In cooperation with

INSTITUTE FOR ECONOMIC RESEARCH AND POLICY CONSULTING

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FORECAST SERIES UKRAINE

Economic forecast for 2023: War causes huge uncertainty

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Executive Summary

- **In 2022, Ukraine‘s GDP is expected to decline by 30.2% yoy due to Russia’s full-scale invasion**
  - Thousands of people killed, millions displaced and lost incomes resulting in massive consumption decline
  - Gross fixed capital accumulation halved but prevented from falling further by key restoration and rebuilding needs
  - Exports dropped due to logistic limitations & war damages
  - Broad-based contraction of all sectors but defense
- **In 2023, the economy is forecast to grow by 1.8% yoy**
  - Effects of displacement remain a drag on recovery
  - Damage repairs, demand for housing for returning households
  - More stable security situation contribute to higher output of export-oriented sectors as well as increase demand for trade and transport services
  - Improved and unblocked logistics and routes will accelerate international trade
  - Ukraine’s economy will still be 29% below 2021 level
- **Overall, the forecast is subject to large uncertainty related to duration and intensity of the war**

Structure

1. Introduction

Background:

- Russia's full-scale war has been ongoing for more than ten months and has been causing massive humanitarian suffering and a steep decline of economic activities
- The war-caused displacement of millions of people and supply chain disruptions will negatively affect economic development also in 2023
- At the same time, Ukraine has been liberating parts of its territories and repairing damages caused by Russia
- Any forecast of the future economic development is however subject to massive uncertainty related to the further intensity and duration of the war

Purposes of this Forecast Series:

- Estimate and forecast the main macroeconomic indicators for 2022 and 2023
- Discuss main downside and upside risk for the forecast

2. Economic Review in 2022

- According to the Ukrstat flash estimate real GDP declined by 37.2% yoy in Q2 and by 30.8% yoy in Q3:
  - Large part of economic activity in areas affected by military action was suspended
  - Ukraine slowly restores life in de-occupied territories
  - Three Odesa-area seaports unblocked from end-July only for grain and oilseed exports
  - Capacity of railways and road crossings with the EU were a bottleneck for exports leading to large queues
  - Industrial and storage facilities were damaged or destroyed by Russia
  - Infrastructure damages reached USD 136 bn by end of November (KSE)
- Real GDP is estimated to decline by 35% yoy in Q4 from 30.8% in Q3:
  - Large targeted destruction of energy infrastructure increase damages significantly
  - Logistics remains an important bottleneck for economic development

Inflation and current account

- CPI accelerated in Q1/Q2/Q3 but stabilized in Q4 at 26.6%
  - Sharp increase in transport costs (42.9% yoy in December) reflecting higher fuel costs, surge in demand for fuel in November
  - Increase in food prices (34.4% yoy in December) in particular for fruit and vegetables due to Russia's occupation in the South of Ukraine
  - Hryvnia devaluation in July and restored taxation of imports added to prices of imported goods but effects decelerated in last months
  - Smaller price increases for goods and services less demanded in wartime.
  - Fixed electricity, heat, gas and water tariffs limited effect of higher energy costs
- Current account recorded USD 7.8 bn surplus in January-October
  - Current transfers of USD 11.7 bn to general government, primarily grants
  - Continued remittances from migrants and capital controls
  - Agricultural exports recovered and are close to pre-war level by weight in Sep and Oct, reported at the same level in November despite lower departures from Odesa ports
  - At the same, steel/iron ore exports remained subdued in line with lower export prices
  - Imports were stable over the last months and remained much lower than in 2021 by volume, but high energy costs pushed up import prices

Review of economic policies

NBU:

- » The key policy rate was hiked by 15 pp to 25% p.a. on 02 June and remains at this level, NBU guidance is that it will be at this level or higher in 2023
- » Official USD/UAH exchange rate was devalued to UAH/USD 36.57 (from UAH/USD 29.25) as of 21 July and remains fixed
- » Reduced regulatory requirements for banks and provided emergency refinancing in the first period
- » Tight capital controls to preserve international reserves and to prevent bank-runs were partially softened throughout Q3 of 2022
- » Increased reserve requirements for bank current accounts in a bid to push up deposit rates

The Parliament / the Government:

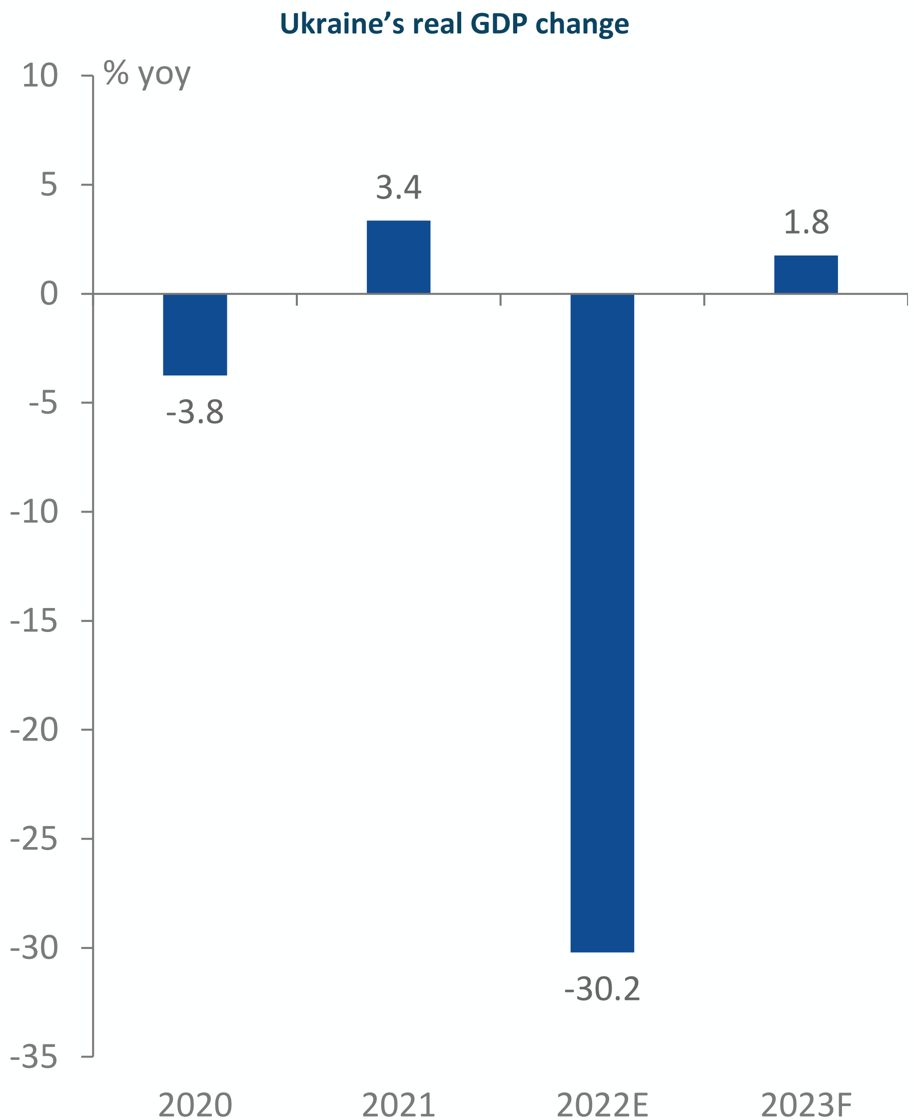
- » VAT and custom duties on imports (including used cars), which were cancelled at the beginning of the war, were restored since July
- » Maintained single tax at 2% of turnover for all companies except for those non-eligible for the use of STS by their activity (regardless their size and number of employees)
- » Partially restored excise on fuels since October 2022, but kept reduced VAT rate of 7% on fuel
- » Decision not to increase energy tariffs for households for the duration of martial law
- » Budget allocations for the Naftogaz to import natural gas
- » Rapid increase in military spending and restricted financing of non-priority spending, including most of capital spending
- » Extended programme of subsidized loans 5-7-9%

3. Assumptions underlying the forecast

Main Assumptions:

- Until July 2023, Ukraine will gradually de-occupy its territories that were occupied
- “Grain Initiative” will remain effective for grain exports by July 2023, afterwards, full operation of Black Sea ports is expected
- State of energy infrastructure will not deteriorate as compared to November 2022
- Agriculture producers will have enough resources for spring sowing that will offset lower area under winter crops
- The United States, the EU, and other international partners will deliver on commitments to provide the financial and military support needed
- Ukraine and the IMF will reach an agreement on a new large programme in 2023
- Capital controls are assumed to be further gradually reduced and a flexible exchange rate approached in 2023
- No changes of key policy rate and tax policy
- Financial sector will remain stable in 2022 and 2023
- The Government will keep energy prices for households until the end of 2023

4. Key forecast indicators for 2022 and 2023



Source: Ukrstat, own forecast for 2022 and 2023

Key GDP parameters:

- » Real GDP is estimated to drop by 30.2% yoy **in 2022**
- » Nominal GDP: UAH 4,856 bn (USD 150 bn)
- » Real GDP increase of 1.8% yoy **in 2023**
- » Nominal GDP: UAH 5,832 bn (USD 151 bn)

Key driving forces:

- » Many households displaced, lost wage incomes, social payments are made in time and in full, impact remains in 2023
- » More stable security situation contributes to higher output of export-oriented sectors
- » Higher demand for trade, transport services
- » Domestic demand will increase but slowly due to a lack of liquidity and large migration
- » Balanced contribution of external trade with net real exports positive in the second half of 2023 due to improved logistics and weaker exchange rate
- » Damage repairs, demand for housing for displaced households

➢ **GDP remains 29% below 2021 level**

GDP forecast: demand side

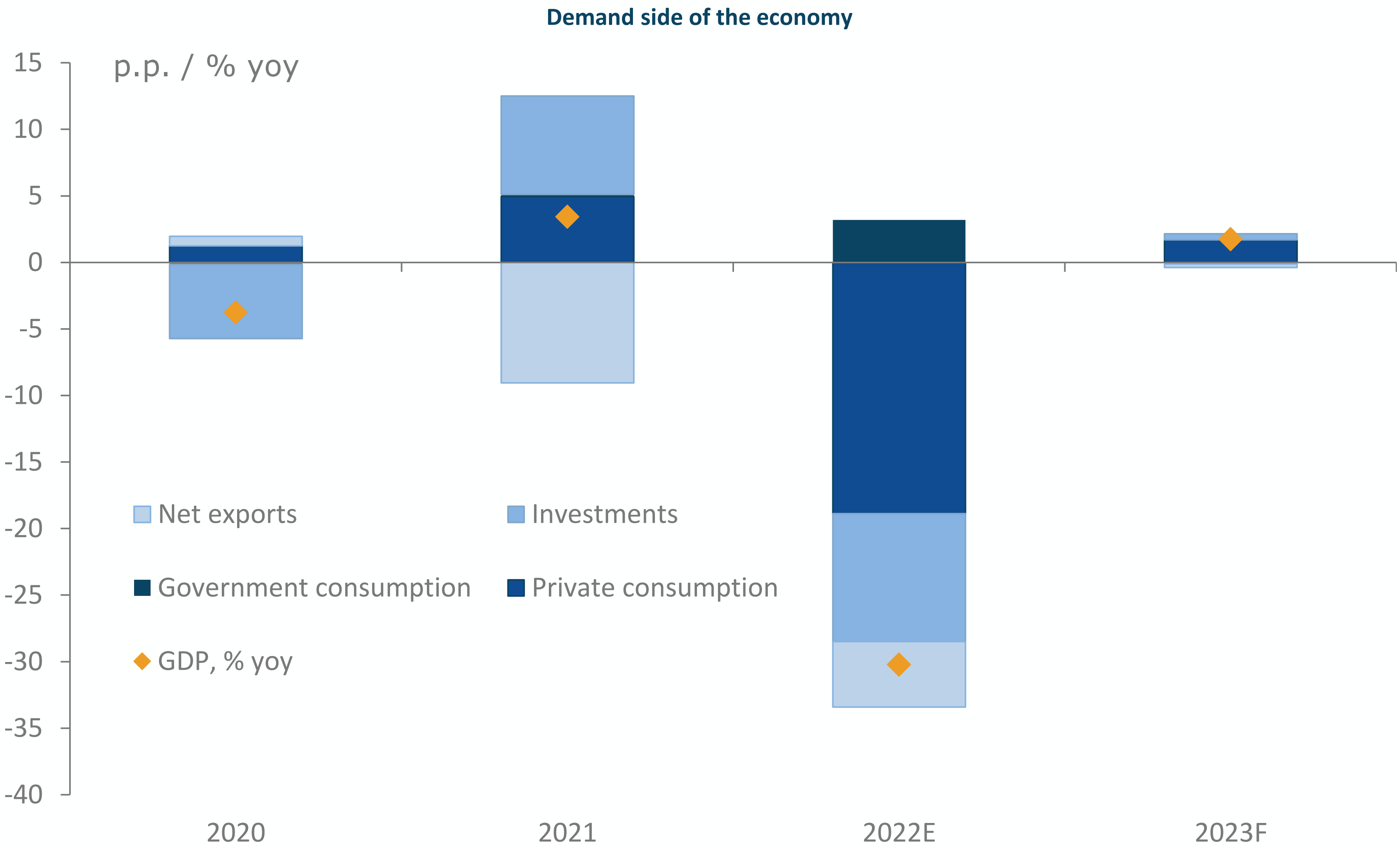
Real GDP forecast: demand side (change in %)

	2020	2021	2022E	2023F
GDP	-3.8	3.4	-30.2	1.8
Including				
Private consumption	1.7	6.9	-28.1	2.6
Government consumption	-0.7	0.8	17.7	-0.3
Fixed capital accumulation	-21.3	9.3	-51.7	7.3
Exports	-5.8	-8.6	-35.9	3.7
Imports	-6.4	14.2	-23.3	3.1

Source: Ukrstat, own forecast for 2022 and 2023

- Private consumption recovers only slowly in 2023 due to the contraction of real household disposable income caused by high migration, inflation, and large unemployment
- Real exports recovery limited in the first half of 2023 with expected improvement in the second half of 2023 primarily due to improved logistics
- Real imports increase in 2023 is limited by the slow growth of domestic demand (both consumption and investment)
- High imports of travel (spending by displaced persons abroad) is expected to remain

Contributions to real GDP growth: demand side



Source: Ukrstat, own forecast for 2022 and 2023

GDP forecast: supply side

Real GDP forecast: supply side (change in %)

	2020	2021	2022E	2023F
GDP	-3.8	3.4	-30.2	1.8
including				
Agriculture	-10.7	15.1	-27.8	0.7
Industry	-4.3	1.6	-36.6	-7.5
Trade	5.1	-0.1	-41.9	4.1
Transport	-16.0	1.7	-39.5	5.9

Source: Ukrstat, own forecast for 2022 and 2023

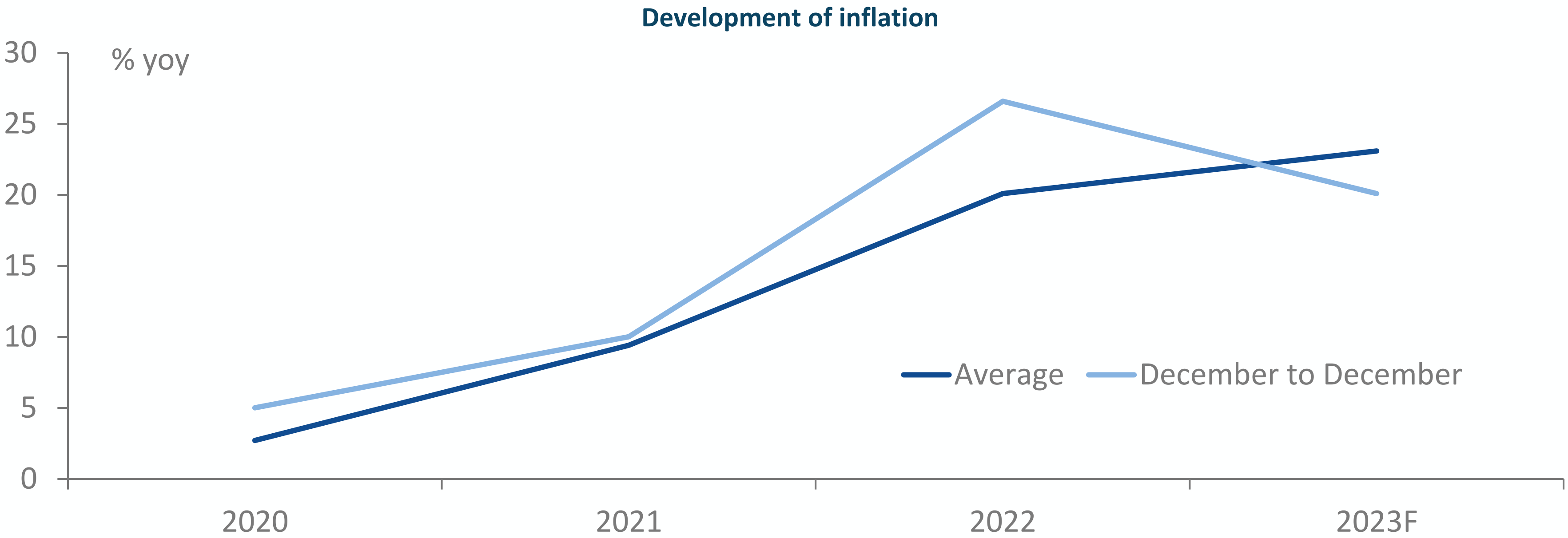
» Moderate recovery in animal husbandry and restoration of agricultural production in liberated areas is expected in 2023

» This is expected to offset lower sowed area for 2023 harvest.

» We project industry to return to growth in the second half of 2023 thanks to improved access to external markets and a modest increase in domestic demand though industry output remains negative in the total year 2023 due to damages to energy infrastructure

» Wholesale trade and transport will benefit from increased external trade and improved domestic demand in 2023

Inflation forecast



Source: Ukrstat, own forecast for 2023

» High inflation expectations and electricity supply disruptions will contribute to price increases in Q1 2023

» Inflation decelerates later in the year due to USD import prices close to 2022 level, improved logistics and more optimal supply chains

» Limited increases in utility costs mandated by the government will remain a restraining factor for inflation

» Weaker exchange rate will keep inflation elevated in the second half of 2023

➢ **Annual average inflation in 2023 will be higher than in 2022 due to large price increases in the first half of 2023 and second half of 2022**

Current account forecast

Current account

		2020	2021	2022E	2023F
Current account balance	USD bn	5.3	-3.2	5.9	2.4
Current account balance	% of GDP	3.4	-1.6	3.9	1.6
Exports of goods	USD bn	45.1	63.1	40.7	39.3
Imports of goods	USD bn	-51.9	-69.8	-54.3	-57.9
Balance of services	USD bn	4.4	4.0	-9.5	-9.1
Transfers and remittances*	USD bn	15.8	18.2	33.8	36.2

Source: Ukrstat, own forecast for 2022 and 2023

- Current account forecast is based on NBU data, which is likely to be revised significantly
- Exports and imports in 2023 are close to 2022 levels as we expect lower average prices for a range of commodities in the next year
- Services deficit reflects continued spending by refugees abroad
- (*)Transfers and remittances are gross (wage income plus secondary transfers) and include grants to the state budget at USD 12.5 bn in 2022 and USD 13.0 bn in 2023.

5. Key risks of the forecast

Downside risks:

- Continuation of the war and further occupation of territories
- Increasing infrastructure destruction all over Ukraine
- Delays in financial assistance from IFIs and bilateral donors
- Termination/disruption of grain initiative

Upside risks:

- De-occupation of Ukrainian territory, and removal of all Russian troops
- Faster than expected full unblocking of seaports
- Early start of large-scale reconstruction

Annex: GDP forecast: supply side – pessimistic scenario

Real GDP forecast - pessimistic: supply side (change in %)

	2020	2021	2022E	2023F
GDP	3.4	3.4	-30.2	-6.2
including				
Agriculture	14.4	15.1	-27.8	-3.0
Industry	1.7	1.6	-36.6	-16.8
Trade	-0.6	-0.1	-41.9	-8.0
Transport	3.3	1.7	-39.5	-7.0

Source: Ukrstat, own forecast for 2022 and 2023

- Pessimistic scenario relates primarily to the higher damages of energy infrastructure and slower recovery of these damages
- We also assume more protracted military action than under base scenario
- Under these conditions, the industrial sectors will suffer substantially, especially this relates to metallurgical companies (which might stop production for several months) and the production of electricity

Annex: Technical note on modelling

- The forecast was produced using the IER short-term macroeconomic forecasting model. The model is based on iterative-analytical techniques, grounded in the system of national accounts
- The model looks at GDP and its components based on production and expenditures. The final result of the GDP forecast is based on forecasts for each component
- The forecast for each component is produced using scenario assumptions and historical relationships. The forecast is built on a system of built-in proportions, which are expected to stay fairly constant
- Components of the GDP by production and by expenditures are interconnected
- Real GDP growth is determined by the summation of the contributions of each component. If the two sides of the GDP accounting equation are not balanced, then another iteration begins. The iterations continue until the two methods of GDP produce balanced results

Annex: forecast indicators

		2020	2021	2022E	2023F
Real Economy					
Nominal GDP	UAH bn	4,222	5,451	4,856	5,832
Nominal GDP	USD bn	156.6	199.8	150.2	151.4
Real GDP	% yoy	-3.8	3.4	-30.2	1.8
Consumer price index	aop, % yoy	2.7	9.4	20.2	23.1
Consumer price index	eop, % yoy	5.0	10.0	26.6	20.1
Balance of Payments					
Current account balance	USD bn	5.3	-3.2	5.9	2.4
Current account balance	% of GDP	3.4	-1.6	3.9	1.6
Exports of goods	USD bn	45.1	63.1	40.7	39.3
Imports of goods	USD bn	-51.9	-69.8	-54.3	-57.9
Balance of services	USD bn	4.4	4.0	-9.0	-8.8
Exchange rate (official)	aop, UAH/USD	26.96	27.29	32.34	38.51

Source: Ukrstat, own forecast for 2022 and 2023

About the German Economic Team

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.*

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