Outlook for 2017: Upswing with more pep

World economic growth sluggish again in 2016…

Economists look back on the year 2016 with mixed feelings. Although there were for the most part no major surprises regarding economic development, that also meant the world economy only grew moderately in 2016 for the fifth consecutive time. In any case – and this is the good news – the fears of recession at the beginning of the year, leading to sharp stock market declines around the world in the first few weeks of the year, have not come true. Our assessment in December 2015 ("global economic growth is likely to reach just over 3% in 2016, a rate similar to those of the preceding years") has therefore proven fairly accurate. The International Monetary Fund (IMF) expects global economic growth this year will reach 3.1% (2015: 3.2%).

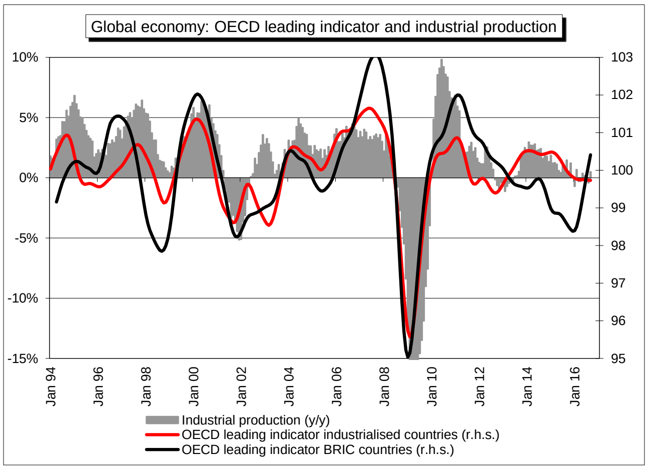
This year's disappointing growth is mainly due to low economic momentum in the emerging markets. The recession in Russia and (to a somewhat lesser extent) in Brazil has continued, while growth has turned out slower than in previous years in many other countries. China and India, however, have been positive exceptions to that. Growth in India will probably come to 7.6% again this year, even though the economic outlook worsened due to a controversial currency reform (at the beginning of November, the government demonetized banknotes higher than INR 100). China's economy grew at a rate of 6.7% in each of the first three quarters of 2016 and thus more strongly than forecast by the IMF, as we also expected 12 months ago ("growth in the full year is ... likely to be between 6.5% and 7% and hence somewhat higher than the IMF's 6.3% forecast"). Despite frequently expressed doubts about official economic data published in China, we regard these numbers as basically credible. The restructuring of the economy promoted by the Chinese government in favor of services and consumption appears to be going successfully so far.

Overall, growth in the emerging markets has slowed this year to about 4% in contrast to growth rates of 7.5% after the 2008 financial crisis. However, this should be viewed as a return to normal, since economic momentum is by no means lower now compared with growth rates in the 1980s and 1990s. Only if one shortens the period of comparison to the past 15 years does the impression arise that the current development is disappointing. This is probably related primarily to the increasing integration of the emerging markets in global trade, partly as a result of China's admission to the World Trade Organization in 2001.

Economic growth in the industrialized countries has also been somewhat weaker than expected this year. That is mainly due to the United States, which is only growing at 1.5% and thus significantly short of the IMF's expectation (2.6%) and our forecast at the end of last year ("we expect economic growth again at a rate between 2% and 2.5% for 2016"). Since, with GDP of just over USD 18 trillion, the United States accounts for a good 20% of the world economy (about USD 75 trillion), each percentage point by which the US growth rate is lower (higher) leads to world economic growth that is 0.2 percentage points lower (higher). The reasons for the slow US growth have been 1) the low oil price, which has led to declining investment in the fracking industry, 2) the revaluation of the US dollar, which has impaired competitiveness of export businesses, and 3) the build-up of excessive inventories, prompting manufacturers to cut production. Apart from the United States, economic development in the other industrialized countries has been roughly as forecast a year ago.

... but signs for 2017 are improving

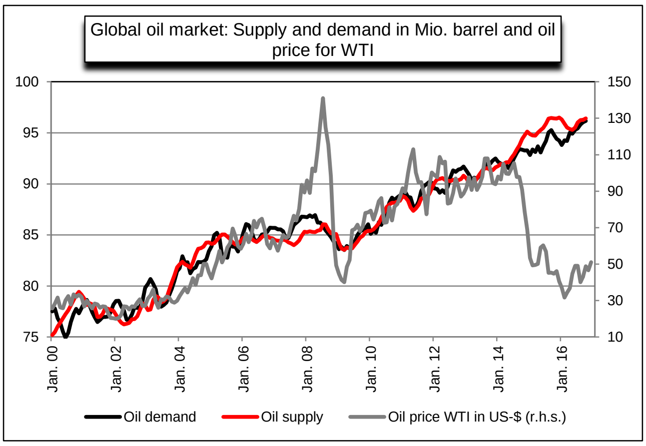
The IMF expects the world economy to grow at a rate of 3.4% next year and hence somewhat faster than in 2016. However, this expectation might prove to be too cautious, since general economic conditions have improved in the past few months, especially in the emerging countries. The message from the latest leading indicators is quite clear.



The purchasing manager indexes as well as the OECD leading indicators have passed their low point and in some cases have risen significantly in the past few months. This is especially evident when one considers the OECD leading indicators. A strong economic recovery appears likely, above all, for the BRIC countries (Brazil, Russia, India, and China), which are very important for global growth due to the size of their economies. While the indicator for India has been climbing already since the beginning of 2014 and has been above the long-term average of 100 points since April 2016, the numbers in Brazil and Russia have also improved in the past months with astonishing rapidity. At just over 101 points, the OECD leading indicator for Brazil is at its highest level since summer 2011, and Russia has also recently surpassed the 100-point mark. In China, the leading indicator has likewise continually improved, but at a somewhat slower pace than in the aforementioned countries.

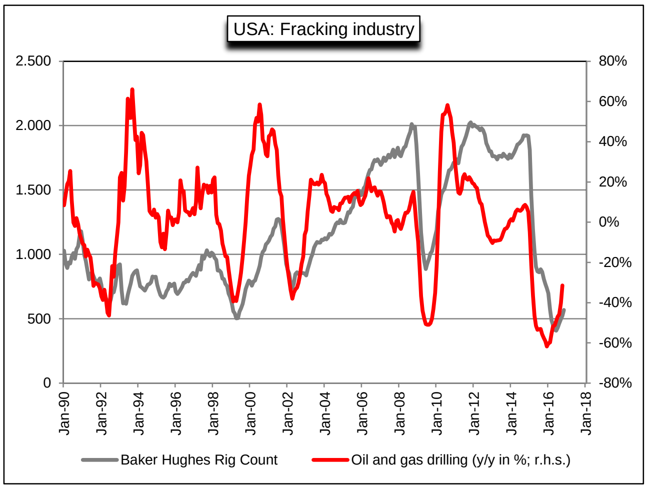
The good news is therefore that the emerging countries will report stronger economic momentum for the first time in 2017 after several consecutive years of disappointing growth. This positive development is mainly due to the recovery of commodity prices, and particularly of the oil price. The associated higher revenues are benefiting governments, businesses, and consumers in the producing countries. Although the higher commodity prices are causing consumers to lose purchasing power, it is wrong to assume that this is more or less a zero-sum game. For, some of the emerging countries' higher revenues will flow back to the industrialized countries, where consumer and capital goods are purchased, and will likewise make for positive economic impetus there. In particular, countries that have close trade relations with emerging countries, as Germany for example has, should benefit from this development.

Recovery of commodity prices continues at more moderate pace



A continuation of the positive trend in the emerging countries is therefore closely tied to the future development of commodity prices. We expect their recovery to continue at a somewhat more moderate pace in 2017. The monthly data released by the US Energy Information Administration (EIA) on global oil supply and demand show that the oil supply continuously grew more strongly than demand from summer 2013 to the beginning of 2016 because of fracking. However, this development has reversed direction in the meantime, and demand for oil is now growing faster than the oil supply. The price of oil should therefore continue to recover in the months ahead. It is also psychologically helpful that OPEC has reached an agreement to limit production, the first of its kind since 2008. But it is still quite unclear whether all countries will abide by this agreement. Substantial price increases from the current level are therefore rather unlikely, especially since fracking is on the rise again in the United States. At the moment, this development does not constitute a threat, even though the number of active drilling rigs has already risen by 50% from its low in May 2016. Compared with the previous fracking peak in spring 2012 (when the active rig count was over 1,400), the number of active drilling rigs was only about 470 at last count.

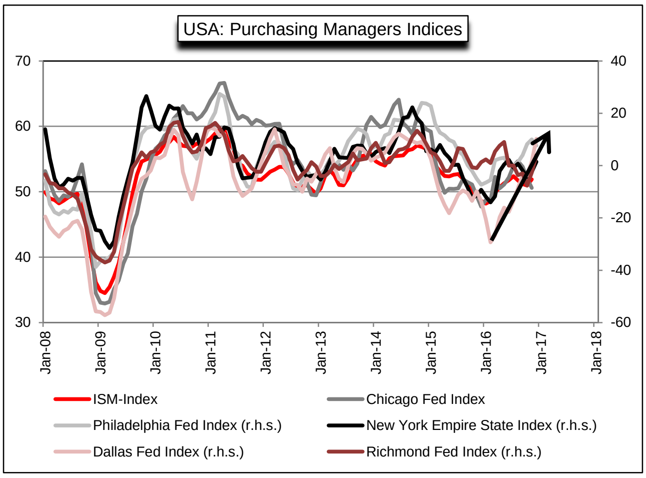
Compared with the IMF's forecasts, we expect growth in 2017 will be somewhat better in China and significantly better in Brazil and Russia (China: 6.3%; Brazil: 0.5%; Russia: 1.1%). However, China's growth will continue to slow in the coming years. That is already a plausible expectation because economic momentum is gradually diminishing in the developing economies. Nevertheless, by itself, China remains the most important engine of the world economy, since it contributes about 1 percentage point of total global growth (and hence significantly more than any other national economy). On the other hand, India will grow more slowly than the IMF expects (7.6%), because its economy is suffering a small growth dip due to the temporary shortage of currency. Nevertheless, the emerging countries overall should achieve a growth rate of just over 5% in the coming year, which would be the strongest increase since 2012.



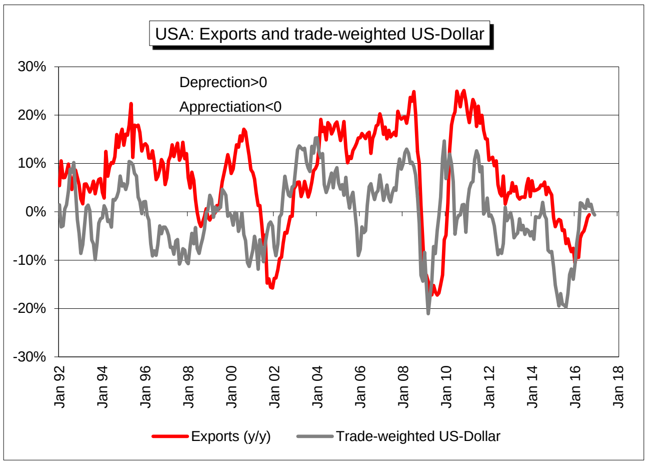
Somewhat greater economic momentum also seems in store for the industrialized countries in 2017. That is primarily thanks to the United States. The basic economic trend in the euro zone and in Japan will not change much overall, but that assumes that political uncertainties will not negatively impact conditions in the real economy. All in all, we regard the IMF's forecasts for the industrialized countries of 1.8% growth in 2017 (2016: 1.6%) as realistic. Altogether, the world economy should thus be able to expand by 3.6% next year, according to our calculations, and thus somewhat more strongly than the IMF expects (3.4%). If this forecast comes true, it will be the strongest growth since 2011.

United States: Growth acceleration – even without Donald Trump

After the US economy grew by only just under 1.5% in 2016, a recovery appears likely in 2017. This year's weak performance is mainly due to low momentum in the first six months (growth of 1.1%), but the second half will turn out significantly better with growth of 2.5% to 3%. The US leading indicators signal that this positive tendency will continue, and the United States will therefore be able to achieve a growth rate of somewhat more than 2% next year, even without the economic policy changes proposed by Donald Trump. Above all, consumption is likely to keep its role as the engine of growth in view of expanding employment. The annual increase of total wages and salaries has been around 4% in the past months, so real income growth at the macroeconomic level of more than 2% may be registered even when inflation is taken into account. This supports the view that retail sales will also grow respectably in the year ahead. However, consumer behavior appears to be changing in the United States – as it is almost everywhere in the world. Online shopping is growing at double-digit percentage rates, while sales of traditional department store chains are falling.



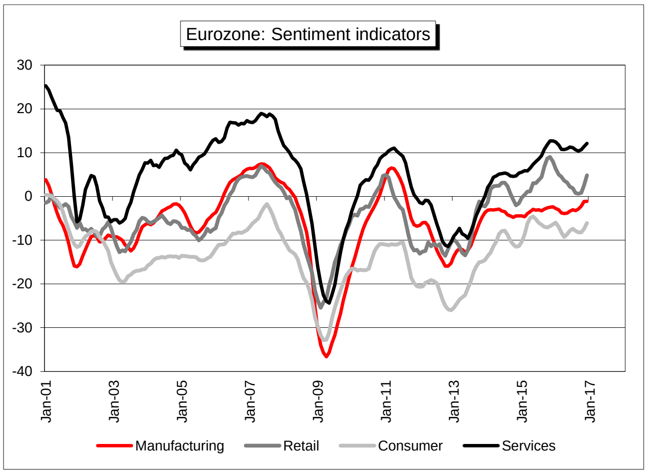
The economic headwind businesses have faced in 2016 is gradually subsiding. The US dollar has not continued to gain in value against the euro and other major currencies this year. Although the greenback has become stronger since the election of Donald Trump, the trade-weighted US dollar, which still showed a year-on-year revaluation of almost 15% a year ago, is now quoting at roughly the same level as in November 2015. This will benefit exports in the near term. The recovery of the oil price will also gradually have a positive impact on the US economy, since oil companies will increase their capital spending.



Even without Donald Trump, US economic growth would therefore accelerate to about 2% next year. If Trump lowers taxes and raises infrastructure spending as advertised, that could stimulate economic momentum even further in the second half of the year, thus making a growth rate of 2.3% attainable. The chances are great that fiscal policy will be more expansionary in view of the Republican majorities in both houses of Congresses, even if not all Republicans are known as fans of government spending programs. However, there are also statements in Trump's campaign platform that could affect growth negatively. Above all, that concerns possible restrictions on free trade, which could lead to new trade wars. Such a policy would also negatively affect the United States itself, so one can only hope that it will not be implemented. Moreover, the planned tax cuts and additional spending could significantly increase the national debt. Donald Trump's economic policy is thus by no means free of risks and side effects. However, the positive aspects will probably predominate at least in the short term, while the possible negative aspects will only emerge later.

Euro zone: Moderate upswing threatened by political uncertainties

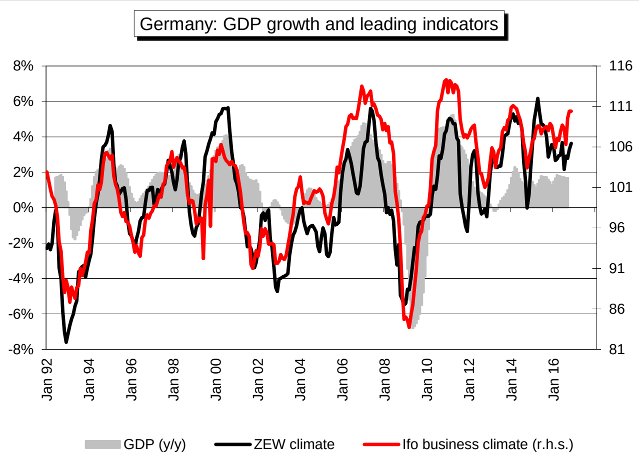
Despite all the political imponderables, the euro zone economy has proven comparatively resilient this year. The sentiment surveys conducted by the EU Commission as well as the purchasing manager indexes for the manufacturing and services sectors indicate that the moderate upswing will continue. The euro zone economy will grow a rate of 1.6% in 2016 and hence about as strongly as we forecast a year ago (1.5%). As expected then, the economies of Ireland, Spain, and Germany are among the engines of the upswing, while the brakes are on in France, Italy, Portugal, and Greece. That is primarily because the latter countries have so far not adopted notable reforms, have implemented reforms too slowly, or have partly repealed them. Consequently, the euro zone overall is stuck in mediocrity.



Unfortunately, this tendency will not change much in the year ahead. Since the positive economic effects of the oil price decline and the euro devaluation are diminishing, real GDP growth will slow slightly in 2017 to only 1.5%. However, this forecast is subject to considerable uncertainties depending, above all, on the political courses set next year. Besides the parliamentary elections in the Netherlands (on March 15, 2017), the presidential elections in France are coming up (April 23 and run-off on May 7), as is the federal parliamentary election in Germany (probably on September 17 or 24). Although most voters want more growth, very few are willing to accept the reforms that will require. This reform fatigue and political apathy are playing into the hands of many "outsiders" and anti-establishment groups, who promote their cause with allegedly simple and initially plausible-sounding arguments. It remains to be seen how successful these parties will be in the upcoming elections. We consider a break-up of the euro zone extremely unlikely, but the associated uncertainty will mean that not only political but also economic developments will more unpredictable.

Germany: Don't be fooled (by the calendar)

After great worries early this year that a possible economic collapse in China and the United States might also substantially impact Germany and similar concerns last summer in the wake of the Brexit referendum, the economy has proven significantly more resilient than expected. Despite many negative factors, real GDP will grow by 1.8% in 2016 and thus even somewhat more strongly than we expected 12 months ago (1.6%). This is primarily due to the good state of the domestic economy, which is benefiting from low unemployment, comparatively high real wage increases, spending on immigration, and booming construction promoted by low interest rates. Exports have also managed to hold their own in the difficult world economic environment and have contributed to growth. This positive configuration is also not going to change much next year. The sole reason why we expect a growth rate of "only" just under 1.4% is the lower number of working days. Since more holidays will fall on weekdays next year, there will be about three fewer workdays than in 2016. This "calendar effect," for which the German Federal Statistical Office (Statistisches Bundesamt) makes no adjustment, will lower economic growth by almost 0.3 percentage points.



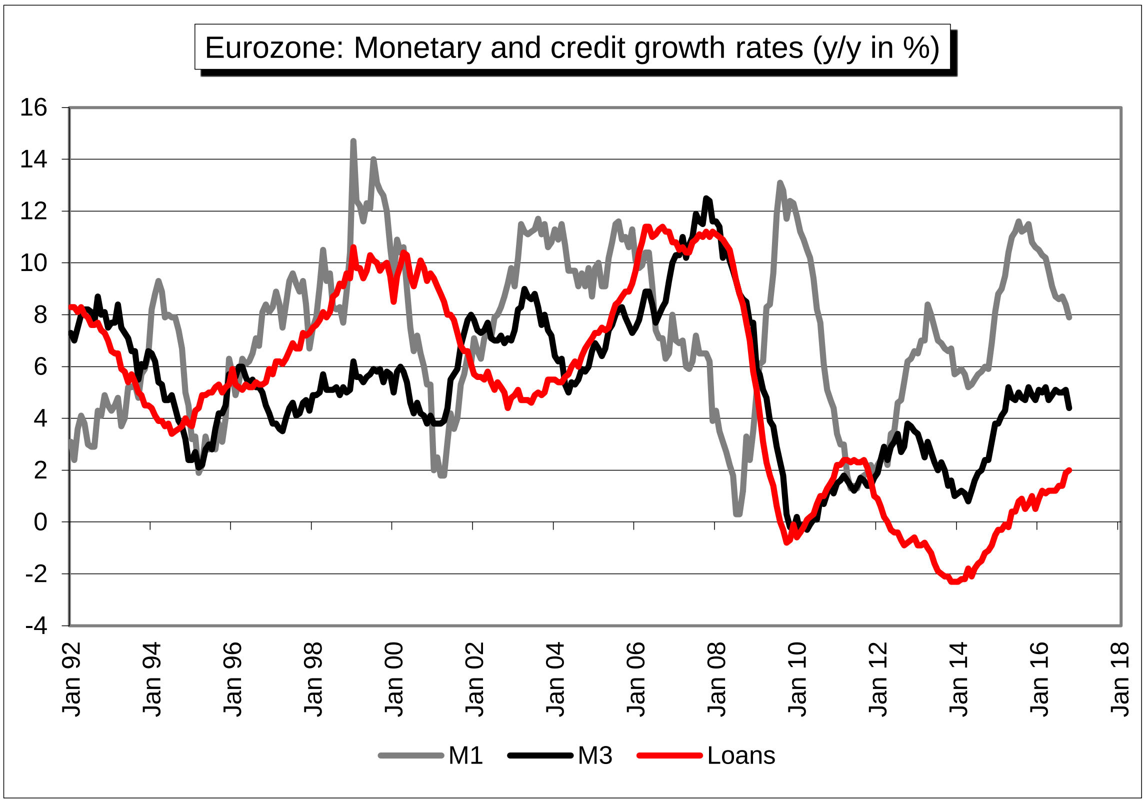
As in the past two years, the strongest growth impetus will again come from private consumption in 2017. After an increase of 1.8% this year, we expect a plus of 1.5% in 2017. Consumption in Germany is benefiting from record-high employment and continuing real wage growth. German exports will grow this year by just under 2.5% despite strong countervailing influences. And the prospects for exports have even improved again lately, which may seem surprising in view of recent political developments. For, both Brexit and the election of Donald Trump have increased at least the "perceived" uncertainties. It is important to remember that the United States is Germany's largest and most important trading partner, trailed closely by Great Britain in third place. However, German companies' export expectations have improved again lately, which is probably due to the better economic conditions in the emerging countries. We therefore expect exports to increase by about 3% next year. On the other hand, equipment spending will develop less dynamically. After only increasing a little in 2016 (+1.3%), we expect it to grow at a similarly subdued rate in 2017. That is mainly due to continuing high political uncertainties, which are keeping capital investment from reacting to interest rates and thus diffusing the impact of monetary policy.

Weekly outlook for December 5-9, 2016

	June	July	Aug.	Sept.	Oct.	Nov.	Release
DE: PMI, services	53.7	54.4	51.7	50.9	54.2	55.0	December 5
DE: New orders, m/m	-0.2%	0.2%	0.9%	-0.6%	1.0%		December 6
DE: New orders, y/y	-2.7%	-0.5%	2.3%	2.7%	2.0%		December 6
DE: Industrial production, m/m	1.1%	-1.5%	3.0%	-1.8%	1.2%		December 7
DE: Industrial production, y/y	0.8%	-1.3%	2.5%	1.1%	1.9%		December 7
DE: Exports, m/m	-0.1%	-1.4%	3.5%	-1.2%	0.7%		December 8
DE: Exports, y/y	-0.8%	-4.5%	4.5%	0.5%	2.2%		December 8
DE: Trade balance, in EUR m	21.1	19.8	21.8	21.1	21.5		December 8
EUR19: PMI, services	52.8	52.9	52.8	52.2	52.8	54.1	December 5
EUR19: Retail sales, m/m	0.1%	0.3%	-0.2%	-0.2%	0.5%		December 5
EUR19: Retail sales, y/y	2.0%	2.2%	1.1%	1.3%	1.9%		December 5

MMWB estimates in red

Chart of the week: Is ECB monetary policy working or not?



The money supply and lending statistics released last week for the euro zone have provided both positive and negative signals. Money supply growth was surprisingly slow in October. That is particularly evident in the case of the M1 aggregate, which increased by a double-digit percentage rate between spring 2015 and spring 2016. At only 7.9% at last count, its growth was weaker than at any time since November 2014. The more broadly defined M3 money supply grew more weakly than expected in October at 4.4%. On the positive side, however, lending improved noticeably. At a growth rate of 2%, it was higher than at any time in the last five years.

Stock marktes	As of 05.12.2016 13:53	Change versus 22.11.2016 -1 Woche	28.10.2016 -1 Monat	26.08.2016 -3 Monate	31.12.2015 YTD
Dow Jones	19170	0,8%	5,6%	4,2%	10,0%
S&P 500	2192	-0,5%	3,1%	1,1%	7,2%
Nasdaq	5369	-0,3%	3,4%	2,9%	7,2%
DAX	10659	-0,5%	-0,3%	0,7%	-0,8%
MDAX	20748	0,2%	-2,0%	-3,8%	-0,1%
TecDAX	1703	-2,2%	-1,6%	-1,2%	-7,0%
EuroStoxx 50	3044	0,0%	-1,1%	1,1%	-6,8%
Stoxx 50	2828	0,2%	-0,2%	-1,1%	-8,8%
SMI (Swiss Market Index)	7852	1,4%	-0,7%	-3,9%	-11,0%
Nikkei 225	18275	0,6%	4,7%	11,7%	-4,0%
Brasilien BOVESPA	60506	-2,3%	-5,9%	4,8%	39,6%
Russland RTS	1065	4,8%	7,4%	9,4%	40,7%
Indien BSE 30	26349	1,5%	-5,7%	-5,2%	0,9%
China Shanghai Composite	3205	-1,3%	3,2%	4,4%	-9,4%
MSCI Welt (in €)	1709	-0,9%	3,3%	4,6%	4,7%
MSCI Emerging Markets (in €)	853	-1,2%	-3,5%	0,0%	9,4%
Bond markets					
Bund-Future	160,28	-112	-180	-742	236
Bobl-Future	131,16	-13	9	-246	49
Schatz-Future	112,26	3	28	26	75
3 Monats Euribor	-0,31	0	0	-2	-18
3M Euribor Future, Dec 2016	-0,31	0	0	0	0
3 Monats $ Libor	0,94	1	5	10	32
Fed Funds Future, Dec 2016	0,53	0	3	-2	0
10 year US Treasuries	2,41	9	57	78	14
10 year Bunds	0,34	19	25	50	-29
10 year JGB	0,04	1	8	11	-22
10 year Swiss Government	-0,12	7	28	39	-5
US Treas 10Y Performance	574,09	0,0%	-3,5%	-4,8%	1,7%
Bund 10Y Performance	612,87	0,4%	-0,2%	-2,4%	5,9%
REX Performance Index	482,81	-0,1%	-0,5%	-1,6%	1,8%
US mortgage rate	0,00	0	0	0	0
IBOXX AA, €	0,67	-3	10	30	-61
IBOXX BBB, €	1,63	-2	24	44	-64
ML US High Yield	6,75	-3	26	0	-214
JPM EMBI+, Index	763	-0,1%	-4,6%	-6,1%	8,4%
Convertible Bonds, Exane 25	6688	0,2%	-1,0%	-1,8%	-3,9%
Commodities					
CRB Index	421,14	0,1%	-1,0%	0,8%	11,0%
MG Base Metal Index	305,63	5,8%	16,9%	21,8%	31,6%
Crude oil Brent	54,78	12,6%	9,1%	9,2%	53,4%
Gold	1167,66	-3,5%	-8,1%	-12,5%	9,9%
Silver	16,59	-0,4%	-6,1%	-11,4%	19,8%
Aluminium	1745,00	-1,2%	1,5%	7,2%	16,3%
Copper	5865,75	4,8%	21,4%	27,4%	24,7%
Iron ore	81,00	6,6%	27,6%	33,9%	84,9%
Freight rates Baltic Dry Index	1198	-2,8%	43,6%	66,4%	150,6%
Currencies					
EUR/ USD	1,0686	0,6%	-2,2%	-5,3%	-1,8%
EUR/ GBP	0,8403	-1,4%	-6,6%	-1,6%	14,0%
EUR/ JPY	122,10	3,7%	6,1%	7,7%	-6,8%
EUR/ CHF	1,0787	0,5%	-0,6%	-1,3%	-0,4%
USD/ CNY	6,8820	-0,1%	1,5%	3,2%	6,0%
USD/ JPY	111,94	0,7%	6,9%	9,9%	-7,0%
USD/ GBP	0,79	-2,3%	-4,4%	3,9%	15,9%

Carsten Klude	+49 40 3282-2572	cklude@mmwarburg.com
Dr. Christian Jasperneite	+49 40 3282-2439	cjasperneite@mmwarburg.com
Martin Hasse	+49 40 3282-2411	mhasse@mmwarburg.com
Dr. Rebekka Haller	+49 40 3282-2452	rhaller@mmwarburg.com