Global Economic Scenario
May 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	1.9% (2.2%)	2.2%	2.3%	2.4%	2.3% (2.5%)	2.5%	2.1%	2.3%
Eurozone	1.6% (1.4%)	1.7% (1.6%)	1.3% (1.2%)	1.5%	1.9% (1.7%)	1.6% (1.7%)	1.6% (1.5%)	1.4%
Japan	1.2%	1.3% (1.2%)	0.9%	1.0%	0.3%	0.7%	0.3% (0.0%)	1.0%
UK	1.7% (1.8%)	1.7%	1.0%	1.3%	2.6%	2.6%	2.3%	2.7%
Switzerland	1.2%	1.5%	1.6%	1.7%	0.6% (0.5%)	0.5%	0.4%	0.7%

Source for Consensus Estimates: Consensus Economics Inc. London, 10 April 2017

USA – 100 days much ado about nothing

GDP Growth

Swiss Life Asset Managers	*Consensus*
2017: 1.9%	*2017: 2.2%*
2018: 2.3%	*2018: 2.4%*

Mr. Trump's first 100 days in office have passed. Given that the new administration has not implemented any of the crucial ideas which were so catchy to many voters during the election campaign, the verdict must be an annihilating one. Donald Trump seemed to be under pressure to at least present something during the course of last week. Therefore, the White House has just submitted a very sketchy tax reform plan summarised on one page only, which not only lacks details but which also neglects the financing side. The plan includes a substantial reduction of the corporate tax rate, as laid out during the election campaign, from 35% to 15%. Furthermore, US companies should be able to repatriate earnings from abroad at a favourable tax rate which has not been specified. The personal income tax should be simplified and the rate will be lowered as well. Importantly, the plan has no mention of the formerly discussed border adjustment tax. Obviously, the administration assumes that all of these tax reductions will simply be compensated for by higher GDP growth, and very much immediately so. This is not in line with empirical experience. From this very simplified draft, we expect a long road ahead for tax legislation. For the deficit-minded Republican party, the impact on the budget deficit will be an important determinant for their consent or refusal of the proposal. Apart from the tax reform, we still lack details of the infrastructure investments which were a big topic during the campaign. Thus the revision we have undertaken from the previous month down to 1.9% growth in the current year solely goes back to yet another downside surprise of GDP growth in the first quarter. The contribution from the weightiest component of GDP, personal consumption, was a slim 0.2 percentage points, a harsh drop from a contribution rate of 2.4 percentage points in the last quarter of 2016. The weakness is spread across all of the main elements of consumer spending, namely so expenditure for durable and non-durable goods as well as services. Another noteworthy drag came from inventory building which shaved off 0.9 percentage points from overall GDP growth. On a very positive note, however, investment spending added 1.1 percentage points, the highest rate since 2013.

Inflation

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

Both, headline as well as core inflation surprised to the downside for the month of March. While a fairly pronounced impact on headline inflation from declining energy prices was to be expected, the drastic correction of wireless telephone service prices was a surprise. These prices delined by 7% from the previous month, the most dramatic correction ever, but should constitute a one-off event only. Consequently, headline inflation corrected by 0.3% in March from February which brought the annual rate down to 2.4% in March from 2.8% previously. February thus marks the peak in headline inflation for this year. In 2017, headline inflation will be above 2% in each single month, a situation not seen since the year 2007. For core inflation we project an annual average of 2.1% this year.

Eurozone – Holiday season strikes back

GDP Growth

Swiss Life Asset Managers	*Consensus*
2017: 1.6%	*2017: 1.7%*
2018: 1.3%	*2018: 1.5%*

A first hurdle in the French elections has been taken and the worst constellation did not materialise. Markets were fearing a second round where the two extremes of the political spectrum would clash. The two big established parties however fell out of the race. No matter who of the two remaining candidates for presidency will make the race on 7 May, parliamentary elections in June will reveal if a viable coalition can be formed. This will be crucial to avoid political gridlock in the second biggest member country of the Eurozone. Away from politics, the economy looks sturdier than ever since the debt crisis culminated five years ago. Ever since the start of the year the macroeconomic surprise index for the currency region hoevered on extremely high levels, indicating that elevated expectations of analysts were even surpassed by actual data. The Spanish economy in particular continued to outperform its peers. The Statistical Office already published the GDP growth rate for the first quarter of 2017, which came in at 0.8% quarterly growth, beating expectations once again. We currently run the risk that our projection for first quarter GDP growth of the currency region as a whole turns out to be too cautious. The first release for GDP growth will be published on 3 May.

Inflation

Swiss Life Asset Managers	*Consensus*
2017: 1.9%	*2017: 1.6%*
2018: 1.6%	*2018: 1.4%*

Other than inflation data out of the US, the harmonised index of consumer prices in the Eurozone is published on a non-seasonally adjusted basis. This means that shifts in the agenda of public holidays from one year to another, as happened with Easter this year, will almost certainly leave traces in the development of prices between the affected months. Consequently, April inflation data for the currency region was pushed up by the timing of Easter and the resulting price spike for package holidays and air flights. Moreover, given the adverse weather conditions in spring and the crop loss of many fruits and vegetables, we revised the inflation outlook for the current year to the upside.

Japan – Inflation target remains out of reach

GDP Growth

Swiss Life Asset Managers	*Consensus*
2017: 1.2%	*2017: 1.3%*
2018: 0.9%	*2018: 1.0%*

The first synchronous global cyclical upswing since 2009 is clearly beneficiary for Japan's manufacturers exporting to China and other parts of Asia. Accordingly, we raised our forecast for GDP growth in 2017 from 0.9% back in October 2016 to currently 1.2%. We expect gross domestic product to have grown by 0.4% during the first quarter 2017. For the time being, this is also a consensus view according to Bloomberg's poll prior to the first release of official data scheduled for May 18. Not only our judement of recent performance, but also assumptions for Japan's future economic growth profile is currently very close to the consensus estimate. Thus, our assumption that growth dynamics are likely to soften slightly over the coming quarters seems to be shared by a majority of forecasters. Compared to last month, we have no need to revise this assessment: Incoming survey data out of the corporate sector such as the purchasing managers index for manufacturers and service providers hint at slower dynamics at the start of the second quarter of 2017. The same holds true for Shoko Chukin Bank's broad-based small business confidence indicator.

Inflation

Swiss Life Asset Managers	*Consensus*
2017: 0.3%	*2017: 0.7%*
2018: 0.3%	*2018: 1.0%*

The govenor of Japan's central bank, Haruhiko Kuroda, recently admitted that the Bank of Japan's unconventional monetary policy still fails to generate the targeted inflation rate of 2%. In our view, Japan's headline inflation rate will not even touch 1% in the remaining months of Kuroda's current term, which ends in April next year. We expect headline inflation to reach a cyclical peak of just 0.6% in the third quarter of this year. Most recently, a massive drop in mobile phone charges frustrated the central bank's reflation efforts. As a consequence of increasing service competition in the domestic economy, annual core inflation fell back into negative territory for the first time since July 2013.

UK – The tipping point?

GDP Growth

Swiss Life Asset Managers	*Consensus*
2017: 1.7%	*2017: 1.7%*
2018: 1.0%	*2018: 1.3%*

The first release of GDP data for the first quarter of 2017 came in a tick below our own estimate. While we expected GDP growth to have slowed to 0.35%, the official rate was 0.3%. Exports continued to benefit from the global cyclical upswing and the weak currency, but domestic activity slowed markedly during the first three months of 2017: In real terms, retail sales fell 1.5% compared with the previous quarter. In our view, the tipping point for the UK economy at which the costs of Brexit start to weigh on the economy has been reached. Most importantly, we expect private households and businesses to spend and invest more reluctantly going forward. While the corporate sector benefits from the highly competitive exchange rate, its appetite to invest in machinery will be limited as long as negotiations with the EU continue. Yet, favourable global economic conditions and the Bank of England's monetary policy accommodation ensure a soft landing of the economy. In our view, quarterly GDP growth will moderate to 0.25% on average until the end of 2018. This is about half the pace seen over the last three years. Thus, Theresa May has good reasons to hold a snap election this June: Not only is the opposition weak, also the position in the economic cycle argues for an early election to buy time to ensure an orderly end to Britain's EU membership.

Inflation

Swiss Life Asset Managers	*Consensus*
2017: 2.6%	*2017: 2.6%*
2018: 2.3%	*2018: 2.7%*

Inflation is set to climb from currently 2.3% to 3.0% until October and to stay above 2% in 2018. Pass-through effects of rising import prices now materialise at the consumer level. Yet, as earnings growth is slowing, retailers' price setting power remains limited. Since the announcement of a snap election, the Sterling's trade-weighted value strengthened which limits the risk of any further rises in import prices over the foreseeable future.

Switzerland – What to expect from the first quarter?

GDP Growth

Swiss Life Asset Managers	*Consensus*
2017: 1.2%	*2017: 1.5%*
2018: 1.6%	*2018: 1.7%*

Economic activity almost came to a standstill in the second half of 2016. While we expect a recovery this year, we do not share the widespread view that the weak data for the final quarter of 2016 will be more than compensated by the numbers for the first quarter of 2017 to be published on June 1. The more optimistic forecasters point at very strong readings for Switzerland's purchasing managers index (PMI) so far this year and modestly recovering export dynamics. Yet, in contrast to the Eurozone and the United Kingdom, the PMI is not a reliable indicator to predict current quarter GDP growth in Switzerland. Our more prudent assessment remains based on the observation that domestic activity is comparably soft given the global economic dynamics. Despite buoyant business sentiment, the unemployment rate holds steady at 3.3% since October 2015. New car registrations grew by 1.5% and retail sales rose by 0.4% during the first quarter of 2017. In our view, these numbers are consistent with our own projection and do not justify a more upbeat estimate. As often, the wild card for a correct growth estimate is the turnover of commodity traders, which is difficult to gauge ahead of the official data publication.

Inflation

Swiss Life Asset Managers	*Consensus*
2017: 0.6%	*2017: 0.5%*
2018: 0.4%	*2018: 0.7%*

Energy prices are trending lower with the price for heating oil down 14% since the start of the year. Meanwhile, two other developments act as counterbalancing forces: Politics in France and the UK resulted in a weaker Swiss Franc. If sustained, this means that import prices will stabilise in the months ahead. We also factor in higher prices for fresh vegetable and fruits as a consequence of adverse weather conditions in the second half of April, which reportedly were destroying a significant part of this year's stone fruit production.