Weekly Economic Commentary

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Better Gauges of Global Growth Ahead

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Highlights

As markets brace for this week, we continue to expect that the U.S. and global economies may accelerate in 2014 relative to 2013's growth rate.

We continue to expect that the FOMC will taper QE by $10 billion per meeting, exit the program by the end of 2014, and begin to raise interest rates in late 2015.

Our view remains that the U.S. economy could accelerate in the second quarter to well above the economy's long-term average growth rate after a weather-induced slowdown in growth in the first quarter of 2014.

A large number of key economic reports, central bank meetings, and geopolitical events this week (June 2–6) should allow market participants to better gauge global growth as we approach the halfway point of the year.

The week includes seven major central bank meetings, with the June 5 European Central Bank (ECB) policy announcement getting most of the attention. The data due out earlier in the week on manufacturing, inflation, unemployment, and consumer spending in the Eurozone for April and May will help to inform the ECB's decision. On the geopolitical front, Ukraine will be in focus when the North Atlantic Treaty Organization (NATO) meets on Tuesday, and the leaders of the G-7 (the G-8 minus Russia) convene on Wednesday. On Friday, June 6, world leaders will gather to mark the 70th anniversary of the D-Day landing in Normandy. Finally, there are municipal elections in South Korea, and Egypt will announce the results of the presidential election it held last week.

Jobs Report Highlights Busy Week on Domestic Data Front

On the domestic front, data on manufacturing (Institute for Supply Management [ISM] on Monday, June 2) and employment (Employment Situation on Friday, June 6) will bookend a very busy week of data for April and May. We believe the data will help market participants gauge the pace of economic growth in the second quarter and, more importantly, where growth is headed in the second half of 2014. This week the Federal Reserve (Fed) will release its Beige Book—a qualitative assessment of banking and economic conditions in each of the 12 regional Fed districts—and markets will hear from three Fed presidents, in what are likely the last public appearances by Federal Open Market Committee (FOMC) members ahead of the June 17–18 FOMC meeting.

Weekly Calendar to Highlight Multi-Speed Global Economy

The global economic backdrop has become more **"multi-speed"** in recent years.

Overseas—aside from the seven central bank meetings and a full docket of European data—Japan's and China's economies will likely be in focus, as investors continue to assess the probability of further action from the Bank of Japan and the Chinese government to stimulate growth as we approach midyear.

As markets brace for this week, we continue to expect that the U.S. and global economies may accelerate in 2014 relative to 2013's growth rate.

1 Central Bank Policies Continue to Diverge

Central Banks: **Seven to Meet This Week**

Raising Rates/ Tightening Policy	On Hold	Cutting Rates/ Easing Policy
Russia	China	U.S.
Brazil	Norway	Japan
Turkey	Switzerland	**Eurozone**
India	**Canada**	Sweden
Indonesia	***United Kingdom****	**Mexico**
	Argentina	**Australia**
		Poland
		South Korea
		Thailand

Source: LPL Financial Research, Bloomberg 06/02/14

* United Kingdom may soon be tightening policy

Since the release of our *Weekly Economic Commentary: Gauging Global Growth—An Update* in mid-April 2014, first quarter gross domestic product (GDP) reports for the word's 20 largest economies are in the books, and consensus growth estimates for 2014, 2015, and 2016 have not moved much. We'll provide an update on the consensus forecasts for global growth in mid-July 2014. Unlike in 2008 and early 2009, when virtually all global economies were reeling, and mid- to late 2009 through 2010, when most global economies were in recovery mode, the global economic backdrop has become more "multi-speed" in recent years. Some economies are slowing; others are accelerating. A few central banks are raising rates, but others are cutting rates, and many are firmly on hold. This pattern holds for both developed economies and emerging market economies alike. The divergence has likely added to volatility in global markets, but the uptick in volatility could provide opportunities for investment managers to add value.

More Central Bank Support Likely Coming From Overseas

Actions by the ECB this week, and additional actions from Chinese authorities—who in recent weeks have embarked on some behind-the-scenes easing moves—along with bold action from the Bank of Japan at its next meeting on June 13, 2014, may provide markets with comfort that the global economy is indeed poised to accelerate this year. The ECB will likely reduce several of the key rates it charges banks in an effort to spur lending and to improve the sluggish Eurozone financial transmission mechanism, but we think it will stop short of embarking on outright quantitative easing (QE). What the ECB does on Thursday, June 5 matters, but what ECB President Mario Draghi says—and how he says it—may matter even more.

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Additionally, the Bank of England (BOE) is meeting this week. With the U.K. economy on the upswing, spare capacity being used, and inflation moving higher, markets are currently anticipating that the BOE is the next major global central bank to begin raising rates later this year. Accelerating growth in the U.K. economy—the world's fifth largest—thus far in 2014 has been a tailwind for global growth. Central banks in Canada, Mexico, India, Australia, and Poland (which together represent more than 10% of global GDP) also meet this week. Although none of these banks are expected to make a change in policy, what they say about growth, global trade, and inflation will help set the tone for markets in the coming weeks and months.

The **seven central banks** meeting this week represent **40%** of global GDP.

As we have noted many times in these reports, China's Central Bank, the People's Bank of China (PBOC), does not meet on a regular schedule like all the other major global central banks. In recent weeks, Chinese authorities, including the PBOC, have initiated several attempts to "fine-tune" and "loosen" policy in China. For example, the PBOC has cut its reserve ratio requirement for some rural banks, and the central government has urged provincial and local governments to speed up spending on infrastructure in order to boost growth. We continue to expect that China's economy will grow between 7% and 7.5% in 2014, avoiding a hard landing (5–6% growth), but not a return to 10% growth, either (based on Bloomberg data).* The next round of Chinese economic data (for May) is due out beginning next weekend (June 8–9).

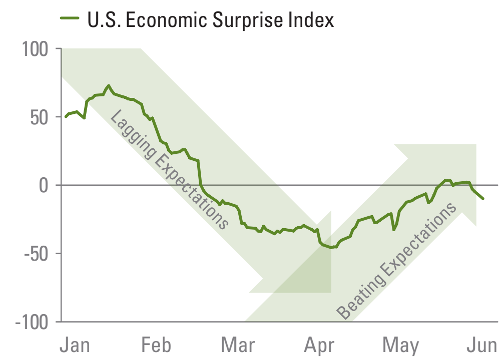
* The consensus GDP growth estimate for 2014 now stands at 7.4%, the same as the 7.4% forecast made back in October 2013, but well below the 8.0% forecast made in mid-2012. Looking out to 2015, the consensus now expects the Chinese economy to decelerate to 7.3%, down 0.5% from the forecast made a year ago, in April 2013.

2 The Fed's Path to Tightening Is Data Dependent

	2014	2015
Real GDP	2.89%	3.1%
Core Inflation	1.5%	1.8%
Unemployment Rate	6.2%	5.7%

Source: LPL Financial Research: Federal Reserve 06/02/14

3 Since Early April, a Return to Normal Weather Has Allowed the Economic Data to Beat Expectations



Source: LPL Financial Research; Bloomberg 06/02/14

We expect that the Fed's next Beige Book will describe an **economy** that has **rebounded sharply** from poor weather in the winter months.

Reading the Fed "Tea Leaves"

Markets will hear from the Federal Reserve this week as well, but the next FOMC meeting isn't until June 17–18, 2014. We continue to expect that the FOMC will taper its QE program by $10 billion per meeting, exit the program altogether by the end of 2014, and begin to raise interest rates in late 2015. That schedule assumes that the economy tracks closely to the Fed's forecast of near 3.0% GDP growth in each of the next two years, a steady decline in the unemployment rate to around 5.5%, and an uptick in inflation to near 2.0%. The Fed will update these forecasts in two weeks. The Fed remains concerned about the health of the labor market and low inflation, and the debate in recent weeks has centered on how much inflation the Fed would tolerate to facilitate more rapid healing in the labor market. A few Fed officials are on the docket this week ahead of next week's unofficial quiet period before the FOMC meeting. We expect that the Fed's Beige Book—due out on Wednesday, June 4—will describe an economy that has rebounded sharply from poor weather in the winter months. We will update our Beige Book Barometer in next week's *Weekly Economic Commentary*.

The U.S. data out this week are crucial to the outlook for the Fed and the global economy. From early January 2014 through early April, U.S. economic data came in below expectations, as the market was too slow to recognize the impact of the poor weather on the economy. As reported last week, the U.S. economy shrank by 1.0% in the first quarter of 2014, raising concerns that the economy was in—or headed for—another recession. We don't share that view, and the data released since early April (for April and May) confirm our view that poor weather was the culprit behind the weak pace of growth in the first quarter.

Everything Ahead

Another run of better-than-expected readings in the United States this week for May on vehicle sales, employment, ISM for manufacturing, ISM for non-manufacturing, and of course the all-important employment report, would help to further convince market participants that the U.S. economy is indeed accelerating. Markets will be most closely focused on the leading components of these reports. For example, the new orders component of the ISM report, the temporary help supply employment count in the monthly employment report, and any adjustment to the vehicle production schedule for June and the third quarter based on the new vehicle sales pace in May. Our view remains that the U.S. economy could accelerate in the second quarter to well above the economy's long-term average growth rate after a weather-induced slowdown in growth in the first quarter of 2014. ■

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.

The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

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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