

## Everything, everywhere, almost all at once

In the Oscar-winning movie, an unlikely hero fights strange, seemingly never-ending dangers as the fate of the world hangs in the balance. In our reality, the frequency of new events chasing each other has exploded. Financial markets can't escape this trend. There's no one hero to save us. And the fight will be fought for many more years



Empirical research has shown that our collective attention span has been reduced significantly with the rise of social media. Even over the last 10 years, the length of time that any one hashtag has stayed in the Top 50 has almost halved. The frequency of new events chasing each other has exploded, so why would the supposedly efficient and highly communicative financial markets escape this trend?

Increasing digitalisation and social media were drivers behind the recent unprecedented withdrawals of bank deposits within just a few hours. Whether there is a link between shrinking collective attention spans and the frequency of financial crises is an interesting research question for new PhD students but not something we can answer here. However, what is clear is that the frequency of crises has become mind-blowing in recent years: the pandemic, lockdowns, war and now, banking turmoil. Everything, everywhere, almost at once.

Financial crises always seem to come on suddenly but take more time to resolve themselves. In a globalised world and highly interconnected markets, the lesson of the last 15 years is that second or third-round effects from financial turmoil can occur in unexpected places. Even if the financial sector as a whole looks more resilient and the toolkits of supervisors, governments and central banks are larger than 15 years ago, there is no reason for complacency. We remain on high alert. The coming months could still show further cracks, either in the financial sector or the real economy, or, even worse, in both.

## Real economy impacts will last longer

In our base case scenario, tensions in financial markets will remain elevated, with no severe escalation, before calming down again. The impact on the real economy, however, will last longer. Monetary policy tightening for us was already the most underrated downside risk for both the US and the eurozone economy.

Every undergraduate student of economics knows that tighter monetary policy at some point in time will drag down the economy. Or, to put it differently, why have central banks at all if the most aggressive monetary policy tightening in decades leaves no mark on the economy? Hence, the rate hikes so far, plus financial sector turmoil, will weigh on lending and, consequently, investment and consumption. As a result, we feel more convinced than ever with our recession call for the US economy and a subdued growth forecast for the eurozone.

## The rate hikes should end soon

In the face of recent market turmoil, central bankers didn't blink. Both the Federal Reserve and the European Central Bank continued their hiking cycles and are trying to separate policy rates as a tool to fight inflation from tools tackling financial instability. At the same time, recent turmoil is a strong reminder that both the Fed and the ECB are very close to the point where more (rate hikes) is not always better. In fact, the expected longer-term real economic fallout will actually help central banks to reach their inflation goals earlier.

As a result, we expect the Fed and the ECB to stop hiking before the summer. A recession in the US will force the Fed to significantly cut rates towards the end of the year, while stubbornly high core inflation will bind the ECB to a "high-for-longer" stance until mid-2024.

Some things seem to never end. Think of all those reality TV programmes; even Harry Potter is to get its own TV series. Financial crises have a longer history, but we know they eventually do end. Their impact, however, can reverberate for much longer.

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