Perspectives
Economics

July 2020

Key messages

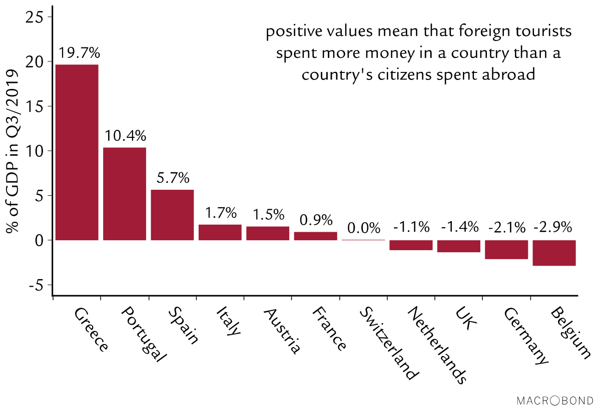
- Tourism season to additionally benefit economies in Europe suffering comparably less from COVID-19
- We remain more optimistic than consensus for the US economy, where data has surprised very positively
- The re-acceleration of COVID-19 cases is unlikely to trigger significant new lockdowns in developed markets

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	-3.4%	-5.6% ↓	3.7%	4.4% ↑	0.8%	0.8% ↑	1.5%	1.8%
Eurozone	-6.3% ↓	-8.4% ↓	5.4% ↓	6.1% ↓	0.4%	0.3%	1.3%	1.0% ↓
Germany	-4.7%	-6.5% ↓	3.8% ↓	5.2%	0.7%	0.6%	1.3%	1.4%
France	-7.6% ↓	-9.7% ↓	6.1% ↑	7.0% ↑	0.4%	0.3%	1.3%	1.1% ↓
UK	-6.1% ↓	-9.0% ↓	4.9% ↑	6.1%	1.0% ↑	0.9% ↓	1.5% ↓	1.3% ↓
Switzerland	-3.8% ↓	-6.0% ↓	4.4% ↑	4.7% ↑	-0.6% ↑	-0.7%	0.6% ↑	0.3%
Japan	-4.6% ↑	-5.3% ↑	2.6% ↓	2.6% ↑	0.0%	-0.3% ↑	0.2%	0.0% ↓
China	1.3% ↑	1.4%	8.2% ↓	8.0% ↓	2.6% ↓	2.9% ↓	1.9% ↓	1.8% ↓

Arrows indicate difference from previous month
Source: Consensus Economics Inc. London, 8 June 2020

Chart of the month



The summer holidays are just around the corner, and many people might spend vacations in their home country. This is a major problem for Southern Europe, a "net exporter of summer holidays". Without international travel, Greece and Portugal would lose around 20% and 10%, respectively, of their third-quarter GDP. The big beneficiary is Northern Europe. Belgium GDP would increase by 3% if all Belgians vacationed in their home country in summer. On an absolute basis, Germany's travel current account deficit is most spectacular (EUR –18 bn in the third quarter 2019). Promising for Switzerland: Google Trends data show that searches in Germany for holidays in Switzerland have surged since borders were reopened.

US
With swing into the second wave

GDP growth

Swiss Life Asset Managers	Consensus
2020: -3.4 %	2020: -5.6 %
2021: 3.7 %	2021: 4.4 %

Incoming US economic data has been overwhelmingly positive since the last edition of this publication. Retail sales, industrial production and housing market data for May rebounded more vigorously than expected by markets as the US economy was reopening. This led to an astonishing decline of the unemployment rate in May. The good mood extended into June as almost all survey data, from regional manufacturing surveys to consumer confidence, surprised positively. The Citi Economic Surprise Index, which measures incoming data against expectations, indeed reached a new all-time high for the US. In the trade-off between containment of the pandemic and limiting economic costs, the US is clearly preferring the latter. At the time of writing, daily new cases were again surging from already high levels, as the pandemic has moved to previously less affected states, mostly in the South. These new regional hotspots, which include economic heavyweights Texas and Florida, account for roughly 22% of US GDP. While the resurgence of cases is certainly a risk for the economic recovery in the third quarter and easing was already stopped or partially reversed in some states, we nevertheless believe that the low appetite for significant lockdown measures, especially in these conservative states, will limit the economic costs. Hence, we stick to our 2020 GDP forecast of –3.4%, which is significantly higher than current consensus expectations.

Inflation

Swiss Life Asset Managers	Consensus
2020: 0.8 %	2020: 0.8 %
2021: 1.5 %	2021: 1.8 %

While most data rebounded in May as lockdowns were eased, US inflation undershot expectations and continued to decline. The main drivers were energy, apparel, used cars and transportation. It thus seems that discounting was still needed to keep demand afloat in May. Nevertheless, May likely marked the trough, as higher energy prices and normalising activity will gradually move headline as well as core inflation higher.

Eurozone
Another decisive EU summit

GDP growth

Swiss Life Asset Managers	Consensus
2020: -6.3 %	2020: -8.4 %
2021: 5.4 %	2021: 6.1 %

From Sicily to Finland, Europe is recovering from the deepest recession in decades. Economic indicators are stabilising or improving with those European economies hit comparably less by COVID-19 in the pole position to experience a U-shaped recovery in the second half of the year. Yet, despite this gradual recovery, unemployment and corporate bankruptcies will continue to rise into next year and possibly beyond. Our own forecast for the 2020 loss in real GDP remains more constructive than those of most of our peers. Of the 29 institutes contributing to this month's consensus poll, only two participants sent in a slightly more optimistic estimate. Apparently, the difference between available forecasts is comparably small with respect to the expected fall in output during the second quarter, but wide as regards the expected economic recovery in the third quarter. For our base case scenario to unfold, renewed lockdown measures need to be strictly limited to local hotspots. In the alternative scenario with a second infection wave overwhelming Europe's healthcare system, a stagnation over several quarters would be the likely consequence. While the national states were in charge to fight the pandemic, it will be up to Europe's multilateral institutions to fight its economic consequences. An agreement over the proposed recovery plan at the Special European Council on 17 and 18 July is essential.

Inflation

Swiss Life Asset Managers	Consensus
2020: 0.4 %	2020: 0.3 %
2021: 1.3 %	2021: 1.0 %

Analysing Eurozone inflation trends during the current crisis is a difficult task. The preliminary numbers for June provided major surprises on either side: while we underestimated inflation in Germany, the number for France came in substantially below expectations. Since March, various statistics offices report difficulties to collect prices for goods and even more for services which were temporarily not on offer.

Germany
Strong rebound in expectations

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -4.7 %	2020: -6.5 %
2021: 3.8 %	2021: 5.2 %

Germany's economy is recovering from the sharp fall in activity in March and April and from the mild recession the country was in already before the outbreak of COVID-19. The German ifo institute's detailed business survey reveals a strong improvement in the assessment of current economic activity but most importantly in business expectations. While expectations regarding future business developments are still comparably low, they improved for the large majority of sectors surveyed by the ifo institute compared to last month, including services industries most impacted by lockdown measures. In the short-term Germany's domestic economy is benefiting from a favourable mix of a successful management of the pandemic, a convincing fiscal policy response and domestic tourism which keeps demand for consumer goods and services in the country this summer. Like business sentiment, consumer confidence has recovered sharply this month. As Europe's largest economy seems to get away from the crisis with a black eye some of its old structural weaknesses are resurfacing. Details in the ifo survey reveal that vehicle manufacturers continue to plan job cuts. With the car industry continuing to struggle, the future of jobs in many of its supplying industries remains uncertain. The ongoing problems in the car industry may explain why Germany's Purchasing Managers' Index for the manufacturing industries failed to recover at the same pace as those in France or the United Kingdom.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.7 %	2020: 0.6 %
2021: 1.3 %	2021: 1.4 %

Inflation in Germany surprised to the upside in June according to preliminary data. Businesses slapped with restrictions to prevent the spread of COVID-19 seem at least temporarily able to pass on higher costs to their customers. Steep price increases were reported for hair and cosmetic services as well as at restaurants. The temporary VAT cut in the second half of the year will add further volatility to the monthly price data.

France
A multiple hit on the economy

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -7.6 %	2020: -9.7 %
2021: 6.1 %	2021: 7.0 %

Like elsewhere in Europe, economic indicators have started improving in France over the past month. Consumer and business confidence recovered from recent lows while the Purchasing Managers' Index returned above the 50-points expansion line in all three sectors manufacturing, services and construction. Yet, compared with other EMU member states, France remains a laggard when it comes to the reopening of the economy. According to Oxford University's COVID-19 Containment Policy Stringency Index, France has still more rigid measures in place than Germany, but also Italy or Spain. The pace of the reopening of an economy determines how quickly domestic activity can recover and return to more normal levels. Lagging other countries may limit the risk of a second wave of new infections, but it can come at an economic price. In addition to the slow easing of containment measures, other factors weigh on the French economy. Its comparably high exposure to the services industry has turned out to be the country's Achilles heel in 2020. As we saw on the front page, France is traditionally a beneficiary of net inbound tourism. Travel restrictions thus mean an additional drag for the tepid recovery. In contrast to EMU member partner Germany, or the United Kingdom the fiscal room to manoeuvre in this current crisis is comparably small in France, which limits further the potential for a quick recovery of final domestic demand.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.4 %	2020: 0.3 %
2021: 1.3 %	2021: 1.1 %

Consumer prices in France rose by just 0.1% in June from year ago levels. The main drag on headline inflation remain energy prices which fell by 9% from levels at the same time last year. We expect French inflation numbers to drop into negative territory in the third quarter this year. The base effect from low energy prices should fade in the second quarter 2021. By then, annual inflation should climb back above 1%.

UK
A successful policy innovation

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -6.1 %	2020: -9.0 %
2021: 4.9 %	2021: 6.1 %

The news flow out of the UK data has been very surprising over the past month. First, the economic plunge in April turned out to be much sharper than we had anticipated, triggering another downward revision of our 2020 GDP forecast. According to monthly GDP data, the economy was running at only 75% of its pre-crisis level in April, with hospitality and restaurants losing more than 90% of their output. But then, positive news kicked in. Retail sales volumes rebounded in May and sentiment among businesses improved significantly in June, with the manufacturing Purchasing Managers' Index even moving slightly into expansion territory. Even more importantly, the newly introduced job retention scheme has proved to be very popular, which will limit the labour market fallout. At the time of writing, around 30% of employees were furloughed, with 80% of monthly salaries up to GBP 2500 being subsidised under the scheme. Starting from July, companies may bring furloughed employees back part-time, while still receiving wage subsidies. This will make it easier for companies to ramp up production again, which supports our view of a gradual recovery in the third quarter. The main risk is a re-acceleration of new cases as restaurants are reopening beginning of July and travel restrictions are eased. Also, trade negotiations between the EU and UK are set to heat up over the next months as the transition period ends in December 2020, bringing renewed uncertainty for businesses.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 1.0 %	2020: 0.9 %
2021: 1.5 %	2021: 1.3 %

Annual headline inflation declined less than expected in May, to 0.5%. We thus slightly revised up our 2020 full-year forecast. We expect May to mark the trough, as higher energy prices and normalisation of economic activity lead to a recovery of prices, especially for heavily discounted goods such as clothing.

Switzerland
The recovery has started

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -3.8 %	2020: -6.0 %
2021: 4.4 %	2021: 4.7 %

Although the first quarter seems long ago, the release of Switzerland's GDP during that period caused a downward revision to our forecast for the full year 2020. Real GDP in the first quarter contracted by 2.6% from the last quarter 2019, which was more than the 2.1% we had expected. A look at the details reveals that we mainly erred in the assessment of construction activity. Yet, the industry's own lobby group reports that order books remain full and that the share of employed persons in short-time work has come down from 10% in April to 5% in May. Three major phases to reopen the economy since May resulted in a quick resumption of domestic activity. According to high frequency data from the KOF Swiss Economic Institute, mobility of the Swiss population has recovered fully back to pre-crisis levels. Compared with other publicly available forecasts, we stay constructive as regards economic activity in the second half of the year. Switzerland should be a net beneficiary of European tourists' limited possibilities to travel over the summer holidays. Falling consumer prices mean rising real wages for most Swiss households. This has stabilised domestic demand already in the aftermath of the currency shock in 2015 and is likely to support spending again this year. Nevertheless, this year's recession will continue to leave deep traces in economic data going forward: we expect both unemployment and the number of bankruptcies in those sectors most hit by the crisis to rise over the months to come.

Inflation	
Swiss Life Asset Managers	Consensus
2020: -0.6 %	2020: -0.7 %
2021: 0.6 %	2021: 0.3 %

Annual inflation is expected to stay in negative territory until the start of 2021. At -1.3%, the annual rate of change in Switzerland's consumer price index has reached its cyclical low in May. Our more constructive view on the recovery of the economy in 2020 may explain why our forecast of 0.6% average annual inflation in 2021 stands markedly above the consensus estimate.

Japan
Manufacturing in the doldrums

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -4.6 %	2020: -5.3 %
2021: 2.6 %	2021: 2.6 %

Japan is currently facing a two-speed economy. While the services sector experienced a sharp decline during the state of emergency, the extent was never as dramatic as in other developed markets. Retail sales dropped to around 88% of pre-crisis levels in May, whereas they plunged to 78% in the United States for example. Hence, the labour market repercussions have also been more benign than elsewhere, which is limiting the damage to domestic consumption. Even though the unemployment rate has risen from the cyclical low of 2.2% in December 2019 to 2.9% in May, Japan is still confronted with a relatively tight labour market as the job-to-applicant ratio remained above one. But quite surprisingly, the manufacturing sector, a stabilising pillar in other developed markets, remains in the doldrums and has delivered a series of negative surprises over the past month. Even though economic dynamics have improved in China and the US, Japan's most important trading partners, industrial production dropped to just 80% of pre-crisis levels in May, and the situation on the orders front remains bleak. A major driver is the auto sector, which reduced output by 50% overall since the start of the year. Nevertheless, we stick to our view of a gradual recovery in the second half of 2020 as foreign demand should rebound. We even upgraded our relatively cautious full-year forecast slightly as first-quarter GDP was revised up.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.0 %	2020: -0.3 %
2021: 0.2 %	2021: 0.0 %

Headline inflation in Japan is hovering marginally above zero currently and has proved to be a bit more resilient than anticipated. Services inflation is still the main drag, but goods such as clothing or furniture have not seen the massive discounts as the same goods in other developed markets during the crisis. We expect inflation to remain at around current levels during the third quarter 2020.

China
Fiscal stimulus to the rescue

GDP growth	
Swiss Life Asset Managers	Consensus
2020: 1.3 %	2020: 1.4 %
2021: 8.2 %	2021: 8.0 %

The Chinese government is stepping up its stimulus measures to support the economy. The country's broad credit measure accelerated to a growth rate of 12.5% in May, supported by the issuance of special local government bonds that are mainly used for infrastructure projects. As a result, infrastructure investments have recovered rapidly and surpassed year-ago levels in May. Chinese consumers, however, seem more prudent. While sales of cars and furniture picked up above last year's levels, catering services remain in deep contraction. The resurgence of new coronavirus cases in Beijing has been a reminder that the risk of a second wave is still present. Although we do not believe that nationwide lockdown measures will be implemented once again, this still means that existing social distancing measures will not be further eased any time soon, which could protract the consumption recovery. Moreover, political risks remain elevated as China is rushing to implement a national security law in Hong Kong. The new law would allow China to increase its grip over Hong Kong citizens, as it – among other measures – plans to set up a national security office to gather information and oversee crimes concerning national security. This move will likely spark an upsurge in social protests in Hong Kong and deteriorate the already worsening US-China relations.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 2.6 %	2020: 2.9 %
2021: 1.9 %	2021: 1.8 %

China's May inflation dipped sharply to 2.4% from 3.3% previously, as food price inflation continues to ease. Especially pork prices that skyrocketed in 2019 – as the African Swine Flu erased a third of China's pork stock – continue to decelerate since pork supply is recovering steadily. As we expect pork prices to continue to ease through the rest of the year, we revise down our annual CPI forecast to 2.6% from 3% previously.

Economic Research

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