

POST-PANDEMIC AND UKRAINE WAR IMPACT ON ECONOMIC ACTIVITIES: ROMANIA CASE STUDY

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ABSTRACT

The aim for the current paper is to provide an overview analysis on the impact over Romania's post-pandemic economy, as well as the impact from the near border Russia-Ukraine war. As a result, the study will investigate the topic of consumers behavior, inflation rise, financial unpredictability and overall economic stability of the country.

In effect, the research shows that both the European countries, as well as the two countries involved in the current political confrontation have experienced high-levels of inflation rates, which affected their economic situation.

Additionally, this paper develops an investigation based on a sample of 109 respondents, regarding their current economic situation. The findings showed that the majority of them has had issues regarding their investments and also, are not very optimistic when it comes to market stabilization.

KEYWORDS: *financial stability, pandemic, war.*

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1. INTRODUCTION

While the global economy is recovering from the COVID-19 pandemic, another systemic shock has been felt worldwide. Russia's invasion of Ukraine marked a tectonic shift in the area of geopolitical risk. Beyond the effect of triggering a deep humanitarian crisis in eastern Europe, the economic impact of the conflict and the associated sanctions will be felt worldwide, slowing economic growth and contributing to rising inflationary pressures, which are already on an upward slope.

As a result, the economic perspectives for the next years will depend on several factors. Clearly, the conflict between Russia and Ukraine will play a major role on a short-term horizon with implications for both trade in goods, services and commodity prices, especially in Europe.

Of course, in the near future, the direction of monetary and fiscal policies, especially in advanced economies, will also play a role in shaping the path of economic growth. Managing trade-offs in economic policy-making will be difficult. The prospect of higher nominal interest rates, needed to combat inflation, and the urgency of fiscal consolidation will lead to a further slowdown in economic activity.

With this in mind, the year 2022 begins with several major challenges, such as: inflation, higher interest rates and the threat of a war very close to Romania's border that could have major economic implications for the country economy.

In particular, Romania was facing a pressing need to adjust its macroeconomic imbalances even before hostilities broke out. Romania has been under the excessive EU budget deficit procedure since the beginning of 2020 even though it is currently suspended due to the pandemic. Efforts to

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reduce the relatively large structural budget deficit in the coming years could have an indirect negative effect on economic growth.

Our focus for the current paper is to present the impact of post-pandemic period and Ukraine's war at national and international level, on the countries' economic situation.

2. LITERATURE REVIEW

Due to Russia's protracted and obvious hesitation, the issue of Ukraine's statehood remained debatable even after the December 1991 Independence vote (Dragneva-Lewers & Wolczuk, 2016). Russia, on the other hand, did not support the Maiden revolutionary overthrow of the democratically elected Yanukovich administration and the deepening of Ukraine's Western orientation (Pabriks & Kudors, 2015). The West has frequently emphasized Russia's animosity against Ukraine (Charap & Darden, 2014).

Russia's 2022 war on Ukraine, as well as the severe economic consequences of the harsh financial sanctions imposed on it, are nevertheless causing an economic disaster on President Vladimir Putin's Russia. The consequences are also threatening the global economy, causing financial markets to tremble, and making life more dangerous for everyone (Wiseman, 2022).

Russia and Ukraine are major exporters of oil, natural gas, coal, wheat, as well as other resources on the world market.

Several studies on the impact of previous Ukraine-Russia conflicts before the most recent crisis in 2022 have been published. Korovkin and Makarin (2019) investigate the economic consequences of the 2014 Russia-Ukraine war, noting that commercial interchange continued between the two countries despite the start of the conflict. Given that this is an ongoing situation with continuously updated material streaming in via various news channels, very little academic study collection has been performed on the 2022 Russia-Ukraine conflict. Furthermore, much emphasis is being placed on the consequences of the present Russia-Ukraine situation on Russia and Ukraine.

According to experts, Europe will experience increased prices and supply chain disruption as a result of Russia's invasion on Ukraine in 2022.

Saudi Arabia's refusal to release extra oil supplies to complement Russia's if exports fall would have a significant influence on world oil prices (Lanktree, 2022).

Russia is not just the world's largest supplier of natural gas and oil, but also a key exporter to Europe (Bhattarai et al., 2022).

Top EU financial officials warned that, while Russia's present aggression on Ukraine may delay EU economic development through higher energy costs and diminished business confidence, the "European Union is ready for it" (Thomas & Strupczewski, 2022).

3. POST-PANDEMIC AND UKRAINE'S WAR EFFECTS AT MACRO-ECONOMIC LEVEL

Mobility restrictions initially led to a decrease in both consumption and production. Governments have spent huge sums to finance the technically unemployed population as well as helping companies to cope with closed or sharply diminished income, while tax revenues have fallen, resulting in unprecedented deficits since the financial crisis.

Accordingly, in the European area, business activities slowed from the beginning of 2022, with outlook indicators suggesting that the region could decline this quarter, consumers being reluctant to spend serious amount of money due to the high cost of living as well as economic and social uncertainty.

Therefore, at the present time, the European Union (EU) and its Member States have taken steps to minimize the negative impact of the COVID-19 pandemic and the war on the economy.

In detail, on April 23rd 2020, EU leaders have decided to work towards the establishment of a European Union recovery fund to mitigate the effects of the crisis. They called on the European Commission to urgently present a proposal that would clarify the connection between the fund and the EU's long-term budget. The proposal, a recovery plan for Europe, was presented by the European Commission on May 27th 2020 (Council of the European Union, 2022). In addition to the recovery package, EU leaders have agreed on a long-term EU budget for the 2021-2027 period of 1074.3 billion EUR. Among other things, the budget will support investments in the digital transition and the green transition, as well as in resilience. Together with the existing 540 billion EUR in funding the overall EU recovery package amounts to 2364.3 billion EUR.

Equally important, the inflation from the Euro Zone hit a new record in June 2022 and compared to the same period from last year reached a level of 8.6 (2022 CNBC LLC. , 2022). Not to mention that inflation was 8.1% in May, which means that prices continue to rise in the European countries.

By the same token, there are more and more questions about the future of the monetary policy in the Euro area, amid fears of a recession in the coming months. In the hypothesis that The Central Bank were to raise the interest rates rapidly, this could further hamper the economic growth at a time when a slowdown is already being felt by the consumers.

In comparison, after joining the European Union, inflation in Romania continued its downward trend towards the European average - although still consistently above it - with higher upward fluctuations in periods of rising the demand for loans (as in 2007-2008) and in periods of taxes increases (2010-2011), respectively with minimums and even negative rates after the decrease of taxes. As can be seen in Figure 1, during the COVID-19 crisis, consumer prices slowed from an annual inflation rate of 4% in 2019 to 2.1% at the end of 2020. In the euro area, inflation went from 1% to -0.3%. Starting with the year 2007, Romania's inflation rate surpassed the euro zone inflation rate. The only periods when Romania had a lower inflation rate were in 2012 and 2015.

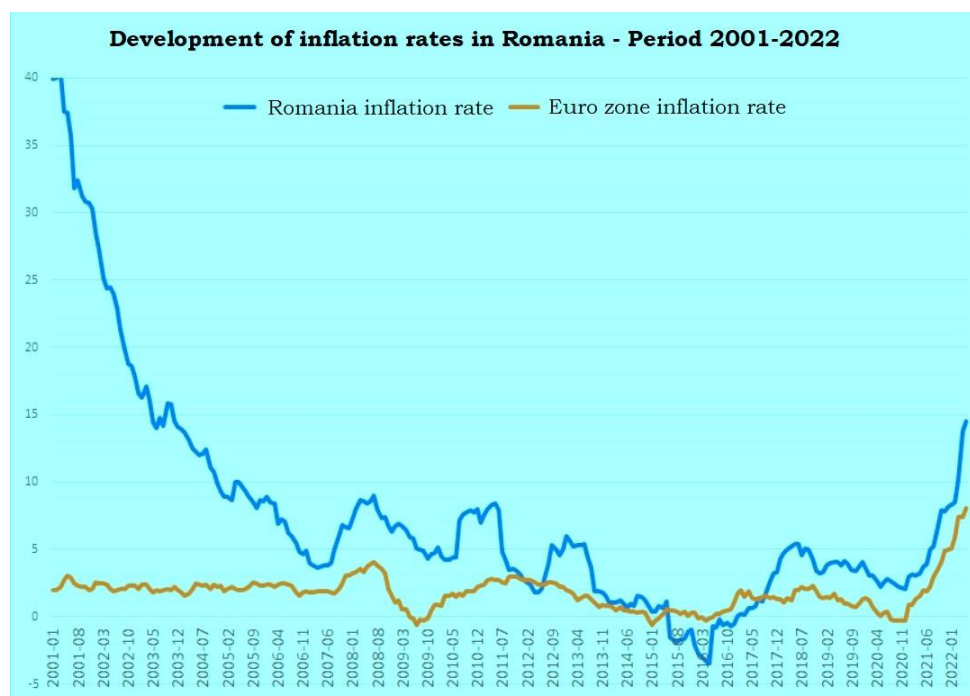


Figure 1. Romania's Core Inflation Rate 2001-2022

Source: authors calculation from (Eurostat, 2022)

In addition, Romania ended 2020 with a fiscal deficit of 9.3% of GDP, the largest in 30 years – as can be seen in Figure 2. The deficit has also been high in 2021, and will continue to stand at over 6% this year and next.

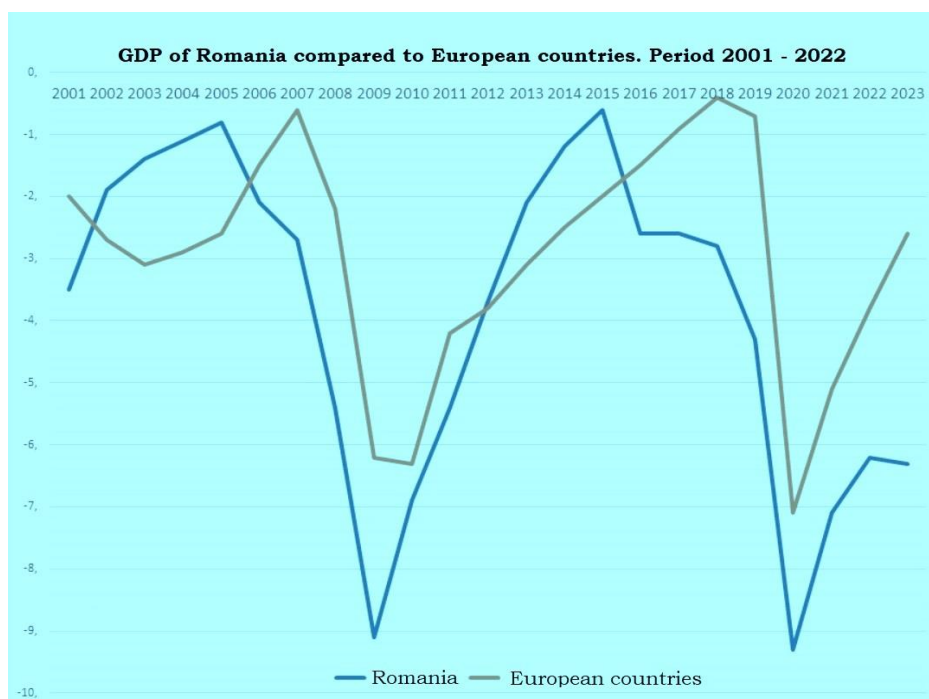


Figure 2. GDP comparison Romania – European countries

Source: authors calculation from (Eurostat, 2022)

Both figures present an undesired situation of Romania's situation, from the GDP's and inflation rate's point of view. In the current context, our country still "suffers" from the post-pandemic effects. These negative impacts will continue further on with the war from Ukraine, which will affect the majority of European countries, both at a micro-economic level, and a macro-economic level.

With this in mind, in the international economic we can observe the use of the term "stagflation", which usually characterize an economy with persistent inflation combined with high unemployment rate and a stagnation for the demand growth. If in the European markets we can discuss and research the phenomenon, in Romania stagnation is not considered a threat. Indeed, part of the stagflation, inflation is present, however, unemployment is extremely low. In our country, we can appreciate that we have a labor shortage (VASILE, et al., 2020). Correspondingly, the aggregate demand in value terms has not really stagnated either, but has been consumed by the increasing energy prices, insurance, food products and services in general.

3.1 Case study: Romania

In the context of the economic slowdown caused by the pandemic and social distancing measures, the European governments have supported the economies by issuing "new" money, easing credit, and other measures to increase the money supply. These policies were necessary and relatively correctly calibrated by the central banks. On the other hand, the risk of inflation was known and highlighted as a predictable negative effect, less destructive than the alternative of no economic or social intervention. In these conditions, the current international economic situation has heightened the need for an extensive analysis in our country as well.

In addition, the steady increasing of the current account deficit which stands at -7.1% of GDP in 2021, the second largest in the EU would require a gradual and rather immediate correction, in order to avoid further rising costs. Additionally, increasing inflation is likely to continue to put pressure on nominal interest rates, eroding consumers' purchasing power and limiting short-term economic growth. However, by supporting appropriate policies designed to encourage investment

and stimulate long-term growth, Romania could more easily overcome this crisis. The full absorption of funds available through the EU Recovery and Resilience Fund would go a long way in improving the prospects for economic growth

Accordingly, Romania needs to adapt and align with the changes in the economic structures generated by the pandemic and the global trends in the implementation of policies and strategies aimed at the transition to a green economy. Romania will also have to make up for delays in vital domains such as health, infrastructure or digitization.

In consonance with the (National Institute of Statistics, 2022) report the Romanian national currency will end next year with a 30% decrease in purchasing power compared to the end of 2020, according to official forecasts. The three years of "recovery" after the COVID 19 crisis will gather as much inflation as they did in the 10 years before the pandemic.

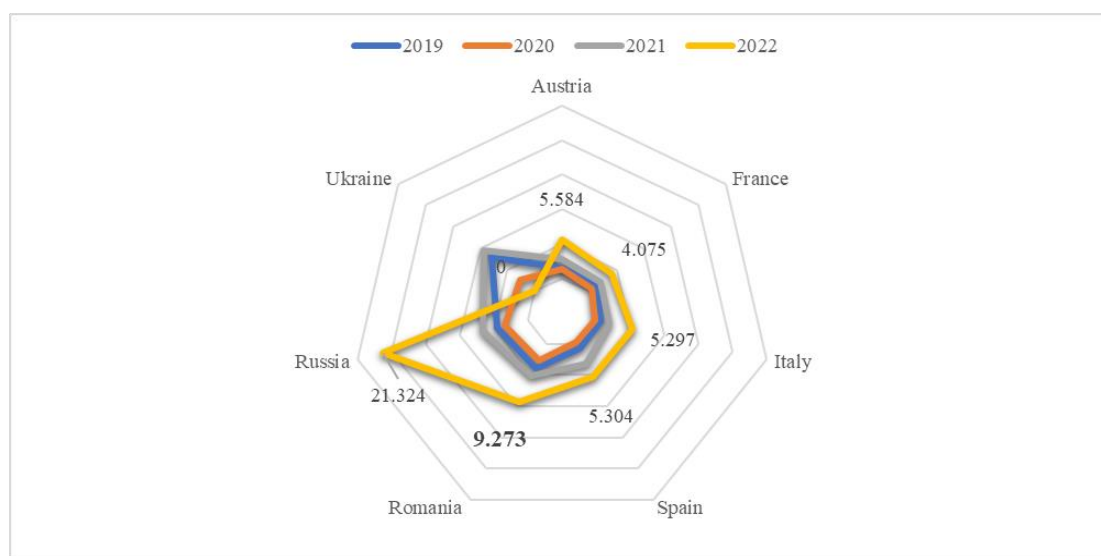


Figure 3. Inflation (average consumer prices), percent change

Source: IMF World Economic Outlook Database, April 2022

The above figure (figure 3) presents the average consumer price, more precisely, the change observed in percentage, until April 2022.

To ease our comparison, we have compared Romania with four European countries (France, Italy, Austria and Spain) and with Ukraine and Russia. For 2022 (at least until April), among the five European countries analyzed, Romania had the highest percent change, respectively 9.273, meaning that our country was more affected from the Ukraine's war.

For 2022, for Ukraine, there are no data available, but the inflation in Russia, reached a percent change equal to 21.324 (an enormous value which affected their entire economy and continues to affect it as well in the present).

Figure 4 presents the negative influence from the Covid-19 waves during its most accentuate surge in a comparative analysis with Hungary and Poland.

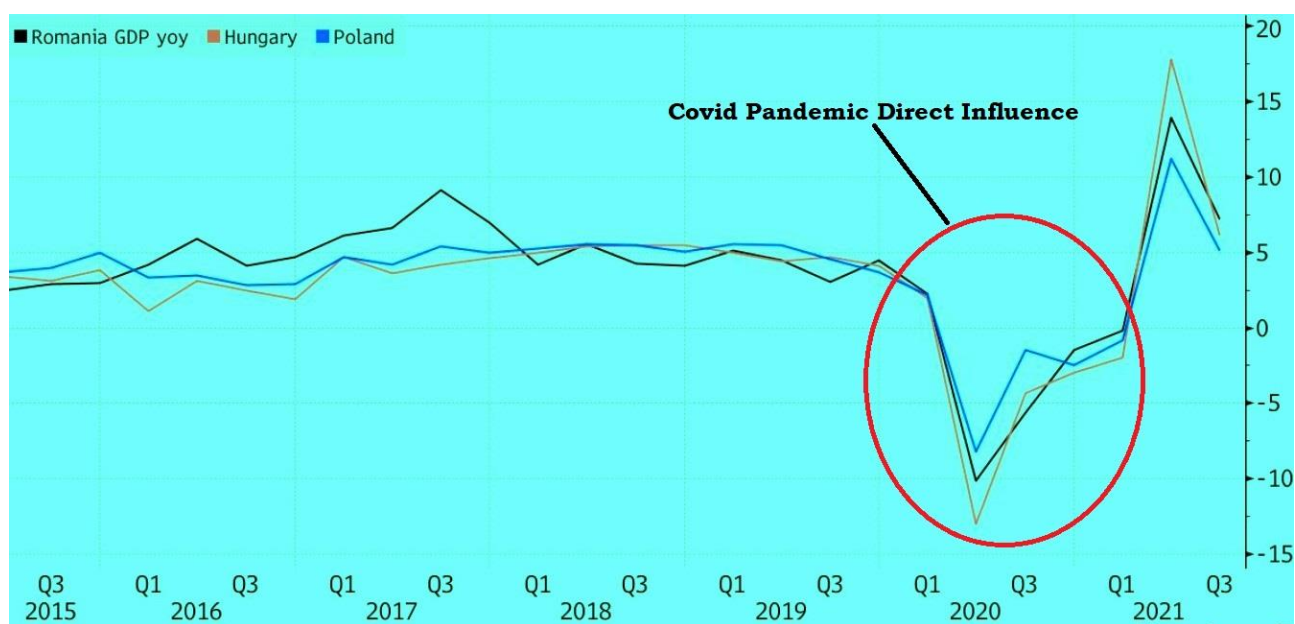


Figure 4. The influence of the pandemics on Romania's GDP
 Source: authors adaptation from (Bloomberg LP, 2021)

Similarly, according to (European Commission, 2022) before the outbreak of the Russian-Ukrainian war, the economic prospects of the European Union indicated a long and robust economic expansion. However, the Russian invasion of Ukraine created new challenges, at a time when the EU had just recovered from the economic impact of the pandemic. The new upward pressure on commodity prices caused further supply disruptions and increased uncertainty. This has led the European Commission to carry out a downward revision of the Union growth prospects, and an upward revision of its inflation forecasts.

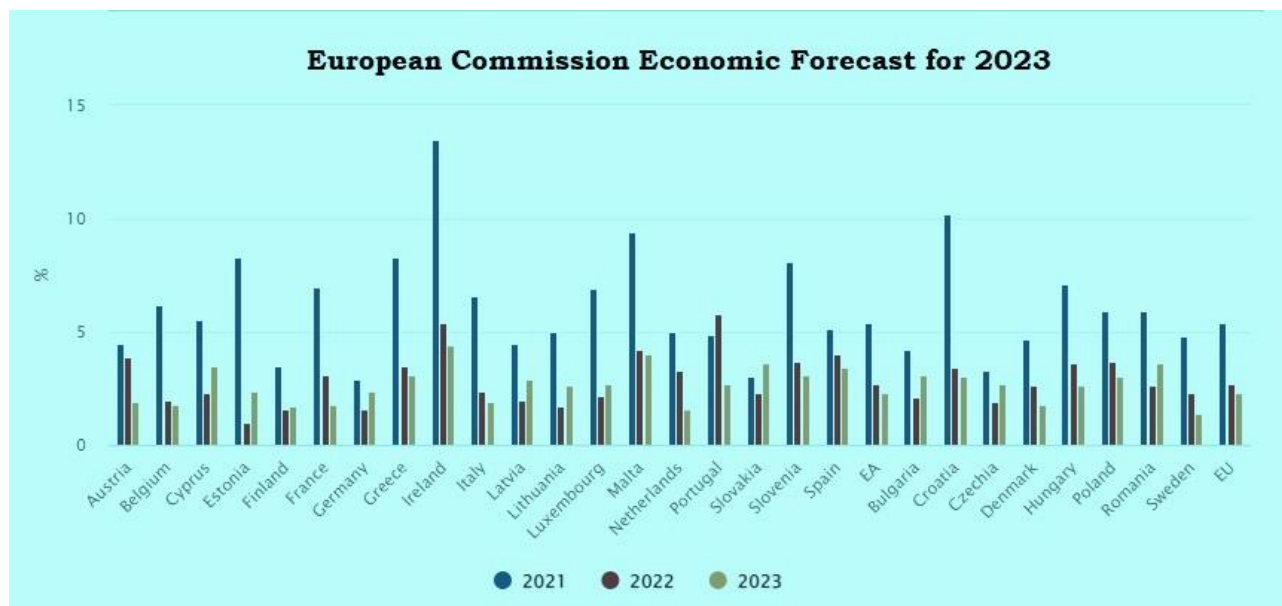


Figure 5. European Commission Economic Forecast for 2023
 Source: authors adaptation from (European Commission, 2022)

Likewise, in the (Global Economic Prospects, 2022) report, the World Bank also forecasts that Romania's GDP will grow by 3.7% in 2023, and in 2024 it would be an increase of 3.9%. Therefore, the slowdown in economic activity at European and global level, according to the

estimates of international institutions, also induces a slowdown in the dynamics of the national economy.

Specifically, Romania's economy is a small economy globally, which makes our country very vulnerable to the movements of international flows. Nevertheless, in 2022, Romania's economy is significantly improved compared to the previous crisis in 2007. For example, at the macroeconomic level, the nominal GDP exceeded 300 billion USD, and the GDP per capita is over 16,000 USD, almost double compared to 2007. Moreover, unemployment rate is low, the only serious problems being the budget deficit and high inflation, both of which are a general feature of post-COVID global economies. In terms of monetary indicators, the situation of the local financial system is much more stable compared to 2007.

3.2 Destabilizing the energy market

The energy market in Romania (oil, gas, electricity) is a central subsidiary of the economic system. By the same token, the rising in energy prices amplify the risks of recession. Therefore, European money markets have lowered their expectations of an aggressive increase in interest rates.

Accelerating the growth of the annual inflation rate in the first months of the second quarter of 2022 continued to be driven by global supply shocks, amplified by the war in Ukraine and the sanctions imposed, which drove and boosted the sharp rise in global inflation.

At an international level, several aggressive environmental protection policies, together with the declining demand during the pandemic, have caused several results. First of all, lower energy investments, rising the costs per unit and a deficit in global production. Specifically, in Romania, one of the countries normally able to cover from its own sources most of the energy needs on the electricity side, and a large part of the oil and gas needs, the situation is more a consequence of the European measures.

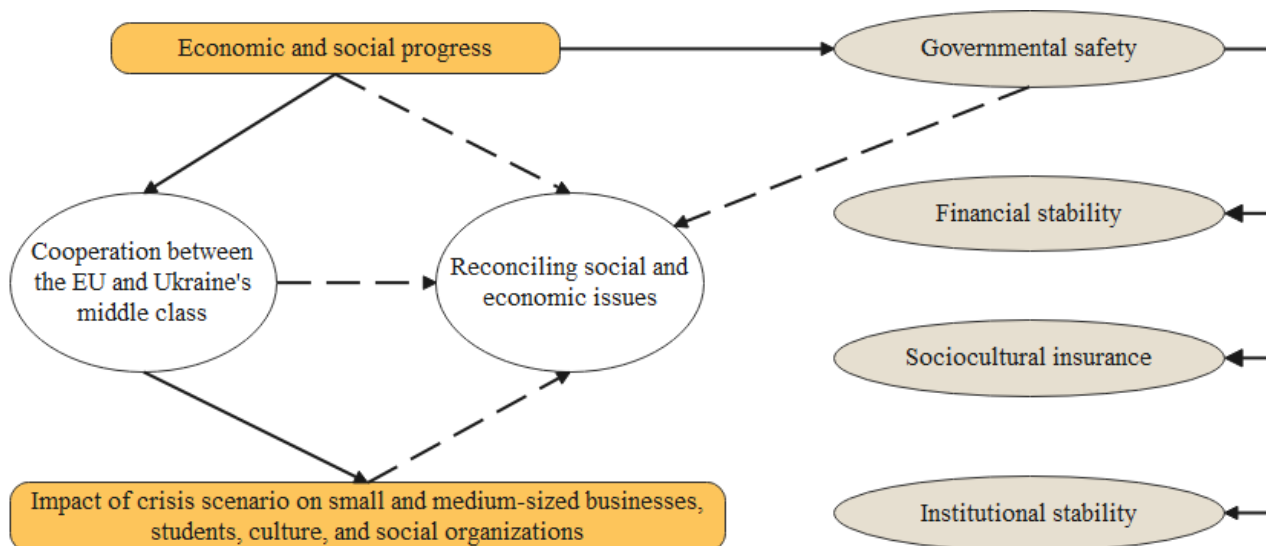


Figure 6. Mechanism for resolving the social and economic effects of the war in Ukraine

Source: Authors' adaptation from Stukalo & Simakhova (2018)

People's deaths, migration, criminality, unemployment, low average earnings compared to Europe, adverse effects on public life and integration, and the need for infrastructure reconstruction are the primary social difficulties of the military conflict in Ukraine. All these socioeconomic repercussions of the war in Ukraine have created an unstable region in Europe and affected geopolitical ties within this continent.

Without a doubt, Ukraine requires a unique strategy to address all of its social and economic issues. Utilizing the sophisticated European expertise and Ukrainian resources that are currently accessible

will only be achievable with an integrated strategy. A possible method for addressing the social and economic issues of the Ukrainian crisis was subsequently offered (figure 6).

4. RESEARCH METHODOLOGY

Each one of us has been affected, at some point, by the Ukraine's war, in a direct or indirect manner. To see how the Romanian people have been dealing so far with the war's effects, we have decided to create a questionnaire which will present the current situation from an economical point of view. The data was gathered during a 3-month period, from May until July 2022. We had a sample of 109 respondents. All respondents were active employees when they answered the questionnaire. The survey was distributed online, via GoogleDocs, and presented 10 questions. Out of the 10 questions, we have focused on four important ones, relevant to our research context and presented in the next section.

4.1 Results

The results were not surprising at all, especially since the Ukraine's war has left a mark on every person's financial situation.

One of the most relevant questions was **Q1: "Has the Ukraine war affected you from an economic point of view?"**

The answers received are depicted in figure 7:

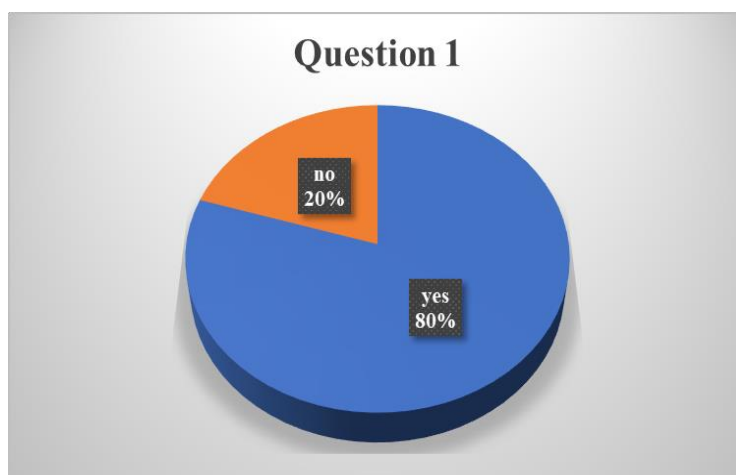


Figure 7. Question 1
Source: Authors' computations

Because we tried to avoid general answers, for each question we have asked the respondents to justify their answer. Among the most predominant answers were the higher costs remarked in almost every sector and the increase of the inflation rate.

Next question, **Q2: "Do you feel unsure regarding your financial assets?"**

The answers received are depicted in figure 8:

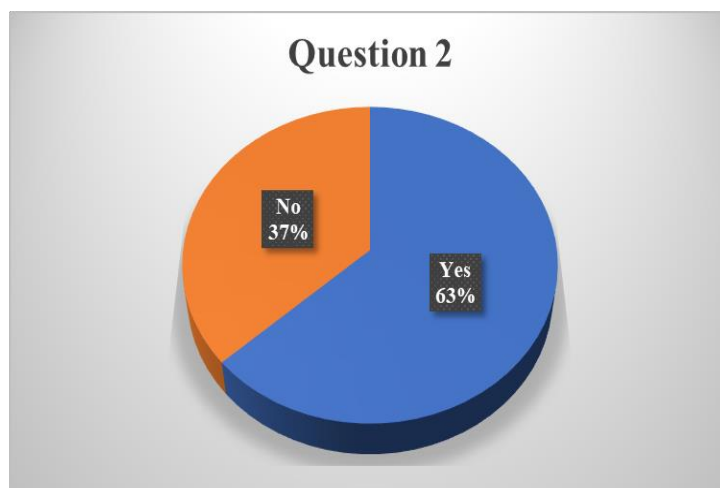


Figure 8. Question 2
Source: Authors' computations

In this case, our respondents justified their answers by stating that they had financial investments and cryptocurrencies investments, which drastically decreased their values.

The following question, **Q3:** "Did you had investments that lowered their value once the Ukraine war started?"

Answers can be seen in figure 9:

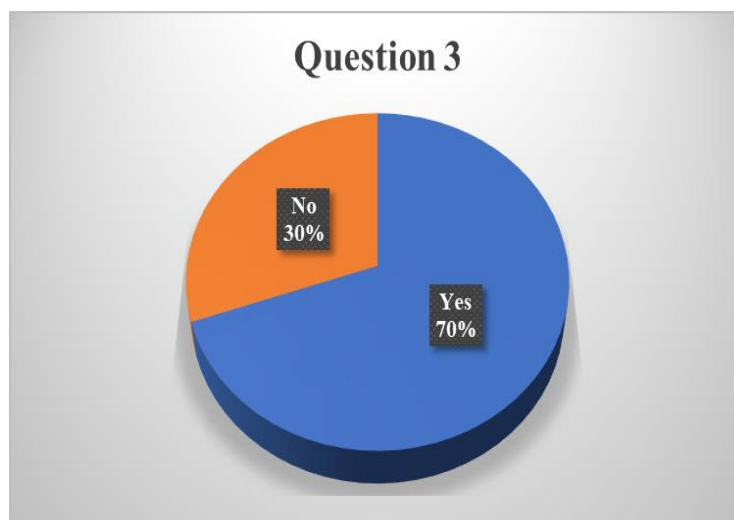


Figure 9. Question 3
Source: Authors' computations

In this case, most of our respondents confirmed that the value of their cryptocurrency portfolio diminished once the war started.

And the last one, **Q4:** "Do you think the financial market will stabilize in 2022?"

The answers are illustrated in figure 10:

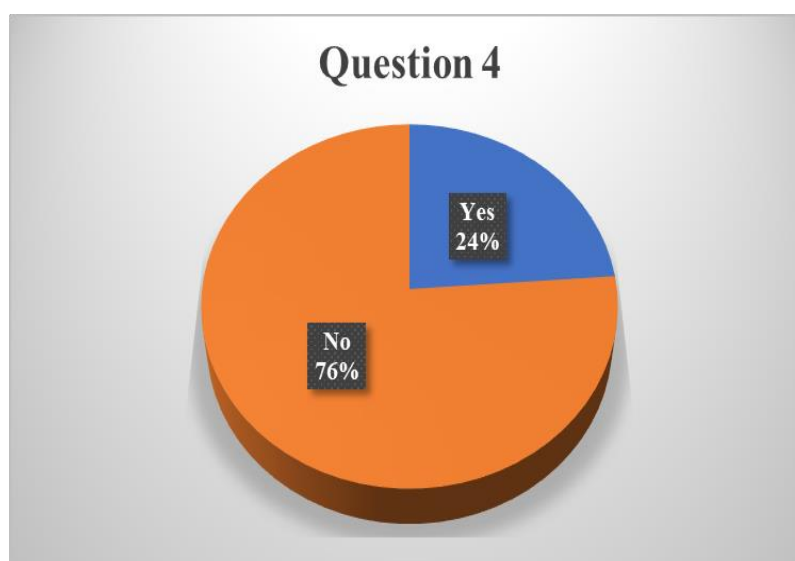


Figure 10. Question 4
Source : Authors' computations

In this case, the predominant answer is, as expected, "No". Most of our respondents, more precisely 83 out of 109, are sure that as long as the war in Ukraine will continue, the economic situation of almost each European country, especially Romania, will be severely affected. Even if the war would be over in 2022, until the market will attain an equilibrium there is still a long way to go.

5. CONCLUSIONS

The pandemic and the methods were managed in Romania, to which we can add the destabilization of the energy market, as well as the Russia-Ukraine war can generate an economic crisis. Apparently, the country has not yet entered in a recession, but there are several premises for this alternative. At an international level institutions have revised the economic growth worldwide, and in Romania we can observe the same situation.

In conclusion, the overlapping of several shocks (the geopolitical context, the successive increases in energy prices and the alteration of global supply chains) accentuate the risks and uncertainties on the Romanian economy, while also affecting short-term expectations and the behavior of the business environment.

In particular, Romania was facing a pressing need to adjust its macroeconomic imbalances even before hostilities broke out. Romania has been under the excessive EU budget deficit procedure since the beginning of 2020 even though it is currently suspended due to the pandemic. Efforts to reduce the relatively large structural budget deficit in the coming years could have an indirect negative effect on economic growth.

Additionally, increasing inflation is likely to continue to put pressure on nominal interest rates, eroding consumers' purchasing power and limiting short-term economic growth. However, by supporting appropriate policies designed to encourage investment and stimulate long-term growth, Romania could more easily overcome this crisis. The full absorption of funds available through the EU Recovery and Resilience Fund would go a long way in improving the prospects for economic growth

On the positive side, the process of capital accumulation in recent years makes it possible that in case of a global crisis, the Romanian economy will be able to absorb the economic shocks much easier compared to the previous crisis. There are still many questions about the future, along with a lot of uncertainty about the evolution of inflation, energy security, but especially about avoiding the escalation of the conflict in Ukraine.

The increasing geopolitical risks brought on by Russia's assault of Ukraine will have a negative impact on the world economy in 2022. As a result, the policy trade-offs faced by central banks throughout the world will be exacerbated. According to our model, such impacts are predicted to greatly increase inflation and decrease GDP. These consequences are considerable, but they don't seem to be big enough to stop the world from recovering from the pandemic. The war's course is, however, extremely unpredictable, and unanticipated events in the fight might lead to significant shifts in the geopolitical risk and exacerbate its economic implications.

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