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Aggressive and Unconventional Monetary Policy– Recessionary Trend in the Global Economy: Way Forward

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Aggressive and Unconventional Monetary Policy– Recessionary Trend in the Global Economy: Way Forward

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1. Introduction:

The question of recession in advanced countries basically arises from the Aggressive and Unconventional Monetary Policy (AUMP) that was pursued by the U.S, U.K., and Euro area. In fact, if the analysis of the AUMP is done in an unbiased manner, then it is obvious that the recent swiftness by most advanced economies (AEs), especially the US, in raising interest rates was not justified. In because of the rise in interest rates in most AEs, the sacrifice ratio (SR) in these countries accounting for nearly half of global GDP, would not only reflect in the recessionary tendencies in major economies of the world but across the planet. The AEs can bear the brunt of SR, but the spill-overs that would happen in emerging economies (EMEs) would be very detrimental to their growth and global recovery. In a flattened world, where EMEs and AEs are significantly integrated not only through trade but also through capital flows as well as confidence channels, such initiatives and spread of recessionary fears can further perpetuate and even aggravate the slow-down.

2. Why the Recession:

In the analysis of the recession, it is important to go back to the sub-prime era of 2005. Consequent to the sub-prime crisis, and the bankruptcy of Lehman Brothers in September, 2008, most of the central banks in AEs, especially the U.S., U.K. and the Euro area, expanded their balance sheets substantially. In some cases, the expansion was four times in less than five years. Consequently, if times were normal, it would have resulted in inflation within two years, given the transmission lag, but because the economic conditions were not normal and most of the countries were operating at the liquidity trap, the money was absorbed dormantly in the system and not result in inflation. The world economy even after a decade of collapse of Lehman Brothers was still recovering because the shock of 2008 was very severe when a new shock, once-in-a-century, in form of a pandemic of Covid - 2020 happened. The

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pandemic brought the whole world to shut-down for many weeks and to a certain slow-down in that year. There was asymmetry in the economy in terms of individual payments, government unemployment benefits and payments to support demand but there were few outlets available for spending. Thus, there was pent up demand in many cases as liquidity was constantly pumped in the economy through salaries or unemployment allowances, whereby many individuals/households were richly compensated though some suffered too. There was enough liquidity in the system and more, and the balance sheets of many central banks once again doubled, especially in the U.S. As economic theory would suggest, following the quantity equation of money, increased money supply would eventually lead to high inflation. The inflating situation, accentuated by pent-up demand, by 2022 was waiting to erupt. In February 2022, conflict of Russia-Ukraine erupted strongly impacting global trade. These two countries, though not very large in terms of GDP, play a significant role in certain commodities like wheat, fertilisers, rare metals and chemicals. As world trade got disrupted and the accumulated effect of the dislocated global value chain because of Covid, inflation erupted in a volcanic style. In general, in the AEs, if a 30 years average is considered, inflation would range less than 2 percent. In 2022, inflation rose to about 9 percent in most of the AEs. The oil prices also rose, and with Russia facing the consequences of sanctions by U.S, oil prices further hardened. In this case, (with hind-sight) U.S did a self-goal by imposing sanctions on Russia. It is interesting to note the observation by the IMF in recent WEO (April 2023) that Russia has boldly faced the impact of sanctions and has been more resilient than many other countries in the post-Covid era.[3]

With the rise in inflation, the aggressiveness of the interest rate hikes led the central banks of AEs, it was obvious that recession would set in and that to tame inflation, growth would be sacrificed (Tables 1 and 2). The sacrifice of growth implies high and increasing unemployment in the current and the forthcoming years which is reflected in data (Table 3). In most advanced countries of the world, unemployment will not come down to the natural rate of unemployment in the next 3-4 years (Table 3). The implication of rising unemployment, is two-fold. On one hand, output in AEs will slow-down, and consequently, there will be capital flow to EMEs. The EMEs may not need this capital inflow and, therefore, this capital may simply bloat the stock exchange index and not convert into investment on the ground. It is for this very reason that the growth projections by the IMF in the next few years are not showing an upward

[33] India had faced the US sanctions after Pokhran, successfully under the leadership of PM A B Vajpayee.

growth trajectory for many years. The fiscal space is constrained (Table 4) and world trade will continue to suffer from uncertainty (Table 5).

In the case of Silicon Valley Bank (SVB) it became apparent very soon that the regulator and the supervisor failed to understand the risk that the bank was exposed to due to rising interest rates. The SVB also threatened the stability of a broader range of banks and therefore was a concern for the financial sector stability in the U.S. In the case of Signature Bank there was a different type of exposure which was not on the radar of the regulator. The Signature Bank has exposed itself to crypto deposits and that was the reason it went into trouble. It had nearly USD 110 billion in assets at the end of 2021-22 and 90 percent of Signature Bank's USD 88.6 billion in deposits were uninsured. First Republic Bank, a regional bank supported by wealthy clients suffered because institutions like SVB and Signature Bank collapse. Credit Suisse is another classic example. The financial performance of Credit Suisse was not good in the previous year and in view of the difficulties in the current financial sector, the next year was also projected to be bad in view of rising interest rates. There can be various reasons about the banks coming under stress, but one thing that is common is that the monetary policy that the Federal Reserve pursued and the regulatory and the supervisory mechanism of the Federal Reserve is under question. The aggressive rate hike, therefore, needs to be examined in view of the financial instability that such a step has caused in the U.S economy.

Another aspect of aggressive policy stances combined with repeated bad policy measures starting from the sub-prime crisis have caused erosion in the credibility of the US policy makers. Consequently, this is reflected in de-dollarisation

3. Way Forward:

What is the solution to this? The solutions are not simple in a complex world. There is a need for a pragmatic approach on a sustainable and long-term basis in the AEs as they account for a major portion of world GDP. The problem is deep rooted. Illustratively, the subprime market should have been regulated more rigorously. After the collapse of Lehman Brothers, the liquidity management should have been more careful, focused, limited and accountable. The balance sheets of central banks in most AEs should not have expanded four times over, when compared with the pre-Lehman situation. Similarly, during the recent Covid, the fiscal and monetary policy should have been more responsible and not as liberal, as if a beauty-contest is in progress amongst nations. The financial support should have been more focused, and not leading to the increase in general liquidity supply in the economy. In the Russia-Ukraine war, the central banks should have thought through and looked at it as basically a supply side disruption and not to be addressed by a blunted instrument, interest rate. In the context of disrupted global value chain, interest rates should not have been used as aggressively.

The moderation in the rise in interest rates in recent months is expected to enhance growth green-shoots in the AEs. The performance of the AEs has a direct relationship with the EMEs. If the AEs are slowing down, the exports from the EMEs suffer immediately. That has an implication for the growth trend in EMEs too. The positive impulses in AEs can enhance growth in EMEs too.

In view of the complexity of the situation, the multilateral institutions like the IMF and the World Bank will have to play a more effective role in bringing the monetary and fiscal authorities together and ensuring that these policies are undertaken with greater sense of responsibility and accountability, not only for the benefit of local residents, but beyond the geographical boundaries, to those countries which have substantial trade relations. This is the only way that one will be able to break the trend of global recession. While inflation is projected to continue to be higher than 2 percent of the normal average of AEs, oil prices are declining and therefore, there is a possibility that inflation may further moderate than expected. Once inflation is moderated, growth is expected to resume its old trajectory. To do so, 18-20 months, given the transmission lag, would be necessary to build that confidence and credibility of the expected new initiative that has been undertaken by the multilateral institutions as well as the central banks.

4. Conclusion:

The recessionary trend that the world is expecting is mainly a cause of monetary and fiscal policies that have not been discussed and do not have strong theoretical basis. The world has faced unprecedented challenges in the last two decades. Consequently, many advanced countries have pursued policies which have not been tested empirically or derived theoretically. The sub-prime crisis and the light touch regulation at that period was, probably, not appropriate. The expansionary unconventional monetary policies also were not appropriate. Therefore, it is important for economic professionals and public policy makers to carefully analyse and look at long-term implications of any new policy initiatives. As in Medicine each new product has to undergo testing for various years and on different animals before human trials. Similarly, in the case of policymaking, the Government, central bankers and also policy makers should consider the medium and long-term implications of any policy initiative.

Since the last two decades, it has emerged that the new policies implemented have been detrimental to the fast integrating global economy. The advanced countries have a responsibility towards the emerging market economies. The spillovers that occur because of adventurous policies become extremely costly for the emerging countries. The role of Multilateral Institutions becomes very important in the new international economic order. Therefore, the International Monetary Fund has to increasingly play a role in both monetary and fiscal policies of the world. The financial sector developments need to be anchored by the Bank for International Settlements. The resultant poverty levels because of Covid and increasing cases of income inequalities, should be addressed by the World Bank. The regional Multilateral Institutions in Asia and Africa have also a role to play. In the globalised world, isolated policies by advanced or emerging market economies would only lead to spillovers, contagion as well as reducing global welfare. Finally, the role of the national governments obviously gets compromised, but overall, coordinated policies enhance globally.

Table 1: Actual and Projected Growth Rates

Year	2017	2018	2019	2020	2021	2022	2023 (P)	2024 (P)	2025 (P)	2026 (P)	2027 (P)	2028 (P)
World	3.8	3.6	2.8	-2.8	6.3	3.4	2.8	3	3.2	3.2	3.1	3
AEs	2.5	2.3	1.7	-4.2	5.4	2.7	1.3	1.4	1.8	1.9	1.8	1.8
United States	2.2	2.9	2.3	-2.8	5.9	2.1	1.6	1.1	1.8	2.1	2.1	2.1
Canada	3	2.8	1.9	-5.1	5	3.4	1.5	1.5	2.2	1.9	1.7	1.7
EuroArea	2.6	1.8	1.6	-6.1	5.4	3.5	0.8	1.4	1.9	1.7	1.5	1.4
Germany	2.7	1	1.1	-3.7	2.6	1.8	-0.1	1.1	2	1.8	1.2	1.1
France	2.4	1.8	1.9	-7.9	6.8	2.6	0.7	1.3	1.9	1.8	1.6	1.5
United Kingdom	2.4	1.7	1.6	-11	7.6	4	-0.3	1	2.2	2	1.8	1.5
Austria	2.3	2.4	1.5	-6.5	4.6	5	0.4	1.1	1.8	1.7	1.7	1.5
Portugal	3.5	2.8	2.7	-8.3	5.5	6.7	1	1.7	2.2	1.9	1.9	1.9
Norway	2.5	0.8	1.1	-1.3	3.9	3.3	2.1	2.5	1.8	1.5	1.3	1.4
United Arab Emirates	0.7	1.3	1.1	-5	3.9	7.4	3.5	3.9	4	4.2	4.3	4.3
Australia	2.4	2.8	1.9	-1.8	5.2	3.7	1.6	1.7	2.1	2.2	2.3	2.3
EMEs	4.7	4.7	3.6	-1.8	6.9	4	3.9	4.2	4	4	3.9	3.9
Brazil	1.3	1.8	1.2	-3.3	5	2.9	0.9	1.5	1.9	2	2	2
Russia	1.8	2.8	2.2	-2.7	5.6	-2.1	0.7	1.3	1	0.8	0.8	0.7
India	**6.8**	**6.5**	**3.9**	**-5.8**	**9.1**	**6.8**	**5.9**	**6.3**	**6.2**	**6.1**	**6**	**6**
China	6.9	6.8	6	2.2	8.5	3	5.2	4.5	4.1	4	3.6	3.4
South Africa	1.2	1.5	0.3	-6.3	4.9	2	0.1	1.8	1.6	1.4	1.4	1.4

Source: World Economic Outlook, 2023

Observations on the Table:

The growth rates in the world economy, both advanced and emerging, are taking time to reach the pre-Covid levels. The Russian economy will continue to suffer the most amongst EMEs. Amongst the AEs, as per the projections the USA has the largest set back. In 2023 growth rates in Germany, UK has suffered significantly.

Table 2: Actual and Projected Inflation Rates

Year	2017	2018	2019	2020	2021	2022	2023 (P)	2024 (P)	2025 (P)	2026 (P)	2027 (P)	2028 (P)
World	3.2	3.6	3.5	3.2	4.7	8.7	7.0	4.9	3.9	3.6	3.5	3.5
AEs	1.7	2.0	1.4	0.7	3.1	7.3	4.7	2.6	2.1	1.9	1.9	1.9
United States	2.1	2.4	1.8	1.3	4.7	8.0	4.5	2.3	2.1	2.0	2.0	2.1
Canada	1.6	2.3	1.9	0.7	3.4	6.8	3.9	2.4	1.9	1.9	1.9	2.0
EuroArea	1.5	1.8	1.2	0.3	2.6	8.4	5.3	2.9	2.2	2.0	1.9	1.9
Germany	1.7	1.9	1.4	0.4	3.2	8.7	6.2	3.1	2.3	2.1	2.0	2.0
France	1.2	2.1	1.3	0.5	2.1	5.9	5.0	2.5	2.1	1.7	1.6	1.6
United Kingdom	2.7	2.5	1.8	0.9	2.6	9.1	6.8	3.0	1.8	2.0	2.0	2.0
Austria	2.2	2.1	1.5	1.4	2.8	8.6	8.2	3.0	2.2	2.0	2.0	2.0
Portugal	1.6	1.2	0.3	-0.1	0.9	8.1	5.7	3.1	2.5	2.2	2.0	2.0
Norway	1.9	2.8	2.2	1.3	3.5	5.8	4.9	2.8	2.6	2.0	2.0	2.0
United Arab Emirates	2.0	3.1	-1.9	-2.1	-0.1	4.8	3.4	2.0	2.0	2.0	2.0	2.0
Australia	2.0	1.9	1.6	0.9	2.8	6.6	5.3	3.2	3.0	2.7	2.7	2.6
EMEs	4.5	4.9	5.1	5.2	5.9	9.8	8.6	6.5	5.2	4.7	4.6	4.4
Brazil	3.4	3.7	3.7	3.2	8.3	9.3	5.0	4.8	3.0	3.0	3.0	3.0
Russia	3.7	2.9	4.5	3.4	6.7	13.8	7.0	4.6	4.0	4.0	4.0	4.0
India	**3.6**	**3.4**	**4.8**	**6.2**	**5.5**	**6.7**	**4.9**	**4.4**	**4.1**	**4.1**	**4.0**	**4.0**
China	1.5	1.9	2.9	2.5	0.9	1.9	2.0	2.2	2.2	2.2	2.2	2.2
South Africa	5.3	4.6	4.1	3.3	4.6	6.9	5.8	4.8	4.5	4.5	4.5	4.5

Source: World Economic Outlook, 2023

Observations on the Table:

Inflation in advanced countries is much above their long-term average specially in the US, Canada, UK, Germany, Austria and France. The projected trajectory of corrections that there will be heightened inflation in these countries in 2023 which may spillover in 2024. The inflationary trends in the EMEs is far more moderated, relatively.

Table 3: Actual and Projected Unemployment Rates

Year	2017	2018	2019	2020	2021	2022	2023 (P)	2024 (P)	2025 (P)	2026 (P)	2027 (P)	2028 (P)
AEs	5.7	5.1	4.8	6.6	5.6	4.5	4.7	5.0	4.9	4.7	4.7	4.6
United States	4.4	3.9	3.7	8.1	5.4	3.6	3.8	4.9	4.8	4.3	4.1	4.1
Canada	6.4	5.9	5.7	9.7	7.5	5.3	5.8	6.2	6.1	6.0	6.0	6.0
EuroArea	9.1	8.2	7.6	8.0	7.8	6.8	6.8	6.8	6.6	6.6	6.5	6.5
Germany	3.6	3.2	3.0	3.6	3.6	3.1	3.3	3.3	3.1	3.1	3.0	3.0
France	9.4	9.0	8.4	8.0	7.9	7.3	7.4	7.3	6.9	6.8	6.7	6.7
United Kingdom	4.4	4.1	3.8	4.6	4.5	3.7	4.2	4.7	4.4	4.2	4.2	4.2
Austria	5.9	5.2	4.8	5.5	6.2	4.8	5.3	5.6	5.4	5.3	5.2	5.2
Portugal	9.2	7.2	6.7	7.1	6.6	6.0	6.6	6.5	6.3	6.2	6.2	6.2
Norway	4.2	3.9	3.7	4.6	4.4	3.3	3.5	3.7	3.6	3.6	3.6	3.6
Australia	5.6	5.3	5.2	6.5	5.1	3.7	4.0	4.1	4.5	4.5	4.7	4.6
EMEs												
Brazil	11.9	11.7	11.1	14.2	11.1	7.9	8.2	8.1	8.1	8.1	8.1	8.1
Russia	5.2	4.8	4.6	5.8	4.8	3.9	3.6	4.3	4.5	4.6	4.7	4.7
China	3.9	3.8	3.6	4.2	4.0	4.2	4.1	3.9	3.8	3.7	3.6	3.5
South Africa	27.5	27.1	28.7	29.2	34.3	33.5	34.7	34.7	34.8	35.1	35.4	35.7

Source: World Economic Outlook, 2023

Observations on the Table:

The unemployment rate reveals a grim situation in the AEs. The projections reveal that for the next five years in most of AEs unemployment rate will be higher than the natural rate of Unemployment. This does not augur well for global growth and welfare.

Table 4: Actual and Projected Gross Government Debt as a percent of GDP

Year	2017	2018	2019	2020	2021	2022	2023 (P)	2024 (P)	2025 (P)	2026 (P)	2027 (P)	202 (P
AEs	103.4	102.9	104.0	122.9	117.4	112.5	112.4	113.6	115.0	115.9	116.7	117.
United States	106.2	107.4	108.7	133.5	126.4	121.7	122.2	125.8	129.1	131.8	134.0	136.
Canada	90.9	90.8	90.2	118.9	115.1	106.6	105.1	102.2	99.2	96.2	93.6	91.
EuroArea	87.6	85.6	83.5	96.6	94.9	90.9	89.8	89.0	87.9	86.9	86.2	85.
Germany	64.6	61.3	58.9	68.0	68.6	66.5	67.2	66.5	64.4	62.3	60.9	59.
France	98.1	97.8	97.4	114.7	112.6	111.1	111.4	112.4	112.8	113.3	114.2	115.
United Kingdom	85.6	85.2	84.5	105.6	108.1	102.6	106.2	109.7	112.8	112.7	113.0	113.
Austria	78.6	74.1	70.6	82.9	82.3	77.8	74.9	72.6	71.4	70.1	68.7	67.
Portugal	126.1	121.5	116.6	134.9	125.4	116.0	112.4	108.6	105.2	102.2	99.3	96.
Norway	38.3	39.4	40.6	46.1	42.7	39.6	38.8	38.5	38.0	37.5	37.0	37.
United Arab Emirates	21.9	21.3	26.8	41.1	35.9	30.0	30.5	29.4	28.3	27.2	26.2	25.
Australia	41.2	41.8	46.7	57.1	57.6	55.7	59.4	62.4	62.9	62.8	62.6	62.
EMEs	51.4	52.7	55.1	64.8	64.3	64.6	67.5	69.8	72.2	74.3	76.3	78.
Brazil	83.6	85.6	87.9	96.8	90.7	85.9	88.4	91.5	93.7	95.2	96.0	96.
Russia	14.3	13.6	13.7	19.2	16.5	19.6	24.9	25.3	25.3	24.3	23.2	21.
India	**69.7**	**70.4**	**75.0**	**88.5**	**84.7**	**83.1**	**83.2**	**83.7**	**83.8**	**83.8**	**83.7**	**83.**
China	55.0	56.7	60.4	70.1	71.8	77.1	82.4	87.2	92.0	96.5	100.8	104.
South Africa	48.6	51.7	56.2	69.0	69.0	71.0	72.3	74.0	77.1	80.0	82.4	84.

Source: World Economic Outlook, 2023

Observations on the Table:

The debt obligations of almost major countries, generally AEs, have increased after the GFC of 2008 and the pandemic of 2020.

Table 5: Actual and Projected Current Account Balance as a percentage to GDP

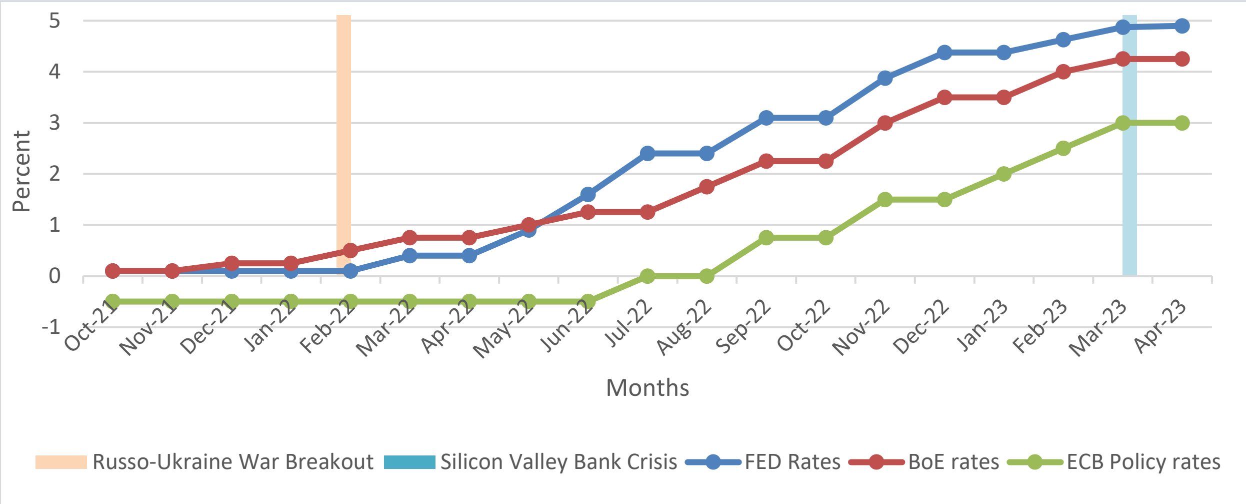
Year	2017	2018	2019	2020	2021	2022	2023 (P)	2024 (P)	2025 (P)	2026 (P)	2027 (P)	2028 (P)
AEs	1.0	0.7	0.7	0.2	0.8	-0.5	0.0	0.3	0.4	0.5	0.4	0.4
United States	-1.9	-2.1	-2.1	-2.9	-3.6	-3.6	-2.7	-2.5	-2.4	-2.3	-2.3	-2.3
Canada	-2.8	-2.4	-2.0	-2.2	-0.3	-0.4	-1.1	-1.1	-1.3	-1.6	-1.8	-2.3
EuroArea	3.1	2.8	2.2	1.6	2.3	-0.7	0.6	0.9	1.3	1.5	1.7	1.7
Germany	7.8	8.0	8.2	7.1	7.7	4.2	4.7	5.1	5.8	6.1	6.0	5.8
France	-0.8	-0.8	0.5	-1.8	0.4	-1.7	-1.2	-0.7	-0.6	-0.6	-0.5	-0.3
United Kingdom	-3.6	-4.1	-2.8	-3.2	-1.5	-5.6	-5.2	-4.4	-3.8	-3.7	-3.6	-3.5
Austria	1.4	0.9	2.4	3.0	0.4	0.3	1.2	0.6	1.0	0.5	0.4	0.3
Portugal	1.3	0.6	0.4	-1.0	-0.8	-1.3	-0.8	-0.7	-0.4	-0.2	-0.1	0.0
Norway	6.3	9.0	3.8	1.1	13.6	30.4	25.4	23.2	21.1	18.7	16.7	14.7
United Arab Emirates	7.0	9.7	8.9	6.0	11.6	11.7	7.1	7.0	6.8	6.7	6.5	6.5
Australia	-2.6	-2.2	0.4	2.2	3.0	1.2	1.4	0.2	-0.2	-0.3	-0.4	-0.4
EMEs	-0.1	-0.2	0.0	0.5	0.8	1.4	0.3	0.0	-0.1	-0.2	-0.3	-0.4
Brazil	-1.2	-2.9	-3.6	-1.9	-2.8	-2.9	-2.7	-2.7	-2.6	-2.6	-2.5	-2.4
Russia	2.0	7.0	3.9	2.4	6.7	10.3	3.6	3.2	2.9	3.0	2.5	2.2
India	**-1.8**	**-2.1**	**-0.9**	**0.9**	**-1.2**	**-2.6**	**-2.2**	**-2.2**	**-2.2**	**-2.4**	**-2.4**	**-2.5**
China	1.5	0.2	0.7	1.7	1.8	2.3	1.4	1.1	0.9	0.7	0.5	0.4
South Africa	-2.4	-2.9	-2.6	2.0	3.7	-0.5	-2.3	-2.6	-2.3	-2.2	-2.1	-2.0

Source: World Economic Outlook, 2023

Observations on the Table:

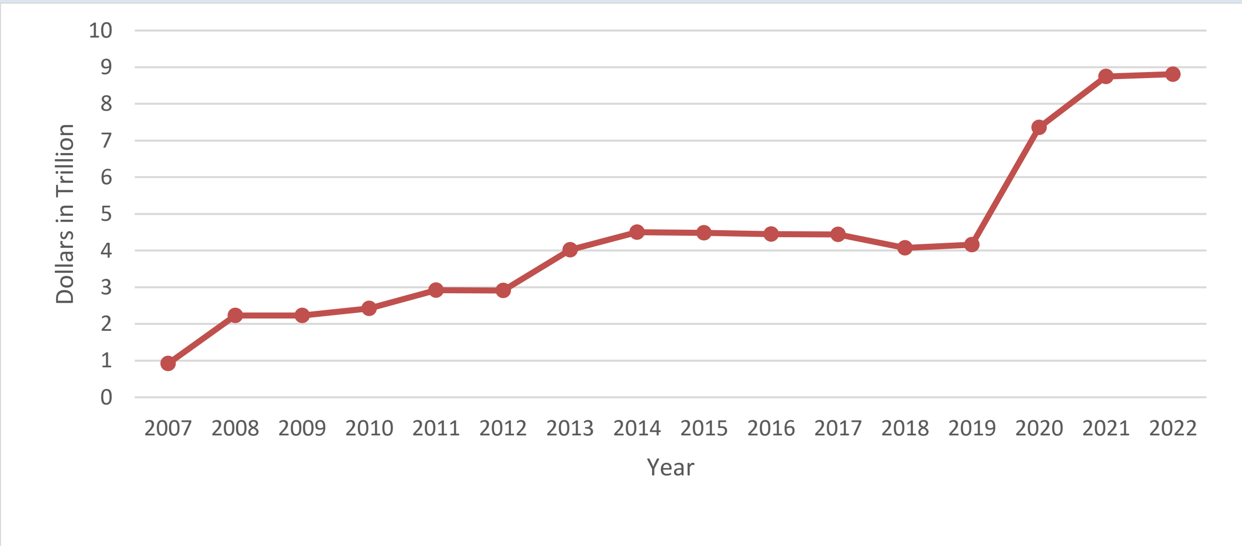
The current account balance reflects the uncertainties in the global markets with the deficits becoming deeper and surpluses becoming less during the GFC in 2008 as well as the pandemic in 2020.

Chart 1: Policy Rates of Central Bank



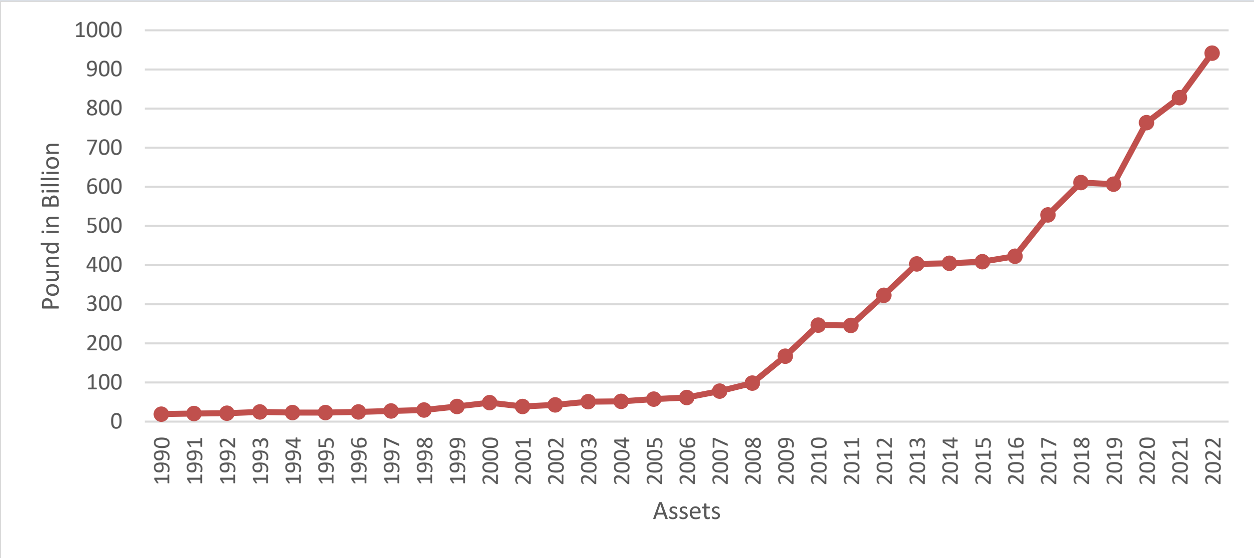
Source: Federal Reserves, BoE and ECB

Chart 2: Balance Sheet of the Federal Reserve



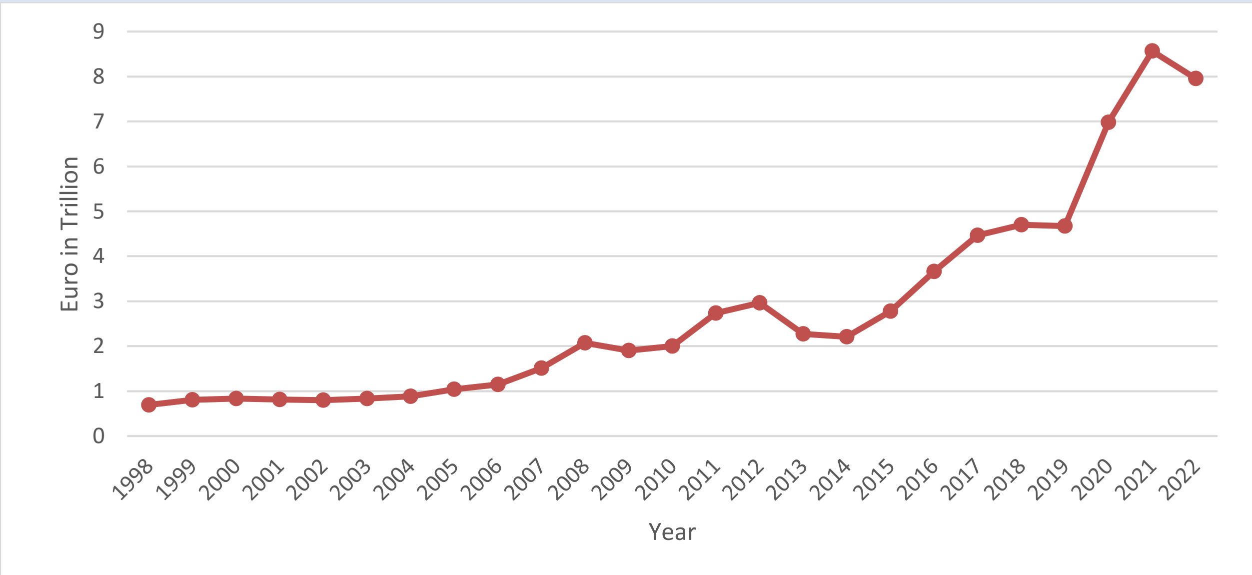
Source: Federal Reserve

Chart 3: Balance Sheet of Bank of England



Source: Bank of England

Chart 4: Balance Sheet of European Central Bank



Source: ECB

Chart 5: Extent of Quantitative Easing (Base 2007=100)