

<https://blog.en.erste-am.com/global-economy-based-goldilocks-principle/>

## The global economy based on the Goldilocks principle

Gerhard Winzer



© (c) iStock

**The global economy is growing moderately, inflation is low, and the monetary policy is loose. This environment supports many asset classes from bonds to equities. The political uncertainty has been absorbed rather well so far too. Will this situation last?**

In order to answer this question, let us first look at the USA. The persistent reduction of the yield differential between short- and long-term US Treasuries (i.e. the flattening of the yield curve) is remarkable. This tendency might suggest a decreasing momentum.

### Global economy in recovery – Eurozone picking up speed

The global economy is growing at a rate of 3% (source: Erste AM), i.e. slightly above the long-term expected growth (the so-called potential growth). As a result, the unemployment rates are falling. While the global economy continues to produce below capacity, the so-called output gap has been gradually turning less negative. In other words, the global economy has been in recovery mode since 2009. The leading indicators such as purchasing managers indices for the month of May suggest a continuation of this trend. The Eurozone stands out: here, some indicators such as the business climate index of the European Commission suggest a further acceleration of real economic growth (from 2.0% in Q1 to 2.5% in Q2; source: Bloomberg and Erste AM).

### Asia and USA raining on parade

Of course, there is a fly in the ointment: some indicators in Asia (e.g. industrial production) and in the USA (e.g. property market) are on the weaker side. This is also reflected in the globally falling economic data surprises; a trend led by the aforementioned two regions.

### Low inflation

The acceleration phase is not only over in the economic growth department. Inflation is also not on the rise anymore. The underlying inflation thus remains on low levels. The inflation development in the USA also illustrates the low levels of inflation pressure. At 4.4% (source: Bloomberg), the unemployment rate is also subdued – which did not prevent core inflation from falling recently (1.5% in April y/y). In the Eurozone, core inflation has been an average 0.8% since the beginning of 2014 (source: Bloomberg) with hardly any indication of an imminent increase. Globally, data surprises for inflation are falling much like economic data surprises. In tandem with this scenario, the inflation priced into the bond market has also been on a decline.

### Less expansive monetary policy

On 8 June, the European Central Bank will presumably change the assessment of its future monetary policy, in short, the forward guidance, in two ways. Firstly, it will describe the economic risks as balanced (currently: downside risk). And secondly, the statement according to which the key-lending rates could also decrease and the bond purchase programme could be expanded as well could be diluted or even taken out completely. This would mean another small step towards the next reduction of the bond purchase programme.

### Further interest rate hikes in the USA

Analysts expect the US Fed funds rate to be stepped up by 25bps to a target bandwidth of 1% to 1.25% on 14 June. In addition, members of the FOMC have indicated the start of a cautious reduction of the central bank balance sheet in the second half of the year.

The character of the monetary policy is still very expansive. At the same time, a further moderate reduction of central bank support is starting to take shape on the horizon. The growth of central bank liquidity will continue to decrease.

### Tightening in China

Credit growth has been extraordinarily high in the past years in China. This was largely due to the so-called shadow banking system. In line with this, the financial stability indicators are suggesting an increased level of risk. With the deflation of 2015 overcome, the economic policy has gradually had its focus shifted to the excesses in the credit sector. The tightening of the regulatory environment in the financial sector resulted, among other things, in a significant interest rate increase. The 3M interbank rate has increased from 2.8% at the beginning of September 2016 to currently 4.6% (source: Bloomberg). The heart of the matter is to find the right balance between deleveraging the shadow banking system and providing sufficient amounts of liquidity for the entire economy. To date there are still hardly any signs that would suggest a drastic decrease in growth. The ones that do stand out are the falling trend of the purchasing managers index for the manufacturing sector since the beginning of the year and the declining commodity prices for metals.

### Political uncertainty

The political uncertainty remains a crucial driving factor for the markets. In the USA, the domestic issues of the Trump cabinet have reduced the likelihood of stimuli. In Brazil, President Temer is facing accusations of bribery. This has dimmed the hope of structural reforms (pensions, job market). In the UK, the lead of the Conservative Party over the Labour Party has decreased in the run-up to the parliamentary elections on 8 June, as has the likelihood of a soft Brexit. In Italy, the probability of snap elections in autumn has increased. The only positive development: in France, the movement of President Macron is ahead in the polls for the parliamentary elections on 11 June (first ballot) and 18 June (second ballot). The movement might even achieve an absolute majority in terms of seats.

### Financial markets are resilient

The combination of moderate growth, low inflation, and a market-friendly monetary policy reminds us of the Goldilocks principle. In the popular fairy-tale "Goldilocks and the Three Bears" one bowl of porridge has the temperature that is just right. This notion of "just right" is also used in the description of economic data. However, there are enough arguments to remain vigilant. On a positive note, both the global economy and the financial markets have proven remarkably resilient after the Great Recession almost ten years ago.

## Legal disclaimer

This document is an advertisement. Unless indicated otherwise, source: Erste Asset Management GmbH. The language of communication of the sales offices is German and the languages of communication of the Management Company also include English.

The prospectus for UCITS funds (including any amendments) is prepared and published in accordance with the provisions of the InvFG 2011 as amended. Information for Investors pursuant to § 21 AIFMG is prepared for the alternative investment funds (AIF) administered by Erste Asset Management GmbH pursuant to the provisions of the AIFMG in conjunction with the InvFG 2011.

The currently valid versions of the prospectus, the Information for Investors pursuant to § 21 AIFMG, and the key information document can be found on the website [www.erste-am.com](http://www.erste-am.com) under "Mandatory publications" and can be obtained free of charge by interested investors at the offices of the Management Company and at the offices of the depositary bank. The exact date of the most recent publication of the prospectus, the languages in which the key information document is available, and any other locations where the documents can be obtained are indicated on the website [www.erste-am.com](http://www.erste-am.com). A summary of the investor rights is available in German and English on the website [www.erste-am.com/investor-rights](http://www.erste-am.com/investor-rights) and can also be obtained from the Management Company.

The Management Company can decide to suspend the provisions it has taken for the sale of unit certificates in other countries in accordance with the regulatory requirements.

**Note:** You are about to purchase a product that may be difficult to understand. We recommend that you read the indicated fund documents before making an investment decision. In addition to the locations listed above, you can obtain these documents free of charge at the offices of the referring Sparkassen bank and the offices of Erste Bank der oesterreichischen Sparkassen AG. You can also access these documents electronically at [www.erste-am.com](http://www.erste-am.com).

**N.B.:** The performance scenarios listed in the key information document are based on a calculation method that is specified in an EU regulation. The future market development cannot be accurately predicted. The depicted performance scenarios merely present potential earnings, but are based on the earnings in the recent past. The actual earnings may be lower than indicated. Our analyses and conclusions are general in nature and do not take into account the individual characteristics of our investors in terms of earnings, taxation, experience and knowledge, investment objective, financial position, capacity for loss, and risk tolerance.

**Please note:** Past performance is not a reliable indicator of the future performance of a fund. Investments in securities entail risks in addition to the opportunities presented here. The value of units and their earnings can rise and fall. Changes in exchange rates can also have a positive or negative effect on the value of an investment. For this reason, you may receive less than your originally invested amount when you redeem your units. Persons who are interested in purchasing units in investment funds are advised to read the current fund prospectus(es) and the Information for Investors pursuant to § 21 AIFMG, especially the risk notices they contain, before making an investment decision. If the fund currency is different than the investor's home currency, changes in the relevant exchange rate can positively or negatively influence the value of the investment and the amount of the costs associated with the fund in the home currency.

We are not permitted to directly or indirectly offer, sell, transfer, or deliver this financial product to natural or legal persons whose place of residence or domicile is located in a country where this is legally prohibited. In this case, we may not provide any product information, either.

Please consult the corresponding information in the fund prospectus and the Information for Investors pursuant to § 21 AIFMG for restrictions on the sale of the fund to American or Russian citizens.

It is expressly noted that this communication does not provide any investment recommendations, but only expresses our current market assessment. Thus, this communication is not a substitute for investment advice, does not take into account the legal regulations aimed at promoting the independence of financial analyses, and is not subject to a prohibition on trading following the distribution of financial analyses.

This document does not represent a sales activity of the Management Company and therefore may not be construed as an offer for the purchase or sale of financial or investment instruments.

Erste Asset Management GmbH is affiliated with the referring Sparkassen banks and Erste Bank.

Please also read the "Information about us and our securities services" published by your bank.

Subject to misprints and errors.



## Gerhard Winzer

Gerhard Winzer has worked at Erste Asset Management since March 2008. Up until March 2009, he was Senior Fund Manager in Fixed Income Asset Allocation; he has been Head Economist since April 2009.

He holds a degree from a polytechnical college and studied economics and business at Vienna University with a special focus on financial markets. He holds a CFA charter and participated from 2001 to 2003 in the doctoral programme for finance at the Center for Central European Financial Markets in Vienna.

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.