THE ECONOMIC OUTLOOK GROUP

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ECONOMIC TALKING POINTS

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QUICK NOTE:

Wars in the Middle East, Ukraine, Soaring Interest Rates, High Energy Prices: The Fallout?

Let me first acknowledge the horrific human tragedy that occurred in Israel over the weekend.

The shocking events was another brutal reminder that any calm in the Middle East is just that, a period of respite and an opportunity to rearm, not lasting peace. Indeed, this latest conflict shows every sign of continuing for months and is almost certain to engulf Syria, Hezbollah in Lebanon and, of course, Iran.

It also demonstrates how even a sophisticated, hi-tech security state like Israel can suffer a catastrophic intelligence failure. It’s a lesson for all countries to grasp. The use of cameras, computers, software, drones, AI, and satellite images provide no absolute assurance of safety against terrorism. Indeed, they may induce intelligence analysts into complacency as they rely excessively on the outcome of national security algorithms.

So what now? The global economy is facing the fifth major exogenous shock in just over three years (...Covid pandemic, supply chain shutdown, Russia's invasion of Ukraine, China's domestic struggles, and now the attack on Israel by Hamas).

I must admit the latest geopolitical storm in the Middle East has shaken the foundation of our own forecasts.

First, Russia's war in Ukraine is for now off the front pages even though there has been no change in its intensity. The tragedy in Israel now dominates the news. Moreover, whatever additional military aid Ukraine's President Zelenskyy sought from the West may now be in jeopardy as a major portion of those arms now get diverted to support Israel's defense.
Could that change the tide of the conflict in Ukraine?

Second, the sudden violence in the Middle East highlights the absurdity, if not danger, of the GOP paralysis in the US House of Representatives. A prolonged disfunction in Congress at a time when the geopolitical pot is in full boil is not just embarrassing, it harms America's own national security and maims our ability to lead in the world.

Third, the risk increases of another disruption in global oil and natural gas supplies just when temperatures are beginning to cool. That can push prices higher in the weeks ahead and frustrate central bank efforts to reduce inflation. Both Brent and WTI oil jumped 3.5% to 4% Monday morning, pushing the price ever closer to $90 a bbl again.

In addition, given the growing geopolitical uncertainties, bond investors are likely to demand a larger risk premium to own US Treasuries, which can then push 10-year yield toward the 5%. As we said before, a yield beyond 5% lasting several months when Americans are carrying record debt is not sustainable.

Final note: If the US economy before this weekend had been hanging by a thread to avoid recession, one has to wonder how much longer that thin string will hold up against the cumulative weight of high interest rates, swelling debt, a looming government shutdown, surging energy prices, a ferocious war in the Middle East and the battles in Ukraine?

The next few weeks will determine whether that fragile string finally snaps. In the meantime, every firm must ready contingency plans in the event the US economy finally capitulates from all the financial, political and geopolitical stresses. Even a resilient economy has its limits.