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CEI GLOBAL REPORT

CEI Centre for International Economy

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The war continues and its economic effects consolidate

The war between Russia and Ukraine continues and certain economic effects consolidate while others appear.

Firstly, the significant role of Russia and Ukraine as agricultural product exporters (see CEI Global Report, March 2022) has pushed the rise in food prices: the index developed by FAO shows a 12.6% increase between February and March, driven by higher prices in vegetable oils, cereals and beef.

In the case of oils and cereals, the impact is direct since Russia and Ukraine are remarkable maize, wheat, sunflower seed and sunflower oil exporters. Likewise, these rises indirectly affect the price of substitute cereals, like rice and oat, and the price of beef cattle feed. According to the Commodity Markets Outlook of the World Bank, the average price of wheat grew 25% in March, the price of soybean 23%, poultry meat 18%, maize 15% and soybean flour 6%. The WB estimates that this year, the price of grains would go up 20% on average, that of beef 15% and poultry 42%.

Many Asian and African medium and small-sized developing countries greatly depend on the food coming from Russia and Ukraine, and they are not likely to be substituted as suppliers in the short term, especially of sunflower oil, since they are the origin of 65% of global exports. This can give rise to food insecurity and political instability, as in 2008 and 2012 in countries in the north of Africa and the Middle East. According to UNCTAD, 69 countries are those most exposed to a shock derived from food, energy and financial issues, among them 25 belonging to Africa, 25 to the Asia-Pacific region and 19 to Latin America and the Caribbean.

Secondly, a reduction is expected to take place in the important role that Russia has as exporter in the oil market due to the fact that several countries seek to change suppliers, some companies have stopped operating in Russia and it will be more difficult to get ships to transport Russian oil. As a result, the price of Brent crude oil went up 21% in March and it is expected to increase 42% this year. The natural gas shows a similar context: fewer imports of Russian gas are expected, the price of gas placed in Europe rose 56% in March and a 111% increase is expected during this year. This situation can lead to two opposing contexts in the long run, according to UNCTAD: in the first place, resuming the use of fossil fuels, especially the most expensive ones, like shale oil, and, in the second place, accelerating the transition towards non-fossil energies.

Thirdly, since Russia is an important exporter of fertilisers and due to the limitations to use ships and trains for their transportation, added to the export restrictions imposed by Russia and China, the average price went up 69% in March and it is expected to grow 150% this year. This will raise the cost of agricultural production and trigger a sustained rise in the price of food.

And, fourthly, the price of nickel, a key input for automobile batteries, rose 41% in March and a 51% increase is expected during 2022. The production of catalytic converters for cars will also be affected because of the place that Russia has in the provision of crucial inputs like palladium and rhodium, which, together with the neon gas exported by Ukraine, are also vital for semiconductors production.

New WTO economic outlooks

The WTO anticipates a fall in the rate of trade growth. Among other causes, the reduction would be originated by the rise in commodity prices, the difficulties for transportation across conflict areas in Ukraine, the export restrictions set by many countries to guarantee domestic supply, the transport interruptions amid the pandemic, and the closure of activities in China due to the resurgence of COVID-19.

The institution expects that global trade goes up 3% in 2022, instead of the 4.7% that it had anticipated in October 2021. Imports growth rate would go down in Europe –3.7% instead of 6.8%–, North America –3.9% instead of 4.5%– and Asia –2% instead of 2.9%–.

Likewise, the WTO simulated the impact on trade and economic activity of several measures adopted by different countries with respect to the base scenario of an outlook without the war. In a scenario only measuring the direct impact of the war, global GDP would fall 0.1% and that of Ukraine, 24%. The different types of sanctions to Russia, including some yet not adopted, would reduce 9.2% the Russian GDP, 1.4% the global GDP and 3.1% that of the European Union, while world exports would be diminished 4%.

The IMF anticipates difficulties for the global economy in the short term

The International Monetary Fund (IMF) published the latest edition of its World Economic Outlook, where it states four issues that the world will have to face due to the war in Ukraine. In the first place, the report highlights the continuation of the armed conflict, which hinders the recovery started once the circulation restrictions imposed during the pandemic were lessened. For the IMF, this situation presupposes direct effects on Ukraine and Russia (due to the sanctions) and indirect impacts on the rest of the world through the commodity prices, trade, the financial bonds and the humanitarian impact, especially in Eastern Europe.

According to the IMF, global GDP would grow 3.6% in 2022 and in 2023, instead of 4.4% and 3.8%, which was the outlook previous to the war. The developed economies would grow 3.3% in 2022 –0.6 percentage points less than in a no-war scenario– and the emerging and developing economies would grow 3.8%, 1 p.p. less; of these, the economies in Latin America would grow 2.5%, and Russia would fall 8.5%, 11.3 p.p. less.

A second problem is inflation, which in the developed economies would be of 5.7% –1.8% p.p. more than without a war– and in the developing countries 8.7% –2.8 p.p. more–. The rise in inflation responds to the increase in the price of commodities, the greater cost of maritime freight and the misalignment in the supply chains that have given rise to increased logistics costs.

A third problem that will have an influence on the outlook in the short term is the evolution of the pandemic and the measures taken to fight it. The reduction of omicron variant cases –after the peak hit at the beginning of the year– and the spread of vaccination are helping to improve the economic activity. But the outbreak of a new variant in China could reverse the situation, particularly due to the Chinese strategy of zero-COVID that implies closing the economic activity in the affected areas.

The fourth problem refers to the social turmoil present in the interior of the countries and the political tensions between countries. The first case derives from the scarcity of foods and fuels and their reflection on the rise in prices. This situation has led, on other opportunities, to restrictions on the domestic commercialisation and on exports, interventions that can negatively affect the economies involved. The second case is the result of the progressive deterioration of the global geopolitical environment, which destabilises the multilateral system of financial, commercial, economic and political rules. The world could be fragmented into blocks, each one with its own rules.

Foreign direct investment surpasses pre-pandemic level

Foreign Direct Investment (FDI) worldwide grew 88% in 2021. It thus surpassed by 37% the level previous to the pandemic, considering the average of the FDI inflows and outflows, according to a report of the OECD.

For the country members of this organisation, FDI outflows grew 168% y-o-y, which means that they already surpassed the 2019 level by 74%, while FDI inflows increased 75% with respect to 2020, slightly 5% above pre-pandemic values.

The United State was the largest recipient of FDI –with 21% of global inflows– and the main source of FDI, with 23% of the outflows. China and Germany follow with much lower amounts: 7% and 8% of the outward FDI flows and 19% of the inward flows, respectively.

With respect to Argentina, FDI inflows amounted to US$ 6.5 billion in 2021, 2% less than in 2019, while FDI outflows stood at US$ 1.4 billion, 11% below the pre-pandemic level.

EUROPE

Fifth package of measures of the EU against Russia

The European Union adopted a new package of measures aimed at increasing the economic pressure on the Russian government, as a response to the invasion of Ukraine. Also, the authorities of the bloc demanded Russia that it should "immediately stop its military aggression in the territory of Ukraine, make an immediate and unconditional retreat of all the forces and military equipment from the totality of Ukraine's lands and fully respect the territorial integrity, sovereignty and independence of Ukraine within its internationally recognised borders".

Some of the measures imposed by the EU are the prohibition of access of Russian vessels in ports of the European Union, of transporting products from Russia along European roads (with some exceptions) and new prohibitions to import products such as coal, wood, cement, fertilisers, seafood and liquor of Russian origin.

Besides, the EU imposed a total ban to make transactions with four large Russian banks, which account for 23% of the banking sector of said country. These financial organisations will not only suffer from the exclusion from the SWIFT system, but they will also suffer the freezing of all their assets in territory of the European Union.

Poland and Bulgaria without Russian gas

Russia suspended the provision of natural gas to Poland and Bulgaria, both being the first countries in the EU to suffer a response of this kind on the part of the Russian government, which seeks to penalise the governments that have imposed sanctions against it after its invasion to Ukraine, on 24 February. The Russian company Gazprom justified the interruption of the gas shipment because of the refusal of the European countries to meet the demand made by Moscow and announced by Vladimir Putin in March, which forced the European buyers to make the corresponding payments for the imports of gas in roubles.

The President of the European Commission, Ursula von der Leyen, described Russia's decision as "blackmailing" and expressed her intention to support Poland and Bulgaria so that the measure has the "least possible impact on European consumers". Also, the authorities of the bloc expressed that the obligation to pay the gas in roubles implies breaching the signed contracts and urged the European energy suppliers not to meet the demands of the Russian government.

Greece concludes repayment of its debt with the IMF

The Greek government paid 1.9 billion euros to the IMF and made an early payoff of the debt that it had contracted with the organisation as of year 2010. Greece's Minister of Finance, Christos Staikouras, announced that, with the advance payment of the debt, the country will save 230 million euros in interests.

As a consequence, Greece takes one more step forward to leave behind the financial crisis that undermined its economy between 2009 and 2018. Nevertheless, the country still has the highest rate of public debt of the EU, which amounts to 193.3% of GDP, more than double the average of the bloc (88.1%).

SOUTH AND CENTRAL AMERICA

Argentina and the EU to have bilateral electronic phytosanitary certification

As of the month of April, the countries of the European Union joined the list of partners with whom our country uses an electronic phytosanitary certification system. Consequently, more than 40% of our exports will be certified under this modality, whose implementation has been worked under development since 2012 and for which our country is a pioneer at the regional level.

This system, known as E-Phyto, is an initiative of the International Plant Protection Convention (IPPC of the Food and Agriculture Organization of the United Nations –FAO–) especially proposed so that developing countries can avoid the financial and negotiation costs of creating their own systems for the exchange of data relative to products and by-products of vegetable origin. The system enables trading of these goods to be made faster and more efficiently, at the same time that it reduces the likelihood of fraud in the documentation since the use of paper is avoided. Likewise, the data exchanged are protected, which increases safety and transparency in the certification process.

Brazil requests the WTO to intercede in the free circulation of fertilisers

Within the framework of the official visit to Brazil of the WTO Director-General, Ngozi Okonjo-Iweala, President Jair Bolsonaro requested the institution to intercede to guarantee the free circulation of the trade of fertilisers. Argentina's Mercosur partner, Brazil, is at the moment the main global importer of that type of product and an important part of its purchases comes from Russia and Belarus, countries that are currently subject to financial and economic sanctions. In that respect, although Brazil launched a National Fertiliser Plan last March to reduce the dependence on this input and avoid impacts on its agricultural production and economy, it is a long-term project and its current position as a net importer (85 % of its consumption, approximately) makes it depend on this supply, especially for export crops like soybean, maize and sugar cane.

In turn, the Director expressed the need to discuss this measure with the partners, but she recognised that the limited circulation of fertilisers, seeds and food would worsen the contexts of scarcity and hunger. Even more, she urged food producer countries, like Brazil, to increase their exporting supply to mitigate the risks of a food security crisis at a global level.

Bolivia creates public agricultural production company

By means of Supreme Decree No. 4701 and within the framework of the process of strengthening of food sovereignty of Bolivia, President Luis Alberto Arce created the Bolivian Agricultural Production Company for the "production, processing and transformation of agricultural and animal products". These can be commercialised both in the domestic and in the foreign market.

This company, which will be under the scope of the Ministry of Rural Development and Lands, will count on initial resources of 140 million Bolivian pesos (nearly US$ 20 million) and the use of state-owned lands for production. Likewise, the company is expected to generate economic surplus that will be used in public policies for productive development and policies with a social nature.

NORTH AMERICA

First data of US GDP in 2022

The US real gross domestic product (GDP) declined at a seasonally adjusted annual rate of 1.4% in the first quarter of 2022 compared to the previous quarter, according to the anticipated estimate published by the Bureau of Economic Analysis (BEA). However, if we consider the year-on-year variation, GDP grew 3.6% in the first three months of the year. In the fourth quarter of 2021, there had been an increase of 6.9% compared to the previous period, and 5.5% year-on-year.

The fall in relation to the previous quarter was mainly due to the deterioration of the trade balance –resulting from the decrease in exports and the increase in imports–, to the reduction in the accumulation of inventories and to lower government spending. On the other hand, both personal consumption expenditure and fixed investment increased.

According to the BEA, the increase in COVID-19 cases in the first three months of the year led to continued restrictions and disruptions in the operations of companies and businesses in some parts of the country. In turn, government aid to businesses and social benefits to households dropped as the provisions of several federal programmes expired or were curtailed. Other factors contributing to the fall in GDP were higher inflation and supply chain issues.

As for the remaining USMCA partners, Mexico's GDP registered a 0.9% increase in the first quarter of this year, compared to the previous quarter, driven by services and secondary activity, while in Canada the preliminary estimates show 1.4% growth over the same period (which translates into a 5.6% annualised growth rate).

Mexico prevails in dispute against Costa Rica at the WTO

The World Trade Organization released the Panel's final report concluding that Costa Rica breached its obligations under the WTO Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement) by imposing unjustified restrictions on Mexican avocado.

The dispute formally began in 2017, after the Costa Rica State Phytosanitary Service (SFE) suspended the import of Hass avocado from Mexico, alleging a supposed "high risk" derived from the imports of this produce due to the possible presence of the avocado sunblotch viroid (ASBVd).

The Panel determined that the measures imposed by Costa Rica are inconsistent with the SPS Agreement, as they were not based on a risk assessment that is appropriate to the circumstances and discriminate against Mexican avocados versus Costa Ricans with a probable presence of ASBVd. In turn, the group confirmed that the avocado exported by Mexico is destined for human consumption and does not pose any risk to the health of the crop.

By virtue of this decision, Mexico may request the formal adoption of the final report by the WTO Dispute Settlement Body and require Costa Rica to bring its measure into conformity and thus comply with the Panel's decision.

The Mexican parliament rejects energy sector reform

The constitutional reform of the energy sector promoted by President Andrés Manuel López Obrador was rejected on 17 April by the Mexican Chamber of Deputies, as it did not reach two-thirds of the vote.

The initiative sought to nullify the model that was designed in 2013 and that liberalised the market, limit to 46% the share of the private sector in energy generation and increase the weight of the state-run company Federal Electricity Commission (CFE, for its acronym in Spanish). Currently, 62% of the energy is produced by private generating companies and the remaining 38% by the CFE.

The reform had given rise to controversy both domestically and internationally. The opposition argued that the initiative would lead to an increase in emissions of polluting gases, given the CFE's heavy dependence on fossil fuels, and to an increase in energy prices in the country. Meanwhile, the private sector stated that the law would harm competition and deter foreign investment in the country.

One of the main foreign opponents was the US, which had expressed its concern about possible damage to US investors in the sector –with approximately US$ 10 billion in investments in Mexico–. Biden's government also stressed that the wording of the draft legislation did not adhere to Mexico's commitments under the USMCA, including those related to investment and state-owned enterprises.

ASIA AND OCEANIA

The IMF downgrades Asia's growth projections

In a context of war in Ukraine, resurgence of new COVID-19 outbreaks in China and tightening financial conditions, the International Monetary Fund revised downward Asia's GDP growth projections to 4.9%, for this year, from the 5.4% estimated in January 2022. The recent forecast is a sharp slowdown compared to the 6.5% growth recorded in 2021. On the other hand, inflation, which was much lower than in other regions, began to rise, and prices are expected to increase by 3.4% in 2022 (1 percentage point more than the expectations in the agency's January outlook).

According to the Deputy Director of the Fund's Asia and Pacific Department, Anne-Marie Gulde-Wolf, Russia's invasion of Ukraine is the greatest challenge to economic growth in the region. Asia's advanced economies are the hardest hit by Europe's fall in demand due to the war, while emerging economies suffer from rising world commodity prices, exacerbated by the conflict. The official also said that given the close commercial ties in Asia, a deeper-than-expected slowdown in China is a significant risk for the region. On the other hand, Gulde-Wolf estimated that, in the medium term, the potential fragmentation of supply chains derived from geopolitical tensions constitutes a great risk for a region that was benefitted by globalisation and relative peace during the last decades. However, Asia remains the most dynamic region in the world and an important source of global growth.

According to the IMF, growth is expected to be 4.4% in China (0.4 percentage points less than January forecast), 2.5% in Korea (0.5 p.p. less), 2.4% in Japan (0.9 p.p. less) and 8.2% in India (0.8 p.p. less).

China urges stabilisation of agricultural production and energy

On 20 April, at a meeting of the Council of State, Chinese Prime Minister Li Keqiang called for efforts to stabilise agricultural production and the supply of important agricultural products, and to ensure and increase energy supply in order to protect the country's economic and social development. Li stressed that all Chinese towns must strictly comply with their responsibilities in food security, and coordinate the epidemic control of COVID-19 and agricultural production. The premier also stressed the importance of opening "green channels" for the transport of fresh agricultural products, such as vegetables, and of providing funds to help grain-producing farmers.

Regarding energy supply, he called for efforts to intensify coal production, with a further 300 million tonnes of coal production capacity added by 2022. Finally, he stressed the need to develop nuclear energy in an orderly manner, and approved the construction of new nuclear reactors in the provinces of Zhejiang, Shandong and Guangdong. In the 14th Five-Year Plan (2021-25), on China's energy system, published by the National Development and Reform Commission (CNDR) and the National Energy Administration in March, the government commits to increasing the installed capacity of operating nuclear power plants to 70 gigawatts (GW) by 2025, up from 51 GW by the end of 2020.

China to reduce coal import tariffs to zero from May

China announced that it will temporarily reduce to zero the import tariffs on all types of coal. Currently, tariffs range from 3% to 6%, depending on the specific type of coal. The measure, which will run from 1 May 2022 to 31 March 2023, appears as the Asian country strives to ensure energy security amid rising global prices and concerns about supply disruption.

The elimination of import tariffs is considered to have little impact on China's coal purchases in 2022, as domestic production remains at record levels and prices reached record highs. However, the measure could benefit imports from Russia, whose tariff is 6% for thermal coal. Chinese coal purchases from that origin fell 30% in March compared to the previous year, but in recent weeks some Chinese traders began to demand low-priced Russian shipments given the measures taken by the European Union against Russia.

In 2021, China imported 323 million tonnes of coal, about 8% of its total consumption.

AFRICA

African economies doubly hit by COVID and war in Ukraine

The global economic crisis triggered by the COVID pandemic in 2020 and the Russian invasion of Ukraine in February this year intensified the risks of declining trade integration between countries, a process called trade deglobalisation (impact on supply chains; relocation of companies' production; global supply shortage).

The World Bank noted that these trends are putting additional strain on Africa's economies which adds to the context of inflation in food prices and fuel prices, posing serious risks for the countries in the continent. In its latest report, the agency estimates a 3.6% growth in 2022, compared to 4% in 2021, as the region continues to grapple with new variants of COVID-19, global inflation, grain supply disruptions and climate crises.

In this context, the President of the African Development Bank (AfDB) reiterated that the continent must "prepare for the inevitability of a global food crisis". In this regard, the AfDB warns that the tripling of fertiliser costs, the increase in energy prices and the rising costs of food baskets in Africa could worsen in the coming months.

A total of 90% of Russia's US$ 4 billion exports to Africa in 2020 consisted of wheat; and 48% of Ukraine's nearly US$ 3 billion exports to the continent were wheat and 31% corn. Among the first measures taken by that institution to mitigate the effects of the food crisis was the activation of the "African Fund for Food Crisis and Emergency Response".

Beyond the measures taken at the institutional level by the AfDB, the African countries are looking for other markets for the provision of wheat for the preparation of basic foods such as bread. In the case of Egypt (the world's largest wheat importer), although it has a sufficient stock until September, the government is trying to obtain supplies from other markets such as Argentina, India, Kazakhstan and Romania. Egypt, like other countries, has banned wheat exports, including to Yemen, which is suffering from a major food crisis.

The situation in the countries of East Africa is even more complicated. The context originated from the war in Ukraine adds to the droughts due to lack of rainfall in the region, raising food prices in an area where 16 million people suffer from food insecurity. For example, more than 90% of Somali wheat flour imports come from Russia and Ukraine, which has a full impact on the food basket of Somali families; in Kenya, families living in arid and semi-arid regions are eating only once a day; and in Ethiopia, nearly 1.5 million livestock have been lost.

In turn, the FAO noted that the situation of West African countries is also very complex. Before the conflict in Ukraine, 25% of the population of that region was facing food insecurity, and it informed that although the impact of the war is still difficult to measure, the scenario will surely worsen.

According to a report from the UN Economic Commission for Africa (ECA), Egypt, Ethiopia, Kenya, Libya, Morocco, Nigeria, Senegal, South Africa, Sudan and Tunisia are the most exposed to the crisis as they rely heavily on imports of wheat and maize from Russia and Ukraine. These countries make up half of Africa's population and two thirds of the continent's GDP.

Afreximbank launches financing programme due to the crisis in Ukraine

The Board of Directors of the African Export-Import Bank (Afreximbank) approved the launch of the "Ukraine Crisis Adjustment Trade Financing Programme for Africa". The programme is a US$ 4 billion line of credit to manage the impact of the Ukrainian crisis on African economies and businesses.

The main objectives of the programme are to help countries cope with increases in import prices and to finance the shortfall in tourism revenues from Russia and Ukraine. Eligible funding applications received from across Africa already exceed US$ 15 billion. There is some urgency to comply with these requests in order to avoid catastrophic social conditions in the region and reduce their risk of becoming political challenges.

Beyond funding, Afreximbank plans to work with the United Nations Economic Commission for Africa, the African Union Commission (AUC) and the African Continental Free Trade Area (AfCFTA) Secretariat to launch the "Intra-African Supply Chain Coordination Group" which will aim at aligning production and consumption, ensuring that African production is destined primarily to meet the needs of the continent.

Ongoing delays in the launch of West Africa’s common currency

The latest launch deadline (2020) for West Africa’s new common currency had to be postponed due to the COVID-19 pandemic. Without a new timetable in place, there is concern among the countries in the region as to whether the ECO remains a viable proposal. It is the fourth time this has been postponed since 2014. The leaders of the Economic Community of West African States (ECOWAS) note that the launch is unlikely to happen before 2025 due to the expected impact of the pandemic on an already fragile regional economy.

Out of the 15 countries in the region, 8 use the CFA franc and 7 other currencies, which are not freely convertible. Meeting the convergence criteria for the adoption of the single currency is a major challenge for both large and small countries. Primary criteria include single-digit inflation at the end of each year; a fiscal deficit below 4% of GDP; and sufficient gross international reserves to cover imports for a minimum of three months. Almost all the countries still fail to meet the convergence criteria, with Togo being the only one of the 15 members to date to do so.

The disruption caused by the pandemic led some countries to seek new monetary strategies. The introduction of digital currencies by the Central Banks of Nigeria and Ghana raised concerns among the rest as to whether these countries are already leaving the ECO project behind. This is important given the size of their economies and the weight in the region, particularly Nigeria, which accounts for 65% of regional GDP and about half of the population.

In the search for concerted efforts to find ways to further facilitate cross-border trade in the absence of a common currency, the Afreximbank’s Pan-African Payment and Settlement System (PAPSS) initiative appears, which will allow for instant cross-border payments in local currencies between African markets. While this may not replace the benefits of a common currency, it could lower the need for it, given the other obstacles to the project.

The economic challenges for the implementation of the currency are met with political considerations. Both France and Côte d’Ivoire indicated that the ECO would be pegged to the EURO and would have guarantees provided by the French Treasury for its stability. Non-French-speaking West African countries, however, are opposed to the new currency having official links with a former colonial power. Reality indicates that there are many other complex issues that need to be finalised for the implementation of the currency, such as addressing exchange rate mechanisms, policy harmonisation measures to control reserves, and finding an exit strategy for those who use different currencies.

CEI GLOBAL REPORT

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