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GLOBAL ECONOMIC HIGHLIGHTS

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CHINESE FIRST QUARTER REAL GDP GROWTH WAS SURPRISINGLY RESILIENT DESPITE TIGHTER CREDIT

CHINA: There was a premier from Anhui / Who took the cheap credit away / Formalism is his foe / Is growth starting to slow? / Still don't bet on stimulus we say. Chinese growth was resilient at the beginning of 2014, impressively so given the headwinds the economy faced. Gross domestic product rose 7.4 percent in the first quarter of 2014 in real year-ago terms, and the current value of GDP reached 12.8 trillion yuan, 7.9 percent more than the same period a year earlier. Reported growth exceeded the consensus forecast of 7.3 percent as well as our expectation for real GDP growth as slow as 7.0-7.2 percent. Headline fixed asset investment growth was very low by Chinese standards at 17.6 percent in year-ago terms in the first quarter, but much of this nominal slowdown is actually due to historically slow increases in investment good prices. Many measures of Chinese inflation and price pressures, whether they be the fixed asset investment deflator, the CPI index, the GDP deflator, or the outright decrease in producer prices, were weak in the first quarter; if anything, CPI inflation's 2.4 percent increase in March could be overstating broad inflationary pressures in China. Prices of Chinese real asset prices, in particular - that is, of real estate, the property, plant and equipment of a factory, and so on - appear to be stagnating in the first quarter of 2014 from official statistics, or even falling in sequential terms. Nevertheless, the first quarter's moderate real GDP growth exceeds the government's implicit 7.0 percent "bottom line" needed to maintain a stable labor market, and indeed, income indicators show increases in real incomes more or less on pace with real GDP, a sign of a labor market near full employment. Likewise, CPI inflation stayed comfortably below the government's "3.5 percent give or take" limit. The quarterly report on national accounts noted progress on several measures of "structural adjustment" that put China on track for a more balanced economy down the road: shrinking the urban-rural income divide; increasing the service sector and final consumption's share in GDP; and decreasing the energy intensity of GDP by 4.3 percent. Not as directly stated but also important, the first quarter's decent reported economic growth comes despite slower money supply and aggregate financing growth in the first quarter of this year. Decent growth and muted inflation provide a green light for China's leadership to double down on its less expansionary credit and fiscal policies in 2014, and also are a green light for the government's anti-corruption drive to continue. The anti-corruption campaign is a headwind to investment by state-controlled firms and to officials' spending on luxury goods and banquets. In addition, on-target growth and inflation hold the door wide open for opening state-controlled sectors to private investment, although it will be anything but simple for the Premier to walk through it. With a decent first quarter taking some pressure off of the government to accelerate investment plans in the remainder of the year, the balance of risks for 2014's full-year GDP growth is little changed following today's numbers. And of course, the unresolved overhang of questionable investments made during the recent credit boom makes it difficult to breathe too easy.

UNITED STATES: The U.S. economy continues to strengthen as winter doldrums give way to spring. Industrial production rose 0.7 percent in March from February, and IP growth in February was revised up to a robust 1.2 percent monthly increase after January's 0.2 percent monthly decline. The University of Michigan's consumer sentiment index rose to 82.6 in April, the highest in nine months, from 80.0 in March, and initial claims for unemployment insurance fell to 300,000 for the week ended April 5, the lowest since 2007; the four week moving average of claims was 316,000, down 5,000 from the preceding week's 321,000 (revised up a touch from 320,000). Record-low unemployment claims mirror the improvement in



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the Bureau of Labor Statistics' JOLTS job openings survey in February 2014 to the strongest level since 2008. Headline and core CPI both rose 0.2 percent in March from February, basically matching the Fed's target; in year-ago terms, headline and core prices rose 1.5 and 1.7 percent, respectively.

CANADA: The Bank of Canada's monetary policy announcement today left the benchmark overnight rate unchanged at 1.0 percent as expected, and struck an optimistic note on the outlook for real GDP growth of roughly 2.5 percent in 2014 and 2015. The BoC expects headline CPI inflation to be near the 2.0 percent target in 2014 and 2015, although "the downside risks to inflation remain important"; core inflation is expected to remain closer to 1.0 percent. The BoC also emphasized that stronger growth "hinges critically on the projected upturn in exports and investment." Since a weaker and more competitive exchange rate would make business investment more attractive and aid exports, Governor Poloz's focus on these sources of demand is a not-terribly-discreet reminder that he is all too happy to see the Canadian dollar weak against the U.S. dollar.

MEXICO: More signs of stabilization in February, behind the headline figure: industrial production rose a weak 0.7 percent in year-ago terms in February, little changed from January's 0.8 percent year-ago increase. But the composition of industrial growth suggests the economy could be stabilizing: after adjustment for seasonal variation, manufacturing output rose a decent 0.2 percent in February from January; construction output rose a large 1.2 percent, reaching the strongest level since June 2013; and mining output rose 0.5 percent; electricity generation fell for a second consecutive month in February, though. Overall, industrial output rose a decent 0.3 percent in February from January. While the prospect of a more market-oriented energy sector is exciting in the long-term, the more important driver of Mexican growth in 2014 will be manufacturing and construction, where growth seems to be stabilizing. This welcome pick-up will only slowly absorb the substantial slack in the country's labor market, meaning wage increases will probably stay modest in 2014, and overall price pressures will be benign. Domestic considerations are still fully supportive of the Bank of Mexico's expansionary monetary policy, and will likely stay that way for the remainder of 2014.

UNITED KINGDOM: The unemployment rate fell to 6.9 percent in February: as expected, this quarterly employment report brings the unemployment rate below the 7.0 percent threshold for considering a rate hike set by the Bank of England in 2013. As in the United States, a rate hike is no longer categorically ruled out by the central bank's forward guidance, although it is not expected in 2014. The employment report also showed real wages to be rising for the first time since 2010, another indication of a more normal British labor market: Average wage growth was 1.7 percent in year-ago terms in the three months to February, exceeding CPI inflation of 1.6 percent.

EUROZONE: Eurozone imports from outside of the currency union rose to €145.7 billion euros in February, a 0.6 percent increase from January, 2014; in year-ago terms, imports rose a modest 0.4 percent. Some of the modest year-ago increase is due to lower energy prices, but it also seems clear that the Eurozone's recovery is generating less demand for exporters in the rest of the world (including the United States) than is typical for a business cycle recovery. On balance it is good news for the longer term global outlook that growth in the Eurozone, especially its periphery, is better balanced than before the euro crisis. Nevertheless, the tepid recovery of Eurozone imports is another reason why export-dependent emerging market economies continue to disappoint in 2014.

JAPAN: Like the United States, Japan saw a winter slowdown due to harsh weather: industrial production fell 2.3 percent in February from January, consistent with manufacturing sentiment surveys showing a temporary drag from winter weather. It is possible that Japanese manufacturers will dial back production in the second quarter as the April 1st tax hike hits, but there is so far insufficient data to see when, or how, their reaction will play out.

BRAZIL: Domestic consumption growth continues to be the sunniest part of the Brazilian economy. Real retail sales rose 8.5 percent in year-ago terms in February 2014 (13.9 percent in nominal local currency terms), up from 6.4 percent real growth in January.

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INDIA: India's economic backdrop is still fragile. The Indian Ministry of Statistics and Programme Implementation's release last Friday of industrial production data for February 2014 showed an 1.9 percent drop in February from a year earlier. Manufacturing output fell even harder, 3.7 percent in yearago terms. Electricity output grew 11.5 percent in yearago terms in February 2014 from February 2013, but this certainly overstates the growth in Indian electrical generation: A late glacial melt and weak hydroelectric output hampered production in February 2013, depressing the base of comparison for this month's statistics. Room for stronger growth in 2014 seems limited for India: High albeit falling inflation is pressuring India's central bank to keep interest rates high, and foreign lenders can be expected to increase pressure on the government to rein in fiscal largesse after the end of elections currently underway.

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