



STRAWS IN THE WIND

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For six months or more, the news on the UK economy has been unremittingly bleak. But look closely and there may be glimmers of hope.

The 1.9 per cent fall in GDP in Q1 of this year followed a drop of similar magnitude in the last quarter of 2008. The news from the jobs market seems to be getting worse daily and export opportunities are constrained by the worst year for the world economy since 1945.

There's no doubt that the UK is heading for its largest fall in output in any calendar year since WWII. And, as Chancellor Darling's budget made very clear, the biggest long-term casualty of the recession will be the public finances. The impact of trying to kick-start activity and rescue the banking system will be felt by the exchequer and us for many years to come.

Signs of life

Yet, there has been a subtle, almost imperceptible change in the commentary on current trends. A great deal of the bad news had been expected and was already factored into the opinions of the media and policymakers. Now, however, some positive (or, at least, less negative) news is emerging and, while nobody should be rash enough to call them "green shoots", it is probably fair to say that there are some hints that the worst may be behind us.

The first part of the economy to feel the squeeze was the housing market. Having been in the doldrums for over a year, it started to show signs of life in the early months of 2009. Mortgage approvals in February rose to their highest for nine months, albeit from a very low base. The Nationwide House Price Index recorded its first increase for 18 months in March (although the Halifax measure continues to fall) and several housebuilders have reported higher viewing figures in the last few months.

Given the huge improvements in affordability (house prices and interest rates relative to income), it would be surprising if demand was not starting to stir. Just because houses were considered "unaffordable" in 2007-08 doesn't mean people no longer needed somewhere

to live. All that is required is a supply of adequate mortgage finance - and this is slowly coming back - which is crucial to first-time buyers. Every housing chain, regardless of length, has at one end a first-time buyer, without whom there is no real market.

The huge cuts in interest rates have helped existing owners and have improved the likelihood that they will move. Those waiting to get on the property ladder, however, have been held back by the unrealistically high (for first-time buyers) deposits required by some lenders. Once this eases, as seems to be happening, the market will start to improve again.

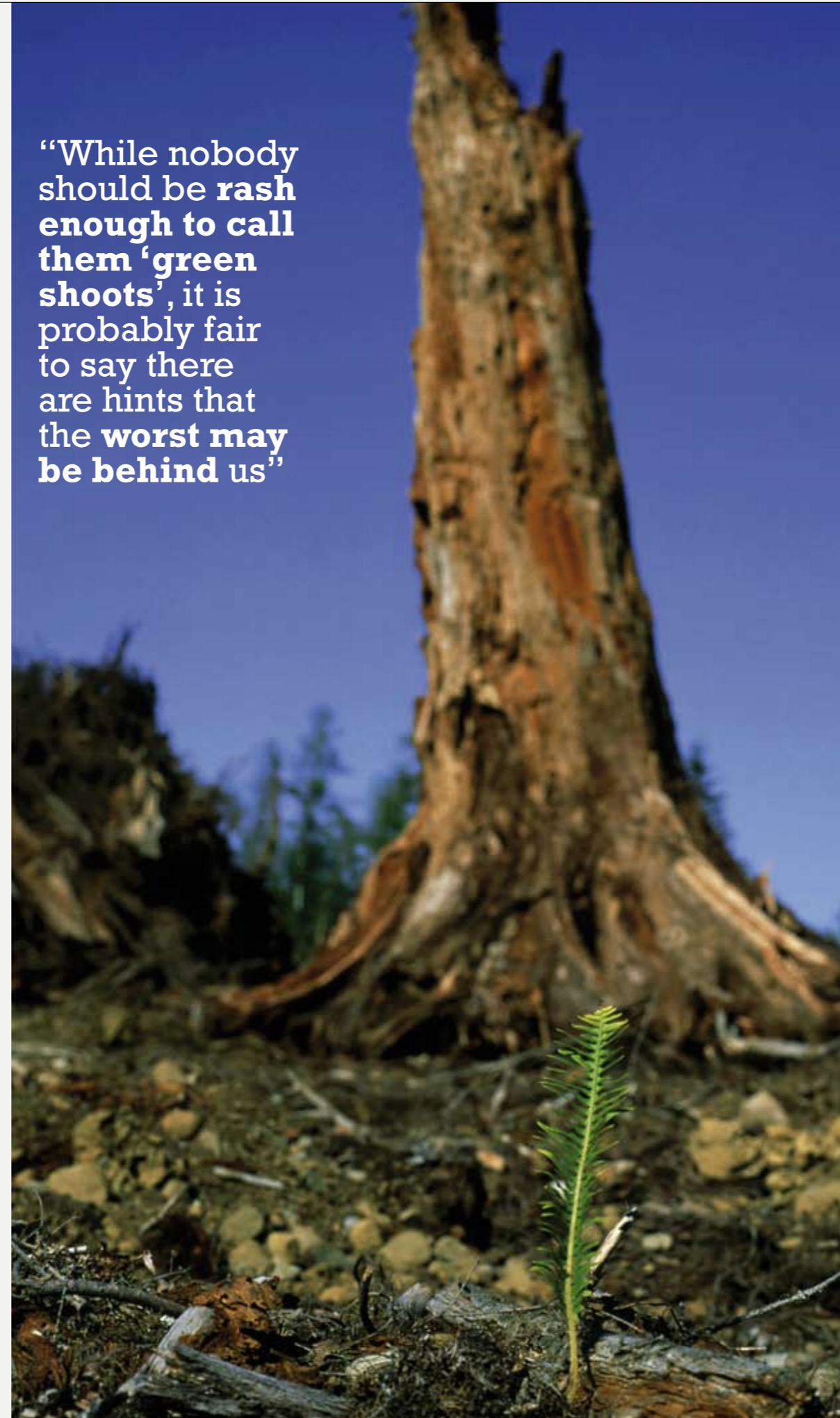
Back to black

It also appears that households are finally trying to deal with their huge debt burden. Following the massive reduction in interest rates over the last six months, there was a net repayment of £245m of consumer credit, the first net repayment since the series started in April 1993. In Q4 2008, moreover, homeowners used their own funds (to the tune of £8bn) to complement borrowing to add to their housing investment, the biggest net injection into the housing market since records began in 1970.

What the last set of backward-looking national accounts revealed, moreover, was widespread destocking by businesses, as is usual at this point in a downturn. But destocking is a one-off adjustment and is replaced by the need to restock, the first step in the recovery process. More significantly, the closely watched, forward-looking Purchasing Managers Index surveys seem to be turning up. Although still below the key threshold of 50 (which implies the industry will contract), the responses have stopped falling. In April, the manufacturing and service sectors registered their highest readings since last August.

Finally, there is even a glimmer of light on the credit front, according to the Bank of England's Credit Conditions Survey. While this qualitative research, based on responses from the banks,

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Charting progress - positive signs



Responses in the Purchasing Managers Index have stopped falling. April's results for manufacturing and services were the highest since August 2008.

Source: Markit

has been a catalogue of gloom for the last 12 months, the current (Q1) survey, published in March, hints at a change. It reported that "credit availability to households and corporates was expected to improve over the next three months, associated with an improvement in the cost and availability of funds".

Patience to the end

None of this adds up to the end of the recession, still less a recovery. But, with some indicators turning up and others falling more slowly, it does suggest daylight on the horizon. There is a growing body of opinion (including HSBC's) that expects the recession to end - the economy to stop shrinking - by the last quarter of 2009.

The three major recessions in the UK since 1945 have lasted between four and six quarters. If the current recession ends by Q4, it will have been a five-quarter recession, bang on average. The recession will end because, statistically, they always do. At the lowest point

of each of the last three recessions, commentators claimed conditions were the worst ever and predicted a long period of slow, even negative, growth. But we came through them, as we will this one.

Given the huge policy stimulus to the economy (in terms of fiscal easing, cuts in interest rates and sterling depreciation), it is a question of when, rather than if, the recovery gets under way. The authorities acted relatively quickly, but the measures take time to feed through, something the policymakers and media pundits seems reluctant to allow. A long overdue correction to an unbalanced economy was always going to last months rather than weeks, regardless of the size of the stimulus.

The US economy was first into recession, and will probably be the first out. We were second in and should not be too far behind in seeing the recession end. Sooner rather than later, the concerns should be about the shape of the recovery, not the length and depth of recession.