Perspectives
Economics

SwissLife
Asset Managers

October 2022

Key messages

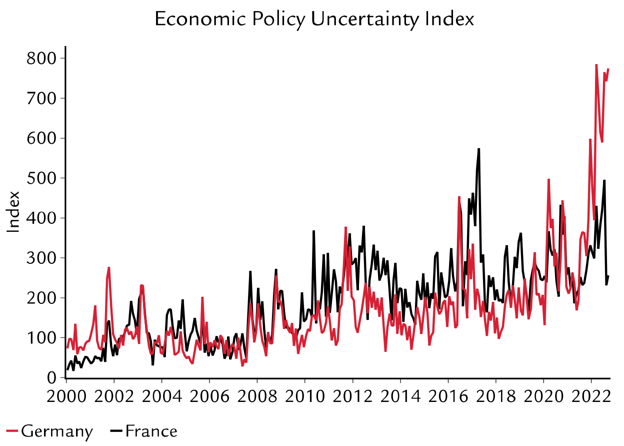
- Eurozone: winter recession now inevitable following shutdown of Nord Stream 1, inflation continues to rise
- US: further interest rate hikes necessary despite economic slowdown and declining inflation
- China: lower GDP forecast 2023 despite possible small easing measures following the October party congress

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	1.6%	1.7%	0.4% ↓	0.5% ↓	8.1% ↓	8.0% ↓	3.9%	3.8%
Eurozone	3.0%	2.9% ↑	0.4% ↓	0.2% ↓	8.1% ↑	8.2% ↑	5.0% ↑	5.4% ↑
Germany	1.6%	1.4% ↓	-0.6% ↓	-0.7% ↓	7.7%	7.8% ↑	5.6% ↑	5.8% ↑
France	2.4%	2.5% ↑	0.3% ↓	0.6% ↓	5.4%	5.5%	3.5%	3.6% ↑
UK	3.5%	3.4%	-0.1% ↓	-0.3% ↓	8.7% ↓	9.2% ↑	5.8% ↓	7.0% ↑
Switzerland	2.2% ↓	2.3% ↓	0.9% ↓	0.8% ↓	2.9% ↑	2.9% ↑	2.1% ↑	2.0% ↑
Japan	1.5% ↑	1.5% ↑	1.4%	1.5% ↓	2.2% ↑	2.2% ↑	1.5% ↑	1.4%
China	3.3%	3.3% ↓	5.1% ↓	5.0% ↓	2.2%	2.3% ↓	2.0%	2.3% ↓

Arrows indicate change from previous month
Source: Consensus Economics Inc. London, 12 September 2022

Chart of the month



Sources: www.policyuncertainty.com, Macrobond, Swiss Life Asset Managers

The war in Ukraine, persistently high inflation rates and signs of imminent recession are all contributing to elevated uncertainty. However, there is a marked difference in perception of the economic crisis within Europe. The indices shown in the chart measure how often terms such as crisis or risk are used in economic reporting. While crisis sentiment is exceptionally high in Germany, uncertainty among our French neighbours is (still) lower than, for example, during Brexit or the 2017 presidential elections.

United States
Economy staying afloat

GDP growth	
Swiss Life Asset Managers	Consensus
2022: 1.6%	2022: 1.7%
2023: 0.4%	2023: 0.5%

Unlike Europe, the US is not experiencing an energy crisis – quite the contrary in fact. Gas exporters are benefiting from higher global market prices for liquefied gas, while households are benefiting most recently from lower gasoline prices, which have plunged by 25% since their peak in mid-June. This development has contributed to a slight recovery in consumer confidence since June and to lower household inflation expectations. Private consumption and the healthy labour market are still keeping the US economy afloat for the time being. The industrial sector is also solid, with purchasing managers reporting another improvement in order books in September. Nevertheless, the economic outlook for 2023 has deteriorated further. The US Federal Reserve has sharpened its rhetoric in the fight against inflation. The stock market slump and lower real wages are causing the savings rate to fall, and precisely now as interest rates are rising, more US households are taking out consumer loans. It remains to be seen whether the US will be able to benefit from relocations of energy-intensive industries from Europe in the future – an issue that is currently appearing in the media (but not yet in economic figures), but which is being hampered by a shortage of skilled workers as well as rising wage and finance costs in the US.

Inflation	
Swiss Life Asset Managers	Consensus
2022: 8.1%	2022: 8.0%
2023: 3.9%	2023: 3.8%

Following the pleasing July data, the August inflation figures surprised yet again on the upside. Core inflation, which excludes energy and food, rose from 5.9% to 6.3%. Petrol and airline tickets were the only categories to record significant price declines, the former combined with negative base effects bringing headline inflation down from 8.5% to 8.3%. Even though the peak in headline inflation is probably behind us, persistently elevated core inflation points to the need for further monetary policy action.

Eurozone
On the brink of recession

GDP growth	
Swiss Life Asset Managers	Consensus
2022: 3.0%	2022: 2.9%
2023: 0.4%	2023: 0.2%

The economic uncertainty shown on page 1 is no coincidence. Although the EU countries are likely to be able to replenish their gas storage capacities above the target levels in advance of the winter months, the risk of electricity shortages remains. An escalation of the war in Ukraine still cannot be ruled out. And on top of all this, the European Central Bank now appears to be serious about the normalisation of monetary policy. The available figures for the Purchasing Managers' Indices for the Eurozone were below 50 points for both manufacturing and services in September. Including this print, the Eurozone manufacturing sector has been contracting for three months in a row, while survey data for service providers has been in contraction territory since August. The Eurozone as a whole is thus at the start of a recession. Not all participating countries will be equally affected by this downturn. France, where inflation is affecting consumers' purchasing power less thanks to a high proportion of administratively set prices, is likely to get off lightly. By contrast, exporting economies whose industrial sectors are suffering from high energy prices are facing far stronger headwinds.

Inflation	
Swiss Life Asset Managers	Consensus
2022: 8.1%	2022: 8.2%
2023: 5.0%	2023: 5.4%

In contrast to the US, the peak of the inflation cycle has not yet been reached in the Eurozone. The latest figures for producer prices show annual increases of over 40% for Germany and Spain. Although the European Central Bank cannot do anything about high energy prices, it would be well advised to tighten monetary policy further. This is the only way for long-term inflation expectations to return to normal in Europe, as in the US, and the only way in which second-round effects can be brought under control.

Germany
Sharp downturn

GDP growth

Swiss Life Asset Managers	Consensus
2022: 1.6%	2022: 1.4%
2023: -0.6%	2023: -0.7%

Now that gas deliveries via Nord Stream 1 have been officially halted, we are forced to revise our growth forecasts downwards again, especially for Germany, and to forecast a significant winter recession. Recession fears are clearly evident in all the September survey data. Purchasing Managers' Indices (PMI) hint at decreasing order intake for both manufacturing and service providers. The sub-indices on future business development fell sharply in both sectors. According to the ifo Institute's survey too, business expectations fell considerably in all industries and are now close to the lows seen during the pandemic. Consumer confidence, which is already at a record low, is likely to deteriorate further. If there is one positive message in this environment, it would be that gas storage levels are continuing to rise and now exceed 90%. In addition, the manufacturing sector in particular had already reduced its gas demand by almost 15% in the second quarter. The decisive factor now will be whether similar savings can also be made by households in the winter season. If so, Germany is likely to be spared the worst energy shortage scenarios.

Inflation

Swiss Life Asset Managers	Consensus
2022: 7.7%	2022: 7.8%
2023: 5.6%	2023: 5.8%

Despite the rapid cooling of the economy, inflation in Germany has not yet reached the peak at the August print of 7.9%. According to the PMI, price pressure increased again in September and the producer price index in August was 45% higher than the previous year – another record increase. Second-round effects from the higher energy prices are becoming increasingly apparent. Politicians are now discussing price caps on electricity and gas bills for households, but no specific proposals are on the table at the time of writing. We are therefore again revising our inflation forecasts upwards for 2023.

France
Support from service providers

GDP growth

Swiss Life Asset Managers	Consensus
2022: 2.4%	2022: 2.5%
2023: 0.3%	2023: 0.6%

France is also affected by the geopolitical uncertainty, even if the public does not yet appear to be as pessimistic as in Germany. A more favourable composition of gross domestic product and a willingness to maximise the fiscal room for manoeuvre have so far prevented business and consumer sentiment from collapsing as elsewhere. Companies are still prepared to create new jobs. In contrast to the Eurozone aggregate, France's services sector remains on an expansion trajectory according to the latest Purchasing Managers' Index. This sector is less affected by the high energy and financing costs than the industry. The energy debate in France is also being conducted in a different way to the rest of Europe, apart from the hotly disputed question of petrol prices. In France, any potential electricity shortage during the winter would be due to the breakdown of a large proportion of its nuclear power plants. Recent figures show that the nuclear power plants currently produce at less than 50% of their potential capacity. However, official statements from the responsible authorities indicate a return to production at around 90% of total capacity by the end of the year.

Inflation

Swiss Life Asset Managers	Consensus
2022: 5.4%	2022: 5.5%
2023: 3.5%	2023: 3.6%

In France, inflation surprised on the downside at 5.8% in August and thus remained lower than in the other major Eurozone economies. However, we do not believe that the inflation peak in France is behind us. Even if the elevated energy prices in France are having less impact on consumer prices, further rises are to be expected. We also expect core inflation to increase further. According to the Purchasing Managers' Index, price pressure has recently increased again for both industry and service providers.

UK
Vote of no confidence

GDP growth	
Swiss Life Asset Managers	Consensus
2022: 3.5%	2022: 3.4%
2023: -0.1%	2023: -0.3%

The mini-budget by the new British Chancellor Kwasi Kwarteng announced at the end of September has been punished by financial markets, with sterling collapsing and two-year government bond yields rising at record speed from 3.5% to 4.5% within two days. A mix of tax cuts completes the previously announced generous measures to address the rising energy costs and will trigger a massive increase in debt this fiscal year, from net GBP 162 bn (before the mini-budget) to GBP 234 bn (9.3% of GDP). In the short term, the freezing of energy costs for households should indeed support economic activity. However, this fiscal largesse may soon turn out to be counterproductive, as the additional inflationary pressure and the depreciation of the pound will force the central bank to apply the brakes even more abruptly. We therefore still anticipate a recession in the UK even after the latest political developments, and have revised the GDP forecast for 2023 down slightly to -0.1%. According to the latest survey of purchasing managers, UK industry is no more able to escape the global downturn than its peers on the mainland. The situation in the services sector was still somewhat better in September, but here too there is a threat of a slowdown following the rise in energy prices for households from October.

Inflation	
Swiss Life Asset Managers	Consensus
2022: 8.7%	2022: 9.2%
2023: 5.8%	2023: 7.0%

The new government under Liz Truss is freezing the energy price cap at GBP 2500 for a typical household – a measure that will last until 2024. As a result, the price cap will "only" rise by 27% instead of 80% in October 2022, which will entail a reduction of the inflation path in 2022 and above all in 2023. However, this does not change the fact that the UK will have the highest inflation rate among the major developed economies in 2023.

Switzerland
Emerging headwinds

GDP growth	
Swiss Life Asset Managers	Consensus
2022: 2.2%	2022: 2.3%
2023: 0.9%	2023: 0.8%

We are forced to undertake a significant downward revision of our assumptions regarding GDP growth for 2022. Switzerland, too, is unable to entirely avoid the economic headwinds sweeping across Europe. Consumers in Switzerland are also exposed to a loss of purchasing power and are cautious about their purchasing plans for consumer durables. Construction expenditure has been stagnating since the beginning of the year, and is likely to have a negative effect on GDP growth in the quarters ahead, given rising financing costs. Even if only a few voices have so far warned of the consequences of a marked appreciation of the Swiss franc, the export economy may well experience a noticeable drop in order intake. The situation is similar for tourism with regard to the coming winter season. Overall, the path has changed regarding the development of real gross domestic product in our baseline scenario: We now anticipate a slight decline in economic output for the first quarter of 2023, but we are still not expecting a recession as such. It is worth noting that in this baseline scenario we assume a guaranteed supply of electricity and gas over the winter months. In the worst-case scenario of an exacerbated shortage, Switzerland will be unable to avoid a recession.

Inflation	
Swiss Life Asset Managers	Consensus
2022: 2.9%	2022: 2.9%
2023: 2.1%	2023: 2.0%

Compared with other central banks in the developed economies, the Swiss National Bank (SNB) raised key interest rates much more sharply, measured against current inflation. On top of that, the SNB seems to be doing nothing about the current appreciation of the Swiss franc on the foreign exchange market either. We share the SNB leaders' confidence that inflation will soon have passed its peak.

Japan
On a shopping trip

GDP growth

Swiss Life Asset Managers	Consensus
2022: 1.5%	2022: 1.5%
2023: 1.4%	2023: 1.5%

The pandemic-related restrictions are now also falling in Japan, and the country will reopen its borders to mass tourism from 11 October. Before the pandemic, Japan recorded around 2.5 million arrivals each month, 85% from Asia and 5% each from the US and Europe. In August 2022 there were just under 170 000 visitors. The reopening should provide a boost to Japan's services sector. Optimism was already visible in the corresponding September Purchasing Managers' Index, which once again printed above the growth threshold of 50, pointing to a strong increase in new order intake. Thanks to the rapid depreciation of the yen since the beginning of the year, holidays in Japan are currently cheaper than they have been in a long time. The yen has depreciated 25% against the US dollar since January, and slightly more than 10% against the Chinese yuan. However, together with the already massive price increases for imported oil and gas, this depreciation is making imports even more expensive and thus creating a record-low trade balance. The Japanese Ministry of Finance recently sought to counteract this by buying yen for the first time since 1998. However, it is doubtful whether such interventions will sustainably support the currency as long as Japan's central bank maintains its ultra-loose interest rate policy while all other major Western central banks are rapidly raising their interest rates.

Inflation

Swiss Life Asset Managers	Consensus
2022: 2.2%	2022: 2.2%
2023: 1.5%	2023: 1.4%

A trip to Japan might now be worthwhile for American and European tourists, also thanks to lower inflation. However, inflationary pressure is also continuing to increase in Japan. Headline inflation and core inflation, which excludes fresh food and energy, rose to 3.0% and 1.6% respectively in August. The central bank continues to give a higher weighting to recession risks in its interest rate decisions.

China
On to the third term of office

GDP growth

Swiss Life Asset Managers	Consensus
2022: 3.3%	2022: 3.3%
2023: 5.1%	2023: 5.0%

On 16 October, the Congress of the Communist Party in China will take place – arguably the most important political event of the decade, providing important indications of changes in power relations as well as possible imminent changes of strategic direction. While it is a safe guess that Xi Jinping will be elected for a third term as the party's general secretary, the focus will be on potential changes in key economic positions, such as those of Premier Li Keqiang and economic tsar Liu He. It will also be interesting to watch for any changes to the Covid strategy. Up to this pivotal political event, China's priority has been to ensure stability and, in particular, to avoid a nationwide Covid outbreak at all costs. Once the congress is over, a gradual easing of the strict containment measures may be possible. However, given the still-low vaccination rate among the vulnerable population, an immediate reversal of the zero-Covid strategy is unlikely in the next few months. Accordingly, we expect the pandemic and the associated containment measures to impact China's economy until at least the second quarter of next year, and are lowering our growth forecast for 2023 to 5.1%.

Inflation

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

China's August inflation rate eased to 2.5% from 2.7%. Lower food and energy prices were two of the drivers. However, core inflation, which excludes the volatile food and energy prices, also remained at a very low level of 0.8%. This indicates the continuing uncertainty among the population due to the Covid strategy, which is weighing on consumption.

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