POLICY BRIEF

# THE WAR IN UKRAINE: IMPACTS, EXPOSURE AND POLICY ISSUES IN ASIA AND THE PACIFIC

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ESCAP 75

MOVING FORWARD TOGETHER

## About this policy brief

This policy brief provides provisional economic assessment of the war in Ukraine for Asia and the Pacific. Its purpose is to share ESCAP's analytical research, on a timely basis, with member States, researchers and other stakeholders on urgent economic and development challenges faced by Asia-Pacific economies.

## Acknowledgements

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# Summary

This policy brief provides a provisional analysis of the multifaceted socioeconomic implications of the war in Ukraine on Asia-Pacific economies. There are three main messages. *First*, amid higher commodity prices, weaker global demand and heightened economic uncertainty, early indicators are pointing to notable adverse macroeconomic impacts of the war in Ukraine on the region. *Second*, the analysis shows that several Asia-Pacific economies are at a relatively greater risk because their economic structure and conditions are more exposed to higher energy and food prices, smaller external financial inflows, rising financing costs and weaker business sentiments. *Third*, Asia-Pacific policymakers can consider various policy measures to reduce the immediate impacts of the war and increase resilience to future economic and price shocks. ESCAP could support its member States in formulating and implementing such policies related to energy, trade and investment, transport and fiscal sectors.

# I. Introduction

The ongoing war in Ukraine, along with sanctions imposed on the Russian Federation, poses yet another major shock to the world economy, merely two years after the COVID-19 outbreak was declared as a global pandemic. Many economies in Asia and the Pacific were already struggling to recover from the pandemic. For example, ESCAP (2022) estimates that, since the pandemic began, the cumulative output loss amounts to nearly $2 trillion while 85 million people have been pushed back into extreme poverty. This additional shock will make economic recovery and achievement of the Sustainable Development Goals (SDGs) an even more daunting task for the region.

This policy brief provides a provisional analysis of the multifaceted socioeconomic implications of the war in Ukraine on Asia-Pacific countries. There are three main messages.

- *First,* early indicators are pointing to notable adverse macroeconomic impacts of the war in Ukraine on the region. Surging global energy and food prices are pushing up consumer inflation, which will disproportionately hurt poorer households. Some countries are registering weaker export, tourism and/or remittance receipts and this will likely intensify as global demand softens further. At the same time, rising interest rates amid surging inflation are impairing households' balance sheets, investor confidence and governments' debt service ability.

- *Second,* several Asia-Pacific economies, many of which are classified as countries in special situations, are deemed more exposed to the war in Ukraine than others. Armenia, Cambodia, Georgia, Kazakhstan, Kiribati, Maldives, Pakistan, Samoa, Solomon Islands, Sri Lanka, Tajikistan and Vanuatu could be harder hit because their economic structure and conditions are more exposed to higher energy and food prices, smaller external financial inflows, rising financing costs and/or a sudden shift in business sentiments.

- *Third,* Asia-Pacific policymakers can consider various policy measures to reduce the immediate impacts of the war in Ukraine and increase resilience to future economic and price shocks. To shield the poor from rising food prices, governments should step-up provision of subsidies and ensure that existing government assistance and subsidy schemes benefit those in need. This would require, however, strong fiscal positions, which had already deteriorated in many Asia-Pacific economies in the aftermath of the pandemic. To boost fiscal space and to maintain public debt sustainability, various fiscal and financing policy options are available and should be explored on urgent basis. Going forward, accelerating the transition towards renewable energy, exploring additional transport routes and leveraging modern technology for seamless cross-border connectivity could help mitigate adverse implications of such future shocks.

The rest of this policy brief is organized as follows. Section 2 provides a brief overview of the macroeconomic impacts of the war so far. Section 3 presents a preliminary exposure analysis from the energy, food and debt and financial flows perspectives. Section 4 then highlights selected short- and medium-term policy options and issues to cope with the impacts of the war and increase economic resilience. Finally, section 5 notes how ESCAP could support its member States in formulating and implementing some of these policies.

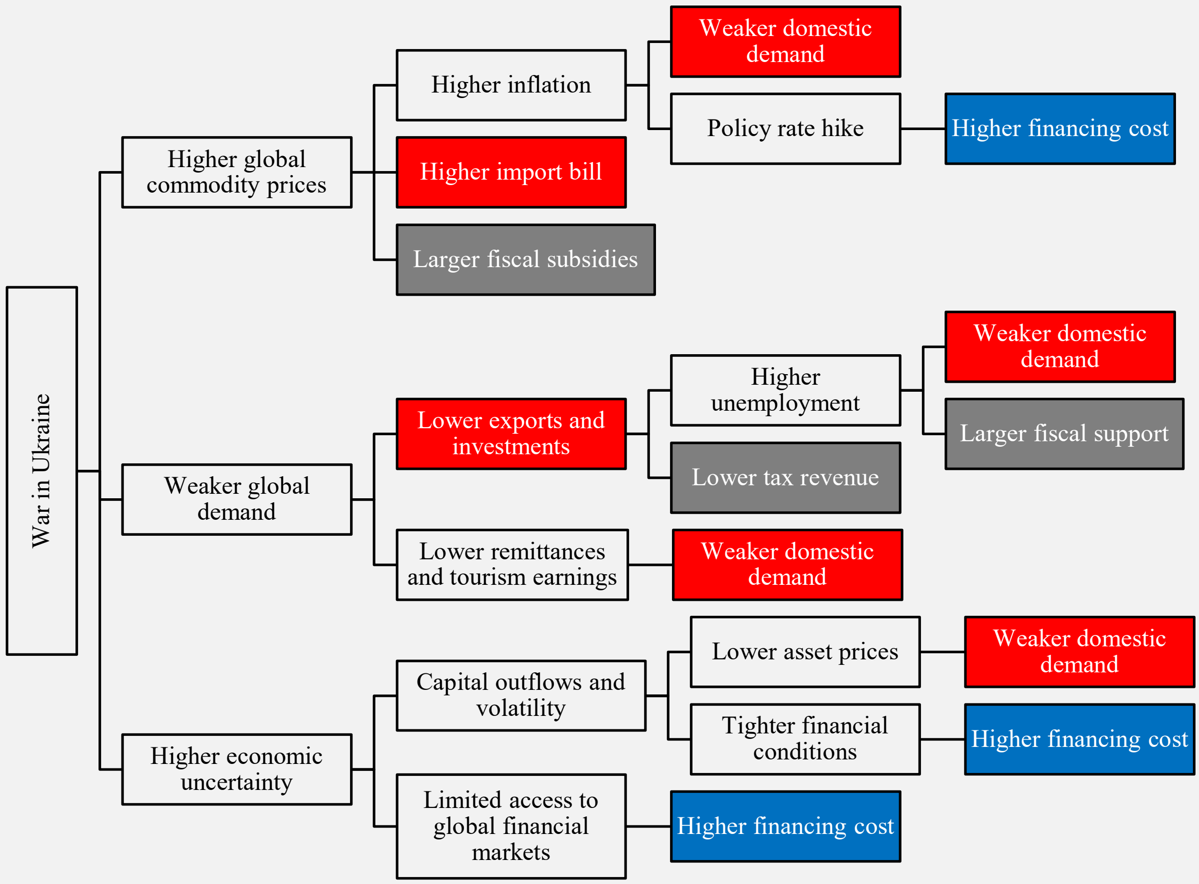
# II. How has the war in Ukraine affected Asia-Pacific economies so far?

From a macroeconomic perspective, the war in Ukraine is affecting Asia and the Pacific through three main channels (figure 1). The *first* channel is through higher global commodity prices. Taken together, the Russian Federation and Ukraine are the world's major exporters of commodities such as oil, gas, nickel, wheat, sunflower oil and fertilizer. *Second*, global demand is likely to moderate amid surging inflation, supply chain disruptions and weaker market sentiments. *Third*, amid rising economic uncertainty, global investors are shifting towards safe-haven markets, causing a rise in risk premiums in developing countries worldwide. Through these transmission channels, the war would result in weaker economic growth, wider fiscal and current account deficits and higher financing costs in the region.

## 2.1 EFFECTS OF HIGHER GLOBAL COMMODITY PRICES

The war in Ukraine is further pushing up global commodity prices from already high levels due to the pandemic-induced disruptions. Halts in domestic production, delays in cross-border transport, and international sanctions and counter-sanction measures are some of the key drivers. Global energy markets were already reeling from extreme price volatility over the past two years. The average crude oil price has jumped from $94 per barrel in February 2022 to $112 per barrel in March before falling slightly to $103 per barrel in April as oil inventories were released by some countries (figure 2). Global prices of coal and natural gas have also surged since the war began. The crude oil price is projected to remain at $100 per barrel on average in 2022 relative to an average of $69 per barrel in 2021 (World Bank, 2022a). This could have sizable adverse impacts on macroeconomic performance and poverty incidence in the region (see box 1). Meanwhile, the FAO Food Price Index reached an all-time high in March 2022 before softening marginally in April (figure 3). Prices of meat, dairy, cereal, oils and sugar have increased as well. Fertilizer price also rose by 20 per cent in March 2022. Overall, food prices are projected to remain elevated in 2022.

## FIGURE 1: ILLUSTRATIVE CHANNELS OF HOW THE WAR IN UKRAINE CAN AFFECT ASIA-PACIFIC ECONOMIES




*Source*: ESCAP.
*Note*: The box colour represents different eventual economic impacts as below.

| | |
|---|---|
| Red | Slower economic growth |
| Grey | Wider fiscal deficit |
| Blue | Higher financing cost |

## BOX 1: POTENTIAL MACROECONOMIC AND POVERTY IMPACTS OF HIGHER OIL PRICES ON ASIA-PACIFIC ECONOMIES

Elevated oil price levels could slow down economic growth and push up inflation notably in the region. Based on the ESCAP macroeconomic model, preliminary estimates suggest that under the scenario that global oil price reaches $120 per barrel on average in 2022 (figure A), the output level in Asia and the Pacific could decline by up to 0.5 per cent relative to the baseline (figure B, panel a). Similarly, under the same scenario, inflation rate could be over 3.50 percentage points above the baseline (figure B, panel b). The lower output level is driven by weaker private consumption amid higher inflation, declining fixed investment assuming rise in the global risk premia (and thus interest rates), and smaller net exports due to higher energy import bills and weaker external demand.

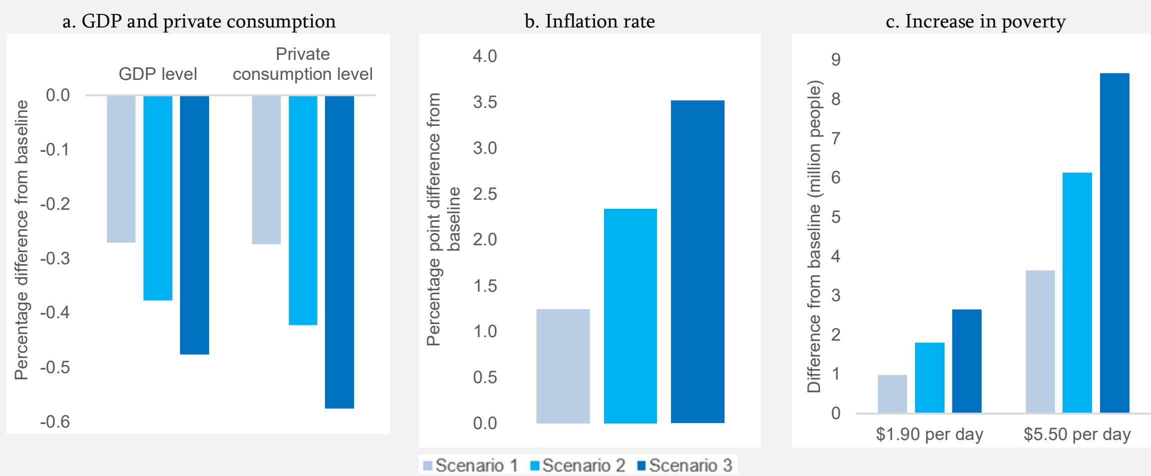
As a result of higher inflation and lower private consumption, the number of poor people in Asia and the Pacific would rise. Based on a $1.90 per day threshold, almost 2.7 million people could fall into poverty as a result of higher oil prices (figure B, panel c). This figure increases notably to around 8.7 million people based on the $5.50 per day threshold.

### FIGURE A: UNDERLYING ASSUMPTIONS ON OIL PRICE LEVELS AND RISK PREMIA IN 2022

| | Scenario 1 | Scenario 2 | Scenario 3 |
|---|---|---|---|
| Global oil price level ($ per barrel) | 90 | 100 | 120 |
| Global risk premia rise (basis points) | 100 | 200 | 300 |

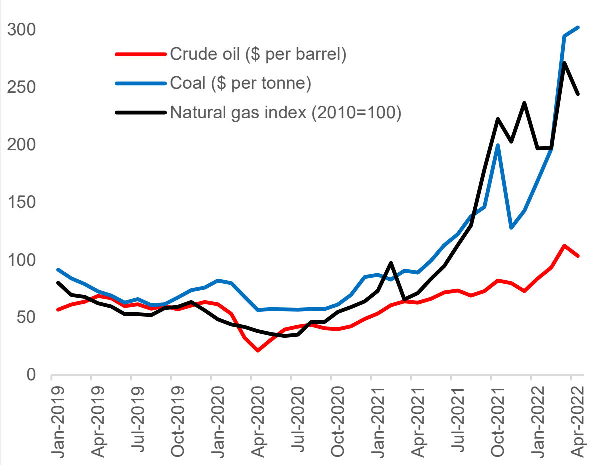
*Note*: The following assumptions are also made for the Russian Federation in all scenarios: 40 per cent currency depreciation, 10 percentage point rise in the interest rate, and 20 per cent decline in export value.

### FIGURE B: ESTIMATED MACROECONOMIC AND POVERTY IMPACTS IN 2022



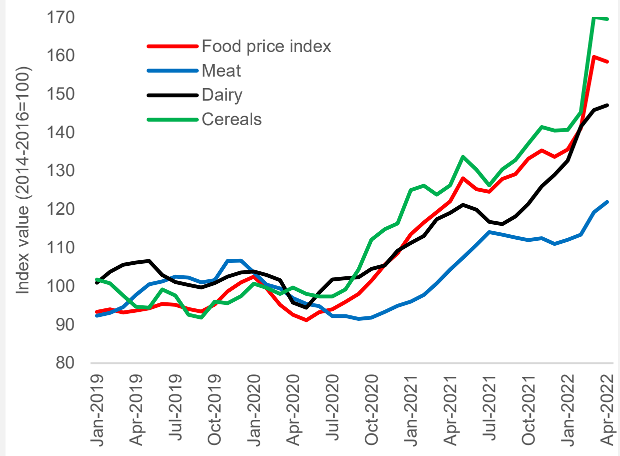

*Source*: ESCAP.

FIGURE 2: PRICES OF MAJOR ENERGY ITEMS SPIKED IN MARCH 2022




*Source*: ESCAP, based on the World Bank Commodity Price data.

FIGURE 3: FOOD PRICES ARE REACHING RECORD HIGH LEVELS



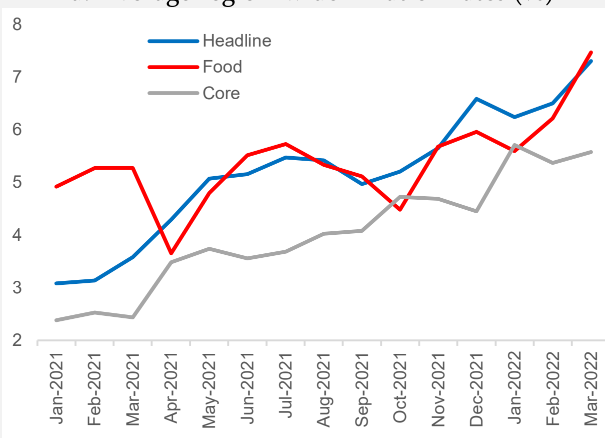

*Source*: ESCAP, based on the FAO Food Price Index.

As a result, inflation rates are rising rapidly in many Asia-Pacific economies. Given that most Asia-Pacific countries are net energy and food importers[1] and that food and energy items account for up to 40 per cent of the consumer price index basket in many economies, the region's average headline inflation rose to 7.3 per cent in March 2022 (figure 4, panel a). In economies such as the Russian Federation and Sri Lanka, increasing inflationary pressure are also driven by sharp currency depreciations (figure 4, panel b). In the Republic of Korea, inflation rose to a near decade-high level. Similarly, inflation rate in Pakistan edged up to 13.4 per cent in April 2022, which is more than double the central bank's inflation target. In addition to weighing down overall household consumption, rising food and energy prices will disproportionately affect poorer households.

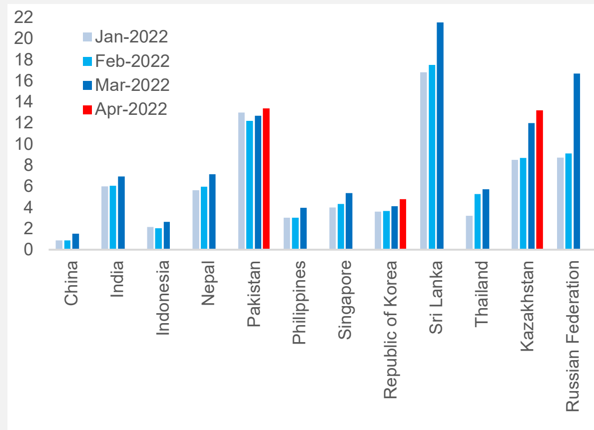
1 At least 27 and 20 Asia-Pacific economies are net importers of oil and food items, respectively. Meanwhile, net fuel exporters include Azerbaijan, Brunei Darussalam, Indonesia, the Islamic Republic of Iran, Kazakhstan, Malaysia and Turkmenistan. Some countries in the region are also major suppliers of liquefied natural gas (Australia, Malaysia and Papua New Guinea), wheat (Australia and India), coal (Australia, Indonesia and Mongolia), and nickel (Indonesia and New Caledonia).

## FIGURE 4: INFLATION RATES ARE RISING NOTABLY IN SEVERAL ASIA-PACIFIC ECONOMIES

a. Average region-wide inflation rates (%)



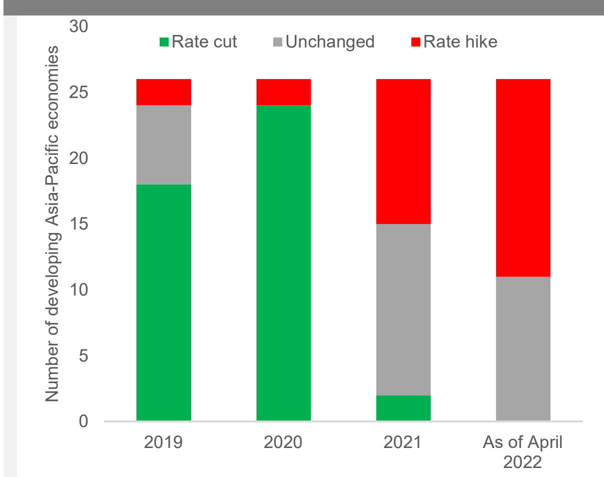

b. Headline inflation rates (%)




*Source*: ESCAP, based on CEIC database.
*Note*: Core inflation is headline inflation excluding food and energy items.

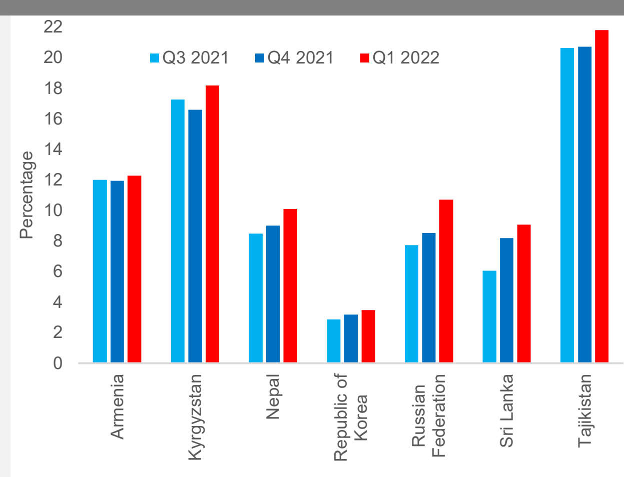
To cope with rising inflation, many Asia-Pacific central banks have started to unwind monetary policy support introduced during the pandemic (figure 5). The policy rates have been increased in most North and Central Asian economies, India, Pakistan, the Republic of Korea, Singapore and Sri Lanka. In addition to escalating price levels, policy rate increase in the United States is also prompting Asia-Pacific central banks to increase policy rates in their own economies. In several economies, higher policy rates have already translated into higher bank lending rates (figure 6). Amid uncertain and fragile economic recovery from the pandemic, a tighter monetary policy would dampen household consumption and the ability of people and firms to service their debt obligations.

## FIGURE 5: POLICY RATES ARE NORMALIZING IN MANY ECONOMIES




*Source*: ESCAP, based on CEIC database.

## FIGURE 6: BANK LENDING RATES ARE TRENDING UPWARDS IN SOME ASIA-PACIFIC COUNTRIES

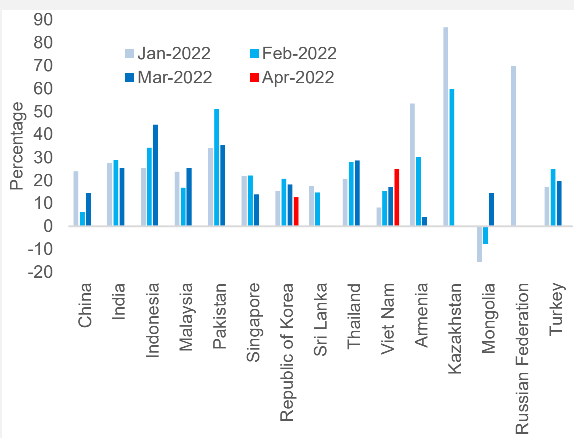



*Source*: ESCAP, based on CEIC database.

## 2.2 EFFECTS OF WEAKER GLOBAL DEMAND

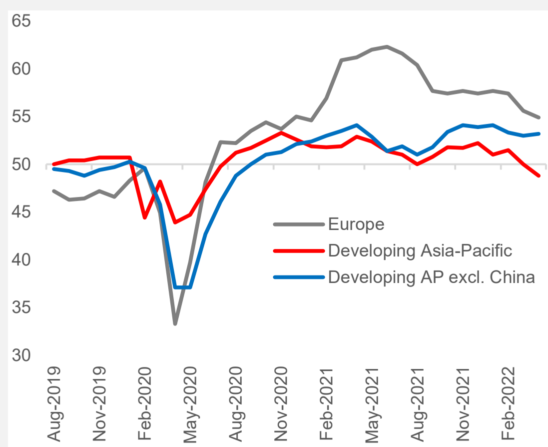
**The Asia-Pacific region recorded mixed export performance in recent months, but export growth is expected to moderate in the coming months.** In net oil exporting countries, such as Indonesia and Malaysia, the uptick in export growth in March 2022 partly benefited from higher oil prices (figure 7). Similarly, Thailand's rice exports increased as buyers looked for alternatives for grains from the Russian Federation and Ukraine. In contrast, in Armenia, where exports to the Russian Federation alone amount to over 5 per cent of its GDP, export growth has plummeted. Export growth in Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan and Uzbekistan are also likely to soften in coming months given their sizeable exports to the Russian Federation and Ukraine. For other Asia-Pacific economies that rely more on manufactured exports to developed markets, recent export data may not fully reflect softening global demand as companies continued to fulfill export orders made prior to the war in Ukraine. Yet, the manufacturing purchasing managers' index for developing Asia-Pacific economies suggests a decline in export orders in March 2022 (figure 8). Partly driven by concerns over COVID-19 lockdowns in China, this is the first contraction recorded since July 2020. Disruptions in the supply of nickel, rare gases and other commodities are also likely to affect related value chains for final products such as semiconductors and fertilizers. The region may also witness some reorganization of value chains as countries shift their sourcing from sanctioned countries.

FIGURE 7: EXPORT GROWTH IN RECENT MONTHS SHOWS A MIXED TREND




*Source*: ESCAP, based on CEIC database.

FIGURE 8: MANUFACTURING PURCHASING MANAGERS' INDEX IS SOFTENING



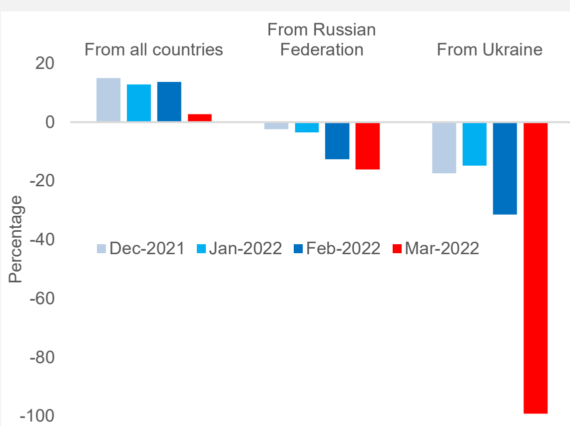

*Source*: ESCAP, based on CEIC database.

*Note*: A PMI reading above (under) 50 represents an expansion (contraction) from the previous month. The Russian Federation and Turkey are included under "Europe".

**Personal remittances, especially to North and Central Asian countries, are decreasing.** The key drivers for this, among others, are weaker economic activity and employment in the Russian Federation[2], volatility of the Russian ruble, and sanctions imposed on the Russian payment systems that disrupt cross-border fund transfers. In Georgia where remittance inflows account for about 13 per cent of GDP, the flows increased by only 2.6 per cent in March 2022 compared to an average growth of 13.8 per cent in the previous three months (figure 9). Remittances from the Russian Federation and Ukraine, which together account for 60 per cent of all Georgia's migrants, were already decreasing but have worsened notably since the war in Ukraine began. In Armenia, Kyrgyzstan, Tajikistan and Uzbekistan where remittances account for over 10 per cent of GDP and at least half of these flows are from migrants working in the Russian Federation, the inflows are projected to decline by 19-33 per cent in 2022 (Ratha and Kim, 2022).

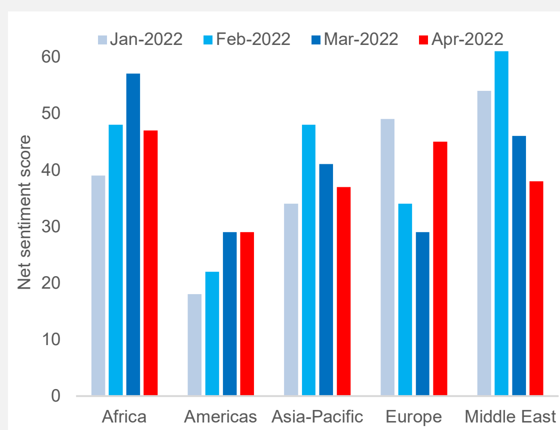
**Some indicators also point to worsening sentiments related to tourism activity.** Travel sentiments in Asia and the Pacific, which are based on travel-related web social conversations, have weakened steadily in March and April 2022 (figure 10). While this is partly attributed to pandemic-related lockdowns in China, the war in Ukraine will hold back global tourism through higher consumer inflation, higher transport costs and rising uncertainty over employment conditions. Countries that typically receive large tourism revenues, such as Cambodia, Maldives, Thailand and several Pacific islands, could be particularly affected. Meanwhile, although the Russian Federation and Ukraine together account for only 3 per cent of global spending on international tourism, neighbouring countries can be notably affected by international airspace restrictions and suspension of major credit card companies in the Russian Federation. In Azerbaijan, Kazakhstan and Mongolia, Russian visitors constitute around a quarter of all visitors.

FIGURE 9: PERSONAL REMITTANCE INFLOWS TO GEORGIA PLUNGED IN MARCH 2022




*Source*: ESCAP, based on CEIC database.

FIGURE 10: TRAVEL SENTIMENTS IN ASIA AND THE PACIFIC HAVE WORSENED SINCE MARCH 2022




*Source*: ESCAP, based on TCI/TRAVELSAT Sentiment Index compiled by the World Tourism Organization.

2 Meanwhile, approximately 600,000 people in the Russian Federation are at risk of losing jobs as over 750 foreign companies announced to curtail or suspend operations in the country (Bloomberg, 2022). In response, the Russian Government has approved a $41 million employment programme to support employees of foreign companies.

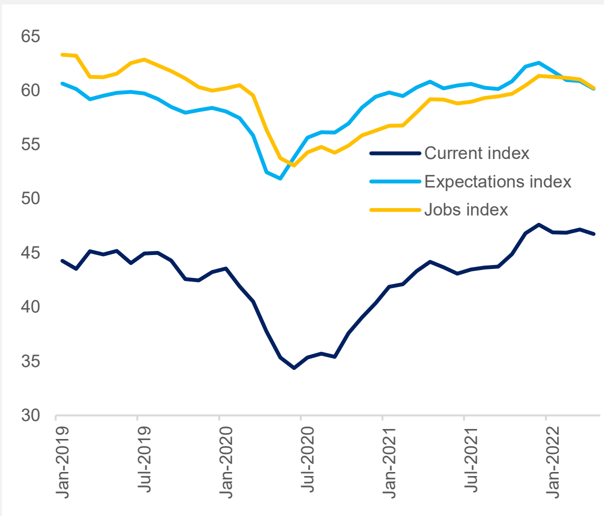
More broadly, weaker export earnings and declining investment inflows together with adverse terms-of-trade could lead to significant balance-of-payments pressures in some countries. Several Asia-Pacific economies have recorded falling foreign exchange reserves since the war in Ukraine began due to wider current account deficits and the use of reserves to stabilize domestic currency values amid capital outflows and higher volatility. With regards to foreign direct investment (FDI), although the Russian Federation accounts for only 2 per cent of total greenfield investments into the Asia-Pacific region, countries that have received sizeable FDI from the Russian Federation, such as Kazakhstan and Viet Nam, could be more affected. Moreover, many North and Central Asian countries have strong business links with Russian firms through non-equity modes of FDI (such as joint ventures, partnerships and licensing agreements) and would be at a greater risk.

## 2.3 EFFECTS OF HEIGHTENED ECONOMIC UNCERTAINTY

Consumer and investor sentiments are weakening in several economies. Concerns over the new rounds of restrictions related to Omicron and China's lockdowns are exacerbated by rising consumer prices. As a result, consumer sentiments towards future economic conditions have deteriorated steadily in major economies (Australia, China, India, Japan and the Republic of Korea) during January and April 2022 (figure 11). A similar downward trend can be observed in Georgia, Indonesia and Thailand. Meanwhile, business confidence is also weaker in countries such as China, the Republic of Korea, the Russian Federation and Thailand. Several stock markets in the region have experienced a sharp decline so far in 2022 amid rising concerns over domestic economic conditions, less risk appetite among global investors induced by the war, and higher interest rates in the United States (figure 12).

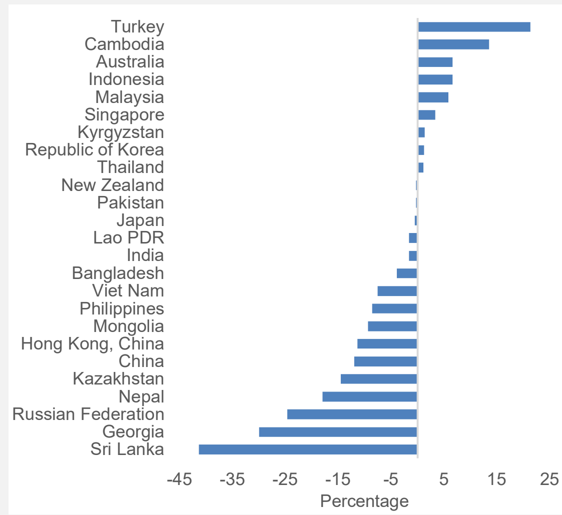
Higher global interest rates and economic uncertainty due to the war in Ukraine are pushing up financing costs for Asia-Pacific governments. The United States Federal Reserve has raised the policy rate by a total of 75 basis points in March and May 2022, while Europe is also signaling rate hikes this year. Together with rising economic uncertainty induced by the war, 10-year sovereign bond yields in most Asia-Pacific economies have risen since end-February 2022 (figure 13). In Sri Lanka, the yield jumped from 13.2 per cent on 26 February 2022 to 33.7 per cent on 9 May amid ongoing fiscal and balance of payment crises. Like the Russian Federation, Sri Lanka's sovereign credit rating has been notably downgraded in recent months (figure 14). More broadly, in addition to higher financing costs, the war will also weaken fiscal positions of most economies of the region through higher subsidy costs of energy and food items and lower tax revenues. This is especially a concern considering that the region's average fiscal deficit-to-GDP ratio already increased from 1.3 per cent in 2019 to 5.3 per cent during 2020-2021.

## FIGURE 11: CONSUMER CONFIDENCE IS WEAKENING IN MAJOR ASIA-PACIFIC ECONOMIES




*Source*: ESCAP, based on CEIC database.

## FIGURE 12: SEVERAL STOCK MARKET INDICES RECORDED A SHARP DECLINE BETWEEN JANUARY AND APRIL 2022




*Source*: ESCAP, based on CEIC database.

## FIGURE 13: SOVEREIGN BOND YIELDS IN MOST ASIA-PACIFIC ECONOMIES HAVE INCREASED IN RECENT MONTHS


*Source*: ESCAP, based on www.worldgovernmentbonds.com.

## FIGURE 14: DETERIORATING SOVEREIGN CREDIT RATINGS IN THE RUSSIAN FEDERATION AND SRI LANKA IN 2022

| S&P rating | | Russian Federation | Sri Lanka |
|---|---|---|---|
| Speculative | BB+ | 28 February | |
| | BB | | |
| | BB- | | |
| Highly speculative | B+ | | |
| | B | | |
| | B- | | |
| Substantial risk | CCC+ | | |
| | CCC | | 13 January |
| | CCC- | 4 March | |
| Extremely speculative | CC | 18 March | 14 April |
| | C | | |
| In default | RD | | |
| | SD | | 25 April |
| | NR | 11 April | |

*Source*: ESCAP, based on www.worldgovernmentbonds.com.
*Note*: RD is restricted default, SD is selective default, and NR is not rated.

# III. Economic exposure of Asia and the Pacific to the war in Ukraine

Based on the preliminary analysis presented above, this section identifies which Asia-Pacific economies are considered more exposed to the war than other regional peers. In more exposed economies, the economic structure and conditions are closely linked with channels through which the war could potentially affect the region. For example, they may rely heavily on imported food and energy whose prices are surging and on tourism receipts and workers' remittances which are dampened by weaker global demand. Countries with larger external debt stocks are also more exposed amid rising global interest rates. In essence, more exposed economies tend to face larger *potential* impacts of the war, although the *actual* impacts are also influenced by how countries respond to this shock (see box 2).

The ESCAP exposure analysis covers three areas that tend to be markedly affected by the war, namely, energy, food and debt and financial flows. Beyond these three areas, some Asia-Pacific countries are also exposed to disruptions in cross-border transport connectivity amid international sanctions and reduced trade flows (see box 3).

BOX 2: ARE COUNTRIES 'EXPOSED' OR 'VULNERABLE' TO SHOCKS?

While related, exposure and vulnerability are two different concepts. Two countries that are equally *exposed* to an adverse shock may not be equally *vulnerable* if one has greater coping ability. For example, a highly exposed country can be less vulnerable if the economic growth impact of government spending (or fiscal multiplier effect) is large, a change in the policy rate translates quickly and fully to bank lending rates,[a] and most people including informal workers are covered by social protection schemes with generous benefit levels. Similarly, a country that is highly exposed to a natural disaster shock may be less vulnerable if public infrastructure is climate resilient and most private and public assets, including housing and agricultural products, are sufficiently covered by catastrophe insurances.

*Note*: [a] Among other conditions, quicker and fuller interest rate pass-through is typically observed in economies with larger, more competitive financial sector.

## BOX 3: EXPOSURE TO CROSS-BORDER TRANSPORT DISRUPTIONS

Several North and Central Asian countries that rely on international transport corridors passing through the Russian Federation could be notably affected. Russian road and rail networks, especially the rail network, are a significant part of the inter-regional land connectivity between Asia and Europe (see figure). While recent progress has been made in strengthening regional and Euro-Asian land transport linkages and enhancing its sustainability through a greater use of rail, the conflict can discourage further development. An immediate effect of the conflict is the imposition of financial sanctions on the Russian Railways, which raises concerns over its payment ability, safety and reputational implications and leads some shippers to explore other routes. .

FIGURE : THE RUSSIAN FEDERATION AND THE TRANS-ASIAN RAILWAY NETWORK


*Source*: ESCAP.

On maritime connections, the blockade of ports in the Black Sea and the Sea of Azov and interrupted call for ships are dampening vessel traffics and the distribution of oil, gas and grain and exacerbating port congestions in Europe. Vessels at Russian and Ukranian ports have declined by over 28 and 48 per cent, respectively, by mid-April 2022 compared to pre-war (World Bank, 2022b). A decrease in vessel turnover would increase charter costs, on top of the rising shipping insurance costs for ships operating in the Black Sea and the Sea of Azov. If the conflict continues and there are prolonged disruptions of transport connections, the affected Asia-Pacific countries will need to consider alternatives for re-routing of goods, including other land, land-sea and maritime routes. Moreover, Russian and Ukrainian make up a significant share of the current maritime workforce (around 15 per cent), which is putting further pressure on the shipping sector.

## 3.1 ENERGY

Cambodia, Pakistan, Solomon Islands and Vanuatu are considered more exposed to rising energy prices than other Asia-Pacific countries. In this context, a country is deemed exposed to higher energy prices if its net fuel exports are sizeable relative to GDP (hence potentially much larger energy import bills), peoples' access to electricity remains rather limited, and domestic electricity generation relies heavily on fossil fuels as key energy sources. Figure 15 displays the threshold values set for these three indicators.[3] When considering the size of net fuel imports alone, Nauru and Palau can be notably affected as net fuel imports are equivalent to around 17 and 9 per cent of GDP, respectively. In Nepal, net fuel imports are also quite large while slightly over 1 in 10 people still have no access to electricity, but the country's electricity generation is driven mainly by hydroelectric sources.

## 3.2 FOOD

Georgia, Kiribati and Solomon Islands appear more exposed to surging food prices than other regional peers. These countries rely heavily on imported food items for domestic consumption and are already facing serious concerns regarding food insecurity. Figure 16 lists five criteria that are used in this analysis. While there are various food categories, the focus here is on cereals (such as wheat, rice and maize), meat, fish, vegetables and fruits.[4] Overall, while Georgia, Kiribati and Solomon Islands are considered more exposed than others, the analysis also indicates that economies such as French Polynesia; Hong Kong, China; Macao, China; Maldives and Samoa rely heavily on imported food items for domestic consumption, but their degree of food insecurity is not particularly high.

### FIGURE 15: ASIA-PACIFIC ECONOMIES THAT ARE MORE EXPOSED TO ENERGY PRICE SHOCKS

| Energy | |
|---|---|
| *Meeting all these criteria*<br>○ Net fuel imports / GDP > 3%<br>○ People without access to electricity / total population > 10%<br>○ Electricity production from oil, gas and coal sources / electricity production from all sources > 50% | - Cambodia<br>- Pakistan<br>- Solomon Islands<br>- Vanuatu |

*Source*: ESCAP, based on data from International Energy Agency (IEA), UNCTAD, and www. worldometers.info/electricity.

3 The exposure analysis in this policy brief is subject to at least two caveats. First, there is some bias because not all indicators are available for all Asia-Pacific economies so countries with more data are assessed by more indicators. Second, except for some indicators whose threshold values are set according to international norms, the threshold values of most variables are based on ESCAP staff judgement. Increasing (decreasing) the stringency of these threshold values would result in fewer (more) countries being considered as more exposed. While not designed to rank which Asia-Pacific countries will be most affected by the war in Ukraine, this exposure analysis guides where more in-depth country-level analysis may be needed.

4 Examples of other major food categories are starchy roots, sugar crops, pulses, treenuts, vegetable oils and spices.

## FIGURE 16: ASIA-PACIFIC ECONOMIES THAT ARE MORE EXPOSED TO FOOD PRICE SHOCKS

| Food | |
|---|---|
| *Meeting at least two of these criteria…*<br>○ Net imports / domestic supply quantity of cereals > 50%<br>○ Net imports / domestic supply quantity of meat or fish > 50%<br>○ Net imports / domestic supply quantity of vegetables or fruits > 50%<br><br>*…as well as at least one of these criteria*<br>○ Prevalence of moderate or severe food insecurity > 30% of population[a]<br>○ Prevalence of undernourishment > 10% of population | - Georgia<br>- Kiribati<br>- Solomon Islands |

*Source*: ESCAP, based on data from the FAO's Food Balance Sheets database and the World Bank's World Development Indicators database.

*Note*: [a] A person is classified as moderately or severely food insecure if she or he is exposed to low quality diets or reduced quantity of food due to a lack of financial or other resources.

## 3.3 DEBT AND FINANCIAL FLOWS

The exposure analysis on debt and financial flows covers five sub-areas, involving domestic/external and public/private aspects of financial flows.

- *Fiscal space*: Countries are considered more exposed if their tax revenues are small relative to GDP, below the potential level, and highly sensitive to economic growth as future tax collection would be dampened further by sluggish economic activity. Countries with large fuel subsidies will also face larger fiscal burden if these subsidies are maintained amid increasing global fuel prices. Finally, Asia-Pacific countries with higher fiscal risks, as suggested by the risk of public debt distress or wider sovereign bond yield spreads, are more exposed given rising financing costs.

- *External financial flows*: Given weaker global demand, countries that have relied on international tourism receipts and personal remittances, including migrant workers in the Russian Federation, could be particularly affected. Together with subdued demand, higher production costs and supply chain disruptions would undermine FDI inflows. Countries that rely on official development assistance (ODA) are also more exposed due to likely tighter fiscal conditions in donor countries.

- *External debt*: Countries with larger total (public and private) external debt stocks and debt service burden relative to their foreign-currency earnings and foreign exchange reserves could be at a greater risk. Currency depreciation due to capital outflows, dimmer prospects of merchandise and service exports, shrinking official reserves amid terms-of-trade shock and wider current account deficits, and rising interest rates are some major factors at play.

- *Banking sector*: Countries where domestic credits to private sector are large, but the banking sector is facing relatively low capital adequacy and high default loan ratios are more exposed. The ability of businesses to fulfill debt obligations will be hampered by weaker revenues and lower profits especially if they absorb part of higher production costs. Meanwhile, currently large household debt stocks also pose a risk to banking sector stability given deteriorating households' balance sheet due to higher inflation, weaker employment conditions, and higher borrowing rates.

- *Equity market*: Clouded by notable economic uncertainty, stock markets in developing countries can be subject to a sudden sell-off, especially where the perceived market risk level is high or where stock prices are high relative to firms' earnings. The negative spillover effects to the rest of the economy will rise with the size of a stock market.

Around half of developing Asia-Pacific economies are considered exposed in at least one of the five sub-areas highlighted. Based on a wide range of indicators, an economy is deemed exposed in a particular area if it exceeds the threshold values for at least half of all indicators in that area (figure 17). For example, in Samoa, ODA received, international tourism receipts and personal remittances each exceeds 10 per cent of GDP so the country is exposed in the area of external financial flows (figure 18). Similarly, in case of both Pakistan and Sri Lanka, the external debt stock and debt service ratios exceed the threshold values (figure 19). Of the 21 Asia-Pacific economies listed in figure 17, 8 are classified as countries in special situations, including Afghanistan, Armenia, Bangladesh, Kazakhstan, Micronesia (Federated States of), Samoa, Tajikistan and Tonga.

FIGURE 17: MORE EXPOSED ASIA-PACIFIC ECONOMIES FROM THE DEBT AND FINANCIAL FLOWS PERSPECTIVE

| Fiscal space | |
|---|---|
| *Meeting at least three of these criteria…*<br>○ Tax revenue / GDP < 10%<br>○ Tax gap / GDP > 3%[a]<br>○ Tax buoyancy > 1.20[a]<br>○ Fuel subsidies / GDP > 3%[b]<br>○ "High" risk of public debt distress[c]<br>○ 10-year government bond yield spread versus the United States > 5%[d] | - Afghanistan<br>- Micronesia, Federated States of |
| **External financial flows** | |
| *Meeting at least three of these criteria…*<br>○ Net official development assistance (ODA) received / GDP > 10%<br>○ Personal remittances / GDP > 10%<br>○ Migrants working in Russian Federation / all migrants > 50%[e]<br>○ International tourism receipts / GDP > 10%<br>○ Net foreign direct investment (FDI) inflows / GDP > 10% | - Armenia<br>- Georgia<br>- Samoa<br>- Tonga |
| **External debt** | |
| *Meeting at least two of these criteria…*<br>○ Present value of external debt / exports of goods, services and primary income > 200%<br>○ Total external debt stocks / official reserves > 300%<br>○ Total debt service / exports of goods, services and primary income > 30% | - Armenia<br>- Georgia<br>- Indonesia<br>- Kazakhstan<br>- Pakistan<br>- Sri Lanka<br>- Tajikistan<br>- Turkey |

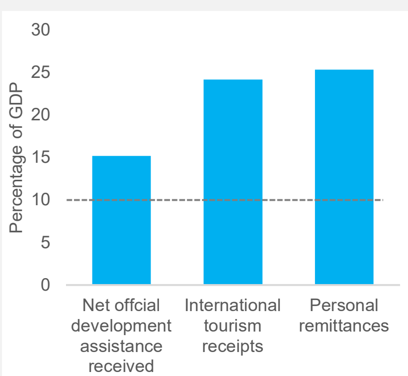
## FIGURE 17: *(continued)*

| Banking sector | |
|---|---|
| *Meeting at least two of these criteria…*<br>○ Domestic credit to private sector / GDP > 100%<br>○ Bank capital / assets < 8%<br>○ Default loans / total loans > 5%[f]<br>○ Household debt / GDP > 80%[f] | - Bangladesh<br>- Hong Kong, China<br>- Korea, Republic of<br>- Macao, China<br>- Malaysia<br>- Pakistan<br>- Thailand<br>- Viet Nam |
| **Equity market** | |
| *Meeting at least two of these criteria…*<br>○ Market capitalization of listed domestic firms / GDP > 100%<br>○ Equity risk premium > 10%[g]<br>○ Price / earning > 20[f] | - Iran, Islamic Republic of<br>- Malaysia<br>- Singapore<br>- Thailand |

*Source*: ESCAP, based on data from the World Bank's World Development Indicators database except otherwise indicated. The data period is 2020 for most variables and 2021 where available.

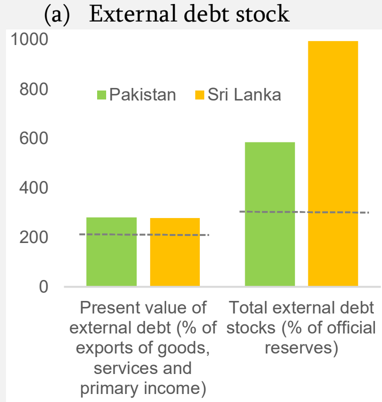
*Note*: [a] ESCAP (FORTHCOMING).
[b] https://fossilfuelsubsidytracker.org/ and IEA.
[c] IMF/World Bank debt sustainability analysis.
[d] www.worldgovernmentbonds.com.
[e] United Nations (2019).
[f] CEIC database.
[g] Damodaran (2022).

## FIGURE 18. SELECTED EXTERNAL FINANCIAL FLOWS IN SAMOA

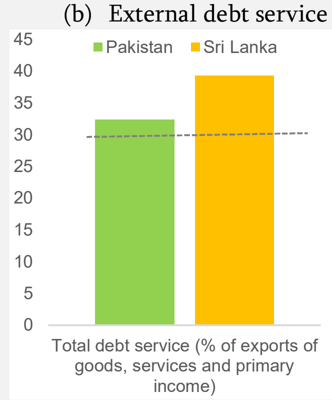



## FIGURE 19. EXTERNAL DEBTS IN PAKISTAN AND SRI LANKA

(a) External debt stock




(b) External debt service




*Source*: ESCAP, based on data from the World Bank's World Development Indicators database.

Several Asia-Pacific countries appear more exposed than others.

- Of the 21 Asia-Pacific economies in figure 17 which are exposed to at least one area, 5 of them face exposure in two areas. These are Armenia, Georgia, Malaysia, Pakistan and Thailand (figure 20). As countries with deeper financial development, Malaysia and Thailand are more exposed on banking sector and equity market. In contrast, the exposure of Armenia and Georgia concentrates on external financial flows and external debt.

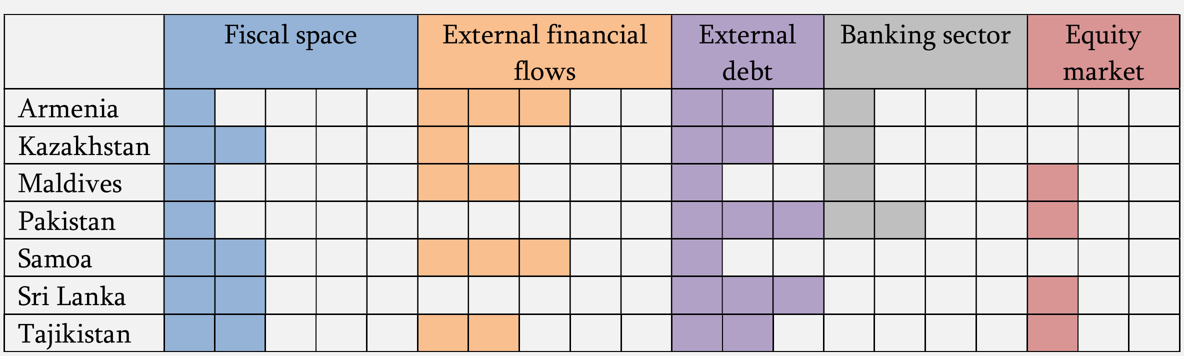
- Meanwhile, we can also identify more exposed countries by looking at the number of indicators in any area where it has exceeded the threshold values. Based on this, there are 7 countries that meet the criteria of at least 6 of all 21 indicators used in this assessment (figure 21). These countries may not be clearly exposed in any one particular area covered here, but they show some signs of exposure in several areas covered. A notable example is Maldives, which does not appear in figure 17, but currently faces a high risk of public debt distress, large external debt stocks relative to reserves, high non-performing loan ratio and large equity risk premium. The country also relies heavily on tourism revenue and foreign direct investment.

FIGURE 20: MORE EXPOSED ASIA-PACIFIC COUNTRIES BASED ON THE NUMBER OF AREAS ON DEBT AND FINANCIAL FLOWS

| | External financial flows | External debt | Banking sector | Equity market |
|---|---|---|---|---|
| Armenia | ● | ● | | |
| Georgia | ● | ● | | |
| Malaysia | | | ● | ● |
| Pakistan | | ● | ● | |
| Thailand | | | ● | ● |

*Source*: ESCAP.

FIGURE 21: MORE EXPOSED ASIA-PACIFIC COUNTRIES BASED ON THE NUMBER OF INDICATORS ACROSS ALL AREAS OF DEBT AND FINANCIAL FLOWS




*Source*: ESCAP.

## <u>BOX 4:</u> UN GLOBAL HEATMAP OF RISK EXPOSURE TO THE WAR IN UKRAINE

UNCTAD and the five United Nations regional economic commissions are jointly assessing country-level risk exposure to the war in Ukraine. This exercise will help facilitate responses by the United Nations system to support its member States. Like ESCAP's exposure analysis presented in this policy brief, the joint exercise focuses on the three pillars of food, fuel and finance, but it also provides an overall risk exposure score for each country. It follows a common framework across all developing regions and prioritizes a smaller set of indicators to ensure global comparability and maximize country coverage.

The preliminary results show that Armenia, Georgia, Kyrgyzstan and Tajikistan have high overall risk exposure due to their direct remittance and trade linkages with the Russian Federation and Ukraine as well as exposures in food, fuel and finance. Afghanistan and Solomon Islands also have high overall risk exposure owing to high dependence on imported food and fuel, high financial vulnerability, and low levels of income. Finally, Cambodia, Lao PDR, Nepal, Pakistan, Sri Lanka and Uzbekistan have less but still substantial risk exposure, as they are considered exposed in at least two of the three pillars. Overall, these provisional findings are consistent with those of the ESCAP analysis.

# IV. Policy considerations

This section highlights selected policy options and issues that Asia-Pacific countries should consider in coping with the adverse impacts of the war in Ukraine and reducing their exposure to future economic or price shocks. The focus here is on short- and medium-term policies related to energy, trade and investment, transport and fiscal sector (table 1).

TABLE 1: SELECTED POLICY OPTIONS AND ISSUES FROM THE TRADE AND INVESTMENT, ENERGY, TRANSPORT AND FISCAL AND FINANCING PERSPECTIVES

| *Short-term policies* | *Medium-term policies* |
|---|---|
| **Trade and investment** | |
| ○ Introduce, at least temporarily, trade liberalization and facilitation measures for affected products to relieve pressure on consumer prices. Such measures include reducing import tariffs, relaxing import quotas and other non-tariff barriers, and easing bureaucratic burden.<br><br>○ Avoid and signal avoidance of export restrictive measures on affected products. Even the possibility of such measures may trigger some countries to hoard supplies to safeguard national interests. So far, several countries have imposed export bans, such as wheat by India, palm oil by Indonesia, and sunflower oil by Turkey. As experience from the COVID-19 pandemic suggests, this will exacerbate the shortages and lead to a spiral of further restrictive interventions.<br><br>○ Countries that have received sizeable FDI inflows from the Russian Federation (such as Kazakhstan and Viet Nam) should assess the potential impacts of the war in Ukraine, including undertaking risk assessments for traditional and non-equity modes of FDI. | ○ Accelerate digital trade facilitation, which helps cut trade costs, shorten delivery times, and reduce losses of perishable agricultural goods. This includes acceding to and implementing the Framework Agreement on Facilitation of cross-border paperless trade in Asia and the Pacific.<br><br>○ Diversify sources of food imports, including through regional agreements. While a growing number of economies have become increasingly dependent on food imports, the number of import partners has decreased, thus making them exposed supply chain disruptions (Kumma and others, 2020).<br><br>○ While remaining open to FDI in general, countries should also enhance the incentives and policy environment to foster sustainable FDI. |

TABLE 1: *(continued)*

| *Short-term policies* | *Medium-term policies* |
| --- | --- |
| **Energy** | |
| ○ Release national oil reserves and increase domestic energy production, where possible | ○ Accelerate the transition towards renewables. In 2019, modern renewable energy rose to 9.8 per cent of regional total final energy consumption, helping drive the total renewable energy share, including both modern and traditional forms to a 10-year high of 15.8 per cent in Asia and the Pacific. Such a transition helps lower energy production costs, reduce dependence on imported fossil fuels, and support commitments to achieve carbon neutrality. Trading renewable energy across borders will also support countries with limited domestic renewable energy resources. For example, in East and North-East Asia which accounts for over 30 per cent of the world's total primary energy supply, studies have shown that developing subregional power grid connectivity based on renewable energy sources would offer socioeconomic and environmental benefits. |
| **Transport** | |
| ○ Strengthen multilateral cooperation on due protection and repatriation of the seafarers. Although there are currently no sanctions targeting seafarers, port closures and other operational challenges (such as payments) are causing difficulties in replacement and repatriation of seafarers and seafarer mobility. Stronger regional cooperation could include the establishment of the Blue Safe Maritime Corridors that allow safe evacuation of seafarers from high-risk and affected areas.[a] | ○ Explore the operation of additional and/or under-used land and multimodal transport routes connecting Asia and Europe. An example of potential alternative is the Middle Transport Corridor, which starts from South-East Asia and runs through China, Kazakhstan, the Caspian Sea, Azerbaijan, Georgia and finally European countries. Yet, similar to other existing alternative corridors, its capacity is very limited compared to the New Eurasia Land Bridge Economic Corridor (Papatolios, 2022). Addressing the infrastructure and operational shortages along the alternative corridors would help avoid re-routing of cargos from land to maritime transport, which is already under significant strain. |

TABLE 1: *(continued)*

| *Short-term policies* | *Medium-term policies* |
| --- | --- |
| | ○ Leverage modern technology for seamless and resilient cross-border connectivity. For example, countries in East and North-East Asia have identified digitalization, particularly electronic data exchange, as one of the priority areas to reduce cross-border railway delays. Meanwhile, countries should further enhance railway efficiency through stronger railway-customs interface, facilitated by regional framework agreements such as the Trans-Asian Railway Network. |
| **Fiscal and financing** | |
| ○ Ensure that existing government assistance and subsidy schemes benefit those in need, including cash transfers and fuel and food price subsidies to support low-income households. More broadly, countries should strengthen social safety nets to mitigate the inflationary impact of rising food and energy prices on the poor.<br><br>○ Temporarily cut consumption taxes on necessary items. For example, Bangladesh cut the value-added tax on certain vegetable oils. | ○ Explore viable fiscal and financing policy options to boost fiscal space and promote policy credibility. Examples are improving tax administration to reduce loopholes, introducing social/green taxes, stepping up capacity to tax the digital economy, making income tax collection more progressive, rationalizing tax incentives, and enhancing public spending efficiency.<br><br>○ Expand the scale and coverage of national emergency financing mechanisms to cope with economic shocks (such as currency swap agreements) and non-economic shocks (such as catastrophe bonds and insurances).<br><br>○ Enhance public debt management practices to better manage growing debt stocks and benefit from lower borrowing costs. These include having transparent debt reporting, independent public debt management office, medium-term debt management frameworks, and adequate consideration of state contingent liabilities. |

*Source:* ESCAP.

*Note:* [a] See www.imo.org/en/MediaCentre/PressBriefings/pages/ECSStatement.aspx.
See the United Nations (2022) for more policy options to address rising food and energy prices.

# V. How can the United Nations, ESCAP and other multilateral institutions help?

At a global level, multilateral development partners, including the United Nations, could support affected economies in various ways (United Nations, 2022). Among others,

- The International Monetary Fund (IMF) can increase access limits for rapid financial assistance, temporarily suspend interest rates surcharges, swiftly operationalize the Resilience and Sustainability Trust (RST) including by allowing access without requiring a regular IMF programme, and promote the rechanneling of Special Drawing Rights (SDR) through the Poverty Reduction and Growth Trust (PRGT) and the RST.

- Multilateral development banks could swiftly activate available mechanisms for emergency financing, explore how they could support the rechanneling of unused SDR, reallocate committed but undisbursed resources for emergency spending, and support new rounds of capital injections for their operation.

- Regarding debt issues, official creditors should step-up their effort to provide more debt relief and incorporate debtor countries' financing needs for the SDGs and climate action when determining the scale of debt relief. The G20 could also reactivate the Debt Service Suspension Initiative (DSSI) for two years and reschedule maturity for 2-5 years. Relatedly, the G20 Common Framework for Debt Treatment would benefit from greater clarity on timelines and transparency on issues such as debt service payment standstill and the need to include private creditors.

ESCAP is already engaged with many Asia-Pacific countries that are considered more exposed to the war in Ukraine. These include, among others, a readiness assessment for cross-border paperless trade in Armenia and Kazakhstan; training for women entrepreneurs in e-commerce and digital marketing in Maldives, Pakistan and Sri Lanka; assessment of the COVID-19 impacts on supply chain connectivity in Kazakhstan and Tajikistan; policy advice on sustainable freight transport in Sri Lanka; and policy options to enhance the fiscal space in Kazakhstan, Pakistan, Samoa, Sri Lanka and Tajikistan.

Upon request, ESCAP could provide further support in various policy areas. These can be in the form of analytical products, knowledge sharing platforms and technical assistance projects, such as

- *Trade and investment policies*: (a) providing technical assistance to develop and implement FDI strategies that are aimed at diversifying sources of investment inflows, facilitating FDI in renewables, and promoting trade diversification and facilitation strategies; and (b) working with national investment promotion agencies to enhance understanding on the implications of internationalized and value-chain linked businesses in their economies.

- *Energy policies*: (a) developing national SDG7 road maps and strategies to phase down coal use; (b) conducting an analysis on extractive industries for sustainable development; and (c) facilitating exchanges of good practices through the Expert Working Groups on SDG7 and Connectivity.

- *Transport policies*: (a) assessing the potential impacts of the war in Ukraine on existing Asia-Europe transport corridors; (b) supporting the preparation of national connectivity plans that consider multiple transport routes for better resilience; (c) providing regional-level support in addressing institutional constraints along the transport corridors; and (d) developing risk management frameworks on subregional transport connectivity.

- *Fiscal and financing policies*: (a) carrying out a tailored assessment of macroeconomic conditions and recovery policies that support sustainable development, with a focus on viable policy options to enhance fiscal space while maintaining public debt sustainability; and (b) proving technical assistance to increase government capacity in leveraging innovative financial instruments, in order to come up with financial resources to cope with the socioeconomic impact of the war in Ukraine.

# VI. Concluding remarks

This policy brief provides a provisional analysis of the multifaceted socioeconomic implications of the war in Ukraine on Asia-Pacific countries. Overall, it highlights that the war and the sanctions imposed on the Russian Federation would likely have notable adverse economic and social impacts on the region, especially in several economies that are deemed more exposed to the war. Asia-Pacific policymakers should quickly react to reduce the immediate impacts while exploring policies to increase a country's resilience to future economic and price shocks. ESCAP can help support its member States in designing and implementing some of these desirable policy actions.

Beyond specific policy options and issues highlighted in this policy brief, there are two broader policy messages.

- *First,* policymakers should strike a balance between being efficient during stable periods and being resilient to shocks. For example, while larger and more open financial sectors make an economy exposed to economic shocks, countries should not deliberately restrain financial sector development simply to avoid a financial crisis. Instead, countries should ensure that prudent financial regulations are in place to manage a country's systemic financial risk. Similarly, while boosting food self-sufficiency level will help reduce a country's exposure to food price spikes, this should not be unrealistically pursued (such as to the extent that it affects landholder rights). Other policy options should be considered simultaneously, such as enhancing agricultural productivity, reducing food waste and leveraging regional cooperation such as food stockpiles.

- *Second*, while some flexibility in policy conduct during shocks is understandable, policymakers should not lose sight of their medium-term development ambitions. For example, while rising energy prices may delay a government's plan to cut down fossil fuel price subsidies or introduce a carbon pricing mechanism, a transition towards low-carbon development should remain a key development agenda. Regardless of global energy price levels, bold and sustained efforts to increase energy efficiency and explore renewable sources of energy are imperative.

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