

London, March 2022 – Blink Concept Plc

A snapshot of the crisis in Ukraine and possible scenarios

A MONTH INTO PUTIN'S WAR

War is back in Europe. When the Russian armed forces began their invasion of Ukraine on 24 February, it became clear that the multipolar reality of the clash between powers (large, medium, small) had become a contemporary reality once again. The current necessity is to adapt to this 'non-end of history' pattern and understand the evolutions, the scenarios, the contexts and why not also the potentialities. Understanding in advance certain dynamics, tracing



Photo Reuters: A Ukrainian tank seen on the move in Mariupol, Ukraine after Russian President Vladimir Putin authorised a military operation in eastern Ukraine on Feb 24, 2022.

their perimeter, and assessing their evolution quickly and constantly allows you to get a clear picture of what is happening so that you can orient your choices accordingly. Guiding these choices within a changing reality, a multidimensional reality where everything is connected, consequential, from supply chains to security issues. Blink Concept is here for it.

A FLUID SITUATION

On the ground, the situation is very fluid. Basically, in a nutshell: Russia did not think it would find such a functional resistance and did not think it would encounter problems of unpreparedness of its troops, it thought in a rapid advance that would take it to Kyiv within a few days. This was not the case and in a month Moscow's units did not conquer any significant territory.

What happens on the ground drives the diplomatic and related international affairs game - not vice versa. This is why the analysis we intend to offer starts from here. If Putin had broken through without encountering Ukrainian resistance and the difficulties of his army and quickly reached the government buildings in Kyiv, we would now be telling a different story about the conflict and the global reactions would also have been different.

The Russian troops are suffering from various types of problems related to both insufficient logistics and the poor preparation of the military, from commanders to recruits. According to some estimates, Russian losses are calculated at around 15,000 men and the forces available to Moscow are represented by troops arriving from afar, young and unmotivated, who are fighting an invasion war for which they were not prepared. In contrast to the Ukrainian resistance where they are fighting for their own home – and they have received significant military aid from the European Union and the United States.

Much has been said about the amazing Ukrainian defense against what appeared to be an overwhelming military force from Russia, but at the heart of the matter is a lack of coordination, planning, and training among the Russian forces. This lack of Russian military professionalism is a problem that has been known for decades. This has also facilitated many communications tapping: Russian troops have found themselves forced to rely on unencrypted systems, allowing Ukraine to spy on their moves, often encouraging counterattacks on troops who thought they were safe.

The result is – except for the city of Kherson in the south – Russia does not control territory. It controls land lines of communication, some roads, and road crossings, but even in those areas, it suffers counterattacks. All the main Ukrainian cities, from Kyiv to Kharkiv, Odesa, or Mariupol, are the object of very violent attacks also linked to Russian frustration, but they are far from being conquered.



Given the situation on the ground, and the way Russian and Ukrainian forces have moved so far, it is difficult for Russia to have the real strength to take over the whole of Ukraine. Only a 1:3 ratio of strength is needed for conquest, and Moscow is not in a position (also for economic reasons) to put this into play. The ratio would increase in the event of territorial control.

What we can assess as credible is a violent occupation, at least in the short to medium term. This will lead to an escalation of the conflict, with phenomena of insurgency and urban fighting and with the risk of the influx of foreign forces of various kinds on Ukrainian soil (the so-called Syrianisation of the conflict). The other dramatic risk: is the use of non-conventional weapons.



(MACRO) ECONOMIC EVALUATIONS

The war in Ukraine has pushed global growth predictions down 0.5 percent.

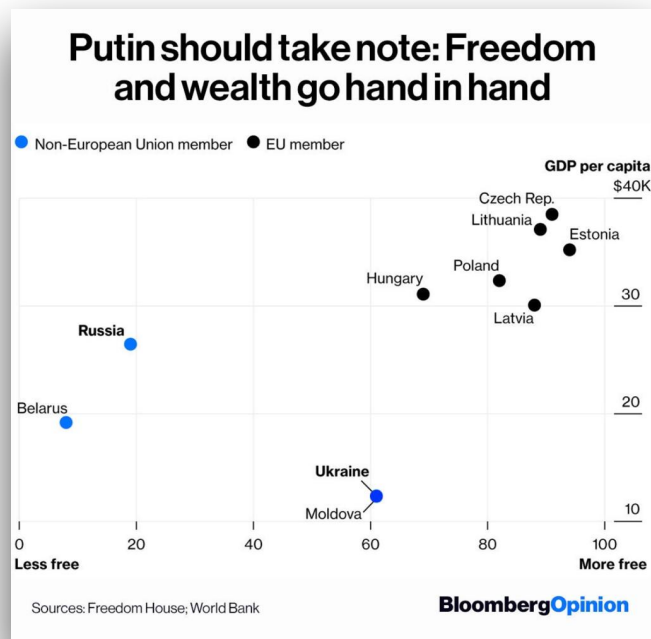
Russia's economy is already lagging behind its neighbors. Since the 2008 global financial crisis, Russia's economy has stagnated, while other former members of the Soviet Union and selected signatories of the Warsaw Pact have left it in the economic dust. Those economies happen to be members of the European Union and — perhaps most poignantly — score highly on Freedom House's Global Freedom Index, which allocates a score out of 100 based on an analysis of civil rights and political liberties.

Bloomberg Opinion's infographic on Freedom House data is clear: freedom is a factor in prosperity. Freedom is a nurturing environment, *humus* from which development grows, stimulates the quality of the individual, enhances the potential of communities.

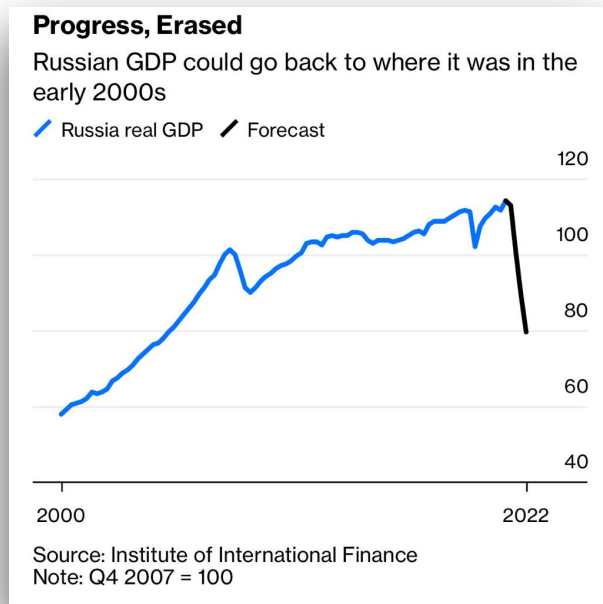
Russia's economy will struggle to pay the price of President Vladimir Putin's invasion. The ruble, however, has been paying the price of his rule for many years.

In the last two weeks, Putin's regime landed another blow to freedom in Russia, this time by turning the practice of journalism itself into a crime. A new law threatens up to 15 years in prison for disseminating "false information," which appears to mean anything that deviates from the official Kremlin narrative.

This is one of the main reasons why many global multinationals have decided to leave Russia, putting the economy and the social environment in further difficulty. But beyond ethical issues, there is a security aspect that is no longer negligible.



How severe is the situation? The Institute of International Finance predicts that



about 20 years of progress could be wiped from Russia's GDP. It's a pretty clear picture: Putin's war is taking one of the top 20 global economies back 20 years (i.e. to where Putin found it when he came to power).

The OECD estimates this shock will lower world output this year by 1.1 percentage points below what it would otherwise have been. The impact on the US will only be 0.9 percentage points, but on the eurozone, it will be 1.4 percentage points. The comparable impact on inflation will be plus 2.5

percentage points for the world, plus 2 percentage points for the eurozone, and 1.4 percentage points for the US. Increased prices of energy and food will reduce the real incomes of consumers by far more than these gross domestic product losses alone. The real incomes of net energy and food-importing countries will also be worse affected than their GDP alone. It is also likely that the OECD's estimates will be too optimistic. That will depend, among other things, on the duration of this evil war and the possible spread to China of sanctions or Europe of embargoes on energy imports.

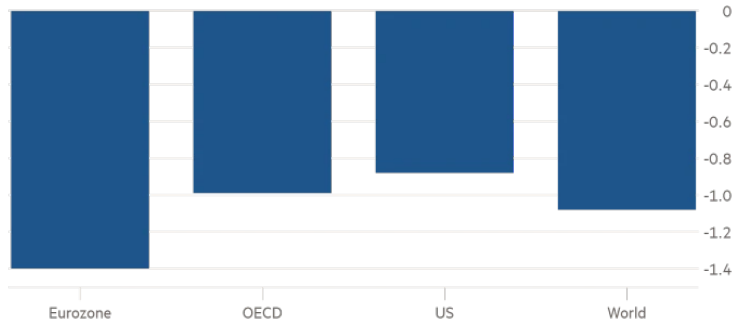
Through an interpolation of the most important outlooks in circulation, we can say that the global growth forecast is downgrading from 4 percent to 3.2 percent as the war in Ukraine continues.



Previous growth for 2022 was seen to slow from 6 percent to 4 percent. But given the Western's tough response to Vladimir Putin's actions, Russia's economy further crippled, disruption of global supply chains, and fuel even higher inflation, the global growth is expected to fall. It could drop further, drop to 3 percent if sanctions on energy trade are backed up with secondary sanctions. In that scenario, major central banks in advanced economies may consider scaling back tightening plans to support real activity.

Russia's war on Ukraine is a big shock to the world economy

Simulated impact on GDP in first full year after the invasion (%)



Combined effect of changes in commodity prices, rouble and other east European currencies vs \$, rise of 10% points in Russian policy rates and risk premia, and falls in domestic demand in 2022 H1 of 15% (Russia) and 40% (Ukraine)
Source: OECD
© FT



A look around the world

Both the outcome of the war and, more importantly, its wider ramifications, including those for the global economy, are, however, largely unknown. What is certain is just two years after the start of the Covid-19 pandemic, this is another economic shock, catastrophic for Ukraine, negative for Russia, and significant for the rest of Europe and much of the world.

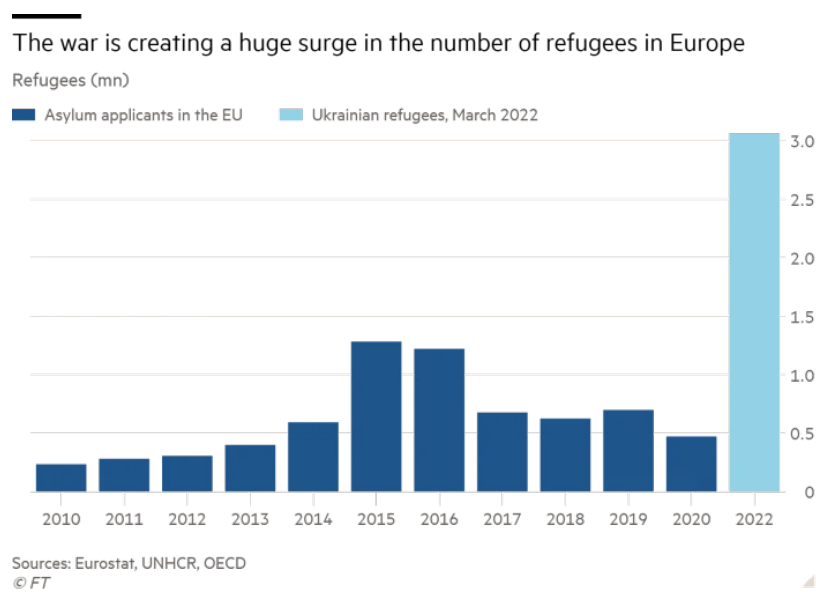
As usual, the impact of refugees is mainly local: they need to be fed and housed, they will find space in

Poland, Romania, Moldova, also because

they will want to stay in their homeland in the hope of being able to return to their homes.

But as has already happened in the past – for example with the Syrian conflict – refugees will also become a strong political issue, capable of altering not

only the internal debate in individual countries but also the EU debate. This could lead to further concentration and efforts by Brussels on the immigration issue. Efforts that would otherwise have been shifted elsewhere.



Globalization is at risk: the increasing intensity of tensions between the West and Russia (and China) puts the clash between models on the plane of the war. The model of Democracies versus that of Authoritarianism is the theme of the moment in international affairs, but if until now it was thought that even rival countries would continue to do business together despite these rivalries – because the globalized business could be protected from geopolitical clashes – now it seems that something is changing. The autocracies will try to reduce their dependence on Western currencies and financial markets. Both they and the West will seek to reduce their dependence on trade with adversaries.



We assess that, in a long-term evaluation, global supply chains will shorten, regionalize, essentially breaking the meaning of the term globalization. International political diatribes and geopolitical issues will play a role in building new alliances or partnerships on supply chains.

As far as monetary policy is concerned, it should be assessed for what may be relevant in wartime: it cannot save those under attack, but it can and must respond to the consequences.

It is conceivable to assess that it will continue to be aimed at controlling inflation and inflationary expectations. But it is possible and necessary for countries to apply their financial resources to take care of refugees and offset the impact of rising energy and food prices on the most vulnerable. These include many in developing countries, especially net importers of energy and food.

Recent events in Ukraine have made the prospect of a new sovereign debt crisis both more imminent and more damaging. Adding to the potential downside risks for some countries, the mechanisms currently in place to address sovereign debt problems have become dysfunctional. While the need for reform was recognized earlier, the recent G20 effort in this direction seems to have failed. Renewed international action is urgently needed to avoid a crippling stalemate. However, the current crisis will make it more difficult to find a solution, just as it has increased the cost of failure.

Furthermore, some countries will require substantial support in the short term because the uncontrolled rise in the cost of food commodities has already resulted in destabilizing consequences in countries in the MENA region – the Arab Spring season. The Special Drawing Rights created last year could now be used for these purposes, with richer countries deciding to give them to those who need them most.

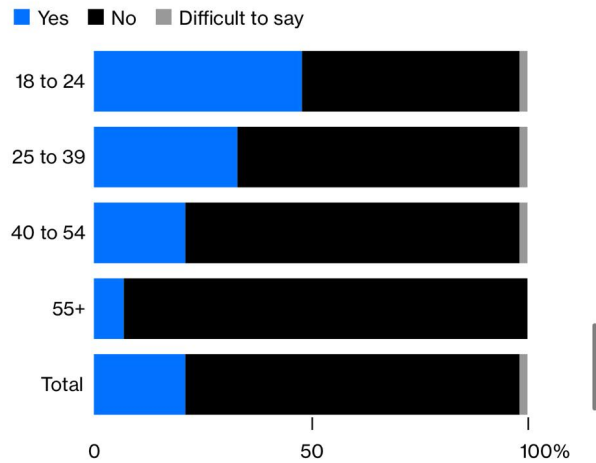
Warnings of a global food crisis are not a drill. After the pandemic, supply chains have held up quite well. The current episode is more like the global food crisis of 2007-2008. The shocks did not come from the trading system, but ended there, with countries banging on export controls to keep products at home. In general, even during food crises, there is enough to eat around the world, but it is in the wrong places. One can try to produce more, or move it to the right ones. In the short term, the second option may be politically more difficult, but it is more likely to be effective.



No small matter: Russia has a hemorrhage of young, outward-looking professionals who were part of a global economy that has largely cut off their country. Before the war broke out, only about 3,000 to 4,000 Russians were registered as workers in Armenia, according to officials. But in the two weeks after the invasion, at least an equal number arrived almost daily in this small country. While thousands have moved on to other destinations, government officials said late last week that about 20,000 remained. Tens of thousands more are trying to start new lives in other countries. The speed and scale of the exodus are evidence of a seismic shift that the invasion has caused within Russia.

Leaving Russia

Would you like to go abroad for permanent residence?



Source: Levada Center
Note: Survey from July 2021.

Energy matters: as is well known, networks of terminals, storage facilities, and naval fleets are used to physically move major commodities around the world – these dynamics are inherently risky in terms of security during a conflict that could expand or result in the opening of multiple fronts. But traders also need the financial markets to help them set minimum prices for futures dates and manage the risk that prices will move against them when commodities are delivered. This is usually done through contracts linked to commodity prices from exchanges such as ICE Futures Europe and CME Group in Chicago. Most European energy contracts are risk-managed in London, overseen by the BoE.

Central banks provide emergency liquidity during times of market stress to stem cash flow problems at solvent institutions. Generally, lenders pledge collateral in exchange for emergency loans. It is unclear exactly how any assistance for commodity market participants would work.

The European Commission presented the rules by which the Member States will be able until the end of the year to support sectors affected by high energy prices, including companies that produce or buy energy. Continuous fluctuations in the price of gas are putting the operations of energy traders at risk. Not only profits are being lost, but also liquidity, as banks are protecting themselves in the climate of



uncertainty by demanding cash margins of 80% of the purchase value. The possibility of providing up to EUR 50 million in aid for each company serves to avoid a vicious circle: gas purchases are postponed, stocks remain low and push up prices, and then even fewer purchases in the future.

The Commission is also considering support measures for consumers, but on this point European countries are divided. There are those who, like the "Mediterranean" governments, are calling for subsidies and lowered prices to protect the poorer sections of the population. And some, like the "Nordic" countries, see these measures as subsidies for fossil fuels to be redirected towards renewables.

So the EU countries are going it alone. Half a dozen of them have already announced cuts in fuel prices. Others, like Sweden, have introduced incentives for buying new electric vehicles. While France has imposed a cap on gas prices. Subsidies and state aid have a cost, which will be added to the 62 billion euros already spent by the four main European economies to cope with the energy crisis. And while at the moment very low-interest rates make it easy to finance such large expenditures, the ECB has announced that rates will have to rise by the end of the year to combat inflation. The era of "free money is over". Add all of this to post-pandemic plan dynamics.

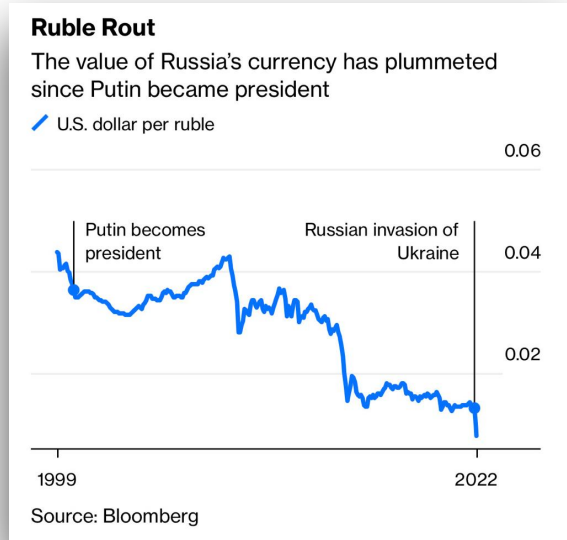
This is why there is renewed discussion of new joint issues of EU debt to finance energy and military spending. According to Italian Prime Minister Draghi, this expenditure could reach 2,000 billion euros, more than double the 800 billion euros of joint debt created to tackle the pandemic. But which many are already dismissing as unfeasible. In short, despite the Russian invasion, the EU seems to have rediscovered its old divisions.



MARKET WATCH

Russia's ruble has rebounded sharply in recent weeks as officials have put together an unorthodox defense of the currency. The latest effort to shore up support came in the form of a direct demand by President Vladimir Putin that Europe - or as he put

it, "hostile countries" - pay for Russian natural gas using rubles, rather than dollars or euros. This is essentially an effort by Russia to create demand for the currency - and the ruble jumped almost 8% on the news.



Putin's latest move has already been labeled a breach of contract by German officials. If it causes a complete break with Europe, which buys 40% of its gas from Russia, the ruble will probably fall again, but such a break would also worsen Europe's energy crisis. European natural

gas prices rose by 30% after Putin made his demand.

Sanctions imposed after Russia's invasion of Ukraine have hammered the value of the ruble, vaporizing about 90% of its value against the dollar at times this year. The government took measures - such as raising interest rates, halting currency trading, and requiring Russian companies to exchange their foreign earnings for rubles - that slowed and eventually stabilized the currency.

Russia supplies 10% of global nickel. Together with Ukraine, it accounts for 29% of global wheat exports. Some other commodities they supply extensively include palladium, natural gas, and corn. So, it is no surprise that the commodities sector has recently hit all-time highs. Nickel, aluminum, and wheat prices reached 50-year highs on 4 March 2022. As a result, commodity currencies such as the Australian dollar (AUD) and the New Zealand dollar (NZD) also rose. Gold prices also surpassed \$2,000/oz on international markets due to the metal's status as a safe-haven asset. On 9 March 2022, MCX gold contracts for April rose 1.67%. Industries that could see a decline include the automotive sector, which will bear the brunt of semiconductor shortages due to a constrained palladium supply chain.



GENERAL ASSESSMENT

Various scenarios can be applied to an assessment of the end of the war. Generally speaking, one can say that Russia will remain a pariah for the West as long as the Putin regime survives, but this perception may not necessarily apply to the rest of the world. We will, for example, have to conceive of a new relationship between Russia and China, and see how these two powers will interact with the Second and Third Worlds. There is a need for cooperation, although, for essential goods such as energy, Europe is already in the process of untying itself from Russian dependence.

We are in a new world. There will be an economic decoupling that we consider deep and irreversible, at least for the short to medium term.

The fluid and rapidly changing nature of the conflict makes it hard to gauge what will happen next in Ukraine, with both Moscow's and the West's next moves unpredictable. By the way, we tried to draft five scenarios.

The pro-Russian junta in Kyiv. Russian President Vladimir Putin, detesting Ukraine's current pro-Western government and its aspirations to join the EU and NATO, wants to install a pro-Russian regime in Kyiv. How and when (and if) this will happen is uncertain. Between now and the next three months Russia could gain piecemeal control of eastern Ukraine, as far as the Dnipro river, and capture the capital Kyiv after a long and bloody siege, or at least take control of part of it so that it can create a Russian-backed puppet government.

Partitioning. The scenario outlined above leads to a de facto partition of the country. The current administration in Kyiv could take refuge in Lviv, a city in Ukraine's far west close to the border with Poland - which allows Ukraine to receive military aid from the EU and the US. At this point, Moscow may be interested in a longer-term complete partition and a massive purge of the civilian population.

Occupation and Insurgency. Assuming Putin wins the military war, the trillion-dollar question is how does he win the peace in Ukraine. Ukrainians have had 30 years of freedom, which they relish, and how can Putin turn back the clock without a brutal crackdown that would make him, and his puppet regime in Kyiv, international pariahs. This is not 1945, 1956, or 1968 where Soviet troops/the NKVD [the Soviet law enforcement agency] bludgeoned civilians into submission, but



2022, in the age of the dawning Internet 3.0, where images and information run at a breakneck pace. This would further burden Russia's international situation.

NATO versus Russia. The Western military alliance NATO has repeatedly refused to directly intervene in the Russia-Ukraine war as doing so would likely bring it into direct conflict with Moscow which, for its part, has warned that any country that "interferes" in what it calls its "special military operation" in Ukraine will face untold consequences. It is not possible to predict whether Putin intends to broaden his war horizons, but it is possible to foresee that if the war were to penetrate Ukraine's neighboring states such as Poland or Romania, Nato members, Article 5 of the alliance, that on collective response, could be activated. The scenario is devastating because it puts us at risk of a nuclear conflict.

The miracle option. Undoubtedly, an unequivocal withdrawal of Russian armed forces from Ukraine would be the best possible outcome for the country in its dire situation. In this hypothetical scenario, Putin would be prevented from toppling Kyiv's government and establishing a puppet regime, while the determination and skill of the Ukrainian resistance forces a stalemate on the battlefield that favors the defenders.



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