vox
Research-based policy analysis and commentary from leading economists

A fragile and fickle recovery

Karim Foda Eswar Prasad

23 April 2012

The world economy is showing scattered signs of improvement but remains fragile according to official forecasts. This column summarises the latest update of the Brookings Institution-FT Tracking Indices for the Global Economic Recovery. It confirms some positive signs but also much to worry about as the world economy continues to meander with no clear sense of direction.

The world economy remains on life support, largely provided by accommodative central banks.

- Concerns about spillovers from a worsening of the European debt crisis and slowing growth in key emerging markets are putting a dampener on consumer and business confidence.
- Equity markets are pulling back from a robust performance in the first quarter of this year as the sobering reality of a continued anaemic recovery dampens investors' optimism.

In short, the world economy is showing scattered signs of improvement but remains fragile according to official forecasts (IMF 2012 and OECD 2012).

The official forecasts, however, are always something of a black box. A newly created index – the Brookings Institution-FT index for the world economy, christened 'TIGER' (Tracking Indices for the Global Economic Recovery) – aims to provide a better handle on the global economy.

What is TIGER?

In the midst of a recovery, it is often the case that various economic indicators yield different perspectives on the strength of an economy and underlying trends. Different types of variables can be helpful in getting a broad perspective on where an economy is in the business cycle and where it may be headed.

Tracking the global economy is facilitated by having consistent and comparable data across countries. To this end, we have gathered data from most of the G20 economies for three types of indicators.

- Real economic activity

This is captured by GDP, industrial production, employment, imports and exports.

- Financial market indicators

This includes national stock market indices, stock market capitalisation, credit growth and, in the case of emerging markets, their bond spreads relative to US treasuries.

- Confidence

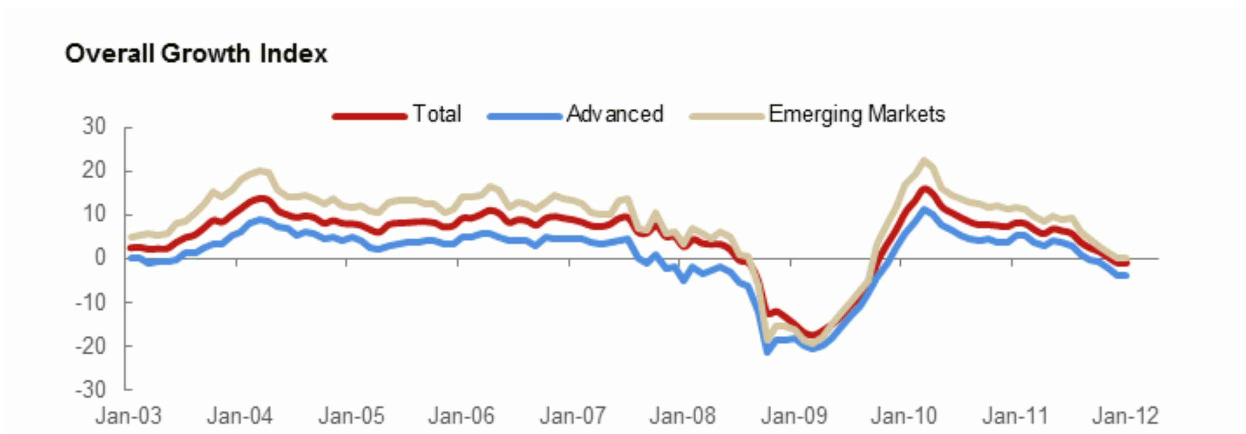
This category includes survey-based measures of business and consumer confidence, which are relevant for gauging the prospects for aggregate demand growth.

TIGER is the combination of these variables (our methodology, using principle components, is explained in detail here). In addition to the global index, we have indices for each country, so TIGER allows us to take the pulse of the world economy as well as individual economies. We have also constructed indices broken down by indicator allowing us to examine, for instance, how business and consumer confidence are doing across the world (see Prasad and Foda 2012a and Prasad and Foda 2012b for more details).

Key themes from the latest update of TIGER

Following a brief surge in activity, the world economy has once again been beset with worries about risks on multiple fronts. In recent months, the overall TIGER index shows continued declines for advanced and emerging economies alike (see Figure 1).

Figure 1. Overall Growth Index



Looming risks and the lack of policy space in advanced economies is taking a toll on economic activity as well as confidence.

In advanced economies, there is considerable uncertainty about what room is left for aggressive policy responses:

- With fiscal policy already in a tight spot and monetary policy out on a limb in these economies, the room to boost domestic demand is limited.

The Eurozone debt crisis, which has eased temporarily due to massive intervention by the ECB as well as promises of fiscal discipline and structural reforms in the distressed economies, remains the major source of global risk.

- Many European economies are being forced to restructure their public finances even as they venture to undertake massive structural reforms.

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.

Among advanced economies, the US economy remains one bright spot but there are few others that show signs of self-sustaining demand growth.

The US recovery is gradually firming up but remains fragile.

- Output growth has been modest at best, but the unemployment rate continues to drop and employment growth has begun to pick up, even if haltingly; the pace still leaves total employment below its pre-crisis level.
- Equity markets turned in a good performance in the first quarter of the year and credit growth has picked up.

These are helping to give a small, but noticeable boost, to consumer and business confidence.

- Japan remains mired in weak growth.

Many countries in the Eurozone are in recession.

- France is on the edge of recession; and
- Even the mighty German economy is showing signs of stumbling.

Emerging markets continue to perform better than advanced economies but their growth momentum is also slowing (see Figure 2).

- China seems to be engineering a soft landing for its economy.

This will not be a smooth process as the economy continues to be buffeted by domestic policy challenges and uncertainties in the global trade and financial environment.

- If growth were to slow sharply, China has room to respond with aggressive expansionary policies.

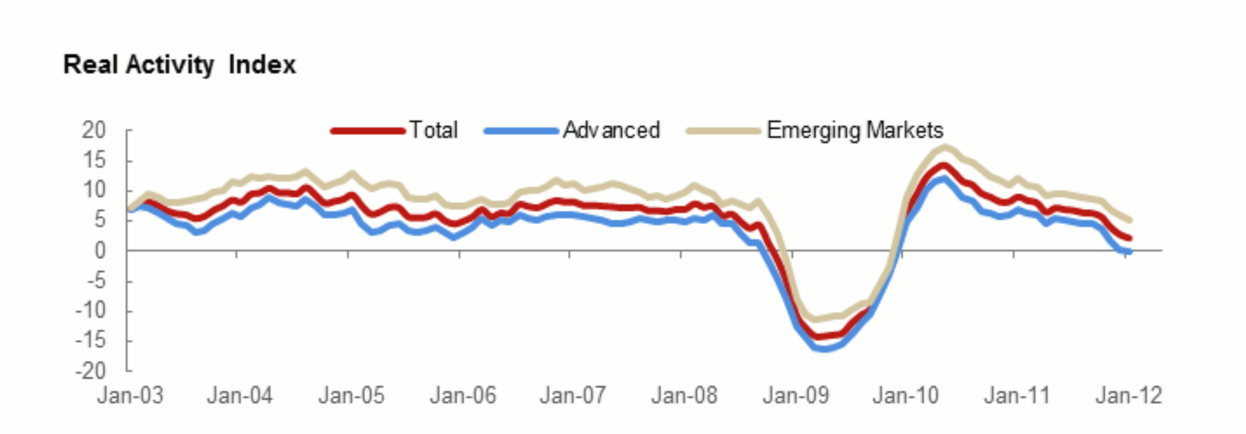
This would secure short-term growth but could set back the long-term goal of rebalancing economic growth and making it less reliant on investment.

- India has hit a rough patch.

Its industrial production growth has hit a wall at the end of 2011, output growth has slowed sharply, and the current-account deficit has been widening and leaving the economy vulnerable to capital-flow reversals.

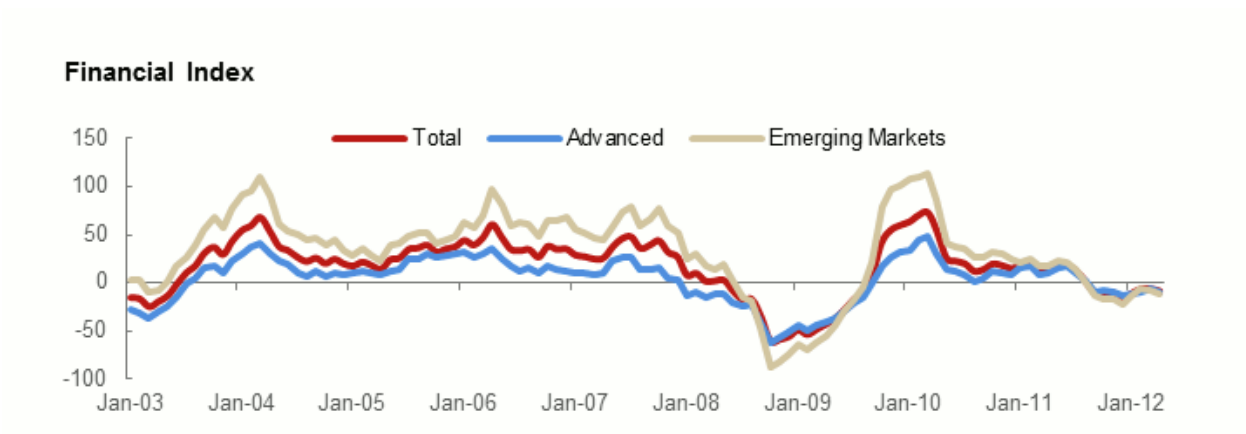
- Brazil, Russia, and most other emerging market economies have also experienced slowdowns in GDP growth, with industrial production growth taking a sizable hit.

Figure 2. Real Activity Index



Financial markets around the world posted a strong performance in the first quarter of 2012 as it appeared that significant steps were finally underway to tackle the Eurozone crisis and the world economy had finally turned the corner (see Figure 3). However, developments in the Eurozone and elsewhere have thrown cold water on this optimism, leading to a weakening of financial indicators in recent weeks.

Figure 3. Financial Index



Conclusion

Four years after the financial crisis drove the world economy to the brink, the pervasive sense of imminent doom has given way to cautious and nervous optimism. However, 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.

References

IMF (2012), “Growth Resuming, Dangers Remain”, WEO IMF, 17 April.
OECD (2012), “What Is The Economic Outlook for OECD Countries?” 29 March.
Prasad, Eswar and Karim Foda (2012a), “April 2012 Update for TIGER: Tracking Indexes for the Global Economic Recovery”, The Brookings Institution.
Prasad, Eswar and Karim Foda (2010b), “Interactive: Tracking the global economic recovery”, FT.com.

Topics: Global economy
Tags:

Comments