**Is the nascent recovery a myth?**

There are signs that the global economic crisis is abating and that a recovery is dawning. Economic data and earnings have surprised on the upside. While this seems reassuring, there are nagging doubts about the sustainability of the anticipated recovery.

Second quarter numbers relating to private consumption, manufacturing production, exports and imports, gross domestic product have been encouraging, in that they have not been as bad as initially feared.

There is no suggestion that the world economy is out of the woods as it is still contracting, albeit at a slower pace than before, although some countries - notably Germany, France, Japan, South Korea and Singapore - have reported positive gross domestic product (GDP) growth in the second quarter.

The United States, the epicentre of the crisis, is itself now forecast to post a 2.9 per cent growth in the third quarter, up from an earlier forecast of 2.2 per cent.

It is important to underline that the increases seen in many of the key macro-economic indicators thus far measured month-on-month or quarter-on-quarter rather than year-on-year, which only suggests that the worst may be over while the recession is still lingering.

Not all indicators are moving in tandem. Job numbers remain unimpressive, with retrenchment still outpacing job creation. Bank loans and private investment remain lethargic. Consumer price indices continue to slide.

Admittedly, as previous crises have shown, employment is a lagging, not a leading, indicator. Employment responds only after normalcy returns, not in the early stages of the upturn. For instance, it took South Korea 18 months for employment growth to surge after the 1997-98 Asian financial crisis.

This is not surprising, since output can grow in the early stages of recovery without having to hire additional workforce, given the excess capacity, especially in the manufacturing sector.

But it is unsafe to make sweeping generlisations, as conditions tend to vary from country to country. For starters, Although adversely affected, China and India are not in recession as the huge domestic sector of their economies helped cushion the impact. Exports constituted just 35 per cent of China's GDP and 22 per cent of India's, in sharp contrast to Singapore's 259 per cent and Malaysia's 118 per cent, last year.

Economies with a large external sector, such as Singapore and Malaysia have also shown considerable resilience, thanks in part to high household savings during good times, on which they could fall back upon during lean times without having to make drastic cutbacks in private consumption.

Perhaps one reason why East Asia is able to ride out the crisis with greater ease, or stay ahead in the global recovery, is that private consumption did not cave in, thanks to the households' capacity to dig into past savings.

So far so good, as relatively stable private consumption in East Asia has helped prevent a sharper downturn even in countries with huge export dependence. But the households' capacity to continue to spend, despite job and income losses, in these countries is not unlimited. Much would also depend on consumer expectations, which have been whipped up by strong government interventions through monetary and fiscal stimuli.

There is the risk of consumer confidence wearing off under the waning effects of the fiscal stimulus packages.

It appears that the upbeat economic data is largely attributable to aggressive government spending under fiscal stimulus packages and business expansion under easier credit conditions rather than to consumer spending. Increased industrial production reported in some countries also appears to have stemmed mainly from manufacturers' response to depleting stocks. There is no empirical evidence to link this to increased real demand.

Notwithstanding the past week's assurances of the finance ministers of the G20 to maintain loose monetary and expansionary fiscal policies recently in London, there are limits to both.

Increased liquidity resulting from expansionary policies may have to be withdrawn through higher interest rates and budgetary restraints, which may contribute to the fragility of the so-called recovery.

Thus, there are signs that suggest the nascent recovery will be short-lived with the global economy suffering another bout of contraction next year before it can see a sustainable real recovery hopefully in 2011.

The possibility of a "double-dip" or a "W-shaped" recovery is more than just theoretical.

Some analysts think the double-dip scenario, even if it matters to industrialised economies, is of no relevance to emerging economies in East Asia, as the latter are in a different league altogether. Their optimism about East Asia is premised on the perceived prowess of the Chinese economy and its extensive regional links.

Be that as it may, it is important to factor in the fault lines that exist in the Chinese economy where massive public investment goes into industries already saddled with overcapacity, such as cement and steel. That consumption accounts for only 35 per cent of China's GDP, with public investment making up roughly 45 per cent, does not augur well.

Moreover, China's huge credit expansion to the tune of 7.4 trillion yuan (RM3.7 trillion) in the first half of the year has raised concerns that some of these loans might not be repaid and that the bulk of them may have gone into speculative activities in the stock and property markets, stoking fears of a market backlash.

The prospects of an imminent recovery, by which is meant a return to double-digit growth, may fuel explosive expectations contributing to potentially dangerous bubbles in the Chinese economy.

What is worrisome is that the crisis has not led the global economy to rebalance itself. The root causes of the crisis - global imbalances - still remain, which suggests that any recovery without establishing a new equilibrium will be short-lived.

**Adapted from “World economy not quite out of the woods yet”, New Straits Times, 30 September 2009**