Perspectives

Economics

SwissLife
Asset Managers

August 2018

Key messages

- As the US is a fairly closed economy, tariffs only have a modest impact on inflation
- Analysts’ expectations are adapting to the new normality of lower growth
- Unfortunate timing for China – domestic headwinds join a clouded export outlook

Comparison of forecasts

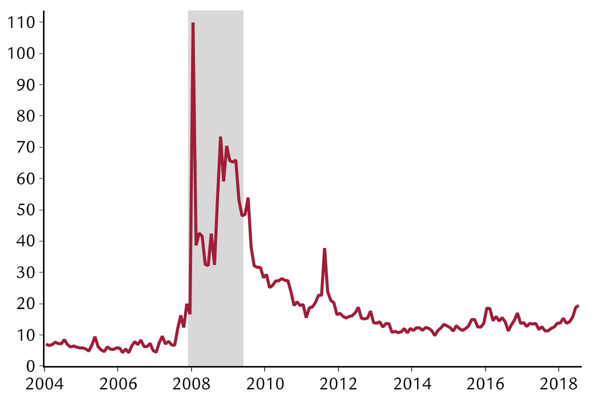
	GDP growth 2018		GDP growth 2019		Inflation 2018		Inflation 2019	
	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus
US	2.7% ↓	2.9%	2.2%	2.6%	2.5%	2.5%	2.1%	2.2%
Eurozone	2.0%	2.2%	1.4%	1.8%	1.6%	1.7% ↑	1.5%	1.6%
UK	1.1%	1.3%	1.0%	1.5%	2.3%	2.5%	2.0%	2.1%
Switzerland	2.1%	2.2%	1.2%	1.7% ↓	1.0%	0.9%	0.9%	1.0%
Japan	0.9%	1.1%	1.1%	1.1%	0.7%	1.0%	0.2%	1.1%
China	6.5%	6.6%	6.1%	6.4%	2.1%	2.2%	2.3%	2.3%

Arrows indicate difference from previous month
Source: Consensus Economics Inc. London, 09.07.2018

Consensus Economics
Forecast Accuracy
Award Winner
Switzerland 2017

Consensus Economics, one of the world's leading economic survey organisation, has announced the recipients of its 2017 Forecast Accuracy Award (FAA) in June 2018. Swiss Life Asset Managers’ economic research team has won this year’s Forecast Accuracy Award for Switzerland.

Chart of the month



United States: Google searches for keyword recession (seasonally adjusted)

Source: MACROBOND

Public interest in particular topics may be a good leading indicator for what will become economic reality: Google data show that internet searches for the term “recession” rose to a record high in January 2008. Later, the Business Cycle Dating Committee of the National Bureau of Economic Research (NBER) decided that the last US recession started in December 2007. Thus, the fact that searches for the word “recession” have started to rise again recently should be taken as a warning sign.

US
No big push for inflation

GDP growth	
Swiss Life Asset Managers	Consensus
2018: 2.7 %	2018 : 2.9 %
2019: 2.2 %	2019 : 2.6 %

Economic data for the second quarter is remarkably strong. Industrial production has increased by 5% on an annualised basis during the second quarter. The ISM purchasing managers' index (PMI) has climbed back above 60 points in June. Finally, retail sales have recovered from their weakness in the first quarter. We forecast an annualised GDP growth rate of 3.4% for the second quarter. Other analysts have even higher estimates. The strong second quarter is a compensation of a weak first quarter rather than the start of a lasting acceleration phase. In our view, GDP growth will moderate slowly but steadily from the third quarter onwards. Our medium-term base case scenario foresees GDP growth to fall below potential by mid-2020. We have not pencilled in a recession until 2021 (the end of our medium-term horizon). Yet, in an environment of growth moderation and a maturing business cycle, we expect a rising recession probability to be a recurring topic. We have reduced our forecast for 2018 as the first quarter was revised lower. The forward looking path is unchanged from last month. While there was a further escalation of the trade dispute with China, we have not adapted our outlook so far as China has not yet announced its countermeasures.

Inflation	
Swiss Life Asset Managers	Consensus
2018: 2.5 %	2018: 2.5 %
2019: 2.1 %	2019: 2.2 %

Although China is the US's top import origin, the announced tariffs by the Trump administration (on Chinese imports worth 50bn and 200bn USD) will only have a modest impact on inflation as the US is a fairly closed economy. The average import price for Chinese products would increase by 4%-6%. As imports from China represent only 2.6% of US GDP, we estimate a one-time increase of consumer prices of 0.1%-0.2%.

Eurozone
Expectations adapt

GDP growth	
Swiss Life Asset Managers	Consensus
2018: 2.0 %	2018 : 2.2 %
2019: 1.4 %	2019 : 1.8 %

Growth moderation remains the major topic. The Eurozone economy witnessed a period of exceptionally high growth rates from late 2016 until late 2017. The quarterly GDP growth rate was on average 0.7%. Dynamics were supported by the global synchronous upswing. In 2018, normality has returned: In the first quarter, the growth rate declined to 0.4%. This roughly corresponds to the mean of the period between the debt crisis and the upswing in late 2016. While we have been comparably prudent on the Eurozone growth outlook for a long time, other analysts have been more optimistic. Since March, economic data came in weaker than generally expected. The negative surprises were as large as last in 2011. That the surprise index remained on very elevated levels for eleven weeks shows that optimism went ahead of itself. Over the last four weeks, the index has become much less negative. Thus, expectations are adapting to normality. How does normality look like? We expect the quarterly GDP growth rate to remain at 0.4% throughout the year. The PMI for the manufacturing sector should stabilise soon. On the political front, there is for once good news: The EU has signed a trade deal with Japan to create the world's largest open economic area.

Inflation	
Swiss Life Asset Managers	Consensus
2018: 1.6 %	2018: 1.7 %
2019: 1.5 %	2019: 1.6 %

Energy is once again an important driver of consumer prices. The annual headline inflation rate reached 2.0% in June. Energy prices contributed 0.8 percentage points to the increase. If the oil price does not increase further, this contribution will fade over coming months. According to our own forecast, the current level of 2.0% marks the peak and headline inflation slowly decelerates towards 1.5% by spring 2019.

UK
A softer Brexit than we thought?

GDP growth

Swiss Life Asset Managers	Consensus
2018: 1.1 %	2018: 1.3 %
2019: 1.0 %	2019: 1.5 %

What a month that was for England and the United Kingdom: England's superb performance at the World Cup, the extraordinary summer weather and Theresa May's decision to opt for a soft version of Brexit all impact economic growth and inflation. Yet, for the time being we refrain from lifting our GDP growth projections which continue to be based on the assumption that high uncertainty around the final Brexit arrangements with the EU weigh on corporate investment plans. May's Chequers proposal is unlikely to soften the EU's stance in upcoming negotiation rounds. While it is always possible for European politicians to settle last minute deals, businesses need to have more visibility for what is to come after March 2019 when Brexit will finally take place. Another reason for not revising our growth assumptions are the newly available monthly GDP data provided by the statistics office ONS: This valuable addition to the common official quarterly national accounts data confirms our view that economic activity has recovered just a bit in the second quarter from a temporary weakness in the first three months of the year: May was a strong month in particular for the services industries while manufacturing output grew for the first month so far this year.

Inflation

Swiss Life Asset Managers	Consensus
2018: 2.3 %	2018: 2.5 %
2019: 2.0 %	2019: 2.1 %

We still expect annual inflation to fall from currently 2.4% to 2.0% until the end of 2018. Yet, two recent trends suggest that upside risks to our forecast are gaining importance. Firstly, as the Sterling weakened by 3% since April, import prices could exert additional pressure on prices for goods coming from abroad. Secondly, the unusual hot and dry summer weather may result in higher prices for fresh food and beverages.

Switzerland
Growth pace cut in half

GDP growth

Swiss Life Asset Managers	Consensus
2018: 2.1 %	2018: 2.2 %
2019: 1.2 %	2019: 1.7 %

A twelve month long period with extraordinary tailwinds for Switzerland's economy comes to an end. Compared with previous episodes of global economic upswings, Switzerland joined the party comparably late. In the second half of 2017, the weakening of the Swiss Franc versus the Euro boosted industrial production and stabilised domestic consumption as shopping abroad became less attractive. Through 2017, the Swiss Franc's external value fell by 6% on a trade weighted basis, encouraging the corporate sector to invest in machinery and staff at home rather than to outsource production. The tourism sector continues to benefit from a favourable combination of a weaker currency and recovering labour markets in the developed world. A further, yet temporary, boost to Swiss GDP figures came from two global sport events: Receipts earned by the organising IOC and FIFA for the Olympic Games and the Football World Cup are forecasted to contribute up to 0.2 percentage points to GDP growth in 2018. As global momentum loses steam and the favourable currency effect has run its course, we believe that Switzerland's economic cycle has peaked: While real GDP grew by 0.6% on average over the past four quarters, we anticipate an average pace of just 0.3% until the end of 2019.

Inflation

Swiss Life Asset Managers	Consensus
2018: 1.0 %	2018: 0.9 %
2019: 0.9 %	2019: 1.0 %

Inflation climbed above 1.1% in June, reaching the highest level in more than eight years. Higher energy prices and recovering price setting power among retailers, restaurants and hotels suggest that consumer price inflation is likely to stay above 1% through the rest of the year. A dampening impact on consumer price inflation over the coming quarters is to be expected from slightly lower rental costs.

Japan
Services resist downward trend

Japan's economy was one of the first to register the headwinds from cooling trade dynamics in the developed world. Concerns related to the trade dispute between the US and China and growing political uncertainty in Europe weigh on business sentiment. According to the quarterly Tankan survey, sentiment among Japan's large manufacturers reached a 13-years high at the end of 2017. Since then, this indicator fell for two consecutive quarters. The sectors most at risk from protectionism are car manufacturers and electric machinery. Meanwhile, the services industries send out different signals: The services sector purchasing managers' index recovered to 51.4 points in June. According to this measure, Japan's services industries have now expanded during an unbroken series of 21 months. While inflation has recently stabilised around 0.7%, we expect the downward trend to resume in autumn and the inflation rate to drop below zero between December 2018 and March 2019.

China
Two types of headwinds

The Chinese economy faces headwinds from the outside as well as from the inside. Although GDP growth has held up well in the second quarter, there are more and more signs of weakening. The tightening measures on financial regulation – aiming to improve financial stability – are weighing on credit creation and infrastructure investment. This impact was to be expected. Yet, it is more pronounced than initially thought and it coincides with a period in which also the export industry faces challenges. The US have announced to impose another round of tariffs. If they carry out their threat, China will be confronted with punitive tariffs on half of its exports to the US. We estimate that the tariffs could lower GDP growth by up to half a percentage point. Yet, we also expect authorities to support the domestic economy with easing policies. Therefore, growth should suffer less. In any case, these are rough estimations, in particular as second-round effects are hard to predict.

Economic Research

Marc Brütsch
Chief Economist
marc.bruetsch@swisslife.ch
@MarcBruetsch

Francesca Boucard
Economist Real Estate
francesca.boucard@swisslife.ch
@f_boucard

Claudia Bernasconi
Senior Economist
claudia.bernasconi @swisslife.ch
@BernasconiCla

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