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UKRAINE WAR MARKET & ECONOMIC UPDATE

MARCH 11, 2022



ECONOMIC & MARKET UPDATE: GLOBAL OUTLOOK SCENARIOS

Economic outlook will be dependent on the impacts of Russia-West tensions on energy prices. In a less adverse scenario, energy supply is not severely disrupted. ECB still focused on normalisation.

SCENARIO 1: NO SIGNIFICANT DISRUPTION OF ENERGY SUPPLY. ACTIVITY DECELERATES.

- Oil and gas prices remain elevated around current levels, with a higher risk premium, related to fears of supply disruptions; but no further increases; relief in price pressures in H2 2022.
- **Sanctions focused on financial sector and non-energy trade.** Russia is not completely cut off from SWIFT. Oil and gas supplies negatively impacted, but not halted.
- **Euro Area growth decelerates** to 2.5%-3.5% in 2022 vs. initial 4% forecasts (growth still supported by post-pandemic recovery and Recovery and Resilience Facility).
- Although higher for longer, inflation falls in H2 2022, while staying above 2% YoY (annual average ~5%). **Expectations of inflation around 2% in 2023 and 2024.**
- The ECB adopts a less hawkish tone, but **remains focused on (a cautious) monetary policy normalisation.** PEPP net purchases end in March. Tapering of APP purchases proceed, but net purchases do not end in 2022. Reinvestment policy remains flexible.
- Risk of delays in rate hikes. Possible 25 bps policy rate increase between Dec 2022 and Q1 2023. One or two possible additional hikes in 2023.
- Fiscal policy mitigates the pass-through of higher energy prices to consumer prices. Higher public deficits and debt.
- 10Y Bund yield around 0.25%-0.35% in 2022 (0.4%-0.45% in 2023). Wider periphery spreads. EUR depreciation in the short term.

ECONOMIC & MARKET UPDATE: GLOBAL OUTLOOK SCENARIOS

In a more adverse scenario, energy supply is disrupted. Higher oil and gas prices with recessive impacts. ECB delays policy normalisation. Return to negative Bund yields.

SCENARIO 2: DISRUPTION OF ENERGY SUPPLY LEADS TO RECESSION.

- Significant escalation of Russia vs. West tensions.
- Russia completely cut off from SWIFT. Wider sanctions on the Russian financial sector and Central Bank. Significant impact on Russia international trade, financial sector and economic activity. **Disruption in Russian oil and gas supplies to Europe. Significantly higher food prices.**
- **Energy prices durably higher.** Brent oil price rises to USD 125-150/barrel. Natural gas price above EUR 180-200/Mwh in Europe. Energy rationing in Europe.
- Euro Area GDP growth slows to 1%-2% in 2022. **Significant risk of recession** (H2 2022, H1 2023).
- **Inflation continues to increase in 2022 (annual average around 6%-7%) and remains well above target in 2023.**
- Fiscal policy mitigates the pass-through of higher energy prices to consumer prices. Pressure for additional fiscal policy easing supporting activity, employment and incomes.
- Acceleration in public investment in energy transition. Higher public deficits and debt.
- **ECB delays the goal of monetary policy normalisation.** Continued QE through open-ended APP (but lower than during Covid). (Possible rate hikes with QE?)
- 10Y Bund yield returns to negative levels. Wider periphery spreads, given lower ECB support, higher deficits and debt and high risk aversion.
- High uncertainty and risk aversion. Stronger USD. EUR depreciation.

ECONOMIC & MARKET UPDATE: POSSIBLE LONG TERM IMPACTS

High commodity prices

A more permanent increase in commodity prices could be expected, as a result of (i) lingering **impacts from the pandemic** (supply-demand imbalances); (ii) long term impacts from the **Ukraine war (trade bans, supply disruptions)**; and (iii) **energy transition efforts, increasing the demand for metals** (e.g. lithium, nickel, cobalt for EV batteries; copper for charging stations, solar panels and wind turbines; aluminum for wind turbines).

Change in EA's fiscal stance

Higher inflation should constrain the role of monetary policy in support to demand. Fiscal policy should be relatively more important in the near future. Higher public spending needs could lead to an increase in fiscal solidarity in the EU/Euro Area. **Possible common debt issues in the EU to fund energy transition and defense spending.** And also, **possible delay of the end of the escape clause from the rules of the Stability and Growth Pact.**

Focus on energy transition

Need to **reduce EU energy dependency** (e.g. from Russia). Diversification of energy supply sources and **faster reduction of the use of fossil fuels** in homes, buildings and business activities. The REPowerEU programme focuses on **decarbonising industry** (e.g. switch to electrification and **renewable hydrogen**), accelerating the roll-out of **renewable projects** and increasing production of **biomethane** from agricultural residues.

Change in global USD role

Sanctions on Russia have created a precedent and a perceived risk that a central bank could be prevented from accessing its USD (or EUR) reserves held in European and US institutions; and a risk that banks and firms could be banned from USD transactions and funding. **Incentive for some economies to shift their debt and reserves out of USD** (and EUR). **Possible increase in the role of the CNY in global trade and debt markets.**

High public spending needs

Public expenditure expected to increase in the main economies, as a result of: (i) **increased military/defense spending** (towards NATO's goal of 2% of the GDP) given the consequences of the Ukraine war on Europe's security and expectations of continued global geopolitical tensions; (ii) **support to energy transition efforts** through public investment, subsidies, etc; (iii) and **mitigation of the adverse economic impacts of higher energy and food prices.**

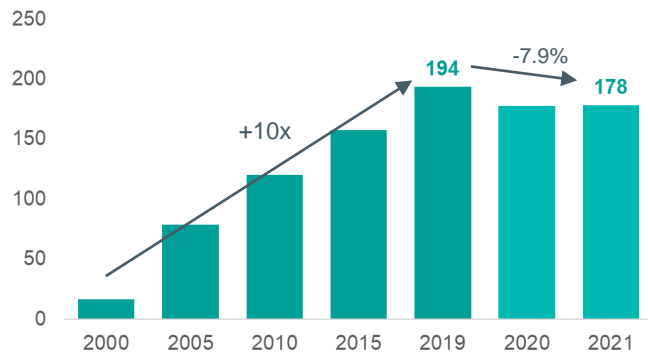
Impacts on globalisation

The Covid-19 pandemic brought an **incentive for economies to reduce their vulnerability to external supply disruptions.** This should be reinforced by the Ukraine war. In the West, focus on lower reliance on energy imports (from Russia). Higher restrictions to East-West trade and financial flows. Russia and China likely to intensify their trade and financial relations. **Possibility of a East-West division in global trade and in the financial system.**

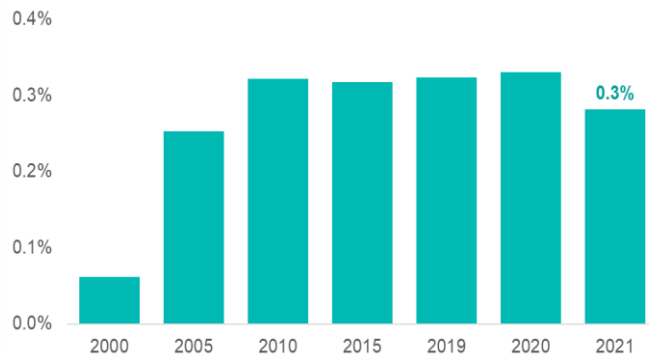
PORTUGAL – RUSSIA ECONOMIC RELATIONS

Portuguese goods exports to Russia

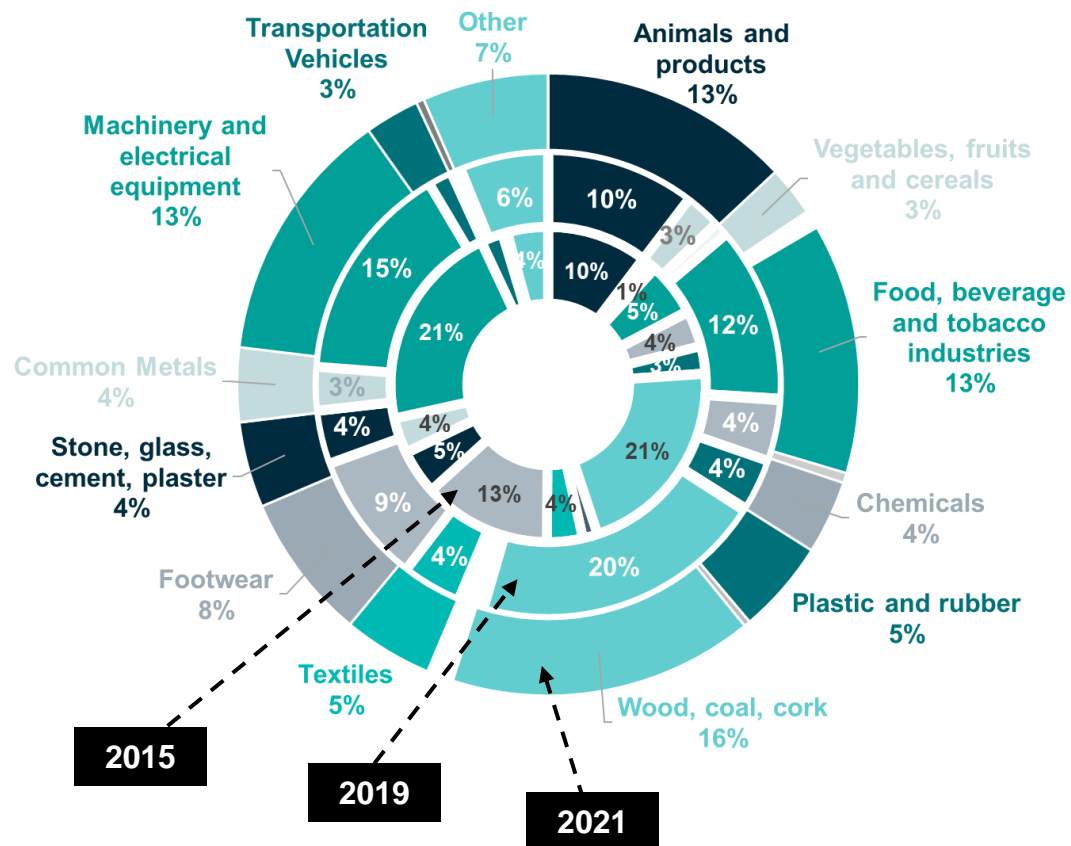
Goods exports
(EUR million)



Goods exports
(% of total Portuguese exports)



Goods exports, by type of product
(% of total Portuguese exports to Russia)

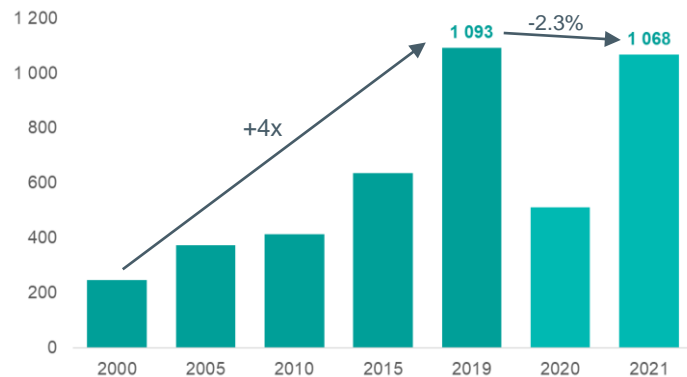


Sources: INE, DDAE.

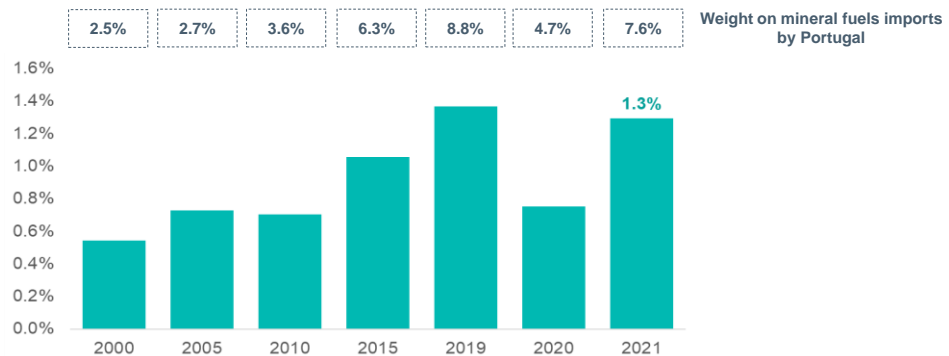
PORTUGAL – RUSSIA ECONOMIC RELATIONS

Portuguese goods imports from Russia

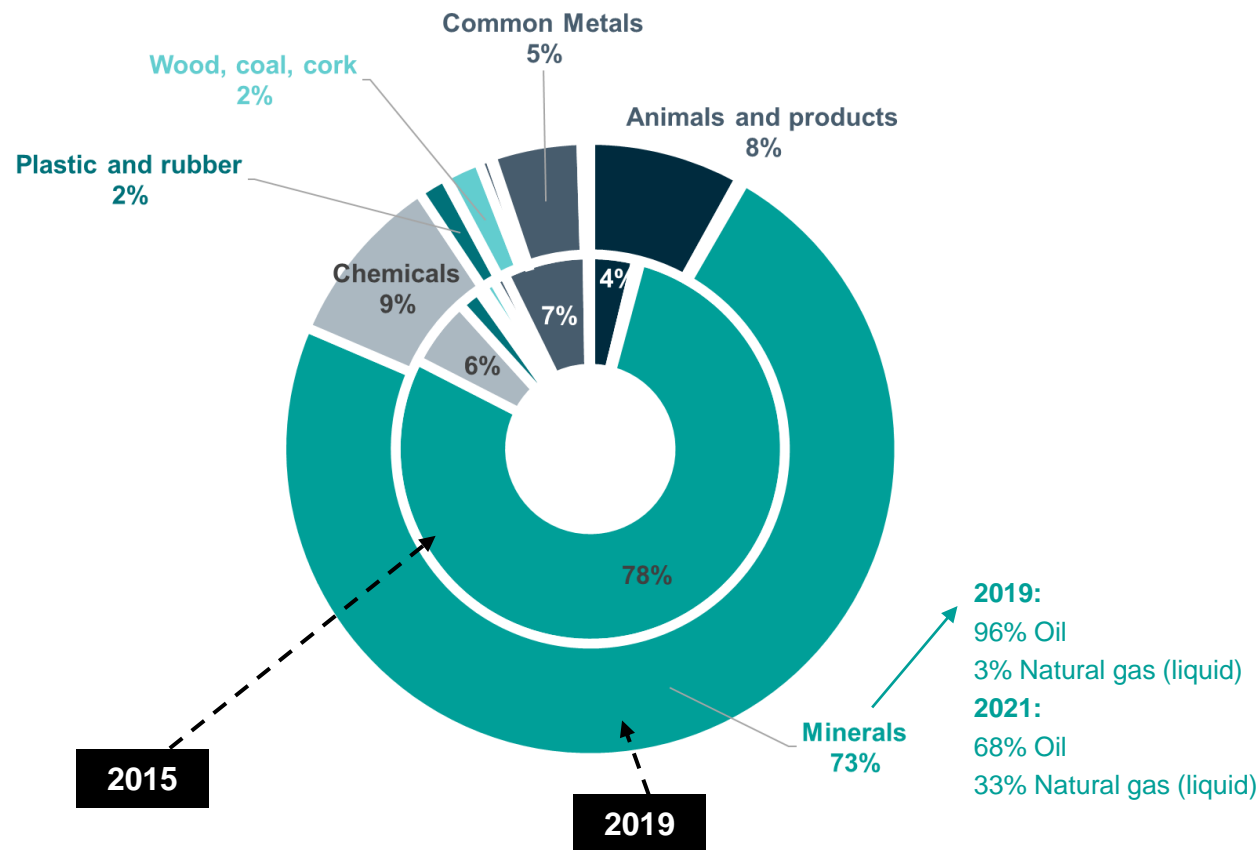
Goods imports (EUR million)



Goods imports (% of total Portuguese imports)



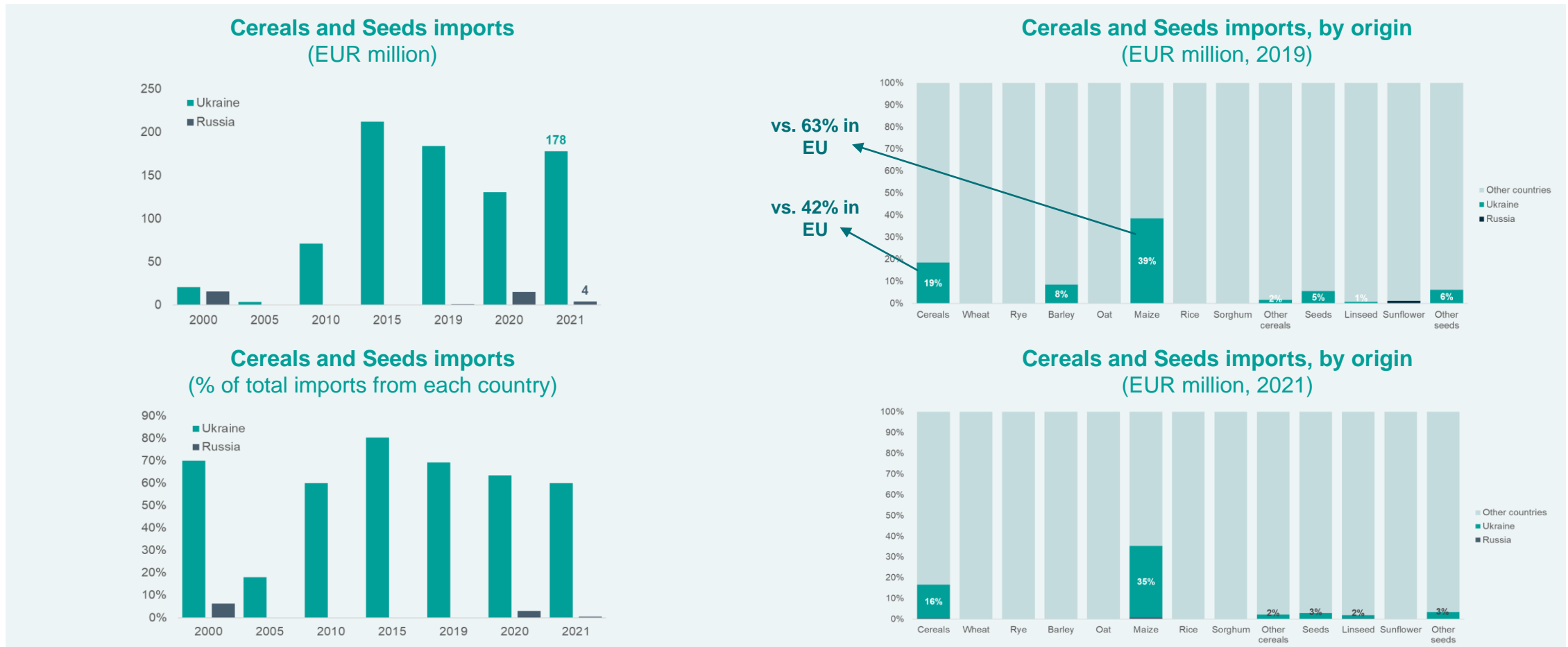
Goods imports, by type of product (% of total imports from Russia)



Sources: INE, DDAE.

PORTUGAL – RUSSIA AND UKRAINE ECONOMIC RELATIONS

Portuguese imports – Cereals and Seeds from Russia and Ukraine

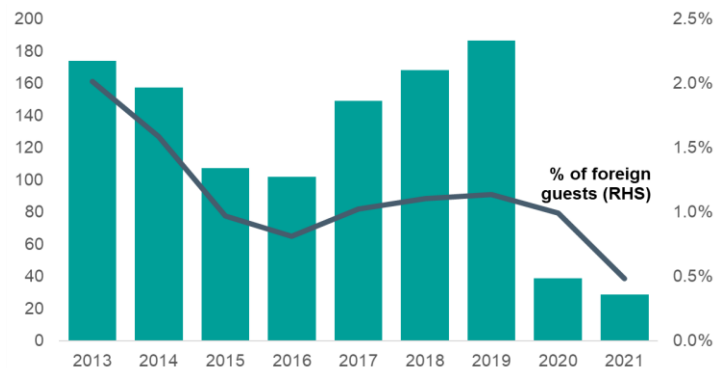


Sources: INE, WTO, DDAE.

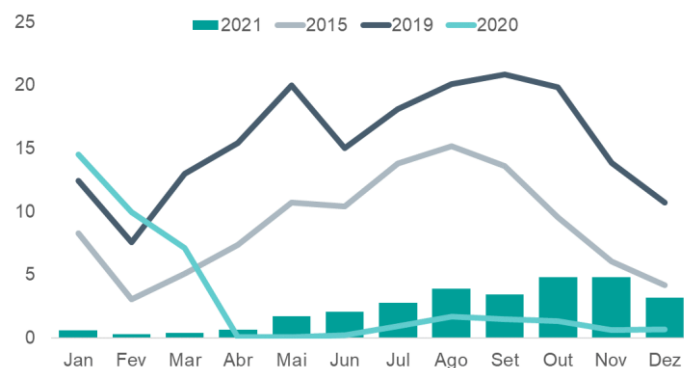
PORTUGAL – RUSSIA ECONOMIC RELATIONS

Tourism

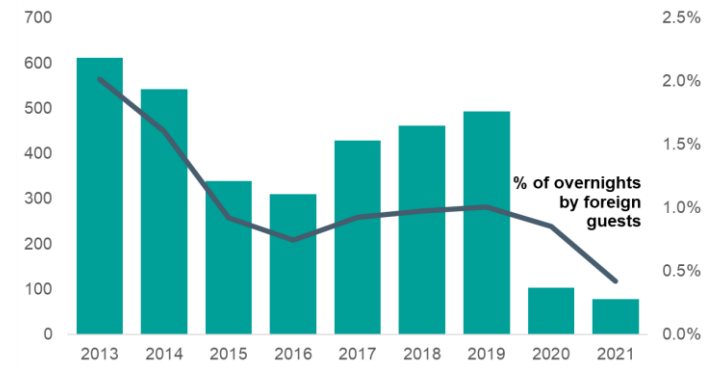
Russian tourists
(thousand and % of total foreign guest)



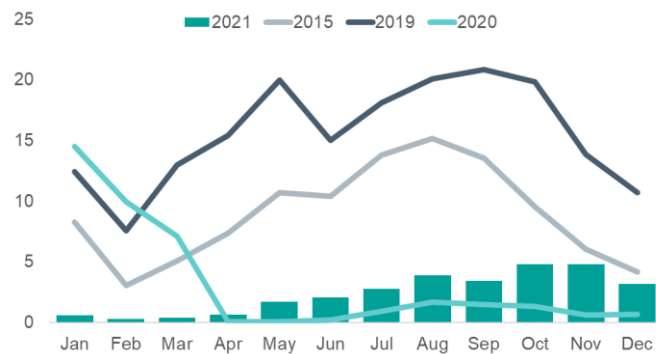
Seasonality of Russian tourists
(thousand)



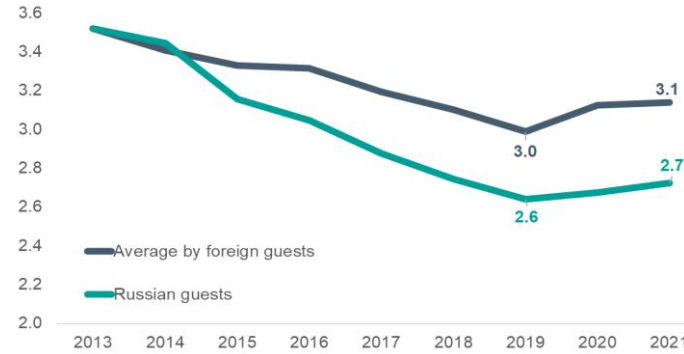
Overnight stays by Russian tourists (thousand and % of total overnight stays by foreigners)



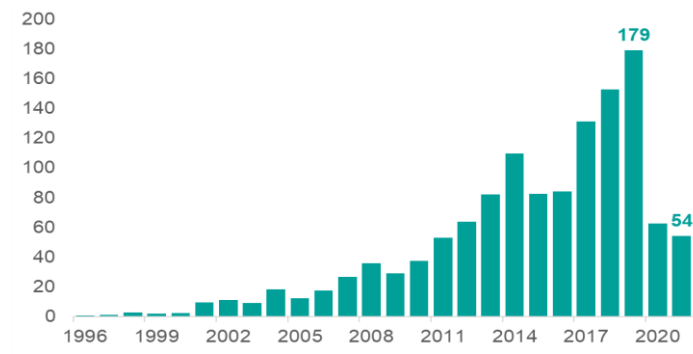
Seasonality of overnight stays by Russian tourists (thousand)



Average number of overnight stays by tourist



Exports of services to Russia, Travel and Tourism (EUR million)

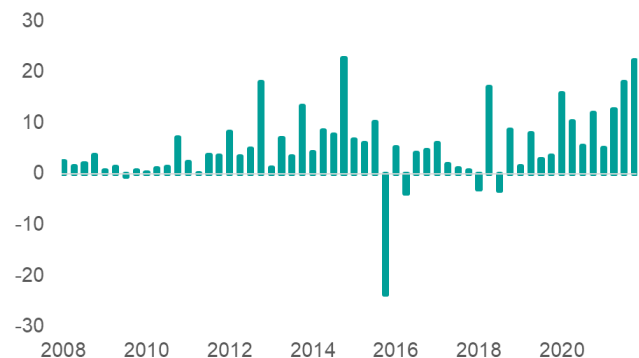


Sources: INE, DDAE.

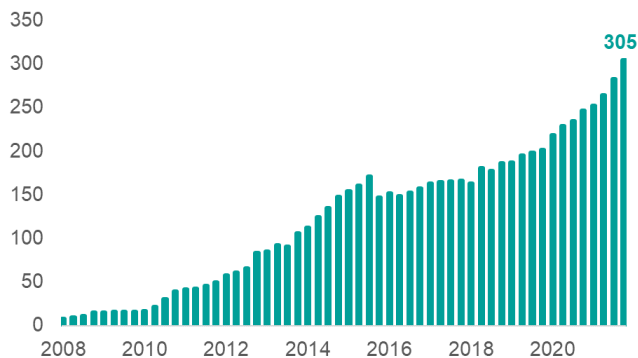
PORTUGAL – RUSSIA ECONOMIC RELATIONS

Investment and Remittances

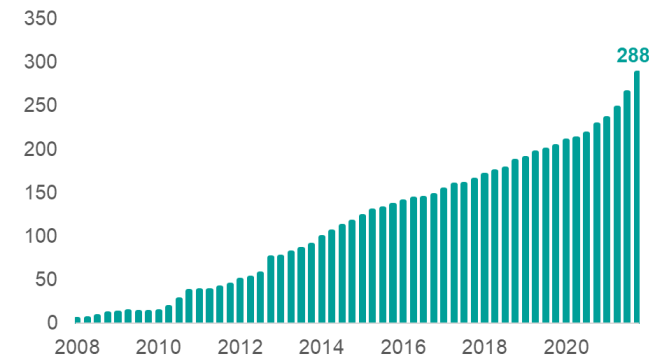
Foreign Direct Investment
(flows, EUR million)



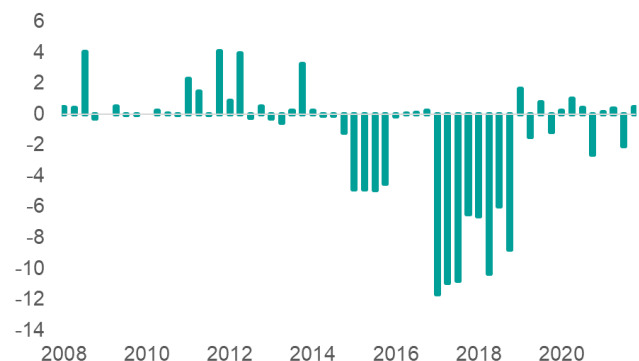
Foreign Direct Investment
(stock, EUR million)



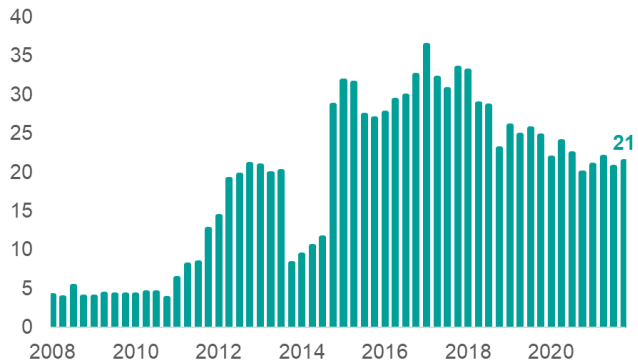
FDI – Real Estate
(stock, EUR million)



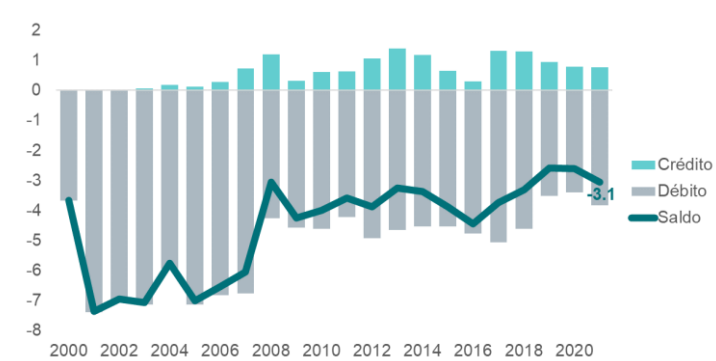
Direct Investment of Portugal in Russia
(flows, EUR million)



Direct Investment of Portugal in Russia
(stock, EUR million)



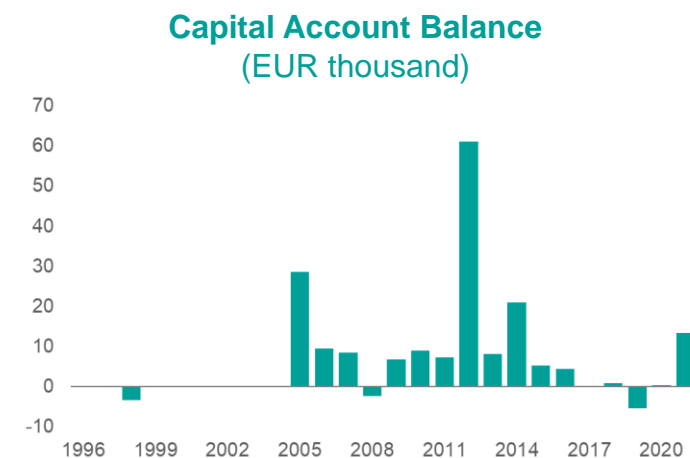
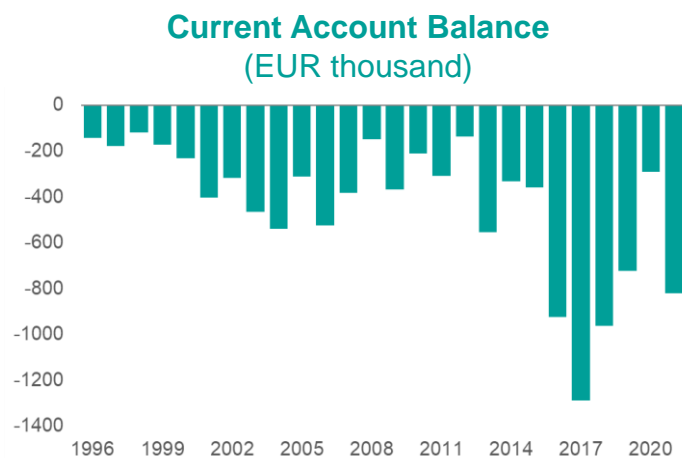
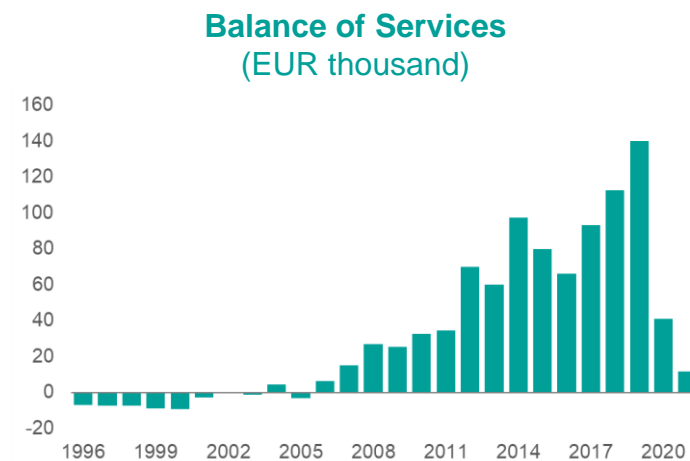
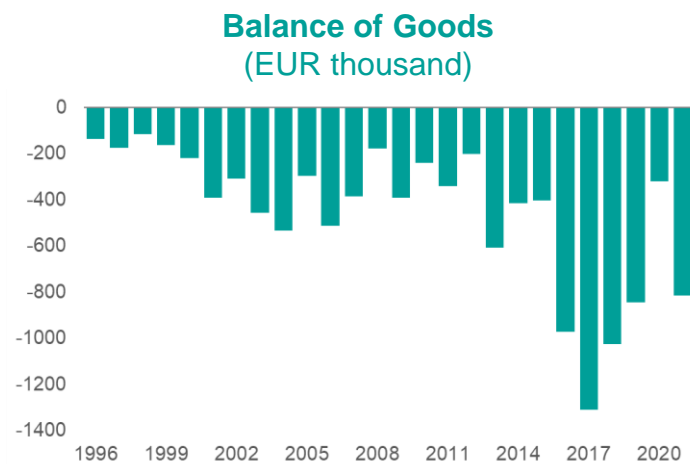
Migrant Remittances
(EUR million)



Sources: Banco de Portugal, DDAE.

PORTUGAL – RUSSIA ECONOMIC RELATIONS

Balance of Payments

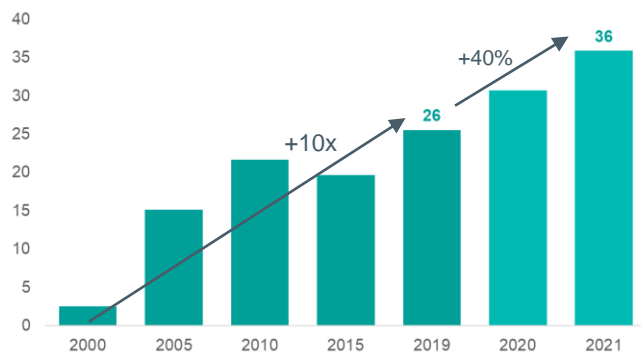


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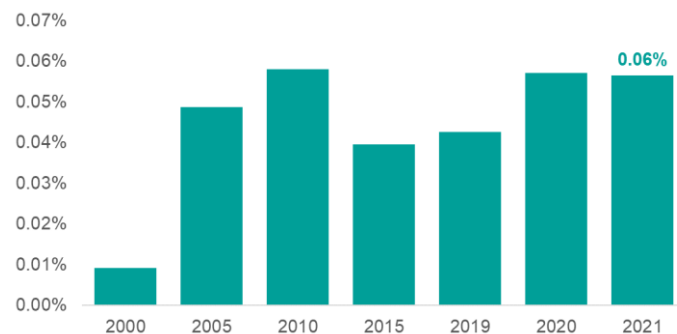
PORTUGAL – UKRAINE ECONOMIC RELATIONS

Portuguese goods exports to Ukraine

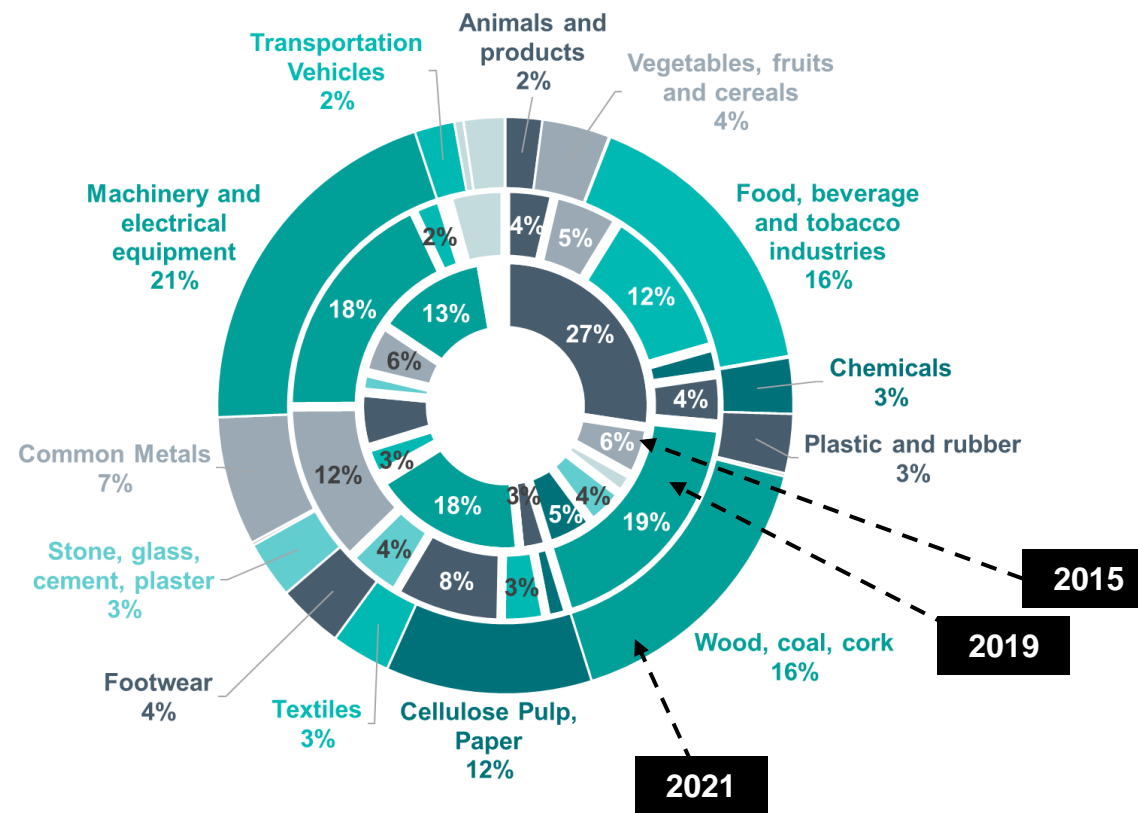
Goods exports (EUR million)



Goods exports (% of total Portuguese exports)



Goods exports, by type of product (% of total Portuguese exports to Ukraine)

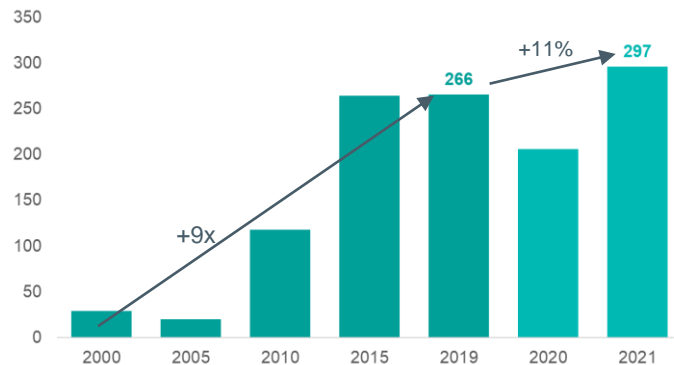


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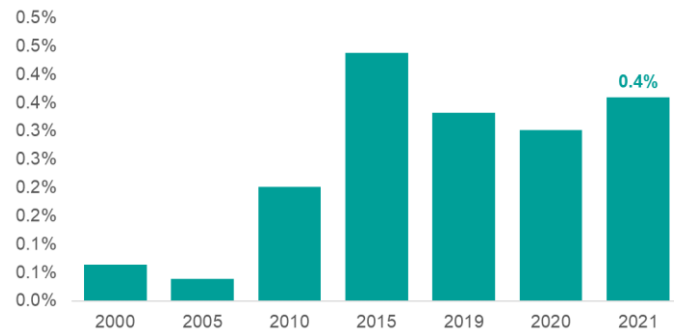
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Portuguese goods imports from Ukraine

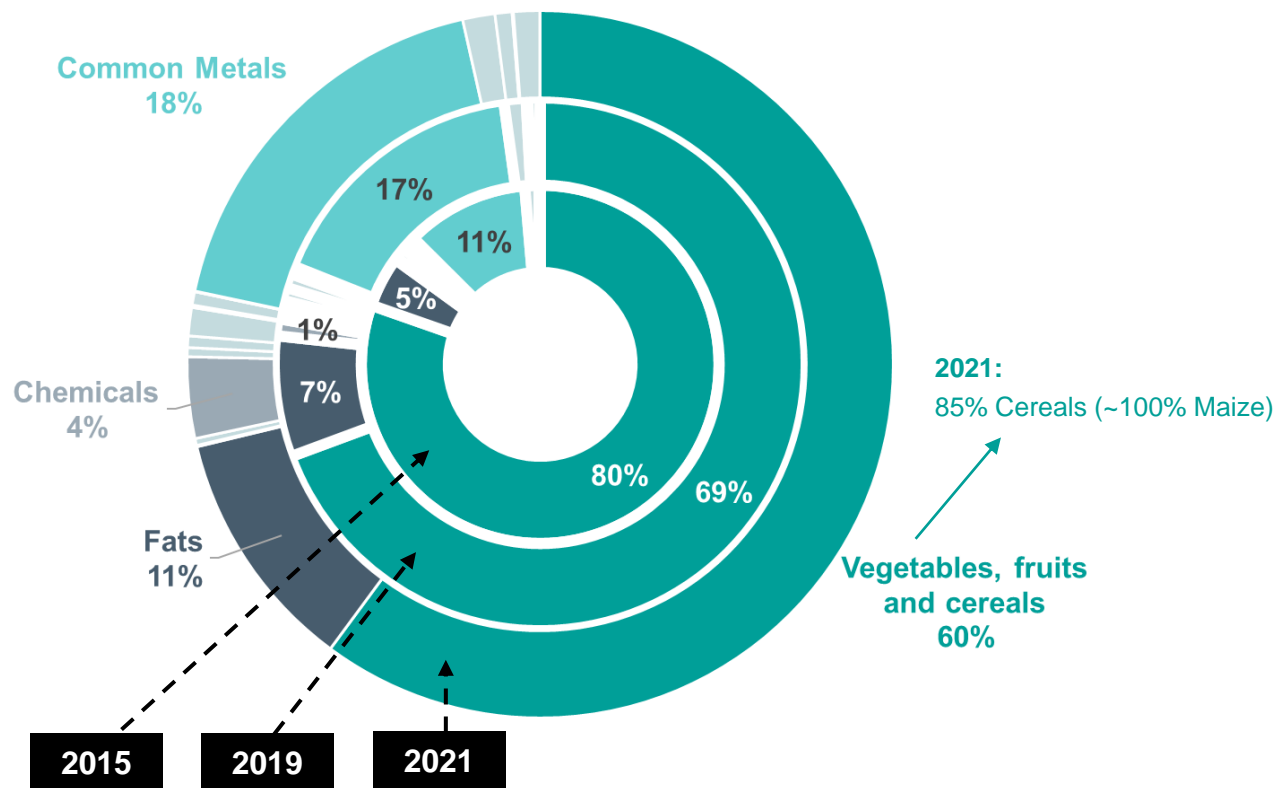
Goods imports
(EUR million)



Goods imports
(% of total Portuguese imports)



Goods imports, by type of product
(% of total imports from Ukraine)



Sources: INE, DDAE.

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DDAE – DEPARTAMENTO DE DESENVOLVIMENTO E ACTIVAÇÃO DA ESTRATÉGIA

Anabela Figueiredo
DDAE Managing Director

anabela.figueiredo@novobanco.pt

RESEARCH ECONÓMICO

Carlos Almeida Andrade
Chief Economist

carlos.andrade@novobanco.pt

+351 21 310 64 93

Tiago Lavrador

tiago.lavrador@novobanco.pt

+351 21 310 64 94

Catarina Silva

catarina.silva@novobanco.pt

+351 21 310 64 92