0.6 percent. DZ BANK expects the inflation rate to decrease from 8.4 percent in 2022 to 5.8 percent in 2023, but this means it will still be well above the ECB's inflation target.

1.4 Trends in Germany

Concerns about a substantial gas shortage in Germany in the six winter months of 2022/2023 did not turn into a reality. Thanks to increased gas supply from other gas-exporting nations and the start-up of Germany's first liquid gas terminal at the start of 2023, the country was able to fill its gas storage facilities to a high level more quickly than in the previous winter, despite having to forego gas imports from Russia. Nonetheless, gas usage had to be reduced in order to avoid shortages. In particular, production restrictions in the energy-intensive industrial sector acted as a brake on economic growth. Consumer price inflation slowed but remained at high levels, curbing consumer spending. As a result, the German economy experienced a recession over the six winter months of 2022/2023.

The real estate sector is now also showing clear signs of weakness. Initially, the prolonged upward trend in the German real estate market continued in 2022. However, demand for property, which had previously been fueled by historically low financing rates and capital market yields, suddenly slumped in the second quarter of 2022 owing to higher interest rates. Having previously risen sharply, residential real estate prices peaked in mid-2022 and are expected to fall by between 4 percent and 6 percent in 2023. Properties that are energy-efficient and/or use renewable energy sources for heating are now particularly sought-after. Commercial real estate prices stagnated in 2021 and fell slightly in 2022, mainly due to the pandemic's impact on the retail sector. Compared with residential real estate, commercial properties could see much sharper price falls of around 10 percent or more in 2023. Despite the persistently high price level in the real estate market, the generally tight supply of properties should counteract an even more pronounced price correction, not least because the rapid rise in financing and construction costs has brought many construction projects to a halt. This makes a marked reduction in completions likely in 2023.

The economic outlook for the coming months remains muted. DZ BANK anticipates only a minimal upturn. In addition, high inflation is eating into consumers' budgets. Rising interest rates and stricter financing conditions are also taking their toll on the economy. Exports are also likely to experience headwinds in the deteriorating foreign trade environment. All of this makes a robust recovery unlikely in the coming quarters. The outlook thus remains fairly bleak, as confirmed by sentiment indicators such as the ifo business climate index and the ZEW Indicator of Economic Sentiment. DZ BANK anticipates a slight decline of 0.2 percent in GDP for 2023.

Inflation is slowly coming down now. Relief measures introduced by the German government (gas and electricity price caps) have somewhat mitigated the energy-price-related fallout from record-high inflation rates. Global market prices for gas and oil are now helping to contain consumer prices too. The gradual easing of supply bottlenecks in the industrial sector and diminishing upward pressure on food prices are also taking some wind out of the sails of inflation. However, inflationary pressure in the service sector is likely to remain high as wages continue to rise. For 2023, DZ BANK anticipates a moderate decline in inflation from 8.7 percent to 6.1 percent. Based on these forecast figures, the German economy is experiencing a period of stagflation.

1.5 Trends in the financial sector

With regard to the agenda of regulatory reforms and the wider macroeconomic downturn, the overall situation in the financial sector has not changed materially compared with the outlook published in the 2022 group management report. Structural changes driven by competition as well as the implementation of various ESG standards are further key factors that are shaping conditions in the financial sector.

The shift in monetary policy that began in 2022 was continued by the major central banks in the reporting period and was further intensified in some instances. This marks a radical departure from the expansionary monetary policy regime of previous years, which had been adopted by the central banks in response to the financial markets crisis. The objective of current policy is to curb inflation, which has risen in the wake of geopolitical crises, and to counteract a stagflationary macroeconomic environment.

In mid-2022, the US Federal Reserve began to trim down its balance sheet by reducing the exposures built up under its asset purchase program and started to raise the federal funds rate, which now stands at 5.25 percent to 5.50 percent. In the reporting period, the European Central Bank (ECB) also reduced its holdings under the asset purchase program (APP) and will cease to reinvest maturing principal payments under the program from July 2023. By contrast, maturing principal payments from securities acquired under the pandemic emergency purchase program (PEPP) will continue to be reinvested until at least the end of 2024. Alongside these measures, the ECB decided to continue raising its key interest rates at a moderate pace, which meant that the main refinancing rate reached 4 percent by the end of June 2023 and 4.25 percent by the end of July 2023. The eurozone yield curve, which had been relatively mildly inverted until recently, has consequently become more strongly inverted but remains at a lower nominal level overall than the US dollar yield curve. The current cycle of interest-rate increases, which remains unparalleled in the history of the ECB in terms of duration and pace, highlights the determination of the central bank to bring inflation back down to the long-term target level of 2 percent. A transmission protection instrument (TPI) was introduced to take account of the risk of fragmentation within the eurozone resulting from the bank's approach. Nonetheless, a substantial further increase in interest rates is regarded as unlikely. Instead, it is expected that the central banks will pause to monitor the impact of the measures they have already adopted.

The overall rise in interest rates should continue to provide a tailwind for interest-driven business in the financial sector, which in turn should have a positive effect on overall earnings. However, the rise in interest rates is also putting mounting pressure on the property market. The risk of loan defaults is therefore rising, especially against the backdrop of persistently high inflation and the slower-than-expected economic recovery (see chapters IV.1.1 and IV.1.4 above for further details). In the reporting period, Germany saw a further fall in the number of planning applications and, by extension, a decline in demand for mortgage loans. These leading indicators, which tend to move several years ahead of actual construction activity, point toward diminishing demand in the real estate market. At the same time, prices for existing properties have fallen only moderately, although (in some cases pronounced) differences have been observable depending on region, market segment, and state of repair (see also chapter IV.1.4). The extent to which higher financing costs may trigger price corrections that necessitate the recognition of impairment losses on real estate assets will need to be monitored on an ongoing basis. In the residential sector, this trend runs counter to persistently strong demand for new housing, which in Germany is partly fueled by a growing influx of migrants from crisis-stricken regions.

The loss of confidence in the banking market triggered by the insolvencies of several US regional banks (explained in chapter IV.3.3 of the risk report) spiked in the first quarter of 2023 due to the crisis at Credit Suisse Group AG, Zurich (Credit Suisse) and its rescue by its competitor UBS Group AG, Zurich (UBS Group). An escalation to a general crisis of confidence in the banking market, which would have tremendous consequences for the entire financial sector, has so far been averted thanks to swift and decisive action by political decision-makers in the United States and Switzerland that have allowed the situation to cool off. There are lingering concerns that a rapid and sustained rise in interest rates could undermine the confidence of investors in US regional banks, which typically have a high level of exposure to commercial real estate. This could cause the crisis of confidence in the banking market to flare up again. However, the European and German banking sectors continue to be regarded as largely resilient to contagion from a banking crisis thanks to the agenda of reforms implemented in recent years by central banks and supervisory authorities in the eurozone.

Waning supply chain disruptions and occasional slight falls in lower energy prices are providing positive macroeconomic impetus, but persistently high inflation rates and looming geopolitical conflicts are presenting major challenges for the global economy. In addition to Russia's ongoing war in Ukraine, which is having an adverse impact on energy and food prices, trade disputes between the United States and China could result in barriers to trade that would have far-reaching consequences for the global economy. Negative knock-on effects, including for the financial sector, cannot be ruled out over the further course of the year. Additional information on overarching macroeconomic risk factors can be found in chapter VI.3 of the risk report.

2 Financial performance

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

The changeover in financial reporting standards for insurance companies from IFRS 4 to IFRS 17 has been implemented with effect from the current reporting year. The comparisons between the figures for 2022 and the forecasts for the current year that are provided in the outlook are based on pro forma reference figures as at December 31, 2022 that have been calculated on the basis of IFRS 17.

According to the current forecast, net interest income including net income from long-term equity investments will increase slightly in 2023 from its already high level. Net interest income is expected to be stabilized by the forecast growth in the interest-bearing business, especially in the operating segments in the DZ BANK Group that are sensitive to interest rates.

Net fee and commission income will probably fall noticeably in 2023 compared with 2022.

Gains and losses on trading activities are expected to deteriorate substantially following exceptionally high net gains in 2022. This is because positive valuation effects that had bolstered gains and losses on trading activities in the previous year will not be repeated in 2023.

Gains and losses on investments are anticipated to improve considerably to a net gain in 2023, partly because the figure for 2022 was depressed by sales of investments and other factors, as mentioned in the 2022 group management report.

Other gains and losses on valuation of financial instruments are also expected to improve substantially to a net gain in 2023, as negative valuation effects that had impacted the prior-year figure will not be repeated.

Net income from insurance business should rise sharply in 2023 in line with expectations. In relation to the R+V segment, this forecast is mainly based on the projected normalization of gains and losses on investments held by insurance companies and thus a substantial year-on-year improvement.

Expenses for loss allowances are still expected to go up significantly in the reporting year, partly due to new business and other factors not taken into account in the existing parameter-based loss allowances.

Given the absence of the positive non-recurring items that arose in 2022, the current forecast for 2023 predicts a substantial fall in other net operating income.

Profit before taxes in 2023 is predicted to be up significantly compared with 2022 even though macroeconomic conditions look set to remain challenging.

The cost/income ratio for the DZ BANK Group is likely to fall moderately in 2023 as a result of the expected noticeable year-on-year increase in income paired with only a small rise in expenses.

Regulatory RORAC, the risk-adjusted performance measure based on regulatory risk capital, will probably rise appreciablythis year compared with 2022 owing to the high level of 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 2023. Further information on liquidity adequacy can be found in the risk report (chapter VI.4).

As matters currently stand, the DZ BANK Group's capital adequacy will continue to be assured for the second half of 2023 from both economic and regulatory perspectives; that is to say, it will continue to have at its disposal the available internal capital and regulatory own funds 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.5).