Global Economic Scenario
June 2016

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	1.9% (2.1%)	1.8% (2.0%)	2.1%	2.3% (2.4%)	1.2%	1.2% (1.3%)	2.2%	2.3% (2.2%)
Euro Area	1.5% (1.3%)	1.6% (1.5%)	1.3%	1.6%	0.1% (0.3%)	0.2% (0.3%)	1.6% (1.7%)	1.3% (1.4%)
Japan	0.6% (0.2%)	0.5% (0.6%)	1.0%	0.5%	-0.4% (0.1%)	0.0%	0.2% (0.3%)	1.5% (1.6%)
UK	1.8% (1.7%)	1.9% (2.0%)	1.7%	2.2%	0.5% (0.7%)	0.7%	1.9% (2.0%)	1.7%
Switzerland	1.0% (0.9%)	1.1%	1.0%	1.5%	-0.3%	-0.6%	0.2% (0.3%)	0.2%

Source for Consensus Estimates: Consensus Economics Inc. London, 9 May 2016

USA – Traditional retailers under pressure

GDP Growth

Swiss Life Asset Managers	*Consensus*
2016: 1.9%	*2016: 1.8%*
2017: 2.1%	*2017: 2.3%*

In the last issue of this paper, we discussed the surprising weakness of US consumer spending over past quarters. However, sales at retailers in April jumped by the most in a year, climbing by 1.3% from the previous month. Furthermore, sales figures for February and March were revised to the upside, modestly improving the growth trajectory for the first quarter. Fears around a drastic slowdown in consumer spending were also stoked by reports of classical department stores and other traditional retailers who are confronted with structural headwinds. The slow-down in personal consumption may thus be more of a microeconomic than a macroeconomic story. Retailers who were early adopters of online shopping platforms and developed further fare a lot better than the ones concentrating on traditional channels only, as consumers purchase more and more goods online. On one hand, statistics may not yet capture the full breadth of this development likely understating the total amounts of goods sold, and on the other hand, the retail world seems increasingly split between providers who succeed in the online world and the ones who don't. Finally, to account for the rising share of services spending and to gauge its contribution correctly poses a challenge of its own for statisticians around the globe. The latest rise of consumer sentiment as published by the University of Michigan underlines a relatively sound consumption environment going into the second quarter. Business survey data remains shaky however. The renewed decline of regional purchasing managers indices poses a risk to the next publication of the ISM purchasing managers index on 1st June. Although the biggest drags on the manufacturing sector, such as the oil price slump as well as strong USD, are waning, the sector continues to exhibit weakness. Not only has recent hawkish communication by Fed officials caused markets to yet again reprice the path of monetary policy, the fact that the presidential election will take place in early November adds to current uncertainties regarding future policy-making. In the light of this, we view uncertain fiscal agendas as a dampening factor for investment spending until after the elections.

Inflation

Swiss Life Asset Managers	*Consensus*
2016: 1.2%	*2016: 1.2%*
2017: 2.2%	*2017: 2.3%*

Headline inflation got a noteworthy lift from energy prices in April, reaching a level of 1.1% annual change. Even with a consensus view on the price of crude oil remaining largely unchanged until the end of this year, headline inflation is bound to approach 2% towards the turn of the year. Base effects from very low levels in 2015 are responsible for this lift. Given the fact that the labour market has reached full employment, late cycle wage increases may moderately add to underlying inflationary tendencies. Service categories in particular should be able to bolster overall price developments.

Euro Area – Strong first quarter not to be repeated

GDP Growth

Swiss Life Asset Managers	*Consensus*
2016: 1.5%	*2016: 1.6%*
2017: 1.3%	*2017: 1.6%*

The fact that the Euro Area economy grew by 0.5% quarterly rate in the first quarter of this year should not lead to untamed optimism, although we had to upgrade our own growth projection for the whole year 2016. First quarter activity clearly benefitted from unusual warm weather and calendar effects which caused the Easter holidays and the related stronger spending to fall into the month of March. Our growth forecast for the remainder of this year looks rather uneventful and compares to average quarterly growth seen in 2014 and 2015. This also means that the strong print in the first quarter of this year does not look sustainable to us. Purchasing managers indices for the month of May hardly budged from levels seen a month before, while at the same time prolonging the pattern of livelier services industries as compared to the manufacturing sector. A slightly stronger Euro on a trade-weighted basis diminishes price competitiveness above all for producing companies. Moreover, certain member countries which have achieved strengthened competitiveness on the back of structural reforms run the risk of losing that position. Progress made in adjusting public spending over past years may ultimately come to an end as the reins are relaxed somewhat. This bolsters growth in the short run, does however interrupt progress made in reducing the debt mountains in the longer run.

Inflation

Swiss Life Asset Managers	*Consensus*
2016: 0.1%	*2016: 0.2%*
2017: 1.6%	*2017: 1.3%*

The disappointing reading of headline inflation for the month of April triggered renewed fears of persistent deflationary tendencies. Yet, seasonal patterns led to distortions in price dynamics between March and April due to the early timing of Easter holidays. According to our own inflation projection, headline inflation will remain in negative territory until August of this year, just to climb to 0.9% by year-end. Core inflation fell back to below 1% in April and will not accelerate notably in the months to come.

Japan – Positive surprise in first quarter GDP data

GDP Growth

Swiss Life Asset Managers	*Consensus*
2016: 0.6%	*2016: 0.5%*
2017: 1.0%	*2017: 0.5%*

The initial release of first quarter GDP data came as a major surprise to most forecasters, including ourselves: Whilst we expected GDP unchanged from the previous quarter, the official data suggest a quarterly growth of 0.4%. Based on these news, we are forced to lift our forecast for average growth in 2016 from 0.2% to 0.6%. GDP was not the only real economic indicator which surprised to the upside recently: Labour market data including cash earnings came in on the strong side, as did March retail sales and industrial production. Sentiment and survey data on the other hand continued to deteriorate with the manufacturing purchasing managers index falling further into contraction territory according to a preliminary reading. Exports declined for the seventh straight month on the strengthening of the Yen and production shortages in the automobile industries following the earthquake in the Kumamoto region. Since months we highlighted the possible delay of the consumption tax hike planned for April 2017 to ensure a positive and steady contribution to growth from private households at a time when exporters find themselves in difficulties. Unconfirmed media reports suggest that prime minister Abe will indeed announce such a delay on June 1, the last day of the current parliamentary session. Unfortunately, that date comes after the copy deadline of this paper. Until now, our forecasts for GDP growth and inflation in 2017 are clean of tax rate hike effects. Should the hike be implemented, we have to adjust our assumptions accordingly next month. After June, a proper comparison of our estimates with consensus numbers will become possible again.

Inflation

Swiss Life Asset Managers	*Consensus*
2016: -0.4%	*2016: 0.0%*
2017: 0.2%	*2017: 1.5%*

Apart from the uncertainty around the consumption tax rate hike, consumer prices are strongly influenced by the strengthening of the Yen. On a trade-weighted base, the Yen appreciated by 12% over the past twelve months which dampens the impact of the recent energy price increase on global markets.

UK – Brexit odds shrinking to less than 25%

GDP Growth

Swiss Life Asset Managers	Consensus
2016: 1.8%	2016: 1.9%
2017: 1.7%	2017: 2.2%

The likelihood that the UK will remain a member of the European Union after the referendum on June 23 has increased since last month. While still suggesting a neck and neck race, most opinion polls report a growing number of respondents preferring the status quo. Most recently bookmaker odds fell to a likelihood for Brexit as low as 25%. We therefore continue to expect that voters will opt for remaining in the EU. In this base case scenario, investment spending in the UK economy is probably increasing during the second half of the year, while exporters will loose the tailwinds from a weak Sterling. Leaving the distorting effects of the referendum on sentiment and investment spending aside, the economic cycle in the UK is best described as having arrived at a late stage. Altough growth has lost some momentum in the first three months of 2016, the economy continued to expand above its long-term potential rate for the thirteenth straight quarter. Muted wage growth remains an atypical characteristic of this cycle. Nevertheless, we continue to observe firm consumption growth. Strong retail sales numbers for April and a substantial upward revision to the March data of the same time series force us to return to 1.8% expected GDP growth in 2016.

Inflation

Swiss Life Asset Managers	Consensus
2016: 0.5%	2016: 0.7%
2017: 1.9%	2017: 1.7%

Calendar effects with all special Easter uppricing activity falling into March resulted in a reverse move in April's consumer price index reading. A general reset of social housing rents by 1% additionally weighed on the aggregate consumer price measure last month. Both are one-off effects which will not be repeated. Going forward, the fact that the output gap closes over the next twelve months and fuel prices contributing positively to inflation justify our view that inflation rates will move up from currently 0.3% to 2.0% until mid-2017.

Switzerland – Energy prices have risen strongly

GDP Growth

Swiss Life Asset Managers	Consensus
2016: 1.0%	2016: 1.1%
2017: 1.0%	2017: 1.5%

Switzerland's first quarter GDP data will be published on June 1st, or shortly after the copy deadline for this paper. Fine-tuning our assumptions, we have raised our estimate for first quarter growth from 0.2% to 0.3%. Leaving all assumptions regarding the GDP profile until end of 2017 unchanged for the time being, this upward revision lifts our forecast for average annual GDP growth in 2016 from previously 0.9% to 1.0%. As our growth forecast stood at the lower end of available estimates ever since the Swiss National Bank has abandoned its minimum exchange rate policy, a slightly more upbeat assessment requires explanation: According to the purchasing managers index, Switzerland's industrial sector was clearly in expansion territory since the start of the year. Strong activity in neighbouring Europe supports the competitive part of Switzerland's exporters. At home, the mild winter caused less interruptions on construction sites than normal. Altough we adjust our quantitative assesment modestly, the qualitatve judgement of moderate domestic activity remains unaltered. Monthly car sales, as a proxy for spending on durable goods, fell 2.6% so far this year compared with 2016.

Inflation

Swiss Life Asset Managers	Consensus
2016: -0.3%	2016: -0.6%
2017: 0.2%	2017: 0.2%

With the external value of the Franc falling since the start of 2016, the big wave of price cuts following last year's currency shock ebbs away. This validates our assumption that inflation returns into positive territory by the final quarter of 2016. As our methodology to forecast inflation works under the assumption of stable commodity prices during the forecast period, we see risks to our forecast skewed to the upside. Retail prices for heating oil rose 30% from their lows in January, lifting the headline inflation rate by 0.5 percentage points.