Russia-Ukraine Conflict

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Impact for the Economy – focus on Europe

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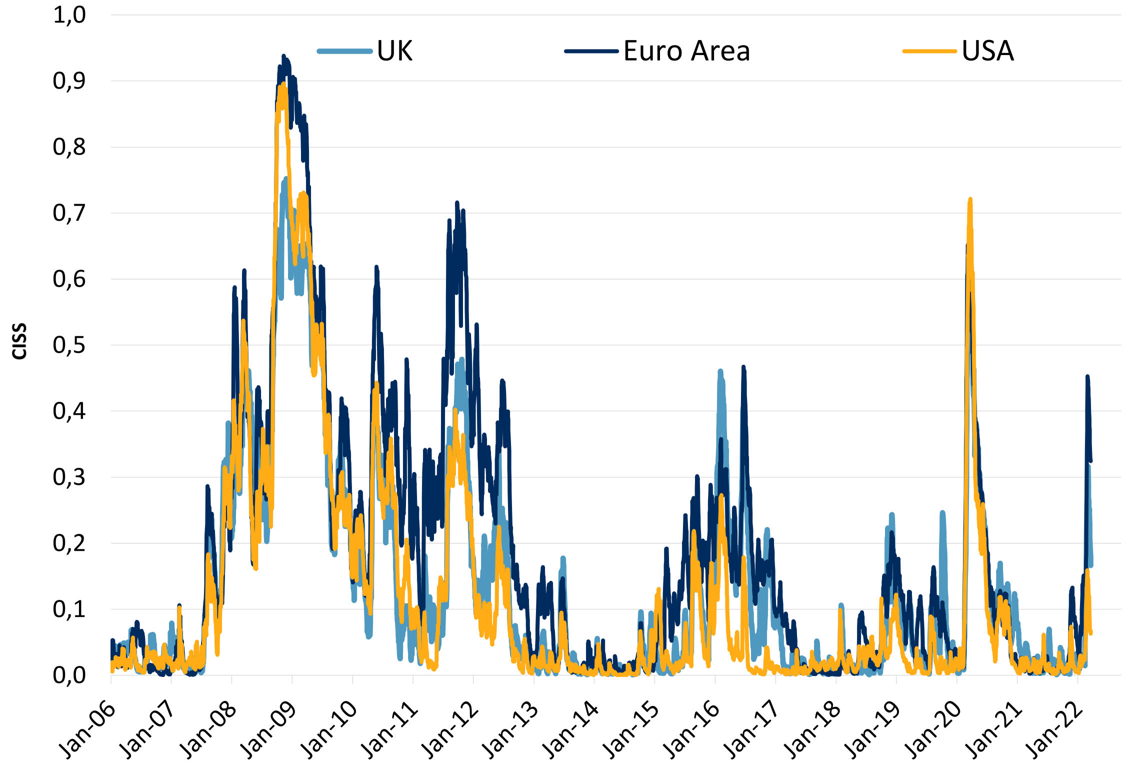
S&P Global Ratings

This report does not constitute a rating action.

Global Macro | Unusually large numbers of negative shocks before a complete recovery from Covid

Composite Index of Systemic Stress

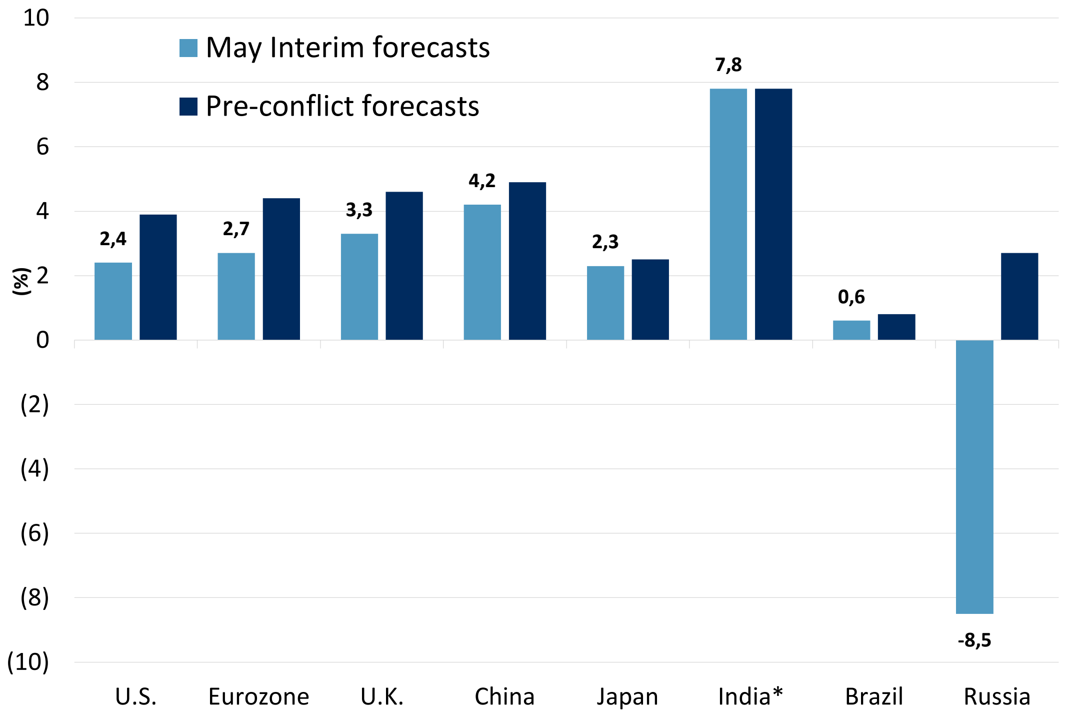


Source: ECB

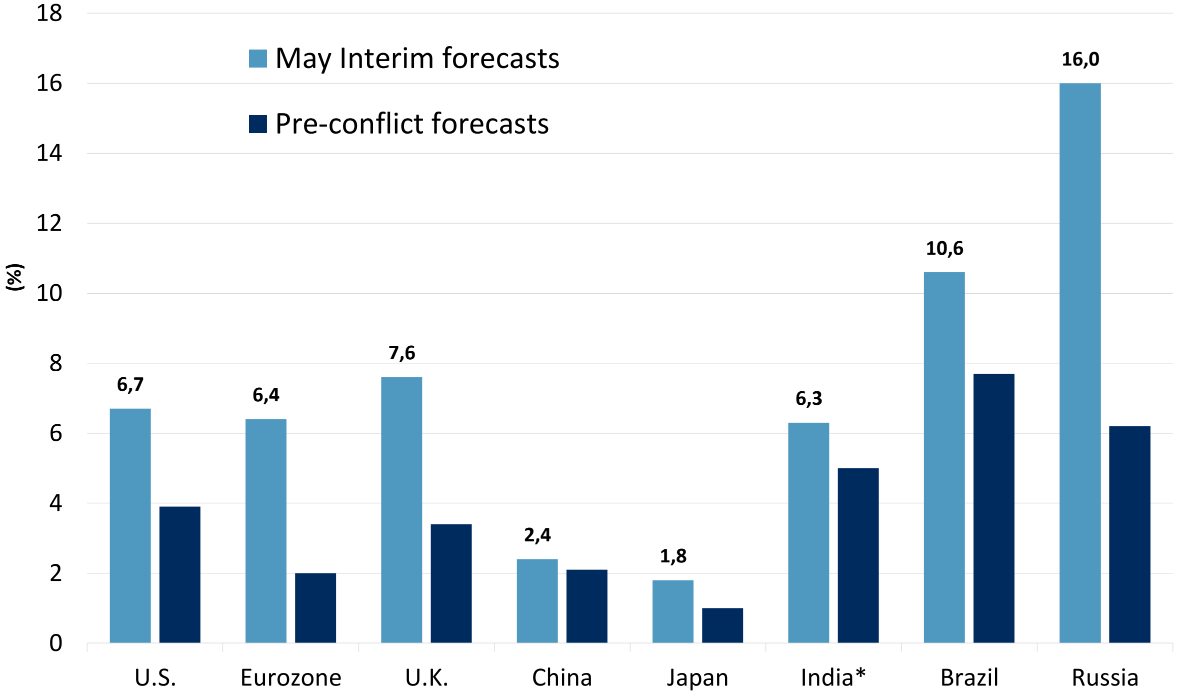
- At the beginning of 2022, the effects of the **COVID-19** pandemic were in retreat in most geographies and a strong rebound was on the cards.
- Two developments have altered this macro picture. One is **Russia's invasion of Ukraine** in late February. This sent energy and commodities prices (even) higher for (even) longer and put a dent in confidence, which was at high levels. The second is **inflation**, which has turned out to be higher, broader based, and more persistent than thought just a few quarters ago.
- More recently, macroeconomic conditions have continued to weaken due to **faster monetary policy normalization**, which will slow demand more than expected, and the **strict lockdowns in China**, which complicate supply issues.

Forecasts | Less growth, more inflation, and above all more uncertainty

2022 Real GDP Growth Forecasts: Major Economies



2022 CPI Forecasts: Major Economies



Source: CEIC, S&P Global Economics; Oxford Economics

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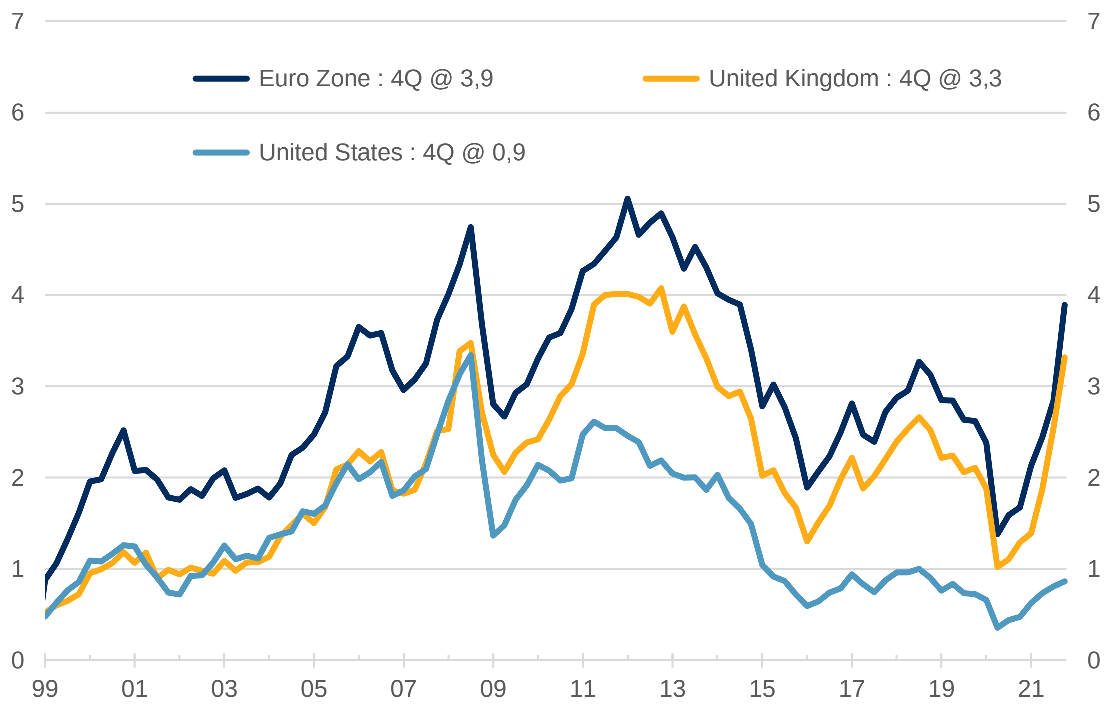
Excess savings and fiscal policy help Europe cushion the price shock, at least temporarily

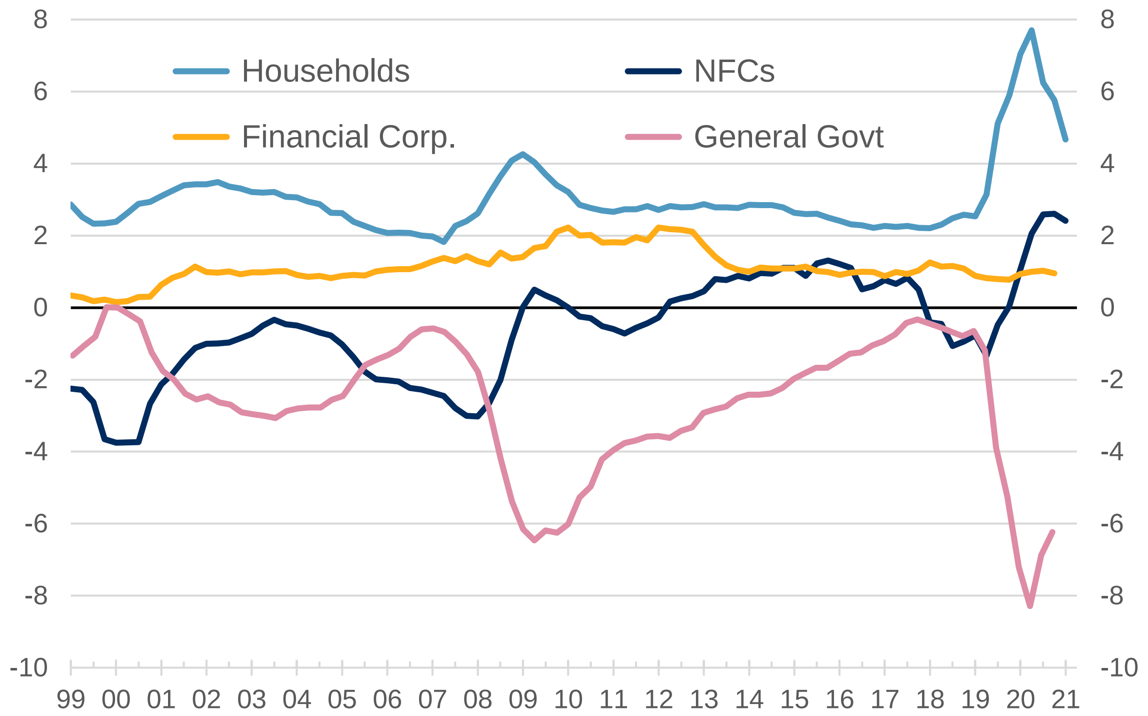
- Supply shortages and dependency on Russia add to Europe's energy imports' bill. Extra-EU energy imports consist of 70% oil, 19% natural gas, 6% LNG and 3% coal. 25% of oil and 47% of natural gas comes from Russia
- For now, large excess savings that corporates and households have accumulated during the pandemic can cover this increased energy bill. But not for the lower deciles of the income distribution, and the pool of excess savings is not unlimited. Fiscal policy is working to mitigate the impact.

Import of Energy (% of GDP)



Sources: Refinitiv, S&P Global Ratings.

Eurozone: net Lending / Borrowing (4Q sum, % of GDP)



Sources: ECB , S&P Global Ratings.

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The conflict in Ukraine is a game changer for commodity prices and supply chains

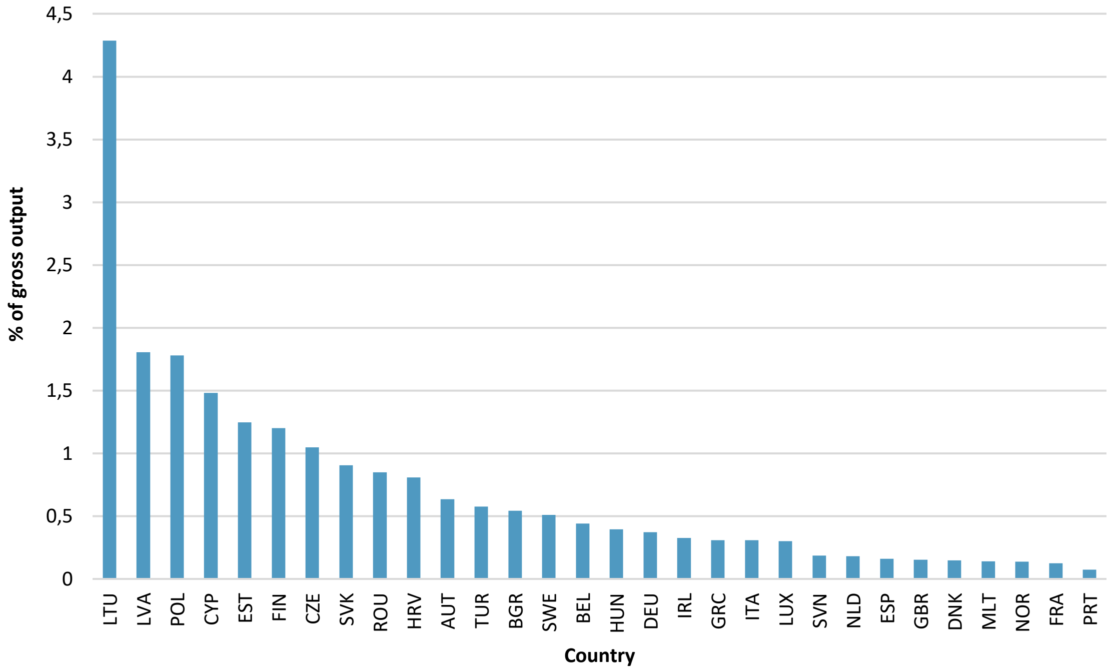
– Supply bottlenecks were starting to ease ahead of the Ukraine conflict. Inventories in finished goods are still low but less than three months ago.

– The conflict in Ukraine is creating new price pressures on food and components from Eastern Europe that are embedded in West European productions. This will have an impact on consumer prices until next year at least.

Global Supply Chain Pressure Index

Sources: NY Fed

Intermediary components from Russia that are embedded in European productions



Sources: S&P Global Ratings. Calculations are based on WIOD

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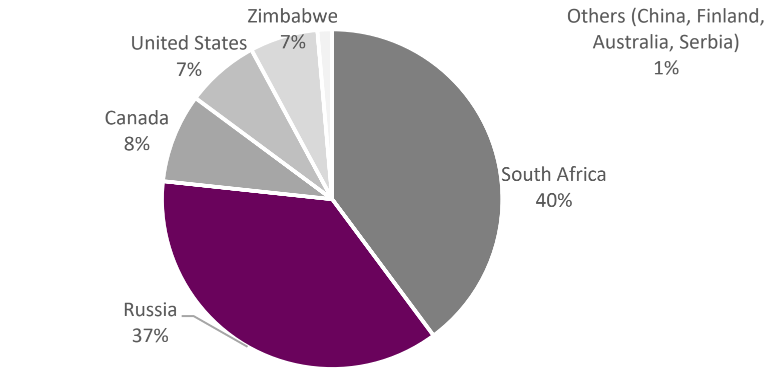
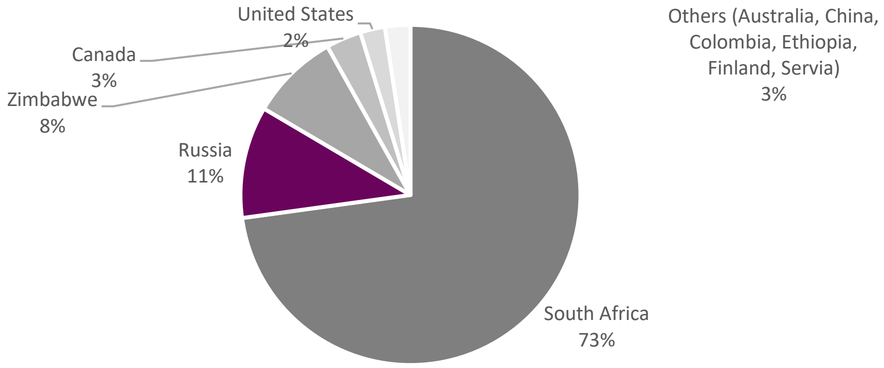
Industrial Materials | Russia Is A Major Source Of Industrial Raw Materials and Minerals

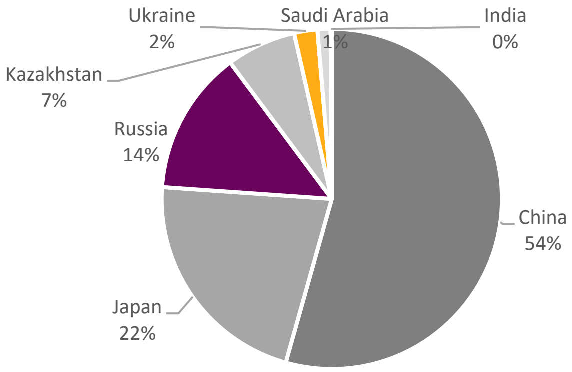
World Palladium Production By Country, 2021e



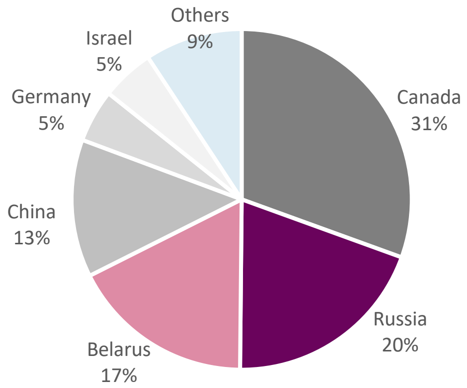
World Platinum Production By Country, 2021e



World Titanium Sponge Production By Country, 2021e



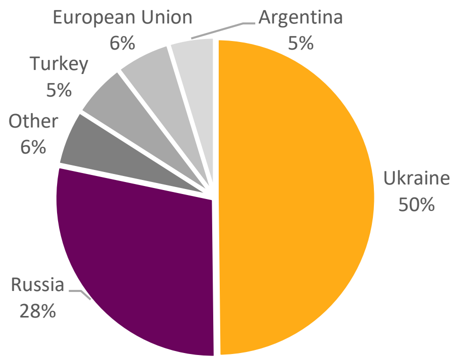
World Potash Production By Country, 2021e



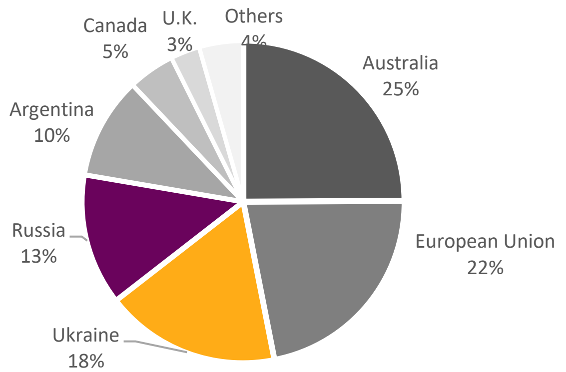
Source: USGS, World Steel Association

Food and Agriculture | Ukraine and Russia Are Both Major Food Exporters

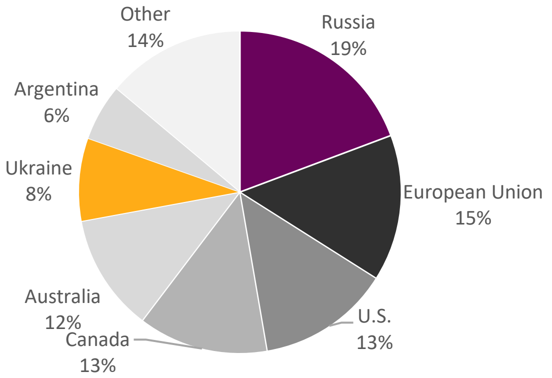
Sunflower Seed Oil, World Exports, 2021/22e



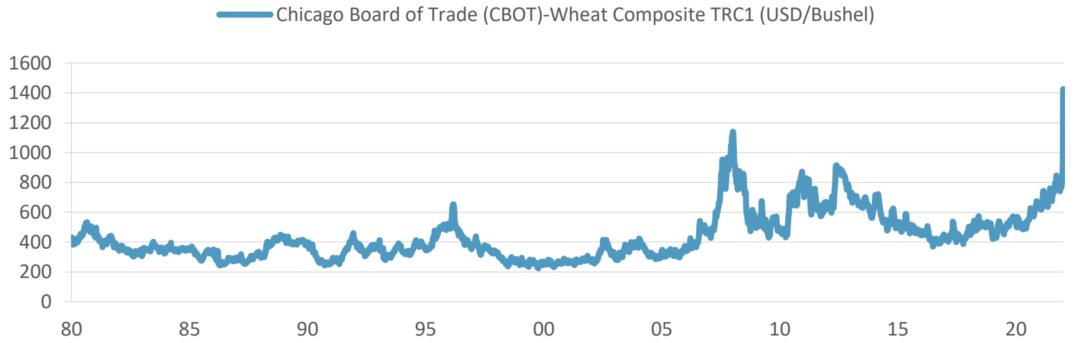
Barley, World Exports, 2021/22e



Wheat Exporters: Share Of World Exports By Country, 2021/22e



Wheat Futures Prices Have Surged To A Record High

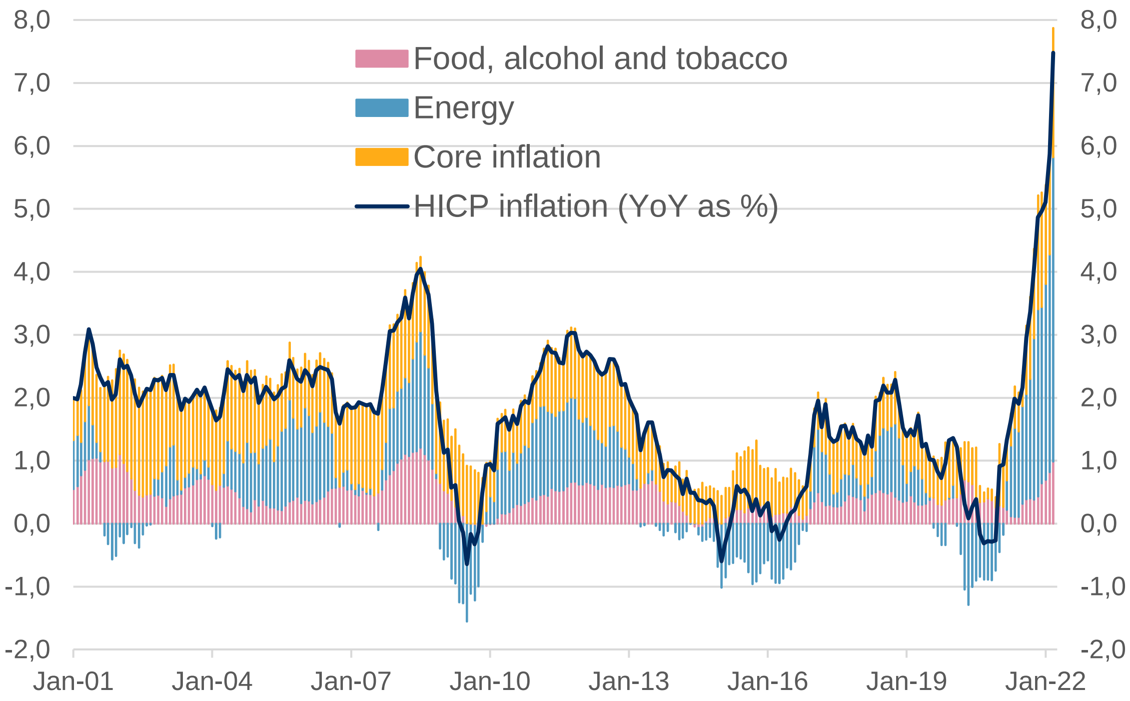


Source: USDA, World Agricultural Outlook Board (WAOB). Shows estimates of production for growing season 2021/22 made in February prior to start of conflict.

Inflation might recede less than expected in the medium term, driven by the steady and broadening rise in commodities prices

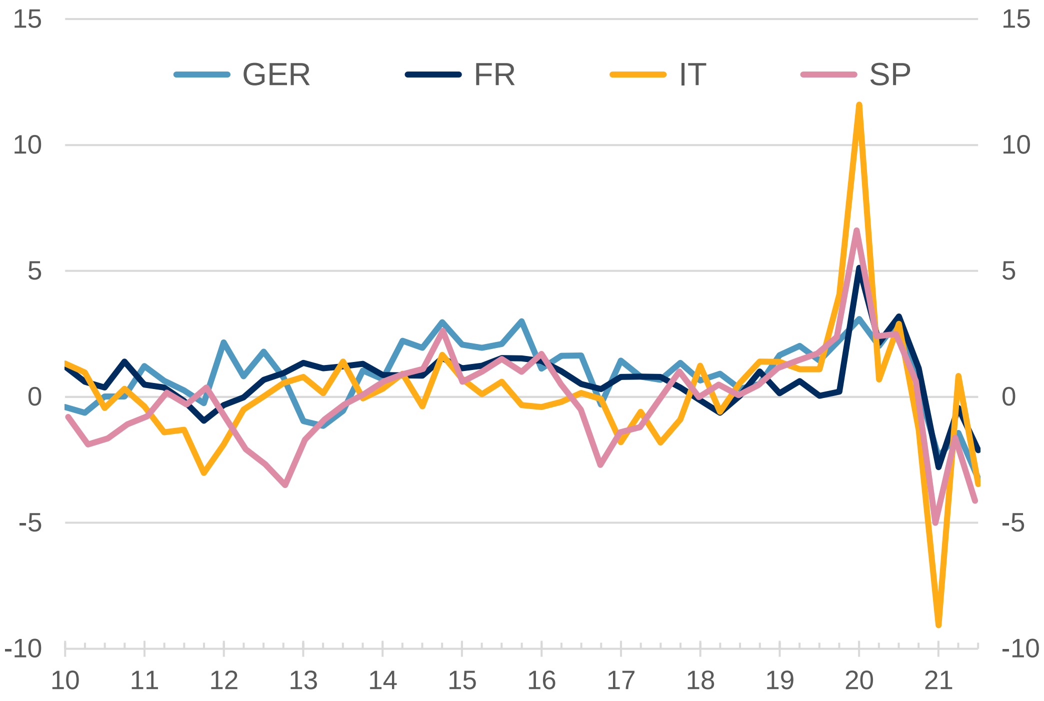
- Inflation is expected to have peaked and to recede slowly from now, unless the conflict escalades. Firming food inflation could however slow the process of disinflation.
- Skyrocketing commodity prices have been passed quicker than usual to the consumer. Things could change as consumers are facing a budget constraint.

Eurozone headline inflation and main contributions (yoy, %)



Sources: Refinitiv, S&P Global Ratings.

Compensation per hour, deflated by CPI (yoy, %)



Sources: Refinitiv, S&P Global Ratings.

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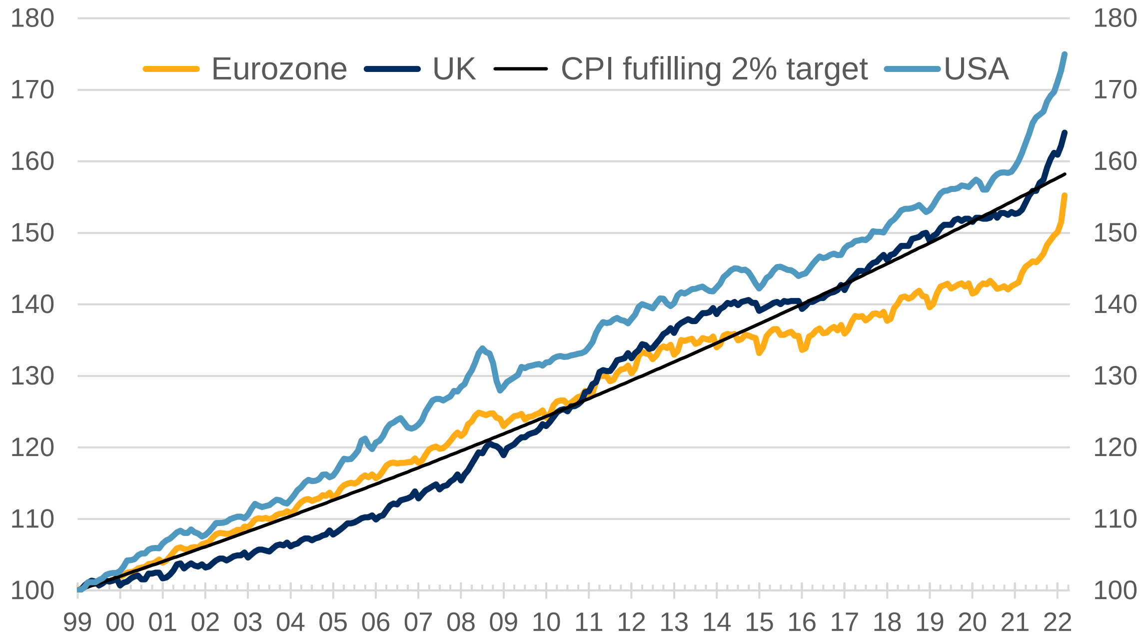
Central banks are likely to keep different strategies to normalize monetary policy

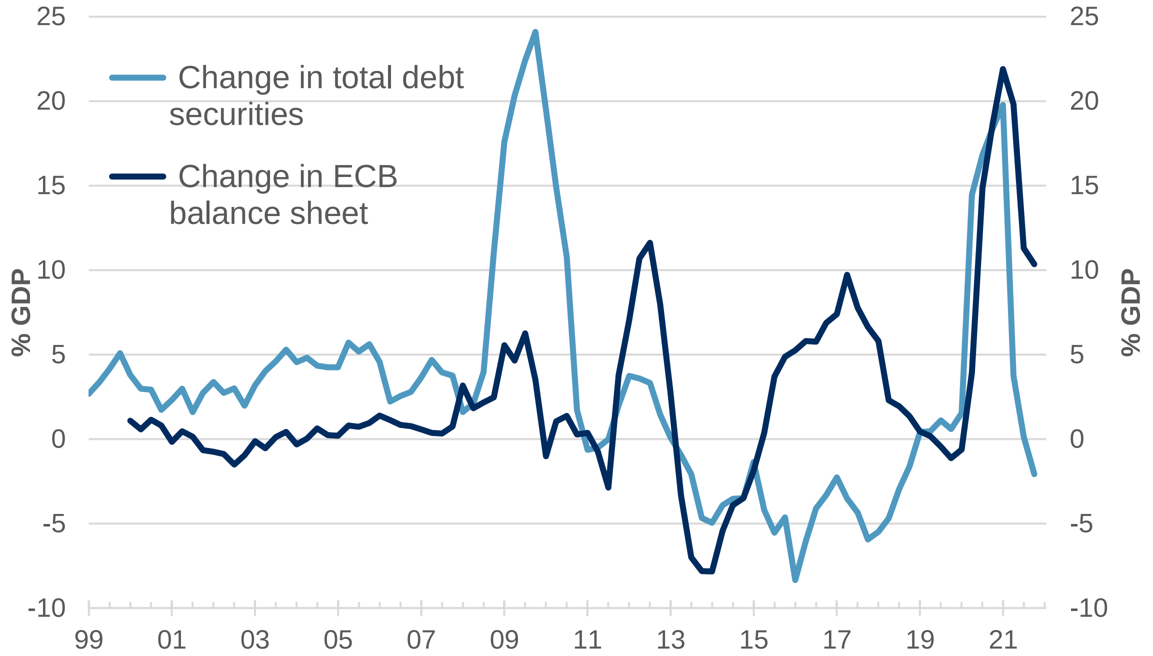
- **Fed**: six to seven rate hikes this year. Four more hikes possible next year. Fed Funds beyond the neutral rate of 2.5% in 2023. We expect the Fed to start reducing its balance sheet by selling mortgage-backed securities and Treasuries starting around mid-2022.
- **ECB:** With a negative price gap, fast tightening financial conditions and wage pressures likely to build up gradually, the ECB is expected to be gradual. A window of opportunity will open in July/September 2022. No outright sales of bonds are likely to be considered.
- **BoE:** expected to lift the bank rate further. Outright sales of government bonds might start in August. Outright sales of corporate bonds have started, with sales to be completed no earlier than towards the end of 2023.

Consumer price level and deviation from central bank target



Source: Refinitiv, S&P Global Ratings.

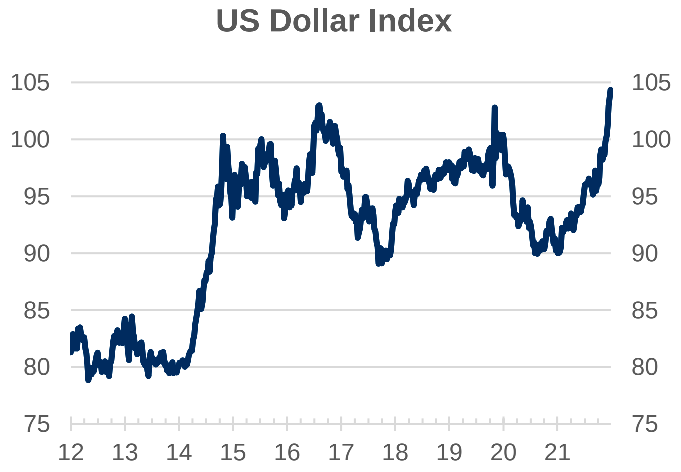
The Eurozone policy mix is not yet divergent



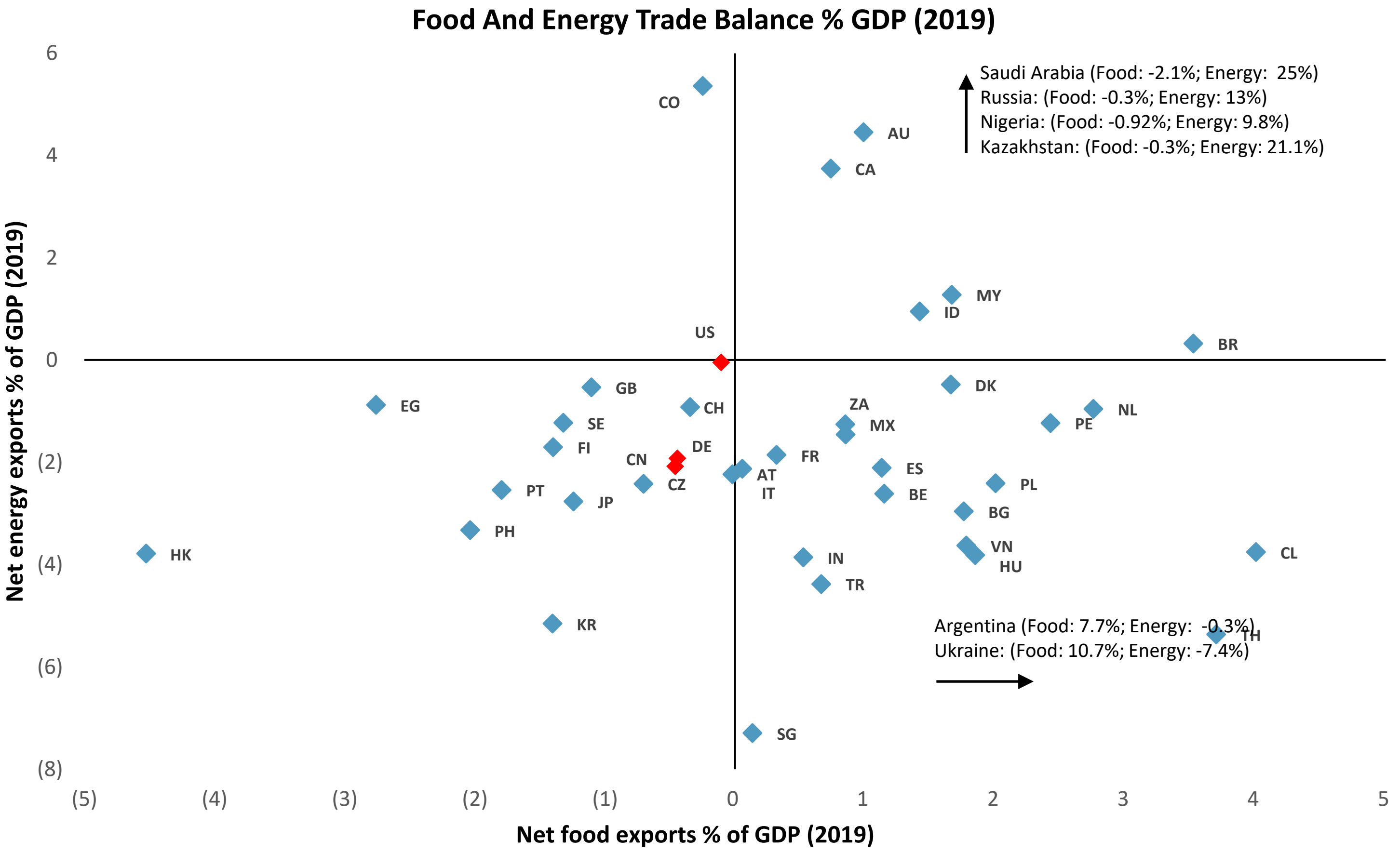
Sources: ECB, Refinitiv, S&P Global Ratings.

The commodity price shock is income redistributive at the global level, with strong regional implications

- *Higher energy prices are slightly negative for global growth*
- *The double whammy of energy and food price shock is negative for many G7 countries excl. the USA*
- *This is having implications for the USD*



Source : Reuters



Source: WTO (Food trade), ITC Trademap (Energy trade), Oxford Economics (GDP)

Note: Argentina:AR; Australia: AU; Austria: AT; Belgium: BE; Brazil: BR; Bulgaria: BG; Canada: CA; Chile: CL; China: CN; Colombia: CO; Czech Republic: CZ; Denmark: DK; Egypt: EG; Finland: FI; France: FR; Germany: DE; Hong Kong: HK; Hungary: HU; India: IN; Indonesia: ID; Italy: IT; Japan: JP; Korea: KR; Malaysia: MY; Mexico: MX; Netherlands: NL; Peru: PE; Philippines: PH; Poland: PL; Portugal: PT; Singapore: SG; South Africa: ZA; Spain: ES; Sweden: SE; Switzerland: CH; Thailand: TH; Turkey: TR; United Kingdom: GB; United States: US; Vietnam: VN

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