Perspectives
Economics

October 2019

Key messages

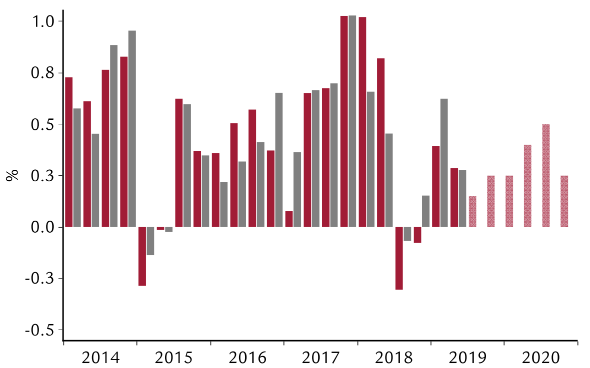
- US inflation numbers likely to keep rising until the first quarter 2020
- The ECB inflation forecast for next year looks unrealistically low in our view
- New orders received by export-dependent Swiss manufacturers collapse by 20% from year ago levels

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	2.3%	2.3%	1.8%	1.8% ↓	1.8%	1.8%	2.2%	2.1%
Eurozone	1.1%	1.1%	1.0%	1.1% ↓	1.3%	1.3%	1.4% ↓	1.3% ↓
Germany	0.5% ↓	0.5% ↓	0.6% ↓	1.4% ↑	1.4% ↓	1.4% ↓	1.6% ↓	1.5% ↓
France	1.3% ↑	1.3%	1.1% ↑	1.2%	1.3%	1.2%	1.5%	1.3% ↓
UK	1.2%	1.2%	1.1% ↑	1.1% ↓	2.0%	2.0% ↑	2.0%	2.1% ↑
Switzerland	0.7% ↓	1.0% ↓	1.2%	1.3% ↓	0.5%	0.5% ↓	0.6%	0.7% ↓
Japan	0.9% ↓	1.0% ↑	0.3%	0.2% ↓	0.6%	0.6% ↓	1.0%	0.8%
China	6.1%	6.2%	6.0%	5.9% ↓	2.5% ↑	2.4%	2.5% ↑	2.3%

Arrows indicate difference from previous month
Source: Consensus Economics Inc. London, 9 September 2019

Chart of the month



Switzerland: Real GDP growth qoq (including forecast until Q4/2020)
Real GDP growth qoq (2014 - Q2/2019; sport events adjusted)

MACROBOND

Major sport events have significant impact on Switzerland's GDP, as economic activity of organisations like the IOC, UEFA or FIFA is assigned to their domicile country under international standards. Thus, Switzerland GDP figures are higher in quarters with a major sport event taking place, and lower in other quarters. The second half of 2018 provides a good example, with official GDP figures signalling a technical recession (two consecutive quarters of negative growth). Adjusted for the fact that no major sport event took place during this time, the technical recession disappears. Looking at our forecast of the official GDP, events like UEFA Euro 2020 and the Olympic Games in Tokyo explain the spikes in our growth assumptions in the second and third quarter next year.

US
Lower expectations

GDP growth	
Swiss Life Asset Managers	Consensus
2019: 2.3 %	2019: 2.3 %
2020: 1.8 %	2020: 1.8 %

Incoming data confirms our view that the economy has been slowing to a GDP growth pace of around 1.8% in the third quarter, which is roughly the US economy's potential. We expect that pace to prevail in the fourth quarter as well. Even though data releases have been rather mixed over the past few weeks, financial markets generally reacted on a positive note, because expectations had already been scaled down. This is also reflected in consensus forecasts for growth, which have converged to our rather cautious forecast. A more conciliatory rhetoric in the US-China trade conflict (renewed talks, postponement of tariff hikes) also lifted investors' mood. Nevertheless, we remain sceptical that noteworthy progress on the thorny issues in that conflict can be achieved. Sentiment among manufacturers remains depressed and consumer confidence has not improved in line with the recovery on the stock market. Other surveys signal improvements, most impressively the ISM non-manufacturing index, but this has not yet translated in a reacceleration of hiring. Employment growth has hovered at a monthly pace of around 150 thousand, close to the threshold of 115 thousand that prevents the unemployment rate from rising.

Inflation	
Swiss Life Asset Managers	Consensus
2019: 1.8 %	2019: 1.8 %
2020: 2.2 %	2020: 2.1 %

We always had a view that US core inflation should move higher in the second half of this year, but the recent moves surpassed all expectations. Over the past three months, the seasonally adjusted index rose 3.4% on an annualized basis, the highest since 2006. This partly reflects payback from earlier weakness and should not be extrapolated, but annual core and headline inflation will likely keep rising as at trend until the first quarter of next year, also driven by the new round of tariffs.

Eurozone
Up to the finance ministers

GDP growth	
Swiss Life Asset Managers	Consensus
2019: 1.1 %	2019: 1.1 %
2020: 1.0 %	2020: 1.1 %

Until mid-2019, the moderation in the Eurozone was largely a story of weak external demand weighing on industrial export champions. Yet, the longer uncertainties around global trade and Brexit persist, the more likely it is that spill-overs into other sectors and EMU member states materialise. According to business surveys, spill-overs into services industries remain limited outside Germany. Manufacturing Purchasing Managers' Indices are available for eight individual Euro countries: the ones for Germany and Austria are clearly in contraction territory, while manufactures in France, the Netherlands and Greece report moderate expansion. The slow-down in economic activity is absorbed by automatic fiscal stabilisers. The fiscal impulse is clearly positive for the current year. Yet, more is probably needed. The outgoing ECB president, Mario Draghi, made it clear that monetary policy alone cannot stimulate the economy endlessly. He urged northern member states to make use of their fiscal room to manoeuvre. While Germany still turns a deaf ear to such calls, the Dutch cabinet has set up plans for a fund worth 50 billion Euro to pump money into innovation, research and infrastructure.

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

Perhaps the biggest surprise from the ECB came not in the form of the monetary policy easing measures, but in the downward revision of their inflation forecast for next year. ECB staff now projects average annual inflation to come in as low as 1% in 2020. After years of overly optimistic inflation projections, the ECB is now leaning at the extreme low end of projections. The range of 30 forecasts entering the sample published by Consensus Economics varies from 1.0% to 1.8%, with only one house sharing the ECB's projection.

Germany
Technical recession very likely

GDP growth

Swiss Life Asset Managers	Consensus
2019: 0.5 %	2019: 0.5 %
2020: 0.6 %	2020: 1.4 %

Our simple model to gauge current quarter GDP dynamics predicts a 0.1% drop in the third quarter. If confirmed, that would mean that Germany's economy is in technical recession. Econometric models have their limits, admittedly our model can only explain half of the quarterly change in Germany's real GDP. Yet, we can say that that the likelihood of a technical recession currently exceeds 50%. What looked like a temporary crisis in Germany's car industry is increasingly spilling over into other sectors. According to the IFO business survey data, sentiment in some services sectors has deteriorated sharply from April until August. In the freight transport business, expectations regarding the business development in the next six months stands at the lowest level since May 2009, when the world economy was slowly coming out of the great recession. Meanwhile, corporate Germany is adapting to the situation. Overcapacities in manufacturing are being reduced. According to the IFO data, a majority of firms in manufacturing industries says they plan to reduce workforce in the coming three months. More short-time work announcements by employers and a rise in the unemployment rate over the coming months is the likely consequence.

Inflation

Swiss Life Asset Managers	Consensus
2019: 1.4 %	2019: 1.4 %
2020: 1.6 %	2020: 1.5 %

We lowered the inflation forecast slightly on the back of a soft print for August. Base effects from last year's roller coaster ride of energy prices mean that annual inflation is set to slow further to 0.8% until October, before temporarily jumping to 2.3% in the first quarter 2020. While past oil price swings explain volatility in inflation data over the next months, a higher risk premium for oil in reaction to the attacks on Saudi-Arabian oil sites pose an upside risk to our forecast.

France
Confidence prevails

GDP growth

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

According to the French financial newspaper "Les Echos", France is one the beneficiaries from trade diversion resulting from the Sino-American trade dispute. In the first six months of 2019, France managed to increase its exports to both China and the US by around 15% compared with the same period last year. In sharp contrast to developments in neighbouring Germany, business sentiment in manufacturing and construction has gathered momentum so far in the third quarter. Private households have an optimistic view on future economic trends as well. According to the consumer sentiment survey conducted by INSEE, a declining net number of respondents is concerned about losing their jobs over the next twelve months. Labour market reforms start to bear fruit. Not least, this can also be seen in the growing number of foreign investors considering doing business in the country. In the financial sector, relocation from London because of Brexit is creating jobs and the same holds true for large infrastructure projects in the public transport system around Paris. In contrast to its German peer, the French government is willing to make use of its full fiscal room to manoeuvre within the Maastricht deficit criteria.

Inflation

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

No change in the inflation forecast was necessary this month. Our assumption for 2020 stays slightly above consensus, which is consistent with our judgement that robust domestic activity provides firms with a modestly rising price setting power. A tighter labour market is expected to lift wages in 2020. Owing to base effects stemming from the oil price fall at the end of last year, annual inflation is set to temporarily rise to around 2% by the first quarter 2020.

UK
Heading to a general election?

GDP growth	
Swiss Life Asset Managers	Consensus
2019: 1.2 %	2019: 1.2 %
2020: 1.1 %	2020: 1.1 %

The spectacular "takeover" of the Brexit agenda by the parliament has strengthened our view that the UK is heading towards another extension and a general election in the fourth quarter. We think that a deal ahead of 31 October is rather unlikely because no convincing solution to the Irish backstop issue has emerged and Boris Johnson's negotiation position has been crippled by the parliament's Brexit bill. A no deal Brexit on 31 October represents a tail risk only, in our view. The spat between the government and parliament has boosted Boris Johnson's popularity and the Conservative Party is currently leading in the polls. If we are indeed heading towards a general election and the Conservatives and the Brexit Party chose to run together on a "no deal platform" versus a rather split opposition, no deal remains a possible scenario. Ironically, a credible "no deal threat" also increases the probability of a breakthrough, as a deal should still be the preferred option on both sides of the Channel. We would currently put the probability of no deal as final result at around 45%. Hence, all our forecasts are based on the scenario that a favourable outcome should prevail. The significant uncertainty will, however, in any case continue to weigh on the UK's economic performance.

Inflation	
Swiss Life Asset Managers	Consensus
2019: 2.0 %	2019: 2.0 %
2020: 2.0 %	2020: 2.1 %

UK inflation data for August were a major miss; broad-based weakness across components led to the decline of headline inflation to 1.7%. We expect, however, inflation to move back towards target in the upcoming months, as inflationary pressures in the form of higher oil prices and soaring wage growth remain in place. The latter has moved to a cyclical high of 4%, the result of a surprisingly tight labour market.

Switzerland
Falling manufacturing orders

GDP growth	
Swiss Life Asset Managers	Consensus
2019: 0.7 %	2019: 1.0 %
2020: 1.2 %	2020: 1.3 %

Two major sport events will boost Switzerland's GDP in 2020 (see page 1). Stronger growth in 2020 than in the current year is thus a common pattern in all available forecasts. As one example, SECO, the State Secretariat for Economic Affairs currently predicts 0.8% growth in 2019 followed by 1.7% next year. Yet, as these numbers are distorted by the above-mentioned factors, they do not accurately mirror the general trends in the real economy. Sentiment in manufacturing remains gloomy, with the Purchasing Managers' Index for this sector holding below the 50-points expansion line for the fifth consecutive month. With 79% of their production sent abroad, Swiss mechanical and engineering industries (MEM industries) are particularly hit by uncertainties related to global trade and weakening dynamics in neighbouring Germany. According to a survey published by Swissmem, a business association, new orders fell by almost 20% compared with the second quarter last year. It is noteworthy, that orders in this sector fell less dramatically in 2015, when Switzerland stood under the shock of a severe currency appreciation. At the margin, jobs in this sector are increasingly at risk and we expect unemployment numbers to start rising in the final quarter 2019.

Inflation	
Swiss Life Asset Managers	Consensus
2019: 0.5 %	2019: 0.6 %
2020: 0.6 %	2020: 0.7 %

The Swiss National Bank (SNB) has published their own updated inflation projections. Their forecast is developed under the conditions that monetary policy remains unchanged over the entire time horizon until mid-2022. Even under this assumption, inflation is not expected to exceed 1.1% at any point in time. This message from the central bank confirms our own medium-term assessment of inflation trends.

Japan
An ill-timed tax hike

Even though the 2014 consumption tax hike led to an economic slump and stained Prime Minister Abe's popularity, Japan is set to raise the tax again on 1 October, from 8% to 10%. Given the weak external demand backdrop, the tax hike appears ill-timed as it weakens the major pillar of current Japanese growth dynamics, namely domestic demand. Still, there is reason to believe that the hangover after the tax hike will be relatively less pronounced this time. The government has already boosted fiscal spending significantly and exempted around 20% of the inflation measurement basket from the tax hike, most importantly food. Also, the positive corporate investment cycle, which should not be affected by the tax hike, remains very much in place. Inflation will obviously get a temporary boost, but against a very weak trend following the strong appreciation of the Japanese yen. Hence, the Bank of Japan will likely keep its very expansionary monetary policy in place, in our view.

China
All eyes on trade talks

The consensus forecast for Chinese GDP growth for 2020 fell to 5.9%. China's economy grows at its slowest pace since the country joined the WTO as it feels the drag of the trade conflict. Exports have slowed down, driven by tariffs and sluggish global demand. Moreover, key indicators, such as industrial production, fixed asset investments and retail sales have gradually decelerated. Export orders received by manufacturers point to ongoing weakness. October should bring new momentum into negotiations as both countries have agreed to reopen talks. While the government keeps a prudent stance as regards fiscal stimulus for now, one of its primary concerns is the impact of the growth slowdown on employment prospects for newly graduated persons. Another major concern remains surging pork prices, which are up by 47% from year ago levels. Traditionally, any failure by the government to safeguard China's population against higher costs of living raises questions as regards the legitimacy to rule the country.

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