ISSUE NO 171 | JANUARY 2023

NEWSLETTER
UKRAINE

Garry Poluschkin

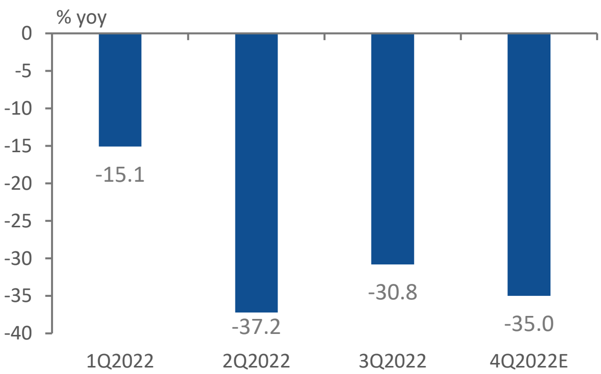
Low growth in a very uncertain environment

Russia's full-scale war against Ukraine has been ongoing for eleven months, causing massive humanitarian suffering and a steep decline in economic activities in Ukraine. Ukraine's GDP is estimated to have fallen by 30.2% in 2022. The extent of the decline is less than estimated in the first months of the invasion as Ukraine has been liberating parts of its territories, utilising the Grain Deal for exports, and repairing damages. However, most of the war-related factors will also affect the economic development in 2023. We forecast the economy to slightly grow by 1.8% yoy in 2023 as we assume a more stable security situation in the second half of the year. However, in this context, the forecast is subject to a high degree of uncertainty about the duration and intensity of Russia's war.

Ukraine's economy faced an unprecedented decline

Russia's full-scale invasion starting 24 February 2022 has been leading to humanitarian suffering and declined economic activities in Ukraine. Seven million people were estimated to be forced to leave the country, another six million were internally displaced and infrastructure damages exceed USD 138 bn. Export-oriented sectors suffer from Russia's blockade of Ukraine's seaports as the Grain Deal for the exports unblocked only a small share of aggregate export capacities. As a response to the economic consequences of the invasion, Ukraine's authorities introduced different economic policy measures including preferential tax policies, extended subsidised loan programme for enterprises, and switched to a fixed exchange rate as well as capital controls. However, given the extent of the destruction, and the limited means of support, Ukraine's economy fell by 37% yoy in the second quarter and by 31% yoy in the third quarter of 2022 according to the Ukrstat estimate.

Quarterly economic development in 2022



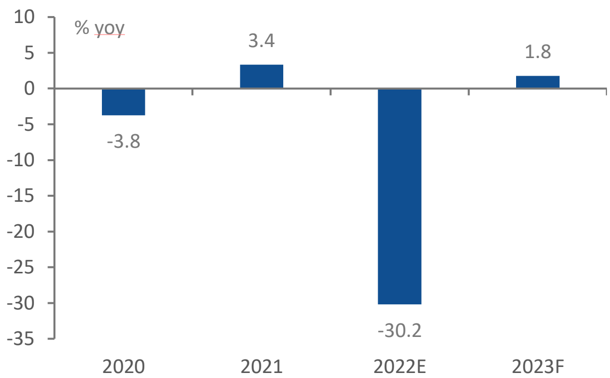
Source: Ukrstat, estimate for 4Q2022

In this context, the Institute for Economic Research and Policy Consulting and the German Economic Team conducted a joint estimate for the total year 2022 and a forecast for 2023. As the fourth quarter was strongly affected by energy blackouts resulting from Russia's attacks on energy infrastructure, GDP is expected to have fallen by 30.2% yoy for the total year 2022. This decline is much less than the World Bank's estimate of -45.1% back in June, as Ukraine's economy has revealed strong resilience. However, the extent shows major efforts needed for the recovery in 2023 and in the years to come.

Low growth in 2023

Most war-related factors keep affecting Ukraine's economic development in 2023. Many households will remain displaced and lost wage incomes will limit the recovery of private consumption. Russia's attacks continue to damage Ukraine's infrastructure.
For the forecast, it is assumed that Ukraine will gradually liberate its territories starting in the second half of 2023. This assumption implies that the support by international partners will be maintained, and they will deliver on their pledges. A more stable security situation will allow for higher output of export-oriented sectors and a positive development of logistics compared to last year will contribute to real growth of exports and imports. Facing these conditions, the economy is forecast to grow by 1.8% yoy in 2023.

Ukraine's annual real GDP change



Source: Ukrstat, estimate for 2022 and forecast for 2023

This forecast is similar to recent ones by other institutions (e.g. Goldman Sachs: +2.0%). Other forecasts foresee a further economic downturn (BNP Ukrsibbank: -5.0%) or project more optimistic growth rates (Ukraine's Ministry of Economy: +3.2%). However, the wide range shows the massive uncertainty that forecasts are subject to.

Demand side: growth driven by base effects

This low growth rate is driven by a weak recovery of private consumption (+2.6%) due to the contraction of real household disposable income since the invasion. The steady repairs of damages to infrastructure will be a driver of fixed capital investment growth at 7.3%, after declining by more than 50% in 2022. Government consumption will slightly decline (-0.3%). Finally, real growth of exports will slightly exceed that of imports due to baseline effects from 2022.

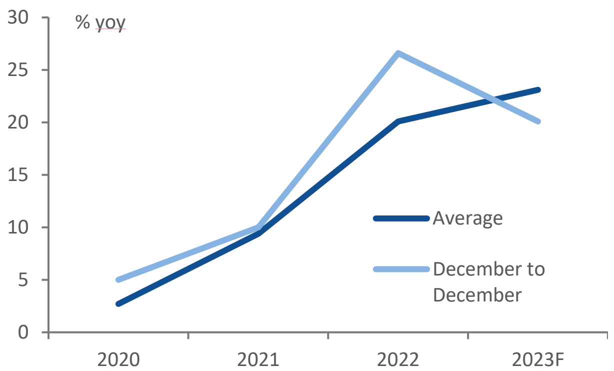
Supply side: industrial output further deteriorates

On the supply side, trade and transportation services will benefit from improved logistics and are forecast to increase by 4.1% and 5.9%, respectively. The effects for agriculture are ambiguous. On the one hand, the sector will further benefit from the Grain Deal. On the other hand, agricultural production will remain adversely affected by mines and other war-related obstacles to harvesting. Therefore, this sector is forecast to grow by just 0.7% yoy. Industrial output will further decline due to the destruction of facilities, infrastructure, and metal production capacities. Also, the Grain Deal does not cover the transport of industrial goods while exports by rail are subject to physical restrictions. Consequently, any large extension of exports by this sector will require the unblocking of seaports.

Inflation will decelerate later in 2023

Disrupted supply chains and large monetary financing accelerated inflation during the second and third quarter of 2022 even though inflation increased less than projected. Improved logistical conditions and slowdown in global inflation will be decelerating factors in 2023. Moreover, if Ukraine's international partners deliver on their pledges of financial aid, the National Bank will be able to stop monetary financing. These effects are forecast to bring inflation down from 26.6% yoy at the end of 2022 to 20.1% yoy at the end of 2023.

Inflation



Source: National Bank, own forecast for 2023

Assuming that the pledged financial aid is realised, and large remittances continue, the current account is forecast to be in surplus, reaching 1.6% of GDP (USD 2.4 bn). This development reduces the pressure on the exchange rate and further stabilises inflation expectations.

Outlook

The continuation of Russia's war against Ukraine leads to an unprecedented uncertainty for economic forecasts, with significant downside risks. For example, if occupations and destructions continue longer and more severely than assumed, the Grain Deal is terminated, or aid from partner countries is delayed, the forecast for Ukraine's economy may significantly worsen. In a pessimistic scenario, the economy is forecast to further decline by 6.2% yoy in 2023. On the other hand, the sooner Ukraine is able to de-occupy its territory, the sooner the economic recovery process accelerates and the earlier the start of the large-scale reconstruction will be.

This newsletter is based on the joint forecast by the Institute for Economic Research and Policy Consulting and the German Economic Team ["Economic forecast for 2023: War causes huge uncertainty"](#).

Editors
Robert Kirchner, Garry Poluschkin
Subscribe / unsubscribe newsletter

German Economic Team
www.german-economic-team.com

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.*

Berlin Economics

Implemented by
BE Berlin Economics GmbH
Schillerstraße 59 | 10627 Berlin
+49 30 / 20 61 34 64–0
info@berlin-economics.com | Impressum