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R&R Weekly Column
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Sanctions on Russia Accelerate the Polarization of International Payment Systems

The war in Ukraine is raging, with the latest reports being of the atrocities of the siege of Mariupol and continued deaths among the civilians. Diplomacy is not making much progress, as the meetings between the Russian and the Ukrainian delegations are effectively fruitless. The EU leaders held an informal meeting in Versailles in France, the final declaration of which asked for an immediate ceasefire, with Russian troops withdrawing from Ukrainian territory but without offering Ukraine a fast track to EU membership.

What is clear is that Macron has gained the role of the de-facto head of Europe (to which he has aspired for some time), thanks in part to Germany's and Italy's relatively low profile (considering that Germany and Italy have the largest economic ties with Russia among major European countries, and will be the worst hit by the sanctions). In recent days Macron has spoken with Putin more than once, alone or together with German Chancellor Olaf Scholz. But these bilateral interactions have had little impact, apart from clarifying that Russia will not stop its invasion anytime soon, and certainly not before having reached the geo-strategic objectives discussed in our previous columns.

Besides this war on the ground, there is the economic conflict deriving from the sanctions imposed on Russia by a large portion of the international community. Among these, there is the disconnection of a number of Russian banks from the SWIFT massaging system for international payments. The SWIFT circuit is based in Brussels (EU) but is commonly perceived to be dominated by the US. We warned about the risks associated with this move even before Russia launched the attack on Ukraine on February 24th, when it was considered only an *extrema ratio*. Now that it has occurred, we reiterate our concerns.

To begin with, China has already offered Russia use of its alternative payment system for international transactions, called CIPS (acronym for Cross-boarder International Payment System), which the country has developed over time and is used mostly in South-East Asia. Clearly CIPS is not as widely used as SWIFT, considering that China itself has partnered with SWIFT for the further development of its CBDC project, alongside CIPS. However, its importance is growing over time, and the acquisition of Russia among its users could provide an unexpected boost to its adoption, and accelerate the process of it becoming utilised more widely.

Secondly, during the past few years the crypto-asset industry has created a system for international transactions that is completely alternative to the traditional circuits. Admittedly, crypto-assets, the most famous of which is Bitcoin, have ceased to be considered a viable and efficient system for international transactions when it became clear that traditional circuits, such as those provided by credit cards, could provide faster, cheaper and more environmentally friendly transactions. However, they may still be used to evade the implementation of sanctions, as recently warned by UK financial regulatory authorities and be used as an alternative channel to traditional payment systems.

Additionally, evidence is emerging that while banks are implementing the sanctions even beyond the letter, crypto exchanges are limiting themselves to adopting only the bear minimum measures to be sanctions compliant, presumably in an attempt to gain ground from this period of crisis of international payment systems.

These two phenomena combined may eventually lead to the total polarisation of the international payment system, with the US and its allies continuing to use SWIFT and the traditional circuits (including the use of emerging "stable-coins"), while China and its allies, including potentially Russia, adopt alternative systems such as CIPS, or those deriving from digital assets such as CBDCs and crypto-assets. This bifurcation of the payment system could mirror the balkanisation of international relations and global supply and value chains of the physical, non-digital world, thus further accelerating the ongoing de-globalisation process.

Our Recent Publications

- *Flash Review: ECB Remains Hawkish To Counter The Inflationary Impact of The War in Ukraine, by Brunello Rosa, 10 March 2022*
- *Flash Preview – ECB To End APP and Assess The Stagflationary Impact of The War In Ukraine, by Brunello Rosa, Nouriel Roubini and Nato Balavadze, 4 March 2022*
- Russia's Invasion of Ukraine: Scenarios, Endgames And Macro- Financial and Policy Implications, *by John C. Hulsman and Marco Lucchin, 1 March 2022*
- **GEOPOLITICAL CORNER:** China and the Ukraine Crisis: The importance of Doing Nothing, *by John C. Hulsman, 8 March 2022*

Looking Ahead

The Week Ahead: US Fed And BoE Expected to Increase Their Policy Rates

In the EZ, February's annual and monthly CPI inflation are expected to rise to 5.8% (*p:* 5.1%) and 0.9% (*p:* 0.3%) respectively, while core CPI inflation is likely to increase to 2.7% y-o-y (*p:* 2.3%). January's IP is expected to shrink by -0.5% y-o-y (*p:* 1.6%).
In the UK, January's unemployment rate is seen decreasing to 4.0% (*p:* 4.1%).
In the US, UK, Japan, at their monetary meetings, Fed and BoE are expected to raise their policy rate to 0.5% (p: 0.25%) and 0.75% (*p:* 0.5%) respectively; BoJ is expected to keep its interest rate unchanged (*p:* -0.1%).

The Quarter Ahead: EU Leaders Met While Russia Continues To Attack; WB Predicts Russian Default, While More Companies Leave

European leaders met at Versailles for a two-day summit to discuss the fallout of Russia's invasion. EU member states reiterated their support for Ukraine's resistance, but leaders pour cold water on Kyiv's bid to get EU membership quickly. In addition, European Council President Charles Michel proposed an extra EUR 500m in military aid to Ukraine.

World Bank warns that Russia and Belarus are moving closer to the default territory, as coordination economic sanctions restricted access to US dollars and other global currencies to pay lenders. Fitch downgraded Russia's sovereign rating to "C".

Nearly 330 companies have left the Russian market so far. Corporate exodus would have not only economic but also a psychological effect on ordinary Russians. From McDonald's to Goldman Sachs, the companies are withdrawing or limiting their operations in Russia. On the other hand, the Kremlin said it could seize the assets of foreign companies and nationalize them.

Russia widens attacks, as the cities in the West of the country are also targeted. Zelensky accused Russia of attacking humanitarian corridors in Mariupol, the city in which Russia has reportedly attacked a maternity hospital. UN Security Council meets over the request from Moscow to discuss "the military biological activities of the US on the territory of Ukraine". Both Washington and Kyiv deny the existence of such laboratories and point out that the claims are "preposterous" and warned that Russia might use the chemical or biological weapon itself against Ukraine. Russian Foreign Minister Lavrov falsely claims that the country "did not attack" its neighbour. The meeting between two Foreign Ministers in Turkey reached no agreement on evacuation corridors or cease-fire in Ukraine. Furthermore, as the UN reports, 2.5 m refugees fled Ukraine so far.

Last Week's Review

Real Economy: EZ Quarterly GDP Slows Down; US Inflation Picks Up; China's Monthly Inflation Accelerates

In the US, inflation data showed: *i)* inflation rose to 7.9% y-o-y (*c*: 7.9%; *p:* 7.5%) and 0.8% m-o-m (*c:* 0.8%; *p:* 0.6%); and *ii)* core-inflation increased to 6.4% y-o-y (*c:* 6.4%; *p:* 6.0%).

Still In the EZ, the ECB left the main refi rate, deposit rate and marginal lending rate unchanged at 0%, -0.5% and 0.25% respectively.

In the EZ, Q4 GDP growth decelerated to 0.3% q-o-q (*c*: 0.3%; *p:* 2.3%) and accelerated to 4.6% y-o-y (c: 4.6%; *p:* 4.0%).

In China, in February inflation rate stayed unchanged at 0.9% y-o-y (*c*: 0.9%; *p:* 0.9%) and rose to 0.6% m-o-m (*c*: 0.3%; *p:* 0.4%).

Financial Markets: Major Stock Indexes Are Down; Volatility Remains Elevated; UST Yields Rise Amid Inflation Fears

Market drivers: Investors continued to assess the fallout from the Crisis in Ukraine and market anxiety rises considerably. Stocks, including S&P 500, Dow, and NASDAQ, fell after peace talks between Ukraine and Russia failed. On the other hand, investors are optimistic about US labour market, which generated the strongest job growth in seven months, beating market expectations.
Global Equities fell w-o-w (MSCI ACWI, -2.3%, to 663). The US S&P 500 Index was down (-2.9% w-o-w, to 4,204). In the EZ, shares rose (Eurostoxx 50, +3.7% w-o-w, to 3,686). In EMs, equities declined (MSCI EMs, -3.7%, to 1,102). Volatility rose considerably to 29.2 (VIX S&P 500, 52w avg.: 21.2; 10y avg.: 17.9).

Fixed Income: *w-o-w*, UST yields rose (+24 bps to 2.0%), following US inflation confirmed higher than expected. German 10-year bonds were up too compared to the last week (+29 bps, to 0.27%).

FX: w-o-w, the US Dollar Index was virtually unchanged (DXY, +0.0%, to 98.62; EUR/USD +0.5%, to 1.09). The EUR advances is partly boosted by the expectation that the eurozone will increase fiscal spending and the ECB will increase rates this year. In EMs, currencies plunged against the USD (MSCI EM Currency Index, -0.3% w-o-w, to 1,713).

Commodities: w-o-w, oil prices were down (Brent, -7.5% to 112USD/b), after surging above $130 during the week. The market reacted to the supply disruptions arising from Russia's invasion of Ukraine and concerns over the possible ban on Russian oil and gas. w-o-w, gold prices slightly declined (-0.2% to 1,985 USD/Oz), while investors opted for riskier assets in some jurisdictions.

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Abbreviations, Acronyms and Definitions

a	*Actual*
AKP	*Justice and Development Party, Turkey*
ann.	*annualized*
ARS	*Argentinian Peso*
avg.	*Average*
bn	*Billion*
BoC	*Bank of Canada*
BoE	*Bank of England*
BoJ	*Bank of Japan*
bpd	*Barrels per day*
bps	*Basis points*
BS	*Balance sheet*
c	*Consensus*
C/A	*Current account*
CB	*Central bank*
CBB	*Central Bank of Bahrain*
CBK	*Central Bank of Kuwait*
CBT	*Central Bank of Turkey*
CDU	*Christian Democratic Union, Germany*
CNY	*Chinese Yuan*
CPI	*Consumer Price Index*
DJIA	*Dow Jones Industrial Average Index*
DJEM	*Dow Jones Emerging Markets Index*
d-o-d	*Day-on-day*
DXY	*US Dollar Index*
EC	*European Commission*
ECB	*European Central Bank*
ECJ	*European Court of Justice*
EIA	*US Energy Information Agency*
EM	*Emerging Markets*
EP	*European Parliament*
EPS	*Earnings per share*
EU	*European Union*
EUR	*Euro*
EZ	*Eurozone*
Fed	*US Federal Reserve*
FOMC	*US Federal Open Market Committee*
FRB	*US Federal Reserve Board*
FX	*Foreign exchange*
FY	*Fiscal Year*
GCC	*Gulf Cooperation Council*
GBP	*British pound*
GDP	*Gross domestic product*
IMF	*International Monetary Fund*
INR	*Indian Rupee*
IPO	*Initial public offering*
IRR	*Iranian Rial*
JPY	*Japanese yen*
k	thousand
KSA	*Kingdom of Saudi Arabia*
LN	*Northern League, Italy*
M5S	*Five Star Movement, Italy*
m-o-m	*Month-on-month*
mb	*Million barrels*
mb/d	*Million barrels per day*
MENA	*Middle East and North Africa*
MHP	*Nationalist Movement Party, Turkey*
mn	*Million*
MPC	*Monetary Policy Committee*
NAFTA	*North-American Free Trade Agreement*
NATO	*North Atlantic Treaty Organization*
OECD	*Organization for Economic Cooperation and Development*
Opec	*Organization of Petroleum Exporting Countries*
p	*Previous*
P2P	*Peer-to-peer*
PBoC	*People's Bank of China*
PCE	*Personal Consumption Expenditures*
PE	*Price to earnings ratio*
PM	*Prime minister*
PMI	*Purchasing managers' index*
pps	*Percentage points*
pw	*Previous week*
QCB	*Qatar Central Bank*
QAR	*Qatari Riyal*
QE	*Quantitative easing*
q-o-q	*Quarter-on-quarter*
RE	*Real estate*
RBA	*Reserve Bank of Australia*
RRR	*Reserve Requirement Ratio*
RUB	*Russian Rouble*
SWF	*Sovereign Wealth Fund*
tn	*Trillion*
TRY	*Turkish Lira*
UAE	*United Arab Emirates*
UK	*United Kingdom*
US	*United States*
USD	*United States Dollar*
USD/b	*USD per barrel*
UST	*US Treasury bills/bonds*
VAT	*Value added tax*
VIX	*Chicago Board Options Exchange Volatility Index*
WTI	*West Texas Intermediate*
WTO	*World Trade Organisation*
w	*Week*
w-o-w	*Week-on-week*
y	*Year*
y-o-y	*Year-on-year*
y-t-d	*Year-to-date*
ZAR	*South African Rand*
2y; 10y	*2-year; 10-year*