The economic and financial effects on Latin America and the Caribbean of the conflict between the Russian Federation and Ukraine

Reflections by Alicia Bárcena, Executive Secretary of the Economic Commission for Latin America and the Caribbean (ECLAC)

UNITED NATIONS

ECLAC

28 March 2022

The conflict between the Russian Federation and Ukraine has come at a time of great uncertainty in the world, relating to several factors: uneven rates of vaccination against coronavirus disease (COVID-19) and new variants of the virus; inflationary pressure and difficulty in maintaining fiscal stimulus packages; trade tensions and risks in the Chinese real estate sector; disruption of supply chains and rises in freight charges; and extreme events caused by climate change.

The conflict will have an impact on the economies of Latin America and the Caribbean through several channels, but primarily the trade channel (with direct and indirect effects), the commodity price channel (including terms of trade and inflation issues) and the financial channel.

A. Three channels that transmit the impact of the conflict to the region

1. Trade channel

Global trade was already weakened before the conflict. The monthly changes in the volume of world trade reflect a collapse and a recovery following the outbreak of the COVID-19 pandemic (see figure 1). In May 2020, global trade underwent its largest year-on-year drop (16.9% compared to the same month in 2019). A strong recovery then began in the second half of 2020, peaking in April 2021, when world trade grew by 24.6% over the same month of 2020. Since then, trade has continued to expand, but the pace of growth has slowed. In August 2021 it grew by 8.2% compared to the same month in 2020. This slowdown is partly a statistical effect of the normalization of growth rates, due to the higher baseline. The slowdown has also been caused by the aforementioned factors fuelling uncertainty.

Figure 1 Year-on-year variation in the volume of global trade in goods, January 2017–August 2021

(Percentages)

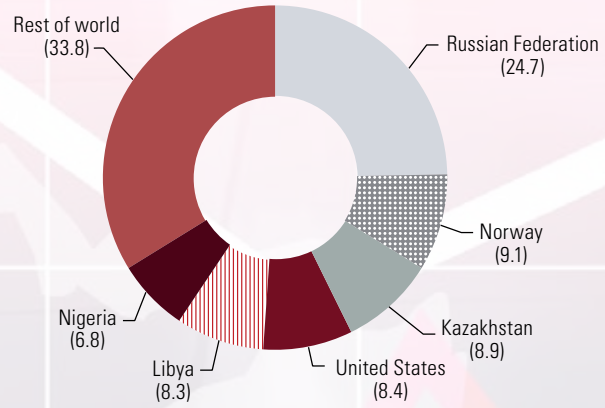
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Netherlands Bureau of Economic Policy Analysis (CPB), World Trade Monitor [online database] https://www.cpb.nl/en/worldtrademonitor.

Although exports from the Russian Federation, Ukraine and Belarus account for just 1.8% of world demand, these countries sell products that are critical for global production. The European Union is dependent on the Russian Federation for energy products. In the first half of 2021, 24.7% of its oil imports and 46.8% of its natural gas imports came from the country (see figure 2).

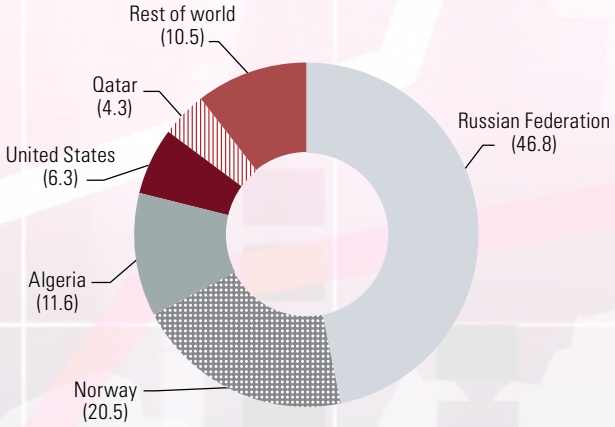
Figure 2 European Union (27 countries): origin of energy product imports, first half of 2021

(Percentages of imported value)

A. Petroleum



B. Natural gas



Source: European Commission, Search Eurostat statistics [online] https://ec.europa.eu/info/statistics/search-eurostat-statistics_en.

The Russian Federation, Ukraine and Belarus account for 12% of world imports of energy products, and 27% of imports of mining products.

(a) Direct effects

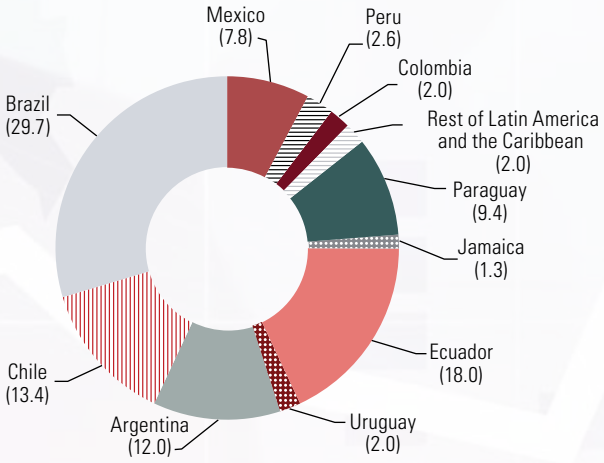
The first channel through which the effects are transferred to the countries of Latin America and the Caribbean is the direct trade effect of the commercial relationships between the countries of the region, on one hand, and the Russian Federation, Ukraine and Belarus, on the other.

The three countries account for just 0.6% of the region's exports.

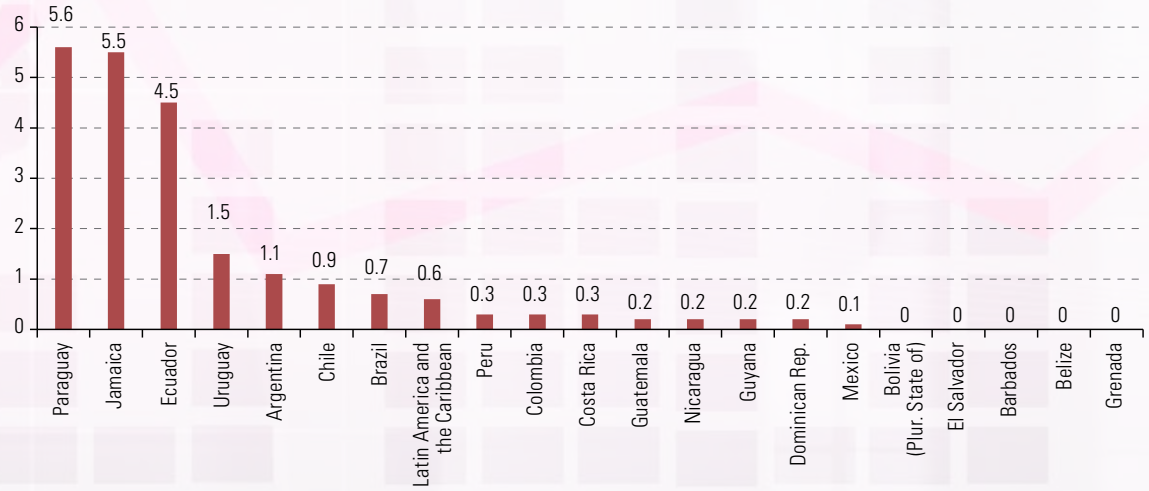
However, some countries and sectors will be impacted by the shutdown of these three markets. In 2020, 5.6%, 5.5% and 4.5% of total exports from Paraguay, Jamaica and Ecuador, respectively, went to the Russian Federation, Ukraine and Belarus, considered together (see figure 3B). In some countries of the region, the products that will be affected are those that diversify exports and create many jobs.

Figure 3 Latin America and the Caribbean: exports to the Russian Federation, Ukraine and Belarus, by country, 2020

A. Percentages of the regional total (US$ 5.134 billion)



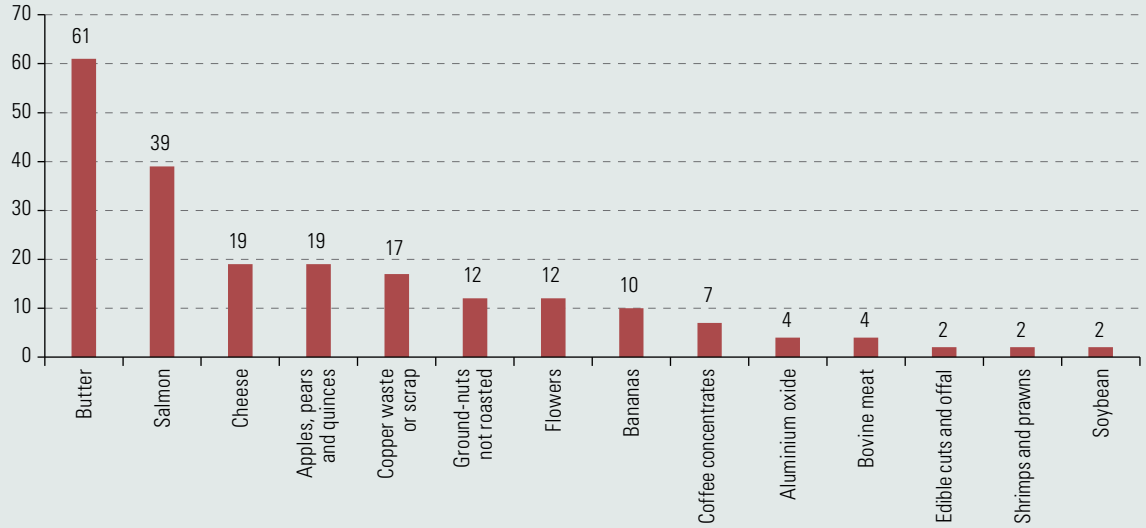
B. Percentages of total exports for each country



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations, United Nations International Trade Statistics Database (UN Comtrade) [online] https://comtrade.un.org/.
Note: Some countries appear in figure 3B with values of 0.0 as their exports to the three countries are, in total, equivalent to less than 0.1% of their total exports.

Agricultural exports will be the most affected. As shown in figure 4, 61% of the region's butter exports are to the Russian Federation. This country is also the destination for a high proportion of the region's exports of salmon (39%), cheese (19%) and apples, pears and quinces (19%). Table 1 shows the proportions of trade with the Russian Federation for a selection of products from eight countries in the region.

Figure 4 Latin America and the Caribbean: main goods exports to the Russian Federation, 2020
(Percentages of exports to the world)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations, United Nations International Trade Statistics Database (UN Comtrade) [online] https://comtrade.un.org/.

Table 1 Latin America and the Caribbean (8 countries): main products traded with the Russian Federation, 2020
(Percentages of total exports and imports of each product)

Country	Exports *(Percentages of total exports of each product)*	Imports *(Percentages of total imports of each product)*
Argentina	Butter: 99%; butterfat: 67%; mandarins: 45%; fresh cheese: 32%; horse meat: 27%; lemons: 25%; apples and pears: 23%.	Ammonium nitrate: 70%; butadiene rubber (BR): 36.2%; potassium chloride: 35.5%; paper and paperboard: 32%; gasoline: 27.4%.
Brazil	Peanuts: 43%; apples: 29%; coffee concentrates: 15%; tractors: 13%.	Flat rolled iron or steel ≥ 600 mm: 98%; ammonium nitrate: 95.5%; mineral fertilizers: 54.5%; potassium chloride: 49%; monoammonium phosphate: 22%.
Chile	Copper waste or scrap: 61%; salmon: 40%; fresh cheese: 35%; almonds: 22%; trout, frozen: 21%; apples and pears: 10%.	Isoprene rubber (IR): 97.7%; ammonium nitrate: 75.5%; wood panels: 41%; nitrates: 38%; potato flakes, granules and pellets: 25%.
Colombia	Cream: 98%; butter: 97%; cocoa paste: 18%; coffee: 15%; bananas: 10%; flowers: 9%.	Helicopters: 99%; books and brochures: 93%; ammonium nitrate: 83%; urea: 31%; aluminium: 25%; potassium chloride: 21%.
Ecuador	Flowers: 36%; coffee: 34%; bananas: 21%; fish: 18%; jams: 15%.	Phosphatic fertilizers: 77%; diammonium phosphate: 69%; ammonium nitrate: 63%; carbon black: 51%.
Jamaica	Aluminium oxide: 99.95%.	Octylphenol: 67%; monoammonium phosphate: 62%. dichloromethane (methylene chloride): 54%.
Paraguay	Butter and fats: 86%; bovine meat: 20%; soybeans: 11%.	Residues of petroleum oils: 35%; fertilizers: 32%; inorganic chemicals: 4.5%.
Uruguay	Bovine livers: 97%; bovine tongues: 80%; processed cheese: 37%; butter: 25%.	Bitumen and asphalt: 77%; potassium chloride: 76%; sodium dichromate: 45%; sulphur: 31%; urea: 22%.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations, United Nations International Trade Statistics Database (UN Comtrade) [online] https://comtrade.un.org/.

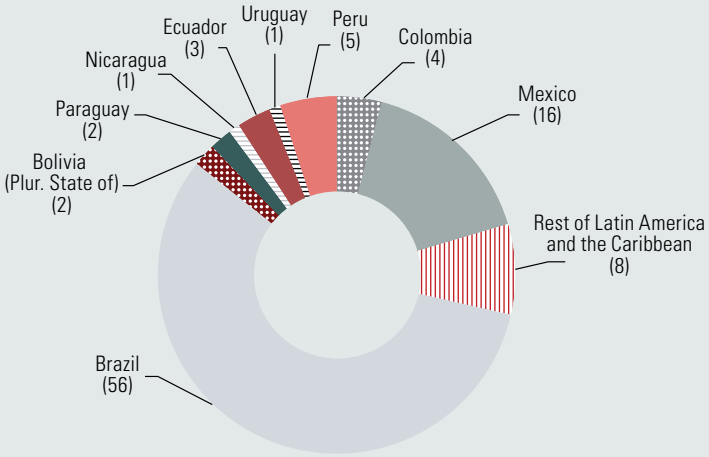
In the case of Ecuador, 21% of banana exports go to the Russian Federation, so the country's government is already looking at the possibility of establishing lines of credit and is negotiating with China and the Republic of Korea as markets for this product whose trade has been affected by the conflict *(El Universo, 2022)*. Similarly, 36% of the flowers, 34% of the coffee, 18% of the fish and 15% of the jams that Ecuador exports are destined for the Russian Federation.

For all Latin American and Caribbean countries, although shipments from the Russian Federation, Ukraine and Belarus account for a low share of imports (0.7% of all goods entering the region), the disruption of supply chains for some intermediate inputs will affect production processes in some sectors and have a more marked impact on certain countries.

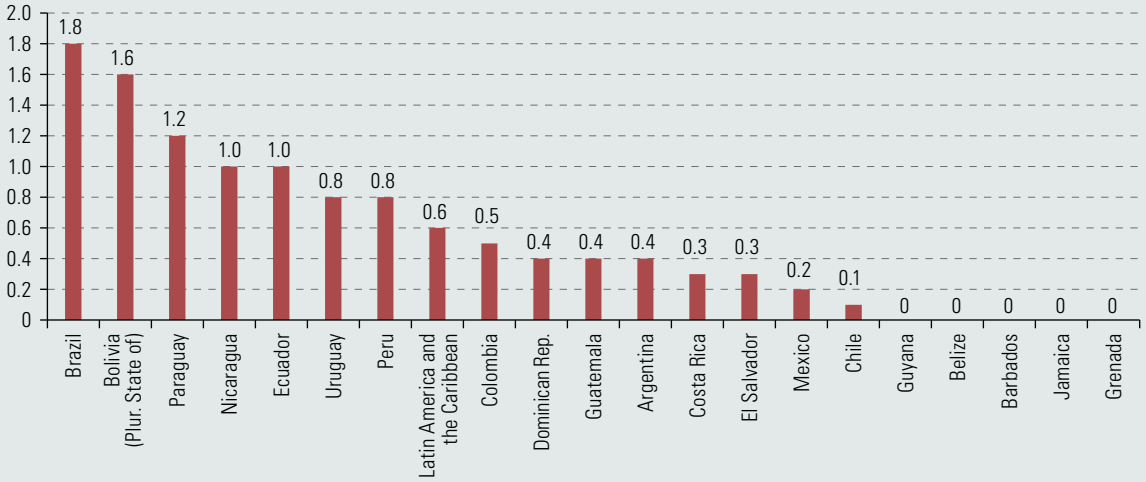
Such is the case of Brazil, with 1.8% of its imports from these three countries, and accounting for 56% of imports into the region from the Russian Federation, Ukraine and Belarus (see figure 5).

Figure 5 Latin America and the Caribbean: imports from the Russian Federation, Ukraine and Belarus, by country, 2020

A. Percentages of the regional total (US$5.345 billion)



B. Percentages of total imports by each country

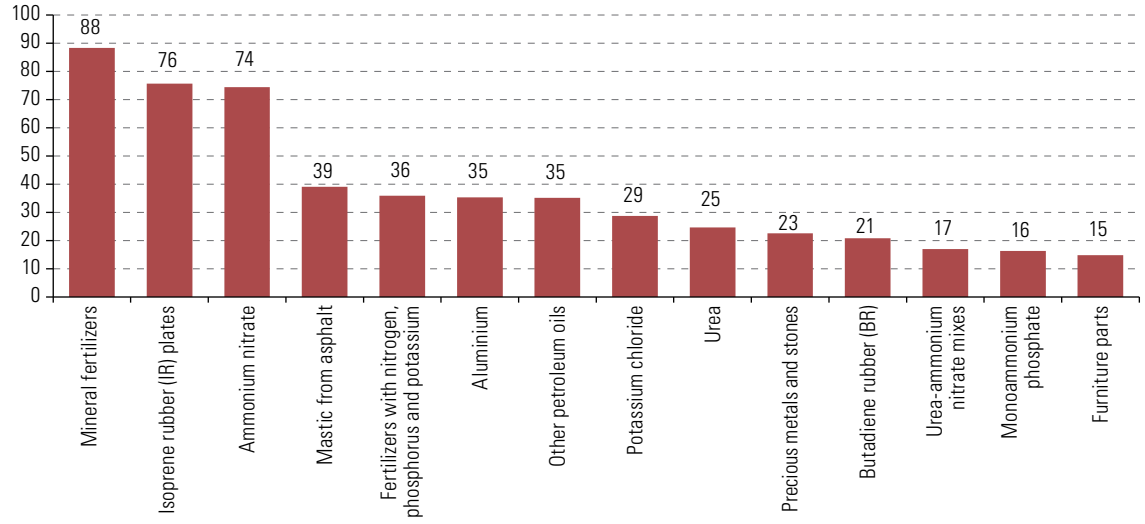


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations, United Nations International Trade Statistics Database (UN Comtrade) [online] https://comtrade.un.org/.

Note: Some countries appear in figure 5B with values of 0.0 as their imports from the three countries are, in total, equivalent to less than 0.1% of their total imports.

Despite the small proportion of imports from the Russian Federation and Ukraine, 88% of the region's extrarregional purchases of mineral fertilizers are from the Russian Federation. High percentages of regional imports of aluminium (35%) and of isoprene rubber plates (76%) and butadiene rubber (21%), all of which are used in the automotive industry, also come from this market. Thus, agriculture, the automotive industry and construction could be directly affected by the decline in the supply of raw materials from the Russian Federation and Ukraine (see figure 6).

Figure 6 Latin America and the Caribbean: main goods imports from the Russian Federation, 2020
(Percentages of global imports)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of United Nations, United Nations International Trade Statistics Database (UN Comtrade) [online] https://comtrade.un.org/.

In that regard, economic sanctions against the Russian Federation have an impact on specific sectors of activity through their effect on value chains. The Russian Federation is a major supplier of certain key inputs for the production of catalytic converters and semiconductors, so shortages could put further pressure on the automotive industry, which is already facing supply constraints.

(b) Indirect effects

There is also an indirect impact on trade that can be expected to be greater for the economies of Latin America and the Caribbean.

The conflict in Ukraine will have an impact on global activity, including the GDP trends of Latin America and the Caribbean's main trading partners (the United States, China and the European Union), with consequences for external demand faced by the region. The effect on the region will depend on the extent of the damage to its trading partners' activity, which —although it is still too early to judge— seems to be more severe in the European Union, which is heavily dependent on energy from the Russian Federation.

The Organisation for Economic Co-operation and Development (OECD) has said that the "moves in commodity prices and financial markets seen since the outbreak of the war could, if sustained, reduce global GDP growth by over 1 percentage point in the first year, with a deep recession in Russia, and push up global consumer price inflation by approximately 2.5 percentage points" (OECD, 2022, p. 3). The estimated impact is a 0.88 percentage point reduction in growth in the case of the United States and a 1.4 percentage point reduction in the euro area (OECD, 2022).

In addition, the need to divert ships from the Black Sea is exacerbating shipping disruption and further increasing shipping costs. Supply shortages as a result of these disruptions will affect trade globally, well beyond specific trade flows with the Russian Federation or Ukraine.

2. Pricing channel

All markets in which the Russian Federation and Ukraine account for a significant share of world trade already reflect large price distortions. This is the case for hydrocarbons, metals and food. These distortions will likely be passed on to domestic prices, affecting the cost of production and consumption baskets.

(a) Hydrocarbon prices

The sharp increase in the price of oil and gas is benefiting energy exporters in the region, such as the Bolivarian Republic of Venezuela, Colombia, Ecuador, Guyana, the Plurinational State of Bolivia and Trinidad and Tobago, among others. However, even the region's hydrocarbon-exporting countries are importers of derivatives (such as gasoline), so the effect is not directly positive.

Energy-importing countries including those in the Caribbean (with the exception of Trinidad and Tobago and Guyana) and in Central American will likely be negatively affected by pressures on the trade balance.

The high price of fossil fuels creates a paradox: on the one hand, low-profitability projects become attractive, as may be the case of unconventional wells, for example, the formation of hydrocarbons at Vaca Muerta in Argentina; on the other hand, it is an incentive to accelerate the introduction of renewable energy sources. The net result will depend on the supply response capacity in the short and medium term. For example, on 10 March, Petrobras, in compliance with its pricing policy based on international parity adopted in 2016, announced increases of 18.8% in the refinery gasoline price, 24.9% for diesel and 16% for liquefied petroleum gas (LPG). While this policy helps to encourage investment in local refining, it increases consumers' vulnerability to international price fluctuations.

Faced with rising international prices, the countries of the region, most of which have insufficient refining capacity and depend on imports of hydrocarbon derivatives and by-products, are adopting measures to avoid or reduce the increase in consumer energy prices. In Brazil, changes were approved in the methodology for calculating the tax on the circulation of goods and services (ICMS) applicable to fuels, and bill 1472/21 for the creation of a stabilization fund is making its way through Congress. In Mexico, the President has announced the maintenance of fuel prices, thanks to a subsidy strategy. El Salvador approved a reduction in the value added tax (VAT) on fuels and the elimination of some taxes on gasoline and diesel for a period of three months, which may be extended. In Chile, a bill was sent to Congress to double the resources of the Fuel Price Stabilization Mechanism (MEPCO).

(b) Agricultural commodity and food prices, and food security

The prices of the main agricultural commodities have increased owing to several factors: (i) a lower supply, mainly of wheat from Ukraine and the Russian Federation; (ii) the closure of ports in the Black Sea that are key to the global fertilizer and grain trade; (iii) low inventory levels and (iv) speculative factors.

The effects on the fertilizer market, in which the Russian Federation is a major producer (accounting for 23% of the ammonium market, 14% of the urea market, 31% of the potassium market and 10% of the processed phosphate market), are in addition to major supply shocks at the end of 2021 because of complications in the natural gas market in Europe. For example, the price of urea has skyrocketed by 90.1% in the last 12 months. As of 18 March, the Green Markets North America Fertilizer Price Index had risen 30% in a year, reaching an all-time high, while the index for potash in Brazil has also reached new highs, after rising 36% since January (Freitas, 2022).

Brazil is the world's largest importer of fertilizers and was caught off guard by the conflict with a significant delay in its purchases required for the second half of the year. It is estimated that the country has purchased 43% less fertilizer for the second half of 2022, compared to the agreements closed in February 2021. Some 72% of farmers will face higher prices than those estimated at the beginning of the year (Freitas, 2022).

Coffee farmers face a similar scenario in Costa Rica, Guatemala and Nicaragua, where lower-productivity fertilizer alternatives are already being considered to offset the price increase and the reduced supply of imported fertilizers. The International Coffee Organization (ICO) estimates that world coffee production will fall by 2.1% in the current commercial year.

The Caribbean is the Latin American and Caribbean subregion most vulnerable to international price increases, including in food prices. Almost all the cereals consumed in the Caribbean are imported. In this subregion, cereal imports represent an average of 102% of domestic supply, while in Central and South America they account for 60% and 31%, respectively.

In the region, food price increases have outpaced wage and household income growth since the onset of the pandemic. In this context, the additional supply-side shock caused by the conflict is putting additional pressure on prices in an already complex environment. Rises in all forms of malnutrition represent one of the possible outcomes. As a result of the pandemic, the prevalence of severe food insecurity in Latin America and the Caribbean rose four percentage points between 2019 and 2020 to 14.2% in 2020 (representing 92.8 million people). The Caribbean was the most affected subregion, with a prevalence of 39.2%. In 2020, 40.9% of the region's population was affected by some type of food insecurity (moderate or severe), including 71.3% in the Caribbean (FAO and others, 2021).

Food inflation figures for February from the larger regional economies are an early warning sign: all show a pickup, breaking a trend of high but declining food inflation prior to the conflict. In Brazil, food inflation reached 9.1% in February, compared to 8.0% in January. In Mexico, food inflation was 11.7% in February, surpassing the 11.0% recorded in January and far exceeding the country's 7.3% year-on-year headline inflation. In Colombia, food inflation hit 23.3% in February, higher than the 19.9% recorded in January and well above the 8.0% year-on-year headline inflation. In Chile, food inflation was 8.4% in February, significantly higher than the 6.0% recorded in January, while headline inflation was 7.8% in February. In Uruguay, food inflation rose to 10.3% in February, up from 7.0% in January, and in Costa Rica, food inflation climbed to 7.3% in February, up from 3.2% in January. Countries with long inflation reporting lags are also likely to record substantial price increases, and the March food inflation figures are likely to show even larger increases, even though the commodity price rises seem to have peaked.

The situation in Haiti is of great concern. Firstly, the country imports almost 70% of its cereal supply. Secondly, double-digit inflation is the norm. As a result, the World Food Programme (WFP) estimates that 45% of the population will experience severe hunger from March to June (FAO/WFP, 2022).

The implications for the region in the short term are twofold. On one hand, rises in food production costs fuel already high inflation. On the other hand, the rises are an opportunity for countries in the region that are producers of agricultural commodities and fertilizers (such as Argentina, Brazil, Paraguay and Uruguay) to cover the market gap left by the Russian Federation, albeit with lower margins due to rising transport prices.

(c) Metal prices

Prices of some metals will rise, not only because of potential disruption of trade with the Russian Federation and Ukraine, which are major producers of titanium, palladium, aluminium and nickel, among other metals, but also because several metals have become safe haven assets in the face of face growing uncertainty, declining returns on other assets and investments, and global inflation.

In the region, metal exporting countries (Plurinational State of Bolivia, Chile and Peru) are expected to benefit from higher prices of these commodities. For net importers of energy products, this positive effect could end up being offset, meaning that the final result for the terms of trade could be negative.

3. Financial channel

Increased financial volatility and global risk aversion as a result of the conflict between the Russian Federation and Ukraine is hurting capital flows to the region.

This could be accompanied by depreciation of local currencies, leading in turn to higher inflation. If capital outflows escalate, this would significantly affect the countries that are most dependent on external financing, which have larger current account deficits.

The situation could also increase the cost of financing for countries in the region, as higher inflation in developed countries puts more pressure on central banks to raise interest rates and adjust their balance sheets.

B. Macroeconomic effects

1. Inflation and monetary policy

Rising commodity prices drive up inflation in the region, putting greater pressure on central banks to raise interest rates more quickly. The increased volatility in international financial markets will also amplify patterns of exchange-rate depreciation in many of the region's economies.

2. Fiscal policy

Latin American and Caribbean countries find themselves facing less fiscal space owing to larger public debts, accompanied by greater pressure to spend to support economic recovery. The expected tightening of access to financing for the region's governments could also create debt sustainability problems or drive fiscal adjustments that could hurt economic recovery.

3. Economic activity, employment and poverty

The combination of all the shocks described will result in slower economic growth than was estimated before the conflict.

This, in turn, will result in a slower recovery in employment in the countries of the region and a negative impact in terms of poverty as incomes deteriorate owing to expected higher inflation.

C. Proposals amid a worsening context marked by uncertainty and volatility

To avoid setbacks beyond those caused by the pandemic, it is essential to maintain policies that protect household incomes as well as the hardest-hit sectors, particularly agriculture, with its concentration of labour-intensive small and medium-sized enterprises (SMEs) and cooperatives.

This will require the implementation of coordinated macroeconomic policies, using all the instruments at the authorities' disposal to appropriately prioritize growth challenges, as well as sectoral employment policies.

Fiscal policy will be crucial for mitigating the effects of the ongoing pandemic and the conflict between the Russian Federation and Ukraine. To this end, it will be necessary to:

- Avoid premature fiscal consolidation measures that slow down recovery, and public spending should prioritize investment in employment-intensive sectors and in environmental sustainability.
- Broaden the range of instruments (monetary, exchange-rate and macroprudential) beyond the interest rate, to address inflationary pressures without undermining the drive for recovery in growth and employment.
- Expand the toolbox available domestically and internationally with multilateral policies for access to liquidity, financing and debt management to increase fiscal space.
- Implement pro-employment growth strategies through productive, labour and care policies, especially for women and young people, with a view to universalizing social protection.
- Move forward with fiscal sustainability, which entails increasing tax revenues by improving the tax burden and tax structure in order to finance growing spending demands.
- Reduce tax evasion, consolidate direct, environmental and digital taxes and review royalties from the extraction of non-renewable resources.

Lastly, in a global economy that is shifting towards regionalization, Latin America and the Caribbean continues to look to extraregional markets. Strengthening productive and trade integration is crucial for reaching efficient scales of production, diversifying exports and reducing exposure to external shocks.

Regional integration is indispensable for achieving a more autonomous production capacity in strategic sectors and advancing towards a regional digital market that fosters intraregional trade, the internationalization of SMEs and the creation of digital products.

Bibliography

BP (2021), *Statistical Review of World Energy 2021*, 70th edition [online] http://www.bp.com/statisticalreview.

ECLAC (Economic Commission for Latin America and the Caribbean) (2021a), *International Trade Outlook for Latin America and the Caribbean, 2021* (LC/PUB.2021/14-P/Rev.1), Santiago.

__(2021b), *Preliminary Overview of the Economies of Latin America and the Caribbean, 2021* (LC/PUB.2022/1-P), Santiago.

El Universo (2022), "Gobierno analiza líneas de crédito y negocia con China y Corea del Sur para colocar banano afectado por conflicto entre Rusia y Ucrania", 14 March [online] https://www.eluniverso.com/noticias/economia/gobierno-analiza-lineas-de-credito-y-negocia-con-china-y-corea-del-sur-para-colocar-banano-afectado-por-conflicto-entre-rusia-y-ucrania-nota/.

European Commission (2022), *Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the regions. REPowerEU: Joint European Action for more affordable, secure and sustainable energy*, Strasburg, 8 March.

FAO (Food and Agriculture Organization of the United Nations) and others (2021), *The State of Food Security and Nutrition in the World 2021: Transforming food systems for food security, improved nutrition and affordable healthy diets for all*, Rome, FAO.

FAO/WFP (Food and Agriculture Organization of the United Nations/Worl Food Programme) (2022), *Hunger Hotspots. FAO-WFP early warnings on acute food insecurity. February to May 2022 Outlook,* Rome [online] https://doi.org/10.4060/cb8376en.

Freitas, T. (2022), "Brazil Farmers Caught in Wrong-Way Bet on Fertilizers as War Drives Up Prices", Bloomberg, 21 March.

Green Car Congress (2022), "IEA issues 10-point plan to cut oil use", 20 March[online] https://www.greencarcongress.com/2022/03/20220320-iea.html.

Lawler, A. (2022), "How much extra oil could OPEC+ pump to cool prices?", Reuters, 11 March.

OECD (Organisation for Economic Co-operation and Development) (2022), *OECD Economic Outlook, Interim Report March 2022: Economic and Social Impacts and Policy Implications of the War in Ukraine*, Paris, OECD Publishing.

OPEC (Organization of the Petroleum Exporting Countries) (2022), *OPEC Monthly Oil Market Report (MOMR)*, March.

Rystad Energy (2022), *Rystad Energy Impact Report: Russia's Invasion of Ukraine, 2 March 2022: What's at stake for global energy markets?*.

The issues outlined in this paper were discussed at the high-level dialogue "Scenarios arising from the conflict in Ukraine", organized by the Economic and Social Council (CES) of Argentina on 23 March 2022. The support of Vianka Aliaga, Economic Affairs Officer in the Office of the Executive Secretary of ECLAC, is gratefully acknowledged.

ECLAC

Economic Commission for Latin America and the Caribbean (ECLAC)
Comisión Económica para América Latina y el Caribe (CEPAL)
www.eclac.org