Global Economic Scenario
October 2017

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

Source for Consensus Estimates: Consensus Economics Inc. London, 11 September 2017

USA – Temporary weather impact

GDP Growth

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

The severe weather that hit the US in August will leave traces in GDP numbers. Yet, it is rather a shifting of activities over time than an overall reduction of GDP. In the aftermath of a hurricane, economic activity typically slows as production is interrupted and as people do not spend their time in shopping malls. This is already reflected in the most recent data publications. Both industrial production and retail sales have contracted during the month of August and were below expectations. However, the damage caused by storms creates a need for reconstruction. Therefore, economic activity usually accelerates a few weeks after a natural disaster. Regarding our own forecast, we have slightly lowered growth in the third quarter and lifted the fourth quarter somewhat. In our view, the overall impact will be neutral. Not even hurricane Katrina, which hit the US in 2005 and caused more devastation than Harvey, had a lasting impact on GDP. Certainly, a hurricane has a large and long-lasting effect on the value of buildings, infrastructure and the likes. Yet, such stock variables do not enter national accounts data. GDP is a flow variable and measures the value added that is created in a given period of time. We have slightly lifted our full-year 2017 growth forecast because the GDP data for the second quarter was revised upwards. According to the second estimation of the Bureau of Economic Analysis (BEA), the quarterly annualised GDP growth rate was 3% in the second quarter of 2017. The purchasing managers' index (PMI) for the manufacturing sector published by ISM has reached a six-year high at 58.8. The last time this indicator broke the mark of 58 was in early 2011. However, we believe that PMIs currently overstate economic dynamics. In our view, annualised GDP growth will not accelerate further from the current pace of 3%. We expect it to settle between 2.0% and 2.4% until the end of 2018. All in all, economic dynamics should be no obstacle for the Federal Reserve to continue monetary policy normalisation. In its September meeting, the FOMC confirmed that it intends to stick to its course of a gradual rate hiking cycle. In addition, the Fed announced to start to reduce its balance sheet in October 2017.

Inflation

Swiss Life Asset Managers	*Consensus*
2017: 2.1%	*2017: 2.0%*
2018: 1.9%	*2018: 1.9%*

The severe weather conditions also affect inflation. Gasoline prices jumped as the storms interrupted production in refineries close to the Gulf of Mexico. According to our estimation, gasoline contributes 0.4 percentage points to the monthly increase of inflation in September. This should lift the headline annual inflation rate to 2.2% and thus above the 2 percent mark. The uptick of fuel prices is however only a temporary phenomenon. Fuel prices are already receding as production is normalising. We expect headline inflation to close the year at 1.7%. Core inflation has been around 1.7% since May and we estimate that it will move broadly sideways until the end of the year.

Eurozone – Growth is sturdy and about to peak

GDP Growth

Swiss Life Asset Managers	Consensus
2017: 2.2%	2017: 2.1%
2018: 1.4%	2018: 1.8%

The growth outlook for the second half of 2017 is brighter than we thought. Forward looking indicators such as the purchasing managers' index (PMI) or consumer confidence keep rising from already elevated levels. Consumers of the Eurozone are as confident as in 2001. As a consequence we lifted our growth forecast for the third and fourth quarter of 2017. Our full-year forecast is 2.2%. While we expect economic activity to remain sturdy in the second half of 2017, we do not see a further acceleration from the 0.6% quarterly growth rate in the second quarter of 2017. In other words, we think that GDP growth has peaked in mid-2017. We expect a distinct moderation from current levels until early 2018. According to our forecast, quarterly growth will slow to 0.3% in 2018. Yet, this is still slightly above potential. Our full-year 2018 forecast is clearly below the consensus estimate. In our view, pent-up demand will not be as much of a support any more next year as the output gap is closing. In addition, the appreciation of the Euro should weigh somewhat on GDP growth. The external sector has already become less of a growth driver in 2016 after the strong rise of the trade balance from 2011 to 2015. Finally, the political environment remains complicated. Angela Merkel's position is weakened after the German elections, elections in Italy – where populist parties achieve high approval rates – are approaching and Brexit negotiations are ongoing.

Inflation

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

Headline inflation has risen to 1.5% in August. Energy was a support in August and should lift the September reading to 1.7% according to our estimation. Moreover core inflation has shown a slight upward trend recently. We expect a further small uptick until year-end. Yet, we have lowered our full-year 2018 forecast slightly for both headline and core inflation as the Euro appreciation turns out to be sustained.

Japan – Abe seeks to benefit from the upswing

GDP Growth

Swiss Life Asset Managers	Consensus
2017: 1.5%	2017: 1.6%
2018: 1.0%	2018: 1.2%

We should have known it before: Japan's national account data are often subject to extreme revisions from one publication to the next. And yet, we trusted the first release of second quarter GDP data too much. This initial release showed a quarterly growth rate of 1.0%, substantially higher than the 0.4% rate we had expected. Consequently, we raised our forecast for 2017 to 1.9% last month. Since then, a second report by the statistics office corrected the initial data markedly to the downside. With 0.6% quarterly growth according to the latest numbers, activity in the second quarter was much closer to our initial assumption. We thus lower our forecast for 2017 again, without becoming more prudent as regards the medium term outlook. Japan is one of the great winners of the current global cyclical upswing. Corporate sector profits are up by 22% from year ago levels, and the number of bankruptcies is declining sharply. We continue to observe a growing willingness of banks to lend out to the private sector. The structural absence of real earnings growth remains the weak spot in Japan's economy. Rigid labour market laws and demographics are partly to blame. The corporate sector continues to prefer adding workers with temporary contracts. Given Manpower's focus on temporary jobs, it is not surprising that Japan currently ranks first among all 43 countries included in the global employment barometer published by this human resources services provider. While Prime Minister Abe is under pressure for a series of domestic political scandals, he still makes a safe bet to call snap elections given the robust economic trend as of late.

Inflation

Swiss Life Asset Managers	Consensus
2017: 0.3%	2017: 0.5%
2018: 0.4%	2018: 0.8%

The lack of wage growth and the Yen's appreciation in the second half 2016 are the most important reasons why efforts to reflate Japan's economy continue to fail. In response to the ongoing weakening of the Yen's trade weighted external value, we are now lifting the inflation forecast for 2018 slightly.

UK – Firm consumption data so far for third quarter

GDP Growth

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

At least until Prime Minister Theresa May's Florence speech, politics appeared disoriented after the summer break. Despite all this political noise, economic dynamics have improved notably in the third quarter 2017. Economic data available so far for the third quarter were mostly solid with real retail sales showing particular strength. Including August data, retail sales rose 1.2% from the second quarter 2017. Against all uncertainties related to Brexit, the economy continues to add jobs bringing the unemployment rate to the lowest number in 42 years. NIESR (National Institute of Economic and Social Research) reports that their tracking estimate of GDP growth accelerated from 0.2% to 0.4% in August. Over the last twelve months, the UK economy benefitted strongly from combined effects of a synchronous cyclical upswing and a substantial gain in competitiveness thanks to a plunging currency after the EU referendum. We expect this positive backdrop for the UK economy to continue until year-end. Longer-term, we stick to our assumption that it is in the interest of all partners to end negotiations between the UK and the EU with a viable deal on free trade. If this is not achievable until 2019, we assume that transitional solutions will be eventually agreed upon.

Inflation

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

Rising inflation until August 2017 is one of many fronts on which the political battle over Brexit continues. So far, average wage growth did not compensate for higher costs of living. We continue to expect annual inflation to reach a cyclical peak at 3.1% in October. Fading base effects from last year's Sterling depreciation should result in lower annual headline inflation in 2018: In our base case we expect annual headline inflation to slow to 2% until the end of next year.

Switzerland – Labour market in a peculiar state

GDP Growth

Swiss Life Asset Managers	Consensus
2017: 0.7%	2017: 1.1%
2018: 1.6%	2018: 1.7%

Downward revisions in the data for preceding quarters, published alongside the second quarter GDP numbers, force us to lower the full-year growth forecast to just 0.7% from 1.1% previously. Other houses went the same path, bringing the consensus forecast down to 1.1% for the time being. Provided another revision of historic data, average annual growth above 1% remains out of reach in our view. Such a scenario would require quarterly growth of 1% or more in both the third and fourth quarter. We expect growth to accelerate to just 0.4% on average in the second half of the year, supported by tailwinds from a weaker Swiss Franc. Meanwhile, domestic activity remains soft compared with other global cyclical recoveries. Domestic orders received by firms in the MEM industries (electrical and mechanical engineering) stand at a low for more than fifteen years according to an index provided by Swissmem, the sector's business association. Moreover, nine out of ten employers do not intend to increase the domestic labour force according to a Manpower survey. With a net reading of 0%, Manpower's employment barometer for Switzerland ranks lowest in the universe of 43 countries covered by the staffing provider.

Inflation

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

On a trade weighted base, the Swiss Franc's external value lost more than 4% compared with last year. We expect higher import prices to feed through into consumer prices over the next eighteen months. Short-term, higher energy prices provide a push to the consumer price index. A potential downside risk emerges from the rents component, a heavyweight in the index. We expect a slight decline in the rents sub-component in the November CPI report, the next time when new data will be available for this quarterly series.