POLICY BRIEFING 01 | 2022

German Economic Team

Economic implications for Moldova, Georgia and Armenia of the war in Ukraine and the sanctions against Russia. A comparative analysis

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Berlin, April 2022

1. Introduction

- The economies of MDA/GEO/ARM are linked to RUS in many ways
- Main links:
  - Exports of goods to RUS
  - Imports from RUS, especially energy
  - Russian tourists visit these countries
  - Migrants in RUS send money to their families (remittances)
- RUS 2022: strong recession and depreciation, due to Western sanctions
- This in turn will most likely have a strong effect on the economic links between RUS and MDA/GEO/ARM

Goals of this policy briefing

- Assessment of the economic implications of a weaker Russian economy on MDA/GEO/ARM (direct effect)
- Identification of further implications on MDA/GEO/ARM of the war in UKR and sanctions against RUS (indirect effect)
- Comparison of the economic implications for MDA, GEO and ARM

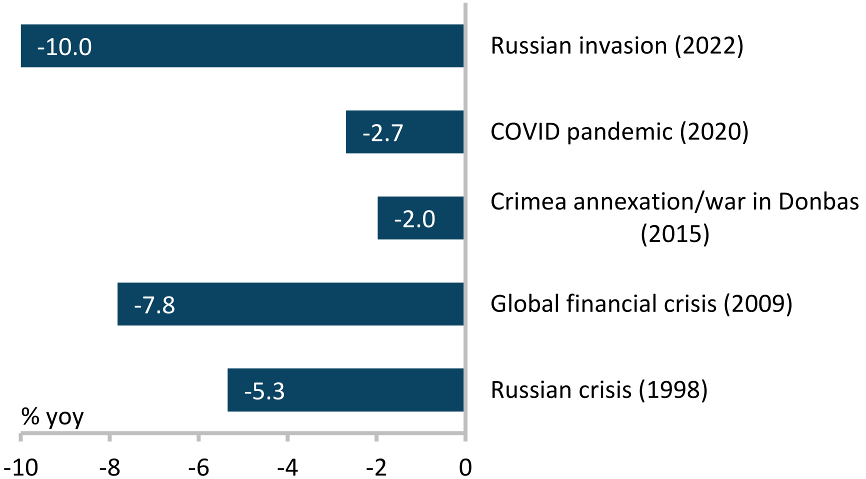
2. Economic outlook in Russia in 2022

Selected economic indicators

Indicators	2022
Real GDP growth, %	-10%
Nominal USD GDP growth, %	-34%
Inflation, % eop	20%
Exchange rate, RUB/USD	120

Sources: Goldman Sachs, CBR, own assumptions/calculations

Historic GDP declines



Sources: Rosstat, own calculations

Severe economic and financial damage

- The war has led to a wave of sanctions on Russia by Western countries
  - Significant impediments to trade, logistics and foreign investment
  - CBR reacted by tightening financial conditions, e.g. emergency policy rate hike to 20%; currently: 17%
  - Material risk that RUS defaults, ratings only slightly above „Default“ status

Still high uncertainty

- As war continues, new sanctions may follow & target the crucial energy sector

➢ **Russia’s real GDP likely to decline by 10% in 2022, which is unprecedented in modern history**

3. Moldova

- **MDA economy** strongly hit by war in UKR and sanctions against RUS
- **Exports** are likely to drop by USD 190 m or 1.6% of GDP in 2022
- Strongest impact on apples (½ of total export drop) & medicaments (ca. ⅙)
- Apples and medicaments could be shipped to UKR; role of donors in financing
- Increase of EU tariff rate quotas (TRQs) for Moldovan plums, grapes and cherries would help to soften the shock
- **Remittances** from RUS to drop by USD 129 m or 1.0% of GDP in 2022; facilitation of labour access of Moldovans in EU would help
- Shock due to higher energy prices (3.5% of GDP); risk of disruption of RUS **gas transit** via UKR; in such a case, MDA could face sizeable electricity shortages
- Higher commodity prices (esp. energy) fuel **inflation**, which is already very high; NBM needs to focus on inflation, i.e. it cannot support the economy
- **Public finance** heavily burdened by weak economy and UKR refugees; budget deficit likely to amount to 7.5% of GDP in 2022

➢ **Strong balance of payments and fiscal shocks; need for donor support**

4. Georgia

- **GEO economy** is adversely affected, but the effect is not very large
- **Goods exports** are likely to drop by USD 65 m or 0.4% of GDP in 2022
- Effect relatively small as transport routes are not affected and there is strong potential for GEO to be substituting Western suppliers to RUS market
- Effects on **tourism revenues** are ambiguous, but the recent influx of Russians to Georgia present potential for additional revenues
- **Remittances** from RUS to drop by USD 210 m or 1.0% of GDP in 2022
- **Oil imports** to become much more expensive (additional cost of 2.1% of GDP), but no issue regarding energy security
- Higher oil prices contribute to **inflation** in GEO; National Bank has to maintain its tight monetary policy; no room for supporting the economy
- **Public finance** affected by weak economy, but new IMF programme agreed

➢ **Limited economic shock for GEO**

➢ **Crucial factors for size of shock: oil prices and remittances**

5. Armenia

- **ARM economy** strongly affected by war in UKR and sanctions against RUS
- Significant drop in **exports** in 2022 expected: USD 244 m or 1.8% of GDP
- Strongest decline: **brandy** (USD 47 m) and further agro-food products (trout, tomatoes, peaches and cheese)
- **Remittances** from RUS likely to drop by 2.8% of GDP; strong shock
- Effect on **tourism** might be positive, due to influx of high-skilled Russians
- Neither **energy** security nor prices affected; ARM purchases Russian oil, which currently trades at a discount; gas contract with Gazprom covers full year
- Consequently, no negative effect of energy prices on **inflation**; despite this, need for maintaining tight monetary policy to anchor expectations
- **Budget deficit** likely to increase due to weaker economic outlook; likely return of large number of migrant workers from RUS later this year would pose a major challenge to fiscal policy; possible role for donors

➢ **Strong economic shock on ARM, mainly due to lower remittances and exports**

6. Regional comparison: exports

Implications of war in UKR and sanctions against RUS on total exports in 2022

	Exports to RUS, share in total	Exports to RUS, share of GDP	Expected drop of total exports	Explanation	Main affected products
MDA	8.8%	2.3%	1.6% of GDP	• Transport routes via UKR disrupted • Reorientation of exports unlikely ➢ **Strong effect** despite limited exposure to RUS	Apples (50% of total drop) and medicaments
GEO	18%	3.4%	0.4% of GDP	• No transport issues • Full reorientation of main export good (ferro-silico-manganese) feasible • GEO wine and water can substitute Western exports to RUS ➢ **Limited effect**	Spirits/brandy and different fruits
ARM	29%	5.9%	1.8% of GDP	• On the one hand: very strong exposure to RUS market • On the other hand: no transport issues • Brandy (No. 1 item): substitution of exports by FRA/ESP to RUS • Diamonds (No. 2 item): full reorientation likely ➢ **Strong effect**, but well below exposure	Brandy and further agro-food products

Source: WITS, own estimates

➢ **Strong effect on ARM because of high exposure; but also on MDA, despite limited exposure**

7. Regional comparison: energy imports, remittances and tourism

Implications of war in UKR and sanctions on energy imports, remittances and tourism in 2022

	Energy imports	Remittances	Tourism
MDA	• Higher oil and gas prices lead to an increase in imports by 3.5% of GDP • 2.8% oil, 0.7% gas ➢ **Very strong effect**	• Likely drop by 50% • 1% of GDP ➢ **Sizeable shock**	• MDA is not an important tourist destination ➢ **No effect**
GEO	• Higher oil prices, no effect on gas prices • Imports to go up by 2.1% of GDP, due to higher oil prices ➢ **Strong effect**	• Likely drop by 50% • 1% of GDP ➢ **Sizeable shock**	• Lower revenues from "traditional" tourists from RUS • But: significant revenues due to influx of high-skilled Russians ➢ **Net effect difficult to forecast**
ARM	• Oil and gas prices not affected ➢ **No effect**	• Likely drop by 50% • 2.8% of GDP ➢ **Strong shock**	• Lower revenues from "traditional" Russian tourists • But: significant revenues due to influx of high-skilled Russians ➢ **Net effect likely to be positive**

Source: IEA, U.S. EIA, WB, Marketwatch, corresponding central bank, own calculations

- **Energy**: (very) strong effect on MDA/GEO, no effect on ARM
- **Remittances**: strongest effect on ARM, due to high exposure
- **Tourism**: positive effect on ARM, unclear prospects for GEO

➢ **Major differences of the effect on MDA, GEO and ARM**

8. Regional comparison: external shocks and effect on GDP

Implications of war in UKR and sanctions against RUS on economic growth in 2022

	GDP forecast 2022, pre war, %	GDP forecast 2022, current, %	Effect on GDP, pp	Main reasons
MDA	4.5	0.3	-4.2	Exports, energy prices and remittances
GEO	5.0	3.5	-1.5	Energy prices and remittances
ARM	5.3*	1.6	-3.7	Exports and remittances

*Source: Ministry of Economy of Moldova, NBG, CBA, IMF, own calculations; *excluding effect of supply constraints in copper industry*

- **MDA** faces the strongest balance of payments shock of all three countries due to lower exports, higher imports and lower remittances; this leads to a revision of the GDP forecast for 2022 by -4.2 pp; very significant
- The effect on the **GEO** economy is – in comparison to MDA and ARM – rather mild and relates mainly to higher oil import prices
- **ARM** is also confronted with severe external shocks to exports and remittances; but energy imports are not affected and tourism is likely to benefit from the current events; consequently, the effect on GDP will be lower than in MDA, despite ARM having much stronger economic ties with RUS

➢ **Significant differences in magnitude and scope of effect on MDA/GEO/ARM**

9. Regional comparison: inflation and public finance

Implications of war in UKR and sanctions against RUS on inflation and public finance in 2022

	Inflation, Mar-22, yoy	Effect on inflation	Budget deficit 2022, current plan	Effect on public finance
MDA	22.2%	Very strong, due to higher oil and gas prices	7.5%	Very strong, also due to refugees from UKR
GEO	11.8%	Strong due to higher oil prices	6.0%	Moderate
ARM	7.4%	Low, given no effect on energy import prices	4.1%	Strong in case many migrant workers in RUS return to ARM

Sources: central banks and Ministries of Finance of corresponding countries, IMF

- **MDA**: very sizeable negative effect on inflation and budget deficit, also due to large number of refugees from UKR; international support needed to maintain/restore macroeconomic stability
- **GEO:** negative effect on inflation due to higher oil prices, but little effect on public finance; effect much weaker than in MDA
- **ARM:** so far limited effect on inflation and public finance; but in the likely scenario of a large number of migrant workers in RUS returning to ARM, public expenditure will be much higher; in such a case, external support needed

➢ **MDA, GEO and ARM face different challenges on inflation and public finance**

About the German Economic Team

German
Economic
Team

Financed by the Federal Ministry for Economic Affairs and Climate Action, the German Economic Team (GET) advises the governments of Ukraine, Belarus*, Moldova, Kosovo, Armenia, Georgia and Uzbekistan on economic policy matters. Berlin Economics has been commissioned with the implementation of the consultancy.

**Advisory activities in Belarus are currently suspended.*

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