

Weekly Economic Commentary



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Central Bank Pulse

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Highlights

Key emerging market central banks have raised rates within the past year in an effort to combat inflation, the threat of inflation, or current account imbalances.

Most developed market central banks are on hold or easing.

The divergence among global central bank policies creates both risks and opportunities for global investors, and especially active managers who invest globally.

Typically, the week after the release of the monthly employment report is quiet for U.S. economic releases, and this week—the week after the April employment report was released on Friday, May 2, 2014—is no different. The highlight of the week is Federal Reserve (Fed) Chair Janet Yellen's testimony before the Joint Economic Committee (JEC) of Congress on Wednesday, May 7, 2014. The Q&A portion of the testimony will be closely watched, as then Fed Chair Ben Bernanke's comments during the Q&A portion of his appearance at the JEC in mid-May 2013 sparked the "taper tantrum" in the U.S. Treasury bond market that drove the yield on the 10-year Treasury from 1.75% to 3.0% between early May and early September of 2013. Although the labor market is clearly improving, most market participants expect Yellen to maintain her dovish tone on the labor market and economy at this week's testimony, as there is still plenty of evidence that the labor market is not "back to normal" (see *Weekly Economic Commentary: What's the Yellen Surprise?*, March 24, 2014).

With little on the domestic economic calendar this week aside from the Yellen appearance and another 80 or so S&P 500 companies reporting first quarter results (with 75% of companies having already reported), market participants are likely to turn their attention overseas. In all, 11 central banks around the globe are meeting this week to set policy, including five developed market central banks:

- The European Central Bank (ECB);
- Bank of England (BOE);
- Bank of Korea;
- The Reserve Bank of Australia; and
- Norges Bank, Norway's central bank.

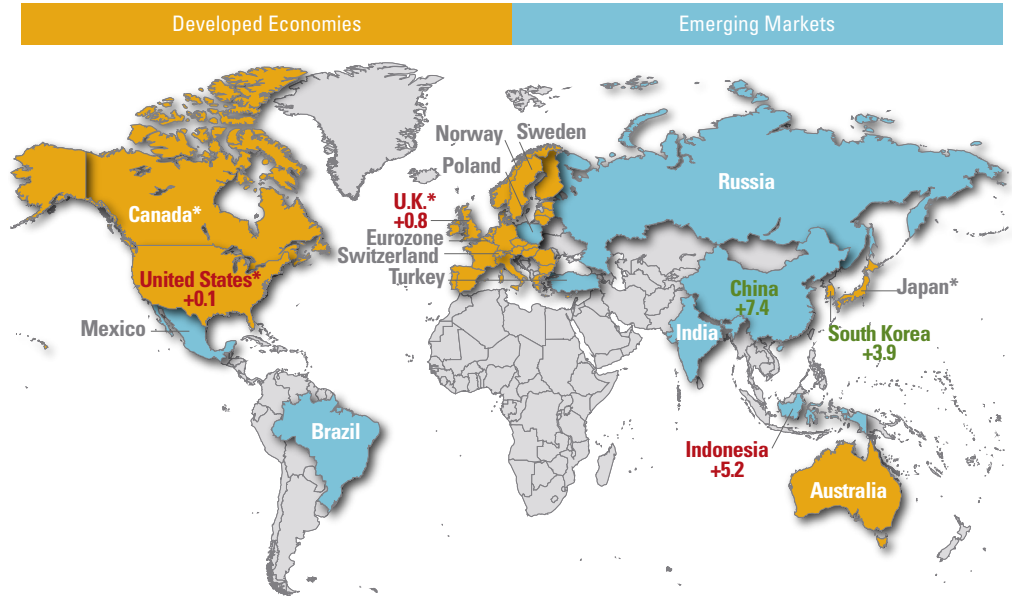
Six emerging market central banks also meet:

- Poland;
- Czech Republic;
- Indonesia;
- Philippines;
- Malaysia; and
- Peru.

1 Most Countries Have Yet to Report Their First Quarter 2014 GDP Figures, but of Those That Have, the Majority Have Come in Short of Expectations

| Country | Estimate | Actual | Report Date |
|-------------|----------|--------------------|-------------|
| Argentina | 1.2% | — | 06/24/14 |
| Australia | +2.9% | — | 06/03/14 |
| Brazil | +2.1% | — | 05/30/14 |
| Canada* | +1.8% | — | 05/30/14 |
| China | +7.3% | +7.4% | 04/15/14 |
| Eurozone | +1.0% | — | 05/15/14 |
| India | +4.9% | — | 05/30/14 |
| Indonesia | +5.6% | +5.2% | 05/05/14 |
| Japan* | +4.1% | — | 05/14/14 |
| Mexico | +2.2% | — | 05/23/14 |
| Norway | — | — | 05/20/14 |
| Poland | +3.0% | — | 05/15/14 |
| Russia | +0.7% | — | 05/16/14 |
| South Korea | +3.8% | +3.9% | 04/23/14 |
| Sweden | +1.2% | — | 05/30/14 |
| Switzerland | +1.9% | — | 05/30/14 |
| Thailand | 1.5% | — | 05/18/14 |
| Turkey | +3.3% | — | 05/30/14 |
| U.K.* | +0.9% | +0.8% | 04/29/14 |
| U.S.* | +1.2% | +0.1% [^] | 04/30/14 |

Q1 2014 GDP (Year-Over-Year % Change Unless Noted*)



Source: LPL Financial Research, Bloomberg 05/05/14

*Quarter-over-quarter annualized; U.K. not annualized

[^]Poor winter weather hurt Q1 growth for the U.S.

Q1 GDP Tracker

As this report was being prepared, Indonesia reported its first quarter GDP figures. The report showed that Indonesia's economy—the 13th largest in the world—expanded by 5.2% in the year ending March 31, 2014, a solid reading, but still below expectations of a 5.6% gain. Most of the weakness was concentrated in exports, which, in turn, is likely related to the slowdown in Chinese economic activity over the past year. Indonesia's first quarter report is the only GDP report from a top 20 economy scheduled for this week. China, South Korea, the United Kingdom, and of course the United States have already reported Q1 GDP figures. Next week (May 12–16, 2014), Japan, the Eurozone, Russia, and Poland will report first quarter GDP. Figure 1 notes the release dates and consensus forecasts (as compiled by Bloomberg News) for the world's 20 largest economies. Unless otherwise indicated, the actual GDP readings and forecasts are year-over-year readings. As we noted in the April 14, 2014, *Weekly Economic Commentary: Gauging Global Growth in 2014 & 2015*, developed market economies are poised to accelerate in 2014, while emerging market economies have seen their growth estimates for 2014 revised downward in recent months.

2 Central Bank Policies Continue to Diverge

| Central Banks | | |
|--|---|---|
|  Raising Rates/ Tightening Policy |  On Hold |  Cutting Rates/ Easing Policy |
| <ul style="list-style-type: none"> Russia Brazil Turkey India Indonesia | <ul style="list-style-type: none"> China Norway Switzerland Canada U.K. Argentina | <ul style="list-style-type: none"> U.S. Japan Eurozone Sweden Mexico Australia Poland South Korea Thailand |

Source: LPL Financial Research, FactSet 05/05/14

In addition, central banks in Australia, Japan, and Thailand will release minutes of recent policy meetings this week, providing market participants with some color around rate decisions made earlier this month and in April 2014.

Although none of the 11 is expected to change policy this week, central bank policies have diverged since the end of the Great Recession in early 2009. At first, most emerging market and developed market central banks were cutting rates to reinvigorate their economies. Later, as growth returned, so did inflation and imbalances in trade and currency movements, which caused several central banks to change policy. Some cut rates or eased policy, but others, including the ECB and the People's Bank of China, tightened between 2009 and 2011.

Global Divergence

Today, among the central banks of the 20 largest economies in the world—which together account for 90% of global gross domestic product (GDP)—there continues to be a divergence among global central banks on rate policy [Figure 2]. Central banks in Russia, Brazil, Turkey, India, and Indonesia have all raised rates within the past year in an effort to combat inflation, the threat of inflation, or current account imbalances. Note that all of these central banks are in emerging markets. But not all emerging market central banks are raising rates. Mexico, Thailand, and Poland have recently cut rates, as have several central banks not in the top 20 (Chile and Hungary, for example).

On the other hand, most developed market central banks are on hold or easing, including the Fed, ECB, and Bank of Japan. We list China as “on hold” but in reality, China could ease policy at any time, and the central bank may or may not be part of that easing, as China’s centralized economy lends itself to a much higher level of government involvement than most other nations. Indeed, in late April, China’s central bank—the Peoples Bank of China—cut reserve requirement ratios for rural banks only. Also on the “on hold” list is the United Kingdom’s BOE, but stronger recent economic data and surging property markets have market participants pricing in a BOE rate hike by the end of 2014.

Global Scope

On balance, the divergence among global central bank policies creates both risks and opportunities for global investors, and especially active managers who invest globally. These conflicting interest rate paths—along with the currency and economic changes they generate—have created an uptick in volatility in financial markets that is likely to continue for several quarters. But this increased volatility may also create opportunities for active investors with strong insight into the international economic, currency, and policy environment to add value, which is why LPL Financial Research continues to believe in active management in this space. ■



IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance reference is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

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| Not FDIC/NCUA Insured Not Bank/Credit Union Guaranteed May Lose Value Not Guaranteed by any Government Agency Not a Bank/Credit Union Deposit |
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