

NEWSLETTER

UKRAINE

Oleksandra Betliy, Robert Kirchner and Garry Poluschkin

Parliament approves 2023 state budget

Russia's full-scale war keeps bringing dramatic human suffering and economic as well as fiscal challenges to Ukraine. Caused by a massive decline of economic activities, tax revenues have decreased strongly during 2022. Nevertheless, Ukraine's state revenues are close to last year's level due to more than USD 10 bn international financial aid in form of grants. State expenditures increased massively compared to last year due to a strong focus on defence activities. As a result, a very high budget deficit has emerged that is financed mainly by international aid in form of loans, as well as monetary financing. The latter one however creates inflationary risks.

The recently approved state budget for 2023 is also strongly impacted by the war. The Cabinet of Ministers (CMU) expects an economic growth of just 3.2% yoy and the revenue side to be below 2021 as share of GDP. The dominance of defence activities at 14% of GDP also remains next year. As a result, funding needs are estimated at USD 38 bn. However, they might further increase if Russia keeps damaging Ukraine's infrastructure. Unlike 2022, monetary financing is excluded as funding instrument to ensure macro-financial stability. Therefore, Ukraine is set to be exclusively dependent on international financial aid. As the CMU does not assume grants, Ukraine's debt ratio is set to increase to 100% of GDP. Therefore, any financial support in form of grants rather than loans would be preferential in 2023 as well.

Macroeconomic assumptions

The Parliament approved the state budget for 2023 on 03 November in time. After an estimated GDP drop by 32% in 2022, the budget plan expects growth of just 3.2% - revised downwards from 4.6% in the budget draft – assuming Ukraine's GDP level 30% below the 2021 level.

Macroeconomic indicators

	2021	2022, estimate	2023, forecast
GDP, UAH bn	5,460	4,728	6,279
GDP, USD bn	200	146	149
GDP real, % yoy	3.4	-32.0	3.2
CPI, aop, %	9.4	20.5	28.4
CPI, eop, %	10.0	29.3	28.0
FX, UAH/USD, aop	27.3	32.3	42.2

Sources: Ministry of Economy and CMU

Domestic demand, primarily private consumption will be contributing to economic growth. Ukrainians are (partially) expected to return home due to an assumed lower intensity of the war. Average inflation is set to remain high and the average exchange rate at UAH/USD 42.2 – a 15% depreciation to the current official rate. Overall, the macroeconomic forecast seems realistic. It is, however, subject to a large uncertainty related to the war.

Revenue side

The plan for fiscal revenues for 2023 is based on the current tax legislation and expected at UAH 1,329 bn, 21.2% of GDP as compared to 23.8% of GDP in 2021 due to lower tax revenues at 18.4% of GDP (down from 20.3% of GDP in 2021). VAT is expected to remain the key tax source in 2023 with a share of 46.4% of revenues while other revenues are expected to be below 2021.

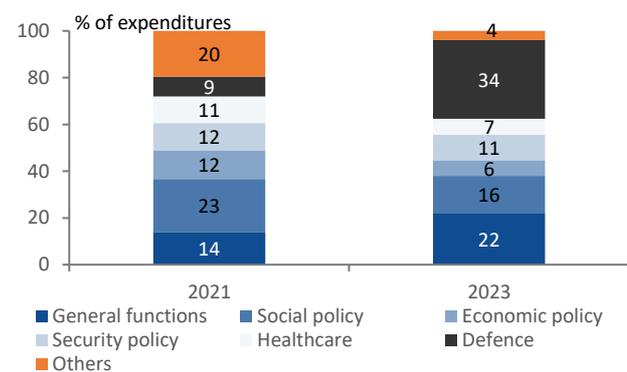
The budget does not include any substantial amount of financial aid in form of grants for 2023 while in 2022 they exceeded USD 10 bn by November.

Furthermore, profits by the National Bank are estimated which would positively contribute to the revenue side.

Expenditure side

Expenditures are planned at UAH 2,581 bn or 41.1% of GDP. Overall, there are three clear priorities for spending: defence, debt servicing, and social protection. About 33.8% of expenditures are to be allocated for defence (13.9% of GDP) compared to 8.6% (2.3%) in 2021.

Structure of expenditures



Source: CMU

Social protection is set at 15.9% of expenditures, thereby keeping the minimum wage and minimum pension at the level of December 2022 resulting in a significant decline in real terms. At the same time, support to vulnerable households is planned to be covered by the housing and utility subsidy, while tariffs for households shall remain unchanged.

Besides, 11.2% of spending is envisaged for security items (e.g., police, border services, and judicial system). Debt servicing is expected to increase to 13% of expenditures despite the debt suspension agreement. Thereby, an annual coupon repayment on war bonds directly purchased by the NBU (at UAH 340 bn so far in 2022) is expected.

The CMU does not envisage substantial financing for reconstruction and recovery due to budget constraints but earmarked UAH 35.5 bn (appr. USD 840 m) for financing a budget programme for the reconstruction of buildings, infrastructural objects, purchase of housing and school buses, etc.

Deficit financing: international financial aid essential

Low revenues and high expenditures result in a deficit planned at UAH 1,251 bn or 19.9% of GDP. External borrowings are estimated at UAH 1,612 bn (= USD 38 bn) whose financing is expected primarily by the US and the EU in equal proportions in form of loans, not grants, which are however at preferential terms.

Plan indicators for the budget 2023 compared to 2021

	2021		2023 Budget*	
	UAH bn	% of GDP	UAH bn	% of GDP
Revenues, i.a.	1,297	23.8	1,329	21.2
Tax revenues	1,107	20.3	1,154	18.4
Further revenues	175	3.2	155	2.5
Grants	1.3	0.0	0.7	0.0
Expenditure	1,490	27.3	2,581	41.1
Defence	128	2.3	870*	13.9*
General functions	207	3.8	572*	9.1*
Social policy	339	6.2	409*	6.5*
Security policy	174	3.2	288*	4.6*
Others	642	11.8	441*	7.0*
Deficit	193	3.5	1,251	19.9
Borrowing	198	3.6	1,612	25.7
External borrowing	111	2.0	1,596	25.4
Domestic borrowing	87	1.6	91	1.4

Sources: National Bank, Ministry of Finances, CMU, *figures for functional classification of expenditures are from the draft submitted for the 1st reading.

The IMF is currently not ready to provide Ukraine with a large programme but instead introduced a 'Program Monitoring with Board involvement' (PMB), which shall result in the elaboration of a macro policy framework to

catalyse donor support and could help pave the way towards a possible full-fledged IMF programme. Domestic deficit financing for 2023 is not expected to be substantial at only UAH 90.7 bn (USD 2.1 bn) from local borrowings – an important step to ensure macro-financial stability. Privatisation is set to play only a marginal role with UAH 6.0 bn (USD 142 m).

Outlook

The State Budget Law for 2023 has several key uncertainties, which will be inherited from 2022. The main one relates to the war: if it lasts longer with intensive fighting and more damages to energy and other infrastructure, the budget is likely to be challenged by even lower tax revenues with the need to finance higher spending. Another risk relates to the inflow of international aid, which turned out to be irregular and unpredictable in 2022. Here, a more coordinated and predictable approach seems essential. So far, the Budget Law assesses the monthly financing needs to narrow down to USD 3 bn in 2023. However, this amount does not include emergency recovery needs estimated at USD 17 bn that the government mentioned during the Autumn IMF and World Bank meetings and the Berlin Recovery Conference. The debt ratio is estimated to increase to 100% of GDP. Thus, any support in form of grants instead of loans – though cheap – would be important for future debt sustainability.

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

*Advisory activities in Belarus are currently suspended.

Editors

Robert Kirchner, Garry Poluschkin

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German Economic Team

www.german-economic-team.com



Implemented by
BE Berlin Economics GmbH
Schillerstraße 59 | 10627 Berlin
+49 30 / 20 61 34 64-0

info@berlin-economics.com | [Impressum](#)