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TITLE: **Good news, but the wrong kind**

TRANSCRIPT:

**Host:** Eric, the global economy continues to perform better than many expected. Surely that should be good news for investors?

**Eric:** Normally, yes. But at the moment, I'm increasingly concerned that it may be the wrong kind of good news.

For the past two years, investors have been waiting for higher interest rates, higher energy prices and repeated geopolitical shocks to break the global economy. Yet it has remained remarkably resilient.

The US economy continues to surprise on the upside. Europe and Japan are holding up better than expected. Corporate profits remain strong, consumers are still spending, and investment in technology and artificial-intelligence infrastructure continues at an extraordinary pace.

But that resilience creates a problem. If economic growth remains strong and inflation refuses to return fully to target, central banks have little reason to stop tightening.

So, the better the economy performs today, the greater the risk that interest rates remain higher for longer—and eventually expose vulnerabilities elsewhere.

**Host:** Your team have drawn a comparison with 2006. What makes that period relevant today?

**Eric:** The comparison isn't that we are about to repeat the global financial crisis. History is never that neat, and the weaknesses today are very different.

What is striking, though, is the atmosphere.

In 2006, the global economy was growing strongly, inflation was proving persistent, energy prices had risen, and central banks had tightened policy. Yet financial markets remained extraordinarily calm. Credit spreads were very tight, asset prices were strong, and the prevailing view was that the economy had successfully absorbed higher interest rates.

For a while, that view was correct. The Federal Reserve stopped raising rates in June 2006, but the US recession didn't begin until December 2007. That was a long enough gap for investors to conclude that the danger had passed.

The lesson is not that another 2007 is inevitable. It is that monetary policy works with long and unpredictable delays. An economy can appear healthy even while higher borrowing costs are quietly accumulating beneath the surface.

Resilience does not prove that higher rates no longer matter. It may simply mean that the full effects haven't arrived yet.

**Host:** What has changed in the monetary-policy picture this month?

**Eric:** We are now seeing something more significant than a single Federal Reserve decision. The Fed, the European Central Bank and the Bank of Japan have all raised rates in September.

That amounts to synchronised tightening across the world's major developed economies.

For much of the past 18 months, the question has been: when can central banks start cutting rates? We may now need to ask a very different question: how high do rates have to go before policy genuinely becomes restrictive?

Japan illustrates the change particularly clearly. Its policy rate has reached 1.25%, and the Bank of Japan is signalling that the policy phase has changed. That may not sound dramatic by American or European standards, but for Japan it represents a profound shift.

Higher rates in the US alone are one thing. Higher rates simultaneously in America, Europe and Japan raise the global cost of capital. That affects currencies, capital flows, refinancing costs and, eventually, asset valuations everywhere.

**Host:** Yet equity and credit markets still seem relatively relaxed.

**Eric:** They do—and perhaps too relaxed.

This is where we need to distinguish between economic risk and market risk. The immediate risk of a global recession looks relatively contained. But market risk is becoming less comfortable.

Equities have absorbed Treasury yields around 5%, oil above $100, further central-bank tightening and a major geopolitical conflict with surprisingly little damage.

But expensive markets don't need a recession to fall. Sometimes they simply need the discount rate to rise far enough.

The key question is not necessarily whether corporate earnings are about to collapse. They probably aren't. It is whether investors will continue paying today's valuations if bond yields remain close to 5%, oil stays above $100 and central banks tighten further.

At some point, the mathematics becomes difficult to ignore.

**Host:** If something does break, where are you looking?

**Eric:** I wouldn't automatically look towards housing, which was the major fault line in 2007.

The US housing market is undoubtedly struggling. Mortgage rates around 7% have damaged affordability and transaction volumes remain weak. But household balance sheets, mortgage underwriting and bank capital are generally stronger than they were before the financial crisis.

The more interesting risks today may lie in private credit, highly leveraged companies, commercial property, hedge-fund leverage and the debt being used to finance the AI investment boom.

We are already seeing some investors request money back from private-credit funds more quickly than those funds are willing or able to return it. That does not make it a crisis, but it is a reminder that stress rarely begins with a major index announcing that something is wrong.

It usually starts quietly—in individual loans, liquidity mismatches and companies discovering that refinancing at 8% feels very different from refinancing at 2%.

**Host:** Geopolitics remains another major source of uncertainty. What are you watching now?

**Eric:** Two things stand out.

First, the US midterm elections could eventually influence Washington's ability to finance offensive operations in the Iran conflict. A change of control in Congress would not automatically end the war, but Congress controls spending. That means the political timetable increasingly matters alongside the military one.

Oil markets now have another variable to consider beyond missiles, tankers and the Strait of Hormuz: the ballot box.

Second, President Trump is due to host President Xi Jinping in Washington this week. The photographs and handshakes will attract attention, but the substance is far more important.

America has leverage through semiconductor technology, financial sanctions and the dollar. China has leverage through its dominance of rare-earth processing and its importance to global supply chains.

At the same time, China remains highly dependent on imported energy. That connects the discussions around trade, technology, Iran, Russia and the Gulf much more closely than markets sometimes appreciate.

Semiconductors have often been described as the new oil. Rare earths may increasingly be thought of as the new Strait of Hormuz.

**Host:** What is the main message for investors this week?

**Eric:** Be careful not to confuse a resilient economy with a risk-free market.

The global economy remains remarkably healthy. Consumers are spending, companies are investing, credit spreads are tight and speculative appetite remains alive—even crypto has been rallying while the Fed raises rates.

Central banks can see all of this. Their conclusion may be that financial conditions still aren't restrictive enough.

So, watch private credit. Watch highly leveraged borrowers. Watch the financing behind the AI boom. Watch Treasury yields, Washington, the Gulf—and this week, watch Trump and Xi.

The good news is that the global economy isn't falling into recession.

The uncomfortable news is that its very strength may allow interest rates to rise until something finally gives.

That is why today's economic resilience may be a reason for investors to remain careful, rather than comfortable.

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