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Short-term noise to make way for increased equity earnings

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Last month's article speculated that the initial estimate of first quarter UK GDP could well be negative, given a severe weather effect in January. Actually, the reported figure was +0.2%; low but still positive and, as I suggested last month, will probably be revised up at some stage.

In contrast to some of the official data however, business surveys in the UK and elsewhere continue to point to quite a sharp V shape recovery in the global economy, especially in the manufacturing sector, which was hit so severely in the downturn.

Economic data has taken something of a back seat in recent days, as attention has turned to the sovereign debt crisis in Europe, but when the dust has settled and sovereign debt issues are relegated from the front to the business pages of newspapers, continued positive momentum in global recovery will drive earnings estimates higher and underpin equity markets.

This is not to argue that Euro governments have succeeded in plugging the sovereign debt leak, just that enough has been done to buy valuable time and stabilise markets.

I still expect both the Bank of England and the Fed to shift their rhetoric on interest rates during the coming months and signal that rates are likely to rise from the current emergency levels. As yet there are few signs from the Fed that their thinking has shifted, however there are a few straws in the wind from the BOE, with some MPC members, as yet unnamed, becoming uncomfortable that policy remains exceptionally accommodative at a time when CPI inflation is well above target.

With a new Budget due next month both the BOE and markets will be looking for some clarity on the extent and timing of fiscal tightening and debt reduction. Given the strong likelihood of another election later this year or in 2011, it will be difficult for the new government to balance the pressure for fiscal rectitude and the need to retain popular support. At the time of writing, a Conservative-Liberal deal looks the most likely outcome, however the best option for the Tories may well be another short spell in opposition and wait for a Labour led traffic-light coalition to head onto the rocks.

Source: rlam as at 12th May 2010, unless otherwise stated.

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