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Concerns over inflation, bubbles and budget deficits set the tone for 2010

Andreas Utermann, Global Chief Investment Officer at RCM, a company of Allianz Global Investors, presents an outlook for inflation, interest rates and equities.

"The major themes for 2010 will be ongoing debates over inflation, budget deficits, bubbles, interest rates and the continued rise of emerging markets.

Inflation – not on the emerging markets agenda

"The emerging markets are experiencing slightly higher and rising inflation rates and their governments will start to tackle this using more restrictive monetary policy. China, in particular, has already started putting the brakes on its credit expansion. Looking at the major OECD economies led by the Euro Zone and the United States of America, we expect a temporary flaring up of inflation followed by a fairly benign outcome. That means for the majority of 2010 inflation will not be a major issue for markets, in the sense that we expect central banks to be flexible with their policies.

"This does not mean that central banks won't start to roll back some of the extraordinary measures such as quantitative easing. The European Central Bank has already started on this task and we are fairly certain that the Federal Reserve and Bank of England will follow suit in due course. Therefore liquidity levels will not be as high this year as in 2009, and as we move through the year will become even less so. However, we expect monetary policy to continue to be accommodative providing a relatively positive background for risk assets.

Budget deficits to remain on the horizon

"Budget deficits will continue to be high in 2010, the funding needs of governments will increase and debt to GDP ratios will edge towards 100% or above for all of the major economies. This obviously causes a number of structural problems that will need addressing. It means that tax rates on individuals will increase, probably affecting the richer deciles of the population, who will have to contribute more. It could also ultimately mean cuts in state spending. Overall these rising budget deficits and increasing tax rates will provide a significant drag on growth in coming years, not just in 2010. Therefore, after the initial recovery in growth that we are currently seeing, we predict a below par economic performance for the major OECD economies for the next two or three years. Rising budget deficits will ultimately also put pressure on long-term interest rates which can be expected to edge up.

Bubble concerns should be kept in check

"The current rise in equity markets and the associated relatively strong performance of risk assets was obviously fuelled by the abundance of liquidity. Our view is that central banks are wise to this, particularly the European Central Bank. The scenario is that we will not see in the near future a renewed global bubble which would once deflated, put us back to where we were 18 months ago. That doesn't mean that we won't see localised bubbles or bubbles in particular asset classes, but they won't be of the nature we have seen in the last two years.

"Emerging markets have in many cases either avoided recession altogether or really only seen a very moderate fall in growth. Certainly China, India and Brazil have continued to grow albeit at slightly lower rates although they will continue to be volatile."

- Ends -

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Photographs

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http://www.rcm.co.uk/press/04_fundmanagers.html

Awards

- RCM named winner of Active North American Equity at Pensions & Investment Provider awards 2009. RCM US Large Cap Select Growth is managed by Scott Migliori, Co-CIO for US Equities, RCM.
- RCM named No.1 leading fund management firm for SRI Research by Thomson Reuters Extel 2009.
- Global CIO of RCM, Andreas Utermann, named CIO of the Year by Funds Europe magazine 2008.
- Winner of European Investment Trust of the Year by Investment Week magazine, 2008, for the RCM-managed Charter European Trust.
- Allianz RCM Global EcoTrends Fund named winner Best Climate Change Investment fund 2008, by Holden & Partners/ Incisive Media.

About RCM (all data source: RCM as at 30/09/09)

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