Perspectives
Economics

August 2023

Key takeaways

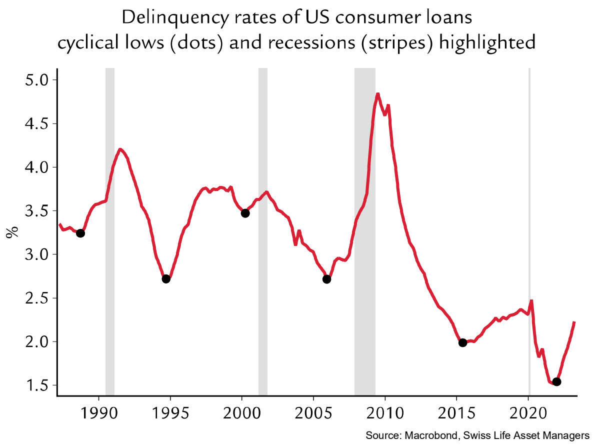
- USA: Early warning indicators continue to point to an economic slowdown
- Eurozone: Despite falling inflation, it is still too early for the ECB to give the all-clear
- China: After weak growth in the second quarter, the hoped-for stimulus package has failed to materialise

Comparison of forecasts

	2023 GDP growth		2024 GDP growth		2023 inflation		2024 inflation	
	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus
USA	1.5% ↑	1.6% ↑	0.1% ↓	0.5%	4.0% ↓	4.1%	2.5%	2.6%
Eurozone	0.4%	0.5% ↓	0.8%	0.9%	5.5%	5.4%	2.4%	2.4%
Germany	-0.2%	-0.3% ↓	0.6%	1.1%	6.0%	5.9% ↓	2.3%	2.6% ↑
France	0.5% ↓	0.6%	0.9%	0.9%	4.8%	5.1% ↓	2.1%	2.5% ↓
Italy	1.1%	1.1% ↑	0.6%	0.8%	6.1%	6.1%	2.1%	2.5%
Spain	1.8%	2.1% ↑	1.2%	1.5%	3.5% ↓	3.6% ↓	2.2% ↓	2.9%
UK	0.0%	0.1%	0.4%	0.4% ↓	7.6% ↑	7.4% ↑	2.9% ↑	3.2%
Switzerland	0.7%	0.8% ↑	1.3% ↓	1.4%	2.1%	2.3% ↓	1.6%	1.5% ↑
Japan	1.2%	1.2% ↑	0.7%	1.0%	2.7%	2.9% ↑	1.2%	1.7% ↑
China	5.1% ↓	5.5% ↓	4.9% ↓	4.8% ↓	0.7% ↓	1.0% ↓	1.5% ↓	2.1% ↓

Arrows indicate change from previous month. Source: Consensus Economics Inc. London, 10 July 2023

Chart of the month



A recession will only begin in the US when private consumption, which has been robust to date, cools. While leading indicators from industry and the housing market have been on red for some time, the problem with consumption is that many indicators do not turn until the recession has already begun. Probably the best leading indicator is consumer credit delinquencies, which have in the past spiked up one to two years before the onset of a recession. Since October 2021, credit delinquencies have been increasing from low levels. We therefore expect higher interest rates and tighter credit standards to increasingly act as a drag on consumption as well.

USA
Illusion of a soft landing

GDP growth	
Swiss Life Asset Managers	Consensus
2023: 1.5%	2023: 1.6%
2024: 0.1%	2024: 0.5%

The latest US economic data showed a robust mid-year picture, while inflation continued to decline in June. This has fuelled the idea on the financial markets that an end to key interest rate hikes and even a "soft landing" of the economy are imminent. While the former is in line with our expectations, we think the latter is unlikely. In the current environment, we understand a "soft landing" as a re-acceleration of growth while inflation continues to fall. This combination would probably only be conceivable for a very short period of time, as a new surge in demand would soon lead to higher inflation again. However, the slightly better-than-expected incoming data suggests that it will probably take longer for the full braking effect of interest rate hikes to be felt, especially in the services sector and the labour market. Yet, most early warning indicators still suggest that a slowdown is imminent, be it the inverse US yield curve, falling road and rail-based freight transport, higher credit defaults (see "chart of the month"), declining housing market transactions or a drop in temporary work. We have therefore postponed the expected economic weakness somewhat, which explains the higher growth forecast for 2023 and the lower growth forecast for 2024.

Inflation	
Swiss Life Asset Managers	Consensus
2023: 4.0%	2023: 4.1%
2024: 2.5%	2024: 2.6%

Headline and core inflation fell more sharply than expected in June, to 3.0% and 4.8% respectively. However, the fall in inflation could be more broad-based; inflation in the middle item in the inflation distribution (median) was still 6.4% in June. In particular, falling prices for flights, hotels and rental cars contributed to lower inflation compared to the previous month. As energy base effects are now coming to an end, headline inflation is set to remain at 3% until year-end despite a further decline in core inflation.

Eurozone
Is the ECB going too far?

GDP growth	
Swiss Life Asset Managers	Consensus
2023: 0.4%	2023: 0.5%
2024: 0.8%	2024: 0.9%

Eurozone inflation fell from 6.1% to 5.5% in June and was thus slightly below expectations. At the same time, most economic indicators have disappointed in recent weeks. Nevertheless, the ECB recently showed its determination to hike interest rates at least one more time, and even revised its medium-term inflation forecast upwards. This raised fears that the ECB might go too far with its monetary policy tightening. It would not be the first time in history that the ECB would have to reverse its interest rate hikes very quickly. We currently see two scenarios in which this would be the case. Firstly, if, contrary to our expectations, the interest rate hikes that have already taken place cause a delayed, very deep economic crisis in which inflation would also very quickly fall below the central bank target. We attribute a probability of around 20% to such a scenario. However, we consider continued weak growth and stubborn inflation to be much more likely (65%). Economic indicators provide mixed signals: industry is weak, but not as weak as the survey data suggested; consumer sentiment remains depressed but has brightened since the winter lows; and the labour market remains robust, even if high frequency indicators have turned on high levels.

Inflation	
Swiss Life Asset Managers	Consensus
2023: 5.5%	2023: 5.4%
2024: 2.4%	2024: 2.4%

Secondly, an ECB policy error would occur if inflation, especially in the services sector, turned out to be driven mainly by external factors after all and thus fell faster than expected after the normalisation of supply chains and the decline in energy prices, and independently of monetary policy. This would mean that the ECB would have raised interest rates too much during an economically weak period. Still-elevated core and services inflation as well as resilient labour markets militate against this in our view.

Germany
New China strategy

GDP growth	
Swiss Life Asset Managers	Consensus
2023: -0.2%	2023: -0.3%
2024: 0.6%	2024: 1.1%

German industry is weak. Industrial production fell again in May, which means that overall it is likely to contribute negatively to growth in the second quarter. According to a survey by the European Commission, German companies have rated their competitive position outside the EU as the worst since autumn 2022, and significantly worse than companies in the other major eurozone countries. The still elevated energy prices are likely to be a major reason for this. The China strategy published by the German government for the first time in mid-July also shows that Germany is increasingly concerned about asymmetric relations with China. As the fourth-largest export destination and the largest import destination, China remains Germany's most important individual trading partner overall. The new strategy focuses on reducing dependencies in key areas and mitigating risks, for example in the area of cybersecurity. Germany is thus taking a more critical tone towards China, albeit nowhere near as critical as that of the US. The strategy underlines the global trend towards more diversified trade relations, which are increasingly focusing on additional sales and production markets alongside China.

Inflation	
Swiss Life Asset Managers	Consensus
2023: 6.0%	2023: 5.9%
2024: 2.3%	2024: 2.6%

The renewed rise in annual inflation to 6.4% in June was predictable due to base effects. However, seasonally adjusted monthly price changes show that price pressure remains elevated in both the services sector and for core goods. Although aggregate producer prices have been declining monthly since October 2022, the decline did not start until April 2023 if energy goods are excluded. Price pressure for core goods is therefore only likely to be dampened with a time lag.

France
Quieter tones

GDP growth	
Swiss Life Asset Managers	Consensus
2023: 0.5%	2023: 0.6%
2024: 0.9%	2024: 0.9%

Suddenly things seem to have gone quiet in France: President Macron has been shying away from the public for weeks despite the considerable need for explanations since the pension reform and especially after the youth riots. The expected government reshuffle also turned out to be a marginal correction. With the beginning of the summer holidays, the economic indicators have sounded softer on a broad front, and here and there the first minor key notes can even be heard. This is particularly true for the manufacturing sector, where preliminary readings for the Purchasing Managers' Index (PMI) for manufacturing for the month of July indicate a further slowdown in momentum. Compared to the previous month, industrial firms reported a continued decline in order intake. This is consistent with a separate survey by the INSEE statistical office, according to which the companies surveyed are as cautious about the outlook for the future production of their own operations as in November 2020. The pace is also slowing down for service companies. According to the Purchasing Managers' Index for the sector, the business situation has also deteriorated over the past two months. As the economic engine becomes ever quieter, there are growing calls in France for the ECB to stop monetary policy tightening immediately.

Inflation	
Swiss Life Asset Managers	Consensus
2023: 4.8%	2023: 5.1%
2024: 2.1%	2024: 2.5%

According to the Banque de France, more and more companies are lowering their selling prices. The same conclusion can be seen in the purchasing managers' surveys in the manufacturing and services sectors. In addition, consumers' and investors' inflation expectations in inflation-protected government bonds have also been declining recently. This development confirms our expectations. We anticipate a fall in inflation from the current 4.5% to around 2.5% in the final quarter of 2023.

Italy
Increased trust

Italy has not only seen surprisingly positive economic growth recently but has also gained trust on the financial markets. In March 2023, the European Central Bank started to just partially replace maturing government bonds in order to reduce its balance sheet. As a result, the ECB was no longer a marginal buyer of Italian government bonds, and there was widespread concern that risk premiums on Italian government bonds might widen. However, demand from domestic and foreign investors appears intact; the yield spread to 10-year German government bonds has even fallen by around 0.8 percentage points since the start of the year. This is key to the sustainability of the debt situation. Even if interest rates remain at 4% and Italy achieves nominal economic growth of 3% in the medium term (1% real growth plus 2% inflation), a return from current budget deficits to primary surpluses, which were +1.3% before the pandemic (average 2010–2019) is necessary to stabilise the debt ratio. However, such fiscal consolidation is currently not foreseeable.

Spain
Increased political uncertainty

The early elections in Spain on 23 July 2023 delivered a surprisingly unclear result. The polls had previously seen the right-wing coalition of the centre-right Partido Popular (PP) and the far-right party Vox as being clearly ahead. However, the election results show that neither the right-wing nor the left-wing coalition of incumbent President Pedro Sanchez won a majority. Although the PP has gained significantly in terms of seats and is now the strongest party, Vox has lost a significant number of seats. The result makes building a government more difficult and throws Spain into a period of political insecurity. Possible ways out of this situation are, on the one hand, a repeat of the election, as was the case in 2019. A left-wing government of the incumbent PSOE and Sumar together with smaller parties would also be conceivable in order to obtain a majority, but this could be difficult. A minority government of the PP with or without Vox would be another possibility.

Switzerland
Stuttering economy

GDP growth

Swiss Life Asset Managers	Consensus
2023: 0.7%	2023: 0.8%
2024: 1.3%	2024: 1.4%

What has been reflected in the Purchasing Managers' Indices (PMI) figures for manufacturing in all developed countries for months is now becoming apparent in the reporting on the business performance of particularly export-oriented Swiss companies. Order intake suggests a decline in production for the second half of the year. In the highly cyclical sectors, our base case scenario of a mild recession has now materialised. Growth in the economy as a whole is being supported for the time being by Swiss households' appetite for consumption and by continued population growth. Nevertheless, the high-frequency index of weekly economic activity published by the State Secretariat for Economic Affairs (SECO) should accurately reflect the current state of the Swiss economy: this indicator has been stagnating since mid-May. With the downward revision of our 2024 forecast, our expectations for GDP growth for both years are slightly below the consensus estimate. As with the European Central Bank, the Swiss National Bank must accept an increased risk of recession in the event of continued interest rate hikes.

Inflation

Swiss Life Asset Managers	Consensus
2023: 2.1%	2023: 2.3%
2024: 1.6%	2024: 1.5%

For the third quarter, the strong franc and further easing of price pressure at producer level point to a further decline in inflation rates at consumer level. Annual inflation should be below 1.5% by October. In the short term, higher energy prices pose a forecast risk. Heating oil currently costs the end user around 7% more than in June. The fall in inflation rates in the winter months will be definitively halted. Then higher rents, the increase in the VAT rate, rising electricity prices and tariff adjustments at the post office and public transport will cause inflation rates to rise again. We expect a new high of 2% in September 2024.

UK
Wage growth remains high

GDP growth	
Swiss Life Asset Managers	Consensus
2023: 0.0%	2023: 0.1%
2024: 0.4%	2024: 0.4%

Monthly GDP growth for May was stronger than expected at -0.1% compared with the previous month, although the additional national holiday to celebrate the coronation of King Charles put pressure on economic activity. The most negative contributor was industrial production, which continued to weaken in May. However, the decline was mainly driven by the volatile electricity and gas sector. The services sector showed no growth in May. However, the labour market remains largely robust. Wage growth also remains high and rose again in May. This is not good news for the Bank of England as inflationary pressure could remain elevated. However, there are initial signs that the labour market is cooling somewhat, albeit very slowly. The unemployment rate rose more strongly than expected again in May. While demand for labour remains high, vacancies are falling slightly. The employment components of the Purchasing Managers' Indices for both the manufacturing and services sectors also fell further in July. For the services sector, however, it is still above the growth threshold of 50. It is likely to take some time before these effects lead to lower wage growth, thus cooling inflationary pressures somewhat. In general, we still do not expect any growth this year.

Inflation	
Swiss Life Asset Managers	Consensus
2023: 7.6%	2023: 7.4%
2024: 2.9%	2024: 3.2%

After months of upside surprises, June inflation finally came in lower than expected, dropping to 7.9% year-on-year from 8.2% in May. The decline in petrol prices had the biggest negative impact, although food price inflation was also slightly lower than in the previous month. The drop in core inflation was also stronger than expected in June. However, services inflation remains significantly more stubborn than goods price inflation.

China
Waiting for stimulus

GDP growth	
Swiss Life Asset Managers	Consensus
2023: 5.1%	2023: 5.5%
2024: 4.9%	2024: 4.8%

What the economic data for April and May had already hinted at has now been confirmed with the release of official second-quarter GDP data. Chinese economic growth slowed significantly in the second quarter and was even lower than expected at 0.8% compared to the previous quarter. In June, industrial production still grew faster than expected. Retail sales growth, on the other hand, fell year-on-year from 12.7% in May to 3.1% in June. However, the strong decline is still explained by last year's lockdown measures. The real estate sector also remains weak. All the relevant indicators such as sales, project starts and completions declined significantly in June. Foreign trade also remains a further weakness in China's economic recovery. Hopes for economic support rested on a significant stimulus package from the government. The July meeting of the Communist Party's Politburo was eagerly awaited as it sets the economic policy agenda for the rest of the year. However, as expected, the announcement of a major stimulus package failed to materialise. Instead, smaller measures have been planned but are unlikely to have a significant effect on economic growth.

Inflation	
Swiss Life Asset Managers	Consensus
2023: 0.7%	2023: 1.0%
2024: 1.5%	2024: 2.1%

The fact that the Chinese economy did not overheat is still reflected in inflation data. Consumer price inflation in June was again lower than expected, amounting to 0.0% year-on-year. Producer price inflation continued to slide into deflationary territory and stood at -5.4% year-on-year, the lowest level since 2015.

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Consensus Economics
Forecast Accuracy Award Winner
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