

November 2019

Key messages

- Corporate animal spirits to remain at depressed levels
- Not much fiscal stimulus to be expected in the Eurozone
- First signs of rising unemployment in Switzerland's manufacturing industries

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%	1.5% ↓	1.8%	1.8%	1.8%	2.1% ↓	2.1%
Eurozone	1.1%	1.1%	0.9% ↓	0.9% ↓	1.2% ↓	1.2% ↓	1.3% ↓	1.2% ↓
Germany	0.5%	0.5%	0.5% ↓	0.8% ↓	1.4%	1.4%	1.5% ↓	1.5%
France	1.3%	1.3%	1.0% ↓	1.2%	1.3%	1.2%	1.5%	1.3%
UK	1.3% ↑	1.2%	1.1%	1.0% ↓	2.0%	1.9% ↓	2.0%	2.1%
Switzerland	0.7%	0.8% ↓	1.2%	1.2% ↓	0.5%	0.5%	0.5% ↓	0.6% ↓
Japan	0.9%	1.0%	0.3%	0.2%	0.6%	0.6%	0.9% ↓	0.7% ↓
China	6.1%	6.2%	5.8% ↓	5.9%	2.6% ↑	2.5% ↑	2.6% ↑	2.5% ↑

Arrows indicate difference from previous month
Source: Consensus Economics Inc. London, 14 October 2019

Chart of the month



The global trade uncertainty index has climbed to new all-time highs in 2019. Unsurprisingly, the US has witnessed one of the sharpest increases, closely followed by Ireland, the small open economy at the centre of the Brexit debate. Trade and other economic policy uncertainties – especially if elevated over prolonged periods – can impact the real economy through different channels such as investment and consumer spending. We are becoming more pessimistic concerning a resolution of the trade war and see new uncertainties related to the US election on the horizon. Hence, we have lowered our US and China 2020 GDP projections.

US Why we expect growth to slow

GDP growth

Swiss Life Asset Managers	Consensus
2019: 2.3 %	2019: 2.3 %
2020: 1.5 %	2020: 1.8 %

We have recently revised down our full-year 2020 US GDP growth forecast to 1.5% from 1.8%, assuming a gradual slowdown from the current quarterly growth pace, which is at around potential. The reasons are twofold. First, we would tone down the recent optimism regarding the US-China trade conflict. The upcoming “mini deal” (see China article in this publication) certainly removes some of the tail risks regarding an escalation of the conflict, but we have become more pessimistic regarding the prospect of a more comprehensive follow-up deal in 2020 that would get rid of the existing tariffs. Add to that the political uncertainties as we head towards the 2020 presidential elections, and it seems obvious that corporate animal spirits and thus capital expenditure will remain at depressed levels. Second, we expect private consumption growth to slow from the current elevated levels, as job creation is slowing. This process has already started, and employment components in various business surveys are signalling that the slowdown will continue over the next few months. Having said that, we do not expect the economy to move into an outright recession as financial conditions remain favourable following the recent easing measures by the US Federal Reserve.

Inflation

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

US core inflation had three months of a hot streak before September data brought a renewed downside surprise. Nevertheless, we expect core inflation to remain supported at the current level of 2.4% as new tariffs have started to kick in in September and wage growth remains at decent levels. As negative energy price base effects fade, we expect headline inflation to move higher and to reach a local peak in February 2020 at around 2.3%.

Eurozone Not a homogenous story to tell

GDP growth

Swiss Life Asset Managers	Consensus
2019: 1.1 %	2019: 1.1 %
2020: 0.9 %	2020: 0.9 %

Even after 20 years of common monetary policy under the rules of the European Central Bank (ECB), storytelling for the Eurozone as one economic region remains difficult, if not meaningless. As Germany and France show, the narratives for individual countries can differ widely when it comes to labour market conditions or fiscal impulses in times of moderating global trade dynamics. The headline of our base case scenario for the world economy until 2022 is “Patches of Recession”. For the Eurozone this somewhat rough description means that we do not expect the entire region to fall into a technical recession. Yet, activity in some countries and industrial sectors is contracting sharply. For us, the most obvious candidate for a recession has always been Germany’s manufacturing sector. Meanwhile, spill-overs into other countries remain limited, depending on each single country’s export dependency and fiscal capacity. Austria and Finland report deteriorating economic sentiment, while momentum remains particularly firm in France, the Netherlands and Greece. In October, business and consumer sentiment improved in Belgium, which is probably the most representative single country to assess economic conditions in the Eurozone as a whole.

Inflation

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

Since last month, inflation expectations underwent yet another downward revision, both in our analysis and in the consensus sample of more than 30 professional forecasts. Headline inflation in the Eurozone is set to temporarily rise until the first quarter 2020. Yet, underlying dynamics remain insufficient to bring headline inflation sustainably near the ECB’s monetary policy target of “close to, but below” 2% in the medium-term. Our current projection for average annual inflation in 2020 and 2021 is 1.3%.

Germany

Temporary surge in inflation

GDP growth

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

On November 14, Germany's statistics office will publish the preliminary GDP data for the third quarter. These numbers will get high public attention as they will probably confirm that Germany is in technical recession with real GDP contracting in two consecutive quarters. Our current estimate is that GDP fell by another 0.2% in the three months until September. Such news weighs on consumer sentiment which has fallen to the lowest reading since April 2017. Incoming survey data covering the final quarter 2019 suggest that the mild recession could continue at least until the end of the year. Spill-overs from manufacturing to other domestic sectors like freight transport services start to materialise. Germany's corporate sector continues to downsize its investment and hiring plans which will weigh on domestic demand in 2020. Automatic stabilisers like unemployment insurance benefits are expected to limit the impact on economic activity, but the ruling coalition government remains unwilling to make use of its vast fiscal room to manoeuvre. On a more positive note, the latest business surveys did also provide some reason for optimism that economic activity could recover in 2020. Such green shoots are: a modest increase in new export orders in the manufacturing Purchasing Managers' Index and the modest improvement in business expectations in the car industry according to the Ifo business sentiment survey.

Inflation

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

October is the last month for a while in which annual inflation stays below 1%. A base effect from last year's fall in energy prices causes an upward shift in headline inflation from 0.7% in October to 2.3% by March 2020. While such a number is likely to cause some noise in the media, policy makers should turn a blind eye to this temporary surge in inflation. Given sub-potential growth in the Eurozone, the risk of accelerating inflation remains low for the foreseeable future.

France

This recession is for the others

GDP growth

Swiss Life Asset Managers	Consensus
2019: 1.3%	2019: 1.3%
2020: 1.0%	2020: 1.2%

Europe in autumn 2019: while Germany is most probably in recession, France celebrates the lowest unemployment rate since January 2008. Is France just a laggard in the cycle who will experience the same moderation of economic activity as did Germany or Switzerland, or is its economy better shielded from global headwinds than the more export-oriented neighbours? Most recent survey data like the Purchasing Managers' Indices hint at continued expansion in both for manufacturing and services. Like in Germany, new export orders received by French manufacturers improved as of late, contradicting the idea that France will suffer from weaker global demand with a delay to Germany's industrial sector. In contrast to Germany, firms' hiring intentions remain at elevated levels. Despite all the news about rising recession risks elsewhere, consumer confidence improved throughout the year according to the statistics office INSEE. Private households are confident that labour market and financial prospects offer good opportunities for major purchases. In contrast to Germany, the government uses its fiscal room to manoeuvre, which further lifts consumer sentiment. In the draft budget submitted to the EU commission, France plans tax cuts for households worth approximately 0.4% of its GDP. As domestic demand supports growth, France is an unlikely candidate for a recession in 2020.

Inflation

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

We left our inflation forecast unchanged. Robust domestic activity provides the corporate sector with a modestly rising price setting power which should result in rising services prices. A tighter labour market is expected to lift wages in 2020. Like elsewhere, temporary base effects stemming from the oil price fall at the end of last year trigger a temporary surge in the annual headline inflation rate. For France, we expect a peak at around 1.8% by February 2020.

UK No-deal Brexit risk evaporates

GDP growth

Swiss Life Asset Managers	Consensus
2019: 1.3%	2019: 1.2%
2020: 1.1%	2020: 1.0%

The past weeks have seen a spectacular turnaround in Brexit sentiment. Very surprisingly, the UK government and the EU have worked out a solution to the Northern Ireland backstop issue that seems, in principle, acceptable to a majority of the UK parliament. The fact that a palatable deal is available has reduced the risk of a “no deal” dramatically, which has led to a strong rebound in Sterling exchange rates. Nevertheless, numerous stumbling blocks remain on the way to approving the necessary UK legislation and actual ratification of the deal until 31 January 2020, when the current extension expires. At the time of writing, it appears that this process is not feasible with the current composition of parliament, and that the UK is heading towards early elections in December. Ideally, elections would bring a stronger mandate for the current or a new government to decide on the way forward. Hence, uncertainties remain elevated in the next few weeks, but we think it is unlikely that the spectre of “no deal” re-emerges among investors. This will put the spotlight back on the economy, which has performed poorly and is unlikely to accelerate next year. Business sentiment will remain subdued as uncertainties regarding the long-term regulatory arrangements with the EU remain and exports are hurt by the rebound of Sterling.

Inflation

Swiss Life Asset Managers	Consensus
2019: 2.0%	2019: 1.9%
2020: 2.0%	2020: 2.1%

Both headline and core inflation came in at 1.7% in September, somewhat weaker than we had expected. This is surprising given past Sterling depreciation and very elevated wage growth of still close to 4% annually. The recent rebound in the currency will certainly ease some of the near-term inflationary pressure, but we would still expect headline and core inflation to move up to the Bank of England’s 2% target in the first quarter of next year.

Switzerland A stagnation in disguise

GDP growth

Swiss Life Asset Managers	Consensus
2019: 0.7%	2019: 0.8%
2020: 1.2%	2020: 1.2%

One should not be misled by the apparent improvement of the projected GDP growth numbers in 2020 compared with 2019. Our forecast for next year (which is in line with the consensus view) needs to be split into three parts: first, “inherited growth” from 2019 of around 0.35%, which would occur in 2020 even in the case of zero quarterly expansion in each of next year’s four quarters. Second, licence fees earned by the IOC and UEFA which organise the Olympic Games in Tokyo and the European football tournament are assigned to Switzerland’s national accounts. This lifts GDP by another 0.25%. Third, the “underlying” annual growth pace which is reduced to a mere 0.6% in our current projections. Net migration, a strong source of growth in recent years has slowed to an annual number of around 45’000 persons, down by 24% from the 2013–2018 average. Since April 2019, Switzerland’s manufacturing Purchasing Managers’ Index has been below 50 points, which is consistent with contraction. Manufacturing accounts for roughly 18% of the economy, which explains why an outright recession is not our base case for Switzerland. Yet, trends in this most cyclical sector are sufficiently bad to expect a gradual increase in the unemployment rate until end of 2020.

Inflation

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

Inflation data for September surprised slightly to the downside, which triggers a downward revision of the forecast for 2020. The widely anticipated decline in residential rental costs is not visible so far in 2019 but continues to pose a downside risk to the inflation forecast for 2020. Contrary, an unexpected surge in energy prices forms the biggest upside risk.

Japan The forgotten trade conflict

Even as the US-China trade conflict is temporarily easing, Japan will likely continue to suffer from external weakness. First, we expect the Chinese economy to slow in 2020 regardless of the “mini deal” that will likely soon be struck between the US and China. Hence, demand from Japan’s most important trading partner should remain weak. Second, Japan is involved in a self-inflicted and often overlooked trade conflict with South Korea. The issue started over a quarrel regarding compensation payments for forced labour in the Second World War and has grown into a tit-for-tat involving significant non-tariff barriers to trade. For example, Japan has banned exports of certain high-tech goods to Korea. Bilateral goods trade is down 10% compared to last year and has spilled over into services trade, as Korean tourist arrivals in Japan have dropped 60% since beginning of this year. As both countries are feeling the strain, renewed talks have been initiated at the occasion of the enthronement of Japan’s Emperor, with no noticeable results so far.

China Growth to drop below 6%

The Chinese economy has slowed down in the third quarter this year, growing at 6.0% from a year ago, down from 6.2% registered in the second quarter. A slump in manufacturing investments as well as exports that have been hit by trade tariffs were the major drivers behind this slowdown. In our view, the downward pressure on the Chinese economy is likely to continue and prompts us to revise down our forecast for 2020 to 5.8% from 6.0% previously. On the one hand, uncertainty over the US-China relations will likely last well beyond 2020. More precisely, any potential deal concluded by the US and China amid the recent resumption in trade negotiations, will likely be too narrow to pave the way for a broad agreement that addresses outstanding strategic issues. On the other hand, the Chinese government’s stimulus measures are expected to remain prudent. Not only keeps the government its focus on long-term issues such as elevated house prices and a high debt burden, it is also restricted by elevated inflation readings due to soaring pork prices.

Economic Research



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