Global Economic Scenario
October 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	1.3% (1.4%)	1.5%	1.8%	2.3%	1.2%	1.2%	2.2% (2.1%)	2.2% (2.3%)
Euro Area	1.5%	1.5%	0.9%	1.3% (1.2%)	0.2% (0.3%)	0.2%	1.5% (1.6%)	1.3%
Japan	0.6% (0.5%)	0.6% (0.5%)	0.9%	0.8%	-0.3% (-0.2%)	-0.2% (-0.1%)	0.1% (0.2%)	0.4% (0.6%)
UK	1.9% (1.6%)	1.7% (1.6%)	0.6% (0.4%)	0.7% (0.6%)	0.7% (0.8%)	0.7%	2.5% (2.6%)	2.3% (2.4%)
Switzerland	1.4% (0.8%)	1.2% (1.0%)	0.9%	1.3% (1.4%)	-0.3%	-0.4%	0.4% (0.3%)	0.3% (0.2%)

Source for Consensus Estimates: Consensus Economics Inc. London, 12 September 2016

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 – It's all about the election

GDP Growth

Swiss Life Asset Managers	*Consensus*
2016: 1.3%	*2016: 1.5%*
2017: 1.8%	*2017: 2.3%*

Once again, the Federal Reserve abstained from pursuing the hiking path which was launched in December 2015. Expectations among analysts for a rate hike in September 2016 were low anyway given the flow of weak data which trickled in over past weeks, forcing us to revise the growth outlook for the current year yet again. However, in the official meeting statement, the economic assessment remained relatively upbeat. This seems surprising in the face of recent weakness in retail sales, industrial production and purchasing managers' indices for manufacturing as well as services industries. Indeed, the central bank gave clear signal that they would be ready to resume rate normalisation at the December FOMC meeting. Apart from monetary policy considerations, the world is starting to seriously tune into the presidential elections with the series of televised debates between Mrs. Clinton and Mr. Trump giving evidence of who may make the race. In the meantime, polls show that Mrs. Clintons' favour is melting away yet again, but holds on to a modest lead over her adversary. Although a Clinton win with a split Congress looks like the most probable outcome at this stage, we have drawn up scenarios for all of the possible constellations after the election day. Besides the fact that politicians often demonstrate amazing flexibility when it comes to pre-election statements and post-election actions, it is extremely hard to pin down Mr. Trump's stance on many of the topics which impact the fate of the US economy. He tends to change his opinion quickly or else contradicts himself. At the very least, protectionism will be back on the agenda under a Trump government while both candidates have pledged to increase infrastructure spending and thus support overall growth. Therefore it is safe to say, that fiscal spending will become more of a growth pillar than over past years when deficit reduction was a priority. It is the source of financing this extra spending which will be handled differently under a Democratic or a Republican president. A Clinton administration and a divided Congress would represent an outcome very close to status quo. A Trump win would in any case lead to increased uncertainty, not least on financial markets.

Inflation

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

Services inflation reached 3% in August, with the prices for medical care even increasing by 5% from August 2015. As goods inflation in annual terms remains well in negative territory, overall headline inflation has reached 1.1% in August - slightly higher than commonly expected. Core inflation has been above 2% ever since November 2015 and according to our own forecast should remain on that level well into 2017. Inflation expectations have somewhat recovered from ultra low levels in July of this year.

Euro Area – Politics as the big unknown too

GDP Growth

Swiss Life Asset Managers	Consensus
2016: 1.5%	2016: 1.5%
2017: 0.9%	2017: 1.3%

While the September flash publication of the purchasing manager indices moved down slightly on the back of weaker readings from the services sector, sentiment in the manufacturing sector brightened up again. A pronounced correction as could have been expected after a Brexit vote did so far not happen. A similar message is given by Germany's latest publication of the ifo business climate index which rebounded substantially in September on the back of stronger current conditions as well as expectations of the participating companies. Given the large upside surprise in the business climate index, it seems that initial concerns over the UK's decision to leave the European Union are fading already. The growth picture thus looks decent in the currency union. Yet, risks emanate rather from the political side here as well. Over the next twelve months, Europe faces an Italian constitutional referendum, a possible third general election in Spain, presidential and parliamentary elections in France and general elections in the Netherlands and in Germany. As elsewhere, that political backdrop is hardly conducive to corporate investment spending. We remain cautious as regards the growth contribution from investment spending, but expect continued sound activity in export industries, construction and sturdy consumption spending throughout the region. A risk to this call is the fact that private households do not benefit from declining energy prices anymore to give extra impetus.

Inflation

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

The fact that inflation expectations are stuck at very low levels certainly is a cause for concern. Even though the decline of energy prices lies behind us, households and corporates are hard to convince to aim for higher price levels. Although we stick to our view of rising inflation as we move into 2017, overall inflation remains subdued given the amount of monetary stimulus pumped into the economy in recent years.

Japan – A better timing for inflation targeting policies?

GDP Growth

Swiss Life Asset Managers	Consensus
2016: 0.6%	2016: 0.6%
2017: 0.9%	2017: 0.8%

On balance, economic data have improved slightly over the last month. Modestly encouraging data releases include the upward revision of the second quarter GDP estimates. According to these official data, the economy grew 0.2% from the previous quarter instead of contracting as reported earlier. Combined with substantial upward revisions for first quarter data, Japan's economy grew at an annualised pace of 1.4% during the first half of 2016. This exceeds Japan's current potential growth rate of around 0.2% by far. Economic momentum remains supported with the manufacturing purchasing managers index returning above the critical 50 points expansion line for the first time since February 2016. In a similar move, consumer confidence recovered to 42 points, its highest reading since January.

Inflation

Swiss Life Asset Managers	Consensus
2016: -0.3%	2016: -0.2%
2017: 0.1%	2017: 0.4%

The Bank of Japan announced a new framework of unconventional monetary policy measures to ensure the reflation of the economy. The yield of a domestic sovereign bond with a maturity of 10 years will be kept below zero until inflation returns to 2% on a sustained basis. While the instruments are new, the target remains the same as at start of Abenomics in 2013. Back then, we had our doubts about the success of such measures at a time when austerity dampened inflationary pressures elsewhere in the world. Even though the Yen depreciated substantially until end of 2014 as a consequence of monetary policy and Abenomics, inflation expectations did not recover and the politics clearly failed so far. As fiscal policy in the developed world is turning more stimulative and output gaps are narrowing, the timing to reflate Japan's economy seems better chosen this time. Nevertheless, in the absence of meaningful labour market reforms to boost domestic consumer demand, we remain sceptical as regards a return to 2% annual inflation in the near to medium term.

UK – Phase one of Brexit: Loose financial conditions

GDP Growth

Swiss Life Asset Managers	*Consensus*
2016: 1.9%	*2016: 1.7%*
2017: 0.6%	*2017: 0.7%*

Domestic activity from business investments to private consumption and construction was widely expected to stagnate into the second half of 2016 as a consequence of Brexit. We revised our growth assumptions accordingly. Immediately after the referendum, business sentiment as well as consumer confidence all appeared to support such a prudent short-term outlook. Additionally, political chaos in the weeks following the referendum did nothing to build trust in the leadership in potentially tough negotiations with the EU. Meanwhile, a working cabinet has been established with a mandate until 2020. Theresa May is buying time until triggering Article 50 which marks the beginning of the negotiation period. Thus, for the time being, the only consequence of Brexit are ultra-loose financial conditions as combined result of currency weakness and additional monetary stimulus. UK businesses currently benefit from a massive, albeit temporary, surge in competitiveness. Purchasing managers indices (PMI) in manufacturing, services and also construction recovered strongly in August. Our model based on the manufacturing PMI suggests 0.3% GDP growth from the previous quarter. This means a slowdown from preceeding quarters, but less dramatic than initially thought. As a consequence, we adjust our assumptions for growth until 2017. In a first phase, the beneficiary impact of loose financial conditions outweighs the headwinds from uncertainties about future access to Europe's single market.

Inflation

Swiss Life Asset Managers	*Consensus*
2016: 0.7%	*2016: 0.7%*
2017: 2.5%	*2017: 2.3%*

We expect inflation to increase from currently 0.6% to around 2.7% by May next year. As the economy proves more robust than previously thought, a combination of rising import prices and recovering price setting power in the service sector exerts upside inflationary pressures.

Switzerland – Second quarter data lack quality

GDP Growth

Swiss Life Asset Managers	*Consensus*
2016: 1.4%	*2016: 1.2%*
2017: 0.9%	*2017: 1.3%*

The first release of second quarter data showed a surprisingly strong quarterly GDP growth rate of 0.6%, exceeding our estimate by 0.4% percentatage points. As first quarter growth was revised up from initially 0.1% to now 0.3%, we are forced to revise our quantitative assumptions substantially. Instead of 0.8%, our forecast for average annual growth now stands at 1.4%. Yet, a look at the qualitiative details of the report on second quarter activity tells us not to get overly enthusiastic about economic dynamics: Domestic private sector demand and investment actually contracted in comparison with the first quarter. Instead, government consumption and inventories were the most important drivers of growth. At first glance, exports' strong recovery 18 months after the currency shock is very welcome news. But here again, a closer look reveals that with textiles and pharmaceuticals, only two out of ten goods categories saw export values rising from December 2014 until August 2016. As the share of pharmaceuticals and chemical products in Switzerland's export portfolio has doubled from 23% to 45% over the past 30 years, the robust performance of this sector distracts commentators' attention from severe headwinds elsewhere. Apart from tourism in the alpine regions, mechanical and electronical engineering firms are particularly suffering from a loss in competitiveness after years of continued appreciation of the Swiss Franc's external value. As a consequence, unemployment in regions with high dependence on the production of mechanical and electronic machinery goods and components continued to rise into the third quarter 2016.

Inflation

Swiss Life Asset Managers	*Consensus*
2016: -0.3%	*2016: -0.4%*
2017: 0.4%	*2017: 0.3%*

With retail prices for gasoline and heating oil rising through September, annual inflation turns positive for the first time since August 2014. We expect headline inflation to reach 0.4% by the first quarter 2017.