The CEO Imperative: Through relentless disruption, how can you stay the course? (PART 2)

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Ever more frequent shocks are reshaping the globe and our economy. Companies must plan for a more local, sustainable and digital world.

(CONTINUED FROM PREVIOUS EDITION)

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Vaccines and COVID-19 therapies have reduced the crippling effects of the pandemic in many countries, and supply bottlenecks had begun to ease before the war in Ukraine. However, even if the pandemic becomes endemic, it is not yet over. Policies to fight COVID-19 vary, and China's zero-tolerance COVID-19 policy, for example, continues to trigger lockdowns that disrupt supply flows.

While it seems probable that some economies will be very severely affected by the war in Ukraine, the short-term global drag on post-pandemic recovery is expected to level out at around 0.4 percentage points, pushing GDP growth toward 3.5% in 2022. Should the war intensify and spread, then impacts would be on a much greater scale, presenting a real risk of global recession.

Key headwinds that flow directly from the war include:

- Higher commodity prices, especially energy, metals, and some food and agricultural products
- Tightening fiscal conditions and intermediation stress, including capital outflows
- Increasing trade and supply chain disruptions
- Lower private sector confidence

These disruptions are intensified because they have emerged against a particularly sensitive backdrop featuring the highest inflation levels experienced in over two decades, elevated energy prices, strained supply chains and volatile financial markets. Central banks were already on a steep trajectory of setting higher interest rates before the war in Ukraine, but these rates are now expected to reach even higher levels as efforts to curb inflation increase.

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Regional impacts as global trade slows

Russia and Ukraine

Russia and Ukraine both face deep economic crises, the former as economic and financial sanctions grip ever tighter: triggering the collapse of the ruble, the widespread withdrawal of foreign firms, and a foreseeable GDP loss of between 5% and 7% already in 2022. At the same time, foreign exchange depreciation and a shortage of imported goods will drive inflation into high double digits. In the unlikely event of China and India joining the call for sanctions, the negative impact on Russia would intensify by about 50%.

Economic activity in Ukraine has been severely disrupted by the war, and the longer-term impact will depend on its duration and scale. Infrastructure costs, modeled from other wars, point to potential GDP losses of up to 50% over multiple years. Even if the war ends soon, this could lead to double-digit GDP loss.

Europe

Europe also will be hard hit because of its significant trade and financial linkages with Ukraine and Russia. With surging energy and food prices weighing on household finances and tightening financial conditions constraining business activity, it seems likely that Eurozone GDP growth will be capped around 3.0% (factoring in a drag of more than 0.6 percentage points).

But even within Europe, there will be large differences, as the Baltic states and Cyprus will be hit hardest while southern Europe and Ireland will be relatively unaffected. Poland, Slovakia and, to a lesser extent, Hungary are seeing a huge refugee inflow that will boost consumption, fiscal spending and inflation. If oil and natural gas purchases are banned, the most impacted countries would include Hungary, the Baltics, Czechia, Slovakia, Germany and Italy.

United States

By contrast, the US economy, benefiting from solid economic momentum before the war in Ukraine, is more insulated than Europe from the most severe impacts. If pressed, the US could become energy-independent, but producers may be reluctant to increase drilling after several recent boom-and-bust cycles.

China

Facing lingering domestic headwinds from a downturn in real estate activity and its zero-tolerance COVID-19 policy, China's GDP growth is expected to slow from 8.1% in 2021 to around 5% in 2022. India's high oil import dependence (nearly 90% of its consumption) heavily exposes the country to the surge in commodity prices. Real GDP growth is likely to slow from 8.1% in 2021 toward 7% in 2022.

As companies consider how to factor in differing GDP growth predictions, business leaders will need to contend with the fragmentation of cross-border trade. While Russia will be isolated by the West, it will still be integrated with China and many other Asian countries. Commodity imports are likely to be replaced by alternative sources in preferred countries, but in some cases that will be difficult as certain supplies, like green minerals, are limited by location.

Other countries

Large energy exporters like Kuwait, United Arab Emirates, Kazakhstan, Saudi Arabia, Australia and Norway are benefiting, at least in the short term, from higher prices. By contrast, Egypt is particularly vulnerable to the effects of the war due to its dependence on wheat imports from Ukraine and Russia. Net importers of oil and other commodities, especially in Asia (Vietnam, Pakistan, Thailand, South Korea), will also lose out, with trade balances in these territories likely to deteriorate.

The global economic rebound that had begun in the wake of the pandemic is already facing some setbacks. But providing the war doesn't settle into a prolonged and deepening conflict or spread to involve other actors, a global recession seems unlikely for the moment.■

(CONTINUED IN NEXT EDITION)

LEADING THROUGH DISRUPTIONS

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