

Are we headed for another GFC? Or something worse?



As share markets plummet around the world (this is the Nikkei in Tokyo on February 9), people are worried we're heading for another GFC. Picture: AFP Photo / Toru Yamanaka.

THE crumbling noises coming from global markets right now sure sound familiar. Are we headed for another GFC, just eight years after the last one?

Many things look similar — property prices going crazy, [debt piling up](#) to the sky, [absurd valuations](#) on important companies. Headlines are announcing imminent doom.

If a GFC comes again, while we're still recovering from the last crash, when interest rates have already been slashed and national budgets are at breaking point, things could get very grim indeed.

But there is good reason to think the headlines might be mistaken: Global financial crises are just not that common.

The chance of one happening is low, but we're jumpy.

A cognitive bias is making another GFC seem more likely than it is. Cognitive biases are mistakes in decision-making we all tend to make. This one is called the availability bias.

According to research, we judge things more likely if we can picture them — if they are easily available to our mind.

A famous study asked US voters to estimate the chance of a certain candidate becoming President. The researchers told half the voters to picture the candidate as president before guessing. The voters who picture him in the White House then said the chance of him becoming president was far higher.

If you can picture a GFC, it's easy to think it's likely. The GFC is easy to call to mind. It's fresh trauma — I can vividly remember watching the sharemarkets fall day after day after day (and getting the \$900 Kevin Rudd bonus!)



Memories of traders on Wall St rushing around panicking are still fresh in our mind, so it's easy to imagine another GFC. Picture: AP Photo/Mark Lennihan

But history tells us proper global financial collapses are rare. There was the Black Monday crash in 1987. But that was mostly a sharemarket crash, not a real economy event, and it reversed itself within a month. There was an Asian financial crisis in 1997, which was mostly contained to a few Asian economies. Truly global crises — like we just went through — are very rare indeed.

That matters a lot because even if it looks like the whole financial system is crashing down, it probably isn't. Even if the financial news comes up first on the nightly TV bulletin, it isn't necessarily another GFC.

Consider this example.

You have a medical test that works 99 times out of 100. You test for a disease that affects 1 in every 1000 people.

If you test 1000 people, you should get 990 people with negative results, 9 people with false positive and just 1 person with a true positive.

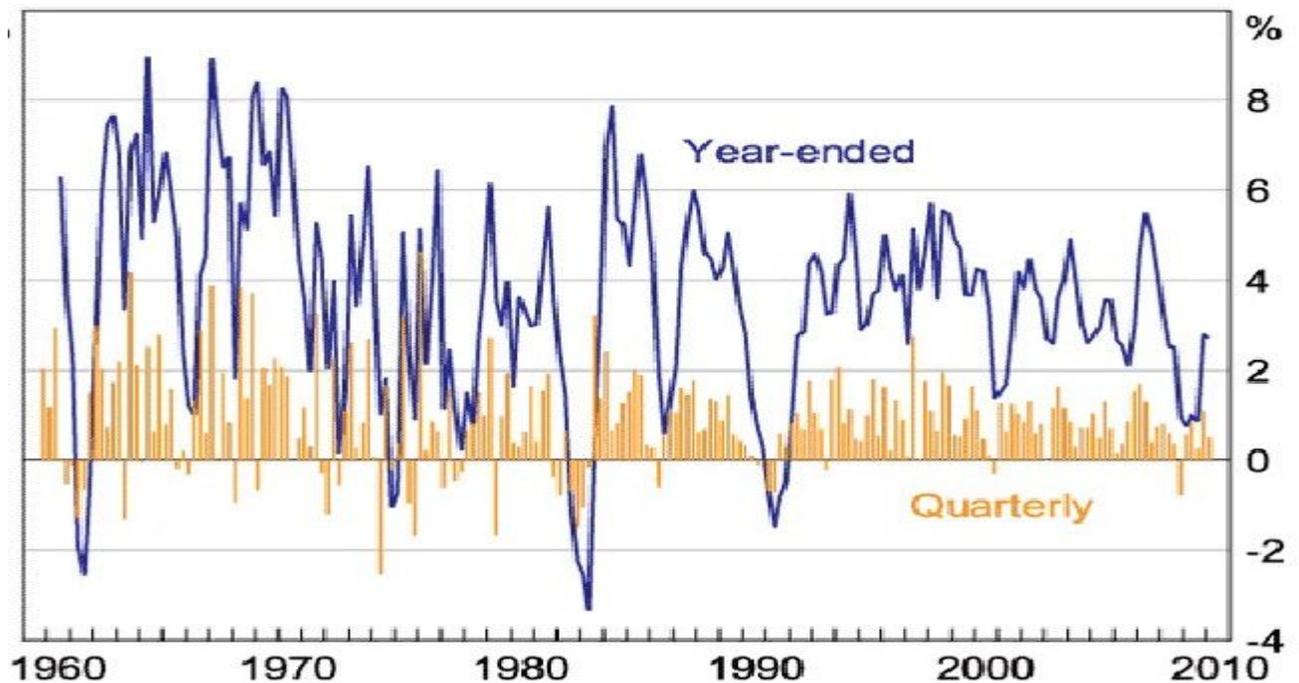
Even though your test works 99 per cent of the time, 90 per cent of your positive results are false!

It goes to show for rare events, what seems like strong evidence can still be wrong. (This is a quick summary of a whole field of study called [Bayesian probability](#) — it's super interesting and you should totally check it out).

So we must be careful not to over-interpret a few sharemarket wobbles. Not every downturn is the next GFC. I'd put money on us dodging another cataclysmic global financial event.

Are we out of the woods? Party time? Not at all. There are things worse than a GFC.

The GFC actually barely scratched Australia's economy. Look at the blue line in this next graph showing Australia's GDP growth. It dips around 2009, but compared to a real recession, the GFC was a bubble bath.



Australian GDP growth. Source: ABS

You can have a GFC without a recession in Australia and — most importantly — you can have a recession in Australia without a GFC.

It's a recession that matters to real people. In the 1990s recession, unemployment surged to 11 per cent — far higher than we saw in the GFC. In the 1980s recession unemployment was more than 10 per cent.

The availability bias that makes a GFC seem likely is making a recession seem unlikely — We haven't had a recession in Australia for so long we've forgotten what they're like.

But such slumps are common in Australian history and they keep happening in other countries. There is no reason to think we're now somehow immune.

If I had to bet, I'd say Australia will go through a recession — probably several of them — before the next GFC.

It might make sense to worry, but let's do so for the right reasons. Otherwise we could be so busy looking at global markets we miss important signs coming from our own economy.

Jason Murphy is an economist. He publishes the blog [Thomas The Thinkengine](#).