Perspectives
Economics

SwissLife
Asset Managers

April 2022

Key messages

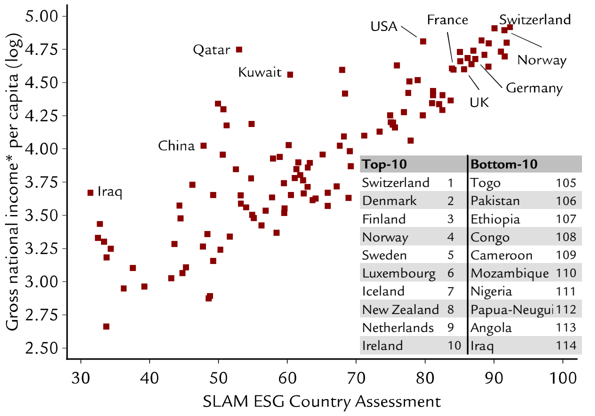
- The war in Ukraine and the sanctions are hitting the Eurozone much harder economically than the USA
- We anticipate a poorer growth/inflation mix in 2022, with stagflation as a risk scenario
- Supply bottlenecks are partially exacerbated again, while lockdown measures in China pose an additional risk

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	3.3% ↓	3.3% ↓	2.3%	2.4% ↓	6.8% ↑	6.6% ↑	2.9% ↑	3.0% ↑
Eurozone	3.3% ↓	3.2% ↓	2.0% ↑	2.3% ↓	5.6% ↑	5.7% ↑	2.2% ↑	2.1% ↑
Germany	2.6% ↓	2.4% ↓	2.2% ↑	2.6% ↓	4.9% ↑	5.2% ↑	2.4% ↑	2.4% ↑
France	3.2% ↓	3.3% ↓	1.5%	1.7% ↓	3.7% ↑	3.9% ↑	2.1% ↑	1.9% ↑
United Kingdom	3.9% ↓	3.9% ↓	1.8% ↓	1.6% ↓	6.7% ↑	6.7% ↑	3.3% ↑	3.6% ↑
Switzerland	2.5% ↓	2.7% ↓	1.4%	1.7% ↓	1.8% ↑	1.8% ↑	0.7% ↑	0.7% ↑
Japan	2.1% ↓	2.3% ↓	1.6%	1.8%	1.2% ↑	1.4% ↑	0.5% ↑	0.9% ↑
China	5.0%	5.0%	5.1%	5.2%	2.3% ↑	2.2%	2.0% ↓	2.3%

Arrows indicate change from previous month
Source: Consensus Economics Inc. London, 14 March 2022

Chart of the month



*income generated from domestic resources at home or abroad

Source: Macrobond, Swiss Life Asset Managers

The latest update of our in-house ESG assessment (environmental, social and governance) for 114 countries puts Switzerland in first place, followed by Denmark. Iraq and Angola come last. The ESG rating is strongly correlated with conventional economic measurements such as gross national income (GNI)* per capita. What stands out here, however, is that well-known oil states in particular, as well as China, Turkey and the USA have a relatively low ESG rating in relation to their GNI. Compared with other developed countries, the USA performs particularly poorly in terms of social issues, such as minority discrimination and access to education and health.

USA
Sanctions hardly hit the USA

GDP growth	
Swiss Life Asset Managers	Consensus
2022: 3.3%	2022: 3.3%
2023: 2.3%	2023: 2.4%

The war in Ukraine is exacerbating the economic divide between the USA and Europe. The sanctions are barely affecting the USA: exports to Russia are insignificant and the USA is not dependent on Russian energy. The USA can almost entirely meet domestic demand through domestic oil production and is a net exporter of gas thanks to LNG. In this respect, the higher energy prices are not an external shock for the US economy: the energy sector is registering enormous inflows of funds due to high prices, although so far distribution of profit has been prioritised over investment. Nevertheless, investment in the sector is expected gradually to pick up, and output from upstream industries (e.g. drilling activities) is on an upward trend. Broad industry has also picked up according to the March purchasing managers' indices; in contrast to Europe, new orders and output have gained momentum, and the supply chain situation has eased slightly. Private households continue to suffer from the persistently high inflation. On a real basis, retail sales are stagnating, and further increases in mortgage rates are likely to slow the housing market in 2022. Overall, we have slightly lowered the growth forecast for 2022 from 3.5% to 3.3%.

Inflation	
Swiss Life Asset Managers	Consensus
2022: 6.8%	2022: 6.6%
2023: 2.9%	2023: 3.0%

US inflation rose to 7.9% in February, and we expect it to reach a cyclical peak of 8.7% in March. The further development of headline inflation depends to a large extent on the development of energy prices. As long as the war does not spread to other countries and an oil and gas embargo on Russia is not imposed, energy prices should stabilise, and inflation rates should gradually decline due to the base effect. However, core inflation will remain high enough (still around 4-5% in the second half of 2022) to keep the US Federal Reserve on a tightening course.

Eurozone
Stagflation as a risk scenario

GDP growth	
Swiss Life Asset Managers	Consensus
2022: 3.3%	2022: 3.2%
2023: 2.0%	2023: 2.3%

In order to assess the economic consequences of the war in Ukraine, we are working both with a "worst case" scenario and with three alternative scenarios under the assumption that the war remains limited to the territory of Ukraine. The crucial question for Europe for the next nine to twelve months remains whether gas supplies from Russia will be maintained or whether they will be stopped by one of the two contracting parties. In the short term, an interruption to the supply of this raw material poses a significant economic risk. A rationing of gas supplies for the coming winter could potentially be one of the necessary consequences. As wages are not keeping pace with price developments, a decline in consumer demand is to be expected in this scenario. Unlike in the USA, potential stagflation in Eurozone countries would therefore not originate from excessive monetary policy tightening. We currently estimate the likelihood of the "full supply stop" scenario to be around 25%. As dependence on Russian gas supplies decreases, this economic risk will diminish further.

Inflation	
Swiss Life Asset Managers	Consensus
2022: 5.6%	2022: 5.7%
2023: 2.2%	2023: 2.1%

In contrast to the start of the pandemic, the European Central Bank (ECB) is under pressure to counter the increasing threat of inflation. A glance at the market for inflation-protected bonds shows that long-term inflation expectations have become less anchored, at least in the short term: While the average so-called "break-even inflation rate" for the next ten years was below the ECB's target of "close to, but below 2%" before the outbreak of war, it has now risen to 2.7% for Germany and France.

Germany
Return to low sentiment

GDP growth	
Swiss Life Asset Managers	Consensus
2022: 2.6%	2022: 2.4%
2023: 2.2%	2023: 2.6%

As soon as an easing of coronavirus measures and supply bottlenecks became apparent, new clouds appeared on the German economic horizon. For example, it can be seen from electricity consumption that industrial production slowed in March. Economists agree that among the countries discussed here, Germany's economy is most affected by the war in Ukraine. The downward revisions of GDP growth forecasts compared to the previous month are correspondingly marked: the current consensus forecast for 2022 is now 2.4% real GDP growth, compared to an expectation of 3.5% in the previous month. Widespread pessimism is also evident in business surveys and consumer sentiment. According to the GfK, the latter fell to its lowest level since February 2021. However, it is important to distinguish sentiment from actual activity indicators: this is evident in the latest figures for the ifo Business Climate Index. Here, data on the current business situation (activity) moved sideways, while responses on future business development (sentiment) collapsed.

Inflation	
Swiss Life Asset Managers	Consensus
2022: 4.9%	2022: 5.2%
2023: 2.4%	2023: 2.4%

This has never happened before: within just one month, the consensus forecast for the average inflation rate for the current year was raised by 1.8 percentage points to 5.2%. We didn't go quite this far with our corrections. However, in our base case scenario, the inflation rate will remain above the ECB's critical 2% threshold for most of the coming quarters. It is becoming increasingly apparent that the sustained change in long-term inflation rates will feed into the forthcoming wage negotiations.

France
A changed labour market

GDP growth	
Swiss Life Asset Managers	Consensus
2022: 3.2%	2022: 3.3%
2023: 1.5%	2023: 1.7%

The war in Ukraine is overshadowing the last days before the first round of the presidential election in France. Foreign policy developments should increase the election chances of the incumbent. However, President Macron can also claim that he has successfully delivered on his promises, particularly with regard to labour market reforms. The result of these measures is an unemployment rate two percentage points lower than when he took office. Youth unemployment in particular has fallen sharply. Under Macron, the number of young people with an apprenticeship has increased by more than 50%. The probability of remaining in employment after completing an apprenticeship is high. Even in the current uncertain geopolitical situation, France's economy is in a robust state. Business sentiment indicators have so far plummeted less than comparable indicators from Germany. In particular, there has so far been no fall in demand in the services sector. High frequency indicators, such as data from Google on length of stay in retail and other leisure activities, rebounded in the second half of March.

Inflation	
Swiss Life Asset Managers	Consensus
2022: 3.7%	2022: 3.9%
2023: 2.1%	2023: 1.9%

In France, inflation only became a major topic of public debate with some delay. Now, however, a household survey conducted by the INSEE statistical office shows that the number of people who expect inflation to rise over the next twelve months is higher than at any time since the survey began in 1971. Dwindling purchasing power is therefore probably set to become an election issue after all. The government has responded by capping petrol prices, which explains why the inflation forecast for the current year is being raised less sharply for France than for other European countries.

United Kingdom
Optimistic service providers

GDP growth	
Swiss Life Asset Managers	Consensus
2022: 3.9%	2022: 3.9%
2023: 1.8%	2023: 1.6%

Often heard buzzwords such as "Londongrad" suggest that the UK could be hit hard economically by the sanctions against Russia. We think this is unlikely. In real economic terms, the situation is not dissimilar to the USA: a high degree of self-sufficiency in oil and gas and hardly any export dependency on Russia. While – unlike in the USA – the purchasing managers' indices (PMI) for the manufacturing sector fell significantly in March, companies view this as more of a temporary weakness. In contrast to the continent, UK industry remains optimistic about the medium-term outlook. And much more importantly, the PMI for service providers, the heavyweight in the UK economy, continued to rise in March (to 61.0 points), even outperforming that of the USA. Similarly to the USA, inflation and higher interest rates are likely to curb private consumption somewhat; the central bank is set to remain on a tightening course despite somewhat more cautious words of late. On the positive side, however, both wages and payrolls are rising (via rising employment), thus partially cushioning the negative effect of higher consumer prices. We slightly reduced our GDP growth forecast for 2022, from 4.2% to a still robust 3.9%.

Inflation	
Swiss Life Asset Managers	Consensus
2022: 6.7%	2022: 6.7%
2023: 3.3%	2023: 3.6%

Inflation in the UK is becoming more broad-based. February headline inflation rose 0.7 percentage points to 6.2%. Higher energy prices played a role in this, but it was surprising that core inflation, which ignores energy and food, increased even more (+0.8 percentage points to 5.2%). This reflects positive momentum in the services sector and above all strong wage growth, which has risen to 4.8%. This means that real wage reductions are currently less drastic in the UK than, for example, in the USA or Germany.

Switzerland
Slowing industrial momentum

GDP growth	
Swiss Life Asset Managers	Consensus
2022: 2.5%	2022: 2.7%
2023: 1.4%	2023: 1.7%

In contrast to other regions, Switzerland did not yet have any sentiment indicators at the time of writing that would allow conclusions to be drawn about future corporate or consumer behaviour in view of the war in Ukraine. Available indicators from the real economy indicate that domestic consumer behaviour has not been affected so far, and international travel, for example, is stable in terms of flight movements from Zurich. The index of weekly economic activity (WEA) of the State Secretariat for Economic Affairs (SECO) points to a moderate slowdown in economic momentum. According to the SECO, this is largely attributable to the pharmaceutical industry, which is affected by rising energy costs and renewed supply bottlenecks. It should be remembered, however, that the pharmaceutical industry's export success was a major reason for the record level of goods exports in February. As Switzerland has imposed sanctions on Russia, it remains to be seen what impact these will have on business performance in the most exposed sectors. Transit trade in commodities in particular contributed disproportionately to Switzerland's gross domestic product relative to the number of employees in recent years.

Inflation	
Swiss Life Asset Managers	Consensus
2022: 1.8%	2022: 1.8%
2023: 0.7%	2023: 0.7%

At 2.2% annual inflation, the inflation rate in February 2022 exceeded the upper end of the Swiss National Bank's target range of 0% to 2% for the first time since 2008. According to our calculations, the inflation rate rose again in March to 2.5%, although this should mark the peak in the current cycle. Only in the event of a further rise in commodity prices as a result of an embargo on Russian gas supplies would we temporarily expect even higher inflation rates in the region of 3% to 5%.

Japan
A terms of trade shock

GDP growth	
Swiss Life Asset Managers	Consensus
2022: 2.1%	2022: 2.3%
2023: 1.6%	2023: 1.8%

Japan is affected by the increased geopolitical uncertainty, even though the country is far from the war zone in Ukraine. Firstly, since the end of World War II, Japan has had no peace agreement with Russia and is in dispute over four Kuril Islands, where Russia has recently launched major military exercises. Secondly, North Korea recently tested a new intercontinental ballistic missile that hit Japan's exclusive economic zone just 150 kilometres from the coast. Economically, Japan is hit by the crisis mainly through higher energy prices; exports to Russia account for only 0.1% of Japan's GDP. Japan is completely dependent on foreign countries for fossil energy and is the world's largest importer of LNG. Although Japan does not wish to enter into any new energy deals with Russia, existing projects there are being upheld for the time being, also for fear that China might step into the breach for these projects. Import prices rose by 34% compared to the previous year, while export prices increased by just 12%. This collapse in the so-called terms of trade (exchange ratio of export/import prices) is leading to a loss of household purchasing power and margin compression for companies. We have therefore further lowered our already cautious growth forecast for 2022 from 2.2% to 2.1%. Japan is thus likely to see the weakest growth among the major developed economies in 2022.

Inflation	
Swiss Life Asset Managers	Consensus
2022: 1.2%	2022: 1.4%
2023: 0.5%	2023: 0.9%

Inflation rose from 0.5% to 0.9% in February and may even exceed the 2% mark in April, which last happened in 2014 due to the depreciation of the yen and rise in consumption tax. While the recent weakening of the yen is also helping, energy and food remain the main drivers of inflation. The Japanese variant on core inflation, which excludes perishable food and energy, remained in negative territory in February (-1.1%).

China
Diplomatic balancing act

GDP growth	
Swiss Life Asset Managers	Consensus
2022: 5.0%	2022: 5.0%
2023: 5.1%	2023: 5.2%

In the midst of the war in Ukraine, China is trying to achieve a diplomatic balancing act. In other words, it is continuing to pursue political orientation towards Russia, while at the same time maintaining strong trade relations with the West. Russia is a major supplier of raw materials to China. China's demand for natural gas will increase significantly over the years as the country pursues its long-term goal of reducing its carbon footprint. At the same time, sound economic relations with the West are crucial, as its trade relations with the USA and Europe are much more important than those with Russia. As a result, China has so far strictly adhered to the Western sanctions framework. In addition to the uncertain geopolitical situation, the pandemic poses a further risk to China's economy. The number of Covid cases is rising sharply, and lockdown measures are being implemented in economically important cities such as Shenzhen and Shanghai. As long as the containment measures remain temporary, the economic impact and disruptions to global supply chains should remain manageable. However, there is a risk that the spread of Covid cases will spiral out of control and potentially more drastic measures will be taken. Despite increased monetary and fiscal stimulus, we are therefore sticking to our 5% growth forecast for 2022.

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

The Ukraine war and the resulting increase in commodity prices will only have a limited impact on China's consumer prices. In terms of food, China is largely self-sufficient. Energy prices will lead to higher producer prices. However, companies bear the greatest burden and do not pass on the increased costs to consumers to a large extent.

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