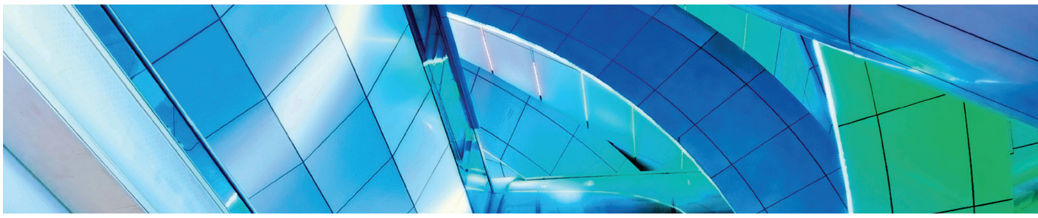
SYZ WEALTH MANAGEMENT



FOCUS

December 2016

MACRO OUTLOOK 2017

HIGHLIGHTS

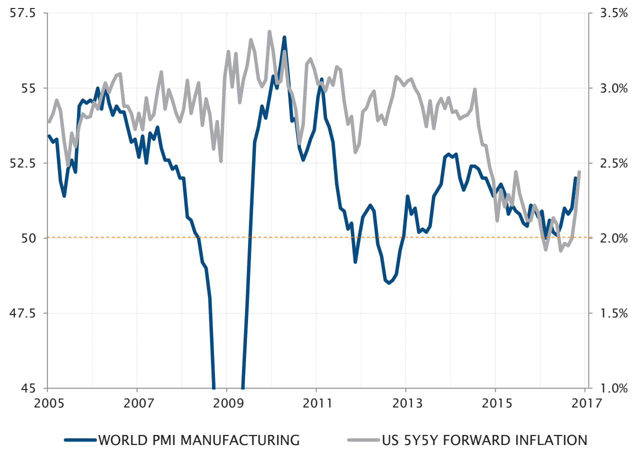
Whether the late dynamic of growth optimism and rising inflation expectations can be sustained is the key question for 2017. The short answer is: probably yes, but only for a brief time period before the gravitational force of underlying factors overcomes cyclical dynamics. The expected US fiscal stimulus will hardly bring any decisive shift in the structural trend, a gradual and inexorable japanisation of the global economy. Bouts of growth and optimism are likely to be followed by periodic flirts with deflation and recession, along with interest rate and FX fluctuations.

Adrien Pichoud
Economist

"Initial positive cyclical dynamics will gradually fade away as pull back forces induced by low potential growth and high debt levels remind investors of the inexorable japanisation of the global economy."

In 2016, investor sentiment has transitioned from global recession and deflation concerns towards growth optimism, rising inflation expectations and overdue monetary policy normalisation. Whether this late dynamic can be sustained is the key question as we approach 2017.

Entering 2017 with positive growth and inflation dynamics



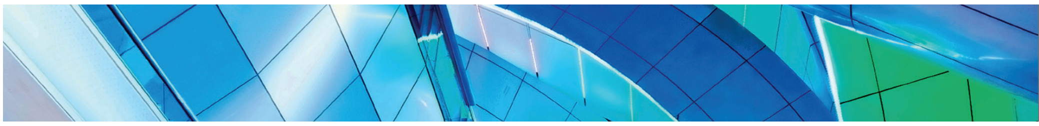
Source: Markit, Bloomberg, SYZ AM

IS THE GLOBAL ECONOMY ABLE TO SURPRISE ON THE UPSIDE?

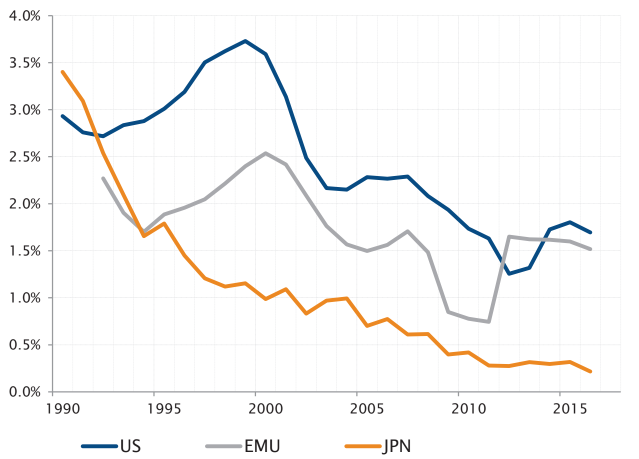
The short answer is: probably yes, but only for a brief period before the reality check of structural underlying factors overcome cyclical dynamics. Interestingly, an unusual number of elements have the potential to influence cyclical developments: fiscal, monetary and trade policies in the US, monetary policy and a heavy political agenda in Europe, US dollar trends and its impact on emerging economies, implications of the Chinese yuan's depreciation and oil price evolution. All of these elements increase tail risks around a central economic scenario barely different from the one of 2016, but can hardly bring any decisive shift in the structural trend: a gradual and inexorable japanisation of the global economy.

Three key features of the last two decades in Japan are becoming shared by a growing part of the world: slowing demographic trends undermining potential GDP growth, lower capacity utilization rates and rising indebtedness. Obviously, Europe is most advanced in this process, with demographic already being an acute issue, along with ample unused production capacity and high debt levels on the public side. But the US economy also exhibits a slowdown in labour force growth, declining capacity utilisation rates and rising debt levels, especially in the corporate and public sector. Several emerging economies have already entered this dynamic, primarily China faces the same kind of demographic, excess capacity, and debt headwinds. Looking forward, it is quite difficult to imagine a (peaceful) scenario in which those dynamics reverse at the global level.

SYZ Wealth Management
Tel. +41 (0)58 799 10 00 - info@syzgroup.com



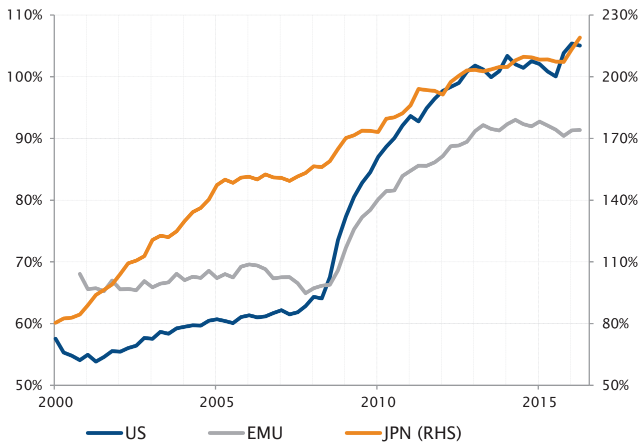
Potential growth is low and slowing in developed economies



Source : Datastream, OECD, SYZ AM

There is another side to the Japanese analogy that bears less negative implications : as long as monetary conditions are kept very accommodative, high and rising debt levels are not an issue per se as the cost of servicing and rolling this debt remains low. Being in a japanised situation of high debt and accommodative monetary policy can therefore last for a while. Bouts of growth and optimism succeed to periodic flirts with deflation and recession along with interest rate and FX fluctuations without decisively breaking the low-growth range, neither on the upside or on the downside. Identifying those cyclical shifts, therefore, is key for building macro-economic (and market) assumptions.

Public debt is high and constrains fiscal policies



Source : Bloomberg, SYZ AM

USA: FISCAL SPENDING VERSUS FINANCIAL TIGHTENING

The US economic outlook for 2017 will clearly be shaped by several opposing cyclical factors. The election of Donald Trump has only reinforced the optimism on growth prospects and the rising interest rate trend, luring investors with the promise of significant fiscal stimulus. What has been neglected is the implications of this policy shift for the growth profile of 2017. Indeed, assuming the Congress agrees on a large fiscal stimulus as promised by candidate Trump, the Fed will finally be in an easier position to engineer the monetary policy normalisation it has unsuccessfully been looking for so far. The net impact on growth is unlikely to be spectacular as the fundamental growth drivers, demography, productivity, and debt levels will not be moved by any aspect of Trumponomics. The inflation picture might initially evolve in a positive direction, with positive base effects on energy prices and gradual upward wage pressures pushing headline inflation higher in the first half of the year. But the disinflationary impact of a stronger USD and the strain of higher labour costs on already unspectacular profit growth will soon cap the pace of price increase. There is no easy way out of a situation of low growth and high indebtedness.

EUROZONE: NEEDS EASED MONETARY CONDITIONS AND POLITICAL STABILITY

The Euro area differs from the US in the sense that it is less advanced in its expansion cycle. As such, it still enjoys the tailwinds of declining unemployment rates and capital spending catch-up. Those elements will keep growth above its forecasted level in 2017, provided two conditions are fulfilled : firstly, no tightening in financial conditions that would undermine the fragile investment dynamic and secondly, no resurgence of political risk premium and euro sustainability concerns. While the pragmatism of a Draghi-led ECB shall ensure the fulfilling of the former condition, the heavy political agenda makes for a significant tail risk around the latter, and therefore on the monetary union's growth prospects.

UK : BREXIT HAS TO BECOME CONCRETE

Political uncertainty has been a defining element for the United Kingdom recently. The many unknowns still surrounding the practical application of the EU referendum (and indeed its mere occurrence) will weigh on economic activity as many investment decisions are kept in stand-by. The impact of the sterling's depreciation will also shape the growth profile, with some positive spill over effect on exporters (including tourism-related) activities but a negative impact on households' purchasing power through rising retail prices. The announced fiscal stimulus might be counterbalanced by a greatly reduced ability for the Bank of England to provide further monetary policy support amid rising inflation.

CH: ALL IS ABOUT THE SWISS FRANC

The Swiss National Bank (SNB) has even less room for manoeuvre and is in an increasingly uncomfortable situation. Were it not for the Swiss franc, the Swiss economy would exhibit a relatively balanced growth outlook, but high external surplus and euro area political risks keep fuelling upward pressures on the currency. However, should those pressures intensify, the SNB can do little more to prevent a further appreciation, given the unprecedented level of its FX reserves and the banking sector's stress already induced by negative short term rates. The Swiss economy remains hostage to developments in the neighbouring euro area.

EMERGING MARKETS: FIRMER FINAL DEMAND VERSUS STRONG USD

For emerging economies, 2017 seems likely to be a tale of two stories. The first story is quite positive, supported by resilient final demand in developed economies and the end of the commodity price correction. Russia will resume positive GDP growth, helped by the rebound in oil prices. The Brazilian economy will also gradually recover with the return of political stability and more realist fiscal policy that provides room for less restrictive monetary policy. India will continue to enjoy the benefits of Modi's push for structural reforms, in a context of favourable demographic dynamic. And China is stabilised for now. The second EM story is less cheery. The dollar strength threatens once again to unsettle the large EM debt stock accumulated since 2009. It also fuels downward pressures on the Chinese currency and induces negative spill overs across all Asian exporters. It finally exerts strain on economies with current account deficits, often amplifying already fragile domestic situations, such as in Turkey or South Africa. Indeed, for the emerging world, a positive global growth dynamic is only good if it doesn't come with a stronger US dollar. Therefore, the first part of the year might still prove shaky for emerging market growth dynamics, before a more benign second half if, as we expect, the Fed is ultimately unable to tighten significantly monetary policy, dissipating upward pressures on rates and the dollar.

JAPAN: STRONG YEN, WEAK YEN?

The outlook for Japan is more of the same. With no more room for manoeuvre on the fiscal and monetary side, yen fluctuations will dictate business cycle evolution. This is how it all ultimately ends in a low growth, high debt world. 2017 is likely to be only one more step in the japanisation of the global economy.