

Study of the Global Economic Recession

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Abstract. Since 2020, the global economy and financial system have suffered the biggest demand and supply shock since the financial crisis in 2008 as the new pneumonia epidemic spread to almost all countries. Panic in international financial markets has been rising, and asset prices of stocks, bonds, currencies, commodities and other assets have fallen rapidly. This paper analyzes the impact of the epidemic on the global economic and financial system from different perspectives, including the supply chain, the Russia-Ukraine war, and the US interest rate hike. In this paper, we argue that since 2020, the "pandemic" of Newcastle pneumonia has caused a comprehensive impact on the manufacturing industry, service industry, public confidence, and social governance, and a liquidity crisis in the international financial markets. Whether the epidemic will evolve into a financial and economic crisis depends on the development of the epidemic and the effectiveness of preventive and control measures, on whether the epidemic will trigger corporate debt defaults and sovereign debt crises in some countries, and on whether a fall in oil prices or geopolitical conflicts will trigger financial and capital flow crises in emerging markets. Given the inevitable impact of the epidemic on the economic growth situation in various regions, the global economy is expected to fall into recession in the future.

Keywords: Economic Recession; Epidemic; Russia-Ukraine War; Interest Rate Hike.

1. Introduction

The world economy is suffering the biggest recession fears since the credit crunch. The IMF forecasts that global growth rate will slow from 6.1% last year to 3.2% in 2022(Pierre, 2022). The U.S. economy has recorded negative growth for two consecutive months, sounding the bell of a technical recession. Being worried about COVID-19 bringing more lockdown measures, together with the crisis in the real estate, China is also facing a gloomy outlook for economic growth. In this paper, I will analyze the reasons that may bring about the next global recession.

2. Supply Chain Disruption

The continuous epidemic has delayed the recovery of global supply chains. Take the auto industry as an example: Shanghai, a world-famous auto city, has been tested by the lockdown this spring. In 2021, China produced 26.528 million vehicles, among which Shanghai produced 2.833 million, accounting for 10.7 percent of the total (Mei, 2022). Take Tesla's Shanghai factory, which implements just-in-time strategy, as an example, the production capacity of the factory lost about 70,000 cars by May 1(Song, 2022). Hyundai shut down its assembly plants in South Korea, mainly due to shortages of parts from China. In the US, the price of used cars exceeded that of new cars due to the chip shortage last year (Suh, 2021). Similarly, due to the weak demand, global semiconductor sales have decreased every month since 2020, and the pace of recovery has slowed down (Young, 2022). According to the Novel Coronavirus Forecast on Global Semiconductor Market published by IDC, 6% percent decline in semiconductor sales can be explained by epidemic (IDC, 2022).

3. Russia- Ukraine War Pushes up Food and Energy Prices

The international community took sanctions against Russia's aggression. Meanwhile, the war affected the transportation of commodities, especially food and natural gas. Ukraine is unable to sell millions of tons of wheat and corn it had planned to export by June after Russia imposed a port blockade on the country, potentially costing it \$6 billion in food exports (Jagtap, 2022). Russia and

Ukraine were once the breadbaskets of the world. According to statistics from the Food and Agriculture Organization of the UN, the two countries exported 62.85 million tonnes of wheat, accounting for 32.5% of the total (Benton, 2022). The crisis in the global food supply chain has intensified under the combined impact of COVID-19 and the War.

The threat of an interruption of energy supply from Russia has triggered unprecedented price rises in fossil fuels: as of 6 April 2022, oil was \$108 per barrel, having been below \$80 per barrel at the turn of the year; 58 natural gas in Europe very briefly reached €345 per megawatt hour (MWh) in March, up from €100 per MWh; 59 and the Australian futures price of coal rose to \$435/tonne in the first half of March – its highest price ever, and triple the price at the start of the year (Bluszcz & Valente, 2022). (Electric price 200%) cite.

4. Stagflation Brings Rate Hike

Stagflation is characterized by sluggish growth accompanied by high inflation. Inflation rate hits 40-year high in many countries due to the supply shocks described above. The US and the UK reported CPI figures above or close to 9% in May 2022 (FRED, 2022).

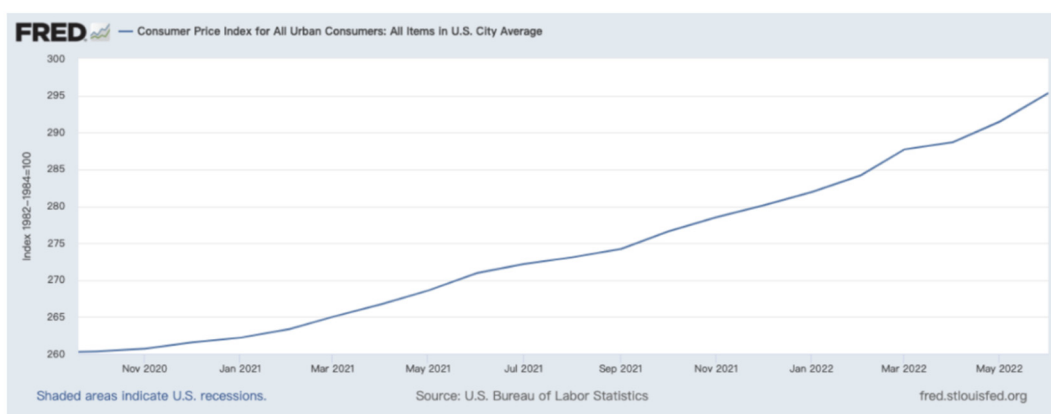


Fig 1. Consumer Price Index for All Urban Consumers: All Items in U.S. City Average

In order to curb stagflation, the Federal Reserve has once again entered the interest rate hike cycle - the Fed announced a 25BP increase in the target range for the federal funds rate to between 0.25% and 0.5% (the Fed's first-rate hike since December 2018). Higher interest rates will bring higher financing costs, which will inhibit consumption and investment. At the same time, higher interest rates will stimulate the willingness to save and hedge against excessive consumption. In addition, interest rates will affect hot money flows, and demand for financial assets represented by dollar bonds will surge. As a result, demand for dollars rose and the dollar appreciates. In doing so, the US can buy goods made in countries like China at lower prices to fend off domestic inflation (Poterba, 2000).



Fig 2. Market Yield on U.S. Treasury Securities at 10 Year Constant Maturity, Quoted on an Investment Basis

Nevertheless, if continued rate hike fails to reverse expected inflation, it could force the Fed to shrink its balance sheet (Ji, 2022). This could trigger a collapse in asset prices, such as the bursting of the US stock bubble. Considering one of the main stores of wealth for American households and even pension accounts is stock investment. The above logic would incur a decline in consumer and investment confidence, transforming inflation to a recession (Rehn, 2022). Powell: 'We're not trying to cause a recession and we don't think we'll need to cause a recession, but we do think it's absolutely necessary to bring inflation down'

Developed countries usually implement the low interest rate policy, the hot money tends to borrow money from them to invest into developing countries. with developed countries implement rate hike, the attraction of investment in EMDEs will become less. This could trigger a collapse in property and stock prices, leading EMDEs to raise interest rates to prevent capital outflows (Rebucci, 2022). However, this would further lead to a sharp contraction in aggregate demand in already fragile economies, leading to turmoil and recession. Emerging economies like China have to guard against the negative impact of the Fed's interest rate hike spillover effect on the economy (Ji, 2022).

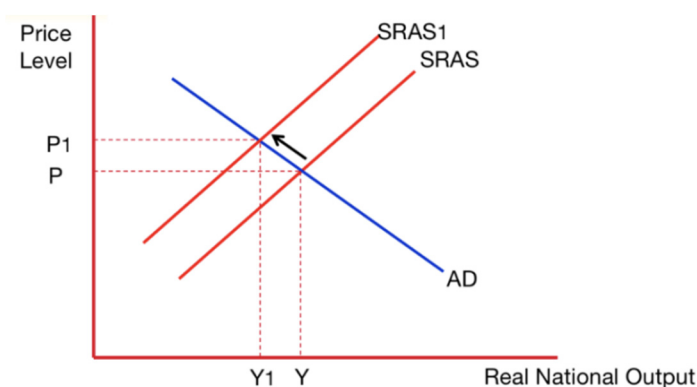


Fig 3. Real National Output

5. Conclusion

The ever-evolving virus, the War with no peace talks in sight, and surging prices have brought unprecedented fears of stagflation. A recession may be the price of fighting that. Global economies need to strengthen cooperation. Reversing the wage-price spiral based on inflation expectations theory is also a priority for central banks. We should be both well prepared and optimistic about the future. As confidence is more important than gold!

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