

FX: RANGES AND LOW VOLATILITY TO PERSIST

THE MACRO ECONOMIC PICTURE EXPLAINS WHY

Presentation to the ECB FXCG
September 24, 2019

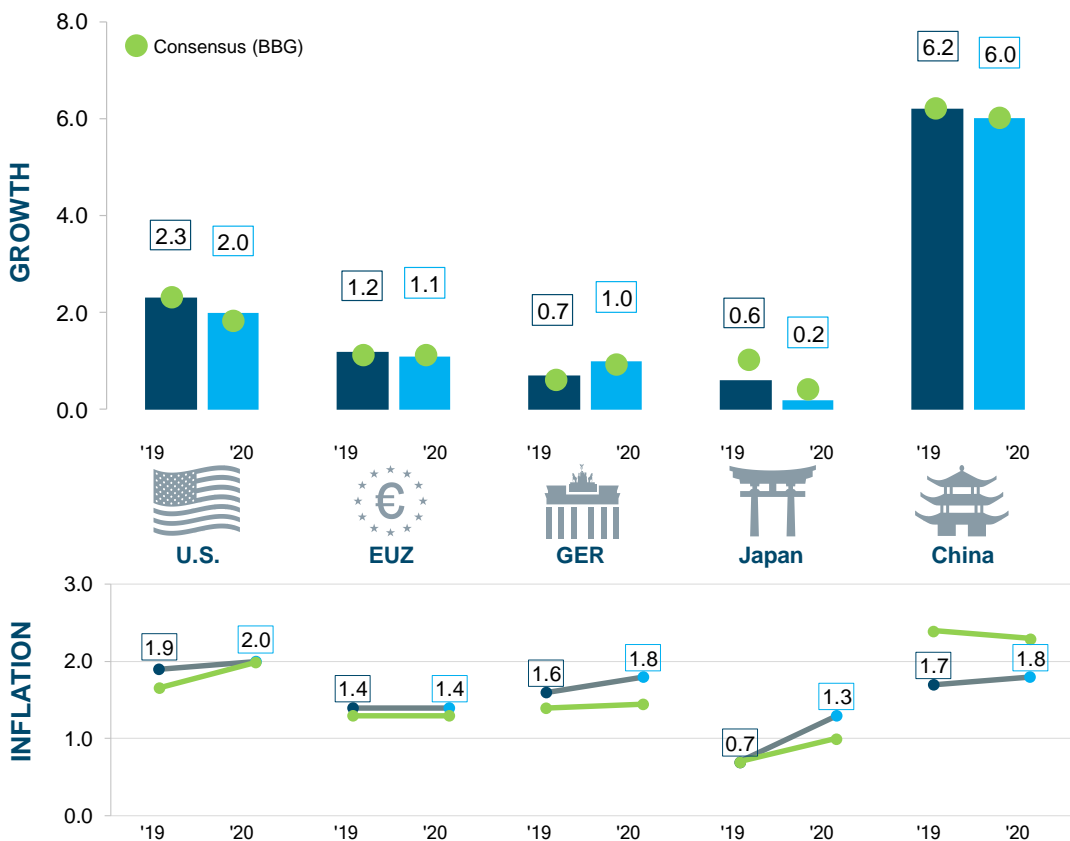


MACRO VIEW: GLOBAL ECONOMY 2019/2020



Growth is moderating but no recession on the horizon

OUR GROWTH AND INFLATION FORECASTS FOR 2019 AND 2020 VS CONSENSUS, IN %



REGIONAL VIEW

- U.S.**
 - GDP:** first round effects of the recent escalation of the trade war should have limited direct impact on GDP growth
 - Inflation:** in case of recent announced trade war measures were to persist, we expect inflation to converge to 2% target
 - Risk:** the constant back and forth regarding the U.S.-China trade conflict weights on the markets leading to more volatility
- EUZ**
 - GDP:** growth is mainly driven by the domestic sector. The rest of the industry still suffers due to trade conflict related uncertainty
 - Inflation:** so far no pass through of higher wages. Inflation expectations are too low, also in comparison with the target
 - Risk:** still no clearance on the outcome of Brexit. We stick to our base case of a "Soft Brexit"
- EM**
 - GDP:** in Asia we expect lower growth rates. LatAm's growth outlook has been revised due to ongoing downgrades of Brazil's forecast
 - Inflation:** inflation remains under control or even continues surprising to the downside in most of EM Asia and in Brazil
 - Risk:** the U.S-China trade conflict and various domestic reasons letting EM markets suffer

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GLOBAL ECONOMY



Manufacturing dismal – service sector still keeping up its mood

PURCHASING MANAGERS' INDICES (PMI)

	Composite							Manufacturing							Service						
	Jan. 19	Feb. 19	Mrz. 19	Apr. 19	Mai. 19	Jun. 19	Jul. 19	Jan. 19	Feb. 19	Mrz. 19	Apr. 19	Mai. 19	Jun. 19	Jul. 19	Jan. 19	Feb. 19	Mrz. 19	Apr. 19	Mai. 19	Jun. 19	Jul. 19
World	52.1	52.6	52.8	52.2	51.2	51.2	51.7	50.8	50.6	50.5	50.4	49.8	49.4	49.3	52.7	53.3	53.7	52.7	51.6	51.9	52.5
United States	54.4	55.5	54.6	53	50.9	51.5	52.6	54.9	53	52.4	52.6	50.5	50.6	50.4	54.2	56	55.3	53	50.9	51.5	53
Eurozone	51	51.9	51.6	51.5	51.8	52.2	51.5	50.5	49.3	47.5	47.9	47.7	47.6	46.5	51.2	52.8	53.3	52.8	52.9	53.6	53.2
France	48.2	50.4	48.9	50.1	51.2	52.7	51.9	51.2	51.5	49.7	50	50.6	51.9	49.7	47.8	50.2	49.1	50.5	51.5	52.9	52.6
Germany	52.1	52.8	51.4	52.2	52.6	52.6	50.9	49.7	47.6	44.1	44.4	44.3	45	43.2	53	55.3	55.4	55.7	55.4	55.8	54.5
United Kingdom	50.3	51.5	50	50.9	50.9	49.7	50.7	52.8	52.1	55.1	53.1	49.4	48	48	50.1	51.3	48.9	50.4	51	50.2	51.4
Japan	50.9	50.7	50.4	50.8	50.7	50.8	50.6	50.3	48.9	49.2	50.2	49.8	49.3	49.4	51.6	52.3	52	51.8	51.7	51.9	51.8
Spain	54.5	53.5	55.4	52.9	52.1	52.1	51.7	52.4	49.9	50.9	51.8	50.1	47.9	48.2	54.7	54.5	56.8	53.1	52.8	53.6	52.9
Italy	48.8	49.6	51.5	49.5	49.9	50.1	51	47.8	47.7	47.4	49.1	49.7	48.4	48.5	49.7	50.4	53.1	50.4	50	50.5	51.7
Brazil	52.3	52.6	53.1	50.6	48.4	49	51.6	52.7	53.4	52.8	51.5	50.2	51	49.9	52	52.2	52.7	49.9	47.8	48.2	52.2
Russia	53.6	54.1	54.6	53	51.5	49.2	50.2	50.9	50.1	52.8	51.8	49.8	48.6	49.3	54.9	55.3	54.4	52.6	52	49.7	50.4
China	50.9	50.7	52.9	52.7	51.5	50.6	50.9	48.3	49.9	50.8	50.2	50.2	49.4	49.9	53.6	51.1	54.4	54.5	52.7	52	51.6
India	53.6	53.8	52.7	51.7	51.7	50.8	53.9	53.9	54.3	52.6	51.8	52.7	52.1	52.5	52.2	52.5	52	51	50.2	49.6	53.8
South Korea								48.3	47.2	48.8	50.2	48.4	47.5	47.3							
Taiwan								47.5	46.3	49	48.2	48.4	45.5	48.1							
Turkey								44.2	46.4	47.2	46.8	45.3	47.9	46.7							

■ >50 and increasing
■ <50 and falling
■ >50 and falling or unchanged
■ <50 and increasing or unchanged

* Values above 50 indicate an improving business development of the industry compared to the previous month, values below 50 indicate shrinking businesses
 Sources: Bloomberg Finance L.P., DWS Investment GmbH; as of September 2019

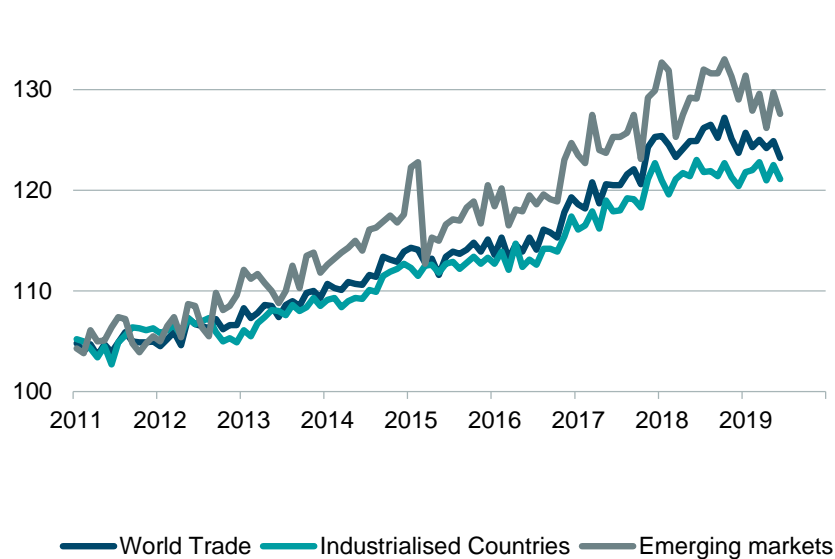
WORLD TRADE: UNDER PRESSURE



The adverse effects from higher US-China tariffs could intensify further

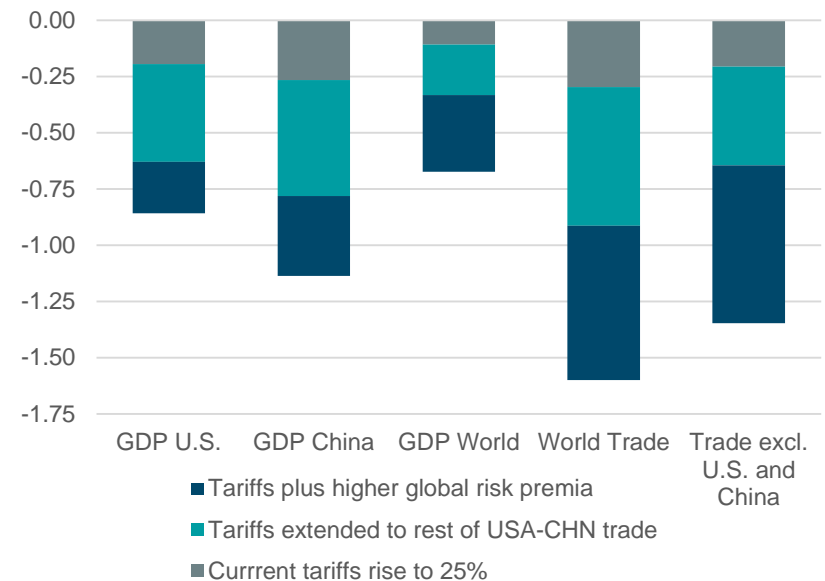
WORLD TRADE

Index (2010=100)



OECD¹: IMPACT ON THE LEVEL OF GDP AND TRADE BY 2021-22

% difference from baseline



¹ Calculation by OECD:

- The first scenario shows the impact of the United States raising tariffs on USD 200 billion of imports from China from 10% to 25% from mid-May 2019 (with reciprocal action by China on USD 60 billion of imports from the United States).
- The second scenario shows the additional impact if tariffs of 25% are imposed on all remaining bilateral non-commodity trade between China and the United States from July 2019.
- The final scenario adds in the impact from a global rise of 50 basis points in investment risk premia that persists for three years before slowly fading thereafter. All tariff shocks are maintained for six years. Based on simulations on NiGEM in forward-looking mode.

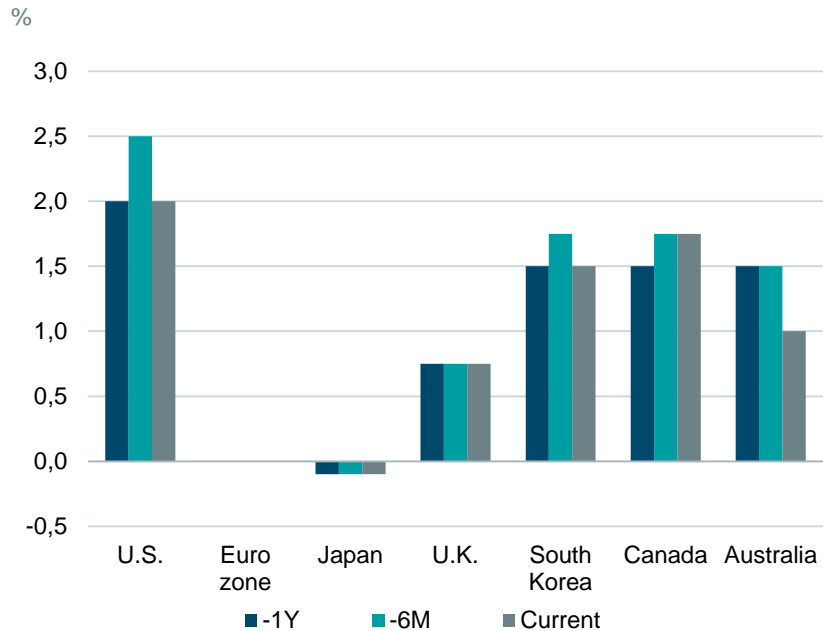
Sources: Haver Analytics Inc., OECD; DWS Investment GmbH. As of: September 2019

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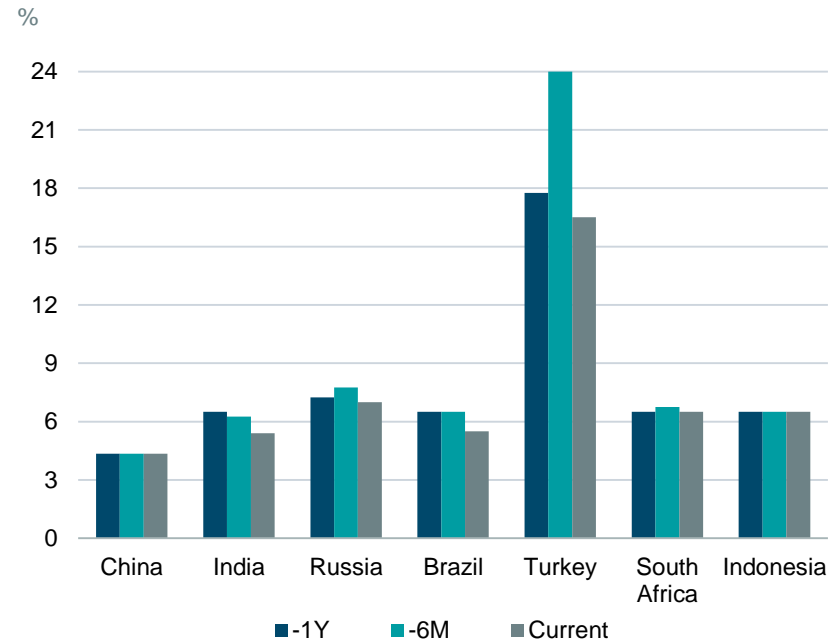
MONETARY POLICY: OVERVIEW

Doves to come?

KEY RATES OF INDUSTRIALIZED COUNTRIES¹



KEY RATES OF DEVELOPING COUNTRIES¹



NEXT STEP WILL BE DOWN

- _ Only a few months ago the general expectation was that central bank rates would rise.
- _ Now rates cuts are generally expected. Australia did the first already.

DEVELOPING COUNTRIES

- _ Also in developing markets most recent interest rate movements were cuts.

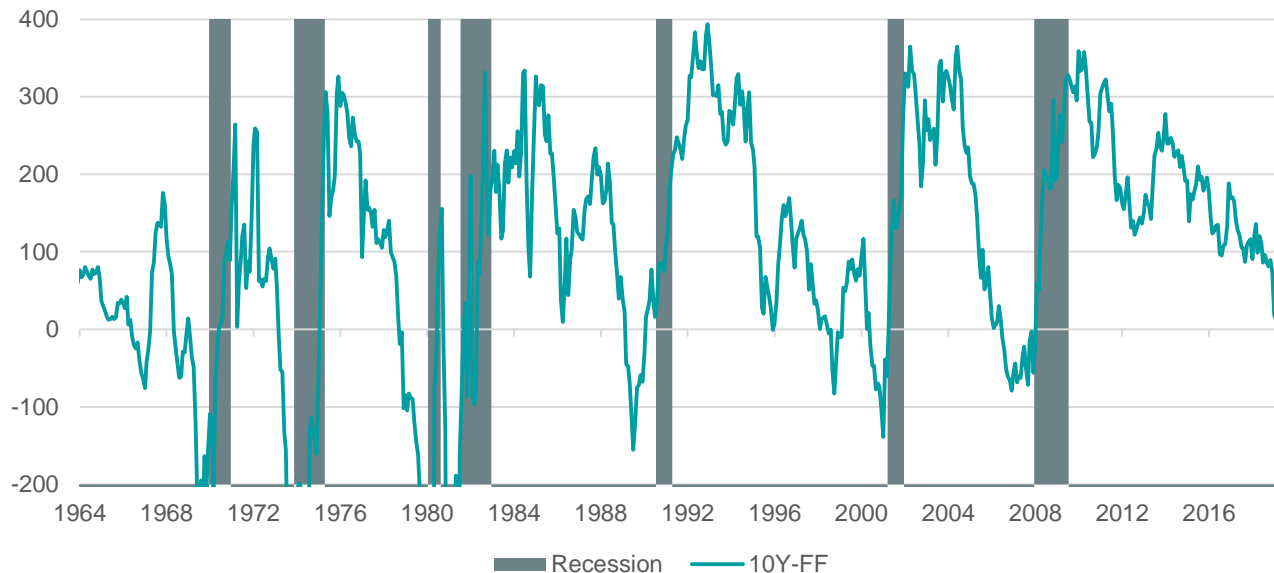
1): Differentiation according to the definition by the IMF. Sources: Bloomberg Finance L.P., DWS Investment GmbH; as of: September 2019

U.S. YIELD CURVE STEEPNESS

Yield curve as recession predictor: the experience since 1964

U.S. YIELD CURVE (10YR – FED FUNDS) VERSUS RECESSIONS

Basis points



Inversion	Recession	Months
05/1966	-	
04/1968	12/1969	20
02/1973	11/1973	9
09/1978	01/1980	16
02/1989	07/1990	17
11/1995	soft patch	
06/1998	soft patch	
05/2000	03/2001	10
06/2006	12/2007	18

- _ Since 1964, yield curve inversion has correctly predicted 2 out of 3 U.S. recessions
- _ Since the mid-1960s, an inverted yield curve was followed by a recession on average after 15 months
- _ The yield curve between 10yr Treasuries and Fed funds has inverted in March 2019
- _ A fed paper¹ concluded in 2018 that the near-term forward spread, i.e. market expectations of a monetary policy easing over the next 12-18 months, does a better job in predicting recessions than a yield curve inversion

¹ Eric C. Engstrom and Steven A. Sharpe: The Near-Term Forward Yield Spread as a Leading Indicator: A Less Distorted Mirror. Finance and Economics Discussion Series, Divisions of Research & Statistics and Monetary Affairs, Federal Reserve Board, Washington, D.C., 2018. Sources: Bloomberg Finance L.P., Federal Reserve Bank of St. Louis, DWS Investment GmbH; as of August 2019

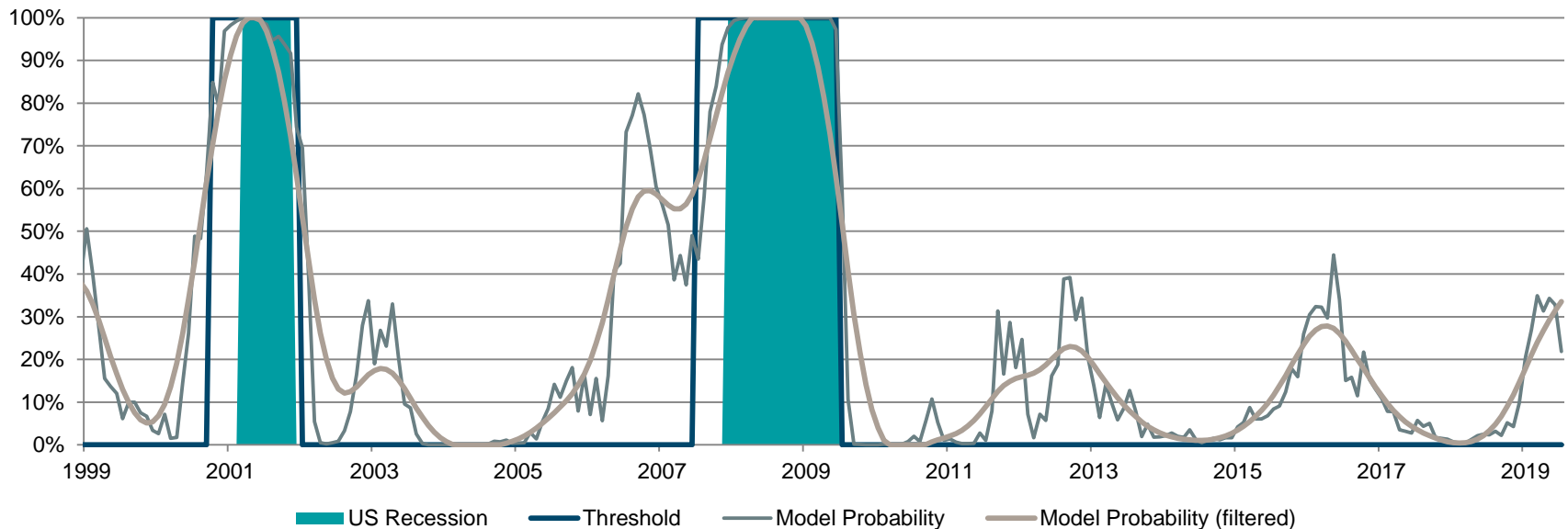
U.S. RECESSION PROBABILITY



~30% probability of a recession in the next 12 months

DWS U.S. RECESSION MODEL

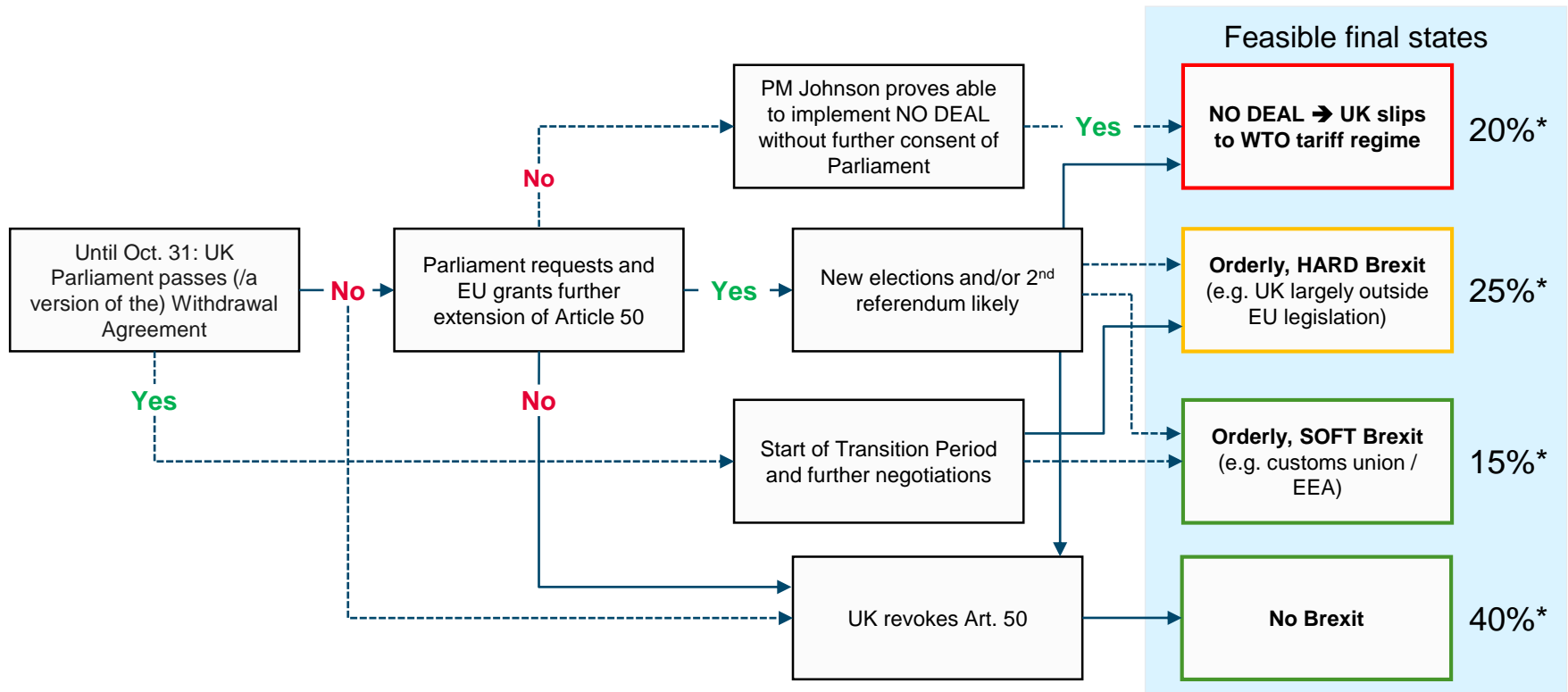
probability



- _ Our recession model incorporates a broader picture of the economy (~ 10 economic indicators) compared to pure market based models
- _ Historically the model provided a true signal if the filtered probability was increasing above 61%
- _ Recent estimations showed a slightly above 30% probability for 3 consecutive months

U.K. ECONOMY

Brexit Update – possible scenarios



WHAT WE ARE WATCHING:

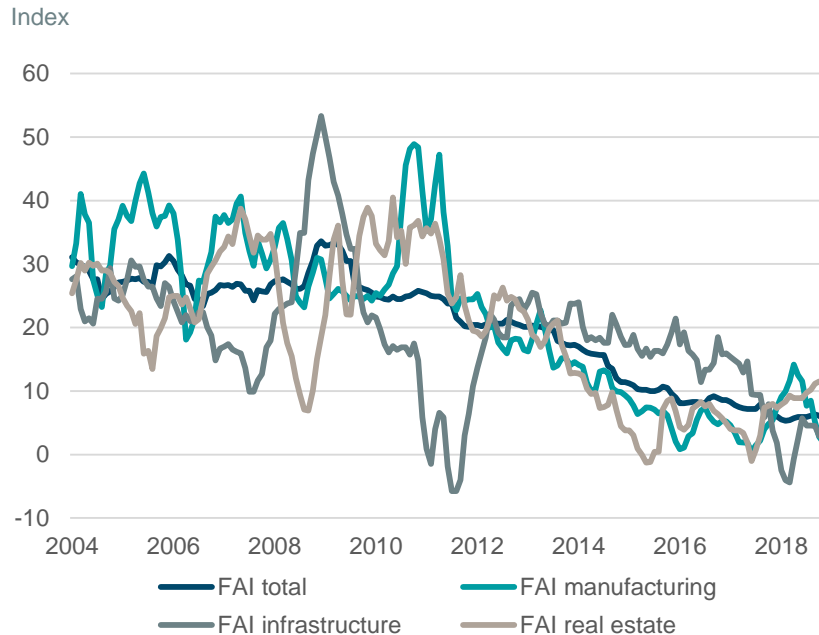
- 1) Willingness of EU 27 to compromise on the Irish backstop: => highly doubtful
- 2) Wide divergence in recent polling (esp. after the win of LibDem at the Brecon and Radnorshire by-election)

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CHINA: SUMMARY AND OUTLOOK

Still sluggish economic growth despite fiscal and monetary support

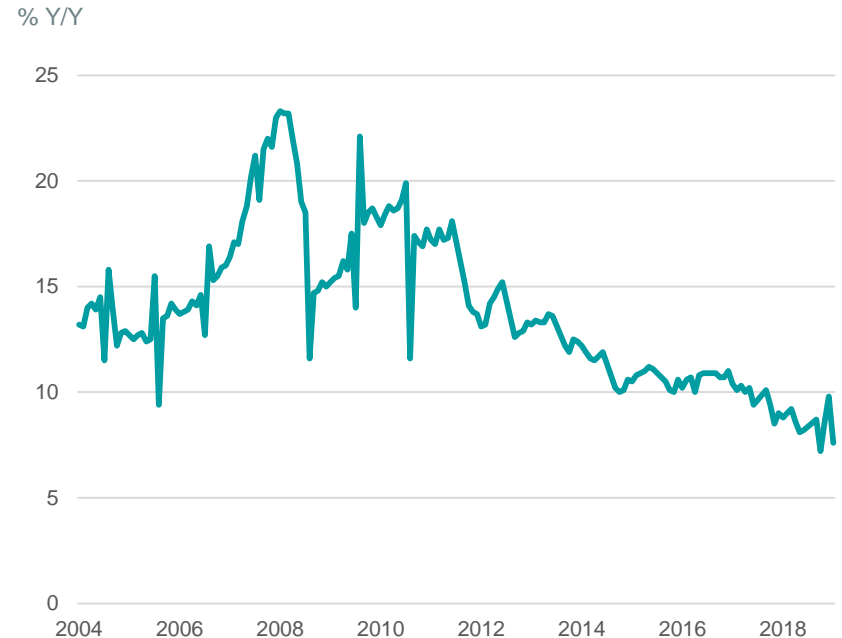
IMPACT OF TRADE CONFLICT ON INVESTMENT IS VISIBLE



GROWTH DYNAMICS SLOWED DUE TO US-CHINA TRADE CONFLICT

- The renewed trade conflict with the U.S. since May has clear impact on investment and production activities in China: July investment only at 5.7% yoy, industrial production at 4.8% and retail sales at 7.6%.
- The easy monetary policy did not have big impact on economic activities, but the huge tax cut for consumers and companies do which can be seen in latest retail sales data.

RETAIL SALES: CONSUMPTION RESILIENCY DUE TO TAX CUTS



FISCAL POLICY IS IN FOCUS

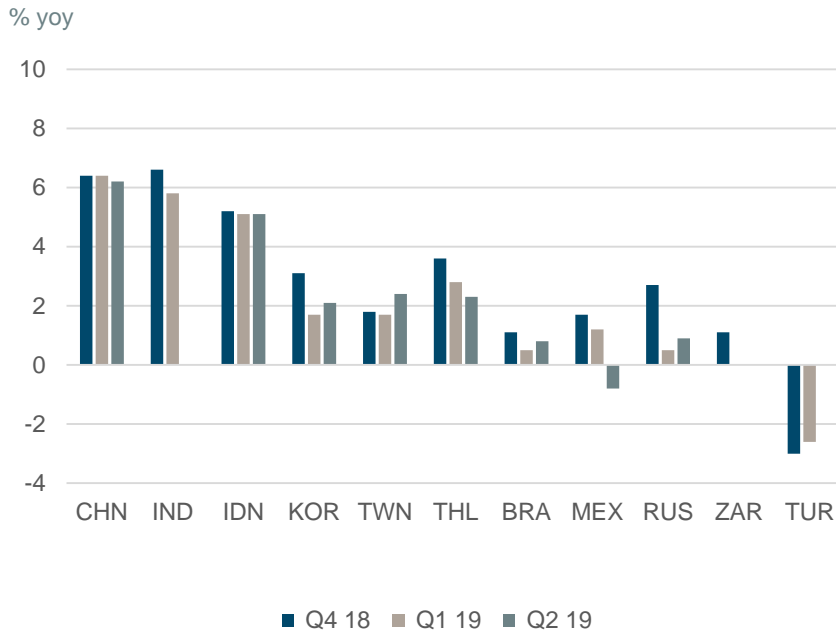
- The high debt level at corporate and private household level lead the government to rethink about long term risks posed on the economy and thus put the focus on fiscal policy.
- The government cut income tax, VAT and corporate tax in size of about 2.5% of GDP since the beginning of the year.
- Fiscal policy is expected to remain in focus if further policy action is needed.

EMERGING MARKETS GROWTH OUTLOOK

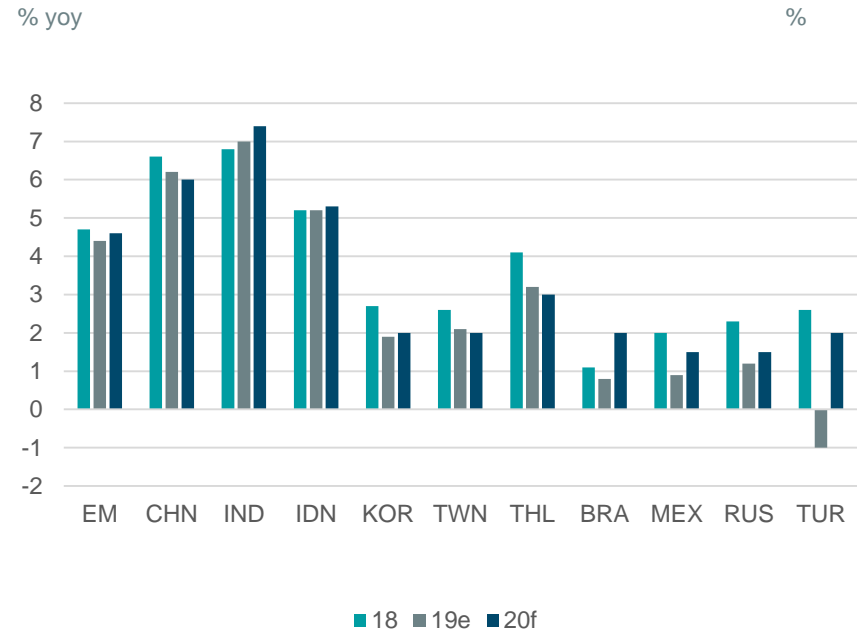


Most countries see lower growth this year

QUARTERLY GDP GROWTH



GDP GROWTH FORECASTS FOR 2019 AND 2020



GROWTH IN Q2 CONTINUES TO BE WEAK IN MOST EM COUNTRIES

- In some countries the drag by global trade conflict was compensated by strong domestic demand in Q2 (Korea, Taiwan). The direct and indirect effects are likely to be stronger in the coming quarters.
- In countries, home-made weakness dampened GDP growth (Brazil, Russia, South Africa, India).

ON AVERAGE: EM GDP GROWTH IS LIKELY TO RECOVER NEXT YEAR

- India is one of the few countries where we expect GDP growth to recover in the course of this year.
- The region with the biggest growth disappointment is Latin America.

PERFORMANCE OVER THE PAST 5 YEARS



12-month periods

	08/14 - 08/15	08/15 - 08/16	08/16 - 08/17	08/17 - 08/18	08/18 - 08/19
GER 2yr	0.1%	0.3%	-0.5%	-0.7%	0.0%
GER 10yr	2.3%	8.0%	-2.0%	1.2%	8.5%
GER 30yr	5.4%	18.6%	-7.7%	3.2%	21.8%
UK 10yr	5.4%	12.3%	-1.0%	-1.1%	9.2%
UST 2yr	0.8%	1.1%	0.5%	-0.1%	4.4%
UST 10yr	3.4%	7.0%	-1.4%	-3.1%	13.7%
UST 30yr	4.6%	16.7%	-5.4%	-2.8%	24.2%
Japan 10yr	2.0%	3.8%	-0.4%	-0.5%	3.6%
EUR IG Corp	0.4%	6.7%	0.6%	0.0%	6.7%
EUR HY	2.0%	6.8%	6.4%	1.2%	4.8%
US IG Corp	-0.4%	9.1%	1.9%	-1.0%	13.0%
US HY	-2.9%	9.1%	8.6%	3.4%	6.6%
EM Credit	-1.1%	10.9%	5.8%	-1.4%	11.8%
EM Sovereign	-3.0%	14.8%	4.5%	-4.6%	13.1%
Italy 10yr	4.7%	9.0%	-3.3%	-6.6%	22.1%
Spain 10yr	2.4%	10.9%	-0.2%	2.4%	12.5%
S&P 500	0.5%	12.6%	16.2%	19.7%	2.9%
Stoxx600	9.4%	-1.9%	12.5%	5.7%	3.0%

	08/14 - 08/15	08/15 - 08/16	08/16 - 08/17	08/17 - 08/18	08/18 - 08/19
Eurostoxx 50	5.7%	-4.8%	16.1%	1.8%	3.8%
DAX	8.3%	3.2%	13.8%	2.6%	-3.4%
SMI	5.0%	-3.7%	12.4%	4.0%	14.0%
FTSE 100	-5.0%	13.0%	14.0%	4.1%	1.4%
MSCI EM	-22.9%	11.8%	24.5%	-0.7%	-4.4%
MSCI Asia xJ	-16.1%	12.9%	24.8%	2.8%	-6.3%
MSCI Latam	-42.4%	19.8%	22.6%	-11.8%	8.9%
MSCI Japan	4.2%	2.9%	13.7%	9.0%	-5.6%
CAC 40	9.6%	-0.9%	18.3%	9.8%	4.9%
MSCI World Index	-4.1%	6.7%	16.2%	13.1%	0.3%

Past performance is not indicative of future returns.

Sources: Bloomberg Finance L.P., DWS Investment GmbH as of August 2019

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