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# BANKING INSIGHT

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## Move Along, Goldilocks

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# MOVE ALONG, GOLDILOCKS

By Angela SP Yap

FORGET ABOUT THE ECONOMIC SWEET SPOT. FUNDAMENTALS ARE WHAT WE WANT.

Sometime in September 2020 – or about nine months into the pandemic – overt signs of market rallying entered mainstream media. Headlines like "Get ready for Goldilocks phase in 2021" and "Indonesia, Philippines well-placed for Asia's Goldilocks phase in 2021" were premised on a single report by a global investment bank which primed investors for "a sweet spot of accelerating and above-trend growth, rising-to-trend inflation, and a big easy policy".

From thereon, others began chiming in. In a letter to shareholders issued in April, one financial chief iterated "it is possible that we will have a Goldilocks moment". As recent as 27 October, the release of the Chancellor of the Exchequer's budget was likened by news agency *Reuters* as *'Rishi Sunak Bets on Goldilocks Economy'*.

When it was clear that predictions had run astray, one analyst, also speaking to news agency *Reuters*, introduced a new term – the "semi-Goldilocks" moment. A good soundbite, for sure, but this hair-splitting term defies logic to any analyst worth his or her salt. What will they conjure up next – a quarter Goldilocks?

As 2021 comes to a close, for those who've been waiting for the Goldilocks gravy train to arrive, we're here to remind that banking is built on sterner stuff. Sweet spots like Goldilocks are fleeting moments whereas the road to economic recovery is paved in fundamentals.

## BEARISH FAIRY TALE

Coined by UCLA senior economist David Shulman in his equity-strategy paper *The Goldilocks Economy: Keeping the Bears at Bay,* the eponymous term taken from a children's fairy tale has been embedded in financial lexicon to denote an economy that's like that third bowl of porridge in the story: just right – not too hot, not too cold.

While there's really no hard and fast rule when it comes to defining the parameters of a Goldilocks economy, consensus dictates a precarious balance (some describe it as a knife's edge) typified by low unemployment rate, increase in asset prices, low market interest rates, low inflation, and steady economic growth. In other words, it is the ideal state where economic growth is, as one bank put it, "warm enough to keep a recession at bay but cool enough to stave off major inflation". The trifecta to every investor's dream.

However, like the law of gravity, nothing stays buoyant forever. A Goldilocks economy is temporary and part of the boom-and-bust cycle. What few will tell you is that the choices you make during this fleeting moment will leave a lasting impact in your organisation and an indelible ripple effect throughout the financial system.

As more countries – especially in emerging markets – move towards greater economic stabilisation after the stress of a crisis, financial institutions are driven to take on more risk in search of greater yield.

It bears reminding that bets that turn sour have knock-on effects. In this regard, the International Monetary Fund (IMF) has warned of the impact such strategies have on economic and financial stability, caused by banks that take on inordinate risks in the hopes of securing the greatest returns on investment.

*The Risk & Return: In Search of Yield,* an article published in the IMF's autumn issue of *Finance & Development* magazine, connects the dots between a firm's investing strategies and its implications for financial stability:

"Low rates of return tempt investors to take risks, which can cause economic and financial instability.

"Firms might seek to boost income through speculative investments financed by debt because borrowing is cheap. Financial institutions such as banks and insurance companies may make risky bets to maintain profits or even to survive. But riskier portfolios increase the likelihood of loss. Higher indebtedness means firms are in a more precarious position when confronted by adverse shocks. The result is greater institutional vulnerability and increased likelihood of economic and

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