Back to school
Month in Review

Barnier warns no ‘decisive’ progress in Brexit talks  
FT, August 31, 2017

North Korea threatens Guam after Trump ‘fire and fury’ vow  
FT, August 09, 2017

‘Catastrophic’ floods in Houston as Harvey crosses Texas  
FT, August 28, 2017

Insurer stocks jump as Irma losses seen less severe than feared  
Reuters, September 11, 2017

Merkel plays it safe on way to fourth term  
FT, August 26, 2017

Yellen, Draghi Didn't Say Much at Jackson Hole Meeting  
Newsmax, 28 August, 2017

Euro strikes $1.20 for first since January 2015  
FT, August 29, 2017

'Safe-Haven' Euro Could Complicate ECB Plan to Roll Back Stimulus  
NYT, September 01, 2017

US stocks finish at new record highs  
FT, September 12, 2017

Bulls see room to run after 8-month gain in emerging markets  
Economic Times, September 02 2017

U.S. Economy Grew 3% in 2nd Quarter, Fastest Pace in 2 Years  
NYT, June 26, 2017

U.S. Inflation Picks Up, Ending Five-Month Streak of Misses  
Bloomberg, September 14 2017

Eurozone grows twice as fast as UK after GDP rises by 0.6% - as it happened  
The Guardian, August 01, 2017

BOE Shifts Hawkish With Hint at Rate Increase Within Months  
Bloomberg, September 14 2017

Trump sides with Democrats on fiscal issues, throwing Republican plans into chaos  
The Washington Post, September 06, 2017

Draghi Fails to Talk Down Euro; Says ECB Will Decide on Tapering this Autumn  
Nasdaq, September 10, 2017
Unlike the last few years, this summer was relatively quiet. As markets look ahead to the rest of the year, the key theme will continue to be the major central banks’ tentative progress toward removing monetary accommodation.

Investors have so far not priced in this outlook. Since the prospects for growth across all the major countries is better than it has been for some time it remains a puzzle why there hasn’t been a greater sell-off in bond markets.

The failure of inflation to rise to the central bank targets of around 2% is only part of the explanation. Geopolitical and political risk have also played a role. But the latest data in the US have started to ease fears of a persistent low inflation scenario, and this should prompt a further move higher in rates as the tightening path for central banks becomes easier.

A gradual repricing of rates should not prove disruptive for risk assets, as it reflects a strong macro backdrop. But a sharp rise in rates, precipitated by a more meaningful pickup in inflation which reveals that central banks may be behind the curve, could be highly disruptive to asset pricing generally. 2013’s taper tantrum provides an example, with US rates rising 140bp in 8 months and wiping billions off risk asset valuations.

David Folkerts-Landau, Group Chief Economist
Steady global growth, macro views shift in favor of Europe. Latest data reinforce central banks’ stance toward tighter policy

**Economic outlook**
- Global growth near potential at 3.7% in 2017-18, up from 3.1% in 2016. We see upside resulting from capex growth, labour shortages, synchronised recovery.
- US economy improves from 2.2% to 2.4% growth in 2018. Volatility in labour market data should not alter Fed’s view of full employment with solid momentum.
- Eurozone cyclically strong: Our upgraded forecasts are above consensus at 2.2% in 2017, 2.0% in 2018. Exports & pent-up domestic demand driving growth.

**Central bank watch**
- Fed: Announcement on balance sheet policy in September; next rate hike in December, 3 more in 2018.
- ECB: QE extension and tapering to be announced in October, despite euro strength.
- BoJ: Not under pressure to act, no change expected in target short rate or yield curve control policy this year.
- BoE: We now expect a 25bp hike in November, but not the start of a hiking cycle.
- PBoC: No urgency to change policy stance, interest rates to remain at the current relatively high level.
- EM: Low inflation buying time for EM CBs, either allowing rate cuts (BR, RU, SA) or delaying rate hikes.

**Views on key themes**
- Central banks on exit path: But signaling remains tentative outside the US; tug of war between CB messaging and market pricing is mediated by inflation.
- Low inflation: US inflation data improved; expect labour market tightness to feed into wages and in turn inflation. USD weakness could be a further boost.
- Political risk: Intensification of North Korean crisis since late July but diplomatic resolution remains likely.
- Regime shift in FX: Rebalancing of investment flows takes over, relative rate expectations lose importance.

**Key downside risks to our view**
- Sharp rise in rates: taper tantrum-type scenario if inflation rises faster, central banks seen behind curve.
- China financial instability: property bubble deflates; rising dollar, DM yields put pressure on outflows, RMB.
- DM growth deceleration: rising policy rates interrupt macro momentum, mild recession.
- De-globalisation: rise of anti-trade policies exacerbates anaemic global trade and sharply slows growth.

Notes: H / M / L indicates estimated probability of risk (High, Medium, Low).
Risk assets have performed strongly, and especially so in dollar terms given the greenback’s weakening

Returns* per asset class in 2017

<table>
<thead>
<tr>
<th>Equities</th>
<th>Corporate Credit</th>
<th>Sovereign debt</th>
<th>FX**</th>
<th>Commodities**</th>
</tr>
</thead>
<tbody>
<tr>
<td>MSCI EM</td>
<td>30</td>
<td>-4</td>
<td>13</td>
<td>15</td>
</tr>
<tr>
<td>Italy</td>
<td>18</td>
<td>5</td>
<td>7</td>
<td>-5</td>
</tr>
<tr>
<td>US S&amp;P 500</td>
<td>13</td>
<td>9</td>
<td>6</td>
<td>-9</td>
</tr>
<tr>
<td>Mexico IPC</td>
<td>11</td>
<td>9</td>
<td>5</td>
<td>-3</td>
</tr>
<tr>
<td>IPC</td>
<td>11</td>
<td>9</td>
<td>5</td>
<td>-4</td>
</tr>
<tr>
<td>France</td>
<td>10</td>
<td>4</td>
<td>2</td>
<td>-1</td>
</tr>
<tr>
<td>Germany</td>
<td>9</td>
<td>7</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Japan</td>
<td>7</td>
<td>6</td>
<td>-1</td>
<td>13</td>
</tr>
<tr>
<td>Russia</td>
<td>4</td>
<td>2</td>
<td>7</td>
<td>7</td>
</tr>
<tr>
<td>China</td>
<td>-4</td>
<td>3</td>
<td>7</td>
<td>6</td>
</tr>
<tr>
<td>Philippines</td>
<td>-9</td>
<td>0</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Mexico IPC</td>
<td>-5</td>
<td>-1</td>
<td>-5</td>
<td>-3</td>
</tr>
<tr>
<td>Mexico IPC</td>
<td>-4</td>
<td>-4</td>
<td>-9</td>
<td>-4</td>
</tr>
</tbody>
</table>

Note: (*) Total return accounts for both income (interest or dividends) and capital appreciation. (**) FX, Commodities are spot returns.

Source: Bloomberg Finance LP, Deutsche Bank Research. As of COB, 26 June 2017

Risk assets have performed strongly, and especially so in dollar terms given the greenback’s weakening:

- Sterling can narrow underperformance gap as market prices in November hike.
- European rates recover from post-Sintra selloff.
- Dollar decline gaining momentum.
- Gold prices boosted by lower Treasury yields.

Still strong, but spreads widened on demand for safe havens.

+8.4% average ytd return on non-USD equity indices becomes +19.7% once translated back into USD-equivalent terms.

+8.4% average ytd return on non-USD equity indices becomes +19.7% once translated back into USD-equivalent terms.

+8.4% average ytd return on non-USD equity indices becomes +19.7% once translated back into USD-equivalent terms.

+8.4% average ytd return on non-USD equity indices becomes +19.7% once translated back into USD-equivalent terms.

+8.4% average ytd return on non-USD equity indices becomes +19.7% once translated back into USD-equivalent terms.

+8.4% average ytd return on non-USD equity indices becomes +19.7% once translated back into USD-equivalent terms.

+8.4% average ytd return on non-USD equity indices becomes +19.7% once translated back into USD-equivalent terms.
Unlike the last couple of years, the summer period was relatively quiet for markets

- Every summer since 2010 had seen market moving events – 2014 the exception
  - Large swings in markets
  - Considerable volatility spikes

- In this respect this summer was relatively quiet
  - Few if any major events
  - Muted volatility
  - Resilient equity markets

Source: Bloomberg Finance LP, Deutsche Bank Research
One of the key moves in markets was the reversal of the rate rise that followed central banks’ hawkish messages in June

- Major central banks surprised with what came across as a co-ordinated hawkish message at the ECB’s annual conference in Sintra in June
  - ECB, Fed, BoE clearly signalled they were on an exit path
  - Backdrop of robust global growth, receding political risk and inflation progress toward target supported the message
- Tone did not go unnoticed, prompting sharp rises in core rates – 20-30bp rise in 5-year yields over a couple of weeks
- Sell-off was short-lived, with a relentless reversal over the last two months...
  - Sharp rally in core rates
  - Current valuations close to or even below pre-Sintra levels
- ...And this despite growth remaining strong, central banks not having changed their message
- In last week, hawkish signals from ECB and BoE, some optimism of US fiscal reform and a better US inflation print have again sparked a rate selloff

Key central banks sent what came across as a co-ordinated hawkish message at Sintra’s ECB annual conference in June

Central Bankers Tell the World Borrowing Costs Are Going Up

Hawkish Central Bankers Spark a Debate About the End of Easy Money

Bank of England's Carney says BoE will debate rate rise in 'coming months'

Note: yield changes since ECB conference in Sintra on 26-Jun-2017
Source: Bloomberg Finance LP, Deutsche Bank Research
In part, this was due to geopolitical risk, notably the escalation of tension between the US and North Korea

- Escalation of tension between US and North Korea grabbed significant attention over last few months
  - More daring actions by NK, more heated rhetoric
- Military conflict remains unlikely
  - Costly for North Korea and South Korea, but also for Japan and, indirectly, for China via disruption of supply chains
  - Little chance of achieving much
  - UN, Europe to temper US response – e.g., latest sanctions don’t include oil embargo, which would have likely triggered military response from NK

- NK sees acquisition of strategic nuclear capability as key to its survival
  - Makes US conventional weapons less effective in case of war
- Timing of escalation coincides with breakthroughs on both missile and nuclear technology by NK
- US adamantly opposed to a nuclear NK
  - Direct threat to US
  - Broader US / Russia / China geopolitical concern
  - Higher likelihood of Japan, South Korea becoming nuclear powers

Volatility spikes this summer driven by US-North Korea tensions – but markets take a sanguine view, with spikes low and falling

"North Korea best not make any more threats to the United States. (...) They will be met with fire, fury and frankly power the likes of which this world has never seen before.”

US President Trump, 9-Aug-2017

"There can only be a peaceful and diplomatic solution [for North Korea]."

German Chancellor Merkel, 5-Sep-2017

Source: Bloomberg Finance LP, Deutsche Bank Research
The main driver though was the limited inflation pressure, especially in the US. This will be the key focus in the coming months.

- After nearing the Fed’s objective, core inflation in the US fell sharply
  - Core PCE 0.6pp below Fed’s target, having fallen from 1.9%
- Decline partly due to negative outliers
  - Wireless services inflation plunged most on record due to Verizon unlimited data plan
- There was also some evidence of broader weakness
- However, the latest inflation data (CPI) rebounded…
- …And we still expect core inflation to move sustainably higher in 2018:
  - Positive base effects from recent weak prints
  - Support from strong growth and recent dollar weakness
  - Tight labour market

---

### Core inflation has fallen sharply in recent months

<table>
<thead>
<tr>
<th>%/y/y</th>
<th>Core PCE</th>
<th>Core CPI</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>0.5</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Source:** BEA, BLS, Haver Analytics, Deutsche Bank Research

### Some of the weakness due to one-offs (e.g., wireless and lodging away)

<table>
<thead>
<tr>
<th>% m/m</th>
<th>CPI-U: wireless telephone services</th>
<th>CPI-U: lodging away from home</th>
</tr>
</thead>
<tbody>
<tr>
<td>6.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>0.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>-2.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>-4.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>-6.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>-8.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Source:** BLS, Haver Analytics, Deutsche Bank Research

### Decline in dollar should help boost core inflation:

Peak impact around mid-2018

<table>
<thead>
<tr>
<th>%pp</th>
<th>Impact on %yoy core PCE inflation from recent dollar weakness</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.3</td>
<td></td>
</tr>
<tr>
<td>0.2</td>
<td></td>
</tr>
<tr>
<td>0.1</td>
<td></td>
</tr>
<tr>
<td>0.0</td>
<td></td>
</tr>
<tr>
<td>-0.1</td>
<td></td>
</tr>
</tbody>
</table>

**Source:** Deutsche Bank Research

### Medium-term view in US broadly unchanged:

Inflation should rise from recent lows

<table>
<thead>
<tr>
<th>%/y/y</th>
<th>Headline CPI</th>
<th>Core CPI</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>0.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>0.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>-0.5</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Source:** BLS, Haver Analytics, Deutsche Bank Research
The latest data pointing to inflation normalising ahead vindicate our strategic view of higher rates

- From a strategic point of view, rates are low
  - Market priced persistently low inflation, at odds with our view of rising inflation in next quarters
  - Little monetary tightening priced, despite clear central banks exit bias
  - Growth outlook robust, financial conditions are supportive – no reason for slowdown without tighter monetary policy
  - Market not pricing easing of fiscal policy or regulation

- Latest developments on the main fronts that had kept rates low suggest rates should now rise
  - Inflation: tentative signs of normalisation in coming quarters
  - Geopolitics: short-lived reaction to latest tit-for-tat suggest greater escalation will be needed to keep rates from rising

- Risk remains of a sharp repricing of rates
  - Inflows into risky assets (e.g., EM debt, corp. credit) as long as central bank tightening delayed
  - 2013 taper tantrum a template – US 10y rising 140bp in 8 months
The other salient market move over the summer has been in FX, with dollar weakness and euro strength

- Dollar started an upcycle in mid-2011
  - Supported by stronger economy, higher rates in US vs. Europe, Japan
  - 40%+ rise in a little over 5 years, with strongest gains as Fed ended QE and started hiking rates
  - Upcycles typically last several years

- But this cycle got interrupted this year – with dollar strength giving way to material weakness

- Weakness accelerated during the summer
  - Euro surge on robust eurozone growth and as ECB confirmed monetary policy tightening bias
  - Decreasing confidence on Fed’s ability to continue hiking, as US inflation faltered

- This is not just a euro vs. dollar story – dollar lost value vs. all major currencies

---

Source: Bloomberg Finance LP, Deutsche Bank Research

Dollar multi-year upcycle interrupted this year

Dollar upcycle

Dollar weakness this summer as euro gained

Trade-weighted Euro

But weakness broad based, not just vs. euro

% change vs. USD, since 20-Jun-17

Source: Bloomberg Finance LP, Deutsche Bank Research
Despite the speed of euro appreciation in the last couple of months, we see risks of a drift higher rather than a reversal

- Sharp rise in euro, vs. dollar but also on a trade weighted basis – up ~10% in 4 months
- Currency at our year-end targets during the summer
- Despite speed of rise, move is not that extreme
  - Sharp move brings year-to-date trading range back in line with historic ranges
- ECB mild pushback not enough to halt appreciation
  - High euro weighs on growth, lowers inflation
  - Strong growth backdrop and ECB desire to start policy exit make verbal intervention less credible

- Euro is more likely to overshoot above 1.20 than to reverse lower
  - Euro only just approaching fair value
  - Speculative positioning not particularly long despite the recent build
  - Post-crisis structural underweight in euro assets is still to be covered, generating demand for the currency
These developments are in a context of a supportive macro backdrop

**Global economy is in a better place**

- **Global growth**
  - World economy escaping 5 year low-to-no growth period
  - Growth to rebound after bottoming in 2016 to slowest pace post-crisis

- **Broad-based uptick**
  - Growth broad-based globally, highly synchronised across regions
  - Momentum remains strong despite recent weakening

- **Economic slack**
  - Economic slack falling
  - Employment gap, output gap closing across major DM economies

- **Political risk**
  - Political event risk materially diminished
  - Brexit and to a lesser extent Italy the notable exceptions

**Global growth remains highly synchronised despite recent easing in momentum**

![Graph showing global growth trends](image)

Note: Diffusion index calculated as % of Composite PMIs above 50 (based on 8-18 countries)
Source: Haver Analytics, Markit, Deutsche Bank Research

**Major developed economies have closed / are closing output gaps**

![Graph showing output gaps across economies](image)

Note: (*) The output gap is a measure of slack in an economy: it is the difference between output and potential output. A negative gap means the economy produces less than potential.
Source: Haver Analytics, OECD, Deutsche Bank Research
Most major economies are growing healthily, and expected to continue to do so through 2018

Global growth outlook

**US: solid growth to continue**
- Growth above recent trend on stronger capex and solid consumer spending
- Near-term data volatility due to hurricanes
- Limited fiscal stimulus expected: upside risks from significant tax cuts / spending increases
- But growth to be low relative to history

**Eurozone: positive outlook**
- Highest growth in years; above-trend pace to continue
- Reduction in political risk supports growth
- Euro strength a negative, but impact lower than in the past
- Growth uptick remains cyclical, raising questions as to how long it can last

**UK: growth to slow down**
- Consumption to suffer from drop in consumers’ real disposable income – high inflation, subdued wage growth, high leverage
- Brexit uncertainty to weigh on business spend
- Weaker sterling not feeding through to exports, but limiting BoE easing room

**China: managed slowdown**
- Gradual growth slowdown continues
- Export recovery supported H1 growth
- But newly introduced supply side reforms have and will continue to weigh on industrial production
- Property and land markets key concern into 2018, as sector boom risks fading

**EM: benign macro backdrop**
- Growth revised up marginally, especially in Asia
- Momentum eased somewhat but still strong; robust DM growth a positive pull factor
- Vulnerabilities pose localised, not systemic risks

**Japan: slowdown expected**
- Economy slowing down into 2018
- Investment cycles coming to an end (business, consumer durables)
- Work style reforms introduced by the government impose cuts to work hours

---

**Real GDP growth** (%)yoy

<table>
<thead>
<tr>
<th>Region</th>
<th>Avg 2017-18</th>
</tr>
</thead>
<tbody>
<tr>
<td>World</td>
<td>3.7</td>
</tr>
<tr>
<td>DM</td>
<td>2.1</td>
</tr>
<tr>
<td>EM</td>
<td>4.8</td>
</tr>
<tr>
<td>US</td>
<td>2.3</td>
</tr>
<tr>
<td>Eurozone</td>
<td>2.1</td>
</tr>
<tr>
<td>Germany</td>
<td>1.8</td>
</tr>
<tr>
<td>France</td>
<td>1.7</td>
</tr>
<tr>
<td>Italy</td>
<td>1.3</td>
</tr>
<tr>
<td>UK</td>
<td>1.3</td>
</tr>
<tr>
<td>Japan</td>
<td>1.3</td>
</tr>
<tr>
<td>India</td>
<td>7.0</td>
</tr>
<tr>
<td>China</td>
<td>6.5</td>
</tr>
<tr>
<td>Brazil</td>
<td>2.3</td>
</tr>
<tr>
<td>Russia</td>
<td>1.9</td>
</tr>
</tbody>
</table>

---

**2017 real GDP growth (%)**

- <0%  - 0-1%  - 1-2%  - 2-3%  - 3-5%  - >5%  - n/a
In recent weeks, the Southern US has been hit by back-to-back severe hurricanes that have devastated the Houston area and Florida.

At this point it is difficult to assess the likely impact on GDP growth, but our early expectations are for:

- Near-term negative impact on activity (e.g., trade, industrial production) which could subtract at least 0.2pp from H2 growth
- Beyond near-term, rebuilding effort should help lift GDP, with effects more dispersed over time

Past hurricanes (e.g., Katrina) suggest that labour market data could also be severely impacted

- Job gains plunged in Sep-2005 after Katrina: -35k versus ~175k average on the previous 3 months
- Initial jobless claims have already spiked higher

For inflation, primary effect is temporary boost to headline inflation from jump in gas prices

- Potential for some spill-over to core (e.g., lodging away as displaced households seek shelter)

Muddied data picture will complicate the Fed’s job, but we anticipate they will look through volatility.
Fed should announce start to phasing out QE reinvestment at its September meeting. Next rate hike in December if inflation firms

- Fed policy decisions are being made in the presence of strong countervailing forces
  - On the hawkish side are solid growth / labour market momentum and loose financial conditions
  - On the dovish side is soft inflation
- We expect Fed to announce start of balance sheet reinvestment phase out at the 20-Sep. meeting
  - Hiking cycle paused to assess impact of announcement
- The bigger question for markets is when the next rate hike will occur

- We expect the Fed to raise rates again in December
  - Inflation developments will be key, and some further evidence of a firming inflation trend likely needed
- Some Fed “dots” are likely to fall at the September meeting but we expect the signal to be that a December hike remains very possible
- In 2018, we see three rate increases – the first coming in June – in line with the Fed and well above the market (<1)

**Projection of roll-off of Fed Treasury holdings**

<table>
<thead>
<tr>
<th>Year</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
</tr>
</thead>
<tbody>
<tr>
<td>USDbn</td>
<td>80</td>
<td>60</td>
<td>40</td>
<td>20</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

- Allow to mature
- Reinvest
- Reinvestment cap

**Loose financial conditions supporting growth**

- DB high frequency FCI (1q ahead, ls)
- Real GDP (rs)

**Disconnect persists between Fed, market on rate hikes**

- FOMC projections
- Median projections
- Market pricing
- DB forecasts

Source: US Treasury, Deutsche Bank Research

Source: BEA, Haver Analytics, Deutsche Bank Research

Source: FRB, Bloomberg Finance LP, Deutsche Bank Research
To recap, the Fed, ECB and to a lesser extent BoE are now on an exit path

<table>
<thead>
<tr>
<th>Macropolicy</th>
<th>Federal Reserve</th>
<th>European Central Bank</th>
<th>Bank of England</th>
<th>Bank of Japan</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Macro backdrop</strong></td>
<td>Strong macro backdrop, growth above trend</td>
<td>Strong macro backdrop, growth above trend</td>
<td>Economy slowing – FX-led real income shock weighs on growth</td>
<td>Economy slowing down into 2018</td>
</tr>
<tr>
<td></td>
<td>At full employment, output gap nearly closed</td>
<td>Employment gap, output gap closing steadily</td>
<td>Close to full employment</td>
<td>Inflation low and well below target</td>
</tr>
<tr>
<td><strong>Key challenge</strong></td>
<td>Soft inflation casts doubt over Fed’s rate guidance</td>
<td>Euro strength weighs on growth, lowers inflation</td>
<td>Conflicting goals: high inflation, weak sterling warrant higher rates, but this threatens growth</td>
<td>Inflation not rising despite massive BoJ stimulus</td>
</tr>
<tr>
<td></td>
<td>Market reluctant to price upcoming normalisation of inflation</td>
<td>Inflation rise not yet self-sustaining</td>
<td>Weak wage inflation</td>
<td>Counter-cyclical nature of Yield Curve Control*</td>
</tr>
<tr>
<td><strong>Policy stance</strong></td>
<td>Sticking to gradual exit</td>
<td>Slow and gradual exit</td>
<td>Tightening bias</td>
<td>On hold, talk of exit not justified at present</td>
</tr>
<tr>
<td></td>
<td>Would like to see convincing evidence of firmer inflation to continue rate hikes</td>
<td>Easy policy needed to reach inflation target</td>
<td>Growth backdrop sufficient for BoE to focus on inflation and FX concerns</td>
<td>Dovish turn in board as two members terms end</td>
</tr>
<tr>
<td><strong>What we expect</strong></td>
<td>Sep-17: announcement of tapering of balance sheet reinvestments</td>
<td>Oct-17: 6-month QE extension, at €40bn/mth</td>
<td>Now expect one-off 25bp hike in Q4-17 – but not a start of a hiking cycle</td>
<td>BoJ not under pressure for urgent action</td>
</tr>
<tr>
<td></td>
<td>Dec-17: rate hike</td>
<td>Mid-18: deposit rate hike</td>
<td></td>
<td>No change expected in target short rate or YCC in 2017</td>
</tr>
<tr>
<td></td>
<td>2018: three hikes</td>
<td>H2-18: likely QE extension at lower pace</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Mid-19: start of hikes</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: (*) BoJ introduced YCC in Sep-2016. Rather than maintaining a commitment to a JPY amount of QE purchases, the BoJ started targeting a 10-year yield around zero. The policy has a counter-cyclical nature: the more inflation normalises and yields rise, the more bonds the BoJ will purchase, thus easing when not needed; the opposite also holds true.
As Brexit talks slowly continue, the key question remains what, if any, transition deal is struck to avoid a negative "crash Brexit"

- Acknowledgment across the board that a transition period has to be agreed to avoid exit without deal
  - Time is too tight to have negotiated future relation by Brexit day in Mar-2019
- Limited progress to date, solely focused on exit issues (e.g., divorce bill, status of UK / EU citizens, etc.)
- Conflicting messages from UK government as to what kind of end-deal is being sought – has to be addressed for transition to be agreed
  - Smooth transition has to resolve tension between globalist Brexiteers and those that wish to stay closer to the EU single market
- Current UK political setup not conducive to the necessary domestic compromises
- UK political and / or economic crisis necessary to drive UK into EEA-style + customs transitional agreement

The big picture

<table>
<thead>
<tr>
<th>Economic argument</th>
<th>Brexit rationale</th>
</tr>
</thead>
</table>
| - Remain as close to single market as possible  
  - Goods trade  
  - Services trade  
  - Accept EU’s playing rules | - Trade deals with rest of world  
- Control of immigration  
- Supremacy of UK law vis-à-vis European Court of Justice |

Key issues

- Minority government starves PM May from much needed flexibility to carry out negotiations
  - Eurosceptic MPs can easily hold government hostage
- No signs of cracks on EU-27 front means UK’s negotiating position is weak
  - If anything, across Europe the EU is more in favour than at time of Brexit vote in Jun-2016
The end-September German election is likely to be a non-event for markets, but it will clear the way for EU integration talks

- Chancellor Merkel widely seen as securing a fourth term against centre-left SPD’s Martin Schulz
- Uncertainty remains over what the governing coalition will look like
  - Several options, given how different parties poll
  - “Colour” of coalition will drive policy trade-offs
- New government to face important domestic issues
  - Erosion of economic drivers – underlying trend growth expected to weaken over next decade

- Multiple issues also on the international front
  - Migration flows
  - Brexit and future EU-UK relations
  - European integration
- This last area is key -- much has changed in the last year and EU leaders are less reticent about calling for more Europe
  - Macron election in France, underperformance of eurosceptic parties across Europe
  - With German election behind, it could be the time for moving into more active integration talks

Pro-European parties garner greatest support

<table>
<thead>
<tr>
<th>Party</th>
<th>Surveys published end-July 2017, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>CDU/CSU</td>
<td>40</td>
</tr>
<tr>
<td>SPD</td>
<td>30</td>
</tr>
<tr>
<td>Left</td>
<td>20</td>
</tr>
<tr>
<td>AfD</td>
<td>10</td>
</tr>
<tr>
<td>FDP</td>
<td>10</td>
</tr>
<tr>
<td>Greens</td>
<td>5</td>
</tr>
<tr>
<td>Others</td>
<td>0</td>
</tr>
</tbody>
</table>

Source: Wahlrecht.de, Deutsche Bank Research
* Average of major surveys (Allensbach, Infratest Dimap, Forsa, Forschungsgrupper Wahlen, TNS Emnid)

Declining trend economic growth on lower hours worked

Source: Deutsche Bundesbank, Deutsche Bank Research
## Summary of market views

<table>
<thead>
<tr>
<th>Asset class</th>
<th>View</th>
<th>Rationale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equities</td>
<td>US: constructive</td>
<td>S&amp;P500 long overdue a pullback, but positive economic backdrop should dominate any correction. Maintain 2,600 year-end target</td>
</tr>
<tr>
<td></td>
<td>Europe: risk of tactical downside</td>
<td>Easing of macro momentum consistent with a correction to European equities in coming months. European equities are however at bottom of range vs. US</td>
</tr>
<tr>
<td>Rates</td>
<td>Strategically bearish</td>
<td>Market still pricing low inflation, little further tightening (“Fed is nearly done”). Latest developments (e.g., US inflation) comfort our bearish positioning</td>
</tr>
<tr>
<td>FX</td>
<td>Dollar risks are asymmetric</td>
<td>Market refuses to price in any additional rate hikes from the Fed. Asymmetric (downside) risk to the dollar as Fed Funds rate approaches neutral.</td>
</tr>
<tr>
<td></td>
<td>Euro upside on investment flows</td>
<td>Relative ECB/Fed monetary policy expectations no longer the prime mover. Euro responding to investment flow imbalances – rebalancing underway of the structural underweight of European assets built post-crisis</td>
</tr>
<tr>
<td>Credit</td>
<td>Constructive Europe</td>
<td>IG spreads likely to move sideways in the short term, with moderate widening bias through the end of the year. We hold a bias for European HY credit spreads widening further in the short term, in the face of significant issuance.</td>
</tr>
<tr>
<td>EM</td>
<td>Staying positive</td>
<td>Strong YTD performance to give way to reduced and more carry-dependent returns in the remainder of the year. EM macro still stronger than DM</td>
</tr>
<tr>
<td>Commodities</td>
<td>Oil prices stabilising</td>
<td>Temporary dislocations resulting from Hurricane Harvey. Threat of oversupply persists in 2018, requiring OPEC to extend its restraint</td>
</tr>
</tbody>
</table>
### DB forecasts

**GDP growth (%)**

<table>
<thead>
<tr>
<th>Region</th>
<th>2015</th>
<th>2016</th>
<th>2017F</th>
<th>2018F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global</td>
<td>3.4</td>
<td>3.1</td>
<td>3.7</td>
<td>3.7</td>
</tr>
<tr>
<td>US</td>
<td>2.9</td>
<td>1.5</td>
<td>2.2</td>
<td>2.4</td>
</tr>
<tr>
<td>Eurozone</td>
<td>1.9</td>
<td>1.8</td>
<td>2.2</td>
<td>2.0</td>
</tr>
<tr>
<td>Germany</td>
<td>1.7</td>
<td>1.9</td>
<td>1.9</td>
<td>1.8</td>
</tr>
<tr>
<td>France</td>
<td>1.0</td>
<td>1.1</td>
<td>1.7</td>
<td>1.7</td>
</tr>
<tr>
<td>Italy</td>
<td>0.8</td>
<td>0.9</td>
<td>1.5</td>
<td>1.2</td>
</tr>
<tr>
<td>Spain</td>
<td>3.2</td>
<td>3.2</td>
<td>3.0</td>
<td>2.5</td>
</tr>
<tr>
<td>Japan</td>
<td>1.1</td>
<td>1.0</td>
<td>1.8</td>
<td>0.7</td>
</tr>
<tr>
<td>UK</td>
<td>2.2</td>
<td>1.8</td>
<td>1.6</td>
<td>1.0</td>
</tr>
<tr>
<td>China</td>
<td>6.9</td>
<td>6.7</td>
<td>6.7</td>
<td>6.3</td>
</tr>
<tr>
<td>India</td>
<td>7.5</td>
<td>7.9</td>
<td>6.5</td>
<td>7.5</td>
</tr>
<tr>
<td>EM Asia</td>
<td>6.2</td>
<td>6.2</td>
<td>6.0</td>
<td>6.0</td>
</tr>
<tr>
<td>EM CEEMEA</td>
<td>1.6</td>
<td>1.4</td>
<td>2.9</td>
<td>2.8</td>
</tr>
<tr>
<td>EM LatAm</td>
<td>-0.3</td>
<td>-1.5</td>
<td>1.1</td>
<td>2.3</td>
</tr>
<tr>
<td>EM</td>
<td>4.2</td>
<td>4.1</td>
<td>4.7</td>
<td>4.9</td>
</tr>
<tr>
<td>DM</td>
<td>2.2</td>
<td>1.6</td>
<td>2.1</td>
<td>2.0</td>
</tr>
</tbody>
</table>

* CPI (%) forecasts are period averages

**CPI inflation, YoY (%)**

<table>
<thead>
<tr>
<th>Region</th>
<th>2015</th>
<th>2016</th>
<th>2017F</th>
<th>2018F</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>0.1</td>
<td>1.3</td>
<td>2.2</td>
<td>2.0</td>
</tr>
<tr>
<td>Eurozone</td>
<td>0.0</td>
<td>0.2</td>
<td>1.5</td>
<td>1.4</td>
</tr>
<tr>
<td>Japan</td>
<td>0.8</td>
<td>-0.1</td>
<td>0.3</td>
<td>0.4</td>
</tr>
<tr>
<td>UK</td>
<td>0.1</td>
<td>0.6</td>
<td>2.6</td>
<td>2.7</td>
</tr>
<tr>
<td>China</td>
<td>1.4</td>
<td>2.0</td>
<td>1.7</td>
<td>2.7</td>
</tr>
</tbody>
</table>

**Central Bank policy rate (%)**

<table>
<thead>
<tr>
<th>Region</th>
<th>Current</th>
<th>Q4-17F</th>
<th>Q4-18F</th>
<th>Q4-19F</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>1.125</td>
<td>1.375</td>
<td>2.125</td>
<td>3.125</td>
</tr>
<tr>
<td>Eurozone</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.50</td>
</tr>
<tr>
<td>Japan</td>
<td>-0.10</td>
<td>-0.10</td>
<td>-0.10</td>
<td>-0.10</td>
</tr>
<tr>
<td>UK</td>
<td>0.25</td>
<td>0.50</td>
<td>0.50</td>
<td>0.50</td>
</tr>
<tr>
<td>China</td>
<td>1.50</td>
<td>1.50</td>
<td>1.50</td>
<td>1.50</td>
</tr>
</tbody>
</table>

**Key market metrics**

<table>
<thead>
<tr>
<th>Metric</th>
<th>Current</th>
<th>Q4-17F</th>
<th>Q4-18F</th>
<th>Q4-19F</th>
</tr>
</thead>
<tbody>
<tr>
<td>US 10Y yield (%)</td>
<td>2.18</td>
<td>2.75</td>
<td>2.96</td>
<td>2.96</td>
</tr>
<tr>
<td>EUR 10Y yield (%)</td>
<td>0.41</td>
<td>0.60</td>
<td></td>
<td></td>
</tr>
<tr>
<td>EUR/USD</td>
<td>1.188</td>
<td>1.17</td>
<td>1.20</td>
<td>1.20</td>
</tr>
<tr>
<td>USD/JPY</td>
<td>111</td>
<td>116</td>
<td>120</td>
<td>110</td>
</tr>
<tr>
<td>S&amp;P 500</td>
<td>2,496</td>
<td>2,600</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Stoxx 600</td>
<td>382</td>
<td>375</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oil WTI (USD/bbl)</td>
<td>49.9</td>
<td>52.0</td>
<td>52.0</td>
<td>53.0</td>
</tr>
<tr>
<td>Oil Brent (USD/bbl)</td>
<td>55.5</td>
<td>55.0</td>
<td>55.0</td>
<td>56.0</td>
</tr>
</tbody>
</table>

Current prices as of 14-Sep-2017

---

Source: Deutsche Bank Research
Keep informed with our regular The House View publications at houseview.research.db.com

The House View range

- **The House View**
  - Monthly report
  - Summarises key financial and economic developments
  - Provides context on Deutsche Bank’s forecasts and outlook for economic growth, monetary policy and financial markets

- **Infographic**
  - A one-pager that tackles a current topic in a few charts and visuals

- **Special**
  - Ad-hoc in depth reports on major underlying topics affecting global economic growth and markets

- **Snapshot**
  - A handy two-page summary of Deutsche Bank Research macro and markets views

- **Macro Forecasts**
  - A summary of Deutsche Bank Markets Research macroeconomic, fixed income, foreign exchange and commodities forecasts
Appendix 1
Important Disclosures
*Other information available upon request

Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors. Other information is sourced from Deutsche Bank, subject companies, and other sources. For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at http://gm.db.com/ger/disclosure/DisclosureDirectory.eqsr. Aside from within this report, important conflict disclosures can also be found at https://gm.db.com/equities under the “Disclosures Lookup” and “Legal” tabs. Investors are strongly encouraged to review this information before investing.

Analyst Certification

This report covers more than one security and was contributed to by more than one analyst. The views expressed in this report accurately reflect the views of each contributor to this compendium report. In addition, each contributor has not and will not receive any compensation for providing a specific recommendation or view in this compendium report. Marcos Arana / Matthew Luzzetti / Michael Hsueh

Attribution

The authors wish to acknowledge the contributions made by Avik Chattopadhyay, Baqar Zaidi and Sourav Dasgupta, in the preparation of this report.
Deutsche Bank and/or its affiliates may also be holding debt or equity securities of the issuers it writes on. Analysts are paid in part based on the profitability of Deutsche Bank AG and its affiliates, which includes investment banking, trading and principal trading revenues.

Opinions, estimates and projections constitute the current judgment of the author as of the date of this report. They do not necessarily reflect the opinions of Deutsche Bank and are subject to change without notice. Deutsche Bank provides liquidity for buyers and sellers of securities issued by the companies it covers. Deutsche Bank research analysts sometimes have shorter-term trade ideas that are consistent or inconsistent with Deutsche Bank’s existing longer term ratings. Trade ideas for equities can be found at the SOLAR link at http://gm.db.com. A SOLAR idea represents a high conviction belief by an analyst that a stock will outperform or underperform the market and/or sector delineated over a time frame of no less than two weeks. In addition to SOLAR ideas, the analysts named in this report may from time to time discuss with our clients, Deutsche Bank salespersons and Deutsche Bank traders, trading strategies or ideas that reference catalysts or events that may have a near-term or medium-term impact on the market price of the securities discussed in this report, which impact may be directionally counter to the analysts’ current 12-month view of total return or investment return as described herein. Deutsche Bank has no obligation to update, modify or amend this report or to otherwise notify a recipient thereof if any opinion, forecast or estimate contained herein changes or subsequently becomes inaccurate. Coverage and the frequency of changes in market conditions and in both general and company specific economic prospects make it difficult to update research at defined intervals. Updates are at the sole discretion of the coverage analyst concerned or of the Research Department Management and as such the majority of reports are published at irregular intervals. This report is provided for informational purposes only and does not take into account the particular investment objectives, financial situations, or needs of individual clients. It is not an offer or a solicitation of an offer to buy or sell any financial instruments or to participate in any particular trading strategy. Target prices are inherently imprecise and a product of the analyst’s judgment. The financial instruments discussed in this report may not be suitable for all investors and investors must make their own informed investment decisions. Prices and availability of financial instruments are subject to change without notice and investment transactions can lead to losses as a result of price fluctuations and other factors. If a financial instrument is domiciled in a currency other than an investor’s currency, a change in exchange rates may adversely affect the investment. Past performance is not necessarily indicative of future results. Unless otherwise indicated, prices are current as of the end of the previous trading session, and are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank, subject companies, and in some cases, other parties.

The Deutsche Bank Research Department is independent of other business areas divisions of the Bank. Details regarding our organizational arrangements and information barriers we have to prevent and avoid conflicts of interest with respect to our research is available on our website under Disclaimer found on the Legal tab.

Macroeconomic fluctuations often account for most of the risks associated with exposures to instruments that promise to pay fixed or variable interest rates. For an investor who is long fixed rate instruments (thus receiving these cash flows), increases in interest rates naturally lift the discount factors applied to the expected cash flows and thus cause a loss. The longer the maturity of a certain cash flow the higher will be the loss. Upside surprises in inflation, fiscal funding needs, and FX depreciation rates are among the most common adverse macroeconomic shocks to receivers. But counterparty exposure, issuer creditworthiness, client segmentation, regulation (including changes in assets holding limits for different types of investors), changes in tax policies, currency convertibility (which may constrain currency conversion, repatriation of profits and/or the liquidation of positions), and settlement issues related to local clearing houses are also important risk factors to be considered. The sensitivity of fixed income instruments to macroeconomic shocks may be mitigated by indexing the contracted cash flows to inflation, to FX depreciation, or to specified interest rates – these are common in emerging markets. It is important to note that the index fixings may -- by construction -- lag or mis-measure the actual move in the underlying variables they are intended to track. The choice of the proper fixing (or metric) is particularly important in swaps markets, where floating coupon rates (i.e., coupons indexed to a typically short-dated interest rate reference index) are exchanged for fixed coupons. It is also important to acknowledge that funding in a currency that differs from the currency in which coupons are denominated carries FX risk. Naturally, options on swaps (swaptions) also bear the risks typical to options in addition to the risks related to rates movements.

Derivative transactions involve numerous risks including, among others, market, counterparty default and illiquidity risk. The appropriateness or otherwise of these products for use by investors is dependent on the investors’ own circumstances including their tax position, their regulatory environment and the nature of their other assets and liabilities, and as such, investors should take expert legal and financial advice before entering into any transaction similar to or inspired by the contents of this publication. The risk of loss in futures trading and options, foreign or domestic, can be substantial. As a result of the high degree of leverage obtainable in futures and options trading, losses may be incurred that are greater than the amount of funds initially deposited. Trading in options involves risk and is not suitable for all investors. Prior to buying or selling an option investors must review the “Characteristics and Risks of Standardized Options”, at http://www.optionsclearing.com/aboutpublications/character-risks.jsp. If you are unable to access the website please contact your Deutsche Bank representative for a copy of this important document.
Participants in foreign exchange transactions may incur risks arising from several factors, including the following: (i) exchange rates can be volatile and are subject to large fluctuations; (ii) the value of currencies may be affected by numerous market factors, including world and national economic, political and regulatory events, events in equity and debt markets and changes in interest rates; and (iii) currencies may be subject to devaluation or government imposed exchange controls which could affect the value of the currency. Investors in securities such as ADRs, whose values are affected by the currency of an underlying security, effectively assume currency risk.

Unless governing law provides otherwise, all transactions should be executed through the Deutsche Bank entity in the investor’s home jurisdiction. Aside from within this report, important conflict disclosures can also be found at https://gm.db.com/equities under the “Disclosures Lookup” and “Legal” tabs. Investors are strongly encouraged to review this information before investing.

Deutsche Bank (which includes Deutsche Bank AG, its branches and all affiliated companies) is not acting as a financial adviser, consultant or fiduciary to you, any of your agents (collectively, “You” or “Your”) with respect to any information provided in the materials attached hereto. Deutsche Bank does not provide investment, legal, tax or accounting advice, Deutsche Bank is not acting as Your impartial adviser, and does not express any opinion or recommendation whatsoever as to any strategies, products or any other information presented in the materials. Information contained herein is being provided solely on the basis that the recipient will make an independent assessment of the merits of any investment decision, and it does not constitute a recommendation of, or express an opinion on, any product or service or any trading strategy.

The information presented is general in nature and is not directed to retirement accounts or any specific person or account type, and is therefore provided to You on the express basis that it is not advice, and You may not rely upon it in making Your decision. The information we provide is being directed only to persons we believe to be financially sophisticated, who are capable of evaluating investment risks independently, both in general and with regard to particular transactions and investment strategies, and who understand that Deutsche Bank has financial interests in the offering of its products and services. If this is not the case, or if You are an IRA or other retail investor receiving this directly from us, we ask that you inform us immediately.

United States: Approved and/or distributed by Deutsche Bank Securities Incorporated, a member of FINRA, NFA and SIPC. Analysts located outside of the United States are employed by non-US affiliates that are not subject to FINRA regulations.

Germany: Approved and/or distributed by Deutsche Bank AG, a joint stock corporation with limited liability incorporated in the Federal Republic of Germany with its principal office in Frankfurt am Main. Deutsche Bank AG is authorized under German Banking Law and is subject to supervision by the European Central Bank and by BaFin, Germany’s Federal Financial Supervisory Authority.

United Kingdom: Approved and/or distributed by Deutsche Bank AG acting through its London Branch at Winchester House, 1 Great Winchester Street, London EC2N 2DB. Deutsche Bank AG in the United Kingdom is authorised by the Prudential Regulation Authority and is subject to limited regulation by the Prudential Regulation Authority and Financial Conduct Authority. Details about the extent of our authorisation and regulation are available on request.

Hong Kong: Distributed by Deutsche Bank AG, Hong Kong Branch or Deutsche Securities Asia Limited.

India: Prepared by Deutsche Equities India Pvt Ltd, which is registered by the Securities and Exchange Board of India (SEBI) as a stock broker. Research Analyst SEBI Registration Number is INH000001741. DEIPL may have received administrative warnings from the SEBI for breaches of Indian regulations.

Japan: Approved and/or distributed by Deutsche Securities Inc.(DSI). Registration number - Registered as a financial instruments dealer by the Head of the Kanto Local Finance Bureau (Kinsho) No. 117. Member of associations: JSDA, Type II Financial Instruments Firms Association and The Financial Futures Association of Japan. Commissions and risks involved in stock transactions - for stock transactions, we charge stock commissions and consumption tax by multiplying the transaction amount by the commission rate agreed with each customer. Stock transactions can lead to losses as a result of share price fluctuations and other factors. Transactions in foreign stocks can lead to additional losses stemming from foreign exchange fluctuations. We may also charge commissions and fees for certain categories of investment advice, products and services. Recommended investment strategies, products and services carry the risk of losses to principal and other losses as a result of changes in market and/or economic trends, and/or fluctuations in market value. Before deciding on the purchase of financial products and/or services, customers should carefully read the relevant disclosures, prospectuses and other documentation. “Moody’s”, “Standard & Poor’s”, and “Fitch” mentioned in this report are not registered credit rating agencies in Japan unless Japan or “Nippon” is specifically designated in the name of the entity. Reports on Japanese listed companies not written by analysts of DSI are written by Deutsche Bank Group’s analysts with the coverage companies specified by DSI. Some of the foreign securities stated on this report are not disclosed according to the Financial Instruments and Exchange Law of Japan. Target prices set by Deutsche Bank’s equity analysts are based on a 12-month forecast period.

Korea: Distributed by Deutsche Securities Korea Co.
