INTERNATIONAL MONETARY AND FINANCIAL COMMITTEE

**Forty-Fifth Meeting**
**April 21, 2022**

**IMFC Statement by Mathias Cormann**
**Secretary-General**
**OECD**

# 2022 IMF and World Bank Spring Meetings

## *Written Statement to the International Monetary Fund Committee*

**Mathias Cormann**
**OECD Secretary-General**

## The Global Economic Outlook

1. **Russia's unprovoked war of aggression against Ukraine has caused a humanitarian crisis and thrown the global economic recovery into doubt.** Prior to the outbreak of the war, most key global macroeconomic variables were projected to normalise following two difficult years marked by the COVID-19 pandemic. In the *December 2021 OECD Economic Outlook*, the global growth rate in 2023 was projected to be similar to that prevailing in the immediate pre-pandemic period, with most OECD economies returning to full employment. Inflation was expected to converge to levels close to policy objectives, though later and from higher levels than previously expected in most countries. Macroeconomic policy settings were also expected to normalise, with exceptional monetary policy accommodation being progressively removed and pandemic-related fiscal measures phased out. This broadly favourable global economic outlook has been disrupted by Russia's large-scale invasion of Ukraine.

2. **The effects of the war will operate through many channels.** Large output falls in both Russia and Ukraine will hamper global economic activity and reduce demand for output from other countries. The global effect is expected to be relatively contained, as Russia and Ukraine account for about 2% of global GDP and trade. Their financial linkages with other countries are also generally limited.

3. **Russia and Ukraine are major suppliers in a number of commodity markets.** They account for about 30% of global exports of wheat, 20% of corn, mineral fertilisers and natural gas, and 11% of oil. Global supply chains are also dependent on Russian exports of several metals, such as nickel and palladium. Russia and Ukraine are also sources of inert gases such as argon and neon, which are used in the production of semiconductors, and are large producers of titanium sponge, which is used in aircraft production. Both countries also have globally important reserves of uranium. The prices of many of these commodities have increased sharply since the onset of the war, despite the absence of any significant disruptions of production or export volumes yet.

4. **Disruptions to, or the cessation of, wheat and other agricultural exports from Russia and Ukraine would result in serious shortages in many emerging-market and developing economies (EMDEs), and exacerbate food price increases that are already weighing on vulnerable social groups in all countries.** There could be an acute risk of economic crises in some EMDEs and humanitarian disasters, with a sharp increase in poverty and hunger. The food supply shock could be compounded by fertiliser shortages, with Russia and Belarus being major suppliers to many countries. To monitor and mitigate such risks, countries must provide the assistance necessary to facilitate planting, including in Ukraine, tackle logistical barriers limiting the supply of food to EMDE importers, and refrain from export restrictions of food and other agricultural products.

5. **The war and related sanctions are also causing global disruptions through financial and business channels.** Sanctions placed on Russia have targeted selected individuals and banks, reduced access to foreign capital and frozen access to foreign exchange reserves held by the Central Bank of Russia (CBR) in Western economies. An initial sharp depreciation of the rouble forced the CBR to more than double its policy interest rate to 20%, and risk premia on Russian sovereign debt have widened substantially. Delays and difficulties in making international payments are disrupting trade and could result in defaults on Russian debts, with US banks now prohibited from handling USD payments from Russia. Financial market conditions around the world have also tightened, reflecting greater risk aversion and uncertainty. Commercial air travel and freight traffic by air and sea are being rerouted, becoming more expensive (including because of higher insurance rates) or ceasing altogether, and many multinational companies have suspended operations in Russia. These disruptions are adding to the supply chain difficulties faced by companies around the world.

6. **The magnitude of the economic impact of the war is highly uncertain, and will depend in part on its duration and the policy responses, but it is clear that it will result in a substantial drag on global growth and stronger inflationary pressures.** High-frequency data already show some of the potential adverse effects on activity and prices. Consumer confidence declined sharply in March, particularly in Europe. Business surveys also suggest a weakening of new manufacturing export orders, and a renewed rise in supply chain pressures, such as delivery times. The preliminary Kiel Trade Indicator for March, based on real time container ship movements, points to a month-on-month reduction in global trade, with a sharp fall in the number of container ships arriving and departing from Russian ports. In Russia, air traffic has slowed considerably, with around one-third fewer flights from major airports in March, and prices are rising sharply. In the last full week of March, consumer prices in Russia were around 8½ per cent higher than a month earlier.

7. **The *March 2022 OECD Economic Outlook Interim Report* provided illustrative simulations suggesting that, compared to a no-war baseline, global growth could be reduced by over 1 percentage point and global inflation raised by close to 2½ percentage points in the first full year after the start of the conflict.** These estimates are based on the assumption that the commodity and financial market shocks seen in the first two weeks of the conflict persist for one year, and include an output decline of over 10% in Russia.

8. **The impact of the simulated shocks differs across regions, with European economies collectively being the hardest hit, particularly those bordering Russia or Ukraine.** This reflects greater gas price rises in Europe than elsewhere and stronger pre-war business and energy linkages with Russia. Advanced economies in the Asia-Pacific region and the Americas have weaker trade and investment links with Russia, and some are commodity producers who are benefiting from the increase in prices seen since the start of the war. Even so, growth in these cases is still hit by weaker global demand and the impact of higher prices on household incomes and spending. Growth outcomes in EMDEs reflect a balance between stronger output in some commodity-producing economies and deeper declines in the major commodity-importing economies, and the adverse impact of higher investment risk premia. Higher food and energy prices are also pushing up inflation more than in the advanced economies.

9. **These simulations provide an initial insight into the potential impact of the war based on the market disruptions observed in its early stages.** They do not incorporate many factors that could intensify the adverse effects, such as further sanctions or embargos, disruptions to shipping and air traffic, the unavailability of key products from Russia, export bans on food and other commodities, or undermined consumer confidence.

10. **A key potential risk is that energy exports from Russia to Europe could cease completely.** The impact of such a shock is difficult to quantify, but could be severe given low levels of gas reserves and limited possibilities to switch quickly to alternative sources. If, for example, gas prices were to return to the peak reached just after the start of the war and remain there, the price shock would be twice as large as assumed in the initial simulations. This would imply an additional 1¼ percentage point increase in inflation in Europe and a further reduction to European growth by over ½ percentage point.

11. **Input-output linkages are another way to assess the direct output effects of a reduction in energy inputs is via input-output linkages.** An illustrative reduction in imported energy inputs in all European economies, equivalent to the share of imported energy inputs from Russia in total energy use in each economy, would directly reduce gross output in European economies by around 1½ percentage point. The impact across Europe would be uneven, with those countries closer and more dependent on Russia being more heavily hit than others. All sectors of the economy would be affected.

12. **The humanitarian cost of the war is high and growing. Over 4.7 million people have already fled Ukraine since the start of the war, far more than the annual flow of asylum-seekers into Europe at the height of the Syrian refugee crisis in 2015-16, which was in the order of 1 million per year.** Supporting refugees from Ukraine will require spending on housing, food, medical assistance, childcare and schooling. The spending challenge is difficult to predict due to uncertainty about the number of refugees, the length of time they will stay, and the amount of spending per refugee. Based on the estimated cost for processing and accommodating asylum-seekers in 2015-16, the inflow of 4.3 million refugees from Ukraine seen so far could result in a direct first-year cost of at least 0.35% of EU GDP, and much more in the major host economies.

13. **There are also other potential longer-term consequences from the war, including pressures for higher spending on defence in Europe and elsewhere, changes to the structure of energy markets, the potential fragmentation of payment systems and shifts in the composition of foreign exchange reserves.** A re-division of the world into blocs separated by barriers would sacrifice some of the gains from specialisation, economies of scale and the diffusion of information and know-how. These changes would diminish the efficiency gains from having a global trade and financial system with a single dominant reserve currency.

<u>**Policy Requirements**</u>

14. **The costs and uncertainty arising from the war add to the challenges already facing policymakers from unexpectedly strong inflationary pressures and imbalances related to the pandemic.** OECD consumer price inflation was 7.7% in February, the highest rate since December 1990, with further increases set to occur in March due to the initial impact of the war on food and energy prices.

15. **Faced with a new negative supply shock of uncertain duration and magnitude, monetary policy should remain focused on ensuring well-anchored inflation expectations.** Steps towards the normalisation of monetary policy should continue in advanced economies, albeit at a differentiated pace and with frequent reassessment as the war evolves. The case for continued normalisation is particularly strong in economies such as the United States, where the recovery from the pandemic is well-advanced and broad-based inflation pressures were already apparent ahead of the recent commodity price surge. A slower pace of policy normalisation is appropriate in economies where core inflation is low, wage pressures remain modest and the impact of the conflict on growth is greatest. In the most affected economies, a pause might be needed to fully assess the consequences of the crisis. In all countries, renewed asset purchases, expanded currency swap lines and a temporary easing of prudential regulations can be used if necessary to ease liquidity shortages in financial markets.

16. **Amidst rising inflationary pressures and a shift towards monetary policy normalisation in the major advanced economies, the monetary policy stance has already been tightened substantially in some EMDEs over the past year to help anchor inflation expectations.** Higher food and energy prices are likely to require additional tightening, given the greater weight of commodities in consumer price inflation in EMDEs.

17. **Ahead of the conflict, the fiscal stance was set to tighten gradually in most advanced economies in 2022-23 due to the withdrawal of pandemic-related support measures and some discretionary fiscal consolidation.** These plans are being reconsidered in many countries in light of the war. Immediate spending priorities include the costs of supporting refugees in Europe and cushioning the immediate effects of the commodity and food price shocks on vulnerable households and companies. In the medium-term, greater investment in clean energy and higher defence spending are both likely to be high on the agenda. Fortunately, debt service burdens generally remain moderate, despite sizeable fiscal deficits and higher debt levels, providing room for additional temporary and carefully targeted fiscal support where needed, particularly while interest rates remain low. Also, in some countries, extra spending could be funded by taxation of windfall gains arising from the spike in energy prices.

18. **The scope for additional fiscal support varies considerably among EMDEs, with many facing difficult trade-offs between supporting incomes and ensuring debt sustainability and investor confidence.** Higher commodity prices should, however, bolster fiscal revenues in commodity-exporting countries, providing some leeway to cushion the shock of higher food and energy prices on household incomes.

19. **Lower-income countries and households spend the highest share of their incomes on energy and food.** Many governments had already introduced measures to offset the effects of the large energy price increases seen before the start of the war, and these measures are now being strengthened further. The policies used include income support, such as transfers, as well as price measures, including lower electricity tariffs for low-income households, VAT cuts on electricity and gas, reductions in excise taxes on liquid fuels and electricity and energy price freezes. In some countries, subsidies have been provided to electricity companies to compensate for capping price increases.

20. **To keep costs manageable, and avoid distorting price signals, support to offset energy price rises should be targeted and temporary.** Lower tax rates and price caps directly reduce energy costs but benefit high-income households as well as those most in need of help. Cash transfers can be better targeted, and have higher multiplier effects if focused on low- and middle-income households, but may take longer to put in place.

21. **The main fiscal issue that arises with supporting refugees from Ukraine is burden-sharing among European countries.** Refugees have initially gone to neighbouring countries, primarily Poland, Romania, Hungary, Moldova, and Slovakia, with some then transiting to other countries. The initial costs are manageable for the EU as a whole, but much less so for these main destination countries individually. Greater burden-sharing of the fiscal costs incurred by receiving countries and EU support to the major host countries would allow support to be delivered more effectively.

22. **Another issue highlighted by the war is the importance of diversifying energy sources to improve energy security.** The war has served as a reminder that many OECD economies are heavily reliant on fossil fuel energy, exposing them to a high risk of price shocks and even shortages. More than a third of the EU's electricity is produced with fossil fuels, and until recently Russia has provided around 40% of European natural gas imports, a similar proportion of coal imports, and approximately one quarter of oil imports. Improving the security of energy supply in Europe is a medium-term endeavour, but significant gains can be achieved quickly. In early March, the International Energy Agency set out a 10 Point Plan on how to reduce reliance on gas imports from Russia by between one-third and one-half over the next year. The European Commission has produced an even more ambitious plan, aiming for a two-thirds reduction this year.

23. **In the longer-term, OECD countries should reduce their reliance on fossil fuel imports by providing incentives to move towards alternative energy sources and investing in clean energy and energy efficiency.** In Europe, improving the interconnection among domestic electricity grids can reduce energy costs and improve security. More generally, a strategic clean energy transition should aim to reduce vulnerabilities along the way, and be coupled with investment in innovation and infrastructure to develop the technologies needed for net-zero. Some progress in that direction has been made via public investment plans to spur recovery from the COVID-19 crisis. Nonetheless, recent analysis derived from the OECD Green Recovery database found that 10% of recovery spending in the OECD, EU and Key Partner countries has mixed or negative impacts on the environment. Much more needs to be done to drive transformational changes, in line with commitments made at COP26 on climate and COP15 on biodiversity.

24. **The OECD is helping to support more ambitious, effective and globally co-ordinated action on climate change, with transitioning away from fossil fuels a key element.** In addition to our International Programme for Action on Climate (IPAC) to monitor and support progress to deliver on the Paris Agreement and reach net zero by 2050, we are developing an Inclusive Forum on Carbon Mitigation Approaches. This Forum, which draws on the success of the OECD/G20 process that paved the way for a landmark international tax agreement last year, will assess and report on comparative effort, cost and impact of various policy approaches covering the broad range of measures across explicit and implicit carbon pricing measures. It is designed to help inform better decision making, and help achieve, over time, an appropriately ambitious, multilaterally agreed, and globally more coherent better coordinate approach to climate action. We hope to launch the Inclusive Forum at our annual Ministerial Council Meeting in June.

25. **While taking all the necessary and appropriate steps to mitigate the many challenges and risks caused by the war, we should also plan now how we can best support the democratically-elected government in Ukraine with their rebuilding and reconstruction effort and how we can best integrate them in the community of market-based democracies around the world.** The OECD stands in strong solidarity with the Ukrainian people. We look forward to supporting Ukraine to start the rebuilding and reconstruction effort when circumstances permit.