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The War in Ukraine: Economic Consequences for Europe and Southeast Asia

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SYNOPSIS

The Russia-Ukraine war has affected the economies of Europe and Southeast Asia, but not to the same extent. For European countries, the impact has been harder, mainly because of their dependence on pipeline gas from Russia and rising prices on global grain markets. Russia, on the other hand, was hit by sanctions, but enjoyed a boom in exports and its military industry. For Southeast Asia, although there are pockets of vulnerability, the economic impact has been limited, mainly because there are few direct economic links with Russia and Ukraine. As the Ukraine war is far from over, there is a need for EU and ASEAN to step up collaboration to bolster their respective economic security and resilience.

COMMENTARY

The war in Ukraine has not only caused tremendous human losses and destruction. Its economic impact is being felt around the world. Global supply chains were just beginning to recover from the effects of the COVID-19 pandemic when the war began in February 2022. Markets for energy and agricultural products were particularly affected, fueling inflation in many parts of the world. However, the intensity of the economic fallout is not the same everywhere. It depends very much on factors such as geography, infrastructure and the nature of individual economic relationships. Nevertheless, the war raises fundamental questions about the future of global economic integration, as policymakers – not least among those in Europe and Southeast Asia – are reminded of the fragility of world trade.

The Impact on Europe

The European economy hardest hit by the war is unsurprisingly Ukraine's. Its GDP fell by 29.2 per cent in 2022, as the country reeled from Russia's ground invasion and air attacks. Eight million Ukrainians, around 20 per cent of the country's population, fled to other countries across Europe. As the Russian navy blocked Ukrainian agricultural exports through its Black Sea ports (except for August 2022 to July 2023, when the Black Sea Grain Initiative allowed ships to transit), Ukraine's exports dropped sharply and global food prices skyrocketed.

Meanwhile, Western sanctions caused an economic crisis in Russia, but it was comparatively brief and shallow. Unlike Ukraine, Russia did not have to deal with the ravages of the war. Its GDP fell by 2.1 per cent in 2022, but subsequently recovered to pre-war levels. As a large energy and food exporter, Russia benefitted from the high prices of food and energy in 2022 following its invasion of Ukraine. Strong exports enabled the Russian government to drastically increase spending on the military, leading to a boom in Russia's military industry and a record low in unemployment.

For the EU, the most important economic consequence of the war was Moscow's decision to stop its gas deliveries in August 2022. Before then, around 50 per cent of EU natural gas imports came from Russia, most of it through pipelines. The EU implemented emergency support measures and several new liquefied natural gas (LNG) terminals were built in record time to avoid a gas shortage in the winter of 2022. Still, gas prices rose tenfold and pushed up electricity prices as well. Inflation in the eurozone briefly surpassed 10 per cent in late 2022, as governments scrambled to set up rescue packages for households and businesses affected by high energy costs. Food prices were also higher for EU consumers, but to a lesser degree.

While energy and food markets subsequently normalised and inflation fell back to pre-war levels in 2023, the economic fallout of the war led to a permanent shift in European views on global trade. The vulnerability of international supply chains and the risks of overly depending on individual trade partners were already the focus of policymakers as a result of the COVID-19 pandemic. When the Ukraine war disrupted supply chains once again and an energy crisis loomed after Russia's gas cut-off, the impetus for the diversification and selective onshoring of key industries was renewed.

The Impact on Southeast Asia

Unlike Europe, the Ukraine war has had limited overall economic impact on Southeast Asia. This is not surprising as the region has few direct economic links with Russia and Ukraine. For instance, the annual two-way trade between Russia, on one hand, and Indonesia, Thailand, Malaysia, the Philippines and Singapore, on the other, amounts to less than 2 per cent of their respective total bilateral trade. While the war culminated in global food and energy price inflation, ASEAN governments have been able to cushion this effect via measures such as subsidies, stockpiling, and price controls.

Nevertheless, pockets of vulnerability exist as some Russian and Ukrainian products are important for the region. For example, Russian fertilisers account for 14.8 per cent of Indonesian, 12.4 per cent of Malaysian, 9.9 per cent of Vietnamese, and 7.5 per cent of Thai total fertiliser imports. Another example is Ukrainian cereals, which account for 16.1 per cent of Indonesian, 8.4 per cent of Thai, 4.3 per cent of Myanmar, and 2.5 per cent of Philippine overall imports. Any supply chain disruption resulting from the Ukraine war can have an adverse impact on countries in Southeast Asia depending on the country and the product affected.

As for investments, the West-led sanctions on Russia can affect the latter's funding capacity in current and future infrastructure projects in Southeast Asia. For instance, it can put stress on Vietnam's energy sector where Novatek is funding Vietnam's LNG power plants, and Vietsovpetro (a Vietnam-Russia joint venture) which is producing 30 per cent of Vietnam's oil.

In the case of tourism, the war has had a positive impact on tourism-dependent economies. For instance, Thailand received about 790,000 Russian visitors between January and June 2023, which amounted to an increase of more than 1,000 per cent compared with the same period last year.

Despite the war's limited impact on ASEAN's external sector, its effects on the financial front cannot be ignored. Measures such as food price controls and subsidies rolled out to households and businesses helped to tame the war-induced inflation, but they partly worsened the regional states' fiscal balances. For the countries heavily reliant on external borrowing, namely Cambodia and Laos, the war can increase their sovereign default risks.

Enhancing Europe-Southeast Asia Economic Cooperation

While world food prices have come off their 2022 highs, risks still linger as a renewal of the Black Sea Grain Initiative looks unlikely. Renewed shortages could rekindle inflation and heighten the likelihood of food and energy insecurity in Europe and Southeast Asia. Also, how the war and its further economic effects will transpire are still unknown.

In such uncertainties, collaboration between Europe and Southeast Asia is needed to help both regions effectively and collectively manage the spillovers of the war in a timely fashion. On top of being each other's third biggest trading partner, both EU and ASEAN have a mutual interest of diversification to bolster their economic security and resilience.

There are several ways to further boost bilateral economic cooperation. One route is to accelerate the ongoing EU-Indonesia, EU-Philippines, and EU-Thailand free trade agreement (FTA) negotiations. Another way is to relaunch the suspended EU-ASEAN FTA talks. Also, non-binding platforms such as the Asia-Europe Meeting (ASEM) should be tapped to pitch innovative ideas, voice concerns, or jointly arrive at agreed solutions.

Furthermore, Track 2 mechanisms such as the RSIS-SWP Dialogue should be used to exchange views and spur debates on pressing policy issues. Finally, both sides should refrain from inward-looking protectionist policies, such as in industrial policy and export controls, especially during crises. This would enable bilateral cooperation between Europe and Southeast Asia to continue moving forward.

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