There may be signs of recovery, but it is bound to be a weak and anaemic one

Let caution be our watchword

MARKET WATCH

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It was the summer of 1930 that US president Herbert Hoover proudly proclaimed that economic recovery had arrived. After all, equity markets had returned some 60 per cent since the 1929 crash, and investors were starting to feel confident once again. Unfortunately, Mr Hoover was almost 14 years premature, and within two years, those share gains had been wiped out, with the market reaching a new low.

The lesson of this story is not that this downturn will be a decade long, or even not to listen to politicians' economic pronouncements, but rather to be cautious of premature declarations of a new bull market.

Employing the alphabet simile that makes for economic commentary, the question for the second quarter of this year is whether there will be the V-shaped recovery the most optimistic analysts are predicting, the W shape historians of the 1930s fear or the more familiar U shape of the 1980s and 1990s.

The British government, like those of many other countries, has pumped billions into the economy to avoid a drawn-out, 1930s-style depression. Current indications are that it has worked, and the experiment is being repeated in the emerging economies of eastern Europe and South America, which are enjoying a $50bn (£30.9bn) World Bank stimulus package into infrastructure.

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Meanwhile, investors in the FTSE have enjoyed as much as 25 per cent returns since its low, while in the big emerging markets, investors have seen half as much again. Such numbers are not in the same league as in Mr Hoover's day, but it does leave some food for thought: what if the recovery doesn't pan out quite as the Treasury expects?

Given the state of public finances and the intensifying political debate in the UK around public spending, the worry is that there really is nothing left if the economy requires another kick.

With a general election on the horizon, politicians are building into their programmes a period of reining in spending and probably increasing taxation.

This will be doubly hard if the economy fails to show signs of firm and steady recovery, since not only will receipts continue to fall, but so will the reputation of the UK economy in the international market. We have already seen a warning (albeit rather meek) from S&P regarding the UK's heretofore perfect gilt rating.

One little-mentioned weapon in the government's armoury is the now nationalised banks. The prime minister has already hinted at an early return to the private sector of Northern Rock, which has repaid £18.2bn of the £27bn it was loaned in 2007.

If the government can do this at a profit, not only might it demonstrate that its economic policies were the right ones, but it could even make a dent in the public finances. After all, the potential value of the Royal Bank of Scotland is huge: once the fifth biggest bank and the tenth largest company in the world, its peak market capitalisation was some £60bn.

There may be real signs of recovery in the coming months, but given the need to rein in public spending, any recovery will be anaemic and certainly not as smooth and strong as the Treasury's figures suggest.

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