



MORNING BRIEFING

January 19, 2017

Rising & Setting Suns

See the [collection](#) of the individual charts linked below.

(1) Banner Q4 for big banks and brokers. (2) Financials fundamentals may be just starting to shine. (3) Room for improvement in IPOs, in M&As, and asset management. (4) Financials playing catch-up after lagging for so long. (5) No bullseye for Abe's "three arrows." (6) 2020 Olympics could boost Japan a bit for a little while. (7) Not much CPI and export bang from the depreciating yen. (8) Aging is a big drag in Japan, as population shrinks. (9) Abe was first foreign leader to visit Trump. (10) A couple of signs of life.

Financials: Rise & Shine. Big banks and brokers reported banner Q4 earnings that largely justified the humdinger of a rally we've seen in the S&P 500 Financials sector since the Brexit vote and the US presidential election. Loan volumes are up, loan loss reserves are declining, and fixed-income markets are hot. Commercial bank deposits are up 5.1% y/y through the first week of the year to a fresh record high of \$11.5 trillion ([Fig. 1](#)). Loans and leases are up 5.8% to \$9.1 trillion ([Fig. 2](#)). Across the board, expenses continue to get trimmed and shares are being repurchased.

What caught our eye in the torrent of earnings season data were the many areas that could still improve to further propel earnings. Equity underwriting is in a slump. The yield curve has steepened, but is still flatter than it has been over most of the past nine years. And the investment management arms of some shops have been sluggish at best. Just imagine what these firms could earn if the good times get rolling. Let's take a look at some of the lackluster areas in banks' and brokers' Q4 results that could become sources of future earnings growth:

(1) *Awaiting higher rates.* Bulls should be excited about the potential for a large increase in net interest income, or the difference between what banks earn on their loans and what they pay on borrowings. A proxy for that earning power is the spread between the 10-year and two-year Treasury yields, which bottomed this summer at 76bps. The spread has widened to 116bps, but it's still below where it was from 2008 through most of 2015. During those seven years, the spread was at a low of 119bps and a high of 291bps ([Fig. 3](#)).

The first inklings of how much these banks and brokers could earn if interest rates move in the right direction were apparent in Q4 results. Net interest income rose 5% y/y at JPMorgan and 7% at Wells Fargo. Net interest income at Bank of America (BAC) popped 6.3% to \$10.3 billion, and CFO Paul Donofrio said the bank should enjoy an extra \$600 million of interest income in Q1 compared to Q4, a 1/13 [WSJ article](#) reported.

(2) *Muted IPOs.* Much of the commentary last week centered on the large jumps in fixed-income trading that helped Q4 earnings. Less was said about the miserable IPO market and the slump in equity underwriting and M&A advisory fees. Global IPOs fell in Q4 by 25.7% to \$51.3 billion, according to Dealogic [data](#) on WSJ.com. Meanwhile, global M&A remained strong but was down slightly to \$1.2 trillion in Q4 from \$1.3 trillion a year earlier ([Fig. 4](#) and [Fig. 5](#)).

Morgan Stanley, for example, reported Q4 equity underwriting revenues of \$225 million, down 36% from \$352 million a year earlier, according to its [press release](#). The decline in equity underwriting

revenue was greater than the jump in fixed-income underwriting in Q4 to \$421 million from \$346 million a year ago. Likewise, JPMorgan's investment banking revenue was up only 1% to \$1.5 billion because debt underwriting fees were "largely offset" by lower advisory and equity underwriting fees. At BAC, total corporate investment banking fees decreased 4%, as higher debt issuance fees weren't enough to offset lower advisory fees and equity issuance fees.

Goldman Sachs, which enjoyed a 12% y/y increase in Q4 revenue, had a 4% y/y decline in investment banking revenues, according to the company's [press release](#). Financial Advisory revenues were down 19% y/y due to a decline in transactions. Fixed-income underwriting revenues jumped 28%, while equity underwriting revenues declined 7%. Along the same lines, revenue from fixed-income market activities rose 78% to \$2 billion, while revenue in equities fell 9% to \$1.6 billion.

(3) *Asset management.* Morgan Stanley's Investment Management arm has room to improve. It reported Q4 net revenues of \$500 million, down from \$621 million a year ago, and pretax income of \$28 million, down from \$123 million. While asset management fees were largely unchanged in Q4 y/y, the firm attributed the decline to write-downs of limited partnership investments in third-party funds, compared with gains in the prior year.

At BAC's Global Wealth and Investment Management business, noninterest income fell to \$2.9 billion, down from \$3.0 billion in Q4-2015. The bank's [press release](#) attributed the decline to "lower transactional revenue." Even Goldman Sachs reported Q4 investment management revenue that rose only 3% y/y, as management and other fees declined 1%.

(4) *Less risk.* Even as fixed-income activity bubbled and loan books grew, the risk taken by some of the banks and brokers decreased. At Morgan Stanley, the average daily value at risk (VAR) declined to \$39 million last quarter, down from \$46 million a year ago. Similarly, at Goldman Sachs, VAR was reduced in Q4 to \$61 million, down from \$71 million a year earlier.

(5) *The numbers.* The S&P 500 Financials sector has trounced the market, gaining 32.2% y/y as of Tuesday's close. Here's how it stacks up against the other S&P 500 sectors: Energy (34.5%), Financials (32.2), Materials (32.0), Industrials (27.6), Tech (26.6), S&P 500 (20.6), Telecom (19.4), Consumer Discretionary (18.0), Utilities (12.9), Consumer Staples (8.2), Real Estate (6.9), and Health Care (5.5) ([table](#)).

An optimist might note that the S&P 500 Financials stocks are playing catch-up from their underperformance for much of the past three years. Consider Bank of America. Its shares underperformed the S&P 500 for most of the past three years. It also underperformed for most of 2016, sometimes in dramatic fashion. At a number of points over the past year, BAC lagged the S&P 500 by roughly 20 percentage points. It only started playing catch-up after Brexit, and it pulled ahead of the S&P 500 for the first time in November.

Likewise, the S&P 500 Diversified Banks index has gained 34.5% y/y. The index is back at its peak levels in 2007, and its forward P/E of 13.1 may be underestimating the industry's earnings potential ([Fig. 6](#)). Net earnings revisions turned positive in October and soared to a four-year high of 26.7% in December ([Fig. 7](#)). That has left analysts targeting 9.7% earnings growth over the next 12 months and 14.0% growth in 2018.

The S&P 500 Investment Banking & Brokerage index gained 53.5% over the past year. There have been a lot of ups and downs over the past 16 years, with the index essentially unchanged from where it was in 2000 ([Fig. 8](#)). Was the index overvalued in 2000? Most certainly. But 16 years is a solid amount of time for excesses to run off. The index is expected to see earnings rise 18.6% over the next 12

months and 16.3% in 2018 ([Fig. 9](#)). If that happens, earnings growth will actually be higher than the current 14.9 forward P/E ([Fig. 10](#)). Earnings estimates in this industry also have risen sharply of late, with net earnings revisions also turning positive in October and up to a 10-year high of 39.4% in December ([Fig. 11](#)).

After 16 years of being mostly range-bound and in the shadow of other outperforming sectors, maybe the sun is rising and starting to shine on some of the Financials sector's major industries.

Japan: Sunset. Japan has been battling deflation and economic stagnation since its real estate and stock market bubbles burst in the early 1990s. Weeks after Prime Minister Shinzo Abe took office in December of 2012, he pledged to revitalize Japan's economy. The three "arrows" of his policy package, coined "Abenomics," were monetary easing, increased government spending, and business deregulation. Abe's arrows might have staved off a recession and excessive deflation, but they've missed the mark on growth. The main obstacle to growth seems to be the country's rapidly aging demographic profile.

The Bank of Japan's [Outlook for Economic Activity and Prices](#) as of October 2016 forecasted 2017 real GDP growth in a range of 1.0%-1.5%, up from an estimate of 0.8%-1.0% for fiscal 2016. "Faster growth is critical to stopping and reversing the run-up in public debt, which is projected to reach 240% of GDP by 2018," observed the OECD in its November [forecast](#). But it's not looking promising. The BOJ expects growth to slow again in 2018 back to the 2016 range. The OECD's November forecast had pegged growth at the lower end of the BOJ's range for both years.

Even so, Japan's economy at least has coped with the yen's recent appreciation, as the OECD pointed out. And thanks to Tokyo's hosting of the 2020 Olympics, short-term growth might benefit from increased infrastructure spending. Yet the Olympics might just leave behind lots of gray-haired spectators and white elephants, i.e., mega-sports domes with no economic purpose that are expensive to maintain. Japan's prospects for growth don't seem promising. The sun still seems to be setting rather than rising on the country's economy.

On the bright side, the 1/16 [FT reported](#): "Morgan Stanley's global strategy team considers Japan the top stock market for 2017. There are three assumptions underlying their bullish conclusion, including first, the depreciation of the yen, and second, the expectation that growth in Japan will be stronger than most investors anticipate. Finally, the strategists believe Japan will be the beneficiary of stronger-than-expected global demand. ... Today, however, global investors aren't believers. They are underweight." We aren't as optimistic. Let's review some of the persistent challenges facing Japan's economy:

(1) *Deflation.* Surprisingly, the weaker yen hasn't abated the deflationary pressures in Japan. The CPI jumped during the spring of 2014 due to a sales tax hike from 5% to 8%. However, the inflationary pressure was short-lived, and the CPI began falling again at the start of 2016 through September ([Fig. 12](#)). November's relatively steep increase in the total CPI of 0.5% y/y was due to higher food prices, while prices for other consumer goods fell. Excluding food, the CPI fell -0.3% y/y.

Japan's consumer spending remains weak, and consumer confidence remains low ([Fig. 13](#) and [Fig. 14](#)). In the face of slow growth, Japan needs more tax revenues to sustain government spending. However, Abe decided to delay the next sales tax hike, which was set to take effect in April 2017, until late 2019 because it might further "damage domestic demand," reported Bloomberg in a 6/1 [article](#).

(2) *Ultra-low interest rates.* Deflation has persisted despite the Bank of Japan's (BOJ) highly aggressive and unconventional monetary policies. In a series of bold moves, the BOJ unexpectedly cut interest rates below zero on January 29, 2016. On September 21, 2016, the BOJ slightly reversed course,

indicating that the limits of monetary policy may have been reached. It aimed to maintain the 10-year government yield at near 0% by altering the pace of Japanese government bond purchases. The 10-year Japanese government yield turned positive during mid-November 2016 for the first time since mid-February 2016. However, it is still incredibly low, at 0.05% as of January 20 ([Fig. 15](#)). (See our [chronology](#) of BOJ monetary policy.)

(3) *Aging population.* The good news is that Japan's unemployment rate has been falling since peaking at 5.5% in July 2009 and was down to 3.1% near the end of last year. However, Japan's aging population, coupled with a low fertility rate, is behind the tightening labor market. The *1/7 Economist* [reported](#) that Japan's workforce has shrunk by about 2 million since it peaked at over 67 million in the late 1990s. Government forecasts show that it could drop to 42 million by mid-century. Unlike other countries, Japan has been exceptionally slow in opening its labor market to foreign labor. The number of foreigners rose in 2015 to a record high of 2.2 million, but that's far from closing the labor force gap, noted *The Economist*. The Japanese government's efforts to create incentives to encourage more of "its own people who are capable of working" to join the workforce might not go far enough.

Another problem in Japan's labor market is the increase in those who have less permanent jobs. According to a *1/5 article* in the *Japan Times*, 40% of Japan's workforce consists of non-regular workers. The lack of job security and low wages only serve to weaken consumption. Wages have been falling since 2013. Deflation has helped to boost real wages, but the recent surge in food prices isn't helping. At the end of 2016, real contractual earnings fell to same level as nominal earnings ([Fig. 16](#)). That's one good reason why consumer confidence is so low.

(4) *Export dependency.* Prime Minister Abe is eager to export Japan out of stagnation. Besides exports in real GDP, which grew 6.5% (saar) on a quarterly basis during Q3, each of the other categories of growth were tepid: private investment (-1.4%, saar), imports (-1.4), and government consumption (1.2) ([Fig. 17](#)). Monetary stimulus has weakened the yen, which lifted exports but perhaps not as dramatically as Abe had hoped. Exports have risen 14.5% since the start of 2012.

In the meantime, the yen has fallen 32% against the dollar since then ([Fig. 18](#) and [Fig. 19](#)). The yen, widely viewed as a "safe haven currency," strengthened briefly in 2016 due to the global financial turmoil earlier last year, particularly leading up to the Brexit vote. The yen started to depreciate again after Trump's victory and continued to fall when the Fed proceeded on its gradual path to raise interest rates during December of 2016. Looking ahead, the yen is likely to depreciate further, with several more Fed rate hikes likely during 2017.

Trading with the US could be more challenging for Japan under President Trump. Japan's economy appeared poised for growth at the end of last year in view of the pending Trans-Pacific Partnership (TPP) trade deal that was being negotiated under President Obama. But President-elect Trump has promised to abandon the TPP when he takes office, so Japan might have to find other ways to achieve its export goals with the US and other Asian countries. That need may explain Abe's eagerness to meet Trump after Election Day on November 17--he was the first foreign leader to do so. Japan's largest export market is the US, followed by China and then Western Europe ([Fig. 20](#)).

(5) *Signs of life.* Industrial production moved higher at end of 2016, driven by a resurgence in exports ([Fig. 21](#)). So too, December's M-PMI was promising, rising to 52.4, the highest since the end of 2015. But that's still a ways off from its 2013 peak ([Fig. 22](#)).

CALENDARS

US. Thurs: Housing Starts & Building Permits 1.200mu/1.230mu, Jobless Claims 255k, Philadelphia

Fed Manufacturing Index 16.0, Weekly Consumer Comfort Index, EIA Petroleum Status Report, Yellen.
Fri: Baker-Hughes Rig Count, Harker, US Presidential Inauguration. (Bloomberg estimates)

Global. Thurs: China GDP 1.7%q/q/6.7%/y/y, China Industrial Production 6.1% y/y, China Retail Sales 10.7% y/y, ECB Rate Decision 0.00%, ECB Margin Lending Facility & Deposit Facility Rates 0.25%/-0.40%, ECB Asset Purchase Target (euros) 80b. **Fri:** UK Retail Sales 7.5% y/y, Canada CPI 1.7% y/y, Canada Retail Sales 0.5%, ECB Survey of Professional Forecasters. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators ([link](#)): The Investors Intelligence Bull/Bear Ratio (BBR) climbed to 3.50 this week--the highest reading since early May 2015. Bullish sentiment is up 18.9ppts the past 10 months to 60.6%, the most bulls since July 2014. Bearish sentiment fell to 17.3% this week--representing the fewest bears since July 2015. The correction count was at 22.1%, holding near its reading of 20.6% at the end of 2016, which was the lowest since June 2014. The AAI Bull Ratio fell to 61.8% last week after climbing the prior three weeks from 58.0% to 64.7%. Bullish sentiment fell from 46.2% to 43.6% during the latest week, while bearish sentiment rose from 25.2% to 27.0%.

S&P 500 Earnings, Revenues & Valuation ([link](#)): S&P 500 consensus forward revenues and earnings rose to record highs last week. The forward profit margin forecast remained steady at a 16-month high of 10.8%, nearing the record high of 10.9% in September 2015 and up from its 24-month low of 10.4% in late March. Forward revenue growth for the S&P 500 improved to 5.7% from 5.6%. That's slightly below mid-December's 5.8%, which was the highest since May 2012, but up from a seven-month low of 2.7% in late February 2016. Forward earnings growth rose to 11.7% from 11.6%; that's the highest since October 2011 and compares to an 11-month low of 4.8% in February 2016. Valuation was steady at 17.2 and slightly below mid-December's 22-month high of 17.3; that compares to February 2015's 12-year high of 17.4 and a 15-month low of 14.9 in January 2016. S&P 500 forward revenues and forward earnings are enjoying a tailwind now from easier y/y comparisons for Energy and improving prospects for Financials, but currency translation looks likely to remain a challenge. Looking at last week's results ex-Energy, the forward revenue and earnings growth rates fall to 3.9% and 8.5%, respectively. The ex-Energy forward profit margin improves to 11.4%, which is close to its record high of 11.5% in August 2007.

S&P 500 Sectors Earnings, Revenues & Valuation ([link](#)): Consensus forward revenue forecasts rose last week for 7/11 sectors, and forward earnings rose for 3/11. Energy, Financials, and Industrials were the only sectors to have forward revenues and earnings rise w/w. Forward revenues and earnings are at or around record highs for 5/11 sectors: Consumer Discretionary, Consumer Staples, Health Care, Industrials, and Tech. Energy's forward revenues and earnings are at or near 14-month highs. The forward P/S and P/E ratios rose for 5/11 sectors. Excluding Real Estate, Financials' P/E of 14.0 is up from 12.0 before the election and remains near mid-December's six-year high of 14.2. Health Care's P/E of 14.6 and P/S of 1.57 have been rising recently, but remain well below their 2015 highs of 17.9 and 1.88, respectively. With Energy's forward revenues and earnings improving, its valuation is beginning to come back to Earth; its P/S ratio of 1.44 compares to a record high of 1.56 in early May, and its P/E of 30.8 is down from a record high of 57.5 then. Higher y/y margins are expected for only 5/11 sectors in 2016, but are expected to improve for 9/11 sectors in 2017. Here's how they rank based on 2017 forecasts: Information Technology (to 20.2% in 2017 from 19.3% in 2016 and from 18.7% in 2015), Real Estate (16.5, 22.2, 21.2), Financials (15.8, 14.6, 14.8), Telecom (11.0, 10.8, 11.3), Health Care (10.8, 10.4, 10.4), Utilities (10.7, 11.0, 10.7), S&P 500 (10.7, 10.1, 10.2), Materials (10.2, 9.3, 9.3), Industrials (9.1, 8.8, 8.8), Consumer Discretionary (7.5, 7.2, 6.9), Consumer Staples (6.9, 6.6, 6.5), and Energy (4.5, 1.2, 4.6).

S&P 500 Earnings Season Monitor ([link](#)): With 7% of S&P 500 companies finished reporting Q4-2016 results, their revenue and earnings surprise metrics and y/y growth comparisons are stronger than at the comparable point of the Q3 season. Of the 35 companies in the S&P 500 that have reported, 71% exceeded industry analysts' earnings estimates by an average of 6.0%; they have averaged a y/y earnings gain of 15.5%. At the same point in Q3-2016, a higher percentage of companies (83%) in the S&P 500 had beaten consensus earnings estimates by a larger 8.4% and earnings were down 0.3% y/y. On the revenue side, 43% beat sales estimates so far, coming in 0.3% below forecast and 4.4% higher than a year earlier. During Q3, a higher 68% were above forecast, which exceeded estimates by 1.2% and rose 3.0% y/y. Q4 earnings results are higher for 83% of companies versus 66% at the same point in Q3, and revenues are higher for 86% versus 71%. These figures will change markedly as Q4 results begin pouring in next week, but early data suggest Q2 was indeed the bottom for y/y comparisons.

US ECONOMIC INDICATORS

Industrial Production ([link](#)): Industrial production in December expanded at its fastest pace in two years, boosted by a 6.6% rebound in utilities output after three months of decline. Industrial production accelerated at a larger-than-expected 0.8%, following a steeper decline in November (to -0.7% from -0.4%) and a slightly stronger increase in October (0.2 from 0.1). Utilities output was a big drag on growth during these two months, falling a total of 7.3%, due to warmer-than-normal temperatures. Manufacturing production recovered 0.2% last month after slipping 0.1% in November and rising 0.3% in October. Consumer goods output rebounded 1.1% after a three-month slide of 1.2% as a 2.1% jump in auto-related output boosted durable goods production; consumer nondurable goods output rose by an eight-month high of 1.0%. Business equipment production recovered 0.7% in December after falling three of the prior four months by 1.3%, led by robust gains in information processing (1.4) and industrial (0.9) equipment production--the latter's the first gain in five months. Manufacturers appear to be finding their footing after fighting some strong headwinds: Factory output expanded 0.7% (saar) during Q4, its best quarterly rate in more than a year; the yearly rate (0.2%) was positive for the first time in six months. While utilities and manufacturing production climbed last month, mining output was unchanged after a 0.7% loss and a 3.5% gain the prior two months. It appears to have found a bottom in recent months after plummeting 16.9% from the end of 2014 through April of this year.

Capacity Utilization ([link](#)): The headline capacity utilization rate in December rebounded to 75.5% after falling three of the prior four months from 75.6% to an eight-month low of 74.9%. Last month's rate was 4.5ppts below its long-run (1972-2015) average. Manufacturing's capacity utilization rate continued to fluctuate just below 75.0%, ticking up from 74.7% to 74.8% last month, 3.7ppts below its long-run average. The mining utilization rate has rebounded from 73.2% to 78.1% in the eight months through December, while the rate for utilities jumped to 79.1% after sliding the prior three months from 82.5% to 74.3% over the period.

GLOBAL ECONOMIC INDICATORS

Global Industrial Production ([link](#)): Output in the emerging economies resumed its climb recently, reaching a new record high in October; production continued to move sideways in the advanced ones. Global output increased 1.5% y/y in October, holding at record highs. Production in the emerging economies expanded 2.7% y/y, with yearly growth in advanced economies flat. The latest monthly data by country show that production in many of the emerging countries we track are at or near record highs. Production in China and Malaysia remained on steep uptrends, setting new record highs, while Indonesia's fell for the fourth month from July's record high. Output in the Philippines continued on a very volatile uptrend, while uptrends have turned more modest in India, Bulgaria, and Poland. Production levels in South Korea and Mexico were stalled at their highs. Output levels in the rest of

Asia, Latin America, and Eastern Europe held around recent highs--except in Brazil, where output was down sharply from recent highs. Output in Thailand remained in a volatile flat trend around recent lows, while Taiwan's has rebounded from recent lows; Russian production continued to move sideways. In the G7 economies, US headline production is stalled below its record high, while Canadian production is stalled around its cyclical high. Output in the UK has been looking topy after recent upswing; Japan's has been holding in a very volatile flat trend, though has moved higher in recent months. Data for the Eurozone's three largest economies showed an upturn in production in November.

GLOBAL INFLATION INDICATORS

World CPI ([link](#)): World consumer inflation in November remained near seven-year lows. The rate ticked up to 2.4% y/y--holding around October's 2.2%--which was the lowest reading since October 2009; it's 1.1ppt below the recent peak of 3.5% at the start of 2016. The emerging economies' inflation rate climbed to 4.1% y/y after sinking in October to a record low of 3.5% for the series going back to 1969; November's rate was the second lowest reading since 1970. The rate for advanced economies rose to a two-year high of 1.1% in November after fluctuating between zero and 1.0% from December 2014 through September 2016.

US CPI ([link](#)): The core CPI rate was just above the Fed's target rate of 2.0% y/y again in December, edging up to 2.2%. That's down from August's 2.3% rate--which matched the peak rate recorded in February, the highest since May 2012. On a monthly basis, core prices rose 0.2% for the second month; the three-month rate was 2.1% (saar), up from 1.7% in November, which was the lowest since February 2015. During December, shelter, motor vehicle insurance, medical care, education, air fares, used cars & trucks, and new vehicles costs increased; that was partially offset by declines in apparel and communications prices. The yearly rate for the headline CPI has been steadily rising since July and hit 2.1% y/y in December, the fastest pace since mid-2014.

Eurozone CPI ([link](#)): Eurozone inflation remained above zero in November for the seventh month after sub-zero readings the prior four months. December's rate confirmed the flash estimate of 1.1%--the highest since September 2013. It remains well below the ECB's inflation target of just under 2.0%. Of the main components, energy (to 2.6% from -1.1% y/y) had the highest annual rate last month--swinging from negative to positive--followed by services (1.3% from 1.1%) and food and alcohol & tobacco (1.2% from 0.7%). The price gain for non-energy industrial goods was at 0.3% y/y for the fifth month. Excluding food, alcohol & tobacco, the CPI inflation rate was at 0.9% y/y, up from 0.8% the prior four months. Of the top four Eurozone economies, inflation rates in Germany (1.7% y/y) and Spain (1.4) were above the Eurozone's 1.1%, while rates in France (0.8) and Italy (0.5) were below.

Emerging Markets CPI ([link](#)): There's still not much inflation in emerging economies, though more countries are emerging from deflation: (1) Asia: Singapore's rate moved above zero for the first time in 25 months, edging up 0.1% in November, while rates in Thailand and South Korea moved just above 1.0% after hovering just above zero for roughly a year. The rate in Taiwan climbed above zero back in January after being below for all of 2015, moving up to 1.5% y/y in December. Inflation is accelerating in the Philippines, while rates in Indonesia and Malaysia are decelerating, though the former may have found a bottom. India's CPI remains in a volatile flat trend, moving to the bottom of its range in December. China's inflation rate is hovering just above 2.0%. (2) Latin America: Chile's rate is slowing from recent highs, while Mexico's is accelerating from record lows. Peru's rate may have found a bottom. (3) Eastern Europe: Inflation is nonexistent in most economies--having remained just below zero in Bulgaria, while rates in both Croatia and Romania moved just above in December. Poland's rate is accelerating, while Hungary's continues to bounce above zero; the Czech Republic's has bounced off its bottom. Rates in Russia and the Ukraine have slowed sharply from recent peaks, though the latter's has turned up recently.

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