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Emerging market turmoil flashes warning lights for global economy

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Emerging economies risk “leading the world economy into a slump”, with lower growth and a rout in financial markets, according to the latest Brookings Institution-Financial Times tracking index.

Released ahead of the annual meetings of the International Monetary Fund and World Bank in Lima, Peru, the index paints a much more pessimistic outlook than the fund is likely to predict later this week.

According to Eswar Prasad of Brookings, weak economic data across most poorer economies has created “a dangerous combination of divergent growth patterns, deficient demand, and deflationary risks”.

Christine Lagarde, IMF managing director, said last week that the global economic patterns

were “disappointing and uneven” with weaker growth than last year and the forecasts published on Tuesday showing only a “modest acceleration expected in 2016”.

The fund’s reasonably sanguine view stems from an expectation that China will succeed in transforming its economy slowly from investment and manufacturing towards consumption and services.

By contrast, the Brookings-FT index, which summarises the latest figures, suggests the downturn is more serious alongside “sharp divergences in growth prospects between the advanced economies and emerging markets, and within these groups as well”.

The Tiger index — Tracking Indices for the Global Economic Recovery — shows how measures of real activity, financial markets and investor confidence compare with their historical averages in the global economy and within each country.

Overall growth index

Advanced economies are holding up better than emerging markets, which are in a slump



Source: Brookings Tiger Index

FT

The extreme weakness in the emerging market component of the Tiger growth index shows that data releases have been significantly weaker than their historic averages.

Divergence is almost as important as a new trend highlighted in the index, however, with India emerging as a bright spot and commodity exporters such as Brazil and Russia mired in recession.

Confidence index

Business and consumer confidence have fallen sharply in emerging markets



Source: Brookings Tiger Index

Because emerging economies are now much more important in the global economy and growth rates are still higher than their developed counterparts, global growth is still hovering around 3 per cent, close to its long-term average.

The concern, according to Mr Prasad is that the slump in emerging economies’ confidence will infect advanced economist in the months ahead.

FT

Despite weak employment figures on Friday, the US still appears a bright spot in the world

economy alongside the UK.

Elsewhere, there are increasing calls for more stimulus from central banks to stop the slide in growth, whose impact is being felt more widely than in commodity exporting countries. But there are increasing concerns that monetary policy has become ineffective in providing the necessary boost, Mr Prasad said.

“The impotence of monetary policy in boosting growth and staving off deflationary pressures has become painfully apparent, especially when it is acting in isolation and when a large number of countries are resorting to the same limited playbook”, he said.

Financial markets have begun to lose confidence in the ability of central banks to restore demand to the global economy, with equity markets in the third quarter posting the biggest losses for any equivalent period since the eurozone crisis of 2011.

While the IMF will recommend that countries maintain policies of cheap money, careful deficit-cutting to minimise the contractionary effects and deep structural reforms to boost the longer-term potential for expansion, such calls have been falling on deaf ears. Ms Lagarde is concerned that promises made at the G20 summit last year have already been broken.

“Few lessons seem to have been learnt and absorbed by national leaders, who continue to rely largely on the convenient but wobbly crutch of monetary policy,” Mr Prasad said.

Financial index

Equity markets have fallen worldwide as investors cope with multiple sources of uncertainty



Source: Brookings Tiger Index

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