WHITESHIELD

STAGFLATION

SNATCHING YOUR ECONOMY FROM THE JAWS OF STAGFLATION

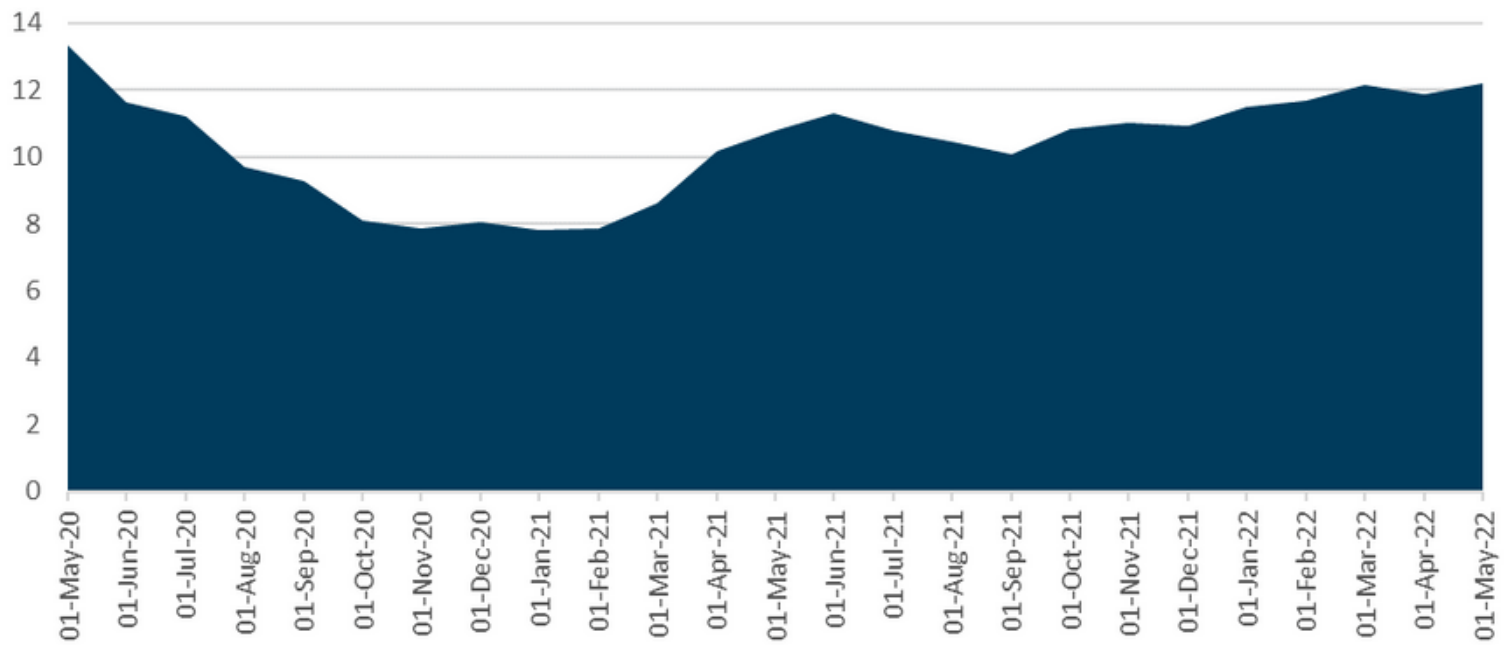
2022

As the Russian-Ukrainian war enters its fifth month, fears of an impending stagflation have intensified and moved up the political agenda. Clearly, the combination of exploding prices and sluggish demand is a deeply worrying prospect for governments, policymakers, and above all low-income populations across the globe. Last time the world experienced stagflation was in the 1970s when inflation and unemployment in the United States exceeded 5% every year between 1974 and 1982. The combined outcome of such a double whammy is what Yale University Professor Arthur M. Okun measured in the "Misery Index". Professor Okun calculated the Misery Index by adding together the unemployment rate and the annual inflation rate.

In 1980, the Misery Index peaked at 20.7 when the US consumer price index registered 13.5% and the unemployment rate was 7.2%.

During the 50 years that followed, the US Misery Index fell steadily, interrupted only by the 2008-9 global financial crisis and most recently by the COVID-19 pandemic that caused tens of millions of people to lose their jobs and pushed the Misery Index to its highest level of 13.8 in May 2020 (Figure 1). Today, skyrocketing inflation rates across all major economies are propelling the Misery Index to new heights.

Figure 1. US Misery Index, May 2020 – May 2022

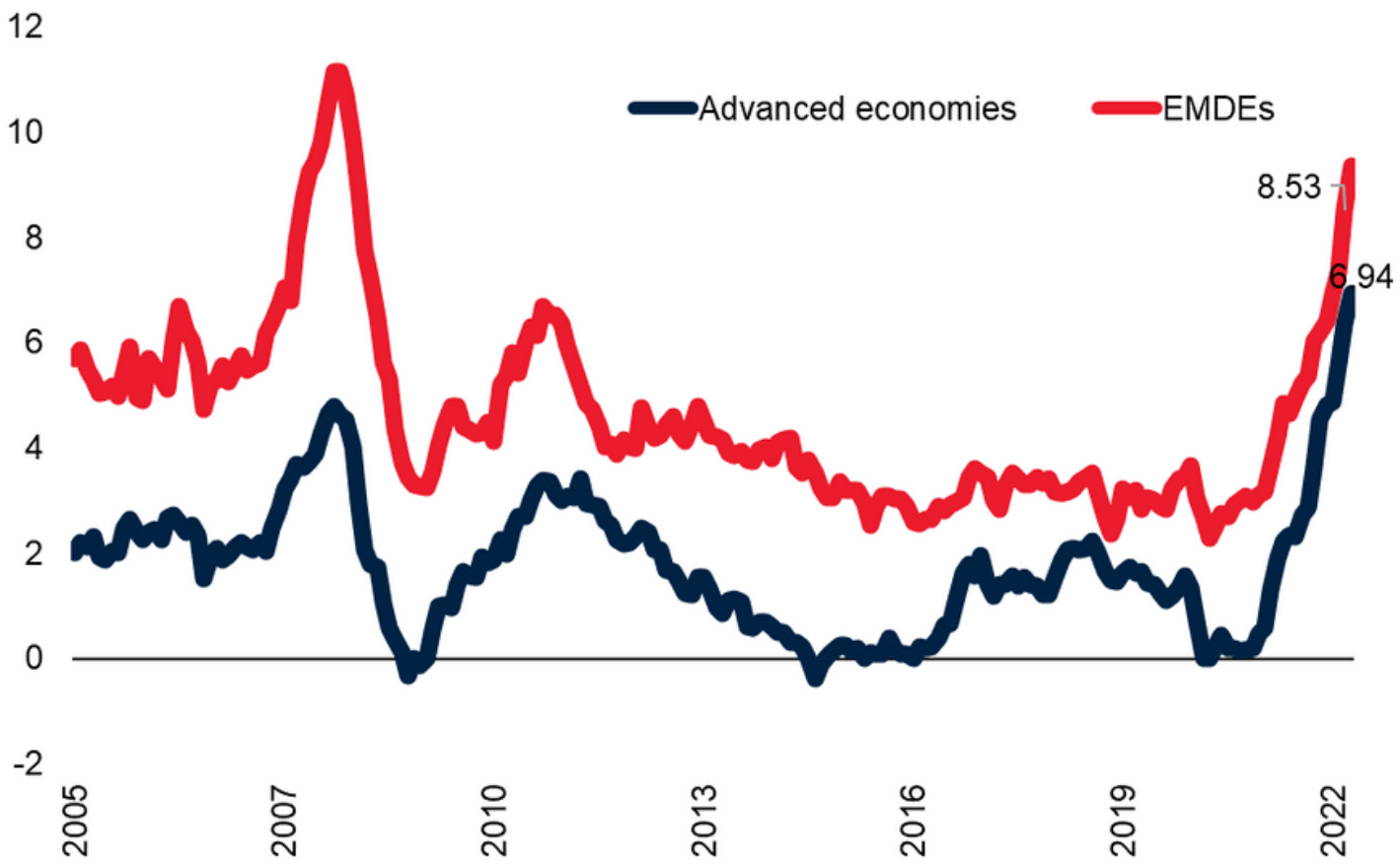


Source: USA Misery Index 2022, *USA Misery Index website*, Whiteshield accessed June 2022, <http://www.miseryindex.us/rawdata.aspx>
Whiteshield Analysis

In May 2022, the US consumer price index reached 8.6%, a level not seen in decades, and the inflationary winds struck around the globe (Figure 2).

According to the World Bank Global Economic Prospects, monthly CPI in the emerging market developing economies (EMDEs) and advanced economies reached 8.5% and 6.9%, respectively, in May 2022 (Figure 2).

Figure 2. Monthly CPI Inflation, %



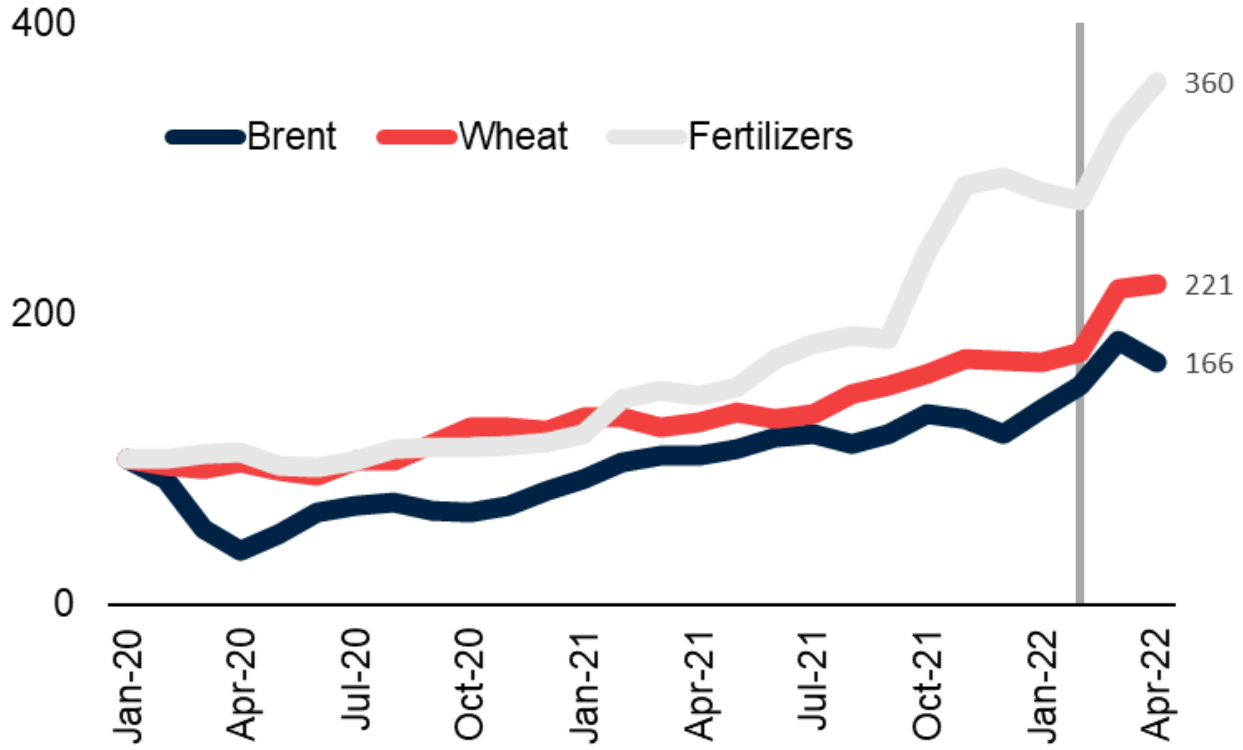
Source: World Bank. 2022. Global Economic Prospects, June 2022. Washington, DC: World Bank
Whiteshield Analysis

The inflationary winds have been triggered by firming post-pandemic demand, persistent supply disruptions caused by both post pandemic hangovers and the Russian-Ukrainian war.

Commodity prices continue to surge, hurting countries in products and services where Russia and Ukraine are major global exporters (Figure 3).

Expectations are for prices to begin to moderate some time in 2023 as commodity production rises elsewhere. However, commodity prices are expected to remain above their average of the past five years considering that Russian supplies of many commodities will take longer to return to the global markets.

Figure 3. Commodity Price Changes. Index, 100 = Jan 2020



Source: World Bank. 2022. Global Economic Prospects, June 2022. Washington, DC: World Bank
Whiteshield Analysis

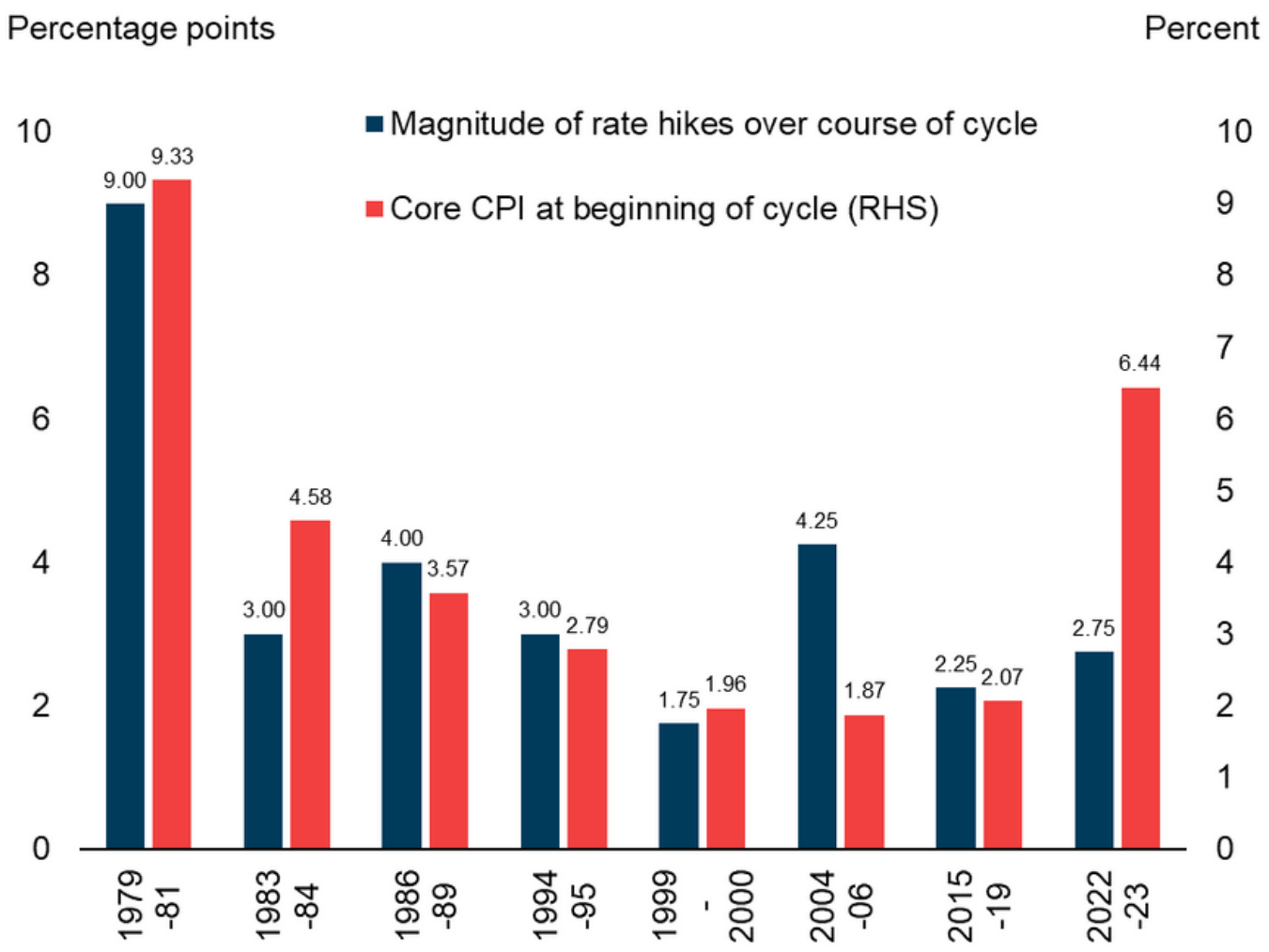
In the face of skyrocketing inflation, central banks across the world have begun to raise interest rates to tame inflation, albeit a bit too late. To be fair, central banks' playbook for fighting inflation has always ignored supply shock disruptions when setting monetary policy.

The belief was that such shocks would eventually work themselves out through market forces. Today, we find ourselves in the midst of non-stop supply disruptions that have been going on for more than two years and counting.

Amid elevated levels of inflation, the war in Ukraine, and rising interest rates, global economic growth is expected to be weak in 2022. The "known unknown" is how much interest rates need to rise before they begin to bring inflation levels back to targets and avoid a hard landing of the economy (Figure 4).

The challenge before us now is to prevent the top jaw of inflation from closing on the lower jaw of stagnation. In other words, the main challenge is to halt the rapid slide into stagflation.

Figure 4. Magnitude of rate hikes and U.S. core CPI during previous Federal Reserve tightening cycles

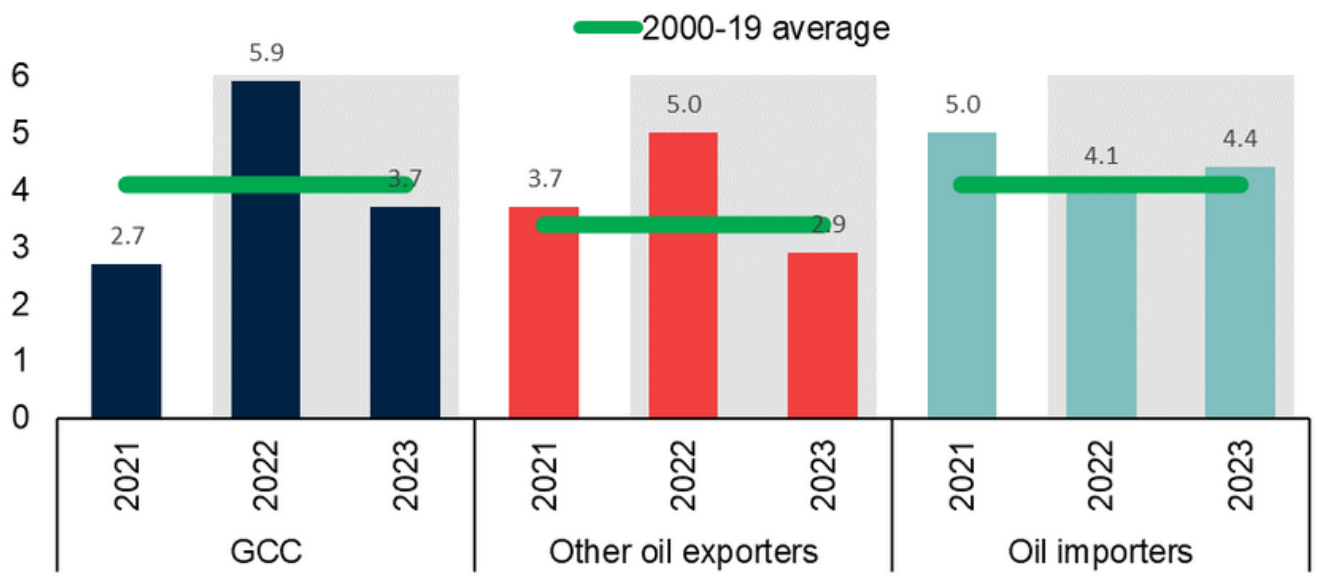


Source: World Bank. 2022. Global Economic Prospects, June 2022. Washington, DC: World Bank
Whiteshield Analysis

What does this mean to the Middle East and North Africa region (MENA)? Barring any unanticipated global economic development, MENA oil-exporting countries are forecast to witness their highest growth rates in 2022 (Figure 5). This is primarily due to higher oil prices and almost complete recovery from the pandemic due to residents' high vaccination rates.

However, the picture is less rosy when it comes to oil-importing countries in the region, especially countries with low vaccination rates. Oil-importing MENA countries are also food-importing countries that rely on hard currency to finance their imports. These countries are already facing mounting food and energy prices and deteriorating external balances.

Figure 5. MENA Countries Growth Rates, %



Source: World Bank. 2022. Global Economic Prospects, June 2022. Washington, DC: World Bank
Whiteshield Analysis

While it is true that GCC countries will continue to benefit from high energy prices, at least in as far as government revenues are concerned, GCC policymakers will face some difficult trade-offs.

Higher oil prices may slow down the urgency of the past ten years to:

- (i) transition to renewable energy sources;
- (ii) diversify the economy away from oil;
- (iii) reduce the role of the public sector in the economy.

Moreover, industries in the region (construction, transport, manufacturing, etc.) are also energy-intensive and will therefore see their input costs of energy, other commodities and borrowing costs ballooning. And since domestic interest rates are synchronized with the US Fed policy interest rates, borrowing and servicing debt costs will go up. Furthermore, the strengthening value of the US dollar will add to the industry's woes and chip further into their competitiveness. Consumers will also face higher food, energy, and borrowing costs, reducing their spending ability and confidence in the future.

Demands for wage increases will follow, further eroding the industry's competitiveness.

In short, what may look like a boom in the GCC for now may quickly turn around if not properly managed. Policymakers must consider the steps necessary to prevent the downswing towards such a scenario. Stress tests and assessments of different policy mixes and risk mitigation scenarios need to be undertaken at the highest levels of government. The over-riding objective is to forge crisis-specific resilience and stabilization plans that help GCC countries wither the gathering global economic storm and to emerge from it much stronger.

Whiteshield is a global advisory firm known for our ability to respond to global challenges rapidly and incisively. We use the most advanced tools and technology and combine them with our team of leading international experts to engage decision-makers in tackling society's most significant challenges. We are recognized for our rapid decision support, innovation, data science algorithms and deep policy expertise. We are specialists in "connecting the dots" between policy, business and enhancing the lives of citizens.