Perspectives
Economics

March 2019

Key messages

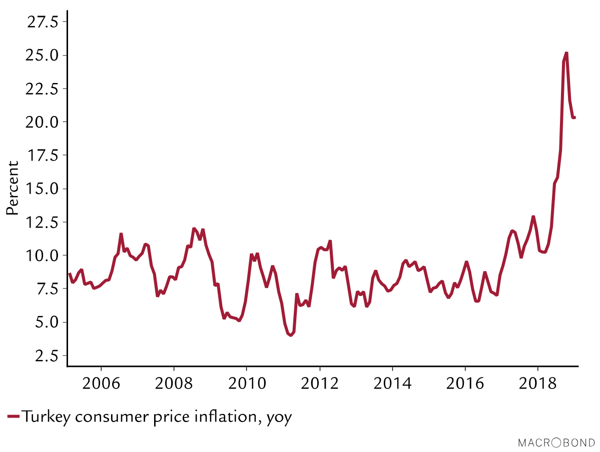
- Brexit is most likely going into extra time
- A sectoral, not a geographical, gap opens in the Eurozone
- Disappointing numbers on first quarter dynamics trigger downward revision to our growth forecasts

Comparison of forecasts

	GDP 2019		GDP 2020		CPI 2019		CPI 2020	
	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus
US	2.3%	2.5%	1.5%	1.9% ↑	1.9%	1.9%	2.2%	2.2%
Eurozone	1.2% ↓	1.3% ↓	1.1%	1.4%	1.4% ↓	1.4% ↓	1.6%	1.5%
UK	1.3% ↓	1.4% ↓	1.3%	1.5% ↓	1.9% ↓	2.0%	2.0%	2.1%
Switzerland	1.2%	1.6% ↑	1.4%	1.7% ↑	0.6%	0.7%	0.8%	0.9%
Japan	0.7% ↓	0.9% ↓	0.4% ↓	0.4%	0.9%	0.8% ↓	1.2% ↓	1.2% ↓
China	6.2%	6.2%	6.0%	6.1%	2.3%	2.2%	2.2%	2.2%

Arrows indicate difference from previous month
Source: Consensus Economics Inc. London, 14.02.2019

Chart of the month



Turkey's currency crisis resulted in an inflation rate as high as 25% in October last year. As the Turkish central bank hiked interest rates to 24%, the currency strengthened and inflation rates have come down considerably. After falling for two consecutive months in November and December, inflation picked up slightly again in January, reaching 20.4%. While inflation in Turkey is still on an elevated level, overall inflation rates in emerging markets have come down, allowing emerging market central banks to turn away from their tight monetary policy stance towards a more dovish one.

US
Mixed signs from US economy

GDP growth	
Swiss Life Asset Managers	Consensus
2019: 2.3 %	2019: 2.5 %
2020: 1.5 %	2020: 1.9 %

The US government shutdown, the dominating issue at the start of the year, has been resolved, and equity markets have continued their rally in February. Apart from these undoubtedly good news, economic data out of the US has been mixed. The huge plunge in December retail sales raised serious questions about the health of US consumption. In addition, industrial production was sluggish and existing home sales fell to the lowest level since 2015, flagging continued risks regarding the US housing market. While we indeed expect the US economy to slow over the next two years, fears of a strong contraction or even imminent recession appear overdone. Labour market conditions have stayed excellent, and the soft patch in consumer sentiment might merely be the result of market turbulence in December and the government shutdown in January. Also, the dovish shift of the US Federal Reserve has already led to significantly lower mortgage rates, boosting mortgage applications in January and February. This might support housing market conditions going forward. In sum, we stick to our below-consensus growth forecast for 2019 and await additional data releases to assess whether the weak activity data were indeed hit by one-off factors.

Inflation	
Swiss Life Asset Managers	Consensus
2019: 1.9 %	2019: 1.9 %
2020: 2.2 %	2020: 2.2 %

Lower oil prices led to a sharp drop in US headline inflation, but the bottom was likely reached in January. On the back of the recent recovery in energy prices, we expect inflation to gradually move up again toward the US Fed's 2% target. Meanwhile, core inflation surprised on the upside in January, reflecting ongoing domestic price pressures related to rising wages. We expect core inflation to remain resilient, while not rising to an extent that would trigger a more aggressive policy stance by the US Fed this year.

Eurozone
A divided economy

GDP growth	
Swiss Life Asset Managers	Consensus
2019: 1.2 %	2019: 1.3 %
2020: 1.1 %	2020: 1.4 %

A gap has opened up in the Eurozone's economy. For once, this gap is not geographical between north and south, but sectoral between manufacturing and services. While most recent data confirm our expectation that Germany's car manufacturing sector is likely to recover from last year's one-offs owing to the new emission standards, manufacturing in general continues to suffer from weakening global dynamics. Brexit uncertainties and the US trade policy power game weigh on corporates' appetite for investments in machinery. Accordingly, the Eurozone manufacturing purchasing managers' index (PMI) fell below the 50 points expansion threshold according to preliminary data for February. The current reading of 49.2 points is the lowest since June 2013. A simple econometric model to gauge current quarter GDP growth on the base of the manufacturing PMI only suggests that GDP might be contracting during the first quarter 2019. Meanwhile, services, which are less dependent on global trade, continue to disprove any recession fears. Adding the PMI data series for the services industries to our model results in a current quarter growth forecast of around 0.1%. Service sector dynamics are supported by improving consumer confidence in Germany and France.

Inflation	
Swiss Life Asset Managers	Consensus
2019: 1.4 %	2019: 1.4 %
2020: 1.6 %	2020: 1.5 %

We lower the inflation forecast for 2019 on the observation of sub-potential growth during the second half last year. The ECB will miss its inflation target of "close to, but below 2%" this year and also in 2020, which means that we do not expect an interest rate hike in 2019. Meanwhile, the case for higher core inflation until end of 2019 has strengthened thanks to accelerating wage dynamics: In the last quarter 2018, negotiated wages across the Eurozone grew by 2.2% from year ago levels, the fastest pace since 2012.

UK
Will Brexit be delayed?

GDP growth

Swiss Life Asset Managers	Consensus
2019: 1.3 %	2019: 1.4 %
2020: 1.3 %	2020: 1.5 %

The end of March Brexit date is getting closer and closer with no signs of any solution on a transition deal at the time of writing. What we can still observe is that there seems to be neither a popular nor a parliamentary mandate to leave the EU without an agreement. Hence, we think a "no-deal Brexit" scenario is a tail risk, which would be the result of a political accident. A "blind Brexit" involving a transitional period thus remains our base case scenario. As Prime Minister May has so far been unsuccessful in garnering a majority for her initial deal or starting fruitful re-negotiations with the EU, an extension of the Brexit data beyond March looks increasingly likely. Hence, Brexit uncertainties are likely to stay with us until at least mid-year. These uncertainties have now finally started to take their toll on economic performance. Business investment has fallen, and investment intentions remain weak according to the Bank of England's agents survey. Hence we marginally downgraded our 2019 GDP forecast. The bright spot remains private consumption, which is supported by resilient labour market conditions.

Inflation

Swiss Life Asset Managers	Consensus
2019: 1.9 %	2019: 2.0 %
2020: 2.0 %	2020: 2.1 %

Headline inflation eased to below 2% in January, below our forecasts. The slow start to the year has prompted us to revise down our 2019 inflation forecast to 1.9% from 2.1%. Higher energy prices should lead to a rebound in the February print, but we expect inflation to fluctuate around the 2% mark for the rest of the year. The rise in wage growth is an upside risk to inflation, but is mitigated by potential dampening effects in our base case that a Brexit deal is ultimately struck. A deal would likely lead to a stronger currency. The unwinding of stockpiling that likely occurred ahead of the Brexit date should prove additionally disinflationary.

Switzerland
Back to potential growth rates

GDP growth

Swiss Life Asset Managers	Consensus
2019: 1.2 %	2019: 1.6 %
2020: 1.4 %	2020: 1.7 %

Two days after the editorial deadline for this paper, SECO, the State Secretariat for Economic Affairs is scheduled to publish its first estimate of fourth quarter 2018 GDP. After the disappointing third quarter during which GDP contracted by 0.2%, we expect a mild recovery back towards long-term annualised potential growth rate of around 1.2%. Our own forecast of 0.3% quarterly growth in the last quarter 2018 is slightly below the consensus forecast of 0.4% according to a recent poll conducted by Bloomberg. Of the 20 institutions contributing to the poll, none expected a renewed contraction. Thus, as in Germany, a technical recession should have been avoided in Switzerland as well. Nevertheless, after decent growth between mid-2015 and summer 2018, economic dynamics have started to slow as of late: Apart from moderating demand from abroad as a result of uncertainties as regards Brexit and the trade dispute between the US and China, we also observe a cooling at the home-front: Most importantly, private consumption and construction activity have clearly softened since mid-2018.

Inflation

Swiss Life Asset Managers	Consensus
2019: 0.6 %	2019: 0.7 %
2020: 0.8 %	2020: 0.9 %

Between July 2018 and January 2019, inflation halved from 1.2% to just 0.6%. Like elsewhere, the main reason for this trend is to be found in the collapse of energy prices in the last quarter 2018. Accordingly, forecasts for inflation in 2019 underwent substantial downward revisions over the past half year. It is now consensus view that inflation stays within the lower half of the Swiss National Bank's inflation target range of between 0% and 2%. With energy prices having corrected to the upside so far in 2019, we expect inflation to stabilise around 0.5% until summer before gradually trending towards 0.9% until December of this year.

Japan
Hit by the industrial cycle

Similar to Europe, Japan has been severely hit by the downturn in the global industrial cycle. In fact, the Japanese economy ended the year 2018 on the same GDP level as in the year before, with net exports being the main culprit for stagnation. The trade balance even turned negative for the first time since 2015. Due to the lower-than-expected starting level, we significantly revised down our 2019 growth forecast to 0.7%, slightly below potential growth. On the flip side of the coin, domestic demand has remained fairly resilient, and business surveys still show a gap between good sentiment in services and a sour mood in manufacturing. Over the next few months, consumption remains supported by front-loaded purchases ahead of the consumption tax hike scheduled for October 2019. For manufacturing sentiment to improve, we would likely need to see relaxation on the trade war front (especially the avoidance of US auto tariffs) as well as signs for a stabilisation of economic activity in China.

China
First stabilisation?

China's exports surprised to the upside, rebounding to 9.1% of growth in January from a 4.4% contraction in December. However, the uptick does likely not reflect a sustainable trend, but is mainly a distortion due to the Chinese New Year, that took place earlier this year so that shipments might have been front-loaded into January. Looking forward, we expect export growth to stay subdued due to payback effects of tariff-induced front-loading to the US as well as weak PMI figures of major export partners, pointing to subdued demand. Overall, China's economy is expected to continue its slowdown into the first quarter 2019. Nevertheless, we do not expect a sharp downturn as the Chinese government will likely step up fiscal and monetary stimulus measures to support the economy. China's broad credit measure has already shown an improvement in January, with bank loans as well as local government bonds picking up, thanks to a pass-through of policy easing measures.

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