

# An economist's view: Ukraine conflict's impact in Asia

31 March 2022



**Speaker**

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**29 April, 2022**

*Authentic leadership : how to stay yourself while leading your business / your people*, **Mathilde Poirieux, Executive Coach at Dynamis**

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## The Russia-Ukraine Conflict: Impact on China and rest of Asia



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- 1. PRELIMINARY THOUGHTS**
  - 2. WHERE DOES THE CHINESE ECONOMY STAND**
  - 3. POTENTIAL IMPACT OF THE WAR IN UKRAINE: TRADE AND FINANCE**
  - 4. WILL CHINA HELP RUSSIA AND, IF SO, CAN IT DO IT?**
  - 5. WHAT ABOUT THE REST OF ASIA**
  - 6. CONCLUSIONS**





# PRELIMINARY THOUGHTS



- Russia's invasion of Ukraine can only have negative consequences for the world at large. This includes China although the direct impact is clearly more limited than that of Europe.
- The key direct channel for the Ukraine war to affect China is the spike in energy and commodity prices more generally
- Western economic/financial sanctions – as well as Western companies' voluntary sanctions on Russia – also having a bearing on China, all the more so the closer China is perceived to stand in its relationship with Russia
- Beyond China, the war in Ukraine has consequences for all Asia with some relative winners and losers, both geographically and sector-wise.





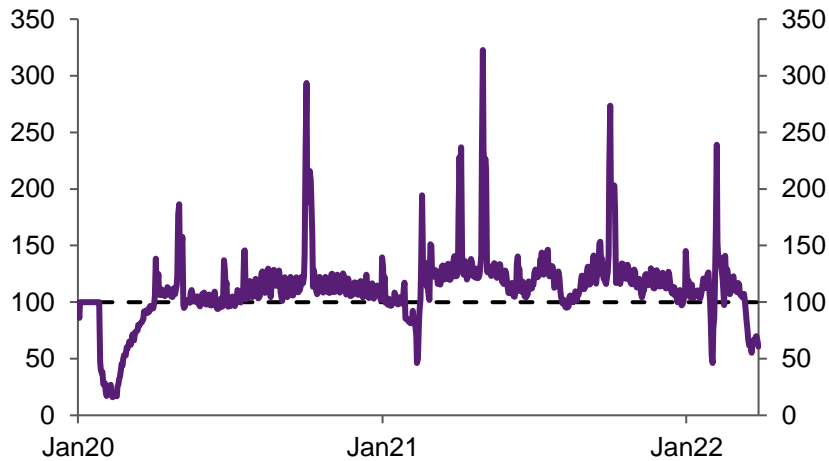
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## WHERE DOES THE CHINESE ECONOMY STAND



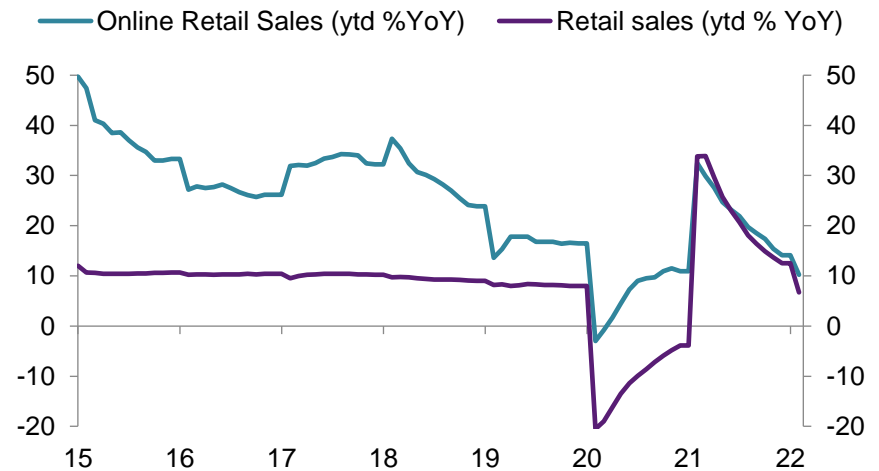
**Omicron outbreak has already reduced China's mobility quite substantially, getting close to that of early 2020 during the first Covid outbreak. Consumption growth has been poor recently, even for online sales and this sharp drop in mobility will not help**

**China: Mobility Index (Jan-2020=100)**



N.B. Data as of Mar 28, 2022. Index calculated based on weighted average of daily traffic into and out of prefectures. The first 5 weeks of 2020 are used as baseline.  
Source: Natixis, CEIC

**Retail Sales and Online Retail Sales**

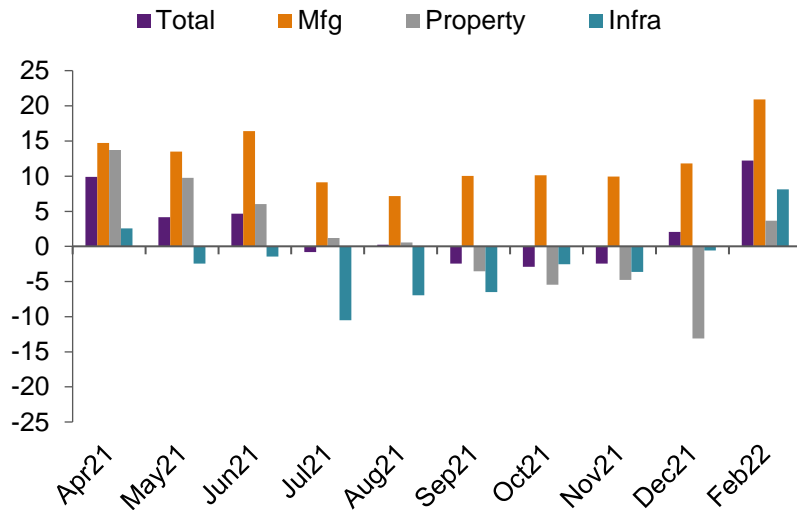


Sources : Natixis, NBS



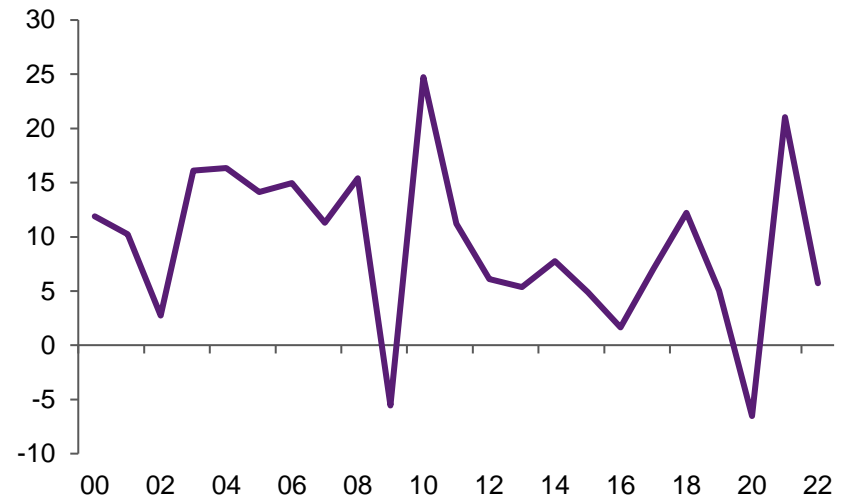
# Incoming data much better than expected for fixed asset investment, still dominated by manufacturing sector. However, data on electricity consumption shows a decelerating picture

China's Investment Breakdown (% YoY)



Source: Natixis, CEIC

China's Energy Production in February since 2000 (YTD, % YoY)



Source: Natixis, CEIC

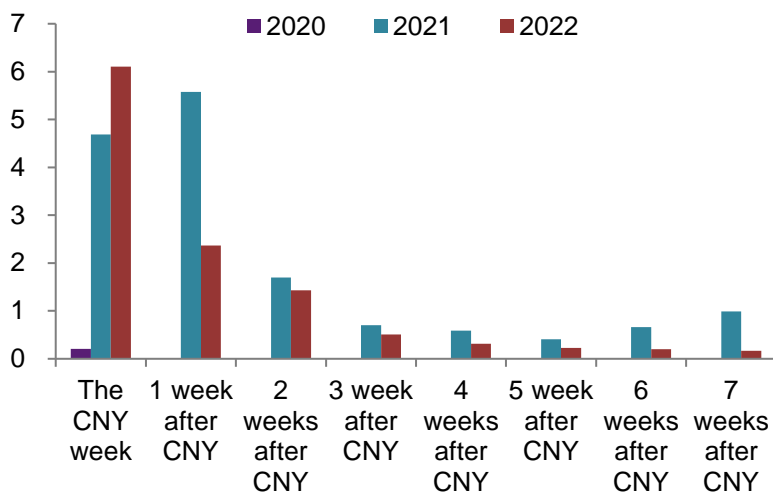


# The impact of the Omicron wave on the Chinese economy is massive and could be extended over time

Obvious impact on consumption of services

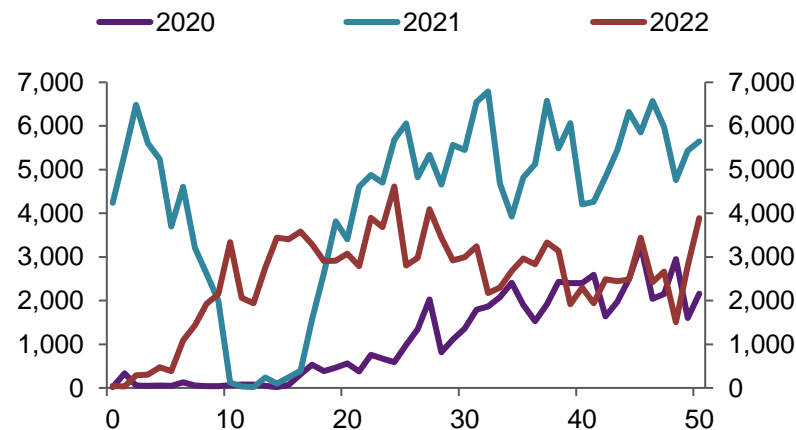
Housing transactions also stagnant against the backdrop of mobility restriction

Weekly Box Office Revenue (million RMB)



Source: Wind, Natixis

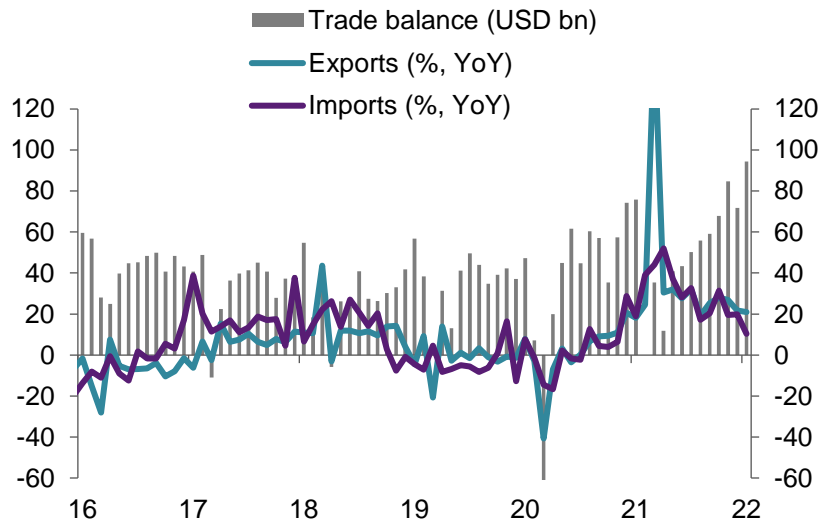
Daily Home Transactions since Lunar New Year



N.B. Counted from the first day of lunar new year. Dataset of 30 large and medium cities. Source: Natixis, WIND

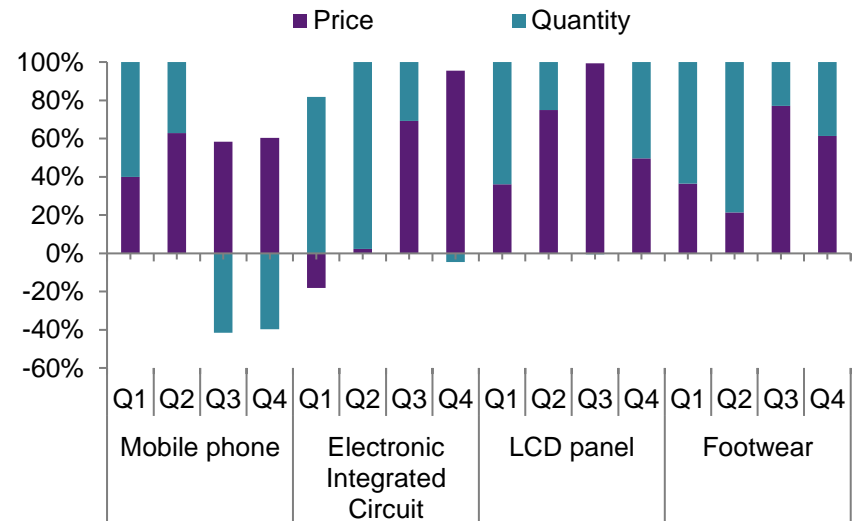
Exports momentum subdued since the beginning of 2022. This is already the case since 2021 if we consider how much price increase have been behind the export boom (rather than volume)

### China's Trade in Goods



Source: Natixis, Bloomberg

### Main export products growth contribution 2021



Source: Natixis, CEIC

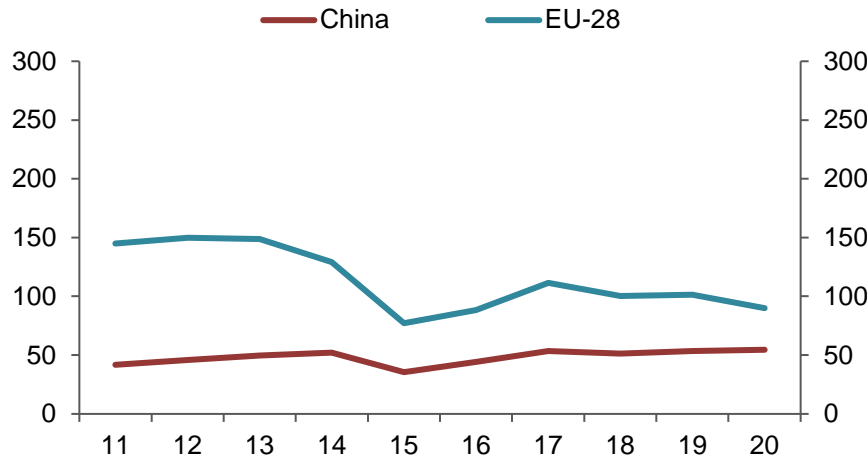




# POTENTIAL IMPACT OF THE WAR IN UKRAINE

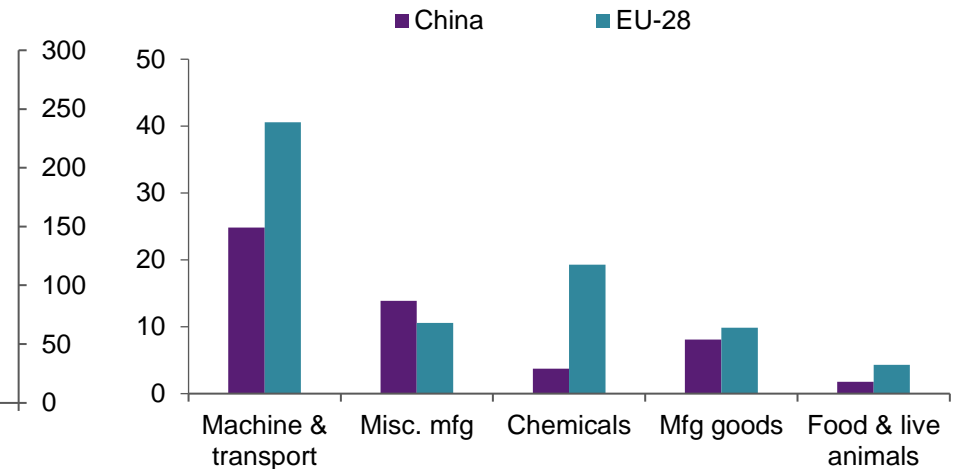
The immediate impact through the trade channels is the soaring energy price, but China's regulated electricity prices could cushion the short-term impact. Over longer term, the strategical relationship between China and Russia as regards energy and other resources is key. Russia is bound to continue to substitute imports away from the EU for Chinese ones

Russia Imports (USD bn)



Source: UNCTAD, Natixis

Russia's Imports from China and the EU (2019, USD mn)

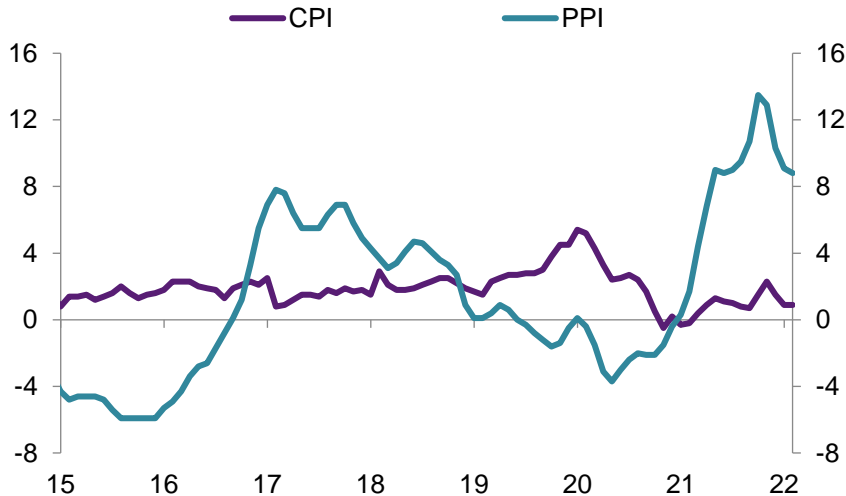


Source: Natixis, UNCTAD



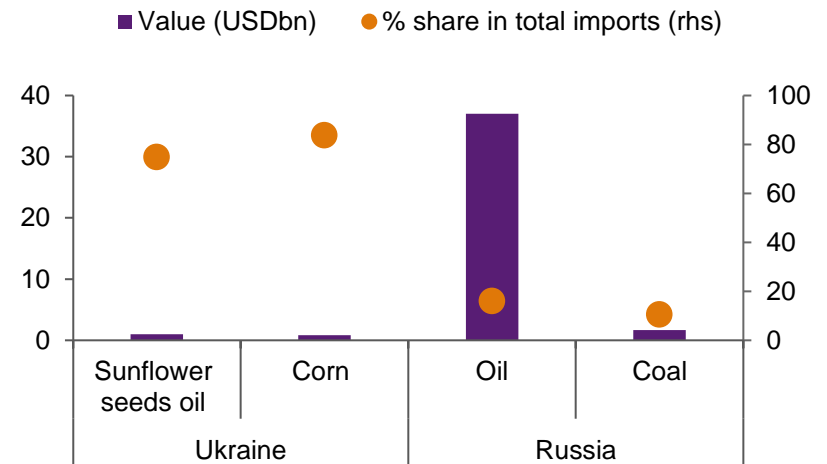
The Ukraine crisis may also affect certain food products which China relies on Ukraine/Russia, but these products comprise a very small portion, so the macroeconomic impact is limited, all the more so given China's recently low CPI inflation

CPI and PPI (%YoY)



Source: Natixis, Bloomberg

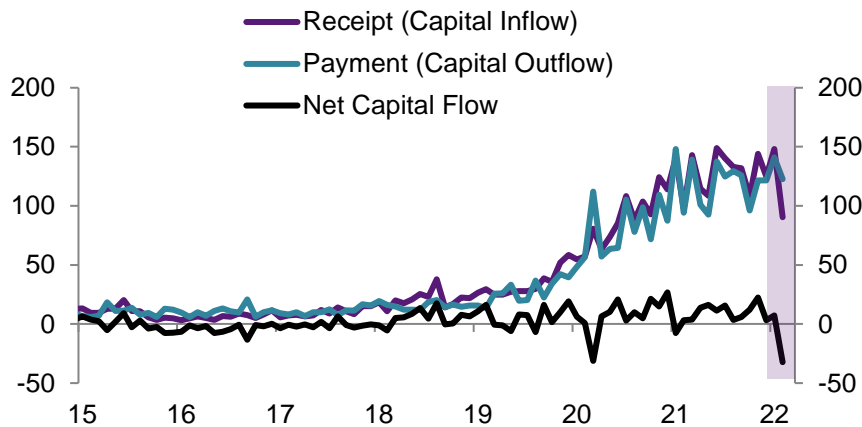
China's Key Imported Goods from Ukraine and Russia (2019)



Source: Natixis, UNCTAD

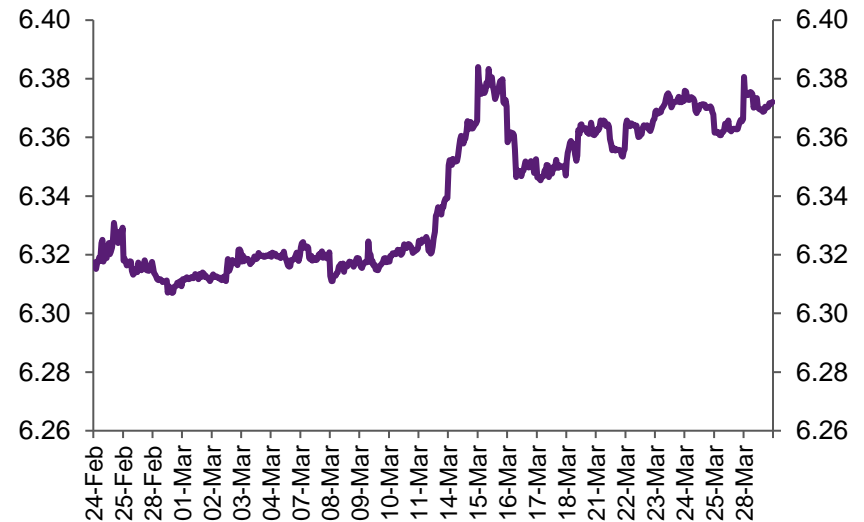
**China seems like a safe haven when Russia started its invasion of Ukraine but the situation changed radically in the second week of March with massive outflows, as shown in the FX payment. The RMB has since weakened slightly**

**China: Net FX Receipt and Payment of Securities Investment (USD bn)**



N.B. Data as of February 2022. FX receipt and payment on behalf of client used.  
Source: Natixis, China State Administration of Foreign Exchange, CEIC

**USDCNY**



Source: Bloomberg, Natixis





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**WILL CHINA HELP  
RUSSIA AND, IF SO,  
CAN IT DO IT?**

## China's role in the Ukraine crisis depends on many factors

- The duration, depth, and potential expansion of Western sanctions and China's response
- The US-EU-China long-term economic relationship after the Ukraine crisis
- China's strategical relationship with Russia, especially as regards energy cooperation



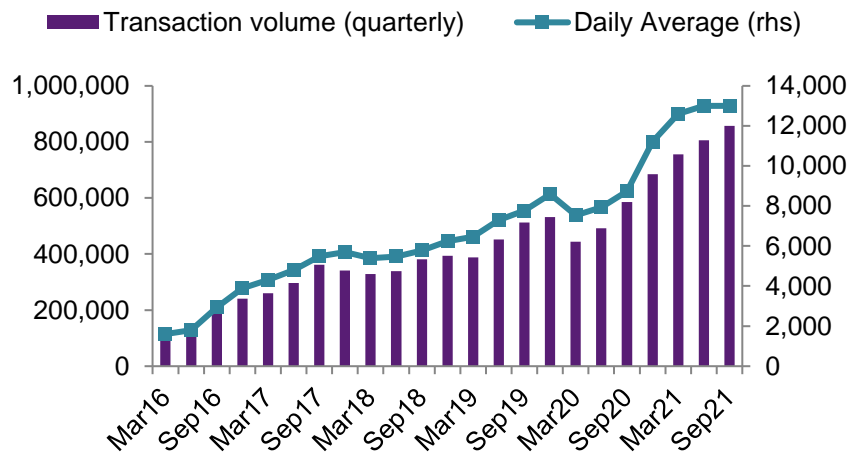
## A valid question is, whether China will help Russia in the short run

- The most likely scenario is that China will abide to the “letter of the law” (Chinese banks no longer offering LCs for Russian operations) but not necessarily the “spirit of the law” (China increasing imports of wheats from Russia)
- The question is whether that will be enough for Russia at the current juncture since sanctions are clearly biting
  - Bans on exports of semiconductors quite important as they constraint Russia’s military capability
    - Is there scope for SMIC?
  - Trade in RMB not enough of a solution, particularly if secondary sanctions are imposed. CIPS still runs on SWIFT

## China's financial infrastructure needs to evolve to offer a respite to Russia: not an immediate answer

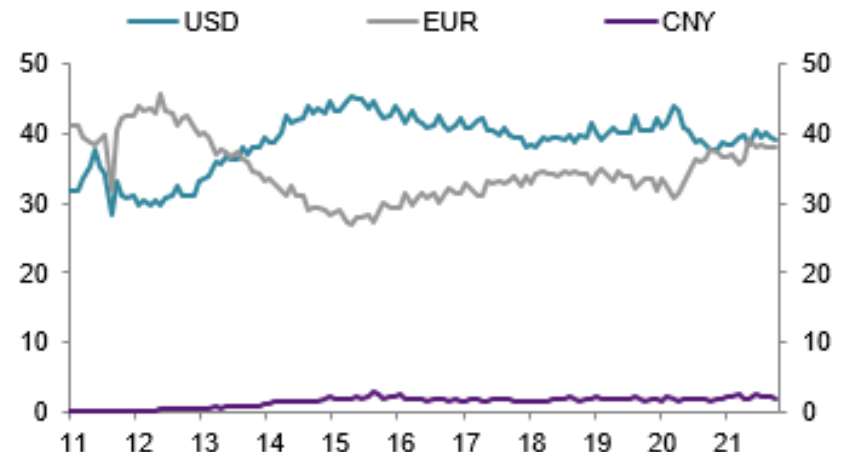
CIPS still underdeveloped even if it were to introduce its own messaging system: not enough counterparties or volume even if growing fast. As for the E-CNY, Russia might not be keen to have it circulating further weakening the ruble, all the more so being non-convertible

**RMB Cross-border Interbank Payment System (transaction volume)**



Source: PBoC

**Share as International Payment Currency(%)**



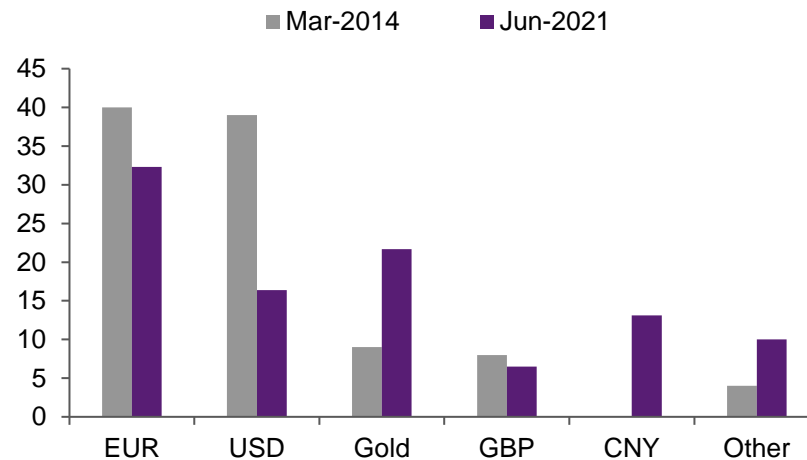
Source: Natixis, SWIFT, Bloomberg



## One potential immediate line of help is the use of Russia's RMB reserves at the PBoC

But this might only be used to pay imports from China, not to serve debt or pay other imports. If PBoC were to convert RMB into USD, it would probably imply bypassing sanctions

**Currency Composition of Russia's Reserve Assets (%)**



Source: Natixis, Bank of Russia, IIF



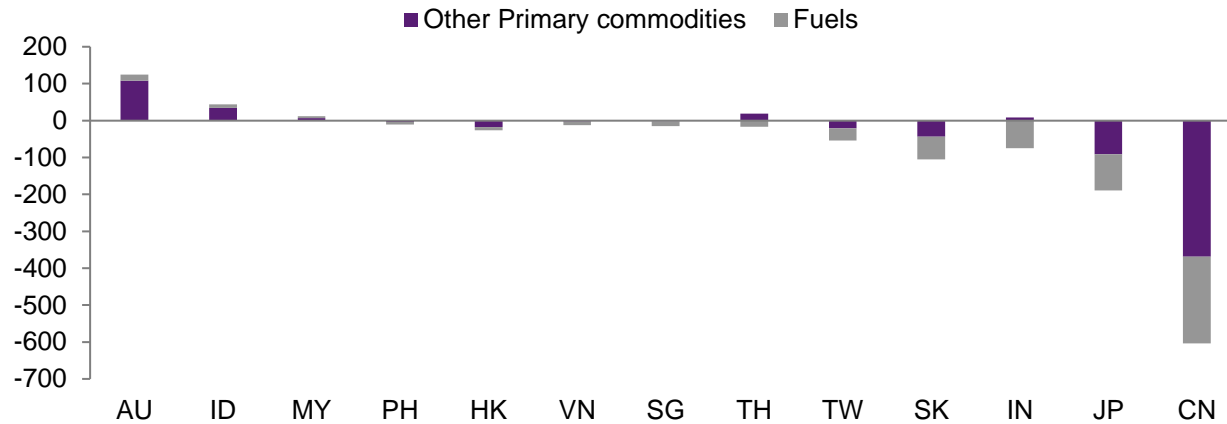
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## WHAT ABOUT THE REST OF ASIA



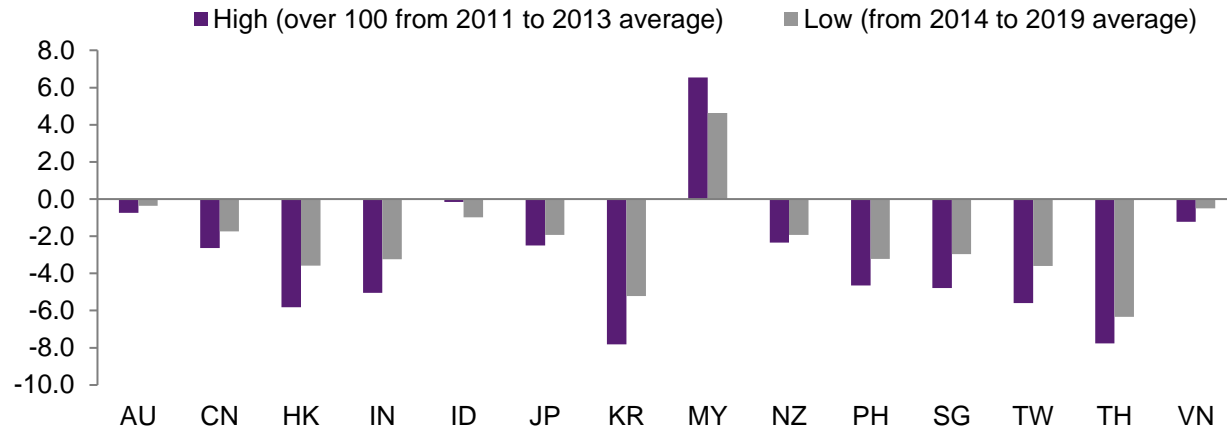
# Three net exporters of commodities – Australia, Indonesia and Malaysia; Everyone else imports so they will pay more

Primary commodity trade balance in Asia in 2020 (USDbn)



Source: Natixis, UNCTAD

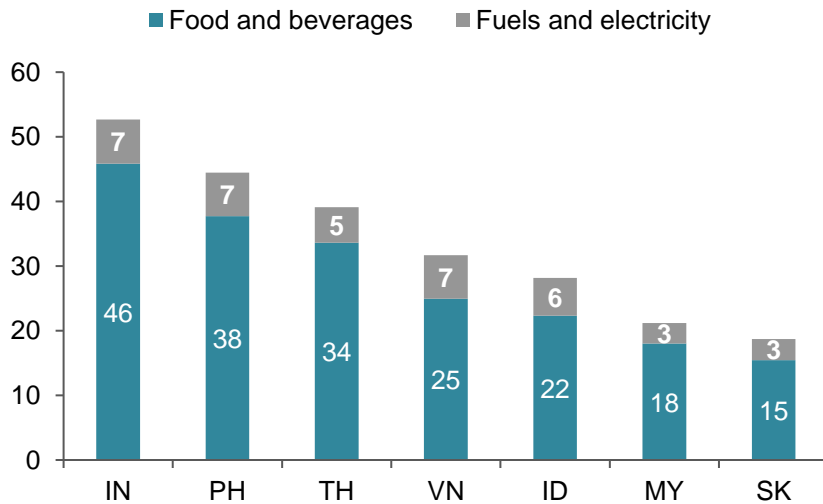
Oil net balance as a share of GDP



Source: Natixis, CEIC

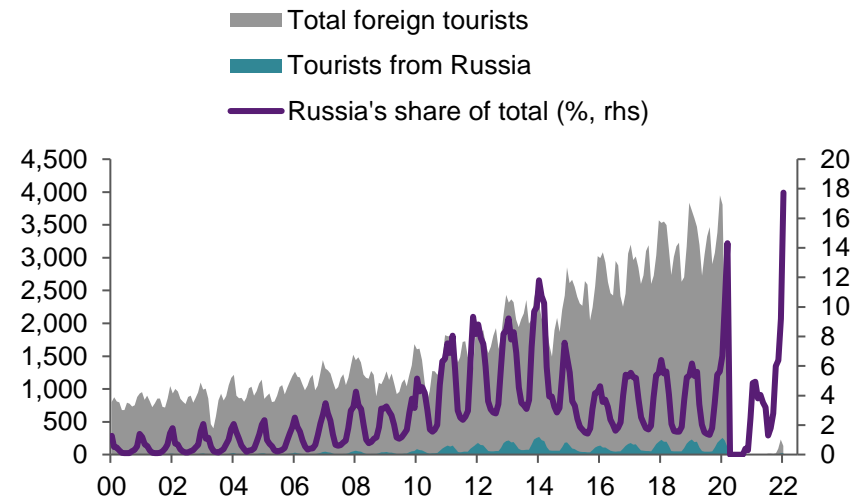
**Current account surplus countries can offset with manufactured exports and sizeable surplus; irrespective, households will pay more & those with a higher share of the CPI basket will see pressure; Beyond trade, Thailand faces pressure from a weaker ruble and China's longer than expected closed borders**

**Food and Energy Weight in CPI Basket (%)**



N.B. Data of MY as of Jan 2022, others as of Feb 2022.  
Source: Natixis, CEIC

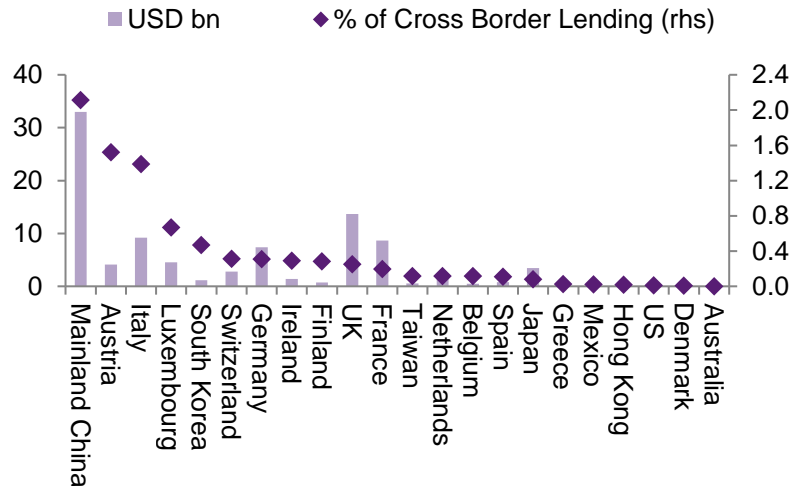
**Tourist Arrival in Thailand (th persons)**



N.B. Data as of Jan 2022.  
Source: Natixis, CEIC

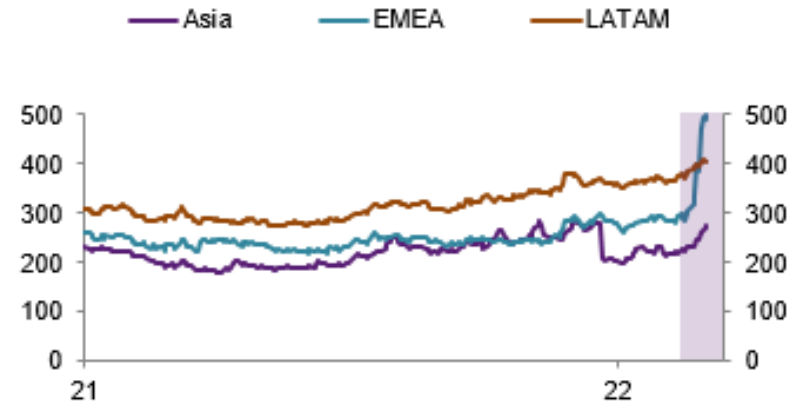
# The spillover from Russia into Asia's financial sector is limited, including the credit spread in USD bonds

### Cross-border Lending to Russian Entities



N.B. Data as of 2021 Q3. \*Estimated value.  
Source: Natixis, Bank of International Settlements

### Credit Spread of USD Bonds (bps)

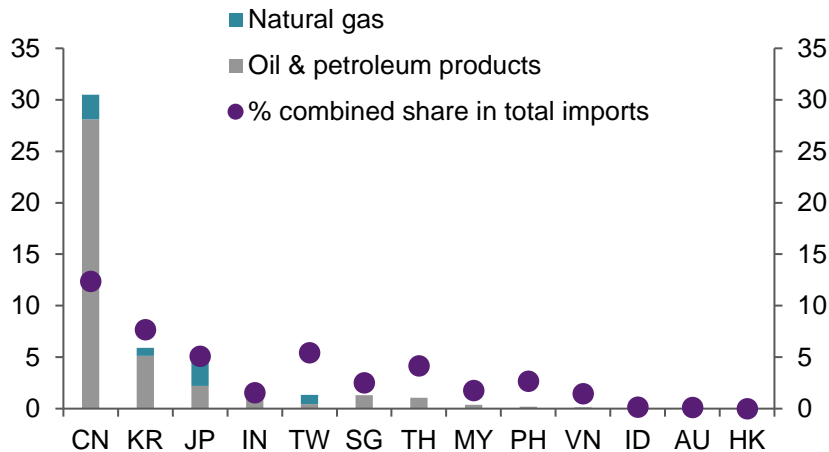


N.B. Data as of 3rd March 2022. Benchmark as the yield of US treasuries based on the respectively weighted maturity.  
Source: Natixis, Bloomberg



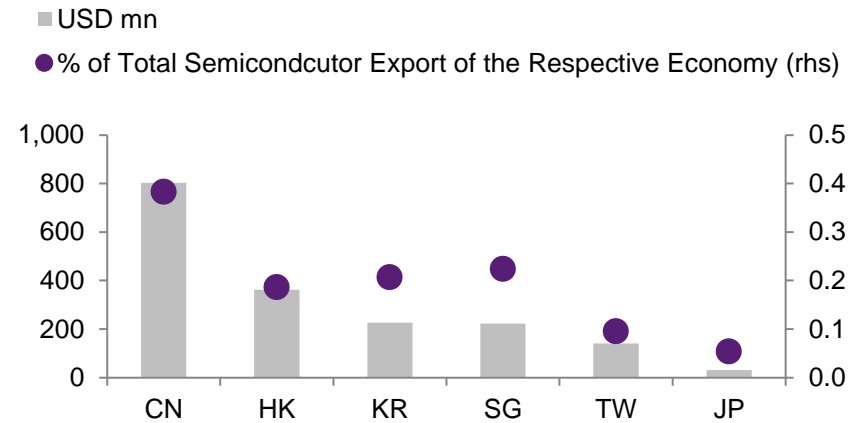
# The energy exposure to Russia varies in Asia also with limited export share, but a key risk is if Asia can find alternatives for raw materials

### Imports of Oil and Gas from Russia (USD bn, 2020)



Source: Natixis, UNCTAD

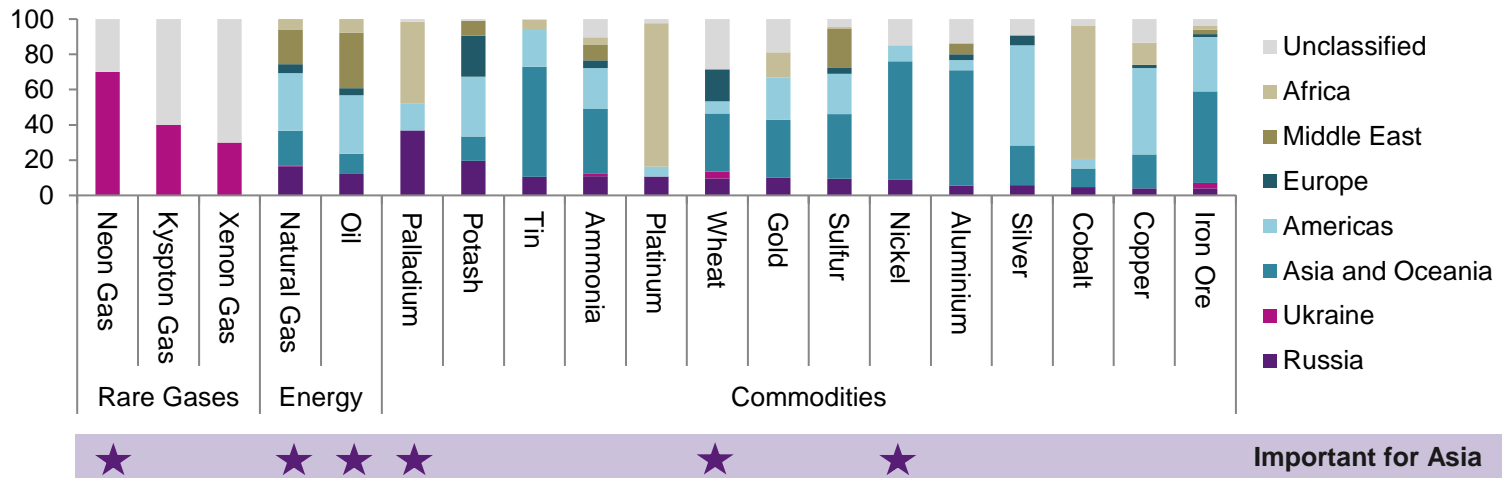
### Semiconductor: Exports to Russia by Major Asian Economies



N.B. Data as of 2020.  
Source: Natixis, UNCTAD

# Some sectors to suffer particularly strongly from the Ukraine-Russia conflict

Key Commodities: Production by Country (% of Global Market Share)



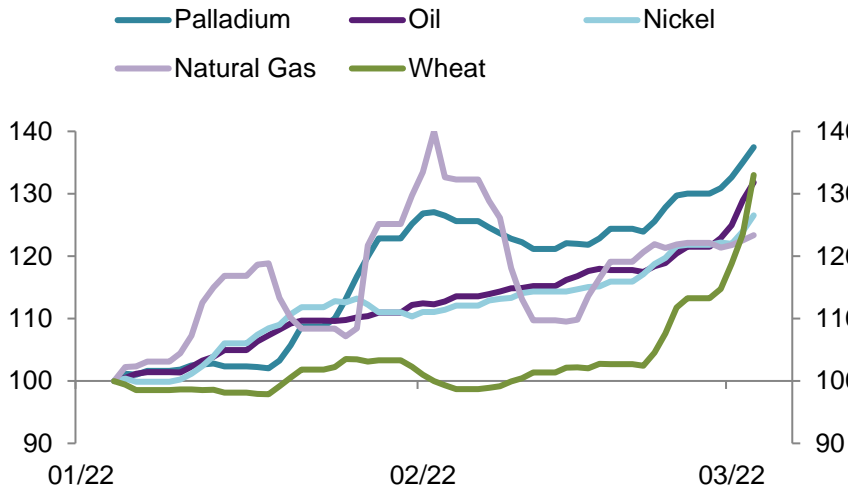
Source: Natixis, United States Geological Survey, United States Department of Agriculture, British Petroleum, TrendForce, Techcet, Bloomberg

Sector	Sub-sector	Share of Russia and Ukraine in Global Production (%)	Key Implication
Energy	Oil	12%	Oil and gas prices will surge with the concern in future supply
	Natural Gas	17%	
Technology	Palladium	37%	Palladium is used in making memory chips (DRAM, NAND Flash) and sensors
	Nickel	9%	Nickel is used in ternary lithium batteries for electric vehicles
	Rare Gases	Neon Gas (70%)	Neon gas, krypton gas and xenon gas are used in lithography processes for semiconductors
Agriculture	Wheat	13%	Food price may surge
Shipping	-	-	Sea and air routes affected

Source: Natixis, United States Geological Survey, United States Department of Agriculture, British Petroleum, TrendForce, Techcet, Bloomberg

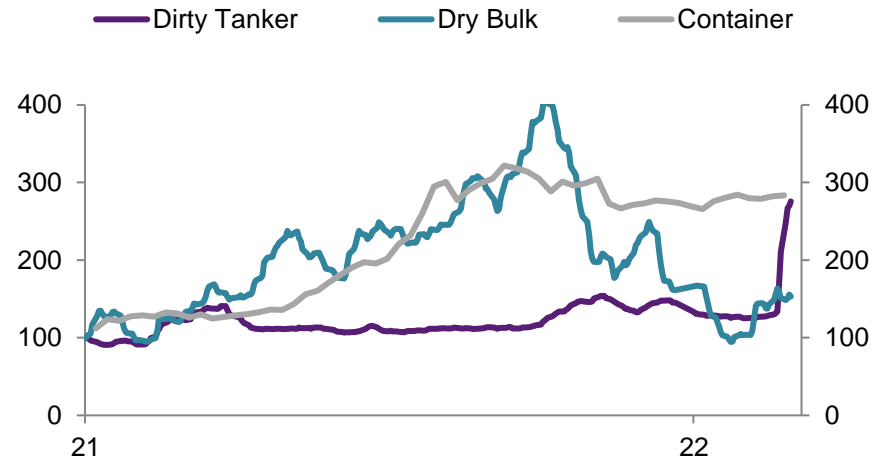
# Asia can feel the heat of inflation from higher commodity prices and transportation costs

**Selected Commodity Price (End 2021=100)**



N.B. Data as of 3rd March 2022. 7-day moving average.  
Source: Natixis, Bloomberg

**Global Shipping Cost (2021=100)**

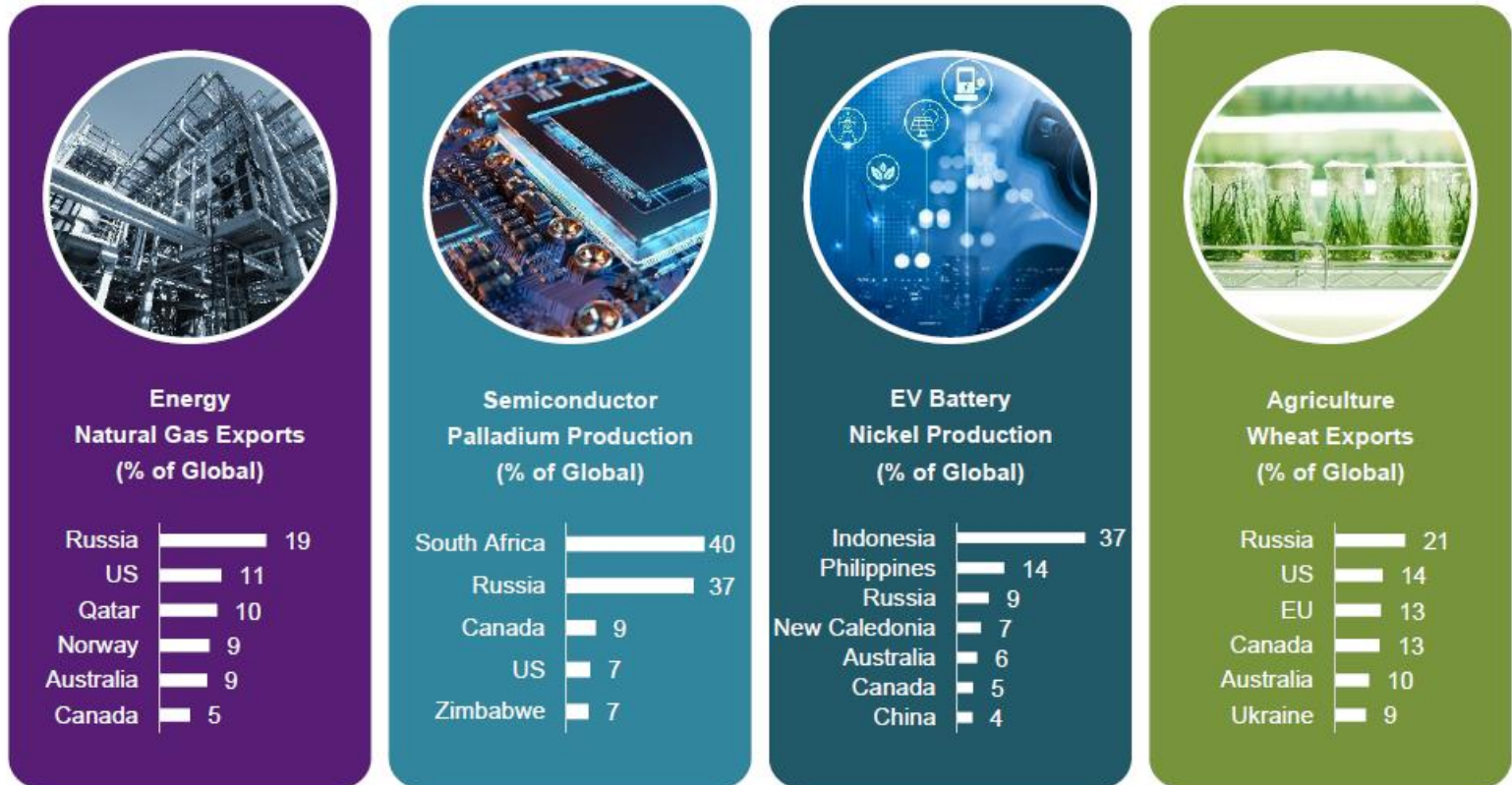


N.B. Data as of 3rd March 2022.  
Source: Natixis, Baltic Exchange, Freightos, Bloomberg



# Some Asian economies can benefit from the rising commodity prices, such as Australia, Malaysia and Indonesia

## Key Commodities with Implications on Asia



N.B. Data as of 2020.

Source: Natixis, United States Geological Survey, United States Department of Agriculture, British Petroleum, Bloomberg



# CONCLUSIONS

## Conclusions

- A struggling Chinese economy needs to deal with a War in Ukraine.
- The immediate impact comes from higher commodity prices but the ongoing Omicron wave is increasing the pressure.
- China's position regarding the conflict is pro-China on the narrative but very cautious on the essence. China's goal is to support Russia at the lowest economic cost (certainly without trespassing sanctions). The medium-term gains from this strategy are threefold:
  - Enhance China's energy security
  - Strengthen military capabilities thanks to Russia
  - Continue to push for a change in the global order
- The final question is whether China will continue to support Russia if the related cost increases (higher risk of sanctions, whether secondary or even directed to China if it were to support Russia militarily). My tentative answer is that China will be very careful but will still support if there is a risk of a change in regime in Russia
- For our business this increases the risks of being caught between two fires but we are still better off than banks with larger exposure in Russia.
- The impact on the rest of Asia is mixed: very positive for Australia, followed by Malaysia but quite negative for Japan as well as India.
- Some sectors are also hit more than others with special attention to potential energy and food shortages as well as supply chain disruption. Shock clearly inflationary for all



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