The bumpy, winding road to recovery

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The media everywhere are abuzz with talk of an impending, if not imminent, recovery for the ailing world economy in general and the emerging economies in particular. This is based on signs of improvement in industrial production, corporate profits, stock market performance, etc.

Increased industrial production in the emerging Asian economies, including South Korea, Singapore and Thailand in recent months, equity market vibrancy in Japan, China, India and Vietnam, and improved profit figures from Goldman Sachs, JP Morgan Chase and the Citigroup Inc in the United States are among the beacons of the much anticipated recovery.

Some analysts are confident that the recession will end in the third quarter. What is not clear is whether recovery will begin as soon as the recession ends. Much would depend on what constitutes an "end to recession" and what is meant by "recovery".

Some see a bottoming out of contraction as the end of recession itself even though the economy may still be contracting, albeit at a slower pace. To others, recession ends only when the economy stops contracting.

Thus far, most crisis-hit economies have shown discernible improvement, prompting some to suggest that the worst is over for them, with their negative gross domestic product (GDP) growth easing considerably in the second quarter.

For the US, the largest economy in the world, the recession appears to have lost momentum with its GDP contracting by 1.5 per cent in the second quarter, contrasting with the 5.5 per cent contraction in the first quarter. But there is no certainty that the US economy will register positive growth in the third quarter.

There is no doubt that the recession will make a huge dent in the major economies this year. The Asian Development Bank has forecast that the US economy will shrink by three per cent this year, while the European Union and Japan will contract by 4.3 per cent and 5.8 per cent, respectively.

There is no recession in the continental economies of China and India, given their large domestic sector and robust domestic demand, but his does not mean that they are unaffected. Growth rates in China have climbed down considerably from 12-13 per cent previously to 7-8 per cent now, while India's growth has correspondingly slowed from 9-10 per cent to 5-6 per cent.

Emerging Asian economies are showing more vibrant signs, leading some observers to think that Asia will lead the global economic recovery and that such recovery is around the corner.

A word of caution: the numbers may have been misinterpreted, showing at best that the crisis-hit economies are stabilising. Signs of stabilisation should not be mistaken for signs of recovery.

There is the danger of these economies settling at a low-level equilibrium, in which case the anticipated recovery will not materialise.

Nor does positive GDP growth per se necessarily signify economic recovery, especially if it falls far short of pre-crisis levels. Strictly speaking, there will be real recovery only when normalcy returns, and that will take a long time.

It is not easy to be pessimistic amid growing talk of "green shoots" and "glimmers of hope", but such perceptions ignore hard realities on the ground. The root cause of the global economic crisis remains - namely global imbalances between saving and investment, consumption and production, exports and imports, etc.

This crisis will persist until the global economy begins to rebalance itself. There are no such signs yet. Countries with chronic balance-of-payment deficits remain in the red, while surplus countries continue to chalk up surpluses despite reduced exports.

The much needed rebalancing is not taking place, apparently because crucial price and expenditure adjustments have been slow. While interest and inflation rates have changed everywhere, exchange rates are headed in the wrong direction with the US dollar staying too strong. There can be no meaningful rebalancing without the greenback weakening.

Meanwhile, increased public expenditure for fiscal stimulus has exacerbated fiscal imbalances. While it is not difficult to defend budget deficits during difficult times, such exercises to reflate ailing economies do have limits. Fiscal stimulus packages may have worked better for a variety of reasons, but the impact tends to be one-off.

The "green shoots" seen in some economies, due largely to huge fiscal spending, may not be sustainable. The governments may spend more to keep the momentum but there are limits. There is the risk of recovery fading without additional pump priming.

There is no solid basis to postulate that a recovery is underway. Unemployment is particularly worrisome. In the US, where it is at a historic high, the situation is likely to get worse, not better, in the near term.

South Korea saw an increase in unemployment in June, despite 2.3 per cent GDP growth in the second quarter, stoking fears of a "jobless recovery".

Jobs tend to take longer time to recover than production, as shown by the Korean experience during the 1997-98 crisis: while industrial production was back to its pre-crisis level by end-1998, employment took another 18 months to recover.

The global economy is still in the doldrums and is unlikely to move out of the woods in the near term. Improvements in industrial production and exports reported in some countries may well be due to replenishing depleted stocks rather increased consumer demand. The 9.3 per cent drop in Singapore's manufacturing in June, after rising in the previous two months, lends credence to this view.

It appears that the "green shoots" may be short lived. There is a 50 per cent chance of a double-dip and a 30 per cent chance of a triple-dip. The road to economic recovery is likely to be bumpy and winding.

Adapted from "The long and rocky road to global recovery", New Straits Times, 5 August 2009