Global Economic Scenario
July 2016

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	1.8% (1.9%)	1.9% (1.8%)	1.9% (2.1%)	2.3%	1.2%	1.3% (1.2%)	2.2%	2.3%
Euro Area	1.5%	1.6%	0.9% (1.3%)	1.6%	0.3% (0.1%)	0.2%	1.5% (1.6%)	1.3%
Japan	0.6%	0.5%	1.0%	0.9% (0.5%)	-0.2% (-0.4%)	-0.1% (0.0%)	0.2%	0.9% (1.5%)
UK	1.4% (1.8%)	1.9%	0.4% (1.7%)	2.1% (2.2%)	0.7% (0.5%)	0.6% (0.7%)	2.5% (1.9%)	1.6% (1.7%)
Switzerland	0.8% (1.0%)	1.1%	0.9% (1.0%)	1.5%	-0.3%	-0.5% (-0.6%)	0.3% (0.2%)	0.3% (0.2%)

Source for Consensus Estimates: Consensus Economics Inc. London, 13 June 2016 (Survey completed prior to UK referendum)

Consensus Economics Forecast Accuracy Award Winner 2015 Switzerland

Consensus Economics, one of the world's leading economic survey organisation, has announced the recipients of its 2015 Forecast Accuracy Award (FAA) in June 2016. Swiss Life Asset Managers' economic research team has won this year's Forecast Accuracy Award for Switzerland. Click here for more information.

USA – Not much damage from Brexit

GDP Growth

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

Needless to say, the Brexit caused us to review our forecasts to the downside, but only slightly so. In our opinion, the effect of the UK potentially leaving the EU in two years time at the earliest and the insecurities this harbors only have limited impact on GDP growth in the US. The adjustments we have actually undertaken are related to an expected decline in business sentiment and more cautious investment spending going forward until the fog surrounding the political developments in Europe lifts a bit. The domestic economy, however, still seems well on track to reach the expected velocity. Initial jobless claims hover around historically low levels and the weak May labour market report is but an aberration from an otherwise tightening trend. We expect payroll growth to move above 150'000 in the upcoming labour market report for June which equals the average employment growth reached in this economic recovery since August 2009. Yet, slowing payroll growth must be expected in a maturing business cycle, while the increasing lack of skilled and available workers may also contribute to the observed slowing in employment growth. The unemployment rate fell below its inflation-neutral rate of 4.8%. Cyclical unemployment has been eroded over the past years and the overall unemployment rate may slowly approach a level which is hard to breach as mismatch unemployment creates a lower bound. The environment for manufacturing industries seems to have improved as well. The latest reading of the ISM manufacturing index climbed more than expected to a level of 53.2 in June which is the highest level since February 2015. Relevant from a forward-looking perspective of manufacturing activity in the third quarter is the fact that the new orders subindex in particular climbed to a level of 57. Sturdy consumer demand in the second quarter helps to pull manufacturing out of a slump which had also been triggered by curbed investments in the energy sector. The notion of increasing activity in the manufacturing sector has also been confirmed by a strong print in durable goods orders for May. The housing market continues to do well, as a renewed plunge in interest rates supports demand besides support from demography, economic growth and income.

Inflation

Swiss Life Asset Managers	Consensus
2016: 1.2%	*2016: 1.3%*
2017: 2.2%	*2017: 2.3%*

If revisions to GDP growth were minor, changes to the headline inflation forecast even more so. Despite an initial strengthening of the US Dollar on a trade-weighted basis on the day of the referendum result, a renewed weakening has set in ever since. The Greenback is thus clearly weaker than at the start of the year, however does not leave immediate traces in our inflation forecast. A certain upside risk exists. Headline inflation will thus move up towards 1.8% from currently 1.1% by the end of this year, with the help of a base effect due to the deflationary effect of the oil price in 2015.

Euro Area – In political limbo

GDP Growth

Swiss Life Asset Managers	*Consensus*
2016: 1.5%	*2016: 1.6%*
2017: 0.9%	*2017: 1.6%*

As in the US but to a larger extent, we downgraded our GDP outlook for 2017 and beyond. We mainly expect the most cyclical component of GDP - business investment - to slow down in the aftermath of the Brexit. For the period between April and December 2016, we expect the quarterly growth rate to be at around 0.25% on average, which compares to an unusually strong first quarter growth rate of 0.55%. Naturally, trade links between the EU, Euro Area and UK are strong, however the dependence is fairly one-sided. While the EU accounts for almost half of UK's exports, the UK being just one of many trading partners accounts for 4%-5% of other EU countries' imports on aggregate. The UK is also a relatively small export destination for EU goods, accounting for 6%-7% of total exports of other EU countries. Within the Euro Area, most important trading partners are Ireland, the Netherlands, Germany and France. How big exactly the impact on growth dynamics in the Euro Area will be depends to a large degree on political events going forward and if certainty for economic decision makers can be restored to some degree. The UK vote to leave the EU has triggered a lively debate about the future of the Union. Many contributors use it as an opportunity to advance ideas they had promoted before. If European leaders agree on a common path forward, this may lend more credibility to the Union in the longer term.

Inflation

Swiss Life Asset Managers	*Consensus*
2016: 0.3%	*2016: 0.2%*
2017: 1.5%	*2017: 1.3%*

Headline inflation in June was yet again slightly higher than what we had built into our own inflation path. This brought the annual inflation rate for June back into positive territory. Further out, Brexit will not leave deep traces in price dynamics across the currency union. The initial reaction of the trade-weighted Euro was appreciation, albeit not massively so. However, the UK vote has certainly heightened the ECB's willingness to support the economy and price dynamics for longer, potentially extending their purchase programme into 2018.

Japan – Accurate assumption on tax hike delay

GDP Growth

Swiss Life Asset Managers	*Consensus*
2016: 0.6%	*2016: 0.5%*
2017: 1.0%	*2017: 0.9%*

Two political events have a major impact on macroeconomic forecasts for Japan and the likely monetary policy reaction: Firstly, prime minister Abe announced to delay the planned consumption tax rate hike from 8% to 10% to avoid the risk of yet another recession in 2017. We have always expected that this fiscal policy measure will be postponed and thus have never included any effects of a higher consumption tax rate into our base case scenarios for GDP growth and inflation. On the other hand, most other institutes were forced to upgrade their GDP forecasts for 2017. As a consequence, the consensus estimate was lifted from previously 0.5% to 0.9%, meaning that our own GDP growth projections are now in line with consensus. Brexit, the second important political development, is likely to weigh on future growth dynamics as exporters will suffer from the Yen's safe haven status. Since the start of the year, the Yen's trade-weighted external value increased by 16%, a trend which accelerated after the EU referendum in the UK. So far, the monetary policy response by the Bank of Japan proved insufficient to prevent the currency from appreciating further. Thus, the recent stabilisation of Japan's economy as indicated by improving business survey readings and strong construction activity may prove short-lived.

Inflation

Swiss Life Asset Managers	*Consensus*
2016: -0.2%	*2016: -0.1%*
2017: 0.2%	*2017: 0.9%*

We lift our forecast for inflation in 2016 slightly on the back of surprisingly firm price data both in April and May. On the other hand, the continued appreciation of the Yen suggests that import prices should moderate in the second half of the year which means that the risks to our forecast are now skewed to the downside. The decision to abstain from a consumption tax rate hike in 2017 triggered a massive downward revision from 1.5% to 0.9% in the consensus forecast. Given the strong Yen, more downward revisions towards our own projection of just 0.2% inflation will probably follow.

UK – After the surprise, the great confusion

GDP Growth

Swiss Life Asset Managers	Consensus
2016: 1.4%	2016: 1.9%
2017: 0.4%	2017: 2.1%

While we did not expect the outcome of the EU referendum, we were prepared for political turmoil in Westminster should the "Leave" campaign win. Yet, the current confusion in UK politics and the abundance of discussed options for the future relationship with the EU is remarkable. Even the possibility that the UK does not leave the EU at all seems not entirely negligible. Yet, under the assumption that Theresa May becomes the next prime minister, Brexit is our base case and the related uncertainties are expected to result in a recession until spring next year. In our new growth profile until end of 2017, the level of GDP is now 2% lower than originally assessed. We lower the growth forecasts for 2016 from 1.8% to 1.4% and for 2017 from 1.7% to 0.4%. An initial and incomplete overview by Consensus Economics, the economic survey organisation, shows that the median post Brexit forecast revision amounts to -0.5 percentage points for 2016 and -1.7 percentage points for 2017. In comparison, our own revisions are currently more moderate. Sentiment readings and the development of the Pound will be decisive for future economic growth.

Inflation

Swiss Life Asset Managers	Consensus
2016: 0.7%	2016: 0.6%
2017: 2.5%	2017: 1.6%

As a consequence of the weaker Pound, we lift our inflation forecasts substantially. For 2017, we now expect average annual inflation to reach 2.5% instead of 1.9% prior to the referendum. According to Consensus Economics, the median forecast revision for 2017 is of a similar size of 0.6 percentage points. Our inflation path now suggests that inflation peaks at around 2.7% between April and September 2017. Under the assumption that the UK falls into recession, we believe that wage growth will moderate substantially. This limits the inflation potential in the new political and foreign exchange rate environment.

Switzerland – Brexit to weigh on exports

GDP Growth

Swiss Life Asset Managers	Consensus
2016: 0.8%	2016: 1.1%
2017: 0.9%	2017: 1.5%

Even without Brexit, the latest retail sales numbers and the drop of the manufacturing purchasing managers index from 55.8 to 51.6 in June validate our prudent forecast for GDP growth in Switzerland. The EU referendum in the UK now triggers an additional, yet mild, downward revision to our forecasts for 2016 and 2017. The initial shock and uncertainties about the future of the EU and its trading partners will probably weigh on domestic corporate investment and more importantly on exports of capital goods to all of Europe. It is still too early to assess the damage of Brexit both in the short-term and long-term perspective. But the double digit depreciation of the Pound against the Swiss Franc is already a fact. Swiss firms depending on foreign demand will suffer from this development as exports to the UK have gained in importance over the last five years amounting to almost 6% of the total just before the referendum. For Swiss hotels, UK visitors rank fourth regarding importance. Econometric analysis shows that a 10% depreciation of the Pound versus the Franc reduces the number of hotel overnight stays booked by British guests by around 7%. While the above mentioned consequences of Brexit affect Switzerland with immediate effect, we believe that negotiations between the EU and the UK on their future relationship will delay important agreements with other nations including Switzerland. This is likely to reduce Switzerland's potential growth rate in the medium-term.

Inflation

Swiss Life Asset Managers	Consensus
2016: -0.3%	2016: -0.5%
2017: 0.3%	2017: 0.3%

The impact of Brexit on consumer prices in Switzerland should be marginal in our view. We continue to expect inflation to return into positive territory by September of this year.