Five ways in which the war in Ukraine will change business

The Russia-Ukraine conflict will accelerate changes already provoked by the pandemic, US-China tensions and climate change

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Five ways in which the war in Ukraine will change business

Although primarily a humanitarian disaster, the Russia-Ukraine conflict will also accelerate changes already provoked by the pandemic, US-China tensions and climate change.

- **The war will add to supply-chain disruptions in sectors such as automotive, increasing the pressure for localisation.**
- **A surge in energy and other commodity prices will hasten public- and private-sector efforts to improve food security.**
- **The investment needed to reduce Europe's reliance on Russian energy will affect funding for clean-energy investments in developing countries.**
- **Financial sanctions against Russia may accelerate the transition from US dollar-backed financial systems to interoperable central bank digital currencies (CBDCs).**
- **Geopolitical tensions over technology (already central to the US-China trade war) will intensify as Russia curbs internet access and faces technology sanctions.**

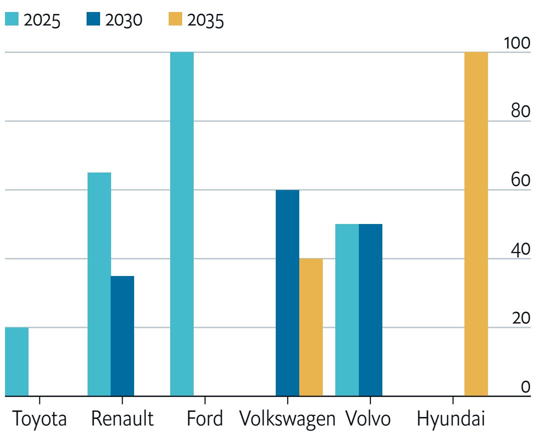
Supply chains will become increasingly localised

Supply chains have already been disrupted by the pandemic, as well as the earlier US-China trade war. The difficulties caused by the Russia-Ukraine war will prolong these disruptions and place added pressure on companies in sectors such as automotive to shorten their supply chains and build resilience. This may mean increasing stock of major components, reining in just-in-time production norms or investing in more local suppliers.

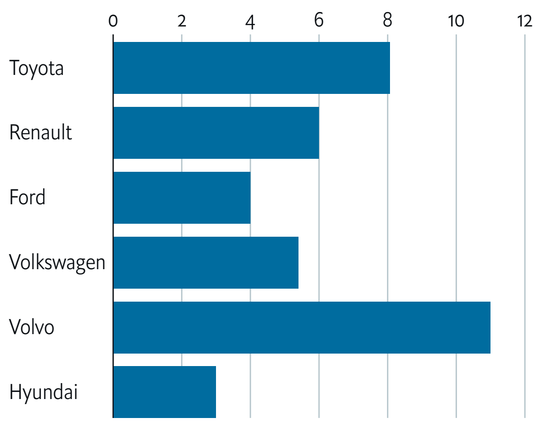
Shorter supply chains are less prone to trade and geopolitical disruptions, and they also lower freight and insurance costs. Moreover, suppliers in countries such as China and Russia are gradually losing their low-cost advantage as labour costs rise, changing the sums in favour of developed-country production.

Carmakers in Europe must make electric switch despite razor-thin margins

Electric vehicle targets by year; % of total sales



Net profit margin, %



Sources: company reports; EIU.

*2019 data

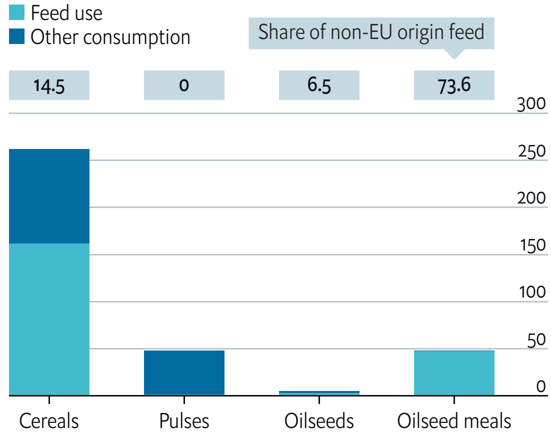
With automakers already investing heavily in local electric-vehicle (EV) and battery production in an effort to transition to green vehicles, there is an opportunity to develop new supplier networks closer to home, often supported by government investment incentives.

The commodity rally will drive adoption of sustainable food policies

The war in Ukraine will keep fuel and commodity prices elevated for much of the year. This will not only raise business costs, but will also heighten existing concerns about energy and food security. The war is already forcing several governments to examine their food and agricultural policies closely, not just in Europe, but also in the Middle East, Singapore and China, among others.

Some EU countries, including Germany, have responded by trying to reduce the share of agricultural products used as feed to scale back meat consumption and popularise alternate-protein products. With about 60% of EU cereal consumption going to animal feed, such an approach will help to insulate the region from global supply shocks. It will also help to achieve sustainability targets, reducing the high methane emissions from livestock.

Cereal and oilseed imports into the EU mainly feed livestock
(2019/20 feed protein source for UK & EU, mt)



*Other consumption: consumption by humans and a small share for biofuels, based on data from 2019.
Sources: Eurostat; EIU.

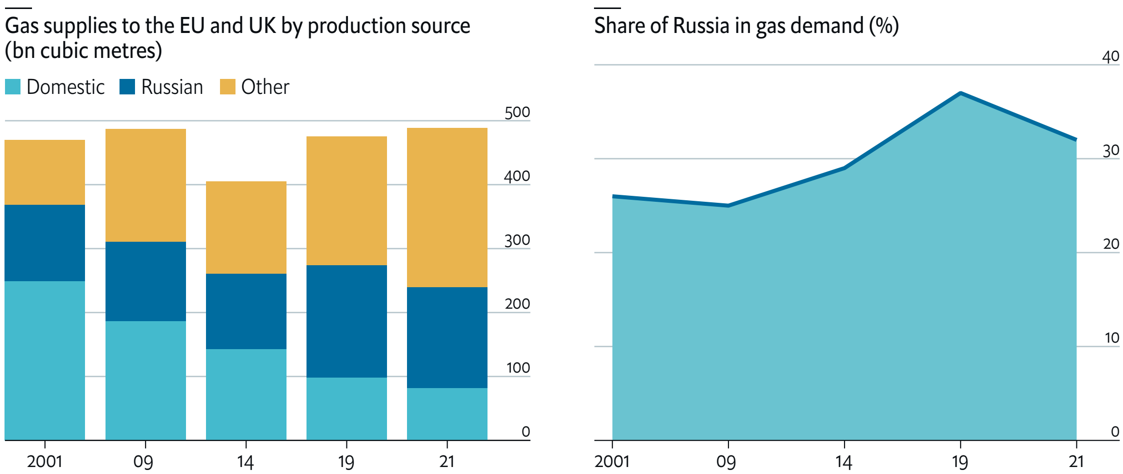
The Middle East, meanwhile, is likely to increase its investment in agritech and other ways of increasing agricultural productivity or reducing water consumption. All this will present opportunities for food tech and alternate protein companies, who will receive government attention and funds.

The energy transition will vary between the developing and developed world

Western sanctions on Russia, despite being unprecedented in scope, have kept open crucial energy supply lines to western Europe; although the US has banned Russian oil imports, Europe's dependence on Russian oil and gas has deterred it from taking similar measures. Even so, European nations will seek to diversify their energy supplies, and this will require heavy investment to ramp up imports of liquefied natural gas (LNG). It will mean investing in greater energy efficiency and heating insulation to lower gas demand for power-generation, and possibly delaying plans to close or phase out nuclear and coal power plants. It would also entail significant public and private investment in renewable power, even as governments widen their defence budgets and commodity prices soar.

All this will make it harder for developed countries to provide financial support to the energy transition in emerging economies—support that has already fallen short of pledges. As a result, emerging economies will continue to invest in fossil-fuel power generation to cater for economic and population growth. The Ukraine-Russia war will, indirectly, widen disparities in the energy transition between developed and developing countries.

EU will need outsized investments to diversify away from Russian gas



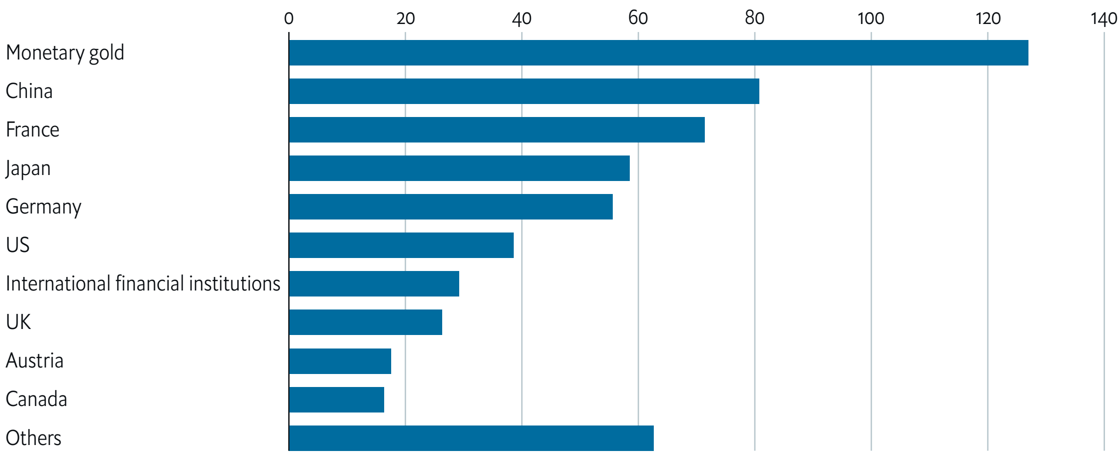
Sources: IEA; EIU.

The weaponisation of financial sanctions will lead to a bifurcation of the global monetary order

In response to Russia's invasion of Ukraine, the US and its allies have resorted to unprecedented economic and financial sanctions, which include the freezing of sovereign reserves, extraterritorial bans on use of currencies, asset seizures and anti-money laundering punishments. They have also entailed the expulsion of some Russian banks from the Belgium-based Society for Worldwide Interbank Financial Telecommunications (SWIFT), the secure messaging system that banks use to execute international payments.

Russian official reserves by location

(end-June 2021)



Source: Central Bank of Russia.

In the short term, this will have a limited impact on Russia's banking system. In the longer term, the weaponisation of financial systems, including card-network systems, will compel Russia and other countries to seek alternatives to established systems centred on the US dollar.

Russia and China already have nascent SWIFT alternatives, but setting up a full-fledged bank-messaging system would be expensive and slow. Instead, any concrete alternative to a US dollar-backed system for international money transfer is likely to use CBDCs. Several countries, especially in Asia, are already trying to interlink their central bank-backed payments platforms, and we expect more countries to embrace multi-CBDCs arrangements. The crisis will take this transition to the next stage.

Tech will become increasingly geopolitical and regionalised

In the US-China trade war, technology sanctions have focused on specific companies. In response to the Russia-Ukraine war, Western allies have, for the first time, imposed country-level technology export curbs on Russia, alongside other unprecedented sanctions.

Technology is becoming increasingly geopolitical and regionalised, in two ways. First, access to technology is seen as a competitive advantage for countries, as evident in US attitudes towards semiconductors. Because the chip sector is fragmented and the product is complex, every actor will need to use US equipment at some point; therefore, any US technology sanction makes a country or company unable to purchase semiconductors.

Secondly, the internet is becoming more national and less global. China has driven this change by using a national firewall to restrict access to content that its government deems dangerous—a measure that Russia wants to adopt. The EU, through its values-led approach to data privacy and regulation of artificial intelligence, has also created regional barriers to the internet.

This regionalisation of the internet will not necessarily lead to a "splinternet", where different systems are completely separate and not interoperable. The broader battle is between the US, which wants to retain the multistakeholder governance model of the internet (open, decentralised and industry-led), and China, which wants a cyber-sovereignty model (closed, centralised and country-led). However, the tensions are not just between democracies and autocracies, but also between blocs, as the relationship between the US and EU shows.

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