Is East Africa immune from Impacts of Russia-Ukraine conflict?

Many East African CEOs had contemplated the Russian-Ukraine war as an event occurring in Europe with little impact on their business. They were wrong. It is now three months into the conflict and global economies are beginning to feel the impact of the war in Ukraine. From financial markets volatility, forex illiquidity, stock market decline, to the impact of sanctions on Russia's government, banks, and businesses by the US, EU and other countries, it is becoming apparent that this conflict will have far reaching implications across the globe.

As Russia's aggression in Ukraine continues, key multinational companies especially from EU and US have pulled out of Russia as a way of expressing their solidarity with Ukraine. These include oil multinationals such BP, which announced that it was offloading its 19.75% shareholding in Rosneft at the onset of the conflict. Shortly after, Shell PLC followed suit announcing that they will cut their ties with Gazprom and related entities, resulting in a $ 5bn write-off of their assets. Other companies such as McDonalds and KPMG have also stopped trading in Russia. While such moves are no doubt at a substantial cost noting the investments made previously, companies have moved to protect their brand by deciding that future business with Russia and Russian entities is not to be continued.

Consequently, this will lead to a loss of global revenues as well as supply chain challenges especially to exporters from Russia.

With the conflict escalating by the day, there is a considerable risk that the physical war in Ukraine will have substantial impacts in East Africa. We have already seen the tightening of the supply chain with exports from Russia being discouraged by CEOs and Governments across the globe. The zero COVID policy by China which has led to lockdowns in key production zones, will also continue to exacerbate East Africa's supply chains woes, leading to product shortages and higher product prices. Perhaps the more direct impacts associated with Russia-Ukraine conflict will be on increased food prices, higher fuel costs, lower tourism revenues, and a decline in investments associated with Russia, or their businesses.

East Africa's investors need to assess whether the region's markets are immune to these geopolitical disruptions and whether they have contingency measures in place to help them absorb the shocks emanating from the conflict.

That Russia and Ukraine account for about a quarter of global wheat exports and supply large quantities of grain to Africa including wheat, maize, and sunflower oil is a well-known fact. Since the conflict began, the Economist Intelligence Unit (EIU), has reported an increase in agricultural input and operating costs, subsequently raising concerns on access to adequate food supplies and the rising cost of food imports in Africa. This is not just an inflationary effect, but it means that the grain required for human and livestock consumption will not be readily available. This is unlikely to be a short-term phenomenon.

The Food Agricultural Organization (FAO) forecasts on 8 April 2022 indicate that this conflict will lead to serious food shortages globally, and more so in chronically food dependent Eastern and the Horn of Africa region. In March 2022, the FAO Food Price Index - a measure of the monthly change in international prices of a basket of food commodities - averaged 159.3 points, a 13.2% increase from 141.1 points in February 2022. This was the highest level since its inception in 1990. The all-time high index was particularly reflected in food items such as meat, dairy, cereals, vegetable oils, and sugar which the index takes into consideration.

FAO further predicts that due to the Russia-Ukraine conflict, the impact on Africa's agriculture will soon be felt through the global agriculture commodities pricing uplifts. Even in the mature markets, the food inflationary pressures are being felt. Recently, the Governor of the Bank of England was quoted by The Times on 17 May 2022 noting that "food shortages pose an apocalyptic inflation threat" .

As the third largest oil producer, several countries including China and Europe (Germany in particular), rely on Russia for oil and natural gas. Russia's invasion of Ukraine has resulted in US and EU sanctions on Russia's oil industry as most of these countries attempt to wean themselves from Russia's oil and gas in the short term. These sanctions have resulted in high inflation across the EU and US, whose leaders have described such inflation as a necessary cost. As expected the disruption of oil and gas supply chains has led to global shortages and high fuel prices. According to the Economist, the demand for fuel surged across the world in 2021 as economies recovered from the Covid-19 pandemic. Even so, global refining capacity dropped leading to high fuel prices and Russia's invasion of Ukraine has pushed them even higher. Whilst the conflict is not solely to blame for high prices in East Africa, these dynamics means that fuel has become 'unaffordable' and inaccessible to the masses in many parts of Africa. In East Africa, several countries have experienced a fuel crisis as shortages of petroleum products and high fuel prices have persisted as a direct result of the Russian-Ukraine war. In Kenya, Uganda, and Tanzania fuel prices increased by an average of 12% from $1.12 to $1.29 in April 2022.

Investors and asset managers in East Africa have also witnessed local currency volatility against the dollar. For instance, the USD to KES exchange rate has increased from 1 USD – KES 113 as of 3 January 2021 to 1 USD – KES 116 as of 26 April 2022. This, if not temporary, will create a circle of inflation, foreign currency shortages especially for importers leading to further supply chain disruptions.

Already there is reported dollar shortage in Kenya, with importers especially manufacturers and international traders, urging the Central Bank of Kenya to release more dollars in the market to ease the persistence shortage.

On a more positive note, the Russia-Ukraine conflict is likely to accelerate sustainability and renewable energy use in East Africa. East Africa's adoption of renewable energy has been on the rise in the recent years, with the International Renewable Energy Agency listing Kenya and Ethiopia as some of the continent's leading countries in energy transition. East African investors will be keenly watching the renewable energy sector with a view of incorporating it in their portfolio, as the sector complements the global Environmental, Social, and Governance (ESG) agenda.

While Russia's investments do not account for a large proportion of East Africa's foreign direct investment (FDI), it is apparent that some projects in the region will be affected by sanctions levelled against Russia and its businesses. These effects include barriers to international payments, reduced availability of project finance, and increased risk aversion by countries and investment partners. Investors and fund managers in East Africa may opt to take caution and review their portfolios or even divest from business or entities that still have ties in Russia because of challenges posed by these sanctions. As the list of sanctioned individuals and entities continue to grow, it will be easier for an investor to simply keep away, rather than pay the high price for violating these sanctions.

In conclusion therefore, the impacts of the conflict in Ukraine are indeed wide ranging. They include Forex illiquidity, stock market volatility, potential future devaluation of local currencies, food and fuel inflation, all of which is likely to make life generally much harder for the businesses, investors and population of East Africa.

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