ECONOMIC RESEARCH

The NewsLine

October 16, 2014

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FINANCIAL MARKETS

Market slump: Recession fears overdone

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Having followed an upward trajectory with only minor fluctuations for some time, the financial markets recently found themselves engulfed by a new wave of uncertainty, triggering a slump in equities and other high-risk securities. This development cannot be traced back to one single cause, but owes itself to a whole combination of factors that have evidently prompted market participants to reassess the outlook for economic and financial market developments over the next few quarters.

As far as the US is concerned, the jitters were doubtless fueled by statements made by representatives of the Federal Reserve and weaker economic data of late. The eurozone saw expectations of a triple-dip recession mount after even Germany's economic engine started to falter. The skeptical mood regarding the euro area is evident not only from the considerable correction on the stock markets, but also from what are, in some cases, marked increases in risk premiums on the government bonds of individual countries. Financial market setbacks like these in turn serve to erode economic confidence, meaning that they can end up being self-reinforcing.

So are these fears of a recession justified? Not as we see things. A trigger for a real recession is missing. In 2008/2009, it was the global financial crisis, and in 2012 it was the escalation of the euro debt crisis that sent the eurozone economy into a tailspin. The overall conditions that currently prevail are more favorable and we even have powerful forces driving the economy. The sharp drop in oil and commodity prices will boost purchasing power and serve to drive the economic engine. The depreciation in the euro will provide real impetus for eurozone countries – given at least moderate growth in global trade. Interest rates are low and banks are starting to relax their lending standards. Consumer sentiment is by no means downbeat. Finally, the eurozone's former crisis countries are now clearly over the worst.

So there is no reason to dramatize the situation. This applies in particular given the drop in inflation in the euro area, which is largely attributable to falling commodity prices and partly also to urgently required adjustment processes in the countries at the center of the crisis, meaning that it does not have any parallels with the oft-cited deflationary trend in Japan.

One risk to the eurozone could, however, rear its head if the financial markets were to lose trust in the willingness of the heavily-indebted member states to implement consolidation and reform measures. This is why it is crucial that the most recent reforms announced in France, Italy and - in the field of infrastructure investment - also in Germany are put into practice. The European Council and the European Central Bank can help to make this happen. The sudden surge in the risk premiums for Greece is presumably due more to the plan for an early exit from aid programs than to adverse macroeconomic developments in Greece itself. 2014 is likely to see Greece achieve GDP growth for the first time in a long while, as well as an overall state budget that will be virtually balanced. The Greek budget now boasts a substantial primary surplus. In this respect, it is important to keep things in perspective.

All in all, the overall backdrop for an economic recovery does not look too bad at all. A slight easing of the tension surrounding the Ukraine-Russia conflict should also have a positive impact. In this sort of environment, it is highly unlikely that uncertainty surrounding the European Central Bank's stress tests, for example, or the timeline for deficit reduction in France alone will throw the economy off track.

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