

August 2019

Key messages

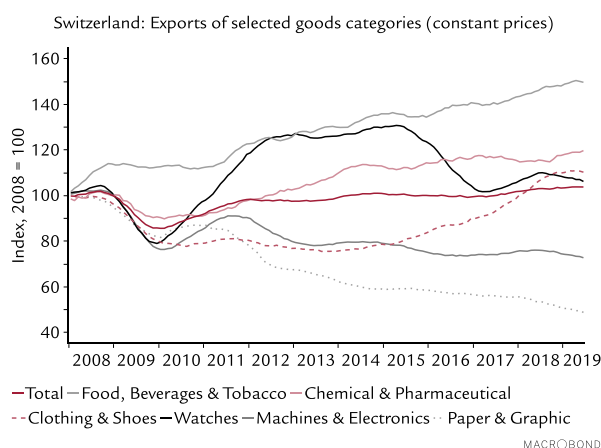
- Easier financial conditions in the US lift consumer sentiment
- No signs of improving industrial activity in Germany
- Falling import prices trigger a downward revision of our inflation forecast for Switzerland

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%	1.9%	1.8%	1.9%	2.2%	2.1%
Eurozone	1.0% ↓	1.1%	1.0% ↓	1.2%	1.3%	1.3%	1.5% ↓	1.4%
Germany	0.7% ↓	0.7% ↓	0.9% ↓	1.4%	1.5%	1.5%	1.7%	1.6%
France	1.4% ↑	1.3%	1.2%	1.3%	1.2%	1.2%	1.5% ↓	1.4%
UK	1.2%	1.3% ↓	1.2%	1.3% ↓	1.9%	1.9%	2.0%	2.0%
Switzerland	1.1% ↓	1.3%	1.2% ↓	1.5%	0.6%	0.6%	0.7% ↓	0.6% ↓
Japan	0.7%	0.7% ↓	0.4%	0.3% ↓	0.6%	0.6%	1.0%	0.8% ↓
China	6.1%	6.2% ↓	6.0%	6.0%	2.3%	2.3%	2.2%	2.3%

Arrows indicate difference from previous month
Source: Consensus Economics Inc. London, 8 July 2019

Chart of the month



According to Switzerland's customs administration, trade in both directions reached new record highs. Yet, a closer look at the data since 2008 reveals that real total exports only grew by just 4% over more than one decade. This was driven by pharmaceutical goods, and within this category by manufactured human plasma. Food and beverages visibly increased as well, mainly driven, however, by coffee capsules sent around the world. Furthermore, the recent increase in clothes and shoes exports is illusionary: this statistic includes unwanted items returned by online shoppers. Exports of machinery and paper product, on the other hand, fell by more than 25%.

US

A financial conditions boost

GDP growth

Swiss Life Asset Managers	Consensus
2019: 2.4 %	2019: 2.5 %
2020: 1.8 %	2020: 1.9 %

The prospect of policy rate cuts by the Federal Reserve and the “truce” in the US-Sino trade conflict at the G20 summit have led to a rally in both bonds and equities. Since their peak at the turn of the year, financial conditions have therefore loosened significantly in the US, falling back to levels last seen in September 2018. The up-and-down in financial conditions was reflected in consumer sentiment surveys. Consumers’ assessment of their future financial situation recently reached the highest level since 2004, underpinned as well by solid gains in real wages. Hence, consumption growth rebounded in the second quarter from its rather depressed levels at the beginning of the year, and the outlook for the second half of the year remains favourable. Meanwhile, the investment and manufacturing cycle in the US remains on a downtrend. Industrial production showed again an outright decline in the second quarter, and order books are thin in historical comparison. Manufacturing sentiment indices will likely show a relief move in July following the improvement in the trade conflict. Nevertheless, we do not expect a significant re-acceleration in industrial dynamics as uncertainty regarding trade policy is set to return and corporate investment intentions remain subdued.

Inflation

Swiss Life Asset Managers	Consensus
2019: 1.8 %	2019: 1.9 %
2020: 2.2 %	2020: 2.1 %

US core inflation rebounded to 2.1% in June, surprising to the upside and supporting the recovery of market-based inflation expectations. The increase was driven by categories (apparel, used cars) which showed inexplicable weakness in the previous months. We expect core inflation to move to 2.2% in August and to settle at that level until year-end. Meanwhile, headline inflation has likely bottomed out in June (at 1.6%) and should increase until year-end due to positive energy contributions.

Eurozone

A stuttering growth engine

GDP growth

Swiss Life Asset Managers	Consensus
2019: 1.0 %	2019: 1.1 %
2020: 1.0 %	2020: 1.2 %

We lowered our forecast for average real GDP growth in 2019 and 2020 as our outlook for Germany has become substantially more prudent. Given its sheer size, the risk of a shallow recession in this country outweighs positive trends elsewhere in the Eurozone. The economic outlook has also clearly deteriorated in Austria, which is exposed to the external shock from global trade uncertainties in a similar way as Germany. Manufacturers in these countries have created plenty of new jobs over the past few years, benefitting from a weak euro and low financing costs. Falling global demand and problems in Europe’s car industry now result in falling orders intake. Over the past few months, manufacturing Purchasing Managers’ Indices (PMI) have been trending lower in both economies, now suggesting contraction in industrial activity. Italy is another Euro member state where a temporary recession has become increasingly likely again. Meanwhile, France and the Netherlands so far appear less affected by global headwinds. In both economies, consumer confidence recovered during the second quarter and the PMI held around the 50-points expansion threshold so far in 2019.

Inflation

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

Ahead of the July meeting of the European Central Bank (ECB), there were speculations that the ECB considers revamping its inflation target. Whether or not a change in the rhetoric away from the ECB’s mantra of attempting to steer inflation towards “close to, but below 2%” would result in an upward shift in inflation expectations is questionable. In principle, the ECB already has a symmetric inflation target, and they have made it clear that they are ready to accept a temporary overshoot of inflation.

Germany

Stagnation in the second quarter

GDP growth

Swiss Life Asset Managers	Consensus
2019: 0.7%	2019: 0.7%
2020: 0.9%	2020: 1.4%

Over the past few weeks, we have received more data covering economic activity during the second quarter 2019. These data confirm earlier comments from the Bundesbank saying that economic activity has slowed further in the Eurozone's largest economy. Therefore, we lower our growth forecast for 2019 and 2020. In contrast to the first quarter, construction is likely to have contributed negatively to growth in the three months to June. Forward-looking indicators from the manufacturing sector suggest that contraction in industrial production continues in the third quarter. According to think tank Ifo's business survey, most respondents from the industrial sector expect their own firm's output to fall over the horizon of the next three months. The current reading of this subindex is the lowest since December 2012. The Ifo's headline business indicator hints at a continued slowdown across sectors in Germany. A noteworthy positive fiscal impulse this year and firm demand by private households are likely to prevent the economy from falling into recession. Yet, uncertainties as regards global trade continue to weigh on private sector sentiment. We expect corporate Germany to cut investment and hiring plans in response to the ongoing headwinds.

Inflation

Swiss Life Asset Managers	Consensus
2019: 1.5%	2019: 1.5%
2020: 1.7%	2020: 1.6%

Consumer price statistics confirm that the economic slowdown described above is triggered by an external shock. Domestically-oriented service providers seemingly have sufficient price setting power. Annual services inflation stands at 1.9%, with price increases for car repair work, social care services, railway tickets and holiday packages all exceeding 3%. Headline inflation surprised to the upside in the revised numbers for June, mainly due to higher food prices.

France

Against the trend

GDP growth

Swiss Life Asset Managers	Consensus
2019: 1.4%	2019: 1.3%
2020: 1.2%	2020: 1.3%

As explained last month, the French economy is less exposed to global headwinds than other European economies like Germany or Switzerland. While industrial production in Germany fell by 3.7% over the twelve months since May 2018, output in the same sector rose by 4.0% in France. Business sentiment remained comparably firm during the second quarter 2019 with Purchasing Managers' Indices remaining in expansion territory, both in the manufacturing and the services sectors. The French statistics office INSEE reports that consumer confidence recovered further until mid-year, exceeding the long-term average of 100 points for the first time since April 2018. We expect the unemployment rate to have declined further in the second quarter this year, but official labour market data are not available before 14 August. With a delay relative to other Euro member states, the unemployment rate in France should by now have come down to a level last seen more than a decade ago. Meanwhile, the French government takes advantage of its entire fiscal room to manoeuvre as the fiscal deficit is likely to reach 3.1% of this year's GDP. According to the EU Commission's report from June, Bruxelles seems willing to accept this breach with the Stability and Growth Pact as "marginal and temporary".

Inflation

Swiss Life Asset Managers	Consensus
2019: 1.2%	2019: 1.2%
2020: 1.5%	2020: 1.4%

Labour market reforms in France are expected to tame wage growth dynamics over the medium-term. Lower social contributions reduce labour costs for firms. Depending on how much of these savings are passed on to their customers, our inflation forecast could be too high. However, upside risks exist in the form of a renewed increase in energy prices and to a lesser degree in rising import prices given the weakening of the euro relative to the USD.

UK

More labour market tightening

GDP growth

Swiss Life Asset Managers	Consensus
2019: 1.2 %	2019: 1.3 %
2020: 1.2 %	2020: 1.3 %

The Brexit uncertainty has taken its toll on activity and sentiment indicators in the UK this year. Based on the already available data, we expect the UK economy to have contracted in the second quarter, while business surveys suggest that growth will remain sluggish for the rest of the year. Boris Johnson, the new prime minister, will soon start another attempt to re-negotiate the Brexit deal. However, with only three months left and an apparent unwillingness from the European side to grant meaningful concessions, uncertainty regarding the final Brexit outcome is set to increase in the near-term. Miraculously, the UK labour market seems to be shielded or has even benefited from the Brexit fallout. Even though employment growth has slowed in 2019, the unemployment rate has hovered at 3.8%, the lowest level since the mid-1970s. Brexit has probably added to the tight labour market, as net migration from the EU has slowed significantly since the June 2016 Brexit referendum. As a result, annual wage growth has increased to 3.6% most recently, the highest level since the financial crisis. Nevertheless, the Bank of England will have no appetite to tighten monetary policy in response. Amid an uncertain economic outlook and looser monetary policy abroad, we expect it to remain in wait-and-see mode.

Inflation

Swiss Life Asset Managers	Consensus
2019: 1.9 %	2019: 1.9 %
2020: 2.0 %	2020: 2.0 %

The June inflation number came in slightly higher than we had anticipated, and we therefore revised up the full-year forecast from 1.8% to 1.9%. The inflation trajectory is dependent on 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, which should cap the upside risks to inflation.

Switzerland

Twin headwinds

GDP growth

Swiss Life Asset Managers	Consensus
2019: 1.1 %	2019: 1.3 %
2020: 1.2 %	2020: 1.5 %

Switzerland is particularly exposed to uncertainties related to global trade policies. No other developed country's exports to China account for a bigger share of GDP than the 3.5% in Switzerland's case. The marked slowdown in economic activity in Germany, Switzerland's most important trading partner, is leaving additional traces in firms' order books. We thus take the second quarter's record-high export volumes with a grain of salt (see page 1). Even if there was a boom in export activity, it has most likely peaked. The manufacturing purchasing managers' index fell into contraction territory in the second quarter. At 47.7 points, its June reading was the lowest since October 2012, suggesting that industrial activity has even dropped below levels seen in the aftermath of the currency shock of 2015. Adding to weaker global trade dynamics, the renewed appreciation of the franc is likely to weigh on external demand going forward. Relative to the euro, the franc's overvaluation exceeds again 10% by traditional measures. This will weigh on activity in alpine tourism regions competing with resorts in neighbouring Austria and France. Incentives for Swiss consumers to shop on the other side of the border have risen as well.

Inflation

Swiss Life Asset Managers	Consensus
2019: 0.6 %	2019: 0.6 %
2020: 0.7 %	2020: 0.6 %

The renewed dovishness of central banks in the US and the Eurozone results in a strengthening of the Swiss franc's external value. On a trade-weighted basis, the franc has gained more than 4% since July 2018. Switzerland's producer and import prices index fell by 1.4% in the year to June, mirroring lower energy prices and a stronger currency. The expectation of a pass-through of lower import prices to consumers led to a lowering of our forecast for inflation in 2020.

Japan

No end to Abenomics in sight

At the 21 July Upper House elections, when half of the seats were up for grabs, Prime Minister Abe's coalition lost its two-third supermajority. Hence, Abe's long-term goal of amending the pacifist constitution suffered a major setback. From an economic point of view, this may even be positive, as it will put the government's focus back on economic policy ("Abenomics"), for which the coalition retains a comfortable majority in both Houses. The next step will be the controversial raise of the consumption tax from 8% to 10% in October aimed at reducing Japan's structural deficit. Even if the negative impact on consumption is cushioned by a vast spending package, the timing of the tax hike is unfortunate as Japan is already amid a cyclical downturn in manufacturing. The latter is amplified by ongoing trade tensions in the region, where the latest addition has been Japanese export restrictions of chemicals crucial to South Korea's high-tech industry. Overall, we expect GDP growth to remain below potential in both 2019 and 2020 (0.7% and 0.4%, respectively).

China

Economy set to slow down

China's economy grew at the slowest pace in 27 years, with its second-quarter year-on-year GDP growth slowing down to 6.2% from a year ago (Q1 2019: 6.4%). The slowdown reflects weak exports, driven by the US-China trade conflict and subdued demand from China's main trading partners. Also, deteriorating sentiment has led to subdued investments, especially in the manufacturing sector. At the same time, June activity data surprised to the upside, with industrial production, fixed asset investments and retail sales showing signs of improvement. However, in our view this recovery is not sustainable, as it is driven by one-off effects: Retail sales have been pushed up by a surge in auto sales as car dealers implemented huge discounts ahead of a new emission standard valid as of 1 July. While China and the US agreed on a trade truce at the G20 summit end of June, future negotiations will be difficult, as the two sides remain at odds over significant issues needed for an agreement. Hence, uncertainty over potential new rounds of tariff threats remains high.

Economic Research



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