Are We Headed for a Global Recession?

Is a downturn inevitable? What have the markets priced in? And what's next for central banks?

With inflation running hotter than it's been in over 40 years, people are worrying about the prospects of a global recession—and with good reason. But what if the factors driving rising prices are beyond the limits of policymakers' control?

The Squeeze on Living Standards

We haven't seen a squeeze on living standards like this for some time. Real incomes are falling in a way that hasn't been seen since the second half of the 1970s, when inflation was very high, or since the early 1980s, when the world suffered through a really big oil shock.

In the 1970s, meat prices rose 25% in one year alone, and milk and dairy prices shot up almost 22%. Driven by war, loose monetary policy, and energy-supply problems, inflation in the 1970s topped out at 22%.

At the moment, an oil shock is playing a part in the squeeze on incomes: energy prices in most parts of the world are up more than 40%. But it's broader than energy alone; we're also seeing food prices inflating at high-single and low double-digit numbers. On top of this, we're seeing prices rise on a range of goods.

So, compared to recent history, when inflation's been around 1.5-2%, we've seen quite a big pickup. Households are feeling that squeeze across the board.

If It Feels Like Things Are Bad, It's Because They Are

The "misery index,"[1] an economic indicator that helps determine how the average citizen is doing economically, is now nearing the highest it's been in over almost 50 years.

We're effectively at the early stages of an economic slowdown. When looking for signs of confirmation, the housing market is a prime example—high mortgage rates are beginning to slow down the market.

Retailers are trying to make cuts as they go along. They're introducing cheaper lines of products so that people can continue to spend, even if they can't spend quite so much.

Moving forward, many will likely adjust their spending habits. We may see more evidence of weaker consumer spending, particularly on retail sales. We believe this will be the second sector to slow after the housing market.

Can Central Bankers Do Anything?

Central-bank policymakers have fallen behind the curve. There's been a lot of uncertainty and I think central bankers didn't want to tighten too early out of fear they could crunch the economy.

Had they reacted earlier, we might not have seen inflation or wages rise as much, and we could be looking at a more gradual slowdown. But now, with central banks playing catch-up with interest-rate hikes, we're likely to see a more aggressive economic slowdown as a result.

Insight from sub-adviser Schroders Investment Management

Keith Wade
Chief Economist and Strategist

Key Points

- Real incomes are falling in a way that hasn't happened since the second half of the 1970s, when inflation topped out at 22%.
- With central banks playing catch-up with interest-rate hikes, we'll likely see a more pronounced economic slowdown as a result.
- Investors haven't yet priced in a recession, but they're thinking seriously about it. That's why we've seen weakness in equities and credit markets.

Is it Beyond Central Bankers' Power to Ease Soaring Costs?

I don't believe so. While central bankers have been quick to blame outside influences for the cost-of-living crisis, such as the war in Ukraine, it's also true that about 80% of the Consumer Price Index[2] isn't based on oil or food prices. What central banks should be doing is targeting the rest of the non-food and non-oil baskets while tightening policy to bring inflation down to offset rises in those two components.

What Can Governments Do to Help?

Governments can help by taking actions that might be unpopular with voters such as raising taxes, freezing income brackets, and tightening the fiscal purse strings, but there's not much else they can do beyond that. Back in the 1970s, they tried all kinds of income and pricing policies and none of them really worked. So it's down to the central banks to strike the right balance.

Are We Headed for a Global Recession?

The probability of a global recession toward the end of this year or early next year is quite high.

Different regions face different risks, however. While inflation risks are fairly widespread—particularly in the US and Europe—China's headwinds have come largely from its zero-COVID policy. While the country has had to shut down much of its economy in order to implement that policy, our assumption is that China can begin to unwind the policy later on this year. Authorities have succeeded in bringing COVID-19 under control, but they're still putting numerous measures in place, so there's still quite a way to go. In the meantime, economic activity is very weak and China isn't currently contributing much to global growth.

In Europe, the issue of bringing inflation under control is just as important as deciding what to do about Russian energy. A partial oil embargo has been implemented, which will put intense pressure on those European industries and households that are dependent on Russian energy. Germany and Italy, for example, receive a quarter of their energy from Russia. So, an embargo could cause quite a sharp slowdown in economic activity.

Are Investors Starting to Price In a Recession?

Not yet, although they have started to think pretty seriously about it. This is why we've seen weakness in equities and parts of the credit markets.

Talk to your financial professional to help cushion your portfolio against market volatility.

[1] The **misery index** is meant to measure the degree of economic distress felt by everyday people, due to the risk of (or actual) joblessness combined with an increasing cost of living. The misery index is calculated by adding the unemployment rate to the inflation rate.

[2] The **Consumer Price Index** is defined by the Bureau of Labor Statistics as a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.