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ON THE WORLD ECONOMIC SITUATION AND PROSPECTS

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Potential economic fallout from the war in Ukraine

Human costs continue to mount since the beginning of the Ukraine war on 24 February 2022. By late March, at least 1,119 civilians have been killed and at least 1,790 injured[1] while many of the victims are still not accounted for. More than 10 million Ukrainians (out of 44 million) have been forcible displaced, 4 million of them abroad[2] and 6.5 million within the country.[3] In addition to the humanitarian crisis in Ukraine and its direct socioeconomic impact on Ukraine's neighbouring countries, the impact of the war has been spreading through multiple channels on the world economy. This Monthly Briefing aims to depict the potential economic impacts of the war and their long-term consequences.

KEY MESSAGES

- » The global impacts of the war in Ukraine are becoming evident, with their true extent dependent on the intensity and duration of the conflict, the attendant sanctions, as well as the policy responses of both individual countries and the international community.
- » The conflict may lead to global, regional and national crises on multiple fronts, through energy, metals, food, and fertiliser price shocks, a refugee crisis, disruptions in global trade, and distress in financial markets; compounded by the shrinkage of the Russian and Ukrainian economies and an undermining of their long-run growth prospects.
- » As a result of the negative spillover effects of the conflict, global output growth may fall by around 0.8 percentage points from its previous forecast in 2022 alone; such developments would further obstruct progress towards eradicating poverty, hunger and several other SDGs.

Downgraded economic prospects for Ukraine and the Russian Federation

Ukraine

The ongoing conflict has already had a devastating impact on the Ukrainian economy and will likely lead to a deep recession, owing to the destruction of production facilities, suspension of economic activity, capital outflows, and the fleeing population. Key infrastructure, including railway links with the Russian Federation, road networks and bridges have been damaged or destroyed. Energy infrastructure is also partially damaged, with many areas in the country cut off from electricity supply. Ukraine's international trade is also suffering a major blow. Commercial shipments from Ukraine are partially blocked. Planting and exports of agricultural commodities, including wheat, corn, barley, and sunflower oil face significant uncertainty. Around 4 million people have left the country as of 25 March 2022. Additionally, over 6.5 million are internally displaced. There is a possibility that a large share of the current outward migration may become permanent, exacerbating the labour shortages and undermining long-run economic performance. In case the conflict persists in the near term, the Ukrainian economy may contract by 30–50 per cent in 2022, with inflation likely exceeding 30 per cent in 2022, given severe supply disruptions for basic goods. Ukraine's ability to meet its significant debt servicing obligations for 2022–2023 is, under the current circumstances, questionable.

Bilateral and multilateral financial support to Ukraine has been strong, with pledges of assistance from the United States, the IMF, the World Bank, and the EU. The National Bank of Poland offered Ukraine an equivalent of $950 million foreign-exchange swap line. However, the actual delivery of the assistance is contingent on the political outcome of the conflict. The country may also face a dilemma of choosing between external debt repayment and reconstruction efforts.

Russian Federation

The Russian economy was previously forecast to expand by 2.7 per cent in 2022[4] but is inevitably poised to face a deep recession instead, which may become protracted depending on the continuance of the conflict and the sanctions.[5] Although the EU, the

1 United Nations Ukraine (2022). Mounting civilian deaths, mass destruction and catastrophic humanitarian situation as Russian Federation attacks Ukraine. Press Release, 28 March.

2 UNHCR (2022). Ukraine Refugee Situation. Accessed 30 March.

3 IOM (2022). Regional Ukraine Response Situation Report #10. 25 March.

4 United Nations (2022). World Economic Situation and Prospects 2022. New York.

5 See next section for more details on economic sanctions imposed on the Russian Federation.

The Monthly Briefing on the World Economic Situation and Prospects is published on the first business day of the month. We welcome your feedback and comments. Author: Grigor Agabekian (agabekian@un.org), with inputs from Julian Rodrik Slotman, Global Economic Monitoring Branch, Economic Analysis and Policy Division, UN DESA.
The full series is available from: http://www.bit.ly/wespbrief

most important Russian energy importer, did not restrict imports of Russian oil, natural gas, metals[6] and many other products, disconnecting some Russian banks from the SWIFT system may complicate trade-related transactions between the EU and the Russian Federation. Over 300 multinational companies from various sectors have exited the Russian market in February–March 2022,[7] and the terms of their return, even if the conflict is resolved, are far from clear.[8] Rebuilding the broken economic and financial links could entail a complex process. Replacing the disrupted supply chains with new ones will be a complicated process too. The value of the Russian rouble has reached historic lows in the first week of March, before moderately rebounding toward the end of March. The Russian stock market temporarily suspended trading on 28 February,[9] but the shares of Russian companies traded abroad have fallen. The Central Bank in late February has increased its key policy rate by 1050 basis points to 20 per cent, and the Government has imposed capital controls.[10] Both private consumption and especially investment in the Russian economy are expected to collapse, and the Russian GDP may shrink by 10–15 per cent in 2022, with only a partial recovery in 2023.

If the most stringent sanctions remain in place and the central bank reserves remain inaccessible, growth of Russian potential output may fall to below 1 per cent because of low FDI, the inability to explore new oil and natural gas deposits and a possible loss of major energy markets in the near future. The scope to find substitutes to embargoed goods in the sanctioned industries is much narrower than it was in 2014, when breaking up intra-industry links with Ukraine and the imposition of a food imports embargo from most of the OECD countries facilitated domestic metallurgy and production of food and chemicals.

Economic sanctions on the Russian Federation

Since 24 February 2022, virtually all developed countries have introduced economic sanctions of an unprecedented scale against the Russian Federation (and, to some extent, Belarus).[11] The sanctions amount to effectively decoupling significant portions of the world's 11th largest economy from the rest of the world, reversing its integration through channels such as trade, finance and travel.[12]

Many Russian industrial sectors have already been sanctioned in the past. For example, in 2018, the United States imposed major export controls targeting Russian defence, aerospace, and maritime sectors. However, the severity of the recent wave of sanctions was somewhat unanticipated. Apart from the defence sector, key Russian industries—such as energy, transport, and technology—will face severe constraints due to restrictions prohibiting exports to the Russian Federation of materials and technologies for oil refining, supplies of airplanes and airplane components, and numerous products considered to be "dual-use technology" goods, including semiconductors.

Furthermore, several important Russian banks have been disconnected from the SWIFT interbank messaging system, curtailing their ability to communicate with other financial institutions. Consequently, external trade of the Russian Federation will face significant hurdles even in trading non-embargoed products. Most dramatically, the United States and a number of other countries have decided to freeze a substantial share of the Russian central bank's foreign exchange reserves (about half of over $640 billion), limiting the ability of fiscal and monetary authorities to mitigate the consequences of economic sanctions through currency support or domestic spending. Transactions with the Central Bank, Ministry of Finance and the National Wealth Fund of the Russian Federation are being limited. A large share of the "security cushion" that was built up over many years appears to be out of reach for the Russian authorities.

Additionally, the United States and the United Kingdom have decided to ban imports of Russian oil and natural gas (effective end-2022), while the European Union announced its intention to reduce its reliance on Russian energy imports. In late February, Germany suspended the certification of the "Nord Stream 2" natural gas pipeline. In early March, Canada revoked the Most Favoured Nation tariff status for the Russian Federation and the move was followed by the EU and G7 countries. Many countries in Europe, along with the United States and Canada, have closed their airspace to Russian airlines (a move that was reciprocated by the Russian Federation) and suspended plane lease agreements. Various development banks, including the World Bank and the Asian Infrastructure Investment Bank (AIIB), led by China, suspended their activities in the Russian Federation and Belarus. The Bank for International Settlements cut off access of the Russian central bank to its services and activities.

These sanctions have the cumulative effect of severely curtailing exports from the Russian Federation including on a wide range of strategically important inputs for numerous industries, for example, rare earth metals, palladium or neon gas, which is used in the production of semiconductors. The Russian Federation,

6 The EU, however, restricted imports of some types of steel from the Russian Federation.

7 Among the companies that have suspended sales, production, servicing or divested their shares in the Russian Federation are Ford, General Motors, Nissan, Renault, Toyota from the automotive sector; Airbus and Boeing from the aviation sector; Citi, Deutsche Bank, Goldman Sachs, JP Morgan from the banking sector; Apple, IBM, Intel and Microsoft from the technology sector; BP, Exxon, Shell from the energy sector; American Express, Ernst and Young, Goldman Sachs, KPMG, Mastercard and Visa from the finance sector; and numerous entertainment and retail firms.

8 The Russian government has threatened to seize assets of those companies and allow domestic businesses to violate their patent rights.

9 Since 21 March, trading opened for federal loan bonds and some other operations were allowed.

10 A wide range of capital control measures were introduced in the Russian Federation in February-March; in particular, transfers overseas are restricted, local firms have very limited access to foreign exchange, and banks are not allowed to sell hard currency to Russian citizens until 9 September 2022.

11 Following the Crimea conflict in 2014 and afterwards, numerous restrictive economic measures were already imposed against the Russian Federation, which retaliated by banning food imports and adopting other restrictions against most OECD countries. Many economic restrictions have also been imposed earlier on Belarus, in particular, in 2021.

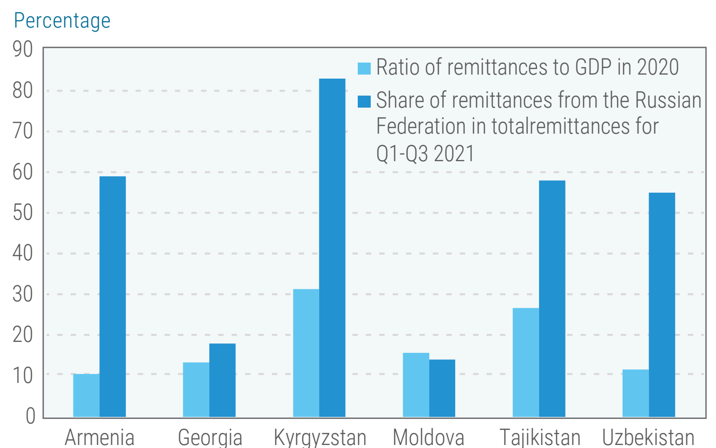
12 After the initial measures taken in February, the scope of sanctions has been widened as additional measures targeting individuals, a wide range of Russian enterprises and industries (among them the energy sector and the Russian financial sector, including the largest Russian financial institution, Sberbank), the Russian sovereign debt, and even the central bank of the Russian Federation.

along with Ukraine, is a leading neon exporter and further damage to microchip production would likely adversely affect a number of industries, including automotive and electronics.

Although the Russian economy accounts for only around 2 per cent of global GDP, the consequences of this conflict will extend far beyond its border and the region through energy and commodity price shocks, disruptions in global supply chain, challenges to food security, a refugee crisis, and elevated geopolitical tensions. Increased military spending will divert funds from social needs. Disruptions in maritime shipping and air traffic, including passenger flights, will likely undermine international trade.[13] Observers have also speculated that the conflict may cause long-lasting shifts in global trade, finance and FDI flows, challenging the model of globalisation that prevailed for the last several decades, possibly leading to a segmentation of the global economy into different trading blocks, and a move away from the dollar-based monetary system.

Figure 1

Dependence of selected CIS countries on remittances



Source: National Central Banks and KNOMAD, the Global Knowledge Partnership on Migration and Development.

Spill-over impact of the Russian downturn on the CIS and Eastern Europe

The effects of the Ukraine crisis on countries in the Commonwealth of Independent States (CIS) and Eastern Europe will be substantial, especially at a time when these economies are just beginning to recover from the COVID-19 crisis. Most CIS countries, especially members of the Eurasian Economic Union,[14] are strongly exposed to the Russian economy through trade and finance flows, and some of them are heavily reliant on migrant workers' remittances (see figure 1). Since the Russian Federation is the primary export destination for most of these countries, the weaker rouble undermines trade prospects. Many CIS countries saw their currencies depreciated (households converted their savings into dollars or the euro), creating significant inflationary pressures. Among the economies of the Caucasus and Central Asia, energy-exporters are in a better position. Kazakhstan enjoys access to oil and natural gas export markets,[15] has a manageable fiscal space and significant foreign exchange reserves. Nevertheless, the country has adopted an anti-crisis plan aimed at mitigating the financial sector shock, protecting local currency deposits, combating inflation and investing into regional development. The National Bank of Kazakhstan has increased its policy rate by 325 basis points.[16]

Uzbekistan also has substantial foreign exchange buffers. By contrast, smaller energy-importing economies of the region, such as Kyrgyzstan and Tajikistan, are highly dependent on remittances, face external debt challenges, and have much more limited fiscal space. A collapsing Russian economy would limit employment opportunities for the migrant workers from the Caucasus and Central Asia, while the depreciating rouble reduces the purchasing power of remittances. According to some estimates, those remittances may decline by as much as 40 per cent in 2022.[17] This would lead to an increase in poverty rates for Central Asian countries. A massive return of migrants from the Russian Federation would escalate tensions in domestic labour markets. On the positive side, the relocation of certain businesses, in particular in the finance and the IT sector, from the Russian Federation to other CIS countries to avoid sanctions may be beneficial for their economies. Some countries may also fill the import gap that emerged in the Russian market as a result of sanctions, although that would require efficient economic management.

For many Eastern European countries, the Russian Federation is an important trading partner, in particular, for intermediate products. The suspensions of automotive production by foreign companies in the Russian Federation have led to supply chain disruptions both on the export and on the import side. The proximity of the East European region to Ukraine sparked significant currency volatility through deteriorating investor sentiment, necessitating central bank interventions and further interest rate hikes, and inflating debt denominated in foreign currencies.

Global repercussions of the geopolitical crisis

Commodity and energy price shock

The conflict has accelerated the upward trend in oil and natural gas prices, along with the prices of metals and other commodities (see figure 2). The announcement in late March that the Russian Federation will seek payment in roubles for natural gas from the so-called "unfriendly countries" further pushed up energy prices in Europe. Prices of agricultural commodities and base metals, such as aluminium, cobalt, nickel, palladium, and titanium,[18] have

13 Almost 50 per cent of air freight is transported by passenger planes.

14 Comprising Armenia, Belarus, Kazakhstan, Kyrgyzstan and the Russian Federation.

15 However, the country exports two-thirds of its oil through Russian ports, which may pose risks.

16 Policy rates were also increased in Armenia, Azerbaijan, Georgia (not a member of the CIS), Moldova, Tajikistan and Uzbekistan.

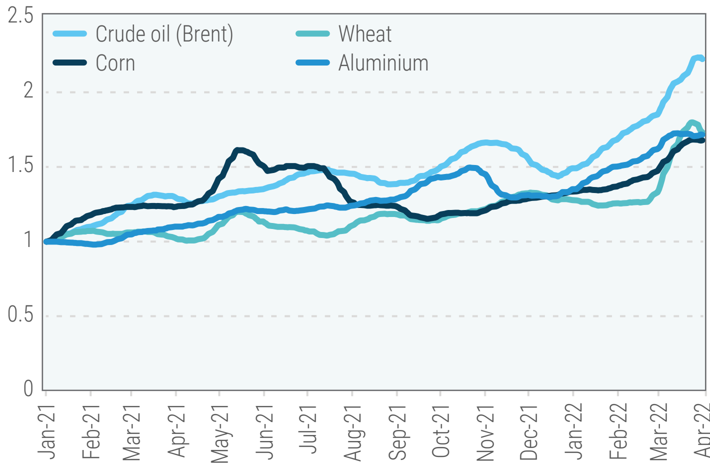
17 See, for example, Ratha, Dilip, and Eung Ju Kim (2022). Russia-Ukraine Conflict: Implications for Remittance flows to Ukraine and Central Asia. 4 March. Washington, D.C.: World Bank blogs.

18 The Russian Federation supplies around 42 per cent of palladium to global markets and is an important exporter of cobalt and nickel.

Figure 2

Global prices of selected commodities

Index (1=January 2021), 4-week moving average

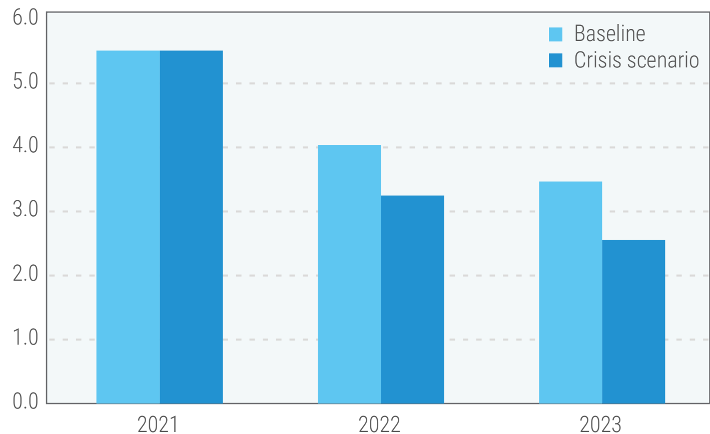


Source: Trading Economics.

Figure 3

Estimated loss to the global economy in case of multiple shocks

Percentage



Source: UN DESA estimation.

Note: The crisis scenario assumes a 50 per cent fall in GDP in Ukraine, a 15 per cent drop in GDP in the Russian Federation, a 5 per cent decline in private consumption in other CIS countries, a price of $150 per barrel of Brent crude in 2022 and a global increase in trade frictions. Post-crisis trajectories for the shocked variables are calculated endogenously. The scenario is modelled in UN DESA's World Economic Forecasting Model and evaluated against the baseline forecasts of the World Economic Situation and Prospects 2022.

also spiked. If those prices increase further and remain elevated, industrial sectors, in particular, automotive and electronics, will be hit hard across the globe. Although energy and commodity exporters are benefiting from the current situation, sustained high commodity prices would disrupt global supply chains, exerting further downward pressure on the global economy. Higher fuel prices, against the background of recovering demand following the COVID-19 pandemic, have already caused high inflation around the globe, outpacing wage growth, especially in low-skilled occupations. Higher prices of oil and natural gas have also driven up the price of coal. Elevated inflation rates in post-COVID economies create a challenging policy dilemma for the leading central banks, prompting the ECB to speed up its exit from the bond purchase programme,[19] while Bank of Japan, on the other hand, decided to maintain its stimulus.

The combination of output shocks to Russia, Ukraine and other CIS countries with a sustained energy price shock could reduce global output by around 0.8 per cent in 2022, according to UN DESA estimates (see figure 3). In case of interruptions in the flow of Russian natural gas to Europe (where the share of Russian natural gas in the total gas imports exceeds 40 per cent), and skyrocketing electricity prices, many European economies may face a severe economic slowdown in 2022. Expensive oil and gas may eventually expedite the shift to renewable energy, but in the near-term energy production may switch to "dirtier" fuels such as coal, contributing to higher CO_2 emissions.

Dealing with the refugee crisis

The escalation of the conflict has led to a massive displacement of population and has triggered a massive flow of refugees from Ukraine to the neighbouring countries. In early March, the border areas of Hungary, Moldova, Poland, Romania, the Russian Federation, Slovakia, and to a lesser extent, Belarus, saw an influx of Ukrainian refugees in need of housing, food, possible medical care, and in the longer term, social adaptation and integration. For some of those countries, the numbers of refugees were in the hundreds of thousands; for Poland (which has an approximately 2-million strong Ukrainian diaspora and became the primary destination for the refugees), the figure exceeded 2.1 million. While the authorities of some of these countries had already expected such developments prior to the conflict and had even made certain logistical preparations, the magnitude of the refugee flow turned out to be much greater than anticipated. According to UNHCR, over 3.6 million people (predominantly women and children) have left Ukraine since the beginning of the conflict and the number is likely to increase further.

Table 1

Number of Ukrainian refugees per host country

Host country	Number of Ukrainian refugees
Belarus	10,902
Hungary	364,804
Republic of Moldova	387,151
Poland	2,336,799
Romania	608,936
Russian Federation	350,632
Slovakia	281,172

Source: UNHCR Operational Data Portal (as of 29 March 2022).

Note: The first host country is not necessarily the destination country; 2 out of 3 refugees entering Moldova, for example, moved further to other countries.

19 In March 2022, the ECB decided to end its bond purchase programme, initially expected to be open-ended, in the third quarter of the year.

Most of the destination countries stated that they are prepared to deal with the arrival of refugees. However, the refugee crisis will impose a considerable financial burden on those countries at a time when they are planning to consolidate their finances after the large stimulus spending to fight the COVID-19 pandemic. Should the war in Ukraine continue indefinitely, the refugees staying in East European host countries may alleviate the depopulation trends and severe labour shortages in the host countries. Even in such a situation, social integration and addressing the possible skill mismatch would require time and resources. The eventual resettlement of refugees across the EU will require addressing numerous administrative, political and financial hurdles. On 8 March 2022, the European Commission adopted a proposal for Cohesion's Action for Refugees in Europe (CARE) allowing member states and regions to provide emergency support to Ukrainian refugees. Meanwhile, Moldova, in contrast to the EU countries from Eastern Europe, has more limited financial resources to address the refugee crisis, and received a pledge of additional support from the IMF. Globally, accommodating and integrating Ukrainian refugees may cost the host countries around $30 billion during the first year, according to some estimates.[20]

Food crisis risks

The Russian Federation and Ukraine are key suppliers of agricultural goods globally.[21] The two countries together supply 16 per cent of the world's cereals, accounting for 25 per cent of global wheat exports, 16 per cent of corn exports and 56 per cent of the exports of sunflower oil.[22] The price of these goods rose sharply since the outbreak of the conflict, against the background of concerns about future crop planting, harvest and trade prospects, influencing the price of bread, meat (as those crops are used as livestock feed), cooking oil and many other products. Prices of food substitutes such as palm oil and other commodities and those of agricultural inputs such as crude oil and fertiliser have sharply increased as well. Logistical difficulties and sanctions affecting the financial services sector and payment systems are restricting trade to and from the region. In March, several large container lines suspended cargo shipments to and from the Russian Federation in response to the sanctions.

Geopolitical conflicts and the pandemic have already contributed to a dramatic escalation in food insecurity. An unprecedented 283 million people in 80 countries are estimated to already be acutely food insecure or at high risk. Countries in Africa and the Middle East—Algeria, Egypt, Kenya, Nigeria, South Africa, Syria, Tunisia and Yemen—are particularly vulnerable as net importers of agricultural products, including wheat, sunflower oil and maize.[23] Egypt is the world's largest wheat importer, with 86 per cent of imports originating from the Russian Federation and Ukraine, and 26 per cent of maize imports from Ukraine. Most of these countries usually maintain inventory of three to five months.[24] If the conflict continues, however, severe supply challenges may emerge,[25] undermining food security in Africa and the Middle East, regions already dealing with soaring food-price inflation due to the disruptions brought about by the COVID-19 pandemic,[26] drought and conflicts. Furthermore, the reduction of wheat supply will inevitably push up prices for wheat produced in other parts of the world, including Argentina and North America, especially if other major consumers purchase large amounts of wheat from those regions. The Russian Federation, along with Belarus, also produce large amounts of key components for fertilizers, like potash, and the shortage of these products would affect agricultural production globally.

Financial markets distress

The recent sharp increase in economic uncertainties, combined with the anticipation of a series of steep interest rate hikes by the Federal Reserve throughout 2022 has led to volatile financial markets for countering risk assessments of inflation expectations on financial asset portfolios. Under this situation, a potential financial contagion, directly or indirectly, as the impact of the war in Ukraine is yet to be certain. The exposure of financial entities to Russian assets is quite low. For example, although the world's largest asset manager BlackRock lost around $17 billion as most of the $18.2 billion of Russian assets held by its clients lost their value, the firm's exposure to Russian assets was less than 0.2 per cent. Still, a massive sell-off of stocks in case of further geopolitical escalation would cause a negative wealth effect in developed economies, weighing on aggregate demand. In addition, a possible sovereign bond default[27] by the Russian Federation, while unlikely to cause a global crisis, would nevertheless lead to financial market turbulence, curtailing access of developing countries to capital markets and worsening their terms for debt refinancing. External public debt of the Russian Federation is estimated at $67 billion[28] (over 60 per cent of which is denominated in local currency), while external debt of the corporate sector exceeds $300 billion.[29] In March, leading credit rating agencies such as Fitch Ratings, Moody's and S&P Global have downgraded Russian sovereign bonds to junk status, as the Government signalled that payment may be made in roubles. A possible Russian sovereign bond default would also put under stress the credit default swap (CDS) market. Although

20 Center for Global Development (2022). New Analysis: Hosting Ukrainian Refugees Could Cost Nations Around the World an Estimated $30 Billion. 2 March. Washington, D.C.

21 Belarus, which is under sanctions, is an important potash producer.

22 The Russian Federation, the world's largest wheat exporter, has already limited shipments of wheat in 2021 through an export tax, and in March temporarily restricted export of wheat to EAEU countries over re-export concerns.

23 Because of the conflict, the Ukrainian wheat that was already paid may not be shipped if Russian troops block Ukraine's access to the Black Sea.

24 Lebanon, however, has only around one month of wheat reserves.

25 Shipping through the Sea of Azov is already disrupted. The Black Sea is used not only by the Russian Federation and Ukraine, but also by Kazakhstan and Romania for the exports of agricultural staples.

26 Over the course of 2020–2022, the price of wheat has already increased by 80 per cent.

27 The Russian government made coupon payments on its US dollar-denominated bonds on 16 March 2022, avoiding default. However, Russian foreign currency-denominated debt securities are still prone to a high possibility of default due to sanctions. The Russian Federation has 15 international bonds with a face value of around $40 billion, around half of them held domestically.

28 Calculated at early February exchange rate.

29 Source: Capital Economics.

the largest Russian corporate debtors are commodity producers benefiting from the current exorbitant commodity prices, the government of the Russian Federation may impose administrative measures restricting companies from debt repayment. Moreover, an escalation of the war beyond the current geographical scope can easily destabilize financial markets. The present sentiment-driven financial markets can be highly volatile and asset price adjustments can be contagious, triggered by a small negative financial event, spiralling between financial and real sectors, both in developed and developing economies. While further international collaboration is urgently called for to minimize further human costs of the crisis and redouble humanitarian assistance, effective modalities for economic cooperation need to be devised to minimize negative consequences of the crisis on the global economy.