

European and US central banks bracing for economic recession

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The European Central Bank last week announced an interest rate hike for the second time this year, something unprecedented in the more than 20 years of its establishment. The ECB also raised inflation fears, predicting that “the economy will stagnate later this year and in the first quarter of 2023”.

ECB President Christine Lagarde said there will probably be more than two and less than five rate hikes, despite her comment late last year that “there is little chance of a rate hike in 2022”.

The eurozone’s economy rebounded in the first half of this year, but its recovery is expected to be slow in the second half because of the recent indefinite closure of the Nord Stream 1 gas pipeline, weak global demand, accelerated monetary tightening by the United States and strained geopolitics. So, when it says that the economy is likely to “stagnate” and more rate hikes are on the way, the ECB is hinting at a recession.

The US Federal Reserve has been more direct. At the Cato Institute’s monetary policy conference on Thursday, Fed Chairman Jerome Powell reiterated the need to act decisively and forcefully on inflation to avoid social costs. By vowing to fight inflation, the Fed hopes to reverse the perception that it has been doing little and send a signal that the US is willing to pay higher economic costs for this.

A recent economic survey by the Fed found that the outlook for US economic growth remains generally weak and that high prices and tight labor markets are likely to cause demand to weaken further over the next 6 to 12 months. As monetary policy continues to tighten, the negative effects of interest rate hikes are transmitting to some important sectors of the US economy. For example, the accelerated decline in US new-home sales has pushed inventories to the level of the 2008 real estate crash.

Faced with a gloomy outlook, the US and European monetary authorities have successively lowered expectations. Some analysts say that for the developed economies in Europe and the US, the longer economic contraction is delayed, the higher future costs will be. Central banks in the US and Europe remained too hesitant at the first signs of inflation last year. They are now ignoring the risk that any policy misstep may lead to a massive economic recession.