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INTELLINEWS

November 2022

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Economic damage from Ukraine war pushing households into poverty across Emerging Europe

Commission recommends EU grant Bosnia candidate status despite slow progress



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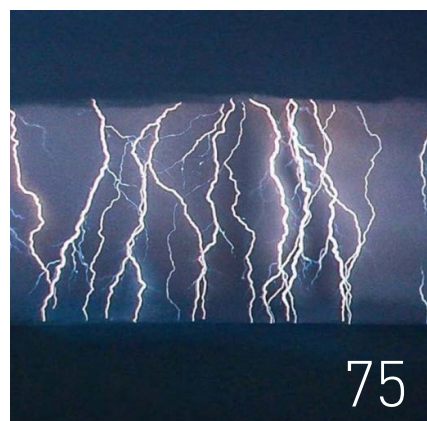
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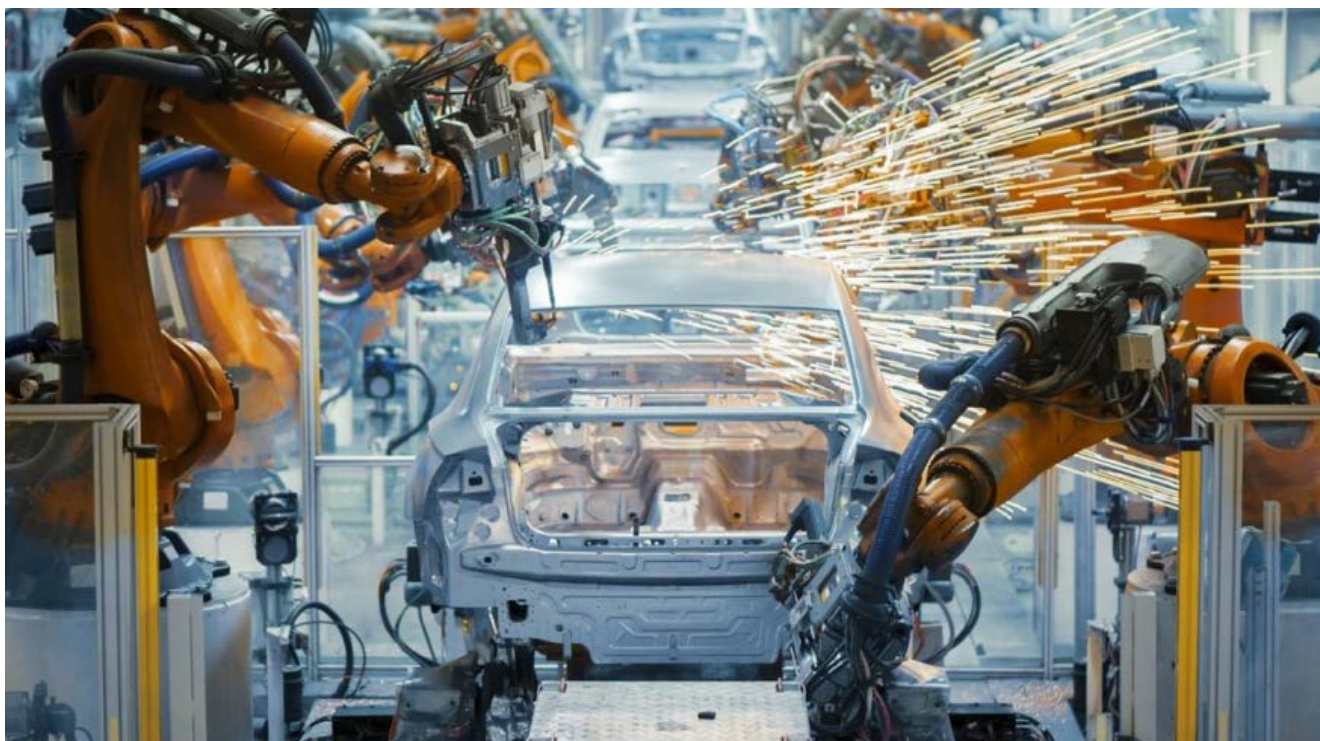
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European car makers will see production fall by up to 40% due to the energy crisis as costs jump more than ten-fold and demand collapses. / bne IntelliNews

# European car production could fall 40% due to energy crisis

**bne IntelliNews**

**E**uropean car production could fall by as much as 40%, or more than 1mn vehicles, per quarter out to the end of 2023 as a result of the energy crisis, S&P Global Mobility said in a report entitled “winter is coming” released on October 11.

Soaring energy prices are driving an increasing number of European industries into loss. As *bne IntelliNews* reported, Europe’s industry is shutting down. Energy-intensive businesses such as metal, fertiliser and petrochemical concerns have already begun to reduce production or stopped work completely after gas and energy prices increased ten-fold this year.

Automotive production is key to several economies in Western and Central Europe that employ thousands of people. Exacerbating the problem is that many Western economies are already in recession, or are about to go into recession, killing off demand for new cars. In a bleak prognosis, the IMF predicted that a third of the world’s countries will go into recession in the next 12 months and that while this year’s crisis will be the worst since the 1970s, next year’s crisis “will be worse.”

Still, so far the car-making sector is holding up well. Hungary’s automotive industry, the country’s biggest manufacturing sector, rose 58% year on year in August, albeit from a low base recorded during the pandemic, and the sector is also doing well in Czechia so far.

S&P Global Mobility said the auto industry’s supply chain was already in trouble after severe supply chain disruptions caused by the coronavirus (COVID 19) pandemic but had started to recover last year as the global economy bounced back. Now energy has risen to all-time highs the industry “may face extensive pressure” from soaring costs or even power cuts, the report said, reports Reuters.

“With energy prices in Europe skyrocketing... a harsh winter could place certain automotive sectors at risk of being unable to keep their production lines running,” the report said.

S&P Global Mobility said costs for car production have already risen to between €687 (\$667) and €773 per vehicle, up from a pre-energy crisis level of €50. Previously the consultant forecasted European car assembly plants would produce between 4mn and 4.5mn units per quarter but has

cut that estimate to as little as 2.75mn to 3mn units per quarter due to the energy crisis.

The slowdown will have global consequences as Europe exports car parts around the globe. Russia's car industry has almost entirely collapsed, as it was heavily dependent on European imports of key components. Russia's car production fell 84% y/y post invasion, but has started to recover somewhat in the last few months, but was still down 62% y/y in August. Russian carmakers have already begun to drop some features like airbags due to the lack of components after sanctions and self-sanctioning regimes came into effect.

For individual countries across Europe, the auto forecaster looked at six factors, including the size of a country's deficit,

debt relative to gross domestic product (GDP), level of energy self-sufficiency and gas storage, Reuters reports.

While automotive powerhouse Germany has relied on Russian gas and is phasing out nuclear power, it has "more budgetary headroom to ride out the energy storm" than some other European countries such as Italy, the report said, adding that European Original Equipment Manufacturers (OEMs) probably have enough financial capacity to ride out the storm this year, but if nothing changes, the smaller manufacturers will start to go to the wall next year.

"I'm worried we'll have some highly skilled craftsman shops in the region either go through forced bankruptcy or just hang up their hats," Edwin Pope, S&P Global Mobility principal analyst for materials and lightweighting, told Reuters. ●

## ENERGY CRISIS

# Bruegel gas use tracker shows a tight market but falling EU consumption

bne IntelliNews

**T**his winter is going to be tough. An energy crisis has already led the EU to spend over half a trillion euros on relief and support. Only last week Germany announced a new €200bn package to deal with the crisis that comes on top of the €80bn it has already spent. And the IMF predicts that a third of the world's nations have already gone, or will go, into recession in the next 12 months. At a recent summit the EU estimates that the bill could rise to €2-4 trillion by the end of 2023. Record high gas prices is a major contributing factor to all these problems, especially in Europe.

"The energy crisis, especially in Europe, is not a transitory shock. The geopolitical realignment of energy supplies in the wake of the war is broad and permanent. Winter 2022 will be challenging, but winter 2023 will likely be worse," Pierre-Olivier Gourinchas, the Director of Research of the IMF, said in a recent blog.

The EU is taking action. The gas storage tanks are now over 90% full just before the heating season starts and, depending on the weather, it seems that Europe can squeak through this winter. A key element will be for Europe to reduce its gas consumption as relatively small reductions make a big difference to the volumes of gas needed. European Commission President Ursula von der Leyen championed a plan to reduce gas consumption by 15% in July in an effort to keep the lights on but while she wanted the



In July the EU launched a plan to reduce gas consumption by 15% to deal with the mounting energy crisis. As of September gas consumption has fallen by 7% on average, but the performance varies widely from country to country.

reductions to be mandatory and EU-wide in the end the plan was massively watered down, with 17 out of the 27 member states receiving exemptions or carve outs.

Belgium-based think-tank Bruegel has been tracking gas consumption and reports that so far Europe has managed to reduce gas consumption by 7%, which will help.

"So far in 2022, we estimate that EU natural gas demand (which does not include storage filling) has declined 7% compared to the average from the period 2019 to 2021," Bruegel said in a report. "Demand in August 2022 was 23% down. Most of this reduction was driven by industry, as households do not consume much gas in September and gas reductions were not apparent in the power sector. For the winter, actual

"The energy crisis, especially in Europe, is not a transitory shock. The geopolitical realignment of energy supplies in the wake of the war is broad and permanent"

### Natural Gas Demand, 2022 vs 2019-21 Average

Year to Date (Jan-Sep)

	Total	Power	Industry	Household
Austria	-4%	23%	-10%	** -10%
Belgium	-14%	-18%	-18%	-10%
Bulgaria	-9%	16%	-13%	** -13%
Czechia	-9%	-1%	-10%	** -10%
Germany	-11%	-3%	-16%	-9%
Denmark/Sweden	-20%	-11%	-21%	** -21%
Estonia	-20%		-21%	** -21%
Spain	2%	21%	-8%	** -8%
Finland	-53%	-58%	-50%	** -50%
France	-1%	46%	-12%	-3%
Greece	3%	9%	-5%	** -5%
Croatia	8%	36%	3%	** 3%
Hungary	-5%	-15%	* -15%	-1%
Ireland				
Italy	-2%	2%	-10%	-3%
Lithuania	-25%	-62%	-22%	** -22%
Luxembourg	-18%	-28	* -28	-10%
Latvia	-30%	-70%	-7%	** -7%
Netherlands	-19%	-21%	* -21%	-17%
Poland	-10%	-21%	-8%	** -8%
Portugal	-4%	8%	-39%	-8%
Romania	-11%	9%	-63%	** -4%
Slovenia	-5%	11%	-6%	** -6%
Slovakia	4%	-40%	10%	** 10%
EU	-7%			

Stars (\* or \*\*) are used to indicate that we can only provide an aggregate value for the two sectors that are marked for a specific country (e.g., for the NL the aggregate power and industry sector reduced by 21%. So we put 21%\* for both sectors, but it is likely that one sector contributed more, and the other less than 21%). \* means industry and power are treated together, while \*\* means industry and households are treated together.

For AT, CZ, GR, LT and SK year-to-date is the period until July as more recent data are not available, while for the NL year-to-date is until June.

Source: Bruegel

household demand reductions and the lowering of gas-burn in the power sector (through fuel switching or electricity demand reduction) will determine by how much industrial gas demand will have to be cut.”

Drilling into the details and the size of gas consumption reduction comparing the 2019-2020 average and 2022 year to date varies widely between countries. The Baltic states and Sweden have all managed to cut their gas consumption by more than 20%, while those states that import no Russian gas – especially Spain and Portugal – have seen barely any change; indeed, Spain, Greece, Slovakia and Croatia have all increased their gas consumption mildly in 2022 compared to the previous two years.

From the two really big gas consumers, Italy and Germany, the former has made very little reduction (-2%), while the former has cut gas use by more than the EU average (-11%).

According to Bruegel most of the big gains in reducing gas consumption have been made by industry and households, with Finland, the Baltics and Sweden standing out, where industry and households account for almost all the savings. The laggards are Spain, Austria, France, Greece, Croatia and Portugal, where power generation has caused an increase in gas consumption.

However, as *bne IntelliNews* reported, Portugal, Spain and Greece do not consumer Russian gas and Portugal in particular is almost entirely dependent on LNG imports under long-term contracts signed well before the energy crisis started, and so has been insulated from the soaring price of gas. ●

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### Sectoral demand reductions year-to-date 2022 compared to average 2019-21



Year to date refers to the period Jan 1st - Sep 30th for all countries apart from Greece, Lithuania, Slovakia (July), Austria, Czechia (August), and the Netherlands (June).

Source: Bruegel

# Polish government's electricity price cap to have only minimal impact on inflation

Adam Antoniak of ING

**A** plan by the Polish government to set a maximum electricity price for households, sensitive consumers, local governments and SMEs – coming on top of the freeze on prices for households up to a certain level of consumption - may cushion the impact of higher electricity prices on 2023 CPI to just 0.2pp - 0.4pp, ING said in an analysis on October 13.

The government announced a freeze on electricity prices up to a certain threshold of annual electricity usage by households and a cap on the electricity price above this threshold.

The maximum price of PLN693 (€144.2) per megawatt-hour (MWh) pertains to the cost of energy only, i.e. excluding fees and taxes. The price cap pertains to annual consumption above 2,000 kWh per household, 2,600 kWh for households with a disabled person and 3,000 kWh for farmers and large families (at least three children).

Below these thresholds, prices are frozen at the 2022 level. At the same time, the government proposed a cap of PLN785/MWh for sensitive consumers, local governments and SMEs, covering up to 90% of their electricity use in 2022.

In 2022, electricity prices (without fees and taxes) for households from the four main regulated distributors (Tauron, Enea, Energa, PGE) range from PLN413.1 to 414.7/MWh. Provided that prices for consumption above the limit of 2000/2600/3000 per kWh are raised to the proposed threshold, the increase will be nearly 70%.

The cost of energy alone, on average, accounts for some 60% of the average electricity bill. The remaining 40% are distribution fees, taxes and other charges.

## Moderate increase in household electricity bills and small impact on CPI

Potential price increases for households are of key importance in terms of the direct impact on CPI. Increases in energy prices for companies and local governments will affect consumer prices indirectly via the gradual pass-through of higher energy costs into prices of final goods and services.

Our survey in the SME sector indicates that price increases have so far been the most frequent business response to expensive energy.

Based on 2018 data, about 70% of households consumed less than 2,500 kWh annually. For the sake of simplicity, we have taken this level as the cut-off point for estimating average price increases for households consuming specific amounts of electricity. This threshold should compensate for households

with higher limits (farmers, disabled, large families).

We do not yet know how the statistical office GUS will approach the proposed solution and translate it into CPI data, but we have decided to plunge in and come up with some preliminary estimates.

Assuming no change in distribution fees and taxes, we estimate an annual increase in the 2023 average household electricity bill of about 8-15%. The range depends on assumptions for the electricity amount consumed above the thresholds.

If the increase is limited to energy prices alone, more expensive electricity bills would bump up the CPI in 2023 by about 0.2pp - 0.4pp.

However, this is a rough estimate. It attempts to gauge the direct impact of prices for households on CPI inflation but does not take into account second-round effects from companies and local governments passing on higher costs to buyers, or a possible increase in the weight of energy in the 2023 CPI basket. We should be able to come up with a more precise estimate when the draft bill is made public.

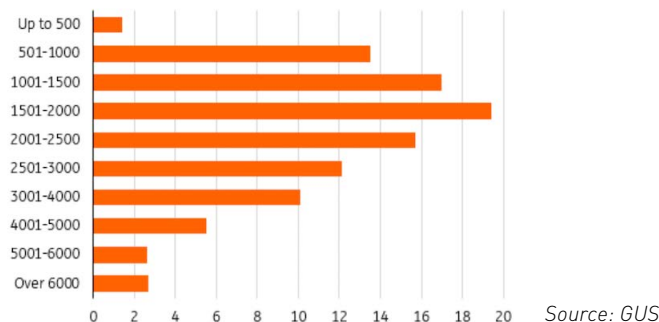
## Headline inflation likely to reach 20% soon

The CPI inflation path for 2023 is uncertain given the uncertainty regarding energy prices. We still await a policy response to high gas prices as authorities may attempt to trim the 2023 price increase for households and sensitive buyers as well.

Meanwhile, petrol prices have risen again amid a strengthening dollar and higher oil prices following OPEC+'s sizeable cut in output targets. In an environment of still significantly rising overall energy costs, the headline CPI inflation may hit 20% late this year or early 2022, up from the latest reading of 17.2% year-on-year in September. ●

## In 2018, the median household consumed 2000kWh of electricity annually

Empirical distribution of electricity consumption in kWh (%)



# Kazakhstan new home to 50 international firms that opted for Russia exit, 50 more could be on the way

## Kanat Shaku in Almaty

**M**ore than 50 international firms have relocated from Russia to Kazakhstan since Moscow invaded Ukraine in late February, while another 56 that have exited Russia in recent months have "expressed their willingness to settle in Kazakhstan".

That's the picture provided by Kazakh Prime Minister Alikhan Smaiylov, who this week brief reporters on the issue. The update on the substantial business relocation amid the economic backlash against Moscow for its war in Ukraine comes amid a substantial relocation of Russian men, sometimes accompanied by families, to Kazakhstan in response to Vladimir Putin's military mobilisation to secure more troops for the war. In the weeks after the mobilisation began in September, Kazakh officials spoke of around 200,000 Russians fleeing to Kazakhstan to avoid the call-up.

How many have stayed and how many have moved on to third countries is unclear. Djoomart Otorbaev, a former prime minister of Kyrgyzstan, and author of the forthcoming "Central Asia's Economic Rebirth in the Shadow of the New Great Game", addressed this and other related issues in a Project Syndicate article published by *The Korea Herald* on October 20, writing: "Bishkek's residents have been confronted with an unusual sight these past few weeks. The streets of Kyrgyzstan's capital are teeming with tens of thousands of educated men with European features – Russian citizens fleeing President Vladimir Putin's 'partial mobilization' of 300,000 reservists to fight his war against Ukraine."

Assessing the substantial movement of Russian companies to Kazakhstan, Kazakh President Kassym-Jomart Tokayev said that officials in the country's commercial capital, Almaty, should settle the relocated companies.

"This will significantly help the economy of our country. Discuss this with the government and the companies," Tokayev told Almaty city officials.

After the outbreak of the war in Ukraine, over a thousand international firms stopped or suspended their operations



Russia is losing out to its "backyard". / CIA, public domain

in Russia, while 320 international firms fully exited the Russian market.

Kazakhstan's deputy foreign minister Roman Vasilenko told German newspaper *Die Welt* in March that companies exiting Russia due to consequences of the war in Ukraine were welcome to move production to Kazakhstan.

On July 14, Kazakh President Kassym-Jomart Tokayev proposed creating "favourable conditions" for approximately 1,000 foreign firms that have halted operations in Russia.

"We're witnessing a global struggle for investment capital. One out of two of the nearly 1,400 major foreign companies have suspended operations or left the Russian market entirely," he said at a government session.

"The government should create favourable conditions for their relocation to Kazakhstan. This will give us a good opportunity to increase production," he added.

The latest figures on firms migrating to Kazakhstan appear to be in line with the country's earlier announced intentions.

Tens of thousands of the Russians who fled Putin's mobilisation may have moved on from Kazakhstan to fellow Central Asian states Uzbekistan and Kyrgyzstan. Among those choosing self-exile, are many skilled information technology workers whom officials in all three countries regard as "prize catches" as they seek to build up local IT industries. ●

"The government should create favourable conditions for their relocation to Kazakhstan. This will give us a good opportunity to increase production"



# Ukraine war leads to traffic jams in Georgia

**Nini Gabritchidze for Eurasianet**

**O**f all the ways the Ukraine war has impacted Georgia, one of the most visible has been the trucks.

Images of endless lines of trucks, anywhere from the mountains of the north to the plains of the south, have become routine in the months since Russia launched its invasion of Ukraine.

That war has caused significant disruption to international transportation routes. Trucks that once ferried goods to and from Russian and Central Asian markets via Ukraine have had to divert because of the war in that country, and shipping giants that once relied on east-to-west Russian railway corridors to and from China also have had to reroute due to international sanctions.

Much of that traffic is now passing through Georgia, a country that for years has touted its potential – hitherto largely unrealised – as a transit hub.

“Instead of Russia, the trucks now pass through Georgia,” one customs official told Jnews, an outlet that operates in Georgia’s south and has for months been reporting on 30-kilometre truck queues near Kartsakhi, on the border with Turkey.

Citing customs statistics, Jnews reported in September that truck traffic through Georgia had increased by 12% in 2022 compared to the previous year, including a 16% increase in traffic between Georgia and Turkey and a 20% rise in traffic between Georgia and Azerbaijan.

Kartsakhi, located in Georgia’s Samtskhe-Javakheti region, is a relatively less-trafficked border point with Turkey. In August, more than 6,000 trucks entered Georgia through this crossing, and more than 8,000 left. Interior Ministry data show that that was more than double the rate of the same period in previous years, including in the pre-pandemic 2019.

Traffic is increasing across all the country’s borders, and it had been increasing even before the Ukraine war boosted it further: Georgia registered more than 70,000 trucks arriving in August of this year, compared to roughly 60,000 in August 2021 and 50,000 in August 2019.

The trucks queued at Kartsakhi have a wide variety of licence plates: from Turkey, Azerbaijan, Belarus, Russia, Ukraine, Kazakhstan and Iran, among others. Jnews has reported that the trucks, waiting in line for days, have been throwing out their trash and “turning the roadside into a dump.”

Kartsakhi – which had not previously seen these sorts of traffic jams – is perhaps the most illustrative of how the geopolitical shifts and war have altered the transportation picture.

Over the past months, Georgian customs authorities have repeatedly reported having to work at their maximum capacity due to “increased road freight traffic” at all border crossing points.

This has included Sarpi, a more heavily trafficked border pass to Turkey in Georgia’s southwestern Adjara region, and Larsi in the country’s north. Larsi is the only land border connecting Georgia and Russia and it also represents a critical lifeline for Armenia, which depends economically on Russia but is landlocked and has no common border with it.

Larsi is perennially crowded with trucks, as poor weather conditions can disrupt traffic across the high-mountain pass. But the congestion has been even worse this year, and Armenia is seeking to start a new ferry service as a detour.

Turkey also has gained interest in the Larsi route. Turkey previously had relied on road transport – much of it through Ukraine – for more than half of its trade with Russia. Many of those trucks now have been rerouted through Georgia, and have been joined by increasing numbers of trucks from other countries in growing lines at Sarpi.

As it has grown as a transit hub, Georgia also has been significantly increasing its own trade with all its four neighbours.

Georgia’s international rail and sea routes, in particular, have risen in significance amid the war-related transportation shifts, boosting interest in the so-called Middle Corridor route.

The Asia-Europe multimodal route avoids Russia by shipping cargo to the south: crossing Central Asia by rail, then by ferry across the Caspian Sea to reach Azerbaijan and again by rail west to Georgia and onward to European ports.



Georgian freight traffic, which had been growing in recent years, has boomed since Russia invaded Ukraine. / Georgian government handout

## Middle Corridor route



International rail traffic through Georgia has been sharply increasing: 477 freight trains arrived in Georgia in August, compared to 356 in the same month in 2021 and 323 in 2019. Georgian Railways reported record-high profits in the first half of 2022.

Georgian ports, too, have reported processing nearly 20% more freight in the first half of this year as compared to 2021.

But there remain obstacles to Georgia taking full advantage of the new transportation opportunities the war has sent its

“We aim to attract greater institutional foreign investment, facilitate projects of regional importance, and strengthen our infrastructural capabilities – thus becoming an actual bridge between East and West”

way. The country has no deep-sea port on the Black Sea, the country's main east-west highway is still under a years-long reconstruction, and the border crossings don't have the capacity to deal with the increased truck traffic.

Georgian leaders say they are paying attention.

“We are [...] heavily investing in our country's infrastructure to increase Georgian transit capabilities for the benefit of the region,” Prime Minister Irakli Garibashvili said in his address to the United Nations General Assembly on September 22. “We aim to attract greater institutional foreign investment,

facilitate projects of regional importance, and strengthen our infrastructural capabilities – thus becoming an actual bridge between East and West.”

In July, Garibashvili went on a tour of Central Asia where he conducted a series of high-level meetings to talk business, including transportation and logistics. The Central Asian countries have so far shown the keenest interest in seeking alternative routes, taking part in regular international meetings with Georgia, Azerbaijan, and Turkey to help develop the route more quickly.

Georgian customs officials have said that border checkpoints are being revamped to help meet the increased freight flows and that they are working closely with bordering countries to find short-term solutions.

The port situation, however, remains murky. The politically controversial Anaklia deep-sea port project was cancelled two years ago. And it won't be until next year that the construction works of the most complicated 52-kilometre section of the main highway are completed.

“We need to make more investments in infrastructure to increase the potential of receiving larger volumes of cargo. However, it's not just about the port. Today, we definitely need a deep-water port and new terminals. We need the railways to be able to carry larger loads,” Mamuka Murjikneli, CEO of Wondernet Express Investment Group, Georgia-based transportation and logistics company, told Business Media Georgia in September. “I think that in the next five years we will be able to receive more cargo and regain the status that our country had historically on the Silk Road.” ●

**Nini Gabritchidze** is a Tbilisi-based journalist. This article first appeared on Eurasianet.

# Russia moots plan for making Turkey a major hub for its gas supplies

## bne IntelliNews

**R**ussian President Vladimir Putin has proposed establishing Turkey as a hub for delivering gas supplies to the EU, in response to the multiple leaks that have rendered the Nord Stream 1 and 2 pipelines inoperable. The proposal has been warmly received by the government in Ankara, but implementing such a project may prove difficult. Turkey could face a potential backlash from the West, while Russia would likely have to cover most of the funding. The project also assumes that some parts of Europe will continue buying Russian gas, despite the EU's ambition to phase out imports, and increasing access to LNG and other alternative sources of supply.

Putin discussed the proposal with his Turkish counterpart Recep Tayyip Erdogan on the sidelines of a regional leaders summit in Kazakhstan's capital Astana.

"If Turkey and our possible buyers in other countries are interested, we could consider building another gas pipeline system and creating a gas hub in Turkey for sales to third countries, especially, of course, the European ones, if they are interested in this, of course," Putin said.

Erdogan noted that both Turkey and Russia had instructed their respective energy authorities to immediately start technical studies on the plan. According to Gazprom CEO Alexei Miller, the project could involve constructing new pipelines in parallel to the existing TurkStream pipeline

"Together with Mr. Putin, we have instructed our ministry of energy and natural resources, and the relevant institution on the Russian side, to work together," Erdogan said. "They will conduct this study. Wherever the most appropriate place is, we will hopefully establish this distribution centre here."

Russia has four routes for sending gas to Europe. First is the Ukrainian gas system, where the gas continues to flow despite the war. It had the capacity to flow upwards of 100bn cubic metres of gas prior to the war, but since then Ukraine has shut down one of its two border points, claiming the theft of supplies by Russian proxies. Ukraine and Russia are also in a renewed dispute over gas transit payments, raising the risk that deliveries could be shut down altogether.

Meanwhile, the 33 bcm per year Yamal-Europe pipeline that runs through Belarus and Poland to Germany has been rendered inop-



Russia's proposal to make Turkey the hub for its gas deliveries to the EU would involve sending said gas through the TurkStream under the Black Sea. / bne IntelliNews

erable since the war started as a result of sanctions and counter-sanctions that Russia and Poland have imposed on each other.

Then there are the Nord Stream 1 and 2 pipelines, with capacities of 55 bcm per year each. Gazprom has acknowledged that a large part of Nord Stream will likely need to be replaced as a result of the leaks. Company CEO Alexei Miller estimated on October 12 that it would take more than a year for the repairs to be completed. One of the two Nord Stream 2 strings is undamaged, and Russia has suggested it could be used to deliver gas if the necessary certification process is completed in Germany. Germany could agree to do this, depending on the stress that its energy system suffers this winter. Several prominent German politicians have called on Berlin to do this, but so far German Chancellor Olaf Scholz's government has not raised this option.

This leaves only the 31.5 bcm per year TurkStream, which runs under the Black Sea and makes landfall in west Turkey. But one of its two strings is used to supply the Turkish market, leaving only 15.75 bcm per year of capacity available for Europe.

Turkey already serves as a key hub of gas flow into Europe. In addition to TurkStream, it also hosts part of the Southern Gas Corridor (SGC) that funnels gas to Southeast Europe from Azerbaijan. It also has several LNG import terminals.

Turkey would have little need for extra Russian gas itself. The country is awaiting the launch of the offshore Sakarya gas field in the Black Sea in early 2023, which will produce 3.7 bcm per year of gas under its first phase of development, and around 15 bcm per year by 2026. It is more likely, then, that Turkey may end up negotiating with Russia to deliver some of the gas it currently buys from Gazprom to Europe instead.

How much extra gas Europe will be interested in receiving from Russia will depend on EU resolve. Some countries heavily dependent on Russian gas and with closer political ties with Moscow will likely push for a later deadline for ending Russian gas imports, and will push for continuing those imports indefinitely. Other non-EU countries such as Serbia will continue receiving supplies from Russia, and expanded transit capacity via Turkey would enable Moscow to cut deliveries through Ukraine. There may also be new markets for Russian gas such as Albania, which currently consumes hardly any gas but is eager to expand its role in order to reduce its reliance on hydropower plants (HPPs). ●

# Will Ukraine suffer in darkness this winter? DTEK's Timchenko believes the energy sector can pull through with help from friends

Dominic Culverwell in Berlin

**R**ussia's extreme strikes on Ukraine's energy infrastructure this week have caused international outrage and concerns that the war-torn country will suffer a cold and dark winter.

DTEK, Ukraine's largest private investor in the energy sector, has been working hard to make sure that doesn't happen. Nevertheless, the challenges are huge, particularly with Moscow's intense focus on destroying as many facilities as possible.

Speaking from a bunker in Kyiv during an air raid alert, DTEK CEO Maksym Timchenko talked about the problems and obstacles that Ukraine is trying to overcome during a briefing on October 13. Hits over the last few days have damaged 30% of Ukraine's energy facilities, leaving thousands of settlements without power whilst forcing Ukraine to stop electricity exports to the EU.

Three of DTEK's power plants were struck, including Ukraine's largest thermal power station (TPP), Burshtyn, which contains DTEK's largest stock of coal. Although the company managed to partly restore operations of two plants, Burshtyn is still only operating at only 50-60%, with five out of 11 power units working. "I hope we can bring back the rest in two weeks' time," he says.

Timchenko made it clear that Russia is not just targeting military objects but critical infrastructure too, beginning with the attack on the Luhansk Power Plant on February 26. The deliberate targeting of energy infrastructure as winter draws closer is designed to put external pressure on Ukraine and exert psychological pressure on citizens, who will soon face temperatures below freezing.

"The main target is generation facilities, mostly related to substations and switch gears, basically the equipment connecting power generation sources to the United Energy Grid of Ukraine," Timchenko explained. "The idea is to destroy the power grid so that we cannot connect and keep operations under a united regime."

With the connections destroyed and damaged, the results are rolling blackouts across the country. To minimise the damage



OMV Petrom and Romgaz are developing the Neptun Deep natural gas deposit in the Black Sea. / OMV Petrom

to their clients, DTEK is working with the electricity transmission system operator Ukrenergo. During blackouts on October 10, the company developed a schedule to inform their employees when electricity would be switched off, depending on the deficit of the capacity.

The situation improved later in the week; however, an attack on a substation on the morning of October 13 posed as a reminder that the situation is increasingly precarious. In some instances, DTEK has lost more than just infrastructure, with a total of three engineers killed in attacks and hundreds of employees injured.

With an increasing number of attacks from the air, particularly from drones, DTEK is protecting its facilities by building concrete blocks around major equipment that connects the stations to the grid. However, this is not always effective, and the company lost a transformer recently after a drone strike. Instead, Timchenko believes air defence is the best solution and is in co-ordination with Ukraine's armed forces.

"We are working closely with armed forces and air defence units and bringing to their attention these attacks," he said, explaining that DTEK is telling the army what specific equipment and what areas are being targeted.

"It can be done easily to bring some equipment to the power station to destroy drones when they approach," he added.

Minister of Energy Herman Halushchenko also called for more air defence from allies earlier this week. In response, the US announced it will speed up the deliveries of two National Advanced Surface-to-Air Missile Systems (NASAMS), while Germany sent the IRIS-T defence system, with three more promised in the near future.

DTEK is attempting to repair the damages imposed on its plants and has a team of eager workers, but is struggling with procuring crucial equipment that connects the plants to the grid. In particular, DTEK needs transformers and switch gears; expensive but vital equipment which Russia is targeting.

“Finding transformers is challenging,” Timchenko explains. “We request from our partners and suppliers this equipment. Also we try to contact the companies operating thermal power stations from the past who can have spare equipment.”

However, for Timchenko, the major challenge is de-occupying the Zaporizhzhia Nuclear Power Plant (ZNPP) that Russian troops captured in early March, escalating fears of a nuclear disaster. Despite calls from the International Atomic Energy Agency (IAEA) for Russia to leave the plant after an inspection found “the presence of Russian military personnel, vehicles and equipment” onsite, Moscow has refused.

With Ukraine’s largest NPP out of Kyiv’s control, DTEK had to compensate by increasing the capacity of other plants by 20%, particularly TPPs, resulting in a depletion of coal supply. Although DTEK accumulated a large amount of coal for the year, stock is running out fast, with 300,000 tonnes burned in one month. Currently, the organisation has 1.2mn tonnes of coal and has developed supply routes through Romania, Poland and Moldova to import 50-80,000 tonnes a month if required.

Nevertheless, Timchenko believes Ukraine “can cope with the current situation in terms of coal supply” but needs a mixture of gas and coal to replace the ZNPP fully. He puts the gas requirements at 2-2.5bn cubic metres, which Kyiv is currently discussing obtaining from the USA or the EU.

“Mixing coal and gas allows us to have enough generational capacity for the winter season,” he stated.

The CEO is also optimistic that Ukraine will not need to rely on EU electricity imports, although acknowledges that this could change if further serious attacks take place. If that is the case, Ukraine has discussed expanding its capacity to import up to

1,000 MW from the Bloc. However, issues lie in connecting Ukraine’s different regions as well as restoring infrastructure in newly liberated territories.

“Today we have enough generational capacity in Ukraine. The problem is bringing this capacity from one region to another,” he said.

“We need to restore supply in occupied territories, like Lyman,” he also claimed, mentioning that DTEK has enough resources and people and is making steady progress.

However, the same optimism doesn’t spread to restarting Ukrainian electricity exports to Europe. Without control of the ZNPP, Ukraine will have to retain its electricity for domestic use, potentially losing out on millions of euros in profit.

“Unless we connect the ZNPP back to the grid, we don’t see how Ukraine could re-export to the EU,” Timchenko said.

Ukraine began exporting electricity to the EU on June 30 after unhooking from the Russian grid the day before the war and synchronising with the European grid a couple of weeks later. It has the potential to export 1,000 MW if the ZNPP returns to Ukraine’s control.

Although the IAEA mission in September triggered some hope that Russia will leave the plant, their blatant rejection of the agency’s orders, as well as the EU’s, has deflated expectations. The head of the IAEA, Rafael Grossi, met with Ukrainian President Volodymyr Zelenskiy on October 13, but Timchenko doesn’t think this will result in much.

“Russians will not allow us to get any power from this station as long as they stay (...) We need to deoccupy this place and then we can think,” he said. ●

## Economic damage from Ukraine war pushing households into poverty across Emerging Europe

Clare Nuttall in Glasgow

**A** new study by the United Nations Children’s Fund (Unicef) finds child poverty has risen by 19% in countries across Southeast and Eastern Europe and Eurasia as a result of the war in Ukraine.

Overall, an additional 10.4mn individuals, or around 2.5% of the total population of 22 countries assessed across the region, will fall into poverty due to the economic shock related to the war in Ukraine, including 4mn children. Thus while children make up 25% of the region’s total population, they will account for 40% of the increase in poverty.

The survey looks at 22 countries across the Eastern Europe and Central Asia region, including Eastern Europe, Southeast Europe, the South Caucasus and Central Asia.

The single worst affected country is Russia, according to the research. Russia’s invasion of Ukraine has rebounded on its own population, with the most significant increase in the number of children living in poverty; an additional 2.8mn children now live in households below the poverty line. That is almost three-quarters of the total increase across the region.



Shoppers at a bazaar in Naryn, Kyrgyzstan, where the war in Ukraine will push 2.8% of children and 1.8% of adults into poverty. / Clare Nuttall

At least an additional half million children in Ukraine will also be plunged into poverty. The actual figure is most likely more, as the projection is based on the International Monetary Fund's (IMF's) spring forecast of a 10% contraction in GDP; with the war dragging on for months already a much sharper economic decline is now expected.

Unicef cites estimates based on IMF growth forecasts from October 2021 (before the invasion of Ukraine) and April 2022 (two months after the invasion) which show that, in the absence of the war, the GDP per capita (USD PPP) for the 22 countries surveyed would have risen to \$24,700 in 2022 from \$23,300 in 2021. What actually happened was a considerably smaller increase to only \$23,600. This means "the war and subsequent economic downturn has cost the region about \$1,100 PPP per person for the 424mn population – or approximately \$462bn PPP in total," the report said.

### Wider impact

While the impact is harshest in Russia and Ukraine, Unicef finds that several Southeast European countries plus Kyrgyzstan in Central Asia will also see a sharp increase in poverty.

Kosovo is likely to be the worst hit with an additional 3.7% of children and 2.1% of adults set to fall into poverty as a result of the crisis. Other badly affected countries include Kyrgyzstan (2.8% of children and 1.8% of adults), Moldova (2.7% and 2.2%) and Belarus (2.6% and 1.1%). Even some EU members are set to see a strong increase in poverty: Croatia (3.1% and 1.7%) and Romania (3.1% and 1.8%).

The exception is Azerbaijan, where the report says poverty is expected to decrease this year. Gas-rich Azerbaijan is expected to benefit from increased demand from European countries seeking to end their dependence on gas imports from Russia.

The problems are not just financial, since child poverty has severe implications for health and education. Unicef forecasts that the increase in poverty could result in an additional 4,500 children dying before their first birthday, and learning losses could be equivalent to an additional 117,000 children dropping out of school this year.

### Burden on poor households

Unicef's report stresses that the burden of the current crisis is failing heavily on poorer households. "The poorer a family is, the greater the proportion of their income that is committed to necessities such as food and fuel," it says.

"The region-wide effect of the economic downturn is truly a crisis for the poor, and a crisis for millions of children. This is because across the region and within countries, the effects of the crisis – and specifically falls in remittances, and increases in food and fuel prices – are not experienced equally. Families with a higher reliance on remittances, and who spend a greater proportion of their incomes on necessities such as fuel and food – primarily the poor and those with more dependents – will be hit the hardest everywhere."

The war and related economic downturn affect families in three main ways, namely higher prices for basic goods (food and fuel); disrupted trade and supply chains, and falling remittances; and increasing uncertainty in business and investment causing a worsening of economic conditions in the long term and stifling the recovery.

Making the problem worse, the current economic downturn, following swiftly after the financial shock of the coronavirus (COVID-19) pandemic, is forcing some governments to reduce public spending or put in place austerity measures.

### The worst crisis

While the Eastern Europe and Central Asia region as a whole grew over the last two decades, there have been a number of crises during that period. They include the global financial crisis of 2008, the annexation of Crimea in 2014 and the subsequent devaluation of the Russian ruble in 2015 and the COVID-19 pandemic. All "led to widespread disruption of markets and supply chains, falls in remittances, and falls in economic growth in the ECA region – and with subsequently serious implications for child poverty risks," said the report. "This is now true for the war in Ukraine."

Unicef's report forecasts the current crisis will be even worse than those that preceded it.

"The current crisis is now piling on more misery for families and children, and worryingly is projected to be the starkest of all recent crises for the region," it says.

"A key concern is that many countries in the ECA region are heavily reliant on Russian markets, and forecasts predict that the economic contraction related in 2022 will be the largest shock in the Russian Federation since the transformation crisis (1992) that followed the collapse of the Soviet Union."

Among the differences from the recent COVID-19 crisis and the current crisis caused by the war in Ukraine, are the refugee flows from the war and more limited fiscal and social protection responses at the national level. ●

# Serbia and Croatia spar over ban on oil transport through Janaf pipeline

Valentina Dimitrievska in Skopje

**S**erbia condemned the EU ban on Serbian imports of oil via Croatia's Janaf oil pipeline on October 6, blaming Croatia for its failure to secure an exemption to sanctions on Russian oil imports.

Croatia and several other EU members decided at the last moment that Serbia would not be exempted from the ban on imports of Russian oil via Janaf, as set out in the original text of the eighth package of sanctions against Russia adopted by the European Commission.

Serbian Prime Minister Ana Brnabic said that Serbia receives 50% of its oil through Janaf, but now it has to pay at least 20% more for oil as it has no alternative oil pipeline.

Serbian President Aleksandar Vucic later told journalists in Prague, where he was attending the European Political Community summit, that the decision to ban the import of Russian oil to Serbia has been postponed until December 1, news agency Tanjug reported.

## Historic grievances

The decision rankled as Janaf was officially put into operation in 1979, when both Croatia and Serbia were part of former Yugoslavia.

"Janaf was created by former Yugoslavia, Serbia and its citizens and it is now being used against us. This decision changes everything," Brnabic told TV Happy, according to the government statement.

Brnabic claimed that Croatia's decision to ban the import of oil via Janaf has nothing to do with the introduction of sanctions against Russia, but it is a "political retaliation and hostile action" by Croatia.

The two countries have a history of tense relations, dating back long before the Croatian independence war with Serbia in 1991-1995. Tensions escalated rapidly in July, after the authorities in Zagreb did not allow Serbian President Aleksandar Vucic to visit the former Jasenovac concentration camp established by the authorities of the Independent State of Croatia (NDH) in occupied Yugoslavia during World War II.

"The decision on oil was postponed until December 1st, but there is no rational explanation for the Croatian intervention, except because I wanted to go to Jasenovac," said Vucic on October 6, as quoted by Tanjug.

Brnabic argued that energy is being used for political

purposes. She pointed out that the EU countries, which have much greater financial aid from the union than Serbia, are exempted from the decision, and only Serbia, at the initiative of Croatia, is not.

"Everything has changed since yesterday and nothing is the same in our relationship with the EU, and also with Croatia," Brnabic said.

Croatian Prime Minister Andrej Plenkovic said in Prague, where he is attending the meeting of the European Political Community, that Serbia can get oil from elsewhere, just not Russian oil, underlining that the Serbian reaction was "stormy and unprecedented".

"Serbia can have all the oil it needs – except Russian," Plenkovic was cited by N1 Serbia.

"If the economy was on the knees ... if the citizens didn't have fuel, that's another thing, but for Serbia to have cheaper oil, and we ... what would we be, fools," Plenkovic commented.

Originally, an exception to the sanctions had been envisaged by allowing transport of Russian oil from the Croatian port of Omisalj through Janaf to Pancevo in Serbia.

One of the media explanations as to why Serbia was not part of the exemption is that the country already imports enough non-Russian oil, so the ban will not cause much damage. Another suspected factor is Belgrade's refusal to align with EU policy and impose sanctions on Russia. ●



Following tougher EU sanctions, Serbia will no longer be able to receive Russian oil through Croatia's pipeline network. / Janaf



## US venture firm launches new fund with exclusive Ukrainian focus

### East West Digital News in Kyiv

Earlier this month ffVC, an international VC firm comprised of several funds in the US and Europe, announced the launch of a new fund exclusively dedicated to Ukrainian founders and startups, East West Digital News reports.

Christened 'ff Blue & Yellow Heritage Fund,' this fund will "invest in startups led by Ukrainian founders, startups relocated from Ukraine and startups that employ Ukrainian refugees." Investments will be made in early stage (pre-Series B) funding rounds.

"While the decision to launch a separate fund to invest exclusively in Ukrainian companies was informed by the [Russian] invasion, it is not rooted in charity," says ffVC.

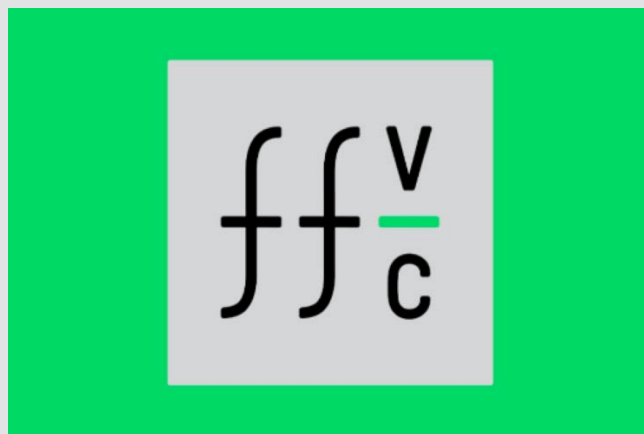
Since the Russian invasion began in February 2022, investment in the region dropped off, concedes ffVC, but "where others see risk, we see opportunity." Not only will the new fund aim "to fill the current funding void"; it will also "help talented teams grow and become large successful international companies."

### Fertile ground for tech innovation

"Ukraine has a storied tradition of world-class innovation and investment success, including the invention of the hard-drive, the market leading software/IT development platform (Gitlab) and messaging platforms that billions use every month (WhatsApp)," argues ffVC.

Supported by a large number of graduates with degrees in technology ("more than in most European countries"), Ukraine's innovation potential was recently illustrated by the emergence of several unicorns founded by Ukrainian entrepreneurs. Meanwhile, a strong R&D sector has emerged in the country, involving "more than 100 major tech companies, including Google, Samsung, Snap, Oracle, Nvidia, Lyft and Ring." ffVC's Ukrainian venture partner Denys Gurak was onboarded to "deepen ties with the local VC and entrepreneurial ecosystems" with the support of Ukraine's Ministry of Digital Transformation.

[www.bne.eu](http://www.bne.eu)



A leading US VC fund has set up a vehicle to exclusively invest into Ukrainian startups. / bne IntelliNews

"The IT sphere has become one of the few that continues to steadily fill the Ukrainian state budget, despite the full-scale invasion," Mykhailo Fedorov, Vice Prime Minister and Minister of Digital Transformation, was quoted as saying.

"Tech companies [...] will become the future recovery of our country. ffVC's Blue and Yellow Heritage Fund will play an important role in [supporting them]. It will invest in our startups and specialists when it is most needed."

### Regional experience

Founded in 2008 and based in New York City, ffVC has nearly \$300mn under management. It claims an "active portfolio of 90+ global companies generating over \$15bn of market value." The ffVC funds not only provide seed funding; the firm says they actively support entrepreneurs in further developments and later-stage fundraising efforts.

ffVC's first investment in a Ukrainian startup was agreed in late 2019, as the fund led a seed round for Respeecher, the maker of a leading voice-cloning software.

In 2020, soon after establishing an office in Warsaw, Poland, ffVC launched its first CEE-focused fund, ff Tech and Gaming, in partnership with local industry players and state institutions. This fund has invested so far in 14 companies in the region "while connecting [the] founders to the US under a one-team approach." ●

"The IT sphere has become one of the few that continues to steadily fill the Ukrainian state budget, despite the full-scale invasion"



# CEE faces 'huge correction' in bond yields, says Erste

Robert Anderson in Prague

Central and Eastern Europe is heading for a “huge correction” in bond yields over the next three quarters, according to Erste Bank, the largest bank based in the region (excluding Russia) by assets.

Erste said it expected a correction of 200 basis points in 10-year yields in Hungary, and from 80-140 bp in Czechia, Poland and Romania, according to a note published on October 10. For Croatia, Slovenia and Slovakia, the Austrian bank predicts a smaller rise of around 30-50 bp.

Bond yield curves will become “even more inverted”, it warns, meaning that short-term rates are higher than long-term ones, typically a sign of looming recession.

The shift in yields follows the end of central bank tightening cycles in the region, as attention turns to the fear of recession rather than inflation, which has been the focus up to now because of supply chain problems and soaring energy and food prices.

Despite inflation still being elevated, all three independent central banks have now halted or at least paused their tightening cycles.

The Czech National Bank (CNB) kept its key interest rate unchanged at 7% in early August, making it the first bank in Emerging Europe to halt the tightening cycle. Erste predicts Czech rates will even start to be reduced in May or June next year.

The Hungarian National Bank (MNB) also ended its tightening cycle on September 27, with rates hiked to 13%, which triggered a sell-off in the forint.

The National Bank of Poland (NBP) also surprised the market by keeping rates at 6.75% at its last meeting on October 5, though Governor Adam Glampinski stressed afterwards that this was a pause rather than a halt.

Romania and Serbia are predicted to end their tightening cycles in 4Q22 and 1Q23 respectively.

Instead central banks have indicated they will use other tools for reducing liquidity, which will support their currencies and indirectly tighten monetary policy. Erste says the CNB will begin selling off the huge foreign reserves it has built up, as a way of supporting the koruna and reducing liquidity in the market, both of which should tighten monetary conditions. The MNB will instead use increases in the reserve ratio and longer sterilisation instruments.

The end of the Central European tightening cycle comes as the European Central Bank (ECB) and the US Fed begin to raise rates, which, along with risk aversion because of Russia's invasion of Ukraine, has put further pressure on CEE bonds.

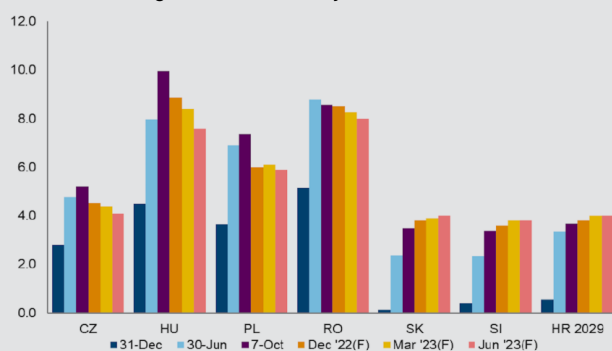
The ECB raised rates in July and August to 1.25% and ended asset purchases. Erste says it expects the main ECB rate to hit 3% next year, which will push 10-year government bond yields up to 3.8% by the end of 2022 and 4.3% by the end of 2023.

The changing global interest rate environment has put Hungary's central bank in a particularly difficult situation because of the fiscal profligacy of Viktor Orban's regime ahead of the general elections in April, and the freezing of Hungary's EU Recovery and Resilience (RRF) and Cohesion Funds over its violations of the rule of law and rampant corruption. The pile-up of economic problems has hit the forint, which is the worst performing currency in Europe so far this year.

Erste says the rise in global interest rates is already having an impact on the cost of government borrowing in the region, at a time when many countries are running high budget deficits because of the cost of helping citizens and businesses cope first with the coronavirus (COVID-19) pandemic and now the surge in energy prices. Fortunately, it says, most countries – apart from Romania – have no urgent foreign currency needs.

Romania's recent expensive eurobond issue has also caused other countries to put their FX borrowing plans “on the back burner”, Erste says, and look to shorter-term local currency domestic options such as Treasury Bills. It predicts, however, that Hungary will make some FX issuances in early 2023, in addition to a CNY2bn (€300mn) Panda bond planned before the end of this year. ●

Forecasted 10Y government bond yields (%)



Forecasted 10Y bond yields / Erste Bank



bne:FX

# Hungarian central bank announces extraordinary measures to halt forint's slide

Tamas Csonka in Budapest

The Hungarian National Bank (MNB) was forced to introduce a number of emergency measures on October 14 to stabilise the financial markets and to halt the decline of the forint, which has broken record lows several times this week. The forint appreciated 3% against major currencies after the announcement, the largest intra-day gain in more than 10 years.

The Monetary Council introduced a new 1-day deposit facility with an interest rate of 18%, which will effectively replace the base interest rate of 13% as the main monetary tool. The policy will stay in place until the forint stabilises, Deputy Governor Barnabas Virag said at a briefing on Friday after the meeting.

Policymakers raised the overnight collateralised loan rate – the top of the interest rate corridor – by 950bp to 25.0%, effective from Friday morning.

The MNB is also introducing a one-day (T/N) FX swap instrument at 17%, designed to ensure the rapid and flexible implementation of tighter monetary conditions in the swap markets.

Policymakers said that MNB is ready to use every instrument in its monetary policy toolkit to ensure market stability in the current turbulent period and “existing challenges warrant the use of targeted and temporary instruments”.

At an online press briefing, Virag blamed the forint's decline on rising FX needs to cover rising energy bills and increasing risk aversion and the increase in short positions against the forint.

The MNB also announced that the central bank would cover the “lion's share” of the FX needed to pay energy imports until the end of the year from reserves. The measure will have a substantial impact on the FX market as Hungary's current account balance, except energy, is showing a surplus, Virag said.

The MNB has remained silent this week as the forint was breaking new records. The central bank has no official exchange rate target and generally does not comment on currency movements. In the past, its low international reserve stock prevented it from direct market interventions to prop up the currency, unlike its Czech peer.

Virag defended the MNB's decision to end the tightening cycle at the last meeting two weeks ago, saying the current 13.0% base rate is “capable of managing fundamental inflation trends”. The MNB had raised the base rate by 1240bp during a 16-month tightening cycle.

It vowed to keep monetary conditions tight by improving monetary transmission. Virag said measures taken to soak up banking sector liquidity have improved monetary policy transmission.

Virag said the September CPI data was “fully in line” with projections, while core inflation was “lower than expected”. Inflation may “rise slightly” in the coming months, but “internal and external factors show the turning point is approaching”, he added. Headline inflation accelerated to 20.1% y/y in September from 15.7% in the previous month, while core inflation shot up from 19% in August to 20.7%.

The next phase of the efforts to keep monetary conditions tight and improve monetary policy transmission will allow the MNB to react to marked changes to risk premiums in the fast-changing wartime environment with the help of flexible instruments, tenders and FX swap instruments, he added.

The stock of overnight deposits had fallen to less than a third, while more than half of liquidity was in long-term deposits, a main target of the central bank.

The 3-, 6- and 12-month Bubor (Budapest Interbank Offered Rate) rates, which serve as a reference for a third of existing mortgage loans and most of the corporate loans, jumped to 16% after the announcement, paving the way for forint lending rates of 20% or higher, financial website Portfolio observed.

The Hungarian forint gained more than 3% against major currencies on Friday, the largest intraday gain in more than 10 years. It was trading 11-13 units below its peak versus the dollar and the euro. The EUR/HUF was trading at 415, up 13% this year, and USD/HUF at 426, some 31% lower than at the start of this year. ●



# Hungarian finance minister raises option of joining ERM-2

Tamas Csonka in Budapest

**H**ungary may seek to join the euro's ERM-2 waiting room this year or next, and the issue is on the government's agenda, said Finance Minister Mihaly Varga at a background meeting with journalists on October 11, where he made it clear that the government is committed to meeting deficit targets for 2022 and 2023.

Varga's comments were aimed at shoring up the exchange rate of the battered forint, which continued to hit new record lows. After the release of the September CPI data, which showed headline data and core inflation soar over 20%, the forint fell to a record low of 429.9 against the euro. The USD/HUF slipped to 443 on Wednesday morning, a historic low.

The Hungarian currency, the third-weakest emerging market currency after the Argentinian peso and Turkish lira, has plunged 5% since the end of September when the Hungarian National Bank wound up its rate-tightening cycle after raising the base rate by 125bp to 13%, the highest in Europe. The forint, which fell 15% against the euro and 36% versus the dollar since the beginning of the year, has been under pressure from the sharp deterioration of the country's external balance due to the country's strong dependence on Russian energy.

The country's economic convergence to the EU average has reached a level where it could enter the ERM-2, which is the precursor to joining the euro area, according to Varga.

Joining the ERM-2 may make Hungary more competitive, given its exposure to the euro area, he said, adding that the government was examining the conditions Croatia undertook to join ERM-2 before its planned euro adoption next year.

His comments could be viewed as the first sign of a possible U-turn by the Orban government on the issue, which has so far shown no willingness to take the technical steps needed to join the euro.

Central bank and government officials previously said that Hungary should join the eurozone if the country's average per capita GDP level converges to that of the EU. Based on 2021 data, Hungary's GDP adjusted to purchasing power parity was 76% of the EU average. The government's economic policy in the last 10 years was based on letting the forint weaken to



Finance Minister Mihaly Varga made it clear that the government is committed to meeting deficit targets for 2022 and 2023. / bne IntelliNews

help exports and mask the country's lack of competitiveness, according to economists.

Varga also spoke about the budgetary outlook for this year, saying the cabinet will stick to meeting the 6.1% deficit target for 2022, which was raised by 1.2pp due to a technical revision after stocking up gas storage buying additional gas.

Parliament will review the 2023 budget, approved in the summer, in December, he said. The budget was approved with a 4.1% GDP growth and a 5.2% inflation target, which has since become outdated. The finance minister flagged recession for 2023 at a recent economic forum and the market is expecting inflation to remain in the 14-16% range next year. Varga made it clear that the 3.5% deficit target in 2023 will be met.

Soaring energy prices have lifted the country's energy bill to \$19bn this year, a 5-6-fold increase, which could be as much as \$29bn, calculated on the highest oil and gas prices this year.

The government expects an agreement on EU funds to be reached this year, and plans to receive the entire funding from Cohesion Funds and the Recovery and Resilience Funds (RRF) in the first half of the year, he said.

Varga said Hungary's deficit can be financed from domestic sources and there is no need to go to the FX market with a large issuance to raise funds or the IMF. The issue of smaller-sized euro- or green panda bonds could be on the horizon, he added. ●

“The Hungarian currency, the third-weakest emerging market currency after the Argentinian peso and Turkish lira, has plunged 5% since the end of September”



# Sistema acquires 47.7% stake in Melon Fashion Group

Theo Normanton in London

**R**ussian investment conglomerate AFK Sistema has agreed to buy a 47.7% stake in Melon Fashion Group JSC for RUB15.8bn, according to a press release on Sistema's website. The stake will be purchased from Swedish Eastnine and East Capital Holding AB, as well as from a group of individual investors.

Sistema says that it will finance the transaction, which is due to be completed by the end of 2022, using a combination of its own and borrowed funds.

Melon Fashion Group (MFG) owns a portfolio of Russian clothing brands including Zarina, befree, Love Republic and Sela. The company, which was founded in 2005, now operates in 181 cities in Russia and the CIS, with over 845 stores.

"Melon Fashion Group is growing fast and demonstrating operational excellence. The transaction is entirely in line with our investment strategy, which is focused on consolidating high-quality assets as well as leveraging opportunities arising from the ongoing market transformation," said Sistema president Tagir Sitdekov.

In 2021, MFG reported that revenue was up 49% year on year at RUB37.5bn as online sales surged. A relatively fragmented Russian apparel market has given leaders extra room for growth, and the group was reportedly eyeing an IPO last year.

"Given the possible interest of other shareholders in the sale of

their stakes, we are ready to consider the possibility of further buyouts," Sistema's press service told *bne IntelliNews*.

"We greatly appreciate the company's development strategy and have huge respect for the management of MFG. MFG has one of the most professional teams in the retail market, under whose leadership the company has demonstrated impressive dynamics of operational and financial performance over the years," the press service added.

The deal makes Sistema MFG's biggest shareholder. The other major shareholders are founder David Kellermann (40%) and CEO Mikhail Urzhumtsev (6%). The remaining stake is owned by a group of private minority investors.

AFK Sistema is a holding company with interests in sectors which include telecommunications, agriculture, financial services and e-commerce. Total assets were valued at RUB1.8 trillion in 2021.

Sistema also has extensive experience in retail, having bought children's goods retailer Detsky Mir when it was only a single outlet. Detsky Mir went public in 2017, bringing Sistema more than RUB60bn to date in share placements and dividends.

Sistema's portfolio also features Russia's e-commerce leader Ozon, whose IPO took place in 2020, and private medicine company Medsi, which includes 120 clinics located in Moscow and other regions of Russia. ●

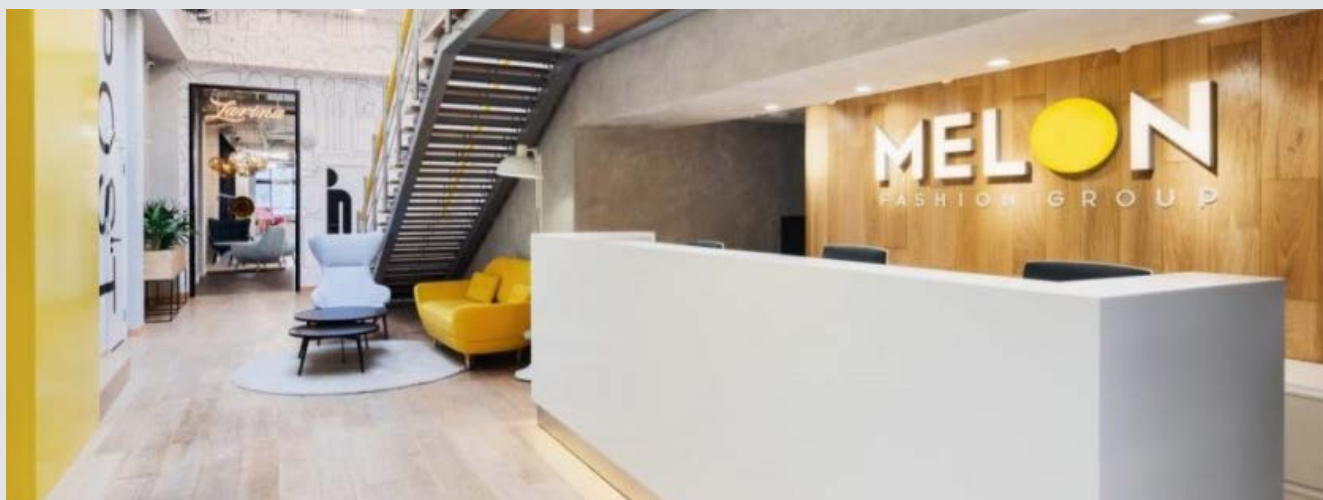


Image: Melon Fashion Group. / bne IntelliNews

# More pain stored up for Emerging Europe in 2023

## bne IntelliNews

There is more pain ahead for Emerging Europe as government efforts to shield populations from the energy crisis and rampant inflation since Russia's invasion of Ukraine have shifted the worst of the economic impact to next year, said the European Bank for Reconstruction and Development (EBRD) as it downgraded GDP growth forecasts for 2023 across most of the region.

The EBRD's current forecasts for growth across its countries of operations in Emerging Europe and the Southern and Eastern Mediterranean (SEMED) are 2.3% in 2022 and 3% in 2023. The development bank thus lifted its projection for 2022 by 1.2 percentage points (pp) but lowered its 2023 forecast by 1.7 pp compared to its last set of forecasts issued in May.

It also warned that the forecasts in its latest Regional Economic Prospects report, published on September 28, are subject to major downside risk should Russia's war in Ukraine escalate or the volume of its gas exports fall further.

Commenting on the changes to its forecasts since May 2022 at a presentation of the report on September 28, EBRD chief economist Beata Javorcik described the region's economic performance in the first half of 2022 as "surprisingly strong", attributed to a large extent to consumers using savings accumulated during the coronavirus (COVID-19) pandemic. Exports also remained at a high level.

"However, the boom [is] coming to end as the impact of the energy crisis, high inflation and uncertainty caused by the war are putting brakes on the economies," Javorcik added.

"We revised upwards our forecasts for 2022, but it now looks bleaker for 2023. We are in for a hard and cold winter."

At the same time, inflation has been soaring, and averaged 16.5% across the EBRD regions in July – higher than at any time since 1998. More price rises are anticipated.

"Inflation does not seem to have peaked yet. In many countries high energy costs have not translated into retail prices paid by households. That means that when governments stop helping out to keep prices low, if energy prices remain high for a while, this will have to happen, so inflation will increase," Javorcik told listeners.

"We are not very optimistic about food prices coming down either. If you look at the futures market, they are expecting food prices to be higher in 2023 than they are today.

"We also see that producer costs have increased in pretty much all our countries of operation faster than consumer

inflation, which suggests firms are not yet passing all increases in costs on to the retail customers."

### Ukraine faces 30% contraction and muted recovery

Ukraine's economy has been devastated by the war, and the EBRD kept its forecast for 2022 unchanged at a 30% contraction, while as the war drags on with no end in sight it now expects a "more muted" recovery of only 8% in 2023. Previously, the EBRD had anticipated 25% growth in 2023, assuming that the recovery would already be underway.

Meanwhile, the EBRD has revised upwards its 2022 forecast for Russia to a contraction of only 5% in 2022, followed by a 3% contraction in 2023.

Professor Sergei Guriev, Sciences Po provost, noted during the presentation that Russia has not – as initially expected after the invasion – entered a macroeconomic crisis, while policymakers have managed to hold inflation in check, helped by the stronger ruble.

However, he pointed out that the strong ruble "is not a proxy for strength, it reflects a decline in imports". Russia has been unable to substitute all the high tech inputs it is now no longer able to get from the West from alternative suppliers such as China.

Javorcik forecast a more severe impact on Russia from the EU sanctions on Russian oil due to come into force in November.

"I think [Russian President Vladimir] Putin's plan is to blackmail Europe during this very difficult winter, but it comes at a huge cost to the Russian budget," Javorcik said. Moreover, she added: "The real shock will come later – the oil embargo coming in in two months will be a real test ... oil matters more than gas for the Russian budget and Putin's ability to continue this war."

### Central and Southeast Europe outperform expectations

The EBRD's forecasts for its three western regions of Emerging Europe – Central Europe and the Baltic states, South-Eastern Europe and the Western Balkans – have all been revised upwards for 2022 after their better-than-expected performance in the first half of this year. However, this will be followed by slower growth in 2023.

Forecasts have been downgraded based on gas supply disruptions and spillovers from slower growth in advanced European economies. The report also notes that the risks to the outlook in the Western Balkans countries have increased, given their fiscal vulnerabilities.

Five countries in particular – Hungary, Moldova, North Macedonia, Serbia and Ukraine – use gas for around two-thirds of their heating, making them most vulnerable to shortages.

There is also the indirect impact of gas supply disruptions or price hikes via Western Europe: "If Germany stops producing that would translate into lower demand for inputs from Central Europe," said Javorcik.

#### Fleeing Russians lift Central Asia and Caucasus economies

There has also been a better-than-expected performance across most of Central Asia and the Caucasus this year, and the EBRD lifted its average 2023 forecast for Central Asia, while those for the three South Caucasus countries were left unchanged.

The EBRD projects GDP in Eastern Europe and the Caucasus (excluding Ukraine) to grow by 4.6% in 2022, with temporary stays by Russians boosting consumption in Armenia and Georgia, a major factor behind the growth in the two countries. Growth is then expected to slow to 2.5% in 2023.

The Central Asian countries are forecast to grow by a similarly robust 4.3% in 2022, then 4.8% in 2023.

"Upward revisions to both years relative to May reflect a boost to consumption driven by public-sector wage hikes, high remittance flows and a sharp increase in shadow trade with Russia, as well as gains in commodity exporters," the EBRD report said.

"We were very worried about the Central Asian countries a few months ago as they are heavily dependent on remittances from Russia and on Russian infrastructure for trade," commented Javorcik.

"However, they surprised us. Remittances remained very strong as labour demand in Russia was high and the ruble remains strong. Central Asia also managed to turn itself into a hub for exports from China."

In the Caucasus, Javorcik said: "Armenia and Georgia did surprisingly well. Their double-digit growth in the first half was given by the exodus of Russians, often educated, IT specialists, who set up companies in Armenia and Georgia. Tourism was also a factor. After Europe closed its airspace to Russian air traffic, Armenia and Georgia benefited."

Meanwhile, in the last week alone around 100,000 people have moved from Russia to Kazakhstan. "If you look at the size of Kazakhstan's population or economy this is not as dramatic as the influx of Ukrainian refugees into Poland. However, it is still important. Many of these people are probably better educated than the average Russian, so in the mid-term it is likely to be good news for Central Asian countries," said Guriev.

However, he stressed that the war is not good for anyone. "In terms of the overall impact on neighbouring countries, there's no doubt things are really negative. Without this war everybody would be better off ... war cannot benefit anybody and everybody loses." ●



bne:Tech

## Russian investment company Kismet Capital Group acquires 100% of Avito from South Africa's Naspers Investment holding

bne IntelliNew

The Russian TMT investment company, Kismet Capital Group, announced that it had signed off on an agreement to acquire a 100% stake in Avito, the world's largest online advertisements platform, from South African holding company Naspers. The deal has been valued at approximately RUB151bn (\$2.4bn).

Kismet has already obtained the relevant permission from Russia's Federal Antimonopoly Service (FAS) and the Governmental Commission for the Control of Foreign Investment in the Russian Federation, the company said in a press release.

The transaction was financed and settled by a banking consortium led by the Russian Agricultural Bank, which is not amongst the Russian banks under sanctions, and the deal is expected to close soon.

The founder of Kismet Capital Group Ivan Tavrin said in a press release: "For Kismet, Avito is a strategic investment that aligns fully with our principles of investing in high-tech market leaders with significant growth potential. Avito is not only an exceptional business with a clear strategy and a professional management team, but it also has a wealth of

talent and intellectual capital.”

“We are pleased to partner with Naspers on this transaction and intend to maintain the strategy of developing Avito as the largest independent platform, while also upholding the best management and motivational practices within the company,” he added.

There had been reports that Russian internet giant VK was interested in acquiring Avito as well as Russian oligarch

“We are pleased to partner with Naspers on this transaction and intend to maintain the strategy of developing Avito as the largest independent platform in the world”

and owner of metals giant NorNickel Vladimir Potanin, but Kismet seems to have pipped both to the post.

A Naspers representative commented on the deal: “Since announcing our intention to exit Avito on May 20, 2022, our goal has been to manage the sale of the business in a responsible and structured way. We believe that this is best achieved through this deal.”

Avito has been for sale since spring, which was announced in May by Prosus, a Dutch investment company that is part of South African investment holding Naspers, reports The Bell. Prosus owns 100% of Avito.

Kismet Capital Group is an investment holding founded in 2016 by Ivan Tavrín that specialises in investments in the technology, media and telecommunications (TMT) sector and has extensive experience in IPOs on international stock exchanges.

More than a dozen firms have been bidding for the company in recent months after it was put up for sale. In the summer, Russian media reported the two main candidates were VK and Potanin. Tavrín's holding offered the highest price, the source told the Bell. He added that Tavrín was an investor who was easy to understand for Naspers, as in 2010 he was a board member of Mail.Ru Group, in which Naspers also owned a large stake.

The company was involved in investments in leading Russian online businesses such as HeadHunter, Cian and Ozon before they went public.

Kismet's portfolio now includes the entertainment holding Media-One (which operates children's TV channel Disney

Channel, music TV channel Muz-TV and entertainment TV channel U), as well as companies from digital outdoor advertising, radio and telecommunications.

As recently profiled by bna IntelliNews, bne IntelliNews' sister publication covering Africa, Naspers (not to be confused with Napster, the music streaming app) is a multinational technology investor in Africa and one of the largest in the world. It is a leading example of a global consumer internet company “that empowers people and enriches communities,” according to its website that is flourishing in Africa's burgeoning tech sector.

Naspers is headquartered in Cape Town, South Africa, and has spread its roots through Southeast Asia, Latin America, Europe and the United States, with market investments in Egypt and Bangladesh. It has been operating for more than a century, as it was founded in 1915.

Tavrín was the CEO of Russian big-three mobile phone provider MegaFon between 2012 and 2016 and led the company's IPO on the London Stock Exchange.

Kismet is also the only company from Russia to successfully list three SPACs (special purpose acquisition companies) on the US Nasdaq exchange. ●

“More than a dozen firms have been bidding for the company in recent months after it was put up for sale”



In the biggest M&A deal since the war in Ukraine started, entrepreneur Ivan Tavrín surprised the market to buy the world's biggest online ad company Avito for \$2.4bn. / bne IntelliNews

# Internet wipeout used by Iran regime to counter protests shuts 300,000 e-commerce stores

bne IntelliNews

Iran has seen the closure of around 300,000 e-commerce stores that depend on social media for business as a result of the government's throttling and disconnecting of the internet during the past month of nationwide protests, *Shargh* has reported.

The situation for businesses reliant on online trade has become so treacherous that some Iranian internet celebrities, famous in the country on platforms including Instagram, have reportedly departed Iran to look for alternative work. Some appear to have left because they have become unpopular with protesting Iranians for not speaking out against the authorities' crackdown on the demonstrations.

Iran's most famous internet food critic, Mashhad native Hamid Sepidnam, who has more than 2mn followers on Instagram, announced on his personal channel that he had left Tehran for abroad. The food blogger was chastised by thousands online, who claimed he fell quiet amid the protests while peers spoke up.

Sepidnam told *bne IntelliNews* that his decision to depart had "nothing to do with the current protests." He was yet to post a statement on his "Mr Taster" food blog to explain his exit.

According to *Shargh*, prior to the igniting of the protests in the country of 85mn in mid-September, Iran's volume of online sales was running at around 750 times the rate of traditional purchases. Internet sales are thought to be a source of income for 9mn Iranians.

The regime's interference with the internet, which has often amounted to an almost total shutdown across the country, has also caused the closure of Iran's cryptocurrency markets. It is estimated that around 12mn Iranians were trading on those markets. Millions of people have been locked out of their crypto wallets.

However, in response to growing anger among businesses and crypto traders hit by the offline market environment, the head of the independent faction in the Iranian parliament, Gholemreza Nouri Qazaljeh, ssaid: "The internet outages and filtering can be justified for today's conditions in society and given the unrest."

[www.bne.eu](http://www.bne.eu)



The offending billboard poster. / bne IntelliNews.

He added "We hope that with the normalisation of conditions, the internet will return to its previous normal state; of course, there was not a lot of satisfaction with the previous state of the internet, because there was a low speed and limited access."

Also amid the information war that has broken out over the unrest, which has sprung to the world's attention for how it is led by protesting women, one of Iran's best-known and admired actresses has proclaimed her support for the protests after discovering how authorities used an image of her in a large "Women of my land" billboard poster raised over Tehran without her permission.

An image of Fatemeh Motamed-Arya and dozens of other images of famous Iranian women, appeared on the billboard put up over Valiasr Square as the authorities attempted to quell the anger among citizens who back the protests.

The move has badly backfired, with Motamed-Arya and others who were not consulted about the use of their image expressing their ire.

Earlier in the week, as the anti-regime protests continued to rage in many parts of Iran, the government switched the message of the banner-poster to a nationalist slogan from a 1941 song. However, the damage was done. The move did little to reduce the anger felt by those who were surprised to find themselves featuring on the billboard.



"In a country where they kill young freedom-seeking people and little girls, I'm not considered a woman," Motamed-Arya cried on camera, while not wearing a hijab, mandatory under the Islamic dress code, as she was driven past the billboard



Referring to Mahsa Amin – the death of whom, following her arrest by Tehran's morality police, sparked the protests – and another victim of the security response to unrest, the actress added in a social media video: "I am a mother, I am Mahsa's [Amini's] mother, Sarina's mother. I am the mom of all those children who've been killed in this country, not a woman among murderers!"

Following Motamed-Arya's objections, film director Marzieh Broumand and Parvaneh Kazemi, a famous Iranian mountaineer, requested that their photos too be removed from the poster.

Broumand wrote on her Instagram: "Gentlemen, remove my photo from the wall under which you oppressed children and young people."

The Iranian cinema director, the creator of several popular films and series for children and teenagers, said that she has always been a supporter of the people protesting and would continue to be so.

Kazemi, who has climbed several peaks above 8,000 metres in the Himalayas, wrote in her Instagram story: "Shame on you that the name of our Iranian women is only used to abuse!"

She also wrote: "I am very angry to see my photo in this picture, while the image of bloodied women and men of my country is imprinted on these streets."

Human rights watchdogs say at least 200 people have been killed across Iran since the protests began. ●

## Hungary's 4iG signs new deal to acquire Israel's Spacecom

### Tamas Csonka in Budapest

**A**cquisitive Budapest-bourse listed IT company 4iG has signed a new contract to acquire a 51% stake in Israeli satellite company Space-Communication over a period of several years. Under the contract, which replaces one signed close to a year earlier, 4iG can acquire a 20% stake in Spacecom in public offerings or private placements as a "first step".

Three years after the acquisition of the 20% stake, 4iG may boost its holding in Spacecom by an additional 31%, pending approval by shareholders and clearance from Israel's Ministry of Communications.

4iG noted that the Ministry of Communications issued approval for its acquisition of a 20% stake in the Israeli company in August, more than half a year after the country's defence ministry blocked the deal due to concerns over the ties between 4iG and the Hungarian government.

According to earlier press reports, concerns were raised by the Israeli security agency Shin Bet about a foreign company controlling Spacecom's Amos satellites, which are also used by Israel's security services.

Spacecom operates the AMOS fleet of four geosynchronous



Israel's defence ministry had blocked 4iG's takeover due to concerns over the ties between it and the Hungarian government. / bne IntelliNews

satellites, offering broadcast and broadband service.

Spacecom's AMOS 3 satellite leases the geostationary orbit held by Hungary under an agreement that will expire in 2024. CarpathiaSat, a 4iG group member, holds the rights to the orbit for a 20-year period from 2024.

Over the years, 4iG has grown from a small IT company to an ICT giant through a string of acquisitions in Hungary and abroad, creating a leading telecommunication group in the CEE and SEE region. In Hungary it is the leader in fixed line, internet, cable, and digital terrestrial broadcasting. The company is majority-owned by Gellert Jaszai, the right-hand man of Hungary's most powerful oligarch Lorinc Meszaros.

First-half net sales of the company jumped 279% y/y to HUF122bn (€290mn) on acquisitions and net profit came to HUF1.6bn, up 226% from a year earlier.

Last month, 4iG and the Hungarian state entered into a non-binding heads of terms with the Vodafone Group to acquire 100% of the telco's Hungarian unit. The transaction would give 4iG 51% of Vodafone Magyarorszag and the state a 49% stake. ●



# Europe's renewable energy supply chain under threat from soaring power prices

Roberta Harrington in London

**E**urope's renewable energy supply chain is under threat from soaring power prices, says Rystad Energy of Oslo. As much as 25% of solar and battery manufacturing capacity in Europe is at risk, says the research firm.

Electricity prices have soared more in Europe since imports of Russian natural gas have been cut in the wake of Moscow's invasion of Ukraine.

The record-breaking electricity prices across Europe are damaging the continent's attempts to build a reliable low-carbon supply chain and reach its decarbonisation targets, said Rystad in research released in early October. Solar and battery manufacturers are especially facing mounting costs, it said.



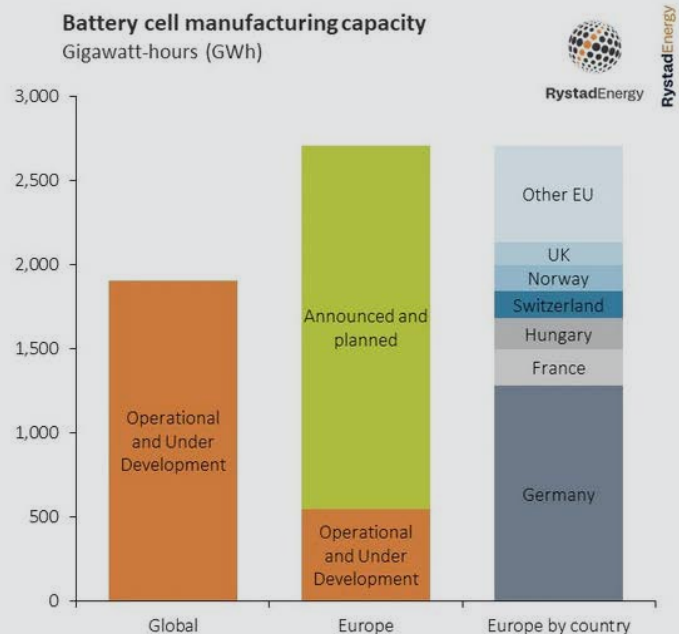
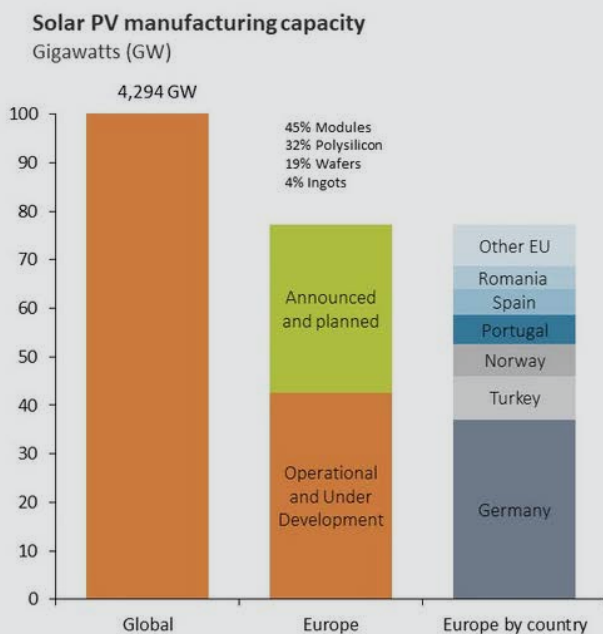
bne IntelliNews

With manufacturers in other regions, such as Asia, enjoying lower electricity input tariffs, European producers are becoming increasingly uncompetitive by comparison, said Rystad.

The Rystad Energy research shows that as much as 35 GW of solar PV manufacturing capacity and more than 2,000 GWh of battery cell manufacturing capacity could be mothballed unless power prices quickly return to normal levels.

These manufacturing processes are energy-intensive, which is leading some operators temporarily to close or abandon production facilities as the cost of doing business escalates.

Unless prices turn around soon, Europe's plans to cut dependence on imported fossil fuels by boosting installed



Source: Rystad Energy's SolarSupplier Solution, Battery Solution, Rystad Energy research and analysis

renewable generation capacity and electric vehicle (EV) usage could be derailed, warns Rystad.

“High power prices not only pose a significant threat to European decarbonisation efforts but could also result in increased reliance on overseas manufacturing, something governments are eager to avoid,” said Audun Martinsen, Rystad Energy’s head of energy service research. “Building a reliable domestic low-carbon supply chain is essential if the continent is going to stick to its goals, including the REPowerEU plan, but as things stand, that is in serious jeopardy.”

“High power prices not only pose a significant threat to European decarbonisation efforts but could also result in increased reliance on overseas manufacturing”

REPowerEU is a plan launched earlier in 2022 to reduce dependence rapidly on Russian fossil fuels and fast forward the green transition. Russia invaded Ukraine in February.

Rystad notes that European electricity prices have risen to unprecedented levels in recent weeks due to unplanned nuclear and hydropower plant (HPP) outages, soaring demand for cooling during an oppressive summer heatwave and reduced gas deliveries from Russia.

Daily average spot power prices in Germany – Europe’s leader in solar and battery cell manufacturing capacity – have, at their highest, surpassed €600 (\$592) per MWh, while rates in France have topped €700 per MWh.

During peak hours, European power prices have spiked to €1,500 per MWh, unsustainable levels for consumers, including the industrial sector, warned Rystad. Although prices have retreated significantly since these record highs in August, rates remain in the €300 to €400 range, many multiples above pre-energy crisis norms.

In recent years, Rystad pointed out that Europeans have benefited from reliable and affordable electricity. Low-carbon manufacturers have also predicated their build-up of production capacity on stable power prices of around €50 per MWh, said Rystad.

Although Europe’s solar manufacturing capacity is relatively modest on a global scale – making up only 2% of total capacity – any shutdowns or abandonment of projects would have significant long-term negative consequences, said Rystad.

The EU is trying to grow its domestic manufacturing capacity. The EU has targeted 20 GW of production capacity by 2025,

and although 35 GW of projects is currently planned, many have not secured funding, increasing the risk that these projects will fall through if high power prices continue, said Rystad in its research note.

In Norway, electricity costs have risen six-fold, leading the energy intensive solar panel manufacturing industry to consider shutting down for the remainder of 2022.

With Europe expected to be short on gas for several years and high electricity prices to continue as a result, attracting financing and investment for solar manufacturing plants could prove challenging, predicted Rystad.

For its part, battery cell manufacturing – crucial in the EV and battery storage supply chain – is even more energy-intensive than solar manufacturing, and Europe is a major global player.

The EU currently boasts about 550 GWh of capacity of battery cell manufacturing, representing 27% of global operational capacity, estimates Rystad.

Announced projects under development are set to boost that total significantly, increasing capacity to 2.7 TWh, positioning the EU as a global leader, continued Rystad. However, those are now at risk and the car manufacturing and battery storage sectors could struggle to source European-made batteries as a result, the research firm said.

One example is Britishvolt’s signature giga-sized battery factory in Blyth in the UK – which would add 30 GWh to the continent’s manufacturing capabilities. It has already been delayed to mid-2025 due to rising energy costs and the need for additional fundraising.

With Chinese manufacturers enjoying much lower power prices, European manufacturers’ plans to rapidly scale production could be challenged. Depending on how long elevated power prices continue, a slowdown in EV adoption

“With Chinese manufacturers enjoying much lower power prices, European manufacturers’ plans to rapidly scale production could be challenged”



# Nord Stream leaks: a catastrophe for climate goals

Richard Lockhart in Edinburgh

The explosions on September 25 at the Nord Stream 1 and 2 pipelines in the Baltic Sea off the Swedish and Danish coasts could create a climate catastrophe that is just beginning to be realised, although it offers rare opportunities to measure the exact impact of methane emissions on the environment.

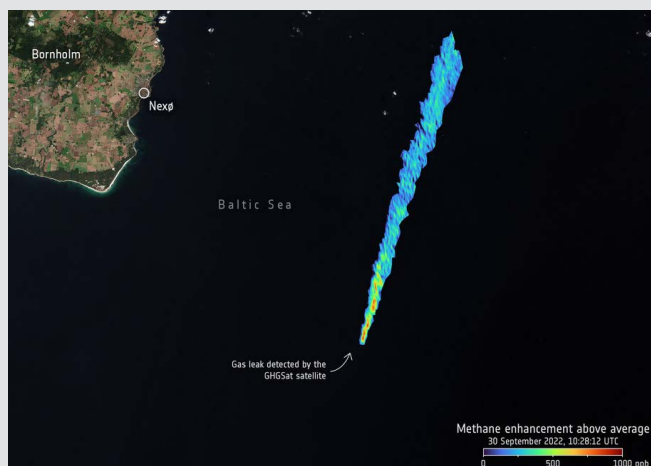
Already dubbed the worst methane leak ever, the three explosions, which created three holes in the two systems, which each consist of two pipes, have released about 300,000 tonnes of methane, causing a 700-metre-wide pool of bubbling water in the Baltic Sea.

The explosions, which the Ukrainian government immediately blamed on Russia, while the German government suggested sabotage, have created large releases of methane, the scientific name for natural gas.

The danger is that methane, over a period of 20 years, is up to 80 times more dangerous than CO<sub>2</sub> in terms of global warming, although after 20 years it becomes less dangerous than CO<sub>2</sub>.

The leak will make it more difficult for Europe, and indeed the world, to meet climate change goals, although the exact effects of the released gas on the environment are just beginning to be realised.

Before the leak, meeting the Paris Climate Agreement's goal of limiting the global temperature rise to 1.5°C would require



Gas bubbling at the Explosion site in the Baltic Sea / Swedish Coast Guard

methane emissions to fall by 45% by 2030, the UN's Global Methane Assessment said in 2021. Such a reduction would avoid nearly 0.3°C of global warming by 2045.

The Nord Stream methane leaks have the potential to cause chaos for efforts to reduce methane emissions over the next two decades, and could increase the already high danger of failing to meet net zero by 2050.

## Explosions

The explosions took place at a depth of 80-90 metres just outside Danish and Swedish territorial waters. This means that sophisticated and advanced underwater technology, or even a submarine, would have been required.

While Germany and the EU pointed the finger at Russia, the Kremlin denied any responsibility, pointing to explicit threats by US President Joe Biden and others ahead of the war that the US would shut down Nord Stream 2 if Russia invaded Ukraine. Russian media also highlighted that a US helicopter was seen in the vicinity on September 25.

The United Nations Environment Programme (UNEP) said it was biggest single release of methane ever.

## Nature of emissions of CH<sub>4</sub> compared to CO<sub>2</sub>

Methane's main danger is that it is 80 times more damaging in the short term than CO<sub>2</sub>, say experts. On the other hand, methane stays in the atmosphere, about 15-20 years, a much shorter time than CO<sub>2</sub>, according to the International Energy Agency (IEA). It dissipates faster than CO<sub>2</sub> but is a much more powerful greenhouse gas (GHG) during its short lifespan, meaning that cutting methane emissions would have a rapid effect on limiting global warming.

Methane is responsible for around 30% of the rise in global temperatures since the Industrial Revolution, the IEA said in March, noting that global methane emissions had risen by 5% in 2021

## Global methane pledge and goals

The UNEP's International Methane Emissions Observatory (IMEO) warned that the leak had occurred at a time when it is imperative to reduce emissions. Indeed, methane was

a major focus of the COP26 conference in Glasgow in 2021, when countries agreed to reduce methane emissions by 30% by 2030, while the gas also featured in the US-China bilateral climate agreement agreed at the event in Scotland.

The Global Methane Pledge could account for 800mn tonnes of CO<sub>2</sub>e reductions by 2030, according to Climate Action Tracker.

Meanwhile, the IEA warned that its Net Zero Emissions by 2050 Scenario required energy-related methane emissions to fall 75% by 2030.

### Security

The explosion took place against the background of Russia's invasion of Ukraine and Western retaliatory sanctions on the Kremlin.

Russia had already stopped gas exports to Europe via Nord Stream 1 at the end of August, while Nord Stream 2 had never operated commercially.

The explosions now mean that any hope of using Nord Stream 2 as a gas import route by Germany is scuppered, and pose serious questions about Europe's, and especially Germany's, reliance on imports of Russian gas.

Nevertheless, Manfredi Caltagirone, the head of the IMEO, warned that the environmental effect of the ruptures poses far more serious long-term questions for the world's ability to meet its net-zero goals.

He warned that the damage to the pipeline posed a problem beyond energy security. "This is the most wasteful way to generate emissions," he said.

The one ray of hope from the leaks is that the sudden discharges of methane into the atmosphere will offer scientists new insights into how methane affects the climate and will increase the knowledge base required to combat global warming.

### Tools for measuring impact of CH<sub>4</sub>

The disaster in the Baltic Sea offers researchers better opportunities to measure the impact of the leak without government or companies making it difficult to assess because of official denials or difficulties in accessing the site.

In 2021, major emissions were confirmed in Texas and Central Asia, while Turkmenistan caused a third of large emission events from oil and gas seen by satellites. In 2022, a gas leak at oil wells in Mexico produced 40,000 tonnes of methane

These were detected and monitored by emerging satellite technology, which can discover, monitor and measure methane leaks that were previously unknown or were difficult to measure accurately. Common sources include gas pipelines, oil wells, fossil fuel processing plants and landfills.

For example, data from the TROPOMI instrument on the

European Sentinel 5P satellite, which is part of the Earth-observing constellation Copernicus, has detected methane at an oil and gas pipeline in Kazakhstan and at oil and gas production facilities in Turkmenistan.

Tropomi's operations have detected preventable emissions from oil and gas fields in Turkmenistan. The installations should have built hardware that would flare off or burn the methane, thereby preventing it from leaking into the atmosphere.

However, the satellite has detected that this is not happening, suggesting that flaring is not taking place, either deliberately or because the technology is not working.

### In comparison

Putting the Nord Stream leak into perspective, the world's coal mines knowingly release the same amount of methane, 300,000 tonnes in total, every 2.5 days, while the mines released 43.5mn tonnes of CH<sub>4</sub> in 2021.

Meanwhile, the Danish government said that the climate impact of the gas leak corresponded to about one-third of the country's total climate impact in one year. This is the equivalent of 778mn cubic metres of natural gas.

Meanwhile, the US oil and gas industry intentionally releases 300,000 tonnes, an amount that could perhaps be labelled a "Nord Stream," every two and a half weeks, Bloomberg reported.

What this means is that while the leaks in the Baltic are attracting global attention as a one-off disaster, similar methane emissions of equal size are happening every week across the world.

If the Nord Stream leaks are a climate catastrophe, then the world needs to know that similar climate catastrophes are happening all the time.

The methane escaping Nord Stream represents the amount of methane emitted every single day from oil, gas and coal energy systems worldwide.

On October 3, the Swedish prosecutor closed off the site of the leaks, pending investigation in to what it said was "suspected gross sabotage".

While investigations continue, and accusations about who is responsible and what the effect on security in the Baltic Sea read might be, the negative effects on the environment will outweigh any geopolitical impact.

The world must also learn that while the gas leaks can be regarded as isolated developments, they have highlighted that catastrophes of similar scale, reach and impact are happening on a continual basis.

The world is experiencing "daily Nord Streams" as it continues to pump out emissions and use up fossil fuels. ●



HIGH INFLATION  
ENERGY CRISIS  
CLIMATE CHANGE  
WAR IN UKRAINE  
LIVING COSTS  
RELATIONSHIP  
CHANGE

# THE FRACTURED WORLD

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Ben Aris in Berlin

**P**utin's war is fundamentally changing the make-up of the world. And that is not a good thing. While it is tempting to say the Cold War is back, the changes are more subtle than that: the Cold War was a clash of two ideologies – communism and capitalism – whereas today even Russia has a capitalist system and is deeply integrated into the global economy. But the global economy is being broken into two camps: a US-led bloc made up of largely G7 members and a Sino-Russia led bloc largely composed of Emerging Markets in Asia, Africa and Latin America.

The two camps will still trade and invest in each other, but there are now extreme government-imposed restrictions that will act as a brake on growth, a reversal of globalisation and result in persistently higher inflation and lower productive amongst other things. Just how this will play out, just how much commerce will remain between the two sides, or indeed if the clash will lead to a global war, remains unclear. But what is already clear is that the change is already doing a lot of damage and the global economy will take years to recover.

“The world economy is fracturing into China- and US-aligned blocs. This will result in shifts in supply chains and reduced technology and investment flows between the two over the coming decade. Geopolitical considerations will play a greater role in economic policy than they have for a generation. If the

shifts are gradual, economies and financial markets in much - but not all - of the world will adapt without too much cost. However, antagonism between the blocs means that the risk of a more abrupt decoupling will cast a shadow over the outlook,” Capital Economics said in a paper that looked at the fracturing of the global economy.

The sanctions regime on Russia has accelerated the reversal of decades of increasing globalisation that already started during the coronavirus pandemic. The most obvious example is the complete remake of the energy system in Europe that has functioned smoothly since the 1970s and sparked an energy crisis that is likely to get worse.

“Since the beginning of 2021, European gas and electricity prices have recorded a rapid increase, which, with a slight delay, has now been affecting households and businesses since summer 2022. We are at a point where the situation is so dramatic that [western] small and medium-sized enterprises, in particular, could fall into insolvency without government support. Private households are also dependent on state aid given that electricity and gas costs have been exploding. In this environment, the growth outlook has therefore deteriorated considerably,” Erste Bank said in its recent attempt assess the changes.

The US has already slapped extreme sanctions on Russia, effectively excluding it from the global financial system

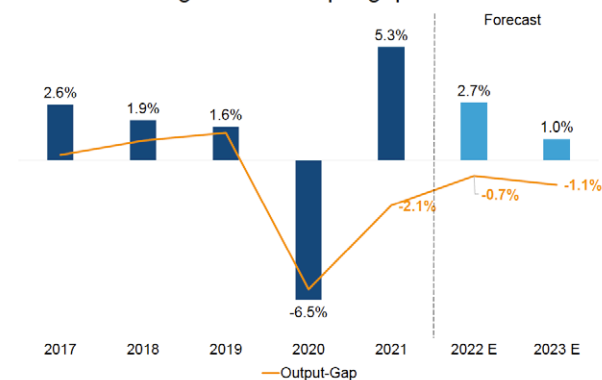
and cutting it off from essential technology, but in the second week of October things went up a gear after the US widened its technology war by introducing extremely harsh export controls on China that experts say will “destroy its semiconductor sector” overnight. China is now as cut off from US hi-tech as Russia.

Europe is also closing its markets to Russia, banning the import of raw materials and the exports of high-tech products and basic inputs that Russian industry needs to function.

The breakup is accelerating the deglobalisation trend that was already underway before the war in Ukraine broke out in February. The coronavirus (COVID 19) disrupted long supply chains stretching from Beijing to Berlin and companies were remaking them, looking for suppliers closer to home to buy some immunity from the next pandemic. “Supply security” has become the post-pandemic by-word.

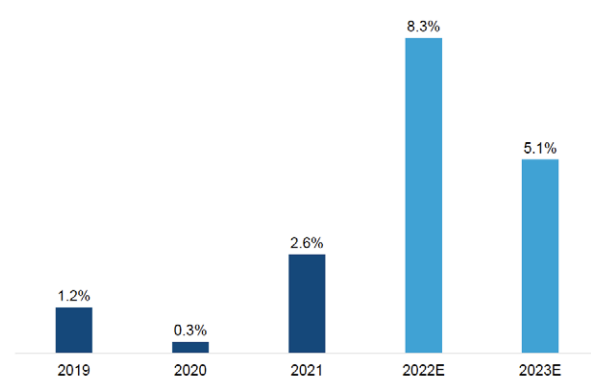
Sanctions have only catalysed this deglobalisation and are being entirely driven by worsening foreign relations. Russian oil ships needed only a few days to sail to German ports, but now already spend weeks at sea to deliver Siberian oil to customers in India. Likewise, factories in the EU heartland have had to abandon Russian coal and buy it from Australia on the other side of the planet adding to the costs and inconvenience that eats into prosperity. The Russian induced energy crisis has also led to the

**Energy crisis dampens growth outlook**  
Eurozone GDP growth vs. output gap



Sources: Eurostat, Erste Group Research

**Significant increase in inflation expected for 2022**  
Eurozone inflation 2019 – 2023e



Sources: Eurostat, Erste Group Research

## Seven factors slowing long-term global growth

Oxford Economics outlined seven dangers the global economy faces in the coming years:

- Alongside near-term recession risks, global growth also faces longer-term headwinds. These include demographics, weaker productivity growth, regional shifts in economic importance, slower growth in China, deglobalisation, and climate change. So, although we also see a few upside risks, our baseline forecast is for world growth to slip to just 2% per year by 2040.
- Looming recessions in several economies are a longer-term growth risk as well. Recessions caused by deliberate disinflation – potentially the sort we face now – have on average resulted in 2%-4% lower G7 GDP in the long run compared with an extrapolated pre-recession trend.
- The global demographic drag is significant. Labour supply growth in advanced economies will halve in 2020-2030 compared to the previous decade, with an even starker decline in emerging economies. Further improvements in the quality of human capital will not be able to offset this.
- China's slowdown is a big deal given how much it has contributed to global growth over the last decade. Growth in other regions such as India and Africa will not be able to offset this. Concerns about deglobalisation are often exaggerated, but the trend away from global trade liberalisation is clear and we think technological 'decoupling' between advanced economies and economies like China and Russia is a genuine risk that would have global costs.
- The transition to net zero will be difficult to manage with a wide range of potential outcomes. Without well-targeted structural policies, it could cut world GDP by around 2% by 2050.
- Some of these headwinds can be mitigated by clever policymaking. But the best chance of better-than-expected long-term growth comes from a step up in productivity growth from technological improvements, such as robotics. But productivity growth has been slowing and is subject to downside risks from recent global shocks and signs of convergence of productivity growth in emerging economies with that in advanced economies.

closure of large energy intensive industries in the EU alarmingly fast.

The bifurcation is also undermining the multinational institutions. The WTO has already been largely sidelined, but the IMF's effectiveness could also be in jeopardy if it is seen as being controlled by the US. The BRICS countries already banded together to set up the BRICS bank, a development bank owned by the leading Emerging Markets without US involvement.

The UN could also be badly affected. During the golden years of globalisation following the collapse of the Soviet Union, the number of Security Council vetoes fell to next to nothing, while the number UN peacekeeping missions expanded vastly as the global community got used to working together. Both those trends are likely to be reversed now as the UN returns to something similar to its Cold War polarisation.

The immediate cost of the fracturing of the world will be a global slowdown. The director of the IMF Kristalina Georgieva said at the fund's annual meeting in October that the cost of the current economic dislocation would be \$4 trillion between now and 2026, but the EU alone has already spent nearly €1 trillion on relief and subsidies to deal with the energy and cost of living crises before the heating season has got under way. That bill is only expected to grow.

Economists say that Europe has probably already gone into recession and the downturn will probably persist through most of next year. The hope is that the recession will be short-lived, but if it persists, fuelled by persistent inflation and stubborn energy crisis then there is a danger of "recession scarring," according to Oxford Economics.

"[Worsening inflation and the persistent energy crisis] carry with them a high risk of long-term scarring. An historical analysis by Blanchard et al. looking at 23 advanced economies over 50 years found that around two-thirds of recessions were associated with output being below the extrapolated pre-recession trend 3-7 years later and





in a significant share of these cases, the rate of output growth being lower too ('super-hysteresis'). Similar results are visible in research by Cerra and Saxena and for emerging markets, in a recent World Bank study. The mechanisms by which these permanent losses may occur are varied, including human capital losses due to unemployment, delays to investment that are not fully recovered, and damage to innovation from lower rates of firm formation," Oxford Economics in its look at the long-term consequences of the current crisis.

To avoid the worst case scenarios Pierre-Olivier Gourinchas, the Economic Counsellor and the Director of Research of the IMF, warned in a recent blog that central banks will have to strike a delicate balance between aggressively hiking rates to curb inflation, but not to overdo it and falling into a deep recession that will be difficult to climb out of, but also difficult to avoid.

"There are risks of both under- and over-tightening. Under-tightening would further entrench inflation, erode the credibility of central banks and de-anchor inflation expectations. As history teaches us, this would only increase the eventual cost of bringing inflation under control," Gourinchas said. "Over-tightening risks pushing the global economy into an unnecessarily severe recession."

And all of this assumes the stand-off with Russia does not descend into general or even nuclear war, which now has a non-zero chance of happening.

The world has entered into a polycrisis, as economist Adam Tooze has dubbed

**"There are risks of both under- and over-tightening. Under-tightening would further entrench inflation, erode the credibility of central banks and de-anchor inflation expectations"**

it. However, with so many moving parts and so much uncertainty in the progression of the war in Ukraine, it is impossible to say how bad things will get, according to Liam Peach, an emerging market economist with Capital Economics, and Tomas Dvorak, an economist with Oxford Economic in a recent podcast with *bne IntelliNews*.

**Globalisation & supply security**

A golden decades-long supercycle of low inflation and large productivity has just come to an end. The gains were driven by the alignment of globalisation of commerce, a revolution in technology, and the end of the socialist experi-

ment. The three billion people living in the East were united with the three billion people living in the West and business boomed. All three of those tailwinds have come around the compass and are now headwinds.

There have been three episodes of globalisation so far: 1870 to 1914, 1945-1971 and the most recently following the end of the Cold War in 1990 to 2018, according to Capital Economics.

In the last one cross-border trade flows increased five-fold and foreign direct investment (FDI) was up seven-fold. Not only was trade globalised but financial flows were too. That is exactly what is being undone now.

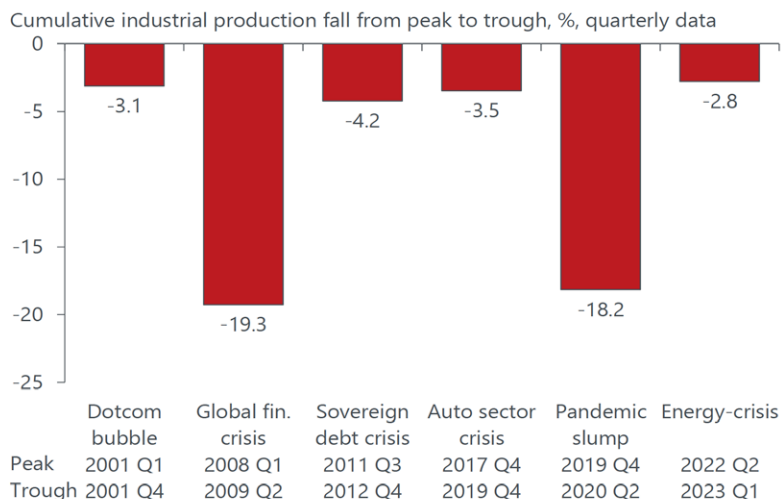
Undoing globalisation will extract a heavy toll on productivity and so hobble growth going forward as we are likely entering a new super-cycle of high inflation and low productivity gains. That will have political consequences too.

"Productivity growth in both the G7 and EM slowed sharply after the oil shocks in the 1970s and again after the global financial crisis [in 2008]. A moderate recent recovery is now under threat from the further shocks related to the pandemic, soaring energy prices, and Russia's war on Ukraine," Oxford Economics said in a recent note.

In the 1970s when globalisation started, the world enjoyed a boost from favourable demographics and rising productivity.

"These factors now constitute headwinds. Most of the world faces a demo-

**Eurozone: Industrial recessions**



Source: Oxford Economics/Haver Analytics

graphic cliff, globalisation is stalling or reversing, resulting in diminishing efficiency and productivity,” says *bne IntelliNews* columnist Les Nemethy in a column about the polycrisis.

The demographic problem is worst in Europe where the population is falling, and crashing in some countries like Spain and the Baltic States, but populations are in decline in many countries in the world and in all of Russia, China, India and Brazil. The only country with a growing population in the two big blocs is the US and almost all of Africa, which has the fastest growth in the world.

Populations around the world are already facing a cost-of-living crisis induced by the coronavirus pandemic and the stress signs are already visible. Protests appeared in Albania in March and since have broken out in a score of countries including Ghana, Czechia and Germany. So far, these protests remain limited to Europe’s poorest countries or the political fringe groups in the richer ones, but the clash between Russia and the West will increase social tensions as the polycrisis increasingly impacts populations in the form of higher bills and rising unemployment.

In one indicator, a new study by the United Nations Children’s Fund (Unicef) finds child poverty has risen by 19% in countries across Southeast and Eastern Europe and Eurasia as a result of the war in Ukraine. Overall, an additional 10.4mn individuals, or around 2.5% of the total population of 22 countries assessed across the region, will fall into poverty due to the economic shock related to the war in Ukraine, including 4mn children. While children make up 25% of the region’s total population, they will account for 40% of the increase in poverty.

The single worst affected country is Russia, according to the research. Russia’s invasion of Ukraine has rebounded on its own population, with the most significant increase in the number of children living in poverty; an additional 2.8mn children now live in households below the poverty line. That

is almost three-quarters of the total increase across the region.

At least an additional half million children in Ukraine will also be plunged into poverty. The actual figure is most likely more. The World Bank recently estimated that a quarter of Ukraine’s population is already living in poverty and that will rise to 55% next year.

Capital Economics estimates that expanded trade was responsible for half of the acceleration in productivity growth in emerging economies after 1990 and globalisation also contributed, through trade links and the free movement of low-cost migrant workers, to keeping developed world inflation pressures low. Britain boomed in the noughties, but an army of “Polish plumbers” kept wage inflation and hence cost rises down. The fall of the Soviet Union and the accession of the new Central European countries to the EU, along with more open borders, and the explosion of the Internet and technology in general, all contributed to the globalisation bump to productivity gains.

By 2010, 97% of world goods exports (and 98% of commercial services exports) came from members of the WTO, according to Capital Economics, and the globalisation drive began to run out of steam. Then the system was hit by three shocks: former US president Donald Trump trade war on China;

the coronavirus pandemic; and now Russia’s invasion of Ukraine.

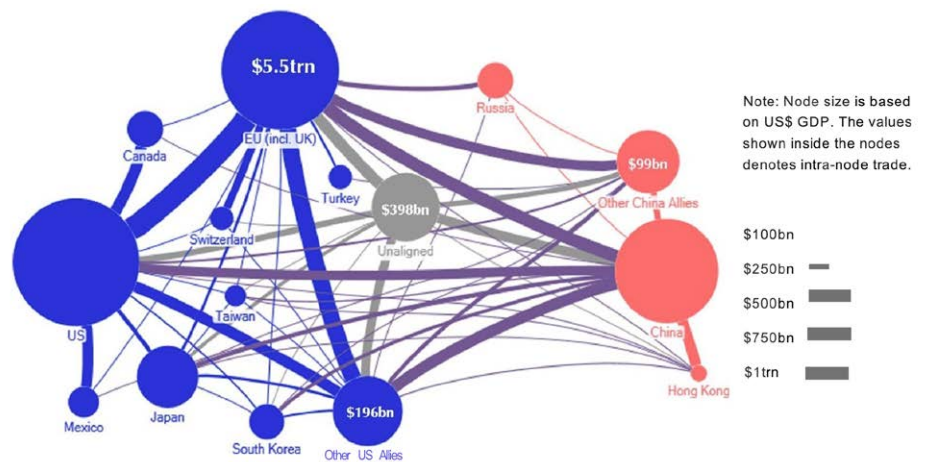
Having said that the fracturing of the world is not the same as deglobalisation.

“Apart from a few categories of goods deemed politically sensitive or strategically important, most trade between the US and China-aligned blocs will continue as before. And where production does shift away from China, it is likely to move to other EMs within the US-aligned bloc, rather than relocating back to advanced economies,” Capital Economics says.

Russia remains a capitalist society and its businessmen will continue to try and trade with the rest of the world, which in return will continue to want to source Russian commodities and Chinese goods that have not been sanctioned. That will result in significant sanctions leakage as *bne IntelliNews* has already explored in a series of articles. Fracturing is driven by governments, not companies.

But global trade is very lopsided. The trade between the US and China-aligned blocs amounts to between a quarter and a third of global trade, which is the share of trade that is vulnerable to fracturing, according to Capital Economics. And two thirds of China’s exports go to the US bloc whereas imports make up only 15%, making China very exposed to sanctions.

### Goods & Services Trade (\$, 2019)



Sources: IMF, WTO, Capital Economics

These three things have shifted thinking and introduced the idea of “supply security” that is increasing dislodging “cheap” as the main consideration for where to build your factory. “Reshoring” or even “friendshoring” have become fashionable terms, while other companies simply choose to hold bigger inventories of key inputs.

The disruption in supplies and the potential for even worse disruptions if China and Russia start to restrict their exports of key commodities has filtered through to governments that are now actively pursuing policies to break their dependencies on key inputs from the Sino-Russian bloc, undoing decades of cross-border investment and the *raison d’être* of globalisation. US and EU that have both launched strikingly similar action plans that identify the following classes of goods as “strategic”.

“The significant overlap between the studies suggests that Western governments have a shared view on the inputs that are either most vulnerable to disruption or most important strategically and for which measures to address supply chain vulnerabilities are most needed,” says Capital Economics.

The Western world’s reliance on China’s rare earth metals is already well known but the coronavirus pandemic revealed that the West is also heavily reliant on China for medicine. According to the US-China Economic and Security Review Commission, around 40% of the generic drugs sold in the US have a single global manufacturer, most of them dependent on active pharmaceutical ingredients sourced from China.

The US review also highlighted its dependency on Taiwan-based Taiwan Semiconductor Manufacturing Company (TSMC) semiconductors, including for weapon’s manufacture, adding to Taiwan’s strategic importance for Washington. The European Commission identified 137 products in its six focus areas for which the EU is highly dependent on imports from outside the EU. China is the source for more than half of these imports by value.

**Classes of “strategic” goods**

USA	EU
<ul style="list-style-type: none"> <li>• Semiconductor manufacturing &amp; advanced packaging</li> <li>• High-capacity batteries</li> <li>• Critical minerals strategic materials, elements</li> <li>• Pharmaceuticals &amp; active pharmaceutical ingredients</li> </ul>	<ul style="list-style-type: none"> <li>• Semiconductors</li> <li>• Batteries</li> <li>• Raw materials (including rare earths and others on a “critical raw materials” list)</li> <li>• Active pharmaceutical ingredients</li> <li>• Hydrogen</li> <li>• Cloud and edge computing</li> </ul>

Source: Capital Economics

For its part, China is also actively working to break its dependence on imports from the West. “And it has been at it longer,” Capital Economics comments. China launched its “Made in China 2025” technology roadmap in 2015 that includes explicit targets for self-sufficiency in many areas. Russia has also tried to kick start its high-tech sector and promote innovation, but all these efforts have resulted in abysmal failures.

**Tech wars**

Europe is at the disadvantage in the energy war with Russia, which remains a major supplier, but where the West dominates is in its control of technology.

The collapse of the Soviet Union came at a very inopportune time for Russia as the almost two decade of chaos that followed means that it missed out on two

world to put a man into space, Russia is even further behind with electronics (although not with software). During the war in Ukraine, the Russian army has been dismantling washing machines to raid their chips to use in replacement missiles as Russia has no domestic production to speak of. The sanctions on the export of machines and electronics to Russia are by far the most effective and will have devastating long-term consequences, condemning its economy to stagnation in the years to come.

With Russia already effectively cut off from almost all Western tech, the US took things to a new level in October by imposing sanctions on China that has destroyed its semiconductor industry overnight, bring down the same sort of crippling sanctions on Beijing that are already in place on Russia.

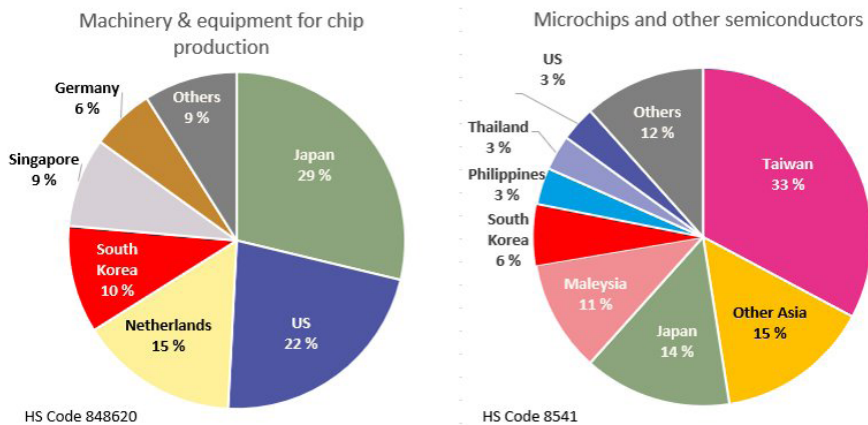
“The Western world’s reliance on China’s rare earth metals is already well known but the coronavirus pandemic revealed that the West is also heavily reliant on China for medicine”

revolutions in the development of precision tools, as featured by *bne IntelliNews* a year ago. Experts say that it is simply not possible to Russia to catch up with the West in less than a generation if not longer. Almost half of Russia’s imports over the last three decades have been machinery and equipment as it has been unable to fill this gap on its own.

Despite being the first country in the

The Biden administration released a series of export controls that carry extreme penalties: any US person or company exporting restricted technology to China or just working there for a tech firm will be stripped of their citizenship and could serve long prison sentences at home. There’s also a licence requirement for the export of American tools or components to China-based fabrication plants. Overnight all US executives and companies working

## Japan, Taiwan and the US were the top providers of semiconductors and semiconductor production equipment to China in 2019.



Sources: Comtrade, Macrobond and BOFIT.

in China left the country as the new rules were suddenly put in place.

The controls have caused the “complete collapse” of China’s semiconductor industry, according to one expert. “This is what annihilation looks like: China’s semiconductor manufacturing industry was reduced to zero at a stroke,” an entrepreneur who tweets under the name Lidang wrote in a thread translated by Jordan Schneider, a senior analyst at Rhodium Group.

“To put it simply, Biden has forced all Americans working in China to pick between quitting their jobs and losing American citizenship,” Lidang wrote. “Every American executive and engineer working in China’s semiconductor manufacturing industry resigned yesterday, paralysing Chinese manufacturing overnight.”

The decision is an overt and aggressive move to cut the Sino-Russia block off from the latest technology forever and ensure the US maintains a hegemonistic technology lead over the rest of the world. Critically, not only will these rules doom the Sino-Russian block to long-term lower productivity, but it should also ensure the US maintains a large lead the production of advanced weaponry.

“I don’t need to tell you that advancements in science and technology are poised to define the geopolitical landscape of the 21st century,” US National Security advisor Jake Sullivan said in

remarks rolling out the new technology strategy on September 16. “They will generate game-changers in health and medicine, food security, and clean energy. We’ll see leap-ahead breakthroughs and new industries that drive our prosperity. And, of course, new military and intelligence capabilities that will shape our national security. Preserving our edge in science and technology is not a “domestic issue” or “national security” issue. It’s both.”

The White House has rapidly beefed up its technology drive and recently launched the US CHIPS act that includes \$52bn of subsidies for domestic semiconductor manufacturing over the next five years, with a ban on recipients of that money from expanding semiconductor manufacturing in China and other “countries of concern” over the next decade.

It has also been bullying semiconductor global giant TSMC to open factories in the US. TSMC is one of only three companies capable of producing sub-10nm semiconductors. High-end semiconductors are extremely difficult to make and thanks to its expertise a staggering 54% of the world’s chip production has become concentrated in TSMC’s factories in Taiwan. The other two companies are America’s Intel and South Korea’s Samsung. China’s leading chip maker Semiconductor Manufacturing International Corporate (SMIC) has a 6% market share but cannot make the sub-10nm chips the leading three

companies can. That puts the world’s entire high-end chip making production capacity inside the US bloc.

TSMC is planning to invest \$40bn in new factories this year, but one of them will be in Arizona, its only plant outside of Taiwan. The decision to build in the US was made “at the insistence of the US government,” TSMC founder Morris Chang said in a recent interview.

The US has started a tech war that it intends to win. Sullivan outlined the US plan starting with “recharging the engine of American technological dynamism and innovation.”

“The EO on Biotech and Biomanufacturing ensures that we not only design the next generation of medicines, materials, and fuels here, but also make them here. From lab to fab, as they say,” Sullivan said.

The second pillar is developing, attracting, and retaining top talent. But the third pillar is extreme protectionism in technology.

“The third pillar is protecting our technology advantages, and preventing our competitors from stealing America’s intellectual property, and using our technologies against us or their own people,” Sullivan said. “On export controls, we have to revisit the long-standing premise of maintaining “relative” advantages over competitors in certain key technologies. We previously maintained a “sliding scale” approach

that said we need to stay only a couple of generations ahead. That is not the strategic environment we are in today.”

Sullivan explicitly outlined a wartime strategy that specifically named Russia as an enemy and named technology sanctions as weapons.

“If implemented in a way that is robust, durable, and comprehensive, they can be a new strategic asset in the US and allied toolkit to impose costs on adversaries, and even over time degrade their battlefield capabilities,” Sullivan said.

Now that weapon has been rolled out and used against China. Chinese Foreign Affairs Ministry spokeswoman Mao Ning accused the US of “abusing export control measures to wantonly block and hobble Chinese enterprises”.

“Such practice runs counter to the principle of fair competition and international trade rules,” Mao said. “It will not only harm Chinese companies’ legitimate rights and interests, but also hurt the interests of US companies.”

### Stagflation

The oil shock in 1973 and an energy crisis in 1979 plunged the world into a decade of miserable stagflation where production collapsed but prices remain stubbornly high, laying the ground work for a string of financial crises that struck in the 1980s. Stagflation is back.

The IMF warned in April that a repeat of the 1970s experience is a major threat and again in its October outlook said central banks urgently need to do something about inflation, but they must tread careful. Failing to curb price rises will make taming inflation more painful later, whereas overdoing the rate hikes will plunge the world into a deep recession that will also permanently slow growth. There is not a lot of wiggle room between these two extremes.

So how are regulators doing? The key to rate hikes is to set the prime rate above the rate of inflation – to make sure banks are offering real positive interest rates, which will encourage people to save their money rather than spend it. However,

despite the increasingly aggressive hikes put in place this year, real interest rates are mostly negative (red in the heatmap). Most central banks across Europe have fallen behind the curve.

CPI inflation, monetary policy interest rates, and real interest rates. Enter the names of countries in the box to see individual or groups of countries’ data.

As the [heatmap shows](#), real interest rates are in the red across much of Europe, with the Baltics and Moldova in particularly bad shape where inflation is well over 20% in all four states. In Poland, Hungary and Czechia inflation is 17.2%, 20.1% and 18% respectively, whereas the prime rates are half that at 6.75%, 11.75% and 7% respectively, leaving all three countries with deeply negative rates, even after a series of emergency rate hikes in Hungary in recent weeks. Capital Economics says that rates are set to stay high for a while longer.

Russia’s emergency rate hike to 20% days after the invasion of Ukraine in February stands out as a blue box in the middle of the chart, but the Central Bank of Russia (CBR) has been cutting

prices, which only make up about a third of the basket.

“The eurozone inflation final estimate for September was revised to 9% y/y, marginally down from 10% in the preliminary estimate. The revision is mostly cosmetic and does not alter the picture of strong inflation pressures which are not yet diminishing. To make it worse for the ECB, there is also a historically high dispersion within eurozone countries, with inflation rates varying from 20% among Baltics countries and around 6% in France,” Oxford Economics said in a recent note. The ECB recently was forced to put in a 75bp rate hike for the first time ever and economists say more large rate hikes are on the way.

Against the extraordinary inflation pressures, the coming global recession will be disinflationary in its own right, so the CBR can afford to cut rates faster than inflation is falling. CBR governor Elvia Nabiullina is currently more worried about soft landing the contracting Russian economy and allowing negative real to encourage spending and growth, otherwise the contraction will overshoot, and the recession

“Despite the increasingly aggressive hikes put in place this year, real interest rates are mostly negative. Most central banks across Europe have fallen behind the curve”

rates fast since then. Russia currently the only country in Europe where inflation is falling and the regulator has gone back to easing monetary policy. (chart) But the Central Bank of Russia’s (CBR) lock down of the financial system days after the invasion of Ukraine means its macroeconomic results are seen as largely artificial.

There is some room to manoeuvre in the rate setting as much of the inflation is driven by things that central banks can’t control: 70% of the current inflation is driven by rising food and energy

becomes unnecessarily deep. Monetary policy meetings have become like driving a car in a slide on an icy road as everyone pumps the brakes carefully, trying to avoid losing control.

### Two blocs’ raw materials

The Russians have a legend that when God was making the world he was flying over Siberia when the tarpaulin on his sled came loose and rained down riches – oil, coal, diamonds, gold and every kind of mineral – onto the land below. So, he froze it to prevent anyone from stealing this treasure.

As the world coalesces into two blocs the distribution of mineral and energy resources is very unevenly distributed, as are the trade relations.

China exported \$521bn worth of goods to the US in 2021, while Chinese exports to Russia stood at \$59bn, down from around \$140bn the year before. Similarly, India's top trade partner is the United States, which accounted for 18.1% of the total 2021, worth \$71bn, whereas Russia is not even among India's top 25 trade partners.

The breakup will not have a major impact on the US-aligned bloc, other than to make problems in sourcing some raw materials, but it will have a much bigger impact on China-led bloc. China's own current economic slowdown will also be a problem for both the bloc and the global economy.

"One consequence is that even if not much appears to change for advanced economies, the shape of the world in 2050 could be very different from what many currently suppose. The share of global output accounted for by the China-bloc has increased sharply over the past three decades, from 10% in 1990 to 25% today. But this surge will peter out over the next few years, in large part due to the productivity sapping effects of fracturing. The China-aligned bloc's weight in the global economy won't increase substantially from here," says Capital Economics.

What remains unclear is how severe the fracturing will be. So far China, while supporting Russia, has kept enough distance to avoid becoming the target of sanctions itself. Currently China's trade turnover with the west is around \$1 trillion a year and it has another \$1 trillion invested in US T-bills. Beijing has invested heavily in developing its technology sector but is not self-sufficient. As the tensions rise, and they will continue to rise, smaller poorer countries will find it increasingly difficult to stay out of the fray.

A full break is not possible as the global economy is now too deeply intertwined. The West's biggest vulnerability is

many of the exotic materials needed in modern manufacturing are produced or refined in Emerging Markets and not Developed Markets. China has limited supplies of some rare earth metals, but it dominates the refining of most of them. In Europe, Ukraine happens to be the only producer of the noble gas neon that is essential in the production of lasers. And Russia is famously home to large deposits of most of the elements on the periodic table as well as food and oil products.

The majority (57%) of global supplies of coal come from the China-led bloc, with China alone accounting for over half of the world's production and Russia making up another 6% of global supply. As coal is bulky proximity makes a difference and the EU imported 46.7% of its coal from Russia – the highest share of any of the fuels imported to the EU from Russia.

Coal imports from Russia was banned in April as part of the fifth package of sanctions that came into effect on August 10, but since then the EU has been forced to ease these sanctions again as it was unable to source enough coal from elsewhere.

Europe's oil and gas dependency is much more significant as *bne IntelliNews* reported in a deep dive into oil and gas and the sanctions leakage that has already begun. But the production of oil and gas globally is

much more balanced between the US- and Chinese-led blocs.

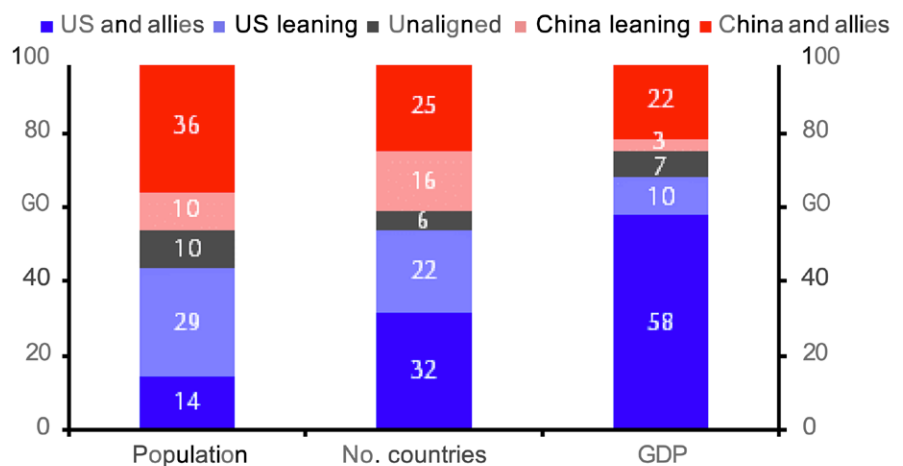
The two blocs are also fairly well balanced on food security, producing enough for their own consumption. Russia's power in agriculture is its large share in the narrow traded-grain business and that specifically affects Africa and the Middle East, which import large amounts of Russian grain.

But these are all well-established commodities with decades of investment behind them and multiple producers. Where the scales are heavily tipped in the Sino-Russia bloc's favour is in the new commodities which have risen in importance recently thanks to technological advances. Lithium and cobalt in particular are the new kids on the block due to the electric vehicle revolution and their production is heavily concentrated in just a few countries.

China plays a particularly important role here as although it doesn't have a wide range of despoils, it has invested heavily in the refining of these more exotic materials and typically has a 50% market share or more in the sale of the refined metals.

"To conclude, the US-led bloc looks in a fairly good position to secure supplies of food and energy, but China holds the cards on supply of metals, notably those needed to transition to a green economy," says Capital Economics.

#### The shape of a Divided World (%)



Source: Capital Economics

## Fractured financial flows

One of the most crushing sanctions imposed on Russia was the SWIFT sanctions only days after Russia's invasion of Ukraine. The US has in effect weaponized the dollar and ejected Russia from the global financial system.

Russia was already actively de-dollarizing before the war in Ukraine started, but it has redoubled its efforts since. It set up its own equivalent of SWIFT in 2014 the System for Transfer of Financial Messages, to reduce the risk of sanctions imposed on Russian businesses and banks. Despite Russian declarations on the effectiveness of this system, SPFS has suffered from a number of shortcomings, including high transaction costs, system availability, and security requirements, which have undermined its reliability and usefulness.

China is due to join the SPFS system in 2022 and India said in 2019 that it was also interested in joining, but neither country has followed through yet. Iran is another candidate to join after it was banned from SWIFT in 2012.

At the same time Russia set up a card settlement system in 2017, the MIR payment system that is meant to serve as an alternative to the US-based Visa and MasterCard system. MIR has already been accepted in 11 other countries, although US pressure recently forced Turkey's leading banks to abandon the system, followed by Egypt's banks a few days later.

China too is concerned with the dominance of the dollar and there is a general trend to settle trading bills in national currencies. From almost zero, Russia and China settled 41.5% of their trade in national currencies in 2020. The use of rupee-rubles in bilateral transactions has quintupled recently.

Since new extreme sanctions were imposed this year, Russia is rapidly going through a process of yuanization its financial system as much as it can; Russia already has the largest share of yuan in its reserves basket of any country in the world and the number

of banks offering yuan-denominated deposit accounts in Moscow has gone from one to 20 since the war started.

Whereas the first two episodes of globalization were driven by the improvement of shipping and especially the advent of steam powered ships, the last episode was driven by the improvement in the speed of communications and the transfer of large amounts of data that allowed for financial integration. The daily turnover on FX markets soared from \$500bn a day in 1989 to \$6.5 trillion in 2019.

"A key pillar of the so-called "Washington Consensus", which shaped global economic policy in the 1990s and 2000s, was a belief in floating exchange rates and open capital accounts. This loosened restrictions on central banks' ability to create money (subject to them meeting their inflation targets), and then allowed that money to cross borders more freely," says Capital Economics.

During the third wave of globalisation countries steadily dismantled controls that had previously restricted the movement of capital. In emerging economies, this liberalisation often formed part of IMF programmes. This is why the SWIFT sanctions will be particularly crippling for Russia as integration into the global financial system is a crucial element in driving its growth.

This financial integration has been most intense in the US-aligned bloc. By 2020 claims of China-aligned countries on US-aligned countries were \$3.6 trillion and US-aligned claims on China-aligned were \$3.1 trillion, however, claims amongst US-aligned countries between themselves was \$65 trillion by 2020. The "global financial system" remains very much a developed market phenomenon.

The US has been by far the biggest beneficiary of globalization and the changes wrought to the global financial system. It has only enhanced the power of the US in the global financial system as an estimated 50% of all this trade that is sent by SWIFT in dollars and 60% of

central bank reserves are denominated in dollars, according to Capital Economics. Russia and China's efforts to switch to using their own currencies to settle trade deals is very much at the margin of the global financial system.

"The dominant use of the dollar in cross-border transactions has increased the centrality of the US within the global financial system. In effect, the US now provides the financial plumbing for the world economy," says Capital Economics.

Nevertheless, the global financial crisis in 2008 and the technology sanctions being imposed now have already slowed the expansion of cross-border bank transfers.

"The reduced growth of financial flows may also reflect the fact that many of the gains from the IT revolution in finance have already been reaped," says Capital Economics, adding that tougher banking regulation that followed the Great Financial Crisis, such as the Basel III and IV rules, have also made it more difficult to make international transfers.

Going forward trade is likely to grow in line with GDP growth, rather than in the boom years of the last globalization episode where trade grew much faster than GDPs. And as firms become more cautious and shorten their supply chains or re-shore factories, trade may start to grow more slowly than GDPs. Europe has already seen its trade plunge into the biggest deficit on record this year as a result of the dislocations caused by the war in Ukraine.

The dollar is likely to retain its dominant position in global trade despite the fact it only accounts for 10% of global GDP. Any replacement has to serve three functions: act as a unit of account; a medium of exchange; and be a store of value. Any currency can be a unit of account, but to be a medium of exchange the currency must have deep pools of liquidity. The euro could possibly challenge the dollar and is widely used inside the EU, but neither the ruble nor the renminbi meet all these conditions. ●



Majority EU-financed projects such as the Warsaw metro could now be in danger if Brussels freezes funding. / www.shutterstock.com

# European Commission reportedly to withhold most of Poland's Cohesion Funds for rule of law failures

Wojciech Kosciński in Warsaw

**T**he European Commission will freeze a substantial part of its Cohesion Funds to Poland unless Warsaw backtracks on its contested judiciary reforms, Polish and international media reported on October 17. The reports were immediately denied by Poland's radical right-wing government.

If true, the move would show that Brussels is no longer penalising Warsaw for what it regards as Warsaw's violations of the rule of law by just withholding the payments from the

EU's Recovery and Resilience Fund (RRF) as previously, but is now using the much larger Cohesion Funds.

It would put Poland in the same basket as Viktor Orbán's Hungary, which is also facing a freeze of both RRF and Cohesion Funds, and indicate that both sides are now digging in for a long conflict that could last until Poland's general election next year.

Reportedly at stake now is €75bn in Cohesion funding, which Brussels earmarked for Poland in its budget

for the years 2021-2027, as well as €31bn from a separate funding pool to be directed at Polish regions. Only 1%-1.5% of cohesion pre-financing has been made available, the newspaper *Rzeczpospolita* reported.

At the centre of the tussle over the funds – of which Poland has long been the EU's largest net recipient by far – is the Law and Justice (PiS) government's overhaul of the judiciary, specifically a new disciplinary regime for judges. Brussels argues this overhaul would allow political interference in the independence of the



judiciary, a violation of one of the key EU principles.

Even though Poland has removed the controversial Disciplinary Chamber of the Supreme Court, Brussels remains sceptical as to the real depth of the reform.

Prime Minister Mateusz Morawiecki said last month that Brussels had broken an agreement to release the RRF funds in return for abolishing the Disciplinary Chamber and that Poland would make no more concessions on the rule of law.

The Commission keeps hinting strongly that the changes were but a smokescreen, as appointments to the new body that replaced the chamber still did not meet the criteria of impartiality and independence from the government.

Poland also needs to reinstate judges suspended under the disciplinary regime and grant judges the right to ask the Court of Justice of the European Union – the bloc’s top court – questions on the interpretation of EU law.

The removal of the Disciplinary Chamber, reinstating judges, and granting the right to reach out to the CJEU are the three so-called milestones Poland agreed to meet in line with a compromise deal reached with Brussels earlier this year.

The deal allowed Brussels to rubber-stamp Poland’s plan to spend €36bn from the EU’s Recovery and Resilience Fund to help the bloc rebuild after the COVID-19 pandemic, payments from which have been on hold due to the feud over the judiciary.

The Commission has since grown ever more suspicious of Poland and has now said that not just the Recovery Fund but also other funds will be withheld, as infringements of judicial independence violate the EU’s charter of fundamental rights, compliance with which is now an essential part of the EU’s budget rules under the so-called Conditionality Mechanism.

Poland appears unfazed by the revelations.

“Funds will be accessible, under [the Recovery Fund] and Cohesion, in due time,” a Polish official told the *Financial Times*, adding that “payment requests under the new round of Cohesion funding would only start to be made

## “Poland’s judiciary reforms go to the heart of the government’s broader stance on member states’ position in the EU”

next year, by which time the rule of law situation would hopefully be resolved”.

The government officially denied that Cohesion Funds were in question. Janusz Wojciechowski, Poland’s Commissioner for Agriculture, said that “Poland is not in danger of having agricultural and Cohesion funds withheld.”

Poland’s judiciary reforms go to the heart of the government’s broader stance on member states’ position in the EU.

Brussels can only have so much say over member states’ rights, the PiS government has long said, warning that the bloc’s institutions – the Commission in particular – keep usurping more and more power, effectively turning the EU into a federalist super-state.

At a rally of the Spanish Euro-sceptic party VOX in Madrid earlier this month, Poland’s Prime Minister Mateusz Morawiecki said that the EU was growing into a “transnational beast without real and traditional values, without soul”.

Poland’s stance on the EU is also the effect of the PiS-led government’s political position at home.

PiS is in a coalition with a strongly anti-EU United Poland without which it would lose its razor-thin majority in the parliament.

Some observers say that the government’s anti-EU rhetoric is poised to intensify in the run-up to the general election due in the autumn of 2023.

PiS has already begun playing a patriotic tune of Germany-dominated EU trying to subjugate Poland for leading the charge against Brussels

bureaucrats. The government media increasingly portray the opposition as working for German, rather than Polish, interests. It has even tried to claim PLN6.23 trillion (€1.32 trillion) in damages from Germany for the devastation of Poland in the Second World War.

A harbinger of Warsaw’s upcoming combative approach to the EU was the replacement of EU Affairs Minister Konrad Szymanski – seen as the government’s most pro-EU figure – with the much more confrontational Szymon Szykowski vel Sek last week.

Meanwhile, Poland’s local governments – many of which are opposition-controlled – say that withdrawal of especially regional funds is a disaster scenario.

“We have plans for thermal modernisation of educational facilities and for a railway link to the southern districts of the city. All this may fall through because of the PiS government’s incomprehensible ideology of eternal war with European institutions,” Aleksandra Dulkiewicz, mayor of Gdansk, one of Poland’s largest cities, told *Rzeczpospolita*. ●

# Leading Czech coalition parties endorse three presidential candidates

Albin Sybera

Czechia's three-party Spolu coalition, which ousted the populist ANO party of billionaire Andrej Babis in last October's general election, has endorsed three independent presidential candidates in the upcoming race for Prague Castle.

Prime Minister Petr Fiala, leader of Spolu [Together] and of the rightwing ODS party, together with the leaders of the Christian Democrats and TOP 09 announced at a press conference on October 4 that Spolu will not run its own candidate, an implicit acknowledgement of the coalition's failure to agree on one, as well as the shortage of time before the November 8 deadline for nominations.

Instead, Fiala pointed the centre-right coalition's voters to three already declared independent candidates: Chairman of the Senate's Foreign Affairs Committee Pavel Fischer, former president of Mendel University Danuse Nerudova, and retired Nato commander and former chief of the Czech army Petr Pavel. Spolu parties have discussed the endorsement with the three candidates.

"I believe that every one of these [candidates] can exercise the presidential office in line with basic values which our parties hold," Fiala told media at a press conference, and added that if Spolu nominated another candidate it would "decrease the chances that presidential office will be held by a person who respects these common values".

Spolu politicians have admitted previously that endorsing just one candidate could be seen as a curse, for that person could become a target for voter anger over the soaring cost of living.

For this reason Spolu won't recommend a single particular candidate but it

plans to launch a support information campaign about values the president should uphold. There are some hundred days left before the first round of the presidential election scheduled for January 13 and 14 and the likely second round to be held two weeks later.

By November 8 candidates will either have to present a list of 50,000 signatures, a signed endorsement by 10 senators

"I believe that every one of these [candidates] can exercise the presidential office in line with basic values which our parties hold"

or 20 parliamentary legislators. So far the Pavel campaign team announced it has reached the 50,000 quorum and a number of other candidates claim to have reached it as well. Signatures will have to be verified by the interior ministry.

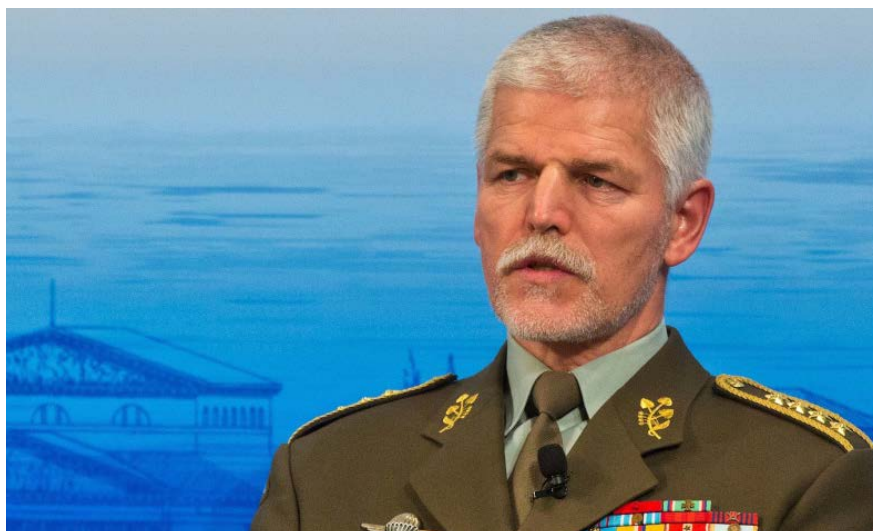
Spolu notably omitted Senator Marek Hilser from the list of endorsed candi-

dates. Hilser is an independent and arguably the most pro-EU voice in the pool and polls place him higher than Fischer and close to Nerudova. Pavel is the election favourite together with the Babis, who has yet to confirm whether or not he is standing.

Babis said recently there are up to "four possible candidates" his ANO party could nominate, which included

three high-profile ANO politicians, but he withheld the final name, fuelling speculations that Babis wanted to see ANO's performance in the municipal and Senate elections first.

ANO fared well in the municipal elections, registering victories in 8 of the 13 largest regional cities, but losing as



General Petr Pavel, who is one of the three endorsed candidates, is currently running second in opinion polls for the presidential election. / bne IntelliNews

expected in the capital Prague and the Moravian metropole Brno. It suffered defeat in the second round run-off of the Senate elections, however, as traditionally low voter turnout played into the hands of Spolu, whose voters are more committed in those contests. Voters opposed to the divisive Babis also tend to gang up against Anó candidates in run-offs. Spolu now holds 41 seats in the 81-member Senate.

Babis is currently leading opinion polls for the presidential election but he now looks more and more inclined to put forward one of his lieutenants, fearing defeat in any run-off against Pavel or another of Spolu's endorsed candidates, which could blight his image with his electorate.

General Pavel has kept some distance from Spolu, perhaps aware of Spolu's faltering popularity in the national polls, which favour ANO and also point to a steady rise of the far right and anti-EU SPD, the second opposition party led by another businessman-politician, Tomio Okamura.

When Pavel announced his candidacy in September one of his key messages was that he is not "indifferent to the fact that in our country some people are more equal than others".

Pavel has also appeared to be more open to euro currency adoption and backed marriage rights for everyone, something which socially conservative sections of Spolu staunchly oppose.

This conservative aspect of Spolu values could also be behind the decision not to endorse Hilser, the most progressive of the candidates. Hilser himself made it clear on Facebook that he did not ask for Spolu's or any other party's endorsement, citing his non-partisanship and his clear stance on criticising business interests in politics.

"I reject the influence of behind-the-scenes actors, which have been suffocating Czech politics since the 90s" wrote Hilser on Tuesday, and outlined "overpriced mobile data, manipulations with municipal property and public finances, debt business ties to politics,

fatal delay in transformation of Czech energy co-responsible for the present high prices" as some of the key features of business dominance of Czech politics.

Voting in the first round may be further fragmented by the candidature of trade union boss Josef Stredula, who is close to the Social Democrats (CSSD), as well as entrepreneur Tomas Brezina and former chairman of the energy regulator's office Alena Vitaskova.

The presidential race may well turn into a second round run-off between a Spolu-endorsed candidate such as Pavel and an ANO candidate, loosely resembling the rightwing and leftwing political battles of ODS and the once dominant CSSD characteristic of the first two decades of the country's post-1989 politics. ANO has now cannibalised the Social Democratic electorate, while the SPD has attracted voters from conservative hard left and pro-Kremlin Czech Communist Party. Both parties dropped out of parliament at the 2021 general election." ●

## Orban faces perfect economic storm of his own making

Tamas Csonka in Budapest

**H**ungary's radical right-wing leader Viktor Orban is struggling to cope with the country's unfolding cost of living crisis, a task made much harder because of his pre-election spending spree and his isolation inside the European Union.

Surging energy prices and a bulging budget deficit have already forced the government to cut back regulated gas and electricity subsidies as energy imports rose to more than 10% of GDP.

Hungary's strongman is trying to shift the blame for the country's looming recession and record inflation on to the EU's sanctions on Russia, a risky

political strategy at a time when Budapest is fighting to secure access to vital EU funds and allay concerns about its violations of the rule of law and its cosy relationship with Vladimir Putin's dictatorship.

Fidesz, bracing for a tight election against a united opposition last spring after three successive supermajority victories, embarked on an unprecedented pre-election spending spree, dishing out 3-4% of GDP in tax rebates, bonus payments for the armed forces and an extra month of pensions. This drove up consumption and GDP, but the public finances are in disarray as a result.

The government claimed that the country's strong economy – bouncing back quickly from the recession caused by the coronavirus (COVID-19) pandemic in 2020 – would cover the fiscal handouts and public investments. But analysts raised the red flag and warned of the negative impacts on inflation and the budget balance.

Headline inflation was already running at close to 8% before the war, climbed to over 15%, and is set to peak at 20% or above, according to the latest forecast by the Hungarian National Bank (MNB). Even before Putin's invasion of Ukraine, the budget gap had already reached 40% of the full-year target of 4.9% of GDP. At the end of August, it widened to 91%.



Surging energy prices and a bulging budget deficit have already forced Prime Minister Viktor Orban to cut back regulated gas and electricity subsidies as energy imports have risen to more than 10% of GDP. / bne IntelliNews

### Gaping budget hole

At an international press conference two days after his party's landslide election victory in April, Orban categorically denied that he would carry out a fiscal consolidation. The word austerity has been cancelled by Fidesz, which only uses it to refer to the IMF-imposed consolidation of public finances carried out by the last non-Fidesz government after the Global Financial Crisis.

To fix the gaping hole in the budget, the government dug out its playbook from 2010, when it took power. It levied extra profit taxes on the finance sector, retail and energy companies and airlines, targeting an estimated HUF800bn in extra revenue for 2022 and 2023. Spending at ministries and state bodies was frozen and some HUF2 trillion in public investments were postponed.

The markets were unimpressed by Orban's first steps to consolidate the budget, reflected in the slide of the Hungarian currency, even as the MNB kept raising rates. The HUF/€ rate slid to 417 in July, a 10% decline since the start of 2022, making the forint the weakest currency in the V4 group.

The MNB lifted the base rate from 0.75% in June 2021 to 13% on September 27, when it called an end to the monetary tightening policy, a risky move according to analysts as inflation

continues to gallop ever higher. The markets were also not impressed by the central bank's decision and the forint plunged to 424 against the euro in intra-day trading on September 29, and to 437 against the dollar.

The sell-off came as geopolitical tensions over Ukraine are on the rise and there are beginning to be fears over the central bank's foreign currency reserves as the country's current account is deteriorating at a rapid pace due to higher energy import bills.

“The markets were unimpressed by Orban's first steps to consolidate the budget, reflected in the slide of the Hungarian currency”

The government's measures have also failed to stem the cost of living crisis. The 4% windfall tax on retailers and a price cap on half a dozen food staples seemed popular at first but came at a heavy price. Retailers, as expected, passed on the extra burdens to consumers. The falling forint has also pushed up the price of imported goods.

By August, food prices on average rose at the fastest clip among EU states in Hungary, close to 31% year on year. The price of basic food staples not regulated by the government rose by many times

the average CPI. The statistics office registered extraordinary price increases: 67% for margarine, 64% for bread, 61% for cheese, 59% for pasta products, 55% for milk products and 54% for butter.

Economists estimate that those earning the median wage of around HUF250,000 now spend half of their salaries on food and utility bills. This is expected to climb further as the winter kicks in and Hungarian households will face the impact of higher utility bills due to the partial phase-out of energy subsidies.

### Felling the totem pole

By July it had become evident that windfall taxes alone would not be enough to fix the budget and more drastic measures were needed. The government was therefore forced to cut back regulated gas and electricity subsidies.

The government had frozen retail electricity and gas prices before the 2014 election. Keeping energy prices low has been a totemic issue for Fidesz and one that was seen as key to winning elections.

## Viktor Orban gets trolled by US ambassador to Hungary on first day on Twitter

### Tamas Csonka in Budapest

Hungarian Prime Minister Viktor Orban belatedly launched his Twitter account, provoking amusement over his narrow choice of personalities to follow and provoking superb trolling by the new US ambassador to Budapest.

Orban had tweeted: "After my first day on Twitter, there's one question on my mind. Where is my good friend, realDonaldTrump?" He accompanied his post with a gif of John Travolta's character Vincent Vega in the film *Pulp Fiction* looking bemused.

One of the first responses came from US Ambassador to Hungary David Pressman, who has recently taken up his post in Budapest. Pressman wrote: "While you look around for your friend, perhaps another friend to follow: the President of the United States, @POTUS ... but as the Hungarian media might say: no pressure. #nyomasgyakorlo.

The US diplomat used the hashtag *nyomasgyakorlo* (a person, who puts pressure on someone) after a columnist of pro-government daily *Magyar Nemzet* criticised Pressman for urging the government to ratify the accession of Sweden and Finland to Nato.

Orban's list of followed leaders include many of his illiberal peers, like Turkish President Recep Tayyip Erdogan, Geert Wilders, the Dutch far-right politician, Brazilian President Jair M. Bolsonaro, French radical rightwing leader Marine LePen, and also his new allies in the region, Milorad Dodik, Serbian member of the three-member Presidency of Bosnia and Herzegovina and Serbian president Aleksandar Vucic and right-wing politicians of the new Italian government, Giorgia Meloni and Matteo Salvini.

The list of reigning mainstream European politicians is much shorter as he follows the leaders of the Visegrad Group, Dutch PM Mark Rutte and Austrian Chancellor Karl Nehammer and Olaf Scholz, German Chancellor. There is only one EU politician on his list, former Belgian Prime Minister Charles Michel, President of the European Council.

The Hungarian prime minister follows a string of conservative philosophers and writers, like Jordan B. Peterson, Israeli nationalist philosopher Yoram Hazony and Rod Dreher, editor of the *American Conservative*, who lives in Budapest funded by the Danube Institute. Pope Francis was also on his list.

He soon followed 44 persons and had more than 65,400 followers.

Orban launched his Twitter account with the goal of providing information to the international public and share his views for the future, according to his spokesperson.

The prime minister's biography on the social media site describes him as "Freedom fighter, Husband, Father, Grandfather, Prime Minister of Hungary".



After their talks in the Kremlin on the first of February, Putin had assured the Hungarian premier that Budapest would receive gas five times below the market price.

Russia has become a key political and economic ally of Orban since his first election landslide in 2010. The government has defended its pragmatic stance of putting economic interests ahead of value-based foreign policy when criticised for cosying up to Eastern

autocrats such as Putin and China's Xi Jinping. The argument was that without "cheap Russian energy", the regulated retail utility prices could not be maintained.

But the notion of cheap Russian gas turned out to be a myth, as shown by the monthly foreign trade data. Hungary's export-oriented economy, generally posting hefty surpluses, has run a deficit for the 13th straight month, posting a record €1.15bn gap in July.

Although the price formula of the 15-year gas agreement with Gazprom signed in September 2021 remains secret, Hungary appears to be paying above the market price, according to these trade statistics. Analysts believe that contract prices are tied to Dutch TTF gas exchange rates with a three-month lag, unlike in the previous contract, when the price was linked to movements in the oil market.

Orban defended the tenability of the subsidy scheme right until the end, when it became clear that the budget could no longer bear the burden. The day of reckoning came on July 12, when the government declared an energy state of emergency, which included the revision of the energy subsidy scheme.

## “Finance Minister Mihaly Varga unveiled shocking data on Hungary’s energy import balance at a conference last month – a €20bn bill”

The blanket cap on household electricity and gas prices is simply unaffordable in the current “wartime energy crisis”, government officials said at the time, with the sinking forint added to the woes. Based on Hungary’s gas imports of 80mn MWh, the increase of gas prices from €20/MWh in 2021 to over €200/MWh would boost the country’s energy bill to €16bn, or one-tenth of the country’s GDP, Concorde brokerage said in a recent report.

Finance Minister Mihaly Varga unveiled shocking data on Hungary’s energy import balance at a conference last month. The price tag paid by Hungary for gas, oil and electricity would reach HUF8 trillion (€20bn) in 2022, against just HUF1.8 trillion in 2019. The €15bn-16bn increase in energy bills in a couple of years accounts for 10-11% of Hungary’s GDP and is three to four times the amount of money Hungary is eligible for from the 2021-2027 EU budget each year.

Varga also noted that the economy will sink into recession from Q4 until the third quarter of 2023, meaning that for that year it will contract 1-2%. The 2023 budget, approved in July, which targeted a 4% growth and a 5% inflation, will have to be amended.

### Soft landing, hard landing

The jury is out on whether Hungary will face a soft or a hard landing. Former MNB deputy governor Akos Peter Bod, an advisor to opposition parties in the 2022 campaign, expects a hard landing, as the country’s exposure to the energy shock is

higher than its neighbours, due to strong dependence on Russian energy sources and the lack of investments in energy efficiency due to distorting price caps.

The energy use of Hungary’s industry remains one of the highest in Europe, while the share of insulated homes is

one of the lowest. In 2016 the EU gave Hungary some HUF500bn for insulating homes but the government decided to use the money for similar projects in the public sector, with mixed results.

Low retail energy prices due to price caps did not provide incentives for households and businesses to carry out energy-efficient investments over the years, for which Hungary is paying a big price now.

Economists are drawing parallels to the 1970s oil shock, which led Hungary to join the IMF in 1982. Eventually, this was seen as the start of the demise of the Communist government. By the time Hungary held its first free elections in 1990, Hungary had become the most indebted country in the region, racking up an eye-watering \$20bn in state debt.

According to recent press reports, an IMF delegation visited Hungary in July, which was not part of the annual Article IV mission. Officials of the Washington-based group said Hungary had not asked for financial assistance.

The widening current account gap, which could rise to €13bn-14bn this year, has dented the central bank’s currency reserves, falling below the key level of the equivalent of three months of imports. This, according to Concorde brokerage chairman Gyogy Jaksity, is a prelude to calling in the IMF.

Others opine that the IMF could only be an option if Hungary fails to agree

with the EU on the payment of frozen funds, and if borrowing costs on the international markets are too high. Independent media 24.hu reported that Hungary is looking for alternative financing sources in China and that a Green Panda bond could be on the table.

Hungary has pledged to co-operate with the European Commission in 17 areas in an attempt to gain access to some €7.5bn in Cohesion Funds from the 2021-2027 budget suspended under the EU’s new Conditionality Mechanism, as well as €5.8bn of Recovery and Resilience Funds that were suspended earlier over the government’s violation of the rule of law and rampant corruption.

Hungary has received €57bn, or 4.5% of its annual GDP, in transfers from Brussels since it joined the EU in 2004 and is a major beneficiary in the new 2021-2027 budget. OTP chairman-CEO Sandor Csanyi warned that without an agreement, the country’s GDP would decline by 0.5%.

Some analysts believed the prime minister’s credibility would be tarnished after breaking his key campaign promise to maintain the energy cap in July, but recent polls show only a slight erosion in Fidesz support and an increase in undecided voters.

Many saw comparisons to 2006 when former Socialist Prime Minister Ferenc Gyurcsany admitted that his government had lied about the state of the economy to win the election.

His speech at Balatonoszod at a closed-caucus meeting was leaked in September 2006, triggering the worst political crisis in Hungary’s history, helping Orban to make a comeback. After two lost elections, there were calls for his removal from the party.

But Hungary’s opposition, still reeling from the election fiasco in the spring, has yet to capitalise on Fidesz breaking its election promises. It has failed to win over disillusioned Fidesz voters, according to analysts. But Orban might not be so lucky if the cost of living crisis continues to deepen. ●

# Polish central bank descends into civil war over rate policy

Wojciech Kosciński in Warsaw

Governor of the National Bank of Poland (NBP) Adam Glapiński along with four members of the NBP's rate-setting body threatened legal action against three other members of the same body on October 11 for their allegedly too critical statements in the media.

Ludwik Kotecki, Przemysław Litwiniuk, and Joanna Tyrowicz all spoke in the media and on social media over the past few days about what they thought was wrong with the NBP's Monetary Policy Council (RPP) – the rate-setting body in question – and its policy to tackle Poland's rampant inflation.

"We do not accept and express our extreme disapproval of actions which, in our opinion, may constitute a violation of the [laws governing NBP's work], therefore, we consider it justified to consider sending a notification of a suspected crime in this case," Glapiński and four other members of the RPP said in a statement.

The statement did not mention anyone by name but the lack of signatures from Kotecki, Litwiniuk, and Tyrowicz strongly hinted at who the addressees were.

Tyrowicz went as far on October 9 as to publish her own annotated version of RPP's most recent communiqué on LinkedIn under the heading "I fixed it for you."

In her text, Tyrowicz alleged that the RPP "did not make necessary steps" to ensure Poland's macroeconomic and financial stability, including limiting the risk of sustained high inflation.

Tyrowicz also dismissed the official communiqué's explanation that high inflation was due to high prices of energy and agricultural commodities.

"We don't know where inflation comes from because since 2019 we have not been carrying out analyses of price mechanisms," Tyrowicz wrote.

Inflation in Poland is likely demand-driven and not due to expensive energy, she told news portal gazeta.pl on October 11.

Litwiniuk, in turn, complained of RPP members' limited access to NBP's analysts.

The critical members were all appointed by the Senate in which the opposition has a majority.

All three say that the central bank should resume monetary tightening or face sustained high inflation that

will not fall to the NBP's target of 2.5% before the end of 2024.

The RPP paused its tightening cycle last week, keeping the central bank's reference interest rate unchanged at 6.75% despite an inflation surge to 17.2% y/y in September.

"Maintaining negative real interest rates seems deeply inappropriate and [is an] inexplicable wait for a miracle," Kotecki said in an interview for Business Insider Polska on October 10.

The Polish zloty weakened slightly against the US dollar and the euro on October 11 in immediate reaction to the news of a conflict brewing inside the RPP but strengthened towards the end of the day. ●

"We consider it justified to consider sending a notification of a suspected crime in this case"



The three monetary policy critics were all appointed by the Senate in which the opposition has a majority.



Unsettling exchange of ideas? It was only very recently that Truss and Erdogan met. / youtube, screengrab.

# Might Trussonomics be a branch of Erdoganomics?

bne IntelliNews

**W**here, the Brits, are wondering, did Trussonomics come from? A Turkish expat in London may have hit on the answer. Might it be a branch of Erdoganomics?

Assessing the critical blow that Liz Truss has dealt to the UK's economy with a mini-budget, her first major policy move since she replaced Boris Johnson as PM on September 5, Yunus Emre Oruc, writing for Middle East Eye, set out his feelings under the headline: "Pound crash: As a Turkish immigrant in the UK, Trussonomics feels all too familiar."

Oruc, who recalled how after the Turkish lira plunged in value during Turkey's August 2018 currency crisis "I decided I could no longer take it in the country", says: "I always thought the British and Turkish governments shared many things in common, from an increasingly chauvinistic approach to the European Union, to a deepening love for populism, to a push to polarise people further for electoral gains. But that long list of anticipated commonalities did

not include self-inflicted hits on their own economies.

"Today, three-and-a-half years after moving to the UK, I can see many similarities between their financial policies, which are taking a severe toll on people's daily lives."

"Trussonomics feels very similar to Erdoganomics," concludes Oruc, proposing "that both are purely driven by ideological, almost dogmatic, stances on the very basics of how the economy works. Their pursuit of growth at all costs aims to make the pie bigger, but not everyone's share grows the same – if it grows at all. This comes at a heavy price, with very little fiscal responsibility displayed by both governments for years. Worst of all, neither aims to redistribute wealth; if anything, both approaches work towards increasing inequality between the rich and poor."

Oddly enough, September 29 featured a speech from Turkish President Recep Tayyip Erdogan in which he took a pop at

the British pound, saying it had "exploded".

The day saw the lira trade at its latest all-time weak rate, at 18.55/\$. With Turkish inflation officially running at more than 80% (in reality it's even far higher than that say many Turkish economists) and the lira in another death spiral (it's down 80% in the past five years), it might be thought that Erdogan would by now command his officials to bring in a big rate hike. Far from it. Under Erdoganomics, higher interest rates translate into more inflation. Thus, Erdogan looked his audience in the eye and doubled down on his unorthodox monetary policy, announcing that with the benchmark rate at 12%, he would be pursuing a single-digit figure in the not-too-distant future.

"Oh the irony, Erdogan giving Truss advice on the economy," wrote Timothy Ash, an emerging markets strategist at BlueBay Asset Management, in a note to investors. "Turkey has 80% inflation and I guess the worst performing currency over the past decade. Lol. How low the U.K. has sunk." ●



# Commission recommends EU grant Bosnia candidate status despite slow progress

Denitsa Koseva in Sofia

The European Commission decided on October 12 to recommend that the EU grant Bosnia & Herzegovina candidate status despite its slow progress, in an attempt to strengthen Western influence and weaken the Russian one in the politically divided Balkan state.

Bosnia formally applied for EU membership in February 2016, but it took three years for its politicians to complete and approve the questionnaire sent by Brussels. Meanwhile, reforms in the deeply divided country have been stalled for years.

Despite that, Bosnia was hoping to get an EU candidate status along with Moldova and Ukraine in June. However, Brussels said the country had made no reforms and did not grant it the status of a formal candidate.

“We are recommending today to the Council to grant candidate status to Bosnia and Herzegovina. We are infusing a positive dynamic into the process and hope for the region to take the chance and follow up on it by implementing key reforms,” EU High Representative for Foreign Affairs and Security Policy/Vice-President of the European Commission Josep Borrell said in a statement on October 12 accompanying the publication of the country’s progress report.

“We are not only assessing the performance of partners, but of future member states. The assessments we make now are also about the kind of Union we want for the future. And it is clear that we believe in the European future of our partners. Russia’s brutal invasion of Ukraine brings into strong relief the importance of EU enlargement, which takes on a new geopolitical significance. It is a long-term investment into peace, prosperity and stability for our continent,” he added.

The EC praised Bosnia for taking some steps to reinforce democracy, the functionality of state institutions, the rule of law, the fight against corruption and organised crime, guaranteed media freedom and migration management in the country.

In its progress report, the EC noted that Bosnia’s Republika Srpska has blocked state-level legislative and executive institutions until spring 2022, leading to an almost complete standstill in reforms during that period.

On the other hand, the government of the Muslim-Croat Federation remained in office for the full 2018-2022 term in a caretaker capacity, which gave it some limited capability for reforms.

Bosnia consists of two autonomous entities – the Federation and Republika

Srpska, as well as of the autonomous Brcko district. Each of them has its own parliament, government and president and there are also state-level institutions.

The EC noted that Republika Srpska has been pushing to unilaterally take over state competences, including on taxation, the judiciary, defence and security, and dismantle state institutions, endangering the country’s EU accession perspective.

Moreover, parliamentary parties could not agree on a solution for constitutional and electoral reforms to bring the constitution in line with the European Convention on Human Rights.

“The Council of Ministers took no steps to develop a national programme for the adoption of the EU acquis. Due to political obstruction, the Ministry of

“We are recommending today to the Council to grant candidate status to Bosnia and Herzegovina”



The EC noted that Bosnia’s Republika Srpska blocked state-level legislative and executive institutions in Sarajevo until spring 2022. / bne IntelliNews

Finance and Treasury hindered the smooth organisation of the October 2022 elections by withholding the required funds," the report noted.

Bosnia has also made limited progress on public administration reform (PAR). Public administration's functioning on all levels has deteriorated due to the lack of a political decision-making body to steer PAR and insufficient implementation of the action plan and capacities to promote the PAR agenda.

"Bosnia and Herzegovina is at an early stage of preparation as regards its judiciary. No progress was made in this area over the reporting period. The independence and impartiality of the judiciary did not improve," the report noted.

It added that the local authorities must take urgent measures to restore public

trust in the judiciary and strengthen its integrity.

"The lack of political commitment to judicial reform and the poor functioning of the judicial system continued to undermine the citizens' enjoyment of rights and the fight against corruption and organised crime," the EC noted.

Bosnia has also failed to make progress in fight against organised crime.

"Political leaders and judicial institutions failed to tackle widespread corruption and actively blocked progress, leading to long-term stalling and increasing signs of political capture. The continued lack of progress at all levels increases the risk of backsliding. Political leaders and judicial institutions need to urgently remedy the situation," the report reads.

Although there have been some indictments for high-level corruption, the overall track record on preventing and repressing corruption was not sufficient, due to operational inefficiency and political interference.

"There are systemic shortcomings in the operational cooperation between law enforcement agencies fighting organised crime, due to non-harmonised criminal legislation, weak institutional coordination, and a very limited exchange of intelligence," the EC noted.

In terms of economic criteria, Bosnia is at an early stage of establishing a functioning market economy. The internal market remained fragmented due to worsening cooperation and coordination of economic policymaking at state level and among the entities. ●

## Interior minister says Serbia 'doesn't belong' in the EU

### bne IntelliNews

Interior Minister Aleksandar Vulin has argued that Serbia doesn't belong in the EU, whose members in any case "don't want" to admit Serbia.

Serbia has been an EU candidate country for more than a decade, since March 2012, and started accession negotiations in 2014. President Aleksandar Vucic has said joining the EU is the country's top foreign policy priority. However, enthusiasm for reforms aimed at accession has waned as the process has dragged on for years, with no prospect of joining in the foreseeable future.

The key sticking point has been Serbia's refusal to recognise Kosovo – which unilaterally declared independence from Belgrade in 2008 – as an independent state. The EU requires the two countries to normalise their relations if either is to progress towards EU accession.

Moreover, following Russia's invasion of Ukraine in February, Serbia has been strongly criticised by EU officials and politicians from EU member states for its refusal to join sanctions on Russia.

Vulin, a key pro-Russian voice within the cabinet, said in an interview with *Vecerni Novosti* published on October 14 that Belgrade should accept that the EU does not want to admit Serbia.

"The question is not whether we want to join the EU, but whether the EU wants Serbia. Judging by the insane blackmail they are exposing us to to recognise Kosovo, abolish Republika Srpska and impose sanctions on Russia, they don't want us," he said.

"The sooner we accept that they don't want us and that we don't belong there, the better off we will be. The attitude towards the EU is not a matter of

emotions but of rational decisions."

In its annual progress report published on October 12 the European Commission urged Serbia to firmly commit to the EU strategic direction



Interior Minister Aleksandar Vulin says Serbia should accept the EU doesn't want it to join.  
mup.gov.rs

and reform path. The Commission noted that Serbia had failed to align with the EU restrictive measures against Russia, following the latter's invasion of Ukraine, and the majority of declarations by the EU high representative on this matter.

Commenting on the recent proposal by France and Germany for a deal on Kosovo – under which Serbia would

to the often troubled relationship between Serbia and neighbouring Croatia, which as an EU member has the power to veto Serbia's progress.

Bilateral disputes with neighbouring states previously stalled the progress of another candidate country, North Macedonia, which was blocked by first Greece and later Bulgaria from opening accession negotiations.

**“The sooner we accept that they don't want us and that we don't belong there, the better off we will be”**

get an accelerated path to the EU if it allows Kosovo to join the UN and other international organisations – Vulin was highly sceptical.

“[W]here did you see the accelerated reception? As far as I know, the final decision is made by each parliament of each EU country. Do you really think that Croats will vote for Serbia's accession to the EU without any other conditions?” he commented, referring

Vulin also criticised the EU as an institution, commenting: “With the loss of political independence, EU members begin to lose their economic strength, which was the main reason for the EU's attractiveness.”

Vulin paid a two-day visit to Moscow on August 22-23, during which he met Foreign Minister Sergei Lavrov and other Russian officials. At the meeting with Lavrov, Vulin said that Serbia is

the only country in Europe that has not “become part of the anti-Russian hysteria”.

The trip sparked a dispute with his colleague Deputy Prime Minister Zorana Mihajlovic, who accused Lavrov of “abusing” Serbia's decision not to impose sanctions on Russia by falsely claiming Serbia supports Russia's invasion of Ukraine. That prompted Vulin to publicly defend Lavrov.

There is strong pro-Russian sentiment within Serbia. A June poll from Demostat showed overwhelming support for Russia and opposition to joining Western sanctions among the Serbian population. According to the poll, 80% of respondents opposed sanctions on Russia, against only 9% in favour.

The same poll showed waning support for EU accession, with 51% of respondents saying they would vote against accession in a referendum on joining the bloc. Just 34% of respondents said they would vote for Serbia's entry into the EU, while 11% would not vote and a further 4% were undecided. ●

## Bulgaria's populist Gerb wins snap general election on record-low turnout

**Denitsa Koseva in Sofia**

**B**ulgaria's former ruling Gerb party is heading towards victory in the October 2 snap general election with between 23% and 25% of the vote, well ahead of reformist Change Continues that got around 19% on a record-low turnout of below 40%, exit polls showed.

Polls indicate Bulgaria will get its most fragmented parliament ever and comments from the key parties in the run-up to the vote offer little hope of a stable majority being formed in parliament.

Given the urgent need to tackle rising prices and secure energy for the winter ahead, the most likely outcome is a technocratic government.

According to Gallup International, seven parties will pass the 4% threshold with Gerb getting 23.5%, followed by Change Continues with 19.5% and the ethnic-Turk Movement for Rights and Freedoms (DPS) with 15.2%.

Fourth would be the far-right Vazrazhdane with 10%, followed by

the Bulgarian Socialist Party (BSP) with 8.9%, reformist Democratic Bulgaria (7%) and nationalist pro-Russian Bulgarian Ascend with 4.7%. There Are Such People (ITN) has a slim chance of passing the 4% threshold with Gallup's data putting it on 3.8%.

The turnout was between 3% and 5% lower compared to the previous early general election, held in mid-November 2021, at between 36.6% and 38%. The votes from abroad are yet to be counted and might give some



Gerb leader, former prime minister Boyko Borissov, speaks to reporters after casting his vote on October 2. / Gerb

advantage to Change Continues, the DPS and Democratic Bulgaria, but even that would not bring more clarity.

### Fragmented parliament

The fragmented parliament will require tough compromises in the negotiations set to follow the election, or Bulgaria will face yet another snap vote. However, people are already tired of early elections and more than 60% would rather have any regular government than go to vote again.

According to Teneo, the fourth general election since April 2021 could lead to a government centred around either Gerb or Change Continues.

Both parties are broadly pro-Western — the new division that has emerged in Bulgarian politics pits Western-oriented against pro-Russian politicians.

However, neither of the two leading parties could form a stable coalition without the risk of losing their supporters by making concessions to potential partners.

Change Continues spent much of its brief time in power trying to root out corruption dating back to previous Gerb governments, and has already ruled out a coalition with Gerb.

Prominent political analyst Daniel Smilov commented during live broadcast by Dnevnik news outlet that

the results from the election can change significantly during the vote count. He added that Gerb and the DPS seem isolated despite their better performance as none of the other pro-Western parties would agree to unite with them.

If Gerb decides to form a government, it could be backed by the DPS — the party has unofficially supported Gerb through three previous governments. However, Gerb's leader Boyko Borissov seems reluctant to formalise this union and, even if he agrees to do that, more MPs will be needed.

On October 2, Borissov indirectly once again invited Democratic Bulgaria to join Gerb, as a fellow pro-Western party.

“The world is at war. We have clearly stated that in this aggression, a war with clear aggressor which is [Russian President Vladimir] Putin — nothing against the Russian people — Bulgaria must be clear, categorical and precise for the place it belongs to — the EU and Nato,” Borissov said after voting.

His statement was seen as an indirect invitation to Democratic Bulgaria to set aside its red lines and agree to form a coalition. However, neither Democratic Bulgaria, nor Change Continues have ever said they could rule with Gerb if Borissov remains the party's leader.

Gerb's deputy leader Tomislav Donchev said the party does not exclude any

party from possible coalition talks. He added the party will make a formal statement on the following day.

Despite the party's condemnation of the invasion of Ukraine, there has been a suggestion that Gerb can theoretically form a coalition with the DPS and BSP with unofficial support from Vazrazhdane and/or Bulgarian Ascend.

The leader of Vazrazhdane, Kostadin Kostadinov, said his party would not join any coalition but that he was ready to hold talks with anyone. His party is openly pro-Russian and wants Bulgaria out of the EU and Nato. Bulgarian Ascend's leader, former caretaker prime minister Stefan Yanev, said his party would negotiate with anyone.

### Rifts in the pro-Western camp

Change Continues, along with its former two coalition partners — the BSP and Democratic Bulgaria — could not get 121 MPs as their number would only be around 100-105. This means that, unless that coalition gets informal support from Gerb or the DPS, the reformist coalition has no chance of forming a government either.

The co-leaders of Change Continues — former prime minister Kiril Petkov and former finance minister Assen Vassilev — commented after the exit polls that a common parliamentary group with Democratic Bulgaria is not possible, contradicting previous claims that the former ruling party will for sure unite in parliament with Democratic Bulgaria.

“We have serious differences [with Democratic Bulgaria], especially in the economic area,” Vassilev commented.

Petkov thanked everyone who voted and said that many people have shown that they want Bulgaria to be different, free of corruption.

“We want to respect the people's choice and Gerb, being the first political force, carries enormous responsibility,” Petkov said.

He reiterated that Change Continues will not unite with Gerb or the DPS.

“We promised that before the election and we shall fulfil our promise,” Petkov said.

Vassilev added that Gerb and the DPS have got a clear mandate to form a coalition and rule the country, but that Change Continues will keep fighting for a European Bulgaria with a social budget that would not allow people to live below the poverty line.

### **Technocratic government expected**

According to Teneo, the most likely scenario would be a technocratic government or another snap vote in the winter, with the former seeming more likely as almost all political parties have said that a stable government is necessary at the moment so that it can tackle the tough challenges of the winter months.

“An expert cabinet with a pre-set agenda and limited timeframe in office could receive support from a wide range of parties. In fact, a technocratic cabinet might be better positioned to advance reforms or tackle the energy crisis than a weak political government,” Teneo noted.

However, a technocratic government would give more power to Bulgaria’s openly pro-Russian President Rumen Radev, who will be able to pick a prime minister-designate if the two largest political parties fail to form a government.

“More generally, a protracted period of political instability in the past 18 months hinders the advancement of deep structural reforms needed to boost the country’s economic competitiveness, strengthen democratic institutions, and improve the effectiveness of the public administration apparatus. The growing public disillusionment with the political system will continue to drive emigration and could lead to the emergence/strengthening of populist movements,” Teneo noted.

The leaders of Gerb, DPS and Democratic Bulgaria have said they would not comment before the first vote counts are announced. ●

## **Slovenian foreign minister says North Macedonia could join the EU by 2030**

### **Valentina Dimitrievska in Skopje**

The membership of North Macedonia in the EU by 2030 is a realistic and achievable goal, Slovenian Foreign Minister Tanja Fajon said on October 18 in Skopje.

Slovenia is one of the strongest supporters of North Macedonia’s EU accession process. During her visit in Skopje, Fajon met Foreign Minister Bujar Osmani and other officials.

Fajon congratulated the government and Macedonian citizens on the historic start of the accession negotiations. North Macedonia launched EU accession negotiations in July this year after Bulgaria lifted its veto on the process.

“I am aware that the beginning of the process was painful and difficult, but now it is necessary to focus on the reform process, which is to the benefit of all citizens,” Fajon said, adding that the country should amend the constitution to be able to progress further on its EU path, according to the statement from the Slovenian foreign ministry.

There is strong opposition within North Macedonia to some of the changes the country must make to progress with accession negotiations.

Fajon said that Slovenia will continue to help North Macedonia on its European path.

Fajon and Osmani assessed that cooperation between the two countries is very good, especially in the political and economic fields.

“I would like the annual exchange of goods between Slovenia and North Macedonia to be raised to €500mn. I am ready to help Slovenian companies on the markets of North Macedonia,” Fajon said in a tweet after meeting North Macedonia’s Deputy PM for Economic Affairs Fatmir Bytyqi.

The country now called North Macedonia has been an EU candidate country since 2005, but its process towards accession has been repeatedly delayed by bilateral disputes with its neighbours. First Greece and later Bulgaria used their veto powers as EU members to block the country’s EU path unless it made concessions to them.

This is on top of the border slowing of the engagement process in recent years amid ‘enlargement fatigue’ among existing EU members, with no state admitted to the union since Croatia in 2013. North Macedonia and other Western Balkan states are also a long way behind their peers in Central Europe economically.

However, following Russia’s invasion of Ukraine in February there has been an effort to revitalise the process. Both Moldova and Ukraine were given candidate status at the EU Council meeting in June, while Albania and North Macedonia were finally allowed to start membership negotiations.



bne IntelliNews

## "We are not scared, we are just very very angry" – Ukrainians respond to major missile attacks on Kyiv

Dominic Culverwell in Berlin

**R**ussia's missile strikes on Kyiv on October 10 have broken two months of relative peace in the capital and once again imprinted a bloody reminder of Moscow's willingness to cause mass destruction.

Rockets rained down over a dozen cities across the country in the morning in what appears to be retaliation for the explosions that partially destroyed the Kerch bridge. But the attacks against Kyiv caught the most attention, with some of the rockets striking close to the presidential administration building on Bankova in the heart of Kyiv.

So far, 10 people have been reported killed in the missile and drone attacks, whilst 60 have been injured. The strikes

hit civilian areas as well as key infrastructure like Kyiv's thermal power plant (TPP). But Kyiv's war-hardened citizens are not going anywhere.

"We are not scared; we are just very very angry. These are fucking terrorists. This is not normal," Kris, a humanitarian worker, told her more than 21,000

the battlefield in recent weeks.

In the morning, Kris heard a petrifying sound "like clouds tearing apart" and a child screaming outside. "It was like some mini-aeroplane was flying, but knowing the airports are closed, it was weird," she tells *bne IntelliNews* in a telephone interview. Spotting smoke billowing

**"Not even a nuke will kick me out of Kyiv"**

Instagram followers. The Kremlin clearly intended to terrify the Ukrainian population, but all it has managed to do is inflame the sense of defiance that has translated into stunning successes on

across her neighbourhood, Kris grabbed her cat and immediately ran to the corridor to seek shelter, an action many Ukrainians are all too familiar with. One hour later, she eventually went

outside after the government instructed people to get water and supplies. Queues formed outside the shops as people cancelled their plans for the following days. Despite the sombre mood, Kyiv's unity and community spirit constantly exceed the pressure of Russian President Vladimir Putin's attacks.

"We had a little party during the air siren," Kris jokes. "I was chatting in the queue with grannies and teenagers at the coffee shop. We were all talking about what an arsehole Putin is." For now, Kris is watching the updates from Kyiv's administrative centre, waiting to see if volunteers are needed. Although there have been no updates at the moment, volunteers will likely be needed this evening.

"I think police and ambulances are busy at the moment. Maybe later they will be cleaning up the destroyed buildings and bridges and will ask citizens for help. We'll see." Like many in Kyiv, Kris won't leave her home town. She will continue to remain in the city and offer her help where it is needed. "Not even a nuke will kick me out of Kyiv," she says. This sentiment is shared by Nikita and

his girlfriend Anna, who also refuse to leave Kyiv, despite the threat of more strikes in the future. "They can shell everything. Why leave for nothing when we can stay and do something," Nikita told *bne IntelliNews*.

"Be Ukrainian, be brave," Anna exclaims.

The couple were actually prepared for the attack, having received a message the evening before from a friend in the army warning of strikes across Ukraine in the morning. According to Nikita, the message said that the attacks will occur in three waves: first to overwhelm anti-aircraft defence; second to target energy infrastructure whilst the anti-aircraft defence reloads; third to target military objects.

However, the strikes hit many civilian targets, including near the Taras Shevchenko University and the popular Shevchenko park, both named after Ukraine's national hero and poet who stood for Ukrainian independence during the Russian empire. One girl was recording a video call on her phone as she walked passed the university as a rocket came down close by, catching her

in the blast. She was unhurt. In a third incident, a car was driving through the heart of the city when a rocket exploded just down the street, but the driver remained unflustered.

Nikita told *bne IntelliNews* that the air sirens have stopped and he hopes that the attacks are over. Nevertheless, the couple is prepared for another wave of missiles and have organised a plan to seek shelter in the subway if strikes resume in the evening.

"We are packing our bags," Anna says.

"Just to make sure we are prepared if there is an emergency," Nick follows up.

Vladimir Putin called the attacks a response to the explosion over the weekend that demolished a chunk of the Kerch bridge, which connects Crimea to Russia and is used by Moscow to transport military equipment to Southern Ukraine.

Although not confirmed to be caused by Kyiv, Putin called the destruction of the bridge a Ukrainian "terrorist act". ●

## UN votes to condemn Russia's annexation of Ukrainian regions

### bne IntelliNews

**M**embers of the UN overwhelmingly voted to condemn Russia's annexation of four Ukrainian regions on October 12, with some of Russia's earlier supporters also joining the motion to censure the move.

A total of 143 countries voted in favour of the motion, five voted against and 35 abstained. Amongst Russia's supporters both India and China abstained again as they have in the previous two UN votes, to condemn the invasion of Ukraine in February and to remove Russia from the UN Human Rights

Council. China is performing a delicate balancing act between backing Russia and protecting its commercial relations with the West. India has emerged as a Russian supporter and one of its biggest customers for sanctions-defying oil exports.

The countries that voted against the motion were Belarus, North Korea, Nicaragua and Syria in addition to Russia itself.

The United Nations General Assembly on Wednesday overwhelmingly voted to condemn Russia's annexation of parts of

Ukraine after Moscow vetoed a similar effort in the Security Council.

As in previous votes, the other countries abstaining from the vote included all of the Central Asian countries and many in Africa which have commercial ties with Russia. In particular, South Africa and Pakistan both abstained, despite a major US diplomatic push to rally the vote against Russia.

Importantly, a number of Russian aligned countries that chose to abstain in the two previous votes this time voted to condemn Russia, including

Egypt, Myanmar, Iraq, UAE and Serbia, which are seen as amongst Russia's strongest supporters. Also the African country of Eritrea has been one of the few countries to vote against Russia in the previous two votes, but this time switched to an abstention in another surprise.

The UN General Assembly vote on March 3 to condemn Russia's invasion of Ukraine went almost unanimously against Russia, with only five countries voting against the motion: Belarus, Syria, North Korea and Eritrea in addition to Russia. China and India both chose to abstain rather than vote against the motion. A total of 141 voted for that motion and 35 abstained.

Another United Nations General Assembly vote to suspend Russia from the UN Human Rights Council for "gross and systematic violations and abuses of human rights" in Ukraine on April 7 also saw the same five countries vote against the motion, with a total of 24 countries voting against the motion, 93 voting in favour and 58 abstaining.

The resolution "condemns the organisation by the Russian Federation of so-called referendums within the internationally recognised borders of Ukraine" and "the attempted illegal annexation" of four regions by President Vladimir Putin. The motion also demanded that Moscow "immediately and unconditionally reverse" its annexation decisions.

The US ambassador to the United Nations, Linda Thomas-Greenfield, had

urged all nations to send a message that the world "will not tolerate seizing a neighbour's land by force."

"Today it is Russia invading Ukraine. But tomorrow it could be another nation whose territory is violated. It could be you. You could be next. What would you expect from this chamber?" she said, the *Moscow Times* reports.

The US vigorously lobbied amongst Russia's supporters to win their support in the latest vote, expending a lot of energy on India in particular. Diplomatic activity is particularly intense at the moment as the West revs up to impose an oil price cap scheme in December that is designed to cut the Kremlin off from its oil export revenues, but will very likely fail if big customers like India refuse to participate. The US has also been actively lobbying against Russia in Africa where the Kremlin has many friends, and will hold a large Africa summit in Washington in December.

The US campaign to isolate Russia and undermine its hydrocarbon business took a big blow when the OPEC+ oil cartel agreed to cut oil production by 2mn barrels per day (bpd) despite intense US pressure to increase production and lower oil prices just as the US goes into its mid-term elections. On the day of the UN vote US President Joe Biden repeated earlier remarks that the White House may see the decision as a "hostile act" by the Kingdom of Saudi Arabia (KSA) against the US and in support of Russia.

Bangladesh, Iraq and Senegal – which abstained in March – also changed their vote to condemn Russia.

Eritrea, one of the world's most closed states, moved from a 'no' to an abstention, while Nicaragua, under growing international pressure over human rights, switched from abstaining to voting 'no', the *Moscow Times* reports.

"South Africa considers the territorial integrity of states and that of Ukraine to be sacrosanct, and we reject all actions that undermine the purposes and principles of the UN Charter and international law," said South Africa's representative, Mathu Joyini, as cited by the *Moscow Times*.

"We have abstained on the resolution because we believe that the objective of this assembly in keeping with its mandate must always be to contribute to a constructive outcome conducive to the creation of sustainable peace in Ukraine," she said.

India's envoy, Ruchira Kamboj, said that "the entire Global South has suffered a substantial collateral damage" from the war and that "pressing issues" were not addressed in the resolution.

Bangladesh, explaining its move to condemn Russia, said that the international community should also stand firm against any attempt by Israel to annex occupied Palestinian territory.

"We strongly believe that the purposes and principles of the UN Charter regarding respect for sovereignty and territorial integrity and peaceful settlement of all disputes must be complied universally for everyone, everywhere, under all circumstances," said Bangladesh's ambassador, Muhammad Abdul Muhith.

In total two more countries voted to condemn Russia's annexation of the Ukrainian regions than voted to condemn the invasion in February, with a total vote count of 143 vs 141 respectively. ●

#### UN votes on russian actions in ukraine

	UN condemn invasion	UN suspend from Human Rights Council	UN condemn annexation of Ukrainian regions
<b>For</b>	141	93	143
<b>Against</b>	5	24	5
<b>Abstain</b>	35	58	35

Source: UN





Belarusian soldiers lining up, but to go where? / <https://twitter.com/MotolkoHelp>

## What can we expect from Lukashenko's escalated war rhetoric?

### bne IntelliNews

**B**elarusian strongman Alexander Lukashenko's recently escalated war rhetoric versus Ukraine has gained both Western capitals' and Kyiv's attention in the last few days. The EU warned Lukashenko on Monday, October 10 that more sanctions await if Minsk chooses to send Belarusian troops into Ukraine.

Lukashenko declared a state of "counter-terrorism operation" in Belarus. He came to this conclusion after his meetings with Belarus' intelligence authorities, where he claims to have received information that neighbouring Nato countries were planning "provocations" and that Ukraine was even planning an invasion of Belarus. The state of counter-terrorism operation broadens the Belarusian security forces' authority to increase detentions, the barring of movement around the country as well as wiretapping.

Two things mostly caught the eyes of Western analysts and diplomats:

1. Lukashenko's announcement of deploying a joint military "grouping"

along with Russian forces on the Ukraine-Belarusian border.

2. The report from independent Belarusian media outlet Nasha Niva that Lukashenko is planning a covert mobilisation, citing anonymous sources.

As of yet, there are no real signs of this military grouping actually forming. Belarusian activists have not recorded military activity of the same scale as that conducted in January-February this year, when Russia launched its full-scale invasion of Ukraine partly from Belarusian territory.

Currently, Ukraine claims that there are up to 1,000 permanently stationed Russian soldiers in Belarus along with six attack aircraft, four Iskander operational tactical missile systems and twelve S-400 air defence systems; certainly not enough for an invasion. Belarusian partisans have reported that about 800 Russian soldiers are being prepared to arrive for training in Belarus.

On the other hand, a member of Belarus' government-in-exile, Pavel

Latushko, is warning that between 25,000-100,000 Russian troops could be sent to Ukraine, although there are no indications of such a large force being prepared as of yet.

According to Lukashenko, the basis of the military grouping would be the Belarusian army, but Belarusian and Western analysts doubt that this force could constitute a significant threat to Ukraine. Totalling just around 48,000, the Belarusian army is among the smallest among the CIS countries. The Belarusian army also has few modern weapons, for example, it has fewer Polonez missiles than the Azerbaijani military, which has been purchasing weapons from all over the world in recent years.

Furthermore, ammunition and some military hardware has been continuously transported to Russia since spring. These transports were recently intensified, with local Belarusian activists reporting the movement of more tanks and ammunition from Belarus to Russia. However, as analysts have previously pointed out, such a move lessens the chance that the Belarusian army is preparing to join the war itself, since it is decreasing its available military hardware in storage. Russia is currently sending Iranian-made Shahed drones en masse to Belarus, probably indicating a future increase in airstrikes against Ukraine's northern regions from Belarusian territory.

Independent Russian news outlet Meduza lists four possible scenarios for what could be behind Lukashenko's statement about a joint military grouping:

1. A verbal tactic meant to distract Ukrainian forces from their ongoing counter-offensives.
2. A cover for the deployment of more Russian aircraft, missile brigades and drones in Belarus.
3. A safeguard for a future escalation of the conflict being mainly pushed by Russia that could fear future Nato involvement.
4. An actual preparation by Russia to re-open Ukraine's northern front.

Among these, Meduza views the fourth possibility as the least likely, since Russia

would need a very large strike force and is likely to have learned from its mistake from this spring when it bogged down in the swampy Pripjat region and was unable to establish supply routes. Options one and two appear more probable and also appear similar to previous scares earlier this year from Lukashenko. Their reasoning resonates with the analysis made by the independent Belarusian military monitoring project Belarusian Hajun, which released a similar assessment two weeks ago.

The third option is also possible. If Putin is seriously considering using tactical nuclear weapons in Ukraine, the Kremlin knows that the situation could significantly deteriorate by leading to Nato involvement. A former Belarusian diplomat believes that Lukashenko could be preparing his army just in case the situation escalated; because if the Kremlin really forced him to participate, he couldn't withhold his military support even if he wanted to.

While Nasha Niva has reported that Lukashenko has decided to conduct a "covert mobilisation," this information still remains unconfirmed, with many exiled Belarusian politicians and

analysts still believing that mobilisation to invade Ukraine would be political suicide for Lukashenko; instead, some believe that the recent announcements are a bluff to draw away Ukrainian troops from their counter-offensives.

Belarusian authorities keep emphasising that there is no mobilisation, and during the past three weeks there have been repeated statements that it won't happen, the last time being yesterday.

#### Ukraine's preparedness

While Ukraine is terminating more and more economic co-operation with Belarus, it won't shut its door on Belarusians. President Zelenskiy's advisor Arestovych recently spoke out about his support for Belarusians struggling under domestic political repressions, and Ukraine's ambassador to Belarus thinks the recent proposal to cancel visa-free travel for Belarusians to Ukraine is a bad idea.

Thus Ukraine's leadership has not turned its backs on the Belarusian people, and is likely have a wide network of contacts both themselves and through domestic Belarusian opposition organisations that can

give accurate information on military movements. Furthermore, Ukraine still holds a lot of good-will with the Belarusian population, who have not begun to hate Ukraine despite the increased propaganda against the Ukrainian Armed Forces.

At the recent G7 meeting, Zelenskiy proposed the sending of an international observation mission to the Ukraine-Belarus border and Ukraine has been worried about a renewed Russian invasion from the Belarusian direction since Lukashenko and Putin had their meeting in Sochi between the 26-27 September.

However, Serhii Naiev, the Commander of the Joint Forces of the Armed Forces of Ukraine, emphasised yesterday that the situation in "Ukraine's north" is fully under control. According to Naiev, Ukraine is keeping close tabs on Russian and Belarusian military movements in Belarus and makes its threat assessments based on the number of troops, their composition and combat potential amassed in Belarus. At the moment, Naiev believes that Ukraine is ready for an attack from Belarus. ●

#### BELARUS CORRUPTION WATCH:

## How the Lukashenko family's friends in the construction business hide from sanctions

### bne IntelliNews

**T**he Serbian brothers Bogoljub and Dragomir Karić have (together with the rest of their family) been running construction businesses throughout the Balkans and post-Soviet countries in the east since 1991. In their latest joint investigation, the Belarusian Investigative Centre (BIC) and the Organised Crime and Corruption Reporting Project (OCCRP) has outlined the brothers' connections to the Minsk regime and investigated the sales and transfers of the family's various properties.

The Karić brothers became known in the 1990's as sponsors of Slobodan Milosević's regime and Bogoljub and Dragomir have advanced their political careers on the side of their business ventures.

In 2004, Bogoljub Karić founded the political party Strength of Serbia movement, which his brother Dragomir joined the same year. Dragomir has since held a position in Belgrade's City Assembly and has been a member of Serbia's Parliament since 2012. Their political careers have gone hand in

hand with their business ventures and it's worth noting that Dragomir has either chaired or been a member of Serbia's parliamentary friendship groups for the countries he's done the most business in, such as the post-Soviet countries and Cyprus.

#### Connections with Alexander Lukashenko's family

In 2006, Bogoljub established the integrated real estate, investment and development company Dana Holdings, and since then construction projects by

Dana Holdings have been a common sight in Minsk, often being criticised for their negative effects on city planning.

As BIC put it in their investigation, “it’s common knowledge that one cannot run a big business in Belarus without Aleksander Lukashenka’s support”, support which the Karić brothers quickly earned.

In 2006, Bogoljub was charged with tax evasion and money laundering in Serbia. However, he fled to his friend the Belarusian strongman Alexander Lukashenko, who helped him evade prosecution in Serbia until the case was dropped. In 2010, he obtained a Belarusian passport. In 2009 Dragomir became an honorary consul for Belarus in Serbia and was praised by Lukashenko for his contributions to “developing” trade ties between the two countries. The two brothers hold frequent meetings with Lukashenko and their meetings have even been featured in the Belarusian state-owned media outlet, BelTA’s reporting.

Currently, their company Dana Astra is behind the the development of the Minsk-Mir residential project, which is heavily marketed by state-owned Belarusian media. At one point in 2021, Lukashenko handed over land to three companies related to the Karić brothers worth \$1bn by exempting the company from the necessary land auctioning procedure. Moreover, Lukashenko exempted the company from certain taxes and allowed the use of taxpayer’s money to pay for water, electricity and road infrastructure in the companies’ residential developments.

The Karić and Lukashenko families also have close ties. Dana Holdings is a current sponsor of Belarus’ National Olympics Committee, which is headed by none other than Alexander Lukashenko’s son Viktor Lukashenko. Viktor’s wife Liliya Lukashenko worked at Dana Astra, a subsidiary of Dana Holdings, between 2014-2016. During her time at Dana Astra, Liliya also became close with Bogoljub’s wife and the two travelled to Greece and Cyprus together several times between 2011

and 2016, often accompanied by Viktor Lukashenko, their children and Viktor’s mother (the ex-wife of Alexander Lukashenko). After 2016, Liliya went on to head “Art Chaos,” an art gallery located in the Dana Mall shopping centre owned by Dana Astra.

### The sale of Dana Astra and sanctions evasion

The EU and UK sanctioned Dana Holdings (Cyprus) and Dana Astra (Belarus) in December 2020 due to the Karić brother’s close ties to the Lukashenko family. In August 2021, the US followed the EU and UK sanctions as well as sanctioning one of Bogoljub’s sons, Nebojsa Karić, and two off-shore firms controlled by Dana Holdings through five companies on Cyprus. In its official statement, the US Department of Treasury branded the Karić family “Lukashenko’s construction wallet.” In June 2022, sanctions against Bogoljub Karić were included in the EU’s sixth sanctions package for his support to and benefits from the Lukashenko regime.

To protect their assets, the Karićs made their family friend Nagip Behluli the head of Dana Holdings in February this year, and already before the 2020 sanctions, the Karić brothers had foreseen the sanctions and sold their five Cyprus subsidiaries to a

company in the UAE called Enterprise Developments Holding two weeks prior to the sanctions. Between 2008 and 2020, the Karićs transferred over €170mn of their Belarusian subsidiary Dana Astra’s profits to these five subsidiaries in Cyprus as dividends.

The head of Enterprise Developments Holding is also a family friend of the Karićs. 41-year-old British businessman Mostafa El-Tobgy has worked at a consulting firm owned by Bogoljub’s daughter Elena, but in 2010 he suddenly transferred all his shares in the company to Bogoljub’s other daughter Daniča. At one point he was also the executive director of the Dana Holdings company group, and he’s featured in several social media posts with the Karić family members. Furthermore, El-Tobgy is a resident of Belarus, where he has a “special work permit” and lives in one of Dana Astra’s upmarket apartments.

The sale of these five companies in Cyprus was set at €700mn, while the total sum for the five companies’ official book value was set at €21,550, thereby giving Dana Holdings a profit of €700m. The money had not been transferred by the end of 2020, and they were instead placed as receivables on Dana Holdings current account. Experts from the OCCRP say that this transaction has “all signs of money laundering.” ●



From left to right: Dragomir Karic, Alexander Lukashenko and Tomislav Nikolic. / President.gov.by



Hungarian Prime Minister Viktor Orbán has forged close ideological and economic ties with Putin's Russia. / bne IntelliNews

## Putin's dwindling circle of friends in Emerging Europe

bne IntelliNews

**T**he number of European countries friendly towards Moscow has dwindled to just a handful since Russia's illegal invasion of Ukraine in February. Defending Moscow's actions is now a toxic option in Europe, because not only has Russia launched an unprovoked land war in Ukraine, but it is also seen by the countries in the eastern part of the continent as posing a potential existential threat to them too.

Further east, the former Soviet republics of Central Asia and the South Caucasus have long lived with the presence of Russia as the pre-eminent great power. With Russia to the north and China to the east, they have little choice but to accommodate Moscow, even while prizing their own territorial integrity just as Ukraine does. That has led their governments to hold back from criticism of

the invasion or from joining sanctions, while declining to cheerlead for Russia or formally recognise its annexations of Ukrainian territory either.

Thus there only are a handful of states in Russia's near neighbourhood that have remained on cordial terms with Moscow – from EU member Hungary and candidate country Serbia in Europe, to Armenia, Azerbaijan and the five Central Asian republics – yet none can be said to approve of the war in Ukraine. Of the Central, Eastern and Southeast Europe region just Bosnia & Herzegovina, Moldova, Serbia, Turkey and of course Belarus have not joined sanctions imposed by the EU and other Western nations. All except Belarus backed UN resolutions condemning the invasion, and even the Central Asian republics, much more vulnerable to Russia, given

their geographic location, stopped short of recognising Moscow's recent annexations of four Ukrainian regions.

Indeed, Russia can probably be said to have only one true friend: **Belarus**. The neighbouring country's leader Alexander Lukashenko has openly said the country is participating in what he and Putin call the "special military operation" in Ukraine, though he does argue Belarus' participation was primarily limited to preventing the conflict from spreading to Belarusian territory and to preventing a Nato strike on his country.

Accordingly, Minsk has been targeted by many of the sanctions imposed on Moscow. Russia and Belarus were also therefore the only significant European countries not invited to the inaugural summit of the European Political Community.

### Friends and foes in the EU

Situated on Nato's eastern flank, the Baltic states, Poland and Romania are among the most hawkish on Russia within the EU. They have consistently argued in favour of tougher sanctions and other actions such as a ban on Russian tourists.

But while the EU has imposed several increasingly tough packages of sanctions on Russia, there are a wide variety of different opinions within the bloc, and one of the eastern EU members – **Hungary** – takes a diametrically opposite position to those of its neighbours.

Viktor Orban, the Hungarian strongman, was not always a fan boy of Russian dictator Vladimir Putin. He depicted himself as a courageous fighter against communism when he first came to power in 1998, even if this was much exaggerated.

But after a secret meeting with Putin while he was subsequently in opposition, Orban returned to power in 2010 with a completely transformed attitude, and he has since forged close ideological and economic ties with Putin's Russia, visiting Moscow regularly.

This has always mystified observers, some of whom have speculated that the Kremlin must have some kompromat on him. Equally likely is that he simply admired Putin's modus operandi, and copied some of his authoritarian tactics, such as the culture wars against sexual minorities.

This year, Orban even flew to Moscow in the run-up to the invasion of Ukraine when Putin was being shunned by Western leaders. After Putin invaded in February, Orban was slow to criticise the Russian dictator.

In the Hungarian general election in April, he painted himself as a supporter of peace, and accused the democratic opposition of seeking to drag the country into war. Orban has refused to let arms supplies to Ukraine go directly across the Hungarian border into Ukraine. He has repeatedly called for a ceasefire and peace talks.

There are also now significant economic reasons for Orban's subservience to Moscow's line. Since his return to power in 2010 his regime has built up energy links with Russia, deepening the country's dependence on Moscow. Hungary now relies on Russia for 65% of its oil and 90% of its gas imports. The latter are made under a secret contract that, according to media investigations, hardly appears to be a bargain for Budapest.

While other countries have been deliberately cutting their energy links with the Kremlin, Orban's foreign and trade minister rushed to meet Putin last month to beg for even more gas ahead of the winter.

This dependence has made the Hungarian radical right-wing leader a constant critic of, and drag on, attempts by the EU to tighten sanctions on the Kremlin.

He has blamed the sanctions rather than Putin's dictatorship for the cost of living crisis, saying that the sanctions hurt Europe more than Russia. His regime is currently launching a national consultation survey to gauge the view of Hungarians on sanctions with biased questions, one of its typical means of steering the

“While other countries have been deliberately cutting their energy links with the Kremlin, Orban's foreign and trade minister rushed to meet Putin last month to beg for even more gas ahead of the winter”

national debate (using public funds) and claiming popular backing for policies it has already decided on.

This stance towards Putin has further damaged the Orban government's already weak standing in EU capitals. Orban is more and more an outlier in Europe owing his relationship with the Russian dictator, with even Poland downgrading its links with him.

Yet by threatening to use his veto, Orban has won an exception on crude oil sanc-

tions for pipeline oil to Hungary (and other former Soviet bloc neighbours). Products and services for nuclear power plants (NPPs) will also be exempted from sanctions. Hungary has recently taken delivery of fuel rods from Russia for its planned massive expansion of the Paks NPP, which is being built by Russia's Rosatom for €12.5bn. Orban even managed to overturn EU plans to impose sanctions on Russian Orthodox Patriarch Kirill.

Aside from Orban, Putin used to be a favourite among many on Europe's far right and populist right, but there was a rush to disavow previous connections after the invasion. French presidential candidate Marine Le Pen's order to have 1.2mn election pamphlets showing her shaking hands with Putin being destroyed a few weeks after the invasion is a case in point.

Italy's snap general election in September 25 was watched closely for signs it could bring about a change in direction for what was previously one of the most hawkish states in the EU.

Giorgia Meloni is set to become the country's next prime minister after her right-wing nationalist Fratelli d'Italia took

the largest share of the vote. She has sent mixed messages on Russia; as one *bne IntelliNews* columnist pointed out, while hailing Russia in her 2021 autobiography as the “last defender of Christian values in Europe”, she has strongly condemned the invasion and voted in favour of sending military aid to Ukraine. Her likely coalition partners – Matteo Salvini, a well-known fan of Putin, and Christian-conservative Forza Italia led by billionaire former prime minister Silvio Berlusconi, who has a long-standing friendship with the Russian president – are seen as more pro-Russian.

### Bulgaria's about-turn

In Southeast Europe, **Bulgaria** did an abrupt turn from Russia hawk under former prime minister Kiril Petkov – Petkov's refusal to pay for gas in rubles led to Gazprom cutting off supplies this spring – to a much softer stance following President Rumen Radev's appointment of a caretaker government under Golub Donev. In a move that sparked protests in Sofia at the prospect of returning to Moscow's sphere of influence, Golob's ministers have said they want to resume talks with Gazprom.

Like Italy, Bulgaria held a general election recently. However, in Bulgaria there is no immediate prospect of a new government being formed, as the parliament is highly fragmented. Thus Radev will continue to play an outsized role in Bulgaria politics. The two parties that took the largest share of the vote on October 2, Gerb and Petkov's Change Continues, both identify as being part of the pro-Western camp, but with major policy differences on other issues. Change Continues has already ruled out a coalition with Gerb. The most likely outcome therefore is another caretaker government pending yet another snap election. Until a stable majority can be formed in Parliament, Radev will be the one with the power to appoint caretaker ministers.

**Russia's friends in the Western Balkans**  
**Serbia**, despite not being an EU member, has been under heavy pressure from Brussels to join EU sanctions on Russia, as one of the candidate countries from the Western Balkans.

Belgrade has so far refused to do this, citing its long-standing friendship with Russia and position of neutrality. On the other hand, Serbia has voted in favour of UN resolutions condemning the invasion of Ukraine, and publicly said it cannot accept the results of the referenda organised on the annexations of parts of eastern Ukraine to Russia.

There are two main reasons for this. First, there remains a strong pro-Russian contingent in Serbia. This was evident in June when Putin was voted the most popular world leader in one poll. Putin sympathisers were also in evidence at a

series of marches against the holding of the EuroPride event in Belgrade earlier this autumn. Even within the cabinet, there are pro-Russian and pro-Western voices.

Secondly, Russia has consistently supported Serbia over the Kosovo issue. Russia has used its position as a permanent member of the UN Security Council to block Kosovo – which unilaterally declared independence from Serbia in 2008 – from joining the UN, and has long been Serbia's staunchest backer on the issue. Serbian politicians also look back to Russia's support during the sanctions imposed during the wars of the 1990s and the Nato bombings of Serbia and Montenegro in 1999.

As with Hungary, there have also been economic benefits to Serbia from refusing to impose sanctions, notably its new long-term gas deal signed with Gazprom on favourable terms this spring at a time when other countries were seeking to move away from dependence on Russian gas.

Neighbouring **Bosnia** has been unable to impose sanctions on Russia, as these have been blocked by leading Bosnian Serb politicians.

Bosnian Serb leader Milorad Dodik is one of Putin's biggest fans in Europe. In the run-up to the October 2 state- and entity-level elections, Dodik visited Putin, who personally endorsed his candidacy.

However, Dodik's position is currently uncertain. Official data shows Dodik was elected president of the county's Serb entity Republika Srpska on October 2 – switching places with his close ally Zeljka Cvijanovic, who will take over Dodik's old position as the Serb member of the tripartite state level presidency. Opposition leaders in Republika Srpska then demanded a recount of the votes and annulment of the election for president of the entity, claiming fraud. The issue has led to thousands-strong protests, and a recount is now in progress.

### Turkey's tricky relationship with Russia

For an idea on just how difficult it is to stay, in full view, on amicable terms with Moscow despite the war, the case of **Turkey** is interesting. The country's

president, Recep Tayyip Erdogan, always eager to maximise his country's gains on all sides where possible, has attempted to maintain strong relations with both Russia and Ukraine throughout the conflict, arguing Ankara should keep itself available as a trusted intermediary ready to serve a key role should opportunities for peace talks arise.

Yet Nato member Turkey appears to have gone too far in exploiting this arrangement for economic gain – too far for the US and Europe to stomach that is. It has become known as a bolthole for Russian investors and as a conduit via which Russia can keep up trade flows otherwise shut off by the West.

Clearly annoyed and concerned, the US lately threatened sanctions against Turkish banks that continued to provide access to Russia's Mir payments system. Five banks quickly backpedalled. What's more, since the Kremlin stepped up the Ukraine conflict by holding sham referenda and annexing territories, even Erdogan appears to have cooled on what level of tolerance and respect he is prepared to offer Putin in public.

Even less guarded about offering Russia a sympathetic ear has been **Iran**, which appears to have provided depleted Russian forces with hundreds of attack and surveillance drones. Iran has made substantial trade and investment gains from keeping up its support for Russia, and stands to make much more, though Tehran, while blaming Nato for pushing Russia into a corner and thus bringing about an environment for conflict, is careful to periodically state that it would like to see an end to the war and a negotiated settlement. The Iranians are also wary of the Russians using heavy discounts to elbow them aside in 'under the radar' oil and gas export markets such as China, where they can avoid US sanctions enforcers.

### Changed balance of power in the South Caucasus

**Armenia** used to be one of the most pro-Russian states in the post-Soviet space, being the fourth country to join the Eurasian Economic Union after its three founders. Contributing factors were its relative poverty and the ever-

present threat from Azerbaijan, its richer and better armed neighbour. Yerevan thus looked to Moscow for support.

However, when Azerbaijan – seizing the opportunity at a time when Russia was distracted by the war in Ukraine – attacked Armenia in September, resulting in almost 300 deaths on both sides and the loss of Armenian sovereign territory, Yerevan didn't find Russian help forthcoming, despite an appeal to the Russia-led Collective Security Treaty Organization (CSTO).

On the evening of September 13, Armenia's government initiated a video summit of the heads of state of the CSTO, which has a collective defence provision under which states are supposed to support their fellow members if their territorial integrity is violated. What Armenia got was merely a fact-finding mission sent by the organisation.

Demonstrating its unhappiness with the lack of action from the CSTO, Armenia declined to take part in military exercises that the CSTO began in Kazakhstan on September 26.

**Azerbaijan** President Ilham Aliyev remains an ally of Putin, and he has ignored Western sanctions and refused to publicly criticise Moscow for its invasion of Ukraine (though he has defended Ukraine's territorial integrity). But he has used the way that the Kremlin's attention is distracted to test its willingness to keep the peace in the South Caucasus.

Last month Azerbaijan launched an attack on Armenia itself, despite Yerevan's military alliance with Moscow. Aliyev has also been conducting peace negotiations with Armenia under EU auspices, sidelining Moscow.

Moscow has hardly reacted, proof that Azerbaijan has actually become more strategically important to Russia since the invasion, as it represents a vital link with Iran and is an intermediary between Moscow and Ankara, with Turkey becoming a critical player in the Ukraine war.

Aliyev believes he has more options now that the EU is courting him as an

alternative energy provider to the bloc. Brussels signed a deal with Baku in July to double the gas imports it buys in order to cut its dependence on Russian supplies. European Commission President Ursula von der Leyen visited Baku in August in a trip notable for its lack of criticism of Aliyev's repressive regime.

### Central Asian nations torn

Central Asian states are taking a cautious approach to the war. Economically interlinked with Russia, they have also suffered economically as a result of the war and sanctions. They don't want to risk enraging Russia by joining sanctions but **Kazakhstan** in particular is concerned about its own territorial integrity; the northern part of the county that lies to the south of Siberia has large ethnic Russian populations and a number of Russian politicians have claimed it belongs to Russia.

Kazakhstan's President Kassym-Jomart Tokayev has several times indicated his unhappiness with the war, while not going so far as to break with Russia – which stepped in to help out when Tokayev faced violent protests this winter. In his speech to the United Nations General Assembly on September 21, in rather general terms Tokayev criticised the fighting of wars and spoke about the dangers in the potential use of nuclear weapons, while not explicitly directing any criticism at Russia.

He had previously snubbed Putin at the June economic forum in St Petersburg, where he made it clear that Kazakhstan would not recognise the Luhansk People's Republic (LNR) and Donetsk People's Republic (DNR) that have since been annexed by Russia. Neither Kazakhstan, nor any other Central Asian state, recognised the two republics as independent nor the subsequent annexations of Ukrainian regions by Russia.

**Uzbekistan** has traditionally been one of the more independent Central Asian states vis a vis Russia, with plenty of its own resources and no border with the regional giant. Though Uzbekistan, like Kazakhstan, often refers to its efforts to maintain a "balanced" foreign policy, it retains close ties with Moscow.

Tashkent has not backed the Russian war in Ukraine and in a statement the foreign ministry said Tashkent remains committed to principles such as respecting other states' sovereignty and territorial integrity. Both Kyrgyzstan and Uzbekistan have warned their citizens not to sign up for participation in Russia's war in Ukraine.

**Kyrgyzstan**, like Armenia, was let down by Russia as the CSTO likewise failed to come to its aid when a border dispute escalated and forces from Tajikistan penetrated deep into Kyrgyzstan this autumn, causing tens of thousands of Kyrgyz to flee their homes. On October 9 Bishkek announced that it had unilaterally cancelled joint military drills that were due to be carried out on its territory by the CSTO.

This announcement came two days after the country's president, Sadyr Japarov, skipped the October 7 CIS summit in St Petersburg that featured celebrations of the 70th birthdays of both Putin and Tajik President Emomali Rahmon. As reported by *bne IntelliNews*, Japarov almost certainly stayed away because of still raw anger in Kyrgyzstan at the military confrontation with Tajikistan.

**Tajikistan**, on the other hand, appears to have accepted that it has little choice but to work with Moscow. Not only is it the FSU's poorest country, but Russia's military presence is critical to guarding the long and porous border with Afghanistan. Thus while Japarov stayed away from the CIS summit this month, Tajik President Emomali Rahmon turned up with the gift of two pyramids of melons.

Remote **Turkmenistan** rarely comments on foreign affairs, maintaining a traditional neutrality, though its closeness to Moscow is clear for all to see. Europe would dearly like to see Ashgabat get serious about constructing a trans-Caspian Sea pipeline via which it could solve some of the European states' energy sourcing difficulties with supplies from known gas reserves that are the world's fourth largest. However, such a move in the current circumstances would undoubtedly upset the Kremlin. Rather than risk that scenario, the Turkmen remain focused on attempting to up their gas exports to the east. ●



According to Forbes, Ivanishvili has a net worth of \$4.8bn, making him Georgia's wealthiest citizen. / Michał Koziczynski

## Georgian MPs want to rid the country of oligarchs, but not all of them

### Mack Tubridy in Tbilisi

Georgia's parliament has begun work on a de-oligarchisation bill that the opposition says will be used to target their business supporters, rather than the country's most famous oligarch, Bidzina Ivanishvili, founder of the ruling Georgian Dream party.

Georgian Dream party MP and chairperson of the parliamentary Legal Issues Committee, Anri Okhanashvili, discussed the de-oligarchisation bill during a press briefing on October 3. Okhanashvili told journalists that the Georgian Dream ruling party intends to use Ukrainian legislation as its model for the new bill, with the difference that in Georgia the parliament will be responsible for compiling a list of potential oligarchs. In Ukraine, the presidential administration compiles a list.

When asked by journalists whether Ivanishvili, the country's so-called "secret ruler," is likely to be included

**"The opposition believes that the deoligarchisation law will be used to punish opposition financiers and to protect the interests of Ivanishvili"**

on the list of oligarchs, Okhanashvili said that "this draft law, physically and objectively, cannot apply to Bidzina Ivanishvili".

As Radio Free Europe/Radio Liberty's Georgian service reports, the bill

contains several guidelines for defining an oligarch. This includes the possession of assets worth at least \$85mn, as well as the funding of political parties and media.

The opposition believes that the de-oligarchisation law will be used to punish opposition financiers and to protect the interests of Ivanishvili. Although MPs from Georgian Dream claim that they are implementing EU recommendations, the opposition views the bill as an instrument for potential political repression.

According to Forbes, Ivanishvili has a net worth of \$4.8bn, making him Georgia's wealthiest citizen. Ivanishvili served as prime minister of Georgia in 2012–2013. After that, he announced his retirement from politics. But in 2018 he formally returned to Georgian Dream. About three years later, he again issued a letter declaring his "final retirement" from politics.

However, many in Georgia regard Ivanishvili as the informal arbiter of major political decision making in the country, and both current and former members of government have said that personnel decisions are made directly with the participation of Ivanishvili.

Back in September, Ukraine's anti-corruption agency argued that Ivanishvili should be sanctioned for his alleged ties to Russia's military campaign against Ukraine. The agency claims that

Ivanishvili has close ties with and has lobbied for the interests of influential Kremlin-allied Russians, including Vladimir Yevtushenkov, a Russian businessman, Georgy Poltavchenko, Saint Petersburg's former governor, and Russian MP Anna Kovyshko. ●



# Too early to call time on the CSTO

Kamila Ibragimova, Peter Leonard for Eurasianet

**T**he Russian-led CSTO military alliance has seen better days.

Last month, Armenia announced it would not attend a series of readiness exercises in Kazakhstan. That was in effect a mute protest at the bloc's unwillingness to intercede on its behalf after it was attacked by Azerbaijan.

And then on October 9, Kyrgyzstan said it was no longer prepared to host another military drill – dubbed Indestructible Brotherhood-2022 – that was to run for five days through October 14.

The Defence Ministry did not state the reasons behind its decision, but the widely accepted explanation is that the government in Bishkek could not countenance hosting troops from Tajikistan, whose forces launched attacks on villages in the southern Kyrgyz province of Batken in mid-September.

Kyrgyzstan later revealed that it would

not be sending any of its troops to participate in the Collective Security Treaty Organisation's Frontier-2022 exercises being held this month in Tajikistan.

And yet, the year had started so promisingly for the Collective Security Treaty Organisation.

When Kazakhstan was gripped by domestic unrest in January, President Kassym-Jomart Tokayev set an important precedent by triggering a mutual defence clause and soliciting military aid.

Troops, mainly from Russia, but also from Armenia, Belarus, Kyrgyzstan and Tajikistan, arrived quickly.

By the time the soldiers had fanned across Almaty, Kazakhstan's second city, the turmoil had all but ended.

This last detail underlines a common misconception about the CSTO. More

than a military alliance analogous to Nato, the bloc is a political entity. The primary function of the Kazakhstan deployment was to lend Tokayev moral support, not to restore order.

"Political signalling was more important than the military component of the operation, that is why the operation was considered to be a success," Yulia Nikitina, a research fellow at the Center for Eurasian Studies at MGIMO University in Moscow, told Eurasianet.

The exact political purpose of the CSTO, however, is a subject of disagreement in the analyst community.

"The most important actor in the organization is Russia. CSTO has enabled Russia to maintain its influence in the Caucasus and Central Asia regions," Ecaterina Locoman, a senior lecturer at the University of Pennsylvania, said in emailed remarks.

In that optic, a leading function of the



CSTO exercises in Tajikistan last October. / CSTO

bloc is to keep other strategic suitors seeking to deepen relations with countries in the region at bay.

Russia is “interested in maintaining the organization as a tool to limit the ability of CSTO members to cooperate with NATO or to limit the influence of other states – for example China – to increase their influence in the Eurasian region,” Locoman wrote.

While some countries in the CSTO have sought to diversify their security ties, their presence within the Moscow-dominated bloc has limited their scope for action.

“It is almost certain that a country like Kazakhstan, with an [Individual Partnership Action Plan] with Nato since 2006, would scale up its relationship with Nato if it was able to, but it must refrain from doing so as a result of

interim government of the time pleaded with the CSTO for help. Security officials from member countries agreed only to provide equipment and transport, however, stopping short of dispatching manpower.

If on that occasion the bloc lacked the stomach to intervene, failure to act on other occasions has stemmed from a lack of solidarity.

“The Armenia-Azerbaijan conflict is the most obvious example. Belarus and Kazakhstan both sided clearly with Azerbaijan in this conflict, even though Armenia is a CSTO member. This effectively neutered the ability of the CSTO to play any role whatsoever in this conflict,” said Cornell of the ISDP. “And more recently, the Kyrgyz-Tajik border conflict is taking place between two CSTO members – and the CSTO is again AWOL.”

Kazakhstan and Kyrgyzstan,” Cornell said.

None of this is to say that the CSTO has outlived its usefulness. And this is because its members never saw the bloc as an analogue to Nato in the first place, so its failure to act like that Western alliance is not seen as a failure.

“Unlike Nato countries, where today we see consolidation and solidarity around Washington’s positions on Ukraine [...] the situation with the CSTO is entirely different,” said Igor Davidzon, author of the 2021 monograph *Regional Security Governance in Post-Soviet Eurasia*.

For CSTO members, the material component of military cooperation with Russia plays the most decisive factor.

“All these countries receive military equipment at domestic Russian rates, and they get training for their officer corps almost free of charge,” Davidzon said.

This combination of material gains and, for some countries, a lack of immediate alternatives, means that it is probably premature to call time on the organisation.

“The CSTO will continue to exist, because some of its members find it advantageous to their own security and international standing,” said Locoman. “States like Armenia, for example, face security threats from other actors in the region, so they are better off within an alliance with Russia than outside such an alliance. Belarus remains isolated internationally, therefore a place within the CSTO offers its regime legitimacy and stability.” ●

**Kamila Ibragimova** is the pseudonym for a journalist in Tajikistan.

**Peter Leonard** is Eurasianet’s Central Asia editor.

This article originally appeared on Eurasianet.

## “Kazakhstan must refrain from scaling up its relation with Nato as a result of Russian pressure”

Russian pressure,” said Svante Cornell, director of the Institute for Security and Development Policy, or ISDP.

But Nikitina questioned the notion that Russia controls the organisation.

“In most cases, national interests outweigh the regional integrationist logic,” she said. “All member states value their sovereignty and do not want to create precedents for external intervention even if it is a friendly group of military allies.”

One big problem is that there has been precious little consensus historically about when interventions could be deemed legitimate, necessary, or even possible.

When the southern Kyrgyzstan city of Osh descended into inter-ethnic bloodshed in June 2010, the shaky

The sense of frustration felt by Kyrgyzstan’s President Sadyr Japarov over that inaction bubbled to the surface during a leaders’ summit of the Conference on Interaction and Confidence-Building Measures in Asia (CICA) in Astana on October 13.

“Unfortunately, existing, authoritative regional organisations are not fully implementing their opportunities and mechanisms to prevent conflicts directly affecting stability in the region,” Japarov said in his speech to the conference, albeit without name-checking the CSTO.

The war now being waged by Russia against Ukraine is another elephant in the room.

“The Ukraine war makes the CSTO increasingly radioactive among some of its member states, particularly



# KEEP YOUR EYES ON THE BALL



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bne  INTELLINEWS



Putin just turned 70 but it seems he didn't get what he wanted for his birthday. / bne IntelliNews

RIMMER

## Post-Putin Russia is worse, not better

Putin's downfall is now inevitable. What happens when he's gone? It gets worse.

**bne IntelliNews**

Happy Birthday, Mr President. Let's hope it's his last.

Vladimir Putin, the recidivist war criminal, might well have dreamt of Marilyn Monroe's breathy returns in his ear or even the Nobel Peace Prize on a silver platter for his seventieth birthday. Pyramid of Tajiki melons and Belarusian tractor notwithstanding, the greeting he most likely received was a report of the latest in a string of Russian/Ukrainian villages (delete according to taste) to be reconquered by the enemy and news of sporadic outbursts of gunfire at enlistment offices across the realm.

Meanwhile, public dissent against the war, but more often mobilisation, has become more widespread and outspoken, and fissures are beginning to open up between various factions within the regime and without. The die was cast for Putin the moment his tanks trundled across the Ukrainian border in February. Russia's defeat, and Putin's downfall, are now inevitable. They are simply a question of time. It could be days. It could be months. Those hoping this looming

cataclysm will usher in a new era of parliamentary democracy midwived by cuddly oppositional liberals are naive, though. The moral arc of the universe is long and *it bends towards disappointment*.

Autocracies are structurally incapable of the peaceful transfer of power, so Putin's end will most likely result from a paroxysm of violence as warring blocs within the security services compete to press the claims of their chosen successor. It will be a case of 'Which bastard is next?' rather than who will be the best person to lead postlapsarian Russia.

Links between organised crime, state institutions and the security services in Russia are well-entrenched and thanks to books like *The Vory* by Mark Galeotti, equally well-advertised. The KGB managed to maintain control of the essential levers of power throughout the disintegration of the Soviet Union and the chaos that followed and it's highly improbable, after some savage internecine feuding and bloodletting, they won't still be in that position after Putin's quietus.

The tentacles of the mafia and the FSB reach into every cranny of Russian society. Making a power play in the vacuum that will develop from Putin's departure, be it political, economic or criminal, is fraught with danger. There's nowhere in the public sphere for an authentic representative opposition to develop and the death throes of the Putin regime won't provide any. The progress of Russian democracy is not suited to the human lifespan.

Even if Putin is forcibly removed from office there is no guarantee that the successful putschists won't continue to prosecute the war under a new commander-in-chief. The whispering campaign against Putin's military leadership –

“Even if Putin is forcibly removed from office there is no guarantee that the successful putschists won't continue to prosecute the war under a new commander-in-chief”

and that of his generals – suggests the error has been in not conducting the special military operation with sufficient vigour rather than regretting it was launched at all. Putin will be well aware that his immediate existential threat will come from his right flank rather than any genuine opposition.

The Russian economy, already kneecapped by sanctions and set to contract 6% in 2022, will shrink next year and underperform thereafter, according to most forecasts, almost regardless of who runs the country. Any period of civil unrest

and political volatility will cosh growth even harder. The best Putin can hope for even if he somehow clings on to power is acting as some kind of petrol pump attendant for China.

Ethnic discontent is already stirring in the Caucasus, where the mobilisation programme has been the most punitive and the prospects for violent opposition to Moscow's governance will increase dramatically with any kind of upheaval in the Kremlin.

Separatist-leaning republics have long focused their discontent on central government but as the state becomes increasingly fissiparous then the chances are that long-standing resentments and ethnic rivalries will have them fighting each other. The only possible short-term benefit the world may derive from a palace coup is that the destructive forces in Russia may turn centripetal rather than centrifugal and this may de-escalate potential conflicts in Eastern Europe, the Middle East and Africa, not to mention Ukraine.

The economic, political and societal implications of Russia post-Putin, then, are uniformly bleak. The destabilisation of the world's largest nuclear power generates huge geopolitical worry and the unforeseen or unintended consequences may be even worse than the admittedly grim vision adumbrated here. This is not a good argument for encouraging Putin to remain in power but it's a warning against premature jubilation should the administration find its own von Stauffenberg.

Russian history does not foster grounds for optimism. The pessimist may think things can't get worse, but the optimist knows 'Oh yes, it can'. Whether Putin is strung up from a gibbet on a windy day or heads, hands bound, to The Hague on that flatbed truck, it will be different when he's gone but probably not better. My favourite *chernomyrdinka*: 'We wanted the best but it turned out like always'. ●



What he wanted for his birthday...



What he got...

STOLYPIN

# Political stalemate leaves battlefield with casting vote

**Mark Galeotti, director of consultancy Mayak Intelligence**

**H**owever much well-meaning Westerners may speak glowingly of the need for talks between Kyiv and Moscow, at present there is no scope or prospect for any meaningful discussions. Instead, it looks like it will only be the battlefield that determines how, what and when any eventual negotiations may be.

## Ukraine's red lines

On 4 October, Volodymyr Zelenskiy signed a decree formally ruling out talks with Vladimir Putin, while adding: "we are ready for a dialogue with Russia, but with another president of Russia." This followed his speech to the UN General Assembly when he directly addressed those in the West who see some kind of solution to the conflict through Ukraine adopting a path of non-alignment. "Those who speak of neutrality mean something else. They pretend to protect someone, but in reality they only protect their vested interests."

In many ways, Zelenskiy was speaking less to Moscow than to the West. Time and again he has ignored the usual diplomatic etiquette and tried to shame or cajole his sometimes hesitant partners to up their game. In this case, he was likely seeking to head off any attempts by any of them to try to bring pressure to bear on Kyiv to make concessions in the name of a mirage of peace.

## Moscow's strategy

However, Moscow continues to float the notion of talks and claim that Kyiv is being prevented from negotiating by its Western puppet-masters. At his recent press conference in Astana, for example, Putin said that "we are open. We have always said that we are open. We reached certain agreements in Istanbul, after all. These agreements were almost initialled. But as soon as our troops withdrew from Kyiv, the Kyiv authorities lost any interest in the talks. That is all there is to it."

This is disingenuous, to say the least. In any case, in practice Putin has made any such discussions effectively impossible by his decision to annex occupied territories (and, indeed, lay claim to lands not even currently under Russian control) on the basis of 'referenda' of not even tenuous legitimacy. In effect, this was the Russian president burning his own



After Ukraine's spectacular counteroffensive the kinetic war in Ukraine is slowing down again but with the political process in a stalemate the battlefield will determine the outcome of the war. / bne IntelliNews

bridges behind him, hoping that this declaration of intent would sufficiently worry Kyiv and, more likely, the West when coupled with his unsubtle (if not especially convincing) hints of a nuclear option.

There has been, after all, another apparent shift in Putin's intent. His ideal goal is presumably still the subjugation of Ukraine, but even the most optimistic Kremlin hawk must realise that, for the moment at least, this is not a credible goal. Instead, just as he abandoned his 'thunder run' on Kyiv when it became clear that could not succeed and instead refocused on the south-east, now he is in effect abandoning any great hope of winning his war on a grand scale, and instead seeking to avoid losing it.

The annexations and the mobilisation are, after all, two sides of the same coin. The troops that are being harvested will be poor ones, under-motivated, undertrained and under-equipped. These are not the forces which, for now, could launch any kind of new offensive. Instead, the hope must be that they could at least hold the line, slow or block further Ukrainian advances this autumn and avoid a general collapse of Russian forces.

The first 'mobiks' are simply being thrown into the war, replenishing units that have taken heavy casualties. Others are being used to form wholly new units, but these will not be deployable until the end of the year at the earliest. Maybe then Putin might hope to regain the initiative on the battlefield – though this is hardly likely – but above all he is hoping that time is his ally.

## Two Wars

This is because there are two wars being fought. The bloody struggle in Ukraine is one, but the other is a 'non-kinetic' one between Russia and the West, being fought in the battlefields of economics, politics and society. They are intertwined, to be sure, but not quite the same, and for all the Western mantra that "the war will end when Ukraine decides," there is scope for a divergence between the two.

The Ukrainians have demonstrated not just an extraordinary determination to defend their homeland, but also the capacity to both outfight and outthink the Russians.

Nonetheless, they remain dependent not just or even mainly on Western weapons, ammunition and training, but on the billions of financial aid keeping their economy alive.

If Putin has any real hope of being able to salvage something that might look like a (partial) victory from this debacle, it depends not on breaking the Ukrainians on the battlefield but in undermining the West's will to continue to bankroll the war.

### Asymmetric wars

At present, then, the two sides are too far apart for any meaningful negotiations. Zelenskiy cannot and will not accept anything less than a Russian withdrawal from all occupied territories (although in practice it is possible that there may end up being some kind of deal on Crimea), along with reparations. Putin cannot and will not at present surrender what he now is claiming is Russian territory.

Any future peace will thus depend on what happens on the battlefield. Ukraine may be able to drive back the Russians until it has taken back what has been seized. Russia could conceivably manage to achieve a stalemate in the conflict, though this is looking less likely.

But we ought not forget the other battlefields, either. Sanctions are not having the kind of immediately cataclysmic effects on Russia their promoters predicted, and nor are they likely to. Nonetheless, they are stripping the Russian economy of capacity and resilience, which could leave it vulnerable to unexpected shocks. Likewise, although at

present it looks unlikely, there could be some seismic shifts in the West which lead to a scaling back of support for Ukraine.

Until something happens to force one side or the other dramatically to revise its demands and expectations, then no talks can bear fruit.

### Stalemates are not necessarily all bad

It is hard to see any of these happening any time soon, though. A Russian military collapse is the most plausible of these scenarios, but even so, probably not worth holding one's breath for. We must accept the likelihood that this terrible war will roll deep into next year, if not longer.

That kind of bloody and dynamic stalemate is hardly an enticing prospect, but it is not necessarily the worst possible outcome. Putin's self-conscious and self-destructive act of bridge-burning means that his old room for manoeuvre, for redefining quite what 'victory' might mean, is vastly reduced. Whether or not his political future – indeed, perhaps even his survival – does depend on the outcome of the war, he likely believes it is existential. Nightmare scenarios like the potential use of non-strategic nuclear weapons, however unlikely, look most plausible if he feels his back is truly up against the wall.

Putin must fail, indeed, yet perhaps he needs to fail sufficiently slowly to get used to the idea, and not be stampeded into a panicked and ill-considered reaction. In that context, and that context alone, a miserable and bloody stalemate may be the lesser evil. ●

## TEHRAN BLOG

# Will the protests be crushed or could the Islamic regime fall?

## bne IntelliNews

Opinion is divided among Iran watchers as to whether the anti-regime protests that have swept the country for nearly three weeks can end in any way except with a crushing of the demonstrators.

On October 5, the *Guardian* published an analysis asking, "Are the protests in Iran just doomed to flare and then be crushed?" while CNN went with the headline, "A barrier of fear has been broken in Iran. The regime may be at a point of no return."



On @1500Tasvir on Twitter, Iranians attempt to document the protests. The photograph is said to show Mohammadamin Takoli, who allegedly suffered a brain injury and died after being hit with tear gas at a close distance. / @1500Tasvir

The Islamic Republic regime, meanwhile, organised more counter-protests and continued to describe the protesters as "rioters" guilty of "sedition". Notably, recent days have seen the protests, in which at least scores are known to have lost their lives, feature an increasing number of acts of defiance led by schoolgirls, while more and more university campuses have been turned into battlegrounds with students attempting to continue their protests while evading security forces.

October 5 also saw Tehran summon the British ambassador to Iran, accusing UK officials of trying to provoke further unrest in the country, while Iranian prosecutors opened a probe into the death of a teenage girl in the capital during the early days of the protests. Nika Shakrami, who would have turned 17 at the weekend, has become an icon for the anti-government movement. Officials have told state media she fell from a roof, but that her death was not linked to the protests.

RFE/RL's Farda Briefing on October 5 was headlined, "Despite weeks of protests, survival of Iranian regime not threatened."

It reported: "There are no major divisions within the establishment or the security forces. There have been no major strikes like the ones that preceded the Islamic Revolution in 1979.

"Even so, prominent rights advocate Nasrin Sotoudeh told TIME magazine that there is 'a very real possibility of regime change.'"

Looking at how previous waves of protests have indeed been crushed during the more than four-decade-long history of the Islamic Republic, the *Guardian* analysis included the

observation that "if the past is a tutor, it is easy to write the obituary of this round of protests". However, the article also noted: "Yet Iran has this capacity to surprise. Any reading of *The Pride and the Fall*, Anthony Parson's self-reproachful account of his failure as British ambassador to Tehran to predict the toppling of the Shah of Iran in 1979, knows Iran can leave the closest observer dumbfounded."

It also pointed out: "Few would have expected these demonstrations to have lasted as long as three weeks, even if their scale, hard to judge from the west, waxes and wanes. And it appears as if the Iranian leadership is caught off balance and nervous about the way its legitimacy is being challenged by this new phenomenon of a leaderless unarmed revolution, which is even drawing in schoolchildren."

Prominent supporters of the protests now include a group of French female film stars led by Oscar winners Juliette Binoche and Marion Cotillard. They have posted videos of themselves cutting their hair in support of the women in Iran protesting the death of Mahsa Amini. It was the death of Amini, following her arrest by Tehran morality police for allegedly wearing her hijab loosely, that sparked the first protests. ●

IMF BLOG

## Policymakers need steady hand as storm clouds gather over global economy

**Pierre-Olivier Gourinchas, Economic Counsellor and the Director of Research of the IMF**

**O**ne-third of the world economy will likely contract this year or next amid shrinking real incomes and rising prices.

The global economy continues to face steep challenges, shaped by the Russian invasion of Ukraine, a cost-of-living crisis caused by persistent and broadening inflationary pressures, and the slowdown in China.

Our global growth forecast for this year is unchanged at 3.2%, while our projection for next year is lowered to 2.7% – 0.2 percentage points below the July forecast.

The 2023 slowdown will be broad-based, with countries accounting for about one-third of the global economy poised to contract this year or next. The three largest economies, the United States, China, and the euro area will continue to stall. Overall, this year's shocks will re-open economic wounds that were only partially healed post-pandemic. In short, the worst is yet to come and, for many people, 2023 will feel like a recession.

In the United States, the tightening of monetary and financial conditions will slow growth to 1% next year. In China, we have lowered next year's growth forecast to 4.4% due to a weakening property sector and continued lockdowns.

The slowdown is most pronounced in the euro area, where the energy crisis caused by the war will continue to take a heavy toll, reducing growth to 0.5% in 2023.

Almost everywhere, rapidly rising prices, especially of food and energy, are causing serious hardship for households, particularly for the poor.

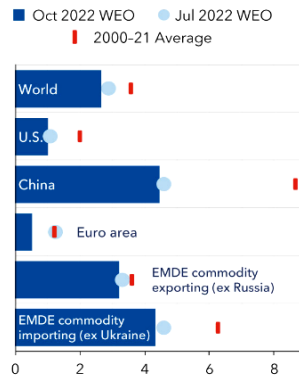
Despite the economic slowdown, inflation pressures are proving broader and more persistent than anticipated. Global inflation is now expected to peak at 9.5% this year before decelerating to 4.1% by 2024. Inflation is also broadening well beyond food and energy. Global core inflation rose from an annualised monthly rate of 4.2% at end-2021 to 6.7% in July for the median country.



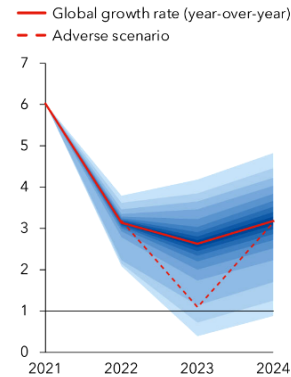
## Broad slowdown

The global growth forecast for this year is unchanged at 3.2%, and the projection for next year has been cut to 2.7%.

### 2023 real GDP growth (percent; year-over-year)



### Uncertainty for global growth (forecast, percent)

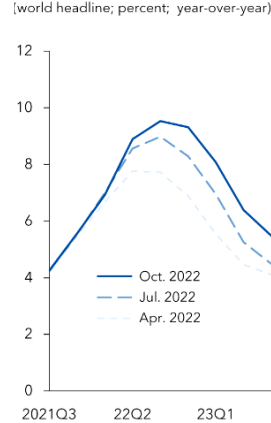


Sources: IMF, World Economic Outlook; and IMF staff calculations.  
Note: Right panel fan shades denote 5-95 percentile; black line represents stagnant global income per capita.

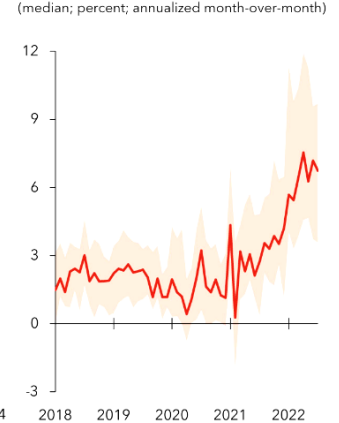
## Persistent price pressures

Global inflation is broadening, and forecast to peak at 9.5% this year before decelerating to 4.1% by 2024.

### Projected inflation path (world headline; percent; year-over-year)



### Core inflation (median; percent; annualized month-over-month)



Sources: Haver Analytics; IMF, World Economic Outlook; and IMF staff calculations.  
Note: The band indicates 25-75 percentile range for each month. Group represents 89.4% of GDP of advanced economies, 75% of emerging market and developing economies, and 81% of world GDP based on purchasing power parity weights.



Downside risks to the outlook remain elevated, while policy trade-offs to address the cost-of-living crisis have become more challenging. Among the ones highlighted in our report:

- The risk of monetary, fiscal or financial policy miscalibration has risen sharply amid high uncertainty and growing fragilities.
- Global financial conditions could deteriorate, and the dollar strengthen further, should turmoil in financial markets erupt, pushing investors towards safe assets. This would add significantly to inflationary pressures and financial fragilities in the rest of the world, especially emerging markets and developing economies.
- Inflation could, yet again, prove more persistent, especially if labour markets remain extremely tight.
- Finally, the war in Ukraine is still raging and further escalation could exacerbate the energy crisis.

Our latest outlook also assesses the risks around our baseline projections. We estimate that there is about a one in four probability that global growth next year could fall below the historically low level of 2%. If many of the risks materialise, global growth would decline to 1.1% with quasi stagnant income-per-capita in 2023. According to our calculations, the likelihood of such an adverse outcome, or worse, is 10 to 15%.

## Cost-of-living crisis

Increasing price pressures remain the most immediate threat to current and future prosperity by squeezing real incomes and undermining macroeconomic stability. Central banks are now laser-focused on restoring price stability, and the pace of tightening has accelerated sharply.

There are risks of both under- and over-tightening. Under-tightening would further entrench inflation, erode the credibility of central banks and de-anchor inflation expectations. As history teaches us, this would only increase the eventual cost of bringing inflation under control.

Over-tightening risks pushing the global economy into an unnecessarily severe recession. Financial markets may also struggle with overly rapid tightening. Yet the costs of these policy mistakes are not symmetric. The hard-won credibility of central banks could be undermined if they misjudge yet again the stubborn persistence of inflation. This would prove much more detrimental to future macroeconomic stability. Where necessary, financial policy should ensure that markets remain stable. However, central banks need to keep a steady hand, with monetary policy firmly focused on taming inflation.

Formulating the appropriate fiscal response to the cost-of-living crisis has become a serious challenge. Let me mention a few key principles.

First, fiscal policy should not work at cross-purpose with monetary authorities' efforts to bring down inflation. Doing so will only prolong inflation and could cause serious financial instability, as recent events have illustrated.

Secondly, the energy crisis, especially in Europe, is not a transitory shock. The geopolitical realignment of energy supplies in the wake of the war is broad and permanent. Winter 2022 will be challenging, but winter 2023 will likely be worse. Price signals will be essential to curb energy demand and stimulate supply. Price controls, untargeted subsidies or export bans are fiscally costly and lead to excess demand, undersupply, misallocation and rationing. They rarely

work. Fiscal policy should instead aim to protect the most vulnerable through targeted and temporary transfers.

Third, fiscal policy can help economies adapt to a more volatile environment by investing in productive capacity: human capital, digitalisation, green energy and supply chain diversification. Expanding these can make economies more resilient to future crises. Unfortunately, these important principles are not always guiding policy right now.

### Effects of a strong dollar

For many emerging markets, the strength of the dollar is a major challenge. The dollar is now at its strongest since the early 2000s, although the appreciation is most pronounced against currencies of advanced economies. So far, the rise appears mostly driven by fundamental forces such as tightening US monetary policy and the energy crisis.

The appropriate response in most emerging and developing countries is to calibrate monetary policy to maintain price stability, while letting exchange rates adjust, conserving valuable foreign exchange reserves for when financial conditions really worsen.

As the global economy is headed for stormy waters, now is

the time for emerging market policymakers to batten down the hatches.

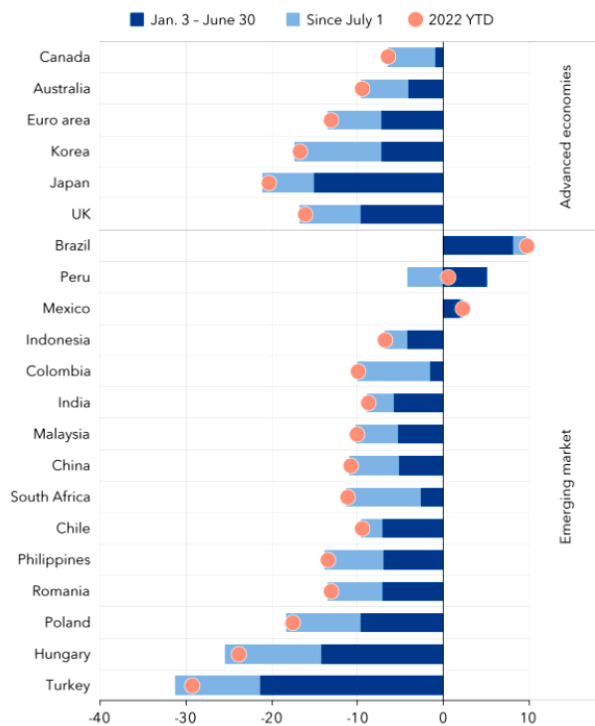
Eligible countries with sound policies should urgently consider improving their liquidity buffers, including by requesting access to precautionary instruments from the Fund. Countries should also aim to minimise the impact of future financial turmoil through a combination of pre-emptive macroprudential and capital flow measures, where appropriate, in line with our Integrated Policy Framework.

Too many low-income countries are in or near debt distress. Progress towards orderly debt restructurings through the Group of Twenty's Common Framework for the most affected is urgently needed to avert a wave of sovereign debt crisis. Time may soon run out.

The energy and food crises, coupled with extreme summer temperatures, are stark reminders of what an uncontrolled climate transition would look like. Progress on climate policies, as well as on debt resolution and other targeted multilateral issues, will prove that a focused multilateralism can indeed achieve progress for all and succeed in overcoming geoeconomic fragmentation pressures. ●

### Surging US dollar

The strong dollar is a major challenge for emerging markets. (exchange rates vis-à-vis US Dollar, percent change)



Source: Haver Analytics and IMF staff calculations.  
Note: As of October 3, 2022. Excluding Russia.

IMF

## Latest World Economic Outlook Growth Projections

(real GDP, annual percent change)	PROJECTIONS		
	2021	2022	2023
<b>World Output</b>	6.0	3.2	2.7
<b>Advanced Economies</b>	5.2	2.4	1.1
United States	5.7	1.6	1.0
Euro Area	5.2	3.1	0.5
Germany	2.6	1.5	-0.3
France	6.8	2.5	0.7
Italy	6.6	3.2	-0.2
Spain	5.1	4.3	1.2
Japan	1.7	1.7	1.6
United Kingdom	7.4	3.6	0.3
Canada	4.5	3.3	1.5
<b>Other Advanced Economies</b>	5.3	2.8	2.3
<b>Emerging Market and Developing Economies</b>	6.6	3.7	3.7
<b>Emerging and Developing Asia</b>	7.2	4.4	4.9
China	8.1	3.2	4.4
India	8.7	6.8	6.1
ASEAN-5	3.4	5.3	4.9
<b>Emerging and Developing Europe</b>	6.8	0.0	0.6
Russia	4.7	-3.4	-2.3
<b>Latin America and the Caribbean</b>	6.9	3.5	1.7
Brazil	4.6	2.8	1.0
Mexico	4.8	2.1	1.2
<b>Middle East and Central Asia</b>	4.5	5.0	3.6
Saudi Arabia	3.2	7.6	3.7
<b>Sub-Saharan Africa</b>	4.7	3.6	3.7
Nigeria	3.6	3.2	3.0
South Africa	4.9	2.1	1.1
<b>Memorandum</b>			
<b>Emerging Market and Middle-Income Economies</b>	6.8	3.6	3.6
<b>Low-Income Developing Countries</b>	4.1	4.8	4.9

Source: IMF, World Economic Outlook, October 2022

Note: For India, data and forecasts are presented on a fiscal year basis, with FY 2021/2022 starting in April 2021. For the October 2022 WEO, India's growth projections are 6.9 percent in 2022 and 5.4 percent in 2023 based on calendar year.

NEMETHY

# Is the world heading towards a “polycrisis”?

**Les Nemethy, CEO and founder of Euro-Phoenix Financial Advisors**

**A**ccording to historian Adam Tooze, we are currently potentially facing a “polycrisis”: a number of smaller to medium-sized crises in the world that have the potential to combine and reinforce each other. Think of a lot of small and medium-sized fires combining to form one magnificent conflagration. Historian Niall Ferguson talks of a crisis shaping up in the 2020s that could be significantly worse than the 1970s.

This article will first take a high-level view of potential drivers of such a crisis, and then an overview individual countries hurtling toward crisis.

## Drivers of Crisis

Debt is always associated with fragility. Whereas during the 1970’s crisis, global debt was hovering in the range of 100% of global GDP, today it is in the range of 350%.

The US Fed was for a long time in denial about inflation, then labelled it as “transitory”. Quantitative Tightening and interest rate hikes were postponed to the point where the genie was already out of the bottle by the time the Fed and ECB started raising interest rates. Over the past months the Fed has pushed through several 75 basis point increases (and the ECB a few relatively minor increases) – but this has proved too little and too late to stop inflation.

Taming of inflation typically requires positive real interest rates. Even after many interest rate hikes, real interest rates in the US remain in the range of negative 4 to 5%, and in Europe 8 to 10% as of beginning of October, 2022. Because of significantly higher debt levels, the pain inflicted by raising interest rates is by definition much higher than in the late 1970s. Something will break.

Another driver: climate change has been driving an agenda of substituting green energy for fossil fuels. The planning was done poorly, particularly in Europe. Even if we look beyond the colossal error of reliance on Russian hydrocarbons, fossil fuels were phased out faster than green fuels could be brought on stream, particularly with respect to satisfying base load capacity. The nuclear industry, a carbon-free source of base load capacity, was virtually shut down in Germany and curtailed in other European countries.



The world is facing multiple crises simultaneously: a pandemic, cost of living crisis, energy crisis, a war and more. How bad will it get? / bne IntelliNews

In the 1970s, the world enjoyed a number of helpful tailwinds, including favourable demographics and rising productivity; globalisation was just beginning. These factors now constitute headwinds. Most of the world faces a demographic cliff, globalisation is stalling or reversing, resulting in diminishing efficiency and productivity.

The above drivers were in place even pre-coronavirus (COVID-19) and pre-Ukrainian war. Covid and the war did serve to accelerate and aggravate each of these drivers.

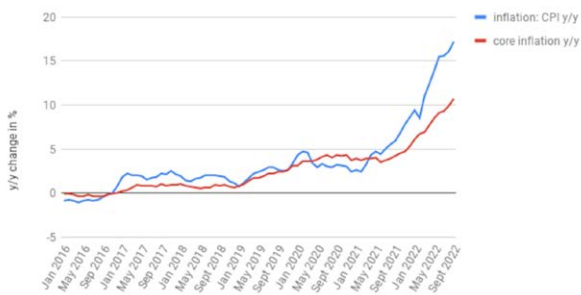
## A quick tour of the world

China is losing its locomotive effect on the world economy due to an imploding real estate sector (which accounted for almost one quarter(!) of GDP), aggravated by the demographic cliff the country is now facing. Covid lockdowns further diminish GDP growth and create supply chain havoc. The government’s insistence on recentralising power to the Communist Party is also likely to have a dampening effect on growth.

Continental Europe faces multiple challenges. The cessation of Russian gas supplies is perhaps the greatest. Meanwhile, Italy’s newly elected right-wing government may bring havoc to debt markets in Europe and put stress on the European banking system (at least half a dozen major European banks see share prices collapsing and have price-to-book ratios less than 40%). Bankruptcy of a globally systemically important bank (G-SIB) such as CSFB is not inconceivable.

Emerging markets throughout the world are in tough shape due to higher US interest rates and global crises sucking up global liquidity. Much of emerging market sovereign and corporate debt is denominated in US dollars, and with the appreciation of the dollar, are becoming increasingly difficult to service. Turkey and Argentina are approaching hyperinflation. Sri Lanka and Pakistan are basket cases. Russia, Iran and Venezuela are facing sanctions.

The US seems to be the only real economic locomotive of the world today; its job market remains surprisingly strong. Even the US economy is decelerating, thanks to ever-higher interest rates. Yet inflation in the US remains robust at over 8%, meaning that the Fed is likely to continue increasing interest rates – until something breaks. And then the world’s last economic locomotive loses traction. ●

**Poland CPI v core inflation, annual change in %**

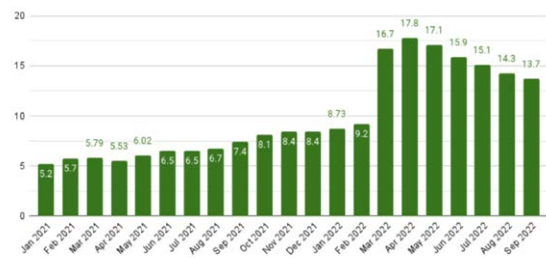
Source: bne IntelliNews

**Poland's core inflation goes into double-digit territory in September**

Poland's core inflation, which measures price growth without food and energy, grew 0.8pp to 10.7% y/y in September (chart), the National Bank of Poland (NBP) said on October 17.

Core inflation growth tracks the expansion of consumer prices (CPI), which also accelerated in September, coming in at 17.2%, a gain of 1.1pp versus the preceding month.

Accelerating CPI and core inflation dash hopes for price growth peaking in 2022. Analysts now expect inflation to start easing from the peak of roughly 20% y/y in February.

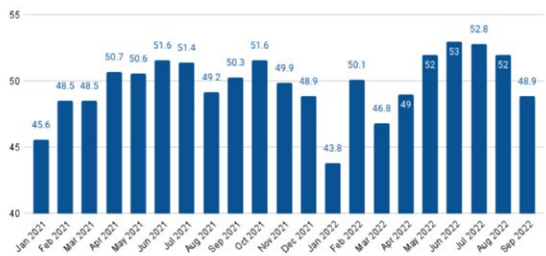
**Russia inflation y/y**

Source: CBR

**The fall in Russian inflation to 13.7% in September is bottoming out**

Inflation continued to fall in Russia in September, to 13.7% year on year, but at a much slower rate than in previous months. The recent period of strong disinflation is coming to an end and the central bank is likely to scale back the frequency of further interest rate cuts, Capital Economics reports.

Consumer prices rose marginally by 0.05% month on month in September, which was the first monthly increase since May. The y/y rate fell from 14.3% to 13.7%.

**Kazakhstan PMI index**

Source: IHS Markit

**Kazakhstan's manufacturing PMI signals renewed contraction**

Kazakhstan's manufacturing sector signalled renewed contraction in September following four months of expansion seen since May, according to the latest purchasing managers' index (PMI) survey data from Tengri Partners and IHS Markit.

The index posted 48.9 in September, following August's 52. The survey noted that new orders fell for the first time in five months amid pressures caused by steep prices and ongoing supply-chain disruptions, which observers often link to effects of the war in Ukraine. As new business fell, firms scaled back production, purchasing activity and employment, with business confidence in decline. Currency weakness also contributed to sharp increases in input costs.

**Historical overview**

Source: S&amp;P Global

**S&P sees 'bleak' prospects for Turkish manufacturing after assessing latest PMI data**

The headline manufacturing purchasing managers' index (PMI) for Turkey fell to 46.9 in September, down from 47.4 in August, marking the seventh month in a row it has been below the 50.0 mark that divides expansion from contraction.

Commenting on the Istanbul Chamber of Industry Türkiye Manufacturing PMI survey data, Andrew Harker, economics director at research compiler S&P Global Market Intelligence, said: "The September PMI data provided few reasons for cheer for Turkish manufacturers as demand conditions both at home and abroad (notably in Europe), remained challenging."

# Poland sees steep deceleration in housing construction

**Rafal Benecki and Piotr Poplawski economists at ING in Poland**

In September, construction output increased by just 0.3% year on year, against a consensus of 6.6% and an increase of 6.1% in August. The decline in growth is mainly the result of reduced building construction. Construction may be one of the weakest elements of the economy at the turn of the year.

Construction of buildings slowed to 8.7% y/y from 25.7% a month ago, although it remained by far the strongest category. New residential construction remains on a strong downward trend, as developers fear a further decline in demand and a collapse in real estate prices, while

construction costs may be rising. The number of housing units under construction remains near record levels, but after a very strong 1H22, this is slowing sharply and is now below last year's level in August (see chart).

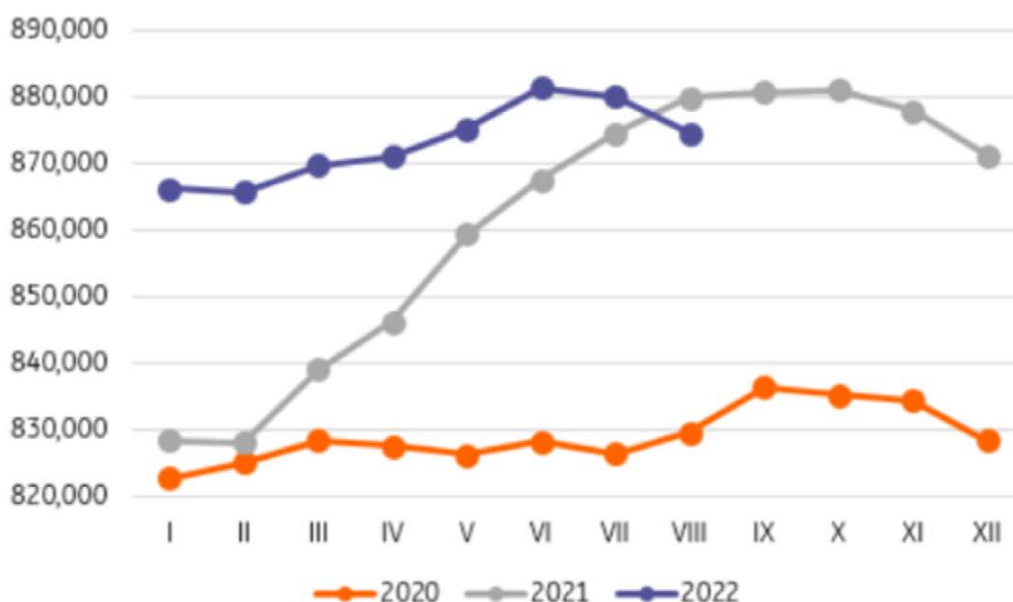
Infrastructure investment-related categories again performed poorly: civil engineering declined by 2.3% y/y (-1.6% y/y in August) and specialised construction works fell by 4.9% y/y (-1.3% y/y a month prior). This is likely the result of effects already seen in previous months – a strong increase in production costs, which makes it difficult to issue new tenders,

particularly by the public sector, (or forces companies to walk off job sites), or a lack of funds from the Recovery Fund.

Construction may turn out to be one of the weakest elements of the domestic economy at the turn of the year, with its annual dynamics sliding into negative levels. Its main driver, housing construction, is weakening significantly, and the necessary monetary tightening does not promise a recovery in demand in the coming quarters. Without access to the Recovery Fund, it is also difficult to assume an imminent improvement in infrastructure investment. ●

## Post-pandemic construction boom fading

Flats under construction



Polish construction is slowing and is now one of the weakest segments of the economy. / bne IntelliNews

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