Ukraine – global economic effects

- Higher energy & commodity prices, and falling equity prices, will weigh on global growth.
- Neighbouring countries will also suffer from reduced trade and sentiment effects.
- Fed will stay on its course and lift rates. The situation for the ECB is trickier.

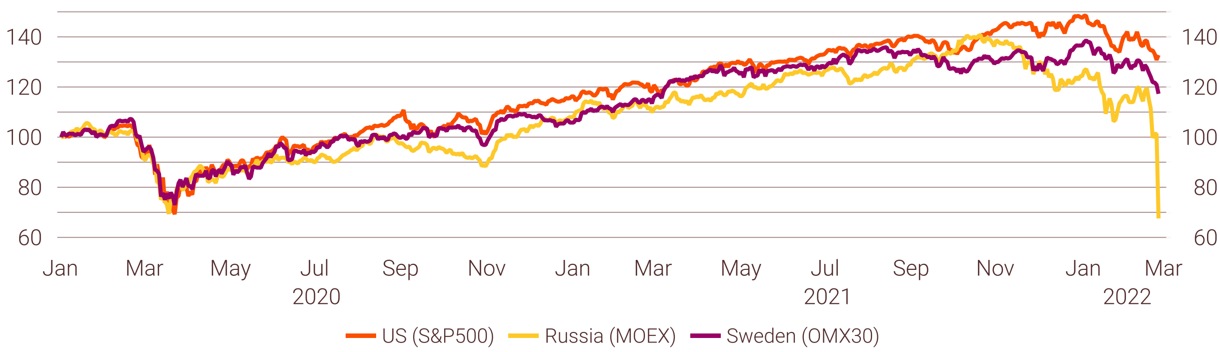
Genuine uncertainty

President Putin's attack on Ukraine will have economic consequences beyond the region. Some negative effects are indeed already playing out on a global scale. The risk sentiment on financial markets have worsened over the past few weeks, manifested in falling equity prices, widening credit spreads and higher oil prices. Many commodity prices have sky-rocketed along with the escalating crisis, not least metal prices (aluminium, nickel, palladium etc).

Falling equity prices and rising commodity prices will have real economic implications. Economies could also suffer from reduced trade as well as from rising uncertainty that could dampen households' and firms' willingness to consume and invest (sentiment effect). While these two channels should be of less importance globally, they could be important for countries with closer trade-linkages to Russia.

Given the fundamental uncertainty of how the crisis will evolve from here, it is of course a delicate matter trying to quantify its economic impact. It's a known unknown - not a black swan - and can perhaps be described as a situation with radical uncertainty.[1] Hence, we will not try to quantify the effects on global GDP nor inflation. We judge, however, that the negative effects on the overall global outlook will be limited, while recognising that there's a risk of a bigger impact on many EU countries.[2]

Stock market indices
2020-01-01=100



Sources: Swedbank Research & Macrobond

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[1] Radical uncertainty relates to events that are insufficiently understood for probabilities to be known or forecasting possible, see Kay and King (2020) "Radical Uncertainty: Decision-Making Beyond the Numbers, by John Kay and Mervyn King"
[2] We have previously published a report on how the Baltic economies might be affected of the crisis. Read more in "The Baltics and Russia – how strong are the economic ties?"

Adding on already high price pressures

Russia is an important supplier of energy, metals, and chemicals to the European market. 90% of the gas consumed in the euro area is imported and Russia alone stands for 40% of total gas imports to the EU. In Germany, the import share is even higher: about 55% of total gas imports come from Russia.

Besides household usage, gas is an important input to the production of electricity, metals, rubber, and fertilizers within the euro area. Disruptions on gas supplies could therefore weigh heavily on European households and corporates. According to the ECB, the impact of a 10% gas rationing shock on the corporate sector is estimated to reduce euro area gross value added by about 0.7%.[3]

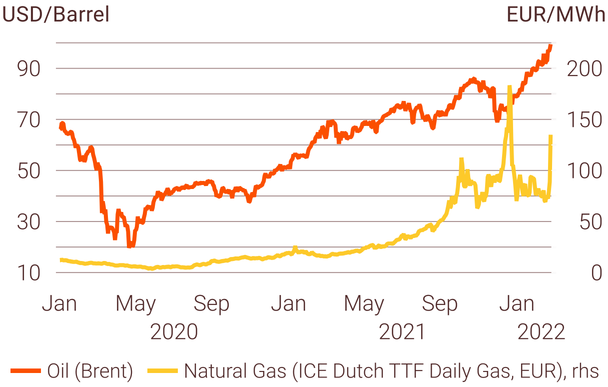
Even though there is a risk for interrupted gas supplies, we should not forget that it would also be very costly for Russia as 75% of their total gas exports goes to the EU. Following the announcement of the EU sanctions, Putin was also quick to state that gas supplies will not be interrupted.

Many commodity prices have jumped on the back of the escalated crisis. Oil prices are up 25% this year, currently trading close to 100 USD/barrel. Natural gas prices rose markedly during last year but dropped at the end of the year and traded relatively stable during this year until recent days when prices rose sharply again.

Metal prices are on average up 15-20% year-to-date, while the precious metal palladium is up 45%. In 2020, Russia stood for 43% of the world's supply of palladium. Also, both Ukraine and Russia are major players of the global grains market and their combined wheat exports account for 23% of global production.[4]

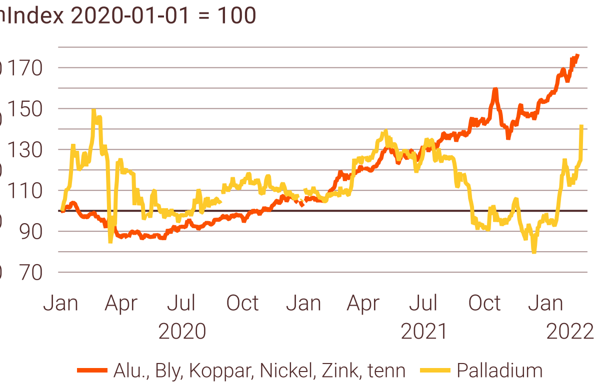
Rising commodity prices add to already high inflation pressures seen in many countries. The longer commodity prices stay elevated, the more firms will pass-on their increasing costs to households.

Oil & gas prices



Sources: Swedbank Research & Macrobond

Sky-rocketing metal prices



Sources: Swedbank Research & Macrobond

[3] https://www.ecb.europa.eu/pub/economic-bulletin/focus/2022/html/ecb.ebbox202201_04~63d8786255.en.html
[4] Forecasts from the US Department of Agriculture for the 2021-22 marketing year

The “mother of all sanctions”?[5]

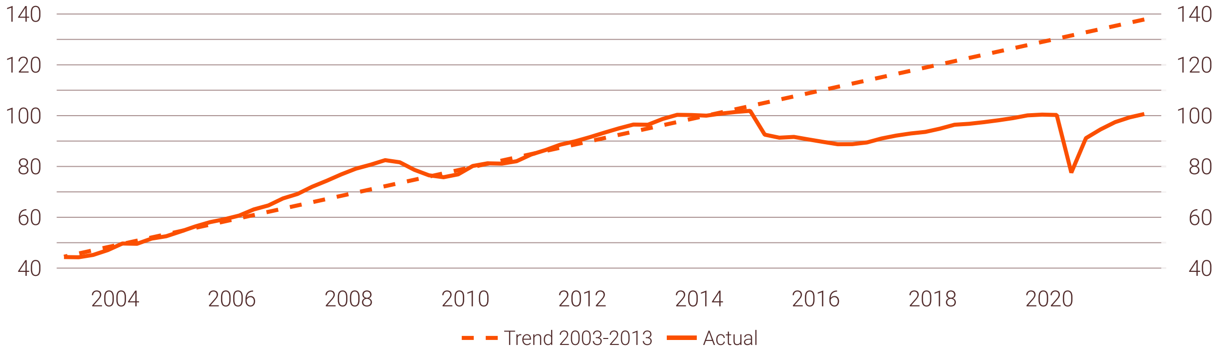
Earlier this week, the EU announced its first set of sanctions against Russia. Also, the US, the UK, Japan, Canada and Australia announced similar sanctions. On top of this, Germany announced that it halts the approval of the Nord Stream 2 gas pipeline.

More sanctions were announced yesterday. Although the details of these sanctions are yet to be revealed, we judge that they won’t have any meaningful impact on a macro-economic level, neither on the global economy nor for individual EU countries, although they could be harmful for specific companies within the EU.[6] If Russia at a later stage will be cut off from the international payment system (SWIFT), the economic damage will be markedly higher, also for other countries.

The sanctions will be more visible also on a macro-economic level in Russia. The economic development in Russia has been strikingly weak since 2014 when Crimea was invaded. Although the weak development – not least for household consumption (see chart) – at least partly could be a consequence of the Western sanctions introduced at the time, a failed domestic economic policy is probably even more important.

Russia: Household consumption

constant prices, RUB, index 2014=100



Sources: Swedbank Research & Macrobond

Financial markets – the quest for a new equilibrium

Financial markets have been characterized by a typical risk-off environment during the crisis, with capital leaving risky assets (equities, cryptos, high yield, SEK etc) in favour of safe assets (government bonds, gold, USD, etc). This makes sense in a risk/reward perspective. After all, there’s no economic upside with the situation and there are evidently many downsides, e.g., associated with the rising commodity prices and their impact on global economy.

Financial markets also hate uncertainty, which has dampened the risk appetite even further. Looking ahead, the uncertainty should gradually fade and at some point, markets will settle at a new equilibrium, from which risk sentiment can begin to normalize. It is of course impossible to tell when financial markets will leave the Ukrainian crisis behind. Presumably, it depends on the actual development on the ground in Ukraine going forward. If Putin escalates the situation even further, financial markets will most likely suffer more. If, on the other hand, the situation will stabilize from here we may very well see a recovery in risk appetite.

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[5] Bob Menendez, chairman of the us Senate’s foreign-relations committee, has described the package being assembled by the chamber as “The mother of all sanctions”.

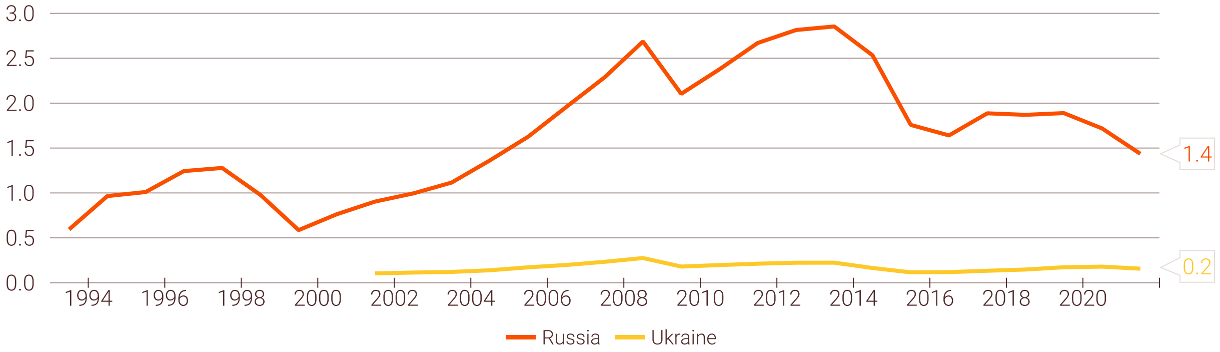
[6] Sanctions from the U.S (Department of Treasury, 24th February)

Small global economic effects but risks to specific sectors

Russia and Ukraine are small economies, weighing only about 1.4% and 0.2% respectively of global GDP (USD). Thus, the direct effects via trade-linkages on most economies and the overall global outlook will be small. The loss of trade caused by a 10% contraction in Russian demand would cost the euro area only about 0.1% of its GDP, according to estimates by Goldman Sachs. As for Sweden, only 1-1.5% of trade is with Russia, and the number for Ukraine is much lower than that.

Russia and Ukraine - small economies

Share of world GDP, current prices, USD



Sources: Swedbank Research & Macrobond

In comparison to the foreign trade shortfalls experienced early in the pandemic, any direct effects on Europe will on aggregate be small and most likely negligible in the US. Also, economic growth is currently to a large extent driven by the rebound in service sector activity, which is less trade-dependent.

The risks to the real economy are, however, unevenly distributed with **potentially large indirect effects** for certain sectors. Commodity shortages and price increases could harm the trade and energy intensive manufacturing sector, and thereby Germany and its trading-partners relatively more.

Squeezed households, via higher energy prices and falling equity prices, may respond with lowering their consumption. But overall, we consider households to be resilient to these potential effects. Higher input prices could also dampen firms' investments and production. This said, the rise in commodity prices so far, is not seen as a game-changer neither for overall inflation nor the economic recovery.

Central banks will stay the course

Higher inflation and lower growth complicate matters for central banks and eventually depend on how persistent the effects will be. Temporary spikes in commodity prices, or lower growth, should be overlooked. Given the current concerns on inflation, however, we should not be surprised if getting inflation down will be prioritized before holding up growth. But the situation differs across countries.

As the economic consequences for the U.S are likely to be small, we do not expect the **Fed** to change its course on reducing stimulus. The first rate hike will come in March (25 bps), followed by more later this year and in 2023.

The situation for the **ECB** is trickier. First, the negative economic consequences would be larger for EA than for US, which suggests that the ECB will move more with caution. Second, should the financial stress escalate further we could see country spreads widen further and there's a limit for the ECB how far they can let Italian and Greek bond spreads go.

We're probably not close to reaching that level yet but it cannot be excluded should things turn more sour. This suggests that the situation might force the ECB to be even more cautious in pulling back support measures.

As regards the **Riksbank,** we do not regard the crisis to be crucial for monetary policy ahead. But on the margin, the crisis risks pulling up inflation even higher in the short-term, not least on the back of the weaker SEK, which should support our call for the Riksbank changing stance at their upcoming meeting in April (and signal a reduction of the asset purchases later this year already). Also, we stick to our forecast of a November hike this year. That said, the reaction from the ECB will matter for the Riksbank.

We see little reason for **Norges Bank** to change stance. They will most likely revise up their rate path on the March meeting, signalling four hikes this year and lift the end point of the rate path. Headline inflation is likely to be lifted by higher energy prices, GDP development well shielded from impact (consumer and business sentiment could be worsening) and trade balance is set to surge even higher – although with limited second-round effects on oil and gas investments. Weaker NOK has also cushioned some of the negative global demand shocks to the economy.

Appendix: Sweden's 20 largest trade partners

Ranking 2021	Export Country	Value January-November	Share (%) 2021	Import Country	Value January-November	Share (%) 2021
	Total	1 480 392	100.0	Total	1 450 154	100.0
1	Norway	159 824	10.8	Germany	248 538	17.1
2	Germany	156 484	10.6	Norway	154 563	10.7
3	USA	124 919	8.4	Netherlands	146 749	10.1
4	Denmark	114 479	7.7	Denmark	100 574	6.9
5	Finland	105 250	7.1	China	82 989	5.7
6	United Kingdom	83 191	5.6	Poland	69 093	4.8
7	Netherlands	75 538	5.1	Finland	65 488	4.5
8	China	61 272	4.1	Belgium	64 371	4.4
9	France	60 708	4.1	France	55 647	3.8
10	Poland	56 869	3.8	Italy	51 514	3.6
11	Belgium	54 998	3.7	United Kingdom	49 492	3.4
12	Italy	44 172	3.0	USA	39 877	2.7
13	Spain	28 807	1.9	Spain	24 668	1.7
14	Japan	22 618	1.5	Czechia	23 249	1.6
15	**Russia**	**20 645**	**1.4**	**Russia**	**17 788**	**1.2**
16	Turkey	13 940	0.9	Austria	17 081	1.2
17	Austria	13 579	0.9	Ireland	16 794	1.2
18	Czechia	13 507	0.9	Hungary	15 968	1.1
19	South Korea	13 483	0.9	Estonia	14 286	1.0
20	Switzerland	13 483	0.9	Lithuania	13 626	0.9

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