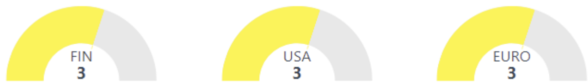
DEPRCON OUTLOOK 02/28/2022

Forecasts (%)	USA	Eurozone	Finland
2021 Q1	1.5	-0.3	0.04
2021 Q2	1.6	2.0	1.8
2021 Q3	0.5	2.2	0.9
2021 Q4	1.7	0.3	0.0 (nc)
2021	5.3	4.2	2.6

Deprcon indexes



OUTLOOK FOR THE WORLD ECONOMY: FEBRUARY[1]

Forecasts (GnS Economics, OECD, Q-to-Q):

Because of the extreme uncertainty and war in Europe, we have decided not to provide any forecasts for the current time, as their reliability would be dismal.

China stimulus: The aggregate financing of the economy of China reached a new record of 6.17 trillion Yuan in January (see Figure 1). Beijing has thus continued its re-leveraging policies. Now that the Olympics are over, we have to wait see, whether the 'credit machine' is wound back down or does Beijing continue run at "full blast".

ECONOMIC INDICATORS

United States, February (January)

Richmond Fed manufacturing: 1 (8)

Empire State manufacturing: 3.1 (0.7)

Dallas Fed manufacturing: 14.5 (16.6)

Manufacturing PMI:[2] 57.6 (55.0)

Service PMI: [3] 56.7 (51.2)

US Consumer Confidence:[4] 110.5 (111.1)

China, January (December)

Caixin manufacturing PMI:[5] 49.1 (50.9)

Service PMI:[6] 51.4 (53.1)

Eurozone, February (January)

Manufacturing PMI:[7] 58.4 (58.7)

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[1] GnS Economics wishes to thank Stefan Törnqvist and Sami Miettinen for their contribution on understanding the repercussions of the SWIFT and central bank sanctions.

[2] Values above 50 indicate growing output, while values under 50 indicate declining output. Figures were obtained from TradingEconomics.

[3] From TradingEconomics.

[4] The Conference Board.

[5] From TradingEconomics.

[6] From TradingEconomics.

[7] From TradingEconomics.

Service PMI:[8] 55.8 (51.1)

THE OUTLOOK

A massive shock hit the world in 24th of February when Russia, after weeks of preparation, started a war against Ukraine with the likely aim of full invasion. While Russia had 'rattled the sabre' with Ukraine already before, very few actually thought that Russia would start a full-scale military operations. We warned on this possibility, or an "escalation" on the 12th of February. Volatility in the financial markets has increased massively, as we warned. In this outlook we concentrate on the likely aftermath of this extremely unfortunate situation.

Some facts about Ukraine and Russia, which is likely to face tough sanctions, are in order. Together the two countries produce around a third of global wheat exported and fifth of corn trade.[9] It is thus no wonder that wheat and corn prices have jumped up. On the 24th, wheat futures trading was halted due to 'limit up', i.e., futures prices rose over 50 cents per bushel.[10]

Prices of, for example, aluminium and nickel have also been rising rapidly (Russia provides around 6% of aluminium and around of 7% of the global demand of nickel). Rising prices are a way for markets to handle the uncertainty. However more shocks are on their way.

Western nations have enacted a series of sanctions aimed at pressuring Russia to stop her military operation. Thus far these have included freezing of Russian assets (e.g. in the UK), cancellation of the Nordstream 2 gas pipeline and personal sanctions to Pres. Putin and Foreign Minister Sergey Lavrov.

Western nations have now agreed that Russian banks will be cut off from the the Society for Worldwide Interbank Financial Telecommunication, SWIFT, system. It is a system of quickly and secure communication between banks. No money is transferred, but it is a crucial part of the global financial infrastructure as financial transaction information, like electronic or card payment information are transferred through it.[11] Exclusion from it will make it considerably more difficult to operate in the modern banking world. News of cutting Russia from it has already sparked bank runs in Russia. In a drastic move, the central bank of Russia raised its key interest rate from 9.5 to 20%. This is a sign of desperation and a fear of wide-spread bank run. The EU has also agreed of banning all transaction with the Russian central bank. This means that it will become harder for the central bank to use its foreign reserves, as it will be unable to sell them for euros. The U.S. is likely to do the same, which would mean that the central bank of Russia would become isolated.

These are drastic moves, but we do not yet know how wide the SWIFT-ban is. It seems not to include all Russian banks, which would made it practically impossible for other countries to pay for their energy imports from Russia. This is something some countries, like Germany, may want to avoid. Now we also have to wait and see how Russia responds. The current administration could even view a full exclusion from the SWIFT as an act of war. Putting Russian deterrence forces, including nuclear, in 'high alert' suggest something like this, but we have to wait and see. We also have to wait and see what Russia does with gas and oil exports to Europe. They are an important source of revenue to Russia and also crucial to many European nations. While the winter months are over in Central and Southern Europe, combined with any cold spree would send gas prices soaring. Russia could also slow fhe flow of oil to global markers and Europe.

So, we are in the middle of a global 'financial battle' against Russia. At this point, it's practically impossible for see all the ends of this campaign. However, one can expect financial markets to react, possible violently, while rising energy and inflation prices will keep inflation pressures high even though there seems to be no signs of panic at the European energy markets, at least not yet. Markets may be expecting that the worst options (full SWIFT exclusion and shutting gas from Russia) will not materialize. However, the combination of higher prices, if materialized, and uncertainty would

[8] From TradingEconomics.

[9] See, e.g., FT.

[10] See, e.g., Barchart.

[11] See more, e.g. from Investopedia.

be a push towards *stagflation*, i.e. the combination of recession and fast inflation. This would put central banks in bind as they would like to support the volatile financial markets with low interest rates, but hastening inflation would lead to a serious economic and political backlash.

We keep monitoring the situation closely.

Appendix: Figures

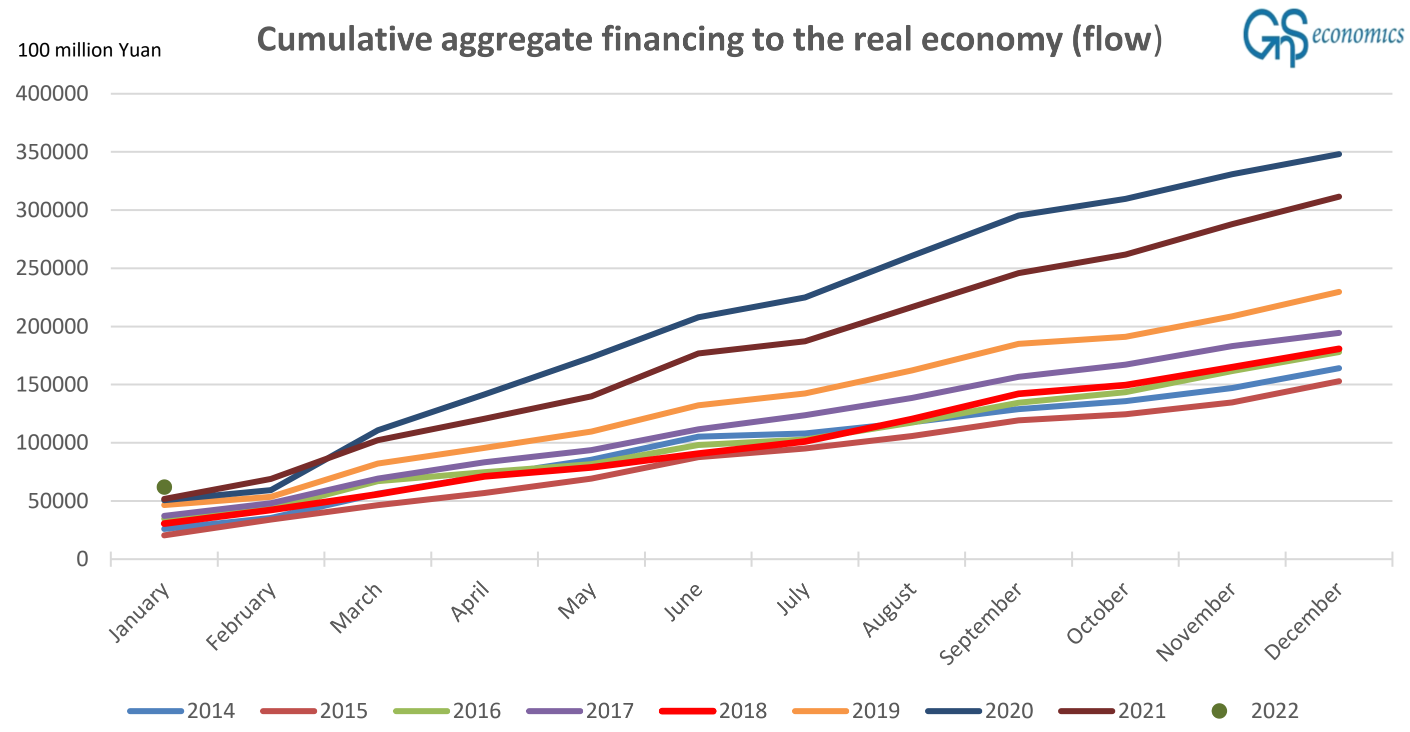

Figure 1. Monthly cumulative aggregate financing to the real economy (flow) in China. Source: GnS Economics, People's Bank of China

Appendix: The Deprcon -index

Deprcon is a **close proximity estimate** on the outlook of the **economy** and **financial markets**. In practice it is assumed to cover the next 1-2 quarters.

Values above three indicate an economic expansion and values below three indicate a downturn. If the indicator gives a value of 3, it signals that the economy is at a turning point. Value 2 gives a recession -warning, while value 4 signals a start of an expansion. Extreme values indicate either that an economy is in danger of overheating (5) or that is heading to a recession/depression (1).

We construct the estimate using information on the stock market, financial markets and our recession and crisis probability forecasts. This means that even if an economy is growing strongly, our outlook for it may be negative if recession and/or crisis probabilities are high.

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