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Ukraine Crisis and Growing Global Economic Insecurity

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Insecurity about the future global economy is growing. Stock prices that mirror business sentiments are falling. After remaining around 33,000 in early June, the Dow Jones industrial average on the New York Stock Exchange declined for the fifth straight market day from 33,180 on June 7 to 30,365 on June 14, losing 2,815 points or 8.5% in a week.

Behind the stock market decline are remarkable price hikes and growing inflation concerns in Western countries, which have prompted European and U.S. monetary authorities to enhance initiatives to increase interest rates. Some people are concerned about possible stagflation in which price hikes coincide with economic stagnation.

Regarding price hikes, the U.S. consumer price index in May posted a sharp year-on-year rise of 8.6%, dashing hopes that inflation would calm down. Energy prices shot up 34%, including gasoline prices that soared 49%. Food prices also increased 12%. Hikes in prices of daily necessities were remarkable.

It may be needless to note that the Ukraine crisis is behind such sharp price hikes. Crude oil prices in the international market began to soar in the second half of last year and topped $100 per barrel in response to Russia's invasion into Ukraine. In March, crude oil prices hit the highest levels since the global financial crisis. Crude oil prices have basically remained high under the impact of Russian oil embargoes by the Group of Seven industrial democracies and the European Union. They now stand at around $120/bbl. Such crude oil price hikes have led to the U.S. gasoline price upsurge, contributing to escalating American citizens' discontent. U.S. natural gas prices are also rising in line with international market price hikes. The benchmark Henry Hub natural gas price rose gradually from $3-4 per million British thermal units early this year, topping $6/MMBtu in April, $8/MMBtu in May and $9/MMBtu in June.

Inflation is serious in Europe as well. The eurozone inflation rate in May hit a record high of 8.1%. The high inflation rate is attributable to remarkable hikes in crude oil, gas, coal, electricity and other energy prices, as well as food and other commodity prices.

Energy and food are daily necessities for citizens. Their price hikes have the same adverse impact as tax increases, reducing disposable income for other goods and private consumption. For corporations, such price hikes lead to higher costs and other worse business conditions, lower spending and investment, and less employment. Energy and food price hikes and subsequent general inflation become a domestic political problem through the abovementioned adverse impacts, forcing governments to address the price hikes. For instance, the U.S. Biden administration in the face of gasoline price hikes ahead of the midterm congressional election has enhanced its request for Saudi Arabia to increase crude oil production to suppress oil prices.

Interest rate hikes to suppress inflation have also gained momentum. The U.S. Federal Open Market Committee decided to raise the federal fund rate by 50 basis points in May for the first time in 22 years and is expected to increase the rate by the same margin at its meetings in June, July and September. Some market participants point out that a rise of 75 basis points would be possible.

The European Central Bank as well is enhancing moves to raise interest rates. It is preparing for the first interest rate hike in a decade. ECB President Christine Lagarde in late May indicated that the ECB would raise its policy interest rate by 25 basis points each at its meetings in July and September. Some analysts note that the rate hike could be 50 basis points. The ECB is required to raise interest rates to fight against inflation while carefully watching the trend of the European economy that has become more vulnerable under the Ukraine crisis.

In such situation, the world has become conscious of economic deceleration risks. On June 7, the World Bank released its global economic prospects forecasting that global economic growth in 2022 would slow down from 5.7% last year to 2.9%. It thus revised the 2022 growth forecast by 1.2 percentage points from 4.1% as reported in January. Given the timing for releasing the forecast, the growth forecast could be revised down further in response to the current inflation acceleration and relevant interest rate hikes.

Given the current international energy situation and food market conditions, no optimism can be warranted about inflation. Crude oil and coal prices are rising, with U.S. gas prices remaining high. European gas and Asian liquefied natural gas spot prices have declined substantially from their recent highs but could rise back depending on future developments regarding Russian gas supply. Simultaneous energy price hikes since the second half of last year are feared to continue further.

Since May, food supply has become a greater matter of concern than energy supply. Warring Ukraine and Russia are key grain exporters for the world. A decline or stagnation in their grain exports and the war's impact on their future grain production could trigger a tighter global food and grain supply-demand balance and price hikes that would be a grave global problem. Initiatives to resolve the problem are attracting global attention.

Energy and food prices are likely to remain high or rise further for their respective reasons, leading to the acceleration of overall inflation. Interest rate hikes to address the inflation acceleration could trigger global economic deceleration or stagflation.

In the first half of the 1980s, the global economy suffered from a prolonged slowdown and stagflation, which came as inflation acceleration triggered by energy price spikes under the oil crises in the 1970s was combined with economic deceleration through global interest rate hikes. The Ukraine crisis is similar to the oil crises in various points, as discussed in "A Japanese Perspective on the International Energy Landscape (581)." We must pay attention to the possibility of the Ukraine crisis causing stagflation. The future international energy situation and world economy are worthy of close attention.

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