Is Putin's war in Ukraine destroying Russia's economic future?

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Whether you call it a special military operation, a preemptive strike, an armed incursion or an outright war, the impact of Putin's actions in Ukraine are likely to have long-term, far reaching impacts on economies around the world, but none more so than that of Ukraine and Russia. I personally believe that Mr. Putin may have underestimated the fierce determination of the Ukrainian people and their military, as well as, the resolve of the majority of the Western world to send a message that what he has done is unacceptable. Looking beyond the short term ramifications of various sanctions and export bans (which we'll briefly discuss later), the long term impact of his actions could result in a sizeable hole that could take years, if the country can ever dig itself out of.

The primary focus for my thesis today is the importance, if not complete reliance of the Russian economy on fossil fuels. According to this BBC article, oil and gas provided 39% of the Russian federal budget revenue and made up 60% of Russian exports in 2019. This Reuters article suggests that by 2020 oil & gas accounted for over 23% of Russian GDP. It also states that overseas trade made up 46% of Russia's GDP according to the World Bank. Oil and gas provided more than half its exports, with metals accounting for 11%, chemicals about 8% and food products 7%. Despite Russia being one of the largest global suppliers of wheat, fertilizer and a few other commodities, it's oil and gas that grease the economic wheels and ultimately finance Mr. Putin's war machine. Yet it seems Mr. Putin is

willing to sacrifice his golden goose in pursuit of something that I'm not sure anyone in the world fully understands.

What do I mean by this? The theory is twofold. For starters, between Western sanctions being imposed on Russian energy and the denied but obvious "weaponization" of natural gas, Europe is rapidly advancing its move to alternative energy sources and ultimately renewable energy. Thus if/when this all settles down and things head back to pre-war type of activity, Russia's fossil fuels could be worth a lot less due to a combination of demand destruction and more reliable suppliers. In particular, only 13% of the world's natural gas is moved by tankers and the rest by pipelines. Russia has spent a lot of time and money developing the infrastructure to deliver gas to Europe that can't readily be replaced to deliver comparable volumes to China, India or whoever is willing to do business with them. And without a lot of foreign investment and LNG expertise, it could be difficult for Russia to access global natural gas markets anywhere.

Following on from the European move away from fossil fuels to renewable energy (of note, I'm talking years not months). As global demand for fossil fuels begins to roll over, I'm pretty sure Middle East oil producers will be the last ones standing and Russia will still "lose" both market share and netback pricing. If Russia is relying on China to buy all their commodities they are likely in for a rude awakening because China tends to look out for #1 and is more than happy to put the screws to anyone who is in a weak bargaining position. My understanding is that today both China and India are already paying significant discounts to WTI or Brent prices for Russian crude, a lot more than the typical quality discount (similar to the heavy oil differential we see for a lot of Canadian crude). That will likely only get more punitive if the world moves to an oil supply surplus and customers have more choice over what

regime they are willing to support.

As for what's going on today, we see things like export bans impacting car and airplane parts. Russian car production, which accounts for over 600,000 Russian workers, is down over 90% in the last 6 months. It has led to Russia easing safety measures to allow cars be built and sold without airbags and anti-lock brakes amongst other measures. Russia's commercial aircraft fleet is comprised of around 55%-60% of foreign built aircraft (primarily Boeing and Airbus) which are no longer providing parts or maintenance services meaning at some point there will probably be a dramatic drop in air travel capacity. This could have a significant impact on the economy given that over 50% of Russian GDP comes from the service industry which includes hotel and catering services, as well as culture and entertainment. Tough to see the service sector picking up the slack if people find it harder and harder to get from point A to point B.

Looking even further ahead into the future, sanctions and a lack of foreign investment today are likely to make things a lot harder for Russia to be able to develop its own renewable energy industry, albeit they do have most of the raw materials. This puts the country and the economy further in the hole as it relies on the rest of the world for technologies and investment to "catch up", assuming renewable technologies achieve their goal of not just being better for the environment, but a far more economic source of energy.

I don't have a crystal ball and I have no idea how this whole situation plays out. However, I find it hard to imagine a scenario where in 5 years from now Russia's economy is in better shape than it was prior to February 24. And the Russian people have one person to "thank" for that.