Perspectives
Economics

SwissLife Asset Managers

May 2018

Key messages

- US core inflation to exceed 2% for the rest of the year
- Global M&A data suggest continued interest in doing business in the United Kingdom
- In Switzerland, inflation is set to climb above 1% later this quarter

Comparison of forecasts

	GDP growth 2018		GDP growth 2019		Inflation 2018		Inflation 2019	
	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus
US	2.5%	2.8%	2.2%	2.6%	2.5%	2.5% ↑	2.0%	2.1%
Eurozone	2.1% ↓	2.4%	1.4%	1.9%	1.4% ↓	1.5%	1.3%	1.5%
UK	1.3%	1.5% ↓	1.0%	1.5%	2.3%	2.6%	2.0%	2.2%
Switzerland	2.0%	2.2% ↑	1.3%	1.8% ↑	1.0% ↑	0.8%	0.8%	1.0%
Japan	1.5%	1.4%	1.1%	1.1%	1.6%	1.0%	0.4%	1.0% ↓
China	6.5%	6.6% ↑	6.1%	6.4% ↑	2.0% ↓	2.3%	2.1% ↓	2.3%

Arrows indicate difference from previous month
Source: Consensus Economics Inc. London, 09.04.2018

Chart of the month

The Purchasing Managers' Index (PMI) for the manufacturing sector is a reliable gauge of current quarter dynamics: In the Eurozone, swings in the PMI explain almost 70% of the variation of quarterly GDP growth rates (R^2 0.69). In the past, the PMI was a timely indicator to understand the severity of the great recession at the end of 2008, but it also signalled the recovery which started in the second quarter 2009. More recently, the index correctly anticipated the synchronous upswing of the global economy by mid-2016. The recent drop in PMI readings confirms our sub-consensus growth forecast for the Eurozone.

US
War of words at the forefront

GDP growth	
Swiss Life Asset Managers	Consensus
2018: 2.5 %	2018: 2.8 %
2019: 2.2 %	2019: 2.6 %

President Trump said that the US was close to renegotiating NAFTA with Canada and Mexico and at the same time threatened again to pull out of the free trade agreement. Similarly, the war of words with China on trade and tariffs has already taken several turns. Financial markets as well as economic actors around the globe are worried and confused as to where this will be heading. All that chatter distracts attention from economic data. After GDP growth in the fourth quarter 2017 was revised slightly to the upside, the first quarter of this year will once again exhibit a temporary slowdown of activity. Since this weakness in the first quarter has almost become a tradition over past years, the odds are high that seasonal adjustment factors applied to first quarter data are not appropriate. Consumer spending above all disappointed in January and February as tax refunds are slow to be paid out to private households. Retail sales numbers for March were sturdy and we are generally not worried about growth perspectives in the current year. The rising fiscal deficit will bolster economic dynamics also in 2019.

Inflation	
Swiss Life Asset Managers	Consensus
2018: 2.5 %	2018: 2.5 %
2019: 2.0 %	2019: 2.1 %

Rising import prices, not least driven by a cheap US Dollar, only slowly feed into goods price inflation. While core services inflation has been fluctuating between 2.5% to 3.1% since the year 2012, core goods price inflation has been in negative territory ever since early 2013. This pattern should not change anytime soon even though core goods prices have turned the corner and will be heading towards the zero line throughout this year. Core inflation exceeded 2% in March and will stay there for the rest of the year.

Eurozone
Capex to strengthen

GDP growth	
Swiss Life Asset Managers	Consensus
2018: 2.1 %	2018: 2.4 %
2019: 1.4%	2019: 1.9 %

Since December 2017 when the Purchasing Managers' index for manufacturing industries reached a high of 60.6 points, the trend has been to the downside. At a level of 56.6 in March 2018, however, the index for the currency union as a whole still points to a sturdy overall growth figure in the first quarter of this year. Yet, some caution seems warranted indeed and we stick to the view that above-potential growth rates are bound to decline towards a more sustainable level throughout this year and into the next. Industrial production data surprised to the downside in several member countries for the month of February. However, latest survey results point to strong fixed investment plans by companies across the region with positive implications for the cyclical outlook. Investment plans firmed considerably in Italy and Spain, remain strong in France and softened somewhat in Germany. Export dynamics still appear sturdy. On the political front, Emmanuel Macron is engaged in a battle with labour unions over structural reforms in France, while the forming of a coalition in Italy is still open.

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

The inflation rate for March was reported a bit lower than our own forecast foresaw. This also caused the slight downward revision of the full-year projection of the headline inflation rate to 1.4% from 1.5% previously. The recent rise of energy prices could translate into a higher reading for April, but the half-official target inflation rate of the ECB of 1.7% will hardly materialise any time soon. A stronger Euro is a dampening factor for price pressures going forward.

UK
Forecasting mission impossible

GDP growth	
Swiss Life Asset Managers	Consensus
2018: 1.3 %	2018: 1.5 %
2019: 1.0 %	2019: 1.5 %

Perhaps it should not come as a big surprise that economic data out of the United Kingdom send contradictory messages in times of negotiations on how to exit the EU. Certainly, fears that Brexit would immediately result in chaos and outright recession for the UK economy were exaggerated. So far, the economy escaped from more adverse developments thanks to the weakening of the Pound in the aftermath of the EU referendum and the synchronous global upswing which started at the same time. Over the past quarters, UK exporters were clearly benefitting from a boost in competitiveness. Meanwhile, a temporary surge in inflation meant stagnating real disposable incomes which held consumers back from big ticket purchases. While sentiment indicators suggest that business confidence suffered from Brexit related uncertainty, actual corporate behaviour appears less desperate: Net job creation continued into the first quarter 2018, keeping the unemployment rate at a low for more than 40 years. Global mergers and acquisition (M&A) data suggest continued appetite of firms to do business in the UK: 10% of all M&A activity so far in 2018 involved UK firms.

Inflation	
Swiss Life Asset Managers	Consensus
2018: 2.3 %	2018: 2.6 %
2019: 2.0 %	2019: 2.0 %

March data for inflation will be published on April 18, one day after the deadline for this text. According to a Bloomberg poll, the consensus forecast for the monthly change in the consumer price index was 0.3%. This matches our own assumption and translates into an annual inflation rate of 2.6%, the lowest since March 2017. If anticipated correctly, the numbers confirm that inflation in the UK is steadily trending lower as the impact of higher import prices after the EU referendum is gradually fading.

Switzerland
Back to inflation of 1% or more

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

Hotel overnight stays rose by around 5% in the first two months of the year, compared with the same period in 2017. Besides superb skiing conditions, demand for Switzerland's tourism services was strongly supported by the weakening of the Swiss Franc versus the Euro after the election of Emmanuel Macron as French president in May 2017. Compared with 2017, the Swiss Franc's external value fell 6% on a trade-weighted base. And, up until now, this trend continues in 2018: Currently, the Franc's trade weighted value is another 1.2% below last year's average. The resulting effects on Switzerland's macroeconomic data are as expected so far: The corporate sector is willing to invest increasingly at home rather than continue outsourcing production. As a consequence, the unemployment rate dropped to 2.9%, or its lowest level since May 2012. While the consensus forecast for 2018 and 2019 rose slightly from the previous month, we remain comparably prudent with our forecasts: Available cyclical indicators like purchasing managers indices suggest that global dynamics have started to moderate slightly heading into the second quarter 2018.

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

One effect of the weaker Swiss Franc is the return of inflation rates into positive territory. As per March 2018, annual inflation stood at 0.8% from where we expect it to climb above 1% until June. Rising energy prices suggest that inflation risks are even skewed to the upside in the short-term. This is a remarkable development compared with the past seven years, during which average annual inflation was -0.2%. As a consequence, the consumer price index today stands 2 percentage points below its peak seen in May 2011.

Japan
A broadening recovery

Like elsewhere in developed economies, Japan's most reliable cyclical indicators suggest a slight moderation in economic dynamics over the past two months. Nevertheless, a substantial additional fiscal package put in place for 2018 and evidence of improving sentiment among less export-dependent small and medium sized firms suggest that the longest economic expansion in almost 30 years is unlikely to end this year. The quarterly Tankan survey revealed a stable overall sentiment in the group of small manufacturers with the survey's subcomponent asking for firms' business expectations rising to the highest level since June 1991. Meanwhile, the weakening political support for prime minister Abe is worth mentioning as current ultra-loose monetary policies conducted by the Bank of Japan are part of "Abenomics", Abe's campaign to reflate Japan's economy. Most recently, financial markets have started to anticipate a change in monetary policy, resulting in the firming of Japans' Yen.

China
Firm start into 2018

GDP growth was firm at the beginning of 2018. The yearly growth rate remains at 6.8% in the first quarter. The composition points towards a gradual rebalancing of the economy: consumption was an important growth driver whereas investment contributed less. Going forward, we expect growth to decelerate. Authorities have signalled their tolerance for a gradual slowdown. At the same time they slowly shift their focus towards higher financial stability and environmental quality. This translates into tighter regulations in these areas. Disappointing activity data for March supports our view of a gradual slowdown. Moreover, we see two dampening impacts for trade: First, the trade-weighted Renminbi has appreciated markedly since mid-2017. Second, trade relations with the US are tense. We expect that negotiations will take place and both sides will make some concessions. Nevertheless, it is likely that some of the announced tariffs will be imposed.

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

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