31 October 2022

Research Briefing | Emerging Markets

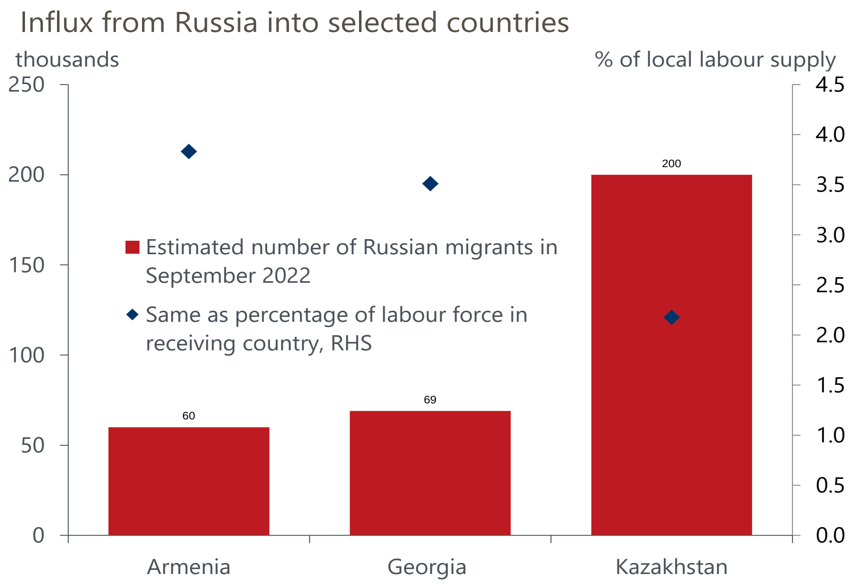
Russia's brain drain benefits its ex-USSR neighbours

- **Since the invasion of Ukraine in late February, hundreds of thousands of Russians have fled to neighbouring countries to avoid the draft. The September mobilisation has added to that wave.**
- **Several countries have recorded large influx relative to the size of their populations, including Armenia, Georgia, and Kazakhstan. In some smaller ex-USSR economies, capital transfers that accompanied the arrival of Russian immigrants have resulted in growth in foreign exchange (FX) reserves. Current accounts have also strengthened, likely bolstered by the inflow of remittances.**
- **In the short term, the new arrivals increase demand for goods and services. On the flip side, though, that migration fuels house price increases and stokes inflation. It may also lead to a rise in tensions by evoking echoes from the Soviet past and more recent conflicts.**
- **In the long term, however, the influx of high-quality human capital could lift growth if these educated, skilled Russian arrivals decide to remain. If host countries handle things right, they could end up with more businesses employing more workers and generating higher tax revenues.**

When the Ukraine war began, hundreds of thousands of Russians left their homeland, fearing that they could be conscripted to the army or that the borders would be closed. Along with the ex-USSR neighbours, Turkey, Finland, and UAE recorded large numbers of Russian arrivals. But with no mobilisation announced during the first few months of the war, some of those who left in February and March returned to Russia to their families and businesses.

The announcement of "partial" mobilisation targeting 300,000 draftees on 21 September provoked a massive wave of panic emigration of mostly male and highly skilled Russians. Russia's EU neighbours (the Baltics and Finland) were not keen on admitting a large number of Russian immigrants and quickly closed their borders. Russians mostly fled to Turkey, Armenia, Georgia, Azerbaijan, and Kazakhstan.

Chart 1: Local labour supply and the number of September arrivals from Russia



Source: Oxford Economics/Haver Analytics

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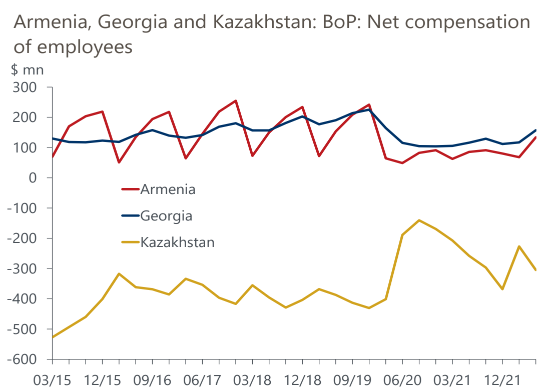
Even Mongolia reported an influx of 16,000 Russians. Apart from the physical proximity, visa-free access and, in the case of former-USSR countries, the widespread use of the Russian language were factors that determined the direction of flight. Bucking the general regional trend, Belarus probably attracted no migrant flows as potential draftees would not feel safe there after the country served as a springboard for the invasion of Ukraine back in February.

While Azerbaijan has not reported how many Russians have arrived since 21 September, anecdotal evidence suggests that the influx is significant. Estimates of new arrivals are available for Armenia, Georgia, and Kazakhstan (see **Chart 1**). Kazakhstan recorded the highest influx, of around 200,000. But with Kazakhstan being a much more populous country (of 19mn) than Armenia (2.8mn) and Georgia (3.7mn), the new arrivals are a smaller percentage of its labour force. Also, according to Kazakh authorities, less than 100,000 new arrivals have filed an application for local social security numbers, which suggests that they plan to move on.

There are several main impact channels

The arrival of tens or even hundreds of thousands highly skilled workers is already having an impact on local economies. Many of the new arrivals are able to work remotely and will initially receive their remuneration from Russia. But from the day of their arrival, they have been spending at least some of their income locally. Therefore, immigrants provide an immediate fillip to local services such as real estate, hotels and restaurants which all get new customers.

Chart 2: There is an uptick in remittances in Armenia and Georgia

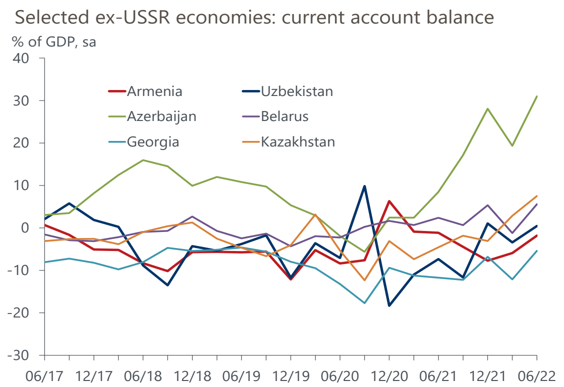


Source: Oxford Economics/Haver Analytics

While no Q3 balance-of-payments data for the region are available yet, H1 data show that this factor may be helping net remittances in Armenia and Georgia to recover from Covid-induced doldrums (**Chart 2**).

The influx of Russian remittances must be helping Russia's neighbours to weather the global energy crisis. With some of the above countries being hydrocarbon exporters (Kazakhstan and Azerbaijan), their current accounts have strengthened owing to the high global commodity prices. But countries like Georgia and Armenia that rely on imports to meet their energy demand seem to have done unusually well during the crisis, with Russian remittances serving as a supportive factor. Current accounts have improved in all countries in our sample in Q2, even though some of them are energy importers (**Chart 3**).

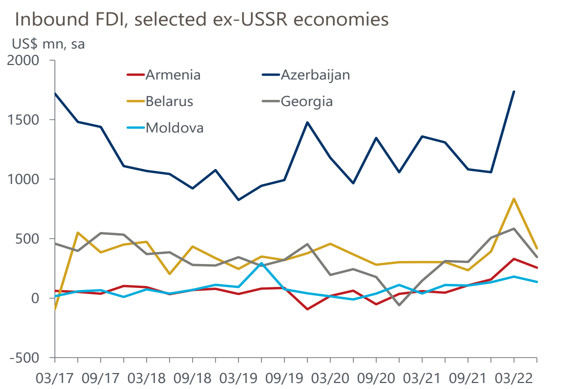
Chart 3: Current accounts have improved



Source: Oxford Economics/Haver Analytics

Besides, those countries in the region that are running current account deficits are finding it easier to cover them with financial account inflows.

Chart 4: Inbound FDI increased in Q1 2022



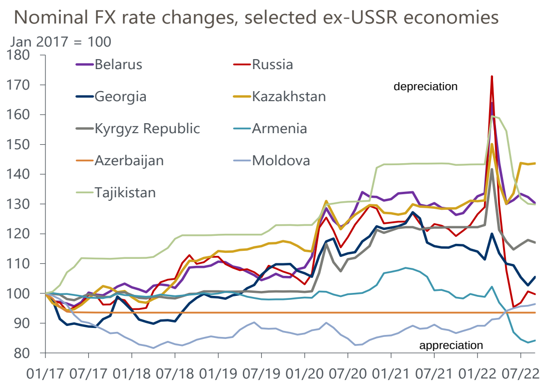
Source: Oxford Economics/Haver Analytics

One of the most important channels of impact of the Russian immigration is the influx of fresh capital into the countries where the new arrivals are settling. Local data on inbound FDI reveal a surge in Q1 this year when the first wave of migrants arrived (**Chart 4**).

According to Russian authorities, in September alone RUB 500bn was withdrawn from bank accounts in Russia, or approximately $8bn. Given the estimate of the number of people who left for Kazakhstan, Armenia and Georgia, and the limit of $10,000 in physical cash that can be legally taken out of Russia, we calculate that the arrivals to those three countries could have brought up to $3bn in cash with them. But much larger amounts must have been legally transferred from the accounts in Russian banks. These countries have not joined sanctions against Russia and receipt of funds from Russia into accounts with local banks is allowed, with no questions asked. These operations have soared since the start of the war and received a new impetus after the September mobilisation announcement. In Kazakhstan, the amount of funds in bank deposits of Russian citizens more than quadrupled to $1.4bn this year.

Anecdotal evidence suggests that the influx of Russian capital is having an impact on demand for residential and commercial real estate across the Caucasus, bolstering local construction sectors.

Chart 5: Armenian dram and Georgian lari have firmed vs. US dollar this year



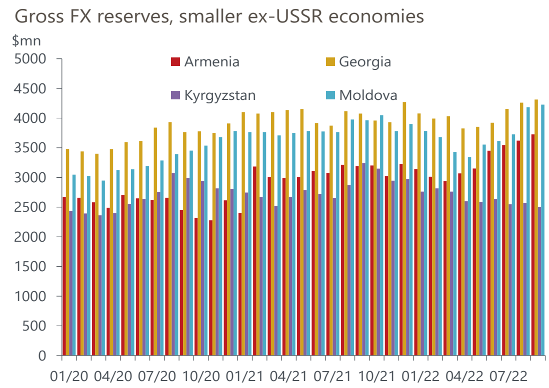
Source: Oxford Economics/Haver Analytics

One more concomitant of the improved balance-of-payments performance is the resilience of the regional currencies to US dollar strength (**Chart 5**). Following a knee-jerk reaction to the Russian invasion in February, most of the regional currencies swiftly regained ground vs. the US dollar, and many of them are now trading at a firmer level vs. USD than in early 2022. This regional trend is in a sharp contrast with the performance of other EM currencies.

Influx of funds allows Russia's neighbours to build stronger buffers

The combination of stronger current accounts and an inflow of fresh capital has allowed the host countries to build up their FX reserves, which increases their resilience to external shocks (**Chart 6**). There is a different (but not unrelated) reason for an increase in Moldova's reserves. Moldova has attracted refugees from Ukraine after the invasion, and it's their funds which are likely boosting its reserves.

Chart 6: FX reserves in Armenia, Georgia, and Moldova have been growing



Source: Oxford Economics/Haver Analytics.

New arrivals spur business activity and bring human capital

Russian immigrants are busy relocating their businesses to the host countries. In Georgia, the number of newly registered companies soared to more than 9,000 in March compared to 3,800 on average in the two previous years. In the subsequent months, it fell to around 7,000 but remained substantially above the pre-war level.

According to Bloomberg, Azerbaijan has created a particularly welcoming environment for the newcomers. Its authorities have established a support structure for expatriates, including low tax rates for newly registered firms. Some of the entrepreneurs and IT-professionals who have recently left Russia may relocate to Azerbaijan from the countries where they fled initially.

Countries that rolled out the red carpet for Russian entrepreneurs have likely improved their country's growth prospects. The new businesses will directly contribute to the economies of the host countries by paying taxes and employing local workers.

In terms of demographics, Russia's loss is the host countries' gain. Anecdotal evidence suggests that the arrivals are well-educated and highly skilled. The wives and children of the Russian men who fled the military draft are going to join them eventually and create additional demand for local goods and services. The countries that welcome the Russians fleeing abroad will enjoy a human capital boost that will lift their long-term growth rates.

There is a flip side, too

Despite the above benefits, in the short term, the arrival of relatively large numbers of Russian immigrants may cause tensions in the receiving countries. Georgia, which lost in a brief war with Russia in 2008, is perhaps the best example: While some sectors of the economy are getting a boost from the Russian influx, Georgians remain wary. Besides, the new arrivals have driven up rents and property prices across the Caucasus. By increasing demand for local goods and services, high arrivals have also boosted living costs.

The influence of the September wave of immigration on the economy is so significant that it is beginning to affect policies. On 26 October, the National Bank of Kazakhstan (NBK) hiked its policy rate 150bps to 16%, above consensus, citing a rise in inflation expectations caused by the surge in newcomers. Policymakers in the countries that have received a high number of Russian migrants need to pick the right mix of policies to benefit most from the influx of Russian skills and capital whilst avoiding overheating.

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