Special Report

Navigating the Russia-Ukraine Crisis

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Navigating the Russia-Ukraine Crisis

- The Russia-Ukraine Crisis has shaken global markets and fired up commodity prices.
- The barrage of sanctions imposed on Russia will have far-reaching effects on the Russian economy as well as global trade and finance.
- Historically, wars have always been followed by periods of economic boom and certain sectors have been impacted more than the others.
- We discuss the sanctions imposed by developed countries and their impact on key sectors such as Oil & Gas, Aerospace & Defense, Metals & Mining, Agriculture, Auto, Semiconductors, Chemicals, Banks and Commercial Aviation.
- We also analyze in detail the impact on sectors including Banking, Oil & Gas and Global Auto Sectors that have significant operations in Russia/Ukraine.

Major Sanctions on Russia

EU

- Excluded 7 Russian banks from using **Swift messaging system** for global transactions
- Banned EU investors from trading in **Russian State bonds**
- Certification process of **Nord Stream 2 gas pipeline** project put on hold by Germany
- Shut down **airspace** facility for Russian aircraft
- Sanctioned goods that can be used for **military** purposes
- Blacklisted prominent **Russian individuals** including Russian President

US

- Restricted Americans from dealing with the **central bank and finance ministry of Russia**
- Imposed restrictions that will remove **Russian banking assets** from the US
- Export controls that restrict Russian access to goods required for **military**
- Sanctions on **energy and defense sector** for import/export and debt-raising
- Sanctions on the company building **Nord Stream 2** project
- Closed **airspace** for Russian planes

UK

- Barred Britain from transacting with **Russian central bank, finance ministry, and wealth fund**
- Sanctioned **Russian companies** to deal in financial instruments in the UK
- Barred **Russian banks** from accessing sterling and clearing payment system
- Established **export controls** on technical equipment in the electronics, telecom, and aerospace sectors
- Restricted **Russian nationals** from holding deposits up to 50,000 pounds in UK banks
- Banned Russian planes from using its **airspace**

Others

- **Japan** has enforced limits on transactions with the Russian central bank and suspended visa issuance for Russian individuals and entities. It also enacted export controls on semiconductors and high-technology products
- **Canada** has imposed limits on transactions with the Russian central bank as well as export controls on semiconductors and high-tech products. It has suspended visa issuance for Russian individuals and entities
- **Australia** has put sanctions on Russian elite citizens and law-makers

Impact on Various Sectors

Sector	Impact	Rationale
Oil and Gas	↑	The disruption in the supply of Russian oil and natural gas led to prices shooting up in both the markets, with crude hitting USD 130/barrel. Oil and Gas companies are expected to record strong cash flow in the medium term due to elevated prices and tight supply resulting from disruption in Russian oil and gas operations.
Aerospace and Defence	↑	Due to the ongoing war between Russia and Ukraine, the spending on military and defence budgets by other countries could increase. This will be positive for the aerospace and defence companies.
Metal and Mining	↑	Russia is a large producer of industrial metals, including aluminium, platinum, copper, and palladium. These metals will likely be in short supply during the military conflict, which will drive up prices. The bull run in the commodities that began after the onset of Covid-19 is likely to accelerate, leading to strong profits for metal and mining companies.
Agriculture	↑	Ukraine and Russia are important sources of global supply of agricultural commodities and account for 14% of the wheat supply and 25% of wheat exports globally. Russia is also a leading producer of soybean. The disruption of the agriculture business in these two countries will result in a tight supply, leading to price rise and food shortages.
Auto	↓	Production of automotive is curtailed by semiconductor shortages in the last two years. The shortage could increase in the near term due to anticipated disruptions of industrial gases from Ukraine and Russia. Further, the increase in metal prices coupled with the ongoing inflationary scenario could lead to hikes in the prices of vehicles which will impact demand.
Semiconductors	↓	The raw material shortage is going to worsen as Russia is a major supplier of palladium and Ukraine of neon gas which are essential components in the production of semiconductor chips.
Chemicals	↓	Russia is a major global exporter of fertilizers, mainly potash, phosphate, and nitrogen-containing fertilizers. The sanctions will adversely affect the sector worldwide. Moreover, high oil and gas prices and tight supply of key components used in chemical manufacturing could hit the margins of chemical producers.
Banks	→	European Banks are relatively more exposed than US and Japanese counterparts. We expect banks in all the three countries to see increase in provisioning towards potential write-down of assets. However, we do not expect any material credit impact for US and Japanese banks. Among European banks, RBI is the most exposed, followed by Unicredit and Societe Generale.
Commercial Aviation	↓	The closure of airspace for Russian planes by major economies and retaliatory measures by Russia will negatively impact the aviation sector. Additionally, due to these actions, flight routes could get longer, resulting in higher costs for the aviation industry, which remains battered by the covid restrictions in the last two years.

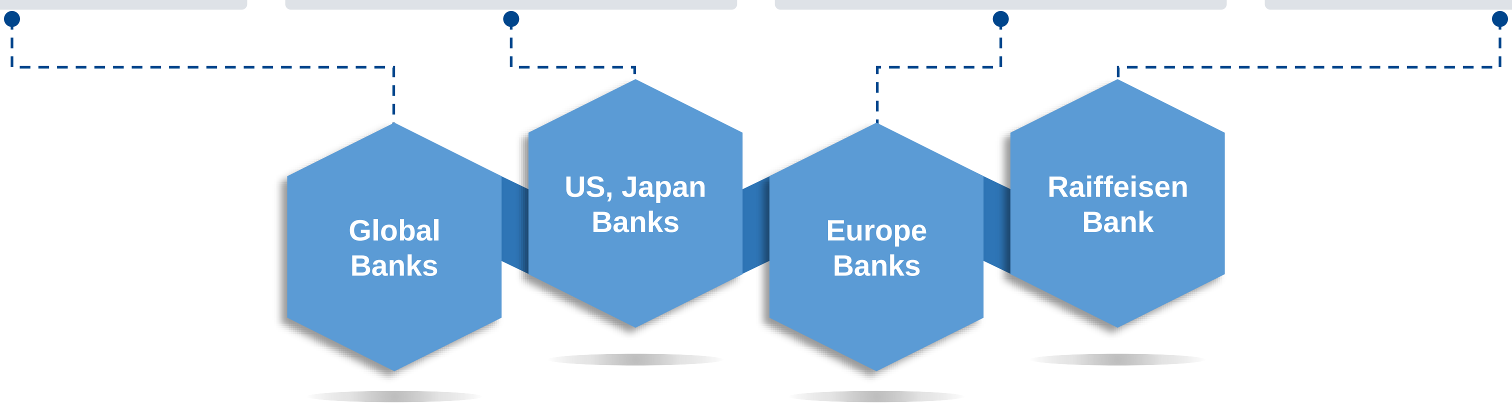
Impact on Banks

- **European Banks are relatively more exposed to Russia than US and Japanese counterparts**
- European, US and Japanese Banks' exposure to Russian sovereign and corporate debt amounts to approximately USD 110bn, USD 25bn and USD 12bn, respectively, as per Bank for International Settlements.
- **Banks in all three countries are expected to see increase in provisioning towards potential write-down of assets.**
- However, for US and Japanese banks the impact would be limited to a decline in upcoming quarters' profit.

- For Citigroup and MUFG, which have the highest exposure in US and Japan at USD 10bn and USD 1.9bn, a full write-down of exposure in Russia would account for 45% and 19% of annual profits, respectively.
- However, we believe **the credit impact for US and Japanese banks is manageable** as capitalization levels remain robust post pandemic.
- Also, the banks have additional levers to pull such as suspending share buybacks.

- **Among European Banks, Raiffeisen Bank (RBI), Unicredit (UCG) and Société Générale (SG) are most at risk** with exposure of USD 25bn, USD 21bn and USD 16bn, respectively, which account for 18x, 9x and 7x times annual profits, respectively.
- A full write-down would completely wipe off RBI's capital and take SG's CET1 ratio below the MDA threshold (minimum requirement for AT1 coupon payments) of 9.02%.
- Unicredit's CET1 ratio would remain above the MDA threshold of 9.03%.

- **Despite the severe impact on RBI, Moody's affirmed its ratings and maintained a stable outlook due to expectation of institutional support.** RBI's status as a central institution of the Austrian Raiffeisen Banking Group (RBG) and its membership in RBG's institutional protection scheme ensure financial support for RBI when in need.
- Moody's also **affirmed RBI's low-trigger AT1 instruments at Ba2,** based on its view that RBI's management will avoid AT1 coupon suspension underpinned by RBI's own financial strength combined with sector support in case of unexpectedly strong decline in CET1 ratios.



Impact on Major Oil & Gas Companies

- **BP Plc, Shell Plc, and Exxon Mobil Corp** announced they will disband their Russian operations, leading to impairments of Russian assets on account of uncertainty regarding their recovery value. Nevertheless, these companies' **strong balance sheets** after robust 2021 cashflows and **strong oil and gas prices will mitigate the negative impact** of these actions.

Shell

- Shell has **fixed assets of ~USD 3bn** in Russia (below 5% of total assets), which will be impaired due to its exit from Russia.
- Its earnings from Russia were ~USD 700mn in 2021, compared with USD 19.3bn of total earnings. Given the strong cashflows of Shell coupled with moderate exposure, the **exit from Russia won't impact the credit profile of the company**.

BP

- **Most affected oil & gas company** due to its material exposure in Russia given its **~20% stake** in the Russian state-controlled entity, **Rosneft,** along with some small joint ventures.
- **Total carrying value** of its Russian investments is **~USD 15bn** which will be impaired due to its exit decision. After the exit, BP will **no longer receive annual dividends of about USD 600mn** and the share of profits from Rosneft (~12% of total EBIT) which is moderate when compared to total profits.
- The company has affirmed that its financial framework will remain unchanged, and it is committed to using 40% of surplus cash flow to reduce debt this year.
- Credit ratios after excluding the Rosneft stake are comfortable and consequently, the credit **rating agencies have not altered BP's credit ratings** despite the company's decision to exit Russia.

Exxon Mobil

- Exxon Mobil's exposure to Russia predominantly relates to the **Sakhalin-1 project**, for which it is the operator.
- Sakhalin-1 is not material to Exxon's overall operations as it is less than 2% of the total production and ~USD 4bn of long-lived assets (less than 2% of total assets) at year-end 2021.

Impact on Global Auto Companies

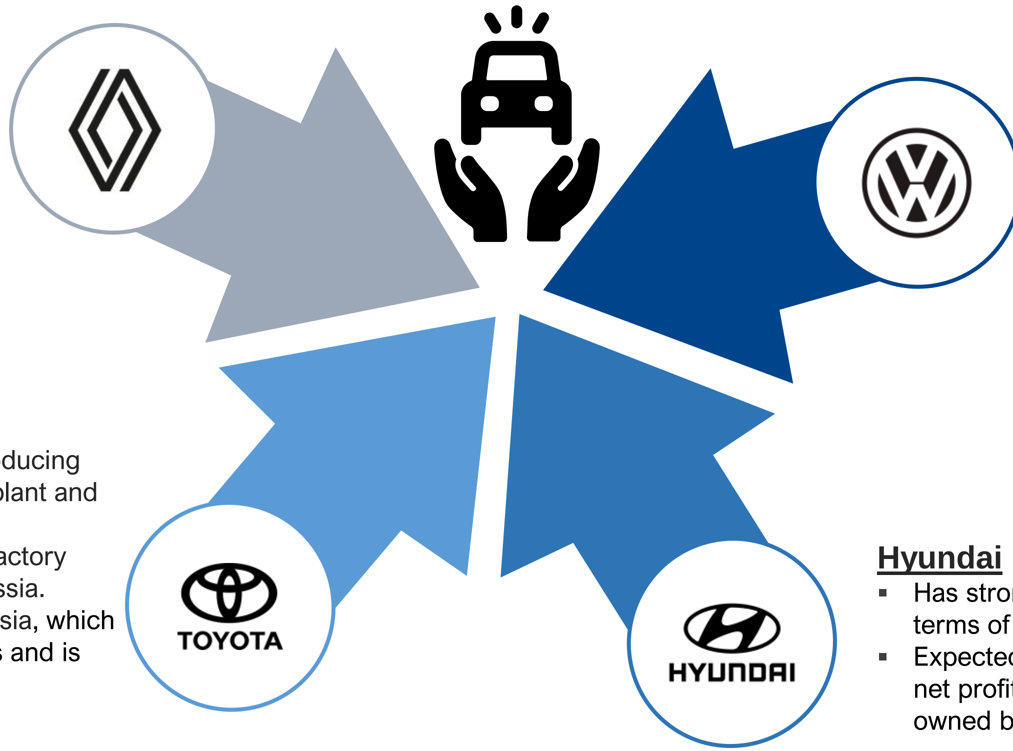
- The sector **remains battered by Covid restrictions** and **supply chain issues and is again under pressure** as the conflict between Russia and Ukraine escalates. This is mainly **driven by disruption in the semiconductor and metal sector**. Ukraine supplies almost 70% of the world's neon, which is essential in chip production. Similarly, Russia is a key producer of palladium, which is used in gasoline cars combustion system.

Renault

- Highest exposure in Russia compared to its peers.
- It has halted production in Russia due to persistent shortage of components.
- A complete shutdown of operations would mean a direct **12% impact** on the revenues

Toyota

- Top Japanese brand in Russia, producing 80,000 vehicles at St. Petersburg plant and employing 2,000 people.
- Has halted production in Russian factory and stopped vehicle imports in Russia.
- It sells around **120,000** cars in Russia, which is almost 1.26% of the overall sales and is not that significant.



Volkswagen

- Has suspended production and exports to Russia.
- It has been struggling before the conflict, but the situation has worsened as it is heavily dependent on wire harness from ukraine, which are needed to organize a cars wiring.
- The company's subsidiary Skoda, which has the second highest sales in Russia will be the hardest hit as it sold 90,400 units in Russia last year, almost **10% of overall sales**.

Hyundai

- Has strong sales in Russia and is ranked 2nd in terms of market share.
- Expected impact of sanctions is ~4% on Hyundai's net profit and 5% on Kia's net profit, which is owned by Hyundai

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