Outlook and Market Review – Fourth Quarter 2013

Economic growth remains sluggish and inflation is not on the radar screen. The Bureau of Economic Analysis revised fourth quarter GDP growth to a 2.4% rate following a revised third quarter 2013 rate of 4.1%. Inventory accumulation boosted third quarter growth but then bled some growth away from the fourth quarter. For all of 2013 GDP growth was only 1.9%. Inflation on both consumer and producer levels is well below 2% and there are no signs that it will pick up in 2014. Low and declining rates of inflation are now a global phenomenon and there is concern that disinflation will make it harder to achieve higher growth rates, since low inflation discourages immediate consumption and hurts borrowers. While the deficit is getting smaller due to cuts in defense and discretionary spending, national debt is expected to continue to grow by approximately $500 billion over the course of the fiscal year. Higher revisions to affordable Health care Act costs will present a major obstacle to controlling entitlement spending. Many economists to include Alan Greenspan, the former Fed Chair, are now pointing to the large and growing debt of the U.S. government as the major obstacle to future growth.

The Fed is likely to maintain a slow but sure approach to tapering its monetary expansion program. While growth is sluggish the unemployment rate is 6.7%, not far away from the 6.5% preliminary target the Fed set last year. Additional reductions in the unemployment rate will be harder to achieve as worker participation picks up with expected increases in job opportunities. Wages are barely keeping up with inflation making it harder for households to cover spending with disposable income. Household credit is growing rapidly in part due to perceived higher levels of wealth in housing and equity-based holdings. Housing prices and stock prices remain on the upswing overall but they are both vulnerable to higher interest rates if the Fed does not manage the tapering program well. The Fed is likely to offer forward guidance that emphasizes flexibility with a willingness to respond if the economy slows. Long term rates will likely edge up slowly throughout the year with the 10 year Treasury approaching 3%.

Consumers make up 70% of GDP and have helped keep GDP growth as high as it is. Government has been a drag on growth and investment spending has not reached its full potential given the level of corporate profits and liquidity in the economy. A continuation of the cyclical rebound will require sustained growth in consumer income along with improvement in investment in real assets. A secular spurt to GDP could come from oil exploration, drilling, and pipeline investments along with investment in new technology to include 3D printing and information "cloud" development. Without secular innovations and renewed growth potential the economy may be stuck on low growth and low inflation for some time.

The International Monetary Fund (IMF) is predicting 3.7% global growth for 2014. Advanced economies are only expected to grow 2.2% with emerging economies forecasted to grow at 5.1%. India is expected to grow 5.1% and Russia has been revised downward to 2%. China posted a 7.7% growth rate in 2013 but large downward revisions are likely.

Forecasters See Low First Quarter 2014 Growth and Slow Improvement

The most recent survey of the 45 professional forecasters by the Philadelphia Federal Reserve Bank provided a less upbeat view of GDP growth and payroll expansion for the first quarter of 2014 but a brighter picture for the unemployment rate. The forecast for first quarter GDP growth fell from 2.5% to only 2.0% with a lower monthly payroll expansion from 187,000 to 177,400. Unemployment was expected to be 7.1% at the end of the first quarter but was revised to 6.7%.

For the remainder of 2014, forecasters see higher GDP growth than predicted in prior forecasts, with the exception of a slightly lower growth in the third quarter of 2.8% rather than 3%. The expected growth for all of 2014 is 2.8%. While the forecasted GDP growth rate is below trend growth, it represents moderate improvement in the overall economy. Forecasters are more optimistic on the unemployment front with an expected 6.3% unemployment rate by the end of the year. Such an expectation is probably overly optimistic if the labor force participation rate improves with the economy. It is important to note that forecasters are expecting the economy to hit an unemployment rate below the Fed's unofficial target of 6.5% by the end of the year, suggesting room for a faster tapering of monetary stimulation. Table 1 below summarizes the quarterly forecasts of GDP growth, unemployment rate, and payroll growth by quarter for 2014. More optimistic updates are noted in green and less optimistic updates are noted in red.

Table 1. Survey of Professional Forecasters' 2014 Quarterly Estimates and Revisions for GDP Growth, Unemployment Rate, and Monthly Job Payrolls

	Real GDP (%)		Unemployment Rate (%)		Payrolls (000s/month)	
Quarter	**Prior**	**Update**	**Prior**	**Update**	**Prior**	**Update**
2014: Q1	**2.5**	**2.0**	**7.1**	**6.7**	**187.0**	**177.4**
2014: Q2	**2.9**	**3.0**	**7.0**	**6.6**	**193.5**	**193.5**
2014: Q3	**2.9**	**2.8**	**6.9**	**6.4**	**201.8**	**195.2**
2014:Q4	**2.0**	**2.7**	**6.8**	**6.3**	**202.1**	**215.0**

Note: Forecast updates as of 2/14/2014

Longer Run Forecasts are More Optimistic – But Growth is Still Low

The forecasters in the Survey of Professional Forecasters boosted their outlook for growth in the U.S. economy over the next three years. Table 2 provides a summary of the consensus forecasts. Forecasters see real GDP growing 2.8% in 2014, up from the prediction of 2.6% in the last survey. Real GDP is expected to grow by 3.1% in 2015, higher than their prediction of 2.8% in the last survey. For 2016, the forecast for real GDP growth, at 3.1%, is 0.4% point higher than the last survey.

Overall, forecasters have a brighter outlook for the unemployment rate as well as a more positive outlook for growth beyond 2014. Forecasters predict that the unemployment rate will be an annual average of 6.5% in 2014, before falling to 6.1% in 2015, 5.7% in 2016, and 5.5% in 2017. The projections for 2014, 2015, and 2016 are below those of the last survey. The unemployment

forecasts are all below the Fed target of 6.5% and assume significant inroads will be made in reducing structural unemployment. Forecasters see little change in job growth in 2014. Projections for the annual-average level of nonfarm payroll employment suggest job gains at a monthly rate of 187,700 in 2014 and 206,900 in 2015. (Annual-average estimates are the year-to-year change in annual- nonfarm payroll employment, converted to a monthly rate.)

Table 2. Survey of Professional Forecasters' Long Run Annual Estimates and Revisions for GDP Growth, Unemployment Rate, and Monthly Job Payrolls

	Real GDP (%)		Unemployment Rate (%)		Payrolls (000s/month)	
Quarter	Prior	Update	Prior	Update	Prior	Update
2014	2.6	2.8	7.0	6.5	189.9	187.7
2015	2.8	3.1	6.4	6.1	N.A.	206.9
2016	2.7	3.1	6.0	5.7	N.A.	N.A.

Note: Forecast updates as of 2/14/2014

Forecasters See Lower Inflation – No Price Pressure from Slow Expansion

Current-quarter headline CPI inflation is expected to average 1.7%, slightly lower than the last survey's already low estimate of 1.8%. Current quarter headline PCE inflation is expected to be 1.3%, well below the prediction of 1.8% from the survey of three months ago. Table 3 presents the quarterly estimates of inflation for both the CPI and PCE.

Table 3. Survey of Professional Forecasters' Quarterly Inflation Estimates and Revisions for the Consumer Price Index (CPI) and Personal Consumption Expenditure Indexes

	Headline CPI (%)		Core CPI (%)		Headline PCE (%)		Core PCE	
Quarter	Prior	Update	Prior	Update	Prior	Update	Prior	Update
2014: Q1	1.89	1.7	1.9	1.8	1.8	1.3	1.7	1.5
2014: Q2	2.0	1.7	1.9	1.8	1.9	1.5	1.8	1.5
2014: Q3	2.0	1.9	2.0	1.9	1.9	1.7	1.7	1.6
2014:Q4	2.1	2.0	2.0	1.9	1.9	1.7	1.8	1.7

Note: Forecast updates as of 2/14/2014

Lower inflation is expected for the next two years (see Table 4). Measured on a fourth-quarter over fourth-quarter basis, CPI inflation is expected to average 1.8% in 2014, down from 2.0% in the last survey, and 2.0% in 2015, down 0.2% from the previous estimate. Forecasters expect fourth-quarter over fourth-quarter headline PCE inflation to average 1.6% in 2014, down from 1.9% in the last survey, and 1.8% in 2015, down 0.1% from the previous estimate.

Table 4. Forecasters' Long Run Annual Inflation Estimates and Revisions for the Consumer Price Index (CPI) and Personal Consumption Expenditure (PCE) Indexes

	Headline CPI (%)		Core CPI (%)		Headline PCE (%)		Core PCE	
Quarter	Prior	Update	Prior	Update	Prior	Update	Prior	Update
2014	2.0	1.8	2.0	1.9	1.9	1.6	1.7	1.6
2015	2.2	2.0	2.1	2.0	1.9	1.8	1.9	1.8

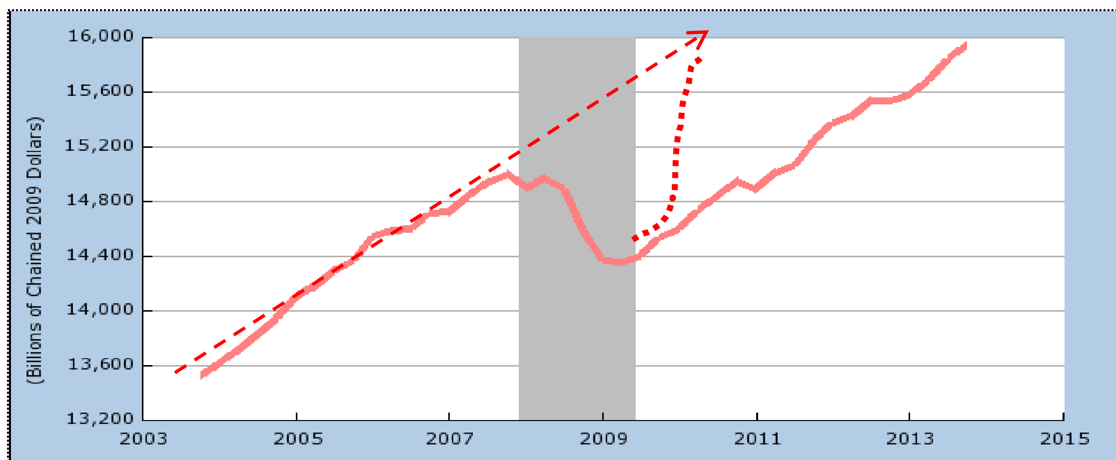
Note: Annual forecasts are from fourth quarter to fourth quarter. Forecast updates as of 2/14/2014

Higher growth predictions do not translate into higher inflation in the forecasts, even for the very long run. Over the next 10 years (2014 to 2023) the forecasters expect headline CPI inflation to average 2.3% at an annual rate. The corresponding estimate for 10-year annual-average PCE inflation is 2.0%. With expected inflation rates around 2% and GDP growth around 3% the long run 10-year Treasury would be around 5% in the absence of Fed intervention.

Equity Valuation and Corporate Fundamentals are Good – What is Holding GDP Back?

The U.S. economy is currently in the slowest recovery from a recession in history. The figure below shows the potential GDP trend line (dashed line) the economy should be tracking compared to the current track (solid line) and a normal recovery typically looks like (dotted line).

Figure 1. Real GDP, GDP Trend, and Normal Recovery to GDP Trend



Note: Shaded areas represent the Great Recession

Actual GDP ——— **Trend GDP** - - - - - - **Normal Recovery Path** ········

The bull market for U.S. stocks reached its fifth anniversary while the economy muddled along in a muted recovery. The S&P 500 has appreciated 175% since bottoming in March 2009. The Schiller S&P 500 cyclically adjusted price-to-earnings ratio is currently around 25.4 versus the historical average of around 15.5, suggesting that current equity values are high. However, high price-to-earnings can be justified if expected growth in earnings is strong or if interest rates are very low. While GDP growth has been slow corporate earnings continue to outpace expectations and interest rates are at historic lows. Another factor in favor of sustaining such high equity values is the fact that there is so much wealth sitting in risk-free and short-term financial assets that could be invested in equities if future economic conditions and risks improve.

Bull Markets and the Fed

The last bull market that began in 1990 lasted nearly 10 years, with the S&P 500 rising more than 400% overall. The current bull market is only five years old but it has benefited from the

same monetary stimulation. Now, with decades of monetary stimulation coming to a slow end the next phase of a strong equity market will require stronger U.S. and global economic fundamentals. Dating all the way back to the Alan Greenspan years as Fed Chair, artificial credit conditions and low interest rates created by the Fed boosted U.S. equity prices by design. While Fed open market operations purchased Treasuries and other securities, fixed income prices moved higher and interest rates fell, prompting investors to move into higher-risk assets such as equities in search for returns. Ample liquidity and low interest rates created ideal conditions for leverage, enhancing both equity and private equity returns. Corporate earnings were maintained by cost cutting rather than revenue expansion. Now that the Fed is tapering its expansionary polices, the stock market should be more sensitive to fundamental economic performance rather than interest rates. The change may take time but expectations for real growth will be needed to keep equity values appreciating. The same argument can be made for housing prices. Lower interest rates and pent up demand have helped revive the real estate market but higher consumer income will be required to keep the housing revival moving as market interest rates slowly increase.

Strong Equity Markets need Growth and Growth needs Strong Equity Markets

The relationship between economic growth and equity values is not a one-way street. Equity values can continue to appreciate if the economy can generate more growth and spending by consumers and investors. Consumers and investors will have more wealth and confidence to spend if equity values appreciate. The current disconnect occurs for investment spending. Corporate profits have been growing at record levels but long term investment in real assets has fallen from about 8% of GDP in 2001 to only about 4% today. Household income has not kept up with spending. The savings rate has declined as consumption has grown to about 70% of GDP.

Consumer spending does not have sufficient backing from disposable income growth to be sustainable at a higher rate of GDP growth. Consumers now look at wealth rather than just income as the source of consumption financing. Rising housing and stock prices have helped fuel consumption beyond what income growth can support alone. Savings rates have fallen and use of credit has risen. Continued stimulus from consumption and investment now depends on sustained health in the value of real assets and stocks along with simultaneous increases in disposable income.

Former Fed Chair Alan Greenspan has explained that the trend of financing government deficit spending rather than investing in real asset accumulation is the key drag on growth. Greenspan’s view suggests that much of the $17 trillion plus federal debt represents lost growth opportunities. A long term plan to reduce debt accumulation without shocking the economy should get the economy back on track. Lower deficits still add to debt accumulation but at a slower rate. Real debt reduction will require a long-term plan accompanied by reforms that stimulate private investment and accumulation of real assets.

***GDP** – The Bureau of Economic Analysis revised Real GDP to 2.4% in the fourth quarter of 2013 compared to the preliminary announcement of 3.2%. Third quarter GDP was 4.1%. Downward revision of the fourth quarter growth rate was largely due to lower personal consumption expenditures than originally estimated.*

- Real final sales of domestic product (GDP minus the change in private inventories) increased 2.3% in the fourth quarter following an increase of 2.5% in the third. Inventory accumulation was the key difference between growth in the third and fourth quarters.

- The 2.4% fourth quarter GDP growth was largely driven by positive growth in personal consumption expenditures, exports, nonresidential fixed investment, and private inventory investment.

- Key negative contributions came from federal government spending, residential fixed investment, state and local government spending, and imports. Table 5 below summarizes the key changes in GDP components from the third to fourth quarters.

Table 5. Changes in Components of GDP in the Third and Fourth Quarters of 2014

GDP Component	Third Qtr. 2014	Fourth Qtr. 2014
Real Personal Consumption	2.0%	2.6%
Real Nonresidential Fixed Investment	4.8%	7.3%
Real Residential Fixed Investment	10.3%	**-8.7%**
Real Exports	3.9%	9.4%
Real Imports	2.4%	1.5%
Real Federal Government Spending	-1.5%	**-12.8%**
National Defense	-.5%	**-14.4%**
Nondefense Spending	-3.1%	**-10.1%**
Real State & Local Gov. Spending	1.7%	**-.5%**
Real Private Inventories	1.67%	0.14%

- Real personal consumption expenditures increased 2.6% in the fourth quarter, compared with an increase of 2.0% in the third. Nondurable goods purchases grew 3.5% while durable goods increased 2.5% and services increased 2.2%.

- Real nonresidential fixed investment increased 7.3% in the fourth quarter, compared with an increase of 4.8% in the third quarter. But, nonresidential structures increased only 0.2% compared with an increase of 13.4% in the prior quarter. Equipment increased 10.6%, compared with an increase of 0.2% in the third quarter.

- Real residential fixed investment fell 8.7% in the fourth quarter compared to an increase of 10.3 % in the third quarter.

- Real exports of goods and services increased 9.4% in the fourth quarter compared to a more modest increase of 3.9% in the third. Real imports of goods and services increased only 1.5% compared to an increase of 2.4% in the third quarter.

- Real federal government consumption expenditures and gross investment decreased 12.8% in the fourth quarter, compared with a decrease of 1.5% in the third. National defense decreased 14.4 %, compared with a decrease of 0.5%. Nondefense spending decreased 10.1%, compared with a decrease of 3.1% in the third quarter.

- Real state and local government consumption expenditures and gross investment fell 0.5%, in contrast to an increase of 1.7% in the third quarter.

- Real private inventories added 0.14% to the fourth-quarter change in real GDP after adding 1.67% points to the third-quarter change.

- The price index for gross domestic purchases increased 1.5% in the fourth quarter following a 1.8% increase in the third quarter. Excluding food and energy prices, the price index for gross domestic purchases increased 1.8% in the fourth quarter, compared with an increase of 1.5% in the third quarter.

***Manufacturing and Production** – Manufacturing increased 4.6% in the fourth quarter of 2013 but severe weather will dampen first quarter 2014 numbers. Retailers are showing confidence in consumers by increasing the inventory to sales ratios early in 2014. Higher inventories will create a drag on manufacturing if sales do not show higher growth in the next few months.*

- The preliminary announcement of 6.2% growth in manufacturing for the fourth quarter was revised downward to 4.6% in the most recent announcement.

- Manufacturing output fell 0.8% in January, partly due to severe weather that cut production in most of the country.

- Total industrial production in January was 2.9% above its level one year ago.

- The capacity utilization rate for total industry production fell to 78.5% in January. The January capacity utilization rate is 1.6% below its long run average (1972-2013) and the 85% utilization rate that is normally considered to be full capacity.

- Retail inventory to sales ratios have been slowly increasing since 2013, reflecting confidence in future sales growth and producing a positive contribution to economic growth. The Figure below illustrates this pattern.

Figure 2. Retail Inventory to Sales Ratio 2005 to 2014

Source: Federal Reserve Bank of St. Louis (FRED)

- Orders for manufactured goods fell 0.7% in January after a 2% decline in December. Durable goods orders declined 1%.

- The latest ISM nonmanufacturing survey in February fell more than expected to 51.6. The February decline places the index about 2.5 points below last year's fourth quarter average.

- The business activity index fell to 54.6 in February. The index is around 2.2 points below the average for 2013.

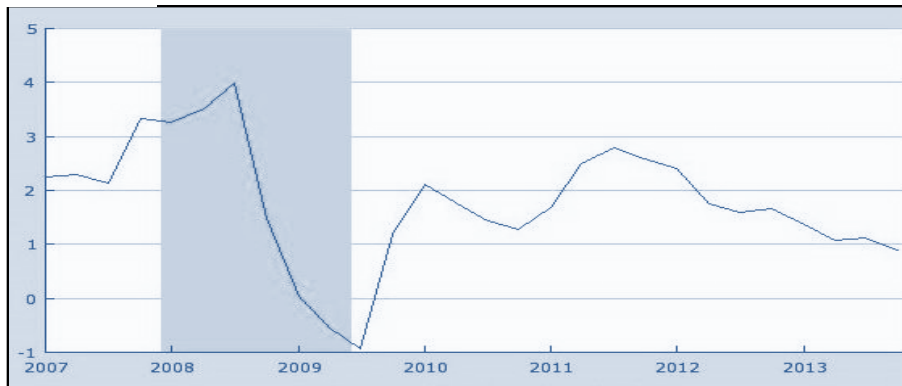
***Inflation** – Inflation rates remain below the Fed target. Inflationary pressures will remain low as long as the economy stays under the 85 % capacity utilization rate. The utilization rate was only 78 % at the start of 2014. While the economy is improving there are no pressures on wages or prices in the near future. Low inflation allows the Fed to set a very slow approach to tapering its bond purchasing program. The Fed would actually like to see the inflation rate pick up to help prompt more spending.*

- The Consumer Price Index for urban consumers (CPI-U) increased 0.1 % in January. January's increase was only the second positive reading in five months. The year-ago change of 1.6% is well below the Fed target.

- The Fed's preferred inflation gauge, the core PCE deflator, when measured on a year-ago basis, remained below 1.5% for all of 2013.
- The PCE price index has grown less than 1% over the past year (see Figure 3 below) — the lowest quarterly growth in inflation since 2009. While the rate is positive it may be considered "disinflationary."

Figure 3. Personal Consumption Expenditure (PCE) Inflation Index 2007-2014

Year Ago % Change



Source: U.S. Department of Commerce Bureau of Economic Analysis

- The ECRI future inflation index increased 2.7 points in February, rising from 101.4 to 104.1. Even with this modest gain the index is 1.2 points below the year-ago level. From a historical perspective the index is depressed. The average for the five years leading up the Great Recession was 119.2.

- The February increase in the ECRI index is the fourth in as many months but it is consistent with modest gains in both the consumer and producer price indexes.

- Core producer prices for consumer goods increased slightly by 0.1% in January while producer prices for core finished goods rose 0.4% during the same month. Producer prices fell 0.1% in February. Strong gains in finished food and energy indexes failed to make up for a sizable decline in the final demand services index. Year-ago growth in overall producer prices slowed to a modest 0.9% in February (see Table 6 below).

Table 6. Producer Price Index % Change from One- Year-Ago

	Feb '14	Jan '14	Dec '14	Nov '14	Oct '14	Sept '14	Aug '14	July '14
Year-ago % Change								
Final Demand	0.9	1.2	1.1	1.1	1.2	1.1	1.6	2.0
Core Goods	1.2	1.3	1.1	1.0	1.0	0.9	1.0	1.0

Source: Bureau of Labor Statistics

***Employment** – The labor market is improving with a 6.7% unemployment rate, but wages and income are not growing fast enough to sustain a level of consumer spending consistent with a normal expansion. Wages and salaries are barely keeping up with inflation. Income is lagging spending causing debt financing of consumption that is not sustainable for long run growth.*

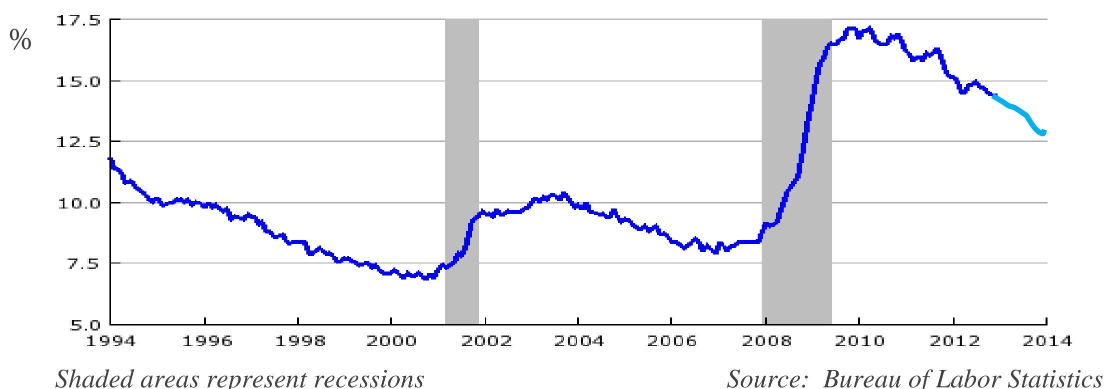
- Both the number of unemployed persons (10.5 million) and the unemployment rate (6.7%) changed little in February. The jobless rate has shown little movement since December. Over the year, the number of unemployed persons and the unemployment rate were down by 1.6 million and 1.0% point, respectively.

- The number of long-term unemployed fell 901,000 over the last year. More recently, the number of long-term unemployed (those jobless for 27 weeks or more) increased by 203,000 in February to 3.8 million. Long term unemployed account for 37.0% of the unemployed.

- In February both the civilian labor force participation rate (63.0%) and the employment-population ratio (58.8%) were unchanged. On a year-ago basis the labor force participation rate was down 0.5%. The employment-population ratio was little changed over the year.

- The U-6 unemployment rate represents total unemployed plus marginally attached workers plus part time workers for economic reasons. The U-6 rate fell to 12.6% in February. While the U-6 rate has been steadily declining, it remains well above the pre-recession level. Figure 4 below illustrates the pattern for U-6 since 1994.

Figure 4. U-6 Unemployment Rate 1994-2014

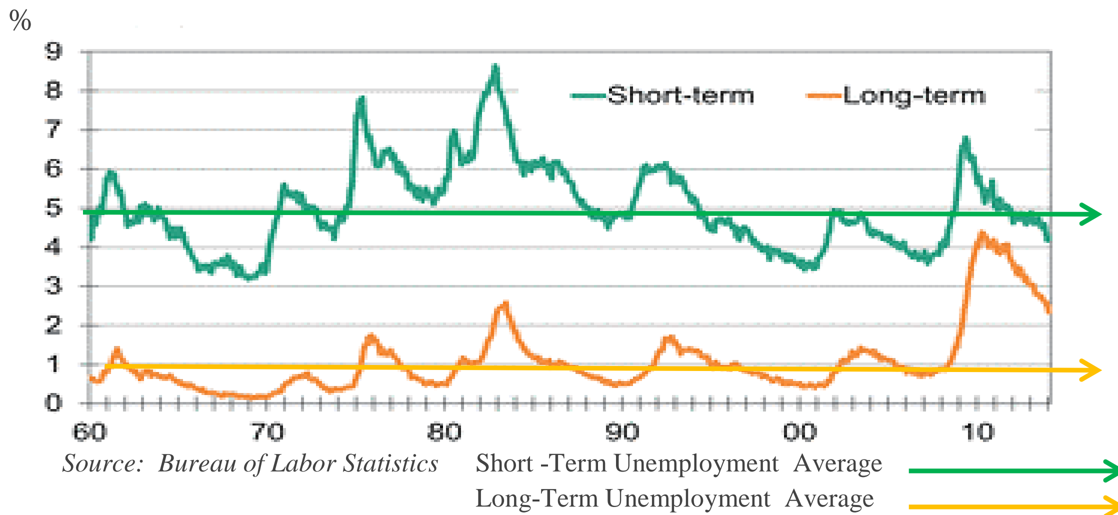


Shaded areas represent recessions *Source: Bureau of Labor Statistics*

- Wages and salaries rose 0.6% and benefit costs rose 0.6% for civilian workers, seasonally adjusted, from September to December 2013. Over the year, compensation rose 2.0%, wages and salaries rose 1.9%, and benefits rose 2.2%. Real wages and salaries (adjusted for inflation) are essentially flat.

- Short-term unemployment has just about returned to pre-recession levels and is just below the long term average. Long-term unemployment remains well above its past average. Figure 5 below illustrates this relationship.

Figure 5. Short-term and Long-term Unemployment Rate 1960-2014



Source: Bureau of Labor Statistics

Short -Term Unemployment Average
Long-Term Unemployment Average

- Figure 6 illustrates how discouraged workers are slowly returning to the work force. This pattern will lead to a higher labor participation rate but will also make it more difficult to lower the unemployment rate.

Figure 6. Discouraged Workers Returning to Work (in Thousands)

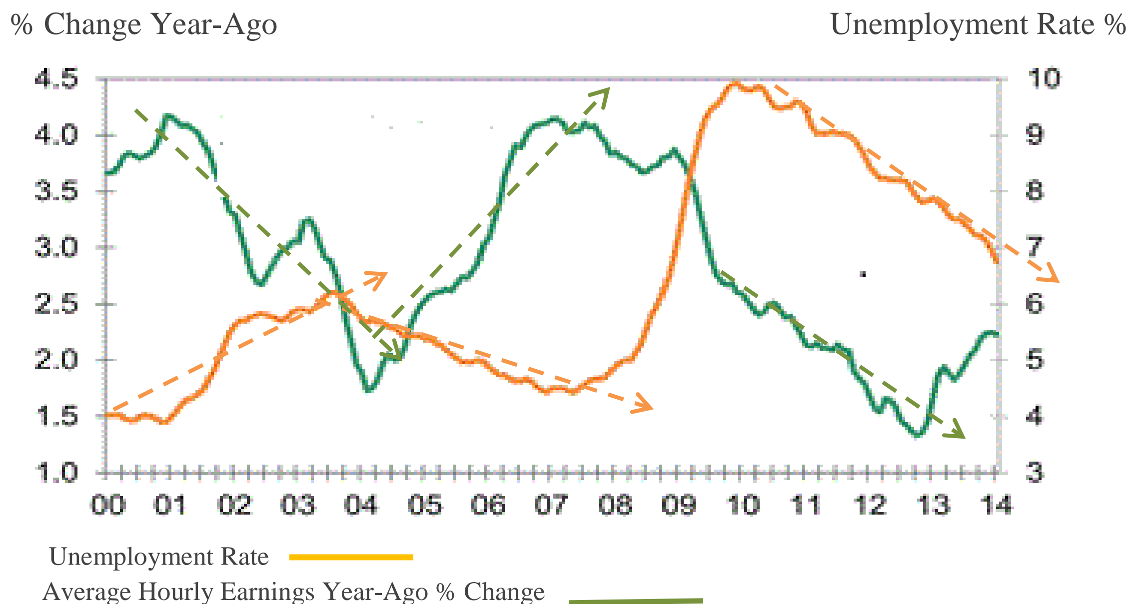
Source: Bureau of Labor Statistics

***Personal Income, Wages, and Credit** – Consumer spending is growing faster than disposable income, requiring higher debt financing to sustain growth in consumption. Real wage growth is flat and much of the impetus for consumer spending is linked to wealth increases due to rising equity and housing values.*

- Personal income grew 0.3% ($43.9 billion) in January while disposable personal income grew 0.4% ($45.2 billion). Personal consumption expenditures increased a bit more than 0.4% ($48.1 billion), outpacing disposable income growth.

- Falling unemployment rates should lead to tighter labor markets with rising wages. This relationship has been absent for most of the recovery. Wage growth fell through 2012 while the unemployment rate slowly improved. Wage growth is just now starting to pick up but the rate of growth is only slightly above the inflation rate, making it difficult for workers to see real wage increases. This relationship is illustrated in Figure 7 below.

Figure 7. Relationship between Unemployment and Wage Growth



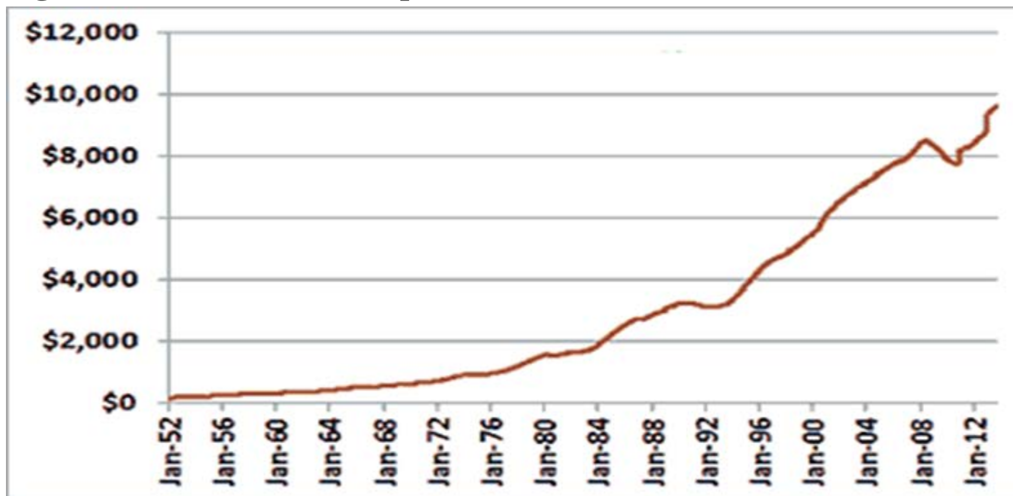
- The latest statistics from the Federal Reserve indicate consumer debt (not including mortgage debt) in the United States continues to increase, reaching nearly $3.03 trillion in September 2013. According to statistics published by the Census Bureau, that works out to over $9,600 in debt for every man, woman and child in the United States.

- Roughly 27% of all consumer debt (as of November 2013) is revolving credit (credit cards). The other 73% of consumer debt is derived from automobile loans, student loans, as well as money borrowed to purchase boats, trailers, or vacations.

- The Federal Reserve reports on the household debt service ratio (DSR). The DSR is equal to debt payments divided by disposable income. The DSR at the end of 2013 was almost 10%. The financial obligations ratio (FOR) is a broader measure of household debt service that includes car lease payments, rental properties, property taxes, and homeowner's insurance. The FOR going into the final quarter of 2013 was 12.95% for homeowners and 26.42% for renters.

- Data from the Federal Reserve and the U.S. Census Bureau are the sources for the data in Figure 8. The graph shows the monthly growth in consumer credit from January 1952 through September 2013 normalized by population growth. The U.S. population roughly doubled between January 1952 (156 million people) and 2013 (317 million) but the amount of debt grew from $160 per person in 1952 to $9,600 per person at the end of 2013.

Figure 8. Consumer Credit per Person



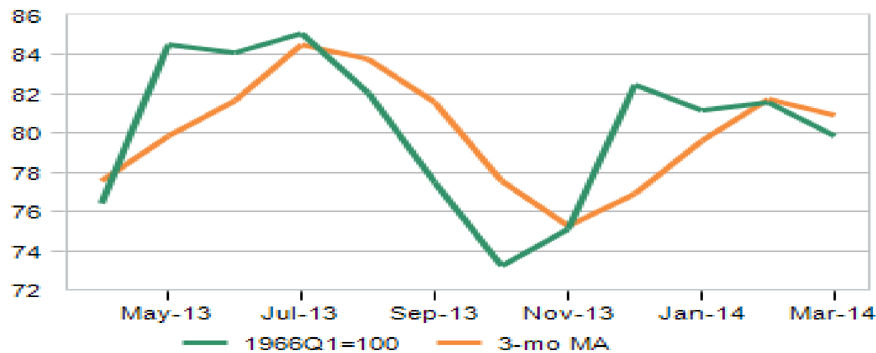
Source: Commerce Department

Sentiment and Confidence – *Consumer sentiment improved in the fourth quarter of 2013 but has pulled back in the first months of 2014. Consumers see some improvement in the economy but the lack of real wage growth and rising debt levels at the household level put a damper on consumer enthusiasm.*

- U.S. consumer sentiment fell in early March. The preliminary Thomson Reuters - University of Michigan index of consumer sentiment fell to 79.9 in March from 81.6 the prior month. The index is at its lowest level since November. Severe weather may have played a role in the sentiment decline. Figure 9 below shows the University of Michigan Index as well as the index 3-month moving average. The fourth quarter

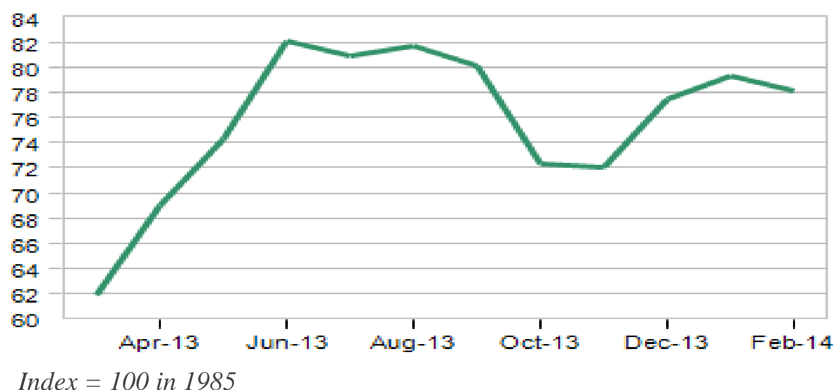
movement of the index gained much of the ground lost in the third quarter but the index has stalled out in the first part of 2014.

Figure 9. University of Michigan Sentiment Index April 2013-March 2014



- The Conference Board index of consumer confidence fell by 1.3 points to 78.1 in February from a downwardly revised 79.4 in January (previously 80.7). This month's drop reverses most of January's gain (see Figure 10).
- The present situation subcomponent (81.7) gained 4.4 points and is perched at its highest level since April 2008, while the expectations sub-index (75.7) lost 5.1 points to hit its lowest reading since November.

Figure 10. Conference Board Consumer Confidence Index March 2013-February 2014



Index = 100 in 1985

Key International Data *– The IMF forecasts 3.7% global growth in 2014. A risk of below-target inflation is also highlighted as aggregate demand is too weak to generate more normal price increases.*

- China's role in the international economy has expanded since the 2008 crisis and it continues to expand as other economies struggle. The Chinese economy grew 7.7% last year, for example. China is a major purchaser of commodities used in industrial production such as copper and iron ore. China's purchasing of commodities helped many developing countries weather the economic crisis. China's economic weakness in the first two months of 2014 causes concern that the slowdown will be transmitted to other economies who are suppliers. The Chinese slowdown is broad-based including manufacturing, housing and investment. Chinese Premier Li Keqiang recently warned lenders to expect high levels of defaults from loans made to factories and to expect "serious challenges" in the years ahead.

- The International Monetary Fund upgraded its world growth forecast for 2014 slightly. The IMF did express concern that a lack of inflation poses a risk, particularly in the euro zone. Inflation that is lower than the set targets increases real debt burdens of governments and households. Low inflation also makes it more difficult for central banks when they try to stimulate growth by lowering nominal interest rates, which are already very low due partly to low inflation.

- The IMF forecasts world growth of 3.7% in 2014. For advanced economies, the IMF projects only 2.2% growth this year. The U.K. had the biggest revision of growth down to 2.4% from 3.0%. The outlooks for Japan and Spain were both revised upward but remained very low (1.7% and 0.6%, respectively).

- For the U.S. the IMF forecasts 2.8% growth for 2014.

- The largest downgrade by the IMF was for Russia, which was lowered a full percentage point to 2% for 2014.

- The forecast was unchanged from the October release for emerging and developing economies. Growth is expected to be 5.1% in 2014.

- The IMF expects India to grow 5.4% in 2014.