

EU: Gas imports in 2021.
European Commission

HOUSE VIEW

THE RE-FOUNDING OF EUROPE

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After the invasion of Ukraine, things in Europe will never be the same again. Though Putin is failing to meet his military objectives and in the best case scenario an agreement of some kind could be reached relatively quickly, from now on the words of Descartes – *that it is prudent never to trust wholly those who have deceived us even once* – will ring truer than ever.

Aside from the political concept of re-founding the EU, the reform of its institutions which began five years ago and the pursuit of greater geopolitical capacity and strategic autonomy, the proximity of our own borders to the Ukraine conflict has been a wake-up call, and drawn our attention to the importance of European security and our unsustainable energy dependence on Russia. Globally, in addition to the severe sanctions applied, the conflict will be an added headwind for globalisation, with control of supply chains playing a key role. Various raw materials, such as European gas, rare earth elements, lithium and nickel – all of which are crucial to the continuity of the energy transition – will trade at an additional risk premium for a long time to come.

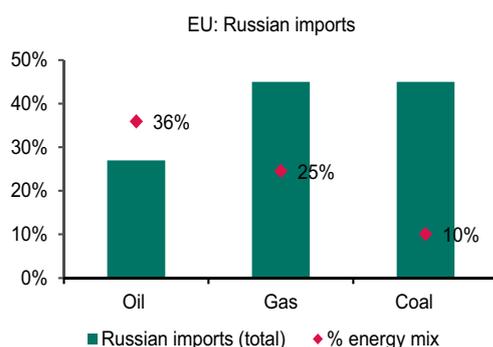
As for the economy, as the report explores, the tragic, savage war waged by Putin will hamstringing growth; we have downgraded our forecast for global GDP growth by four tenths of a point to 3.4%. Given the sustained increase in raw material costs, we now expect inflation to remain higher for longer, forecasting an annual average of 6.5% versus a previous estimate of 5.1% and delaying the expected turning point until the summer months.

We face this economic slowdown in a more mature phase of the cycle, with stimulus tapering measures well underway by central banks in a bid to curb rising inflation. However, despite the loss of economic momentum, the war in Ukraine will also generate opportunities. Cycle aside, we would highlight the following points:

Energy: Europe will tackle the environmental transition by prioritising energy self-sufficiency. It will only achieve this goal in the medium term thanks to the new RePowerEU Plan, which unfortunately will not allow it to hit the target recently announced by the Commission to slash dependence on Russian gas by two thirds before the end of the year.

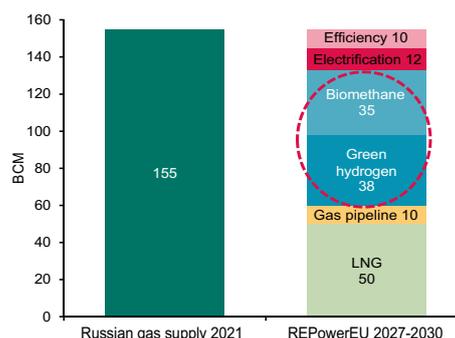
1. ENERGY DEPENDENCY IS UNSUSTAINABLE

Sources: European Commission and Banca March



2. REPOWEREU IS THE SOLUTION, BUT A LONG-TERM ONE

Sources: European Commission and Banca March



We continue to believe that in the short-term, Europe will not be able to stop importing Russian gas, and the main threat to our economy would be if Moscow decided to restrict its gas exports, which account for 45% of total EU gas imports. As graph 1 shows, all of the sanctions imposed to date have swerved this area, given the huge extent of our dependence. This was clearly exemplified by Europe’s reaction to the war crimes that have come to light recently; the focus remained firmly on the far lower-impact decision to limit coal imports, which account for just 10% of our primary energy sources.

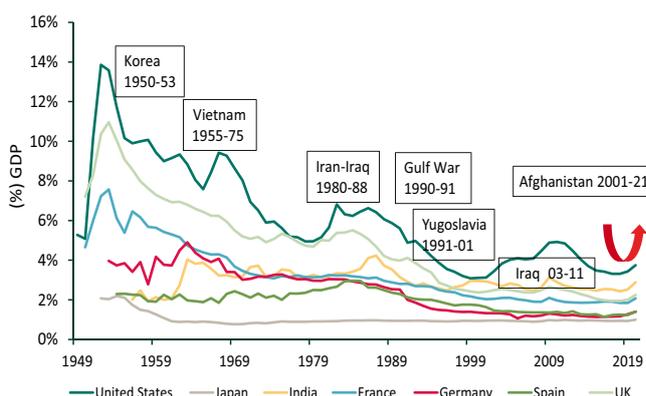
The targets stipulated under RePowerEU (2027/2030) are ambitious and will require the deployment of greater public funds and incentives, which reinforces our bet on the energy transition and particularly in Europe.

Safety: the threat of Russia will drive us towards a more unstable world and the trend of falling military spending will reverse. Against this backdrop, investment in cybersecurity will continue to benefit.

The new Strategic Compass plan by Brussels will see Europe create a “rapid response force” of 5,000 troops - to be operational as of 2025 - dismissing the creation of a common European army.

3. MILITARY SPENDING AFTER WARS

Sources: SIPRI and Banca March



Although no specific funds have been allocated as yet, the decision adopted recently by Germany to allocate €100bn and become the third largest global power by spending on defence - surpassed only by the US and China - suggests the beginning of a long-term trend. Since the invasion of Ukraine, another seven EU members – Belgium, Romania, Italy, Poland, Sweden, Denmark and Spain – have committed to upping their defence budgets.

The battle to protect online security and pare down cyber-risks will also continue to intensify. According to the Centre for Strategic Studies and McAfee, cybersecurity costs and losses from cyber-crime before the invasion of Ukraine stood at over a trillion dollars; more than 1% of global GDP.

We do not expect to see a solution to the Ukraine conflict anytime soon, because Putin’s options for retreat are increasingly limited. Military success continues to elude him just a month before the Victory Day Parade in Moscow’s Red Square, which has commemorated the victory over Nazi Germany ever year since 1945.

In a situation like this - where absolutely anything is possible - the only sensible approach is to channel Aristotle’s iconic assertion that “*the punishment of the liar is not to be believed, even when telling the truth*”. The smart approach, then, is to seek exposure to regions like the US, which are a certain distance away from the eye of the storm and are less vulnerable than Europe in terms of pressure on raw materials.

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