V Outlook

1 Economic conditions

1.1 Global economic trends

A marked slowdown was evident in the global economy in 2019. Numerous political risks and escalation of the trade disputes between the US and China during the year subdued the economic climate around the globe considerably, contributing to a widespread slump in growth.

However, the weakening of growth rates across all countries is likely to have bottomed out at the end of 2019. The 'phase 1' trade deal agreed between the US and China following months of negotiations is the first important step toward de-escalating the trade dispute, which has been smoldering since 2018. The deal between the US and China will probably also have a positive impact on the global economy and international trade. Nevertheless, it would be premature to expect a comprehensive recovery.

Furthermore, a new factor, the coronavirus outbreak, has emerged since the start of this year. It has not yet had any significant adverse effect on the DZ BANK Group, but its implications for the global economy are not yet known.

In the US, the economic stimulus from the 2018 tax reforms is tailing off. It is therefore anticipated that growth rates will continue to ease over the coming years. Currently, it is clear that the financial markets do not consider the rising government debt in the US to be a serious problem for the time being. In 2019, the Fed instigated a cycle of interest-rate cuts because of the uncertain economic outlook. Monetary policy will probably remain unchanged in the current year, although it is quite conceivable that there could be a further slight fall in the federal funds rate.

In Europe, growth rates dropped more sharply than in the US in 2019. They are likely to remain low in 2020 and only gradually return to something close to the trend growth rates. This is because the fallout from the trade dispute between the US and China, concerns that the conflict in the Middle East will worsen, and uncertainty surrounding the withdrawal of the UK from the EU single market without a free trade agreement all remain in the air, at least for the time being, even if a serious deterioration is not currently anticipated.

The ECB will also probably continue to maintain its extremely expansionary monetary policy. No improvement in the deposit rate is likely to be on the agenda for the foreseeable future. This prediction is supported by a number of factors. Firstly, it is undeniable that monetary policy is already very expansionary, because the ECB took the deposit rate further into negative territory in September 2019 and decided to restart bond-buying. In addition, sentiment indicators are currently pointing to stabilization of the economy, which means that the ECB is unlikely to feel inclined to adopt additional corrective measures. Furthermore, as the waters become calmer in terms of geopolitical risks, this could allow the ECB more time to maintain its existing monetary policy.

No significant upward pressure on consumer prices is expected in 2020. Inflation rates are therefore unlikely to reach a level that could be considered a cause for concern by central banks.

1.2 Trends in the USA

Although economic growth in the US is forecast to slacken from the rate of 2.3 percent in 2019 to a rate of 1.9 percent in 2020, few people share the worries about a recession that are aired now and again. The unemployment rate will remain around the historic low and the prospects for housebuilding are looking brighter once more, although manufacturing is unlikely to become the motor of growth again for a while.

The economic climate in the US at the start of 2020 did not suggest that there would be a significant economic acceleration. Purchasing manager surveys at the end of 2019 presented a mixed picture. Among service providers, sentiment indicators lay well above the growth threshold, whereas the manufacturing climate remained muted despite the emerging signs of a deal with China. On the other hand, consumer surveys indicated that spending would continue unabated. It is thus likely that household consumption will continue to play the role of growth driver in the current year.

It is still anticipated that the inflation rate will not rise beyond the 2 percent mark for any length of time because there is hardly any wage pressure, which would have to be passed on through prices, despite the high level of employment. US inflation is therefore forecast to remain more or less unchanged at 2.0 percent in 2020. Ultimately, price pressure in the US will thus remain very subdued in spite of the prolonged economic upturn.

1.3 Trends in the eurozone

At the beginning of 2020, there has not yet been any real improvement in the economic prospects for the eurozone. The emerging de-escalation of the trade dispute between the US and China based on the 'phase 1' trade deal is likely to ease some of the international economic risks, at the very least. On the other hand, the threat of a trade dispute between the US and Europe has not yet been eliminated. This could inflict further damage on export-oriented industries in the eurozone, which are already suffering from a persistent drop in demand.

The UK left the EU on January 31, 2020. Initially, not much will change as regards the direct economic relationships between the UK and the EU because there is an agreed transition period until the end of 2020. In the intervening period, the aim is to negotiate a free trade agreement that will govern the future relationship.

Economic momentum in the eurozone remained modest at the beginning of 2020. Because of this, economic growth of just 0.9 percent is forecast for 2020, compared with 1.2 percent in 2019. There was little strong economic stimulus at the start of the year, for example in terms of fiscal policy.

The inflation rate in the eurozone will probably be more moderate over the course of 2020. Assuming the above, the inflation rate for the whole of 2020 is projected at 1.6 percent, compared with 1.2 percent in 2019.

1.4 Trends in Germany

Expansion of economic output in the past year was at its weakest since 2013, the growth rate in real terms being just 0.6 percent. Therefore, the pace of growth more than halved compared with the 2018 figure. Official figures confirm, however, that Germany did not slip into the feared technical recession (two consecutive quarters of decline in GDP) over the course of 2019. Following the contraction of economic output of 0.2 percent in the second quarter, the country posted marginally positive growth figures for the second half of the year. The slowdown in the pace of growth in the domestic economy was primarily attributable to the industrial sector. Over the last year, global demand for German manufacturing products has lost much of its momentum because of the detrimental impact of various political problems.

Looking forward to 2020, it appears that there will not be a recession after all because the downturn in the economy bottomed out at the end of 2019. Assuming that global economic growth has rallied and that there will be no further escalation of the various political crises, a growth rate of around 1 percent can be expected in Germany in 2020. However, more than one third of this growth rate can be attributed solely to the effect of the number of working days in the year and is not related to the economy. Thus, a genuine economic recovery in Germany cannot yet be anticipated in 2020; at best, the projections are for stabilization of growth at a low level.

The average rate of inflation in Germany for 2020 will probably be only slightly higher than in the previous year at 1.8 percent (2019: 1.4 percent). There are no predictions of higher inflationary pressure over the longer term in Germany either.

1.5 Trends in the financial sector

For some years, the financial sector has faced considerable pressure in terms of both adjustment and costs caused by the need to comply with regulatory reforms and implement structural change to adapt to competitive conditions.

The regulatory measures introduced since the financial crisis have had a range of objectives, including restructuring of the supervisory architecture and improved capital and liquidity adequacy in order to make the financial sector more resilient in the event of a crisis. A further objective is to ensure that the risks arising from the business activities in the financial industry are not borne by the public sector and thus the taxpayer.

Further information on the regulatory environment can be found in section 5.1 of the opportunity and risk report.

In response to these regulatory requirements, banks have reduced their leverage over the last few years and substantially bolstered their risk-bearing capacity by improving liquidity and capital adequacy.

In addition, new competitors with approaches based on the use of technology are presenting the financial sector with the challenge of scrutinizing its existing business models, adapting them as required, and substantially improving its efficiency by digitalizing business and IT processes. The corresponding capital investment is initially likely to push up costs in the industry before the anticipated profitability gains can be realized.

Efforts to address the challenges described above will be made more difficult in 2020 by what is expected, from the current perspective, to remain a comparatively low level of nominal interest rates. This will be accompanied by a relatively flat yield curve and will prevent any significant increase in margins in interest-related business.

The statements are based on a current assessment of the ECB's monetary policy, which will remain expansionary because of low inflation rates in the eurozone. Interest rates are not expected to return to normal levels in 2020.

Following a period of gradual interest-rate hikes, the Fed changed course in January 2019 and lowered the target range for the federal funds rate three times with the objective of keeping the US economy on a growth trajectory while ensuring price stability. Currently, the Fed is initially expected to pursue a wait-and-see monetary policy in 2020 with the option of implementing further interest-rate cuts if necessary.

Despite the expansionary monetary policy, the economic outlook remains subdued, particularly for the eurozone, with the result that there are no expectations of any overly positive boost for the financial performance of the European financial sector.

In this regard, the potential impact of uncertain political developments on the economic position of banks and insurance companies should also not be ignored. Further information on macroeconomic risk factors can be found in section 5.2 of the opportunity and risk report.

2 Financial position and financial performance

Key features of the 2020 financial year alongside a continuation of the challenging market and competitive conditions will include the further evolution of the DZ BANK Group's operating business and capital expenditure on new technologies (Letter to shareholders).

The forecasts below are based on the outcome of the DZ BANK Group's annual planning process. Further information on the planning process can be found in the 'DZ BANK Group fundamentals' chapter (section 2.4). Variances from the underlying planning scenario, in the form of opportunities and risks, may have an influence on financial position and financial performance.

According to the planning for 2020, **total assets** will end the year slightly higher compared with the figure as at the end of 2019. The forecast growth, which will have a corresponding impact on the balance sheet, is expected be focused in the BSH, TeamBank, and R+V operating segments. However, the level of total assets will also reflect the countervailing effect from the planned contraction of the portfolios of loans and advances in the DVB operating segment and from the predicted decline in the volume of deposits in the DZ PRIVATBANK operating segment.

In 2019, the DZ BANK Group generated an exceptional **profit before taxes** that was at the upper end of the long-term target range of €1.5 billion to €2.0 billion, even after taking account of the generally positive one-off items (Business report, section 3.1). **Profit before taxes** in 2020 is likely to be at the lower end of this long-term target range of €1.5 billion to €2.0 billion. The amounts in the information below each take account of the aforementioned one-off items.

The future financial performance of the DZ BANK Group could be subject to risks arising from the economic conditions outlined above. The situation is monitored continuously and factored into planning and management.

In 2020, **net interest income** including income from long-term equity investments is currently anticipated to decline significantly because interest rates are likely to remain low, which will particularly affect the interest-rate-sensitive business models in the DZ BANK Group.

Net fee and commission income is projected to make another hefty contribution to the earnings of the DZ BANK Group in 2020. This is due to the predicted growth in the volume of assets under management and the associated volume-related income in the UMH and DZ PRIVATBANK operating segments.

Net gains under **gains and losses on trading activities** in 2020 are predicted to be at a higher level than those in 2019.

Customer-driven capital markets business in the DZ BANK – CICB operating segment will probably provide particular impetus in 2020. The primary prerequisite for a steady level of net gains under gains and losses on trading activities is considered to be a stable financial and capital markets environment.

Gains and losses on investments are expected to deteriorate significantly in 2020.

The net gains under **other gains and losses on valuation of financial instruments** are likely to be at a low level in 2020.

Net income from insurance business in 2020 is expected to be well below the 2019 figure. From the current perspective, the gross premiums in the various divisions of the R+V operating segment are predicted to rise significantly, whereas the net gains under gains and losses on investments held by insurance companies will probably fall back sharply to normal levels in 2020.

Loss allowances are likely to rise considerably in 2020 in line with the volume of the lending portfolio, the targeted volume of new business, and the long-term standard risk costs.

Administrative expenses are predicted to be marginally higher in 2020 than they were in 2019. While staff expenses will decline slightly according to current predictions, general and administrative expenses are likely to rise markedly in view of the planned growth and capital spending requirements.

The DZ BANK Group's **other net operating income** is projected to increase sharply in 2020.

The **cost/income ratio** for the DZ BANK Group is likely to rise significantly in 2020 as a result of the expected year-on-year decrease in income and an almost unchanged level of expenses. As before, the DZ BANK Group will be focusing its energies on managing costs and generating growth in the operating business.

Regulatory RORAC, the risk-adjusted performance measure based on regulatory risk capital, will decline substantially in 2020 on current assessments because of the lower income projections.

3 Liquidity and capital adequacy

Based on the position in the year under review and the funding measures planned for 2020, the DZ BANK Group predicts that it will be able to continue maintaining an appropriate level of economic and regulatory **liquidity adequacy** in 2020.

Further information on liquidity adequacy can be found in sections 6.2 and 6.3 of the opportunity and risk report.

As matters currently stand, the DZ BANK Group's **capital adequacy** will continue to be assured for 2020 from both economic and regulatory perspectives; that is to say, it will continue to have at its disposal the available internal capital necessary to cover the risks associated with the finance business and other risks arising from the group's business operations.

Over the last few years, the DZ BANK Group has greatly strengthened its capital base from its own resources (through the retention of profits) and through corporate action. In 2020, a high priority will once again be given to strengthening the capital base.

Further information on capital adequacy can be found in sections 7.2 and 7.3 of the opportunity and risk report.

4 Operating segments in detail

4.1 BSH

Residential construction will remain one of the key components of the German economy in 2020. According to a forecast by the Deutsches Institut für Wirtschaftsforschung (DIW Berlin) [German Institute for Economic Research], the construction industry will grow at a nominal rate of over 6 percent, a rate significantly greater than that for the economy as a whole. Both new building and the renovation and modernization of existing buildings will benefit from the ECB's expansionary monetary policy. At the same time, it is anticipated that the labor market will remain largely unaffected by the weakness in German industry. Pay settlements will also cause incomes to rise markedly. The drivers behind the real estate boom will therefore remain in place in 2020.

Projections estimate that 310,000 homes will be completed in 2020, compared with a corresponding figure of around 300,000 in 2019. But that still does not match the level of demand, which various studies put at 350,000 to 400,000 homes per year. Added to this, there was a construction backlog at the start of 2020 comprising some 693,000 homes that had been approved but had not yet been completed. This is a record figure, currently representing 2.5 years' worth of construction activity. Based on this data, construction industry trade associations forecast that house-building will generate sales revenue of €54.2 billion in 2020 compared with a figure of just under €51 billion in 2019, a year-on-year increase of 7 percent. BSH, a specialist in home finance, will also benefit from this activity.

In its core home finance business, BSH expects earnings to be slightly higher than the record level achieved in 2019. As regards home savings, the second core business at BSH, new business is predicted to be markedly below the 2019 level because of the continuing challenges presented by persistently low interest rates and significant regulatory requirements.

Taking these various factors into account, BSH anticipates that its **profit before taxes** will see a sharp year-on-year decline in 2020.

The low interest rates are likely to have a substantial detrimental impact on interest income in 2020. However, there will be a positive year-on-year effect from a sharp fall in interest expense caused by a lower addition to the provisions for risks attaching to older rate scales in building society operations. Based on these assumptions, **net interest income** is projected to rise sharply in 2020.

With regard to **loss allowances**, BSH will continue to benefit from Germany's good economic performance and low unemployment rate. As a consequence, loss allowances will – compared with the adjusted figure for 2019 – probably hold steady in 2020 despite the marked expansion of non-collective lending business in previous years.

Net fee and commission income in 2020 is expected to remain around the 2019 level based on marginal expansion of the home finance business and a significant contraction of new home savings business.

Gains and losses on investments are projected to deteriorate significantly because the gains from the disposal of the shares in ČMSS were included as a one-off item in the 2019 figure.

Administrative expenses will be substantially higher in 2020, a consequence of strategic projects and action plans in connection with the further development of the home savings and home finance core businesses. Strict cost discipline and savings will help to limit the increase.

On current calculations, the **cost/income ratio** will worsen substantially, largely because the sharp rise in net interest income will be insufficient to offset the substantial deterioration in gains and losses on investments and much higher administrative expenses.

Regulatory RORAC will probably be down a little because of the slightly higher capital requirements and the fall in profit before taxes.

4.2 R+V

In the opinion of R+V, the 2020 financial year will continue to be shaped by the challenging conditions. The market environment will remain very tough from any number of perspectives, including political issues, regulation, low interest rates, economic conditions, and consumer behavior.

Back in 2017, R+V launched its 'Wachstum durch Wandel' (growth through change) program with the overall objective of consolidating its position in the market and equipping itself for the future. The main aims within the strategic program are to safeguard profitable growth over the long term, bring about further growth in sales, refine the strong R+V corporate culture, and sharpen the focus on customer needs.

In line with this strategy, R+V – the composite insurer in the Volksbanken Raiffeisenbanken cooperative financial network – is planning to continue on its trajectory of profitable growth in 2020. The value added for the cooperative financial network should also increase steadily as a result.

Slight overall growth is expected in **gross premiums written**. This will be generated across all divisions in the R+V Group.

In non-life insurance, **gross premiums written** are forecast to grow marginally in 2020. The **claims rate** will probably remain at the level of 2019. Based on a slight rise in the expense ratio, the **combined ratio** (total of insurance business operating expenses and claims expenses divided by premiums earned) is projected to be a little higher than the 2019 figure.

In the life insurance and health insurance business, the **gross premiums written** for 2020 are predicted to be slightly above the level of 2019. In previous years, single-premium insurance policies accounted for a significant proportion of new business. New single-premium business is subject to some volatility and a contraction is therefore always possible, particularly in a shifting interest-rate environment.

The latest pension insurance report (2019) published by the Bundesministerium für Arbeit und Soziales (BMAS) [German Federal Ministry of Labour and Social Affairs] states that the ratio of pensions to pay (before tax), referred to as the security level, will fall from the current level of 48.2 percent to 44.6 percent by 2033. This means that the level of provision from the statutory pension by itself is declining. In the report, the German government expressly states that the statutory pension alone is no longer sufficient to maintain an existing standard of living. It recommends that retirees also make use of the options offered by the German Retirement Income Act (AltEinkG) and government subsidies. The German Act to Strengthen Occupational Pensions (BRSG), which came into force on January 1, 2018, is a further component in the efforts to prevent old-age poverty. This act is focused particularly on small and medium-sized enterprises (SMEs) as well as on employees with low incomes, who are more likely to be affected by old-age poverty. Industry-specific pension schemes such as the dedicated schemes available in Germany for the chemicals industry (Chemie-Versorgungswerk), engineering industry (MetallRente), pharmacy industry (ApothekenRente), healthcare industry (KlinikRente), and media industry (Versorgungswerk der Presse) are helping to popularize occupational pension provision.

It is expected that awareness of the economic losses from natural disasters, global economic growth, and the growing global population will generate a sustained high level of demand for reinsurance. Following the major loss events that occurred in previous years, it is anticipated that there will be a further increase in the price of reinsurance cover in 2020. R+V will continue to pursue its strategy of profitable growth in its inward reinsurance business.

Further substantial growth in **gross premiums written** is predicted. On the costs side, R+V anticipates an unchanged administrative expenses ratio (net insurance business operating expenses divided by net premiums earned) and a small improvement in the combined ratio in 2020.

Investing activity is based on a long-term investment strategy combined with an integrated approach to risk management. Focusing on asset protection, the strategy is designed to ensure that insurance obligations can be met at all times.

The budgeted **gains and losses on investments held by insurance companies** for 2020 are down sharply compared with the previous year, as the equivalent figure in 2019 had risen substantially because of the fall in the level of market interest rates. In contrast, no material change in the low interest rates is anticipated in 2020.

The overall result of the above factors in the planning is a substantial decline in **profit before taxes** compared with the 2019 figure, which had been significantly boosted by the positive trend in capital markets.

Regulatory RORAC is expected to fall sharply in 2020 in line with the forecast decline in profit before taxes combined with a slight rise in capital requirements.

4.3 TeamBank

Although the signs that the economy is clouding over are unmistakable, consumer spending is likely to remain a key driver of economic growth in 2020. Steady growth is therefore predicted for the consumer finance market. This solid growth trajectory, combined with consumers' increasing preference for digital delivery channels, makes the market very attractive to competitors. Further digital competitors from the non- and near-bank sector with disruptive business models are expected to enter the market. Fintechs are continuing to gain importance and the activities of the tech giants are also becoming increasingly visible in the German banking industry.

In collaboration with the cooperative banks, TeamBank is aiming in 2020 to generate profitable, sustainable growth at a rate that is consistently higher than that of the market. TeamBank remains focused on directing customers who prefer online/mobile channels to the cooperative banks, and attracting new customers and members as well as retaining existing ones.

TeamBank is forecasting strong portfolio growth in 2020, which is projected to lead to a corresponding rise in **net interest income**.

A significant rise in **loss allowances** is anticipated as a consequence of the portfolio expansion in 2020 and prudent credit assessment of customers who are added to the portfolio as a result of innovations in products and lending processes.

Administrative expenses will rise sharply in 2020, mainly because of the planned investment to upgrade the technical infrastructure as a prerequisite for the focus on growth.

In view of the anticipated challenge presented by the market and competitors, **profit before taxes** is predicted to decrease moderately.

Consequently, the **cost/income ratio** for 2020 will worsen slightly compared with the 2019 level.

The rise in minimum capital requirements will lead to a small decline in **regulatory RORAC** in 2020.

4.4 UMH

UMH is setting itself ambitious targets for 2020.

Against the backdrop of persistently tough political and capital market conditions (the withdrawal of the UK from the EU, the trade dispute between China and the US, the continuation of low interest rates in Europe and many other parts of the world, the anticipated slowdown of growth in the US and eurozone), UMH intends to continue systematically exploiting opportunities to deliver a positive business performance.

UMH is once again aiming to achieve a very high level of assets under management at the end of 2020, although this level is projected to be slightly down compared with the position at the end of 2019. New business will be sustained at a high level. Expectations regarding overall performance are slightly higher for 2020.

Net fee and commission income is projected to rise a little in 2020, mainly as a consequence of the expected slight increase in volume-dependent income resulting from the marginally higher average level of assets under management.

Net finance costs – comprising net interest income, gains and losses on investments, and other gains and losses on valuation of financial instruments – are likely to improve significantly in 2020, primarily because of a sharp fall in the expense from the valuation of guarantee commitments for investment products and the absence of the expense from the valuation of options in connection with the acquisition of shares in a long-term equity investment. However, the contribution from own-account investing is predicted to fall substantially.

Administrative expenses are projected to rise significantly in 2020. Staff expenses will be a little higher as a consequence of growth-related recruitment and planned salary increases. Some of this increase will be offset by a small reduction in variable remuneration components linked to company KPIs. Consultancy and office operating costs will cause general and administrative expenses to go up sharply. Depreciation, amortization, and impairment will increase significantly, mainly as a result of costs for buildings and of the first-time recognition of capital expenditure relating to completed projects.

A sharp decrease in **other net operating income** is expected, predominantly because of the absence of the gain recognized in 2019 on the disposal of Union Investment Towarzystwo Funduszy Inwestycyjnych S.A. (TFI), Poland.

Based on the factors described above, **profit before taxes** is once again projected to be at a high level in 2020, but lower than the profit before taxes generated in 2019.

The situation will be similar for the **cost/income ratio** and **regulatory RORAC**.

4.5 DZ BANK – CICB

The persistently low level of interest rates is presenting a challenge for the banking industry. In addition, the German banking market, which had previously consisted of three pillars, has now been extended to include a fourth pillar, which consists of entities such as fintechs and foreign banks. This fourth pillar is significantly ratcheting up the competitive pressure in the industry.

Advancing digitalization will determine future development, creating both opportunities and risks for the financial sector. Greater use of digital technologies is enhancing transparency in the market. At the same time, banks can themselves benefit from the use of digital technologies to respond to changes in customer requirements.

Because of this market environment, **profit before taxes** at DZ BANK – CICB is expected to fall sharply in 2020, after taking account of one-off items (Business report, section 3.1).

Net interest income (excluding income from long-term equity investments) in 2020 is predicted to fall well below the 2019 level. It is anticipated that net interest income from customer business will be affected, notably, by a small anticipated rise in the margin contribution from interest-bearing business and a fall in other net interest income. In terms of planning, a positive contribution is expected from the interest-bearing business, particularly with corporate customers in Germany and abroad, and from the development lending business and money market business.

It is anticipated that the growth in corporate banking will be driven by further increases in volume. The projected growth and the stepping up of corporate banking business are linked to the systematic implementation of activities under the 'Verbund First 4.0' strategic program.

The target for 2020 is to maintain the margin at an almost constant level despite a market environment that is expected to remain highly competitive and an interest-rate environment that is currently very challenging. The anticipated growth delivering a boost for net interest income is likely to be derived from a continuing expansion of volume.

Other net operating interest income mainly consists of operating income from money market business outside the cooperative financial network, promissory notes, and securities. The anticipated decline in net interest income in the planning period is mainly due to the fact that margins are expected to fall while portfolio volumes remain broadly unchanged. In addition, it is projected that intermediary-related money market funding will remain virtually constant.

Loss allowances are likely to rise significantly in 2020. Reversals recognized in 2019 have not been included in the planning for 2020. In 2019, additions were also partly offset by income from recoveries on loans and advances previously impaired.

The planning for loss allowances in 2020 is based on the expected loss from the lending business, particularly in corporate banking. Loss allowances will probably return to their normal level in 2020 and change in line with the lending portfolio, the targeted volume of new business, and the long-term standard risk costs.

Net fee and commission income is projected to rise slightly in 2020, primarily as a result of the planned growth in service fees in individual operating units. Growth opportunities are likely to be exploited, particularly in the Transaction Banking business line as a consequence of the comprehensive digitalization strategy combined with efficiency optimization in payments processing and depositary services.

Gains and losses on trading activities are forecast to improve significantly in 2020, provided there is no substantial market turmoil. Gains on trading activities in the DZ BANK – CICB operating segment will be generated from margins in customer business involving investment and risk management products and from the related customer-initiated trading contributions.

In this context, key income drivers are likely to be the exploitation of cross-selling potential in corporate banking, the expansion of the range of products via targeted product initiatives, and the harnessing of potential in the securities business by stepping up collaboration with the cooperative banks in customer business. There are also plans to expand institutional customer business on e-trading platforms.

In all probability, **administrative expenses** will rise again slightly in 2020. Despite the continuing plans for implementation of the 'Verbund First 4.0' strategic program aimed at leveraging specific efficiencies, cutting the number of full-time equivalents, and reducing the number of external employees in project and line activities, there are likely to be additional countervailing general and administrative expenses arising from strategic investment in the digitalization of market access and in IT as well as from higher contributions to the BVR protection scheme and for banking supervision. IT costs will also rise as a result of the planned insourcing in connection with VR Smart Finanz and VR FACTOREM. However, some of these costs will be offset by corresponding income under these contractual arrangements.

Current assessments show that the **cost/income ratio** will worsen slightly in 2020 as a result of the conservative projection of financial performance compared with 2019 and the rise in administrative expenses.

As things stand, **regulatory RORAC** will probably decline in 2020 based on slightly higher capital requirements and the increase in loss allowances.

4.6 DZ HYP

Because of the perpetually low level of interest rates, real estate remains an attractive investment product. Investors from both Germany and abroad are expected to continue increasing the proportion of real estate in their portfolios at the expense of interest-bearing investment products. Demand in the real estate market is thus likely to remain high over the next few years. Real estate in Germany will play a key role because of the economic and political stability in the country. On the supply side, in terms of real estate finance, there is likely to be ongoing pressure to consolidate within the industry accompanied by increased capital requirements in the banking sector. This combination of supply and demand could lead to rising credit margins in 2020 for real estate finance, from which DZ HYP would also benefit. Overall, this anticipated scenario creates a solid foundation for DZ HYP, which is forecasting that the volume of new business in real estate finance in 2020 will be a little below the 2019 figure with a slight rise in interest margins.

Net interest income in 2020 is projected to be slightly below the 2019 figure because of lower expected one-off items in connection with the early redemption of loans. Real estate lending is expected to increase slightly, as are the associated margins.

Loss allowances for 2020 are forecast on the basis of standard risk costs and are thus likely to increase markedly.

Based on current assessments, the credit spreads in government financing in 2020 are expected to deviate only minimally from their level in 2019. **Other gains and losses on valuation of financial instruments**, which resulted in a net gain in 2019, will therefore probably be close to zero in 2020 and thus down significantly year on year.

Administrative expenses are projected to be at the level of 2019.

Based on stable operating performance with various countervailing effects on earnings, but particularly because of the decline in **other gains and losses on valuation of financial instruments**, the **profit before taxes** at DZ HYP in 2020 is predicted to be significantly below the corresponding 2019 figure.

Accordingly, the **cost/income ratio** is expected to rise significantly.

Regulatory RORAC is also likely to decline considerably due to the fall in profit before taxes forecast for 2020.

4.7 DZ PRIVATBANK

Although the economy of the eurozone will lose momentum in the medium term, economic sentiment is expected to remain in positive territory despite the adverse factors.

The inflation rate in the eurozone will probably not exceed the ECB's target of 2 percent in 2020.

Based on current assessments, **net interest income** will fall sharply in 2020 because of the persistently low interest rates.

In 2020, **net fee and commission income** is predicted to rise substantially thanks to the good performance of the private banking and fund services businesses.

The assets under management in private banking will also rise because of planned increases in inflow rates from the independent sales activities of partners. The main value driver is fund volume, which is likely to grow substantially – particularly in the case of third-party funds.

Gains and losses on trading activities are forecast to deteriorate significantly in 2020.

Administrative expenses are expected to rise moderately in 2020. The increase will be due not only to the sustained growth of costs relating to regulatory requirements but also to high levels of capital expenditure.

Based on current forecasts, **profit before taxes** will decline only slightly year on year, despite a challenging market environment.

The **cost/income ratio** and **regulatory RORAC** are both forecast to be on a par with 2019.

4.8 VR Smart Finanz

The priorities for VR Smart Finanz in 2020 are to step up collaboration with the cooperative banks and achieve a greater level of market penetration for the existing solutions aimed at small-business and self-employed customers. In view of the economic conditions, slightly faster economic growth is anticipated compared with 2019.

VR Smart Finanz continues to pursue a decentralized approach in which it aims to provide digital solutions to support the cooperative banks.

The organizational structure implemented in 2019 encourages agile approaches to working, the objective of which is to create a stronger customer focus and increase speed of delivery. On the basis of the restructuring carried out in 2019, VR Smart Finanz plans to carry out a further reduction in headcount in 2020 to 420 full-time equivalents. VR Smart Finanz sources from selected divisions with the aim of enabling it to leverage synergies in the DZ BANK Group and benefit from divisions that operate as centers of expertise. A key project in this regard is the outsourcing of IT operations to DZ BANK, which is to be implemented in a number of stages by the end of 2020. In addition, it is planned to sell VR FACTOREM GmbH to DZ BANK in the first half of 2020, as a result of which the sales activities in non-strategic areas of business will be ended.

In 2020, VR Smart Finanz will continue to focus on joint marketing with the cooperative banks and on the objective of tapping into the available potential for income and growth from small businesses, the self-employed, and the (lower) SME segment.

VR Smart Finanz is forecasting a sharp increase in the volume of business and number of customers in 2020, which will be achieved by focusing on marketing, expanding collaboration with banks offering significant potential, and accelerating the creation of new sales channels. At the same time, it is planning to implement specific measures to increase customer loyalty and thereby influence the portfolio structure. A significant rise in volume is expected particularly in connection with the digitalized and automated 'VR Smart flexibel' business loan and 'VR Smart express' asset finance businesses, as a result of which **net interest income** is projected to increase sharply year on year.

The greater level of collaboration with the cooperative banks and the increase in business volumes will also be reflected in much higher **bank commissions** and **fee and commission expenses**.

Based on a conservative risk projection and the increase in business volume, it is anticipated that there will be a significant rise in **loss allowances**. As a consequence of the growth in the profitable 'VR Smart express' and 'VR Smart flexibel' financing solutions, the margin after risk is forecast to remain constant in the portfolio as a whole.

Following completion of the sale of the non-strategic businesses, the reduction in headcount, and the progressive automation of the financing solutions, **administrative expenses** are expected to fall slightly.

This will also be reflected in a substantial improvement in the **cost/income ratio** and **regulatory RORAC**. The anticipated significant increase in business volume, combined with constant margins and greatly diminishing effects from the transformation program, is projected to lead to a substantial improvement in **profit before taxes** from ordinary activities.

4.9 DVB

DVB's outlook for 2020 is determined by sector-specific developments and macroeconomic factors. Moreover, the strategic considerations that emerged during 2018 will continue to have an impact on DVB's business performance in 2020. In this context, DVB sold its land transport finance business in December 2018 (transaction completed on May 3, 2019). In the first quarter of 2019, it sold its aviation business[1] and its wholly owned subsidiary LogPay Financial Services GmbH (transaction completed on October 30, 2019).

Following the sale of core business units in 2019, the Board of Managing Directors has decided, after due consultation, to allow the remaining portfolios to run off. As a result, DVB will continue to manage its existing business as a fully operational bank but, in the shipping finance business, cease active marketing and, as a rule, not enter into any new business.

In view of the general state of transport markets and the aforementioned strategic decisions, the objectives for 2020 are as follows:

- Complete the sale and carve-out of AIM and AAM, probably during the first half of 2020
- Fulfill and deliver all post-completion activities and obligations in connection with the three transactions referred to above
- Continue to allow the maritime portfolio to run off; actively wind down the NPL portfolio
- Focus on simplifying the operating model while carrying out the run-off plan.
- During the transformation of the business model, DVB will remain a reliable partner to its customers, business partners, and other relevant stakeholders by maintaining a constant dialogue and continuing to fulfill its obligations under existing agreements in a thorough and professional manner.

Overall, DVB's projected financial performance in 2020 will be heavily influenced by conditions in the maritime market and the decision of the Board of Managing Directors to allow the bank's remaining portfolios to run off. The bank is committed to achieving the objectives outlined above and living up to its reputation as a reliable and solid financial institution. DVB is optimistic that its results for 2020 will be in line with the financial planning and will meet stakeholders' expectations. For 2020, DVB currently anticipates that it will generate a **loss before taxes** in the mid double-digit millions of euros.

4.10 DZ BANK – holding function

The **loss before taxes** is forecast to be significantly lower in 2020.

Net interest income is predicted to rise sharply in 2020 overall.

Administrative expenses in 2020 will probably be slightly lower than the 2019 level. However, it is anticipated that expenses for the bank levy and contributions (particularly the BVR protection scheme) will increase slightly in the period covered by the forecast. Likewise, IT and project expenses are expected to rise a little.

By contrast, there will probably be a slight fall in the group function expenses and the other expenses for the benefit of the group and local cooperative banks.

[1] The transfer of the aviation finance portfolio, the employees, and other parts of the business infrastructure was completed on November 18, 2019; only a small portion of the credit portfolio was still to be transferred in stages as at the start of 2020. The transaction relating to the aviation investment management (AIM) and aviation asset management (AAM) activities has not yet been completed. The sale is expected to be completed by the end of the first half of 2020.