Swiss Re Institute

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Economic Insights:
The world economy in 2019: the three Ps to watch

In a nutshell

We expect softer and diverging global economic growth in 2019. Overall, we believe the balance of risks is skewed to the downside. We are keeping a close watch on the three Ps: prices, as inflationary pressures are increasing in the medium term; policies, as central banks transition from quantitative easing (QE) to quantitative tightening (QT); and politics, as trade tensions mount. Still, the environment remains upbeat and one of stronger growth for insurance markets, thanks also to emerging markets powering on.

Over the past two years, global economic growth was the best it has been in a long time. While the outlook is still benign, we believe softer and more diverging global growth is ahead. We forecast US GDP growth to decline by 0.7%pts to 2.2% over the next year (consensus: 2.6%), on the back of a fading fiscal stimulus, tighter monetary policy and trade tensions. We also expect the Euro area economy to slow somewhat to 1.5%, which is still above its longer-term growth trend. For the UK, we anticipate growth rates to average 1.6%, though this is highly dependent on a benign Brexit outcome. For emerging markets, where growth projections can vary significantly by country, we believe GDP growth will rise modestly to 4.9%. In China, we predict GDP growth to fall to about 6.3%.

We are not overly concerned about consumer price inflation in 2019. Even with a 20% increase in oil prices from current levels, we estimate US and Euro Area headline inflation to remain below their current levels. However, the drivers for medium-term increases in inflation are well in place. In the US, the economy is already at full capacity, the labour market is very tight and wages are increasing, which puts the economy at risk of overheating. In Europe, core inflation (excluding energy prices) has stabilised at around 1% in recent years. We expect it to rise somewhat in 2019, yet more moderately than the ECB projects. But like in the US, the output gap in Europe is narrowing and wages are increasing.

Central banks will continue their gradual policy normalisation next year. However, the normalisation processes are at very different stages. We believe the US Fed will raise rates twice more in 2019, simultaneously marking the end of its hiking cycle. Despite the Fed dots[1] predicting three hikes, financial market pricing is sceptical and prices only one hike next year, and roughly 10bps of rate cuts in 2020. In the Euro area, we believe the ECB will execute a first 25bps deposit rate hike in the second half of 2019 and then pause. In fact, financial markets seem to doubt that the ECB will raise rates at all next year. Beyond 2019, it's quite likely that the ECB is not able to meaningfully normalise monetary policy before the next recession. Meanwhile in the UK, the Bank of

[1] The Fed's "dot plot" is published four times a year. It shows the Federal Open Market Committee (FOMC) participants' short-term interest rate projections.

Key takeaways

- We expect GDP growth to soften in most large economies in 2019. Overall, the balance of risk is skewed to the downside.
- We predict that headline inflation in advanced economies will decrease somewhat from current levels. The drivers for medium-term increases, however, are well in place.
- We expect two rate hikes by the US Fed in 2019 to mark the end of their tightening cycle. The ECB could hike rates once in the second half of next year.
- The still favourable economic circumstances support above 3% growth in global insurance premiums over the next few years.

About Economic Insights
Analysis of key economic developments and their implications for the global re/insurance industry.

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England is expected to raise rates once in 2019, assuming that a common denominator on Brexit is found.

Our forecast for longer-term interest rates is that the US 10-year government bond yields will not sustainably rise much higher than current levels; this is due to the still existing and well-known structural factors, such as a large debt overhang, low productivity growth and well-anchored inflation expectations. We do expect some modest increases in German 10-year government bond yields in response to less monetary accommodation by the ECB, particularly on the quantitative easing (QE) side. We forecast 10-year Bund yields to settle at 1% by end-2019.

Figure 1
Overview of key macroeconomic forecasts

Key forecasts (in %)

	Real GDP growth annual average		Headline Inflation annual average		CB policy rate at year-end		10y yield govt bond at year-end	
	2019	Consensus	2019	Consensus	2019	Consensus	2019	Consensus
US	2.2	2.6	2.3	2.3	2.88	3.04	3.2	3.5
UK	1.6	1.5	2.3	2.2	1.00	1.09	1.8	2.0
Euro area	1.5	1.7	1.4	1.7	0.25	0.11	1.0	1.0
China	6.3	6.2	2.4	2.3	-	-	-	-

Source: Swiss Re Institute, Bloomberg as of 29.11.2018

Overall, we believe the balance of risk is tilted to the downside with trade tensions being our number one risk to watch. Our baseline scenario already assumes a 25% tariff on all goods traded between the US and China and an associated negative impact of 0.1 to 0.2% pts on global GDP growth. However, these figures could worsen to about 1.5-2.5% pts if a full-blown trade war occurs, and a 10% tariff rate on all goods traded worldwide is imposed. Trade tensions have also reignited the risk of a sharp slowdown in China's economy, which would also have a severe impact on the global economy. Other risks we see are overheating/recession in the US, stronger than expected inflationary pressures (both a 15% likelihood) and a central bank policy error (20% likelihood). While we acknowledge that the confrontation between the Italian government and the EU has the potential to worsen - and perhaps drive the Italian government bond spread versus Germany higher - we still believe that the probability of destabilisation in the Euro area remains very low.

The still favourable economic circumstances support above 3% growth in global insurance premiums over the next few years. China and emerging Asia are the main engines of growth due to their increasing wealth and insurance penetration. Marine and trade credit lines would suffer the most if trade tariffs are imposed. Finally, the increase in interest rates to date will help insurance profitability through higher reinvestment yields in fixed income, albeit very slowly.

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