

Global Economic Outlook – April 2006

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Global Summary: Solid Growth in First Quarter. Further Interest Rate Hikes, BoJ Joins

Growth: Solid Global Growth in First Quarter (Q1). United States (U.S.) & Europe Rebound

- U.S. rebounds to 5 percent growth and Eurozone to 2 percent in Q1. Japan strong. Growth remains buoyant in China and India; and solid in other emerging markets.
- Global economy on track to post stronger, more balanced growth in 2006.

Inflation: Headline Under Renewed Pressure. Core Contained

- A short-lived pullback in oil prices pushed headline inflation lower in the U.S. and Europe. The renewed surge in oil prices likely to push headline inflation higher in the U.S. and Europe in the second quarter (Q2).
- Core inflation remains contained, around 2.1 percent in the U.S. and around 1.3 percent in Europe. Japan's core inflation consolidating above zero, confirming the end of deflation.

Interest Rates: U.S. Federal Reserve (Fed) Hike in March - Likely in May. European Central Bank (ECB) Pause. Bank of Japan (BoJ) Moves to Zero Rates

- The Fed raised the fed funds rate to 4.75 percent in March, indicating it may not be finished with raising rates. With a tight labor market, the Fed is likely to hike again in May.
- The ECB is on hold at 2.5 percent in April and likely to pause again in May on concerns about rising Euro. ECB likely to raise rates further in H2 with growth rebounding, inflation above target, and strong credit growth.
- Policy shift by the BoJ ending quantitative easing (QE) and moving to the zero-interest-rate policy (ZIRP). No substantive change in policy yet as short-term interest rates remain at zero.

Currency: Dollar Falls

- With interest rate and growth differentials narrowing, dollar down against the Euro and Yen.

Corporate Profits: Solid, Earnings Surprise

- Strong profit growth with profit share of Gross Domestic Product (GDP) at record highs in all regions. U.S. after-tax corporate profits rose 11.7 percent in the Q4, up 39 percent year on year (YoY). Earnings continue to surprise on the upside. U.S. Q4 earnings per share (EPS) growth of 14 percent YoY, the 10th consecutive quarter of double-digit earnings growth.

Regional Outlook - USA, Europe, UK, Japan, China

USA Summary: Solid First Quarter Rebound! Fed Not Yet Done?

Growth: Sharp Rebound in Q1 from Q4 Pause. Slower Growth in H2 2006

- Strong momentum in Q1. Consumer spending and production data point to around 5 percent GDP growth.
- Growth outlook beyond Q1 is less optimistic. Leading economic and business confidence indicators, and housing market data point to slower growth in H2.

Inflation: Headline Under Pressure. Core Contained

- Headline inflation eased in February with a short-lived pullback in oil prices. Overall CPI falls back to a 3.6 percent rate. Overall CPI set to pick up again in March with a renewed surge in gasoline prices.
- Core inflation remains under control, around 2.1 percent annual rate.

Interest Rates: Fed Tightening Goes into Extra Innings

- The Fed raised the fed funds rate to 4.75 percent in March, indicating it *may* not be finished with hiking rates.
- Fed upbeat on the near-term outlook, cautious on the outlook beyond Q1, concerned about inflation risks.
- With the funds rate now above neutral, the economy likely to slow after Q1 rebound and core inflation under control, rates are close to a peak. However, with a tight labor market, the Fed likely to hike again in May.

Currency: Dollar in Modest Downtrend

- Dollar falls 2 percent against Euro in Q1. Flat against Yen.
- Further dollar weakness with narrowing of growth and interest rate gap. Growth rebound in Japan and Euroland is reducing U.S. growth advantage. ECB rate hikes and a policy shift in Japan (eventually leading to higher rates) narrowing the interest gap.

Europe Summary: Eurozone Solid in H1. More ECB Rate Hikes In Pipeline

Growth: Eurozone Recovery Gaining Momentum to Above-trend Growth. U.K. Remains Below-Trend

- Eurozone recovery gaining momentum. Business confidence strong. Consumer confidence in uptrend. Actual data on retail sales and business orders solid.
- Eurozone on track to above-trend growth in half year from January to June (H1), led by Germany and France. Solid 2 percent growth in Q1 and even stronger 2.5 percent growth in Q2.
- U.K. economy in a steady recovery from the consumer-driven weakness in early 2005. Housing market stabilizing, but labor market turning soft. Q1 growth tracking around 2 percent.

Inflation: Headline remains above ECB target. Core under control. ECB raises Inflation Forecast

- Eurozone: Headline inflation remains above ECB target in Q1. Core inflation well behaved, around 1.3 percent.
- ECB revises inflation forecast higher – expects inflation to remain above 2 percent target in 2006.
- UK: Headline inflation around 2 percent and likely to remain around Bank of England (BoE) target.

Interest Rates: Brief Pause. More ECB Rate Hikes in H2. BoE on Hold now. Further rate cuts in H2.

- ECB on hold at 2.5 percent in April and likely to pause again in May on concerns about rising Euro. ECB likely to raise rates further in half year from July to December (H2), with growth rebounding, inflation above target, and strong credit growth. Surging Euro likely to slow rate hike pace.
- U.K.: BoE remains on hold now. With a soft labor market dampening consumer spending, and inflation expected to fall below the BoE's 2 percent target, BoE likely to cut rates further in H2 2006.

Currency: Euro gains, Sterling Falls

- Euro gains 2 percent against the dollar in Q1 with growth gap and interest differential narrowing. Euro rises to record high against Yen.
- Soft growth and expectations of further BoE rate cuts keeps Sterling under pressure.

Japan & China Summary: Japan-Solid Growth To Continue; China-More Balanced Growth

Growth: Strong Momentum in Japan; China Remains on Cruise Control

- Japan's growth outlook upbeat with solid momentum in early 2006. Leading Economic Indicators and business confidence indicators in an uptrend. Real GDP in Q4 2005 was the highest in 11 years.
- Japanese economy now firing on all cylinders with strong consumption, business investment and exports.
- Chinese economy continues to power ahead. Growth pace expected to remain above 9 percent in 2006. Industrial output and fixed asset investment remain robust.
- Chinese government policy focus now on quality of growth, promoting consumption and rural development, de-emphasize investment spending, improving productivity and value added.

Inflation: Japan's Core Inflation Well in Positive Territory; Inflation Contained in China

- Core inflation consolidating above zero, up 0.5 percent for the fifth month. Increasing capacity utilization and tightening labor market should add to inflationary pressures, signaling an end to deflation.
- China headline consumer price inflation remains well behaved and eased to 0.9 percent after the recent up tick. Expect a slight up tick in 2006 with steadily increasing consumption, domestic oil price hikes and acceleration of money supply.

Interest Rates/Currency: BoJ Policy Shift; Pressure for further RMB Appreciation

- Monetary policy change by Bank of Japan ending QE and moving back to ZIRP. No material change in policy yet as short-term interest rates remain at zero.
- BoJ Policy change unlikely to affect the pace of Japan's economic recovery.
- Pressure on People's Bank of China to further appreciate the Yuan with President Hu Jintao to visit the US in April, the next G-8 meeting, and the US Treasury's semiannual report on currencies.

Disclosure:

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