Perspectives
Economics

December 2018

Key messages

- We introduce our forecasts for 2020 anticipating moderate growth around potential
- Lower oil price suggests that headline inflation will drop below 2% in US and Eurozone before year end
- Outlook for Eurozone still predominantly depending on politics

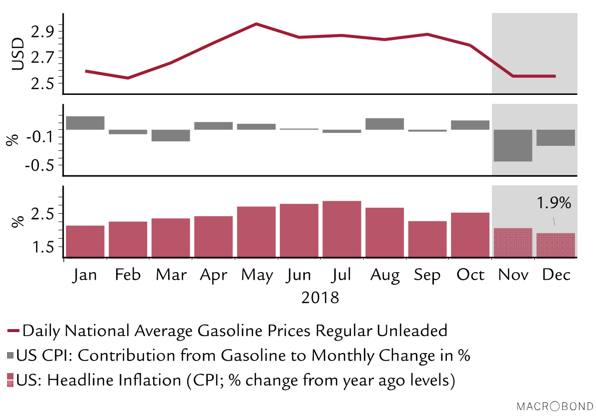
Comparison of forecasts

	GDP growth 2019		GDP growth 2020		Inflation 2019		Inflation 2020	
	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus
US	2.3% ↑	2.7% ↑	1.5%	n.a.	1.8% ↓	2.3%	2.1%	n.a.
Eurozone	1.3%	1.7% ↓	1.1%	n.a.	1.6%	1.7%	1.5%	n.a.
UK	1.4% ↑	1.5%	1.3%	n.a.	2.1% ↓	2.2% ↓	2.0%	n.a.
Switzerland	1.2%	1.8% ↑	1.3%	n.a.	0.7%	1.0%	0.7%	n.a.
Japan	1.3%	1.1% ↓	0.6%	n.a.	1.2% ↑	1.1%	1.7%	n.a.
China	6.2% ↑	6.3%	6.0%	n.a.	2.6% ↑	2.4% ↑	2.2%	n.a.

Arrows indicate difference from previous month
Source: Consensus Economics Inc. London, 12.11.2018

Chart of the month

US: Contribution of gasoline component after seasonal adjustment



Crude oil is currently 30% cheaper than on October 3. In the US, where the share of taxes in the retail price for gasoline is comparably small, prices at the pumping stations have started to drop in response. Compared to May, US consumers pay 13% less for a tankful. Seasonal adjustment factors applied to construct the consumer price index in the US amplify the effect in the last two months of the year. As a consequence, we now expect US headline inflation to drop below 2% by December.

US
Higher interest rates start to bite

GDP growth	
Swiss Life Asset Managers	Consensus
2019: 2.3 %	2019 : 2.7 %
2020: 1.5 %	2020 : n.a.

The substantial fiscal stimulus boosted GDP growth in the second and the third quarter 2018, but it seems as if the economy is losing some speed towards year-end. Notably, industrial production had a weak start into final quarter 2018, and both durable goods orders and business sentiment indicators suggest slower production growth over the months ahead. On the investment side, higher interest rates are especially starting to bite on the housing market, with broad-based weakness visible across indicators. Consumer sentiment remains buoyant as wages rise and the unemployment rate declines, but we think it is very unlikely that the rapid growth pace in consumption can be sustained going forward. In combination with the fading fiscal stimulus, we foresee GDP growth in 2019 to average 2.3%, still above potential, but below generally optimistic consensus forecasts. We expect this late-cyclical slowdown to extend into 2020 as domestic drivers run out of steam amid tightening financial conditions. Also, the global demand backdrop is likely to weaken further, driven by an expected slowdown in China.

Inflation	
Swiss Life Asset Managers	Consensus
2019: 1.8 %	2019: 2.3 %
2020: 2.1 %	2020: n.a.

The spectacular up and down in crude oil prices is leaving its mark on US inflation dynamics. Headline inflation spiked to 2.5% in October, but is now set to fall rapidly until year end. The negative energy base effect will extend into 2019 and should keep headline inflation below the 2% mark for most of the year. Meanwhile, core inflation has run into a slight soft patch, driven by services, but we expect this to be a temporary phenomenon. All labour market indicators as well as commentary from corporates point to increasing wage pressures. This should eventually filter through to consumer prices and keep core inflation on an uptrend. Risks to our forecast are skewed to the upside and mainly encompass an escalation of the trade dispute as well as a renewed surge in oil prices.

Eurozone
A rebound in the last quarter

GDP growth	
Swiss Life Asset Managers	Consensus
2019: 1.3 %	2019 : 1.7 %
2020: 1.1 %	2020 : n.a.

Incoming data confirm our view that economic momentum slowed further towards the end of 2018. Our model based on the purchasing managers index for manufacturing suggests that fourth quarter growth should come in at 0.3%. For the time being, we look through the model's signal and expect a mild rebound in the fourth quarter. GDP numbers out of Germany were hugely distorted by the problem in Germany's car manufacturing industries resulting in an atypically unfavourable net trade result. Exports dropped markedly while imports posted a decent growth. Yet, this should only be a temporary phenomenon and we expect a payback to the upside in the current quarter. Meanwhile, Brexit and Italy's budget struggle with the EU Commission weigh on sentiment and could possibly delay investment decisions by the corporate sector. In Italy, credit costs for the private sector have already started to rise. According to their latest forecasts, the OECD expects fiscal policy to contribute slightly more positively to growth over the next three years compared to the period from 2016 to 2018.

Inflation	
Swiss Life Asset Managers	Consensus
2019: 1.6 %	2019: 1.7%
2020: 1.5 %	2020: n.a.

The latest move in the oil price comes as a support to our assumption that the spike in headline inflation in the Eurozone should be temporary only. This will not force the ECB to normalise monetary policy at a faster pace. Yes, inflation currently stands at 2.2% and thus above the central bank's target of "close to, but below 2%". And it is also true, that inflation currently exceeds 1.8% in 14 of the 19 member states. Yet, it is important to understand that the energy component in the consumer price index contributed 1.0% to the annual rate of 2.2% in Eurozone headline inflation in October. This was due to the rise in oil price in the twelve months until October. Since then, the price for crude oil dropped by 18% in Euros, or enough to let inflation fall below 2% again until end of 2018 already.

UK
The end game

GDP growth	
Swiss Life Asset Managers	Consensus
2019: 1.4 %	2019: 1.5 %
2020: 1.3 %	2020: n.a.

As expected, third quarter GDP growth came in strong, helped by favourable weather conditions. Compared with the previous quarter, GDP rose by 0.6%, the fastest pace in seven quarters. Strong private consumption in July, boosted by good weather and World Cup celebrations will not be repeated in the foreseeable future. The decent performance masks the slowing underlying momentum. GDP stagnated in the months August and September according estimates published by the Office for National Statistics. Furthermore, business investments contributed negatively to growth for the third straight quarter. Incoming data for the fourth quarter suggest that dynamics have slowed even further. Retail sales fell for a second straight month, while purchasing managers indices hint at slower momentum in manufacturing, construction and the service sectors alike. As discussed in previous editions, we think that a "Blind Brexit" is the most likely scenario until March 2019. This means that the British parliament will eventually agree on a deal with the EU, which leaves most details to be finalised during a potentially long transition period. Yet, until March next year, the risk for a "No Deal" remains elevated.

Inflation	
Swiss Life Asset Managers	Consensus
2019: 2.1 %	2019: 2.2 %
2020: 2.0 %	2020: n.a.

Inflation data surprised to the downside in October for the second consecutive month and lower energy prices suggest there is further downside risk to the outlook in the short-term. We expect inflation to drop to 2.2% until year-end. That is significantly lower than the 3% rate seen at the start of the year. Going forward, we expect inflation to stabilise. This should even hold in the case of an extreme Brexit outcome. In a "No-Deal" scenario, temporarily moderating economic activity should weigh on price setting power of domestic suppliers and dampen wage growth. This would balance the impact from higher import prices should Sterling weaken again.

Switzerland
Order books get thinner

GDP growth	
Swiss Life Asset Managers	Consensus
2019: 1.2 %	2019: 1.8 %
2020: 1.3 %	2020: n.a.

Third quarter GDP data will be published on November 29, after our editorial deadline. Our working assumption is that GDP grew by 0.3% over the quarter, or 2.8% from year ago levels. The economy has lost momentum since spring. Recent data from Swissmem, a business association in the mechanical and electrical engineering industries, suggest that new orders fell by 12% in the third quarter on a seasonally adjusted base. According to Swissmem, more than 80% of their members' production is sold abroad. While slower orders intake in these sectors is a mirror image of softening growth dynamics in the world economy, domestic consumption goes through a soft patch as well, with retail sales stagnating and car sales falling by 9% from the first half of the year. Car sales are expected to rebound once diesel cars, which are compliant with new emission standards come to the market. But the other drags are likely to persist and expected to weigh on growth next year. A further reason for prudence is that migration will no longer boost activity by the same amount as in the last decade: compared with the years 2013 to 2015, some 33'000 people less will have migrated to Switzerland on balance this year.

Inflation	
Swiss Life Asset Managers	Consensus
2019: 0.7 %	2019: 1.0 %
2020: 0.7%	2020: n.a.

The sharp fall in the spot market price for oil and its derivatives since early October will only be mirrored in retail prices for heating oil with a delay. The faster transport capacity constraints on the River Rhine ease, the faster headline inflation will come down. In our view, inflation is set to fall below 1% in December this year. As the traditional retail sectors remain under severe pressure to cope with online offerings and new competitors, price setting power remains limited. Additionally, we expect rents to decline gradually over the coming quarters. With a weight of almost 20% in the consumer price index, stable or even falling rental costs help to cap inflation pressures going forward.

Japan
Growth to remain volatile

Economic growth in Japan hit its cyclical peak in 2017 and should continue to gradually trend lower over the next two years. Monetary policy will not provide additional support, and the strongest growth push from the rising female labour force participation is likely behind us. Still, we expect growth to remain above potential as rising wages and low interest rates provide a favourable consumption and investment backdrop. The growth profile will, however, be very volatile over the quarters ahead. Natural disasters already distorted activity indicators in the second half of 2018. Volatility should increase in 2019 as consumers will front-load purchases ahead of the October consumption tax hike, leading to a sluggish start to 2020. The fiscal stimulus, which is intended to soften the tax blow, represents an additional wild card for the forecast. Meanwhile, core inflation should remain stuck at low levels. The recent spike in headline inflation, driven by food and energy, will thus prove temporary.

China
More easing measures to come

The US trade dispute is threatening to increase pressure on China's already slowing economy, driven by its domestic deleveraging policies enacted over the past year. Therefore, policymakers have been shifting focus towards growth-boosting measures, including monetary and fiscal policies. While the most recent releases of China's fixed asset investments show some signs that the government's infrastructure push is starting to bite, retail sales as well as credit growth have been disappointing to the downside. This, combined with an expected drop in exports next year, points to a further slowdown of the world's second largest economy in the upcoming year. Therefore, there is little doubt that China will increase its stimulus over the coming months. The scale of the measures will depend on incoming data and future US trade policy. On the sidelines of a G20 summit, held in Argentina at the end of November, China President Xi and US President Trump will discuss trade relations. At the time of writing, the outcome of the meeting was not known.

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