April 23, 2014

GLOBAL ECONOMIC HIGHLIGHTS

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EUROZONE IMPROVES AGAIN; MONETARY POLICY NEUTRAL IN MEXICO AND CHINA, TRENDING TIGHTER IN BRAZIL

CHINA: The flash release of the HSBC manufacturing purchasing manager's index for China rose slightly to 48.3 in April from 48.0 in March, reaching a level consistent with year-ago real GDP growth of over seven percent. That is good enough for the Chinese government to feel comfortable leaving its policy stance in neutral - i.e., not expansionary - territory in April. A stabilizing PMI could also give the People's Bank of China the confidence needed to allow the exchange rate to revert to a stronger level, one consistent with market forces (although it is questionable whether the yuan's recent weakness had anything to do with economic fundamentals in the first place, as opposed to the central bank shaking out speculative investments in the currency). China is in the second quarter of what looks to be a third year of real GDP growth under eight percent, clearly the country's "new normal." Yet the continued slow pace of investment by private Chinese firms suggests uncertainty toward the country's economic fundamentals remains high. A credible reckoning of the legacy of the recent credit boom - the "potential risks to public finance and the financial system," in the Premier's phrase – would be a good start, but unfortunately seems unlikely in 2014.

UNITED STATES: More signs are trickling in showing the U.S. economy to be perking up after the winter slow patch. The Conference Board's Leading Economic Index for the United States rose 0.8 percent in March, as did the coincident index, by 0.2 percent. Like most broad-based U.S. economic indicators, the LEI and CEI point to stronger growth coming after the winter soft patch. Similarly, home sales should pick up over the course of 2014, although the pickup is not visible in the latest release: existing home sales fell 0.2 percent in March, the seventh decline in the past eight months. Existing home sales are down 15 percent from their recovery-to-date peak in July 2013, held back by tight inventories, higher mortgage interest rates, and probably also by some lagged effects of harsh winter weather.

CANADA: Retail sales rose 0.5 percent in February from a month earlier; excluding sales at gas stations, sales were up 0.8 percent. Retail sales volumes rose 0.1 percent from January 2014. In year-ago terms, total retail sales were up 3.7 percent, while sales excluding gas stations were up by less, 3.3 percent. February's okay retail sales growth would have been stronger if not for "pain at the pump" caused by the weaker Loonie, which raised consumer energy prices 4.4 percent from a year earlier in February, handily outpacing the increase in prices of domestically produced consumer goods. This is the flip side of a weaker currency, which boosts exports: important imported goods, like food and gasoline, become more expensive. Canadian households are, in effect, subsidizing their country's push for more competitive exports by paying higher prices at the pump.

MEXICO: No rate cut on the horizon in Mexico despite the highest unemployment rate in 25 months. The Mexican unemployment rate rose to 5.3 percent on a seasonally-adjusted basis in March, the highest since February 2012. The underemployment rate also rose in March 2014 to 8.6 percent from 8.3 percent in February. Both the unemployment and underemployment rates were higher than the same month of March 2013, when they were 4.5 percent and 7.8 percent respectively. Mexico's first quarter was wobblier than seemed possible on January first, although a steadily rising labor force participation rate means that the unemployment rate tends to overstate the degree of weakness in in the economy. Nevertheless, the Mexican economy is not yet firing on all cylinders. March's soft employment report was unsurprising, since

it followed a batch of soft reports for output indicators in early 2014. The labor market's substantial slack limits wage increases, holding back consumer spending power and growth of domestic demand. The soft patch is also likely already incorporated in the Bank of Mexico's policy stance, as signaled in the minutes of the March Monetary Policy Decision, which implied that the Bank would release a downgraded forecast for 2014's growth outlook at this coming Friday's meeting. Banxico currently is projecting 3.0-4.0 percent real GDP growth for the year, and a lower range of 2.6-3.2 percent seems justified by the data in hand for the first quarter. The policy implications of a softer growth outlook are limited – Mexico's central bank is very unlikely to cut rates in 2014 with the Fed taper proceeding.

UNITED KINGDOM: The Bank of England's *Agents' Summary of Business Conditions* survey for April showed measures of demand are strong, capacity utilization is "close to normal," and wage pressures and service price inflation are rising although still in ranges consistent with the 2.0 percent CPI inflation target. The minutes of the BoE's April 9 Monetary Policy Committee Meeting show the Bank's dovish stance unchanged, despite the many recent signs of a stronger British economy. The MPC minutes imply that market expectations for a first British rate hike in the first half of 2015 are well-founded: the MPC reiterated that normalization of interest rates would be "gradual" and that, when the rate hike cycle forecasted to begin in 2015 does end, the Bank Rate will likely settle at a level "materially below" its 5 percent average prior to the financial crisis.

EUROZONE: The flash manufacturing PMI release for April rose to 53.3 from 53.0 in March, and the flash services PMI rose to 53.1 from 52.2 in March. The services index reached a 34-month high, excellent news for the sector that provides most of the jobs in the Eurozone and other advanced economies. Given that the level of the unemployment rate, rather than its trajectory, plays a bigger role in determining the inflation rate, the European Central Bank is still likely to make monetary policy more expansionary in coming months. The PMI has only a secondary impact on the policy outlook for the Eurozone and its currency – the key to the forecast is still trend CPI inflation, which is likely to stay materially below the ECB's below-but-close-to-2-percent target in the remainder of 2014.

BRAZIL: The Brazilian unemployment rate fell to 5.0 percent in March 2014 from 5.1 percent in February, before seasonal adjustment – The Brazilian statistical authority does not release a seasonally-adjusted unemployment rate. On a seasonally-adjusted basis, the Brazilian unemployment rate would have likely reached 4.7 in March, another all-time low. In this tight labor market, employers are raising wages and improving employment conditions to keep workers, despite the slow pace of top-line economic growth. Median real incomes rose 3.0 percent in March from a year earlier, outpacing growth in the overall economy -- the latest read of which is last week's release of the IBC-Br index, the central bank's monthly proxy for real GDP growth, which showed a 2.4 percent seasonally-adjusted year-ago increase in February 2014. The number of workers with formal contracts in the private sector rose 2.0 percent from a year earlier in March 2014, showing a shift in employment from the informal to the formal sector. The Brazilian Institute of Geography and Statistics also released the mid-April report on consumer prices late last week, showing the CPI index rose 6.2 percent from a year earlier, unchanged after rounding from the March inflation report. The Central Bank of Brazil's April 2 monetary policy decision made the direction of monetary policy data-dependent in the second quarter, and these data argue for another interest rate hike. Inflation is solidly above the central bank's 4.5 percent target: Prices of imported goods are rising quickly, as are stickier prices of services, which provide a read on inflation's underlying trend. It still seems most likely that the current interest rate hike cycle will continue until the benchmark Selic rate reaches 11.50 to 11.75 percent, two to three 25 bps hikes in the future.

INDIA: Electrical generation by utilities rose 5.4 percent in year-ago terms in March, a moderate increase that looks to be more or less in line with India's overall pace of economic growth. Electricity output growth spiked in the same terms in February 2014 to 11.5 percent due to a misleading year-ago comparison with February 2013, when inclement weather reduced the glacial melt feeding hydroelectric power plants. The Indian economy is on pace for real GDP growth exceeding 5 percent in 2014, better than 2013.

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