

# Nascent Revival in Global Industrial Growth

Global industrial growth has begun to recover, especially in non-Japan Asia.

**End to U.S. Recession in Sight** As we discussed earlier this month ([↗U.S. Cyclical Outlook, Vol. XIV, No. 4, April 2009](#)), a business cycle recovery in the U.S. is now on the horizon. Among the indications of such a revival ahead is a three-month advance in the U.S. Long Leading Index (USLLI) that began last December and is now almost as pronounced, pervasive and persistent as in past cyclical upturns in the USLLI. Following the standard pattern of events in the lead-up to an economic recovery, this upswing has already been

followed by a six-week upturn in the Weekly Leading Index (WLI) that started in the beginning of March.

We expect the U.S. economy to begin expanding later this year, probably by summer. But, as in past recoveries, this does not mean that economic activity will return to pre-recession levels any time soon. Specifically, it means that the economy will stop contracting and begin to expand – and sooner than most expect.

Even before that – probably this spring – we are set to see a U.S. growth rate cycle upturn, when the economy’s pace of contraction begins to ease, as we predicted last month ([↗U.S. Cyclical Outlook, Vol. XIV, No. 3, March 2009](#)). While that forecast is fast becoming part of the conventional wisdom, most do not appreciate the implications for a business cycle recovery.

Going back to the late 1930s, every U.S. growth rate cycle upturn has been followed zero to four months later by a business cycle recovery. Whether or not the time lag this time is again confined to this tight range, we are likely to see a fairly similar pattern unfold in the current business cycle. If so, it should have major implications for the evolution of this global recession.

**Divergent Patterns** While a U.S. business cycle recovery would certainly be good news for the global economy, it will not result in a quick end to the global recession. The economic outlook is already beginning to brighten in some parts of the world, but other regions that are poster children for the intensity of this downturn remain immersed in gloom.

In fact, this recession has been so intense not only because of its immense geographical reach, but also because of its severity, especially for the three biggest developed economies. In the U.S., this contraction is now about to surpass the longest postwar recessions in duration, and become the longest recession since the Great Depression. In addition, the decline in overall U.S. economic activity is already the greatest since World War II.

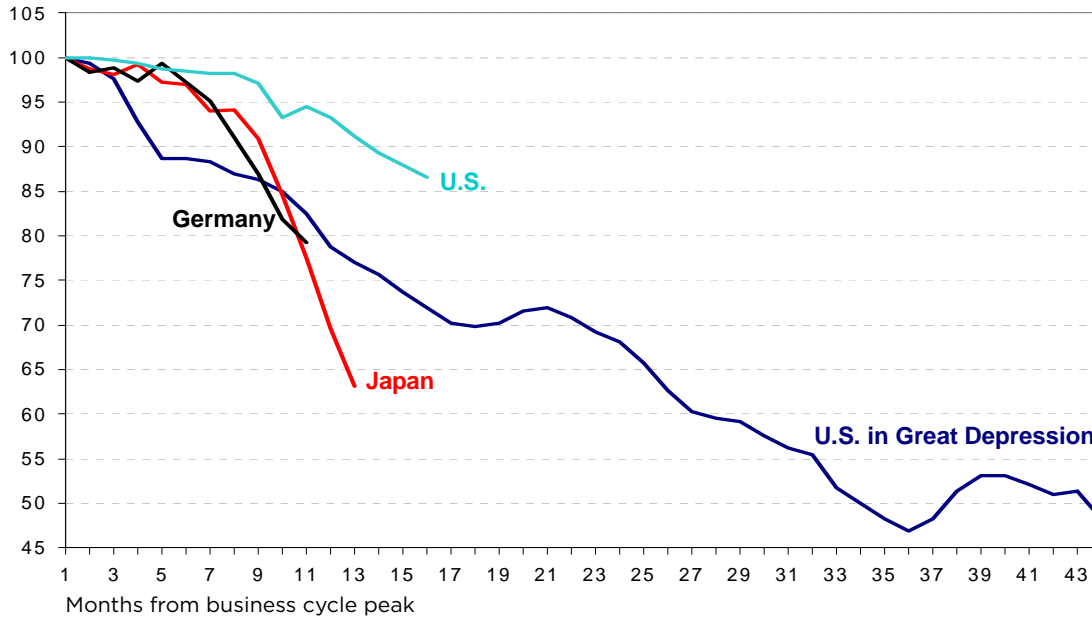
But the downturns in Japan and Germany are even worse, especially in terms of industrial production. This is particularly significant because trade in

## Divergent Outlooks

	Current Growth	Consensus Growth Outlook	ECRI Growth Outlook
↗U.S.	Recessionary	Recessionary	Slow
↗Canada	Recessionary	Recessionary	Recessionary
↗Mexico	Recessionary	Recessionary	Recessionary
↗Germany	Recessionary	Recessionary	Recessionary
↗France	Recessionary	Recessionary	Recessionary
↗U.K.	Recessionary	Recessionary	Recessionary
↗Italy	Recessionary	Recessionary	Recessionary
↗Spain	Recessionary	Recessionary	Recessionary
↗Switzerland	Slow	Recessionary/Slow	Recessionary/Slow
↗Sweden	Recessionary	Recessionary	Recessionary
↗Austria	Recessionary	Recessionary	Recessionary
↗Japan	Recessionary	Recessionary	Recessionary
↗China	Slow	Slow	Slow/Average
↗India	Slow	Slow	Slow/Average
↗Korea	Recessionary	Recessionary	Recessionary/Slow
↗Australia	Slow/Average	Recessionary	Slow/Average
↗Taiwan	Recessionary	Recessionary	Recessionary/Slow
↗New Zealand	Recessionary	Recessionary	Recessionary/Slow
↗South Africa	Recessionary	Recessionary	Recessionary

### FOCUS: French Outlook

**Chart 1a: Industrial Production in Current Recessions Compared to Great Depression (Level at Business Cycle Peak = 100)**



manufactured goods has been a key mechanism for the international transmission of this recession.

Comparing today’s economy to the Great Depression has become commonplace. In that context, it is instructive to contrast what is happening now with the pattern of decline in U.S. industrial production during the 1929-33 recession.

As Chart 1a shows, that downturn saw U.S. industrial production decline by 53% over a three-year period (long deep blue line) starting in August 1929, which was the peak of that business cycle. In the current recession, however, U.S. industrial production has declined only 13% in the 15 months since the December 2007 business cycle peak (light blue line), less than half as much as at the same point in the Great Depression.

The picture is radically different in Japan and Germany. As of February 2009, just a year after the February 2008 peak in the Japanese business cycle, industrial production (red line) had dived by 37% – compared with a 23% plunge in U.S. industrial production a year into the Great Depression. Virtually the entire drop in Japanese industrial production has occurred in just nine months, starting last May – a striking pace of decline.

In Germany, where the recession began in April 2008, industrial production (black line) has so far followed the Japanese track, plunging by 21% in just ten months through February. Almost all of this decline has taken place in just six months, since last August.

Clearly, it is in Japan and Germany – rather than in the U.S. – that the recessionary downturns in industrial production have surpassed the rate of decline in U.S. industrial production during the Great Depression. The fact that industrial output in the world’s second- and third-largest economies has plunged to this extent and at this rate is a telltale sign of the depth of this global recession and where it has hit hardest. As we shall see, the news is not quite as dismal in other key economies.

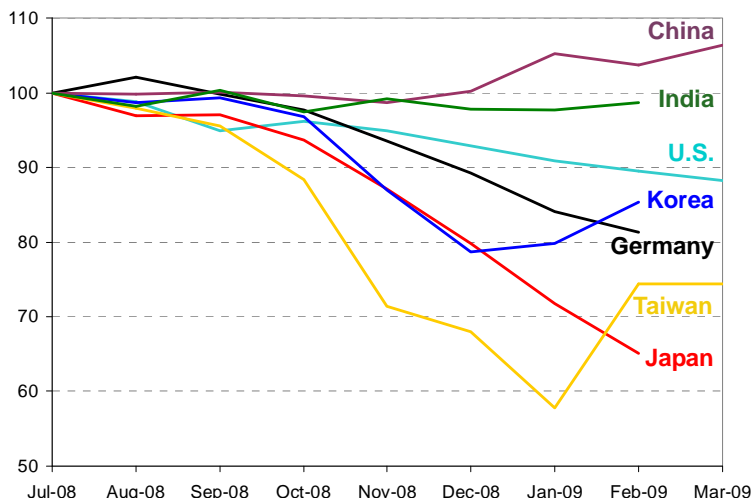
Chart 1b shows the trajectories of industrial production in seven important economies starting in July 2008, which is the likely start date of this global recession based on the peak in ECRI’s 19-Country Coincident Index. For the purpose of comparison, industrial production in each country shown in the chart is rebased to 100 in July 2008.

As expected, industrial production shows a 35% dive since last summer in Japan (red line), and a nearly 20% drop in Germany (black line). In contrast, industrial production has seen less than a 12% decline in the U.S. since that point (light blue line).

What is notable, however, is the pattern of declines in industrial production in Asia excluding Japan. In fact, it had plummeted by 42% by January in Taiwan (yellow line) before staging a 29% rebound. In Korea, as well, it had dropped over 21% by December (dark blue line) before bouncing back by 8% in the next two months.

In India (green line), the decline was far smaller – only about 2% by October – but there has already been

**Chart 1b: Industrial Production in Current Global Recession**



a 1% rebound since then. In China, the picture is even brighter, with industrial production having slipped only 1% by November (purple line) before rebounding to a new high, 6% above last July's reading.

**Japanese and German industrial output plunges. Industrial production rising in non-Japan Asia.**

In sum, Asian industrial production outside Japan took huge hits in the smaller export-dependent economies like Korea and Taiwan, but has already begun to bounce back, while in China and India the declines were far more modest, but rebounds are already in evidence. All this is consistent with the reversal of the Bullwhip Effect and, more importantly, the upturn in the Financial Related Diffusion Index (FRDI) that we highlighted in this publication earlier this year ([↗ Vol. XIV, No. 2, February 2009](#)). In fact, following the upturn in the FRDI, we have seen a three-month uptick in the growth rate of the U.S. Leading Manufacturing Index that should bolster the upcoming U.S. growth rate cycle upturn.

We also now see a three-month uptick in the growth rate of the German Leading Manufacturing Index, which should result in a slackening in the pace of decline of German industrial production in the next few months. However, according to the German Long Leading Index, this will not be sufficient to bring the German recession to a close in the near future.

The situation in Japan is even worse, with growth in the Japanese Leading Manufacturing Index still in a free fall. Thus, we do not yet foresee an end to the

nosedive in Japanese industrial production; nor is the Japanese business cycle recession likely to draw to a close any time soon.

Why has the Japanese recession been so horrendous? After all, it is already by far the worst Japanese recession in the postwar period. The relative tardiness of Japanese stimulus may be partly responsible for the lack of any signs of revival, but the root cause of the deep recession may be the increased exposure of the Japanese economy to exports in recent years. This was due in part to the migration of production back to Japan following the earlier weakness of the yen, which boomeranged on Japanese business with the demise of the "carry trade" and the consequent strengthening of the yen since the beginning of the global downturn.

Moreover, in many cases, Japanese small businesses, which spearheaded Japanese export growth in recent years, were the high-technology suppliers to manufacturers in other Asian economies such as Taiwan and China. Placed as they were at the far end of the supply chain, away from the consumer, they were newly positioned to feel the greatest pain from the Bullwhip Effect. Hopefully, this will see some reversal in the coming months, but there is as yet no objective indication that this will soon occur.

**Conclusions** One reason this global recession has been so intense is the plunge in industrial production in the major export-oriented economies, particularly Japan and Germany, where its pace has surpassed that seen in the Great Depression. Yet there are already signs of a bounce-back in production in most Asian economies outside Japan. Unfortunately, the Japanese recession is likely to deepen even further.

Indications of imminent upturns in industrial growth are evident in Europe ([↗ page 13](#)), specifically in Germany and even more so in France ([↗ pages 4 to 6](#)), but the business cycle recessions in the Eurozone are set to persist for now. Against that dark backdrop, the likelihood of a U.S. business cycle upturn is welcome news. In fact, a clear upturn in the U.S. Leading Imports Index ([↗ page 7](#)), suggests that the U.S. economy is getting ready to once again act as a locomotive for global economic growth.

Growth in China and India is also set to revive in the coming months, as is the case with the smaller export-oriented economies of Asia. In sum, there are now some rays of hope piercing the gloom about the global economy, belying the growing pessimism about the first global contraction since World War II. ■