Special Report: "Double-dip" fuelled by uncertainty not facts

The term "Double-dip" recession makes an excellent headline, one which has caught the eye and imagination of investors since gaining current usage this year. Economists and financial analysts have been arguing whether the United States economy will experience a "double-dip", in other words another crash or, with the worst already in the past, moderate but steady growth for the immediate future.

The National Bureau of Economic Research, a group of academic economists that officially declares the starts and ends of recessions, has no precise definition of a "double-dip" recession. In econo-speak, NBER Chairman Robert Hall explains: "The idea - hypothetical because it has yet to happen - is that activity might rise for a period, but not far enough to complete a cycle, then fall again, and finally rise again above its original level, only then completing the cycle". Brian Bethune, economist at HIS Global Insight, has a similar view to Hall's, but says: "There is no mathematical formula, it's a judgement call."

Nouriel Roubini, Professor of Economics at New York University and founder of Roubini Global Economics views European sovereign debt as providing the catalyst for a "double-dip" recession. Roubini was labelled "Doctor Doom" by The New York Times after he predicted that a bubble in mortgages and mortgage-backed securities would trigger a global financial crisis. Robert P. Murphy, a senior fellow in Business and Economic Studies at the California-based Pacific Research Institute wrote on *MarketWatch:* "The alleged economic recovery is unfortunately just as illusory as the prosperity of the housing-bubble years". Both economists come from vastly different ends of the economic spectrum. Whereas Roubini himself was once part of the US Administration, Murphy is a well-known proponent of Austrian economic theory which, in short, believes in minimal government interference in the economy. In addition, there is a strong party-political bias to much of the "double-dip" rhetoric as Republicans attempt to demonstrate that Obama's economic policies have not worked.

Fed watchers are coming to grips with a new phrase that has appeared in FOMC language after Bernanke's remark in testimony before Congress last week: "We also recognize that the economic outlook remains unusually uncertain." Nevertheless the Fed sees GDP growth for US at 3.0% to 3.5% in 2010, 3.5% to 4.5% in 2011 and 2012, low inflation and an unemployment rate that will decline to between 7.00% and 7.5% by 2012. Bernanke also reiterated that the federal funds rate will remain at exceptionally low levels for an extended period of time and that the Fed stands ready to act should the economy, especially labour hiring, falter.

While Bernanke told Congress that the economic outlook remained "unusually uncertain", corporate America was sending a very different message. Caterpillar, the world's biggest maker of digging and earth-moving machinery said revenue growth this year should exceed analysts' estimates by US$8 billion and Eaton, a maker of power systems and hydraulic equipment that end market demand will grow by 8%. Although the US economy is primarily service-based, manufacturing has an outsized impact on GDP growth. More than 80% of the industrial companies in the S&P 500 that have reported earnings this quarter, have beaten analysts' estimates. Caterpillar, Boeing and Eaton shares are all up more than 18% this year. Technology rebounded after Apple joined Intel and Texas Instruments with stellar results, the company reporting quarterly net income of US$3.25 billion. Noticeable on balance sheets are the high cash reserves being held.

According to the US Commerce Department almost 65% of US bi-lateral trade is with Canada, Mexico and East Asia (See April Special Report: Does Europe Really Matter?) where the East Asian Development Bank says the region's economic upturn is firmly on track, raising its growth forecast for the region to 8.1%. This robust growth is led by China at 9.6% and Singapore at 12.5%. Only last week the Chinese government loosened real-estate controls and forced land held by speculators to be built with homes for the middle and lower classes. The announcement sent commodity markets sharply higher, boosting shares in Freeport-McMoran Copper & Gold, Potash of Saskatchewan and equipment makers Bucyrus International, Joy Global and Caterpillar.

At the end of last week, EU bank stress test results were just hitting the newswires. Markets responded positively to the initial results that showed only 7 of the 91 banks tested had failed with a combined capital shortfall of US$4.5 billion

What is assured is that uncertainty will continue to challenge facts throughout 2010.