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Global economic recovery stuck below takeoff speed

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The global economic recovery remains stuck below takeoff speed, unable to achieve liftoff and facing the risk of stalling. Half-hearted fiscal austerity measures are proving to be a drag on growth and doing little to rebuild investor and consumer confidence.

Monetary policy continues to shoulder the burden of limiting downside risks and has kept financial markets buoyant even in the face of weak growth prospects.

The Brookings-FT Tiger index shows growth momentum remains weak in nearly all major advanced and emerging market economies. The best that can be said about the weak pace of economic activity is that it has bottomed out in some key economies. However, prospects of a strong cyclical pickup in growth are likely to be hampered by continued policy uncertainty and concerns about further financial market turbulence, with the simmering eurozone debt crisis once again coming close to boiling over.

The US economy continues to be a relatively bright spot, with economic activity showing modest strength and equity markets booming. Consumer demand continues to prop up the weak recovery, although even that is tenuous as labor market performance remains weak.

The Fed's commitment to maintain easy monetary policy until the unemployment rate falls to 6.5 percent has boosted bond and equity markets. The Fed's actions have also helped to limit downside risks to growth in the short term but at the cost of creating greater financial system risks. Fiscal policy, both directly and through the uncertainty about its future course, is hampering the recovery.

Growth in the core eurozone economies, including Germany and France, remains weak while the eurozone periphery remains mired in a danger zone. The backstop provided by the ECB's interventions bought some time for European policymakers, who have been squandering it with political squabbling. There has in fact been some progress on fiscal and structural reforms in countries such as Greece and Spain. However, in general the pace of reforms in the eurozone periphery economies has been far too slow.

There are few grounds to anticipate improved growth momentum in these economies, which continue to post shrinking GDP levels. They also have dismal levels of business and consumer confidence, as well as financial systems that are still in distress and unable to provide much credit to finance a recovery. Moreover, recent developments such as the outcome of the Italian elections and the mishandled Cyprus bank rescue plan have raised the risks of an unpleasant end-game to the crisis.

The Bank of Japan’s new leadership has clearly signaled its intention to employ a broad and aggressive set of unconventional monetary policy measures to reverse deflation and support growth. For these measures to gain traction, they need to be supplemented by structural reform measures that are essential to revive the economy’s productivity and competitiveness. Bolstering Japan’s productivity and long-term growth prospects requires reforms of the tax system, labor markets, and various aspects of the regulatory regime.

Emerging markets are treading water as their policy space becomes increasingly constrained and they continue to be buffeted by a weak external environment.

The outlook for China’s economy is evenly balanced, with some indicators such as industrial production suggesting that growth has stabilised. Inflation appears to have moderated, leaving room for policy stimulus if growth were to slow. The new leadership has hit the ground running in terms of laying out its economic reform agenda and making a series of statements and high-level appointments that bode well for reform prospects.

The difficult task of developing specific action plans and implementing them lies ahead. Still, it seems clear that the government is prepared to accept lower growth than in the past decade so long as that growth is more sustainable and increasingly driven by private consumption and productive investment.

In India, the optimism engendered by a wave of modest but important reforms at the end of 2012 has given way to renewed gloom as the February 2013 budget did not sustain the reform momentum. The budget contained some steps to put public finances on a more sustainable path, but even the modest deficit reduction goals may be upended by weak growth. The large current account deficit remains a source of vulnerability and the high level of inflation has constrained monetary policy’s ability to support growth.

Latin American economies have hit a rough patch, with countries like Argentina and Brazil experiencing significant slowdowns. Even Mexico, one of the strongest performers in the region of late, is in danger of losing momentum as export growth has been hit hard by weak external demand.

Politicians around the world continue to avoid tough structural reforms, instead relying on central banks to continue propping up growth. Policy and political uncertainty remain sources of drag that could prevent the world economy from attaining liftoff, raising the risk of a crash.

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