The Bottom Line

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SECONDARY EFFECTS OF THE RUSSIA-UKRAINE CRISIS

Summary

The war in Ukraine and sanctions on Russia are creating additional challenges for shippers and manufacturers in addition to the expected increase in ocean freight rates.

Background

In February, Russia recognized the independence of two regions – Donetsk and Luhansk – in the eastern part of Ukraine. In response to this aggression, the Biden administration placed Russian elites and two banks on the Specially Designated Nationals list, effectively kicking them out of the U.S. banking system, banning them from trading with Americans, and freezing their U.S. assets.

With the onset of active conflict, the United States, in concert with the U.K. and E.U., has continued to apply pressure to Russia. As the fighting has continued, sanctions have been expanded to include the oil and gas industry, telecommunication, laser systems, avionics, and maritime technologies.

The U.S. Congress is considering removing the Most Favored Nation status, effectively increasing the duty rates ten times on any imports currently permitted from Russia. Other countries have already removed Russia's Normal Trade Relations status, the equivalent to the U.S. move. The ever-increasing pressure will have trickle-down effects on multiple industries in the U.S. and worldwide.

Current Status

Oil: Oil prices have surged to the highest level since 2008 as the United States has moved to ban Russian oil imports. Spending will likely increase on securing supplies of fossil and renewable energy sources. "The crisis raises the case for countries to have local supplies of each," says Erica Groshen, former Federal Reserve official and senior economic advisor at Cornell University School of Industrial & Labor Relations.

Airfreight capacity: Russian carriers have 980 passenger jets in service, of which 777 are leased. The European Union has given leasing companies until March 28 to wind up current rental contracts in Russia. High oil prices are compounded by circuitous flight paths needed to avoid Russian airspace. The detour can add up to 3.5 hours of flying and more fuel consumed. Another effect of this extended flight time is reduced payload capacity by some 10% on 777Fs, according to Dorothea von Boxberg, chief executive of Lufthansa Cargo.

Diamonds: With the breakout of war in Ukraine and the resulting Russian economic sanctions, the supply of rough diamonds may be cut by over 25% as Russian-owned Alrosa, the world's largest diamond producer by volume, was placed on the sanction list. Alrosa is responsible for 90% of Russia's diamond production and 28% of global supply.

Defense spending: Erica Groshen sees defense industries and energy companies prospering in the near term. Defense, alongside cybersecurity, is fast making its way to the top of the political agenda in Europe and the U.S. In anticipation of increased profits, stocks in the aerospace and defense sector have already rallied substantially over the past week.

Grain: "Ukraine and Russia are both global breadbaskets," says Andrew Milligan, Edinburgh-based market strategy veteran, and former U.K. Treasury official. According to the U.S. Department of Agriculture, combined wheat exports from the two countries make up 29% of the global export market. As a result, traders have bid up grain prices by 77% since the beginning of February, anticipating that supplies will drop due to the conflict and sanctions.

Fertilizer: Supplies of agricultural fertilizer may decrease worldwide, as Russia and its ally Belarus control more than a third of the world's potash production, a key ingredient in fertilizer. And Russia alone holds 14% of nitrogen-based plant food production, according to a report from financial research firm CFRA. Reduced global availability could send prices for these nutrients higher and financially hobble farm belts across a slew of countries.

Neon: Ukraine's two leading suppliers of neon, which produce about half the world's supply of the critical ingredient for making chips, have halted their operations as Moscow has sharpened its attack on the country, threatening to raise prices and aggravate the semiconductor shortage.

Impact

Goldman's economists, led by Jan Hatzius, said the chance of a recession in the United States over the next year has risen as high as 35%. "Rising commodity prices will likely result in a drag on consumer spending, as households — and lower-income households in particular — are forced to spend a larger share of income on food and gas," they told clients on Thursday.

Financial conditions for businesses have also tightened, making it harder for them to access cash. Europe's woes will also hurt American companies with global supply chains and operations. Because Russia is a significant exporter of oil and gas and critical agricultural products and industrial metals, the effects of its economic collapse and isolation will be experienced globally.

RESOURCES

Russia Could Hit U.S. Chip Industry, White House Warns (Reuters)

'Too Big to Sanction'? 10 Key Facts About Russia's Oil and Commodity Exports (Markets Insider)

BIMCO: War in Ukraine Will Hurt Growth in All Shipping Segments (MarineLog)

Shipping Costs Rise, Transport Tightens as War Escalates in Ukraine (IndustryWeek)

How the Russia-Ukraine War is Worsening Shipping Snarls and Pushing Up Freight Rates (CNBC)

Air Freight "Turned Upside Down" as Capacity Slumps and Rates Climb (The LoadStar)

Explainer: How Sanctions Against Russia are Battering the Global Aviation Industry (Reuters)

Diamond Jewelry Industry on Edge as Russia Sanctions Threaten to Impact Diamond Supply (Forbes)

How Sanctions on Russia Will Hurt - and Help - the World's Economies (Time)

Risk of a US Recession as High as 35%, Goldman Sachs Says (CNN Business)