Global Stagflation Risk

What is the issue?

Due to Russia's invasion of Ukraine, the economic costs of the conflict in Eastern Europe threaten to stall the shaky global recovery from the COVID-19 pandemic.

What sanctions were imposed on Russia?

- The US, EU, United Kingdom and Canada had announced that the assets of Russia's central bank will be frozen, which would make it difficult for it from selling them overseas to support its own banks and companies.
- With a view to isolate Russia from the international financial system, the western allies decided to block selected Russian banks from the SWIFT messaging system used to validate and complete international payment transactions.
- They also resolved to impose restrictions on the Russian central bank's ability to access and deploy the country's war chest of an estimated 630 billion dollars in foreign exchange reserves.

What is the current status of the global economy due to the war?

> *Stagflation is characterized by slow economic growth and relatively high unemployment which is at the same time accompanied by rising prices.*

- The expansive financial sanctions imposed on Russia by the U.S. and its western allies have sent the value of the Rouble plunging by more than 60% against the dollar since the start of the conflict.
- The war-led disruptions to supply and the sanctions have sent the prices of several key commodities soaring.
- Brent crude futures are currently about 29% higher than before the invasion began on February 24.
- The price of natural gas has also risen sharply in Europe amid concerns of the U.S. proposal to shut the tap on Russian energy exports or by retaliatory sanctions by Moscow.
- An embargo on energy supplies from Russia could send already high electricity costs in the eurozone countries.
- This in turn would hit consumers, as well as businesses and factories, forcing them to either raise prices or possibly even temporarily shut operations.
- Stagflation would sharpen trade-offs between expansion and inflation.

Russia supplies Europe about 40% of its gas requirements, roughly a quarter of its oil and almost half its coal needs.

What forecasts have been made for the future?

- Inflation in the euro area had accelerated to 5.8% in February, mainly on account of a more than 31% surge in energy prices,
- With the uptrend in oil prices steepening sharply, the outlook for price gains in Europe and worldwide is not encouraging.
- The IMF cut its forecast for global growth in 2022 to 4.4% citing the Omicron variant, rising energy prices and supply disruptions and warned that the war in Ukraine posed grave risks to the global recovery.
- With analysts projecting that crude prices will cross 180 dollars and some traders punting on prices surpassing 200 dollars a barrel, India can hardly be optimistic.
- In a paper 'The Impact of Crude Price Shock on India's Current Account Deficit, Inflation and Fiscal Deficit', two senior RBI researchers proposed that a 10 dollar increase in the price of oil from a 65 dollar level would raise headline inflation by about 49 basis points.
- India's policymakers face a tough choice of bearing the cost of lower revenue by cutting fuel taxes or risking both faster inflation and slower growth.

References

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