Global Economic Scenario
February 2017

SwissLife
Asset Managers

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

	GDP 2017		GDP 2018		CPI 2017		CPI 2018	
	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus
USA	2.3% (2.2%)	2.3%	2.3%	2.3% (n.a.)	2.5% (2.4%)	2.4%	2.1%	2.3% (n.a.)
Eurozone	1.3% (1.2%)	1.4%	1.2%	1.5% (n.a.)	1.8% (1.5%)	1.4% (1.3%)	1.6%	1.4% (n.a.)
Japan	1.1% (1.0%)	1.1% (1.0%)	0.9%	0.9% (n.a.)	0.7% (0.9%)	0.6% (0.5%)	0.1%	0.9% (n.a.)
UK	1.7% (1.3%)	1.4% (1.3%)	1.0%	1.4% (n.a.)	2.6% (2.4%)	2.5%	2.2%	2.6% (n.a.)
Switzerland	1.2% (1.0%)	1.5%	1.5%	1.7% (n.a.)	0.3%	0.3%	0.4%	0.7% (n.a.)

Source for Consensus Estimates: Consensus Economics Inc. London, 9 January 2017

USA – Awaiting a new political agenda

GDP Growth

Swiss Life Asset Managers	*Consensus*
2017: 2.3%	*2017: 2.3%*
2018: 2.3%	*2018: 2.3%*

As already highlighted in last month's edition, the business sentiment of small and medium-sized firms (NFIB index) continues to reflect buoyant fiscal optimism. The NFIB index jumped to the highest level since December 2004 – one of the most pronounced increases since the inception of the data series in 1986. In particular, sales expectations skyrocketed. The same business cycle optimism is reflected in all of the regional business surveys, but also in consumer sentiment readings. While the GDP growth number for the third quarter 2016 was once again revised to the upside – the sole reason for our 2017 growth revision – real economic data indeed confirm rather strong dynamics at the turn of the year. Yet, with the inauguration day of Mr. Trump just around the corner, the US policy outlook remains one of the most important macro debates, also shaping the path of GDP growth rates going forward. Considering unprecedented policy uncertainty, most forecasters hold their breath for the time being and abstain from changing their outlook so close to the handover of office in the White House. We join the crowd in this respect. The aspects which matter the most are taxation of corporates, fiscal spending and potential protectionism. In a next step, should the fiscal impulse indeed prove to be noteworthy, one also needs to consider the potential reaction of the Federal Reserve to such a stimulus including the multiplier effect this generates. At this stage, our own growth forecast for 2017 runs the risk of being too low if the policy agenda and decisions of the new administration are able to revive animal spirits of entrepreneurs. As mentioned many times before, capex spending of companies was unusually timid in this recovery phase and this may well change in a more tax-friendly environment. We allocate the thrust of the fiscal impulse, i.e. infrastructure spending as such, into the year 2018. In the current interest rate environment, uncertainty also arises as regards the potential growth contribution from residential spending. The standard long-term fixed mortgage rates have increased notably since the reflation theme is playing out which may dampen construction activity as well as related durable goods consumption. This constitutes a slight downside risk to an otherwise constructive economic outlook given current political uncertainties.

Inflation

Swiss Life Asset Managers	*Consensus*
2017: 2.5%	*2017: 2.4%*
2018: 2.1%	*2018: 2.3%.*

Again, energy prices will deliver a substantial share to the monthly increase of inflation from November to December 2016. In annual terms, this renewed step-up on a monthly basis adds to the base effect, emanating from the low level of energy prices a year earlier, and pushed headline inflation to 2.1%. During the year 2017, headline inflation will reach an early peak by March at 2.7% just to move somewhat lower through the remainder of the year. A certain upside risk stems from Trump's intention to levy tariffs on foreign imports which could potentially push the domestic price level up further.

Eurozone – Strong dynamics for now

GDP Growth

Swiss Life Asset Managers	Consensus
2017: 1.3%	*2017: 1.4%*
2018: 1.2%	*2018: 1.5%*

The Eurozone economy is likely to have grown as much as the US in the fourth quarter of 2016, at a 0.5% quarterly pace. This is clearly above potential growth yet again. High frequency macroeconomic data over the past three months already indicated a very healthy momentum, not only in Europe, but rather on a global scale. This effect is equally visible in leading indicators for global trade. Morgan Stanley's world trade monitor impressively underlines the revival of global activity which ultimately benefits trade-oriented companies. Another driver for strong economic momentum in the single currency region are financial conditions which were a support ever since the strong decline of the Euro's external value as from mid-2014 on. Loose financial conditions continue to be a noteworthy underpinning for overall macro dynamics. Bank lending has recovered somewhat from the miserable levels in previous years. As elsewhere, sentiment indicators as well as purchasing managers indices get carried away from the general wave of economic optimism triggered by political change in the US. Monetary policy and asset purchases of the ECB over past quarters paved the ground for more fiscal easing going forward as governments' interest rate burden on debt has diminished dramatically. Despite excessive debt ratios still in many member countries, several prominent institutions are advocating increased deficit spending in order to boost growth further. It is critical, however, not to lose structural reform goals out of sight.

Inflation

Swiss Life Asset Managers	Consensus
2017: 1.8%	*2017: 1.4%*
2018: 1.6%	*2018: 1.4%*

During the best part of the year, headline inflation will be very close to the ECB's target of 2%. Core inflation, on the other hand, will likely hover below 1% still for many months in 2017, averaging just 1.2% according to our own forecast. Unlike in the US, there is still ample slack in the labour market in many countries and wage growth remains far from being inflationary. Yet, at the current growth pace, the output gap should continue to narrow.

Japan – Broad improvement home and abroad

GDP Growth

Swiss Life Asset Managers	Consensus
2017: 1.1%	*2017: 1.1%*
2018: 0.9%	*2018: 0.9%*

For the time being, we stick to our base case assumption that Donald Trump's new administration will restrict itself to implementing only symbolic tariff policy changes. While a future trade war remains a risk worth watching for Japan's exporters, the economic facts speak a different language for the time being: On the business side, the manufacturing purchasing managers index (PMI) rose to 52.4 in December, the highest level recorded in 2016. Meanwhile, the service sector PMI rose for the fourth straight month and ended the year well in expansionary territory. As mentioned last month already, lending activity has started to accelerate by mid 2016, a trend which continued until the final days of 2016. Consumer confidence recovered to its highest level since September 2013, or the early days of Abenomics. These developments triggered upward revisions both to our own growth assumptions and also the consensus forecast. Most recently, core machinery orders from overseas rose by almost 10% in the year until November, helped by the fall in the Yen's trade weigthed value by 11% since September. Thus, despite threatening gestures from the other side of the Pacific, Japan takes part in the current synchronous global upswing.

Inflation

Swiss Life Asset Managers	Consensus
2017: 0.7%	*2017: 0.6%*
2018: 0.1%	*2018: 0.9%*

The weaker Yen and global reflation suggest that the return to positive inflation rates is sustainable. Yet, the separate consumer price index for the Tokyo area which is published one month prior to the release of nationwide data, hints at a volatile development of headline inflation in the last quarter 2016: In Tokyo, prices for fresh food which rose sharply in September and October, fell by 6.5% in December from the previous month. Anticipating a similar move in the nationwide index, we had to lower our assumption on the index level for December 2016 markedly to the downside. This lowers the base to calculate the annual percentage change of the index and thus our forecast for inflation through 2017.

UK – Brexit means hard Brexit

GDP Growth

Swiss Life Asset Managers	Consensus
2017: 1.7%	2017: 1.4%
2018: 1.0%	2018: 1.4%

Industrial production data and the December set of purchasing managers indices across all sectors sharpened the picture of a continued strong expansion following the EU referendum last year. Like most observers, we underestimated the impact of the windfall gain in competiveness thanks to a weak currency. British exporters benefit strongly from the global upswing. The marked upward revision to our forecast for 2017 is mostly due to a substantial lift of our growth assumption for the final quarter 2016: We now expect 0.6% quarterly growth, up from 0.4% previously. The markedly below consensus forecast for 2018 is based on prudence as regards the economic costs of Brexit. Prime minister Theresa May's blueprint of a hard Brexit seems to justify such cautious base case assumptions. Most importantly, it remains unclear whether a free trade agreement with the EU which includes the financial industries is negotiable within two years from March by when we expect the British government to trigger Article 50. What looms for the years ahead is a regime of provisional regulations which may tame animal spirits.

Inflation

Swiss Life Asset Managers	Consensus
2017: 2.6%	2017: 2.5%
2018: 2.2%	2018: 2.6%

Like elsewhere, inflation is on the rise in the UK. Besides the tight labour market and energy price base effects, the weak Pound acts as a separate force. In December, annual inflation rose to 1.6%. With import costs up by 17% from a year ago, we expect more pass-through to consumers in coming months. As one prominent example, Apple has announced to raise the price for App purchases from 79 Pence to 99 Pence, or by 25%. Accordingly, inflation is set to climb further through 2017 before peaking at 2.9% in the month of November.

Switzerland – Signs of recovering domestic demand

GDP Growth

Swiss Life Asset Managers	Consensus
2017: 1.2%	2017: 1.5%
2018: 1.5%	2018: 1.7%

Two years ago, the Swiss National Bank abandoned its minimum exchange rate policy. Up to the third quarter 2016, domestic consumption developed as we had expected immediately after the SNB's announcement: After an initial boom thanks to lower import prices, consumption stagnated during the first three quarters of 2016 as demand for durable goods was satisfied. More recently, we observe a gradual pick-up in domestic demand. September, November and December were the three strongest months for Swiss car dealers in 2016. At the same time, real retail sales finally showed some strength in the final quarter of 2017. We thus adjusted our assumptions for quarterly GDP growth in the final quarter 2016 from 0.2% to 0.3%. The release of official fourth quarter GDP data is scheduled for March 2. We also project slightly stronger growth throughout 2017 as the synchronous global upswing is likely to benefit Swiss exporters more than initially anticipated. Compared with the consensus estimate, our forecast remains on the prudent side both for 2017 and 2018.

Inflation

Swiss Life Asset Managers	Consensus
2017: 0.3%	2017: 0.3%
2018: 0.4%	2018: 0.7%.

Since September 2014, annual inflation was in negative territory with a cyclical trough reached at -1.4% in September 2015. Low energy prices through the first half of 2016 prolonged Switzerland's deflationary period. Thanks to a substantial positive contribution from heating oil, January 2017 will mark the return to positive headline inflation. Under the assumption of stable energy prices, we expect modestly positive inflation rates over the entire forecast horizon until end of 2018.