IN-DEPTH ANALYSIS

European Parliament

Economic repercussions of Russia's war on Ukraine – Weekly Digest

This paper provides a summary of recent economic, financial and budgetary decisions and developments following President Vladimir Putin's decision of 24 February to start a military attack against Ukraine. It includes recent information relating to the EU sanctions regime, policies supporting energy, economic and financial resilience in the EU, including the coordination of national economic and fiscal measures, and economic estimates for EU Member States. It also highlights policy recommendations made in the public domain to mitigate any adverse economic, financial and social effects and to support economic recovery in the EU and the Euro Area.

The effectiveness of the EU sanctions regime will critically depend on many factors, notably on the resilience of Russia to the consequences of the sanctions, on the actual implementation of the sanctions and on the resilience of the EU to withstand the consequences of the sanctions imposed and more generally of the broader economic effects of the war in Ukraine.

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Policies aimed at responding and mitigating the adverse economic effects will have to be comprehensive and will need to be addressed on all levels of decision-making. Conceptually, one may categorise such actions as relating to international co-operation, common EU level tools and actions, national and regional level meaures, and last but not least, those undertaken by individual companies and citizens. In the area of energy imports, production, and consumption, all these levels of decision-making may play a crucial role, if well informed and coordinated. A clear example are short term measures to save energy consumption by companies, public sector and households. This regular digest will highlight recent developments and recommendations in all these dimensions.

EU economic sanctions: latest developments

On 5 April, Commission President von der Leyen presented the **fifth round of sanctions** against Russia. This package rests on **six pillars**:

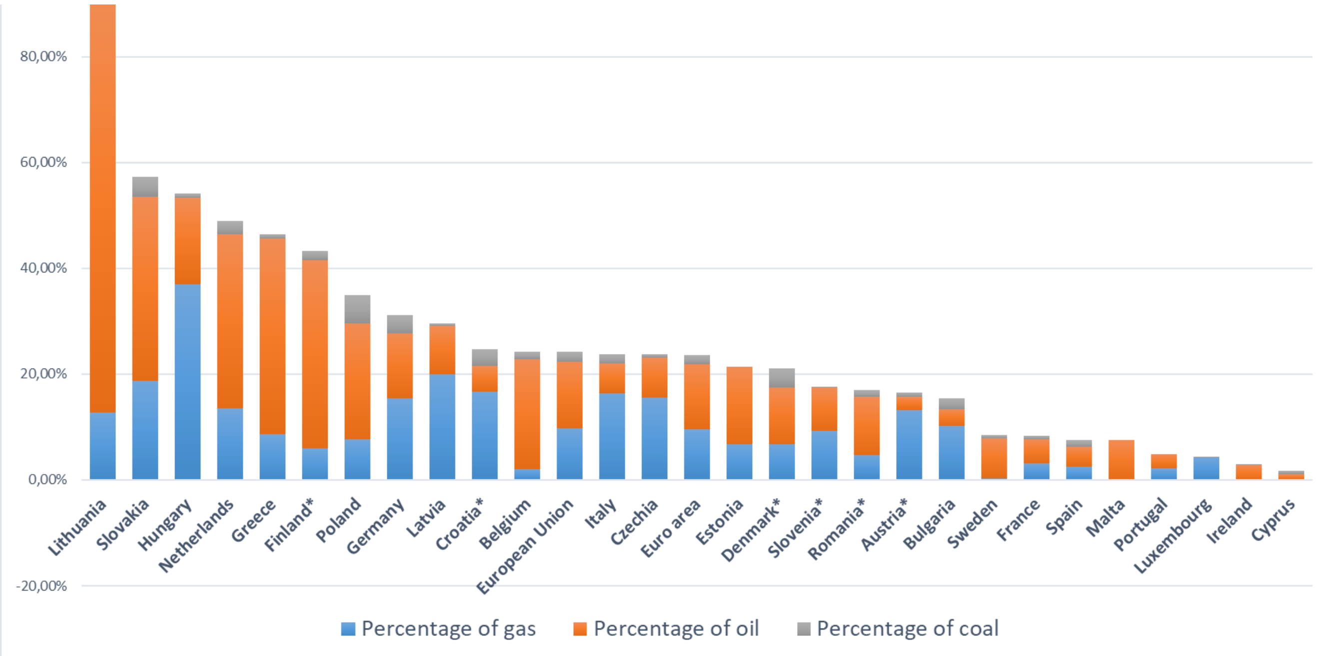
1) an import ban on **coal** from Russia (see Figure 1);
2) a full transaction ban on four key Russian **banks**, representing a 23% market share in Russia, including the second largest Russian bank, VTB;

3) a general ban on Russian **vessels** from accessing EU ports, with some exemptions (agricultural and food products, humanitarian aid and energy);
4) further targeted **export bans**, including quantum computers, advanced semiconductors, sensitive machinery and transportation equipment;
5) specific new **import bans** on products ranging from wood to cement, from seafood to liquor;
6) and **additional measures** like a general ban on the participation of Russian companies in Member States' public procurement.

President von der Leyen furthermore mentioned that the Commission was working on additional sanctions, including on oil imports (also see figure 1; please note that EU trade somewhat distorts the picture displayed therein - in Lithuania , for example, the oil imports considerably exceed own consumption, and a significant share thereof is exported; on the other hand, Luxembourg has little direct oil imports from Russia, but has an indirect procurement thereof from other EU Member States).

The sanctions package was discussed by EU Ambassadors on the 6 and the 7 April (see here and here); the Council adopted it on 8 April.

Figure 1: Percentage of total gross available energy coming from Russian imports for Member States, 2020



*Assumptions were made for countries that did not identify imports from Russia (Denmark, Estonia, Croatia, Austria, Romania, Slovenia, Finland). The assumptions made for individual countries are:
Denmark: 50% of net-imports from Germany are assumed to be from Russia; Estonia: 80% of imports from Latvia are assumed to be from Russia; Croatia: 80% of net-imports are assumed to be from Russia; Austria: 80% of net imports are assumed to be from Russia; Romania: 80% of imports from Hungary are assumed to be from Russia; Slovenia: 80% of imports from Austria are assumed to be from Russia; Finland: 80% of imports from Estonia are assumed to be from Russia;
Source: *Eurostat (including estimates for non-reported data)*

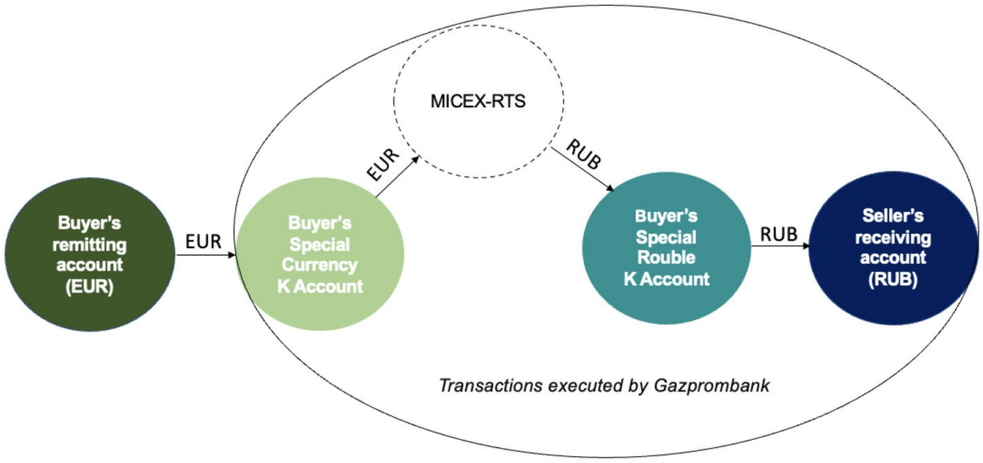
On 7 April, the **European Parliament adopted a resolution calling for a step up of sanctions on Russia** (including a full embargo on oil, coal, nuclear fuel and gas and further addressing the links between Russia and Belarus), calling for a special United Nations tribunal for war crimes and fostering delivery of weapons to Ukraine. The resolution also calls to expell Russia from international organisations and for increasing the effectiveness of sanctions, notably by fostering international cooperation.

Following a video conference meeting, G7 Energy Ministers and EU Energy Commissioner Kadri Simson issued **a joint statement on 28 March rejecting Russian President Vladimir Putin's demand that Russian gas deliveries be paid for in roubles**. The statement reaffirms that agreed contracts for gas deliveries must be respected - as most of these contracts explicitly stipulate payment in euros or dollars - and underlines the intention of the G7 partners to call on companies based in their countries not to accede to the Russian demand.

On 31 March, President Putin nevertheless signed a **decree** which, in essence, requires buyers from 'unfriendly' countries to **pay in roubles** for gas delivered to them after 1 April 2022.

A publication by the Oxford Institute for Energy Studies explains the intended **payment mechanism** The decree requires gas buyers to open two special accounts with an authorised bank (Gazprombank), and pay in foreign currency. Gazprombank shall then sell the foreign currency at the Moscow exchange and transfer the rouble proceeds to the buyer's rouble-denominated account. To settle the payment, Gazprombank shall finally transfer the rouble funds from the buyer's account to Gazprom's account in Gazprombank figure 2).

Figure 2: Sequence of the intended mechanism to pay in roubles for gas deliveries



Source: Oxford Institute for Energy Studies "Rouble gas payment mechanism: implications for gas supply contracts"

Effective implementation and enforcement of the sanctions imposed remains a challenge (see notably here and here). International coordination is being pursued through task forces created to that effect [1] and the Commission is responding to questions to ensure consistent application. Commission Q&A are continously being updated. These cover, currently, 5 sections - general questions, individual financial measures, finance and banking, trade and costums and other fields. On banking and finance, the Commission notably replied to questions regarding crypto assets, trading or euro-denominated banknotes.

On 5 April, the **Ecofin Council adopted conclusions where it supported** "*on-going work to identify and combat practices that aim to circumvent and undermine EU sanctions, including in some cases the risk of circumvention that could derive from certain transactions in crypto-assets*" and emphasised "*the importance of continued efforts to enforce strictly and uniformly all sanctions adopted.*".

[1] A number of bodies to coordinate enforcement have recently been launched. The Commission launched a "Freeze and Seize" task force, while the US Justice Department announced a task force known as KleptoCapture. Both aim to work alongside the so called REPO task force, coordinating finance, justice, home affairs and trade ministries across Australia, Canada, the European Union, France, Germany, Italy, Japan, the United Kingdom and the United States. The banking industry, however, complains that sanctions imposed in the EU, US and UK are different in scope and raise questions as to its implementation.

Following up on calls for increased control (or banning) of '**golden passports'** and **'golden residence permits'** schemes, the Commission issued a recommendation to Member States on 28 March. The recommendation asks Member State still operating investor citizenship schemes to terminate such scheme immediately and to carry out assessments to determine whether citizenship previously granted to Russian or Belarusian nationals subject to sanctions should be withdrawn. As regards Investor Residence Schemes, the Commission is asking Member States to (a) establish and conduct strict checks before issuing any residence permit by investment; (b) immediately withdraw or refuse the renewal of the residence permits granted under an investor residence scheme to Russian or Belarusian nationals who are subject to EU sanctions and (c) suspend the issuance of residence permits under investor residence schemes to all Russian and Belarusian nationals. The recommendation asks Member States holding such regimes to report back to the Commission by end of May; the Commission will keep the Parliament and the Council informed of developments[2] [3].

Securing gas supplies in Europe - the EU critical infrastructures framework

On 6 April, the Commission published a Communication with **guidance to the Member States concerning foreign direct investment from Russia and Belarus**. The Communication sets out that the EU is open to foreign investment (FDI), underlining, however, that the openness is not unconditional and needs to be balanced by appropriate tools to safeguard security. It cautions that Russia's military agression calls for greater vigilance towards Russian and Belarusian direct investments within the Single Market, going beyond investments by persons or entities subject to sanctions: "*In the current circumstances, there is a heightened risk that any investment directly or indirectly related to a person or entity associated with, controlled by or subject to influence by the Russian or Belarusian government into critical assets in the EU may give reasonable grounds to conclude that the investment may pose a threat to security or public order in Member States*".

In the existing institutional set-up, the **responsibility for screening FDI rests with Member States**. National screening mechanisms are in force in 18 Member States (see list). Given the significantly heightened risk, the Commission calls upon Member States to systematically scrutinise Russian and Belarusian FDI, to ensure close cooperation between national authorities, and asks those without screening mechanism to set them up urgently. The communication sets out that in 2020, Russian individuals or entities control about 17.000 EU companies, have potential controlling stakes in another 7.000 companies and minority stakes in a further 4.000 companies. There is no indication, however, as to what extent those companies might be in control of "critical assets".

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2 On a resolution adopted 9 March, the European Parliament requested the Commission to put forward a legislative proposal to "*comprehensively regulate various aspects of RBI [Residency by Investments] schemes with the aim of harmonising standards and procedures and strengthening the fight against organised crime, money laundering, corruption and tax evasion*" and called on Member States to "*stop operating their CBI [Citizenship by Investment] and RBI schemes for all Russian applicants with immediate effect; urges Member States to reassess all approved applications from Russian nationals over the past few years, exploiting all possibilities under national and Union law to ensure that no Russian individual with financial, business or other links to the Putin regime retains his or her citizenship and residency rights or that such individuals are temporarily blocked from exercising those rights*". Parliament further called on the Commission "*to verify such reassessments carried out by Member States and to urgently present a legislative proposal to completely ban CBI schemes and to ban RBI schemes for Russian nationals subject to targeted measures*". An earlier resolution, adopted on 1 March, expressed similar concerns.

3 On 6 April the Commission stepped up its ongoing procedure against the Maltese investor citizenship scheme by sending a "*reasoned opinion*" to the Maltese authorities. The Commission press release further notes "*In October 2020, the Commission had also started an infringement procedure against **Cyprus** for its investor citizenship scheme. Cyprus repealed its scheme and stopped receiving new applications on 1 November 2020. However, it continued to process pending applications. As a result, the Commission decided to send a reasoned opinion to Cyprus on 9 June 2021. Since then, Cyprus stopped processing applications and, as of 15 October 2021, revoked the citizenship of 39 investors. (...) The Commission was also in contact with **Bulgaria**, highlighting its concerns regarding an investor citizenship scheme operated by that Member State. On 24 March 2022, the Bulgarian Parliament approved an amendment to the Bulgarian Citizenship Act, which aims to end the investor citizenship scheme.*".

One may note in this context that the Federal Ministry for Economic Affairs and Climate Action in Germany has temporarily appointed the **Bundesnetzagentur** (the Federal Network Agency for Electricity, Gas, Telecommunications, Post and Railway) as **fiduciary for the Gazprom Germania Group**, which operates critical infrastructure that is of outstanding importance for the gas supply in Germany. The decision comes against a background of unclear legal relationships and follows the violation of the reporting obligation under the Foreign Trade and Payments Ordinance.

The energy and transport sectors have a critical importance to EU security. Directive 2008/114/EU provides for a **common method of identifying critical infrastructures** (CI)[4] in the energy and transport sectors[5] and for a common approach to the assessment of the need to improve the protection of such infrastructures[6]. The Directive required MS to identify their CI by January 2011 (and regularly review it). No list of CI is publicly available. Operators of CI need to identify its assets and define security measures to protect them. In June 2020, the Commission launched a consultation to assess the need for revising Directive 2008/114. Results are available here. On December 2020, the Commission adopted a proposal to revise the Directive (negotiations pending; see here)[7].

EU policy responses to improve energy, economic and financial resilience

Policies relating to energy supply and demand

The Heads of State or Government (HoSG) of the EU Member States agreed at the **European Council of 24-25 March** to **undertake common purchases of gas on a voluntary basis** in order to strengthen their bargaining power and thus try to obtain more advantageous prices from suppliers. The conclusions adopted state that the Member States and the Commission will "*work together on voluntary common purchase of gas, LNG and hydrogen*" through a "*common purchases platform*". This will allow the Commission to negotiate with gas suppliers on behalf of those MS that wish to do so for the next winter.

The **possibility of capping or modulating the price of gas** by regulatory means is specifically mentioned in the European Council conclusions: the HoSG thus agreed to ask the Council of the EU and the Commission "*as a matter of urgency, to reach out to the energy stakeholders, and to discuss, if and how, the short-term options as presented by the Commission*", including the "*price caps*", would contribute to "*reducing the gas price and*

[4] CI means an asset, system of parts thereof located in Member States which are essential for the maintenance of vital societal functions, health, security, economic or social well-being of people, and the disruption or destruction of which would have a significant impact in at least two Member States.

[5] An annex to the Directive further specifies the relevant sectors - on energy, electricity, oil and gas infrastructures are identified. LNG terminals are also included.

[6] See here for an analysis of the main elements of the Directive.

[7] Two additional legal texts aim at protecting gas infrastructures (and supply) in the EU: Regulation 2017/1938 and Regulation 715/2009. The first one concerns measures to safeguard the security of gas supply, creating a solidarity mechanism designed to address extreme situations where supply is at stake; the second addresses the conditions for access to the natural gas transmission networks. Both texts are being amended by a Commission proposal of 23 March 2022, following up on the Commission RePowerEU Communication and amending earlier proposals (here and here) on the internal markets for renewables and natural gases and for hydrogen (of 15 December 2021, negotiations of which are still pending - see here and here). The March 2022 proposal introduces three targeted amendments to the 2021 proposals: a storage filling obligation, a certification of the storage system operators (existing and new ones) and a tariff rebate scheme. These amendments address the risks of gas supply to Europe following the Russian attack on Ukraine. The new certification procedure allows Member States to refuse certification - and thus, effectively prevent operation - from operators that "*could negatively affect the incentives and ability of the storage operator to fill the storage facility*" or which "*may put at risk the security of energy supply or the essential security interests of any Member State or of the Union*". Member States are also asked to prioritise certification of the largest operators and of those whose "*storages have recently been filled at consistently low levels*". This might be the case in Germany (see Politico here and a February 2022 analysis of the Institute of International Finance).

addressing its contagion effect on electricity markets". This examination should be done "*taking into account national circumstances*".

In parallel to the European Council summit, the **Commission and the US agreed on 25 March on a [significant increase in US LNG deliveries](#) to the EU**. In order to reduce Europe's dependence on Russian energy, **the US will "*strive*" to supply** the EU with at least 15 billion cubic metres (bcm) of additional LNG in 2022, including through collaboration with international partners, and thereafter about 50 bcm per year until at least 2030. This represents a significant increase on US LNG deliveries to the EU, which stood at 22 bcm in 2021. These additional volumes should contribute to the Commission's objective of reducing the EU's dependence on Russian fossil fuels by two-thirds by the end of this year, and completely by 2027[8].

On the costs to the Union, the joint statement says that "*the price formula of LNG supplies to the EU should reflect long-term market fundamentals, and stability of the cooperation of the demand and supply side, and that this growth be consistent with our shared net zero goals*".

Coordination of national economic and fiscal policies

On 5 April, the ECOFIN Council discussed the impact of the war in Ukraine on the European economies, based on a new assessment by the European Commission. The discussion focused in particular on the measures taken at national and European level to deal with the increase in energy and raw material prices. **The importance of coordination between member states of national support plans was stressed**. EU economy and finance ministers agreed to continue to monitor developments closely and confirmed the need for European unity and solidarity.

Banking and financial stability related developments

The European Banking Authority (EBA) published on 1 April an updated Risk Dashboard, which contains a section on the impact of the Russian invasion of Ukraine on the EU/EEA banking sector. In line with the assessment of other banking supervisors, EBA's initial assessment is that the **first-round risks to the EU banking system are not a fundamental threat to financial stability**, considering the comparatively low volume of direct exposures to Russia and Ukraine that are concentrated in a few EU MS (in particular France, Austria, and Italy). Direct exposures of European banks are mostly loans to firms in the manufacturing (EUR 16 bn), wholesale and retail (EUR 10 bn) sectors, as well as mining (EUR 9 bn). Exposures to Russian sovereign bonds are in comparison small (EUR 4 bn). EBA finds that **second-round effects**, however, including higher energy costs, the fiscal impact, the impact of sanctions (from all actors involved), cyber risks and the **longer-term impact on supply chains in the global economy**, are more worrying from a financial stability perspective.

The ECB announced on 28 March that it has concluded new agreements with the central banks of five European countries outside the euro area - Poland, Hungary, Albania, Northern Macedonia and San Marino

[8] A February 2022 paper by the Institute of International Finance questions the effectiveness of such an approach: "*Replacing Russian natural gas imports with LNG poses a multi-faceted challenge that involves a) import terminal and pipeline infrastructure, as well as b) availability of LNG from existing sources. Based on 2021 numbers, European LNG terminals would be able to handle an additional 1,000 TWh (or roughly 50% of total capacity) which would go a long way to close the gap resulting from a potential disruption of Russian deliveries. But the regional distribution of terminals and structure of European pipeline infrastructure would not necessarily allow distribution of the required amounts based on individual countries' needs, in particular as countries in Eastern Europe are generally more dependent on Russian imports and pipeline systems are not designed for this direction of flows. The main issue with the LNG option, however, is the limited availability of additional supplies on the market. Global liquefication capacity is almost fully used up, and LNG vessels are in very high demand as well. Furthermore, LNG is sold and acquired largely via long-term contracts so that European buyers would compete for a relatively small share of the market. Finally, additional demand of around 1,000 TWh, which represents roughly 20% of the existing global LNG market, would put strong upward pressure on prices. While favorable market conditions for producers and exporters will likely trigger additional investments in LNG infrastructure, their impact will not be felt for several years.*".

- until mid-January 2023, which will enable them to provide liquidity to the national banking system in the event of financial turmoil. In particular, the ECB and Narodowy Bank Polski have agreed to establish a precautionary '*swap*' line to provide euro liquidity to financial institutions in Poland. Under this agreement, the National Bank of Poland could borrow up to €10 billion in exchange for zlotys. The ECB statement reads: "*In the context of heightened geopolitical tensions triggered by the Russian invasion of Ukraine, the lines are designed to prevent spillover effects in euro area financial markets and economies that might adversely affect the smooth transmission of the ECB's monetary policy.*"

Supporting Ukrainan refugees: latest developments

To complement other measures of humanitarian assistance, the Commission adopted on 1 April a proposal for a Council Recommendation on the **conversion of hryvnia banknotes into the currency of host Member States** by refugees. The National Bank of Ukraine had to suspend the exchange of hryvnia banknotes into foreign cash, in order to protect Ukraine's limited foreign exchange reserves. That decision in turn made the conversion outside of Ukraine also difficult or impossible. Some Member States therefore consider to put national schemes in place that support the conversion of a limited amount of hryvnias per person. The Commission's aim is to promote a consistent approach to such schemes, suggesting a maximum limit of 10,000 hryvnias per person (approximately EUR 300), for a minimum duration of three month, at the official exchange rate as published by the National Bank of Ukraine.

On 4 April, the Council adopted a set of legislative amendments making it possible for member states to redirect resources from cohesion policy funds and the Fund for European Aid for the Most Deprived (FEAD) to assist the refugees escaping the Russian military aggression against Ukraine (Cohesion's Action for Refugees in Europe (**CARE**)).

The proposal was adopted by the Commission in early March and **flexibilises the EU cohesion funds framework** (see previous EGOV briefing for more details[9]). The legislation (see here for the final text; Parliament position here) will enter into force in the coming days and will allow (a) exceptional flexibility to transfer resources between programmes financed by the European Regional Development Fund and the European Social Fund to address the inflow of refugees; (b) Member States to use up to EUR 9.5 billion under the 2022 tranche of REACT-EU[10], as well as unallocated cohesion policy resources under the 2014-2020 budgetary period; and (c) extending by one accounting year the 100% financing from the EU budget for cohesion programmes, to alleviate the burden on national and regional budgets due to the inflow of refugees from Ukraine. The 3 measures are estimated to release almost **EUR 17 billion**.

On the same date, the Council also approved the final position agreed with the Parliament (see here) as regards the Commission proposal to amend t**he 2014-2020 home affairs funds and the 2021-2027 asylum, migration and integration fund**. The regulation[11] will (a) unlock access to unspent amounts, thus allowing to use such resources for the reception of persons escaping the war in Ukraine; (b) extend by one

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[9] The relevant steps of the legislative procedure can be found here. The Council note noting the agreement of Parliament and Council can be found here.

[10] On 6 April, COREPER approved a Commission proposal to increase pre-financing from REACT-EU resources; the European Parliament agreed to the proposal on 7 April. The proposal, once finalised and published, will immediately allow a total of EUR 3.5 billion disbursements of the EUR 10 bn available. The pre-financing from the 2021 tranche of REACT-EU will be increased from 11% to 15% for all member states, and from 11% to 45% for those EU countries where the inflow of refugees from Ukraine amounted to over 1% of their populations at the end of the first month following the Russian invasion. The countries which will receive 45% pre-financing are Hungary, Poland, Romania and Slovakia, which share a border with Ukraine, as well as Austria, Bulgaria, Czechia, Estonia and Lithuania, which had accommodated a number of displaced persons equivalent to over 1% of their populations by 23 March 2022. In addition, the proposal introduces a unit cost per person of EUR 40, thereby enabling an easier and swifter implementation of the funds.

[11] Details of the legislative file can be found here.

year the implementation period of the 2014-2020 home affairs funds; and (c) allow the possibility to make additional financial contributions under the 2021-2027 fund as external assigned revenue. This initiative is expected to release around **EUR 420 million** in additional support from unused funds. Both legislative procedures were completed in less than one month.

Latest estimates of energy imports embargo for EU Member States

On 4 April, the *Conseil d'analyse économique*, which reports to the French Prime Minister, estimated the effects of an embargo on energy imports from Russia using a macroeconomic model involving 30 sectors and 40 countries, taking into account cascading effects along production chains.

According to the simulations, such a measure would **reduce French national income by about 0.2%, i.e. a loss of €91 per person**. The effects would be greater for **Germany (about 0.3% loss of GDP, or €100 per person)**. For the **European Union as a whole, the drop in GDP would be around 0.2 to 0.3%, or around €100 per person**, although there is considerable heterogeneity, with some countries being much more affected than others (in particular Lithuania, Bulgaria, Slovakia, Finland and Czechia).

These relatively moderate effects, which the authors consider to be perfectly "*manageable*", are largely due to the fact that international trade, which is taken into account in the simulation, broadly diffuses the magnitude of the shock between countries: if Germany is severely affected by a reduction in its gas supplies, it will be able to substitute intermediate goods needed for the production process with imports from France. Substitution, which also reflects the capacity of firms to adapt to the consequences of the embargo, can take place at the level of intermediate goods, but also of inputs in the production process, as well as between final consumer goods.

The assumptions regarding substitution efforts in the production process are key to understand the relatively moderate impact of an embargo on energy imports from Russia, according to that study. Without this substitution phenomenon, the economic impact would be much higher in Germany (loss of GDP of about 1.3 to 2.2%, i.e. a loss of income per capita of 600 to 900 euros), whereas under the same hypothesis, the impact would remain similar to that previously estimated for France (loss of GDP of about 0.2 to 0.3%, i.e. a loss of income of about 100 euros per capita), due to a lower exposure to gas imports from Russia.

For the authors, the assumption of no substitution in the production process as assumed in the most dramatic simulations is unrealistic. They claim it is not supported by any historical evidence, nor by any existing empirical research. Whether it is the impact of the sudden shutdown of nuclear power plants in Japan following Fukushima or the sudden disruption of Chinese supply chains following the covid crisis, the evidence shows that substitution, while far from perfect, is also clearly different from zero.

Given the very heterogeneous impact of an embargo on the economies of EU member countries, the **authors propose a 40% tariff on Russian fossil fuel imports as an alternative** to a very sharp reduction in energy imports from Russia . Such a tariff would reduce the quantities imported by about 80% (compared to 100% in the case of an embargo). In this case, the economic losses, particularly for the countries most dependent on Russian supplies (Lithuania, Bulgaria, etc.), would be greatly reduced compared to an embargo: losses would be divided by a factor of 3 or 4.

Please see Annex 3 for a table comparing similar estimates.

Selected recent economic estimates by national authorities in EU Member States

Some Member States have recently publish updated projections about the economic effects related to the war. However, those projections cannot easily be compared, not least due to the different assumptions and scenarios, different econometric models and different cut-off dates used. Summaries of selected national forecasts are provided below (also see EGOV briefing).

Given the uncertainty about the duration of the war in Ukraine, these forecasts underline a number of risks that could impact and derail economic developments. The risks to the baseline scenario are tilted to the downside in the case of economic activity and to the upside in the case of inflation.

In March the **Central bank of Poland** (*Narodowy Bank Polski*) published its inflation and GDP projections[12]. Compared to the last projection round published in November 2021, the GDP projections were reviewed downwards to 4.4% and 3.0% for 2022 and 2023 respectively (compared to 4.9% for both 2022 and 2023 projected in November). Inflation forecast have been also severely reviewed and is currently projected to reach 10.8% in 2022 and 9.0% in 2023 (compared to 5.8% and 3.6% in the respective years).

Bank of Lithuania (*Lietuvos bankas*) in its latest economic projection also highlighted that *"the impact of these sanctions [against Russia] is expected to affect both Lithuanian and EU economies through three main channels – foreign trade, raw material supply and prices, and business and household sentiment. Russia's aggression in Ukraine will have a negative impact on Lithuania's economy through declining exports, a shortage of imported raw materials, an uncertain investment climate and rising energy prices"*. Even though some of the negative impact on Lithuania's economy is mitigated due to the fact that Lithuania's foreign trade with Russia is not intense and accounted for 6% of total export (3% to Ukraine and 3% to Belarus), economic growth was revised downwards to 2.7% for both 2022 and 2023[13]. Also inflation projections were revised upwards to 10.5% in 2022 and 2.7% in 2023.

Similarly, the **Bank of Latvia** (Latvias Banka) reviewed its projections for the Latvian economy[14] *"owing to Russia's invasion of Ukraine ... gross domestic product (GDP) for 2022 and 2023 have been revised downwards to 1.8% and 3.2% respectively (from 4.2% in 2022 and 4.0% in 2023 in the December growth forecast) ... Latvia's inflation projections for 2022 and 2023 have been revised upwards to 9.5% and 3.7% respectively (from 6.1% in 2022 and 2.9% in 2023 in the December inflation forecast) on account of the rising global energy and food prices, which have increased further since the outbreak of the war in Ukraine"*.

The latest economic forecast by the **Bank of Estonia** (Eesti Pank)[15] estimates, that *"A combination of several factors will push the Estonian economy into recession in 2022. GDP at constant prices will decline by 0.4% in 2022 because of the much higher inflation than was earlier expected, which will reduce consumption opportunities, and also because of increased uncertainty, supply problems, and reduced opportunities for exporting"*. Growth

[12] Assuming that *"in the coming quarters, the domestic economic situation will be influenced by a strong negative supply shock ... [combining] of the effects of Russia's aggression against Ukraine ... the earlier increases in energy commodity prices ... and CO2 emission allowances, as well as disturbances in the supply chains. In the longer horizon of the forecast, the expected economic slowdown abroad will have a negative impact on the domestic economic growth ... The scale of the slowdown in domestic GDP growth will, however, be mitigated by changes in the fiscal policy resulting from the adoption of the Anti-Inflation Shield and the Polish Deal, as well as the increased inflow of immigrants to Poland from Ukraine (consumption and net exports)"*.

[13] Bank of Lithuania also runs shock sensitivity analysis based on the ECB's severe scenario, under which *"in 2022, Lithuania's GDP would decline by 1.2 %, and average annual inflation would rise to 11.1%"*.

[14] Bank of Latvia also conducted scenario analysis of potential future inflation developments.

[15] *"The biggest change in the outlook for the economy has understandably been caused by Russia's military aggression. The uncertainty about the further progress of the war means that the economic forecast also stands on very uncertain ground. This forecast reflects the scenario considered the most likely, but reality could turn out better or worse ... The forecast assumes that Estonian exports to Russia, Belarus and Ukraine will be stopped and will not recover throughout the forecast horizon"*.

projections for 2023 and 2024 are 2.0% and 3.5% respectively, while inflation is estimated to reach 10.2%, 2.4% and 1.7% in 2022, 2023 and 2024 respectively. It envisages that *"the problems in production will deepen ... unemployment will increase because of the economic difficulties ... inflation will pass through to wages ... uncertainty will be reflected in some loss of momentum in the real estate market"*.

According to the **National Bank of Belgium** latest projections, Belgium's economic[16] growth would now be 2.4% in 2022, 1.5% in 2023 and 1.9% in 2024. Compared to the autumn projections published in December, this represents a downward revision of GDP growth by 1.2 percentage points for 2022-2023. As a result of persistently high energy prices, inflation is also revised upwards significantly in the short term, to over 5% by the end of this year. However, the current forecasts do not indicate a long-term wage-price spiral either: inflationary pressure is expected to ease over the next two years.

The **Dutch central bank** (*De Nederlandse Bank*) published a paper on the impact of the war in Ukraine for the economy of the Netherlands[17], which presented economic projections under two scenarios. In the baseline scenario, projected GDP growth in 2022 and 2023 combined is now projected to be a mere 0.2 percentage point lower than in the December projection, and stand at 3.5% and 1.5% for 2022 and 2023 respectively. In this scenario, the negative impact of the ongoing war on economic growth of higher energy prices and lower world trade growth is largely offset by a large growth carry-over from 2021 and the impact of the coalition agreement made with the new government.

Conversely, an alternative scenario is presented[18], under which economic growth in the Netherlands falls back by an average of 1.1 percentage points per annum for 2022-2023.

The **Bank of Spain** (Banco de España) has published on 5 April its new macroeconomic projections for the Spanish economy for the period 2022-2024. Overall, average GDP growth in Spain is expected at 4.5% in 2022, 2.9% in 2023 and 2.5% in 2024. This means a downward revision of GDP growth compared to the December 2021 projections by 0.9 pp in 2022 and 1 pp in 2023, and upwards by 0.7 pp in 2024. In annual average terms, the HICP is expected to accelerate from 3% in 2021 to 7.5% in 2022.

On 24 March, **Banco de Portugal** published its March Economic Bulletin (only available in Portuguese) with a cut off date of 10 March. On the assumption of a milder conflict, with no escalation and a dissipation the effects of the war over the medium term, it forecasts that the GDP will growth 4,9% in 2022 (4,9% in 2021) and will converge in the following years to growth rates close to long term (2,9% in 2023 and 2,0% in 2024). Inflation is expected to grow in 2022 to 4,0%, reducing to 1,6% in 2023 and 2024. Inflation peak in 2022 results from higher energy prices and bottlenecks in international trade chains. Banco de Portugal also prepared simulations on the basis of a more extreme scenario where the effects of the war are more intense and protracted, including the impact of a gaz embargo on Russia. Channels of contagion forecasted include

[16] The decline in domestic and foreign demand for Belgian products, combined with the renewed uncertainty and soaring energy prices, is also causing a temporary, albeit substantial, slowdown in the expansion of business investment. The shock would mainly be passed on through increases in the prices of both energy and certain raw materials, but also through the rise in borrowing rates, reflected by the increase in the rate of 10-year Belgian government bonds. The National Bank of Belgium however stresses that its forecasts are not based on a worst-case scenario for the international context and the energy and commodities markets, implying that energy exports from Russia to Europe will not be subject to severe restrictions and that Belgium's industrial production processes will not be completely paralysed by supply shortages from Russia.

[17] Which very much stresses the war in Ukraine is yet -after Covid 19- another shock to the economy. Such concatenation of shocks is unprecedented both in nature and magnitude, making it difficult to predict its economic impact. Important changes in the international assumptions compared to the previous projection (December 2021) are higher energy and commodity prices, lower growth in world trade relevant to the Netherlands and higher interest rates. Energy prices have risen sharply since the outbreak of the war.

[18] According to Dutch central bank assumptions, it cannot be ruled out that the markets for energy and commodities have been disrupted to such an extent that prices will remain high for a longer period of time worldwide, with a dampening effect on international economic activity. The shock is expected to result in lLower real disposable incomes, negative wealth effects and higher unemployment further depressing consumer spending. The adverse effect on the public finances is still limited in 2022, partly because unemployment does not yet rise steeply in 2022 and nominal tax revenues initially hold up due to higher prices. In 2023, however, public finances clearly deteriorate significantly in this scenario, partly due to rising unemployment, as the government deficit increases to 3.3% of GDP.

price increase of imported raw materials (notably, energy products) impacting purshasing power and the economic activity overall; further restrictions on the side of the offer, due to logistics and transport bottlenecks; and of trade (noting that the exposure of the Portuguese economy to energy and grains of Russia and Ukraine are below the euro area average in 2015 to 2019). On that scenario, the forecasts stagnation of the economic activity in 2022 and a reduction on the GDP growth rate of 1,3 pp in 2022 and 0,2 pp in 2023, swith a positive impact in 2024. Inflation is estimated to reach 5,9% in 2022, 2% in 2023 and 1,9% in 2024, respectively 1,8 pp, 0,4 pp and 0,3 pp above the base scenario.

According to the latest **Bank of Greece** economic projection published on 7 April, taking into account the latest developments related to Russian war in Ukraine and relating repercussions in international markets, *"against this background, the Greek economy is expected to keep growing in 2022, but at a slower pace than the initial forecast of 4.8%. GDP growth is limited to 3.8% in the baseline scenario and 2.8% in the adverse scenario, depending on the extent and duration of the shocks in international energy and food prices, as well as the deterioration in confidence and financial market turmoil"*. Inflation is expected to be one of the main factors that will have a negative impact on households' disporable income (which in turn will drag down private consumption), higher production costs for corporate sector (which in turn will have negative impact of firms' profitability. *"Under the baseline scenario, inflation is expected to accelerate to 5.2% in 2022, while a further increase to 7% is projected under the adverse scenario. A de-escalation of inflation is expected in 2023, provided that supply chains are fully restored and energy prices fall"*.

The **Dutch Centraal Plan Bureau** (CPB) published a set of scenarios in addition to a baseline estimate. It is explained that scenario provides a consistent picture of a possible outcome. This does not say much about the probability of that outcome, but it does say something about the coherence of developments: if A occurs, B is also probable. In recent weeks CPB has outlined various scenarios and provided analyzes of the possible consequences of the invasion of Ukraine. The decrease in purchasing power is signficant in all scenarios. In the baseline scenario, the economy is projected to grow by 3.6% in 2022 and by 1.7% in 2023. Mainly on the back of lower trade and higher inflation, the alternative scenario shows 1.7% growth in 2022 and zero growth in 2023.

See **Annex 2** for some key economic indiactors for EU Member States.

See **Annex 3** for a list of some recent estimates focusing on the economic effects of a total or limited emargo of Russian eneregy imports.

Previous EGOV Weekly Digests:

- Economic repercussions of Russia's war on Ukraine – Weekly Digest - 25 March 2022
- Economic repercussions of Russia's war on Ukraine – Weekly Digest - 18 March 2022
- EU economic and financial developments: Weekly Picks - 11 March 2022

Policy recommendations in the public domain: Some recent picks

E. Chaney, C. Gollier, T. Philippon, R. Portes: Economics and politics of measures to stop financing Russian aggression against Ukraine (22 March 2022)

The financial and economic sanctions imposed on Russia to force it to end its invasion of Ukraine have not yet had the desired impact. This column argues that cutting off the financing of the Russian aggression is essential and requires the immediate ban of imports of Russian oil together with taxing imports of Russian gas, while cushioning the shock of these measures on households, especially those with low incomes.

This is why, in addition to the ten measures put forward by the International Energy Agency, the authors are proposing three measures to be enforced immediately by EU members, in order to cut off the financing of the war of terror waged by Russia. these are the following: 1. Complete ban on Russian oil imports; 2. A tax on Russian gas imports, proceeds allocated to Ukrainians; 3. Cushion the shock on low incomes.

P. Bergeijk: Sanctions against the Russian war on Ukraine could be made to work (28 March 2022)

The 2022 economic sanctions against Russia may have been described as without precedent but that is an exaggeration. For example, sanctions against the Iraqi invasion of Kuwait in 1990 froze immediately all foreign assets and a total oil boycott was enforced. The Western world has learned little from the ineffective sanctions against Russia's annexation of Crimea in 2014, as those sanctions were predominantly symbolic and as result failed to achieve the desired outcome. Broad-based sanctions, through their impact at large, are more apt to communicate to the Russian population that the 2022 war on Ukraine is in no way comparable to the 2014. Given the increased Russian resilience, the increasingly autocratic nature of President Putin's government, and the failure of European democracies to implement appropriate broad-based measures, targeted sanctions are unlikely to influence the Kremlin's calculus. The EU could only influence that calculus by restoring its reputation as a credible applicant of strong sanctions, including an embargo on capital goods and a boycott of Russian energy. President Zelensky's allies could very well be CEOs rather than MPs, as the divestment of western companies will shrink the Russian economy directly, but also indirectly, because FDI has significant spill over effects (e.g. access to modern technologies).

J. Pisany-Ferry: Crunch Time for Europe's Economic Sanctions (29 March 2022)

After Russia invaded Ukraine, Europe deployed an array of monetary, financial, trade, and investment sanctions. But as the war continues, will the sanctions remain effective? And if their impact weakens, will the EU be able to step them up meaningfully? A worrying sign is that there were no further announcements at the leaders' meeting on March 24. Banning Russia's central bank from accessing its reserves was costless for the EU. However, virtually any additional steps would entail an economic cost for Europe. The OECD recently estimated that assuming prices of energy and commodities remain elevated, Eurozone growth will be reduced by about 1.5 percentage points, and inflation will rise by two percentage points, but it rightly observes that government policies can help cushion the shock. The more difficult question is how much it would cost Europe to reduce and ultimately eliminate its dependence on Russian energy. Currently, Russia can hardly export its gas elsewhere than westward, whereas the EU's greater substitution capacities put it in a stronger position than its adversary. In the case of Germany, the overall cost of an abrupt stop to Russian energy imports is estimated between 0.5% and 3% of GDP, but results vary among the different member states. Europe's leaders should make it clear to the public that they cannot defeat an adversary ready to endure a 20% drop in national income if Europeans are not willing to risk a 2% decline in their own.

C.Odendahl and J.Springford: The EU must triple down on green investment (24 March 2022)

During the pandemic, Europe found common resolve in fiscal policy that few thought it could gather. Considering that, Europe's security (and once more its economic recovery) is at stake again, now with the war in Ukraine, it is *in the interests of the richer North that the East and the South can invest. The Recovery and Resilience Facility smartly combines transfers from richer to poorer member-states, and cheap loans, in return for reforms and investment commitments. Europe should put together a RRF 2.0 to focus on energy that is green and secure, that is, on projects that can rapidly reduce the need for imported fossil fuels. That would make Europe as a whole less vulnerable to Russia and will allow all countries to invest in energy and defense with the same boldness that Germany has done. European policy-makers should use this crisis to secure the triple dividend that green investment can bring: make Europe less dependent on Russian energy, help fight inflation and reduce Europe's carbon emissions. Match that with a triple funding of taxation, national and European borrowing, and Europe will have made another big step forward towards meaningful integration where it matters: in protecting two of the most important public goods, security, and a stable climate.*

M. Obstfeld: The G20 Must Speak Truth to Putin (31 March 2022)

One prominent and direct repercussion of Russias's invasion of Ukraine is the prospective fall in global food supply. Even before the invasion, the food prices were approaching record highs due to the confluence of factors that generated food-price spikes in 2007-08 and 2010. Ukraine and Russia are top exporters of wheat, maize, sunflower seeds and oil. The UN Food and Agriculture Organisation estimates an 8-22% increase in food prices over the course of this year and the next. The G20 was urged to collectively reject beggar-thy-neighbour food export taxes or controls a they produced massive increases in global food prices in the past. Even though part of the global economic shock from the war is due to the sanctions. However, these would be sacled back if Russia withdrew its forces. The G20 summit must go on even with deep disagreements between members. The group must demonstrate the it is capable of condemning the realities of an uncomfortable situation. A communiqué candidly indetifying Russia as the source of both the problem and its remediation could be endorsed by the bulk of members. Even though substaintive agreement will advence global welfare, nonetheless, it is important that fundamental disagreements are acknowledged.

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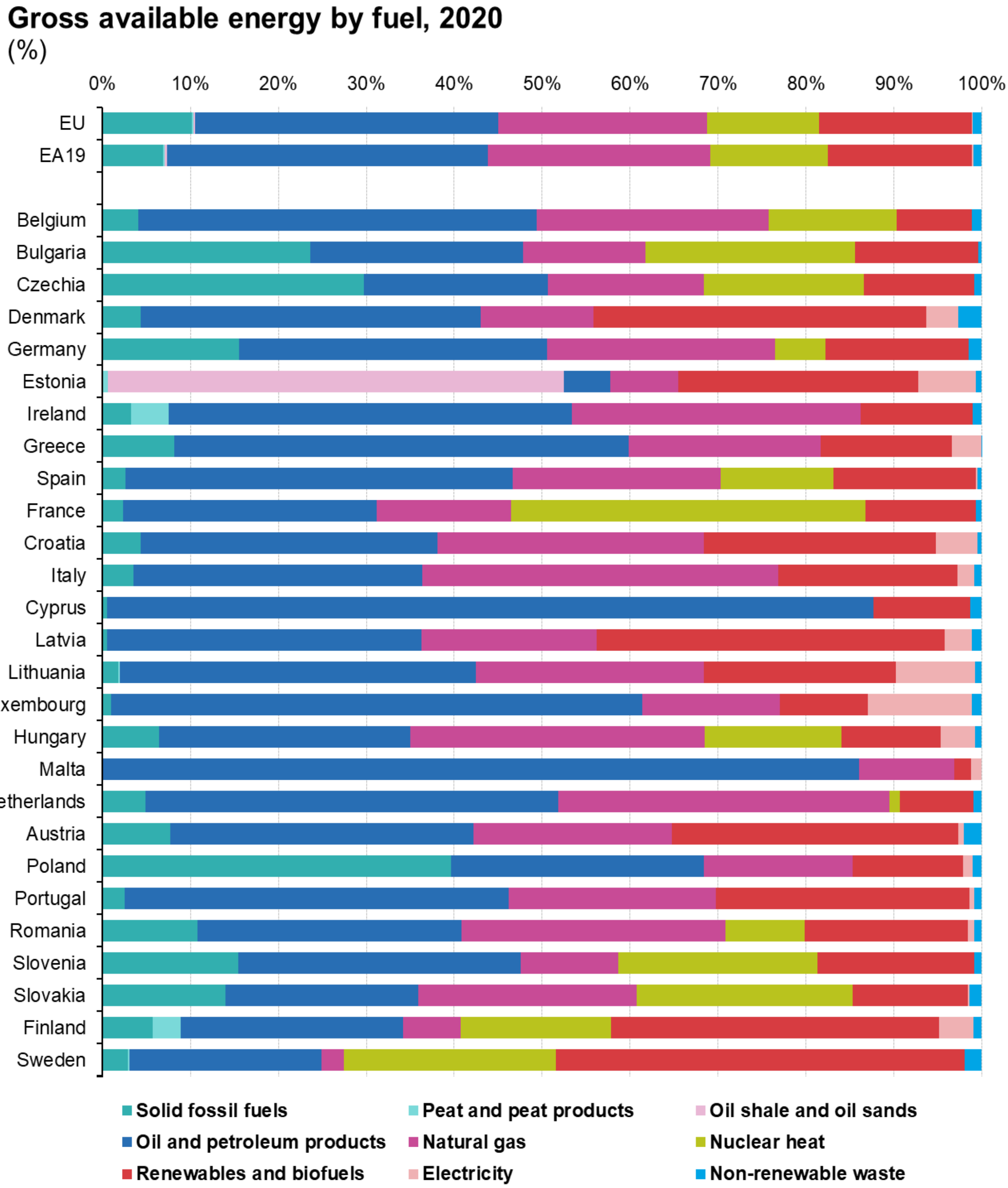
Annex 1: Energy mix in EU Member States in 2020



Source: Eurostat

Annex 2: Some recent estimates on economic effects of total or partial embargo of Russian energy imports

Institution	Key scenario	Methodology, assumptions, restrictions	GDP reduction in %	Additional inflation	Region affected
Bachmann et al.	Full embargo of all energy imports from Russia	Key assumption: share of fossil energy imports (gas, oil and coal) in German production is small to begin with at about 2-2.5% of GDP Complex multi-sector model Uncertainty surrounding elasticities of substitution, which is hard to discipline empirically, especially for large changes in the economy's input mix Macroeconomic analysis is hence subject to a large degree of uncertainty	0,2-0,3	-	Germany
Bachmann et al.	Full embargo of all energy imports from Russia	Simplified model 10% oil, gas, coal shock	2,2	-	Germany
Bachmann et al.	Full embargo of all energy imports from Russia	Simplified model, 30% gas shock	1,4	-	Germany
Bayer, Kriwoluzky, Seyrich (DIW, 2022)	Full embargo of gas and oil from Russia	Effects on the financial sector disregarded No analysis of effects on diffent industry sectors Assumption that Maastricht criteria remain suspended Effects on perceived government default risk (and spreads) disregarded Assumption that private consumption will not be affected	3	2,3	Germany
Baqaee, Moll et al. (Conseil d'Analyse	Full embargo of all Russian energy imports	Estimates rest on the assumption that the firms have the possibility to substitute intermediate	EU: 0,2 - 0,3 Germany: 0,3	-	EU Germany;

Economique, 2022)		goods or inputs in the production process. Not taking into account this effect would lead to higher impact, but would not be realistic based on historical and empirical insights according to the authors.	France: 0,2		France
OECD forecast (17 March)	Full embargo of Russian energy imports	Effects along the production chain not taken into account, could lead to smaller impact.	2	3,5	Euro Area

Annex 3: Some key economic indicators for EU Member States

Country	Total energy dependency on Russia (2020)	Gross government debt to GDP ratio (2021)	Private sector debt, consolidated - % of GDP (2020)	Inflation March 2022 (e-estimated, p-previous month)	
European Union	24,4%	92,1%		6,2%	p
Euro area	23,8%	100,0%		5,9%	p
Belgium	24,3%	112,7%	192,0%	9,3%	e
Bulgaria	15,4%	26,7%	94,3%	8,4%	p
Czechia	23,7%	42,4%	81,9%	10,0%	p
Denmark	21,1%	41,0%	220,9%	5,3%	p
Germany	31,1%	71,4%	120,1%	7,6%	e
Estonia	21,4%	18,4%	104,4%	14,8%	e
Ireland	3,2%	55,6%	188,9%	6,9%	e
Greece	46,5%	202,9%	125,3%	8,0%	e
Spain	7,5%	120,6%	146,4%	9,8%	e
France	8,4%	114,6%	173,7%	5,1%	e
Croatia	24,7%	82,3%	98,0%	6,3%	p
Italy	23,8%	154,4%	118,7%	7,0%	e
Cyprus	1,7%	104,1%	259,7%	6,2%	e
Latvia	31,0%	48,2%	66,7%	11,2%	e
Lithuania	96,1%	45,3%	54,7%	15,6%	e
Luxembourg	4,3%	25,9%	316,8%	7,9%	e
Hungary	54,2%	79,2%	76,4%	8,4%	p
Malta	7,5%	61,4%	139,0%	4,6%	e
Netherlands	49,0%	57,5%	233,7%	11,9%	e
Austria	16,5%	82,9%	131,2%	6,7%	e
Poland	35,0%	54,7%	75,8%	8,1%	p
Portugal	4,9%	128,1%	163,7%	5,5%	e
Romania	17,0%	49,3%	48,4%	7,9%	p
Slovenia	17,6%	77,7%	69,7%	6,0%	e
Slovakia	57,3%	61,8%	95,3%	9,5%	e
Finland	45,0%	71,2%	153,3%	5,6%	e
Sweden	8,5%	37,3%	215,5%	4,4%	p

Sources: Eurostat, European Commission