

Ukraine Russia War: Its Impact on Indian Economy (An Analysis)

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ABSTRACT

COVID shock affected both demand and supply thus the net impact was on the real GDP however, Russia-Ukraine war creates a supply shock for the Indian economy. As per a report by financial express Indian manufacturers, with the beginning of verbal assault and expectations of war, have increased the prices of goods in January and early February 2022, well before the actual war started. The oil sector of the economy is deteriorated as a 10% increase in crude oil is likely to increase inflation by 30 basis points. The net impact on inflation could turn to be more structural and complex as high oil prices might create a pass-through impact on other sectors. Conflict has increased the world prices for most of the consumer commodities, with deepened impact on edible oils, wheat and grains, fertilizers, gas, crude oil, and metals. Rising Inflation has also created significant hindrances and uncertainties for the economic growth in India, forcing the expected GDP growth to be around only 7.8%-9% in fy 2022 from the expected double-digit growth. During the past few decades, India and Ukraine have strong education ties, especially in the medical and engineering fields, which is also severely affected as Indian citizens have returned in view of the conflict.

Key Words : MRC, WPI,CPI, CAD, Mmbd, FY, NATO

INTRODUCTION

After COVID-19 and bull prices during last financial year, India was optimistic towards growth with recovering stock market, improving reserves, picking up of production and manufacturing activates, recuperating market forces of demand and supply, interest rates and volatility getting under control, at least to an extent. However, Russia-Ukraine conflict brought new challenges for India and the whole world. As Russia-Ukraine war began on 24th February and in response US imposed sanctions on Russian economy, the direct impact on Indian economy is on the trade with these nations. However, this has a little influence on India as proportion of trade with Russia is just around 1% of economy's total foreign trade, and that too is in the sector of defense where government can lookout for ways to safeguard the deals, to a larger degree. However, the indirect impact of war on Indian economy is significant due to domestic inflation and

economic decay caused via market factors such as rising prices of metals and edible oil, depreciation of Rupees, rising crude oil prices, which in turn raises transportation and inter-state movement of commodities, among others. Moreover, most of the indices of the stock market have fallen by more than 10% since 1st February, 2022, with certain short breaks. Brentcrude oil prices is expected to skyrocket to around \$115 barrel within the next month, however appropriate estimations about movement of oil prices are difficult to ascertain due to zero-covid policy of China and slackening world demand for oil. This is in turn creating a substantial volatility and uncertainty in the market that is causing considerable hindrances for Indian economy during policy making and future expectations. Economist Jayanth R Verma, member of Monetary Policy Committee (MRC) of Reserve Bank, also stated that inflation is much higher than the stipulated target, investment has remained subdued during this period of war, and private consumption has not fully

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recovered, especially considering the challenges faced by Indian economy due to three-year pandemic. With the immediate impact on health, education, manufacturing, service, tourism and other sectors, war may have a short or medium run deteriorating impact on price level, economic productivity, inequality, employment, wages, and demographic dividend, among others. On the other hand, war and subsequent economic sanctions on Russia also presents a window of unlikely opportunity for the Indian agri-exporters, as the world is looking at India to fill the vacuum created in stocks of wheat, maize, millet and other US and Europe's breadbasket. India, still significantly dependent on agriculture and allied activities, sold a record 1.4 million tonnes of wheat in April, and for the first time Turkey has placed an order for 50,000 tonnes of wheat, joining Egypt.

To measure the impact of Russia-Ukraine war on Indian economy, as well as to investigate for the possibility for harnessing the benefits, it is important to conduct a robust evidence-based reactions, along with study of responsive policies and monitoring system is essential to mitigate adverse effects.

Impact of Russia-Ukraine War on India Economy:

After World war-II ends in 1945, Russia-Ukraine conflict is probably the largest traditional attack causing huge loss of life, infrastructure loss, human rights violations, among others just in Ukraine and Russia, but also because of huge global economic crisis. Having extremely significant trade, diplomacy, nuclear energy, technology, and military relations with Russia, India has taken a neutral stance, with depicting significant concerns for implications of war and calling for resolving issues through diplomacy. However, India, or any other nation in current integrated and inter-connected globalized geo-political world, cannot remain immune from the ravages of the war. In this study, we analyse the major impacts of war on Indian economy such as impact on Oil Prices, inflation and economic growth, energy and food crisis, as well as impact on Rupees. We also discuss the changing world order in context of the conflict.

Impact on Oil Prices:

A major portion of the world demand, including Indian demand, for oil is fulfilled by the Russia as it is second largest exporters of crude oil, only after Saudi Arabia. However, the Russia-Ukraine war has raised the global prices of Brent crude oil up to \$139 per barrel

in March, which later pulled back to around \$107 per barrel. Overall, it has mounted by around 20% from around \$89 per barrel since the war started. Given the adverse impact of pandemic, the rising oil prices could further worsen the manufacturing, tourism, transportation and allied economic sectors, which in turn may create inflationary, fiscal, and external sector crisis in the Indian economy. On the other hand, the Russian oil prices also fell down from its pre-war level, due to sanctions and boycott of Russia by US and several European economies. In order to understand the impact of conflict on Brent crude oil prices is from the experience.

ICICI securities noted that with an expected 60% of the world restricting trade with Russia, world oil-crude supply is to reduce by 3 mmbd, keeping Brentcrude price above \$100 per barrel for much of fy 2022. India imports around 85% of its demand for oil, and crude oil related products have a direct share of over 9% in WPI basket. Report by Bank of Baroda Chief Economist Madan Sabnavis, a 10% rise in crude would approximately increase WPI inflation by around 0.9%, raising the baseline expected WPI to around 11.5-12% for fy 2022. On the other hand, every \$1 per barrel increase in oil prices is also expected to raise petroleum prices by 60-70 paise per litter in retail fuel prices leading the rise in proportion of oil imports in India's total imports to around 25.8 %, which is expected to swell further. Moreover, a 10% hike in oil prices is expected to increase India's CAD by US\$ 15 bn (around 0.4% of GDP) worsening trade deficit. Escalated fuel prices is also expected to reduce consumption directly, which was already affected by pandemic, reducing PFCE to Rs. 80-81 lakh crore in 2021-2022 from 83.22 lakh crore in 2019-20.

Inflation and economic growth:

While COVID shock affected both demand and supply thus the net impact was on the real GDP however, Russia-Ukraine war creates a supply shock for the Indian economy. As per a report by financial express Indian manufacturers, with the beginning of verbal assault and expectations of war, have increased the prices of goods in January and early February 2022, well before the actual war started. The oil sector of the economy is deteriorated as a 10% increase in crude oil is likely to increase inflation by 30 basis points. The net impact on inflation could turn to be more structural and complex as high oil prices might create a pass-through impact on other sectors. Conflict has increased the world prices for most of the consumer

commodities, with deepened impact on edible oils, wheat and grains, fertilizers, gas, crude oil, and metals.

Rising Inflation has also created significant hindrances and uncertainties for the economic growth in India, forcing the expected GDP growth to be around only 7.8%-9% in fy 2022 from the expected double-digit growth. During the past few decades, India and Ukraine have strong education ties, especially in the medical and engineering fields, which is also severely affected as Indian citizens have returned in view of the conflict.

Energy Crisis:

The real extent of shock is much larger for the real economy as the rate of inflation of fuel prices is much greater than the inflation of crude oil prices, which is significant for framing monetary policies. A report by Bloomberg states that though crude oil is being traded at around \$100 per barrel however, for people not owning oil refinery the real impact on economy is larger as if the crude oil is being traded between \$150 and \$275 per barrel. This is because real economy mostly buys refined petroleum products such as petrol, diesel, jet-fuel etc., rather than the crude oil which is majorly purchased only by the oil refineries. Typically, inflation of Brent crude oil and petroleum product move in a symmetrical manner with difference lying in a small markup of around \$10 per barrel, however, this relationship is broken due to the conflict. In world market, Diesel is being traded at about \$170 per barrel whereas petrol is being traded at \$150 per barrel, primarily due to explosion of refining margin. This, is in turn, happened due to the following factors:

- High demand-supply gap of petrol and diesel,
- US and allied nations released large amount of Crude oil from their strategic reserves, which helped in controlling oil prices, however only a small fraction of emergency release was in the form of refined products and thus have not addressed rising prices of refined products.
- Russia was a major exporter of not only the crude oil but also of diesel and semi-processed oil that were turned into fuel by western refineries. However, sanctions and unilateral embargos of Russian oil has dried this flow in the international market.
- Outside China and Middle East, oil distillation capacity reduced by 1.9 billion barrels a day since end of 2019 and refining plants in the international market are suffering to process enough crude to

satisfy world demand for fuel. In addition to sanctions, this is also set off as old refineries struggle to compete, as well as increased cost due to environmental regulations, expectation of future decline in oil demand, fall in demand due to covid, among others, resulting in huge shut down of refinery operations between 2020-2022 in US and Europe.

This has benefitted the independent oil refineries with unusual very-high profit margins. This has also increased the share prices of U.S. refining giants Marathon Petroleum Corp. and Valero Energy Corp., to a record high and ultimately, has caused a serious shock to the energy sector of India and the international economy.

The Global Food Crisis:

Retail and wholesale food inflation is also rising in India, with most recent data indicating WPI food and CPI food reaching to 10.33% and 5.43%. Russia and Ukraine supply around 30% of global wheat exports which has fallen due to the conflict and subsequently, bid has risen for acquiring the wheat and Agri-products such as maize, rice and soy, adversely impacting poor. India, as emerging major wheat supplier, is attempting to boost exports of wheat however is severely constrained by shortage of fertilizers. Russia and Belarus produced 40% of international exports of fertilizers and pesticides per year, which is also fallen due to conflict impacting the harvest capacity in India and rest of the world. This along with droughts, floods and heat invigorated by climate change have increased the Wheat and maize prices in March 2022 much above than their respective 14-year records. IPES (International Panel of Experts on Sustainable Food Systems) noted that due to climate change, widespread absolute poverty, and conflicts between the nations, the global food security is under serious risk of crisis, which in turn would result substantially high prices for medium to long run, unless appropriate actions are taken. Along with the shortage of wheat and grains due to lack of supply from Russia and Ukraine, the food prices are also driven up by artificially inflating prices as investors and financial speculators jumped into grain futures, before even conflict started in expectations of future profits. In an open inter connected world economy, small changes in expectations can lead to huge impact in the real economy. This has impacted India as well, creating a persistence pressure

of food inflation and threatening India with a potential shortage of food supply especially for Wheat, edible oils and grains and may extend to poultry, milk and other dairy products.

The Payment Method:

Russia-Ukraine conflict, and the subsequent sanctions on Russian economy, created a hurdle for international trade with Russia as several major Russian banks were barred from the SWIFT, which lets international banks to communicate about payments and transfers among each other. SWIFT (Society for Worldwide Interbank Financial Telecommunications), with more than 11,000 participating banks and financial institutions, plays a major role for global trade and finance. However, as Russian economy was barred from SWIFT a major concern among international traders evolved due to apprehensiveness towards receiving payments. Ajay Sahai, CEO and director of FIEO (Federation of Indian Export Organisations), mentioned that there is about \$400 million in unrealized receipts for exports and receiving payments have now become a problem and resulting financial consequences can be steep. Russian companies have offered to trade via payment through third parties, however ECGC, exporters, banks and other financial intermediaries insist to cover such third parties into contract, which is missing from most of the undergoing contracts. This, India is working to find alternative ways by setting up an alternative payment system to trade with Russia. Panel led by Mr. Ajay Seth, economic affairs secretary, along with ministries of food and consumer affairs, external affairs, fertilizers, commerce, and petroleum, is focused on identifying a potential bank, to prioritize imports of edible oil and fertilizers as well as payments owed to India. When a bank is finalized, both Russia and India will deposit their respective currencies in it, in order to facilitate trade at a nominal exchange rate that is to be arrived by pegging it to an international currency.

Conclusion:

First Corona and then, Russia-Ukraine conflict have accelerated an ongoing shift in rebalancing of the power. With medium-term to long run consequences of infrastructural and other destruction in Ukraine and Russia; humanitarian, security and food crisis in Europe and US; geostrategic pressures face by Japan, China, India and South Asian economies; huge economic turmoil

in Sri Lanka whose impacts are expected to remain for at least medium run, the world order is again recalibrating. In order to recreate a sphere of their influence and for opposition of expansion of western militia power such as NATO; as well as to create a buffer region for their own security, Russia have attempted to destroy the Ukrainian military infrastructure, create a space for their military forces and enhance control over the black sea. However, as Russia-Ukraine conflict continues, and Ukraine getting economic and military support from the western economy, sanctions, and subsequent isolation of Russia in interconnected world, these ambitions are improbable to fulfil. However, both Russian and Ukraine economies are expected to bear a long run cost of this conflict. On the other hand, through continuous hostility towards Russia for over two decades, struggle to reclaim their influence over the world, providing military support, aid, assistance and advice to Ukraine and other economies following anti-Russian sentiments since 2014, adherence to difference between narrative of democracy vs authoritarianism, US economy has also created a situation of economic stress for themselves, as they face high oil price volatility, food grain shortage, disruptions in supply chain, economic stagflation, among other disruptions. Thus, in a bid to grab the control, power has been shifting from both the fronts and in his "Interim National Security Strategic Guidance" document, in March 2021, Biden also declared that global dynamics have evolved in which US needs to restore its strategic edge. The first step was withdrawing army from middle east, in order to emphasis more on expanding NATO and on trade war with China and strategic war with Russia, which US considers as major dual targets against his influence. With majority of public and world support, US strategist are convinced that the conflict will weaken Russia for a long time, as mounting world sanctions on Russia and its intensities is stressing Russian economy and forcing it to move inwards and closed at least for a time. Moreover, with disruptions in the supply chain due to imposed sanctions, US economy is also hoping to again emerge as the major manufacturing sector of the world while forming an international alliance against Russia that could assist its long-run strategic competition. For this. US is unwilling to allow neutral, non-aligned powers like India, or multipolar world dynamics like BRICS in order to form a unilateral alliance. Indian stance of neutrality, avoiding sanctions on Russia especially for trade in defence and crude oil, abstentions during voting in security councils

and UN resolutions have garnered huge pressure from US and allied nations, calling Indian position' a bit "shaky". However, India is forced to uphold a neutral position in order to continue cooperation with time-tested partner Russia with whom India maintains defence, hydrocarbon, fertilizers, and trade relations in other commodities, and especially dependent for defence sector and arms trade. On the other hand, India needs to enhance and continue relations with its new partner US, especially given its turmoil with Pakistan and China. Meanwhile, this war also threatens to create the potential for reviving conventional and hybrid warfare, as well as initiative to enhance nuclear capabilities.

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