Perspectives
Economics

SwissLife Asset Managers

October 2020

Key messages

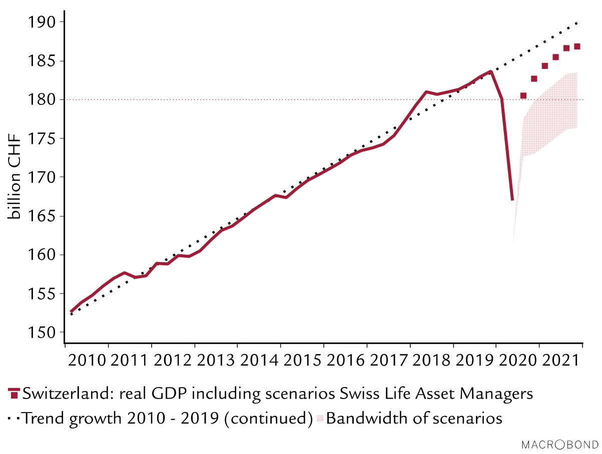
- Substantial upward revisions in the consensus GDP growth forecasts in the US and Switzerland
- Partial expiry of fiscal stimulus measures dampens the pace of economic recovery in the UK and elsewhere
- New Japanese prime minister likely to stick to predecessor's economic policy

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	-3.5% ↑	-4.4% ↑	4.0%	3.8% ↓	1.2%	1.1% ↑	1.9% ↑	1.9% ↑
Eurozone	-6.6% ↓	-7.7% ↑	5.3%	5.5% ↓	0.4% ↓	0.4%	1.1% ↓	1.0% ↓
Germany	-5.0% ↓	-5.7% ↑	4.1% ↑	4.6% ↓	0.6%	0.5%	1.6%	1.5% ↓
France	-8.0%	-9.5% ↑	7.2% ↓	6.9% ↓	0.6% ↓	0.5%	1.2% ↓	1.0%
UK	-8.9% ↓	-10.1% ↓	7.4% ↑	6.5% ↑	0.8% ↓	0.8% ↑	1.5% ↓	1.5% ↑
Switzerland	-3.8%	-5.1% ↑	4.4%	4.1% ↓	-0.5%	-0.7%	0.6%	0.2%
Japan	-4.8% ↓	-5.6% ↓	2.6%	2.6% ↑	0.1% ↓	-0.1%	0.2%	0.1% ↓
China	2.5% ↑	2.2% ↑	7.4% ↓	7.9% ↑	2.7%	2.8% ↑	1.9%	2.0%

Arrows indicate difference from previous month
Source: Consensus Economics Inc. London, 14 September 2020

Chart of the month



The world economy has recovered since May. In the US and Switzerland, "peak pessimism" is clearly behind us, with consensus forecasts for 2020 GDP growth moving up and the gap to our own projections narrowing this month. It is becoming increasingly clear that Switzerland is getting away from the COVID-19 crisis with a black eye. Yet, the recession has a lasting impact and we think it is important to highlight that even Switzerland's GDP will not return to its pre-crisis level before the final quarter 2021. In our base case scenario, GDP in Switzerland will fall three percentage points short of its underlying trend seen from 2010 until 2019. Welcome to the "97% economy"!

US
Bracing for election day

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -3.5 %	2020: -4.4 %
2021: 4.0 %	2021: 3.8 %

Incoming data confirm that the US economy recovered significantly in the third quarter, in line with our above-consensus view. Notably, the unemployment rate dropped again spectacularly, from 10.2% to 8.4%. In our view, higher employment will outweigh the negative effect on consumption stemming from lower unemployment benefits. On that front, executive orders by the president have averted a "fiscal cliff", but a permanent solution in the form of a second stimulus package is needed. With no progress so far in Congress, we only expect a compromise to emerge after the elections. On the latter, polls are currently only confident about one outcome, namely that Democrats will keep control of the House of Representatives. If President Trump is re-elected, he would thus still face limited room to manoeuvre, which implies continuity on economic policy. The same is true if a new President Biden faced a Republican Senate. In our view, the only gamechanger for the economic outlook would be a Democratic landslide, i.e. Joe Biden as president enjoying full support in Congress. This would pose an upward risk to our 2021 GDP forecast, as front-loaded fiscal spending is likely to outweigh negative effects from Biden's tax plans. The only result we should truly worry about is "no result at all", i.e. a lengthy, disorderly dispute about the outcome of the presidential race.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 1.2 %	2020: 1.1 %
2021: 1.9 %	2021: 1.9 %

In August, US consumer prices normalised further from the crisis-induced slump that occurred between March and June. Similar to economic data, however, the speed of the recovery has slowed, and annual inflation rates are thus set to stabilise over the period ahead. We expect core inflation to remain at around 1.7% until year end, while headline inflation should edge lower due to slightly lower energy price base effects until December. We expect headline inflation to (temporarily) surpass the 2% mark in the second quarter 2021 only.

Eurozone
Inflation (mis)-perceptions

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -6.6 %	2020: -7.7 %
2021: 5.3 %	2021: 5.5 %

The renewed increase in COVID-19 infection cases across Europe is reflected in weaker Purchasing Managers' Indices (PMI) for the services sector in September. While this indicates a stuttering economy at the end of the third quarter, high frequency data like Google's mobility indicators suggest that individual activity is not impacted by locally imposed, targeted containment measures. A second wave of infections has always been part of our base scenario. A tipping point in the recovery path for the economy would only occur if Europe's health care systems were overwhelmed, triggering renewed massive containment measures on a nationwide scale. Despite the recent negative news flow, such a scenario remains out of sight, in our view. Yet, as fiscal emergency measures will expire over time, the momentum of the economic recovery will slow into the final quarter 2020. Certain jobs will be lost permanently, and certain firms will disappear over the next quarters. We expect unemployment numbers to rise across Europe, an anticipation which is also reflected in consumer sentiment, which remains well below pre-crisis levels in all member states. A second look at the impressive annual growth rates projected for 2021 reveals that we expect an underlying average quarterly growth rate of just 0.5% throughout next year.

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

A wide gap has opened between official inflation statistics and the public's actual inflation perception. According to the EU Commission's consumer confidence survey, the perceived inflation rate in the Eurozone is currently exceeding 6%, while official consumer price inflation was below 1.8% for all 19 EMU member states in August. Whether the combination of coordinated massive monetary and fiscal policy impulses and high individual inflation perceptions eventually result in a structural upward shift of long-term inflation expectations of economic agents remains an open question.

Germany
Manufacturing, the latecomer

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -5.0 %	2020: -5.7 %
2021: 4.1 %	2021: 4.6 %

While the increase in new COVID-19 cases has been less drastic in Germany compared to other European countries, on a local level some stricter containment measures are still being implemented. For example, Munich, a virus hotspot, has announced stricter social distancing rules and new masks requirements at the end of September. Such announcements could impede the recovery heading into the final quarter of the year as they weigh on consumer confidence, which once again missed consensus expectations in its October print. Likewise, the September services Purchasing Managers' Index (PMI) disappointed. It dropped below the 50 mark and recorded weaker dynamics in the forward-looking subcomponents business expectations and actual incoming business. Meanwhile, activity data revealed that already the third quarter started on a weaker footing than expected. July industrial production confirmed what manufacturing PMI had already foreshadowed: the recovery is slower in Germany's manufacturing sector compared to its peers, as production remains 12% below its pre-crisis level. We thus slightly downgraded our 2020 GDP growth forecast. However, the catch-up potential for manufacturing looks substantial. In a large upside surprise, the September manufacturing PMI increased to 56.6 points, driven by new orders that reached the highest level since March 2010. Other leading indicators such as the truck toll mileage index also look solid.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.6 %	2020: 0.5 %
2021: 1.6 %	2021: 1.5 %

August harmonised consumer price inflation fell slightly into negative territory (-0.1%) for the first time since 2016. The VAT cut implemented in July thus left a clear mark on headline inflation, which had stood at close to 1% during the second quarter. We expect headline inflation to hover at around zero until year-end, before energy price base effects and the reversal of the tax cut drive it towards 2% in the course of 2021.

France
The pandemic strikes back

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -8.0 %	2020: -9.5 %
2021: 7.2 %	2021: 6.9 %

After the strong rebound in May and June, the economic recovery lost steam in the third quarter. Industrial production increased less than expected in July, reaching 93% of its pre-crisis level. According to the Purchasing Managers' Index (PMI), both manufacturing output and new orders increased only moderately in August and September, certainly much less than in neighbouring Germany and Italy. Even more problematic is the significant drop of the services PMI below the 50-points mark in September. Especially incoming business has slowed, which might reflect worries surrounding the recent surge in COVID-19 cases way above the highs seen back in April. Among Eurozone economies, only Spain is currently seeing more infections per capita than France. Nevertheless, the number of hospitalisations and intensive care unit admissions for COVID-19 patients remains well below previous peaks, by a factor of 6 and 8, respectively, likely reflecting more testing capacities and more positive test results among younger people. Hence, the health care system looks far from being overwhelmed, and the government's strategy will likely remain unchanged, namely targeted and local measures to contain the pandemic, thus limiting the economic damage. Indeed, contrary to the services PMI, the Google Mobility Index for retail, leisure and work has continued to slowly improve during the month of September, not yet indicating any change in individuals' behaviour.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.6 %	2020: 0.5 %
2021: 1.2 %	2021: 1.0 %

Inflation numbers between June and August were very volatile, a major driver being the different timing of summer sales compared to last year. Annual clothing inflation for example surged to 11.6% in July, before dropping to -0.8% in August. We expect headline inflation rates to be less volatile in the months ahead, remaining in a 0.3-0.5% range until year-end.

UK
Brexit woes add insult to injury

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -8.9 %	2020: -10.1 %
2021: 7.4 %	2021: 6.5 %

Our view on UK-EU trade negotiations has always been that "things need to get worse before they get better", a pattern we had already seen in previous years before critical Brexit deadlines. Currently, things are going according to script. This time, the government pulled the so-called Internal Market Bill out of the hat, a bill that should officially safeguard UK domestic interests if negotiations with the EU fail, but that directly contradicts the Withdrawal Agreement signed just months ago. Most probably, it is a means to put additional pressure on the EU in the trade negotiations that have yielded no progress so far. We indeed still believe that a narrow deal on goods trade should ultimately emerge. Both sides have a strong interest not to erect trade barriers, and despite contentious issues such as fishing rights, it should be easier to find common ground on goods trade than on the complicated Northern Ireland issue that was settled at the eleventh-hour last year. Nevertheless, a compromise will likely only be reached shortly before the end of December deadline, which implies continued uncertainty for businesses that are already confronted with a surprisingly sluggish recovery and uncertainty whether the job retention scheme will be prolonged beyond October 2020. Contrary to most other developed economies, "peak pessimism" has not yet been left behind. The 2020 GDP consensus estimate and our own forecast were revised down in each monthly forecast round since March and December, respectively.

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

The value-added tax (VAT) cut as well as the "eat out to help out" programme left its mark in the August consumer price inflation report. Annual headline inflation fell from 1.0% to 0.2%. We expect inflation to recover somewhat until year-end, before the unwinding of the temporary VAT cut will lead to a jump above the 1%-mark at the beginning of 2021.

Switzerland
Consensus forecast moves higher

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -3.8 %	2020: -5.1 %
2021: 4.4 %	2021: 4.1 %

Switzerland's real GDP shrunk by 8.2% in the second quarter, which was exactly in line with our own projection. High frequency indicators and an accurate assessment of the impact of social distancing and lockdown measures on individual sectors allowed a precision landing despite the lack of visibility at the start of the quarter. It allows us to leave our forecast for 2020 at -3.8% for the fourth consecutive month. As incoming indicators came in better than feared by most analysts, the consensus estimate saw a noteworthy upward revision from -5.6% to -5.1% over the last month. The large exposure to the pharmaceutical industry, a comparably early reopening of the economy and a sweeping fiscal response to fight the recession help Switzerland to get away from the COVID-19 crisis with a black eye. All these factors remain in place, with the pharmaceutical industry benefiting from rising demand related to the search for treatments and vaccines to fight the pandemic. Potential renewed targeted containment measures to cope with a second wave of new infections may temporarily have a dampening impact on domestic economic activity in the services sectors. Meanwhile, as social life normalises gradually, the longer-term impacts of the crisis are coming to the surface: among them are the weak orders intake in the mechanical and electrical engineering industries and prospects of rising unemployment and corporate bankruptcies in the aftermath of the crisis.

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

Annual consumer price inflation is set to stay negative until early 2021, when base effects from very low energy prices will fade. While hotels were in the position to raise prices during the summer months, falling import prices are still offsetting price pressure in the domestic services sectors. At 0.6%, our inflation forecast for the coming year is the highest in the sample of 18 institutions polled by Consensus Economics Inc.

Japan
Suganomics follows Abenomics

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -4.8 %	2020: -5.6 %
2021: 2.6 %	2021: 2.6 %

Due to health reasons, Shinzo Abe stepped down as the longest-serving Japanese prime minister, handing over to Yoshihide Suga who was elected leader of the ruling Liberal Democratic Party on 14 September. Shinzo Abe's economic policies ("Abenomics") were pivotal in reviving economic growth and ending three decades of deflation. Following years of economic underperformance, Japan's real GDP per capita increased by 1.3% p.a. during the Abenomics years 2012-2019, twice as fast as in Switzerland and higher than in Germany or the UK. The track record on inflation might seem disappointing when looking at consumer prices, but much more important is the fact that pricing power of companies has risen. The GDP deflator, which also captures prices of investment spending and external trade, declined by a whopping 16% between 1994 and 2012, when Abe took power. Since then, it has recovered by 4%, supported by extremely loose monetary policy and structural reforms, which also helped to push growth of base wages into positive territory again. As reflected in the benign market reaction, we expect continuity in both monetary and economic policy under Prime Minister Suga. According to political analysts, the only potential change might be a slight shift of "Suganomics" from "macro" to "micro", i.e. a more industry-specific approach to reform (e.g. banking sector reform, sector-specific digitisation push).

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

Shinzo Abe's resignation just precedes a renewed dip of consumer price inflation into negative territory, as positive base effects from last year's consumption tax hike drop out of the calculation in October. Underlying inflation has been weak due to underutilised capacities and a stronger yen, but the ongoing recovery should ultimately push inflation back above zero in the second quarter 2021.

China
Recovery gaining steam

GDP growth	
Swiss Life Asset Managers	Consensus
2020: 2.5 %	2020: 2.2 %
2021: 7.4 %	2021: 7.9 %

China's economic recovery is gaining steam. Since the country has been successful in containing the spread of the pandemic, it has substantially eased its social-distancing measures. This shift has been evident in recent economic indicators. August retails sales have reached year-ago levels for the first time this year, while the official NBS Purchasing Managers' Index (PMI) for the services sector remained well in expansionary territory. Therefore, we expect the recovery in the services sector to pick up speed and revise up our annual GDP forecast to 2.5%, from 2.3% previously. However, headwinds remain: On the one hand, the government is determined to cool the property market, as housing prices in tier-1 cities started to soar. On the other hand, the US-China conflict is not abating. With multiple threats looming, such as restrictions of US technology exports to Chinese semiconductor company SMIC, the risk of a decoupling between the two superpowers has increased. This in turn would not only dent Chinese growth in the short-term, but also weigh on China's potential growth due to weaker productivity growth if technology transfer comes to an end. Moreover, a potential shift to the Democrats in the upcoming US elections would not necessarily be a boon for China, since the hawkish view towards the country is not limited to the Trump administration.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 2.7 %	2020: 2.8 %
2021: 1.9 %	2021: 2.0 %

Food prices in China continue to decelerate, as the country's pork supply continues to recover from the destruction the African Swine Fever caused. As we expect pork price inflation to continue to decelerate, Chinese consumer prices should continue to ease in the upcoming months. Meanwhile, core prices remained very low at 0.5%, showing that the demand recovery still has some way to go.

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