Macroeconomic implications of the Russian invasion of Ukraine

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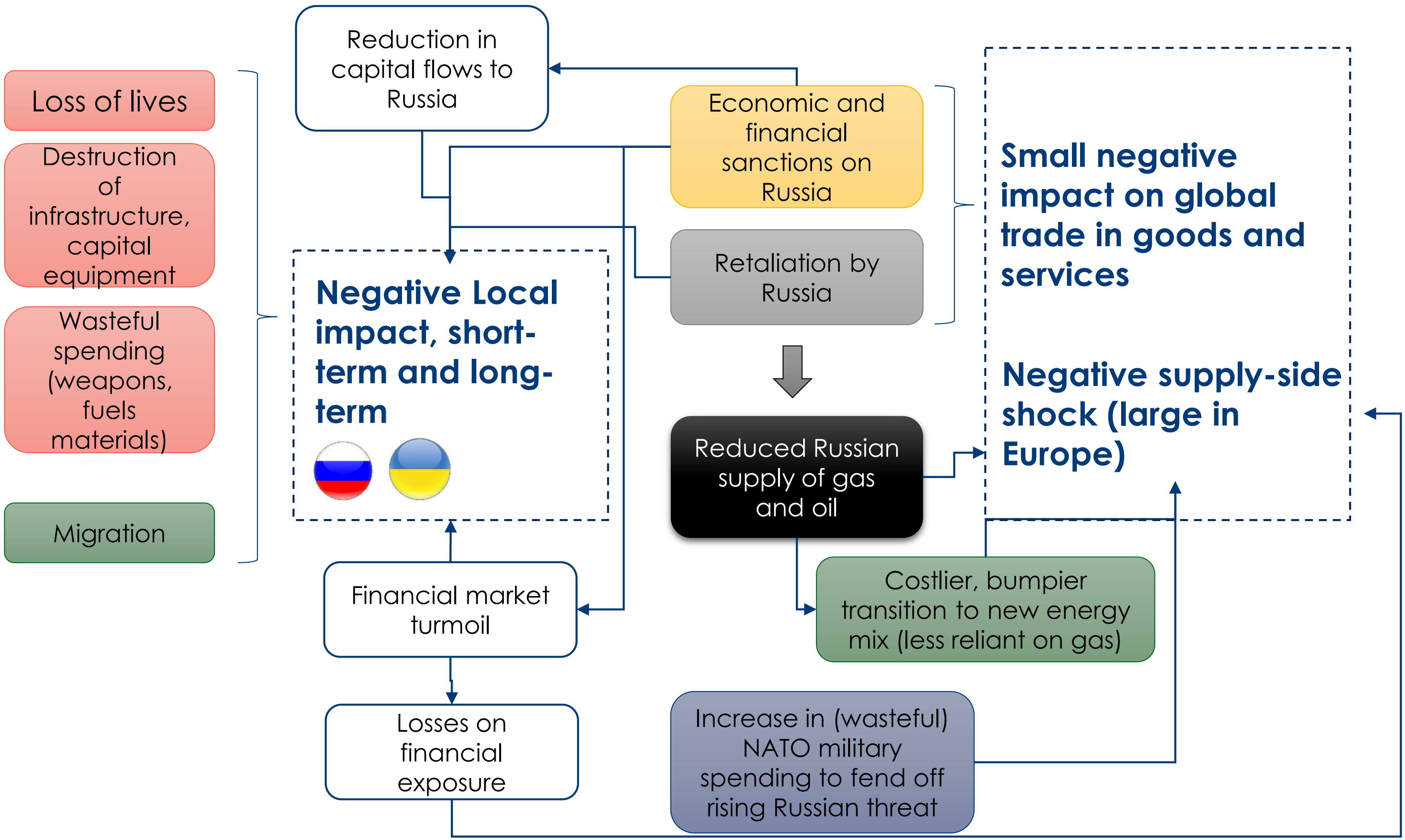
Macroeconomic impact: a map



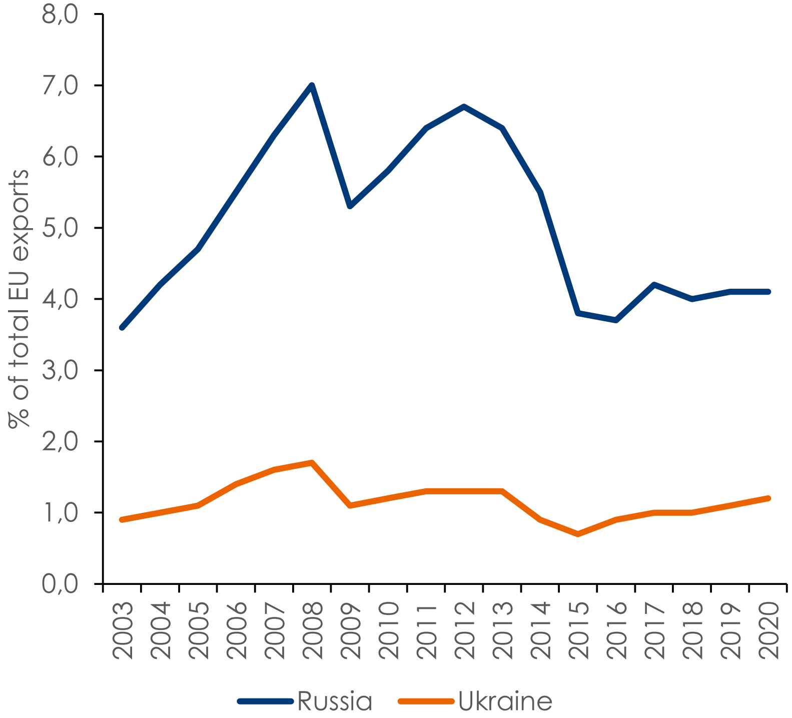
Impact of sanctions

- In 2019, the IMF estimated that the economic sanctions related to the first war in Ukraine had reduced Russian GDP growth by 0.2% per year. Other estimates are lower.
- Impact on the rest of the world very small.
- The impact on trade affected mostly goods not hit by sanctions (reduced availability of finance, weaker FX etc.)

- **Freezing of Russian central bank assets** in US, EU, UK undermines the capability of the central bank to support the RUB and may destabilise the domestic financial market (spike in cash withdrawals, confidence crisis)

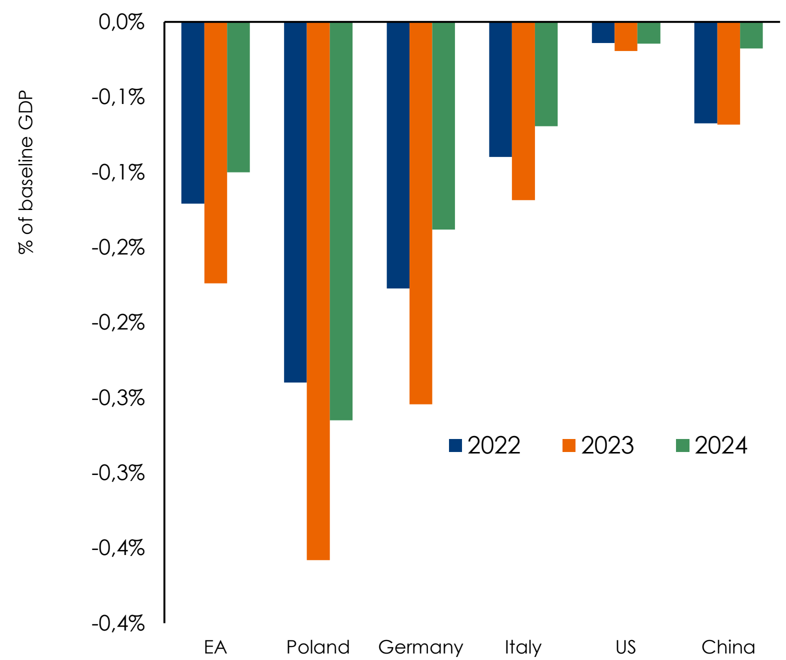
Sanctions and Russian imports: impact to be moderate for most countries

EU exports to Russia declined sharply in 2014-15, and never recovered



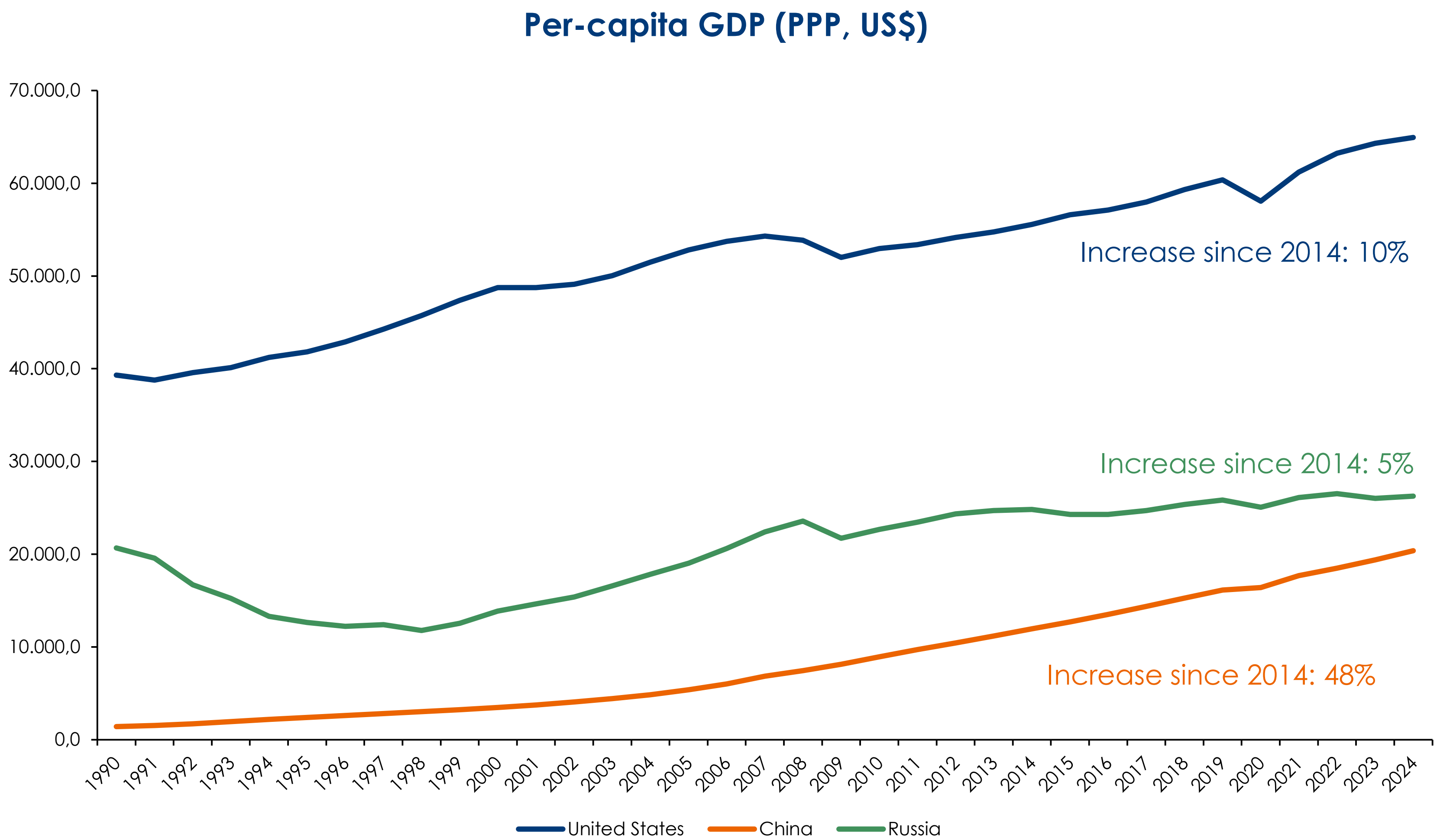
Source: Eurostat. Data in % of total exports to non-EU countries

Expected impact of shrinking Russian trade flows on GDP – selected countries



Note: in the simulation, Russian imports of goods and services are 13% lower in 2022 and 18% lower in 2023-23. The impact evenly spread across countries

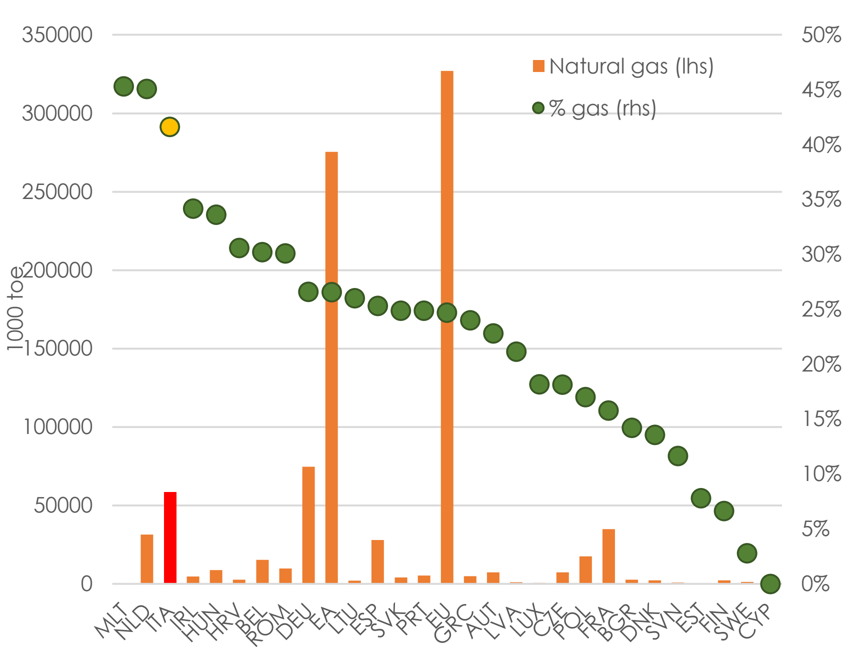
Russia is losing ground vs both the US and China, and sanctions will strengthen this trend



Source: Oxford Economics and Intesa Sanpaolo projections

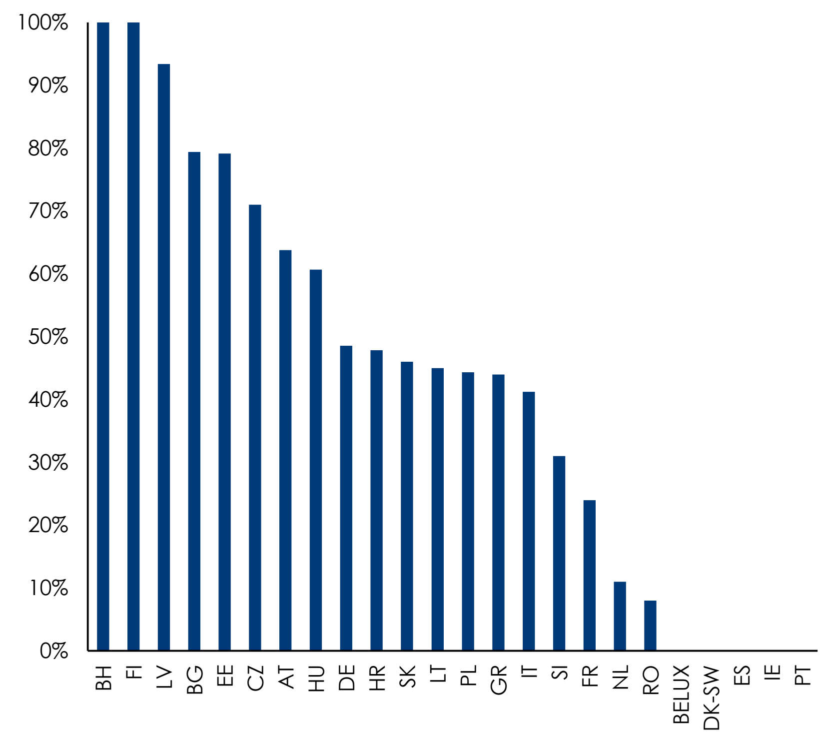
Natural gas is very relevant for the EU, and Russia provides almost half of the imported supply

Natural gas as % of total primary energy



Source: Eurostat

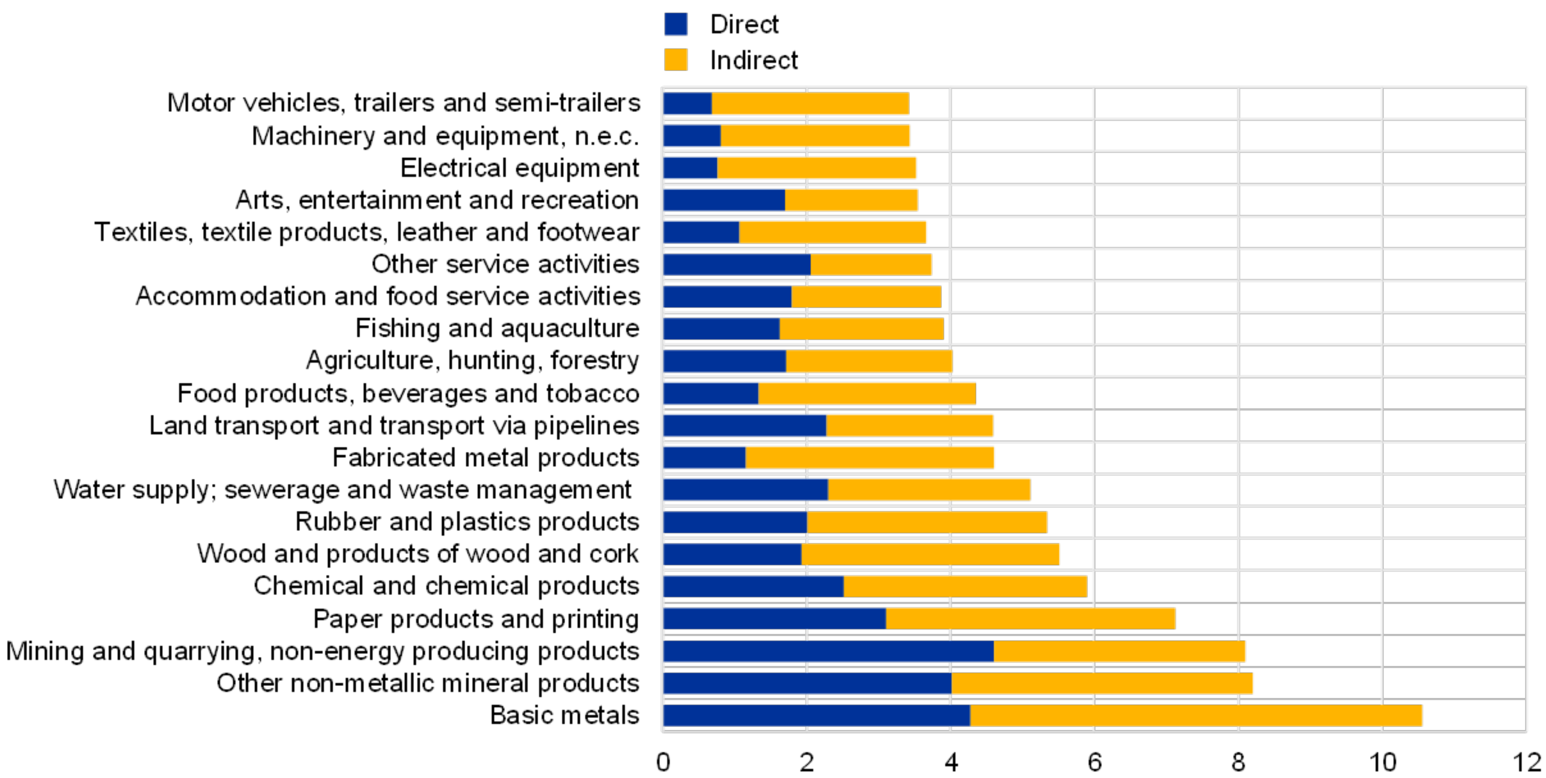
Share of Imported natural gas from Russia (2020 or most recent year)



Source: ACER, from the Comext database

The impact will also depend on the sector composition of the economy

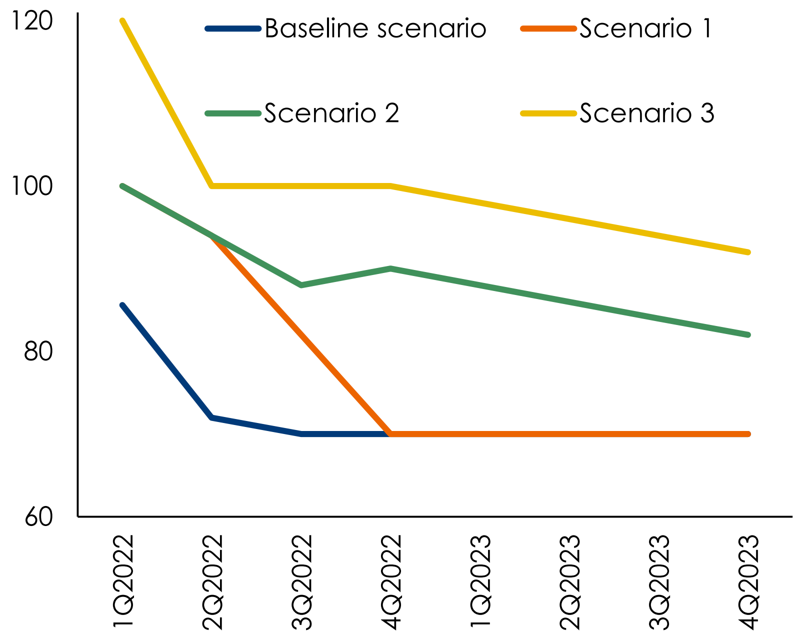
Direct and indirect gas and electricity use by sector (2018, % of total output)



Source: Vanessa Gunnella, Valerie Jarvis, Richard Morris and Máté Tóth: "Natural gas dependence and risks to euro area activity", ECB Economic Bulletin, Issue 1/2022, Chart C

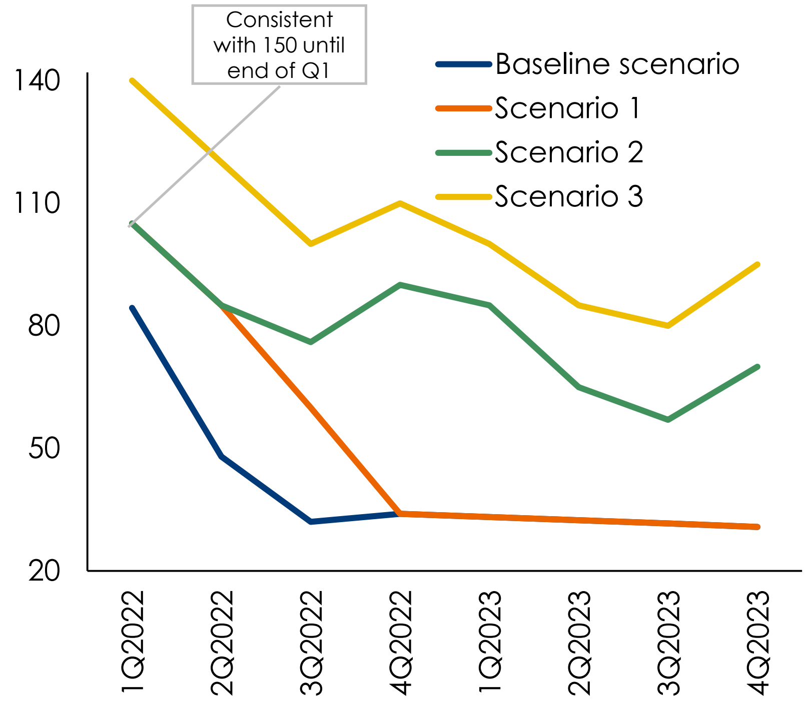
Simulated scenarios for gas and oil prices

(a) Assumptions on oil prices



Source: L. Biagioli, A. Dell'Anno e A. Volpi: "The economic effects of tensions between Russia and Ukraine", Focus, Intesa Sanpaolo, 16 February 2022

(a) Assumptions on gas prices (TTF)



Source: L. Biagioli, A. Dell'Anno e A. Volpi: "The economic effects of tensions between Russia and Ukraine", Focus, Intesa Sanpaolo, 16 February 2022

Putin's leadership: kleptocratic or imperialistic?

Kleptocracy model → De-escalation
Gas flows will continue
Steps to regain access to financial markets

But is the invasion of Ukraine consistent with such model?

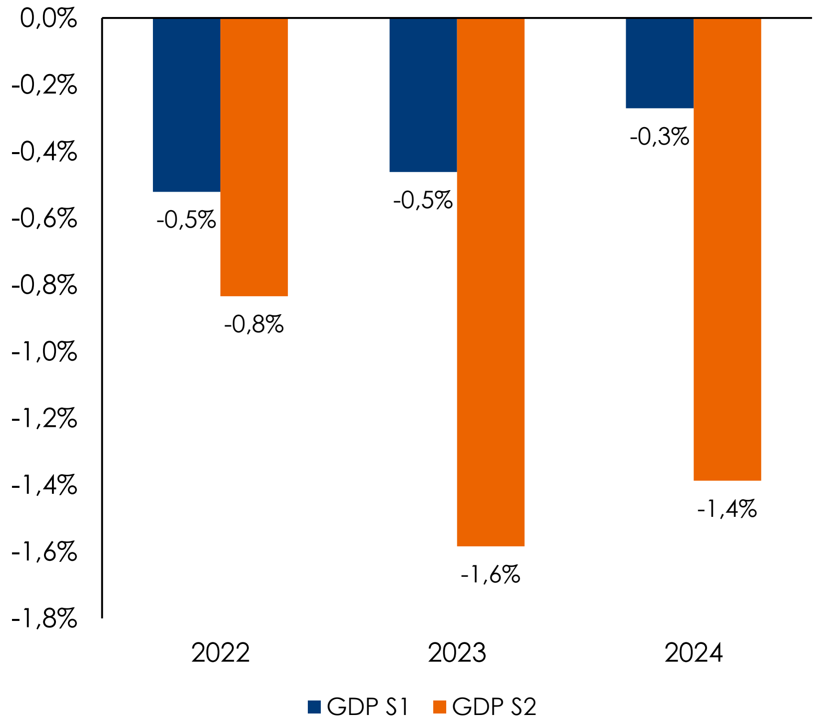
Joschka Fischer:
"In seeking to redraw the map by force, he hopes to reverse the European project and re-establish Russia as the preeminent power, at least in Eastern Europe. The humiliations of the 1990s are to be erased, with Russia once again becoming a global power, on par with the United States and China"
("Russia's stolen future", *Project Syndicate,* 24 Feb 2022)

Olaf Scholz (speech, 27 February 2022):
"Anyone who reads Putin's historicising essays, who has watched his televised declaration of war on Ukraine, or who has recently – as I have done – held hours of direct talks with him, can no longer have any doubt that Putin wants to build a Russian empire."

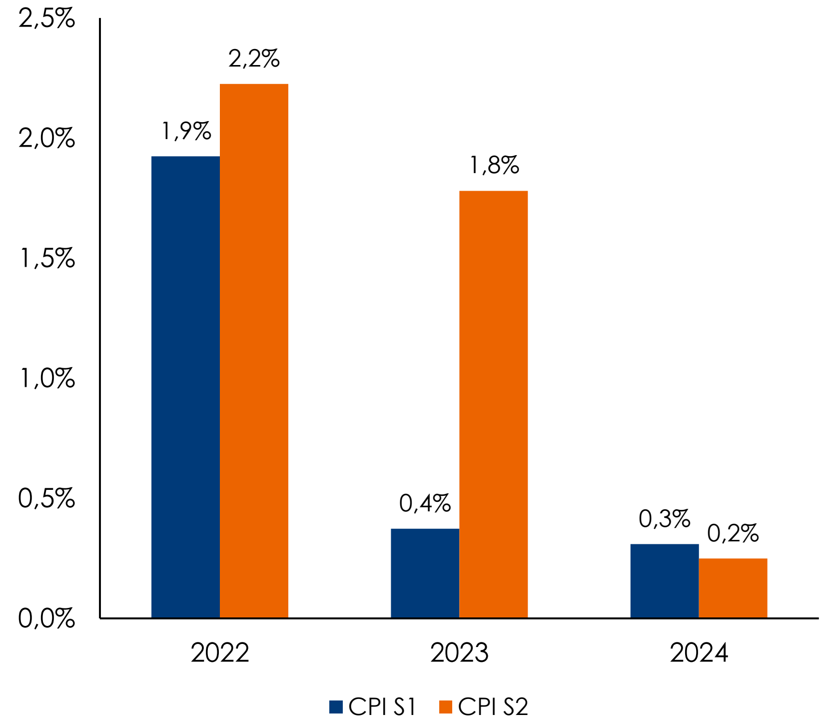
Imperialistic model → Full subjugation of Ukraine
Management of gas flows can be weaponised
New cold war in Europe
(defeat by overstretch? Putsch?)

Euro area: the impact of the energy shock on GDP growth and inflation will be significant

Impact on GDP (deviation from baseline level)



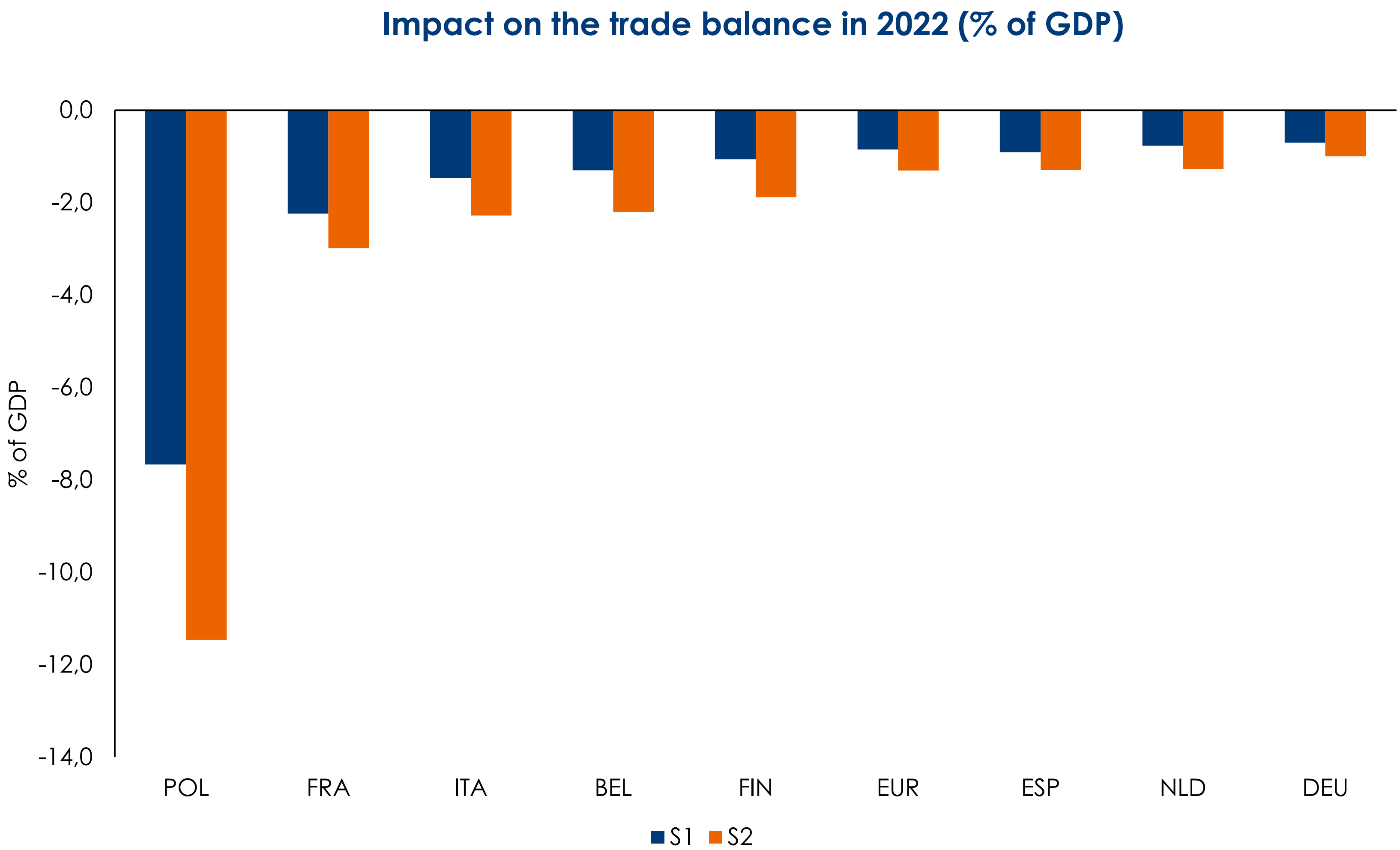
Impact on annual inflation rate



Source: Intesa Sanpaolo

Note: S1 = scenario 1, S2 = scenario 2, as defined in previous slide. S2 additionally assumes a negative shock on Russian GDP and import flows. Simulations run with the global model of Oxford Economics

Europe will be hit first through the trade balance



Source: Intesa Sanpaolo. Note: estimates are provisional

Italy: lower GDP growth, much higher inflation

The impact on the Italian economy follows a similar path, with more effects through the energy channel and less through the trade channel.

Consumer spending and Gross Fixed Investment will both be hit.

The government deficit will be higher in both scenarios: in Scenario 2, +0.6% in 2022 and +0.9% in 2023.

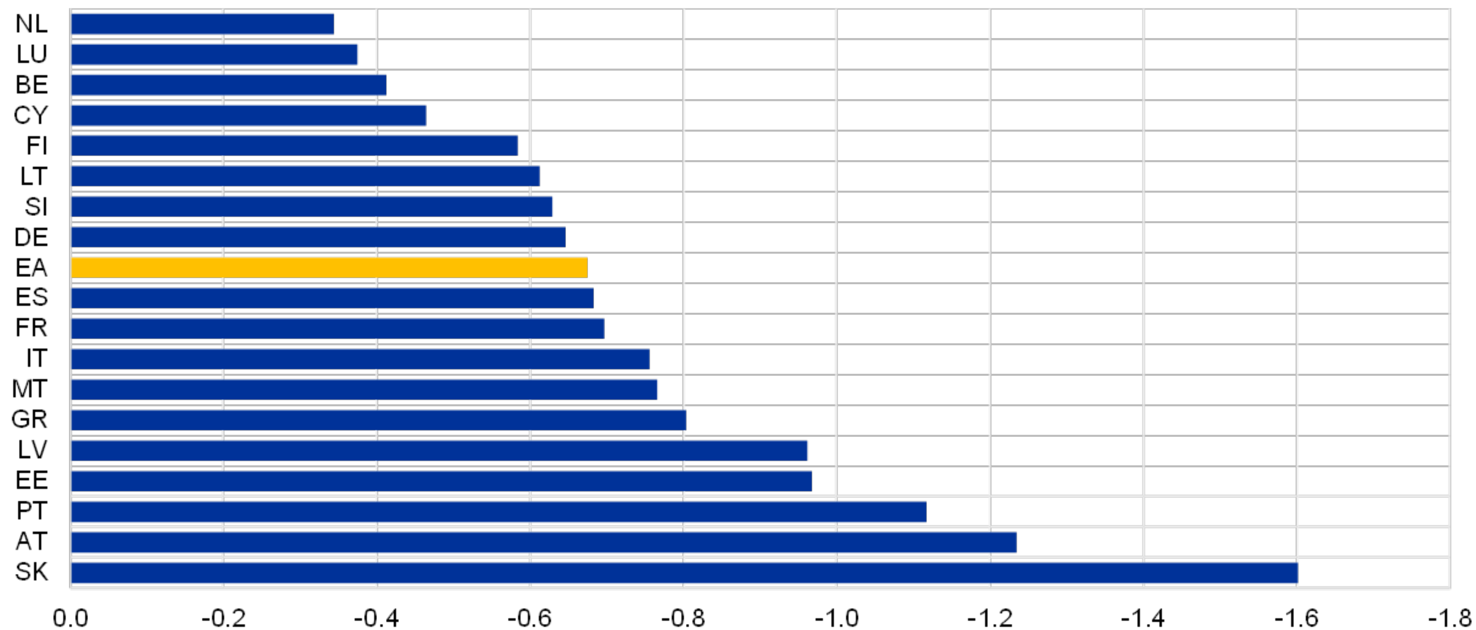
	Impact on GDP y/y % growth			Impact on y/y % inflation		
	2022	2023	2024	2022	2023	2024
Scenario 1 Transitory shock	-0.5	+0.0	+0.3	1.0	0.7	-1.1
Scenario 2 Persistent shock	-0.7	-0.9	-0.1	1.2	3.5	0.2

Source: Intesa Sanpaolo. Scenarios as defined in previous slides

In the worst case, gas will have to be rationed

A significant reduction in the supply of natural gas from Russia would require more imports from other sources, fuel switch, and possibly rationing of the supply to industry in the worst periods. The impact on GDP would be severe.

Impact on GVA of a 10% decrease in the supply of natural gas



Source: Vanessa Gunnella, Valerie Jarvis, Richard Morris and Máté Tóth: "Natural gas dependence and risks to euro area activity", ECB Economic Bulletin, Issue 1/2022, Chart D

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ECB: an acceleration of the policy normalisation becomes unlikely

The spike in scenario uncertainty will force the ECB to shorten the guidance and move cautiously in reducing the net purchases. For the time, we stick to the forecast of 1 rate hike by the end of the year.

Philip Lane
Interview, 23 Feb

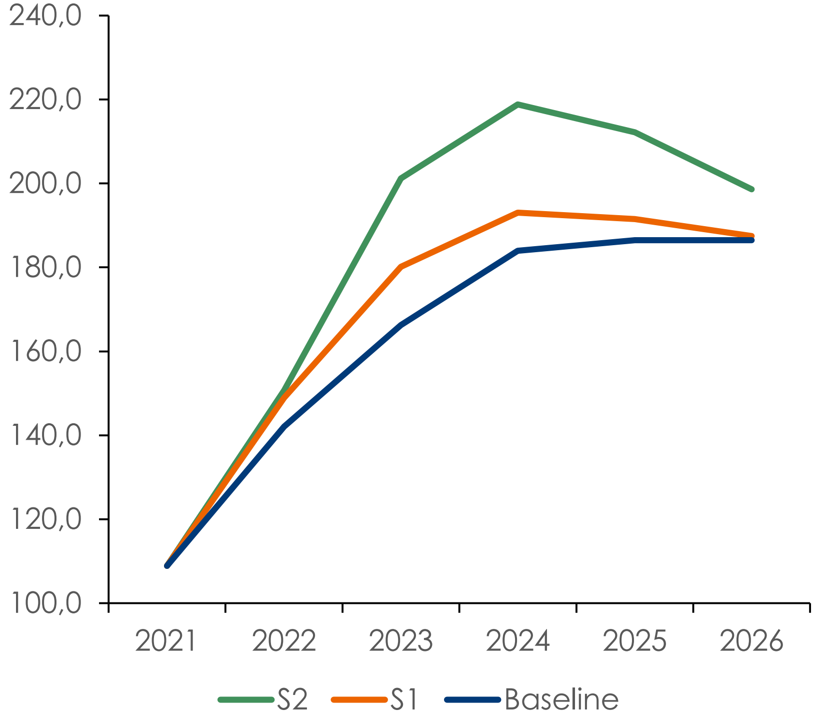
«We will conduct a comprehensive assessment of the economic outlook at our March meeting. This includes the recent developments on the geopolitical front. These not only have implications for oil and gas prices, but also for investor confidence, consumer confidence, trade and so on. So in terms of inflation there is not just the mechanical effect from commodity prices, for the medium-term outlook the macroeconomic effects need to be incorporated. As we already flagged at the February meeting, the geopolitical tensions are a very important risk factor right now, for Europe in particular»

Isabel Schnabel
Interview, 15 Feb

«Geopolitical developments are part of our assessment. We are monitoring the situation closely. We would consider not only the impact on energy prices but also the broader repercussions on global and domestic growth and financing conditions. Given the likely negative effects of an escalation of the crisis on growth and confidence, including through potential sanctions, it is in my view unlikely that we would accelerate policy normalisation in such circumstances *[i.e., future conflict in Ukraine]*.»

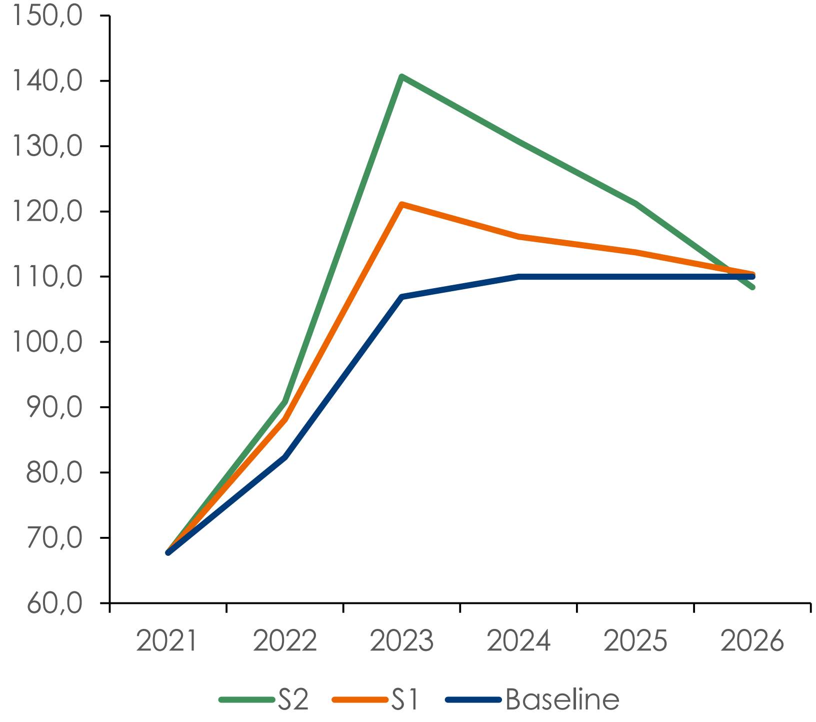
The crisis is negative for sovereign spreads

10Y Btp-Bund spread in the simulation scenarios



Source: Intesa Sanpaolo

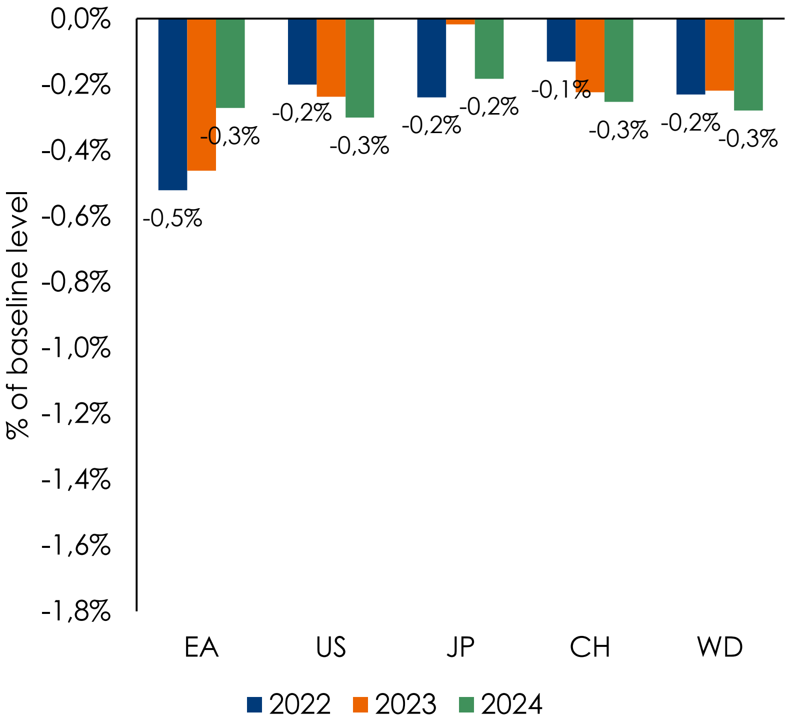
10Y Bono-Bund spread in the simulation scenarios



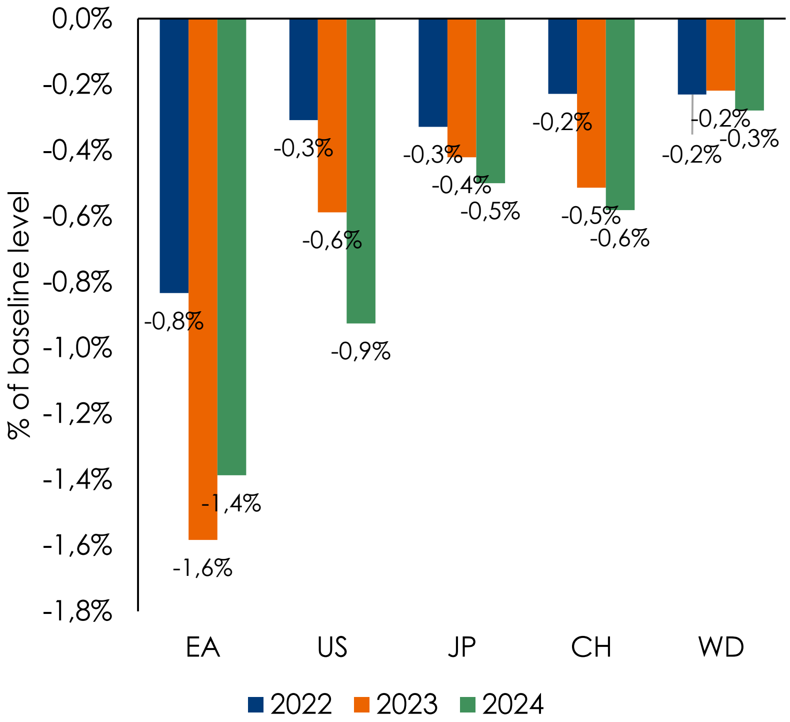
Source: Intesa Sanpaolo

This is a idiosyncratic european shock

GDP impact of Scenario 1 (temporary spike)



GDP impact of Scenario 2 (persistent shock)



Source: Intesa Sanpaolo

Note: S1 = scenario 1, S2 = scenario 2, as defined in previous slide. S2 additionally assumes a negative shock on Russian GDP and import flows. Simulations run with the global model of Oxford Economics

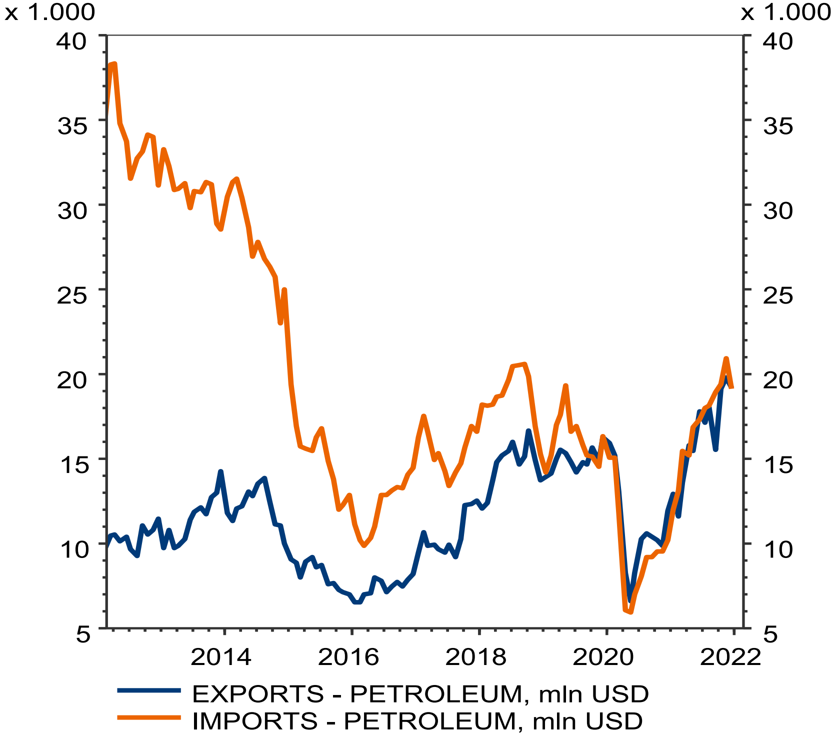
The United States is protected from the direct consequences of the war

US exposure to trade and financial exchanges with Russia and Ukraine is limited

	Russia	Ukraine
Exports	6.4	2.5
% total	0.30%	0.10%
Imports	29.7	1.9
% total	0.10%	0.10%
bank exposure	14.7	1.7
% bank exposure	0.30%	0%

Source: Census Bureau, BIS

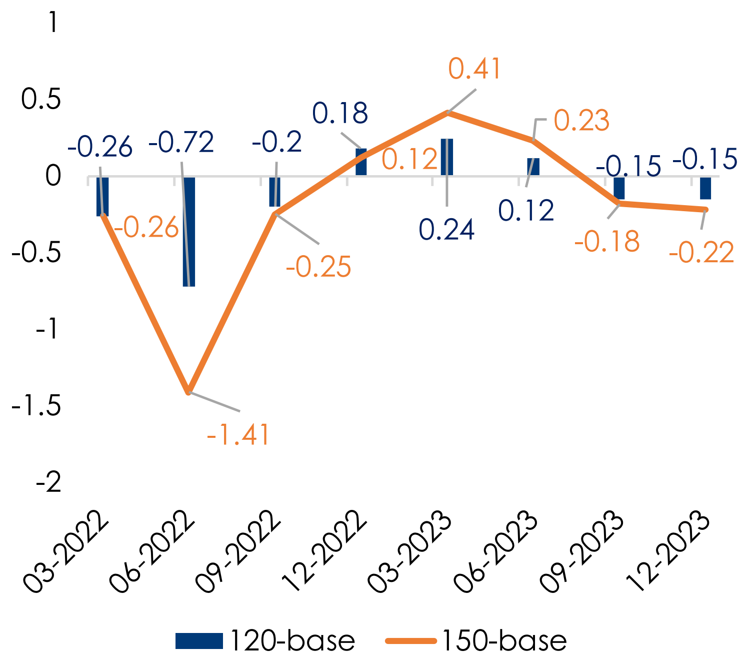
The balance of net oil exports is zero, the import of gas and oil from Russia is about 3% of the total



Source: Refinitiv-Datastream

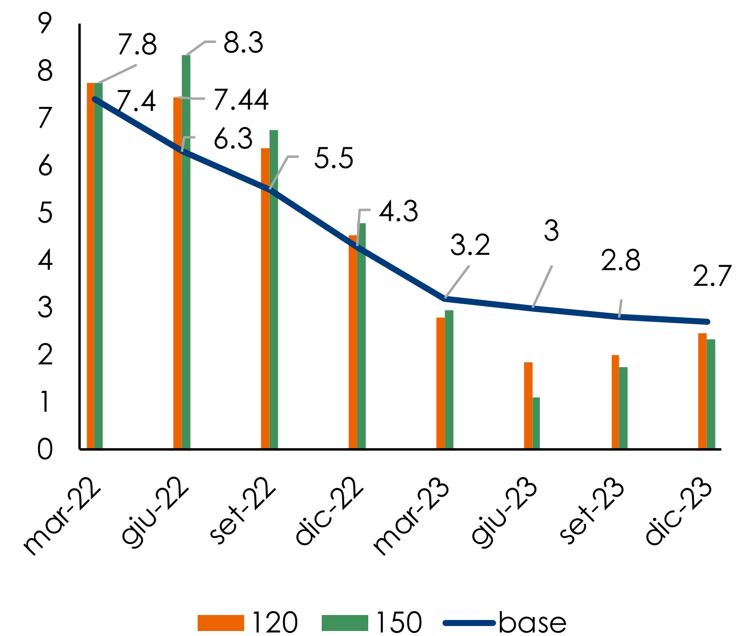
Indirect effects - Alternative scenarios for oil prices

Transient shock scenarios in Q2: effects on GDP limited, but potentially amplified by worsening supply bottlenecks



Source: Intesa Sanpaolo on OEF model. Assumptions: oil price at USD 120 or USD 150 in Q2, falling to USD 100 in Q3 and USD 80 in Q4. Effect on GDP 2022: -0.2 pp with scenario 120, -0.4 pp with scenario 150

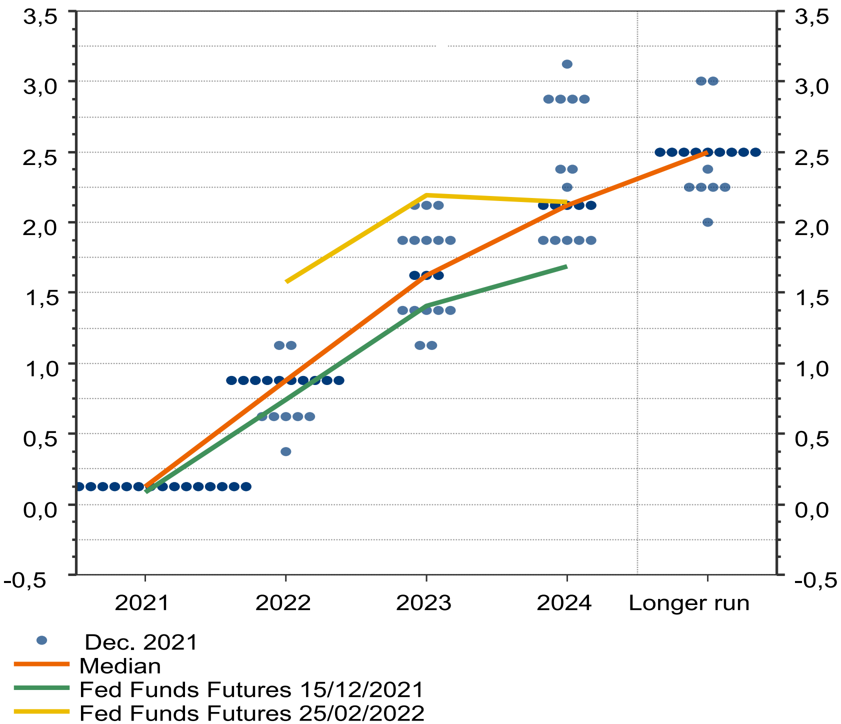
Possible inflation peak near 9% y/y



Source: Intesa Sanpaolo on OEF model

The Fed, even in the face of a supply shock, will continue with its rate hike programme

The FOMC has signalled that there will be a breakthrough in March



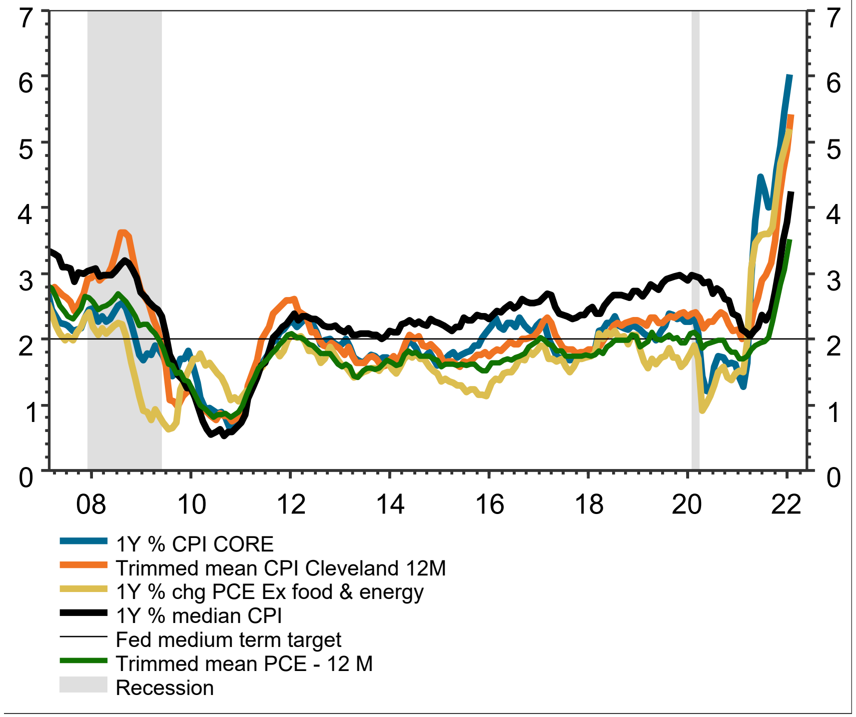
Source: Refinitiv-Datastream

Consensus for March turnaround, doubts about the size of the first rise: 25 or 50 bp?

- **Bowman**: "I, as all of my colleagues will as well, be watching the data closely to judge the appropriate size of an increase at the March meeting."
- **Mester.** "barring an unexpected turn in the economy, I believe it will be appropriate to move the funds rate up in March."
- **Barkin:** "I think it's timely to get started and steadily move back towards pre-pandemic levels."
- **Bostic**: it is time to "move off the emergency stance".
- **Waller**: 'After the latest inflation numbers, I think we should all be alarmed. (...) "Should the data break against us in the coming weeks, we need to be prepared to hike the policy rate by" a half-percentage point.

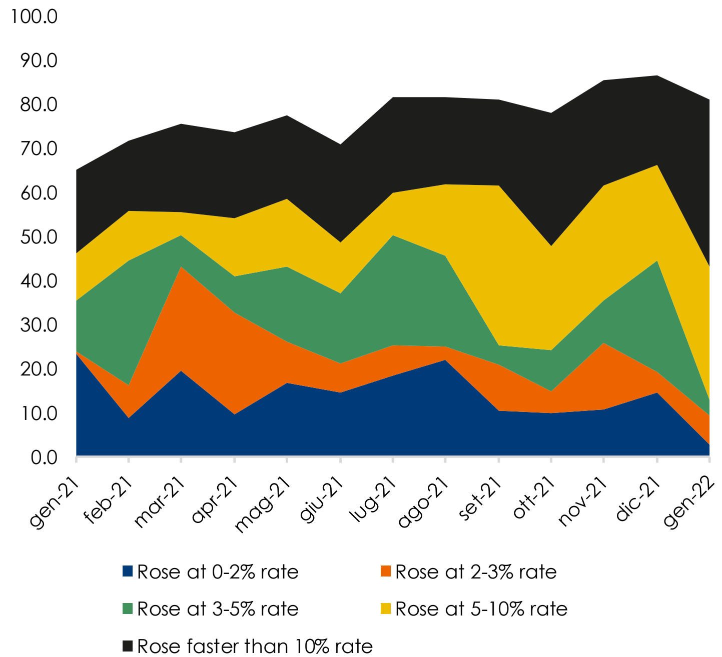
Inflation will be the key driver of US monetary policy

All measures of underlying inflation point the same way



Source: Refinitiv-Datastream

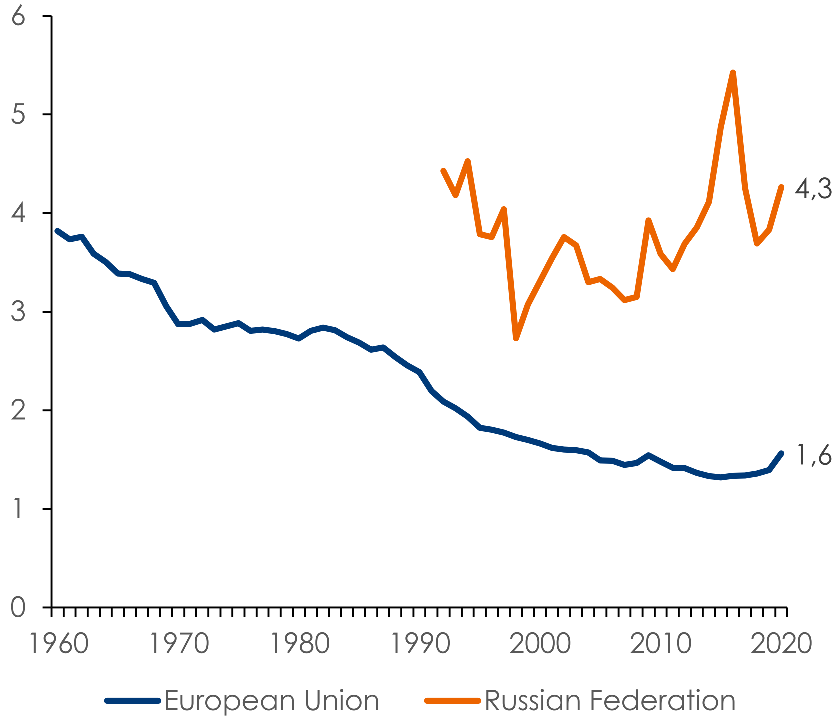
In January, prices of more than 68% of the consumption basket increased by more than 5% annually



Source: Dallas Fed

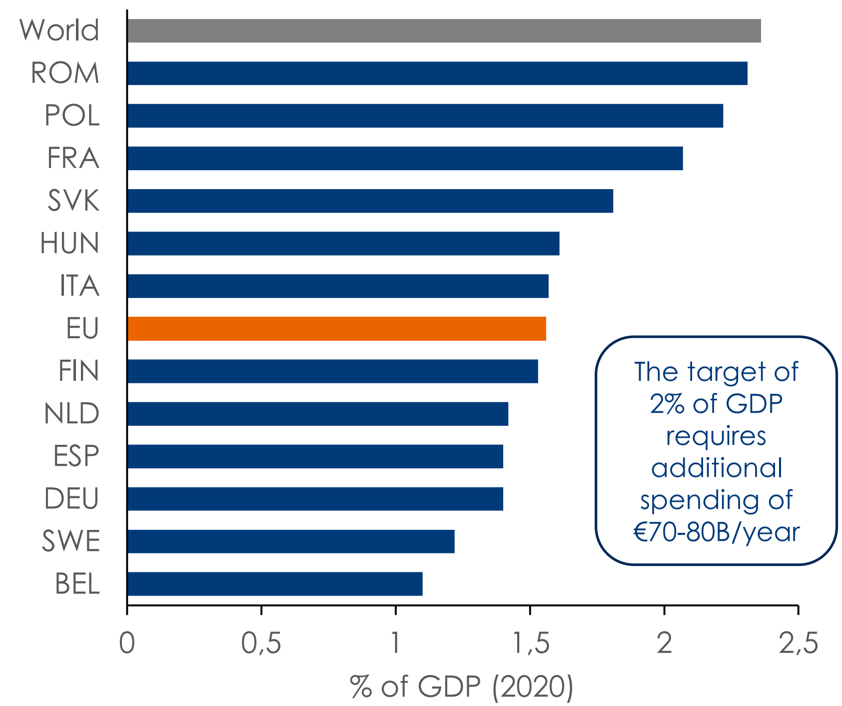
Russia's threatening stance will cause a new arms race, adding to the budget burden of EU countries

Military spending as % of GDP



Source: World Bank.

Military spending in the EU



Source: World Bank.

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