

We're in a polycrisis, and this is what it means

The word of the moment appears to be 'polycrisis', defined by Collins as the *simultaneous occurrence of several catastrophic events*. It's apt, given the war in Ukraine, inflation, the pandemic... you name it. Europe's been at the epicentre of most of it. Now it seems a US variant is in the making



A new polycrisis is unfolding

Carsten Brzeski on growing concerns of a global 'polycrisis'

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Things are brewing in the States

There appears to be no respite from seemingly never-ending economic crises and concern. The banking crisis in the US is far from over, and even if regulators have been very efficient in ringfencing failing institutions up to now, we all know the adage that 'past performance is no guarantee of future success', and it's rarely been so true for financial markets right now.

Regional banks had increased their lending portfolio significantly over the last year, while the

larger ones became more cautious, given the changed interest rate environment. Tighter lending standards as a result of the recent banking turmoil will leave further marks on the real economy, with commercial real estate often cited as the possible next shoe to drop. And there's more, the political debate on the debt ceiling is fiercer than ever, increasing the risk of an – intended or unintended – fatal accident: a default on US treasuries.

A recent study by the US Council of Economic Advisors shows that a short default on US treasuries would cost 0.6 percentage points of GDP growth, while a protracted period would cost more than six percentage points. Leaving aside the effects of financial turmoil from such an unprecedented event, we still believe in a last-minute compromise. But the uncertainty and expenditure cuts in such a settlement will weigh on growth in the coming months. Add to this the ongoing student loan discussion and the lagged impact of the Fed's tightening, and the US has its very own definition of polycrisis.

With a looming recession in the US, it is easy to see the Fed not only stopping rate hikes but also cutting rates at the end of the year. As my colleague James Knightley always reminds all of us: on average, it only took six months in the US between the last rate hike and the first rate cut. To some extent, it is an advantage for the Fed that the US economy still shows many characteristics of a real business cycle: from bust to boom to bust. In such a situation, countercyclical monetary policy is almost a no-brainer and definitely the correct policy prescription.

Europe's somewhat depressing future

The situation in Europe, unfortunately, is slightly different. Here, the polycrisis of last year, the enormous structural challenges and transitions have somehow let a typical textbook business cycle disappear. Instead, the eurozone economy is facing a future of subdued growth at best. In fact, private consumption is still below pre-pandemic levels in real terms and industrial production is not really gaining momentum.

Still, the European Central Bank has sent clear signals that it intends to continue hiking rates over the coming months. The question is whether these intentions can actually come true. Demand for new loans has been on an unprecedented downward slide, the growth optimism from the start of the year is fading again, and the lagged impact from earlier rate hikes is still finding its way into the real economy.

It is hard to see how the eurozone and the ECB can escape a recession and rate cuts in the US. Of course, we all know the traditional reflex of European policymakers: Europe is not the US. The infamous 'decoupling' will probably make the rounds, but history tells us that decoupling almost always turns out to be an illusion after a couple of months; think of the ECB's communication in late 2021 when the Fed was already envisaging rate hikes or of the financial crisis when Europeans thought subprime was a pure US issue.

As a consequence, the ECB looks set to continue hiking rates for longer than the Fed but given the weak growth outlook for the eurozone and knock-on effects from everything going on in America, risks are high that every next single rate hike could turn out to be – at least with hindsight – a policy mistake.

What a luxury were those days with only a few crises! The macro policy answer was so much

easier, but even then often disputed. Right now, we definitely don't envy central bankers and governments. Finding the right answers is, to say the least, somewhat complicated.

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

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