Using Economic Indicators in Analysing Financial Markets

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BY

BERND KRAMPEN

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INVESTOR IN PEOPLE

Table of Contents

List of Figures

Part III

Chapter 6

Chapter 7

Chapter 10

List of Tables

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List of Market Relevant Economic Indicators

(Continued)

About the Author

Bernd Krampen has studied economics at the universities of Kiel (Germany) and Swansea (United Kingdom). Since 1997 he has worked as financial analyst and economist for Norddeutsche Landesbank in Hanover (Germany). He is responsible for assessing and forecasting economic activity, inflation, interest rates and exchange rates for various countries. His focus lies on fundamental economic analysis, but he also examines behavioural aspects. He also has gained some relevant experience teaching financial economics in educational institutions (e.g. Sparkassenakademie Niedersachsen). His publications include contributions to peer-reviewed journals such as the *German Journal of Risk and Insurance*. He lives in Barsinghausen near Hanover with his wife Sandra and their daughters Alessia and Noelia.

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Preface

> Research is formalized curiosity. It is poking and prying with a purpose.
>
> (Zora Neale Hurston)

> Imagination is the highest form of research.
>
> (Albert Einstein)

Where are the economy and the financial markets heading? What is the outlook for growth, and what are the growth drivers? What does this mean for the expected trends on the financial markets? These questions, which at first glance seem rather academic, can mean hard cash – with the right investments on the financial markets. After all, economic developments have a significant influence on financial market variables such as interest rates, exchange rates and shares. Correct positioning on the financial markets can actually generate profits for one's own investments when macroeconomic trends materialise. In this respect, the question of the economy is not merely an academic-sporting exercise, but creates advantages for one's own wallet.

More than 2 ½ decades of working as an economist in a bank have provided a wealth of experience on how capital markets work and how they can react to new news. Which moods of people, impulses from politics and other (unexpected) influences cause which market movements? Such a wealth of experience is accumulated quasi incidentally over time. Theories and models learned at University have to be compared with experienced reality again and again and can then be considered useful or less useful. Obviously, some of the experiences and insights gained are of interest and of added value.

The main point of this book is to recognise that business cycle analysis is firstly complex, secondly affected by many interdependencies, and thirdly that a forecast of future development should not be overrated. For although there are a large number of indicators that show good tendencies, one problem of analysis is that they often go in different directions. This also explains the differing opinions of economists and analysts when it comes to the future. The weighing of the different indicators is decisive. Unfortunately, however, there is not even agreement on the effects and developments either to the present or the past. One of the intentions of this book is to make readers pause, question, reflect and look critically at many things when connections are all too clear. Things are not always as they –

simplistically – appear. Business cycle analysis and economics are not sciences, but applied theories that are supposed to describe the summed actions of many people as a result.

The first step in the analysis to assess the economic development and the implications for the financial markets should be to correctly evaluate the new news flying in every day. It is important to be able to classify the publications of economic data. What do the indicators contain, which are relevant to the market, how to forecast them? Part II deals with the most market-relevant indicators from the major regions.

Analysts want to get an assessment for the coming months to several years. The tools that can be used for this are discussed in Part III. Basically, the aim is to identify the trends for GDP growth and inflation in the next quarters with the help of the economic data available on a monthly basis. The focus is on growth contributions, leading indicators and forecasting recessions. The good forecast properties of sentiment indicators, the NAHB index as an example for the real estate market and an introduction into psychology in analysing financial markets will be discussed in Part IV.