

June 2019

## Key messages

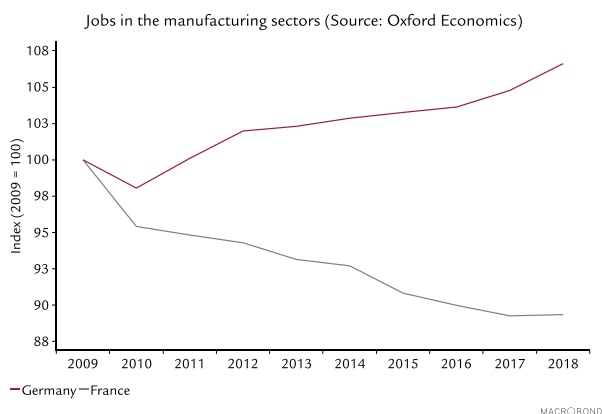
- After robust first quarter growth, the global economy remains in the grip of the trade war
- Germany: Short-term pessimism seems overdone; yet concerns about medium-term outlook justified
- Acceleration of Swiss GDP through the first quarter not sustainable in our view

## 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	2.4% ↑	2.6% ↑	1.8%	1.9% ↓	1.9%	1.9% ↑	2.2%	2.1% ↓
Eurozone	1.2% ↑	1.1%	1.2%	1.3% ↑	1.4%	1.4% ↑	1.6%	1.4%
Germany	1.1%	0.8%	1.3% ↑	1.5%	1.5% ↑	1.5% ↑	1.7% ↑	1.6%
France	1.2%	1.3%	1.2%	1.3%	1.2% ↑	1.2%	1.6% ↑	1.5% ↑
UK	1.4% ↑	1.4% ↑	1.3% ↑	1.4% ↓	1.9%	2.0%	2.0%	2.0% ↓
Switzerland	1.3% ↑	1.2%	1.4% ↓	1.5%	0.7%	0.6%	0.8%	0.8%
Japan	0.6%	0.6%	0.4%	0.4% ↓	0.7%	0.6%	1.1%	0.9% ↓
China	6.1% ↓	6.3% ↑	6.0%	6.1%	2.3% ↑	2.3% ↑	2.2%	2.2% ↑

Arrows indicate difference from previous month  
Source: Consensus Economics Inc. London, 13 May 2019

## Chart of the month



With this edition, we introduce the individual coverage of Germany and France in addition to our comments on the Eurozone. Our chart of the month illustrates that the labour markets of these two economies went into two completely different directions over the last ten years since the Great Financial Crisis. While Germany's economy created 7% new jobs in the manufacturing sector since 2009, France lost 11%. It's a tale of early and effective labour market reforms in Germany, the beneficiary effects of a weak currency for German exporters and the difficulty for the European Central Bank to implement a monetary policy that fits all Euro member states.

## US

### In the grip of the trade war

#### GDP growth

Swiss Life Asset Managers	Consensus
2019: 2.4%	2019: 2.6%
2020: 1.8%	2020: 1.9%

The US got off to an excellent start in 2019. The surprisingly strong GDP growth in the first quarter led us and most peers to revise up the growth forecast for the full year. Maybe the year even started “too well” for the US economy and equity markets, as the benign backdrop might have motivated President Trump to raise the ante in the trade conflict with China. The recent escalation will make it very difficult to find any near-term solution in the conflict. Quite to the contrary, further escalation now appears likely. The economic consequences are very difficult to gauge. In our view, the direct impact of the tariff increase from 10% to 25% on USD 200 bn of imports is limited for the US economy. The additional cost for US importers and consumers is in the order of 0.15% of GDP, which is a maximum estimate as the depreciation of the Chinese currency and price concessions by Chinese producers alleviate the burden. Much more problematic is the blacklisting of Huawei and potential retaliations. Such non-tariff barriers to trade increase uncertainty as they threaten to disrupt supply chains. Hence, we believe that the recovery seen in various sentiment indicators in May might prove short-lived. In addition, a reversal of the significant inventory build-up in the first quarter might weigh on growth in the subsequent quarters. Hence, we feel comfortable with the slightly below-potential GDP growth forecast of 2.4%.

#### Inflation

Swiss Life Asset Managers	Consensus
2019: 1.9%	2019: 1.9%
2020: 2.2%	2020: 2.1%

We expect US headline inflation to hover marginally below 2% over the next months. Energy price base effects will be neutral-to-negative in the near-term, while rising inflation in core services is counterbalanced by idiosyncratic weakness in core goods inflation. These effects should prove temporary, and we expect a slight pickup in headline and core inflation as we head into 2020.

## Eurozone

### Spill-over fears

#### GDP growth

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

Until last month, our forecast for growth in 2019 was below the consensus estimate ever since publication of such data started in January 2018. This has changed: Surprisingly firm first quarter data for all major Eurozone members triggered an upward revision to our forecast for the full-year 2019. While pessimism among analysts and investors has increased on the back of global trade tensions, the economy remains supported by strong domestic demand. Consumers benefit from improvements on the labour market and fiscal policy is expected to deliver strong impulses to growth this year. Pessimism centers around poor sentiment indicators, mainly out of Germany’s manufacturing sector. Resilience in other sectors or regions tends to be overlooked. While the manufacturing PMI fell below the critical 50 points mark in Germany, Italy and Austria, it stays in expansion territory in France, Spain, the Netherlands, Ireland and most strongly so in Greece. Italy’s manufacturing PMI recovered in April from multi-year lows seen in the first quarter. Spillovers from Germany’s ailing car industry to other parts of its economy, like services or construction, pose a non-negligible risk for the Eurozone. Yet, robust dynamics in regions and sectors less exposed to trade tensions still justify a forecast of growth around the region’s potential.

#### Inflation

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

The late Easter date this year triggered noise in the inflation data with distortions to the downside in March and to the upside in April. Annual inflation is set to drop to 1.4% again in May and to average just 1.3% until year-end assuming stable energy prices. The tightening labour market and accelerating wage growth are reasons to expect core inflation to rise from an average of 1.1% this quarter to 1.5% in the final quarter 2019.

## Germany Coping with overcapacities

### GDP growth

Swiss Life Asset Managers	Consensus
2019: 1.1%	2019: 0.8%
2020: 1.3%	2020: 1.5%

Germany's economy was a success story over the past decade. Private sector job creation was remarkable, even in manufacturing which underwent massive restructuring elsewhere in the developed world. Despite global headwinds, the domestic economy proved resilient in the first quarter 2019 with private consumption and construction activity being major contributors to the 0.4% quarterly growth rate. Nevertheless, prudence, if not pessimism, prevails: While the consensus forecast for the full year 2019 was 1.9% one year ago, it fell to 0.8% by May. In our view, short-term fears are overdone. We expect quarterly growth to slow to a pace slightly below potential. The outlook for industrial production outside construction has not improved according to business surveys. However, rising wages and a decent fiscal impulse should ensure domestic activity to contribute positively to growth in the quarters ahead. Yet, in contrast to the consensus view, we do not expect a fast acceleration of dynamics in 2020. Germany's successful business model of the past may well turn out as the Achilles heel in the current cyclical slowdown. In the worst case, the country enters a "triple austerity" as the notoriously high savings ratio of private households, prudent corporate investment activity and the debt brake on the fiscal front could all exert dampening effects in the medium term.

### Inflation

Swiss Life Asset Managers	Consensus
2019: 1.5%	2019: 1.5%
2020: 1.7%	2020: 1.6%

Headline inflation surged to 2.1% in April, as the effects of this year's late Easter were more important here than elsewhere in Europe. Most of this jump is temporary. Thus, we expect headline inflation to ease to 1.4%. Nevertheless, the upward trend in core inflation on the back of rising wages and further rising prices for energy components such as gasoline and heating oil in May mean that headline inflation should continue to trend higher in the second half of this year and during the first quarter 2020. We expect Germany's headline inflation rate to reach a peak at 2.2% by March 2020.

## France Resilient sentiment indicators

### GDP growth

Swiss Life Asset Managers	Consensus
2019: 1.2%	2019: 1.3%
2020: 1.2%	2020: 1.3%

Compared with Germany, French exporters benefitted far less from the global upswing in 2017 and 2018. This turns out to be an advantage in the current economic slowdown, as global headwinds pose comparably less problems for the French economy. Over the past twelve months, the consensus forecast for GDP growth in France through 2019 was lowered from 1.8% to currently 1.3%. Thus, the current consensus forecast is close to our own projection of 1.2%, and in line with France's current potential output. Lower forecasts compared to those published a year ago show that the mood has become more prudent, but less dramatically so than in Germany. This finding may surprise given the protests expressed by the Gilet Jaunes movement or the French result of the European elections. Yet, economic survey data justify such optimism and do not hint at a further loss of economic momentum: Both the national statistics office INSEE's consumer sentiment measure as well as its business confidence indicator have recovered markedly from their lows reached by the end of last year. Back in December, president Macron unveiled several measures to support disposable incomes in response to street protests. In sum, the fiscal stimulus reaches almost 1% worth of potential GDP this year. This is the strongest positive contribution coming from fiscal policy since 2009.

### Inflation

Swiss Life Asset Managers	Consensus
2019: 1.2%	2019: 1.2%
2020: 1.6%	2020: 1.5%

Headline inflation eases substantially from above 2.5% in the third quarter 2018 to around 1.0% by September this year. Underlying growth dynamics and a further improvement on the labour market resulting in modest wage growth suggest that the monetary policy by the ECB is about right for France and should not be normalised any time soon. Lower social contributions reduce labour costs for corporates. Should companies in the services sectors pass on these savings to consumers, inflation is likely to come in even lower than we currently expect.

## UK

### New leader, same old problems

#### GDP growth

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

Theresa May's announcement to step down as Prime Minister only seemingly paves the way for a fresh start in the Brexit saga. The next Prime Minister will likely come from the hard-line "Brexit faction" of the Conservative Party but will face the exact same problems as his predecessor: First, a Parliament which is opposed to a no-deal scenario and second, an EU which is unlikely to make any significant concession to the UK. Hence, gridlock and uncertainty are set to continue over the summer months. While not our base case, the risk of a "hard Brexit" at the October 31 deadline has risen. This scenario could materialize if no deal is struck until then and the EU refuses to extend the deadline, or if any hard-line Prime Minister strives for a hard Brexit, ignoring parliament's calls to request another extension from the EU. More likely from today's point of view is that the exit date is postponed yet again. This implies continued uncertainty and a wide range of possible final outcomes, including no Brexit at all. Amid this uncertainty, we expect economic growth to slow following a surprisingly good start to the year, which was boosted by an unsustainable inventory build-up.

#### Inflation

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

Inflation developments in the UK have surprised somewhat to the downside this year. Headline inflation stayed below 2% in the first quarter, before rising to 2.1% in April, boosted by the late timing of Easter in 2019 compared to 2018. For the rest of the year, we expect inflation to fluctuate around the 2% mark. Risks to our forecast are tilted to the upside following the renewed depreciation of Sterling, which is a consequence of the breakdown of Brexit talks. Nevertheless, inflation will likely be no major concern for the Bank of England, which we expect to stay put as long as the Brexit situation remains unresolved.

## Switzerland

### A strong first quarter

#### GDP growth

Swiss Life Asset Managers	Consensus
2019: 1.3%	2019: 1.2%
2020: 1.4%	2020: 1.5%

GDP data for the first quarter surprised strongly to the upside, accelerating to 0.6% from 0.3% previously. The data reveal resilience given the trade tensions between the US and China and the cyclical industrial slowdown in Europe. Foreign demand boosted production in the pharmaceutical and in the watch and precision instrument sectors. Domestic activity contributed strongly to growth with construction recovering from a weak second half of 2018. Private consumption and government expenditures were additional drivers of growth. The government's contribution to first quarter growth was twice as high as the average over the past five years. We expect a payback in this component in the quarters ahead. Private households' consumption expenditures are also unlikely to repeat their strong performance. Car sales are now back to normal after a temporary fall in the second half of 2018. Meanwhile, consumer sentiment and the employment outlook deteriorate. Adding to the picture of moderating dynamics are intensifying headwinds for exporters. The risk of an escalation of trade tensions is not negligible and the Swiss Franc appreciated markedly against the Euro over the past few weeks.

#### Inflation

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

Switzerland's consumer price index rose 0.7% in April from year ago levels, in line with our assumptions. Inflation will stay in the lower half of the Swiss National Bank's (SNB) target band of 0% to 2%. Thus, the SNB is under no pressure to abandon its negative interest policy soon. Energy prices seem to have peaked and should stop contributing positively to inflation. Meanwhile, the recent strengthening of the Swiss Franc means falling import price pressure going forward. By purchasing power parity measures, the Swiss Franc is now overvalued again by more than 10% versus the Euro.

## Japan

### Decision time on the tax hike

The Japanese government intends to raise the consumption tax from 8% to 10% in October 2019 to reduce its structural fiscal deficit. This will lead to a boom-and-bust pattern in private consumption and higher inflation next year that we have both reflected in our forecasts. However, Prime Minister Abe is reportedly contemplating to postpone the tax hike yet again to keep the economy and his “Abenomics” project afloat. The economic backdrop is indeed sending conflicting signals. Survey indicators for the domestic economy remain robust and GDP growth in the first quarter surprised to the upside. External demand, however, is weak and trade war risks are mounting. Also, the quality of GDP growth turned out to be bad in the first quarter as numbers were boosted by a substantial drop in imports, usually a precursor of weak domestic demand. One development worth watching in that regard is the recent (potentially temporary) divergence between falling wages and rising consumer price inflation, which weighs on purchasing power.

## China

### Trade tensions back again

After a long period of easing trade tensions between the US and China, which raised hopes that a deal between the two trading powers can be reached, the trade dispute re-escalated again in May. The US raised tariffs on USD 200 bn of Chinese goods from 10% to 25% and is threatening to impose tariffs on the remaining Chinese imports that have not been affected yet, amounting to around USD 300 bn. In response, China retaliated by increasing tariffs on USD 60 bn of US imports. The direct impact of tariffs on the Chinese economy is limited, in our view. However, the indirect impact due to increased uncertainty, weighing on business confidence and therefore investments, might be more significant. Making things worse, the re-escalation of tensions is not limited to trade but expanding towards a “tech war”, as the US is ratcheting up technology restrictions against Chinese firms, including the country’s technology giant Huawei – denting hopes of a swift trade deal in the near future.

## Economic Research



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