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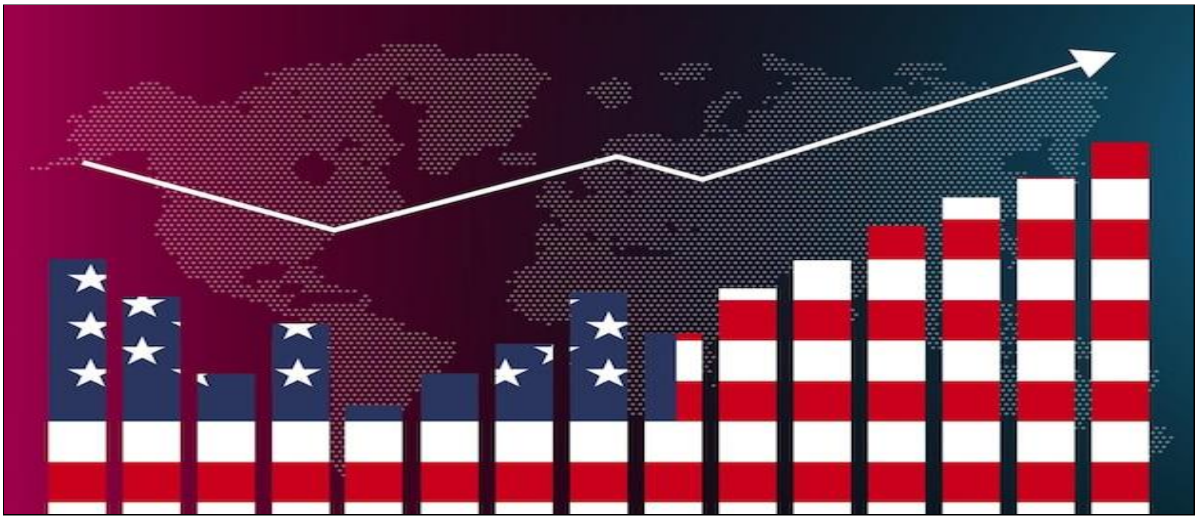
MSC Fintech with Business Analytics (Core)

MACRO MIRRORS: COMPARING 1980 AND 2022 IN US ECONOMIC HISTORY



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1.INTRODUCTION

This research paper examines the complex economic dynamics that existed in the US throughout the 1970s and 1980s Great Inflation period and makes comparisons to the post pandemic financial crises of the US market in 2022. Considered the macroeconomic conditions of both eras, with an emphasis on pinpointing important elements that shaped economic paths. The study highlights the effects of two important macroeconomic factors i.e., Inflation and Unemployment on economic circumstances while clarifying their significance in each age. Through identifying similarities and differences between 1980 and 2022, this study aims to show how the US economy has changed over time.

The United States experienced the Great Inflation from 1970 to 1980, which was a complicated economic event influenced by several variables. Due to geopolitical events like the Iranian Revolution and the OAPEC oil ban, there were two major oil price shocks in the early 1970s that caused oil prices to double and contributed to cost-push inflation. After struggling with expansionary monetary policies for a while, Chairman Paul Volcker of the Federal Reserve changed policy in the late 1970s, which led to high interest rates. Stagflation, a rare mix of high inflation and unemployment, was seen during this time because to spiralling wage-price relationships in the labour market. The decade saw increased volatility in the financial markets and served as a test field for policies aimed at reining in inflation. The U.S. economy didn't start to emerge from this difficult phase until the early 1980s.

The COVID-19 pandemic has presented the world economy with historically unseen difficulties, and its aftermath has resulted in a new era of complex economic dynamics. At the nexus of post-pandemic financial recovery, the United States finds itself struggling to recover from the terrible health disaster. Widespread lockdowns, supply chain delays, and changes in consumer behaviour have had a profound impact on the country's economic environment.

To analyse the many opportunities and difficulties that characterise this phase of recovery, this study sets out to investigate the post-pandemic financial problems in the American economy. It aims to offer insights into the complex process of reconstructing and remaking the economic future of the United States by analysing the changing economic dynamics, governmental reactions, and industry reconfiguration.

Crises are severe reflections of the dynamics between the financial industry and the real economy at a given moment. Therefore, understanding financial crises requires a grasp of macro financial links, which is a highly challenging endeavour in and of itself. The purpose of this research is to give a concentrated investigation of two macroeconomic variables, unemployment and inflation, and their relationship with respect to USA great inflation period and post pandemic financial crises both locally and internationally.

Evaluating how the major macroeconomic indicators responded to the epidemic and how they performed in comparison to previous Great Inflation period is interesting. A more thorough presentation of the potential effects of COVID-19 and worldwide financial crises on important macroeconomic indicators may be found in the next section.

Additional investigation is structured around mapping data and graphical presentation of effect of macro-economic variables to both crises with respect to US as base economy and UK and Europe is taken into consideration for evaluation.

Next section focuses on the Global market impact because of crises. while the last portion is focused on the conclusion and policy recommendation to crises. The section is based on the results.

2.LITERATURE REVIEW

The Covid -19 pandemic is a whole new experience, and it has likely shocked our political and economic structures more than anything since the 1930s Great Depression. Furthermore, our current economic situation is distinct. because of the public health problem interacting with the economy, the political and behavioural reactions of different American and international classes society. *(Princeton University, 2020).*

The Covid-19 pandemic has caused contraction of economy, The International Monetary Fund (IMF) projects a 3% contraction in the global economy in 2020, with advanced economies anticipated to suffer a double-digit loss *(Gopinath 2020).*

Over $9 trillion in direct fiscal stimulus, public sector loans, equity injections, guarantees, and other fiscal measures have already been spent by governments globally to offset this economic shock. *(Blinder, Alan S., 2023)*

The Group of Twenty (G20) advanced and developing market economies have incurred most of this spending, totalling $8 trillion. Across the G20, this equates to an average of 4.5% of GDP. *(Barbier,E.B., 8 JUNE 2020)*

When the Organisation of the Petroleum Exporting Countries (OPEC) almost multiplied the price of oil in only three months in the autumn of 1973, stagflation truly got off. The costs of products and services associated to energy naturally increased as well, causing headline inflation to soar from 7.4 percent in September 1973 to 10 percent in February 1974 and ultimately to a peak of 12.2 percent in November 1974.

The removal of price limits contributed to an even quicker rise in core inflation. From only 3.8% in September 1973 to 11.2 % in November 1974, it increased dramatically. *(Alan S blinder,journal of economic perspectives-volume 37, 2023)*

History has shown that unemployment and inflation went in opposing directions. The idea of recessions was to reduce inflation. And yet there they were, seeing the onset of an inflationary recession. Then known dilemma presented by adverse supply shocks was unusual at the time *(American Economic Review,Bernanke, Ben S. and Alan S. Blinder., 1992)*.

Based on the depressing results of the decade 1970-1980, particularly the rising and volatile rates of unemployment and inflation, it is difficult to argue that the policy was sound in any manner. But just how? The time frame tends to serve as finest example of the risks connected to discretion. *(Board of Governors of the Federal Reserve System, 2023)*

Nominal interest rates may become close to zero during low inflation, which makes it more difficult for central banks to cut their policy rates and stabilise the economy. Scholars who have examined this matter have calculated a trade-off between the probability of reaching the zero lower bound on nominal interest rates and the central bank's inflation target. *(The Federal reserve bank -economic research department, 2007)*

3.MACRO ECONOMIC VARIABLES

A. UNEMPLOYMENT

According to Economic Research report, unemployment hit 8.8% during the Great Inflation period, and reach 15% throughout the Covid -19 pandemic. Additionally, they revealed that in March, 3.5 million job workers had already submitted an insurance claim to the US government. *(Zongyun Li, Panteha Farmanesh, Dervis Kirikkaleli & Rania Itani, 2021)*

The current pandemic's greater unemployment rate is mostly due to health-related factors. Millions of Americans have lost their employment because of the sudden nationwide lockdowns and a severe drop-in economic activity. Regarding the Great Inflation period, there are no such restrictions.

Figure 1 Comparison of Unemployment during Great Inflation and COVID-19.

(U.S.Beuro of labor statstics,FRED, 2023)

While looking at the figure 1, There is a notable difference in unemployment rates between the COVID-19 pandemic's economic effects from 2020 to 2022 and the USA's Great Inflation from 1970 to 1980. The Great Inflation's peak unemployment rate, which was 9% in April 1975, reflected the time's economic difficulties.

On the other hand, a more noticeable high was caused by the COVID-19 crisis, when unemployment rate surged to 14% in the first quarter of 2020.

Although both crises had a significant impact on the labour market, the COVID-19 pandemic—which was characterised by sudden and widespread firm closures because of lockdowns—caused unemployment to grow more sharply and quickly. The difference in the peak unemployment rates highlights how unusual and sudden the pandemic-caused economic collapse was, outpacing the difficulties of the Great Inflation era.

B. INFLATION

Different economic situations can explain the differences in the maximum rates of inflation between the COVID-19 period of and the Great Inflation. Due to variables including oil price shocks, wage-price spirals, and worldwide uncertainty, there were extended periods of high prices during the Great Inflation.

On the other hand, during the COVID-19 era, base effects, surplus demand, fiscal stimulus measures, and supply chain disruptions all contributed to an increase in inflation.

Whereas the COVID-19 period was determined by the exceptional global health crises and distinct economic solutions, the Great Inflation was characterised by structural issues and geopolitical forces.

Figure 2 clearly shows that There is a clear difference in the greatest inflation rates ever observed between the COVID-19 pandemic's economic and the Great Inflation of the USA. The peak of the Great Inflation was reached in June 1980, when the rate of inflation reached an astounding 15.81%, indicating a period of severe economic instability.

Figure 2 Comparison of Inflation during Great Inflation and COVID-19.

(Fred Economic research data, 2023)

In comparison, the maximum inflation rate in 2022 hit 8.9% during the COVID-19 crisis. The two crises are different from one another, as seen by the difference in peak inflation rates.

Extended periods of extraordinarily high inflation were hallmarks of the Great Inflation, but inflation increased throughout the COVID-19 pandemic, although at a less little rate. The detailed comparison highlights the complexity of economic difficulties by emphasising the specific dynamics of the more recent pandemic-induced economic disruptions as well as the severity of the Great Inflation.

C. RELATIONSHIP BETWEEN INFLATION AND UNEMPLOYMENT

There are many significant variations in the way that high unemployment and inflation behaved during the COVID-19 period and the Great Inflation of the USA. The Great Inflation peaked in 1975, when recessions were common, with an 8.8% unemployment rate. Curiously, 1980 saw the greatest inflation rate of 15.81%, indicating a delayed and significant effect on prices.

On the other hand, during the COVID-19 era, unemployment, and inflation both saw a sharp increase at the same time, rising to 15% and 8.9%, respectively. The sudden interruptions in the economy brought on by supply chain disruptions and lockdowns during the COVID-19 pandemic are responsible for the corresponding rise in both unemployment and inflation.

Figure 3 Comparing Unemployment and Inflation with Both crises.

(Economic Research, Fred(CPI and Unemployement rate), 2023)

In contrast, the Great Inflation showed a more irregular trend, with unemployment peaking before inflation. These trends highlight the distinctive features of each crisis: the COVID-19 era was characterised by the swift and interrelated effects of a worldwide health crisis on pricing and labour markets, whereas the Great Inflation was characterised by chronic economic difficulties.

4.RESULTS

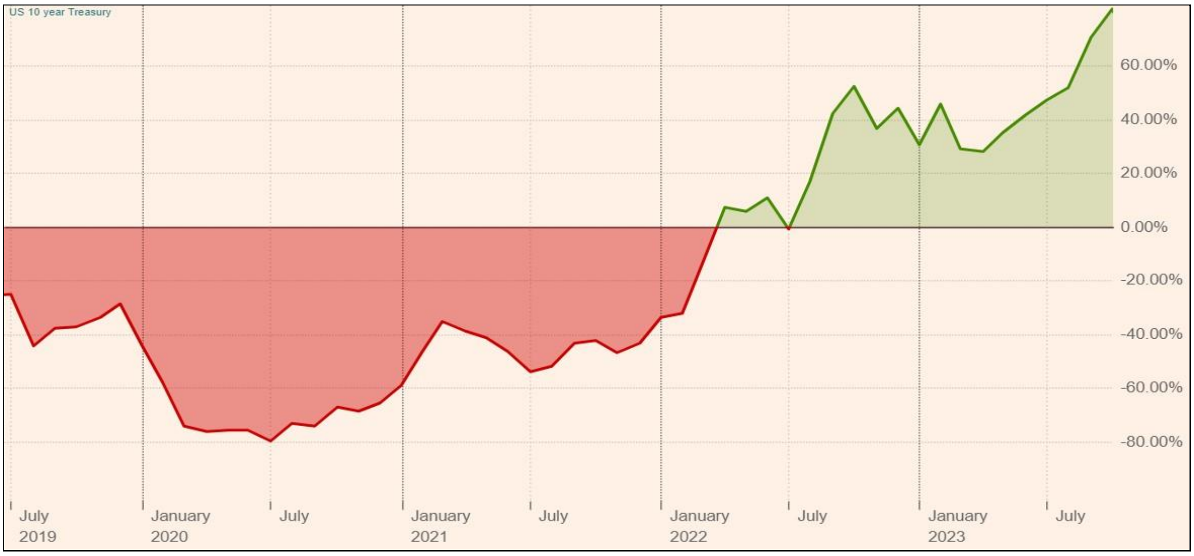
GLOBAL IMPACT-COVID 19

- **Discussion of global impact after the COVID-19 pandemic, critical analyses of markets in the US, UK and Europe before, during and after the crisis.**

The worldwide financial markets were significantly impacted by the COVID-19 epidemic, affecting the money, bond, equities, and commodities markets in several countries. Important patterns and movements can be found by examining movements before, during, and afterwards the crisis.

(1) USA ECONOMY MARKET ANALYSIS

Figure 4 Market Yield on USA 10-year Treasury Bond



(USA 10 year T.Bond-Financial Times, 2023)

Money Market (Bond Market): Prior to the epidemic, low interest rates defined the American money market and bond markets. The Federal Reserve quickly put monetary stimulus plans into place during the crisis, cutting interest rates and making significant asset acquisitions. Bond prices soared as a result, and yields fell. Following the crisis, addresses of a possible reduction of these measures affected bond market movements, creating volatility.

Equity Market: Prior to the epidemic, historical highs were being reached in the US equity markets. There was a severe market correction during the crisis, with notable drops in the main indexes. However, a strong post-crisis rebound in stocks was driven by bold fiscal and monetary measures as well as optimism for the development of vaccines.

Commodity Market: The epidemic caused a sharp drop in the price of commodities, especially oil, as fears over excess and decreased demand arose. After the crisis, commodities prices recovered as demand increased and economic activity resumed, although some volatility continued.

2.UNITED KINGDOM MARKET ANALYSIS

Figure 5 Indices (Dow Jones, S&P 500, FTSE 100) from year 2019- 2023.

(Indices data -Dow jones, s&p 500 , FTSE100-Financial Times, 2023)

Money Market (Bond Market): The money market moves in the UK were very similar to those in the US. Comparable steps were taken by the Bank of England to mitigate the economic consequences. Low interest rates were common before to the financial crisis, and the central bank cut rates and used quantitative easing at that time. Bond market dynamics were impacted by concerns of tighter monetary policy after the crisis.

Equity Market: The pre-crisis bull market in UK equities was followed by a severe decline during the epidemic, following U.S. habits. After the crisis, the government's fiscal assistance policies and hope for an economic recovery helped boost the equity market higher.

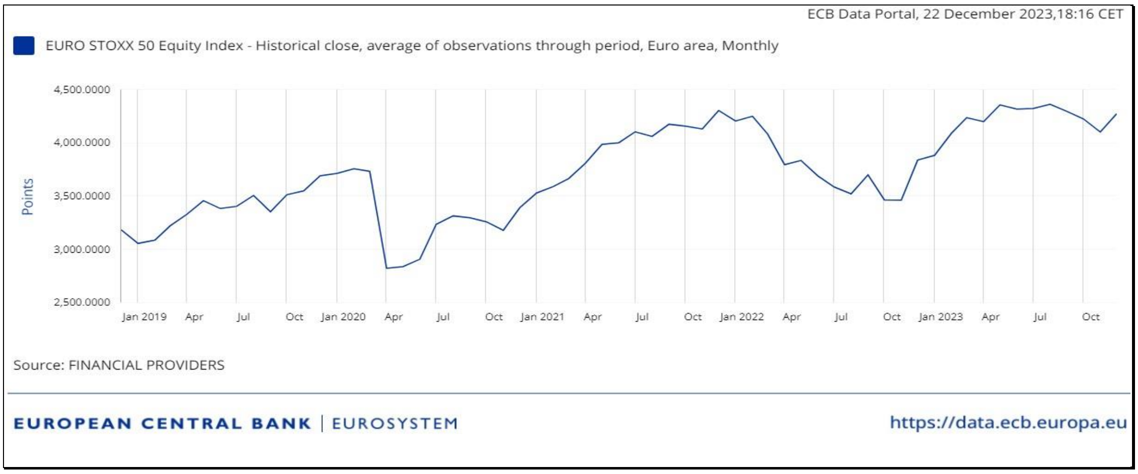
Commodity Market: The UK saw a drop in commodity prices during the epidemic, in line with the global trend. There were difficulties, namely with the oil market. The post-crisis rebound was linked to the world economy's comeback.

3.EUROZONE ECONOMY MARKET ANALYSIS

Money Market (Bond Market): The European Central Bank (ECB) coordinated activities among numerous nations that make up the Eurozone. Interest rates were low before to the crisis. The European Central Bank (ECB) carried out stimulus programmes, which included buying bonds. Bond market fluctuations were impacted by proposals for changing monetary policy after the crisis.

Equity Market:

Figure 6 Euro Stoxx 50 Index (Equity)

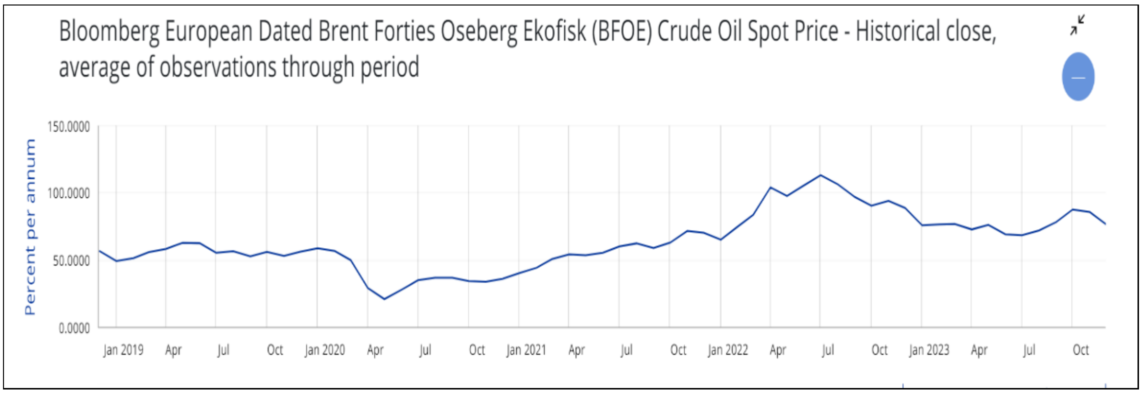


(European Central Bank, 2023)

While looking at Figure 6 it has been observed that during the pandemic, the equities markets in the Eurozone fell, mirroring worldwide patterns. The post-crisis rebound in the equities market was facilitated by the EU's immunisation programmes and budgetary reaction.

Commodity Market:

Figure 7 Crude Oil Price Index (Commodity-BFOE)



(Bloomberg (BFOE) Crude Oil Spot Price -Commodity index, 2023)

Reduced demand during the pandemic influenced commodity markets in the Eurozone, including those for metals and oil. Commodity prices recovered after the crisis, but with major volatility, as economic activity picked up again.

The COVID-19 epidemic caused governments and central banks around the world to take extraordinary action, which resulted in dramatic changes in the financial markets. Even though the crisis caused a great deal of volatility, the US, UK, and Eurozone money, bond, equities, and commodities markets were stabilised and recovered largely because to the adoption of monetary and fiscal policies. These marketplaces are still being shaped by enduring difficulties and changing regulations.

5.CONCLUSION AND POLICY IMPLICATIONS

- **Considering the macroeconomic landscape of 2022, regulatory changes have been made to prevent a repeat.**

The study initially gathered data for the analysis from a variety of reliable sources, including the Federal Reserve Bank of America and the American Economic Research Division. The impact of the crisis was examined through an analysis of each variable, whereby the average change and average were computed and subsequently shown in a graphical manner.

The Covid-19 pandemic crisis is having a greater negative impact on industrial output, consumer spending, total corporate inventories, and unemployment than the Great Inflation crisis did.

Ultimately, we discover the fact that economies are not experiencing a recession while the crisis is not particularly remarkable. A crisis like this has a negative effect on international trade and inventory levels, which lowers industrial production and employment. Low consumer spending is therefore further made possible by the unemployment.

However, the pandemic has caused an accelerated shift to e-commerce, Record-breaking growth is being seen in automation, contactless systems (such as automated payments, doors, and lifts), artificial intelligence, home delivery services, WfH technology, and many other areas.

Central bank has taken several regulatory actions to control economic stability in the event of a high rate of inflation in 2022. These actions involve changing interest rates, tightening monetary policy, enforcing stricter financial laws, modifying fiscal policy, and dealing with trade and supply chain policies.

Monetary Policy: The Federal Reserve used several measures to boost economic activity and give financial markets liquidity. This involved creating lending facilities to boost the flow of credit, adopting quantitative easing (purchasing financial assets to infuse money into the economy), and cutting interest rates to almost zero. It was commonly accepted that the Federal Reserve was aiming for core inflation to be between 1.5% and 2%.

Fiscal Policy: To promote healthcare efforts and give direct financial help to individuals and companies, the U.S. government developed multiple fiscal stimulus packages. These packages contained financial assistance for companies, increased unemployment compensation, and direct payments to people.

Regulatory flexibility: To allow financial institutions and enterprises that were having difficulties during the pandemic some flexibility, regulatory bodies temporarily modified a few norms and regulations. This was carried out to support financial market stability and aid in economic recovery.

In addition, the market's expectations are greatly influenced by central banks' openness and clarity in communicating their inflation objectives (US and UK Gvt targeting Inflation rate at 2% by end of 2023) and policies.

The regulatory environment should be updated to reflect the macroeconomic climate of today, considering shifts in market structures, globalisation, and technology since the 1980s. Regulators should prioritise promoting economic development while avoiding inflationary pressures to maintain a balanced approach.

6.OPINION

- **How would you profit against the high inflation period currently?**

In periods of high inflation, investors can use several tactics to protect and increase their money. Think about putting money into tangible assets like real estate and commodities like gold, which have historically served as inflation hedges.

Investing in equities of firms with pricing power, dividend-paying stocks, and sectors like utilities and healthcare can give resilience during inflationary periods. Treasury Inflation-Protected Securities (TIPS) are one way to protect against rising costs.

Other factors to consider include diversification into other currencies and assets, short-term investments that might profit from future interest rate hikes, and careful cryptocurrency investigation. Reducing the term of fixed-income investments might help reduce interest rate risk. In the end, managing the possibilities and problems brought about by high inflation may be accomplished with a well-diversified portfolio and a strategic strategy catered to one's risk tolerance and financial objectives.

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