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Whisper it, but this could be a good year for growth

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There are a number of major non-economic risks that could completely upset the applecart

Most commentators on the world economy seem to settle easily into a mood of gloom and doom. And it is true that over recent years global economic growth has been weak. But is this bound to continue? I don't think so. Indeed, I can see some major positives which are not receiving enough attention.

Admittedly, the world remains seriously uncertain. In particular, there are a number of major non-economic risks that could completely upset the applecart: continued instability in the Middle East, worries about North Korea, difficult relationships between Russia and the west, Mr Trump's uncertain grip on world affairs, the danger of a lurch towards protectionism, and political risk in the eurozone. So, to all of you who feel naturally inclined towards pessimism I have to say that you might yet be vindicated.

But as far as the pure economics are concerned, there are decided grounds for optimism. Why are we where we are? The event of overwhelming significance that has determined economic outcomes over the last several years is the financial crisis of 2007/9 and the associated Great Recession. It took us to the brink of global depression.

Yet we always knew that at some point the problems unleashed by the financial crisis would be overcome, although we did not know how long the transition period would take. Interestingly, in their mammoth investigation of past financial crises, the economists Kenneth Rogoff and Carmen Reinhart, concluded that major financial crises tended to depress economic growth for about 10 years. This year is the 10th anniversary of the onset of the global financial crisis. Accordingly, it would not be surprising if the world were now to be showing signs of escaping from its clutches.

After 10 years, with bank recapitalisations, write-offs and the benefits of sustained economic growth filtering through, you would expect banks now to be in a much stronger position. With some exceptions, they are. In the UK, of course, we still have one or two troubled banks. Moreover, on the continent much of the banking system is extremely weak and in serious need of capital injections. But the broad picture is that the world has made significant progress from the position it faced 10 years ago.

You can see this in the growth rates of bank lending and broad money. In the US, over the last year bank lending has grown by more than 7%. In the UK the equivalent figure is more like 4%, but this growth rate is an enormous change from the contractions that happened after the crisis, and the rate continues to strengthen. Although the euro-zone remains mired in serious difficulties, and the rate of growth of bank lending over the last year is still only 2%, it too has been rising.

We have always known that weak banks would inhibit recovery and strong banks would foster it, so the signs of a move back towards banking normality are distinctly welcome. The availability of credit is particularly important for firms, households and sectors that are under immediate financial pressure. One of the key characteristics of a weak financial system is that it will not enable them to ride out a difficult, though temporary, tough patch. Instead, they will be forced to cut back on spending. By contrast, a well-functioning financial system will enable them to think long-term and to withstand any temporary setbacks.

This could be particularly important for the UK over the next year as households face a squeeze as a result of the incipient increase in inflation. The ready availability of finance could also encourage UK exporters to respond to the fall of the pound by seeking to increase sales, in contrast to how they believed when sterling fell after the financial crisis.

A second major factor strengthening demand is also related to the financial crisis. In most countries the Great Recession seriously weakened the public finances. After an initial loosening, the response was a tightening of fiscal policy which, despite propaganda about “expansionary contractions”, had the effect of weakening demand. That has come to an end. Indeed, in the US there is now set to be a distinct fiscal loosening.

A third major factor making for a stronger world economy is not directly related to the financial crisis. At the beginning of last year the markets and many commentators managed to get themselves extremely worked up over the damage supposedly done to the world economy by low oil prices. By contrast, it seemed to me that low oil prices had to be a good thing. But the losses from low oil prices were highly concentrated and visible in the short term; by contrast, the gains were more widely distributed and might only become evident to the beneficiaries after a period of time. Accordingly, it was likely that there would be a short-term hit to the global economy, offset by a longer-term gain. We are now into that longer term.

Meanwhile, the recovery from ultra-low oil prices has brought a further benefit, namely the easing of the pressure on hard-pressed companies and countries. Russia, for instance, should emerge from recession this year. Even so, oil consuming companies and individuals are still facing much lower prices than they were two years ago. The result is that the world should now be experiencing a substantial net dividend from lower oil prices.

The upshot of all of this is that world growth this year is set to be higher than last year. Not only that, but it may well be a good deal stronger than almost anyone expects. Of course, in the world of forecasting you have to be prepared for surprises. Over the last few years we have all been exceedingly well prepared for downside surprises. What I am about to say is decidedly risky but I will say it nevertheless: I have a hunch that we now need to be prepared for surprises on the upside.

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