Perspectives
Economics

June 2022

Key messages

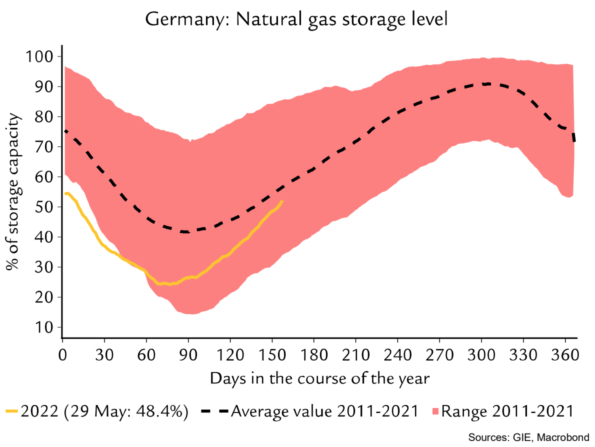
– Our medium-term baseline scenario includes the start of a mild recession in the US next year
– China's expected abandonment of its zero-Covid policy from 2023 is positive for Europe and Japan
– Inflation has likely peaked in the US, Europe will follow with a time lag in Q3

Comparison of forecasts

	2022 GDP growth		2023 GDP growth		2022 inflation		2023 inflation	
	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus
US	2.7% ↓	2.8% ↓	1.5% ↓	2.1% ↓	7.4% ↑	7.2% ↑	3.2% ↑	3.3% ↑
Eurozone	2.6% ↓	2.7% ↓	2.0%	2.2% ↓	6.3% ↑	6.8% ↑	2.5% ↑	2.6% ↑
Germany	1.9% ↓	2.0% ↓	2.2%	2.4% ↓	6.4% ↑	6.6% ↑	2.9% ↑	3.0% ↑
France	2.9% ↓	2.9% ↓	1.5%	1.7% ↓	4.2% ↑	4.5% ↑	2.3% ↑	2.3% ↑
United Kingdom	3.9% ↓	3.8% ↓	0.9% ↓	1.0% ↓	7.3% ↑	7.8% ↑	4.0% ↑	4.3% ↑
Switzerland	2.5%	2.6%	1.2% ↓	1.8%	2.1% ↑	2.1% ↑	1.1% ↑	1.0% ↑
Japan	1.6% ↓	2.0% ↓	1.6%	1.9% ↑	1.7%	1.7% ↑	0.7%	1.1% ↑
China	4.3% ↓	4.7% ↓	5.2%	5.1%	2.3%	2.2% ↑	2.0%	2.3% ↑

Arrows indicate change from previous month
Source: Consensus Economics Inc. London, 9 May 2022

Chart of the month



All scenarios related to inflation and the further economic trend in Europe depend to a large extent on the war in Ukraine and the gas supply. Importing countries in Europe are aiming for independence from Russian gas supplies. This entails creating prerequisites for importing liquid gas. In the short term, it must be ensured that natural gas storage facilities are sufficiently full before the next heating period. The level of Germany's natural gas storage facilities reflects the success of efforts made to date: as of 29 May, the storage facilities were 48.4% full. This is still slightly below-average for the time of year.

US
Soft landing or recession?

GDP growth	
Swiss Life Asset Managers	Consensus
2022: 2.7%	2022: 2.8%
2023: 1.5%	2023: 2.1%

Despite a sharp rise in interest rates, especially in the mortgage market, the US economy is not, in our view, facing an imminent recession. The labour market is still extremely tight, retail sales and industrial output were recently strong, and the Purchasing Managers' Index is still in expansionary territory. In historical terms, however, the Fed was unable to avoid a recession in around 80% of the interest rate hike cycles. Its last success was in 1994 at a time of structurally declining inflation and rising productivity, both factors that are missing today. Supporting factors today could be the relatively robust financial state of households, the scope on the labour market – in terms of both a normalisation of labour force participation and demand for staff, as well as a faster than expected easing of supply bottlenecks and energy prices. However, the financial condition of households and the labour market are precisely the factors that could force the Fed to raise interest rates more sharply than planned in order to achieve the desired effects. In view of these considerations, we believe a mild recession without a credit crisis to be likely in the next two years. This forecast is based on the blueprint of the 2001 recession.

Inflation	
Swiss Life Asset Managers	Consensus
2022: 7.4%	2022: 7.2%
2023: 3.2%	2023: 3.3%

US inflation declined to 8.3% in April and is thus likely to have passed its cyclical peak. Core inflation also fell further to 6.2%, while energy prices posted the first drop since April 2021. However, inflation in core services, the component that can be best influenced by monetary policy, continued to rise and amounted to 9.0% in April.

Eurozone
Wage pressure increasing

GDP growth	
Swiss Life Asset Managers	Consensus
2022: 2.6%	2022: 2.7%
2023: 2.0%	2023: 2.2%

The European economy is facing headwinds for multiple reasons. As long-term effects of the pandemic and the Chinese government's sustained zero-Covid policy, industrial companies are still battling supply chain problems. At the same time, demand from China remains muted. As a result of the war in Ukraine, the rise in energy prices is accentuating the problems for companies. The member states of the monetary union will become independent of Russian gas supplies at different speeds (see Chart of the month on page 1). Rising inflation will force the European Central Bank (ECB) to implement initial rate hikes in the course of the summer. Both private-sector and state debtors within the monetary union are affected to varying degrees by higher financing costs and by a possible energy embargo. Ten years after the promise made by Mario Draghi, then President of the ECB, to save the euro, he is now – as Prime Minister of Italy – running the country facing the greatest direct risk of higher interest rates. On the positive side, Europe is likely to benefit from a stabilisation of economic conditions in China over a 12-month period. After a recovery in the first half of 2023, recessionary risks are likely to gradually increase in Europe too.

Inflation	
Swiss Life Asset Managers	Consensus
2022: 6.3%	2022: 6.8%
2023: 2.5%	2023: 2.6%

With the exception of the Netherlands, first estimates on the inflation rate for May reflect a renewed increase in annual inflation in all member states of the monetary union. Even if the particularly sharp rise in energy prices is factored out, inflationary pressure is increasing. It is becoming ever clearer that the European Central Bank will have to normalise its monetary policy faster than it initially intended.

Germany
Industry remains sluggish

GDP growth	
Swiss Life Asset Managers	Consensus
2022: 1.9%	2022: 2.0%
2023: 2.2%	2023: 2.4%

Germany's industrial output dropped by 3.9% in March, thus disappointing consensus expectations of –1%. The manufacturing sector was the main driver of the decline. The automotive sector lost 14%. German industry is now at around 10% below the pre-pandemic level and is bringing up the rear among major developed economies. This is due to the war in Ukraine, ongoing delivery bottlenecks and high energy prices. However, the latest company surveys are providing a more positive picture. The ifo Business Climate Index surprised positively, driven mainly by the better-than-expected current situation. Overall, expectations improved slightly but are still low. Car manufacturers posted one of the sharpest improvements. After their expectations plummeted in March, there has now been a similarly sharp swing back in the other direction. The Purchasing Managers' Index (PMI) for manufacturing produced a surprising slight rise to 54.7. This was due to a higher output and employment index. Order intake continued to decline, however, and remained below the 50 points mark for the second month in a row. Overall, the situation will remain challenging in the foreseeable future. In the medium term, however, Germany is likely to benefit from China's expected abandonment of its zero-Covid policy.

Inflation	
Swiss Life Asset Managers	Consensus
2022: 6.4%	2022: 6.6%
2023: 2.9%	2023: 3.0%

Following inflation of 7.4% in April, the leading figures for May in Germany show a rise in overall inflation to 7.9%, which is higher than both we and the consensus expected. Energy and food prices are the most likely reasons for this. According to the PMI, the pressure on input and output prices continued to decline at very high levels, and the number of companies that – according to an ifo survey – want to raise their prices in the next three months fell slightly for the first time in months.

France
Strong domestic economy

GDP growth	
Swiss Life Asset Managers	Consensus
2022: 2.9%	2022: 2.9%
2023: 1.5%	2023: 1.7%

France's economy is also unable to escape the geopolitical headwind. A revised estimate of GDP for the first quarter of the year shows a decline compared with the prior quarter. Nevertheless, France's domestic economy is more resilient than, for example, Germany's. For instance, in May, the Purchasing Managers' Index (PMI) for the services sector showed only a minor correction from its cyclical peak in the previous month. Manufacturing is also benefiting from the robust domestic demand. According to the PMI, industrial companies saw a decline in orders from abroad. However, orders within the country continued to increase. Entrepreneurial confidence is still evident on the labour market too. According to the Manpower labour market barometer, the employment outlook for Q3 2022 improved again. France is expected to benefit to a disproportionately high degree this year from the revival of cross-border tourism. As elsewhere in Europe, the loss of purchasing power is impacting on French households' propensity to spend. Even if the government is temporarily capping petrol prices, inflation is well above nominal wage growth. The upcoming normalisation of monetary policy is also likely to dampen the willingness to invest in the medium term.

Inflation	
Swiss Life Asset Managers	Consensus
2022: 4.2%	2022: 4.5%
2023: 2.3%	2023: 2.3%

Even if inflation is below the level in Germany or Italy, the loss of purchasing power was already a topic in the French presidential election campaign. Since then, the inflation rate has risen again. According to the harmonised consumer price index, annual inflation amounted to 5.8% in May. This level has not been reached before in the 25 years of this inflation index's existence.

United Kingdom
Pessimistic central bank

GDP growth	
Swiss Life Asset Managers	Consensus
2022: 3.9%	2022: 3.8%
2023: 0.9%	2023: 1.0%

The Bank of England surprised the markets in May with sharply downgraded growth forecasts, including negative growth in the fourth quarter of 2022. The Bank also puts the peak inflation rate at 10% in the fourth quarter of 2022 and unemployment is set to rise to 5.5% across the forecast horizon to 2025. In other words, the Bank of England does not believe it can achieve a soft landing of the economy in this interest rate cycle. Fiscal policy is currently attempting to cushion the economic consequences for the poorest households in particular. Our forecast remains rather more constructive but also assumes a growth slowdown in the next few quarters. In particular, expected GDP growth in the current quarter will be weak at 0.1%, following the lower-than-expected growth of 0.8% in the first quarter. Despite persistently strong labour market figures, consumer sentiment dropped to the lowest level in its history in May. The higher cost of living is likely to be the main reason. The Purchasing Managers' Index (PMI) of service providers also suffered a sharp slump in April but remains in the growth zone. The PMI downtrend in the manufacturing sector continued but remained at a comfortable level. Pressure on delivery deadlines continued to ease.

Inflation	
Swiss Life Asset Managers	Consensus
2022: 7.3%	2022: 7.8%
2023: 4.0%	2023: 4.3%

Unlike the Bank of England, we expect overall inflation to have peaked at 9.0% in April and that it will drop to around 7% by the end of the year. We also expect core inflation to ease very gradually in the months ahead. An upside risk with regard to our forecast in the second half is the raising of the energy price cap by the British energy regulator Ofgem in October.

Switzerland
Mixed economic signals

GDP growth	
Swiss Life Asset Managers	Consensus
2022: 2.5%	2022: 2.6%
2023: 1.2%	2023: 1.8%

The first official estimate of Switzerland's gross domestic product in Q1 reflected growth of 0.5% compared with the previous quarter. The Swiss economy thus again demonstrated that it is more resistant to geopolitical risks than those of its larger neighbours. The current signals in terms of economic momentum are increasingly mixed. High frequency indicators such as the index of weekly economic activity from the State Secretariat for Economic Affairs (SECO) or the flight movement data at Zurich Airport show a clear upswing since mid-April. The services sector in general and the tourism sector in particular are looking ahead with confidence to the summer season. Domestic demand is also being supported by the extremely robust labour market. By contrast, the economic barometer of the KOF Swiss Economic Institute appears to be anticipating a slowdown in growth momentum. The barometer fell sharply in May and is now below the long-term average. This indicator also takes financial market variables into account. Of these, particularly mortgage interest rates have risen sharply since the beginning of the year. Construction activity slowed in Q1 2022 already. This trend is likely to continue in the next few quarters.

Inflation	
Swiss Life Asset Managers	Consensus
2022: 2.1%	2022: 2.1%
2023: 1.1%	2023: 1.0%

The markedly high proportion (26%) of administratively set prices in the market basket used to measure consumer prices entails a delay in the passing-on of increased purchase prices, such that inflation will remain perceptible in 2023. Swiss households will therefore see only next year that prices for electricity have risen by up to 20%. We are taking account of this by increasing our inflation forecast across the entire period until mid-2023.

Japan
Further recovery predicted

GDP growth	
Swiss Life Asset Managers	Consensus
2022: 1.6%	2022: 2.0%
2023: 1.6%	2023: 1.9%

Real GDP declined by 0.2% in Q1 in Japan. The fall was mainly due to high import growth, a sign of robust domestic demand. This is also reflected in relatively stable consumer spending and corporate investments. We are again expecting positive quarterly growth for the second quarter. The economic recovery is likely to continue thereafter as well, albeit to a lesser extent. The Purchasing Managers' Index for industry remained at 53.2 in May and thus stayed in the growth zone, although down slightly, while the PMI for the services sector recovered to above the 50 mark. However, the situation with respect to delivery times was exacerbated again, according to the PMI. China's zero-Covid policy is likely to play a large part here. It also explains part of the 5.5% slump in Japan's real exports in April. On the one hand, the lower demand from China had a direct effect, on the other hand, the lack of Chinese intermediate products likely led to fewer goods being exported to other countries. In our baseline assumptions, China will move away from its strict zero-Covid policy over the course of 2023, which should benefit Japan. Japan itself is likely to ease its strict Covid measures in the tourism sector at the latest after the upper house elections in July 2022. Such a move will have a particularly positive impact on the services sector.

Inflation	
Swiss Life Asset Managers	Consensus
2022: 1.7%	2022: 1.7%
2023: 0.7%	2023: 1.1%

For the first time since 2014, headline inflation rose above the central bank target from 2% to 2.5% in April. Core inflation also climbed to 2.1%, from 0.8% in the previous month. We expect headline inflation to remain at a similar level in May, but to fall below 2% by July 2022 at the latest. This means that there is no immediate need for the Japanese Central Bank to act.

China
Lasting zero-Covid policy in 2022

GDP growth	
Swiss Life Asset Managers	Consensus
2022: 4.3%	2022: 4.7%
2023: 5.2%	2023: 5.1%

China's April activity data reflect the impact of the recent wave of Omicron and the strict zero-Covid strategy on China's economy. Industrial production contracted by 2.9% year-on-year, and retail sales growth of –11.1% was well below consensus estimates. At the same time, the situation on the labour market has deteriorated significantly, as the unemployment rate in cities rose from 5.8% in March to 6.1%. As the lockdown in Shanghai was extended into May, we expect another weak month that will confirm our assessment of a GDP contraction in the second quarter. On a positive note, the number of Covid cases has fallen significantly since the peak in mid-April, and Shanghai has announced a timetable for a gradual reopening of its economy. In addition, Covid cases in other provinces are limited, as the authorities are taking precautions to avoid getting into a situation as chaotic as in Shanghai. This reduces the risk of the virus spreading nationwide. Nevertheless, the harsh containment measures and the adherence to the zero-Covid strategy will weigh on the Chinese economy until at least after the party congress in autumn 2022 and pose a downside risk to our current forecast.

Inflation	
Swiss Life Asset Managers	Consensus
2022: 2.3%	2022: 2.2%
2023: 2.0%	2023: 2.3%

Inflation in China rose from 1.5% to 2.1% in April, driven by higher food and energy prices. In addition, the logistics interruptions caused by Omicron are resulting in rising logistics costs. At the same time, however, the lockdown is weighing on core inflation, which stood at just 0.9%, as uncertainty about income prospects is weighing on sentiment and weakening consumption.

Economic Research

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