Viewpoint by Gerard Lyons

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Shining a light: the G20 meeting in Sydney revealed clear tensions between economies that are progressing at different speeds

Investment and exports are essential to rebuild our economic well-being

At the weekend, the finance ministers and central bank governors from the world's major G20 economies gathered in Sydney to determine the latest global policy agenda.

These meetings provide an opportunity to assess what is happening to the global economy and what it means for the UK.

I am positive about what lies ahead. Despite this, it is easy to understand why there is so much uncertainty. The world economy has faced at least three paradoxes in recent years.

There has been the policy paradox, where the policies many countries want to pursue in the long term are not those they have been able to implement in the near term. As a result, there has been an exceptional degree of policy stimulus, with low rates, ample liquidity and increased debt.

Previously, G20 countries were able to ease policy at the same time, but because economies recover at different speeds it is not easy for them to co-ordinate exit strategies from low interest rates. This adds to the volatility we have seen recently in financial markets, particularly as there is a fear that premature policy tightening in the West could derail recovery.

There is also the regulatory paradox. In the wake of the crisis, economies tightened regulations, particularly in the financial sector. In isolation regulations tend to make sense, but collectively when you add them all together they can become daunting for business, dampening recovery.

The final paradox is the balanced economy paradox. The policies each economy may want to pursue in isolation to get back into shape are not necessarily the policies you want all countries to follow at same time, lest demand weakens.

Even in Sydney it was clear there were tensions, as ensuring the right balance between global needs and getting your own house in order is always a challenge, particularly for the major economies.

Last year the International Monetary Fund (IMF) talked of a three-speed world economy, with the emerging economies in the fast lane, the US in the middle and the UK with Europe in the slow lane. While that was right then, it is far more complex now, with a multi-speed global economy. Instead of a three-lane British motorway, it appears more like a multi-lane US highway, with greater variability in the speeds at which countries are moving.

It is easy to be confused by such a conflicting global picture. Yet three messages stand out for the UK.

First, we should not be surprised by near-term setbacks across emerging economies that have been racing ahead in recent years. Even they have to pause for breath, as the business cycle exists. For them the trend is up, but there will be setbacks. The UK has sensibly been focusing on exporting more to these economies and that is still the right thing to do, but such a policy may take longer to succeed.

So far this year, economies such as Turkey and South Africa that were dependent upon foreign financial inflows have been hit by market turbulence. Indeed, many emerging economies such as India or Brazil are at the stage of the economic cycle where they encounter inflation or trade problems. Such setbacks should not detract from what is still a positive longer-term picture.

Likewise, too, with China, where financial markets worry about credit conditions and are spooked by any signs of slowdown, as with data last week suggesting manufacturing output fell in the wake of the Chinese new year. China is moving to a slower, more sustainable, pace of growth and will achieve that, but in an economy of its scale that is not a smooth process.

Second, Western economies are now expected to drive more of global growth, but even here the picture is not uniform. The US looks in best shape. Even Japan has seen four successive quarters of growth. Yet the IMF last week said that although Europe is turning the corner, a lack of demand and risk of deflation remained.

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So there are still risks, but at least these now seem more balanced than before. Indeed, one issue discussed in the run-up to Sydney was that there was no shortage of capital globally looking for places to invest, and no shortage of investment opportunities, with a phenomenal £35 trillion of infrastructure opportunities being talked about globally over the next couple of decades.

Such an infrastructure boom is reflective of the changing shape of the world economy, where growth opportunities abound.

The third message for the UK is to expect stronger global growth. The world economy grew only 3.1pc in 2012 and 3pc last year, but according to the IMF it now looks set for a more healthy 3.7pc this year and 3.9pc next.

This is a significant step up, and such growth is needed to make inroads into the still high rates of youth unemployment across Europe and Africa. Even in the UK, while the numbers in work are rising, the picture is not great for everyone as unemployment is high, and there are many in part-time work or on zero-hours contracts.

It is in this context that last Thursday's speech by the Chancellor in Hong Kong was relevant. George Osborne talked of recovery, but said it was too dependent upon consumer borrowing and the City, and not balanced enough by investment and exports. I think that was right.

We need to see increased investment, and that should happen as demand recovers and firms become more confident. Also, it is important that real wages start to rise, given the squeeze on incomes in recent years. This also should happen, as inflation decelerates and wages increase. If demand does rise, it should allow the UK to make inroads into its productivity gap, which data last week showed was still large versus our competitors.

In any economy, the outlook depends upon the interaction between the fundamentals, policy and confidence. While each of these is important, you really need all three to be working together to get the best outcome. It is fair to say that confidence has been in short supply until recently, both here in the UK and many Western economies. Now, things are starting to change.

It is a point echoed by the Governor of the Bank of England, particularly in his recent speech in Davos where he implied the level of the economy was still too low and interest rates need to remain low, before rising gradually. I agree. Monetary policy has been the shock absorber for the UK in recent years, and along with macro-prudential policy will be key in ensuring that recovery is sustained.

Should we be optimistic? At the beginning of last year, I wrote here, the UK economy would grow at 2pc in 2013. It grew 1.9pc. This year, my forecast of 3.5pc to 4pc growth for 2014 is again at the top end of expectations.

It is too early to say how the recent floods will dampen activity, but the fact that the UK is now among the fastest growing of the advanced economies should give us confidence.

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