Higher for longer interest rates hit the global economy

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If one had gone by so-called “market expectations” at the start of the year, then it was going to be relatively plain sailing for the world economy.

Inflation was coming down, there were going to be as many as six interest rate cuts by the US Federal Reserve this year, and at least three, the stock market boom would continue on the bank of the potential of artificial intelligence and there would be a “soft landing” for the global economy.

Four months on, this happy scenario is in tatters. The latest data from the US, reflected in other countries as well, indicates that inflation after falling from its previous high levels has reach a sticking point above the target of 2 percent, meaning interest rate cuts markets have been clamouring for are being pushed further down the track.

Fed chair Jerome Powell indicated as much in remarks earlier this month saying that the central bank would need to have “confidence” inflation was moving sustainably down to the target before it would be appropriate to ease monetary policy.

“The recent data have clearly not given us greater confidence, and instead indicate that it’s likely to take longer than expected to achieve that confidence,” Powell said.

The change in the interest landscape saw options markets suggesting a roughly 20 percent chance of a rise in rates over the next 12 months with the yield on 10-year Treasury bonds spiking to more than 5 percent. Wall Street experienced its longest losing streak in 18 months before rebounding somewhat at the start of this week.

In the longer term the growing problems for the US and world economy were outlined in reports prepared for the annual spring meeting of the International Monetary Fund (IMF) held last week.

While it put forward what has been described as a relatively “sunny” outlook for the near term—estimates of global growth were revised upwards—the IMF forecast for the long term presented a different picture.

It noted that since the global financial crisis, amid fluctuations, the general trend for growth was down which would continue with global growth at the end of the decade falling to more than a percentage point below the pre-pandemic average.

The IMF said this was a result of weak productivity, a fall back in globalisation as countries pursue increasingly nationalist economic policies, the misallocation of capital resources and increasing geopolitical turmoil.

In her remarks to the gathering, IMF managing director Kristalina Georgieva warned the global economy was at risk of falling into what she called “the tepid Twenties.”

The class struggle does not usually get much of a mention in IMF reports although it is always present in the thinking of the guardians of the interests of global capital. But on this occasion, it was referred to directly by the IMF chief as she warned that the fall in global growth could lead to “popular discontent” with the political establishment.

The downward trend and how to address it is “what I think [about] when I wake up in the middle of the night,” Georgieva said.

Another issue of concern was the stability of the financial system due to the rise of US public debt. At around the equivalent of US GDP and set to rise even further in coming years, it has reached what is universally acknowledged as an “unsustainable” level.

The IMF Fiscal Monitor report was replete with calls for the US and other governments to tackle this issue with the restoration of “fiscal buffers” to be achieved by targeting spending on health and pensions and social service entitlement programs.

The toxic combination of higher for longer interest rates and slower growth are beginning to become ever more apparent.

This week Bloomberg reported that South Korea is "emerging as a closely watched weak link in the $63 trillion world of shadow banking"—the growing role of hedge funds, equity funds and other non-bank institutions in the global financial system.

The cause of concern is the rise in delinquency rates under conditions where because of higher interest rates Citigroup economists estimate that around $80 billion worth of project-finance debt is "troubled."

Shadow banking finance to the real estate sector is now more than four times the level it was a decade ago.

According to the Bloomberg report, the role of South Korea's shadow banking sector in areas that may risk financial stability is "second only to the US in relative size."

Quentin Fitzsimmons, a financial manager at the T. Rowe Price Group, told the news agency: "What is happening in Korea is probably a microcosm of what could be happening elsewhere. It has made me concerned."

The growing financial problems in South Korea, one of the world's major industrial centres, come amidst mounting concerns that its economic growth "model"—heavy industry and computer chip production backed by the state—is running out of steam.

This week, the *Financial Times* (FT) published an article headlined "Is South Korea's economic miracle over?"

The answer it gave is almost certainly yes.

The FT reported that the government is seeking to boost the development of new computer chip technologies and their manufacture "amid growing anxiety that the country's leading export industry will be usurped by rivals across Asia and the west."

According to a Bank of Korea report last year, cited in the article, having risen at an average of 6.4 percent between 1970 and 2022, annual growth was set to slow to an average of 2.1 percent in the 2020s, 0.6 percent in the 2030s and then start to shrink by 0.1 percent a year in the 2040s.

For China, the world's largest manufacturing centre, whose growth has been pivotal to the expansion of the world economy for more than a quarter of a century, the situation is no better.

The crisis in the Chinese real estate and property development sector which has seen the collapse of at least 50 companies, of which Evergrande is the most well-known, has not been resolved as the problems of the economy are compounded by a global economic slowdown and escalating warfare measures by the US and increasingly the European powers.

On Wednesday, the *New York Times* reported on the growing crisis in the car industry resulting from the slowing of demand and the switch to electric vehicles, leading off a with a description of the fate of a major complex in Chongqing, China's largest western city.

The complex, which was a joint venture of a Chinese company and Hyundai, the South Korean industrial giant, was opened in 2017 with high levels of robots and other equipment to produce petrol-driven cars. It was sold late last year for fraction of the $1.1 billion it cost to build and "unmown grass at the site has already grown knee high."

According to the article: "Dozens of gasoline-powered vehicle factories are barely running or have already been mothballed."

The slowdown goes beyond petrol-driven cars and extends to the electric vehicle market not only in China but globally with major car firms, including Tesla, announcing price cuts.

The developing car industry crisis is symptomatic of the marked slowdown in the global economy which will be exacerbated by the continuation of elevated interest rates.

The US is the only major economy experiencing growth, but it does so under conditions where the boost provided by the Biden administration—handouts to corporations under the Inflation Reduction Act and increased military spending—is raising the mountain of unsustainable debt.

The European economy, led down by the world's third largest economy, Germany, is barely growing. The UK economy is at or near recession and growth in Japan, the world's fourth largest is barely above zero.

The target for Chinese growth is 5 percent. But this is the lowest level in more than three decades and the government will be struggling to meet it.