

Ukraine War and Covid

The world economy in upheaval

Dr. Michael Heise on Global Economics
Juni 2022

The Ukraine war is a humanitarian low point and a geopolitical watershed that will result in fundamental changes in the world order. For the economy, new patterns of division of labor will emerge. For businesses and investors, political risks have increased.



The global economy is burdened by the Ukraine war in several ways. It exacerbates existing supply bottlenecks as a result of the Corona crisis and lockdowns in China. Enormous price increases for energy sources and other raw materials are weakening growth and further stoking inflation. Central banks have therefore initiated a significant turnaround in interest rates. With no relief in sight on energy and commodity markets, also due to the ongoing war, the risk of recession is currently quite considerable. In addition, a number of long-term shifts are already emerging which will have a structural and lasting impact on the global economy.

Turning point in defense and energy policy

The Ukraine war has had a lasting impact in the area of defense policy. The peace dividend of past decades has finally become history. For example, about half of the NATO states have announced higher defense budgets. Increasing military spending is also to be expected in China and Russia. This also means that fewer resources will be available for other growth-promoting government spending.

Significant changes will also take place in the global energy markets. Western countries will push the expansion of renewable energies and gradually replace previous supplies of Russian energy raw materials with other sources of supply. For Russia, the reorientation of its energy policy will entail considerable losses. And Western countries will have to prepare for a prolonged period of high energy costs.

Changes in the financial markets due to sanctions

The sanctions against Russia not only involve trade bans in the technology sector, entry restrictions and asset freezes, but also the extensive exclusion of Russian financial institutions from the global payments network (Swift) messaging service. As a result of the sanctions, a large portion of its foreign reserves are now unusable by the Russian Central Bank. In response, Russia has demanded payment for energy supplies in rubles and imposed capital controls. The value of the currency has stabilized as a result.

Turning point of the Inflation

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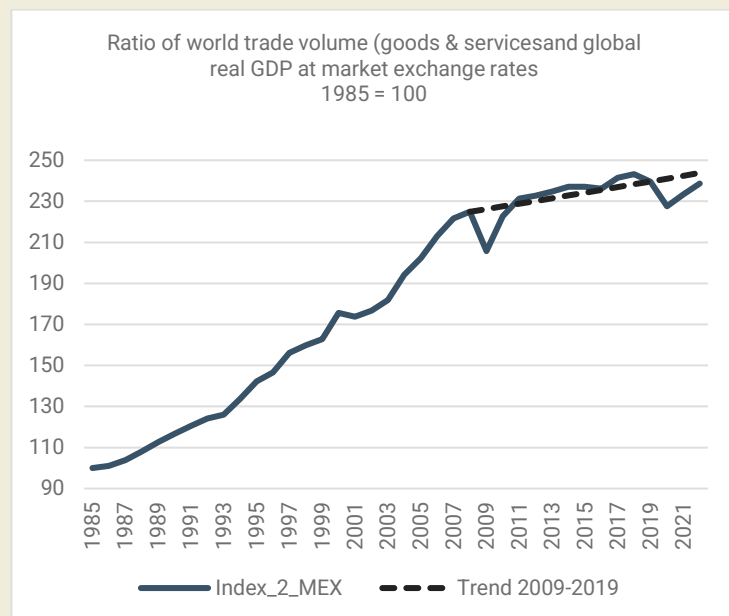
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Financial sanctions are also having repercussions in China, which has currency reserves of about \$3.4 trillion and has been trying for years to end the dominance of the U.S. dollar in world financial markets. China is likely to push the use of the renminbi in international payments (for energy trading, for example) and further develop its own international payments system (CIPS), which has so far been designed only for yuan payments. The digital version of the yuan is also likely to aim to be a pioneer and gain more international prominence.

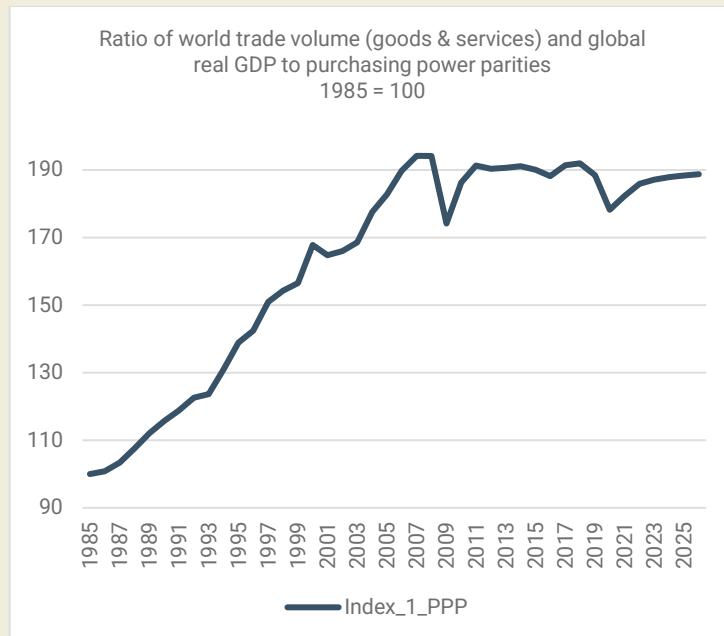
All of this is likely to increase the international use of the renminbi and give rise to parallel systems and market standards. However, the primacy of the U.S. dollar will not be threatened unless the Chinese government is willing to pledge full convertibility of the currency and thus open itself widely to international markets.

Less globalization, more regionalization

The so-called deglobalization that has been observed since the great financial crisis of 2008 and is reflected in relatively weak growth in world trade, global direct investment and international production linkages has been exacerbated by the supply disruptions in the wake of the Covid crisis and the Ukraine war.



Source: International Monetary Fund, World Economic Outlook



Source: International Monetary Fund, World Economic Outlook

Many companies have found that complex global supply chains have proven fragile and prone to disruption. Reactions to this have been many and varied. Most notably, additional sources of raw materials and intermediates are being developed, alternative production locations are being considered where political uncertainties are very high, and higher inventory levels are generally being sought in order to become more "resilient."

For Germany, economic relations with China are of outstanding importance. China is often at the top of the sales markets for traditional German industries, such as automotive manufacturing, and is an important investment location. China supplies rare earths, raw materials and electronic components that are needed in many industries, such as renewable technologies. According to surveys, however, many companies are wondering whether they need to rethink their China strategies.

More recently, drastic Chinese policy interventions, for example in the technology, education and real estate sectors, and tightened surveillance procedures have created the impression that China, unlike in the past, is pursuing its political goals without regard for the economic consequences. The uncompromising quarantining of millions of people as part of the pandemic response has reinforced this impression.

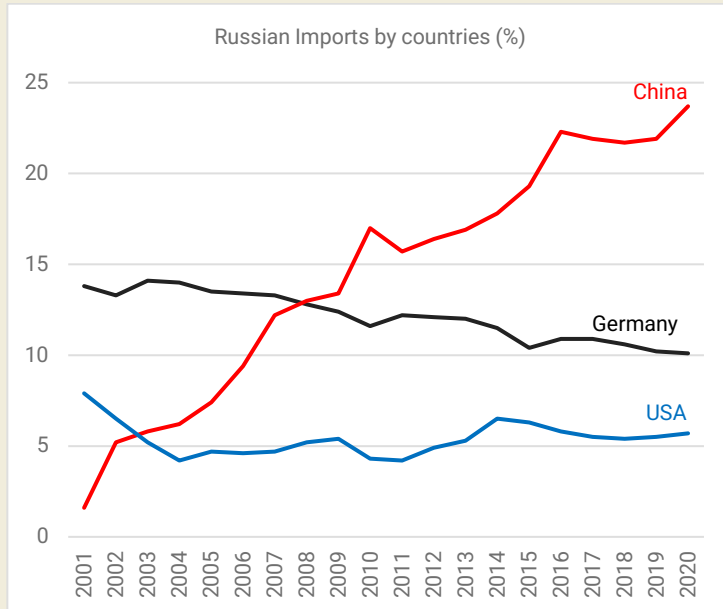
Moreover, China is increasingly linked economically with Russia. The cultural similarities between Russia and China are small, but both meet in their rejection of the United States as a unipolar

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world power. The scenario of a Chinese-led eastern power bloc with Russia cannot therefore be entirely dismissed.



Quelle: GTAI

Fragmentation of the world economy harms everyone

A geostrategic split of the world economy into a power bloc dominated by China and the U.S.-led alliance of the West would not only have serious security consequences, but also economic ones. Trade and capital movements would become more regionally oriented and increasingly follow geopolitical criteria. Cooperation between countries in technology and science would be reduced, as would cooperation on climate policy, environmental policy and development policy issues. Organizations such as the World Trade Organization, the World Bank and the International Monetary Fund would lose importance as global rule-setters and would have to reposition themselves. The principle of a rule-based global economic order would be weakened in the face of the power of the strongest.

To counteract such a disintegration of the global economy, the most important thing is to maintain the cohesion of free and democratic states. China has much to lose if it risks increasing isolation from the markets of OECD countries. China will hardly be able to achieve its goal of becoming the number one economic power if international investment and trade relations decline, especially since China is also undergoing a major demographic turnaround and therefore cannot rely solely on its domestic economy.

Conclusion

The global economy is in a state of upheaval due to the Covid pandemic and Russia's Ukraine war. Less globalization, more regional integration of trade and capital movements. Political risks have increased significantly for internationally active companies and capital investors. Direct investment and technological know-how are likely to be relocated from countries where the political environment is unpredictable. Sources of supply for raw materials and intermediate products are being diversified. This will tend to dampen global productivity and growth dynamics.

A prosperity-preserving world order requires above all political negotiations and accepted rules aimed at balancing interests. Despite the current sanctions against Russia, it is not in the interest of the "West" to break off relations with Russia virtually forever and thereby promote a Chinese power bloc. Nor will economic sanctions against China bring the hoped-for success. In the long term, the development of global prosperity will depend on whether it is possible to further develop global rules in the interests of all and to prevent an end to multilateralism.

Notes on investment strategy - investment recommendation pursuant to Section 85 of the German Securities Trading Act (WpHG) in conjunction with the German Securities Trading Act (WpHG). VO (EU) No. 596/2014

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Rating system of the absolute valuation	
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