

Russo-Ukrainian conflict shocks commodity markets

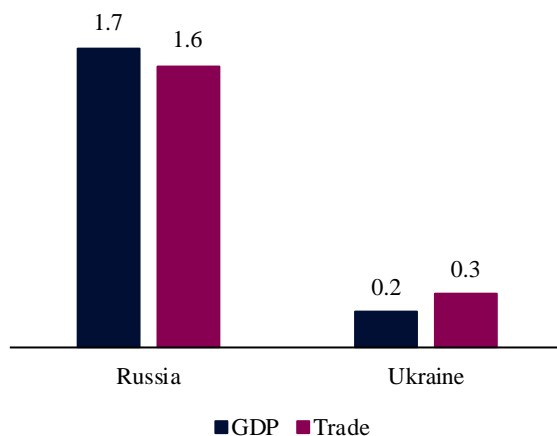
The 2020s are proving to be a period turmoil with shocks and uncertainty. Just when the global economy was seemingly turning the page from the Covid-19 pandemic, another significant event is producing negative geopolitical and economic consequences: the Russo-Ukrainian conflict. While the seeds of the conflict have been developing for years, the bilateral disputes between Russia and Ukraine started to escalate in 2021, before breaking into an open war in late February 2022.

Following the initial military invasion, the US and the European Union (EU) decided to support Ukraine by inflicting comprehensive economic pain to Russia via embargoes, sanctions and trade bans. With this, the Russian economy was quickly disrupted and to a large extent disintegrated from the rest of the world in less than a month.

In this piece, we highlight the main points about the economic consequences of the Russo-Ukrainian conflict.

flows of USD 100 Bn, represents significantly less. Therefore, irrespective of the magnitude of the downturn that the conflict may cause in either country, direct global demand destruction will likely be small on a global scale.

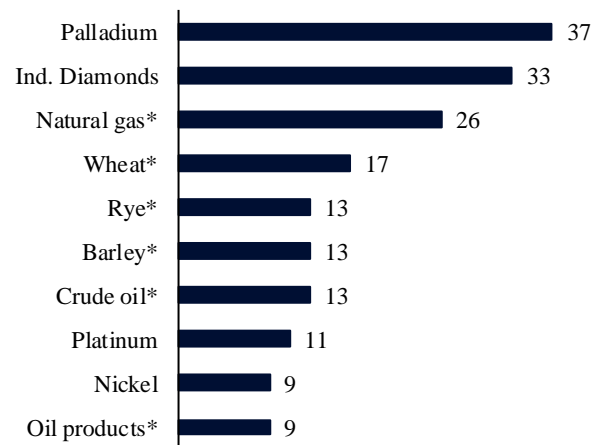
Russia and Ukraine's GDP and trade
 (% of global total, 2020)



Sources: Haver, IMF, QNB analysis

On the one hand, the direct impact of the conflict on global demand is rather limited, due to the sheer size of both the Russian and Ukrainian economies. In fact, with a nominal GDP of USD 1.5 trillion and trade flows of USD 600 billion (Bn), Russia represents less than 2% of either global activity or trade. Ukraine, a USD 155 Bn economy with trade

Russia's share of global market
 (%)



Sources: USGS, USDA, BP, QNB analysis

On the other hand, despite the modest nominal size of both economies, their natural resource base is large and disruptions can indirectly affect the global economy via supply shocks in commodity markets. Russia is the world's largest transcontinental country with a territory that spans over eleven time zones and include massive deposits of natural resources, such as crude oil, natural gas, minerals precious metals and arable land. In fact, both Russia and Ukraine are important producers of fertilizers, wheat and other key products for the food industry. Hence, Russo-Ukrainian military action and sanctions are causing supply destruction at a large scale, severely stressing key commodity markets. This will produce higher global inflation and lower disposable income across countries, negatively affecting demand. This will further intensify "stagflationary pressures," i.e., the trend of lower growth and higher prices. Vulnerable emerging markets will likely suffer from a deterioration of fiscal and current account positions. In the extreme cases, low-income countries can face mass food shortages and civil strife.

Moreover, while financial integration between Russia and the rest of the world is relatively small, the impact of commodity price spikes and asset destruction can be significant for commodity houses, brokerage firms and banks with direct exposure to Russia. Some signs of financial stress are already starting to emerge, as money market spreads are widening and Far East Asian commodity houses are experiencing multi-billion USD margin calls. If such issues continue, there could be a sudden deleveraging in commodity markets, due to supply disruptions and collateral destruction. Cascading credit events in commodity markets could affect banks and other institutions that provide funding for such activities. In addition, Eastern European banks with exposure to Russia can also suffer significant

losses, stressing the European financial system. Negative financial shocks could therefore add to the existing downward pressures on global growth.

All in all, Russo-Ukrainian military action and sanctions are largely spurring supply side shocks, rather than demand, for the global economy. This is taking place via commodity markets, amplifying inflation and creating scarcity of resources across the world. Financial risks are also increasing due to the direct and indirect effects of the shocks on financial institutions as well as on commodity traders.

QNB Economics Team:

James Mason
Senior Economist
+974-4453-4643

Luiz Pinto*
Economist
+974-4453-4642

* Corresponding author

DISCLAIMER: *The information in this publication (“Information”) has been prepared by Qatar National Bank (Q.P.S.C.) (“QNB”) which term includes its branches and affiliated companies. The Information is believed to be, and has been obtained from, sources deemed to be reliable; however, QNB makes no guarantee, representation or warranty of any kind, express or implied, as to the Information’s accuracy, completeness or reliability and shall not be held responsible in any way (including in respect of negligence) for any errors in, or omissions from, the Information. QNB expressly disclaims all warranties or merchantability or fitness for a particular purpose with respect to the Information. Any hyperlinks to third party websites are provided for reader convenience only and QNB does not endorse the content of, is not responsible for, nor does it offer the reader any reliance with respect to the accuracy or security controls of these websites. QNB is not acting as a financial adviser, consultant or fiduciary with respect to the Information and is not providing investment, legal, tax or accounting advice. The Information presented is general in nature: it is not advice, an offer, promotion, solicitation or recommendation in respect of any information or products presented in this publication. This publication is provided solely on the basis that the recipient will make an independent evaluation of the Information at the recipient’s sole risk and responsibility. It may not be relied upon to make any investment decision. QNB recommends that the recipient obtains investment, legal, tax or accounting advice from independent professional advisors before making any investment decision. Any opinions expressed in this publication are the opinions of the author as at the date of publication. They do not necessarily reflect the opinions of QNB who reserves the right to amend any Information at any time without notice. QNB, its directors, officers, employees, representatives or agents do not assume any liability for any loss, injury, damages or expenses that may result from or be related in any way to the reliance by any person upon the Information. The publication is distributed on a complementary basis and may not be distributed, modified, published, re-posted, reused, sold, transmitted or reproduced in whole or in part without the permission of QNB. The Information has not, to the best of QNB’s knowledge, been reviewed by Qatar Central Bank, the Qatar Financial Markets Authority, nor any governmental, quasi-governmental, regulatory or advisory authority either in or outside Qatar and no approval has been either solicited or received by QNB in respect of the Information.*