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Short-term recovery

Gerhard Winzer

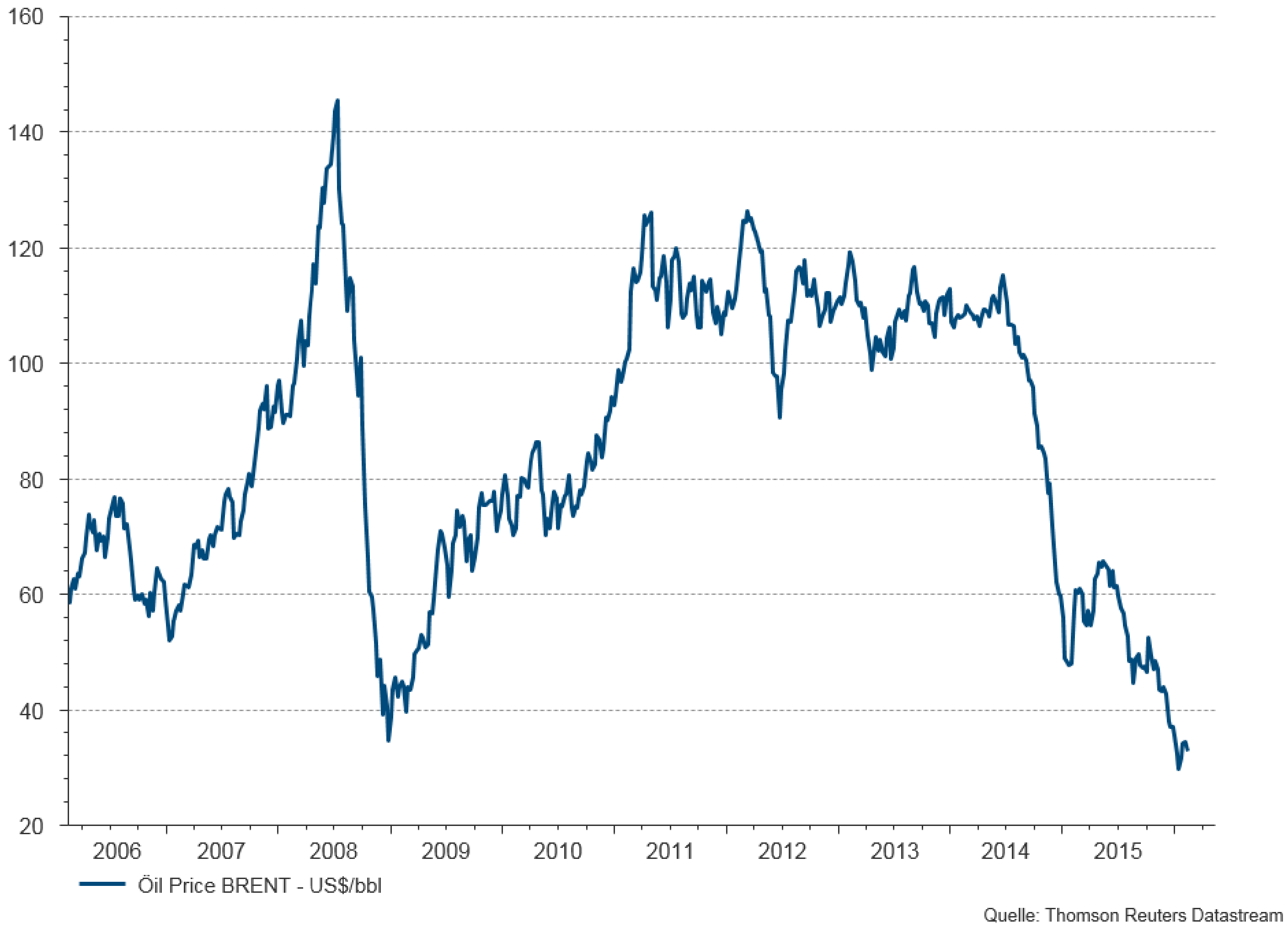
Growth is weak, and the downside risks are elevated. However, in a pre-emptive move, the market has already priced in the materialisation of some of the risks. The current development would not immediately suggest it. A short-term phase of recovery on the equity markets would fit this picture.

The past days and weeks have not been easy. The market participants feel unsettled, and pessimism has been on the rise. While the former is justified, we regard the degree of pessimism as overshooting, at least in the short run. The market now has a drastic and imminent economic weakening, i.e. a partial materialisation of the existing risks, priced in.

Indeed, the currently available data do not suggest any reason for euphoria: economic growth is low. Global GDP growth in Q4 2015 was down to only +1.8% relative to the previous month. In addition, for the coming quarters important leading indicators such as those provided by the OECD suggest a decline in economic growth in the industrialised countries and stabilisation on low levels in the emerging economies. The trend of disappointed growth expectations, in place for years now, will presumably continue. The data do not indicate an imminent recession. For example, the fallen oil price supports retail sales in the USA.

Global inflation is very low. If the energy prices stabilise, annual inflation rates will rise slightly in the second half of the year on the back of the base effect. The possible second-round and spill-over effects from the falling goods prices to the higher service prices are an aspect worth monitoring. The central banks are unlikely to achieve their respective inflation targets in the foreseeable future. In the wake of the drastic fall of the inflation rates priced into the bond yields, the inflation expectations of consumers have now also fallen in the USA. The data do not suggest a transition from low inflation (“lowflation”) to deflation, although the risk of this situation occurring remains elevated.

Oilprice development (01/2006 – 02/2016)



Source: Thomson Reuters Datastream; Crude Oil-Brent FOB US$/Barrel

Stabilisation of commodity prices and emerging currencies

In addition to the disappointed growth expectations (with regard to real GDP and inflation), the decline in commodity prices and the adjustment process in the emerging economies are affecting the markets. Commodity prices and emerging currencies have stabilised especially due to the hefty decline in expected interest rate hikes in the USA and the resulting depreciation of the trade-weighted US dollar. The situation remains tense. Among other things, the liquidity situation has deteriorated in the emerging economies. In addition, in China both exports and imports are on the decline, and the Chinese foreign exchange reserves have been dropping rapidly.

The financial environment has become more restrictive. Share prices have fallen, spreads (default risk) have widened, and volatilities have increased. There is the risk of negative feedback of stress from the financial markets to the banking sector and the real economy. Stabilising markets would curtail this risk.

Central banks have reacted to this environment with expansive strategies. More and more central banks are implementing a negative interest rate policy. At the end of January the Japanese central bank cut the interest rate for additional surplus liquidity of commercial banks deposited with the central bank to minus 0.1%. The European Central Bank will cut the interest rate on deposit accounts further from currently -0.30% (with -0.50% currently priced in). In an important speech to the US Congress, the US Fed president Yellin also advocated a wait-and-see stance. A rate hike in the USA does not fit the fragile global environment. The only stagnating monetary base (M0) seems to be disadvantageous enough to the financial markets.

The negative interest rate policies pursued by the central banks also create collateral damage. Among other things, they eat into the profitability of banks. This, too, explains the revaluation of the banking sector (as does the increased systematic risk).

Wichtige rechtliche Hinweise

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From July 1997 to June 2007, he worked in research at CAIB, Bank Austria Creditanstalt, and UniCredit Markets & Investment Banking. His last position was as Executive Director for Fixed Income / FX Research and Strategy. He was responsible for research on asset allocation at Raiffeisen Zentralbank (RZB) in Vienna from July 2007 to February 2008.