GOLDILOCKS ECONOMY

Big Bear, Medium Bear and Little Bear prepare porridge for breakfast. Waiting for it to cool down, they decide to go out for a walk, leaving the door open. A little old lady enters the house and tastes the contents of the three bowls, devouring the little Bear's bowl, which was hot just right, while the big Bear's was very hot and the middle Bear's was still too hot. The spoons are wooden because if they were silver, the wicked old lady would have put them in her pocket. The wicked old woman sits on the small chair, breaking it. Then she falls asleep in the small bed, having tried them all, because it was appropriate to her physique. Returning, the bears discover what has happened. But the old lady, who was sleeping in the little bear's bed, wakes up and escapes through the window. This is the plot of Goldilocks, in Italian *Riccioli d'oro*. The ancient fable was first written down in 1837 by the Romantic poet Robert Southey. But in historical reality there are various versions that transpose the oral tradition. In the 1831 one by Eleanor Mure, the old lady does not run away, but is impaled on the steeple of St Paul 's Cathedral in London; in others, bears maul her.

Over time, the fable was transformed until it became the tale we know today, where the protagonist is no longer an evil old woman, but a naughty, curious and cheeky little girl with golden curls who takes refuge in the bears' family home to refresh herself after wandering in the woods: when they discover her, she apologises and runs away. A fairy tale that has accompanied the childhood of many children, especially in the Anglo-Saxon world, with the idea of instilling a moral that has often been adapted to the educational standards of the time.

The world of finance has chosen it to describe an economic situation that is neither too hot nor too cold, i.e. an ideal equilibrium condition. The term Goldilocks is intended to convey the idea of an economic environment in which growth is strong enough to sustain employment without causing excessive inflation. In other words, the economy is in a 'just right' state, similar to the food or bed of

Goldilocks that was just right after trying the various options available.

The adoption of terms such as 'Goldilocks economy' probably occurred in the early 1990s to describe the situation in the US or other economies that were experiencing stable growth, low inflation and low unemployment, without the extreme peaks that had characterised earlier periods. Robert J. Gordon's text, published in the Brookings Papers in 1998, renders the period well: the study highlights a situation where, despite forecasts of accelerating inflation with the unemployment rate below 6%, unemployment actually slowed significantly between 1994 and 1998.[1] This allowed the Federal Reserve to keep interest rates low, which pushed the stock market to unprecedented valuations at the time.

More recently, the idea of a *Goldilocks* economy has been associated with an environment in which, despite zero or negative rates, inflation does not rear its head: public debt can thus be financed free of charge. Ludwig Straub, Atif R. Miam and Amir Sufi, in a text from 2021, "A Goldilocks Theory of Fiscal Deficits"[2], identify a "Goldilocks zone" in which the nominal interest rate on government debt is lower than the growth rate of the economy, allowing significant levels of government debt and allowing times of weak demand to overcome to reach potential *output*. This study also emphasises the fragility of this zone, which can disappear in the face of a decrease in potential Gross Domestic Product (GDP) growth, an increase in aggregate demand or a reduction in income inequality.

The approach of both analyses contributes to the narrative that led the stock markets to break historical records in this first quarter. In particular, the S&P posted a gain of almost 10%, with an impressive 30% *rally* from its 27 October low. There were no major surprises in March with the Federal Reserve continuing to believe in solid growth and maintaining its plan to cut rates this year. During the month, stock markets posted +3.3% (MSCI US), Germany (+3.1%) France (+2.5%) and Japan (+2.5%) all reached new highs.

[1] Robert J. Gordon, "Foundation of the Goldilocks Economy: Supply Shocks and the Time-Varying NAIRU", *Brookings Papers on Economic Activity*, n.2, 1998.

[2] Atif R. Mian, Ludwig Straub, Amir Sufi, *A Goldilocks Theory of Fiscal Deficits*, NBER Working Paper No. 29707, Gennaio 2022.

Some slight changes appeared on the macroeconomic front. February's non-farm payrolls data maintained healthy growth of 275,000 jobs and retail sales showed a modest 1.5% year-on-year increase, while inflation stopped falling significantly. In late March, the Federal Open Market Committee (FOMC) saw the Fed maintain its plan of three rate cuts this year, raising its growth outlook to 2026 (to 2% or better). Inflation projections (PCE) remained stable. These signals point to the scenario of 'no landing with three rate cuts', which is even better than the previous idea of a soft landing with the same monetary interventions. Indeed, until not so long ago, investors expected a recession, or at any rate, some form of more or less hard landing. Not any more. Inflation has come down from its peaks, although high interest rates have failed, at least in the US, to bend growth. Expansionary fiscal policy has continued to keep demand alive with employment at record lows and inflation falling, although the latest data are more uncertain. The ample liquidity provided to cope with the Covid crisis still seems inexhaustible: against a few central banks draining liquidity, there are China and Japan pumping in plenty. A context that is thus easily defined by *Goldilocks*.

Market optimism has not spared Europe either, as some forward-looking indicators confirm. Real wages are starting to rise. The savings accumulated during the Covid, some 8% of GDP, are still there. Public spending has left behind the rhetoric of *austerity* and embraced that of the *Recovery Fund*. The expected restart of China[3] will also move European demand.

Will the optimism on the stock markets continue into the second quarter? After such a powerful rally in recent months, it would be legitimate to expect a correction or at least a standstill. But the reasons supporting the stock markets are still there. It is possible that the US economy, showing no significant signs of weakening, will push the Federal Reserve to lower its expectations on how many rate cuts to make this year. For the markets, however, what matters is that the downward trajectory is maintained: if they are cut

[3] China's consumer price index rose 0.7% year-on-year in March, from -0.8% in the previous month. Year-on-year growth in electricity consumption and total profits of industrial enterprises rose to 11% and 10% respectively.

twice instead of three times because growth is important, they will pay less attention to the persistence of inflation in the last mile. Inflation, however, cannot get out of hand. Oil prices up to $90 would not shift expectations of general price rises by much, but above that level they probably would.

Among the drivers of stock market growth is the advent of artificial intelligence and the stocks that directly carry it. In 1998, Robert J. Gordon, after analysing the reasons that kept inflation low, did not want to give too much weight to those who identified technology as being able to hold down inflation because, in his view, it was necessary to explain "how the benefits of high technology have contained measured inflation without pushing measured productivity."[4] Today, however, the effects of artificial intelligence are fast and can affect many sectors of the economy by pushing up productivity: it is no coincidence that market exuberance is expanding outside of IT stocks. Markets are likely to wait for first-quarter corporate results and managers ' notes to identify how far artificial intelligence has entered everyday operations and at what cost. Today, however, the effects of artificial intelligence are fast and can affect many sectors of the economy, driving productivity gains: it is no coincidence that market exuberance is expanding outside of IT stocks. The markets will probably wait for the first quarter's corporate results and *managers*' notes to identify how far artificial intelligence has entered day-to-day operations and at what cost.

So all is well? The economic data, especially in the US, but not only there, are Goldilocks: investment choices must be organised around these objective impulses. But the more global reality, with a war in Ukraine, a crisis in the Middle East with Israel, and an escalating challenge between the US and China, could change many expectations and remind markets that the fairy tale of Goldilocks, before embodying the beautiful little girl of our childhood, was represented by an evil, thieving old woman.

Translated with ww.DeepL.com/Translator/CSM

[4] Robert J. Gordon, *Op. cit.*