# The External Environment

## AIECE: Spring Meeting; Kiel, 12-13 May 2022

**Lorena Vincenzi**

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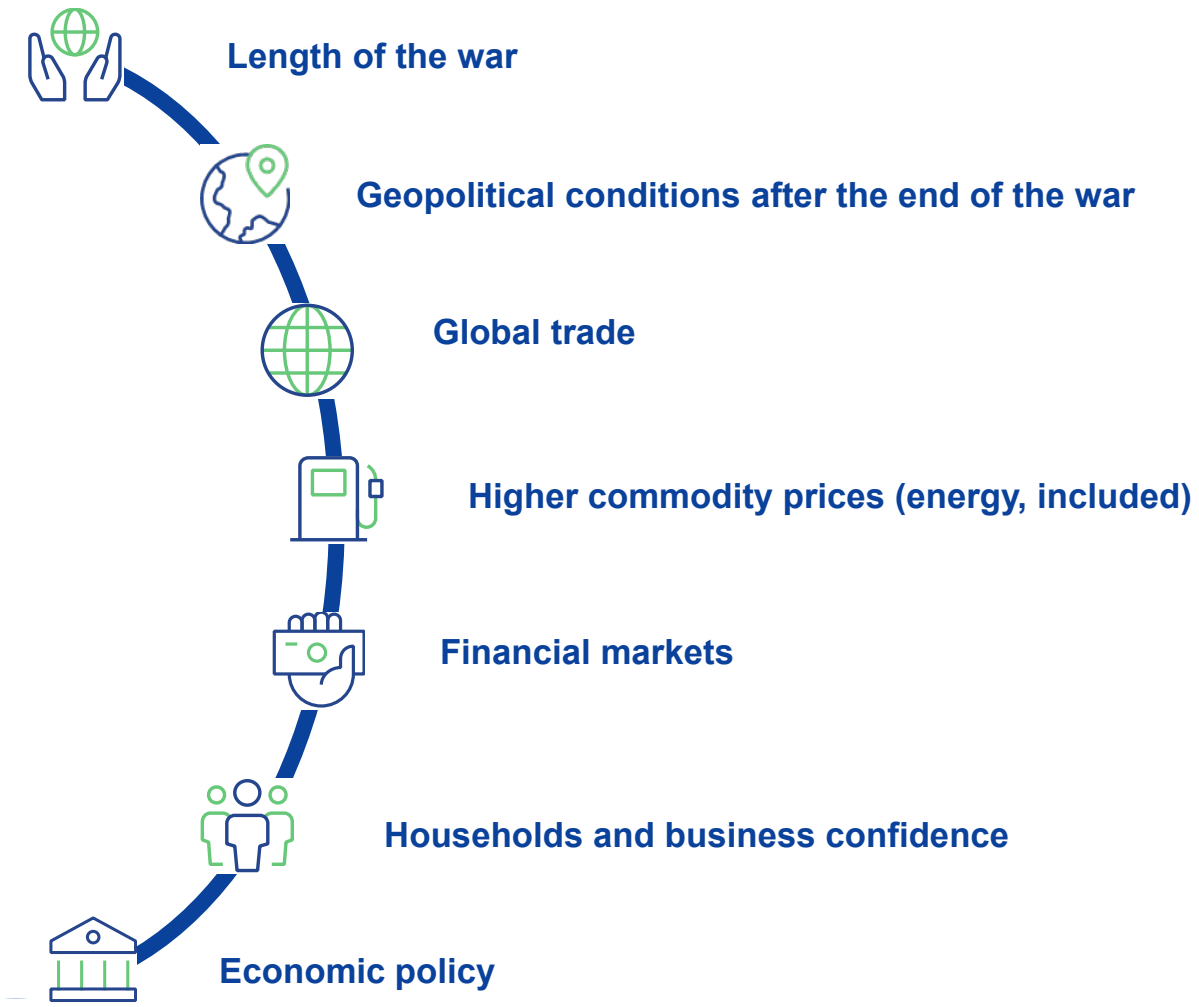
## Agenda

- The effects of the Russian invasion of Ukraine on the global economy
- The US economy
- The Chinese economy
- Prometeia's forecasts for the global economy at a glance

Is the risk of stagflation increasing?

# Russia invades Ukraine: global economy decelerates *(Europe stops)*

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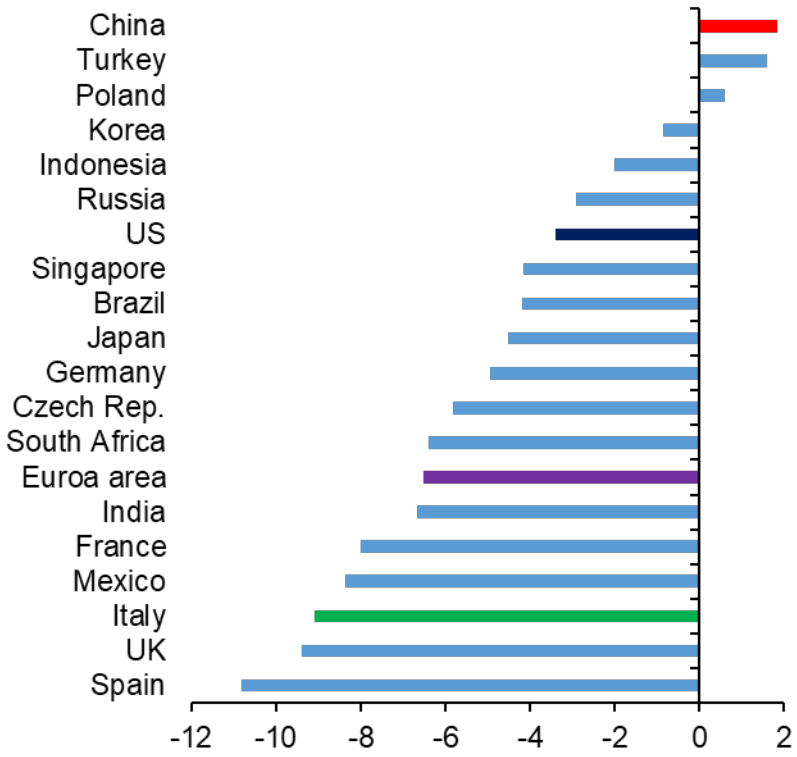
# One step back: stong rebound in 2021, as expected,…

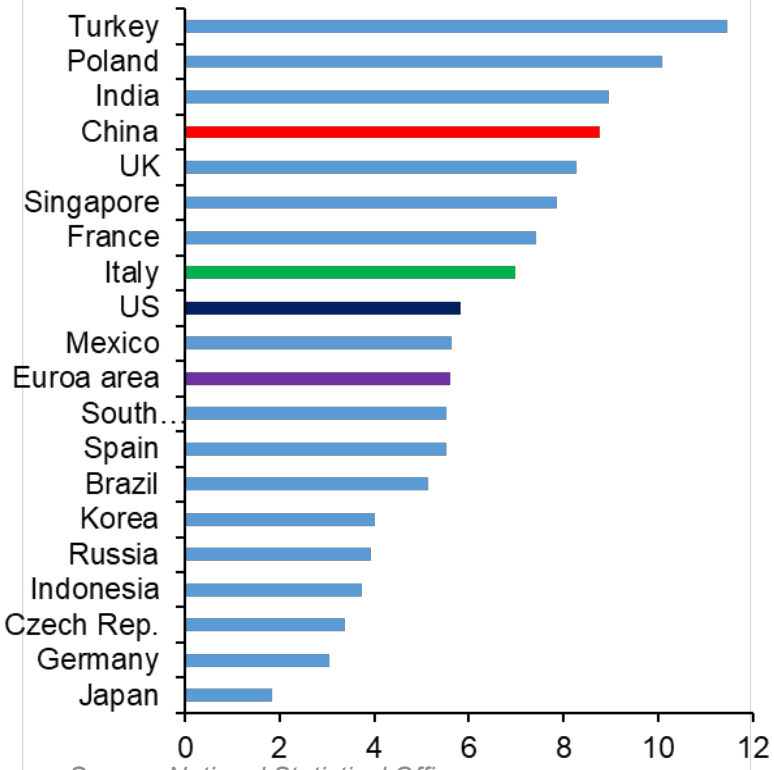
## Not all countries recovered to pre-pandemic GDP levels

**REAL GDP**

**2020 annual % change**

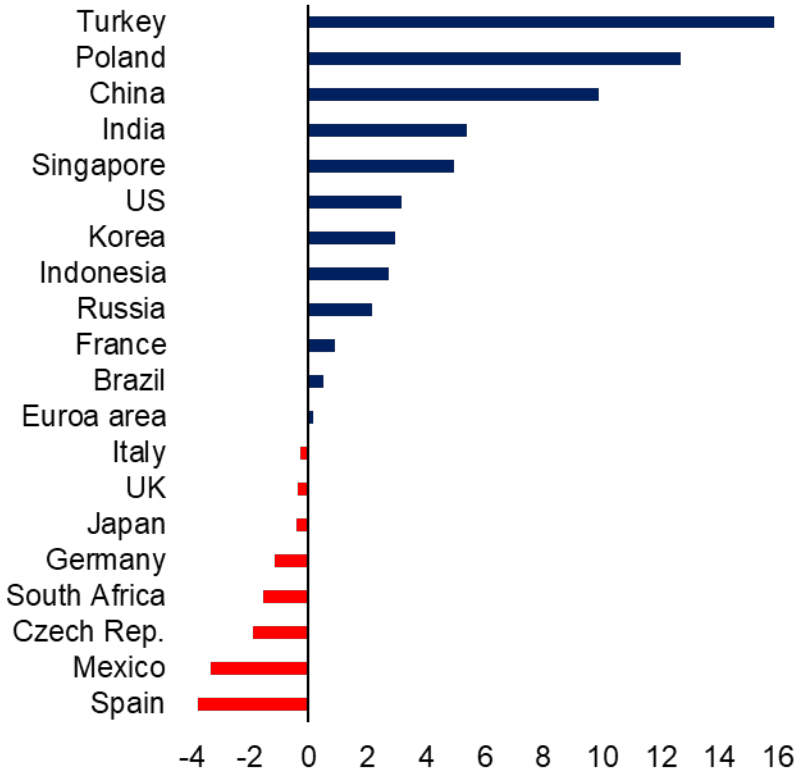



**2021 annual % change**




*Source: National Statistical Offices*

**GAP Q4-21 with respect to Q4-2019 % change**

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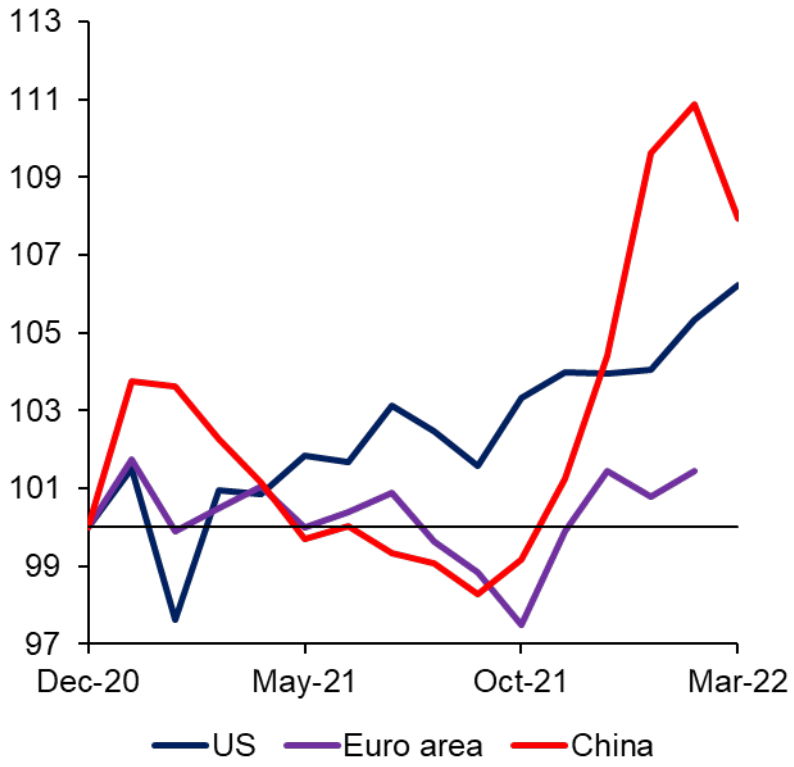
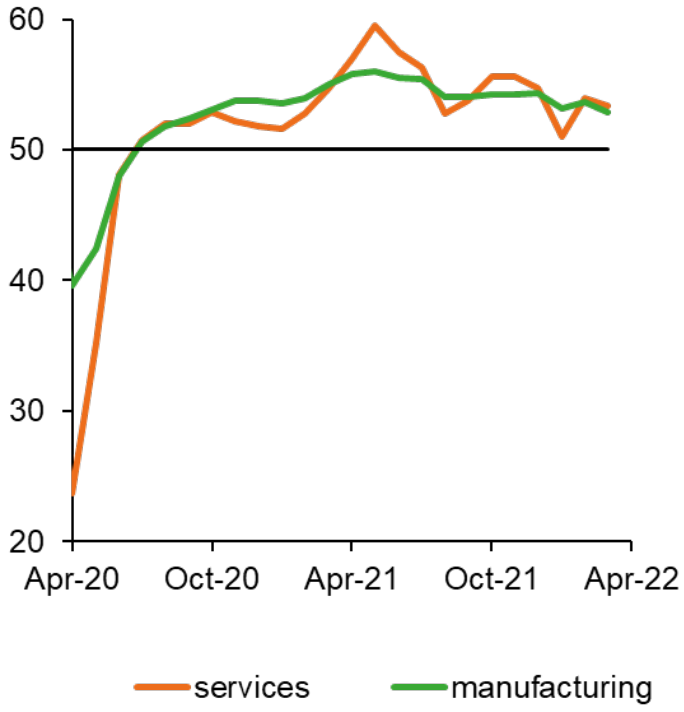
# … and mixed signs on economic activity at the beginning of 2022…

**INDUSTRIAL PRODUCTION INDEX**
December 2020 = 100




*Source: Prometeia's calculations on National Statistical Offices and Fed*

**GLOBAL ECONOMY PMI**
balance




*Source: JP Morgan*

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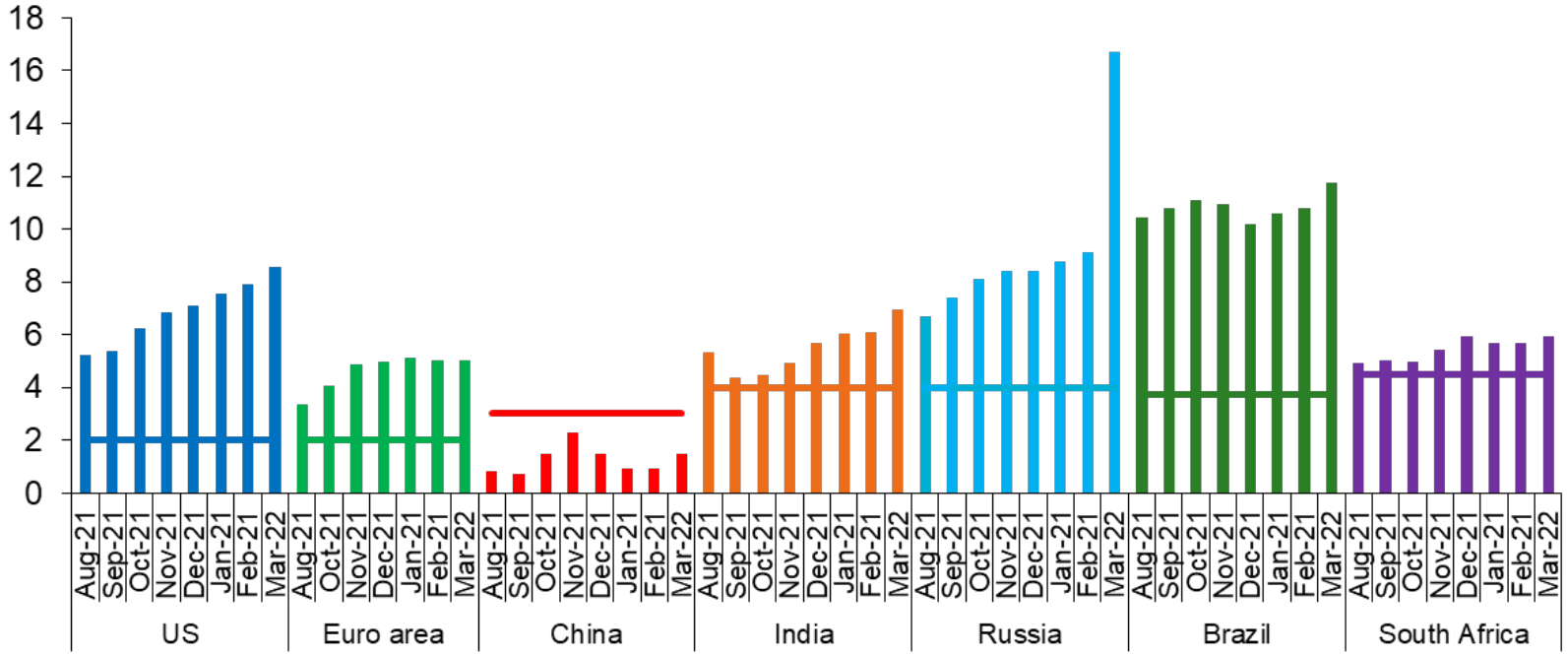
# … but increasingly worrying inflation

**CONSUMER INFLATION AND CENTRAL BANKS' TARGET RATE* - %**




* central value in case of interval

*Source: National Statistical Offices and Central Banks*

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# Russia e Ukraine in the global economy

## Relatively low weights from a macroeconomic perspective

**0.4% of global** GDP in PPP, 2020

**$3725** per-capita income, 2020

**43 millions -** population

**0.27% of global exports** (US$)

**0.32% of global imports** (US$)

**3% of global** GDP in PPP, 2020

**$10127** per-capita income, 2020

**140 millions -** population

**2.2% of global exports** (US$)

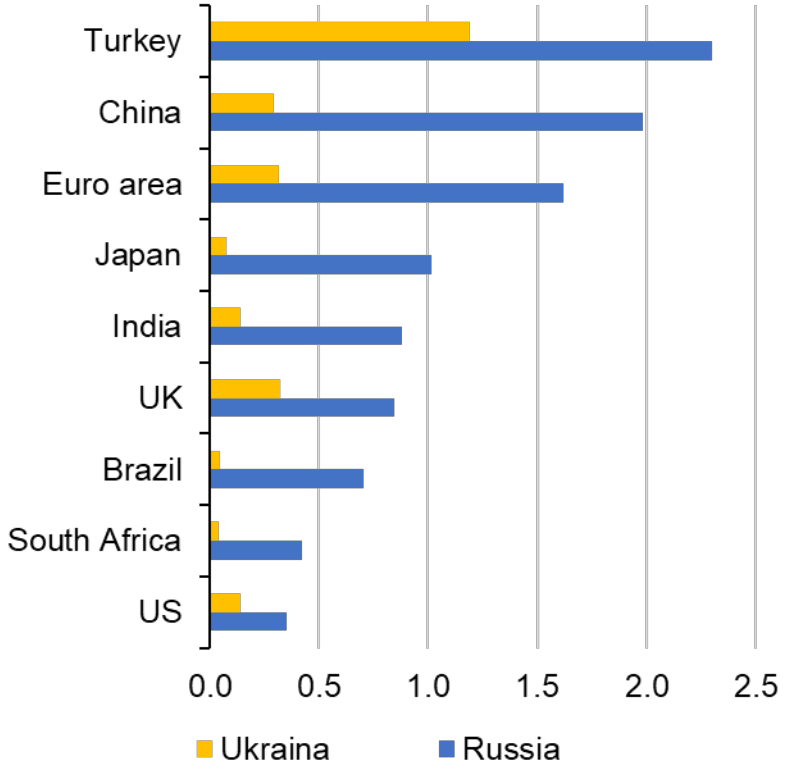
**1.3% of global imports** (US$)

**16.6% of global gas production**

**12.1% of global oil production**

**RUSSIA AND UKRAINE AS EXPORT MARKETS**

shares of total exports of the single country, $




*Source: Prometeia's calculations on IMF data*

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# Sanctions to Russia

## Industrialized vs emergent countries?

**SANCTIONS IN 2014**

Since March 2014, the EU has progressively imposed restrictive measures on Russia in response to the illegal annexation of Crimea in 2014.
In March 2015, EU leaders decided to align the existing sanctions regime with the full implementation of the Minsk agreements. Since this did not happen, the Council extended the economic sanctions. The economic sanctions are currently extended until 31 July 2022.

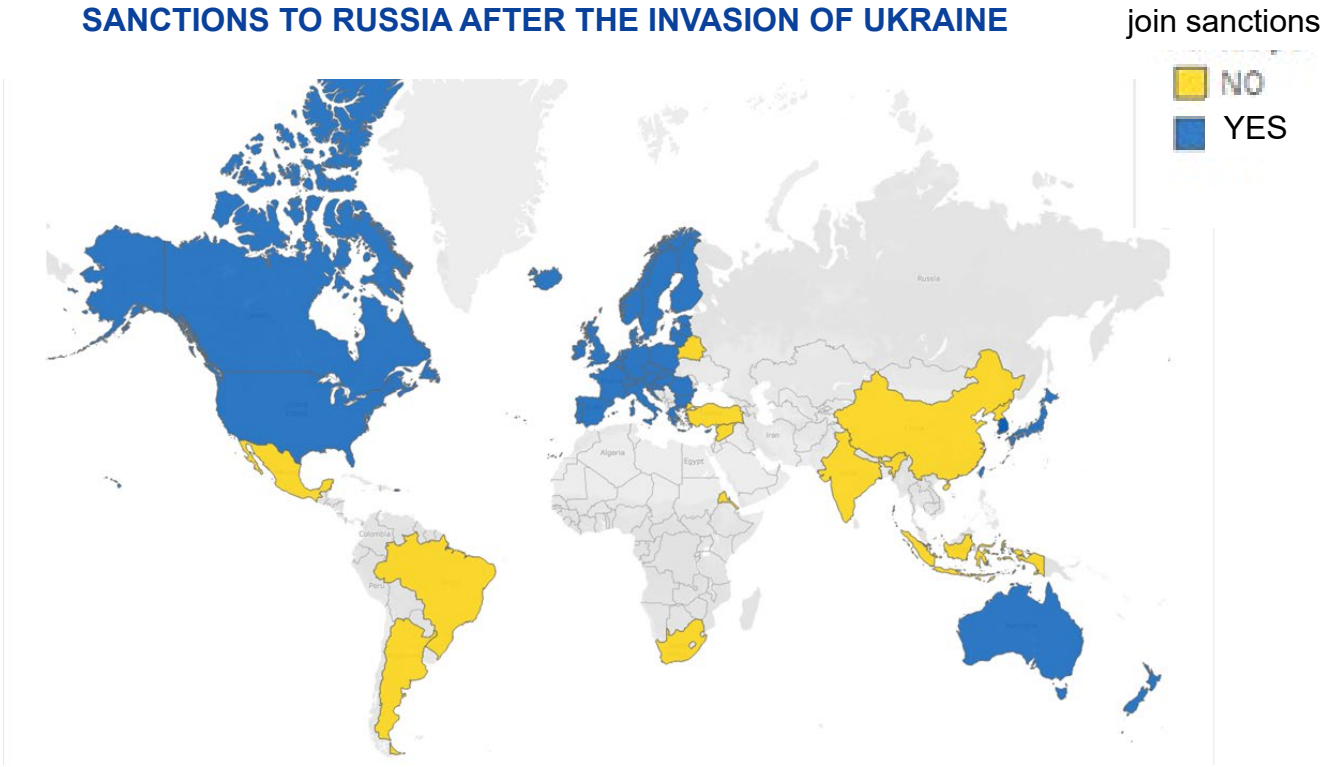
**SANCTIONS IN 2022**

In 2022 The EU has adopted five packages of sanctions in response to Russia's unprecedented and unprovoked military attack against Ukraine.

- individual sanctions
- economic sanctions
- restrictions on media
- diplomatic measures
- restrictions on economic relations with the non-government controlled areas of Donetsk and Luhansk
- Restrictions on economic cooperation

Source: The Council of the European Union

**SANCTIONS TO RUSSIA AFTER THE INVASION OF UKRAINE**




*Source: Peterson Institute for International Economics*

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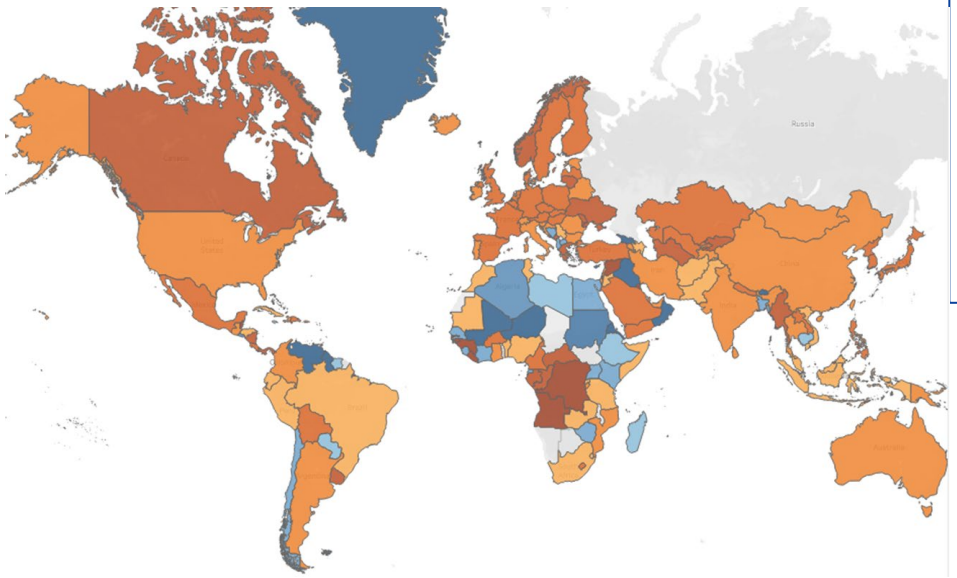
# Russia's imports

## India increased importance besides China and Sub-Saharan Africa

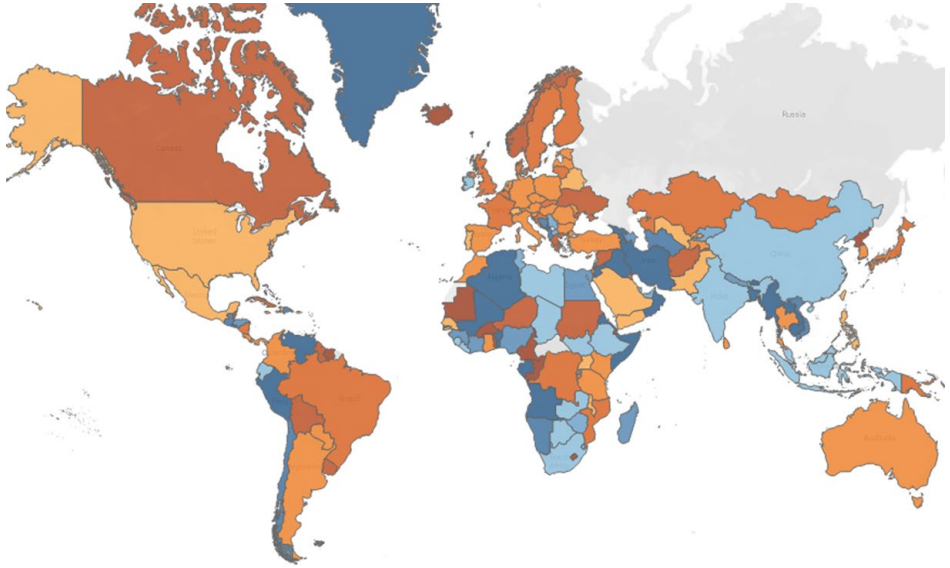
**CRIMEA EFFECT**
**(sanctions and recession)**



Russian imports

- ✓ decreased by 30% from Europe and 15% from the US
- ✓ increased by more than 20% from China and India, more than 50% from Sub-Saharian Africa

**POST-CRIMEA**
**(redirection)**



US dollars

% Difference in Value

-100.0% 100.0%

*Source: Prometeia'calculations on IMF Direction of Trade Statistics data*

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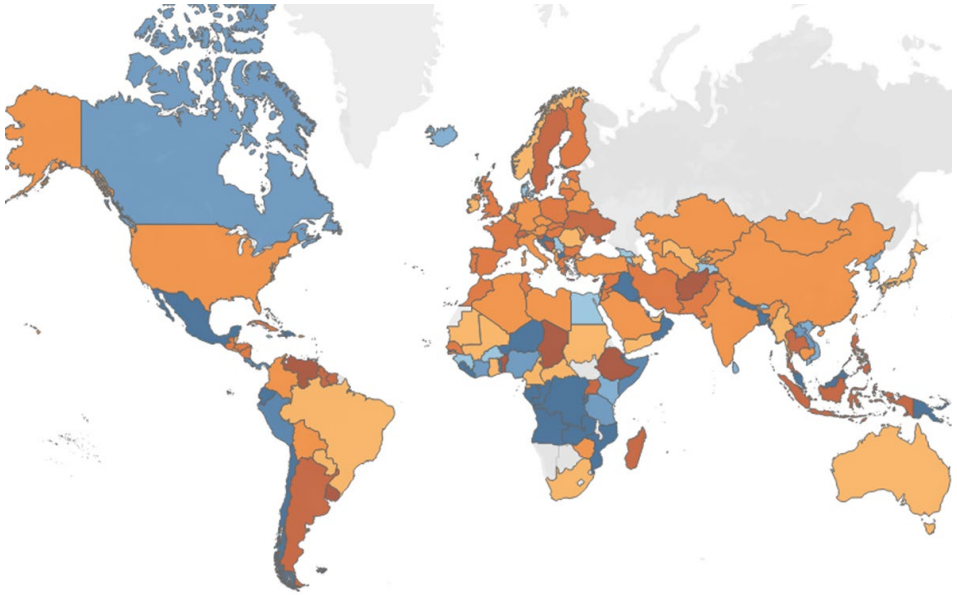
# Russia's exports

## Increasing penetration of Russia into Sub-Saharan Africa, Arab countries...as well as China

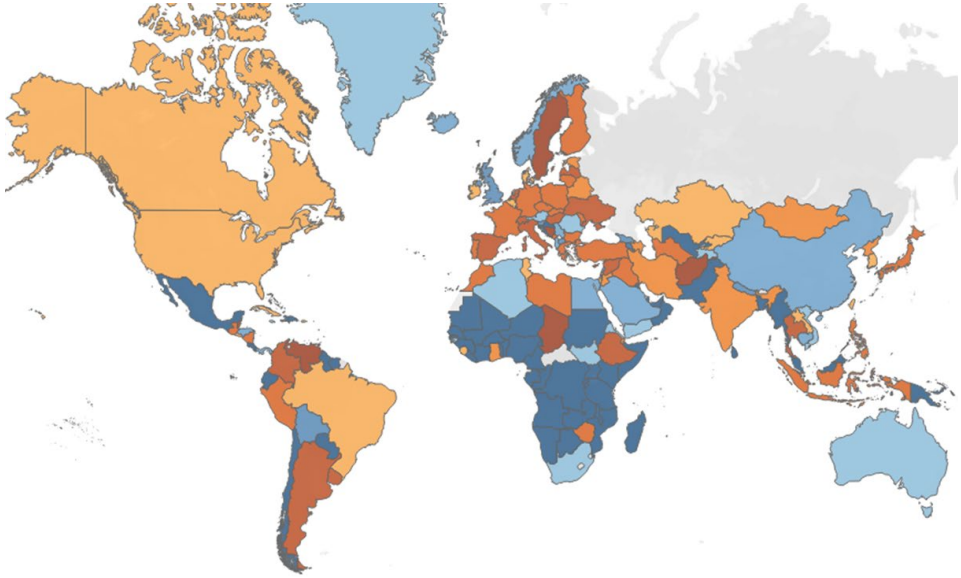
**CRIMEA EFFECT**
**(sanctions and recession)**



Russian exports

- ✓ decreased by 40% in Europe, by 16% in US
- ✓ increased by 40% in China, more than 50% in Sub-Saharian Africa

**POST-CRIMEA**
**(redirection)**



US dollars

% Difference in Value

-100.0% 100.0%

*Source: Prometeia'calculations on IMF Direction of Trade Statistics data*

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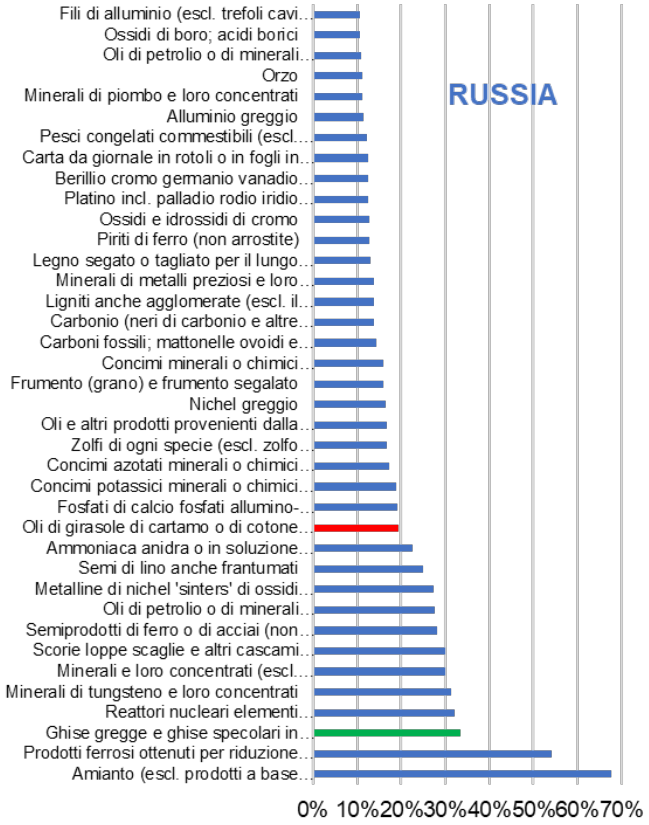
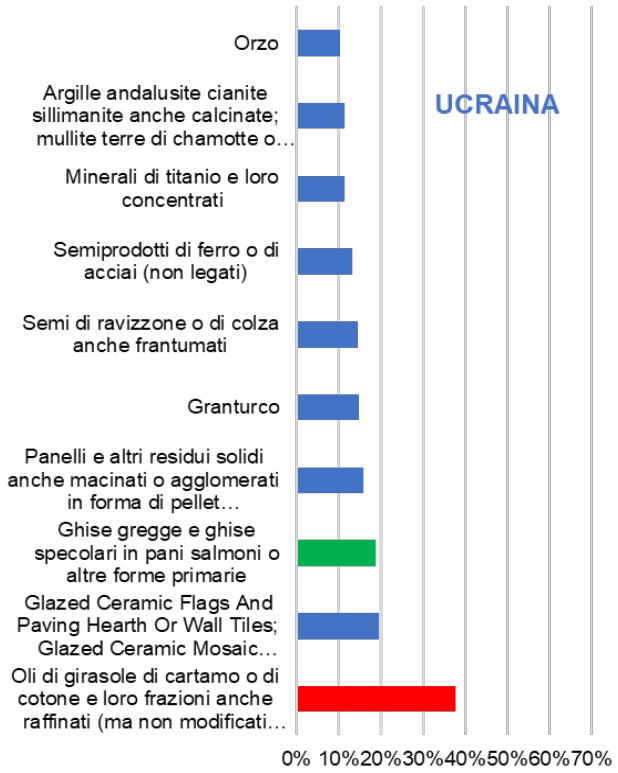
# Russia e Ukraine in the commodity markets

## Relevant weights in commodity production

### RUSSIA E UKRAINE AS COMMODITY EXPORTERS

shares on global exports by type, $

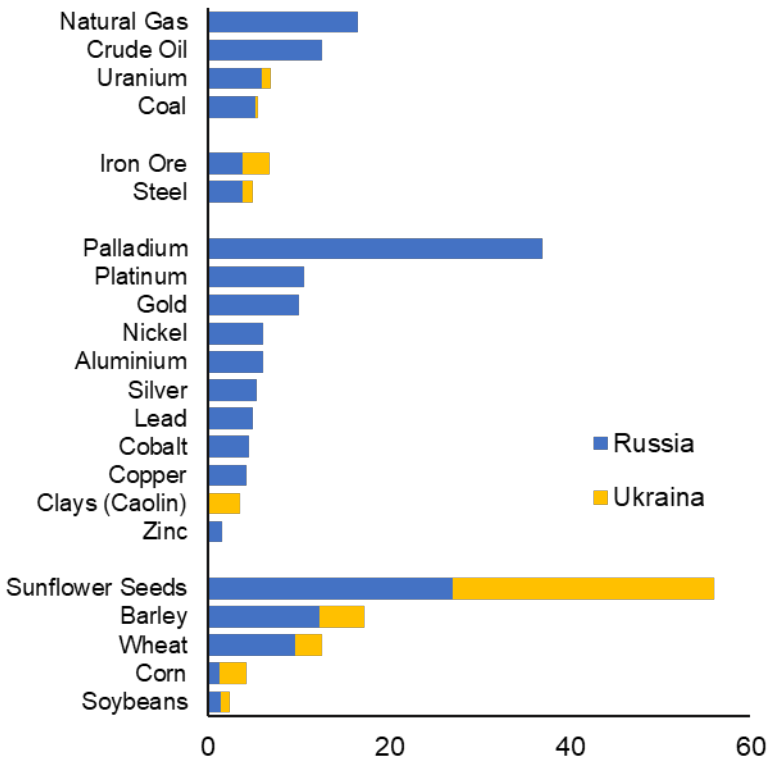



*Source: Prometeia's calculations on Trade Data Monitor data*

### RUSSIA AND UKRAINE AS COMMODITY PRODUCERS

volumes 2020, % shares of global production




*Source: Prometeia's calculations on TDM, BP Statistical Review of World Energy data*

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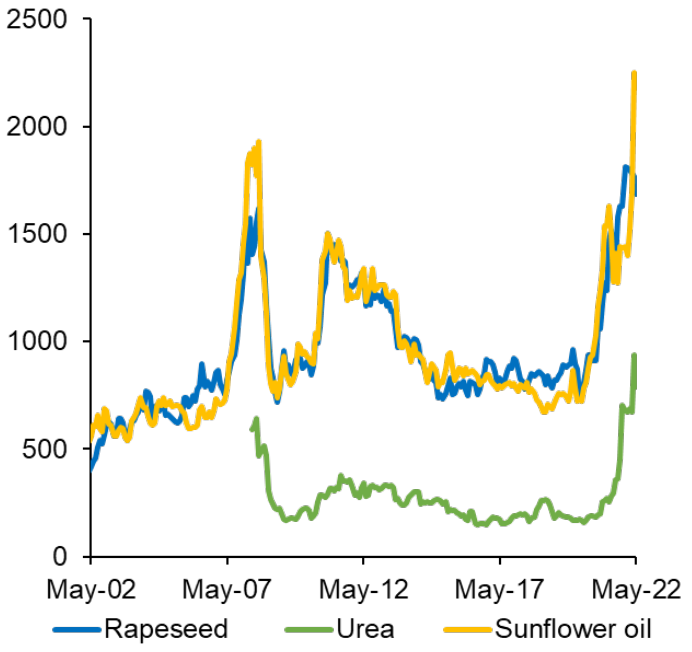
# Commodity international prices

## New peaks for several agricultural products

**THE ECONOMIST PRICE INDICES OF INDUSTRIAL PRODUCTS** - $, 2015=100

Source: Refinitiv

**PRICES OF AGRICULTURAL PRODUCTS***



** US$ per bushel, sunflower oil US$ per ton*

Source: Refinitiv

Source: Refinitiv

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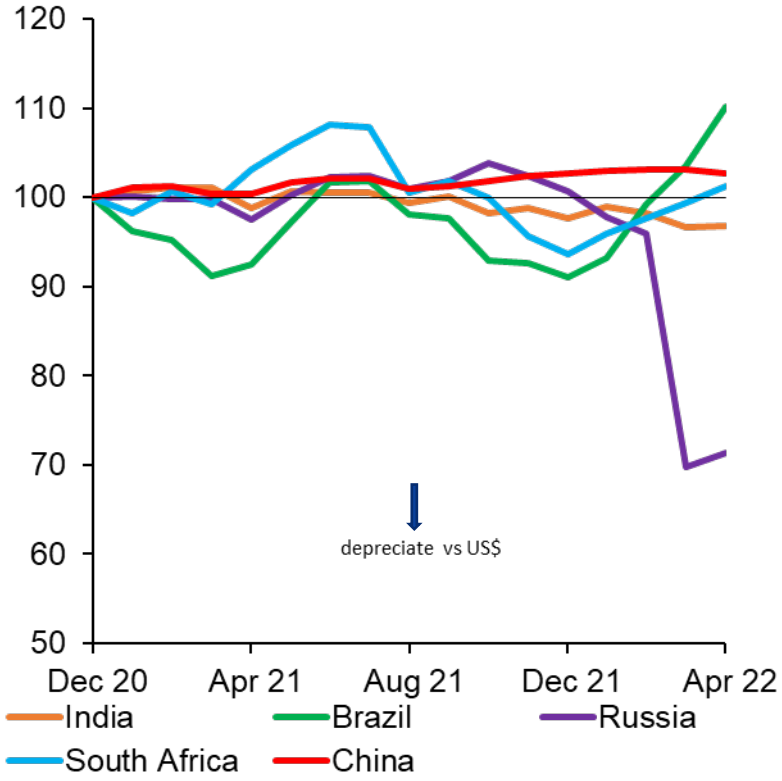
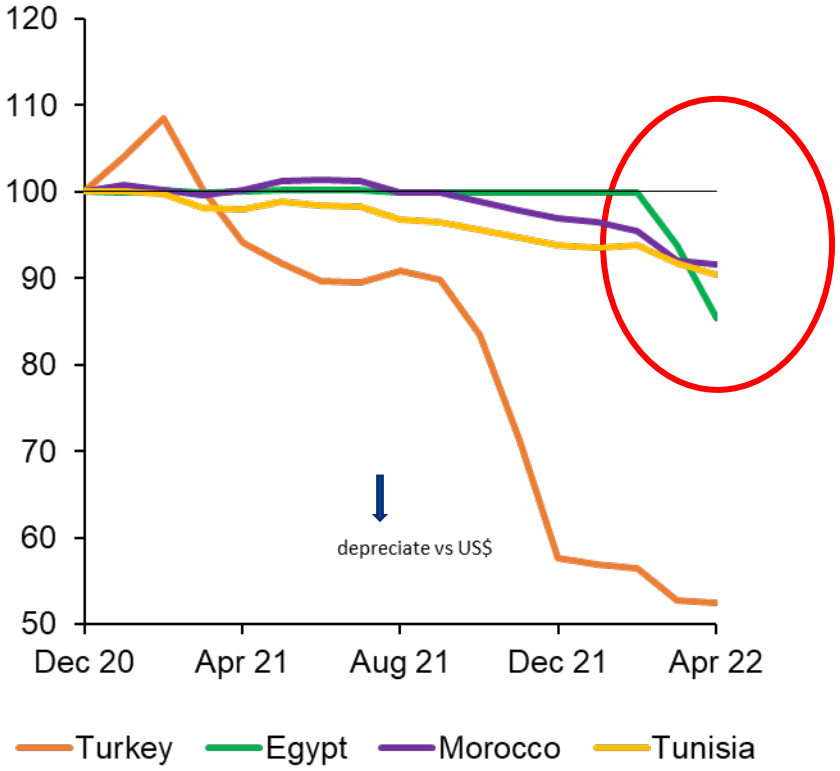
# Emerging economies' exchange rate

## Tensions in emerging countries that had been "indirectly" affected by increases in industrial commodity prices

**EXCHANGE RATES VS US DOLLAR**
December 2020 = 100




*Source: Prometeia's calculations on Refinitiv data*

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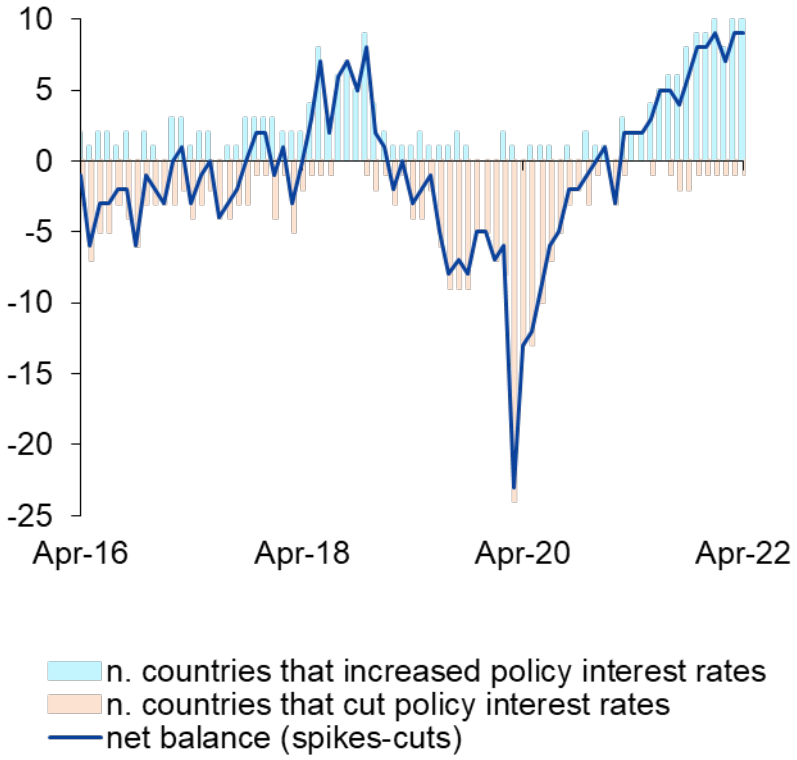
# Emerging economies' monetary policy interest rates

## Restrictive monetary policies to counteract inflationary pressures

**INDICATOR OF MONETARY POLICY IN EMERGING MARKETS**




*Source: Prometeia's calculations on Refinitiv data*

**Emerging markets central banks: between the reputation to defend, the inflation target and the risk of triggering a recession**

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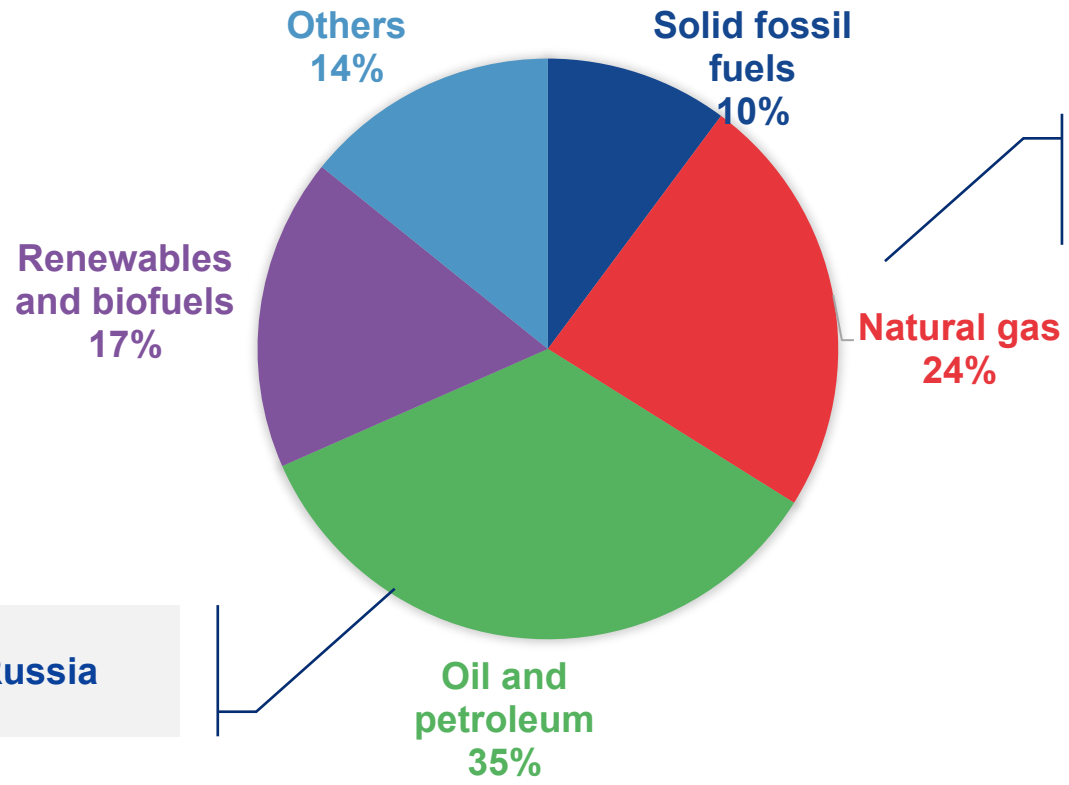
# EU energy dependence

## Energy mix in 2019, fuel's share of energy needs




41.1% from Russia

36.5% from Russia

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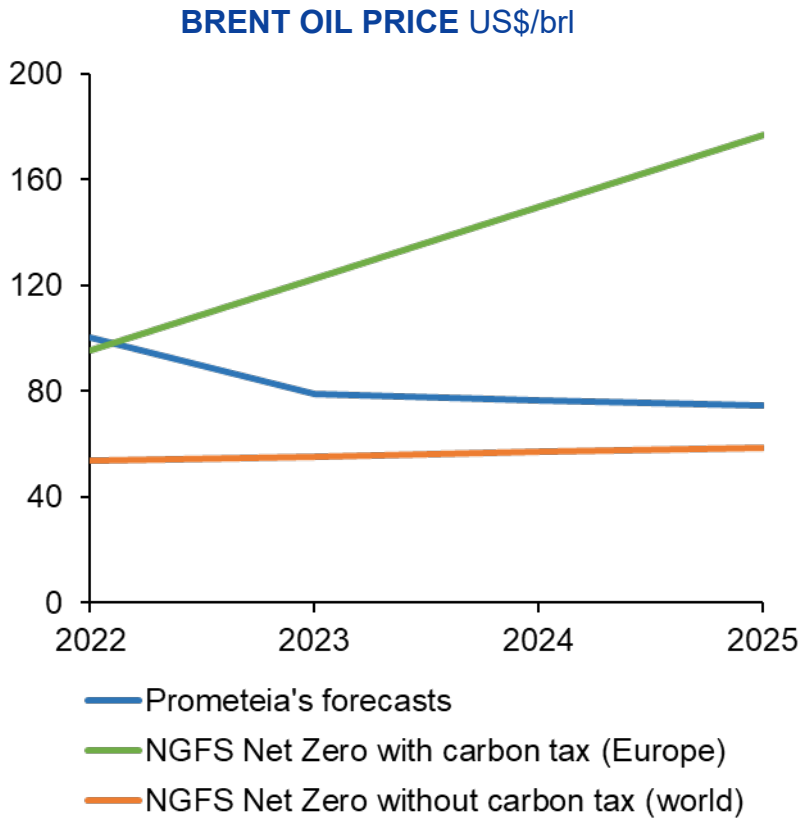
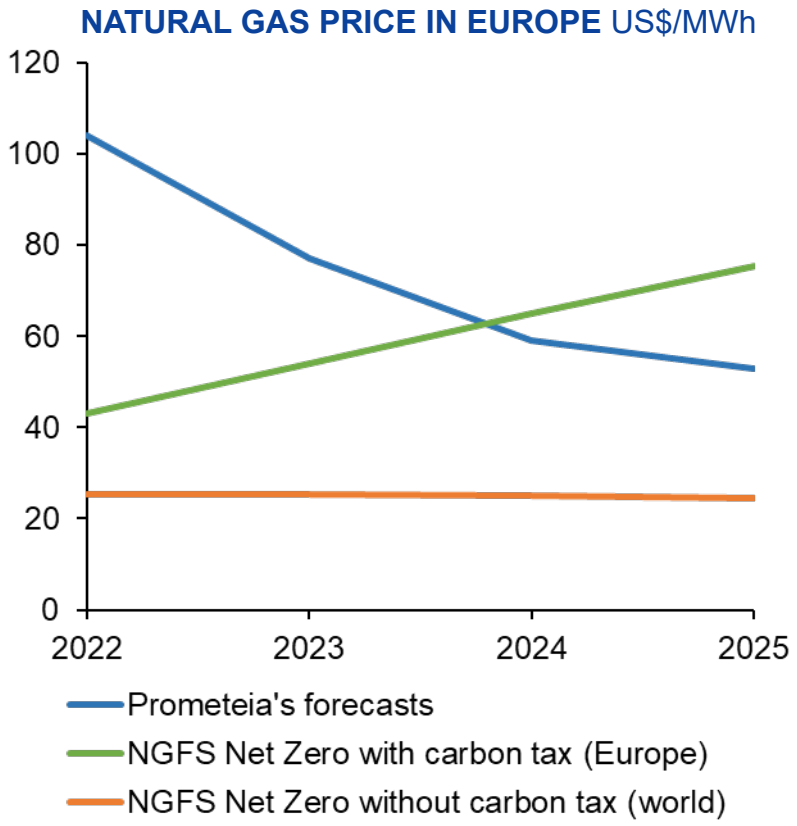
*Fonte: Prometeia's calculation on Eurostat data*

# High energy prices but lower than those needed for Net Zero transition

## Oil and gas prices fall back from Q3-2022 but remain higher than pre-Russian invasion in Ukraine




*Fonte: Prometeia e NGFS (NIGEM with input from REMIND-MAgPIE 2.1-4.2).*

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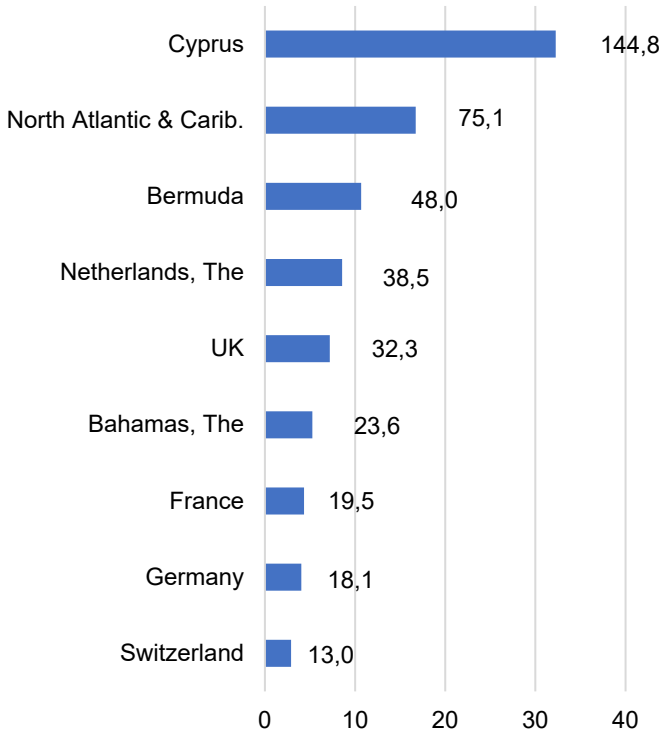
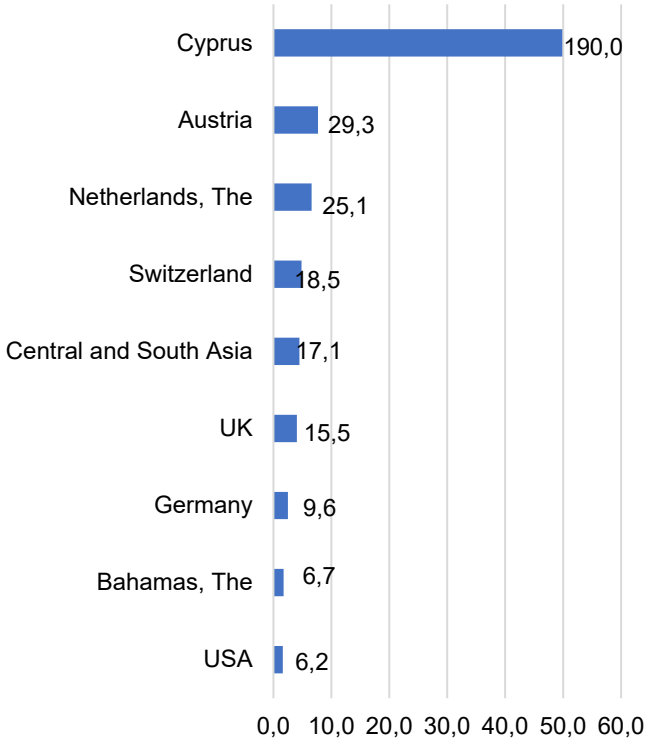
# Russia in financial markets - FDI

**FDI INFLOWS IN RUSSIA -** 2020, shares % and billion US$




**FDI OUTFLOWS FROM RUSSIA -** 2020, shares % and billion US$




*Source: IMF, Coordinated Direct Investment Survey*

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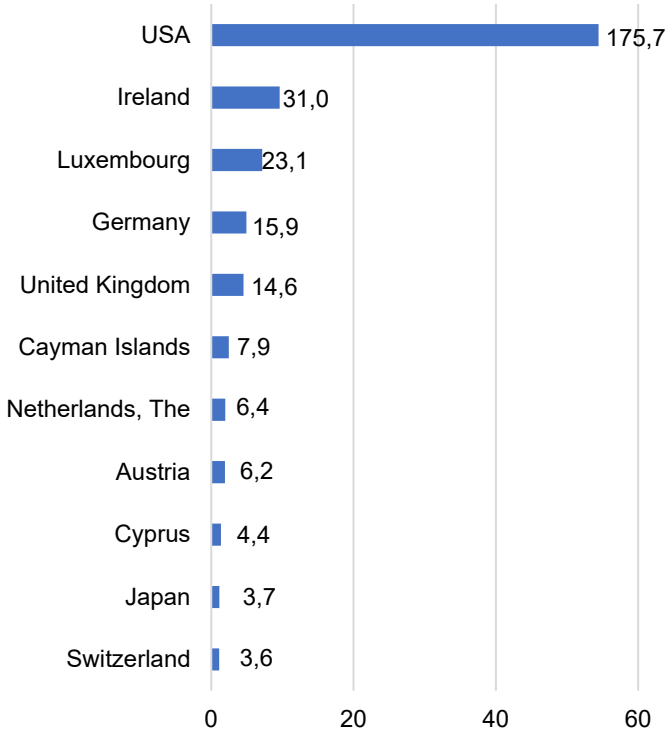
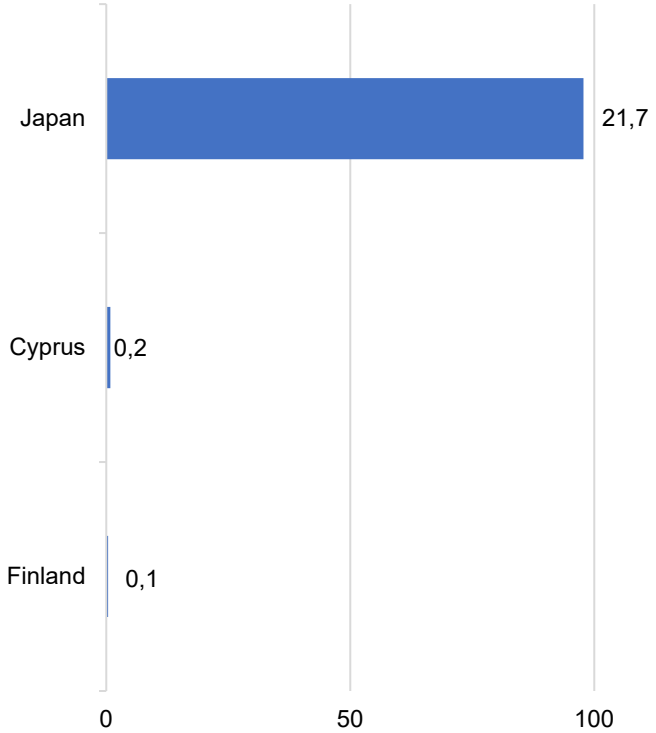
# Russia in financial markets – Portfolio investments

**PORTFOLIO INVESTMENTS IN RUSSIA,** shares and billion US$




**RUSSIA PORTFOLIO INVESTMENTS ABROAD,** shares and billion US$




*Source: IMF, Coordinated Portfolio Investments Survery*

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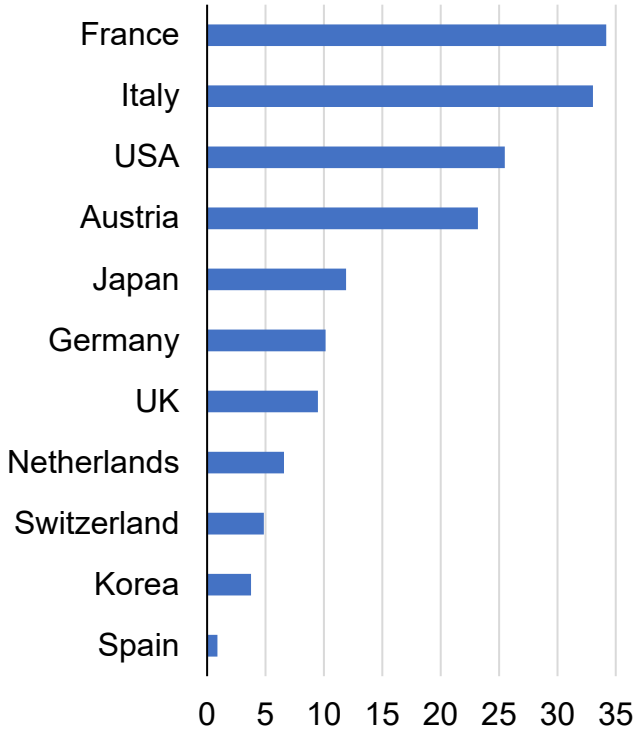
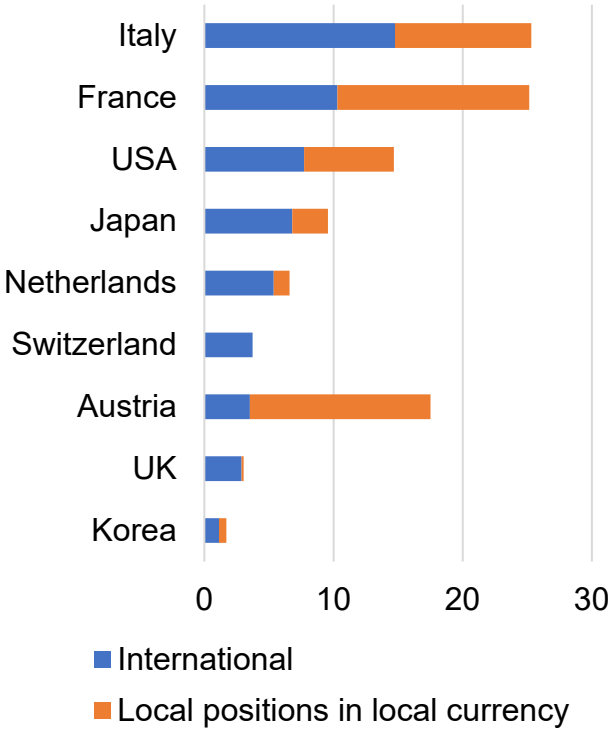
# Russia: exposure of non-resident banks

**CREDITS AND OTHER***
September 2021, billion US$



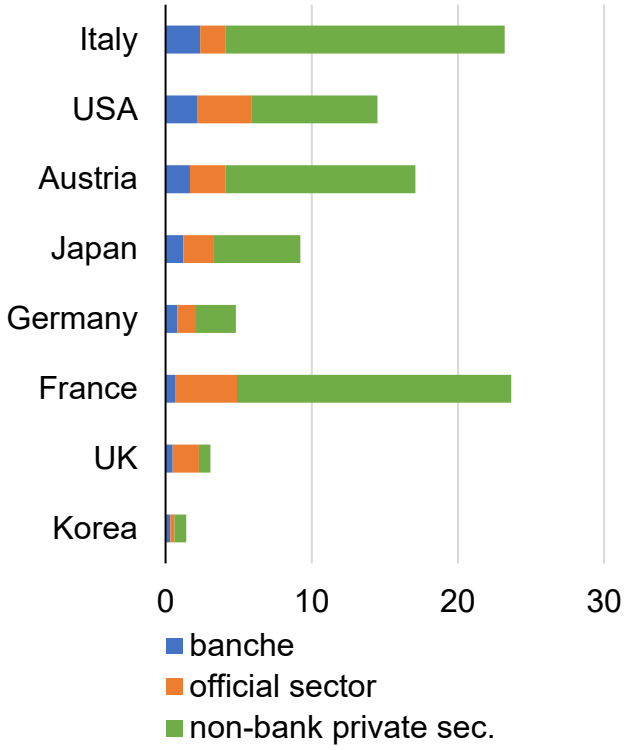

** including derivatives contracts, guarantee extended, credit commitments*

**CREDITS**
September 2021, billion US$




*Fonte: BIS, Consolidated Banking Statistics*

**CREDITS BY SECTOR**
September 2021, billion US$

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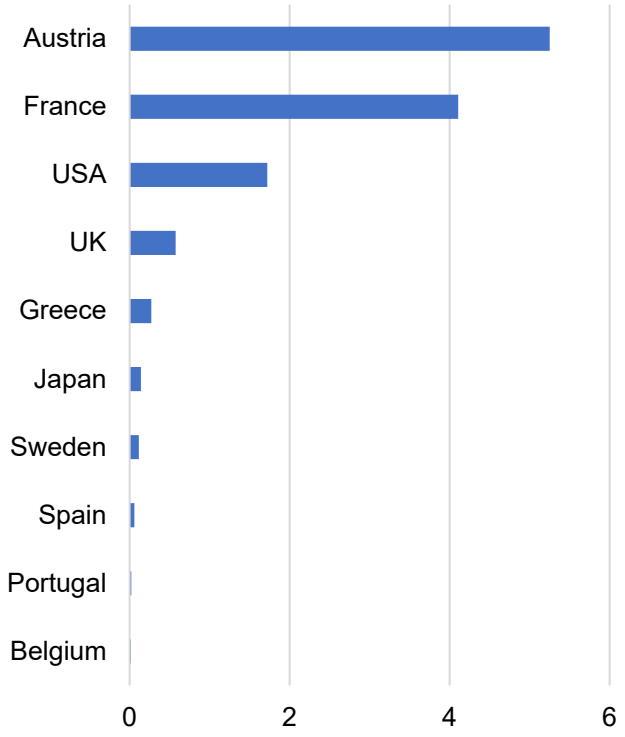
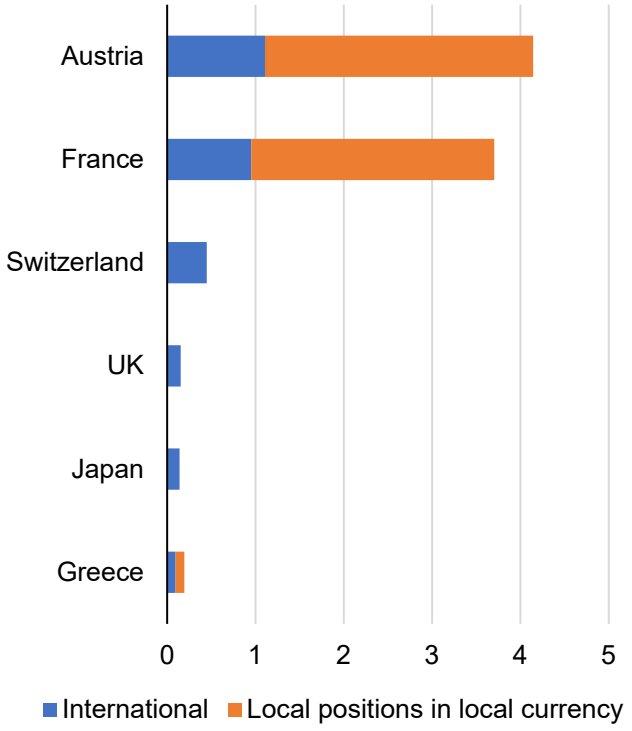
# Ukraine: exposure of non-resident banks

**CREDITS AND OTHER***
September 2021, billion US$



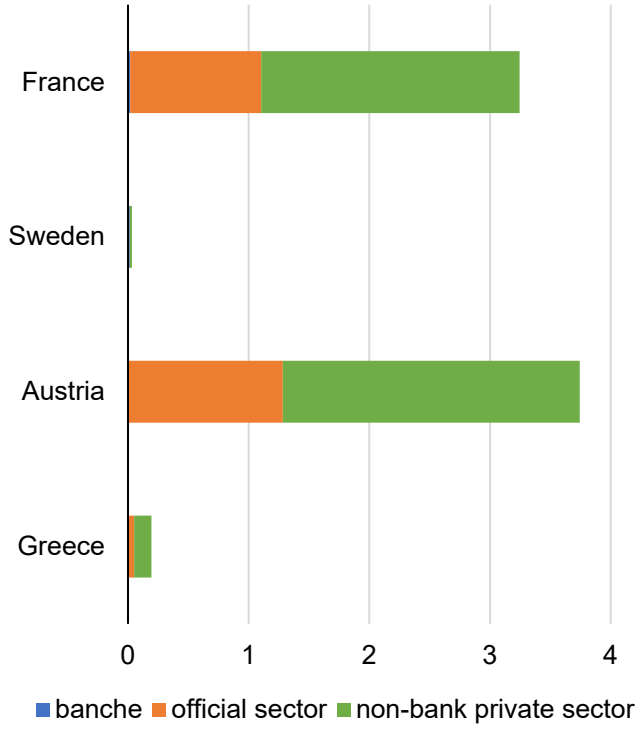

** including derivatives contracts, guarantee extended, credit commitments*

**CREDITS**
September 2021, billion US$




*Fonte: BIS, Consolidated Banking Statistics*

**CREDITS BY SECTOR**
September 2021, billion US$

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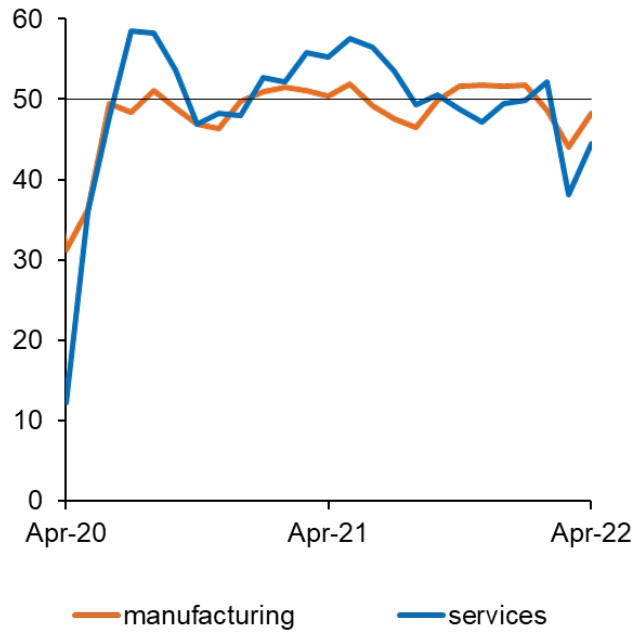
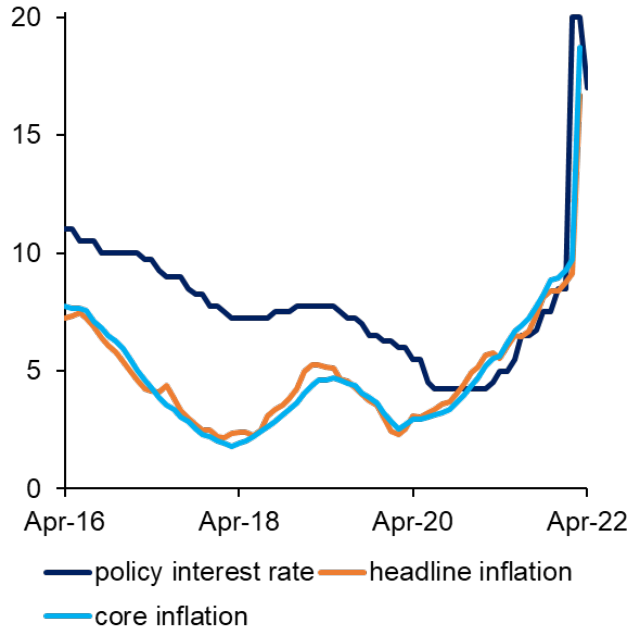
# Russia: worsening economy

**PMI**




**INFLATION AND MONETARY POLICY INTEREST RATE**




**RUBLO vs US$ EXCHANGE RATE**

*Source: Refinitiv*

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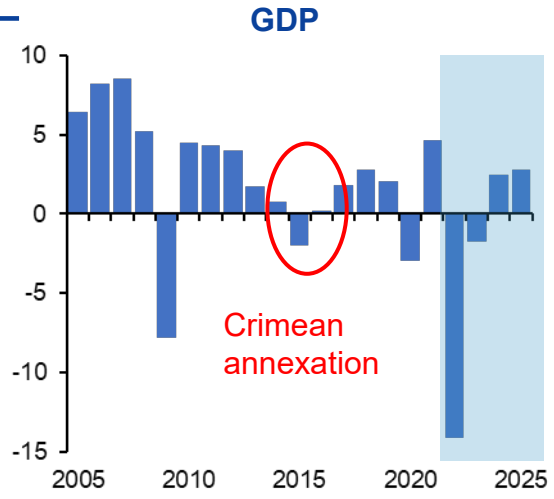
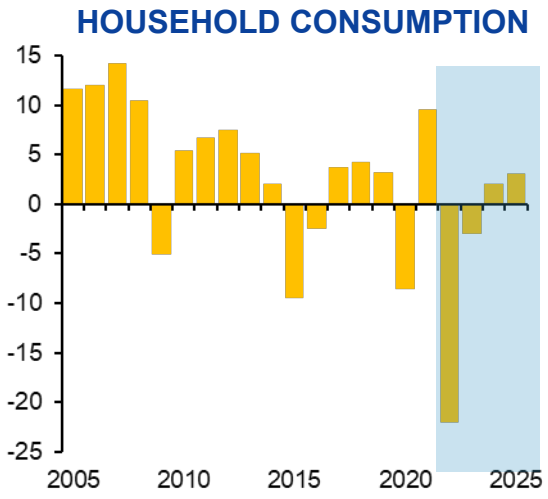
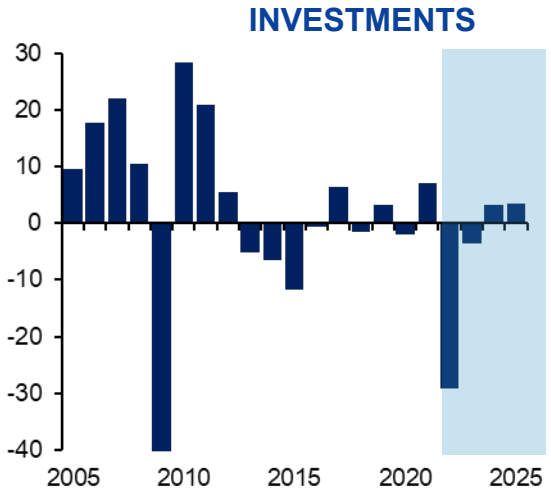
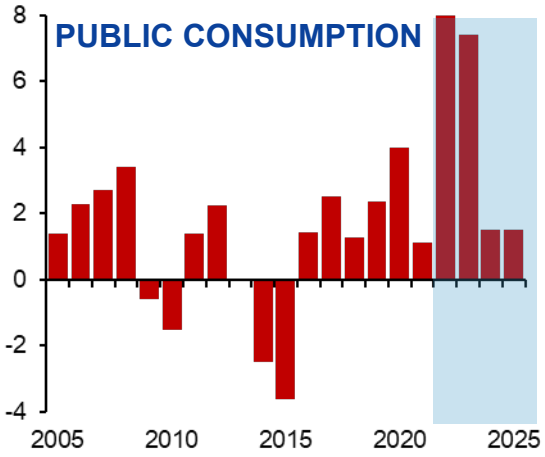
# Russia: two years of recession

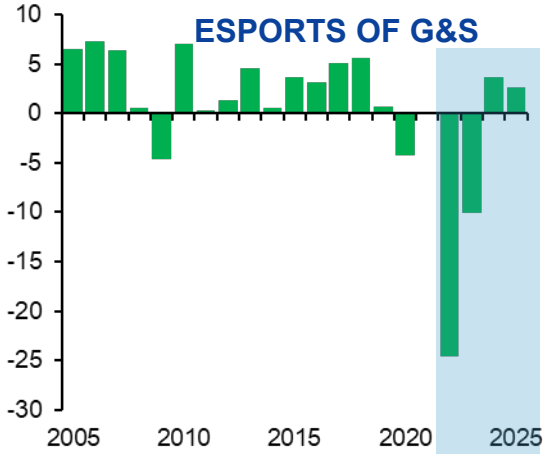
## Sanctions extert negative effects on consumption and investments

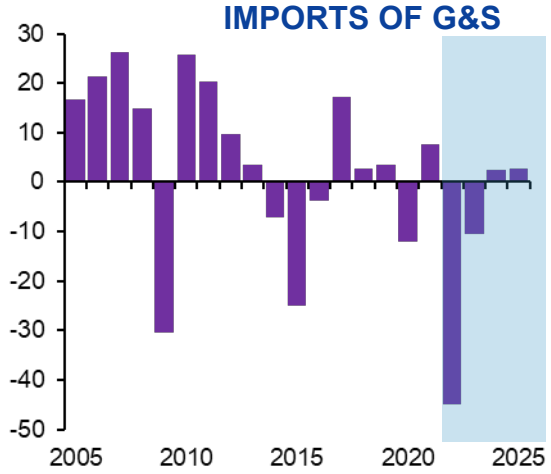



percent

*Fonte: previsioni Prometeia su dati World Bank*

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# Questions for discussion

- It seems unlikely that Russia will resume its role in the global economy once the war in Ukraine is over. Do we agree on this? How will this affect global trade and international commodity prices?

- Putting together the Green Transition and Russia's expected diminished role, is the global economy, and Europe in particular, ready to deal with higher energy and commodity prices? Are we entering a period of high inflation, especially in commodity markets?

- Are Russia and China going to increase their economic integration? (a vertical integration: Russia specialized in commodities, China in manufacturing)

- Yellen on April 13 in her speech on «Way forward for the Global Economy» talked of «friend-shoring» to achive «free but secure trade». (She never mentioned WTO) Should we expect to move to a bipolar (three-polar?) global economy?

- Large emerging countries/regions, India, Africa...which pole will they join? With what consequences? (Europe seems more inclined to move within existing WTO rules - Lagarde). What should we expect in the future?

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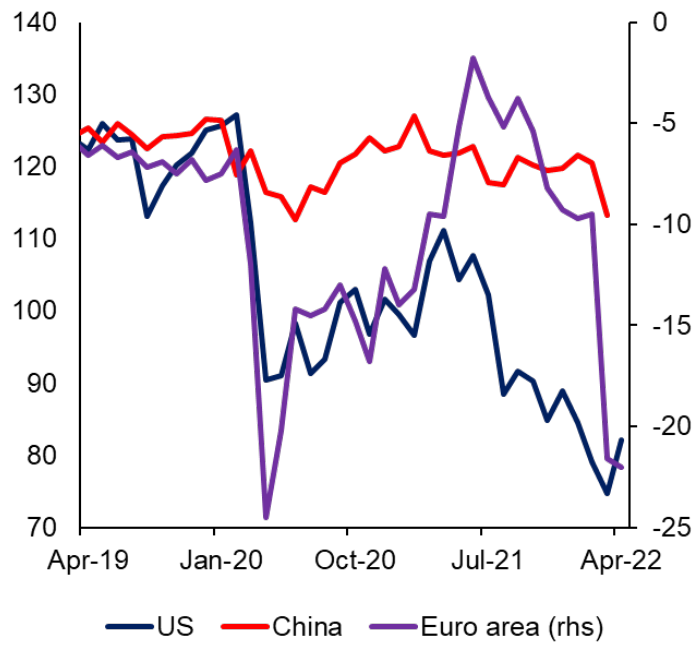
# Confidence climate

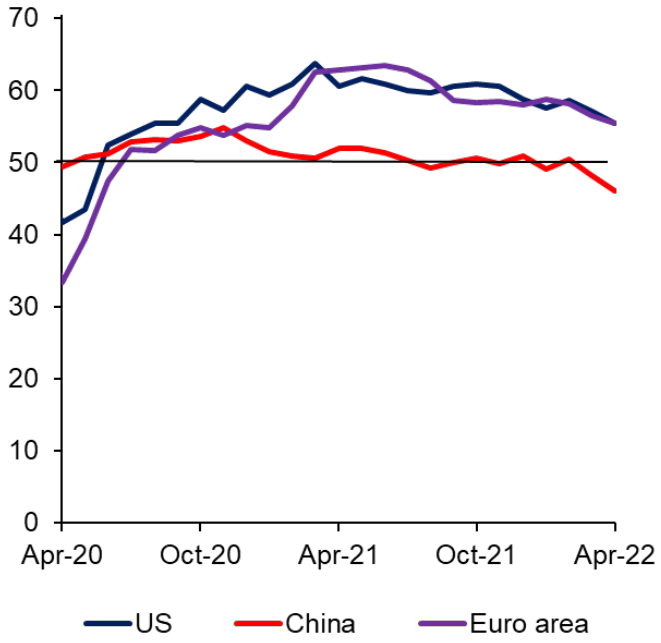
## In March consumer confidence began to worsen, while the deterioration in business confidence was less dramatic

**HOUSEHOLD CONFIDENCE**
**indices (lhs) and** balance **(rhs)**



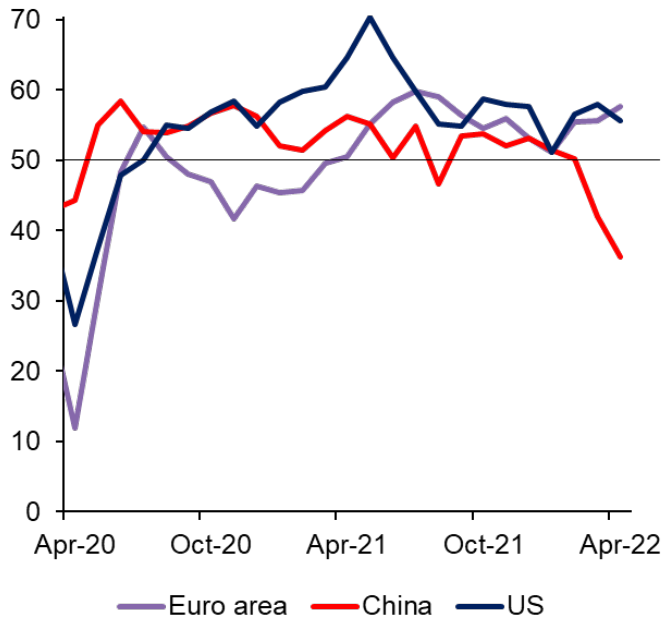

*Source: University of Michigan, Eurostat, China National Bureau*

**PMI MANUFACTURING**
balnace




*Source: Refinitiv*

**PMI SERVICES**
balnace




*Source: Refinitiv*

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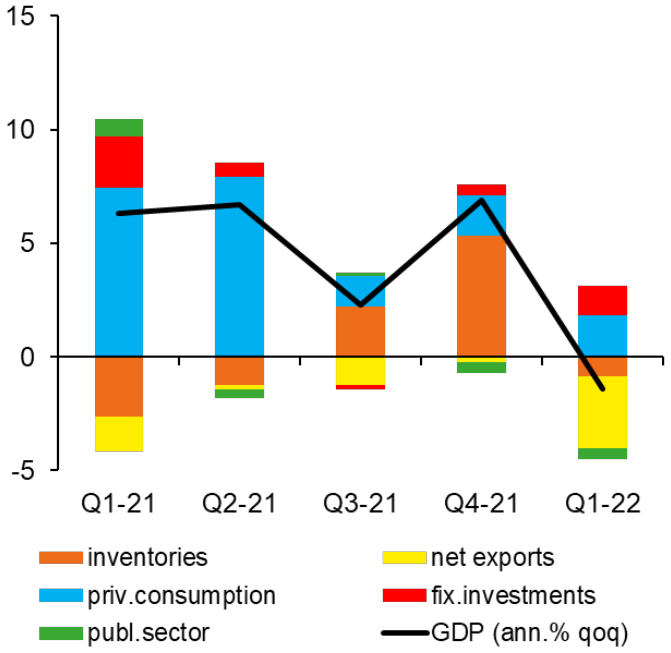
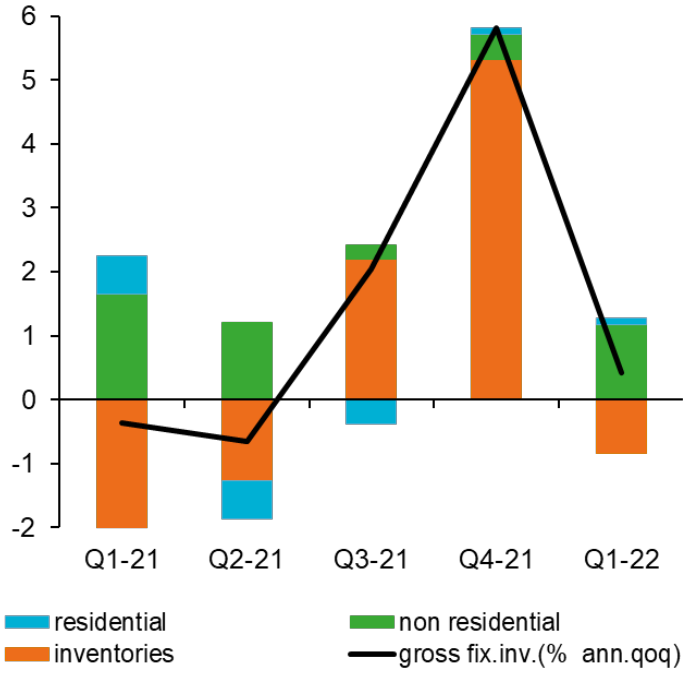
# US GDP in Q1-2022

## Less worse than it sounds

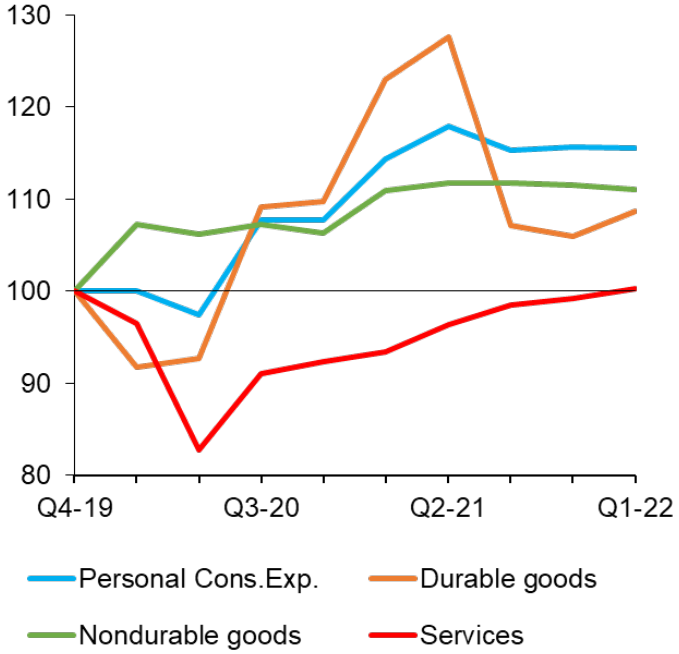
**CONTRIBUTIONS TO GDP GROWTH**
% points and annual % change




**CONTRIBUTIONS TO GROSS CAPITAL FORMATION**
% points and annual % change




**PERSONAL CONSUMPTION EXPENDITURE**
chained $, Q4-19 = 100

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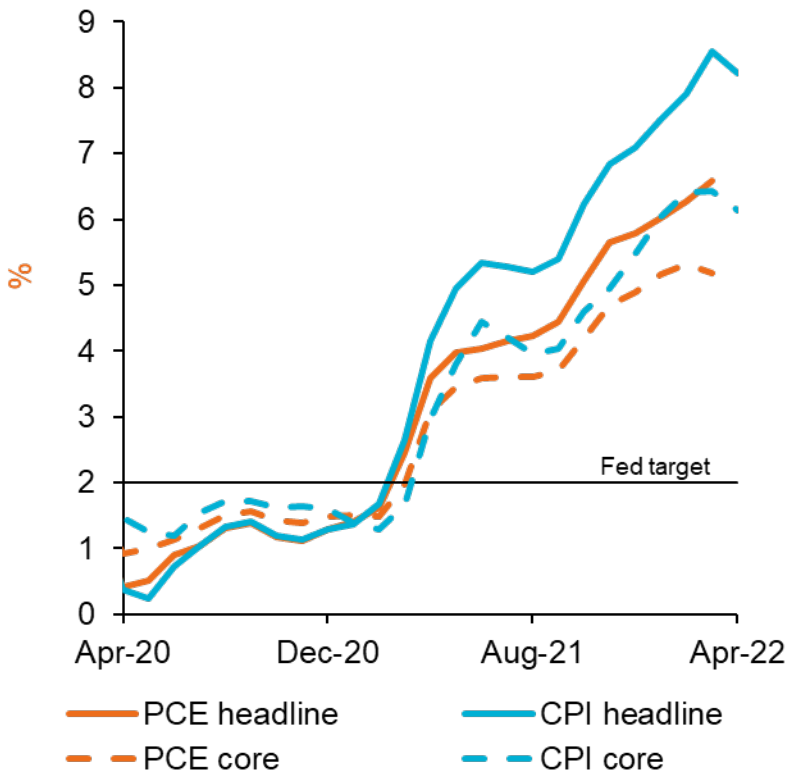
*Source: Bureau of Economic Analysis*

# US: new peak of inflation…

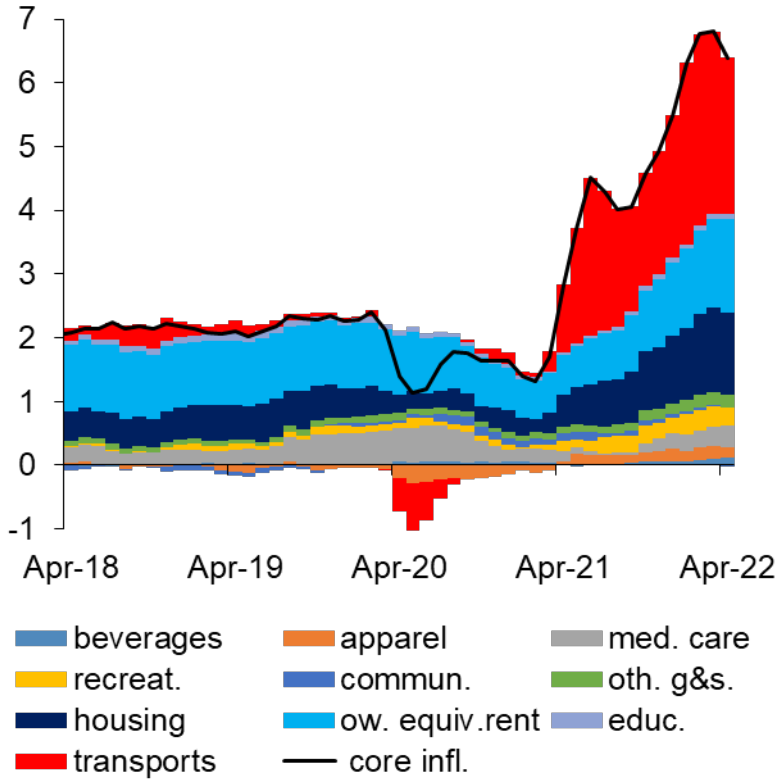
## Demand driven inflation alongside supply chain disruptions

**CONSUMER INFLATION %**




*Source: Bureau of Labor Statistics and Bureau of Economic Analysis*

**CORE INFLATION AND MAIN CONTRIBUTIONS - CPI**




*Source: Bureau of Labor Statistics*

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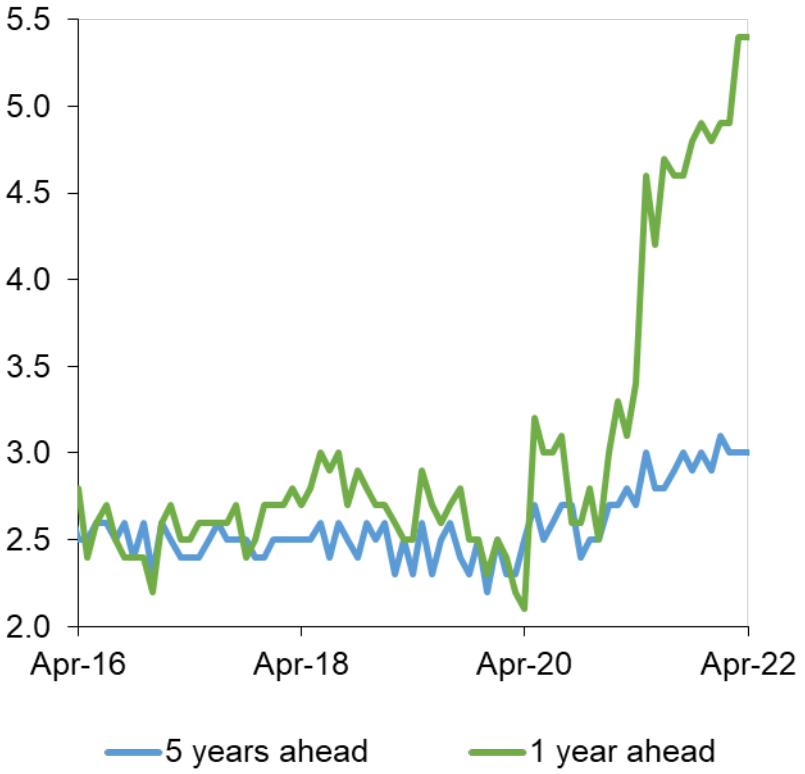
# US: ... with some effects on expectations

**5-YEAR BREAKEVEN INFLATION RATE***

* 5-Year Treasury Inflation-Indexed Constant Maturity Securities and 5-Year Treasury Constant Maturity Securities

*Source: FRED, Federal Reserve of Saint Louis*

**MEDIAN EXPECTED INFLATION**




*Source University of Michigan*

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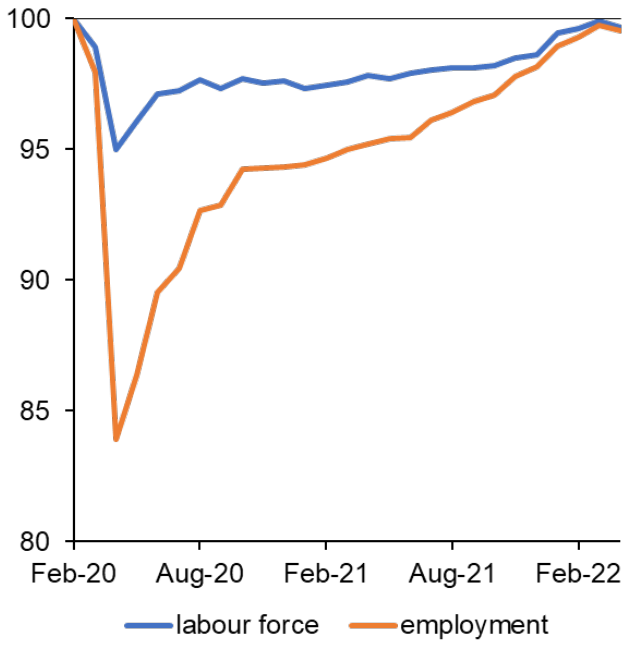
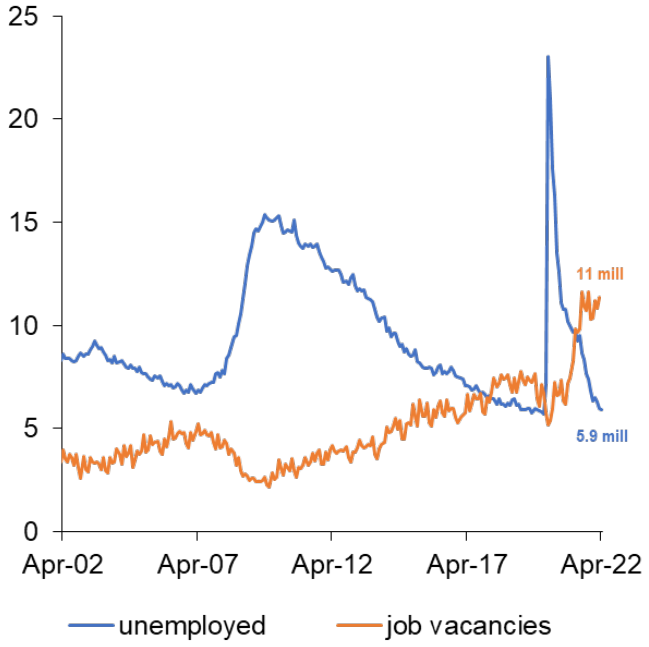
# US: tight conditions in the labour market

## 5 million workers are missing

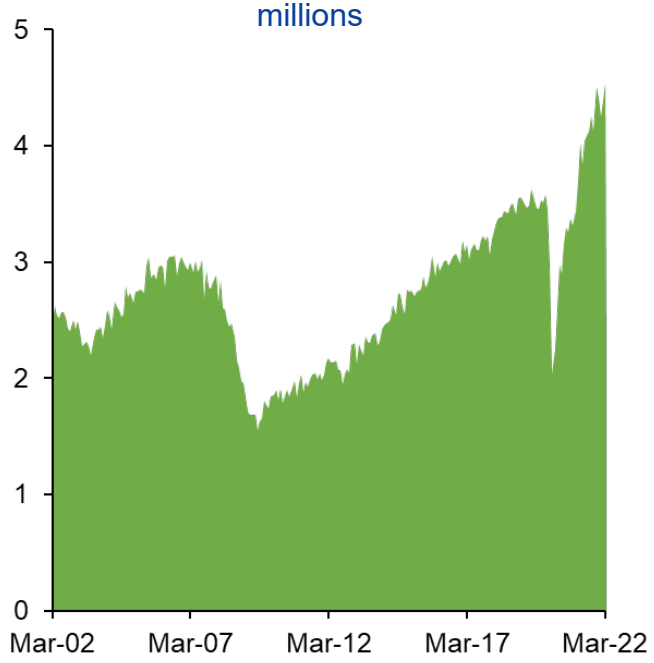
**LABOUR FORCE AND EMPLOYMENT**
February - 2020 = 100




**JOB VACANCIES AND UNEMPLOYED**
millions




**QUITS**
millions




*Source: Bureau of Labor Statistics*

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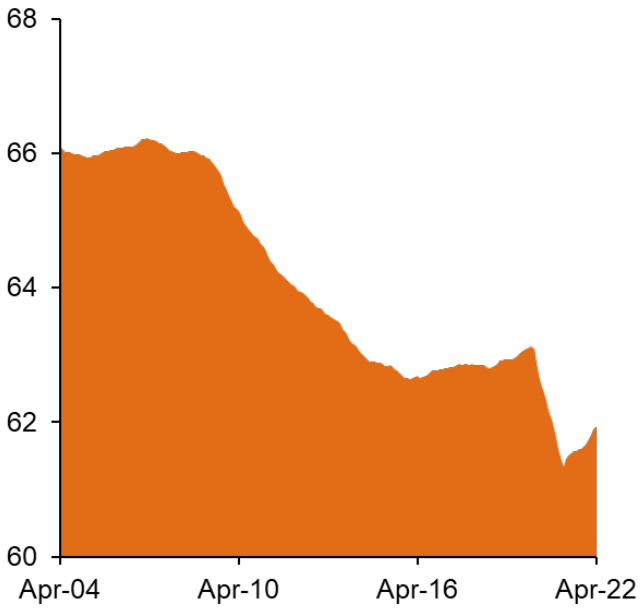
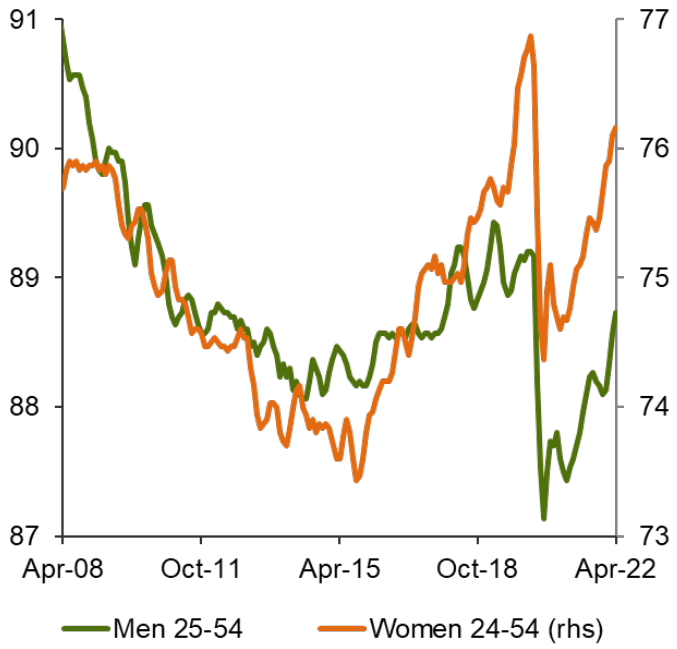
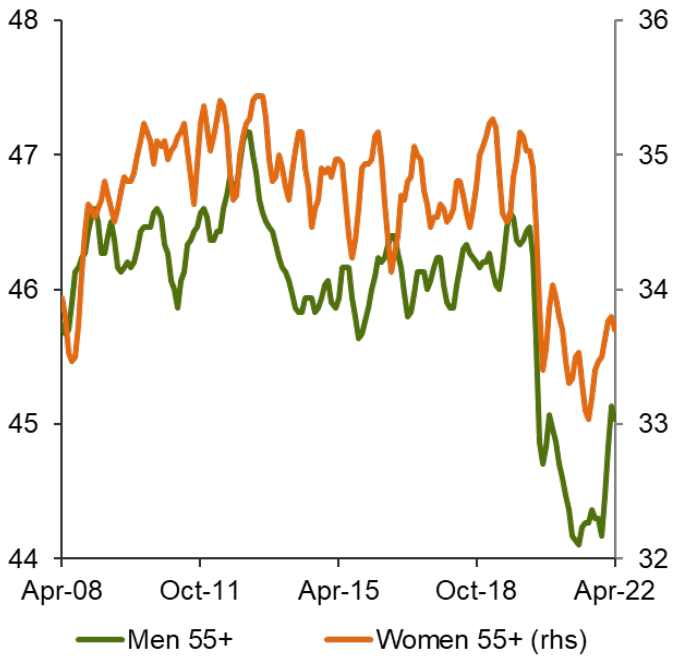
# US labour market: from «Great resignation»...

## PARTICIPATION RATE*




## PARTICIPATION RATE BY SEX AND AGE GROUP




*on population 15+

*Fonte: Bureau of Labor Statistics*

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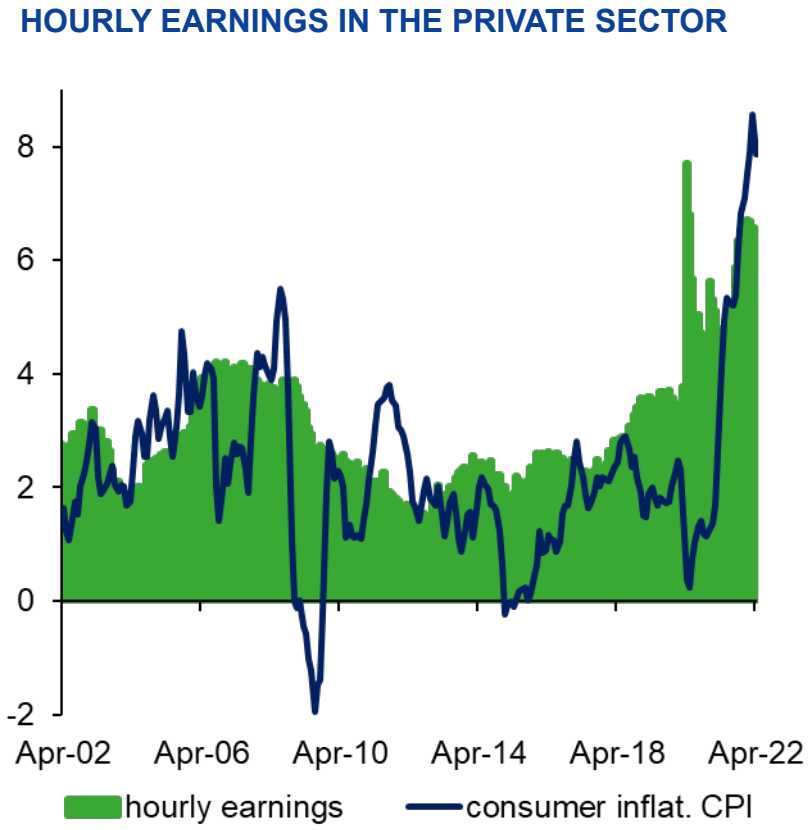
# US labour market: … to «Great renegotiation», that is, upward pressure on wages

(B. Hobijn; Great Resignations are common during fast recoveries; FRBSF Economic Letter; April 2022)

Source: Bureau of Economic Analysis




Source Bureau of Labor Statistics

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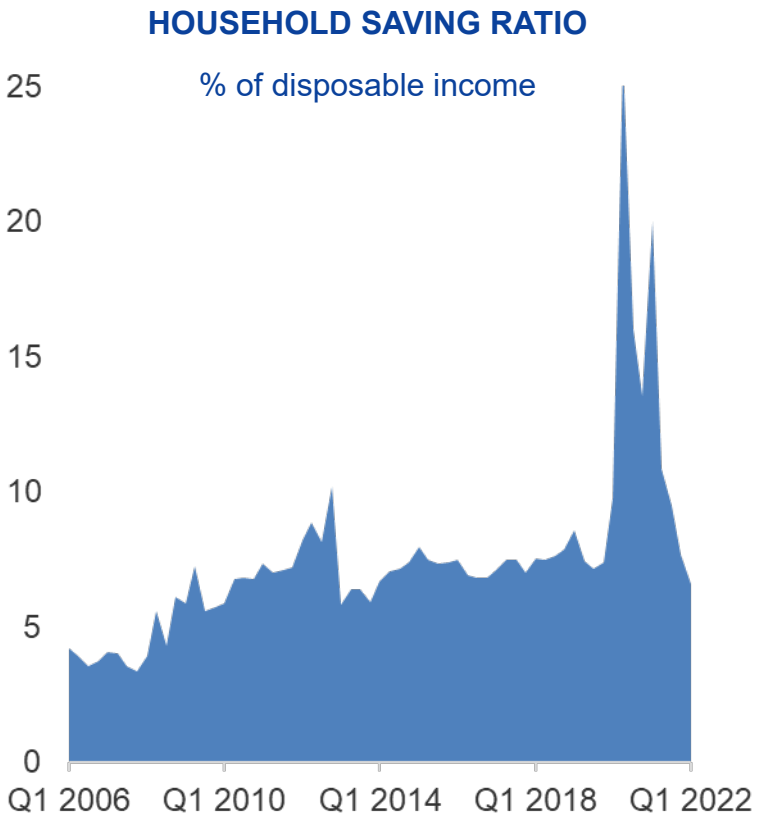
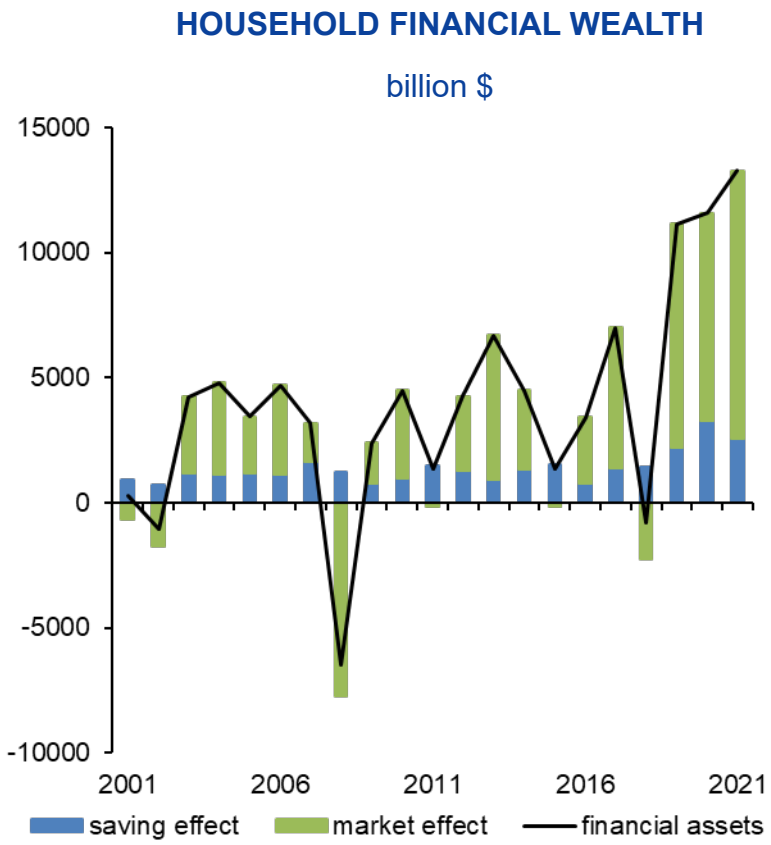
# US households: solid financial conditions

## Savings and financial wealth as buffers




*Source: Bureau of Economic Analysis*




*Source: Prometeia's calculations on Federal Reserve data*

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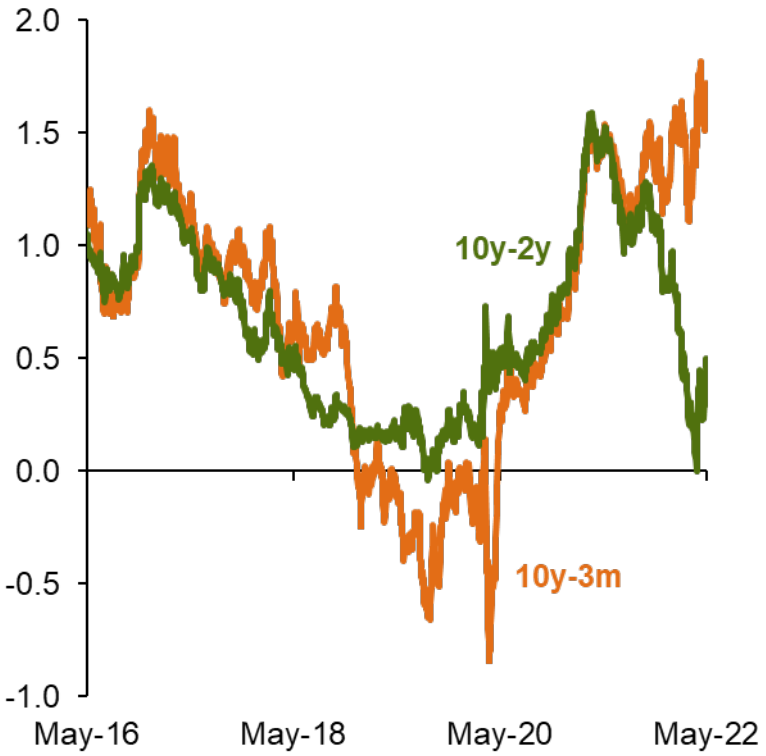
# US: is increasing the risk of recession?

**TWO TERM SPREADS %**




*Source: Prometeia, s calculation on Refinitiv data*

**Markets do not seem to clearly anticipate a recession**

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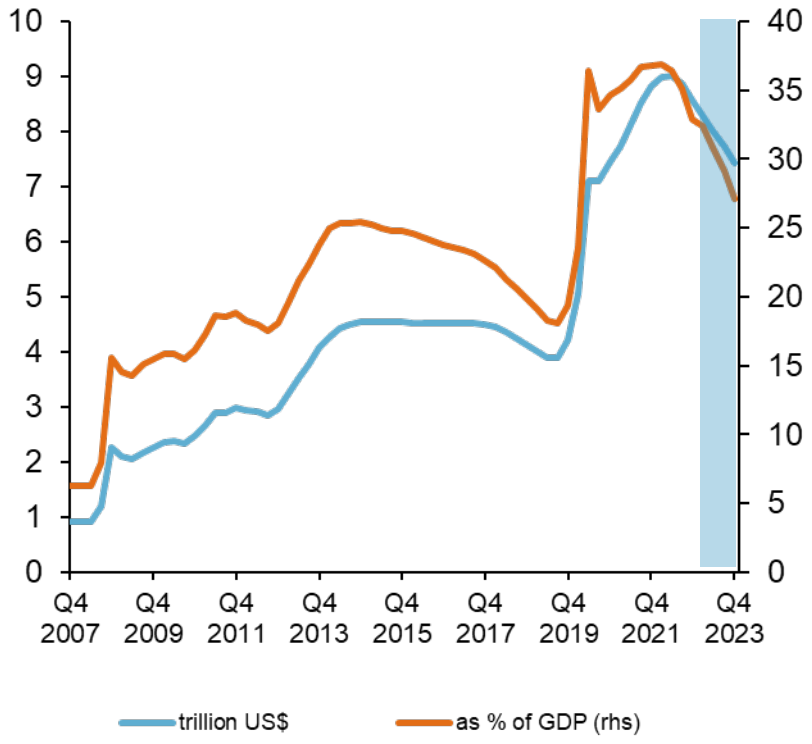
# US: quantitave tightening, which effects on interest rates?

## Higher policy interest rates and Quantitavie Tightening

**FED BALANCE SHEET**




*Source: Prometeia's calculation on Federal reserve and Bureau of Economic Analysis*

**QT faster and more intense than in 2017-2019 when it began nearly two years after the first policy rate hike and progressed very gradually.**

**Which effects on interest rates?**

**Powell said that the effects are highly uncertain but some estimates suggest around 25bp with the path announced (When? Not clear )**

**According to literature**

| Fed balance sheet reduction | effects on 10y Treasury yield |
|---|---|
| $10 billions | 1bp * |
| $25 billions | 1bp ** |

* D'Amico, King (2013)
** Gagnon et al. (2018)

**Reduction announced in May - billion US$**

| *at the end of 2022* | *at the end of 2023* |
|---|---|
| 522.5 | 1140 |

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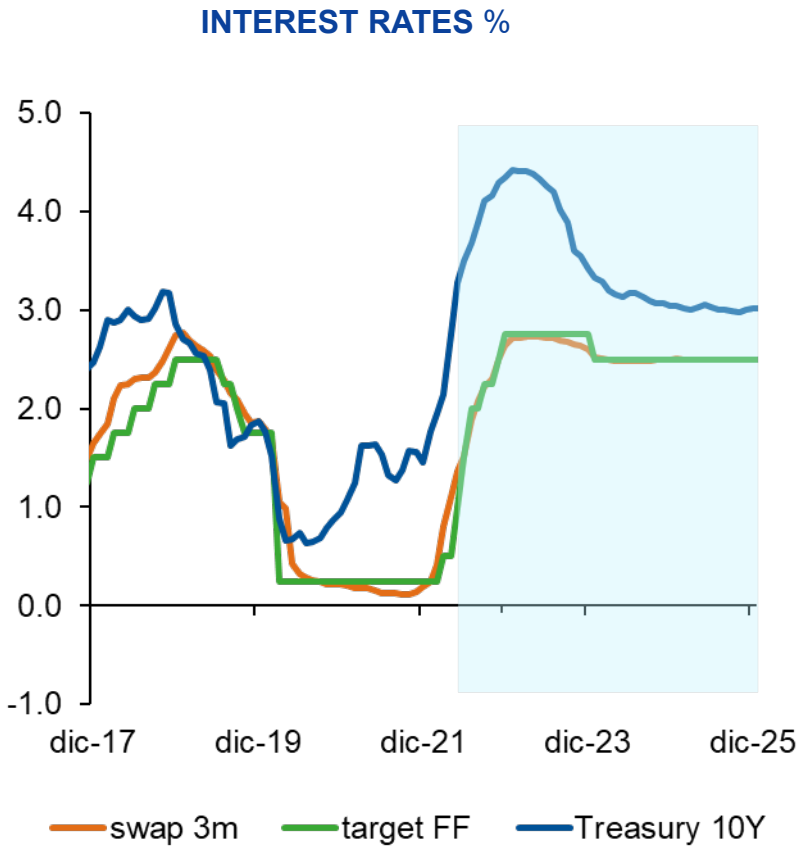
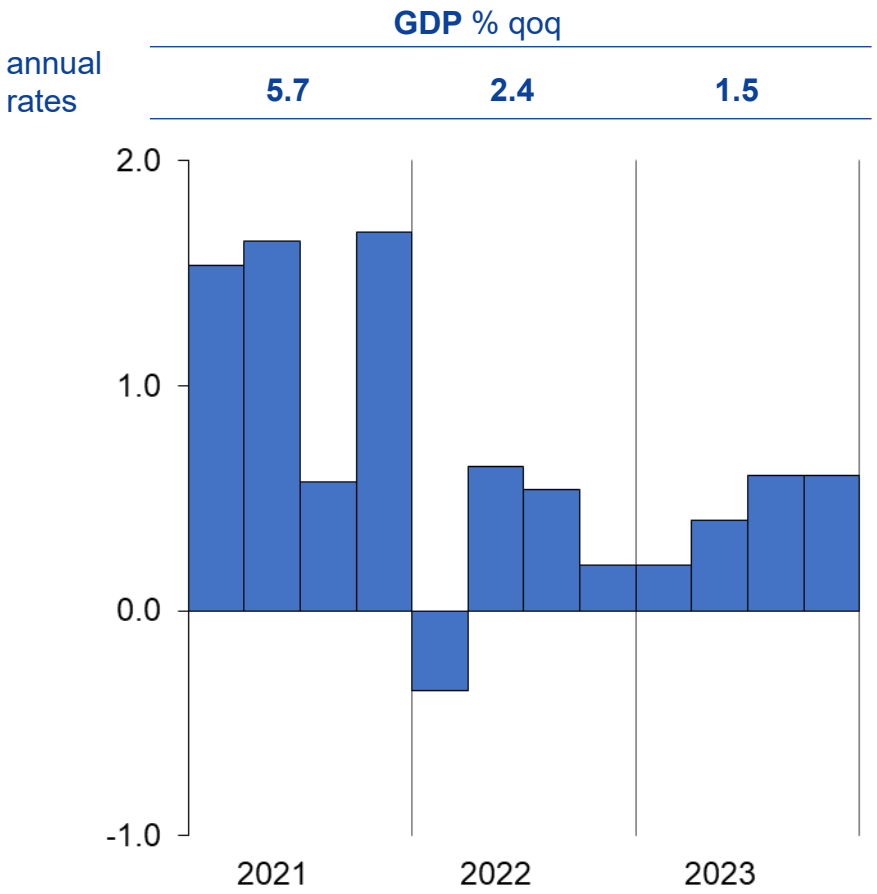
# US monetary policy

## Higher policy interest rates and Quantitavie Tightening but no recession




*Source: Prometeia Forecasts, Brief, May 2022*

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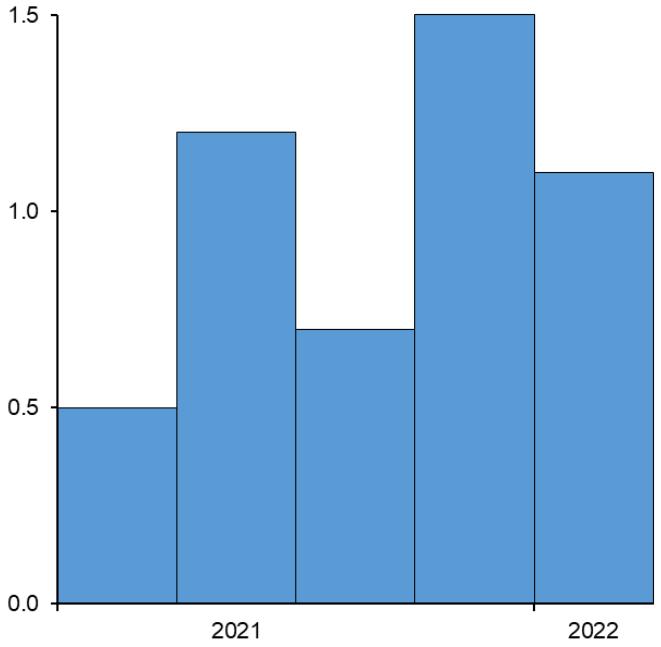
# China: new lockdowns are hurting growth

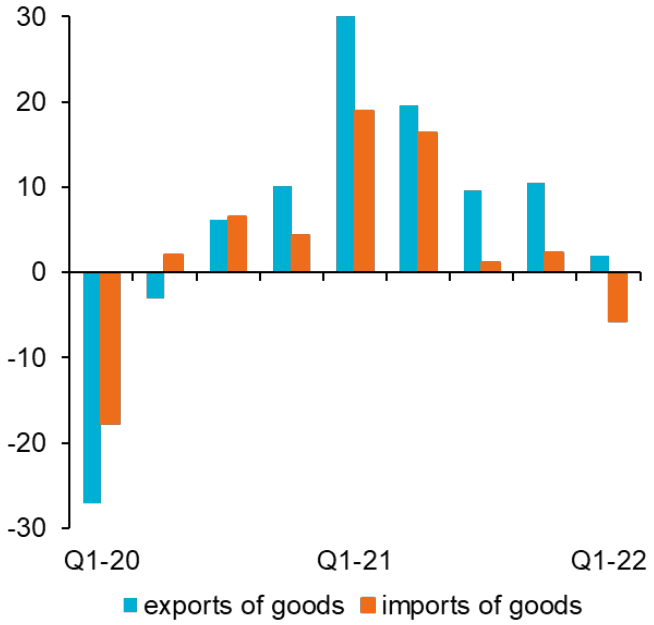
## Due to new outbreaks of Covid-19 and circumscribed lockdowns, China struggles to keep growth in line with the target

**REAL GDP** - % qoq



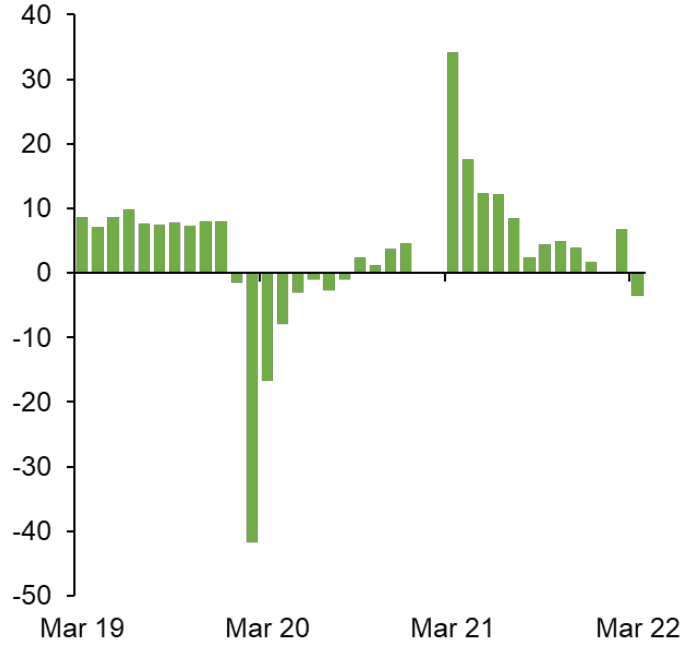

*Source: China National Bureau*

**TRADE OF GOODS** - volumes % yoy




*Source: Prometeia's calculations on China Customs data*

**RETAIL SALES** - values % yoy




*Source: China National Bureau*

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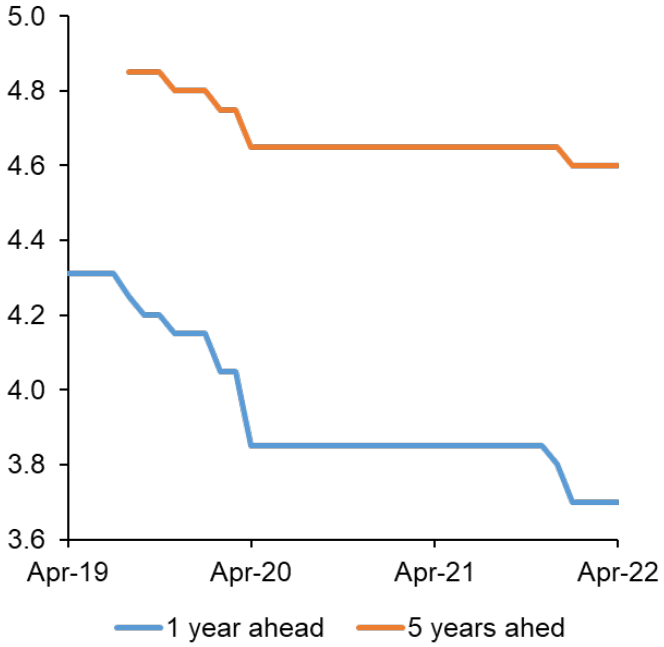
# China: government is increasing the support to the economy

## Due to new outbreaks of Covid-19 and circumscribed lockdowns, China struggles to keep growth in line with the target

**SOCIAL FINANCING** - % yoy

*Source: People Bank of China*

**INTEREST RATES ON BANKS LOANS** - %




*Source: People Bank of China*

- ✓ Transfers of approximately $150 billion (0.9% of GDP) from central bank profits to the ministry of economy aimed at reducing the tax burden on small and medium-sized enterprises

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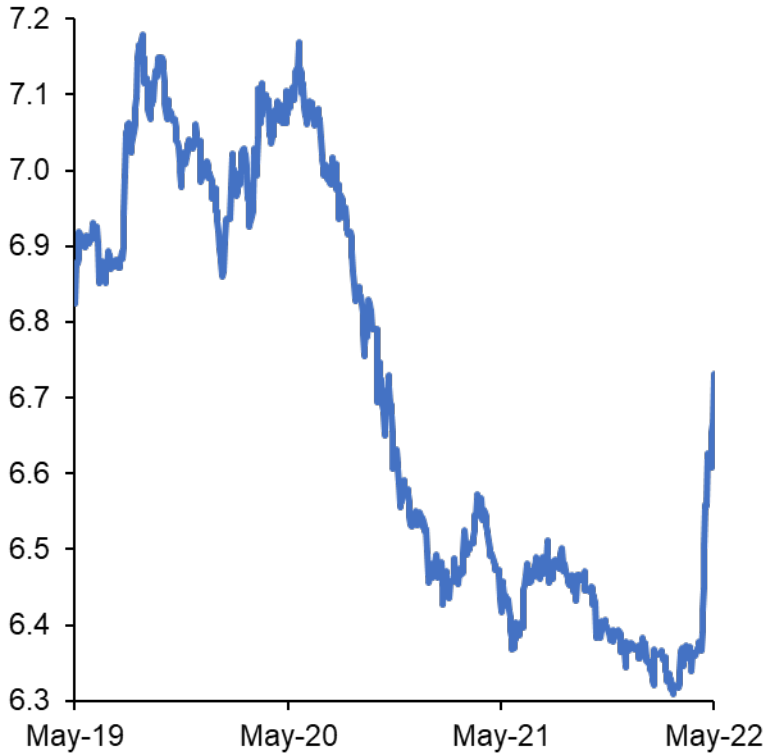
# China: GDP growth below government target in 2022 and 2023

## Falling international investor confidence?

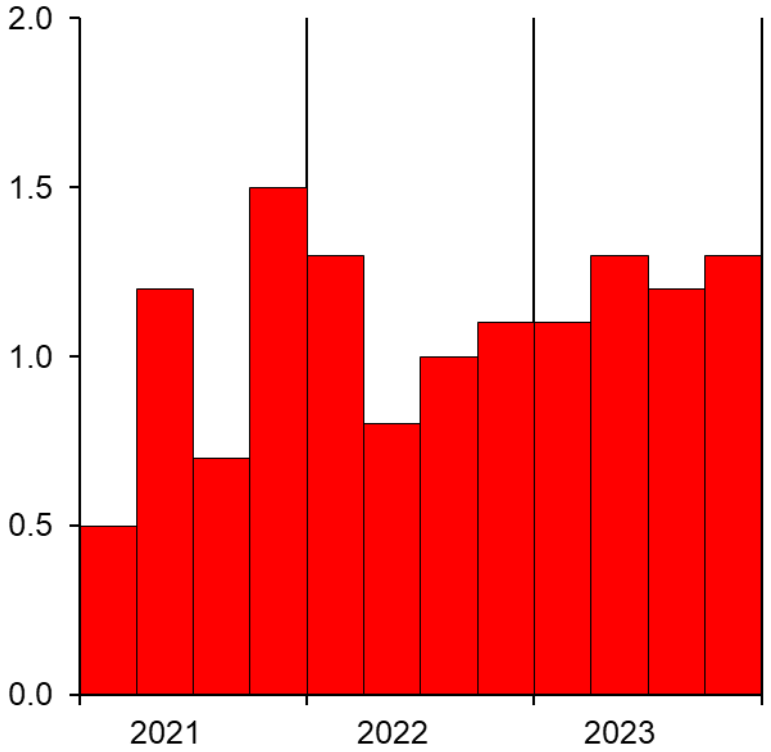
**EXCHANGE RATE YUAN/$**




*Source: Refinitiv*

**GDP** % qoq

| annual rates | 8.1 | 4.5 | 4.6 |
|---|---|---|---|




*Source: Prometeia Forecasts, Brief, May 2022*

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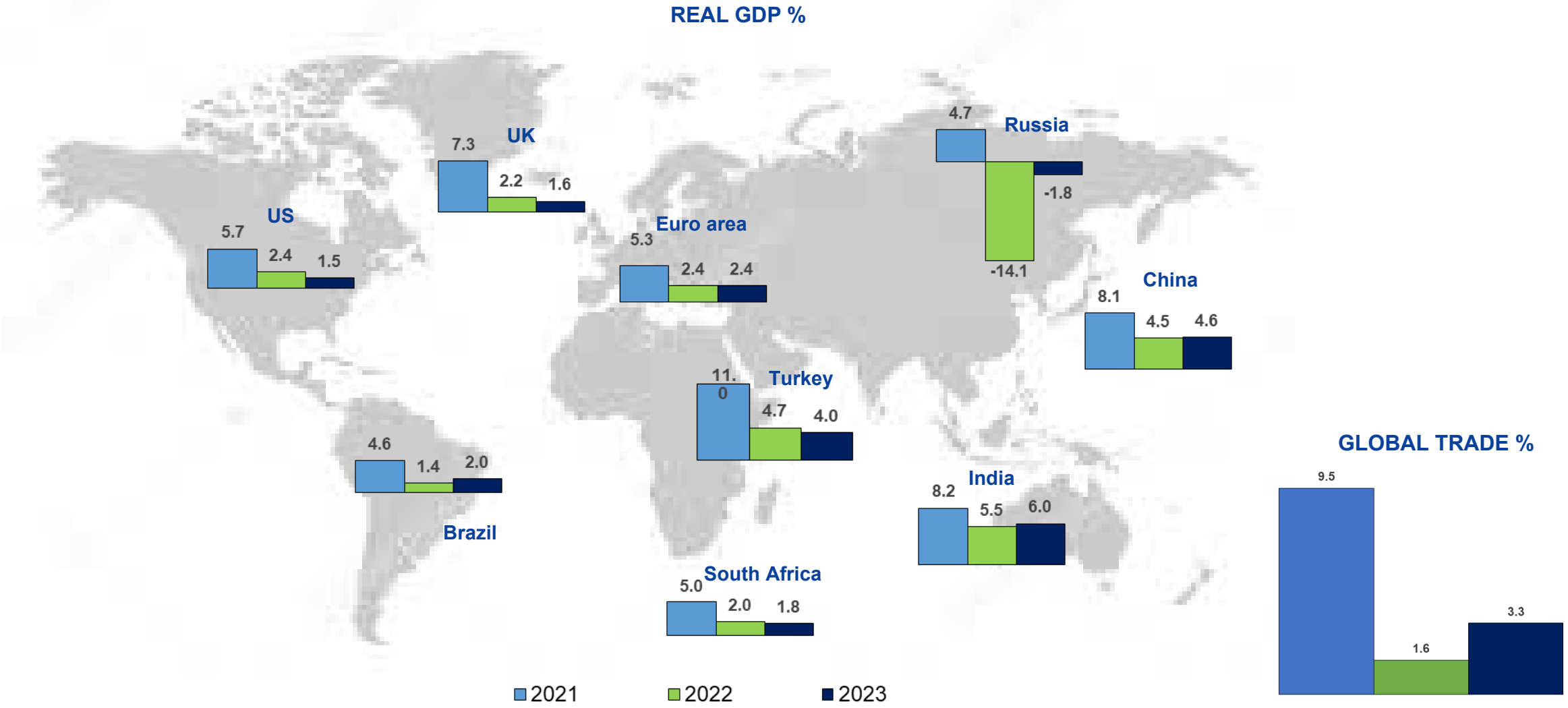
# The forecasts at a glance

## Global GDP and international trade decelerating....

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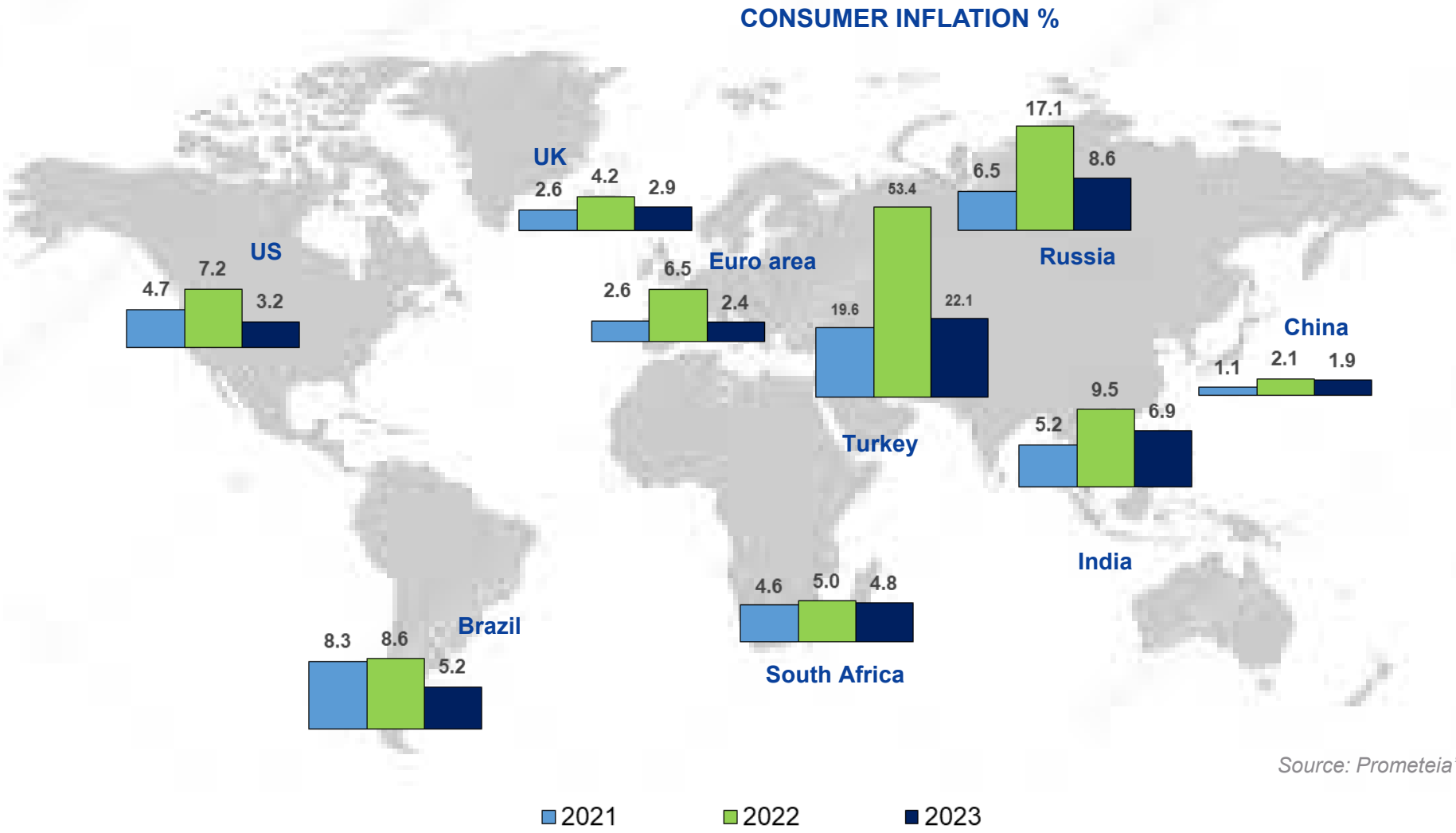
*Source: Prometeia's Forecasts, Brief May 2022*

# The forecasts at a glance

... and persistng high inflation

-




*Source: Prometeia's Forecasts, Brief May 2022*

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# Questions for discussion

Prometeia's poll on March 31 at the presentation of Rapporto di Previsione

## Will the Fed be able to control inflation?

| | |
|---|---|
| 1. No, inflation will remain high | 20% |
| 2. Yes, but at high cost to the economy | 62% |
| 3. Yes, a soft-landing is possible | 14% |

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