Perspectives
Economics

July 2018

Key messages

- Incoming data hint at robust second quarter growth in the US
- Italy's anti-establishment coalition and the trade dispute with the US weigh on confidence in Europe
- While unemployment falls in Switzerland, real disposable incomes are likely to shrink in 2018

Comparison of forecasts

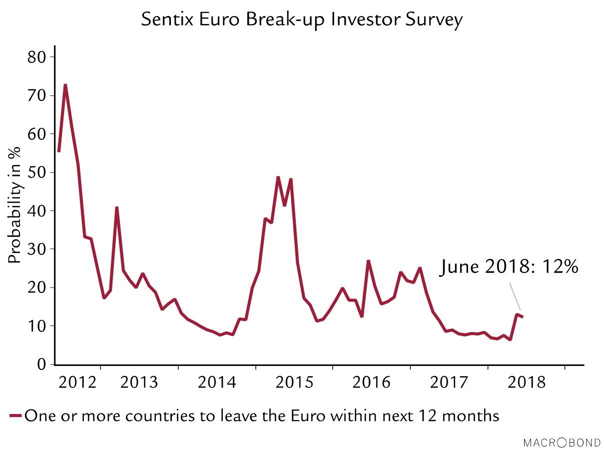
	GDP growth 2018		GDP growth 2019		Inflation 2018		Inflation 2019	
	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus
US	2.8% ↑	2.9% ↑	2.2%	2.6%	2.5%	2.5%	2.1%	2.2%
Eurozone	2.0% ↓	2.2% ↓	1.4%	1.8% ↓	1.6% ↑	1.6% ↑	1.5%	1.6% ↑
UK	1.1%	1.3% ↓	1.0%	1.5%	2.3% ↑	2.5%	2.0%	2.1% ↓
Switzerland	2.1% ↑	2.2%	1.2%	1.8%	1.0%	0.9% ↑	0.9% ↓	1.0%
Japan	0.9% ↑	1.1% ↓	1.1%	1.1%	0.7%	1.0%	0.2%	1.1%
China	6.5%	6.6%	6.1%	6.4%	2.1% ↑	2.2%	2.3% ↑	2.3%

Arrows indicate difference from previous month
Source: Consensus Economics Inc. London, 11.06.2018

Consensus Economics
Forecast Accuracy
Award Winner
Switzerland 2017

Consensus Economics, one of the world's leading economic survey organisation, has announced the recipients of its 2017 Forecast Accuracy Award (FAA) in June 2018. Swiss Life Asset Managers' economic research team has won this year's Forecast Accuracy Award for Switzerland.

Chart of the month



Italy's anti-establishment coalition ends Europe's 52 weeks long honeymoon with Emmanuel Macron: After the presidential election in France, financial markets were pricing out any Euro break-up risks. Now, the most recent result of an investors' survey conducted by Sentix suggests that the risk of at least one country leaving the Euro starts being evaluated more seriously again.

US
Unfazed by gasoline prices

GDP growth	
Swiss Life Asset Managers	Consensus
2018: 2.8 %	2018 : 2.9 %
2019: 2.2 %	2019 : 2.6 %

Some observers were worried about economic dynamics in the US, especially since GDP growth in the first quarter turned out to be weaker than expected. However, a weak first quarter has been rather the rule than the exception for the US economy over past years. Probably accountable to seasonal adjustment methods applied to data. Yet, the US consumer has come back with a vengeance. Retail sales data in the second quarter thus far point to an above average contribution of personal consumption to overall growth. A booming labour market, increasing net wealth and tax cuts leave consumers largely unfazed by higher energy bills. Even though households may have to spend more on gasoline, under the line, the US economy has become a net beneficiary of rising oil prices. Being the second largest crude oil producer in the meantime, the US energy sector generates higher revenues and raises investments as well as employment. Moreover, despite Mr. Trump's rumblings about trade discrimination of the US economy, the trade deficit has turned less negative lately supporting GDP calculations. We revised our outlook for second quarter growth as well as for the whole year to the upside. Yet, further escalation of the trade dispute remains a big risk not only for the US economy.

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

By July 2018, the headline inflation rate will hit 3%, to decline thereafter to 2.2% by yearend. The core inflation rate on the other hand, which excludes highly volatile components such as energy and food, hovers between 2.1% and 2.3% for the next 18 months according to our forecast. Should energy prices decline further from these levels, we will have to review our forecast.

Eurozone
Slowdown, but not more

GDP growth	
Swiss Life Asset Managers	Consensus
2018: 2.0 %	2018 : 2.2 %
2019: 1.4 %	2019 : 1.8 %

Business surveys throughout the currency union have softened since the start of the year. The business climate index of the German ifo institute seems to have found a bottom, although that needs to be confirmed in the next reading. Purchasing managers' indices softened substantially but this decline too should decelerate going forward. The slowdown left its imprint on GDP growth in the first quarter of this year which caused our downward revision of the full-year outlook. While the gap of industrial activity has noticeably widened between the US and European economies, the consumption picture looks equally sturdy in the Eurozone. Consumer confidence as measured by Eurostat reached the highest level since the turn of the millennium. Labour markets continue to heal and wage pressures are building in certain member countries. In France, private households profit from lower social security contributions. Even though entrepreneurial spirits are impaired by protectionist disputes for the time being and the cyclical slowdown is ongoing, growth rates will remain above potential well into 2019. According to survey results, the investment outlook remains favourable but less so than last year, in line with the moderation of cyclical momentum.

Inflation	
Swiss Life Asset Managers	Consensus
2018: 1.6 %	2018: 1.6 %
2019: 1.5 %	2019: 1.6 %

The ECB lifted its inflation forecast to 1.7% for 2018, 2019 and 2020. Notably, core inflation is now seen at 1.9% by 2020. We maintain a more cautious forecast, although in the long run, exchange rate fluctuations and energy prices will play a major role in determining the path of inflation readings. We expect a somewhat stronger Euro until yearend, the value of which suffered mainly due to politics in Italy.

UK
More encouraging data

GDP growth	
Swiss Life Asset Managers	Consensus
2018: 1.1 %	2018: 1.3 %
2019: 1.0 %	2019: 1.5 %

June 23 marked the second anniversary of the EU-referendum. Negotiators have nine months left to come to terms on the future relation with the EU. Continued job creation suggests employers prefer hiring staff to meet firm global demand rather than investing in machinery for the time being. In their view, Britain's flexible job market would allow a quick downsizing of labour should a failure of Brexit negotiations cause a severe economic crisis. Meanwhile, the ongoing Sterling weakness continues to boost Britain's competitiveness. After a weak first quarter, indicators like purchasing managers indices or the CBI's (Confederation of British Industry) order survey stabilised or even improved into mid-year. Helped by good weather, the royal wedding and rising real disposable incomes, retail sales rose 1.9% from the first quarter. In our base case, we expect the UK to post quarterly growth rates of between 0.2% and 0.3% over the coming quarters, slightly below the actual potential of the economy.

Inflation	
Swiss Life Asset Managers	Consensus
2018: 2.3 %	2018: 2.5 %
2019: 2.0 %	2019: 2.1 %

One immediate impact of the EU-Referendum was the severe depreciation of the Sterling which resulted in sharp rises of import prices. As a consequence, consumer price inflation rose to 3.1% until November last year. Six months later, our assessment that inflation rates above the central bank's comfort level should prove temporary was correct. Base effects after the stabilisation of foreign exchange rates and the cooling of economic dynamics to below potential both resulted in easing price pressure. Even against the backdrop of rising energy prices, annual inflation fell to 2.4% by May. In our projections, this is not the end of the downward trend: We expect annual inflation to fall below 2% until the end of this year. Survey data reflecting businesses' price setting power hint at very limited domestic price setting power. Expected selling prices fell to the lowest level this year according to the CBI.

Switzerland
Inflation north of 1%

GDP growth	
Swiss Life Asset Managers	Consensus
2018: 2.1 %	2018: 2.2 %
2019: 1.2 %	2019: 1.8 %

As explained last month, the drop in Switzerland's unemployment rate is due to methodical changes and overstates developments in the domestic labour market. Disposable incomes of households will get a hit this year as nominal wage growth does not fully compensate for rising inflation. Nevertheless, we continue to expect firm domestic dynamics. Meanwhile, external developments are increasingly casting shadows on global economic perspectives: Around the globe, manufacturing purchasing managers' indices (PMI) suggest that momentum of the synchronous global upswing has peaked in the last quarter of 2017. Slowing external demand is more worrisome for Switzerland's export industries than an overvalued currency. Moreover, Switzerland is particularly exposed to an accelerating trade dispute between the US and China, as Switzerland exports comparably more to China than any other European country. Thus, most recent developments justify our prudent growth forecast for 2019.

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

The weaker Swiss Franc and higher energy prices were the main causes for inflation to climb to 1% until May 2018. This is the highest inflation rate since March 2011. In June, both the above mentioned trends stopped. Swiss Franc strengthened versus the Euro and the price for crude oil has apparently peaked. Nevertheless, pass-through effects of earlier increases in import prices will continue to exert upside pressure on consumer prices. We also expect further increases in domestic service prices, with hotels and restaurants testing their price setting power. Annual inflation is set to climb further to 1.4% until November. After that, lower rental costs for apartments and fading base effects should result in inflation trending lower to around 0.9% until mid-2019. We could err on the upside in case of a fast fall in commodity prices or a significant further appreciation of the Swiss Franc.

Japan
Following the global trend

Japan's economy was a major beneficiary of the synchronous global upswing since mid-2016. Apparently, it is also one of the first to register the headwinds from cooling trade dynamics in the developed world. Concerns related to the trade dispute between the US and China and growing political uncertainty in Europe apparently start to weigh on business sentiment. Japan's economic sectors most at risk from protectionism are car manufacturers and electric machinery. Meanwhile, available data for the second quarter from industrial production to exports suggest a recovery from the weakness reported for the first three months of the year. On the other hand, inflation continues to trend lower and could temporarily fall below the zero line again by the end of the year. In this light, Abenomics appear as a policy failure, as the reflation of the economy with inflation sustainably returning to 2% remains out of reach.

China
Outlook is getting clouded

Activity data has held up well so far this year. Yet, there are more and more signs for a deceleration until year-end. First, the real estate sector – a major driver of the Chinese economy – has peaked. Second, the measures taken by the government in order to curb financial leverage weigh on credit creation and infrastructure investments. These are the short-term costs in terms of growth in order to improve the economic model over the medium-term. Third, tensions with the US are running high and we cannot rule out a further escalation. The direct impact on Chinese GDP growth of the announced 25% additional tariffs on 34bn of Chinese goods should be limited. Yet, uncertainty is damaging for business and investment. In order to counterbalance these difficulties, authorities are fine-tuning their policies. While the longer-term goal remains higher financial stability, some easing measures have been taken in recent weeks.

Economic Research

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

Sylvia Walter
Senior Economist
sylvia.walter@swisslife.ch
@SylviaWalter13

Claudia Bernasconi
Senior Economist
Emerging Markets
claudia.bernasconi@swisslife.ch
@BernasconiCla

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

Do you have any questions or would you 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/research