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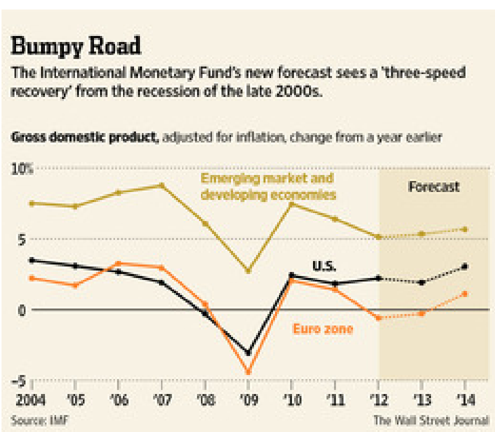
Faster Growth Relies on a Bump-Free Road

By DAVID WESSEL

The consensus forecast for the world economy, as it so often seems to be, is that this year looks a little shaky, but next year will be better. "Global prospects have improved," the International Monetary Fund said in its semiannual forecast this week, "but the road to recovery...will remain bumpy."

The past few days illustrate just how big those bumps can be.



There was the horror at the Boston Marathon, a reminder that terrorism remains a threat. Commodity prices fell—and it wasn't just gold; oil was down, too—a reminder that economic vigor, or lack of it, in China has global repercussions. And there was the hiccup in the U.S. stock market after a string of record highs, a reminder that the mood of the market can change abruptly.

Looking ahead, the IMF sees "a three-speed recovery" unfolding after a slowdown in growth in 2012. Emerging markets and developing countries are going strong, it said. The U.S. isn't doing great, but it's getting better. Europe is doing poorly.

The combined result, it predicts, will be a quickening in the pace of global growth from 3.2% in 2012 to 3.3% this year and an acceleration to 4.0% next year. That would make growth in 2014 better than in 22 of the past 30 years.

The trouble is that almost everything has to go right for that to happen. What might not?

Europe tops almost every economic worry list. The European Central Bank's "whatever it takes" vow bought time for elected European governments to figure out how to shore up their union, but they seem to be squandering it.

They have, so far, managed to avoid catastrophe each time they're confronted with a crisis. Thank goodness for that.

But, in part because of domestic politics, Europe's governments aren't doing what's needed to restore confidence in their banks or reignite growth. Credit isn't flowing to businesses in the periphery of Europe, and the ECB hasn't found a way to fix that. Without strong demand from Germany and France, the periphery can't avoid the downward spiral of budget deficits, austerity and recession, which then result in bigger deficits.

The U.S. appears to be on an improving trajectory despite some disappointing data for March. Unemployment is still high and wages are stagnant, but rising house prices and (at least so far) rising stock prices have buoyed spending. Housing starts, measured at an annual rate, have crossed the 1 million mark for the first time since June 2008. A deepening of the European recession would hurt. Despite the rise of Asia, between one-fifth and one-quarter of all U.S. exports of goods and services go to the European Union.

But the biggest risks to the U.S. economy now appear to come from its own government. The IMF cautioned Washington about "overly strong" deficit reduction under way right now, pleading for less belt-tightening now and more later.

Federal Reserve officials, meanwhile, are talking loudly about lifting the foot off the monetary gas pedal later this year. The timing of this is tricky: Wait too long and the Fed could be sowing seeds of financial instability. Move too quickly, and markets could overreact or the economy could lose momentum.

Seib & Wessel

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Japan has been missing from conversations about the world economy lately, seen as perpetually stuck in a mix of mild deflation and hardly any growth. The new government and its central bank have shown admirable resolve to get Japan moving again, hence the tolerance from U.S. and European leaders of Japan's weaker yen. There's a strong case that Japan needs the Bernanke-on-steroids monetary policy it's now attempting.

But the effects—on Japan's bond market and on its currency—are far from certain. And given Japan's already heavy debt load, any missteps on fiscal policy or failure to pursue promised regulatory changes could erode investor confidence in Japanese government bonds, and push up the yields the Bank of Japan is trying to keep down.

And then there's China. The IMF is forecasting an acceleration of growth there, though chief economist Olivier Blanchard emphasized that call was made before this week's report that growth slowed in the first quarter. Chinese economic data aren't reliable, but it's


Reuters

The effects of Japan's new monetary policy are far from certain.

hard to imagine the government would have understated economic growth. Electricity consumption and other indicators also are flashing caution.

"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," says Cornell University's Eswar Prasad, former chief of the IMF China desk. But achieving that requires a deft hand on the economic tiller, steering away from the shoals of too much credit without sinking the ship. China's extraordinary success over the past couple of decades is encouraging, but past performance is no guarantee of future results.

Mind the bumps.

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