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Tiger index: Too early to declare recovery victory

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The latest update of the Brookings-FT Tiger index shows that the global economic recovery is back on track, although it remains slow and unsteady. The recovery is being borne along by surging business and consumer confidence in advanced economies, and stabilisation in the growth of emerging markets. However, it may be premature for policymakers to declare victory as the recovery is still tenuous and just a shock or two away from turning into another slump.

Advanced economies seem to have put the worst behind them. The US economy continues to push forward at a modest pace and the UK is experiencing surprisingly good growth, while the core eurozone economies and Japan are also turning in positive growth. Across the board, private sector confidence has improved in these economies and inflation remains subdued. However, labour market performance continues to be weak and financial conditions are still mixed. The postponement of the US Federal Reserve's tapering of its quantitative easing policies sparked a rally in equity markets but credit growth has not picked up in most advanced economies, still acting as a drag on the recovery.

Emerging market economies seem to have halted the loss of their growth momentum. China's growth is beginning to look more secure, with indicators from industrial production to imports and exports showing renewed strength. Other major emerging markets, including Brazil and India, have taken hard hits to their growth this year but their growth rates now appear to be stabilising, albeit at lower levels than in previous years. Interestingly, private sector confidence in these countries has yet to recover after being shaken by their weak growth performance and heightened external risks in recent months. The volatility of capital flows engendered by the Fed's vacillations on its tapering measures have added to the difficult external circumstances these countries continue to face.

Risks abound around the world, many created by ineffectual policy making. The US economy continues to suffer from lopsided fiscal adjustment—excessive austerity in the short run and little progress on longer-term fiscal discipline. The eurozone periphery economies remain wracked by high unemployment and social instability. There may be more trouble to come if growth does not revive soon and reveal some payoffs for the painful reforms undertaken so far, even if those reforms are far from adequate. Underlying political fragilities, including the mounting political crisis in Italy, are another wildcard. Many emerging markets seem to have been resting on their laurels as previous rounds of reforms helped them get through the financial crisis with a show of resilience that has now faded.

Central banks around the world have managed to pull off a delicate balancing act, keeping growth going by pulling out all the stops. Unconventional monetary policies by the advanced economy central banks seem to have reached their zenith and may have to be wound down if the recovery firms up and the balance of risks shifts towards stoking inflation and financial system imbalances, even though these might seem like distant risks if at all.

The question now is whether politicians will use the breathing room their economies have attained to refocus on fundamental reforms that are still very much needed. In the US, fiscal and financial regulatory reforms are a priority, while in Europe structural reforms to financial systems and labor markets are necessary to keep the eurozone periphery economies on track. In China, financial market reforms are a key priority to get growth more balanced.

In recent months, the vulnerabilities of emerging markets like Brazil, India, and Indonesia that have sizable budget and current account deficits have become all too apparent. In these economies, central banks are faced with the nearly impossible balancing act of supporting growth, keeping inflation under control, supporting their currencies, and ensuring financial stability. Unless other policies start pulling in the same direction, it will be difficult to maintain this high-wire act much longer, especially if the external environment were to deteriorate again.

The world economy has turned the corner but remains vulnerable to being knocked off course. This is a time for redoubled efforts at undertaking the reforms that are essential in virtually every major economy to reduce risks and keep growth from stumbling, rather than continuing to rely on the crutch of creative monetary policy. A respite from economic gloom would be a terrible thing to waste.

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