



May 12, 2022

Russia's 2022 War Against Ukraine: Global Economic Effects

The Russian Federation's (Russia) renewed invasion of Ukraine in February 2022, and the increasing number of international sanctions that followed, have heightened congressional interest in understanding the implications of these developments for the U.S. and global economy. The war, which has already led to economic, security, and humanitarian crises in the region, is causing wide-ranging spillover effects globally and is likely to hamper national economic recoveries from the COVID-19 pandemic. The overall impact will ultimately depend on the duration and fallout of the war and sanctions, and on policy responses. The trade disruptions, inflationary pressures, and security concerns have started to weigh on consumer and investor sentiment, reduce real incomes, and depress global demand for imports. If prolonged, the war could lead to a more widespread regional—and potentially global—economic recession and increase the risk of social unrest in both advanced and emerging economies. Members of Congress may monitor the situation and help inform potential U.S. economic policy responses.

Overview

Russia's war against Ukraine is having ripple effects across the globe and poses risks and challenges to the global economy that compound preexisting ones created or exacerbated by the pandemic. Global trade tensions and, more recently, a surge in COVID-19 cases in China that has entire cities back in lockdown also add to global economic instability. Disruptions, and the potential risk that they could worsen, come at the same time that global supply chains are already under stress. In 2021, there was a surge in demand for physical goods that resulted from economic stimulus programs and a sharp shift in spending from services to consumer durables, while supplies remained restricted by pandemic-induced constraints on production and transportation. Russia's invasion and subsequent sanctions immediately placed additional strains on supply chains, and ensuing developments are likely to exacerbate supply-demand imbalances in the global economy.

While projections of the economic impact are based on limited data and certain assumptions, many analysts agree that the war will result in a near-term reduction in global economic growth. According to preliminary estimates by the World Bank, the Ukrainian and Russian economies could contract in 2022 by 45% and 11%, respectively. While Russia and Ukraine's shares of the global economy are relatively small, the Organisation for Economic Cooperation and Development (OECD) and World Trade Organization (WTO) project that the war could reduce global economic growth by 0.7 to 1.3 percentage points (p.p.), push up prices globally by about 2.5 p.p., and slow global trade growth by up to 2.3 p.p. The economic impact is expected to be more severe and lasting in Europe than in the United States.

The effects of the war on the global economy are varied and complex and involve several factors. These include lives lost; mass displacement of people; disruptions to financial and business linkages; destruction of infrastructure; factory stoppages; shipping container shortages and blocked or disrupted transportation routes; market volatility; and the potential fragmentation of international financial and trade systems, as geopolitical considerations reduce global economic interdependence. Overall, these factors could potentially derail the post-pandemic global economic recovery and complicate matters for policymakers through two principal channels: (1) disruptions to international trade and supply chains and (2) changes to commodity prices and related inflationary pressures.

International Trade and Supply Chains

Major disruptions to international trade and supply chains pose a risk to the global economy. While the direct impact of the war might be relatively limited, its indirect impact on the sourcing and movement of goods and services around the world could be significant. To date, a number of war-related events have disrupted supply chains or have raised the possibility of disruptions in the near term. These include a wide range of sanctions on Russia and enhanced export controls, plant stoppages, and restricted rail and sea transit routes across Europe and Asia. In addition, Russia has banned the export of certain manufactured goods, timber, and food grains. It also has reportedly considered, among other things, restricting certain hydrocarbon and mineral exports and nationalizing the assets of foreign-based firms that suspend or stop operations and leave assets behind.

Shipping Constraints

Major shippers, concerned about violating international sanctions or the safety of their crews, have halted or curtailed many of their services to and from Russia. The United States, United Kingdom (UK), and European Union (EU) have banned Russian-flagged ships from entering their ports (with some exceptions, including for energy-related cargos). Meanwhile, sanctions have taken much-needed capacity out of the global air cargo market and significantly increased cargo rates. Russia has closed its airspace to airplanes owned, registered, or controlled by more than 30 countries in retaliation for sanctions. As a result, cargo carriers now have to divert flights while also avoiding warzone areas. Some suppliers will need to use slower or more expensive modes of transportation.

The shipping industry, which plays a major role in international trade and global supply chains, was facing a shortage of vessels and containers when international sanctions drove up crude oil prices, which further increased shipping costs. The situation is exacerbated by a shortfall in shipping crews due to the war. Some analysts expect the surge in container rates and insurance costs to continue to drive up freight costs worldwide.

Public backlash abroad against U.S. and multinational firms operating in Russia, as well as concerns about staff safety and potential sanctions violations, have already led many foreign firms to exit the Russian market or cut ties with

Russia altogether, thereby further upending some global business operations and supply chains. These actions may result in profit and asset losses, as well as foregone export and investment opportunities, for businesses and workers around the world.

The war's impact on global trade has been most severe in the Black Sea region, where Russian and Ukrainian ports are major hubs for grains destined for the EU, Africa, and Asia. Some analysts have warned of shortages of—and price increases for—substitutes of certain grains and other food inputs not produced in Ukraine or Russia, as other countries try to fill the gap in imports.

Commodity Prices and Inflation

In the immediate aftermath of Russia's invasion of Ukraine, the prices of crude oil, natural gas, fertilizers, and key minerals and commodities, including rare earths and grains, increased sharply. Russia and Ukraine together account for a significant share of global wheat, corn, and sunflower oil exports, and they are major suppliers to markets in Europe and the Middle East. In addition, a number of industries around the world depend on Russian and Ukrainian inputs for which there are limited alternative sources of supply, including neon (for semiconductors), palladium (catalytic converters), nickel (EV batteries), and titanium (aerospace). Russia and Belarus, also affected by many sanctions due to its support of Russia, are two of the world's largest potash producers, a key ingredient in agricultural fertilizers. Global fertilizer prices had already soared to multi-year highs in 2021, following a surge in natural gas and coal prices and export restrictions by a number of potash-producing countries. The war-induced disruptions in fertilizer manufacturing will likely drive up prices further and put next year's agricultural supplies under stress by reducing crop yields and output quality.

Growth, Inflation, and Policy Challenges

The war and the sanctions could hamper global economic growth for some time amid rising inflation and heightened uncertainty. Weaker growth, however, could imply less inflationary pressures. At the same time, higher prices may induce more production, which would eventually help relieve upward price pressures. Ultimately, while there will likely be an elevated level of inflationary pressure worldwide, its impact will vary. In particular, it will depend on individual countries' trade dependencies and overall macroeconomic and fiscal conditions. Prior to Russia's invasion, major central banks were expected to tighten monetary policy to contain inflation, which had already been hovering at decades' high levels in many countries. However, raising interest rates at this time could further exacerbate rising manufacturing and production costs. The uncertainty around economic recovery and higher prices could limit monetary policy options and ultimately slow or delay central banks' plans to further hike rates. Relatedly, growing debt burdens via higher defense, social, and humanitarian spending could add to the risk of fiscal crises in some countries.

With some exceptions, much of the recent price volatility reflects concerns about potential risks and is not the result of major current disruptions to supply or broad sanctions on trade. Investors worry that the conflict could result in additional disruptive trade measures globally, including a reduction or total ban on the purchase of Russian oil (and possibly natural gas) by Europe, or a possible decision by the Russian government to halt or further curtail exports of key commodities. Russia has suspended the delivery of

natural gas to Poland and Bulgaria. If Russia were to impose new retaliatory countermeasures, particularly on energy exports to Europe, or if the war in Ukraine severely disrupts or damages gas transmission systems, an acute energy shortage is possible in Europe—one that could potentially lead to a severe global economic slowdown amid a spike in global oil and gas prices. Higher global commodity prices, if sustained or exacerbated, may cause accelerated and prolonged inflation in many countries. Further price surges could increase hunger and food insecurity for some people, particularly across import-reliant countries in the Middle East and Africa (e.g., Egypt, Lebanon, Libya, and Yemen). These developments could also risk exacerbating political turmoil and creating migration crises in these regions.

Outlook and Issues for Congress

The global economic impact of Russia's war against Ukraine is likely to be uneven across sectors and regions, and subject to considerable uncertainty. Countries that have close economic ties with Russia are at greater risk of supply disruptions, and companies that are highly exposed to the Russian economy or dependent on certain Russian inputs will be affected the most. In addition, if the crisis has a significant negative impact on European economies, many of which are highly dependent on Russia for energy, minerals, and agricultural commodities, this could have potentially serious knock-on effects on the economies of major European trading partners, including the United States and China. Major commodity-producing countries, however, may see export earnings rise. The crisis also has the potential to further disrupt and undermine China's efforts to reshape global trade and solidify its centrality in global supply chains—particularly through One Belt One Road—with trade and investment implications for Europe, Asia, and, to a lesser extent, North America.

The ongoing war, like the COVID-19 pandemic, has accelerated and magnified existing problems in global supply chains and emphasized the interconnected nature of the global economy. For many, the war further highlights the importance of improving the resilience of domestic and global supply chains and potentially limiting trade dependencies on certain countries. This new emphasis presents the United States and its allies with questions about the manner and extent to which government policy can and should alter existing production and supplier arrangements. In particular, Congress could consider the costs and benefits of adopting policies that attempt to reallocate resources within the economy toward developing domestic production of goods currently being imported from Russia and Belarus. Another option for Congress would be to reinforce U.S. support for global trade arrangements and agreements with like-minded trading partners, while also encouraging “reshoring” and “friend-shoring,” and utilizing a greater diversity of foreign suppliers to increase resilience.

See also CRS Report R47054, *Russia's 2022 Invasion of Ukraine: Related CRS Products*.

Andres B. Schwarzenberg, Analyst in International Trade and Finance

Disclaimer

This document was prepared by the Congressional Research Service (CRS). CRS serves as nonpartisan shared staff to congressional committees and Members of Congress. It operates solely at the behest of and under the direction of Congress. Information in a CRS Report should not be relied upon for purposes other than public understanding of information that has been provided by CRS to Members of Congress in connection with CRS's institutional role. CRS Reports, as a work of the United States Government, are not subject to copyright protection in the United States. Any CRS Report may be reproduced and distributed in its entirety without permission from CRS. However, as a CRS Report may include copyrighted images or material from a third party, you may need to obtain the permission of the copyright holder if you wish to copy or otherwise use copyrighted material.