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ECONOMIC &
MARKET
ANALYSIS

May 4, 2007

International Market Roundup

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Growth Outlook for China and India

- Both India and China have experienced rapid growth in recent decades. Sustaining this rate of economic expansion will require less reliance on abundant labor and capital and more support from improved productivity.
- In the United States, data and events support another status quo decision from the FOMC. Key uncertainties in the outlook remain unresolved but officials' primary concern still is the risk of inflation persistence.
- Recent economic data reports suggest that the European Central Bank will not need to accelerate the scheduled June rate hike. But comments from some ECB representatives suggest that there is a risk of a further rate hike after June.

This Week

Overview: Growth Outlook for China and India

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- **Both India and China have experienced rapid growth in recent decades.**
- **Sustaining this rate of economic expansion will require less reliance upon abundant labor and capital and more support from improved productivity.**
- **India will need more investment in infrastructure and education, while China will need to achieve more balanced economic expansion with less reliance upon rapid export growth.**

We believe both China and India have the potential to sustain rapid growth.

Economic growth in Asia averaged 5.3% annually in the second half of the Twentieth Century, and China and India have recorded even faster growth in recent decades. Whether both countries can sustain such strong growth rates in the immediate future is critical to the course of the global economy. There are several reasons why we believe both countries have the potential to sustain rapid growth in the perceivable future.

The reasons for this optimistic outlook include rapid catch-up in adopting technology, market-oriented reforms, and movement of labor to the cities.

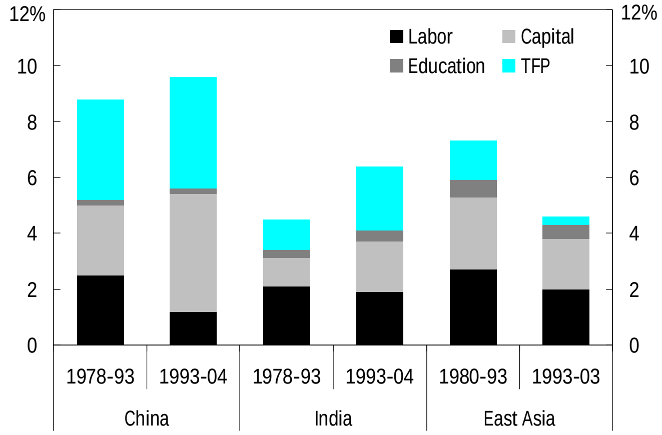
First, as relatively poor countries, China and India may achieve fast catch-up, benefiting from ‘‘the advantages of backwardness,’’ that is, the ability to adopt existing technologies (rather than innovating on the frontier) and gain in productivity from relatively less institutionally challenging shifts out of agriculture to labor intensive manufacturing. Even when measured in purchasing power parity terms, GDP per capita in China and India stood at only 14% and 7%, respectively, of that of the United States, in 2003. Second, market-oriented reforms have been the key contributor to faster economic growth in both countries. There is no question that these countries will stay on the reform path, which should help overcome institutional constraints and promote productivity growth. Third, both countries still have huge surplus labor in the countryside, which points to the short-term potential for faster growth from relocating labor to more efficient employment in cities.

But future growth likely cannot rely upon abundant labor and capital.

Investment is a key factor driving variations in growth performance. In a well-publicized article published in the mid-1990s,‘‘The Myths of Asia’s Miracle,’’[1] economist Paul Krugman argued that strong growth in some East Asian economies in the 1980s and early 1990s could not be sustained because these countries were relying mainly on factor (labor and capital) mobilization and not on productivity improvements. An extreme example of such unsustainable economic expansion is the former Soviet Union, which achieved

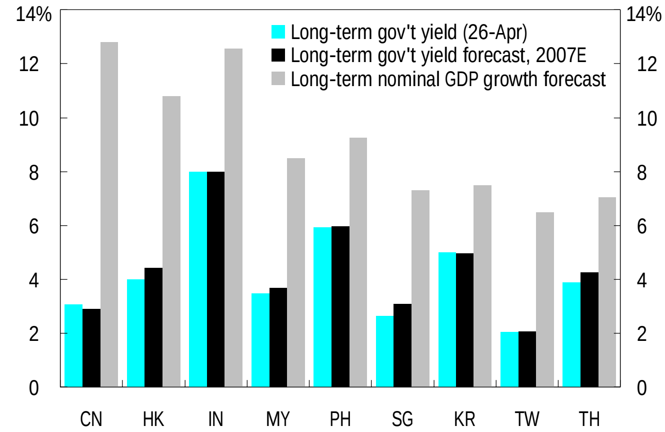
[1] Paul Krugman, “The Myth of Asia’s Miracle,” *Foreign Affairs*, Vol. 73, No. 6, Nov./Dec. 1994.

Figure 1. Contributions of Labor, Capital, Education, and Total Factor Productivity to GDP Growth in China, India, and East Asia (Percent)



Source: Barry Bosworth and Susan A. Collins, "Accounting for Growth: Comparing China and India," Working Paper 12943, 2007, National Bureau of Economic Research, Cambridge, Massachusetts.

Figure 2. Long-Term Nominal GDP Growth Forecasts and Long-Term Government Bond Yields (Percent)



Sources: CEIC Data Company and Citi estimates.

remarkable growth in both the 1930s and 1950s, but then collapsed in the 1980s, as marginal returns to additional factor inputs dropped to nearly zero.

Productivity improvement will be crucial for further sustainable growth.

Findings of a recent growth accounting exercise by Barry Bosworth and Susan Collins[2] appear to confirm Krugman's point that productivity improvement is crucial for sustainable growth. The authors estimate that total factor productivity (TFP) growth contributed only 6.5% to overall GDP growth in East Asian economies, excluding China, during 1993–2003 (see Figure 1).

And such productivity improvement does appear to be happening.

Bosworth and Collins also found two factors responsible for growth acceleration from the 1980s to the 1990s in China and India: (1) more rapid accumulation of physical capital; and (2) faster growth of total factor productivity. Capital accumulation was a result of investment. From 1993–2004, capital accumulation accounted for 44% of GDP growth in China and 28% of growth in India. By comparison, during the same period, total factor productivity improvement accounted for 41.7% and 35.9% of GDP growth, respectively, in China and India. This analysis provides at least preliminary evidence that the recent rapid growth in these two countries may be sustainable since the continued use of additional labor and capital has limits that TFP does not. Some optimists have even argued that the annual growth potential of China and India has probably already shifted to around 10% in the last few years.

Inflation has recently become an issue for India...

Recently, however, both economies have encountered some important macroeconomic problems. As we have pointed out,[3] while the Indian economy achieved 9% GDP growth last year, annual inflation rates have picked up from 4.4% in fiscal 2006 to 5.3% in fiscal 2007 and rose above 6% recently (see Figure 3). Meanwhile, India's current account deficit widened from 1.1% to 1.8% of GDP during the same period. Bottleneck problems have become widespread, especially in energy and infrastructure. Costs of both unskilled and skilled labor have also jumped significantly.

[2] Barry Bosworth and Susan A. Collins, "Accounting for Growth: Comparing China and India," *Working Paper 12943*, 2007, National Bureau of Economic Research, Cambridge, Massachusetts.

[3] See "Overheating and the Question of Growth Potential", *India Macroscope*, Citi, April 19, 2007.

Figure 3. Selected Macroeconomic Indicators for China and India, 2005-2006

	China		India	
	2005	2006	FY06	FY07
GDP Growth (% YoY)	10.2	10.7	9.0	9.2
CPI/WPI (% YoY, p.a.)	1.8	1.5	4.4	5.3
Current Account (% of GDP)	7.2	6.8	-1.1	-1.6
Fiscal Balance (% of GDP)	-1.1	-1.0	-4.1	-3.7
Money Supply M2 (% YoY)	16.3	16.9	21.2	18.0
Stock Prices (% YoY)*	42.3	46.7	-8.3	130.4
Investment Share (% of GDP)	43.7	42.3	33.8	35.0

*Note: Shanghai Stock Exchange Composite Index and Bombay Stock Exchange Sensitive Index.
Sources: CEIC Data Company and Citi estimates.

These developments appear to confirm that the Indian economy has hit a speed limit and is already overheating.

...and China's export growth rate appears unsustainable.

China has a different problem. While GDP growth has remained higher than 10% for the past five years, the inflation rate has exceeded 3% only occasionally. However, structural imbalances could derail the sustainability of Chinese economic growth. In 2006, investment probably accounted for 45% of GDP, and the trade surplus increased by 73.9%. GDP growth further accelerated to 11.1% during the first quarter, and CPI inflation rose to 3.3% in March, higher than the official target of less than 3%. China's above-10% GDP growth during recent years has been supported by extraordinary external demand, which accounts for a significant portion of China's investment surge. But China's growing size implies increasing adjustment costs for the rest of the world, which makes China's 30% export growth unsustainable.

China will need to raise the cost of production factors.

China also adopted growth-centered economic policy during its reform period by depressing the costs of production factors. This policy contributed to abnormal prosperity, but also was responsible for the increasing risks in China today. Recent policy efforts aimed at liberalizing factor markets may eventually lead to more costly, but better-priced, production factors, such as labor, land and other natural resources, energy, and capital.

Central banks in both China and India have been tightening monetary policy...

The People's Bank of China (PBoC) and the Reserve Bank of India (RBI) have tightened monetary policies for the past year through increases in China's base lending rates and hikes in India's repo rates. The central banks have also tried to tighten liquidity conditions by raising reserve requirements. We believe this will continue in the coming year, pointing to potential downside risks for the growth outlook in both countries.

...which should bring growth rates down slightly to more sustainable levels.

These developments, especially the overheating problems in India and the imbalance risks in China, suggest that growth in these countries has probably exceeded its long run potential. The near-term risks in China may not look as serious as India's, but measures tackling these problems should eventually bring growth rates to slightly lower, but sustainable, levels in both countries. In order to sustain strong growth, both countries will need to strengthen economic reforms that will ease resource constraints and promote productivity growth.

China will need to improve financial intermediation...

In China, reforms in two areas will be critical: improving the efficiency of resource allocation and balancing the contributing sources of economic growth. Efficiency in financial intermediation has been a key concern, due to significant distortions to the costs of capital, underdeveloped capital markets, and difficulties in financing small and medium enterprises. Proper pricing of natural resources will be important not only for improving living standards, but also for the long-term sustainability of growth. Unbalanced growth in consumption, investment, and net exports cannot continue forever.

...while India needs more investment in infrastructure and an increased supply of skilled labor.

In India, the key to higher economic performance is more investment, particularly in bottleneck areas such as highways, railways, airlines, and even energy. Easing the labor supply constraint may be particularly complicated. India has already experienced a severe talent shortage and has started to make efforts through improving on-the-job training, expanding the higher education system and recruiting foreign workers. However, a significant expansion of supply may take time. One potential area that could generate significant productivity gains in the short term is the shift of rural surplus labor into urban industries, following China's experience. For this to happen, however, India needs to implement a wide range of reforms in areas such as, labor law, taxation policy, and local regulations that would permit more vibrant growth in labor-intensive manufacturing.

Sustained rapid economic expansion very likely will lead to appreciation of both countries' currencies.

Overall, we are confident that China and India can sustain rapid economic growth in the coming decade, despite downside risks to near-term growth outlook. However, as we have noted and judging from the experiences of other East Asian economies, sustainable rapid economic expansion implies strong TFP growth. This often leads to sharp currency appreciation, as has been the case in Japan, Korea, and Taiwan. China and India are not likely to be an exception. This is the key reason behind our forecast for a much stronger renminbi, rupee, and many other Asian currencies over the next five years.

Near term, we expect continued monetary tightening.

Near-term macroeconomic risks imply that the central banks in China and India likely will continue to tighten their monetary policies. We now expect the RBI to hike India's repo rate once more this year and the PBoC to raise China's base lending rate twice more this year. Abundant liquidity in these countries, though, should limit moves in market interest rates. With relatively more sluggish growth performance, other East Asian economies face little overheating risks, and interest rates should be largely stable.

Higher real interest rates are likely in the longer term.

In the long run, however, the costs of capital are probably too low in Asia, as evidenced by wide gaps between nominal GDP growth and long-term bond yields (see Figure 2). Therefore, a risk exists that at some point market interest rates will move higher, particularly in China and India, pushing up the cost of capital across the region.

United States: The Growth Debate Stalls

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- **Data and events support another status quo decision from the FOMC. Key uncertainties in the outlook remain unresolved but officials' primary concern still is the risk of inflation persistence.**
- **Job growth has softened due to headcount reductions in housing-related industries. The favorable profit backdrop will continue to be a lifeline to non-housing related employment and business spending.**

Standoff in the outlook debate will keep Fed policy on hold next week.

The table is set for another status quo decision from Federal Reserve officials meeting this coming week. Although the expansion has slowed visibly, the sources of weakness remain remarkably isolated with scant signs of a self-feeding downturn, while the financial backdrop points to a gradual recovery beyond the next quarter or two. Improving inflation prospects are part of that story too.

The main policy bias remains focused on the chance of persistent inflation.

Nonetheless, price pressures still are simmering and the persistence of high and rising energy prices is wearing on the public's confidence in low inflation. This backdrop suggests that the FOMC will reaffirm the current funds rate and retain the primary focus on the upside risks to inflation. Although we think the longer horizon favors an easing of these concerns with the chance of a limited retracement of earlier tightening, the hurdles to any move in policy near term are formidable.

Jobs data were soft but hardly alarming.

In important respects, the path toward resolving key uncertainties in the outlook seems stalled and policy has little reason to take sides now. This morning's employment report fittingly capped a week in which data gave encouragement to our soft landing view but still left doubts about the period ahead. The employment gain of 88,000 was close to consensus, a little below estimates of sustainable growth. But given the volatility in these surveys and the prior month's exaggerated gain of 177,000, the relative weakness in April was unsurprising. The jobless rate at 4.5% remains in the middle of a 4.4% to 4.6% range that has prevailed since last September.

Slowing in hiring remains concentrated in the housing pipeline.

The softening in job growth in the past year from about 220,000 per month to 157,000 is in large part the result of the slowdown in industries that had fed off the housing boom. Lacking the industry detail for April, rough estimates are that job losses in this sector have netted declines in headcount of 175,000 or 15,000 per month. Toward the peak of the boom these firms were adding upwards of 30,000 per month.

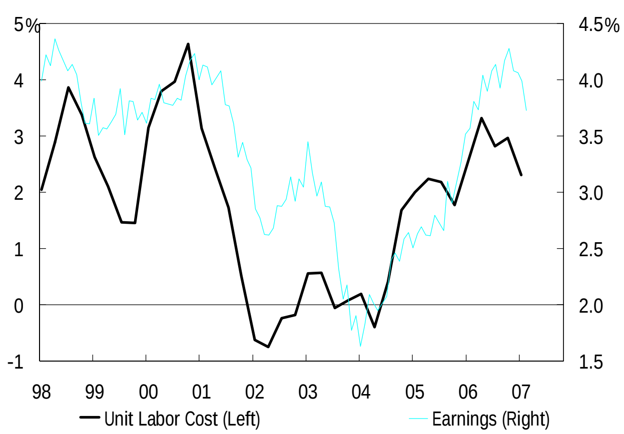
Even these industries display mixed trends.

Most of the losses have been among residential contractors (down almost 5%) and housing-related manufacturing and real estate financing (down around 3%). Surprisingly, employment among housing-related retailers has been little changed, while the number of jobs at real estate firms actually has risen on balance in the past year.

The strong profit backdrop remains a key support to hiring generally...

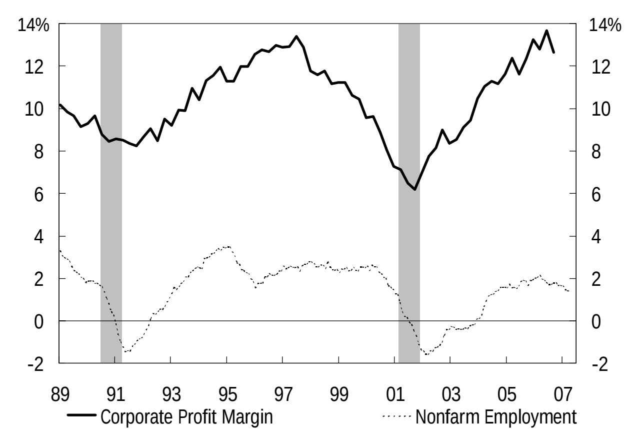
The relative resilience in broader hiring trends draws attention to the continued upside surprises in profits and profitability among firms. On this score, the latest readings on productivity and costs suggest that the erosion in profit margins witnessed in the latter part of 2006 did not continue in the first quarter. Productivity rose in the period slightly (1.7% annual rate in the nonfarm business sector) despite a strong cyclical undertow of

Figure 4. United States — Yr.-to-Yr. Pct. Chg. in Average Hourly Earnings and Unit Labor Costs (2-Qtr. Average), 1998-Apr 07



Source: Bureau of Labor Statistics.

Figure 5. United States — Corporate Profit Margins and Year-to-Year Percent Change in Nonfarm Payrolls, 1989-Apr 07



Note: Shaded regions denotes periods of recession.
Sources: Bureau of Labor Statistics and Bureau of Economic Analysis.

slowing output, while compensation leveled off after the big bonus-driven gains of the fourth quarter. A similar moderation has crept into hourly earnings data (see Figure 4). With margins still perched near historic highs, we are not inclined to expect a serious pullback in employment (see Figure 5) barring more tangible weakness in surveys of hiring intentions. At the same time, the modestly elevated trend in labor costs seems likely to hold without overburdening companies

...and to business spending as well.

Profit trends also suggest downside limits to the slowing in business investment that may have been overstated recently by concentrated declines in construction machinery and heavy trucks. Slowing growth was bound to moderate capital outlays, especially in the context of what has been an underwhelming capex recovery since the drag from the 1990s' tech bust was set aside almost four years ago.

Surveys point to moderate gains in capex.

Nonetheless, scenarios that put investment alongside housing as downside risks to the expansion probably go too far and the most recent data support that judgment. New orders in the past few ISM surveys point to moderate gains in equipment spending ahead and the April reading is the most encouraging of these (see Figure 6).

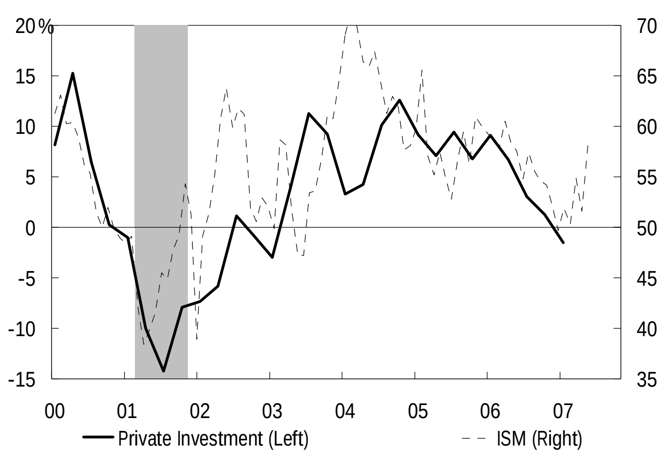
Ultimately, the outlook hinges on the financial setting and consumer demand.

To be sure, the fate of investment still hinges on key undecided elements in the outlook, the financial setting and the course of consumer demand itself. For Fed officials, the financial markets' favorable response to the latest earnings season is reassurance to stand pat. Our index of financial conditions declined again in April, but virtually all of that reflects the temporary liquidity-draining effect of higher energy prices on real cash balances. The index is still a distance from the typical backdrop for Fed easing (see Figure 7) and were it not for energy's drag would be sitting at roughly plus 0.9 sigma, or much looser than norms.

Higher gasoline prices will tax consumer spending...

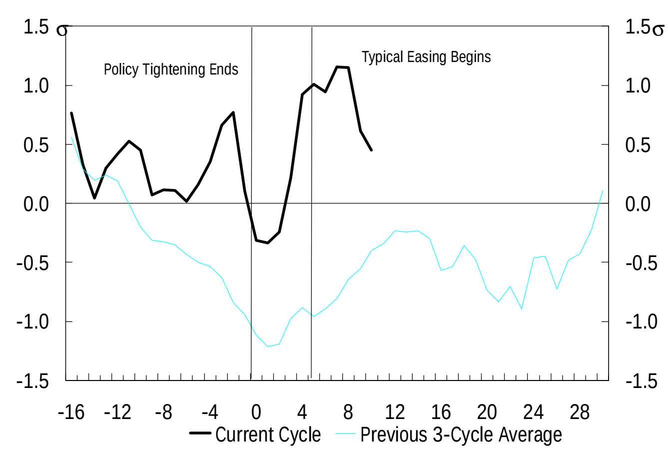
Unfortunately, another bout of rising gasoline prices is a real and tangible threat to consumers and a source of inflation anxiety as well. Real incomes will be curbed substantially in the current quarter, probably enough to cut in half the recent 4% growth track in spending. April retail sales due next week may show hints of this, but the softness

Figure 6. United States — Yr.-to-Yr. Pct. Chg. in Real Private Nonresidential Investment vs. ISM Manufacturing New Orders Index (3-Mo. Lag), 2000-Apr 07



Note: Shaded region denotes periods of recession.
Sources: Bureau of Economic Analysis and Institute for Supply Management.

Figure 7. United States — Citigroup Financial Conditions Index: Current Cycle vs. Previous 3-Cycle Average, Sep 87-Apr 07



Source: Citigroup.

in spending last month was likely more to do with weakness early in the month when extreme cold and wet weather plagued the Eastern half of the country. More recent data as well as the respectable 16.2 million selling rate for light vehicles in April suggests consumers remain a key driver even now.

...but also keep the fate of inflation expectations in doubt.

Fed officials will be watching consumers closely as households wrestle with the effects of higher gas prices amid peak seasonal demands in the next several weeks. A meaningful pullback in discretionary spending would heighten concern about downside risks and help limit chances of price pressures passing through. But recent surveys of long-term inflation expectations have been stubbornly at or near the high end of their historical range at 3.1% and the repeated ratcheting of energy prices may be taking a toll on confidence in longer-term price stability. As a result, uncertainty about the paths of growth and inflation underpins both policymakers' and investors' range-bound mindset.

ECB Preview – Turning to Strong Vigilance

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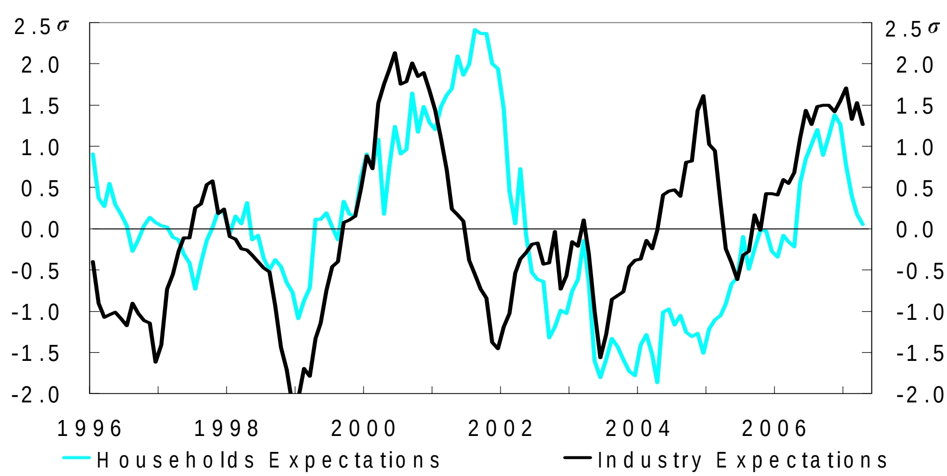
- **Recent economic data reports suggest that the European Central Bank (ECB) will not need to accelerate the scheduled June rate hike.**
- **Comments from some ECB representatives suggest that there is a risk of a further rate hike after June.**
- **The ECB is likely to continue providing implicit guidance on the near-term interest rate outlook without making pre-commitments for the medium- to longer-term.**

The ECB is on track for a June rate hike.

Available economic and financial market data since the last European Central Bank (ECB) governing council meeting do not suggest any change in the schedule for the clearly telegraphed June rate hike. While some council members started to flirt publicly with rates above 4%, suggesting that a further rate hike after June is possible, there were no statements indicating that the ECB is going to advance the rate hike to May. Thus, we expect the wording in the pre-rate decision board meeting press statement to be escalated to "strong vigilance" to ensure price stability.

Figure 8. Euro Area — Price Expectations By Sectors (SD Around Mean), 1996-Apr 07



Source: EU Commission.

Activity data suggest temporary growth moderation in early 2007.

Real economic data reported since the last ECB meeting were mixed. The new information is not likely to alter the ECB's view a month before the June update of the ECB's staff projections. Retail sales and industrial production for the first two months of 2007 suggest GDP growth moderated to about 0.6% quarter over quarter in the first quarter 2007 from 0.9% quarter over quarter in the fourth quarter. The latest business and consumer surveys remained at high levels, but were a little below consensus expectations.

Increasing signs of ongoing growth moderation outside Germany.

The April survey results also highlighted the fact that export-intensive manufacturing sectors remain the key driving force of the expansion (see Figure 9). Indeed, the second consecutive small decline in the manufacturing PMI outside Germany in April suggests that a moderation in manufacturing activity in these countries might be under way. In addition, recent housing market news suggests that the positive contribution from construction to GDP growth for the euro area excluding Germany is likely to shrink, although construction in Germany is likely to rebound after an expected drop in the second quarter.

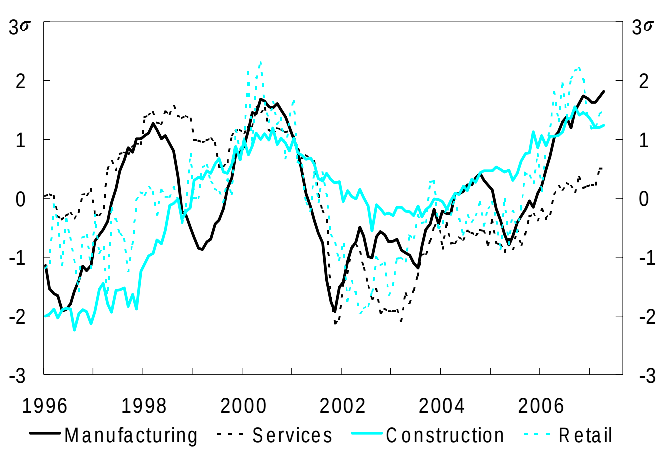
Recent price data were benign.

Most new data regarding the actual and near-term inflation outlook were benign. The flash estimate for the April harmonized inflation rate of 1.8% year over year (down from 1.9% in March) was lower than expected, and producer price inflation continued to moderate in March. Furthermore, consumer and business inflation expectations continued to decline in April, despite the increase in oil prices in recent months (see Figure 8). However, industry inflation expectations remained at a high level.

Headline monetary and credit data surprised on the upside.

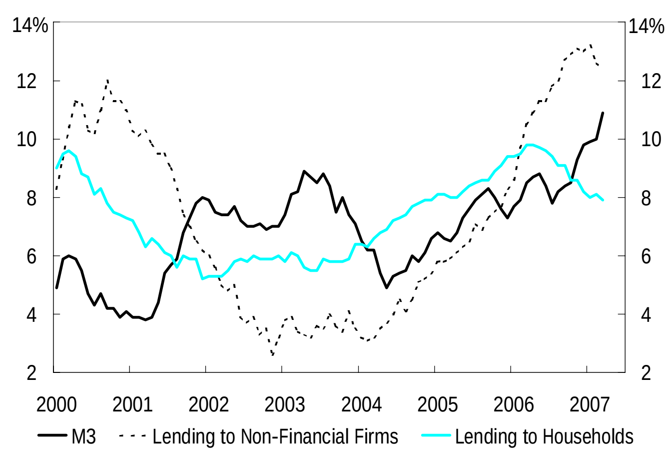
News from the recent money and credit data was mixed. Bad news was found in the unexpected jump in M3 growth from 10.0% in February to 10.9% in March and the unchanged high growth rate (of 10.8% year over year) of private-sector credit growth. The ECB will probably highlight these as a major source of concern regarding future price stability. But, the momentum in bank loans has continued to moderate. Lending to households slowed from an annual 9.8% last April to 8.1% year over year in February and 7.9% in March, while lending to nonfinancial corporations slowed from 13.2%year over year in January to 12.6% in February and 12.4% in March (see Figure 10).

Figure 9. Euro Area — Business Confidence By Sectors (SD Around Mean), 1996-Apr 07



Source: EU Commission.

Figure 10. Euro Area — M3 and Bank Lending By Sector (Y/Y Pct Change), 2000-Mar 07



Source: ECB.

The ECB has focused on German wage deals that have not surprised much on the upside so far.

Compared to the last ECB rate setting meeting, there was little news on wages. The widely focused-on wage talks in the German metal industry continued on May 3. As the ECB was not largely concerned about the above-4% annual wage gain (including a 0.7% one-off payment) in the German chemical industry in April, a likely total annual wage gain around 4.5% in the metal industry should not be a huge surprise for the ECB. For the time being, there are few signs that weaker performing German sectors will show similar wage gains.[4] Thus, unit labor costs are likely to decline further in Germany in 2007 and will probably increase modestly in the euro area.

Modest EUR appreciation continues, helping to tighten monetary conditions without additional rate hikes.

Since the April meeting, the EUR exchange rate, cited by several council members as an important factor for the ECB, continued to appreciate moderately by 0.9% against the US dollar and 0.5% on a trade-weighted basis. As we have argued before, given the divergence between the export-led growth in Germany and the domestic-led moderation elsewhere in the euro area, the ECB might welcome a further tightening in monetary conditions via a stronger currency rather than further rate hikes.[5] It is worth mentioning that the Eurogroup agreed to delegate comments regarding the currency to its chairman Jean-Claude Juncker. As Juncker is currently not concerned about the EUR strength, there seems to be little near-term political pressure on the ECB to enact policies leading to a weaker EUR.

New information provides no basis to advance the rate hike to May.

On balance, the new information since the April 12 ECB meeting does not suggest that the ECB has to advance the 25 basis point hike expected in June to the May meeting, which takes place in Dublin. Indeed, apart from the headline money and credit data, the latest information suggests that medium-term inflationary pressures diminished somewhat, suggesting that there is no need for a surprising rate hike in May.

ECB is likely to continue policy of near-term guidance.

At some point, the ECB might want to change from the recent tactic of “guidance by code word.” Nevertheless, we do not expect a change at present. The latest ECB Monthly Bulletin argues that the current system is working well: “Effective communication contributes considerably to the effectiveness, credibility, and predictability of monetary policy…through the flexible use of implicit forward language in its regular economic and monetary assessment, the ECB has managed to give implicit guidance on its inclinations over very short horizons.”[6] Given that, we do not expect the ECB to change its communication tactic right now. Thus, we believe the ECB will move to the next stage in announcing a rate hike in June with the “strong vigilance” phrase. But, in line with previous policies “avoiding any kind of pre-commitment with regard to future policy *decisions,”* the ECB is unlikely to give much guidance about the future course of policy beyond the June hike.

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[4] Note, the construction employers did not approve a preliminary agreement of a 3.5% annual wage increase in the construction sector; there was only a first round of talks in the retailing sector, where the trade union Verdi asked for a 4.5% annual wage gain.

[5] See “Euro Area — A Stronger Euro Is In The Interest of Europe,” *Euro Weekly*, Citi, April 19, 2007.

[6] See “Communicating Monetary Policy to Financial Markets,” *Monthly Bulletin*, ECB, April 2007.

Economic Indicators

United States

Thu May 10 8:30am	***Initial Jobless Claims (May 5)*** ***Beneficiaries (Apr 28)***	**Forecast: 310,000** **Forecast: 2.51 Million**	
	Initial jobless claims likely rose by 5,000 to 310,000 for the week ended May 5 following the prior week's 21,000-person drop. The number of beneficiaries likely remained elevated.		
Thu May 10 8:30am	***Import Price Index (Apr)***	**Forecast: 1.3%** **Excluding Fuel: 0.2%**	
	A 7.0% jump in petroleum prices likely drove the overall import price index higher. We expect the nonpetroleum index remained quite tame.		
Thu May 10 8:30am	***International Trade Deficit (Mar)***	**Forecast: $59.5 billion**	
	We look for the trade deficit to have widened by about $1.0 billion in March. The rise in factory shipments suggests that exports rebounded from after the surprising decline at the start of the year. But a jump in oil imports, reflecting increases in both price and volume, more than offset the pickup in exports.		
Thu May 10 2:00pm	***Federal Budget Surplus (Apr)***	**Forecast: $160 billion**	
	Buoyed by a nearly 23% ($36 billion) surge in non-withheld tax payments versus the prior year, the Federal Government probably accumulated a $160 billion surplus in April. Given this revenue inflow, we now expect the FY07 budget deficit to fall to about $145 billion.		
Fri May 11 8:30am	***Producer Price Index (Apr)***	**Forecast: 0.5%** **Excluding Food and Energy: 0.2%**	
	Producer prices likely jumped in April on higher energy and food prices. The core figure probably remained fairly tame, though. We expect a pickup in core intermediate prices, due to the rise in commodity prices.		
Fri May 11 8:30am	***Retail Sales (Apr)***	**Forecast: 0.3%** **Excluding Automobiles: 0.4%**	
	The overall tone of the retail sales report should be soft, reflecting the unseasonable weather in the early part of the month. The bulk of the spending increase in the month reflected the steep rise in gasoline prices. Core retail sales, which excludes sales at auto dealers, gas stations and building suppliers, likely was unchanged.		
Fri May 11 8:30am	***Business Inventories (Mar)***	**Forecast: 0.2%**	
	Our estimate for business inventories imbeds the already reported 0.2% rise in manufacturing stocks, a 0.6% increase in wholesale inventories, and a 0.1% decline in retail inventories. The expected drop at the retail level is concentrated in motor vehicles.		

Germany

May 7 11:00am London Time	***Incoming Orders (Mar)***	**Forecast: -1.3% Mo.-Mo.; 9.3% Yr.-Yr.**	**Previous: +3.9% Mo.-Mo.; 9.5% Yr.-Yr.**
	After the huge positive surprise in manufacturing orders in February, we expect a technical drop in March. However, the surge in VDMA machinery orders suggests that, as we have seen several times in previous months, big-ticket orders might have led to a further gain in manufacturing orders in March. After the 6.8% month-on-month surge we expect a drop in foreign orders, while domestic orders are likely to increase for a fifth consecutive month. If our forecast is correct, 1Q orders on average would be up by 2.4% quarter on quarter after declining 0.4% quarter on quarter in 4Q 2006.		
May 8 11:00am London Time	***Industrial Production (Mar)***	**Forecast: -0.3% Mo.-Mo.; 8.1% Yr.-Yr.**	**Previous: +0.9% Mo.-Mo.; 7.6% Yr.-Yr.**
	We expect a mainly technical decline in industrial output in March. As a consequence of the unusually mild start to the year, the seasonal adjustment procedure will have a negative impact on the March reading. In March the seasonal adjustment procedure corrects for the usual rebound in activity at the start of spring after the weather-related moderation in winter. This year this recovery will be small, as the usual fall in production at the start of the year did not take place because of the warm weather. The negative impact on seasonally adjusted construction output probably will be large and manufacturing activity is likely to suffer somewhat as well. However, we expect a fifth consecutive increase in manufacturing output in March. If our forecast is correct, total industrial output increased by 2.0% quarter on quarter in 1Q compared to 1.1% quarter on quarter in 4Q.		
May 9 7:00am London Time	***Current Account (Mar)***	**Forecast: €13.9 Billion Surplus**	**Previous: €8.3 Billion Surplus**
	We expect a second consecutive increase in seasonally adjusted nominal exports by around 1% month on month and a downward correction of the 5.7% month-on-month surge in February imports by around 1.5% in March. This would lead to a widening in the adjusted trade surplus from €13.8 billion in February to €15.7 billion in March. However, if our forecast is correct, the aggregated 1Q trade surplus of €45.3 billion would be €5.5 billion smaller than in 4Q. With benign seasonal factors in other components of the non-adjusted current account, the surplus is likely to increase to €13.9 billion, €4.5 billion higher than in March 2006.		

Economic Indicators

France

May 10 | ***Industrial Production (Mar)*** | **Forecast: -0.3% Mo.-Mo.; 0.5% Yr.-Yr.** | **Previous: 1.1% Mo.-Mo; 2.6%Yr.-Yr**

7:45am

London Time

After picking-up in February, industrial production probably slightly declined by 0.3% month on month in March. If our forecast is correct, 1Q industrial activity would rise by 1.0% quarter on quarter in 1Q 07 after –0.1% quarter on quarter in 4Q 2006, in line with buoyant business surveys released at the beginning of the year.

Italy

May 10 | ***Industrial Production (Mar, Seasonally Adjusted)*** | **Forecast: -0.2% Mo.-Mo.; 0.4% Yr.-Yr.** | **Previous: -0.5% Mo.-Mo.; 0.5% Yr.-Yr.**

9:00am

London Time

Industrial production is likely to fall by 0.2% month on month in March, leading to an annual increase of 0.4%. Although the series is volatile and difficult to predict, the ISAE business survey and the manufacturing PMI suggest that the March fall will be limited and followed by a weak recovery.

Spain

May 11 | ***Harmonised Consumer Prices (Apr, Final)*** | **Forecast: 1.2% Mo.-Mo.; 2.5% Yr.-Yr.** | **Previous: 0.8% Mo.-Mo.; 2.5% Yr.-Yr.**

The statistical office probably will confirm the flash estimates for the April national defined inflation and the harmonised index of consumer prices of 2.5% year on year. A cut in prices for natural gas has been offset by the increase in tobacco and food prices. However, seasonal factors probably contributed to a 1.2% month-on-month increase in the non-seasonally adjusted national and the harmonised index.

United Kingdom

May 10 | ***Industrial Production (Mar)*** | **Forecast: 0.5% Mo.-Mo.; 0.1% Yr.-Yr.** | **Prior: -0.2% Mo.-Mo.; 0.3% Yr.-Yr.**

9:30am | ***Manufacturing Output (Mar)*** | **Forecast: 0.6% Mo.-Mo.; 1.0% Yr.-Yr.** | **Prior: -0.6% Mo.-Mo.; 1.2% Yr.-Yr.**

London Time

It is a bit hard to know what to make of these data. All surveys suggest that manufacturing activity is expanding rapidly, and really are exceptionally strong. But, the ONS data have shown two consecutive monthly declines in output and even with the rebound that we expect for March, 1Q output will be flat quarter on quarter. Painful experience leads us to trust the surveys and not the ONS data. We assume that at some point the ONS data will be revised up, or catch up with the stronger trends in the surveys. But, it is unclear when this will happen.

May 10 | ***Trade Balance – Goods & Services (Mar)*** | **Forecast: £-4.4 Billion** | **Previous: £-4.3 Billion**

9:30am | ***Trade Balance – Goods Only (Mar)*** | **Forecast: £-6.9 Billion** | **Previous: £-6.8 Billion**

London Time

The trade balance has been fairly stable in recent months, with a bit of noise on either side. We do expect the deficit to trend wider this year, driven by the pickup in U.K. imports and domestic demand, and hence on balance expect a slightly higher deficit this month. But, the effect is quite modest from month to month and can be easily masked by the natural volatility in these data.

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International Financial and Economic Calendar 14 May 07 – 18 May 07

	United States	Japan	Europe	Europe	United Kingdom	Canada/Australia
MONDAY 14		8:50 Corp. Goods Price Index, Apr BoP Current Account, Mar	**France** 7:45 Qrtly Insee Industrial Investment Survey, Apr **Euro Area** 10:00 Ind. Production, Mar	**Spain** GDP Flash Estimate, 1Q **Finland** Consumer Prices, Apr	M/M Y/Y 9:30 Producer Input Prices Mar 1.2% SA -0.6% Apr 0.5%* SA 0.7%* Producer Output Prices Mar 0.6% 2.7% Apr 0.4%* 2.4%* Ex Tax Mar 0.4% 2.7% Apr 0.3%* 2.5%* Ex F, D, T, F Mar 0.4% 2.9% Apr 0.3%* 3.0%*	**Canada** 8:30 Manufacturing Survey, Mar **Australia** Housing Finance, Mar
TUESDAY 15	8:30 Consumer Price Index Total ExF&E Mar 0.6% 0.1% Apr 0.6%* 0.2%* 8:30 Empire State Manufacturing Apr 3.8% May 10:00 Real Earnings, Apr 1:00 Housing Market Index Apr 33 May	8:50 Pvt. Machinery Orders, Mar	**Germany** 7:00 GDP Flash Estimate, 1Q **France** 7:40 GDP Flash Estimate, 1Q 7:45 Consumer Prices, Apr **Euro Area** 10:00 GDP Flash Estimate, 1Q **Belgium** Bankruptcies, Apr	**Italy** 9:00 GDP Flash Estimate, 1Q **Netherlands** GDP Flash Estimate, 1Q Unemployment, Feb-Apr **Portugal** Consumer Prices, Apr **Finland:** Monthly GDP, Mar **Norway:** Trade Balance, Apr **Switzerland** Retail Sales, Mar	M/M Y/Y 9:30 Consumer Prices Mar 0.5% 3.1% Apr 0.3%* 2.8%* CPI Ex F, D, T, E Mar 0.4% 1.9% Apr 0.4%* 2.0%* Retail Prices Mar 0.6% 4.8% Apr 0.5%* 4.6%* RPIX – Ex Mortgages Mar 0.6% 3.9% Apr 0.5%* 3.6%*	**Canada** 8:30 Auto Sales, Mar
WEDNESDAY 16	8:30 Housing Starts & Permits Mar 1.52M 1.54M Apr 9:15 Industrial Prod. & Cap. Util. Mar -0.2% 81.4% Apr	BoJ Two-Day Meeting	**Germany** 7:00 Final CPI, Apr **Euro Area** 10:00 HICP, Apr (Details) **Austria** Consumer Prices, Apr	**Italy** 10:00 Final CPI, Apr **Netherlands:** Trade Bal., Mar Household Consumption, Mar **Finland:** Producer Prices, Apr **Portugal:** Labor Costs, 1Q	9:30 LFS Employment Q/Q Y/Y Dec-Feb -47K 0.5% Jan-Mar 0.0K* 0.5%* LFS Unemployment Q/Q Rate Dec-Feb +21K 5.4% Jan-Mar -22K* 5.4%* Claimant Count Unemployment M/M Rate Mar -9.2K 5.4% Apr -10.0K* 5.4%* Average Earnings M/M Y/Y Feb 1.5% 5.1% Mar -0.4%* 5.0%* 10:30 BoE *Inflation Report*	**Canada** 8:30 Int'l Trans. in Securities, Mar **Australia** Wage Price Index, 1Q
THURSDAY 17	8:30 Jobless Claims, May 12 10:00 Leading Indicators Mar 0.1% Apr 12:00 Philly Outlook Survey Apr 0.2% May	BoJ Meeting Outcome		**Portugal** Labor Market, 1Q		**Canada** 8:30 Consumer Prices, Apr 8:30 Wholesale Trade, Mar **Australia** Consumer Sentiment, May RBA Bulletin, May
FRIDAY 18	9:45 Reuters/Michigan Sentiment AprF 87.1 MayP	8:50 Tertiary Ind. Activity, Mar	**Germany** 7:00 Producer Prices, Apr **G-8 Finance Ministers' Meeting** (Potsdam, Germany)	**Italy** 9:00 Industrial Orders, Mar **Spain** New Industrial Orders, Mar	9:30 Retail Sales Volumes M/M Y/Y Mar 0.3% 4.8% Apr 0.6%* 4.7%*	**Canada** 8:30 Retail Sales, Mar

*Citigroup estimates.

Times are: GMT -5 for North America; GMT +1 for Europe; GMT +9 for Japan; GMT +11 for Australia.

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International Financial and Economic Calendar 7 May 07 – 11 May 07

United States	Japan	Europe	Europe	United Kingdom	Canada/Australia
MONDAY 7					
3:00 Consumer Install. Credit Feb $3.0B Mar $6.0B*		**Germany** M/M Y/Y 11:00 Incoming Orders Feb 3.9% 9.5% Mar -1.3%* 9.3%* **EU:** EU Commission's Spring Economic Forecasts **Eurogroup** Meeting of euro-area Finance Ministers (Brussels)	**Austria** Wholesale Prices, Apr **Denmark** Manuf. Orders & Sales, Mar	**Bank Holiday**	**Canada** 8:30 Building Permits Feb -22.4% Mar 1.5%* **Australia** Business Conditions, Apr
TUESDAY 8					
10:00 Wholesale Inventories Feb 0.5% Mar 0.6%*		**EU:** ECOFIN meeting of EU-27 Finance Ministers (Brussels) **Germany** M/M Y/Y 7:00 Insolvencies, Feb 11:00 Industrial Production Feb 0.9% 7.6% Mar -0.3%* 8.1%*	**Sweden** Borrowing Requirement, Apr **Norway** Industrial Production, Mar **Greece** Consumer Prices, Apr		**Canada** 8:15 Housing Starts Mar 210.9K Apr 220.0K* **Australia** Retail Sales & Bldg Approvals, Mar Commonwealth Budget, 2007-08
WEDNESDAY 9					
FOMC Meeting		**Germany** 7:00 Current Account Feb €8.3B Surplus Mar €13.9B* Surplus **Netherlands** Industrial Production, Mar **Denmark** Balance of Payments, Mar Bankruptcies, Apr	**Portugal** Trade Balance, Mar **Belgium** Harmonized CPI, Apr **Sweden** Industrial Production, Mar	MPC Meeting Starts	**Australia** House Prices, 1Q
THURSDAY 10					
8:30 Jobless Claims, May 5 310 Thous* 8:30 Import Price Index Total ExFuel Mar 1.7% 0.2% Apr 1.3%* 0.2%* 8:30 International Trade Feb $58.4B Mar $-59.5B* 2:00 Federal Budget Surplus Apr 06 $118.8B Apr 07 $160.0B*	8:50 Money Supply, Apr	**Euro Area:** ECB Meeting (Dublin) **France** M/M Y/Y 7:45 Industrial Production Feb 1.1% 2.6% Mar -0.3%* 0.5%* **Belgium** Industrial Production, Mar Incoming Orders, Mar **Netherlands** Consumer Prices, Apr **Ireland** Consumer Prices, Apr	**Italy** M/M Y/Y 9:00 Industrial Production (SA) Feb -0.5% 0.5% Mar -0.2%* 0.4%* **Finland** New Manuf. Orders, Mar **Greece** Industrial Production, Mar **Denmark:** Consumer Prices, Apr **Norway** Consumer Prices, Apr Producer Prices, Apr **Sweden** Consumer Prices, Apr	M/M Y/Y 9:30 Industrial Production Feb -0.2% 0.3% Mar 0.5%* 0.1%* Manufacturing Output Feb -0.6% 1.2% Mar 0.6%* 1.0%* 9:30 Trade Balance – Goods Feb £-6.8B Mar £-6.9B* Goods & Services Feb £-4.3B Mar £-4.4B* **12:00 MPC Outcome**	**Canada** 8:30 Int'l Merch. Trade Balance Feb C$4.9B Mar C$5.4B* 8:30 New Housing Price Index Feb 0.5% Mar 0.5%* **Australia** Employment, Apr
FRIDAY 11					
8:30 Producer Price Index Total ExF&E Mar 1.0% 0.0% Apr 0.5%* 0.2%* 8:30 Retail Sales Total ExAuto Mar 0.7% 0.8% Apr 0.3%* 0.4%* 8:30 Business Inventories Feb 0.3% Mar 0.2%*		**Netherlands** Retail Sales, Mar **Ireland** Industrial Production, Mar (During The Weekend) **Germany:** State Elections in Bremen (May 13)	**Spain** M/M Y/Y Harmonized CPI (Details) Mar 0.8% 2.5% Apr 1.2%* 2.5%*		**Canada** 7:00 Labor Force Survey Emp. Unemp.Rate Mar 54.9K 6.1% Apr 15.0K* 6.2%*

*Citigroup estimates.
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