

# A snapshot on potential impact of the Russia-Ukraina conflict

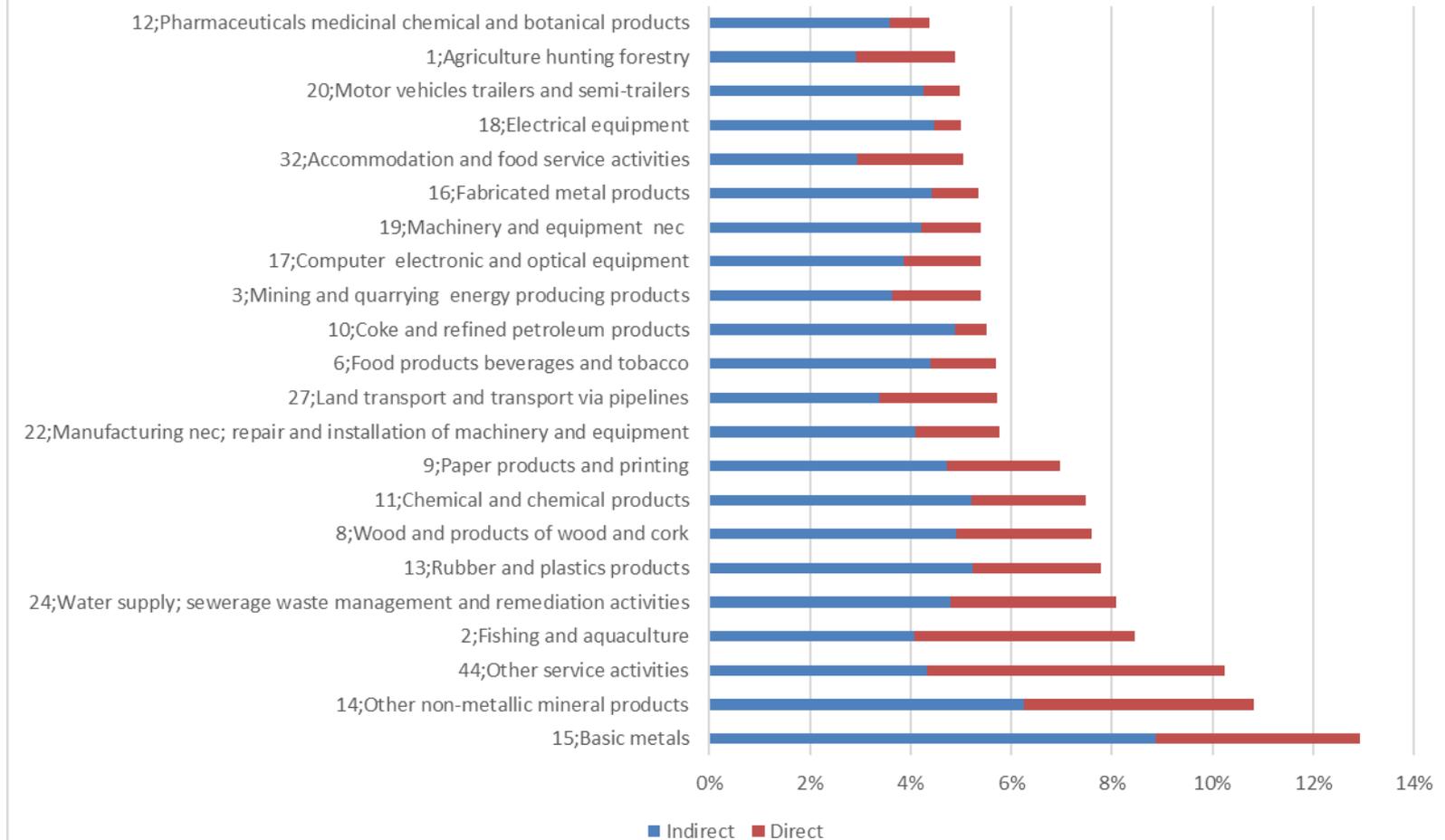
Back of the envelope calculations

Luxembourg

01/0/2022

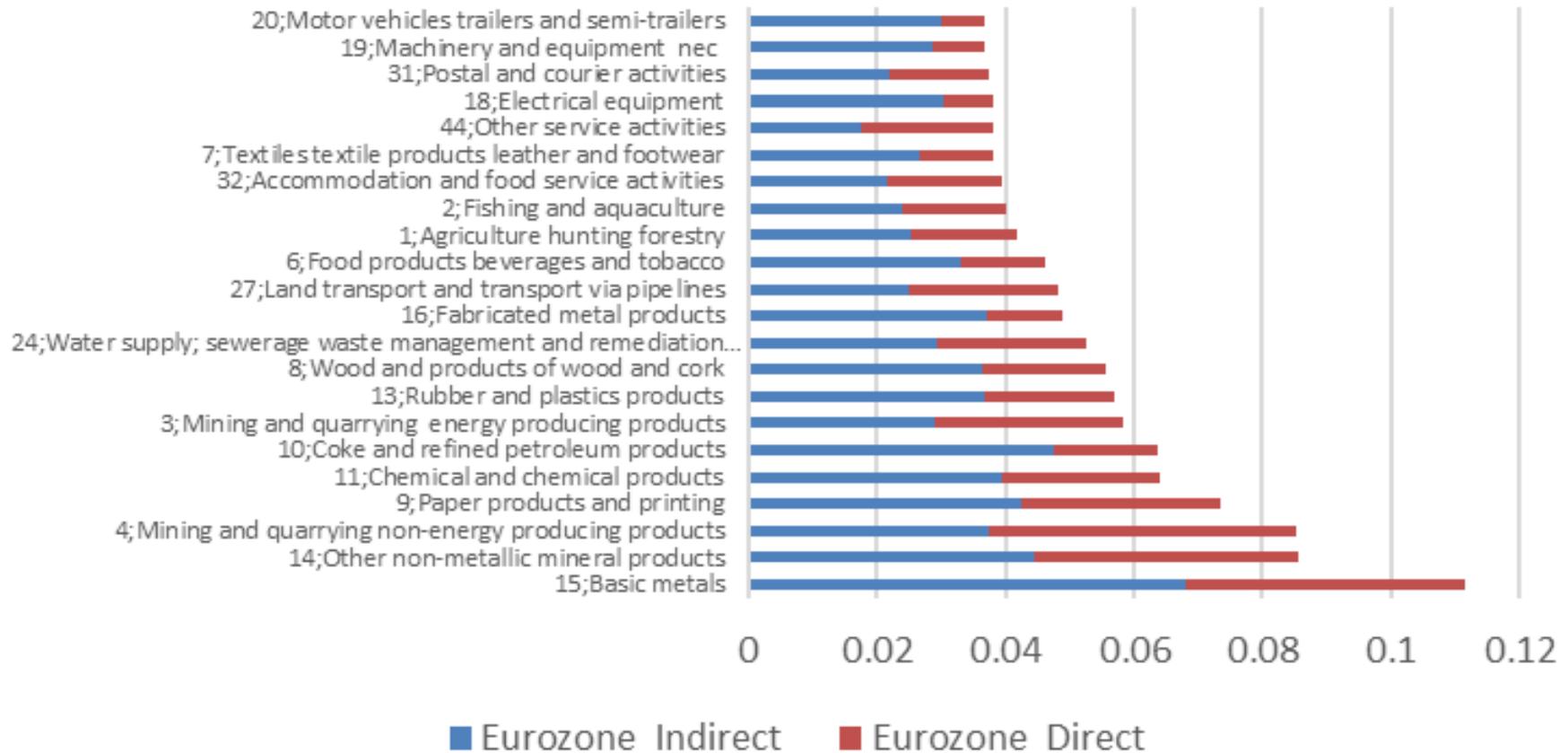
# The energy related channel: direct and indirect energy use in Italy

Italy: direct and indirect gas and electricity use by sector



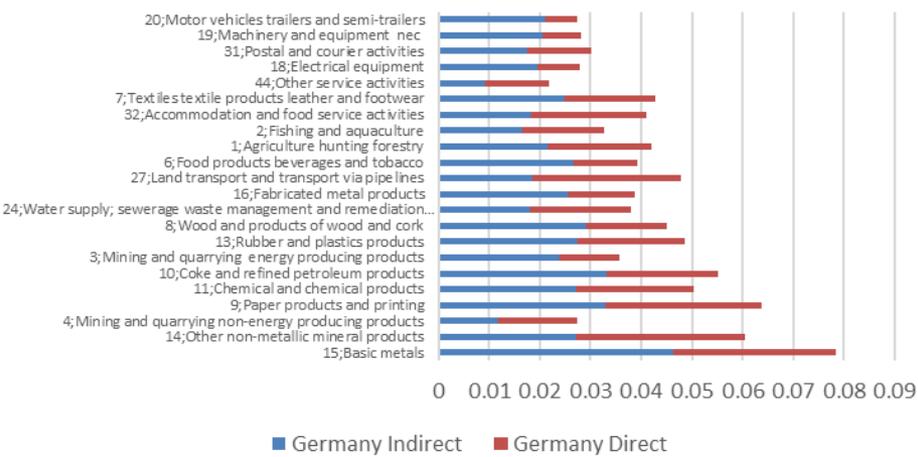
# Direct and indirect energy use in Eurozone

## Eurozone

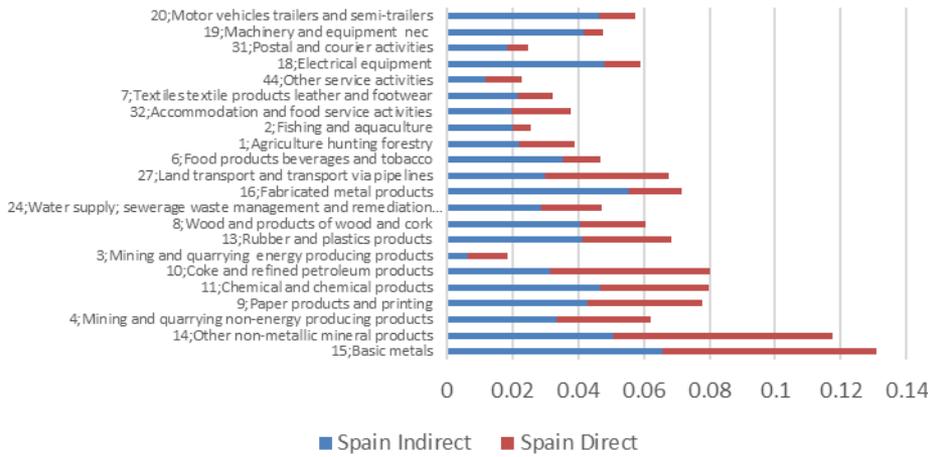


# Bigger (by GDP) EU countries

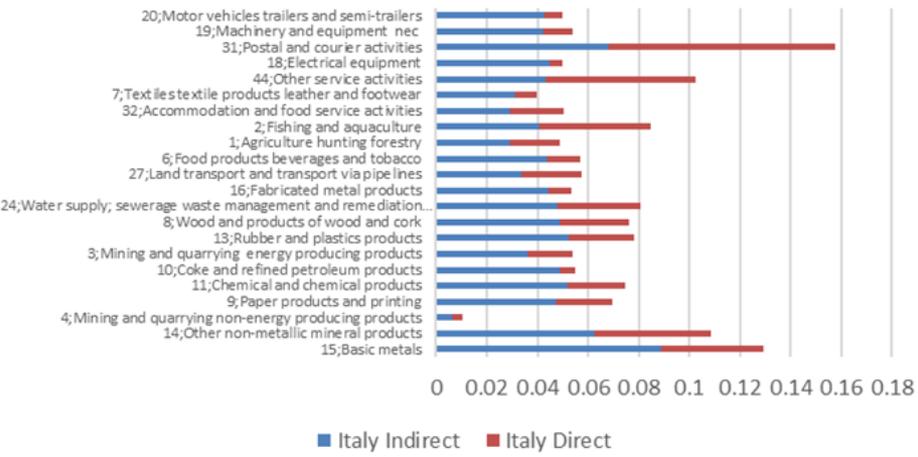
## Germany



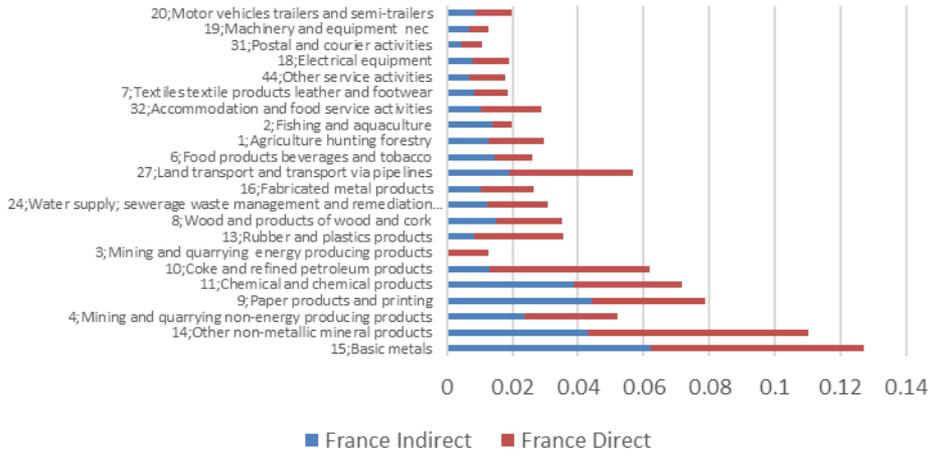
## Spain



## Italy

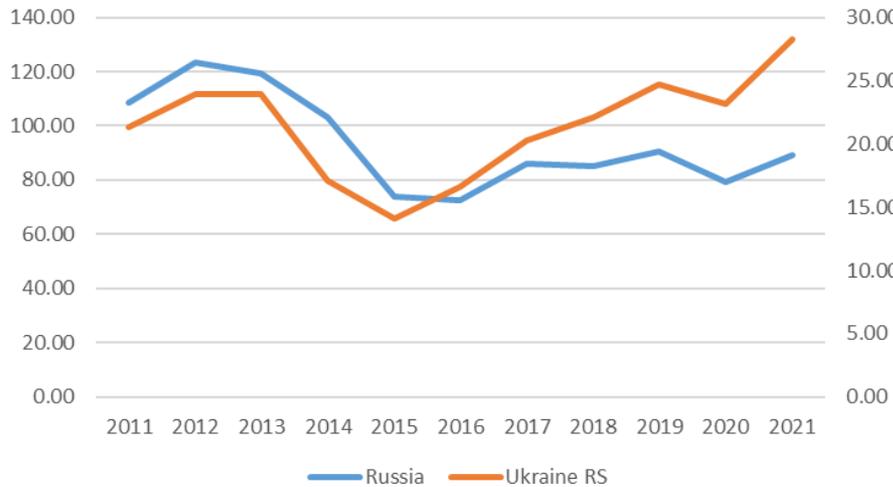


## France

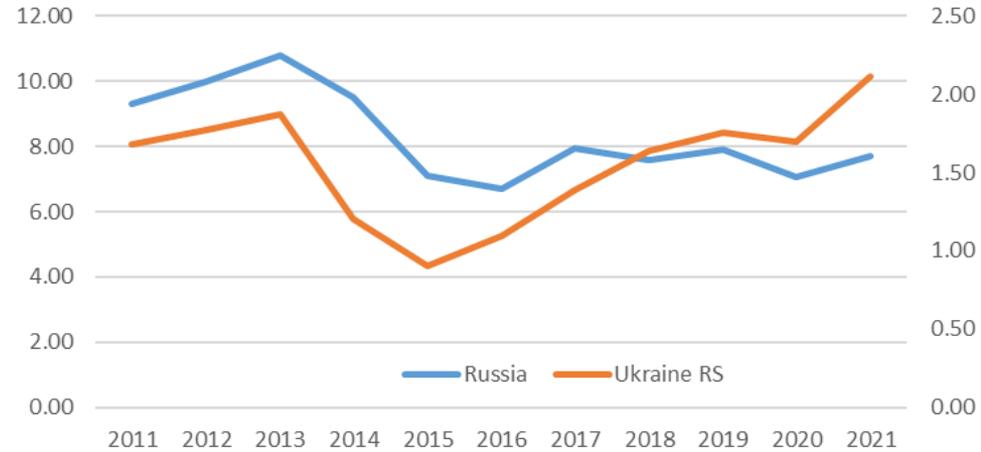


# The export channel

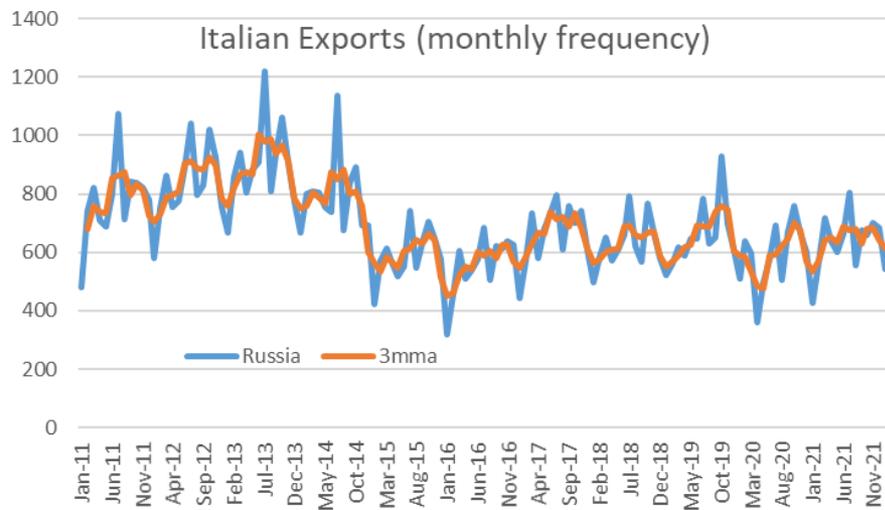
## EU27 exports (bn Euro)



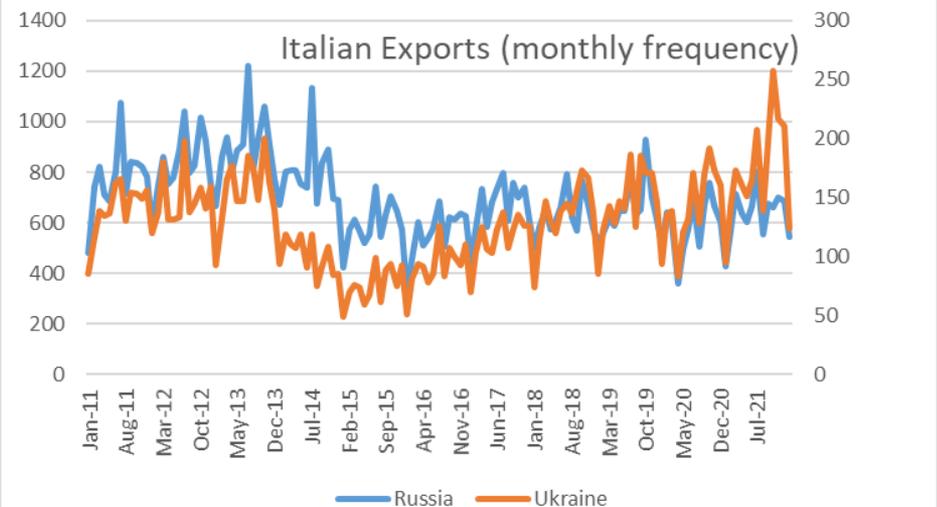
## Italian exports (bn Euro)



## Italian Exports (monthly frequency)



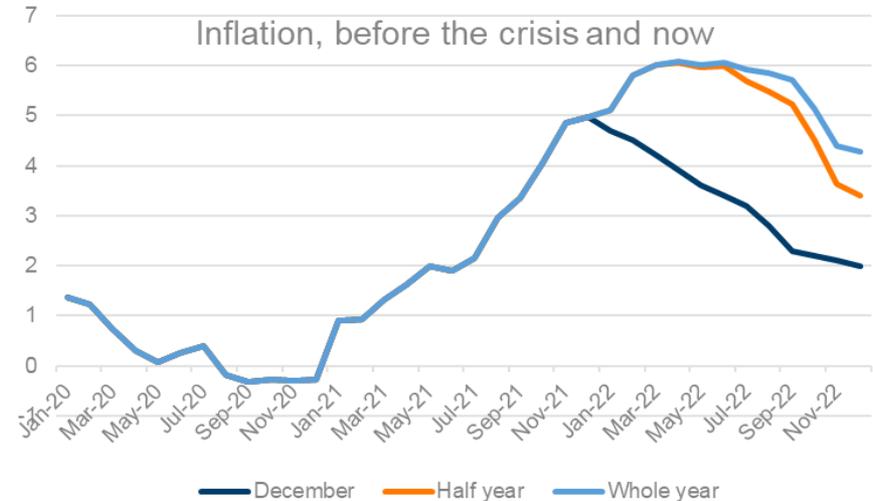
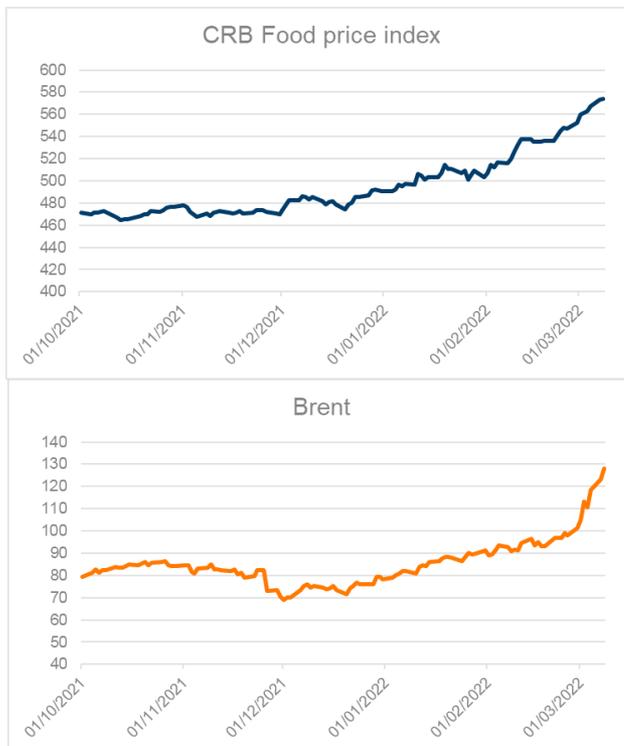
## Italian Exports (monthly frequency)



# The disposable income channel: an aggregate look at the price shock and at its repercussions on inflation

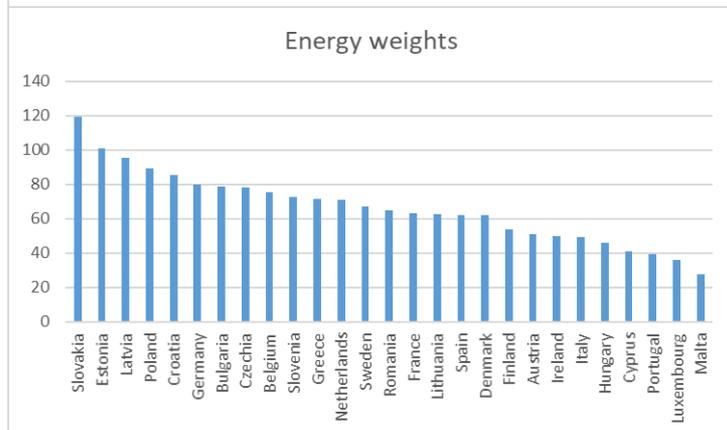
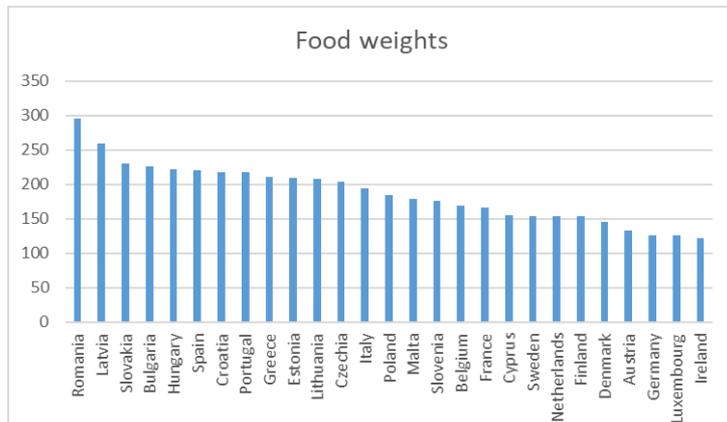
Ukraine and Russia jointly play a big role in world production and export of energy related products and agricultural, unprocessed and processed food products. Actually both prices are skyrocketing as a consequence of tensions. Assuming persistent pressures on prices (i.e. both food and oil prices staying at the level hit at the end of last week for the whole 2022 or for half of the year) ends up with the projections below for Eurozone inflation. Total impact on real disposable income or on real purchasing power can be in the order of 2-2.5% with respect to precrisis levels.

**Hypothesis on food and energy prices: 2022 average 45% higher than in 2021**



## 1 - energy and food prices in the basket of EU countries

The weight of the two items in the consumption basket in EU is not homogeneous. We used the differential weights to distribute the expected impact by countries. For food, among the weights making up the HICP provided by Eurostat, the category “Food and non-alcoholic beverages” is used, while for energy it is “Electricity, gas and other fuels”, a sub-category of “Housing, Water, Electricity, Gas and Other Fuels”



$$D_i = \frac{F_i - \bar{F}}{\bar{F}}$$

$D_i$  represents the percentage deviation of country  $i$  from the EU level energy basket

$$P_{\text{Adjusted}, i} = p_i (1 + D_{\text{Food}, i}) (1 + D_{\text{Energy}, i})$$

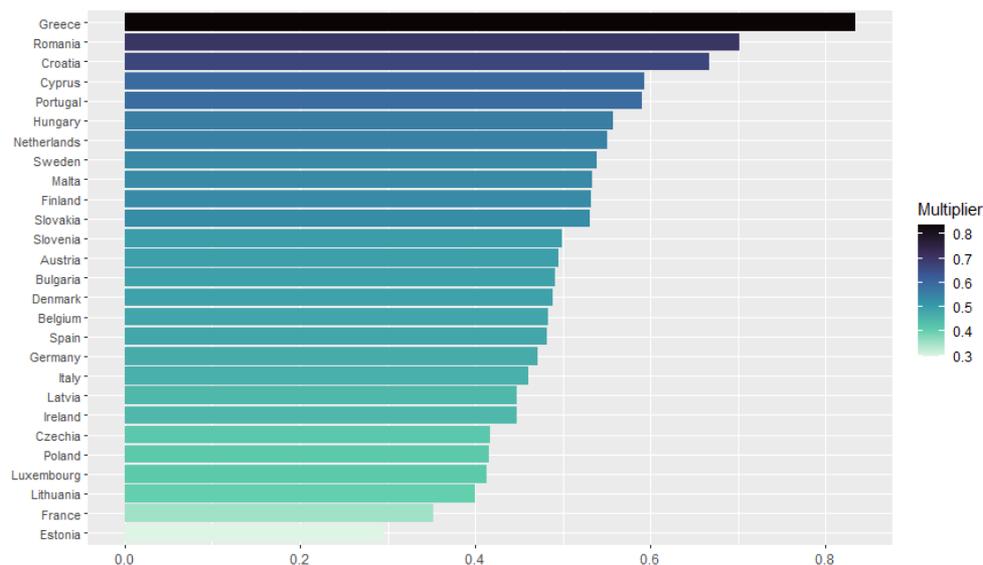
This information is then combined with the previously projected values of the Eurozone HICP and the MoM inflation rates for 2022.

## 2 – from the change in real disposable income to consumption

We now move to assess the impact on consumption of the rise in prices, while taking into account differences in the income distributions across EU countries. As a first step in the analysis, we take the ratio between each quintile's consumption expenditure and disposable income, for each member state with a simple hypothesis on ability to save as a determinant of this transmission. quintiles with a higher ratio of consumption to disposable income will have – all else equal – a lower ability to dis-save to maintain their consumption during periods of rampant inflation. Finally, we multiply the impact by the share of consumption expenditure for each quintile

Values of the ratio	Impact on consumption
Higher than 0.95	100%
Between 0.85 and 0.95	70%
Between 0.75 and 0.85	50%
Between 0.5 and 0.75	30%
Lower than 0.5	No impact

The graph shows the result of this calculation and represent for each country the multiplier we applied for moving from the (country specific) price shock (hence a real disposable income shock) to the impact on consumption.

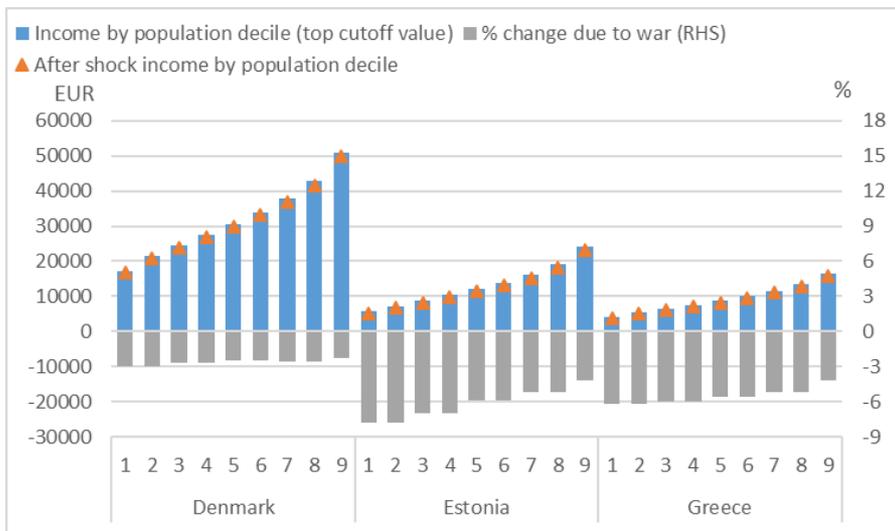


With all these ingredients, it seems likely that the impact on households real consumption can well be a drop in consumption growth by around 1.1% as a minimum, and without explicitly considering the other impacts (any transmission of uncertainty, lower activity and weakening labour market).

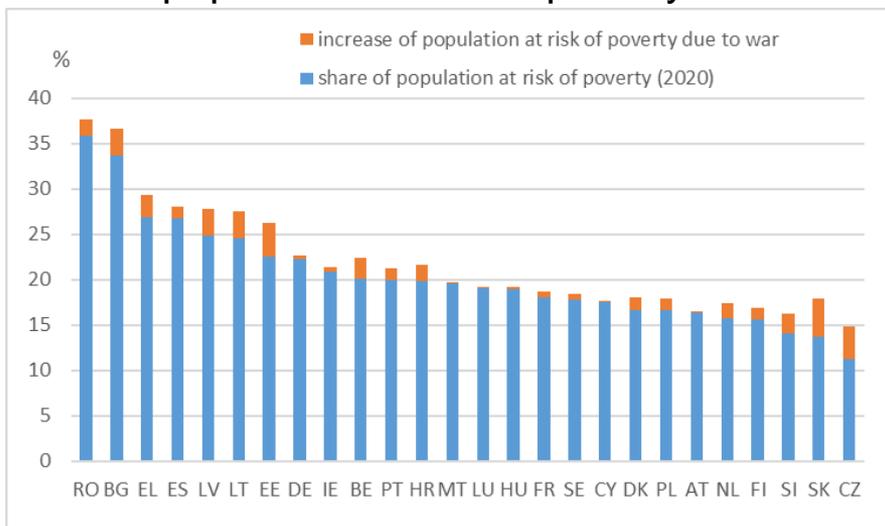
## Disaggregating the impact:

### 3 – the increase in the share of vulnerable population

#### The shock to income due to war

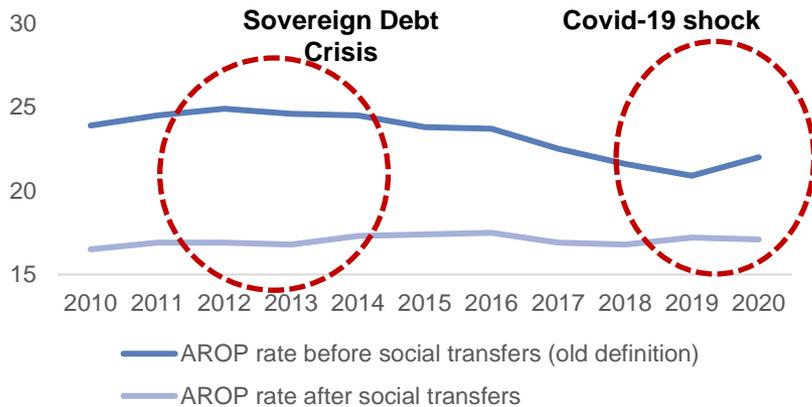


... translates to increase in population at risk to poverty

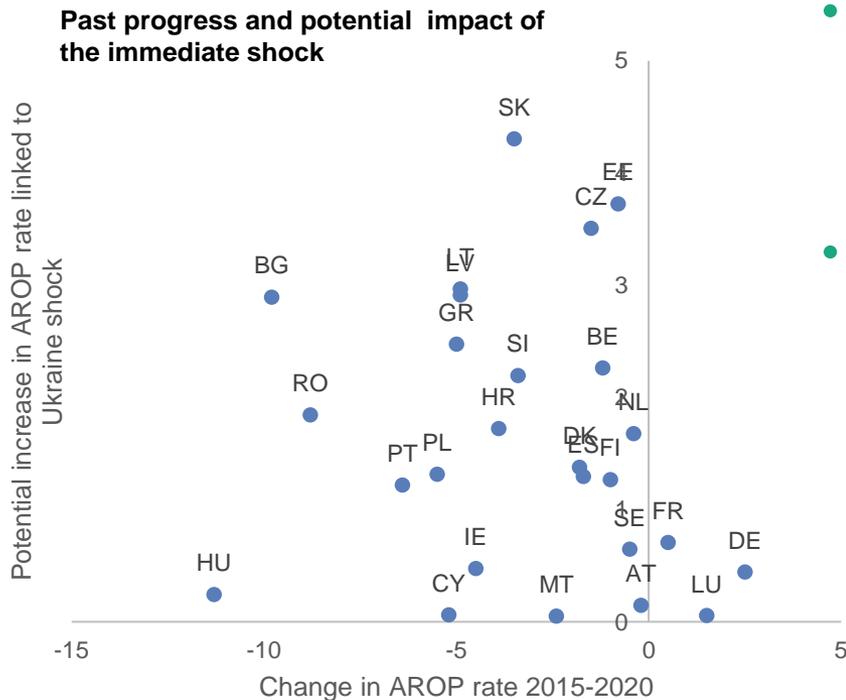


- Price increase of food and energy hits low-income earners disproportionately.
- Also within each country, the consumption basket changes with income, i.e. the lower the income, the higher the proportion of Food and Energy in the consumption basket.
- We used the share of Food and Energy expenditure in the consumption basket of each quintile of the population to distribute the impact of the price shock in each country as calculated above, and translate it in a disposable income shock across the income distribution.
- Households are particularly impacted in Romania and Bulgaria where the consumption basket is more sensitive to energy and food prices and where a relative large share of population is at risk of poverty, with a lot of countries more exposed and impacted in CEE.
- We applied a decile-specific real income shock due to war across the income distribution in each country. Using the after-shock income and the at-risk-of poverty income threshold (60% of median income), we have calculated the number of people that additionally became at risk of poverty. This adds up to one million people more at risk of poverty on the EU level (without Italy).

# Policy action needs to respond to mitigate risks for vulnerable households and lasting damage to social inclusion



- At risk of poverty rates peaked with the sovereign debt crisis but had started to decline. Policy measures helped to mitigate risks for households that resulted from the Covid-19 shock.
- In the absence of policy action, the new price shocks risk to severely set back progress in poverty reduction in some countries.
- Some groups stand to be hit disproportionately. Risk of poverty rates are higher for women than for men and almost double the EU average for single households with dependent children.

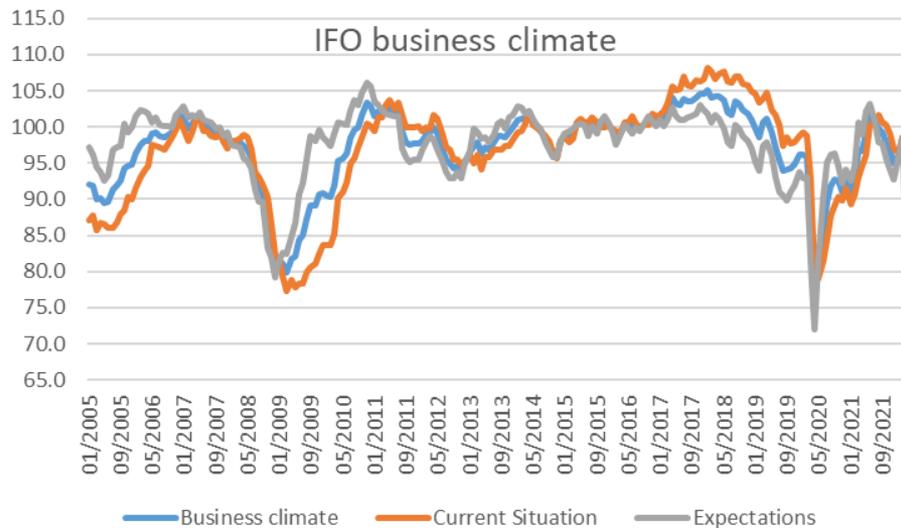


Note: AROP rate before social transfers, new definition. Includes provisional and estimated values for some countries.

# Emerging Policy responses to price shocks: Compensation, market intervention, risks of rising asymmetries?

- Social transfers play a key role in reducing vulnerabilities even in normal times (at risks of poverty rates after transfers are some 2 to more than 10 ppts lower).
- Member States have already been reacting to (risks of) price increases with different measures to support households, firms or halt price increases through market interventions.
  - E.g. bans to grain exports, temporary energy price cap regulation in Romania limits prices for households and SMEs, higher support for heating costs for vulnerable households in Germany...
- Transfer and benefit systems are country specific. To tackle immediate vulnerabilities, compensation for households (directly through transfers and/or tax systems) will likely be needed. Countries with larger shares of vulnerable people and more limited fiscal resources are in a more difficult position to protect and support the vulnerable parts of the population.
- Beyond household support, a strong **focus on maintaining employment** is necessary as a key source of household incomes → role for EIB to support viable firms. Well-targeted measures can help to maintain employment in viable firms hit by the shock and support corporate transformation (+ energy efficiency). Differences in willingness and ability to support could imply problems with a view to the single market
- There is a risk that higher needs for current expenditures negatively impact on local investment with potential negative impact on regional cohesion.

## First evidences on business surveys



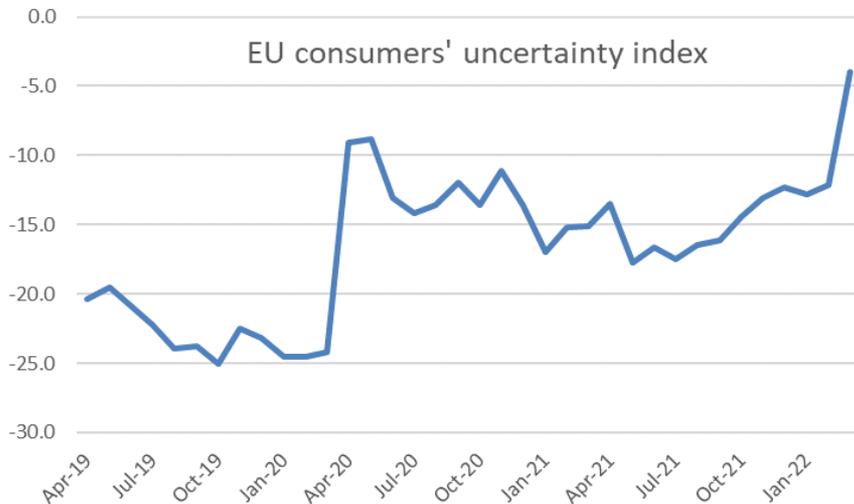
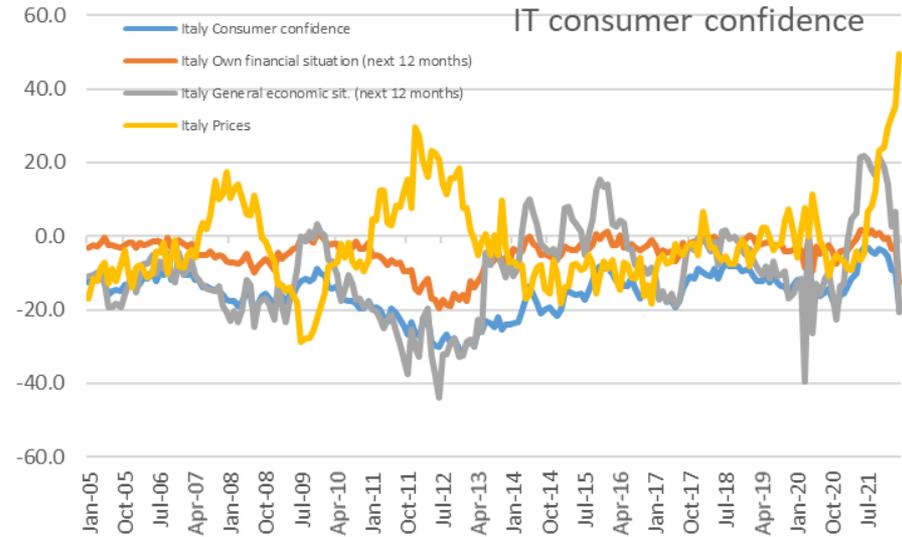
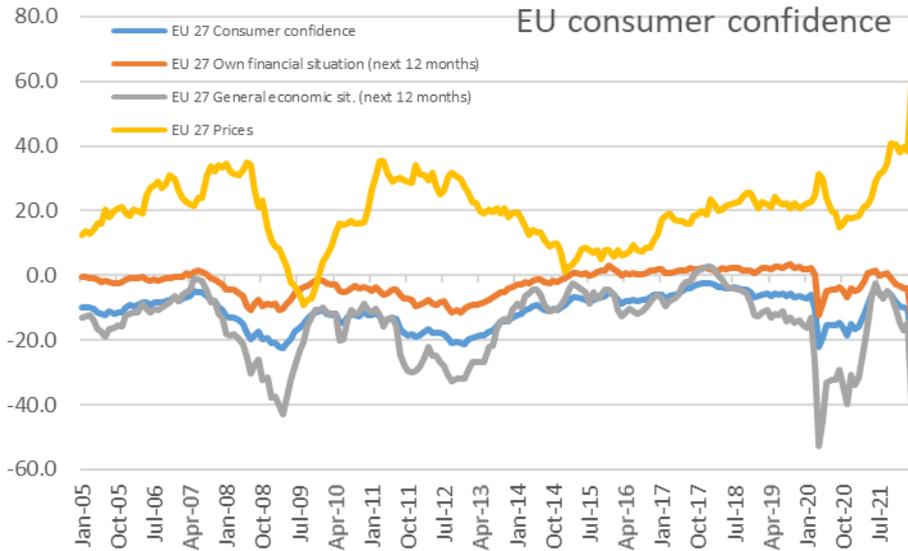
Ifo business climate declined from 98.5 to 90.8 in March. While Current Situation index stayed almost unchanged (down from 98.6 to 97) expectations plunged from 98.4 to 85.1.

.... You can believe in surveys or not (but we believe a lot in surveys, don't we?) but this is telling a lot. The sharpest decline EVER in expectations. Steeper than in March 2020 (-13.3 points vs -11.9).

Keep in mind that a level around 90 is a recessionary one as you can easily gauge from the graph on the left.

Companies in the manufacturing sector rated their business outlook as extremely uncertain. The plot on the right is the index for uncertainty (there is a specific question asking to managers how difficult is to predict the development of their company's business situation). Also in this case the increase was notable (even though a bit less steep than in March 2020).

# First evidences on consumer confidence



Focusing on consumers (the picture for Europe is clearer but in the end for Italy it is the same). Big drop in confidence due to prices expectations skyrocketing and to those related to general and personal economic and financial situation falling. Uncertainty (again, computed as the ability to project own situation in the future) jumped.