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By the Coface Economic Research Department, in collaboration with Institut français des relations internationales (IFRI)

War in Ukraine: Many (big) losers, few (real) winners

EXECUTIVE SUMMARY

More than two months after the beginning of Russia's invasion of Ukraine on 24 February, and despite several rounds of negotiations, prospects for a rapid resolution of the war seem increasingly unlikely. As the conflict has intensified, Western sanctions against Russia have continued to pile up, with no less than five waves of sanctions – six very soon – imposed by the European Union since the beginning of the war. In this context, a rapid lifting of economic sanctions and a return to the pre-war situation seems completely illusory, even if a peace agreement is signed between Russia and Ukraine. In terms of economic consequences, we have revised upwards our initial estimate (published in early March[1]) of the short-term cost to the global economy – to approximately one percentage point in 2022.

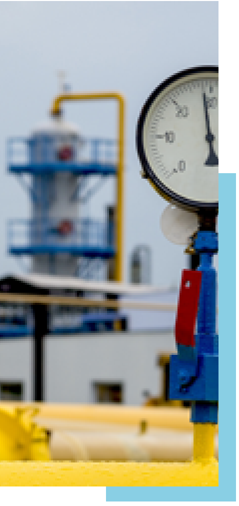
In a strongly and persistently adverse environment, the war in Ukraine will have few winners and many losers. The importance of the belligerents – mainly Russia, but also Ukraine and Belarus – in the production of many commodities and the fears of supply disruptions have led to a surge in prices, which, despite the recent fall back for some of them, remain at very high levels. Inflationary pressures, already prevalent in most regions, are thus exacerbated, leading to a decline in household disposable income and, ultimately, in consumption, as the current anxiety-inducing environment and very high uncertainty will, in all likelihood, encourage precautionary savings. Volatility and uncertainty will also weigh heavily on the investment decisions of companies whose financial situation, despite record-high cash buffers, is also likely to deteriorate significantly as production costs keep increasing or remain high. Beyond Central and Eastern European economies, which have significant economic linkage and trade flows with Russia, Western European countries are the most exposed due to their high dependence on Russian fossil fuels. While the shockwave will be felt differently and at varying times in different parts of the world, no region will be spared from imported inflation, supply chain disruptions, and the resulting global trade sluggishness. We therefore estimate that the war will also have a significant negative impact in the U.S., where the Fed will be forced to conduct more interest rate hikes than initially expected, with massive consequences for the rest of the world. As with any significant monetary tightening by the Fed, most emerging markets will indeed have to follow suit in order to avoid capital outflows and currency depreciation – especially those with large current account deficits and/or high short-term external debt. On top of that - and as already mentioned in our July 2021 Barometer - political risk had significantly increased with the pandemic: this issue will remain more topical than ever, as supply difficulties and soaring food prices are likely to fuel social tensions.

It is worth mentioning that the balance of risks is clearly tilted downwards, as headwinds are accumulating, most notably the resurgence of COVID-19 cases in China, which will fuel both global inflationary pressures and supply chain disruptions. In such a context, the choices that monetary authorities are currently facing are probably as difficult as crucial, in an environment combining decades-high inflation, need for fiscal leeway, and very high levels of public and private debt.

As the economic consequences of the war in Ukraine will mainly materialize from the second half of 2022 onwards, they will obviously affect 2022 GDP growth figures[2], but even more so those for 2023 and beyond – longer term prospects that our next Barometer will cover. In other words, scars are likely to be deep and, beyond human casualties, the economic consequences will be felt for years after this new war on European soil has ended. While it is still too early to predict how the global economy will redesign itself after the successive shocks the early 2020's are all about, the perception we have since the beginning of the pandemic still applies: the world has shifted, and nothing will ever be the same.

1 - Coface Focus: Economic consequences of the Russia-Ukraine conflict: Stagflation ahead. March 7, 2022. *https://www.coface.com/News-Publications/Publications/Russia-Ukraine-conflict-Stagflation-ahead*

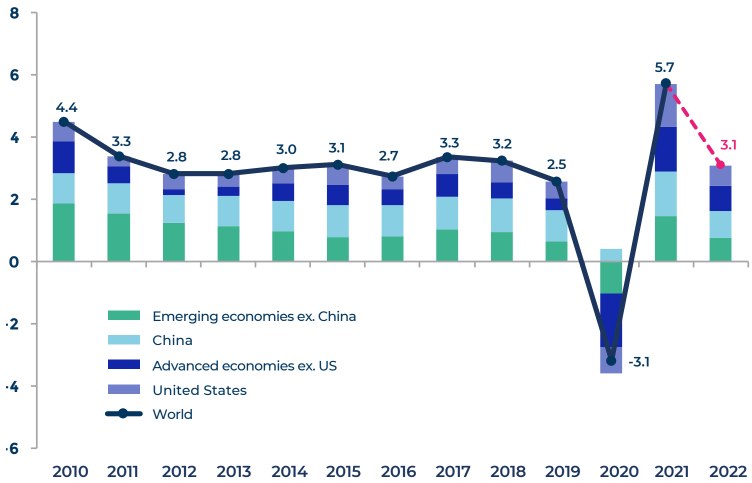
2 - Which should remain positive due to the post-pandemic rebound, still ongoing at the beginning of the year.



Europe in the midst of war and economic turmoil

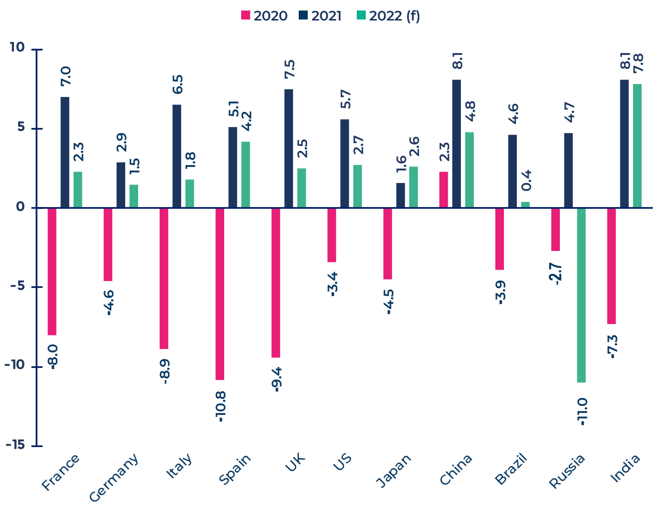
In our world map of the economic impact of the war in Ukraine **(see Chart 6 page 7)**, the belligerent countries are, unsurprisingly, the most severely affected, although it is difficult to accurately estimate the extent of the economic damage. While Ukraine will experience a historic recession due to the stoppage of many activities while the war lasts, the Russian economy will also be strongly impacted[3] by Western sanctions, the departure from the country of most Western companies and the measures taken by the local authorities in reaction to the sanctions (capital controls, sharp rise in the key interest rate) to limit - successfully - the depreciation of the rouble. It is also no surprise that the other countries that appear to be the most affected are those that are close to the belligerents, both geographically and economically: the European and Central Asian economies, with an estimated net negative effect of ~1.5 percentage points on 2022 GDP growth at the aggregate level **(Charts 1 & 2)**.

Chart 1: Global real GDP growth (annual average, %, contributions by region)



Sources : IMF, Coface

Chart 2: GDP growth (selected countries, annual average, %)



Sources : IMF, Coface

BOX 1: OUTLOOK OF THE WAR (BY IFRI)

Following the failure of the blitzkrieg against Ukraine launched on 24 February, the Kremlin seems confused about its objectives and is struggling to adapt its strategy to the available means. In these conditions, the military dynamics on the field will be decisive to determine the duration and the outcome of the war. The latter will depend on the Ukrainian army's capacity to resist and, therefore, on the delivery of arms by the West, which has swiftly adapted on this matter and is now providing Ukraine with offensive systems.

Moscow needs to display a convincing achievement by 9 May, the day of the celebration of the Soviet Victory over Nazi Germany. The most suitable scenario would have been the "liberation" of the Donbass within its administrative borders and the signing of a ceasefire agreement on Russian terms. However, this is hindered by both the difficulty of Russian troops to advance quickly (including to overcome the resistance in Mariupol) and the de facto cessation of talks, with each side accusing the other of unwillingness to compromise. There is a risk of stalemate in the Donbass, a situation comparable to that between 2014 and the beginning of 2022, but on a different scale and within wider borders. This unsatisfying state of affairs could lead Russia to escalate for a breakthrough with, for instance, the tactical use of weapons of mass destruction on the battlefield. The Western reaction will be crucial: an escalation may then occur, which could prompt Russia to strike a NATO target, such as an arms depot or a convoy in Poland, thus engaging NATO's credibility. The situation is therefore as uncertain as in the first phase of the conflict.

Its evolution will also depend on the pace at which two other dynamics - economic and social - will weigh on the Russian war effort. So far, the Russian economy has been resilient and the Central Bank has stabilised the rouble. However, the core of the Russian economic model, based on energy rents, has not been affected so far. While the West is divided over the embargo on Russian hydrocarbons, calculating the cost to their economies, Russia itself seems to be hastening the process by cutting off gas to Poland and Bulgaria. This indicates that economic considerations are secondary to what Russia perceives as a threat to its vital interests. On the Western side, judging by the latest U.S. statements, sanctions will not be lifted as long as Vladimir Putin remains in power and that Russia is a menace to neighbouring countries. To loosen the stranglehold of the sanctions, China's help will be crucial for Moscow, but will gradually increase the dependence on Beijing and make it critical.

Finally, the political and social dynamics within Russia are, for the time being, contained by propaganda and repression, including against the elites. A palace or a street revolution will probably not occur, but an erosion of the Putin system is already underway, as the cost of his actions is weighing heavily on the country's future. If on 9 May, instead of announcing victory (even partial), Vladimir Putin officially declares war and general mobilisation, the consequences are likely to accelerate this erosion.

3 - We have lowered our 2022 GDP growth forecast from -15% to -38% for Ukraine and from -7.5% to -11% for Russia since the Focus published in early March.
4 - The Ifo Business Climate sub-index for business expectation declined from 98.4 points in February to 85.1 points in March.

While the shockwave will be felt differently and at varying times in different parts of the world, Central and Eastern European (CEE) countries are already experiencing the consequences of the war. Foreign trade dependence on Russia is particularly high for the Baltic countries (for instance, total exports and imports with Russia represented 15.1% of Lithuanian GDP last year), which are expected to suffer directly from the Russian downturn. In March, despite government measures to limit the impact, several CEE countries recorded double-digit inflation: Estonia, Lithuania, the Czech Republic, Poland and Romania. In order to try to curb inflation, CEE central banks have continued monetary tightening. Since the beginning of the Russian invasion of Ukraine, the Czech and Romanian central banks hiked interest rates by 50 basis points, the Hungarian by 200 basis points, while the Polish central bank already conducted two hikes, by 175 basis points in total. After depreciating in late February, the Czech koruna already regained its average value recorded in January 2022, while the Polish zloty and Hungarian forint remain slightly weaker, by ~2% and ~5% respectively. Last week, Russia completely halted gas supply to Poland and Bulgaria. The suspension came after Russian President Putin signed a new decree in late March requiring EU buyers to pay in roubles for Russian gas via a new currency conversion mechanism. While Poland informed that its gas storages were 76% full and had invested in infrastructure enabling imports from other directions than Russia, it still needs to secure alternative supplies for the remainder of the year in an already tight global market. While Bulgaria imports 90% of its gas needs from Russian sources, the Bulgarian energy ministry said it had no intention to impose restrictions on gas consumption, which could lead to severe disruptions in industry if the country were to run out of natural gas.

The Eurozone, and more generally Western Europe, will not be spared, as all countries will be negatively affected due to the region's high dependence on fossil fuel imports, especially from Russia. For the time being, without any disruption in natural gas flows but very high prices, the countries most affected are those most dependent on gas, regardless of where it comes from. This is even truer as all the countries in the Eurozone are highly interdependent, and among the countries most dependent on gas – and more particularly gas from Russia – are its first and third largest economies, Germany and Italy.

The pivotal German manufacturing industry, in particular automotive, chemicals and metals, are being impacted sharply by supply chain disruptions, the scarcity of commodities and high energy prices. In March, business expectations recorded a historic fall[4], even stronger than the one at the beginning of the pandemic. We estimate a strong negative impact of 1.6 pp in both countries. The impact would be weaker but still significant in the rest of the region, often higher than 1 pp. As evidence that even the countries least dependent on Russian energy will face a downturn, the production outlook for industry in France recorded its second largest drop ever (surpassed only by April 2020) and price expectations reached a record high in April. Some countries, like Spain and the Netherlands, are expected to suffer from an even sharper increase in inflation, as about half of households have variable energy contracts, making them particularly vulnerable. The latter country is even more affected, as 71% of Dutch households use natural gas for heating.

A complete cut-off of natural gas supply from Russia, a more adverse scenario that looks increasingly likely, would further affect economic activity with an additional impact of up to 2-2.5 pp on EU GDP growth. This estimate is slightly lower than in early March, as we now assume that the EU would find alternative suppliers, or switch from natural gas to other primary energy sources (wherever/whenever possible) that would partially offset the cut in Russian flows **(Box 2)**.

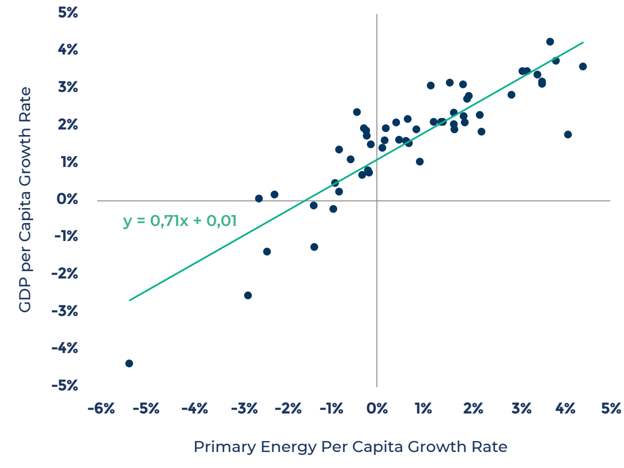
BOX 2: COMPLETE CUT-OFF ON RUSSIAN NATURAL GAS: A QUICK ASSESSMENT OF POTENTIAL SHORTFALL IN THE EU AND ITS IMPACT ON GDP GROWTH (IN COLLABORATION WITH IFRI)

In 2021, total EU gas consumption reached 412 billion cubic meters (bcm), a very high level due to economic activity and weather, and imported 337.5 bcm, out of which 155 bcm were supplied by Gazprom and 16 bcm by LNG through the Yamal LNG plant. In the event of a total disruption in Russian gas imports, around 170 bcm would have to be substituted on an annualised basis.

In 2022, natural gas demand in Europe should be approximately 6-7% lower due to the milder weather and extreme price levels (-15% down year-to-date, partly due to 1Q base effects). This should help reduce the need for imports from Russia given that European production should be more or less stable (other things being equal). The fall in European demand, coupled with additional LNG supplies (o.w. 15 bcm promised by the U.S.) and more pipeline deliveries from some neighbouring countries such as Norway or Algeria, suggests that ~100 bcm (~25% of total European demand in 2021) of Russian natural gas would still have to be substituted.

Assuming a 25% decline in gas-fired electricity production due to higher use of coal and better availability of hydro and renewables, ~30 bcm of natural gas use could be saved, which would leave a ~70 bcm shortfall (~4% of EU primary energy consumption). If households reduce their gas heating needs, an additional 20 bcm could be saved, resulting in a final shortfall of "only" 50 bcm (~3% of EU primary energy consumption). Assuming a GDP-to-energy elasticity between 0.6 and 0.7[5], an order of magnitude suggested by a simple regression analysis (see chart below), the final impact on EU GDP would amount to ~2-2.5 pp on a full year basis – depending on curtailment choices.

Chart 3:
World primary energy & GDP per capita growth rates (1965-2020)



5 - See, for instance, Giraud & Kahraman (2014), How dependent is growth from primary energy? The dependency ratio of Energy in 33 countries (1970-2011).

Some countries would be particularly vulnerable, most notably Germany. Having no LNG terminal, the country has very limited alternatives. There are programmes to charter floating LNG-terminal ships, with two of them starting in late 2022/early 2023. However, they can compensate for only a very limited part of natural gas imports from Russia. Newly built terminals could start operating from 2026. Therefore, a complete halt of Russian gas deliveries or an EU embargo of Russian gas would completely jeopardize Germany's economic model. Despite having spare capacity to import more gas through the Transmed pipeline and having reached an agreement with Algeria to expand deliveries by 50%, Italy is also heavily dependent on Russian gas, and full diversification away from Russia is not yet within sight. No need to mention that uncertainties would be even higher if such a scenario were to materialize, with potential spillover effects likely to cause (far) more damage.

In this environment combining decades-high inflation, need for fiscal leeway - with all governments taking measures to limit the impact of this inflation surge on businesses and, above all, on households -, and already high levels of public and private debt, the European Central Bank's (ECB) response will have a significant influence on our forecast. The ECB finished the Pandemic Emergency Purchasing Programme in March and could end all QE-purchases in Q3 2022. Although a first increase of the deposit rate is expected towards the end of the year, central bankers will be probably cautious with rate hikes, as they want to soothe financial markets and keep yields of European bonds low. Spreads between Italian and German 10-year bonds have been rising steadily since October and stand at around 160 basis points, 60 points above the levels of early 2021, but still at only half of those observed during the Salvini-induced political crisis of 2018.
Unlike the ECB, the Bank of England (BoE) already raised its rates three consecutive times in anticipation of a strengthening of inflationary pressures and even began to reduce its balance sheet after having bought massive amounts of government bonds during the pandemic. With commodity prices expected to remain high, which would thus lead the UK Energy Authority (Ofgem) to increase the annual energy price cap by around 30% in October 2022 (after already +54% in April), the BoE will most likely be forced to continue in this direction throughout the year and further hamper activity growth in the United Kingdom.

As neighbours and partners of Russia, the economies of Central Asia (Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan and Uzbekistan) and the South Caucasus (Armenia, Georgia, Azerbaijan being an exception as an oil and gas exporter) face major geopolitical, social and economic risks. Trade with Russia represents 12.5% of CCA's exports of goods and 25% of their imports. A decrease of their exports to the latter has already been observed, as well as a decline in households' revenues due to a fall in remittances sent by expatriates in Russia: for instance, Tajikistan reported a 75% drop in remittances received in the first 10 days of March 2022. In the region, remittances from expatriates in Russia are a core source of revenues for households: 31% of GDP in the Kyrgyz Republic, 27% in Tajikistan, 11% in Uzbekistan, 6% in Armenia, with Russia being the largest provider. Turkey's is also expected to be on the front line, as the country has strong economic ties with Russia, both in terms of trade (11% of total imports) and foreign investments (about one-fifth of projects undertaken by the Turkish construction sector abroad are in Russia). Given Turkey's dependence on imported key raw materials such as natural gas, metals and grains, disruptions in supply chains weigh on the country's production volumes. Additionally, the rise in all types of commodities and transportation prices hit corporate sector profitability. In the first two months of 2022, Turkey's energy imports surged by 208% to USD 17 billion from a year earlier. This is expected to widen the current account deficit and add to inflationary pressures that are already extremely high. Therefore, we have lowered our GDP growth forecast by 1 pp to 2.5%.

The inflationary effects of war push a hawkish Fed to cool down activity faster than expected

On the other side of the Atlantic, the impact on growth is expected to be more modest because of limited trade and financial exposure to Russia and Ukraine. Nonetheless, as in Europe, the impact on inflation prospects and supply chains is likely to weigh on consumption and residential investment, particularly in the US. The fast increase in inflation is already eroding consumers' confidence, particularly for their future prospects and spending plans. The impact of the war in Ukraine on prices was already visible in the March CPI print, as food and energy were the main drivers of the headline inflation rate, which reached a 41-year high (+8.5%). Stripped from these elements, price growth on a monthly basis ebbed. While this may indicate that a peak in inflation is nearing, it remains significantly above the Federal Reserve's 2% target, and the broadening nature of price pressures in recent months is prompting the U.S. central bank to scale down the monetary policy accommodation implemented to respond to the pandemic faster than previously anticipated.

After a first 25 basis points increase of the Federal Funds Rate at the March meeting, most members of the monetary policy committee have voiced support to bring the rate to a "neutral" level – i.e. the rate at which monetary policy is neither restrictive nor accommodative – by year-end. With most estimates placing the neutral rate between 2% and 3%, this would be one of the most aggressive tightening cycles since the 1990s. While these rate hikes are not set in stone, the Fed is likely to raise its interest rate by half a percentage point at each of its May (3-4) and June (14-15) meetings. In turn, tighter policy will contribute to moderate U.S. growth, as it dampens aggregate demand, starting with residential investment. Combined with inflation eroding consumption, this is the main factor behind our downward revision of our 2022 U.S. GDP growth forecast to 2,7% (-1 ppt vs. our February pre-war forecast). The economic outlook looks definitely less robust and more uncertain than at the beginning of the year. In Canada, while our 2022 GDP growth forecast remains unchanged at 3.8%, the war is also affecting the economy, but the negative impact of higher inflation and tighter monetary policy on consumption and housing investment are anticipated to be offset by higher commodity revenues, starting with those of energy.

While the situation is uneven in Africa, some countries will face all challenges: monetary tightening, food shortages and political risk

The African continent, where we estimate an overall net negative effect of 0.5 pp, is a perfect example of how the current situation is affecting emerging and developing economies. With inflationary pressures intensifying, their possible amplification by currency depreciation and poorly anchored expectations, the U.S. Federal Reserve starting to tighten its policy, and its impact on capital flows, most emerging markets will have to follow suit. Therefore, some African central banks have already lifted their leading interest rates from their low points: South Africa (75 bp), Mozambique (200 bp), Namibia (50 bp), Zambia (50 bp), Zimbabwe (2000 bp), Ghana (250 bp), and Egypt (100 bp). Countries in Western and Central Africa, which are part of monetary unions (WAEMU and CAEMU), are relatively protected by the link between their shared currencies and the Euro. In the rest of the continent, more interest rates hikes are expected. Fiscal accounts, already battered by the pandemic, risk further deteriorating. Most governments will choose to soften the impact from the rise in food and energy prices (and possibly some shortages) on their population to avoid social unrest and an increase in food insecurity by increasing their subsidies and/or social transfers. Consequently, their debt load would increase, with could push many at risk of debt distress, while a handful are already in this situation (Cabo Verde, Chad, Ethiopia, Mozambique, Somalia, Sudan, Zambia, and Zimbabwe).

Like during the pandemic, their fate, in that regard, will depend on the financial implication of the multinational bodies (IMF, World Bank, African Development bank), and bilateral partners (EU, UK, Gulf countries, China). Moreover, this time, some (mostly in the Horn and the Sahel) will see their food supply even more dependent on the UN food programmes, which will be under strain due to the rise in food prices. Additionally, during the pandemic, the public accounts were weakened. This time, the external accounts will be just as much so due to the increase in the import bill. In that regard, the emerging and developing African countries that have access to financial markets will be more exposed than those without, as they mostly rely on concessional lending.

Another characteristic to take into account is their natural resources endowment. Net oil and gas exporters such as Algeria, Angola and Gabon - the only countries on the continent for which we estimate a positive impact -, as well as Congo, Chad, Equatorial Guinea, Ghana, Niger, and South Sudan, will be able to balance out part of their food bill. However, Nigeria's crude oil and LNG exports revenues will be balanced out by its petroleum products imports, at least until the end of the year, when a giant refinery should come online. Countries that have metallic (possibly precious) ores and export crops, such as South Africa, which is an exporter of platinum, palladium, gold, chromium, and manganese, will also manage to foot the bill, at least partially. Western African countries have food crops (rice, maize, cassava, millet-sorghum, yams, groundnuts, lentils, beans, and cowpeas) that constitute a large part of their food consumption, reducing their dependence on imports. Northern Africa, except for oil producing Algeria and Libya, will be hard hit due to its high dependence on imported cereals, cooking oil, and energy. Additionally, Morocco and Tunisia are involved in the European automotive value chain, still confronted with input shortages. Egypt, despite more revenues from gold, gas exports, and Suez Canal revenues, will suffer from the desertion of Russian and Ukrainian tourists. Multilateral and bilateral aid will be much appreciated, especially by Tunisia, due to frail fiscal and external accounts.

Asia will not be spared from the consequences of the war, plus the Omicron-related slowdown in China

While the region has been relatively less impacted for now, many economies in Asia are net oil and gas importers, thus, high energy prices have aggravated inflation. In the region, Singapore, Cambodia, Mongolia, Laos and Thailand are among the most reliant on fuel imports. Higher fuel prices also feed through to increased prices for fertilizers, adding to input costs for agri-food producers in the region. With Ukraine and Russia accounting for three-quarters of the global market for sunflower oil, and exports at a standstill, prices of edible oils have surged, with reports of India and Indonesia being hit by shortages and high prices of cooking oil. All these were reflected in the March CPI data, which indicated notably higher inflation rates for many economies in Asia, driven by food and energy costs, with India and Thailand reporting large increases. Governments in the region have tapped into fiscal levers to contain energy prices. Japan has increased subsidies to oil distributors, while Indian state-owned fuel retailers froze pump prices. Thailand provided cash subsidies for cooking oil and fuel. However, countries that already have fuel subsidies in place, such as Indonesia and Malaysia, will see a substantial increase in fiscal spending if international oil prices remain elevated throughout the year, which will put greater pressure on their government budgets. Meanwhile, net primary energy exporters like Australia, Indonesia, Brunei, and Mongolia, would benefit from higher energy prices. With underlying inflationary pressures remaining a key risk, several economies have tightened their monetary policies, including Singapore, Taiwan, South Korea and New Zealand. Other Asian central banks are expected to follow, particularly as the Federal Reserve is expected

BOX 3: SURGE IN COVID-19 CASES IN CHINA

The surge in new infections in China since early March required wider and harsher pandemic control measures, as the country remains committed to a dynamic zero-COVID policy, where authorities aim to break the chain of virus transmissions by taking early measures to detect, report, and quarantine new cases.

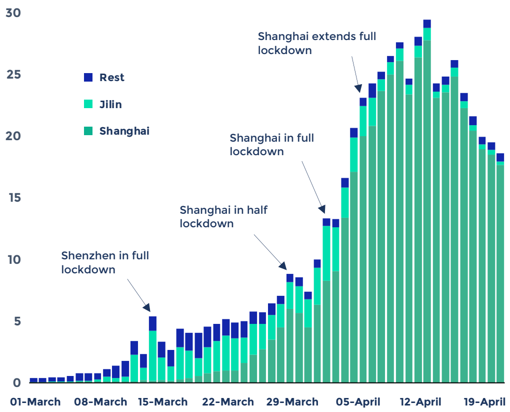
The broadening of COVID controls across China has a negative impact on consumption, economic activity and logistics operations. According to Gavekal Dragonomics, 87 of China's 100 top cities, accounting for 70% of GDP, have imposed some form of COVID control. Shenzhen, a major manufacturing and technology hub, went into a weeklong lockdown on 14 March, while Shanghai started tightening restrictions from 11 March, before imposing a citywide lockdown from 28 March. With new infections rising quickly through the first half of April, dominated by new cases reported in Shanghai, the Chinese city launched a third round of mass testing on 21 April.

Strong performance in the first two months of the year had helped first quarter GDP growth to beat expectations at 4.8% YoY, but March data reflected early impact of the current Omicron wave. Retail sales fell by 3.5% YoY during March (vs. +6.7% in Jan-Feb), while services production contracted by 0.9% YoY (vs. +4.2% in Jan-Feb). PMI surveys for March also indicated the first deterioration of business conditions in seven months, with manufacturing output and services activity both worsening from February levels. The unemployment rate also rose to 5.8% in March, the highest in nearly two years, amid signs of deterioration in the labour market. There were also new reports of severe disruptions to land logistics operations due to temporary closures of warehouses and reduced capacity of trucking services.

The escalation in the zero-COVID policy and widening disruptions on economic activity in April means that the Chinese economy has started the second quarter on a notably weaker footing. We have therefore revised the 2022 GDP growth rate down to 4.8% (from 5.4% previously). Given China's prominent role in the world economy, Chinese demand slowdown and local supply bottlenecks will affect global trade and production. For example, half of Apple's 200 top suppliers are operating in areas hit by COVID controls. An extended lockdown period could strike a further blow to the automotive and technology sectors.

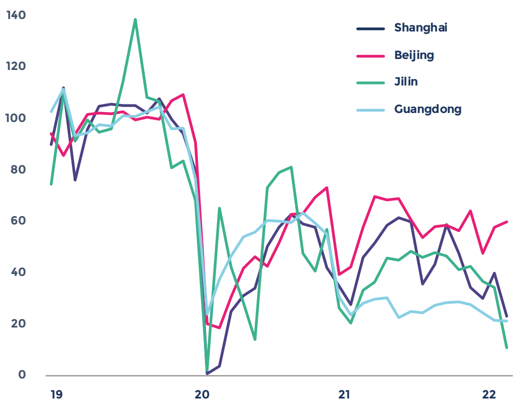
to frontload its interest rate increases over the next two months. A prolonged Russia-Ukraine conflict or further escalation will have longer-term repercussions on consumer and business confidence in Asia, with an estimated net negative impact on 2022 GDP growth of 0.5 pp in aggregate. In China, over the last weeks, the impact on economic activity was more locally inflicted than due to the Russia-Ukraine conflict **(See Box 3 above)**. Nevertheless, the country will inevitably be hit by the decline in global demand, particularly from Europe **(Charts 4 & 5)**.

Chart 4: China's daily new infections (number of cases, thousands)



Sources : China's NHC, Coface

Chart 5: China highway passenger traffic (2019 average = 100)



Sources : China Ministry of Transport, Coface

Uncertain net impact in Latin America, but strong risk of social unrest

Latin America is another region that is particularly vulnerable to sudden tightening of monetary policy by the Fed, but should benefit from rising commodity prices. With higher export revenues mitigating somewhat the impact on GDP, the net effect of the war in the region – that we estimate at -0.1 pp at the aggregate level – is uncertain at the time of writing and may not be fully felt in the near future. Net oil importers (Chile, Peru, Mexico and Argentina) are more vulnerable, as stronger agriculture and metals prices (favouring exports) may not fully offset the impact of higher energy prices. Still, the main concern regarding trade is for fertilizers, since Latin America's imports from Russia are highly concentrated in that segment (accounting for 48% of total purchased goods), which could affect the profitability of next year's crops. Overall, risks to activity are tilted downwards, depending on the conflict's length and, thus, the spillover effects on global supply chain disruptions. Furthermore, this has also clouded the outlook for the already overall high inflation in the region. As matter of fact, consumer prices in major Latin American economies soared sharply in March 2022. Monthly increases in prices have reached multi-decade highs in Brazil (1.6% MoM, 11% YoY), Chile (1.9% MoM, 9% YoY) and Peru (1.5% MoM, 7% YoY). More worrisome, in Argentina, the CPI climbed by 6.7% in the month and by 55% over the last 12 months. Therefore, the overall erosion of purchasing power in Latin America is likely to increase dissatisfaction with the ruling powers, raising the risks of social unrest. This is particularly true in a region with low GDP per capita, where food and energy play a significant role in the vast majority of the populations' consumption baskets. Aware of this landscape, the governments have taken measures to smooth the negative inflationary shock (such as subsidies and tax cuts). Nevertheless, social risks have already materialized in some instances. In April, large protests were triggered in Peru by the sharp rise in fuel and fertilizer prices. Importantly, regarding monetary policy, high inflation and the nascent increase in policy rates in developed economies pressured the region´s central banks to further constrict their own rates (affecting financing costs). In fact, Brazil has implemented the most hawkish monetary policy across the region. Its central bank raised the benchmark Selic rate to 11.75% during its March 2022 meeting, accumulating a hike of 975 basis points in the last 12 months.

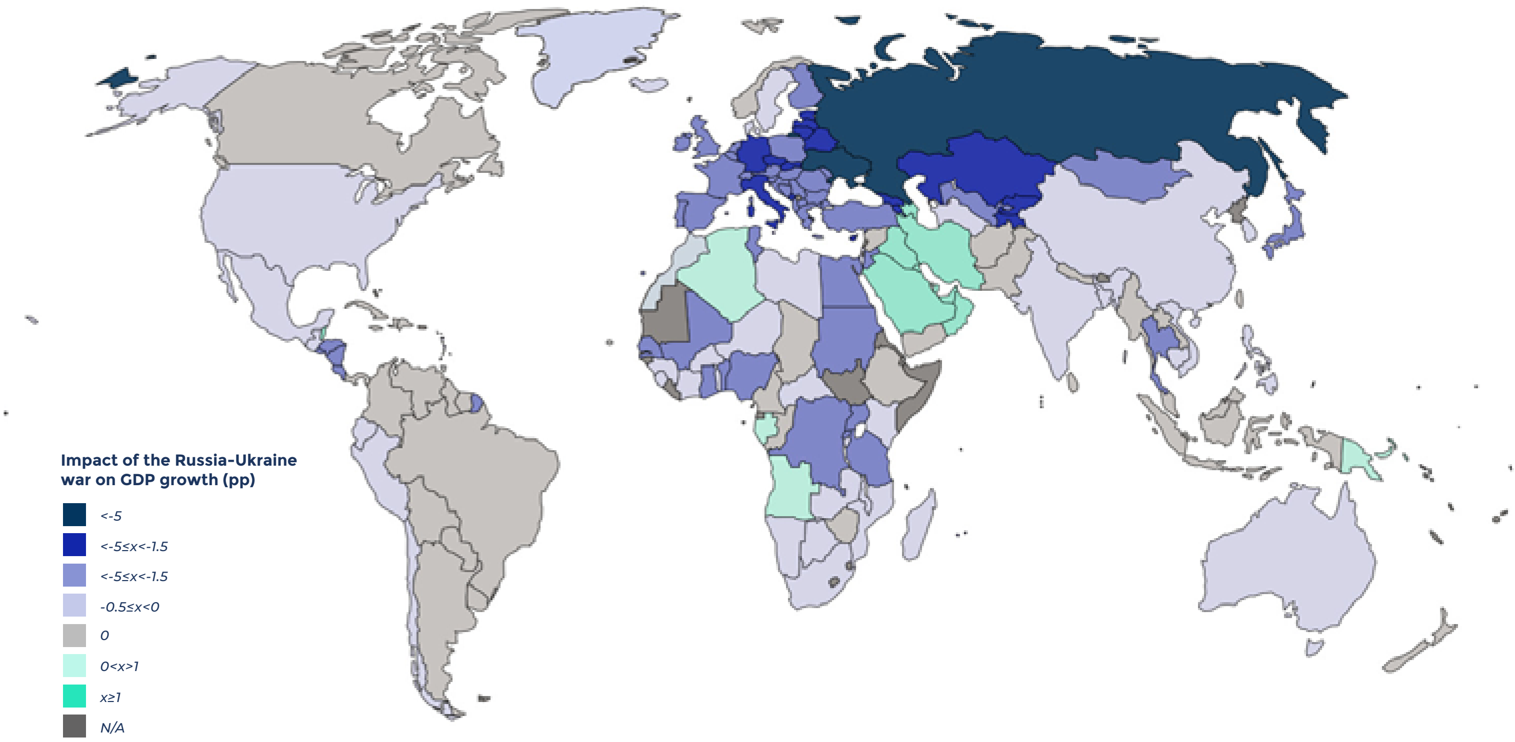
As a result, Brazil is the first country to reach a positive real interest rate. Nonetheless, the other central banks with inflation targeting regimes are also following the same trend (including the monetary authorities in Chile, Colombia, Mexico and Peru). Additionally, Argentina´s programme with the IMF requires it to move its real policy rate into positive territory to address high inflation. Therefore, the policy rate has moved up from 38% in January 2022 to 47% in April. Overall, the high cost pressures (because of supply chain disruptions and higher commodity prices) and the tightening of global credit conditions are expected to take a toll on payment experience in the region.

Gulf countries are among the few to benefit from the situation, but not without risks

The GCC countries are expected to be among the very few winners of the current situation, with an estimated net positive effect on 2022 GDP growth of +1.1 pp. In spite of economic diversification efforts, most of the GCC economies are still heavily dependent on oil revenues. Higher oil prices will allow for greater consumption and investment spending from the public sector.

It will thus boost the sentiment in the private sector and lead to higher investments in non-oil activities as well. Consequently, rising hydrocarbon and metal prices are expected to support growth performances and improve fiscal balances in the GCC countries. Latest PMI data indicate that output growth remained strong in the UAE and Saudi Arabia. The latter recorded the fastest economic growth rate in a decade in Q1 2022, with GDP climbing by 9.6% GDP YoY, propelled by higher oil prices and production. However, it is worth noting that GCC countries import around 85% of their food, so the rise in agricultural commodity prices could jeopardize the region's food security. Therefore, no region is immune to the risks posed by the economic consequences of the war in Ukraine **(Chart 6)**.

Chart 6: Revisions to Coface 2022 GDP growth forecast due to the war in Ukraine (in percentage points)



Source: Coface

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