Perspectives
Economics

January 2020

Key messages

- Record long upswing of US economy continues into 2020
- Only temporary rise in headline inflation in the Eurozone
- Cyclical trough in Swiss unemployment rates is behind us

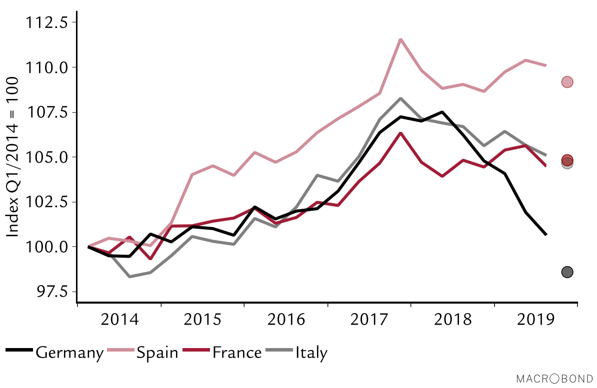
Comparison of forecasts

	GDP 2020		GDP 2021		CPI 2020		CPI 2021	
	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus
US	1.7% ↑	1.8%	1.8%	n.a.	2.1%	2.0%	2.1%	n.a.
Eurozone	0.9%	1.0%	1.1%	n.a.	1.2% ↓	1.2%	1.3%	n.a.
Germany	0.6%	0.9% ↑	1.1%	n.a.	1.3% ↓	1.4% ↓	1.4%	n.a.
France	1.0%	1.2% ↑	1.1%	n.a.	1.3%	1.2% ↓	1.4%	n.a.
UK	1.2% ↑	1.1%	1.3%	n.a.	1.9%	1.8% ↓	1.9%	n.a.
Switzerland	1.3% ↑	1.2% ↑	1.2%	n.a.	0.0% ↓	0.3% ↓	0.6%	n.a.
Japan	0.3%	0.3% ↑	0.6%	n.a.	0.5%	0.6% ↓	0.3%	n.a.
China	5.8%	5.8%	5.6%	n.a.	3.5% ↑	2.9% ↑	2.0%	n.a.

Arrows indicate difference from previous month
Source: Consensus Economics Inc. London, 9 December 2019

Chart of the month

EMU4 quarterly industrial production, excl. construction
(Dots = October values)



While the French are fighting the pension reform these days, they could also be celebrating their ongoing economic resilience: Three out of the four largest eurozone economies saw their industrial production (excluding construction) declining in October, the notable exception being France. German industrial production took the greatest hit (–1.5%), declining to below 2014 levels. This weak data print shows that Germany's industrial sector remained in contraction going into the fourth quarter of 2019. On the brighter side, recent soft indicators have shown signs of stabilisation at low levels. Overall, we remain more cautious regarding 2020 economic growth prospects for Germany compared to France.

US
Resilient domestic economy

GDP growth	
Swiss Life Asset Managers	Consensus
2020: 1.7 %	2020: 1.8 %
2021: 1.8 %	2021: n.a.

In 2019, the trade dispute rattled markets, led to unprecedented levels of uncertainty, and was partly responsible for the three policy rate cuts by the US Federal Reserve. Yet, when economic historians will once look back at GDP growth figures for 2019, they might ask what the fuss was all about. During the "peak pessimism" period in the second and third quarter, the US economy continued to grow at a rock-solid 2% pace, and data released for the fourth quarter 2019 indicate that domestic demand remained resilient. Consumer sentiment increased and November non-farm payrolls grew at a higher pace than estimated by any of the 69 economists polled by Bloomberg. Small businesses turned more optimistic, signalling to increase hiring and pay. The single-largest disappointment was, however, the ISM manufacturing survey that has been hovering in contraction territory for four straight months. In the survey, companies again mentioned significant risks regarding international trade, in line with our view that political uncertainty will continue to weigh on business investment despite a more constructive tone between the US and China recently. Nevertheless, as the US economy will probably head into 2020 with more "speed" than previously expected, we increased our full-year forecast to 1.7%, still somewhat below potential.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 2.1 %	2020: 2.0 %
2021: 2.1 %	2021: n.a.

US headline inflation surprised positively for two straight months due to a stronger-than-expected rise in energy prices. Headline inflation thus moved up to 2.1% in November, further closing the gap to core inflation which remained unchanged at 2.3%, as expected. Due to fading energy price base effects, headline inflation is set to move higher, reaching a peak in January and February 2020 before moderating again towards 2.1% during the course of the year.

Eurozone
Only limited help from abroad

GDP growth	
Swiss Life Asset Managers	Consensus
2020: 0.9 %	2020: 1.0 %
2021: 1.1 %	2021: n.a.

Domestic conditions and low interest rates continue to support activity in Europe's construction sector and services industry going forward. Our base case implies a gradual pick-up in quarterly GDP dynamics. On average, we expect GDP to grow by 0.25% per quarter in 2020 and by 0.3% in 2021. Yet it will take time to clear the skies from the current patches of recession in export-oriented countries and industries. Germany's car industry and its domestic and foreign suppliers remain heavily under pressure to adjust capacity. Purchasing Managers' Indices remain particularly soft in Germany and Austria. Unlike in the three previous recovery periods of the past decade, the demand impulse from emerging markets is likely to be called off in 2020 as global trade uncertainties weigh on animal spirits in the corporate sector around the globe. Thus, a fiscal stimulus is more than welcome to support domestic activity in the year ahead. According to IMF projections for 2020, the change in the cyclically-adjusted primary balance as a percentage of GDP will be most positive in Greece, the Netherlands, Belgium and Germany. We think, however, that the estimated numbers for Germany are too optimistic. After benefiting strongly from a fiscal boost in 2019, the French and Irish economies will have to do without any additional positive fiscal impulse in 2020.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 1.2 %	2020: 1.2 %
2021: 1.3 %	2021: n.a.

In our view, growth dynamics over the coming two years are insufficient to generate accelerating inflation pressure. Thus, the current inflation target of the European Central Bank (ECB) of sustained inflation "close to, but below 2%" remains out of reach even if we extend our forecast horizon by one year until the end of 2021. According to our projections, core inflation in the Eurozone will only increase very gradually to around 1.4% in 2021, even in light of ongoing monetary policy accommodation by the ECB.

Germany
A relief that seems premature

GDP growth	
Swiss Life Asset Managers	Consensus
2020: 0.6 %	2020: 0.9 %
2021: 1.1 %	2021: n.a.

With 0.08% quarterly GDP growth in the third quarter, Germany's economy avoided a technical recession by a very thin margin. In our view, the broad relief that followed the release of GDP data was premature. In the absence of any additional meaningful stimulus from either monetary or fiscal policy for the domestic economy in the short term, Germany continues to depend on demand from abroad to reanimate economic dynamics in its industrial sector. In contrast to the last three acceleration periods in 2009, 2013 and 2016, emerging markets are unlikely to play yet again the role of the global economy's growth engine. Thus, the ongoing adjustment process in Germany's car manufacturing sector will continue to weigh on growth in the quarters ahead. Incoming data for the final quarter 2019 suggests that there was no pick-up in activity with industrial output having fallen to below 2014 levels. Factory orders fell again by 0.4% in October from the previous month. Compared with the same month last year, orders received by Germany's manufacturing sector are down by 5.5%. On the surface, business sentiment indicators like Germany's ifo business climate survey or the purchasing managers' survey for the manufacturing sectors have started to hint at stabilising conditions. Yet, a closer look at the details in the November ifo survey reveals that a growing net number of firms in the manufacturing sector plans to reduce their labour force in the next three months.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 1.3 %	2020: 1.4 %
2021: 1.4 %	2021: n.a.

November inflation data came in at 1.2%, substantially below our expectation of 1.6%. Consequently, we reduce our forecast for inflation in 2020 to 1.3%. The cooling of the labour market is likely to dampen price setting power in the domestic economy, which limits the upside risks in the medium term. Base effects from last year's roller coaster ride in the energy price components will boost headline inflation only temporarily during the first quarter 2020.

France
Strikes to weigh on sentiment

GDP growth	
Swiss Life Asset Managers	Consensus
2020: 1.0 %	2020: 1.2 %
2021: 1.1 %	2021: n.a.

In 2019, the French economy suffered less from global headwinds than its Eastern neighbours. Domestic activity recovered markedly in the first half of the year from a weak last quarter 2018 in which the Gilets Jaunes street protests weighed on consumer and business sentiment. A proactive fiscal policy stance provided strong support to the economy that was missing in Germany. Yet, budget constraints set by the Maastricht criteria limit the potential for an additional fiscal boost in 2020. In fact, the fiscal impulse in France is expected to be negative in 2020 according to IMF projections. There are more reasons to expect a gradual moderation of economic dynamics in the quarters ahead. Labour market data suggest that the fall in France's unemployment numbers is coming to an end. According to INSEE, the statistics office, the mainland unemployment rate rose slightly from a cyclical trough of 8.2% to 8.3% in the third quarter. More recently, a business survey conducted by the Bank of France revealed that firms' willingness to hire more people has fallen to the lowest level since May 2015. Yet, this last number must be taken with a grain of salt as this survey asked firms about their hiring activity over the next month. In the light of the anticipated strikes and street protests the pension reforms, this survey and other economic data yet to come are probably distorted as were indicators gauging economic sentiment in the final quarter 2018.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 1.3 %	2020: 1.2 %
2021: 1.4 %	2021: n.a.

Inflation came in at 1.2% in November and is expected to reach an average of 1.3% in 2019. Services prices fell in each of the last three months, suggesting that there is only very limited price setting power for domestic suppliers. We forecast average annual inflation to reach 1.3% again in 2020 and 1.4% in 2021. Thus, an accommodative monetary policy stance by the ECB remains fundamentally justified from a French perspective.

UK
A lost year

GDP growth	
Swiss Life Asset Managers	Consensus
2020: 1.2 %	2020: 1.1 %
2021: 1.3 %	2021: n.a.

At the time of writing, UK voters went to the polls as a "lost year" was drawing to a close. Monthly GDP data showed that the UK economy stagnated between January and October 2019, driven by weakness in manufacturing, construction and financial services, while most other services sectors added positively to GDP. Admittedly, the UK was also hit by the fallout of the US-China trade dispute, but most of the problems were home-made. The self-inflicted Brexit uncertainty has kept investment intentions at the lowest level since the financial crisis, according to the Bank of England Agents' Survey. In normal times, this should wreak havoc for any government seeking re-election, but these times are different. First, the situation for households is much better than GDP figures suggest. The UK labour market remained tight as firms are hiring instead of investing, and real wages are growing at a stunning rate of 2% annually. Second, the Tories have generous fiscal plans, the main reason why we upgraded the 2020 GDP forecast. Third, Conservative voters probably hope that the promised Brexit at the end of January will reinvigorate corporate animal spirits. We would indeed foresee a temporary surge of optimism if the Conservatives formed a majority government but would expect renewed uncertainty as soon as UK-EU trade negotiations kick off in 2020.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 1.9 %	2020: 1.8 %
2021: 1.9 %	2021: n.a.

The Bank of England is one of the few developed market central banks having consistently delivered on its inflation target in 2019. We expect headline as well as core inflation to remain close to target in 2020 and 2021. While the support from Sterling is fading given the strong appreciation over the past months, elevated wage growth should keep domestic inflationary pressures in place.

Switzerland
Caught in a slack period

GDP growth	
Swiss Life Asset Managers	Consensus
2020: 1.3 %	2020: 1.2 %
2021: 1.2 %	2021: n.a.

The preliminary data for GDP growth in the third quarter surprised us to the upside: instead of the expected 0.2%, real GDP was reported to have grown by 0.4%, the fastest pace in five quarters. While the underlying trend in economic dynamics during the third quarter was generally reported as flat, two sectors contributed in a sizeable amount to growth. First, the energy sector recorded its strongest ever growth and a surge in exports on the back of favourable weather conditions. Second, pharmaceutical firms registered yet another strong rise in production and export activity, in contrast to the more cyclical machinery industries. Real output of the pharmaceutical sector has more than tripled since 2004, while output of the machinery sector has just risen by 2% over the past fifteen years. SECO, Switzerland's State Secretariat for Economic Affairs, has introduced a new monthly economic indicator, allowing a timely assessment of economic sentiment in the current quarter. According to this new nowcaster, Switzerland remains in a slack period in the final quarter 2019. It is very important not to misinterpret the forecast for 2020: Switzerland's GDP will get a significant boost from major global sport events as licence fees generated by organising UEFA and IOC will enter Switzerland's national accounts as their domicile country.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.0 %	2020: 0.3 %
2021: 0.6 %	2021: n.a.

As producer- and import prices fell by 2.5% in the year until November and energy prices continued to trend sideways, upside pressure on consumer prices remains limited. The Swiss National Bank's own conditional inflation forecast suggests that inflation is to rise only to 1.2% until the third quarter 2022, even if monetary policy remains unchanged. Thus, the absence of inflation will remain a major characteristic for Switzerland's economy in the quarters ahead.

Japan
An overstated fiscal package

GDP growth

Swiss Life Asset Managers	Consensus
2020: 0.3 %	2020: 0.3 %
2021: 0.6 %	2021: n.a.

Japanese GDP data are prone to hefty revisions between the first and final estimate, and the release for the third quarter 2019 was no exception. Instead of just 0.1%, final numbers showed that the Japanese economy even expanded 0.4% in the three months before the October consumption tax hike. Of course, this is not necessarily a positive sign. It could suggest that the front-loading of purchases (to avoid a higher tax) was much stronger than previously thought, implying an even sharper drop in the fourth quarter. At least the Japanese government appears to be worried. On 5 December, it approved a long-awaited fiscal package allegedly worth JPY 26 trn (4.6% of GDP) to cushion the blow of the tax hike. As usual, the headline number of the package is grossly overstated, as it includes private investment that is expected to be triggered by the measures. Pure fiscal spending amounts to around JPY 9.4 trn (1.7% of GDP), which is centered around infrastructure projects and is likely spread over a long period of time, making it difficult to estimate the effects on the upcoming growth numbers. In combination with very low fiscal multipliers in Japan, rather disappointing outcomes of past fiscal packages and the fact that we had already penciled in some fiscal measures, we did not change our above-consensus 2020 GDP forecast.

Inflation

Swiss Life Asset Managers	Consensus
2020: 0.5 %	2020: 0.6 %
2021: 0.3 %	2021: n.a.

As mentioned in the previous edition of this publication, the consumption tax hike has had a surprisingly modest impact on consumer prices. Prices barely moved in October, and preliminary November data for the Tokyo region still suggest very little pass-through to consumer prices. Admittedly, annual headline inflation in Tokyo surprisingly doubled to 0.8% in November, but this was driven by food prices that are largely exempted from the tax hike. Core inflation remained unchanged at 0.7%.

China
Inflation surge in year of the pig

GDP growth

Swiss Life Asset Managers	Consensus
2020: 5.8 %	2020: 5.8 %
2021: 5.6 %	2021: n.a.

China's November manufacturing Purchasing Managers' Indices improved considerably as the country's private survey reading climbed up further to 53.2 and the official NBS reading surpassed the 50 points mark that separates expansion from contraction. However, hard data shows that downward pressure on the sector remains elevated. Industrial profits slumped sharply as producer prices are edging lower, which is a negative signal for companies' capacity to invest and hire. Moreover, exports contracted by 1.1% compared to a year ago. A regional breakdown shows that the major contributor to the export slump were exports to the US that contracted by 23%, showing that imposed tariffs on a total of 360bn USD of Chinese products remain a big headwind. Hence, it is getting increasingly important for China to reach a comprehensive deal with the US that clears off the trade spat. Nevertheless, it does not suggest that trade negotiations will get any easier in 2020, as the ongoing drag on exports implies that a substantial removal of existing tariffs will be a key demand for a potential trade deal from the Chinese side. Despite the downward pressure on China's economy, Beijing will likely remain prudent with its fiscal and monetary policy stance, due to financial risks related to the very elevated debt burden.

Inflation

Swiss Life Asset Managers	Consensus
2020: 3.5 %	2020: 2.9 %
2021: 2.0 %	2021: n.a.

Inflation climbed sharply in November to 4.5%, the highest reading since January 2012, as pork prices doubled. Pork accounts for 2.4% of China's CPI basket and prices are expected to surge as the African Swine Fever erased more than half of the country's pork stock. Hence, we expect inflation to pick up further in the coming months. In contrast, producer prices, an indicator for corporate profitability, contracted by 1.4%, suggesting that demand remains weak.

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