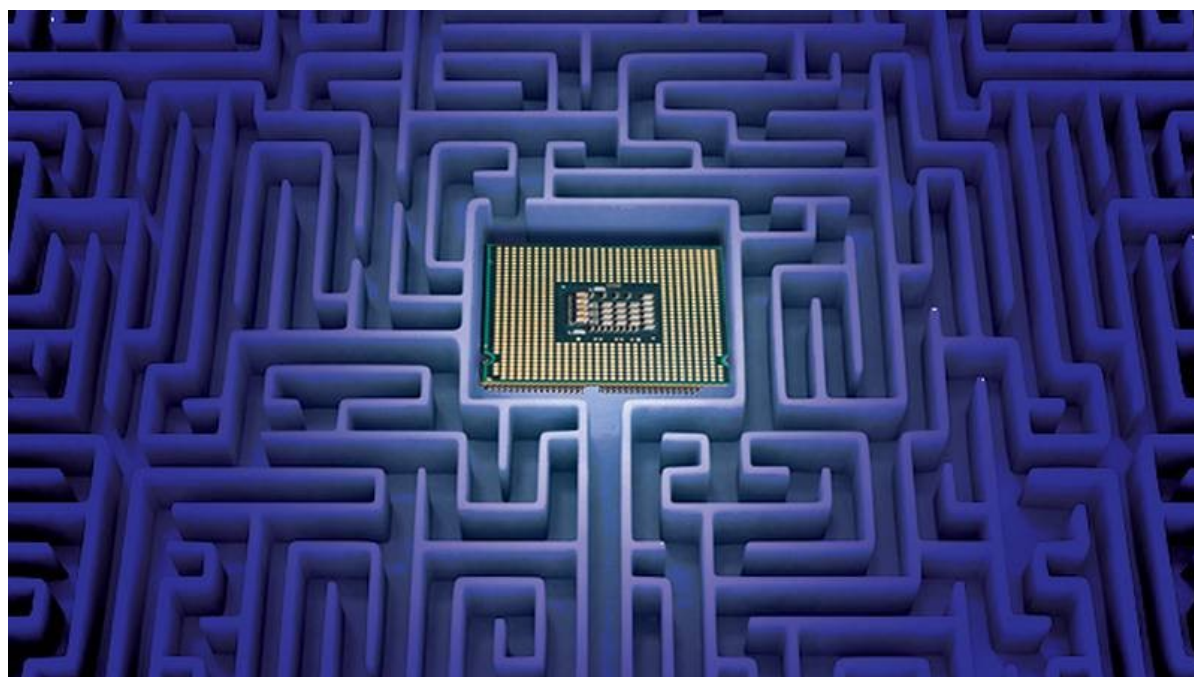


WEEKEND

'Phantom orders', the global chip shortage and the next big recession

Supply and demand imbalances caused by the pandemic are sowing the seeds for economic chaos

YOSSI SHEFFI



An acute global shortage of semiconductor chips has threatened supply chains across multiple industries. The National

Of the countless problems the [Covid-19 pandemic](#) has thrown at companies, a global shortage of microchips is one of the most pernicious. Eventually, the supply of chips will recover, but will affected markets then return to normality?

The likely answer is no. In dealing with the scarcity of chips and associated impact on production schedules, markets have helped to seed another crisis in the form of a global economic recession.

The scarcity of chips has hit a wide cross-section of industries, causing backlogs of orders for products including vehicles, consumer electronics and household appliances. Automakers have been [severely impacted](#). According to one estimate by the US-based consulting firm AlixPartners, the global chip shortage cost the auto industry \$210 billion in 2021.

The roots of the crisis stretch back to the early days of the pandemic. In the first part of 2020, the arrival of Covid-19 put a brake on economies worldwide. Demand for products and services fell precipitously as consumers stayed at home and governments imposed various restrictions on travel and in-person meetings. The GDP of the world's largest economy – the US – fell almost 33 per cent in the second quarter of 2020.

As the crisis gained momentum, governments around the globe reacted by injecting huge amounts of money into their economies in various forms such as unemployment benefits, eviction moratoriums and cash grants. Central banks supported these policies in a number of ways, such as keeping a lid on interest rates.

In combination, the above developments laid the groundwork for a jolting increase in demand that was at the heart of

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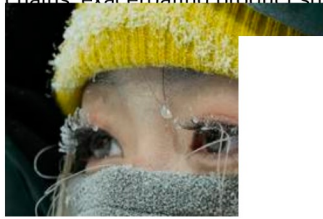
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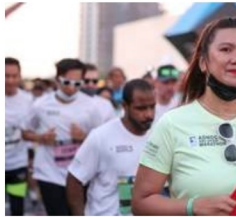
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governments' largesse encouraged consumers to start buying again, and demand for phones and cars, which are reliant on supplies of microchips, soared. Congestion and inflation and warehousing afflicted the entire world economy. As consumer spending faltered, governments had to keep up with the sudden turnaround in demand. The abrupt mismatch between supply and demand increases the cost of transportation and warehousing – dislocated the world's supply chains, exacerbating product shortages in multiple markets.



Even in Beijing's isolation bubble, the excitement of the Winter Olympics



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Product shortages continue to plague markets and are unlikely to stabilise. Moreover, the behaviours that underpin them are creating conditions conducive to a significant economic downturn.

A key driving force is a well-known supply chain effect. As today's product manufacturers struggle to keep up with demand, they often over-order, assuming that only a fraction of their order will be needed. The next link in the supply chain passes it to a tier-one supplier. The tier-one supplier then passes it to a tier-two supplier, and so on, until it reaches small, sub-tier suppliers deep in the supply chain.

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As today's product manufacturers struggle to keep up with demand, they often over-order, assuming that current demand will continue to grow. The inflated order, in turn, inflates the order further, and so on, until it reaches small, sub-tier suppliers deep in the supply chain.

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As companies today grapple with shortages of parts and components, they should be aware of how the underlying causes of these shortages aided by the bullwhip effect could cause markets to pivot, and prepare for the worst.

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