

Broad-based global recovery on the horizon

Global economic update: Nov 2009

By Kevin Lings, economist and Melissa Dyer, Stanlib

The global economy has entered a recovery phase. Although most economies remain fragile, forward-looking economic indicators point to economic conditions getting “less worse”. US housing figures have improved moderately. China’s economic data are impressive although its export performance will need to improve to balance out the largely internally-driven GDP growth. Our view is that there will be a moderation in world growth in 2011, especially in developed countries.

Economic indicators point to broad-based recovery

During August, the leading indicator for the Organisation for Economic Co-operation and Development (OECD) area, which includes 29 of the largest economies in the world, increased for the sixth consecutive month which is a strong indication of an unfolding economic recovery.

This indicator has 10 underlying components such as money supply and the average number of working hours. It has a good track record in forecasting GDP (gross domestic product) growth by up to 12 months, and has a strong link with the equity market.

The recovery appears to be relatively broad-based with leading indicators in each of the G7 economies improving, especially evident in France and Italy. Importantly, the leading indicators for China, India, Brazil and Russia are also all on the rise.

Moderate improvement in US housing figures

The US housing market, which was at the heart of the global credit crisis, has also improved. A range of US housing indicators shows that the market appears to be improving slowly after a dramatic and drawn-out collapse in 2008 although the September data was a little disappointing.

In particular, construction of new houses and the granting of building permits appear to be slowing down. Average house prices in the US have risen for three consecutive months. New and existing home sales have improved in the past three months and the ratio of available houses (inventory) to housing sales has improved significantly in the past couple of months. In particular, new home inventories are down at 7.3 months of sales, which is the lowest level since April 2007 and home vacancy rates have improved marginally.

This does not mean that the housing market is convincingly on the road to recovery. Homes sold as foreclosures remain extremely high and there are many houses still at risk of default or foreclosure. In addition, the inventory level is not yet at a point that would cement ongoing price stabilization. Nevertheless, the housing market does appear to have stabilized, with tentative indications that a modest improvement is underway, albeit off a very low base.

The China Factor: activity is accelerating

The large emerging economies continue to attract a great deal of attention and China remains at the core of that focus.

China released a broad range of key economic data recently. Some of the highlights are:

- Overall, economic activity is accelerating, especially domestic expenditure. China's GDP grew by 8.9% in the third quarter of this year compared to last year and year-to-date growth is up 7.7%.
- All of this activity is domestically driven. Year-to-date fixed investment spending contributed an amazing 7.3% to GDP, while consumer spending added 3.6%.
- In contrast, net exports subtracted 3.6% from growth. In other words the lack of export performance is now hurting the Chinese economy; if one excluded the external sector then China's GDP would be growing by an amazing 11.3%.
- China is well on track to achieve 8% GDP growth for 2009 as a whole - this at a time when most economies have been in recession.

China's consumer inflation rate for September 2009 remained in deflation at 0.8%. There is, however, a growing concern that inflation could continue to increase so the government may have to ease up on its stimulus programme in the near future. A reduction in the stimulus programme could have a negative impact on the global equity markets.

Overall, China continues to impress, especially its domestic economic growth, but to be sustainable it is hoped that their export performance improves as this will help to restore some balance to their GDP growth.

Questions over sustainability of the recovery

Overall, the so-called 'V' shaped global economic recovery is now very evident, and reflected in the latest GDP data. The US posted impressive annualised GDP growth of 3.5%q/q* in the third quarter compared with a decline of 0.7% q/q in the previous quarter and a decline of 6.4%q/q in Q1 2009. **This is the first increase in US GDP since the second quarter in 2008, and signals the end of the US recession.**

The big question is "will the recovery be sustained?"

STANLIB's view is that while there is evidence of a reasonable economic recovery that should unfold more fully over the next 12 months (most forecasts for 2009 and 2010 are currently being revised up), there are a number of factors that suggest that world growth, especially in the developed world, could moderate in 2011. These include: continued reduction in credit appetite by households, a withdrawal of the extreme fiscal and monetary policy stimulus, increased cost of financial regulation, and low levels of fixed investment given the excess capacity. This does not imply a 'double-dip' recession, but rather a moderation in the rate of recovery.

* q/q: quarter-to-quarter