Losing Steam

The global recovery is faltering.

By Eswar Prasad

The world economy is losing momentum as its major growth engines decelerate and a confluence of short-term factors and long-term constraints—including geopolitical tensions, high public debt levels, and aging populations—begin to bite. The latest update to the Brookings-Financial Times Tracking Indexes for the Global Economic Recovery (TIGER) shows that economic activity is weakening across the board. Despite relatively favorable financial market performance earlier this year, consumer and business confidence have taken a major hit.

While the United States continues to post steady GDP growth, other advanced economies are in a parlous state, facing dismal growth prospects or even teetering on the edge of recession. Emerging market economies are generally in better shape, with China showing some signs of stabilization, and India continuing to power ahead.

Fortunately, inflationary pressures are easing around the world, but rising energy prices and widening geopolitical fissures could halt this progress and hamper growth. Equity markets rallied for a few months, owing partly to optimism about the productivity gains from technological innovation, but concerns about growth prospects have begun to weigh on their performance.

The U.S. economy has proven remarkably resilient, weathering high interest rates, rising government debt, political dysfunction, and other challenges. Household consumption and job creation have remained robust, though at a slowing pace. To its credit, the U.S. Federal Reserve has recovered from its early stumble and is now taming inflation without tipping the country into a

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recession. But strains are starting to show, especially in financial markets, and the economy's late-cycle momentum is losing steam.

The eurozone, for its part, has adjusted to the negative spillovers from the Ukraine war, and inflationary pressures have eased in the bloc, although the European Central Bank's commitment to meeting its inflation target will keep monetary conditions tight. But growth remains uneven, with some of the core and periphery economies struggling. Germany, Europe's biggest economy, is barely growing, having been hit hard by weak external demand and rising competition from foreign manufacturers. Italy is in similar straits, while France has fared marginally better. Greece and Spain, on the other hand, have been bolstered by domestic demand and a resurgence of tourism.

Elsewhere in the developed world, after a post-covid rebound, growth in the United Kingdom has been dampened by labor market strife and interest rate hikes to contain inflation. And Japan's economy has been boosted by depreciation of the yen, while domestic demand remains restrained. The Bank of Japan seems tolerant of a weak currency and above-target inflation, which will continue supporting growth.

Despite being buffeted by various adverse domestic and external factors, China's economy has shown signs of stabilizing, owing to fiscal and monetary stimulus measures intended to bolster the property market. For now, consumer price deflation has been averted, although domestic demand continues to sputter, and exports are sagging.

But the downturn in the property sector, which accounts for a significant share of China's GDP and household wealth, has raised serious concerns and increased financial risks. Private sector confidence has plunged, hurting household consumption as well as investment. Given that the property sector remains in limbo despite government support, and that a shrinking labor force and geopolitical tensions are only adding to the uncertainty, maintaining growth even in the 4–5 percent range will be challenging in the coming years.

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Meanwhile, neighboring India has solidified its status as the world's fastest-growing major economy, bolstered by robust exports and domestic investment. The country benefits from a young and growing labor force, orderly fiscal and monetary policies, and efficiency gains from digitization. Moreover, India is well-positioned to take advantage of the shifts in global trade and investment patterns being driven by geopolitical realignments and has already attracted considerable foreign capital. However, the high level of public debt, inadequate (albeit improving) infrastructure, and incomplete labor market, banking, and public governance reforms could make it difficult to realize this potential.

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Brazil and Mexico are also bright spots, as falling inflation and rising exports have boosted their prospects, while Nigeria remains a solid performer. Russia has withstood Western sanctions following its invasion of Ukraine and, despite the large strains that the war has put on its economy, is eking out low growth, fueled mainly by energy exports.

The strong dollar has inflicted enormous costs on many emerging market and low-income economies, some of which, like Argentina, have also been beset by domestic political uncertainty and policy mismanagement. Cooperation among bilateral and multilateral creditors to expedite debt restructuring for developing countries beset by rising debt-servicing costs and tightening financing conditions will be essential.

In sum, festering geopolitical tensions and structural factors such as unfavorable demographics and high debt levels have taken a toll on household and business confidence worldwide and dampened private-sector demand. The specter of high inflation is receding, although it is premature to declare victory—central banks will need to remain vigilant. The challenge for governments around the world is to rebuild confidence and enhance productivity by using fiscal policy effectively and taking measures to improve the functioning of labor, product, and financial markets. This remains the key to getting the global recovery back on track. ◆