Global Economic Scenario
April 2017

SwissLife
Asset Managers

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	2.2% (2.3%)	2.2% (2.3%)	2.3%	2.4%	2.5% (2.8%)	2.5%	2.1%	2.3%
Eurozone	1.4% (1.3%)	1.6%	1.2%	1.5%	1.7% (2.0%)	1.7% (1.6%)	1.5% (1.6%)	1.4%
Japan	1.2% (1.1%)	1.2%	0.9%	1.0%	0.3% (0.8%)	0.7%	0.0% (0.1%)	1.0%
UK	1.8% (1.7%)	1.7% (1.5%)	1.0%	1.3%	2.6% (2.5%)	2.6%	2.3% (2.2%)	2.7%
Switzerland	1.2%	1.5%	1.6% (1.5%)	1.7%	0.5%	0.5% (0.4%)	0.4%	0.7% (0.6%)

Source for Consensus Estimates: Consensus Economics Inc. London, 13 March 2017

USA – Credibility of new administration is dented

GDP Growth

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

Checks and balances are working and the new administration is forced to bow to reality. Support for the proposed health care reform was too thin even within the Republican party. The major election campaign promise to repeal Obamacare thus proved to be difficult. On a positive note, this failure opens up the possibility to discuss tax reform earlier than initially thought. However, the obstacles to tax reform are at least as great as those that blocked the health care bill. Without the fiscal savings from replacing Obamacare with a cheaper program, the supporters of tax reform will have an even bigger fiscal hole to fill when they present their bill. Furthermore, the White House view of the border adjustment taxes proposed by the House Republicans remains unclear. Lobbyists expressing pros and cons of a border adjustment tax (which would make imports more expensive), do not do so with the same vigour. Import-oriented sectors and above all retailers aggressively lobby against the idea of such a tax. The potential beneficiaries seem less determined since the net effect on their business is more complex. Obviously, they also have to take into account that trading partners may strike back in retaliation. The border adjustment tax also lacks support from the Freedom Caucus which is the conservative and libertarian branch of the Republican party and which succeeded in the past to actually block the passage of bills in the House of Representatives. To summarise: the political outlook remains hazy. Our expectation is that economic optimism is bound to moderate from currently stunning levels on the business and consumer side. The hard economic data which have been published for the first quarter thus far do not confirm such strong activity. Weaker than expected activity in terms of industrial production, homes sales and inventory build-up caused us to slightly downgrade the projection for Q1 GDP, the advance estimate of which will be published on 28 April. As in the years before, we may observe first quarter growth which is initially reported to have been weak, some of that weakness was explained by the statistical office's difficulties with seasonal adjustment. Our assumption for annualised growth of 1.8% in the first quarter is slightly below the rate observed in the fourth quarter 2016.

Inflation

Swiss Life Asset Managers	*Consensus*
2017: 2.5%	*2017: 2.5%*
2018: 2.1%	*2018: 2.3%*

Markets reacted with a high dose of nervousness to oil-related data out of the US. Higher production as well as a rising number of active rigs translated into a pronounced correction of the oil price since the beginning of March. This leaves traces in headline inflation in March and causes our downward revision of the annual average of headline inflation. Even more so, our claim that the peak in headline inflation was reached in February holds true. While long-term inflation expectations of consumers have climbed, their view on the short-term price dynamics remains largely unchanged. Similarly, 5-year 5-year forward breakevens have corrected to the downside again, having reached an intermediate peak at 2.3% at the end of January.

Eurozone – Strong first quarter in the cards

GDP Growth

Swiss Life Asset Managers	*Consensus*
2017: 1.4%	*2017: 1.6%*
2018: 1.2%	*2018: 1.5%*

The danger from the political front has seemingly moderated since the worst fears regarding the outcome of the election in the Netherlands have not materialised. Furthermore, a victory of Marine Le Pen and thus a turn to populism in the second biggest Eurozone member economy has become increasingly unlikely as well. At the same time, macroeconomic data paint a picture of very strong economic dynamics throughout the region since the beginning of the year. Other than in the US, sentiment data and real actvity are fairly aligned and caused us to slightly revise our projection for GDP growth in the first quarter to the upside. As a matter of fact, purchasing managers indices for both, the manufacturing as well as services industries remain on fairly elevated levels in March. Sturdy export activity in January underlines that the Eurozone is a beneficiary of the global cyclical upswing while domestic demand is robust. Employment in the currency region as a whole continues to grow while labour markets in Germany as well as France took the smallest hits during the financial crisis in terms of job loss. However, the unemployment rate in many member countries remains uncomfortably high which tames demand for higher wages. According to the latest ECB bank lending survey, demand for credit of small and medium-sized enterprises has risen and banks are prepared to meet rising demand. The last long-term refinancing operation by which the ECB provides cheap financing to Eurozone banks was fully allotted.

Inflation

Swiss Life Asset Managers	*Consensus*
2017: 1.7%	*2017: 1.7%*
2018: 1.5%	*2018: 1.4%*

The March headline inflation reading slumped by 0.5 percentage points, from 2.0% to 1.5% due to the renewed decline of energy prices in March. In our own inflation path, the February level marks the peak of headline inflation this year. Core inflation will rise slightly from current levels to barely surpass 1% by the end of 2017. Earlier fears of some market commentators that we have entered a new era of inflation pressure prove overdone.

Japan – With support from China

GDP Growth

Swiss Life Asset Managers	*Consensus*
2017: 1.2%	*2017: 1.2%*
2018: 0.9%	*2018: 1.0%*

The first synchronous global cyclical upswing since 2009 strongly benefits Japan's manufacturers exporting to China and other parts of Asia. As a result of this, Japan's manufacturing purchasing managers index (PMI) holds above the 50 points expansion line since September 2016. Apparently, growth momentum has softened somewhat as of late, with the PMI easing slightly to 52.4 points in March from a cyclical peak of 53.3 points reached in February. Small and medium sized firms which have a larger exposure to the domestic economy are lagging somewhat behind in the cycle. Yet, it is a promising sign that the Shoko Chukin Bank's small business confidence survey managed to surpass the critical 50 points mark for the first time since 2014. The most recent results of Japan's quarterly Tankan survey confirm this general trend: Both indices for large and small manufacturers improved during the first three months of the year. Meanwhile, personal consumption remains sluggish despite a fairly tight labour market. Structural factors like the shrinking and ageing population continue to outweigh the cyclical tailwinds when it comes to aggregate domestic demand.

Inflation

Swiss Life Asset Managers	*Consensus*
2017: 0.3%	*2017: 0.7%*
2018: 0.0%	*2018: 1.0%*

Japan's annual inflation rate crossed the zero line in October last year. Until recently, we expected inflation to remain in positive territory until the second quarter next year. Yet, actual inflation readings fell short of our and the consensus' expectation both for January and February. Additional information from the consumer price index of the Tokyo area suggests that inflation remained subdued in March. Thus, price developments through the first quarter 2017 trigger a substantial downward revision of our forecast for average annual inflation both this year and in 2018. Like elsewhere, the biggest boost for inflation lies behind us. According to our current projection, the cyclical peak will be reached at 0.6% in September.

UK – Two or more years of uncertainty ahead of us

GDP Growth

Swiss Life Asset Managers	Consensus
2017: 1.8%	*2017: 1.7%*
2018: 1.0%	*2018: 1.3%*

The synchronous global upswing which started in summer 2016 and the Pound's loss in external value provided strong tailwinds for the UK economy ever since a majority of voters decided to leave the EU in June 2016. On a trade-weighted basis, the Pound was 11% weaker during the first quarter of 2017 compared to the same period a year before. In contrast to fears that the UK economy would suffer from an immediate hit as a consequence of Brexit, quarterly GDP growth rates accelerated to 0.6% and 0.7% respectively in the last two quarters of 2016. And yet, the details for the fourth quarter show that concerns about the costs of Brexit might have been wrong in timing, but not in substance: While net trade was a positive contributor to growth, the corporate sector invested less in machinery and other technology compared with preceeding quarters. This can be interpreted as a sign of uncertainty ahead of tough negotiations on future market access with the EU. Main witnesses of our assessment that dynamics weakened slightly during the first quarter of 2017 are soft retail sales data and the tendency of purchasing managers indices across all sectors to lose some of the momentum observed by the end of 2016.

Inflation

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

We expect inflation to climb from currently 2.3% to 3.0% until October 2017 and to stay above 2% throughout 2018. Pass-through effects of rising import prices following the Pound's depreciation now materialise at the consumer level: Anecdotal evidence of double digit price increases ranges from purchases in Apple's App store to chocolate snacks or popcorn. Additionally, higher tariffs for gas and electricity announced by energy providers add approximately 0.1% to annual inflation.

Switzerland – Negative rates support public finances

GDP Growth

Swiss Life Asset Managers	Consensus
2017: 1.2%	*2017: 1.5%*
2018: 1.6%	*2018: 1.7%*

Even though GDP data published by early March revealed that the economy virtually stagnated in the second half of 2016, the consensus forecast saw no downward revision compared to last month's estimate. In our view, 1.5% average annual growth is a very ambitious number for 2017 as it requires annualised quarterly growth rates of 2% for each single quarter. Another scenario leading to the same result would require a strong jump in the first quarter to lift the base for the annual growth calculation through the following quarters. While we remain reluctant to share our peers' optimism entirely, we raise our forecast slightly to 1.2% in the light of accelerating growth dynamics in neighbouring Europe. Additionally, the fact that public finances and thus government consumption benefit from negative interest rates and higher than expected tax receipts was not sufficiently mirrored in our previous growth profile. The weak spots in Switzerland's economy remain private domestic demand and export dynamics in sectors which are directly competing against suppliers from the Eurozone and the UK with their weak currencies a strong advantage.

Inflation

Swiss Life Asset Managers	Consensus
2017: 0.5%	*2017: 0.5%*
2018: 0.4%	*2018: 0.7%*

Energy prices fell markedly in March, meaning that inflation moderates from 0.6% to 0.5% this month. In our base case scenario we expect inflation to soften to 0.3% over the summer before accelerating to a temporary peak of 0.9% in November this year. Yet, we expect inflation to remain below 1% for the entire forecast horizon until the end of 2018. A renewed increase in energy prices, or a surprise softening of the Swiss Franc once fears related to the election in France disappear, provide certain upside risks to this forecast.