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## Analysis: Is the global private sector riding to the rescue?

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By [Mike Dolan](#)

LONDON (Reuters) - Whisper it, but the private sector of the world's major economies may be rebounding in the nick of time -- just before the hammer comes down on public finances in many countries next year.

Amid all the angst this week over policy exhaustion and mounting debt burdens in developed nations, factories around the globe appear to have rewed up in October for the first time in six months.

Surprisingly strong readings of manufacturing sentiment from the United States, Britain, Germany and China -- bellwethers of world economic growth -- all offered hope that the heavy burden of economic support may at last be passing from public to private hands.

After a mid-year funk in which a "double-dip" recession was the big fear for households, firms and investors worldwide, the upbeat October business polls offer a glimmer of hope that governments can at least start to tackle bloated budgets next year without delivering a double-whammy to their economies.

Economists at JPMorgan aggregate national manufacturing surveys into a global index and they estimate this showed an acceleration in factory growth in October for the first time since April.

Their index rose 1.2 points to 53.7, well above the 50 level dividing overall expansion from contraction, and consistent with 4 percent annualized global industrial production growth -- well off the 10 percent peaks of the March 2009-March 2010 recovery but double the 2 percent lull of the past three months.

They also point out this advance was led by a near 2-point jump in new manufacturing orders, one of the forward-looking components of the so-called Purchasing Managers Indices (PMI).

But most encouraging of all, a critical ratio of orders to inventories -- signaling relative changes in new business relative to accumulation of unsold stock -- also popped higher.

"This month's survey hints that the industry cycle is bottoming and that better times lie around the corner in early 2011," JPMorgan said, stressing its own in-house caution until further data next month. "It suggests that the inventory correction and the consequent drag on manufacturing output are beginning to lose intensity."

### PLAYING THE INVENTORY STORY

But it's this manufacturing inventory story that has been crucial in deciphering the twists and turns of businesses' reaction to the financial shocks of the past three years.

The deep global recession triggered by Lehman Brothers' collapse in 2008 was largely due to factories, racked by uncertainty about future demand, suddenly shutting down production in the face of the uncertainty and then running down existing inventory to meet whatever final sales persisted.

This production shutdown and hiring freeze caused a gross domestic product shock that reverberated around the world during the winter of 2008/09 and led to one of the steepest world recessions since World War Two.

Yet, final demand did not collapse nearly as much as expected -- in large part due to huge monetary and fiscal stimuli loosely coordinated by the top world economies.

Fast forward to March 2009 and factories realized they had already run dangerously low of inventory and quickly rebooted production, and eventually hiring, through the remainder of last year. The financial market and GDP surge that followed showed just how valuable tracking this behavior can be.

"Double-dip" worriers, however, feared this inventory rebuilding had run its course by the second quarter of this year and were correct in predicting an economic retreat over the past six months as inventory production ebbed again without a countervailing pick-up in orders. Economies began to splutter.

So October's quick rebound, coming as it does in the final quarter of 2010, could be another defining moment.

And the pop in the critical orders/inventory ratio, which had been falling steadily since April, could mark a major turn if sustained.

Moreover, the October manufacturing burst is also remarkable in its widespread nature. The German and Chinese sectors had already been accelerating through recent months but big gains in the United States and Britain were more startling.

Even euro zone laggards Ireland and Spain saw their factory sectors move back to expansion last month from contraction.

JPMorgan's own caution stems from concern about the speed with which a \$115 billion annualized rate accumulation of U.S. business inventories in the third quarter can be worked off and from weakness in manufacturing readings from South Korea and Taiwan.

But the positive tilt to the surveys tally with other leading barometers of the global economic recovery.

Goldman Sachs' "Global Leading Indicator" slowed to 4.3 percent year-on-year growth last month from 5.1 percent in September, but it remains robust above historical averages into the fourth quarter of 2010.

"This supports our expectation that global growth will remain strong going forward," Goldman economists told clients.

If so, the private sector recovery will be vital next year as austerity budgets in Europe and elsewhere kick in.

Cornell University Professor and Brookings scholar Eswar Prasad this week sketched the fiscal mess in advanced economies.

Based on International Monetary Fund forecasts, he calculated aggregate net government debt in the world will more than double from \$23 trillion, or 44 percent of world GDP, in 2007 to \$48 trillion, or 65 percent of GDP, in 2015.

And advanced economies, where aggregate debt-to-GDP ratios will rise from 48 percent in 2007 to 71 percent this year and a whopping 85 percent in 2015, are the root cause.

"Advanced economies had better get their fiscal act together once the recovery is better entrenched," he wrote, warning of the risk of global instability if debt piles are left untouched.

(Reuters Graphics by Scott Barber; Editing by Susan Fenton)

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