Economic Consequences of the Ukraine Conflict

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Outline

- Consequences for Ukraine
- Consequences for Russia
- Consequences for the EU
- Sanctions and their impacts
Consequences for Ukraine

- The role of Crimea is modest
- But Donbass:
  - 16% of Ukraine’s GDP
  - 6.5 million population
  - Home to coal-mining and metallurgy

Source: wiiw based on national statistics.
Foreign trade by region
2013, in % of total

Exports of goods

- Crimea & Sevastopol: 1.6%
- Donetsk: 25.2%
- Rest of Ukraine: 73.2%

Imports of goods

- Crimea & Sevastopol: 1.5%
- Donetsk: 7.2%
- Rest of Ukraine: 90.8%

Source: wiiw based on national statistics.

GDP per capita, EUR at PPP, 2012

Ukrainian average: EUR 6,800

Source: wiiw based on national statistics.
Economic costs of the war in Donbass

- Economic damage currently estimated at USD 7-8 billion (6% of GDP)
- Industrial production in August 2014 dropped by
  - 60% in Donetsk and 85% in Luhansk (year-on-year)
  - largely on account of power cuts and railway disruptions
- Over 1 million refugees
  - including some 320 thousand to other regions of Ukraine
  - and nearly 900 thousand to Russia
  - may undermine long-term recovery prospects

Economic prospects

- This year: 8-10% GDP recession
  - war-related destructions in Donbass
  - restrictions on military and dual-use goods exports to Russia
  - inflation erodes purchasing power
  - investments collapse
- Prospects for stabilisation highly uncertain
  - conflict settlement crucial

Exports dynamics in January-July 2014
% change year-on-year
Consequences for Russia

GDP growth: current (realistic) scenario; contributions of main components to GDP growth, in pp

Costs of the conflict: about 1% of GDP in 2014 (close to EUR 20 billion), due to lower GDP growth (-1 pp), falling investments (-6 pp) compared to the pre-conflict scenario

Source: wiiw Annual Database, national statistics, own estimates.
Russia was ‘stuck in transition’, economy close to stagnation already before Ukraine crisis. Key challenges (old and new):

- Energy exports and growth sustainability
  - Increased pressures on energy supply diversification (both in the EU and RU)
  - Sectoral sanctions already start to bite, no longer largely symbolic
  - Investment climate already suffers, imports and FDI down, capital flight

- Diversification and modernisation of the economy under threat
  - Growing reform pressures owing to sanctions?
  - Yet modernisation is more difficult without more FDI!

- Stability of the ruling elite
  - Putin’s ratings grow, Russia’s ratings fall, rouble and MICEX fluctuate
  - Yet this may change with more hardship …

- Integration on the post-Soviet space derailed/fails?
  - Crimea not really helpful for Putin’s Eurasia integration project
  - New design/reset of EU neighbourhood policies?
Share of Russia in EU goods exports, in % of total, 2013

Source: wiiw Annual Database, EU Comext.

Share of goods exports to Russia in % of GDP, 2013

Source: wiiw Annual Database, EU Comext.
Share of domestic value added of exports to Russia in % of GDP, 2013 (estimated)

- Baltics, SK, SI, BG, PL, CZ, FI, HU, DE are more exposed than others; LT, EE, SK, LV net exports to Russia are more than 2% of GDP (AT: 0.6%)

Source: EU Comext, WIOD, own estimates.

Scenario (Ia): estimated loss of GDP (in %) if domestic value added of exports to Russia drops by 10%

- Baltics, SK, BG, PL, CZ, FI, HU, DE most exposed; Lithuania would lose 0.4% of GDP, Austria 0.06% of GDP

Source: Own estimates based on wiiw Annual Database, EU Comext.
Scenario (IIa): estimated loss of GDP (in %) if domestic value added of exports to Russia drops by 50%

- Baltics, SK, BG, PL, CZ, FI, HU, DE more exposed than others; Lithuania would lose up to 2% of GDP

Source: Own estimates based on WIOD Database, EU Comext.

EU export exposure to Russia: 5 key industries and 12 major exporting countries, EUR mn, 2013

Source: wiiw Annual Database, EU Comext.
Share of Russia in goods imports, in % of total, 2013

Energy accounts for 80% of EU imports from Russia

Source: wiiw Annual Database, EU Comext.

EU import exposure to Russia: 5 key industries and 12 major importing countries, EUR mn, 2013

Oil and gas: Austria, Germany and the Netherlands estimated.

Source: wiiw Annual Database, EU Comext.
Scenario (II): estimated GDP loss (in %) if exports (both goods and services) to Russia drop by 50%

Baltics, Cyprus, SK, FI, SI, CZ more exposed than others; Lithuania would lose nearly 9% of GDP

Source. Own estimates based on wiiw Annual Database, EU Comext.

Scenario (I): estimated GDP loss (in %) if domestic value added of goods and services exports to Russia drops by 10%

Cyprus, Baltics, BG, SK, FI, PL, CZ would lose most; Cyprus would lose more than 1% of GDP

Source. Own estimates based on wiiw Annual Database, EU Comext.
Estimated GDP loss (in %) resulting from Russia’s August 2014 food import ban

Lithuania could lose about 2.6% of GDP

Western sanctions and their impacts (I)

- Sanctions unlikely to have desired effects – whatever these might be (change Russian behaviour?)
- But sanctions still painful for all sides (UA, RU, EU)
- Russia retaliates, some EU countries suffer more
- Russian investment and GDP growth down
- Import substitution and export diversion
- Capital flight, exchange rate fluctuation and inflation
- Russia turning inwards and even more assertive?
- Greater medium-term reform pressures?

Western sanctions and their impacts (II)

- Eurasian integration derailed?
- Lasting damage to East-West relations
- Serious medium- and long-term repercussions on Russian growth, living standards and stability
- Trade and energy supplies diversification
- Russian modernisation hampered without more FDI, technology imports and better East-West relations
- What about Ukraine, Crimea and Novorossia?
- Sanctions’ effectiveness versus impact
Thank you for your attention!

Country codes

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