

September 2019

## Key messages

- Growing risk of a no-deal Brexit
- A technical recession in Germany increasingly likely
- Core inflation on the rise in developed economies

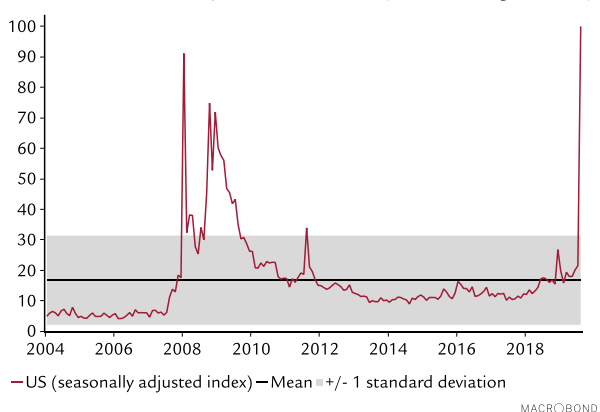
## Comparison of forecasts

	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	2.3% ↓	2.3% ↓	1.8%	1.9%	1.8%	1.8% ↓	2.2%	2.1%
Eurozone	1.1% ↑	1.1%	1.0%	1.2%	1.3%	1.3%	1.5%	1.4%
Germany	0.6% ↓	0.6% ↓	0.7% ↓	1.2% ↓	1.5%	1.5%	1.7%	1.6%
France	1.2% ↓	1.3%	1.1% ↓	1.2% ↓	1.3% ↑	1.2%	1.5%	1.4%
UK	1.2%	1.2% ↓	1.1% ↓	1.2% ↓	2.0% ↑	1.9%	2.0%	2.0%
Switzerland	1.1%	1.3%	1.2%	1.4% ↓	0.5% ↓	0.6%	0.6% ↓	0.8% ↑
Japan	1.0% ↑	0.9% ↑	0.3% ↓	0.3%	0.6%	0.7% ↑	1.0%	0.8%
China	6.1%	6.2%	6.0%	6.0%	2.4% ↑	2.4% ↑	2.3% ↑	2.3%

Arrows indicate difference from previous month  
Source: Consensus Economics Inc. London, 12 August 2019

## Chart of the month

Internet searches for keyword "Recession" (Source: Google Trends)



Big data may help to assess economic trends. Data provided by Google measuring search volumes for the term “recession” are worth watching in this context. In August 2019, search volumes jumped to levels not seen since January 2008 in the US. This behaviour may be a response to media coverage of recession risks and does not necessarily signal a change in US consumers’ behaviour. Yet, it is noteworthy that according to the NBER (National Bureau of Economic Research), the start of the last US recession coincided with the peak in internet search activity for the word “recession”.

## US

### Tariffs now hitting consumers

#### GDP growth

Swiss Life Asset Managers	Consensus
2019: 2.3 %	2019: 2.3 %
2020: 1.8 %	2020: 1.9 %

The month of August brought a new wave of negative news as trade tensions between the US and China escalated. Almost all remaining imports from China not yet affected will be tariffed at 15%, starting on either 1 September or 15 December. President Trump also announced to move existing tariffs even higher. Contrary to previous rounds of tariffs which had a bias towards intermediate and capital goods, consumer goods such as mobile phones, computers, clothing or toys will be in focus this time. The negative news flow has already left its mark on consumer surveys in August, and recession fears have generally increased according to Google Trends data (see chart of the month). Hence, we expect the increased uncertainty to gradually weigh on private consumption going forward. “Big-ticket items” such as vehicles have already embarked on a downturn. The projected slowdown adds to an already weak investment picture and should lead to slightly below-potential growth next year. On a positive note, the significant drop in interest rates is supporting the housing market. Sentiment among homebuilders, mortgage approvals and transaction data have improved significantly since beginning of the year.

#### Inflation

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

US inflation surprised to the upside in both June and July. Core inflation has moved up to 2.2%, and we expect another rise in August to 2.3%, driven by both goods and services. The new round of tariffs might add 10 to 20 basis points to inflation, but as the rise would be temporary only, it is unlikely to have any effect on monetary policy. The latter will be more focused on the negative demand effect of tariffs. Hence, we expect the Federal Reserve to cut its policy rate by 25 basis points each at the September and December 2019 meeting.

## Eurozone

### What's next in monetary policy?

#### GDP growth

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

According to the most recent indicators from the manufacturing sector, cyclical momentum is weakest in economies with a high export dependency on regions outside the Eurozone. Purchasing Managers' Indices (PMI) for the manufacturing sector are particularly depressed in Germany and Austria, while they remain in expansionary territory in France, the Netherlands or Greece. Thus, contagion from Germany's ailing industrial sector to other regions or sectors remains limited for the time being. The Eurozone-wide PMI for the services sector is currently higher than on average during the first half of the year. We anticipate that the ECB will provide renewed monetary policy stimulus, which should ensure favourable credit conditions across the Eurozone. In addition, fiscal room to manoeuvre exists, not least thanks to financial repression which helps to cap nominal sovereign bond yields and ensures affordable refinancing of maturing bonds. While France is exploiting its fiscal capacity to full extent, German policy makers are far more reluctant. Political tensions remain elevated with Italy's government crisis, Brexit and the potentially escalating trade conflict all weighing on the outlook for the Eurozone.

#### Inflation

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

The extent and the chosen instruments to provide the Eurozone economy with additional monetary policy stimulus remain unknown until the ECB meeting on September 12. We doubt that a new easing package by the ECB will result in a sustainable change in long-term inflation expectations. In the short-term though, we think that financial markets are not correctly priced for the imminent temporary increase in headline inflation to 1.9% until the end of the first quarter 2020.

## Germany

### In technical recession?

#### GDP growth

Swiss Life Asset Managers	Consensus
2019: 0.6 %	2019: 0.6 %
2020: 0.7 %	2020: 1.2 %

Similar to the US, internet searches for the term “Rezession” have risen sharply in Germany, reaching the highest level since November 2008. Since GDP contracted in the second quarter, there is a considerable risk that Germany’s economy has entered a technical recession. In its latest monthly report, the Bundesbank suggests that the economy has continued to shrink in the current quarter due to the ongoing weakness in the industrial sector. If the Bundesbank’s assessment is correct, the condition for a technical recession would be fulfilled. Our own model based on the Purchasing Managers’ Indices currently predicts 0% growth in the third quarter. Whether or not GDP eventually shrinks in the third quarter depends on dynamics in the services sector. Up until April, business sentiment in services and other domestically-oriented sectors remained strong, suggesting limited spill-overs from the rapidly deteriorating momentum in manufacturing activity. According to the ifo survey, this has changed markedly since. In August, the business climate index for the services sector fell below its long-term average. Ample fiscal room to manoeuvre would be available to limit the damage of the downturn. Yet, German policy makers so far appear reluctant to ramp up fiscal support.

#### Inflation

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

Our inflation forecast remains unchanged as the July data came in broadly in line with our forecast. Annual headline inflation numbers will be volatile over the coming months, as the decline in energy prices during last year’s final quarter causes a substantial base effect. Germany’s headline inflation rate is expected to exceed 2% by the end of 2019 and may even rise to a rate as high as 2.6% until March 2020.

## France

### Rebound in manufacturing

#### GDP growth

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

The French economy remains less affected by global headwinds than other European economies like Germany or Switzerland. In the second quarter 2019, GDP grew by 0.3% supported by corporate capital expenditure. Household consumption was disappointing and increased at the slowest pace of the past four quarters. Nevertheless, consumer confidence remains on an upward trend, defying the global trend of rising uncertainty. French consumers are increasingly constructive regarding future purchases of major household goods, which bodes well for the second half of the year. The unemployment rate dropped to its lowest levels since the first quarter 2009. Recently, the French manufacturing Purchasing Managers’ Index (PMI) for August moved back above the critical 50 points expansion line. The PMI in the services industry continues to recover from the doldrums caused by the Gilets Jaunes protests between December 2018 and March 2019. At 53.3 points, it stands at its highest level since November 2018, suggesting firm momentum in the domestic economy. Lower financing costs for both the public and the private sector should provide support to domestic demand and continue to protect the French economy from recessionary tendencies in Germany.

#### Inflation

Swiss Life Asset Managers	Consensus
2019: 1.3 %	2019: 1.2 %
2020: 1.5 %	2020: 1.4 %

Inflation came in higher than expected in the last two months. Therefore, we adjust our inflation forecast for 2019 to 1.3%. The forecast for 2020 stays slightly above consensus, which is consistent with our judgement that firm domestic activity should provide companies with a modestly rising price setting power. Owing to base effects stemming from the oil price fall at the end of last year, annual headline inflation is set to temporarily rise to around 2% by the first quarter 2020.

## UK

### Anything can happen now

#### GDP growth

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

Brexit remains the dominating issue for the UK economic outlook. Risks for a hard Brexit have increased further and reached a probability of around 50% at the time of writing, a subjective assessment mired in considerable uncertainty. The two main routes towards a hard Brexit are as follows. First, Boris Johnson will strive towards that result on 31 October as re-negotiations will likely prove unsuccessful, and parliament might find itself unable or unwilling to stop him. Second, in the more likely event of a conflict between parliament and government, an early election will be needed to sort the situation out. In the British first-past-the-post electoral system, a general election may, however, end up with a majority for Brexiteers if they are better able than their opponents to pool votes. As our growth forecasts are still based on a favourable Brexit outcome, risks are significantly skewed to the downside. In the event of a hard Brexit, we would expect the disruptions to lead to at least one quarter of declining output, with a new equilibrium at a lower GDP growth level unfolding subsequently. Increased preparedness by companies, temporary waivers and a weaker pound may soften the blow to the economy, but as there is no historical precedent for Brexit, the potential consequences are very difficult to assess.

#### Inflation

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

July inflation data again surprised to the upside, with both headline and core inflation edging up to 2.1% and 1.9%, respectively. Pass-through effects from the weaker currency and higher wage growth have added to inflationary pressure. The inflation trajectory is very dependent on currency and thus Brexit developments. As the probability for a hard Brexit and thus further Sterling depreciation has increased, the risk to our stable inflation outlook is skewed to the upside.

## Switzerland

### Resilient industrial activity

#### GDP growth

Swiss Life Asset Managers	Consensus
2019: 1.1 %	2019: 1.3 %
2020: 1.2 %	2020: 1.4 %

Switzerland's dependency on foreign demand explains our cautious forecast for economic growth. Also, the ongoing appreciation of the Swiss Franc adds headwinds to services sectors particularly exposed to competition from the neighbouring Eurozone. Cross-border "shopping tourism" has become increasingly attractive and alpine tourism resorts are again losing competitiveness against their French and Austrian counterparts. Adding to these drags, the risk of a technical recession in Germany, still by far the most important trading partner, results in an increasingly prudent investment and hiring activity in the corporate sector. After a strong first quarter, we expect quarterly GDP growth to have stagnated in the second quarter 2019, mirroring trends in Germany. Risks to this assessment are skewed to the upside as industrial production is reported to have continued rising in the second quarter, which stands in contrast with sharply deteriorating business sentiment indicators out of the manufacturing sector. Output of pharmaceutical products rose by almost 14% in the second quarter according to data published by the Federal Statistics Office. The release date for second quarter GDP data is September 5.

#### Inflation

Swiss Life Asset Managers	Consensus
2019: 0.5 %	2019: 0.6 %
2020: 0.6 %	2020: 0.8 %

We lowered our forecast for average inflation in 2019 to 0.5%. A temporary drop in retail gasoline prices in August and the ongoing strengthening of the Swiss Franc both imply that consumer prices will rise less than previously thought. On a trade-weighted basis, the Swiss Franc's external value rose to its highest level since the second quarter 2015. Consequently, Switzerland's producer and import price index fell by 1.7% in the year until July 2019.

## Japan Surprisingly resilient

The Japanese economy is very exposed to Chinese demand and international trade in general, and its potential growth is among the lowest in the developed world. Yet, to everyone's surprise, the Japanese economy managed to grow almost as fast as the US in the first half of this year, and even twice as fast as the Eurozone economy. We therefore revised up our 2019 GDP forecast significantly. The main growth driver remains domestic demand. The positive corporate investment cycle continues unabatedly, and households are ramping up spending ahead of the October consumption tax hike. We do not expect the good times to last. The more consumers front-load purchases, the bigger the "hangover" after the tax hike will turn out. We thus cut the 2020 forecast slightly to 0.3%, expecting weaker consumption and a continued drag from external demand, amplified by the significant strengthening of the Japanese yen. Underlying inflation will thus remain weak and an expansionary stance by the Bank of Japan warranted going forward.

## China A harsher stance

The trade truce agreed on at the G20 summit end of June was short-lived. Already beginning of August, President Trump announced to impose tariffs on the remaining USD 300 bn of Chinese imports. In response, Beijing announced that it would slap new tariffs of 5–10% on USD 75 bn of US imports, prompting the US to announce another 5% tariff increase on all Chinese imports. With China taking on a harsher stance in the trade dispute, trade negotiations are likely to be much more difficult than before the recent re-escalation. While China is feeling the drag from trade tensions on its economy, the Chinese government's stimulus measures are likely to remain prudent. It made clear that a stimulus of the property market is not an option to spur growth. Moreover, the PBoC, China's central bank, introduced a new lending benchmark, with the aim to bring down corporate loan rates, while being reluctant to lower its official benchmark policy rate. Such a move would signify a broader easing stance, but at the same time put downward pressure on the currency.

## Economic Research



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**Released and approved by the Economics Department, Swiss Life Asset Management Ltd, Zurich**

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