Global Economic Scenario
July 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	2.1%	2.2% (2.1%)	2.3%	2.4%	2.0% (2.2%)	2.3% (2.4%)	1.9% (2.0%)	2.2%
Eurozone	1.9% (1.7%)	1.8% (1.7%)	1.3%	1.6%	1.6% (1.8%)	1.6%	1.5%	1.4%
Japan	1.2% (1.4%)	1.4%	0.9%	1.1%	0.3% (0.5%)	0.6% (0.7%)	0.3% (0.4%)	0.8% (1.0%)
UK	1.5%	1.6% (1.7%)	1.0%	1.4%	2.7% (2.6%)	2.7% (2.6%)	2.3% (2.2%)	2.7%
Switzerland	1.1% (1.2%)	1.4% (1.5%)	1.6%	1.7%	0.6%	0.5%	0.5%	0.7% (0.6%)

Source for Consensus Estimates: Consensus Economics Inc. London, 12 June 2017

USA – Wage conundrum?

GDP Growth

Swiss Life Asset Managers	*Consensus*
2017: 2.1%	*2017: 2.2%*
2018: 2.3%	*2018: 2.4%*

Political standstill in Washington D.C. continues to dampen former hopes that the Trump administration will quickly move ahead with tax and healthcare reform or with an agreement on infrastructure spending which used to be a hefty topic during the election campaign. Consequently, economic optimism has retraced somewhat. This sobering is increasingly visible in business sentiment surveys moderating from elevated levels. Therefore, the US growth outlook remains clouded by policy uncertainty. Notwithstanding, the growth contribution from business investment in the first quarter was remarkable. We table on a positive contribution from corporate capital expenditures also in the second quarter and beyond, do however doubt that the pace of the first quarter can be kept up. Oddly enough, the consumer had gone on strike at the start of the year. Car sales seem to have reached a saturation point while retail sales in general proved to be weak. Unusual weather conditions in the first three months of this year must partly be blamed for this. As stressed by Fed President Yellen, the labour market represents a strong pillar for consumers, which is also visible in the high level of consumer confidence. Furthermore wealth gains have been noteworthy over past quarters and years even, stemming from financial market performance as well as an ongoing recovery in house prices. Labour market slack has vanished over the past eight years of labour market recovery. The conundrum remains why growth in average hourly earnings remains relatively tepid given the maturity of the business cycle. Looking at a broader range of wage measures, however, wage growth has reached a level of 3% from the previous year, which seems a more plausible level considering the stage of the cycle. At the same time, wage dispersion is fairly high between sectors and it seems that automation plays a certain role. Where labour is easy to replace with machines, wage growth tends to be more lacklustre. Retail trade which is under structural pressure from online shopping, displays wage growth largely below the average. Furthermore, two deep recessions since the start of the millennium left many displaced workers who reprice themselves into the market by accepting lower wages. Finally the demographic element plays an important role as well as the number of pension-age workers in the workforce is high.

Inflation

Swiss Life Asset Managers	*Consensus*
2017: 2.0%	*2017: 2.3%*
2018: 1.9%	*2018: 2.2%*

Once again, energy prices lend some volatility to the monthly change in headline inflation. The renewed decline of the crude oil price and of its derivatives is the main reason for our downwards revision for the current year. A big drag for the May inflation reading were prices for apparel, a sector constantly under pressure from online competition and exposed to weather fluctuations. Meanwhile the Federal Reserve hastened to assure market participants that they look through energy price fluctuations and that they aim at reaching both targets within their dual mandate.

Eurozone – Optimism abound

GDP Growth

Swiss Life Asset Managers	Consensus
2017: 1.9%	2017: 1.8%
2018: 1.3%	2018: 1.6%

Incoming data underline the notion that the economic recovery is broadening out, as regards geographical coverage across the currency union as well as from a sectorial point of view. Given the acceleration of a range of sentiment data of consumers as well as entrepreneurs throughout the second quarter, another upwards revision to second quarter GDP growth seems unavoidable. Optimism in the industry is fuelled by entrepreneurs' more positive assessment of order books. Consumer sentiment reflects a more favourable assessment as regards economic prospects in general, future unemployment as well as savings expectations. Hard data confirm the trend that survey data has signalled since the start of the year. Our revision to the full-year GDP growth forecast is thus driven by a stronger than expected momentum in the first half of 2017. Slightly lower growth rates from elevated levels must be expected for the second half of the year. Over coming months and quarters, the development of labour market data will be scrutinized closely, particularly since the French President put reform measures in France at the top of his agenda. As a reaction, strikes may be in the offing later this year. Some caution seems warranted given that Austrian as well as Italian elections may result in government participation of a populist party.

Inflation

Swiss Life Asset Managers	Consensus
2017: 1.6%	2017: 1.6%
2018: 1.5%	2018: 1.4%

The ECB President started to prepare markets for a normalisation of monetary policy at the ECB Forum in Portugal. He stressed that the risk of deflation was gone and that reflationary forces were at play. He also suggested that monetary stimulus can be reduced without tightening financial conditions. The June print of headline inflation at 1.3% marks an intermediate low point in our own forecast, but coming months' rates will stay clearly below 2%. The ECB is still not in a hurry to reduce monetary stimulus. Slack in the labour market is still ample.

Japan – Lowering the inflation forecast

GDP Growth

Swiss Life Asset Managers	Consensus
2017: 1.2%	2017: 1.4%
2018: 0.9%	2018: 1.1%

Japan's first quarter GDP underwent a slight downward revision impacting our forecast for real GDP growth in 2017. Japan's export industries continue to benefit from the first synchronous global upswing since 2009. Lately, Japan's purchasing managers index (PMI) for the manufacturing industries improved to 53.1 points. Since September 2016, this index holds above the critical 50 points expansion threshold. After a soft patch between April and May, domestic drivers also regained momentum: The domestically oriented service sector purchasing managers index improved together with Shoko Chukin Bank's small business confidence indicator and consumer confidence. Bank lending activity remains firm compared with the recent past and dynamics in retail sales remained stronger than in the previous year. Signs of firming domestic activity would help to extend the economic recovery once the impulses from foreign demand fade. Annualised GDP growth rates of around 1% on average until the end of 2018 appear achievable. Such growth rates would exceed Japan's current potential rate according to OECD calculations. A sustainable return to positive inflation rates is thus increasingly likely. Improving fundamentals led to renewed investment flows of foreign capital into Japan's stock market. Over the last three months, Japan's leading stock market index outperformed its peers in other developed regions.

Inflation

Swiss Life Asset Managers	Consensus
2017: 0.3%	2017: 0.6%
2018: 0.3%	2018: 0.8%

Last month we raised the inflation forecast for full year 2017 on the back of information of strong inflation data for the Tokyo area for May. Meanwhile, the official release of the nationwide consumer price index came in markedly below trends in Japan's capital. As we see no reason to revise our forward looking assumptions on price developments for the time being, we take a step back and return to our initial projection of just 0.3% average inflation through 2017.

UK – From uncertainty to bedlam

GDP Growth

Swiss Life Asset Managers	*Consensus*
2017: 1.5%	*2017: 1.6%*
2018: 1.0%	*2018: 1.4%*

Two months ago, we expected that the snap election would provide the government with a strong mandate to negotiate on Brexit. Instead, voters succeeded to surprise commentators and markets for the third time in only two years: The resulting minority government will clearly add to uncertainties and trigger more reluctance when it comes to investments and job creation. We would not exclude another general election in the next two years. Influenced also by renewed terror attacks and the Grenfell tragedy, consumer confidence took a hit in June. On a more positive note, we see three reasons why economic momentum is still stronger than suggested by the soft 0.2% first quarter growth rate: Firstly, the apparent drag from net trade is at odds with global dynamics and tailwinds to exports from the currency. Secondly, coincident indicators like purchasing managers indices suggest that the economy grew by 0.3% to 0.5% during the second quarter. Thirdly, real retail sales grew by around 1% until May compared with the first quarter. As a consequence, we continue to expect average quarterly GDP growth rates of 0.3% until the end of 2017.

Inflation

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

Among all economic data series, inflation is most visibly affected by last year's EU referendum. The immediate weakening of the Pound and recovering energy prices during the second half of 2016 triggered inflation to rise from 0.5% in June last year to currently 2.9%. Yet, inflation is not only an imported disease: Domestic suppliers in services sector continue to test their price setting power with prices in hotels or restaurants rising at an annual pace of around 3%. We expect the inflation cycle to maintain its momentum during the second half of this year and expect headline inflation to peak above 3% during the final quarter of 2017.

Switzerland – Soft first quarter triggers revisions

GDP Growth

Swiss Life Asset Managers	*Consensus*
2017: 1.1%	*2017: 1.4%*
2018: 1.6%	*2018: 1.7%*

Frequent readers of our documents are familiar with our prudent assessment of domestic economic trends. And yet, first quarter GDP numbers even disappointed our sub-consensus estimates and trigger a mild downward revision to our forecast for 2017. Going forward, we continue to expect only modest support from those drivers, which kept the Swiss economy growing after the SNB abandoned the currency peg in 2015. In particular, we expect only flat to slightly positive impulses from construction, spending on durable goods and net migration. In contrast to other regions except the United Kingdom, consumer confidence weakened so far this year in Switzerland. The cyclical music continues to play in neighbouring Europe, with renewed political enthusiasm after the elections in France. Certain analysts and media commentators predict that the Euro appreciates because of strengthening dynamics and prospects of a monetary policy normalisation by the European Central Bank. We consider such hopes as premature and note that the Swiss Franc's trade weighted value remains above last year's levels.

Inflation

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

Inflation dropped to 0.3% by June, according to our calculations. Yet, as the fall in energy prices ended in late June, we expect no further negative contribution to monthly inflation from that side for the time being. Short-term prices for fresh food pose an upside risk to the forecast. After extremely low temperatures in April, prices for certain fruits increased massively compared with last year, which leaves traces in the consumer price index during the summer months. A sudden depreciation of the Swiss Franc versus the Euro and higher import prices pose another - limited - risk to the forecast.