# Eurozone

EY Eurozone Forecast

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## Outlook for financial services

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# Welcome

Spring may be here, but signs of renewal are more visible in some areas of the Eurozone than others. Overall economic growth remains anemic, and we continue to see a two-speed recovery. But this is not simply about a solid core and a weaker periphery. Instead there are indications that a split may be emerging between the countries that have made structural reforms and others that are yet to do so. This is illustrated by the contrast between a resurgent Ireland and a recovering Spain, and persistently weak forecasts for growth in France, Belgium and the Netherlands.


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In the case of Ireland and Spain, it may also be significant that economic reforms have been matched by restructuring in the banking sector. If so, perhaps we can expect that the asset quality review (AQR) getting underway across the Eurozone will allow other countries to feel the benefits of a fresh start. There is growing evidence that the Eurozone's major banks – encouraged by national regulators – are taking action to pre-empt the AQR's findings and avoid surprising shareholders with the announcement of a capital shortfall.

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The effects of the AQR may also be felt beyond the 129 Eurozone banks covered by the comprehensive assessment of the European Central Bank (ECB). If the AQR leads to a "halo effect" for smaller banks and those outside the Eurozone, we will know if the initiative has succeeded in establishing a new 'gold standard' for balance sheet reporting.

With the AQR in progress, attention is now shifting towards its possible consequences for European financial services. Strategic planning requires firms to look beyond the outcome of the process and consider the broader impact. What will the Eurozone financial landscape look like once the AQR has run its course?

One possible effect of the AQR may be to encourage the ECB to hold interest rates at their current very low levels for even longer than expected. Having taken steps to strengthen the Eurozone's banks, this would encourage companies and consumers to borrow, as well as potentially making it easier for Eurozone governments to run larger deficits or delay necessary reforms.

However, the experience of the past few years suggests that a new paradigm of ultra-low interest rates and increasing regulation will create significant challenges for the financial industry. These include margin pressure (particularly for insurers) financial repression for savers, and a tendency for pension deficits to deepen. Prolonged low interest rates would also increase the pressure on financial firms to cut costs further and adapt their business models. While this may encourage innovations such as new digital services to emerge, it could also lead to tighter insurance underwriting and tougher lending standards. For now this is all conjecture, but these are the types of scenarios that Eurozone financial firms should be modelling.

Whatever the AQR's long-term effects, in the short term governments will be hoping that it helps to ease the flow of credit to the SME sector that plays such a vital role in the Eurozone's economy. With the economic cycle at an inflection point, it is also a good time for governments to look critically at promoting other sources of funding to support growth. This is about much more than banks' balance sheets. Insurance capital, pension fund capital, investment fund capital and other sources of debt will all be needed to meet Europe's future investment and infrastructure requirements. Certainty and stability in the regulatory and legislative environment will be essential to attracting investors.

So it is encouraging that European policy-makers show growing awareness of this issue. Positive developments include the recent movement on matching-adjustment under Solvency II, which should significantly increase the available pool of investment capital, and the EC's green paper on long-term investment funds.

These are welcome first steps, but much more needs to be done. Possible pitfalls, such as tighter shadow banking regulation, also need to be navigated. The ability of Eurozone governments to deliver a sustainable economic recovery may depend on achieving better balance and diversification in long-term funding markets.

# Macroeconomic overview

**Economic recovery in the Eurozone is expected to continue through 2014. The pace of the recovery is expected to gather slowly as exports strengthen in response to rising global demand, and a return to modest investment growth on the back of rising domestic demand.**

### Recovery will gather momentum gradually in 2014 …

Following 2 years of decline, we forecast Eurozone GDP growth of 1% in 2014, followed by a pickup to a still very modest 1.4% in 2015 and only slightly faster at about 1.6% a year in 2016–18.

### … and some upside risks to growth are also starting to appear

One source of upside risk to growth is on the government side. With less pressure from financial markets and the European Commission (EC), governments may allow some easing of fiscal targets, especially if accompanied by structural reforms that boost potential growth and long-term revenues. The possibility of higher public spending means that the drag on growth from fiscal austerity could be lower than assumed. This will in turn support stronger private sector demand.

We might also see Eurozone monetary policy diverging markedly from US policy this year. While the US Federal Reserve is reducing the level of monetary stimulus, the ECB could ease monetary policy further, especially given the growing threat of deflation (inflation slowed to 0.7% in January). This should see the euro start to weaken, which in turn would give a further boost to exports.

### But there are threats from divergence and deflation …

However, the pace of recovery will be different across member states. Divergence is nothing new, but the divide is no longer simply between the core and peripheral countries. While the outlook is now relatively positive for Germany, Ireland and, to a lesser extent, Spain, countries that have been slow to respond to the need for change — including France, Belgium and the Netherlands — are losing competitiveness and face more sluggish growth.

There is also a threat of deflation, which would add to the problems of sluggish growth by raising the real levels of debt. At the same time businesses face continued tight credit conditions as banks try to repair their finances ahead of the findings of the ECB's AQR in November this year. Meanwhile, doubts persist about prospects for some leading emerging markets in the wake of recent market turmoil.

### … and high unemployment remains a major concern

While unemployment is expected to stabilize this year, it will remain high, at about 12%, and GDP growth of only 1% leaves little room for net job creation. Divergence among countries is again marked, with some of the periphery facing much higher jobless levels, despite improving growth prospects.

Levels of youth unemployment are particularly worrying. In some peripheral countries it is now over 50%. This raises concerns about loss of skills and job opportunities for a generation of young people. It also poses questions about the effectiveness of education, availability of training and labor mobility.

# Executive summary

Balance sheets

**€30t**

**We expect total assets in Eurozone banks to be €30t at the end of 2014 — broadly unchanged from the end of 2013.**

## Banking sector highlights

- We expect total assets in Eurozone banks to be €30t at the end of 2014 — broadly unchanged from the end of 2013.
- Business loans are now expected to grow by just 0.5% to reach €4.4b in 2014. But we expect growth to pick up to 3.8% in 2015.
- Non-performing loans (NPLs) are expected to fall to 7.6% by the end of 2014, from their peak of 8% in 2013.
- Operating income at Eurozone banks is forecast to rise by 4.2% in 2014, after 2 consecutive years of decline.

Life premiums

**4.1%**

**Life premium income is forecast to rise by 4.1%, to $581b in 2014, helped by a shift toward less interest-sensitive products.**

## Insurance sector highlights

- Life premium income is forecast to rise by 4.1%, to $581b in 2014, helped by a shift toward less interest-sensitive products.
- Despite considerable divergence at the country level, we forecast average non-life premium growth of 2.4% across the Eurozone.
- Profits in the insurance industry continue to increase, despite the challenging environment. We expect average growth of 10% in 2014 and 7% a year in 2015–18.
- Unemployment in the Eurozone is forecast at 12% of the workforce in 2014, and we expect it to remain persistently high. This will limit prospects for insurance, especially in the periphery.

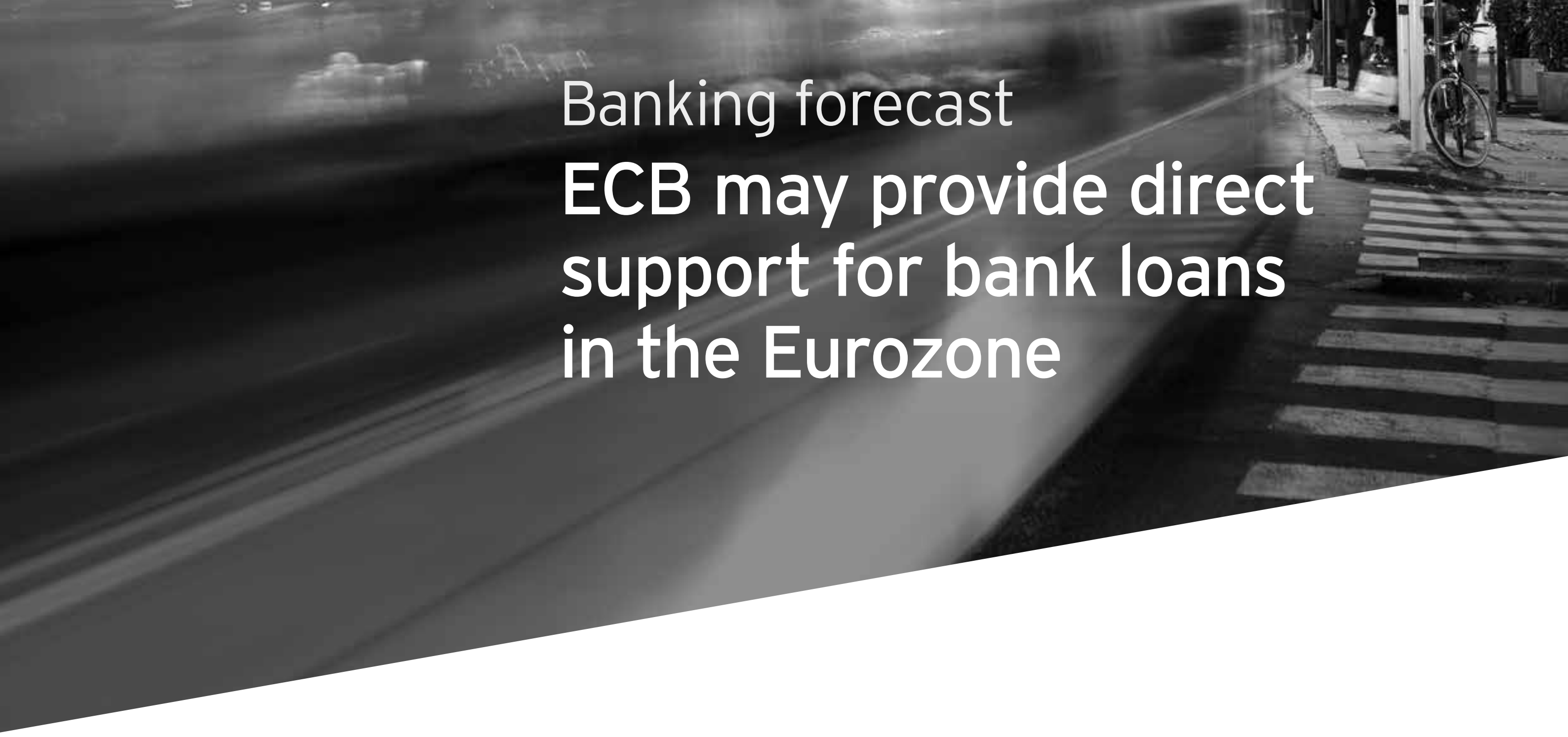
AUMs

**€6.1t**

**AUMs in the Eurozone are expected to increase by 6.6% in 2014, and 24% over the next 5 years to reach €6.1t.**

## Asset management sector highlights

- Assets under management (AUMs) in the Eurozone are expected to increase by 6.6% in 2014, and 24% over the next 5 years to reach €6.1t.
- We expect AUMs in bond funds to grow by just 6% in 2013–18, while equity funds will experience growth of 50% in the same period.
- As risk appetite continues to improve, we expect multi-asset funds to grow rapidly, with AUMs rising by 56% from their 2013 level to reach €722b by 2018.
- AUMs in hedge funds should start to grow again from this year. But the €37b AUMs forecast for 2018 will still be 21% below the 2007 peak.



Banking forecast

# ECB may provide direct support for bank loans in the Eurozone

## Viewpoint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The ECB's AQR has barely begun, but there are plenty of signs that it is already having a significant impact on the Eurozone's banks. Several major institutions have announced "kitchen sink" results in recent weeks, taking radical steps to tidy up their balance sheets.

It is too early to judge the long-term benefits of this spring cleaning, but the medium-term effects on lending are clear. Forecasts for business lending growth in 2014 have been revised down again, from 1.6% to just 0.5%. True, lending growth is expected to strengthen next year, and demand for credit could expand faster if the Eurozone recovery accelerates. However, economic underperformance or a further deterioration in asset quality could have the opposite effect.

Overall, it is increasingly uncertain that Eurozone banks will be able to achieve pre-crisis levels of credit growth in the foreseeable future. In fact, many remain under pressure to exit non-core businesses and reduce their overall leverage. So it is likely that some banks will adapt their business models by providing less direct lending to corporate customers, in favor of advising them on accessing finance from a range of different sources. A forecast that Eurozone banks' total assets will not exceed their 2011 peak until 2018 seems to support this vision.

Of course, limited credit growth will create other challenges for the Eurozone's banks. The most fundamental will be the need to rebuild their returns on equity (RoE). Many large banks are currently generating returns of around 4%, far below their typical target levels of around 15%.

Research by EY suggests that banks will find it extremely challenging to achieve this kind of RoE uplift. Sensitivity analysis indicates that cost reductions of around 35% or revenue growth of more than 20% might be required just to achieve their average cost of equity (10%). Should banks wish to reach 15% RoE they would be required to reduce costs by 66% or grow revenues by 44% – a goal beyond the scope of most banks in the current climate. This also does not take account of the fact that many banks could still see 1%-2% knocked off their RoEs by tougher capital requirements and leverage limits. Whatever the effects of the AQR, the Eurozone's banks face a long road back to recovery.

> It is increasingly uncertain that Eurozone banks will be able to achieve pre-crisis levels of credit growth in the foreseeable future. In fact, many remain under pressure to exit non-core businesses and reduce their overall leverage.

## ECB may provide direct support for bank loans in the Eurozone

Interest rates in the Eurozone remain at very low levels and the ECB has been discussing the launch of alternative monetary policies to fight the threat of deflation in the region.

Support for the loan market is one possible tactic, as negative loan growth increases deflation risks. Some form of long-term refinancing operation (LTRO) extension seems likely to support peripheral banks still dependent on this funding source. However, we think a new LTRO would not have a significant impact on the banking sector, because market funding costs have now returned to more normal levels (banks can now obtain funding at cheaper levels on average than investment grade corporates). The ECB has also been examining other options to address the fragmentation of bank lending in the region and stimulate credit availability for small and medium-sized enterprises (SMEs) given the hurdles associated with outright quantitative easing.

One option would be negative rates for banks' deposits at the ECB (effectively charging banks to keep excess cash at the central bank). However, transmission from money market rates to other rates in the economy is not assured, and such a move would damage bank profitability at a challenging time for the sector. Alternatively, the ECB could seek to stimulate lending directly through purchases of bank loans or securitized assets. It seems likely that the ECB would prefer to buy marketable debt rather than bank loans, given the better pricing transparency. But it is questionable whether this would have a substantial impact due to the small size of the securitization market in the Eurozone.

Indeed, the likely effectiveness of any central bank plan to stimulate the supply of lending is open to question because bank funding costs have already narrowed significantly, and surveys suggest that demand for credit remains very weak. The ECB's own lending survey for Q1 2014 showed a net balance of 10% of banks reporting that demand for loans had declined over the past 3 months. We therefore remain cautious about the likely effectiveness of any ECB policies aimed at stimulating the supply of loans in the current environment. Targeted intervention to support lending in the Eurozone will only become likely if there is a renewed downturn in economic or financial conditions.

## AQR results are likely to support a gradual recovery in lending

Independent estimates of the capital deficit for the Eurozone banking system range from a manageable €50b to a politically unpalatable €300b. We believe the AQR will reveal a capital shortfall toward the lower end of this range. Banks in the periphery have the most obvious problems in terms of asset quality, but, with the exception of Italy, these banks have already been stress-tested by the ECB, the EC and the International Monetary Fund (IMF) and raised provisions against expected losses. However, in the case of Italy, it should be noted that the Bank of Italy has been inspecting the major Italian banks over the past two to three years, and IMF analyses of the Italian banking sector have been broadly positive. With the German Government still opposed to using the European Stability Mechanism for direct recapitalization of financial institutions, it is likely that national regulators will encourage banks to purge their balance sheets and recapitalize ahead of the publication of the AQR results.

Our central scenario is therefore that the AQR results will not uncover substantial capital holes in banking sectors at the national level. The AQR process therefore has the potential to help restore confidence in the region's banks. Nevertheless, banks are likely to remain very cautious until the process is complete, given the ongoing regulatory pressure to strengthen balance sheets. Despite the possibility of further monetary easing, credit conditions in much of the Eurozone will remain tight this year. Against this background, we have revised down our forecasts for business and consumer lending, with growth of just 0.5% and 0.4% respectively now expected in 2014. Still, this would represent an improvement from the declines seen last year.

### Business lending

€4.4b

**We expect business loans to grow by just 0.5% in 2014, reaching €4.4b. But we expect growth to pick up to 3.8% in 2015.**

### NPLs

7.6%

**NPLs are expected to fall to 7.6% by the end of 2014, from their peak of 8% in 2013.**

### Operating income

4.2%

**Operating income at Eurozone banks is forecast to rise by 4.2% in 2014, after 2 consecutive years of decline.**

# Banking forecast

Loan growth is forecast to accelerate in 2015, with growth of 3.8% in business loans and 2.9% in consumer credit. Indeed, the outlook should gradually brighten in 2015–18, as confidence returns and the economic recovery gains traction. This year should represent a turning point for asset quality because NPLs are now expected to start declining after reaching 8% of outstanding loans last year. Progress in clearing these bad debts from bank balance sheets will be gradual: we expect NPLs to fall to 7.6% of outstanding loans by the end of 2014 and 6.7% in 2015. Concerns about future bad debts will recede, which should give banks the confidence to gradually relax lending conditions.

### Ongoing improvements in market conditions will leave banks well placed to meet higher demand for loans

This raises the question of whether banks in the Eurozone would be able to meet higher demand for new loans in a scenario where the economic recovery in the region outperforms our expectations. This could be generated by a faster-than-expected increase in consumer and business confidence, for example, stimulating higher levels of spending in the domestic economy. Such a scenario would be consistent with real GDP being around 1% higher than our central forecast by the end of 2015, but it would also need to be supported by increased lending to the private sector.

This rate of growth in economic activity would be consistent with business loans being around 1.9% higher than baseline by the end of 2015, while consumer credit would be around 1.5% above baseline. This would equate to growth in business loans of 5.7% and growth in consumer credit of 4.4% in 2015. We believe that banks could accommodate this level of growth in loan demand, which would still be subdued by pre-recession standards (over the period 1998–2007, growth in business loans averaged 7.5% a year, while consumer credit grew by 5.4% a year on average). Banks' ability to meet this demand for loans would be contingent on continued improvements in access to market funding and worries over the AQR process fading in Q4 this year, to coincide with the likely acceleration in loan demand in this scenario.

We have also investigated the sensitivity of our economic growth projections to an outcome that results in current bank lending constraints spilling over into 2015. Abstracting from the size of the capital requirements uncovered by the AQR, we have examined two hypothetical scenarios where tight credit conditions next year cause lending to business and consumers to be reduced by 1% or 2% relative to baseline by the end of 2015.

Our simulations indicate that a 1% decline in lending relative to baseline would reduce GDP by around 0.3% by the end of 2015. The impact on economic activity from these lending constraints is dampened by the fact that firms and households would have access to other sources of funding. However, a 2% decline in lending would result in a larger 0.7% fall. The size of the impact on GDP is proportionately larger for the 2% fall, because firms and households would increasingly struggle to find alternative sources of funding as lending is constrained further.

### Bank balance sheets remain under pressure this year

Balance-sheet restructuring and shedding of non-core assets will continue to be a strong theme this year while banks focus on increasing efficiency. Consequently, we expect the size of Eurozone banks' balance sheets to remain broadly unchanged at the end of 2014 compared to the end of 2013, at around €30t. Total assets are expected to expand more significantly in 2015–18, but the pace of this growth will be constrained by the more risk-averse strategies and business models that banks have adopted. As a result, bank assets will not exceed their 2011 peak of €33,533b until 2018.

Banks seeking to increase their equity-asset ratio generally do so either by raising new capital or reducing assets by constraining lending activity or disposing of non-core assets. A third option would be for banks to raise money directly from capital markets through securitization. This would reduce the need for banks to constrain lending to businesses and households. Unfortunately, the securitization market in the Eurozone is underdeveloped and issuance remains subdued compared to pre-crisis levels. Eurozone policy-makers could therefore focus initiatives to encourage the development of this market, as it would create significant benefits for the broader economy.

### Renewed growth in operating income as the economy stabilizes

Higher volatility has contributed to a good start to 2014 for equities trading in Europe and investment banking divisions are benefiting from an upturn in mergers and acquisitions (M&A). But fixed income, currency and commodities revenues are likely to come under pressure from low interest rates, the migration of over-the-counter (OTC) derivatives to central clearing counterparties, and the global regulatory probe into price manipulation in the foreign exchange market. Taken together, this suggests that wholesale banking revenues will experience modest, albeit positive, growth in 2014.

Meanwhile, very low interest rates and a flat yield curve present a challenging environment for operating margins at retail banks. However, our expectation of (modest) renewed growth in loan volumes will provide some lift to revenues. Overall, we expect operating income at Eurozone banks to rise by 4.2% in 2014 after 2 consecutive years of decline. Revenues should gather momentum in 2015–18, with the unfolding economic recovery and greater regulatory certainty.

# Insurance forecast

## Life business shifts toward less interest-sensitive products

### Viewpoint

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With the announcement of the January 2016 date, European insurers finally have a fixed Solvency II target to aim for. The largest insurers are already prepared, having previously been working toward compliance in 2013 or 2014. Mid-market insurers may need to initiate a few final projects, but the European Insurance and Occupational Pensions Authority's interim measures should not cause significant problems for most firms.

For most Eurozone insurers, adapting their business models to a post-Solvency II world is likely to be much harder than meeting the required standards for capital, disclosure and reporting.

For most Eurozone insurers, adapting their business models to a post-Solvency II world is likely to be much harder than meeting the required standards for capital, disclosure and reporting.

The task is made more urgent by the low growth, low interest rate environment facing the industry. Life insurance premiums are only recovering very slowly, reflecting the squeezed household incomes and high unemployment that characterize many markets. Non-life premiums are growing slightly faster than before, but this conceals significant variations. For example, since the start of the year growth forecasts for 2015 have been upgraded for Germany, but downgraded for France.

Life insurers are responding to current market conditions with increasing interest in assets that offer attractive but acceptable risk-return profiles. Many firms are being drawn to debt backed by real estate or infrastructure assets. A handful are also dipping their toes into direct corporate lending, but their natural caution means that this is unlikely to represent anything more than a small proportion of total assets.

Meanwhile, non-life insurers' results continue to feel the effect of the floods and storms that hit Europe in late 2013 and early 2014. The impact is largely limited to gross results, and reinsurance rates are likely to climb as a result. Some classes of business could also see localized increases in primary rates, but this is unlikely to herald any broad-based upturn in pricing.

Returning to regulation, Solvency II is not the only item on insurers' agendas. The IASB's implementation target of 2018 for IFRS 9 may be a long way off, but firms should be aware that IFRS 4 Phase II accounting for insurance contracts may be introduced on this date too. By mid-summer, the Financial Stability Board will announce those reinsurers designated as Globally Systemically Important Insurers (GSII). The nine insurers already designated as GSIIs will watch with interest the developments at the International Association of Insurance Supervisors (IAIS) as it develops the basic capital requirements (BCR) which will apply to all group activities, including non-insurance subsidiaries. Field-testing begins in March 2014 to calibrate the BCR to adequately capture the risk profiles, with the aim of finalizing its design by November this year. The IAIS will subsequently work to develop the high loss absorption (HLA) requirements for GSIIs to be completed by the end of 2015.

# Insurance forecast

## Life business shifts toward less interest-sensitive products

New business for life insurers in the Eurozone recovered last year after the sharp falls experienced in 2012, but growth in premium income is likely to remain modest going forward. Our forecasts indicate that life premium income will rise by 4.1% in 2014, to $581b for the Eurozone as a whole. This is a reflection of the sluggish recovery expected in discretionary incomes and low levels of confidence, meaning households are postponing long-term investment decisions. This also means that new contracts are increasingly being signed for lower amounts.

This headline growth rate masks a shift in the underlying mix of new business, with many firms withdrawing from interest-sensitive products due to the low-rate environment and focusing more on risk-based products or investment-linked contracts, which are less sensitive to interest rates. The low-rate environment makes it critical for life insurers to maintain high underwriting standards, as low investment returns will not be able to compensate for losses elsewhere in the business.

## Non-life insurers are redesigning products to protect revenues

The outlook for the non-life insurance business is brightening, as the unfolding economic recovery in the Eurozone brings with it the prospect of higher car and home sales and associated insurance policies. We expect non-life premium income in the Eurozone to increase by 2.4% this year, although there is a considerable degree of divergence at the country level.

We expect solid non-life premium growth in Germany and France of 3.8% and 2.3% respectively. But the outlook is more subdued elsewhere in the Eurozone. In particular, weak recoveries in Italy and the Netherlands mean that premium income is likely to remain broadly flat this year. Further moderate declines are expected in periphery countries, such as Spain (down 0.2%), which is still struggling with high unemployment and weak growth in household incomes.

Persistently high levels of unemployment in many peripheral economies mean that any growth in premium incomes is likely to be modest at best in 2015–18. Unemployment in Spain, for example, is expected to remain above 20% of the workforce even in 2018. Insurers in these countries will therefore need to adapt by redesigning and repricing products to control costs and protect revenues.

Increased frequency and severity of natural catastrophes, such as heavy snowfalls, hailstorms or flooding, will also continue to threaten the profitability of non-life insurers throughout Europe, with cost for related reinsurance coverage in most countries rising.

## Better asset and liability management will help to conserve profitability

Although the forecast increase in premium income will be welcomed by insurers, the low-rate environment continues to present challenges, particularly for the life business. Our forecasts imply that benchmark 10-year government bond yields in Germany will only rise gradually over the next few years, approaching 3.5% in 2018. German and Dutch life insurers are particularly exposed to the low-yield environment, as it squeezes margins on the relatively high proportion of products with guaranteed yields sold in these countries. Life insurers across the Eurozone are seeking to adapt by limiting guarantees or shifting toward unit-linked or variable products.

Investment strategies are also being adapted to the low-rate environment, with better asset and liability management and diversification into higher-yielding (albeit more illiquid) assets such as corporate loans and infrastructure debt. The ongoing deleveraging by banks in the Eurozone is likely to result in a significant supply of legacy loans to the market over the coming year. Insurers are also poised to offer new funding to companies looking to reduce their dependence on traditional borrowing.

These trends should help to ensure that profits in the insurance industry continue to increase despite the challenging environment. Average growth of 10% in the Eurozone is expected in 2014 and 7% a year in 2015–18.

## New capital requirements for global insurers will have broader implications

Although a deal has now been reached that creates a relatively benign Solvency II outcome, it is too soon for insurers in the Eurozone to become complacent that the regulatory landscape is now settled. The forthcoming conversion to IFRS 4 Phase II will also drive significant procedural change, requiring insurers to fundamentally re-assess how they report their financial results and manage their business. The impact of the proposed new standard will be felt across the finance function and may require changes to both strategic financial management processes and the finance operating model. Taken together with the implementation of the delayed Solvency II regulations and other accounting requirements, the scale of change insurers will face is unprecedented. New regulatory debates have also surfaced at the global level, most notably the GSIIs program and the Common Framework (ComFrame) process. The Financial Stability Board announced in July 2013 a list of nine groups designated to be GSIIs, of which three are based in the Eurozone. A decision on a list of reinsurers that will be classified as GSIIs has been deferred to July 2014. This exercise is a prelude to requiring GSIIs to hold more capital to reflect their systemic importance in the international financial system, with a timetable for the design and implementation of the new regime running to January 2019.

The IAIS is now working to develop BCR for GSIIs which will apply to all group activities, including non-insurance subsidiaries. A field-testing exercise will begin in March 2014 to calibrate the BCR to adequately capture the risk profiles of insurers, with the aim of finalizing its design by November 2014. Building on the BCR, the IAIS will subsequently work to devise high loss absorption (HLA) requirements for GSIIs to be completed by the end of 2015, as well as new global insurance capital standards (ICS) to apply to all Internationally Active Insurance Groups (IAIGs) as part of the ComFrame process.

In light of the aggressive timetable for the development of the BCR rules, it is likely that their design will be fairly simplistic. Nevertheless, industry bodies have expressed concern that the new regime should be careful to avoid any unintended consequences such as the creation of pro-cyclical behavior.

Although these two policy initiatives are aimed at global (re)insurers, their relevance is likely to extend well beyond this sub-set of internationally active groups. Indeed, it is likely that these new capital standards will eventually influence the standards applicable to all companies in the insurance sector as national policymakers continue work to develop their domestic supervisory regimes. This makes it crucial that the Eurozone insurance industry engages with global policymakers during the public consultation process.

### European supervisors continue to focus on conduct of business

Meanwhile, the financial services conduct agenda is now reaching some form of conclusion. The revised Markets in Financial Instruments Directive (MiFID 2) is now agreed between the Council of the European Union and the European Parliament and the proposed Packaged Retail Investment Products (PRIPS) regulation is likely to be agreed before the May elections. New rules for insurance investment products will be applied through both MiFID2 and PRIPS and will include strengthened disclosure requirements and a ban on commission payments to independent financial advisors. Although the details of PRIPS are yet to be finalized, particularly in terms of the scope and the definition of products within this, implementation of the changes will need to be undertaken in the remainder of 2014 and 2015 by insurers creating considerable challenges in terms of operational — and potentially strategic — change.

Non-life premiums

2.4%

**Despite considerable divergence at the country level, we forecast 2.4% average non-life premium growth across the Eurozone.**

Profits

10%

**Profits in the insurance industry continue to increase, despite the challenging environment. We expect average growth of 10% in 2014 and 7% a year in 2015–18.**

Unemployment

12%

**Unemployment in the Eurozone is at 12% in 2014, and we expect it to remain persistently high. This will limit prospects for insurance, especially in the periphery.**

# Asset management forecast
## Eurozone well placed to grow AUMs

### Viewpoint


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As predicted last quarter, the economic recovery continues to attract capital into European equities. As in the US, this trend is being mirrored by a widespread withdrawal from bond markets. The Eurozone's ratio of equity funds to bond funds, which stood at 100% at the start of 2013, is predicted to reach 129% this year and 140% in 2015. The shift is so rapid that many bond management houses are rushing to enhance their equity management capabilities. Investors' increasing willingness to reduce their cash holdings — a key indicator of risk appetite — is further illustrated by growing outflows from money market funds.


European asset managers are casting their net wider than ever in the search for attractive yields. As a result, the investment environment is becoming more and more creative.


Should this level of inflows be ringing alarm bells? Some of the current interest in European equities reflects the recent emerging markets retreat and is unlikely to be sustainable. Several large European asset managers have also recently changed hands. In the past this has sometimes been an early indicator that equity values are reaching their peak.

But for now, we see no reason for concern. With the major Eurozone economies all expected to grow in 2014, the prospects for European company profits are growing brighter. Recent M&A activity involving asset managers seems to owe more to banks' capital needs than to overvalued equity markets.

Equities are not the only show in town. European asset managers are casting their net wider than ever in the search for attractive yields. As a result, the investment environment is becoming more and more creative. Shipping assets and debt are just two examples of real-world assets catching the attention of new investors. It is good to see firms embracing innovation in the search for value, but those of us with long memories will hope that managers remember to keep a careful eye on possible illiquidity risk.

Of course, asset managers are not getting things all their own way. The regulatory temperature remains high, with new European restrictions on variable compensation a particularly hot issue. In theory these should improve the alignment of interests between asset managers and their clients. In practice it is far less certain that they will reduce overall costs, or have any meaningful effect on investor protection.

### Eurozone well placed to grow AUMs

European markets are recovering and equity valuations still appear relatively low, especially compared with the US. This supports our view that inflows into European funds will continue amid the ongoing investor retreat from emerging markets. Overall, we expect AUMs in the Eurozone to witness another year of solid growth, averaging 6.6% in 2014.

Overall, we expect that Eurozone AUMs will grow by 24% over the next 5 years, to reach €6,051b by 2018. Over the medium-term, the Eurozone remains well placed to continue attracting assets from other global regions due to the region's political stability, large stock exchanges, and the strong regulatory and technical infrastructures of its main financial centers. Reduction of transaction costs through the launch of new platforms, as well as rapid new product development will add to incentives for fund inflow. Indeed, one product that is expected to see particularly strong growth in coming years is the exchange-traded fund, a passive investment with low costs that is capturing increasing amounts of business from active funds.

### "Great rotation" into equities to continue despite recent volatility

The "great rotation" from bonds into equities is likely to continue this year, despite the recent volatility of equity markets. With portfolios still weighted toward fixed income, a strategic shift toward equities is likely to gather pace as recovery prospects become clearer and current risk-aversion dissipates. As a result, we expect AUMs in bonds to grow by just 6% between 2013 and 2018, while equity funds will experience growth of 50% over the same period. The share of AUMs in bonds will therefore decline from 29% in 2013 to 25% in 2018, while AUMs in equities will rise from 33% to 40% over the same period.

Similarly, we expect investors to switch away from other safe-haven assets. For example, AUMs in money market funds are expected to decline by 15% to €765b by 2016 before stabilizing. We expect investors will increasingly look to diversify their investments beyond equities into alternatives such as infrastructure and property, which offer attractive yields in a low-rate environment. AUMs in property funds are forecast to rise by 19% over the next 5 years.

### AUMs in multi-asset funds will continue to outperform

AUMs in multi-asset funds rose by 21% last year, representing the fastest growth rate of all fund types. We continue to expect that the improved risk appetite among investors will drive multi-asset funds to outperform the broader market over the period 2014–16, with investors seeking to gain exposure to a range of different asset classes to diversify risk.

The growth of multi-asset funds also reflects a greater focus by both retail and institutional investors on diversified income-generating assets in light of population trends (the number of people over the age of 65 is expected to increase by 6.6% by 2018). Institutional investors will be particularly keen to retain exposure to long-dated fixed income within their investment portfolios in order to better match the duration of their defined-benefit pension liabilities. Overall, we expect AUMs in multi-asset funds to reach €722b by 2018, representing a 56% increase from their 2013 level.

Equity funds

50%

**We expect AUMs in bond funds to grow by just 6% in 2013–18, while equity funds should experience growth of 50% in the same period.**

Multi-asset funds

56%

**As risk appetite continues to improve, we expect multi-asset funds to grow rapidly, with AUMs rising by 56% from 2013 levels to reach €722b by 2018.**

Hedge funds

€37b

**AUMs in hedge funds should start to grow again from this year. But the €37b AUMs forecast for 2018 will still be 21% below the 2007 peak.**

# Asset management forecast

## Hedge fund managers seek to outsource functions to cut costs

European hedge funds had another difficult year in 2013 as AUMs declined, but 2014 should represent a turning point as markets strengthen and inflows pick up. Our forecasts indicate that hedge fund AUMs will increase to €37b by 2018, but this will still be lower than the €46b peak reached in 2007. Hedge fund growth is forecast to be modest over the medium-term relative to other fund types, reflecting the overall size of the industry and large number of hedge fund managers. This is making it more difficult for the average fund to profit from market inefficiencies.

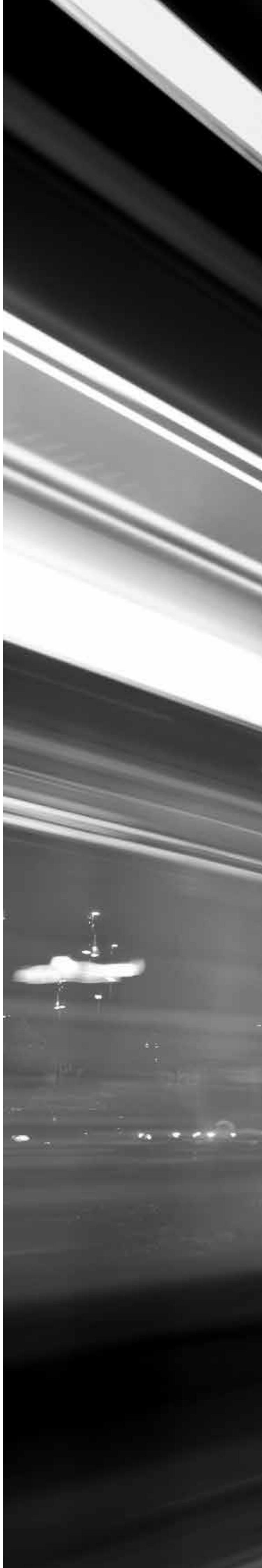
The underperformance of hedge funds in recent years has also made it challenging for their managers to justify high fees relative to mutual funds. This is likely to result in increased fee compression at a time when the regulatory costs of doing business are rising. As hedge fund managers seek to cut costs, they are increasingly looking to outsource a variety of functions. This is creating opportunities for universal banks that are able to offer multiple services, ranging from risk analytics and custodial services to fund administration.

## Smaller member states lead growth as host centers for fund management

Although the larger economies of Germany, France and Italy will continue to account for the largest share of AUMs in the Eurozone based on the provenance of the assets, smaller economies, such as Luxembourg and Ireland, will experience stronger growth as host centers for fund management on behalf of other domiciles. These smaller centers retain fund-specific locational advantages while distributing throughout the European Union (EU) under new passporting arrangements.

For example, Luxembourg's early implementation of Undertakings for Collective Investment in Transferable Securities (UCITS) investment-fund directives has helped to position it as one of the largest host centers in the world. This lead has been secured by responsive regulation and highly developed support services, even though its low-tax advantages have been gradually reduced by EU harmonization. With more than €2,600b in net AUMs hosted at the end of 2013 (an historic high, based on data from the Association of Luxembourg Fund Industry), Luxembourg is now the largest investment fund center in Europe and the second largest in the world after the US. Wider information-sharing as banking union proceeds may cause some repatriation of funds to other Eurozone countries, but the impact will be limited — especially if rules are relaxed for private banks because of their low systemic risk.

There is also scope for substantial growth of UCITS and alternative investment fund management business in Ireland, where 12.5% corporation tax and foreign-investor tax exemption are durable advantages. Ireland hosted more than €2,500b in AUMs in 2013 (based on data from the Irish Funds Industry Association), which represents a doubling from the low point in 2009.



# Highlights

## France

- We expect a modest 0.7% rise in total assets at French banks by the end of 2014.
- Stronger-than-expected performance has caused an upgraded outlook in life premium income to 3.6% in 2014.
- French AUMs are expected to fall by 2.5%, to €614b in 2014, reflecting large outflows from money market funds.

## Germany

- We expect the German economy to strengthen this year, generating growth of 3.3% in business loans.
- Non-life premium income is expected to grow by 3.8% in 2014, making Germany one of the strongest markets in the Eurozone this year.
- German AUMs are forecast to grow by just 4.8% this year. This is slower than the Eurozone average of 6.6% growth.

## Italy

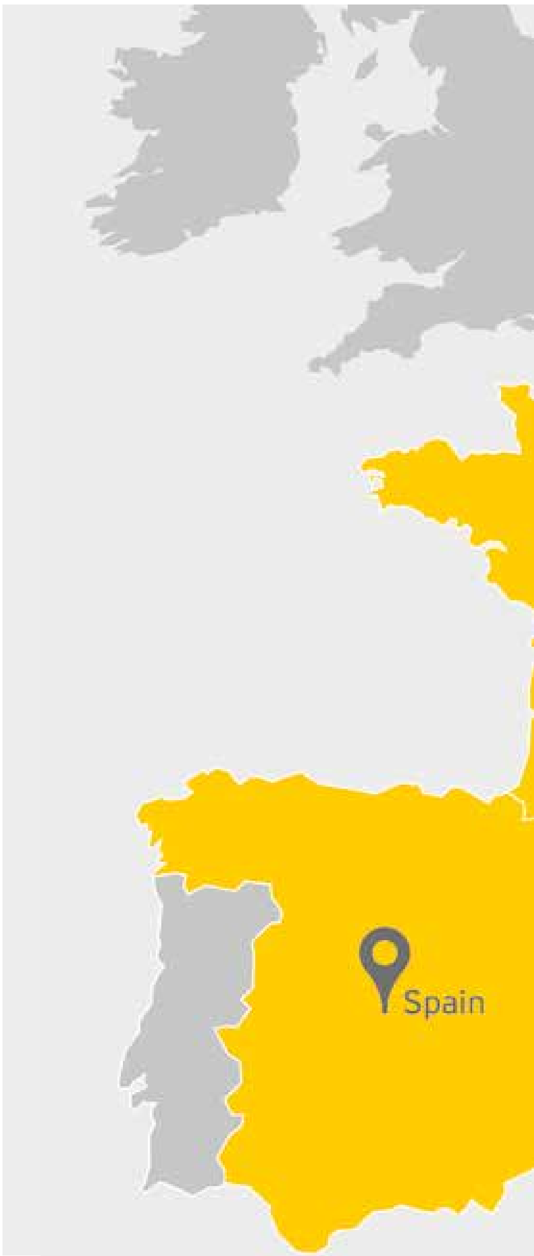
- Further modest declines in both lending to businesses (down 0.1%) and consumer credit (down 0.2%) are expected.
- Despite the weak economic backdrop, life premiums bounced back strongly last year. We now expect growth of 7.5% in 2014.
- Italian-focused funds are benefiting from renewed optimism regarding the economic recovery in the periphery. Total growth in AUMs of 11.1% is expected in 2014.

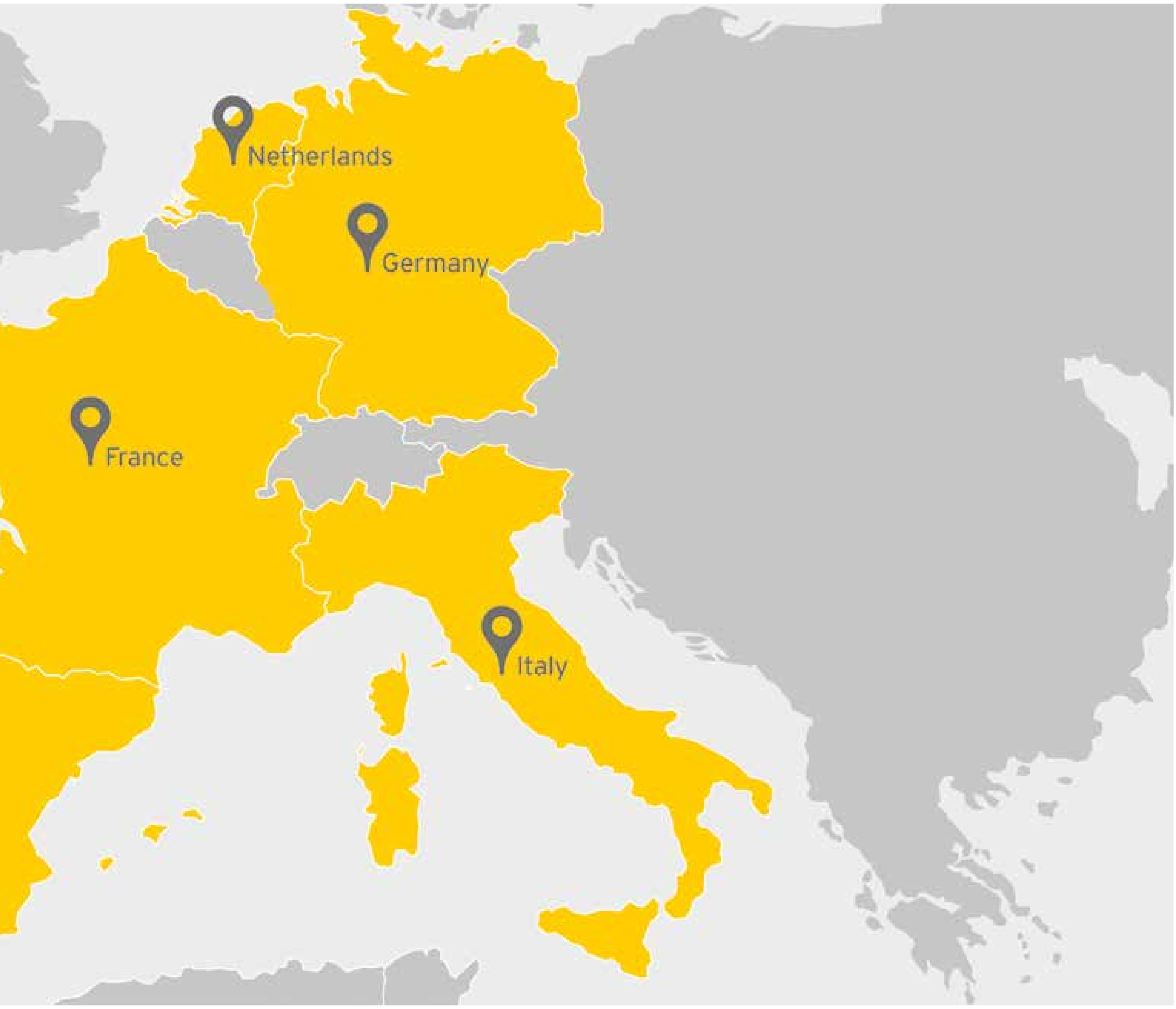
## Netherlands

- We expect total assets to contract 3.2% by the end of 2014 as banks seek to strengthen their balance sheets.
- In 2014 life insurance premiums are expected to reach $25b, although this would still be 36% below the pre-crisis peak reached in 2008.
- AUMs in the Netherlands are expected to grow only modestly, by 2.7% this year.

## Spain

- Total loans are expected to fall by 2.7% this year, but positive growth should resume in 2015.
- Non-life premium income expected to contract by 0.2% this year, which would represent the 6th consecutive annual fall.
- We expect AUMs gains of 15% in 2014, reflecting strong inflows and further equity market gains in Spain.




Netherlands
Germany
France
Italy

# Key issues

## France

### Banking

Bank lending growth slowed sharply through 2012–13 and we expect lending to businesses to remain broadly flat in 2014, which may represent a constraint on investment spending this year. Mortgage lending should be more buoyant, however, with growth of 1.8% expected against a background of moderate house price increases.

Bank balance sheets expanded by 2.2% in 2013, but we think banks will be more conservative in their growth strategies this year as they await the results of the AQR process. In particular, French banks would be vulnerable to any substantial revaluation of their derivative holdings due to their large gross positions. Therefore, we expect a more modest 0.7% rise in total assets to €8,314b by the end of 2014. However, banks should be able to refocus on growth from 2015, when we forecast balance sheets to expand by 2.7%.

### Insurance

Life premium sales recovered last year, supported by single premium sales as savers switched from competing banking products. This stronger-than-expected performance has caused us to upgrade the outlook for growth in premium income to 3.6% in 2014 (previously 1.7%).

We expect the French economy will struggle to build on the stronger growth seen last spring and in other parts of the Eurozone. As a result, the unemployment rate is likely to continue to climb this year. It is unlikely that demand for non-life products will be unlocked until the job outlook improves, which is likely to happen only very gradually from 2016. As a result, we expect relatively subdued growth in non-life premiums of around 2% a year in 2014–15.

### Asset management

Large outflows are expected from money market funds over the coming year linked to the return of investor risk appetite. This will have a disproportionate impact on French AUMs due to the large share of these fund types (money market funds account for almost half of total French AUMs). The expected 9.6% decline in AUMs in money market funds will only partly be offset by the strong 11.8% rise in AUMs in multi-asset funds and a 6.1% increase in equity funds. We therefore expect total AUMs to decline by 2.5% in 2014, followed by only very modest growth of 0.4% in 2015.

### Bank assets

**€8,314b**

French banks would be vulnerable to any substantial revaluation of their derivative holdings given their gross positions. We therefore expect a modest 0.7% rise in total assets to €8,314b by the end of 2014.

## Germany

### Banking

The German banking sector appears relatively robust, with loan-to-deposit ratios below the Eurozone average and limited NPLs. Cross-border exposures have also fallen significantly in recent years. Moreover, over 40% of the German banking sector (measured by assets) comprises small banks that are not subject to the AQR, so will therefore not experience the associated pressures to constrain their balance sheets.

This places the banking sector on a firm footing to respond to the pickup in loan demand expected this year as the economic recovery gathers momentum. We project that business loans and consumer credit will rise by around 3.3% this year, while the continued rise in house prices will support growth of 4% in residential mortgages. After two consecutive years of contraction, we expect bank balance sheets to expand by 1.5% by the end of 2014 to reach €7,720b.

### Insurance

Life insurance premiums last year were supported by strong sales of disability and long-term care insurance, which offset contraction in term sales. In light of the stronger-than-expected performance of life premiums last year, we have revised up our forecast for life premium income growth slightly, to 2.3% in 2014 (previously 1.7%).

We expect non-life premium income to grow by 3.8% in 2014, making Germany one of the strongest markets in the Eurozone this year. This is a reflection of the strengthening economic environment and low levels of unemployment. House prices are also expected to keep rising, with growth of 3.5% a year on average in 2014–18.

### Asset management

We expect German bond funds to experience outflows this year as investors move their funds into other fund types with higher yields. AUMs in bond funds are expected to decline by 4% in 2014, which contrasts with strong growth in multi-asset funds (12.3%) and equity funds (7.5%).

Overall, German AUMs are forecast to grow by 4.8% this year, which is rather slower than the Eurozone average of 6.6%. This largely reflects the recent preference by investors for assets in non-core Eurozone economies as they exit safe-haven assets for alternatives with higher perceived returns.

### Business loans

**3.3%**

We expect the German economy to strengthen this year, generating growth of 3.3% in business loans.

## Italy

### Banking

Italian balance sheets are likely to remain under pressure this year as banks await the results of the AQR. Given the high level of NPLs in Italy and the lack of any third-party stress tests to date, the AQR process has the potential to uncover surprises. On the other hand, this downside is tempered by the fact that the Bank of Italy has been inspecting the major Italian banks over the past 2-3 years and the IMF's analyses of the Italian banking sector have been broadly positive. The sharp rise in NPLs last year also suggests that the national regulator has urged early recognition of bad loans with associated provisioning. Our central scenario therefore assumes that the AQR will not reveal substantial capital holes at the national level when the results are published towards the end of this year.

We expect further modest declines in both lending to businesses (down 0.1%) and consumer credit (down 0.2%) as the Italian economy struggles to grow this year. But with deposit growth expected to be relatively buoyant, this will at least help banks to bring down their loan-to-deposit ratios.

### Insurance

After 2 consecutive years of sharp declines, life insurance premiums bounced back strongly with growth of 14.7% in 2013, supported by sales of traditional and unit-linked products. This positive momentum is expected to spill over into 2014, with solid growth of 7.5% now expected, despite the relatively weak economic backdrop.

With the economy having emerged from recession, we expect non-life premium incomes to stabilize in 2014, after contracting last year. Growth will remain weak, at around 2.5% a year in 2015–18, reflecting the subdued outlook for economic growth, which is also reflected in prospects for new car sales and house prices.

### Asset management

Italian-focused funds are benefiting from buoyant investor inflows due to renewed optimism regarding the economic recovery in the periphery. Total AUMs rose by 9.8% in 2013, supported by a 36% jump in multi-asset funds and a 15% rise in equity funds. These fund types are expected to continue to benefit from the return of investors' risk appetite, with growth of 29% and 9% respectively expected in 2014.

Total growth in AUMs of 11% is expected in 2014, which would be significantly higher than the Eurozone average of 6.6%.

### Life insurance premiums

**7.5%**

Despite the weak economic backdrop, life premiums bounced back strongly last year, and we now expect growth of 7.5% in 2014.

## Netherlands

### Banking

The Dutch banking sector is large relative to the size of the country's economy (total assets are equivalent to around 400% of GDP) and it is heavily exposed to the domestic corporate and household sectors. The loan-to-deposit ratio of 123% in 2013 was also significantly higher than the Eurozone average, suggesting that the sector is more highly leveraged than many of its peers. On the other hand, NPLs in the Netherlands have remained low, suggesting that credit quality will not be a major issue in the AQR.

Dutch banks are now in the process of reducing their reliance on wholesale funding and strengthening their balance sheets ahead of the AQR, as well as repaying support packages from the Government. We expect this will translate into quite a significant 3.2% contraction in the size of balance sheets this year.

### Insurance

After 2 consecutive years of contraction, the outlook for Dutch insurance premiums is improving, supported by renewed growth in the economy. Another source of hope is the expected stabilization of house prices this year, following declines of almost 20% over the past 5 years. Against this background, we expect life insurance premiums to grow by around 4.9% in 2014, to reach $25b, although this would still be 36% below the pre-crisis peak of $29b reached in 2008. Non-life premiums are expected to remain broadly flat this year following last year's 3% contraction.

### Asset management

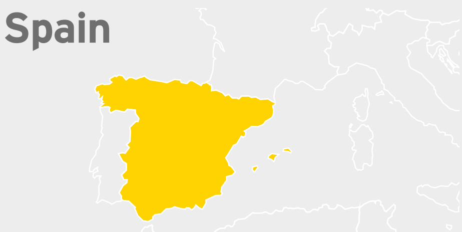
AUMs in the Netherlands are expected to grow only modestly by 2.7% this year, as it is viewed as a relatively low-yielding core Eurozone market by investors. Compared with much of the rest of the Eurozone, the pace of the Dutch economic recovery will be limited and this will be reflected in subdued returns on Dutch financial assets and sluggish fund inflows. Against this background, we expect growth in total AUMs to average just 3% a year in 2015–18. Equity funds are forecast to be the fastest-growing fund type over this period, but growth will still only average around 4.9% a year.

### Bank balance sheets

**€2.2t**

We expect total assets to contract 3.2% by the end of 2014, to €2.2t, as banks seek to strengthen their balance sheets.

## Spain



### Banking

The Spanish banking sector appears much healthier after recent efforts to restructure and recapitalize the sector. Nevertheless, banks will remain cautious about lending in an environment where NPLs are still rising. Although the economy is now out of recession, we believe that NPLs will not peak until the middle of this year.

But assuming that the AQR does not uncover significant capital shortfalls, confidence in the banking sector should improve following publication of the results. This is expected to support a gradual easing of credit conditions beginning in H2 2014. Total loans are therefore expected to fall by 2.7% this year, but positive growth should resume in 2015. However, future loan growth is unlikely to be strong, as demand for loans will be constrained by private sector deleveraging pressures for some time.

### Insurance

We expect volumes of life sales to remain fairly stable this year, with premium incomes rising by just 1.2%. This reflects the subdued economic backdrop, sluggish recovery in disposable incomes and high levels of unemployment. With household debt still at very high levels — at an average of 125% of income — households are likely to postpone long-term investment decisions until they have paid down their debts. We therefore expect life premiums to grow by just 2.5% a year on average in 2015–18.

We expect non-life premium income to contract by 0.2% this year, which would represent the 6th consecutive annual fall. With house prices continuing to fall and new car registrations down nearly 60% from pre-crisis levels, this creates a difficult environment for the non-life business. Although conditions should gradually improve, we expect non-life premium income to rise by just 2.2% a year on average in 2015–18.

### Asset management

The value of Spanish AUMs received a strong boost last year from the stock market rally and decline in bond yields (which increased the capital value of the bonds) that was generated by a reappraisal of the country's economic prospects. With these gains extending into 2014 and investor inflows remaining buoyant, we expect total AUMs in Spain to experience another strong year of growth. Our forecasts suggest that total AUMs will expand by around 15% in 2014. All fund types should benefit from this upswing in AUMs except property funds, which will continue to struggle due to the ongoing weakness of the Spanish construction sector.

### AUMs

**15%**

We expect AUMs gains of 15% in 2014, reflecting strong inflows and further equity market gains in Spain.

# Appendix

# Introduction

Table 1

Forecast for the Eurozone economy (annual percentage changes unless specified)

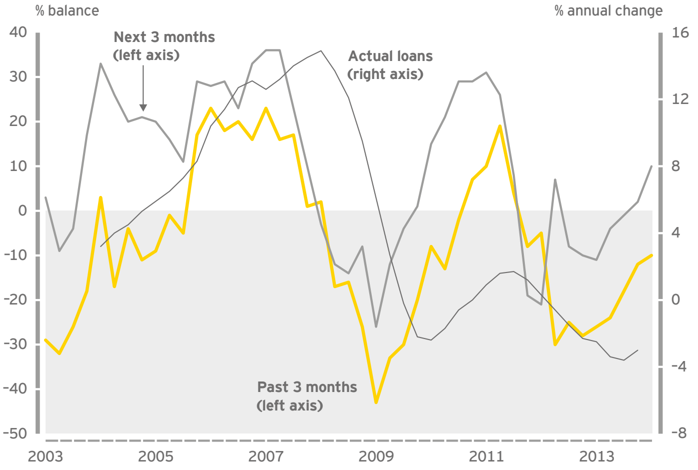
| Macro variables | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| GDP | -0.4 | 1.0 | 1.4 | 1.5 | 1.6 | 1.7 |
| Consumer prices | 1.4 | 1.1 | 1.5 | 1.8 | 1.7 | 1.5 |
| Unemployment rate (level) | 12.1 | 12.0 | 11.8 | 11.6 | 11.3 | 11.0 |
| Government budget (% of GDP) | -3.0 | -2.6 | -2.1 | -1.7 | -1.4 | -1.1 |
| Government debt (% of GDP) | 95.1 | 96.9 | 98.4 | 98.9 | 98.6 | 98.0 |
| ECB main refinancing rate (%) | 0.5 | 0.3 | 0.3 | 0.3 | 0.4 | 1.4 |
| Exchange rate ($ per €) | 1.33 | 1.30 | 1.25 | 1.22 | 1.20 | 1.20 |

Source: Oxford Economics.

# Banking

Chart 1

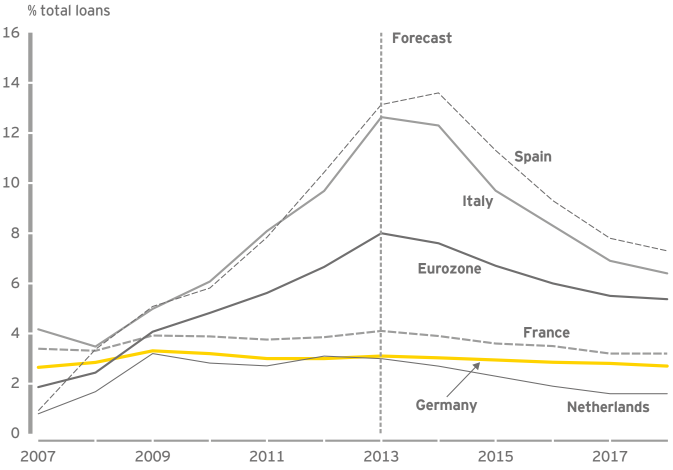
**ECB lending survey — corporate loan demand**




Source: Oxford Economics; Haver Analytics.

Chart 3

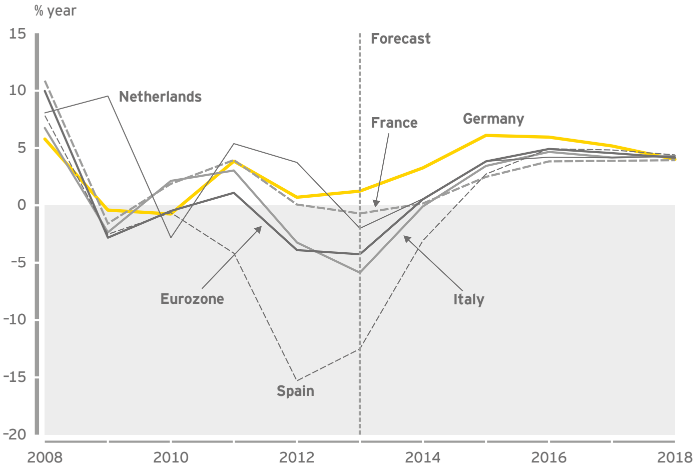
**Eurozone non-performing bank loans**




Source: Oxford Economics; Haver Analytics.

Chart 2

**Lending to non-financial corporations**




Source: Oxford Economics; Haver Analytics.

Table 2
Forecast for the Eurozone economy

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| **Macro variables** | | | | | | |
| Nominal GDP growth (%) | 1.0 | 2.2 | 2.9 | 3.3 | 3.3 | 3.2 |
| Real GDP growth (%) | -0.4 | 1.0 | 1.4 | 1.5 | 1.6 | 1.7 |
| Nominal consumption growth (%) | 0.6 | 1.7 | 2.7 | 3.1 | 3.2 | 3.0 |
| Nominal personal disposable income growth (%) | 0.6 | 1.3 | 2.4 | 3.0 | 3.1 | 3.0 |
| Nominal private investment growth (%) | -2.8 | 2.9 | 4.0 | 4.4 | 4.3 | 4.0 |
| **Financial variables** | | | | | | |
| 3-month Euribor rate (%) | 0.2 | 0.3 | 0.3 | 0.3 | 0.5 | 1.4 |
| 10-year government bond yield (%, Eurozone average) | 3.0 | 2.9 | 3.3 | 3.6 | 3.9 | 4.2 |

Source: Oxford Economics.

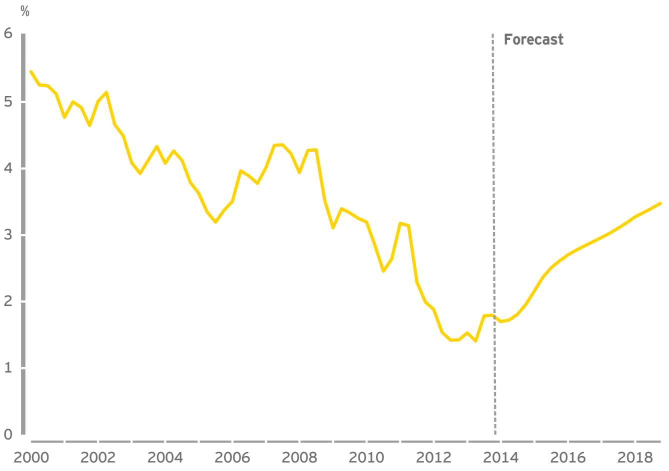
Table 3
Eurozone: banking

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| Total assets (€b) | 30,453 | 30,408 | 31,286 | 32,356 | 33,488 | 34,588 |
| Total loans (€b) | 11,731 | 11,849 | 12,287 | 12,805 | 13,317 | 13,807 |
| Business/corporate loans (€b) | 4,343 | 4,366 | 4,533 | 4,757 | 4,974 | 5,180 |
| Consumer credit (€b) | 576 | 579 | 595 | 616 | 637 | 659 |
| Residential mortgage loans (€b) | 3,858 | 3,917 | 4,024 | 4,150 | 4,280 | 4,404 |
| Non-performing loans as % of total gross loans | 8.0 | 7.6 | 6.7 | 6.0 | 5.5 | 5.4 |
| Deposits (% year) | 0.4 | 3.5 | 4.3 | 4.7 | 4.7 | 4.8 |
| Loans/deposits (%) | 106 | 103 | 103 | 102 | 102 | 100 |
| Total operating income (€b) | 579 | 604 | 652 | 709 | 765 | 814 |

Source: ECB; Oxford Economics.

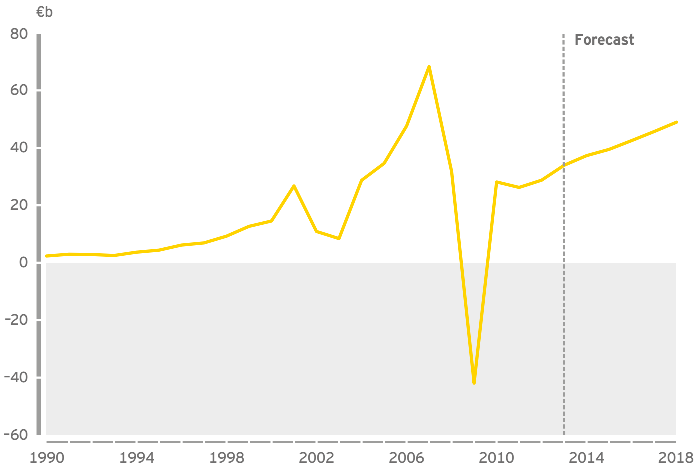
# Insurance

Chart 4
**German 10-year bond yield**



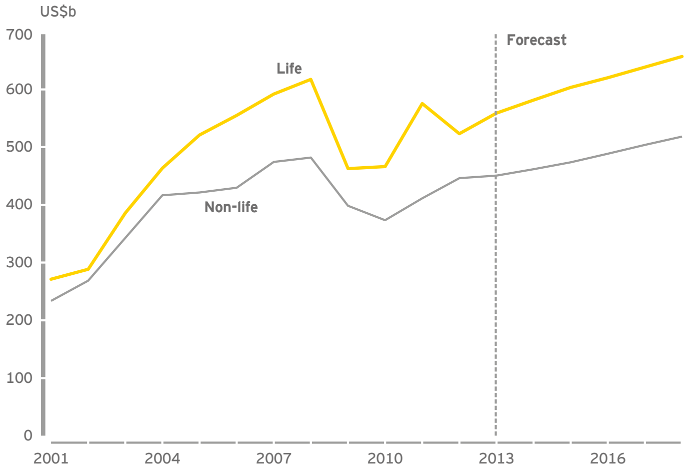

Source: Oxford Economics; Haver Analytics.

Chart 5
**Eurozone insurance profits**




Source: Oxford Economics; Datastream.

Chart 6
**Eurozone insurance premiums**




Source: Oxford Economics; OECD.

Table 4
## Forecast for the Eurozone economy

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| **Macro variables** | | | | | | |
| Nominal GDP growth (%) | 1.0 | 2.2 | 2.9 | 3.3 | 3.3 | 3.2 |
| Real GDP growth (%) | -0.4 | 1.0 | 1.4 | 1.5 | 1.6 | 1.7 |
| CPI (% yoy) | 1.4 | 1.1 | 1.5 | 1.8 | 1.7 | 1.5 |
| **Labour market** | | | | | | |
| Total employment (thousands) | 145,011 | 145,037 | 145,440 | 145,987 | 146,692 | 147,462 |
| Employment in manufacturing (thousands) | 21,280 | 21,105 | 21,045 | 21,025 | 21,003 | 20,959 |
| Employment in non-manufacturing (thousands) | 123,730 | 123,931 | 124,394 | 124,962 | 125,689 | 126,503 |
| Unemployment (thousands) | 19,164 | 18,982 | 18,666 | 18,372 | 17,942 | 17,485 |
| **Demographics** | | | | | | |
| Population (thousands) | 332,738 | 333,153 | 333,348 | 333,417 | 333,490 | 333,567 |
| Population of working age (thousands) | 218,174 | 218,171 | 218,137 | 218,070 | 218,008 | 217,928 |
| Population, 65+ (thousands) | 63,823 | 64,836 | 65,896 | 66,982 | 68,067 | 69,152 |
| **Consumers** | | | | | | |
| Nominal personal disposable income (% yoy) | 0.6 | 1.3 | 2.4 | 3.0 | 3.1 | 3.0 |
| Gross household financial wealth (€b) | 17,725 | 18,534 | 19,188 | 19,994 | 20,874 | 21,758 |
| Total household borrowings (€b) | 6,820 | 6,846 | 6,941 | 7,084 | 7,279 | 7,519 |
| **Motoring** | | | | | | |
| Car registrations (thousands)* | 6,753 | 6,754 | 6,811 | 6,974 | 7,091 | 7,146 |
| **Housing market** | | | | | | |
| House prices (% yoy) | -1.9 | 0.8 | 2.1 | 2.7 | 2.8 | 2.7 |
| **Corporate sector** | | | | | | |
| Company profits (€b) | 2,053 | 2,120 | 2,187 | 2,263 | 2,341 | 2,416 |
| **Financial variables** | | | | | | |
| 3-month Euribor rate (%) | 0.2 | 0.3 | 0.3 | 0.3 | 0.5 | 1.4 |
| 10-year government bond yields (%) | 3.0 | 2.9 | 3.3 | 3.6 | 3.9 | 4.2 |
| Equity market (% yoy) | 18.6 | 8.8 | 7.4 | 7.8 | 7.1 | 6.3 |

Source: Oxford Economics.

*Car registrations and company profits refer to the sum of Germany, France, Italy and Spain.

Table 5
## Eurozone: insurance

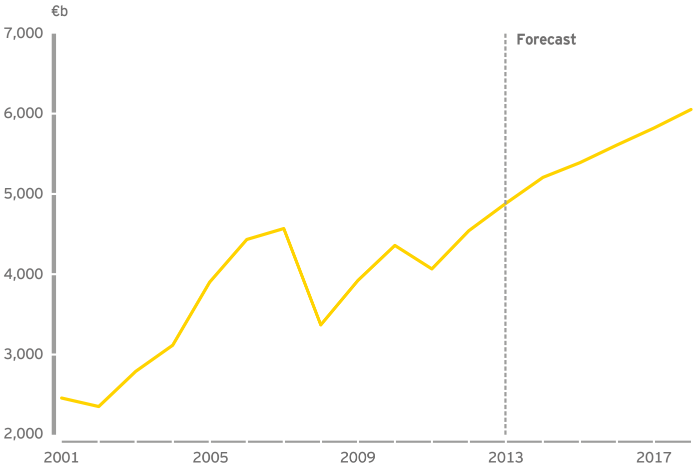
| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| Life gross premium (US$b) | 559 | 581 | 603 | 620 | 638 | 657 |
| *% year* | *6.8* | *4.1* | *3.8* | *2.8* | *2.9* | *2.9* |
| Life gross claims payments (US$b) | 225 | 240 | 256 | 272 | 287 | 302 |
| *Life claims ratio (%)* | *40* | *41* | *42* | *44* | *45* | *46* |
| Non-life gross premium (US$b) | 451 | 462 | 474 | 489 | 504 | 518 |
| *% year* | *1.0* | *2.4* | *2.6* | *3.1* | *3.1* | *2.9* |
| Non-life gross claims payments (US$b) | 256 | 269 | 282 | 298 | 314 | 329 |
| *Non-life claims ratio (%)* | *57* | *58* | *60* | *61* | *62* | *63* |
| Profits (€b) | 33.9 | 37.3 | 39.5 | 42.5 | 45.7 | 48.9 |

Source: Oxford Economics.

# Asset management

Chart 7

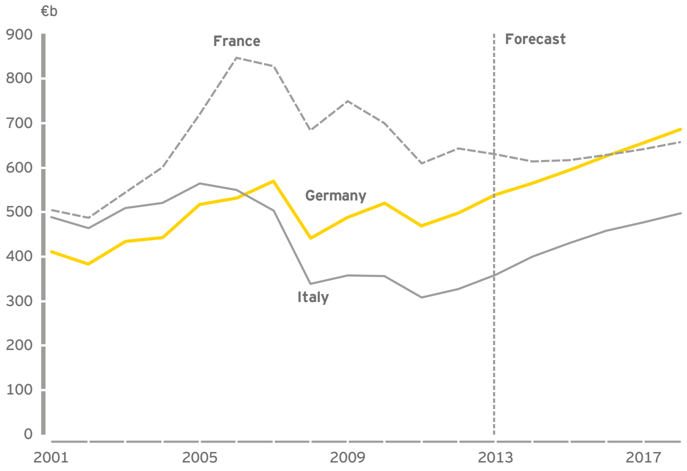
**Total assets under management**




Source: Oxford Economics; Lipper.

Chart 9

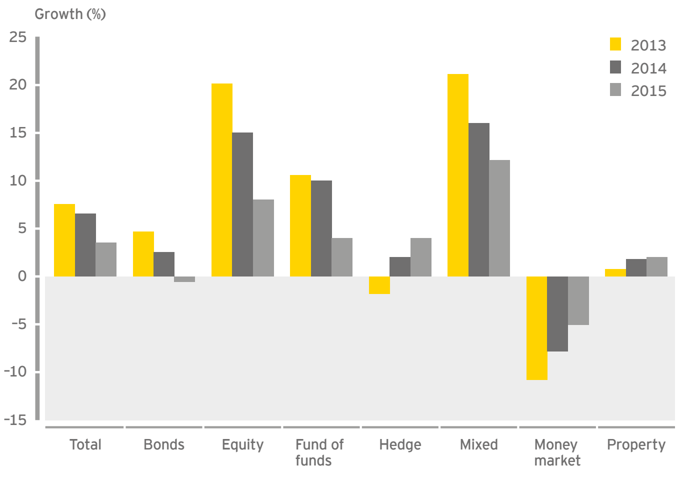
**Assets under management by country**




Source: Oxford Economics; Haver Analytics.

Chart 8

**Assets under management by fund type**




Source: Oxford Economics; Lipper.

Table 6
## Forecast for the Eurozone economy

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| **Macro variables** | | | | | | |
| Nominal GDP growth (%) | 1.0 | 2.2 | 2.9 | 3.3 | 3.3 | 3.2 |
| Real GDP growth (%) | -0.4 | 1.0 | 1.4 | 1.5 | 1.6 | 1.7 |
| CPI (%) | 1.4 | 1.1 | 1.5 | 1.8 | 1.7 | 1.5 |
| **Financial variables** | | | | | | |
| 3-month Euribor rate (%) | 0.2 | 0.3 | 0.3 | 0.3 | 0.5 | 1.4 |
| 10-year government bond yield (%, Eurozone average) | 3.0 | 2.9 | 3.3 | 3.6 | 3.9 | 4.2 |
| DJ Euro Stoxx 50 equity price Index | 3,018 | 3,282 | 3,524 | 3,797 | 4,065 | 4,321 |
| **Households** | | | | | | |
| Wealth (€b) | 17,725 | 18,534 | 19,188 | 19,994 | 20,874 | 21,758 |
| Savings flow (€b) | 815 | 804 | 805 | 822 | 845 | 870 |
| Pensions holdings (€b) | 6,117 | 6,851 | 7,074 | 7,346 | 7,640 | 7,967 |

Source: Oxford Economics.

Table 7
## Eurozone: asset management

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| Total assets under management (€b)* | 4,884 | 5,205 | 5,389 | 5,608 | 5,821 | 6,051 |
| *% year* | *7.5* | *6.6* | *3.5* | *4.1* | *3.8* | *4.0* |
| Bonds (€b) | 1,407 | 1,442 | 1,435 | 1,449 | 1,470 | 1,498 |
| Equity (€b) | 1,621 | 1,864 | 2,013 | 2,163 | 2,293 | 2,431 |
| Fund of funds (€b) | 363 | 399 | 415 | 432 | 449 | 467 |
| Hedge (€b) | 31 | 32 | 33 | 35 | 36 | 37 |
| Mixed (€b) | 464 | 538 | 604 | 654 | 687 | 722 |
| Money market (€b) | 895 | 825 | 783 | 765 | 769 | 773 |
| Property (€b) | 103 | 104 | 107 | 111 | 116 | 122 |

Source: Oxford Economics; Lipper FMI.

*UCITS and non-UCITS assets.

# France

Table 8

**France: banking**

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| Total assets (€b) | 8,253 | 8,314 | 8,539 | 8,786 | 9,053 | 9,346 |
| Total loans (€b) | 2,290 | 2,308 | 2,372 | 2,458 | 2,544 | 2,633 |
| Business/corporate loans (€b) | 810 | 811 | 831 | 863 | 897 | 932 |
| Consumer credit (€b) | 143 | 144 | 148 | 152 | 157 | 163 |
| Residential mortgage loans (€b) | 899 | 916 | 942 | 973 | 1,003 | 1,032 |
| Non-performing loans as % of total gross loans | 4.1 | 3.9 | 3.6 | 3.5 | 3.2 | 3.2 |
| Deposits (% year) | 2.5 | 3.8 | 4.3 | 4.0 | 3.8 | 3.9 |
| Loans/deposits (%) | 114 | 110 | 109 | 108 | 108 | 108 |
| Total operating income (€b) | 136 | 147 | 159 | 173 | 183 | 190 |

Source: ECB; Oxford Economics.

Table 9

**France: insurance**

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| Life gross premium (US$b) | 169 | 175 | 182 | 187 | 192 | 198 |
| *% year* | *5.2* | *3.6* | *4.1* | *2.5* | *2.8* | *3.0* |
| Life gross claims payments (US$b) | 36 | 43 | 50 | 57 | 65 | 73 |
| *Life claims ratio (%)* | *21* | *24* | *28* | *31* | *34* | *37* |
| Non-life gross premium (US$b) | 101 | 103 | 105 | 107 | 109 | 112 |
| *% year* | *2.6* | *2.3* | *1.8* | *2.2* | *2.3* | *2.3* |
| Non-life gross claims payments (US$b) | 67 | 68 | 69 | 70 | 72 | 73 |
| *Non-life claims ratio (%)* | *66* | *66* | *66* | *66* | *65* | *65* |
| Profits (€b) | 5.5 | 6.1 | 6.3 | 6.7 | 7.0 | 7.4 |

Source: Oxford Economics.

Table 10

**France: asset management**

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| Total assets under management (€b)* | 630 | 614 | 617 | 628 | 641 | 657 |
| *% year* | *-2.0* | *-2.5* | *0.4* | *1.8* | *2.2* | *2.4* |
| Bonds (€b) | 68 | 66 | 66 | 65 | 66 | 66 |
| Equity (€b) | 148 | 157 | 169 | 182 | 189 | 197 |
| Fund of funds (€b) | 87 | 88 | 92 | 95 | 97 | 100 |
| Hedge (€b) | 0.6 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 |
| Mixed (€b) | 34 | 38 | 41 | 44 | 45 | 46 |
| Money market (€b) | 292 | 264 | 248 | 242 | 244 | 248 |
| Property (€b) | - | - | - | - | - | - |

Source: Oxford Economics; Lipper FMI.

*UCITS and non-UCITS assets.

# Germany

Table 11
**Germany: banking**

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| Total assets (€b) | 7,604 | 7,720 | 7,973 | 8,245 | 8,504 | 8,716 |
| Total loans (€b) | 3,107 | 3,221 | 3,405 | 3,577 | 3,736 | 3,871 |
| Business/corporate loans (€b) | 1,395 | 1,440 | 1,528 | 1,619 | 1,703 | 1,772 |
| Consumer credit (€b) | 223 | 230 | 241 | 253 | 264 | 273 |
| Residential mortgage loans (€b) | 837 | 870 | 905 | 938 | 968 | 996 |
| Non-performing loans as % of total gross loans | 3.1 | 3.0 | 2.9 | 2.9 | 2.8 | 2.7 |
| Deposits (% year) | -0.6 | 2.7 | 3.3 | 4.0 | 3.7 | 3.5 |
| Loans/deposits (%) | 94 | 95 | 97 | 98 | 99 | 99 |
| Total operating income (€b) | 130 | 141 | 153 | 167 | 185 | 201 |

Source: ECB; Oxford Economics.

Table 12
**Germany: insurance**

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| Life gross premium (US$b) | 114 | 117 | 121 | 126 | 131 | 135 |
| *% year* | *6.4* | *2.3* | *3.5* | *4.0* | *3.6* | *3.0* |
| Life gross claims payments (US$b) | 91 | 92 | 96 | 99 | 103 | 106 |
| *Life claims ratio (%)* | *79* | *79* | *79* | *79* | *79* | *79* |
| Non-life gross premium (US$b) | 201 | 208 | 216 | 225 | 233 | 240 |
| *% year* | *2.7* | *3.8* | *3.7* | *4.0* | *3.7* | *3.1* |
| Non-life gross claims payments (US$b) | 136 | 144 | 151 | 159 | 167 | 175 |
| *Non-life claims ratio (%)* | *68* | *69* | *70* | *71* | *72* | *73* |
| Profits (€b) | 10.6 | 9.9 | 9.6 | 10.0 | 10.5 | 11.2 |

Source: Oxford Economics.

Table 13
**Germany: asset management**

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| Total assets under management (€b)* | 540 | 565 | 594 | 626 | 655 | 686 |
| *% year* | *8.2* | *4.8* | *5.0* | *5.5* | *4.6* | *4.7* |
| Bonds (€b) | 115 | 110 | 107 | 108 | 108 | 109 |
| Equity (€b) | 146 | 157 | 169 | 182 | 196 | 211 |
| Fund of funds (€b) | 72 | 73 | 75 | 78 | 81 | 85 |
| Hedge (€b) | 0.6 | 0.6 | 0.6 | 0.7 | 0.7 | 0.7 |
| Mixed (€b) | 101 | 113 | 125 | 135 | 141 | 147 |
| Money market (€b) | 23 | 23 | 23 | 24 | 24 | 24 |
| Property (€b) | 82 | 88 | 93 | 98 | 104 | 109 |

Source: Oxford Economics; Lipper FMI.

*UCITS and non-UCITS assets.

# Italy

Table 14
**Italy: banking**

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| Total assets (€b) | 4,050 | 4,055 | 4,190 | 4,377 | 4,565 | 4,751 |
| Total loans (€b) | 1,930 | 1,945 | 2,008 | 2,097 | 2,185 | 2,275 |
| Business/corporate loans (€b) | 814 | 813 | 841 | 880 | 917 | 957 |
| Consumer credit (€b) | 59 | 59 | 60 | 62 | 63 | 65 |
| Residential mortgage loans (€b) | 361 | 366 | 378 | 393 | 410 | 425 |
| Non-performing loans as % of total gross loans | 12.6 | 12.3 | 9.7 | 8.3 | 6.9 | 6.4 |
| Deposits (% year) | 2.0 | 4.9 | 5.5 | 6.2 | 6.5 | 6.6 |
| Loans/deposits (%) | 125 | 120 | 118 | 116 | 113 | 111 |
| Total operating income (€b) | 79 | 80 | 87 | 96 | 104 | 112 |

Source: ECB; Oxford Economics.

Table 15
**Italy: insurance**

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| Life gross premium (US$b) | 105 | 113 | 118 | 121 | 124 | 127 |
| *% year* | *14.7* | *7.5* | *4.0* | *2.3* | *2.5* | *2.6* |
| Life gross claims payments (US$b) | 34 | 37 | 40 | 42 | 43 | 44 |
| *Life claims ratio (%)* | *32* | *33* | *34* | *35* | *35* | *35* |
| Non-life gross premium (US$b) | 45 | 45 | 45 | 47 | 48 | 49 |
| *% year* | *-3.7* | *0.0* | *1.8* | *2.5* | *2.8* | *2.8* |
| Non-life gross claims payments (US$b) | 9 | 11 | 14 | 17 | 20 | 23 |
| *Non-life claims ratio (%)* | *20* | *26* | *31* | *36* | *42* | *47* |
| Profits (€b) | 0.8 | 1.3 | 1.5 | 1.8 | 2.0 | 2.2 |

Source: Oxford Economics.

Table 16
**Italy: asset management**

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| Total assets under management (€b)* | 360 | 400 | 431 | 458 | 476 | 497 |
| *% year* | *10.0* | *11.1* | *7.7* | *6.3* | *4.1* | *4.3* |
| Bonds (€b) | 153 | 162 | 163 | 167 | 171 | 176 |
| Equity (€b) | 58 | 63 | 69 | 74 | 79 | 85 |
| Fund of funds (€b) | 41 | 43 | 46 | 48 | 50 | 53 |
| Hedge (€b) | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Mixed (€b) | 76 | 98 | 119 | 134 | 141 | 148 |
| Money market (€b) | 31 | 33 | 34 | 35 | 35 | 35 |
| Property (€b) | - | - | - | - | - | - |

Source: Oxford Economics; Lipper FMI.

*UCITS and non-UCITS assets.

# Netherlands

Table 17
**Netherlands: banking**

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| Total assets (€b) | 2,250 | 2,178 | 2,245 | 2,316 | 2,393 | 2,479 |
| Total loans (€b) | 1,099 | 1,108 | 1,145 | 1,188 | 1,231 | 1,275 |
| Business/corporate loans (€b) | 614 | 617 | 641 | 668 | 696 | 726 |
| Consumer credit (€b) | 25 | 25 | 25 | 26 | 27 | 28 |
| Residential mortgage loans (€b) | 388 | 395 | 405 | 416 | 426 | 436 |
| Non-performing loans as % of total gross loans | 3.0 | 2.7 | 2.3 | 1.9 | 1.6 | 1.6 |
| Deposits (% year) | -0.4 | 4.5 | 5.6 | 6.1 | 6.4 | 6.6 |
| Loans/deposits (%) | 123 | 119 | 116 | 113 | 110 | 107 |
| Total operating income (€b) | 41 | 44 | 47 | 51 | 54 | 57 |

Source: ECB; Oxford Economics.

Table 18
**Netherlands: insurance**

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| Life gross premium (US$b) | 24 | 25 | 26 | 27 | 27 | 28 |
| *% year* | *-2.8* | *4.9* | *4.6* | *2.3* | *2.6* | *2.9* |
| Life gross claims payments (US$b) | 18 | 18 | 19 | 19 | 19 | 19 |
| *Life claims ratio (%)* | *76* | *74* | *72* | *70* | *68* | *68* |
| Non-life gross premium (US$b) | 26 | 26 | 27 | 27 | 28 | 29 |
| *% year* | *-3.0* | *0.2* | *1.4* | *2.6* | *3.0* | *2.9* |
| Non-life gross claims payments (US$b) | 18 | 18 | 18 | 18 | 19 | 20 |
| *Non-life claims ratio (%)* | *67* | *67* | *68* | *68* | *68* | *68* |
| Profits (€b) | 4.4 | 6.3 | 7.4 | 8.3 | 9.2 | 10.0 |

Source: Oxford Economics.

Table 19
**Netherlands: asset management**

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| Total assets under management (€b)* | 66 | 68 | 70 | 73 | 77 | 77 |
| *% year* | *0.3* | *2.7* | *2.8* | *4.5* | *5.0* | *5.0* |
| Bonds (€b) | 16 | 17 | 16 | 16 | 16 | 16 |
| Equity (€b) | 30 | 31 | 33 | 35 | 38 | 38 |
| Fund of funds (€b) | 14 | 14 | 14 | 15 | 15 | 15 |
| Hedge (€b) | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Mixed (€b) | 6 | 6 | 6 | 6 | 7 | 7 |
| Money market (€b) | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Property (€b) | - | - | - | - | - | - |

Source: Oxford Economics; Lipper FMI.

*UCITS and non-UCITS assets.

# Spain

Table 20
**Spain: banking**

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| Total assets (€b) | 3,064 | 2,967 | 3,016 | 3,127 | 3,275 | 3,409 |
| Total loans (€b) | 1,556 | 1,514 | 1,539 | 1,591 | 1,651 | 1,711 |
| Business/corporate loans (€b) | 699 | 678 | 697 | 731 | 766 | 800 |
| Consumer credit (€b) | 171 | 168 | 170 | 174 | 179 | 185 |
| Residential mortgage loans (€b) | 580 | 566 | 568 | 579 | 594 | 610 |
| Non-performing loans as % of total gross loans | 13.1 | 13.6 | 11.3 | 9.3 | 7.8 | 7.3 |
| Deposits (% year) | 0.8 | 2.6 | 4.5 | 5.0 | 5.3 | 5.8 |
| Loans/deposits (%) | 111 | 105 | 102 | 101 | 99 | 97 |
| Total operating income (€b) | 95 | 90 | 95 | 102 | 109 | 115 |

Source: ECB; Oxford Economics.

Table 21
**Spain: insurance**

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| Life gross premium (US$b) | 34 | 35 | 35 | 36 | 37 | 38 |
| *% year* | *1.3* | *1.2* | *1.7* | *2.3* | *2.9* | *3.1* |
| Life gross claims payments (US$b) | 20 | 21 | 22 | 23 | 24 | 25 |
| *Life claims ratio (%)* | *59* | *60* | *61* | *63* | *64* | *65* |
| Non-life gross premium (US$b) | 38 | 38 | 38 | 39 | 40 | 41 |
| *% year* | *-3.0* | *-0.2* | *0.9* | *2.2* | *2.8* | *3.1* |
| Non-life gross claims payments (US$b) | 13 | 14 | 15 | 17 | 19 | 21 |
| *Non-life claims ratio (%)* | *34* | *37* | *41* | *44* | *47* | *50* |
| Profits (€b) | 0.9 | 1.0 | 1.0 | 1.1 | 1.2 | 1.3 |

Source: Oxford Economics.

Table 22
**Spain: asset management**

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| Total assets under management (€b)* | 116 | 134 | 142 | 147 | 152 | 158 |
| *% year* | *45.0* | *15.3* | *6.3* | *3.4* | *3.4* | *4.2* |
| Bonds (€b) | 50 | 57 | 57 | 58 | 60 | 62 |
| Equity (€b) | 17 | 19 | 20 | 21 | 23 | 24 |
| Fund of funds (€b) | 15 | 17 | 18 | 18 | 19 | 20 |
| Hedge (€b) | 0.6 | 0.7 | 0.7 | 0.7 | 0.8 | 0.8 |
| Mixed (€b) | 13 | 15 | 16 | 17 | 18 | 19 |
| Money market (€b) | 16 | 22 | 27 | 27 | 27 | 28 |
| Property (€b) | 4 | 4 | 4 | 4 | 4 | 4 |

Source: Oxford Economics; Lipper FMI.

*UCITS and non-UCITS assets.

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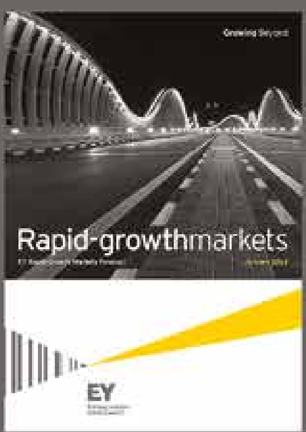


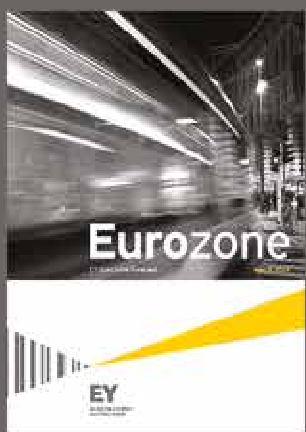

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