

Is There Light At the End of the Tunnel?

Vicky Pryce

The World Bank recently warned that the current, as they call it, 'synchronised', though not necessarily coordinated, raising of interest rates, however necessary in their view, is likely to lead to global recession. With core inflation now exceeding central bank targets worldwide, the OECD has issued downbeat forecasts for the developed nations in 2023 with the UK likely to show stagnation for the year overall, one of the worst performers in its table except for Russia which is likely to see declines both this year and next. The IMF in its forecast accompanying its annual meeting in Washington this week now expects a drop in German and Italian GDP in 2023, both much affected by the cutting of Russian energy supplies. The UK's growth rate for next year was downgraded to 0.3%.

If that proves correct some of the earlier progress in making up for the damage done by Covid may get undone. The US has been among the strongest performers so far as, despite two quarters of negative GDP growth in the first half of 2022, output by the middle of the year was nevertheless some 3.5% above pre-Covid levels. But the Eurozone was just 1.8% up and the UK was still 0.2% below pre-pandemic levels. And the outlook generally seems to have worsened since. The global PMI has been in stagnation or contraction territory in the summer months and economic sentiment has been in decline almost universally. Higher interest rates are having an effect in restraining demand and cost of living issues and higher input costs are threatening consumer confidence. The World Trade Organisation now expects global merchandise trade to grow by only 1% next year, a further blow to globalisation. And the war in Ukraine continues to cast its shadow.

As clouds are gathering, is there any light at the end of the tunnel? Difficult to envisage as the conflict with Russia continues. Nevertheless there are some hopeful signs. Europe though threatened with electricity supply outages and possible energy rationing has managed to a) greatly reduce energy consumption and b) fill gas storage facilities ahead of schedule. Cooperating between countries in assisting with regional supply shortages is increasing with France for example now beginning to export gas to Germany to make up for its shortfalls as supply from Russia has fallen to a trickle.

But on the positive side gas prices in Europe have halved in the past month. The UK National Grid, which has warned of possible outages in the UK this winter appears to have done a deal with France to ensure the electricity interconnection between the two countries does its job. Oil prices have remained below \$100 a barrel despite OPEC+ decision to reduce production by 2m barrels a day.

Supply chain issues have also been easing markedly and freight rates have halved from their previous heights. Even international food prices have been on a decline though that is not reflected yet in prices in shops as much of the earlier increase has still to be passed on. Inflation is forecast to move down towards target levels within the next two years and possibly by then interest rates should be in retreat.

But two years may be too long a time both in politics and economics. Individual country attempts to soften the blow through subsidies or price freezes and with further stimulus packages are being penalised by the markets. Witness the UK and the sovereign debt downgrade that followed the unfunded tax cuts announced on September 23, even with the now reversed abolition of the 45p higher rate of income tax. More U-turns may follow. And Germany is in trouble with its less well-

endowed neighbours for its own €200b energy subsidy package for German households and businesses.

So how will it all end. Even if one were to imagine a good resolution in Ukraine, there is no doubt that the international institutions will be dealing with heavily indebted states, firms and consumers for some time to come. Untangling all while also avoiding a debt- induced recession will be the next challenge. UK policymakers take note..

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