Lucky few high and dry when all around is stormy weather
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How is the world going? The global economy squeaked through the financial crisis, buffered by strong fiscal stimulus, extreme monetary policy settings and a powerful response from prudential authorities. This was good policymaking, but the crisis has left toxic residue not yet purged. As well, these extreme policy settings are not sustainable. No ammo remains in the fiscal cannon: monetary policy is already flat to the floor.

The fiscal and monetary policies that saved the world from depression are largely still in place but have not triggered self-sustained growth in the countries affected by the crisis.

The International Monetary Fund forecasts that the world will plod along at a steady pace, overall figures hiding differentials of performance and, more importantly, unresolved problems that put risks predominantly on the downside.

Europe and the US creep forward at a pace that leaves unemployment little changed over the next few years. Financial markets have been coaxed back to a semblance of normalcy, but balance sheet adjustment (for countries as well as companies and individuals) is not complete.

The crisis ended the American consumer's dis-saving spree, but forced the government to step in with additional spending in order to keep the economy moving. This budget deficit (close to 10 per cent of gross domestic product) doesn't just reflect cyclical effects that would be reversed as unemployment falls. Politics has so far prevented a fix for the longer-term issues: mis-structured entitlements and Medicare, and continuing tax perks for the rich. Without a political breakthrough, the US faces substantial deficits as far as the eye can see.

Continental Europe is not much better off, but the immediate threats are in the peripheral countries, headed by Greece, but now including Ireland and Portugal, with Spain teetering on the brink.

The method of addressing the Greek mess is an instructive foretaste of the intractable politics. From the start, it has been clear that Greece was insolvent and that a debt restructure would be necessary, with creditors writing off some of the debt.

An early restructure would have severely damaged some European banks that held Greek debt, especially in France and Germany. Thus a "fix" was put in place, which delays the final reckoning and allows the private-sector debt holders time to get out, unloading the problems onto their governments.

At some stage the governments of Europe will have to bail out Greece, further adding to their own debt burdens.

Ireland is waiting to go through the same wringer, with the new government looking to lighten the terms of its rescue at the expense of the Europeans. Portugal is next in line.

Fingers are crossed for Spain, which is in better shape but is following a self-imposed austerity path, beginning with unemployment at 20 per cent.

On top of these unresolved fiscal problems, Germany's legendary efficiency and wage restraint have created substantial relative cost disparities within the straitjacket of the euro. Other members of the euro zone (notably the peripheral countries struggling with national bankruptcy) do not have exchange rate adjustment as a policy option.

To add to the intra-European tension, commodity prices are pushing Germany's inflation into uncomfortable territory, encouraging it to lean on the European Central Bank to raise interest rates.

The UK has embarked on a budget path that could be described as bold: Sir Humphrey might call it courageous. Even though its credit rating is still unquestioned, it has set out to rein in government debt quickly. This may turn out to be an admirable, long-term nation-building strategy, but in the short term it throws a wet blanket over the economy.

It is too early to judge the economic effects of events playing out in Japan, but even without its triple tragedy, the country's forecast growth path was modest. Similarly, there is a question mark over how long it will be before the Middle East returns to some normality.

Before we get too gloomy, let's recall contagion pessimists confidently predicted that recession in the US and Europe would greatly inhibit growth in the rest of the world. For these forecasters, the two-speed world we now find ourselves in didn't seem feasible. To our great advantage here in Australia, they turned out to be wrong, and the whole of non-Japan Asia and Latin America are forecast to continue their rapid advance.

On the same side of the argument, history tells us that the usual "muddle-through" scenario is often the best forecast. Unsustainable things won't continue. Most of the things we worry about won't happen. If we are tripped up, it will be because of something that no one forecast.

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