RISING PRICES, RISING TENSIONS

Ukraine and the pandemic have caused a global shock which has brought inflation spikes and the prospect of economic warfare. DeAnne Julius looks at the implications

The blame game is on among economists and central bankers over how inflation got out of control.

The facts are stark. Since the beginning of this year inflation in Europe and the United States has steadily climbed towards – and sometimes beyond – 10 per cent, while in Nigeria and some other developing countries it has exceeded 20 per cent. In Britain it has reached a 40-year high.

This has meant a huge rise in the cost of living for millions of people. It has also been a considerable shock to central banks which were used to managing a steady inflation rate of between zero and 2 per cent over the past two decades.

There are two schools of thought among economists about what caused this strong acceleration in inflation. Everyone agrees that part of the problem has been the double shocks of the Covid pandemic and the Russian invasion of Ukraine.

The pandemic shut down large parts of the service sectors of economies and disrupted supply chains into manufacturing. In addition, many governments provided fiscal support through furloughs for people laid off work and grants to keep businesses afloat while they were unable to produce or sell. The result was a rise in savings and a sudden bounce-back in demand when Covid restrictions were lifted.

But it takes time for ports to reopen and for companies to rehire the staff they lost. With demand exceeding supply across whole economies, prices were driven up, sometimes sharply. This price spike might have abated over 12 to 18 months had it not been for the Russian invasion.

The war in Ukraine created a global shortage of the food grains that Ukraine normally exports and the oil and gas that Russia normally supplies to Europe and beyond. The sanctions imposed on Russia and its blockade of Ukraine's trading ports created a major squeeze on global supplies of energy, fertilizers and food grains. The prices of these basic, widely traded commodities that are used around the world began to double, triple and sometimes multiply further.

The nature of these one-off external shocks has led to confusion and debate over whether the current inflation surge is temporary or long-lasting.

On the one hand, the pandemic shutdowns are over in most places, with the exception of China. Most people are back in work, although some are suffering long Covid and others are reconsidering their priorities. Supply chains and inventories are being rebuilt. Some grain is being shipped out of Odessa and global food prices have come off their peaks.

New era of economic fragmentation

Extending this scenario implies that inflation will moderate without central banks needing to raise interest rates too aggressively. Indeed, if they were to do so, it could provoke a severe recession just as demand and supply were coming back into balance.

Other economists point out that the cost-of-living shock has already led to demonstrations, strikes and demands for wage increases to compensate for higher prices.

Higher wages translate into higher costs for companies which, in turn, leads them to raise prices further as they attempt to remain profitable or at least break even. Wages make up more than half of total costs in the hospitality, food service and retail sectors where profit margins are already low. It is the job of central banks to halt such a wage-price spiral before it gets out of hand.

Raising interest rates is their main tool to do so, which is why Jay Powell, the US Federal Reserve chairman, promises to 'keep at it' until inflation comes down to the US target of 2 per cent on the Fed's preferred measure of inflation, the core Personal Consumption Expenditure, which rose by 4.6 per cent in August. This could mean much higher interest rates will be needed, both in the US and elsewhere.

The Russian invasion has dramatically changed the geopolitical backdrop. We may be entering a new era of economic fragmentation, reversing four decades of globalization that brought lower production costs for businesses from off-shoring, lower prices for consumers from cheaper imported goods and higher incomes in many developing countries from new jobs in manufacturing goods for export, with China a key player. All of these effects kept a lid on prices through global competition.

Now the debate about temporary versus long-lasting inflation must reflect the weaponizing of trade and finance to disrupt past patterns of production and exchange.

The political rift between the US and China that developed under the Trump administration resulted in trade tariffs and restrictions on cross-border sales of semiconductors and other high-tech equipment. The rift deepened under President Biden with bans on US companies to prevent them selling chips to China and the threat of delisting Chinese companies from the US stock market.

Then the invasion of Ukraine brought a raft of economic sanctions against Russia including freezing the foreign exchange reserves of its central bank and the assets of some Russian companies and individuals.

We may be in the foothills of an economic war between the great powers. The deeper 'no-limits friendship' proclaimed by Vladimir Putin and Xi Jinping presents a potent threat to an integrated world economy. Despite their chequered history, Russia and China perceive a common enemy in the West and share a resentment of being treated without the respect they feel they deserve.

There is also a natural complementarity

in their two economies. Russia has the energy and natural resources that China needs; while China has the technology and industrial know-how Russia lacks. Trade between the two has jumped with increased Russian oil exports to China, partly offsetting Russia's loss of European markets due to sanctions. The two have also agreed to use their domestic currencies to pay for trade, rather than the dollar.

In addition, they are both autocratic regimes capable of controlling their domestic narratives and suppressing dissent. This provides a powerful base for propaganda and paranoia that can lead to irrational policy and a tit-for-tat escalation of disputes.

A chaotic period of economic disruptions and resulting inflation spikes is not certain. Both Russia and China have weaknesses in their economic models.

The Russian state is heavily dependent on energy exports which themselves are vulnerable to curtailed western demand, to the lack of western equipment and expertise and to the accelerated investment by others in renewable energy alternatives.

China's long period of rapid economic growth is staggering to a halt from its zero-tolerance policy towards Covid, while there is no sign of an exit strategy.

Meanwhile the property sector is in free fall and the many foreign enterprises that set up manufacturing in China, bringing skills and technology as well as money, have begun to relocate to India, Vietnam, Singapore and other more predictable business environments. Both countries suffer from shrinking labour forces and growing numbers of retirees needing healthcare and income support.

The West too faces challenges, including destabilizing threats to its democracies from populist political parties. The relative predictability of the post-Second World War era has been shaken by the global pandemic, geopolitical incursions and extreme climate events.

Instead of cooperative attempts to tackle such issues, they have led to a re-ordering of global alliances with incompatible narratives and increasing barriers and sanctions.

This changing international environment means that the debate about inflation – its causes and possible persistence – is no longer just about economics and central banking. It reflects the complexity of today's interconnected world and the tectonic shifts in great power rivalry.

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FOOD FOR ACTION, NOT THOUGHT

With so many millions facing hunger, the world needs to root out the causes of this crisis now, writes Arif Husain

When the United Nation's World Food Programme sets records, it does not bode well for the world. Since 2020, when the programme assisted 116 million people, each year has been record-breaking. This year it will assist over 150 million people.

Acute hunger is driven by three things: conflicts, climatic shocks and the dramatic economic and social fallout from the Covid pandemic. These are exacerbated by structural weaknesses, such as inequalities and a glaring lack of social safety nets, which make the situation dramatically worse.

Food commodity prices at the start of 2022 were at a 10-year high, and fuel prices at a seven-year high. Rising prices deepen the challenges for those barely able to pay for food in normal times, a problem that has been much amplified by the war in Ukraine, which acts as the world's 'breadbasket'.

The food crisis is unique because it is unfolding amid a more difficult global context than with the food and fuel crises of 2008.

Then the world was more peaceful. Last year, seven out of 10 people who were in hunger crisis were so because of conflict, which disrupts all aspects of a food system, from the harvesting, processing and transport of food to its sale, availability and consumption. This in turn can often constrain the humanitarian assistance on offer.

State-based armed conflicts have roughly doubled between 2010 and 2020, as has the number of people forced to flee their homes due to war, violence, fear of persecution or human rights violations. This number has risen from 43 million in 2012 to more than 100 million in 2022.

The invasion of Ukraine further disrupted food supplies, pushing prices to record highs. The combined result is that today 345 million people are in hunger crisis, including some 50 million people in 45 countries who are in hunger emergencies, which is a step away from famine.

The world was already dealing with a severe hunger crisis when Ukraine erupted. The economic fallout from the Covid pandemic dealt an unprecedented shock to the world economy as incomes collapsed due to job losses, and inflation was ramped up caused by supply chain disruption.

In less than 18 months, governments around the world had spent upwards of $26 trillion or 30 per cent of global GDP dealing with the disease and its economic fallout. The debt levels of low- to middle-income countries had ballooned, and their currencies had begun to depreciate. About 60 per cent of low-income countries today are in, or at high risk of, debt distress.

The fact that the dollar is at a two-decade high, now at parity with the euro, has driven up food import bills and made debt servicing more expensive for many of the poorest countries. And as central banks around the world tighten monetary policy to bring inflation under control, interest rate hikes in advanced economies are increasing the cost of credit for low-income countries. More than 40 currencies have lost upwards of 15 per cent of their value