Elston

Elston Insights

8th July 2022

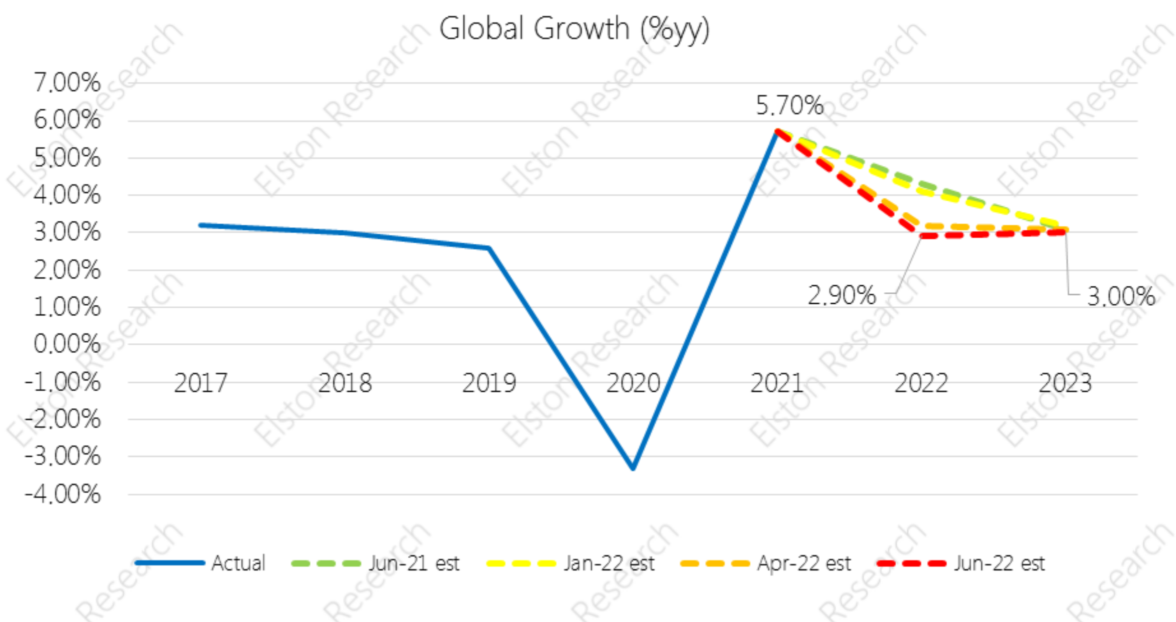
The Risk to Growth

- Growth slowdown prompts stagflation fears
- Tightening monetary regime could trigger global recession
- Developing economies are set to be the hardest hit

A perfect storm of events is giving rise to the gloomiest global economic outlook since the 1970s. Supply chain disruption brought about by the Covid-19 pandemic has collided with a spiral in energy and commodity prices triggered by the Ukraine war, unleashing a bout of persistently high inflation. Central banks have been slow to react, sticking to their line that the inflation was transitory, meaning that they are now faced with the finest of tightropes to walk between curbing inflation and triggering recession.

The World Bank has been steadily revising down its 2022 global growth estimates over the last 12 months. From +4.3%yy in June 2021, to +3.20% in April 2022 to +2.90% in June 2022.

Fig.1. World Bank Global Growth downgrades

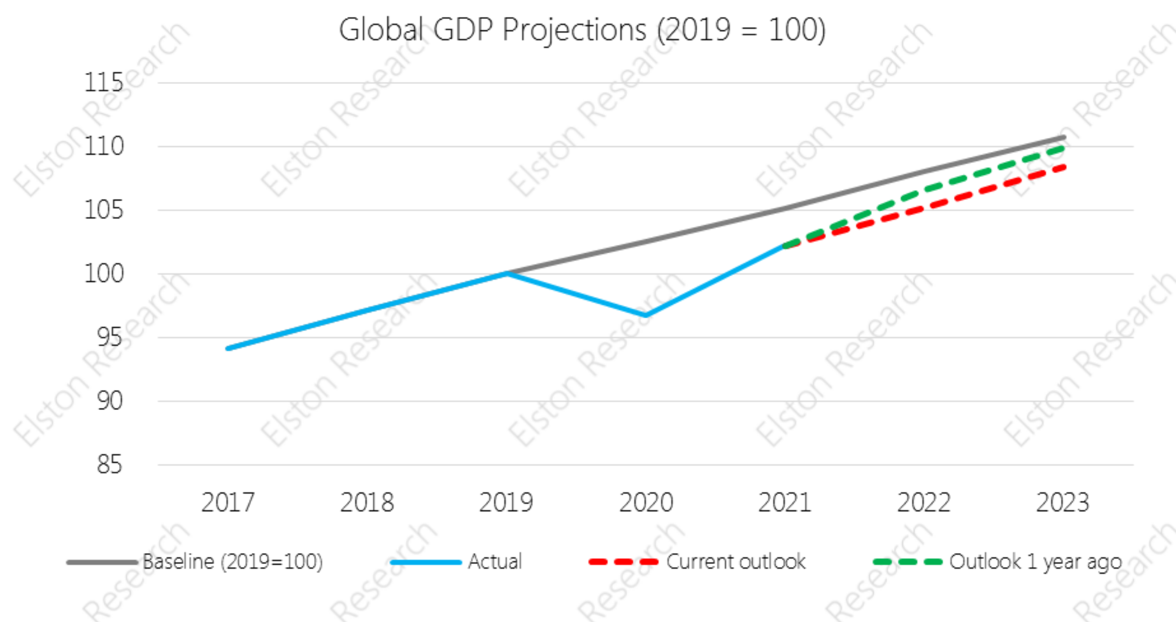


Source: Elston research, World Bank data

No longer playing catch up

The downgrade means that instead of the wolrd economy "catching up" with pre-COVID trajectory, following the restart, it will now fall short.

Fig.2. Global growth trajectories using revised forecasts



Source: Elston research, World Bank data

End of the cheap money era

From the aftermath of the financial crisis to the start of 2022, monetary policy has been extremely accommodative, with a prolonged period of low or negative interest rates and large-scale asset purchase programmes. Bringing an end to this regime - a necessary move to curb inflation – and thereby removing cheap debt and the various artificial props that have sustained markets for so long, will have a severe impact on growth.

Rising interest rates: who does it hurt the most?

The interest hikes that were necessary in the 1970s and that are being implemented now in Europe and the US will have the greatest impact on countries burdened by debt, mostly emerging market and developing economies. For them, growth is expected to fall from 6.6% in 2021 to 3.4% in 2022. The World Bank estimates that for 2023, real income per capita will remain below pre-Covid levels in approximately 40% of developing economies.

Key contrasts with the 1970s

It is tempting to see the current situation as a re-run of the inflationary period in the 1970s, but there are some key differences. In the wake of the financial crisis, financial institutions were obliged to recapitalise with the result that their balance sheets today are generally quite robust. In addition to this, and very much unlike in the 1970s, the US dollar is strong. Commodity prices have also jumped by less than they did five decades earlier. Most significantly, and as highlighted by

Professor Patrick Minford in our interview with him earlier in the year, central banks are now a very different breed. Price stability is a clear mandate and they can point to a long and credible track record of achieving their inflation targets.

Energy squeeze

Nonetheless, what the 1970s didn't have was a war involving Russia and the resulting effect on energy prices. Between supply controls on the Russian side and sanctions imposed by external trading partners, there has been a surge in energy prices, the effect of which will be lower real incomes, higher production costs for manufacturers and pressure on macroeconomic policymaking for net energy importers. In this respect Natural Gas in the 2020s is playing the role of Oil in the 1970s in this new cold war.

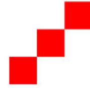
What could change

There are of course factors that can change, thereby shifting the current landscape. The most significant would be de-escalation of the Russian offensive in Ukraine which would in turn ease the pressure on energy and commodity prices that has contributed to the rise in inflation globally. Alternatively one can hope for a carefully balanced war of attrition, whereby policy makers and central bankers avoid too many mis-steps on the road to bringing inflation under control while managing spending in such as way as to minimise a steep drop-off in growth. For the time-being, investors should be positioned defensively and remain braced for volatility.

Henry Cobbe, CFA and Marina Gardiner

Elston Consulting

Elston



Find out more

For more insights and information on research, portfolios and indices, visit:

www.elstonsolutions.co.uk or NH ETF<Go>

www.elstonsolutions.co.uk

ABOUT ELSTON

We research, design and build investment solutions with and for asset owners, managers and advisers.

Our Research & CPD focuses on multi-asset strategies, index funds and ETFs.

NOTICES

With reference to the European Union Directive 2014/65/EU on markets in financial instruments ("MiFID II"): this Report does not provide a recommendation for an action, provides information freely available for public consumption and does not therefore constitute "Research" as defined by MiFID II. This is because this report contains purely factual information on one or several financial instruments or issuers and does not explicitly or implicitly recommend or suggest an investment strategy. It does not therefore constitute an investment recommendation as defined within the meaning of Article 3(1)(35) of EU Markets Abuse Regulation ("MAR"), in conjunction with Article 3(1)(34) of MAR. For further information, please refer to ESMA guidance ESMA70-145-111 Version 12.

With reference to the European Union's Market Abuse Regulation (Regulation (EU) 596/2014): we warrant that the information in this report is presented objectively, and the following commercial interests are hereby disclosed: Elston Consulting Limited creates research portfolios and administers indices that may or may not be referenced in this report. If referenced, this is clearly designated and is to raise awareness and provide purely factual information as regards these portfolios and/or indices.

An "Index" is a Regulated Benchmark. An "Index Portfolio" is not a regulated benchmark but a research portfolio of index-tracking investments with a periodic rebalancing scheme.

All company, product and service names and trademarks used in this article are for identification purposes only and are the property of their respective owners, and their usage does not imply endorsement.

This document is not an advertisement or financial promotion. It is provided for informational purposes only and is not intended to be an offer or solicitation, or the basis for any contract to purchase or sell any security or other instrument, or for Elston Consulting Limited to enter into or arrange any type of transaction as a consequence of any information contained herein.

This document is issued by Elston Consulting Limited registered in England & Wales, registration number 07125478, registered office: 1 King William Street, London EC4N 7AF.

© Elston Consulting Limited. All rights reserved No unauthorised reproduction.