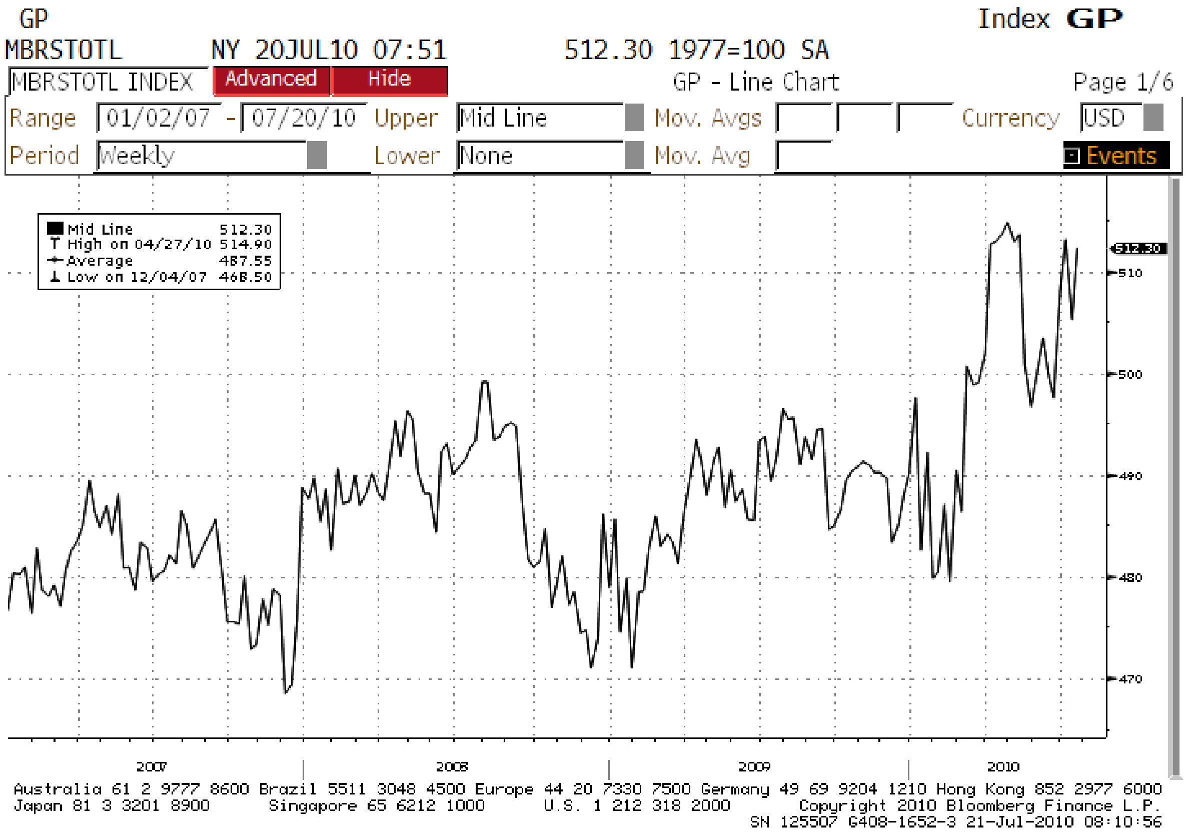
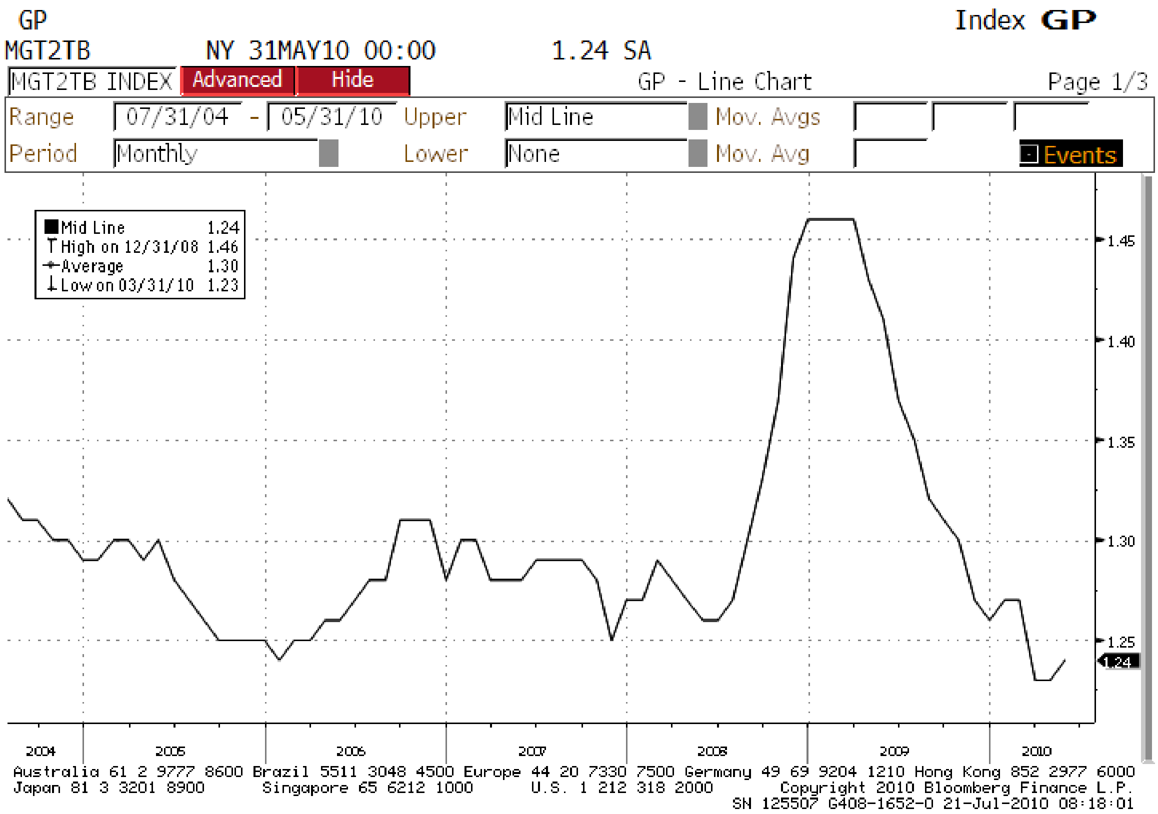
What Double Dip?

The market chatter has been going on and on about a double dip for months now. So just to play devil's advocate, I thought I'd look for basic economic evidence that says OTHERWISE.

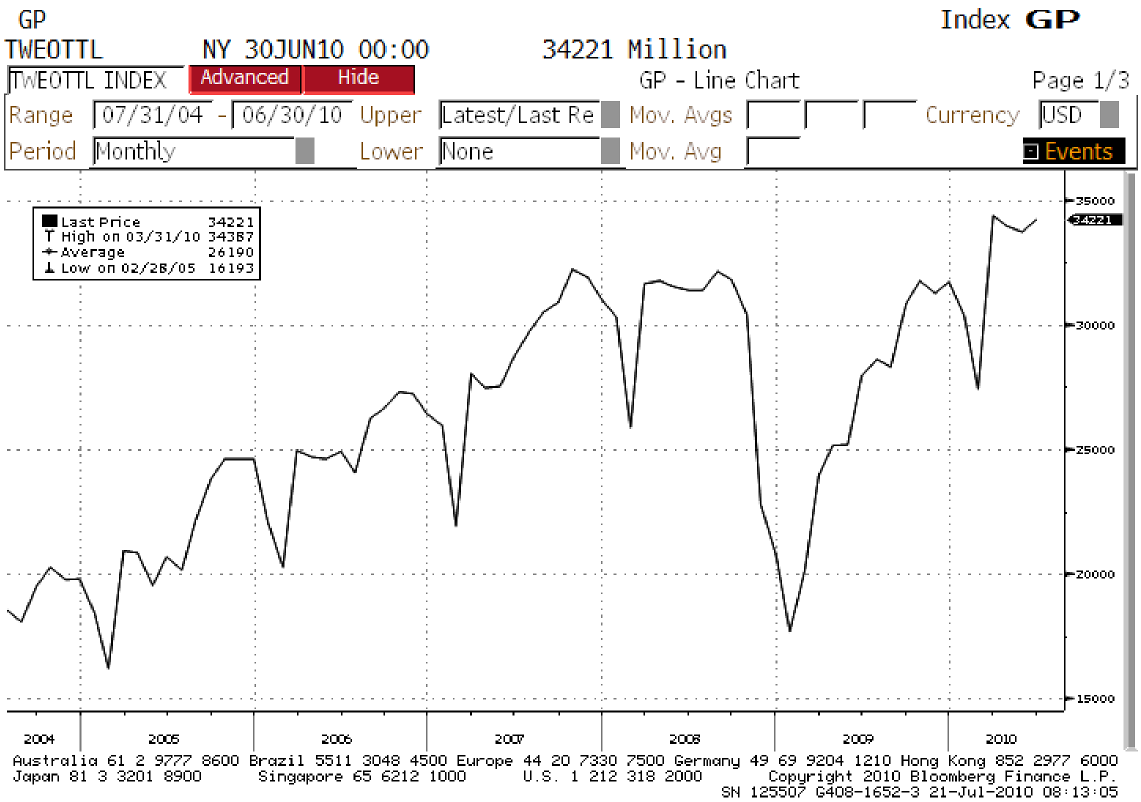
First up, the US consumer. In the following chart that shows weekly chain store sales in the US, there is no conclusive signs of weakness. In fact, the sales levels are at all time highs, significantly above pre-Lehman crisis levels. The data is very current, the latest point being for the week ended 17 July, 2010.



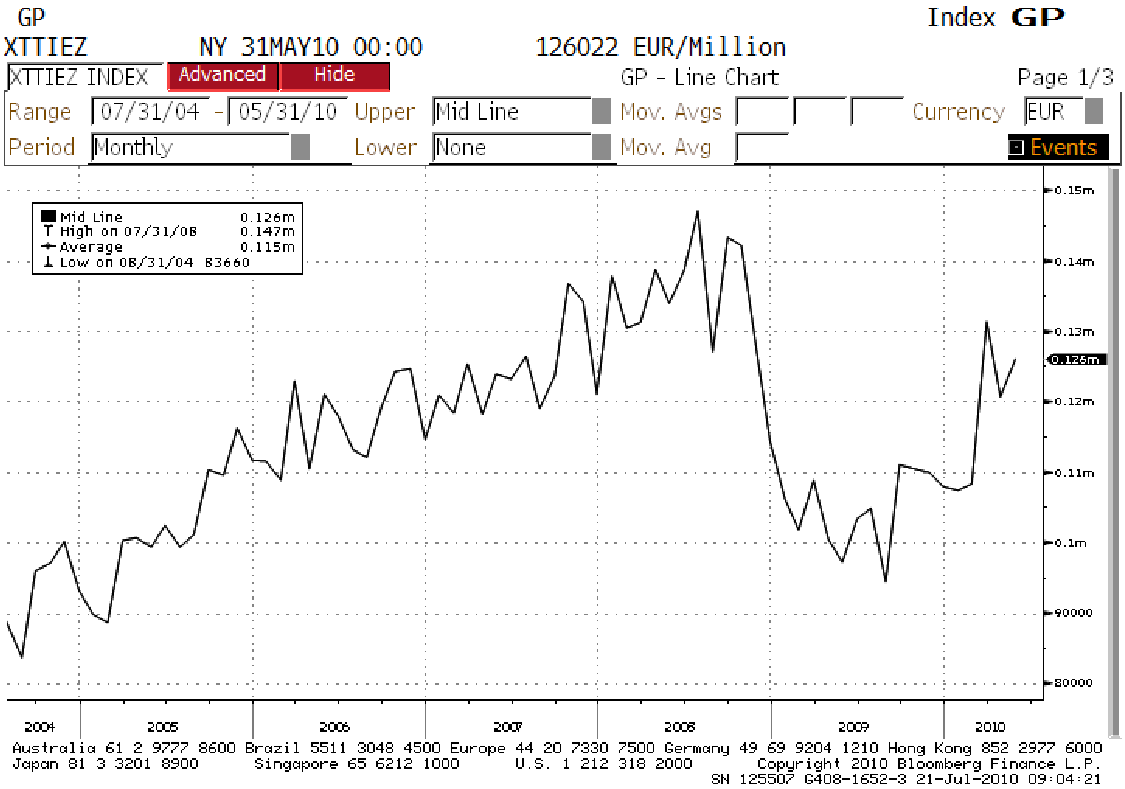
If the US consumer is spending, is there any inventory in the system that could disrupt the production side of the economy? The next chart shows the ratio of Manufacturing and Trade Inventory to Sales for all businesses (retail, wholesale and manufacturing). Clearly, as of May 2010, there is no sign of inventory backing up in the system. In fact, this ratio is significantly BELOW pre-Lehman crisis levels – which means the system is leaner than before. As consumer spending clearly remained robust right up to the week ended 17 July, it is inconceivable that this ratio could have spiked up sharply over the course of June and early July.



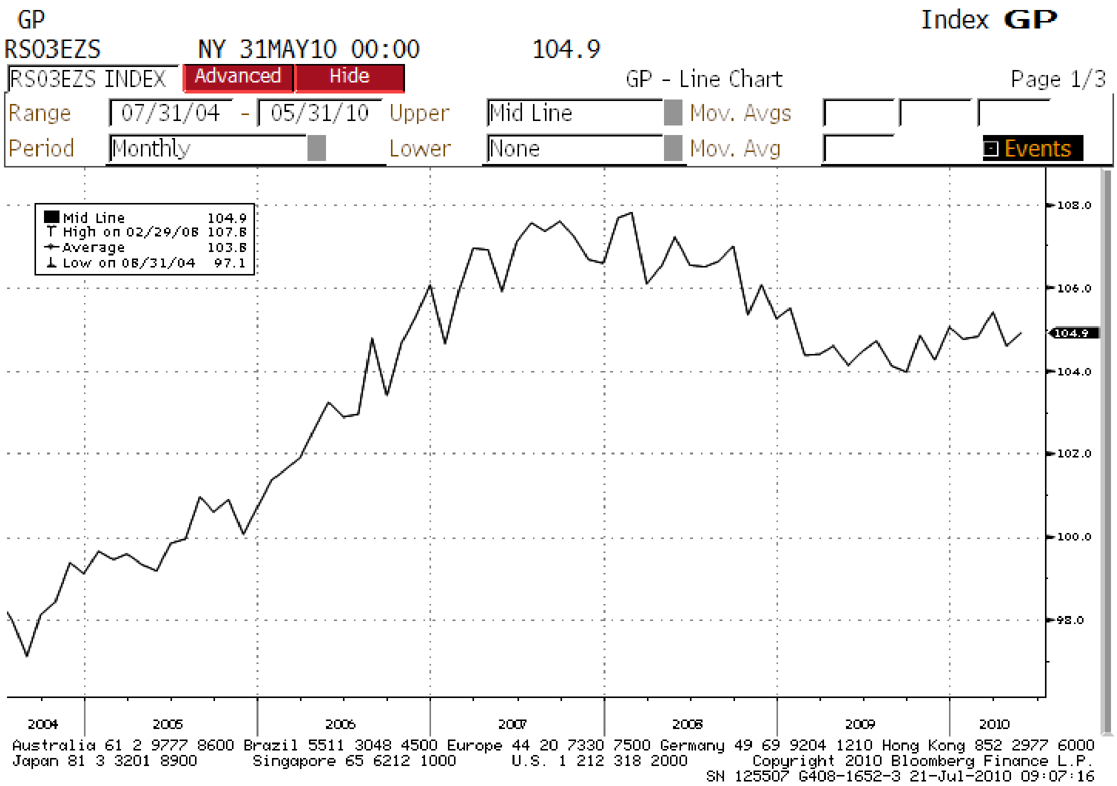
If US consumers are spending and inventory isn't piling up in the supply chain, then orders to the major exporting countries in Asia should be holding up, shouldn't it? Well the next chart showing Taiwan's Export Orders up to June 2010 shows that this is indeed so.



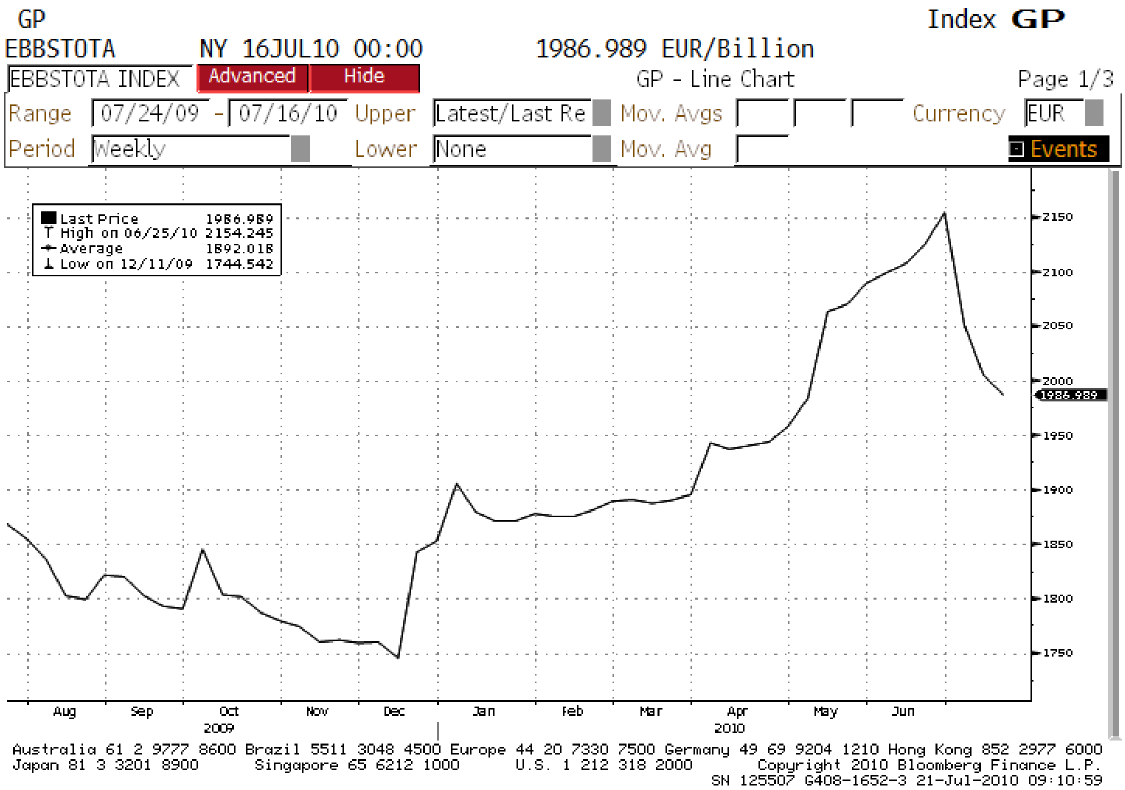
Maybe the US is ok but Europe must be collapsing, right? This is harder to answer as the EU-wide data is mostly available only up to May 2010. But so far, the import numbers are consistent with a gradual, if slow, recovery.



This message is reinforced when you consider the index of EU non-food retail sales.

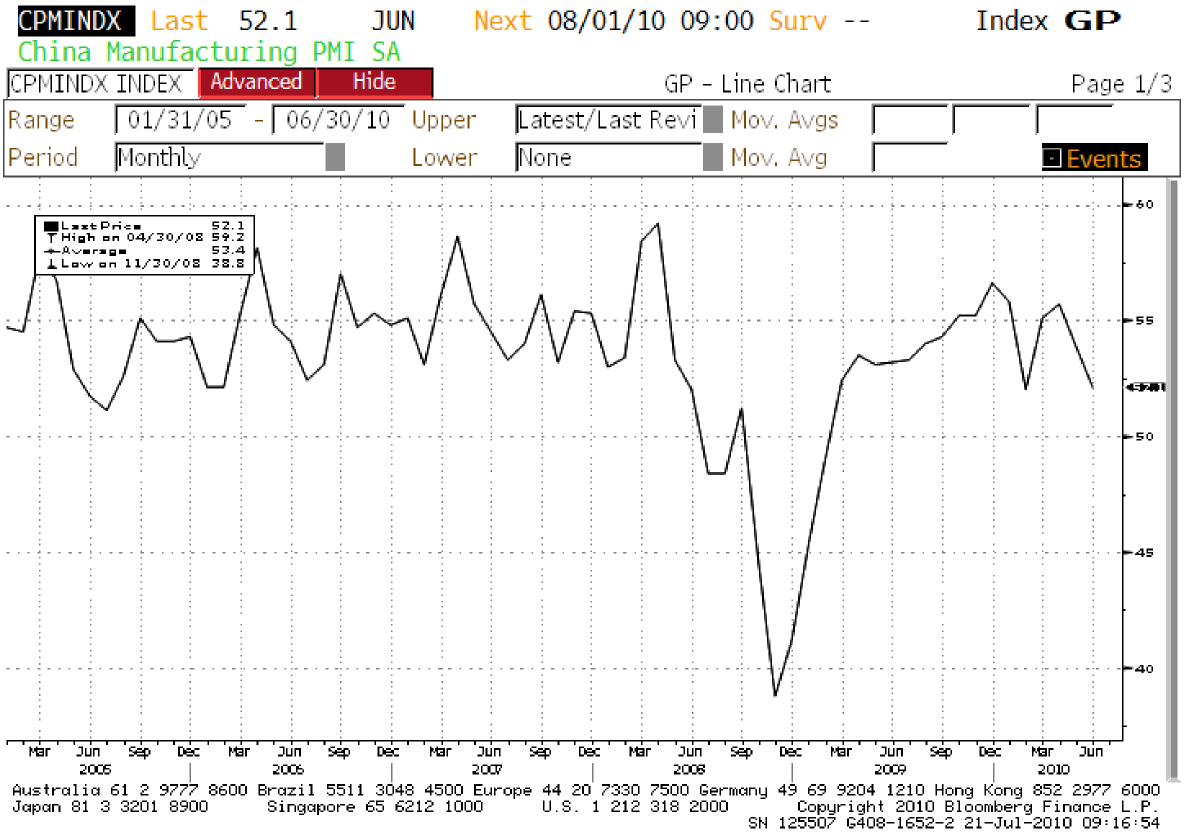


We do have a weekly data series that comes out of EU that can be very useful in current circumstances. This is the ECB (European Central Bank) total balance sheet. As you can see, over the last 3 weeks, the ECB has reduced its balance sheet by almost EUR 200 billion! These are not the actions of a central bank whose economic territory is falling into an abyss. Unless the ECB is composed of blind, dogmatic idiots, I can think of no other reason for these actions than that in the ECB's opinion, the EU-crisis has passed and economic conditions have stabilised.



By the way, an ECB in tightening mode is also the reason that all the short-Euro positions have been devastated in the past 2 weeks.

Recently, a lot of noise was made about China's Manufactuing PMI falling. The chart is on the next page. Yes, it has fallen from the peak level of 56.6 in Dec 09 to 52.1 in Jun 10. But the PMI has to be interpreted correctly. Any reading above 50 is a signal that the industry is EXPANDING! The absolute level isn't all that significant. Even during the bubble pre-Lehman crisis period, this index never exceeded 59.2.



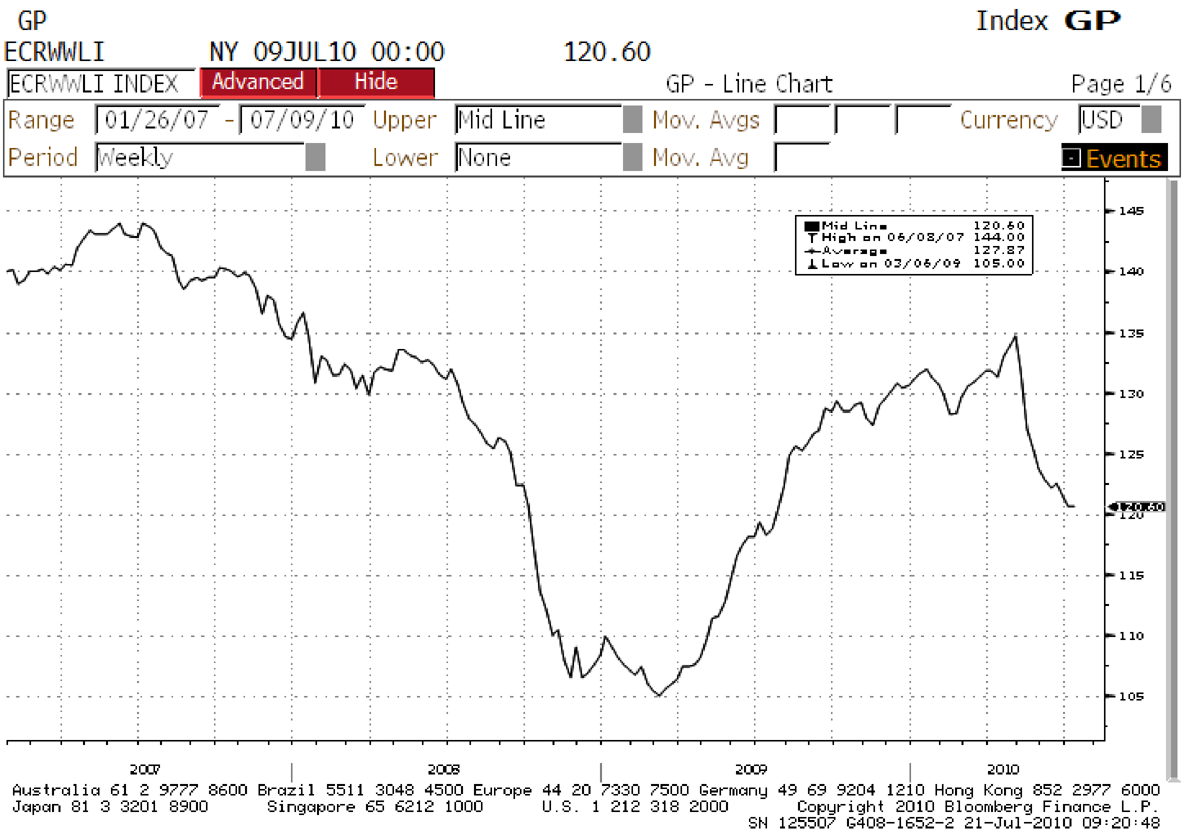
Finally, we come to the ECRI Weekly Leading Index (next page). I like this index very much as it has often proven much more accurate about the US economy than almost any other data point. *Note that the index has stabilised in the past two weeks.*

My interpretation of this chart would simply be as follows.

"The US economy recovered sharply from its Lehman crisis collapse. However, it has not regained the full strength of its pre-crisis vigour. Moreoever, the pace of recovery has cooled."

But this is very different from interpreting the index as saying "*we are on the verge of another big dip*".

If you look at the same index further back and look at how it has behaved in previous recessions, you will see more or less the same pattern – i.e. a sharp bounce from the recession depths, followed by a cooling off period before the economy regains its full vigour. (specifically, look at the late part of 1991 as well as 2002)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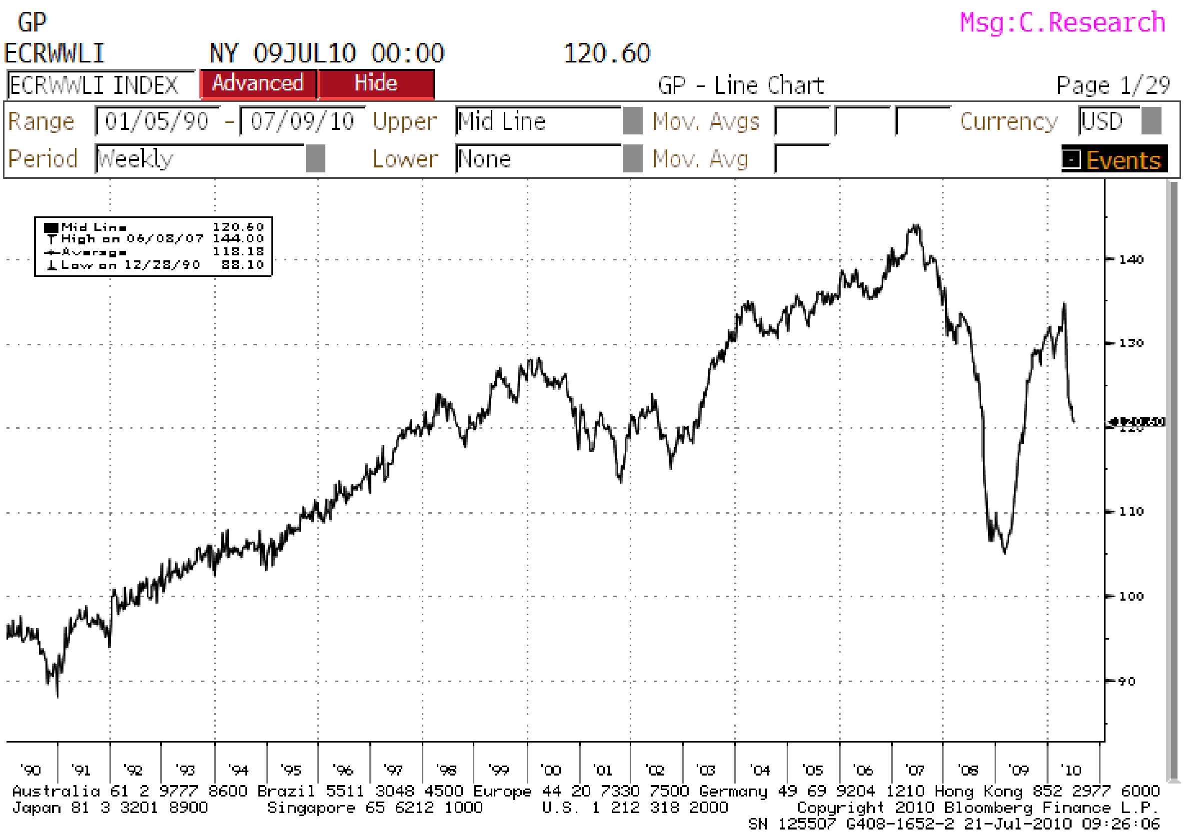
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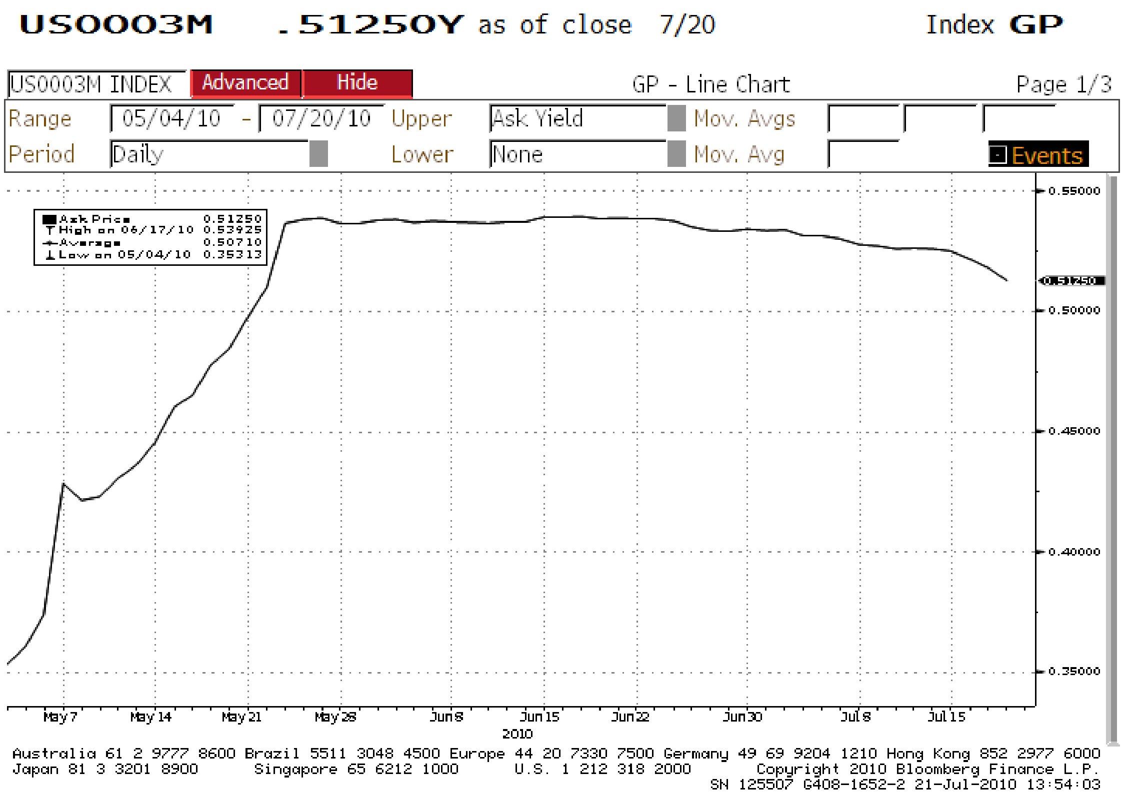
And now, we look at 3 market indicators. The first is the 3 month LIBOR and the TED spread, which seem to be used as a measure of risk appetite in the credit markets. In both instances, after spiking skywards during the Eurozone crisis in May, they have been coming down steadily. Presumably this is a sign that credit markets are returning to some normalcy. How can this be bad for the economy?



Meanwhile, the VIX index, which is perpetually used as an indicator of risk appetite for US equities, tells a similar story. VIX spiked in May, meaning appetite for US equities waned. But since late May, it has been coming down and is in fact almost returning to pre-Eurozone crisis levels. So, if one were consistent in one's interpretation, the logical conclusion is the US equity market is regaining its appetite for risk. How could it be doing so if a double dip recession just around the corner?

So, where is this double dip? Maybe the indicators are lagging but I am not so sure.

Throughout 2007, I hardly ever received warnings about an impending recession. Why? Because the previous one was in 2000-2001 and had faded from memory.

But the Lehman crisis and subsequent recession was only 18 months ago, and still fresh in everyone's minds. Therefore, I have been receiving non-stop warnings about another deep recession from all kinds of people – chartists, economists, analysts and even businessmen. Everyone appears to be preparing for the "last war".