Perspectives
Economics

SwissLife
Asset Managers

April 2020

Key messages

- In our base case, the world economy recovers in the second half 2020 in a U-shaped form from recession
- China: coal consumption, which can be used as a proxy for industrial activity, rises continuously
- Coronabonds? The Eurozone will likely need to resort to some form of risk sharing

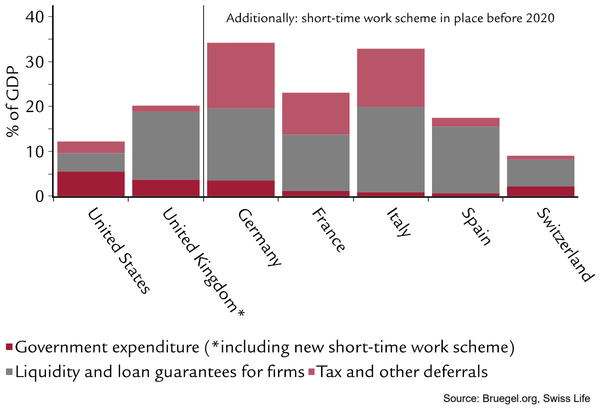
Comparison of forecasts

	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	-1.0% ↓	1.6% ↓	3.2% ↑	2.0%	1.6% ↓	1.8% ↓	2.1%	2.1%
Eurozone	-2.0% ↓	0.6% ↓	2.8% ↑	1.3% ↑	0.6% ↓	1.1% ↓	1.4%	1.4%
Germany	-1.7% ↓	0.5% ↓	2.6% ↑	1.2% ↑	0.7% ↓	1.3% ↓	1.4%	1.5%
France	-1.6% ↓	0.8% ↓	2.5% ↑	1.2%	0.8% ↓	1.2% ↓	1.4%	1.1% ↓
UK	-1.4% ↓	0.8% ↓	2.5% ↑	1.3% ↓	1.3% ↓	1.5% ↓	1.8%	1.8% ↓
Switzerland	-1.3% ↓	1.0% ↓	3.1% ↑	1.4% ↑	-0.3% ↓	0.2% ↓	0.6%	0.7%
Japan	-3.1% ↓	-0.7% ↓	2.3% ↑	1.1% ↑	0.3% ↓	0.4% ↓	0.3%	0.5% ↓
China	3.8% ↓	5.2% ↓	8.4% ↑	6.1% ↑	3.6% ↑	3.4% ↑	2.0%	2.2%

Arrows indicate difference from previous month
Source: Consensus Economics Inc. London, 9 March 2020

Chart of the month

Estimated fiscal response to pandemic



With the global spread of the coronavirus and the implementation of strict containment measures, most economies will experience an enormous drop in economic output. Fiscal and monetary authorities have already announced generous stimulus measures, which include new discretionary spending (dark red bars) as well as liquidity provisions and loan guarantees for companies (grey bars). Besides these measures, short-time work schemes already in place before 2020 are key to cushion the impact on labour markets. The UK introduced such a scheme in March 2020. With no such scheme in place, the US will likely experience a sharp increase in unemployment despite its $2 trillion spending package.

US
The sudden recession

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -1.0 %	2020: 1.6 %
2021: 3.2 %	2021: 2.0 %

Since the previous edition of this publication, the US has moved from one of the least affected developed economies to the global hotspot of the coronavirus pandemic. As test capacities have been finally ramped up, US data on the coronavirus have become more reliable, showing – at the time of writing – unabated exponential growth in new infections. In terms of infection dynamics, the US is lagging Italy and Switzerland by about 15 and 9 days, respectively, implying that even more severe lockdown measures might become necessary. We thus expect an immediate, sharp, but short-lived recession in the first half of this year. Contrary to European countries, there is no nationwide short-time work scheme in place in the US. Hence, companies affected by lockdowns have resorted to mass layoffs. In the last week of March and the first week of April, 10 million workers (6% of the employed workforce) claimed unemployment benefits, the fastest increase seen in history. Hence, we would not be surprised to see the unemployment rate peaking between 10 and 15% in April and May before rapidly declining again if lockdown measures are eased as expected. It will, however, not be a swift return to normal. In our base case, we expect some supply-side restrictions in the services sector to remain in place, while fiscal policy is unlikely to fully compensate for the demand shortfall. Despite the expected gradual recovery in the second half of the year, we only foresee output to return to pre-crisis levels in early 2021.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 1.6 %	2020: 1.8 %
2021: 2.1 %	2021: 2.1 %

The collapse of the oil price might push headline inflation as low as 0.8% in April, down from a January peak of 2.5%. Meanwhile, core inflation surprised to the upside in January and February, and we only expect a minor decline to around 2.1-2.3% over the next months. We think that the disinflationary demand shortfall might be compensated by higher inflationary pressure from the supply shock, at least in the near term.

Eurozone
Next stop: coronabonds?

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -2.0 %	2020: 0.6 %
2021: 2.8 %	2021: 1.3 %

The coronavirus pandemic is not only causing extraordinary human suffering but will also bring an unprecedented drop in economic activity in the first half of this year. No hard data is available at the time of writing, but survey data for the Eurozone paint a bleak picture. In March, the Purchasing Managers' Index (PMI) for services dropped to 26.4 points, a contraction never seen in the history of the series (i.e. well below the low of 40.9 registered during the 2009 financial crisis). The manufacturing PMI held up better at 44.5 points but should deteriorate further in April due to falling external demand and the fact that Spain and Italy decided to shut down all non-essential industrial activity at the end of March. In our base case, we expect activity to rebound in May and June, assuming that lockdown measures were successful enough to be gradually lifted. Nevertheless, the economic damage, especially in Italy, will be enormous and fiscal sustainability issues in this highly indebted country will soon arise. So far, monetary policy has provided an effective backstop to widening peripheral bond spreads, with the European Central Bank stepping up asset purchases and relaxing the issue limits on bond purchases. Medium-term, however, the Eurozone will likely need to resort to some form of risk sharing to avoid the risk of a "euro crisis 2.0", be it through established instruments such as the European Stability Mechanism (ESM) or common bond issuance (so-called eurobonds or "coronabonds").

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.6 %	2020: 1.1 %
2021: 1.4 %	2021: 1.4 %

The economic havoc caused by the coronavirus pandemic will make it even harder for monetary policymakers to achieve their inflation target. While supply shortages of certain products might cause upward pressure on inflation, this will be outweighed by lower energy prices in the near-term and a widening output gap in the medium term, in our view.

Germany
Corona spread ousts black zero

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -1.7 %	2020: 0.5 %
2021: 2.6 %	2021: 1.2 %

At little over 6000 cases the German Robert Koch Institute raised the threat level for Germany to "high" on 17 March. Cases have since surged further. Albeit avoiding a total lockdown, on 22 March Germany prohibited gatherings of more than two people until at least 20 April. These developments have prompted us to sharply revise down our 2020 GDP forecast as we now expect massive output contractions in March and April. Peak to trough, the hit will by far exceed the one seen during the global financial crisis. Short-time work will help to cushion the effect on unemployment, which we, nevertheless, expect to increase. The March ifo survey showed the largest ever drop in business expectations over the next six months. The decline was broad-based across sectors with food, beverage and toilet articles within retail sales being the exception. The services sector was hit most, particularly travel agencies and tour operators as well as accommodation and food services. Given this unprecedented economic shock, Germany's finance minister Scholz suggested already on 13 March that the black zero may have to go. On 25 March the lower house suspended the debt brake and approved a €750 billion stimulus package consisting of €600 billion in loan guarantees (around 10% of GDP) and €120 billion in new discretionary spending (3.5%). The massive policy stimulus will support the gradual recovery in the second half of 2020.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.7 %	2020: 1.3 %
2021: 1.4 %	2021: 1.5 %

As oil prices crashed, March inflation dropped to a four-months-low of 1.3%, down from 1.7% in February. We expect price pressure to remain low during the quasi-shutdown of the economy. However, the massive policy stimulus together with potential supply shortages could exert upward pressure on inflation in the second half of the year.

France
35% of activity is being missed

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -1.6 %	2020: 0.8 %
2021: 2.5 %	2021: 1.2 %

France is hit much harder by the coronavirus pandemic than neighbouring Germany. In certain regions of eastern France, the sheer number of hospitalisations has overwhelmed the health care system, which has most likely contributed to the above-average case fatality rate of more than 6% currently. The government reacted with far-reaching lockdown measures as well as with a significant fiscal package. The latter includes government spending (including for a short-time work scheme and for postponement of tax payments) and state guarantees for new company loans (ceiling of EUR 300 bn). During recessions, France is usually faring better than other European economies due to the large share of its services and government sector. While the latter is a stabilising factor indeed, the current lockdown is hurting the services sector disproportionately. The Purchasing Managers' Index for the services sector fell to 27.4 in March, lower than in Germany, Japan, the US or the UK. As there is no historical precedent to estimate the effect of widespread lockdowns on GDP, there is currently huge uncertainty regarding any point forecast. Our working assumption was that GDP in European economies might drop to 80-90% of normal levels in March and April, which could still turn out to be too optimistic. The French statistical office INSEE recently published a preliminary estimate that activity in France was in fact running, at the end of March, at just 65% of pre-crisis levels.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.8 %	2020: 1.2 %
2021: 1.4 %	2021: 1.1 %

The bigger-than-expected drop of the oil price triggered a significant downward revision of our 2020 full-year inflation forecast to 0.8% from 1.4%. We expect, however, inflation to normalise to an average level of 1.4% in 2021, assuming that a gradual U-shaped economic recovery kicks in in the second half of this year, gradually narrowing the output gap in France.

UK
No man is an island

GDP growth

Swiss Life Asset Managers	Consensus
2020: -1.4 %	2020: 0.8 %
2021: 2.5 %	2021: 1.3 %

For some time, it seemed that the UK might use a different, less radical way to cope with the coronavirus pandemic. Eventually, the government needed to resort to the same lockdown measures that were taken on the Continent as it became clear that the healthcare system would otherwise be overwhelmed. The fiscal response was impressive, with targeted measures including a job retentions scheme, broadening of unemployment benefits to the self-employed, loan guarantees, tax deferrals and outright spending measures. The government attached a price tag of 18% of GDP to the package, but the ultimate fiscal cost will be determined by the length and depth of the recession. We expect activity to drop by at least 12% in March and April, followed by a recovery in May and June if lockdown measures can be gradually eased. The crisis complicates several issues in the UK: First, it hits consumers at a time when the savings rate is already low in historical comparison (5%, versus around 7% before the 2009 financial crisis). Second, the generous fiscal package increases external financing needs as the UK is running a chronic current account deficit (sterling was among the worst-performing major currencies year-to-date). Third, EU-UK negotiations are likely to take a backseat as policymakers are absorbed by the pandemic. More time is likely needed, but Boris Johnson is still ruling out an extension of the deadline. Hence, uncertainty regarding trade relations will remain elevated in 2020.

Inflation

Swiss Life Asset Managers	Consensus
2020: 1.3 %	2020: 1.5 %
2021: 1.8 %	2021: 1.8 %

We lowered our 2020 inflation forecast on the back of lower energy prices to 1.3% from 1.5%. Core inflation however, is likely to hover between 1.5% and 2.0% this year. While the recession is likely to reinforce the trend of moderating wage pressure, the depreciation of sterling and supply constraints should add positively to underlying inflation, with an overall neutral effect in our base case.

Switzerland
The safety net is in place

GDP growth

Swiss Life Asset Managers	Consensus
2020: -1.3 %	2020: 1.0 %
2021: 3.1 %	2021: 1.4 %

For the time being, we have hardly any real economic data available to properly assess the economic damage of the pandemic and of the necessary lockdown measures. In our base case, we assume that developed economies will see a similar timespan as China between local outbreak and the relaxation of subsequently imposed lockdown measures. If China can be used as a blueprint, we expect a gradual pick-up in activity from May onwards. Until then, we expect the output of Switzerland's economy to drop by 12%. This would imply a real GDP drop of 1.3% on average in 2020 from year ago levels. The main risks to our scenario are an even sharper drop until May, a second wave of the pandemic in Asia or a renewed debt crisis in Europe caused by the catastrophic situation in Italy and Spain. Meanwhile, we think that Switzerland's authorities have spun an efficient safety net to limit the risk of a longer-lasting demand shock. Nevertheless, the damage that is already visible leaves no doubt that Switzerland is currently in recession. Data published by SECO (State Secretariat for Economic Affairs) allow a first estimate of the short-term impact on the labour market: despite an extensive short-term work compensation programme, the cantonal labour offices registered a sharp increase in people applying for unemployment benefits. We expect the unemployment rate to have risen to 2.9% in March from 2.5% in February, when the world economy was still a different animal.

Inflation

Swiss Life Asset Managers	Consensus
2020: -0.3 %	2020: 0.2 %
2021: 0.6 %	2021: 0.7 %

Compared with the start of the year, heating oil is currently 25% cheaper, which by itself lowers Switzerland's consumer price index by around 0.2%. Uncertainty as regards the short-term inflation outlook is high, but we think that the disinflationary effect of discounting by retailers is likely to outweigh rising prices for goods and services which became temporarily scarce.

Japan
Is the worst already over?

GDP growth

Swiss Life Asset Managers	Consensus
2020: -3.1 %	2020: -0.7 %
2021: 2.3 %	2021: 1.1 %

Japan was hit early by the coronavirus pandemic. In the last edition of this publication, Japan was the fourth-most affected country in terms of infections but has since even moved out of the top 30. This was achieved with surprisingly few restrictions to daily life. The closing of schools was the most dramatic move. Otherwise, the government mostly issued recommendations, from avoiding unnecessary travel to cancelling large events. Activity data up until February turned out to be surprisingly good, with both retail sales and industrial production recovering from the slump experienced after the October 2019 consumption tax hike. Nevertheless, the outlook has since worsened. First, the massive spread of the virus in other developed economies will weigh on external demand in the second quarter. Second, the postponement of the Tokyo Summer Olympics into 2021 is a drag on third-quarter growth. Third, infections have recently started to re-accelerate notably in the Tokyo area, which might trigger lockdown measures in Japan's economic powerhouse. While we previously assumed that the economic pain will be centered to the first quarter, it now looks likely that it will be more evenly spread across the first and second quarter, with a neutral effect on our full-year GDP forecast.

Inflation

Swiss Life Asset Managers	Consensus
2020: 0.3 %	2020: 0.4 %
2021: 0.3 %	2021: 0.5 %

As in other economies, we revised Japanese headline significantly on the back of lower energy prices and now expect inflation to average 0.3% in both 2020 and 2021. Interestingly, the Japanese yen has only appreciated marginally year-to-date, while the spring wage negotiations (so-called shunto) still point towards modest wage gains for Japanese workers. Hence, we do not expect this recession to trigger renewed deflation in Japan for the time being.

China
Tepid economic recovery

GDP growth

Swiss Life Asset Managers	Consensus
2020: 3.8 %	2020: 5.2 %
2021: 8.4 %	2021: 6.1 %

China's economy suffered a slump as the draconian lockdown measures to contain the spreading of the coronavirus paralyzed economic activity. All economic indicators fell to levels never seen before, with fixed asset investments contracting by 24.5%, industrial production plunging by 13.5% and retail sales dropping by 20.5% in January and February from a year earlier. This will translate into a substantial economic contraction in the first quarter this year, leading us to sharply revise down our full year GDP growth forecast to 3.8% from 5.4% previously. As new domestic coronavirus cases officially approach zero, the government is lifting lockdown restrictions and has started to move towards a pro-growth stance. High frequency indicators such as coal consumption, which can be used as a proxy for industrial activity, are continuously improving. However, the recovery in consumption remains tepid, as indicated by weekly car sales that remain at weak levels. A potential further increase in unemployment could dent consumption over the course of the year. Moreover, the pandemic has caused a global recession, which dampens demand for Chinese goods. Therefore, we expect only a gradual recovery of the Chinese economy in the second quarter this year.

Inflation

Swiss Life Asset Managers	Consensus
2020: 3.6 %	2020: 3.4 %
2021: 2.0 %	2021: 2.2 %

February inflation remained elevated at 5.2%, driven by rising food prices. Food prices accelerated due to food hoarding as well as transport restrictions in order to limit the spreading of the coronavirus. As new coronavirus cases decreased significantly, restrictions are being lifted. This together with the slump in energy prices should lead to a decline in inflation in the upcoming months.

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