A Wide U-Turn

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The ongoing flow of improving data (i.e. green shoots, hasn't that term grown tiresome?) is encouraging, but talk of recovery may be premature and the renewed vigour in financial markets risks going too far, too soon (*Chart 1*). While the economic data have perked up to less-bad levels, they remain very weak for the most part. When markets cheer for a still-hefty 539k drop in U.S. employment (as they did last week) you know the threshold for positive news is low. The story is true internationally as well. Japan is a good example, as industrial production rose 1.8% in March (production intentions are also up) and exports for that month increased as well, but both remain far below year-ago levels (34% and 44%, respectively).

The trend of better data will likely continue over the coming months, signalling that the worst might be over, but good times aren't necessarily around the corner. Indeed, as spending collapsed, so did goods orders and production. Companies cut orders amid falling sales to facilitate a drawdown in stocks, leading to even weaker production and the extreme plunge in global output over the past six months. As inventories are drawn down to appropriate levels, a bounce in production is likely as stockpiles can't fall forever. The improvement in global manufacturing PMIs in April (especially new orders) hints at such a move (*Chart 2*).

However, after an initial boost in production back to suitable levels (so inventories are no longer being drawn down), production should only grow with sales, which aren't expected to recover quickly in the developed world, as savings rates rise. China and other developing economies will be a source of growth, but aren't yet large enough to carry the global economy like the U.S. consumer has for the past decade (*Chart 3*). That could mean that the decent data over the next couple of months will paint an overly optimistic picture.

If the recovery assumes more of a U-shape, as we expect, we're likely entering the flat bottom of the U, as opposed to a sharp upslope. The recent spate of better data is definitely good news and probably signals that the worst is over, but we won't see meaningful growth until 2010.

CHART 1
TIME TO CURB YOUR ENTHUSIASM?

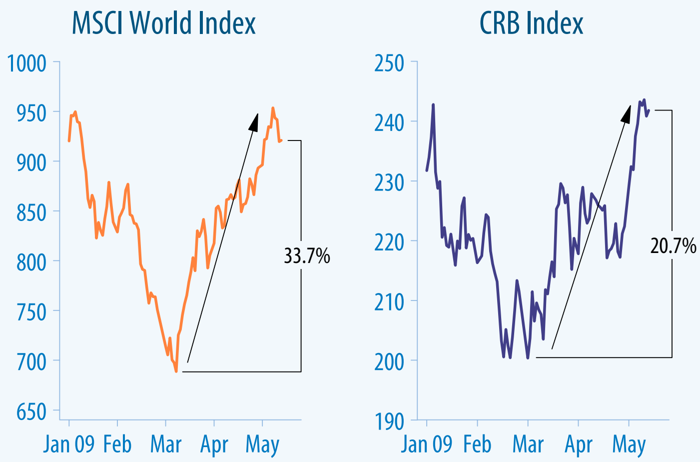

CHART 2
PRODUCTION BOTTOMING?

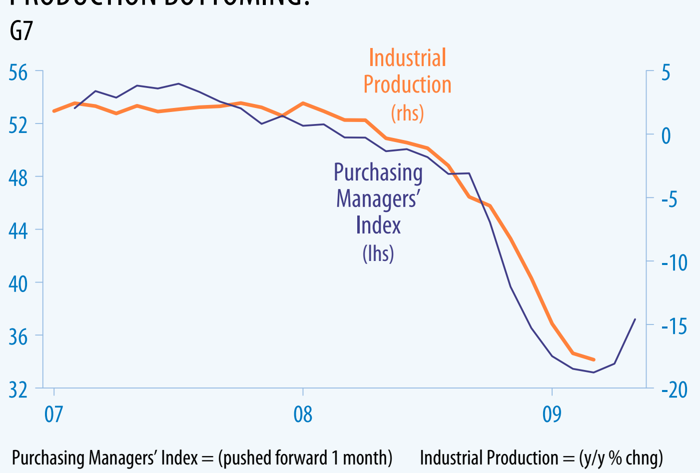

CHART 3
U.S. CONSUMER STILL DOMINANT