Global Economic Scenario
January 2017

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	1.6% (1.5%)	1.6% (1.5%)	2.2%	2.3% (2.2%)	1.3%	1.3% (1.2%)	2.4%	2.4% (2.3%)
Euro Area	1.6%	1.6%	1.2%	1.4% (1.3%)	0.2%	0.2%	1.5%	1.3%
Japan	1.0% (0.8%)	0.7% (0.6%)	1.0%	1.0% (0.9%)	-0.1% (-0.2%)	-0.2%	0.9% (0.5%)	0.5% (0.4%)
UK	2.1% (2.0%)	2.0%	1.3% (1.2%)	1.3% (1.1%)	0.7% (0.6%)	0.7%	2.4% (2.3%)	2.5%
Switzerland	1.3% (1.5%)	1.4% (1.5%)	1.0% (1.1%)	1.5%	-0.4%	-0.4%	0.3% (0.2%)	0.3%

Source for Consensus Estimates: Consensus Economics Inc. London, 5 December 2016

USA – Trump inherits very tight labour market

GDP Growth

Swiss Life Asset Managers	*Consensus*
2017: 2.2%	*2017: 2.3%*
2018: 2.3%	*2018: n.a.*

A net 31% of small and medium-sized companies reported that they had open job positions for which they cannot find workers. This represents the highest level since the boom year 2006 according to the latest NFIB survey. At the same time, approximately 2.3 million workers are currently holding multiple part-time jobs – the highest level ever. These two data series clearly point to an overheating of the labour market. At the same time, the underemployment rate resumed its downward trend which started in April 2010 from a level of 17.1% to nowadays 9.3% which is not too far away from the previous' cycle low of 7.9% in 2006. Mr. Trump will be in the lucky position to take over an economy which is essentially at full employment. Furthermore, expectations for higher nominal growth have strengthened ever since the presidential election. Markets are following suit. In fact, estimates of the size of the fiscal boost which the new administration will implement vary quite a bit. Given the deficit-averse stance of the Republican party, we consider an estimate of 150 bn USD, or approximately 0.7% of GDP, of additional fiscal measures for the coming year as a reasonable assumption. As regards the timing of positive stimulus on the total economy including multiplier effects, we allocate the thrust of economic impulse into the year 2018. However as financial conditions have tightened over past weeks, we leave the growth oulook for 2017 unchanged for the time being.

Inflation

Swiss Life Asset Managers	*Consensus*
2017: 2.4%	*2017: 2.4%*
2018: 2.1%	*2018: n.a.*

In the meantime, we have come a long way in terms of inflation expectations. The 5-year 5-year forward breakeven rate, measuring the expected inflation rate over a five-year period that begins five years from now, the Fed's preferred measure of inflation expectations, has climbed markedly with an extra boost after Trump's election victory. While a low was reached at 1.43% early this year, the forward breakeven rate now stands at 2.12%, not too far from the average rate since 2008 which is at 2.36%. The reflation trade on the back of Trumponomics and the hope for higher growth as well as inflation has not yet come to a halt. The OPEC's announcement to limit crude oil output starting next year lifted the price of oil and provided yet another tailwind to inflation expectations. Thus far, the price of gasoline at the pump has increased by 1.4% in December from the previous month. After adjusting for seasonal factors, the increase is at 2.6%. Although the latest labour market report rendered a disappointment in terms of average hourly earnings growth, the unemployment rate dropped markedly and we get ample signs of imminent wage pressure, not least from business surveys. To a certain extent, inflation expectations and markets have adjusted to economic reality. One also needs to highlight however, that the biggest reset in actual inflation lies behind us. We foresee a peak of headline inflation at around 2.6% by the middle of next year and in the absence of further boost factors, expect the inflation rate to moderate to 2.2% by the end of 2017.

Euro Area – More fiscal flexibility here too

GDP Growth

Swiss Life Asset Managers	*Consensus*
2017: 1.2%	*2017: 1.4%*
2018: 1.2%	*2018: n.a.*

The Euro Area economy has outperformed all other regions discussed in this paper as concerns the level of the economic surprise index published by Citigroup. This surprise index tracks how economic data are faring relative to expectations. A positive reading means that economic data have exceeded economists' consensus estimates. We feel encouraged to stick to our view that current quarter GDP growth may be stronger than in the third quarter where we saw 0.3% quarterly growth. One needs to stress that it is the formerly called PIGS countries which deliver the highest growth rates of all with Portugal growing at a quarterly pace of 0.8%, Ireland at 4.0%, Greece at 0.8% and Spain at 0.7%. Progress in the Italian economy remains lacklustre even more so after Mr. Renzi lost the referendum, as expected, and the political landscape remains hazy. The "new" government's key task will be to deal with the banking crisis and to design a new election law. Yet, the space for fiscal easing has grown throughout the region, particularly since the European Commission gave green light for stronger fiscal spending. Germany, however, which is equipped with the highest degree of fiscal flexibility still seems hesitant to actually deploy it. EU leaders are currently holding a summit where an extension of the Juncker plan for strategic investments will be discussed besides other issues.

Inflation

Swiss Life Asset Managers	*Consensus*
2017: 1.5%	*2017: 1.3%*
2018: 1.6%	*2018: n.a.*

During the latest press conference, Mr. Draghi stated that the ECBs inflation mission (of 2% headline inflation rate) will only be accomplished in 2019 according to their latest forecasts. And we would agree. 1.6%, our forecast for 2018, is not a level that the ECB considers as being close to 2%. Although the rise in the oil price currently reinforces the base effect, we will still remain below 1% headline inflation in December 2016, just to rise to 1.2% by the start of the new year. At the end of 2017, headline and core inflation will converge at around 1.5% to 1.6% according to our own forecast.

Japan – Weaker Yen to support reflation efforts

GDP Growth

Swiss Life Asset Managers	*Consensus*
2017: 1.0%	*2017: 1.0%*
2018: 0.8%	*2018: n.a.*

Since November the Japanese Yen's external value dropped by 9% according to trade-weighted exchange rate indices. This recent move corrects more than half of the currency appreciation between mid 2015 and September 2016. In the short-term, this development should boost economic activity in Japan as its exporters benefit from the current cyclical global upswing. Polls among manufacturers such as the quarterly Tankan survey and the monthly manufacturing purchasing managers index (PMI) confirm improving dynamics over the recent past. Meanwhile, the services sector PMI gained further in November after having moved above 50 points for the first time since July the month before. The improvement in sentiment remains broad-based as show the growing optimism among small and medium sized firms and sturdy data from the construction sector. Financial services recover too with bank lending picking up since mid-year. While economic momentum has clearly improved since mid-year, a new threat to Japan's recovery appears on the horizon: Donald Trump's withdrawal from the Trans Pacific Partnership (TPP) trade agreement project thwarts Abe's plans to deregulate Japan's economy with the help of foreign pressure. Japan's export industries are also a likely victim of protecionist measures potentially introduced by the new US government: Not only are 20% of Japan's exports going to the US, a termination of NAFTA would strongly impact Japanese car manufacturers operating in Canada and Mexico for delivery to the US market.

Inflation

Swiss Life Asset Managers	*Consensus*
2017: 0.9%	*2017: 0.5%*
2018: 0.1%	*2018: n.a.*

Given the combined trend of a weakening exchange rate and rising commodity prices, we adjust our inflation forecast yet again to the upside. Assuming unchanged energy prices and a further weakening of the Yen versus the US Dollar, we expect annual headline inflation to stay in positive territory through the entire year 2017.

UK – Peak in service price inflation left behind

GDP Growth

Swiss Life Asset Managers	*Consensus*
2017: 1.3%	*2017: 1.3%*
2018: 0.8%	*2018: n.a.*

As discussed last month, we made our decision to fine-tune the assumption for GDP growth during the final quarter 2016 dependent on the November readings for the various purchasing managers indices as well as the retail sales data for the same month. In the meantime, these data indeed point at continued strong economic dynamics thanks to windfall gains in competitiveness and accelerating earnings growth in the labour market. We thus lift our forecast for current quarter GDP growth from 0.3% to 0.4%. Our econometric model based on purchasing managers indices suggests that growth might even have accelerated to 0.6%. The reason why we overrule our own model are resurfacing uncertainities around Brexit which are also dampening medium-term prospects. The most recent set of labour market indicators revealed that employment growth came to a standstill in the three months to October. Thus, a more prudent hiring and investment behaviour in the corporate world still seems a likely consequence of Brexit in the medium term.

Inflation

Swiss Life Asset Managers	*Consensus*
2017: 2.4%	*2017: 2.5%*
2018: 2.2%	*2018: n.a.*

Inflation data for November came in slightly higher than projected. At 1.2%, annual inflation rose to its highest level since October 2014, or when the crude oil price started its descent. In our comparably modest inflation profile for 2017, inflation should reach a peak at 2.7% by October. Service price inflation, which reached 2.8% by August 2016 is moderating and stands at 2.2% in November. This makes it unlikely that headline inflation will exceed 3% at any time next year. The forecast is heavily dependent on pass-through rates of higher import prices to the consumer. Any recovery of the Sterling's external value in coming months poses a downside risk to our forecast for inflation over the next two years.

Switzerland – Third quarter data confirm our concerns

GDP Growth

Swiss Life Asset Managers	*Consensus*
2017: 1.0%	*2017: 1.5%*
2018: 1.5%	*2018: n.a.*

Ever since the Swiss National Bank abandoned its minimum exchange rate policy in January 2015, we were prudent in our forecast for domestic activity. So, the strong GDP report for the second quarter 2016 took us by surprise and triggered a marked upward revision in our projections. Yet, as GDP growth in the second quarter was almost exclusively driven by government consumption and turnover at commodity traders, we were skepical as regards the sustainability of growth rates witnessed in the first half 2016. Meanwhile, third quarter data confimed our judgement that domestic private activity virtually stagnated so far this year. Government consumption contributed negatively to growth in the third quarter and likely remained a drag in the final quarter 2016. Unfortunately Switzerland's purchasing managers index for the manufacturing sector is a far less reliable indicator to gauge GDP growth than the ones for the Euro Area or the United Kingdom. Nevertheless, its recent jump to 56.6 points, or the highest reading since February 2014, means that exporters benefit from the upswing of the global economy. We thus continue to expect a return to 0.2% quarterly GDP growth in the current quarter and an average pace of 0.3% through 2017.

Inflation

Swiss Life Asset Managers	*Consensus*
2017: 0.3%	*2017: 0.3%*
2018: 0.4%	*2018: n.a.*

Inflation data surprised to the downside so far in the fourth quarter, mainly due to lower prices for holiday packages and hotel overnight stays. Prices for new cars also came in lower in November as car sales stagnated during most of 2016. As a consequence of continued appreciation of the Swiss Franc, a new car costs 22% less than a comparable model in 2010. Higher fees for public transport and the rise in energy prices mean that annual inflation is set to turn positive by January 2017.