IS THERE AN IMPENDING US-INDUCED RECESSION AT THE END OF 2022?

Ritwik Sasmal
Analyst

Ankur Rastogi
Vice President

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Concerns abound around the threat of a US recession in the near term. Indeed, this is a million-dollar question amid the global economic challenges currently. Based on the World Bank's recently published report, Global Economic Prospects, June 2022, the world economy is projected to accelerate at a slower pace of 2.9% in 2022 and 3% in 2023-24. Therefore, it is safe to say growth in the US economy will also be in tandem with this slowdown. Economists at Nomura lowered the US real GDP forecast to 1.8% from 2.5% earlier (Bloomberg News). On the whole, the Fed's stringent financial policies, coupled with soaring inflation rates, supply distortions in the food and energy sector as well as volatile global diplomacies have led to significant insecurities among the population. Consequently, these factors play a pivotal role in decelerating economic activities across the world's largest economy.

Some unwarranted events have triggered a slow phase in the global economy as well. On one side, the Ukraine-Russia conflict has adversely impacted the supply chain of several commodities, especially natural gas, and fertiliser raw materials for agricultural produce, among others. On the other, food price inflation is growing exponentially across numerous economies; interestingly, most developed and developing nations are finding it difficult to tackle such high inflationary pressure.

As a matter of fact, there is staggered growth, on one hand, and high inflation **(Figure 1)** on the other. Since mid-2020, there has been a continued rise in global inflation, resulting in a volatile commodity market in many ways. Therefore, price hikes, coupled with slow growth in the world economy, has given rise to **stagflation**. Even, the World Bank report pointed out the same concerns.

Figure 1 : Monthly CPI inflation (%), year-on-year

Source: World Bank, Global Economic Prospects, June 2022

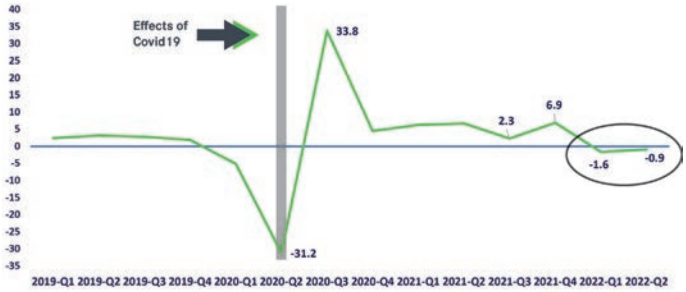
Note: EMDEs = emerging market and developing economies

Historical facts indicate that US faced stagflation for nearly a decade in the 70s. When the country provided financial help to Israel in the Yom Kipper War, there was embargo on oil imports from Arab countries in 1973. As a result, crude oil prices surged to USD11.65 per barrel from USD2.90 per barrel (Federal Reserve History). On the downside, the unemployment rate rose to 9% between 1973 and 1975 (CBS News). Overall, the US economy was negatively impacted by the energy price shock and weak economy. Indeed, this is a critical situation from a macroeconomic perspective as monetary policies of central bank cannot provide any respite. Therefore, it is noteworthy to observe how the US economy is performing in the current scenario of global slowdown.

US economy – Indication of macro parameters

GDP growth numbers for the previous quarter are not promising. **Figure 2** depicts a slump from Q4 2021 to Q2 2022. Interestingly, Real GDP data shows the negative growth for a consecutive two quarters of 2022, and it really hints that the economy is going through a turbulence. This was primarily ascribed to the Ukraine-Russia war, which has greatly impacted the energy sector. Secondly, there is an induced high price effect of energy market volatility in the global supply chain of commodities. To be precise, almost every country has been experiencing a high inflation rate for a substantial period of time. Moreover, pandemic-induced lockdown in China worsened the situation.

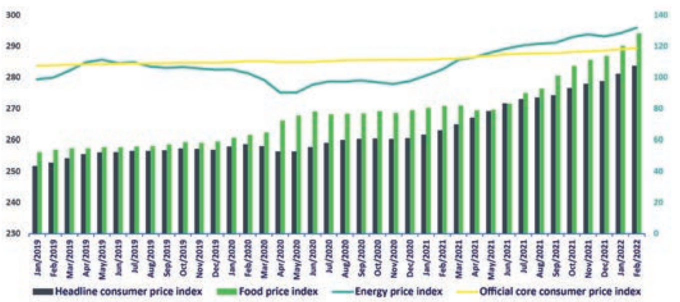
Figure 2: USA Real GDP growth (% change from preceding quarter)



Source: US Buerau of Economic Analysis

Coming to the US price indices, **Figure 3** illustrates how price inflation, in terms of food and energy, has had a major impact on commodities. This is also quite evident in the official *core consumer price index,* which has maintained a steady pace around 120. As per theory, the core consumer price index does not consider food and energy commodities; hence, there is almost no reflection of volatility in the official core consumer price index.

Figure 3: USA: Price indices (Headline, Food, Energy, Core)



Source: World Bank

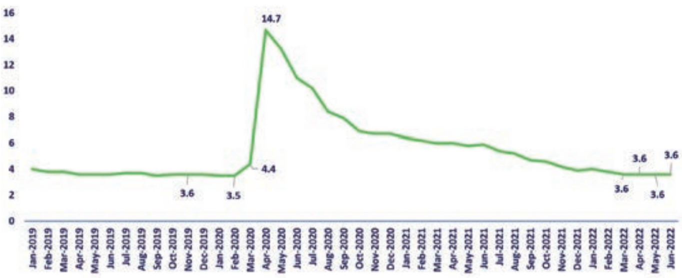
Figure 4: USA: Long Term Interest Rate (%)

Source: OECD

High inflation is a major concern as it impacts day-to-day living. The Fed's monetary policy of *inflation targeting* also has impactful relevance amid high inflation. In **Figure 4**, it is strikingly prominent that the central bank has adopted a tight monetary policy by increasing the long-term interest rate (LTIR) since the start of 2022. The graph also depicts LTIR was relatively low during the second half of 2021 and hints that the US economy was capable of managing upward inflationary price pressure.

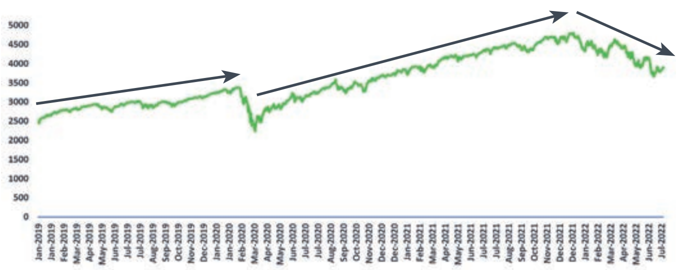
In line with GDP growth and inflation, unemployment rate is another major macroeconomic indicator. As evinced from historical facts, a weak economy (lower economic activities) mostly has a high unemployment rate. However, in **Figure 5**, the US unemployment rate has remained constant at 3.6% from March–June 2022. It is highly plausible that the labour market takes time to adjust in a changing economic structure and therefore, unemployment data has been stalled over the last 3-4 months. Though the US economy is witnessing high inflation, the unemployment rate has not decreased (generally there exists a negative relationship between inflation and unemployment rate as per Philips curve theory in short-run dynamics) in the short term; rather it remains in a steady-state phase. We need to pause and ask if it indicates that the labour market needs additional time to adjust with the deterioration in major economic indices. Another good indicator of an organised economy is the stock market index; in the US, *S&P 500* is a composite indicator of large-cap equities; moreover, recent daily data from S&P Dow Jones Indices LLC shows a downtrend in the index value **(Figure 6)** since the beginning of 2022. It will be pertinent to see corporates' reaction to this market trend. If corporates implicitly trust it to the core of their business reflex, then they will aim to lower business volumes; as a result, economic activities will get reduced and face a heavy jolt aggravating the GDP growth.

Figure 5: USA: Unemployment rate (%)



Soruce: U.S. Bureau of Labor Stastics

Figure 6: USA: S&P 500 index (Jan'19 - Jul'22)



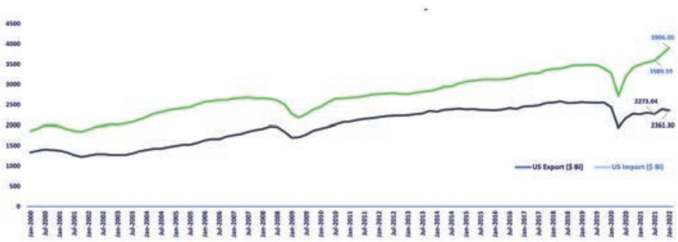
Source: S&P Dow Jones Indices LLC

All said, it can be summarised that US's macroeconomic trends are not very promising given the data under various categories (GDP growth, price indices, long-term interest rates, unemployment rate and stock market index) and may negatively impact domestic consumption, going forward. This indicates that a contraction in economic activities will undoubtedly affect exports and imports and it will spill-over to other global economies who are strongly connected with the US through international trade agreements. Now we will consider the country's export-import ecosystem.

Export-Import: Where does the US stand?

According to the *US Bureau of Economic Analysis,* the region is the second-largest importer in the world. Roughly, the US imports capital goods (22%), consumer goods (21%) and automotive and engineering machines (12%). **Figure 7** also shows US import bills are approximately USD1,000bn higher than export earnings. This indicates the region's imports are greater than exports.

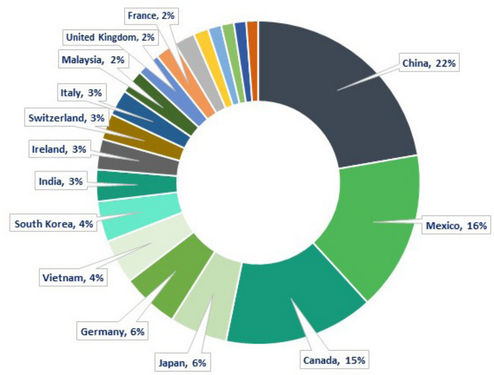
Figure 7: USA: Exports & Imports (Qrt1-2000 to Qrt1-2022)



Source: US Buerau Economic Analysis

It is important to understand which global economies are largely dependent on US imports. Based on *United Nations Comtrade* data, 2021, we have structured a percentage share dounut chart **(Figure 8)** of top 20 countries from whom the US imports the most to reinforce the fact that exports from China, Mexico, Canada, Japan and Germany have a substantial contribution in US domestic consumption. In line with this, **Figure 9** depicts product-wise imports in the US. This import share (%) is out of top 20 importing products of the US. Machinery, nuclear reactors account for the highest share (18%), followed by electrical & electronic equipment (17%). Automotive ranks third, and mineral fuels and oil distillation products are placed at fourth. Pharmaceutical products is another important segment, constituting 6%. In general, US significantly invests in pearls, precious stones, optical apparatus, plastics (in various forms), furniture, metals etc. Therefore, the US's trade relationship with China, Canada, Mexico, among others, has become more evident.

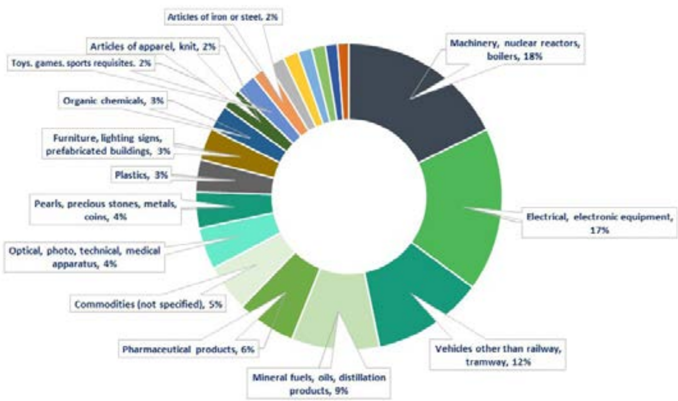
Figure 8: US Import share (%) by Top 20 countries (2021)



Source: UN Comtrade

Note: This share (%) of US import is out of top 20 importing countries of the USA

Figure 9: US Import share (%) by Top 20 products (2021)

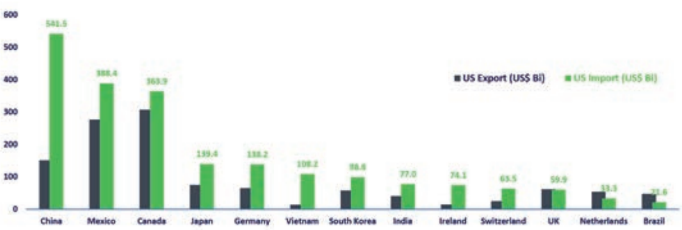


Source: UN Comtrade

Note: This share (%) of US import is out of top 20 importing products of the USA

Figure 10 illustrates the bilateral trade relations of major economies (in USD bn). China's exports, the biggest trade partner for US, stood at USD540bn. Exports from Mexico and Canada totalled USD388bn and USD363bn, respectively. **Table 1** shows China, Mexico, Canada, Japan and Germany have a good share in exports to the US market.

Figure 10: Exports & Imports in2021



Source: UN Comtrade

Note: Due to unavailability of 2021 data, USA export data for Vietnam, South Korea & Ireland are from 2020, USA import date for Brazil is from 2020

Table 1: USA's import dependency by country

Country	Exports to USA (% total exports)
China	18%
Mexico	83%
Canada	76%
Japan	19%
Germany	9%

Source: Data: Trading Economics

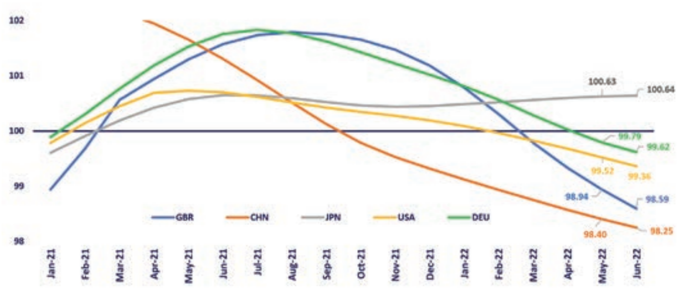
Note: This export percentage share of each country is with respect to their total individual export volume

The most critical situation is for Mexico and Canada. More than 75% of their exports land into the US market. Similarly, China has a high percentage (18%) of total exports dedicated to the US market. If the economic slowdown continues unabated, then automatically the import bills will go down (as happened in 2008 financial crisis and Covid-19 pandemic from 2020). Hence, the repercussions for these exporters will be on a magnanimous scale. This trickle-down effect will also be visible on regions depending on China, Mexico, Canada, Japan, and Germany for import bills. Thus, this economic slowdown will percolate to other developing and emerging markets and give rise to a global economic recession.

Business cycle facts:
Top five economies

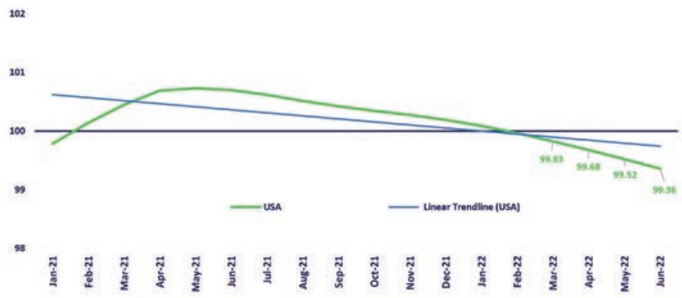
This article mainly focuses on the US economy and discusses the impact on other major economies in the event of a continued slowdown. Coming to the top four economies: China (CHN), UK (GBR), Japan (JPN) and Germany (DEU), the *Composite Leading Indicator* (CLI) gives early signals of turning points in business cycles. As **Figure 11a** shows, any value above 100 means the economy is performing well and in the short run there is a less chance of a recessionary movement. However, if the index is less than 100 units then there is good chance that an economy will face hardships. The graph clearly indicates that UK, China and Germany have a downtrend for CLI, but Japan faces a slight upward trend as per June 2022 data. In the case of US **(Figure 11b)**, the CLI trend is constantly downward, and is a cause for real concern if it persists in the upcoming timeframe.

Figure 11a: Composite Leading Indicator (CLI)



Source: OECD

Figure 11b: USA Composite Leading Indicator (CLI)



Source: OECD

Considering all these data facts and analysis, rational justifications indicate a US-induced global recession may be a legitimate possibility if all the associated macro parameters continue to weaken over time. Indeed, as our analysis is based on certain assumptions and conditions, a clear-cut answer about recession is hard to apprehend. Nevertheless, all the supporting facts and data depict a slowdown in the US economy over the last 4-5 months. In this context, AGR's research team offers a list of insights for the world economy. These futuristic possibilities may not be directly connected with the US or recession only, rather they try to envisage the bigger global picture in terms of energy transition, supply-side bottlenecks and socio-political diplomacies.

AGR's future projections

- **As the US economy is considerably fragile, given the low growth numbers and high commodity prices, there are visible signs of a mild recession which may hamper the growth trajectories of major US trade partners like Mexico, Canada and China.**
- **The global economy will remain unsettled due to weak diplomatic synergies among major powers. Furthermore, short-term volatile energy shocks and Ukraine-Russia war will have a severe impact on worldwide economic growth. If the war persists, then growth across European countries would be greatly dented.**
- **The energy crisis, along with supply-side bottlenecks in commodity markets, will hinder the growth dynamics of developing nations. Emerging and developing markets are expected to recover in the second half of 2023, as consumerism will swiftly aid the demand trajectory.**
- **Energy transition may have a significant impact on US revenue earnings as well as for other major economies. As of now, the Electric vehicle (EV) ecosystem cannot completely replace the traditional revenue earning system for most governments as global EV sales numbers are not justified to reap the equivalent revenue benefits of oil energy. In fact, in the short run, energy transition will indirectly dampen growth for economies which have a bigger share of revenue from oil and petroleum product exports.**

Author's connect:
ritwiks@avalonglobalresearch.com
ankurr@avalonglobalresearch.com

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AVALON
GLOBAL RESEARCH

AGR Knowledge Services Pvt Ltd
1st Floor, Kalpataru Point, Kamani Marg,
Sion (East), Mumbai 400 022, India
+91-22-42792600
+91-22-42792681
info@avalonglobalresearch.com
avalonglobalresearch.com