

Slowdown In Global Industrial Growth at Hand

Job growth will pick up in the major economies, but we are on the cusp of a new global industrial slowdown.

Favorable Job Growth Outlook Nearly a year after it began, the global economic recovery is finally being acknowledged by investors and businesses. As a result, measures of international business confidence are ramping up, and stock prices are hitting their highest readings in well over a year.

Even so, there are widespread doubts about job recoveries, especially in Western economies. However,

as we pointed out recently ([↗U.S. Cyclical Outlook, Vol. XV, No. 3, March 2010](#)), the U.S. recovery is already stronger than the last two, not only in terms of GDP growth, but also in terms of the speed of the turnaround in the jobless rate. Unemployment peaked last October, soon after the recession ended, instead of drifting up for a year and a half, as in the last two recoveries.

The German and Canadian economies are already adding jobs, while the U.S. is on the cusp of positive employment growth. The other major European economies are still losing jobs. However, as anticipated by the cyclical upturns in the growth rates of the respective leading employment indexes (LEIs) for those European economies, job growth has already turned up. With the LEI levels also rising in every major Western economy, most of Europe should start adding jobs in the coming months.

There is a common perception that consumer spending growth picks up only after job growth has taken hold. In reality, as we discuss later ([↗pages 4 to 6](#)), the reverse is generally true: more often than not, cyclical upturns in consumer spending growth anticipate upturns in job growth. In that context, job growth prospects should be helped by the decisive upturns in consumer spending growth in all G7 economies except Germany, where employment is already rising, in any case.

The central point is that, notwithstanding the gloom and doom that was so pervasive until recently, fairly normal business cycle recoveries have been unfolding in every major economy, as telegraphed by ECRI's long leading indexes in mid-2009 ([↗International Cyclical Outlook, Vol. XIV, No. 7, July 2009](#)). In that same report, we also dispelled the prevailing concerns about a double dip in the U.S. – a theme chosen as this week's cover story by a popular financial magazine, eight long months after we made that call.

That long lag highlights an issue of particular importance to users of ECRI's work. While the lead of a leading index over a cyclical turning point in economic activity is certainly of historical importance,

Divergent Outlooks

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

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what matters to most practitioners is the lag between ECRI's forecast and the general recognition of reality. In the above example, the lag seems to have been about eight months, which is close to the median lead of the U.S. Long Leading Index (USLLI) at business cycle troughs.

In this context, it is notable that, in the same report, we foresaw an easing in global industrial growth on the "far horizon," based on a downturn in the Financial Related Diffusion Index (FRDI). Referring to the Global Industrial Production Index (GIPI), we spelled out our specific conclusion that "it would not be surprising if GIPI growth began to ease by late 2009 or early 2010." As we shall see, that prediction may turn out to be right on the nose in terms of timing. However, the general recognition by the consensus of that global industrial slowdown could very well take a few more months.

This is because the FRDI has a median lead of almost a year at cyclical troughs in global industrial growth. Thus, it typically foresees turning points very far ahead, with a lead time that is even longer than that of the USLLI. Therefore, it makes sense that, following our forecast of a slowdown in global industrial growth "on the far horizon," the cyclical revival in industrial growth actually gained momentum for several months.

The belated recognition of the strength of that upturn in industrial growth has fueled strong convictions about its sustainability. Of course, with perceptions once again lagging reality, this may be an increasingly risky stance to take.

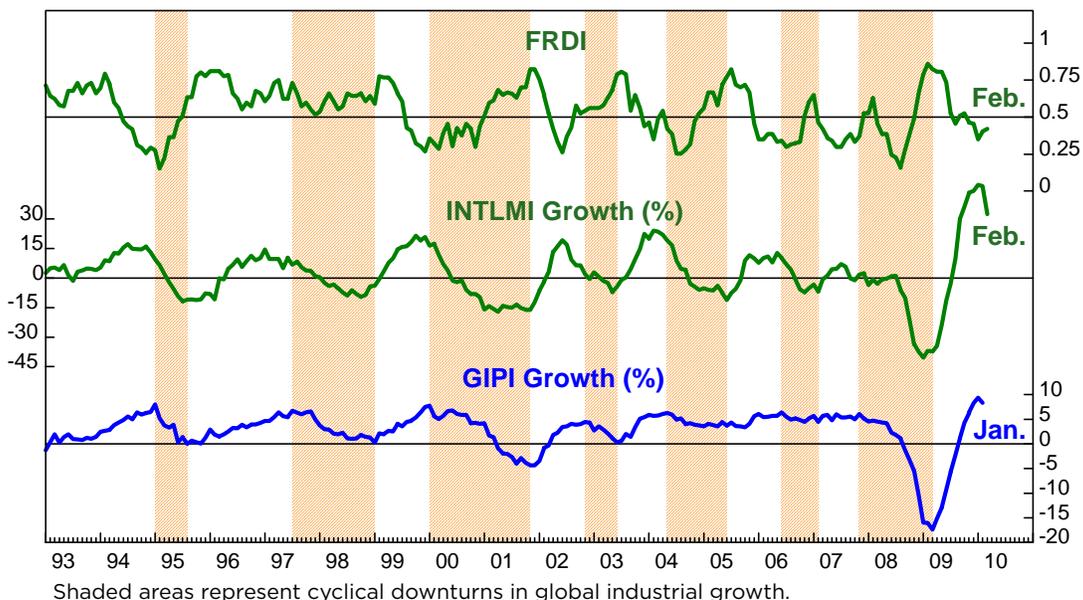
Global Industrial Growth to Slow Soon As we have explained, the FRDI is a long leading indicator of global industrial growth, for which GIPI growth is a good proxy. However, the FRDI's lead times are somewhat variable, as is the case for most leading indicators.

The International Leading Manufacturing Index (INTLMI) growth rate is a short leading indicator of global industrial growth, which almost always turns well after the FRDI but shortly before GIPI growth. Thus, a cyclical turn in INTLMI growth, following an earlier turn in the FRDI, is generally a reliable indication of a near-term cyclical turn in GIPI growth. This standard sequence of turning points is therefore a useful tool to help refine the forecast of a cyclical turn in terms of timing.

As Chart 1 shows, the FRDI (top line) turned down in early 2009, as we had noted last July. A much more recent development is a downturn in INTLMI growth (middle line). In fact, INTLMI growth has now been falling for two months. It is in this context that the one-month downtick in GIPI growth is especially interesting. While it is too soon to tell, it is possible that this is the beginning of the cyclical downturn in GIPI growth that we predicted eight months ago. If not, GIPI growth is still likely to turn down in the near future.

In other words, the global industrial slowdown, which we predicted in mid-2009, appears to be arriving on schedule. Of course, this does not mean that there will soon be general recognition of that slowdown.

Chart 1: Indicators of Global Industrial Growth



Popular Misconceptions As we discussed a few years back ([↗U.S. Cyclical Outlook, Vol. XII, No. 2, February 2007](#)), the "market moving indicators" followed by most investors are almost all roughly coincident in nature. Thus, even for those who closely monitor economic data, there is a natural inclination, when presented with evidence of a cyclical turn in any economic indicator, to assume that there are immediate implications for a turn in the cycle.

Only a few decision makers are familiar with long leading indicators like the FRDI or the USLLI, which signal upcoming cyclical turns well ahead of the event. Hence, such indicators can be very valuable when properly interpreted, in the context of a sequential signaling system involving, for instance, the FRDI, INTLMI growth and GIPI growth. A separate sequential signaling system, useful for forecasting U.S.

**Industrial slowdown arriving on schedule.
Global growth to ease.**

recessions and recoveries, involves the USLLI, the Weekly Leading Index, the U.S. Short Leading Index and the U.S. Coincident Index.

One virtue of such sequences is to provide early warning of upcoming turns in the cycle, often before forward-looking financial markets register the shift. Their other advantage is to afford increasing levels of confidence as one indicator after another exhibits a cyclical turn in the expected sequence.

The lack of understanding of long leading indicators is quite common even among otherwise sophisticated observers, including professional economists. But it does not explain why they are so ready to believe that, once the economic cycle has turned, it will keep going for years. As intimated, this is likely to be a costly assumption in the context of global industrial growth.

Perhaps they, too, share the belief of most people that the economy should keep improving indefinitely unless some agency aborts this progress, deliberately or otherwise. In that context, it is no wonder that, in a poll released this week, 41% of Americans blamed Wall Street or other businesses for the recession, and 37% blamed the government (presumably including the Fed), while only 8% blamed the business cycle. While it is not difficult to see why they would hold Wall Street or the government responsible for the severity of the recession, it is symptomatic of the common lack of understanding of a market economy to assume, in effect, that the business cycle can be repealed by better

business or policy management, particularly in a mature developed economy.

Unfortunately, especially in the U.S., recessions are likely to return with greater frequency than we have become accustomed to. Meanwhile, in fast-growing developing economies like China and India, economic contractions will become fairly infrequent in the years ahead. That could help feed the hubris that has grown in those countries in the wake of the Great Recession, while fueling anti-establishment anger and resentment in the West, and especially in the United States.

While the global economic recovery will continue, growth is likely to start easing in the coming months. This is especially evident from the clear downturns in long leading index growth for the U.S. ([↗Chart 5b, page 9](#)) and the major European economies ([↗Chart 11b, page 15](#); [↗Chart 13b, page 17](#); [↗Chart 15b, page 19](#); [↗Chart 17b, page 21](#); and [↗Chart 19b, page 23](#)).

Also, a downturn in global industrial growth is likely to take hold soon. This dimming outlook is already being reflected in falling long leading index growth for Korea ([↗Chart 30b, page 34](#)) and Taiwan ([↗Chart 32b, page 36](#)), along with the downturn in the growth rate of the Chinese Leading Industrial Production Index ([↗Chart 27, page 31](#)).

At this point, such slowdowns look unlikely to result in new recessions. Rather, if they help postpone a serious build-up of inflation pressures, Western central banks could have more leeway to keep rates low for an extended period of time.

However, there is a possibility that the outcome will not be quite so benign: the downturns could become more severe, even as inflation pressures keep climbing. We will therefore closely monitor the relevant long leading indexes and the future inflation gauges for early clues to an increase in such risks. ■