IV Outlook

1 Economic conditions

1.1 Global economic trends

The global economic outlook for 2024 and 2025 is improving because inflation has now fallen sharply from the very high levels seen over the past two years. This lower rate of inflation, combined with significant wage increases, is causing real incomes to rise and giving consumers greater purchasing power. Moreover, the prospect of falling interest rates should be more conducive to capital investment. In both the eurozone and the United States, however, the decline in inflation has tailed off at levels above the central banks' stated targets. This can be explained by increased upward pressure on wages, in particular from prices for services, and from an increase in the cost of housing in the United States. That is why the central banks remain cautious about easing the monetary policy reins, even though the European Central Bank (ECB) made an initial interest-rate cut in June 2024. The global economic outlook may have brightened, but there are still some cloudy patches ahead.

Threats to global economic growth include the risk of fresh protectionist measures being imposed on trade between the United States, China, and Europe. For example, the European Union may potentially impose higher tariffs on certain Chinese products that the European Commission believes are being subsidized and thus distorting competition. Furthermore, geopolitical tensions, such as the conflict between Israel and the terrorist organization Hamas in the Middle East and the stand-off over the position of Taiwan, may push up commodity and energy prices or prompt a further escalation of trade disputes. This would adversely affect global inflation and economic growth and would hit the heavily export-dependent German economy particularly hard. Supply chain disruptions, an upswing in energy prices, and tariffs could cause inflation to rise again.

The risk that the fall in inflation will stall, as it did in the first six months of 2024, will remain present in the second half of the year and not only because of stubbornly high prices for services. At the start of the year, energy prices were still having a disinflationary effect but are expected to start exerting upward pressure on inflation again in the second half of this year. Rates of inflation in most regions of the global economy are therefore likely to trend sideways or fall only slightly in the third and fourth quarters of 2024. Inflation will continue to run higher than the rates targeted by the western central banks.

1.2 Trends in the USA

In the first half of 2024, the US economy grew at a far slower rate than in the second half of 2023. Although consumer spending remained robust, the sharp rise in imports acted as a brake on economic growth. DZ BANK also predicts more moderate growth rates for US gross domestic product (GDP) over the rest of this year. All in all, the economy is forecast to expand by a solid 2.5 percent in 2024 as a whole.

Economic growth is likely to be held back as a result of key interest rates and inflation remaining high. The US labor market is also showing gradual signs of cooling, although it still paints a healthy picture overall. However, the number of vacancies is slowly falling and the unemployment rate has been edging up in recent months. This should result in an easing of upward wage pressure.

Nonetheless, the inflation rate is coming down only slowly. This is mainly because of persistent inflationary pressure in the housing sector, which will only ease later on in the year. For 2024 as a whole, DZ BANK still forecasts an average inflation rate of 3 percent.

The biggest political event this year will be the presidential election on November 5, 2024. According to the polls, a tight race between Kamala Harris and Donald Trump is expected. The re-election of Donald Trump could raise the risk of new trade disputes.

1.3 Trends in the eurozone

In the first quarter of 2024, GDP in the eurozone rose by 0.3 percent compared with the previous quarter. This marked an end to the bout of weakness that had seen a slight fall in economic output in the third and fourth quarters of 2023.

The eurozone's economic recovery is expected to continue during the remaining months of 2024. The improvement in the survey-based sentiment indicators continued into the summer. However, some surveys – such as the purchasing managers' indices – have since deteriorated slightly, suggesting that the recovery is likely to be moderate at best and that a broad-based upswing is not yet on the cards. Rapidly rising wages and declining inflationary pressure mean that consumer spending will probably be the biggest source of support for the economic rebound. For 2024 as a whole, DZ BANK anticipates economic growth of 0.75 percent.

Upward pressure on consumer prices has continued to ease compared with last year. By the time that summer arrived, however, the fall in inflation had ground to a halt in the eurozone. Nevertheless, the ECB lowered its key interest rates by 25 basis points in June, although it did concede that monetary policy would have to remain restrictive this year. The inflation rate in the eurozone is likely to be higher than the ECB's target for the remainder of 2024 because sharp wage increases mean that prices are continuing to climb in the services sector. DZ BANK expects an average inflation rate for the year of 2.5 percent.

1.4 Trends in Germany

The German economy saw a surprising increase in GDP of 0.2 percent in the first quarter of 2024 compared with the previous quarter. This was thanks to exports and construction investment, with mild weather in January and February enabling a very high level of construction activity.

However, the construction sector was unable to maintain the momentum in the second quarter. The period of low interest rates had fueled brisk demand for real estate but this tapered off markedly in 2022 when interest rates surged. This led to a significant correction of property prices from the high levels they had reached. Between mid-2022 and the first quarter of 2024, residential property prices dropped by almost 9 percent, although they have since turned the corner. The slight reduction in interest rates compared with 2023, the significant increases in income, and the fall in purchase prices mean that owning a home is now more affordable again. Moreover, high net inward migration is driving up rents, especially as housing is in short supply anyway. Nonetheless, investment in housebuilding is being held back by high costs for construction and borrowing.

On the flip side, manufacturing output is proving astonishingly robust in the face of poor order levels. The services sector has also been reporting revenue growth in the year to date. Survey-based indicators such as the ifo business climate index are less clear-cut, however. Business expectations had risen for four months in succession but declined again slightly in June. Although the assessment of the business situation remained stable, the main indicator also edged down in June. Overall, the data is still at a low level despite the phases of significant improvement.

Consumers also remained cautious in the first half of 2024. However, the lower rate of inflation and the increase in collectively agreed wages should lead to growth in real incomes as the year continues. This will in turn result in higher consumer spending and thus support economic growth. For 2024, DZ BANK anticipates a rise in GDP of 0.25 percent.

The rate of inflation was significantly lower in the first half of 2024 than in the corresponding prior-year period, but the fall in inflation has not continued. The downward effect on inflation of the Deutschland-Ticket, a subsidized public transportation ticket introduced in May 2023, stopped being relevant to the calculation of inflation in May 2024 and, in fact, led to a slight rise in the inflation rate again. In the second half of the year, the inflation rate is likely to fluctuate within a narrow range overall. Persistent upward pressure on wages is predicted to continue driving up prices for services. DZ BANK anticipates that energy prices will start contributing to inflation again by the end of 2024, whereas upward pressure on prices for industrial goods and food is expected to remain low. Overall, the average inflation rate for 2024 is forecast to be 2.5 percent.

1.5 Trends in the financial sector

Conditions in the financial sector were stable in the first half of 2024. The ECB continues to scale back its asset purchase program (APP) and pandemic emergency purchase program (PEPP), steadily reducing the volumes of assets held. Although repayments for securities purchased under PEPP continue to be reinvested at present, this is set to finish at the end of this year. The ECB's cautious and flexible approach, combined with the transmission protection instrument (TPI), has helped to prevent the excessive widening of spreads on the bonds of individual eurozone countries and thus to counter potential fragmentation risk. Current spread levels also reflect the somewhat muted economic environment.

So far this year, the key interest rates of the world's major central banks have remained high, although they have now stabilized following the significant hikes seen in 2023. The US Federal Reserve has kept the federal funds rate unchanged in a range of 5.25 percent to 5.5 percent, demonstrating its wait-and-see stance. In June, the ECB lowered the main refinancing rate for the eurozone moderately from 4.5 percent to 4.25 percent, marking the end for now of a period of rising interest rates in the eurozone. Although further interest-rate cuts are not expected any time soon, a renewed increase is viewed as unlikely.

Interest-related business is therefore likely to have passed its peak. With inflation falling, the current interest-rate trend may provide further stimulus for the real estate market. However, its effect will be limited given that the general level of interest rates remains high, investment costs are high, and economic growth is still muted. As the rate of inflation is diminishing and wages are rising sharply, improved consumer sentiment may create further positive effects.

Although geopolitical turmoil and the related trade disputes are holding back global economic growth, DZ BANK expects the German economy to grow slightly. Given that the factors generating uncertainty are occurring simultaneously and that they are relevant to the major economic areas (United States, Europe, and China), it is impossible to rule out unexpected adverse effects on companies and households, which in turn would continue to have negative implications for the financial position and financial performance of the financial sector in the second half of 2024.

Regardless of the aforementioned macroeconomic situation, the financial sector still faces considerable pressures in terms of both adjustment and costs. These arise from structural changes and regulatory requirements. The recent increases in upward pressure on prices and the potential threat of a wage/price spiral could further accelerate this process. This environment is presenting the financial sector with the challenge of scrutinizing its existing business models, adapting them as required, and substantially improving its efficiency by digitalizing business processes.

The agenda of regulatory reforms initiated in response to the financial crisis has a range of objectives, including making the financial sector more resilient in the event of a crisis – mainly through improved capital and liquidity adequacy – and ensuring that the risks arising from the business activities in the financial industry are not borne by the public sector. As a result, the financial industry has progressively reduced its leverage and substantially bolstered its risk-bearing capacity by improving liquidity and capital adequacy. The planned implementation of EU banking regulations must also be seen in this light.

The issue that is likely to continue shaping activities in the financial industry in the long term is the implementation of the multifaceted environmental, social, and corporate governance (ESG) standards and their implications for the business models used in the sector. At present, the primary challenge faced by the financial sector is to implement the relevant requirements at an operational level throughout the value chain, which includes business management, risk management, and the internal and external reporting systems. The consideration of ESG aspects in the financial and capital markets is, on the one hand, opening up new market opportunities for the financial sector. On the other, events in the various ESG categories should also be seen as risks and managed accordingly.

2 Financial position and 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.

Net interest income (including net income from long-term equity investments) in 2024 is projected to be significantly higher than in 2023. The figure for the reporting year will receive a significant boost not only from the good level of income from the operating business but also from accounting-related effects that have a positive impact on net interest income but a countervailing impact on gains and losses on trading activities.

Net fee and commission income is expected to be significantly higher in 2024 than in 2023 and thus continue to contribute significantly to the earnings of the DZ BANK Group, driven by the UMH, DZ BANK – CICB, and DZ PRIVATBANK operating segments.

Gains and losses on trading activities will likely deteriorate substantially this year. This is because there were material positive IFRS-related effects resulting from rules on the recognition and measurement of financial instruments in the DZ BANK – CICB operating segment in 2023, whereas the 2024 figure will be adversely affected by negative factors (see chapter 3.2.5 'DZ BANK – CICB' of the business report). The accounting-related effects mentioned above in connection with net interest income will have a negative impact on gains and losses on trading activities.

Gains and losses on investments are anticipated to improve noticeably to a net gain, partly because the figure for 2023 included losses on the sale of securities and impairment losses on a joint venture.

Other gains and losses on valuation of financial instruments will deteriorate markedly in the reporting year, returning to a normal level. This will largely be driven by the anticipated slight widening of credit spreads in public-sector finance in the DZ HYP operating segment and by the valuation of guarantee commitments and resulting realized gains and losses in the UMH operating segment.

The latest forecasts show that **net income from insurance business** will fall significantly in 2024. This is because gains and losses on investments held by insurance companies are expected to deteriorate sharply owing to the still volatile conditions in the capital and financial markets. Nevertheless, insurance finance income or expenses will see a marked improvement. The insurance service result will be influenced by the expected increase in claims incurred in inward reinsurance. Insurance service expenses are predicted to rise significantly overall.

Expenses for **loss allowances** are expected to be much higher in 2024 in view of the targeted volume of new business, the likely reduction in reversals of loss allowances, and the decline in income from loans and advances previously impaired.

Administrative expenses will rise marginally in 2024 compared with 2023 due to a slight increase in general and administrative expenses, although this will be partly offset by savings in connection with the bank levy.

Other net operating income is projected to increase substantially once again this year. This is mainly because the 2023 figure was adversely affected by non-recurring items in the UMH and DZ PRIVATBANK operating segments, albeit with a countervailing effect from reversals of provisions in the DZ BANK – CICB operating segment.

In 2023, the DZ BANK Group's profit before taxes was much higher than forecast. Based on current assessments, **profit before taxes** in 2024 is predicted to be within the long-term target range of €2 billion to €2.5 billion even though the macroeconomic environment is expected to remain challenging.

The **cost/income ratio** is likely to be a little higher in 2024 as a result of the expected small year-on-year decrease in income and simultaneous slight rise in administrative expenses.

The substantial fall in **regulatory RORAC** projected for 2024 is based on the expected decrease in income, the sharply rising regulatory base rate of return used in the calculation, and R+V's solvency capital requirement.

3 Liquidity and capital adequacy

The DZ BANK Group is assuming that it can continue to maintain an appropriate level of economic and regulatory **liquidity adequacy** in the second half of 2024. Further information on liquidity adequacy can be found in the risk report (chapter VI.5).

As matters currently stand, the DZ BANK Group's **capital adequacy** will continue to be assured for the second half of 2024 from both economic and regulatory perspectives; that is to say, it will continue to have at its disposal the available internal capital and 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.4).