RUSSIA’S INVASION OF UKRAINE: IMPLICATIONS FOR DEVELOPING ASIA

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Russia’s invasion of Ukraine: Implications for developing Asia

The direct fallout from the Russian invasion of Ukraine will likely be limited for developing Asia, except in the Caucasus and Central Asia. Indeed, the limited exposure will curtail the direct impact of the war in most of the region, but the effects will be large for the Caucasus and Central Asia, as well as for Mongolia, which all have close trade and financial links with the Russia. Declining remittances from Russia will also weigh on the external balances of economies heavily reliant on these inflows.

Indirect effects will be felt across the region through higher energy and food prices. Oil and natural gas prices rose sharply following the invasion, and they are expected to remain elevated this year. Energy bills will rise for oil and gas importers, pushing inflation up and weighing on demand. Energy exporters will benefit from rising prices. Russia and Ukraine are also key producers of sunflower seed oil, wheat, barley, corn, and fertilizers. And global prices for these products and certain substitutes have surged. Limited access to Black Sea ports and a disrupted spring planting season in Ukraine could keep prices high throughout the year. International sanctions might also affect the availability of base metals, including nickel and palladium, as Russia is a key exporter of these metals.

Further escalation or a prolonged war could have a lasting impact on global sentiment and commodity markets. This would further delay the recovery from the COVID-19 pandemic. Heightened risk could negatively affect consumer, producer, and investor confidence, reducing developing Asia’s domestic demand, hurting exports, and delaying investment. A flight to safety could spur capital outflows from emerging markets, compounding the effect of tighter financial conditions from the US Federal Reserve raising its policy rate.

Extent of the sanctions and impact on the Russian economy

The sanctions imposed by Western countries and their partners on Russia are particularly harsh. Following the invasion of Ukraine on 24 February, sanctions were imposed by the EU and the US, as well as Australia; Canada; Japan; New Zealand; the Republic of Korea; Singapore; Switzerland; Taipei, China; and the United Kingdom (UK). The sanctions vary, but they generally include travel bans and freezing the assets of individuals, as well as the following:

- Export bans. These not only target goods with military applications but also civilian aircraft and spare aircraft parts, semiconductors, and equipment for oil refineries and telecommunications. The US sanctions apply to exports from any location as long as they embody certain US goods or technology.

- Disconnection from SWIFT. The Society for Worldwide Interbank Financial Telecommunication (SWIFT) enables exchanges of cross-border payment orders. Seven Russian banks have been disconnected from SWIFT, including state-owned VTB Bank.

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1 The information underlying this Special Topic is as of 25 March 2022.
Central bank asset freeze. The Central Bank of the Russian Federation is banned from trading assets in euros, US dollars, pound sterling, Swiss francs, and yen, either to prop up the ruble or to settle a bilateral trade deficit. This freezes about 60% of the central bank’s $630 billion of international reserves. On 24 March, leaders of the G7 also banned gold transactions with the central bank, with gold accounting for another 22% of prewar reserves.

The UK and the US announced energy embargoes, and the US sanctioned all large Russian banks. On 8 March, the US President banned imports of Russian fossil fuels and the British Prime Minister announced an embargo on Russian oil imports by the end of the year. Together, these sanctions will reduce the potential market for Russian oil and gas by 5%. The US Treasury froze the assets of all the largest banks and disconnected them from capital markets. These sanctions apply to majority state-owned Sberbank and VTB Bank, Russia’s largest and second largest bank, respectively, holding a combined 75% market share.

Sanctions induce self-sanctioning, notably in the energy sector. Although the sanctions have spared commodities, many buyers have slashed purchases from Russia for fear of future sanctions or reputational damage. Banks, insurers, and shipping companies have also become wary. This has translated into Russian oil selling at a 31% discount as of 25 March. Many foreign companies are also exiting Russia, including car manufacturers, oil majors, retailers, and service providers. This will depress foreign investment and may directly cause about a million job losses.

The ruble depreciated by 48% against the euro from 16 February to 7 March, and it was still down, by 23%, on 25 March. To curtail capital outflows and prop up the ruble, the Central Bank of the Russian Federation raised the policy rate from 9.5% to 20.0%. It also imposed capital controls: foreign currency sales are suspended, dividends and coupon payments to nonresidents are restricted, and exporters are forced to convert 80% of the foreign currency they receive to rubles. Even if the implications are unclear, the Russian President has also demanded that 48 economies deemed “hostile” pay for gas deliveries in rubles. These measures prevented bank runs and reversed the ruble’s free fall, although the currency was still down by 23% as on 25 March (Figure 1.2.1). The weaker ruble has increased the cost of imports and pushed inflation from an already high 9.2% in February to 14.5% on 18 March. This will hurt living standards and dampen growth prospects.

Figure 1.2.1 Euros per ruble
The rouble lost 21% of its value against the euro from 16 February to 25 March 2022.


The sanctions could trigger a financial crisis in Russia. The initial stock market crash was steeper than in all previous financial crises in Russia (Figure 1.2.2 and Box 1.2.1). The benchmark stock market index fell by 52% from 10 February—its preinvasion peak—to 24 February, when trading on the Moscow stock exchange was halted. Trading reopened on 24 March, but not all shares were allowed to trade and foreigners were not allowed to sell their shares. This makes the slight rebound difficult to interpret. Fitch Ratings, Moody’s Investors Service, and S&P Global Ratings downgraded Russia’s sovereign debt to “junk,” and sovereign default is no longer improbable, according to the managing director of the International Monetary Fund (CBS 2022). Private sector borrowers are allowed to repay their foreign currency debt owed to lenders from “hostile” economies in rubles. Contagion in global financial markets has been moderate—the Euro Stoxx 50 lost 8% of its value from 10 February to 25 March, and the S&P 500 gained 1%. Domestic consumption and investment are expected to collapse. As of mid-March, estimates by global investment banks for GDP growth in 2022 range from a 7% contraction to a 12% decline in growth. For 2023, expectations vary from 0% to a 4% decline.
Armenia and Tajikistan are particularly vulnerable to falling investment from Russia. Liquidity needs to support core operations in Russia may limit future investments in the Caucasus and Central Asia. This would weigh on the GDPs of economies in this subregion in the short term and on productivity in the longer term. The impact is expected to be the largest for Armenia, where Russia-based investors hold $1 billion worth of investments, equivalent to 8.3% of GDP (Figure 1.2.3, panel B). These include investments in food production, mining, manufacturing, real estate, and railways. Tajikistan holds $400 million worth of Russian-owned assets, equivalent to 4.8% of GDP.

Sanctions and economic crisis in Russia will curtail nascent recoveries in some tourism-dependent economies in developing Asia. The recovery of tourism and GDP in Georgia, where Russians accounted for 16% of foreign tourists and tourism for 9% of GDP before the COVID-19 pandemic, are likely to be affected. Similarly, early tourism recoveries in Maldives and Sri Lanka may be reversed since they have been largely driven by tourists from Russia—and also Belarus, Kazakhstan, and Ukraine—who have to some extent offset falling arrivals from Australia, the PRC, and other traditional regional markets (Box 1.1.2).

Direct impacts will be large in the Caucasus and Central Asia, but limited elsewhere in developing Asia

The war will have modest effects on investment and trade in developing Asia because of the region’s limited exposure to Russia and Ukraine. The two countries supplied 2.6% of developing Asia’s imports in 2019 and they were the destination of only 1.6% of the region’s exports. Developing Asia accounts for 5% of foreign investment in Russia, far less than the EU and even the UK (Figure 1.2.3, panel A). Singapore is the largest regional investor, with an FDI stock of $4 billion.

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Recovery continues amid global headwinds

Russian Federation asset holdings as a share of total bank liabilities

Armenia’s banks are particularly exposed to financing from the Russian Federation.

Most countries in the Caucasus and Central Asia, as well as Mongolia, have close trade links with Russia. The economic downturn and the ruble’s depreciation will reduce exports to Russia, which account for about 20% of total exports in Armenia and Georgia, and more than 10% in the Kyrgyz Republic and Uzbekistan (Figure 1.2.5, panel A). Exposure to Russian demand is lower in Azerbaijan, Tajikistan, and Turkmenistan, which mostly export energy products and base metals to the EU, the PRC, and Turkey. The downturn in Russia may also cause supply disruptions, particularly affecting countries importing large volumes from Russia. Russia accounts for more than 15% of imports for all countries in the Caucasus and Central Asia, except Georgia (panel B). Exposure exceeds 25% for Armenia, Kazakhstan, and Mongolia. The war may also disrupt trade routes for some of these economies.

Falling remittances from Russia will also affect economies in the Caucasus and Central Asia. The value of remittances from Russia will be slashed by the economic crisis in the country lowering migrant workers’ incomes, the disconnection of key Russian banks from SWIFT complicating money transfers, and the ruble’s depreciation. Coupled with rising energy prices, the drop in remittances will weaken balances of payments. The impact will be the strongest where remittances are equivalent to large shares of GDP—in the Kyrgyz Republic and Tajikistan, for example (Figure 1.2.6). By reducing consumption and investment, declining remittances will also weigh on tax income and government budgets. Declining remittances, combined with declining receipts from exports to Russia, will also lower demand for local currencies, adding pressure on already depreciating exchange rates (Figure 1.2.7). Weaker currencies will reinforce inflationary pressures, and large depreciations may also create liquidity risks in economies with substantial foreign currency-denominated debt, such as Armenia, Georgia, and Uzbekistan.

Countries in the Caucasus and Central Asia and Mongolia have close trade links with the Russian Federation.

Figure 1.2.5 Trade exposure to the Russian Federation and Ukraine

A. Share of bilateral exports in total exports

B. Share of bilateral imports in total imports

Note: Data as of 30 September 2021.
The largest impact for developing Asia will be through energy prices

Energy prices spiked following the Russian invasion of Ukraine and are expected to remain elevated. Russia is the second largest global exporter of oil and the fourth of natural gas, with market shares of 11% and 9%, respectively. Energy prices soared on actual and potential disruptions to Russia’s supplies. On 25 March, Brent crude oil traded at $121, up by 27% from 16 February, and in Asia, prices for liquefied natural gas (LNG) were up by 50% (Figure 1.2.8). These sharp increases added to preexisting price pressures. Oil prices rose by 50% in 2021, driven by the global economic recovery and the slow unwinding of output cuts agreed to by Organization of the Petroleum Exporting Countries (OPEC) Plus members. LNG prices increased by 113% in Asia last year. The US and UK embargoes on Russian mineral fuels will further strain prices, although the two countries’ oil imports from Russia only account for 0.7% of global oil trade. The impact of a possible EU embargo on Russia's oil exports would be more than tenfold higher since the EU absorbs 49% of Russia's oil sales, accounting for 5% of global oil trade. Available estimates suggest that a sudden halt in Russian oil exports would boost prices to $160–$200 per barrel (Bain 2022; Thomson Reuters 2022). Elevated oil price futures indicate that markets expect a prolonged period of high prices ahead.

Rising output could curtail the increase in oil prices. Replacing lost Russian supplies would require a coordinated global effort. Increases in production from US shale operators are unlikely in the short term because this will require drilling new rigs, but supply pressures could ease if strategic reserves are released. Market demands for paying dividends rather than increasing production and environmental considerations are also making new investment in shale operations less attractive. OPEC members, however, have spare oil production capacity equivalent to

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**Figure 1.2.6 Remittances in the Caucasus and Central Asia**

Remittances from the Russian Federation exceed 15% of GDP in the Kyrgyz Republic and Tajikistan.

**Figure 1.2.7 Euros per local currency units**

Some currencies from the Caucasus and Central Asia are already sliding along with the ruble.

**Figure 1.2.8 Oil and natural gas prices**

Energy prices surged after the Russian invasion of Ukraine.
45% of Russia’s output (Figure 1.2.9). A meaningful boost to OPEC production would require breaking the agreement made with Russia in the OPEC Plus framework to only gradually unwind the current output cuts. On 9 March, the United Arab Emirates announced

its interest, but this would have to involve Saudi Arabia, which controls the largest spare capacity. The lifting of sanctions on Iran and, to some extent, Venezuela would also contribute to increasing supply.

**High energy prices will aggravate inflation and pose challenges for growth in developing Asia.**

On average, oil prices this year could be 50% higher or more relative to 2021. Estimates suggest that oil prices could push up headline inflation by 2 percentage points and even more for economies where transport looms larger in the consumer basket (Choi et al. 2018). Economies where oil imports are equivalent to large shares of GDP will also be particularly affected, including Cambodia, several Pacific island nations, Singapore, the Kyrgyz Republic, and Tajikistan (Figure 1.2.10, panel A). On the external front, rises in energy import bills will have the greatest impact on energy-importing economies that are managing balance-of-payment strains, including Sri Lanka, whose currency depreciated by 30% from 9 to 25 March. Rising energy prices will also add to strains on public finance, notably where fuel is subsidized—such as in Pakistan, where spreads for 10-year sovereign bonds widened by 57 basis points from 16 February to 25 March. Higher inflation will weigh on regional growth by squeezing consumers’

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**Figure 1.2.9 Russian production and OPEC spare capacity**

OPEC’s spare capacity accounts for 45% of Russian production.

- **Russian Federation**
- **Saudi Arabia**
- **United Arab Emirates**
- **Iran**
- **Others**

Million barrels per day

OPEC = Organization of the Petroleum Exporting Countries.


**Figure 1.2.10 Oil and natural gas net trade-to-GDP in developing Asian economies**

**A. Net imports-to-GDP**

Oil and gas net imports exceed 5% of GDP in 16 developing Asian economies.

**B. Net exports-to-GDP**

Oil and gas net exports exceed 5% of GDP in six developing Asian economies.

GDP = gross domestic product.

Note: The sample is restricted to economies where net oil and gas imports or exports exceeded 5% of GDP in 2019.

Sources: Observatory of Economic Complexity; World Bank. *World Development Indicators database* (both accessed 15 March 2022).
Disposable incomes and may trigger policy rate hikes, which would further dampen growth. Slower growth in Europe because of higher energy prices may also weigh on demand for Asian goods.

**Higher energy prices will benefit oil and gas exporters.** These include Azerbaijan and Brunei Darussalam, where oil and gas export account for more than one third of GDP, and also Kazakhstan, Papua New Guinea, and Turkmenistan, where the shares of energy exports in GDP range from 15% to 19% (Figure 1.2.10, panel B). Kazakhstan’s ability to export oil, however, has been reduced by the war as about 60% is transported by pipeline to the Russian Black Sea port of Novorossiysk, where it is mixed with Russian oil. This and the proximity of Novorossiysk to the war zone have put off buyers and insurers. The Government of the Russian Federation announced on 22 March that loading bays at the port of Novorossiysk were damaged by a storm, forcing the pipeline to close for at least 1.5 months.

**Higher prices and supply disruptions for non-energy commodities will also affect developing Asia**

**Food prices have increased on actual and potential supply disruptions.** Ukraine and Russia account for a combined 55% of global exports of sunflower seed oil, 22% for wheat, 17% for barley, and 12% for corn (Figure 1.2.11). The geography of the war has cut production centers in central and eastern Ukraine from ports in the southwest of the country. In addition, most shipping companies cannot get insurance to approach Black Sea ports in Russia and Ukraine. While food products are not subject to sanctions, Russia’s grain exports will be constrained by capital controls, lack of trade finance and insurance, and self-sanctioning. The war also threatens the harvests of winter crops already sown, notably wheat and barley, and the sowing of spring crops, including corn and sunflowers. These existing and potential disruptions to global supply have pushed prices up. As of 25 March, global wheat prices rose by 38% and 15% for corn from 20 January—the day prior to the recognition of the breakaway republics of Donetsk and Luhansk by Russia (Figure 1.2.12). Prices also increased by 9% for palm oil, which is a substitute for sunflower oil and can be processed into biofuel. This comes in addition to a 44% increase in palm oil prices from 1 January 2021 to the outbreak of the war due to adverse weather in South America and Southeast Asia. As of 25 March, rice prices remained stable in Asia.
Fertilizer prices have increased. Natural gas is the key input in nitrogen fertilizers, with Russia accounting for 13% of global exports. Russia and Belarus also account for a combined 32% of global potassic fertilizer exports. Rising gas prices and sanctions imposed on Russia and Belarus have boosted fertilizer prices. As of 25 March, the North America Fertilizer Price Index increased by 45% from 20 January. Increases in fertilizer prices are particularly concerning for India, which is the world’s largest nitrogen fertilizer importer and where food accounts for 46% of the consumer basket. Besides fertilizers, elevated oil prices also make farming more costly, which will further kindle food inflation.

The supply of inputs into industrial value chains may be disrupted by sanctions and the war itself. Ukraine accounts for 70% of the global supply of neon, a gas critical for the lasers used to engrave semiconductor chips. Neon itself is a byproduct of Russian steel manufacturing that is refined in Ukraine. Russia provides 24% of the global supply of palladium, an input in catalytic converters that turn toxic exhaust gas into less toxic gases. Russia also supplies 23% of the global exports of nickel, which is used in stainless steel and batteries. Supply-chain disruptions may also affect products transported across Russia. This will particularly impact shipments between Central Asia and Europe, for which alternative routes are much more costly. Shipping from the PRC to Europe is also affected. Zyxel Communications—a manufacturer of information technology network equipment—notably stopped shipping from the PRC to Europe by rail. Large logistics companies also suspended rail shipping routes through Russia, including CMA CGM, Maersk, and MSC.

A further escalation or a prolonged war could have a lasting impact on global sentiment and commodity markets. In the first 2 weeks of March, geopolitical tensions surged to levels not seen since the Iraq war, as measured by reports in English-language newspapers (Figure 1.1.1). Heightened geopolitical risk may depress business and consumer sentiment, translating into delays in investment and depressed consumption. This would compound effects from the hiking cycle started by the Federal Reserve in March. Capital outflows from emerging markets may also increase as financial conditions tighten. Members of the Russia-led Eurasian Economic Union, including Armenia, Kazakhstan, and the Kyrgyz Republic, could be particularly affected.

Longer-term impacts on developing Asia

EU oil and gas diversification could be a boon for Azerbaijan, Kazakhstan, and Turkmenistan. Efforts by the EU to diversify its natural gas supply will accelerate, possibly benefiting Azerbaijan and Kazakhstan, which both have operational pipelines. Turkmenistan does not have a pipeline to Europe and would need to ship oil by tanker across the Caspian Sea until one is built. The EU’s diversification efforts might also benefit LNG exporters, such as Brunei Darussalam, Indonesia, and Malaysia.

The diversification of central banks’ foreign reserves may result in higher gold prices and a stronger yuan. Although magnitudes and contexts are vastly different, the freezing of the Central Bank of the Russian Federation’s assets follow the US freezing of the reserves of Afghanistan’s central bank last August. These precedents may push other central banks to diversify their foreign reserves, since euros and US dollars together account for 80% of global foreign reserves, but yuan assets only account for 3%. The PRC holds the largest foreign reserves globally, but India and other developing Asian economies also accumulated substantial reserves following the Asian financial crisis in 1997. The diversification of these reserves would put upward pressure on gold prices, benefiting regional gold exporters, such as the Kyrgyz Republic, the Lao People’s Democratic Republic, and Mongolia. Significant increases in yuan-denominated foreign reserve holdings, however, may require deeper and more liquid markets.

The Russian invasion of Ukraine might speed up the green transition in developing Asia. High fossil fuel prices increase the attractiveness of switching to more reliable renewable energy. Initiatives to reduce dependence on Russia will also push governments to accelerate the green transition. In the short term,
however, energy security concerns might boost the extraction of fossil fuels where they are available. Oil and gas supply disruptions in Europe might also boost purchases of coal. Australia and Indonesia are the world’s largest coal suppliers.

**Prolonged tensions between Russia and Europe could increase the number of Russian refugees in the Caucasus and Central Asia.** The vast majority of Ukrainian refugees are in the EU, but many Russians have also fled Russia to countries in the Caucasus and Central Asia, where visas are not required. Exact figures are difficult to assess, but available estimates suggest that at least 200,000 Russians have, 2 weeks into the war, fled Russia. The mayor of Tbilisi has said that 25,000 Russians have arrived in Georgia and authorities in Armenia have counted 80,000 Russians arriving in Yerevan. Other reports describe shortages of accommodation in Bishkek and Tashkent and an increasing number of bank account openings by Russians in Armenia. Many of these refugees are highly skilled, notably in the information technology sector. Although many will settle in other countries, some will stay and contribute to boosting long-term productivity.

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**Box 1.2.1 Impact of sanctions on the Russian Federation after the annexation of Crimea**

**The sanctions imposed on Russia after the annexation of Crimea in 2014 had a limited impact on economic growth, but they were milder.** These sanctions triggered large capital outflows, a fall in investment, and a sharp depreciation in the ruble. The Russian economy grew more slowly than those of other oil-exporting economies during 2014–2021, as the box figure shows. The International Monetary Fund estimated that sanctions subtracted 0.2 percentage points from gross domestic product (GDP) growth over 2014–2018—against 0.9 points due to low oil prices (IMF 2019). Both factors added to systemic constraints to development, including weak governance and rule of law.

**The government has strengthened fiscal and external buffers since 2014.** The National Wealth Fund is worth $198 billion—equivalent to 12% of GDP, largely invested domestically. Before the invasion of Ukraine, international reserves were equivalent to 2.6 years of imports at their 2019 levels. Most importantly, the share of reserves held in US dollars, euros, and pound sterling declined from more than 85% in 2014 to 55% at the end of 2021. This was compensated by rising shares of gold and yuan–denominated securities. External debt has also declined: 82% of private sector debt is now owned domestically, limiting refinancing risks. Sovereign debt is limited, at 18% of GDP. These buffers, however, will be much less useful to withstand the crisis over the invasion of Ukraine given the freezing of most of the overseas assets of the Central Bank of the Russian Federation.

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Asian Development Outlook 2022  
*Mobilizing Taxes for Development*

Developing Asia faces greater uncertainty from the Russian invasion of Ukraine even as the region continues to contend with COVID-19 outbreaks. The war has sent shockwaves across financial and commodity markets. The highly transmissible Omicron variant has fueled a sharp rise in cases in the region, though its less severe health impact, coupled with increased immunity, has allowed economies to remain relatively open. As such, growth in the region is forecast to remain strong, supported by recovering domestic demand. The Russian invasion of Ukraine, aggressive monetary policy tightening in the US, and renewed COVID-19 outbreaks pose near-term risks to the outlook, alongside medium-term risks such as rising inequality due to school closures.

Fiscal resources are needed to aid recovery and support sustainable development. But deficits and debt expanded substantially during the pandemic. Mobilizing taxes and optimizing tax incentives needs to be combined with improved spending efficiency to help developing Asia achieve its development objectives.

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