The Telegraph

Day of reckoning postponed as global recovery builds

Monetary expansion in Europe, America and China all point to stronger growth this year, signalling another leg to the global expansion

US President Barack Obama gestures to reporters. The American economy grew at a 2.3pc rate in the second quarter

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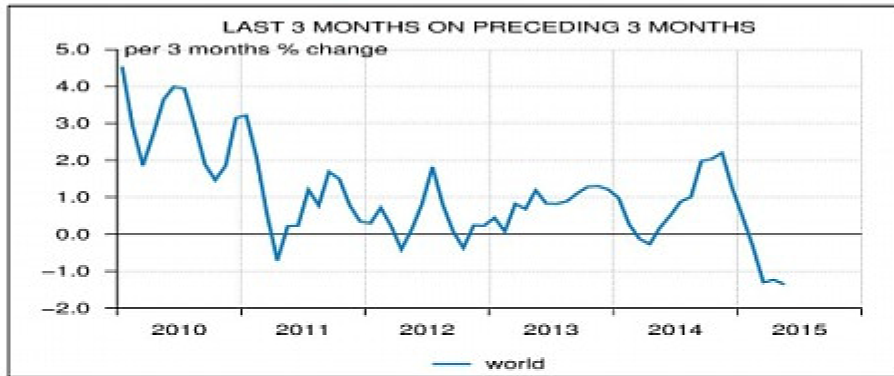
With hindsight it is clear that the world economy came within a whisker of recession earlier this year.

Global shipping volumes contracted by 3.4pc between January and May, according to Holland's CPB world trade index.

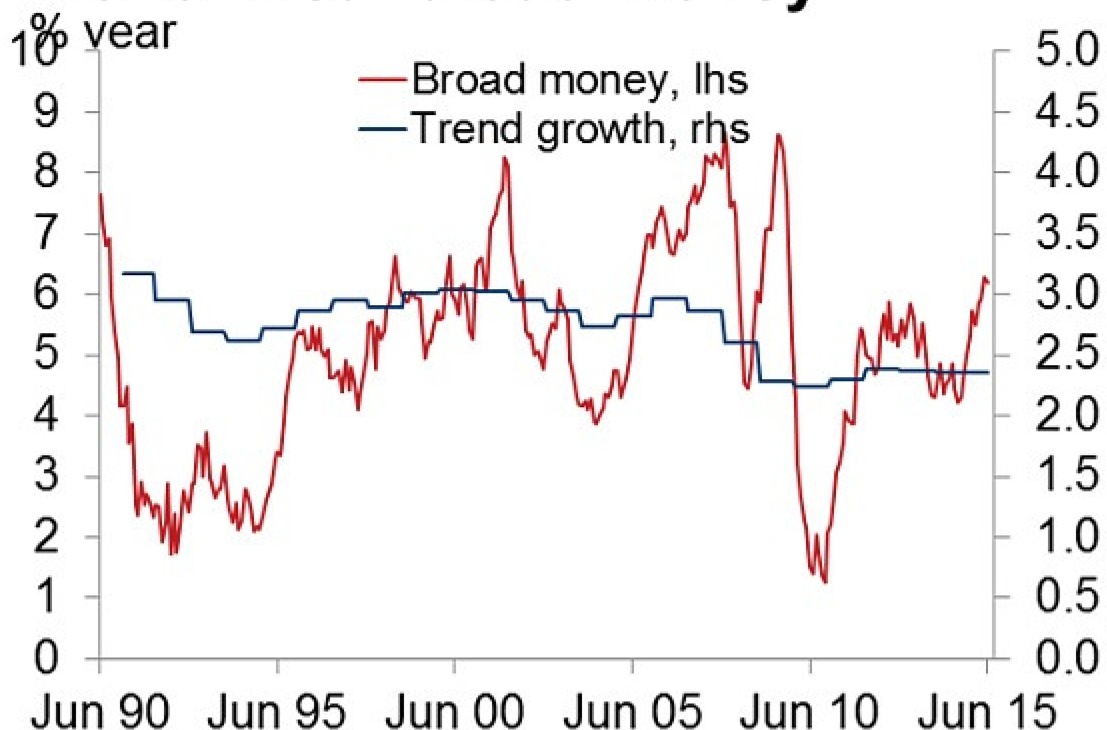
This episode is now behind us. Leading indicators and monetary data in the US, Europe and China point to an accelerating rebound over coming months.



Gabriel Stein, from Oxford Economics, says the growth rate of the world's real M3 money supply – based on the US, China, EMU, the UK, Japan and Canada – rose to a six-year high of 6.2pc in June.

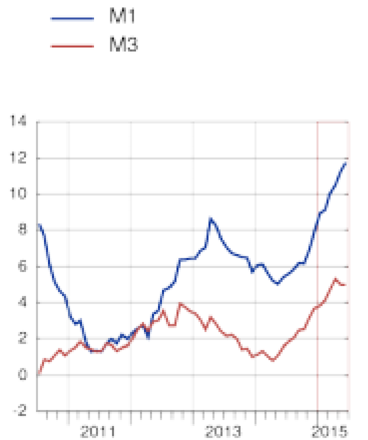
The M3 gauge tends to lead economic growth by 12 months or so, suggesting that the worst may soon be over.

In Europe, the monetary kindling wood of recovery is clearly catching fire.**Spain is growing at its fastest pace since the post-Lehman crisis**. So is Ireland.



The triple effects of quantitative easing by the European Central Bank, a 12pc fall in the trade-weighted index of the euro in 15 months and the fall in Brent crude prices from $110 to $50, have together lifted Euroland out of its six-year depression.

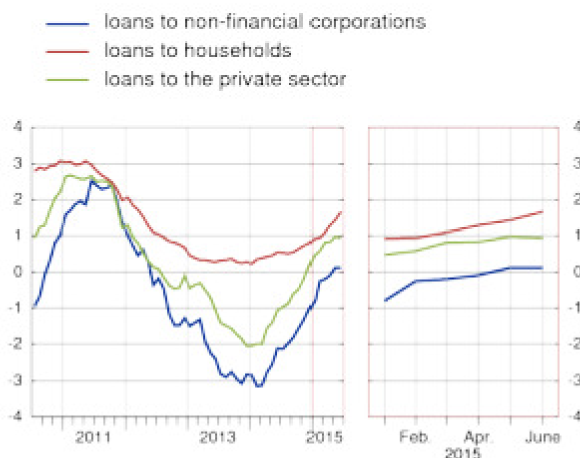
The property slump is over. Standard & Poor's expects house prices to rise 3pc in Holland, 4pc in Portugal, 5pc in Germany and 9pc in Ireland this year.



The eurozone money supply is surging

Simon Ward, from Henderson Global Investors, said a key gauge of the eurozone money supply – real six-month M1 – is growing a blistering rate of 12.6pc. This implies a surge in spending later this year. "Monetary policy is too loose in the eurozone. It is highly questionable whether they can really keep going with QE until the end of next year," he said.

America is slowly weathering the effects of the strong dollar. The economy grew at a 2.3pc rate in the second quarter. Capital Economics expects it to accelerate to 3pc in the second half. Loans are growing at an 8pc rate. It is not a glorious boom, but nor is it the stuff of global meltdowns.

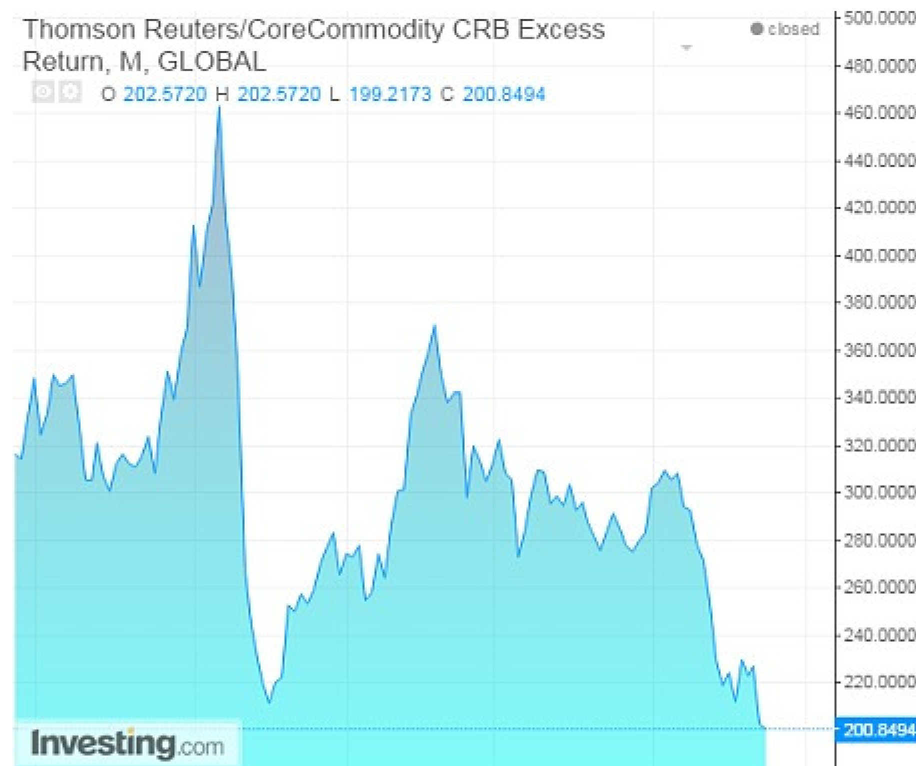


The commodity crash may feel as if Armageddon has arrived but it is, in reality, the tail-end of China's hard landing, compounded by Saudi Arabia's political decision to flood the global crude market and strike a blow against Russia, Iran and the US shale industry.

"There has been a sharp drop in the 'commodity-intensity' of China's economic growth," said George Magnus, a trade expert and a senior adviser to UBS.

“This has sent very chilly winds through parts of the world. Vast swathes of the emerging market universe have lost their export prop."

The synchronized rout that we have seen across the gamut of commodities – from copper, to thermal coal, soya and milk - is certainly hair-raising. The Reuters-Jeffrey CRB index of raw materials has collapsed by almost 60pc from its peak in 2008 and is back to levels first reached in 1971.



There is a risk that this could go too far and metastasize, leading to a second leg of global deflation. This would play havoc with debt dynamics in a world where debt ratios have risen by 30 percentage points of GDP since 2008, reaching unprecedented levels.

Yet commodity crashes are double-edged. They act as a stimulus for the world economy. The consuming nations are enjoying a $500bn "tax cut" from the**OPEC cartel.**

The slide may soon touch bottom in any case, if it has not already done so. The Baltic Dry Index measuring freight rates for dry commodities has almost doubled since the start of June. The shipping firm Clarksons said it is being driven by a revival of Chinese steel demand.

The chances are that the growth scare of 2015 will prove to be a false alarm, much like the nasty episodes of 1987 and 1998 when market tantrums – frightening at the time – turned out to be innocuous. The cycle had another two years’ life both times.

Markets over-reacted violently this week to **a fall in China’s PMI manufacturing gauge to 47.8 in July**, fearing that the economy is now in the grip of such powerful

debt-deleveraging that stimulus no longer works. But the survey was distorted by the immediate fallout from the stock market debacle in Shanghai.

Nomura says its "growth surprise index" is signalling a “strong rebound” after touching the bottom in May.

The bank’s "heat map" for China shows that 53pc of the components are flashing “hot”, including electricity output, chemical fibres, non-ferrous metals, chemical fertilizers, real estate investment, car production and M2 money. The "hot" ratio is up from 44pc in May, and 31pc last October.

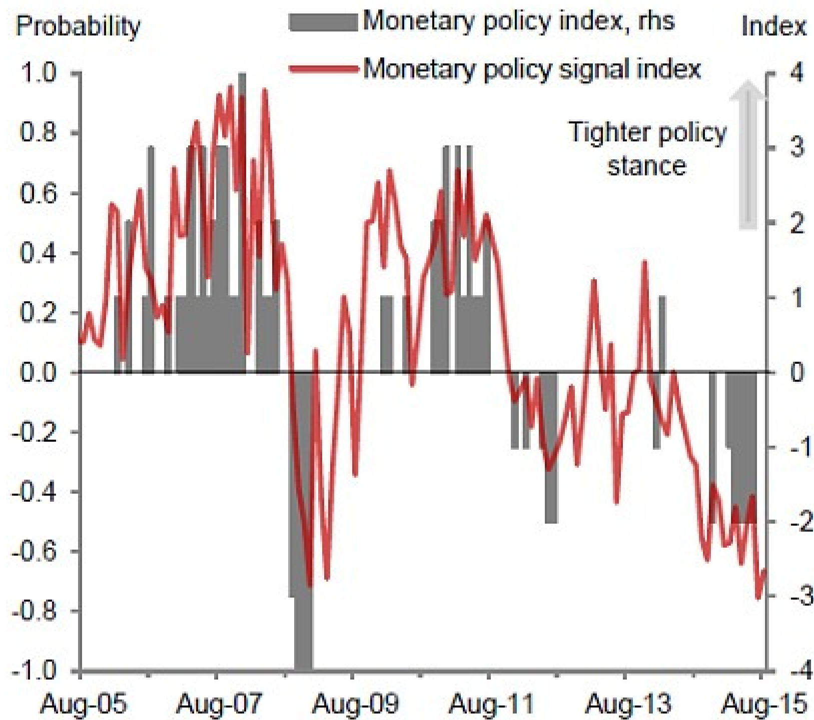
It hard to know whether premier Li Keqiang misjudged China’s hard-landing earlier this year. The Politburo is deliberately trying to deflate the country’s $26 trillion credit bubble – up from $9 trillion in early 2009 - knowing that stimulus-as-usual is becomes more dangerous with each stop-go mini-cycle.

Yet the calibrated slowdown may have gone too far. One-year borrowing costs rose from zero in 2011 to 5pc in real terms last year as deflation took hold, a form of passive monetary tightening.

Thanks to China’s dollar peg, the exchange rate has risen 20pc against the euro, 60pc against the Japanese yen and 100pc against the Russian rouble since mid-2012.

At the same time the economy went over a “fiscal cliff” at the start of the year as local governments saw a collapse in revenues from land sales and were prohibited from bank borrowing.

The authorities were slow to respond to multiple shocks but they have finally get their bond market off the ground. Local entities are issuing securities at a pace of $130bn a month, amounting to a shot of stimulus. Real borrowing costs have halved since late last year.



Source: Nomura Global Economics estimate.

Nomura says monetary policy is now as loose as in the depths of the post-Lehman crisis. A mini-blitz of a fresh infrastructure spending has begun to plug the fiscal gap.

It is not a return to the manic uber-stimulus of the boom years, but it is unlikely that China will spiral deeper into its slump over coming months. The Communist Party controls the quantity of credit through the state-controlled banks, and it is using that lever to pump-prime the economy.

If need be, it can cut the reserve requirement ratio for banks from 18.5pc to zero, injecting $3 trillion into the system. Only once Beijing has played that final card, should we start to worry. China's day of reckoning is still far away.