FINN MCGUIRK

mosaic moment

EPISODE_03

RISK-SHARING FOR UKRAINE

MARTIN BLUM

INTRO

0:01 **Got a moment? Fast changing risks affect people, businesses, and economies in today's turbulent world. Perils like cybersecurity, political violence, or threats to financial institutions. Listen in as Mosaic Insurance specialists quiz fellow experts on trending industry topics. Welcome to this Mosaic Moment.**

0:22 Hi, I'm Finn McGuirk, Head of Political Risk for Mosaic Insurance. Today, I'm speaking to Martin Blum, Head of Debt Strategy and Capital Markets Development for Raiffeisen Bank International. RBI is a leading corporate retail and investment bank in Central and Eastern Europe, with subsidiaries in 13 countries.

Thanks for joining me, Martin. Martin and I have known each other for many years, we have a shared professional interest in keeping up-to-date and analyzing macroeconomic developments. But we come into that subject with very different perspectives, and with a very different level of focus. As a political risk underwriter, I'm required to stay abreast of macroeconomic developments, as they affect developing markets around the world. Whereas Martin is a focused expert on Central and Eastern Europe and developing political and economic risks there. Obviously, one of the big issues facing political risk underwriters at the moment is the conflict in Ukraine, and on the human level, that is almost unfathomable in terms of the level of suffering. It's a huge, tragic event that is still emerging, but the conflict also has considerable effects on economies around the world. From my teams, and my following of those effects around the world, I think we've been a little surprised by the focus being almost as much on countries that are geographically far away from the epicenter, rather than what you might describe as the "near abroad." But, nevertheless, we are asked to support clients who are doing business in Central Asia, and Central and Eastern Europe. So, it requires us to stay abreast of those developments and try to analyze those risks. Martin, from your point of view, has sufficient time now passed to get an idea about the effects of that conflict in terms of remittances and energy prices on those economies in the near abroad? Or, do you think that story is still too rapidly evolving to come to a firm view?

2:27 Thanks, Finn. I think the simple answers are yes, and yes. So, there's been certainly enough time to appraise the initial impact on the region's economies and markets. But, by the same token, clearly the situation is still evolving on the ground, not only in terms of the human tragedy of the conflict, but also in terms of its spillover to economies in the region, and the sanctions response is also playing out still, too. So, in this context, we've by no means seen the full impact on Central European or Central Asian economies, yet. But we can say a couple of things: already, if we look back over the last four months, and the first point I'd touch on there is that higher energy prices...

...have obviously had a profound impact on both the CE-regions, external imbalances, and also, obviously, inflation, too. And what that means in practice is that the current account deficits in the CE region have widened, in some cases, to levels not seen since before the 2008–2009 global financial crisis. And by the same token, higher energy prices have also been one of the key factors pushing inflation in many countries in the region, above 10%. And I think, you know, from an immediate spillover impact from Russia's invasion of Ukraine, the inflation impact is perhaps the most visible, and that, in turn, creates a real challenge for policymakers. Not only in the US or the Eurozone, but also in the CE and Central Asian region, too. And the positive, particularly from a sovereign risk perspective, is that central banks across the region have really stepped up to the challenge of significantly tightened monetary policy. And, in turn, that's something which, I think, you know, is underpinning the medium-term credibility of policymakers across the region.

It's also worth noting that the National Bank of Ukraine, so, Ukraine Central Bank, recently also tightened monetary policy-hiking interest rates—15% to 25%—in the bid to reduce foreign-exchange pressure. And that's important for two reasons: one, because obviously, it reduces the scope for further international reserves loss, which is good for sovereign creditworthiness. And, also, because it underscores that notwithstanding the conflict, that policymakers still have to do relatively orthodox things in terms of policy choices, and that's exactly what's happening in Ukraine, too, which is ultimately positive. The second point I'd make in terms of the immediate spillover of the conflict to the region, is that the impact on economic activity, itself, has been somewhat more muted than feared. And that's also true for Central Asia and the Caucuses. And what we've seen in terms of inward remittances, has been quite surprising insofar as that flows from March onwards have been actually stronger than previously. So, they've accelerated rather than decelerated. That's been very, very visible, for example, in Uzbekistan. The second point, which is, I think, to some extent, related to the first, is that ethics depreciation-pressure across Central Asia has also been quite limited and reverse quite fast following the initial weakening of currencies in Central Asia. And the reason for that was also because the ruble has been surprisingly strong since sanctions were imposed, too. So, in short, the initial impact of Russia's invasion of Ukraine has been relatively muted in terms of economic activity outside of Ukraine, of course, but we do think that headwinds to economic activity will progressively intensify as we move into the second half of this year, particularly if energy price pressure sustains.

7:01 Thank you. You've already sort of touched on Ukraine's own actions in trying to manage the economic fallout of the crisis. I guess, from our point of view, we've seen in Britain quite a strong reaction just from British people, in looking to help Ukraine for the crisis, and perhaps partly because of that, the British government has been visible in offering significant tangible help to Ukraine. But more broadly and more significantly, from the international community, there has been significant help offered, particularly from international financial institutions. Now, I'd say from a political risk underwriter's point of view, it will be nigh-on impossible for us to increase our exposure to Ukraine at the moment. But the level of international support has profound implications on our existing exposures that we ran out from previously supporting the Ukrainian economy. From our point of view, that level of international support signifies a strong, ongoing commitment to the future of Ukraine. But is that also how you're seeing it?

8:03 That's absolutely right. And I think it's really difficult to overstate the importance, or to understate the importance, of international support for the Ukrainian economy. The US obviously came up recently, with a $40 billion aid package, of which around $8 billion will be channeled in direct budget support for the Ukrainian government. The European Commission has proposed a €9-billion macro financial assistance package for Ukraine, too, for this year, which also would directly support Ukraine's government and hence also the economy. And that's obviously in addition to support from super nationals – the IMF, the EIB the World Bank, and also a lot of bilateral support. And this is really, really important, because obviously, the budgetary and the fiscal impact of the war is significant. The finance ministry estimates around $5 billion a month of deficit related to the impact of the war on the budget and the economy. And that gap needs to be plugged and if it's not plugged by international support, it needs to be plugged by domestic bond sales, which is occurring on a weekly basis, every Tuesday. But in addition, if there are gaps, then the central bank has to directly finance the government, which from a longer-term perspective, the lower that is, the better it will be for Ukrainian markets and the exchange rate when markets reopen again at some point in the future.

The two related points are also very important to highlight in this context, and if you speak to people in Ukraine's finance ministry, which I have in the last few months, these are points which strongly come across. The first one is that grants from the international community are preferred, as opposed to concessional loans, because obviously grants do not add to the country's debt. So, it's better for long term credit worthiness. And the second point, from a from a medium-term perspective, is how best to facilitate private sector participation in Ukraine's reconstruction. And this is obviously a crucial point, insofar as this will define the welfare of Ukraine's citizens in the long term, and it cannot only be done by international bodies, the private sector progressively will have to become involved, and there will be an element there, I think of risk sharing.

10:47 In terms of the European response, we are seeing a lot of coverage on the European energy sanctions being applied to Russia, and particularly on the uneven pain that that represents for the member states of the EU. I wonder if you see that as a strain on the cohesion of the EU, and maybe a threat to the formation of a single, coherent, EU foreign policy?

11:12 I view it somewhat more optimistically, than that, so sort of a mirror image to some extent of what you just asked. And specifically, I think, if we take a step back and look at the six rounds of sanctions that the EU countries have so far imposed against Russia, it proves that pretty robust and pretty aggressive EU foreign policy can and has worked and that the EU can, from a foreign-policy perspective, act in concert with other large players such as the US or the UK. And that's despite having to make compromises to placate countries such as Hungary. Also keep in mind, the EU in the context of trying to offset or work against some of the country's specific spillovers from the energy-price implications from sanctions. The EU has an initiative called "Repower EU," and part of that provides up to €225 billion of funding to facilitate the energy transition and essentially to improve energy security in the region. So, taken together, on balance, US actions in the last four months, strengthen my belief in the common EU foreign policy.

12:39 Well, thank you very much, Martin, for your time and your thoughts in this conversation. I know we'll be very carefully monitoring events as they continue to unfold. So, thank you very much.

12:48 Thanks, Finn, and Mosaic for inviting me today.

OUTRO

12:51 Thanks for listening. Feel free to download, follow and share on social and recommend us to colleagues and clients. See you here next time for another Mosaic Moment.

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