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Austerity, raising rates and the increasing risk of a global recession

The past few weeks have seen a tightening of the monetary policy stance of world central banks

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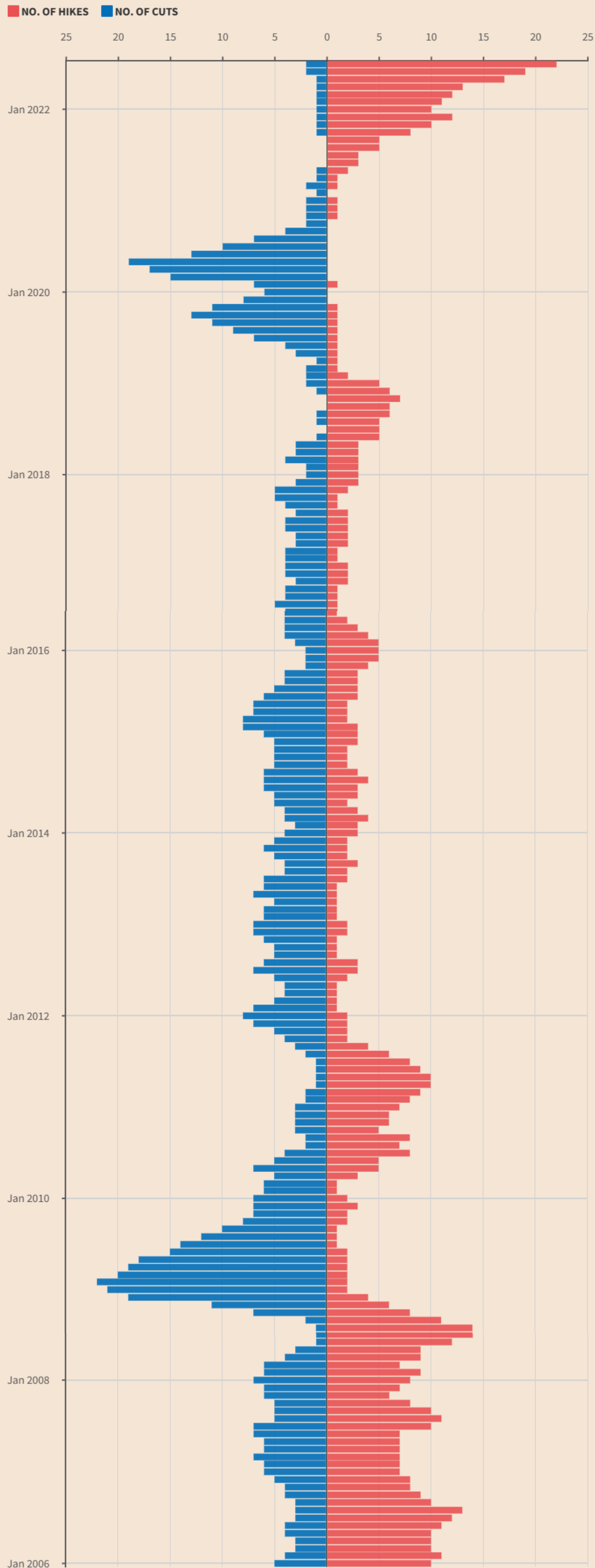
CENTRAL BANKS



The past few weeks have seen a tightening of the monetary policy stance of world central banks. Despite the prolonged decline in the price of oil and primary food goods, inflation continues to worsen in the core part (net of energy and food).
A few days ago, the Swedish Riksbank raised interest rates by as much as 100 basis points, while the Federal Reserve (FED) “limited” itself to an increase of 75 basis points for the third consecutive meeting. Both the European Central Bank (ECB) and those of the remaining OECD countries are following with a new round of substantial hikes.
Although only 15 months have passed since the start of this restrictive cycle, the intensity of central bank interventions globally is the highest ever recorded, with perfect synchrony between different geographical areas. Over 100 restrictive monetary policy measures have been launched since the beginning of 2022, an amount greater than the expansionary effort that followed the pandemic crisis of 2020 and comparable to the reaction that followed the financial crisis of 2008-2009.
Moreover, there is a synchronized trend towards a progressive fiscal tightening, with the elimination of emergency transfers to the private sector and a gradual increase in taxation. In 2023, OECD countries are expected to reduce their primary deficits to pre-pandemic levels (on average at 3% of GDP), after a temporary peak in 2020 at over 10% of GDP.
A specific indicator developed by the World Bank measures the restrictiveness of fiscal policies net of the economic cycle taking into account the changes in the structural balance; it is observed that in 2023 the restrictiveness index should reach its record value, never observed in 30 years. available in historical series.

The effects of this synergy between restrictive fiscal and monetary policies launched in a short period of time must be evaluated in view of a close interdependence between the macro-areas of the global economy. No country is immune to the negative effects of the restrictive policies of others, but it's hit by them in proportion to the opening of its economy to global trade.

The main transmission mechanism remains the exchange rate against the world reserve currency, the US dollar. Since energy goods are priced in dollars along with much of the volumes of goods traded on international markets, a strong dollar amplifies any inflationary shocks for the rest of the world.

Central banks of economies that have a significant trade in terms of import / export volumes with the US or that are heavily dependent on imports of energy products are de facto conditioned to follow the monetary policy of the Fed. In this way, the inflationary shock partially bounces back towards countries with which trading is intense.

In a context of rapid and coordinated interest rate increases such as the current one, the cumulative effect in terms of a slowdown in GDP, export volumes and employment may be greater than expected. According to World Bank estimates, a serious global crisis in the near future would delay by about 7 years the achievement of GDP levels that would have been reached already in 2024 (January 2020 estimates): a seven year loss.

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