WESTPAC ECONOMIC BULLETIN

How is New Zealand exposed to the Russia-Ukraine conflict?

28 February 2022

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- The conflict in the Ukraine will have a significant human cost. It will also have important implications for global economic conditions.
- New Zealand's direct trade exposure to the region is limited. However, we are likely to see a boost to already strong inflation pressures due to higher fuel costs. Food prices could also be affected.
- The New Zealand economy may also be exposed to the conflict through financial conditions, though the impacts to date have been fairly limited.

The past week has seen the situation in Ukraine deteriorate rapidly as Russian troops have moved into the country. The major impact of the conflict will be on the lives of those in the region, as well as their families and loved ones around the world, including here in New Zealand. However, there will also be important implications for global economic conditions.

Many countries have now announced sanctions on Russia, including the US, European Union nations, the UK, Japan, Canada, Australia and New Zealand. In New Zealand's case, that includes restrictions on exports intended for use by the military or armed forces (though food products that are not intended for use by the armed forces are exempted). There are also some restrictions on travel.

Sanctions imposed by other nations include restrictions on exports to Russia (including military equipment, technology and transport equipment), as well as sanctions targeting specific individuals.

Measures have also been introduced to limit Russia's access to financial networks. That includes restricting Russia's access to the global SWIFT payments network. The SWIFT network is used by banks and other financial institutions to facilitate the rapid transfer of funds across borders, and losing access to this network is likely to cause significant disruptions to Russia's financial system. Notably, this could have sizeable impacts on the sale and purchase of agricultural and energy products, resulting in extra costs and delays. As Russia is an important supplier of energy to a number of European economies, this could also result in higher costs for other nations.

New Zealand's direct trade exposure to the region is limited. In 2021, Russia took only 0.4% of our exports and Ukraine took just 0.03%, with trade mainly related to exports of dairy products, which could be directed to other markets if it came to that. New Zealand only imports a very small amount of goods from either country.

The indirect effects from trade are most likely to be inflationary ones. The main way that most New Zealand households and businesses are exposed to the conflict is through higher oil prices. Oil prices have been rising as tensions between the two countries intensified, and last week Brent crude cracked $100/barrel for the first time since 2014. Prices have since pulled back, but are still around $97/barrel.

The sanctions imposed over the past week have not targeted energy markets, in order to limit the upwards pressure on prices. Russia controls around 8% of global oil production, including 25% of the European market. Restricting Russian supply into energy markets where inventory levels are already low would put enormous upward pressure on crude prices.

Even in the absence of sanctions, the high level of international oil prices is already causing pain at the pumps. Prices for 91 octane petrol are now running around $2.70/ltr. That's up 12% since the start of this year and is siphoning a large amount out of many New Zealanders' wallets. Those high prices will also add to already strong upwards pressure on transport and operating costs for businesses.

The conflict could also put upward pressure on world food prices. That's a notable contrast with the Crimean invasion in 2014, when Russia placed a ban on food imports from countries that had placed sanctions on it. New Zealand wasn't included in that group, but it meant that other major food exporting nations had to find other markets, pushing down prices for things like dairy products. Russia has never removed that import ban, which means that it lacks any additional leverage over food-exporting nations this time.

Meanwhile, Ukraine is an important exporter of grains, and the conflict is adding to the upward pressure on feed prices. Those developments will add to the pressure on already constrained production levels.

We're already forecasting that New Zealand consumer price inflation will hit a three-decade high of 6.3% in the March quarter. If oil prices continue to rise, inflation could reach an even higher peak, and could remain above the RBNZ's target range for longer.

The New Zealand economy may also be exposed to the conflict through financial conditions, though the impacts to date have been fairly limited. Global equity markets, including the NZX, did drop sharply last week as the invasion began and risk aversion spiked. However, overseas markets staged a recovery late in the week, retracing most (if not all) of their earlier falls. Similarly, the NZ dollar has bounced around on risk-off/risk-on sentiment in global markets, but hasn't shown any clear direction.

More generally, the conflict is likely to reinforce the increased volatility seen in financial market since the start of the year. But despite this, we don't expect recent events will have a significant impact on policy decisions from major central banks. Over the coming months we're forecasting measured policy rate increases of 25bps from RBNZ, as well as the RBA and US Federal Reserve.

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