Global Economic Scenario
August 2016

SwissLife
Asset Managers

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

	GDP 2016		GDP 2017		CPI 2016		CPI 2017	
	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus
USA	1.8%	1.9%	1.9%	2.2% (2.3%)	1.2%	1.3%	2.2%	2.3%
Euro Area	1.5%	1.5% (1.6%)	0.9%	1.3% (1.6%)	0.3%	0.3% (0.2%)	1.6% (1.5%)	1.3%
Japan	0.6%	0.5%	1.0%	0.8% (0.9%)	-0.2%	-0.1%	0.2%	0.6% (0.9%)
UK	1.4%	1.6% (1.9%)	0.4%	0.7% (2.1%)	0.8% (0.7%)	0.7% (0.6%)	2.6% (2.5%)	2.4% (1.6%)
Switzerland	0.8%	1.0% (1.1%)	0.9%	1.3% (1.5%)	-0.4% (-0.3%)	-0.5%	0.3%	0.3%

Source for Consensus Estimates: Consensus Economics Inc. London, 11 July 2016

Consensus Economics
Forecast Accuracy
Award Winner
2015 Switzerland

Consensus Economics, one of the world's leading economic survey organisation, has announced the recipients of its 2015 Forecast Accuracy Award (FAA) in June 2016. Swiss Life Asset Managers' economic research team has won this year's Forecast Accuracy Award for Switzerland. Click here for more information.

USA – Bottlenecks and rising prices

GDP Growth

Swiss Life Asset Managers	Consensus
2016: 1.8%	*2016: 1.9%*
2017: 1.9%	*2017: 2.2%*

As presaged in last month's edition of this paper, weak employment growth in May was only an aberration from an otherwise tightening trend in the labour market. At a level of 287 thousand new nonfarm payrolls, expectations for job growth were significantly exceeded in June. The unemployment rate climbed slightly albeit on the back of a rising labour force participation rate, which signals increasing confidence among formerly jobless persons to actually be able to find a job. Underemployment fell again to reach a level of still elevated 9.6% in June. The 3-month change in average hourly earnings has reached 2.6% on an annualised basis, will however surpass 3% in our view late this year or in early 2017. Many sectors are affected by a lack of skilled workers, above all the construction sector where many workers found jobs elsewhere in the wake of the subprime and housing crisis not too long ago. Wage negotiation power of employees seems to rise on a broad basis. Personal consumption expenditures remain well supported from that angle. Furthermore, consumer balance sheets remain in very healthy shape. Commercial banks continue to ease credit conditions for household mortgages. As a matter of fact, the "household debt service ratio" - a measure of how much the average household has to pay on a monthly basis to satisfy debt obligations in relation to the household income – has never been lower since its publication in 1980. This index currently stands at 10% down from more than 13% at its peak in 2007. Consequently, retail sales surprised yet again to the upside for the month of June. This rounds up a picture of second quarter growth momentum which should compensate for the weak growth figure in the first quarter. Quarterly annualised GDP growth may well surpass 2.5%, a tad higher than what we have built into our own GDP forecast. As discussed last month, coming quarters will hardly reveal a Brexit effect. Sentiment surveys may move lower, however, economic activity continues to be driven by the strong domestic backdrop. This is also reflected by the fact that the Fed fund futures market has started to partly price in a rate hike in September.

Inflation

Swiss Life Asset Managers	Consensus
2016: 1.2%	*2016: 1.3%*
2017: 2.2%	*2017: 2.3%*

Given the fact that crude oil has retraced some of the price gains from previous months, gasoline is bound to be a negative contributor to headline inflation in July. This will not undermine the strong base effect which will set in as from August on and push headline inflation to 1.8% by year end, from currently 1%. Apart from the base effect, rising wage pressure is bound to increasingly contribute to underlying inflationary pressure going forward. As certain sectors are faced with a lack of skilled workers, they are thus inclined to attract candidates via higher wages. Service sector prices are already growing at a pace of 4.6% over a three month annualised basis due to strong domestic dynamics.

Euro Area – Survey data defy Brexit

GDP Growth

Swiss Life Asset Managers	*Consensus*
2016: 1.5%	*2016: 1.5%*
2017: 0.9%	*2017: 1.3%*

Euro Area "flash" PMIs were highly anticipated giving a first indication of how sentiment would change in the aftermath of the EU referendum in UK. As a matter of fact, the initial publication of the purchasing managers index for July did indeed reveal a weaker index, however the correction was far less pronounced than commonly expected. The index for manufacturing industries fell to 51.9, well above the crucial threshold of 50. The index for the services industries held at 52.7, only a tad below the level reached in June. The ifo institute's business climate indicator equally defied fears that the UK vote may depress sentiment also in the rest of Europe and thus impact business decisions negatively. While the future road map for the Brexit remains uncertain, a big impact on sentiment is hardly visible at this stage. Meanwhile, the ECB published its bank lending survey for the second quarter 2016. According to the report, a further improvement of credit conditions for companies and households as well as a continued increase in loan demand for all loan categories are supporting the ongoing recovery in credit growth. Credit standards for loans to enterprises eased more than expected. While the survey period included post Brexit days, no clear picture emerged on how banks assess the impact of the vote. The survey also revealed that 60% of commercial banks took advantage of the ECB's TLTRO2, driven mainly by profitability motives. This allows banks to ease credit conditions further.

Inflation

Swiss Life Asset Managers	*Consensus*
2016: 0.3%	*2016: 0.3%*
2017: 1.6%	*2017: 1.3%*

The monthly change of headline inflation in July displays a negative seasonality due to summer sales season. For the upcoming July print, we expect -0.5% monthly change which nevertheless leads to an increase of the annual inflation rate to 0.2% from currently 0.1%. This will just be a first step to higher headline inflation which will end the year at a level of 1.1% according to our own forecast. Inflation expectations remain on extremely low levels and have room to correct to the upside.

Japan – Waiting for monetary & fiscal stimulus

GDP Growth

Swiss Life Asset Managers	*Consensus*
2016: 0.6%	*2016: 0.5%*
2017: 1.0%	*2017: 0.8%*

Economic forecasting in Japan remains driven by the political agenda more than by cyclical trends. Last month, it was the government's decision to postpone the planned consumption tax hike which triggered massive corrections in growth and inflation forecasts by those economists who previously thought the measure would be implemented. Since then, forecasters had to pay tribute to the decision of British voters to leave the EU. Brexit is likely to weigh on Japan's export dynamics over the coming quarters. Yet, we think that the impact is limited, not least because the Yen has stopped from appreciating over the last few weeks. Nevertheless, since the start of the year, the Yen's trade-weighted external value rose by 14%, despite the introduction of negative interest rates by the Bank of Japan. It is commonly expected that prime minister Abe interprets his party's election victory earlier this month as a mandate to step up fiscal and monetary policies further to revive Japan's economy. It is an open secret that even forms of helicopter money to be introduced by the central bank are part of the plans currently discussed by the authorities. We expect the announcement of supplementary monetary and fiscal policy tools in the course of next month. Thus, it appears very likely that a next round of forecast revisions waits just around the corner and that risks to our current projection of 0.25% quarterly GDP growth until end of 2017 are skewed to the upside.

Inflation

Swiss Life Asset Managers	*Consensus*
2016: -0.2%	*2016: -0.1%*
2017: 0.2%	*2017: 0.6%*

The appreciation of the Yen suggests that import prices should moderate in the second half of the year. The decision to abstain from a consumption tax rate hike in 2017 triggered a massive downward revision from 1.5% to 0.6% in the consensus forecast over the last two months. Given the strong Yen, more downward revisions by our peers towards our own projection of just 0.2% inflation will probably follow.

UK – “Brexit means Brexit”, and probably recession

GDP Growth

Swiss Life Asset Managers	Consensus
2016: 1.4%	*2016: 1.6%*
2017: 0.4%	*2017: 0.7%*

In our base case scenario, we take prime minister Theresa May’s words “Brexit means Brexit” at face value. A comparison with consensus reveals that our own downward forecast adjustments following the EU referendum were slightly more moderate than those of our peers. While the consensus forecast for 2017 was cut from 2.2% to 0.7% between May and now, we only reduced our own projection from initially 1.7% to 0.4%. We expect GDP to contract by -0.2% through the current quarter and to remain flat over the two following quarters until March 2017. June 23, the day of the Brexit vote, clearly marks a watershed in survey data and economic statistics: recently published data measuring economic activity prior to that date are painting a picture of an economy growing above potential for fourteen straight quarters. Since then, survey data across the board suggest that recession risks have increased substantially. Both the combined purchasing managers index for manufacturing and services industries as well as the Confederation of British Industry’s (CBI) business optimism index fell to their lowest readings since April 2009, when the world economy was in the midst of the Great Recession.

Inflation

Swiss Life Asset Managers	Consensus
2016: 0.8%	*2016: 0.7%*
2017: 2.6%	*2017: 2.4%*

Strong June data revealed the accelerating inflationary momentum until mid-year. As a consequence of the weaker Pound following the vote to leave the EU, we expect annual inflation to reach 2.6% in 2017 instead of 1.9% prior to the vote. Including the firm print for core inflation through June, our adjusted inflation path suggests that inflation peaks at around 2.9% in May 2017. As we think the UK drops into recession, we believe that wage growth will moderate substantially which caps the inflation potential over the next quarters.

Switzerland – Surprisingly firm labour market data

GDP Growth

Swiss Life Asset Managers	Consensus
2016: 0.8%	*2016: 1.0%*
2017: 0.9%	*2017: 1.3%*

Last month we cut our already prudent growth forecast yet again in the light of Brexit. Since then, the consensus estimate underwent a similar downward correction. We continue to believe that exporters of goods and machinery and also the tourism sector will be hit, as the UK’s importance as an export destination grew over the last four years. For the time being, no fresh data was published to support or contradict our adjusted assumptions. Yet, we now have sufficient data available to undertake a reality check for our initial views on economic conditions in year two after the Swiss National Bank abandoned its minimum exchange rate policy: with the important exception of the watch industry, exports have recovered remarkably fast. Our long-held assumption that the economic recovery in neighbouring Europe supports activity in Switzerland is thus validated by incoming data. Our prudent forecast has always been built on the view that the domestic economy will switch to a slower gear after a consumption boom in 2015 and years of decent growth in the construction sector. Retail sales data and new car registrations are clearly trending lower so far this year, justifying these assumptions. One important exception is worth mentioning: remaining steady at 3.3%, the unemployment rate has stopped rising further in May and June. Our initial forecast that the unemployment rate could reach 3.7% by year-end may well turn out too pessimistic.

Inflation

Swiss Life Asset Managers	Consensus
2016: -0.4%	*2016: -0.5%*
2017: 0.3%	*2017: 0.3%*

As energy prices dropped slightly in July, we lower the forecast headline inflation in 2016 somewhat. Yet, we continue to expect a return to positive inflation prints before the end of this year.