Perspectives
Economics

Swiss Life Asset Managers

August 2024 – Update on the recent market turbulences in the Flash Comment *on page 7*

Key takeaways

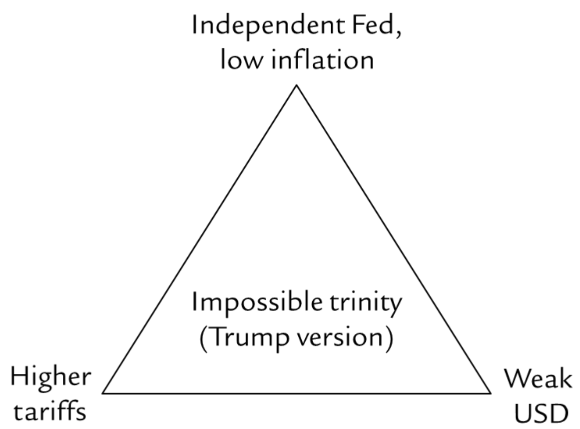
- USA: surprisingly strong growth in the second quarter, although growth drivers are unsustainable
- Europe: the economy remained more resilient than expected in the second quarter
- China: exports have supported growth so far, but face challenges

Comparison of forecasts

	2024 GDP growth		2025 GDP growth		2024 inflation		2025 inflation	
	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus
USA	2.5% ↑	2.3%	1.7%	1.7%	3.0% ↓	3.1% ↓	2.3% ↓	2.3% ↓
Eurozone	0.7% ↑	0.7%	1.0%	1.4%	2.3%	2.4%	1.9%	2.0%
Germany	0.1%	0.2%	1.0%	1.1% ↓	2.3%	2.3% ↓	1.9%	2.0%
France	1.2% ↑	0.9%	1.0%	1.2%	2.1%	2.4% ↓	1.4%	1.8% ↓
Italy	0.8% ↓	0.9% ↑	0.8%	1.0%	1.1%	1.2% ↓	1.9%	1.7% ↓
Spain	2.6% ↑	2.3% ↑	1.5%	1.9%	3.0% ↓	3.1%	2.1%	2.1%
UK	0.9% ↑	0.8% ↑	1.0%	1.1%	2.6% ↓	2.6%	2.1% ↓	2.3%
Switzerland	1.3%	1.4% ↑	1.0%	1.5% ↓	1.2%	1.3%	0.5%	1.1%
Japan	-0.1% ↓	0.1% ↓	0.9% ↑	1.3% ↑	2.5% ↑	2.5% ↓	1.5%	2.1% ↑
China	4.7% ↓	4.9% ↓	4.4%	4.4%	0.4% ↓	0.6%	1.8%	1.5%

Arrows indicate change from previous month. Source: Consensus Economics Inc. London, 11 July 2024

Chart of the month



The economic policy objective of Donald Trump's election campaign is to strengthen the country's industrial base with higher tariffs and a weak dollar. Trump's trilemma, however, is that he can only pursue two of the three goals shown on the left at the same time. According to the textbook, higher tariffs lead to a stronger dollar. His targets would only be achievable if Trump could push the central bank into a low-interest-rate policy, which could lead to an unpopular surge in inflation. However, we do not believe that an attack on the independence of the US Federal Reserve would be successful. Overall, we therefore consider a USD depreciation policy to be unrealistic.

USA
The soft patch that wasn't

GDP growth

Swiss Life Asset Managers	Consensus
2024: 2.5%	2024: 2.3%
2025: 1.7%	2025: 1.7%

Various indicators, in particular disappointing retail and labour market figures, indicated that the weak phase of the US economy continued in the second quarter of 2024. This made it all the more surprising when the first GDP estimate for the second quarter showed an acceleration in growth, from 1.4% in the first quarter to 2.8% in the second quarter (annualised quarter-on-quarter growth). Growth was broad-based, although neither the acceleration of private or public consumption growth is particularly sustainable – the former due to the decline in the household savings rate to just 3.4% and the latter due to the precarious budget situation in the US. In this respect, we still expect weaker growth in the second half of the year and see interest rate cuts by the US Federal Reserve as a necessary pre-condition to prevent the US economy from heading for a hard landing. The curbing effect of the high interest rates was reflected in the second quarter in the decline in investments in residential construction. The default rate of consumer credit has also been rising steadily since the end of 2021, although no figures are available yet for the second quarter of 2024. While the US elections are bringing some economic policy uncertainty, we consider them to be less important for the economic outlook than the development of monetary policy.

Inflation

Swiss Life Asset Managers	Consensus
2024: 3.0%	2024: 3.1%
2025: 2.3%	2025: 2.3%

The June data brought another downside surprise in US inflation. For the first time since the pandemic, prices for the entire basket of goods have fallen compared to the previous month. The sharp decline in inflation for housing costs and other services (excluding energy) is particularly noteworthy, as these were still price drivers in the first quarter of 2024. Leading indicators continue to point to a benign inflation development in the second half of the year.

Eurozone
More resilient than expected

GDP growth

Swiss Life Asset Managers	Consensus
2024: 0.7%	2024: 0.7%
2025: 1.0%	2025: 1.4%

Preliminary data for GDP growth in the second quarter suggests that economic activity in the eurozone remained more resilient than expected. At 0.3% quarter-on-quarter, the European economy grew at the same pace as in the first quarter. As always, no details were disclosed with the preliminary estimate. However, country data suggests that the stronger growth is mainly due to Spain and France. The German economy, by contrast, unexpectedly contracted by 0.1%. In Spain and France, where details are already known, net trade was the main growth driver, while private consumption also remained positive. We have slightly raised our growth forecast for 2024, but this is a retrospective change due to the better figures for the second quarter. Looking ahead to the third quarter, the preliminary purchasing managers' indices for the eurozone in July point to a slowdown in economic activity. Surprisingly, the index for the industrial sector weakened for the second month in a row. The weakness was mainly driven by the production component, but the forward-looking sub-components also remain subdued. The index for the services sector in the eurozone suggests that growth here is also slowing.

Inflation

Swiss Life Asset Managers	Consensus
2024: 2.3%	2024: 2.4%
2025: 1.9%	2025: 2.0%

Inflation eased somewhat in June to stand at 2.9%. Both food and energy price inflation fell slightly in June. The July inflation rate was not yet available at the time of writing. However, July inflation data for Spain showed a faster deceleration than expected, while the inflation rate in Germany surprised on the upside.

Germany
One budget, many questions

GDP growth	
Swiss Life Asset Managers	Consensus
2024: 0.1%	2024: 0.2%
2025: 1.0%	2025: 1.1%

Overall, economic data in Germany paints a weak picture. Activity data such as industrial production, exports and imports declined in May. According to an initial estimate, GDP contracted by 0.1% in the second quarter. July's ifo survey data and purchasing managers' indices were weaker than expected across all sectors. Only consumer confidence improved further from a low level. In order to counter the economic weakness, the Federal Government recently agreed on the so-called "Growth Initiative – New Economic Dynamics for Germany". However, the assumption that this package will already generate significant positive growth effects next year and thus also relieve the national budget seems optimistic. Other aspects of the budget now available for 2025 and the financial plan up to 2028 are also questionable, in particular the above-average spending cuts still to be defined ("Globale Minderausgaben"). The adoption of the growth package and the budget in Parliament are therefore not likely to be without debate. A pending ruling by the Constitutional Court on the legality of the solidarity surcharge could, in the worst case, create another huge hole in the state coffers. Discussions about further (military) special funds or even a renewed suspension or reform of the debt brake are therefore not off the table yet.

Inflation	
Swiss Life Asset Managers	Consensus
2024: 2.3%	2024: 2.3%
2025: 1.9%	2025: 2.0%

The somewhat slower momentum in the services sector according to surveys is also reflected in easing price pressure according to the purchasing managers' indices in this sector. In June, monthly seasonally adjusted services inflation fell to the lowest level this year. However, according to initial estimates, headline inflation surprisingly rose in July from 2.2% to 2.3%, although the reasons remain unclear due to as yet unpublished details.

France
Overly restrictive monetary policy

GDP growth	
Swiss Life Asset Managers	Consensus
2024: 1.2%	2024: 0.9%
2025: 1.0%	2025: 1.2%

The latest survey data published was shockingly weak on the business side. Whether the slump in sentiment is really an economic signal or rather a noisy echo of the new elections is currently difficult to assess. The unclear majority in Parliament means that renewed voting after a period of twelve months remains a conceivable scenario. The hosting of the Summer Olympics may also have a negative impact on industry in the meantime and make it more difficult to assess the true state of the French economy. However, a glance at Germany and Belgium shows that business sentiment also declined sharply there in July. Indeed's high-frequency data on the volume of job advertisements on online platforms also points to a slowdown of the labour market in other European countries. These observations suggest a broader economic weakness, particularly in the industrial sector. As discussed below, inflation in France will soon fall below 2%. We also expect a growth path below long-term growth potential. This leads to the conclusion that the ECB's monetary policy is now far too restrictive. The glimmer of hope offered by the current data is robust consumer confidence. The beginning of the end of the purchasing power crisis postulated by us in January is thus confirmed.

Inflation	
Swiss Life Asset Managers	Consensus
2024: 2.1%	2024: 2.4%
2025: 1.4%	2025: 1.8%

In our baseline scenario, the inflation rate will fall below 2% in August 2024 for the first time in three years and not rise above it again until the end of 2025. Despite all the uncertainty about the future direction of economic policy, we are leaving our assumptions for inflation until the end of 2025 unchanged for the time being. An important element in our forecast is the expectation of a significant reduction in electricity tariffs for private households from February 2025.

Italy
Consumption supporting growth

According to initial estimates, the Italian economy grew by 0.2% in the second quarter of 2024 compared to the previous quarter, which is in line with our expectations and roughly the pace of growth at which the economy has been progressing for a year. The Istat statistical office reported in its press release that domestic consumption contributed positively to growth, while the industrial sector and foreign trade curbed it. The signs for the third quarter are mixed. At the time of writing, the July purchasing managers' indices (PMI) were not yet available, but the results of the Istat survey were. According to the latter, consumers are more optimistic about the future; consumer confidence has improved particularly due to the situation on the labour market. Business sentiment, by contrast, declined in most sectors. The slump in tourism is particularly striking, where companies reported significantly less new business precisely at the start of the summer season. We expect GDP to grow by 0.8% in 2024 and 2025 respectively.

Spain
European GDP champion

Spain is not only the new European football champion, but also European growth champion. The Spanish economy posted strong growth of 0.8% in the second quarter of 2024 compared to the previous quarter and thus significantly exceeded our expectations. The positive surprise was mainly driven by weak imports, which led to higher net trade figures. Growth in private consumer spending was slightly lower than in the first quarter, suggesting that the expected consumption recovery is already slowing somewhat. On the supply side, all sectors except the primary sector posted positive growth. However, the manufacturing and construction sectors weakened compared to the previous quarter, while the services sector grew slightly. We have raised our GDP forecast for 2024 to 2.6% due to the strong second quarter. However, we expect a slowdown in the second half of the year compared to the first half.

Switzerland
Recurring uncertainty

GDP growth	
Swiss Life Asset Managers	Consensus
2024: 1.3%	2024: 1.4%
2025: 1.0%	2025: 1.5%

As mentioned a month ago, following the two interest rate cuts in the first half of the year, the monetary policy stance of the Swiss National Bank (SNB) is no longer restrictive in our view. Further momentum for the Swiss economy must therefore now come from a recovery in global economic demand. According to a survey by the Swiss Economic Institute at ETH Zurich, industrial companies' expectations of order intake over the next three months rose in June to their highest level since September 2021. However, the recurring uncertainty about the economic upturn in Europe and renewed appreciation pressure on the Swiss franc show that external momentum is likely to be only moderate. We expect growth rates in Europe merely to return to levels close to their potential in the medium term. China is also not acting as a growth driver in the current cycle as it did in the years following the global financial crisis in 2008. These observations explain why our forecast for GDP growth in Switzerland for the coming year is significantly below consensus expectations.

Inflation	
Swiss Life Asset Managers	Consensus
2024: 1.2%	2024: 1.3%
2025: 0.5%	2025: 1.1%

The inflation rate in Switzerland has been below 2% since June 2023 and thus within the target range of 0% to 2%, which the SNB is aiming for to maintain price stability. In contrast to other regions, the core inflation rate of 1.1% is currently even below the general inflation rate, indicating easing price pressure across the board. This is likely to decrease further in the coming year, as existing rents will not be increased further and electricity tariffs are likely to be significantly lowered in most places. We expect average annual inflation of 0.8% for 2026.

UK
Upbeat sentiment

GDP growth

Swiss Life Asset Managers	Consensus
2024: 0.9%	2024: 0.8%
2025: 1.0%	2025: 1.1%

The British general election on 4 July ended as expected with a landslide victory for the Labour Party, which won almost two-thirds of the parliamentary seats (412 of the 650 seats in the House of Commons). The Tories got just 112 seats compared to 365 seats in the 2019 election. However, the election showed the effects of the British first-past-the-post system. Labour's share of the vote was just 34.1%. On 17 July, the new parliament was opened with the reading of the King's speech by King Charles III. The speech included around 40 bills, many of them focused on economic growth. Amongst other things, the Labour government plans to give local governments more decision-making power to implement infrastructure projects more quickly. The new government plans to nationalise the railway companies and to draft a law to improve employment conditions. The Labour government is taking over the UK economy as it picks up. The Consensus Economics forecast for 2024 GDP growth has improved steadily since the start of the year as economic activity surprised positively in the first half of the year. The July purchasing managers' indices point to an encouraging start to the second half of the year. Companies in both the industrial and service sectors are reporting a renewed surge in demand and hiring more staff. We have therefore slightly raised our GDP forecast for 2024.

Inflation

Swiss Life Asset Managers	Consensus
2024: 2.6%	2024: 2.6%
2025: 2.1%	2025: 2.3%

Inflation remained at the central bank target of 2.0% in June. However, services inflation remains persistent. Financial markets expect the Bank of England to be able to deliver a rate cut this year. Together with rising real wages, this should have a positive impact on household consumer spending, where we expect an improvement over the course of the year.

China
Headwinds not giving way

GDP growth

Swiss Life Asset Managers	Consensus
2024: 4.7%	2024: 4.9%
2025: 4.4%	2025: 4.4%

At 4.7%, China's GDP growth in the second quarter disappointed expectations. This has prompted us to lower our GDP growth forecast for this year from 4.9% to 4.7%. The main reason for the weakness of the Chinese economy was poor consumption. The sluggish consumer demand is due to a deep crisis of confidence among the population regarding the further development of the real estate market. One of the supporting factors for the Chinese economy was exports. In June, China reported the highest trade surplus ever achieved. Nevertheless, this external environment faces headwinds. On the one hand, the US economy is expected to slow down. At the same time, China faces increasing trade barriers with the US, which would worsen if Donald Trump were elected US President. However, we consider Trump's announced 60% tariff on all Chinese goods to be unenforceable. On the one hand, the US relies on many essential goods from China which account for a significant share of more than 50% of total US imports of these items, such as rare earths, lithium-ion batteries and pharmaceutical ingredients. Accordingly, there is a risk that China could react with countermeasures. In addition, resistance from US companies would be significant due to the inflationary impact that such a duty would have.

Inflation

Swiss Life Asset Managers	Consensus
2024: 0.4%	2024: 0.6%
2025: 1.8%	2025: 1.5%

We have further reduced our inflation forecast for China for this year from 0.6% to 0.4% due to a lower-than-expected June inflation reading of just 0.2%. The persistent weakness in consumer demand remains the main driver of these low figures, which we expect to continue for the rest of the year.

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Perspectives
Flash Comment

7 August 2024

Summer storm on financial markets

What has happened?

- After a positive July, financial market sentiment reversed abruptly at the beginning of August.
- What started with a correction on the Japanese equity market on 1 August ended up engulfing global financial markets.
- Although no single event triggered this correction, the combination of weaker-than-expected US labour market data, uninspiring earnings and outlooks by US companies and the unexpected policy rate increase in Japan rattled investors and led to a sharp correction on equity markets, wider credit spreads and a significant fall in bond yields.

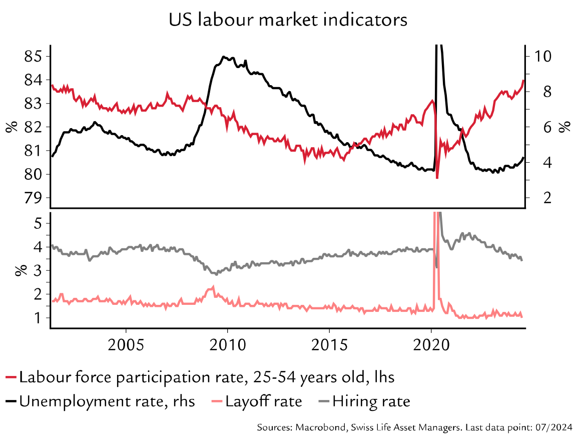
Our economic assessment

- The unexpected increase in the US unemployment rate from 4.1% in June to 4.3% in July led to worries that the US economy is on the brink of recession.
- A moderation of the excessively high US consumption growth and a looser labour market have always been part of our base case scenario for 2024. So it is not rising unemployment per se that is concerning, but rather the recent speed at which it has increased.
- Encouragingly, it is not increased "firing" that is pushing up unemployment, but reduced hiring amid a surge in labour force participation (see chart). The latter is not necessarily a bad sign for the economy. Furthermore, negative effects from Hurricane Beryl might have impacted the July data.
- Also, the unemployment rate is currently the only indicator showing pronounced weakness. The payrolls survey indicated that the US economy was adding jobs in July, although at a slow pace. Meanwhile, purchasing managers' indices suggest that the services sector was still doing fine in July.
- The biggest risk is that the "recession scare" might start to weigh on consumer and corporate sentiment and thus initiate a negative economic feedback loop. Monetary policy easing is key to alleviate these concerns. We expect the US central bank to start a policy rate cutting cycle in September.

Our market assessment

- The ongoing correction has potentially been amplified by the seasonal thin market liquidity, implying that we could see a rebound in the short term. However, the fundamentals remain weak, as the moves were insufficient to correct the high valuation of equities and credits.
- We therefore expect continued volatility on financial markets. Equity markets are likely to continue their rotation in favour of cheaper regions, sectors, and market segments. Corporate bonds and high yield spreads might widen further. Yield levels are likely to fall slightly, although the significant drop over the last days might limit the downside potential. On the currency front, we see limits to a further appreciation of CHF relative to EUR and USD, as the SNB might intervene. After the move up, we see no further upside potential for EUR/USD as lower rates in USD will likely be matched by lower EUR rates.
- The market's focus on the risk of an economic slowdown led to a modest decline in oil prices, despite the risk of a further escalation in the Middle East. Any such escalation would introduce an additional element of volatility that would, in our view, hurt European markets in particular.

US labour market: less hiring amid rising participation



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