Perspectives
Economics

November/December 2023

Key takeaways

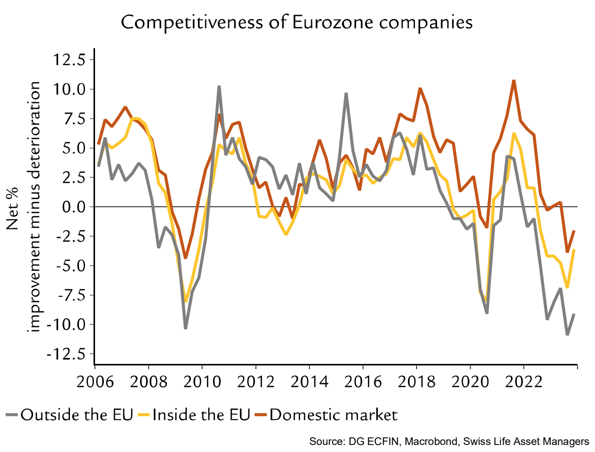
- War between Israel and Hamas carries the risk of a renewed rise in energy prices, especially for Europe
- Better-than-expected economic growth in the third quarter, particularly in the US and China
- Outlook remains cautious: tight monetary policy leaving its mark, high government debt back in focus

Comparison of forecasts

	2023 GDP growth		2024 GDP growth		2023 inflation		2024 inflation	
	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus
USA	2.4% ↑	2.2% ↑	0.6% ↑	0.9% ↑	4.2%	4.1%	2.8%	2.6% ↑
Eurozone	0.5%	0.5%	0.6%	0.6% ↓	5.6% ↓	5.6% ↑	2.4% ↓	2.5%
Germany	-0.2% ↑	-0.4%	0.2%	0.5% ↓	6.1%	6.1% ↑	2.4% ↓	2.7%
France	0.9% ↑	0.8%	0.8%	0.8%	4.9% ↓	5.0%	2.4%	2.7%
Italy	0.7% ↓	0.7% ↓	0.5%	0.6% ↓	5.9% ↓	6.0%	2.1%	2.5% ↑
Spain	2.3% ↑	2.3% ↑	1.2%	1.3% ↓	3.7% ↓	3.7% ↑	2.1% ↓	3.3% ↑
UK	0.5% ↑	0.4% ↑	0.3%	0.3% ↓	7.5% ↑	7.4%	3.0%	3.1%
Switzerland	0.7%	0.8%	1.0%	1.2% ↓	2.1% ↓	2.2% ↓	1.9%	1.6%
Japan	1.8%	1.9% ↑	0.6%	0.9%	3.1% ↑	3.2% ↑	1.6%	2.2% ↑
China	5.4% ↑	5.0%	4.7%	4.4% ↓	0.5%	0.6% ↓	1.2%	1.7% ↓

Arrows indicate change from previous month. Source: Consensus Economics Inc. London, 9 October 2023

Chart of the month



More and more companies in the Eurozone have been reporting a deterioration in their competitiveness since 2022. This is particularly noticeable on markets outside the EU, especially for German companies. One driver is likely to be the ongoing high energy prices. The competitiveness of energy-intensive industries such as chemicals, metal and paper production is particularly low. Pharmaceutical companies and car manufacturers are also complaining about increasing competition, the latter particularly due to electric cars from China. The EU has therefore recently launched an anti-subsidy investigation into imports of Chinese electric cars.

USA
A country on a spending spree

GDP growth

Swiss Life Asset Managers	Consensus
2023: 2.4%	2023: 2.2%
2024: 0.6%	2024: 0.9%

According to the initial GDP estimate, the US economy grew by 1.2% in the third quarter of 2023 compared to the previous quarter, which represents a significant acceleration and the strongest growth since the end of 2021. However, the growth was one-sided. The main drivers were extremely strong private consumption and inventory. Government consumption also contributed positively to growth again, which is a problematic sign in view of the poor budgetary situation, while investment and foreign trade stagnated. With regard to private consumption, the unwavering desire to purchase durable goods is particularly noteworthy. While spending on services has recovered further, in contrast to other economies the expected significant shift of spending back from goods to services following the end of the pandemic has failed to materialise. This may also explain why durable goods orders performed well in September and according to the Purchasing Managers' Indices the manufacturing sector is in better shape than in Europe. However, strong consumption came at the expense of a lower savings rate. Real household incomes fell in September for the second consecutive month. While maintaining our cautious view for the following quarters, we have been obliged to raise the growth forecasts for 2023 and 2024 slightly due to the strong figures in the third quarter.

Inflation

Swiss Life Asset Managers	Consensus
2023: 4.2%	2023: 4.1%
2024: 2.8%	2024: 2.6%

While the inflation rate continued to decline in September, service prices (excluding energy) slightly regained momentum in the third quarter, which is not surprising given the strong consumption. Only the expected economic slowdown will bring relief here. This also applies to the prevailing high wage pressure: here the unions recently managed to win significant wage increases from car manufacturers by taking strike action.

Eurozone
Impact of Middle East conflict

GDP growth

Swiss Life Asset Managers	Consensus
2023: 0.5%	2023: 0.5%
2024: 0.6%	2024: 0.6%

The preliminary October Purchasing Managers' Indices for both manufacturing and the services sector point to a continued slowdown in economic momentum in the Eurozone. The war between Israel and Hamas that broke out at the beginning of October could also leave more marks on the Eurozone economy than, for example, in the US. While the impact of the slump in demand from Israel is likely to be small (exports to Israel account for only 0.2% of Eurozone GDP), the war threatens to push up oil and gas prices, which would lead to a renewed increase in inflation in the Eurozone and curb economic activity. We do not expect any significant rise in energy prices in the least negative scenario in which the war remains limited to Israel and the Palestinian territories. If, as currently seems increasingly to be the case, the war spills over to other Arab countries such as Lebanon and Syria, where Iran supports various groups, we expect increased volatility in energy prices and a risk premium due to the looming risk of a direct conflict with Iran. However, in our view, only the worst case of a direct conflict between Israel and Iran in which other major powers such as the US and China could also intervene would lead to a significant and protracted rise in energy prices.

Inflation

Swiss Life Asset Managers	Consensus
2023: 5.6%	2023: 5.6%
2024: 2.4%	2024: 2.5%

At 2.9%, headline inflation in the Eurozone fell to its lowest level in more than two years in October, putting it well below core inflation at 4.2%. A major part of this resulted from falling energy prices. Price pressure for core goods also eased substantially. While an escalation in the Middle East entails upside risks for inflation, the recently lower-than-expected economic momentum poses downside risks.

Germany
No cause for optimism

GDP growth

Swiss Life Asset Managers	Consensus
2023: -0.2%	2023: -0.4%
2024: 0.2%	2024: 0.5%

According to initial estimates, the German economy contracted by 0.1% in the third quarter, slightly less than we had anticipated. In addition, growth in the first two quarters of 2023 has been upgraded to 0.1% and 0.0%, meaning that Germany was not in a technical recession after all. Looking ahead, however, we see little cause for optimism and believe that Germany is actually in a recession at the moment. Two reasons why our forecasts are not even lower are the resilient labour market and the expected slight support from private consumption. However, the downside risks for both factors have risen recently. According to the Purchasing Managers' Index, employment also fell in the services sector for the first time since the pandemic and the speed of the decline in manufacturing increased further, although the decline in production and new business slowed down. Consumer sentiment also fell further in October and thus continued the renewed downward trend that began in May. With energy prices rising once more and increased fears of unemployment, households are more pessimistic about expected income again, although headline inflation is expected to decline further and wages are set to rise.

Inflation

Swiss Life Asset Managers	Consensus
2023: 6.1%	2023: 6.1%
2024: 2.4%	2024: 2.7%

In its search for new gas suppliers following the outbreak of war in Ukraine, Germany signed an agreement with Qatar on the import of liquefied natural gas at the end of 2022, which was already strongly criticised at the time. This criticism is now even louder following the outbreak of war between Israel and Hamas, which is supported by Qatar. As long as Qatar also plays a mediating role in the Middle East, the agreement is likely to remain in place. However, an escalation of the situation would increase the insecurity of gas supply and thus gas prices would rise again.

France
Record deficit

GDP growth

Swiss Life Asset Managers	Consensus
2023: 0.9%	2023: 0.8%
2024: 0.8%	2024: 0.8%

Similarly to the US, fiscal policy supported growth in 2023 and successfully mitigated monetary policy headwinds in the form of higher financing costs for businesses and homeowners. The result is a record-high deficit in the national budget so far this year. The cumulative negative balance as of August even exceeds that seen during the pandemic in 2020. The sustainability of government debt is therefore once again at the forefront of discussions. On the financial markets, the risk premium for French government bonds has already risen again compared to comparable German securities. The risk premium is currently more than one standard deviation above the long-term average of the past 20 years. In addition to this deterioration in structural conditions, cyclical indicators also suggest a further slowdown in momentum. For example, an indicator from the National Institute of Statistics and Economic Studies (INSEE) points to a decidedly unfavourable economic climate in October 2023: this indicator has only been below its current level in four months over the past five years and three of these four occasions occurred during the period of containment measures to combat the pandemic.

Inflation

Swiss Life Asset Managers	Consensus
2023: 4.9%	2023: 5.0%
2024: 2.4%	2024: 2.7%

Detailed figures on the contributions to the consumer price inflation are not yet available for the month of October. However, the preliminary estimate by INSEE confirmed our assumption that base effects and slowing economic momentum led to a further decline in headline inflation. The aggregate inflation rate stood at 4%, two percentage points below its January 2023 level. In our base case scenario and assuming stable energy prices, the inflation rate is set to return to below 2% from October 2024.

Italy
State budget out of sync

Government bond yields increased on a broad basis in the Eurozone in the third quarter. Combined with an Italian budget proposal that exudes little desire for austerity, discussions about the sustainability of Italy's debt situation have reignited and the spread between Italian and German government bonds has widened again. While the dreaded revaluation of Italy's S&P credit rating did not materialise in October, the reviews by Fitch and Moody's were still pending at the time of writing. The Italian government envisages an improvement in the primary deficit (deficit excluding interest payments) from -1.5% of GDP in 2023 to -0.2% in 2024. However, this improvement is based on what we consider to be excessively optimistic GDP growth assumptions by the government (1.2% compared to our own forecast of 0.5% for 2024). At the same time, the interest burden is expected to increase over the years, meaning that despite the planned but rather half-hearted fiscal consolidation, the overall deficit will not fall below the Maastricht threshold of 3% of GDP again until 2026.

Spain
Slowdown in the winter

Spain is much less affected than Germany by the deterioration in the competitive position of Eurozone companies (see chart of the month). In Spain, companies in the clothing, plastics, paper and metal industries reported the strongest deterioration in their competitive position in the third quarter. By contrast, the position of producers of metal products, vehicles, furniture and pharmaceuticals actually improved over the same period. Overall, the Spanish economy grew by 0.3% in the third quarter, slightly more than we had expected. Consumption and trade both contributed positively. However, the restrictive monetary policy is also leaving its mark on the Spanish economy: investments were already declining in the third quarter and corporate credit demand has recently deteriorated again significantly. In addition, consumer sentiment is worsening again despite lower inflation since August. We therefore expect economic momentum also to slow in Spain in the winter quarters.

Switzerland
Zero growth

GDP growth	
Swiss Life Asset Managers	Consensus
2023: 0.7%	2023: 0.8%
2024: 1.0%	2024: 1.2%

Since the second quarter of this year, the Swiss economy has been bobbing up and down in shallow waves. This has not changed at the start of the final quarter. Indicators available to date, such as the October reading of the economic barometer of the KOF Swiss Economic Institute at ETH Zurich, confirm this finding. The Purchasing Managers' Index (PMI) for manufacturing fell significantly in October to 40.6 points. The main reason for the renewed decline in the PMI is the sharp contraction in production compared to September and the low backlog of orders, which does not give reason to expect a rapid turnaround. Historically, the Swiss economy was in recession when the PMI was so low. It is no coincidence that there have also been increased reports recently of job losses in the domestic economy. Growth continues to be driven by domestic consumer demand and population growth. According to the State Secretariat for Migration (SEM), with the exception of July, monthly data on net immigration has so far been at a record level for the period since 2014.

Inflation	
Swiss Life Asset Managers	Consensus
2023: 2.1%	2023: 2.2%
2024: 1.9%	2024: 1.6%

Following the significant decline in the inflation rate over the summer months, the increase in existing rents is now included in the calculation of consumer prices in the fourth quarter of 2023. Together with higher electricity tariffs and the VAT increase from the start of 2024, the higher rents will lead to a renewed rise in the inflation rate to just over 2% in the course of the first quarter of 2024. Geopolitical developments bring about countervailing forecasting risks in the short term: on the one hand, energy prices rose markedly in October, while on the other hand, the appreciation of the Swiss franc is driving down import prices.

UK
Labour market turnaround

GDP growth

Swiss Life Asset Managers	Consensus
2023: 0.5%	2023: 0.4%
2024: 0.3%	2024: 0.3%

The monthly GDP data altogether came in somewhat better than our cautious forecasts and prompted us to revise the forecast for 2023 slightly upwards. However, this does little to change the picture of a UK economy that has largely been moving sideways since the start of 2022 with no sign of growth drivers. While the Bank of England is now expected to leave rates unchanged, monetary policy is tight and is taking its toll. The various indicators show that house prices are at best stagnating or even falling significantly. In addition, following months of recovery, consumer sentiment plummeted again in October, mainly due to the worsening assessment of the economic outlook. This is reflected in persistently weak retail sales volumes, which have stayed put since the beginning of 2023 and even lost momentum in the third quarter. On a positive note, real wages are currently rising due to falling inflation. However, wage growth is now also expected to slow down as the labour market has turned, with employment declining in the third quarter. The Purchasing Managers' Indices for October do not point to an improvement in the fourth quarter, particularly in the services sector. Due to the lack of growth drivers, our GDP growth forecast of 0.3% for 2024 remains cautious.

Inflation

Swiss Life Asset Managers	Consensus
2023: 7.5%	2023: 7.4%
2024: 3.0%	2024: 3.1%

UK inflation continues to surprise. Following the downside surprise in August, the September figures were somewhat stronger than expected again, necessitating a forecast adjustment. Overall, core inflation continues to trend downwards, slightly more for core goods prices than for service prices. We expect core inflation, which is currently 6.1%, to fall below the 5% mark again in the first quarter of 2024.

China
Consumption top, real estate flop

GDP growth

Swiss Life Asset Managers	Consensus
2023: 5.4%	2023: 5.0%
2024: 4.7%	2024: 4.4%

China's GDP growth for the third quarter of this year came in stronger than expected at 4.9%. In addition, monthly September data for industrial production and consumption also grew at a solid pace. The consumption outlook is indeed encouraging. In addition to retail sales for the month of September, which grew by a solid 5.5% year-on-year, daily indicators of box office revenues are also pointing to a sustained improvement. Meanwhile, the unemployment rate has fallen from 5.2% to 5.0%, while the household savings rate is approaching pre-pandemic levels – an indication that households are less worried about their income expectations and are accordingly spending more again. We are therefore raising our GDP forecast for 2023 from 5.0% previously to 5.4%. Meanwhile, the real estate sector remains the weak spot in the economy. Both investments and sales continue to decline due to the confidence shock hitting investors from the sector. However, there is a silver lining on the horizon: completions of pre-sold properties are continuing to rise significantly. This could help to restore confidence over time as buyers of houses that have already been sold become more confident that they are getting the properties they have previously paid for.

Inflation

Swiss Life Asset Managers	Consensus
2023: 0.5%	2023: 0.6%
2024: 1.2%	2024: 1.7%

China's September inflation data remained weak with a headline inflation rate of 0.0%. While prices in leisure and transport are picking up slightly, goods prices related to real estate remain weak, reflecting the ongoing weakness of this sector. Producer prices remained in deflationary territory at -2.5% year-on-year but picked up slightly compared to the previous month.

Economic Research

Marc Brütsch
Chief Economist
marc.bruetsch@swisslife-am.com
@MarcBruetsch

Damian Künzi
Head Macroeconomic Research
damian.kuenzi@swisslife-am.com
@kunzi_damian

Josipa Markovic
Economist Emerging Markets
josipa.markovic@swisslife-am.com

Rita Fleer
Economist Quantitative Analysis
rita.fleer@swisslife-am.com

Florence Hartmann
Economist Developed Markets
florence.hartmann@swisslife-am.com

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