

Eastern Europe at the Forefront of the Ukrainian Refugee Crisis

Ukrainian Refugees – Will they Stay in the EU Long-term?

Pre-war Trade and Value Chain Integration of Russia and Ukraine
with the EU and EU-CEE

The ‘Great Disinflation’: How Important Was the ‘China Factor’?



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LEON PODKAMINER

OLIVER REITER

MARYNA TVERDOSTUP

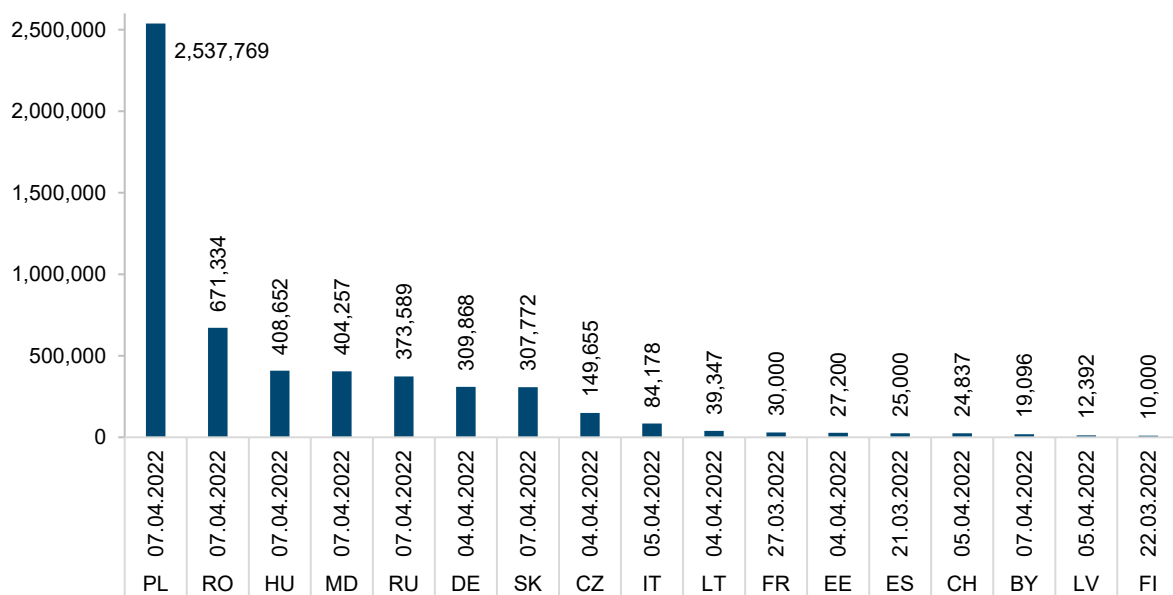
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Chart of the Month: Eastern Europe at the forefront of the Ukrainian refugee crisis

BY ISILDA MARA

Influx of Ukrainian refugees by receiving country, cumulative



Note: the most recent data have been reported.

Source: UNHCR¹ and CReAM².

Europe is faced with an unprecedented number of refugees due to Russia's recent invasion of Ukraine. As of April 07, 2022, the number of Ukrainians fleeing their country was estimated to have exceeded 5.4 million (more than 12% of the population). The daily influx reached its peak level of over 220,000 on March 08, 2022 – and has been slowly receding since then. Ukraine's neighbouring EU countries, including Poland, Romania, Hungary, Moldova, but also Slovakia, have been at the forefront and are providing shelter to more than 4.3 million refugees from Ukraine. Poland has been the central destination country, hosting more than 2.5 million refugees. Moreover, many Ukrainians have been fleeing to Russia – more than 373,000 people – because the routes from war-torn places (notably Mariupol) to the central part of the country and further west have been limited and often impassable.

The longer the war lasts, the larger the number of refugees from Ukraine will be. Nevertheless, the concentration of the war in the eastern part of the country is allowing many refugees from the western part to return to their homes.³

¹ <https://data.unhcr.org/en/situations/ukraine>

² Centre for Research and Analysis of Migration (CReAM), <https://cream-migration.org/ukraine-hub.htm>

³ <https://www.nytimes.com/2022/04/05/world/europe/ukraine-refugee-war-return.html>

Opinion Corner*: Ukrainian refugees – will they stay in the EU long-term?

BY MARYNA TVERDOSTUP

As EU labour markets face an inflow of refugees unseen since World War II, the question of economic and social integration is beyond urgent. With war developments still fluid, one cannot assess whether people aim for a permanent or short-term stay in the EU and thus, whether the policy focus should be on temporary or permanent employment. Yet a number of factors driving the intention to stay can be debated.

What makes the inflow of Ukrainian refugees so distinctly different from the refugee crises faced by Europe in the last decades? The Yugoslav wars of the 1990s and the Syrian civil war of the last decade caused refugee crises in Europe that were unprecedented since World War II. The war launched by Russia in Ukraine has brought on another refugee crisis – the largest and, presumably, most relatable to, particularly, Eastern and Northern Europeans, who once faced the realities or endured the major influence of the Soviet Union. Yet the Ukrainian refugee crisis will likely evolve differently and refugees' intention to stay is one of the major reasons why.

Undoubtedly, a large share of those fleeing the war will stay in the EU at least in the medium term. However, many will also go back, if they have not done so already. While the flow of people returning to Ukraine in the first weeks of war involved mainly EU-residing Ukrainian men heading to fight for their country, this is no longer the case. An increasing number of women, children, and the elderly – those who escaped to Europe as the war started – are now going back¹. According to some sources, the inflow of people to Ukraine now outnumbers the outflow, despite the military action unfolding in the East and South-East of the country². Various reasons – personal, host-country driven, as well as developments on the front line – will shape Ukrainians' intention to stay in the EU.

FAMILY SEPARATION

Ukrainians are not quite like other refugees arriving in the EU in the last decades, neither from the perspective of age and gender composition, nor in the way the EU welcomes them. With men aged 18 to 60 mostly prohibited from leaving Ukraine, around 84% of refugees are women, of whom 58% fled with minor children³, according to a recent survey. Therefore, despite the average age of Ukrainian refugees being below 40 (according to the same survey), a large share of those coming to the EU have limited willingness to work – restrained either by childcare needs, age, or health conditions.

* Disclaimer: The views expressed in the Opinion Corner section of the Monthly Report are exclusively those of the authors and do not necessarily represent the official view of wiiv.

¹ <https://news.un.org/en/story/2022/04/1116212>

² <https://www.bbc.com/news/world-europe-61105013>

³ <https://www.schengenvisainfo.com/news/germany-84-of-refugees-from-ukraine-are-women-survey-reveals/>

The gender-biased composition of the refugee flow reflects not only on labour market activity. As an absolute majority of women fleeing with children left their spouses in Ukraine, families will seek re-unification as soon as the bombs stop falling, which for many Ukrainian refugees means going back home. Yet one essential condition needs to be met – the war should be victorious for Ukraine. If so, hundreds of thousands of Ukrainians will leave the EU and those whose families were separated will be among the first to do so. On the contrary, those who had the opportunity to reunite with relatives living abroad – the only Ukrainians for whom the war has at least some silver lining – most probably will seek to stay.

LABOUR MARKET PROSPECTS

Fitting into the EU labour market could bring both opportunities and challenges for many Ukrainians. The widely-discussed issue of the post-pandemic labour shortages⁴ plays in favour of the refugees, as those fleeing war – many of whom are well-educated and skilled – may find at least temporary jobs. Yet several issues will likely persist. These include skills mismatches and overqualification, as many refugees will take up any job offered; the short-term and/or part-time nature of the majority of job arrangements, at least initial ones; and individual employment restrictions, including mothers' childcare needs or the health restrictions of the elderly and people with disabilities.

As a result, refugees are likely to live on the edge of poverty, even if employed, as living costs range high in many EU countries and state support may be reduced in case of gainful employment. This will likely trigger return, particularly for those with no extra savings or other financial resources to fund their needs. The notable wealth heterogeneity of Ukrainian refugees comes into play here, as some refugees can afford decent self-funded living over the longer run, whereas some have no other option than to stay in organised hosting for weeks, if not months, hoping to find affordable state-subsidised accommodation and a job to self-sustain. Naturally, the drive to return will be stronger among the latter.

WILL THERE BE A HOME TO RETURN TO?

For those Ukrainians coming from the regions of major military action the outlook is grim. By now, the majority of people returning to Ukraine include those living in Western Ukraine as this part of the country has so far been spared major military offensives, as well as those coming from regions freed from Russian occupation and from Kyiv. As the situation on the front line is extremely fluid, one cannot say confidently which parts of the country will remain liveable, or whose homes will remain intact. Yet one thing is certain – refugees who lost their homes back in Ukraine will have a stronger motive to stay in the EU, as the psychological trauma of going back to the place which used to be your home and now lays in ruins cannot be overstated.

One point in favour of Ukrainian refugees' return is geographical proximity. For those with homes thousands of miles away, as in case of Syrian refugees in the EU, return is a difficult business – both logistically and financially. Many Ukrainians who fled to neighbouring Hungary, Poland, and Romania may have decided to do so with the intention of going back as soon as the situation allows. Even those staying in more distant Germany, France, or Italy are not necessarily considering permanent migration, as Ukrainians are free to move across the EU and travel costs have been reduced to a minimum for refugees. Whereas fleeing overseas to Canada or the US signals a higher likelihood of seeking a permanent stay.

⁴ <https://www.ft.com/content/fc3d94f1-9c6c-4f5e-8536-9db90ff221cc>

EU HOSPITALITY – LIMITLESS COMPASSION, YET LIMITED CAPACITY

An extraordinarily well-coordinated EU response to Ukrainian war refugees' inflow and adoption of a unified 'temporary protection' scheme in all EU member states is a milestone for EU refugee policy. For Ukrainians 'temporary protection' implies official residence status, access to the labour market, education, childcare, healthcare, and the right to basic state support. These steps, unquestionably, provide essential support for refugees and importantly, allow Ukrainians to feel welcomed in the EU. The EU's support builds up a foundation for 'a new life starting from scratch', which is of paramount importance for those who have had their 'old life' back home ruined.

However, whereas compassion and eagerness to help will not run out in the foreseeable future, resources likely will, especially when it comes to accommodation. Whereas organised short-term accommodation in refugee centres, hotels, and private homes does not cause any concern, longer-term housing may cause problems. The housing crisis may start to emerge in the upcoming months for the earliest cohorts of refugees – those who have already spent months in temporary accommodation and in the homes of friends or relatives. Rental costs range far above the amounts most Ukrainian refugees can pay and this may be so even with employment, bearing in mind that a large share of working-age refugees is arriving with dependents – minor children and/or elderly relatives. Thus, affordable long-term accommodation may be one of the key factors shaping individual decisions to stay in the EU or to go back to war-torn Ukraine.

THE BOTTOM-LINE

When judging the current numbers of Ukrainian refugees accepted by EU member states, one needs to bear in mind the varying intentions to stay among those fleeing the war. Ukrainians who aim to stay in the EU will integrate economically and socially, whereas those who aim to return home will do so. Thus, the first group needs support in finding long-term accommodation, job-search assistance, access to education, including language courses, certification of Ukrainian education credentials and re-qualification, as well as childcare. The needs of those aiming to return to Ukraine are different, as they likely seek temporary solutions – short-term affordable accommodation, access to basic services and temporary jobs to cover current living costs.

Pre-war trade and value chain integration of Russia and Ukraine with the EU and EU-CEE

BY OLIVER REITER

Teaser: Both gross and value added exports from Russia to the EU have declined since 2014. By contrast, Ukraine's trade integration with the EU has been on the rise. Still, Russian value added is a crucial input in some EU-CEE countries' industries.

INTRODUCTION

The world was shocked by Russia's invasion of Ukraine. With the outcome and duration of the war still very much unclear, it is difficult to forecast how Ukraine and Russia but also the EU27 and the world as a whole will react to the shifts in global trade flows that this conflict will induce.

We can already see the first consequences of the war. Energy prices have been rising in the EU27 as there is fear of a cut in the supply of Russian natural gas. There is an ongoing discussion between the EU27 members on how to best reduce their dependency on gas. Furthermore, since Ukraine and Russia are large exporters of grain, fertilisers and sunflower oil, it is feared that significant supply shortages due to the war will have serious consequences for countries that are dependent on these imports.

In this article we shall take stock of trade dependencies between Russia and Ukraine on the one side and Central and East European EU Member States (EU-CEE) and the EU27 countries on the other side. Furthermore, since nowadays stages of production are often spread across multiple countries, we will take a closer look at value added trade flows.

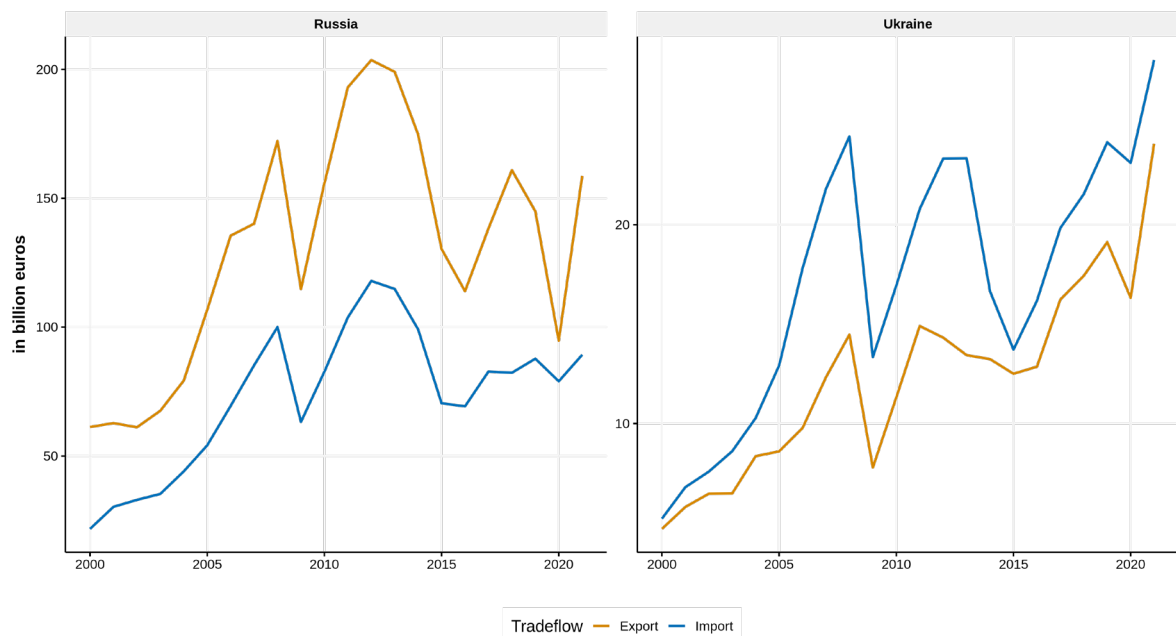
GROSS EXPORTS

Figure 1 depicts the total export and import flows of Russia and Ukraine with the EU27 up until 2021, e.g., the blue line indicates the imports of Russia or Ukraine from the EU27 and the orange line indicates exports from Russia and Ukraine to the EU27.

The developments of trade flows are quite different for the two countries: First, the overall magnitude of trade is, of course, higher with Russia than with Ukraine. While Russian exports ranged from 100 to 150 billion euros and Russian imports between 80 and 90 billion euros in the last five years, for Ukraine this ranged between 15 and 25 billion for both exports and imports. We can also see that the two countries differ in the trade balance: Russia has a positive trade balance with the EU27, i.e. it exports more to the EU27 than it imports, but it is the other way around for Ukraine. Furthermore, the trends over the last years are quite different for the two countries: Ukraine-EU27 trade declined drastically after 2013 but steadily increased from 2015 onwards. Trade with Russia also slumped after 2013 and then stayed at a lower level: exports never climbed back to the 2013 level of more than 200 billion euros.

Table 1 shows the shares of Russia and Ukraine in the reported trade flows of eleven EU-CEE countries. We can make out two groups of countries: The first group are the Baltic countries, where Russia is important for both exports and imports. Estonia, Latvia and Lithuania deliver, respectively, 6, 12 and 13% of their exports to Russia and source 8% (both Estonia and Latvia) and 13% (Lithuania) of their imports from it. For the rest of the countries, exports to Russia only account for 1% to 3% of total exports. It is the import side where Russia plays a bigger role: Russia has a sizable share in the imports of Bulgaria and Poland with 9% and 6%, respectively.

Figure 1 / Trade development of Russia and Ukraine with the EU27



Source: EU Comext, wiiw elaboration.

Ukraine however plays a relatively small role in both EU-CEE exports and imports: imports from Ukraine are in no EU-CEE country higher than 2% and mostly around or below 1%. For Latvia, Poland, Hungary and Lithuania, Ukraine plays a small role as an export market, with shares ranging from 1 to 3.2%. For the other EU-CEE countries, less than 1% of their exports go to Ukraine.

It is, however, interesting to note that it is the Baltic countries and Poland that are arguing most vigorously for stronger sanctions, while also being the countries that are likely to feel the strongest impact (of the sanctions imposed by the EU and also by possible countersanctions of Russia).

Table 1 / EU-CEE countries and Russia/Ukraine shares in trade, in % of a nation's total exports/imports, averaged over 2015 to 2021

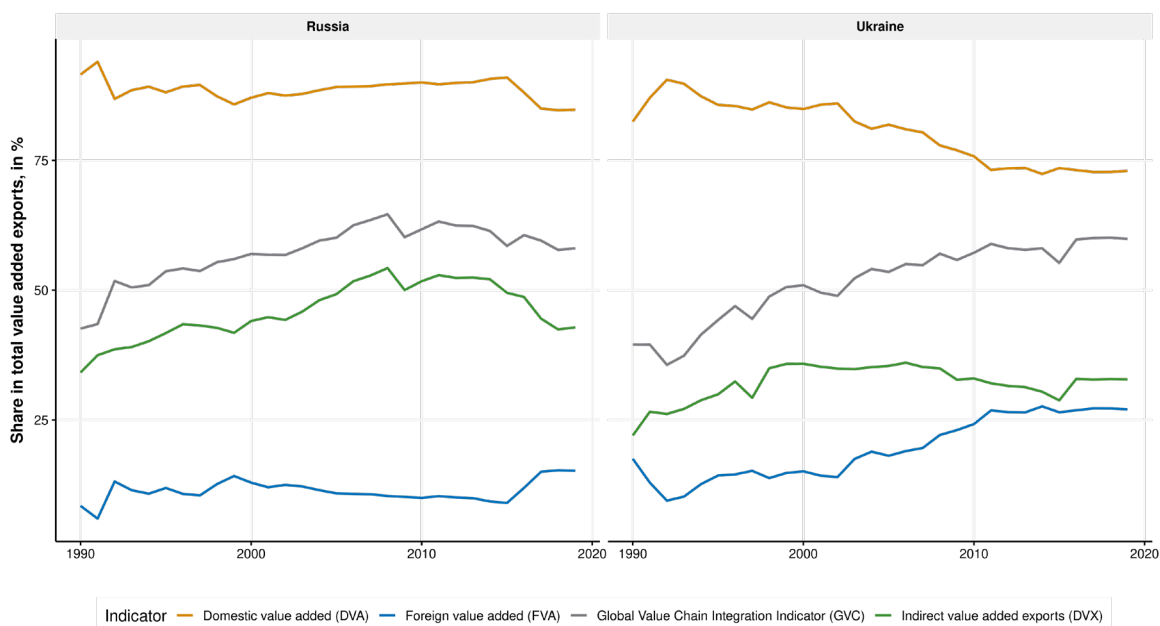
Country	Exports to		Imports from	
	Russia	Ukraine	Russia	Ukraine
Bulgaria	1.7	0.8	9.1	1.7
Croatia	1.2	0.3	1.5	0.1
Czechia	2.0	0.6	1.8	0.6
Estonia	5.9	0.7	8.1	0.6
Hungary	1.5	2.1	3.6	1.5
Latvia	12.5	1.2	7.9	1.0
Lithuania	13.4	3.2	13.1	0.9
Poland	2.9	2.0	6.0	1.1
Romania	1.6	0.8	3.2	1.1
Slovakia	1.9	0.7	4.4	0.7
Slovenia	2.3	0.5	1.1	0.2

Source: EU Comext, wiiw elaboration.

VALUE ADDED TRADE

Global value chains have become a prominent feature of the analysis of the global trade landscape. When production is spread over multiple countries, the gross export figures cloud the fact that the value added needed to produce the exported goods might actually be created in several countries and not only in the exporting country.

Figure 2 / Value chain integration indicators of Russia and Ukraine on the national level



Source: UNCTAD-EORA Global Value Chain Database, wiiw elaboration.

With the help of multi-country input-output tables (MC-IOT, we use the EORA database (see Casella et al., 2019)) we can track where value added is produced and where it is exported. Figure 2 shows such a decomposition: the value added contained in exports is split into domestic value added (DVA) and foreign value added (FVA). Additionally, indirect value added exports (DVX) shows value added that is contained in the exports of another country. FVA and DVX are also known as backward and forward linkages. Backward linkages measure how much foreign value added is employed in domestic production (and so are a measure of upstream integration). Forward linkages inform us of how much domestic value added is then contained in another country's exports, i.e. value added that is exported as intermediate input. As a result, it's a sign of downstream integration. The global value chain integration indicator (GVC) is simply the sum of FVA and DVX and can thus be thought of as a measure of overall integration into global value chains, since it is the total of backward and forward linkages.

For Russia, value chain integration rises from 1990 onwards until 2008 and then stagnates. While backward linkages stay relatively constant over the whole observed time period (except for a sudden increase after 2015), most of the variation in the value chain integration indicator comes from the movement in forward linkages (or DVX). Forward linkages begin to decline after 2014, indicating that this could be a result of the sanctions imposed by the EU27 after the annexation of Crimea by Russia.

Korhonen et al. (2018) however argue that the drop in the price of oil in 2014 and 2015 had a larger effect on the Russian economy than the then-imposed sanctions of the EU on Russia. They note that Russia's market share in the EU had already begun to decline before the sanctions were imposed, and that the sanctions thus only prolonged this development.

We observe a significant increase in global value chain integration in Ukraine, from 40% in 1990 to 60% in 2019. Backward and forward linkages, both of which have increased by ten percentage points, are driving this increase. The domestic value added content of Ukraine's value added exports has dropped from 82 percent to 73 percent.

VALUE ADDED FLOWS BY PRODUCING AND EXPORTING COUNTRY

We may also break these statistics down to a bilateral level: one nation produces the value added, while the other country exports it. So, for example, we may ask:

- › Which nations provide the majority of the value added that Ukraine then exports? This is a type of backward linkage that has been disaggregated.
- › Based on Russia's value added, which nations export it? This would be a disaggregated forward linkage analysis.

Table 2 depicts the division into producing and exporting countries. It is not surprising that the majority of value added created in Russia or Ukraine is likewise exported by those countries.

Table 2 / Producing versus exporting country value added shares, in % of total, 2019

Producing: Russia		Producing: Ukraine	
Exporting country	Share	Exporting country	Share
Russia	66.4	Ukraine	69.0
European Union	22.4	European Union	17.3
Germany	7.6	Russia	6.0
Netherlands	2.4	Germany	4.5
China	2.0	Poland	2.5
Italy	1.7	Italy	1.5
France	1.6	Czechia	1.1
Japan	1.5	Slovakia	1.1
Ukraine	1.4	Hungary	1.0
Czechia	1.3	Netherlands	0.9

Exporting: Russia		Exporting: Ukraine	
Producing country	Share	Producing country	Share
Russia	84.8	Ukraine	73.0
European Union	4.7	Russia	9.8
US	2.7	European Union	9.1
Germany	1.3	Germany	2.5
China	1.2	China	1.8
Ukraine	1.2	Poland	1.2
Belarus	0.7	US	0.9
Poland	0.5	Italy	0.8
India	0.5	Turkmenistan	0.7
Netherlands	0.4	UK	0.6

Source: UNCTAD-EORA Global Value Chain Database, wiiw elaboration.

The table for Russia again shows Russia's dependency on the EU market: 22% of value added that is produced in Russia is finally exported by the EU27 countries. This means the EU27 countries are an important buyer of Russian intermediaries (especially energy carriers like oil or natural gas) that end up as components of European final goods exports. China with 2% and Japan with 1.5% are already much smaller exporters of Russian value added. Eighty-one percent of value added that is exported by Russia is also produced in Russia. Only 4.5% is value added originally produced by the EU, 2.6% is produced by the US and 1.2% by China. This statistic probably illustrates the policy of import substitution that is being pursued by the Russian government with the goal of reducing the negative impact of sanctions.

The table for Ukraine illustrates the country's geographical location between Russia and East European countries: Russia is Ukraine's largest (single nation) trading partner, accounting for 6% of forward and 9% of backward linkages, respectively. Only when the European Union is considered as a whole does it export 17.3% of the value added created in Ukraine. With Poland, Czechia, Slovakia and Hungary we see a set of East European countries that export Ukrainian value added. In terms of backward connections, we can observe that China is the most important non-European producer of Ukraine's value added exports.

INDUSTRY LEVEL RESULTS

We can also break down value added flows further: from producing country as a whole into producing industries within the country. Thus, we can see which industry in, e.g., Russia, is producing most of the value added that is then exported by EU27 countries.

Table 3 / EU-CEE exporting country and industry value added share, in % of total industry value added, 2017

Exporting		Producing		
country	Exporting industry	country	Share	Rank
Bulgaria	Petroleum, chemical and non-metallic mineral products	Russia	1.65	5
Croatia	Petroleum, chemical and non-metallic mineral products	Russia	0.58	17
Czechia	Coke, refined petroleum products and nuclear fuels	Russia	48.11	1
Estonia	Electrical energy, gas, steam and hot water	Russia	16.48	2
Hungary	Coke, refined petroleum products and nuclear fuels	Russia	22.63	2
Latvia	Coke, refined petroleum products and nuclear fuels	Russia	15.64	2
Lithuania	Chemicals, chemical products and man-made fibres	Russia	49.28	1
Poland	Air transport services	Russia	1.65	6
Romania	Coke, refined petroleum products and nuclear fuels	Russia	21.76	2
Slovakia	Coke, refined petroleum products and nuclear fuels	Russia	56.26	1
Slovenia	Crude petroleum and natural gas; services incidental to oil and gas extraction excluding surveying	Russia	4.12	2
Bulgaria	Petroleum, chemical and non-metallic mineral products	Ukraine	2.21	4
Croatia	Metal products	Ukraine	0.18	31
Czechia	Basic metals	Ukraine	2.35	5
Estonia	Fabricated metal products, except machinery and equipment	Ukraine	1.37	8
Hungary	Basic metals	Ukraine	1.31	14
Latvia	Basic metals	Ukraine	2.79	5
Lithuania	Other non-metallic mineral products	Ukraine	2.97	6
Poland	Coke, refined petroleum products and nuclear fuels	Ukraine	8.73	2
Romania	Metal ores	Ukraine	1.51	6
Slovakia	Basic metals	Ukraine	2.89	7
Slovenia	Crude petroleum and natural gas; services incidental to oil and gas extraction excluding surveying	Ukraine	0.62	32

Note: The UNCTAD-EORA database does not use a uniform industry classification. Even if some industry names sound similar, they might refer to different industries and a direct comparison of industries is thus not possible.

Source: UNCTAD-EORA Global Value Chain Database, wiiw elaboration.

Using data for the most recent available year 2017, we can see that it is the primary sectors in both Russia and Ukraine that are producing the most value added which ends up in EU27 exports. For Russia, the 'mining and quarrying' industry contributes almost 20% of the total, while 'Coke, refined petroleum and nuclear fuel' and 'Non-ferrous metals' account for 12% and 11% respectively. Interestingly, there are two industries that also account for sizable value added shares and that act mainly as facilitators for the three industries already mentioned: the 'wholesale & retail trade; repairs' and 'Land transport; transport via pipelines' industry are responsible for another 13% and 9.2% respectively. We see a very similar picture for Ukraine: it is the export of raw materials such as iron ore

(19%), coal (13%), power (11%) and metals (5%) as well as the transport of these goods (7%) that accounts for the largest industry shares in value added.

Table 3 shows, for eleven EU-CEE countries, the industries which export the highest share of value added produced in Russia or Ukraine. The rank column gives the rank of Russia or Ukraine within that industry. For instance, in Bulgaria, the 'Petroleum, chemical and non-metallic mineral products' industry is the industry that shows the highest share of Russian value added, namely 1.7% of the total industry value added. In that industry, Russia is the fifth largest contributor of value added among all countries.

We observe that it is mainly the 'Coke, refined petroleum products and nuclear fuels' (in five countries the industry with the highest Russian share, ranging from 15.6% in Latvia to 56% in Slovakia) industry where Russian value added plays a significant role. The 'Chemicals, chemical products and man-made fibres' industry in Lithuania is also highly dependent on Russian value added: 49% of it is produced there. In three countries (Czechia, Lithuania and Slovakia), Russian value added makes up the biggest share of total value added (i.e., Russia's rank is 1), even larger than the domestically produced share.

Ukrainian value added plays a much less important role in the value added exports of EU-CEE countries: only in Poland in the 'Coke, refined petroleum products and nuclear fuels' industry can we find a significant share of Ukrainian value added: 8.7%. In the other country-industries, value added that was produced in Ukraine usually makes up less than 3% of total value added and is thus not a primary contributor of value added.

SANCTIONS AND TRADE POLICY

The EU and the US have imposed a wide variety of sanctions as a response to Russia's invasion of Ukraine: The assets of the Russian Central Bank as well as of oligarchs and politicians have been frozen, and Russian banks have also been removed from the SWIFT network and are thus now unable to conduct cross-border financial transactions.

Canada has already used instruments from trade policy by revoking Russia's 'Most Favoured Nation' status: All Russian exports to Canada are now subject to a tariff rate of 35%.¹ In the EU there is considerably more discussion on how to reduce the dependency of the EU on Russian oil and gas, while the US has already banned all imports of Russian oil. As we have seen above, some EU countries (also Western EU members and not only the EU-CEE countries that were reported) are heavily dependent on Russian oil and gas and thus understandably reluctant to drastically reduce their energy imports. Economists have proposed using an import tariff on natural gas as this would reduce the imported quantity of natural gas. Due to demand being more elastic than supply, the costs of this policy would fall on the producers of natural gas, thus on Russia.²

¹ See <https://www.canada.ca/en/department-finance/news/2022/03/canada-cuts-russia-and-belarus-from-most-favoured-nation-tariff-treatment.html> (accessed 28.3.2022).

² See <https://voxeu.org/article/how-solve-europe-s-russian-gas-conundrum-tariff>, <https://www.project-syndicate.org/commentary/case-for-punitive-tax-on-russian-oil-by-ricardo-hausmann-2022-02> and <https://www.faz.net/aktuell/wirtschaft/energieversorgung-aus-russland-total-embargo-fuer-gas-und-oel-17906637.html?GEPc=s3&premium=0x78ce71a0a7bd01af322db46a1cfc17ab> (in German).

The US has even issued export restrictions on American technology being exported to Russia: all exporters of certain electric and electronical equipment have to obtain a license from the Department of Commerce which is, by default, denied. Thus even re-exporting American technology is prohibited and counteracting firms in third countries can themselves become targets of sanctions.³

CONCLUSION

We have seen that the trade volumes between the EU27 and Russia and Ukraine are showing different trajectories: while Russian exports to the EU27 have decreased since 2014 and have stayed on a lower level since then, trade flows with Ukraine have climbed back after a drop in 2014 and also eclipsed the levels from 2014. Looking at value added trade figures, we see a similar picture: the trade integration of the EU27 with Russia has been declining since 2014, even though it is still an important trading partner (in terms of Russian value added exported by the EU27).

From the value added numbers we see that Russian value added plays a very important role in some EU-CEE countries' industries, while Ukraine's role is much less significant.

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³ See <https://www.economist.com/business/2022/02/25/america-has-targeted-russias-technological-fabric>

The 'Great Disinflation': How important was the 'China Factor'?¹

BY LEON PODKAMINER

Contrary to common belief, China's integration into the global manufacturing system does not seem to have depressed wage shares in the advanced countries. If anything, it also failed to raise unemployment rates in the advanced countries. The 'Great Disinflation' theory advanced by Goodhart and Pradhan (2020) is unconvincing, and so is their conclusion that the approaching great demographic reversal augurs an inflation revival.

The recent work by Goodhart and Pradhan (2020) suggests that the long era of low inflation might be coming to an end: '... globalisation and demographic shocks have led to an extraordinarily deflationary trend over the last 30 years ...' (p. 9). 'The integration of China into the global manufacturing complex by itself more than doubled the available labour supply for the production of tradeable products among the advanced economies' (p. 2). '... The economic effects of this have been a dramatic ... weakening in the bargaining power of the labour force ... no wonder that the deflationary forces have been so strong ...' (p. 5). But '... The Great Reversal Is Now Starting ...' (p. 9): '... a sharp decline in the number of those entering the labour force ...' plus increased demand for labour needed for looking after the elderly, whose numbers will increase very strongly and rapidly (p. 11).

This note argues that the effects of China's integration into the world economy may not have had much of a disinflationary effect on the advanced economies until relatively late. Moreover, it suggests that the repression of wages in the advanced economies took place *before* the full-scale integration of China into the global trading system. Demography need not have been responsible for the repression of global inflation. Therefore, the approaching demographic reversal does not necessarily augur a revival of high inflation.

A BRIEF HISTORY OF DISINFLATION IN ADVANCED ECONOMIES

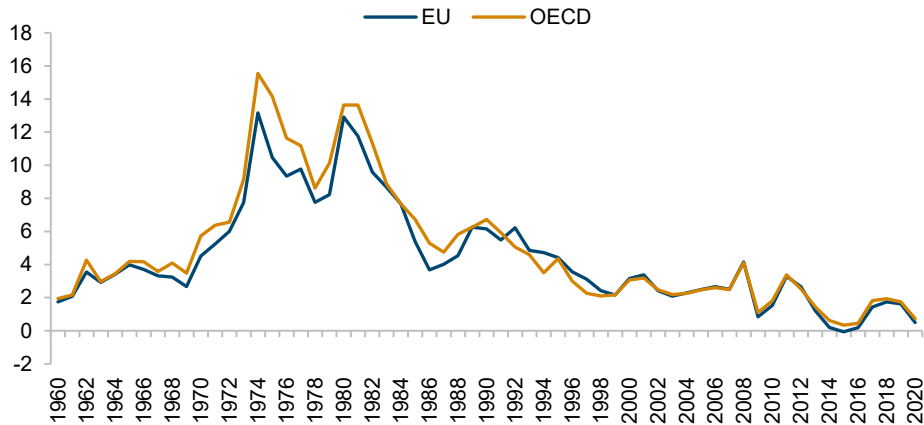
The collapse of the Bretton Woods system in the early 1970s coincided with inflation rising in the advanced economies. The two exogenous oil-price shocks (1973 and 1979) hitting the global economy provoked high inflation which peaked in 1975 and 1980-81 (see Figure 1).

Moderate/low inflation (starting from around the mid-1990s) was preceded by several years of gradual disinflation which may be attributed to several factors. First of all, a plunge in oil prices (1986). Moreover, economic growth during those years, additionally punctuated by recessionary episodes (1981-82, 1993), was anaemic. Later recessionary episodes (2002-03, 2008-09, 2012-13) occurred during the low inflation years. Those episodes may have kept inflation under control as well. Low and unstable growth itself was, arguably, a consequence of economic policies enacted, especially in the 1980s and until the

¹ This is an abridged version of the text appearing in the Real World Economics Review, issue 98, March 2022.

mid-1990s. During these years real interest rates were abnormally high: monetary policies were instrumental in restricting both inflation and economic growth.

Figure 1 / Inflation in the advanced economies since 1960, in %



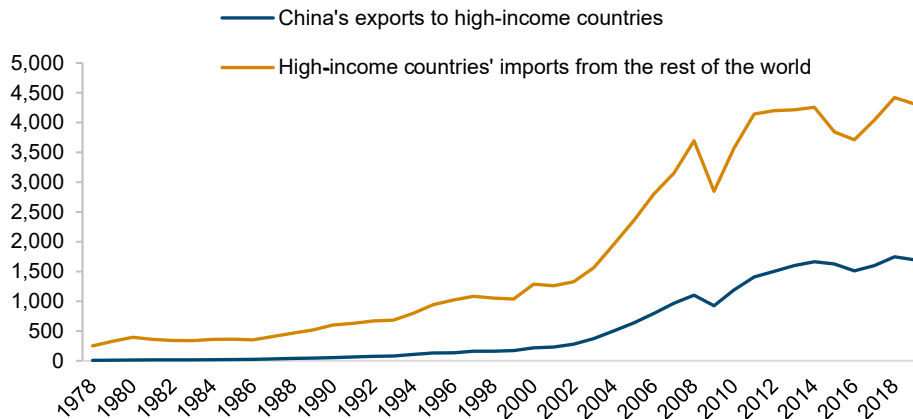
Source: WDI.

THE 'CHINA FACTOR' MAY HAVE OPERATED SINCE ABOUT 2005 BUT...

China entered the World Trade Organization in 1997. But it took several years for China to become an important partner of the advanced countries. Chinese merchandise exports to high income countries had long been insignificant as compared with high-income countries' merchandise imports from the rest of the world (i.e. from the low and medium income countries). Only by 2003 did Chinese exports to the high-income countries start to rise (Figure 2).

Figure 2 / China's merchandise exports to high-income countries and merchandise imports from the rest of the world by high-income countries

(in bn USD)



Source: WDI.

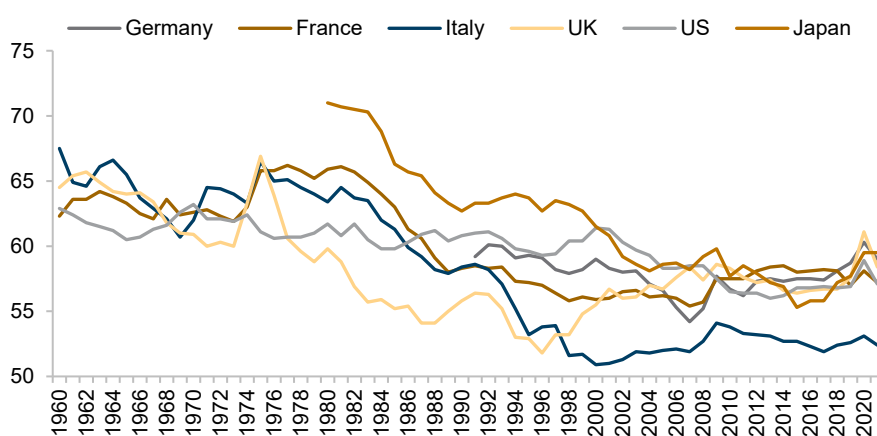
The integration of China into the global economy effectively started around that year, not quite '30 years ago'². Until that year Chinese exports to high income countries were minute compared with the total imports of high-income countries, or even relative to their imports from other low-to-medium-income countries. Thus, it is perfectly reasonable to expect the post-2003 developments to have had some impact on the economic fates of the latter. But there is little justification for the claim that China's exports could have played a significant role in the initial years of intensified globalisation (from around 1990 until the early 2000s).

... IT DID NOT AFFECT WAGE SHARES IN THE HIGH-INCOME COUNTRIES

The presumed deflationary consequences of China's integration into the global economy should have materialised through the repression of wages in high-income countries (via a 'dramatic weakening of labour's bargaining power'). But this presumption is hard to square with the available data on the (adjusted) GDP labour share.

Figure 3 suggests that the GDP wage shares in the major advanced countries had followed declining trends until the early 1990s. Later on, these shares either stabilised or even rebounded slightly (see Table 1).

Figure 3 / Adjusted GDP labour shares, major advanced countries, in %



Source: AMECO.

Table 1 / Changes in adjusted GDP labour shares, major advanced economies, in percentage points

	Germany	France	Italy	UK	US	Japan
1960-1975		3.5	-1	2.4	-1.8	
1975-1990		-7.5	-8.1	-11.1	-0.3	-8.3 ^a
1990-2005	-2.7 ^b	-2.1	-6.4	0.9	-2.5	-4.1
2005-2020	3.7	1.9	1.1	4.4	0.6	0.9

Source: AMECO. a: years 1980-1990. b: years 1991-2005.

² Goodhart and Pradhan book 'was mainly written in 2019' (p. 213). The implied starting date for China's entrance into the global economy is 1989 – much too early by any account.

Evidently, the downward adjustments in the labour shares occurred *before* China's exports effectively entered the world market (and before the full-scale liberalisation of trade and capital flows that took place around 1990). In most cases the years 1975-1990 were really critical in that respect. But the years 2005-2020 witnessed some rebound in the labour shares. Data on the average unemployment rates convey much the same message: unemployment tended to contract *after* 2003 (see Table 2). Apparently, rapidly rising Chinese exports did not push employees in the advanced countries out of work – at least within a couple of years following 2003. (After 2008 unemployment rose, evidently under the impact of the Great Recession and – in the Euro Area – also during the secondary recession in 2011-12. The later recovery pushed unemployment rates further down.)

Table 2 / Average unemployment rates, in %

	1990-95	1996-99	2000-03	2004-07	2008-15	2016-19
Euro Area	9.6	10.4	8.4	8.5	10.3	8.8
UK	9.1	6.8	5.2	5.1	9.9	4.3
US	6.4	4.8	5.1	5.0	7.1	4.2
Japan	2.5	3.9	5.1	4.3	4.4	2.7

Source: AMECO.

CONCLUDING REMARKS

The 'Great Disinflation' since about 1990 appears to have coincided with progressive globalisation and a seemingly massive increase in the global availability of labour force. However, China's expansion, effectively since about 2003, cannot really be invoked to explain the deflationary tendencies. Contrary to common belief China's integration into the global manufacturing system does not seem to have depressed wage shares in the advanced countries. If anything, it also failed to raise unemployment rates in the advanced countries. The 'Great Disinflation' theory advanced by Goodhart and Pradhan is unconvincing and so is their conclusion that the approaching great demographic reversal augurs an inflation revival. An alternative explanation of the inflation trends since the mid-1980s may point to the fact that, contrary to 'common knowledge', deepening and widening globalisation has depressed global economic growth (Podkaminer, 2021, 2022). That, in turn, may have been instrumental in restricting global inflation.

REFERENCES

Goodhart, Ch. and Pradhan, M. (2020) *The Great Demographic Reversal. Ageing Societies, Waning Inequality, and an Inflation Revival*. Palgrave Macmillan.

Podkaminer, L. (2021) 'Does trade support global economic growth? Further evidence on the global trade – global growth connection'. *Bank & Credit*, vol. 52, no.1, 23-36.

Podkaminer, L. (2022) 'Economic stagnation in the Euro Area'. In Wray, R. and Dantas, F. (eds.) *Handbook of Economic Stagnation*. Elsevier.

Monthly and quarterly statistics for Central, East and Southeast Europe

The monthly and quarterly statistics cover **22 countries** of the CESEE region. The graphical form of presenting statistical data is intended to facilitate the **analysis of short-term macroeconomic developments**. The set of indicators captures trends in the real and monetary sectors of the economy, in the labour market, as well as in the financial and external sectors.

Baseline data and a variety of other monthly and quarterly statistics, **country-specific** definitions of indicators and **methodological information** on particular time series are **available in the wiiw Monthly Database** under: <https://data.wiiw.ac.at/monthly-database.html>. Users regularly interested in a certain set of indicators may create a personalised query which can then be quickly downloaded for updates each month.

Conventional signs and abbreviations used

%	per cent
ER	exchange rate
GDP	Gross Domestic Product
HICP	Harmonised Index of Consumer Prices (for new EU member states)
LFS	Labour Force Survey
NPISHs	Non-profit institutions serving households
p.a.	per annum
PPI	Producer Price Index
reg.	registered
y-o-y	year on year

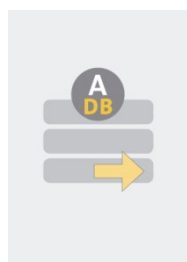
The following national currencies are used:

ALL	Albanian lek	HRK	Croatian kuna	RON	Romanian leu
BAM	Bosnian convertible mark	HUF	Hungarian forint	RSD	Serbian dinar
BGN	Bulgarian lev	KZT	Kazakh tenge	RUB	Russian rouble
BYN	Belarusian rouble	MKD	Macedonian denar	TRY	Turkish lira
CZK	Czech koruna	PLN	Polish zloty	UAH	Ukrainian hryvnia

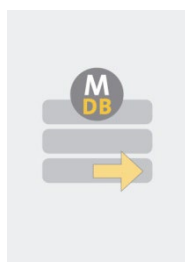
EUR euro – national currency for Montenegro, Kosovo and for the euro-area countries Estonia (from January 2011, euro-fixed before), Latvia (from January 2014, euro-fixed before), Lithuania (from January 2015, euro-fixed before), Slovakia (from January 2009, euro-fixed before) and Slovenia (from January 2007, euro-fixed before).

Sources of statistical data: Eurostat, National Statistical Offices, Central Banks and Public Employment Services; wiiw estimates.

Online database access



wiiw Annual Database



wiiw Monthly Database



wiiw FDI Database

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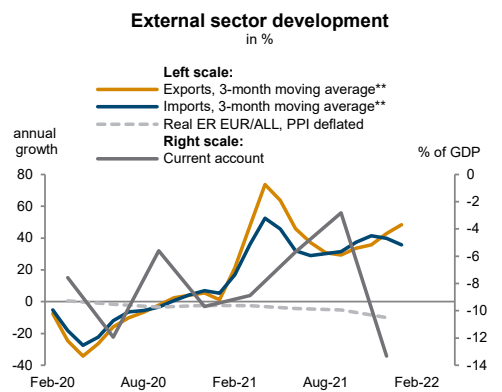
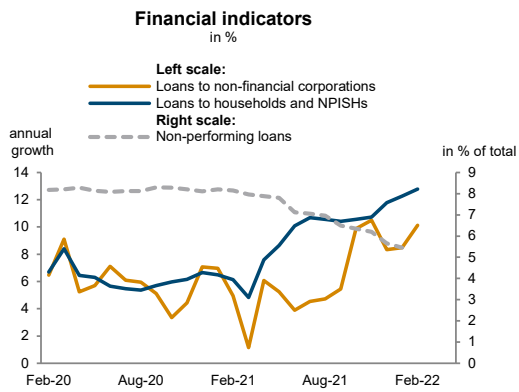
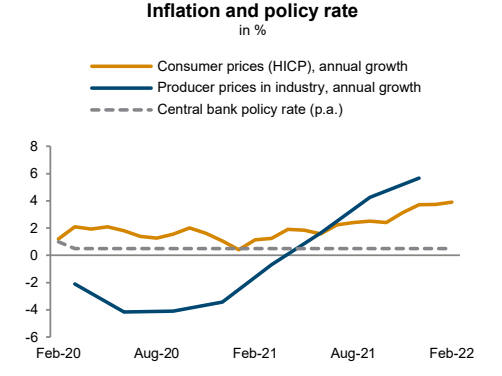
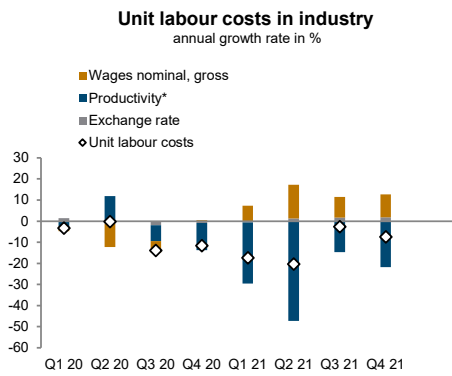
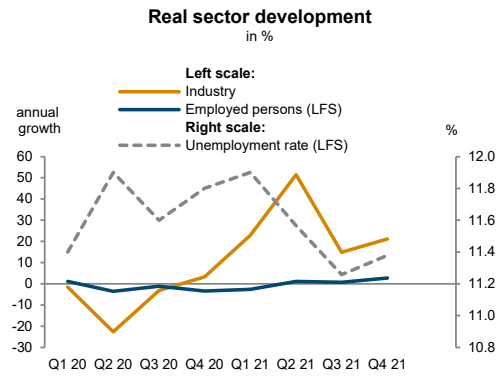
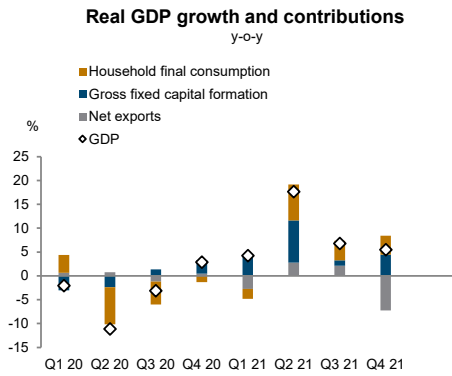
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Albania

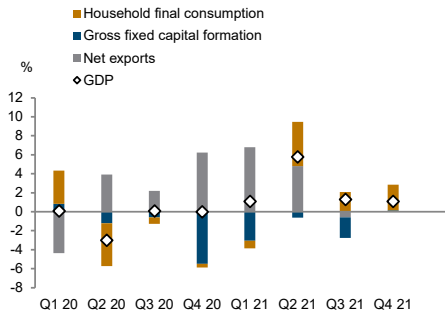


*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.
 **EUR based.

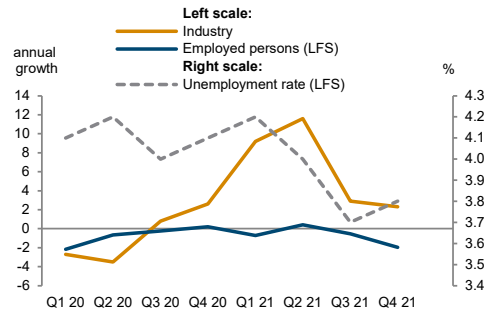
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Belarus

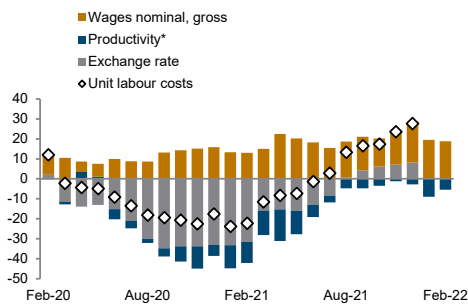
Real GDP growth and contributions
y-o-y



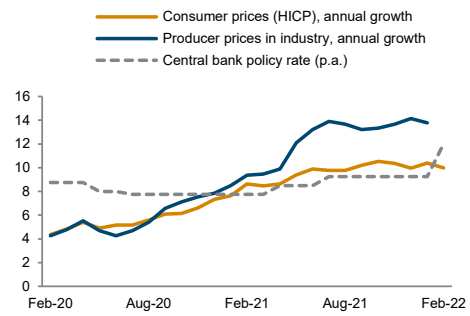
Real sector development
in %



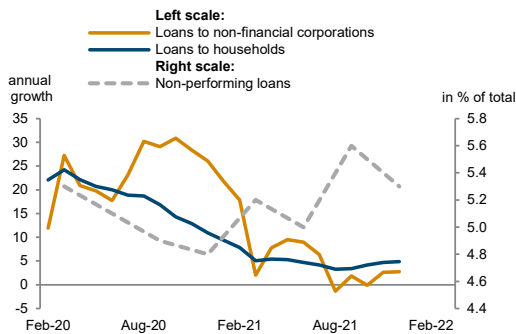
Unit labour costs in industry
annual growth rate in %



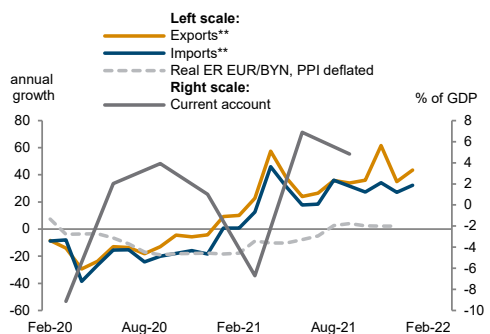
Inflation and policy rate
in %



Financial indicators
in %



External sector development
in %

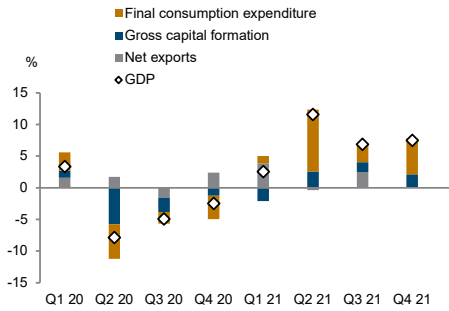


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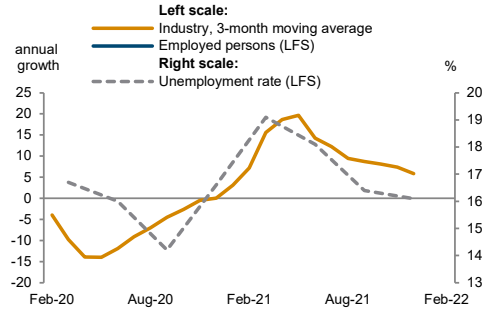
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Bosnia and Herzegovina

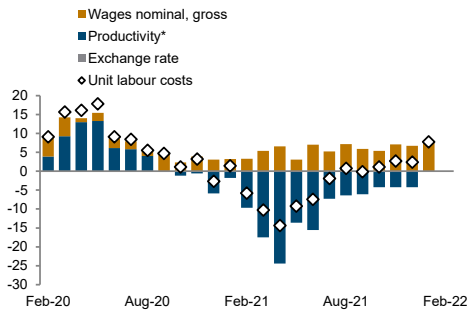
Real GDP growth and contributions
y-o-y



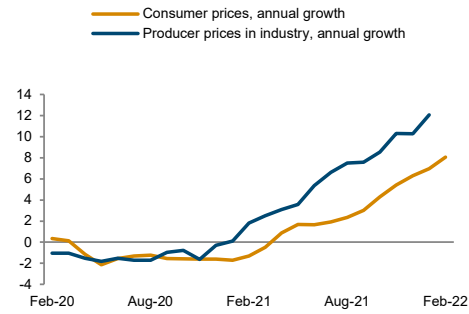
Real sector development
in %



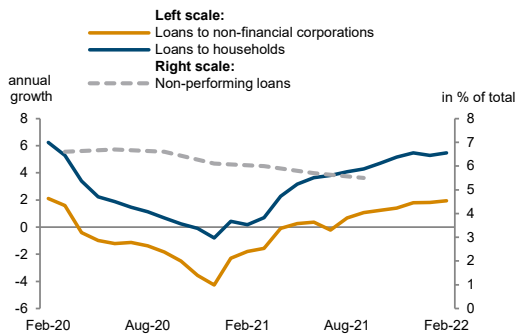
Unit labour costs in industry
annual growth rate in %



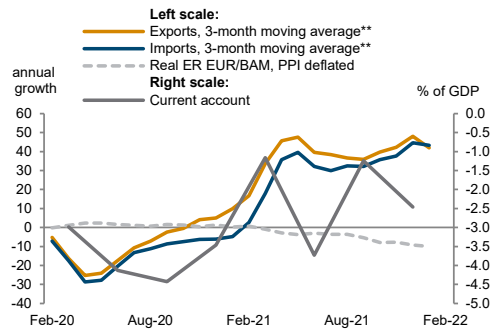
Inflation
in %



Financial indicators
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External sector development
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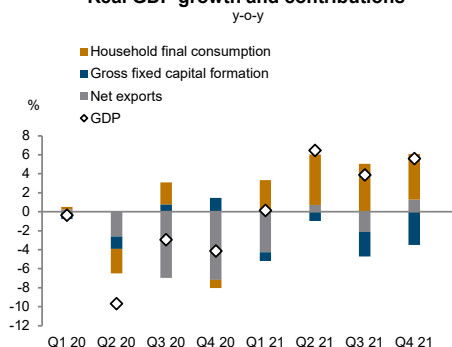
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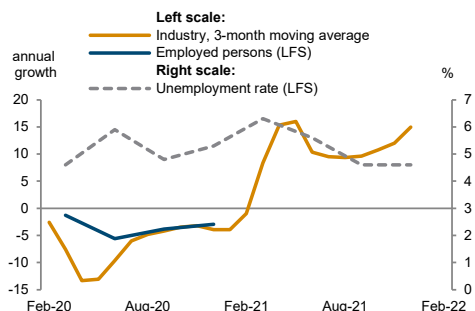
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Bulgaria

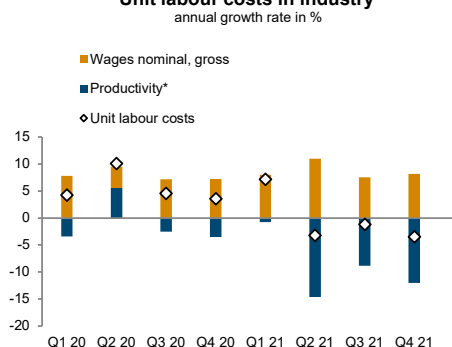
Real GDP growth and contributions



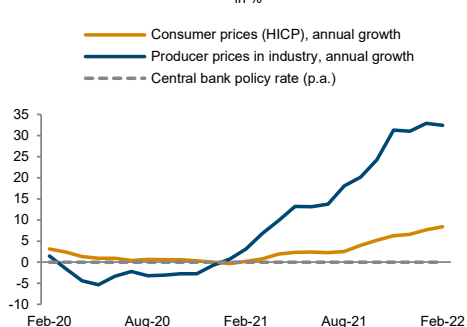
Real sector development



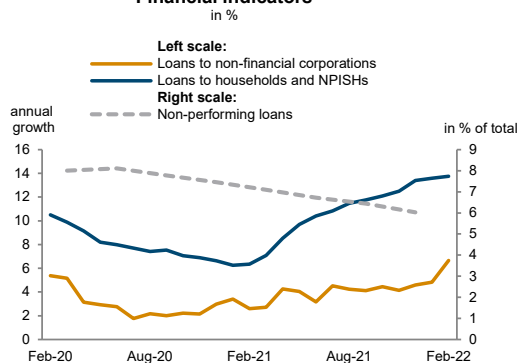
Unit labour costs in industry



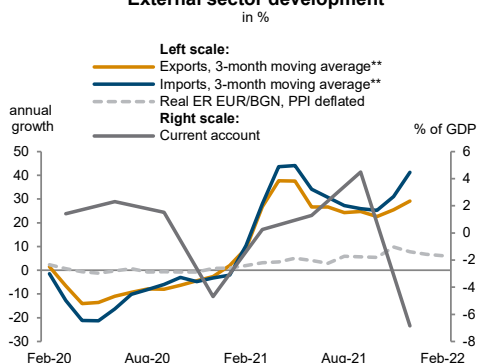
Inflation and policy rate



Financial indicators



External sector development



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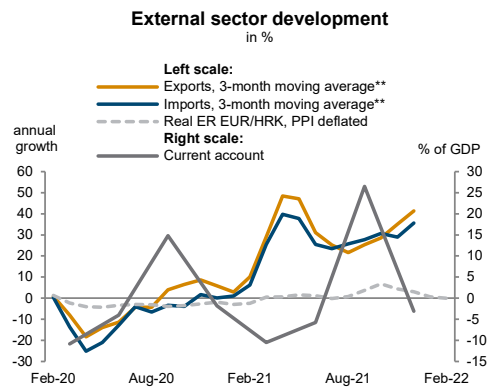
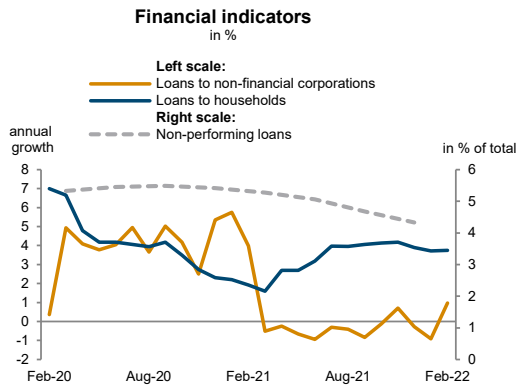
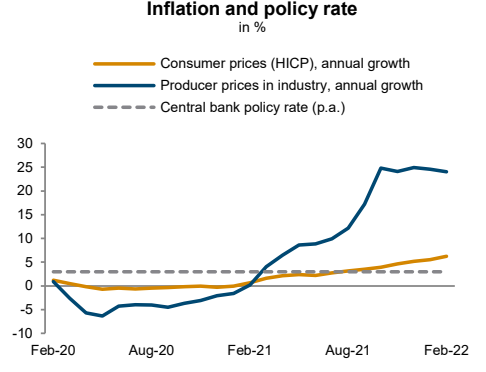
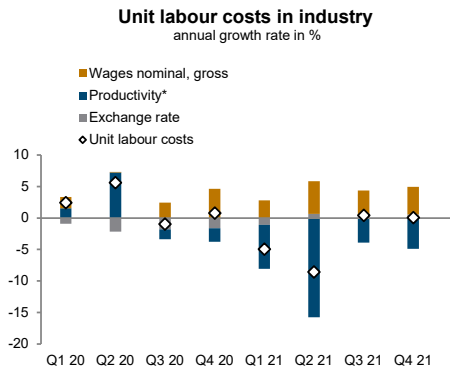
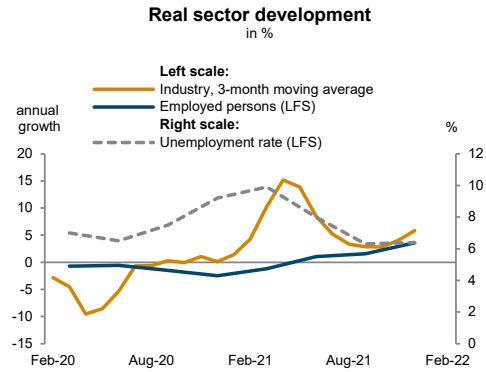
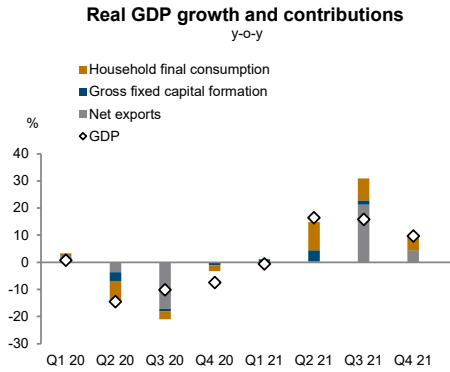
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Croatia

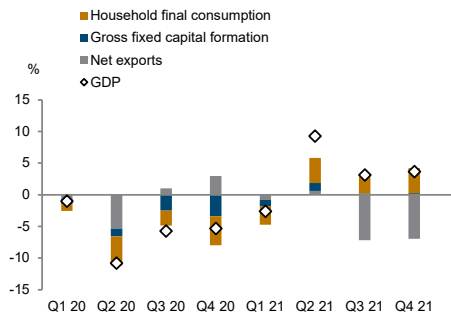


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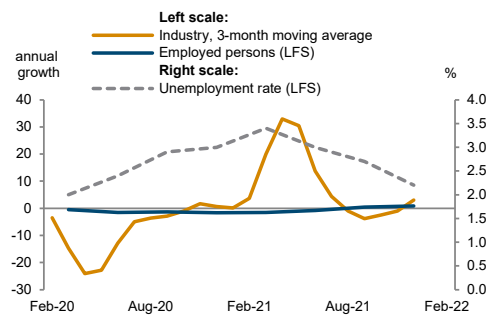
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Czechia

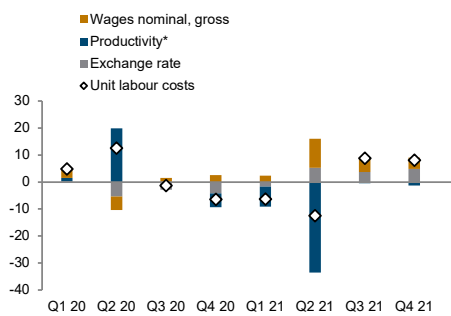
Real GDP growth and contributions
y-o-y



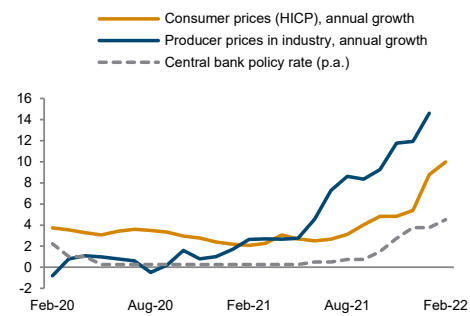
Real sector development
in %



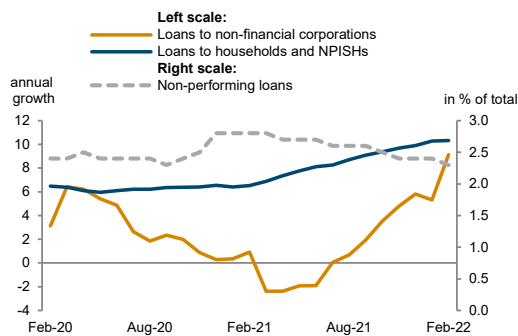
Unit labour costs in industry
annual growth rate in %



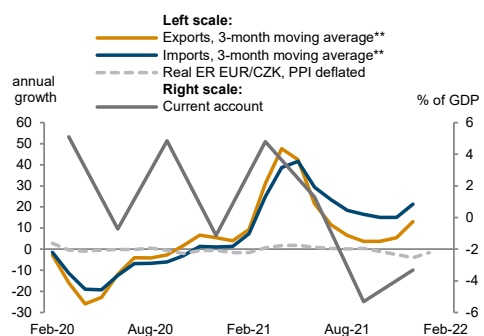
Inflation and policy rate
in %



Financial indicators
in %



External sector development
in %



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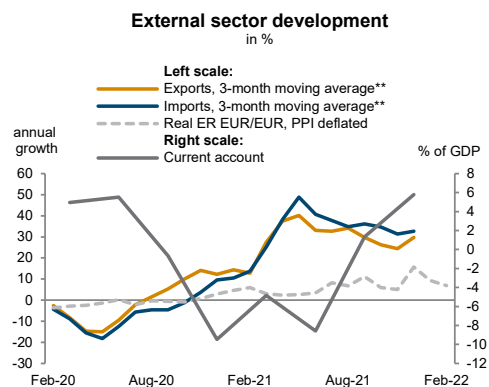
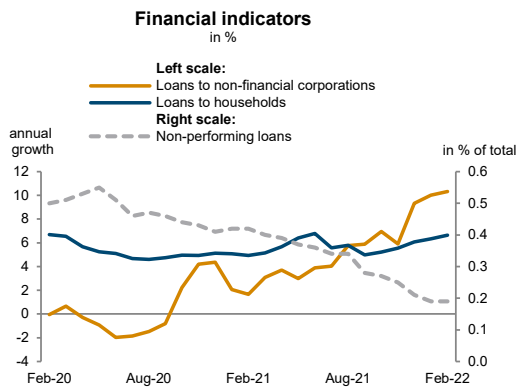
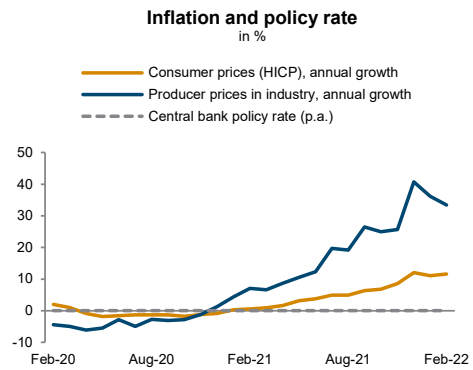
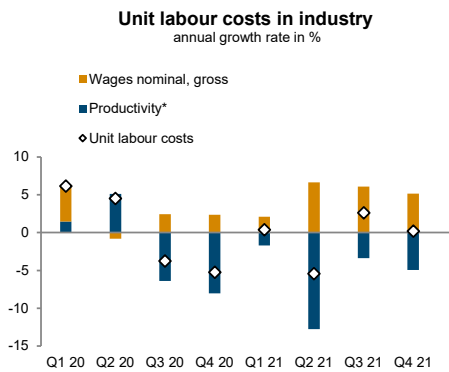
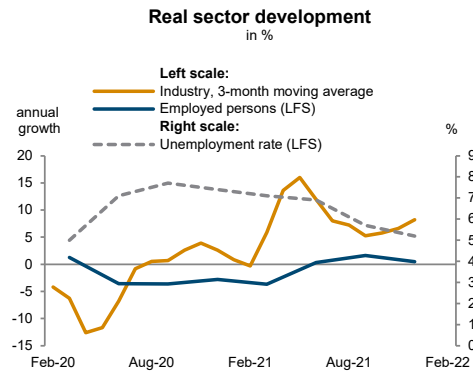
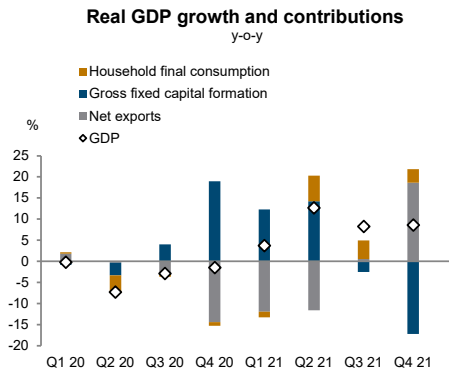
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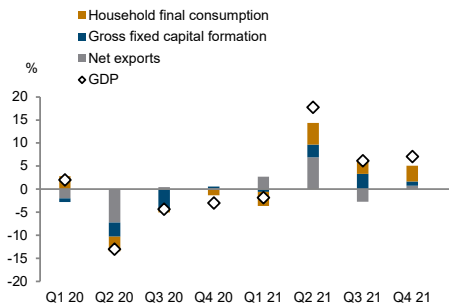


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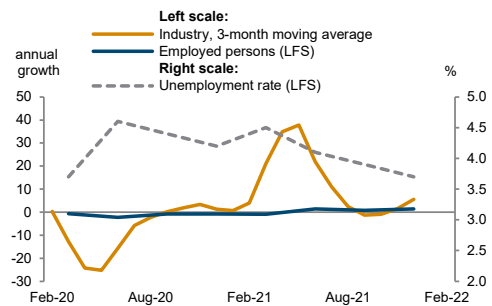
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Hungary

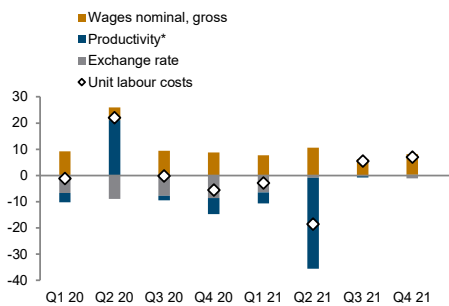
Real GDP growth and contributions
y-o-y



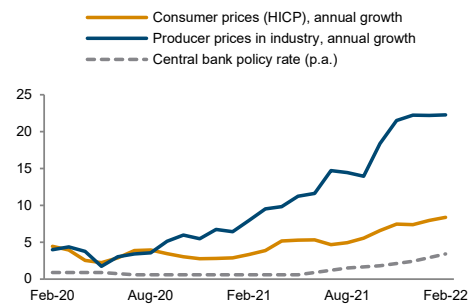
Real sector development
in %



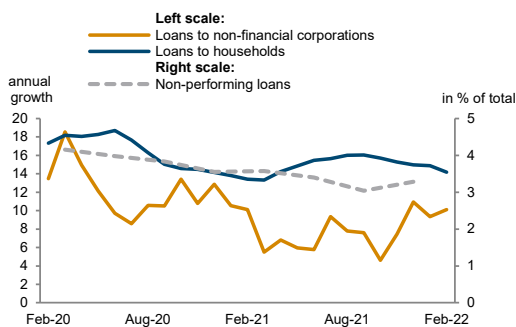
Unit labour costs in industry
annual growth rate in %



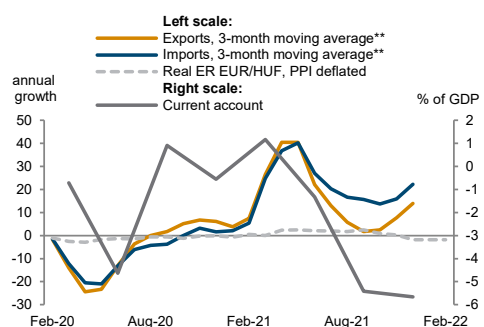
Inflation and policy rate
in %



Financial indicators
in %



External sector development
in %



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**EUR based.

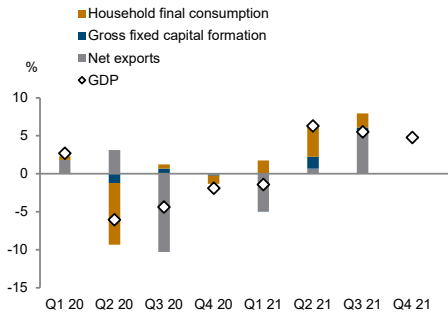
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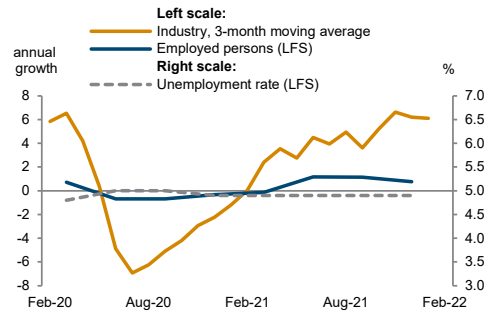
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Kazakhstan

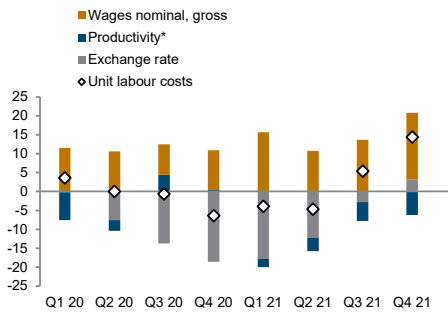
Real GDP growth and contributions
y-o-y



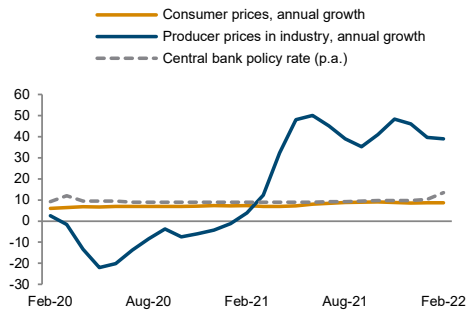
Real sector development
in %



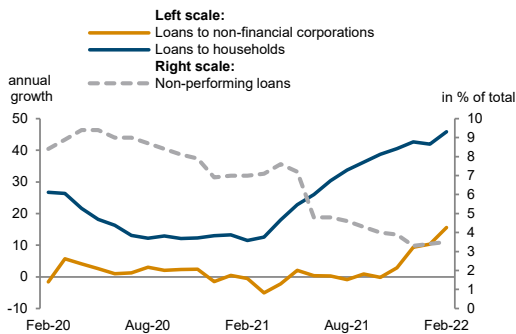
Unit labour costs in industry
annual growth rate in %



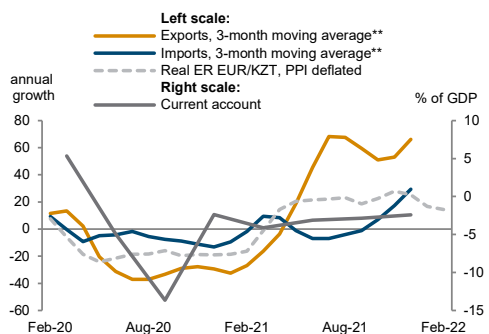
Inflation and policy rate
in %



Financial indicators
in %



External sector development
in %



*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

**EUR based.

Source: wiiw Monthly Database incorporating Eurostat and national statistics.

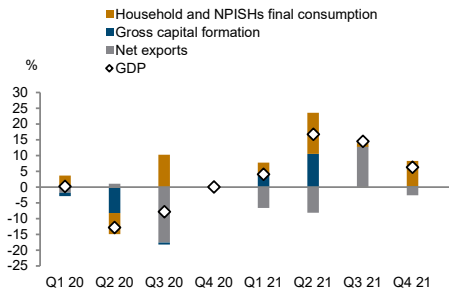
Baseline data, country-specific definitions and methodological breaks in time series are available under:

<https://data.wiiw.ac.at/monthly-database.html>

Kosovo

Real GDP growth and contributions

y-o-y



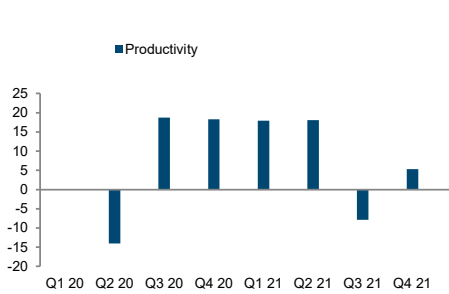
Real sector development

in %



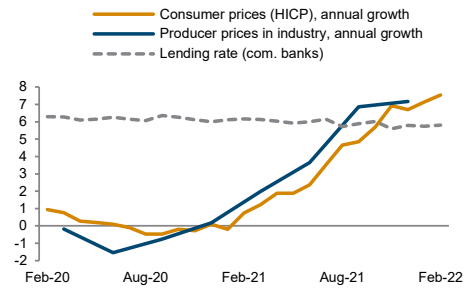
Productivity in industry

annual growth rate in %



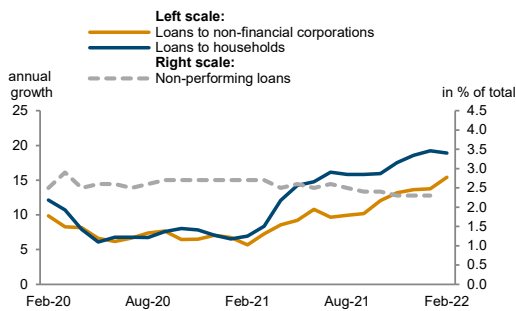
Inflation and lending rate

in %



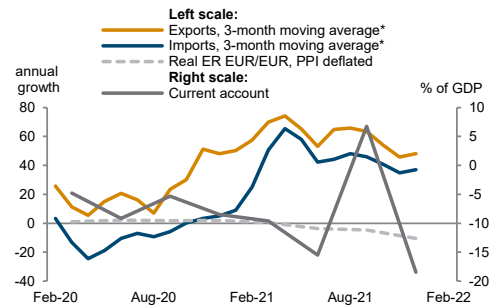
Financial indicators

in %



External sector development

in %



*EUR based.

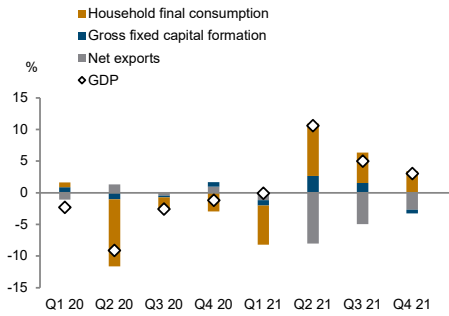
Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

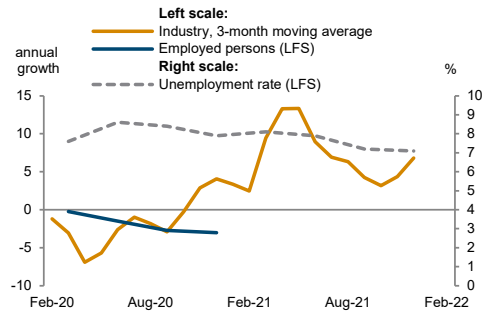
<https://data.wiiw.ac.at/monthly-database.html>

Latvia

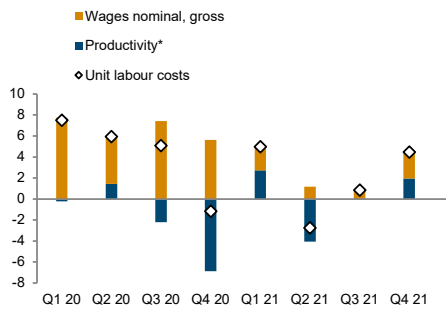
Real GDP growth and contributions
y-o-y



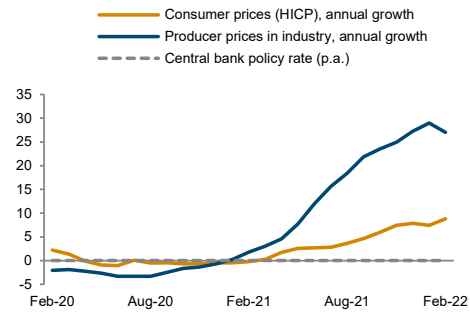
Real sector development
in %



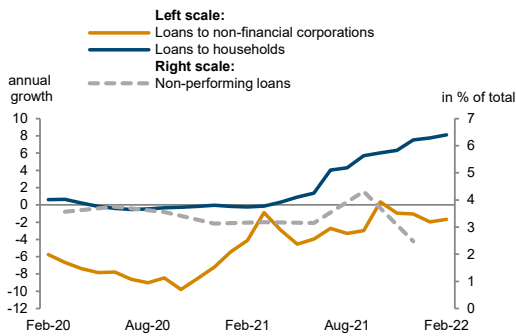
Unit labour costs in industry
annual growth rate in %



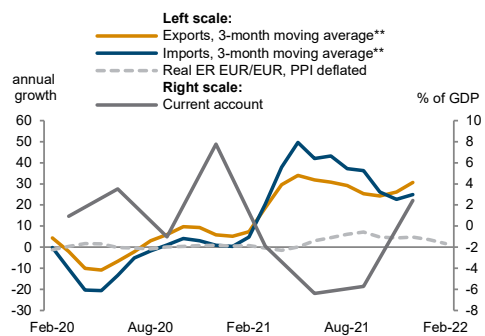
Inflation and policy rate
in %



Financial indicators
in %



External sector development
in %



*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

**EUR based.

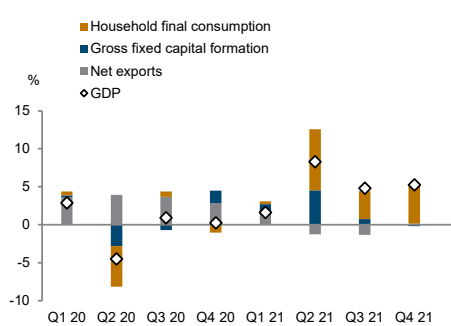
Source: wiiw Monthly Database incorporating Eurostat and national statistics.

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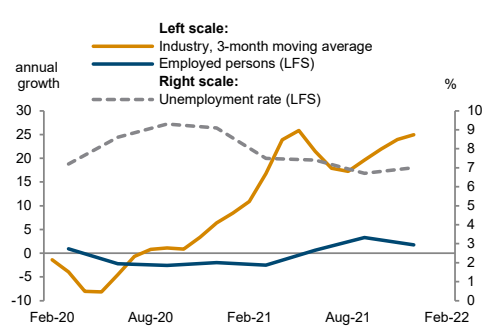
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Lithuania

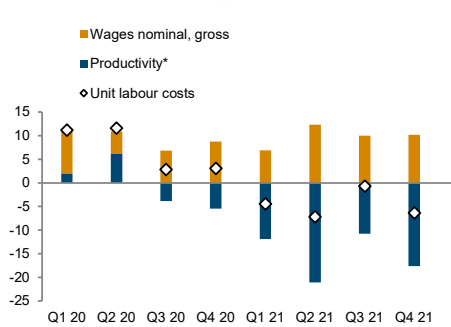
Real GDP growth and contributions



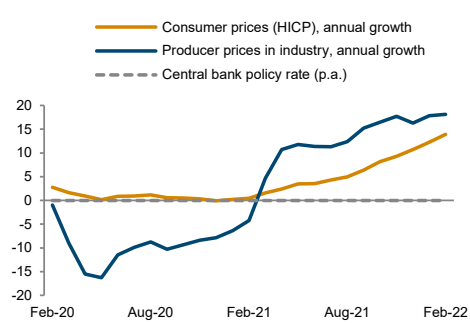
Real sector development



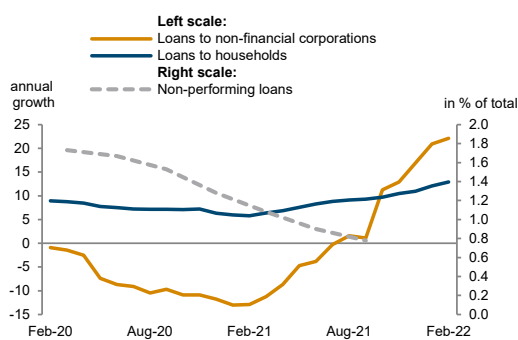
Unit labour costs in industry



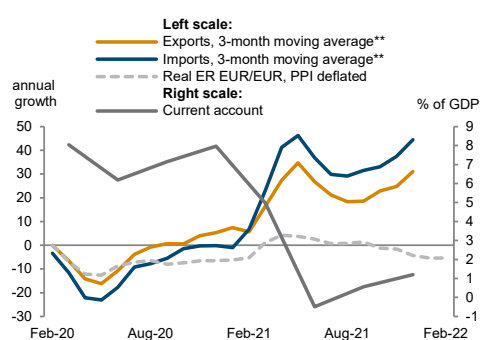
Inflation and policy rate



Financial indicators



External sector development



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**EUR based.

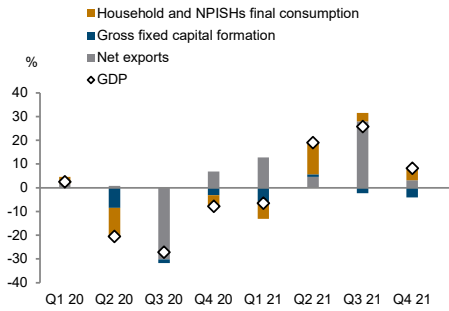
Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

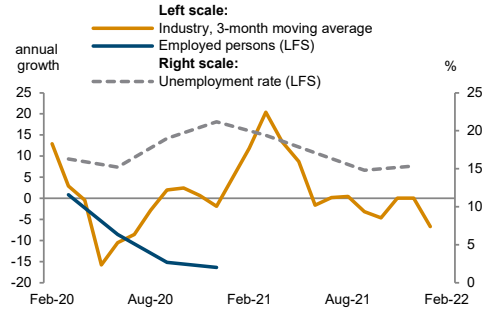
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Montenegro

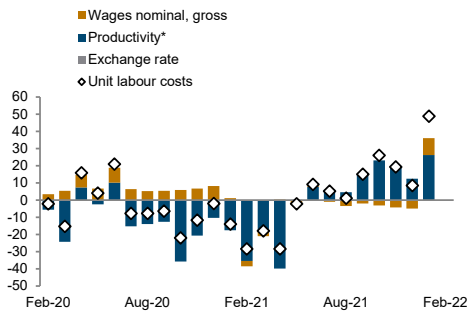
Real GDP growth and contributions
y-o-y



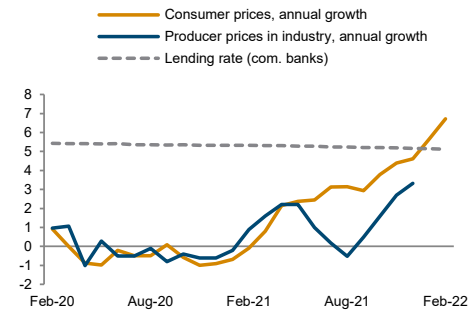
Real sector development
in %



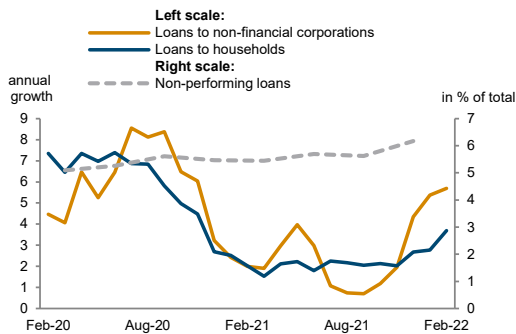
Unit labour costs in industry
annual growth rate in %



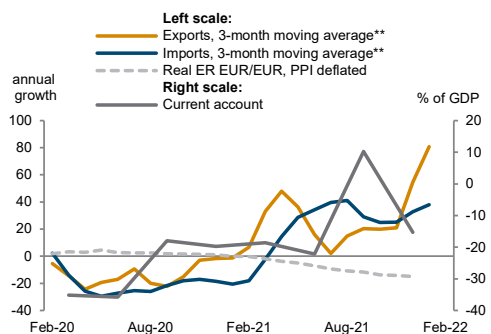
Inflation and lending rate
in %



Financial indicators
in %



External sector development
in %



*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

**EUR based.

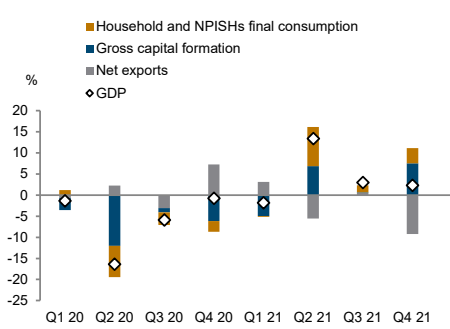
Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

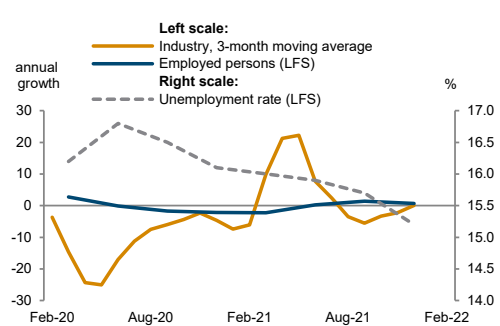
<https://data.wiiw.ac.at/monthly-database.html>

North Macedonia

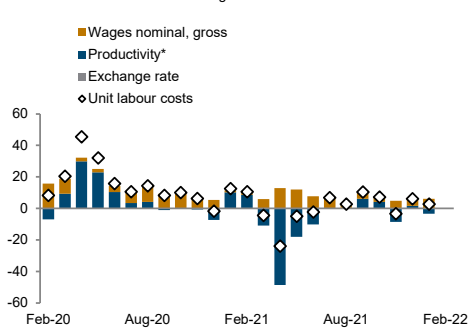
Real GDP growth and contributions



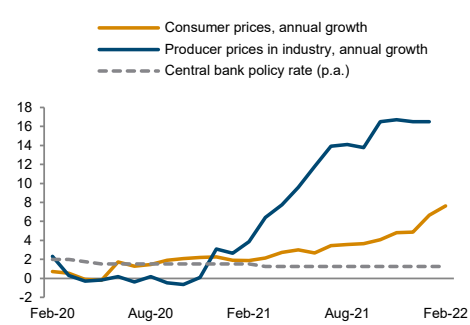
Real sector development



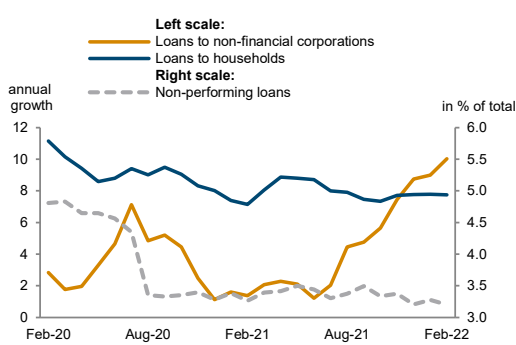
Unit labour costs in industry



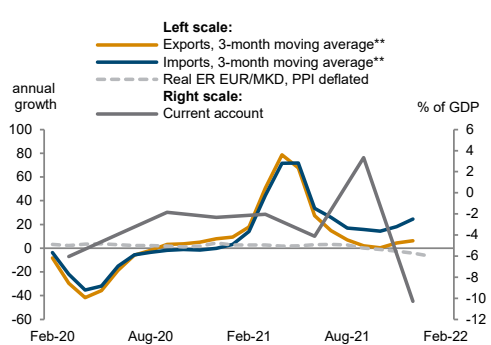
Inflation and policy rate



Financial indicators



External sector development



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**EUR based.

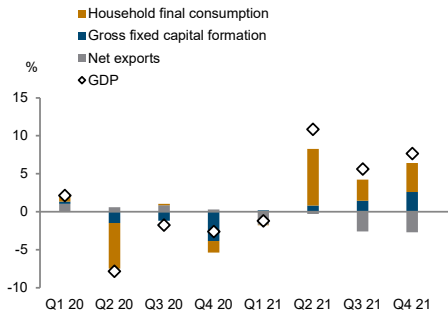
Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

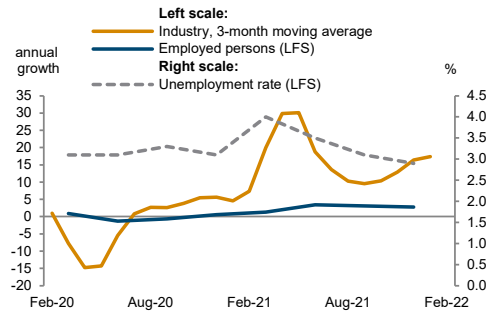
<https://data.wiiw.ac.at/monthly-database.html>

Poland

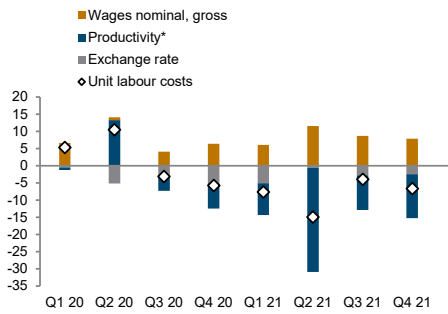
Real GDP growth and contributions
y-o-y



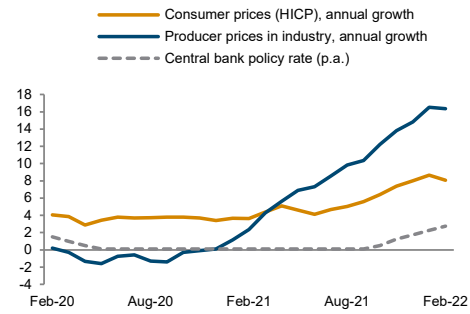
Real sector development
in %



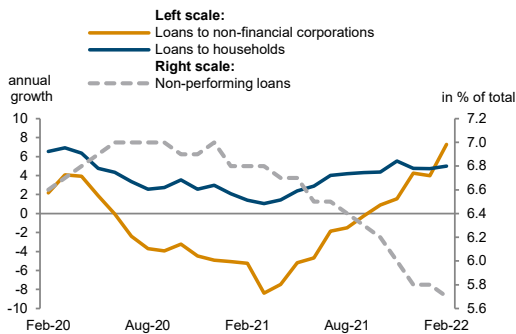
Unit labour costs in industry
annual growth rate in %



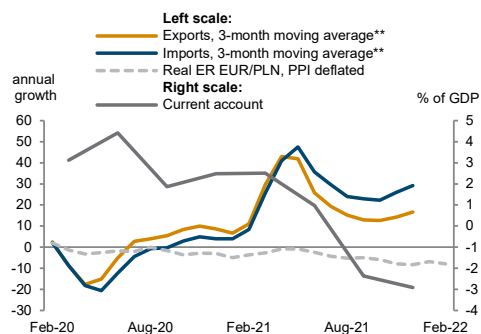
Inflation and policy rate
in %



Financial indicators
in %



External sector development
in %



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**EUR based.

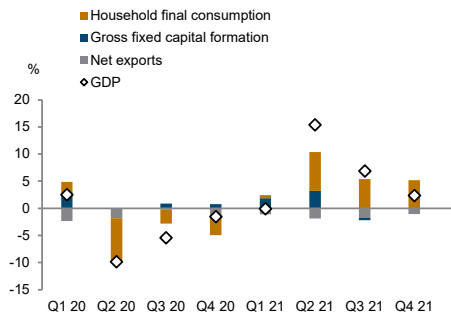
Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

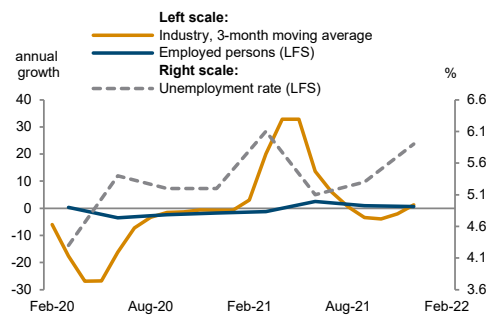
<https://data.wiiw.ac.at/monthly-database.html>

Romania

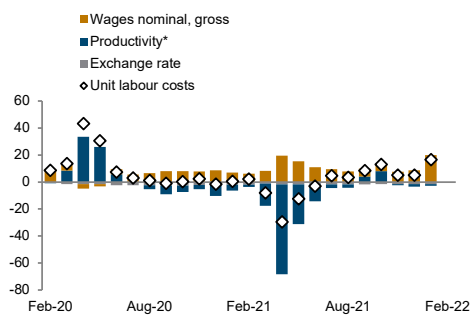
Real GDP growth and contributions
y-o-y



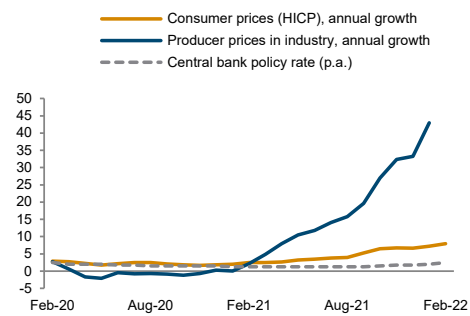
Real sector development
in %



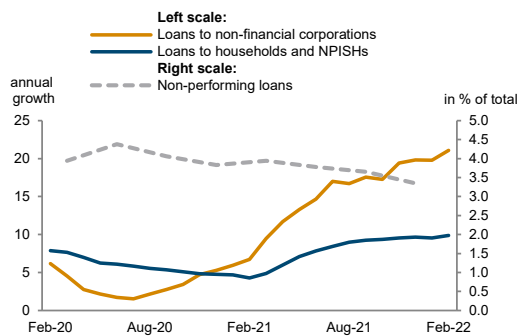
Unit labour costs in industry
annual growth rate in %



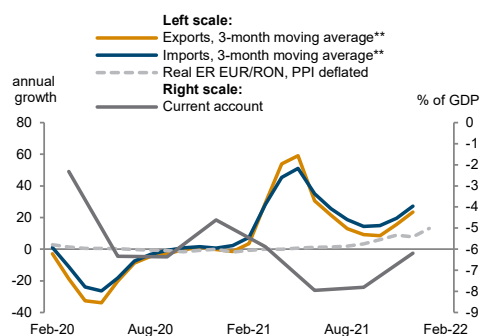
Inflation and policy rate
in %



Financial indicators
in %



External sector development
in %



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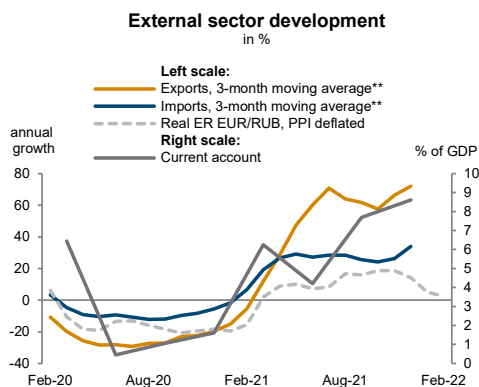
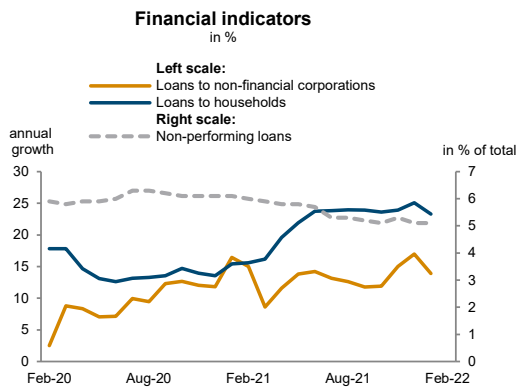
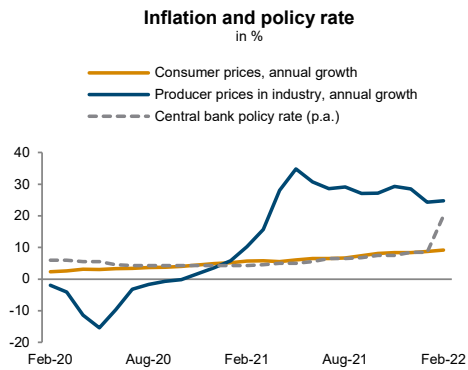
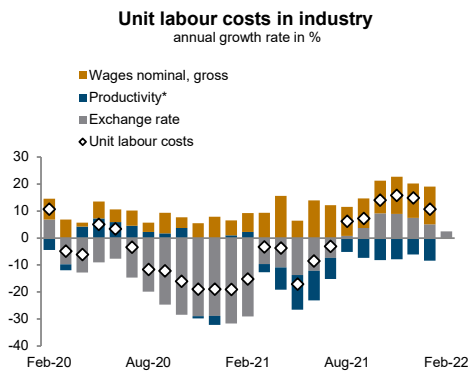
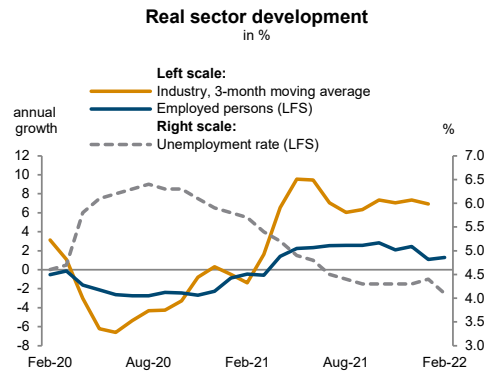
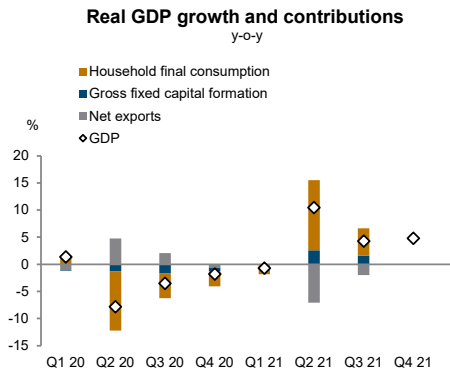
**EUR based.

Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

<https://data.wiiw.ac.at/monthly-database.html>

Russia



*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

**EUR based.

Source: wiiw Monthly Database incorporating Eurostat and national statistics.

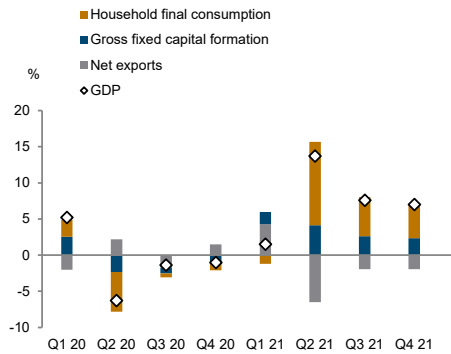
Baseline data, country-specific definitions and methodological breaks in time series are available under:

<https://data.wiiw.ac.at/monthly-database.html>

Serbia

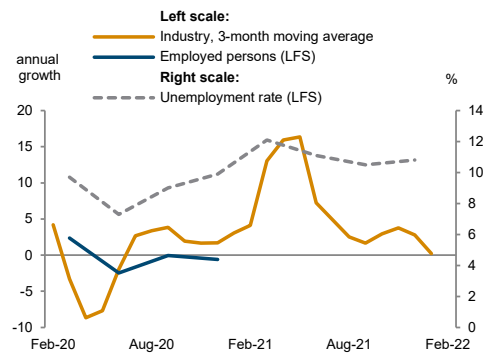
Real GDP growth and contributions

y-o-y



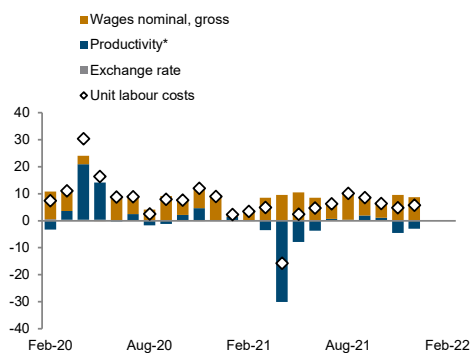
Real sector development

in %



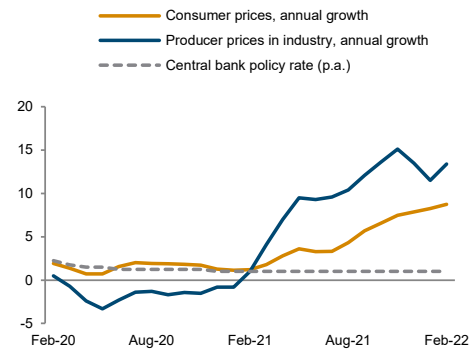
Unit labour costs in industry

annual growth rate in %



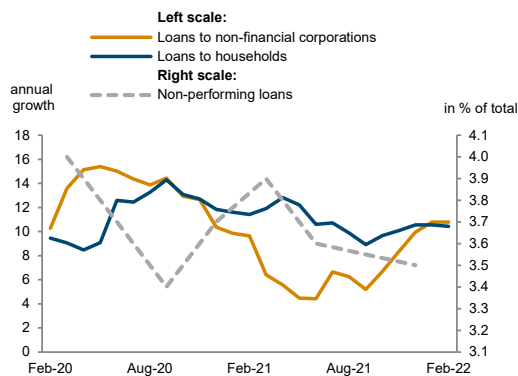
Inflation and policy rate

in %



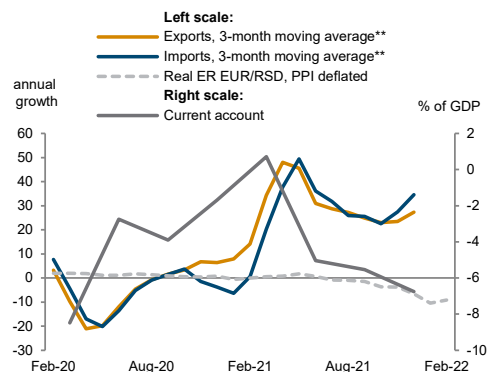
Financial indicators

in %



External sector development

in %



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**EUR based.

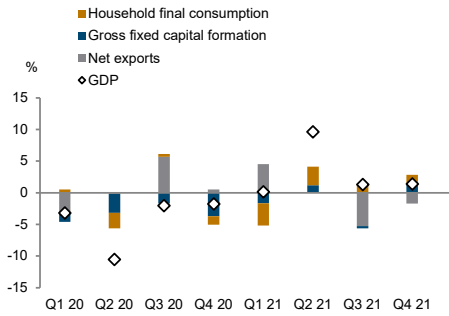
Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

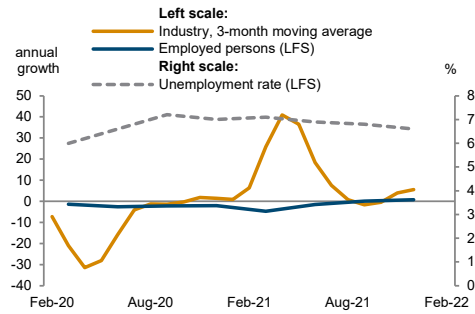
<https://data.wiiw.ac.at/monthly-database.html>

Slovakia

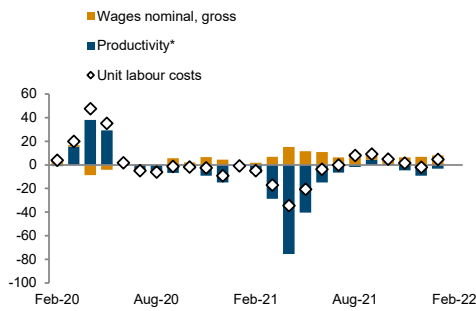
Real GDP growth and contributions
y-o-y



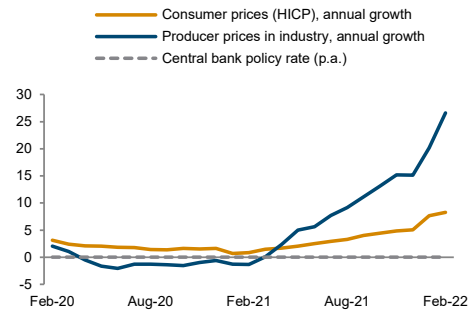
Real sector development
in %



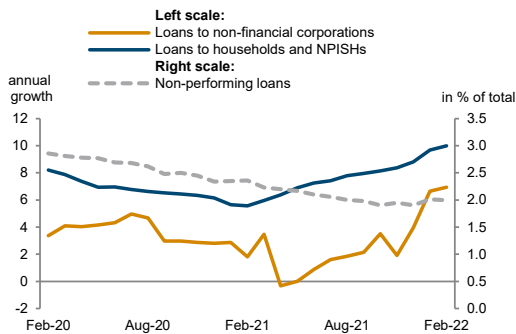
Unit labour costs in industry
annual growth rate in %



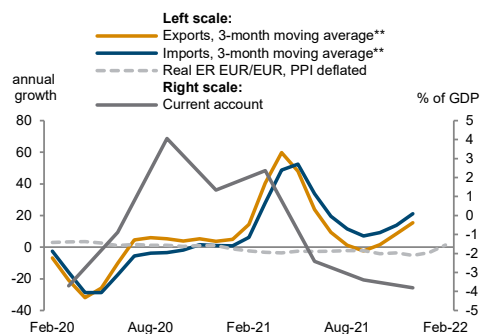
Inflation and policy rate
in %



Financial indicators
in %



External sector development
in %



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**EUR based.

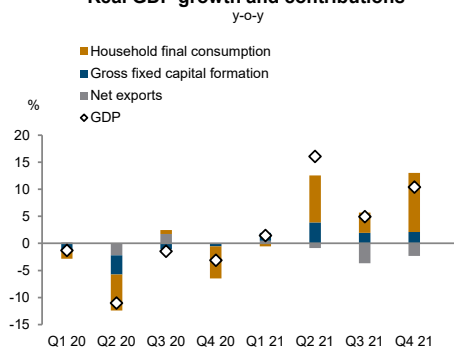
Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

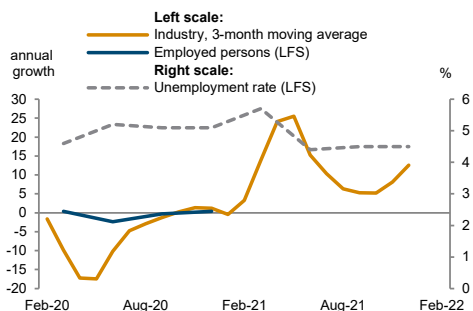
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Slovenia

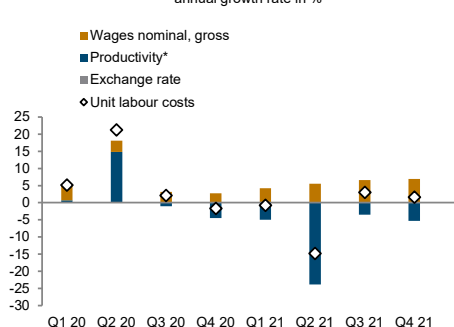
Real GDP growth and contributions



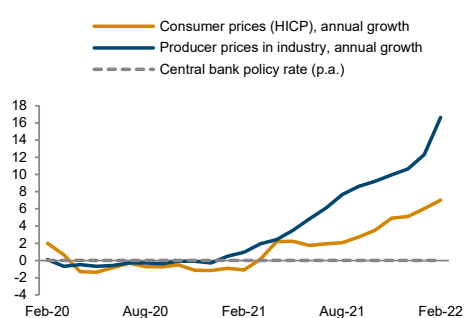
Real sector development



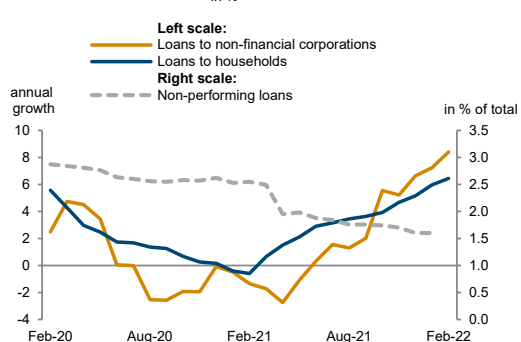
Unit labour costs in industry



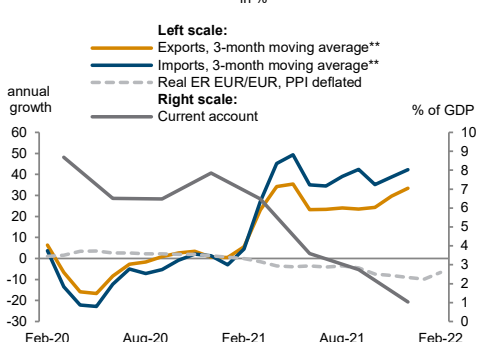
Inflation and policy rate



Financial indicators



External sector development



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**EUR based.

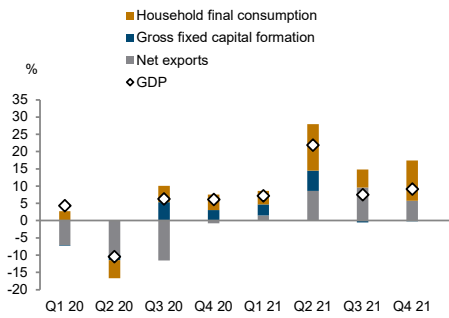
Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

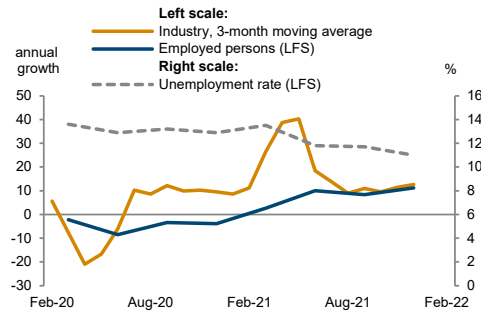
<https://data.wiiw.ac.at/monthly-database.html>

Turkey

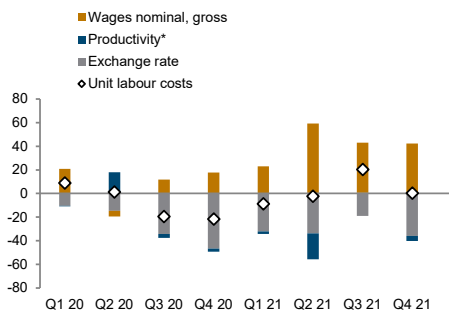
Real GDP growth and contributions
y-o-y



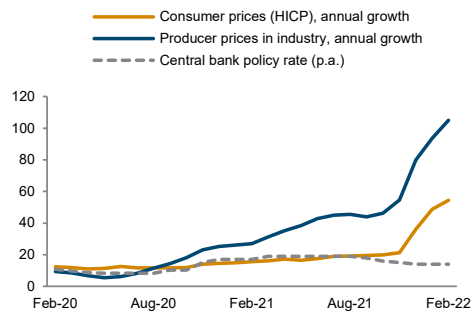
Real sector development
in %



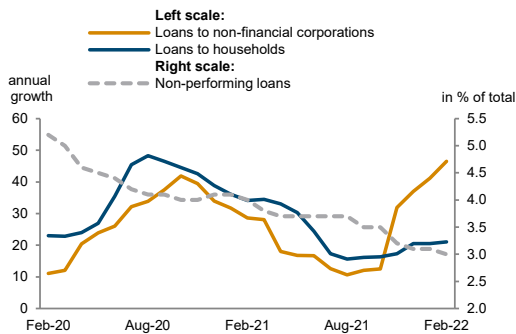
Unit labour costs in industry
annual growth rate in %



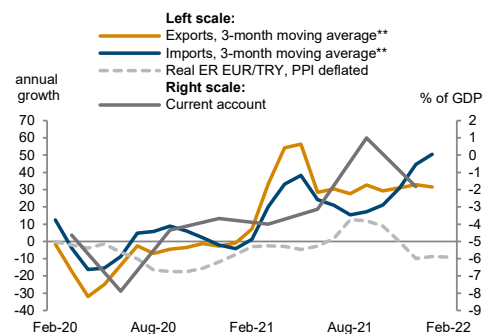
Inflation and policy rate
in %



Financial indicators
in %



External sector development
in %



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**EUR based.

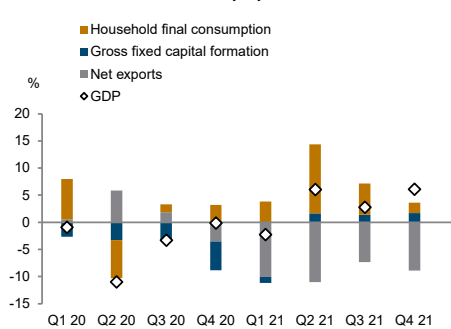
Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

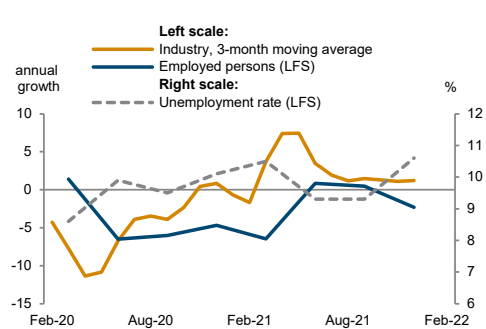
<https://data.wiiw.ac.at/monthly-database.html>

Ukraine

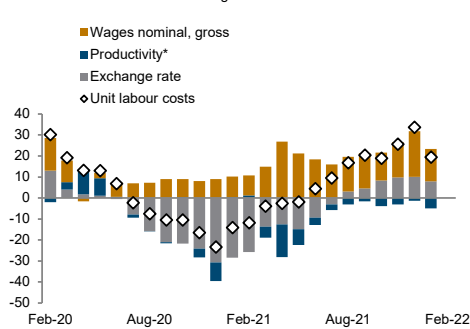
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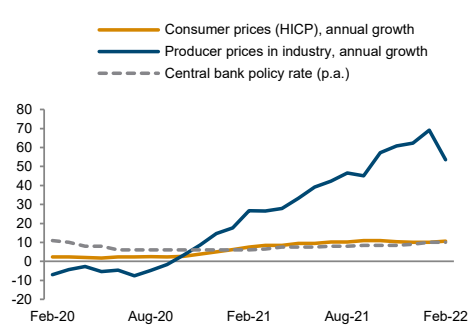
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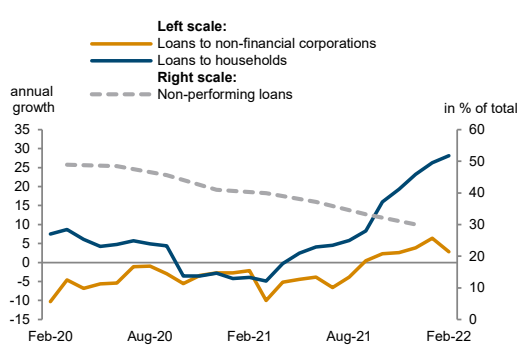
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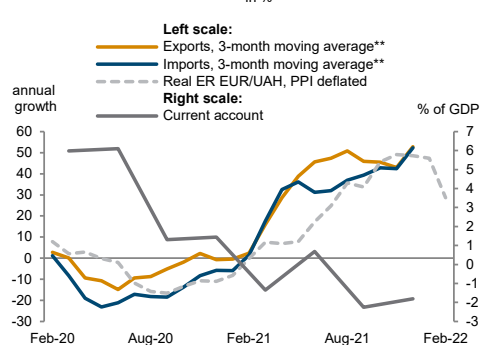
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*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

**EUR based.

Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

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Monthly and quarterly statistics for Central, East and Southeast Europe are compiled by the statistics department: Alexandra Bykova (coordination), Beata Borosak, Nadja Heger, Beate Muck, Monika Schwarzhappel, Galina Vasaros and David Zenz.

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