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A positive outlook for 2010's global economy

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The old saw goes that equity markets climb a wall of worry and in recent days, the list of worries seems to be lengthening. The fear that the Euro sovereign debt crisis might become another Lehman event is very much to the fore, with memories of that debacle still fresh in the mind.

The parallels with Greece and sub-prime lending are not hard to find, with the effect of recession loading debt onto an entity, in this case a country, which is not really in a position to pay.

By sharing their own AAA rating with others, the Germans hope to stop the rot, but this type of guarantee only works if markets really do believe that other countries and the IMF will stand behind Greece. While the IMF guarantee may be credible, some European politicians have been implying that the rescue fund is only a theoretical instrument and may never have to be used.

This is indeed the case, but the underlying suspicion is that, unlike in a proper Federal state such as the US, European solidarity with Greece is lukewarm. There is also the fear that we are just playing pass the parcel with the debt mountain, from households to the banking sector and now governments. Given that there is no such thing as government money, just tax revenues, the burden will ultimately fall back on households, although governments can spread the pain between current and future generations.

Another fear is that, barely six months into the recovery, the economic data is already showing signs of fatigue. Markets reacted badly to this month's US payroll numbers, despite a small miss relative to expectations and in what can be a volatile series. Similar concerns surrounded the latest PMI data from China, a series which has a very short history and is riddled with seasonality issues. It seems that everyone is actively looking for bad news even when it's not there.

With the consensus view on the economy and equity market outlook seemingly so bearish, I remain somewhat stubbornly on the other side of the argument. I expect that the current strength of the global economic upswing, led by the US and emerging economies, coupled with the expectation that interest rates stay lower for longer, will shift sentiment back in a more positive direction before the end of the year.

Source: rlam as at 7th June 2010 unless otherwise stated.

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