

April 2019

Key messages

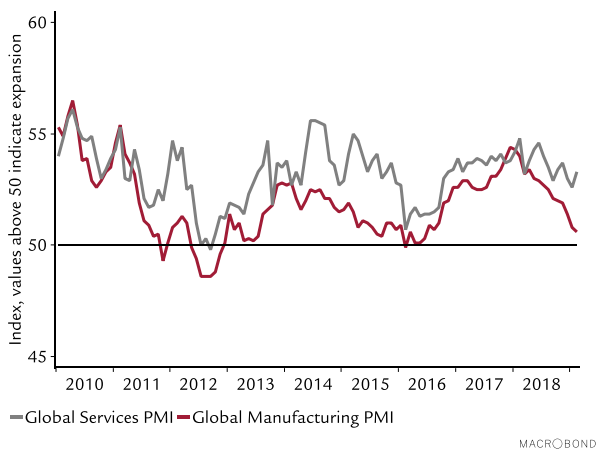
- The US economy is still slowing, while we believe that the worst in the Eurozone is over
- Consensus expectations have been cut drastically and are now broadly in line with our forecasts
- Political risks in the form of Brexit and potential US tariffs on autos will keep uncertainty elevated

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% | 2.4% ↓ | 1.5% | 2.0% ↑ | 1.9% | 1.8% ↓ | 2.2% | 2.2% |
| Eurozone | 1.2% | 1.2% ↓ | 1.1% | 1.4% | 1.4% | 1.3% ↓ | 1.6% | 1.5% |
| UK | 1.3% | 1.3% ↓ | 1.3% | 1.5% | 1.9% | 2.0% | 2.0% | 2.1% |
| Switzerland | 1.0% ↓ | 1.3% ↓ | 1.4% | 1.5% ↓ | 0.6% | 0.6% ↓ | 0.8% | 0.9% |
| Japan | 0.7% | 0.7% ↓ | 0.4% | 0.4% | 0.9% | 0.7% ↓ | 1.2% ↓ | 1.0% ↓ |
| China | 6.2% | 6.2% | 6.0% | 6.1% | 2.2% ↓ | 2.1% ↓ | 2.2% | 2.1% ↓ |

Arrows indicate difference from previous month
Source: Consensus Economics Inc. London, 11.03.2019

Chart of the month



A huge gap has opened up between slowing manufacturing activity and resilient domestic economies across the globe. This is best reflected in the Purchasing Managers' Indices (PMI), the broadest leading indicator for the global economy. Part of the slowdown in manufacturing is technical in nature, as some payback following the extraordinary synchronised upswing in 2017 had to be expected. More fundamentally, the slowing Chinese economy has been a driving factor for the downturn in manufacturing. Meanwhile, dovish central banks, rising real wages and looser financial conditions have supported domestic demand, especially in developed economies.

US A soft landing

GDP growth

| Swiss Life Asset Managers | Consensus |
|---------------------------|------------|
| 2019: 2.3% | 2019: 2.4% |
| 2020: 1.5% | 2020: 2.0% |

The US economy is in the midst of a gradual slowdown which will bring growth closer to potential this year and likely even below next year. Most recent data releases, have been very much in line with our projections. One notable exception was the February labour market report which showed US employment growth almost stalling, raising the spectre of a more pronounced slowdown. Much of the weak employment data can, however, be attributed to temporary issues such as the government shutdown and adverse weather conditions. Other aspects of the report actually surprised very positively – the unemployment rate dropped and wage growth accelerated further. Conditions for US consumers thus remain favourable, reflected in a rebound in consumer sentiment indicators. Looser financial conditions, reflected in lower mortgage rates and an equity market rally, supported sentiment as well. The very dovish turn of the US Federal Reserve at their March meeting will likely keep financial conditions buoyant. Hence, we expect consumption to remain fairly solid, defying fears that arose following dismal retail sales numbers around the turn of the year. Nevertheless, as in other economies, industrial activity will remain under pressure due to weaker foreign demand and no signs of a ramp-up in domestic investments.

Inflation

| Swiss Life Asset Managers | Consensus |
|---------------------------|------------|
| 2019: 1.9% | 2019: 1.8% |
| 2020: 2.2% | 2020: 2.2% |

We have long been positioned below consensus with our 2019 inflation forecast, but have recently been overtaken by the analyst community. The disappointing inflation numbers at the start of the year are indeed a downside risk to our forecast, but other signs are more encouraging. First, most of the rebound in oil prices will only show up in March inflation numbers, as gasoline prices have lagged oil prices. Second, wage growth has accelerated further, making a strong case for a recovery of core inflation over the months ahead.

Eurozone A series of one-offs hit growth

GDP growth

| Swiss Life Asset Managers | Consensus |
|---------------------------|------------|
| 2019: 1.2% | 2019: 1.2% |
| 2020: 1.1% | 2020: 1.4% |

The OECD revised Eurozone 2019 growth significantly lower, from 1.8% to 1.0%, but the news content is very limited as consensus expectations have already been trending lower since November last year. Uncertainties related to Brexit and global trade are clearly weighing on all export-oriented economies in Europe. On top of moderating global economic momentum, Germany's manufacturing sector was hit by three developments: First, the new emission standards for cars caused massive delays in production during the second half of 2018. However, more recent statistics on new orders and new car registrations across Europe suggest that this effect should prove temporary. Hence, industrial production is likely to further recover in the months ahead. The second impediment to Germany's manufacturers was the low water levels on major water transport ways like the river Rhine. Water levels have normalised in March, and we expect transport activity to improve accordingly. A third threat to Germany's manufacturers and European carmakers is unlikely to disappear as smoothly as the other two sources of concern: Until May, the US administration is expected to announce changes in the tariff structure for car imports. Thus, risks to our growth outlook remain skewed to the downside for the moment.

Inflation

| Swiss Life Asset Managers | Consensus |
|---------------------------|------------|
| 2019: 1.4% | 2019: 1.3% |
| 2020: 1.6% | 2020: 1.5% |

Our inflation projections for the Eurozone are slightly above consensus as we do expect recovering energy prices and continued wage growth to feed through to consumer prices later this year. Short-term, we do expect annual inflation to accelerate to 1.9% until April 2019, before base effects inherited from last year's fall of the oil price result in a renewed drop in the headline inflation rate. Core inflation is expected to rise from currently 1.0% to 1.5% by the end of 2019.

UK Plenty of unknowns

GDP growth

| Swiss Life Asset Managers | Consensus |
|---------------------------|------------|
| 2019: 1.3% | 2019: 1.3% |
| 2020: 1.3% | 2020: 1.5% |

Our base case scenario for how Brexit negotiations would develop has always been that there will be a deal, but that plenty of issues will remain unsettled by March 29. We continue to see the risk of a “no-deal Brexit” as limited, but a political accident in Westminster can still not be excluded. Meanwhile, as this text is being completed on the day of yet another summit with Theresa May and her EU partners, we think that an agreement on an extension period remains the most likely outcome until end of March. While the political unknowns remain plentiful, the economic resilience remains astonishing. According to Citigroup’s economic surprises indices, the UK economy is the only major developed economy to have posted net positive surprises with the economic data published over the last month. Apparently, market expectations have been overly pessimistic with Brexit looming. Instead, a report on monthly GDP dynamics published by the ONS (Office for National Statistics) suggests that the economy expanded by 0.5% in January 2019, the fastest monthly rate since December 2016.

Inflation

| Swiss Life Asset Managers | Consensus |
|---------------------------|------------|
| 2019: 1.9% | 2019: 2.0% |
| 2020: 2.0% | 2020: 2.1% |

Headline inflation stayed below 2% in February, with annual core inflation surprisingly easing to 1.8%. The late Easter date this year may cause some distortion in the monthly inflation prints for the upcoming two months. Yet, once this potential volatility is overcome, we expect inflation to fluctuate around 1.9% for the rest of the year. This is somewhat below our previous assumptions and comes in response to the recent strengthening of the British Pound. A “no-deal Brexit” would most likely trigger a renewed weakening of the currency and cause a temporary surge in inflation via higher import prices. On the other side, the continued rise in wage growth is an upside risk to inflation in case that a Brexit agreement is ultimately struck.

Switzerland Slowing to more normal pace

GDP growth

| Swiss Life Asset Managers | Consensus |
|---------------------------|------------|
| 2019: 1.0% | 2019: 1.3% |
| 2020: 1.4% | 2020: 1.5% |

What a change a year can make. Twelve months ago, our forecast for GDP growth in 2019 stood at 1.3%. This was substantially below the consensus projection which back then stood at 1.8%. Uncertainties on global trade dynamics and business surveys hinting at substantially less new orders received by firms in the manufacturing sectors have triggered substantial downward revisions to the growth projections for 2019. In March, the Federal Government’s expert group lowered its forecast for growth through 2019 to 1.1%, down from 1.5% previously. Swissmem, the business association for firms in mechanical and electrical engineering industries, reported a year-on-year drop of new orders by 11% in the fourth quarter 2018. Export dynamics in other sectors like pharmaceutical industries and services look more robust and are likely to contribute positively to growth during the first quarter 2019. It is important to understand that the observed slowdown in economic momentum is a return to a more normal pace from an exceptional buoyancy in the years 2017 and 2018.

Inflation

| Swiss Life Asset Managers | Consensus |
|---------------------------|------------|
| 2019: 0.6% | 2019: 0.6% |
| 2020: 0.8% | 2020: 0.9% |

Similar to the downgrades in the growth forecasts, current assumptions on inflation in 2019 are substantially lower than one year ago. The main reason for the downward revisions was the falling oil price. Compared with the fourth quarter 2018, the retail price for heating oil fell by 11% on average until mid-March 2019. Even though crude oil prices recovered from the lows reached by the end of 2018, upside risks to our inflation call are limited for 2019 as we expect the rents component in the consumer price index to stay flat or even move gradually lower until December. In our base case scenario until end of 2021, inflation is expected to stay in the lower half of the price stability band of 0% to 2% targeted by the Swiss National Bank.

Japan Growth close to potential

The Japanese economy is ailing from the weakness in external demand, while domestic drivers are gradually running out of steam. The latter includes an extremely tight labour market, limiting the potential from supply-driven growth, and monetary policy reaching its limits to ease policy further. We expect growth to be close to potential this year, but with significant swings in the quarterly data. The scheduled consumption tax hike in October will lead to front-loaded consumer purchases, followed by a sharp drop in activity in the fourth quarter of 2019. The government tries to cushion that blow by various stimulus measures, but it is difficult to assess to what extent these will actually feed into growth numbers. Past experiences with large fiscal packages have been rather disappointing, as fiscal multipliers tend to be extremely low in Japan. Inflation will obviously get a temporary boost by the consumption tax hike, but we expect the underlying trend in inflation to remain in a subdued range of 0% to 0.5%.

China Enhanced easing measures

China's government is committed to support the country's economy that has been slowing due to Beijing's campaign to control financial risk, and the trade conflict with the US that took a toll on business and consumer confidence. This has been reaffirmed this month in the government work report – the roadmap of China's economic targets for the current year – in which Chinese premier Li Keqiang unveiled a tax cut amounting to RMB 2 trillion as well as an increase in the issuance of special local government bonds to support infrastructure spending. Although the announced easing measures reaffirm a growth supporting policy stance, they remain prudent compared to past stimulus cycles, as the country remains focused to follow a more sustainable growth path. For 2019, China lowered its growth target to a range of 6–6.5%, showing its willingness to accept a slower economic expansion. Meanwhile, first indicators, such as the broad credit measure, retail sales and fixed asset investments already show signs of stabilisation.

Economic Research



Marc Brütsch
Chief Economist
marc.bruetsch@swisslife.ch
@MarcBruetsch



Damian Künzi
Economist Developed Markets
damian.kuenzi@swisslife.ch



Josipa Markovic
Economist Emerging Markets
josipa.markovic@swisslife.ch



Francesca Boucard
Economist Real Estate
francesca.boucard@swisslife.ch
@f_boucard

If you have any questions or if you would like to subscribe to this publication,

Please send an email to: info@swisslife-am.com.

For more information visit our website at: www.swisslife-am.com



Released and approved by the Economics Department, Swiss Life Asset Management Ltd, Zurich

Swiss Life Asset Managers may have acted upon or used research recommendations before they were published. The contents of this document are based upon sources of information believed to be reliable but no guarantee is given as to their accuracy or completeness. This document includes forward-looking statements, which are based on our current opinions, expectations and projections. We undertake no obligation to update or revise any forward-looking statements. Actual results could differ materially from those anticipated in the forward-looking statements.

France: This publication is distributed in France by Swiss Life Asset Management (France), 44 avenue Georges Pompidou, F-92302 Levallois-Perret and Swiss Life Real Estate Management, 153 rue Saint Honoré, F-75001 Paris to its clients and prospects. **Germany:** This publication is distributed in Germany by Corpus Sireo Real Estate GmbH, Aachenerstrasse 186, D-50931 Köln and Swiss Life Invest GmbH, Zeppelinstrasse 1, D-85748 Garching b. München. **UK:** This publication is distributed by Mayfair Capital Investment Management Ltd., 2 Cavendish Square, London W1G 0PU. **Switzerland:** This publication is distributed by Swiss Life Asset Management Ltd., General Guisan Quai 40, CH-8022 Zurich.