

The global implications of Ukraine's tragedy

Given the horrendous human tragedy in Ukraine, it seems almost crass to talk about global economic implications right now. But that's our job. The international sanctions against Russia will impact people across the globe. Giving a preliminary assessment of that is what we're focusing on in March's ING Monthly



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'It's unthinkable that I would ever experience war on my doorstep': Carsten Brzeski on the economic impact of Russia's invasion of Ukraine

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My parents were born during the second world war. My mother-in-law was a Hungarian refugee. I grew up next to the Berlin Wall. It was unthinkable that I would experience war on my doorstep. And that's why it's difficult to talk just about economics as we witness the tragedy unfolding in Ukraine. But it's my and my colleagues' job to assess the potential impact of this bitter conflict amid some of the harshest sanctions ever seen against Russia; we're not going to be affected just emotionally by the unfolding images on our screens.

The sanctions are unlikely to stop the war as long as Russia can continue selling oil and gas to Europe and other countries. And the revenues from the extraordinarily high energy prices actually partly offset the negative effects of the sanctions. We'll look at those direct effects. And we'll consider the indirect consequences on countries and markets around the world as governments and central banks continue to fight inflationary and many other pressures.

A closer look at the sanctions

So far, the sanction response to the military escalation has been aggressive and generally coordinated, but careful not to disrupt Russia's key commodity exports to the main partners. That is probably explained by Russia's importance to the commodity and financial markets and also by the necessity to leave room for additional pressure should things get still worse. The measures announced in the headlines are bold, including full blocking sanctions against banks, a cut-off from the SWIFT messaging system which allows financial institutions to authorise payments, the sanctioning of private assets of individual Russians (the Specially Designated Nationals list), export bans on high tech goods and sanctions on the Central Bank of Russia. These are all elements from the most severe Iranian playbook.

The details are more nuanced

When you zoom into the details, the approach is more nuanced. So far, financial sanctions on Russian banks range from full blocking, including a freeze of foreign assets, to the prohibition of companies' new equity and foreign debt. The cut off from SWIFT has been preliminarily approved, but apparently, this will be decided on an individual basis for banks and not all names will be accompanied by full blocking sanctions; it will still be possible to make payments via other channels. It also looks as if transactions for oil and gas payments are excluded. Apparently, credit card payments already started to be rejected in Russia over the weekend. Almost half of the Central Bank of Russia's FX reserves were frozen as were those held with Western central banks. Special Drawing Rights and gold still seem to be available.

There could be several ways to counter or offset the current sanctions on the Russian side. Russia's central bank hiked policy interest rates to 20% and introduced capital controls earlier this week. Other options could include freezing inward foreign direct investment in response to EU/US sanctions against non-financials, and the suspension of business activity. Think of a moratorium on banks' foreign liability repayments to the US and EU, in response to the freezing of bank assets or a complete moratorium on corporate debt repayments in response to the freezing of CBR assets.

On the trade side, there should definitely be a ban on imports from the EU as well as a ban on air transit over Russia (the Siberian channel), making trans-Eurasia flights more difficult and expensive. An embargo on exports of titanium and other rare metals (redirection to the East), cutting off gas or oil to the EU would be other options. The oil and gas sector accounts for half of Russia's exports of goods, but only 15-20% of GDP, and up to 5% of employment.

A more general assessment of economic implications

Without the slightest doubt, this war will be devastating for Ukraine. As for Russia, the short and

longer-term implications will definitely hurt the economy. But EU countries will also be among those which will be hit the most by these sanctions. We don't want to speculate about how this war will evolve but it seems fair to say that these measures will be in place for a long time and energy prices will stay high, or go even higher, as time goes on. In this scenario, there are both long and short-term implications not just for energy and commodities but also for fiscal policy.

Europe gets nearly 40% of its natural gas and 25% of its oil from Russia; of course, this differs across countries. Heating and gas bills, that were already soaring are likely to go higher still. Both Ukraine and Russia are also called the global breadbasket, and food prices are also likely to surge. Both countries account for roughly a quarter of total global wheat exports. We also need to mention the supply issue. For Europe, the effects of that could be severe, undermining the industrial and private consumption rebound we were expecting as Omicron restrictions ease. We'll probably have to wait until next winter's heating season to see the biggest impact. Globally, a surge in commodity prices will aggravate already existing inflationary pressures, and Turkey is particularly at risk here.

The risks of stagflation have increased

Also fuelling inflation fears are possible shortages of essential metals such as palladium, aluminium and nickel, creating further disruption to global supply chains already suffering from the pandemic and shortages of semiconductors. Palladium, for example, is used in automotive production, mobile phones and even dental fillings. Nickel is used to make steel and electric car batteries. In the shorter run, disruptions to the energy and commodity supply will weigh on growth and push up inflation for longer. The risks of stagflation have increased, particularly for Europe.

The new reality is likely to slow down or delay policy normalisation, not least for the European Central Bank. At next week's ECB meeting, any hints of rate hikes are out of the question. We expect the bank to avoid tying its hands in any direction, still announcing a taper while not ruling out new easing of monetary policy if needed.

At the same time, there is also hope. The united European reaction illustrates the continent can work together effectively and swiftly if it wants. Also, the German government's announcement to increase defence spending by €100bn this year and annual defence spending to 2% of GDP indicates that more fiscal stimulus is in the offing. The government's plan to build two LNG terminals as soon as possible goes in the same direction. More generally, energy supply disruptions and purchasing power losses could also still trigger government support schemes similar to those we saw during the lockdowns.

These examples illustrate that the Ukraine war and its economic implications will put more pressure on the green transition and efforts to speed it up. It's not much, but we need to find any silver lining where we can.

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