# Global Economic Scenario
# *September 2017*

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

*Source for Consensus Estimates: Consensus Economics Inc. London, 7 August 2017*

### USA – Full employment, low inflation

#### GDP Growth

| *Swiss Life Asset Managers* | *Consensus* |
|---|---|
| *2017: 2.0%* | *2017: 2.1%* |
| *2018: 2.3%* | *2018: 2.4%* |

The US consumer has staged a comeback. At least retail sales growth for the month of July substantially surpassed common expectations. Although one reading is not enough to draw conclusions for the whole of the third quarter, worries of some observers that US consumers have gone on strike seem premature as well. Moreover, the data for preceding months were revised to the upside. The strength of retail sales was fairly broad-based. While car sales seemed to have reached a saturation point at the end of last year, sales figures have found a bottom and increased slightly in July. As regards the real estate sector, housing starts as well as building permits declined in July, but the composition of the report looks more promising. Multi-family building which tends to be more volatile anyway posted a remarkable drop, while single-family activity is holding up well. The drag from higher mortgage rates in the past on housing activity may have run its course for now. Momentum in the real estate industry as expressed by the NAHB index, i.e. the sentiment among homebuilders, remains on an elevated level of 68 points. Any value above 50 points to rising activity in the sector. Meanwhile, in Washington, two crucial fiscal deadlines are moving nearer: The Treasury has estimated that Congress must act by 29 September to address the nation's debt ceiling. Furthermore 30 September is the end of the fiscal year, and thus the deadline for Congress to authorise budget legislation to keep the government functioning when the new fiscal year begins on 1 October. Congress will thus be tied up until the end of September before they can tackle other important issues. Deadlines are tight while hopes for a tax reform to be launched this year seem to have died.

#### Inflation

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

The slight downside surprise of inflation readings for the month of July should be compensated by a stronger monthly increase of headline inflation in August. Gasoline prices above all are the driver of this effect. After seasonal adjustment, pump prices for gasoline are 6% higher in August than in July. As regards the weakness of July readings in headline as well as core inflation, two main drivers can be identified which should actually be one-off factors rather than a persistent pattern to be extrapolated to upcoming publications: prices of hotel overnight stays corrected by 4% in July from June and prices for software and internet services fell by almost 1%. The usually volatile elements within headline calculation were neutral in July. Both, headline as well as core inflation thus stand at an annual change of 1.7% in July, well below the levels reached at the turn of the year. This downward trend is not completed yet, although the additional decline will be less pronounced. According to our own projection, headline inflation will close the year at a level of 1.5%, while core inflation moves largely sideways from here. Should Dollar weakness persist, import price dynamics should quicken and support overall inflation readings further down the timeline.

## Eurozone – Growth outperforms expectations

### GDP Growth

| | |
|---|---|
| *Swiss Life Asset Managers* | *Consensus* |
| *2017: 2.0%* | *2017: 2.0%* |
| *2018: 1.4%* | *2018: 1.8%* |

The advance release of second quarter GDP growth was even upgraded slightly which lifted our whole year forecast for both years included in this paper. The quarterly growth rate was reported at 0.6% or 2.5% annualised growth, which is 2.5 times the potential rate as calculated by the OECD. Indeed, economic momentum is strong and converging between the member countries of the currency union. The economic outperformers keep on generating strong GDP growth while the weaker links are picking up. All of the member countries which reported GDP growth for the second quarter have delivered positive growth on a quarterly basis, and this includes Greece, Portugal and most importantly Italy. However at the same time, one needs to stress that it will be difficult to uphold current dynamics into the year 2018, which partly explains our sub-consensus forecast. Once pent-up demand will be satisfied, overall GDP growth is bound to settle on more sustainable levels. Given the pronounced appreciation of the Euro, which may dampen export activity if sustained, we feel comfortable to err on the lower side of available forecasts. Certain political hurdles are yet to be taken: Emmanuel Macron is faced not only with declining approval rates, but he will be confronted with general strikes against his reform agenda in September. Secondly, populists in Italy are still riding on a strong popularity wave which may cause their government participation in the upcoming election which will take place in May 2018 at the latest.

### Inflation

| | |
|---|---|
| *Swiss Life Asset Managers* | *Consensus* |
| *2017: 1.5%* | *2017: 1.5%* |
| *2018: 1.4%* | *2018: 1.3%* |

Inflation readings in the Eurozone did not disappoint to the downside as elsewhere, but the Euro appreciation certainly constitutes a notable downside risk to our own forecasts. If the strength proves sustained we would have to revise our forecasts downwards. Notwithstanding, headline inflation will end the year at 1.2% according to our own projection which is somewhat lower than the current level.

## Japan – A pronounced growth-inflation gap

### GDP Growth

| | |
|---|---|
| *Swiss Life Asset Managers* | *Consensus* |
| *2017: 1.9%* | *2017: 1.4%* |
| *2018: 1.1%* | *2018: 1.1%* |

The growth momentum in Japan caught most observers by surprise. The economy grew by 0.9% in the second quarter from the previous one, the sixth straight quarter of positive GDP growth. This marks the longest expansion in more than a decade. Growth was mainly driven by domestic demand while net trade actually shaved off from overall growth. Private consumption in particular posted a very robust performance, contributing 0.5 percentage points to the quarterly growth rate of 0.9%. Public investment as well as private capital expenditures equally proved noteworthy growth pillars. The fact that net trade constituted a drag on growth does not go back to weakness in exports but mainly so to strong import growth which is also a sign of a sound domestic environment. Although preliminary GDP readings are often prone to be revised substantially in coming reports, we take this result for granted and thus upgrade the outlook for average growth in the current year. The comparison with consensus figures is therefore not legitimate this month because other houses did not yet have the chance to build the second quarter result into their projections. At the same time, we do not expect this pace of growth to be upheld for the rest of the year. As in other developed economies, we may well have seen the peak of economic momentum in the first half of this year.

### Inflation

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

As elsewhere, wage growth is suspiciously lacking despite a record low unemployment rate and an overall very tight labour market. Resource utilisation and inflation pressures seem to have decoupled, at least for the time being. The GDP deflator fell for the fourth quarter in a row, decoupling from the growth picture. The Japanese economy will remain far below the 2% inflation target which the Bank of Japan explicitly set out as being one of the main aims of Abenomics. According to our current forecast, headline inflation will close the year 2017 at a level of 0%. Hardly a success story for the administration.

## UK – Import prices have stabilised

### GDP Growth

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

GDP data for the second quarter came in as we have expected: 0.3% on a quarterly basis. This is an acceleration compared to the first quarter (0.2%). Yet, during the first half of 2017, the UK economy has grown at roughly half the pace achieved in the second half of 2016. Thus, the Brexit vote is leaving its traces. We expect the slower momentum of 0.3% quarterly growth to continue until year-end. Unfortunately, we do not yet have the subcomponents of GDP to gauge whether the surprising upward trend in capex continued in spring. Consumers should have contributed their part to higher growth as retail sales have markedly recovered in the second quarter. Import prices have been a support here as they did not increase anymore in the second quarter. In contrast, consumer confidence has taken a hit since June due to the terror attack in Manchester. The weakening of the government after the snap election might also have played a role. The consumer confidence index has fallen back to the low reached right after the Brexit vote.

### Inflation

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

In recent quarters, import prices have been a major driver for inflation. After the massive drop from late 2015 to late 2016, the trade-weighted Pound has declined a lot less in 2017. As a result, prices of imported goods (except oil) have not moved up anymore since March 2017. The overall import price index, which also includes oil, has even declined by 1% during the second quarter. Due to the strong base effect, the annual change of import prices is still very large and pushes the annual inflation rate higher. According to our forecast, inflation will reach a peak of 3.1% in October 2017. Thus, there is still some way to go from the current level of 2.6%. The upside revision of our full year forecast is due to a slightly higher monthly price increase in July.

## Switzerland – Sustained depreciation?

### GDP Growth

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

The major topic for the Swiss economy is and remains the exchange rate. In July, EUR/CHF climbed above 1.10 and in August it even broke 1.15 for a few days. 1.15 was the highest level ever reached since the Swiss National Bank (SNB) abandoned the floor. The Euro has not only strengthened against the Swiss Franc but against most major currencies. For the time being, our economic forecasts are still based on an exchange rate of slightly below 1.10. Should the currency pair EUR/CHF remain around 1.15 on a sustained basis that is certainly good news for the Swiss economy and we would lift our growth forecast. Yet, it would not be a reason to become euphoric. The Franc would remain relatively strong. In our view, the currency still leaves its traces in private consumption. The recovery of real retail sales is fragile. Yet, there is light at the end of the tunnel: Consumer confidence is back at its long-term average. The subcomponents show that the Swiss do, nevertheless, not find it a good time to make big purchases. Many households have bought a new car or washing machine and the likes in recent years to benefit from cheaper import prices. On 5 September, second quarter GDP numbers will be published. We expect a solid 0.4% quarterly growth rate. Thus, somewhat higher than the 0.3% in the first quarter.

### Inflation

| Swiss Life Asset Managers | Consensus |
|---|---|
| 2017: 0.6% | 2017: 0.4% |
| 2018: 0.5% | 2018: 0.6% |

We have slightly lifted our inflation forecast for this and next year due to the recent increase of gasoline and heating oil prices. In July, the inflation rate was 0.3%. We expect it to gradually move higher until year-end, yet not to cross the 1 percent mark. Should the exchange rate against the Euro remain around 1.15 for longer, we would raise our inflation forecast because of higher import prices.