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

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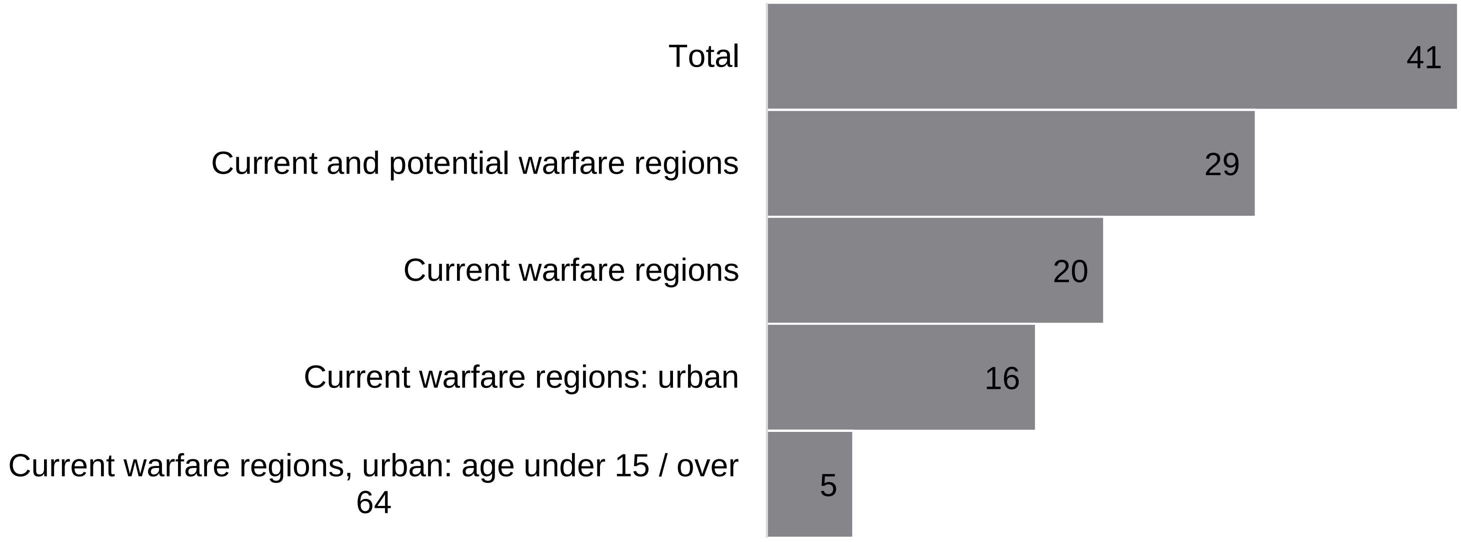
Overview

1. Humanitarian impact
2. Inflation and GDP
3. Financial contagion in CEE
4. Trade
5. Labour markets
6. Medium-term structural changes

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

Ukrainian population's exposure to the conflict

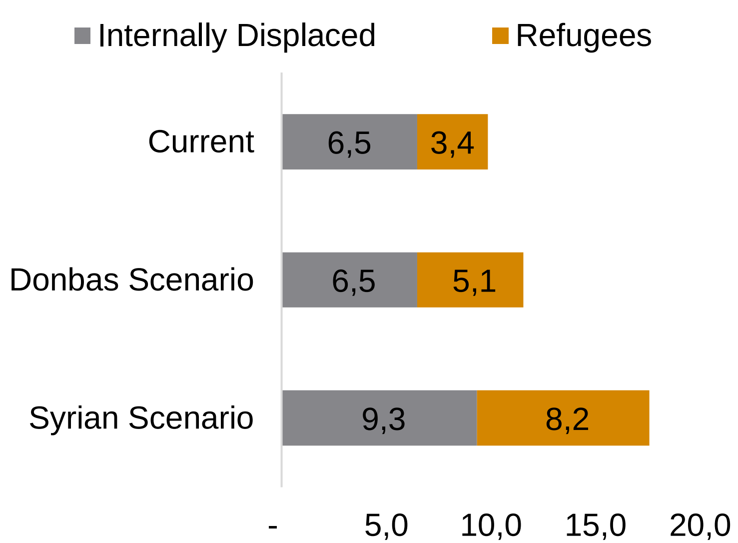


Note: Potential warfare regions are defined as regions that contain part of the river Dnipro on their territory, plus Odesa, but that so far have not witnessed a mass Russian armed forces presence.

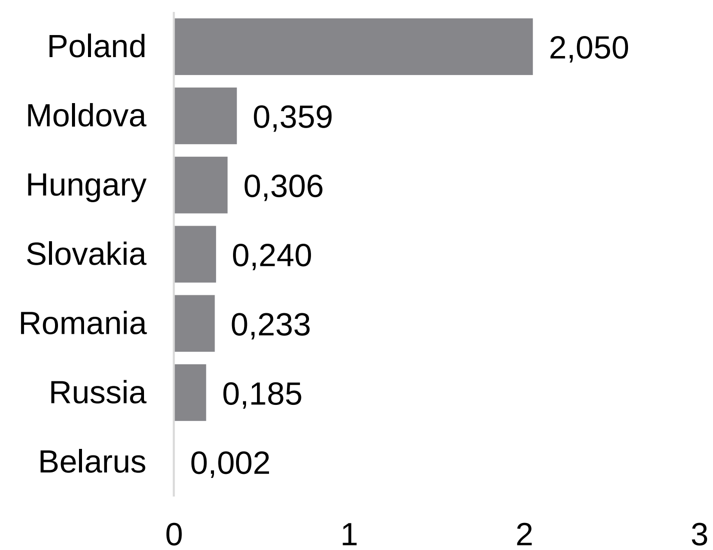
Source: Ukrstat, UNOCHA, own calculations.

Humanitarian impact: Refugee inflows likely to be 3x the 2015-16 crisis

Displacement: current and under scenarios, millions



Current number of refugees by host country, millions



Note: Figures reported as “current” (left panel) include survey-based estimates for IDPs, while the refugee data are administrative. The Donbas scenario assumes the displaced-to-total ratio, the IDP-to-displaced ratio and the refugee-to-displaced ratio to be as during the Donbas conflict at the peak of the crisis, in January 2015. The Syrian scenario assumes the same ratios as were reported for Syria as of 15 March 2022. The ratios are then multiplied by the estimated registered population of both current warfare and potential warfare regions. See Table 7 and Table 8 in the Annex for the parameter ratios and definitions of current and potential warfare regions.

Source: UNOCHA, own calculations.

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

Main characteristics of regions on the front line

Regions	Population 2021	GDP 2019	Industrial production 2020	Goods exports 2020	Services exports* 2019	Agricultural production 2020	FDI stock* 2020
	million people	shares in the total for the country, %					
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
Total for the selected regions	**18.91**	**52.7**	**43.1**	**50.3**	**75.4**	**34.0**	**66.0**
Total for the selected regions without Kyiv city	***15.96***	***28.8***	***31.3***	***25.0***	***26.9***	***34.0***	***19.6***

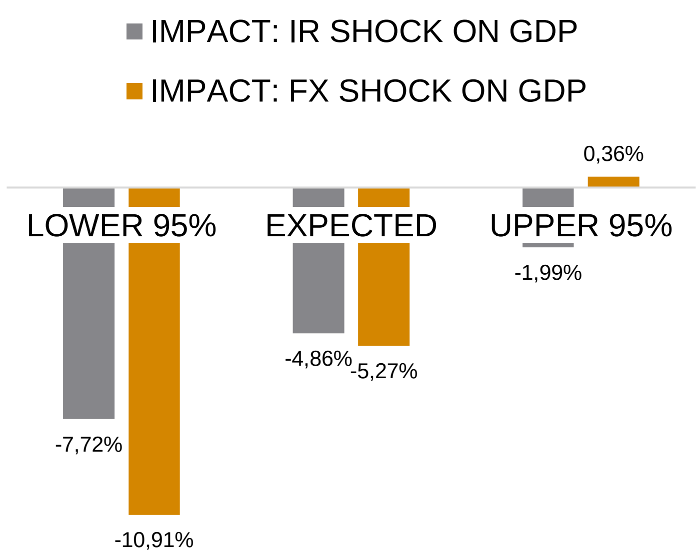
* Excluding unallocated value.
Source: State Statistics Service of Ukraine, National Bank of Ukraine.

* Excluding unallocated value.

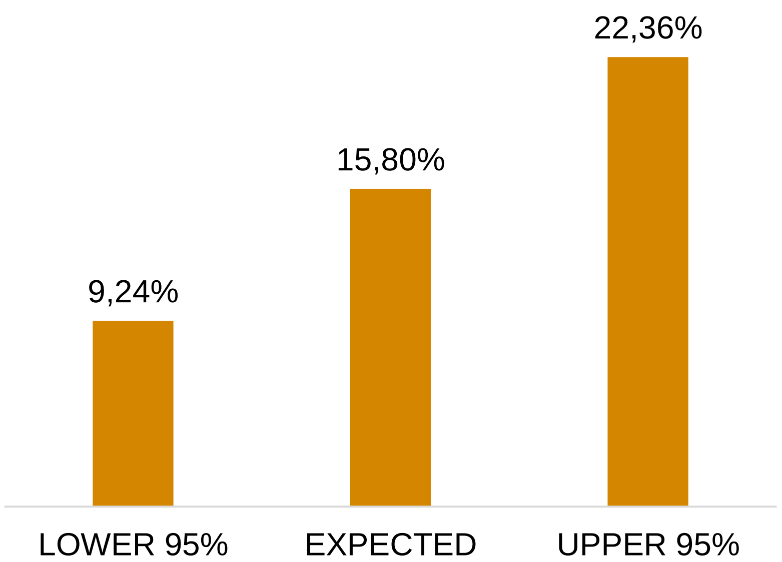
Source: State Statistics Service of Ukraine, National Bank of Ukraine.

For Russia, this is an economic disaster: GDP will fall by at least ~8%, 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

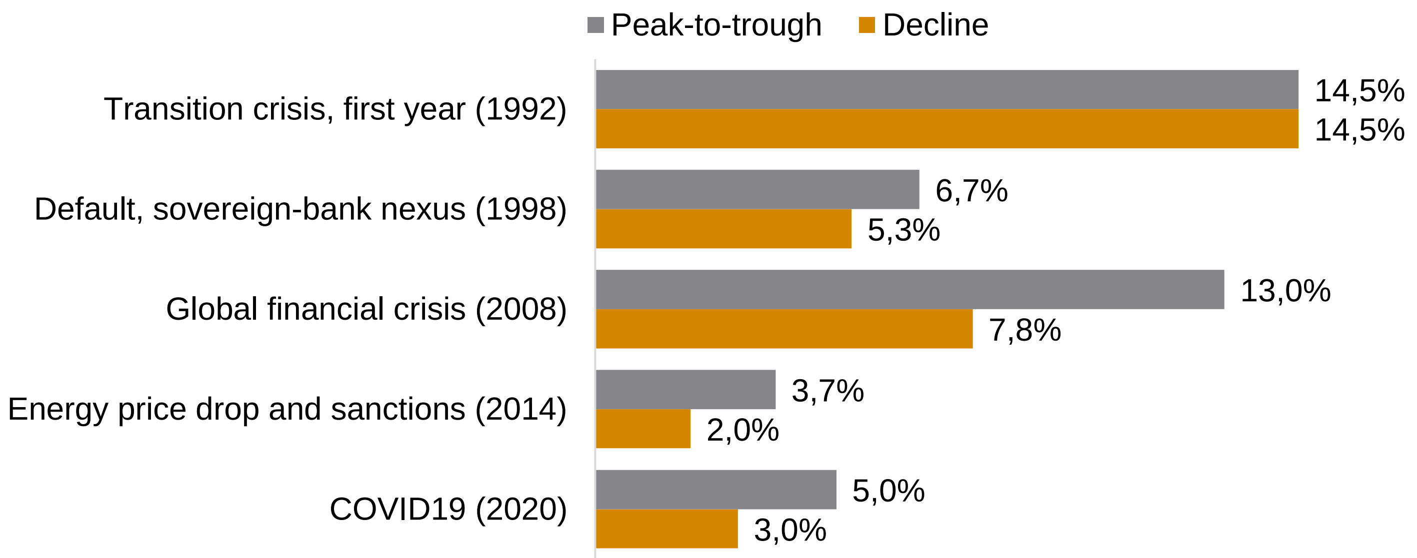


Notes: Shock scenarios assume a 10.5% increase in the key rate and depreciation of the national currency to half of its original value. Values show cumulative dynamic multipliers of doubling gas and oil prices, estimated using a 2-lag VARX model. Estimated with quarterly data. See report Annex for more details 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: Recession unlikely to get close to 15%, but around 10% is possible

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

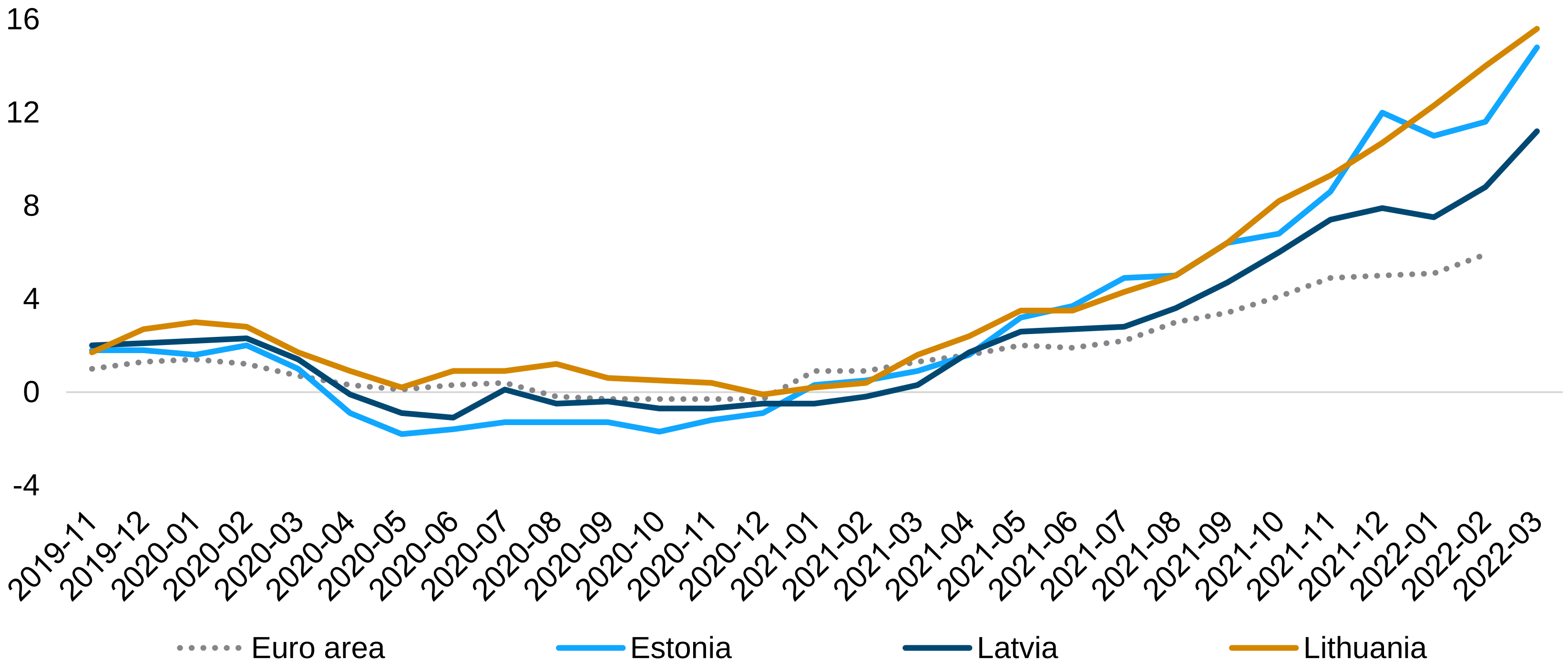


Note: Peak-to-trough value for 1992 calculated as a simple growth rate due to no negative growth rates in 1990 and 1991. Transition crisis 1992 reflects only the strongest episode of GDP decline in a single year. Value for 2014 compares with 2013 growth rate due to macroeconomic turbulence of Russia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

Source: World Bank.

Rest of Europe: main impact will be higher inflation and lower growth, especially in CEE

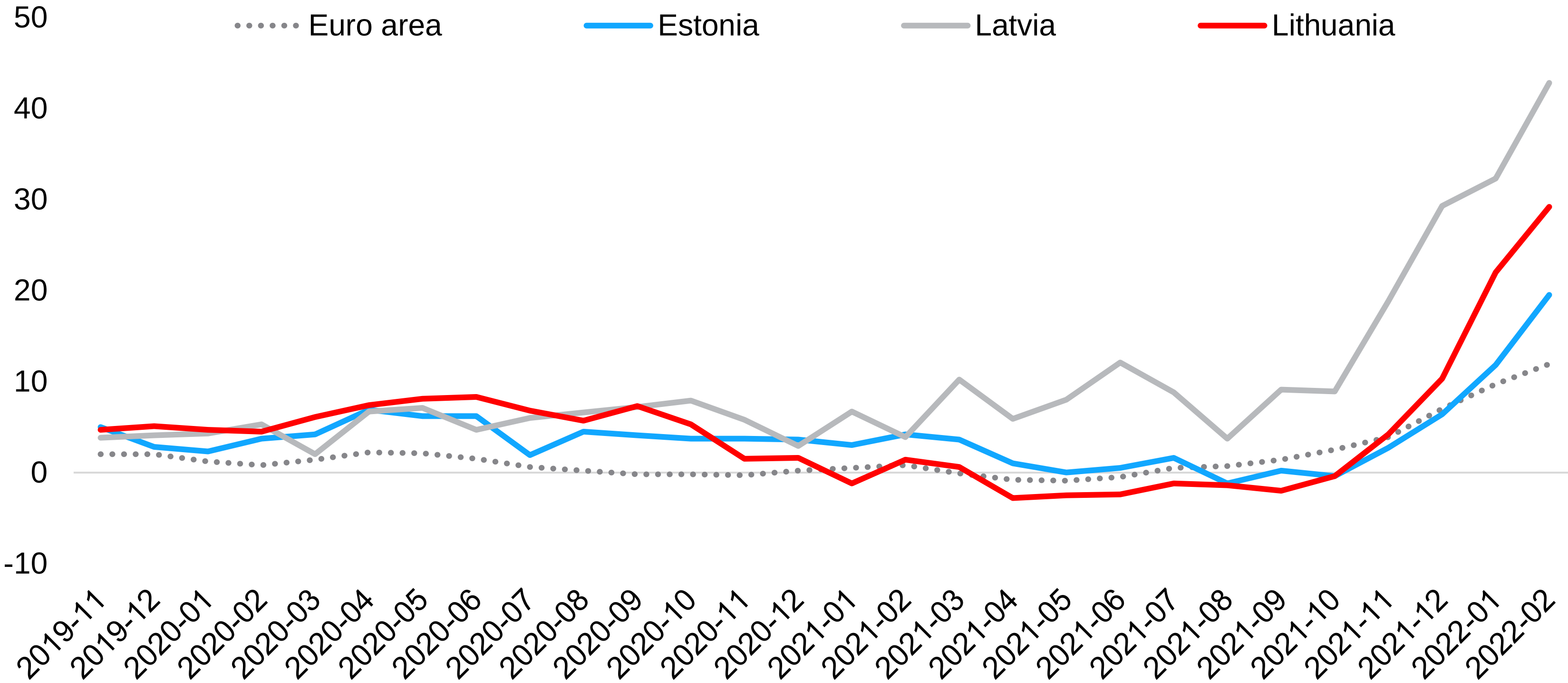
Harmonised index of consumer prices, % change, year on year



Source: Eurostat.

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

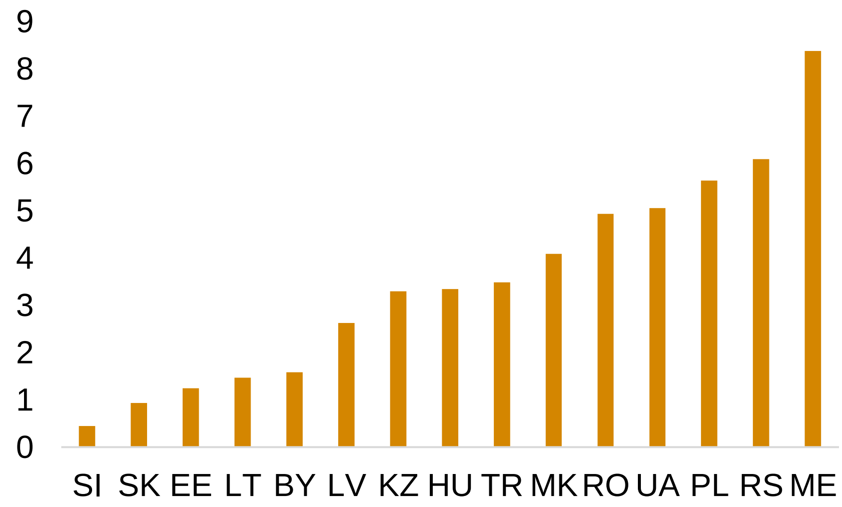


Source: Eurostat.

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

Percentage change in the value of the national currency versus US dollar, end 2021 to 30 March 2022

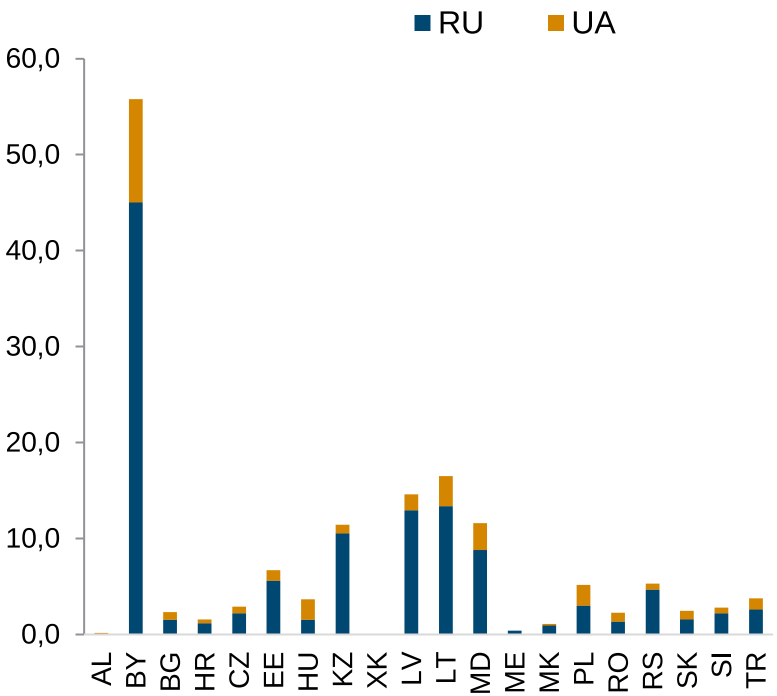
Months of import cover: gross central bank reserves, excluding gold, divided by average monthly value of imports, end 2021

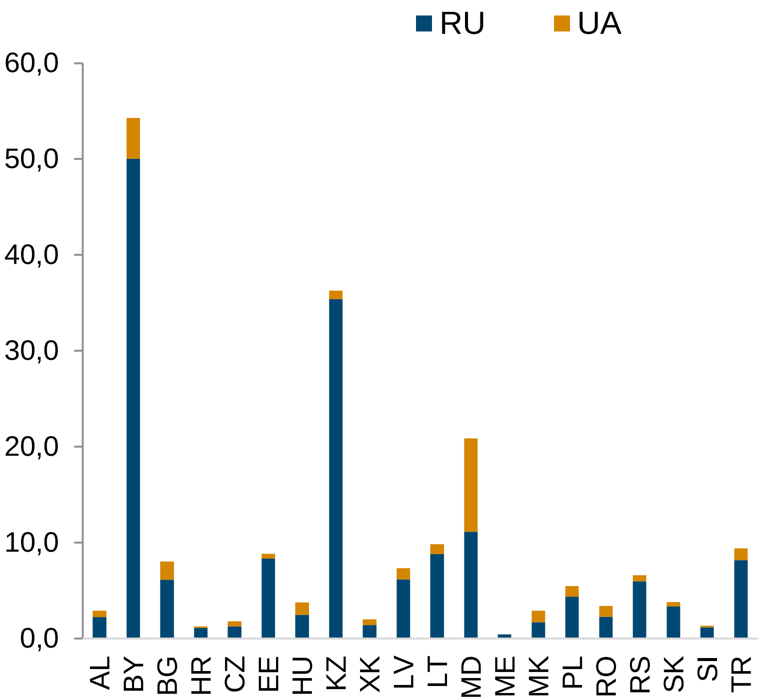


Sources: National sources, wiiw.

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

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

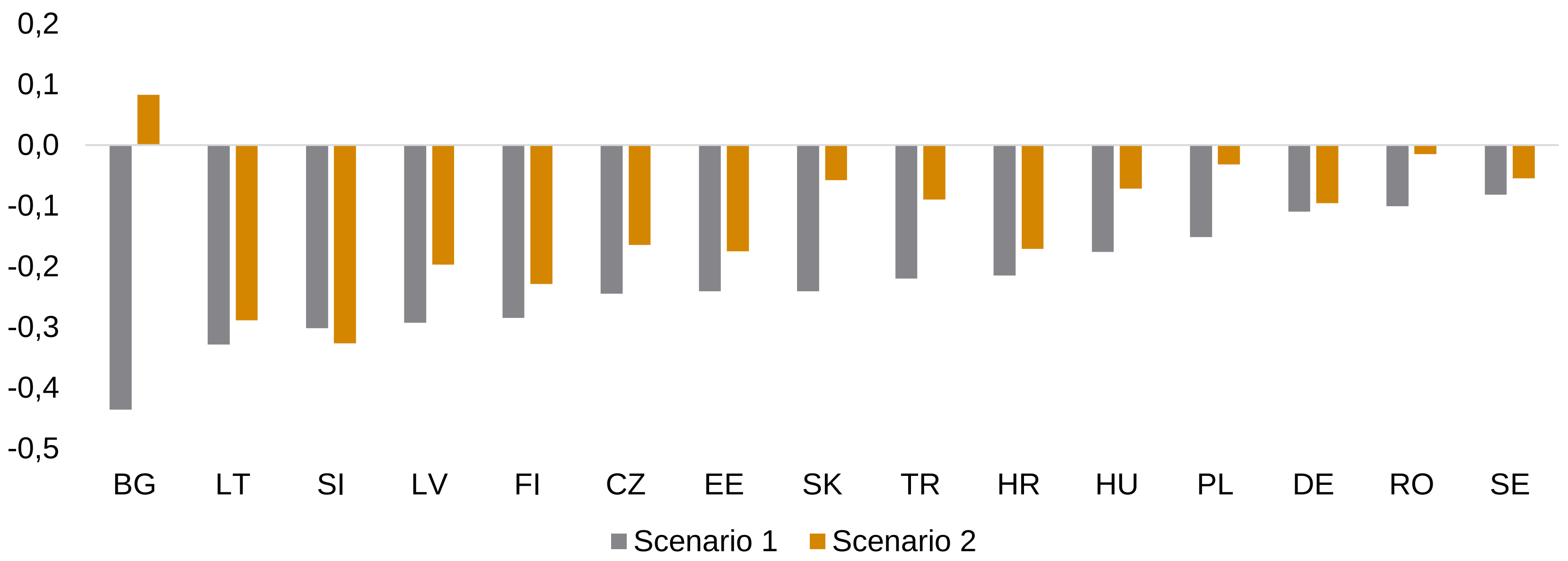




Source: National sources, wiiw.

Quantifying the trade impact: Mostly limited (as long as the gas keeps flowing)

Impact of decline in Russia demand on GDP of selected EU + CEE countries, percentage points

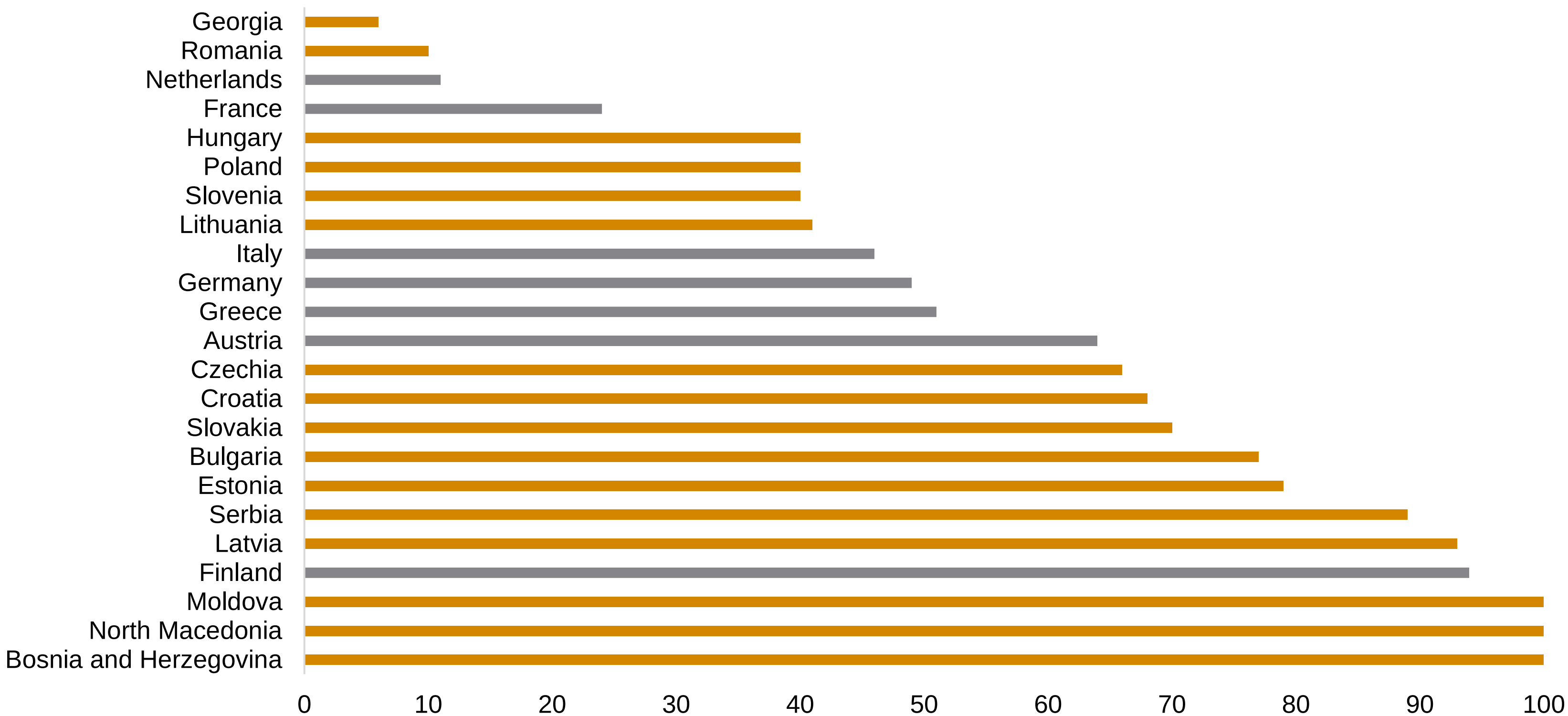


Note: Left-hand charts shows pp impact on real GDP in the event of a decline in Russian demand of 10%, a decline in Russian imports of 30% and a decline in Russian final goods exports of 13%. Scenario 1 = decline in Russian final goods exports can be substituted by importing countries with domestic production or imports from other countries. Scenario 2 = allow for changes in the sourcing structures by applying the 'partial global extraction method'

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

And if the gas is turned off? Much of CEE has huge reliance on Russia

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



Source: Statista.

Complete stop in EU gas imports from Russia would probably cause recession

- Winter passing in Europe, so the pressure on households less. And there is some fiscal space to cushion the blow for poorest.
- Clear vulnerability for large parts of EU industry – that is likely to be a big part of the reason why it hasn't happened yet.
- Our estimate: Import stop would cut around 3pp from euro area growth in 2022, and maybe a bit more in most exposed parts of EU-CEE.
- Bottom line: the moral case is clear, the costs are manageable, we should do it.

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.
- <u>All of this is managable, but positive labour market supply shock likely to be more evident next year.</u>

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: Divided future, 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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Russia's Invasion of Ukraine:

Assessment of the Humanitarian, Economic and Financial Impact in the Short and Medium Term

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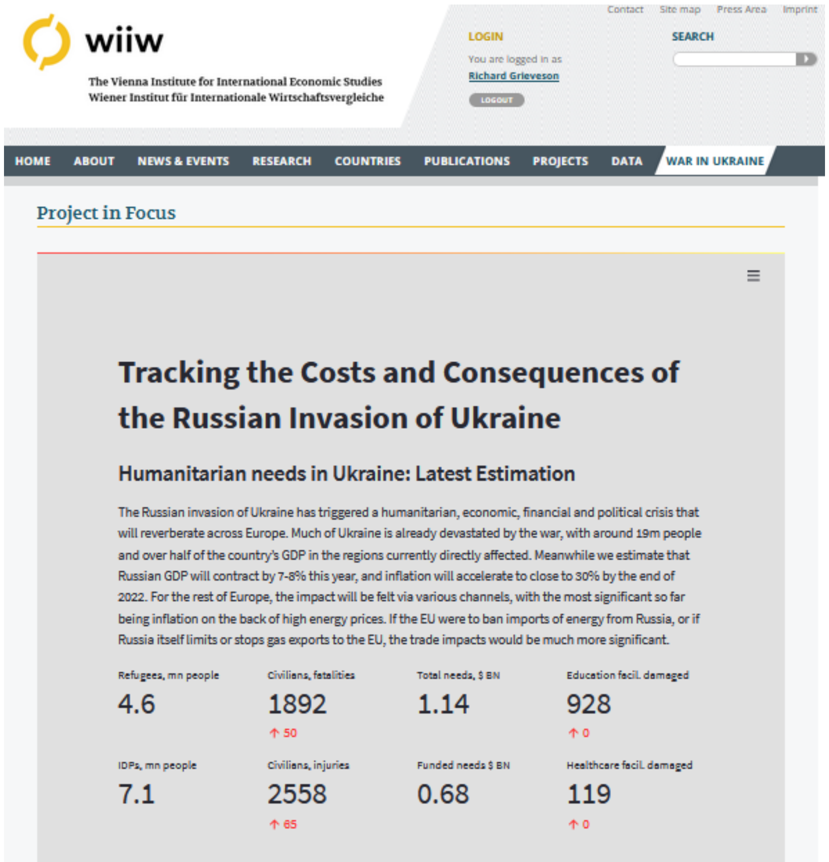
[New website section devoted to Ukraine with regular updates]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Project in Focus

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

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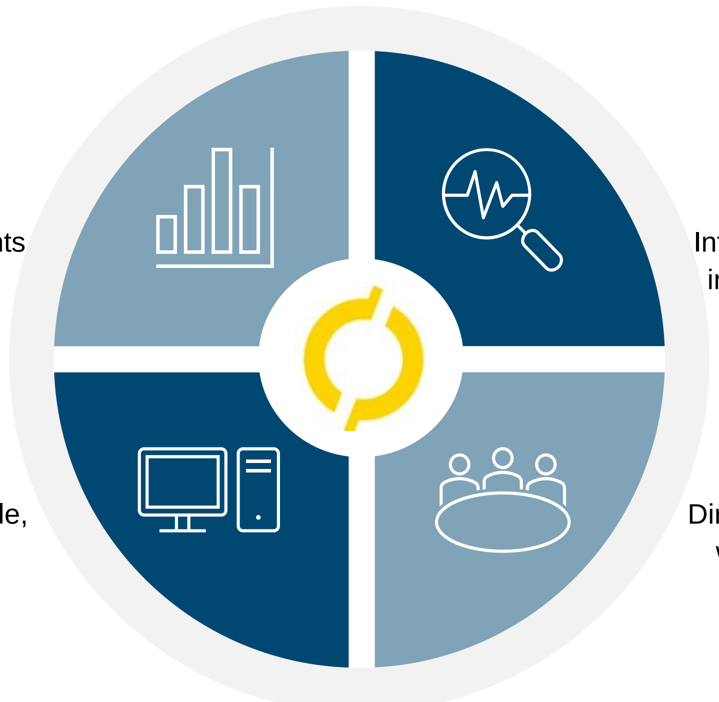

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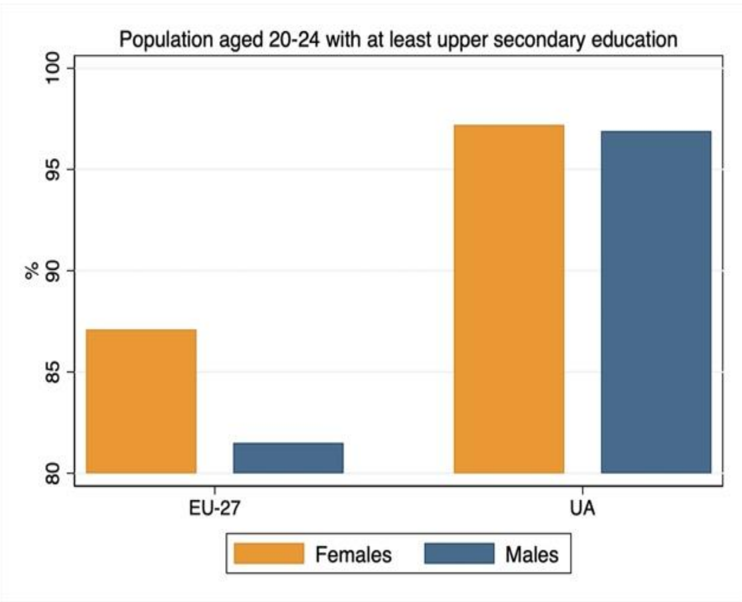
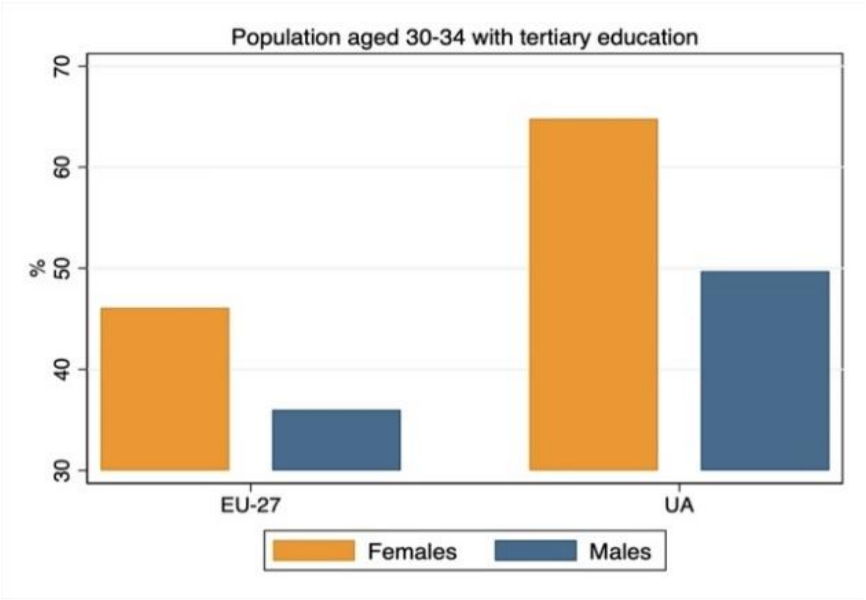
Full details: wiiw membership.

Extra slides

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

Educational attainment in Ukrainian population and EU27 average, 2020





Source: National Statistical Office of Ukraine.

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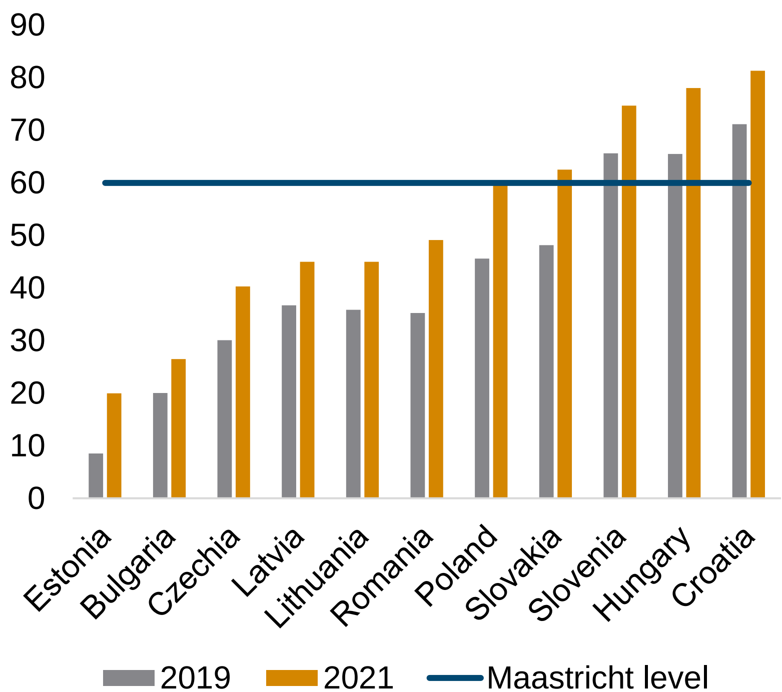
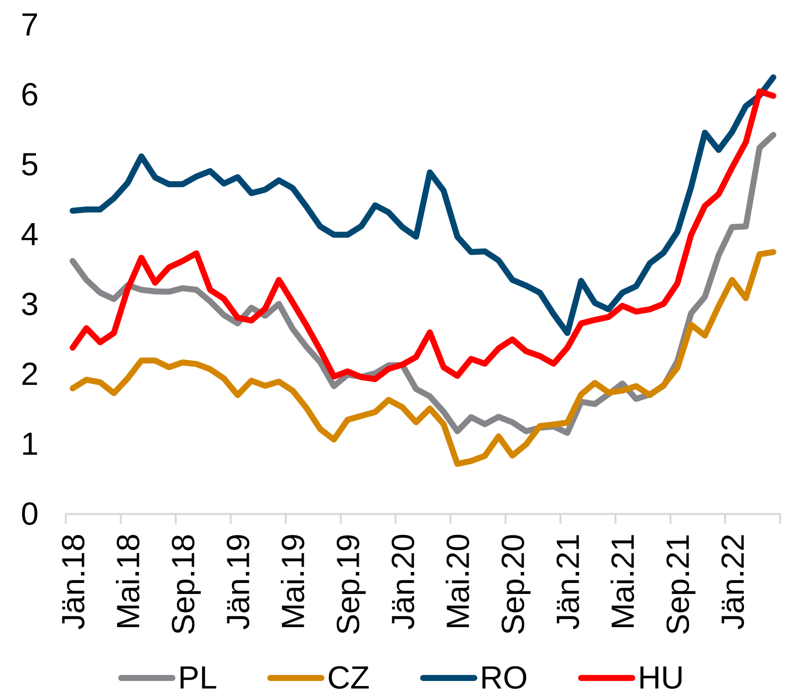
Fiscal space? Higher public debt, but most below 60%; nominal rates rising (but for now negative in real terms)

Gross general government debt, % of GDP



Nominal 10-year sovereign interest rates, %



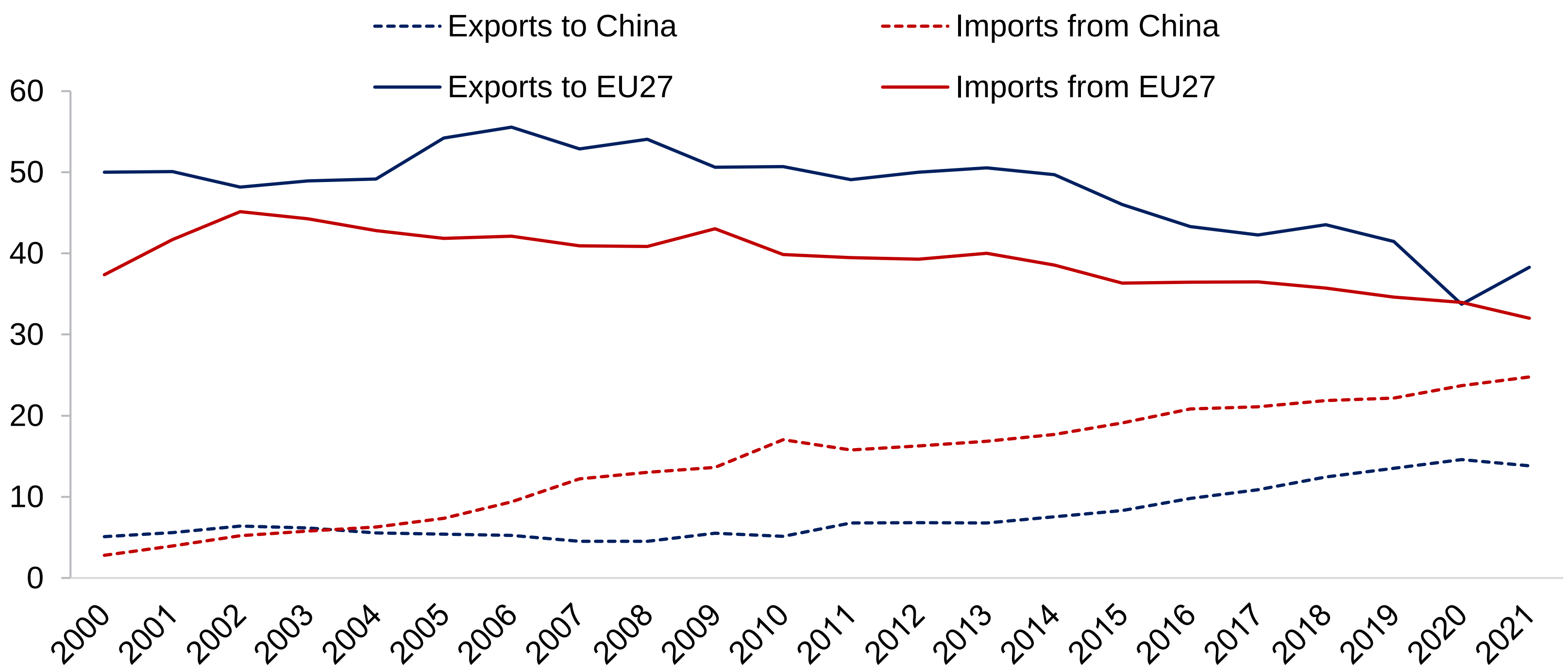
Sources: Eurostat, national sources, wiiw.

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

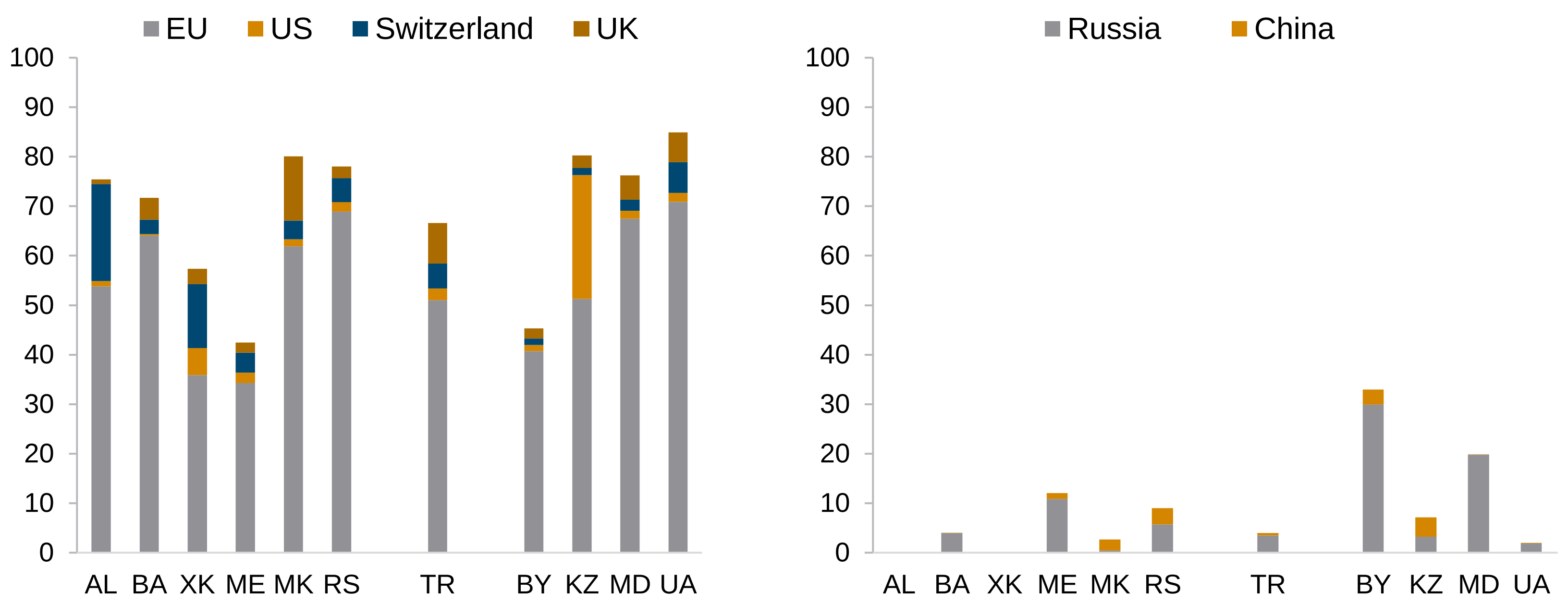
Russia's merchandise trade with the EU and China, % of total



Source: Russian Federal State Statistics Service.

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



Source: National sources, wiiw.

For EU-CEE: More defence and green spending, but long-term investors could become more cautious

- Further push for green transition (not always popular in CEE).
- Reaffirmation of NATO presence in region and US security commitment to Europe.
- But next US election is not far away – not all possible presidents are like Biden.
- Could affect investor sentiment in parts of EU-CEE.