Global Economic Scenario
September 2016

SwissLife
Asset Managers

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

Source for Consensus Estimates: Consensus Economics Inc. London, 8 August 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 – Struggle with a "new" conundrum

GDP Growth

Swiss Life Asset Managers	*Consensus*
2016: 1.4%	*2016: 1.5%*
2017: 1.8%	*2017: 2.3%*

We saw three quarters in a row with disappointing GDP growth. Expectations were high concerning real GDP growth in the second quarter of this year, based on the notion that the US consumer staged a comeback. This puzzlestone of the story actually fell right into place, however all other components largely failed to support overall growth dynamics. At 1.2%, quarterly growth was half as strong as we assumed and led to our own growth revision for the full year 2016. 2.4 percentage points contribution came from personal consumption while all other components slashed off 1.2 percentage points. Forward-looking, we left our already cautious outlook unchanged. Given that the second quarter was again associated with sturdy employment growth, labour productivity, which relates output to input, even plunged further from historically low levels. Insofar, the low productivity rate is but the flip side of a strong labour market recovery since the year 2009. Output could not keep pace with the employment build-up. What is painfully missing is actually business investments, the component which usually boosts growth rates early in the business cycle and which is the very element paving the way for higher productivity and trend output going forward. As is the case in other developed economies as well, the US seems to have entered a phase of "new normal", characterised by low potential growth, low productivity, modest inflation and a low rate environment. Central bankers around the world are struggling with the conundrum of low and declining productivity. Unfavourable demographics, i.e. low population growth as well as a lack of technological breakthroughs do not break the spell. On a more positive note, the average US household seems to be doing increasingly well. Full employment, wage gains, wealth increases, a declining savings rate and the low rate environment combine to support consumer spending. Equally so on a more positive note, the fact that the change in inventories diminished GDP growth for five consecutive quarters should bode well for inventory build-up going forward, especially so since domestic demand for goods is strong. So far, we have not incorporated a positive growth contribution from inventory build-up in the second half of this year which may well prove too cautious.

Inflation

Swiss Life Asset Managers	*Consensus*
2016: 1.2%	*2016: 1.2%*
2017: 2.1%	*2017: 2.3%*

Since the start of August, crude oil has gained almost 19%. This price move is actually the reverse development of the one observed in July when energy prices actually depressed the monthly change of the inflation rate. This V-shaped development of energy prices leaves traces in the monthly pattern, does however not impact our whole year forecast for headline inflation. At full employment, we expect wage growth to increase and to support price dynamics in the year to come. However, markets do not buy into this notion yet. Inflation expectations continue to hover on very low levels still.

Euro Area – No hard data yet

GDP Growth

Swiss Life Asset Managers	*Consensus*
2016: 1.5%	*2016: 1.5%*
2017: 0.9%	*2017: 1.2%*

The quarterly growth rate of GDP was 0.3% in the second quarter. This translates into an annualised growth rate of roughly 1.2% which is modest yet above potential growth currently amounting to only 0.9%. We, as well as consensus, have anticipated the slowdown compared to the strong first quarter, which had a growth rate of 0.6%, and the solid year 2015. The peak of the recent recovery in the Euro Area has already been reached. Yet, the cycle is still far from being completed. After the Brexit vote, we have adjusted our growth path. We lowered the third quarter slightly to 0.3% quarterly growth and the fourth quarter to 0.2%. Moreover, we have reduced all quarters in 2017 from 0.3% to 0.2%. Initial reactions to the Brexit vote have been less severe than expected. While gauging the impact on the Euro Area economy is still difficult, we know that uncertainty will remain elevated for a prolonged period. So far, no hard data have been published for the post-Brexit period. Therefore we have not altered our growth path. Risks are however to the upside. The purchasing managers index (PMI) for the manufacturing sector gives the first indication for activity in the third quarter. The final reading for July was 52.0, which amounts to the average of the second quarter. The confidence indicator for the industrial sector published by the European Commission actually increased slightly. Yet, the corresponding reading for consumer confidence declined somewhat. The PMI and confidence indicator of the European Commission describing the services sector were almost unchanged in July compared to June.

Inflation

Swiss Life Asset Managers	*Consensus*
2016: 0.3%	*2016: 0.2%*
2017: 1.6%	*2017: 1.3%*

Summer sales, and to a smaller extent lower energy prices, caused the monthly inflation rate to fall to -0.6% in July. Annual inflation was 0.2%. According to our forecast, annual inflation rises to just above 1% until December due to the base effect of energy prices. Core inflation, which excludes energy and food prices, is already at 0.9% and thus at a similar level.

Japan – Growth thanks to domestic demand

GDP Growth

Swiss Life Asset Managers	*Consensus*
2016: 0.5%	*2016: 0.5%*
2017: 0.9%	*2017: 0.8%*

The latest GDP report for the second quarter raised expectations even further as regards an upcoming fiscal and monetary package to stimulate growth and trigger inflation pressures. The Bank of Japan is due to release a comprehensive assessment of economic conditions in the second half of September. After a fairly strong growth print in the first quarter of this year, GDP stagnated in the second quarter and led us to revise the whole year outlook to the downside. Domestic demand was the sole driver of growth, as external activity suffered from the continuous appreciation of the Japanese Yen. Moreover, the start into the third quarter regarding export activity was a very weak one. As a matter of fact, Japanese exports recorded the fastest drop since 2009, declining by 14% in July from the same month in the previous year. Since imports fell even more, the trade balance has turned into positive territory ever since the start of the year. The labour market remains a strong pillar for the personal consumption outlook. Not only has the unemployment rate continued to drop but employment growth remains strong while the labour force participation rate is on an increasing trend since 2013, above all driven by increased participation of female workers. As a result aggregate labour income has risen. As a support for current quarter growth, a rise in housing and public investment seems to be in the cards.

Inflation

Swiss Life Asset Managers	*Consensus*
2016: -0.2%	*2016: -0.1%*
2017: 0.2%	*2017: 0.6%*

Underlying inflation remains very low in Japan and the marked appreciation of the Yen depresses prices further. The central bank's aim to reach 2% headline inflation seems very much out of reach. Its committment to reach that goal signals indeed that more easing is just around the corner. According to our own inflation path, the Japanese economy will remain stuck in deflationary territory until the end of this year to only move slightly above the zero line throughout the year 2017.

UK – Steep fall from a strong second quarter

GDP Growth

Swiss Life Asset Managers	*Consensus*
2016: 1.6%	*2016: 1.6%*
2017: 0.4%	*2017: 0.6%*

Our case of a shallow recession this year got somewhat compromised by the latest retail sales data which were a lot stronger than could be expected after the vote to leave the EU. This marks a strong start into the third quarter. The monthly increase of 1.4% of total retail sales in July was markedly higher than the expected 0.1% increase and is even more remarkable as consumer confidence was in free fall after the Brexit vote. The statistics office argues that the first summer month with warm weather boosted apparel and shoe sales while the increased number of tourists took advantage of the cheap Pound to travel to the UK and shop. In the meantime, second quarter GDP was published at 0.6% and proved to be stronger than the 0.4% quarterly growth rate which we had foreseen in our own forecast. This alone is responsible for the upwards revision of this year's GDP projection. Survey data indeed point to a sharp deterioration of the business and consumption environment. Deloitte's CFO survey illustrates the reduced willingness of decision makers to engage in capital expenditures or to spur hiring in the current environment. We thus stick to our expectation that the growth momentum over the next four quarters in aggregate is best described with the term stagnation.

Inflation

Swiss Life Asset Managers	*Consensus*
2016: 0.8%	*2016: 0.7%*
2017: 2.6%	*2017: 2.4%*

For the first time since May 2012, import prices have turned into positive territory in annual terms. This is largely driven by the marked depreciation of the British Pound which started to weaken even ahead of the EU referendum. Within the July CPI reading, food and gasoline prices were pushed higher by the base effect. The full Brexit effect will only be felt in the months ahead. In our forecast for headline inflation, the peak will be reached in May 2017 at 3%.

Switzerland – Pressure on retail trade still elevated

GDP Growth

Swiss Life Asset Managers	*Consensus*
2016: 0.8%	*2016: 1.0%*
2017: 0.9%	*2017: 1.4%*

Second quarter GDP will be published on 6 September. We expect 0.3% quarterly growth. This lies between the strong fourth quarter 2015 and the weak first quarter of this year. As we do not have any hard data for the post-Brexit period we have not altered our path further out, which is based on 0.2% quarterly growth for the second half of this year. This is consistent with the normalisation of the PMI from 54 in the second quarter to 50.1 in July. With regards to growth drivers, our long-held view of weaker domestic demand and support from the recovery in the Euro Area has materialised. First, retail sales have suffered due to shopping tourism. The contraction in the beginning of this year was exceptionally strong. Real retail sales declined by 2.3% in the first half of this year. They contracted as much during the full year 2015. The level of domestic trade is currently back to the ones last seen in 2012. In nominal terms, the correction is even bigger due to deflation and exchange rate pass-through. Furthermore, consumers are still prudent. Consumer sentiment moves sideways and stays well below the long-term average. Second, the recovery of external trade is impressive. The trade balance, in CHF, increased by 21% since December 2014. While imports declined due to the currency effect, exports recovered surprisingly fast and are back on their upward trend they have followed since 2010.

Inflation

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

We raised our forecast for 2016 slightly as we expected a larger drop in the consumer price index in July. The consensus made a similar move. According to our forecast, August will be the last month with a negative annual inflation rate. Annual inflation should turn positive in September and climb up to 0.3% until year-end.