Outlook and Market Review – First Quarter 2013

According to the preliminary announcement by the Bureau of Economic Analysis, the economy grew at a 2.5% annual rate in the first quarter of 2013. Sequestration began in March with only a small impact on first quarter growth, but the Congressional Budget Office estimates that the forthcoming $65 billion reduction in federal spending will lower growth for the year by about 0.5%. Growth in the 1.8% to 2% range is expected in the next few quarters with only slightly better growth going into 2014. The consensus of economists in the Survey of Professional Forecasters as well as those contributing to the Blue Chip Economic Forecast is for growth of no more than 3% for the next few years. In the five years since the Great Recession officially ended, the economy has not had growth as high as 3% in four successive quarters. Unemployment remains high at 7.5% and even with a stronger labor market overall, the unemployment rate is expected to remain above the Fed's announced target of 6.5% for several more years.

Consumers are keeping the economy above water even though wages and salaries are flat. Consumer spending grew at a 3.2% rate in the first quarter, but savings rates are falling and credit purchases are increasing. A rebound in housing prices and a raging bull market for stocks have bolstered consumer wealth to help support consumer spending, but these forms of support for spending are not permanent. With government spending at all levels in decline and with little permanent support for consumer spending, a serious improvement in growth requires stronger private investment and exports. Business confidence remains low and there is little hope for a significant overhaul of the tax code, entitlement revision, or deregulation in areas that would spur investment. Export-led growth is also unlikely given the overall global economic slowdown

With growth remaining low, inflation is expected to remain at or below the 2% to 2.5% target of the Fed well into 2015. The labor market is improving and monthly additions to payrolls should continue to be in the 165,000 to 185,000 range throughout the year. Even so, the unemployment rate is expected to remain above 7% for the remainder of 2013 and 2014. Global economic growth is sluggish overall with much of the Eurozone in recession in the first half of 2013.These conditions suggest a prolonged global "easy money" response that the U.S. and Japan have already adopted. Australia and the ECB (Eurozone central bank) have recently joined the bandwagon for monetary easing. With mounting sovereign debt in the last decade, central banks are left with little choice but to keep the cost of debt service low with easy money and low interest rates. Interest rates should remain low with a range of 1.7% to 2.1% for the ten-year Treasury. There is some concern that the raging stock market is pulling funds from bonds and putting downward pressure on bond prices and upward pressure on interest rates. This relationship is not severe at this point, partly due to a lack of investor confidence and sentiment. However, if confidence picks up and risk premiums collapse further, we may see interest rates move up.

What Forecasters Expect for GDP, Unemployment, Payrolls, and Inflation

Slow Growth, Slow Growth, and More Slow Growth - Recent revisions in forecasts from the Survey of 42 Professional Economists published by the Federal Reserve Bank of Philadelphia in April show little change in the outlook for growth in the U.S. economy. The panel expects growth to be slightly lower than expected in previous forecasts for the second and third quarters followed by slightly higher than previously expected growth in the fourth quarter of this year. The revised forecast calls for real GDP to grow at an annual rate of only 1.8% in the second quarter of this year followed by growth of 2.3% and 2.7% in the remaining quarters of 2013. Forecasts for GDP growth in 2014, 2015, and 2016 are all below the post-WWII average GDP growth rate of 3.2%.

While forecasters do not see much improvement in growth, they have a more optimistic view of the labor market. The unemployment rate is expected to fall to 7.1% in 2014, 6.6% in 2015, and 6.1% in 2016. The GDP growth projections by the forecasters seem too low for such an improvement in unemployment; nevertheless, even with the more optimistic employment expectations, the economy will generate an unemployment rate above the Fed's 6.5% target until 2016. Monthly job gains are expected to average 169,800 in 2013 and 180,400 in 2014. Such healthy job gains appear to out of line with the low GDP forecasts. Table 1 below summarizes the median (consensus) GDP, Unemployment Rate, and Increase in Monthly Payroll forecasts from the Philadelphia Survey of Professional Forecasters

Table 1. Survey of Professional Forecasters Median Forecasts and Revisions for GDP, Unemployment, and Payrolls

	Real GDP (%)		Unemployment Rate (%)		Payrolls (000s per month)	
Quarter	**Prior**	**New**	**Prior**	**New**	**Prior**	**New**
2013:Q2	2.3	**1.8**	7.7	**7.6**	154.2	**179.0**
2013:Q3	2.6	**2.3**	7.6	**7.5**	172.0	**142.7**
2013:Q4	2.5	**2.7**	7.5	**7.4**	180.4	**173.3**
2014:Q1	2.7	**2.5**	7.4	**7.3**	171.5	**179.0**
Annual	**Prior**	**New**	**Prior**	**New**	**Prior**	**New**
2013	1.9	**2.0**	7.7	**7.6**	164.1	**169.8**
2014	2.8	2.8	7.2	**7.1**	176.8	**180.4**
2015	2.9	**3.0**	6.7	**6.6**	N.A.	N.A.
2016	3.0	**2.9**	6.3	**6.1**	N.A.	N.A.

* Annual percentages
April 2013 Release

Green represents more optimistic revisions
Red represents more pessimistic revisions

Forecasters still see tame Inflation in the Short and Long Run - Forecasters in the Philadelphia Fed Survey see slightly lower inflation (both for the Headline CPI and PCE index measures) in the next five quarters. The forecasters expect second quarter 2013 headline CPI inflation to average 1.6 %, lower than the last survey's estimate of 2.1%. On a fourth-quarter over fourth-quarter basis, headline CPI inflation is expected to average 1.7% in 2013, down from 2.0% in the last survey. Over the next 10 years, 2013 to 2022, forecasters expect headline CPI inflation to average 2.3% at an annual rate and PCE inflation to average 2.0%.

Overall, inflation forecasts remain consistent with the low growth scenario. The economy is not likely to grow fast enough to put demand-pull pressures on prices. A weak global economy is expected to offer plenty of foreign competition that will help keep prices low. The implication is that low interest rates and easy money policies by the Fed and a large number of other foreign central banks are likely to persist into 2017 in response to weak economies and low inflation. Table 2 summarizes the median inflation forecasts from the 42 professional economists in the survey.

Table 2. Survey of Professional Forecasters Median Forecasts and Revisions for Inflation

	Headline CPI		Core CPI		Headline PCE		Core PCE	
Quarterly	**Prior**	**New**	**Prior**	**New**	**Prior**	**New**	Prior	**New**
2013:Q2	2.1	**1.6**	2.0	**1.9**	1.9	**1.4**	1.7	**1.4**
2013:Q3	2.1	**2.0**	2.0	2.0	1.9	**1.8**	1.8	**1.6**
2013:Q4	2.1	**2.0**	2.0	2.0	1.9	1.9	1.7	**1.8**
2014:Q1	2.1	**2.0**	2.0	2.0	2.0	**1.9**	1.8	**1.9**
2014:Q2	N.A.	2.2	N.A.	2.1	N.A.	2.0	N.A.	1.9
Annual	**Prior**	**New**	**Prior**	**New**	**Prior**	**New**	Prior	**New**
2013	2.0	**1.7**	1.9	**2.0**	1.8	**1.4**	1.6	**1.5**
2014	2.2	2.2	2.1	2.1	2.0	2.0	1.9	1.9
2015	2.3	2.3	2.2	**2.1**	2.0	2.0	1.9	1.9
Long Term	**Prior**	**New**	**Prior**	**New**	**Prior**	**New**	Prior	**New**
2013-2017	2.3	**2.2**	N.A.	N.A.	2.0	2.0	N.A.	N.A.
2013-2022	2.3	2.3	N.A.	N.A.	2.0	2.0	N.A.	N.A.

Data are Annual % changes
April 2013 Release

Green represents more optimistic forecasts
Red represents more pessimistic forecasts

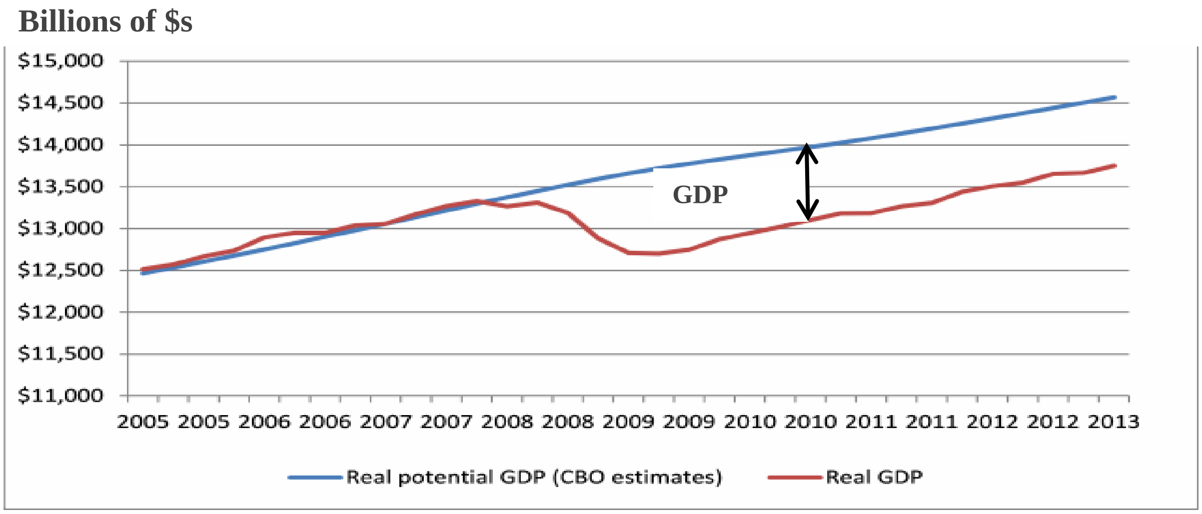
The Permanent Income Hypothesis and Chronic Underperformance

While first quarter growth of 2.5% is low for a recovery, it is higher than what might be expected based on the fundamentals of the economy. Unplanned inventory buildup was a large component of the 2.5% growth in the first quarter, which will lead to a drag on second quarter growth unless consumption takes another large leap forward. Consumer spending was robust in the first quarter but disposable income took a big hit from higher taxes. In the first quarter of 2013, real disposable income saw its biggest drop since 2009 while the savings rate fell to the lowest since the end of 2007. Consumers have pent up demand from the prolonged economic slump and the surge in spending appears to be driven by artificially low interest rates and corresponding increases in prices of houses and equities, making consumers feel wealthier.

The Permanent Income Hypothesis, a view linked to Nobel laureate Milton Friedman, maintains that consumption spending is ultimately driven by permanent income. Consumers separate temporary or transitory income from stable and predictable income when making spending decisions, especially for spending on durable goods. In the first quarter, consumers appeared to interpret the low interest rate environment and high equity return environment as permanent, since the more predictable source of income actually declined. The danger is that Fed policies are not permanent, even though they have been in place for an extraordinarily long time and appear to be on target for at least two more years. There is a fundamental imbalance between inflation, interest rates, and real rates of return on equity that is not sustainable in the long run. This imbalance is not just in the United States. Many countries are now using central banks to offset fiscal policy debt accumulation with low interest rate – easy money policies. This is uncharted territory on a global scale. There is no precedent for unwinding prolonged easy money policies in scenarios of massive sovereign debt, low inflation, low interest rate, high liquidity, and poor economic fundamentals.

One thing we do know is that this recovery is the weakest of the modern era. The economy remains far below its full potential. Industrial production remains below pre-recession levels and we still have a deficit of nearly 6 million full-time jobs (nearly 13 million if we account for population growth as well as jobs lost during the recession) to make up. The figure below illustrates the gap between potential and realized GDP based on estimates provided by the Congressional Budget Office. The economy will not be fully healed until this gap is closed, but the economy appears to be on a track that is not closing ground even after five years. Prolonging the current blend of monetary and fiscal policies without fundamental tax, entitlement, regulation, and government budgeting reforms is likely to keep the economy on the current path.

Figure 1. GDP Shortfall and Chronic Underperformance

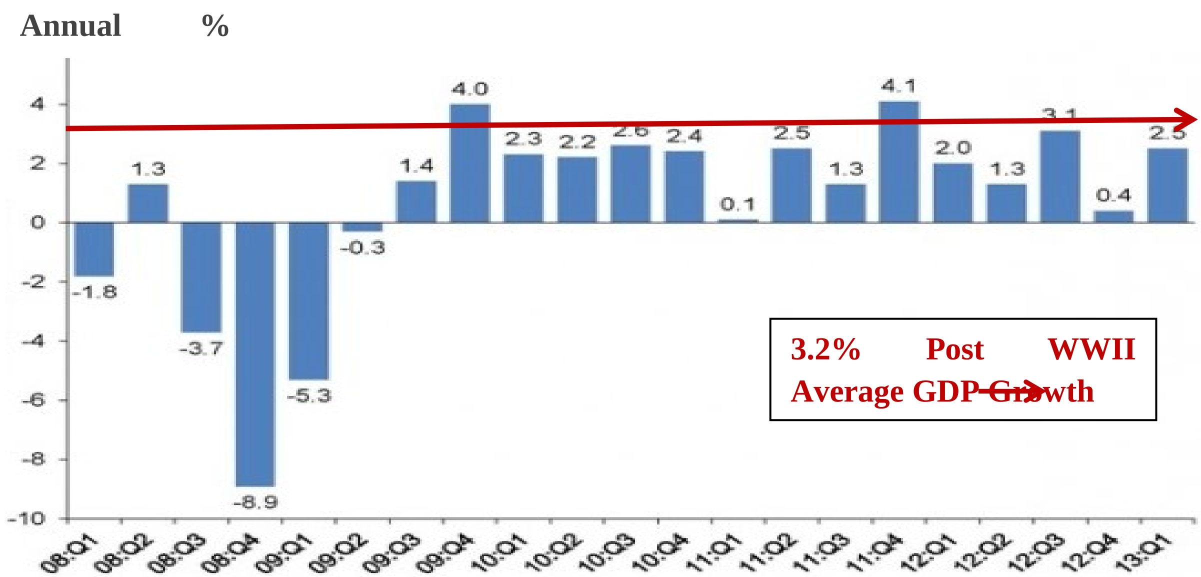


Summary of Recent Data

GDP– *Growth will continue to be slow and fragile. First quarter 2013 growth was spurred by consumer spending, inventory investment and, to a lesser extent, by residential investment, nonresidential investment, and exports. Government spending and imports were key drags on growth. Sequestration will play a role for the remainder of the year and is expected to reduce growth by about 0.5% for the year. Only two of the fifteen quarters of the "recovery" have exceeded the long run average 3.2% GDP growth rate.*

- The economy grew at a 2.5% annual rate in the first quarter of 2013, according to the "advance" estimate released by the Bureau of Economic Analysis. The estimate is based on source data that are subject to revision. Growth in the last quarter of 2012 was revised upward to 0.4%. Figure 2 below shows the GDP growth rates for the great recession and the recovery period.

Figure 2. Real GDP Growth by Quarter (2008 to Present)



- Consumer spending was the key driver of GDP in the first quarter. Real personal consumption expenditures increased 3.2%, compared with an increase of 1.8% in the fourth quarter. Spending on durable goods increased 8.1 % in the first quarter compared to the fourth quarter increase of 13.6%. Nondurable good consumption increased 1.0% compared with an increase of 0.1% last quarter. Spending on services increased 3.1% in the first quarter compared with an increase of 0.6% in the prior quarter.

- Residential investment grew at a 12.6% rate in the first quarter and has increased for eight quarters in a row. Real nonresidential fixed investment increased 2.1% in the first quarter, compared with an increase of 13.2% in the fourth. Nonresidential structures decreased 0.3%, in contrast to an increase of 16.7% last quarter. Equipment and software increased 3.0%, compared with an increase of 11.8%.

- Real exports of goods and services increased 2.9% in the first quarter, in contrast to a decrease of 2.8% in the fourth. Real imports of goods and services increased 5.4%, in contrast to a decrease of 4.2% in the fourth quarter.

- Real federal government consumption expenditures and gross investment fell 8.4% in the first quarter, compared with a decrease of 14.8% in the fourth. National defense spending fell 11.5%, following a decline of 22.1% in the first quarter. Nondefense government spending fell 2.0%, in contrast to an increase of 1.7% in the fourth quarter. Real state and local government consumption expenditures and gross investment fell 1.2%, compared with a decline of 1.5% last quarter.

- The change in real private inventories added 1.03% points to the first-quarter change in real GDP after subtracting 1.52% points from the fourth-quarter change. Private businesses increased inventories $50.3 billion in the first quarter, following increases of $13.3 billion in the fourth quarter and $60.3 billion in the third.

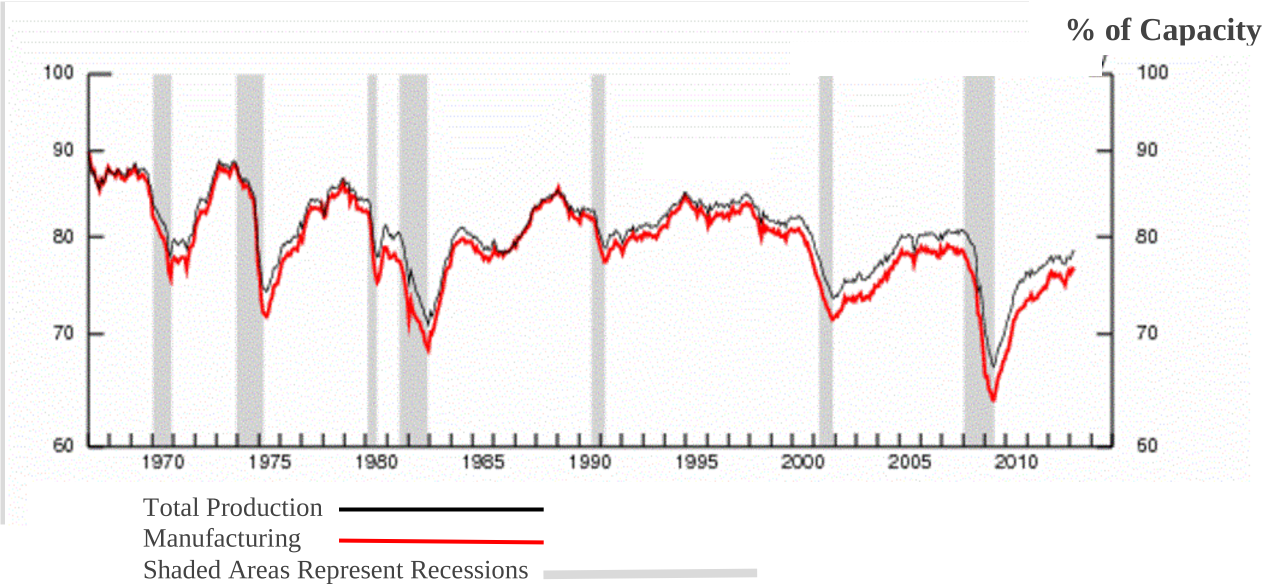
- Real final sales of domestic product -- GDP less change in private inventories -- increased 1.5% in the first quarter, compared to a 1.9% increase in the fourth.

- Sequestration began on March 1 and had only a modest impact on first quarter growth. Yet, a general slowing of government spending detracted from growth in the first quarter. Federal defense spending fell 11.5% at an annual rate in the first quarter while federal nondefense spending declined at a 2.0% rate. State and local government purchases fell at a 1.2% rate.

- Industrial production rose 0.4% in March after increasing 1.1% in February. For the first quarter as a whole, output moved up at an annual rate of 5.0%, its largest gain since the first quarter of 2012. Manufacturing output edged down 0.1% in March after rising 0.9% in February; the index advanced at an annual rate of 5.3% in the first quarter.

- At 99.5% of its 2007 average, total industrial production in March was 3.5% above its year-earlier level. The rate of capacity utilization for total industry moved up in March to 78.5%, a rate that is 1.2% points above its level of a year earlier but 1.7% points below its long-run (1972--2012) average. Figure 3. illustrates the longer term view of both total and manufacturing capacity utilization.

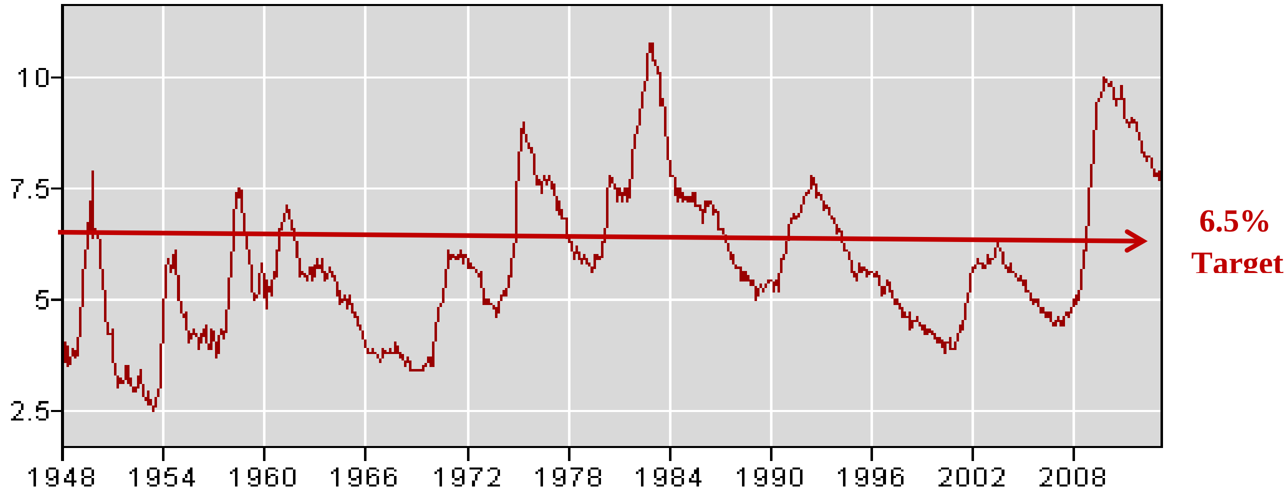
Figure 3. Industrial Production Capacity Utilization



Unemployment and the Labor Market – *The unemployment rate inched down to 7.5% in April from 7.9% at the start of the year. The total unemployment rate adjusted for marginally attached and part time workers declined to 13.9 % from 14.4% in January. Wages and benefits continue to increase at about the same rate as inflation. Overall, the labor market is improving but at a painfully slow pace. It will take many quarters of improvement at this pace to eventually lower unemployment to the Fed's 6.5% target.*

- The unemployment rate in April was 7.5%, with 11.7 million unemployed. Figure 4. below plots unemployment since 1948 relative to the Fed's 6.5% target.

Figure 4. Unemployment Rate (Monthly from 1948 to 2013)



- The total unemployment rate (U-6), which includes all persons marginally attached to the labor force plus total employed part time for economic reasons, plus all persons marginally attached to the labor force was 13.9 % in April compared to the 14.4% rate in January. Table 3 shows the movement in both U-3 and U-6 since December of 2012.

Table 3. Seasonally Adjusted Unemployment Rates (April 2012 to April 2013)

	Dec. 2012	**Jan. 2013**	**Feb. 2013**	**Mar. 2013**	**April 2013**
U-3 *Official Unemployment Rate*	7.8	7.9	7.7	7.6	7.5
U-6 *Total unemployment plus marginally attached workers plus total part time workers as a %age of the civilian labor force.*	14.4	14.4	14.3	13.8	13.9

- The labor force participation rate in April declined to 63.3% compared to the 63.6% rate in January. The employment-population ratio was 58.6% in April and has shown little movement over the past year.

- The number of long-term unemployed (those jobless for 27weeks or more) declined by 258,000 to 4.4 million in April. Over the past 12 months, the number of long-term unemployed has decreased by 687,000.

- The number of involuntary part-time workers increased in April by 278,000 to 7.9 million, largely offsetting a decrease in March.

- In April, 2.3 million persons were marginally attached to the labor force, essentially unchanged from a year earlier. These individuals were not counted as unemployed because they had not searched for work in the 4 weeks preceding the survey.

- The average workweek for employees on private nonfarm payrolls fell by 0.2 hour in April to 34.4 hours. Within manufacturing, the workweek decreased by 0.1 hour to 40.7 hours, and overtime fell by 0.1 hour to 3.3 hours. The average workweek for production and nonsupervisory employees on private nonfarm payrolls fell to 33.7 hours.

- The average hourly earnings for all employees on private nonfarm payrolls rose by 4 cents to $23.87 in April. Over the year, average hourly earnings increased by 1.9%.

- Compensation costs for civilian workers increased 0.3 %, seasonally adjusted, for the 3-month period ending March 2013, essentially unchanged from the 0.4% increase for the December 2012 3-month period.

- Benefit costs increased 1.9% for the 12-month period ending March 2013, down from the March 2012 increase of 2.7%.

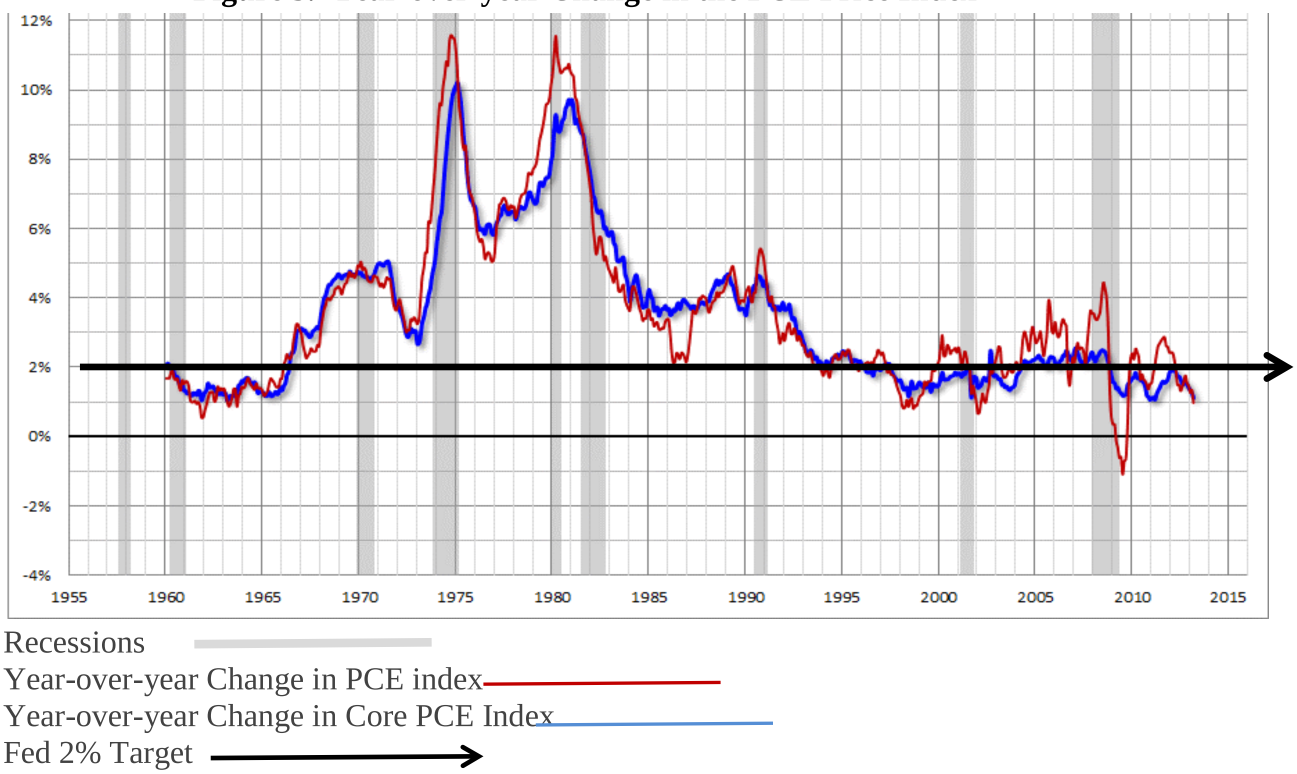
- Total compensation costs for civilian workers increased 1.8% for the 12-month period ending March 2013 following the 1.9% increase for the 12-month period ending March 2012. Wages and salaries increased 1.6% for the current 12-month period. In March 2012 the 12-month increase was 1.7%.

- Nonfarm business sector labor productivity increased at a 0.7% annual rate during the first quarter of 2013. The increase in productivity reflects increases of 2.5% in output and 1.8% in hours worked. From the first quarter of 2012 to the first quarter of 2013, productivity increased 0.9% as output and hours worked increased 2.5% and 1.5%, respectively. Unit labor costs in nonfarm businesses increased 0.5% in the first quarter of 2013. Unit labor costs rose 0.6% over the last four quarters.

Inflation - *The December 12, 2012 Federal Open Market Committee minutes affirm the commitment to a 0% to 0.25% Fed Fund rate as long as the unemployment rate exceeds 6.5% and inflation is no more than 0.5% above the long run 2% target. Inflation has been below the Fed's target and falling over recent months. Economic conditions remain too weak for significant inflation pressures at either the consumer or producer levels, even with the massive expansion of bank reserves by the Fed.*

- In April, the year-over-year PCE price index increased by only 0.97% following the 1.34% rate in March. The year over year increase in the core PCE in April was 1.13% compared to the 1.29% increase measured in March. The figure below illustrates the monthly year-over-year change in the PCE inflation indexes.

Figure 5. Year-over-year Change in the PCE Price Index



- Over the last 12 months, the Consumer Price Index for All Urban Consumers (CPI-U) increased only 1.5% before seasonal adjustment. The index fell 0.2% in March on a seasonally adjusted basis.

- Over the last 12 months the "core' CPI-U index increased 1.9%. The food index rose 1.5% and the energy index declined 1.6% over this period.

- The price index for gross domestic purchases, which measures prices paid by U.S. residents, increased at an annualized rate of 1.1% in the first quarter, compared with an increase of 1.6% in the fourth. Excluding food and energy prices, the price index for gross domestic purchases increased at a 1.3% annualized rate in the first quarter, compared with an increase of 1.2% in the fourth quarter.

- Based on data from the U.S. Bureau of Labor Statistics, the Producer Price Index for finished goods fell 0.6% in March while finished goods prices rose 0.7% in February and 0.2% in January. At the earlier stages of processing, prices received by manufacturers of intermediate goods fell 0.9% in March, and the crude goods index declined 2.5%.

- Prices for finished goods increased 1.1% for the 12 months ended March 2013, the smallest year-over-year advance since a 0.5% rise in July 2012.

Sentiment and Confidence - *Consumer Confidence improved in April, as consumers' expectations about the short-term economic outlook and their income prospects improved. Confidence however remains fragile, and the needed overhaul of the tax code and entitlement system to get the economy moving is taking a back seat to social issues. Expectations are likely to bounce around over the course of the year and it is too soon to tell if confidence is actually on the mend. Much of the positive outlook depends on continued easy money policies of the Fed.*

- The Conference Board's Consumer Confidence Index® rebounded in April after falling in March. The Index reached 68.1 in April (1985=100) from 61.9 in March. The Present Situation Index increased to 60.4 from 59.2. The Expectations Index improved to 73.3 from 63.7 last month.

- Consumers' assessment of current conditions improved moderately in April. Respondents saying business conditions are "good" increased to 17.2% from 16.4%, while those stating business conditions are "bad" decreased to 28.1% from 29.1%. Consumers' assessment of the labor market was mixed. Those claiming jobs are "plentiful" edged up to 9.8% from 9.5%, however those claiming jobs are "hard to get" increased to 37.1% from 35.4%.

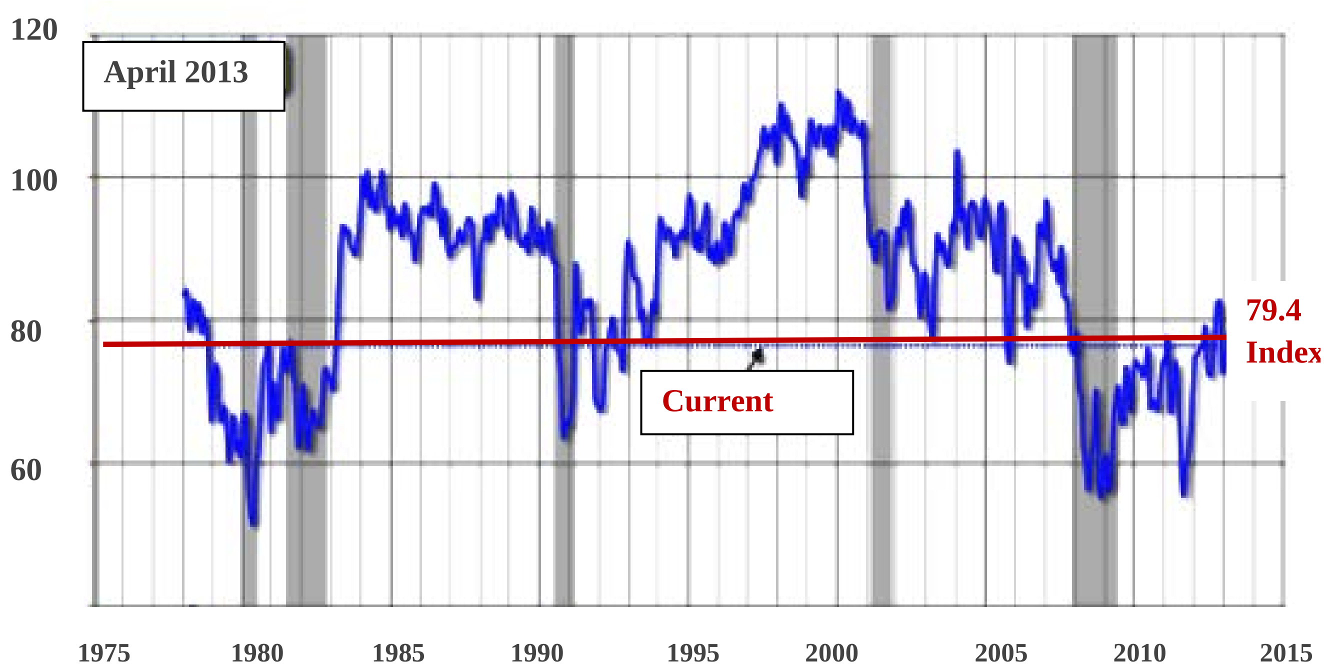
- Consumers were considerably more upbeat about the short-term outlook. The percentage of consumers expecting business conditions to improve over the next six months increased to 16.9 % from 15.0 %, while those anticipating business conditions to worsen decreased to 15.1% from 17.7%.

- Consumers' outlook for the labor market was also more positive. Those expecting more jobs in the months ahead improved to 14.2% from 13.0%, while those expecting fewer jobs decreased to 22.4% from 26.0 %. The proportion of consumers expecting their incomes to increase rose to 16.8% from 14.6%, while those expecting a decrease declined to 16.0% from 17.7%.

- The University of Michigan Consumer Sentiment final number for April was 76.4 compared to the preliminary reading of 72.3. The index was 78.6 in March.

- Figure 6 below provides a long term view of the University of Michigan Index. From the starting point in 1978, consumer sentiment is 10% below the average reading (arithmetic mean) and 9% below the geometric mean. The current index level is at the 29th percentile of the 424 monthly data points in this series. There is a long way to go to regain pre-recession levels of confidence.

Figure 6. University of Michigan Consumer Sentiment Index

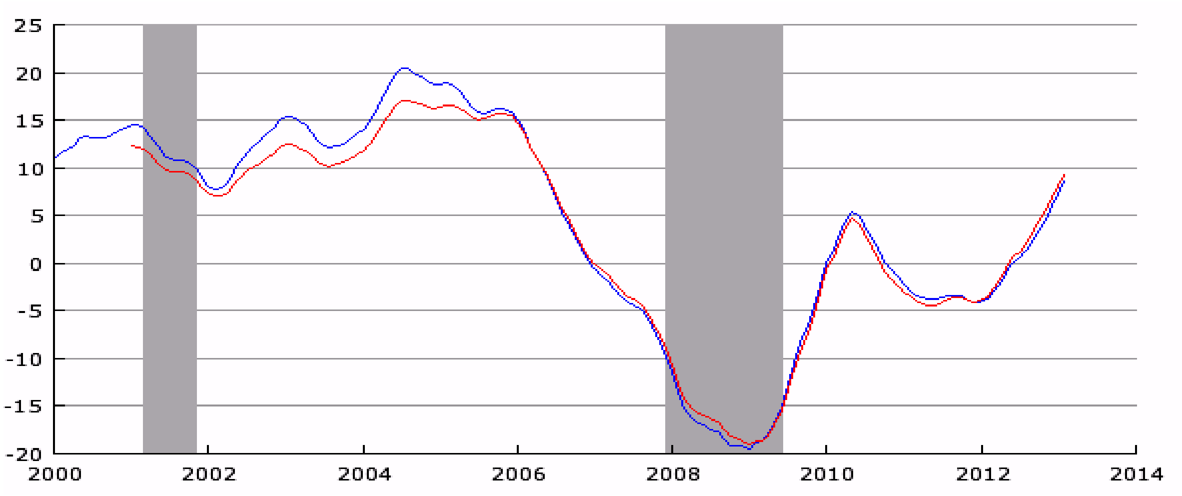


- The Conference Board Leading Economic Index® for the U.S. declined 0.1% in March to 94.7 (2004 = 100), following a 0.5% increase in February, and a 0.5% increase in January. The leading indicator still points to a continuing but slow growth environment. Key positive indicators are the favorable interest rate spreads and other financial components. Meanwhile, the coincident economic index, a measure of current conditions, is down since December due to a large decline in personal income.

Housing - *Home construction is rising and low mortgage rates are continuing to keep affordability conditions at historically favorable levels. The bad news is that underwriting standards remain tight even with ample bank liquidity. With rents increasing and home prices declining the affordability factor favoring rental versus owning is reversing. Improving housing prices are leading to rising equity values for many homeowners.*

- The non-seasonally adjusted Case-Shiller home price index (20 cities) for February 2013 (released in April) showed the ninth year-over-year gain in housing prices since the end of the housing stimulus in 2010. Figure 7. below shows the Case-Shiller index since 2000.

Figure 7. Case Shiller Home Price Index Prices Year-over-Year Change



Case Shiller 10-city Home Price Index
Case Shiller 20-city Home Price Index
Shaded Area Represents Recessions

- Home prices **increased** year-over-year 9.3% (versus the originally reported 8.1% in January).

- Excluding distressed sales, home prices increased on a year-over-year basis by 10.1 % in February 2013 compared to February 2012. On a month-over-month basis, excluding distressed sales, home prices increased 1.5 percent in February 2013 compared to January 2013.

- There is a strong demand relative to supply in the current housing market. Buyer traffic is 25 percent above a year ago when we were already seeing notable gains in shopping activity. In the same timeframe, housing inventories have trended much lower, which is continuing to pressure home prices. Homes are selling much faster. The typical home sold in March was on the market for one month less than it took to sell a year ago.

Summary of Key Global Economic Issues – *Europe continues to be in a recession and fiscal austerity is prolonging the recovery. The fiscal debt crisis in many of the EU countries is the prime reason why fiscal restraint is widespread. The EU and Australian central banks have now joined Japan and the U.S. with "easy money" approaches to address slumping economies. Currency battles are shaping up as easy money policies are causing a realignment of currency values to the detriment of hard currency countries such as China.*

- In its spring economic forecast, the EU said that gross domestic product in the 17 member countries that use the euro will shrink by 0.4% this year. This is better than the 0.6% contraction in 2012 but 0.1% worse than the EU had forecast back in February. The report also had bad news for the wider 27-country EU: it now expects the region's economy to shrink by 0.1% in 2013, against a forecast of 0.1% growth in February.

- With a population of more than half a billion people, the EU is the world's largest export market. If the region's economy remains stuck in reverse, order books for companies in the U.S. and Asia will be hit.

- March data for industrial production and industrial trade confirm that France officially re-entered recession in the first quarter of 2013. Final figures are expected to show that French GDP fell by around 0.2% in 2013's first quarter, following 2012's fourth quarter contraction of 0.3%. With key indicators in decline for two consecutive quarters, France will officially be considered in recession. The recession will likely deepen in Q2. By rejoining the southern and peripheral economies in recession, France's outlook does not bode well for the Eurozone. France is the second largest economy in the EU.

- The EU forecasts GDP growth in Germany, Europe's largest economy, will fall from 0.7% in 2012 to 0.4% this year as demand from other parts of Europe falls.

- The European Central Bank cut its benchmark interest rate a quarter-point to a record low of 0.50%. The ECB president noted that the bank is prepared to act if needed.

- Unemployment across the EU is expected to hit an average of 12.2% this year, up from 11.4% in 2012. In both Greece and Spain it is expected to peak at 27%.

- Industrial production in China for April rose 9.3% from a year earlier, improving from a gain of 8.9% in March, and a 9.9% rise for the January-February period. April's growth data confirmed that China's rebound continued into the second quarter. However, China faces external headwinds, excess capacity and unexpected moderation of investment growth. Consumer demand remains resilient.

- China's economic data is not bad enough to trigger policy easing. Rather, China is most likely to continue policy tightening on credit growth. April monetary data suggests that the tightening has already started. Real GDP growth will slow to 7.5% in Q2 due to policy tightening.

- Central banks in Japan, Australia, and the Eurozone have all recently joined the U.S. in "easy money" policies. At some point China will need to respond to the systematic appreciation of its currency that is occurring relative to major trading partners and competitors.