Perspectives
Economics

February 2019

Key messages

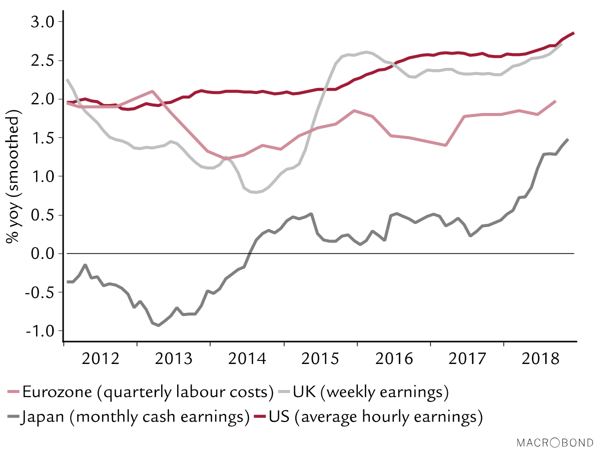
- While headline inflation falls due to lower energy prices, core inflation maintains upward momentum
- We continue to expect a gradual recovery in industrial production data out of Continental Europe
- A “Blind Brexit” remains the most likely outcome of Europe’s biggest political issue

Comparison of forecasts

	GDP 2019		GDP 2020		CPI 2020		CPI 2020	
	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus
US	2.3%	2.5% ↓	1.5%	1.8%	1.9% ↑	1.9% ↓	2.2%	2.2%
Eurozone	1.3%	1.5% ↓	1.1%	1.4%	1.6%	1.5% ↓	1.6%	1.5%
UK	1.4%	1.5%	1.3%	1.6%	2.1% ↑	2.0% ↓	2.0%	2.1%
Switzerland	1.2%	1.5% ↓	1.4% ↑	1.6%	0.6%	0.7% ↓	0.8%	0.9%
Japan	1.0% ↓	1.0% ↓	0.5% ↓	0.4%	0.9% ↓	0.9%	1.5% ↓	1.3%
China	6.2%	6.2% ↓	6.0%	6.1%	2.3% ↓	2.2% ↓	2.2%	2.2%

Arrows indicate difference from previous month
Source: Consensus Economics Inc. London, 14.01.2019

Chart of the month



Years of above-potential growth have led to falling unemployment rates in most developed markets. Even in the Eurozone, where the growth engine stuttered in 2018, the unemployment rate continued to decline – reaching new post-crisis lows. Hence, wage growth has picked up in all major economies. In combination with lower oil prices, consumption is set to remain solid in 2019. Some of the wage growth should also feed into core inflation, which we expect to very gradually rise in the US, the Eurozone, Japan and the UK this year.

US
Shutdown adds growth risks

GDP growth	
Swiss Life Asset Managers	Consensus
2019: 2.3 %	2019: 2.5 %
2020: 1.5 %	2020: 1.8 %

The shutdown of around 30% of the US government has been the longest on record and there are no signs of a resolution at the time of writing. As government employees and contractors are missing their paychecks, each week of closed government is estimated to subtract around 0.1 percentage points of annualized quarterly GDP growth. In addition, tax refunds might arrive somewhat delayed this year, which could additionally weigh on growth in the first quarter. Once the government re-opens, we expect growth to rebound as employees are being repaid lost salaries. Still, some permanent loss of output is likely especially if the recent decline in consumer sentiment proved to be more protracted. On the positive side, the US economy ended the year 2018 on a strong note, carrying over more swing into 2019 than we had previously expected. Hence, we keep our cautious, below-consensus GDP growth forecast of 2.3% for 2019 unchanged at this stage, while monitoring the downside risks stemming from the shutdown. We also stick to our view that US recession risks are low this year, as the labour market has remained very healthy and the US Federal Reserve has signalled to move to a more cautious policy stance.

Inflation	
Swiss Life Asset Managers	Consensus
2019: 1.9 %	2019: 1.9 %
2020: 2.2 %	2020: 2.2 %

US headline inflation fell below 2% in December on the back of lower oil prices. We expect another drop in January, followed by a moderate recovery during the rest of the year. Core inflation has remained solid, and the expected decline in January should mainly reflect a negative base effect. Overall, we foresee core inflation to embark on a very gradual uptrend, as rising wage growth should filter through into services prices. Still, both headline and core inflation will remain well within the US Fed's comfort zone, giving it room to manoeuvre on the monetary policy front.

Eurozone
Home-grown inflation on the rise

GDP growth	
Swiss Life Asset Managers	Consensus
2019: 1.3 %	2019: 1.5 %
2020: 1.1 %	2020: 1.4 %

Was it just the "diesel dip", or is a global slowdown behind soft data from the cyclical industrial sectors across the Eurozone? Apart from unsolved political issues in the European Union, this is the central question in all forecasting exercises for the Eurozone. As far as softening global dynamics are concerned, we have developed a prudent forecast long before the majority of our peers: relative to consensus, our forecast for Eurozone growth stood markedly below the consensus forecast since January 2018 already. When problems of Germany's car manufacturers became visible in economic data, we lowered our forecast for the 2019 from 1.4% to 1.3%. For the time being, we continue to consider domestic conditions as firm: wage growth has started to accelerate and lending conditions for the corporate sector have continued to ease in the final quarter 2018. Thus, for the time being, our answers to the questions above are as follows: short-term, we expect a rebound in industrial activity, making up for some of the losses in the car industries through the second half of 2018. Yet, medium-term, headwinds in the form of trade policy and monetary policy normalisation weigh on the outlook for 2020.

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

While we still think that the ECB will miss their inflation target of "close to, but below 2%" this year and in 2020, we suddenly find ourselves above consensus with our forecasts for both years. In our view, headline inflation forecasts elsewhere have corrected too rapidly in response to falling energy prices. Upside risks in core inflation have grown as of late: accelerating wage dynamics across the region have triggered a rise in our index of domestically generated inflation to 1.5% by the end of the third quarter 2018. This is the highest rate since 2012.

UK
We still expect a "Blind Brexit"

GDP growth	
Swiss Life Asset Managers	Consensus
2019: 1.4 %	2019: 1.5 %
2020: 1.3 %	2020: 1.6 %

We cannot predict to which end the debate on Brexit in the House of Commons will lead. Neither do we know much about the EU's flexibility on extending negotiations. Nevertheless, we interpret recent developments such as there is no mandate for a "no-deal" Brexit for Theresa May and that a noticeable number of EU members seems willing to extend the negotiation period beyond March 29. As always in Europe's recent history, the ultimate decisions will be made in the final hours. Despite the cacophony in Westminster, in our view, a "Blind Brexit" remains the most likely outcome: that means a negotiated compromise on a minimum of issues with an agreement on extending negotiations for a defined period of time. Given all the uncertainties, we have to continue thinking in scenarios: in the second week of January, London based Consensus Economics asked their UK panellists about their 2019 growth forecasts under three alternative scenarios. According to this poll, UK GDP would grow by 0.88% in a "No Deal" scenario, by 1.48% should a compromise be reached and 1.63% in case of no Brexit.

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

Inflation in the UK has eased from 3.0% in January 2018 to 2.1% in the final month of the year. Higher railway fares which will enter consumer price statistics in January 2019 prevent inflation from falling further during the first quarter 2019 in our view. In a worst case Brexit scenario it is imaginable that higher import prices and transportation bottlenecks could result in higher prices for imported goods after March 29. On the other hand, anecdotal evidence of massive stockpiling suggests that there is a risk of heavy discounting by suppliers in case that a "No Deal" scenario could be prevented. In our base case, we expect inflation to ease to slightly below 2% in the third quarter 2019.

Switzerland
A wave of disappointing data

GDP growth	
Swiss Life Asset Managers	Consensus
2019: 1.2 %	2019: 1.5 %
2020: 1.4 %	2020: 1.6 %

Citigroup's economic surprises index reflects the substantial change in momentum as regards economic dynamics in Switzerland: back in September 2018, the index stood more than one standard deviation above its historic mean. Only four months later, the index finds itself more than one standard deviation below long-term average. Thus, incoming data have disappointed expectations markedly. As a consequence, the consensus forecast for growth in 2019 has been lowered in two steps since November from initially 1.8% to now 1.5%. Since Switzerland's manufacturing purchasing managers' index contains no data on incoming orders, a look at developments elsewhere tells us more about future export dynamics: the Swiss National Bank's (SNB) "manufacturing abroad PMI" suggests that export growth is set to slow by half over the next three quarters. In sum, recent developments confirm our earlier prudence as regards global dynamics and their impact on the Swiss economy. Thus we leave our forecast for 2019 unchanged at 1.2%, which is where it stood since May last year.

Inflation	
Swiss Life Asset Managers	Consensus
2019: 0.6 %	2019: 0.7 %
2020: 0.8 %	2020: 0.9 %

The trend in inflation is down, with falling energy prices playing a key role. Retail prices for gasoline and heating oil continued to fall through January, which forced us to lower the forecast for average annual inflation in 2019 to just 0.6%. Given the SNB's monetary policy target of holding inflation in a band of between 0% and 2%, the central bank is prudently watching price developments and has few incentives to change course. This is even truer as rents, a heavyweight in the consumer price index, are likely to contribute negatively to inflation in 2019. An immediate reversal of the oil price's down-move of the last three months poses the biggest upside risk to our forecast for the being.

Japan
Relaxing immigration rules

Japan's economy experienced a disappointing year 2018. Growth slowed back to potential, undershooting economists' expectations and defying fairly resilient business surveys. We see few catalysts that could bring a major acceleration and thus cut our GDP forecast for 2019 to 1.0%. The domestic economy should remain well supported by rising household incomes, but external demand is suffering from the slowdown in the global industrial cycle. To address the intensifying labour shortage, the government has relaxed immigration rules. Under a new scheme effective April 2019, some additional 345'000 workers (0.5% of the current labour force) will be granted work visas over the next five years. The growth effect of this measure alone is marginal. However, the move has to be seen in the context of a general cautious push toward a more liberal immigration regime, which would be a long-term positive for the economy. At last, it seems that Prime Minister Abe is starting to deliver on his "Third Arrow".

China
Economic moderation continues

China's annual GDP growth has slowed down to 6.6 percent in 2018, representing the slowest annual growth rate since 1990. Fourth quarter GDP growth fell to 6.4%, slowing for three consecutive quarters. Nevertheless, December data showed that the country's key economic indicators, retail sales, fixed asset investment and industrial production have stabilized, although at low levels. China's economic slowdown was mainly driven by Beijing's campaign to control financial risk which led to a drop in infrastructure spending and limited credit access for privately owned companies. Moreover, the trade conflict with the US is weighing on business and consumer sentiment, leading to a slowdown in consumption and capital expenditure. While a continued moderation of China's economic expansion is to be expected as the country is increasingly focusing on growth quality over quantity, China will likely step up fiscal and monetary stimulus measures, which should prevent a sharper downturn of its economy.

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