Perspectives
Economics

August 2020

Key messages

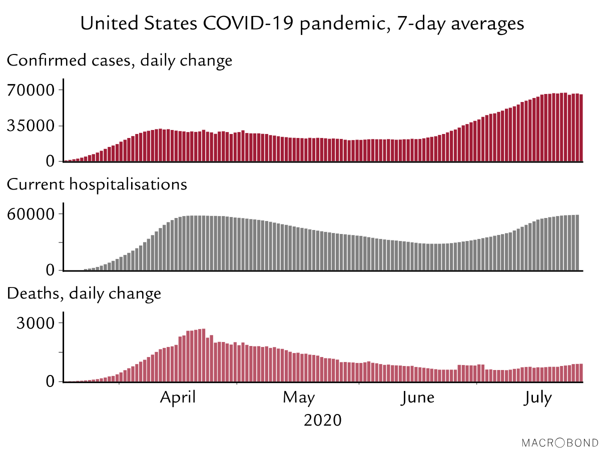
- Recovery is ongoing with short-term economic dynamics stronger in Europe compared to the US
- GDP: disappointing April in France and May in the UK but stronger than expected recovery in Q2 in China
- Political tail risk lower in Eurozone after EU debt issuance deal but US-China geopolitical tensions increasing

Comparison of forecasts

	2020 GDP growth		2021 GDP growth		2020 inflation rate		2021 inflation rate	
	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus
USA	-3.7% ↓	-5.3% ↑	4.3% ↑	4.0% ↓	1.0% ↑	0.8%	1.6% ↑	1.7% ↓
Eurozone	-6.5% ↓	-8.1% ↑	5.5% ↑	5.9% ↓	0.5% ↑	0.4% ↑	1.1% ↓	1.0%
Germany	-4.7%	-6.3% ↑	3.8%	5.0% ↓	1.0% ↑	0.6%	1.5% ↑	1.5% ↑
France	-8.3% ↓	-9.9% ↓	7.7% ↑	7.0%	0.4%	0.5% ↑	1.2% ↓	1.1%
UK	-7.9% ↓	-9.2% ↓	6.8% ↑	5.9% ↓	0.6% ↓	0.8% ↓	1.5%	1.3%
Switzerland	-3.8%	-5.9% ↑	4.4%	4.6% ↓	-0.6%	-0.7%	0.6%	0.2% ↓
Japan	-4.6%	-5.1% ↑	2.6%	2.5% ↓	0.1% ↑	-0.2% ↑	0.2%	0.1% ↑
China	2.3% ↑	1.7% ↑	7.5% ↓	7.9% ↓	2.6%	2.7% ↓	1.9%	1.9% ↑

Arrows indicate difference from previous month
Source: Consensus Economics Inc. London, 13 July 2020

Chart of the month



The COVID-19 pandemic seems out of control in the US. As the virus spread to previously less affected regions, infections reached new record highs in July. However, hospitalisations and deaths due to COVID-19, even when accounting for a certain lag, remain lower than the surge in cases would suggest. Potential explanations are more testing, more cases among younger people, more efficient treatment of patients and higher hospital capacities. With a few local exceptions, the US health care system is not overwhelmed. In combination with the recent stabilisation of daily new cases, the appetite for renewed containment measures is very limited, especially in the more conservative Southern and Midwestern states.

US
Third quarter hitting a bump

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -3.7 %	2020: -5.3 %
2021: 4.3 %	2021: 4.0 %

In the balancing act between containment of the pandemic and limiting economic costs, most US states clearly prefer the latter. The strictest measure taken in the current hotspots Texas and Florida is the closing of bars, while other states are just pausing rather than reversing their opening plans for the economy. California is the exception, where a wide range of restrictions for indoor activities were imposed in most counties starting in mid-July. This partial lockdown is significant, as California accounts for 15% of US GDP. But even in the more reluctant states, mobility data published by Google as well as the stabilisation in daily new cases indicate that people voluntarily practice more social distancing. This will put a dent in July activity data and weigh on the recovery for the rest of the third quarter, after a spectacular recovery at the end of the second quarter which sent the Citi Economic Surprise Index to new all-time highs. While we still believe that the US economy will weather the recession better and grow faster in 2020 than consensus currently expects, the short-term will certainly see economic dynamics shifting to Europe, where the recovery potential is admittedly also higher. This shift was already evident in July Purchasing Managers' Indices, where the Eurozone and the UK clearly outperformed the US in both the manufacturing and services sector.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 1.0 %	2020: 0.8 %
2021: 1.6 %	2021: 1.7 %

Annual headline inflation staged a spectacular comeback in June, rising to 0.6% from 0.1% previously. Higher energy prices were the main driver, but it was core inflation which delivered the upside surprise. Following three months of declining prices in core goods and stagnation in core services prices, the demand recovery led to recovering prices in both areas. The recent decline of the trade-weighted US dollar might additionally spur inflationary pressure, hence our upward revision of our 2020 inflation forecast to 1.0% from 0.8%.

Eurozone
Closing the spread

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -6.5 %	2020: -8.1 %
2021: 5.5 %	2021: 5.9 %

At the height of the pandemic in Italy in early March, European Central Bank's president Lagarde said that the central bank was "not here to close spreads" between the borrowing costs of member states, as she called on governments to soften the economic impact of the COVID-19 outbreak. Four months later, EU politicians made a major step towards setting up a recovery plan, including the EU's first-ever common debt issuance of hundreds of billions of euros. Consequently, the spread of Italy's 10-year sovereign bond over German bonds narrowed from 279 in March to 146 basis points until the end of July. As we expected monetary and fiscal policy to go "all in" to cope with the crisis, the political breakthrough does not trigger a revision of our short-term growth projection. Rather, this step towards a fiscal union – at least of some kind – reduces longer term break-up risks of the Eurozone. Meanwhile, the economic recovery is on track with preliminary July data for Purchasing Managers' Indices hinting at accelerating momentum in manufacturing and services industries. The continuation on this path hinges on the successful containment of the virus. According to Oxford University's COVID-19 Containment Policy Stringency Index, at least five Euro member states (among them Italy and Spain) had to backpedal on their reopening ambitions as of late.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.5 %	2020: 0.4 %
2021: 1.1 %	2021: 1.0 %

The ECB may not be here to "close spreads", but within their current mandate, the central bank has to ensure price stability defined by an inflation target of "close to, but below 2%". Currently, the ECB is clearly missing this target. At 1.8%, Slovakia reports the highest inflation rate of the 19 Eurozone member states. Those fearful of rising inflation point at deglobalisation and the coordinated fiscal and monetary stimulus as potential triggers, but only time will tell whether in 2020 the disinflationary trend of the past thirty years came to its end.

Germany
So far so good

GDP growth

Swiss Life Asset Managers	Consensus
2020: -4.7 %	2020: -6.3 %
2021: 3.8 %	2021: 5.0 %

At the time of writing only one Landkreis registered COVID-19 infections above 50 per 100'000 inhabitants within seven days, the German benchmark above which renewed containment measures should be imposed. However, weekly cases at the end of July were higher compared to the start of the month in eleven out of sixteen Länder, most visibly so in Hamburg and Bremen. Clearly, the risk of a second wave and of new economic disruptions is lingering, but for the time being the economic recovery is ongoing. In May, retail sales rebounded by a surprising 14% and consumer confidence has continued to improve since then. In the same vein, at 56.7 the July services Purchasing Managers' Indices (PMI) surprised to the upside with a particularly strong increase in the employment component. According to the July ifo survey, services are now back in the boom quadrant of ifo's business cycle clock, with both the current assessment and business expectations in positive territory for the first time since December 2019. Meanwhile, in the manufacturing industry, ifo business expectations improved further and the PMI hit the 50 mark, driven by the forward-looking new orders component but still lagging other economies. The manufacturing employment component deteriorated, hinting at ongoing difficulties in certain sectors. Overall, the recovery is already visible, but only the publication of the second quarter GDP on 30 July will reveal the extent of the initial shock.

Inflation

Swiss Life Asset Managers	Consensus
2020: 1.0 %	2020: 0.6 %
2021: 1.5 %	2021: 1.5 %

From 1 July to 31 December 2020, German consumers are profiting from lower value added taxes, paying a normal rate of 16% instead of 19% and a reduced rate of 5% instead of 7%. The effect of this reduction on the July CPI will only become evident after this text goes to print. We expect a limited pass-through only, due to the temporary nature of this measure. Meanwhile, we revised our full year inflation forecast upward after the positive June surprise.

France
Better late than never

GDP growth

Swiss Life Asset Managers	Consensus
2020: -8.3 %	2020: -9.9 %
2021: 7.7 %	2021: 7.0 %

While previously hesitating with the economic reopening, France now belongs to the countries with the least strict containment measures according to the Oxford Policy Stringency Index. Based on positive cases per capita, the test positivity rate, the reproduction number and hospitalisation relative to hospital capacity, all départements on the continent were classified as green territory at the time of writing. This development is mirrored in France's Google retail and recreation mobility index, which caught up with previously leading Germany in July. Profiting from the reopening, the services sectors reported a strong increase in July's Purchasing Managers' Index (PMI) to 57.8, driven by incoming new business. The manufacturing PMI remained above 50 for the second consecutive month but disappointed consensus expectations with the new orders and future output component both declining. According to the statistics office INSEE, demand increases have so far been satisfied by selling inventory, particularly in the automobile sector. Overall, France has seen a strong, domestically driven recovery in economic activity, with household consumption almost reaching pre-crisis levels. However, the estimated drop in economic activity in April, published by the statistics office INSEE, has been stronger than we had expected, resulting in a slight downward revision of our 2020 GDP forecast. Second quarter GDP will be released on 31 July.

Inflation

Swiss Life Asset Managers	Consensus
2020: 0.4 %	2020: 0.5 %
2021: 1.2 %	2021: 1.1 %

According to our forecasts, headline inflation is set to decline in July and August compared to last year and to remain very low for the remainder of the year. The appreciation of the euro could further weigh on inflation in eurozone countries, but evidence suggests that France belongs to the countries with a low exchange rate pass-through. Base effects will push up inflation in 2021.

UK
Pent-up demand

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -7.9 %	2020: -9.2 %
2021: 6.8 %	2021: 5.9 %

The UK is one of few economies to release monthly GDP figures, which allows us to closely track our assumptions regarding the recovery. The latest release of May figures came as a shocker. Instead of the expected return to around 83% of pre-crisis output, the UK economy only grew by 1.8% month-on-month, thus reaching roughly 75% of pre-crisis levels. The main reason for the miss was very weak service sector activity, while manufacturing output already showed a decent recovery from its April lows. Data for June are conflicting. Whereas Google mobility data for retail and recreation as well as Purchasing Managers' Indices indicate a slow recovery, slower than on the Continent, real retail sales recovered faster than expected. June sales volumes were even 2.5% higher than in February, a sign of significant pent-up demand, but with a massive shift from high street to online retailers, which saw a year-to-date sales increase of more than 50%. We expect activity in the services sector to recover rapidly in the third quarter against the backdrop of relatively low and stable infection numbers and further reopening steps. The temporary VAT cut for restaurants, hotels and some leisure activities should also marginally support demand in these battered sectors. Nevertheless, the weaker-than-expected second quarter prompted another downward revision of our full-year forecast to -7.9% from -6.1%.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.6 %	2020: 0.8 %
2021: 1.5 %	2021: 1.3 %

The newly introduced temporary VAT cut (to 5% from 20%, applicable between 15 July 2020 and 12 January 2021) mentioned above as well as the "Eat Out to Help Out" scheme, which allows for a 50% discount in participating restaurants in August, will push down inflation in July and August. We thus revise down our 2020 inflation forecast to 0.6% from 1.0% previously.

Switzerland
Stop-and-go recovery

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -3.8 %	2020: -5.9 %
2021: 4.4 %	2021: 4.6 %

Business surveys suggest that the more domestically oriented services sectors and small and medium sized firms recovered faster than those industries which are fully integrated into the – still partially interrupted – global supply chains. Retail and construction activity has recovered almost back to pre-crisis levels with representatives of the latter sector reporting full order books for the remainder of the year. This is a positive development which may also explain the surprisingly robust labour market data reported for June. The seasonally adjusted unemployment rate fell to 3.3% from 3.4% in May, whereas we and consensus had expected a slight increase. Furthermore, as imports fell more rapidly than exports, the trade surplus could be a supportive factor for GDP in the second quarter. For the time being we expect a quarterly GDP contraction of 8.2%, compared with a -8.7% consensus estimate according to Bloomberg reports. The first estimate will only be released on 27 August. High frequency data suggest that momentum in stationary retail sales has moderated somewhat, but Swiss residents spending their summer holidays at home should provide support during the third quarter. Yet, rising new infections remind us of the risk of targeted local lockdowns in important economic centres such as Geneva or Zurich. Therefore, during this unprecedented recession, high uncertainty regarding short-term economic dynamics persists.

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

For twenty years, the Swiss National Bank's monetary policy aims at ensuring price stability defined as annual consumer price inflation in a range of between 0% and 2%. While average annual inflation came in at around 1% in the years 2000 until 2009, it fell to 0% since then. Current projections suggest that inflation rates will remain at the lower end of the SNB's target range in the medium term.

Japan
Economic paralysis

GDP growth

Swiss Life Asset Managers	Consensus
2020: -4.6 %	2020: -5.1 %
2021: 2.6 %	2021: 2.5 %

Japan is currently living in its own economic cycle. While all other developed economies are recovering quickly, progress in Japan has remained slow. And while other countries are swiftly re-opening their economy, Japanese businesses fear renewed restraint from consumers as July has brought a new wave of COVID-19 infections – especially in Japan's economic powerhouse Tokyo. Admittedly, infection numbers remain relatively low and the government seems unwilling to issue stricter social distancing recommendations, but the newest development might help to explain why the services Purchasing Managers' Index (PMI) was still hovering at the 45-points mark in July, below the expansion threshold of 50 points. On the manufacturing front, weakness persists as well. In July, the situation improved markedly in Europe and the US, where the new orders component in the manufacturing PMIs jumped above 50, whereas the new orders component in Japan was hovering around the 35 mark in June and July. A glimmer of hope is the fact that the generous capital expenditure plans by Japanese large corporates remain intact according to the latest Tankan survey. On the political front, there is continued speculation about new fiscal measures to bolster household spending and potential early elections, although the latter remains questionable given relatively low approval ratings for the Abe government currently.

Inflation

Swiss Life Asset Managers	Consensus
2020: 0.1 %	2020: -0.2 %
2021: 0.2 %	2021: 0.1 %

In June, headline inflation again proved to be more resilient than we had expected, triggering another slight upward revision of our 2020 inflation forecast to 0.1% from 0.0%. Inflation numbers are expected to hover at the current level until September, before falling into negative territory for around six months as the positive base effect from last year's consumption tax hike drops out of the calculation.

China
Sharp rebound in second quarter

GDP growth

Swiss Life Asset Managers	Consensus
2020: 2.3 %	2020: 1.7 %
2021: 7.5 %	2021: 7.9 %

China's economy expanded by 3.2% in the second quarter from a year earlier, recovering swiftly from the 6.8% contraction previously. On the one hand, the rebound has been supported by a resilient export performance, since global demand for Chinese medical equipment, such as face masks, has been elevated. On the other hand, infrastructure and property investments picked up markedly, reflecting the government's push to swiftly get out of the recession. Following the strong economic performance in the second quarter, we revise up our annual GDP growth forecast for this year to 2.3% from 1.3% previously. Looking ahead, the recovery for the second half of the year will likely be less pronounced, as government stimulus measures, particularly for the property sector, will slow down. Various tier-1 cities already started to restrict their housing policy measures as house prices started to accelerate. Besides the overall uncertainty concerning the future development of the pandemic, one of the major downside risks for the Chinese economy are heightened geopolitical tensions with the US. In the latest move, the US closed down the Chinese consulate in Houston, which has been followed by the closure of the US consulate in Chengdu. Given that the US' focus has shifted away from trade and technology topics towards IP theft and human rights issues, there is a chance that a wider reaction globally against China will follow.

Inflation

Swiss Life Asset Managers	Consensus
2020: 2.6 %	2020: 2.7 %
2021: 1.9 %	2021: 1.9 %

Annual headline inflation ticked up slightly to 2.5% in June from 2.4% previously. Pork prices remained the major contributor and edged up slightly again. However, pork price increases have slowed down significantly since March, and we expect the downward trend to go on as pork supply has continued to recover. On the other hand, core CPI slowed to 0.9% from 1.1% before, reflecting ongoing weakness in demand.

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