

The **outlook for Asia** following the Russian invasion of Ukraine

How the Russia-Ukraine war is reshaping
geopolitical and economic developments in Asia

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Contact us

LONDON

Economist Intelligence
20 Cabot Square, London E14 4QW,
United Kingdom
Tel: +44 (0)20 7576 8000
e-mail: london@eiu.com

NEW YORK

Economist Intelligence
750 Third Ave, 5th Floor,
New York NY 10017, United States
Tel: +1 212 541 0500
e-mail: americas@eiu.com

HONG KONG

Economist Intelligence
1301 Cityplaza Four 12 Taikoo Wan Road Taikoo
Shing, Hong Kong
Tel: + 852 2585 3888
e-mail: asia@eiu.com

GURGAON

Economist Intelligence
Skootr Spaces, Unit No. 1 12th Floor, Tower B,
Building No. 9 DLF Cyber City, Phase - III Gurgaon -
122002 Haryana,
India
Tel: +91 124 6409486
e-mail: asia@eiu.com

DUBAI

Economist Intelligence
PO Box No - 450056, Office No - 1301A Aurora
Tower Dubai Media City Dubai,
United Arab Emirates
Tel: +971 4 4463 147
e-mail: mea@eiu.com

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Contents

The outlook for Asia following the Russian invasion of Ukraine	2
In charts: Asia's exposure to Russia's war in Ukraine	4
Asia's geopolitics after Russia's war in Ukraine	9

The outlook for Asia following the Russian invasion of Ukraine

Asia is not in the eye of the storm of the crisis triggered by Russia's invasion of Ukraine, but it will nevertheless feel its effects. In this white paper EIU shares a selection of its recent client-only content that analyses how the war will affect economic growth and inflation in the region. It also offers projections on what the crisis means for Asian geopolitics, including the crucial issue of US-China relations.

Economically, Asia is less exposed than other regions to the war. We have lowered our global real GDP growth forecast for 2022 to 3.4%, from 3.9% pre-war, as a result of downward revisions to our forecasts for the US and EU economies, as well as for Russia and Ukraine. In contrast, we have not revised our growth forecasts for Asia's largest economies substantially shallower trade and investment linkages between the region and Russia/Ukraine mean that international sanctions will be less consequential. Growth in Asia will still slow this year, but the region's relative resilience to events in Ukraine will reinforce its importance in the world economy and its attraction to global businesses.

Asia will experience weaker growth, higher inflation in 2022

	Real GDP (%)		Consumer price index (%)		Current-account balance (% of GDP)	
	2021	2022	2021	2022	2021	2022
Australia	4.7	3.2	2.9	4.3	3.5	2.2
Bangladesh	6.9	6.1	5.5	6.1	-1.9	-3.9
China	8.1	5.5	0.9	2.0	1.8	1.8
Hong Kong	6.4	0.8	1.6	4.5	4.3	-1.6
India	8.9	7.2	5.1	5.1	-0.6	-1.8
Indonesia	3.7	5.2	1.6	3.8	0.3	0.5
Japan	1.7	2.8	-0.2	1.7	2.9	1.1
Malaysia	3.1	4.0	2.5	2.9	3.5	2.9
Pakistan	4.0	3.0	9.5	9.5	-3.8	-5.4
Philippines	5.4	6.0	4.4	4.5	-1.9	-2.0
Singapore	7.2	3.8	2.3	3.0	17.8	16.8
South Korea	4.0	2.7	2.5	3.2	4.9	2.5
Taiwan	6.4	4.5	2.0	3.8	15.0	13.1
Thailand	1.6	2.9	1.2	5.0	-2.1	0.1
Vietnam	2.6	6.8	1.8	2.3	1.2	1.5

Note. Forecasts as of April 6th.

Source: EIU.

Still, organisations in Asia or with exposure to the region should be monitoring several areas of concern. A softening in global growth will hurt Asia's exports, which is likely to hamper the recovery in domestic demand from the covid-19 pandemic. Elevated global food and energy prices will push

THE OUTLOOK FOR ASIA FOLLOWING THE RUSSIAN INVASION OF UKRAINE

EXAMINE THE REGIONAL, POLITICAL AND ECONOMIC IMPLICATIONS

up inflation, which while weaker than elsewhere in the world, will still affect household spending and, potentially, social stability. Accelerated global monetary policy tightening will exacerbate financial and exchange-rate strains for vulnerable economies such as Pakistan and Sri Lanka. Variations mean that it will be sensible to have a multi-faceted approach to the region, and focus on markets that are less exposed to the crisis.

Geopolitically, too, the war is set to exacerbate regional divisions. Although US allies in the region have joined sanctions on Russia, a number of Asian governments have sought to distance themselves from the crisis. India has adopted a position of neutrality, whereas China has leaned towards Russia in its response creating additional tensions in its relations with the US and the EU. A complex, more bifurcated geopolitical environment in the region will create challenges for firms as business and regulatory policies follow these political directions.

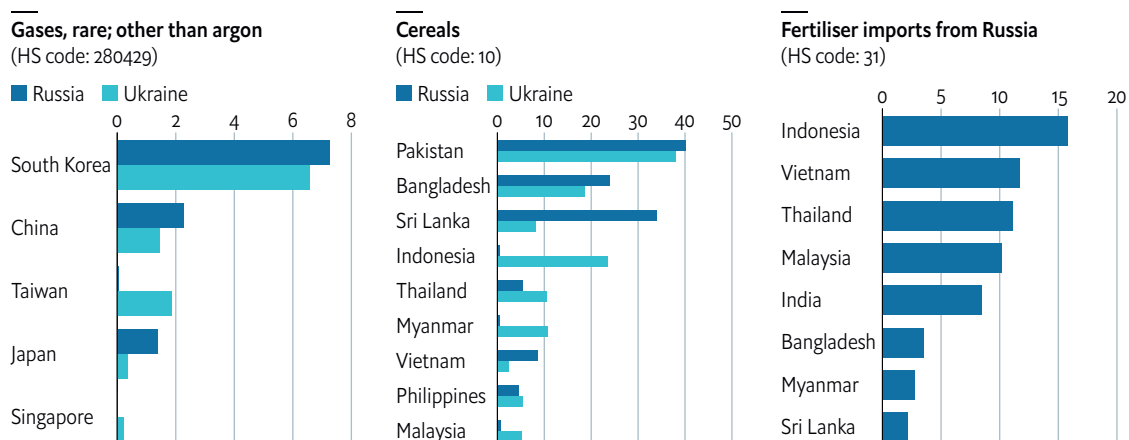
In charts: Asia's exposure to Russia's war in Ukraine

Asia's low trade vulnerability will limit direct supply-chain disruption

- Asia's direct goods trade exposure to Russia and Ukraine is low. Neither country is a significant export destination or source of imports for any Asian country. Supply-chain disruption from the conflict will be much lower than in Europe.
- Still, there are areas of import exposure. Russia represents a meaningful source of energy supply for China, Japan and South Korea. While our baseline assumption is that international sanctions will not compromise access to Russia's oil and natural gas, there may still be a desire among importers (especially US allies) to shift to alternative supply.
- Other niche dependencies include reliance on Russia and Ukraine as a source of fertiliser and grain in South-east and South Asia, which could cause disruption in the agricultural sector. North-east Asia—home to the world's leading chipmakers—also has some exposure to any disruption in the supply of rare gases used in semiconductor production.

Asia's trade exposure to the war is low, but there are vulnerabilities

(imports from Russia and Ukraine as a share of world imports, 2020; %)



Sources: WITS; Taiwan Bureau of Foreign Trade; ITC Trademap; EIU.

The conflict's impact on global commodity prices and financial markets will be the bigger concern for Asia

- While direct exposure to the conflict is low in Asia, indirect consequences flowing from the conflict will still be meaningful for Asia's economies. Surges in global prices for energy and agricultural commodities will be the main concern in the region, given relatively high levels of import dependence (even if not directly on Russia and Ukraine). This will apply upward pressure on local prices and could affect energy and food security.

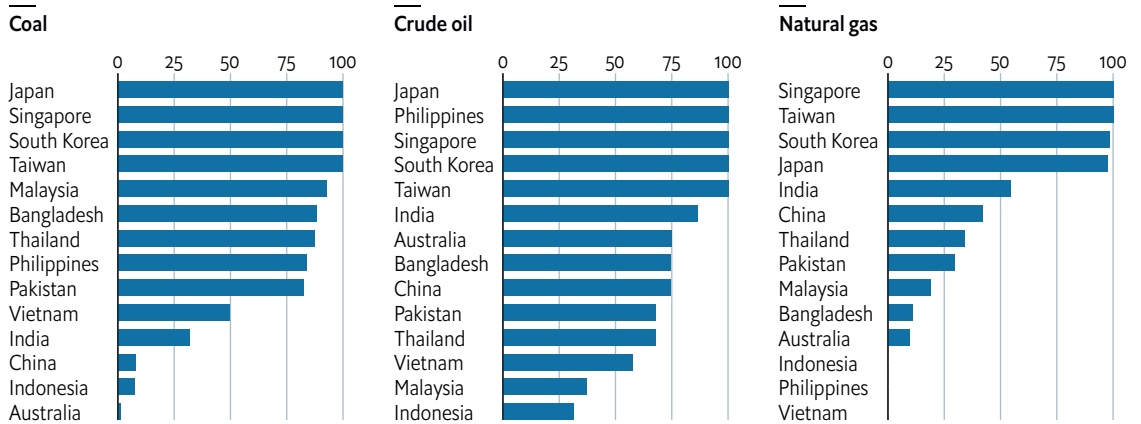
THE OUTLOOK FOR ASIA FOLLOWING THE RUSSIAN INVASION OF UKRAINE

EXAMINE THE REGIONAL, POLITICAL AND ECONOMIC IMPLICATIONS

- There will be export benefits for some countries from higher commodity prices and a global search for alternative supply. Net exporters of coal (Australia, Indonesia, Mongolia), crude oil (Brunei, Malaysia) and liquefied natural gas (Australia, Papua New Guinea, Malaysia) will be energy producers to watch. A loss of Russian nickel supply will provide tailwinds for Indonesia and New Caledonia, while Australia and India may play a role in plugging the gap in global wheat supply.
- Risk-aversion in financial markets could also trigger capital outflows from the region, pressurising emerging-market currencies (which were already vulnerable to depreciation as a result of rising US interest rates this year).
- A further indirect concern is whether geopolitical tensions could prompt reprisal measures targeting countries that back measures against Russia. Cyber-attacks and punitive economic policies are potential areas to watch.

Asia's reliance on imported energy exposes it to higher prices

(imports as a share of total energy supply of that category; %)



Sources: IEA; EIU.

Sanctions on Russia's defence firms will lead to diversification of Asian arms supply

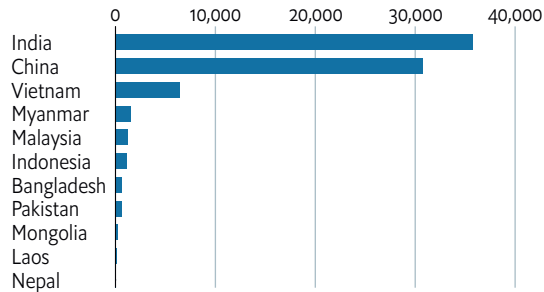
- Russia is also a significant supplier of conventional arms to several Asian governments. The country has been the major source of weaponry for China, India and Vietnam over the past 20 years, which has in turn underpinned strong military-to-military ties. This may be an influential factor in persuading India—the only democracy among the three—not to condemn Russia's invasion.
- International sanctions on Russian defence firms will impede the future access of Asian countries to these arms. This will create opportunities for companies from other countries, as well as domestic producers.

THE OUTLOOK FOR ASIA FOLLOWING THE RUSSIAN INVASION OF UKRAINE

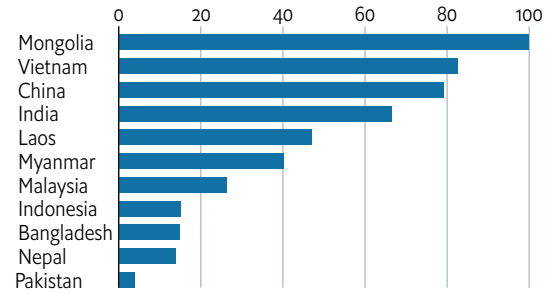
EXAMINE THE REGIONAL, POLITICAL AND ECONOMIC IMPLICATIONS

Sanctions could force Asia's armed forces to diversify from Russian weaponry

Arms imports from Russia, 2000-20
(SIPRI trend-indicator value*; m)



Arms imports from Russia as a share of total imports, 2000-20
(%)



Sources: SIPRI; EIU.

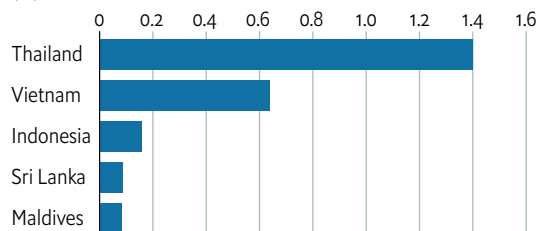
*SIPRI's trend-indicator value measures transfers of military capability rather than the financial value of arms transfers.

Asia is still open to Russian tourists, but they may not come

- Tourism is the main potential exposure within services trade, and with Asian air routes still open to Russian airlines, unlike those in Europe, such trade could continue (and potentially expand). However, the willingness of Russians to travel will probably be affected by economic disruption, rouble depreciation and the withdrawal of international payment services from Russia.
- Reliance on Russian tourists is low in the region overall. Thailand received 1.4m visitors from Russia in 2019, the highest number in Asia, but this still only accounted for less than 4% of total arrivals that year. Without the conflict, however, Russian tourism could have increased in importance, given ongoing curbs on outgoing Chinese travellers.

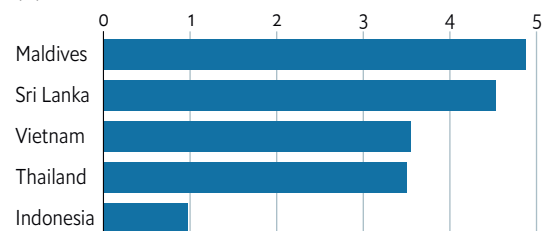
The loss of Russian tourists would have limited implications for Asia

Visitor arrivals from Russia, 2019
(m)



Sources: National sources; EIU.

Visitor arrivals from Russia as a share of total arrivals, 2019
(%)



A handful of Russia-backed investments in Asia could be affected

- Russia's investment and lending footprint in Asia is small, despite efforts to deepen its presence in the region under its decade-long "pivot to the East" policy.
- There are a handful of Russia-backed projects that could be affected by international sanctions and diminishing financial resources, potentially leading to divestment. These include investments in energy infrastructure in Vietnam and the Rooppur nuclear power plant in Bangladesh.

THE OUTLOOK FOR ASIA FOLLOWING THE RUSSIAN INVASION OF UKRAINE

EXAMINE THE REGIONAL, POLITICAL AND ECONOMIC IMPLICATIONS

- Asian investment and lending in Russia pales against that of the EU, and is unlikely to be a significant source of earnings for the region's companies and banks. Production facilities in Russia are mainly for that market only, suggesting that departures from the market—such as Japan-based carmaker Toyota's decision to shutter its plant in St Petersburg—will not have a significant impact on companies' broader and more lucrative European operations.

Flagship investment projects between Asia and Russia

Russian investment in Asia

Destination country	Company	Sector	Project
Bangladesh	Rosatom	Energy	Construction of Rooppur nuclear power plant due to begin operation in 2023
India	Rosneft	Energy	Minority stake in Nayara Energy, which operates India's second-largest oil refinery
Vietnam	Novatek	Energy	Ca Na integrated liquefied natural gas (LNG) complex
Vietnam	Zarubezhneft	Energy	Minority stake in Vietsovpetro, which produces 30% of Vietnam's oil

Asian investment in Russia

Source country	Company	Sector	Project
China	CNPC, Silk Road Fund	Energy	Minority stakes in Yamai LNG project
China	CNPC, CNOOC	Energy	Minority stakes in Arctic 2 LNG project
China	Alibaba	Technology	Minority stake in an e-commerce joint venture, AliExpress
China	China Export-Import bank	Finance	Line of credit framework agreement with Russia's VEB
Japan	Mitsui	Energy	Minority stake in Arctic 2 LNG project
Japan	Mitsui, Mitsubishi	Energy	Minority stake in Sakhalin 2 LNG project
Thailand	CP Group	Agriculture	Has operated Russian livestock businesses since 2006. In August 2021 it announced plans to acquire the Russian subsidiary of a German meat producer, Tönnies
Vietnam	TH Group	Agriculture	Kaluga province milk processing centre

Source: EIU.

What role will Asia play in pressurising the Russian economy?

- Russia's invasion of Ukraine has been broadly, although not universally, condemned in Asia. US treaty allies and close partners have all announced that they will join sanctions, and some have indicated that they will adopt separate measures of their own.
- These measures will add to the stress created by Western sanctions. For example, while Russia's overall reliance on semiconductors from South Korea and Taiwan is low, a loss of access to the high-end chips produced by these countries will still cause problems for some key Russian industries, such as defence and space, given a lack of alternative supply.
- China stands out in Asia as holding significant economic leverage over Russia. The country accounts for almost 20% of Russia's external trade and provides about 70% of its electronic and technology goods. Although Chinese firms will tread cautiously on sanctions, their preference will be to find ways to maintain links; their ability to do so will be critical for Russia's economy.

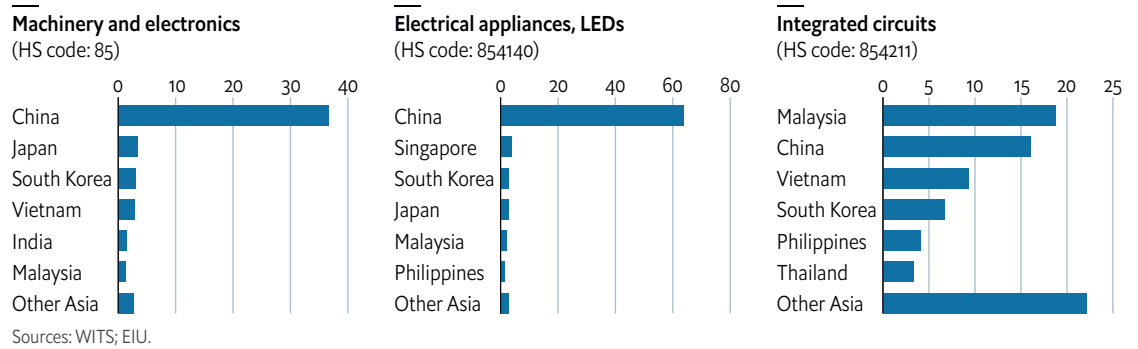
THE OUTLOOK FOR ASIA FOLLOWING THE RUSSIAN INVASION OF UKRAINE

EXAMINE THE REGIONAL, POLITICAL AND ECONOMIC IMPLICATIONS

On the investment and lending side, we are sceptical that China—the only really possible candidate in Asia—will significantly expand its currently limited footprint in Russia, for a mix of commercial and diplomatic reasons. If Russia hopes that Asian countries might replace the foreign capital currently leaving the market, it is likely to be disappointed.

Chinese supply dominates Russian technology imports

(Asian market share of Russian imports, 2018; % of total)



Asia's geopolitics after Russia's war in Ukraine

- The ability of the US to focus on the Indo-Pacific will be affected by Russia's war in Ukraine, but assuming that the conflict does not escalate further, the region will remain central to US's long-term security and economic strategy.
- China will secure some near-term strategic benefits in Asia from a more distracted US. However, with the crisis also likely to deepen regional concerns about its influence and hasten balancing actions, these gains are far from clear-cut.
- The Ukraine crisis adds another layer to an increasingly complex geopolitical environment in Asia, with widening political and economic divergence between China and the US set to challenge regional governments and international firms.

EIU has written on how the Ukraine crisis is set to have an important impact on geopolitics in Europe, but also beyond. In Asia, the main concern will be how it shapes the approach of China and the US in the region and in their own bilateral relations. We see a more complex and bifurcated geopolitical environment, and a rise in defence spending.

US focus on the Indo-Pacific will soften in the near term

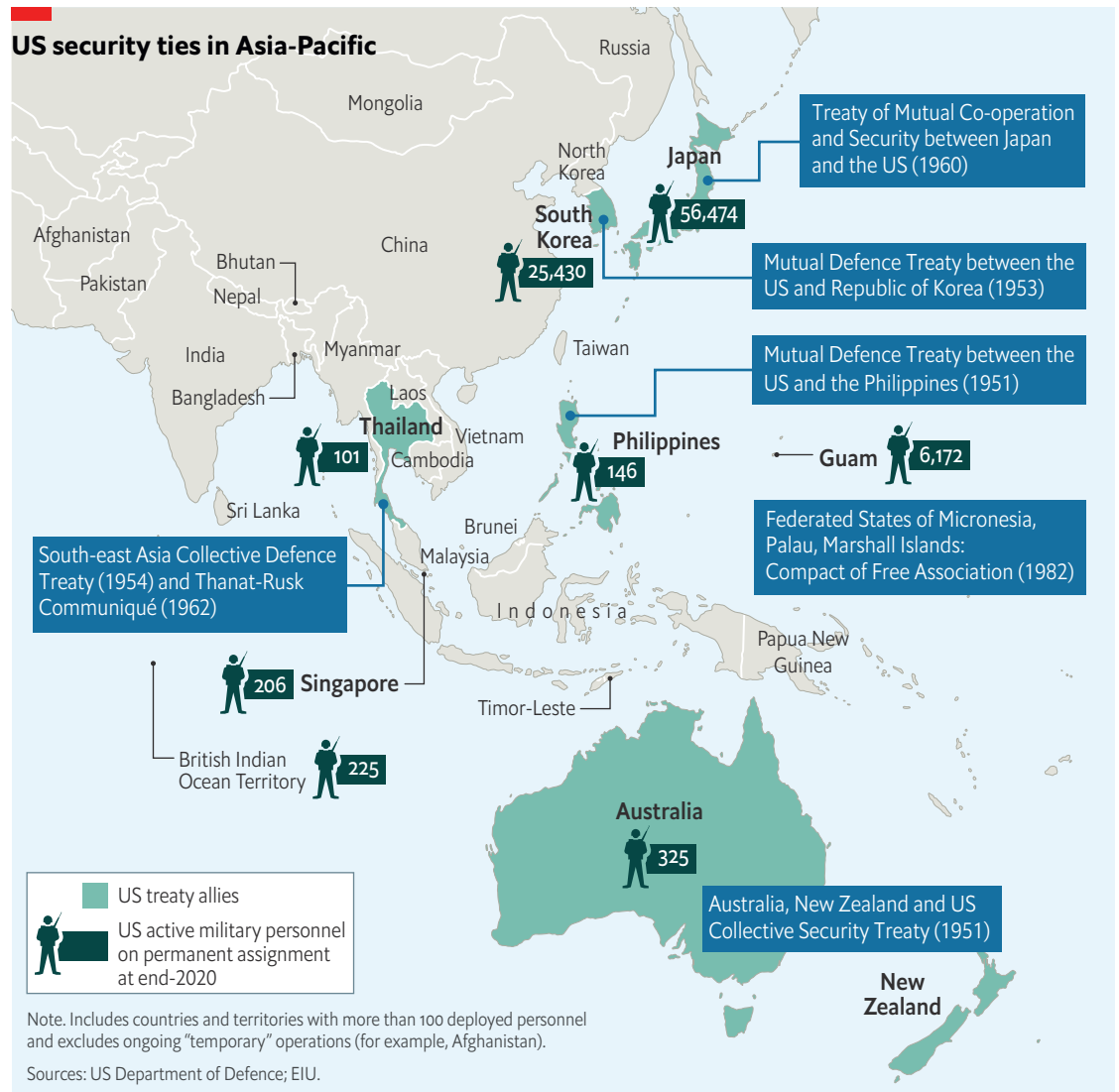
One likely consequence of the crisis is that the US will be less able to deliver in the near term on its Indo-Pacific strategy, which is designed to finally bring about the "pivot" in US military and diplomatic resources to Asia first promised in the late 2000s. The challenge posed to the international order by Russian actions, and the potential threat it represents to NATO, will require an ongoing and robust US response. Already, it has pledged significant military aid and assistance to Ukraine and Europe.

This does not necessarily mean a reduction in the US diplomatic or defence footprint in Asia, but will probably affect current plans to expand it. Already, for example, a planned meeting between the US president, Joe Biden, and Association of South-East Asian Nations (ASEAN) leaders in late March has been postponed. US efforts to bring forward this year a proposed economic framework for Asia are likely to be affected.

Whether US distraction from its goals in the Indo-Pacific will persist in the long term will depend on the duration and development of the war in Ukraine. There is little doubt that the US views China as posing the main threat to its global primacy, and that its national security and economic interests in the Indo-Pacific have been steadily elevated over those elsewhere. It has a commitment to Taiwan's security, for example, that while officially ambiguous is still much stronger than that to Ukraine. Nevertheless, US strategic goals in Asia could still be overridden if NATO members were drawn directly into conflict with Russia.

THE OUTLOOK FOR ASIA FOLLOWING THE RUSSIAN INVASION OF UKRAINE

EXAMINE THE REGIONAL, POLITICAL AND ECONOMIC IMPLICATIONS

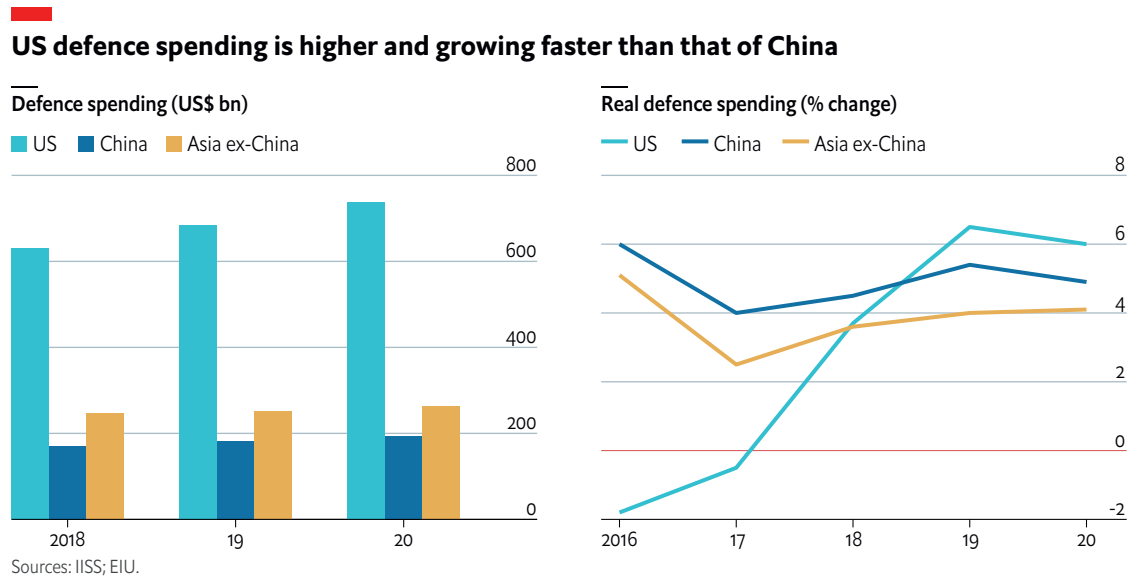


There are some strategic gains for China in Asia...

In the near term, a more distracted US provides some benefits for China in its own neighbourhood, as its rising influence will be subject to less contestation. Militarily, most US operations in Asia ought to be unaffected, given that they are conducted from regional military bases designed to function independently and largely use naval assets unlikely to be required in Europe. However, events in Ukraine could still make freedom-of-navigation operations in the region or joint military exercises with partners less urgent, or affect plans such as deciding how to transfer nuclear submarine technology to Australia under the AUKUS pact. Economically, US absence would give more room to China to shape the trade and investment rules of the region, as it has been attempting to do through its support of mega-regional trade deals.

THE OUTLOOK FOR ASIA FOLLOWING THE RUSSIAN INVASION OF UKRAINE

EXAMINE THE REGIONAL, POLITICAL AND ECONOMIC IMPLICATIONS



In this context, some countries may come to the view that it is wiser to “bandwagon” with China and accept it as a de facto regional hegemon in the hope of securing benefits, such as under the Belt and Road Initiative. In an admittedly unlikely scenario where the US becomes severely militarily stretched, it could even hamper its ability to project power in the region and honour defence commitments. For China, this would reduce the risk associated with an effort to annex Taiwan, or enforcement of its sovereignty claims in the East and South China Seas. The broad sanctions that the US and others have introduced on Russia have also provided China with an illustrative example from which it can learn and prepare.

...But these gains are far from clear-cut

Despite this fact, the strategic benefits for China in Asia are not clear-cut. Russia’s invasion of a smaller, independent neighbour will re-emphasise for many in Asia concerns about Chinese intentions in the region, especially if China was to abandon its ambiguous stance on the crisis to align decisively with Russia. Many could seek stronger ties with the US to balance against China, and raise their own defence spending. US allies such as Japan and South Korea may push for access to US missile and nuclear technology, as Australia has done, and indicate a firmer willingness to assist with the defence of Taiwan. For Taiwan, the Ukraine crisis is also likely to prompt consideration of its preparedness to preserve its status—making China’s ultimate goal of unification more challenging.

THE OUTLOOK FOR ASIA FOLLOWING THE RUSSIAN INVASION OF UKRAINE

EXAMINE THE REGIONAL, POLITICAL AND ECONOMIC IMPLICATIONS

China and Japan have most space to increase defence budgets in Asia



Countries that have aimed for neutrality in terms of the US-China relationship may lean more towards a US position. Singapore, for example, has been critical of Russia and unusually joined sanctions, and called on China to exercise its influence over the country. While India has refused to condemn Russia for its actions, it would not be against a broader effort to pressure China, including through the Quad diplomatic grouping.

Moreover, if the NATO solidarity on display in response to the crisis persists, European powers could also become more involved in Asia. France, Germany and the UK already have Indo-Pacific strategies similar to that of the US and, while their attention will be focused on events closer to home for the time being, this could change—especially if they view the threat posed by Russia as linked with China. Germany has already announced a significant rise in defence spending, breaking with past practice.

The emergence of a concert of mainly democratic powers united around the idea of limiting China's regional influence could easily offset benefits for the country stemming from a period of US distraction. Indeed, the US may find it easier to project influence, through its allies and partners, regardless of whether it is in a position to increase resources. This group of countries would hold more economic weight than any that China could comfortably include in its own coalition, such as a war-weary Russia or North Korea. The mixed strategic benefits of the conflict explain the diplomatic tightrope that China has been walking so far through the crisis.

A more complex, bifurcated regional geopolitical environment

Risks associated with major regional flashpoints could also be exacerbated. If the Ukraine war constrains the ability of the US to act as a global policeman, opportunistic actors could sense a chance to further their agendas. North Korea's nuclear weapons programme will be an important risk to watch in Asia, with inter-Korean ties set to become more strained following the election of a more hawkish South Korean president. Long-standing territorial conflicts, like that between India and Pakistan, could be more vulnerable to escalation. Monitoring of non-traditional security threats, such as terrorism, could also be affected.

Overall, the Ukraine conflict adds another layer of complexity to the geopolitical environment in Asia. Higher defence spending will reduce the share of government budgets available for social and economic development needs. We expect US allies, such as Australia, Japan and South Korea, to step

THE OUTLOOK FOR ASIA FOLLOWING THE RUSSIAN INVASION OF UKRAINE

EXAMINE THE REGIONAL, POLITICAL AND ECONOMIC IMPLICATIONS

Ukraine crisis could heighten risks tied to Asia's geopolitical flashpoints

Risk scenario	Probability	Impact	Risk intensity
A security conflict emerges across the Taiwan Strait	Moderate	Very high	15
China moves against Taiwan's holdings in the South China Sea	Moderate	High	12
North Korea resumes development of nuclear weapons	Low	Very high	10
India-China tensions escalate to a military conflict	Low	Very high	10
A major conflict breaks out between India and Pakistan	Low	Very high	10
Armed hostilities breaks out between China and Japan in the East China Sea	Low	Very high	10
Major clashes break out among claimants in the South China Sea	Low	Very high	10

Intensity colour key: 1 to 4  5 to 8  9 to 12  13 to 16  17 to 25 

Note. Intensity is a product of the probability and impact ratings, where "very low" scores 1 and "very high" scores 5.

Source: EIU Risk Briefing.

up their actions especially. A trend towards political and economic bifurcation was already evident before Russia's invasion, as tensions between China and the US have deepened, and there is a good chance that they will be accelerated by recent events (if not occur overnight). This will affect the unity of regional bodies, such as ASEAN, and create ongoing operating challenges for international firms operating across multiple markets, as regulatory divergence becomes more marked.

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