



ACC NEWS



Update

March 5th, 2022

Post-COVID-19 and the Russian invasion of Ukraine will be catalysts for a global reset and subsequent re-alignment.

Financial Domino effects

- **Ripping Russia** — the world's 11th largest economy — out of the global financial system is bound to cause collateral damage, Emily writes. Why it matters:
 - Even the most targeted bombing campaign can strike bystanders, and economic war is perhaps more indiscriminate — and harder to control.
 - “War has unintended casualties. Economic war is the same,” said Aaron Klein, a senior fellow in economic studies at Brookings.
 - Oil and gas prices have skyrocketed even though energy was purposefully carved out of sanctions. And shares of Sberbank, Russia's largest bank, are trading for pennies — perhaps surprising since it wasn't cut off from the SWIFT global payments network (though it is subject to other sanctions).
- **Sanctions** - Since Russia invaded Ukraine last week, the U.S. and its European allies moved fast to levy some of the harshest sanctions ever imposed.
 - The strikes were targeted. The West tried to keep the energy sector — a massive part of the Russian economy — out of the most severe penalties, so European countries could continue to buy oil and gas.
- **The big picture:** Broad shifts in the way the world financial system works could take years to emerge.
 - "The fallout for global trade and finance is enormous," said Justine Walker, the global head of sanctions, compliance and risk at ACAMS.
 - "It will essentially spur conflicts in other regions," on top of food insecurity, she said, if countries can't get the resources they need.
 - And once you put sanctions in place, it's hard to go back to the before-times.
 - Russia will start to operate in different ways, carving out an alternate financial system to work in, for example — much like Iran has done after being cut off from SWIFT by the Trump administration.
- **The consequences** for the rest of the world are only starting to shake out.
 - After the first Gulf War, the rise in oil prices helped create a recession, Klein at Brookings pointed out. He ruled out the possibility that this would happen now in the U.S., but Europe will feel rising energy costs more acutely.
 - The bigger unforeseen consequence could come in the payments arena, Klein and others have warned. The sanctions against Russia "weaponize payments," and that could push Russia and other countries into alternate systems — making it harder to wage economic war the next time around.
 - There's also the possibility of a Russian economic collapse hurting some other financial institutions or markets. Back in 1998, the collapse of the Russian economy toppled a hedge fund that wound up threatening the entire financial system.
- **The bottom line:** "One thing I've learned is you don't know what you don't know," Klein said.
- **Cash flows:** Exporters to Russia are “in a pickle” in that

- There is fruit that arrived in Russia, still unpaid, fruit on the water, and fruit stuck in Rotterdam
- Dutch authorities are now scan checking every container in tracking consignments that are Russia-bound
- A huge bottleneck has now developed in Rotterdam, stalling ocean traffic in both directions
- Cash is tied up as Russia more than likely will not pay
- Banks are reacting to sanctions and the threat they pose, by also stalling transactions and payments
- This on top of the COVID-19 supply chain challenges that exporters in general have experienced

Metals

Prices for metals crucial to manufacturing — especially the auto industry — continue to soar.

- **Palladium:** A key metal used in catalytic converters that automakers install to scrub engine emissions. It's up roughly 40% this year. Russia, the world's largest producer, is responsible for 40% of global output.
- **Nickel:** A central ingredient in stainless steel and rechargeable batteries for electric vehicles. It's up about 30% in 2022. Russia is the third-largest producer, mining roughly 10% of the world's nickel.
- **Aluminum:** The lightweight metal is vital to industries across the economy from consumer packaging to aerospace and defense and construction. This year it's up more than 30%. United Company Rusal — formerly led by oligarch Oleg Deripaska before he was sanctioned in 2018 — is one of the world's largest producers.
- **Cobalt:** Another key ingredient of electric vehicle batteries, for which demand has surged in recent years. It's up more than 7%. Russia is the world's second-largest producer of cobalt, much of which is mined by Norilsk Nickel, a mining giant whose oligarch president Vladimir Potanin is close to Russian President Vladimir Putin, making it a potential target of sanctions.

Geopolitics

The Russian invasion of Ukraine is and will transform global re-alignments and geopolitics.

- **EU**
 - The EU has bonded and in a way that has previously been beset with differences and delays.
 - EU measures, which commission president Ursula von der Leyen said she expected to be endorsed, would mark the first time the 27-nation bloc finances the purchase and delivery of weapons and equipment to a country under attack
- **EU/U.S.**
 - The rapid rollout of sanctions and other actions in a rare window of conformity and unison, evidences a dialogue between the EU and the U.S. that stretches back to 2021. Biden's trip to the Vatican is now becoming clear was also a convention between the EU and the U.S. regarding the looming conflict with Russia.
 - It is also becoming clearer that the U.S. has played a leading role by sharing accurate and forecast information with its European allies.
 - Sanctions and other actions were premeditated and purposeful, rapidly implemented and calculated.
 - This bodes for future relationships, particularly looking at China.
- **China/Russia**
 - China and Russia have long sought a relationship to combat America's global influence and controls, particularly where the global economy is based on the \$US.
 - Look to see how this plays out with crypto currencies and a new world bank centered on these countries and aligned 3rd World partners such as Brazil, Mexico, South Africa and India (BRICS).
 - Smaller countries sanctioned by the global system such as Iran, Cuba and Venezuela may also gravitate to such a financial arrangement.

- This will include a similar transfer mechanism as is currently in place with SWIFT.
- China and Russia had previously begun effecting payments in non- $\text{\$US}$ transactions
- The current international conflict will more than likely accelerate financial system divisions
- It remains to be seen how China reacts and navigates the financial relations it enjoys with its partners, as too much may alienate the U.S., without whom, the Chinese economy will stagnate
- The fact that this has happened so suddenly means that the international system is flummoxed
- **China**
 - China has a $\text{\$1.2 trillion}$ “blue economy” where it is investing in a global initiative for predominantly 3rd World nations. This is for two primary objectives
 - Strategic
 - Military
 - Strategic minerals sourcing for its manufacturing base
 - Reduced dependence on the South China Sea for exports
 - But China needs the U.S. market for its goods, failing which internal challenges will soon arise.
- **Germany**
 - Germany had fundamentally changed its approach to global relations and positioning, a new Germany is emerging which will not revert to its status and influence positioning since 1945.
 - With a single speech, Chancellor Scholz ushered in an era of monumental change for a country that has been comfortable with the status quo for three decades. Putin’s war of aggression changed everything in a matter of hours.
 - The optimism of coaxing revisionist powers with Wandel durch Handel (change through trade) is all but gone.
- **Neutrality**

Neutral countries have in some cases shifted policy in light of the Russian invasion of Ukraine. Some neutral country reactions;

- **Sweden** has entered a regional conflict for the 1st time in 80 years
- **Switzerland** – the 1st time it has entered any conflict
- **Finland** - Russia's invasion of Ukraine is causing a rapidly growing number of Finns to support membership of NATO, suggesting the country's delicate balancing act between the Kremlin and the U.S.-led military alliance could be coming to an end.
- **Austria** - Austria is a member of the EU and as such part of the sanctions campaign against Russia It has demanded that Russia comply with humanitarian law and create secure corridors for civilians to leave Ukraine and international organizations to send aid in.
- **Ireland** - Irish leaders have stressed in recent days that while the country will maintain its policy of military neutrality, it is not politically neutral in the Ukrainian conflict.
- **Japan** – Japan has sanctioned Putin and other senior Russian officials and frozen their assets. Former prime minister Shinzo Abe has suggested Japan host US nuclear weapons in the wake of the Russian invasion.
- **Monaco** – has joined the EU sanctions packages and will proceed with freezing assets and imposing sanctions on certain Russians.
- **Moldova** – has formally applied for membership of the EU after the Russian invasion. It has closed its airspace and declared a state of emergency. Moldova shares a roughly 1,200-kilometer border with Ukraine, including its breakaway region of Transdniester, which has a heavily Russian-speaking population. Russia stations around 1,200 troops in Moldova as peacekeepers.
- **Russians abroad**

There are many Russians living outside the Russian Federation. They are facing acute financial problems as bank accounts and credit cards are frozen

- In Marbella in Southern Spain, 2,300 Russians cannot return to Russia as (i) their funds are locked and (ii) there are no flights from the EU to their homeland
- Russian food stores in Germany and the Czech Republic reported cases of vandalism
- Classrooms in both Australia and the U.K. have been forced to put in measures to safeguard Russian students
- **Africa**
 - Industrialization in Africa has been sluggish, with manufacturing accounting for only 13 percent of Africa's GDP and 25 percent of its exports - a share which is the smallest of any region in the world. This is not a good prospect for a mineral-rich continent whose population is still stuck in rudimentary subsistence farming and occasional cash crops that won't break even.
 - China will and has been engaging in exploiting Africa, both financially and strategically
 - For the last two decades since the start of this millennium, international trade patterns have changed markedly, with Africa trading away from its traditional Western European trading partners to the Eastern Asian economies, specifically China.
 - As China cements its position as a global power, it seems to leverage Africa's economic backwardness to achieve this goal by ushering the sleeping giant into an industrialized continent. This will continue and may see acceleration.
 - China has set its foothold in virtually all sub-Saharan Africa seaports leading flagship port development projects running into billions of dollars.
 - 41 of the 46 sub-Saharan African ports identified by a CSIS report had their construction or expansion overseen by Chinese entities.
- **Taiwan**
 - Xi is certainly watching events in Ukraine, but his calculus for whether to use force against Taiwan is shaped primarily by domestic factors, not foreign ones.
 - Chinese leaders are considering "armed reunification" with Taiwan more seriously than at any time in the last 50 years. But Xi will assert Chinese control over the island only if he is confident his military can conduct a successful amphibious invasion and if he believes the timing is right for his own career.
 - China's leaders likely do not fear U.S.-led economic sanctions in the event of a Taiwan takeover because they probably think that China's own productive capacity, resources, and friendly partners will allow them to survive on their own, especially since China will soon be the world's largest economy.
 - Russia would have to invade a NATO ally without provoking a U.S. military response for Chinese leaders to seriously question Washington's commitment to defending Taiwan.



Global supply chain

Supply chains that rattled the global economy through the pandemic are unleashing another shock as efforts to choke off trade with Russia strain resources ranging from fertilizer needed for crops and palladium for car-making, to oil that's used to produce almost everything.

The upshot: a world economy that again faces the prospect of stagflationary forces as inflation quickens and growth fades, compelling central banks to choose which to tackle while fearing the challenge they don't take on then gets out of hand.

The choice is even starker now than it was during the early days of the pandemic. Back then, monetary policy makers elected to buoy demand as a recession hit. Now inflation is at multi-decade highs, forcing them to focus on runaway prices, although perhaps alert to the risk they may have to move more slowly than anticipated.

"Were this 2022 supply shock a first, central banks would be more confident of its transitory inflation impact," said Alan Ruskin, chief international strategist at Deutsche Bank AG. "But this is an inflation shock compounding pre-existing evidence of sticky inflation, so adding to concerns that policy will have to treat attendant higher prices as more than a temporary phenomenon, even if growth slows."

Already, signs are mounting that supply lines are fraying anew as the sanctions-driven economic blockade increases President Vladimir Putin's reliance on domestic production and prevents Russian companies from reaching markets and investors abroad.

Almost all of the 10-largest container shipping companies -- responsible for moving some 80% of global trade -- have stopped accepting bookings for Russian cargo and ports from Europe to the U.S. are turning away the nation's vessels. Some companies are choosing to self-sanction by refusing to buy Russian commodities, even if it remains legal to do so.

For auto makers, the dependence on Russian supplies is deep. The country is the third-largest supplier of nickel in lithium-ion batteries and provides 40% of the palladium for catalytic converters, with that metal also impacted by widespread flight bans. About 90% of U.S. semiconductor-grade neon supplies comes from Ukraine, according to Fitch.

All told, the mounting supply chain crisis could end up being enough to knock \$1 trillion off the value of the world economy and add 3% to global inflation this year, according to the U.K.'s National Institute for Economic Research.

"The conflict in Ukraine imposes further economic stress on a system stretched by Covid," said Jagjit Chadha, director of NIESR. "Supply chains will be further fractured, and monetary and fiscal policies put under a severe examination."

Further elements of the global supply chain;

- **Asian/East European** supply chains, dominant in investment and development over the past 20 years, will now see a reset. Rail investment and transloading via Rotterdam and other EU ports will see renewed scrutiny amidst new threats.
- **Ports of entry** –international port alignments with
 - Colombo in Sri Lanka where China has invested large sums
 - China is channeling its foreign direct investment in the establishment of special economic zones in strategic ports in Africa, such as Djibouti. China's footprint in financing Africa's first transboundary electrified railway, which links the port with Ethiopia, is critical in securing its supply chain.
- **Flying Geese Paradigm** - Kaname Akamatsu named it the "Flying Geese Paradigm" (FGP), which predicts that industrialization will occur when factories from an industrialized country move to a developing one, like geese migrating over long distances. African countries believe this will encourage investment in their infrastructure and supply chains.
- **Inspections** – countries around the globe will strengthen screening over export control approvals and bans so as to ensure sanctions are enforced

- **Air Space** – air space restrictions and closings will change airline routes and schedules
- **COSCO/OOCL** – both Chinese state-owned steamship lines continue to visit Russian ports. It remains to be seen what impact this has pending sanctions against any vessel or carrier violating sanctions. COSCO/OOCL, where the latter is a wholly-owned subsidiary of the former, and jointly # 3 shipping company in the world, will need to review shipping to Russia and then using these vessels to ship to countries imposing sanctions against Russia and Belarus.

Inflation / Interest Rate Increases

Around the world, economists are raising their forecasts for inflation and cutting those for growth. JPMorgan Chase & Co. economists now see global growth of 3.1% on a fourth quarter to fourth quarter basis, down 0.8 percentage point since Feb. 18. And they forecast inflation of 4.6% in the final three months of the year, up 0.9 percentage point.

At issue for central banks are the tradeoffs between raising rates to offset a supply-side inflation jolt they aren't equipped to fix, just as those pressures weigh on consumers spending and corporate confidence.

"The key question mark is global monetary policy makers' response: Will they prioritize economic growth amid elevated uncertainty or opt to tighten monetary policy even faster due to the inflationary shock," said Tuuli McCully, head of Asia-Pacific economics at Scotiabank.

The betting of most is that they will still focus on restraining inflation before it becomes entrenched in their economies. The Organisation for Economic Cooperation and Development reported on Thursday that inflation averaged 7.2% across its members in January, the most since 1991.

"Policy makers need to adjust policy in the same way as they eventually did following the adverse oil supply shocks of the 1970s, which is to lift rates," said Steve Barrow, head of FX strategy at Standard Bank.

U.S. Federal Reserve Chair Jerome Powell on Wednesday signaled a quarter percentage-point hike in interest rates this month, joining a chorus of central bankers raising rates around the world as they try to cool inflation.

As he was speaking, Bank of Canada Governor Tiff Macklem was already beginning what may turn out to be a series of rate increases. Hungary followed the next day.

Having hiked twice in recent months, Bank of England officials are warning that the fallout from the attack on Ukraine will potentially upend the outlook for the U.K. economy, although they still seem on track to act again this month.

Still, the invasion's fallout is likely to deepen a policy divergence as some push up borrowing costs and others either slow their tightening or stay on the sidelines for now.

The war muddies the outlook for the European Central Bank, which had been tip toeing toward constraining monetary policy, but whose economy is more closely-linked to Russia's than most. Having previously flagged next week's meeting as a decisive one for the future of policy, officials are now more likely to stay in a holding pattern

In Asia, the Bank of Japan continues to support the economy while the People's Bank of China is cutting interest rates.

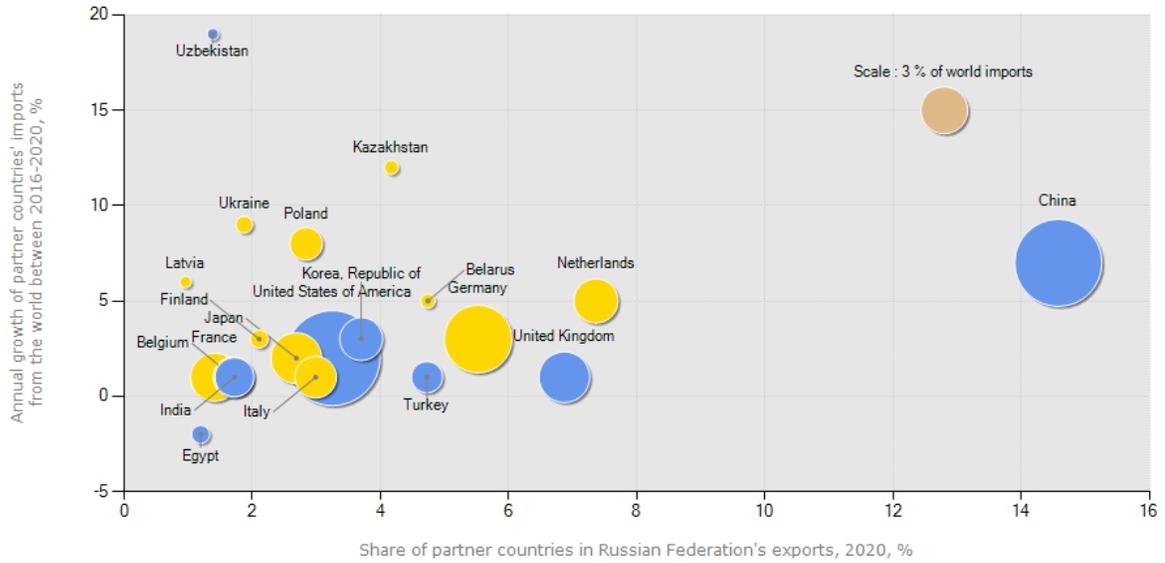
It's not only the central banks thinking about the economic aftershocks. The war will also force European governments to borrow more to pay for an influx of migrants and strengthen their armies.

Gary Luk, who runs a Hong Kong-based freight forwarding company, said about 20% of his business has been affected by the war because it involves organizing cargo including audio equipment and electronic gadgets to be flown or shipped from China to Eastern Europe.

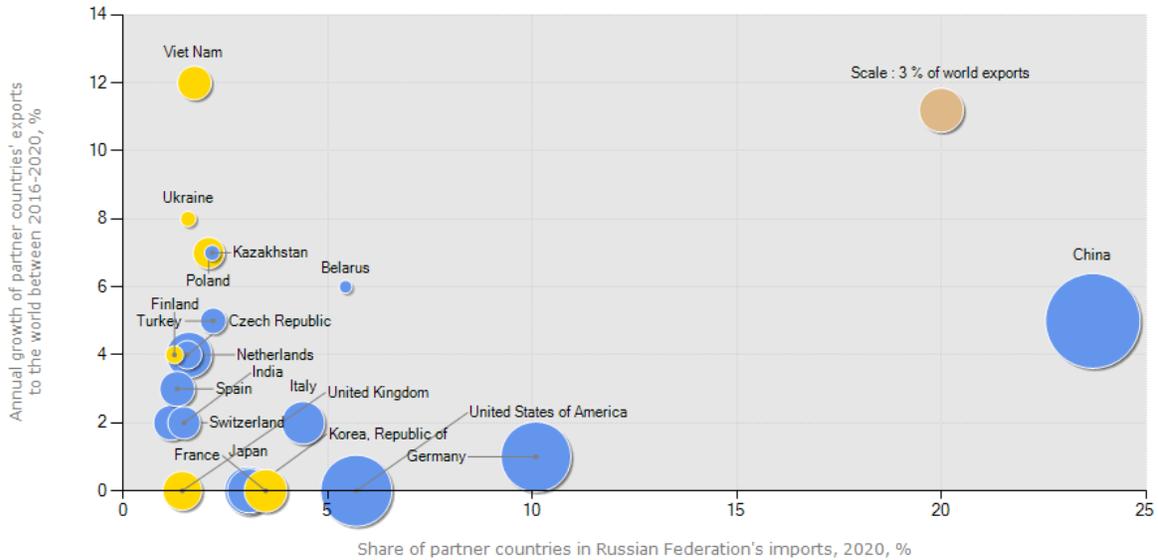
Plunging currencies mean his clients in Russia and Ukraine face skyrocketing costs to pay for his service in U.S. dollars, so they are delaying payment, Luk said. Overdue payment has amounted to a six-digit figure in dollars, putting increasing pressure on his company's cash flow, he said.

Russian Trading Partners

Prospects for market diversification for a product exported by Russian Federation in 2020
Product : TOTAL All products



Prospects for diversification of suppliers for a product imported by Russian Federation in 2020
Product : TOTAL All products



● Russian Federation import growth from partner < Partner export growth to the world
 ● Russian Federation import growth from partner > Partner export growth to the world
 ● Reference bubble
 The bubble size is proportional to the share in world exports of partner countries for the selected product

