Why I'm not gripped by 'irrational despair' over the world's stock markets

There are reasons to be cheerful following last week's stock market rout - but the spectre of eurozone weakness remains, writes Roger Bootle

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By Roger Bootle

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Regular readers would not normally look to me as a source of optimism. Yet, in the midst of the current all-enveloping gloom about the world economic outlook, although not exactly optimistic, I find myself nothing like as pessimistic as the financial markets appear to be.

Their gloom has started to affect most commentators and could, I suppose, lead to a widespread fall in confidence in the real economy which could then produce, unnecessarily, the very thing that the markets are worried about.

So, are the markets right to be worried? Supposedly, they look into the future in a cold, calculating, rational way. Not for them the swings of emotion that affect human beings in the rest of their life. Well, that’s what the financial textbooks say.

Yet we know that markets can sometimes succumb to euphoria. Former Fed chairman, **Alan Greenspan**, once referred to their “irrational exuberance”.

They were irrationally exuberant about tech stocks during the internet boom and later they were irrationally exuberant about both the American property market and the ability of derivatives and various forms of financial engineering to magic risk out of the financial system.

But if the markets are capable of irrational exuberance then they should surely also be capable of irrational despair. I think that is what is happening at the moment. Every item of news seems to be interpreted bearishly.

So, when the **Swedish central bank last week cut interest rates** in an attempt to boost the economy, that was interpreted as a signal that things must be really bad.

Ditto each fall in oil prices. Just as we thought we were clawing our way back after the disaster of 2008/9, we are now experiencing a succession of false dusks.

What is the current gloom of market participants and commentators founded on?


Former Fed chairman, Alan Greenspan, referred to the ?irrational exuberance? of markets Photo: Reuters

I suspect that it is partly a reaction to their failure to anticipate the financial crisis and the subsequent collapse of output. They are determined not to be caught out again.

But if we are looking for solid reasons for pessimism rather than psychological analysis, I suppose most people's answer would be the trouble in China.

Yet all that has happened in China is a slowdown in the growth rate. This slowdown has stopped well short of a recession and doesn't look as though it is going to develop into one.

"Although the banking system remains weak in several countries, there has been a good deal of progress since the crash."

Indeed, several indicators suggest that the Chinese economy has stabilised, albeit at a much lower growth rate than a few years ago.

Over and above China, of course, but partly associated with it, there has been a collapse in oil and commodity prices.

This has brought severe pain to those companies and countries that produce these things.

In principle, there should be offsetting gains for their consumers but, as I have written before, these gains are small and widely dispersed. Consequently, even if they add up to the same amount in total, they don't make as much impact.

And there is a clear asymmetry with regard to solvency and credit risk.

Umpteen companies, and even some countries, could be sent over the edge by the fall in oil prices but nowhere will a default or bankruptcy be averted by the fact that oil consumers' real incomes have been boosted by a trivial amount.

Oil wealth is no longer accumulating in a vast global savings glut, or pushing up asset prices Photo: Alamy

Even so, **low oil prices are providing a boost to many countries**, including the UK.

Recently, another ingredient has entered the mix – namely the apparent weakness of major banks.

This seems to have its root in the supposed adverse consequences of negative interest rates for bank profitability, possible exposure to those companies and countries that have lost as a result of the fall in oil and commodity prices, and general exposure to the softness of the world economy.

In fact, although the banking system remains weak in several countries, there has been a good deal of progress since the crash.

Moreover, **the bank lending and money supply figures** do not suggest that the system as a whole is in crisis.

Moreover, the world economy continues to grow by between two and 3pc per annum.

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Admittedly, this is slower than the rates of growth registered before the 2008/9 crash.

Aggregate demand has not grown strongly enough since then to return the world economy to normal. But the reasons for this are different from what is commonly supposed.

The Chinese slowdown is only one contributor, and indeed a minor one for us here in the UK. British exports to China, although growing rapidly, are small. Ireland is a bigger market for us than China.

An important source of weakness in the world economy is the eurozone, which has still not got back to the pre-crisis level of output.

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By contrast, the US and UK are 10pc and 7pc respectively above their pre-crisis levels. Imagine how much better the world would now look if euro-zone GDP had managed the same increase in GDP as the US, or even the UK.

Admittedly, it did manage growth of about 1.5pc last year – which was good by its low standards – but it now seems to be slipping back.

We all know why the eurozone has been so weak. It is a combination of the stranglehold on the weaker peripheral countries wrought by a loss of competitiveness, excessive debt levels and fiscal stringency; the persistent tendency to underspend in Germany and the Netherlands; and the pronounced structural problems in France.

Roger Bootle: 'Why aren?t more people banging on about eurozone weakness, rather than China?' Photo: Reuters

The first two are a direct result of the euro.

It is now widely acknowledged that the euro has been an economic disaster for Europe.

It is still not widely perceived, though, that it is also a leading factor behind the weakness of the global economy. The eurozone economy is larger than China's.

Moreover, its current account surplus is larger too. Why aren't more people banging on about eurozone weakness, rather than China, as the reason for the world's travails?

Mind you, this particular part of the world's problems does not look likely to be fixed any time soon.

Perhaps I have talked myself into becoming a paid-up member of the pessimistic tendency after all.

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