

May 9<sup>th</sup> 2022

JVI Webinar: The economic outlook for Europe

# **Russia's Invasion of Ukraine: Assessment of the humanitarian, economic and financial impact**

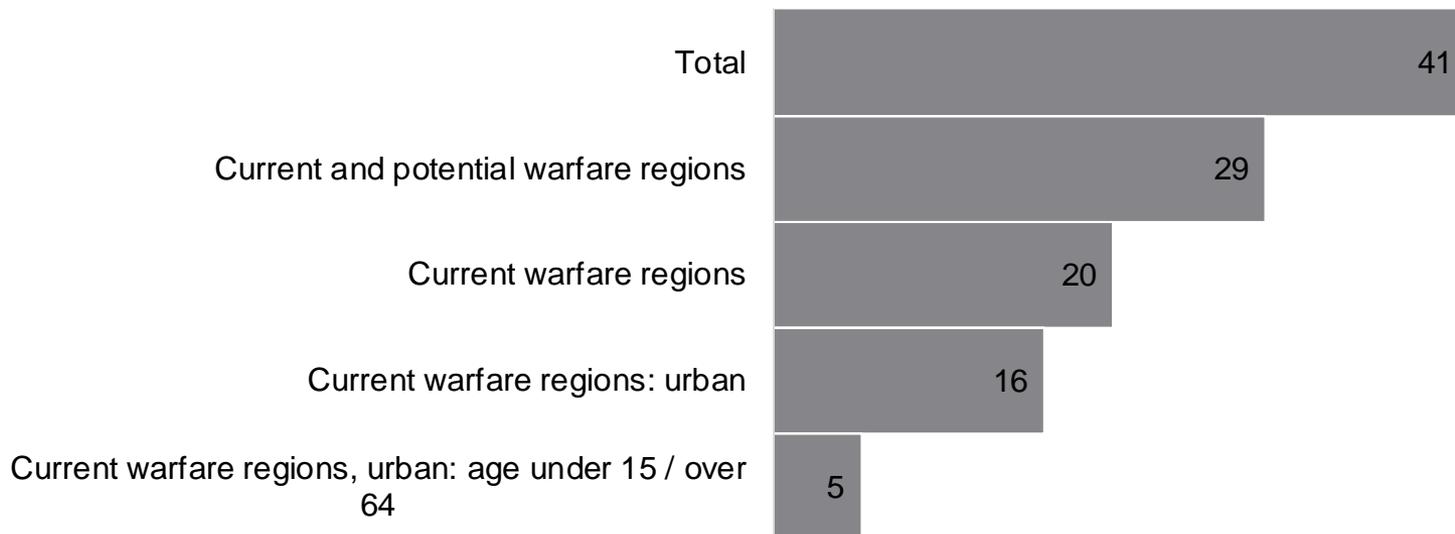
Richard Grieveson, wiiw Deputy Director

## Overview

1. Humanitarian impact
2. Macro fallout
3. Trade impact
4. Financial contagion, monetary + fiscal policy reaction
5. Labour markets
6. Medium-term implications and policy priorities

# Humanitarian impact: Up to 29m in Ukraine could be directly affected by the invasion

## Ukrainian population's exposure to the conflict

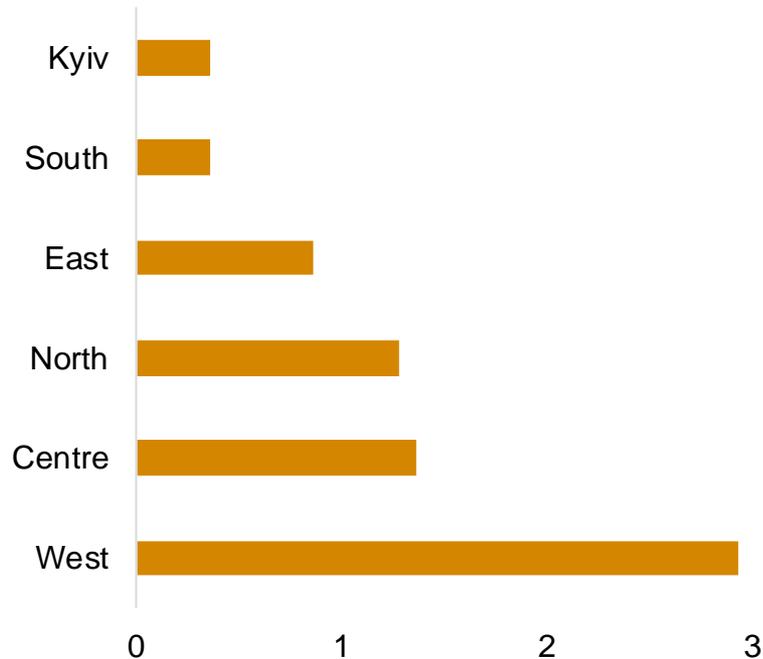


Note: Potential warfare regions are defined as regions that contain part of the river Dniro on their territory, plus Odesa, but that so far have not witnessed a mass Russian armed forces presence.

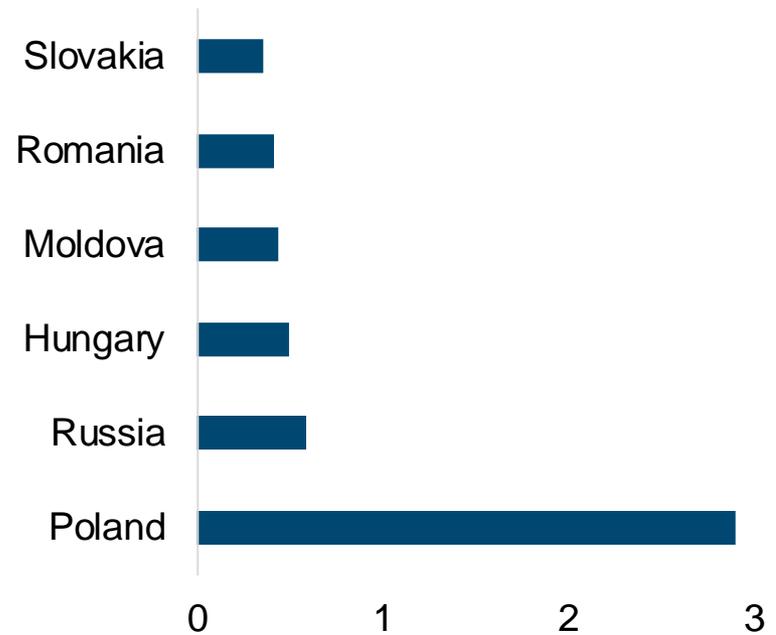
Source: Ukrstat, UNOCHA, own calculations.

## A major humanitarian crisis: Refugee inflows to EU likely to be 3x the 2015-16 crisis

Internally displaced people (IDPs), millions

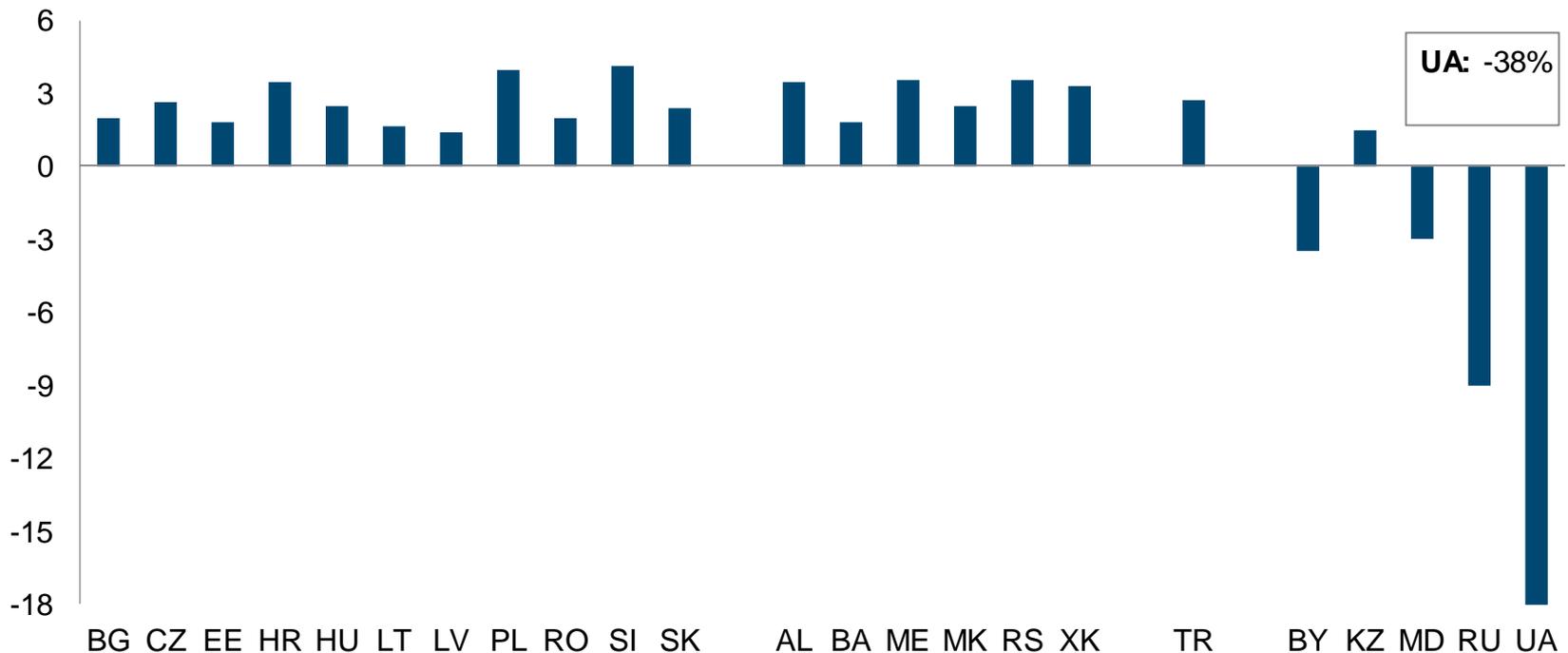


Current number of refugees by host country, millions



## Economic forecasts for CESEE: Deep recessions in CIS+UA, weaker but positive growth for rest

Real GDP growth in 2022, in %, baseline scenario



# Economic cost of invasion for Ukraine will be dramatic: Regions accounting for 53% of GDP affected directly

Main characteristics of regions having been or currently on the front line

Regions	Population 2021 million people	GDP 2019	Industrial	Goods	Services	Agricultural	FDI
			production 2020 shares in the total for the country, %	exports 2020	exports* 2019	production 2020	stock* 2020
Kyiv city	2.95	23.9	11.8	25.3	48.5	-	46.4
Chernihiv	0.96	2.0	1.4	1.8	0.4	6.9	1.1
Kharkiv	2.60	6.2	7.1	3.0	4.6	6.4	2.2
Kherson	1.00	1.6	1.3	0.6	0.4	3.9	0.9
Kyiv	1.80	5.5	5.1	4.0	4.2	5.9	4.4
Mykolayiv	1.09	2.3	2.5	4.6	5.9	3.1	1.5
Donetsk	4.06	5.2	10.3	8.0	1.1	3.3	5.0
Luhansk	2.10	1.0	0.8	0.3	0.4	2.2	0.8
<b>Total for the selected regions</b>	<b>18.91</b>	<b>52.7</b>	<b>43.1</b>	<b>50.3</b>	<b>75.4</b>	<b>34.0</b>	<b>66.0</b>
<b>Total for the selected regions without Kyiv city</b>	<b>15.96</b>	<b>28.8</b>	<b>31.3</b>	<b>25.0</b>	<b>26.9</b>	<b>34.0</b>	<b>19.6</b>

\* Excluding unallocated value.

Source: State Statistics Service of Ukraine, National Bank of Ukraine.

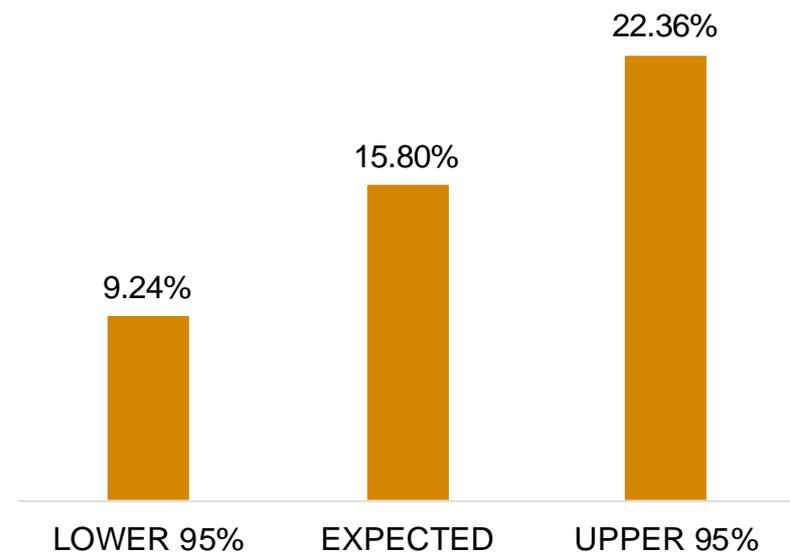
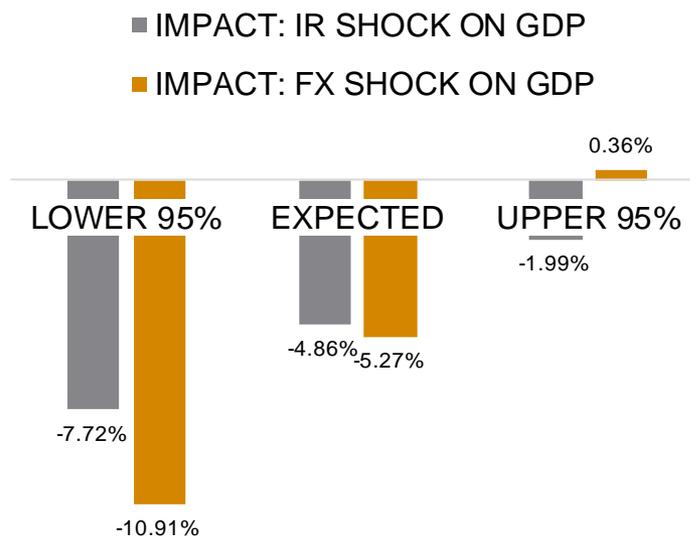
\* Excluding unallocated value.

Source: State Statistics Service of Ukraine, National Bank of Ukraine.

For Russia, this is an economic disaster: GDP will fall by around 10%, inflation could hit around 30% by end-year

Impact of interest rate and currency shocks on Russia real GDP

Impact of currency shock on Russian inflation

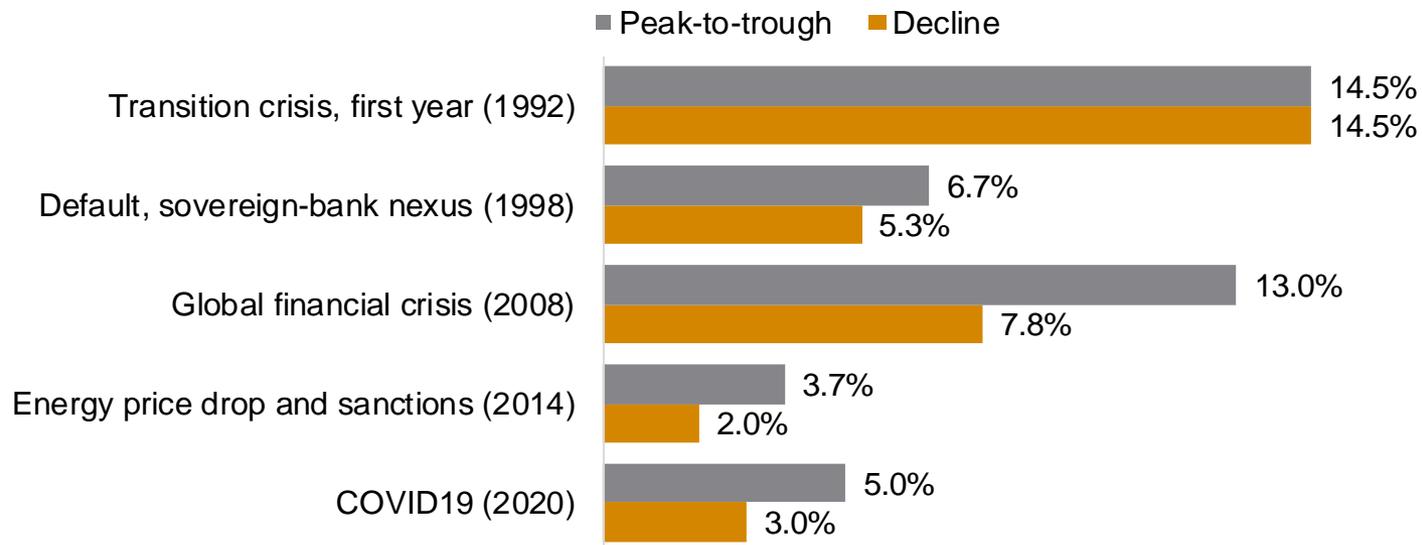


Notes: Shock scenarios assume a 10.5% increase in the key rate and depreciation of the national currency to half of its original value. Values show cumulative dynamic multipliers of doubling gas and oil prices, estimated using a 2-lag VARX model. Estimated with quarterly data. See report Annex for more detail on model specification and sensitivity of results to the model specification.

Sources: IMF International Financial Statistics (IFS), Yahoo Finance, own calculations.

## Historical context gives further guide: About -15% is the “extreme” case

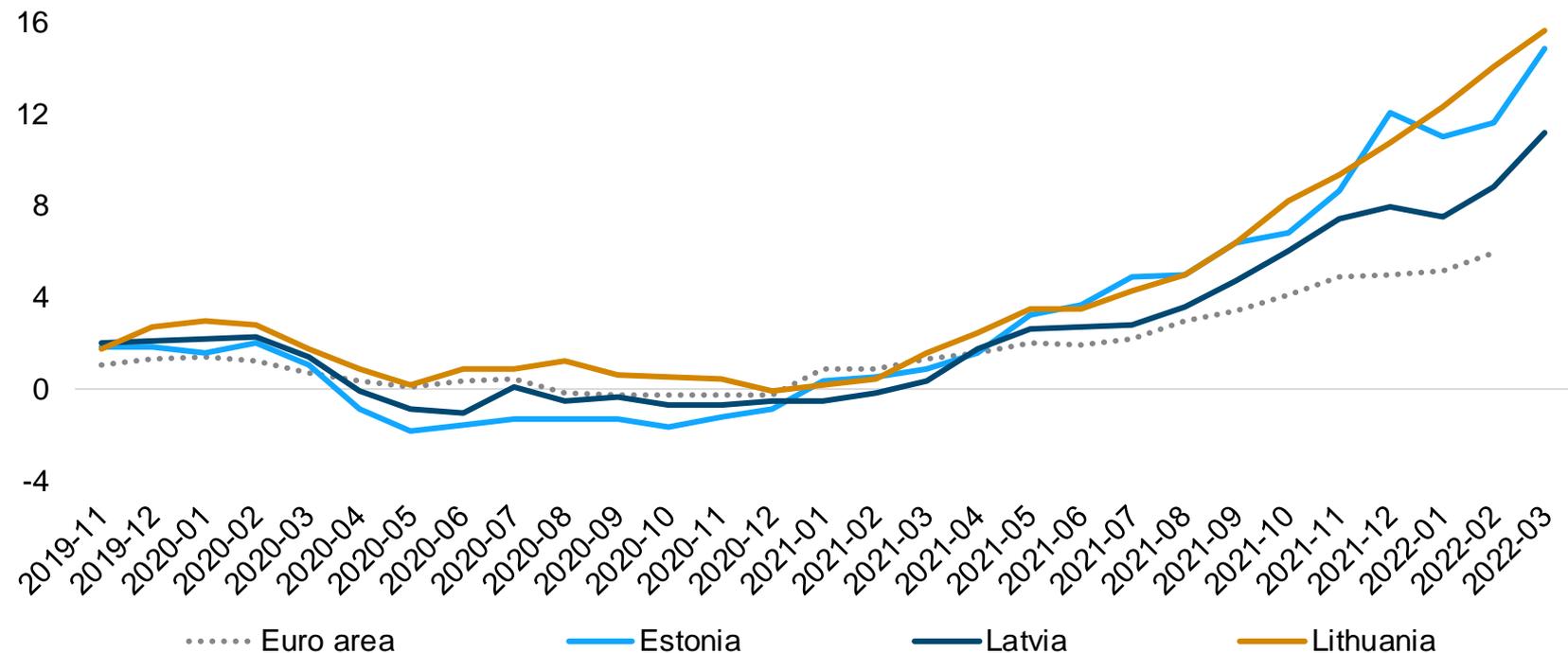
### Biggest declines in Russian real GDP in the post-communist era



Note: Peak-to-trough value for 1992 calculated as a simple growth rate due to no negative growth rates in 1990 and 1991. Transition crisis 1992 reflects only the strongest episode of GDP decline in a single year. Value for 2014 compares with 2013 growth rate due to macroeconomic turbulence of Russia in Q4 2014.

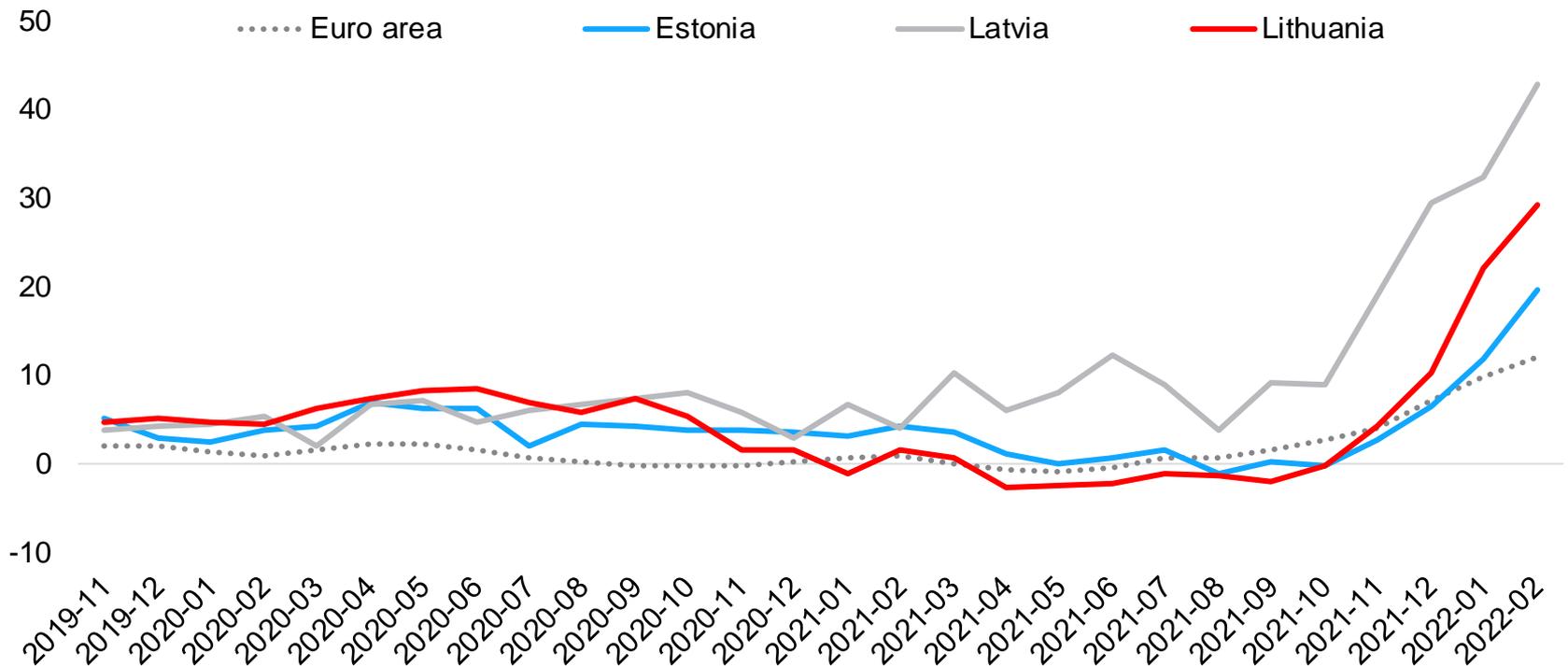
## Main impact in most of Europe will be higher inflation and lower growth, especially in CEE

Harmonised index of consumer prices, % change, year on year



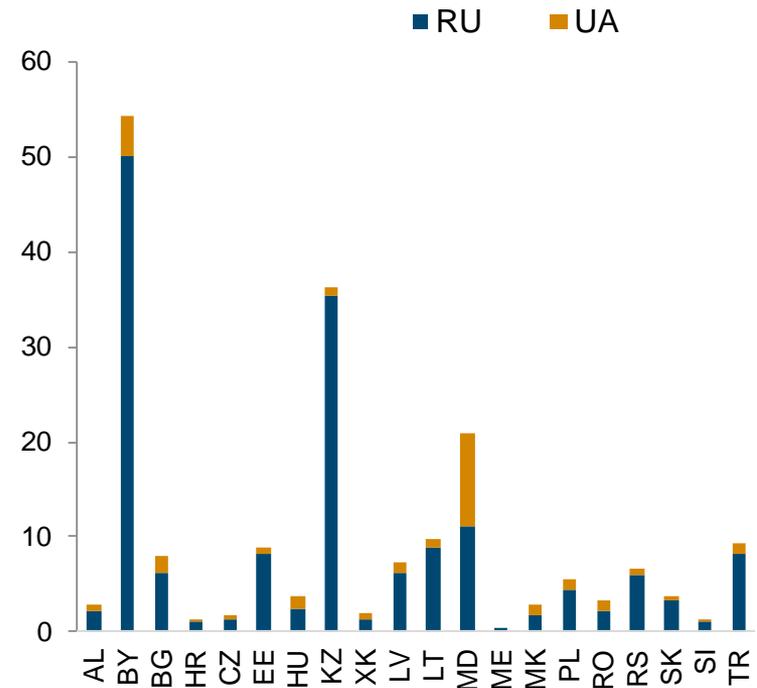
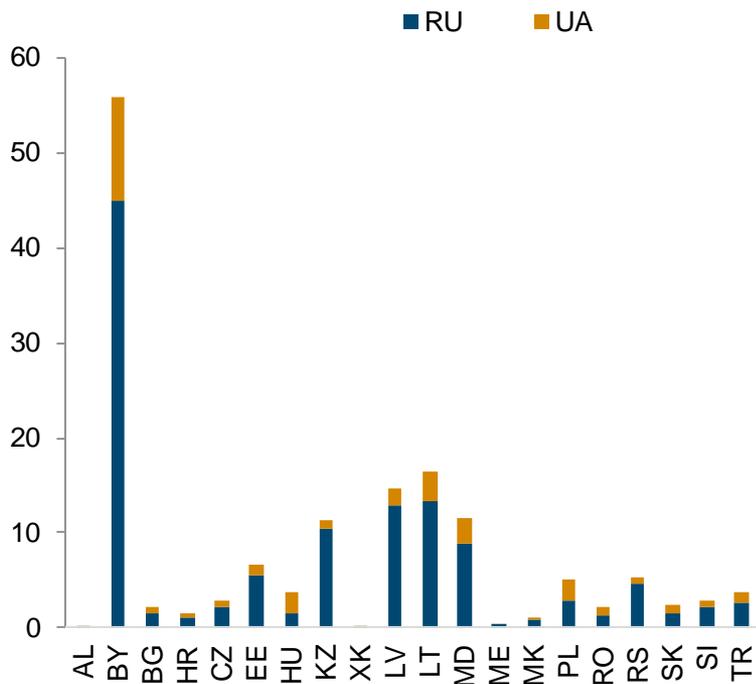
## Food prices a big issue, especially for poorer households – governments increasingly considering controls

Harmonised index of consumer prices; flours and other cereals; % change, year on year



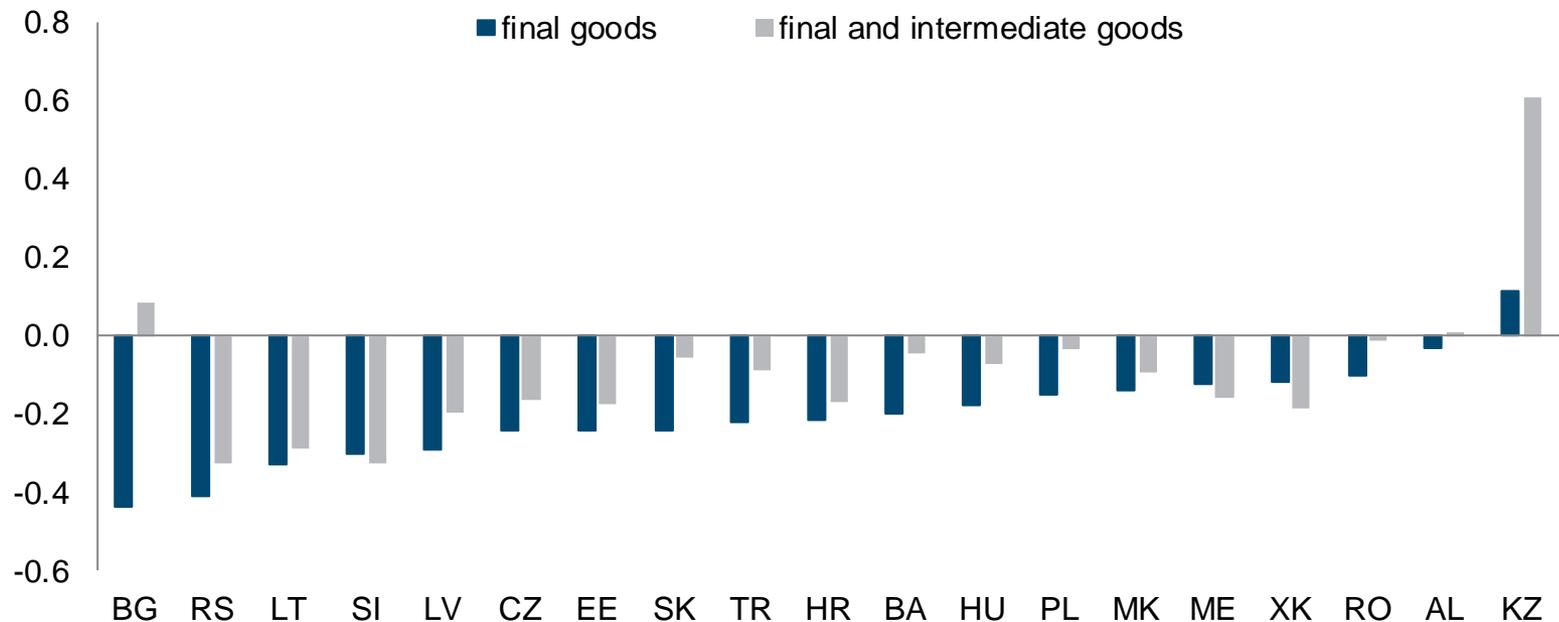
## Trade impact: Most of CESEE have limited exposure, reflecting partial de-coupling since 2013

Exports to (left) and imports from (right) Russia and Ukraine, 2020, % of total



## Trade channel: Direct impact of the recession in Russia on European economies will be limited

Estimated GDP effects of a 9% recession in Russia via the trade channel, in pp

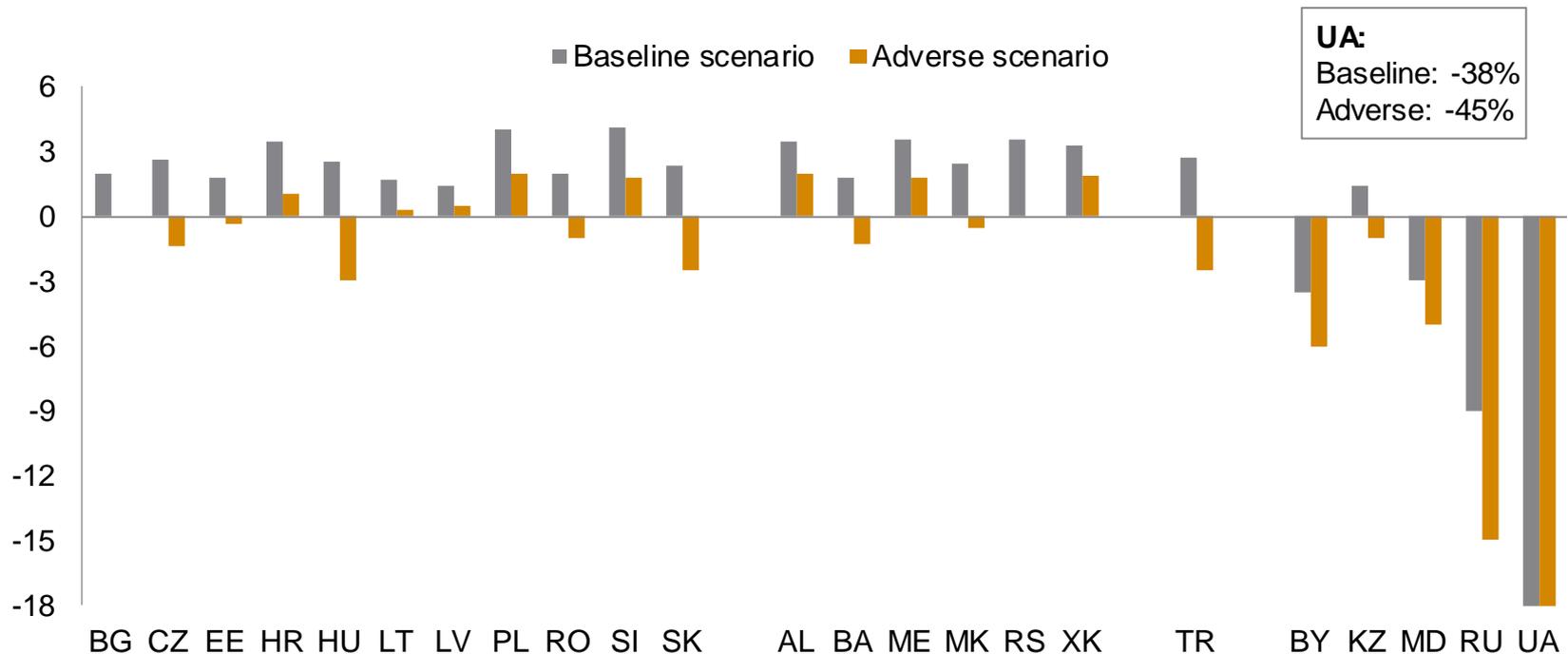


Note: Western Balkan countries based on wiiw MC-IOT.

Source: OECD TiVA database, Release 2021, own calculations.

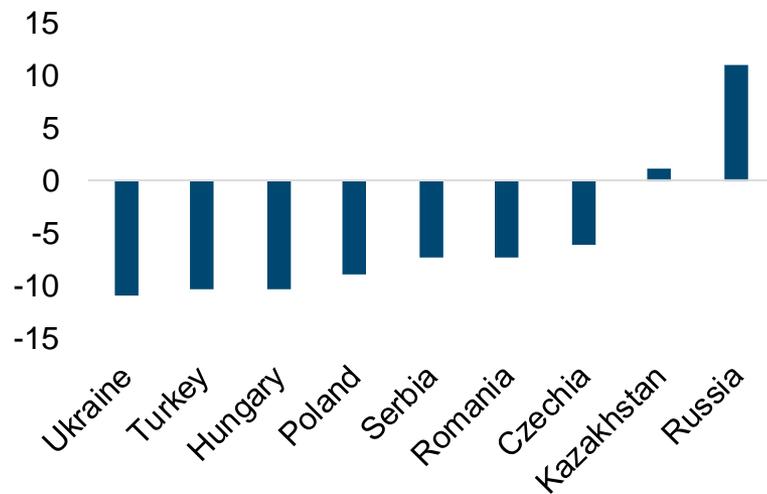
# Energy embargo would subtract ~3pp from euro area growth, and weaken CESEE momentum considerably

Real GDP growth in 2022, in %

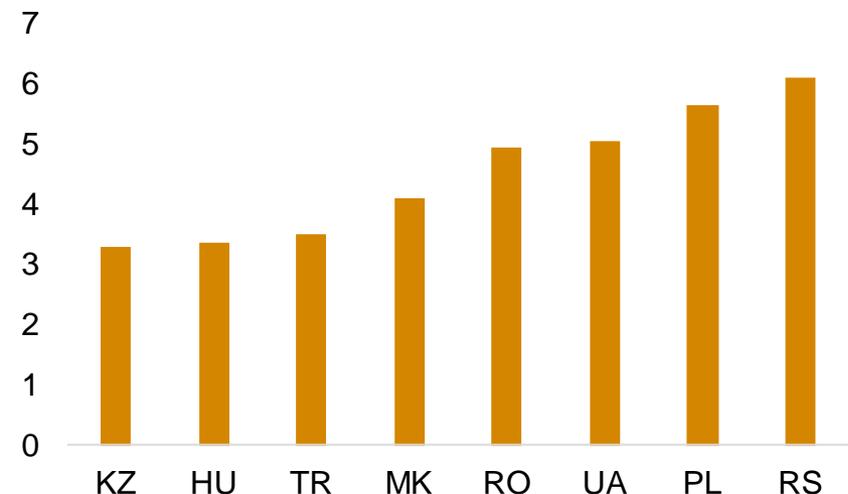


Financial contagion also important, but stability risks are limited – most have policy space to maintain calm

Percentage change in value of national currency versus US\$ since end-2021

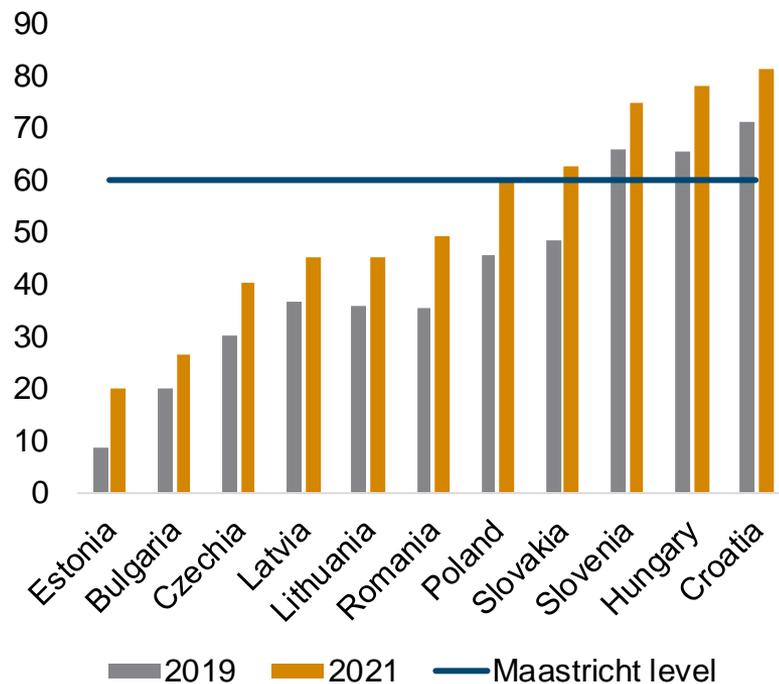


Months of import cover: gross central bank reserves, excluding gold, divided by average monthly value of imports, end-2021

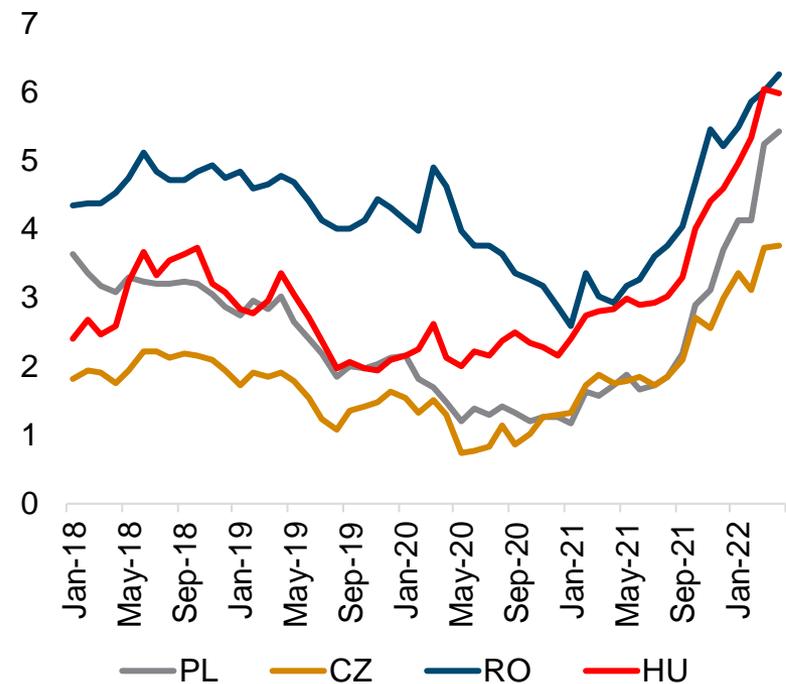


# Fiscal space? Higher public debt, but most below 60%; nominal rates rising (but for now negative in real terms)

Gross general government debt, %  
of GDP



Nominal 10-year sovereign interest  
rates, %



## Labour market impact: A challenging first year, but then help for CEE countries struggling with labour shortages

- EC temporary protection scheme is positive step to foster Ukrainian refugees' integration into EU labour markets.
- However, three main challenges:
  - Those fleeing the war are mostly women, children and the elderly.
  - Some EU labour markets are still recovering from the COVID-19 crisis.
  - Although average education level of Ukrainians is above EU average, doubts about the transferability of refugees' skills, knowledge and work experience, at least in the short-run.
- All of this is manageable, but positive labour market supply shock likely to be more evident next year.

## First thoughts on the medium term: A major acceleration of Russia-West decoupling that started in 2013

- February 2022 was probably the swansong for broader European economic and financial integration.
- For Ukraine: Stalemate in war, major rebuilding in unoccupied part, stagnation and decline in Russian-occupied part.
- For Russia: Already weak long-term growth outlook now worse, stronger reliance on China, but China cannot replace all Western tech transfer.
- For non-EU-CEE: Balancing act will become much harder; in economic/financial terms EU/US much more important than Russia/China for most.
- For EU: Faster green transition, more defence spending, but long-term investors could become more cautious (depends on US politics).

## Policy priorities for EU

### **In Ukraine:**

- Immediate priority is to address humanitarian crisis + support government as much as possible
- Once war ends, US + EU should be ready with plan for reconstruction of unoccupied part of Ukraine
- Beyond that, stronger EU economic integration with unoccupied part of Ukraine

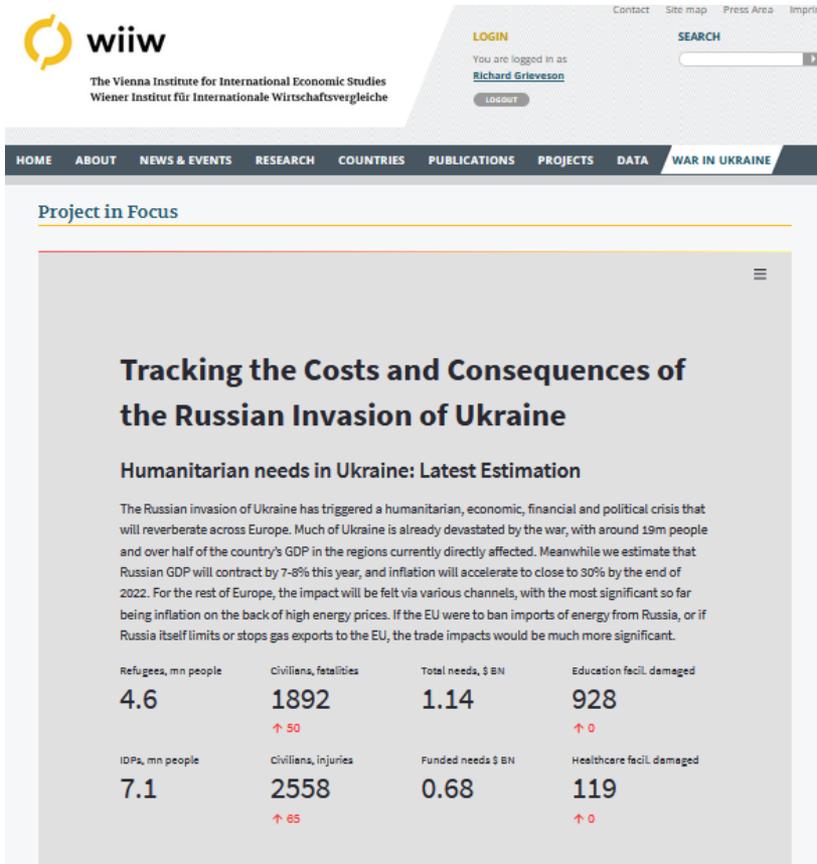
### **In the rest of Europe:**

- Measures to support poorest households through spike in energy + food prices
- Acceleration of green transition
- Acceleration of Western Balkan EU integration

[Full report available free on the wiiw website](#)



# New website section devoted to Ukraine with regular updates



**Project in Focus**

## Tracking the Costs and Consequences of the Russian Invasion of Ukraine

### Humanitarian needs in Ukraine: Latest Estimation

The Russian invasion of Ukraine has triggered a humanitarian, economic, financial and political crisis that will reverberate across Europe. Much of Ukraine is already devastated by the war, with around 19m people and over half of the country's GDP in the regions currently directly affected. Meanwhile we estimate that Russian GDP will contract by 7-8% this year, and inflation will accelerate to close to 30% by the end of 2022. For the rest of Europe, the impact will be felt via various channels, with the most significant so far being inflation on the back of high energy prices. If the EU were to ban imports of energy from Russia, or if Russia itself limits or stops gas exports to the EU, the trade impacts would be much more significant.

Refugees, mn people	Civilians, fatalities	Total needs, \$ BN	Education facil. damaged
4.6	1892 ↑ 50	1.14	928 ↑ 0
IDPs, mn people	Civilians, injuries	Funded needs \$ BN	Healthcare facil. damaged
7.1	2558 ↑ 65	0.68	119 ↑ 0

income opportunities and information flows constrained, they will become more dependent on state-provided revenues. This, in turn, will increase the likelihood that they are co-opted and that the anti-Western sentiment in Russia will harden.

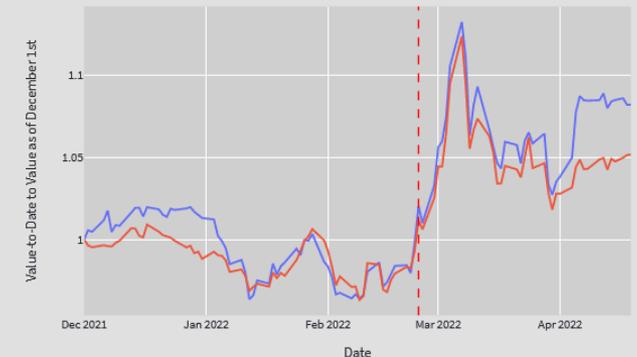
## Spillovers to Europe and Global Markets

Financial contagion is already visible in CESEE: currencies have weakened in countries near to Russia and Ukraine due to higher risk aversion, and interest rates on government debt have increased in some cases. Investor sentiment – both domestic and foreign – in the Baltic states is likely to suffer amid fears that Russia has designs on more than Ukraine. Nevertheless, most of the region has strong macroeconomic fundamentals, and policymakers have some space to use fiscal and monetary tools to ensure macro-financial stability.

Select the currency pair for comparison

USD/HUF × USD/PLN ×

Selected CEE currency pairs  
Source: Investing.com



The chart displays the ratio of current value to the value as of December 1st for two currency pairs: USD/HUF (blue line) and USD/PLN (orange line). Both ratios start at 1.00 in December 2021. The USD/PLN ratio shows a sharp increase starting in late February, peaking at approximately 1.15 in early March 2022, before declining to around 1.05 by April. The USD/HUF ratio also shows a similar but less pronounced spike, reaching about 1.08 in early March 2022.

## The project team



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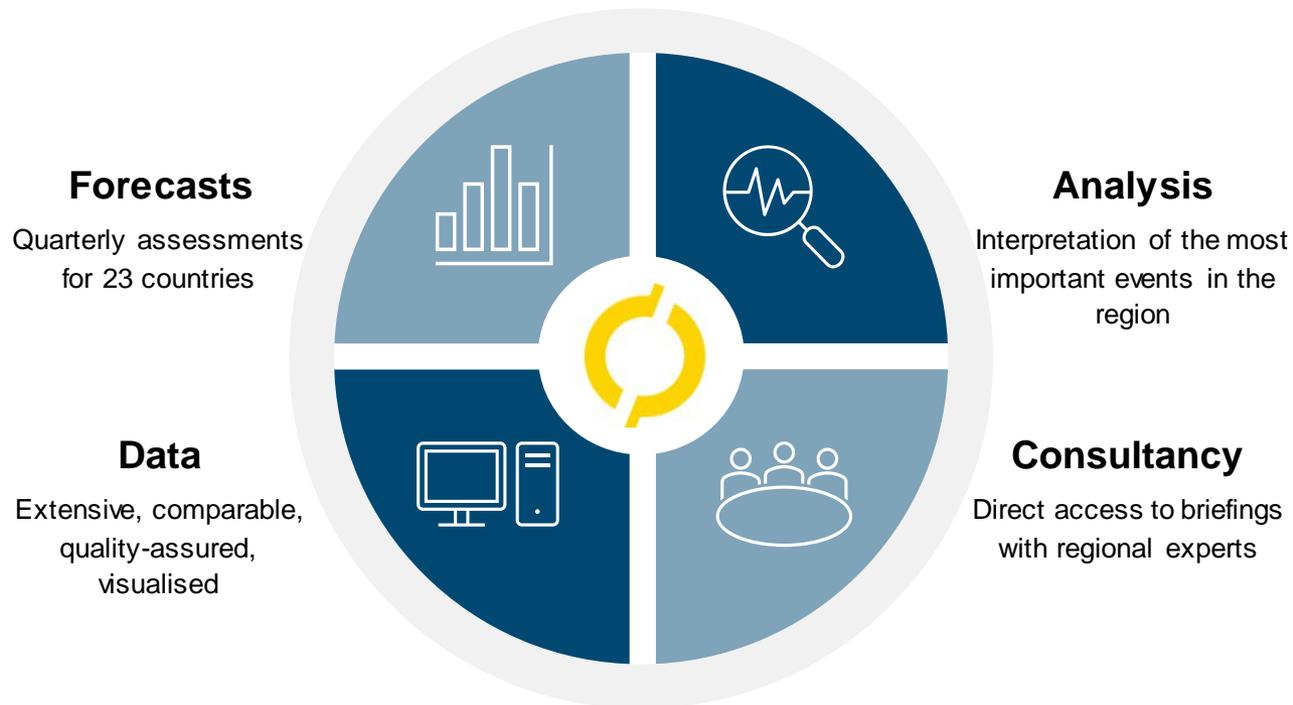
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# wiiw membership package: making sense of the noise in CEE



Full details: [wiiw membership](#).

## Extra slides

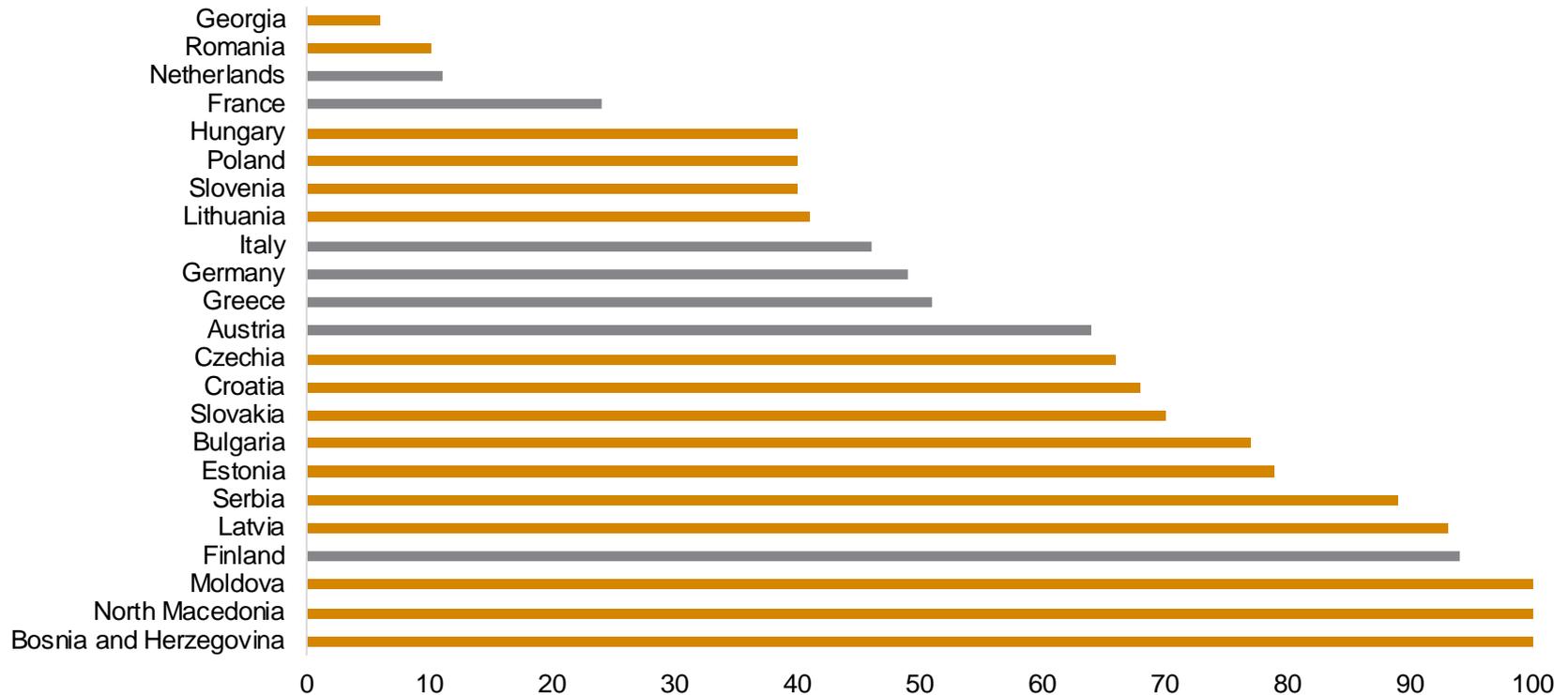


## Growth forecasts and revisions – baseline scenario

		Forecast, %			Revisions, pp		
		2022	2023	2024	2022	2023	2024
EU-CEE	BG	2.0	3.7	3.5	↓ -1.8	↑ 0.2	⇒ 0.0
	CZ	2.6	3.5	4.2	↓ -1.4	↓ -0.1	↑ 0.6
	EE	1.8	3.4	3.1	↓ -1.7	↓ -0.6	↓ -0.2
	HR	3.5	4.0	3.1	↓ -1.2	↓ -0.1	↓ -0.2
	HU	2.5	3.9	4.5	↓ -2.0	↓ -0.1	↑ 0.8
	LT	1.7	2.8	2.6	↓ -2.0	↓ -0.5	↓ -0.3
	LV	1.4	2.2	2.3	↓ -2.9	↓ -1.4	↓ -0.7
	PL	4.0	3.5	3.6	↓ -0.9	↓ -1.4	↓ -0.7
	RO	2.0	3.5	4.5	↓ -2.3	↓ -1.0	↓ -0.3
	SI	4.1	3.3	2.8	⇒ 0.0	⇒ 0.0	↓ -0.2
Western Balkans	SK	2.4	3.1	3.0	↓ -1.5	↓ -0.6	↓ -0.3
	AL	3.5	3.7	3.9	↓ -0.7	↓ -0.3	↑ 0.1
	BA	1.8	2.3	2.3	↓ -0.7	↓ -0.5	↓ -0.3
	ME	3.5	3.7	3.3	↓ -1.0	↑ 0.7	↑ 0.6
	MK	2.5	2.7	2.7	↓ -1.0	↓ -0.5	↓ -0.3
	RS	3.6	3.4	3.4	↓ -1.3	↓ -1.1	↓ -0.6
Turkey	XK	3.3	3.7	3.9	↓ -1.0	↓ -0.3	↓ -0.1
TR	2.7	2.8	3.2	↓ -0.8	↓ -0.7	↓ -0.8	
CIS+UA	BY	-3.5	1.6	2.0	↓ -4.5	↓ -0.4	⇒ 0.0
	KZ	1.5	3.2	4.0	↓ -2.7	↓ -1.2	↓ -0.1
	MD	-3.0	3.0	4.0	↓ -7.0	↓ -1.5	↓ -0.5
	RU	-9.0	-1.5	1.0	↓ -11.0	↓ -3.0	↓ -0.5
	UA	-38.0	5.0	13.0	↓ -41.5	↑ 1.5	↑ 9.0

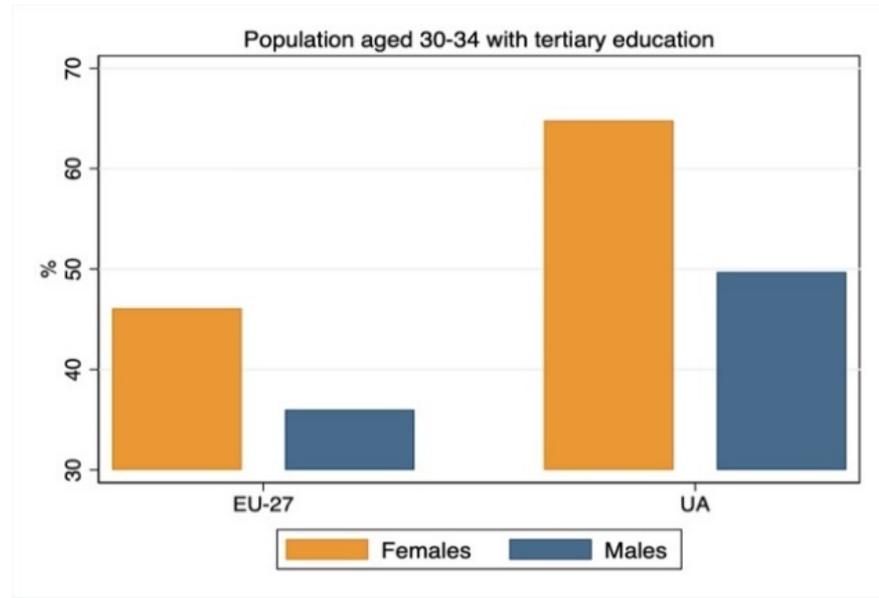
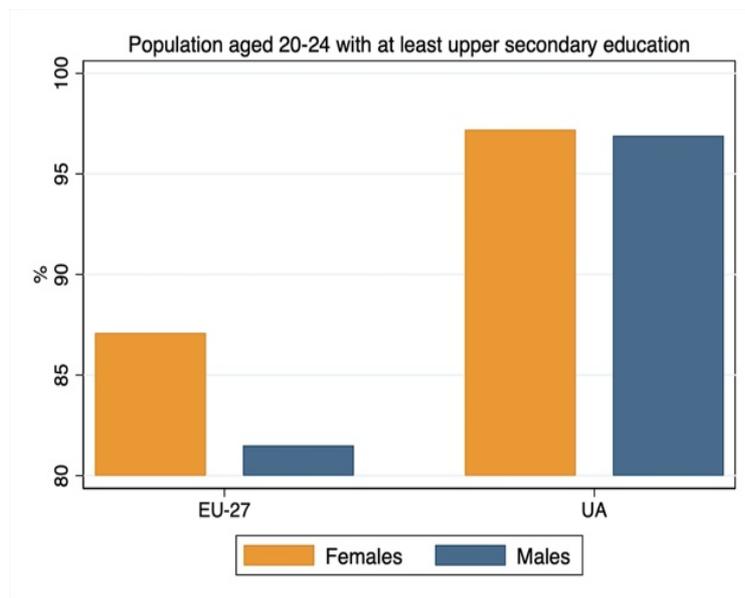
## A full gas embargo now would have a much more significant impact

Share of gas supply from Russia, % of total, 2020



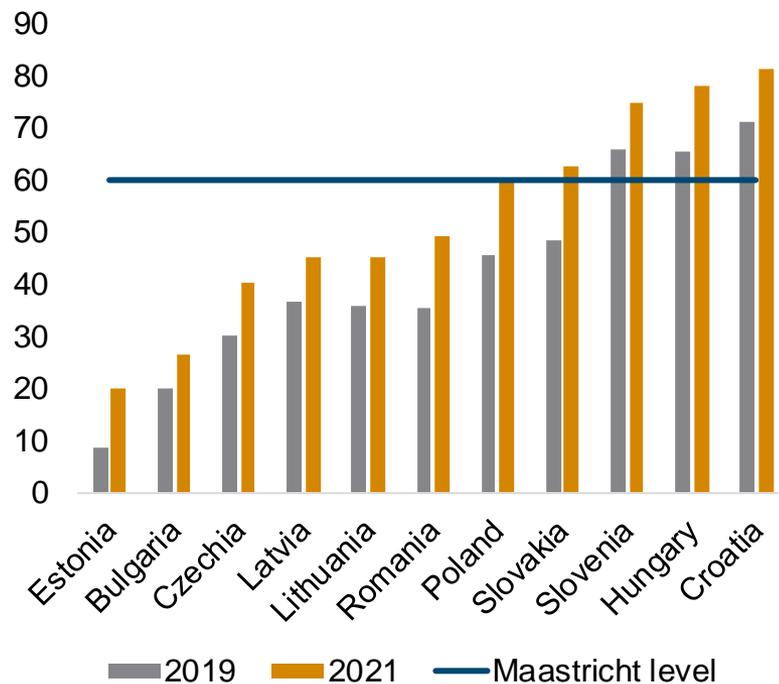
# Labour market integration in EU-CEE: Major challenges, but also opportunity given labour shortages

Educational attainment in Ukrainian population and EU27 average, 2020

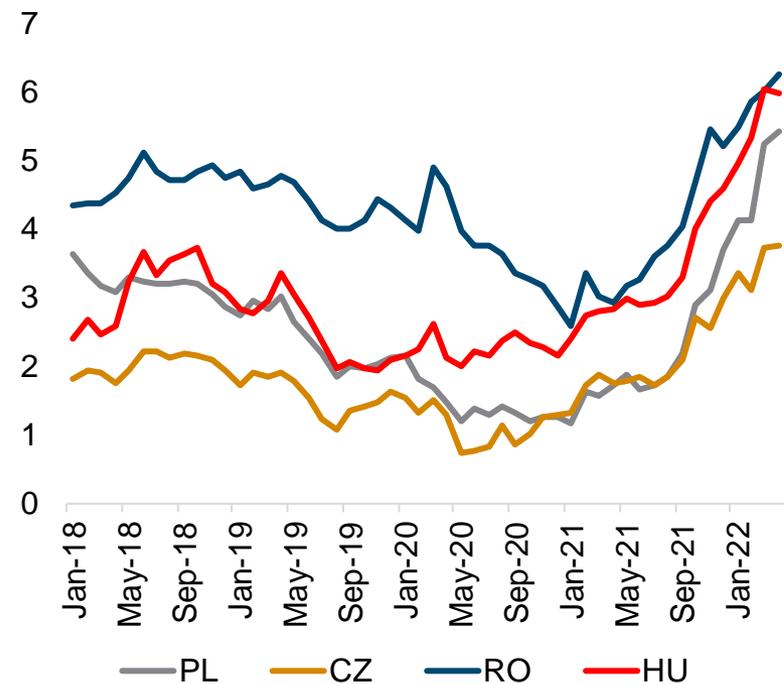


# Fiscal space? Higher public debt, but most below 60%; nominal rates rising (but for now negative in real terms)

Gross general government debt, %  
of GDP



Nominal 10-year sovereign interest  
rates, %

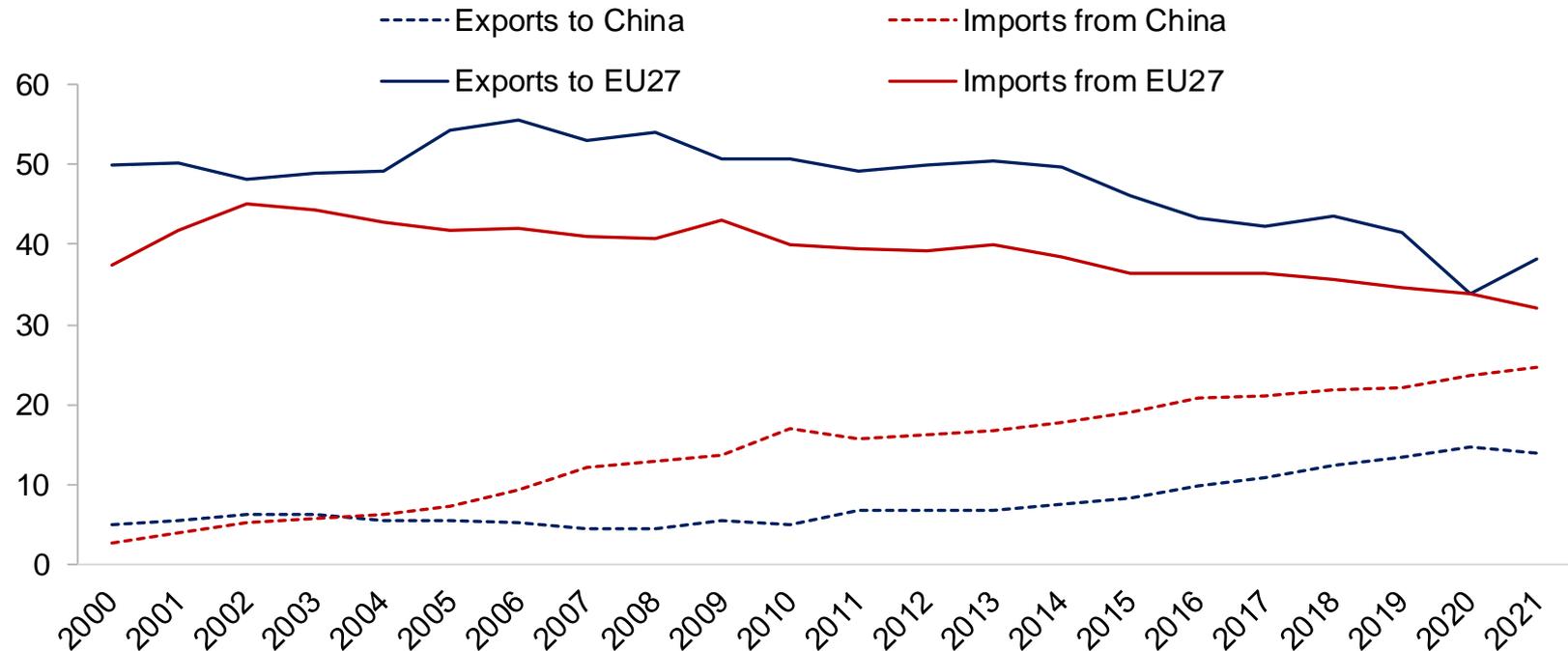


## For Ukraine: Long-term rebuilding and possibly divided future

- Severe destruction: human life, infrastructure, housing. 5-10m refugees. Rebuilding job on a monumental scale.
- Independent part of Ukraine will see many refugees return, massive Western financial support and greater integration with EU.
- Western investment would drive technological upgrading and productivity improvements. Interesting opportunities in IT and agricultural sectors.
- Potentially Russian-occupied part: Worse destruction, continued outward migration, isolation from much of global economy.

## For Russia: A bleak future as China's (junior) partner, only partial replacement of Western tech transfer

Russia's merchandise trade with the EU and China, % of total



For non-EU CEE: Balancing act between Russia and West will become harder, most will have to choose (Turkey + Serbia in particular have big decisions to make)

Share of inward FDI stock in selected CEE countries, % of total, by origin

