

## The Russian Invasion of Ukraine: Its Potential Implications and Impact

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On 21 February, after months of building up forces close to Ukraine’s borders, Vladimir Putin recognised the Luhansk and Donetsk regions of Ukraine as “independent people’s republics.” He ordered the Russian Defence Ministry to deploy troops in those regions to “maintain the peace.” These actions commenced on the anniversary of Russia’s invasion of Crimea almost eight years to the day.

The prelude to this sequence of events has been brewing for a long time. Ukraine’s relationship with NATO commenced after the collapse of the Soviet Union and has evolved over time, culminating with the 2008 Bucharest Summit declaring that Ukraine would follow a process toward becoming a member of the NATO alliance. This decision was reiterated by NATO leaders in a June 2021 summit in Brussels. NATO’s movement eastward has long been a sore spot for Russia. NATO leaders and the United States have expressed a willingness to discuss arms control and other security matters with Russia but have to date been unwilling to commit to a cessation of future NATO expansion.

### An invasion or a prelude to invasion?

The threat of invasion has been escalating for some time, with leaders in the West urging Russia to stand down and pursue diplomatic channels. This week’s events have altered the conversation and confirmed the fears of many regarding Vladimir Putin’s real intentions.

Monday’s announcement recognising the two separatist regions as “independent” and the commitment of “peacekeeping forces” included provocative language that has been interpreted by many as an indication that Putin’s actions earlier this week are unfortunately not his end game. He expressed “hopes” that the question of sovereignty would be resolved in the course of talks between Kyiv and each of the two separatist regions but that this is not possible due to the “escalating” military activity. He asserted that Russia intends to fulfil its

responsibilities and called for Ukraine to demilitarise itself. He cited his request of Kyiv to, in effect, disarm as “most important.”<sup>1</sup>

Thus, for now, the West sees Putin’s demands of Kyiv to negotiate—in essence—with a gun to the head as initiating a full-scale invasion of Ukraine. President Biden said as much yesterday, condemning Putin’s actions as “a flagrant violation of international law.” In his speech announcing sanctions and other actions, the president asserted that Russia is positioned to launch a massive attack against Ukraine with well over 150,000 Russian troops along with war planes and offensive missile systems surrounding Ukraine. Russia’s deployments include forces positioned in Belarus from the north and amphibious assault ships, missile cruisers and submarines manoeuvring in the Black Sea to the south. Russia has also moved supplies of food and medical equipment into position on the border.<sup>2</sup>

The president also announced that, in addition to providing defensive assistance to Ukraine, U.S. forces and equipment already stationed in Europe are being deployed to strengthen Estonia, Latvia and Lithuania, making two points clear. First, these deployments are defensive in nature as the U.S. has no intention of fighting Russia. Second, the U.S. and its allies will defend “every inch of NATO territory.”<sup>3</sup>

In response to Russian threats, Ukraine has proclaimed a 30-day state of emergency. Military reservists between the ages of 18 and 60 have been called up and ordinary civilians are now allowed to bear firearms. Ukraine President Volodymyr Zelensky said yesterday that he’ll “put Ukraine on a war footing” if there is a “broad escalation” by Russia.<sup>4</sup>

## The sanctions

Yesterday, the White House announced a package of sanctions aimed at severing Russia from Western financing and punishing the elites who benefit from the Kremlin’s aggression and corrupt policies. President Biden noted that the sanctions were the initial wave of punitive measures the U.S. is prepared to take and that the full effect of the sanctions

<sup>1</sup> “Putin recognizes separatist claims to Ukraine’s entire Donbass region,” Victor Jack and Douglas Busvine, Politico, 22 February 2022, available at [www.politico.eu/article/vladimir-putin-russia-ukraine-donbass-separatist-recognition/](http://www.politico.eu/article/vladimir-putin-russia-ukraine-donbass-separatist-recognition/).

<sup>2</sup> “None of us should be fooled’: President Biden’s Speech on Russia,” Azi Paybarah, New York Times, 22 February 2022, available at [www.nytimes.com/2022/02/22/world/europe/biden-speech-transcript.html](http://www.nytimes.com/2022/02/22/world/europe/biden-speech-transcript.html).

<sup>3</sup> Ibid.

<sup>4</sup> “Ukraine to Declare 30-Day State of Emergency,” Zachary Basu, 23 February 2022, Axios, available at [www.axios.com/ukraine-emergency-russia-invasion-bd2fec00-174f-45d9-befa-2d9b1cce44e0.html](http://www.axios.com/ukraine-emergency-russia-invasion-bd2fec00-174f-45d9-befa-2d9b1cce44e0.html).

planned would extend far beyond the steps the U.S. and its allies took in response to Russia's invasion of Crimea.

The U.S. sanctions target two major Russian banks and the country's sovereign debt, meaning it can no longer raise money from the West nor can it trade any new debt on U.S. markets. Starting today, the U.S. will also impose sanctions on Russian elites and their family members. According to President Biden, the sanctions have been closely coordinated among Western allies and will be escalated in severity if Russia escalates the crisis further.<sup>5</sup>

The key to the effectiveness of these actions as a response from the international community is a unified front by the West. Along with the U.S. and citing violations of international law by the Kremlin, the European Union bloc imposed a range of sanctions on Russia, including curbs on Moscow's ability to raise capital on the EU's financial markets.<sup>6</sup> As the European Council finalises its sanctions package, its statement used language that suggests close alignment with the U.S. sanctions. The United Kingdom, however, has executed a slightly different approach against Russia. Prime Minister Boris Johnson announced that five Russian banks and three elites had been added to the U.K. Sanctions List as an initial step toward punitive measures against the Kremlin.<sup>7</sup> In addition, media reports suggest that the U.K. will be finalising in the coming days an even stronger sanctions package to impose on Russia.<sup>8</sup>

German Chancellor Olaf Scholz also sent a powerful message that a unified response will prevail by halting certification of the Nord Stream 2 pipeline.<sup>9</sup> The U.S. piled on with sanctions against the owner of the pipeline.<sup>10</sup> All parties noted they are prepared to escalate measures if Russia further advances its aggression. These measures can damage the ruble, limit Russian oil exports, restrict Russia's ability to industrialise its economy and exert

<sup>5</sup> Ibid.

<sup>6</sup> "EU Sanctions to Limit Moscow's Access to Financial Markets," Lili Bayer, Politico, 22 February 2022, available at [www.politico.eu/article/eu-sanctions-to-limit-moscows-access-to-financial-markets/](http://www.politico.eu/article/eu-sanctions-to-limit-moscows-access-to-financial-markets/).

<sup>7</sup> "UK Sanctions Five Russian Banks and Three Oligarchs," Christina Gallardo, Politico, 22 February 2022, available at [www.politico.eu/article/uk-sanctions-five-russian-banks-and-three-oligarchs/](http://www.politico.eu/article/uk-sanctions-five-russian-banks-and-three-oligarchs/).

<sup>8</sup> "London Playbook: Sanctions Scoop – Ratcheting up – Mad Vlad," Alex Wickham, Politico, 23 February 2022, available at [www.politico.eu/newsletter/london-playbook/sanctions-scoop-ratcheting-up-mad-vlad/](http://www.politico.eu/newsletter/london-playbook/sanctions-scoop-ratcheting-up-mad-vlad/).

<sup>9</sup> "Germany Shelves Nord Stream 2 Pipeline," Laurenz Gehrke, Esther Webber and America Hernandez, Politico, 22 February 2022, available at [www.politico.eu/article/germany-to-stop-nord-stream-2/](http://www.politico.eu/article/germany-to-stop-nord-stream-2/).

<sup>10</sup> "Biden Announces Sanctions Against Nord Stream 2 Owner, Reversing 2021 Decision," Ronn Blitzer, Fox Business, 23 February 2022, available at [www.foxbusiness.com/politics/biden-sanctions-nord-stream-2-pipeline-russia-germany](http://www.foxbusiness.com/politics/biden-sanctions-nord-stream-2-pipeline-russia-germany).

pressure on Putin's wealthy supporters by limiting their ability to move money and capital around the world.

Over the last eight years since Western sanctions targeted Moscow during the Crimea crisis, Russia has learned a few lessons on how to withstand financial pressure from the West. Russia's efforts to sanctions proof its economy has come in the form of stockpiling currency reserves, relying less on budgets from Washington, and transforming its trade to replace Western imports. These efforts may very well lessen the blow of sanctions at least in the short term, but they do not provide Russia full immunity to economic damage.

Freedom-loving peoples around the globe can only hope that the collective impact of the sanctions imposed yesterday by the West exacts a significant enough price paid to pre-empt Russia's initiating a wider war. The sanctions announced thus far are intended to be a proportionate response to Putin's moves on the board. There are more severe sanctions available if Putin elects to escalate. To illustrate, steps can be undertaken to block Russia's access to critical technologies through export controls, limiting Russia's ability to obtain what it needs to sustain and advance its military or high-tech sectors, e.g., semiconductors and advanced machinery and manufacturing equipment. These sanctions would likely apply to third-country exports, e.g., U.S. technology exported to a third country cannot be used for products shipped to Russia.

### **Potential implications and impact**

The tragedy unfolding before the world could lead to a humanitarian crisis of staggering proportions. Furthermore, while potentially catastrophic in the extreme on multiple levels, the invasion is only a catalyst to a broader story that will play out over time. The sanctions imposed upon Russia are not cost-free.<sup>11</sup>

Europe's banks—particularly those in Austria, Italy and France—are the world's most exposed to Russia. Since the Ukrainian crisis began building, they have been on high alert in anticipation of widespread government-imposed sanctions. As for U.S. banks, they appear to be less concerned about the impact of Russia sanctions on their business. Since Putin's annexation of Crimea and resulting efforts by the U.S. to blacklist specific individuals, limit access by Russia's state-owned financial institutions to Western capital markets, and impose trade bans on weapons and various technologies, particularly in the oil sector, U.S. banks

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<sup>11</sup> "To Hurt Russia, the West Will End Up Hurting Itself," Christine Romans, CNN Business, 23 February 2022, available at [www.cnn.com/2022/02/23/economy/russia-ukraine-sanctions/index.html](http://www.cnn.com/2022/02/23/economy/russia-ukraine-sanctions/index.html).

have reduced their exposure to Russia. Thus, they are more focused on the market impact of geopolitical tensions caused by Putin's recent actions.<sup>12</sup>

What will be the primary impact on oil and natural gas prices worldwide? Disruption of Russian energy exports as a result of the conflict could temporarily contribute to rising global energy prices, particularly in Europe. There could also be ripple effects across the global economy and financial markets, pushing up prices on other commodities, such as nickel, platinum, palladium and wheat. There is also the potential impact on economic growth over the next year as well as the annual rate of inflation.

For companies, there are several important questions to consider:

1. Where are raw materials and components sourced and are those sources of supply affected by this crisis?
2. Will rising energy prices significantly impact operations? Is there reliance on commodities that will be affected by rising prices?
3. Will this event and the spectre of further escalation affect central bank policies to the detriment of any aspects of the company's operations that are interest rate sensitive?

The answer to the first question depends upon the organisation's supply chain footprint. Any materials and components sourced from Ukraine, Russia or surrounding areas could be affected. Rising energy costs could increase the costs of transporting goods across lengthy supply chains. The primary Ukraine exports are raw materials, e.g., iron, steel, mining products, agricultural products, chemical products and machinery. Its major trading partners, apart from Russia, are Poland, Italy, Turkey and Germany. Thus, this is likely more of a European issue than a U.S. issue.

Answers to the last two questions are largely determined by the extent of the crisis, something we don't know yet. Will Putin stop at the borders of the two regions in Eastern Ukraine and give Kyiv an "out" if it were to recognise their sovereignty as "independent republics"? Alternatively, will the current sanctions lead Putin to invade Ukraine to save face and play the long game? The situation could deescalate or escalate in unexpected ways.

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<sup>12</sup> "Europe's Banks Brace for Russia Fallout While U.S. Banks See Limited Pain," Lawrence White, Alexandra Schwarz-goerlich and Pete Schroeder, Reuters, 22 February 2022, available at [www.reuters.com/business/finance/contagion-sanctions-europes-banks-brace-russia-fallout-2022-02-22/](http://www.reuters.com/business/finance/contagion-sanctions-europes-banks-brace-russia-fallout-2022-02-22/).

This is the crux of the crisis at this time. The damage to Russia's markets and economy from the current wave of sanctions would likely be limited, and perhaps even symbolic, if its troops do not advance beyond the two eastern Ukrainian regions.<sup>13</sup> Will cutting the two “republics” out of Ukraine be enough to satisfy Putin? Or will he be willing to accept a much higher price, including enormous bloodshed that would relegate his status on the world stage to a pariah? His choices will ultimately determine the effect on financial institutions and the cost of energy for companies around the world.

As for the Fed and other central banks, according to the International Monetary Fund, Russia's economy ranks as the world's 11<sup>th</sup> largest and is only 1/20<sup>th</sup> the size of the U.S. and 1/15<sup>th</sup> the size of China. Therefore, it is likely not big enough by itself to affect global markets or global economic growth even if it were to suffer significant economic damage as a result of sanctions from the West. So the essence of this question is whether Russia's actions could result in economic consequences that would prompt the Fed in the U.S., for example, in its forthcoming March and subsequent meetings, to undertake measures beyond what the street expects. We will find out for sure next month.

### Cyber threat exposure

One other point bears mention. As a result of Russia's aggression, governments, institutions and jurisdictions around the world have been placed on high alert for cyberattacks. For example, FINRA in the U.S. issued a cybersecurity alert on February 15. At the state level, Wall Street has braced for potential attacks. The Cybersecurity & Infrastructure Security Agency (CISA) and the FBI have issued a “Shields Up” warning this week regarding the potential for attacks from Russian sources. CISA recommends that all organisations, with emphasis on financial institutions and organisations responsible for critical infrastructure, adopt a “heightened posture related to cybersecurity.”<sup>14</sup>

And that is just the United States. Other countries are on high alert, too. The point is clear: This is a time for vigilance on the cyber front, especially on the human perimeter. Russia may retaliate in response to the West's sanctions. Ukraine's parliament is currently coping with a denial-of-service attack on its website.

<sup>13</sup> “Russia is Already Paying a Hefty Financial Price for its Aggression,” Charles Riley, CNN Business, 22 February 2022, available at [www.cnn.com/2022/02/22/investing/russia-markets-ruble-economy/index.html](http://www.cnn.com/2022/02/22/investing/russia-markets-ruble-economy/index.html).

<sup>14</sup> “Wall Street Braced for Russian Sanctions & Hackers,” Eugene Grygo, Financial Technologies Forum, 22 February 2022, available at [www.ftfnews.com/wall-street-braces-for-russian-hackers-sanctions/30713](http://www.ftfnews.com/wall-street-braces-for-russian-hackers-sanctions/30713).

## Concluding comments

The Ukrainian crisis could have far-reaching ramifications depending solely on the direction Vladimir Putin decides to take. Western policymakers anticipate that additional sanctions are on the horizon. As of this writing, the signs are there that such is the case. However, the question remains as to whether Putin presses on. If he does, will it be because the costs to him and Russia are worth it or because the threat of Western sanctions are not credible? Could it also mean that he is betting that EU resolve to close down Russian oil exports will weaken if energy prices were to spike further?

As the world watches, these are important questions. The West's response to this crisis could very well affect the calculus of the parties engaged in other geopolitical regional situations.

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