Global Economic Scenario
January 2016

SwissLife
Asset Managers

Revisions since last month (in brackets forecasts as per previous month)

	GDP 2015		GDP 2016		CPI 2015		CPI 2016	
	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus
USA	2.5%	2.5% (2.4%)	2.5%	2.5% (2.6%)	0.1% (0.2%)	0.2% (0.1%)	1.7% (1.9%)	1.7%
Euro Area	1.5%	1.5%	1.4%	1.7%	0.1%	0.1%	1.3%	1.0% (1.1%)
Japan	0.7%	0.6%	1.0% (0.9%)	1.2% (1.3%)	0.8%	0.8%	0.3%	0.7% (0.8%)
UK	2.4% (2.3%)	2.4% (2.5%)	1.9%	2.3% (2.4%)	0.1%	0.1%	1.1% (1.2%)	1.1% (1.3%)
Switzerland	0.7%	0.8%	0.7%	1.2%	-1.1%	-1.1%	0.0%	-0.3% (-0.2%)

Source for Consensus Estimates: Consensus Economics Inc. London, 7 December 2015

USA – Very strong labour market in Q4 thus far

GDP Growth

Swiss Life Asset Managers	*Consensus*
2016: 2.5%	*2016: 2.6%*
2017: 2.1%	*2017: n.a.*

The November employment report clearly showed the "further improvement" in the labour market which Fed policymakers said was needed to raise key rates. Payrolls increased by 211'000 and there were upward revisions totalling 35'000 to the two preceding months results. Equally so, the household survey was positive as well, showing a stable unemployment rate of 5.0% while also revealing a slight increase in the labour force participation. The setback of average hourly earnings to an annual change of 2.3% from 2.5% in October may be viewed as disappointing. Yet, much of this goes back to a strong base effect, as average hourly earnings had increased substantially in November of last year. To summarise, the latest report on the health of the labour market certainly solidifies the case for a Fed rate hike later this month and this view seems to be shared by market participants. One may even argue that if job growth continues at the current pace and the base effect for headline inflation actually kicks in as foreseen in our outlook, then investors may feel under pressure to re-assess the amount of tightening which has been priced in until the end of next year. As a matter of fact, the year-over-year change of average hourly earnings for December may surprise some market watchers to the upside. These figures will be published early next year and the aforementioned base effect should reverse to show growth of earnings reach 2.8% from currently 2.3% - a rather large jump in historical context. Optimism gets dampened, however, by the latest reading of the purchasing managers' index for the manufacturing industry. Unexpectedly, the ISM index dropped below the crucial threshold of 50 which indicates contraction in the manufacturing sector. To dim the outlook further, the non-manufacturing ISM followed suit, declining to 55.9 in the November print from 59.1 previously, holding comfortably above the threshold therefore. As in other economies, service sector activity will therefore continue to drive growth expansion, being less hurt by dollar appreciation. Finally, growth expectations were dampened by the publication of the trade balance for October. In real terms, goods exports fell 2.4% from September and goods imports were flat on the month. This led the real goods deficit to widen to $60 billion. On balance, the October trade report reflects soft international demand and the strong Dollar. PMIs and the trade balance justify our rather cautious growth outlook heading into 2016.

Inflation

Swiss Life Asset Managers	*Consensus*
2016: 1.7%	*2016: 1.7%*
2017: 2.2%	*2017: n.a.*

Due to the continued decline of energy prices, we had to lower our forecast for headline inflation in November once again. The year-over-year rate will nevertheless strengthen to 0.4% from currently 0.1%, just to end the year at 0.9%. Core inflation may well reach the Fed's target of 2.0% with the upcoming November print.

Euro Area – Consumption driven growth

GDP Growth

Swiss Life Asset Managers	Consensus
2016: 1.4%	2016: 1.7%
2017: 1.3%	2017: n.a.

For the years 2016 and 2017, we are positioned slightly below consensus as regards annual average GDP growth. Despite that fact, actual real GDP growth will exceed potential output until the end of 2017. We expect continued strong support from domestic demand across the currency region, although the contribution from business fixed investment remains lacklustre compared to other business cycles. Personal consumption, on the other hand, gets some tailwind not only from low inflation but also from a continued modest decline of the unemployment rate which now stands at 10.7% for the Euro Area as a whole. Finally, given the continued recovery of the labour markets, wage growth should give modest support. Given the refugee crises and increased public spending on security, fiscal austerity has dropped from governments' agenda for now.

Inflation

Swiss Life Asset Managers	Consensus
2016: 1.3%	2016: 1.1%
2017: 1.7%	2017: n.a.

The latest advance estimate of consumer price inflation for the month of November was a disappointment. Core inflation which has shown resilience thus far, hardly displaying any pass-through effect from the strong decline of commodity prices, dropped back to a level of 0.9% where it stood in August and September of this year. This preliminary print, however, did not trigger an overreaction of the ECB, which actually disappointed market expectations in terms of further easing measures. The disappointing CPI print was mainly the result of a weak print out of Italy, where the end of the Milan exposition created a temporary plunge of services prices. In the wake of its meeting, the ECB also revised down its own inflation outlook last updated in September of this year. They expect average annual inflation to reach 1.0% in 2016 from 1.1% previously and 1.6% in 2017 from 1.7%. It remains to be seen if diverging monetary policies and the resulting depreciation of the Euro will be able to lift headline inflation clearly above 1% as early as next year. To approach the ECB's target of 2%, energy prices needed to rise.

Japan – A recession that never happened

GDP Growth

Swiss Life Asset Managers	Consensus
2016: 1.0%	2016: 1.3%
2017: 1.0%	2017: n.a.

In our last two issues, we discussed first the probability and later the alleged confirmation that Japan fell once again in a technical recession during the third quarter of 2015. Only a few weeks later it is clear that the first preliminary data sent out a false signal. As it happened so often with Japan's national account data, the second official estimate contained substantial revisions to third quarter GDP data. Even the prefix changed: Instead of contracting by -0.2%, GDP is now reported to have grown by 0.3% in the three months until September. The latest data are more consistent with our own observation of improving sentiment indicators in the business sector as well as among private households. This trend continued into the final quarter of 2015: In November, Japan's manufacturing sector purchasing managers index climbed to its highest level since March 2014. Small business sentiment recovered from a temporary dip through the second quarter. The Shoko Chukin Bank's sentiment indicator climbed to 49.9. Any reading above 50 suggests that a majority of firms participating in the poll express a positive assessment of their current situation. The last time this indicator stood above 50 points was during the first quarter 2014. Consumer confidence as well improved further until November, reaching its highest level since December 2013.

Inflation

Swiss Life Asset Managers	Consensus
2016: 0.3%	2016: 0.8%
2017: 0.3%	2017: n.a.

We stick to our sub-consensus inflation forecast for 2016 as wage growth continues to disappoint. A renewed consumption tax hike by April 2017 from 8% to 10% is still in the cards. For the time being, we have not yet included such a measure into our inflation path for 2017. This explains the wide gap to the consensus estimate of 2.0% inflation by 2017 according to the latest Bloomberg poll. During the first quarter 2016, we will closely monitor the political debate. Once we are convinced that the tax hike will come, we will adjust the 2017 inflation (and growth) forecasts accordingly.

UK – No further cooling in the final quarter 2015

GDP Growth

Swiss Life Asset Managers	*Consensus*
2016: 1.9%	*2016: 2.4%*
2017: 1.8%	*2017: n.a.*

At first glance, news that growth in the third quarter slowed to 0.5% and that the majority of incoming data for the last quarter 2015 disappointed market expectations, validates our sub-consensus forecast for the UK. Yet, a closer look at the data so far available for the current quarter suggests that economic dynamics did not cool further compared with the pace reported for the third quarter. Our own GDP growth model derived from current quarter PMI values even hints at a 0.6% gain from the previous quarter, consistent with the three-month rolling estimate provided by NIESR, the National Institute of Economic and Social Research. Our PMI model suggests that GDP growth picked up by probably as much as 0.2%. Another reason, which made us revisit the growth path for the coming quarters, was the soft tone as regards future fiscal austerity in George Osborne's Autumn Statement on public finances. As we raise our forecast slightly on news of continued underlying strength in the domestic economy and prospects of a less restrictive fiscal policy, the urgency for monetary policy normalisation is more evident than ever. The Bank of England should follow the US central bank by tightening monetary policy in the first half of 2016.

Inflation

Swiss Life Asset Managers	*Consensus*
2016: 1.1%	*2016: 1.3%*
2017: 2.0%	*2017: n.a.*

Falling energy prices until the end of November mean that we had to adjust our inflation profile slightly to the downside. Looking through commodity price developments and their heavy short-term impact on headline inflation, we spot recovering price setting power in parts of the domestic services industry resulting in rising core inflation even as energy prices fall and the Sterling appreciates. Wage growth exceeding 2% since more than a year in the private sector and accelerating from 0.6% to 1.4% from December 2014 until recently in the public sector is an additional source for future inflation.

Switzerland – Illusive consensus forecast

GDP Growth

Swiss Life Asset Managers	*Consensus*
2016: 0.7%	*2016: 1.2%*
2017: 1.0%	*2017: n.a.*

Last week, we learned that Switzerland's economy stagnated in the third quarter. Thus, substantial downward revisions in our peers' forecasts for 2016 are likely. To reach 1.2% average real annual GDP growth in 2016, Switzerland should return to a quarterly pace of around 0.4% in each quarter of 2016, or the same pace as recorded during the expansionary period of 2012 until 2014. In our view, this is an illusion: As mentioned many times in earlier publications, firm private consumption prevented Switzerland from a recession after the SNB abandoned its minimum exchange rate policy. Households benefited from lower import prices for big-ticket items. This year's firm contribution to GDP growth by private consumption will not repeat itself in 2016, as prices stabilise and demand for durable goods is satisfied. In fact, monthly car sales have dropped by 6% so far in the last quarter from average volumes reported between February and September. Efforts to consolidate public finances on all state levels are likely to result in a fiscal drag. Consequently hiring activity will eventually slow also in the public sector. Our model suggests an increase in the unemployment rate from currently 3.4% to 3.7% until the end of 2016.

Inflation

Swiss Life Asset Managers	*Consensus*
2016: 0.0%	*2016: -0.2%*
2017: 0.2%	*2017: n.a.*

On a trade weighted basis, the Swiss Franc weakened since mid-2015. Import prices seem to have stopped falling therefore. Assuming unchanged energy prices, inflation should return into positive territory in the second half of 2016. Yet, the underlying inflationary forces remain soft given the immense pressure on retailers and hotels from foreign competition. Only in the unlikely case that the price for Brent crude oil surges above 100 USD per barrel, inflation in Switzerland could cross the critical threshold of 2% from here until the end of 2017.