# Perspectives
*Economics*

*July 2019*

## Key messages

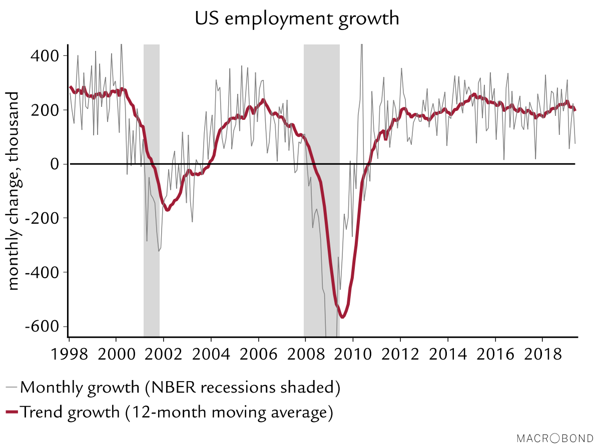
- US labour market not yet signalling accelerating recession risks
- Political obstacles dampening Eurozone still not removed
- Swiss firms to review hiring plans as trade conflict weighs on foreign demand

## 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 | 2.4% | 2.5% ↓ | 1.8% | 1.8% ↓ | 1.8% ↓ | 1.9% | 2.2% | 2.1% |
| Eurozone | 1.2% | 1.1% | 1.2% | 1.3% | 1.3% ↓ | 1.3% ↓ | 1.6% | 1.4% |
| Germany | 1.1% | 0.8% | 1.3% | 1.4% ↑ | 1.4% ↓ | 1.5% | 1.7% | 1.6% |
| France | 1.3% ↑ | 1.3% | 1.2% | 1.3% | 1.2% | 1.2% | 1.6% | 1.4% ↓ |
| UK | 1.2% ↓ | 1.4% | 1.2% ↓ | 1.4% | 1.8% ↓ | 1.9% ↓ | 2.0% | 2.0% |
| Switzerland | 1.3% | 1.3% ↑ | 1.4% | 1.5% | 0.6% ↓ | 0.6% | 0.8% | 0.8% |
| Japan | 0.7% ↑ | 0.8% ↑ | 0.4% | 0.4% | 0.6% ↓ | 0.6% | 1.0% ↓ | 0.9% |
| China | 6.1% | 6.3% | 6.0% | 6.0% ↓ | 2.3% | 2.3% | 2.2% | 2.3% ↑ |

Arrows indicate difference from previous month
Source: Consensus Economics Inc. London, 10 June 2019

## Chart of the month




The May US labour market report disappointed with a feeble increase in non-farm payrolls and moderating wage growth. Market participants, already worried about medium-term recession risks, have thus increased their bets that the Federal Reserve will cut policy rates this year. The turnaround in the trend of employment growth is indeed worrying, as it tends to be an early warning sign of an approaching recession. Nevertheless, we would be cautious to extrapolate the latest weakness, as forward-looking indicators such as hiring plans, job openings and employment components in the ISM business surveys have either stabilised at very favourable levels or even improved recently.

## *US*
## The unimpressed consumer

| **GDP growth** | |
|---|---|
| Swiss Life Asset Managers | Consensus |
| 2019: 2.4 % | 2019: 2.5 % |
| 2020: 1.8 % | 2020: 1.8 % |

The US consumer seems to be unimpressed by the deteriorating trade conflict and the intensifying recession debate among financial market participants. Judging by the already available monthly data, retail sales growth even accelerated in the second quarter, while consumer sentiment indicators are hovering at very elevated levels. As elsewhere in the developed world, the ongoing weakness in the manufacturing sector has not yet filtered through to the services sector. The more dovish stance of the US Federal Reserve, which will likely cut policy rates this year as an "insurance" against trade war risks, should help to keep consumption and the US housing market afloat in the near-term, resulting in GDP growth at around potential for the rest of the year. Nevertheless, medium-term recession risks have increased, in our view. The escalation of the trade conflict and the related uncertainty might start to weigh on corporates' animal spirits. In combination with increased margin pressures, reflected in persistently weak consumer price inflation and rising wage costs, job creation and business investment could suffer further and the record-long US expansion thus run out of steam. Hence, we will keep a close eye on employment growth, bank lending and business surveys, which have all deteriorated as a trend from very favourable levels.

| **Inflation** | |
|---|---|
| Swiss Life Asset Managers | Consensus |
| 2019: 1.8 % | 2019: 1.8 % |
| 2020: 2.2 % | 2020: 2.1 % |

The biggest surprise to us this year has been the persistent weakness in US core inflation, stemming from both goods and services. Other measures of underlying inflation as well as wage growth had been more upbeat for quite some time but have also started to moderate most recently. In combination with the big drop in oil prices (which was likely excessive given ongoing political risks in the Middle East), we have downgraded our full-year headline inflation forecast to 1.8% from 1.9%.

## *Eurozone*
## Political obstacles not removed

| **GDP growth** | |
|---|---|
| Swiss Life Asset Managers | Consensus |
| 2019: 1.2 % | 2019: 1.1 % |
| 2020: 1.2 % | 2020: 1.3 % |

Immediately after the election of Donald Trump as president of the United States in 2016, we have lowered our assumptions for global trade dynamics in anticipation of disruptive trade policies. For this reason, our Eurozone growth forecast for 2019 looked comparably prudent last year, when an upbeat sentiment still prevailed. Since then pessimism among analysts and investors has increased on the back of intensifying global trade tensions. Therefore, our forecast has suddenly become a consensus view. The reason why we abstain from lowering our forecasts for this year and 2020 at this stage is the apparent resilience of domestic demand. Consumers benefit from improvements on the labour market and fiscal policy is expected to deliver strong impulses to growth this year. While sentiment indicators in Germany continued to deteriorate in the second quarter, robust dynamics in regions and sectors less exposed to trade tensions still justify a forecast of growth around the region's potential. Still, there are plenty of reasons to worry for the 2020 outlook, where we are currently positioned below consensus on growth. We expect many of the political obstacles (trade conflict, Brexit, tensions between Italy and the EU) to remain in place and to weigh on growth well into 2020.

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

The ECB's inflation target of "close to, but below 2%" remains out of reach. The current inflation rate in all four heavyweights in the Eurozone stands at 1.3% or lower. As wages rise, margin compression forms a major risk. Business surveys reveal that firms' selling price expectations have fallen in 18 out of 19 member states compared with 2018. The exception is Cyprus, where the corporate sector signals rising price setting power.

## *Germany*
## Widespread pessimism

| **GDP growth** | |
|---|---|
| Swiss Life Asset Managers | Consensus |
| 2019: 1.1 % | 2019: 0.8 % |
| 2020: 1.3 % | 2020: 1.4 % |

Sentiment among economists regarding Germany continued to deteriorate in the second quarter 2019. Less than one year ago, our forecast of then 1.3% growth for 2019 was comparably prudent. Today, we find ourselves with the most optimistic projection for 2019 GDP growth of all forecasts in the sample collected by Consensus Economics. Sceptics find support in the most recent assessment by Germany's Bundesbank which thinks that GDP contracted in the second quarter, driven by ongoing weakness in manufacturing and export activity. The Bundesbank expects real GDP to grow by just 0.6% from previous year's levels in 2019 and by 1.2% next year. Last December, the Bundesbank still expected 1.6% growth for both years. We differ from the Bundesbank's assessment as we expect comparably stronger domestic demand. Admittedly, capacity utilisation in car industries has not regained traction so far this year and the job market tightening has probably run its course in the manufacturing sector. However, private households continue to spend, and construction activity is expected to be a strong contributor to growth in 2019 and next year. Assumptions on the cyclically-adjusted primary budget balance suggest that the fiscal impulse as a share of nominal GDP will be the strongest since 2010.

| **Inflation** | |
|---|---|
| Swiss Life Asset Managers | Consensus |
| 2019: 1.4 % | 2019: 1.5 % |
| 2020: 1.7 % | 2020: 1.6 % |

Headline inflation eased markedly in June from a temporary spike due to the late Easter date. According to preliminary data, inflation fell to 1.3%, below our assumption of 1.4%. Given the downward trend in energy prices, we have reassessed our inflation profile and lowered the forecast for 2019 to 1.4%. Due to a base effect inherited from last year's swings in the oil price, headline inflation numbers remain on a roller coaster ride. The headline rate is set to drop below 1% in the third quarter, and to exceed 2% anew by early 2020.

## *France*
## A separate mini-cycle

| **GDP growth** | |
|---|---|
| Swiss Life Asset Managers | Consensus |
| 2019: 1.3 % | 2019: 1.3 % |
| 2020: 1.2 % | 2020: 1.3 % |

The French economy is far less affected from global headwinds than neighbouring countries like Germany, Switzerland or Italy. Details in the latest composite Purchasing Managers' Indices show that new orders received by French firms have recovered to above the critical 50 points expansion mark over the past two months, while orders intake by German and Italian firms continued to contract. France's comparably more domestically-oriented business cycle seems more affected by home-made political developments than by the trade conflict between the US and China. Therefore, the impact of President Macron's reform agenda and the "Gilets Jaunes" movement's opposition to it seems to be of higher relevance for current growth dynamics in France. Both the INSEE consumer confidence indicator as well as a broad series of business sentiment surveys have recovered strongly from their lows seen in December 2018, when the "Gilets Jaunes" protests had a hugely disruptive impact on economic activity. Meanwhile, labour market reforms are showing first results in the form of improving labour market data and growing optimism among consumers about their individual job prospects. Available hard data on private households' consumption and manufacturing production encouraged us to slightly lift the GDP growth forecast for 2019.

| **Inflation** | |
|---|---|
| Swiss Life Asset Managers | Consensus |
| 2019: 1.2 % | 2019: 1.2 % |
| 2020: 1.6 % | 2020: 1.4 % |

Our inflation forecast remains unchanged for both this year and 2020. Domestically generated inflation pressure suggests that the monetary policy set by the ECB is about right for France and should not be normalised any time soon. The risk to the inflation projection is skewed to the downside as energy prices are trending lower. In addition to that, lower social contributions reduce labour costs for firms. Should services firms pass on these savings to consumers, inflation is likely to come in even lower than we currently expect.

## *UK*
## Back to reality

| **GDP growth** | |
|---|---|
| Swiss Life Asset Managers | Consensus |
| 2019: 1.2 % | 2019: 1.4 % |
| 2020: 1.2 % | 2020: 1.4 % |

We repeatedly mentioned that the first-quarter activity data painted a too glorious picture of the British economy, as an inventory build-up boosted growth numbers. Still, we were surprised by the hefty payback seen in April activity data and the plunge of the manufacturing Purchasing Managers' Index, into contraction territory. Hence, we revised down the full-year GDP forecast to 1.2% from 1.4%. According to the Bank of England's Agents survey, investment intentions in both the manufacturing and the services sector are now at the lowest level since the financial crisis and unlikely to improve given continued Brexit uncertainty. All leading candidates in the race to replace Theresa May as Conservative Party leader have vowed to re-negotiate a deal with the EU. If the attempt is unsuccessful, some candidates have threatened to leave the EU without a deal on 31 October 2019, opting for the draconian measure to suspend parliament if it remains opposed to "no deal". We still think an extension of the deadline, potentially followed by an early election, is the more likely scenario, and we put the probability of a no-deal Brexit at around 30% (only slightly below the current consensus estimate of 32%).

| **Inflation** | |
|---|---|
| Swiss Life Asset Managers | Consensus |
| 2019: 1.8 % | 2019: 1.9 % |
| 2020: 2.0 % | 2020: 2.0 % |

We revised down the 2019 inflation forecast to 1.8% from 1.9% previously, taking into account slightly disappointing inflation numbers since the beginning of the year and the recent decline in oil prices. The inflation trajectory will hinge on further currency and thus Brexit developments. As a lot of negativity already seems to be priced into Sterling, we do not expect significant depreciation from here in our base case scenario, which should cap the upside risks to inflation.

## *Switzerland*
## More prudent hiring plans

| **GDP growth** | |
|---|---|
| Swiss Life Asset Managers | Consensus |
| 2019: 1.3 % | 2019: 1.3 % |
| 2020: 1.4 % | 2020: 1.5 % |

The consensus forecast for real GDP growth underwent a mild upside adjustment, following the release of surprisingly firm first quarter data. Thus, our own forecast for 2019 is currently exactly mirroring the consensus view. Meanwhile, our projection for 2020 remains slightly more prudent than the consensus forecast. SECO, the federal government's State Secretariat for Economic Affairs, expects economic activity to rebound from a temporary soft patch and currently projects GDP to grow by 1.7% next year. Compared with our own forecasts, SECO has a markedly more upbeat forecast for the corporate sector's investment spending in equipment and software. SECO expects this element of GDP to grow by 3.2% next year (after 0.8% in 2019). In comparison, our own numbers look more prudent. We expect business spending to rise by 1.1% this year and 1.2% in 2020. As we think that the medium-term risks of a shallow recession in economies like Japan, Germany or the United Kingdom has increased, we think that Switzerland's export-oriented sectors are likely to respond with prudent investment and hiring activity to intensifying global headwinds.

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

An important part of the Swiss National Bank's (SNB) communication toolkit is the conditional inflation forecast. According to the June 2019 projections, inflation will not surpass 1.5% between now and the first quarter 2022, even if the current monetary policy is maintained over that time horizon. We also expect inflation to remain well within the SNB's target zone of 0% to 2% in the foreseeable future. In the short-term, falling energy prices in June even resulted in a renewed downward revision to our forecast for full-year 2019.

## *Japan*
## Investment cycle still in place

Japanese first-quarter growth already surprised to the upside in the first estimate and was even revised up in the final release due to stronger-than-expected business investment. This prompted us to increase the full-year forecast by 10 basis points to 0.7%, even if we assume much weaker quarterly growth for the rest of the year. Indeed, net exports should again contribute negatively as global trade frictions and the stronger Japanese yen weigh on external demand, while the huge drop in import volumes in the first quarter is likely to reverse in the following quarters. Also, we expect private consumption to remain weak as a trend. Consumer sentiment has plunged to the lowest level since early 2015 and real wages are squeezed by a combination of stagnating nominal wages and temporarily higher inflation. The most important growth driver remains business investment, where the positive cycle is still in place amid very tight labour market conditions and record-low interest rates.

## *China*
## Economy under pressure

Amid the re-escalation of trade tensions with the US early May, China's May activity data showed a broad-based slowdown. Annual industrial production growth slowed to 5.0%, the weakest reading since 2002. Fixed asset investments also dropped to a 9-month low, growing at 5.6% (April: 6.1%), with weaker infrastructure as well as real estate investments. Only retail sales growth jumped in May to 8.6% (April: 7.2%), but part of this increase was likely driven by a different timing of Labour Day holidays, with more days off in May this year compared to a year ago. Hence, Chinese policymakers are pressured to unleash further stimulus measures to prevent a sharp slowdown of the economy. China still has room for further easing measures, with targeted as well as broad-based cuts in the required deposit reserve ratio for major domestic banks, tax rebates for exporting companies that are affected by trade tariffs, more local government bond issuances to support infrastructure investments, as well as an improved execution of already promised tax and fee cuts.

## Economic Research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