

The Russia-Ukraine conflict and implications for India



When the US sneezes, the world catches a cold...

...how will the current sneeze impact India?

The Ukraine migraine for India

...can hope for the best but should prepare for the worst!

Russia announced a pullback of some of its troops around Ukraine's borders and welcomed further talks with the West. But the US and its allies want further evidence of the troop movements and cautioned that the threat of a Russian invasion still exists. **However, the stalemate appears to be far from over and the broader context around the Russia-Ukraine conflict cannot be ignored.**

There is also a possibility that Russia's aggressive stance is all about posturing, with the aim of getting NATO to be less interventionist in Eastern Europe. However, if the current situation escalates with Ukraine being invaded by Russia, it could have a ripple effect on all economies. **With both Russia and the US involved, this could either turn out be (1) an all-out conflict which would have damaging short- and medium-term consequences or (2) a second cold war which could potentially have medium to long term consequences including sanctions.** In the case of the former, it will be within the realms of unpredictability. However, if it is the latter where another cold war ensues, there could potentially be sanctions imposed on Russia and / or its allied countries.

In either of the above scenarios, an impact may be felt by the Indian economy due to rising oil prices, supply chain shocks and potentially other challenges on both sides on both borders.

Looking at the major factors from two lenses below, we believe that India is delicately placed and hence requires a firmer footing.



India's security and defence preparedness

- ❑ An old ally in Russia and a new ally in the US on either side of the conflict results in India taking a neutral position. **Alignment** is key in the current and fast evolving polarized world.
- ❑ Impact of any **sanctions** on Russia and / or its allied countries by NATO may impact India's defence procurements from them – which, if not at former levels, are still significant
- ❑ A **strengthening Pakistan-China alliance**



Economics in India

- ❑ RBI is forecasting transitory **inflation** but a conflict will lead to an increase due to increasing oil and gas prices. Given the current stress on energy supply chains, oil beyond \$ 100 a barrel will lead to higher inflation
- ❑ Higher cost of oil will impact the current **fiscal deficit** assumptions which may lead to government looking at reducing expenditure including capex
- ❑ With **record borrowing** of more than INR 14 tn already impacting borrowing costs, the monetary tightening due to higher inflation together with depreciating INR driven by fiscal deficit concerns can lead to significant increase in borrowing costs

If the situation...		Our Take
#	...escalates resulting in Ukraine's invasion	<ul style="list-style-type: none">• India may face issues in the short to medium term in its defence preparedness due to possible sanctions on Russia and supply chain shocks
#	...escalates but does not end up in an invasion	<ul style="list-style-type: none">• There still may be sanctions on Russia and / or its allied countries along with the uncertainty of the balance in the region – which may have short to medium term consequences for India
#	...subsides from where it is today	<ul style="list-style-type: none">• It will not impact India substantially• However, it will highlight the need of finding alignment in today's polarized world

A strong Russia will possibly result in a less focused US which will result in a stronger China, with which India would not be comfortable

Towards Russia or towards US – that is the dilemma

A gazillion dollar question for India

Russia has been a strategic partner for India for more than half a century. In the meantime, India's relations with the US have in the last decade or so elevated to the extent of becoming a comprehensive global strategic partnership.

In today's globalized world, there is always a grey with very less black and white. There maybe friends forever but there is always a friends-with-benefits angle that cannot be sidelined. **Interdependent independence is now the sought-after norm and will possibly remain.** Isolated well-being is no longer possible. India has always believed in co-operation and has always stood for diplomatic routes – quiet, constructive and non-violent. This is reflected in its global positioning as well.

Two recent instances highlight what has been India's stance for decades. Firstly, India announced its diplomatic boycott of the Beijing Winter Olympics. So did the US. However, Russia has criticized such boycotts accusing the "western countries" of politicizing sports. Secondly, India abstained from a conclusive tilt in the last UNSC meet thereby avoiding a perceptual situation of supporting the US-led efforts to mediate between Ukraine and Russia.

Walking the tight rope between US and Russia, India has always managed to keep a balance between its interests, its principles and its compulsions. Viewing the entire situation from India's perspective, what is important is to

Similar events in the more recent past do not provide a clear picture against which to benchmark

There have been similar conflicts before in the region - be it the Russo-Georgian war in 2008 or the Crimea annexation in 2014 or the more recent Nagorno-Karabakh conflict in 2020 between Armenia and Azerbaijan. The impacts of these recent events do not give a conclusive indication towards the impact the current crisis will have on the Indian economy. **We try to find out why...**

2008:

The world was still coming to terms with the global financial crisis – the most serious since the Great Depression. Governments were doling out bailouts with the intent to provide a demand-driven push to the economy. India was doing the same under the UPA government due to which India also overshot its fiscal deficit target.

2014:

The year was witnessing (1) events post the Scottish Independence Referendum Act 2013, (2) European countries including Italy and Greece fighting recession, (3) Ebola outbreak in Africa and (4) the emergence of ISIS. India, on the other hand, was witnessing an election campaign that ultimately saw the incumbent party being defeated by an unbelievable margin – perceived a very big positive for the country.

2020:

The world was and is still coming out of the COVID pandemic that gripped the population for almost two full years. The US, with its 1-year old Government under President Joe

to the geopolitics concerning the US and Russia. Unlike India's stance with China where trade has reportedly crossed \$100bn despite there being border issues and a deadlock at the strategic level, India has till date maintained a balance between its strategic ties with US and Russia.

The currently ongoing crisis with respect to Ukraine, however, has different proportions. And having its origins in some manner in 2008 when Ukraine announced it would join NATO some day, the crisis has escalated to a point where (at the point of writing this piece), the US has warned that swift and severe costs would be imposed on Russia in case of an invasion of Ukraine. Russia meanwhile has reportedly moved long range artillery into fighting positions.

Here, we endeavor to assess the level of impact such events may potentially have on India.

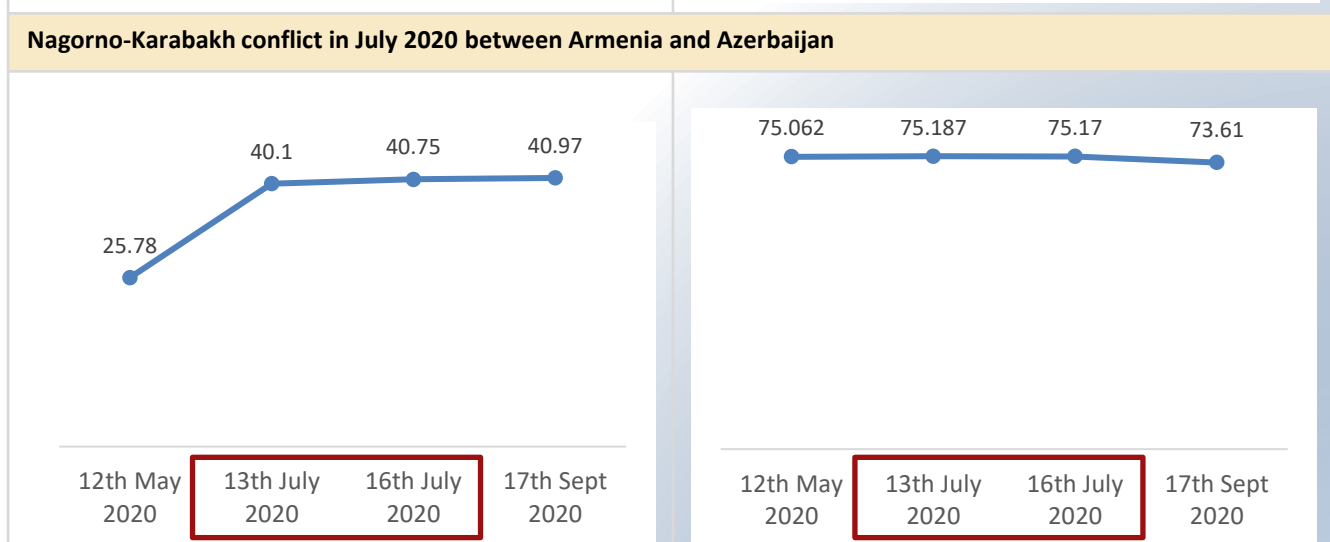
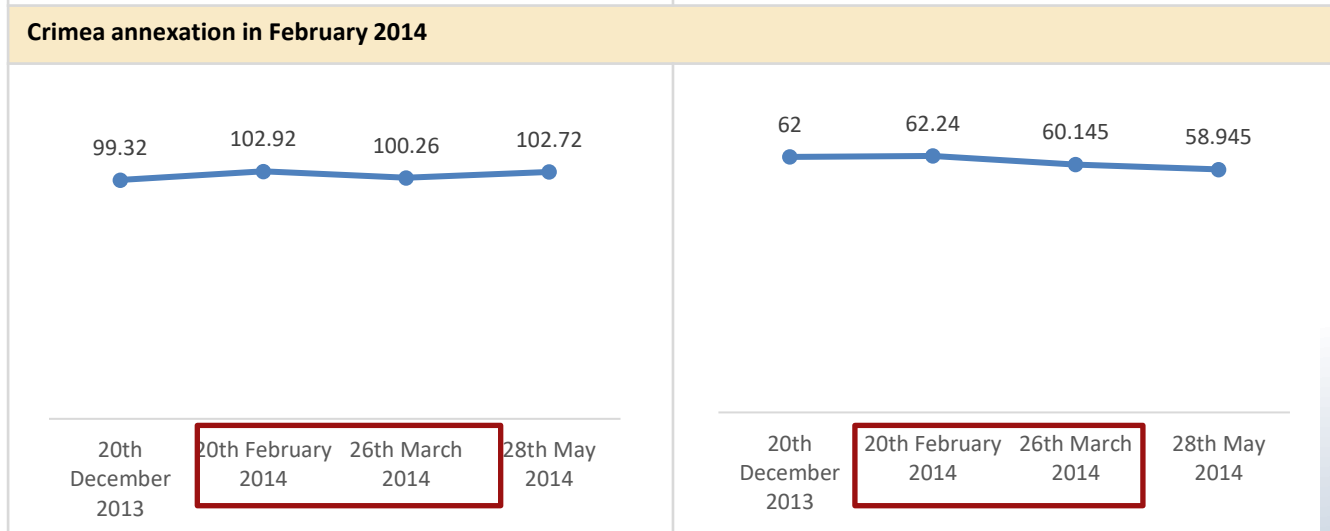
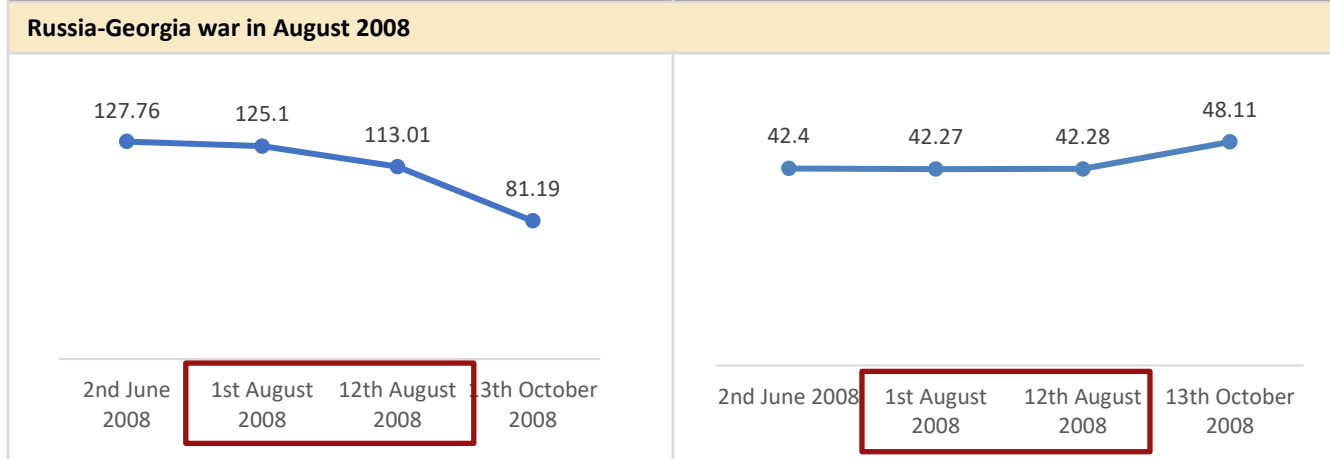
Biden is facing its own economic concerns with inflation as high as 7.5%.

India too is coming out of the COVID pandemic while facing issues on the eastern border.

It is interesting to note that all three years, when the events under consideration took place, were outlier years where among other things the world and / or most of the world was battling major economic, climatic or pandemic related issues. **Hence, the impact on the Indian economy or markets was either not very pronounced and / or was a result of various other major factors.**

When two countries were embroiled in war / armed conflict, crude oil prices did not rise during the confrontation period: In fact, prices fell. USD-INR rates were steady, except during the Russia-Crimea conflict.

Commodity (WTI Crude Oil in USD per barrel)	Currency (1 USD to INR)
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The WTI price chart indicates a fall in levels or flattish change during the period of each event. This means the Indian economy was either unaffected in the short term or the negative impact was offset by more positive factors. However, the consensus is that a further escalation in the Russia-Ukraine crisis will cause crude prices to rise. During previous conflicts, the currency markets (USD-INR) also did not show major stresses with the notable exception of the Crimea annexation when the rupee strengthened. However, over a two-month period following such events, currency markets did show significant movement (in some cases) which can be attributed to a host of factors.

India's CY22 YTD metrics reflect an impact due to the geopolitics

...and it can go either ways from here

India has a trade relationship with Ukraine with a trade deficit balance. India's bilateral trade with Ukraine stood at around \$2.7bn in 2020 with:

- imports by India from Ukraine accounting for almost 70% of this trade relationship – vegetable oils, fertilizers, nuclear reactors, boilers and machinery
- while India's exports to Ukraine make up the balance trade including for pharmaceuticals, electric machinery etc

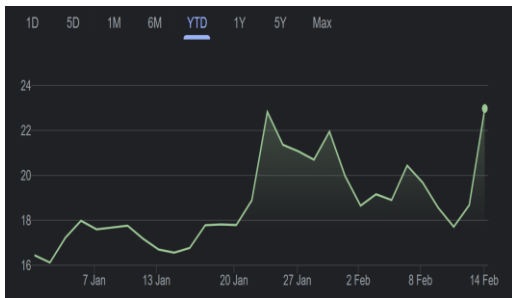
The relevance of the current crisis from an India perspective is with respect to its stance on US and / or Russia's global strategies.

India's foreign policy hence needs to now consider scenarios and have a slightly more pronounced alignment.

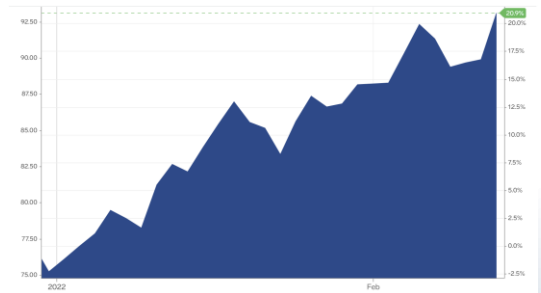
A strong Russia will result in the US getting distracted which will possibly result in a stronger China – this is something that India is not looking forward to given the history and the more recent border issues.

India's strategic steps in the recent past including reducing dependence on Russian defence equipment and stronger relationships and policy discussions with the US have also suggested a thought through and planned approach towards its opinion of a global order.

There is no denying that there are other factors also that collectively result in the impact on the metrics. There are US inflation concerns as well as the current ongoing pandemic concerns. However, geopolitics is a key denominator in many such cases. (P.S. the data is YTD as per close on 14th Feb 2022)



NIFTY VIX is currently at its highest this year YTD (Google Finance)



WTI Crude oil prices are at the highest YTD (Business Insider)



INR has also further depreciated YTD (Business Insider)

...and Ukraine being a minerals powerhouse is a source for many strategic industries and hence an extended crisis situation may have an impact on India

Ukraine's global rank in production of...	1 st	2 nd	3 rd	4 th	5 th	6 th	7 th	8 th	9 th	10 th
Titanium	(China, RSA, Australia, Canada, Mozambique)									
Gallium	(China)									
Germanium	(China, Russia, US, Japan)									
Uranium	(Kazakhstan, Canada, Australia, Namibia, Niger, Uzbekistan, Russia, China, US)									

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