Perspectives
Economics

April 2018

Key messages

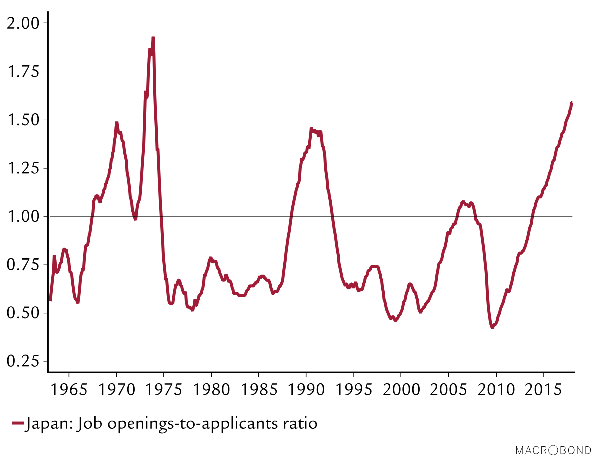
- US consumers are waiting for their tax refunds
- While deflation fears have gone, risks of accelerating inflation remain limited as global growth moderates
- With the exception of Japan, our GDP growth forecasts for 2019 are below consensus estimates

Comparison of forecasts

	GDP 2018				GDP 2019				CPI 2018				CPI 2019			
	Swiss Life AM		Consensus		Swiss Life AM		Consensus		Swiss Life AM		Consensus		Swiss Life AM		Consensus	
US	2.5%	↓	2.8%		2.2%		2.6%	↑	2.5%	↓	2.4%	↑	2.0%	↓	2.1%	↓
Eurozone	2.2%	↑	2.4%	↑	1.4%		1.9%		1.5%		1.5%		1.3%		1.5%	
UK	1.3%	↓	1.6%	↑	1.0%		1.5%		2.3%	↓	2.6%		2.0%		2.2%	
Switzerland	2.0%	↑	2.1%	↑	1.3%		1.7%		0.9%	↑	0.8%		0.8%		1.0%	
Japan	1.5%	↑	1.4%		1.1%		1.1%		1.6%	↑	1.0%		0.4%		1.1%	
China	6.5%		6.5%		6.1%		6.3%		2.3%	↑	2.3%		2.2%	↑	2.3%	↑

Arrows indicate difference from previous month
Source for Consensus: Consensus Economics Inc. London, 12.03.2018

Chart of the month



The performance of the Japanese labour market has been impressive over past years. While the labour force participation rate has increased, this additional pool of workers got easily integrated into the working population. The unemployment rate dropped to 2.4% in January 2018, the lowest rate since March 1993. There are still clearly more job openings than available workers as illustrated by the chart on the left side. The ratio hit the highest level since 1974. The relentless tightening of the labour market should persist. Yet, as in other economies too, wage inflation remains very modest.

US
Tax refunds are late

GDP growth	
Swiss Life Asset Managers	Consensus
2018: 2.5 %	2018: 2.8 %
2019: 2.2%	2019: 2.6 %

Having received retail sales data for February after modest January sales figures, one needs to adopt a cautious stance as regards the contribution of personal consumption to overall GDP growth in the first quarter. Total sales fell for the third month in a row. In February, the total value of sales was dragged down by weak auto sales and the fall in gasoline prices. Excluding cars and gasoline, sales have increased by 0.3% from the previous month, which is still a sturdy number. This year, tax authorities are slow to refund formerly withheld income tax payments to households, which puts a brake on consumer spending in February. The odds are that once refunds are booked on households' bank accounts, retail sales may rebound in March. The increase of mortgage interest rates and the impact on consumer spending bears watching going forward. Besides the obvious weakness of personal consumption, however, risks for overall GDP growth in the first quarter arise from the threat of higher tariffs for imports. This should bring import activity forward to avoid higher prices of imported goods. Higher imports weigh on GDP growth. Due to those reasons, we felt the need to downgrade the growth outlook for the first quarter only which however has an impact on annual average GDP growth for 2018.

Inflation	
Swiss Life Asset Managers	Consensus
2018: 2.5 %	2018: 2.4 %
2019: 2.0 %	2019: 2.1 %

Our high-frequency data on prices at gasoline stations hint at yet another negative contribution of fuel to headline inflation in March. The downward revision of the annual average for 2018 is to be traced back to this development. Over past months, core goods prices have increased from very negative territory to slightly negative territory. Core services prices moved sideways, posting an annual increase of 2.6% in February. We expect this pattern to persist. In the medium to long-term, wage inflation and productivity will be major drivers of price pressures.

Eurozone
Not in the comfort zone yet

GDP growth	
Swiss Life Asset Managers	Consensus
2018: 2.2 %	2018: 2.4 %
2019: 1.4 %	2019: 1.9 %

Certain political hurdles have been taken although the government formation in Italy is still out in the open. With no absolute majority emerging, the parties have the option of coalition building. This process may take a while. Survey data on the business side across the Eurozone have weakened and can be expected to weaken further from current levels given the risk of an escalation when it comes to trade tariffs and rising protectionism. Although purchasing managers' indices from the manufacturing sector may have reached a peak at this stage of the cycle, the services sector's current activity also looks very robust. The domestically- driven side of the economy is catching up and benefits from the ongoing healing of the labour market in most member countries. A noteworthy exception here is Italy where the unemployment rate has receded much more slowly than elsewhere in the currency region and on the contrary has increased again lately. After many quarters of above potential growth, we doubt that the Eurozone economy will pick up speed again. Our growth path going forward much rather foresees quarterly growth rates which slow down to 1.2% annualised growth in 2019 from currently 2.0%. Financial conditions may tighten moderately going forward, but not enough to endanger economic dynamics.

Inflation	
Swiss Life Asset Managers	Consensus
2018: 1.5 %	2018: 1.5 %
2019: 1.3 %	2019: 1.5 %

Inflation pressure remains largely absent in this cycle so far. The base effect will push headline inflation towards the ominous level of 1.7%, which has been viewed by the market as being a threshold level for the ECB to feel comfortable. By year-end 2018, however, that comfort will already be gone again. Our own forecast foresees inflation to drop back to 1.4% by December 2018. A stronger Euro cheapens imports and prevents core as well as headline inflation to reach the ECB's target. Core inflation will be stuck at around 1% for the best part of this year.

UK
The data start softening

GDP growth	
Swiss Life Asset Managers	Consensus
2018: 1.3 %	2018: 1.6 %
2019: 1.0 %	2019: 1.5 %

According to the latest poll conducted by Consensus Economics, the range of available forecasts for GDP growth in 2018 remains widespread: While the most optimistic analysts expect growth to reach 2% (and thus to accelerate from 2017), the most prudent assumptions stand at a mere 1% real growth rate. With a slightly lowered forecast of now 1.3%, we line up at the lower end of the range. As discussed in previous comments, all depends on the corporate sector's willingness to invest in times of high uncertainty as regards access to Europe's single market. In the meantime, a deal on the transition period has been reached between the negotiation partners. Yet, in light of the looming risk of additional damage on global trade caused by US trade policies, we continue to expect widespread restraint amongst firms when it comes to invest in the UK. Clearly, the above mentioned political developments force us to think in scenarios with binary outcomes and our prudence may well prove overly cautious. Yet, the incoming data speak for themselves: As per February, the cyclical manufacturing purchasing manager's index dropped to its lowest reading since June 2017. Additionally, the NIESR rolling estimate of quarterly growth dynamics eased to 0.3%, or only half the pace reported for the last quarter 2017.

Inflation	
Swiss Life Asset Managers	Consensus
2018: 2.3 %	2018: 2.6 %
2019: 2.0 %	2019: 2.2 %

February data confirmed our view that the surge in inflation, which followed the Sterling depreciation after the EU referendum in summer 2016, was only temporary. Annual inflation fell from 3.0% to 2.7%, with lower food and fuel prices pushing the headline number strongly downwards. The most recent print came in slightly below our assumptions. Together with the recent strengthening of the Sterling and our forecast of below potential growth over the coming quarters, this justifies a slight reduction of our forecasts.

Switzerland
Unemployment falls below 3%

GDP growth	
Swiss Life Asset Managers	Consensus
2018: 2.0 %	2018: 2.1 %
2019: 1.3 %	2019: 1.7 %

Economic growth strengthened in the second half of 2017 as can be seen by the fourth quarter GDP data: On average, real GDP grew by 1.1% from the previous year, with annual growth accelerating to 1.9% through the final quarter 2017. This marks the strongest annual gain since 2014. The last three years stood under the impression of the currency shock imposed on the economy by the Swiss National Bank with their decision to abandon the minimum exchange rate policy. Three years ago, we assumed that improving growth dynamics elsewhere should prevent Switzerland from a recession despite the strong Franc. On the other hand, we expected a prolonged period with subdued growth because of weak private consumption as well as prudent investment and hiring activity by private firms weighing on domestic dynamics. All of this materialised and made Switzerland a laggard in the current global upswing which started in 2016. Yet, available data for the first quarter 2018 suggest that Switzerland continues to catch up: Only in four months since its inception in 1995, the manufacturing sector's purchasing managers index (PMI) reached a higher level than the one reported for March 2018. Real retail sales stabilised since mid-2017 and the unemployment rate dropped below 3% for the first time since August 2012.

Inflation	
Swiss Life Asset Managers	Consensus
2018: 0.9 %	2018: 0.8 %
2019: 0.8 %	2019: 1.0 %

Data for the consumer price index surprised to the upside in each of the last three months. Retailers and service providers start testing their price setting power in light of stronger economic dynamics and rising import prices. In February, the impact of the weaker Swiss Franc became particularly obvious as package prices for holidays abroad were strongly contributing to the upside move in the consumer price index. As a consequence, we lift our forecast to 0.9% inflation on average this year.

Japan
Fading tailwinds from weak Yen

Last month, we explained that Japan's national account statistics have a notorious tradition of massive revisions between the first estimate and the final numbers. And indeed, it happened again. The surprisingly low initial report for the final quarter 2017 forced us temporarily to cut our growth forecast for 2018. Since then, a first revision has validated our earlier assumptions. Thus, we have to bring the forecast back to where it has been two months ago. A fiscal stimulus throughout 2018 ensures that Japan's economic expansion, which is already the longest since the end of the eighties, will continue. This winning streak resulted in tight labour market conditions (as described on page 1). Yet, last year's strong economic growth was decisively supported by the synchronous global upswing and the marked weakening of the Japanese Yen. With risks of a wave of protectionist measures building and the Yen's trade weighted external value having increased by 5% since the start of the year, these tailwinds for the exporting sectors seem to fade.

China
Xi's new era reinforced

Activity data had a strong start into the year 2018. In recent weeks, politics was however more important than economic data. The National People's Congress has set the policy priorities. The first main topic was Xi Jinping's new era. President Xi who heralds and defines this new era has further strengthened his power. The new era itself, addresses the needs for a better life, e.g. reducing poverty and air pollution. Authorities have committed to shift their focus from the quantity to the quality of growth. Yet, China is still at the very beginning of this transition. The second main topic was financial stability. In order to contain financial leverage and to curb shadow banking, financial regulation will be tightened further and the monetary policy stance should be neutral. These policy priorities will strengthen China's economic model. The main risk involved is overtightening of financial regulation. The other major risk is US trade policy. China has reacted prudently to the announcements attempting to avoid an escalation of trade measures.

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