Perspectives
Economics

September 2018

Key messages

- US: Pro-cyclical fiscal stimulus does its trick right on time ahead of the mid-term elections
- Brexit: Theresa May still negotiating on two fronts
- Swiss economy shifting to a slower gear heading into second half 2018

Comparison of forecasts

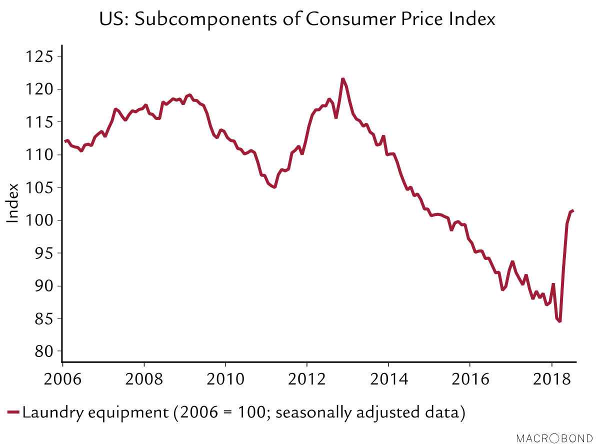
	GDP growth 2018		GDP growth 2019		Inflation 2018		Inflation 2019	
	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus
US	2.7%	2.9%	2.2%	2.6%	2.5%	2.5%	2.1%	2.2%
Eurozone	2.0%	2.1% ↓	1.4%	1.8%	1.7% ↑	1.7%	1.6% ↑	1.6%
UK	1.2% ↑	1.3%	1.0%	1.5%	2.5% ↑	2.4% ↓	2.2% ↑	2.1%
Switzerland	2.1%	2.2%	1.2%	1.7%	1.0%	1.0% ↑	0.9%	1.0%
Japan	0.9%	1.1%	1.1%	1.2% ↑	0.8% ↑	0.9%	0.3% ↑	1.1%
China	6.5%	6.6%	6.1%	6.3% ↓	2.1%	2.1% ↓	2.3%	2.3%

Arrows indicate difference from previous month
Source: Consensus Economics Inc. London, 13.08.2018

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



US consumer price data offer an idea on the immediate effect of President Trump's trade policy: The price increase by 20% for laundry equipment suggests that higher import tariffs were passed on entirely to consumers. Nevertheless, it is important to keep in mind that US imports of goods and services account for just 15% of the country's gross domestic product.

US
Fiscal stimulus does its trick

GDP growth	
Swiss Life Asset Managers	Consensus
2018: 2.7 %	2018 : 2.9 %
2019: 2.2 %	2019 : 2.6 %

Ten years after the financial crisis, the US economic expansion shows no signs of exhaustion. After annualised GDP growth of more than 4% in the second quarter, tracking estimates for the current quarter suggest that a similar pace could again be reached. Private consumption data in particular had a good start into the third quarter. Apparently, the tax cuts have now started to boost consumption. Thus, the pro-cyclical fiscal boost by the Trump administration does its trick right on time ahead of the mid-term elections. This judgement is even more valid when looking at the corporate sector: Non-residential construction spending and expenditures on core capital goods are clearly supporting economic growth thus far in 2018. Business sentiment among small and medium sized firms improved to near a record level in July according to the NFIB (National Federation of Independent Business). Despite all these signs of buoyant domestic economic activity, a number of Fed watchers points at the ever flattening yield curve. According to them, this development suggest an elevated recession risk for 2019. Yet, econometric models based on the yield curve steepness suggest that the likelihood for the US to be in recession in a year's time is actually still below 20%.

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

Higher tariffs feeding through into prices for certain goods provide spectacular evidence for everybody afraid of inflation getting out of control. Yet, as imports from China represent only 2.6% of US GDP, the total impact on inflation should not exceed 0.2%. Falling commodity prices and weaker service prices increases as of late substantiate our view that annual inflation has peaked last month.

Eurozone
Inflation temporarily above 2%

GDP growth	
Swiss Life Asset Managers	Consensus
2018: 2.0 %	2018 : 2.1 %
2019: 1.4 %	2019 : 1.8 %

Survey data are eagerly awaited to gauge the pace of the growth moderation and to see how much confidence is dragged down by political tensions. The purchasing managers' index of Germany and France has stabilised in June and remains well in expansionary territory. Consumer confidence dropped quite a bit in August. While we would expect that the peak of consumer confidence is already behind us we do not foresee a rapid decline. The labour market is still improving: The Unemployment rate continues to fall and wage growth is picking up. In our view, private consumption will therefore remain a growth pillar going forward. The industry sector, however, has shown some weakness recently. After a pronounced increase between summer 2016 and end 2017, industrial production has moderated in 2018. Relations between the EU and the US are important for the outlook of industry. In late July, Donald Trump and Jean-Claude Juncker have found an agreement. An imposition of US tariffs on European car imports has thereby become less likely, at least in the near future. The focus will shift to Italian politics over coming weeks. In September, the new government will present its first budget revealing the projection for the budget deficit as well as political priorities.

Inflation	
Swiss Life Asset Managers	Consensus
2018: 1.7 %	2018: 1.7 %
2019: 1.6 %	2019: 1.6 %

In July headline inflation has surpassed the 2 percent line for the first time since 2012. The energy component alone has contributed 0.9 percentage points to the 2.1% inflation rate. As the base effect of low energy prices in summer 2017 is fading out, headline inflation has reached the peak in our view. With the output gap closing and wage growth finally picking up we see core inflation gradually moving higher towards 1.5%.

UK
213 days to depart the EU

GDP growth	
Swiss Life Asset Managers	Consensus
2018: 1.2 %	2018: 1.3 %
2019: 1.0 %	2019: 1.5 %

The UK is scheduled to depart the EU at 11pm UK time on 29 March, 2019. Meanwhile, recent developments did not bring more clarity on the form of Brexit and future relations with the EU. Instead, confusion has increased: At first glance it looked as if Theresa May's Chequers proposal and the subsequent resignation of two "Brexiteers" from her cabinet paved the way for a softer Brexit. Yet, only a few days later, a poll published by the Sunday Times revealed an odd response by the public: A rising number of respondents expressed support for Boris Johnson. At the same, number of those answering that they would prefer to stay in the EU also increased. Theresa May still needs to negotiate on two fronts, with the EU and her own Conservative Party. Currently, London is full of rumours regarding attempts to challenge May's party leadership role at the annual convention in a months' time. In times of such uncertainties, it is understandable that the Governor of the Bank of England (BoE), Mark Carney, warned of the consequences of a "No Deal Brexit". Yet, he is just one actor more to add inconsistencies to the debate: His remarks came only one day after the BoE raised its benchmark interest rate, which should usually be taken as a sign of economic confidence.

Inflation	
Swiss Life Asset Managers	Consensus
2018: 2.5 %	2018: 2.4 %
2019: 2.2 %	2019: 2.1 %

After Carney's remarks on risks of a "No deal Brexit", the Sterling weakened markedly. In trade weighted terms, its value today is 4% lower than the average of the first half 2018. This compares with the 9% loss in the three months after the referendum in 2016. Back then, higher import prices triggered a significant increase in inflation. As uncertainties around Brexit will persist, the Sterling should remain weak in our view. As a consequence of resulting rising import prices, we lift our inflation forecast for both 2018 and 2019.

Switzerland
Consumers don't buy the boom

GDP growth	
Swiss Life Asset Managers	Consensus
2018: 2.1 %	2018: 2.2 %
2019: 1.2 %	2019: 1.7 %

Unlike in most other economies, second quarter GDP data are still not published. For the time being we stick to our assessment that GDP continued to grow at a 0.5% quarterly rate. That would mark the fifth straight quarter in which the economy grew markedly above the long-term potential rate. For the second quarter, risk are even slightly skewed to the upside: Firstly, we observed higher than expected growth rates elsewhere, meaning that Switzerland's export industries might have benefitted from the ongoing cyclical upswing. That would be consistent with still remarkably elevated reading for Switzerland's purchasing managers index. Secondly, we know that Football World Cup licence earned by organising FIFA enter Switzerland's national account data, giving GDP an additional boost during the second quarter. Meanwhile, consumer confidence took a surprise hit in the second quarter. So far, consumers did not benefit much from recovering exports as wages did not keep up with rising inflation. As global dynamics are clearly cooling, we expect growth rates to moderate markedly into the second half of 2018: After five quarter with an average GDP growth rate of 0.6%, we currently expect only half that pace on average during the next six quarters.

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

Two major developments explain the rapid increase in inflation over the past twelve months: Last year's weakening of the Swiss Franc triggered an increase of import prices. Energy prices in particular rose sharply, resulting in 30% higher costs for heating oil compared to 2017. While energy prices continued to rise in August, currency effects are likely to prevent inflation from rising much further in the second half of 2018. Additionally, we expect rents for apartments to decline slightly over the coming twelve months.

Japan
Inflation remains well below 2%

The Bank of Japan has signalled that its policy will become a little bit less accommodative. While the monetary stimulus might be reduced gradually it will still remain very large for many quarters. Inflation is still well below the target of two percent and will not move close to the target any time soon. The large gap between our forecast and consensus for 2019 is related to the consumption tax. As the timing of the consumption tax hike is still uncertain, we have not yet built it in our inflation forecast path. In any case, a tax hike has only a temporary impact. A more sustainable source of inflation is for example an improving labour market. And there are indeed signs for this. Wage growth is gradually picking up and it becomes more difficult for firms to find workers. As employees are getting more bargaining power, temporary contracts are being replaced by permanent jobs. Thus, there is evidence for a fundamental improvement of the labour market.

China
Counteracting measures

China's economy is undergoing a transformation as financial tightening measures are unfolding their effects. Infrastructure investment is slowing markedly and credit creation is receding. Authorities have initiated the longer-term plan to improve financial stability in 2017. Back then, they were willing to accept a certain growth moderation. Today, the situation is more complicated as the US is implementing protectionist measures to curb Chinese imports. China's government tries to offset the drag on growth stemming from the weaker export outlook by stimulating the domestic economy. Easing measures have already been taken and more will follow. The scale of the measure will depend on incoming data and US trade policy. Should the US implement the announced tariffs, half of China's exports to the US would be affected by punitive tariffs. In that case we expect decisive easing measures to limit the downward pressure on growth.

Economic Research

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