Green Shoots Or a Desert?

Whilst much of the current industry tittle-tattle focuses on the 'green shoots of recovery' debate (are there/aren't there?) and/or the 'shape of the downturn' (V, U, W, sharp, stretched, extended, etc), we prefer to take a more sober look at the underlying trends.

As mentioned in our May Global Semiconductor Report, at minus 24.2 percent growth Q4-08 was a little worse than our 22.5 percent January IFS forecast, whereas Q1-09's 15.5 percent fall was slightly better than our minus 18 percent number. The counterbalancing overall effect of the two was to put the 2009 market slightly ahead of our official minus 28 percent forecast, to minus 25.3 percent. In our book, this does not constitute a 'forecast revision' given that the basic forecast assumptions and analysis had not changed; it was merely 'fine-tuning the number'. So far, so good.

However Q2-09 might well be different in that it now looks to be coming in with growth in the 4 to 5 percent range, versus our minus 2 percent January estimate. If true, this would represent a material change to our 2009 forecast, improving it from minus 28 to minus 21.3 percent, assuming that the second half of the year rolled out as planned, and removing most of the down-side risk potentials. Keep an eye out for our verdict on this, which will be presented on July 21st at our Mid-Term Industry Forecast Seminar in London.

But what is actually going on in the markets? The first quarter was clearly a difficult time for the industry with the combined effect of the global recession on top of the normal Q1 seasonality weakness. Not quite a knockout punch, but a real double-whammy. Based on a reasonable cross industry sampling, the overall result was a net 12 percent fall in electronic equipment sales versus Q1-08.

Aside from Government/Military – the only sector to grow – every market and geographic region was negatively impacted, with Japan and Taiwan/China the worst hit - however the latter is the first to show a rebound.

Looking at the key mobile and PC industry sectors, both of these have been hit badly by the discretional consumer spending slowdown, with Q1-09 phone and PC unit sales down 16 and 20 percent respectively versus Q1-08. Given the magnitude of these declines – all markets, sectors, regions, customers, consumers and enterprise – the industry and chip market exited the first quarter in remarkably good shape, relatively speaking. That is not to say it will be plain sailing hereon out, far from it, but that the industry has clearly weathered the worst of the storm, bloodied but (mostly) not beaten.

The 12 percent, 16 percent and 20 percent OEM, mobile and PC sales declines are key industry benchmarks in that they represent the absolute worst-case full-year scenarios. Our January 2009 forecast called for 8.2 percent, 15 percent and 22 percent declines here respectively, which are all well in line with the way the market is unwinding. Given we expect the Q1-09 12:12 declines to improve as the year rolls out, the downside risks to our forecast are clearly diminishing.

From an economic perspective, our 8.2 percent electronic equipment industry decline was based on the then IMF's World GDP growth forecast of plus 1.8 percent. This however has been subsequently revised down three times, first to +0.5 percent on January 28, then to -0.5 to -1.0 percent on March 13, to the current forecast of -1.3 percent in the April 2009 World Economic Output Report. Intuitively one would worry that these downward revisions ought to force a corresponding revision to the electronics equipment market; in reality this does not seem to be the case.

Which in turn beggars the big unanswerable question: "To what extent are these downward revisions to world GDP growth the cause or effect of the electronic equipment industry decline, and what impact will their downward revision (and for that matter subsequent recovery), have on the 2009 and beyond electronic equipment industry absolute growth number?"

The bottom line answer? No one actually has the faintest idea; furthermore it is impossible to calculate. Whilst anecdotally and intellectually there is an obvious link between GDP and the electronic equipment industry growth rates, the electronic equipment industry represents only 2-3 percent of total World GPD. In contrast, at their peak, the financial derivatives markets totalled 120 percent of world GDP!

With recession, cutbacks clearly hit the electronic equipment industry early, as both enterprises and consumers hit the 'stop spending' button relatively quickly. In the case of the 2008 downturn, for 'relatively quickly' read 'instantaneously fast'. The impact on the chip market is immediate, aggravated by the associated component and WIP inventory burn, with overshoot inevitable.

Inventory levels clearly stabilised during Q1-09 and are being rebuilt in Q2, most probably targeting an electronics equipment production level 12 percent down on this time last year, i.e. in line with first quarter actual. This being the case, the industry will have adjusted much faster than in previous cycles, with today's inventory imbalance levels already peaked and much more in line with the 2H-06 'course-adjusting' excess than the post-dot com bubble burst 2001 flood.

To summarise, the downside risks to the 2009 market are clearly abating with our 13 percent third quarter growth forecast still looking reasonably robust, given the current inventory rebuild plus a touch of seasonal strength. Likewise, it is still credible for this to be followed by a seasonally weak 3 percent forth quarter growth given the normal end of year inventory clean out.

With the global economic recovery then starting to gain traction in 2010, a 'normal' quarterly (-2%, +2%, +14%, +3%) 2010 growth pattern would be reasonable, yielding a 2010 annual growth of around 17 percent, well in line with our '15 percent with lots of upside potential' January 2009 forecast. Whilst the slightly revised 2009 quarterly growth pattern would call for an (upwards) formal forecast revision to the actual 'growth number', the underlying market analysis and assessment presented at our January 2009 Forecast Seminar will not have materially changed, either for 2009 or 2010.