

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	2.1% (2.0%)	2.1% (2.2%)	2.1%	2.4%	1.2%	1.3%	2.2%	2.2%
Euro Area	1.3%	1.5% (1.6%)	1.3%	1.6% (1.7%)	0.2% (0.4%)	0.3% (0.5%)	1.7%	1.4% (1.5%)
Japan	0.2% (0.5%)	0.7% (1.0%)	1.0%	0.6%	0.1% (-0.1%)	0.0% (0.3%)	0.3%	1.6% (1.8%)
UK	1.8%	2.0% (2.2%)	1.8%	2.2%	0.5%	0.7% (0.8%)	2.0% (1.9%)	1.8%
Switzerland	0.9% (0.7%)	1.1%	1.0%	1.5% (1.6%)	-0.3% (-0.5%)	-0.6% (-0.5%)	0.3% (0.2%)	0.2% (0.3%)

Source for Consensus Estimates: Consensus Economics Inc. London, 7 March 2016

USA – What is “close to normal” then?

GDP Growth

Swiss Life Asset Managers	Consensus
2016: 2.1%	2016: 2.1%
2017: 2.1%	2017: 2.4%

If the economy had been “close to normal” on 11 February, it should currently be “above normal” if one takes growth-relevant data into consideration. Macroeconomic data have certainly improved ever since Mrs. Yellen’s statement, without leading to renewed USD appreciation. Fourth quarter GDP growth was revised higher. Even the oil price and thus inflation expectations have moved into the desired direction and that is up. All these conditions should actually set the stage for ongoing normalisation of monetary policy, however, the “no hike” decision met markets’ expectations, but the accompanying dovish statement remains difficult to comprehend. As a matter of fact, the manufacturing sector in particular seems to slowly overcome the weakness caused by the pronounced appreciation of the USD and averse effects from the oil price decline. The plunge of the ISM manufacturing survey below the critical 50 threshold in October and its persistence below that mark had contributed to the fears of an imminent recession which shook up markets at the start of this year. Meanwhile, the sharp rise of regional purchasing managers indices in March substantiates our view that the ISM survey will be able to surpass the 50 line with its next publication on 1 April. Even though durable goods orders and shipments disappointed in February, we expect the willingness to engage in capital

equipment to revive as sentiment improves. Meanwhile, the labour market continues to strengthen, but wage growth has remained suspiciously absent in nominal terms. Employment gains have been on respectable levels ever since 2010 but the pace is bound to moderate as full employment has been reached. Consumers continue to enjoy the benefits of low energy prices, a sturdy labour market and real wage growth. The debt service ratio, a measure of total household debt payments in relation to total household disposable income hovers at around 10% which is the lowest level since the data series was first published in 1980.

Inflation

Swiss Life Asset Managers	Consensus
2016: 1.2%	2016: 1.3%
2017: 2.2%	2017: 2.2%

The surprising development over past months is the fact that neither the strong USD nor low commodity prices have led to a noticeable pass-through to core inflation readings. Quite the contrary, as stated repeatedly in earlier issues of this paper, underlying inflationary pressures are not to be underestimated whilst the core CPI has already reached a level of 2.3%. Unsurprisingly, domestic price pressures continue to mount along with the diminishing slack in the economy. Core services prices excluding energy services – an appropriate measure for domestically generated pressure – have risen to 3.1% from a level of 2.4% only a year ago. Going forward we would expect more firming of services prices, not least driven by higher wages which should finally kick in after full employment has been reached.

Euro Area – Rising business confidence

GDP Growth

<i>Swiss Life Asset Managers</i>	<i>Consensus</i>
2016: 1.3%	2016: 1.5%
2017: 1.3%	2017: 1.6%

The ECB still has the power to surprise, though the marginal return of actions is decreasing. The decision to start buying corporate bonds certainly constitutes an important shift in the ECB's policy direction. Macroeconomic fundamentals would not have warranted yet another drastic step towards easier monetary policy, distorting financial markets further. While the purchasing managers index for manufacturing industries increased in the preliminary reading for March to a level of 51.4, the equivalent for service industries accelerated even further to reach a level of 54.0 in March. Equally so, the ifo business climate indicator in Germany rose for the first time in four months, with a marked improvement in the retail sector subcomponent leading the increase. While stronger domestic demand seems to be in the cards, the export sector feels the slowdown in emerging markets. Furthermore, the Euro has appreciated on a trade-weighted basis since the end of February despite the ECB's renewed attempt to lower its attractiveness. Real earnings growth in Germany has displayed a strong trend to the upside over past quarters and has reached the highest level since the early 1990s when the reunification effect was clearly tangible.

Inflation

<i>Swiss Life Asset Managers</i>	<i>Consensus</i>
2016: 0.2%	2016: 0.3%
2017: 1.7%	2017: 1.4%

Since Mario Draghi, the ECB's president, stated some three weeks ago that interest rates had probably reached their low, the Bank has gone to great lengths to actually stress that interest rates could still go lower. This is also the headline which greets visitors to the ECB's homepage at the time of writing this document. Headline inflation has dropped back below the zero line in February and will remain there until mid-year according to our own projection. Core inflation, which excludes the most volatile elements such as energy and food, has reached a level of 0.8% and will likely hover around these levels for the rest of the year. The latest appreciation of the Euro certainly is anathema to the ECB.

Japan – Deteriorating sentiment in corporate Japan

GDP Growth

<i>Swiss Life Asset Managers</i>	<i>Consensus</i>
2016: 0.2%	2016: 0.7%
2017: 1.0%	2017: 0.6%

While a modest upward revision to final quarter 2015 national accounts data reveals that business spending was more robust in 2015 than previously assumed, the mood among entrepreneurs seems to have deteriorated over the first quarter 2016: According to preliminary data for March, the purchasing managers index in the manufacturing sector dropped below the 50 points expansion line for the first time since April last year. Deteriorating momentum in corporate Japan seems broad based, as reveals a separate survey of 1'000 small and medium sized firms in all areas of the economy conducted by Shoko Chukin Bank. As concerns domestic contribution to GDP growth in 2016, private consumption by households is unlikely to compensate for moderating capital expenditures by firms. As of February, consumer confidence fell to its lowest reading in more than a year. As a consequence, we lower our forecast for GDP growth in the first quarter 2016. Japan's economy thus remains in recession. Given the current economic environment, we remain sceptical whether the government will indeed proceed with the planned consumption tax rate hike from 8% to 10% in April 2017. Thus, our above consensus forecast for 2017 should not be misread as stronger optimism on future economic dynamics. We simply have not included the impact of a potential tax hike into our growth profile while most of our peers have already done so.

Inflation

<i>Swiss Life Asset Managers</i>	<i>Consensus</i>
2016: 0.1%	2016: 0.0%
2017: 0.3%	2017: 1.6%

As is the case regarding the 2017 GDP forecast, our numbers for the inflation outlook are difficult to compare with the consensus. Should prime minister Abe follow the same script as in 2014, when he called a snap election to win a mandate to delay the tax hike, he will most likely dissolve parliament after the G7 summit which Japan hosts in May. Although slightly deteriorating last month, Abe's cabinet approval ratings remain sufficiently high to secure him a majority in case of a renewed snap election.

UK – Strong labour market boosts consumption

GDP Growth

<i>Swiss Life Asset Managers</i>	<i>Consensus</i>
2016: 1.8%	2016: 2.0%
2017: 1.8%	2017: 2.2%

As everybody has now started to develop his own scenarios as regards the outcome of the EU referendum in June, politics are dominating discussions on the UK economy for the time being. We consider it as positive that the vote will be held soon, reducing the period of uncertainty for businesses at home and abroad to the shortest possible time. Yet, of course this judgement is only true when a majority of voters will decide that Britain should stay in the EU. This is the outcome we consider as most likely, based on indicators like the 66% odds for the “Stay” campaign to win according to bookmakers, or the 70% probability for the same result attached by more than 770 experts participating in the crowd-forecasting competition organised by the Good Judgement Project on political forecasts. Most recent economic surveys reveal a certain degree of uncertainty among economic subjects. The purchasing managers index for the manufacturing sector temporarily dropped to its lowest reading since April 2013. Meanwhile, retail sales data for the first two months of the year show strong dynamics in domestic consumption. According to this real economic data, sales volumes were up by 1.5% from the last quarter 2015. Car sales are up by almost 5% compared with the first two months in 2015.

Inflation

<i>Swiss Life Asset Managers</i>	<i>Consensus</i>
2016: 0.5%	2016: 0.7%
2017: 2.0%	2017: 1.8%

Renewed momentum in private sector earnings growth is reflected in resilient consumption data. Mirroring rising disposable incomes, annual inflation in the hotels and restaurant component of the consumer price index rose from 1.6% to 1.9%. In our view, the moderate inflation print for February should prove temporary as the softness can be explained by the volatile component of transport services. Energy prices are set to contribute positively to inflation both in March and also April.

Switzerland – Growing camp of prudent forecasters

GDP Growth

<i>Swiss Life Asset Managers</i>	<i>Consensus</i>
2016: 0.9%	2016: 1.1%
2017: 1.0%	2017: 1.5%

At first glance, the reduction by 0.1% in the revised GDP 2016 forecasts published by the State Secretariat for Economic Affairs (SECO) or think tank KOF from the Federal Institute of Technology in Zurich (ETHZ) look cosmetic. Yet, as these revisions include most recent news on strong activity in the final quarter 2015, the forward looking projections underwent marked corrections to the downside. A Bloomberg poll of 14 economists shows that the 0.4% quarterly growth rate reported for the last quarter 2015 surprised everybody to the upside, including ourselves. The higher than previously assumed base from which the growth path for this year starts, means that we have to lift our own forecast for 2016 from 0.7% to 0.9%. Looking at current activity indicators and the confirmation of a gradual increase in the unemployment rate as indicated by our own model, we see no reason to revise our projections going forward. Regular readers of this paper are aware that we have always been prudent in our assumptions on domestic activity and respective growth contribution from private consumption, construction activity and government spending. That also holds true for the second year after the National Bank’s decision to abandon the minimum exchange rate against the Euro.

Inflation

<i>Swiss Life Asset Managers</i>	<i>Consensus</i>
2016: -0.3%	2016: -0.6%
2017: 0.3%	2017: 0.2%

We adjust the inflation forecast slightly to the upside for three reasons: Firstly, data for February came in a bit higher than expected. Second, and most important: Energy prices edged higher in March following the rise of the price for crude oil on spot markets. The retail price for heating oil is currently 12% up from its low recorded on February 11. And thirdly, the announced 3% increase for public transport fees as of December 2016 lifts inflation by around 0.06% throughout 2017.

Released and approved by the Economics Department, Swiss Life Asset Management AG, Zurich

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