Perspectives
Economics

March 2020

Key messages

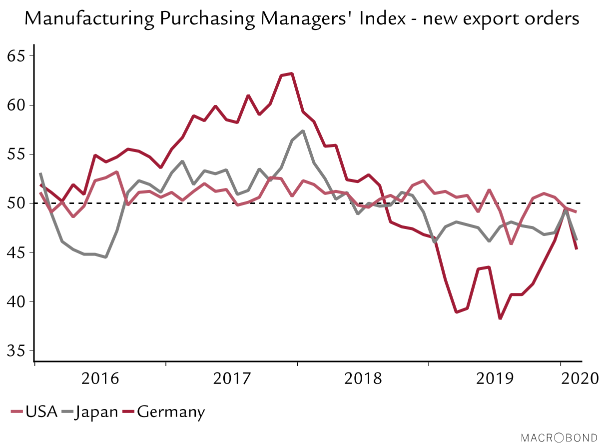
- Coronavirus: v-shaped recovery in China from current standstill remains our base case assumption
- Spill-overs from China and the current outbreak in Europe will weigh on growth in Eurozone and Switzerland
- In the short-term, lower energy prices result in lower headline inflation numbers in the US and Switzerland

Comparison of forecasts

	GDP 2020		GDP 2021		CPI 2020		CPI 2021	
	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus
US	1.7%	1.9%	1.8%	2.0% ↑	2.1% ↓	2.0% ↓	2.1%	2.1%
Eurozone	0.8% ↓	0.9% ↓	1.1%	1.2%	1.2%	1.2% ↓	1.4%	1.4%
Germany	0.5% ↓	0.9%	1.1%	1.1% ↑	1.2%	1.4% ↓	1.4%	1.5%
France	0.9% ↓	1.1% ↓	1.1%	1.2%	1.4%	1.3% ↑	1.4%	1.3%
UK	1.0% ↓	1.1%	1.3%	1.5% ↑	1.5%	1.6% ↓	1.8%	1.9%
Switzerland	1.2% ↓	1.3%	1.2%	1.3%	0.1%	0.3%	0.6%	0.7%
Japan	-0.5% ↓	0.3% ↓	0.8% ↑	0.8%	0.6%	0.6%	0.3%	0.6%
China	5.4% ↓	5.6% ↓	5.8% ↑	5.8% ↑	3.4%	3.2% ↑	2.0%	2.2%

Arrows indicate difference from previous month
Source: Consensus Economics Inc. London, 10 February 2020

Chart of the month



There is no doubt that the coronavirus outbreak will hit China's economy sharply in the first quarter 2020. We expect spill-over effects on the global economy through exports, global supply chains and tourism, particularly for Asian economies with close ties to China. Some pessimism associated with the coronavirus outbreak is already visible in the new export order sub-component of the February Purchasing Managers' Index. A decline was reported in Germany, Japan and the US. We expect a further deterioration after the recent spreading in Europe.

US
Lower oil prices a mixed blessing

GDP growth	
Swiss Life Asset Managers	Consensus
2020: 1.7 %	2020: 1.9 %
2021: 1.8 %	2021: 2.0 %

The US is the only major economy for which we did not downgrade the growth forecast following the outbreak of the coronavirus epidemic. At the time of writing, the spread of the virus is contained in the US, and the biggest negative impact will likely stem from supply chain disruptions that might prove temporary. Also, exports to China as a share of GDP are almost negligible at around 0.6% of GDP. Lower oil prices, a result of collapsing demand out of China, are a mixed blessing. On the one hand, it exacerbates the troubles of the cash-strapped shale industry and reinforces our out-of-consensus view that business investment will not pick up in 2020. On the other hand, US consumers' wallets will get a decent relief from lower gasoline prices. Cyclically, we still see the US economy in a mild downturn, reflected in our below-potential growth forecast of 1.7% for the full year. The start to the year has been rather sluggish, with weak retail sales and a decline in industrial production, partly a result of Boeing's production shutdown for the 737 MAX aircraft. Survey data have been mixed as well. Upbeat regional surveys are contrasting with a decline in the Markit manufacturing PMI (Purchasing Managers' Index) in February. Meanwhile, the services PMI surprisingly dropped to 49.5, which is below the 50-points expansion mark and thus the lowest level in more than six years.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 2.1 %	2020: 2.0 %
2021: 2.1 %	2021: 2.1 %

The significant drop in oil prices will have a bigger impact on headline inflation in the US than in other developed markets as US gasoline prices are more sensitive to crude prices since tax rates are very low. Together with a relatively strong USD, this leads us to downgrade our 2020 US inflation forecast by 10 basis points. Headline inflation likely reached a local peak in February at 2.5%, before it will likely moderate again.

Eurozone
Coronavirus on the rise

GDP growth	
Swiss Life Asset Managers	Consensus
2020: 0.8 %	2020: 0.9 %
2021: 1.1 %	2021: 1.2 %

The latest developments make it clear that the coronavirus will hit Eurozone economic activity, at least temporarily. Lower export demand from China, supply chain disruptions and a decline in tourism all negatively impact economic growth. With the virus spreading in Italy at the time of writing, counteracting measures will have an additional, direct effect there. Also, the risk of a further spreading within Europe has clearly risen. Under these circumstances, uncertainty around any forecasts is high. We base our forecasts only on information currently available, without taking guesses about where and when the virus will spread next. This approach warrants downward revisions of first-quarter GDP growth of export-oriented Germany and of now directly-affected Italy. We expect Italy's GDP to contract in the first quarter. As Italy already reported negative real GDP growth in the final quarter 2019, Italy will slide into a technical recession. A further escalation of the coronavirus situation poses a major downside risk to our Eurozone outlook. Our growth forecasts for 2020 and 2021 are currently slightly below consensus. Compared to consensus, we especially see a slower pick-up in underlying momentum in Germany. The Eurozone thus needs to find ways to support domestic demand. In the current interest rate environment, it should use its fiscal room more decisively.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 1.2 %	2020: 1.2 %
2021: 1.4 %	2021: 1.4 %

Growth dynamics are insufficient to exert upward pressure on inflation. Only six member states with a weight of less than 6% of the Eurozone's GDP currently report inflation rates of 1.8% or above. Wage growth, the most important driver of domestic inflationary pressures, has started to moderate as of late. In the short-term, this might be compensated by rising import prices due to past euro depreciation.

Germany
Recovery further postponed

GDP growth	
Swiss Life Asset Managers	Consensus
2020: 0.5 %	2020: 0.9 %
2021: 1.1 %	2021: 1.1 %

The February issue of the consensus forecasts published by Consensus Economics Inc. highlights the uncertainties around the outlook for Europe's biggest economy. According to this poll, the forecasts for 2020 GDP growth range from 0.2% to 1.4%. This is an unusually wide divergence among the 27 institutions participating in the survey. With our current forecast of 0.5% growth, we belong to the most prudent fifth of the sample. Our forecast is down from 0.6% previously, due to a negative impact of the coronavirus. Incoming business sentiment indicators do not yet fully reflect the damaging impact of the coronavirus outbreak. In our view, the tentative recovery of Germany's industrial sector will at least be temporarily interrupted, meaning that the manufacturing sector's Purchasing Managers' Index is set to remain in contraction territory for a few more months. According to the most recent ifo survey, business expectations in the trade and services sectors declined in February. If the coronavirus remains a temporary phenomenon, Germany's economy is likely to experience a v-shaped recovery in the second half of 2020 at the latest, kick-started by low global manufacturing inventory levels. Nevertheless, we expect sub-potential growth and elevated uncertainty in the corporate sector to result in a gradual rise in unemployment in the course of 2020. Germany has ample fiscal room to manoeuvre, but the lack of political leadership increasingly appears to be an additional drag on economic sentiment.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 1.2 %	2020: 1.4 %
2021: 1.4 %	2021: 1.5 %

Headline annual inflation is likely to reach 1.7% in February, the highest rate since April 2019, when inflation temporarily exceeded 2%. In our base case, the February reading marks the peak over the entire forecast horizon until end of 2021. We expect inflation to drop below 1.0% for the period between April and October 2020.

France
Labour market reforms bear fruit

GDP growth	
Swiss Life Asset Managers	Consensus
2020: 0.9 %	2020: 1.1 %
2021: 1.1 %	2021: 1.2 %

Real GDP contracted by –0.1% in the final quarter 2019, mainly driven by an inventory drop. Therefore, "inherited growth", or the resulting annual growth number through 2020 that we would observe if each quarter's growth were zero this year, fell to just 0.2%. We expect a rebound in the inventory component to contribute positively to growth in the first half 2020. Meanwhile, French services and luxury goods industries are likely to suffer from falling demand related to the uncertainties caused by the coronavirus. The net impact resulting from the above-mentioned developments is slightly negative in our view and warrants a downward revision to the 2020 GDP growth forecast from 1.0% to 0.9%. On a more encouraging note, the French unemployment rate continued to decline in the final quarter 2019. At 7.9%, it is now at its lowest level since 2008. Apparently, labour market reforms undertaken by president Macron and his predecessor Hollande are bearing fruit. According to the Banque de France, business sentiment improved in February, recovering from a temporary hit by the strikes in December 2019. Consumer confidence improved steadily over the past twelve months, suggesting robust private domestic demand. In contrast to 2019, the fiscal impulse in France is expected to be negative in 2020, according to IMF projections. Yet, fiscal measures to support businesses remain a likely response, should the external shock in the form of the coronavirus become a more significant drag than currently assumed.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 1.4 %	2020: 1.3 %
2021: 1.4 %	2021: 1.3 %

We leave the inflation forecast unchanged as the pass-through of lower crude oil prices is comparably small in France due to the high tax share in the retail price for heating oil and gasoline. Even if there was a small impact on headline inflation stemming from falling energy prices, this would be offset by higher import prices for other goods due to the weak euro.

UK
All eyes on the budget

GDP growth

Swiss Life Asset Managers	Consensus
2020: 1.0 %	2020: 1.1 %
2021: 1.3 %	2021: 1.5 %

The UK economy has started well into 2020, confirming our view of a cyclical turning point after a lost year in 2019. The latest retail sales and employment growth data came in well above expectations. Also, Purchasing Managers' Indices (PMI) shrugged off any coronavirus fears in their February release as manufacturing sentiment increased further, driven by higher output and new orders, while the services PMI stabilised well within expansionary territory. The UK is indeed less exposed to external demand from China than the Continent, but the current coronavirus outbreak in Italy and the extended weakness of the German economy still threaten to spill over to the UK. This is why we have revised down our 2020 GDP growth forecast marginally to 1.0%. This is still higher than growth in Germany or France, for the simple reason that the UK is the only major European economy besides the Netherlands to pursue significant fiscal stimulus in 2020. The extent and the exact measures will be revealed on 11 March at the presentation of the budget. It is generally expected that measures will include a "tax cut" by raising the threshold to pay National Insurance, spending targeted at "left-behind regions" as well as infrastructure investment. Spending increases are now more likely than before as Sajid Javid has been pushed out of the government and replaced by the allegedly more "expansionary-minded" new Chancellor Rishi Sunak.

Inflation

Swiss Life Asset Managers	Consensus
2020: 1.5 %	2020: 1.6 %
2021: 1.8 %	2021: 1.9 %

In line with our expectation, headline inflation rebounded strongly in January, from 1.3% to 1.8%, indicating that the previous month's print was an outlier. We expect, however, somewhat weaker headline inflation for the rest of the year. Lower gasoline prices will likely weigh on the February print, and wage growth has been moderating since mid-2019, indicating less domestic inflationary pressure for the time being.

Switzerland
Renewed exchange rate concerns

GDP growth

Swiss Life Asset Managers	Consensus
2020: 1.2 %	2020: 1.3 %
2021: 1.2 %	2021: 1.3 %

Assessing short-term current growth dynamics in Switzerland is extremely difficult. In contrast to most other economies, we still do not have an official estimate for fourth-quarter 2019 GDP growth. Ahead of the release of preliminary data on 3 March, we lowered our estimate for fourth quarter GDP growth from 0.25% to 0.15% in response to disappointing data from neighbouring economies. Meanwhile, a poll conducted at the start of the year in the machinery, electrical and metal industry, the sector which was hit hardest by weaker global trade dynamics, suggests a stabilisation or even a slight improvement in business activity. Yet, a turnaround may be further postponed. The impact of the coronavirus via export demand and tourism warrants a downward revision of our growth forecast for the first quarter 2020. Foreign exchange rate developments are a further channel through which we expect the epidemic to have a negative economic impact. Relative to the euro, the Swiss franc has appreciated by more than 5% from year ago levels. It remains to be seen whether this appreciation proves to be sustainable. As we assume a v-shaped rebound in activity in China during the second quarter, most of the losses in manufacturing output could be offset later in the year. Losses in the services industries, and most importantly in tourism, are unlikely to be fully compensated.

Inflation

Swiss Life Asset Managers	Consensus
2020: 0.1 %	2020: 0.3 %
2021: 0.6 %	2021: 0.7 %

The novel coronavirus outbreak led to lower energy prices and lower import prices due to a stronger Swiss franc. Both are likely to result in weaker headline inflation numbers in the short-term. Depending on the future development, bottlenecks in the global supply chain could result in higher producer and consumer prices later in the year.

Japan
Technical recession likely

GDP growth

Swiss Life Asset Managers	Consensus
2020: –0.5 %	2020: 0.3 %
2021: 0.8 %	2021: 0.8 %

A stream of negative news has led to a massive downward revision of our Japan 2020 GDP forecast from 0.3% to –0.5%. First, Japanese GDP numbers for the fourth quarter came as a shocker. Despite encouraging news from business surveys that Japan was digesting the October 2019 consumption tax hike relatively well, GDP dropped by 1.6% quarter-on-quarter, more than we and any of the 24 economists polled by Bloomberg had expected. Consumers essentially went on strike, and business investments plunged as well. If we compare the boom-and-bust cycle in consumption just before and after the tax hike, the 2019 tax hike was almost as severe as the 2014 hike, even though the latter was less steep. Second, the coronavirus is spreading to an extent in Japan that has started to spook the population as well as markets, with seemingly unrelated cases popping up across the country. At the time of writing, Japan was the fourth-most affected country in terms of confirmed coronavirus cases. This is adding to an already bleak outlook due to weak external demand and a drop of tourists out of China. In February, Purchasing Managers' Indices declined significantly in both the manufacturing and services sector, driven by the forward-looking new orders components. Hence, we expect Japan to be in a technical recession, defined as two consecutive quarters with declining GDP.

Inflation

Swiss Life Asset Managers	Consensus
2020: 0.6 %	2020: 0.6 %
2021: 0.3 %	2021: 0.6%

Japanese headline and core inflation have been on an upward trend since October 2019, when then consumption tax was raised. It thus seems that higher taxes are only very gradually passed to consumer prices, as compared to 2014 when the tax hike led to an immediate spike in inflation. We expect headline inflation to fluctuate between 0.5% and 1.1% in the first half of this year before moderating again due to a lack of inflationary pressure as a result of weak economic momentum and sluggish wage growth.

China
Coronavirus hits first quarter

GDP growth

Swiss Life Asset Managers	Consensus
2020: 5.4 %	2020: 5.6 %
2021: 5.8 %	2021: 5.8 %

The coronavirus outbreak is likely to bring a large slump in China's first-quarter GDP. The current coronavirus outbreak will likely have a much larger impact on China's economy compared to the 2003 SARS outbreak. First of all, the fear factor among Chinese citizens has a dramatic effect on people's mobility, leading to a slump in tourism, retail sales, entertainment activities etc. Hence, the services sector, which nowadays accounts for a much larger share of GDP compared to 2003, will get a substantial hit. Second, Chinese measures to limit the spreading have been much larger. 20 provinces, accounting for 77% of economic output, extended the Chinese New Year holiday by an additional week. Moreover, migrant workers were requested to complete a quarantine period of two weeks, meaning that production will only gradually be resumed. Therefore, we expect China's first-quarter year-on-year GDP growth to slow down to 3.8%, from 6% previously. However, as we expect the number of infected patients to peak in the first quarter this year, the slump should be followed by a v-shaped rebound in the second quarter due to pent-up demand. As the rebound will not fully compensate the losses suffered in the first quarter, especially in the services sector, we revise down our full-year 2020 GDP forecast to 5.4%, from 5.9% previously.

Inflation

Swiss Life Asset Managers	Consensus
2020: 3.4 %	2020: 3.2 %
2021: 2.0 %	2021: 2.2 %

Inflation in January soared to 5.4%, mainly driven by the difference of timing of the Chinese New Year, which took place in February in 2019 but in January this year. As this distortion should reverse in February, we expect inflation to decelerate in the upcoming reading. Meanwhile, the impact of the coronavirus should be rather muted. Disruptions to transport and supply shocks exert upward pressure on prices, while weak demand for recreation, transportation and housing should counterbalance this effect.

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