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Will 2023 Be a Year of Economic Crisis?

Dec 15, 2022

War in Ukraine. Protests in China and Iran. Energy shortages in Europe. Protectionism in the United States. Skyrocketing debt in developing countries. And soaring inflation and slowing growth almost everywhere. The last 12 months have piled one challenge for the global economy on top of another.

In this *Big Question*, we ask Anat Admati, Jim O'Neill, and Eswar Prasad whether a major crisis is imminent.

Featured in this Big Question

ANAT ADMATI

JIM O'NEILL

ESWAR PRASAD

Anat Admati

Multiple plausible scenarios may trigger what would qualify as an "economic crisis" in 2023. If the war in Ukraine escalates further, or tensions with China – for example, over Taiwan – intensify, supply chains may be affected, causing shortages and price increases. Cyberattacks can disrupt key infrastructure at any time and anywhere, with potentially significant repercussions. And since the financial system is as fragile, dangerous, and distorted as it has ever been (perhaps even more so), a crisis there is certainly possible. Regulators have repeatedly missed opportunities to reform the system since the 2007-2009 crisis, making it clear that "further crises will come."

An enormous buildup of risks across the financial system – often ignored by regulators and investors, only to emerge suddenly– is concerning. Many European banks already appear quite weak. According to a 2018 study, "off-balance-sheet" debt levels have grown since 2007. A recent report shows that there is $65 trillion in hidden US-dollar debt in foreign-exchange markets – a much larger sum than prior to 2008 – and points to other risks. According to the World Bank, since 2000, the world's poorest countries have been spending the highest share of their export revenues on debt-service payments to rich countries, and debt-related risks are rising in low- and middle-income economies as well. Central banks routinely intervene to calm turbulent markets, as the Bank of England recently did to prop up the government-bond (gilt) market and protect pension funds. But a crisis involving multiple jurisdictions and key institutions with unsustainable commitments may not be easily contained.

Any "new" crisis will ultimately be rooted in the ongoing, intertwined crises of capitalism and democracy. Our economic system appears rigged and unjust, and many are rightly angry. When asked recently to write a short essay on "what has gone wrong with capitalism and how to fix it," I argued that "financialized capitalism" has undermined, overwhelmed, and corrupted democratic governments, and that flawed narratives have created confusion and blocked reforms. Martin Wolf, whose forthcoming book is entitled *The Crisis of Democratic Capitalism,* expresses similar concerns. Unless and until we diagnose the problems properly and fix the rules of the game, our world will be in peril.

Jim O'Neill

I am, frankly, not at all sure. There remain so many known unknowns out there, not to mention possible new developments that no one can predict. At the same time, after three years of the pandemic, Russia's invasion of Ukraine, and the unexpected surge in inflation, we are all so scarred that we are probably not ready for positive surprises.

What would happen if a resolution is reached on the Ukraine war? What if China's exit from its zero-COVID policy goes smoothly, enabling a sharp economic rebound? What if, on top of these developments, world trade suddenly rises sharply? If you throw in more effective action by monetary policymakers to rein in inflation – a probable scenario, in line with the latest central-bank forecasts – it is not difficult to imagine a large rally in global equity markets. I think the chances of this happening are not negligible.

Of course, less sanguine scenarios are also probable. China's exit from zero-COVID could lead to more negative health outcomes, jeopardizing economic recovery and leaving political leaders in a quandary. Given some of the economy's persistent underlying issues stemming from high debt leverage in property-related sectors, Chinese stocks confront the running of the bears.

Likewise, inflation might not ease in line with central banks' expectations, and the modest signs of a knock-on effect in labor markets – in the form of rising wages – start to become embedded in behavior. In these circumstances, short-term interest rates would almost certainly rise a lot more than currently expected. This would set the scene for a repeat of 2022, and could lead to a full-blown financial crisis.

On balance, however, I find myself a bit more inclined toward the optimistic scenario. That is certainly a sharp contrast to this time last year, when it seemed reasonably obvious – even before the Ukraine war started – that 2022 would be challenging.

Eswar Prasad

Next year is shaping up to be a rough one for the global economy. Weakening growth momentum across the board, the fallout from a series of self-inflicted policy wounds, and severe constraints on policymakers' room for maneuver portend heightened risks of further economic pain and financial turmoil in 2023.

On a positive note, the world economy seems to have adapted to a series of unfavorable shocks over the last year, including a protracted war in Ukraine, volatile energy prices, and the disruptions from China's draconian zero-COVID policy. Inflation in the major economies seems to have stabilized, and is even showing signs of edging down.

To be sure, as the chaos arising from China's attempted exit from zero-COVID shows, policymakers are operating on a knife's edge, with little margin for error. Nonetheless, an explosive worldwide economic or financial crisis does not seem likely, unless policymakers in any of the major economies act capriciously or orchestrate a major geopolitical flare-up.

That said, some parts of the world are arguably already in crisis. Low-income countries have been hit hard by surges in food and commodity prices, the devastating effects of climate change, and limited access to foreign finance. Even in middle- and high-income economies, a combination of factors is hammering poor people's living standards.

Whether or not a major crisis occurs in 2023, economic inequality – both within and across countries – is likely to deepen further, unless policymakers take resolute and constructive steps to rebuild consumer and business confidence.

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Anat Admati, Professor of Finance and Economics at the Stanford Graduate School of Business, is co-author (with Martin Hellwig) of *The Bankers' New Clothes: What's Wrong with Banking and What to Do about It*.

JIM O'NEILL

Jim O'Neill, a former chairman of Goldman Sachs Asset Management and a former UK treasury minister, is a member of the Pan-European Commission on Health and Sustainable Development.

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