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Economic outlook 2019: reasons to remain optimistic

Erste AM Communications



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- Global economy continues to grow strongly, but the number of countries with declining growth rates is rising
- Interest rate hike cycle could be paused in 2019
- Opportunities on the equity markets and in high-yield asset classes
- Volatile environment suggests fund savings plans

There are signs of the global economy shifting down a gear in 2019. A number of important leading indicators suggest a gradual weakening of real global economic growth. The absolute level remains solid, however, at an estimated growth rate of about 3.25% above the long-term expected value (i.e. potential).

Disruptions: China, trade conflict, Italy, and Brexit

While the number of countries with falling growth rates has increased, not a single economy has reported negative GDP growth. In a press conference on the outlook for 2019 Heinz Bednar, CEO of Erste Asset Management (Erste AM), said that *"the risk of a recession in 2019 was very low. Given the significant decrease in share and corporate bond prices in November the chances for investors on the international capital markets are intact."*

Possible disruptions such as the budgetary conflict between the EU and Italy getting out of hand, a hard Brexit (i.e. the UK leaving the EU with no deal), and an end to the ceasefire between the USA and China could lead to elevated volatility yet again. In order to earn real yields, there are no alternatives to equities and high-yield corporate bonds, according to Bednar. The experts of Erste Asset Management also see selective investment opportunities in local currencies due to the negative impact the interest rate hikes in the USA have had on the emerging market.

As Gerold Permoser, Chief Investment Officer (CIO) of the company, has pointed out, *"the risk of inflation is contained with the exception of the USA, where the Fed has reached its 2.0% target and the low unemployment rate could drive up inflation."* In Europe, inflation has remained below the 2.0% target of the central bank. The higher growth rate of labour costs has not reached the bottom line yet. In China, inflation has even fallen due to a decrease in producer prices. The significant decrease in the oil price has also dampened inflation.

Ringling the Opening Bell for 2019: Erste AM, Managing Director Heinz Bednar (left) and CIO, Gerold Permoser.

Central banks might push pause button on rate hikes

"As long as inflation remains low in the developed economies, the central banks may pause their interest rate hike cycle in case of a strain on the financial environment," as Permoser explains. This is particularly true for the central bank in the USA, which has recently indicated a pause in its regime of rate hikes due to signs of weakness in the property market. While another rate hike in December is priced in on the markets, at this point it is unclear whether we will see another rate increase in 2019. Permoser does not envisage a strong rise in interest rates for the euro area either. We might see a rate hike by the ECB, but it is unclear when. Volatility will remain an issue on the bond markets in 2019. In an environment of stable yields and intact growth opportunities, Erste Asset Management prefers high-yield corporate bonds in Europa and the USA as well as emerging markets corporate bonds in local currency.

Equities remain the favourite among the asset classes

Political risks and a slight economic slowdown on the one hand, as well as low interest rates and robust company earnings on the other hand paint a picture where we yet again regard equities as the most attractive asset class in 2019. While the bulls have been somewhat reined in, equity investments have to be seen from a long-term perspective. *"Prior to 2018, we were witnessing a long phase of rising prices."* According to Erste AM CIO Permoser, the recent correction on the international stock exchanges has led valuations based on expected company earnings back to fair levels. With regard to 2019, the expert says that regional performance differences will decrease, and a lot is there to suggest that a broadly diversified, global equity strategy is the way to go.

Higher volatility speaking in favour of fund savings plan

Volatility has increased significantly in comparison with previous years. According to Heinz Bednar, this scenario favours investment fund savings plans. The regular deposits of even small amounts results in an attractive average price in the long run. Such a plan can be tailored to the needs of the client and can include a wide range of different fund products.

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