BACK FROM THE BRINK?

After months of gloom, investors and businesses are starting to think that the world's economies will soon turn the corner. By David Smith and Kirstie Hamilton

IT MAY be because the war in Afghanistan is going better than had been expected. It could be a false dawn. But suddenly, perceptibly, the economic clouds are starting to lift.

Nobody doubts that there are tough times ahead. And few are banking on a sudden return to the booming global economy of a year ago. But the risk of a prolonged downturn, with no recovery in sight, is fading.

"After September 11, as far as business was concerned, pretty well everything came to an end," says Doug McWilliams of the Centre for Economics and Business Research. "But in the past 10 days or so there's been a definite feeling that you can't sit on your hands forever."

He expects business activity to increase in the new year, with companies starting to spend much more on mergers and acquisitions, advertising and marketing budgets, and capital investment.

Part of this could be because the sharp decline in company profits is coming to an end. "Amid the US corporate-earnings wreckage, there are signs that the outlook is stabilising," says SG Securities. "This is better than we could say at the same time last quarter."

Brian Hilliard, SG's head of economic research, says: "We always saw the fourth quarter as a black hole. What it is looking like is that this will be the low point."

Others are picking up similar straws in the wind. Adam Singer, chief executive of Telewest, the cable-television company, says: "We haven't seen even a blip in demand. You might expect businesses like ours to do well in recessions but we have been surprised by the fast take-up of higher-value products, such as high-speed internet access."

Doug Flynn, chief executive of Aegis, Britain's second-largest advertising and marketing company, says: "There are micro and macro signs that the upturn will be sooner and steeper than people expect. We are planning for flat revenues next year but have some reason for hope of better — and we do not think we are looking at life through rose-tinted spectacles."

ITV advertising was forecast to decline by 20% in November, but early indications are that the actual fall may be about 15%. While hardly good news, this is the first time in a year that ITV advertising has beaten the market's expectations.

Other companies are also doing better than they had hoped. In the last recession MFI, the kitchens company, suffered badly as consumers slashed their spending.

John Hancock, MFI's chief executive, fully expected his customers to put their plans for a new kitchen on hold in the wake of September 11. The reality has been quite different.

"To our surprise, we have seen no real effect on consumers," he says. "If anything, the second half of the year is actually proving stronger than the first. If you have a pretty benign environment, with interest rates at their lowest for 50 years and unemployment at a 30-year low, that is not the picture of an economy about to fall off a cliff."

Even in the beleaguered airline sector, which suffered a new blow to passenger confidence with Monday's American Airlines crash in New York, the picture is not universally gloomy.

Rod Eddington, British Airways' chief executive, said there were "slight glimpses" of hope in the airline's December bookings.

UNTIL Wednesday last week, the one place you would not have expected a strong recovery was America. The September 11 attacks on New York and Washington shook the nation to its roots and were followed by a mood of panic over anthrax and fear of further terrorist attacks.

Consumer confidence, it was said, took such a battering because of these fears and soaring unemployment that people stayed at home. A mood of collective gloom, it seemed, had descended over the economy.

If so, Americans have a strange way of showing it. Official figures revealed that American retail sales jumped by 7.1% in October, easily a record and more than outweighing September's 2.4% fall.

The figures were heavily boosted by zero-interest finance and other incentive deals offered by car manufacturers, which lifted sales more than 25% on the month. Even without these, however, retail sales would have risen 1%. For some economists the figures, taken together with a drop in weekly jobless claims, showed that America was already starting to turn the corner.

> **'Not only does the Bank think Britain will avoid recession — it also believes that the recovery will be strong'**

Ian Shepherdson, chief economist at High Frequency Economics in New York, says: "People complain of being miserable and nervous, but there are plenty of things happening to temper that misery."

He points not only to the incentive deals to buy new cars but also to the summer tax rebates, most of which are yet to be spent, further tax cuts to come, mortgage refinancing at low interest rates, lower energy prices and above-inflation growth in incomes.

"We're seeing a classic cyclical upturn generated by extremely loose fiscal policy," Shepherdson says. He does not even expect America's gross domestic product to fall in the current quarter, which would mean the economy had avoided formal recession following its third-quarter contraction.

Not all the data are strong. Figures on Friday showed the 13th successive fall in American industrial production and, at 1.1%, the biggest monthly fall since November 1990. Most economists also think that America's recovery is not yet happening, but that it will soon.

"The odds of a short recession have increased," says Ethan Harris, chief US economist at Lehman Brothers. "We believe a turnround is still several months away, but the preconditions for a solid recovery continue to build.

"Military victory in Afghanistan does not guarantee an end to the terrorist threat, but it carries a strong symbolic value. Equally important is the continuing decline in oil prices."

Cheaper oil could be a big factor in a recovery. When the ministerial meeting of the Organisation of Petroleum Exporting Countries (Opec) broke up in Vienna on Thursday, it was with a warning on oil prices.

"I wouldn't be surprised if oil fell to $10 a barrel," said Adel Khalid Al-Sabeeh, Kuwait's oil minister. Although his warning was intended as a shot across the bows to non-Opec members such as Russia, which have refused to cut their production to boost the oil price into Opec's $22 to $28 a barrel range — on Friday the price was $18 — it confirmed the weakness of the market.

Economists say lower oil prices are the equivalent of a tax cut — cheaper petrol prices free money for consumers to spend on other things, while cutting industry's costs.

"The collapse in oil prices is very significant," says Gerard Lyons, head of global-markets research at Standard Chartered. "We have a price war that is pushing prices lower. This is excellent news for consumers and the world economy."

In Britain the Bank of England, which published its quarterly inflation report last week, surprised analysts with its upbeat tone.

Mervyn King, the deputy governor, said there was only a 1 in 10 chance of a recession, using the Bank's definition — GDP over any four quarters dropping below its level of the previous four.

The Bank, while warning that there were still serious risks of a more prolonged global downturn, was upbeat about longer-term growth prospects. While the probability of growth at the end of next year being less than 1% was just 10%, the probability of it exceeding 3% was 23%, the inflation report said.

For 2003, there was a 39% chance of 3%-plus growth, and only a 7% chance of a sub-1% expansion.

Michael Saunders, an economist with Schroder Salomon Smith Barney, says: "This was a marked upgrading to the monetary policy committee's assessment of the growth outlook two years out."

Not only does the Bank think Britain will avoid recession — it also believes that the recovery will be strong.

DESPITE bucketloads of bad news being thrown over investors, the stock market has staged a strong rally over the past six weeks. Since September 21, when the FTSE 100 index tumbled to a near five-year low of 4,433, it has rallied by 18%.

"Normally with the market up by 20% we would be dancing in the streets," says Robert Buckland, UK strategist at Schroder Salomon Smith Barney. "But for the time being all we have done is to regain the dreadful drops after September 11. Anyone who bought the market four months ago is still down."

Buckland believes the bear market in shares, which has afflicted the market for two years, is coming to an end.

"This is the first rebound that has regained the previous low (ie, risen higher than the low point in March this year) in this downturn," he says. "We think the central banks have got us across the ravine."

Mike Lenhoff, chief portfolio strategist at Gerrard, a stockbroker, says: "There are several reasons why the overall tone of the markets has improved. First, equity markets are banking on a US-led recovery next year that will be fostered by this year's cuts in interest rates and also by the collapse in oil prices.

Second, the roots of the rebound can be traced to the September low, when the market had become very undervalued."

Lenhoff cites two additional reasons for the market's optimism — the favourable progress of the war in Afghanistan and the US Treasury's decision to stop issuing 30-year bonds, which helped to push down long-term interest rates.

Whatever the reasons, the market is behaving very differently when confronted with bad news than it did six months ago. Companies such as Electrocomponents, FKI and Pearson have produced poor results, in most cases including a profit warning, only for their shares to bounce by the end of the day.

Buckland says: "One of the things analysts are scratching their heads about is the bizarre situation in which firms produce terrible numbers but by the end of the day the shares rise."

He characterises this behaviour as investors looking "across the ravine" to the other side. Shares in LVMH, the luxury-goods group, for instance, bounced last week despite the firm issuing its third profit warning in a row.

Analysts attributed the jump to stronger than expected American retail-sales figures and repeated interest-rate cuts.

"The market is trying to look further ahead," Buckland says. "Until September 11 people said, 'the market is beginning to look cheap but I don't trust it until I see things improving'. Now they're saying, 'maybe things will start to improve'."

TRADE TALKS BACK ON TRACK

ONE significant hurdle to global economic recovery was overcome last week when weary negotiators from 142 countries, meeting in Doha, Qatar, agreed on a new world trade round.

The World Trade Organisation (WTO) agreement 'removed the stain of Seattle', according to US trade representative Robert Zoellick, referring to the failed attempt to launch a new round two years ago amid violent clashes by anti-globalisation protesters.

'The WTO is back on track and the train has left the station,' said Pascal Lamy, Europe's trade commissioner.

The new round will cover agriculture, manufacture and services, and will aim to phase out export subsidies for farm products, although, at the insistence of France, a clause was inserted in the agreement saying that the future of such subsidies would not be prejudged.

It will also attempt to boost flows of investment by tackling cartels and other anti-competitive practices.

The Doha round, which is called the Doha development agenda and is geared towards meeting the needs of poorer countries, will include greater access to medicines, particularly for HIV and Aids, and quota-free access to rich-country markets for the products of the least developed countries. Objections by India, another stumbling block, were overcome at the last minute.

The negotiations are scheduled to last three years — not the seven years taken to conclude the previous deal, the Uruguay round.


Hewitt: gains for Britain

Patricia Hewitt, the trade and industry secretary who led the British delegation, said there would be gains for Britain. 'These negotiations will be good for British business and consumers,' she said. 'As the world's fifth-largest trader, the potential benefits of further trade liberalisation are considerable.

'Halving trade protection around the world would boost the average income of every household in Britain by nearly £500 a year.'

Digby Jones, director-general of the CBI, who was in the UK delegation, agreed. 'These negotiations will have enough breadth to allow overall gains for British business,' he said.

'Great efforts have been made to recognise the concerns of developing nations, and the outcome reflects that.'

The Doha agenda will continue a tariff reduction process that began after the second world war under the General Agreement on Tariffs and Trade (Gatt).