FINANCIAL TIMES

November 21, 2011 8:22 pm

The markets are not the monster

39

By Gideon Rachman

Last year, Angela Merkel promised to show the markets who is boss. "There is a kind of battle over what power the financial markets have and how much room for policymaking the politicians have," said the German chancellor. It was vital, she added, to assert the "primacy of politics".

As the bond markets force Italian, Spanish and even French bonds into the danger zone, it is tempting to say that Ms Merkel and European politicians are losing their battle with the markets. But resorting to the imagery of warfare makes exactly the same dangerous mistake that the chancellor made – which is to see financial markets as a monster to be controlled.

Click to enlarge

The markets are not the enemy of European politicians. They are their friends. In fact, they are all that stands between political leaders and angry citizens. If the markets will not lend money to governments, politicians can only get it from one other place – the voters. As Europe is discovering, that means either higher taxes or cuts in public spending. Only the markets stand between the politicians and deep austerity.

Nonetheless, European politicians often talk of financial markets in frankly hostile terms. Ms Merkel's statement was relatively mild by the standards of some colleagues. Last year, Jean-Claude Juncker, the prime minister of Luxembourg and the president of the Eurogroup – which co-ordinates the 17 countries that use the European single currency – proclaimed: "We have to be able to stop the financial markets. We have the instruments of torture in the basement." This is a bit like asking the bank manager to extend you a loan – then adding that, if you don't like the terms, you reserve the right to waterboard him.

As the crisis in the eurozone has deepened, so anti-market rhetoric has become more common, darker and more conspiratorial. It is quite common to hear it argued that the "Anglo-Saxons" have always hated the euro and are now intent on destroying it. (The Financial Times is all part of the plot, incidentally). You can hear this argument not just from far-left members of the European Parliament, but also from senior officials at the European Commission – and from business-people who really ought to know better. Last August, as it became clear that French banks were threatened by the debt crisis, Laurence Parisot, the head of the French business federation, claimed: "There has been a kind of psychological warfare and an attempt to destabilise the euro area."

There are many misunderstandings embedded in the common belief that the markets are somehow out to destroy the euro. The first is that financial markets are a single-minded entity, rather than a balance of opinion between buyers and sellers. One top European official, (French, not British) groaned recently that: "The average anti-capitalist demonstrator in London has more understanding of how markets work than the average German politician." Key institutions such as the European Commission and the German finance ministry are full of lawyers and academic economists. But they are very short of people who have actually worked in the financial markets.

While it is certainly true that there will be trading strategies based on the idea of debt-default in Europe – or the break-up of the European single currency – there are others who have made a different judgement. Some people in the financial markets will make money if the euro crisis intensifies. Others will go bankrupt. Indeed MF Global, the New York-based brokerage house, has already gone under because it placed too much faith in European sovereign bonds.

Sometimes, when financiers bet against misconceived government policies, they are actually doing countries a favour. George Soros made a great deal of money in 1992, by making huge trades, based on the idea that sterling would have to leave the European Exchange Rate Mechanism. The Bank of England lost a lot of money trying to hold off the markets and Mr Soros. But ultimately, leaving the ERM was good news for the British economy.

Overall, however, it is a huge misconception to believe that people in the financial markets are willing on the break-up of the euro. On the contrary, it is financiers who are often the most keenly aware that euro break-up would be enormously disruptive – and could well lead to the failure of many banks and financial institutions. That would mean lost jobs in the City and on Wall Street – as well as in the wider society as a whole.

Indeed far from willing on the European debt crisis, investors have seemed almost pathetically eager to believe that everything is going to be ok. Every time there is an EU summit and an announcement of a new deal to solve the crisis, markets bounce for a few days. Then people read the fine print – and hopes and markets sink again.

If and when the euro crisis intensifies, so conspiracy theories about the evil markets will gain ground in continental Europe. You can already hear mutterings that Mario Draghi at the European Central Bank and Mario Monti, the new Italian prime minister, may be secretly promoting the interests of high finance rather than ordinary citizens – because they both once worked for Goldman Sachs.

In fact, almost everybody – banks, politicians and, above all, ordinary people all over the world – has a huge interest in Europe overcoming its sovereign debt crisis. If that is to happen, politicians need to reassure investors – not fantasise about torturing them in a basement.