Perspectives
Economics

February 2018

Key messages

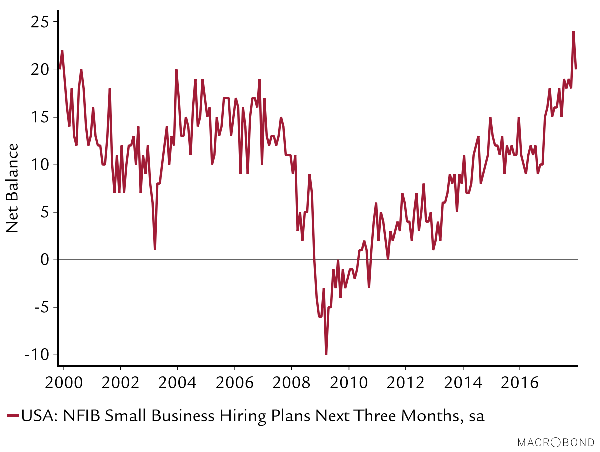
- Central bank policy will shape the economic and financial year 2018
- The odds of a mild rise in inflation are increasing in certain economies
- Economists are currently most uncertain when it comes to project GDP growth in the United Kingdom

Comparison of forecasts

	GDP 2018				GDP 2019				CPI 2018				CPI 2019			
	Swiss Life AM		Consensus		Swiss Life AM		Consensus		Swiss Life AM		Consensus		Swiss Life AM		Consensus	
US	2.6%	↑	2.7%	↑	1.9%		2.4%	n.a.	2.4%	↑	2.1%		2.1%	↑	2.1%	n.a.
Eurozone	2.0%	↑	2.2%	↑	1.3%	↑	1.8%	n.a.	1.5%	↑	1.4%		1.3%		1.6%	n.a.
UK	1.5%	↑	1.4%	↓	1.0%		1.5%	n.a.	2.5%		2.6%		2.0%		2.2%	n.a.
Switzerland	1.9%		1.9%		1.3%		1.7%	n.a.	0.8%	↑	0.8%	↑	0.8%		1.0%	n.a.
Japan	1.6%		1.4%	↑	1.1%		1.1%	n.a.	1.1%	↑	0.9%		0.4%		1.1%	n.a.
China	6.5%	↑	6.5%	↑	6.1%		6.3%	n.a.	2.1%	↑	2.2%		2.1%	↓	2.2%	n.a.

Arrows indicate difference from previous month
Source for Consensus: Consensus Economics Inc. London, 08.01.2018

Chart of the month



Corporate America has delivered strong results last year, even outside the energy sector which experienced a revival in 2017. With tailwind from the tax reform package which was sealed in December, entrepreneurs are inclined to invest and push hiring further. Small businesses as represented by the National Federation of Independent Business (NFIB) are particularly optimistic. Job creation will thus continue in an environment where the labour market has already reached full employment. Wage growth is bound to rise in 2018.

US
Record-long business cycle

GDP growth

Swiss Life Asset Managers	Consensus
2018: 2.6 %	2018: 2.7 %
2019: 1.9 %	2019: 2.4 %

The current economic expansion, which officially started in June 2009, is on track to beat historical record. Even though the level of GDP growth since then has been unusually moderate, the length of the business cycle is remarkable. This extended recovery phase entails a labour market at extreme tightness. Given tax relief for companies and an ongoing strong business environment, entrepreneurs' willingness to compete for skilled labour is intact. Some of the windfall from corporate tax cuts will flow into business investment. Financial institutions in particular report that the business atmosphere has been strengthened by tax reform and by the general trend toward deregulation which should support loan growth. Private households will also feel the beneficial effects of tax cuts, however some of that additional spending will go into imports and will thus temper the GDP effect. The tax reform package is designed in such a way that the impact will be front-loaded and we acknowledge this with a GDP forecast for 2018 at 2.6%, clearly above potential growth. Yet, given the maturity of the cycle, we prefer to err on the low side when it comes to the growth outlook in 2019.

Inflation

Swiss Life Asset Managers	Consensus
2018: 2.4 %	2018: 2.1 %
2019: 2.1 %	2019: 2.1 %

By July 2018, headline inflation will temporarily reach 3%, under the assumption that the oil price does not move drastically lower from the currently elevated level. Past Dollar weakness and strong economic momentum should support inflation pressure.

Eurozone
Rising tide lifts all boats

GDP growth

Swiss Life Asset Managers	Consensus
2018: 2.0 %	2018: 2.2 %
2019: 1.3 %	2019: 1.8 %

At the beginning of 2017, the GDP growth forecast for 2017 as published by Consensus Economics was at 1.4%. Given the perceived political risks in the currency union last year, our own forecast was even more cautious than that. While the publication of GDP for the last quarter 2017 is still outstanding, we bet on a final outcome of annual average growth of 2.3% for the year 2017, almost double our own initial forecast. Precondition for this to materialise is a quarterly growth figure in the fourth quarter 2017 equal to the one in the third quarter, at 0.6%. Given the latest hard data, this seems easily achievable. Consumers played an active part in the recovery last year and this trend to sturdy consumer spending should persist. The labour market continues to recover from the damage of the financial and the debt crisis. Equally so, investment spending may gain momentum. The trade balance proved resilient towards Euro appreciation thus far, but will weaken going forward well into 2019 in our view. We would also expect that consumers' pent-up demand will be saturated by then.

Inflation

Swiss Life Asset Managers	Consensus
2018: 1.5 %	2018: 1.4 %
2019: 1.3 %	2019: 1.6 %

Despite strong economic momentum, price pressures outside of the energy complex remain benign. Import as well as producer prices have softened since the Euro appreciation kicked in. We will keep a watchful eye on wage dynamics in 2018.

UK
Wide margin of uncertainty

GDP growth	
Swiss Life Asset Managers	Consensus
2018: 1.5%	2018: 1.4%
2019: 1.0%	2019: 1.5%

Ten years after the financial crisis, threats which kept investors awake at night seem to be overcome: Bullishness on equities is widespread among global investors and for many, Europe's future seems to look far brighter since Emmanuel Macron was elected French president. Yet, there is one place, where uncertainty on political and economic developments remains elevated: According to the latest data published by Consensus Economics, the UK GDP growth forecasts for 2018 range from a mere 0.9% to 2.2%, which is an extraordinary wide range. Clearly, the ongoing Brexit negotiations cast a shadow on economists' projections for Britain. Further evidence of the uncertainty is that we lift our forecast from 1.2% to 1.5% at the same time as the consensus forecast comes down to 1.4% from 1.5%. As a matter of fact and supporting our slightly more constructive judgement, the majority of the data covering the fourth quarter 2017 came in above expectations.

Inflation	
Swiss Life Asset Managers	Consensus
2018: 2.5%	2018: 2.6%
2019: 2.0%	2019: 2.2%

In December 2017, headline inflation eased to 3.0%, confirming our view that the surge in inflation which followed the EU-referendum was temporary. Higher prices for fuels and heating oil as well as rising railway fares suggest that headline inflation will return to 3.1% with the print for January, before it begins its downward journey. Assuming stable energy prices and no further sterling devaluation, headline inflation should drop below 2.5% by mid-year 2018 and gradually decline towards 2% in the second half of the year.

Switzerland
Inflation on a seven-year high

GDP growth	
Swiss Life Asset Managers	Consensus
2018: 1.9%	2018: 1.9%
2019: 1.3%	2019: 1.7%

A firm reading of the purchasing managers' index for December 2017 suggests that manufacturers continue to benefit from the global upswing. At home, retail sales stabilised in the second half 2017, with signs of accelerating dynamics towards the end of the year. While retailers continue to suffer from online offerings, shopping on the other side of the Swiss border has become less attractive given the 10% appreciation of the Euro since April last year. The weaker currency combined with favourable conditions for winter sports provide tailwinds for the alpine tourism regions, which should result in further improvements in hotel overnight stays over the winter months. In our view, the Swiss Franc remains overvalued relative to the Euro. A further devaluation towards the region of 1.20 – 1.22 is our base case for 2018. That should prompt the corporate sector to invest more in staff or machinery in Switzerland instead of continuing with their outsourcing measures of the recent past.

Inflation	
Swiss Life Asset Managers	Consensus
2018: 0.8%	2018: 0.8%
2019: 0.8%	2019: 1.0%

Details in the consumer price data for December 2017 reveal that some retailers and service providers like restaurants and hotels started to test their price setting power in light of accelerating economic dynamics and rising import prices. A surprisingly strong contribution from these sectors is in parts responsible why we lift our forecast for average annual inflation in 2018 to 0.8%. Additionally, we observe higher retail prices for energy products through January, a trend which is also pointing to higher inflation than previously expected.

Japan
BoJ to remain supportive

The Japanese economy has had positive ripple effects in exports and business investment from the global expansionary phase. The latest report on machinery orders, domestic as well as foreign, underlines the point of continued sturdy momentum. Annual GDP growth in 2017- at 1.8% according to our own forecast - would be the highest since the year 2013. The jobless rate is at a meagre 2.7% and thus on the lowest level since the early 1990s. Here too, wage growth remains the big absentee thus far. Inflation remains well below the price stability target, despite the Bank of Japan having introduced their "inflation-overshooting commitment". To maintain effectiveness of monetary policy, the central bank needs to uphold inflation expectations. We do not foresee a premature end of their yield curve targeting regime.

China
Better than expected

2017 marks a year of positive surprises: Generally, economic data came in better than expected. The annual growth of real GDP was 6.9% in 2017. At the beginning of 2017, the consensus expectation was 6.4%. Thus, the economic environment turned out to be much stronger than initially expected. This has two implications for policy. First, the goal of doubling GDP by 2020 from 2010 levels becomes reachable even if growth slows over coming years. We expect growth to decelerate to 6.5% in 2018 and 6.1% in 2019. If GDP grows by 6.0% in 2020, the development target is met. Thus, authorities are likely to tolerate weaker growth. Second, the stable economic environment provided the government with a window of opportunity to tackle pressing structural issues. The focus is on deleveraging as well as on financial and environmental regulation. Yet, it remains to be seen how strictly the reform path is pursued once the economy becomes weaker.

Economic Research

Marc Brütsch
Chief Economist
marc.bruetsch@swisslife.ch
@MarcBruetsch

Claudia Bernasconi
Senior Economist
Emerging Markets
claudia.bernasconi@swisslife.ch
@BernasconiCla

Sylvia Walter
Senior Economist
sylvia.walter@swisslife.ch
@SylviaWalter13

Francesca Boucard
Economist Real Estate
francesca.boucard@swisslife.ch
@f_boucard

If you have any questions or if you would like to subscribe to this publication,
Please send an email to: info@swisslife-am.com.
For more information visit our website at: www.swisslife-am.com