# Perspectives
*Economics*

Swiss Life Asset Managers

*March 2022*

## Key messages

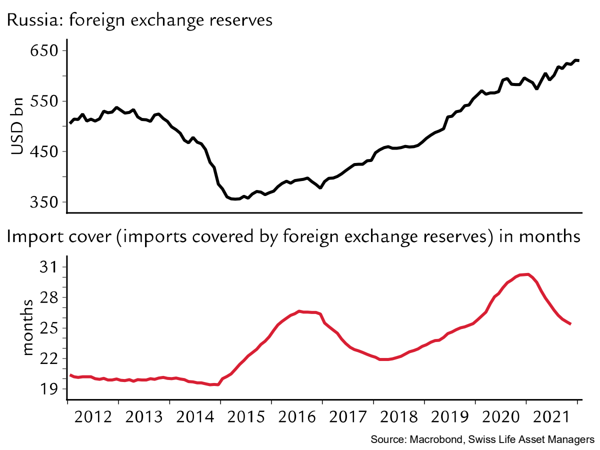
- The war in Ukraine is bringing misery and geopolitical uncertainty to Europe. Economically, however, the impact of the sanctions for the Eurozone is weak, as exports to Russia are of little importance.
- The biggest economic risk for Europe is posed by a potential halt to Russian gas supplies.
- Inflation in Europe is half driven by energy prices but is becoming increasingly broad-based in the US.

## 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 |
| USA | 3.5% ↓ | 3.7% ↓ | 2.3% | 2.5% ↓ | 5.9% ↑ | 5.2% ↑ | 2.7% ↑ | 2.6% |
| Eurozone | 3.7% | 3.9% ↓ | 1.9% ↑ | 2.5% | 4.5% ↑ | 3.9% ↑ | 2.0% ↑ | 1.7% ↑ |
| Germany | 3.4% ↓ | 3.5% ↓ | 2.0% ↑ | 2.7% ↑ | 3.8% ↑ | 3.4% ↑ | 2.1% ↑ | 1.9% |
| France | 3.5% | 3.8% | 1.5% | 2.1% ↑ | 3.3% ↑ | 2.6% ↑ | 1.8% ↑ | 1.5% |
| United Kingdom | 4.2% | 4.3% | 1.9% ↓ | 2.0% ↓ | 5.8% ↑ | 5.4% ↑ | 2.7% ↑ | 2.7% ↑ |
| Switzerland | 2.6% | 2.9% ↓ | 1.4% | 1.9% | 1.1% ↑ | 1.0% ↑ | 0.6% | 0.6% |
| Japan | 2.2% ↓ | 2.8% ↓ | 1.6% | 1.8% ↑ | 1.0% ↑ | 1.0% ↑ | 0.4% ↑ | 0.7% |
| China | 5.0% | 5.0% | 5.1% | 5.2% ↓ | 2.1% ↑ | 2.2% | 2.2% ↑ | 2.3% |

Arrows indicate change from previous month
Source: Consensus Economics Inc. London, 7 February 2022

## Chart of the month




Russia has accumulated foreign exchange reserves of around USD 640 billion, which can partially cushion the impact of potential financial sanctions. However, the recent sanctions adopted by the West against the Russian central bank may cut off access to much of these reserves. In a risk scenario, this harsh measure could make Vladimir Putin even more willing to impose countermeasures and halt gas supplies to the West. However, it is also possible that in this weakened position he will have to rely all the more on his main source of income – energy exports.

## *USA*
## Inflation more broad-based

| **GDP growth** | |
|---|---|
| Swiss Life Asset Managers | Consensus |
| 2022: 3.5% | 2022: 3.7% |
| 2023: 2.3% | 2023: 2.5% |

Economically, the main impact on the US of the Ukraine war will be higher energy prices. Inflation has already left its mark on economic data. According to a survey by the University of Michigan, consumer confidence has fallen to its lowest level since 2011 despite the improvement in the labour market, with respondents primarily lamenting the high prices of durable goods. Consumption has not slumped as a result, and nominal retail sales even grew above-average in January. However, here too inflation is at work, with sales volumes moving sideways at high levels since March 2021 in price-adjusted terms. The tighter monetary policy will also have a restraining effect: the average interest rate on 30-year fixed mortgages, which in the US are usually used to pledge houses, has risen since the beginning of the year from 3.3% to 4.2%. The housing market, which is currently still performing very well, is likely to lose some momentum in 2022, as is the investment cycle, which has benefited from brisk lending activity. With regard to GDP growth, following a weak start to the year due to the pandemic we expect an acceleration in the second quarter, driven by service consumption, which should also benefit from the steady improvement on the labour market.

| **Inflation** | |
|---|---|
| Swiss Life Asset Managers | Consensus |
| 2022: 5.9% | 2022: 5.2% |
| 2023: 2.7% | 2023: 2.6% |

US inflation again surprised on the upside in January 2022, rising from 7.0% to 7.5%. Inflation became more broad-based. Although the categories energy (27% year-on-year price increase) and food (+7%) remained strong drivers, core inflation (+6%) also picked up. Particularly striking were rising prices for the index heavyweight medical services, which was not an inflation driver in 2021. Combined with surprisingly strong wage increases in the January labour market report, this lays the basis for the first interest rate hike by the US Federal Reserve in March 2022.

## *Eurozone*
## One crisis follows another

| **GDP growth** | |
|---|---|
| Swiss Life Asset Managers | Consensus |
| 2022: 3.7% | 2022: 3.9% |
| 2023: 1.9% | 2023: 2.5% |

The economic uncertainty due to the pandemic has barely receded and already the war in Ukraine is ushering in the next wave of uncertainty in Europe. The sanctions against Russian banks, which also affect their access to the SWIFT payment messaging system, will significantly impede exports to Russia. However, the latter have become significantly less important for the Eurozone, accounting for 0.5% of GDP in 2020, which is half their peak in 2012. Europe would be more vulnerable if Russia were to use gas supplies to exert pressure. According to data from the think tank Bruegel, pipeline deliveries from Russia are currently around a third lower than last year. Although imports of liquefied natural gas have doubled compared to the previous year, they are unlikely to be capable of offsetting a significant additional reduction from Russia. Energy rationing and stagflation would be possible consequences if a supply halt were to be implemented. Even without such an escalation, energy prices are likely to remain high, with surprisingly little impact on private consumption so far. This is due to the labour market, which is in excellent shape in the Eurozone. Employment has already surpassed pre-crisis levels, and the unemployment rate reached a new low of 7.0% in December 2021.

| **Inflation** | |
|---|---|
| Swiss Life Asset Managers | Consensus |
| 2022: 4.5% | 2022: 3.9% |
| 2023: 2.0% | 2023: 1.7% |

Contrary to expectations, Eurozone inflation did not fall in January, but rose further from 5.0% to 5.1%. A good half of inflation is driven by higher energy prices, while core inflation fell slightly from 2.6% to 2.3%. Wage pressure is still low but expected to increase in 2022. Persistently high energy prices and efforts to quickly break free from dependence on Russian gas suggest a higher inflation regime in the short to medium term and have led to corresponding adjustments to our forecasts for 2022 and 2023.

## *Germany*
## Shorter delivery times

| **GDP growth** | |
|---|---|
| Swiss Life Asset Managers | Consensus |
| 2022: 3.4% | 2022: 3.5% |
| 2023: 2.0% | 2023: 2.7% |

Without the big question mark about the development of the Ukraine war – in particular the latent risk of a supply halt of Russian gas – the outlook for Germany's economy would undoubtedly be rosy. It is becoming increasingly clear that the momentum in German industry will accelerate significantly in the coming months. According to the Purchasing Managers' Index (PMI), order intake from foreign markets has accelerated significantly. The strongest impact in the short term, however, is the surprisingly sharp upturn in the more domestically oriented services sector. Preliminary results of the PMI survey indicate for February the highest reading for this sector since August 2021. The imminent easing of the last remaining containment measures should result in a significant growth spurt in the second quarter. The sanctions against Russia could hit Germany somewhat more severely than other countries; exports to Russia account for around 0.7% of GDP. However, a U-turn in fiscal policy is on the horizon, as the government has promised generous funds for armaments and intends to significantly step up its efforts to move away from dependence on Russian gas, for example with the construction of LNG terminals.

| **Inflation** | |
|---|---|
| Swiss Life Asset Managers | Consensus |
| 2022: 3.8% | 2022: 3.4% |
| 2023: 2.1% | 2023: 1.9% |

Although annual inflation fell from 5.3% to 4.9% in January, this drop was much less pronounced than we had expected. Inflation remains strongly driven by energy prices. The February readings for the Purchasing Managers' Index (PMI) are sending out signs of easing, with the survey reading on delivery times its most positive since December 2020. No wage/price spiral has as yet set in and collective wages only rose by 1.1% year-on-year by January 2022.

## *France*
## Macron keeps a promise

| **GDP growth** | |
|---|---|
| Swiss Life Asset Managers | Consensus |
| 2022: 3.5% | 2022: 3.8% |
| 2023: 1.5% | 2023: 2.1% |

With the foreseeable end of the measures to combat the pandemic, the presidential election is coming to the fore. A review of the election promises made by winning candidate Emmanuel Macron in 2017 gives him good marks: The unemployment rate in mainland France stood at 7.2% at the end of 2021, just above the 7% target that Emmanuel Macron pledged to French voters five years ago. The unemployment rate when he took office was 9.2%. In the short-term, economic momentum remains intact, as evidenced, for example, by preliminary readings for the Purchasing Managers' Indices (PMI) in the manufacturing and services sectors. Both rose significantly in February, with the reading for the services sector climbing to its highest level since January 2018. Whether this upturn continues in the coming months will depend less on the course of the pandemic than on the dangerous situation surrounding Ukraine. As uncertain as the development of this conflict currently is, it is difficult to assess the medium-term economic consequences.

| **Inflation** | |
|---|---|
| Swiss Life Asset Managers | Consensus |
| 2022: 3.3% | 2022: 2.6% |
| 2023: 1.8% | 2023: 1.5% |

Energy prices remain the main reason for the persistently high inflation. Slight signs of easing are coming from manufacturing where, according to the February PMI survey, input prices rose less sharply than in the previous months. The big unknown remains the development of fossil fuel prices. Due to the war in Ukraine, these are likely to be higher than previously expected, which has prompted us to revise our forecasts upwards.

## *United Kingdom*
## Bouncing into the new year

**GDP growth**

| Swiss Life Asset Managers | Consensus |
|---|---|
| 2022: 4.2% | 2022: 4.3% |
| 2023: 1.9% | 2023: 2.0% |

The UK economy ended the year considerably better than most economists had expected. One year ago, we expected British GDP to remain at a gap of 2.9% relative to pre-crisis levels in the fourth quarter 2021. At the end of the day this was actually just 0.4%, making the UK the country where we most underestimated the comeback in 2021. Rapid and widespread opening steps and a small weighting of the manufacturing sector, which struggled globally with supply bottlenecks, contributed to this. Initial figures for the new year suggest that the UK has carried through the momentum to 2022. January retail sales recovered better than expected from the weak month of December caused by the pandemic, and preliminary February figures for the Purchasing Managers' Index (PMI) point to a significant acceleration in the services sector and solid growth in the manufacturing sector. Particularly striking in the services PMI is the employment component, which has been higher than in the other major developed economies for the past three months and points to ongoing labour shortages.

**Inflation**

| Swiss Life Asset Managers | Consensus |
|---|---|
| 2022: 5.8% | 2022: 5.4% |
| 2023: 2.7% | 2023: 2.7% |

The labour shortages are reflected in strong wage growth. According to the latest figures from December, the average salary including variable compensation rose by 4.3% year on year. Growth was particularly strong in the services sector at 4.7%. This should contribute to higher consumer price inflation in 2022. However, the recent sharp upward revisions to the inflation rate in 2022 are mainly due to higher energy prices. The regulatory authority Ofgem has announced that it will raise the price cap for electricity and gas by a massive 54% as of 1 April. We therefore expect the inflation cycle to peak at 7.6% in April 2022.

## *Switzerland*
## Delayed rise in inflation?

**GDP growth**

| Swiss Life Asset Managers | Consensus |
|---|---|
| 2022: 2.6% | 2022: 2.9% |
| 2023: 1.4% | 2023: 1.9% |

The first official estimate of Switzerland's gross domestic product for the fourth quarter of 2021 shows quarterly growth of 0.3%, which is exactly in line with our expectations. Combined with slight revisions to the data from previous quarters, this results in real GDP growth for 2021 as a whole of 3.7%. In December, the omicron wave slowed momentum in the domestic economy, which continued until mid-February. The almost complete lifting of containment measures in the third week of February should speed up domestic economic activity in the short term. However, it should be noted that the added value of the sectors affected by the certification requirement (catering and entertainment) is comparatively low. It also remains questionable whether these sectors will be able to utilise their potential at all in the coming months. Such hopes could also be thwarted by a shortage of labour. Our forecast for GDP growth this year and next remains comparably cautious.

**Inflation**

| Swiss Life Asset Managers | Consensus |
|---|---|
| 2022: 1.1% | 2022: 1.0% |
| 2023: 0.6% | 2023: 0.6% |

Annual inflation stood at 1.7% in January, its highest level since October 2008. However, inflation in Switzerland remains low by international comparison and in line with the Swiss National Bank's target range of 0% to 2%. One striking feature of inflation measurement in Switzerland is the high proportion of officially fixed prices for goods and services in the basket of the Swiss Consumer Price Index. Until now, this has had a dampening effect in particular on electricity prices. However, even with administered prices, higher costs could still be passed on to final consumers albeit with a delay.

## *Japan*
## The borders are opening

**GDP growth**

| Swiss Life Asset Managers | Consensus |
|---|---|
| 2022: 2.2% | 2022: 2.8% |
| 2023: 1.6% | 2023: 1.8% |

Japan appears to be experiencing the pandemic with a delay. While the omicron wave seemed to have been broken in early February, high infection numbers by Japanese standards meant that reported daily deaths related to Covid were higher than at any time throughout the pandemic. In most other developed markets, this peak was reached well back in winter 2020/2021. Likewise, the booster campaign is only just getting underway, and while elsewhere most of the measures are coming to an end, Japan is already "celebrating" the fact that foreign business travellers and students will be allowed to travel into the country again under a strict quota and visa regime from March for the first time since the start of the pandemic. Meanwhile, economic recovery is proving sluggish. GDP grew on average by just under 0.2% per quarter during 2021, and at the end of the year there was a gap of 0.2% compared to pre-crisis levels. The start of 2022 does not bode well: the Purchasing Managers' Index (PMI) for manufacturing fell to 52.9 in February, mainly due to weak manufacturing data. The services PMI plunged to 42.7 in February, its lowest level since May 2020 and well below the growth threshold of 50. However, there are signs of restrictions being lifted in various prefectures, which should gradually improve economic data after the "coronavirus winter".

**Inflation**

| Swiss Life Asset Managers | Consensus |
|---|---|
| 2022: 1.0% | 2022: 1.0% |
| 2023: 0.4% | 2023: 0.7% |

Inflation was just 0.5% in January and is currently an issue in Japan above all in the energy and food sectors. However, the Japanese variant of core inflation, which excludes perishable food and energy, fell further into deflation (-1.1%). Moreover, as wage growth slipped slightly into negative territory, there is no reason for the Bank of Japan to change its monetary policy.

## *China*
## China celebrates the Olympics

**GDP growth**

| Swiss Life Asset Managers | Consensus |
|---|---|
| 2022: 5.0% | 2022: 5.0% |
| 2023: 5.1% | 2023: 5.2% |

China recently celebrated the close of the Winter Olympics, in which the country won nine gold medals, four more than the previous record of five gold medals in Vancouver 2010. What is positive from an economic perspective is the fact that the Olympic Games ended without a major Covid outbreak that could have led to far-reaching lockdown measures. China has thus once again demonstrated that its strict control measures can successfully contain the spread of the virus. Nevertheless, the rigorous zero-Covid approach is weighing on the domestic economy. During the New Year celebrations, several provinces urged the population not to leave their cities. High frequency data show that travel activity only increased marginally compared to the previous year and was around 50% below pre-crisis levels. In addition, regional production shutdowns in the run-up to the Winter Olympics weighed on manufacturing activity, causing the Caixin Manufacturing PMI to drop to 49.1 in January. The Ukraine war poses another risk to China's growth prospects. Should the conflict escalate dramatically, and Europe's economy slow down significantly, China could also be affected, as exports from China to the EU account for almost 3% of China's GDP.

**Inflation**

| Swiss Life Asset Managers | Consensus |
|---|---|
| 2022: 2.1% | 2022: 2.2% |
| 2023: 2.2% | 2023: 2.3% |

Unlike most other major economies, inflation is not an issue in China. In January, it stood at 0.9%, well below the 3% target, giving the authorities leeway for further reductions in monetary interest rates. Producer prices also fell from 10.3% to 9.1%. This serves to reduce the pressure on manufacturers to pass on costs to customers.

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