Tea Leaf

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Your guide to understanding today's economy and financial markets

November 18, 2009

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Rebound

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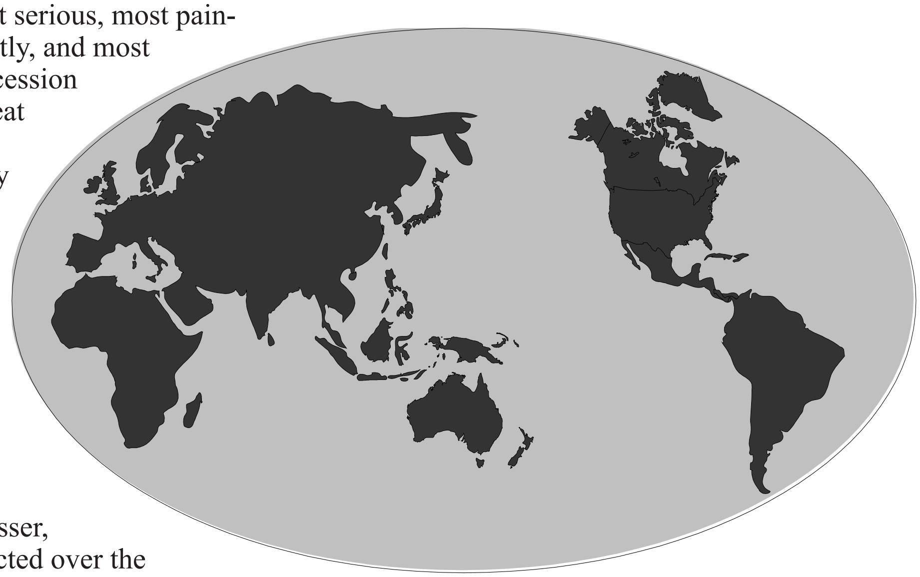
The consensus view of forecasting economists at mid-year 2009 was that the global economy, at that time in its first overall recession since just after WWII, would not likely emerge from recession until perhaps 2010's second quarter. Like most forecasts, that view was wrong. The global economy has already begun to grow again.

We have written extensively in recent months about the presumed emergence of the American economy from its most lengthy, most serious, most painful, most costly, and most pervasive recession since the Great Depression. The economy grew at a 3.5% real (inflation adjusted) annual rate during the July-September quarter, with comparable, or slightly lesser, growth expected over the next four quarters.



When all is said and done, the official scorekeeper for the economy, the National Bureau of Economic Research, will likely make a call next year that the U.S. recession officially ended this past summer. The U.S. is not alone in seeing economic conditions improve.

While real global economic growth during calendar year 2009 will be negative, a solid rebound seems on tap during 2010, with real growth exceeding 3.0%. Better performance is expected during 2011. Even so, rising unemployment during 2010 in many developed and emerging markets will, unfortunately, be the norm.

JAPAN

I remember discussions being held roughly 20 years ago that ski trail signs at Utah ski resorts should be in both English and Japanese, as recognition that Japan was soon going to dominate the global economy…

…not so fast

For now, Japan remains the world's second largest economy. Rapid Chinese growth will eventually reverse that order. Japan's massive economic growth in the 45 years following WWII gave way to "the lost decade" of the 1990s. Some would argue it has now lost two decades, with anemic growth during the current decade as well.

The Japanese economy plunged at nearly a 14% annual rate during the six months ending in March 2009, tied to major weakness in the global economy and a severe decline in Japanese exports to the world. However, the economy staged a rebound during the two subsequent quarters, led in part by massive government stimulus. Japan's just-announced 4.8% annual growth rate during the third quarter exceeded expectations.

Japan today is a nation expecting only modest economic growth during 2010, ongoing deflation, record high unemployment approaching 6.0%, and the budget implications of an aging and declining population. Japan's government debt is by far the highest of all Western nations, likely to reach 227% of gross domestic product in 2010, according to the International Monetary Fund. Confidence in new political leadership is lagging.

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CHINA

Economic growth picked up speed in recent months, following a sharp slowing late last year and during 2009's first quarter. A powerful 9.0% growth pace seems likely during 2010, again leading the world's major players.

China felt less impact from the global downturn of the past year than did other major economies. A solid recovery in manufacturing output and exports is now in place.

Even as strong economic growth has returned, major challenges remain. The Chinese followed many nations with its own $586 billion stimulus program. Efforts to unwind such stimulus will be challenging.

In addition, Chinese efforts to keep the currency, the yuan, largely fixed to the dollar have led to nearly a 30% rise in the money supply this year, resulting in rising inflation concerns and enormous flows of outside funds into Chinese assets. Record prices for apartments and a 74% rise in the benchmark stock index have led to rising concerns about an asset bubble *(Bloomberg.com)*.

The Chinese leadership will remain under intense global pressure to allow the undervalued yuan to rise in value, in part to reduce the level of exports and help build domestic demand. Even so, the Chinese will make such adjustments on their own timetable.

INDIA

A return to the powerful 9.0% annual growth pace recorded prior to the global downturn is the goal of Indian leadership in coming years. While such rapid growth may not occur soon, the nation's potential to challenge China for Asian economic leadership remains valid.

India joined China and Indonesia as the only Asian economies to escape severe recession during the past year *(Reuters)*. Most forecasters see India growing roughly 7.0% in 2010, followed by slightly stronger performance in 2011, in part based upon expectations for a wetter monsoon season. While expecting a similar growth pace this year and next, Citigroup sees the Indian industrial sector growing at 5.5%, with the service sector growing at a stronger 8.6% annual pace.

A greater share of Indian economic performance is comprised of internal demand—consumer and business spending—than is found in neighboring China. As a result, the Indian economy is less dependent upon exports than is the Chinese economy.

Like so many major nations, much of recent growth has been fueled by massive government spending and highly accommodative monetary policy. As with other nations, India will need to "exit" such aggressive strategies before debt levels and inflation pressures become burdensome.

EUROPE

The most painful recession since WWII is over. A modest 1.5% annual economic growth pace returned in the third quarter for the 16 nations who use the euro currency. As with its counterparts around the globe, a revival from serious recession was fueled in part by rising exports and major stimulus programs across various European nations.

While European economic growth has returned, its fragile and limited nature will keep consumer spending at modest levels. Increased government spending and aggressive monetary stimulus provided by the European Central Bank will need to be ratcheted back in due time.

European economic growth traditionally trails that of the U.S. and China. No exception is likely this time around the economic cycle. One constraint to European growth will be the stronger euro versus the U.S. dollar (and by pegging, versus the Chinese yuan as well…see China above). German exporters, in particular, are fearful that euro strength will limit the ability of export industries to contribute to a return to economic growth.

The neighboring United Kingdom remains mired in recession, with only modest growth prospects in coming quarters. Former euro sector top performers Ireland and Spain, who saw home values skyrocket in recent years, remain stuck in recession as well.

Jeff

"TEA"ser

She was only a whiskey maker, but he loved her still.

—from Bill Losey

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