Global Economic Scenario
August 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	2.1%	2.2%	2.3%	2.3% (2.4%)	2.0%	2.1% (2.3%)	1.9%	2.1% (2.2%)
Eurozone	1.9%	1.9% (1.8%)	1.3%	1.7% (1.6%)	1.5% (1.6%)	1.5% (1.6%)	1.4% (1.5%)	1.4%
Japan	1.2%	1.4%	0.9%	1.1%	0.3%	0.5% (0.6%)	0.3%	0.8%
UK	1.6% (1.5%)	1.6%	1.0%	1.4%	2.6% (2.7%)	2.7%	2.2% (2.3%)	2.7%
Switzerland	1.1%	1.4%	1.6%	1.7%	0.5% (0.6%)	0.5%	0.4% (0.5%)	0.7%

Source for Consensus Estimates: Consensus Economics Inc. London, 10 July 2017

USA – Weak inflation challenges Fed

GDP Growth

Swiss Life Asset Managers	*Consensus*
2017: 2.1%	*2017: 2.2%*
2018: 2.3%	*2018: 2.3%*

Once again, US economic reform hopes are dimming. Trump's health-care reform bill does not find the necessary support from within the Republican Party. Tax reform discussions seem to advance only very slowly. Finally two trade reports were/are still pending which should have been published a while ago: firstly a comprehensive report on significant trade deficits, which is intended to assess whether a trading partner is discriminating against US companies. Secondly, the objectives for the upcoming NAFTA renegotiations were released only recently. Since much of the growth optimism since the election last year rested on the assumption of rising fiscal growth support, the sobering starts to be visible in forecast revisions for GDP growth in 2018. Indeed, although the start into the second quarter of this year looked rather promising from a weak first quarter, certain macroeconomic data disappointed for the months of May as well as June. Consequently the economic surprise index as published by Citigroup hardly ever plunged as much as it did from a peak in March of this year well into June. Consumption continues to show weakness insofar as retail sales posted the second consecutive month of decline in June. Since April data had opened the quarter on a rather strong footing however, we expect a stronger contribution to overall growth than in the first quarter of this year. The advance report on GDP growth in the second quarter will be released on 28 July and we stick to our forecast of 2.4% quarterly annualised growth which would still be a full percentage point stronger than the first quarter. While the first quarter suffered from a substantial inventory drag, this pattern may reverse in the second quarter. Business investment, on the other hand, which had reached impressive altitude in the first quarter has probably moderated ever since. Yet, the manufacturing sector seems to do very well. While the ISM manufacturing PMI snapped back to reach a level of 57.8 in June, industrial production grew 0.4% in June from the previous month fuelled by gains in mining, motor vehicles and materials. Despite its maturity, the cyclical pattern remains intact.

Inflation

Swiss Life Asset Managers	*Consensus*
2017: 2.0%	*2017: 2.1%*
2018: 1.9%	*2018: 2.1%*

Two developments are reassuring that inflation measures should not correct much more to the downside from here: the trade-weighted US Dollar has depreciated by almost 7% since its peak reached in December 2016. Secondly, the lagged effect of past energy price declines should have fully played out by now. The CPI report for June was on the weak side once again. Major drags were again the transportation component (which includes energy), apparel, lodging as well as airfare tickets. Apparel prices have in fact declined for the fourth month in a row, which is an unusual tendency. This may just underline the structural pressure which the retail sector is facing having to make broad price concessions given fierce competition also from the online world.

Eurozone – Optimism abound

GDP Growth

Swiss Life Asset Managers	Consensus
2017: 1.9%	2017: 1.9%
2018: 1.3%	2018: 1.7%

The cyclical strength of the manufacturing industry is intact and has been strengthening well into the second quarter of this year. Industrial production posted a strong gain in May, rising by 4% from the same month of the preceding year. The purchasing managers index for the industry continues to climb, thus far unimpressed by the appreciation of the single currency. GDP growth for the second quarter for the entire Eurozone will be reported on 1st August and we would expect the growth rate to come in at a 2% annualised pace, which would mark the third quarter in a row with an above or at 2% growth rate. While industrial activity is bustling, economic growth is increasingly broad-based. Private consumption has become a noteworthy positive contributor as well. The retail trade confidence indicator published by the European Commission keeps going strong and has a high correlation with actual retail sales volumes. Growth of retail sales is strong and compares to the levels reached in the years 2004-2006. Yet, pent-up demand will have disappeared by next year, partly explaining our relatively cautious growth outlook for 2018. Furthermore, the strengthening of the Euro will have a lagged dampening effect on dynamics. Over the longer term, political viability of structural reforms is key to unlocking the potential of the economy, above all in France and Italy. Finally, political uncertainty is bound to return in the form of elections in Italy where populist parties are gaining ground.

Inflation

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

Headline inflation for June was confirmed at 1.3% which is the same level as in May. Core inflation edged up slightly to 1.1%, remains however well below the ECB's comfort level. In his last interview, the ECB President seemed intent to clarify what the term "reflation" meant, since his speech at the central bank's forum in Sintra was interpreted as being very hawkish. In our own forecast, headline inflation will plunge towards the end of the year whereas core inflation will climb higher.

Japan – Abenomics missing targets

GDP Growth

Swiss Life Asset Managers	Consensus
2017: 1.2%	2017: 1.4%
2018: 0.9%	2018: 1.1%

Supported by global tailwinds, economic fundamentals appeared solid by mid-year 2017. Upbeat business sentiment and accelerating construction activity confirm our view that overall growth accelerated during the second quarter, offsetting a significant temporary drag from net trade. Net trade contribution to GDP should recover from here with demand from Asia expected to firm further. Coincident indicators like the purchasing managers index for manufacturing suggest that economic dynamics maintain their momentum in the third quarter. In response to improving economic data, global investors flock to Japan, making its stock market the best performer among developed regions over the past year. Is it time to declare Abenomics a success almost five years after their introduction? Given the most recent political developments, we see little reason to change our sceptical judgement: Recently, Japan's finance minister Taro Aso had to admit that one key target of Abenomics will not be reached in the foreseen time: He postponed the goal of achieving a balanced primary household by 2020 to a later date. Failure to fulfil his promises and the scandal over a nationalist school recently cost Prime Minister Abe enormous amounts of popularity: Cabinet approval ratings collapsed from 48 to 35 points in just one month. This is the poorest result for Abe ever since he entered office in December 2012.

Inflation

Swiss Life Asset Managers	Consensus
2017: 0.3%	2017: 0.5%
2018: 0.3%	2018: 0.8%

Another target of Abenomics was the return of inflation to around 2% on a sustainable base with the help of monetary policy. That looked ambitious in the first years when austerity elsewhere intensified disinflationary trends. Even, with the current global upswing and given that Japan's unemployment rate fell to its lowest level since 1994, the result remains disappointing. As the corporate sector prefers part-time workers over full-employment contracts, wage growth remains the missing element in Japan's reflation puzzle.

UK – A tick less inflationary

GDP Growth

Swiss Life Asset Managers	Consensus
2017: 1.6%	2017: 1.6%
2018: 1.0%	2018: 1.4%

Incoming data suggest that the UK economy regained momentum in the second quarter 2017. We continue to expect 0.3% quarterly growth, up from 0.2% reported for the first three months and wait for the first official data due on July 26 to confirm the forecast. Although coincident indicators from the business side like purchasing managers indices lost steam towards mid-year, it is too early for a swansong on the UK economy. Combined tailwinds from a synchronous global economic upswing which started one year ago and the windfall gains in competitiveness thanks to the weak currency remain key supports for the exporting industries. As a consequence, the labour market remains unaffected by uncertainties related to Brexit so far. At home, private consumption continues to contribute positively to growth: Despite the temporary spike in inflation weighing on households' budgets, retail sales grew by more than 1% in the three months until June 2017.

Inflation

Swiss Life Asset Managers	Consensus
2017: 2.6%	2017: 2.7%
2018: 2.2%	2018: 2.7%

We revise our inflation forecast for 2017 to the downside as June inflation data came in a tick lower than we expected. On aggregate, prices were stable compared with the previous month and rose 2.6% from year ago levels. One major factor holding the consumer price index back were energy prices. So far available data suggest that fuel prices continued to contribute negatively to inflation through July. In our base case, we expect Brexit negotiations to result in a workable deal satisfying both partners. Under this assumption, the Sterling should gradually recover from its current weakness over the coming quarters and years. Thus, the impact from higher import prices on UK inflation should fade in 2018 and beyond. We expect the cyclical peak in headline inflation to be reached at 3.0% by October this year.

Switzerland – Not going to the shops

GDP Growth

Swiss Life Asset Managers	Consensus
2017: 1.1%	2017: 1.4%
2018: 1.6%	2018: 1.7%

Two major events made headlines over the past weeks: Firstly, the surprise jump of Switzerland's purchasing managers index (PMI) for the manufacturing industries to 60.1, or its highest reading since February 2011. And secondly, the fact that the exchange rate against the Euro rose above 1.10 for the first time since June 2016. Both events triggered enthusiastic comments that Switzerland has finally overcome the currency shock of 2015. We are less impressed: In contrast to the Eurozone, where PMI moves explain 80% of the cyclical swings in GDP, Switzerland's PMI is less powerful to predict growth in any given quarter. Private consumption remains a drag on domestic activity with both real retail sales and new car registrations down 1.4% in the second quarter. Reports of record export volumes suggesting fading damage from the strong Franc miss out that net trade contribution through the second quarter was weaker than in the first quarter 2017.

Inflation

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

Like in most other regions, Switzerland's inflation surprised to the downside in June. Culture and recreation was the only index category with rising prices since May. Falling prices for clothes and household furniture suggest that seasonal sales started well ahead of the holiday period in response to sales volumes. While we lower our forecast for inflation slightly, we consider three upside risks worth monitoring: Short-term, adverse weather conditions in April could lift prices for fresh vegetable and fruits. Secondly transport bottlenecks on the river Rhine could result in higher prices for heating oil shipped on the waterway as was the case in October 2015. And lastly, a marked further depreciation of the Swiss Franc versus the Euro poses another - limited - risk to the forecast.

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