Perspectives
Economics

SwissLife
Asset Managers

July 2022

Key messages

- Recession fears continue to rise following weak consumer and corporate survey data
- As interest rates rise, concerns about European sovereign debt are increasing and provoking ECB activism
- Inflation risks remain on the upside, the situation with regard to Russian gas supplies is worsening

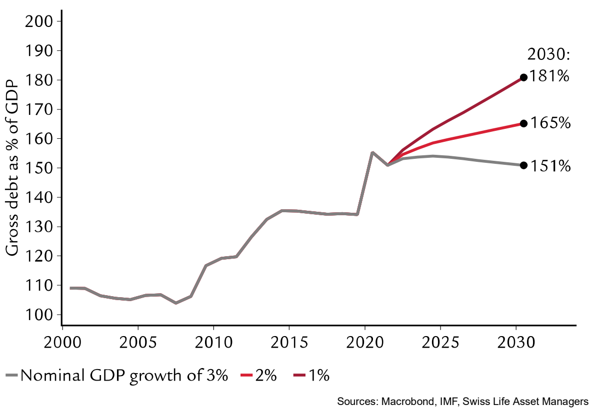
Comparison of forecasts

	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	2.5% ↓	2.6% ↓	1.4% ↓	1.8% ↓	8.3% ↑	7.7% ↑	3.8% ↑	3.6% ↑
Eurozone	2.9% ↑	2.8% ↑	1.8% ↓	2.0% ↓	7.1% ↑	7.2% ↑	3.1% ↑	3.2% ↑
Germany	1.8% ↓	1.8% ↓	2.0% ↓	2.1% ↓	7.0% ↑	6.9% ↑	3.4% ↑	3.4% ↑
France	2.5% ↓	2.5% ↓	1.4% ↓	1.6% ↓	4.7% ↑	5.0% ↑	2.6% ↑	2.6% ↑
United Kingdom	3.5% ↓	3.5% ↓	0.4% ↓	0.8% ↓	8.1% ↑	8.5% ↑	4.9% ↑	5.2% ↑
Switzerland	2.5%	2.5% ↓	1.2%	1.6% ↓	2.4% ↑	2.3% ↑	1.3% ↑	1.2% ↑
Japan	1.5% ↓	1.7% ↓	1.6%	1.9%	2.0% ↑	1.9% ↑	1.0% ↑	1.2% ↑
China	4.3%	4.3% ↓	5.2%	5.2% ↑	2.3%	2.2%	2.0%	2.3%

Arrows indicate change from previous month
Source: Consensus Economics Inc. London, 13 June 2022

Chart of the month

Italy: Scenarios for the debt ratio at an interest rate of 3.5%



The interest rate turnaround is here, and thus the question of whether a new debt crisis is looming in the Eurozone. The yield differential ("spread") between Italian and German government bonds has widened, triggering activism by the European Central Bank, which aims to counter the "fragmentation" in the Eurozone. Whether Italy's debt situation is sustainable at the current interest rate of 3.5% on 10-year bonds depends on nominal growth. Assuming Italy's budget returns to a primary surplus within five years, Italy would need to achieve real growth of 1% and inflation of 2% (= nominal growth of 3%) to stabilise the debt ratio.

US
Consumption at any price?

GDP growth	
Swiss Life Asset Managers	Consensus
2022: 2.5%	2022: 2.6%
2023: 1.4%	2023: 1.8%

Private consumption accounts for around 70% of US gross domestic product, and is therefore crucial to the development of economic activity. The starting position of US households is favourable, especially compared to 2008. The wealth of all income classes relative to liabilities has increased significantly since the financial crisis. Furthermore, state support enabled US households to accumulate massive excess liquidity during the pandemic. At the moment, lower income groups in particular are benefiting from a very tight labour market and wage growth of around 7%. However, this growth does not fully compensate for inflation, which is why real wages have been declining since 2020. As a result, consumers are increasingly financing their spending by reducing their savings and taking on additional debt. The April savings rates stood at a historically low 4.4%. Estimates suggest that the current decline in the savings rate could be maintained until at least 2023, thanks to the pandemic savings. However, falling consumer sentiment might curb the propensity to spend beforehand. The rise in consumer credit is likely to be more problematic. Although default rates have remained low so far, lower income groups in particular are becoming increasingly concerned about their creditworthiness. The risk of an earlier-than-expected recession is therefore high, with hardly anyone expecting a soft landing anymore.

Inflation	
Swiss Life Asset Managers	Consensus
2022: 8.3%	2022: 7.7%
2023: 3.8%	2023: 3.6%

After a small drop in April, US inflation surprised again to the upside, reaching a new high of 8.6%. The drivers were once again price increases for food and energy, but also significantly higher air fares and rising rents. We are revising the energy price path upwards over the coming months.

Eurozone
Still on the ECB's drip

GDP growth	
Swiss Life Asset Managers	Consensus
2022: 2.9%	2022: 2.8%
2023: 1.8%	2023: 2.0%

The coming days will mark the anniversary of the former ECB president Mario Draghi's pledge that the European Central Bank would do "whatever it takes to preserve the euro". Just in time for the anniversary of the peak of the European debt crisis, all eyes are once again on the ECB. With the notorious exception of Japan, the ECB will be the last of the major central banks to initiate an interest rate turnaround from July. The very prospect of such a move triggered a strong market reaction with a sharp widening of sovereign bond spreads for the southern member countries. Italy in particular has been exposed to strong headwinds in the short term. Ironically, Mario Draghi has meanwhile switched roles, and now needs support from the central bank as Prime Minister of Italy. The design of the ECB's "anti-fragmentation tool" is also very important with a view to next year's Italian elections. Nevertheless, interest rate hikes by the ECB are inevitable in view of the elevated inflation figures and accelerating wage pressure, even if the economic outlook continues to deteriorate throughout the Eurozone. Meanwhile, positive impetus is being provided by the easing of supply chain problems. The first car manufacturers have been able to ramp up production again.

Inflation	
Swiss Life Asset Managers	Consensus
2022: 7.1%	2022: 7.2%
2023: 3.1%	2023: 3.2%

Energy prices continue to exert significant price pressure. The ECB's more hesitant behaviour to date is creating additional inflationary pressure in the form of a weak euro and thus higher import prices. Even in anticipation of interest rate increases by the ECB and slowing economic momentum, the inflation rate will not fall below 2% again until mid-2024.

Germany
A series of disappointments

GDP growth

Swiss Life Asset Managers	Consensus
2022: 1.8%	2022: 1.8%
2023: 2.0%	2023: 2.1%

We are looking in vain for a positive surprise among last month's German economic data. Retail sales plunged massively in April and industrial production grew less than expected. The expectations in the ifo survey were unable to continue their slight recovery from the previous month. The Purchasing Managers' Index for June was also consistently disappointing. While it remained in the growth zone for both manufacturing and service providers, it slowed more sharply than expected. What is particularly worrying is the further slump in industrial new orders to its lowest level since 2020. Incoming business for service providers is now also below the growth mark. However, this may be due to a normalisation of momentum after the reopening. Meanwhile, price pressure remains high, although some easing is visible. The situation regarding delivery deadlines also continued to ease overall. However, in response to reduced gas supplies from Russia, Federal Minister for Economic Affairs Habeck activated emergency level two out of three, and believes that the replenishment of gas stores before the winter months is at risk. A further worsening of the gas situation remains the biggest recession risk in Germany.

Inflation

Swiss Life Asset Managers	Consensus
2022: 7.0%	2022: 6.9%
2023: 3.4%	2023: 3.4%

The June inflation data for Germany will not be released until after our editorial deadline. The consensus expects a further rise to 8.0%, close to our forecast of 8.1%. Energy prices will continue to pose a significant upside risk in the following months as Russian gas supplies decline. Without being specific, Habeck promised relief for households that will suffer from the inevitable increase in heating costs.

France
Increasingly gloomy mood

GDP growth

Swiss Life Asset Managers	Consensus
2022: 2.5%	2022: 2.5%
2023: 1.4%	2023: 1.6%

Over the past month, most newly published data pointed to a further slowdown in economic momentum. Consumer sentiment fell in June to its lowest level since 2013. The current uncertainty thus exceeds the pessimism during the lockdown or at the height of the "gilets jaunes" protests. Maintaining purchasing power is at the top of the household agenda, and the pressure on employers and politicians to meet wage demands will increase accordingly. This picture fits in with the geopolitical uncertainty and possibly also with the stalemate following the general elections, which did not produce a clear majority. Nevertheless, it remains important to distinguish between sentiment and the actual situation when assessing the economic conditions. For example, the labour market situation is currently far rosier than consumer confidence would suggest. The unemployment rate is currently the lowest it has been in the last 20 years. Surveys in the manufacturing sector also show that companies have recently become more optimistic about the business performance of their own companies. Furthermore, the outlook for France's tourism industry is currently positive. In this light, fears of a recession seem premature.

Inflation

Swiss Life Asset Managers	Consensus
2022: 4.7%	2022: 5.0%
2023: 2.6%	2023: 2.6%

Unfortunately, the June inflation figures were not yet available when this document was finalised. However, it can be assumed that the inflation rate will have risen again. Service providers are still in a position to enforce their increased price setting power. In addition, data from the European Commission show that fuel prices increased again by 11% in June compared to the previous month.

United Kingdom
Emerging recession?

GDP growth

Swiss Life Asset Managers	Consensus
2022: 3.5%	2022: 3.5%
2023: 0.4%	2023: 0.8%

In the UK, too, investors' concerns are growing about an approaching recession. The Bank of England is tightening monetary policy and record inflation is gnawing at the purchasing power of consumers, who are consuming fewer and fewer goods, at least in the retail sector. Real (i.e. price-adjusted) retail sales have been falling almost continuously since their April 2021 peak. Combined with an overall decline in industrial production since the start of 2022, we expect GDP to have contracted in the second quarter for the first time since the pandemic. Whether the rise in the unemployment rate in April also signals a trend reversal remains to be seen. Interestingly, according to the GfK consumer sentiment survey, the latest survey's assessment of job security has improved slightly, and the unions are more combative than they have been in years. The rather bleak economic signs are in stark contrast to the still-constructive corporate survey data: In the UK, the manufacturing Purchasing Managers' Indices (PMI) held up much better than on the continent, and the PMIs for service providers showed no signs of deterioration. Nevertheless, we still expect a significant slowdown in economic activity and a slight recession in 2023.

Inflation

Swiss Life Asset Managers	Consensus
2022: 8.1%	2022: 8.5%
2023: 4.9%	2023: 5.2%

Inflation rose marginally in May from 9.0% to 9.1%, with core inflation slowing slightly for the first time since last September (down from 6.2% in April to 5.9% in May). However, it is too early to give the all-clear, as inflation dynamics have shifted from goods prices, which are subject to strong global influence, to services. This domestically oriented sector is where monetary policy works best, encouraging the Bank of England to continue raising interest rates despite the recession risks.

Switzerland
No fear of a strong franc

GDP growth

Swiss Life Asset Managers	Consensus
2022: 2.5%	2022: 2.5%
2023: 1.2%	2023: 1.6%

Economic momentum is still hardly being affected by the war in Ukraine. SECO's index of weekly economic activity has been on a steady upward trend since April, and employment is reaching new heights. Following a downward revision in March, we are leaving our 2022 GDP growth forecast unchanged for the fourth consecutive time. However, we still expect a cooldown, which is reflected in a forecast for 2023 that is significantly more cautious than the consensus. With the exception of the European Central Bank and the Bank of Japan, all central banks have begun tightening financial conditions. This reduces demand for export goods from Swiss manufacturers. Export prospects are also clouded by the fact that the Swiss National Bank (SNB) is no longer shielding the domestic currency against appreciation. The development of the domestic economy will be increasingly heterogeneous. Demand for services remains strong, not least due to the need to catch up after two years of limited opportunities. Consumer demand is also being supported by the robust state of the labour market. In contrast, the rise in financing costs has led to a decline in construction activity and companies' propensity to invest.

Inflation

Swiss Life Asset Managers	Consensus
2022: 2.4%	2022: 2.3%
2023: 1.3%	2023: 1.2%

In addition to the discontinuation of the negative interest rate policy, the SNB can reduce inflationary pressure by increasing its tolerance for an appreciation of the Swiss franc. According to some models, especially those based on producer prices purchasing power parity, the Swiss franc is currently significantly undervalued. A quarter of the Swiss Consumer Price Index consists of import prices. Therefore, the effect of lower import prices on inflation may be significant.

Japan
Please open up

GDP growth

Swiss Life Asset Managers	Consensus
2022: 1.5%	2022: 1.7%
2023: 1.6%	2023: 1.9%

The Japanese government recently increased its cap on inbound travel to 20 000 people per day (compared to 3500 in March). As a result, tourism is likely to gain some momentum again, even if part of the higher quota is for returning Japanese people and foreign workers. Public pressure for opening is increasing, not only for tourism, but also for the reopening of nuclear reactors ten years after the Fukushima disaster. According to a Nikkei survey, 49% of respondents said that the current entry restrictions are too strict. The same poll shows that 53% support the reopening of nuclear reactors due to higher energy prices and fears of energy shortages. However, both the complete lifting of the entry restrictions and a rapid re-commissioning of most reactors remain unlikely. Nevertheless, contrary to trends in other Western economies, the services Purchasing Managers' Index (PMI) recovered further, and orders remained robust. Momentum in the manufacturing sector slowed less than elsewhere according to purchasing managers, with the PMI falling from 53.3 to 52.7. However, order intake fell slightly below the 50 mark. Japan, too, is unable to completely escape the global slowdown.

Inflation

Swiss Life Asset Managers	Consensus
2022: 2.0%	2022: 1.9%
2023: 1.0%	2023: 1.2%

As expected, headline inflation in Japan remained at 2.5% in May, while core inflation remained at 2.1%. Food prices continued to rise, while political interventions continue to curb energy prices. While the weakness of the yen continues and thus remains a positive driver of inflation, new subsidies in the tourism sector could lead to lower inflation in the summer.

China
A bumpy road to recovery

GDP growth

Swiss Life Asset Managers	Consensus
2022: 4.3%	2022: 4.3%
2023: 5.2%	2023: 5.2%

After the two-month lockdown in Shanghai that ended at the beginning of June, China's economy is on the road to recovery. High-frequency data for June point to a significant improvement in economic performance. By mid-June, the daily congestion index in the country's five largest cities had returned to pre-lockdown levels, suggesting a considerable improvement in the mobility situation. In addition, daily real estate transactions started to pick up in the battered real estate sector, although they are still below last year's level. Consumption remains last in terms of recovery. Daily car sales picked up slightly, but remain well below the long-term average. This shows that consumers are concerned about the prospects of the economy and are reluctant to make any major purchases. One reason for this reluctance is China's zero-Covid strategy. The reopening of Shanghai, for instance, involves a number of containment measures. In addition to various locations such as restaurants that remain closed, districts will be closed off again in the event of positive Covid cases. For as long as the zero-Covid approach remains in place, the road to economic recovery will be a bumpy one.

Inflation

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

China's inflation rate remained stable in May at a modest 2.1% compared with the previous month. Core inflation and services inflation in particular were very low at 0.9% and 0.7% respectively, reflecting weak demand as the lockdown measures in Shanghai extended into May.

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