The Russia-Ukraine conflict erupted on February 24, 2022 prompting the western alliance led by the US and members of the European Union (EU) to retaliate with severe economic and financial sanctions against Russia. Not only did these developments impact the Russian and Ukrainian economies, they also had unavoidable global repercussions and Thailand is no exception. The impact of the Russia-Ukraine conflict can be summarized under 3 main channels (Chart 1) as follow:

(1) Energy and commodity prices: **The Russia-Ukraine conflict directly affects energy and commodity prices** because Russia is a major producer and exporter of many key goods such as oil (10% of global oil export), pig iron (35%), palladium (25%), nickel (20%), chemical fertilizers (13%) and wheat (8%). As such, commodities prices saw an overall increase when US and allies imposed sanctions against Russia. The S&P Goldman Sachs Commodity Index (GSCI Index) increased as much as 17%[1] from the week prior to the sanctions. Furthermore, the shortage of the aforementioned commodities might impact the production of goods across the global supply chain. Examples include palladium which is a key input in the manufacturing of car exhaust pipes and semiconductors, and nickel which is used in the production of stainless steel and EV batteries.

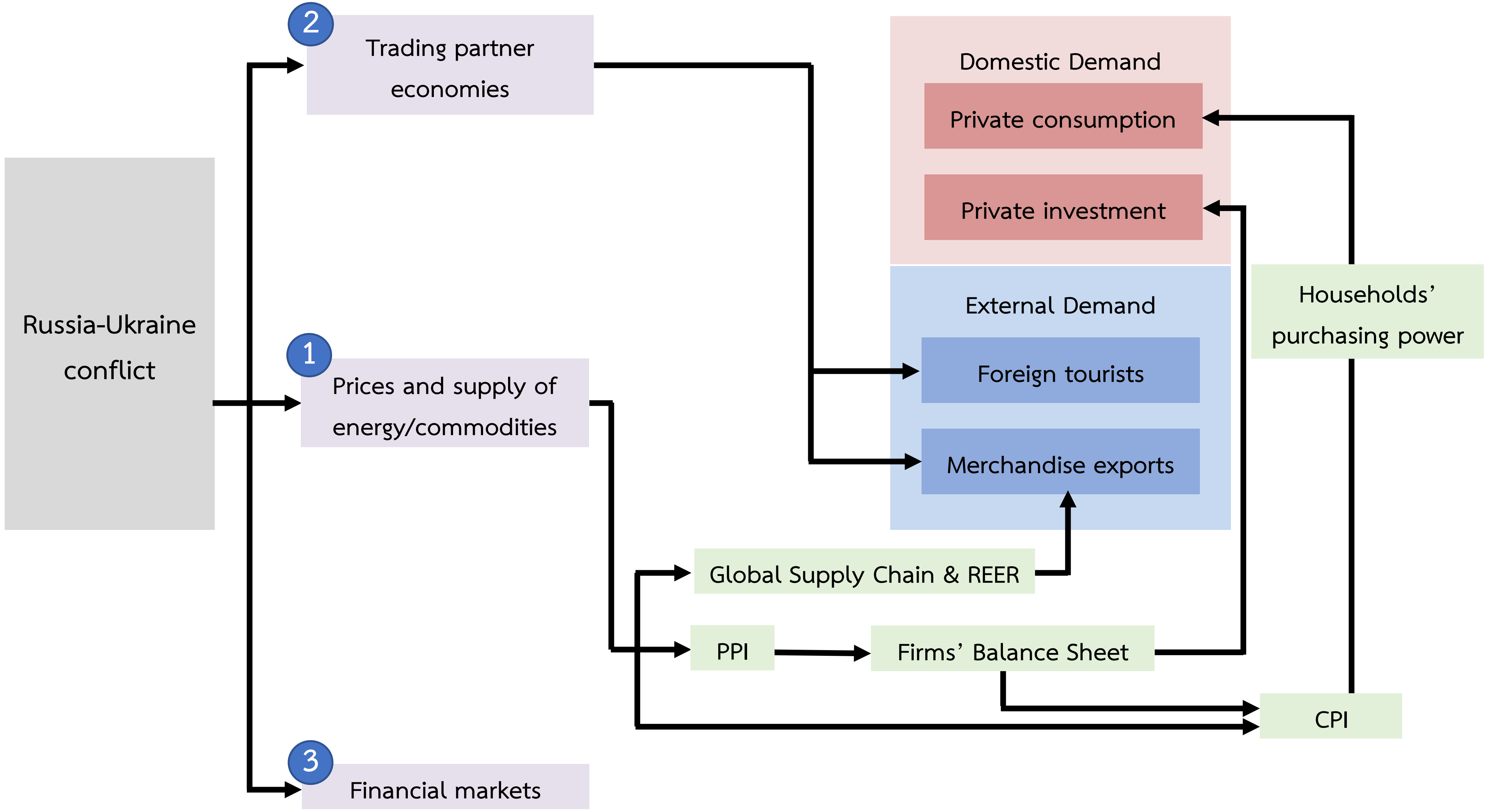
[1] *Data from Refinitiv as of 3 March 2022*

Rising energy and commodity prices would impact the costs of producing goods and services as reflected by the producer price index (PPI). If businesses are unable to absorb those higher costs, they would pass it on to consumer prices as reflected by the consumer price index (CPI), resulting in higher inflation. Inflation in Thailand is expected to rise above the target range and peak in the second and third quarters of 2022 before gradually declining into the target range in the beginning of 2023 (Every 10 USD/barrel increase in oil prices would see headline inflation rise by about 0.5%)[2]. Higher prices would hamper private consumption. On the other hand, higher costs mean less profit for the businesses which could subsequently impact private investment. On the whole, the slowdown in domestic demand from both consumption and investment may weigh on Thailand's overall economic recovery.

(2) Trading partners' growth: The combination of the aforementioned impact on energy and commodity prices and uncertainties surrounding possible retaliations from either side affects many countries around the world, including those that are Thailand's trading partners especially the euro area. The growth slowdown of trading partners would result in a decline in external demand which impacts the Thai economy through 2 main channels:

[2] *A 10 USD/barrel increase in crude oil prices would also see GDP declining by 0.1% and the current account deficit increase by about 3.8 billion USD (or 0.8% of GDP)*

Figure 1: Flow chart illustrating the channels through which the Russia-Ukraine conflict affects the Thai economy



(2.1) Merchandise exports

The slowdown in trading partners' growth leads to a slowdown in Thailand's merchandise exports which would subsequently impact Thailand's consumption, investment, and overall economic growth. If the impact on EU economies is severe, Thai exports would be impacted significantly because the EU is Thailand's 4th largest export market, accounting for 10% of total export value. Meanwhile, the direct impact on Thai exports to Russia and Ukraine would have limited bearing on overall growth because exports to Russia and Ukraine combined make up only 0.5% of total exports.

(2.2) Foreign Tourists

The Russia-Ukraine conflict would likely result in a decline in the number of 2 groups of foreign tourists: (1) Russian tourists, which account for about 4% of all foreign tourists arriving in Thailand before the pandemic. The decline in number of Russian tourists may come about as a result of sanctions imposed by Western nations that sent the Ruble depreciating by more than 60% and payment limitations due to many Russian banks being removed from the SWIFT[3] network and major payment providers such as VISA and Mastercard ceasing to provide service to Russian banks; and (2) European tourists, which account for about 16% of all foreign tourists arriving in Thailand before the pandemic, might be affected by the closure of the Russian airspace that made international travel more costly. Both European and Russian tourists play an important part in the recovery of the Thai tourism sector, especially in 2022 when there is little tourist arrival from China due to the Chinese government's Zero-COVID policy.

(3) Financial Markets Severe sanctions initially resulted in a global risk-off sentiment. Investors sold off risky assets causing their prices to fall globally before rebounding after concerns among investors subsided. Likewise, the Thai stock market (SET Index) initially fell 5% and the baht depreciated 3%[4]. However, the overall impact has been limited partly because of Thailand's strong external stability as reflected in the large international reserves and low external debt. The impact of the conflict on Thai mutual funds that invest in Russian equity and bond was quite limited because these funds account for only 0.3% of total investment of Foreign Investment Funds (FIF). There was also no sign of mass unit redemption in recent periods.

[3] *Society for Worldwide Interbank Financial Telecommunication (SWIFT) is a secure financial messaging service. More details can be found in the BOT's Payment Insight Vol.13 (Feb 2022) "SWIFT: cross-border financial messaging*

[4] *Data as of 9 March 2022 compared with data as of 24 February 2022*

[5] *Data from Morningstar as of end-December 2021*