Perspectives
Economics

SwissLife
Asset Managers

June 2018

Key messages

- Higher oil price means a short-term upside risk for our inflation forecasts
- Italy's anti-establishment coalition causes return of uncertainty regarding the future of the Euro
- Disappointing data out of Japan trigger substantial forecast revisions

Comparison of forecasts

	GDP growth 2018		GDP growth 2019		2018		2019 Inflation	
	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus
USA	2.6% ↑	2.8% ↑	2.2%	2.6%	2.5%	2.5%	2.1% ↑	2.2% ↑
Eurozone	2.1%	2.3% ↓	1.4%	1.9%	1.5% ↑	1.5%	1.5% ↑	1.5%
UK	1.1% ↓	1.4% ↓	1.0%	1.5%	2.2% ↓	2.5% ↓	2.0%	2.2%
Switzerland	2.0%	2.2%	1.2% ↓	1.8%	1.0%	0.8%	1.0% ↑	1.0%
Japan	0.8% ↓	1.3% ↓	1.1%	1.1%	0.7% ↓	1.0%	0.2% ↓	1.1% ↑
China	6.5%	6.6%	6.1%	6.4%	2.0%	2.2% ↓	2.1%	2.3%

Arrows indicate difference from previous month
Source: Consensus Economics Inc. London, 14.05.2018

Chart of the month

Consensus Economics, the world's leading economic survey organisation, announced the winners of the 2017 "Forecast Accuracy Awards" on 30 April 2018. With its award, the institute singles out the best forecasts of local GDP growth and inflation. For Switzerland, Consensus Economics compared the estimates of more than 15 institutes. Swiss Life Asset Managers has now been found the most reliable predictor for the second time, after its win in 2015.

US
Q1 not so bad after all

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

The slowdown of GDP growth in the first quarter of 2018 turns out to be less pronounced than commonly expected. Yet, the advance estimate of growth was only slightly above our own forecast. Meanwhile, retail sales numbers were revised higher for February and March, suggesting less weakness in consumption spending in the first quarter compared with what was captured in the advance release GDP. Furthermore, April retail sales point to a healthy start to consumer spending in the second quarter. While consumers are likely to adjust spending to reflect higher after-tax incomes, there are risks that higher gasoline costs may offset some of this spending. We will look to future retail sales reports to see how spending evolves. Business investment spending was a strong growth pillar again in the first quarter. Given sound corporate earnings and a lower tax burden, capital expenditure should remain sturdy this year. Business sentiment remains on elevated level despite the ongoing trade disputes. Procyclical fiscal spending will continue to bolster growth, before crowding out will hit momentum beyond 2019.

Inflation	
Swiss Life Asset Managers	Consensus
2018: 2.5 %	2018: 2.5 %
2019: 2.1 %	2019: 2.2 %

The US government's withdrawal from the Iran agreement caused the oil price to spike up even more. Since the start of the second quarter, a barrel of Brent crude oil has become around 11% more expensive. Luckily this oil and thus gasoline price increase falls into driving season, a time of the year when gasoline prices are usually under upwards pressure anyway. The statistical office smooths this out by applying seasonal factors, so that the latest increase is almost a non-event for headline inflation. Yet, should the political situation calm down and oil prices fall, we face a downside risk to our headline inflation forecast.

Eurozone
Another populist government

GDP growth	
Swiss Life Asset Managers	Consensus
2018: 2.1 %	2018: 2.3 %
2019: 1.4 %	2019: 1.9 %

Eurostat published the GDP growth figure of the currency union for the first quarter and the figure matched our own forecast. At a pace of 0.4% on a quarterly basis, actual GDP growth still is way above potential but weakened markedly. To a certain extent, harsh winter conditions are to be blamed, but we also rate this disappointing figure as being a result of the past appreciation of the Euro. This notion is underlined by the correction of purchasing managers' indices across the region and the German ifo index, which equally signalled a somewhat more cautious business environment. The lingering trade dispute and political tensions on a global scale certainly contributed to the deteriorating business sentiment. Our cautious outlook for next year's GDP growth is increasingly justified. Moreover, politics at home are equally concerning. Italy's populists are set to take over power soon. Their generous fiscal plans signal trouble, also with their partners in the Eurozone. Meanwhile, Italian bonds tumbled as the next government indicated they may ask for a write-down on public debt.

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

The strong Euro has caused import prices for goods to correct markedly to the downside. In fact, import prices for consumer as well as capital goods are in deflationary territory. This may constitute a slight drag on consumer prices if companies pass these lower import prices on to households. So far, however, price dynamics at the consumer front have not faltered. The April headline inflation reading was higher than we had expected which caused upwards revisions to our forecast for this as well as next year. Additional support comes from higher energy prices for the time being.

UK
Inflation to decline further

GDP growth	
Swiss Life Asset Managers	Consensus
2018: 1.1 %	2018: 1.4 %
2019: 1.0 %	2019: 1.5 %

The first official release of GDP numbers for the first quarter was a negative surprise for most economists producing forecasts in these times of high Brexit related uncertainties. Judging by the sample published by Consensus Economics, we were generally more prudent than our peers with the forecast for GDP growth in full-year 2018 since quite a while. Nevertheless, a separate survey conducted by Bloomberg showed that our forecast of 0.3% quarterly growth in the first quarter was in line with the median estimate out of this sample. The actual outcome of just 0.1% growth thus triggers a downward revision in our forecast for 2018 from 1.3% to 1.1%. A downward revision in the consensus forecast is likely to follow. Weak growth and the confirmation to our view that the inflation spike was only temporary led the Bank of England refrain from hiking interest rates. Whether or not monetary policy normalisation is off the table until the UK has left the EU, or only postponed until August this year, depends on the degree by which first quarter activity was held back by the harsh winter weather. Weakness in construction was clearly weather related, but this cannot be said about soft activity in financial sectors. Available data so far suggest that the economy continued to expand below potential rather than shifting to higher gear in the second quarter 2018.

Inflation	
Swiss Life Asset Managers	Consensus
2018: 2.2 %	2018: 2.5 %
2019: 2.0 %	2019: 2.2 %

The statistics office will publish April inflation data one day after our editorial deadline. Our forecast for 2018 has been below consensus since many months and thus far our outsider view has been confirmed by the data. For April, we expect annual inflation to have fallen to 2.4%. Like elsewhere, rising energy prices form a short-term upside risk for our inflation projections.

Switzerland
Beware of the semantics

GDP growth	
Swiss Life Asset Managers	Consensus
2018: 2.0 %	2018: 2.2 %
2019: 1.2 %	2019: 1.8 %

Switzerland's unemployment rate fell to 2.7%, a low since 2011. That suggests that the unemployment rate fell from 3.3% to 2.7% in just one year. A positive impact of the weaker Franc on domestic employment was to be expected. Yet, the latest numbers warrant some prudence: Finally, all cantons have agreed on the same standards to differentiate between unemployed and job seekers. As a consequence, Zurich, Switzerland's biggest canton, now reports a significantly lower unemployment rate than before. Thus, the decline in the unemployment rate has more to do with semantics than with cyclical dynamics and we do not expect any further decline from here until the end of 2018. Meanwhile, business sentiment remains upbeat with export sentiment among small and medium sized firms having climbed to a record high. The preliminary official estimate of first quarter GDP is due on May 31. For the time being, we continue to expect a quarterly growth rate of 0.5%, although private consumption data and GDP data out of neighbouring Europe hint at considerable downside risks. Looking ahead, mounting tensions as regards the trade dispute between the US and China are an important risk for Switzerland going forward: Switzerland's exports to China account for almost 5% of GDP. No other European country has such a high export exposure to China.

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

Inflation is on the rise as the weaker Franc and rising energy prices have a noticeable impact. The combined producer and import price index rose 2.7% in the year until April, the strongest annual gain since 2008. Consumer price inflation is expected to rise to 1.0% by June and to climb even further to around 1.4% until November. That would mark the highest reading since 2010.

Japan
Noticeable revisions

We had to undertake substantial changes to both our forecasts for GDP growth and inflation: The release of first quarter data came as a negative surprise, suggesting that GDP fell by 0.2% from the previous quarter. This would mean that Japan's longest expansion in the past 28 years came to an end. Yet, in Japan, the interpretation of early reports of national account data warrants some prudence as huge revisions are the norm, not the exception. This is also true when looking at the latest official data for real GDP in 2017. The revisions force us to lower our full-year 2018 real GDP growth forecast from 1.5% to just 0.8%. Meanwhile, the trend to surprisingly high inflation prints by the end of 2017 was reversed during the past two months. Although our current inflation forecast is now much lower than before, upside risks in the form of higher energy prices or a higher consumer tax rate in late 2019 persist.

China
Policy fine-tuning

In recent months, Chinese authorities have emphasised two economic policy goals: ensuring financial stability and a gradual reorientation towards quality of growth. The implementation of the appropriate policies comes with a cost in terms of growth. Thus, it was clear from the beginning that both goals will be pursued in a gradual manner. Overall, activity data still holds up well. Yet, the global environment has become tougher for China in recent weeks: the US has started a trade dispute with China and the global economy has reached a peak in terms of growth. China's authorities have reacted with a fine-tuning of their policies by sending some easing signals. The policy aims remain unchanged, yet the government will act more cautiously in order not to put too much downward pressure on the economy given the global uncertainties. If needed some easing measures will be implemented.

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