



EU4Business



*EU4Business: From Policies to Action - phase 2*

## **Assessing the economic impact of the war in Ukraine on Eastern Partner countries**

*Preliminary findings*



# EaP countries' economic links with Russia

	<b>Economy</b> (Russia's share in country's)					<b>International agreements</b>
	<b>Trade</b>	<b>Food import</b>	<b>Natural gas import</b>	<b>Remittances (% of GDP)</b>	<b>FDI</b>	
<b>ARMENIA</b>	32%	32%	88%	3.7%	31%	• Member of Eurasian Economic Union
<b>AZERBAIJAN</b>	9%	29%	0%	1.8%	4%	
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Source: UNComtrade, Central Banks of EaP countries, IMF Coordinated Direct Investment Surveys database

# Key developments sparked by Russia's invasion of Ukraine in February 2022

**Wave of Ukrainian refugees**

**Shocks to energy and commodities markets**

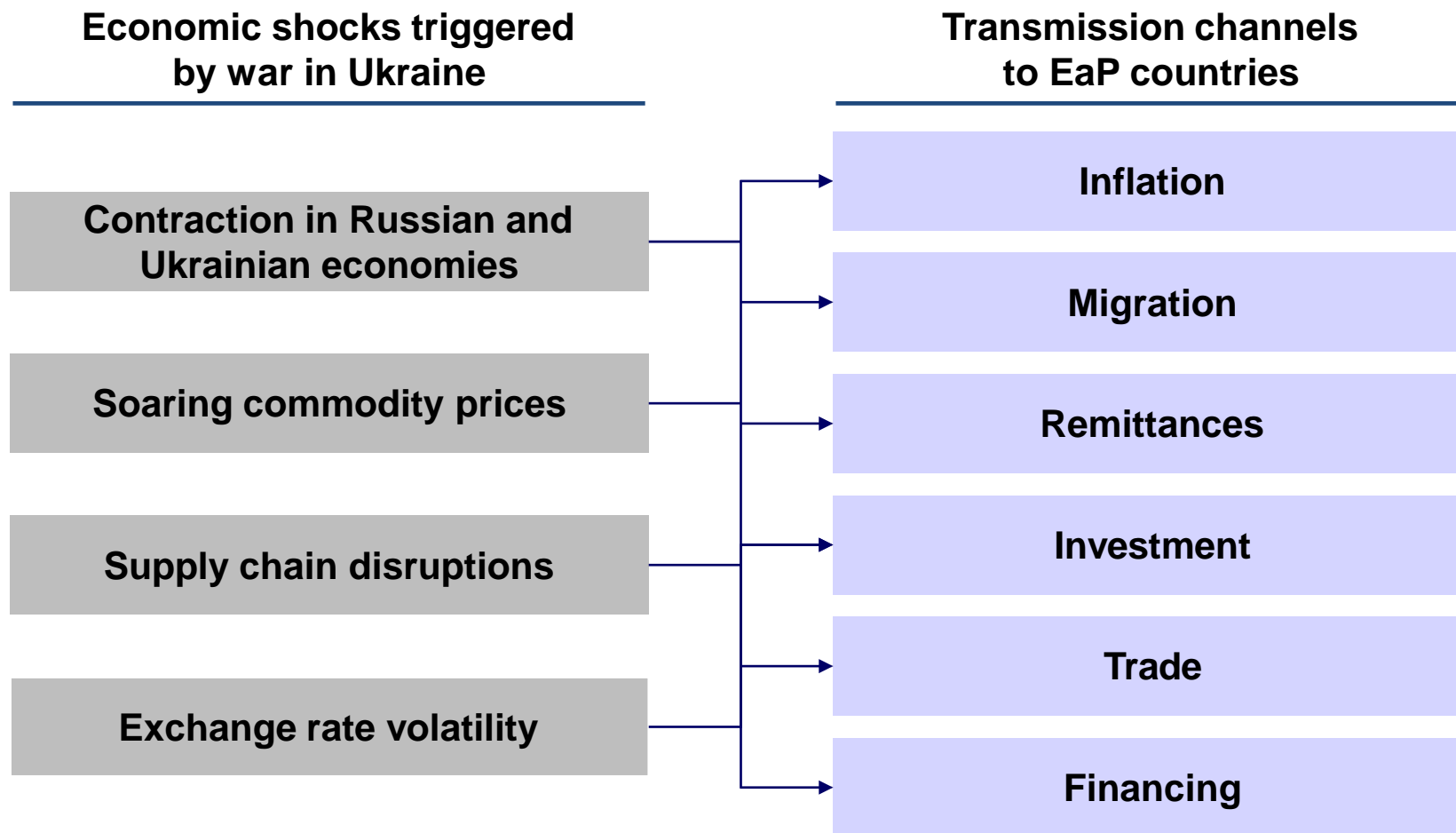
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**How are these developments affecting EaP countries?**

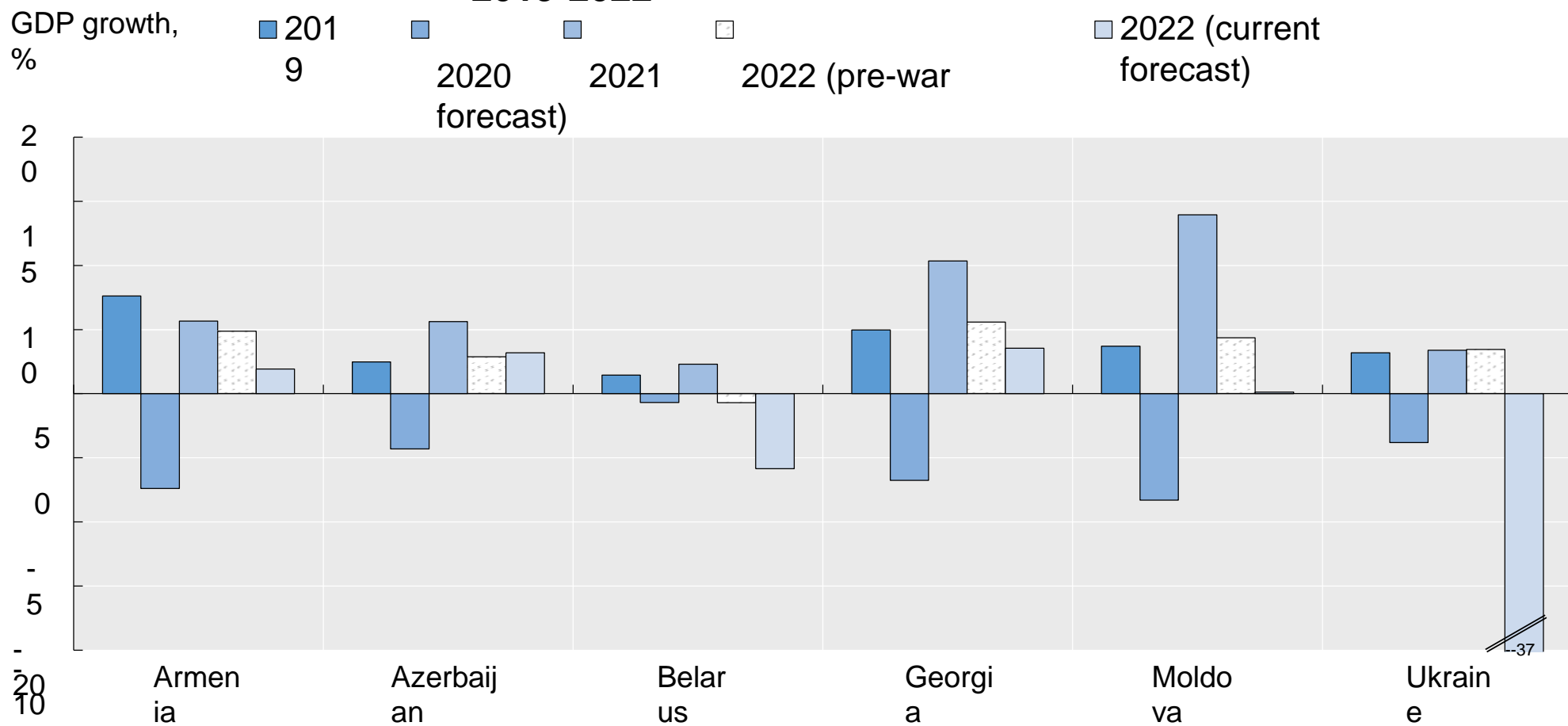
# Economic shocks reverberate across EaP countries through multiple transmission channels



**What is the impact on SMEs?**

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## GDP growth in EaP countries, 2019-2022

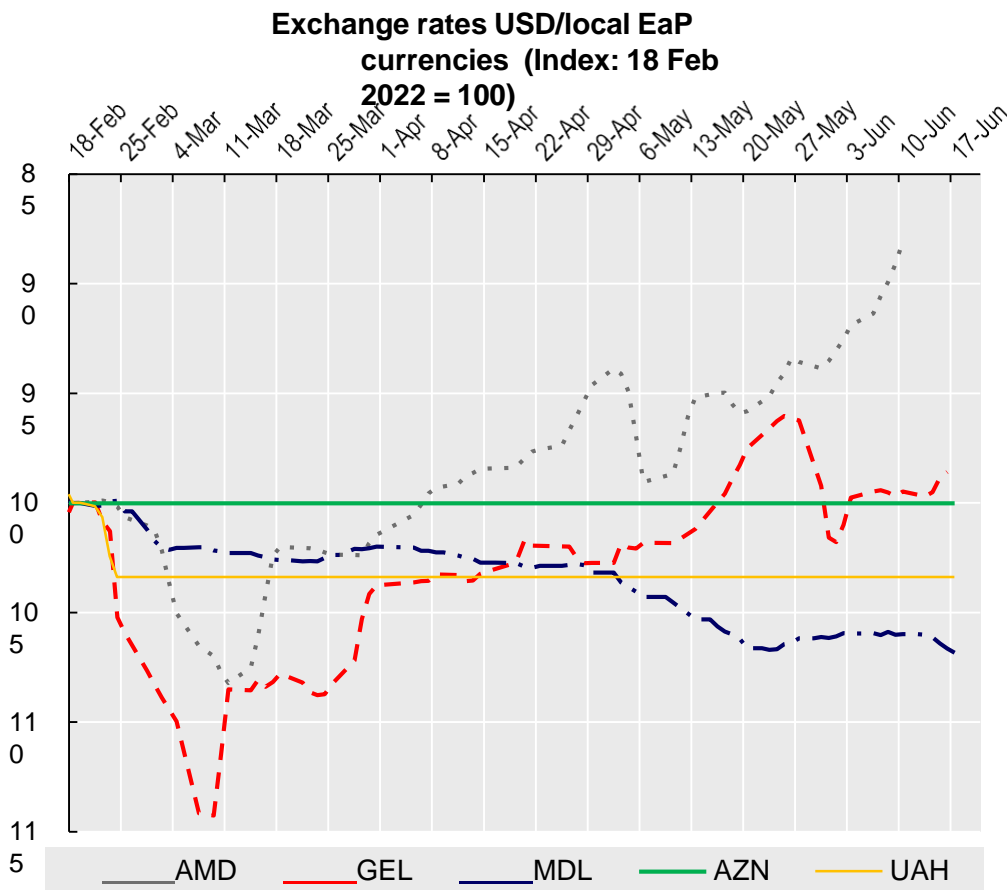


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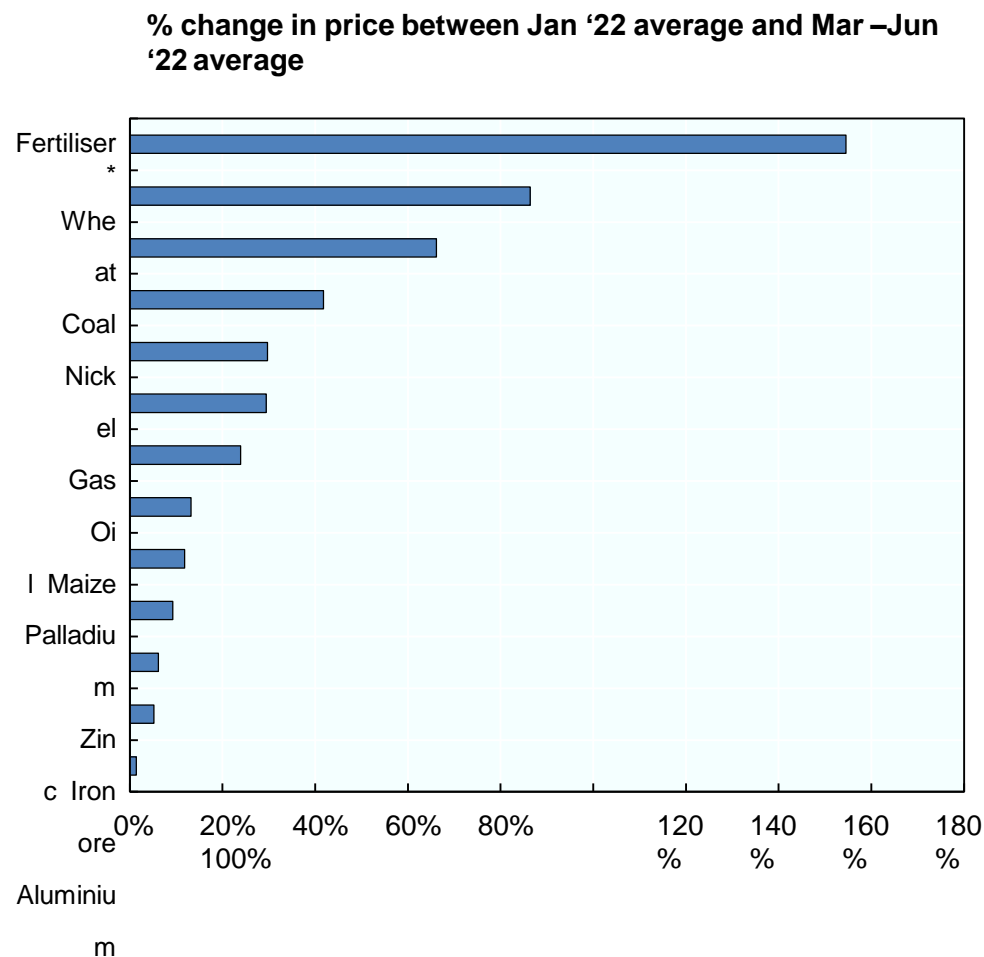
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# Short term market reactions add to pre-existing inflationary pressures and threaten food security for the most vulnerable

## EaP currencies experiencing large fluctuations



## Increases in the world prices of energy and food commodities



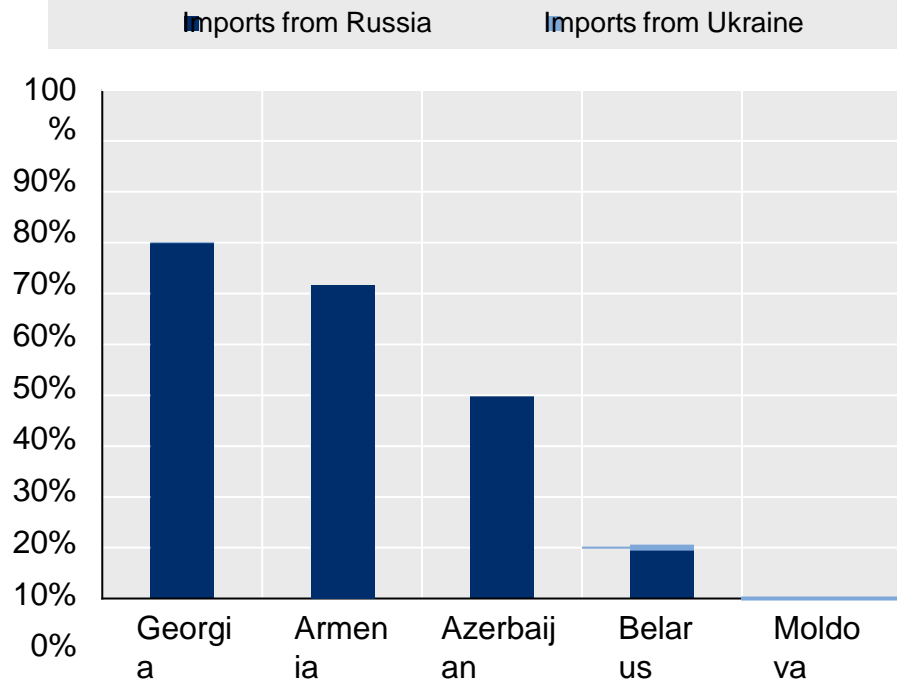
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# The extent of food and energy dependency on Russia varies across EaP countries

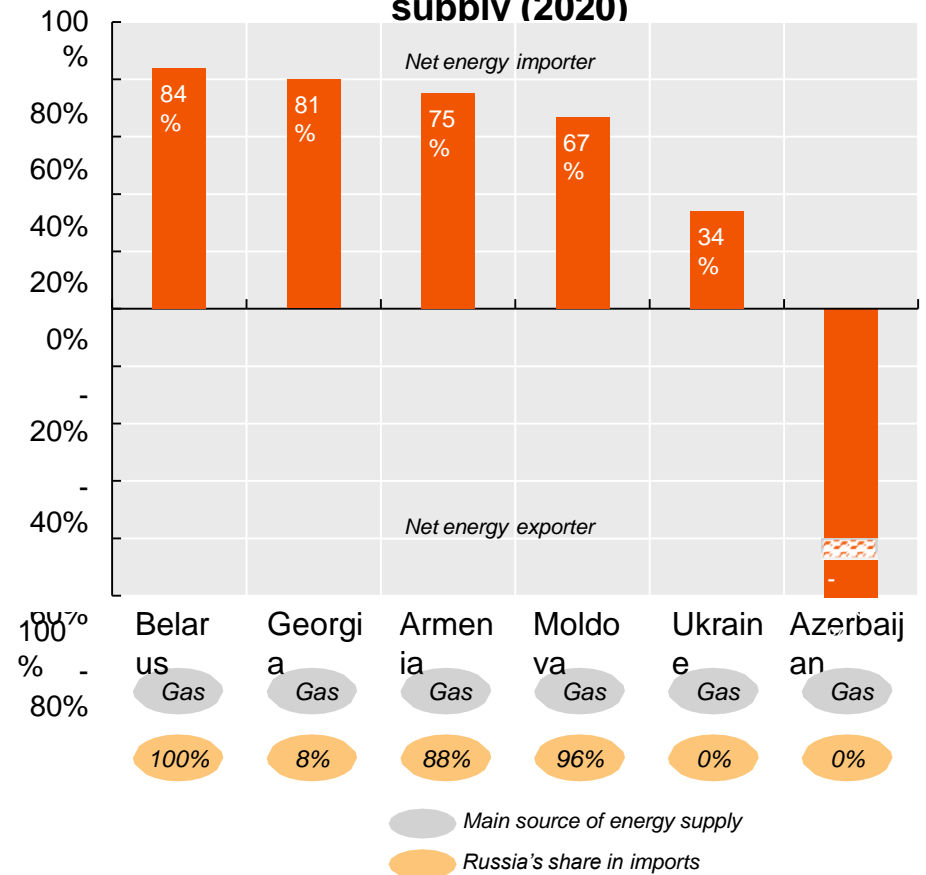
## South Caucasus countries are heavily dependent on imports of wheat from Russia

Share of wheat imports in total domestic utilisation (2020)



## Armenia and Moldova are heavily reliant on Russian energy imports

Energy dependency rate: share of energy imports in total energy supply (2020)

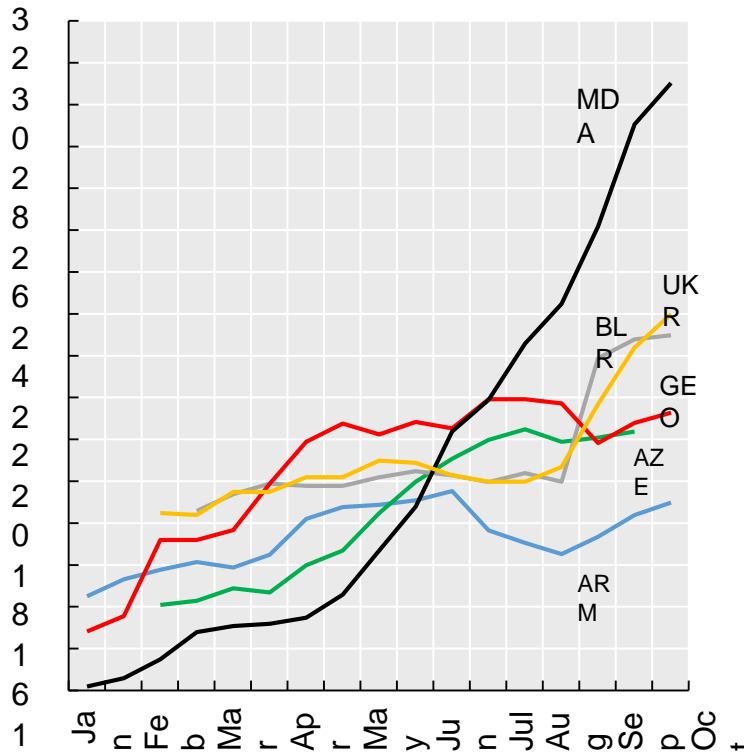


Note: data on wheat imports and domestic utilisation for Belarus and Moldova from 2019; data on energy imports for Armenia from 2019.

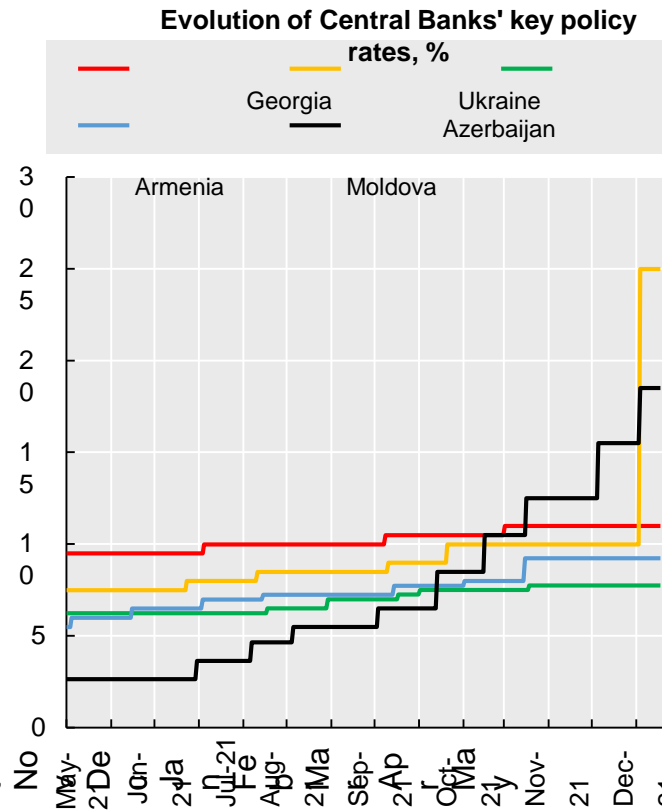
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# Inflation accelerating across the EaP region, central banks respond by tightening monetary policy

## Inflation beyond forecasts in most EaP countries



## Central banks increased the policy rates 3 to 9 times in last 12 months



**Depreciation of local currencies increases the price of imported goods, adding to the inflationary pressures from rising energy and food prices**

**Food inflation will disproportionately affect low income and vulnerable groups**

Source: National Statistical Offices and Central Banks of EaP countries



# Inflows of refugees pose challenges for Moldova, new patterns of migration could be an opportunity for countries in South Caucasus

Over 7.5 mln border crossings and over 5 mln refugees from Ukraine since 24 February 2022

**Moldova received nearly 500,000 Ukrainians as of 16 June 2022 (19% of Moldova's population)**

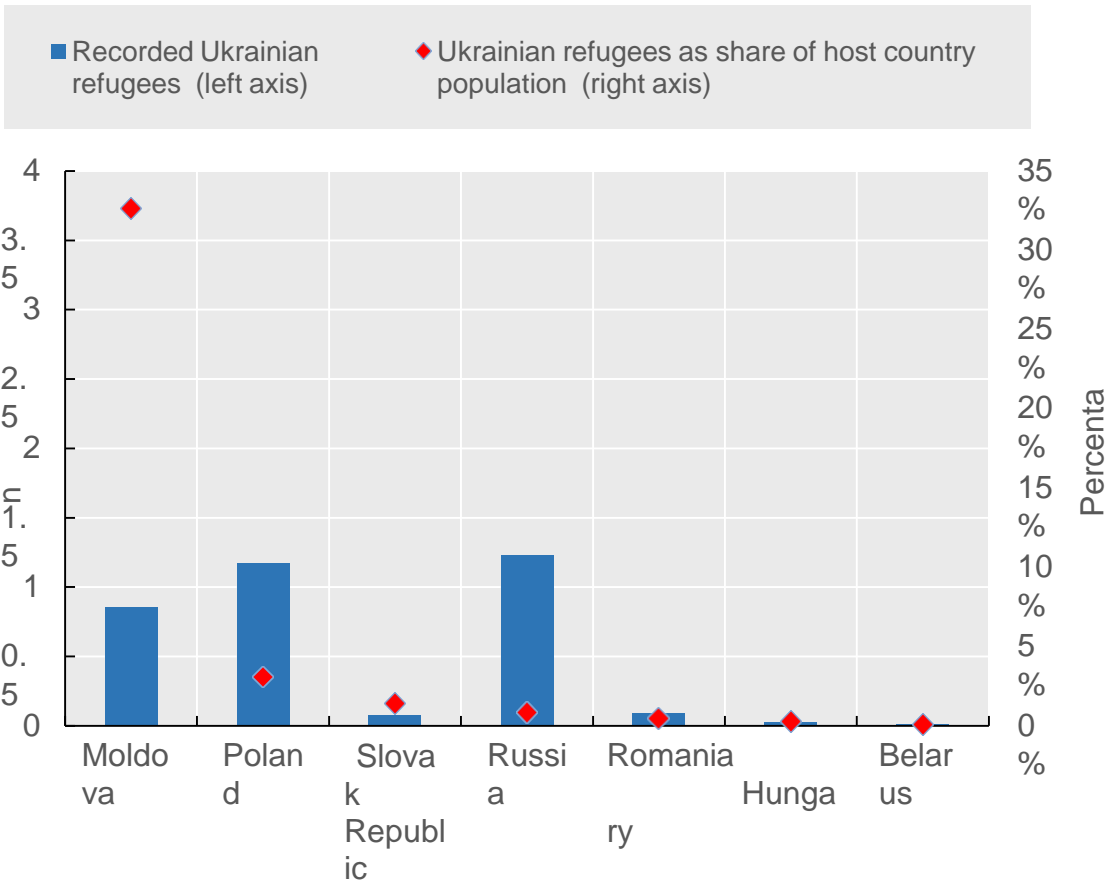
- 130 ths return to Ukraine, 285 ths move abroad,
- 85k stay in Moldova (3.3% of Moldova's population)

**Challenges ahead to integrate refugees in Moldovan society**

- Over 30% of refugees are school-aged children
- Limited employment opportunities for adults
- EU donors pledged EUR 659 Mln in financial aid

**New migration patterns in South Caucasus could present opportunities for local economies**

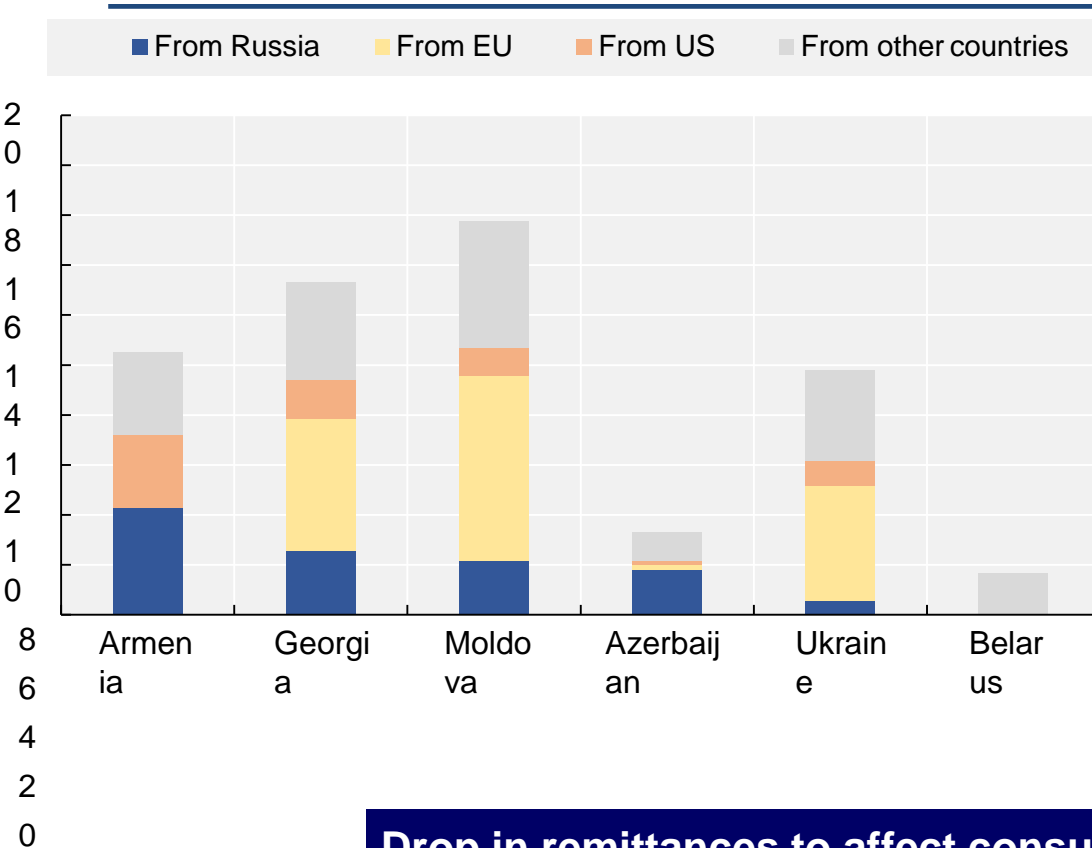
- Reports of highly educated Russian professionals moving to Armenia and Georgia
- High rate of new business creation in IT sector



Source: UNHCR (as of 13 Jun 22) and WB (population data for 2020); expert interviews

# Contraction in Russia's economy likely to reduce remittances to EaP countries over the medium term

**Total remittances inflows as % of GDP (2020)**



**Drop in remittances to affect consumption of poorest households, already dealing with effects of food and energy inflation**

**Trend in 2022 shows initial signs of drop in remittances from Russia**

- GEO: -16% (March 22 y-o-y)
- MDA: - 92% in RUB-denominated (Mar-May y-o-y)

**However, large increases of remittances from Russia in Armenia and Georgia in April and May**

- Likely determined by influx of Russians to the two countries

**High seasonality of work migration means that largest effect on remittances only visible after the summer**

- Construction season peaks after April

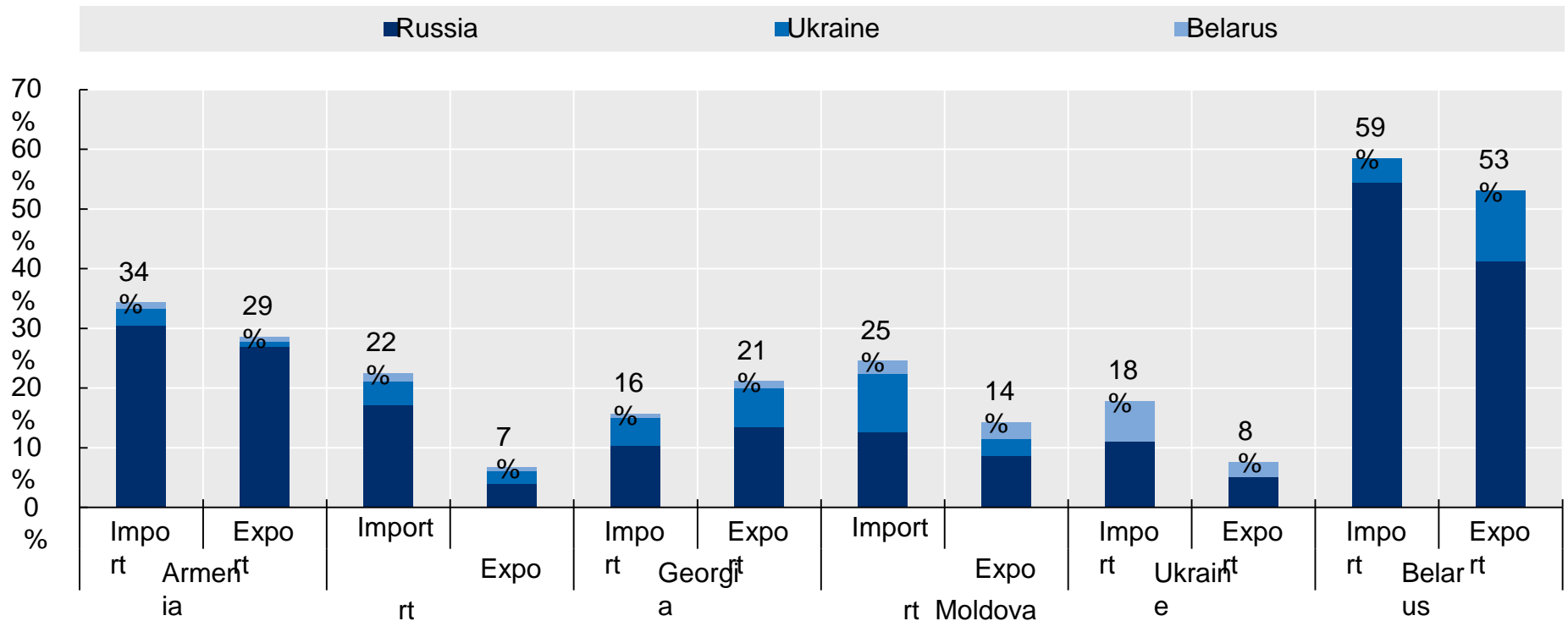
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- ~13% of Moldovans abroad are in Ukraine

Source: World Bank Development Indicators for remittances as % of GDP; UNDESA, International Migration Stock (2020), Central Bank websites of EaP countries; interviews with local experts from EaP countries

# EaP countries' trade structures are heavily exposed to Russia and Ukraine

## Share of trade flows from/to Russia, Belarus and Ukraine (2018-2021)



### Top 3 exports to Russia, Belarus and Ukraine

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- Precious stones & metals
- Apparel, clothing accessories

- Azerbaijan**
- Mineral fuels
  - Fruits and nuts
  - Vegetables

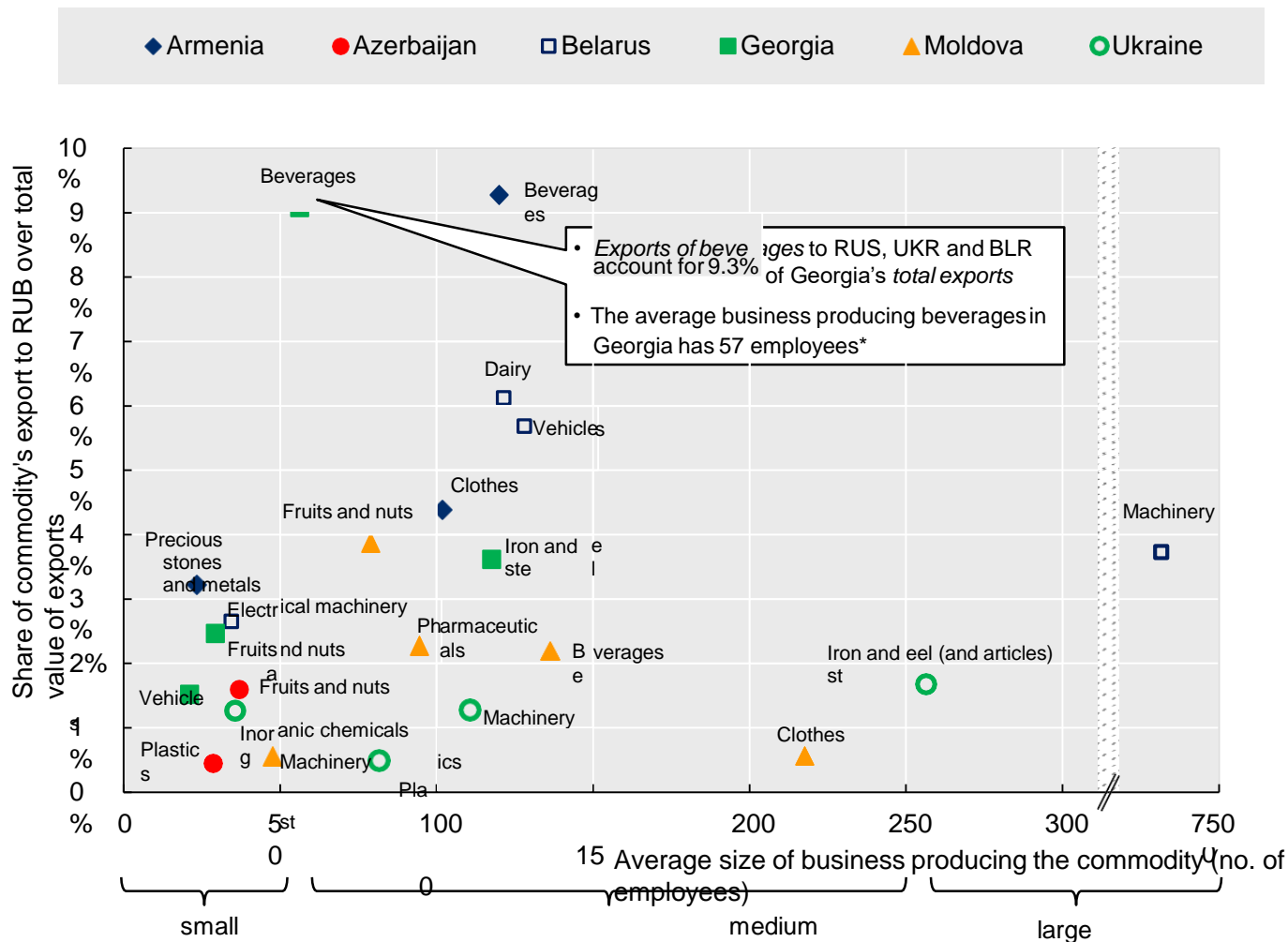
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- Fruits and nuts
- Pharmaceutical products
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- Machinery and appliances
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# Exporting SMEs at risk of hard blow from trade disruptions, with heterogeneous effects depending on sectors

## Presence of SMEs in selected export-oriented sectors



**Businesses operating in some of the most exposed sectors typically have fewer than 100 employees**

**Export profiles of each country offer an indication of which SMEs may be more vulnerable**

- In Georgia and Armenia, producers of beverages (e.g. wine, spirits, mineral waters)
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**Mixed dynamics on tourism**

- Increased arrivals from Russia and Ukraine
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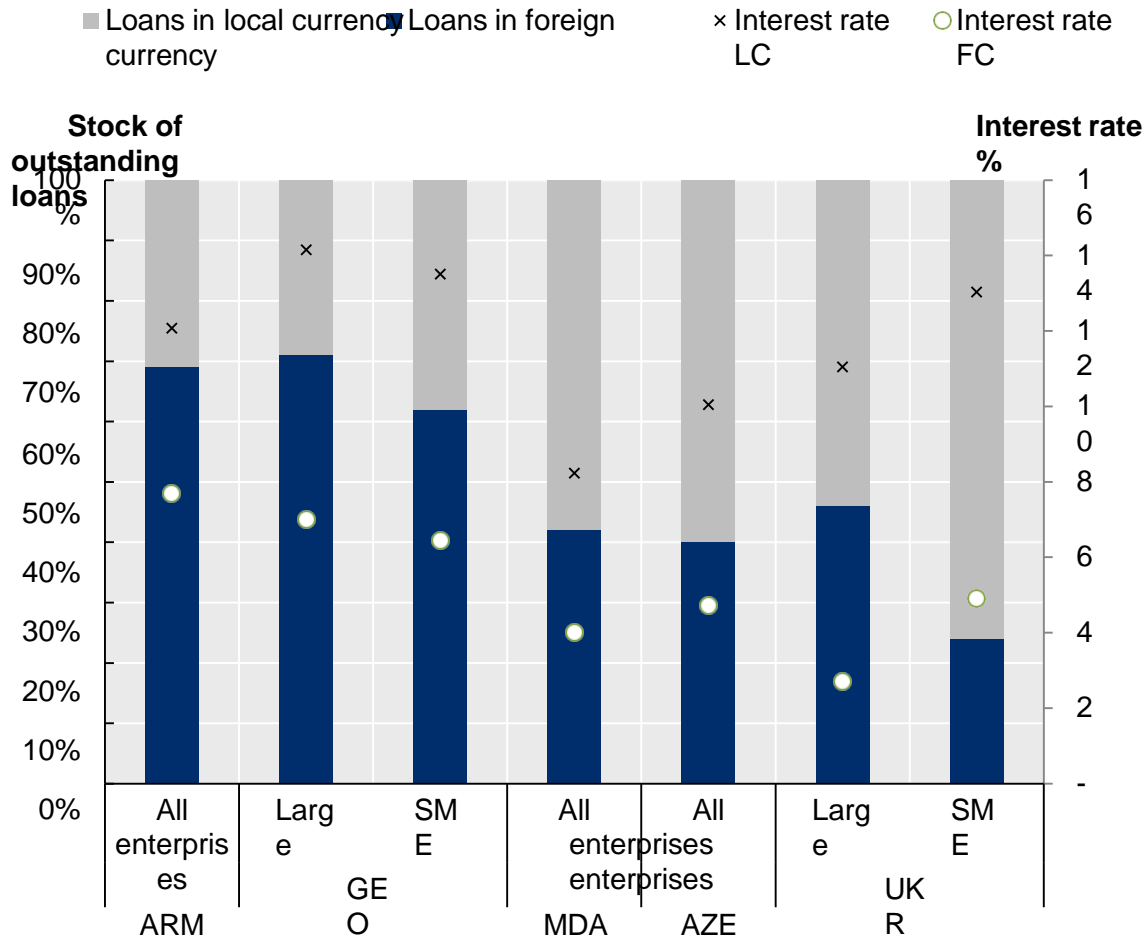
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## Volume and average interest rate of outstanding loans, by currency



### High share of loans issued in foreign currency (USD, EUR), both for large companies and SMEs

- 24% in UKR, up to >60% in ARM and GEO

### Risk of mismatch between assets and revenues (mostly in local currency) and liabilities (in foreign currency)

- Local currency depreciation magnifies foreign currency liabilities
- Export revenues are a natural hedge for dollar-denominated debt

### A large depreciation and a shock to trade flows could force unhedged borrowers into default

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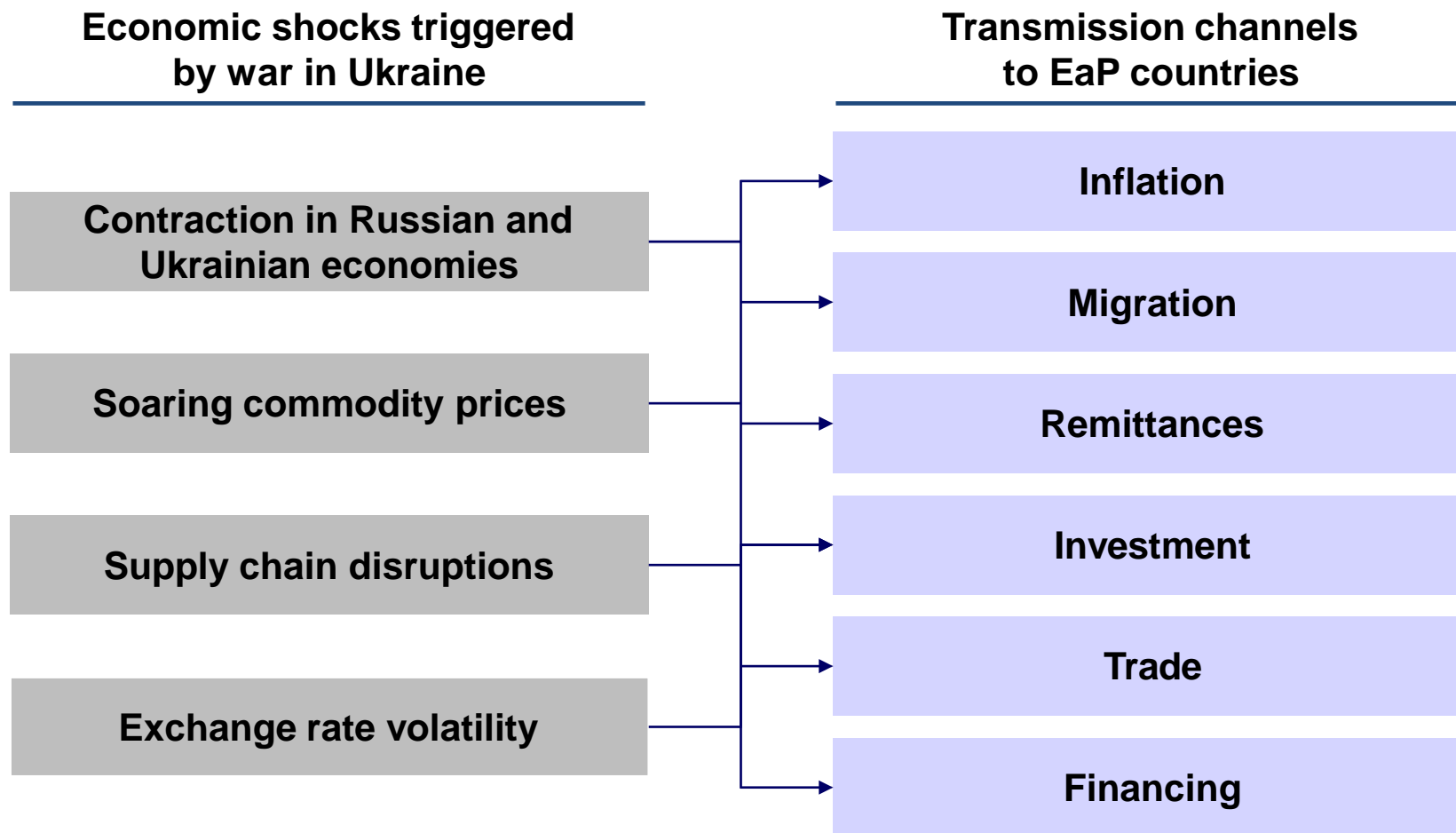
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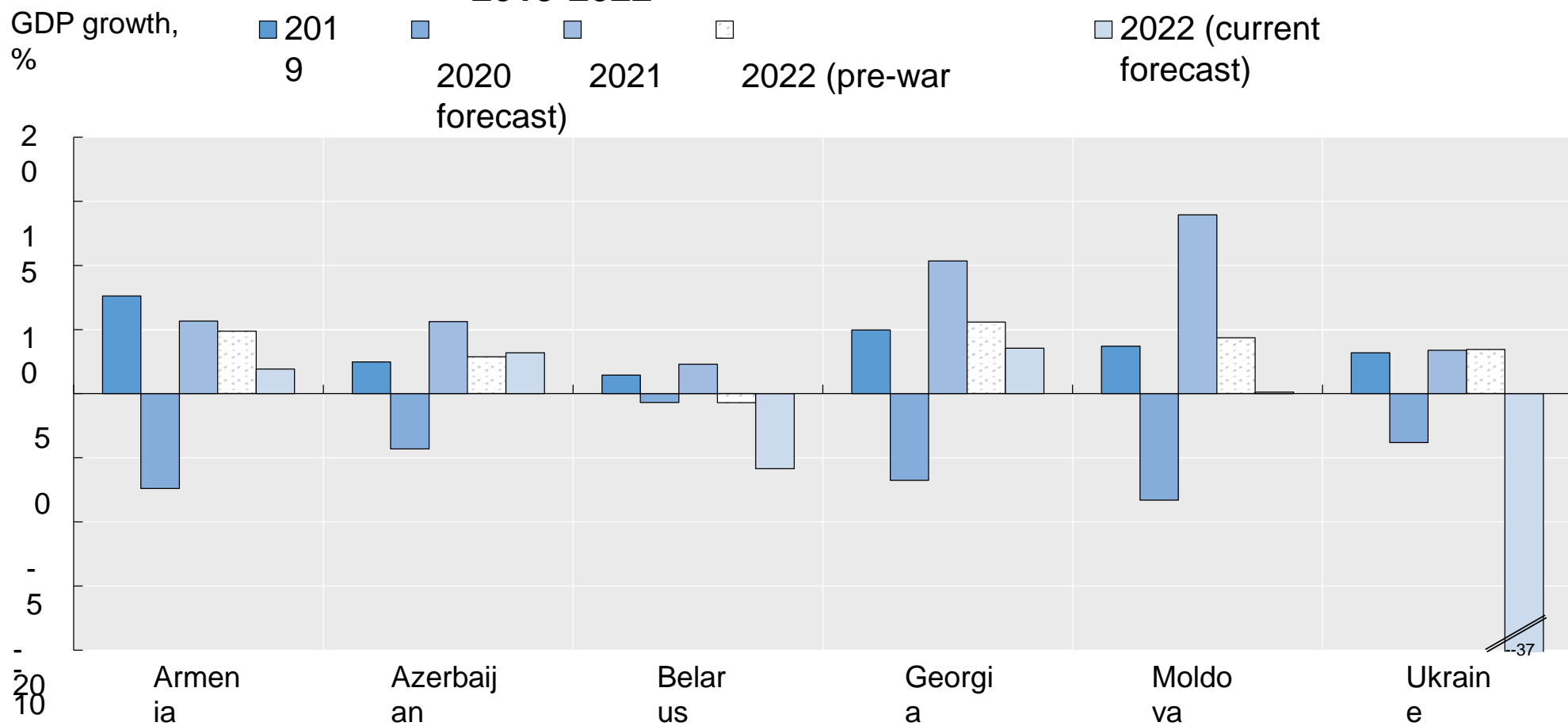
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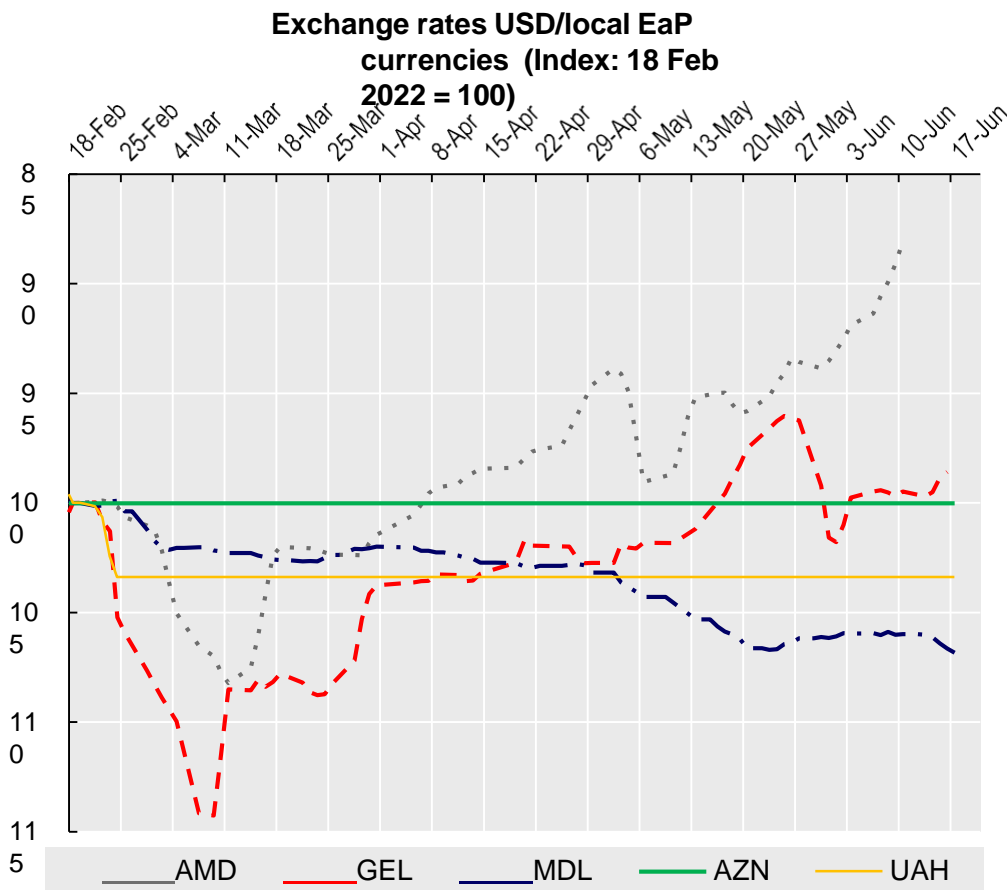


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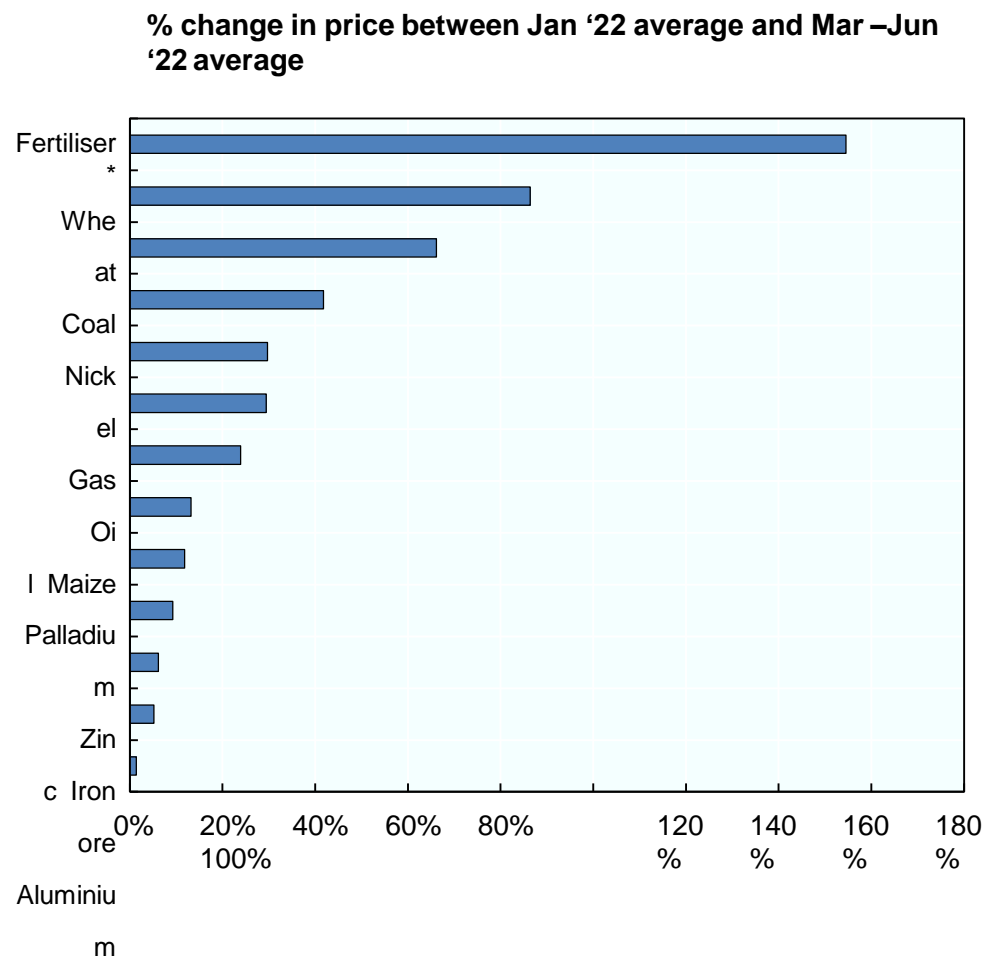
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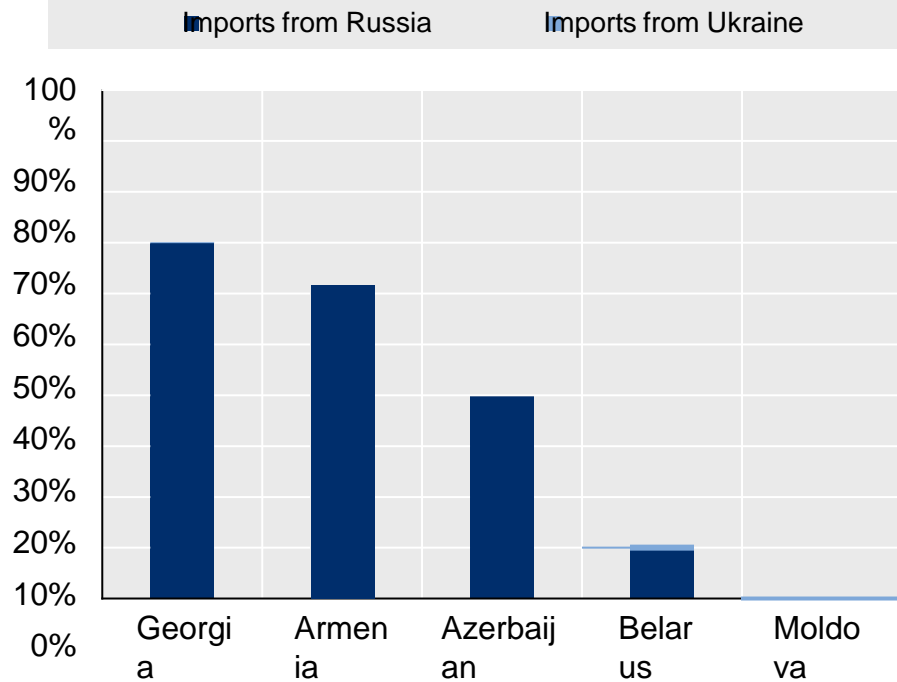
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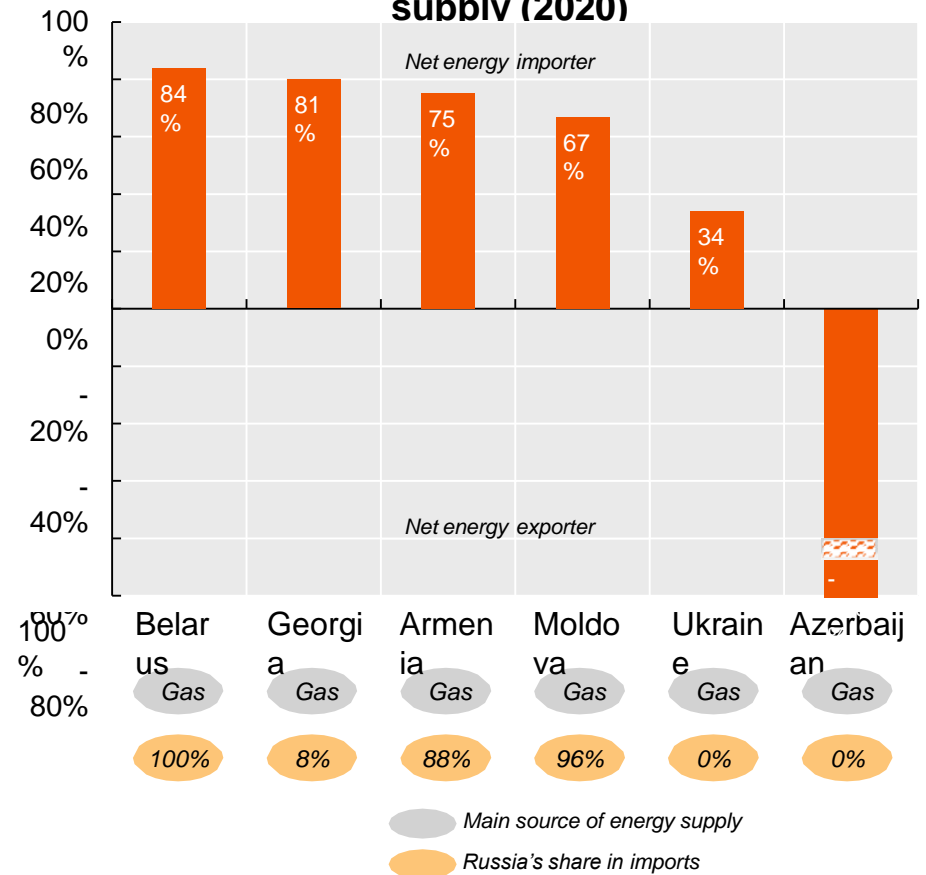
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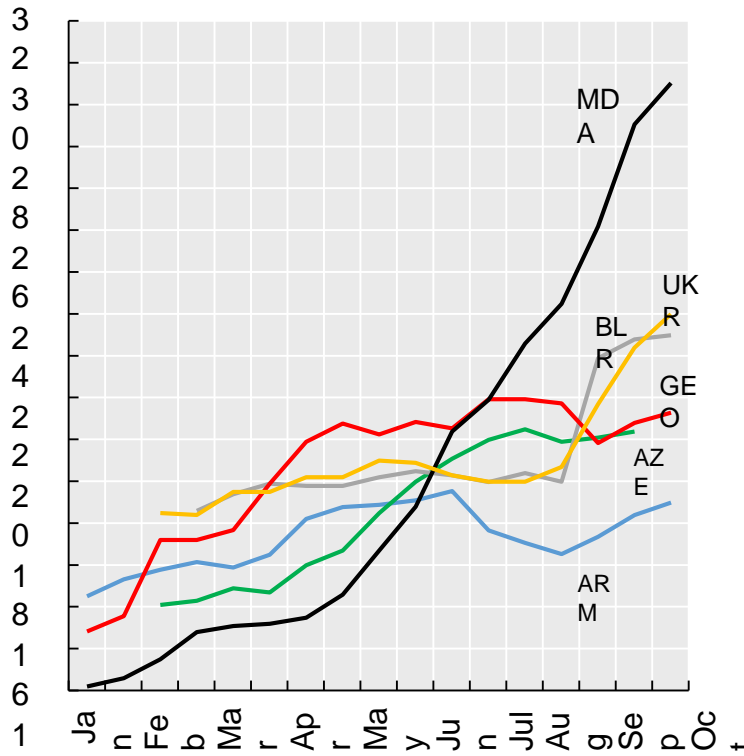


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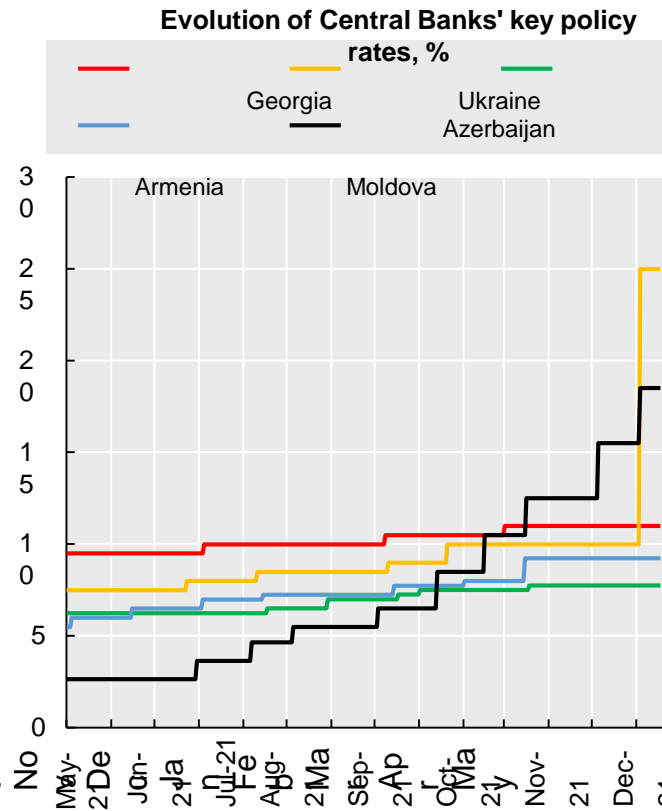
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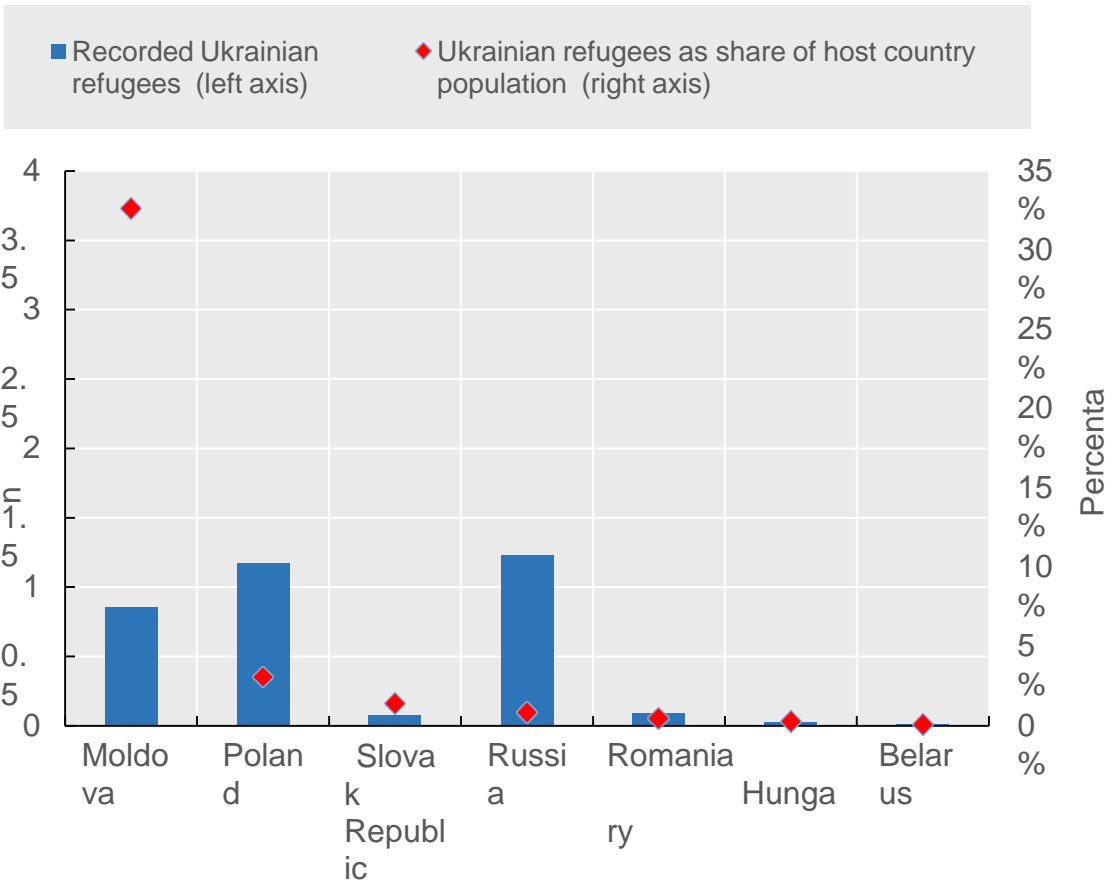
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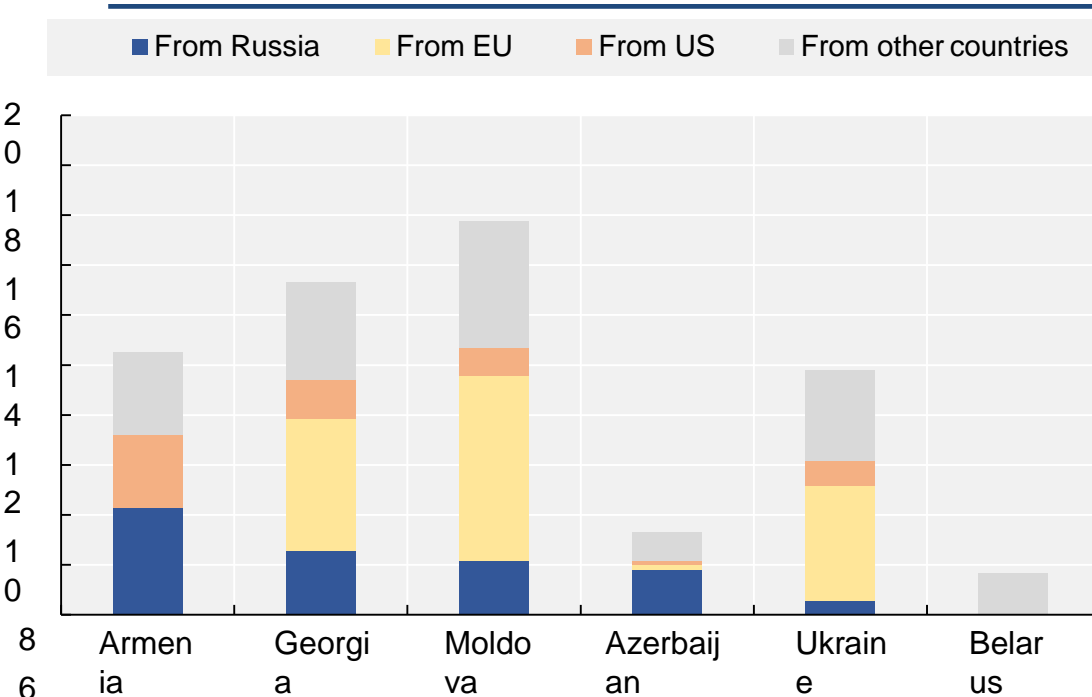
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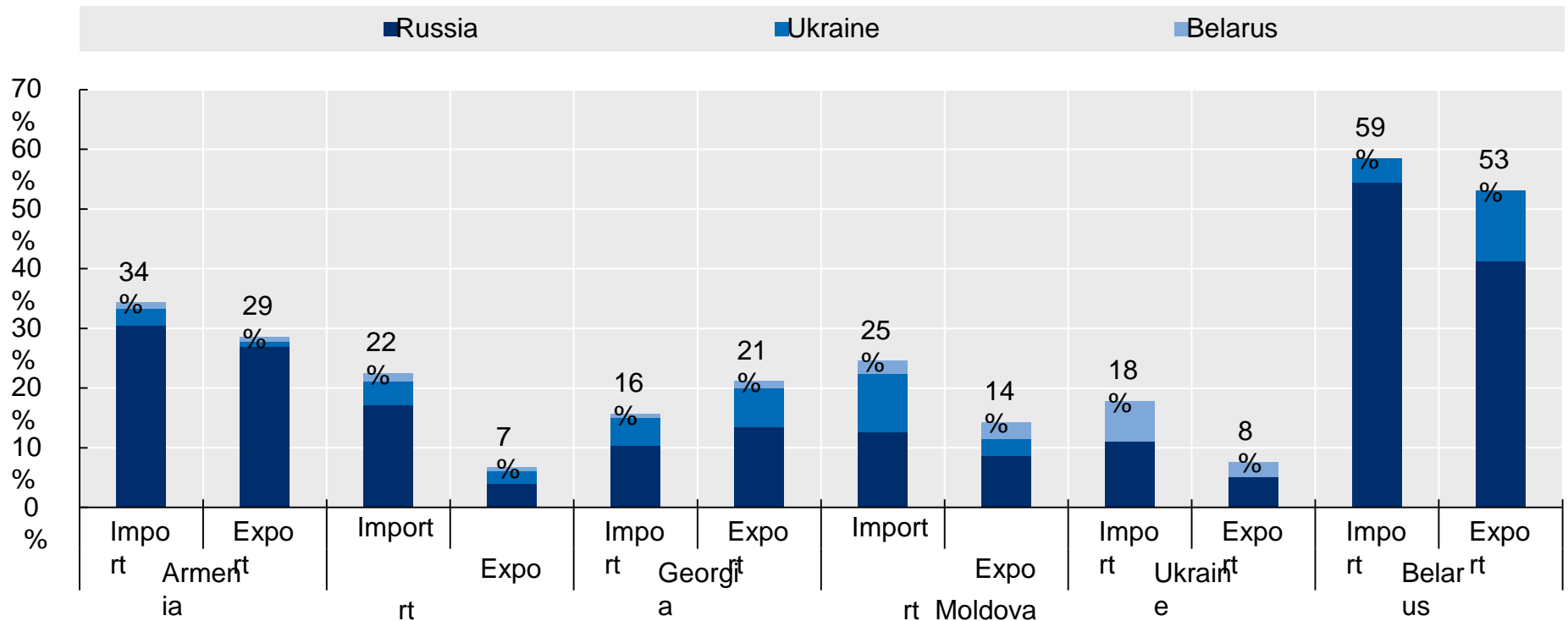
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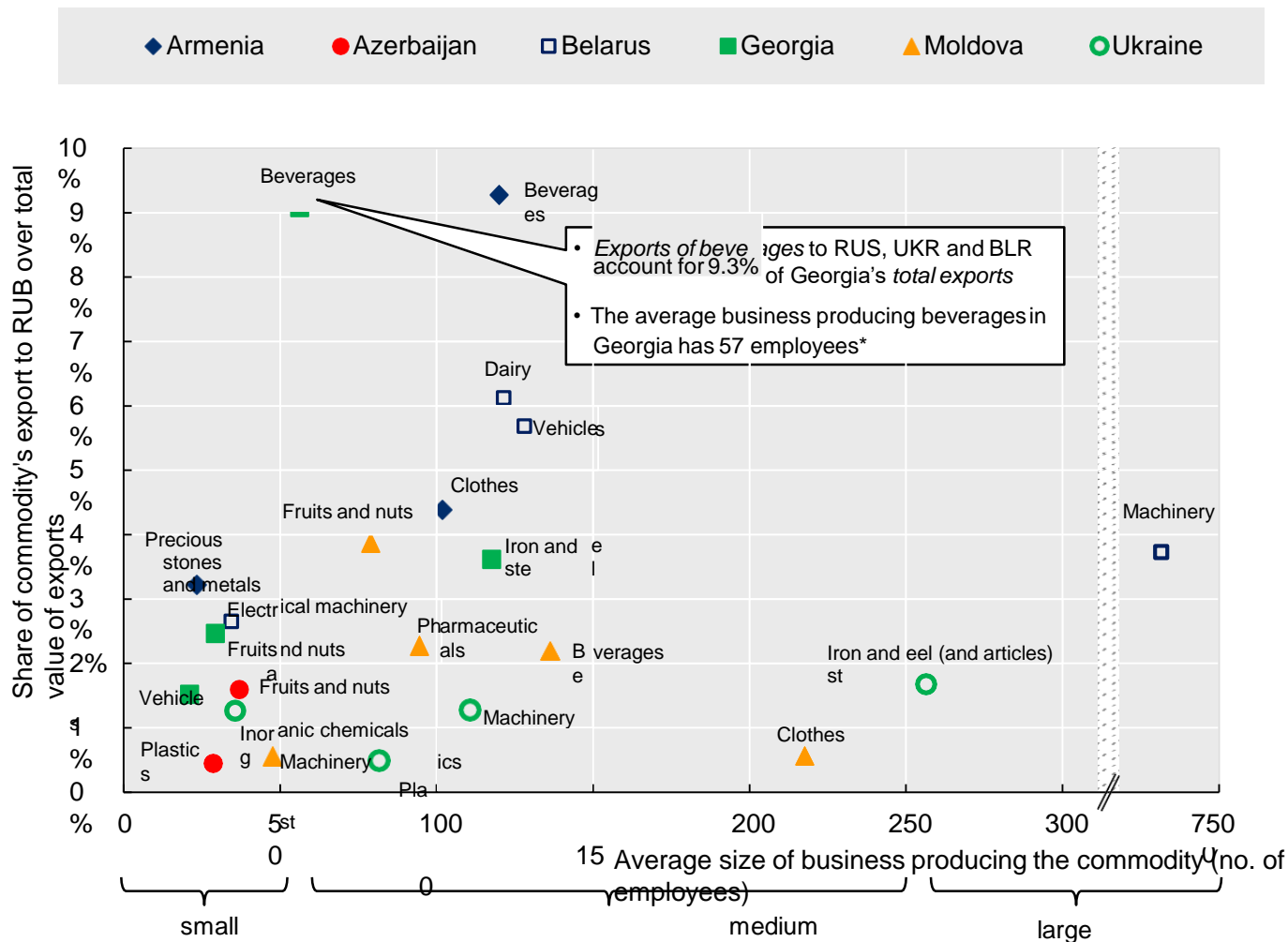
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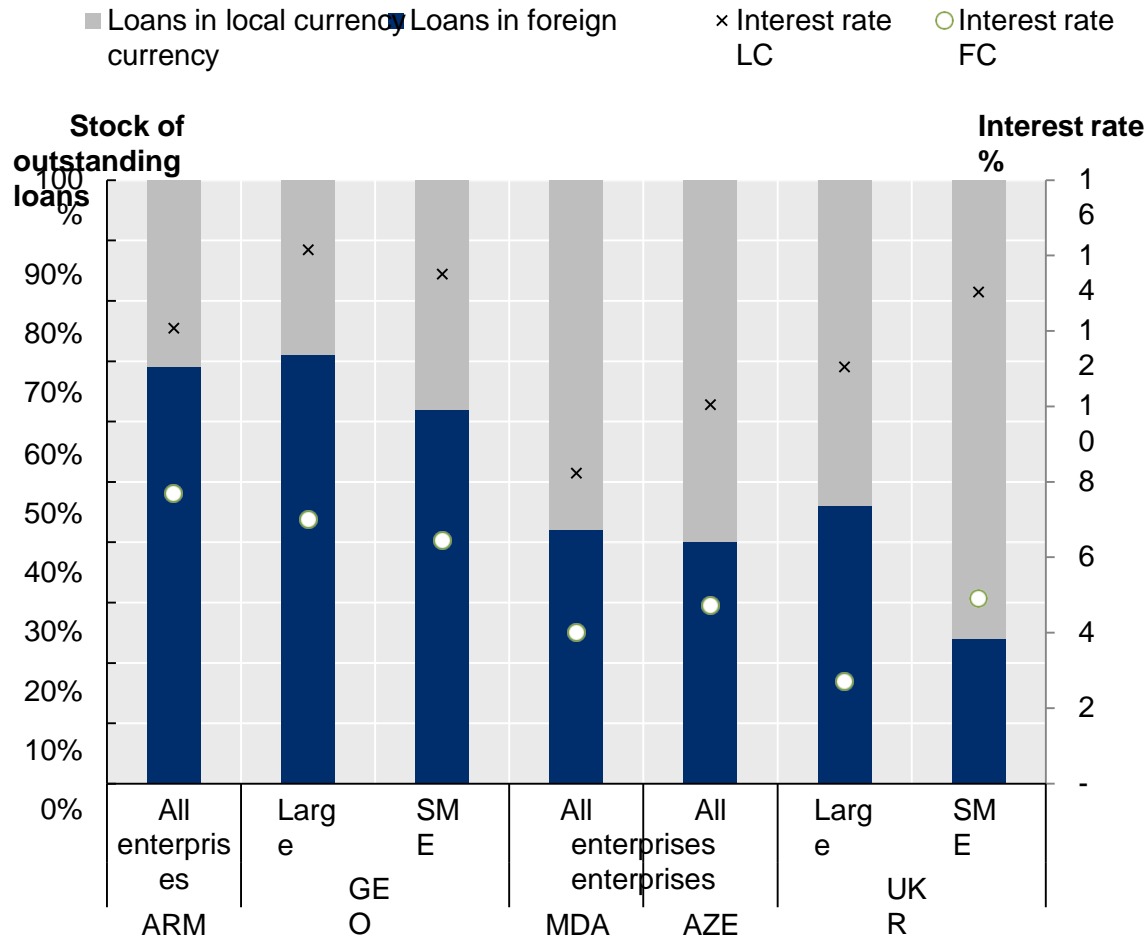
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# Country-by-country overview

	Armenia	Azerbaijan	Georgia	Moldova
Main challenges	Exports	Exports (non-energy)	Exports	Exports
	Remittances	Inflation	Remittances	Remittances
	Inflation		Energy prices	Energy prices
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Potential opportunities	Influx of skilled professionals (e.g. IT)	High energy prices increase export revenues  Increased demand for transport services through middle corridor	Export diversification  Influx of skilled professionals (e.g. IT)  Increased demand for transport services through middle corridor	Export diversification

# Policy options

## **Help and protect refugees**

- Providing short-term emergency humanitarian assistance
- Offering medium term support for accommodation, medical care, and education

## **Ease impact of price rises**

- Targeted, temporary and means-tested support is needed to help the most vulnerable

## **Trade openness and diversification**

- Diversify import sources / abolish import duties from countries without free trade agreement
- Diversify export markets with increased marketing efforts and trade representations
- Consider (temporarily) increasing tariff rate quotas for selected products exported by DCFTA countries into the EU

## **Connectivity**

- Enhance multi-modal transport infrastructure to enable South Caucasus' potential as transit option for the middle corridor
- Foster intra-regional co-operation to co-ordinate investment and reforms

## **Business environment**

- Promote investment and business environment to attract companies relocating from Russia
- Integrate (highly-skilled) migrants in local labor markets

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