

## OMFIF advisory council meeting

7 March 2022

### Views and predictions of the council members

#### **1. Wider implications of war in Ukraine: 'a major reordering is underway'**

- 'A major reordering is under way of the world economy and of world economic structures. In the race for digitalisation, Europe is way behind. I thought the European structures were not strong enough. This has been proven to be correct. Europe is going to require a lot of intellectual flexibility to cope with this.'
- 'Investment flows have shown a structural change. Asian and American dollars have become the safe havens. This partly reflects the view that Europe will be suffering more than elsewhere from the Ukrainian crisis, also Europe has fallen behind in big data and big tech.'
- 'These problems didn't come from nowhere. The economic and financial system is embedded in other systems such as public health. If you have a problem anywhere, it has effects everywhere. It is worse than the 1970s, then we had energy plus inflation. Now we have the post-pandemic economy, long-term hysteresis, climate change, emerging markets, the need for renewables to replace fossil fuels, big increases in commodity and energy prices. All this will have a big political dimension.'
- 'Investors may be encouraged to go into other uncorrelated assets such as China's government bonds and gold. Countries will want to escape from the danger of asset freezes.'
- 'A period of conflict with a country that does not want to be prone to military subjugation could be rather long. This will not be an Anschluss like in 1938. The conflict could last two, three or five years. Could we be moving to a bipolar global order? Does this mean the end of ESG as energy policy priorities change and America ships more liquefied natural gas to Europe? Is dollar sovereignty now assured? Will the war and the sanctions bring about greater efforts to diversify payment systems away from dollar dependence, and boost extra desire to replace fiat systems?'

#### **2. Side-effects of dollar sovereignty: 'Other countries will be trying to move beyond the dollar system'**

- 'We worry about dollar sovereignty and the bipolar world order. Many entities are overweight in dollar and exposed in this way.'
- 'Russia being cut out of Swift has given other countries the view that they may be vulnerable – this has implications for China. Other countries will be trying to move beyond the dollar system.'
- 'Currency swap arrangements could accelerate the idea of diversification to other arrangements. There seems to be a lot more trade between Russia and China.'
- 'Now the renminbi as well as dollar and yen are back in play as safe havens. Trends already in place before the Russia invasion are now being exacerbated. Is China now more vulnerable out of Swift? Compensating factors include the Chinese/Russia swap lines, in place before the conflict. Also China is the US' biggest trade partner. The Chinese don't want to be cut out of globalisation.'
- 'Cryptocurrency has underperformed – why is this?'

### **3. Economic warfare against Russia and prospects for Sino-Russian partnership: 'Russia and China together don't make a very effective combination'**

- 'Many sovereign funds will now seek to leave Russia as a market.'
- 'Russia has become an unviable market – this has become a moral issue.'
- 'I'm not sure whether this will drive the world towards a more bipolar system, with Russia and China on one side. There's not a lot of support for doing business with Russia. No one is on its side. Everyone is against it. Russia and China together don't make a very effective combination, Russia is only 7% to 10% of the size of the Chinese and American economies. I do not count on China counting on Russia, this may not be in either country's best interests.'

### **4. Role of China and India**

- 'India always likes to stand alone and look different to other economies. China should emerge strongly out of this crisis.'
- 'I see China emerging as a more powerful country from this.'
- 'China will use its power, but it will be very pragmatic. China does not want to cut itself off from globalisation.'

### **5. Inflation is back to stay: 'Stagflation scenario becomes much more likely'**

- 'Inflation is back- This initially had nothing to do with the war, but reflected the effects of Covid-19 in limiting supply and then, in the aftermath, driving up consumption of commodities. Energy shortages came on top of this, wage demands will be rising in many countries, globalisation has suffered, supply chains have changed.'
- 'Inflation in labour markets is starting. The US labour market is exceptionally strong.'
- 'The stagflation scenario becomes much more likely. This is an asset allocator's nightmare, with equities selling off and bond yields rising. Governments require new fiscal measures to protect consumers from higher energy prices.'
- 'Inflation is returning. We are back to the 1970s. We will have a long stagflation which could go on for five to 10 years.'

### **6. Monetary policy: 'Financial repression a strong possibility'**

- 'We are still predicting six Federal Reserve rate hikes this year of 25 basis points each.'
- 'Financial repression is a strong possibility, as in the US during and after the second world war. We are back to what John Kenneth Galbraith said: the policy choice is between the unpalatable and the disastrous.'
- 'Despite the war, we still think the ECB will cut back its asset purchase programmes and European interest rates will be zero by the end of the year. Lagarde will want to take action on inflation.'
- 'Normalisation of monetary policy will be put on hold, there will be government guidance about interest. I expect central banks will become less independent as stagflation is here to stay.'

## **7. Sustainable economics: 'Net zero is still valid'**

- 'Green transformation will be affected by the price of energy. On the one hand demand will shift; on the other, high energy prices will encourage substitution for fossil fuels. So overall the war could give a boost to sustainable economics.'
- 'There are upside risks to demand plus supply disruptions. There is a level at which crude becomes too costly, demand destruction kicks in. This will accelerate the trend towards greening the economy.'
- 'On green development I am optimistic: the net zero target is still valid.'
- 'Net zero is still accessible, Russia has taught the west Europeans to lower their dependence on hydrocarbons.'

## **8. Changes in Germany and Europe: 'This is for real'**

- 'Europe has rallied together, the change in Germany is very remarkable.'
- 'Western Europe has come out stronger from this, however it is also strengthening the hard-line narrative against China.'
- 'These German changes are for real, these are not just words. €100bn will be spent on the Bundeswehr. The conservative principles of German defence policy have been called into question. This is more than just about money – there will be questions about the efficiency of the Bundeswehr procurement policies.'
- 'Public opinion in Germany is on the side of the boost to defence, pay much more attention than in recent decades. There is a large consensus for the change in policy, strong parliamentary support. However, it could be there will be less money available for other budgetary plans.'
- 'There will be more co-operation between the UK and Europe as a result of the war.'