

The Economic Toll of Russia-Ukraine War Weighed at IMF Spring Conference

By: Emerging Markets Team | May 11, 2022

Boston - The April spring meeting of the IMF in Washington, D.C. illustrated the pervasive impact Russia's invasion of Ukraine has had on slowing the global economy's recovery from the pandemic. Emerging markets team members perceived a general tone of pessimism, with selected optimistic factors mixed in—like the positive impact of higher commodity prices for exporting nations.

Global growth is projected to slow from an estimated 6.1% last year to 3.6% in 2022 and 2023 — a decrease in projected growth of 0.8 percentage points and 0.2 percentage points, respectively, from January's projections. At the same time, increased commodity prices and supply chain issues are driving inflation higher than predicted—5.7% in advanced economies in 2022 (a boost of 1.8 percentage points from January) and 8.7% for emerging markets (up 2.8% from January predictions).

In general, many central banks were said to be behind the curve in rate hikes, increasing the likelihood that they will have to tighten more aggressively than planned. Tighter monetary conditions have also created a more difficult situation for European nations that had been considering fiscal stimulus to boost the buildout of transitional energy sources.

The Russian invasion is also driving geopolitical realignments—countries that once found it advantageous to "straddle the fence" between major powers increasingly don't have that luxury. Going forward, more countries may be forced to choose a side.

Another broad theme at the meeting centered around difficulties with debt restructuring, as was agreed to under the Common Framework of Paris Club terms. But China has balked at participating under those rules, seeking to provide debt relief under its own terms. One possible path discussed was an effort to roll out the Common Framework for a broader range of countries, beyond low-income nations, to achieve more success stories.

The following are regional observations from the emerging markets team:

Latin America

- Except for the Dominican Republic and Ecuador, attendees were largely negative on the region.
- Regional central banks have generally been more proactive in tightening monetary policy than peers in the rest of EM and the developed world. Chile's central bank acknowledged uncertainty about the timing of the inflation peak but was confident that monetary policy tightening, coupled with plans to cut spending by 20% in real terms, will eventually tame inflation.

In Colombia, the central bank appears to be comfortable with the pace of monetary policy tightening, despite rising inflation prints and market perception that the monetary authority is behind the curve.

- Elections in Colombia and Brazil are being closely followed for their potential impact on economic policies.

G10 Countries

- The prospect of a recession in Western Europe was top of mind, as Russia may halt its gas exports to the region.
- Monetary policy is getting tighter across the board.
- Fiscal policy views, however, are varied. Dollar Bloc countries are focused on less fiscal spending to reduce inflationary pressures. Meanwhile, Western European countries are focused on shifting energy reliance away from Russia and cushioning the impact of higher energy prices on households and businesses. That will lead to higher government spending and investment in coming years.

Asia

- There are stark contrasts in the pace of economic recovery across the region. For instance, China is imposing new lock downs to pursue covid zero, while South Korea has lifted all covid rules and opened its borders.
- Many Asian nations are big energy importers, and rising prices are lowering growth expectations. Governments have responded with energy subsidies, which delays the region's fiscal consolidation effort.
- Central banks are saying they do not need rate hikes yet. While Inflation may not be an issue yet, the output gap from many Asian countries is an issue. COVID restrictions have been limiting operations and the output of exports.
- China says it wants to be neutral, but it is siding with Russia. Korea and Japan are vocal about standing with Ukraine, while India emphasizes its need for trade with Russia.
- Attendees were closely watching the disastrous economic situation in Sri Lanka, and the protests taking place, along with the impact of Pakistan's new government.

Europe, Middle East, Africa (EMEA)

- Attendees emphasized that sanctions against Russia will continue, sending a message that things will not go "back to normal" and disrupting the supply chain so Russia can't rebuild. Sanctions will also serve as a message to companies still doing business in Russia.
- Energy sanctions will be a different, more thoughtful approach, based on cost/benefit analysis. It could take months or potentially years for Russia to divert oil supplies away from Europe to elsewhere, and in the meantime, it could result in lower production levels.
The EU seems to be on track to agree on some form of an oil embargo, while a gas embargo might take a lot longer.

Germany, a large importer of Russian oil, may be able to handle an oil embargo.

- For Central and Eastern European countries, including Hungary, Czech and Poland, the IMF revised growth down and inflation up.
The global forecast revisions of the IMF are even more pronounced for the energy exporting CEE region: current account and budget deficits larger and growth could be contracting quarter over quarter from here.
- Egypt imports 80% of its wheat from Russia and Ukraine so the war has drastically affected the country. However, the country took action to protect itself from the impact by devaluing the currency and raising interest rates. The country is expected to be one of the largest issuers of sovereign debt this year. Despite aggressive actions, the IMF downgraded its growth forecast.
- Saudi Arabia has benefited from higher oil prices, but its non-oil industries are also doing well. Reforms and privatization initiatives are continuing.
- Oman's outlook was seen as positive, driven by the global demand for hydrocarbons. The country also has few ties to Russia or Ukraine.
- In the second half of 2021, most economies of Africa had a strong rebound. While growth forecasts for 2022 have been revised downwards, the region is still expected to expand.
- Most Sub-Saharan African (SSA) economies faced an adverse terms of trade shock as they are food and fuel importers. But some countries like Angola, which will benefit from high oil prices, and South Africa, which will benefit from higher metal prices, should have space for a looser fiscal policy.
- The aggravation of food insecurity in SSA was a key topic. It arose not only because of higher food prices but also because of adverse weather conditions, especially in Horn of Africa.
- As EU economies seek to replace Russian Oil and Gas, we saw great interest in various oil and gas projects of the region, which could be a game changer for countries which were not traditionally oil and gas exporters as Senegal, Mozambique and Ivory Coast.

Bottom line: Disruptions from the war are imposing a significant drag on the global economy, and inflation is a growing challenge. At the same time, the commitment to isolate and contain Russia appears strong, and countries are realigning and adapting the new circumstances.



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