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

Source for Consensus Estimates: Consensus Economics Inc. London, 9 October 2017

USA – Surprise index in positive territory

GDP Growth

Swiss Life Asset Managers	*Consensus*
2017: 2.2%	*2017: 2.2%*
2018: 2.4%	*2018: 2.4%*

In general, forecasters were hardly impressed by the tax proposals submitted by the Republican leadership in the House of Representatives, Senate and the White House ("Big Six"), released end of September. The growth outlook for coming quarters, both of the consensus, as well as our own remains unchanged at this stage. We had built in a slight support from the tax reform for GDP growth in 2018 months ago when certain relief for businesses and individuals was dangled in front of US taxpayers. The proposed framework only contains rough outlines of a bill and the funding of the reforms remains open, making it unlikely to be passed any time soon. As far as the outline goes, it will clearly blow out fiscal deficits. What caused our GDP revision was not the tax package, but the publication of third quarter data. Real GDP came in at 3% quarterly annualised growth, stronger than commonly expected. Yet a big chunk of the growth rate goes back to inventory build-up in the wake of the hurricanes. Furthermore, once again, businesses invested in equipment, adding 0.5 percentage points to the overall growth rate in the third quarter. More recently, the economic surprise index, which continuously measures actual data relative to expectations, has turned into positive territory. Thus, most incoming data were able to surprise market participants positively. The purchasing managers' index published by the Institute for Supply Management (ISM) sur-passed 60 points in October marking the highest level since 2004. The subcomponent for new orders in particular boosted the overall index which bodes well for future production. Equally so, actual durable goods orders suggested firmer business investment as well as ongoing inventory accumulation. Consumer spending too seems to be on a solid footing. Car sales in September rebounded to levels last seen in 2005 after a long streak of disappointing figures throughout this year. The labour market continues to tighten. The unemployment rate has dropped to 4.2% in September which is the lowest level since the heyday at the beginning of this millennium. Finally wage growth has reacted to diminished slack in the labour market. A monthly gain of average hourly earnings of 0.5% in September clearly surpassed market expectations and led to a repricing of Fed hike expectations.

Inflation

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

A strong rise of energy prices in September as a consequence of the hurricane season pushed headline inflation to 2.2%, as built into our own inflation forecast. The past two months of strong prints have lifted the base for the 2018 inflation outlook. Again, our revision to 2.1% headline inflation in 2018 is thus driven by past data rather than a changed assessment of underlying price pressures. Nevertheless, one needs to pay attention to a potential feedback of higher wage growth and pricing power into the price setting behaviour of companies.

Eurozone – ECB starts to "re-calibrate"

GDP Growth

Swiss Life Asset Managers	Consensus
2017: 2.3%	2017: 2.2%
2018: 1.6%	2018: 1.8%

The third quarter 2017 marks the seventeenth straight quarter with positive GDP growth in the Eurozone. The eighteenth quarter is just developing and there is no end in sight of this favourable growth environment. Business sentiment surveys remain on elevated levels throughout the region. So far, the Euro appreciation has hardly dented the optimism and we run an upside risk for our growth outlook for the last quarter of this year. Furthermore, businesses seem to be increasingly inclined to engage in capex spending which has long been neglected during this cycle. Yet, certain caution as regards the growth outlook for next year seems warranted: As regards consumer spending, a driver of growth over past quarters, we only see very limited upside from these levels. Pent-up demand has been satisfied in many of the member countries over past quarters. Euro appreciation should start to weigh on growth dynamics. The Catalonia crisis may depress sentiment. German coalition talks are tough. Finally, Austria's and Italy's elections could end in government participation of populists and feed concerns about their ambitions to leave the monetary union.

Inflation

Swiss Life Asset Managers	Consensus
2017: 1.5%	2017: 1.5%
2018: 1.2%	2018: 1.3%

The appreciation of the Euro constitutes a downside risk to price pressure as import prices tend to correct with a lag to a stronger home currency. We have revised our inflation forecast accordingly and are now in line with the ECB's projection. The inflation figure for October posted a downside surprise, mainly driven by a weak German reading where prices for packaged holidays slumped. The central bank in the meantime feels comfortable enough with inflation dynamics to start the recalibration process of monetary policy. As from January 2018, they will reduce the size of monthly asset purchases to 30 billion Euro from 60 billion currently. A change of interest rate policy will only happen "well past" the end of QE.

Japan – A newly rediscovered economy

GDP Growth

Swiss Life Asset Managers	Consensus
2017: 1.6%	2017: 1.6%
2018: 1.1%	2018: 1.2%

Last month, we expected Prime Minister Abe to win a comfortable majority in the snap election on the back of strong economic fundamentals and a wave of patriotism in response to threats from North Korea. The electorate has confirmed this prediction since. Yet another fiscal impulse to extend the economic measures known as Abenomics seems likely. At current stage though, we refrain from including any fiscal impulse to our projections as timing, form and size are still unclear. Furthermore, an extra demand stimulus is not what is needed most these days: As explained in previous comments, Japan's economy is a big beneficiary of the cyclical global upswing: Each of the most prominent economic indicators speaks the same language: Large manufacturers' business sentiment is on its highest level since 2007, while the broader manufacturing purchasing managers index (PMI) holds in expansionary territory since September 2016. Consumer confidence climbed to a four-years high recently. Real economic data as well are coming in strong and still manage to surprise to the upside. The banking sector lends out to the private sector, with annual credit growth exceeding 3%. It is no surprise that after years of neglect, international investors seem to return to Japan in the hunt for yield. In their view, Japan is one of the few remaining equity markets in the developed world offering attractive valuations.

Inflation

Swiss Life Asset Managers	Consensus
2017: 0.3%	2017: 0.4%
2018: 0.4%	2018: 0.7%

Incoming data for nationwide inflation until September this year and the advance report on price trends during October for the Tokyo area confirm our projections so far. Although we have built in an acceleration of domestic inflation due to strong economic dynamics, our forecast for 2018 remains prudent compared with consensus. Japan's growth currently by far exceeds its potential output. And yet, subdued wage growth limits the price setting power of domestic suppliers.

UK – A quarter of negotiation time already spent

GDP Growth

Swiss Life Asset Managers	Consensus
2017: 1.5%	2017: 1.6%
2018: 1.0%	2018: 1.4%

After a firm start until August, retail sales fell in the last month of the third quarter. In real terms, retail sales still rose 0.6% from the previous quarter, meaning that private consumption should have contributed positively to growth. The first official estimate for third quarter GDP data came in slightly stronger than expected. Meanwhile, revisions to the data set for preceding quarters trigger a mild downward revision to our full-year 2017 forecast from 1.6% previously to 1.5%. Until now, Brexit had a perfect timing: Since summer last year, when the British electorate decided to leave the EU, the UK economy benefitted from improving competitiveness in times of a marked global economic upswing. In contrast to fears immediately after the EU referendum, the corporate sector continued to add jobs until mid-2017. Yet, Brexit uncertainties remain a predominant factor in forecasting future economic activity. With a quarter of the time foreseen for negotiations with the EU already spent, risks of a standstill in the talks and the danger of a hard Brexit have grown in our view. Accordingly, soft indicators like business climate and consumer confidence have started to deteriorate since summer. Convinced that sentiment of economic actors are a guide to real future economic performance, we stick to our sub-consensus forecast for 2018 and beyond.

Inflation

Swiss Life Asset Managers	Consensus
2017: 2.7%	2017: 2.7%
2018: 2.4%	2018: 2.6%

Inflation in the UK reaches its cyclical peak in the fourth quarter 2017 as the impact of the weak Sterling should start to gradually soften. We expect annual inflation to climb to 3.2% in October before easing to 2.4% until mid-2018. Given the continued Brexit uncertainties, we expect the UK economy to growth below its potential rate, suggesting that domestically generated inflation pressures should remain contained in the years ahead.

Switzerland – A much cheaper Swiss Franc

GDP Growth

Swiss Life Asset Managers	Consensus
2017: 0.8%	2017: 0.8%
2018: 1.9%	2018: 1.8%

Academic studies published by the State Secretariat for Economic Affairs SECO confirm our view on the impact of the adverse exchange rate situation until mid-2017: First, given its concentration on pharmaceuticals and niche producers, Switzerland's goods export performance depends more on changes in global activity than on exchange rate moves. And second, the more traditional industrial firms lost competitiveness relative to their peers abroad: While employment in Switzerland's industrial sector fell by 4% since 2010, it rose by 7% in Germany in the same period. These jobs are lost for good. Meanwhile, the more innovative exporters benefit from the global upswing. The weaker Swiss Franc provides fresh tailwinds for tourism: Germany and the Netherlands belong to the top ten foreign markets for Swiss hotels. Guests from these countries have a particular preference for winter holidays and their demand is highly sensitive to the exchange rate: According to our elasticity estimates, the number of overnight stays booked out of these countries rises by around 10% when the Euro strengthens by 10% versus the Franc. Thus, a 9% stronger Euro since April bodes well for the coming winter season. Other beneficiaries of recent exchange rate moves should be retailers in regions close to the border.

Inflation

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

The Swiss Franc's external value fell by 6% compared to 2016 on a trade weighted basis. Thus, higher import prices should gradually impact prices in 2018. We expect a slight decline in the rents sub-component in the November consumer price data. Apart from isolated price cuts for marketing purposes by discounters, next year's reduction of the regular VAT rate from 8% to 7.7% is a minor event in our view.