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Impact of Russia's Invasion of Ukraine in 2014 on Ukraine's Trade, FDI and Tourism Flows

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1. Background

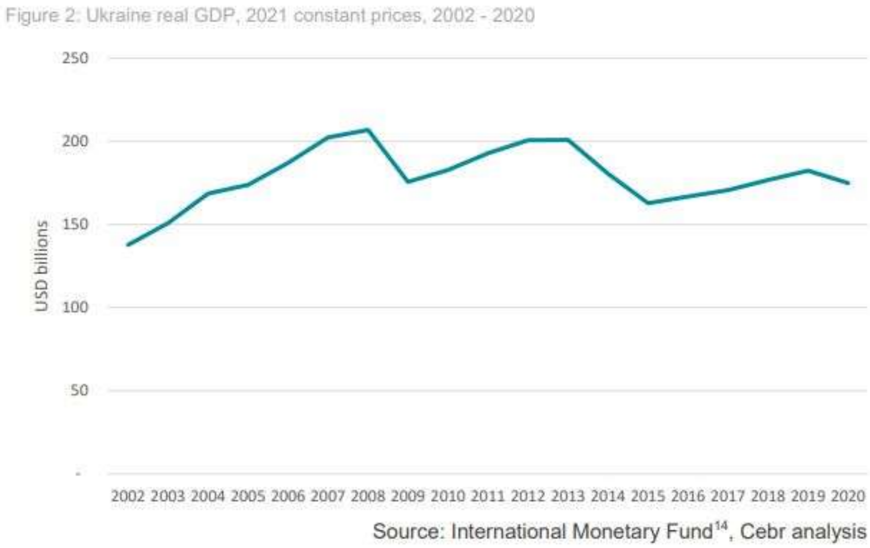
Ukraine formed part of the Soviet Union until 1991, at which point it declared independence from Russia. However, since then, it has been an imperfect democracy with a weak economy and foreign policy that wavers between pro-Russian and pro-European identification. In November 2013, Ukraine experienced an internal crisis when its then President Viktor Yanukovych rejected a deal for greater integration with the European Union (EU) which sparked mass protests and ultimately resulted in the exile of the President. With this, Russia tried to salvage its lost influence, invaded Ukraine and annexed Crimea in March 2014. In April 2014, pro-Russia separatist rebels began seizing territory in Eastern Ukraine and fighting intensified between the separatist group and the Ukrainian military. In August 2014, Russia's military invaded Eastern Ukraine to support the rebel group, which resulted in stringent economic sanctions imposed on Russia by the United States and EU. However, the burden of these sanctions fell on the EU, which is heavily reliant on Russian natural gas exports.

The Russia-Ukraine conflict and sanctions imposed on Russia by the US and Europe had serious consequences not only for Russia and Ukraine, but for Europe. The US imposed a number of sanctions including travel bans, asset freezes of Russian individuals, bans on borrowing by leading Russian banks and companies, as well as restrictions on exports of military and dual-use goods to Russia. These sanctions dampened Russia's investment climate and economic growth, which resulted in Russia's GDP contracting by EUR20bn in 2014, EUR30bn in 2015 and EUR60bn in 2016 – a one percentage point loss in GDP. In contrast, Ukraine's GDP contracted by 6% (EUR6bn) due to the conflict, with industrial production coming to a standstill, largely attributed to power cuts and railway disruptions. The effects of the conflict on individual EU countries varied by its degree of reliance on the Russian export market. Even though the EU as a whole has relatively low trade exposure to Russia, some EU countries, such as the Baltic States, trade heavily with Russia, and were hard hit by the export ban.

2. Effects on Ukrainian GDP

The Ukrainian economy has been highly volatile since the global financial crisis in 2008 but stagnated further in 2013 due to the onset of trade sanctions by Russia and high political instability. However, the impact of the conflict became more pronounced in 2014 when the annexation of Crimea and Russia's military invasion in Donbass lead to a 10.1% contraction in GDP. Following this, hostilities continued to rise, and investor confidence fell causing the economy to shrink by a further 9,8% in 2015 as shown in Figure 1 below:

FIGURE 1: UKRAINE REAL GDP, 2002-2020



In summary, Ukraine's cumulative loss in GDP as a result of the conflict with Russia totalled USD280bn from 2014 to 2020, or USD40bn per annum, equivalent to 19.9% of Ukraine's pre-conflict GDP.

3. Effects on Ukrainian FDI

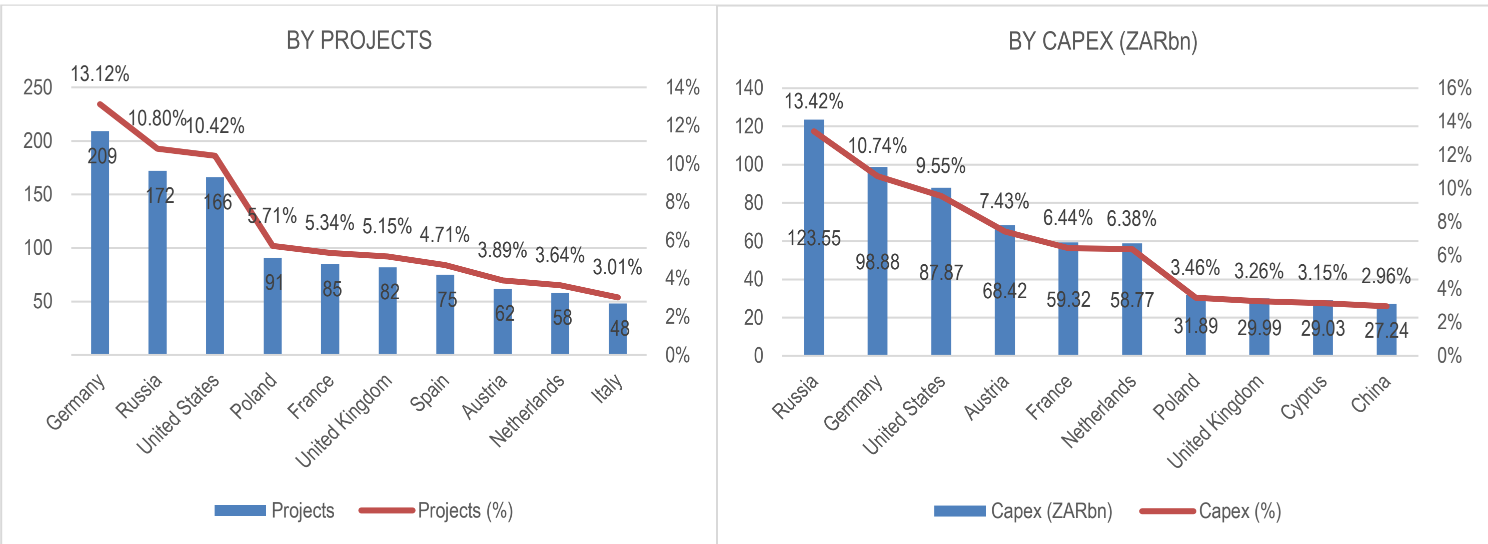
Over the period 2003 to 2021, 1,593 Greenfield FDI projects were invested into the Ukraine with a total capital expenditure (capex) of ZAR980.48bn. This collective investment by 1,062 global companies created 261,172 jobs over the period under review.

FIGURE 2: FDI INTO UKRAINE, 2003-2021

Source: FDI Markets, 2022

As Figure 3 shows, Germany was Ukraine's largest source market for FDI projects invested over the period 2003 to 2021 accounting for 13.12% of all projects, while Russia followed in close second with 172 projects (accounting for 10.80%). Further, Russia was the largest source market for FDI capex, accounting for 13.42% of capex, followed by Germany (10.74%) and the US (9.55%). It is important to note that majority of FDI projects from Russia occurred pre-2013, with only 16 out of the 172 projects occurring between 2014 and 2021.

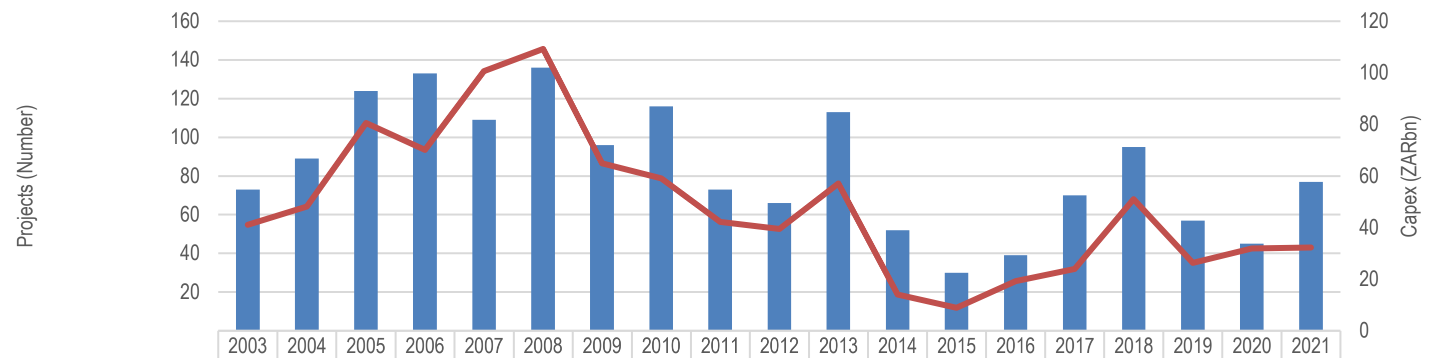
FIGURE 3: FDI INTO UKRAINE by SOURCE MARKET, 2003-2021



Source: FDI Markets, 2022

Following the Euromaidan that took place in late 2013 and continued into early 2014, the annexation of the Crimea and the onset of warfare in Donbass, FDI inflows in Ukraine declined drastically, from ZAR57.05bn in 2013 to ZAR14.01bn in 2014. Similarly, the number of FDI projects dropped by 54% from 113 projects in 2013 to 52 projects in 2014. Investor confidence remained low in the years following the Russia-Ukraine war as FDI failed to return to its pre-2014 levels, with hopeful signs of recovery only occurring in 2018.

FIGURE 4: TREND IN FDI INTO UKRAINE, 2003-2021

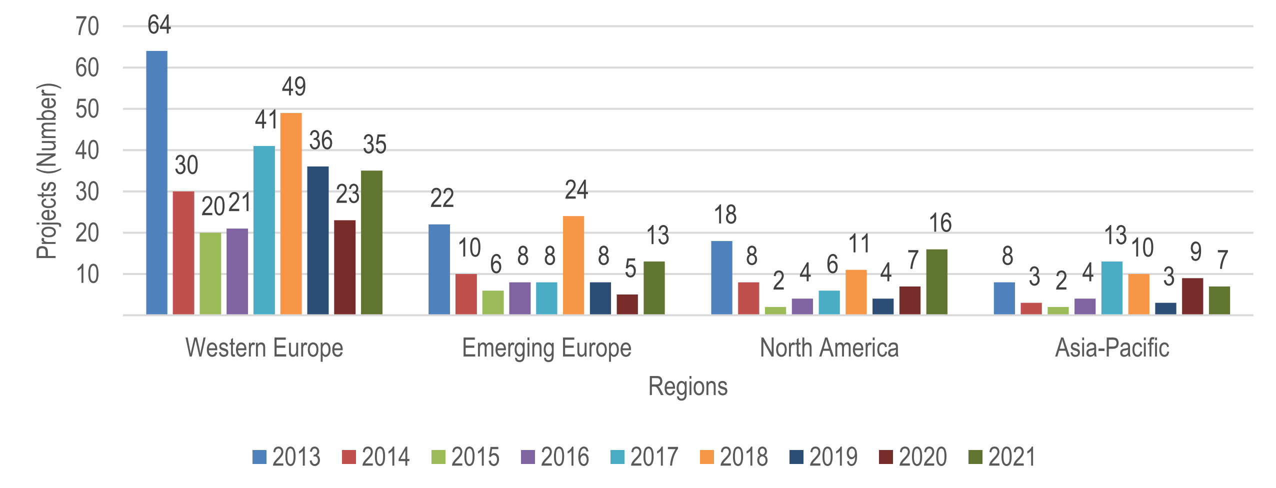


	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Projects	73	89	124	133	109	136	96	116	73	66	113	52	30	39	70	95	57	45	77
Capex (ZARbn)	41.15	48.18	80.52	70.16	100.64	109.26	64.9	59.14	42.19	39.52	57.05	14.01	8.91	19.28	23.98	50.98	26.31	31.95	32.33

Source: FDI Markets, 2022

Western Europe was the largest source region for inward FDI into Ukraine in 2013, with 64 projects invested. This capital undertaking fell by nearly 50% to 30 projects invested in 2014 and nearly 70% in 2015 and 2016, which was indicative of low investor confidence. A similar trend can be seen in other regions, with inward FDI investments from Emerging Europe and North America falling significantly and remaining low for at least four years following the conflict in 2014.

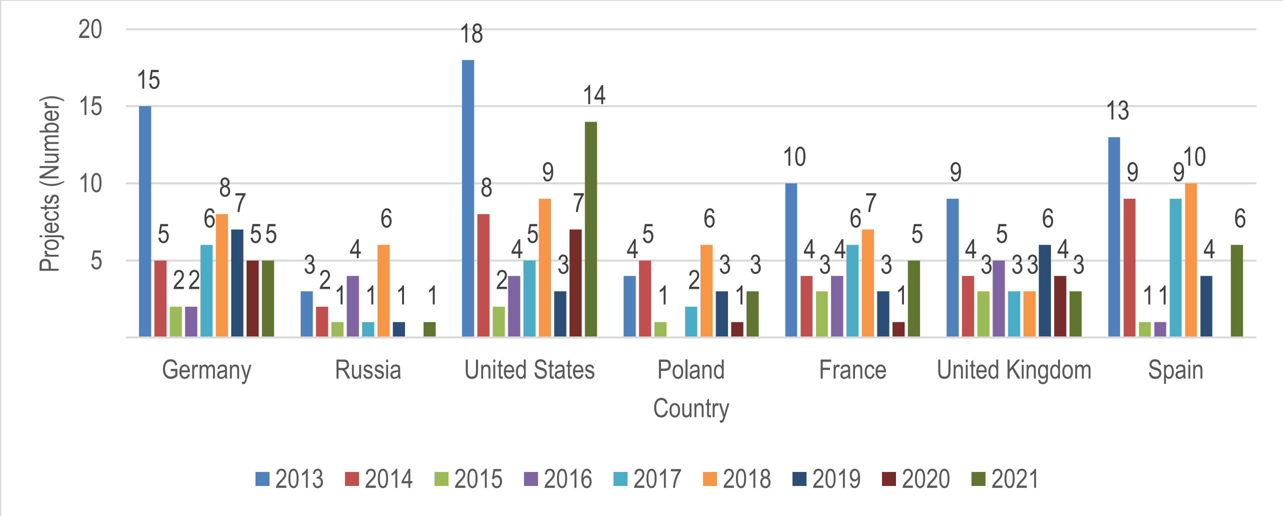
FIGURE 5: FDI INTO UKRAINE by WORLD REGIONS, 2013-2021



Source: FDI Markets, 2022

FDI from the top seven investing countries is shown below in Figure 6. Following the war in 2014, FDI projects from Germany fell by 67%, from 15 projects invested in 2013 to five projects in 2014. Similarly, FDI projects from the US fell by 55%, by 60% from France, and 55% from the United Kingdom. From the top seven investing countries into Ukraine, Poland was the only country to increase FDI projects into Ukraine, albeit marginal by one project in 2014.

FIGURE 6: FDI INTO UKRAINE by COUNTRY, 2013-2021

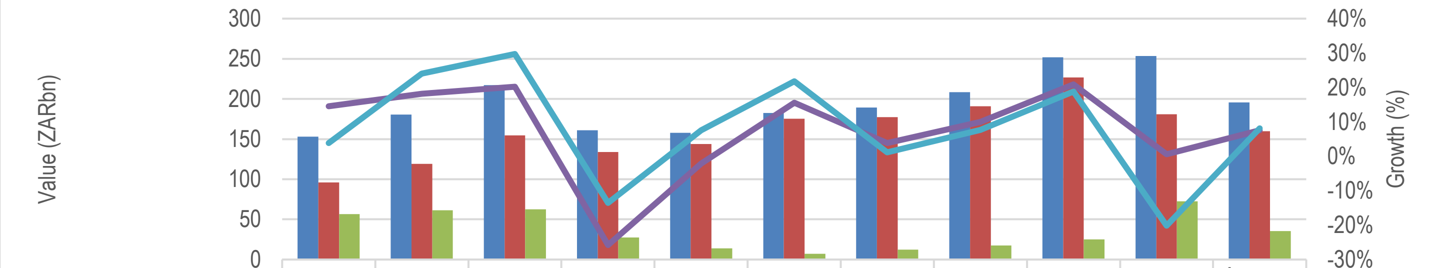


Source: FDI Markets, 2022

4. Effects on Ukrainian Trade

Ukraine's trade in services experienced positive growth from 2011 to 2013, with services exports growing from 14.50% in 2011 to 20.02% by 2013. However, amid tensions arising from the Russia-Ukraine conflict, service exports declined by 25.79% while import services declined by 13.54% in 2014. This was due in part to Russian sanctions imposed on Ukraine, as well as a drop in demand for Ukrainian services and travel bans imposed by Russia in retaliation to strict sanctions imposed by the EU in 2014.

FIGURE 7: UKRAINE TRADE IN SERVICES, 2011-2020

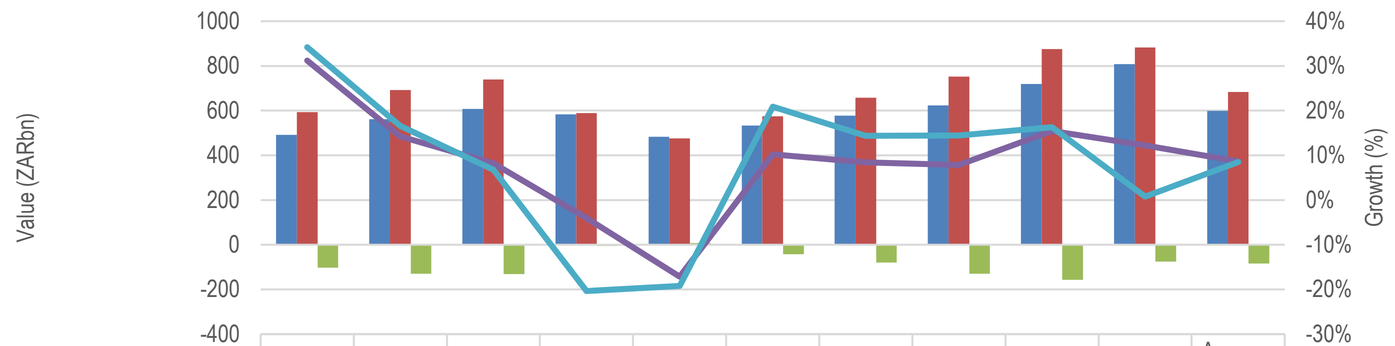


	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Average (2011-2020)
Exports (ZARbn)	152.94	180.66	217.15	161.14	157.81	182.43	189.49	208.5	252.08	253.63	195.583
Imports (ZARbn)	96.23	119.32	154.79	133.84	143.95	175.27	177.26	190.91	226.82	181.1	159.949
Trade Bal (ZARbn)	56.7	61.34	62.36	27.3	13.86	7.17	12.23	17.59	25.26	72.53	35.634
Export growth (%)	14.50%	18.13%	20.20%	-25.79%	-2.07%	15.60%	3.87%	10.03%	20.90%	0.62%	7.60%
Import growth (%)	3.87%	23.99%	29.73%	-13.54%	7.55%	21.76%	1.14%	7.70%	18.81%	-20.16%	8.09%

Source: TradeMap, 2022

As a result of the war with Russia and various economic sanctions imposed, Ukraine's exports declined by 4.01% in 2014, its first negative growth in exports since 2011. Foreign trade worsened in 2015 where export growth declined by 17.15%. The deterioration of exports corresponds primarily with shrinking trade with Russia, as well as a decline in exports to the EU as a result of a decline in industrial production in the war-zone area of Donbas. In contrast, Ukrainian import growth declined by 20.36% in 2014 and 19.18% in 2015, in line with Russia announcing a ban on imported food from Ukraine in retaliation to Ukraine blacklisting many Russian banks, defence firms and airlines – in line with EU sanctions.

FIGURE 8: UKRAINE TRADE IN GOODS, 2011-2020

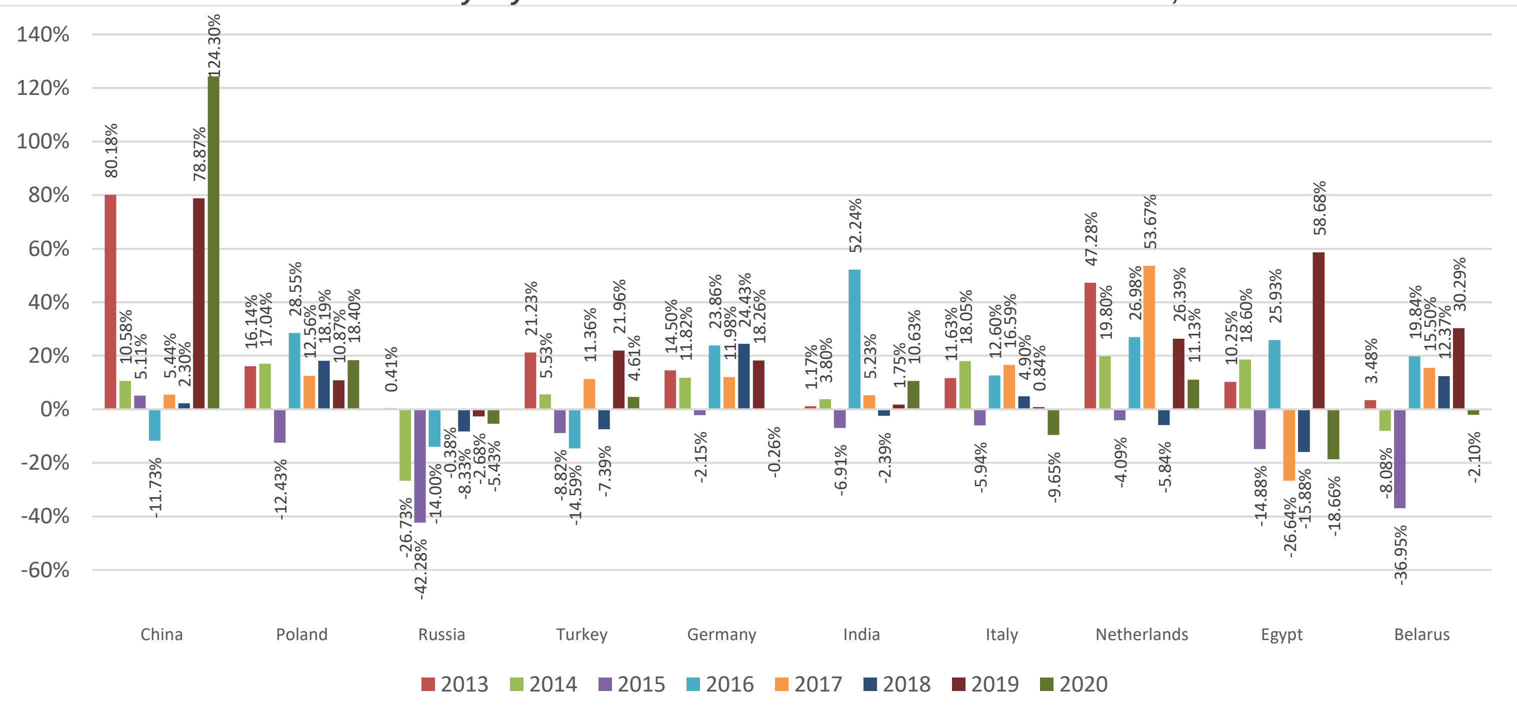


	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Average (2011-2020)
Exports (ZARbn)	491.79	561.83	608.06	583.69	483.6	532.89	577.77	623.22	719.54	807.68	599.01
Imports (ZARbn)	594	692.38	739.29	588.76	475.85	575.23	657.73	752.94	875.88	882.74	683.48
Trade Bal (ZARbn)	-102.21	-130.55	-131.23	-5.07	7.75	-42.33	-79.97	-129.72	-156.34	-75.06	-84.47
Export growth (%)	31.20%	14.24%	8.23%	-4.01%	-17.15%	10.19%	8.42%	7.87%	15.46%	12.25%	8.67%
Import growth (%)	34.19%	16.56%	6.77%	-20.36%	-19.18%	20.88%	14.34%	14.47%	16.33%	0.78%	8.48%

Source: TradeMap, 2022

As displayed in Figure 9 below, Ukrainian exports to its largest export markets fell drastically in 2014, primarily as a result of the Russia-Ukraine war. Due to these tensions, exports to Russia, who was Ukraine's largest export market in 2013, fell by 26.73% in 2014 and 42.82% in 2015, while exports to other significant export partners such as China fell from an export growth rate of 80% in 2013 to 10% in 2014.

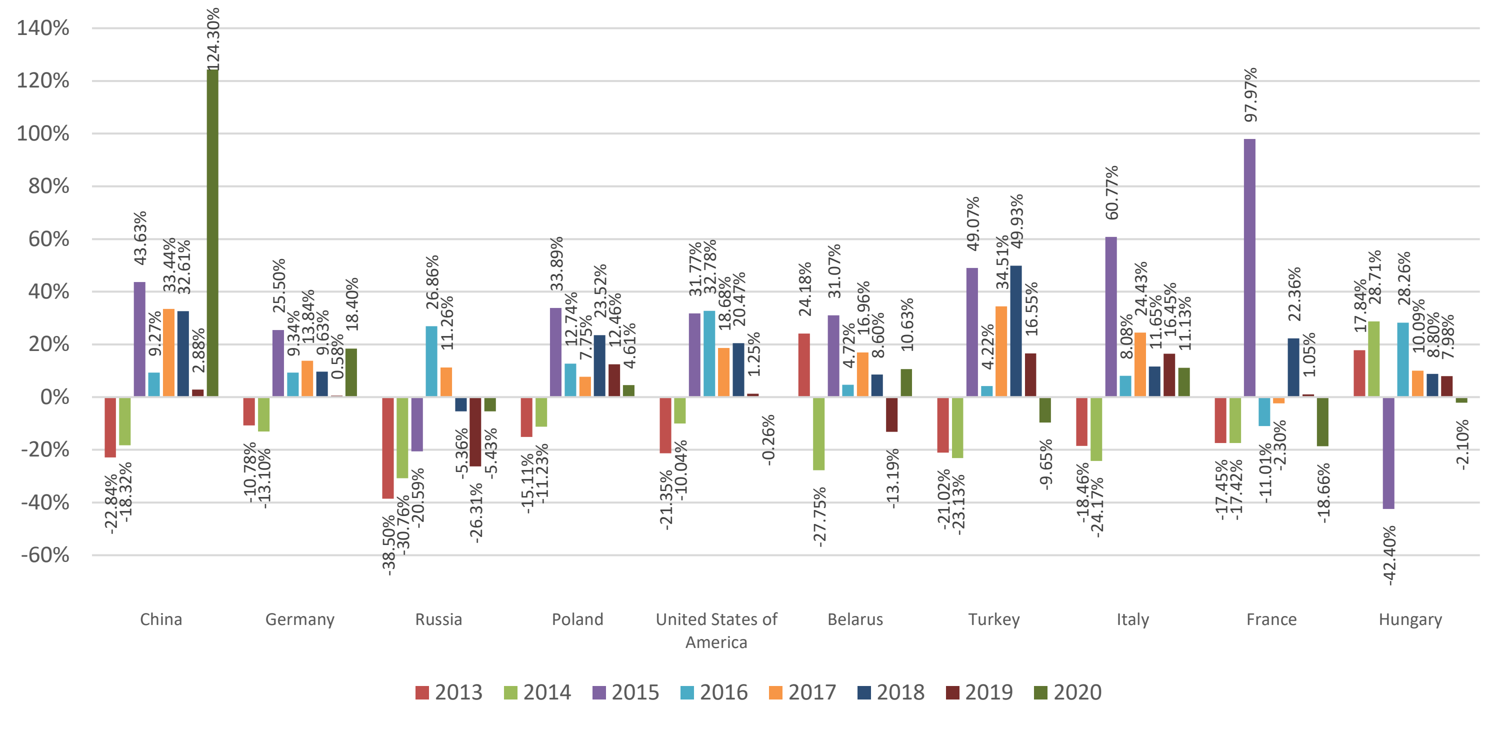
FIGURE 9: UKRAINE y-o-y EXPORT GROWTH TO TOP 10 EXPORT MARKETS, 2013-2020



Source: TradeMap, 2022

In contrast, import growth from large import partners followed a similar trajectory, with imports from Russia sustaining negative growth from 2013 through to 2015. Ukraine's imports from other large import markets all experienced negative growth in 2014, with imports from China declining by -18.32%; Belarus declining by -27.75% and Italy declining by -24.17% in 2014.

FIGURE 10: UKRAINE y-o-y IMPORT GROWTH TO TOP 10 IMPORT MARKETS, 2013-2020



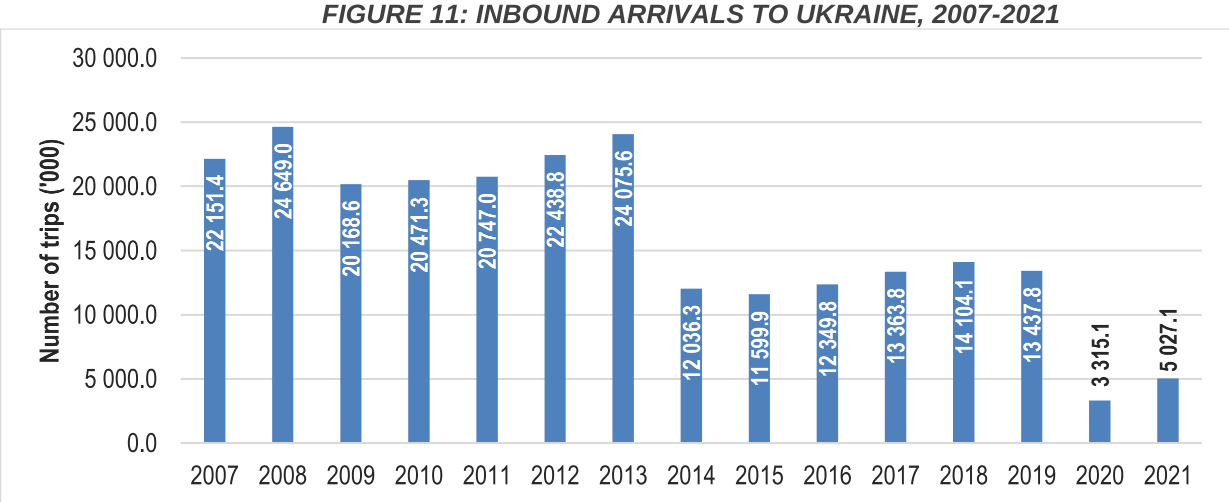
Source: TradeMap, 2022

5. Effects on Ukrainian Tourism

5.1 Inbound Arrivals to Ukraine: 2007 – 2021

Inbound trips to Ukraine have struggled to recover post 2013, reaching its peak at 14 million in 2018, just over half of the 24 million trips the country recorded in 2013. Between 2007 and 2013, inbound arrivals to Ukraine grew by an average annual growth (AAGR) rate of 2% and dropped to an AAGR of -6% between 2014 and 2019. With the onset of the COVID-19 pandemic, inbound arrivals declined by -75%, from 13.4 million in 2019 to 3.3 million in 2020 and recovered to 5 million in 2021. Inbound arrivals to Ukraine are expected to recover slowly and are unlikely to reach 2019 levels within the next five years.

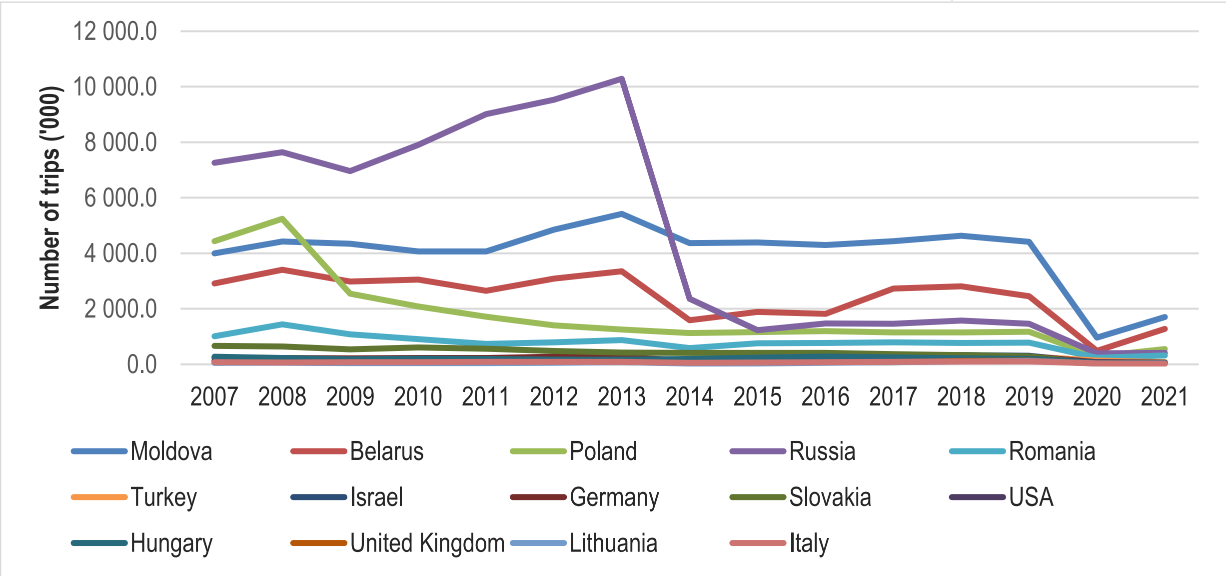
FIGURE 11: INBOUND ARRIVALS TO UKRAINE, 2007-2021



Source: Euromonitor International, 2022

In terms of number of trips, Moldova, Belarus, Poland, Russia, and Romania have remained the country's top inbound source markets since 2007. However, inbound arrivals declined by -50% in 2014 due to the Russia-Ukraine war. Arrivals from Russia, in particular, declined by a massive -77%, falling from 10.2 million in 2013 to only 2.3 million in 2014 and have remained below the 2 million mark since then. Lithuania (-65%), Belarus (-52%), Germany (-48%), and the UK (-46%) saw the biggest declines in inbound arrivals from 2013 to 2014, after Russia.

FIGURE 12: TOP INBOUND COUNTRIES TO UKRAINE, 2007 - 2021

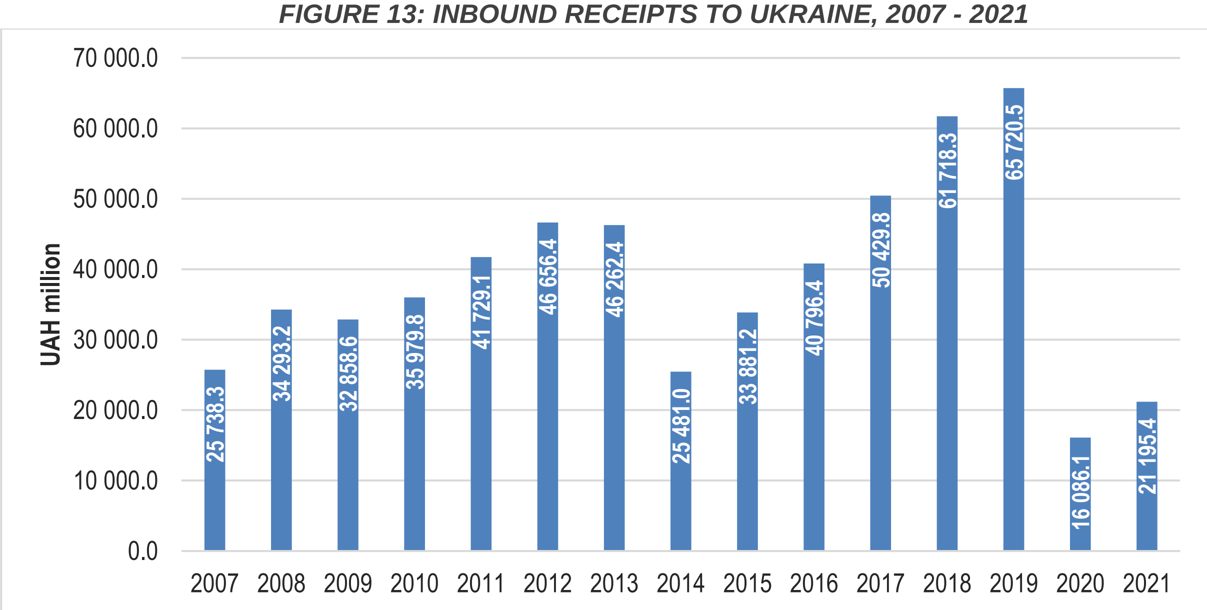


Source: Euromonitor International, 2022

5.2 Inbound Tourism Expenditure in Ukraine: 2007 – 2021

The Russia-Ukraine war had a major impact on inbound receipts in 2014 as Ukraine's retail sales value declined by -45% from 2013 to 2014. Since 2015, inbound receipts grew steadily reaching UAH 65.7 billion in 2019. However due to the COVID-19 pandemic, tourism retail sales declined by -76% to UAH 16 billion in 2020.

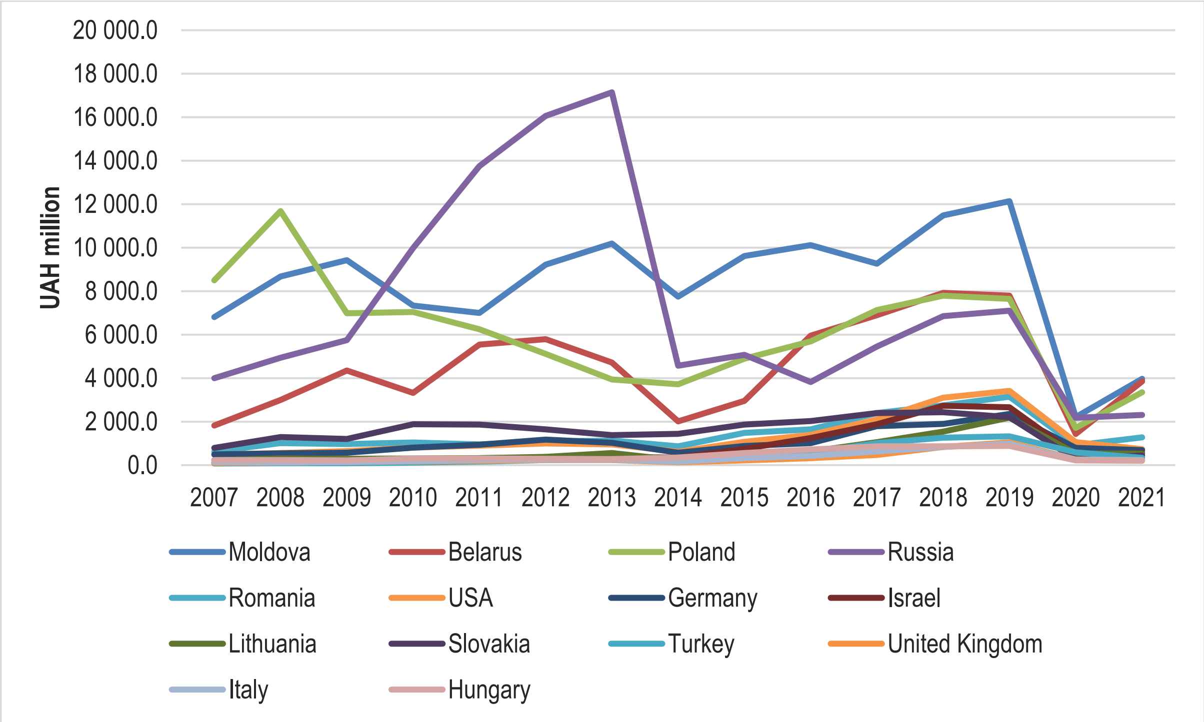
FIGURE 13: INBOUND RECEIPTS TO UKRAINE, 2007 - 2021



Source: Euromonitor International, 2022

Moldova, Belarus, Poland, and Russia have remained Ukraine's top inbound markets in monetary terms since 2007. Slovakia was historically the fifth biggest spender but has been overtaken by Romania since 2018. Inbound receipts from Russia declined by -73%, falling from UAH 17 billion in 2013 to UAH 4.5 billion in 2014. Further declines followed from Lithuania (-60%), Belarus (-57%), Germany (-44%) and the UK (-41%). Overall, Ukraine lost UAH 20 billion in 2014, due to the Russia-Ukraine war and the country recorded another loss of UAH 49 billion due to the COVID-19 pandemic in 2020.

FIGURE 13: RETAIL VALUE BY TOP INBOUND MARKETS TO UKRAINE, 2007 - 2021



Source: Euromonitor International, 2022