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**RE-MADE IN AMERICA**

As most developing, and many emerging, nations find themselves in the depths of recession, all eyes will be on the US to drag the world out of the doldrums.

The past few months have been dire for the global economy, as it endures by far the worst downturn since the 1930s. As mining companies, manufacturers, distributors and retailers have woken up to the severity of the situation, product supply chains have been emptied of surplus inventories. As a result, industrial production and cross-border trade have collapsed more quickly than any pundit would have thought possible.

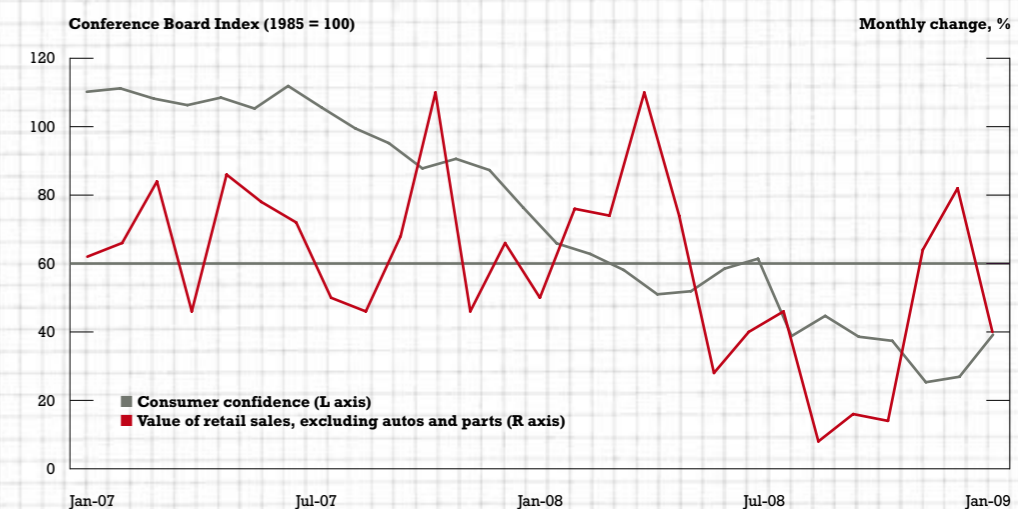
Almost all advanced economies, and many emerging ones, now find themselves in recession, although as a general description that fails to do justice to the predicament in some countries. Germany's GDP is expected to shrink by around five per cent this year, and Japan's by more than six per cent. Some small, once-frothy bubble economies, such as Iceland, Ireland, the Baltic States and Ukraine, are faring even worse. Meanwhile, by a stroke of irony, the debt-fuelled, property-obsessed economies of the US and Britain are getting off fairly lightly.

Amid the gloom, few people are now talking about decoupling. The notion that the major emerging nations have the economic clout to pull the global economy through now looks fanciful. While China, India and some others are still achieving decent growth, the momentum has flagged as export demand has slumped and domestic asset bubbles have burst.

The inescapable conclusion is that a global economic recovery will, once again, have to rely on the motive power provided by America. While the US is not as dominant a player as it



**Loosening the purse strings**



After hitting all-time lows in early 2009, consumer sentiment is starting to recover. Plunging oil prices and positive signs in the housing market are buoying confidence.

Source: Thomson Datastream

once was, it still accounts for over a fifth of global output, as measured in nominal terms.

**Anatomy of a recession**

The US economy has now registered two quarters of sharply negative growth, with GDP contracting by more than three per cent during Q4 of 2008 and Q1 of 2009. While retrenchment on the part of households has been a significant factor, the biggest falls have come from capital spending, destocking and exports. In March, industrial production was nearly 13 per cent down on an annual basis, having fallen by five per cent in the first quarter, and capacity utilisation was at its lowest since data was first collected in 1967.

Not surprisingly, unemployment is soaring, with more than five million Americans having lost their jobs since the start of 2008. The unemployment rate that then stood at less than one in 20 is likely to be close to one in ten by next year.

But there are several things going for the US economy. The first is the vigour with which politicians and policymakers are pursuing solutions to the dislocations in the country's financial sector, and promoting measures to support economic activity. The second is the predilection of Americans to spend their money rather than save it - a trait shared by British consumers.

The Troubled Assets Relief Programme (TARP), passed by Congress in October, allocated up to \$750bn to assist stricken banks, while in February President Obama

signed into law a fiscal stimulus package valued at \$787bn. These measures, together with an ambitious set of budget proposals, will mean a deficit for the US government equivalent to 12.7 per cent of GDP in the fiscal year from this October. On top of that, the Public Private Investment Programme has been launched, which will stimulate markets for toxic assets.

The Federal Reserve has also been taking aggressive actions. It was the first central bank to cut its policy interest rate to close to zero, in December 2008. Moreover, since the banking crisis broke last September, it has allowed its balance sheet to more than double in size, offering support to the financial sector against a broader-than-normal range of collateral, and making outright purchases of corporate debt and mortgage-backed securities (a process it has termed "credit easing").

Then, in March, it followed the Bank of England's lead and embarked on full-blown quantitative easing, announcing a programme

**0.5% increase in spending by US households**

in Q1 of 2009. Pressures on consumers to save are being offset by other factors.

to purchase \$300bn of US government securities within a much larger \$1.15trn support package to be implemented before the end of the year.

**Consumers lead the way**

Despite anecdotal evidence about deserted up-market shopping malls, spending is far from dead. Indeed, when the GDP figures for Q1 were released, showing another fall of 1.5 per cent, it was revealed that spending by households had actually increased, by a modest 0.5 per cent. This is borne out by the more positive tone of recent retail sales data, which has pointed to better conditions than at any time since the autumn of 2007.

While there are no doubt plenty of people who are worried about their employment prospects, or who feel less inclined to spend as the wealth tied up in their houses disappears, this is more than offset by other factors. With fuel not subject to hefty taxation, the plunge in the price of oil has delivered a sizeable fillip to Americans' discretionary spending power. Furthermore, the inclination to save is being blunted for some by negligible interest rates, while for many homeowners the cost of servicing their mortgages has also come down.

This doesn't mean the boom times are imminent again for US retailers, but at least resilient spending is providing a valuable cushion while other engines of growth are in sharp reverse.

Better still, there is mounting evidence that the housing market may be nearing the trough of the cycle. The pace of price declines seems to be easing, and some of the activity indicators are now reporting sporadic monthly increases, although a clear upward trend has yet to be established. At a more subtle level, consumer sentiment, as measured by long-established monthly tracking surveys, has started to recover, after hitting all-time lows earlier in the year.

With the Federal Reserve throwing everything but the kitchen sink at the problem and President Obama's fiscal stimulus package kicking in, there's a good chance the economy will start to grow again during the summer months. A further round of tax cuts should coincide with an abating of domestic and global destocking to bring a halt to the steep falls in GDP. The big proviso, of course, is that the financial system continues to heal.

If that is the case, then HSBC's current projections suggest the US economy will shrink by around 1.5 per cent during 2009, before returning to anaemic growth of 0.5 per cent in 2010. While hardly a resumption of

normality, it might indicate that the worst is over and pave the way for a modest upturn in the global economy. One very useful side-effect will be to cure America's huge current account deficit, which was a hallmark of the global economy during the past decade, and which indirectly contributed to the current crisis.

