

# Capital Markets Strategy

Essential insights for the C-Suite



## Two Years Later

Assessing the Impact of Russia-Ukraine

FEB 2024



# Miscalculations

Just as Europe miscalculated in its assessment of energy dependence and geo-strategic Russia risk, so too did President Putin regarding his confidence in the timing and feasibility of his Ukraine invasion. Driven not by economic objectives, Putin's calculus emanated more from nationalism, expansive ambitions and revisionist territorial claims tied to Russian history.

***"Ukraine is not just a neighbor. It is an inherent part of our history, culture and spiritual space."***

President Vladimir Putin  
(February 2022)



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# The Impact of Russia-Ukraine (2 Years Later)

## Humanitarian Impact: Devastating

Largest European land war since WW2: Hundreds of thousands of military and civilian casualties. Europe's largest refugee crisis since WW2: Nearly 10 million Ukrainians internally displaced, and more than 8 million have left the country. Extraordinary environmental, social and political damage.

## Geopolitical Impact: Seismic

Largest globally coordinated public & private sector sanctions on record. NATO strengthening and expansion. Sino-Russian geostrategic re-alignment. Rerouting of global trade and energy supplies. Resurgent global military spending.

## Economic Impact: Regional

Following initial sanctions-driven contraction, Russia's "war economy" has grown rapidly in 2023-24. Destructive contraction in Ukraine's economy. Ukraine dependence on foreign financial support. EU economy initially resilient on lower energy prices, now slowing from inflation, policy tightening and manufacturing recession.

## Market Impact: Marginal

Modest de-dollarization of selected markets. Unexpected outperformance of Russian equities. Counterintuitive decline in oil, natural gas & wheat prices. Virtually no impact on USD credit markets. Ruble depreciation.

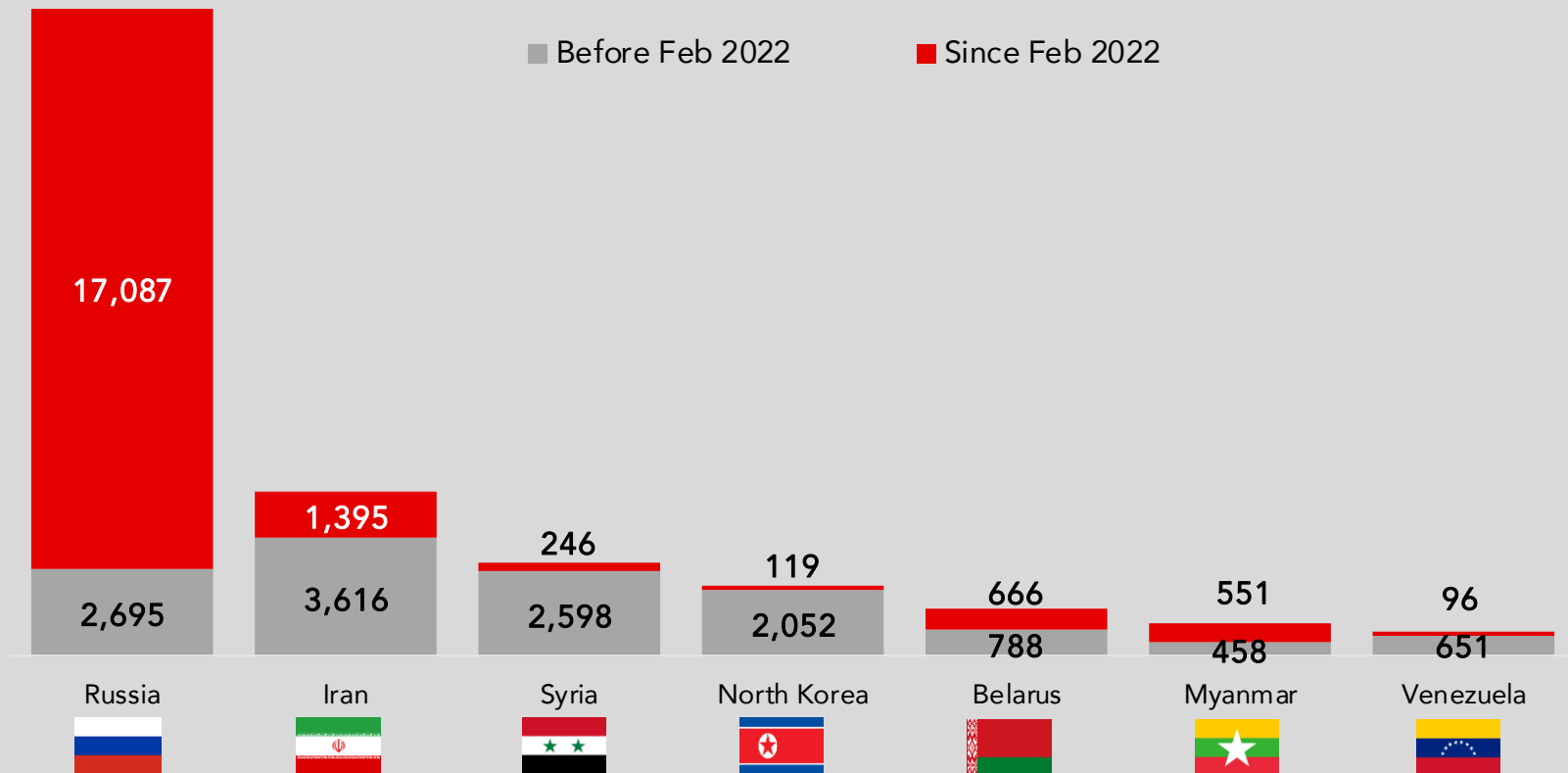


# ***1 The World's Most Sanctioned Country***

# The World's Most Sanctioned Country

In response to the Ukrainian invasion, Russia has become the world's most sanctioned country. Following the death of imprisoned Russian opposition leader, Alexei Navalny, Washington announced an additional 500 targets for sanctions on Russia, in addition to the thousands already in place.

# of total sanctions

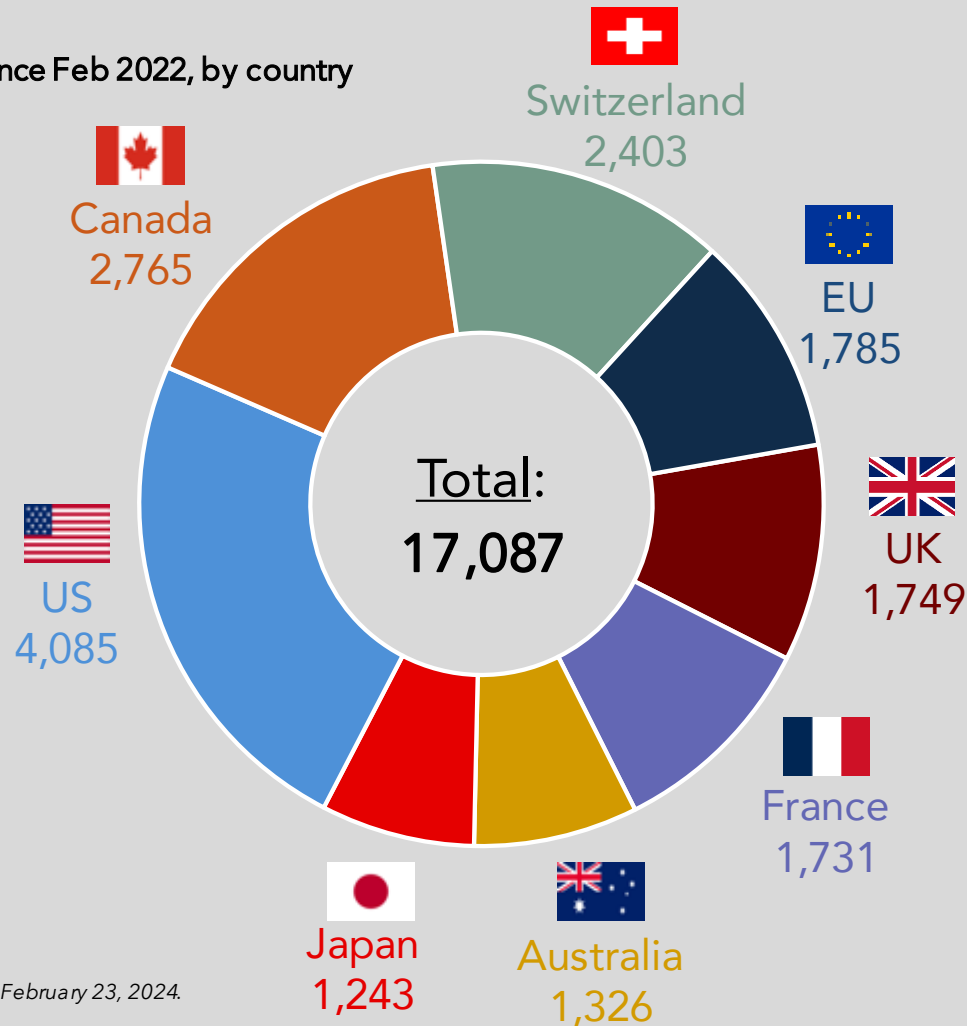


Source: (1) Castellum.AI. Data as of February 23, 2024.

# The World's Most Sanctioned Country

Countries sanctioning Russia account for about 60% of global GDP. Europe's policy response has been notably formidable, including 13 rounds of sanctions, additional export controls and a comprehensive reduction in the continent's Russian energy dependency.

# of Russian sanctions since Feb 2022, by country



Source: (1) Castellum.AI. Data as of February 23, 2024.

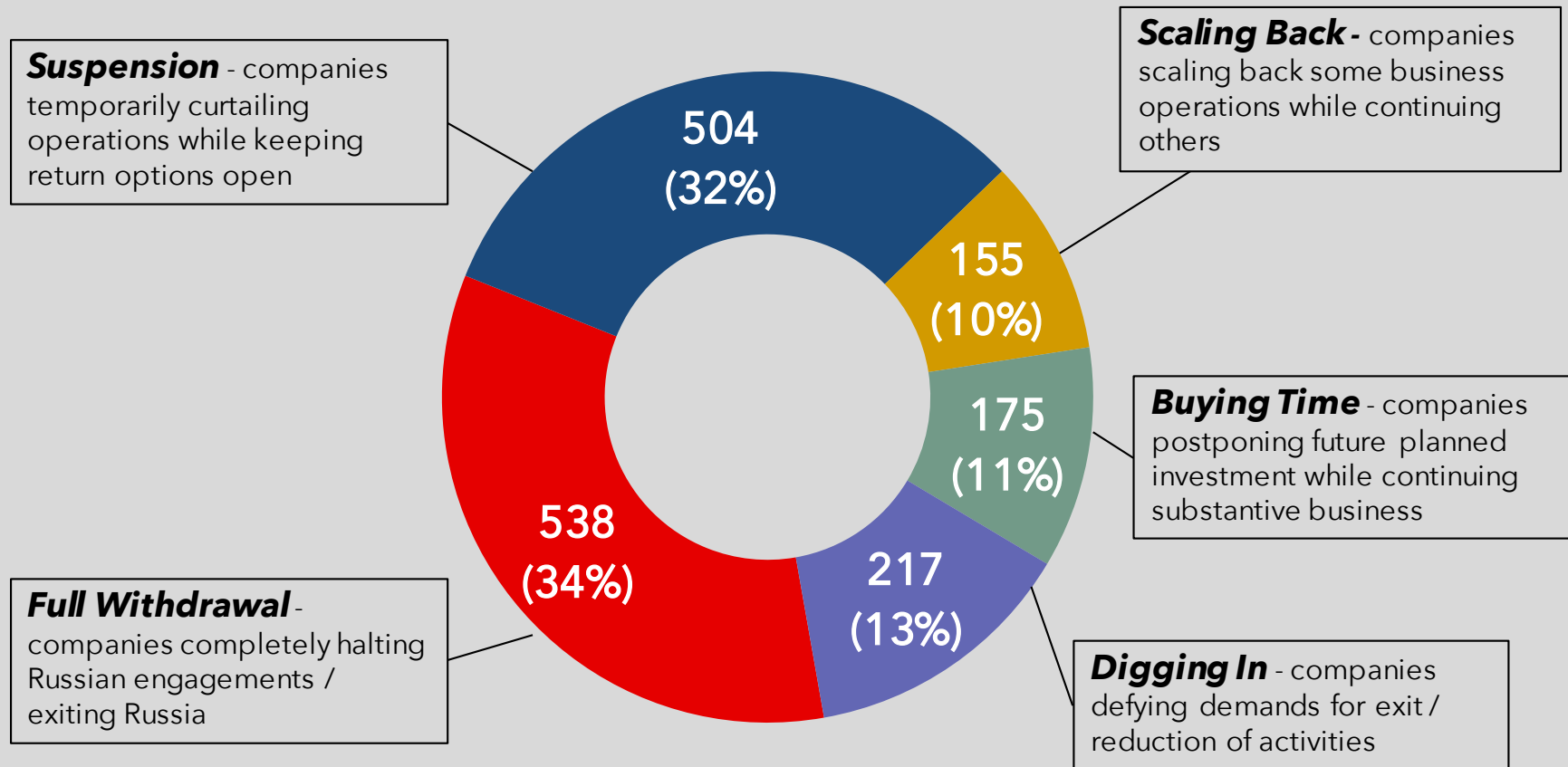
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# Corporate Sector "Self-Sanctioning" of Russia

Yale University has created a comprehensive tracker of corporate responses to Russia's invasion of Ukraine. Of the more than 1,200 companies globally included in their tracking analysis, over 75% have either fully withdrawn, suspended or scaled back their Russia business.

Number of companies "self-sanctioning" Russia

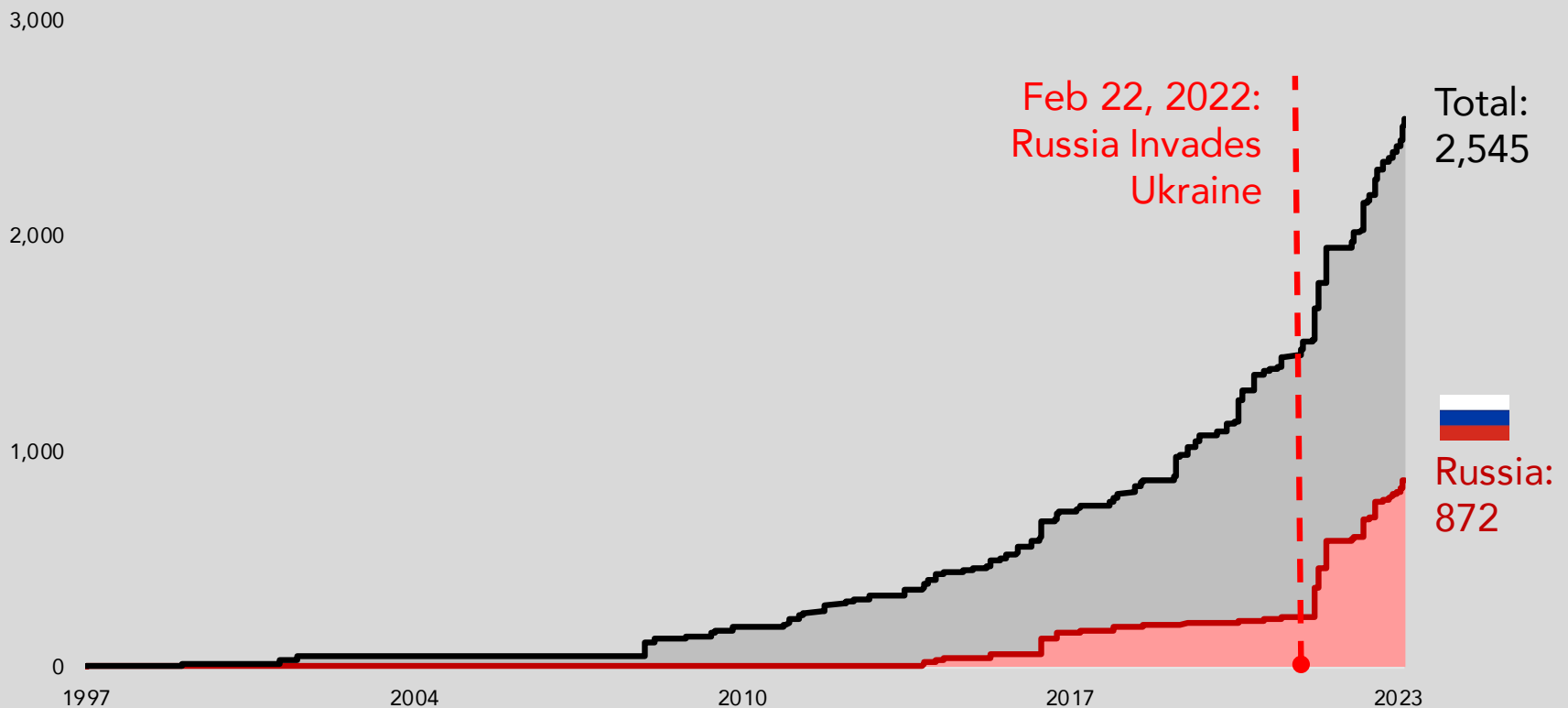


Source: (1) Yale School of Management. Data as of January 28, 2024.

# US Commerce Department Sanctioning

In addition to sanctions policy led by the US Treasury and other government agencies, the US Commerce Department has added hundreds of Russian companies to its so-called "Entity List" since the Ukraine invasion two years ago, thereby precluding US companies from exporting goods and technology to entities in Russia's defense, energy and other strategic sectors without a US government approved license.

Cumulative additions to the US Commerce Department Entity List (1997 – 2023)

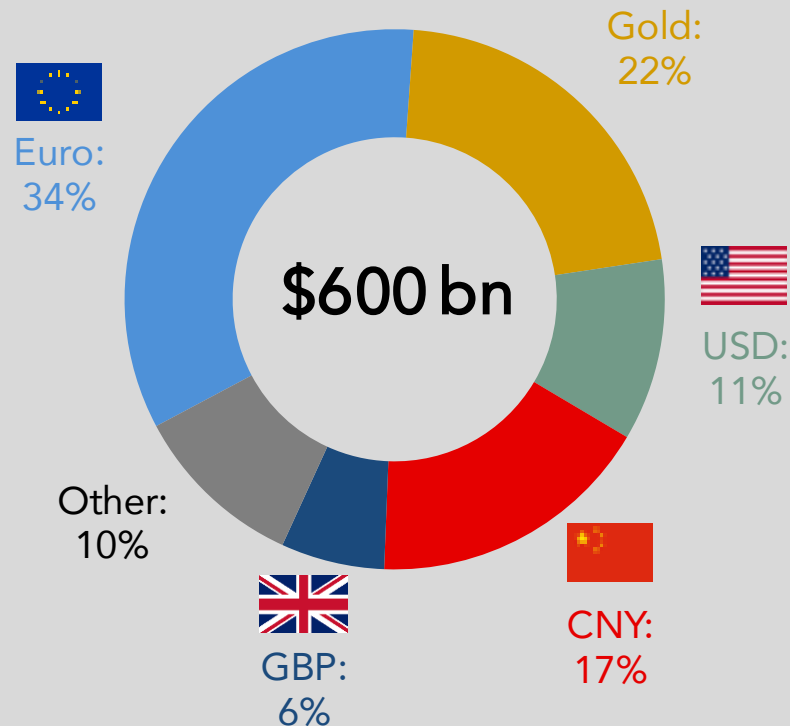


Source: (1) Commerce Department. Includes entities and sub-entities but removes duplicate entities. Entities added to the list multiple times are included from their first effective date. Excludes entities with no specified effective date. Data through December 2023. China figures include Hong Kong. Undated entries excluded.

# Targeting Russia's \$600 Billion of FX Reserves

Russia has confirmed that approximately \$300 bn of its global FX reserves have been frozen by the West, much of it in Europe (and in particular, in Belgium with clearing house Euroclear). The KSE Institute estimates that, as of June 2023, damage to Ukraine's real estate, infrastructure and economy have risen above \$250 billion in aggregate (nearly 15% of Russia's GDP and nearly half of their outstanding FX reserves). With taxpayers across Europe and the US sensitive to increased Ukraine financial obligations, targeting Russia's FX reserves represents both opportunity and risk (legal, precedent, capital flow exodus) for Western policymakers.

Central Bank of Russia foreign exchange and gold assets



Source: (1) Statista, "Distribution of Foreign Exchange and Monetary Gold Assets of the Central Bank of Russia." January 2022 data. World Bank.



## **2 *Geostrategic Realignment***

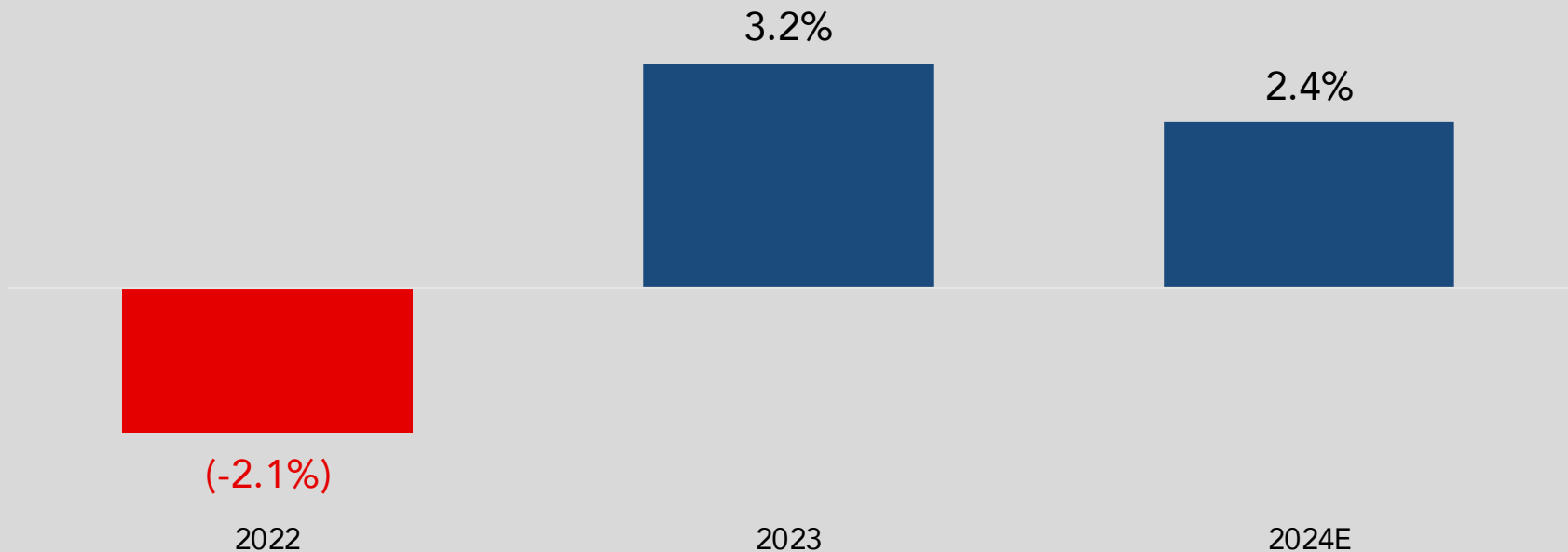


# Russia's Wartime Economy



Following Western sanctions and export restrictions, Russia's economy contracted more than 2% in 2022. However, fueled by increased war-time spending and an effective redirection of its energy and trading partnerships (most notably, with China), Russia's economy expanded more than 3% in 2023, and is expected to grow 2.4% in 2024.

Russia GDP growth, y/y



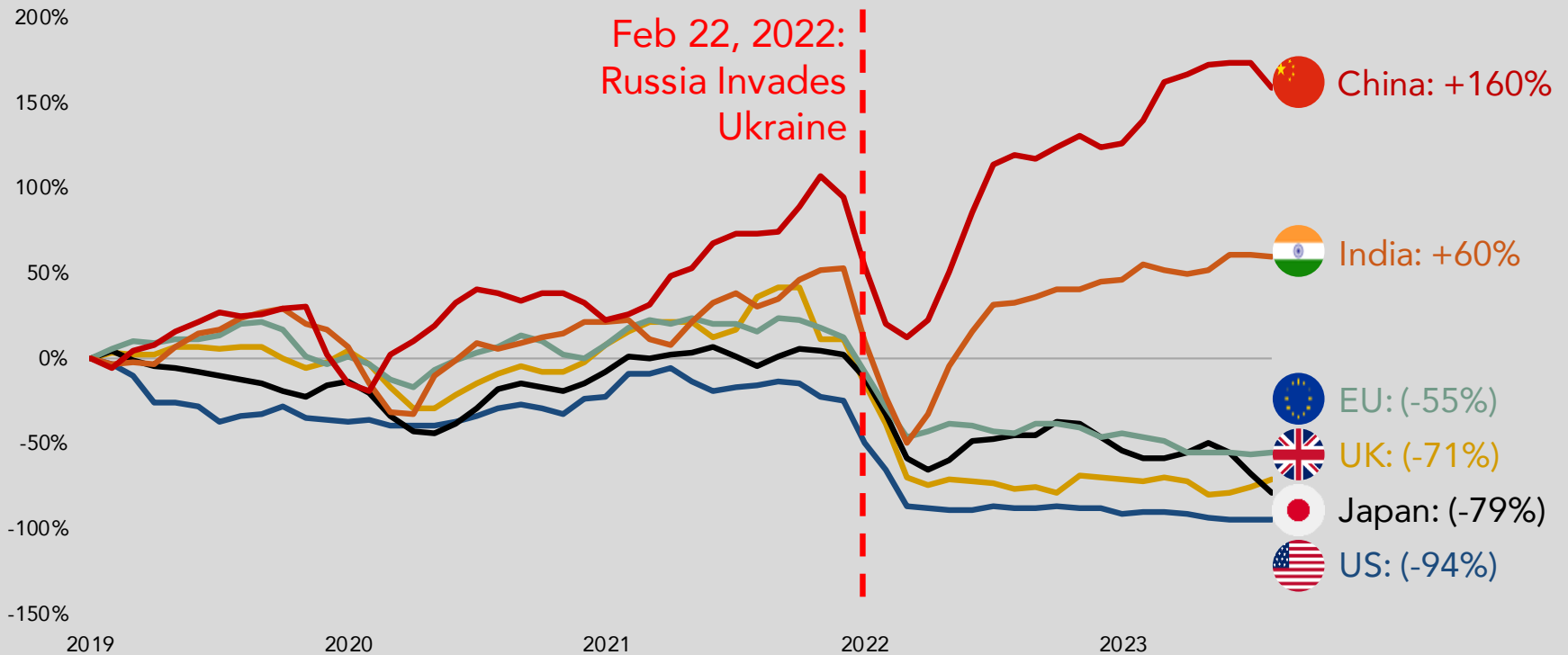
While Russia's economy recorded solid growth in 2023, the US Treasury Department estimates that Russia's economy is nearly 5% smaller than its pre-invasion forecasts.

Source: (1) Oxford Economics. Data as of February 23, 2024.

# Russia Rapidly Redirected its Trade Flows

More rapidly than anticipated, Russia redirected nearly all of its pre-war trade flows with the US, Europe and Japan to China, India and numerous emerging markets. Notably, China's RMB as a share of Russian export settlement has increased from 0.4% in January 2022 to 36% today. Russia has also benefited from a large global network of shipping companies, insurers and energy companies that do not adhere to Western legal frameworks and architecture.

Change in exports to Russia since Q1 2019

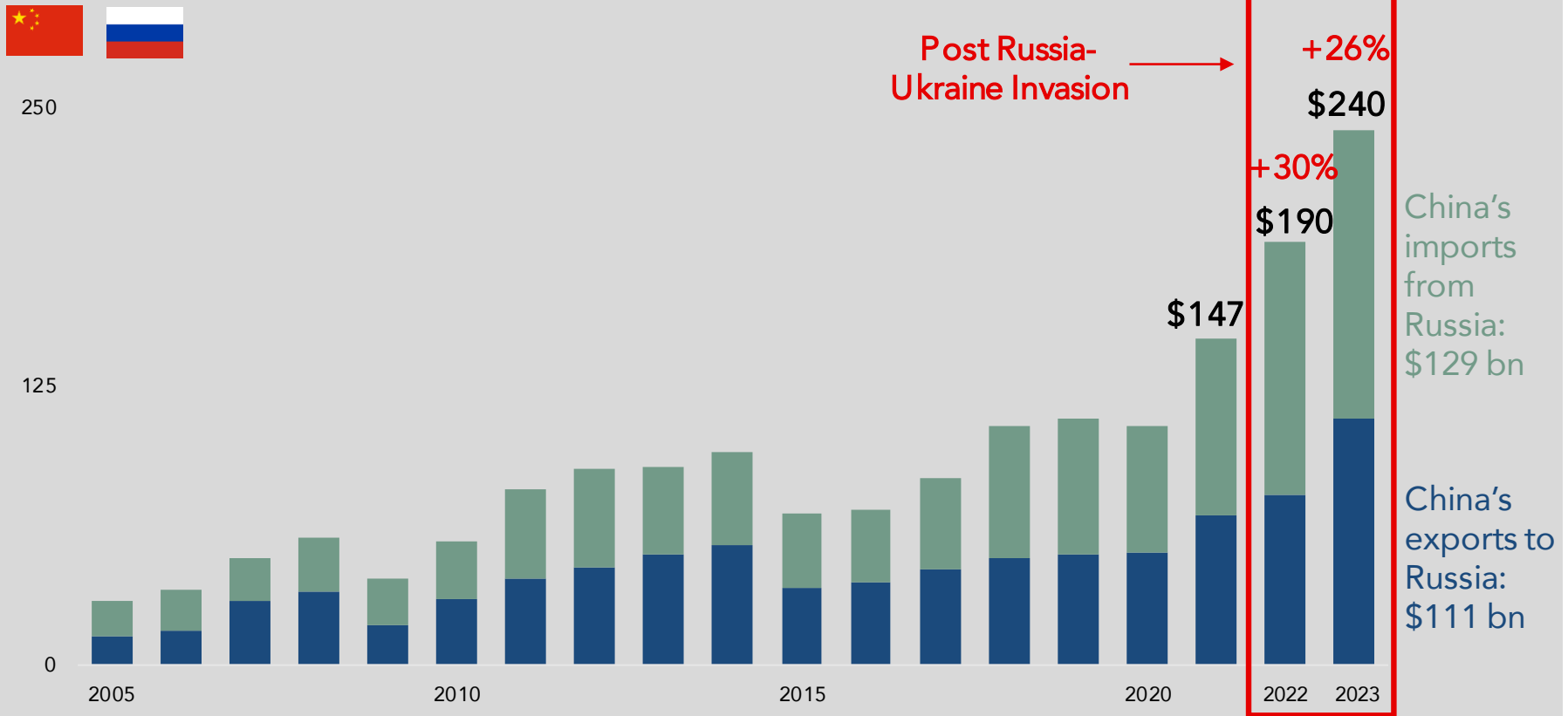


Source: (1) Bloomberg. Data as of February 23, 2024. IMF World Trade. China trade data is from the Customs General Administration PRC.

# Sino-Russian Trade Flows Rising

Weeks before the invasion, China and Russia announced a strategic partnership with “no limits.” Driven by a deliberate geo-strategic realignment, Sino-Russian trade flows have surged since the Ukraine invasion two years ago. The record volumes of 2023 were driven by increased trade in energy, electronics, industrial and military components.

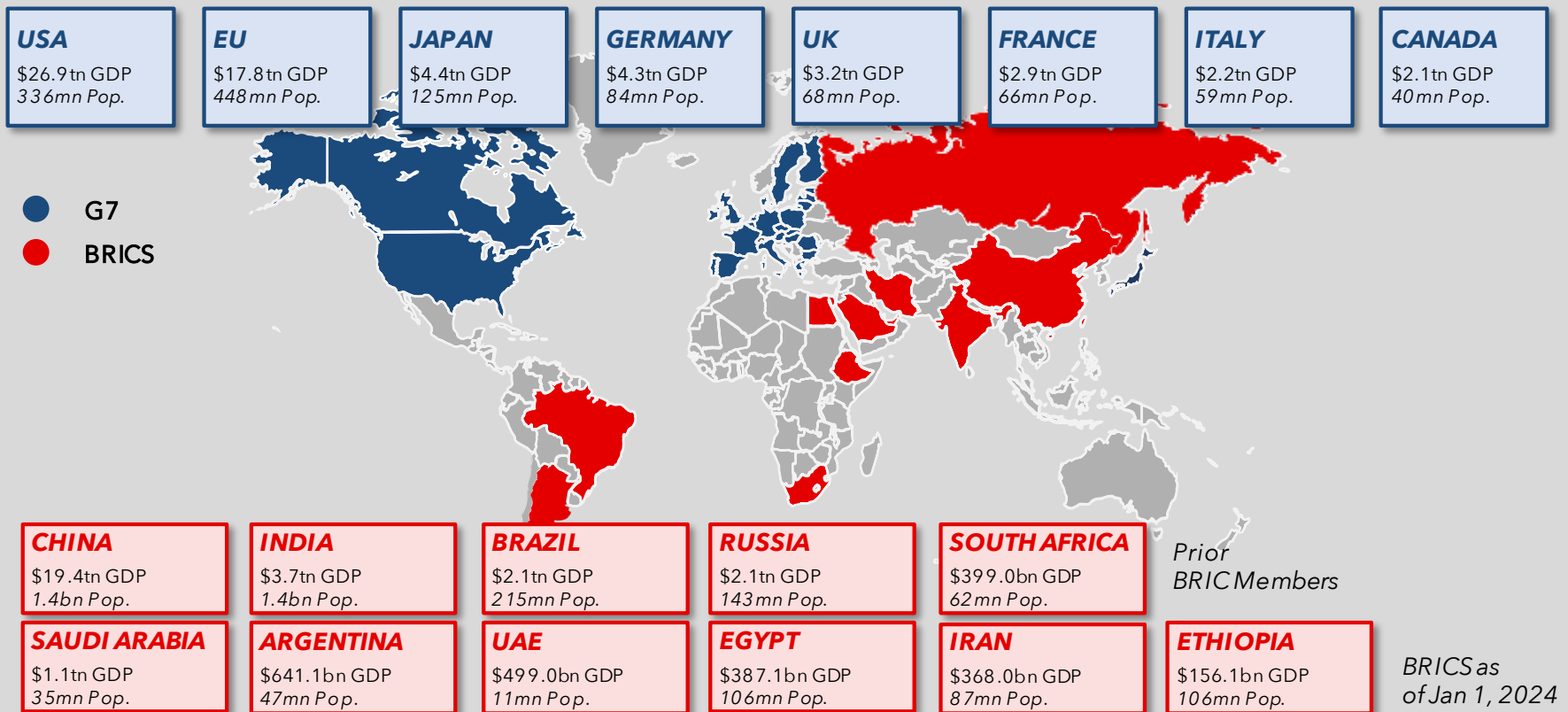
China's imports & exports with Russia, USD bn



Source: (1) Bloomberg, "Taiwan is not ready for a war with China: Balance of Power." China's General Administration of Customs. Year to date calculated through November. Commerce Department.

# Sino-Russian Pivot to Global South

The BRICS economic group expanded in January 2024 with 6 additional members in “Phase 1” of a multi-year expansion process. The expanded 11 member group, with an enlarged presence across the Global South, accounts for 29% of global GDP (37% on a PPP basis), and 46% of the world’s population. The expanded bloc, which will meet again in Kazan, Russia in October 2024, seeks to offer an alternative to the post WW2, Western-dominated, global financial and economic architecture.



\*By convention, although the EU is a member of the G7, only GDP of Germany, France and Italy is included in aggregate G7 GDP statistics.

Source: (1) IMF. World Economic Outlook Database. 2023 estimates. GDP in USD based on GDP in national currency converted to USD using market exchange rates.



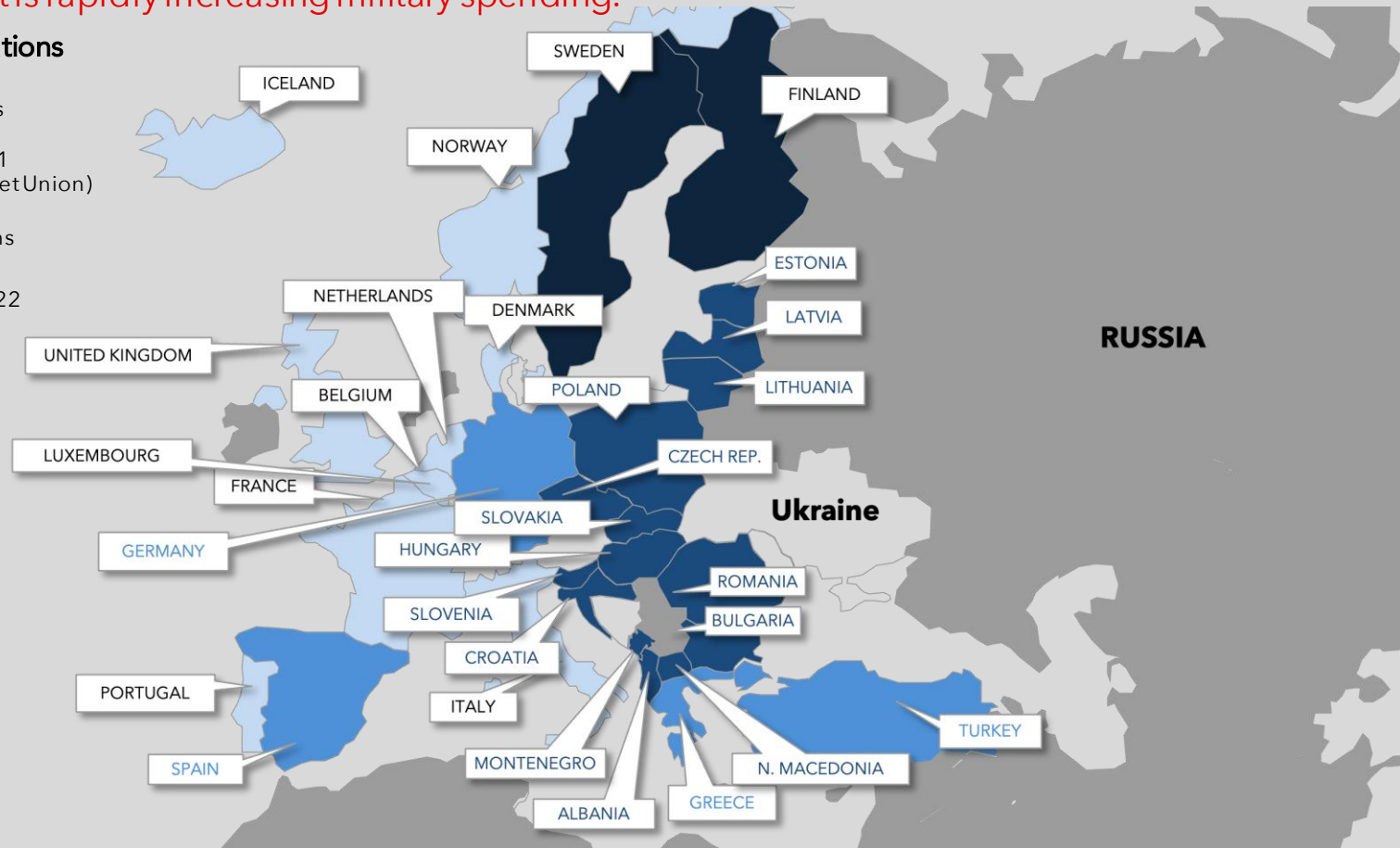
# Reinvigorated NATO Expansion



In a strategic miscalculation, Russia's invasion of Ukraine precipitated an overnight "resurrection" of NATO's strength, commitment and membership that was largely unanticipated prior to the war. Following resolution of its 19 month diplomatic struggle with Hungary, Sweden is now following Finland as the 32nd country to join NATO in a reinvigorated regional security partnership that is rapidly increasing military spending.

## NATO Member Nations

- Founding Members
- Members as of 1991  
(Dissolution of Soviet Union)
- 1991-2021 Additions
- Additions Since 2022



Source: NATO. Note: Map excludes NATO members, the US & Canada \*Sweden ratification imminent.

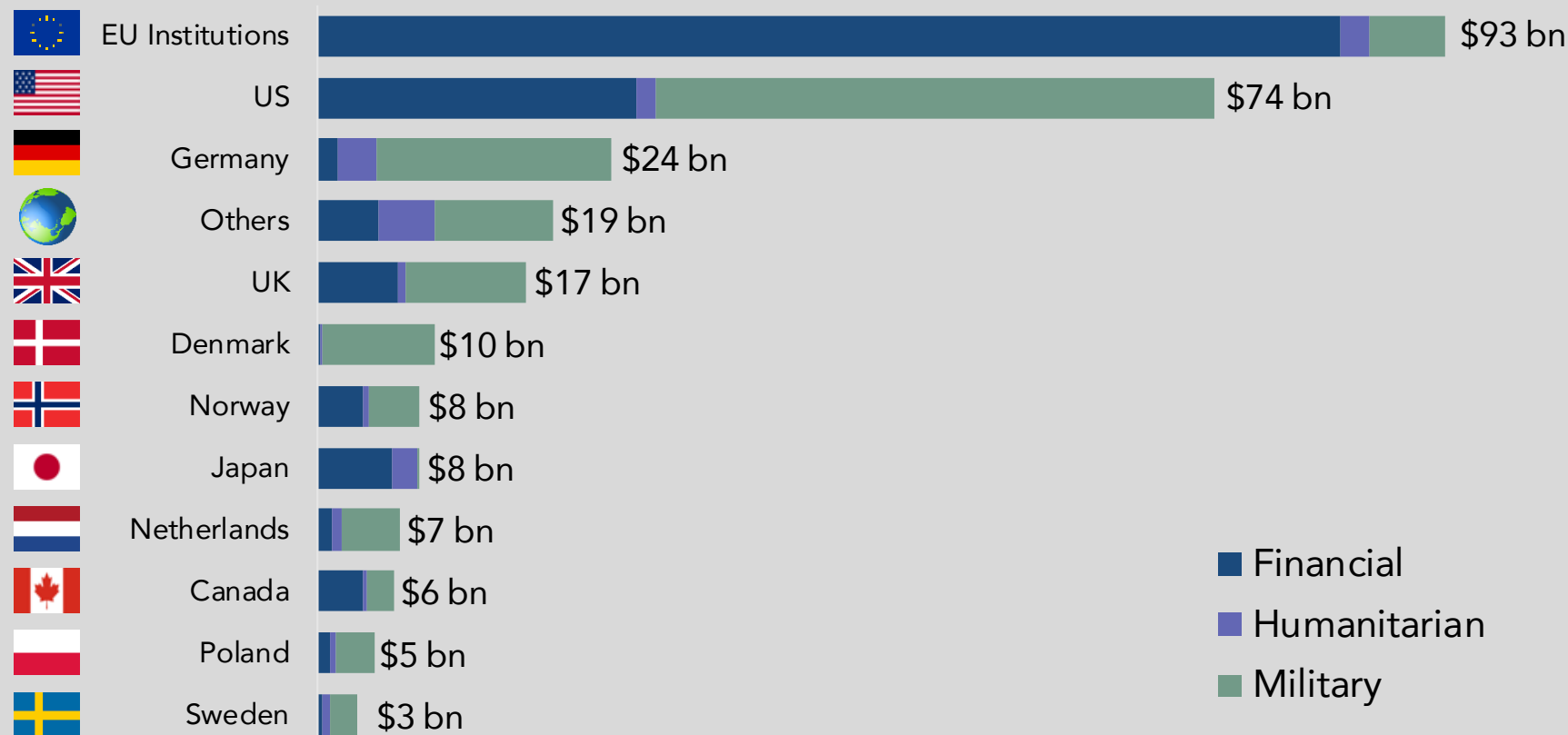


# **3 *Resurgent Global Military Spending***

# Military & Financial Aid to Ukraine

With its economy devastated by war, Ukraine has become entirely dependent on Western financial and military support that becomes more complicated with time. In the US, political support for large financial outlays have become more divisive, while Europe's capacity for military support (i.e., ex-financial) has substantive physical limitations.

## Commitments to Ukraine, USD bn

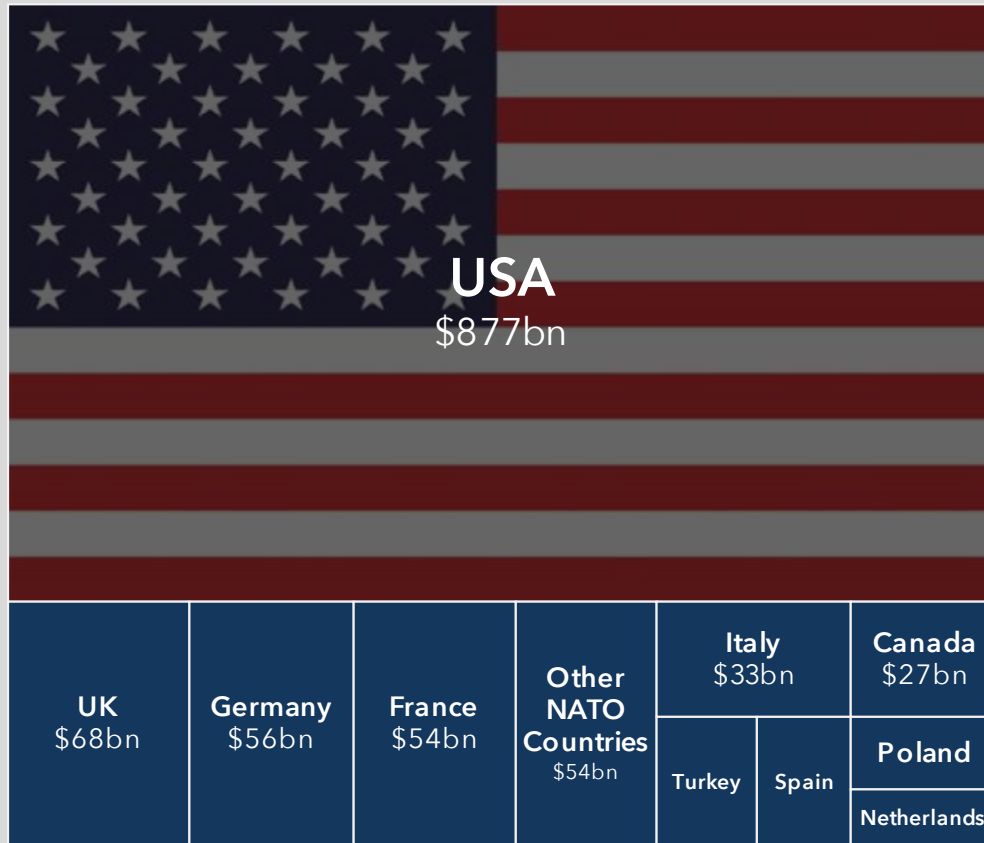


Source: (1) Kiel Institute for the World Economy. Note: Includes commitments from January 24, 2022 through January 15, 2024. EUR/USD calculated using January 15 close.

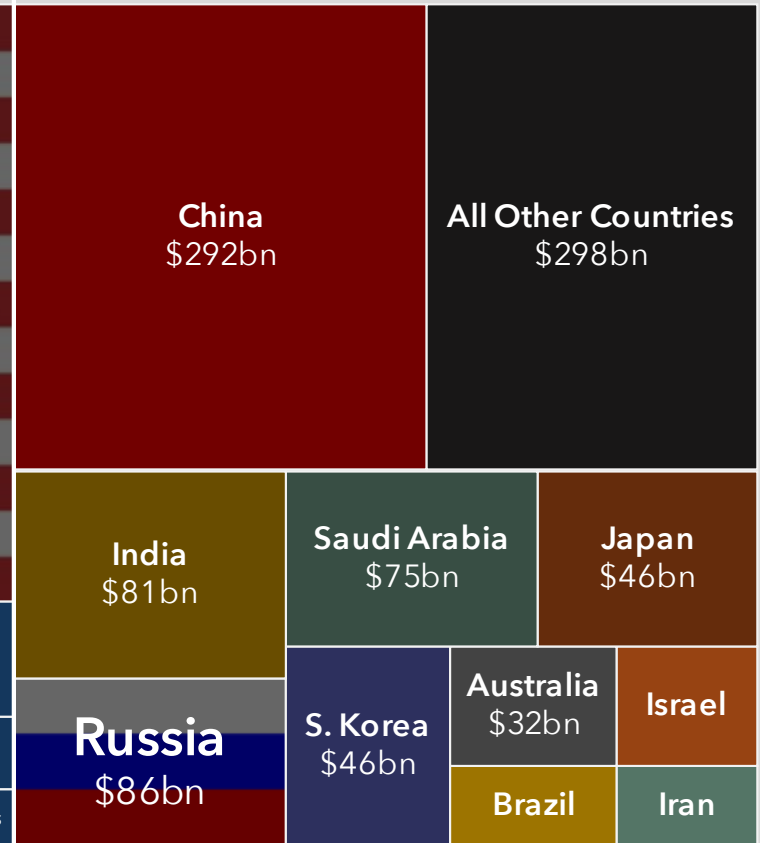
# Global Defense Spending

While a US military response to the Ukraine crisis is not "on the table" for both strategic and security reasons, it is worth noting that annual US military spending is more than 10x that of Russia - an observation perhaps secondary to the more important point that both countries are leading nuclear powers

**Total NATO: \$1.2 trillion**



**Rest of the World: \$1.0 tn**



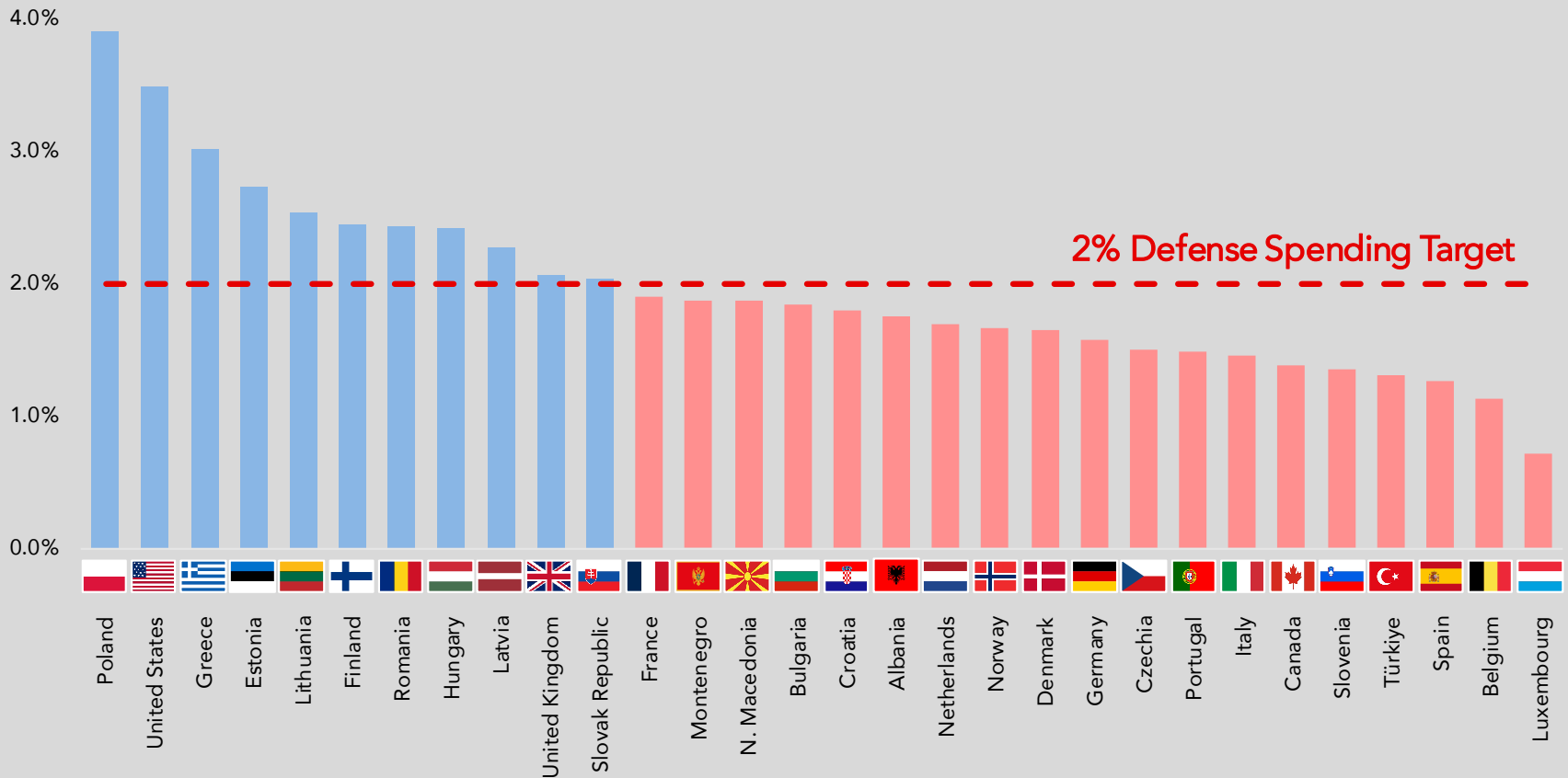
Source: (1) Stockholm International. Peace Research Institute. 2022 data in USD at current prices and exchange rates.



# NATO Defense Spending Commitments Rising

NATO defense spending declined sharply after the Soviet Union's dissolution in 1991, but began to rise sharply following Russia's 2014 and 2022 invasions of Ukraine. 18 NATO members are expected to meet the 2% of GDP military defense spending targets in 2024, up from 11 countries today and just three in 2014.

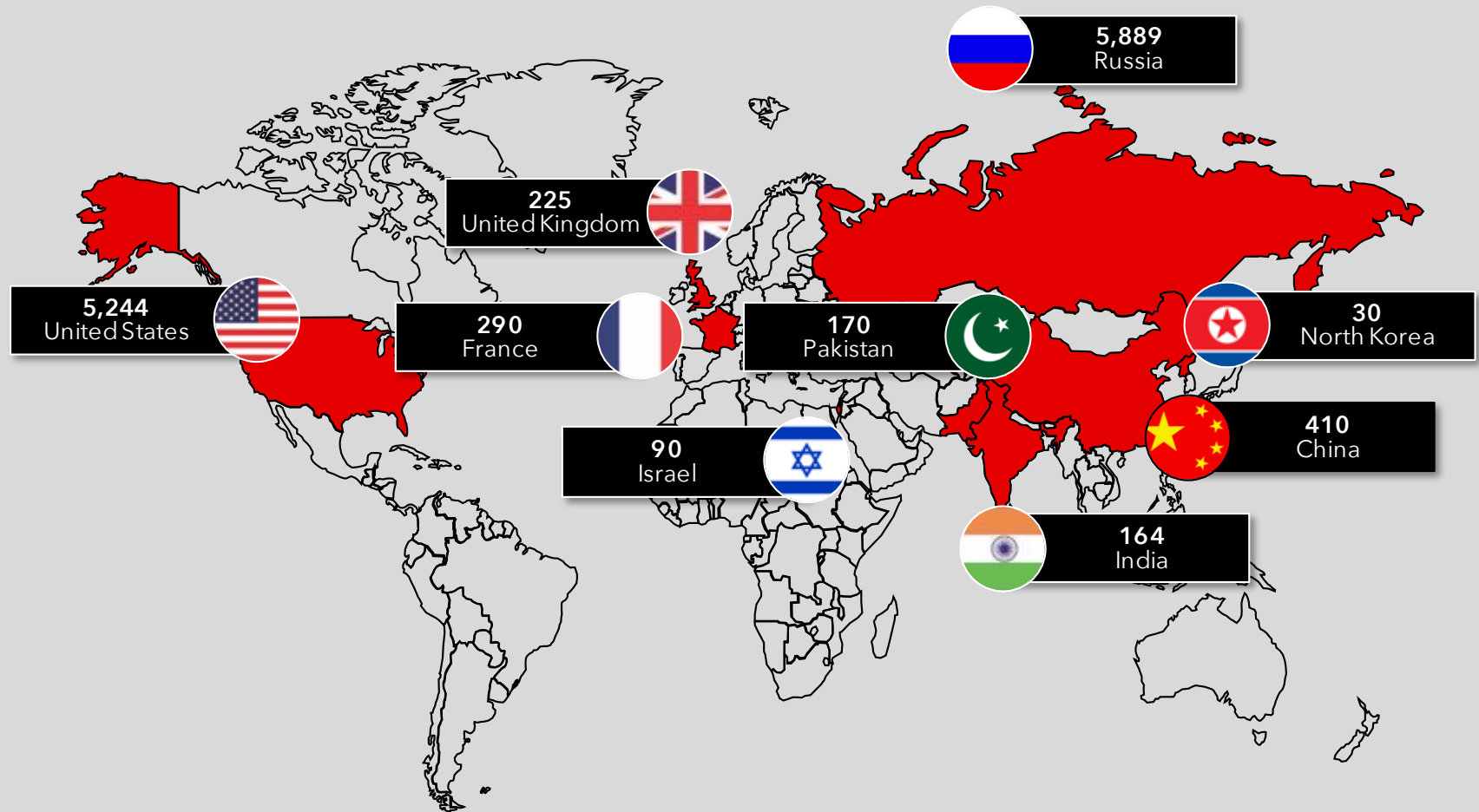
NATO country defense expenditure as a share of GDP



Source: (1) Data based on information provided on NATO's website, calculated as of July 7, 2023. Bloomberg Economics.

# The World's Nuclear Arsenal

Global nuclear warhead inventory, by country



Source: Arms Control Association. Estimated June 2023 warhead inventories. US Department of State, and the SIPRI.

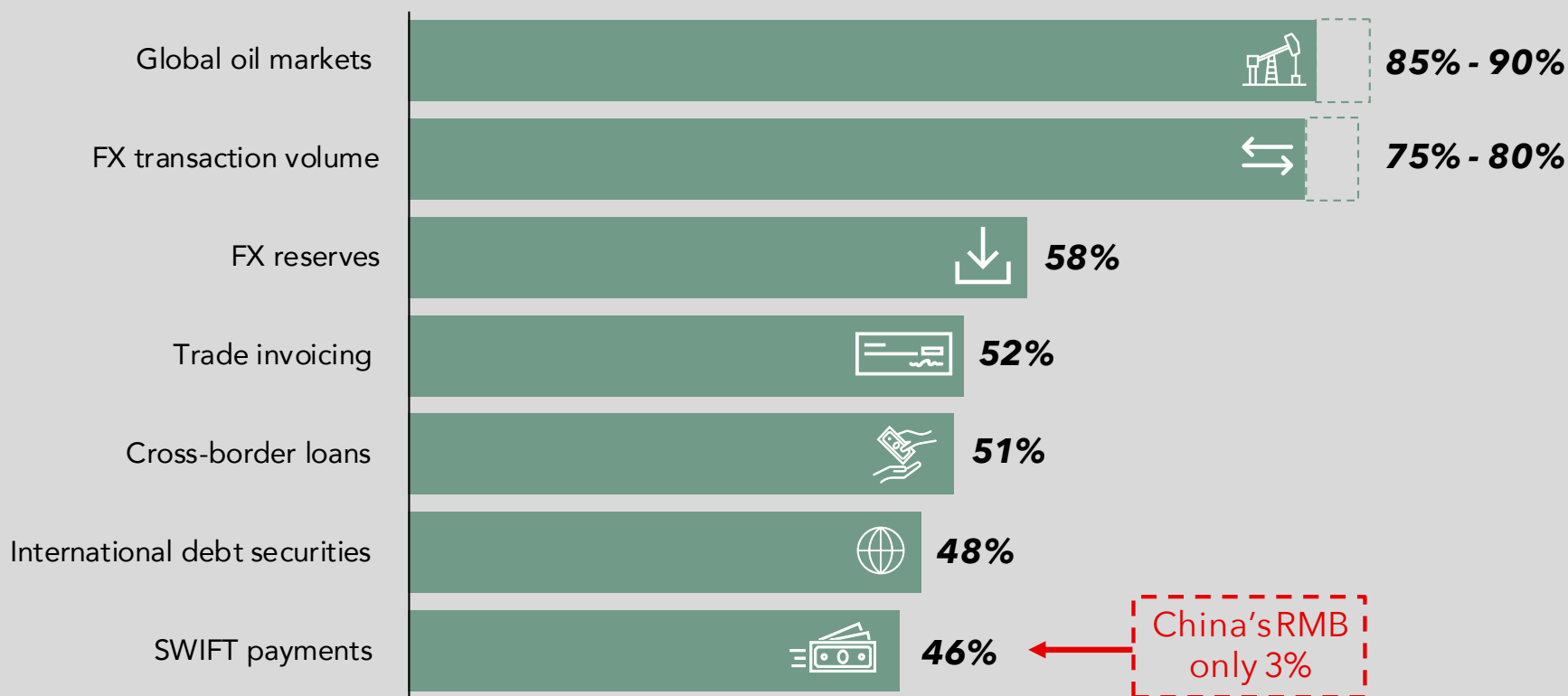


# ***4 Limited Contagion to Global Markets***

# Modest De-dollarization Since 2022

More than 50 years after President Nixon closed the door on Bretton Woods, the US dollar continues to play a dominant role in the global financial system. While global geo-political realignments since Russia's invasion of Ukraine have been significant, de-dollarization and multi-currency settlement across selected markets have been relatively modest over the past two years.

## USD share of global markets (2023)



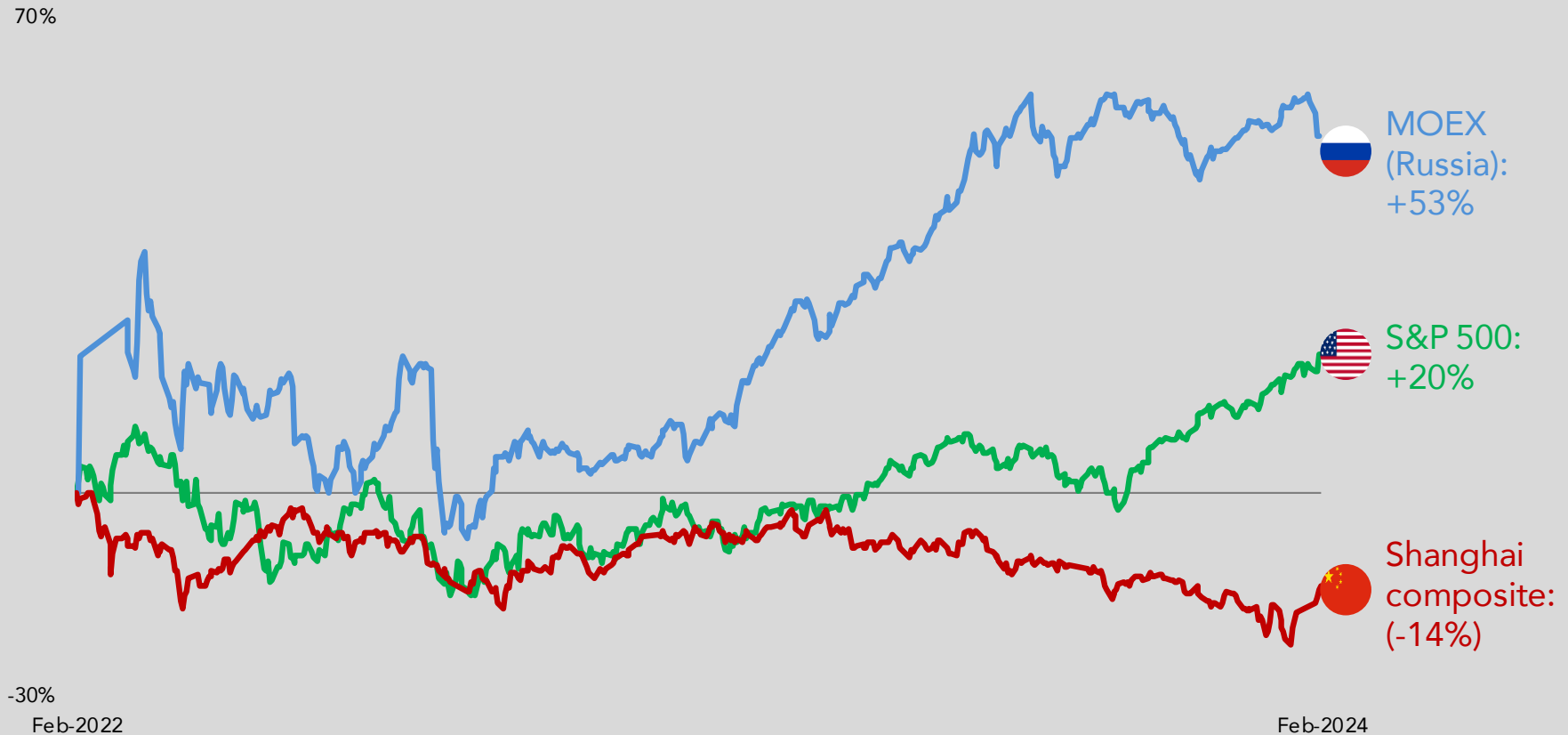
Source: (1) BIS, "The Global Foreign Exchange Market in a Higher-Volatility Environment" (December 2022). G Gopinath, "The international price system", NBER Working Papers, no 2164, 2015; IMF; Bloomberg; CPB World Trade Monitor; SWIFT; BIS debt securities statistics; BIS locational banking statistics; BIS Triennial Central Bank Survey. Foreign Affairs ("Great Powers Don't Default: The Dangers of Debt Ceiling Brinkmanship" by Matt Pottinger and Daleep Singh)



# Russian Equities Outperforming

Driven by a rebounding “war-time” economy and trapped domestic retail investors with “nowhere else to go”, Russian equity markets have outperformed the much larger, more liquid stock exchanges in the US and China since the Ukraine invasion two years ago.

Equity market performance since Feb 23, 2022

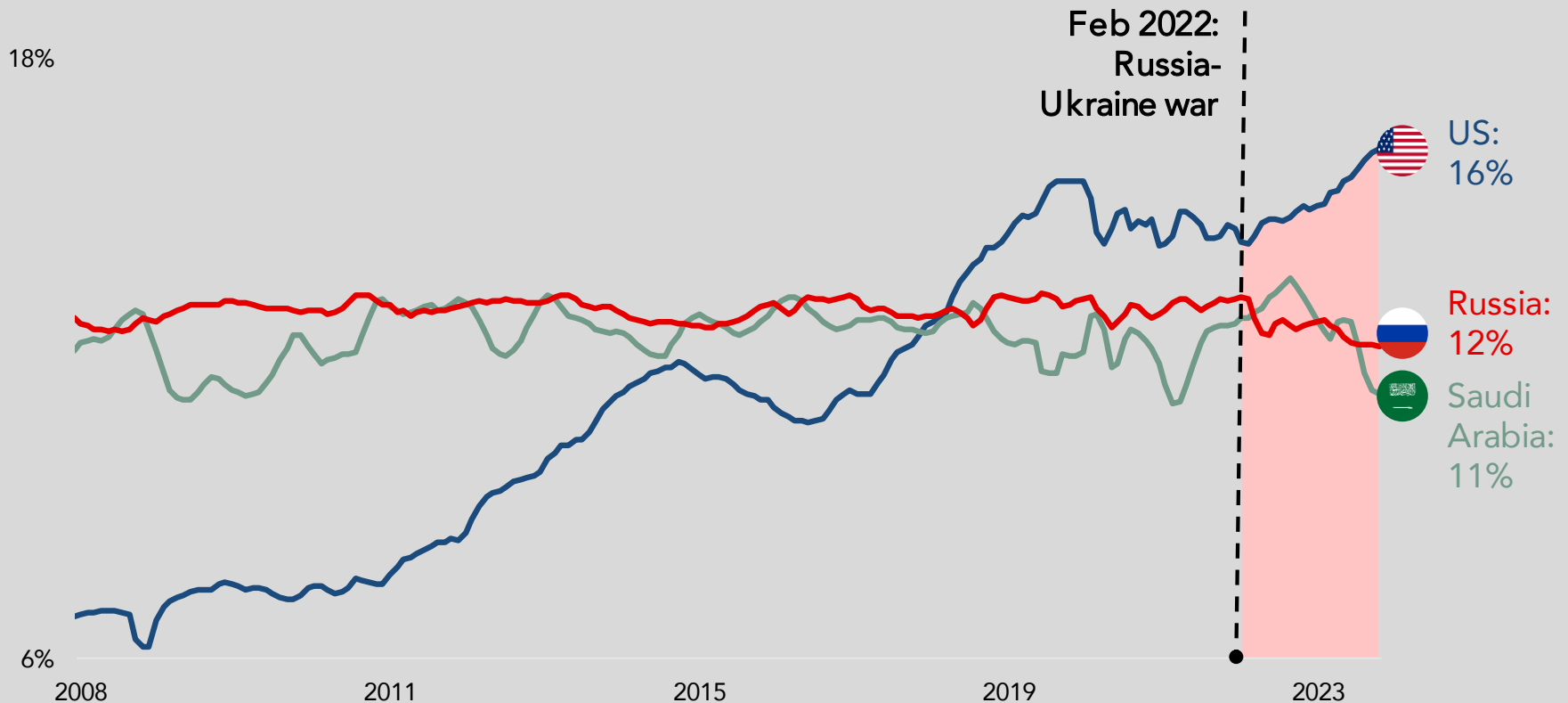


Source: (1) Bloomberg. Data as of February 23, 2024.

# Surging US Oil Production

Over the last two years, the US has expanded its formidable leadership in global oil production, accounting for more than 13 m/b/d and approximately 16% of global supply. Increased US production and relatively stable Russian supply have been important drivers of the decline in energy prices, even as OPEC scales back production and the West tightens its grip on Russian sanctions and export controls.

Oil production as % of world total

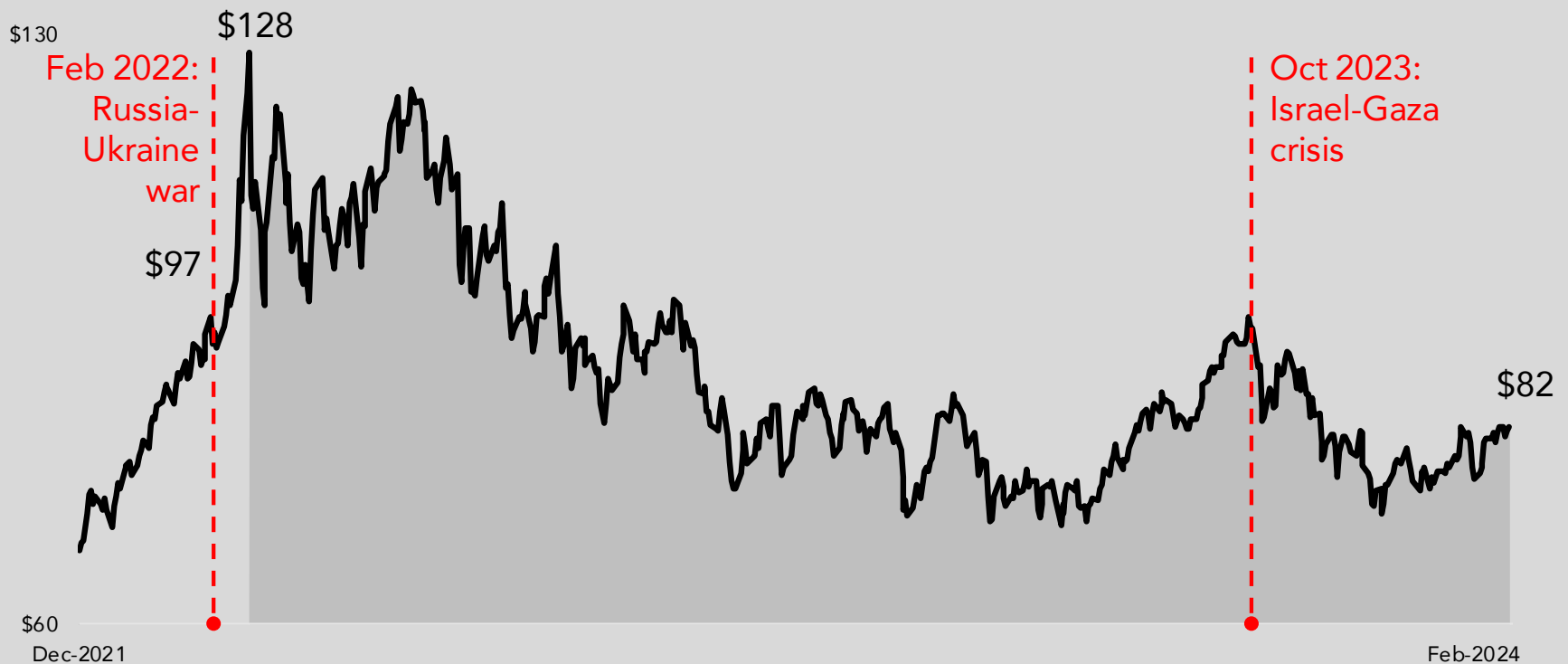


Source: (1) Bloomberg. Data through October 2023. EIA. 3 month moving average.

# Counterintuitive Decline in Oil Prices

After initially surging following Russia's Feb 2022 Ukraine invasion, oil prices have declined markedly over the last two years, even as geopolitical risk remains elevated. Surging US production, stable Russian outflows and softer China demand have all been contributing factors. While Middle East tension has escalated sharply since October, oil transport out of Iran and GCC countries in the Persian Gulf continues largely uninterrupted as shipping disruptions have been largely concentrated on the opposite side of the Saudi peninsula, by the Gulf of Aden and Red Sea.

Brent oil prices since Dec 2021



Source: (1) Bloomberg. Data as of February 23, 2024.

# Europe's Rapid Reduction in Russian Gas Dependencies



Following a post invasion surge in EU gas prices in the summer of 2022, the rapid decline in EU nat gas prices proved critical to the performance of Europe's economy over the last two years, as well as its energy security architecture. The speed of Europe's pivot was impressive, and was aided by: (i) rapid domestic installation of LNG terminals; (ii) resurgent US production and LNG exports; (iii) China's COVID lockdown and subsequent economic under-performance; (iv) disciplined EU domestic consumption restrictions, (v) a sluggish manufacturing sector, and (vi) warmer winter temperatures.

## EU natural gas prices since Dec 2021

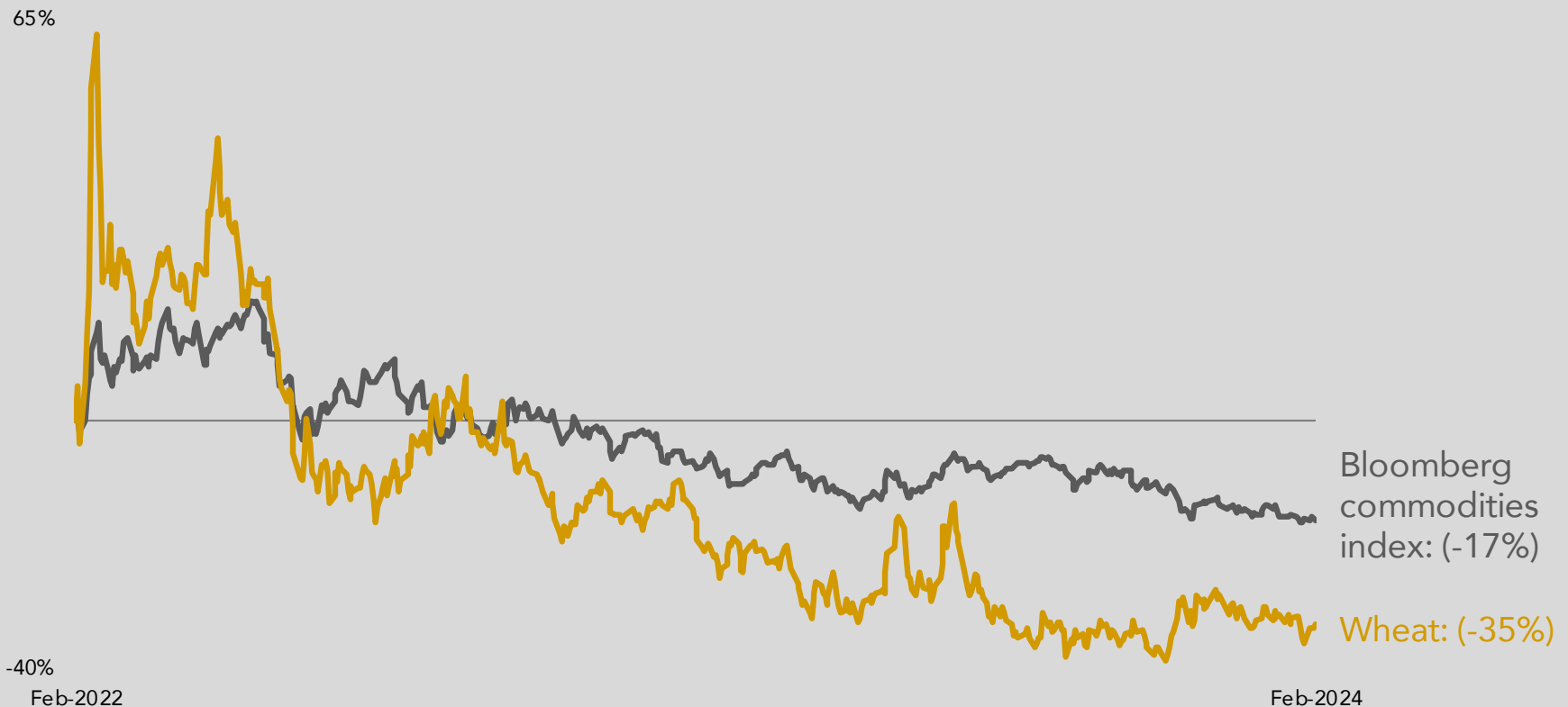


Source: (1) Bloomberg. Data as of February 23, 2024.

# Unexpected Decline in Global Wheat Prices

Remarkably, although Ukraine has been known as “the bread basket of Europe”, wheat prices have actually declined by 33% since the war began two years ago. Contributing factors include: Russian wheat production well above its 5 year average, record Russian wheat exports (world’s largest wheat exporter) and softer global demand.

Bloomberg commodities index and wheat performance since Feb 23, 2022



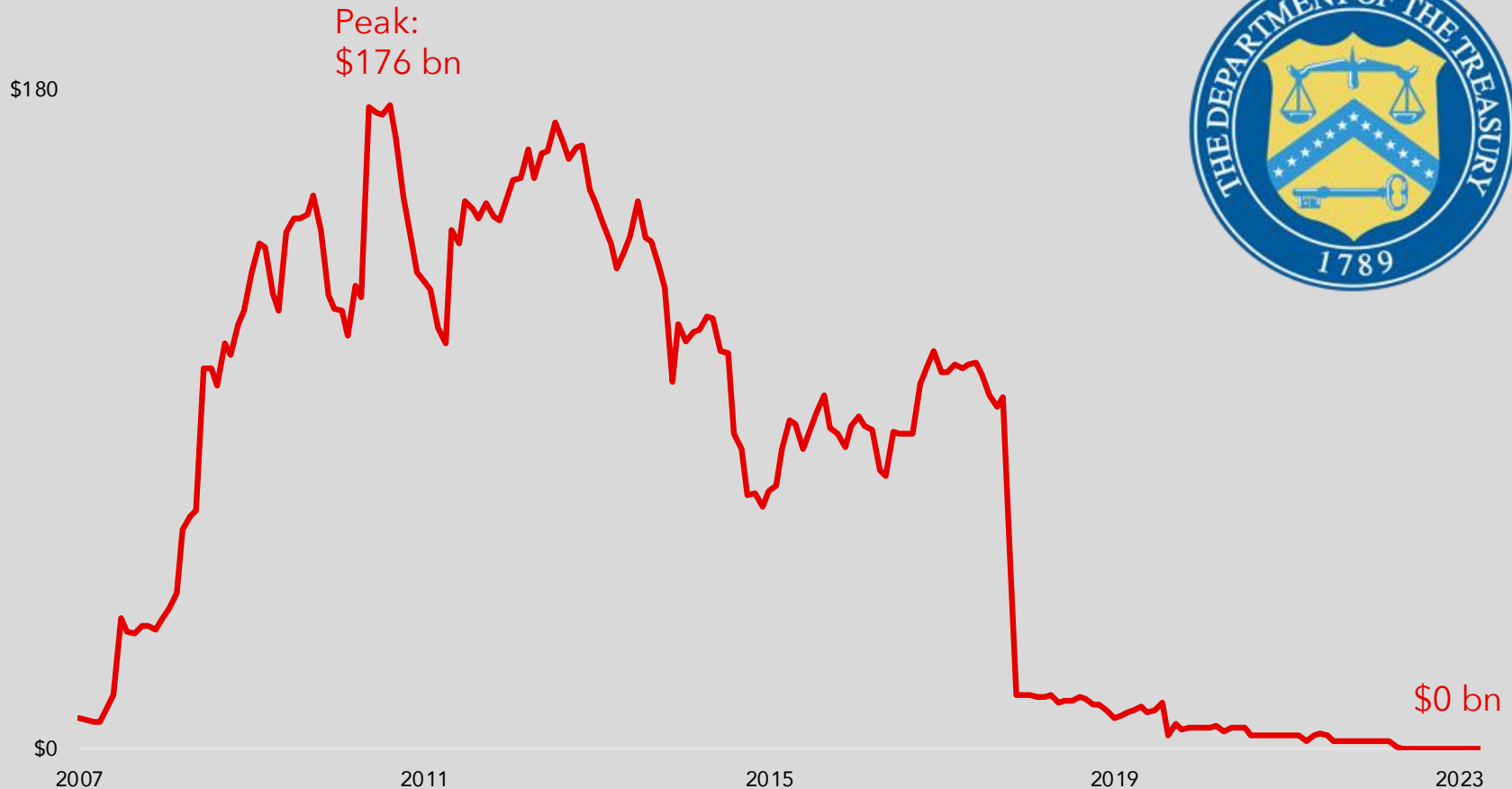
Source: (1) Bloomberg. Data as of February 23, 2024.

# Virtually No Impact to USD Credit Markets



As of 2021, just 16% of Russia's central bank reserves were in US dollars, down from 40% four years earlier. In order to reduce US dollar exposure, Russia has reduced its holdings of US Treasuries by 98% from peak in 2010.

## Russia's ownership of USTs (USD bn)

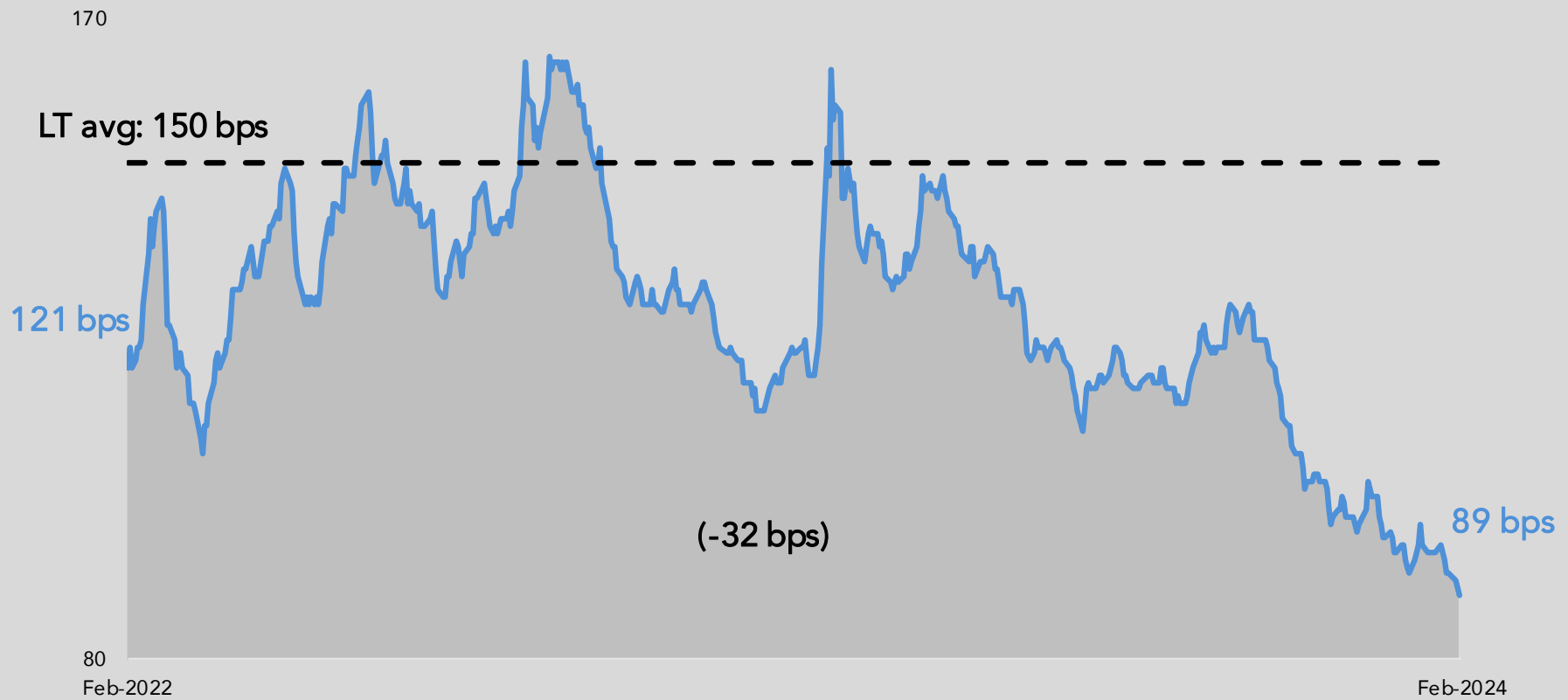


Source: (1) Bloomberg, "Russia's Yearlong Quest to Quit Dollar is Blunting Sanctions". Data as of February 23, 2024.

# Virtually No Impact to USD Credit Markets

In 2024, USD IG credit markets have outperformed expectations from both a fundamental and technical perspective. After the strongest January IG issuance month on record, February volumes have already outperformed full-month expectations. IG credit spreads have also traded well inside long-term averages this year with the IG index, BBB and single-A spreads all touching new YTD lows of 94 bps, 118 bps and 51 bps, respectively.

## USD IG OAS



Source: (1) Bloomberg. Data as of February 23, 2024.

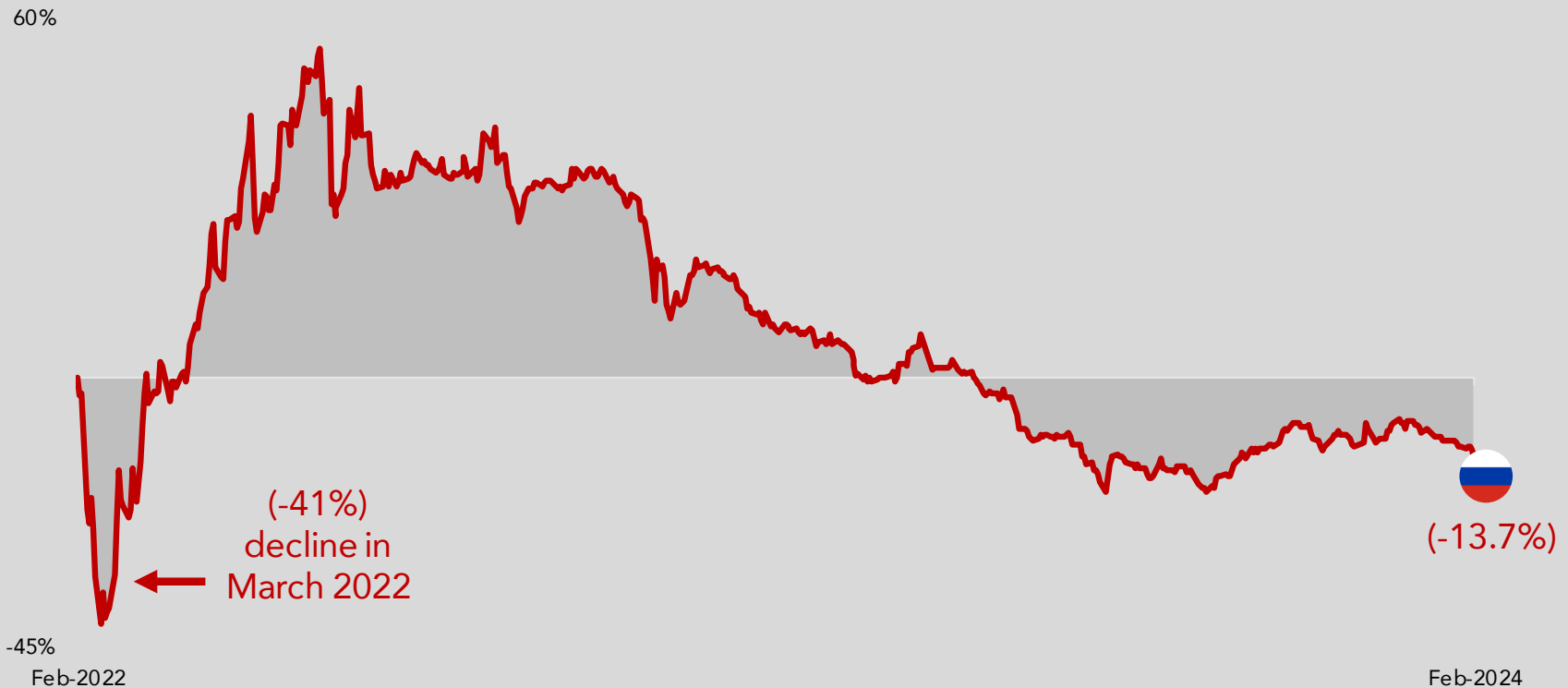


# Ruble Depreciation



Following a 41% decline in the months after Russia's invasion of Ukraine, strict capital controls and higher energy prices drove the ruble up over 50%. While Western sanctions, lower Russian exports and higher imports challenged the ruble in 2023, it has been one of the best performing EM currencies in 2024. Domestic policymakers have taken action to provide more currency support ahead of the upcoming March 15-17 Russian presidential election.

## Ruble vs. USD performance since Feb 23, 2022



Source: (1) Bloomberg. Data as of February 23, 2024.

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### Role

Tom Joyce is a Managing Director and Capital Markets Strategist within MUFG's global capital markets and investment banking business. Based in New York, Tom heads a team that creates customized analytical content for multi-national S&P 500 companies. His team provides in depth analysis on the impact of economic, political, public policy and regulatory dynamics on the US credit, foreign exchange, rates and commodities markets.

### Experience

Tom has over 25 years of Investment Banking experience in New York, London, Hong Kong, and San Francisco. Over the last 15 years, Tom created and built the Capital Markets Strategy role, advising corporate C-Suite executives (Boards, CEOs, CFOs, and Treasurers) on the pervasive macro forces driving markets. Tom also presents at dozens of corporate events each year including Board meetings, CEO ExCo sessions, CFO and Treasury off-sites, corporate leadership events and conferences.

### Education

Tom's educational background includes a year of study at Oxford University from 1991 - 1992, a Bachelor of Arts in Political Science from Holy Cross College in 1993, and a MBA from Kellogg Business School, Northwestern University in 2000.

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### Experience

Hailey has a decade of Wall Street experience, including three years as a Consumer Sector Specialist in Equity Sales and seven years as a Capital Markets Strategist. Hailey is also a member of MUFG's Inclusion & Diversity Council and has devoted years to participating in and developing Wall Street recruiting programs.

### Education

Hailey graduated with honors from the University of Michigan's Ross School of Business with a BBA and a minor in International Studies.

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### Experience

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### Education

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### Personal

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### Experience

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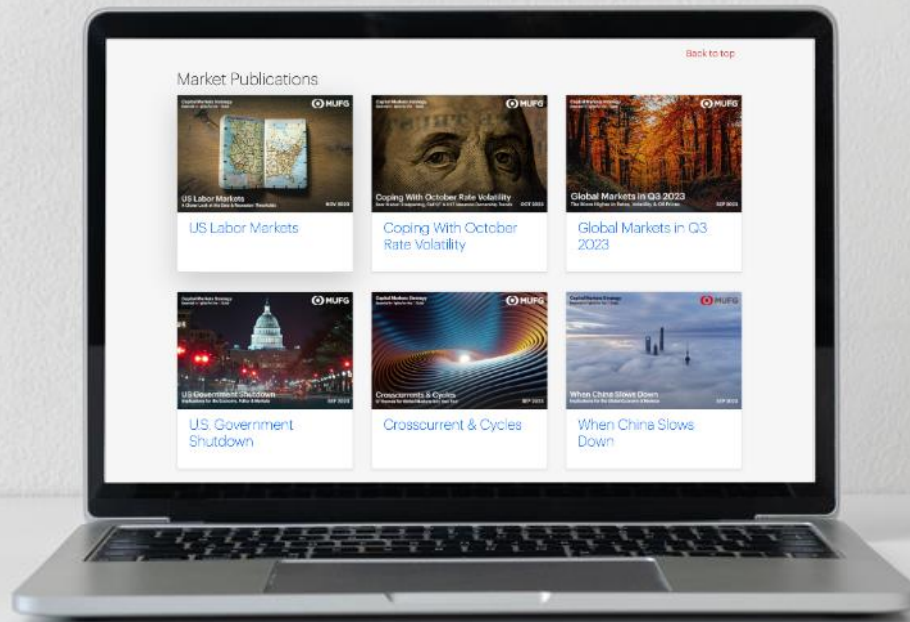
### Education

Angela graduated with honors from Carnegie Mellon University's Tepper School of Business with a BS in Business Administration with an additional major in Statistics and a minor in Media Design. She was a member of Alpha Kappa Psi business fraternity and the Undergraduate Entrepreneurship Association.

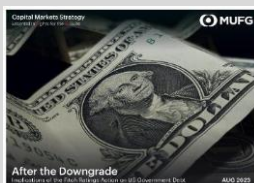


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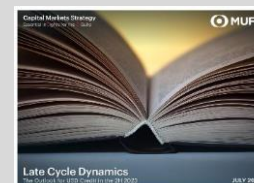
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