

Be extremely wary of the wary

Long view

Glenn Mumford

There's a remarkable consensus building on the trajectory of the global economic recovery.

Depending on who you talk to, it's going to be "sub-par" or "muted". United States Federal Reserve Chairman Ben Bernanke suggested "sluggish" last week, while US Treasury Secretary Tim Geithner opted for "slow". Prime Minister Kevin Rudd went for "long and tough, with plenty of bumps along the way".

It's been a similar story among economists. Citigroup's Michael Saunders favoured "gradual", while Morgan Stanley's Richard Berner preferred "modest".

An array of downbeat adjectives, all pointing to a similar conclusion: don't expect anything too flash on growth as we haul ourselves out of the abyss.

But what if they're wrong?

I get the feeling this communal conservatism reflects a classic case of *forecasting risk aversion*. History has taught us to be extremely wary of such displays of analytic unanimity.

I'd argue that this apparent embrace of the lacklustre, courtesy of a U-shaped recovery, is simply setting the scene for an impending positive surprise.

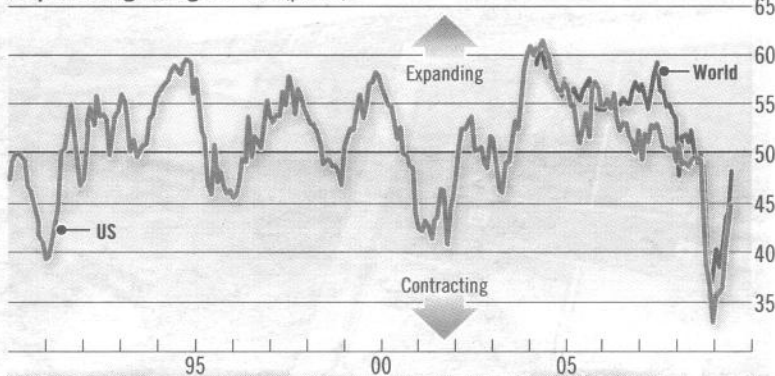
Why? Because it seriously underestimates the economic response to what has been an unprecedented global stimulus effort.

Detractors have pointed to the International Monetary Fund's analysis of past recessions, which highlights the subdued nature of recoveries from recessions that are both synchronised and have their origins in a financial crisis. Unfortunately, none of the IMF examples reflect recessions that were subject to synchronised pump-priming on a scale seen this year. This makes comparisons impossible.

Trillions of dollars of fiscal stimulus and aggressive credit easing have set the scene for an economic recovery that looks set to surprise on the upside. We'll get to see this first-hand, when resurgent private-sector demand competes with public-sector stimulus efforts. Given the sharp rebound in business

On the up

US purchasing managers index (points)



SOURCE: BLOOMBERG, RBS, NOMURA, CONFERENCE BOARD

and consumer sentiment indicators over recent weeks, this looks to be far closer than many imagine.

This is already being seen in the US, where housing data has started to improve and The Conference Board's leading economic index has moved back above the key 100 level.

We may even get fireworks as early as the current quarter. US third-quarter growth expectations have shifted from 0.5 per cent to 1 per cent. But there appears to be further scope for improvement, with Morgan Stanley noting the normal seasonal process of July factory closures hasn't been seen this year. It suggests "the boost from seasonal factors . . . could be immense".

Merrill Lynch strategist Sheryl King is one of the few to already be pushing a V-shaped recovery.

"Markets think that we are going to get this gradual rise in growth . . . but business cycles never end like that," she notes. Instead, with the effects of economic stimulus bubbling beneath the surface, "you usually get some pop in growth".

Those favouring a sub-par response point to credit constraints faced by the private sector. This reflects perceived weakness in both the supply and the demand of credit

— banks slow to lend to customers unwilling to borrow. This is certainly a factor, but I get the feeling its impact — particularly in relation to business credit demand — is being exaggerated.

Certainly, data from the banking sector suggests demand for business loans has declined. But looking at the banks only tells us half the story.

Over the past six months, corporates have turned in droves to

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global equity and credit markets, with hundreds of billions of dollars of debt and equity issuance finding a home with investors. This reflects both debt retirement and new funding of growth — a process that draws into question a forecast decline in global business investment.

With larger corporates forsaking banks in favour of capital markets, this has acted to improve the availability of credit to small businesses, as banks move to fill the lending void. By way of example, in

June British banks extended an additional £391 million of credit small businesses. This is a trend that's being seen globally.

But what of trade? If you had to pick one event that summed up the crisis, it would be the dramatic declines in trade flows that took place in the fourth quarter of 2008.

We saw an unparalleled 30 per cent fall in activity as consumer spending hit a wall and businesses moved to rely on inventory drawdown to fill supply chains. This had particularly savage repercussions for Europe and Asia.

But this process has already begun to unwind. In the US we're seeing the first signs of restocking. China is ahead of the curve, given aggressive rebuilding of inventory and an impressive re-orientation of domestic growth drivers. All this suggests we're about to experience normal rebound in trade flows. That would traditionally retrace the quantum of any decline, rather than the insipid partial rebound that many economists are assuming.

Forget "sub-par" or "sluggish". Ignore "modest" and "muted". It sounds like a robust V to me.

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