Implications of Russia-Ukraine War

Risks and Opportunities for Nigeria
Key Highlights

• Russia and Ukraine – which were carved out of the defunct Soviet Union – have had a long history of conflicts. The current crisis between the duo started on February 24, 2022.

• The key transmission channels of the crisis to the global economy and Nigeria include:
  • **Trade channel:** The tensions have triggered global supply chain disruptions, largely affecting countries exposed to trade with the warring nations.
  • **Financial channel:** Uncertainties will make investors seek safe-havens, and this could prompt capital outflows from emerging markets, including Nigeria.
  • **Commodity price channel:** Constraints to supply due to the geopolitical tension have pushed up global commodity prices. This will generally fuel global inflation.
  • **Technology transfer channel:** Nigeria has close economic ties with Russia. The crisis will hinder further procurement of expertise and equipment from Russia.
  • **Foreign policy channel:** Nigeria’s alliance with Russia could suffer a setback due to fears that she might face sanctions from the West like those on Russia.
  • **Migration channel:** The crisis has made millions flee Ukraine for neighbouring countries. About 4,000 Nigerians are currently studying in Ukrainian universities.

• The key action points to mitigate the impact of the crisis on the Nigerian economy include:
  • Removing the constraints to agricultural productivity to improve food security.
  • Supporting value chain development to ensure that primary products are processed locally rather than exported in their raw state.
  • Implementing the Petroleum Industry Act (PIA) in a holistic manner is key to attracting huge investments into Nigeria’s oil and gas sector.
  • Leveraging the benefits of the African Continental Free Trade Area agreement (AfCFTA) and ensuring effective border control.
  • Removing capital controls and encouraging the inflow of stable investments, such as Foreign Direct Investment (FDI).
Introduction

The year 2022 marks the third year since the outbreak of the COVID-19 pandemic, with the spread of the viral infection losing momentum on a daily basis. While the global economy and all countries of the world are braced for post-COVID-19 recovery in 2022, the geopolitical tensions between Russia and Ukraine erupted, thereby overshadowing the concerns over the global pandemic. It is worth noting that until August 1991, Ukraine was a satellite state of the defunct Soviet Union. This establishes the context for understanding the two countries’ political and economic ties. The conflict between Russia and Ukraine is complicated by a history of broken promises, mistrust, and suspicion on both sides of the Western and Eastern blocs.

From 1922 to the recent Russian Army's invasion of Ukraine, the two countries have been involved in a number of conflicts. For instance, in 2014, some sections of Donbass in the eastern region of Ukraine were taken over by pro-Russian separatists. Also, in 2018, Russia seized Ukrainian navy vessels. The current crisis – which started on February 24, 2022 - was precipitated by the North Atlantic Treaty Organization (NATO) decision to admit Ukraine into its security alliance. In April 2018, Ukraine was invited to join the alliance.

As a reaction to Russia's invasion of Ukraine, the West has imposed multiple sanctions on Russia. On February 28, 2022, the United States of America and the European Union unveiled sanctions targeting the Central Bank of Russia (CBR). These sanctions prevent the CBR from accessing about half of the US$643 billion that Russia holds in external reserves by blocking the Bank's ability to convert assets held in US dollars and Euros into Rubles. These punitive measures also prevent Russia from tapping into her emergency sovereign wealth fund, known as the National Wealth Fund (NWF).

Moreover, the crisis between the warring countries and the various sanctions on Russia have economic and humanitarian implications. On the economic front, the geopolitical tensions will dampen the expected optimism in 2022. The crisis will not only affect the warring countries, but will also leave a big scar on the global economy and countries that are directly or indirectly exposed to both countries through the supply chain, trade and investment channels. This turn of events will cause global forecasts to be revised downwards.

In January 2022, the IMF projected global economic growth and global trade volume growth of 4.4 percent and 6.0 percent for 2022, respectively. The United Nations Conference on Trade and Development (UNCTAD) also forecast a 15-20 percent increase in global Foreign Direct Investments (FDI) for 2022. On the humanitarian side, the tensions have resulted in huge losses, including at least 16,000 deaths, 1,900 non-fatal injuries; approximately 3.3 million people have been displaced, and at least 1,700 buildings have been destroyed, as well as, properties worth US$119 billion have been damaged. To this end, this Brief uncovers the sources of exposure to the Russia-Ukraine crisis for the global and Nigerian economy. It also highlights key action points that the Nigerian government should take to moderate the impact of the crisis on the economy.

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Sources of Exposure to the Russia-Ukraine Crisis for the Global Economy and Nigeria
The geopolitical tensions between Russia and Ukraine have snowballed into a full-blown crisis with implications for the global economy. Against the backdrop of the strategic role of Russia and Ukraine on the global space, the fallout from the crisis could affect countries, inclusive of Nigeria, through many channels, a few of which are discussed below.

The Foreign Trade Channel: The impact of the Russia-Ukraine crisis on the global economy is reflected in the positions of both countries on the global trade space. Russia and Ukraine are the first and fifth world’s largest wheat exporters, controlling about 27 percent of global wheat supplies. Russia is the second-largest crude oil exporter after Saudi Arabia and is the world’s largest exporter of natural gas in 2021 and the third-largest coal exporter after Indonesia and Australia. Both Ukraine and Russia account for 14 percent of the global corn exports. If the geopolitical tensions between Russia and Ukraine are not nipped in the bud, it will largely affect global supply chains and weaken the level of global trade and exchanges. Figure 1 shows the top ten countries with the greatest import exposure to commodities - including wheat, barley, corn, colza seeds and sunflower oil and seeds - from Russia and Ukraine.

Africa remains susceptible as the continent accounted for 36 percent of Ukraine’s exports and was the country’s largest export destination in the 2020-21 agricultural season. On a regional level, about 90 percent of the total volume of wheat consumed in East Africa emanates from the two warring countries. By implication, a prolonged tension between Russia and Ukraine would threaten food security in Africa unless other big exporters of wheat, such as the United States of America, step in to fill the global demand gap.

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According to the NBS data, Russia was among Nigeria’s top ten import trading partners in the third quarter of 2021, accounting for about 4 percent of Nigeria’s total merchandise imports in the quarter. This suggests that the persistence of the crisis would reduce the volume of trade between both countries. Similarly, Ukraine being part of Nigeria’s top 10 import locations in the fourth quarter of 2021 suggests that the war between Russia and Ukraine could induce supply chain disruptions and negatively affect import supplies (such as wheat) to Nigeria until both countries reach a truce. While Nigeria could explore other sources for wheat purchase, the crisis will have a short-term negative impact on Nigeria through the trade channel.

The Financial/Capital Flows Channel: The imposition of sanctions on Russia by severing its ties to the global payment system, such as SWIFT, would lead to global financial tightening. This is coming at a time when central banks in advanced economies are returning to monetary policy normalisation since 2018 in response to heightening inflationary pressures. However, the emerging economies will be challenged by deepened capital outflows as investors seek safe havens and take advantage of higher returns on investment in advanced countries.

In response, emerging economies, including Nigeria, might resume monetary policy tightening to moderate the pace and momentum of capital outflows. Specifically, Nigeria has a weak exposure to the warring countries through the investment channel. According to the Nigerian Bureau of Statistics (NBS), Russia was not among the sources of foreign investment inflows into Nigeria in 2020 and 2021. Although foreign investment inflows into Nigeria that emanated from Russia was less than 1 percent of the total inflows in 2019 (equivalent to US$84.3 million), the former remains susceptible to a drastic fall in investments or their stoppage from the latter.
The Commodity Price Channel: The global commodity prices of products - including grains (wheat and corn), fertiliser, metals and energy products (crude oil and natural gas) - have soared as the global supply of these commodities remained suppressed by the crisis between Russia and Ukraine (see Table 1). Sanctions on Russian exports from the European Union and North America are expected to tighten global supply and push up the prices of grains and energy products. While the crisis holds both opportunities and risks for commodity-importing and commodity-exporting countries, the net effect on global inflation cannot be overemphasised. This implies that with rising prices, wealth is being transferred from commodity-importing countries to commodity-exporting countries. The Economist Intelligent Unit (EIU) projects that global inflation would rise above 6 percent in 2022, occasioned by the crisis.

On the supply side, the major oil exporters, including Nigeria, will benefit from rising global oil prices in terms of higher oil export earnings. As the news of Russia’s invasion of Ukraine broke out on February 24, 2022, the Brent crude price spiked to US$105 per barrel, and Nigeria’s Bonny Light price rose to an 8-year high of US$139.4 per barrel as of March 8, 2022. The EIU expects the global oil price to remain above US$100 per barrel as the geopolitical crisis persists. The EIU also forecast a 50 percent rise in natural gas price in 2022-23. However, constrained domestic crude oil production in countries like Nigeria will cap the gains from the oil price increase.

<table>
<thead>
<tr>
<th>Commodity</th>
<th>January 2022</th>
<th>February 2022</th>
<th>Percent change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonny Light (US$/bbl)</td>
<td>89.1</td>
<td>99.6</td>
<td>11.8</td>
</tr>
<tr>
<td>Brent crude (US$/bbl)</td>
<td>85.5</td>
<td>95.8</td>
<td>12.0</td>
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<tr>
<td>LNG, Japan (US$/MMBtu)</td>
<td>14.69</td>
<td>14.94</td>
<td>1.7</td>
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<tr>
<td>DAP (US$/mt)</td>
<td>699.4</td>
<td>747.1</td>
<td>6.8</td>
</tr>
<tr>
<td>Potassium chloride (US$/mt)</td>
<td>221.0</td>
<td>391.8</td>
<td>77.3</td>
</tr>
<tr>
<td>TSP (US$/mt)</td>
<td>676.3</td>
<td>687.5</td>
<td>1.7</td>
</tr>
<tr>
<td>Maise (US$/mt)</td>
<td>276.6</td>
<td>292.6</td>
<td>5.8</td>
</tr>
<tr>
<td>Rice (US$/mt)</td>
<td>419.0</td>
<td>422.0</td>
<td>0.7</td>
</tr>
<tr>
<td>Wheat (US$/mt)</td>
<td>374.2</td>
<td>390.5</td>
<td>4.4</td>
</tr>
<tr>
<td>Gold (US$/toz)</td>
<td>1,816</td>
<td>1,856</td>
<td>2.2</td>
</tr>
<tr>
<td>Platinum (US$/toz)</td>
<td>994</td>
<td>1,049</td>
<td>5.5</td>
</tr>
<tr>
<td>Copper (US$/mt)</td>
<td>9,782</td>
<td>9,943</td>
<td>1.6</td>
</tr>
</tbody>
</table>

Source: CBN, World Bank

See EIU Update (2022)
On the demand side, countries that depend on the importation of refined fuel products, such as Nigeria, will experience a hike in import bills as the rally in crude oil prices persists. This will deteriorate Nigeria’s trade balance which stood at a deficit of N1.9 trillion in 2021. Considering the fact that the Nigerian government maintains the existing fuel subsidy regime, higher crude oil prices will mean a huge fiscal burden imposed on the nation’s treasury by rising subsidy costs. The World Bank projects that subsidy payments in Nigeria will hit N4 trillion in 2022. In addition, Nigeria is a major importer of wheat from Russia, and the product is the third most widely consumed grain in the country. The hike in the price of wheat will come with rising costs of inputs to flour millers and the producers of value-added products, such as bread. Coupled with increasing insecurity, the rise in imported food inflation will keep the overall food inflation and headline inflation elevated.

The Technology Transfers Channel: Over the years, Russia has been a major location for technology transfers to Nigeria: notably, the Ajaokuta Steel Rolling Mill. While the Nigerian Government is working hard to leverage the technology transfer from Russia to rehabilitate the Ajaokuta Complex alongside other similar industrial facilities, the Russia-Ukraine crisis will constitute a setback for re-integrating Russia into Nigeria’s industrial development path. Nigeria’s close ally with Russia will also be challenged for fear of being sanctioned at a time when the latter is facing multiple sanctions from the West.

The Foreign Policy Channel: Nigeria established a bilateral relationship with Russia in 1960 when Russia was at the frontline of the decolonisation of African countries. However, the bilateral relationship has been oscillatory, often being truncated by Nigeria’s affiliation with Western Europe and North America. Nonetheless, Nigeria and Russia signed a legal framework agreement in 2021 that will pave the way for Russia to supply Nigeria with military equipment, services, and training. The war could slow the pace of military procurement from Russia since the West has not shown willingness to supply armaments to aid the fight against insurgency and banditry in Nigeria.

Migration Channel: Russia is among the top ten migrant destinations globally. This implies that migrants would be more likely to seek asylum elsewhere as the crisis between Russia and Ukraine deepens. As the attack on Ukraine mounts, neighbouring countries, such as Poland, will become overwhelmed by the influx of refugees into these countries. The impact of the crisis on Nigerians studying in Ukraine will be severe considering that the country plays host to about 4,000 schooling Nigerians (representing 20 percent of foreign university students in Ukraine)"
Conclusion and Action Points for the Nigerian government

The NESG calls for urgent steps to be taken to improve food security in Nigeria by removing constraints to the production and supply of agricultural products to the market. The key constraints include inadequate storage facilities leading to substantial post-harvest losses; insecurity in the major food-producing regions; huge dependence on food importation, land fragmentation, the proliferation of small farm holdings, and the inaccessibility of inputs at subsidised rates, among others. There is no doubt that by improving farm yields and making agricultural products available to consumers, food inflation and the overall headline inflation would be kept low. Possible supply chain disruptions emanating from the Russia-Ukraine tensions should drive improved productivity of Nigeria’s agricultural sector, particularly the production of grains. There is also the need for support schemes that will incentivise the massive production of agricultural products to meet the growing local demand.

The NESG acknowledges the improvement in earnings from non-oil exports, but more efforts need to be channelled to support value chain development in Nigeria. While the non-oil sector accounts for over 90 percent of Nigeria’s Gross Domestic Product (GDP), the export revenue potential of the sector has not been maximally harnessed, as reflected in its 11 percent contribution to the overall exports in 2021. Supply chain disruptions arising from the Russia-Ukraine crisis would make it imperative for Nigeria to explore its comparative advantage in the areas of agro-allied and light manufacturing products. Increased production of value-added products will improve Nigeria’s unfavourable terms of trade position due to her huge dependence on primary product exports. This will also help the country diversify its revenue base and export markets. Considering that Nigeria is a net importer of manufactured products, there is a need to address key constraints to the growth of the manufacturing sector, including the illiquidity of the foreign exchange market and limited foreign exchange access, infrastructural and logistic bottlenecks and policy lopsidedness, among others.

The NESG lauds the recent passage of the Petroleum Industry Act (PIA). Meanwhile, the holistic implementation of the PIA is key to attracting investments into the oil and gas sector. The PIA, when implemented, presents a unique opportunity for Nigeria to stimulate investment inflows into the upstream segment of the oil and gas sector, as the sector is currently in a recession. It will also incentivise renewed investments in the downstream segment, including the resuscitation of the existing refineries and the construction of new ones. The upcoming Dangote Refinery is an instance. Meanwhile, the delay in implementing the PIA, particularly with respect to fuel subsidy removal, will constrict the fiscal space. As a fallout from the delay, the NNPC has requested N3 trillion for fuel subsidy payments in 2022. In addition, the geopolitical tensions would drastically reduce Russia’s production and supply of natural gas to the global market. This ultimately opens an opportunity for major natural gas exporters in Africa, including Nigeria, to fill the expected shortfall in global natural gas supply. It is worthy of note that Nigeria recently signed an agreement with Niger and Algeria to develop a US$13 billion Trans-Saharan Gas Pipeline to aid natural gas exports. Improved local production of refined petroleum products and natural gas would boost foreign exchange savings and contribute significantly to external reserves accretion in Nigeria.
The NESG advocates that leveraging the African Continental Free Trade Area agreement (AfCFTA) and ensuring effective border control should be taken more seriously. Nigeria can leverage the trade pact by diversifying its export sources away from crude oil and targeting new markets. To fully harness the benefits of the Free Trade Area, there is an urgent need to improve logistics associated with clearing consignments at the country's ports. Needful to know is that only two out of the six seaports in Nigeria are fully operational. A considerable amount of foreign exchange is lost due to delays in consignment clearance and damages experienced during the process. Additionally, there is a need to address the porous nature of Nigeria's land borders. This will help improve proceeds from custom duties collection and foreign exchange inflow into Nigeria. Effective border control will also ensure that smuggling activities are reduced to the barest minimum.

The NESG canvasses for the removal of capital controls and the inflows of stable investments. Stiff controls on capital inflows occasioned by market illiquidity and foreign exchange rationing have discouraged prospective investors from considering Nigeria as a good investment destination. This has primarily limited Nigeria’s capital importation to portfolio investment or hot money, prone to capital flight. Moreover, the negative real returns on investment serve as a significant disincentive for the inflow of foreign investments into the country. To this end, the country needs to implement investment-friendly policies that will encourage the influx of stable investments, such as, Foreign Direct Investment (FDI). Associated with FDI inflow is technological transfers from the country of origin to Nigeria. Domestic and foreign investments inflows are also important to revitalise the moribund industrial establishments in Nigeria, such as the Ajaokuta Steel Rolling Company. This will also help to plough back raw materials and intermediate inputs that could have otherwise been exported with little or no value addition.
ABOUT NESG

The NESG is an independent, non-partisan, non-sectarian organization, committed to fostering open and continuous dialogue on Nigeria’s economic development. The NESG strives to forge a mutual understanding between leaders of thought so as to explore, discover and support initiatives directed at improving Nigeria’s economic policies, institutions, and management.

THE SUMMIT HOUSE
6 Oba Elegushi Street,
Off Oba Adeyinka Oyekan Avenue,
Ikoyi, Lagos.
P.M.B 71347, Victoria Island, Lagos.

ABUJA LIAISON OFFICE:
4th Floor, Unity Bank Tower,
Beside Reinsurance building
Plot 785, Herbert Macaulay Way,
Central Business District, Abuja

www.nesgroup.org
info@nesgroup.org
+234-01-295 2849 | +234-01-295 2003
officialNESG