



Global Economic Scenario

June 2014

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

	GDP 2014				GDP 2015				CPI 2014				CPI 2015			
	Swiss Life AM		Consensus		Swiss Life AM		Consensus		Swiss Life AM		Consensus		Swiss Life AM		Consensus	
USA	2.2%	(2.6%)	2.5%	(2.7%)	2.5%	(2.4%)	3.1%	(3.0%)	1.9%	(1.8%)	1.8%	(1.7%)	2.4%		1.9%	
Euro Area	1.0%	(1.3%)	1.1%	(1.2%)	1.4%		1.4%	(1.5%)	0.9%	(1.0%)	0.8%	(0.9%)	2.0%		1.3%	
Japan	1.4%	(0.8%)	1.3%		0.9%		1.3%		2.3%		2.6%		1.1%		1.8%	(1.7%)
UK	2.8%	(2.6%)	2.9%	(2.8%)	2.0%	(1.9%)	2.5%	(2.4%)	1.9%	(2.0%)	1.9%		2.7%		2.0%	(2.1%)
Switzerland	1.3%		2.2%	(2.1%)	1.3%		2.2%		-0.1%	(0.3%)	0.1%	(0.2%)	0.5%	(0.6%)	0.7%	(0.8%)

USA – Interest rates decouple from economic momentum

GDP Growth

Swiss Life Asset Managers	Consensus
2014: 2.2%	2014: 2.5%
2015: 2.5%	2015: 3.1%

GDP growth in the first quarter turned out to be a lot weaker than commonly expected. As a consequence, we had to revise our own forecast slightly to the downside. As a matter of fact, the second estimate of GDP growth published on 29 May even revealed a deeply negative quarterly growth rate. Obviously most of that sluggishness has to be attributed to the extremely harsh winter conditions in the first quarter which interrupted economic activity to an unusually large extent, and will therefore be of a temporary nature. As a matter of fact, evidence from the labour market signals ongoing recovery, as regards employment growth as well as wages. Given the latest trend in jobless claims figures, payroll growth in May should have strengthened substantially although slack in the labour market in general remains ample, as Fed chairwoman Yellen emphasized again. The outlook for personal consumption is supported by the fact that the average household's balance sheet is much more healthy than a couple of years ago and debt service is actually running at historical lows. Therefore, the deleveraging headwind in the private sector of the economy has run its course, while the budget deficit of the government continues to surprise expectations positively as well. Consequently, the fiscal drag will be clearly reduced going forward. Yet, the latest retail sales data for

April were rather disappointing. Nevertheless they are in line with an acceleration in the second quarter from a very weak first one. News on the housing market has been fundamentally weaker and is part of the story why we feel comfortable to forecast less growth momentum than Consensus well into next year. Residential investment has slowed sharply over the last quarters. Sentiment among homebuilders has dropped below the level of 50 which would be consistent with expansion in the industry. The latest bond rally does not seem sustainable to us however given where we see economic growth heading and given the fact that inflation has turned the corner and even reached Fed target. As a consequence we expect mortgage rates to edge higher, with an adverse effect on mortgage demand, refinancing and residential investment.

Inflation

Swiss Life Asset Managers	Consensus
2014: 1.9%	2014: 1.8%
2015: 2.4%	2015: 1.9%

Finally consensus is building that inflation has turned the corner and inflation expectations have decidedly corrected to the upside. Indeed, import prices have begun to rise and a broad range of inflation subcategories are beginning to gather upward momentum. All in all, headline inflation will continue to rise gradually from a current level which is already on Fed target. Bottlenecks in certain industries will emerge causing slight upward momentum in wages. Indeed the latest FOMC minutes reveal that the Fed is busy discussing its exit strategy.

Source for Consensus Estimates: Consensus Economics Inc. London, 12 May 2014



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Euro Area – First quarter disappointment

GDP Growth

Swiss Life Asset Managers	Consensus
2014: 1.0%	2014: 1.1%
2015: 1.4%	2015: 1.4%

As in the US, Q1 GDP growth disappointed, although this came rather unexpected. Contrary to the US, expectations were rather that the non-existent winter weather in large parts of Europe may have helped to boost economic activity. The German economy surprised on the strong side and was the only significant contributor to Euro Area growth, but this was not able to offset downside surprises in France, Italy, Portugal and mostly so in the Netherlands. Growth in the Netherlands collapsed by 1.4% on a quarterly basis and thus cut off 0.1% from area-wide growth dynamics. On the back of positive consumption growth, imports had rebounded on a broad basis causing the trade balance to act as a drag on overall quarterly growth. Diverging trends of the two biggest member economies were not only visible in the growth figures but also manifest themselves in the latest survey data. The French INSEE business climate decreased in April and hardly reflects an acceleration in manufacturing activity which the economy so badly needs. Sentiment among German entrepreneurs however remains rather sturdy. For the region as a whole, flash purchasing managers indices in the services sector strengthened while the manufacturing sector seems to be losing steam.

Inflation

Swiss Life Asset Managers	Consensus
2014: 0.9%	2014: 0.8%
2015: 2.0%	2015: 1.3%

Commodity prices are supporting our call for higher headline inflation readings for the remainder of this year. Although inflation expectations across time horizons have notably corrected to the downside, there seems to slowly build a consensus that the deflation scare may have gone too far. A healthy bout of disinflation is what helps the economy to recover. It remains a close call if the ECB will be willing to engage in monetary policy loosening yet again. Markets fully price that in already.

Japan – Sentiment and official data tell different stories

GDP Growth

Swiss Life Asset Managers	Consensus
2014: 1.4%	2014: 1.3%
2015: 0.9%	2015: 1.3%

With hindsight, the impact of Japan's sales tax hike by 3% as per April 2014 will be measured by smoothing data for the first and the second quarter 2014. So far, we only know half of the story: Apparently, final demand in the first three months of the year was much stronger than we and most other forecasters have thought. That resulted in a quarterly GDP growth rate of 1.5%, or double the pace than what we have assumed. According to the first release of GDP data, consumers brought forward more purchases to avoid the sales tax increase than what was estimated by models based on earlier experience with tax hikes. We adjust our growth forecast for the full year 2014 accordingly, exposing ourselves to two substantial risks: First, early estimates of Japan's GDP are chronically vulnerable to substantial revisions, meaning that our initial assumption could still be validated. Second, the stronger than expected effect of the sales tax hike prior to its implementation might suggest that the payback in the form of collapsing demand for durable goods during the second quarter might as well be more important than thought. Up to now, we expect a quarterly contraction by 0.9% in the second quarter. Our scepticism is supported by a sharp fall in sentiment across the board: Japan's purchasing manager index, sentiment among small and medium sized firms and consumer confidence all dropped at a faster pace in the last three months than in the aftermath of the Tohoku earthquake and tsunami in 2011.

Inflation

Swiss Life Asset Managers	Consensus
2014: 2.3%	2014: 2.6%
2015: 1.1%	2015: 1.8%

Annual inflation is set to climb above 3% with the next release on May 30. Via a base effect, headline inflation will stay at elevated levels for the next 12 months. Assuming that the government sticks to a further sales tax hike by October 2015, annual headline inflation will stay in positive territory for the longest period since 1994.



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UK – *Enjoy it while it lasts*

GDP Growth

Swiss Life Asset Managers	Consensus
2014: 2.8%	2014: 2.9%
2015: 2.0%	2015: 2.5%

A study of the fiscal efforts undertaken by various European governments since 2009 reveals that adjustment in the United Kingdom progressed comparably less than in countries like Italy, Spain, Ireland, Portugal or Greece relative to target. Staying outside the Euro and a flexible labour market allowed a different policy mix than what was required elsewhere. Despite a collapse in demand for British goods and services from the continent, the economic and monetary policy mix “made in Britain” ensured a comparably early recovery in domestic demand and business investments, which becomes more broad based day by day. Survey indicators and real economic data like retail sales for April leave no doubt that dynamics did not moderate at the start of the second quarter. As a consequence, we raise our growth forecast slightly. The British have good reason to enjoy the economic recovery while it lasts: No headwinds from fiscal policy are expected until the election in May 2015. Yet, the remaining fiscal adjustment required until 2020 still amounts to 6% of GDP. Whoever wins the election in a year’s time, will thus again have to come back on austerity measures. Those measures, combined with tighter financial conditions in the form of a stronger Sterling and a less accommodative monetary policy, explain why we anticipate a moderation in growth dynamics in the quarters ahead.

Inflation

Swiss Life Asset Managers	Consensus
2014: 1.9%	2014: 1.9%
2015: 2.7%	2015: 2.0%

The inflation cycle is past its low and the potential for mounting inflationary pressure is not negligible given the fact that the UK economy is clearly running above potential since mid 2013.

Switzerland – *First quarter GDP data due*

GDP Growth

Swiss Life Asset Managers	Consensus
2014: 1.3%	2014: 2.2%
2015: 1.3%	2015: 2.2%

One day after this paper’s copy deadline, Switzerland’s first quarter GDP data will be published. Consistent with our markedly below consensus forecast for full-year 2014, our estimate of 0.3% quarterly growth is among the most cautious in the poll conducted by Bloomberg in the week prior to the release. The median estimate stood at 0.6% quarterly growth, with 7 out of 18 forecasters even expecting growth to come in at 0.7%. Upside risks to our own forecast appear substantial given the remarkable optimism among our peers. By now, the two main reasons for our cautious stance are probably well known: First, we believe that there is not much pent-up demand left in the domestic economy. This assumption is confirmed by car sales statistics and the fact that real retail sales were down 0.9% compared with the average through the last quarter 2013. Second, we observe a loss in competitiveness relative to neighbouring Europe. Thus, Swiss exporters benefit less from the recovery in the Euro Area compared with earlier episodes of cyclical upswings in their largest export market. The details on final domestic demand and net trade in the first quarter GDP data will provide a test to our judgement on these two sources of moderating growth dynamics.

Inflation

Swiss Life Asset Managers	Consensus
2014: -0.1%	2014: 0.1%
2015: 0.5%	2015: 0.7%

We undo the upward revision in the forecast from last month again as we expected a higher reading for inflation in April than the actual outcome. Energy prices were broadly stable in May and the announced 2.9% increase in public transport fees will only effect prices in December 2014. We thus see no reason to alter the forward looking inflation profile.

Released and approved by the Economics Department, Swiss Life Asset Management AG, Zurich

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