Perspectives

Economics

SwissLife Asset Managers

May 2020

Key messages

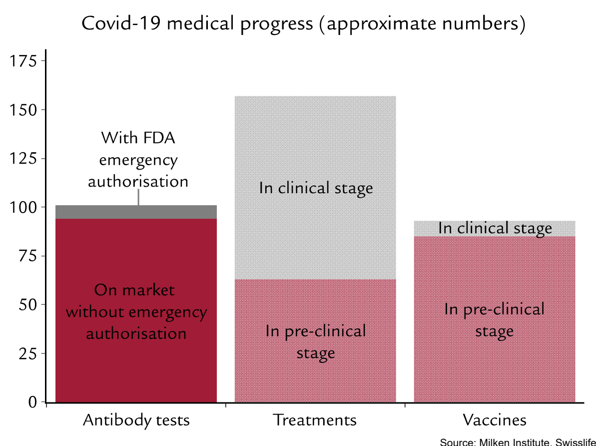
- In our base case, a gradual recovery of the world economy is about to start
- China to lead the recovery followed by the US and Switzerland
- Where in place, short-term work compensation programmes provide an efficient safety net

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	-3.0% ↓	-4.0% ↓	3.7% ↑	3.9% ↑	0.9% ↓	0.8% ↓	1.5% ↓	1.8% ↓
Eurozone	-5.8% ↓	-5.7% ↓	5.9% ↑	5.4% ↑	0.2% ↓	0.4% ↓	1.3% ↓	1.3% ↓
Germany	-4.7% ↓	-5.0% ↓	3.9% ↑	4.5% ↑	0.4% ↓	0.7% ↓	1.3% ↓	1.4% ↓
France	-5.6% ↓	-5.4% ↓	5.0% ↑	5.1% ↑	0.2% ↓	0.4% ↓	1.3% ↓	1.3%
UK	-4.2% ↓	-5.4% ↓	3.6% ↑	4.7% ↑	0.9% ↓	1.0% ↓	1.7% ↓	1.6% ↓
Switzerland	-3.1% ↓	-3.3% ↓	3.6% ↑	3.6% ↑	-0.5% ↓	-0.5% ↓	0.6%	0.5% ↓
Japan	-4.9% ↓	-3.3% ↓	2.6% ↑	2.1% ↑	0.1% ↓	-0.1% ↓	0.3%	0.2% ↓
China	1.2% ↓	2.0% ↓	8.4%	7.8% ↑	3.4% ↓	3.3% ↓	2.0%	2.1% ↓

Arrows indicate difference from previous month
Source: Consensus Economics Inc. London, 6 April 2020

Chart of the month



Many countries are shifting the focus to a gradual easing of lockdown measures with the hope of support from medical progress. First, a much faster increase in diagnostic testing capacity is needed. Second, reliable antibody tests would allow estimation of the immunisation rate. Yet, many of these tests have not yet been authorised and first studies hint at below 100% reliability. Third, great hope is with existing drugs as treatments, but the recent news flow has been mostly disappointing. Finally, a vaccine would be the real game changer. Experts are hoping to develop one at record speed. Considering the large uncertainties and the average development time of ten years, many have, however, cautioned against too much optimism.

US
April should mark the trough

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -3.0 %	2020: -4.0 %
2021: 3.7 %	2021: 3.9 %

Lockdown measures in the US were generally introduced later and are patchier than in other economies as they are administered by the States and not the federal government. Activity data held up relatively well in March, even as most States moved into some form of lockdown during the last 10 days of the month. Nominal retail sales mainly suffered from lower gasoline prices but were otherwise surprisingly little hit in March. Industrial production was more affected, with manufacturing output declining 6% month-on-month. We expect an even larger drop in activity in April, while a gradual recovery is likely to unfold in May as restrictions on the economy are being eased. Whether or not the relatively early opening plans make sense from an epidemiological point of view (daily new cases were stabilising but not yet falling at the time of writing), they might help to reduce the immediate economic damage. Indeed, US Purchasing Managers' Indices dropped less in April compared to European countries, and we currently expect annual growth to come in at –3.0% in 2020, slightly above consensus. Nevertheless, the return to pre-crisis levels will likely take much longer than previously thought (our current base case for the US is in H2 2021) as certain sectors (e.g. leisure, tourism, restaurants) will remain in the doldrums for longer. Also, the surge in US unemployment will weigh on demand well into 2021.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.9 %	2020: 0.8 %
2021: 1.5 %	2021: 1.8 %

US inflation figures for March undoubtedly showed that the coronavirus crisis is disinflationary in nature. Besides the expected collapse in energy prices, core inflation dropped 0.1% month-on-month, driven by both goods and services. However, some distortion arises from the fact that the fixed basket of goods contains items that were difficult to consume and heavily discounted during the lockdown, such as airfares and hotel rates. Also, the lockdown generally hampered the collection of price data.

Eurozone
A test of European solidarity

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -5.8 %	2020: -5.7 %
2021: 5.9 %	2021: 5.4 %

Europe is gradually easing some lockdown measures imposed since February to contain the COVID-19 pandemic. While certain shops and other services are reopening under strict conditions in Austria and Germany, the easing is far more gradual in the most hit countries Italy and Spain. According to our current calculations, economic output fell by more than a third from pre-crisis level in Spain and Italy until end of April. Germany is likely to get away with a black eye (as well as a bleeding nose), losing around 14% during the same period. As cross-border travelling will be one of the last activities to be freed from bans, tourism dependent economies will suffer severely from missing inbound travelling. Labour markets in southern European countries will deteriorate sharply in the months ahead resulting in a persistent shock to internal demand. Aggregate Eurozone GDP is expected to return to pre-crisis levels in 2022. It might take even longer for Spain and Italy. The backstop provided by monetary policy prevented sovereign bond spreads for Spain and Italy form widening further despite prospects of Italy's debt to GDP ratio to rise beyond 150%. Medium-term, Eurozone fiscal policy needs to resort to some form of risk sharing. Without the proposed Rescue Fund and further steps towards completion of the monetary union, the risk of a "euro crisis 2.0" will likely resurface.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.2 %	2020: 0.4 %
2021: 1.3 %	2021: 1.3 %

The current economic crisis is often wrongly compared to situations at the end of a war which are followed by inflation. However, the supply and the subsequent demand shock caused by the lockdown result in an unprecedented underutilisation of otherwise intact infrastructure, manufacturing and labour market capacities. The resulting output gap first needs to be closed, before accelerating inflation poses a potential risk.

Germany
Getting away with a black eye

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -4.7 %	2020: -5.0 %
2021: 3.9 %	2021: 4.5 %

Compared to most other EMU member states, Germany seems to be getting away from both the pandemic and the subsequent recession with a black eye and a bleeding nose. Business climate indicators and consumer sentiment fell at an unprecedented pace. Yet, as Germany's health care system never came close to being overwhelmed by the pandemic, the country is likely to enter a recovery stage earlier than other large Western economies. Car manufacturers are stepping up production and shops have already started to open gradually. Germany's reliable short-time work compensation programme and further fiscal policy stimulus amounting to more than 10% of Germany's nominal GDP will support the gradual recovery in the second half of 2020. In contrast to France, Italy and Spain, Germany is less dependent on services which suffer comparably more than manufacturing in the current crisis. The loss from the fact that international travel bans may stay in place over the summer months could be partially compensated by additional domestic demand for tourism offerings. The biggest risk is a second wave of the pandemic resulting in a persistent collapse of foreign demand for Germany's manufacturing and engineering industries and renewed tightening of lockdown measures.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.4 %	2020: 0.7 %
2021: 1.3 %	2021: 1.4 %

In Germany, fear of accelerating inflation is a typical reaction to monetary accommodation. This could be observed in the years from 2008 to at least 2012, although scaremongers were persistently proven wrong by actual numbers. The same narratives came back to life with the recent co-ordinated monetary and fiscal policy measures. Yet, the fall in energy prices and the wide negative output gap pose deflationary rather than inflationary risks, at least in the short term. Unless energy prices shoot up in an unforeseen way, headline inflation rates in Germany are set to stay below 2% over the entire forecast horizon until end of 2021.

France
An unfavourable business mix

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -5.6 %	2020: -5.4 %
2021: 5.0 %	2021: 5.1 %

One month ago, our working assumption was that GDP in European economies might drop to 80-90% of normal levels in March and April. As this now seems too optimistic, we lower our projections for annual GDP growth yet again. Our current forecast for 2020 and 2021 is slightly below consensus. According to the French statistical office INSEE, capacity utilisation fell to 56% in March, far below the long-term average rate of 81%. Back in January, capacity utilisation stood at 77%. With imposed lockdown measures in France being comparably stricter and expected to stay in place for longer than in neighbouring Germany, we expect activity to resume by the end of the second quarter at best. As services are contributing comparably more to gross value added in France than in Germany, the French economy was better protected during the previous economic downturn since 2008. Yet, this time the services sectors are suffering most from the crisis. According to preliminary data, the services sectors Purchasing Managers' Index (PMI) fell to 10.4 points in April. This marks a low since records started in 1998. Manufacturing sentiment too fell deep into recession territory, but the PMI data for these sectors did not fall far below levels seen during the great recession of 2008 and 2009.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.2 %	2020: 0.4 %
2021: 1.3 %	2021: 1.3 %

Low energy prices mean that inflation is set to come in very low in 2020 and investors still have time to assess future inflation risks. While growth forecasts underwent massive revisions since last month, the consensus inflation forecast for France remains unchanged for 2021. A partial deglobalisation seems a likely medium-term consequence of COVID-19. This does not necessarily trigger an inflation spiral as suppliers are not in the position to pass on higher production costs to their customers. As we expect GDP only to return to pre-crisis levels in 2022, the output gap is set to remain negative for a prolonged period.

UK
Deeper recession, slower recovery

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -4.2 %	2020: -5.4 %
2021: 3.6 %	2021: 4.7 %

The UK was late in imposing lockdowns and will be later than most countries on the Continent to lift restrictions again. As daily new cases were still not showing a sustainable decline at the end of April, the government extended the lockdown regime into May with no indication on how the exit strategy might look like. Evidence on the economic fallout is still scarce. The only major activity data released for March were retail sales volumes, which dropped by 3.7% compared to February. This is the largest monthly drop in the history of the series, but the worst is yet to come. The Purchasing Managers' Index for the services sector showed an unprecedented drop in April to 13.4 points, implying that almost none of the polled companies saw business activity improving compared to the previous month. As in the other developed markets, we also expect the recession in the UK to be deeper and the recovery to be slower than previously assumed, hence the significant downward revision from –1.4% to –4.2%. The repercussion on private demand will depend on labour market developments, which are difficult to gauge as the effectiveness of the government's new job retention programme is still unclear. At the time of writing, around 4 million employees were enrolled, a rather modest figure compared to the German-speaking world with their similar and well-established short-time work schemes. Also, the programme is set to expire end of June, which is likely too early to avoid a surge in unemployment.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.9 %	2020: 1.0 %
2021: 1.7 %	2021: 1.6 %

The March inflation report showed a large decline in energy-related prices, as expected, and clear signs of a "coronavirus impact". Items in high demand such as healthcare or communication saw higher inflation, while inflation in disrupted sectors such as restaurants, hotels or recreation moderated. The overall impact of the crisis will be disinflationary, in our view.

Switzerland
Short-term work safety net holds

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -3.1 %	2020: -3.3 %
2021: 3.6 %	2021: 3.6 %

According to SECO, Switzerland's State Secretariat for Economic Affairs, filings for short-term work compensation have risen to 1.85 million, which is equivalent to around one third of Switzerland's total number of employees. Roughly half of the applications have been approved so far. At the same time, the number of unemployed persons is expected to reach 155'000 by end of April, causing the unemployment rate to rise to 3.4% from 2.5% at the end of 2019. Despite this rapid increase, the safety net in the form of the short-time work programme seems to hold for the moment. With the medical data improving, Switzerland is gradually easing restrictions. Yet, the economic damage is probably substantially bigger than estimated one month ago. For 2020, we now expect GDP to contract by 3.1% in the wake of the measures to contain COVID-19. This compares with a forecast of -1.3% a month ago. The uncertainty with respect to such projections remains very high and the impact of lockdown measures varies between individual sectors. While we think that output of a third of the economy (including financial services, education, health and government) will remain largely unscathed by the pandemic, the rest of the economy experiences a substantial temporary hit of between 5% and 80% compared to the pre-crisis output. For the two hardest hit sectors (accommodation & leisure) we expect output only to recover to around 75% of pre-crisis levels until end of 2020.

Inflation	
Swiss Life Asset Managers	Consensus
2020: -0.5 %	2020: -0.5 %
2021: 0.6 %	2021: 0.5 %

Switzerland is back in deflation with consumer prices falling from year ago levels. We expect April inflation to drop to -0.7% due to the sharp drop in energy prices and the strong Swiss Franc. As we expect a certain normalisation of global activity in the second half of the year, energy prices should recover gradually and contribute positively to next year's inflation numbers.

Japan
A balancing act

GDP growth

Swiss Life Asset Managers	Consensus
2020: -4.9 %	2020: -3.3 %
2021: 2.6 %	2021: 2.1 %

Even though the coronavirus pandemic affected Japan as one of the first developed nations, infection rates were very low before they started to take off in the last week of March. Still, both infection numbers as well as the death toll remain relatively low. Also, the government tries to stick to a strategy comparable to Sweden. Prime Minister Abe declared a state of emergency in April, but no national lockdown measures were imposed apart from the closing of schools. Most social distancing rules remain voluntary. A stated aim of the strategy is to balance between medical and economic risks, a strategy apparently successful so far. The Japanese economy will undoubtedly experience a severe recession in the first half of 2020, but the April Purchasing Managers' Indices imply that Japanese businesses were less hit than their European counterparts. Nevertheless, the government stepped up its fiscal effort in April, announcing a package ostensibly worth 20% of GDP (usually, the stated numbers are exaggerated), including direct payments to businesses and households. At the same time, the Bank of Japan signaled flexibility to buy as much government bonds as it deems necessary in order to keep yields around targets, thus paving the way for potentially more fiscal measures to come.

Inflation

Swiss Life Asset Managers	Consensus
2020: 0.1 %	2020: -0.1 %
2021: 0.3 %	2021: 0.2 %

The Japanese economy will only avoid a negative inflation number for the full-year 2020 due to the consumption tax hike in October 2019. Lower energy prices, the year-to-date appreciation of the Japanese yen as well as lower consumer demand are likely to exert downward pressure on prices in the coming months. Wage pressures, which were surprisingly strong up until February, are also likely to ease as the job-to-applicant ratio fell sharply in March.

China
Economy shrinks sharply

GDP growth

Swiss Life Asset Managers	Consensus
2020: 1.2 %	2020: 2.0 %
2021: 8.4 %	2021: 7.8 %

In the first quarter, China's economy contracted by 6.8% from year-ago levels after a nationwide lockdown, including factory shutdowns, disrupted economic activity. Monthly indicators, however, showed a recovery in the month of March across the board. Especially on the supply side the situation improved substantially, with industrial production rebounding from the February double-digit contraction to -1.1%. Nevertheless, on the consumption front things look less dynamic, evidenced by a much smaller recovery in retail sales, extending the double-digit contraction into March. Besides the only tepid improvement in domestic demand, external demand poses an additional challenge, given the deep global recession. Therefore, we revised down our full year GDP forecast to 1.2% from 3.8% previously. Looking ahead, we expect a continuous but gradual recovery in economic activity as lockdown measures are widely being removed and prevention measures in the form of digital tracing are being enforced. The major risk to our forecast remains the eruption of a second wave of coronavirus cases, as new clusters are emerging. Most recently, Harbin, a northeastern Chinese city, recorded an increase in cases due to infected Chinese travellers arriving from Russia.

Inflation

Swiss Life Asset Managers	Consensus
2020: 3.4 %	2020: 3.3 %
2021: 2.0 %	2021: 2.1 %

March inflation moderated more strongly than expected, driven by lower food prices as supply constraints on some food items eased, while oil prices plummeted. Moreover, excluding food and energy, core inflation remained at a very low level of 1.2%. We expect inflation to continue to moderate due to weak demand and low oil prices and therefore revise down our full year inflation forecast to 3.4% from 3.6% previously.

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Perspectives
Financial Markets

Swiss Life
Asset Managers

May 2020

Interest rates & bonds

Nothing is off-limits anymore

USA

- 30 million jobless claims were filed over the past six weeks, while sentiment indicators in the US plunged to unprecedented levels.
- A combination of large-scale fiscal and monetary packages along with steps to gradually open the economy again have nonetheless calmed fixed income markets for now.

Eurozone

- We have yet to see hard economic data, but sentiment indicators signal a deep economic contraction, with the service sectors being the hardest hit.
- The ECB continues to buy bonds under its various asset purchase programmes, while the fiscal stimulus dampens the negative effect on the real economy.

UK

- April Purchasing Managers' Indices dropped to 13.4 for services and 32.6 for manufacturing, highlighting the unprecedented economic shock from the measures taken to contain the Covid-19 outbreak.
- The BoE announced GBP 200 billion of asset purchases alongside a 65 basis points cut in policy rates, which should help to mitigate the economic fallout.

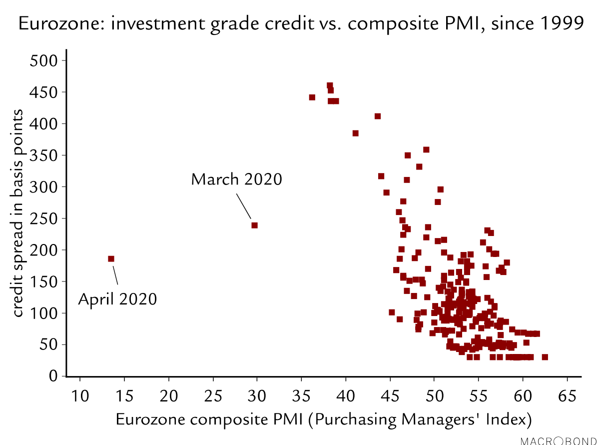
Switzerland

- While we expect the Swiss economy to prove more resilient than its European neighbours due to a swift fiscal response and a favourable sector composition, it will nevertheless experience a sharp contraction.
- The SNB will continue to focus on currency interventions, while we view policy rate cuts as unlikely.

Japan

- Although Japan is less severely impacted by the pandemic, economic activity is expected to slow down materially.
- The Bank of Japan has further expanded its quantitative easing programme by removing the limit on government bond purchases.

April 2020 – weaker economy, but tighter spreads



Nothing seems to be off-limits anymore for central banks in order to dampen the economic fallout from the pandemic. Unlimited quantitative easing by the Bank of Japan, direct lending by the US Federal Reserve to corporate credit issuers and even purchases of "fallen angels" (i.e. bonds that were downgraded from investment grade to high yield) are now part of the toolbox. While credit markets calmed in April, with EUR and USD credit spreads tightening by 53 and 71 basis points respectively, we remain sceptical about the latest market moves. The earnings season is in full swing. So far, earnings have fallen by 25% in Europe and 15% in the US, while most companies withdrew their forward guidance. We believe that investors who still believe in a V-shaped recovery are in for a disappointment. Rather we expect a U-shaped recovery, with still big uncertainties regarding the extent of the current decline as well as the duration of the subsequent recovery. Under these circumstances, we think it is prudent to stay defensive over the coming month. We remain underweight credit risk and seek shelter in areas supported by central banks, namely short-dated USD corporate bonds and securities eligible for the ECB's CSPP (corporate sector purchase programme). We expect government bond yields to be range-bound, hence our neutral to slightly long duration position.

Equities

Another milestone passed but challenges ahead

USA

- The US is lagging other developed economies regarding the slowdown of new Covid-19 infections, but it is nevertheless easing the lockdown in order to restart the economy.
- The historically low oil price is putting pressure on the US oil industry and related sectors, but broader negative spill-overs should be limited.
- Despite the weak fundamentals, the broad diversification of the US equity market and its very significant share of sectors less impacted by the virus (for example Technology) lead us to keep our slight overweight in US stocks.

Eurozone

- The good progress in reversing the infection trend is allowing most countries to start a stepwise reduction of lockdown measures.
- However, this process will be slower than in Asia or the US. In combination with the strong reliance on international trade and the still unresolved debt problem in the periphery, the Eurozone economy will take longer to reach pre-crisis levels. We therefore stick to our underweight position in Eurozone equities.

UK

- In the fog of the Covid-19 crisis it is easy to miss that the Brexit discussion has not advanced at all.
- We do not expect any swift progress on this issue, while the economy is still battered by the coronavirus pandemic. We stay underweight UK equities.

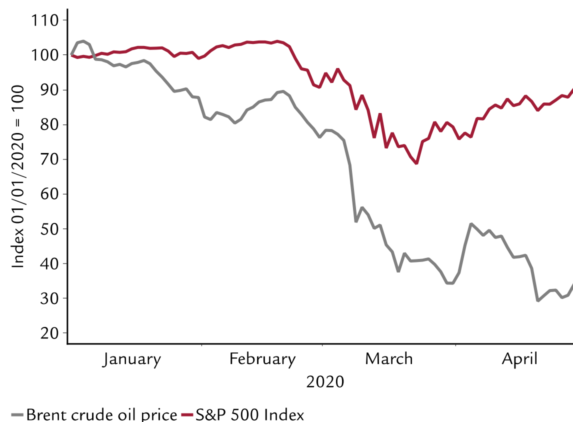
Switzerland

- While Swiss stocks are not cheap, the defensive nature of this equity market makes it a very attractive choice in the current uncertain environment.
- We therefore continue to be neutral Swiss equities.

Japan

- Japan is confronted with a second wave of infections and the government has reinforced its social distancing recommendations to contain the epidemic.
- Economic prospects have thus darkened compared to one month ago. We remain underweight Japanese equities.

Equities recovering, while oil is at 21-year lows



The month of April saw a continuation of the equity market recovery that started at the end of March as we passed another milestone of our "epidemic playbook" that we described in the last edition of this publication: daily new infection numbers peaked, which was followed by discussions around the globe on how and when to lift lockdown measures. Nevertheless, the recovery was based on relatively weak fundamentals, as survey data dropped to unprecedented levels and companies retracted their future earnings guidance due to high economic uncertainty. The massive drop of the Brent crude oil price to levels last seen in the late 1990ies and the temporary negative spot prices for US crude (WTI) are further negative signs, indicating a severe global demand shortfall amid full storage capacities. Lastly, the equity market rally in April was based on relatively thin trading volumes, indicating that many investors refrained from increasing their equity exposure.

Uncertainties will prevail over the next month and keep equity markets volatile. These uncertainties relate to the pandemic (risk of a second wave once lockdowns are eased), the medical response (potential positive and negative news regarding vaccines and treatments) and the economic outlook in general. Our overall equity view is thus biased towards being defensive.

Currencies

JPY should outperform among the safe havens

USA

- In April, the USD appreciated against the cyclical EUR and emerging market currencies, but lost somewhat against the JPY and commodity-related currencies such as GBP or CAD.
- The interest rate advantage of USD has faded, removing an important reason that had kept us positive on the greenback for a long time. We now prefer a neutral view on the USD against EUR, GBP and CHF.

Eurozone

- The EUR was under pressure in April, as economic data plunged more than in other developed markets and as EU policy-makers failed to come up with a coherent response to medium-term risks for highly-indebted countries such as Italy and Spain.
- The EUR reduced some of the losses on the last day of April when the ECB disappointed markets by not stepping up its asset purchase programme. We have a neutral view on both EUR/CHF and EUR/USD.

UK

- After an up and down in April, GBP ended the month somewhat stronger against the USD, in line with other currencies that are sensitive to commodity prices.
- We change our view on GBP/USD from positive to neutral.

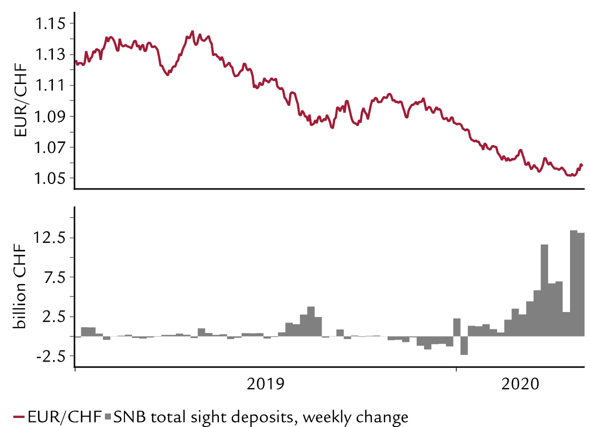
Switzerland

- In April, generous SNB interventions contributed to keeping EUR/CHF above the 1.05 mark.
- While the CHF remains under appreciation pressure, not least due to fading interest rate differentials to other economies, ongoing SNB currency interventions should limit the downside on EUR/CHF.

Japan

- Among safe haven currencies, JPY showed the strongest appreciation in April.
- We expect this to remain the case over the coming month and reiterate our negative view on USD/JPY.

SNB interventions so-far successful in stabilizing EUR/CHF



After a very volatile month of March, currency markets calmed in April, and a familiar pattern well-known from 2019 was re-established – appreciation of USD and JPY (both considered safe haven currencies) despite a rally in risky assets. Our positive view on EUR/USD expressed last month, which was based on the argument of a fading carry advantage, was thus proven wrong. Markets probably focused more on economic prospects, which are indeed worse for the Eurozone as compared to the US, in our view. Also, the medium-term risk of a "euro crisis 2.0" is still not off the table, as policy-makers failed to resort to a credible form of risk-sharing between Eurozone member states, e.g. in the form of "coronabonds". We opt for a neutral view on EUR/USD over the coming month but see the JPY stronger against all major currencies amid high uncertainty.

In April, the odd-one out amongst safe haven currencies was the CHF, which only appreciated marginally against EUR and lost around 1% against the USD. This is even more surprising as interest rates between Switzerland and Germany have converged, decreasing the carry cost of holding CHF. Hence, it appears that the ongoing foreign exchange interventions by the Swiss National Bank (SNB) were successful in absorbing CHF appreciation pressure in April. EUR/CHF indeed never dropped below 1.05, at the "cost" of sight deposits at the SNB increasing by CHF 30 billion in the month of April. We keep a neutral view on EUR/CHF.

Swiss Life Asset Managers

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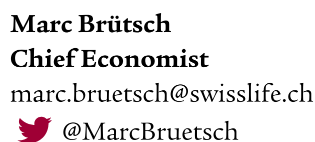

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