

AN UNSTABLE BALANCE

09/04/2021 | DIDIER SAINT-GEORGES

The world economy is set to grow this year, but rising interest rates could kick off a period of financial-market instability, explains ([../people/didier-saint-georges-2 ""](#)), a Carmignac Strategic Investment Committee member.

WHAT'S YOUR TAKE ON THE CURRENT STATE OF FINANCIAL MARKETS?

Didier Saint-Georges: Early in March, we discussed [the potential impact of rising interest rates on the stock market](#) as we looked at US economic growth. Developments since then haven't changed the underlying situation. There's still a risk that interest rates will keep rising, making share prices more volatile in the process. The economic and political data that come out in the next few months could prove decisive in shaping a new financial-market trend.

YOU MENTIONED THE DANGER OF AN OVERHEATING ECONOMY IN THE US LAST MONTH. HOW DO YOU VIEW THAT ISSUE TODAY?

DSG : That danger has by no means gone away. A successful ramp-up of the country's vaccination programme has made the US public health situation much more manageable than in Europe and the emerging world (China excluded). The number of new hospital admissions hasn't risen. This means that the US economy is already in the re-opening phase, with the direct relief cheques included in the Biden administration's American Rescue Plan already on their way to households.

PRESIDENT BIDEN SEEMS QUITE DETERMINED TO SUSTAIN THE US ECONOMY.

DSG : Yes, the new administration shows tremendous determination to push through its \$2 trillion American Jobs Plan, probably soon to be followed by an additional \$1 trillion in social spending. The amounts under discussion are unprecedented, and the political imperative of supporting economic growth at least until the mid-term elections in late 2022 points to continuing fiscal stimulus next year.

WHAT IS YOUR OUTLOOK FOR ECONOMIC GROWTH IN THE UNITED STATES?

DSG : The current momentum looks set to continue in America. GDP (Gross Domestic Product) may well expand by better than 7% in 2021. Our estimate is that previously shut-down sectors like hospitality, air travel and leisure have recovered to about 50% of their usual level of business, while the jobless rate has apparently continued to recede in most US states. But one thing should be kept in mind. A surge in pent-up consumer demand, combined with what is apparently unlimited fiscal stimulus, gives weight to forecasts of an overheating economy – in other words, growth accompanied by sharply rising prices.

CAN'T THE FEDERAL RESERVE – THE US CENTRAL BANK – TAKE ACTION TO PREVENT THE ECONOMY FROM OVERHEATING?

DSG : The Federal Reserve (Fed) is confronted with something like “Sophie’s choice”: either reduce the risk of overheating or step in to prevent a trend reversal in financial markets. By postponing any move to raise its own policy rates, the Fed is fuelling fears that a combination of economic growth, high government spending and falling unemployment will drive prices up. Those fears in turn may lead to rising long-term interest rates, which tend to hold back the stock market and hurt sectors like real estate. Conversely, if the Fed does lift its rates, short-term interest rates will automatically head upwards in financial-market trading, thereby generating risk for the stock market, or even for the economy as a whole.

YOUR DESCRIPTION OF THE US ECONOMY SEEMS A FAR CRY FROM WHAT WE’RE CURRENTLY SEEING IN EUROPE.

DSG : The accumulated delays in the European Union’s vaccination process are taking a heavy toll, because they will make tough restrictions on economic activity unavoidable for several more months. The eurozone economy will have a hard time expanding by more than 4% this year, despite a highly favourable basis of comparison with the low reached last year.

WELL, THEN HOW DO YOU ACCOUNT FOR THE PARADOX THAT EUROPEAN EQUITIES OUTPERFORMED US EQUITIES IN THE FIRST QUARTER OF THE YEAR?

DSG : Europe’s lag in economic recovery is attributable both to vaccination foul-ups and to the region’s rather modest recovery plans when compared with the US, but it has at least offered the advantage – so far – of putting less upward pressure on interest rates. That same lag explains the recent outperformance chalked up by European equities. But Europe’s financial markets and economy can’t be separated from global developments, so the region’s economy stands a good chance of catching up, particularly now that the vaccination campaign is at last accelerating. In addition, interest rates in Europe should eventually trend upwards, as in the United States.

INVESTORS SEEM RATHER UPBEAT FOR NOW.

DSG : Among investors, excitement about the economic upswing is currently overshadowing any concerns over an overheating economy, steadily rising inflation and an excessive upward drift in interest rates. Those dangers seem rather remote today, particularly to Europeans. Besides, price increases can be mitigated by a variety of factors still at work today, like demography, huge debt burdens and disruptive technology. But the current balance in financial markets is unstable.

HOW SO?

DSG : As risk managers, we feel we can’t rule out the prospect that the new impetus given to the US economy may spell an end to the paradigm that has held sway in financial markets for the past decade. As in the late 1960s, America today is undergoing a truly radical shift in economic policy. And just as back then, once even “American exceptionalism” – the privilege of being able to take a more carefree approach to economic policy than other countries, due to the United States’ dominant status – proves powerless to erase the country’s colossal accumulated deficits, the dollar could eventually depreciate – which would be good news for emerging economies.

HOW DO YOU AT CARMIGNAC DEAL WITH THOSE ISSUES?

DSG : Given the danger of rising interest rates, our short-term priority is to manage the risk of an upcoming period of financial-market instability so that we can make the most of the high-potential investments in our portfolio for the long run. In the months to come, we will go on investing in accordance with our long-term convictions. Some of these, like the energy transition, will even emerge in better shape from Washington's stimulus programmes. At the same time, we will be keeping a close watch on stock-market imbalances.

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