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GLOBAL ECONOMIC HIGHLIGHTS

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EVEN MORE US FISCAL STIMULUS TO STOKE GROWTH AND DEFICITS IN 2018 AND 2019; RATE HIKE IN MEXICO

UNITED STATES: The Bipartisan Budget Act of 2018 passed February 8 will increase federal spending and borrowing by about $150 billion dollars per year in 2018 and 2019. It and the deficit-funded Tax Cuts and Jobs Act will increase the federal deficit by over one percent of GDP in 2018 and another one percent in 2019. This creates upside risk to our forecast for 2.7 percent real GDP growth in 2018. In addition, with the unemployment rate at a 17-year low and average hourly earnings growth at the highest since mid-2009 in January, additional stimulus also creates upside risk to the inflation outlook for 2019 and beyond. Fiscal deficits also are increasing trade deficits by causing demand to grow faster than the US economy's capacity to produce; this effect is visible in current data. The US foreign trade deficit rose to $53.1 billion dollars in December from $50.4 billion in November: Exports rose $3.5 billion to $203.4 billion, while imports rose $6.2 billion to $256.5 billion. For all of 2017, exports rose 5.5 percent and imports 6.7 percent. The strong holiday shopping season and rising business investment in late 2017 spurred demand for imported goods and services. US crude production broke above 10 million barrels per day in the week of February 2, the highest since weekly data were first released in 1983; US petroleum stocks rose for a second consecutive week as production strengthened.

EUROZONE: German Chancellor Angela Merkel's center-right Christian Democratic Union and Bavarian Christian Social Union coalition will again be the senior party in a grand coalition government, with the center-left Social Democratic Party still the junior party. The two parties reached the deal on February 7, ensuring political continuity in Germany in 2018. Despite positive political developments, the euro weakened the week of February 5 as long-term interest rates rose and stock prices fell; this "tightening of financial conditions" – the ECB's term – could delay the ECB's taper of quantitative easing if it is sustained.

JAPAN: Not much growth in year-end bonuses in Japan: Average monthly cash earnings grew a tepid 0.7 percent in year-over-year terms in December 2017, little changed from December 2016's 0.6 percent year-over-year increase. Japanese employers pay bi-annual bonuses in December, so the month's earnings data are an important signal of the trend in wage growth, and by extension inflation. The Bank of Japan is still far from achieving its target of two percent CPI inflation.

CANADA: The labor market gave back some of its recent gains in January, with the unemployment rate ticking back up to 5.9 percent from a multi-decade low of 5.8 percent in December and household employment down a large 88,000 from December. Details were stronger than the headline, with full-time work up by 49,000 and part-time employment down 137,000; hours worked grew 2.8 percent in year-over-year terms, much faster than employment's 1.6 percent (a sharp slowdown from December's 2.3 percent). January's declines in both public and private employment suggest that weather may have distorted the data – January in Canada, after all – and employment losses were not limited to Ontario, which raised its minimum wage from $11.60 to $14.00 per hour on January 1.

MEXICO: Matching our expectation, the Bank of Mexico raised the benchmark interbank interest rate 0.25 percentage points to 7.50 percent at its February 8 monetary policy decision. The Bank sees risks to growth to the downside, and risks to inflation to the upside over its forecast horizon, due to limited slack in labor markets, uncertainty regarding the NAFTA renegotiation, the possibility of a renewed depreciation of the peso, and "potential volatility during the electoral process." But if no negative shocks occur, the Bank expects inflation to slow over the course of 2018 and reach the Bank's target of 3.0 percent in the first quarter of 2019. If events follow the Bank of Mexico's benign baseline scenario, policy rate hikes are likely over, with the Bank of Mexico's next move a rate cut after the July 1 election.

CHINA: Foreign reserves rose $21.5 billion US dollars to $3.161 trillion in January, a twelfth consecutive monthly increase. Even after a year's increase, China's foreign reserves have only retraced 16 percent of their decline from their peak in June 2014 to January 2017. If US interest rates continue to rise in 2018 and the dollar stabilizes, capital outflows from China could resume.

UNITED KINGDOM: The Bank of England prepared financial markets for tighter monetary policy in 2018 at its February 8 monetary policy decision. Their growth outlook is not particularly upbeat – the February *Inflation Report* forecasts real GDP growth at a weak 1.7 percent year-over-year in the first quarter of 2018, 1.8 percent in the first quarter of 2019, and 1.7 percent in the first quarter of 2020. But the Bank's February *Inflation Report* also reduced the projection for potential real GDP growth to just 1.5 percent, held back by reduced immigration to the UK from the rest of the EU and by expectations of increased barriers to UK companies exporting to EU markets. The Bank of England projects that the unemployment rate will fall from 4.3 percent in early 2018 to 4.2 percent in early 2019 and 4.1 percent in early 2020, which would be the lowest since 1975. To prevent wage pressures from growing too rapidly, the BoE will probably raise the bank rate by 0.25 percentage points to 0.75 percent in 2018, most likely at the May 10 release of the *Inflation Report* for the second quarter of 2018.

BRAZIL: As expected, the Central Bank of Brazil reduced its benchmark Selic rate 0.25 percentage points to 6.75 percent. The Bank's monetary policy announcement signaled that they are likely to leave interest rates on hold at their next policy decision, but that view "might change in favor of … easing if the Committee's baseline scenario or balance of risks change." The Central Bank sees downside risks to inflation from the possibility of pension reforms which could raise Brazil's sovereign credit rating, and from the current low level of inflation which could spill over to slower core inflation if sustained.

INDIA: The Reserve Bank of India held its policy repo rate unchanged at 6.0 percent at its February 7 monetary policy decision: The RBI expects growth to improve in coming quarters and for inflation in the 2018-2019 fiscal year to range between 5.1 and 5.6 percent, on the high end of the RBI's target range of 4 percent plus or minus two percent. While the RBI's current policy stance is neutral, its next move is most likely a hike in the second half of 2018 as imported energy prices raise Indian inflation.

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