

May 2019

## Key messages

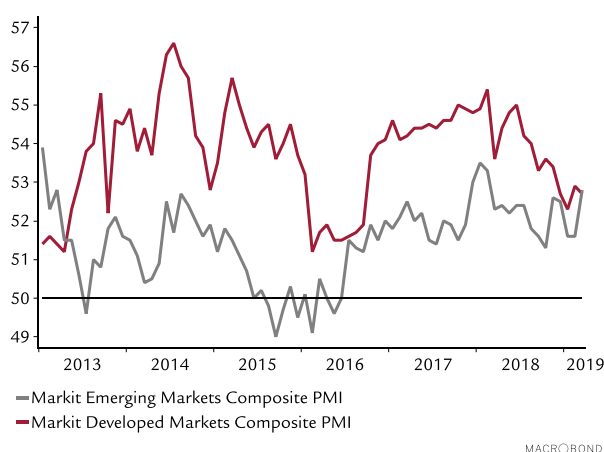
- The inversion of the US yield curve has hit the headlines, but we still deem recession risks to be low
- Data out of China suggest that the authorities' stimulus measures are now reaching the real economy
- Eurozone momentum has remained weak, but should recover amid improved external demand

## Comparison of forecasts

	GDP 2019		GDP 2020		CPI 2019		CPI 2020	
	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus
US	2.3%	2.4%	1.8% ↑	2.0%	1.9%	1.8%	2.2%	2.2%
Eurozone	1.1% ↓	1.1% ↓	1.2% ↑	1.3% ↓	1.4%	1.3%	1.6%	1.4% ↓
UK	1.3%	1.3%	1.3%	1.5%	1.9%	2.0%	2.0%	2.1%
Switzerland	1.0%	1.2% ↓	1.4%	1.5%	0.7% ↑	0.6%	0.8%	0.8% ↓
Japan	0.6% ↓	0.6% ↓	0.4%	0.5% ↑	0.7% ↓	0.6% ↓	1.1% ↓	1.0%
China	6.2%	6.2%	6.0%	6.1%	2.2%	2.1%	2.2%	2.1%

Arrows indicate difference from previous month  
Source: Consensus Economics Inc. London, 08 April 2019

## Chart of the month



For the first time since 2013, the emerging markets Purchasing Managers' Index (PMI) – the broadest leading indicator for economic activity – has caught up with that of developed markets. The main driver of the uptick in emerging markets is China, where the manufacturing sector returned to growth, reporting a manufacturing PMI of 50.8 points, surpassing the neutral level of 50 points that separates expansion from contraction. This upswing suggests that the slowing Chinese economy has started to stabilise amid enforced government stimulus measures, triggering a rebound in other emerging markets PMIs, specifically in Asia.

## US

### Who is afraid of the yield curve?

#### GDP growth

Swiss Life Asset Managers	Consensus
2019: 2.3 %	2019: 2.4 %
2020: 1.8 %	2020: 2.0 %

Over the past weeks, it was not economic data releases but the ominous US yield curve inversion that hit the economic headlines. For the first time since the financial crisis, the yield on a 10-year US government bond fell below the yield on a 3-month Treasury bill. This inversion, but also current money market pricing, are telling us that investors expect the Federal Reserve to cut rates over a two-year horizon, implying some form of recession or at least a severe economic downturn. Indeed, a yield curve inversion served as a reliable early recession signal in the past. While many argue that the signal might be distorted this time due to the heavy involvement of central banks in the bond market, we advise to take the message seriously. Still, it is important to highlight significant time lags: in the past two cycles, it took up to two-and-a-half years between the first inversion and the start of the recession, with solid growth and further equity market gains in between. And contrary to the past two cycles, the US Fed seems well aware of the risks and announced a pause (in our view even the end) of the hiking cycle, which might prolong the economic expansion even further. The latter is reflected in a slight upward revision of our 2020 GDP forecast to 1.8% from 1.5%. Hence, we deem the near-term recession risk to be low, which is in line with recent data that showed robust economic activity and benign sentiment among companies and consumers.

#### Inflation

Swiss Life Asset Managers	Consensus
2019: 1.9 %	2019: 1.8 %
2020: 2.2 %	2020: 2.2 %

Recent inflation prints have surprised to the downside in the US, but we still feel comfortable with our slightly above-consensus forecast of 1.9% for this year. First, the significant increase of the oil price has not yet fully fed into inflation numbers, and core inflation was held down by idiosyncratic factors (drop in apparel and used car prices), which might prove temporary.

## Eurozone

### Still a very mixed bag of data

#### GDP growth

Swiss Life Asset Managers	Consensus
2019: 1.1 %	2019: 1.1 %
2020: 1.2 %	2020: 1.3 %

At the beginning of this year, we still had a substantially more prudent forecast for 2019 Eurozone GDP growth than most of our peers or international institutions like the OECD or the IMF. In the meantime, growing pessimism led to marked downward revisions by a large number of forecasters. As a consequence, we find that our own forecast has become the consensus view for the time being. Last month, we wrote that the worst in the Eurozone was probably over. Yet, incoming data suggest that it is too early to declare the end of the decline in economic momentum. Ongoing weakness in manufacturing Purchasing Managers' Indices (PMI) out of Germany and Italy suggest that the cyclical slowdown in the manufacturing sectors is more pronounced than previously thought and that the multiple drags on Germany's carmakers have longer-lasting effects on the entire supply chain. Most importantly, the trade dispute with the US administration appears to intensify and to weigh on corporates' investment decisions. Hence, there is some risk of contagion into Germany's domestic economy, which has so far fared very well amid favorable financial conditions and a tight labor market. Better signs of dynamic economic activity come in the form of robust manufacturing PMIs for countries like Spain or Greece as well as broad-based improvement in business sentiment in France.

#### Inflation

Swiss Life Asset Managers	Consensus
2019: 1.4 %	2019: 1.3 %
2020: 1.6 %	2020: 1.4 %

Eurozone inflation, especially its core measure, has remained surprisingly weak given higher wage growth and the narrowing output gap. The March inflation report might be distorted by the late Easter date this year, which could trigger a certain reversal in the April data. Nevertheless, we do not expect core inflation to recover above 1% before the final quarter of 2019.

## UK

### Temporary splendid isolation

#### GDP growth

Swiss Life Asset Managers	Consensus
2019: 1.3 %	2019: 1.3 %
2020: 1.3 %	2020: 1.5 %

Contrary to other regions, economic dynamics in the UK have not cooled further so far of 2019. Monthly GDP estimates until February suggest that the economy grew by 0.3% in the first quarter of the year, a slightly accelerated pace compared with the last quarter of 2018. Incoming data are solid across all sectors from retail sales to manufacturing and continue to be mirrored in a firming labour market. At first glance, these observations are counterintuitive given all the nerve-racking Brexit debates. Yet, it looks as if Brexit concerns kept the UK economy isolated from global cyclical headwinds, which weigh on export-dependent economies on the European continent. This may prove a temporary blessing only. According to the Purchasing Managers' Index, manufacturers' stocks of purchased goods climbed to record highs in the first quarter as a result of contingency measures to cope with a potential hard Brexit. Most likely, we will see a reversal in the months ahead, resulting in moderating manufacturing dynamics.

#### Inflation

Swiss Life Asset Managers	Consensus
2019: 1.9 %	2019: 2.0 %
2020: 2.0 %	2020: 2.1 %

We still see a hard Brexit as a tail risk only, so the probability of a renewed depreciation of Sterling is low for the remainder of the year, which should keep import prices in check. Over the past three months, we have overestimated headline inflation trends. The year-to-date appreciation of sterling, but also limited price setting power in the retail sector amid the Brexit uncertainties may explain subdued inflation pressures so far this year. With energy prices trending up, headline inflation is set to rise to just above 2% until mid-year. Like elsewhere, we expect data for March and April to be distorted. A comparably weak print for March followed by strong price increases in certain tourism-related components in April are the expected consequence of the unusually late Easter date.

## Switzerland

### A long expected fall

#### GDP growth

Swiss Life Asset Managers	Consensus
2019: 1.0 %	2019: 1.2 %
2020: 1.4 %	2020: 1.5 %

Switzerland's Purchasing Managers' Index (PMI) for the manufacturing sectors dropped sharply from 55.4 to 50.3 points in March. This was the biggest monthly fall in this time series since November 2008, when the financial crisis reached the world economy. The markedly lower level of Switzerland's manufacturing PMI is more consistent with earlier signals of other surveys that have a greater reliability as leading indicators, most importantly Swissmem's quarterly survey on new orders and think tank KOF's industrial survey. Interestingly, the latter suggests that firms' expectations of orders intake over the next three months have stabilised in March after falling each month since February 2018. We thus see no need to revise our forecast for the current year. The fact that the Swiss franc did not appreciate on a trade-weighted basis and encouraging signs of improving dynamics in emerging markets limit the risks of a recession despite the pronounced slowdown in the neighbouring Eurozone.

#### Inflation

Swiss Life Asset Managers	Consensus
2019: 0.7 %	2019: 0.6 %
2020: 0.8 %	2020: 0.8 %

Last month, the Swiss National Bank (SNB) published its updated quarterly conditional inflation forecast. According to these projections, headline inflation will not rise above 1.5% until the end of 2021 under the current monetary policy regime. Between the lines, one could conclude that the SNB will not remove negative rates for the foreseeable future. We continue to consider the risk for a sustained surge in inflation as limited, both in Switzerland and elsewhere in the developed world, which should keep interest rates low. Nevertheless, higher prices for crude oil since the start of the year mean that heating oil and fuels will contribute more strongly to inflation this year than previously thought. As a consequence, we raise the 2019 inflation forecast to 0.7% from 0.6%.

## Japan Still in sour mood

Similar to Europe, Japan has been hit by the global downturn in the industrial cycle, the result of falling external demand especially out of China. March data are still missing at the time of writing, but it is near-certain that industrial production, machinery orders and export volumes continued their decline in the first quarter of 2019. While consumption and investment have been fairly robust, the significant drop in import volumes signals downside risks to domestic demand as well. Contrary to Europe, we have not observed any signs of stabilisation in Japanese survey data even as recent leading indicators for China signalled better times ahead. Hence, we revised down the 2019 GDP forecast to 0.6%, which is slightly below potential. Inflationary pressures will thus remain largely absent, aggravated by the fact that we expect the Japanese yen to appreciate. The Bank of Japan only has very limited room for additional easing measures, and the baton will likely be passed to fiscal policy over the next two years.

## China Economic stabilisation goes on

China's March manufacturing Purchasing Managers' Index (PMI) moved above the 50 points mark that separates expansion from contraction, with the country's official NBS PMI coming in at 50.5 points, up from February's print of 49.2. The reading reflects mainly an improvement in domestic demand, while external demand, measured by new export orders, ticked up as well, but remained in contractionary territory. The rebound shows improved sentiment, mainly from smaller companies amid easing financing conditions and stronger-than-expected tax cuts in order to stimulate the slowing economy. Meanwhile, China's broad credit measure also improved more than expected, pointing to an ongoing stabilisation of the economy. However, for the rebound to continue a deal in the US-China trade dispute is crucial. While the two sides remain in frequent negotiations showing the willingness to find some sort of a trade deal, trade negotiations could last for longer as it seems to be difficult to agree on specific measures to resolve more structural issues.

## Economic Research



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