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The border tension between Russia and Ukraine heightened in the past week raises questions of whether this crisis will have broader global and Asia implications. In the following market note, Sue Trinh, Head of Macro Strategy, Asia, considers the potential macroeconomic impact of a broader Russia-Ukraine conflict and its effect on Asia-Pacific economies

In Focus: The Russia-Ukraine crisis could bring global impact and spillover effects

In our view, the border tensions between Russia and Ukraine could have substantial implications that have yet to be priced in by the markets.

Russia's role in physical markets

Russia is the world's leading exporter of natural gas (17.1% of global production) and its second largest exporter of crude oil (12.1%). For context, Saudi Arabia accounts for 12.5%[1].

Russia and Ukraine are also significant agricultural producers. Their combined wheat, barley and maize exports represent 21% of the global total. And together, they supply 60% of the world's sunflower oils. Russia and Belarus also account for approximately 20% of total fertilizer exports, vital for global food production[2].

Meanwhile, Russia is one of the world's largest producers of critical metals. It's the biggest exporter of palladium (20.7% of total volume) and ranks number two after Chile in terms of refined copper (7.1%). Meanwhile, the country holds the third position for nickel (11.2%) and aluminum (9%)[3].

The global macroeconomic impact of escalation

Potential punitive sanctions on Russia that disrupt the supply of such goods would have an important impact on the global economy, given the virtually inelastic demand for these strategically important resources.

Moreover, the need for these specific commodities has historically surged in times of conflict. This could be problematic for stretched global supply chains and trigger upward price pressure in an already painfully inflationary environment. In such a scenario, it would act as an additional stagflationary shock – that is lower growth but higher inflation – and in this scenario, would hurt net importers of these commodities the most.

Notably, Asia-Pacific is the world's largest net food and energy importer. However, we continue to stress that the region is not monolithic, so a spike in food and energy prices would have an uneven impact. For net importers, such a development would be a negative term of trade shock and the subsequent consequences for economic growth, exacerbated by weak domestic demand. The converse would be true for net exporters of food and energy. The largest net exporters of food and energy (and therefore least vulnerable) here are New Zealand, Malaysia, Vietnam, Australia, and Indonesia.

But there are also larger spillover effects to consider:

(1) Rising food and energy prices would lead to higher inflation *and* inflation expectations. Food inflation is particularly impactful due to the greater

[1] B.P. Statistical Review of World Energy 2021.
[2] OECD-FAO Agricultural Outlook 2021-2030.
[3] World Bank, Rosstat, Macrobond.

weighting of food-related items in Asian CPI baskets. The economies with the lowest net food and energy CPI basket weights and, therefore, the least vulnerable are Hong Kong, Australia, South Korea, and Mainland China.

(2) We expect export momentum to slow as global consumption patterns normalise amid reduced inventories. Without strong export growth to materially offset rising food and energy import prices, some economies could be subject to worsening current account balances. The economies least reliant on foreign demand are the Philippines, Hong Kong, India, South Korea, and Thailand.

(3) Fiscal positions could deteriorate if governments increase subsidies to help contain inflation and ease the burden on low-income households. This would come when budgets have weakened after two years of emergency pandemic responses. The markets with the strongest fiscal positions are Singapore, Vietnam, Taiwan, Thailand, and the Philippines.

(4) The risk of a liquidity shock from a combination of demand shock, supply shock, and a flight to safety would expose those vulnerable economies with high debt levels to either a domestic credit or external funding shock. The economies with the most robust debt positions (low private sector and external leverage, as well as low debt-servicing costs) are Indonesia, the Philippines, New Zealand, and India.

(5) Having adequate policy space to respond to such a macro challenge is essential. Policymakers among the net food and energy importers face a dilemma. They could raise interest rates but at the cost of even weaker economic growth. Alternatively, they may look through higher headline inflation but at the risk of capital outflows, currency depreciation, and even higher inflation. Lastly, there is the option to impose capital controls, but this comes with the risk of sovereign credit rating downgrades, reduced capital inflows and lower long-term potential growth. In contrast, we believe large net oil exporters will be better placed in such a situation.

Higher food and energy prices should improve current account and fiscal positions, capital inflows, local currency performance, and sovereign credit ratings. To the extent that currencies appreciate or governments with strong fiscal positions subsidise retail food or energy prices, the inflationary impact would generally be more muted than for net oil importers.

A screen for the least vulnerable to potential shocks

Singapore, Malaysia, the US, Australia, and New Zealand should be the biggest beneficiaries of any surge in food and energy prices. Indonesia, the Philippines, New Zealand, and India appear the least exposed to a potential liquidity shock. Balancing the simultaneous impact from these two shocks, our analysis suggests Malaysia, New Zealand, the US, Australia, Vietnam, and Taiwan will be the relative macro-outperformers among the economies we follow.

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