Perspectives
Economics

June 2020

Key messages

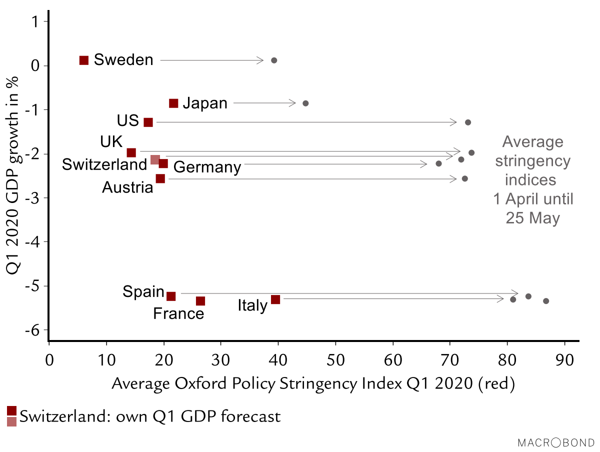
- As European economies and the US are gradually reopening, the economic recovery has started
- Our forecasts are comparably constructive, especially in Switzerland due to its favourable sector composition
- Inflation data come in at the low end of expectations, triggering downward revisions

Comparison of forecasts

	GDP 2020		GDP 2021		CPI 2020		CPI 2021	
	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus
US	-3.4% ↓	-5.4% ↓	3.7%	4.3% ↑	0.8% ↓	0.7% ↓	1.5%	1.8%
Eurozone	-6.2% ↓	-7.9% ↓	5.9%	6.2% ↑	0.4% ↑	0.3% ↓	1.3%	1.1% ↓
Germany	-4.7%	-6.3% ↓	3.9%	5.2% ↑	0.7% ↑	0.6% ↓	1.3%	1.4%
France	-7.3% ↓	-8.2% ↓	5.8% ↑	6.7% ↑	0.4% ↑	0.3% ↓	1.3%	1.2% ↓
UK	-5.7% ↓	-7.9% ↓	4.6% ↑	6.1% ↑	0.9%	1.0%	1.7%	1.4% ↓
Switzerland	-3.1%	-5.5% ↓	3.6%	4.3% ↑	-0.8% ↓	-0.7% ↓	0.5% ↓	0.3% ↓
Japan	-4.7% ↑	-5.5% ↓	2.9% ↑	2.4% ↑	0.0% ↓	-0.4% ↓	0.2% ↓	0.1% ↓
China	1.2%	1.4% ↓	8.4%	8.1% ↑	3.0% ↓	3.1% ↓	2.0%	1.9% ↓

Arrows indicate difference from previous month
Source: Consensus Economics Inc. London, 11 May 2020

Chart of the month



First estimates of GDP growth in the first quarter of 2020 confirmed the negative COVID-19 impact but generally surprised to the upside. Economies with stricter containment policies, as measured by the Oxford COVID-19 Stringency Index, have experienced sharper GDP contractions on average. Even though the reopening of economies is ongoing, average containment measures in Q2 will be stricter than in Q1 and most economies will therefore experience a much larger GDP drop. Nevertheless, economic data confirms the onset of a slow recovery in the second half of Q2 and we expect the hurdles for renewed nationwide, strict lockdowns to be much higher going forward.

US
Unemployment: how temporary?

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -3.4 %	2020: - 5.4 %
2021: 3.7 %	2021: 4.3 %

With the publication of April activity data, the true extent of the coronavirus impact on the US economy finally became visible. As expected, the services sector bore the brunt. Retail sales plunged 16% month-on-month, while industrial production declined by a slightly less horrid 11%. Both drops are unprecedented, which is especially remarkable for industrial production where the history goes back as far as to 1919. Nevertheless, we still believe that the recession in the US will be less pronounced than in Europe due to less stringent lockdown measures. Where the US seems much harder hit is on the labour market as there is no nationwide short-time work scheme. Between mid-March and mid-May, more than 36 million Americans claimed unemployment benefits, and were it not for the significant drop in labour force participation, the unemployment rate would have moved above 17% in April. However, 78% of all unemployed people expect to be recalled by their previous employer within the next 6 months, thus counting as temporary unemployed. Admittedly, some temporary unemployment will become permanent in the course of this year, but we indeed believe that payrolls as well as the unemployment rate will revert rapidly to more normal levels once lockdown measures are eased. Our current assumption is that the US unemployment rate will move to roughly 8% by December 2020.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.8 %	2020: 0.7 %
2021: 1.5 %	2021: 1.8 %

The April core inflation index showed the biggest monthly drop in the history of the series as consumers were offered significant discounts on both goods and services prices in the wake of the crisis. In addition, low energy prices continue to weigh on headline inflation. We expect May and June to mark the trough at close to zero percent annual inflation, before the easing of lockdowns and slightly higher energy prices lead to a normalisation of inflation readings.

Eurozone
Yes, we are open(ing)

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -6.2 %	2020: -7.9 %
2021: 5.9 %	2021: 6.2 %

Ongoing downward revisions in GDP projections for the second quarter 2020 suggest that the glass remains half empty in light of the most severe recession in decades. Yet, the same glass can now also be looked at as half full as the news from the medical front have clearly improved since last month. Successful attempts to flatten the infection curve allow for a faster than previously expected reopening of the economy. Even the lifting of travel bans ahead of the summer holiday season has become a realistic scenario. Incoming business sentiment surveys suggest that peak pessimism is left behind, and actual economic data are starting to come in slightly better than expected in polls conducted among economists. Restrictions are abandoned at different speed and the beginning of the economic recovery is very much depending on that pace. According to the latest levels of Oxford Policy Stringency Index (see chart of the month), Luxembourg, Slovenia and Austria so far went the furthest in withdrawing initial lockdown measures. Surprisingly, Italy lifted a wide range of confinement rules in an attempt to prevent its economy from even further damage. Spain and France appear far more reluctant which is why we expect the recovery to start with a delay there. On the political stage, the joint Franco-German EU recovery plan is welcome news to limit the risk of a "euro crisis 2.0" in the medium-term.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.4 %	2020: 0.3 %
2021: 1.3 %	2021: 1.1 %

Here we are again: As European authorities coordinate fiscal and monetary policy to cope with a severe economic crisis, it did not take long for many commentators to warn about inflation getting out of control. The supply and the subsequent demand shock caused by the lockdown result in an unprecedented underutilisation of otherwise intact infrastructure, manufacturing and labour market capacities. The resulting output gap first needs to be closed, before accelerating inflation poses a potential risk.

Germany
Improving business sentiment

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -4.7 %	2020: -6.3 %
2021: 3.9 %	2021: 5.2 %

Germany's economy has embarked on a modest recovery as the opening of the domestic economy continued without a significant increase of new COVID-19 infections. Despite these early signs of improving dynamics, we expect real GDP to have contracted by 9.3% in the second quarter from the previous period, for which official data already revealed a quarterly contraction of 2.2%. No doubt, this is a severe recession also for Germany. And yet, our forecast for full year 2020 is comparably optimistic relative to the consensus and therefore requires some explanation: In our view, the current recession hits Germany less than the other large economies in the Eurozone. Firstly, Germany never had to go as far as Italy, Spain or France with lockdown measures and it could also reopen parts of its economy faster than its peers. Secondly, this recession particularly affects service industries which play a less important role for Germany than for neighbouring France. Manufacturing, Germany's economic backbone, is likely to recover more quickly from the initial supply shock. And finally, Germany has ample fiscal room to manoeuvre. Most recent business sentiment surveys conducted during May seem to confirm our assessment that the trough is left behind: According to the ifo business climate indicator, business expectations have recovered to a three month high, while the employment component in the manufacturing Purchasing Managers' Index stays above its historic lows seen during the great recession of 2008 and 2009.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.7 %	2020: 0.6 %
2021: 1.3 %	2021: 1.4 %

European statistics offices report major difficulties to collect prices for a range of goods and services during the lockdown period. This may explain why we underestimated monthly inflation numbers for Germany in April. If developments elsewhere in the world are any guide, then low inflation numbers in May and June should compensate for the surprisingly high number in April.

France
Only slowly reopening

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -7.3 %	2020: -8.2 %
2021: 5.8 %	2021: 6.7 %

In the first quarter 2020, the unemployment rate in mainland France fell to 7.6%, the lowest number since 2008. It is worth remembering that Emmanuel Macron ran his election campaign in 2017 on the promise to reduce unemployment to 7% until 2021. But then came COVID-19. Already in March, the French economy took a serious hit, resulting in a sharp contraction of GDP by 5.8% during the first quarter 2020. Compared with neighbouring Italy and Spain where the health impact of COVID-19 was even worse, the French data look particularly shocking. Methodology to estimate GDP for March may play a role, as the French statistics office apparently based its ad hoc calculations mostly on figures from the production side. The extremely low capacity utilisation numbers reported for March and April were likely important anchor points in these estimations. With more data available, revisions to the initial GDP report are likely. Nevertheless, GDP will fall even more in the second quarter. We forecast a quarterly drop by 12%. According to the Oxford University Policy Stringency Index, French COVID-19 containment measures were amongst the most restrictive. Even more importantly, France is relaxing those measures far more reluctantly than most other European countries. The combination of a particularly strong dependency on its services industries and a slow pace in normalising daily life suggest that France will be a laggard in the economic recovery, which has already begun elsewhere in Europe.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.4 %	2020: 0.3 %
2021: 1.3 %	2021: 1.2 %

Low energy prices mean that inflation is set to come in very low in 2020. Yet, like elsewhere in Europe, statistics offices have problems to properly estimate current economic indicators. On the prices front, some data were simply not available between March and May. Alternative measures applied to estimate prices are difficult to anticipate by forecasters and leave room for forecasting errors in the short term.

UK
Europe's laggard

GDP growth

Swiss Life Asset Managers	Consensus
2020: - 5.7 %	2020: - 7.9 %
2021: 4.6 %	2021: 6.1 %

When economies on the Continent were rapidly sliding into recession in March, the UK was experiencing the calm before the worst storm in decades. UK GDP only declined 2.0% in the first quarter, less bad than anticipated, and the unemployment rate (three-month average) even declined to 3.9% instead of rising as had been expected by most economists. Data for the lockdown period is not plentiful, but what we know so far is consistent with a massive drop in economic activity, which prompted another revision of our 2020 GDP forecast to –5.7% from –4.3%. In April, car registrations came to a near standstill (–97% year-on-year), retail sales volumes dropped 18% compared to March and unemployment claims rose by a record 856 thousand. According to the composite Purchasing Managers' Index (PMI), things did not improve in May. At 28.9, the flash reading is still deep in contraction territory and worse than composite PMIs in Germany, France or the US, where the easing of lockdown measures is more advanced. The count of daily new COVID-19 cases is only moderating slowly in what is now the hardest hit country in Europe in terms of coronavirus deaths. As such, a swift return to normal is not in the cards. Non-essential stores are only allowed to re-open from 15 June, and while other countries are opening their borders for tourists, the UK has recently introduced harsh quarantine rules for inbound travellers. As such, risks to our growth forecast remain tilted to the downside.

Inflation

Swiss Life Asset Managers	Consensus
2020: 0.9 %	2020: 1.0 %
2021: 1.7 %	2021: 1.4 %

The coronavirus crisis is disinflationary in nature, and the soft April inflation report delivered yet another confirmation. Core inflation moderated to 1.4%, and low energy prices brought headline inflation to 0.8%. We expect another sharp drop in May before a normalisation of economic activity and potentially higher energy prices lead to a normalisation of inflation readings.

Switzerland
Pharma: knight in shining armour

GDP growth

Swiss Life Asset Managers	Consensus
2020: -3.1 %	2020: -5.5 %
2021: 3.6 %	2021: 4.3 %

In line with the continued easing of containment measures through May, several high frequency indicators are signalling a gradual recovery: TrendEcon, an indicator based on Google search trends, recovered back to levels last seen at the beginning of March; the mobility index published by KOF ETHZ offset approximately half of its March drop; usage of debit cards in local stores reached a new annual high, which is likely partially explained by a shift away from cash as well as the interruption of shopping tourism abroad. The fever curve based on financial markets data as well as news headlines, developed by Burri and Kaufmann from the University of Neuchâtel, is still elevated but has continuously declined from its mid-March spike. While uncertainty remains very high, such data reinforce our more optimistic view compared to consensus. Furthermore, the Q1 industrial production increase by 0.8% compared to the year before indicates that Switzerland's industry composition is beneficial in the current crisis: pharmaceutical production increased by 26.7%, offsetting the drop in all other manufacturing categories. Also, we think that the hurdle for a renewed nationwide lockdown has increased substantially, particularly in Switzerland, where the health system in most cantons never came close to being overwhelmed. Yet, despite the onset of a gradual economic recovery in May, we expect the unemployment rate to increase to 4.5% in the second half of 2020 and to only recover to around 4% until end of 2021.

Inflation

Swiss Life Asset Managers	Consensus
2020: -0.8 %	2020: -0.7 %
2021: 0.5 %	2021: 0.3 %

April 2020 consumer prices contracted by 1.1% compared to April 2019 which was more than we had expected. Without the price decline of -16.7% for petroleum products, deflation amounted to -0.6%. Goods prices, particularly those of imported goods, contracted more than services prices. The Federal Statistics Office noted that for some categories only 25% to 75% of prices normally recorded were available.

Japan
Defeating the second wave

GDP growth

Swiss Life Asset Managers	Consensus
2020: -4.7 %	2020: -5.5 %
2021: 2.9 %	2021: 2.4 %

In the balancing act between containing the epidemic and restricting daily life, Japan seems to have done a good job. The second wave that the country experienced in April is ebbing rapidly, and the government is now lifting the state of emergency that it declared on 4 April. Most containment measures were voluntary (also for constitutional reasons), but the success in managing the second wave suggests high compliance with the government's recommendations. Hence, the negative economic impact in April and May will nevertheless be significant. Whereas GDP and survey data for the first quarter surprised positively, sentiment indicators suggest a sharp contraction in both the manufacturing and services sector in April and May. Quite surprisingly, Japan does not seem to benefit yet from the economic normalisation in China. The trade deficit with China widened significantly in April and the export orders component in the Purchasing Managers' Index dropped to an all-time low of 30 points in May. While we still expect June data to improve, the extent of the rebound might thus turn out to be underwhelming. On the positive side, it might spark an even stronger fiscal policy response. According to media reports, the second supplementary budget currently in discussion will contain more direct public spending than initially planned.

Inflation

Swiss Life Asset Managers	Consensus
2020: 0.0 %	2020: -0.4 %
2021: 0.2 %	2021: 0.1 %

Japanese headline inflation dropped to 0.1% in April and will turn negative in the following months. Apart from lower energy prices, the government's push for free education led to another drop of the education price index (now at -10% year-on-year), whereas the COVID-19-related demand shortfall is pushing down prices especially in the "culture and recreation" subcomponent. We expect monthly inflation readings to turn positive again by the second quarter of 2021.

China
Growth target abandoned

GDP growth

Swiss Life Asset Managers	Consensus
2020: 1.2 %	2020: 1.4 %
2021: 8.4 %	2021: 8.1 %

For the first time in decades, China dropped its annual economic growth target at this year's National People's Congress that sets out the country's economic and social development plan for the year. This reflects the great uncertainty concerning the economic impact of the pandemic. Since a healthy labour market will be key in order to get Chinese demand back on track, the focus has widely been put on stabilising employment. Therefore, the fiscal deficit target was raised to 3.6% from 2.8% before and a 1 trillion yuan special COVID-19 bond will be issued to support employment growth. Moreover, infrastructure investments in projects such as the 5G network and electric cars are to be expanded and will likely be once again China's pillar of growth. While the country's economic agenda did not come as a surprise, China's announced plan to enact a national security legislation in Hong Kong was more worrying. Not only did the announcement trigger renewed demonstrations in Hong Kong, it also heightens already existing conflicts with the US. US-China tensions have recently flared up, moving from trade to financial and technology issues as well as to geopolitics. The anti-China rhetoric will likely further heat up the closer we move to the US presidential elections, as a tough stance towards China likely remains an essential part of Donald Trump's presidential campaign.

Inflation

Swiss Life Asset Managers	Consensus
2020: 3.0 %	2020: 3.1 %
2021: 2.0 %	2021: 1.9 %

China's April headline inflation fell more strongly than expected as food prices moderated. Especially pork prices dropped as the hog stock continues to improve from the effect of the African Swine fever that wiped out a third of the country's hog and breeding stock last year. Also, core inflation dropped slightly to a low of 1.1% form 1.2% previously, reflecting ongoing sluggish demand.

Economic Research

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