

One Year of War in Ukraine

The war has been tremendously costly, in Ukraine and beyond.

By Vaibhav Tandon

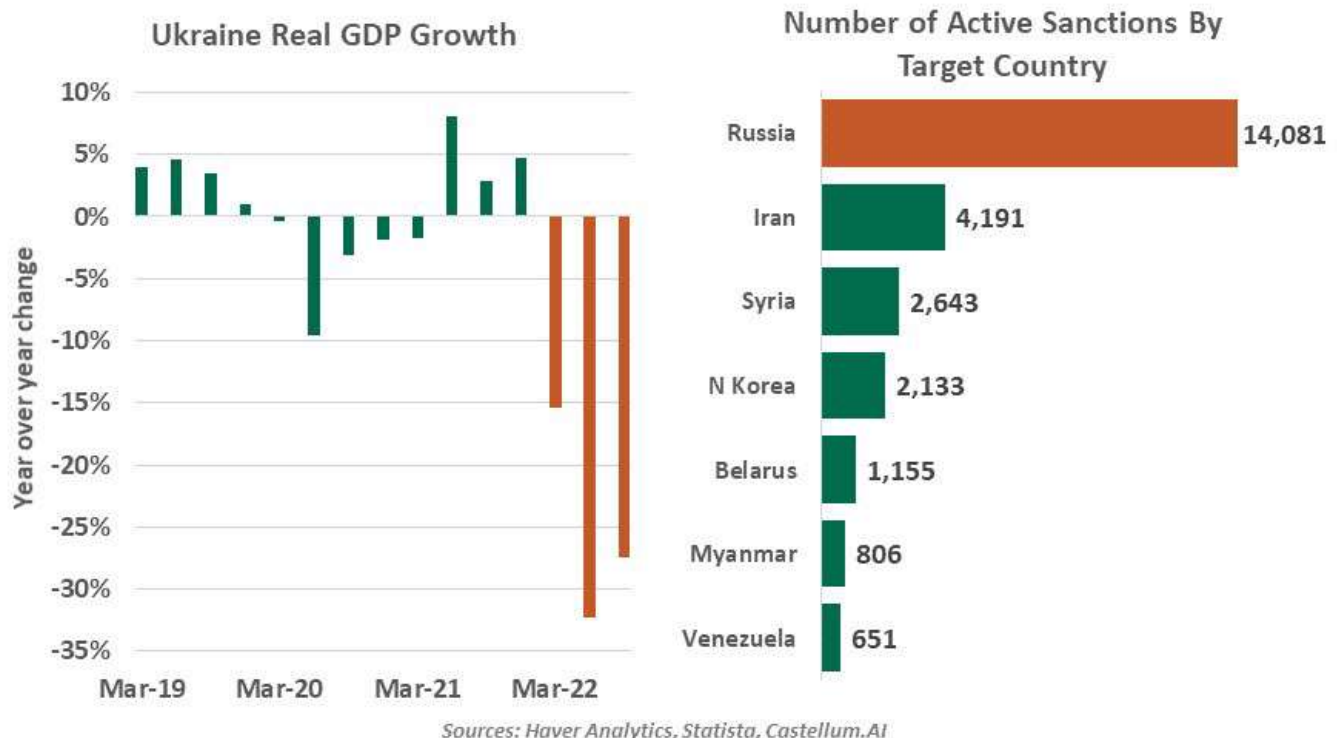


On February 24, 2022, Russian forces rolled into Ukraine. Some forecast a brutal but short campaign; however, one year later, there is no end in sight to the conflict. The situation remains a key risk, both economically and geopolitically.

Ukraine has withstood the largest military aggression in Europe since World War II. The war has inflicted immense humanitarian suffering on its people. According to United Nations data, at least 8,000 Ukrainians have died, over 13,000 have been injured and 14 million (one-third of the population) have been displaced from their homes.

Prior to the conflict, Ukraine was one of the poorest nations in Europe. In three decades of independence, Ukraine's economy has suffered hyperinflation, financial instability and severe recessions. The war has made a bad economic situation immensely worse.

According to World Bank estimates, the number of people living in poverty in Ukraine increased ten-fold in 2022. Waves of missile strikes targeting energy and other critical infrastructure have caused long power outages, impairing industrial activity. The agriculture sector has also suffered severe losses, with many granaries wrecked and large areas of arable land turned into minefields.



The blockade of the country's seaports has led to a sharp fall in exports. According to economy ministry data, Ukrainian exports fell by over a third in value and volume in 2022 owing to limited access to Black Sea ports.

The crisis has caused massive budgetary problems. Kyiv has been forced to divert huge amounts of funds to defense spending, which soared a whopping 818% and accounted for 42% of total fiscal expenditures from January through November 2022. Kyiv is relying heavily on foreign grants and loans to cover an expected \$38 billion budget deficit and keep the economy afloat. International financial assistance accounted for 23% of Ukraine's fiscal revenues last year. Inflation has surged to 26% year over year, bringing more misery to already troubled citizens.

Overall, Ukraine's economy has suffered its sharpest decline in more than 30 years. Gross domestic product (GDP) **plunged** 30% in 2022 and is expected to shrink further this year.

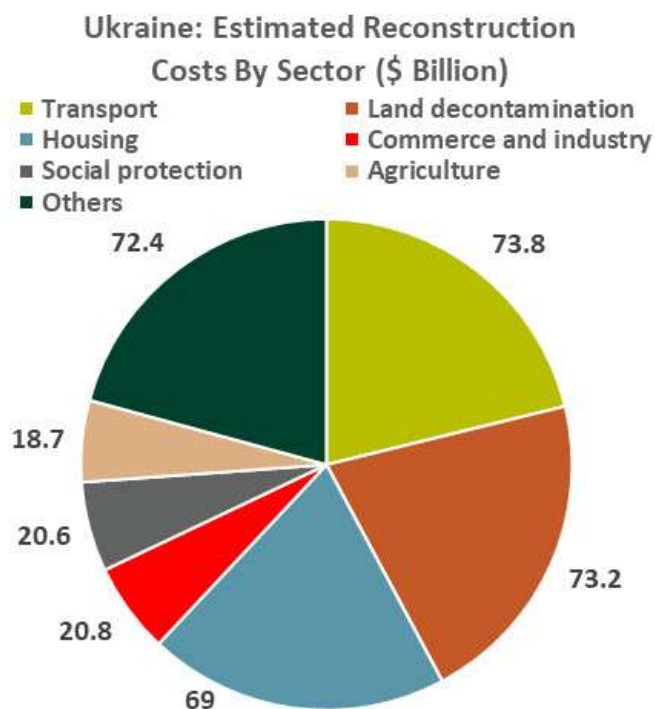
The conflict has delivered a major shock to Ukraine and a sizeable blow to Russia.

Russia's actions brought about a strong response from the international community. The U.S. and its partners have organized the largest set of sanctions and export restrictions ever

imposed on any major world economy. America alone has implemented or expanded over 2,000 sanctions and more than 375 export control Entity Listings. Russia is now the world's most sanctioned country, with over 14,000 limitations imposed on its individuals and corporations. The restrictions are preventing access to critical inputs and technologies, affecting Russia's ability to prosecute the war.

Over 190 international companies have exited Russia since the start of the war. Imports of a range of Russian goods into the U.S. are now subject to higher tariffs. Russian equity markets are 30% below pre-war levels.

Despite all of this, Russia's economy has avoided the deep debacle some had predicted for it. Most western nations have either imposed an import ban or cut their reliance on Russian oil and gas; however, these commodities have made their way into energy-starved emerging markets like India and China — albeit at discounts relative to market prices. Economies accounting for more than 30% of global GDP continue to trade with Moscow, preventing economic isolation. A rising number of countries have also been settling trade in rubles, bypassing **financial sanctions**.



Sources: Yahoo Finance, World Bank

The Russian economy contracted by 2.2% last year, only a fraction of the 10% decline estimated in the first month of the war. The International Monetary Fund expects the Russian economy to grow faster than the U.K. this year and next, further raising questions about the **effectiveness** of corrective sanctions in a globalized world.

The economic consequences from Russia's invasion have been global. Europe has suffered the most, dealing with rapidly rising gas prices for most of 2022. The war has cost an average British household an extra £1,000 in higher energy bills over the last 12 months. European

economies, large and small, have been facing the highest inflation in decades, which has forced central banks to raise interest rates.

Even if the war ended tomorrow, the cost of reconstruction would be huge.

Measuring the economic impact of a war is a complex job. Common gauges like GDP losses and joblessness fail to capture the longer-term effects of conflicts. The cost of Ukrainian reconstruction was pegged at about \$350 billion last September: 1.6 times the size of the Ukrainian economy. That assessment didn't take into account the damage thereafter, especially the recent destruction of critical infrastructure.

In the long term, Ukraine will struggle to rebuild its population and social structure, which are essential to a well-functioning economy. Companies and countries may hesitate to conduct business with Ukraine, given its vulnerable geography.

In addition to financial assistance from **multilateral institutions**, the European Union and the United States have committed more than \$100 billion in military, financial, and humanitarian aid to support the Ukrainian economy. The Europeans are also exploring **options** to utilize \$300 billion in frozen Russian Central Bank reserves for recovery and reconstruction efforts.

The danger of further escalation is no less real than in the early days of the war. As long as military operations are underway, the economic situation in Ukraine will not improve much.

Kyiv is fighting hard to safeguard its sovereignty, and Russia has not backed down. The temptation to break the stalemate with escalation may prove powerful to the combatants, and troubling to markets.

Benjamin Franklin once said: "Wars are not paid for in wartime, the bill comes later." The bill for the Russia/Ukraine war is already immense, and getting bigger every day.



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Vaibhav Tandon is an Economist within the Global Risk Management division of Northern Trust. In this role, Vaibhav briefs clients and colleagues on the economy and business conditions, supports internal stress testing and capital allocation processes, and publishes the bank's formal economic viewpoint. He publishes weekly economic commentaries and monthly global outlooks.

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