UKRAINE: Delays in providing Western aid pose existential threat

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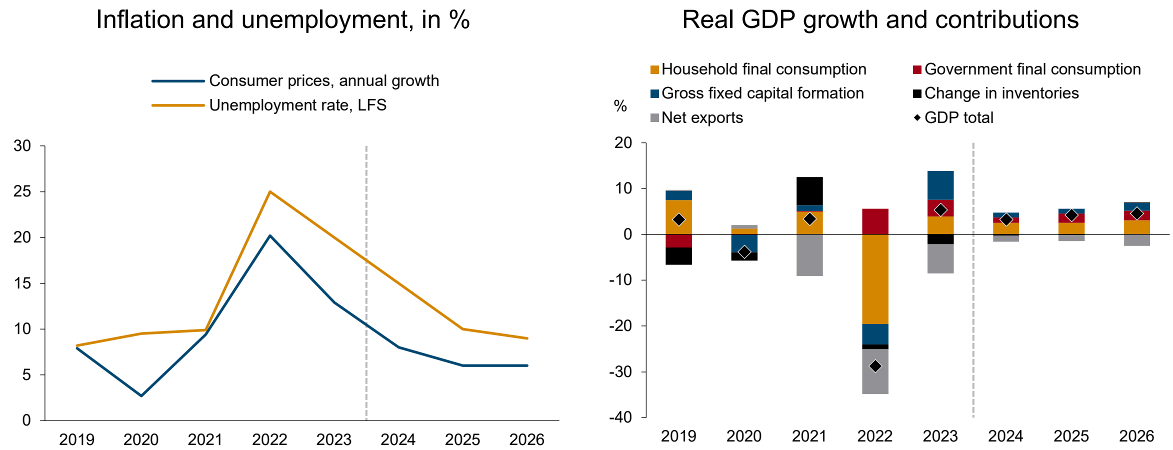
GDP growth exceeded 5% in 2023, thanks to the resilience of the economy under war conditions and ample financial and military aid from the West. The establishment of a new shipping route in the Black Sea helped Ukraine partly offset the effects of the border blockade by Poland. However, friction has recently surfaced over the provision of military and financial assistance to Ukraine, and that could hamper further recovery of the economy in 2024. Economic growth will accelerate in 2025-2026, conditional on a reduction in security risks and an expansion of the reconstruction efforts. Downside risks to the forecast have increased: top among these is the risk that Ukraine could lose the war, due to inadequate support from the West.

Figure 6.23 / Ukraine: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

In 2023, the Ukrainian economy showed remarkable resilience, growing by 5.3% year on year. The low base of comparison, of course, played an important role here; nonetheless, there were many signs of a broad economic recovery in the midst of the war. Growth was registered in many sectors, especially in agriculture and food processing, the manufacturing of construction materials, weapons, motor vehicles and electronic equipment, as well as construction. The defence industry saw a rise in production, with drones being the fastest-growing segment – more than 200 drone-producing companies have been created, and the country is on track to produce 1m drones in 2024.[22]

[22] https://kyivindependent.com/zelensky-ukraine-to-produce-1-million-drones-next-year/

The establishment of a new shipping route in the Black Sea and better anti-missile defence capabilities have been crucial for the economy's functioning. The new sea corridor has compensated for the losses caused by Russia's termination of the grain deal in July 2023, and allows Ukrainian goods to be exported by sea without the need for them to undergo Russian inspection. Moreover, businesses are now able to transport not only grain, but also other goods, including metallurgical products – something that has helped with the recovery of the metallurgy sector. By preventing any significant damage to the energy system from Russian missile attacks, Ukraine was able to avoid widespread blackouts during the winter, and in recent months has been able to resume its export of electricity to Europe.

The opening of the new sea corridor also softened the blow from Poland's blockade of the border with Ukraine and the curbs on the import by the EU of many Ukrainian foodstuffs – a move introduced to appease farmers. The geographical structure of Ukraine's agricultural exports has been moving back toward the pre-2022 situation, when non-EU countries accounted for the bulk of them. For example, in 2021, Egypt, Indonesia, Turkey, Pakistan, Morocco, Bangladesh, Lebanon, Saudi Arabia and Tunisia together accounted for more than two thirds of Ukraine's wheat exports.

Ukraine's merchandise exports to Poland fell in 2023 by almost 30% year on year (in USD terms) – double the rate of decline for overall merchandise exports. The road blockade appears to have had the greatest adverse effect primarily on Ukraine's non-commodities exports, such as furniture, wood and articles of wood, textiles and apparel. For example, exports of furniture to Poland – which used to account for about 7% of Ukraine's merchandise exports to the country in 2021 – declined in 2023 by 20% year on year (in USD terms). Ukraine is currently unable to use the river and sea routes for the transportation of such goods, as this is mainly undertaken in containers. The Ukrainian government has been working to set up container transportation on the Danube and via the Black Sea; however, in the short term companies that used to export to Poland will have to go through a painful adjustment period.

Investment has been the biggest driver of growth in 2023, reflecting the need to boost Ukraine's defence against Russia and rebuild the infrastructure damaged by Russia's missile attacks. Gross fixed capital formation grew in 2023 by more than 50% in annual terms, which led to a 5 percentage point increase in its share in GDP (to 16.9%).

Final consumption also demonstrated robust expansion. Households increased their consumption in 2023 by 6.3% year on year in real terms on the back of the real wage growth (about 4% year on year) as well as the rapid fall in consumer inflation, which decreased from 26% year on year in January 2023 to 5.1% year on year in December 2023. Inflationary pressures have eased, owing to the strong harvest and a better supply of certain food products, a moratorium on rises in utility tariffs, a fall in the growth of global oil prices and a more stable situation on the foreign exchange market.

Inflation has slowed further this year: in February, the consumer price inflation was recorded at 4.3% year on year, its lowest level since 2020. At the same time, core inflation has fallen more slowly than anticipated, due to the restricted supply of certain imported goods (due to the Polish border blockade) and stronger wage growth brought about by the restricted supply of labour caused by emigration and military mobilisation. Inflationary pressures are expected to rise in the coming months, in particular following a likely rise in electricity tariffs in the wake of recent Russian strikes on the energy infrastructure. Therefore average annual inflation is expected to accelerate to 8% in 2024. In 2025-2026, it is anticipated that inflation will slow to 6% per annum, assuming the availability of adequate external financial aid.

Foreign financial assistance has been crucial for the economy: in 2023, inflows totalled around USD 43bn, or about 25% of GDP. This has allowed the government to increase its consumption by 9% year on year in real terms, in order to finance its defence needs and social spending. It has also been essential for assuring macro-financial stability in the country. The national bank could increase its forex reserves in 2023 by 42%, to over USD 40.5bn, which covers more than five months of imports.

Military support has been very important as well: Ukraine's ability to successfully defend itself against Russia is a prerequisite for its economic recovery. In 2023, according to the Ukraine Support Tracker of the Kiel Institute, Ukraine received commitments of military equipment, weapons and ammunitions put at more than USD 40bn (this figure is actually likely to be higher, since for many transactions value estimates were not available). The US accounted for more than half of the value of these commitments.

However, this year foreign financial and military aid has been disrupted by both the inability of the US Congress to approve the promised funds and delays surrounding the approval of aid by the EU. In January-February 2024, Ukraine received only USD 809m of foreign aid, and the government has had to issue domestic bonds to finance the fiscal deficit. The approval of the EU Ukraine Facility (EUR 50bn for four years) and the disbursement of EUR 4.5bn from it at the end of March are positive developments, but will not make up for the missing US funds, given that the total foreign financing needs in 2024 alone are estimated by the International Monetary Fund at around USD 40bn. The government has taken steps to increase fiscal revenues, but these will not be sufficient to offset the missing foreign aid.

The lack of military support from the US is particularly critical. Dwindling ammunition stocks and inadequate air defence against Russian missile attacks pose a grave threat to Ukraine. In March alone, Russia fired over 3,000 guided aerial bombs, 600 drones and 400 missiles at Ukraine. The EU has been working on ramping up its defence industry and increasing the production of weapons and ammunitions, as well as on providing additional funds for Ukraine's military needs; but the process is too slow to allow Ukraine to match its military capabilities with those of the aggressor.

In light of the friction surrounding the provision of military and financial assistance to Ukraine, GDP growth in 2024 is expected to slow to 3%. In the baseline scenario, we assume that the EU will be able to adequately scale up its military and financial assistance to Ukraine by the end of this year, and that the US will not withdraw from its support for Ukraine, whatever the outcome of the presidential elections in November 2024. This will mean a reduction in the security risks in 2025-2026 and an expansion of the reconstruction efforts, partially financed by increasing inflows of foreign direct investment. As a result, GDP growth will gradually accelerate to 4.5% in 2026.

Risks to the forecast continue to be on the downside, with the principal risk being that Ukraine could lose the war due to insufficient support from the West. Mr Trump's (re)election as president in 2024 and the EU's inability to expand its defence sector and provide greater military and financial support to Ukraine could lead to that very outcome. Intensified missile attacks by Russia and lack of anti-missile defence capability in Ukraine could lead to bigger disruptions to the economy and a growing exodus from the country.

Table 6.23 / Ukraine: Selected economic indicators

	2020	2021	2022	2023 1)	2024	2025 Forecast	2026
Population, th pers., average	41,745	41,378	35,000	36,700	37,000	37,300	37,500
Gross domestic product, UAH bn, nom.	4,222	5,451	5,239	6,538	7,300	8,100	9,000
annual change in % (real)	-3.8	3.4	-28.8	5.3	3.2	4.2	4.6
GDP/capita (EUR at PPP)	8,580	9,470	8,580	8,760	.	.	.
Consumption of households, UAH bn, nom.	3,054	3,718	3,284	4,078	.	.	.
annual change in % (real)	1.7	6.9	-28.7	6.3	4.0	4.0	5.0
Gross fixed capital form., UAH bn, nom.	564	720	622	1,105	.	.	.
annual change in % (real)	-21.3	9.3	-33.9	52.9	6.0	6.0	10.0
Gross industrial production							
annual change in % (real)	-4.5	1.9	-36.7	6.0	3.0	5.0	7.0
Gross agricultural production							
annual change in % (real)	-10.1	16.4	-25.0	6.0	.	.	.
Construction output							
annual change in % (real)	5.6	6.8	-64.8	22.6	.	.	.
Employed persons, LFS, th, average	15,915	15,610	13,000	13,500	14,000	14,500	14,600
annual change in %	-4.0	-1.9	-16.7	3.8	3.7	3.6	0.7
Unemployed persons, LFS, th, average	1,674	1,712	4,330	3,380	2,470	1,610	1,440
Unemployment rate, LFS, in %, average	9.5	9.9	25.0	20.0	15	10	9
Reg. unemployment rate, in %, eop 2)	1.6	1.1	.	.	.	.	.
Average monthly gross wages, UAH 3)	11,591	14,014	14,847	17,442	19,400	22,000	25,700
annual change in % (real, gross)	7.5	10.5	-11.9	4.1	3.0	7.0	10.0
Consumer prices, % p.a.	2.7	9.4	20.2	12.9	8.0	6.0	6.0
Producer prices in industry, % p.a.	-1.6	40.8	7.6	10.0	9.0	5.0	5.0
General governm. budget, nat. def., % of GDP							
Revenues	32.6	30.5	41.9	47.5	40.0	40.0	40.0
Expenditures	37.9	33.9	58.1	67.8	57.0	55.0	52.0
Deficit (-) / surplus (+)	-5.3	-3.4	-16.1	-20.3	-17.0	-15.0	-12.0
General gov. gross debt, nat. def., % of GDP	60.4	49.0	77.8	84.4	90.0	93.0	95.0
Stock of loans of non-fin. private sector, % p.a.	-2.8	8.2	-3.1	-0.4	.	.	.
Non-performing loans (NPL), in %, eop	41.0	30.0	38.1	37.4	.	.	.
Central bank policy rate, % p.a., eop 4)	6.00	9.00	25.00	15.00	13.0	11.0	8.0
Current account, EUR m 5)	4,612	-3,278	7,587	-8,514	-7,300	-8,300	-12,500
Current account, % of GDP	3.4	-1.9	4.9	-5.2	-4.3	-4.7	-6.4
Exports of goods, BOP, EUR m 5)	39,527	53,301	38,926	32,062	33,100	34,700	36,800
annual change in %	-3.9	34.8	-27.0	-17.6	3.2	4.8	6.1
Imports of goods, BOP, EUR m 5)	45,462	58,911	52,871	58,684	61,700	65,400	72,000
annual change in %	-15.6	29.6	-10.3	11.0	5.1	6.0	10.1
Exports of services, BOP, EUR m 5)	13,628	15,532	15,816	15,177	15,700	16,100	17,600
annual change in %	-12.6	14.0	1.8	-4.0	3.4	2.5	9.3
Imports of services, BOP, EUR m 5)	9,775	12,178	26,366	23,128	22,200	23,300	24,500
annual change in %	-30.3	24.6	116.5	-12.3	-4.0	5.0	5.2
FDI liabilities, EUR m 5)	266	6,717	235	4,007	.	.	.
FDI assets, EUR m 5)	317	368	32	119	.	.	.
Gross reserves of CB excl. gold, EUR m 5)	22,422	25,920	25,282	34,840	.	.	.
Gross external debt, EUR m 5)	102,293	114,426	122,948	145,362	153,000	167,000	176,000
Gross external debt, % of GDP	74.6	67.8	79.7	88.0	90.0	93.0	91.0
Average exchange rate UAH/EUR	30.79	32.31	33.98	39.56	43.2	45.4	46.4

Note: Excluding the territories occupied by the Russian Federation until 2022, and territories where the military actions are/were conducted in 2022 and 2023. Due to the war, most of the usual statistical data are not being collected or published (partly wiiw estimates). This means that all Ukraine forecasts are subject to an unusually high degree of uncertainty.

1) Preliminary and wiiw estimates. - 2) In % of working age population, wiiw estimate. - 3) Enterprises with 10 and more employees. - 4) Discount rate of CB. - 5) Converted from USD.

Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.