

December 2019

Key messages

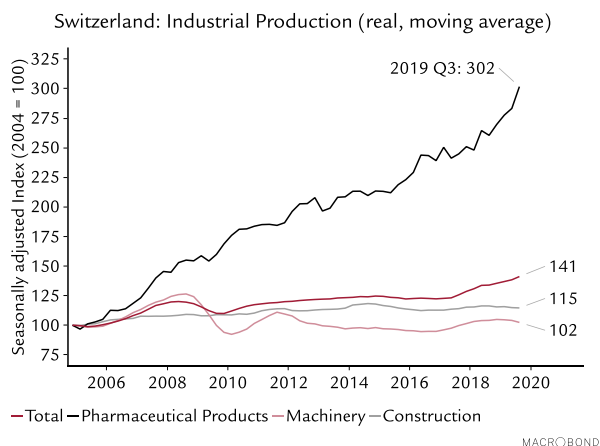
- Only limited signs that activity is picking up in Germany
- Zero inflation in Switzerland as rental costs and import prices keep positive price pressures in check
- China steps up easing measures

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%	2.0% ↓
Eurozone	1.2% ↑	1.1%	0.9%	1.0% ↑	1.2%	1.2%	1.3%	1.2%
Germany	0.6% ↑	0.5%	0.6% ↑	0.8%	1.4%	1.4%	1.5%	1.5%
France	1.3%	1.3%	1.0%	1.1% ↓	1.3%	1.2%	1.3%	1.3% ↓
UK	1.3%	1.3% ↑	1.1%	1.1% ↑	1.8% ↓	1.9%	1.9%	1.9% ↓
Switzerland	0.7%	0.8%	1.2%	1.1% ↓	0.4% ↓	0.4% ↓	0.2% ↓	0.4% ↓
Japan	0.9%	1.0%	0.3%	0.2%	0.5% ↓	0.6%	0.5% ↓	0.7%
China	6.1%	6.1% ↓	5.8%	5.8% ↓	2.9% ↑	2.6% ↑	3.3% ↑	2.7% ↑

Arrows indicate difference from previous month
Source: Consensus Economics Inc. London, 11 November 2019

Chart of the month



Our chart of the month is a short history of Switzerland's secondary sector. Total industrial production grew by 41% since the final quarter 2004. Behind this average number one finds a tectonic shift in Switzerland's economy. While production of pharmaceutical goods more than tripled over the past fifteen years, machinery output stagnated in real terms. Total construction rose by 15% over the same period, a rather unimpressive number given the rise of Switzerland's population by more than one million since 2004.

US Housing market to the rescue

GDP growth

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

US activity data showed that the US had a relatively weak start to the fourth quarter. However, both industrial production and labour market data for October were distorted by the strike at General Motors, which was one of the largest in recent years. With the strike now being over, we expect activity to rebound during the rest of the quarter and to be consistent with moderate GDP growth of around 1.6% annualized. We especially expect housing activity data to come in positively. The US housing market has been one of the biggest beneficiaries of lower interest rates. The rate on a 30-year fixed mortgage, which is the standard vehicle to finance a home in the US, fell from almost 5% end of last year to 3.7% currently. Building permits have recently jumped to the highest level in the current cycle, while housing transactions data are gradually improving from last year's lull. Hence, we expect residential investment to balance to some extent the ongoing weakness in business investment. Despite lower interest rates, consumers are reluctant to splurge on "big-ticket" consumer goods. The propensity to buy large household durables are well below 2018 peaks according to the University of Michigan consumer survey, and auto sales have remained sluggish.

Inflation

Swiss Life Asset Managers	Consensus
2019: 1.8%	2019: 1.8%
2020: 2.1%	2020: 2.0%

October CPI data brought an upward surprise for headline inflation due to a strong rebound of energy prices, while core inflation surprised negatively on the back of two consecutive months with falling goods prices. The latter is surprising as new tariffs were implemented in September (primarily on consumer goods), with apparently no material impact so far. We expect core inflation to stabilise at the current level of 2.3% over the coming months, while headline inflation should move higher due to fading negative base effects on energy.

Eurozone A set of positive surprises

GDP growth

Swiss Life Asset Managers	Consensus
2019: 1.2%	2019: 1.1%
2020: 0.9%	2020: 1.0%

According to data published by Citigroup, the number of economic data surprising negatively relative to economists' forecasts has declined since early October. Sentiment on financial markets and in the media has improved substantially in response to better-than-feared third quarter GDP data for the biggest EMU member states Germany, France and Italy. As these numbers came in better than what we had projected for Germany and Italy, we had to revise up our forecast for GDP growth in 2019. Data covering activity in the fourth quarter hint at a further stabilisation in manufacturing industries with the new orders components in business surveys recovering from very low levels. Activity in the services sector and labour market data, however, continued to deteriorate, which is a typical pattern as the labour market tends to lag the economic cycle. In our view, domestic economic activity remains subdued, although the fiscal impulse in the Eurozone should be bigger next year than in 2019. Unlike in the episodes of 2010 or 2017, demand from emerging markets is unlikely to add further tailwinds to the apparent economic recovery in the Eurozone. We thus expect only a gradual return to growth rates around potential until 2021.

Inflation

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

Eurozone inflation is expected to edge higher in the months ahead as base effects echo last year's roller coaster ride of energy prices. Yet, this upside trend will only be temporary. In the medium term, headline inflation remains well below the ECB's current policy target level of "close to, but below 2%" in our base case scenario. The average inflation rate of 1.3% should stay unchanged in 2021 according to our projections. Thus, current market-implied break-even inflation rates of around 1.2% seem appropriate for the foreseeable future.

Germany Recession avoided

GDP growth

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

Germany's corporate sector continues to adjust investment and hiring plans. Business investments in equipment fell by 9.8% in the third quarter. And yet, with the help of strong private and public consumption, Germany avoided a technical recession, defined as two or more consecutive quarters with negative quarterly GDP growth. Exports were another positive driver of growth in the third quarter, suggesting that foreign demand has bottomed in the summer months. So, were all the stories about Germany's inevitable recession overdone? Available survey data for the last quarter 2019 paint a mixed picture: while orders received by manufacturers indeed seem to be picking up, business climate in the services sectors continues to deteriorate. According to a preliminary estimate, the Purchasing Managers' Index (PMI) for the services sector dropped to 51.3 points in November. That is its lowest reading since a temporary blip to 50.6 points in 2016. A simple model to gauge GDP growth in the current quarter based on values of the PMI for all sectors and the broad ifo business climate index suggests that private sector growth dynamics have deteriorated further in the last quarter. Germany's economy is currently stagnating rather than recovering. Unless manufacturing industries gather momentum more rapidly, Germany continues to depend on government consumption to produce positive GDP growth numbers in the final quarter 2019.

Inflation

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

The November price data set is particularly important for properly forecasting German inflation in the coming year: In this month, seasonal factors in prices for package holidays play an increasingly important role. According to Bloomberg, forecasts for annual inflation in November vary from 0.8% to 1.8%. Should our own projection of a 1.6% increase from year ago levels be correct, German headline inflation would be on track to temporarily exceed 2% in the first quarter of 2020.

France All eyes on the pension reform

GDP growth

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

The importance of economic uncertainty caused by the *Gilets Jaunes* movement is visible in economic data for the final quarter 2018. In response to street protests, president Macron was forced to implement fiscal measures earlier this year. In hindsight, this fiscal stimulus was perfectly timed as it shielded the French economy from global economic headwinds. However, the government's quick response limits the fiscal room to manoeuvre in the coming years. According to our calculation, the budget plan for 2020 submitted to the EU commission results in a negative fiscal impulse. Yet, private sector dynamics appear robust enough to keep a growth pace around France's long-term potential rate. Since December 2018, sentiment indicators have improved strongly. Consumer confidence rose from 86 points in December 2018 to 104 points in October 2019. In contrast to Germany, Switzerland or Austria, the French manufacturing Purchasing Managers' Index remained in expansion territory throughout 2019 except in March and July. Job creation in manufacturing continues. Against this backdrop of solid economic fundamentals, the risk of another wave of street protests is rising again. A broad movement of various labour unions in the transport sector has announced 5 December as the start date for major strikes to stop Macron's plans to reform the French pension system. The lessons from last year show how quickly such street protest could result in economic uncertainty.

Inflation

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

Inflation in France surprised slightly to the downside both in September and October, bringing the annual headline inflation rate down to 0.9% at the start of the final quarter 2019. We expect a noteworthy rise in inflation over the months ahead. Base effects from last year's energy price swings play a major role and cause annual headline inflation to increase to around 1.6% until the first quarter of 2020.

UK New cliff edge looming

GDP growth

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

For the upcoming 12 December general election, polls suggest that the Conservative Party has significantly extended its lead over the Labour Party. While the UK's first-past-the-post voting system makes it very tricky to translate voting shares into projections for seat gains in the House of Commons, we assume a Conservative majority government as our base case for the economic forecasts. Betting markets agree, currently assigning a probability of roughly 70% for a Conservative majority. Interestingly, Sterling has not risen in line with rising odds of a Conservative majority, trading sideways against the US Dollar since mid-October. This is not surprising, as risks are far from gone. In the current withdrawal agreement with the EU, the transition period already ends in December 2020, most likely not leaving enough time to settle on a final trade deal. However, Boris Johnson has already vowed not to extend the transition period. As the request for an extension needs to be placed before 30 June 2020, markets should be prepared for a volatile political environment in the first half of 2020. In a worst-case scenario, a hard rupture in trade relations between the UK and EU at the end of 2020 is still a possibility. In any case, we expect the uncertainty to weigh on economic dynamics in 2020 despite the promised fiscal stimulus measures.

Inflation

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

Inflation dropped stronger than expected in October, to 1.5% from 1.7%, following the introduction of energy price caps by the regulatory body Ofgem. Meanwhile, core inflation remained stable at 1.7%. Even though we expect inflation to rebound again over the coming months, the downside surprise in October triggered a revision of both the 2019 and 2020 inflation forecast (to 1.8% and 1.9%, respectively).

Switzerland Zero inflation

GDP growth

Swiss Life Asset Managers	Consensus
2019: 0.7%	2019: 0.8%
2020: 1.2%	2020: 1.1%

The release of the preliminary data for third-quarter GDP growth was released on 28 November, shortly after our editorial deadline. According to a poll conducted among 16 economists by Bloomberg, the consensus forecast stood at 0.2% real GDP growth from the previous quarter, in line with our own projections. In our view, growth has moderated compared with the first half of the year as the slowdown in the mechanical and electrical engineering industries continues. Two industry groups, Swissmem and Swissmechanic, report ongoing difficulties in their recent quarterly publications: According to Swissmem, new orders from abroad received by their members fell by 18.9% in the third quarter from a year ago. A separate poll conducted by Swissmechanic reveals that 62% of the responding firms expect fewer orders in the final quarter 2019 compared with the previous quarter. Domestic demand, both from the private sector and from government consumption, is likely to continue supporting the economy. Meanwhile, construction most likely contributed negatively to GDP growth in the third quarter according to a separate report on industrial activity published by the Federal Statistical Office.

Inflation

Swiss Life Asset Managers	Consensus
2019: 0.4%	2019: 0.4%
2020: 0.2%	2020: 0.4%

October was the second straight month in which inflation came in substantially below our assumptions. Apparently, the strengthening of the Swiss Franc resulted in a pronounced pass-through of lower import prices to retail customers. Compared with year-ago levels, the consumer price index fell by -0.3% until October. Assuming stable energy prices and expecting flat rental costs, we project annual inflation to hover around the zero percent line until August 2020.

Japan Firms lack pricing power

In October, Japan increased the consumption tax from 8% to 10%. Contrary to the previous increase in 2014 (from 5% to 8%), repercussions for the economy seem less severe this time. In 2014, consumers heavily front-loaded purchases. Real private consumption surged 1.9% in the two quarters before the tax hike and then dropped by 4.8% in the subsequent quarter. Also, consumer prices spiked by around 1.6%, implying a significant pass-through from higher taxes to prices in 2014. This time, however, consumer prices barely budged. Headline inflation remained unchanged in October and core inflation rose only 20 basis points to 0.7%. Also, front-loading was quite muted, with private consumption growing 1.0% overall in the two quarters before the tax hike. Admittedly, the 2019 tax hike was less steep and various goods were excluded. Nevertheless, October inflation data were a big downside surprise, indicating a lack of firms' pricing power. On the positive side, consumers' purchasing power remains intact, bringing some upside risk to our 2020 GDP forecast.

China Balanced easing

China's October activity data weakened across the board, with fixed asset investments, retail sales as well as industrial production further decelerating. Moreover, the slowdown was underlined by a slump in credit growth. Amid these developments, China is getting increasingly concerned about a sharp drop in economic growth and has therefore stepped up its easing measures. On the one hand, it cut the capital requirement ratio for infrastructure projects. On the other hand, the PBoC, China's central bank, cut its lending benchmark rate in an attempt to reduce financing costs for the real economy. However, this has been a very moderate 5 basis points rate cut, showing Beijing's dilemma of a worsening growth slowdown amid a rapid rise in inflation, which constrains room for more aggressive monetary easing. China's inflation rate rose sharply to 3.8% in October as pork prices doubled, due to the African swine fever that erased more than a third of the country's pork stock.

Economic Research



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