Economic Ramifications on South Asian Nations in the Wake of Russia-Ukraine Conflict

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Introduction

After a month of cautioning Ukraine to quash its plan of joining NATO, the Russian president Vladimir Putin finally ordered its forces to attack Ukraine and what was pre-empted earlier that Russia will create a Crimea-like situation, by creating two new states – Luhansk and Donetsk Peoples Republics in the Donbas region – became bad to worse, with Putin deciding to topple the democratically elected government of Ukraine.

Ukraine, which had earlier thought that America and the rest of its NATO allies will come out to defend her, had to revisit their strategy as Putin threatened both the US and Europe to be prepared for a full-scale nuclear war if they try to meddle with its operation in Ukraine.

For its aggressive invasion in Ukraine, United Nations condemned Russia, which resulted in a series of economic sanctions imposed on Russia. However, the war is yet continuing. In a statement to Axios on 28 February, provided through his advisor, the Ukrainian president Volodymyr Zelenskyy urged NATO to declare a no-fly zone over Ukraine, which would bar all unauthorized aircraft from flying over the country.

However, the NATO countries have ruled out policing a no-fly zone over the Ukrainian skies as it would intensify the conflict by directly involving foreign militaries against the Russian troops.

Economic and Trade Connections of Russia-Ukraine War

A slow advancement of the Russian forces has also made things hot for Putin in his home ground, as economic sanctions have further choked a steadily recovering Russian economy. On the one side, the Ukrainian people have fought bravely making it difficult for the Russians to gain foot on the ground; thousands of Russians joins the anti-war protests after the Ukraine invasion.

Ukraine has slowly moved towards Western trading allies after gaining an independence from the former USSR in 1991. This happened as the conflict with Russia aggravated in the 2010s. However, after much talks, Ukraine Association Agreement with the EU in 2014 paved the way for free trade between European countries and Ukraine, this reducing the trade dependency on Russia.

Interestingly, the trade figures between Ukraine and Russia touched $49.2 billion in 2011, but since then, it has plunged by 85% to $7.2 billion in 2020, with EU nations such as Poland and Germany overtaking Russia as far as trade is concerned with Ukraine. In 2021, the Ukraine's trade volume with EU totaled to over $58 billion.

Impact on Oil and Gas Prices

The war at this point seems to be a global economic game changer. After Russia's creation of Luhansk and Donetsk regions in Ukraine, Germany has already halted the Nord Stream 2 gas pipeline project, which was designed to double the flow of Russian gas in Germany.

Soaring gas prices and rapidly shifting trade decisions suggest that events of the past two weeks will raise the temperature on global economies. Economists fear, this would reset the global supply chain disruption in motion, and will create fresh headaches for the auto industry.

Amid the ongoing Russia – Ukraine conflict, petrol prices have peaked another record high. It was reported on 7th March that oil prices soared to $139 a barrel at one point, the highest level for almost 14 years. Not only that but today viz 22 March, the oil prices surged about 3% during early trade. In the morning, the May contract of Brent on the Intercontinental Exchange was trading at $111.07, higher by 2.91% from its previous close. The April contract of West Texas Intermediate on the NYMEX rose 3.04% to $107.88 a barrel.

International Energy Agency (IEA), in its oil market report for March 2022, has stated that Russia invasion of Ukraine and the Western nations' imposition of sanctions on its oil exports could imply that about 3 million barrels a day of Russian supply efficiently cut off from international markets from next month April.

Going by the above scenario, the surge in oil and gas price would mean a spike in electricity and gas consumption, increase in price in food shopping, vehicles could get expensive, etc.

Russian Banking Sector and Economic Impact on South Asia

To build pressure, the US and EU has already imposed a SWIFT ban on selected Russian banks. With this ban, Russia has already been cut off from its international, financial and trade ties instantly. Apart from this, Russia's domestic payment system has also been disrupted because of the ban, to the extent that all transactions with any card issued by the major credit card networks, including VISA, MasterCard, Amex, etc., are not been able to process the payment.

The ongoing crisis between Russia and Ukraine would directly impact South Asia's trade connections, mainly through rising commodity costs as the region is the net importer of commodities. South Asia was witnessing rising inflation even before the conflict between Russia and Ukraine erupted. However, the crisis will put an adverse impact on the regions commodity prices, thus creating the further gap – increase the relative production cost and exploiting the cheap labor competitiveness along with energy industries.

It has to be understood that South Asia has a higher dependence on fossil fuel for energy generation in comparison with other parts of Asia. Therefore, less global demand for goods and services from South Asia and uncertainty in financial markets will further impact the South Asian region.

Considering the current situation, the direct impact of the Russia and Ukraine conflict would result in higher inflation in South Asia and the indirect would be slower economic growth coupled with uncertainties in the market. Although it also depends on the kind of relations the countries have with Russia and Ukraine in terms of trade and economic ties.

Market and Economic Woes

The Indian markets crashed by 4.7% the day Russia attacked Ukraine. At the inter-bank foreign exchange market, the rupee opened at 75.02 against the US dollar but later dropped to a low of 75.75. This was mainly due to outflow of funds from emerging markets owing to geopolitical uncertainties. The foreign reserves have fallen over 2-3% from its peak.

As far as India's macroeconomic indicators and corporate earnings are concerned, they may come under pressure amid the deepening conflict in Ukraine and its effect on international energy prices. India imports nearly 85% of its crude oil requirements and costlier crude will widen the current account deficit, according to an ET report.

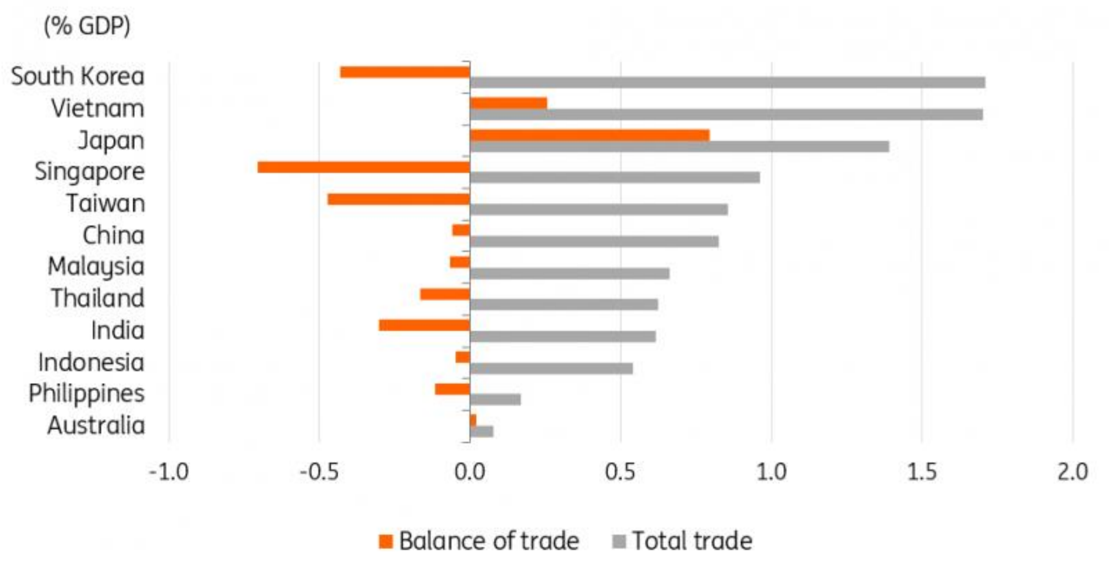
Among other things, the precious metals account for nearly 2-2.5% of their total raw material cost. However, because of the war, prices of precious metals have gone up by 10-30% following the current flare in Ukraine. The war will also affect crude & crude derivatives that are used in tyre manufacturing and account for around 18-20% of raw material cost of tyre makers. Now, the cumulative increase in raw material prices, if passed on to consumers, may lead to a 2.3% increase in vehicle prices. The gross margin of the automakers has dropped by 8-10% in the past six quarters, and it is likely to remain under pressure in the near term.

As far as the steel is concerned, export opportunities for Indian steel makers may increase. Since Russia and Ukraine account for nearly 10% of the total global steel export, the sanction on Russia may improve export opportunities for Indian steel makers. The Euro zone imports nearly 30 million tonnes of steel, of which 20% originates from Russia and about 10% from Indian steel makers.

In the meantime, if we look at Nepal, the country's population is paying Rs 150 for per litre of petrol and Rs 133 for diesel and kerosene at filling station in the wake of the international crude oil prices hitting a record $139 per barrel on March 8. Not only that but the state-owned Nepal Oil Corporation (NOC) is losing Rs 16 for every litre of petrol and Rs 12 for diesel it sells, raking up losses of Rs 5 billion every month.

Similarly, Bangladesh would be equally impact due the ongoing crisis between Russia and Ukraine. In the last fiscal, Bangladesh exported about $665.30 million to Russia. Out of this trade, about 95% was textile and clothing. Certainly, the further worsening of crisis will hamper Bangladesh's export as the shipping cost is going to shoot up. The bugger challenging aspect would be to retain export receipts as the US and the EU has imposed sanction on Russian banks to exclude the country from the international financial system.

Asia Trade with Russia and Ukraine (2021 Values Where Available)



(Source: CIEC, ING)

The Russia-Ukraine conflict would have nil or negligible impact on India's foreign trade and the crisis may give domestic exporters an opportunity to ship more wheat in the global markets. In 2019, Russia and Ukraine together exported more than a quarter (25.4%) of the world's wheat. Egypt, Turkey and Bangladesh buy more than half of Russia's wheat.

Out of the total trade between Asia with Russia and Ukraine, the war will greatly affect South Korea, Vietnam, and Japan. For South Korea, imports outweigh exports (mostly energy). But both Vietnam and Japan run small bilateral trade surpluses with these two nations. In all cases, the extent of trade is small, with total trade less than 2% of GDP for both Vietnam and Korea.

Singapore and Taiwan run similar bilateral deficits with Russia and Ukraine, of about 0.5% GDP, though overall trade is equivalent to less than 1% of nominal GDP. For all other countries, including China, total trade amounts to less than 1% of nominal GDP and the bilateral trade positions are very small.

Asian economies are often heavily reliant on imported energy, with only a few economies coming close to being net energy exporters. For the surplus countries, spiking energy prices will provide a windfall gain boosting revenues from this trade and possibly even boosting demand and sales as Russia-Ukraine sources are blocked off or avoided resulting in substitution for other suppliers.

Conclusion

If we look at the ongoing conflict between Ukraine and Russia, the full-fledged war in Europe, dispatching troops to Ukraine by Western allies and imposing heavy economic sanctions on Russia (barring Russian gas and oil exports to the world) could emerge as the worst consequences. Additionally, the situation could worsen further if Russia will be ready to use nuclear weapons as this will shake the Western world further.

In midst of this, the economic jolt on South Asia would be more adverse, even worse than the covid pandemic. Possible, it would trigger the recession, with major impact on South Asian nations. Though bigger and larger South Asian economies with huge domestic market and fiscal space (such as India and Bangladesh) may be able to pass the rough waters, however, the small nations such as Nepal, Sri Lanka, Bhutan, Maldives could see heavy impact on their growth cycle. Pakistan, which is already facing economic heat, will also see decline in its economic growth.

Moreover, the proper economic management for South Asian nations during this conflict would not be easy. However, to ensure their economic stability and safeguard their financial interests, countries in the South Asia should quickly implement effective monetary policies, improve external debt management, and eliminate the hardships on the poor. Also, they should make well-calculated economic reforms to encourage the private sector and markets.

Towards the end, one can say as long as the crisis between Russia and Ukraine will continue, South Asia will certainly b effacing economic headwinds, especially those countries that have a direct trade linkage with either of the two nations. Also, South Asia could find the alternate route or trading partner in order to ensure that their economic ecosystem won’t be affected much, however, the shipping and transportation cost will give them headaches. The countries in region with strong manufacturing acumen will pass the rough waters, but industries that are majorly service-driven, will see some interruption in their financial healthy, this impacting trade.

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