Perspectives

Economics

February 2020

Key messages

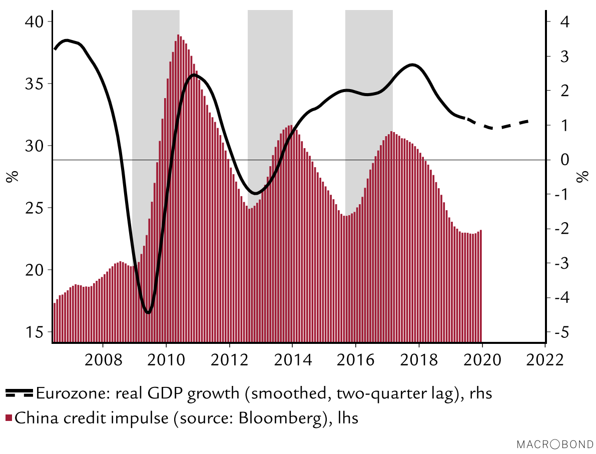
- Coronavirus outbreak: too early to assess the magnitude of economic repercussions
- Only temporary rise in headline inflation in the Eurozone
- Tentative signs of improving dynamics in Switzerland's manufacturing sectors

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%	1.9% ↑	1.8%	1.9%	2.2% ↑	2.1% ↑	2.1%	2.1%
Eurozone	0.9%	1.0%	1.1%	1.2%	1.2%	1.3% ↑	1.4% ↑	1.4%
Germany	0.6%	0.9%	1.1%	1.0%	1.2% ↓	1.5% ↑	1.4%	1.5%
France	1.0%	1.2%	1.1%	1.2%	1.4% ↑	1.2%	1.4%	1.3%
UK	1.1% ↓	1.1%	1.3%	1.4%	1.5% ↓	1.7% ↓	1.8% ↓	1.9%
Switzerland	1.3%	1.3% ↑	1.2%	1.3%	0.1% ↑	0.3%	0.6%	0.7%
Japan	0.3%	0.4% ↑	0.6%	0.8%	0.6% ↑	0.6%	0.3%	0.6%
China	5.9% ↑	5.9% ↑	5.6%	5.7%	3.4% ↓	3.1% ↑	2.0%	2.2%

Arrows indicate difference from previous month
Source: Consensus Economics Inc. London, 13 January 2020

Chart of the month



China's vast stimulus programs managed to kick-start growth in the Eurozone three times since the global financial crisis in 2008. Especially Europe's largest economy was supported by China's rising demand for German cars and engineering tools. These days, China's growth engine has started to splutter. Policy makers are emphasising growth quality over quantity and are ready to tolerate a gradual slowdown of the economy. Hence, in contrast to the past downturns, we do not expect Eurozone economic activity to be lifted by a substantial credit boost in China this year.

US
Boeing woes

GDP growth

Swiss Life Asset Managers	Consensus
2020: 1.7 %	2020: 1.9 %
2021: 1.8 %	2021: 1.9 %

The US economy ended 2019 on a soft note. Even though retail sales were solid in December, weakness in earlier months suggests that quarterly sales growth receded. Industrial production showed an outright drop in the fourth quarter while business inventories declined as well. On the positive side, housing starts jumped in December, reflecting a general improvement in the housing market but also favourable weather conditions. While activity data implies a slowdown of GDP growth in the fourth quarter, a decline in imports should compensate for the negative impact. Imports probably dropped in anticipation of a trade deal, which gave companies an incentive to shift imports into the new year. Prospects for first-quarter growth are thus muted, not least because of the production stop of the Boeing 737 MAX in January. In 2019, the problems at Boeing only had an impact on the composition of GDP, but not on total output, as Boeing still produced 42 737 MAX planes on average per month. As most of these were not delivered, business investment in aircrafts dropped, while inventories increased. The production stop will reduce first-quarter GDP growth by around 20 basis points (non-annualised), but effects on the labour market should be muted as Boeing workers are not furloughed. It is unclear when production will resume, but Boeing guided that this should be the case before mid-2020.

Inflation

Swiss Life Asset Managers	Consensus
2020: 2.2 %	2020: 2.1 %
2021: 2.1 %	2021: 2.1 %

Headline inflation for December came in somewhat higher than we had anticipated. Boosted by energy price base effects, we expect inflation to peak in January and February at around 2.5% before receding again. Domestic inflationary pressure appears contained as wage growth is levelling off, and we thus expect core inflation to remain in a 2.0–2.3% range throughout 2020.

Eurozone
Fiscal room to manoeuvre

GDP growth

Swiss Life Asset Managers	Consensus
2020: 0.9 %	2020: 1.0 %
2021: 1.1 %	2021: 1.2 %

Incoming data since the start of the year confirm our view that economic conditions in Europe's industrial sectors have stabilised. Orders intake reported by manufacturing companies are trending up according to the Markit Purchasing Managers' Indices. Demand from outside the Eurozone is improving as the risk of a further escalation of the trade conflict between the US and China seems contained for the time being. Following a soft patch in the fourth quarter of 2019, we expect the quarterly growth pace to recover to 0.25% in the first three months of the current year. Our full-year growth forecasts are slightly below the consensus estimate for 2020 and 2021 as we expect spill-overs from earlier weakness in the export-oriented manufacturing sectors to weigh on domestically oriented services industries. As the growth impulse stemming from emerging markets is unlikely to be as important as during the last three recovery periods in 2009, 2013 and 2016, Europe needs to find ways to support domestic demand. In our view, the fiscal room to manoeuvre is ample given the low interest rate environment provided by monetary policy of the past 10 years. While France enjoyed a frontloaded positive fiscal impulse in 2019, the IMF anticipates a notable fiscal impulse for countries like Germany, the Netherlands, Belgium or Austria to materialise in 2020.

Inflation

Swiss Life Asset Managers	Consensus
2020: 1.2 %	2020: 1.3 %
2021: 1.4 %	2021: 1.4 %

Growth dynamics over the coming two years are insufficient to exert upward pressure on inflation. Only seven member states with a weight of just 11% of the Eurozone's GDP currently report inflation rates of 1.8% or above. Even if heavyweights Germany and France join this club in the first quarter 2020, this is only temporary. Wage growth, the most important trigger for a sustainable acceleration in domestic inflation pressures, has started to moderate as of late.

Germany
After the rain comes the… fog

GDP growth	
Swiss Life Asset Managers	Consensus
2020: 0.6 %	2020: 0.9 %
2021: 1.1 %	2021: 1.0 %

According to the German federal statistics office, GDP grew by a meager 0.6% in 2019, the weakest expansion since 2013. GDP estimates for the fourth quarter 2019 will only be published by mid-February. However, the first yearly growth estimate as well as November data on Germany's industrial sector confirm our call for caution. While the 1.1% increase in November industrial production compared to October points to a stabilisation, a further and unexpected fall in factory orders by 1.3% dashes hopes of a faster recovery. Likewise, November exports were weaker than expected with exports of cars and car parts declining again. Going into 2020, survey data hint at a bottoming out in manufacturing sentiment, in line with our expectations. At 45.5 points, the manufacturing Purchasing Managers' Index (PMI) remains well in contractionary territory, but an upward trend from its September low of 41.7 is now visible. The increase in January was driven by the forward-looking new orders component. Ifo survey results for the business climate in manufacturing confirmed that the storm is over. However, employment expectations continued their downward trend, proving that the sky has not yet cleared. Looking at the services sector, the Markit PMI increased further. Here, however, Ifo expectations moved into the opposite direction. We still expect the services sector to soften somewhat in 2020, due to less dynamic labour markets.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 1.2 %	2020: 1.5 %
2021: 1.4 %	2021: 1.5 %

December inflation came in at 1.5%, in line with our expectation. Overall, German inflation was weak in 2019, with an average inflation rate of 1.4%, compared to 1.9% in 2018. The weak year-end dynamics translate into a slightly lower inflation forecast for 2020. We expect inflation to reach its peak of 1.8% in the first quarter due to base effects from energy prices. Afterwards, we see fading inflationary pressure amid a softening labour market.

France
Riding its own cycle

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

The French economy rides on its own cycle. In 2019, France was comparably less affected by global headwinds, which triggered a massive contraction in certain manufacturing sectors elsewhere in Europe. Domestic demand in France remained firm, not least helped by generous fiscal policy. Yet, budget constraints set by the Maastricht criteria limit the potential for an additional fiscal boost in 2020. 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 short-term. The French services sector Purchasing Managers' Index continued to trend lower at the start of the year. Admittedly, it is difficult to assess how much of these moderating dynamics in the services industries is attributable to the strikes against the pension reform and are thus only temporary. The same must be said about consumer sentiment indicators and households' intentions to purchase large items. Consumer climate took a hit by end of last year and it remains to be seen whether sentiment recovers as quickly as it did in the first months of 2019 when the violent "Gilet Jaunes" protests abated. The coronavirus means an additional temporary risk given the importance of tourism and exports of luxury goods to Asia for the French economy. On a positive note, French airplane manufacturer Airbus may benefit from the problems affecting its competitor Boeing in the US.

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

Headline inflation rises owing to base effects from oil prices developments at the start of 2019. Temporarily, inflation is likely to rise to around 1.8% until February this year. Moderating pressure from energy prices and slower economic dynamics suggest that the February print will mark the cyclical peak in annual headline inflation. Inflation is expected to settle at around 1.4% over the coming quarters in our base case scenario.

UK
At a turning point?

GDP growth	
Swiss Life Asset Managers	Consensus
2020: 1.1 %	2020: 1.1 %
2021: 1.3 %	2021: 1.4 %

A depressing series of activity data releases for the fourth quarter confirmed that 2019 was a lost year for the UK. November GDP declined by 0.3% compared to the previous month, and dismal retail sales suggest that December did not yet bring the long-anticipated turnaround. In fact, retail sales volumes had been declining in the second half of 2019, which is extremely unusual outside recessions. Nevertheless, we expect that the worst in the UK is over. The strong appreciation of sterling since August 2019 likely weighed on growth, but this effect should dissipate going forward. Moreover, the December general elections cleared at least some of the political uncertainties, and the fiscal stimulus plans of the government should impact 2020 growth positively. The latest round of Purchasing Managers' Indices confirmed the turnaround in sentiment, especially in the services sector. On the manufacturing side, we keep a relatively cautious view, as we expect business investment to remain muted given the continued uncertainty around future UK-EU trade relations. Trade negotiations will kick off after the UK leaves the EU on 31 January, but we do not expect any swift progress as numerous stumbling blocks remain, ranging from issues such as financial services up until fishing rights.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 1.5 %	2020: 1.7 %
2021: 1.8 %	2021: 1.9 %

UK headline inflation surprised meaningfully to the downside in December, dropping to the lowest level in three years (1.3%). Both previous sterling appreciation and moderating wage growth likely played a role. Due to the lower starting point for this year, we downgraded the 2020 forecast significantly to 1.5% from 1.9% previously. Regarding core inflation, the drop in December should be short-lived. We expect core inflation to fluctuate in a 1.5–2.0% range in 2020, well within the Bank of England's comfort zone.

Switzerland
A recovery at risk

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

Geopolitical uncertainties and the resulting headwinds for the export-oriented manufacturers of mechanical and electrical goods start to spill over into services industries and more domestically oriented small and medium sized firms. Unemployment has begun to rise modestly in those regions and industries most affected by the earlier cooling of global trade. Real export volumes fell in the final quarter 2019 compared with the third quarter. On the positive side, manufacturers report a modest improvement in orders received. The research institute KOF's industrial survey shows that expectations of orders rose for three straight months until January 2020 and are now at their highest level since January 2019. Yet, this tentative recovery is at risk given the additional headwinds emerging from a marked appreciation of the Swiss franc and the coronavirus outbreak. The trade-weighted Swiss franc has appreciated by 1.1% year-to-date. Over the past twelve months, the Swiss franc strengthened by more than 5% to the euro. A strong franc weighs on the outlook for tourism and retailers facing competition from neighbouring countries. Meanwhile, it is too early to assess the impact of the coronavirus on economic activity. However, it is worth remembering that SARS was one of the triggers of a temporary recession in early 2003.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.1 %	2020: 0.3 %
2021: 0.6 %	2021: 0.7 %

Three important factors are currently exerting downward pressure on Switzerland's consumer price inflation. Firstly, the strengthening of the Swiss franc versus the US dollar and euro means falling import prices. Secondly, lower energy prices since the start of the year result in a negative contribution to monthly inflation both in January and February. And finally, rental costs as they enter the consumer price index are likely to moderate later in the year.

Japan
Tourism to take a hit

GDP growth	
Swiss Life Asset Managers	Consensus
2020: 0.3 %	2020: 0.4 %
2021: 0.6 %	2021: 0.8 %

We are getting more and more signs that the Japanese economy is digesting the October 2019 consumption tax hike far better than the previous hike in 2014, even when accounting for the fact that the 2019 tax hike was less steep and excluded various products. Looking through the volatility induced by the 2019 tax hike, the moderately positive consumption trend still seems to be intact. Also, the plunge of the services PMI (Purchasing Managers' Index) below the neutral 50 points mark was short-lived, with the index returning to a solid 52.1 reading in January. The outbreak of the coronavirus epidemic is, however, threatening the recovery in the services sector in the first quarter 2020. Chinese guests accounted for 30% of all tourism arrivals in Japan in 2019 and have become an important factor for retail spending as well. Chinese tourism arrivals will likely decline meaningfully in the first quarter and are thus adding to the soft patch in the sector following a huge drop in South Korean tourists last year, a result of Japanese-Korean political tensions. While it is too early to quantify the impact on the economy given the uncertainty at the time of writing, we feel comfortable with the fact that our 2020 GDP growth forecast is already on the cautious side compared to consensus expectations.

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

December headline inflation surprised to the upside, and we revised up our 2020 inflation forecast due to the higher starting point for this year. Core inflation, which excludes energy and fresh food, also moved higher in December (to 0.9%), reaching the highest level since early 2016. While the immediate impact of the consumption tax hike in October was extremely muted, it now appears that retailers are gradually passing on higher input costs to consumers, bringing some upside risks to our 2020 inflation forecasts.

China
Watch out for the coronavirus

GDP growth	
Swiss Life Asset Managers	Consensus
2020: 5.9 %	2020: 5.9 %
2021: 5.6 %	2021: 5.7 %

China's economy grew 6.1% in 2019, the lowest rate since 1990. However, December activity data point to a stabilisation in the manufacturing sector. Manufacturing investment and production rebounded and the slump in car sales is bottoming out. Moreover, after months of negotiations, the US and China finally signed a "phase one" trade deal. While the deal decreases the risk of an all-out trade war and therefore reduces uncertainty, which hampered investment decisions over the course of 2019, the scope of it remains very limited. US tariffs on a total of 360 bn USD of Chinese goods have not been eliminated and China's use of industrial subsidies has not been addressed. Also, the trade deal does nothing to restrict the US from using legal or political tools to try to constrain China's technological advance. A new significant risk to monitor is the outbreak of the coronavirus, with the potential to rapidly spread in the country as it is coinciding with the Chinese New Year festivities. At the outbreak of the SARS virus in 2003, retail sales plummeted, and China's second quarter GDP growth dropped to 9.1% from 11.1% previously. Given that consumption makes up a much larger share of China's economy nowadays, an outbreak of a pandemic could have severe economic implications.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 3.4 %	2020: 3.1 %
2021: 2.0 %	2021: 2.2 %

December inflation remained at an elevated level of 4.5%, unchanged from the month before. The stabilisation reflects surging energy prices, while pork price inflation – the main driver of the sharp pickup in inflation in 2019 – decelerated. We expect consumer price inflation to pick up in January due to higher food prices amid the Chinese New Year festivities. As the African Swine Fever created severe pork shortages, pork prices are likely to remain elevated before normalising in the second half of this year.

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