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NEWSLETTER
UKRAINE

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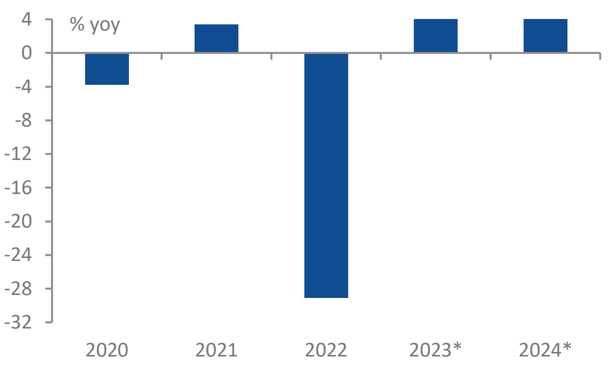
Economic growth supports resilience

Russia's full-scale war has been ongoing for more than 600 days, causing massive humanitarian suffering. Ukraine's GDP fell by 29.1% yoy in 2022. This year, Ukraine experiences moderate growth of 4.1%, as war-related factors keep limiting growth perspectives, and in 2024 we forecast that growth will accelerate to 5.5%. While private consumption and investment are back on a growth path and trade and transport sectors adjust to supply chain challenges, damages to social critical infrastructure keep rising, restraining Ukrainians abroad to return. One of key elements is securing external financing of the budget to keep the economy and rebuilding of critical infrastructure afloat. Disbursements of financial aid as well as of frozen Russian assets and/or its generated revenues will still be important to finance the expected fiscal gaps over the coming years. However, the economic forecast and the associated financing needs are subject to exceptionally high uncertainty of the further development of Russia's war.

Growth in 2023 and 2024, but from a low basis

Ukraine's GDP dropped by 29.1% in 2022. Though the economy is projected to grow by 4.1% in 2023 and by 5.5% in 2024, Ukraine is far from full recovery as GDP is forecast to remain 22% below pre-war level in 2024.

Ukraine's annual real GDP change



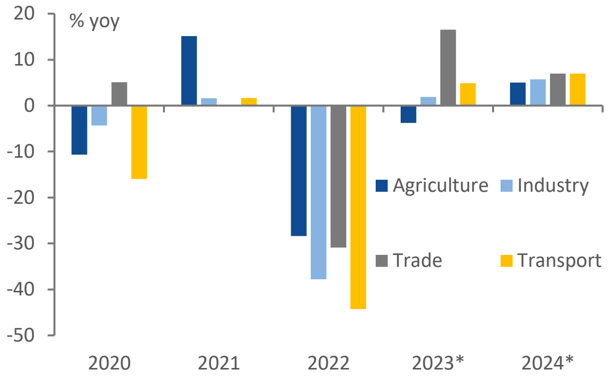
*Sources: Ukrstat, *IER/forecast*

Supply side: Gradual adjustment in key sectors

On the supply side, the main production factors capital and labour are strongly hit. Infrastructure damages exceed USD 151 bn (until Sep-23) and particularly destroyed residential buildings are the decisive factor for the 5 m Ukrainians abroad not to return home. These developments restrain economic development perspectives and affect all main sectors.

While weather conditions are very favourable, the agriculture sector growth perspective is impeded due to destroyed as well as mined land resources, and so is the recovery of the industry sector by damaged production facilities and occupied production hubs, for example of Mariupol.

Development of key sectors



*Sources: Ukrstat, *IER/GET forecast*

Trade and transport will benefit to some extent from a recovery of domestic demand, but are still in the process of adjustment.

Demand side: Slow growth

Growth rates are driven by private consumption as the main contributor (7.9% and 6.3%, respectively) due to a slightly improved labour market situation and savings accumulated in previous years. Investment growth is related to construction needs from a very low base, but is restrained by a lack of financing, and so do government capital outlays. As a result, real gross fixed capital accumulation will increase by 11% in 2023 and 9.2% in 2024. Real exports are expected to further decline in 2023 and start growing only in 2024, as logistics are still adjusting to challenges coming from occupied key pre-war export routes via the Azov Sea and trade restrictions by a few EU neighbourhood countries. As real imports recover to a limited degree, the trade deficit is expected to increase further.

Current account in deficit

Inflows of international aid and remittances, that are part of the secondary income, will not cover the trade deficit. This development in part also reflects expected lower grants to the budget. As a result, we forecast a current account deficit of 5.7% of GDP in 2023 and 7.9% of GDP in 2024.

Inflation: Faster slowdown than expected

Inflation slowed more than expected and reached 7.1% yoy in September. This development allowed the NBU to cut the policy rate from 25% to 16% p.a. within the second half of this year in three steps. We project inflation to return to 10% yoy in December 2024 in response to stronger demand pressure from private consumption.

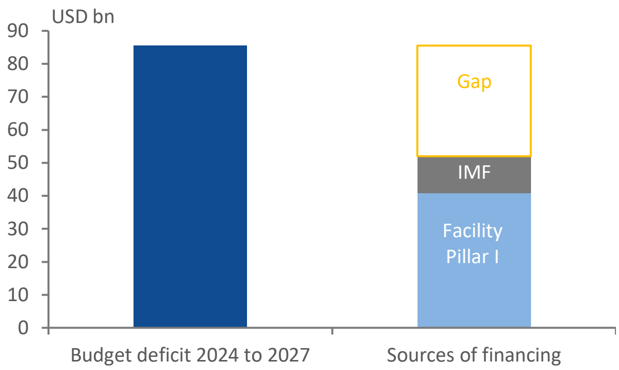
But the forecast is subject to the assumption of avoiding monetary budget financing in 2024 as has been temporarily done in the course of 2022.

Fiscal deficit: Dependency on international assistance

Thereby, fiscal considerations come into place. In 2023, international assistance in grants and concessional loans already reached USD 34 bn, exceeding the amount of last year. However, so far, Ukraine does not have enough approved financing for next year. The draft 2024 budget calls for USD 42 bn in external funding.

In October, the US failed to approve financial support for Ukraine for the end of this and for the next year. At the same time, the EU will provide monthly tranches until the end of this year. From 2024 onwards, the European Parliament approved already the Ukraine facility, amounting to EUR 50 bn, where about 75% would be set as budget support (Pillar I). The disbursements would be quarterly based on reviews of fulfilled conditionalities. For the time period 2024 to 2027, however, the current financial commitments are not enough to finance the projected gap between revenues and expenditures. The IMF projects accumulated budget deficits of USD 85.5 bn for 2024 to 2027 while the commitments sum up to just USD 52 bn. The result is a gap amounting of USD 33.5 bn for this time period.

Budget financing needs and commitments 2024 to 2027



Sources: European Parliament, IMF estimates

What could be done about this gap?

Firstly, a strategy to increase revenues is required. Secondly, Ukraine's partners to find options to assist Ukraine in sustaining financing resources. Preparation of a legal solution to use frozen Russian assets would be a very welcome kind of support. In this context, the transfer of generated revenues and later the use of frozen assets are considered as an option by the European Parliament in its approval of the facility. Looking at our current forecast for the debt ratio of 87% to 89% of GDP in 2023 and 2024, respectively, this source of financing has top priority. Further loan programmes, even if concessional, would increase the likelihood of debt restructuring, unless Russian frozen assets are disbursed.

Outlook

The massive fiscal challenges already mentioned still do not take into account the extraordinarily large reconstruction costs that already exceed USD 411 bn. While progress has been made on establishing coordination between institutions, the following questions remain open and might become relevant for the forthcoming Ukraine Reconstruction Conference in Germany in 2024:

- Continued international support in form of grants vs. loans
- Partnership between private investors and public institutions on investment guarantees
- Further legal steps towards using frozen Russian assets

These objectives and the overall macroeconomic forecast are subject to exceptionally high war-related uncertainty. Overall, however, joining forces between Ukraine and its international partners in bringing the war to an end as quickly as possible is the key precondition for Ukraine's future economic growth perspectives.

This newsletter is based on the joint Economic Forecast 2023 and 2024 by the Institute for Economic Research and Policy Consulting and the German Economic Team and the forthcoming Economic Monitor for Ukraine.

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**Advisory activities in Belarus are currently suspended.*

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