Global Economic Scenario
December 2017

Revisions since last month (in brackets forecasts as per previous month)

	GDP 2018		GDP 2019		CPI 2018		CPI 2019	
	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus
USA	2.5% (2.4%)	2.5% (2.4%)	1.9% (n.a.)	n.a.	2.3% (2.1%)	2.1% (2.0%)	2.0% (n.a.)	n.a.
Eurozone	1.9% (1.6%)	1.9% (1.8%)	1.2% (n.a.)	n.a.	1.2%	1.3%	1.3% (n.a.)	n.a.
Japan	1.3% (1.1%)	1.3% (1.2%)	1.1% (n.a.)	n.a.	0.4%	0.7%	0.4% (n.a.)	n.a.
UK	1.0%	1.4%	0.9% (n.a.)	n.a.	2.3% (2.4%)	2.6%	2.0% (n.a.)	n.a.
Switzerland	1.9%	1.8%	1.3% (n.a.)	n.a.	0.6% (0.5%)	0.7%	0.8% (n.a.)	n.a.

Source for Consensus Estimates: Consensus Economics Inc. London, 6 November 2017

USA – Construction stages a comeback

GDP Growth

Swiss Life Asset Managers	*Consensus*
2018: 2.5%	*2018: 2.5%*
2019: 1.9%	*2019: n.a.*

Since our last publication, the House of Representatives passed their version of a tax reform package. In a next step, the full Senate will have to vote on their own version of tax reforms once lawmakers will be back from the extended Thanksgiving break. A certain amount of tax cuts for corporates as well as private households is foreseen, which would enlarge the budget deficit also in the longer term. Tax relief may be somewhat front-loaded so as to please the electorate ahead of the upcoming mid-term elections in November 2018. At the start of the current year already, we have actually increased our GDP projection for the first half of 2018, so that we see no immediate need to raise the forecast again. Negotiations may still drag on for a while and the financing side of the tax package still is likely to trigger intense discussions. In any case, at this stage, the economy is not in need of fiscal support. Current economic activity still looks very sturdy. Reports from the real estate market in particular show a substantial rebound of activity, some of which may be due to reconstruction after the Hurricane damages. However, housing starts posted a solid increase in October not only in the South, but also in the other parts of the country. Equally so, building permits which have a leading character for construction activity going forward, rose by 5.9% in October from the previous month. After two consecutive quarters where private residential investment shaved off 0.25-0.30 percentage points of overall GDP growth, we are likely to see a positive contribution in the fourth quarter. Apart from car sales, which have rebounded nicely over the past two months, personal consumption remains uncharacteristically modest. The combined effect of record low unemployment and declining underemployment, sturdy employment growth, a high degree of job security, rising wages and wealth gains should actually entice US consumers to go out and spend. Retail sales figures around Black Friday will give some indication of where consumer spending is heading into the important Christmas season.

Inflation

Swiss Life Asset Managers	*Consensus*
2018: 2.3%	*2018: 2.1%*
2019: 2.0%	*2019: n.a.*

The November inflation figure will be edging higher again due to a sound contribution from energy. In our own path, headline inflation will come in at 2.2% in November. Transitory factors have suppressed headline as well as core inflation this year. Prices for mobile device services corrected dramatically in spring which derailed the outlook for the rest of the year. On a more structural basis, health care services prices were a source of weakness ever since the introduction of Obamacare and the dampening regulatory pressure on price developments. Health care is a big weight in core inflation readings. This weakness should have found a bottom however. The development of core goods prices, import prices as well as producer prices justifies not only a slight upward revision of headline inflation into next year, but will give the Fed confidence to pursue a modest tightening path even with a new Chairperson. Financial conditions remain loose.

Eurozone – Ifo business climate hits historic record

GDP Growth

Swiss Life Asset Managers	Consensus
2018: 1.9%	2018: 1.9%
2019: 1.2%	2019: n.a.

Our own model to gauge GDP growth on the basis of the purchasing managers index points to yet another strong reading in the current quarter. Though the model tends to overestimate actual activity, we nevertheless felt the need to upgrade our own growth outlook for the last quarter of this year. Furthermore, given that the Euro appreciation has not left any traces in business confidence thus far, we also reviewed growth dynamics in the first half of 2018 which led to the upside revision from the prior month. The ifo business climate actually climbed to the highest level on record. Expectations in particular jumped again in November, completely undisturbed by political uncertainties in Germany. A survey held by UBS among 600 companies in the big four member countries points to a pick-up in investment spending, in particular in France. Retained earnings are the biggest source of funding, followed by bank credit. As regards employment intentions, they rose sharply in France, remain strong in Germany, have moderated in Spain and actually turned negative in Italy. This should be taken as a warning signal, especially since Italy needs to take an important political hurdle as well, with major elections potentially being held in early March 2018.

Inflation

Swiss Life Asset Managers	Consensus
2018: 1.2%	2018: 1.3%
2019: 1.3%	2019: n.a.

Headline inflation is commonly expected to drop below 1% at the start of next year, which will be a purely technical correction from a year-over-year perspective, as the base in early 2017 was very high. Despite the sturdy economic momentum, we expect the Euro appreciation to leave its mark in import prices which dampen overall inflation dynamics. General food prices have been an important contributor to overall inflation recently. A severe butter shortage in France, where per capita butter consumption is the highest in the world, led to soaring prices of this staple.

Japan – Mr. Kuroda's moving 2% inflation target

GDP Growth

Swiss Life Asset Managers	Consensus
2018: 1.3%	2018: 1.3%
2019: 1.1%	2019: n.a.%

After long years of neglect, Japan's economy continues to attract attention from Western media and investors. Since summer 2016, Japan is a clear beneficiary of the global cyclical upswing. Going forward, yet another fiscal package should ensure more creation of permanent jobs and eventually wage growth in the home economy. News that at least two more nuclear plants should resume power generation by the start of next year mean that the country's dependency on energy imports should diminish further. This is likely to result in improving net growth contribution from trade. In our view, these developments warrant a modest lift of our growth projections for 2018. Meanwhile, tailwinds of the cyclical upswing should moderate somewhat until summer 2018. We anticipate quarterly GDP growth rates of around 0.3% until end of 2019. This is slightly less than the 0.4% average quarterly pace observed since mid-2016, but still by far exceeds Japan's potential growth rate estimated to be slightly above 0% by the OECD.

Inflation

Swiss Life Asset Managers	Consensus
2018: 0.4%	2018: 0.7%
2019: 0.4%	2019: n.a.

It is the same procedure each year when we extend the forecast horizon for Japan by one year: The same two questions keep on returning to the surface: The first is whether fiscal and monetary policy measures finally succeed in achieving the target of 2% inflation on a sustained base. In our view, there is only a very low probability for this to materialise. Instead, we believe that the inflation cycle has peaked at 0.7% by September this year. The second recurrent issue is the overdue increase of the consumption tax rate from 8% to 10%. Such a step would temporarily lift inflation as observed in 2014 when the tax rate was raised from 5% to 8%. Solid economic fundamentals and prime minister Abe's firm political majority suggest a growing likelihood for such a move to take place in the final quarter 2019. Yet, we will not include any impact on our inflation path until the tax rate hike will be officially announced.

UK – Incoming data beat expectations

GDP Growth

Swiss Life Asset Managers	*Consensus*
2018: 1.0%	*2018: 1.4%*
2019: 0.9%	*2019: n.a.*

When submitting his budget to parliament, Philip Hammond, the Chancellor of the Exchequer, presented new growth forecasts by the Office for Budget Responsibility (OBR). The revised assumption of only 1.5% GDP growth through 2017 instead of the previously expected 2.0%, matches what consensus and we anticipated since mid-year. Meanwhile, the economy regained momentum at the start of the last quarter 2017: The majority of incoming data beats estimates with retail sales and orders received by industrial firms coming in particularly strong. Thus, rather than weighing on current activity, we think that Brexit casts clouds over the medium-term outlook for the UK economy: 2018 will mark the year in which the corporate sector will have to decide on long-term investment and job plans for a country outside the European Union. As a "Hard Brexit", i.e. the departure from the single market without exchange for a customs union remains the most likely scenario, businesses will have to prepare for a prolonged transitory period before a free trade agreement is settled. In our view, reluctant business spending and deteriorating labour market conditions will curb growth substantially over the coming two years. Within the sample of 32 institutes polled by Consensus Economics, only five are more, or at least equally prudent as regards the growth forecast for 2018.

Inflation

Swiss Life Asset Managers	*Consensus*
2018: 2.3%	*2018: 2.6%*
2019: 2.0%	*2019: n.a.*

Inflation for October came in below our expectation. Nevertheless, with energy prices trending higher through all of November, we leave the forecast for average annual inflation through 2017 unchanged at 2.7%. Furthermore, we see no reason to revise our assumption that annual headline inflation rates are peaking in the current quarter as the impact from the weak Sterling starts to fade going forward.

Switzerland – Highest inflation rate since 2011

GDP Growth

Swiss Life Asset Managers	*Consensus*
2018: 1.9%	*2018: 1.8%*
2019: 1.3%	*2019: n.a.*

We finished this text two days prior to the release of third quarter GDP data. According to a Bloomberg poll, our forecast of 0.5% quarterly growth was slightly below the consensus of 0.6% among 23 participating institutes. Uncertainty ahead of the release was high, with forecasts varying from 0.4% to 1.1%. Compared with economic dynamics elsewhere, Swiss GDP data for the first half of 2017 look extraordinarily weak. Thus, an upside risk to our own forecast exists in the form of compensatory swings in the more volatile components of the national accounts. Going forward, we expect positive impulses from the weaker Swiss Franc for alpine tourism regions and in the retail sector. Swiss consumers spend around 10 billion Swiss Francs, or 1.5% of Switzerland's GDP in shops along the border to Germany, France, Italy or Austria. With the Euro 9% more expensive compared with the average through the first half 2017, we assume that Swiss retailers will regain a small part of this share.

Inflation

Swiss Life Asset Managers	*Consensus*
2018: 0.6%	*2018: 0.7%*
2019: 0.8%	*2019: n.a.*

Inflation is expected to reach 0.9% in November 2017, the highest reading since March 2011. We need to go back to 1996 to find a year during which the Swiss Franc's external value fell by more than in 2017. Thus, all estimates on medium-term pass-through rates of rising import prices lack any meaningful recent experience. If sustained, current exchange rate levels and macroeconomic fundamentals should result in inflation rates near 1% until the end of 2019. More short-term, we anticipate lower rents to weigh on the inflation data series for November. This drag from one of the heavyweights in the consumer price index should be offset by higher energy prices which are expected to contribute positively to inflation until the end of 2017.