# Can it be...the recovery?

**The outlook for the world economy is better than it was, but there are still big risks out there**


THERE are tantalising signs of good news in the world economy. In America firms are hiring more and consumers are spending more. The euro zone's recession is proving milder than expected. Greece's debt restructuring, the first sovereign default in a developed economy for 60 years, has passed off without a hitch. Cheered by the signs of recovery, and relieved that disaster has been avoided (particularly in Europe, which towards the end of last year seemed on the brink of a calamity of Lehman-like magnitude), financial markets have been climbing steadily higher. The **MSCI** global share index is up by almost 9% since the beginning of the year and by 20% since its lows last October.

After so much gloom, it is hardly surprising that the world's animal spirits are beginning to leap again. Yet there are good reasons to be wary of all the optimism. Global growth, dragged down by less ebullient emerging economies as well as recession in Europe, is still likely to be slower this year than it was in 2cm.

And there are still big risks out there. Too often since the 2008 financial crisis investors' hopes for strong and lasting growth have been dashed-whether by bad luck (soaring oil prices), bad policy (too much budget austerity too fast) or the painful realisation that recoveries after asset busts are generally weak and fragile. If tensions with Iran over its nuclear programme spike, for instance, an oil-supply shock could once more cause havoc. Much could yet go wrong.

## Less gloom, but no boom

Conveniently enough for a president who is seeking re-election in November, the clearest signs of recovery are in America. The good news is both cyclical, as stronger employment fuels income and spending, and structural, as evidence mounts that the drags from the housing bust are waning (see pages 30-31). Exclude the temporary work involved in carrying out America's 2010 census, and more jobs have been created in the three months since November than in any three-month period since 2006. Unemployment and underemployment are both falling. House prices continue to drift lower, but both construction and home sales have started to rise. Consumer credit is growing and the fiscal squeeze has loosened, thanks to an easing of state-level budgets and Congress's extension of temporary tax cuts until the end of the year.

None of this is the stuff of boom times. For the year as a whole America's economy will probably grow around its trend rate of around 2.5%. That's a lot lower than might be expected after a normal recession; but after financial crises, when consumers are weighed down by debt, recoveries tend to be anaemic. That level of growth will not bring the jobless rate down fast, but it would be an improvement on 2on and, more important, it could be the first step towards a self-sustaining recovery, thanks to the virtuous circle of stronger job growth leading to higher consumer spending, which in turn should generate more jobs.

Europe, by contrast, remains a long way from recovery. There the good news is simply that things are a lot less bad than they might have been. Thanks to the massive provision of liquidity to banks by the European Central Bank **(ECB)** under Mario Draghi's new management, both a financial collapse and a nasty credit crunch seem to have been averted. The result is a shallow recession which Germany may escape altogether. For others, however, it's still not clear where growth will come from. Most European countries, particularly those on the euro zone's periphery, are imposing austerity on their economies to get their deficits down. The structural reforms they are introducing to help boost growth will take time to have much effect.

But as long as it remains shallow, a European recession will do limited damage on the rest of the world. And that is an important reason why the outlook for many emerging economies is better than it was a couple of months ago. To be sure, growth has slowed markedly in many emerging economies, from China to Brazil, as tighter monetary policy has dampened domestic spending. But a collapse in Europe risked a far deeper slowdown in the emerging world, as exports plunged and foreign capital fled. With a euro-zone catastrophe off the table, at least for now, capital flows to the emerging world are rising and export-oriented economies (particularly in Asia) are starting to accelerate again.

China is the exception: its recent trade figures were surprisingly grim (see page 86). But even there, the outlook for the rest of this year is better than recent news suggests. That's because a welcome fall in inflation leaves room for the Chinese government to ease monetary and fiscal policy, even if curbs on property speculation will remain. The government will not allow too sharp a slowdown, since this year's change of leadership in China puts a premium on maintaining social stability.

Add up this disparate evidence and the case for modest optimism is solid. But much more needs to be done to build a more durable recovery.

## The last crusade

European countries need to stop focusing so intently on austerity and instead do more to generate growth. The **ECB'S** liquidity injections have successfully bought time for indebted governments, but for permanent relief the euro zone needs to build institutions that allow joint liability for government debts balanced with fiscal discipline.

America's priority should be to craft a medium-term plan which puts the budget deficit on a downward path without snuffing out the recovery. There is, unfortunately, not a chance that it will do that before November's presidential election. China's economy remains too reliant on investment rather than domestic consumption. Rather than encourage the building of roads and railways, any stimulus this year should push cheap housing and higher wages, as well as pensions and health spending.

The reasons for optimism are real. But if policymakers get it wrong again, the recovery could yet turn to dust.

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