Forecast report

Forward-looking statements

The Deka Group's planning is based on the assumptions about future economic development that appear the most probable from a current standpoint. Statements about the expected development in the second half of 2019 are nevertheless subject to uncertainty.

Actual trends in the international capital, money and property markets or in the Deka Group's business divisions may diverge significantly from our assumptions, which are partly based on expert estimates. The Deka Group's risk position is summarised in the risk report. If the risk scenarios referred to in the risk report should materialise, for example as a result of stress situations or counterparty default, this may result in negative differences from the forecast during the remaining months of the 2019 financial year. Conversely, opportunities may result in expectations being exceeded.

Expected macroeconomic trends

Looking ahead to the second half of the year, DekaBank expects the moderate economic growth witnessed of late to continue. Global expansion of 3.0% is predicted for 2019 as a whole. No serious slowdown is expected in any region of the global economy. Nevertheless, economic downside risks emanating primarily from the political arena are likely to dominate the capital markets. After US President Trump raised tariffs for Chinese products again in the spring and threatened to impose new tariffs against Mexico, his behaviour seems to be even less predictable. Trust between the US and China, in particular, is likely to have been destroyed to such an extent that any rapprochement is unlikely for the time being. In addition, relations between the US and the EU could move further into the spotlight again as a result of the imminent decision on protective tariffs on car imports. Even if the trade conflict does not escalate, the ongoing uncertainty is likely to weigh on the overall mood on the financial markets and in the real economy.

In terms of economic growth, this has so far been offset by buoyant domestic demand and flourishing labour markets. Given that unemployment rates in most of the world's industrialised nations are already very low, however, consumer spending will, for the foreseeable future, no longer be able to prop up growth to the extent witnessed to date. Even if the trade disputes do not intensify any further, the economic damage is therefore likely to gradually increase.

What is more, political uncertainties are also creating an uncertain environment for the financial markets and the real economy. The UK's withdrawal from the EU is likely to become a more prominent topic again in the near future. It is unlikely that the new prime minister and parliament will reach an agreement on the terms of the UK's departure by the end of October. A second referendum or early election may be required to break this deadlock. This makes the spectrum of possible scenarios very broad, ranging from a hard Brexit to a decision to remain in the EU. Within the EU, the rise of populist forces has led to mounting political risks. In the European Parliament, the majority held by the pro-European parties is thinner than it once was. In the European Council, too, there are individual governments that are not in favour of further integration. This lack of unity is making it difficult for the EU to adopt a common stance on key issues, including how to deal with Italy's increased budget deficits, global trade disputes and Brexit.

Expected environment for asset management

Perceived risks, as well as low inflation rates and the possibility of a further drop in inflation expectations, mean that all eyes are on the world’s major central banks. DekaBank expects the Fed and the ECB to cut their key interest rates in the second half of 2019, a move that will have a significant impact on the capital markets. This will generally have a dampening effect on yields on safe-haven government bonds and provide support for riskier assets.

Real estate asset management remains an appealing asset class. However, investment opportunities for real estate funds remain limited, meaning that restraint is still called for when attracting new inflows. Higher completions and fewer space conversion projects are likely to translate into a significant slowdown in rental growth in Europe from 2020 onwards. In the ongoing low interest rate environment, yields will remain low for the foreseeable future, presenting fund management with particular challenges.

Expected environment for the banking business

In view of the only moderate pace of economic growth and persistently low inflation, the ECB believes that it has to continue with a highly expansionary monetary policy. Alongside expansionary measures, its most important tool remains its forward guidance, in which it has underscored its intention to keep key interest rates at a very low level for some time to come.

This means that the excess liquidity on the money market is likely to persist for the time being, pushing EONIA and EURIBOR rates towards the current deposit rate of –0.40%. Consequently, the short end of the Bund curve will also remain stuck well below zero. The prospect of very expansionary monetary policy for years to come is, however, exerting downward pressure on yields in the longer maturity ranges, too. As a result, while the yield on ten-year German government bonds is expected to rise somewhat, it will remain in negative territory until well into next year.

Corporate bonds, as well as uncovered and covered bank bonds (*Pfandbriefe*), have reaped considerable benefits from the turnaround in guidance from the ECB and other major central banks. With the prospect of a prolonged period of extremely low interest rates, even low risk premiums are becoming increasingly appealing. While the economic outlook has clouded over due to the trade dispute, expansion as opposed to recession is still on the cards both in Germany and at global level, offering companies a strong foundation for their business. Since the major central banks are also signalling that they will provide continuing, or even additional, monetary support if setbacks appear on the horizon, rising spreads will soon be interpreted as an entry signal again on the capital market. The weaker economic outlook, however, leaves little more scope for price gains from spread narrowing in the near future.

In the individual market segments of its capital markets business, the Deka Group still expects only moderate changes compared to 2018. In the financing business, the continuing high level of market liquidity and investment pressure among institutional investors will put heavy pressure on margins, which may be reflected in the terms and conditions offered.

Expected business development and profit performance

In the forecast report included in the 2018 Group management report, the economic result for 2019 as a whole was predicted to be roughly on a par with 2018, i.e. at around €450m. Developments in the first half of the year generally confirm this forecast. In view of the current capital market situation and the persistently low interest rates, however, it is impossible, from today's perspective, to rule out the prospect of negative effects particularly on the business activities of companies in Deka's equity investment portfolio, resulting in negative earnings effects for the Deka Group in the second half of the year. This would push the economic result for 2019 down to well below the previous year's figure.

The analysis of the potential impact from the leveraging and implementation of efficiency measures under the DekaPro strategic programme has not yet been completed. It was therefore not yet possible to include the resulting effects on earnings in the forecast for the interim report.

With a continued focus on investment fund business that maintains lasting value, including regular securities saving, net sales are expected to by far exceed the previous year's level.

The Asset Management Securities business division is still aiming for higher net sales as against the end of 2018, and therefore an increase in total customer assets. This is to be supported by the optimisation of the product offering for lump-sum investments, investment fund savings and fund-based asset management concepts across all distribution channels. A rise in net sales is expected for the institutional business, driven primarily by sales of special funds and mandates.

Risks will come from the political arena (US foreign and trade policy), the escalation of latent armed conflicts, Brexit and nationalist currents in Europe. These could put pressure on the stock markets and dampen investors' risk appetite, or trigger fund outflows. In addition, a pronounced stock market correction could negatively affect total customer assets.

The Asset Management Real Estate business division aims to improve net sales in the institutional business again – without changing sales quotas for mutual real estate funds – and achieve an overall increase in total customer assets. New open-ended real estate funds are being planned for the retail business, which will enable the business division to respond to the sustained high demand for its real estate products among private investors. Potential in the institutional sector is to be tapped through new products and intensified sales activities, among other things. The strategic focus on core real estate along with strong commitments regarding quality and stability make the division the first-choice partner for savings banks and customers when investing in commercial property. Moreover, the division plans to reinforce its attractiveness to sustainability-oriented investors by consistently taking into account sustainability criteria in portfolio management and when purchasing property.

Risks to performance arise from fierce competition in the transaction markets, which makes transaction planning difficult. While the interest-driven boom improves sale prospects, it also puts increased requirements on the structuring of property purchases. There is also the risk of cyclical changes in value in the event of a downturn on property markets.

The Asset Management Services business division expects assets under custody to have increased by the end of 2019 in line with the targeted growth in asset management, consolidating its competitive standing in the *Sparkassen-Finanzgruppe*. The Digital Multichannel Management subdivision will put a special focus on enhancing the "internet branch" and integrating it with sales channels based on physical branches and other media. The Deka Group will strengthen the position of the Depositary subdivision through growth in the Deka Group investment companies' mutual funds and by obtaining third-party mandates.

Risks to future performance include rising pressure on margins for depositaries as well as market-induced outflows of funds. In Digital Multichannel Management, rising expenses could result from additional regulatory requirements imposed by the supervisory authorities.

The Capital Markets business division will continue its existing strategic direction as a customer-centric product and solution provider focused on the development of suitable structured products and the derivatives, issuance and trading businesses as 2019 progresses. In certificates business, the focus will remain on retail products. The Deka Group will remain committed to positioning itself as an infrastructure provider with global capital market access.

Risks arise particularly from a drop in customer activity prompted by political or market/economic events, regulatory intervention in the design of products and definition of terms and conditions, further increased market pressure on fees and greater competition among brokers.

The Financing business division aims to increase new business in 2019 in its defined core segments in specialised and real estate financing. The planned expansion of the lending portfolio will serve as a basis for sustainable contributions to the division’s results. The focus will remain on quality leadership in existing asset classes while maintaining a stability-oriented and risk-aware strategic focus.

Risks include political crises, which could adversely affect the economic outlook for lending segments in which we operate. This could lead to a need for higher loan loss provisions, or to increased capital adequacy requirements as a result of a downgrading of our credit ratings. The long acquisition periods and intense competitive pressure for credit assets may also mean that the planned new business volume cannot be achieved.

Expected financial and risk position

For the remaining months of the current year, the Deka Group is anticipating a continued sound financial position with largely stable total assets. While a volume increase is planned in the financing business, a reduction in volume is expected in the Capital Markets business division. Balance sheet management will be geared towards ensuring compliance with an appropriate leverage ratio.

The Group’s liquidity position is expected to remain at a comfortable level. The Deka Group can thus fulfil its role as the liquidity, risk and collateral platform for the savings banks and other institutional customers without restriction.

The Common Equity Tier 1 capital ratio (fully loaded) is expected to be below the level reached at the midpoint of 2019, but above the strategic target of 13%. This is due, in particular, to the planned volume expansion in the Financing business division.

Following developments in the first half of the year and an expected further slight increase, risk appetite utilisation will remain at a non-critical level for the remaining six months. Utilisation of risk capacity (risk capacity has fallen significantly, as was to be expected now that subordinated capital components now no longer count towards internal capital) will also remain at a non-critical level, as described in the forecast report published in the 2018 Group management report. In view of the current capital market situation and the continuing low interest rates, it is impossible, from today's perspective, to rule out the possibility of negative earnings effects in the second half of the year. These effects would reduce risk capacity, particularly in DekaBank's equity investment portfolio. Capacity utilisation would not, however, rise to a critical level even if potential negative earnings effects were taken into account.