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World economy still on life support

By Chris Giles in London

The world economy "remains on life support" from central banks and has deteriorated since last autumn, the latest Brookings Institution-Financial Times tracking index shows, despite some recent signs of stabilisation.

Economic weakness extends across the Group of 20 leading economies, according to the Tiger (Tracking Indices for the Global Economic Recovery) index, but advanced economies have deteriorated more than developing countries.

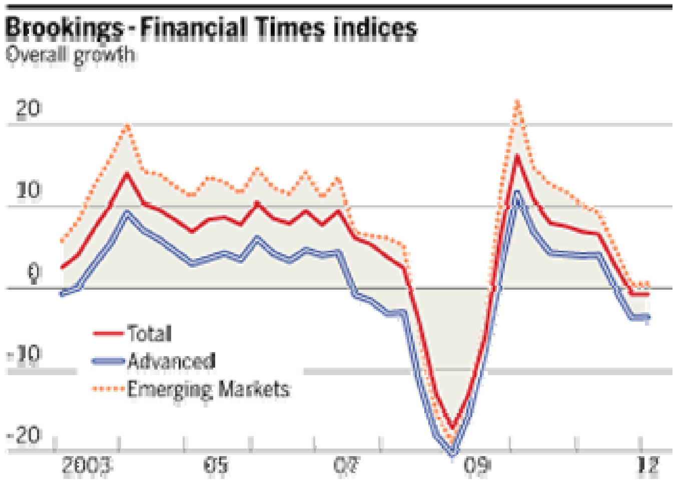
The index provides support for the message Christine Lagarde, managing director of the International Monetary Fund, sent last week that although there has been some improvement since the turn of the year, "the risks remain high, the situation fragile".

Although financial markets recovered significantly in the first quarter of the year as investors welcomed the European Central Bank's massive injection of liquidity into the eurozone's banks, the outlook for growth and jobs has become more precarious almost everywhere except in the US.

Professor Eswar Prasad of the Brookings Institution said: "The global economic recovery is still sputtering due to a lack of robust demand, policy tools that are stretched to their limits and unable to muster much traction, and enormous risks posed by weak financial systems and political uncertainty."

The Tiger index combines measures of real economic activity, financial variables and indicators of confidence according to the degree to which they are all moving up or down at the same time. Using sophisticated statistical methods it can capture the co-movements of data which are measured on a very different basis and across many countries.

The real economy component of the index has been hard hit as growth prospects in Europe, already fragile



Source: Indices developed by Eswar Prasad and Karim Foda

after the 2011 crisis, have been further undermined by brutal austerity plans in many countries. "This is stifling growth, worsening debt to GDP ratios in the short run, and generating an unsustainable political situation at the domestic and pan-European levels," Prof Prasad said.

The US recovery, by contrast has become more robust although it remains vulnerable to shocks and its growth remains modest.

But it is not just the advanced economies that are suffering. The growth outlook in emerging markets has also deteriorated with industrial output falling short of expectations in all of the Bric countries – Brazil, Russia, India and China.

"The burden of sustaining world growth is taking a toll on emerging market economies," Prof Prasad said.

The financial conditions and confidence indicators of the Tiger index have performed better in 2012 and have ticked up as investors, households and companies have breathed a sigh of relief that an implosion of the European economy, which seemed a realistic possibility in the winter, has become less acute.

With growth forecasts worse than six months ago, the upturn in confidence will need to be reflected in real recoveries soon if such confidence is likely to continue.