Economic Indicators Explanations

GPD - Gross Domestic Product

- Measures the total value of all goods and services being produce by a country during the reporting period.
- An increase in GPD means the economy is growing, because of this it can be used to measure the level of inflation within the economy.
- **Strong GDP results indicate a healthy economy, suggesting that the currency may increase in value compared to currencies for countries with weaker economies.**

CPI - Consumer Price Index

- Measures the cost to buy a defined basket of goods and services. It is expressed as an index based on a starting value of 100.
- A CPI of 112 means that it now costs 12% more to buy the same basket of goods and services today than it did when the starting index value was first determined.
- By comparing results from one period to the next, it is possible to measure changes in consumer buying power and the effects of inflation.
- Inflation is a concern to currency traders as it affects the price of everything bought and sold within an economy, and this has a direct impact on the supply and demand for a country's currency.
- **A CPI that continues to trend upwards month over month could be a signal that inflation is eroding buying power to the point that the Central Bank will raise interest rates to curb spending. An increase in interest rates may lead to an increase in demand for the currency as the potential for a higher return makes the currency more attractive for investors.**

PPI - Producer Price Index

- Also an inflation indicator, the PPI tracks the changes in prices that producers receive for their products and it is also expressed as an index based on a starting value of 100.
- Excludes volatile items such as energy and food to avoid distorting the index.
- **Like other inflation-based reports, increasing PPI values could signal an interest rate hike to combat inflation. Interest rate increases can lead to a greater demand for the currency.**

Employment Reports

- Employment reports have an immediate impact on currencies because employment levels directly affect current and future spending habits.
- An increase in unemployment is a *negative* indicator as it implies that more people are not receiving a regular salary. This is a sure signal that consumer spending will decline.
- **If employment trends downwards, the economy could weaken as fewer people will have the means to purchase non-essential goods. If employment is increasing,**

then spending is likewise expected to increase, and a stronger economy often leads to a stronger currency.

Interest Rates

- Most Central Banks maintain a "benchmark" interest rate.
- Depending on the jurisdiction, the Central Bank rate serves as the guide for the rate at which the Central Bank and other commercial banks lend each other funds to meet short-term operational needs.
- Commercial lending rates are also affected by the Central Bank rate, and it is this linking of short-term rates to the commercial rates that makes interest rate policy the primary monetary tool for Central Banks.
- As noted earlier, the Central Bank can increase rates during periods of high growth (inflation) in a bid to reduce consumer spending which should help bring growth back to a more manageable level.
- If deflation is a problem and the economy needs a boost, Central Banks can lower interest rates to entice more consumer lending. The expected outcome is that overall consumer spending will increase as consumers have access to less costly loans.
- Forex traders in particular pay close attention to changes in interest rates as investors tend to seek out currencies offering higher returns and this demand can cause a currency to appreciate.
- Also, the greater the interest rate differential between two currencies, the greater the profit potential of a *carry trade* strategy. See Trading Strategies and Best Practices in Lesson 4 for more information on carry trades.
- **Investors naturally look to currencies that provide the best return. If interest rates rise for a particular currency, investors will increase their holdings in that currency to profit on the higher return. The resulting increase in demand for the currency could cause it to appreciate in value compared to other currencies.**

Yield Curve

- Yield is the interest on fixed-income securities which includes such investments as futures contracts and government bonds.
- Referred to as "fixed" income because the payment stream (the *yield*) remains constant until maturity.
- For example, a simple 5-year bond with a 3 percent annual yield, would pay $300 a year for the next five years on an initial $10,000 investment.
- The yield curve shows the relationship between the yield, and the time to maturity.
    - Upward Curve - The normal yield curve shifts upwards over time. This pattern indicates an increase in the yield. This is good for Investors.
    - Flat Curve - This means the investors are still willing to hold long term but they do not see much room for economic growth & short term interest rates will remain stable.

    - Downward Curve - An inverted yield curve that slopes downwards over time indicates a negative outlook for the market in the future. This could suggest the onset of a prolonged economic downturn or possible recession.
    - Hump Curve - A humped curve occurs when both short and long-term yields are equal, but medium-term yields are higher. This could indicate an expectation that the economy may be entering a period of growth, but this growth is not expected to be sustainable over the long-term.
- As an investor you may be happy with a 5 percent return when the basic lending rate is 2 percent. However, if short-term interest rates rise and the lending rate jumps to 6 percent, your 5 percent return is no longer so attractive, and there are probably other options that could generate more income for your investment.
- Liquidity spread is the term used to describe the difference between the yield and short-term rates.
- If short-term interest rates rise above the fixed yield, the bond holder is said to be in a position of *negative* liquidity spread.
- When plotted on a chart, the yield is represented along the y-axis, while time to maturity is charted vertically on the x-axis. This results in a yield curve shape that some investors suggest offers insight into future interest rates.
- **Because the yield curve is seen as an indicator of future interest rates, its impact on currency values is much the same as that of interest rates in general.**

ISM - Institute of Supply Management

- The ISM report is another inflation indicator. It measures the level of new orders and helps predict manufacturing activity for the upcoming period.
- It is expressed as an index based on 50. A number less than 50 means that manufacturing has contracted from the previous period, while a number greater than 50 indicates growth for the previous period.
- Because the ISM captures current factory production levels, it provides insight into the expected level of consumer demand for goods in the immediate future.
- **Also tracks inflationary pressures in the economy. An ISM trending upwards can suggest a growing economy, which makes the currency attractive to forex traders.**

Retail Sales Report

- The Retail Sales Report tracks consumer spending patterns – items such as health care and education are not included.
- An increase in the Retail Sales Report is likely to be seen as positive for the currency as it suggests growing consumer confidence.
- **A stronger Retail Sales report indicates overall growth in the economy, thus increasing the currency's appeal to investors.**

IPI - Industrial Production Index

- Shows the monthly change in production for the major industrial sectors including mining, manufacturing, and public utilities.
- Considered an accurate assessment of employment in the manufacturing sectors, average earnings, and overall income levels.
- An increase in IPI suggests continued growth which is seen as a positive for the economy.
- **A positive or increasing IPI suggests continued economic growth, which often leads to a stronger currency.**

CPI - Commodity Price Index

- Tracks the changes in the average value of commodity prices such as oil, minerals, and metals.
- This index is particularly relevant for countries like Canada and Australia (known as the "commodity dollars") that serve as major commodity exporters.
- For commodity exporters, an increase in this index suggests greater potential for earning higher prices from these exports.
- **An increase in the Commodity Price Index means that commodities are generating more income for the economy, which often leads to an appreciation in the country's currency.**

Trade Balance

- Compares the total value of imports to the total value of exports for a reporting period.
- A negative value indicates that more goods were imported than were exported (a trade deficit) – while a positive trade balance means that exports exceeded imports (a trade surplus).
- If the balance of trade shows a *surplus* or *declining* deficit, then there may be an increased demand for the currency.
- If the report shows a growing *deficit*, then the increased supply – together with a decrease in demand for the exporting currency – could lead to a devaluation against other currencies.
- **The Trade Balance Report provides insight into the demand for a currency on the global markets. If the balance of trade shows a surplus or declining deficit, then there may be an increased demand for the currency. If the report shows a growing deficit, then the increased supply of the currency could lead to a devaluation against other currencies.**

Current Account

- **Current Account deficits can have a negative impact on the currency for the same reasons cited for Trade Balance deficits. When in a deficit situation, a country is forced to convert its own currency to the currencies of other countries. This increases the supply of currency, resulting in a potential devaluation against other currencies.**