Perspectives
Economics

Swiss Life Asset Managers

September 2020

Key messages

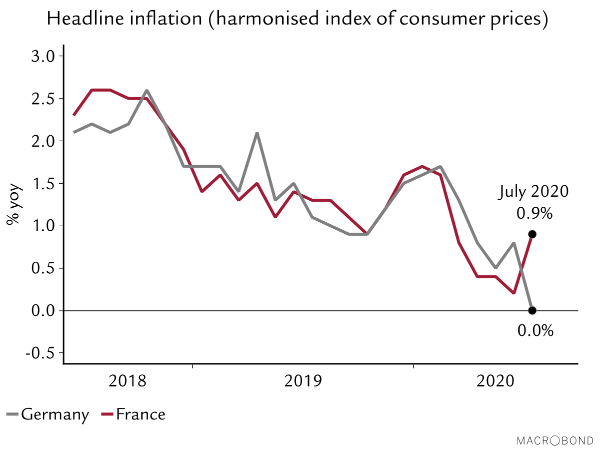
- Temporary effects are distorting inflation data for the time being
- Unemployment and corporate bankruptcies to continue rising long into the ongoing economic recovery
- Pace of the economic recovery highly correlated with extent of containment measures implemented

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%	-5.2% ↑	4.0% ↓	4.0%	1.2% ↑	0.9% ↑	1.8% ↑	1.7%
Eurozone	-6.4% ↑	-7.9% ↑	5.3% ↓	5.7% ↓	0.6% ↑	0.4%	1.2% ↑	1.1% ↑
Germany	-4.8% ↓	-6.1% ↑	4.0% ↑	4.7% ↓	0.6% ↓	0.5% ↓	1.6% ↑	1.6% ↑
France	-8.0% ↑	-9.6% ↑	7.3% ↓	7.2% ↑	0.7% ↑	0.5%	1.3% ↑	1.0% ↓
UK	-8.2% ↓	-9.9% ↓	7.2% ↑	6.4% ↑	0.9% ↑	0.7% ↓	1.6% ↑	1.4% ↑
Switzerland	-3.8%	-5.6% ↑	4.4%	4.4% ↓	-0.5% ↑	-0.7%	0.6%	0.2%
Japan	-4.6%	-5.3% ↓	2.6%	2.5%	0.2% ↑	-0.1% ↑	0.2%	0.2% ↑
China	2.3%	2.1% ↑	7.5%	7.8% ↓	2.7% ↑	2.7%	1.9%	2.0% ↑

Arrows indicate difference from previous month
Source: Consensus Economics Inc. London, 10 August 2020

Chart of the month



The July inflation reports took economists by surprise and generally led to upward revisions of our 2020 inflation forecasts. Two major, albeit temporary effects were at work. In the US and France, the demand recovery led to a rebound of prices in battered areas such as clothing. Also, many services were unavailable during the lockdown and prices had to be imputed. In the UK, renewed data collection in these services, which tend to have an above-average inflation rate, put an upward bias to headline inflation. The outlier in July was Germany, where the pass-through from the temporary VAT cut on consumer prices was much larger than anticipated, which led to opposite inflation dynamics than in neighbouring France.

US
Politics in focus

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -3.7 %	2020: -5.2 %
2021: 4.0 %	2021: 4.0 %

The surge in COVID-19 cases in July and the related containment measures in certain states have not led to any economic setback, contrary to our expectations. Retail sales and industrial production rose by 1.2% and 3.0% month-on-month in July, with the former now surpassing pre-crisis levels. Most importantly, the July labour market report showed uninterrupted employment growth and a substantial drop in the unemployment rate, from 11.1% to 10.2%. However, the latter was also driven by a surprising – most likely temporary – decline in the labour force participation rate. Overall, we see the US economy rebounding by an above-consensus 7.8% in the third quarter, after a 9.1% plunge in the second quarter. The economic recovery as well as the improvement in the medical situation in important swing states such as Florida, Texas, Ohio or Pennsylvania might explain why President Trump has recently re-gained ground against Joe Biden in the presidential race, according to polls and betting odds. While the presidential race is unlikely to have an immediate economic effect, the more important political risk to watch is the – currently stalled – "CARES 2" fiscal package. We still expect this second round of stimulus to ultimately pass in Congress due to pressure on both parties from state and local governments, but a failure remains possible, which would most likely stall the consumption recovery in the US.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 1.2 %	2020: 0.9 %
2021: 1.8 %	2021: 1.7 %

In another upside surprise, annual headline inflation recovered further in July, to 1.0% from 0.6% previously. The surge was driven by the largest monthly increase in core inflation since 1991 (0.6% month-on-month). However, this is not a move to a more inflationary regime, in our view, but merely reflects the return to more normal price levels in areas such as clothing and transportation services, which were severely hit by the COVID-19 crisis.

Eurozone
Next phase: targeted measures

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -6.4 %	2020: -7.9 %
2021: 5.3 %	2021: 5.7 %

At the start of the second quarter, visibility of reliable economic indicators was extremely poor. Back then, economists, us included, underestimated the magnitude of the shock on the economy during the lockdowns, but also the hit on activity in the latter half of the first quarter when consumers and businesses began practising social distancing. Since then, much progress in understanding the nature of the pandemic and its impact on individual sectors was made: when second quarter GDP data for the Eurozone were released, the forecast error relative to the actual outcome was surprisingly small: According to Bloomberg, the consensus estimate for Eurozone second quarter GDP was a contraction by -12.1%, which turned out a precision landing. In the case of Germany, our own estimate perfectly matched the number of the second estimate by Germany's statistic office. Authorities too are on a learning curve on how to cope with the pandemic. Despite the recent rise of newly reported infection cases, we continue to expect that targeted measures on a local scale should be sufficient to prevent Europe's health care system from being overwhelmed over the winter months. Going forward, we would also advise fiscal policy to implement more targeted measures. In a next phase, support for innovation is preferable over preserving ossified structures.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.6 %	2020: 0.4 %
2021: 1.2 %	2021: 1.1 %

Given the large amount of underutilised resources and the assumption that pre-crisis activity level will not be reached before 2022, we do not expect a fast rise in inflation anytime soon. The main reason, why we project headline inflation to return above 1% in 2021 is a base effect stemming from energy price volatility earlier this year. Apart from difficulties to measure prices during the lockdown period (see page 1), Germany's temporary VAT cut additionally complicates the assessment of price developments.

Germany
Attention, VAT passing through

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -4.8 %	2020: -6.1 %
2021: 4.0 %	2021: 4.7 %

Germany's second quarter GDP dropped by 9.7% according to the second estimate, in line with our forecast and below consensus expectations (-9.0%). This is by far the largest hit since the calculation of quarterly German GDP, with all expenditure components except government consumption contributing negatively. While the current quarter will set another growth record in the opposite direction, we do not foresee a full compensation of the large losses until 2022. Third-quarter data so far revealed a still robust labour market as the seasonally adjusted unemployment rate stagnated at 6.4%. At the same time, workers concerned in new short time work announcements declined to around 190 thousand from a peak of 8 million in April. The employment component in the manufacturing Purchasing Managers' Index (PMI) improved in August but remains well below 50 points, which marks the expansion threshold. The overall manufacturing PMI increased to 53.0 from 51.0 previously, with a strong contribution from new orders. This is in line with the higher manufacturing ifo business climate print. Business climate improved in the services sector as well, according to the ifo survey, driven by both current assessment and expectations. Less encouragingly, the services PMI declined to 50.8 from 55.6. This disappointment could mirror the generally upward trending daily new COVID-19 cases and new local containment measures.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.6 %	2020: 0.5 %
2021: 1.6 %	2021: 1.6 %

July revealed a much larger pass-through of the temporary VAT cut than we had anticipated. The harmonised index of consumer prices stagnated compared to a year ago, after an increase of 0.8% in June. This was driven by a decline in prices for goods, while prices for services registered an above-average increase. Consequently, we lower our 2020 forecast to 0.6% from 1.0%, and increase our 2021 forecast to 1.6% from 1.5% previously.

France
A flagging recovery?

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -8.0 %	2020: -9.6 %
2021: 7.3 %	2021: 7.2 %

Since the publication of our last document, economic data for France posted positive surprises that warrant an upward adjustment to our growth forecast for 2020, reversing the correction done last month. GDP fell less than expected in the second quarter and industrial production growth came in strong both for May and June. Initially, survey indicators for the current quarter came in strong as well: according to Banque de France, industrial sentiment jumped to 99.4 in July from 89.1 points. This is the best reading since May 2019 and confirms firm values for the Purchasing Managers' Indices (PMI) for July released one month ago. Google's retail and recreation mobility index, which measures the length of stay of individuals at specific places, recovered further in August. The seven-day moving average of this index is now only 7% below its long-term baseline level, compared with a maximum gap of –88% in the first week of April. Yet, the stream of encouraging economic news was suddenly interrupted by disappointing preliminary August readings for the PMIs in both manufacturing and services. According to this indicator, industrial activity contracted in August, with new orders received by manufacturers falling for a second straight month. As economic activity remains highly correlated with the stringency of COVID-19 containment measures, we monitor very closely the current development of reported cases.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.7 %	2020: 0.5 %
2021: 1.3 %	2021: 1.0 %

French inflation numbers surprised to the upside in three out of four months until July. As discussed on page one, a temporary rise in clothing prices (+12% compared to year-ago-levels) was a major driver. With energy prices stabilising as of late, we expect underlying volatility in consumer prices to ease. A return to annual inflation rates above 1% is expected by the end of the first quarter 2021.

UK
A labour market mirage

GDP growth

Swiss Life Asset Managers	Consensus
2020: -8.2 %	2020: -9.9 %
2021: 7.2 %	2021: 6.4 %

What we suspected is now official. The UK is, in terms of GDP drop in the second quarter, the hardest-hit economy among all major developed markets (-20.4% quarter-on-quarter), even underperforming Italy and Spain. But let the past be the past. Looking at third-quarter data, a significant recovery appears to be underway. Google mobility data for retail and recreation suggest that the UK is at least getting closer the levels recorded by other European nations or the US in August. More importantly, the pent-up demand in private consumption is being unleashed after the lockdown, with retail sales volumes significantly surpassing pre-crisis levels in July and the Purchasing Managers' Index (PMI) for the services sector reaching 60.1 points in August. A key support to the recovery is the hugely successful "job retention scheme" (essentially wage subsidies), which kept the unemployment rate at an artificially low 3.9% during the second quarter. However, the labour market miracle might soon turn into a mirage as the Chancellor refused to extend the scheme beyond the end of October. This fiscal cliff will likely push many currently furloughed workers into unemployment, incurring a downside risk to private consumption as we move into the next year. In combination with still dismal investment intentions, exacerbated by Brexit uncertainty, we expect the UK to be among the last developed markets to reach pre-crisis levels, at the earliest in 2022 in our base case scenario.

Inflation

Swiss Life Asset Managers	Consensus
2020: 0.9 %	2020: 0.7 %
2021: 1.6 %	2021: 1.4 %

In July, the number of items unavailable for price estimates due to ongoing restrictions dropped significantly, from 67 to 12. This likely put an upward bias on inflation, as less items used imputed prices (see chart of the month). This effect far outweighed the temporary VAT cut that was initiated mid-July for selected items, as annual headline inflation surprisingly rose by 40 basis points to 1.0%.

Switzerland
Less bad as feared by some

GDP growth

Swiss Life Asset Managers	Consensus
2020: -3.8 %	2020: -5.6 %
2021: 4.4 %	2021: 4.4 %

Economically, Switzerland is leaving the first phase of the pandemic with a black eye. Thanks to the importance of the pharmaceutical sectors, industrial production fell by around 8% in the second quarter, substantially less than in other Western economies. Output of the pharmaceutical sector dropped by just 0.2% over the second quarter. Recently published data suggest that construction activity slowed less than initially feared and order books remain filled. Overall, Swiss real GDP fell by 8.2% during the second quarter according to preliminary official estimates. In other manufacturing areas, the outlook remains subdued. Surveys among firms in the mechanical and electrical engineering (MEM) industries reveal sluggish orders intake at the start of the third quarter. Meanwhile, the recovery in the services sector, which followed the easing of lockdown measures in May, continues. Hotels and restaurants in the alpine regions reported strong domestic demand, which also helped reducing unemployment rates temporarily there. The fact that many Swiss residents spent their holidays in the country had a net positive impact on final consumption in the summer months. We expect real GDP growth to rebound by 8.8% during the third quarter. While our own projections remain comparably optimistic, some of our peers have adjusted their projections to the upside recently: over the past two months, the consensus forecast for 2020 rose from -6.0% to currently -5.6%.

Inflation

Swiss Life Asset Managers	Consensus
2020: -0.5 %	2020: -0.7 %
2021: 0.6 %	2021: 0.2 %

Like elsewhere, Switzerland's statistics office reported difficulties to collect price data during the lockdown period. Yet, by July, these problems were fully solved except for air transport tariffs. Although it is premature to declare a clear trend, stronger demand for certain goods and services as a result of the pandemic is reflected in the price data. Among those categories which saw prices rising as of late one finds furniture, new cars and hotels.

Japan
Auto industry recovering

GDP growth

Swiss Life Asset Managers	Consensus
2020: -4.6 %	2020: -5.3 %
2021: 2.6 %	2021: 2.5 %

Japan is the laggard in the ongoing global industrial recovery, but things are now finally improving. Like Germany, the exposure to the auto sector was likely the main culprit for the slow turnaround. Contrary to retail sales, car sales were still significantly below pre-crisis levels at the end of the second quarter in all major economies. During the crisis, many car manufactures reacted by closing whole production lines. As a result, vehicle production was the industrial segment most hit by the crisis in Japan, with production dropping to 50% of pre-crisis levels in May. In June, production was ramped up again to 60% of pre-crisis levels, and July saw a significant increase of car exports by roughly 40% compared to June on a seasonally adjusted basis. Despite the improvement, Purchasing Managers' Indices still suggest that the industrial recovery in Japan will be less dynamic than elsewhere. Relatively solid consumption amid few restrictions was the main reason why Japan saw the smallest GDP drop among major developed markets during the second quarter. Universal cash handouts of 100 thousand yen per resident also softened the blow to consumption. However, with the fiscal support fading and labour market risks mounting, evident by the collapse in the job-to-applicant ratio, the recovery in private consumption is likely to face more headwinds during the remaining months of the year.

Inflation

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

The normalisation of activity has led to higher inflation rates in areas such as culture, recreation, furniture or household goods. The inflation path up until July had been a bit steeper than anticipated, hence our slight upward revision of the 2020 inflation forecast to 0.2% from 0.1%. Nevertheless, inflationary pressures seem to be overall contained heading into 2021 due to falling nominal wages and a relatively strong Japanese yen.

China
Uneven recovery continues

GDP growth

Swiss Life Asset Managers	Consensus
2020: 2.3 %	2020: 2.1 %
2021: 7.5 %	2021: 7.8 %

China's economy continues to recover in the second half of this year. However, economic data for the month of July showed that the recovery remained uneven and was mainly driven by the state-supported industrial sector. In particular, the increase in investments was fuelled by state-owned companies' property and infrastructure projects, while demand of private companies was still lagging. Moreover, consumption continued to be weak, with July retail sales growth remaining in contraction. Besides the backing of the government, an important supportive factor for China's economy this year is trade, as China is benefitting from strong demand for its export products, such as medical equipment as well as work-from-home-related items such as computers and mobile phones. Looking ahead, the recovery pace will likely moderate, since policy makers are tentatively dialling down stimulus measures, particularly in the real estate sector. The major risk for the country's economic expansion are rising US-China tensions. Amid the growing anti-China sentiment in the West, the Chinese government is calling for a so-called "dual circulation" growth model, which emphasizes on self-sufficiency in terms of demand and technological supply. While China has already been focusing on rebalancing its economy away from exports towards consumption-led growth, the current environment will likely enhance its inward-focused shift.

Inflation

Swiss Life Asset Managers	Consensus
2020: 2.7 %	2020: 2.7 %
2021: 1.9 %	2021: 2.0 %

July headline inflation increased to 2.7% from 2.5% previously, as food prices ticked up due to transportation disruptions caused by floods in central and southern China. On the other hand, core inflation (which excludes food and energy prices), dipped to the weakest reading since 2010, reflecting ongoing weak demand. We expect headline inflation to decline in the upcoming months, due to a recovery of pork supply that should lead to a gradual decrease in pork prices.

Economic Research

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