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The world economy is recovering

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By Eswar Prasad and Karim Foda

Despite all the portents of doom the world economy has been quietly mending itself.

This is not to say that the recovery is firmly entrenched or that few risks remain, but despite the rough patches in 2010, it is important to keep in mind that the economic picture looks far better now than it did a year ago.

Why do we conclude this? To get an accurate picture of where the world economy now stands, we need to look at a broad set of economic data. We have gathered data from the G20 economies for three types of indicators: real economic activity, captured by GDP, industrial production, employment, imports and exports; financial indicators such as national stock market indexes, stock market capitalization and, in the case of emerging markets, their bond spreads relative to U.S. treasuries; and finally, indicators of business and consumer confidence. *Visit the index*

By combining information from these variables using statistical techniques, we can take the pulse of individual economies as well as the world economy. And thus was born the Brookings Institution-Financial Times index for the world economy, which we have christened TIGER—Tracking Indices for the Global Economic Recovery.

The composite indexes reveal five dominant themes. First, the global economy turned the corner by mid-2009 and has strengthened gradually since then. Growth rates of many indicators have rebounded strongly after plunging into negative territory during 2008.

These high growth rates are off a lower base of course and there is still a lot of ground to be made up before the levels of these indicators are back at their pre-crisis levels. For instance, growth rates of industrial production in many G20 economies are now higher than before the crisis but, because growth rates fell sharply during 2008, the levels of industrial production are still below pre-crisis levels. Still, the recovery has clearly gathered momentum.

Second, the recovery has been rather uneven. Growth rates of industrial production and trade volumes have recovered strongly, while the recovery in GDP and employment has been modest at best. Employment growth, which tends to be a lagging indicator of the business cycle, was very weak in advanced economies until the beginning of 2010 but is now showing some signs of life. So the recovery is ever so slowly becoming more broad-based.

Third, the performance of world financial markets has outpaced that of key macro variables. In the last two months, however, financial markets have dipped as they have been rattled by the problems in Europe. This could signal prescience of financial markets about more difficult times ahead or just a temporary pullback from an earlier surge of unfounded optimism. Either way, this is not good for the recovery. Then again, a more tempered financial market performance may not be such a bad thing for the longer term.

Fourth, confidence measures have regained some of the ground they lost during the worst of the crisis. In both advanced and emerging market economies, business confidence is still rising gradually but consumer confidence in advanced economies has been stuck in a rut in recent months. Resurgent business confidence is a positive sign as it could boost investment. But weak consumer confidence and minimal employment growth could dampen the recovery if they translate into tepid growth in private consumption.

And finally, emerging markets felt the effects of the global crisis later than the advanced economies and have also recovered more sharply. Among the major emerging markets, the recoveries in China and India have been particularly strong.

So far in 2010, emerging markets are still barreling their way to a strong performance despite the problems that have beset advanced economies. Perhaps, in a long-term structural sense, they are becoming less dependent on advanced economies. But emerging markets cannot pull the world economy along by themselves. If advanced economies continue to turn in a weak performance, we are in for a long and hard slog towards a durable global economic recovery.

We are certainly not out of the woods yet and all manner of risks could forestall the recovery. While it is easy to paint dire scenarios, it is still worth recognizing that there is a lot of positive news relative to the desperate circumstances that the world economy was in a year ago. It's not yet time to open up the bubbly, but at least there is less need now for a stiff drink.

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For in-depth information on the raw data behind the TIGER index visit the Brookings webpage

Tags: economic index, economic recovery, TIGER

May 25, 2010 5:35pm in Crisis, Economics, Fiscal policy, Monetary policy | 6 comments

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beaugarde | June 8 4:22pm | Permalink Report

I meant to write "The really distressing thing is the lack of political opposition by unions, and others in the Anglo-American world", not "worrying".

beaugarde | June 8 3:55pm | Permalink Report

Re: Larry Summers

Well, he played an important role in supporting the repeal of Glass-Stegal and preventing efforts by Brooksley Born to regulate derivatives in the late 1990s. But yes, Mr. Wolf is right, Larry Summers wasn't directly in charge of things during the Bush administration, I stand corrected on that. I was borrowing from Nassim Taleb, and to change the analogy a bit, perhaps Mr. Summers could be compared to the bus mechanic who, in good faith believes he's repairing the bus, but his repairs will cause the brakes and the steering wheel to fail catastrophically at the next sharp turn on the mountain pass.

Sometimes when I read my remarks they seem intemperate, but my grandfather lived through the first Great Depression here in the U.S. and I know directly from him the dire effects of bad economics.
The really worrying thing is why there are no oppositional political movements in the Anglo-American world that would be committed to restoring the New Deal or social-democracy. Where are the unions? The greatest economic crisis since the 1930s and not a sound from them.

Martin Wolf | June 7 3:41pm | Permalink Report

Why did Larry Summers crash the bus while driving blindfolded? Is @Beauregarde unaware that Mr Summers stopped being Treasury Secretary in early 2001? This bus was crashed by the Bush administration. But I rather agree with the rest of what he says. I think there is far too much optimism around about the recovery. What is remarkable is how weak the recovery is, given the gigantic monetary and fiscal stimuli.

beaugarde | May 30 11:42pm | Permalink Report

Nice article, but you are dreaming if you think the world is anywhere near a solid recovery. Even Larry Summers, the man who crashed the bus while driving blindfolded, is so worried that he suggested a new stimulus of $200 million just last week.
The economic situation is very, very dangerous. We're still in a liquidity trap, savage cutbacks in government spending are underway across the G-8 where in the US in particular, millions are unemployed with no prospect of work. There is a speculative attack against sovereign debt similar to the kind of things that have gone in the commodity markets over the last ten years that is destabilizing financial markets.
The world is very close to a deflationary spiral, indeed that may have already begun, and once it does this very weak recovery will be quickly brought to an end and then my friends, you will see real human misery and suffering, as happened in the Great Depression.
With what consequences, I wonder. That might be an interesting topic for a discussion, "The political and social consequences of a Second Great Depression."

Donald Hsu | May 28 10:31pm | Permalink Report

Professor, you said, "Among the major emerging markets, the recoveries in China and India have been particularly strong."

What about Brazil, Russian, Central Eastern Europe countries? Are they recovering too?

henrye | May 26 6:51pm | Permalink Report

European economy = Japanese Kieretsu. Lightning rod during times of development & growth, but an anchor to post bubble recovery.