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Markit Economics Research
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Global economy

PMIs are signalling a turning point in global economic cycle, though emerging Asia is leading the upturn

- **Global recovery path led by Asian manufacturing.**
- **Equity and FX markets respond, favouring commodity countries.**

Global contraction eases in Q2

The Global PMI, compiled by Markit for JPMorgan, rose to an eight-month high in May. Although remaining below the 50.0 no-change level to signal the continued contraction of the output of the combined global manufacturing and services economies, the rate of decline has eased significantly over the past three months. This suggests that the estimated 3.5% year-on-year fall in GDP in Q1 will represent a peak of the recession, with Q2 seeing a more modest contraction.

…led by emerging Asia

PMIs are rebounding almost as fast as they fell late last year, largely because the pick up is synchronised globally. Just as a synchronised downturn exacerbated national problems in the aftermath of the Lehman's collapse, the reverse appears to be happening this year. Charts 2 and 3 plot PMI manufacturing output indices from key countries in the developed world and emerging markets respectively to illustrate this point. Generally speaking, rates of contraction appear to have peaked late last year and have since eased. There are some differences, however. Most notably, China and India have already seen output rise for two successive months in April and May, indicating that Asian emerging markets are leading the recovery path.

The UK and US economies are following, possibly due to growth responding to the speed with which authorities have addressed banking sector problems and loosened policy. The UK PMIs even suggest that the private sector economy returned to growth in May for the first time in 14 months, led by the service sector. Meanwhile, the ISM's new orders component of its PMI

Chart 1: Global PMI and GDP

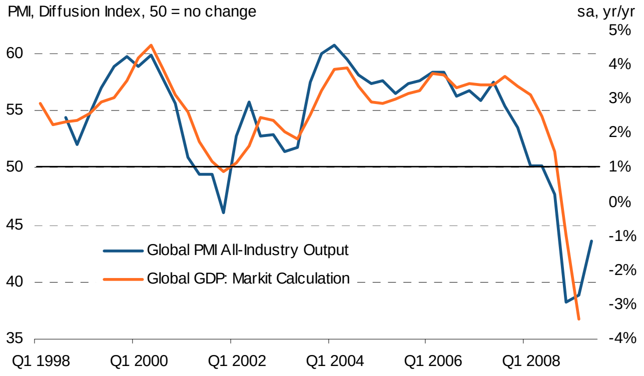


Chart 2: Developed world manufacturing output

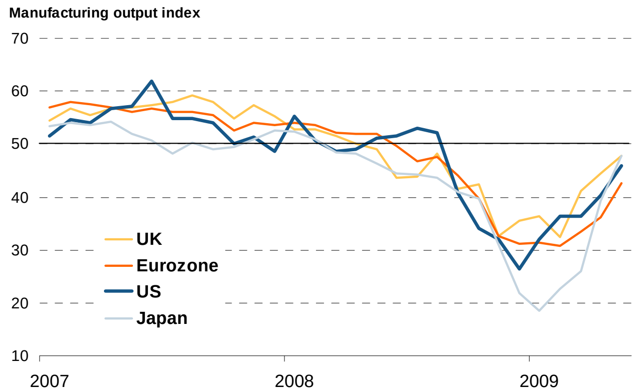
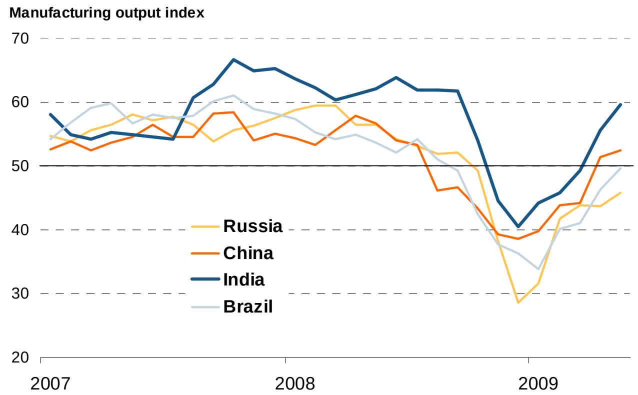


Chart 3: Emerging market manufacturing output



Sources: Markit, ISM.

survey also signalled a return to growth of demand for US goods for the first time in 18 months.

Further back, lagging the recovery path are the Eurozone and Central and Eastern European economies although, even here, rates of contraction have eased considerably in recent months (notably in the Eurozone, where the Composite Output Index has posted record rises in the past two months, though it remains firmly below the 50.0 no-change level).

Currency and equity markets reflect rising hopes of upturn led by manufacturing

The improved outlook for the global economy, one which is based on a swift return to growth of worldwide trade and manufacturing output, raises the likelihood of higher commodity prices, on the basis that any resumption of manufacturing growth will re-stoke demand for raw materials, therefore boosting prices.

Commodity prices have already shown signs of bottoming out (see chart 4), and the view that spare capacity will provide a buffer before rising demand generates upward price pressures needs to be treated with caution: suppliers' delivery times continued to lengthen in May, but are signalling a switch away from a buyers' market (see chart 5). This is in part because manufacturing inventory levels have been cut so sharply during the downturn (see chart 6).

The brighter prospects for the global economy have consequently driven a movement away from the safe haven of the US dollar to other currencies, and notably commodity currencies. At the time of writing, the Australian and New Zealand dollars have both risen 22% from their lowest closing prices against the greenback earlier this year, while the South African rand is up 25%, the Canadian dollar up 16% and the Brazilian real 21%. The euro and sterling have also risen, reflecting their better than expected economic data in recent months, up 12% and 15% respectively against the US dollar.

Equities have also followed the recovery path painted by the economic data, with emerging manufacturing leading the way. The FTSE Emerging Index has risen some 71% from its low in March while the FTSE Developed World Index has risen 'just' 43%.

It is possible that the equity market divergence may also be in part attributable to new signs that China and India may have decoupled from the west (explored elsewhere in the www.markit.com data commentary section), though it is impossible to clearly distinguish cyclical from structural influences at this stage.

Chart 4: Commodity prices

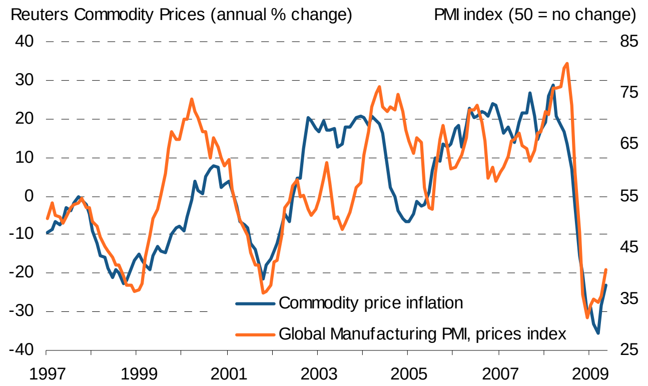


Chart 5: Supply chain capacity and prices

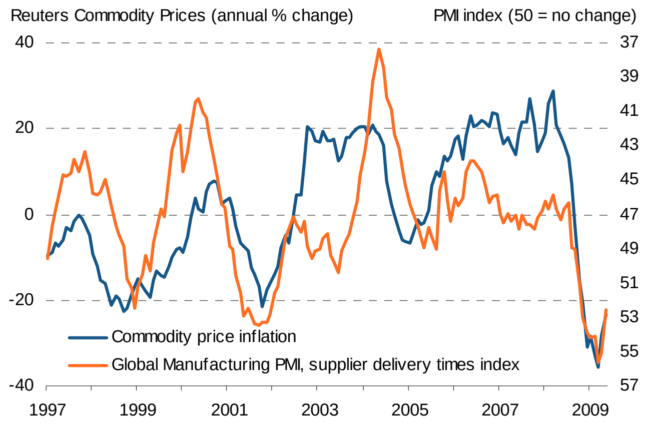
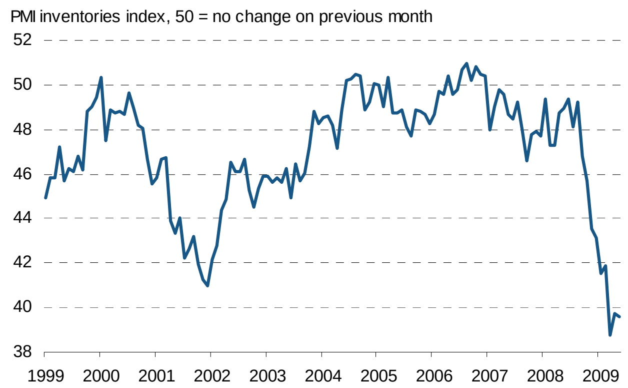


Chart 6: Global manufacturing inventories

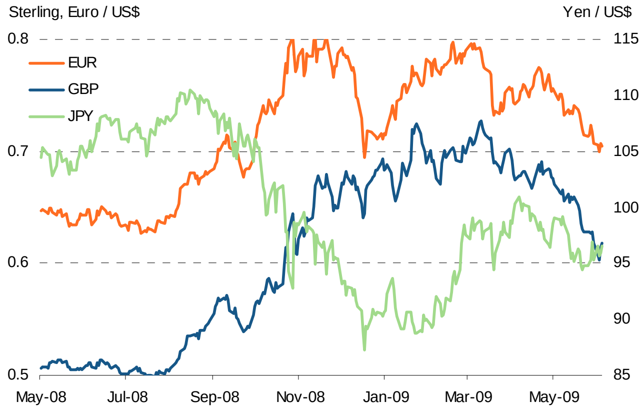


Sources: Thomson Reuters, Markit.

Shape of recovery remains uncertain

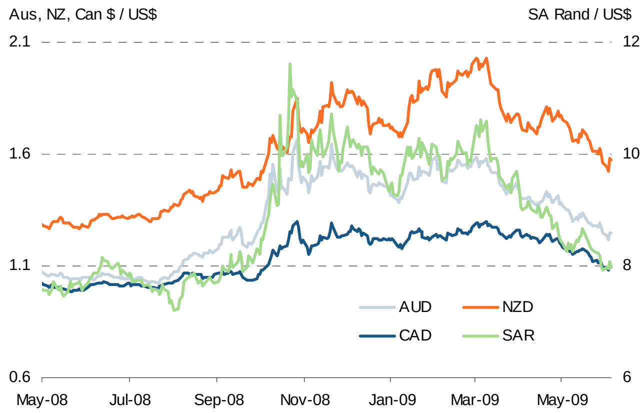
While signs have grown in May of a turning point in the recession, and even an end to the recession in some countries, the shape of any recovery remains very uncertain. Furthermore, up to now, evidence of any turnaround is largely confined to survey data (especially the PMIs). PMI survey sub-indices on inventories and business confidence provide hints that momentum is building, and fear of corporate default has eased significantly (see www.markit.com), but rising unemployment, consumer spending, bank lending and the financing of public sector debt are likely to be key determinants of the shape of economic growth over the medium term.

Chart 7: Developed world exchange rates



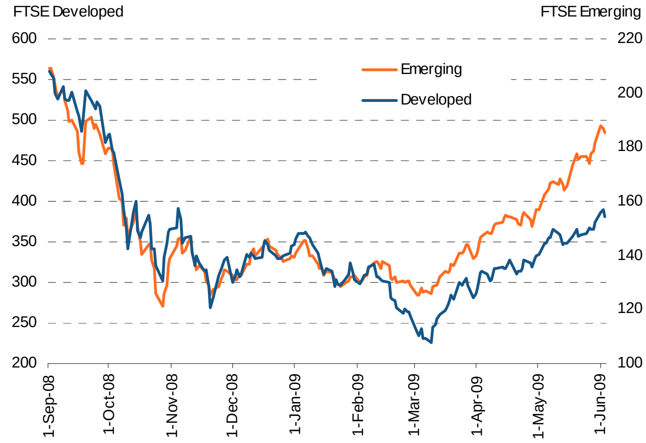
Source: Ecowin.

Chart 8: Commodity country exchange rates



Source: Ecowin.

Chart 9: Emerging v. developed equities



Source: FTSE.

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