CCG Report

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乌克兰危机对全球供应链和中国经济的影响

The Impact of the Crisis in Ukraine on Global Supply Chains and China's Economy

Abstract

The war between Russia and Ukraine broke out on February 24th when Russian President Vladimir Putin issued an order for a special military operation in the eastern part of Ukraine. The action immediately became the top news worldwide and the U.S. and Europe strongly condemned Russia. The UN Security Council and General Assembly held a number of emergency meetings and the General Assembly adopted resolutions. The military operation sent shock waves through world capital markets and commodity market, while the prices of crude oil, agricultural products, and non-ferrous metals were in violent turmoil.

The U.S. and Europe rapidly announced “devastating sanctions” against Russia, which has had a major impact on the Russian economy, world financial markets, energy, agriculture, semiconductor chips, automobiles and other supply chains. For more than half a month, world markets have remained unstable due constant changes in the conflict and negotiations between Russia and Ukraine, sanctions imposed on Russia by the U.S. and Europe and the reaction of the international community.

This report attempts to analyze the massive shock caused by the Ukraine crisis and the US-European sanctions against Russia, providing initial estimates on the impact on the Russian economy, world financial markets, energy and food markets, global supply chains, the European economy and the world economy. We will also estimate several possible conclusions to the Ukraine crisis and the subsequent geostrategic impact on Europe. Finally, we will examine the impact on the Chinese economy beyond its borders, concluding with relevant recommendations.

As this situation is evolving rapidly and the outlook is highly uncertain, this report provides a staged estimate and analysis. CCG will continue to monitor the situation and update this report as further developments and possible outcomes become clear.

I.

Turmoil in world markets and "devastating sanctions" against Russia by the U.S. and Europe

(i) Great turbulence in the world market

Over the past two weeks, since the outbreak of the Ukraine crisis, the U.S. and European stock markets have fallen in quick succession, while crude oil, gold and food prices have soared, in relation to the US Dollar, both the Euro and the British Pound have fallen, while the Ruble has plunged to historic lows and the Yuan has trended slightly down against the dollar after an initial shock.

In the stock market, compared with the close on March 11th and February 25th, the three major New York stock indexes - Dow Jones, Nasdaq and S&P - suffered cumulative declines of 3.27%, 6.21% and 4.11% respectively, while technology stocks suffered an even greater blow. Europe's three major stock indexes - the FTSE 100, Germany's DAX and France's CAC40 suffered cumulative declines of 4.46%, 6.45% and 7.29%, respectively, far bigger blows than those experienced in the U.S. Two additional factors - the Ukraine crisis and the expected Fed's interest rate increase - also had a greater impact on the A-share market in the Chinese mainland as well as the Hong Kong stock market. The Shanghai Composite Index fell by 5.28% and the Hang Seng Index fell by 13.1% during the same period, and continued to fall sharply in the following days.

In currency markets, the US Dollar exchange strengthened, with its index rising by a cumulative 2.68% in two weeks, from 96.5433 to 99.1263. The Euro and the Pound fell by a cumulative 3.17% and 2.75% against the Dollar respectively. The Ruble plunged against the Dollar, from 83.8608 to 133.2500 Rubles per Dollar, a decline of 37.07%. The Yuan, on the other hand, edged down 0.35% against the Dollar, falling from 6.3174 to 6.3394 to the Dollar. But the Yuan rose against the Euro and the Pound, breaking the 7 Yuan per Euro barrier on March 9th and reaching 8.33 Yuan per Pound on the same day, an increase of 2.57%. Gold maintained its value much better than the Dollar, with prices increasing from $1890.10 to $1993.47 per ounce, or 5.47%, over a period of two weeks approaching the $2000 mark.

In energy, crude oil prices and natural gas prices surged. West Texas Intermediate (WTI)

Crude Oil rose from $91.93 to $109.21 per barrel on the New York market in two weeks, while Brent Crude Oil on the London market rose from $94.56 to $112.30, both with a cumulative gain of 18.8%.

In the international grain market, food prices also surged. Recent futures prices for soybeans, corn and wheat in the Chicago Board of Trade saw cumulative rises of 5.99%, 16.39% and 29.02% respectively over two weeks, with an impressive rise in wheat in particular. Russia and Ukraine together account for a quarter of the world's wheat exports. The war between two sides has caused widespread concern in the market about the wheat supply chain worldwide.

This week, as market tensions eased with the fourth round of talks between Russia and Ukraine crude oil and gold prices retreated slightly, but in the near-term, these trends will depend on how the Russian-Ukrainian conflict develops.

(ii) "Devastating Sanctions" against Russia by the U.S. and Europe

As soon as the conflict between Russia and Ukraine broke out, the U.S. and the EU quickly announced "devastating sanctions" against Russia.

Financial sanctions: On February 28th, the U.S. administration announced that the Central Bank of the Russian Federation (CBR) and other Russian financial institutions were banned from using the U.S. dollar for settlement, and some Russian banks were excluded from the Society for Worldwide Interbank Financial Telecommunication (SWIFT). This move led to a considerable portion of Russia's foreign reserves becoming unusable, prompting a sharp drop in the Ruble. The Internet was cut off, while MasterCard, Visa and mobile payments were blocked.

Energy sanctions: On March 8th, the U.S. president Joe Biden signed an executive order to ban the import of oil and liquefied natural gas from Russia. On the same day, the European Commission also outlined a plan to cut gas imports from Russia by two-thirds before the end of 2022.

Assets and personal sanctions: The assets of Russian government and officials assets in the U.S. and Europe were frozen.

Trade sanctions: This mainly included bans on supplying high-tech products such as semiconductor chips to Russia. On March 11th, Biden announced that the U.S. would revoke Russia's "Most Favored Nation" status (“permanent normal trade relations” status), thereby increasing the average level of U.S. tariffs on products from Russia from 3 percent to 30 percent. On March 14th, the EU also announced the cancellation of “most favored nation” trade status with Russia.

The U.S. and European multinationals have implemented or echoed these sanctions. BP, Shell, ExxonMobil and others have withdrawn their shares in Russian oil and gas companies. Boeing, Airbus, MasterCard, Visa, McDonald’s, Microsoft, IBM, Apple, Intel, Google, Twitter, Facebook, Warner Brothers and Disney have also pulled out of Russia.

Total sanctions on Russia, including cultural sanctions, imposed by the U.S. and the West now number more than 5,000, which is unprecedented in both scale and intensity.

Russia did not show any sign of weakness and immediately took strong counter-sanctions. The country announced a list of over 200 banned export products in areas including technology, telecommunications, medical equipment, transportation and agricultural machinery.

Russia also severely restricted or halted exports of products on which the world market depends heavily, including fertilizers (Russia is the world’s largest producer of fertilizers), precious metals, industrial metals, timber, wheat and sugar.

Russia created a list of 48 countries and regions that were named ‘unfriendly countries’ (regions), canceling royalty payments, demanding they repay Ruble denominated loans, and prohibiting food exports to them.

In business, Russia blacklisted 59 foreign companies including Apple, Volkswagen, IKEA, Microsoft, IBM, Shell, McDonald’s, Porsche, Toyota and H&M, seizing both corporate and management level personal accounts and assets, and introducing outside management and nationalization of their properties. On March 10th, the deputy secretary of Russia’s Security Council Dmitry Medvedev warned foreign companies that are preparing or in the process large-scale withdrawals from Russia that responsive measures were being developed, including bankruptcy (liquidation) and nationalization of assets.

Statistics show that McDonald’s alone has 847 stores in Russia. If the Russian government takes the above measures, the company will lose $50 million per month.

II.

Impact on the Russian and world economy

(i) Impact on the Russian economy

Yale University Senior Fellow Stephen Roach believes that the announcement by the U.S. of sanctions on Russia's sovereign debt held by central banks has caused major ratings agencies such as Fitch, Moody's and S&P to reduce the country's sovereign rating to "junk" status. On March 3rd, the London Stock Exchange announced the suspension of trading in 27 Russian-linked stocks, reducing their value to zero.

The U.S. and Europe announced a ban on the Russian central bank's access to SWIFT, making nearly half of Russia's foreign reserves (about $300 billion) unavailable and a plunge in the value of the Ruble, which prompted CBR to raise its benchmark interest rate from 9.5% to 20%.

Some Russian economists believe that the biggest blow to Russia from the U.S. and Western sanctions is the financial system. Major Russian banks cannot settle the accounts their customers in foreign currencies (about $50 billion per day). Bank cards and cross-border e-commerce business have been affected. It is also expected that imports of Russian electronics, aviation equipment and automobiles will be affected and dozens of Western companies in Russia will close or leave.

On March 8th, Biden said the U.S. banned imports of Russian energy resources, which fueled a further spike in world oil prices. Recent WTI Crude Oil futures prices broke the $130 per barrel barrier, reaching the highest level since 2008. According to Roach, this will force central banks in all countries to raise interest rates, increasing the risk of recession. However, it remains to be seen whether this will last for years as it did in the late 1970s to early 1980s.

Former Atlantic Council senior fellow Anders Aslund said on March 2nd that "all Russia's capital markets appeared to be wiped out" and that the CBR could no longer use foreign currency to quell the turmoil the Ruble faces and has been forced to rely on non-market instruments. As a result, "the West took down Russian finances in one day."

French Finance Minister Bruno Le Maire said the U.S. and European sanctions against Russia were aimed to cripple the Russian economy and would work, as sanctions banned Western investors from doing business with the Russian central bank, and froze Russian assets abroad.

Goldman Sachs raised its forecast for Russia's 2022 inflation to 17% from the original 5% and lowered its GDP growth to -7% from 2%. It also estimates that Russian domestic demand will decrease by 10% or slightly more.

A survey released by CBR on March 10th indicates that Russian GDP is expected to fall by 8% in 2022.

The economic consequences of U.S. and Western sanctions against Russia are estimated to be quite severe. After the Crimean referendum in 2014, the West imposed severe sanctions on Russia. The average annual growth rate of Russian GDP in 2014-2019 is only 0.4%, compared with an average of about 6.7% in 2002-2008, before the global financial crisis.

(ii) Impact on global energy supply chains: imbalances in world crude oil supply and demand have resulted in a sharp rise in oil and gas prices

In 2021, world crude oil demand rose rapidly as the world economy gradually recovered, with average daily consumption reaching 99.53 million barrels, up 3.33 million barrels from 96.2 million barrels in 2020. Increased production by the Organization of the Petroleum Exporting Countries (OPEC) as 1.4 million barrels lower than expected, and the U.S. potential crude oil increase production was only 1 million barrels due to the rising cost of shale oil. Meanwhile, Russian production reached 10.9 million barrels per day, which is close to capacity. This has resulted in supply falling slightly short of demand, causing oil prices to rise steadily. Recent futures price for WTI Crude Oil on the New York market rose more than $77 at the end of 2021. After Biden announced a ban on Russian crude oil imports, the EU had to follow suit and announced a gradual reduction of crude oil imports from Russia. Some 120 million tons of crude oil were imported by the EU from Russia in 2021, accounting for 52.3% of all Russian crude oil exports. Supply restrictions have exacerbated the shortage of crude oil supply in the world market. The price of oil closed at $106.49 on March 10th in New York. Experts estimate it could rise to $185, far exceeding the record of $147 set in 2008.

The EU is the largest importer of natural gas in the world. In 2021, 42.3% of its imports came from Russia (155 billion cubic meters). The Nord Stream II project was halted after the outbreak of the Ukraine crisis, while the Yamal pipeline from Poland to Germany, one of the seven existing Russian gas pipelines to Europe, has also been halted (maximum capacity 33 billion cubic meters). The EU says it will import 70% less gas from Russia this year than the previous year, a reduction of 112 billion cubic meter. Of this 112 billion cubic meters shortfall, 50 billion cubic meters will come from other sources, while the rest will be supplanted by solar and wind energy. This man-made supply shortage has severely impacted global natural gas supply chains, exacerbating gas shortages and price spikes in Europe. On March 7, the Dutch TTF Gas Futures price for April soared to $3,899 per cubic meter, up 271% from the pre-conflict period.

European Commission President Von der Leyen presented the main points of the new energy strategy to phase out fossil fuel imports from Russia by 2027 (named REPowerEU, to be published in May this year) at an informal EU summit in Versailles on March 10th.

Sanctions between the EU, the US and Russia in the energy sector has resulted in a mismatch between global energy supply and demand. Crude oil prices plunged at the beginning of the 2020 Covid-19 pandemic, and once even saw WTI crude oil futures prices fall to negative numbers. A large group of US shale oil producers were unable to maintain their business, and had to close down or declare bankruptcy, which greatly dampened investors' incentive to invest in crude oil; this is in addition to the expectation that climate change issues may bring shifts to long-term energy consumption trends. The crude oil crisis is a structural problem and cannot be changed in the short term by increasing energy production by other energy suppliers. Existing global oil and gas supply chains have been disrupted and in some cases cut off, which will have a lasting negative impact on the world energy landscape and economic growth.

(iii) Impact on commodity and capital markets

Sanctions applied by the U.S. and European countries have cut business ties between Russian financial institutions and SWIFT, which is supposed to objectively record the data and flows of international payments, and is part of the reason for the current international payments crisis. Trade, investment, and service payments between foreign countries and Russia has been disrupted, affecting most countries and regions with which Russia has a large trade volume. First among these is the EU. Bilateral trade between Russia and Europe in 2021 was $282 billion, mainly with Germany and the Netherlands. At the same time, the move fundamentally stifles Russia's transactions on international capital markets as well as transactions by international capital on Russian securities and bond markets.

The outbreak and continuation of the Ukraine crisis has greatly impacted world stock and currency markets. The crisis erupted in Europe, prompting a fall in the Euro exchange rate and capital outflows, while the U.S. was offshore and relatively safe. The U.S. Dollar and U.S. capital markets, therefore, became a safe haven, which can be seen in the increased value of the US Dollar and the rush for U.S. bonds. If this trend continues, it will fuel international capital flows from emerging and developing countries to the U.S., resulting in new difficulties in maintaining balance of payments and debt burdens.

(iv) Impact on global food security and food supply chains

A direct reaction to the outbreak of the Ukraine crisis was a surge in global food prices, which may result in a global food crisis. Russia and Ukraine are first and fifth in terms of global wheat exports and together account for a quarter of total global wheat exports. On March 9th, the Associated Press said Ukraine had announced a ban on wheat and oat exports to secure domestic supplies. Russia also announced a ban on wheat exports after suffering from sanctions by the U.S. and the West.

Even if Russia and Ukraine had not

enacted export bans, it would be very difficult to export their goods. Under the U.S. and European sanctions, the world's three largest shipping companies have suspended shipping services in Russia. Two-thirds of Ukraine's grain exports and three-quarters of sunflower oil exports are shipped from Black Sea ports. These shipments have been interrupted due to the war.

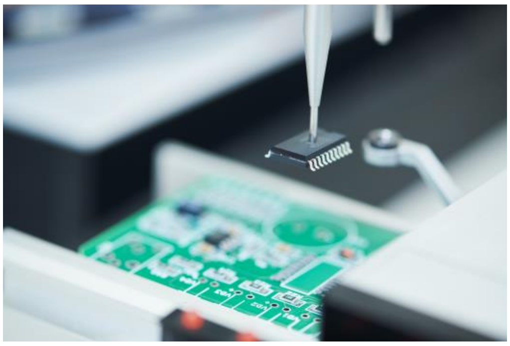
Disruptions to global food supplies will undoubtedly increase further. Global food prices have already risen 40 percent in 2021 and are estimated by an AP report to continue to rise by nearly a third in 2022. The risk of a new global food crisis is very high and will particularly affect many low-income countries.

It is worth noting that high energy prices will have a significant impact on global food production in 2022. The current impact on grain exports from Russia and Ukraine may only be a prelude to a tightening of the global food supply. The long tail effect will extend to the end of this year and early next year as higher energy prices will raise the cost of food production, which in turn will affect the storage of agricultural harvests this year.

(v) The impact on the global industrial supply chains

1.Semiconductors

Most of the inert gases such as neon, which are necessary for semiconductor production processes, come from Russia and Ukraine. According to a Moody's report, Russia and Ukraine account for 70% of global production of inert neon gas. Ukraine supplies 50 percent of the global requirements and 90 percent of U.S. requirements. According to the Financial Times, Micron said it currently has sufficient stocks, but if a prolonged Russian-Ukrainian crisis would affect subsequent supplies and it will take 6 to 12 months to find alternative sources. This is particularly worrying that, given the worldwide shortage of semiconductor chips, the industry is increasing production capacity on a large scale, with production estimated to increase by one-third in the next four years. If the Russia-Ukraine crisis persists, disruptions or reductions in inert gas supplies will seriously threaten the global semiconductor industry.



2. Automotive

Germany's Volkswagen Group announced on March 2nd that the group's Porsche plant in Leipzig will cease production until the end of next week and an assembly plant in Wolfgang will also be shut down, both due to a shortage in the supply of car coils. BMW plants in Germany and elsewhere in Europe have also announced a shutdown due to disruptions in the supply of automotive wire harnesses from western Ukraine. Renault in France has also announced a partial shutdown because it has a large presence in Russia, accounting for 8% of the group's profits.

3. Aerospace

Russia is an important source of several key metals that the world aerospace industry relies on. These include palladium and titanium exports, for which Russia accounts for 43% and 40% of global exports respectively. Russia's ceasing exports is bound to seriously affect the aerospace industries of developed countries in Europe and the United States. At the same time, Russia also provides cargo and manned spacecraft services to the International Space Station and a further deepening of sanctions in the future will lead to a lack of supplies to the ISS, the withdrawal of stationed astronauts, and a possible shortening of its service life due to lack of sufficient fuel for attitude adjustment.

(vi) Impact on the world economy

Shortly after the military conflict between Russia and Ukraine broke out, the International Monetary Fund and the World Bank issued a joint statement warning of the impact on the global economy. Bank President David Malpass said on March 2nd that the Russia-Ukraine confrontation will affect global economic growth. The International Monetary Fund Director General Kristalina Georgieva said on March 10 that the organization's April update of the world economic outlook would be lowered in its 2022 world economic growth forecast. Its world economic outlook released in January had forecast 4.2% growth in world GDP in 2022.

The UK's National Institute of Economic and Social Research (NIESR) last week predicted that the Russia-Ukraine crisis and the subsequent spike in energy and food prices will cost $1 trillion in global GDP, shrinking GDP growth by 1 percentage point by 2022 and raising global inflation by three percentage points in 2022 and two percentage points in 2023.

The surge in oil prices triggered by the Ukraine crisis has further pushed up U.S. inflation, with CPI rising 7.9% year-over-year in February, further intensifying from 7.5% in January. U.S. Treasury Secretary Yellen believes that 2022 will see very high inflation (uncomfortably high). CNBC reported on March 6 that the latest forecast of 14 major research institutions for U.S. GDP growth in 2022 is 3.2%, down 0.3 percentage points from the 3.5% forecast in February.

The Ukraine crisis has had an even greater impact on the EU economy. Barclays lowered its 2022 EU GDP growth to 3.5% from last month's forecast of 4.1%. JPMorgan, on the other hand, lowered its forecast from 4.2% to 3.2%, a full 1 percentage point lower.

French research institute REXECODE believes the Russia-Ukraine crisis will shrink France's GDP growth rate by 0.7 to 1.0 percentage points in 2022, EuroTimes reported on March 7, citing France's Le Monde. The French National Economic Institute in January had expected French GDP growth of 3.6 percent in 2022.

From the forecasts above, the conclusion that the crisis in Ukraine will have a negative impact on the global economy is already mainstream. Europe will have to bear the impact of significant inflation in the short term because of the "decoupling" from Russia, while the pace of recovery from the pandemic for some developing countries will slow. However, the specific performance of the relevant impact, affected by the conflict situation and its knock-on effects, remains to be further analyzed.

III.

Possible End of the Ukraine Crisis, Long-Term Impact of the Changing Geopolitical Landscape in Europe

The crisis in Ukraine continues to escalate on the battlefield with no sign of de-escalation; the two sides are still some way from reaching a compromise, despite four rounds of negotiations. The whole situation is in a stalemate, and the danger of escalation is much greater than the prospect of de-escalation. This is because the crisis in Ukraine is the result of the continuous collision of geopolitical rivalries and the long-term accumulation of disaffection, which finally erupted in conflict. The nature of the crisis is the result of both the need for U.S. hegemony to drive NATO to infringe on Russia's security buffer, and Russia's traditional geopolitical outlook triggering the search for a "buffer zone" in its regional neighborhood. It is therefore difficult to quell quickly, or at a very superficial level. Regardless of the outcome, the geopolitical landscape of Europe will change significantly and its impact will be long-term.

(i) The critical situation and possible ends of the Ukraine crisis

1. The critical situation of the Ukraine crisis

On the battlefield, Russia did not defeat Ukraine and capture Kiev as quickly as was widely expected. Nor did the Ukrainian army collapse quickly. Russia failed to take a single major city with the exception of Kherson. An important reason for this was the guiding philosophy of the "Peking Model," (referring to the peaceful settlement of conflict when the besieged KMT troops in Peking accepted the PLA proposal of "peaceful regrouping" in 1949) which was to avoid civilian casualties and massive destruction of cities, and to force Ukraine into submission by destroying its military facilities and morale. However, Ukraine, with the support of the United States and NATO, put up strong resistance. A total of 28 NATO countries, led by the United States, have added fuel to the fire by continuously supplying Ukraine with weapons, ammunition and medicine. The U.S. has pushed through Congress military aid and material assistance to Ukraine that has reached $10 billion. Germany has provided 1,000 anti-tank missiles and 500 Stinger surface-to-air missiles. The Netherlands has provided 200 Stinger surface-to-air missiles. France provided 300 million Euros in military supplies and sent 1,500 troops to NATO's eastern front. The Czech Republic, Lithuania and others have also provided weapons. "Volunteers" from Britain and other countries have also arrived in Ukraine. All of this means that the war is likely to continue.

At the negotiating table, the Russian's three conditions are very clear: recognition of Russian sovereignty over Crimea and the independence of the two eastern oblasts of Ukraine; the demilitarization and "de-Nazification" of Ukraine; and Ukraine's non-admission to NATO and neutrality. The bottom line for the Ukrainian side is that Russia returns Crimea and there is no room for negotiation on the sovereignty issue. Thus, despite the desire of both sides to negotiate, their willingness to continue negotiations and their consensus on humanitarian access, the positions of the two sides are completely opposed on the fundamental issues. As a result, even if the parties are able to ride the agreement, there are numerous problems with its landing and maintenance, and exchanges of fire and unrest of varying scales are likely to continue.

2. Three possible short-term endings of the Ukraine crisis

First, continued mediation of the international community and the participation of China, France, Germany and Turkey in mediation has resulted in the Russian and Ukrainian sides agreeing to cease fire for a relatively short period of time. While this did not succeed in de-escalating the conflict, the two sides continued to negotiate. The negotiations will likely drag on as armed conflict continues intermittently. This would likely result in a comprehensive peace agreement. Such an outcome is most desirable and a realistic possibility, but it will take enormous efforts.

Second, the intensity and depth of the war will continue to deepen, but the Ukrainian government and the Russian side would reach a ceasefire agreement on an official level. Putin's strategic goals will mostly be achieved, which means that the war will not be prolonged. While this is a possibility, given the current situation on the battlefield and the strong support of the United States and NATO countries for Ukraine, it will be difficult for the Russian side to achieve its goal.

Third, the two sides continue to hold each other off for a long period of time - six months or even longer. While Ukraine may lose some territories and/or cities, Zelensky's government will not choose to compromise, Russia will occupy some important cities, but constant attacks by the Ukrainian army and other anti-Russian armed forces mean that the war will continue. In this situation, the extended war may lead to the involvement of neighboring countries or irrational decisions by decision-makers, or even the risk of nuclear war.

Throughout the conflict, NATO has stated that it had no plans to send troops to Ukraine and refused to establish a no-fly zone. Ukraine's President Zelensky acknowledged the fact that is unable to join NATO and his willingness to discuss security guarantees if Ukraine does not join NATO. This is an improvement in the foundation for negotiation and coordination. If the parties step up communication and coordination at this time, it may be possible to de-escalate or even pacify the current conflict.

(ii) The root causes of the crisis in Ukraine will not be eliminated and its essence will not change

1. The complex history between NATO's eastward expansion and Russia and Ukraine

The crux of the crisis in Ukraine is not Ukraine itself, but the strategic contradictions between Russia and NATO. NATO's continued expansion to the east has pushed its borders closer to Russia's western border. Russia's traditional geopolitical outlook has led it to seek to create a "buffer zone" around itself to oppose NATO's eastward expansion. The two sides have been at odds on this issue for many years.

Before the outbreak of the current crisis in Ukraine, Putin publicly stated that before the collapse of the Soviet Union, NATO had promised not to "expand one inch" to the east. For its part, NATO denied that it had promised not to expand eastward. In fact, NATO has maintained a very aggressive approach to the issue of expansion, continuously incorporating former Soviet Eastern Bloc member states. By 2020, NATO had conducted five rounds of expansion in eastern and southeastern Europe. Beginning with the accession of Poland, Hungary and the Czech Republic to NATO in 1999 and ending with the accession of North Macedonia to NATO in 2020, NATO has absorbed 14 states in more than 20 years and now has a total of 30 members. At the beginning of the century, Ukraine and Georgia, two former Soviet republics, also began actively seeking to join NATO, which has taken a welcoming stance toward the two countries' intentions. This means that NATO's influence is not limited to Russia's western border, but extends to Russia's southwestern and southern "soft belly" regions.

The Russian leadership's view of security, inherited from the European concept of "balance of powers" since the early 19th century, seeks to preserve the "security space" between Russia and NATO. Guided by this view of security, Russia believes that NATO's expansion to the east poses a significant threat to its own security, particularly in the traditional sense of geopolitical and military security. For example, if Ukraine joins NATO, Russia could lose its military base in Sevastopol, Crimea, and thus lose its influence over most of the Black Sea. If Georgia joins NATO, it would not only mean that the Russian navy would have to retreat to a small corner of the Black Sea, but also result in instability in the North Caucasus, affecting separatist-leaning regions such as Chechnya.

On the military front, Russian forces have also had to face more dominant NATO forces and their military pressure. Russian Deputy Defense Minister Alexander Fomin has said that compared to 2020, in 2021 the number of sorties by NATO reconnaissance aircraft in the Black Sea region increased from 436 to 710, an increase of 60 percent. In contrast, in the Baltic Sea region, NATO countries conducted more than 1,200 sorties and more than 50 sorties for maritime reconnaissance. In 2021, NATO Joint Forces Command, respectively, conducted up to 15 exercises in the Black Sea and more than 20 multi-combat training in the Baltic Sea. If Ukraine joins NATO, NATO's ICBMs could be placed on the Russian-Ukrainian border, which would make it almost impossible for the Russians to raise an alarm because of the significantly reduced distance. This would be unacceptable for Russia.

On the other hand, Russia's perception of Ukraine is not based exclusively on the single concept of the "sovereign state" or "nation-state" as described in the Westphalian system. Russia's frequent emphasis on the long-standing, "inseparable" economic, cultural, religious and historical ties between Russia and Ukraine shows that Russia's understanding of Ukraine's statehood often goes beyond the borders of international law. Putin also attaches great importance to Ukraine's strategic position in Russia's geopolitical security and its role as a cultural link. This is the main reason why he concluded in his speech on February 23 this year that "Ukraine, in the sense of a modern state, did not exist in the first place". Putin's speech, NATO's expansion to the east and the problems in Ukraine's internal affairs reveal the highly complex historical origins of the Ukrainian crisis. The Russian-Ukrainian relations, which have been maintained by the fragile Normandy Consensus since 2014, are very unstable under the influence of the uneven power of the stakeholders and the possibility of U.S. intervention.

2. The role of the United States in the Russia-Ukraine conflict

With its dominance over NATO, the U.S. has pushed for its eastward expansion, with the purpose of suppressing Russia and dividing Europe, the essence of which is the need of U.S. strategic interests and global hegemony.

Regardless of its size, location, economy and civilization history, the Eurasian plate is undoubtedly the center of gravity of the world (i.e., the concept of the "world island" proposed by the British geopolitician Halford John Mackinder in 1904), while the United States is in the Western Hemisphere and is an extraterritorial country. Therefore, in order to maintain its post-World War II world hegemony and prevent a multipolar world outlook, it was necessary to control the Eurasian plate, which is composed of three major power centers: Europe, Russia and China.

Its goal is to squeeze Russia as much as possible in the Eurasian plate and eliminate or weaken Russia as one of those poles. While Russia is not as powerful as the former Soviet Union, it is a huge country, rich in resources, and second only to the United States in military power. Therefore, the United States is unwilling to sit back and watch Russia become powerful again.

It also wishes to control Europe, especially Western Europe, in the Eurasian plate, establishing it as another pole. The U.S. is trying to provoke the conflict between Russia and Europe, using Ukraine as a fulcrum to pry the confrontation and tension between Russia and Europe. In the event of a war between Russia and Ukraine, a U.S.-led NATO would be able to immediately respond and take control of the situation, while the EU, which has repeatedly sought "strategic autonomy" and tried to become a pole outside the U.S., takes a back seat.

In addition to the geopolitical gains, the United States could reap huge economic benefits from a Russian-European conflict. First, the United States would significantly increase its natural gas exports to Europe. More than 40 percent of Europe's natural gas supply comes from Russia, and Russian gas exports to the EU amounted to 192.6 billion cubic meters in 2021, accounting for 81 percent of its total exports, mainly via pipelines through Ukraine and Nord Stream I. With the outbreak of war in Ukraine, both routes have been cut off and Nord Stream II has been suspended. Combined with the European Union's decision to gradually scale back its demand for Russian energy, Russian gas exports to Europe will shrink. U.S. gas production surged from 727.4 billion cubic meters to 914.6 billion cubic meters between 2016 and 2020, representing 81 percent of the global increase, of which only 25.6 billion cubic meters will be exported to Europe. 2022 will see U.S. gas production capacity exceed 1 trillion cubic meters, and buyers are urgently needed. Due to the war in Ukraine and sanctions against Russia, Russia's gas exports to Europe will be reduced by 199 million cubic meters per day, or a combined 72.6 billion cubic meters for the year. This part of the market gap can be conveniently picked up by the United States.

In the capital markets, the Russian-European conflict has strengthened the position of the Dollar and attracted world capital flows to the United States. After the NATO war in Kosovo in 1999, the Euro, which had just officially gone into circulation, depreciated sharply. The Dollar rose against the Euro from 1.17:1 at the end of the previous year to 0.87:1 at its lowest in November 2000, making it difficult for the Euro to challenge the Dollar in terms of credit, reserves and payments. After the Maidan Revolution, the broad and nominal exchange rate for the U.S. Dollar against major currencies increased from 95.3221 in February to 103.5995 in December, an increase of 8.7%. As a direct result of the dollar's appreciation, a large amount of international capital flowed into the United States, driving a stock and bond market boom. After this crisis in Ukraine, the Dollar's position will be doubly strengthened as it will be more valuable and the U.S. will become a safe haven because Europe is no longer safe.

The Russia-Ukraine conflict will also depress Russian-European trade and slow the EU's economic recovery. The EU is Russia's largest trading partner, and bilateral trade between Russia and Europe reached $282 billion in 2021, accounting for 35.7% of Russia's total exports and imports. Bilateral trade will shrink as EU countries join the sanctions against Russia and Russian-European trade cannot use SWIFT. This is exactly what the U.S. needs, because these rather large bilateral trade relations are an obstacle to the EU's assertiveness towards Russia. The U.S. itself does not need to worry about this. 2021 U.S.-Russian trade was $34.4 billion, only 1/8 of Russian-European trade.

The crisis in Ukraine has also produced considerable profits for the U.S. domestic military-industrial complex. As the fighting continues, the United States, Germany and other NATO countries have supplied arms to Ukraine. More importantly, it has created great anxiety among European countries about European security, greatly increasing their dependence on NATO and ultimately on the United States. Most typically in Germany, the Scholz government announced a major shift in German defense policy on February 27th, deciding to increase Germany's defense fund by 100 billion Euros and raise defense spending to more than 2 percent of GDP, in addition to supplying arms directly to Ukraine. Merkel, on the other hand, had strongly opposed raising this share during the Trump era. Poland, for its part, announced on March 11th that it would raise its military spending from 2 percent to 3 percent in the next fiscal year and nearly triple the size of its military. It is feared that an increase in military spending by NATO countries is inevitable. This is a rare opportunity for the U.S. military-industrial complex to sell weapons, equipment and related services to Europe.

(iii) The long-term impact of the Russian-Ukrainian war on the geopolitical landscape of Europe

Although the Russian-Ukrainian conflict may end with a temporary compromise as powers vie for influence. As mentioned above, the U.S. occupies the main aspect of the conflict due to its huge and fundamental strategic and economic interests. Therefore, even if the Russian-Ukrainian war should end, the conflict will not be over, only temporarily alleviated and there will be long-term, substantial consequences as detailed below.

1. European countries' confrontation with Russia will solidify

NATO countries' concerns about Russia, especially Eastern European countries and the three Baltic states' antipathy and wariness toward Russia, will rise further. Some neutral countries adjacent to Russia such as Sweden and Finland have also expressed their willingness to join NATO.

2. NATO status will be strengthened

As part of the Russian-Ukrainian conflict settlement arrangement, NATO must not pose a threat to Russia and must not place offensive weapons near the Russian border. However, NATO has the right to strengthen defense forces in the territories of its member states to defend against Russia.

3. U.S. control of Europe will be strengthened

Europe, especially the old European powers such as France and Germany will suffer a setback in their quest for independence.

4. European-Russian trade will recover, but lack any major growth

European countries will further promote alternative energy sources and reduce gas and crude oil imports. In 2021, German-Russian trade was worth 60 billion Euros, which is only a little more than 60% of German-Czech trade, valued at 97 billion Dollars and less than half of German-Polish trade, which reached 145.6 billion Dollars. In the short term, Russia's position will decline further. Therefore, both the EU and Russia need to find alternative markets and sources of supply outside each other.

IV.

Impact on China

In the near term, China will be affected by the war between Russia and Ukraine mainly in terms of upstream of energy, transportation and chemical industries triggered by rising energy prices. Along with the general rise in commodity prices, this trend will be transmitted to the manufacturing industry and the down industrial chains, driving up production costs and consumer goods prices. In addition, U.S. and European sanctions against Russia may result in secondary sanctions on Chinese enterprises, resulting in some pressure on China-Russia trade in the short term. If the Russia-Ukraine conflict is prolonged, China may face more economic costs.

However, due to the size of China's economy and the integrity its industrial chain, China will remain extremely resilient and maintain medium to high growth rates. While external shocks will have a broader impact on the economy, they are still manageable. Russia is bound to turn more to China in trade and use the RMB for clearing and settlement. Russian-Chinese supply chains will remain stable, but there is a possibility that Russia may impose temporary measures to ban on trade in some commodities due to wartime factors. For example, on March 15th Russia announced a temporary suspension of grain exports to Eurasian Economic Union member states (i.e. Kazakhstan, Kyrgyzstan, Armenia and Belarus). These temporary measures risk potential supply chain volatility in China and Russia.

In the long run, the Russian-Ukrainian conflict has brought about fundamental changes in the geopolitical landscape of Europe and corresponding adjustments in global supply chains. China faces both the challenges of a tougher external environment and greater opportunities that this brings.

(i) Recent overall impact

The general external environment: Russia and Ukraine have both maintained good relations with China, and European countries are somewhat dissatisfied with China's reluctance to condemn Russia, but they also are more interested in trading with China to ease their economic woes. The U.S. is both dissatisfied with China's unwillingness to follow through with condemnation and sanctions against Russia, and will maintain political and economic pressure on China, specifically by intensifying provocations in the Taiwan Straits. However, certain opportunities remain to improve relations.

1. Energy Security

In 2021, China's energy dependence will reach 72% and its natural gas dependence will exceed 40%. China refrained from joining the West in banning or reducing imports from Russia. On the contrary, it will increase them. 16% of China's crude oil imports and 9% of its natural gas imports are from Russia, so it is less likely that there will be major problems with energy security. However, a major problem is that the soaring prices of oil and gas on the world market have significantly increased the cost of economic development. 512.978 million tons of crude oil were imported into China in 2021, 5.4% less than the previous year, but total cost reached $257.331 billion, an increase of 44.2%, equivalent to $67.8 per barrel. Oil prices have soared since the outbreak of the crisis in Ukraine. The current price of WTI has exceeded $110 per barrel, and the price of Brent oil is close to $120.

China imports more than 10 million barrels of crude oil per day. Even by conservative estimates, if the average price of imported oil for the year 2022 is $120 per barrel and imports continue to decrease by 5% compared to the previous year, the annual cost of crude oil imports will reach $432.748 billion, a net increase of $175.417 billion, equivalent to more than a quarter of the entire trade surplus in 2021.

In other words, in 2022, China's foreign trade surplus may decline for the first time in many years thanks to soaring energy prices. More importantly, international oil prices will remain high for a long period of time, affecting not only transportation and travel, but increasing the costs of manufacturing and agricultural sectors, especially the chemical industry. This will push up the cost of production in China's agricultural and industrial sectors, and will be transmitted to the downstream consumer, creating an inflationary thrust. This will create new difficulties in accomplishing the annual GDP growth target of 5.5%. However, U.S. and European sanctions on Russian oil and gas exports are likely to be relaxed in the end, due to the EU's high dependence on Russian oil and gas. Therefore the impact on world energy security may also be lessened in the end.

Since the U.S. will likely shift the focus of natural gas exports to the EU, coupled with issues such as the cost of freight for LNG, it is unlikely that China will increase its LNG imports from the U.S. The focus should be on the diversification of its natural gas import sources.

2. Food Security

Similarly, as China is not involved in sanctions against Russia, Russia and Ukraine will not ban grain exports to China, but they may reduce exports due to domestic needs. At the same time, as Ukraine gradually enters the spring planting season, delayed planting due to the continued conflict will likely bring about a reduction in grain production in the fall, the long tail effect of which will continue into the next year. Ukraine is China's largest importer of sunflower seed oil and the second largest importer of corn, and it is possible that China will need to increase imports from the United States, Brazil and Argentina to temporarily replace reduced imports of agricultural products from Ukraine. As China's per capita grain capacity is significantly higher than the safety line determined by the United Nations

Food Program, there is no overall security problems in staple foods such as cereals, but in oil, meat and high-end imported foods, which are affected by the rise in food prices in the international market, there will be some price fluctuations.

3. Supply Chain Security

Since China is not involved in the sanctions against Russia, there will be no policy restrictions on the supply of inert gases and other non-ferrous metals supplied by Russia for semiconductor production in China, but its semiconductor manufacturers need to consider whether the use of Russian products will affect exports and settlement with Russian suppliers in the context of U.S. sanctions against Russia, and look for import substitutes if necessary. As the prices of these commodities soar due to the comprehensive sanctions imposed by the West on Russia, China should consider the rising impact of these products on its producer prices and adjust its procurement and reserves.

4. Import and export

In 2021, total trade between China and Russia rose to $146.9 billion, more than half of which was in energy. Russia's share in China's overall import and export trade is only 2.4%, which has limited impact on the general situation of China's international trade. 17% of the trade between China and Russia is already settled in RMB, which means that the crisis in Ukraine will drive an increase in the proportion of RMB settlements.

Facing extreme sanctions from the U.S. and Europe, Russia needs to increase its trade with China. The Ministry of Industry and Trade of Nizhny Novgorod Oblast has announced that it is ready to shift the exports of the region's enterprises to the Asian market, viewing the Chinese and Indian markets as "very promising ". The oblast was an important center of the Warsaw Pact military and machinery industry during the Soviet era, which means the possibility of accelerated growth in Russian-Chinese trade.

5. Foreign Exchange and Capital Markets

In the two weeks since the outbreak of the Ukraine crisis, major Western currencies such as the Euro and the British Pound have generally fallen against the U.S. Dollar. The Ruble has plunged against the U.S. Dollar, while the RMB has recently fallen against the U.S. Dollar, but actually risen against the Euro and the British Pound. This reveals two trends: first, China is affected by the Ukraine crisis in a complex way, involving multiple interests;

second, the strong fundamentals of the Chinese economy have kept the RMB exchange rate relatively stable. Although the sharp shocks in global capital markets have inevitably affected the capital markets in mainland China and Hong Kong, the impact transmitted to the real economy side was relatively small. The U.S. Dollar will strengthen in the future due to factors such as the Federal Reserve's interest rate hike, but the RMB will remain stable overall.

(ii) Risk

1. The possibility of U.S. collateral sanctions

Xiaomi and SMIC have received notices from the U.S. Department of Commerce not to export cell phones, chips and other related products containing U.S. technology to Russia. U.S. White House Press Secretary Jen Psaki threatened not long ago that the U.S. would take measures against China if it did not implement sanctions against Russia. At a meeting between Chinese State Councilor Yang Jiechi and U.S. National Security Advisor to the President Jake Sullivan in Rome on March 14th, the U.S. side also said that if China continues to "support" Russia, the U.S. side will consider imposing "secondary sanctions" (i.e., sanctions targeting non-U.S. third-party citizens or institutions that have business ties with the sanctioned party) on Chinese companies. In this context, Chinese companies need to reconsider the way they conduct business with Russia.

2. The China-Europe Railway Express may encounter certain difficulties

The Global Times reported on March 5th that the China-Europe Railway Express via Ukraine had been suspended. The original train from Zakhony to Budapest via Alashankou to Ukraine has been temporarily rerouted via Belarus and Poland. However, the total share of this part of the cargo is not significant as it counts for 8% of China-EU trade. If the EU sanctions against Russia involve the closure of border crossings and the refusal to accept trains from the Russian Railways (RZD), then CEB trains may be fully affected, since all routes of CEB trains pass through Russia. Another difficulty is in freight settlement. The main operating company of the Russian section of the CEB is Russian Railways, which also includes commercial companies with Russian government participation. If the company is included in the EU sanctions list, it will seriously affect the normal operation of China-Europe trains. In addition, freight rates are currently denominated in US Dollars. If the West cuts off Russia's intermediate settlement channel in the international financial system, freight settlement will not be able to proceed normally. It should be considered that some of these routes may be restricted by EU sanctions against Russia, so alternative routes should be taken to replace or enhance maritime transport, and logistics costs should be re-accounted for in order to optimize China-Europe logistics routes.

(iii) Long-term impact

1. Positive Impact

After the crisis in Ukraine, which has constrained European development to some extent, the need to expand cooperation with China will be significantly strengthened in the long run, especially in terms of exports to China, mutual investments and cooperation in the fourth industrial revolution. Europe will also pay more attention to the Asian market, which is centered on China. Europe's shift to Asia and China is an inevitable choice for the EU to sustain its economic development, and launching economic cooperation with the EU will bring China possible new opportunities.

2. Negative effects

The outbreak of the Russia-Ukraine conflict has not changed U.S. strategies to contain China. On the contrary, changes in the European strategic landscape will bring the EU closer to the U.S. politically, allowing the U.S. to create a larger and more responsive international presence and increase pressure on China. The West's radical sanctions against Russia also provide various possible policy references for future "extreme pressure" in the event of a possible deterioration in U.S.-China relations. China should pay special attention to studying and preventing U.S. blockades and restrictions in financial payments and settlements, cyber security, and key technologies (chips and semiconductors, aerospace, etc.).

V.

Review of the situation to turn crisis into opportunity and strive for greater development opportunities

Based on this analysis, China is faced with a severe external environment, but also new historical opportunities. After the Russia-Ukraine conflict, Chinese President Xi Jinping made frequent calls with leaders of various countries and proposed that "all efforts conducive to the peaceful resolution of the crisis should be supported". Since China has good relations with both the EU and Russia, this crisis is an opportunity for China to give full play to its soft power. At the same time, the initiative to participate in the mediation of the Russian-Ukrainian conflict is conducive to enhancing China's international status. Taking advantage of a period when the U.S. and Europe are focusing their attention on the Russia-Ukraine issue, China should consider various ways to enhance Sino-European relations, stabilize Sino-U.S. relations and improve its external environment. China should calmly observe and analyze the situation and manage to turn the crisis into an opportunity. In this regard, China should consider the following strategies.

First, China should maintain a correct and fair position and work to promote peace. China should strive to play a greater role in bringing about a truce between Russia and Ukraine and achieving peace. In particular, China should pay attention to efforts to strengthen cooperation and communication with EU countries, especially France and Germany; and strive to form a mechanism for multi-party talks within the framework of the United Nations, with the UN P5 working together with Ukraine and the EU to facilitate a ceasefire deal between the two sides and reduce possible instability after the ceasefire to a manageable minimum.

Second, continue to calmly and prudently maintain and develop normal trade relations with Russia and Ukraine.

Third, strengthen communication and cooperation with the EU. We will strive to hold a China-EU summit in April and push for restarting the review of the China-EU Investment Agreement (CAI); actively expand trade relations with EU countries and strengthen China-EU cooperation in renewable energy, green environment and digital economy; China should try to build connections between the "Belt and Road Initiative" and the EU's "Global Gateway" infrastructure initiative.

Fourth, strengthen dialogue and cooperation with the United States to stabilize Sino-U.S. relations. In this process, China should talk more about cooperation, while avoiding escalating conflict. Maintaining an open and cooperative attitude toward the U.S.-led G7 "Building a Better World" infrastructure initiative (B3W) is one of the options. This will greatly increase the common ground between the two sides. China can communicate with the U.S. and Europe about a visit of the U.N. High Commissioner for Human Rights Michelle Bachelet to China in May this year, and prepare for her visit to Xinjiang so that she can understand the real situation in Xinjiang and contribute to easing the accusations of developed countries against China on human rights issues and to lifting the sanctions against Xinjiang.

In terms of domestic policies, China should focus more on the domestic market, pay more attention to the new "dual-circulation" model, which focuses on the domestic side, and make proactive investments in infrastructure as appropriate; accelerate the implementation of its national science and technology development strategy, and accelerate research and development in semiconductors, artificial intelligence, big data, robotics, new energy vehicles, biomedicine and the industrial Internet. China should speed up R&D to continuously enhance national technological security and speed up its pace of digital transformation of the economy.

In such a complex external environment, it is especially important to make efforts in expanding openness, deepening reforms, encouraging more multinational companies from all over the world, especially from developed countries such as Europe, America and Japan, to invest in China, and attract the world's capital markets to invest in China. China should insist on building a high-level open economy. The country should accelerate the upgrading of relevant laws and regulations in the field of international trade, to adopt itself to advanced provisions of international FTAs such as the Comprehensive and Progressive Trans-Pacific Partnership Agreement (CPTPP). China also needs to continue to promote negotiations with member countries of the Digital Economic Partnership Agreement (DEPA), while it deepens its investment and trade ties with members of the Regional Comprehensive Economic Partnership Agreement (RCEP), and release the potential of the world's largest regional economic partnership by uniting powerful economies with greater openness to reduce the impact of the Covid-19 pandemic, regional conflicts and other factors on global economic development.

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Global Vision for China, Chinese Wisdom for the World

Founded in 2008 and headquartered in Beijing, the Center for China and Globalization (CCG) is China's leading global non-governmental think tank. It has more than ten branches and overseas representatives and over 100 full-time researchers and staff engaged in research on globalization, global governance, international economy and trade, international relations and global migration.

CCG is a member of the Belt and Road Think Tank Alliance, a founding member of the US Research Think Tank Alliance established by the Ministry of Finance, a National Talent Research Facility, the site of the China International Professional Committee for Talents of the Ministry of Human Resources and Social Security, and a national Postdoctoral Programme research center. CCG has also been granted Special Consultative Status by the United Nations.

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