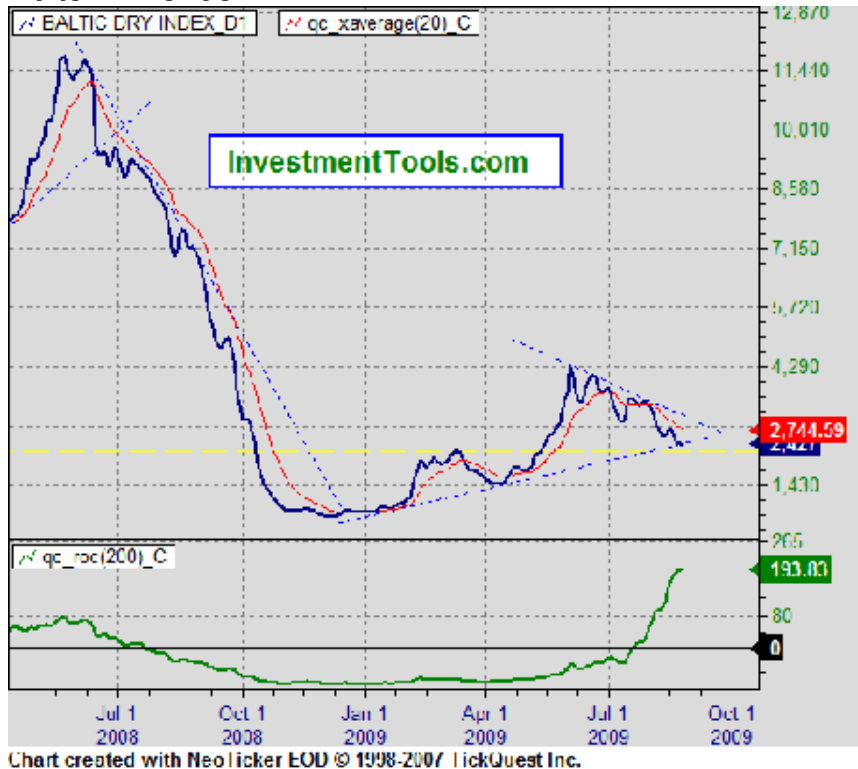


Can the soufflé really rise again?

Ambrose Evans-Pritchard

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Two facts that should give pause for thought.

1) Japanese data released on Thursday showed that exports fell yet again in July. They are down 39.5pc to the US, and 26.5pc to China.

Japan is the world's second biggest economy. It lives on exports. It is also a key part of the supply chain for the Chinese economy. How can this hard data be reconciled with the extreme V-shaped recovery already priced in by the markets?

By the way, Toyota is suspending a key production line at its Takaoka plant in central Japan. It is cutting global capacity by 1m vehicles.

2) The Baltic Dry Index measuring freight rates for bulk goods and commodities has been falling almost continuously for eleven weeks, dropping from 4,290 to 2,778 on Thursday.

Is this just a glut of ships or is this telling us what the Shanghai market is also telling us, that credit tightening by the Chinese government is pulling the rug from underneath the latest commodity bubble?

There is something wrong with the entire recovery tale, which ignores the fact that [excess plant](#) is still at the highest level since the Great Depression (capacity use is 70pc in Europe, 68pc in the US, 65pc in Japan, and as low as 50pc in some countries, according to the World Bank's Justin Lin). Companies will have to cut jobs and investment.

Soaring "confidence" indicators have decoupled from reality. The world economy is still prostrate. GDP has shrunk 4pc, 6pc, 8pc, even 12pc or more in a large group of countries. There it more or less sits, like a deflated soufflé.

An end to technical recession in France, Germany, and Japan because Q2 (and undoubtedly Q3 to come) ekes out a rise from a collapsed base does not mean anything – except that zero interest rates worldwide, and a massive fiscal stimulus that is pushing public debts towards 100pc across the OECD states (and cannot easily be repeated once the first sugar rush subsides), has mercifully prevented the Great Contraction from turning into an immediate catastrophe.

As the Bank of England's Governor [Mervyn King puts it](#): "It's the level, stupid". The level of economic activity is years away from full recovery.

The Bundesbank's Axel Weber says it will take until 2013 for Germany to get back to where it was. He also warns, by the way, that there will be a second wave of the credit crisis as Germany's home-grown troubles come to the fore. Round one was imported havoc from the US: round two will be rising defaults at home and a credit squeeze as ratings downgrades force banks to set aside fresh capital. (I enclose the Weber link for German readers <http://www.sueddeutsche.de/finanzen/916/484353/text/>)

I have no idea when stock markets and commodities – especially base metals – will reflect the hard facts on the ground (ie, an end to the Chinese construction bubble). Timing is not my forte. Nor is the market.

But I am absolutely convinced that those who think we can return to the status quo ante of the credit bubble as if nothing has happened are delusional. As almost every central banker in Jackson Hole reminded us over the weekend, it is going to be a very long hard slog.

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