CROSS-CONTINENTAL RIPPLES: ANALYZING THE ECONOMIC IMPACT OF THE UKRAINE-RUSSIA CONFLICT ON INDIAN INVESTMENT

Submitted by

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ABSTRACT

Every war incurs significant economic costs, including infrastructure damage, a reduced workforce, resource depletion, and increased public debt. Wars often lead to inflation, resulting in heightened uncertainty and a loss of confidence in the financial system. Consequently, investment and savings levels typically decrease.

Investment is a crucial factor in determining productivity levels, capital formation, and overall economic growth and development. A country's progress is often measured by the volume of investments, both domestic and from non-resident Indians (NRIs). Investments are the foundation upon which an economy is built. A financial sector's existence alone is insufficient for economic prosperity without a strong real sector characterized by investments that create assets and generate returns. Due to the interconnected nature of the global economy, any significant event, such as the adoption of a new economic policy, can impact the Indian economy as well.

This study aims to analyze the impact of the Russia-Ukraine war on the Indian economy, particularly focusing on the investment sector. It also examines the prospects of the Indian economy in light of this conflict by evaluating various factors influencing the Indian economy

INTRODUCTION

The ongoing conflict between Russia and Ukraine has escalated, with Russia intensifying its bombardment and shelling of Ukrainian cities in an effort to gain control. This aggression has resulted in significant loss of life, destruction of properties, and disruption of livelihoods. Despite widespread international condemnation and various oppositions, Russia continues its campaign of aggression and territorial acquisition. In response, numerous countries have imposed a range of sanctions aimed at halting the conflict. These sanctions have led to a mass exodus of companies from Russia, propelling the country toward an economic default, depleting store shelves, and causing the rouble to plummet in value.

The repercussions of the Russia-Ukraine war are not confined to the immediate region but have far-reaching impacts globally, akin to the disturbances caused by any major war. The conflict has triggered sharp increases in fuel and food prices, contributing to economic instability and hardship for many countries. The rise in commodity prices has been accompanied by a tragic toll on civilian lives and widespread property damage. Additionally, the disruption extends to international trade, causing ripple effects that complicate global economic relations.

Focusing on the impact of this war on the Indian economy, it is important to note that both Russia and Ukraine play relatively minor roles in India's foreign trade and investment landscape. Consequently, the direct economic impact on India is somewhat limited. The primary sectors affected are pharmaceuticals and the sunflower oil refining industry, where both countries are significant suppliers. However, the surge in crude oil prices as a result of the conflict poses a significant threat to India's economic stability.

Despite the limited trade relationships, the broader economic disturbances caused by the war, particularly the rising oil prices, could have a considerable adverse effect on India. This is because India's economy is highly sensitive to fluctuations in oil prices, which affect inflation rates and the overall cost of goods and services. Increased oil prices can lead to higher transportation and manufacturing costs, which in turn can slow economic growth and increase inflationary pressures.

Moreover, while Russia and Ukraine may not be major trading partners, the geopolitical instability caused by the war could influence global markets and investor confidence, indirectly affecting India's economic landscape. The uncertainty and risk associated with the war can lead to volatility in financial markets, impacting investments and economic forecasts.

In the long term, the war's continued progression could have more profound implications for India. Prolonged conflict could exacerbate global economic instability, leading to further increases in commodity prices and disruptions in international supply chains. These effects could compound over time, leading to more significant economic challenges for India, particularly if global trade and investment patterns shift in response to the ongoing conflict.
Furthermore, India may face strategic and diplomatic pressures as it navigates its relationships with both Russia and Western countries imposing sanctions. Balancing these relationships while managing the economic fallout from the war will be a complex task for Indian policymakers.

REVIEW OF LITERATURE

Numerous studies have explored how political risk influences the flow of investment into developing countries, typically treating investment as the dependent variable and war as an independent variable. However, the specific examination of how civil war affects investment is considerably less common in the existing literature.

Expanding on this, it is evident that political risk is a broad category encompassing various forms of instability, such as government changes, regulatory shifts, and conflicts, including wars. While general political risks have been extensively analysed for their impact on investment decisions, the nuanced effects of civil wars—armed conflicts within a country—remain underexplored.

Civil wars can have unique and profound impacts on investment, potentially deterring foreign and domestic investors due to increased uncertainty, destruction of infrastructure, and disruption of economic activities. Despite the significant implications, the scarcity of focused research on civil wars suggests a gap in understanding how these internal conflicts specifically influence investor behaviour and economic development in affected regions. Addressing this gap could provide valuable insights for policymakers and investors looking to navigate the complexities of investing in conflict-prone areas.

Busse and Hefeker (2007) study the impact of internal conflict (as one element of political risk) and find that FDI is indeed deterred by conflict. However, Blanco (2012), examining similar determinants of FDI for Latin American countries, finds no significant impact of internal conflict. Resnick (2001) shows that domestic conflict (along with other determinants including democracy and democratic transition) has a significant impact on reducing inward FDI in developing countries.

Using firm level data, Driffield, Jones and Crotty (2013) also find that conflict deters FDI.

Collier and Hoeffler (2004) discovered that the occurrence of civil wars leads to a substantial decrease in foreign direct investment (FDI). Specifically, they found that during periods of conflict, FDI is reduced by approximately 50% when compared to times of peace

Fielding (2004) examines how civil conflict in Israel impacts the movement of financial capital. By gauging conflict intensity based on the quarterly number of fatalities, he discovers compelling proof that heightened conflict intensity notably escalates the outflow of capital.

However, none of these studies make a clear distinction between various categories of investments and how their movement is affected by conflicts between nations

OBJECTIVES OF THE STUDY

1. To examine the effects of the conflict between Russia and Ukraine on the Indian economy overall.
2. To explore how the Russian-Ukraine conflict affects investment in India.
3. To comprehend the patterns of Foreign Direct Investment (FDI) into India amidst the backdrop of the Russian-Ukraine war.

METHODOLOGY

The foundation of this research paper is built upon data predominantly sourced from secondary outlets. It leans heavily on the objectivity inherent in both historical records and modern scholarly literature to construct a comprehensive framework for the study. By harnessing the impartiality ingrained in these sources, the research endeavours to reach conclusions devoid of bias.

The primary focus of data collection revolves around examining the ramifications of the Russia-Ukraine conflict on the Indian economy. This exploration specifically targets the sphere of investment, aiming to unearth insights into how this geopolitical upheaval has influenced investment patterns and economic dynamics within the Indian context. Through meticulous analysis and thoughtful interpretation, the study seeks to shed light on the multifaceted impacts of this global event on India's economic landscape.

WAR AND INVESTMENT

Savings and investments are fundamental pillars in the process of capital formation, essential for steering a country towards economic development. However, this journey can encounter disruptive forces, with war emerging as a significant disruptor impacting economies on multiple fronts. The onset of war triggers seismic shifts in economic variables, particularly investments, complicating predictions and thwarting economic planning efforts. Even with hindsight, grasping the full extent of war's repercussions on economic situations and post-war readjustment proves daunting.

Investment dynamics are shaped by a myriad of factors, including economic conditions and investor risk appetite. Amidst wartime scenarios, concerns about safety and stability become paramount, deterring investors from taking risks or incurring losses. Consequently, this upheaval ripples across international trade, public finance, and a nation's economic landscape.

In essence, the aftermath of war often presents formidable obstacles to prudent investments. Yet, despite these challenges, imperatives such as production demands, energy needs, and the entrepreneurial spirit of business leaders frequently prevail. The resilience of economies, coupled with adaptive measures and strategic investments, helps in navigating the complexities wrought by war. Though daunting, history attests to the capacity of nations to recover and rebuild, harnessing the ingenuity and resourcefulness of their people to foster economic growth in the aftermath of conflict.

IMPACT OF RUSSIA-UKRAINE WAR ON INDIAN ECONOMY

The ongoing conflict between Russia and Ukraine has far-reaching implications, extending beyond the geographical boundaries of the two nations involved. This geopolitical tension not only disrupts regional stability but also reverberates across global markets, affecting high-frequency indicators such as financial markets, exchange rates, investment opportunities, and crude oil prices.

In India, the repercussions of this conflict are keenly felt. As an emerging economy poised for growth, India faces new challenges emanating from the evolving global landscape. With peace being threatened, the echoes of past conflicts, notably the Second World War, serve as stark reminders of the fragility of global stability.

Recent developments have accentuated India's vulnerability to the geopolitical tumult. The State Bank of India's decision to refrain from sanctioning transactions with Russia reflects the tightening grip of international restrictions imposed on Russia. Given India's heavy reliance on imported crude oil, constituting 80% of its total consumption, any disruption in global oil markets can significantly impact its economy.

Furthermore, India finds itself grappling with a trade deficit with Russia, exacerbated by a lack of exports and increased imports from the country. This trade asymmetry underscores India's susceptibility to geopolitical shifts and underscores the urgent need for diversification and resilience in its trade relations.

In navigating these turbulent waters, India faces a critical juncture in its developmental trajectory. The ability to navigate geopolitical uncertainties while fostering economic growth and stability will be paramount. As the world witnesses geopolitical tensions unfolding, India's response and adaptation to these challenges will shape its trajectory on the global stage

The report said that 2.8% of India’s total imports are from Russia.

India's trade with		Russia	Ukraine
Exports	$ million	2,547.00	372.00
	% share	0.80	0.10
Imports	$ million	6,894.00	1,980.00
	% share	1.60	0.50
Total trade	$ million	9,440.00	2,352.00
	% share	1.30	0.30
trade balance	$ million	−4,347.00	−1,608.

Source: SBI research

IMPACT OF WAR ON INVESTMENTS

The supply-chain crisis and trade shocks resulting from Russia's invasion of Ukraine have ignited concerns about a significant surge in inflation over the next 6 to 8 months. This inflationary pressure is expected to be compounded by disruptions in global commodity supply chains, particularly in key areas like nickel and wheat, where Russia and Ukraine play significant roles as major exporters. These disruptions have already propelled commodity prices to record highs, exacerbating concerns about inflationary pressures worldwide.

In response to the anticipated surge in inflation, the Indian government has taken measures such as cutting oil excise duties to mitigate the impact. However, these measures are likely to widen the current account deficit, posing challenges to India's economic growth trajectory. HDFC Bank's recent downgrade of growth forecasts underscores the seriousness of these challenges, with expectations for growth now reduced to 7.9% from an earlier projection of 8.2%. Additionally, the bank predicts that the current account deficit will reach 2.3%, further dampening growth prospects.

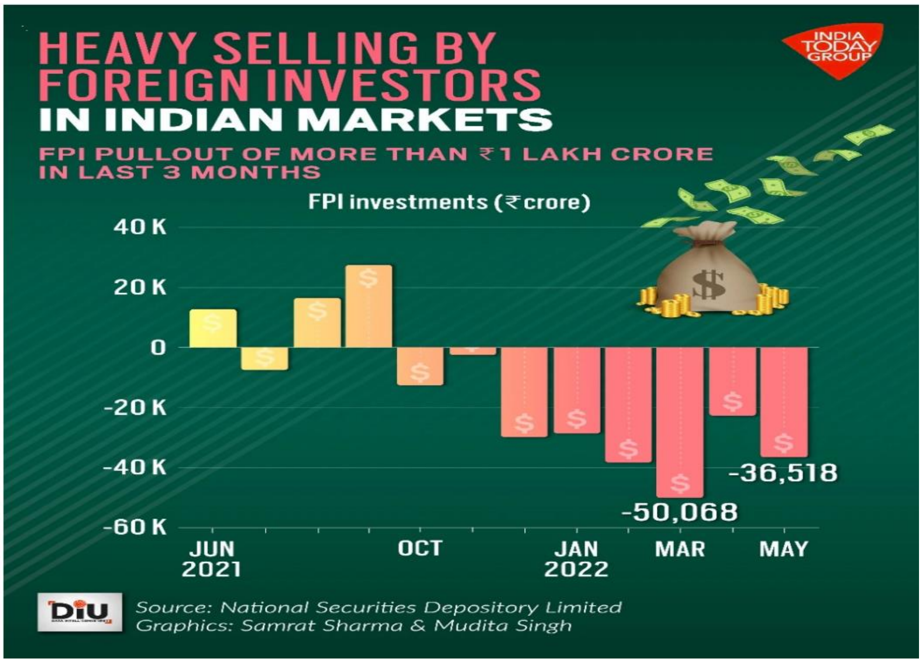
The escalation of the conflict between Russia and Ukraine is expected to have broader repercussions on economic growth and inflation globally. In India, the annual inflation rate has already surged to 6.01% in January 2022, reaching a 7-month high and exceeding the Reserve Bank of India's (RBI) inflation-targeting band. These developments pose significant challenges for the RBI in managing monetary policy to control inflation while supporting economic growth.

The impact of the crisis extends beyond inflation and economic growth, affecting various sectors of the Indian economy differently. While some sectors face significant challenges, others stand to benefit or remain relatively resilient. The IT industry, financials, and capital goods sectors are among those likely to benefit, with the Indian IT sector potentially emerging as an alternative for businesses exiting Ukrainian and Eastern European markets.

Similarly, the Indian agriculture sector is expected to remain resilient, supported by sufficient stocks to sustain growth momentum despite disruptions in commodity supplies from Russia.
Furthermore, India's tourism sector could see gains from sanctions imposed on Russia, potentially becoming a transit hub for Russian citizens and boosting the airline industry. Rising gold prices present an opportunity for India, the world's second-largest consumer of gold, to capitalize on the wealth effect and potentially bolster capital reserves for investment and growth.

However, despite potential opportunities, India's economy is not immune to the adverse impacts of the crisis. Market volatility is likely to persist in the coming months, presenting both risks and opportunities for investors. The recent decline in stock market indices, such as the Sensex and Nifty 50, underscores the heightened uncertainty and volatility.
In such uncertain times, long-term investors are advised to exercise caution and adopt a strategic approach to investment. Hasty liquidation of investments in a volatile market may lead to regrets, particularly if markets bounce back unexpectedly. Instead, investors should focus on their investment goals and consider the broader economic context before making decisions. Diversification and a long-term investment horizon remain essential strategies for navigating turbulent market conditions and capitalizing on potential opportunities arising from geopolitical crises like the Russia-Ukraine conflict.

In the aftermath of the Russia-Ukraine conflict's onset three months ago, foreign portfolio investors (FPIs) have significantly withdrawn over Rs. 1 lakh crore from Indian markets. This sum surpasses the total withdrawals of the preceding nine months combined by Rs. 50,000 crores. FPI sentiment has soured due to various factors, prominently influenced by the global wave of monetary tightening stemming from soaring inflation rates. This tightening phenomenon has adversely impacted emerging markets worldwide, India included. However, what distinguishes the recent period is the magnitude of FPIs' divestment from Indian equities, marking an unparalleled level of sell-off. This substantial withdrawal underscores the apprehensions and uncertainties prevailing in global financial markets, amplifying the need for robust economic policies to stabilize and rejuvenate investor confidence in India's market.



FINDINGS

India's diplomatic approach to the Russia-Ukraine crisis has been marked by neutrality, a strategic stance grounded in economic realities. Russia holds a significant position in India's economic landscape, with substantial investments in crucial sectors like civil nuclear energy and defence. The bilateral trade between the two countries encompasses a wide array of commodities, including gas, crude oil, metals, fertilizers, and agricultural products like wheat and sunflower oil.

The imposition of sanctions on Russia has led to a surge in prices for its exports, benefiting Indian industries involved in sectors such as oil production, refining, and metal processing. However, this boon for certain sectors translates into higher input costs for industries like automotive, paints, FMCG, and airlines, consequently impacting consumers.

The repercussions of the crisis extend beyond trade dynamics. Foreign portfolio investors (FPIs) have withdrawn substantial sums from Indian markets, exceeding Rs. 1 lakh crore, which has implications for India's forex reserves. The depletion of reserves coupled with the likelihood of increased inflation due to expensive oil imports poses challenges for India's economic stability.

While the immediate effects may seem manageable, the long-term consequences warrant careful consideration. The volatility in global markets, coupled with India's vulnerability to external shocks, underscores the need for strategic foresight. As the conflict's resolution looms, India must evaluate the lessons and opportunities arising from the crisis. Balancing economic interests with geopolitical realities will be imperative in navigating the aftermath and safeguarding India's interests on the global stage.

IMPLICATIONS OF THE STUDY

A comprehensive study on the repercussions of the Ukraine-Russia conflict on Indian investment yields critical insights into the global economic landscape. The conflict, marked by geopolitical tensions and military actions, has profound implications for Indian investors, particularly in sectors sensitive to energy prices and geopolitical stability. The study reveals a complex interplay of factors influencing Indian investment decisions, including the volatility of global markets, shifts in energy prices, and geopolitical risk assessments. With India heavily reliant on imports for energy resources, any disruption in the global energy supply chain due to the conflict can significantly impact investment sentiment, especially in sectors such as manufacturing, transportation, and infrastructure development. Moreover, the study highlights the need for Indian policymakers and businesses to recalibrate their risk management strategies and diversify investment portfolios to mitigate potential losses stemming from geopolitical uncertainties. Additionally, the study underscores the importance of fostering diplomatic dialogue and international cooperation to address the underlying causes of conflicts like the one between Ukraine and Russia, as a peaceful resolution can alleviate market uncertainties and create a conducive environment for sustainable investment growth. Overall, the study underscores the intricate interconnectedness of the global economy and the imperative for Indian investors to adapt to evolving geopolitical dynamics to safeguard their investments and capitalize on emerging opportunities amidst geopolitical uncertainties.

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