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Global Economy

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Beware risks inherent in the global recovery

By Chris Giles in London

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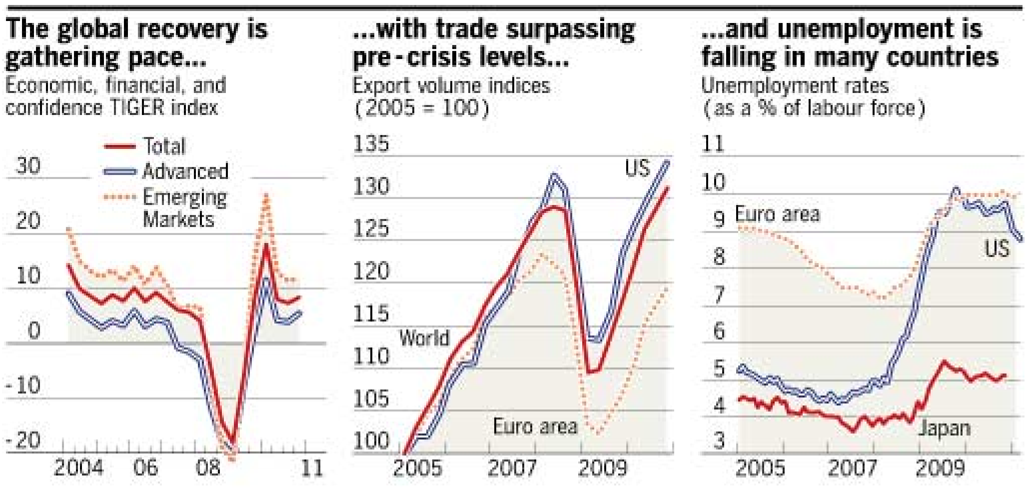
The increase in eurozone interest rates is only one sign of a global economic recovery that appears to be self-sustaining and gathering fresh momentum.

The Organisation for Economic Co-operation and Development said this week that, outside Japan, the annualised growth rate of the Group of Seven economies would probably reach 3 per cent in the first half of the year, “with financial conditions improving across the board”.

The Brookings Institution/FT Tracking Indices for the global economic recovery (Tiger) have ticked up, reflecting better news from real indicators such as industrial production and livelier “animal spirits” – or business confidence – in company bosses. Eswar Prasad, a senior fellow at Brookings, said: “While it is still premature to declare victory after the ravages [of the global crisis], the world economy is now in a far better state than it was a year ago.”

The strength of the global economy. which is running as hot as it was in the years preceding the economic and financial crisis, is evident in many indicators. World trade volumes have recovered all the lost ground from the crisis and hit a new peak at about the turn of the year. Employment is growing rapidly in emerging economies, but also in Germany and the US among advanced economies, where jobless rates have fallen.

Germany is the star performer among advanced economies, with resurgent industrial production and unemployment falling to its lowest level since reunification in 1990.



The International Monetary Fund will publish its latest short-term forecasts for the world on Monday. But it confirmed on Thursday its medium-term view that the world economy can grow by an average of 4.6 per cent a year until 2015.

However, the levels of growth in different economies remain highly divergent. Just as before the crisis, emerging economies are growing at rates close to 6 per cent, while rates of 2-3 per cent are the ambition for most advanced economies.

During long periods, such differences have huge effects. By the end of 2012, the most recent figures from the International Monetary Fund suggest that emerging economies will be 33 per cent larger than they were at the start of 2007; developed economies are likely to have expanded only 3 per cent during the whole period.

The earthquake and tsunami that hit Japan last month signal just one of the many risks that might compromise the global outlook, according to Prof Prasad. “A variety of unpleasant shocks – revolution, war, natural disasters, rising food prices and debt crises – all signal choppy waters ahead,” he said.

A concern for the immediate outlook is the effect of rising oil prices, which threatens to squeeze incomes in advanced economies and to exacerbate inflationary pressure in emerging economies.

Risks can also come from policy errors. The divide on monetary policy between the hawkish European Central Bank and the more dovish Federal Reserve and Bank of England suggests that one or more of these central banks will find it has to deal either with an inflation shock or deficient demand.

In emerging economies, the risks of inflation rising because the authorities are too worried about tightening monetary policy or allowing greater currency appreciation are high.

Fiscal strains also present a cloud on the horizon, not only in the periphery of the eurozone. The UK, poster child of those wanting countries to take firm action on budget deficits, is one of the weakest advanced economies, with little growth at the end of 2010 and the start of 2011. While others – Portugal, but also the US – are stretching investor patience with political wrangling over deficit reduction.

Even if none of these policy risks materialises, the IMF believes global trade imbalances are still likely to grow in the years ahead and with imbalances comes the danger of another sudden crisis. So as ministers and central bankers prepare for next week's spring meetings of the fund and World Bank, tensions are bound to be as much in evidence as relief at the strength of the world recovery.