Economics Intelligence Cell

What Lies Ahead for Global Economy?

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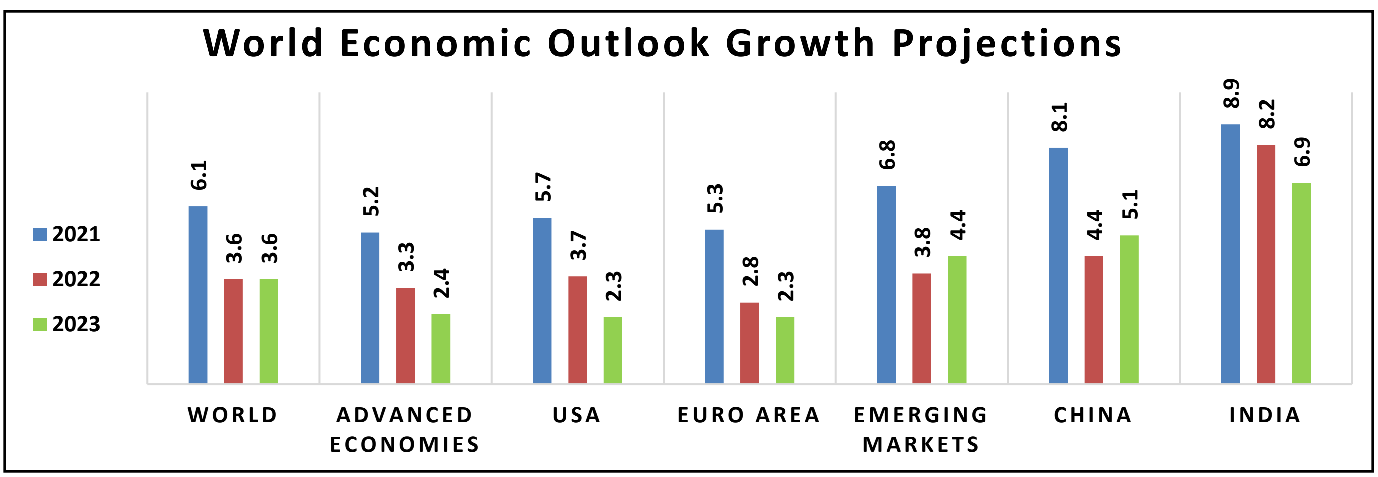
The above question has been reverberating across economies and markets given the current world economic order. Global growth is projected to slow from an estimated 6.1 percent in 2021 to 3.6 percent in 2022 and 2023 according to IMF's projections.

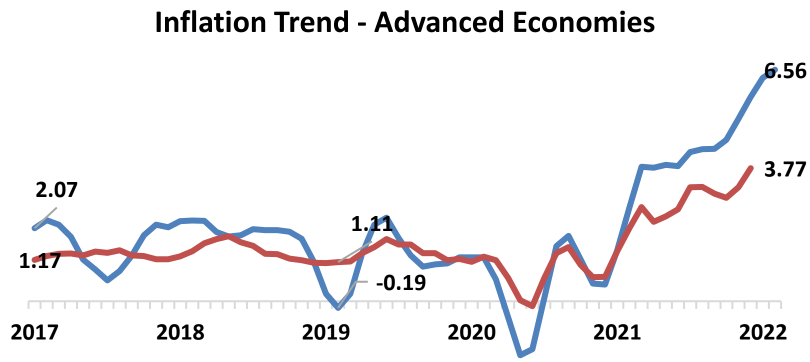
The world economy was gaining grounds after being battered by the pandemic when the Russia – Ukraine war broke out. The war has exposed the vulnerabilities built up in the economies during the pandemic.

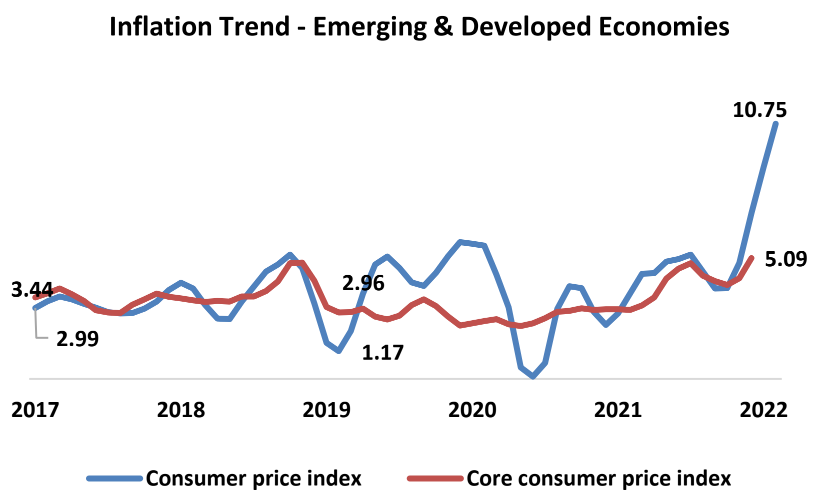
The Russia Ukraine war is not just a humanitarian crisis but is also threating the financial stability of countries round the globe. Due to the war, already ruptured supply chains are further stressed. Additionally, the Zero Covid strategy adopted in China – an export powerhouse, has strangled the global supply chains. Due to this, the prices of food, fuel and commodities across countries have skyrocketed.



These disruptions have added to persisting global inflation woes. US inflation accelerated to 8.5% in March’22, hitting four decade high. Inflation in Euro Zone surged to 7.5% in March, registering another record high. Retail inflation in India soared to an 8 year high at 7.79% in April. The rise in inflation is posing a dilemma for the central banks as they face tough choice ahead between supporting nascent growth and containing inflation. Central Banks are feared to be behind the curve and thus are expected to raise rates aggressively in the coming quarters.

Faster rate increases in response could rattle financial markets and tighten financial conditions globally. These developments could come with a slowing of US demand and trade and may lead to capital outflows and currency depreciation in emerging markets. Increase in the rates will also mean a jump in the debt servicing cost for developing nation’s right after they have borrowed billions of dollars to fight Covid-19. This will further fuel the capital flights. We can already witness these factors coming at play in economies like Sri Lanka, Egypt, Pakistan & Peru that are dealing with their worst economic crisis





The biggest default looming in emerging economies is in Russia, where Putin’s decision to invade Ukraine has brought sanctions, economic isolation, and a pledge to pay debts only in rubles — which would likely be ruled a breach of commitments, triggering losses for investors. Moreover, the pandemic is still existing and spread of virus could give birth to lethal variants, promoting lockdowns and production disruptions. The signs of stress building up can be seen in many economic and financial indicators. The US Treasury yield curve inverted for the first time since August 2019. It is considered as a signal upcoming economic recession in US by many economists. Credit-default swaps on developing-country debt has also spiked in the first weeks of the Ukraine war, showing a growing fear of default. The World Bank calculates 60% of low-income countries are in debt distress already, or at high risk of it. The line of countries in rescue talks with the IMF is lengthening every day.

On this backdrop the role of central banks is of paramount importance to tackle the inflationary pressures. It is also crucial that central banks in advanced economies provide clear guidance for the normalization process ahead so as to minimize the vulnerability for emerging economies. A concerted and cooperative actions at the national and international levels to prevent worse outcomes is the need of the hour improve economic prospects for all.

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