Global Economic Scenario
January 2018

SwissLife
Asset Managers

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

	GDP 2018		GDP 2019		CPI 2018		CPI 2019	
	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus
USA	2.5%	2.5%	1.9%	n.a.	2.3%	2.1%	2.0%	n.a.
Eurozone	1.9%	2.1% (1.9%)	1.2%	n.a.	1.2%	1.4% (1.3%)	1.3%	n.a.
Japan	1.6% (1.3%)	1.3%	1.1%	n.a.	0.5% (0.4%)	0.8% (0.7%)	0.4%	n.a.
UK	1.2% (1.0%)	1.5% (1.4%)	1.0% (0.9%)	n.a.	2.5% (2.3%)	2.6%	2.0%	n.a.
Switzerland	1.9%	1.9% (1.8%)	1.3%	n.a.	0.6%	0.7%	0.8%	n.a.

Source for Consensus Estimates: Consensus Economics Inc. London, 4 December 2017

USA – Entrepreneurs embrace the prospect of tax cuts

GDP Growth

Swiss Life Asset Managers	*Consensus*
2018: 2.5%	*2018: 2.5%*
2019: 1.9%	*2019: n.a.*

We expect the last quarter of 2017 to generate yet another sturdy GDP growth figure. Our assumption for quarterly annualised real GDP growth is at 2.6%, somewhat lower than in the second and third quarter of this year, but still clearly above the potential output as calculated by the OECD. While the inventory build-up may exhibit strong swings from one quarter to the next, we have indications that the inventory drawdown may act as a drag after a strong positive contribution of 0.8 percentage points in the third quarter. Personal consumption expenditures, the heavyweight in GDP calculations, may however prove to be robust given strong sales numbers around Black Friday. We rate this as a harbinger of satisfactory sales for Christmas as well. Going into 2018, we remain confident that on average, growth momentum will be sustained across coming quarters, with a stronger first half of the year followed by somewhat weaker quarters in the second half. Needless to say, a lot hinges on the exact design and timing of the tax package which still has to be agreed on after both, the House of Representatives as well as the Senate, have submitted their own versions of tax reform. The differences are currently being discussed and may be resolved in so-called conference committees before yearend. Yet, financial markets as well as entrepreneurs in the US are interpreting the current versions of future tax legislation as being mainly beneficial for them, even though details are still lacking at this stage. The optimism of small companies, represented by the National Federation of Independent Business, shot up to the highest level since November 2004. This particular sentiment index had immediately soared after the presidential election last year, stabilised thereafter and saw a strong rebound now. Hopes are that corporate taxes will be cut dramatically. Yet, the implementation looks likely to happen in 2019 only. We nevertheless assume that the inclination of companies to hire and above all to engage in capital investments remains intact or may strengthen further. This should keep growth momentum of the whole economy on elevated level until the end of 2018 at the least.

Inflation

Swiss Life Asset Managers	*Consensus*
2018: 2.3%	*2018: 2.1%*
2019: 2.0%	*2019: n.a.*

The latest labour market report underlined yet again the big conundrum when it comes to the absence of noteworthy wage inflation. The core CPI reading for November underlined that impression. Standard textbooks tell us that inflation and unemployment have a stable and inverse relationship. Once slack in the labour market disappears, inflation pressure should build up. This relationship is called the Phillips curve. The US labour market is at full employment and unemployment at 4.1% is below the mark which is commonly acknowledged to be a threshold for higher wage inflation. In 2018, we should finally see wage inflation which is more in line with the tightness of the labour market, supporting overall inflation to a certain extent.

Eurozone – Growth at the peak

GDP Growth

Swiss Life Asset Managers	*Consensus*
2018: 1.9%	*2018: 2.1%*
2019: 1.2%	*2019: n.a.*

Only at the turn of the millennium has consumer confidence in the currency region been higher than today. And the consumer has been an important contributor to above-potential growth momentum over past quarters. As sturdy as consumption spending will remain, further acceleration from current levels seems unlikely to us. Yet, consumption spending constitutes a reliable growth pillar throughout 2018 in our view, given that the economic recovery spurs the healing of the labour market in many of the member countries. Increasingly so, impetus comes from companies' investment decisions, namely so in machinery and equipment, a sign that entrepreneurs drop their distrust in the sustainability of the economic upswing. So far, their optimism remains unfazed by the appreciation of the Euro. Retained earnings are high and credit demand is reviving in most member countries. Order books are brimming, ensuring production and exports over the coming months. Monetary policy will remain accommodative enough not to endanger economic dynamics. What remains as a main risk factor is politics. So far, Germany lacks a government and elections in Italy may well generate a government participation of populist parties in the third-biggest member country.

Inflation

Swiss Life Asset Managers	*Consensus*
2018: 1.2%	*2018: 1.4%*
2019: 1.3%	*2019: n.a.*

Decelerating core inflation over the past two months came unexpected and causes researchers to eagerly await the ECB staff's updated forecasts, to be introduced on 14 December. They hope to be able to derive from the ECB's inflation forecast, if and for how long they will extend quantitative easing beyond 2018. Our own forecasts do not foresee the achievement of the ECB's goal of a headline inflation rate of close but below 2%. Core inflation will hardly reach 1% on average next year, under the assumption that a stronger Euro will slowly filter into prices and products via lower import prices.

Japan – Pro-cyclical fiscal stimulus

GDP Growth

Swiss Life Asset Managers	*Consensus*
2018: 1.6%	*2018: 1.3%*
2019: 1.1%	*2019: n.a.%*

Japan's economic growth accelerated in the second half of the year and leading indicators suggest that this country continues to be one of the main beneficiaries of the synchronous global upswing. Our projections for 2017 and more importantly 2018 exceed the median growth forecast of the sample polled by Consensus Economics. In an international context, Japan's employers are particularly keen to hire additional workforce in the short-term: Japan's net result in Manpower's global employment barometer ranks second after Taiwan for the first quarter 2018. Yet another fiscal package is likely to pass parliament before the end of the year. In parts, the additional budget will be aimed at improving military defence ability against threats from North Korea. While it is highly doubtful, that the economy needs such a stimulus, it should ensure more creation of permanent jobs and eventually wage growth in the home economy. The planned resumption of power generation by at least two more nuclear plants at the start of next year means that the country's dependency on energy imports diminishes further. This is likely to result in an improving net growth contribution from trade and additionally warrants our comparably upbeat growth forecast for 2018.

Inflation

Swiss Life Asset Managers	*Consensus*
2018: 0.5%	*2018: 0.8%*
2019: 0.4%	*2019: n.a.*

As output gaps are closing in all major economies and labour markets tighten, the chances to reflate Japan's economy are bigger than at the start of "Abenomics", when large parts of the developed world underwent deflationary austerity measures. Yet, in our view, there is only a low probability for achieving a return to 2% inflation on a sustained base. It remains uncertain whether the consumption tax rate will be raised from 8% to 10% sometime in 2019. Such a step would only temporarily lift inflation as observed in 2014. We refrain from including any impact on our inflation path until the tax rate hike will be officially announced.

UK – A softer Brexit than what we have thought?

GDP Growth

Swiss Life Asset Managers	Consensus
2018: 1.2%	*2018: 1.5%*
2019: 1.0%	*2019: n.a.*

Prime minister May achieved an agreement with her negotiation partners that sufficient progress has been made in settling the three priority issues on the way to the UK's departure from EU. Despite this apparent progress, uncertainties about the final outcome remain high. Under such insecurity, prudent corporate investment in machinery and jobs weighs on growth. Firms from outside Europe, like Japanese car manufacturers, are unlikely to continue to use the UK as an entrance to Europe's single market. Moreover, the departure of two EU regulatory authorities to Paris and Amsterdam triggers private sector relocation in financial and pharmaceutical sectors. Thus, we anticipate sub-potential growth until 2019. Offsetting these structural impediments, cyclical dynamics have improved lately thanks to the ongoing global economic upswing. The purchasing managers' index for the manufacturing sector rose to its highest level since August 2013. Combined with the perceived growing probability for a Brexit solution which includes a customs union, this warrants a mild upward revision of our forecast for the rest of 2017 and for 2018.

Inflation

Swiss Life Asset Managers	Consensus
2018: 2.5%	*2018: 2.6%*
2019: 2.0%	*2019: n.a.*

Instead of cooling from 3.0% to 2.9%, headline inflation rose to 3.1%. The volatile air fares component and higher energy prices were main reasons for this upside surprise, together with food prices which rose at the fastest annual pace since 2013. Core inflation remained stable, suggesting some moderation in services. We lift our forecast for 2018 for three reasons: First, we adjust for the forecasting error in November. Second, rising energy prices so far in December trigger a higher projection for the current month. And thirdly, transport authorities have announced a 3.1% increase in rail fares as of January. This lifts headline inflation through 2018 by 0.05%.

Switzerland – Improving employment outlook

GDP Growth

Swiss Life Asset Managers	Consensus
2018: 1.9%	*2018: 1.9%*
2019: 1.3%	*2019: n.a.*

In our last edition, we discussed the uncertainty ahead of the release of third quarter GDP data. While we expected an acceleration to 0.5% quarterly growth, the actual outcome showed even more momentum with a 0.6% pace. Alongside with positively surprising third quarter data, upward revisions to historic data were also published by the State Secretariat for Economic Affairs (SECO). As a consequence, our forecast for 2017 underwent an upward revision to 1.0% from 0.8%. Going forward, economic momentum remains strong. Our own assumptions for the quarterly GDP growth profile exceed the OECD's new estimate of 1.4% potential annual growth for each single quarter until end of 2018. The sharpest devaluation of the Swiss Franc's external value since 1996 acts like a stimulus programme for the domestic economy. We see the EURCHF exchange rate fluctuating between 1.16 and 1.22 through 2018. Under these favourable circumstances, we expect more job creation and domestic business investment spending and less outsourcing compared to the recent past. The job barometer of Manpower, a human resources service provider, improved slightly during the last three months, signalling that a net majority of firms plans to add jobs during the first quarter 2018.

Inflation

Swiss Life Asset Managers	Consensus
2018: 0.6%	*2018: 0.7%*
2019: 0.8%	*2019: n.a.*

Annual inflation climbed to 0.8% in November, the highest rate since 2011. Energy prices and higher costs due to the weaker Franc are the most important drivers of consumer prices in the months ahead. Nevertheless, we anticipate base effects from last year to result in lower annual inflation readings throughout the first half 2018. We will have to wait until September next year to see inflation returning to current levels again.

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