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INSTITUTE FOR ECONOMIC RESEARCH AND POLICY CONSULTING

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# Macroeconomic outlook 2024 - 2025

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# Executive Summary

- RUS full-scale war is ongoing and keeps having a devastating impact on Ukraine's economy
- However, GDP is back on a growth path since 2023, and is forecast to further grow in 2024 - 2025
- Based on a set of assumptions on the war and international aid, we estimate a **GDP growth of 3.6% in 2024 and 3.4% in 2025**
  - Demand side: Private consumption and rebuilding investment activities will remain the main drivers in 2024 and 2025
  - Supply side: Moderate growth across all main sector: energy destructions and other war-related factors impede the development
- Trade deficit is not expected to be offset by primary and secondary incomes, **leading to a CA deficit** of 10.3% of GDP in 2024 and 12.9% of GDP in 2025
- Average inflation is forecast to **fall to 5.2% in 2024 and 7.6% in 2025, after 12.8% in 2023**
- A significant part of the financial aid comes in form of loans, and domestic borrowing is forecast to still play a significant role. Thus, the debt burden is forecast to grow **to 96% of GDP in 2024 and to exceed 100% of GDP in 2025** given the assumption of a debt restructuring agreement
- However, the forecast is subject to large uncertainty related to further development of the war

# Structure

1. Introduction
2. Review of the economic development in 2023 and 1H2024
3. Assumptions underlying the forecast
4. Key forecast indicators for 2024 and 2025
5. Key risks for the forecast

Annex

# 1. Introduction

## Background:

- Russia's full-scale war has been ongoing for 30 months
- The **displacement of millions of people**, **further fighting**, **temporary occupation of Ukraine's territories**, **mines**, **destroyed energy infrastructure** and **blocked logistic routes** and further war-caused challenges continue to negatively affect the economic development with no end to the war in sight
- At the same time, Ukraine has been showing strong resilience in adapting to these adverse conditions caused by Russia, but is **relying on the ongoing international support**
- Any forecast of the future economic development is however subject to massive war-related uncertainty and possible revisions

## Purposes of this analysis:

- Update the forecast for the main macroeconomic indicators for 2024 and 2025
- Discuss main downside and upside risks for the forecast

# 2. Review of the economic development in 2023 and 1H2024

## Economic development:

- According to Ukrstat, real GDP grew by 5.3% in 2023 and by 6.5% yoy in 1Q2024.
- This is somewhat higher than IER initial estimate of real GDP increase at 5.0% yoy for 1Q
- The available data is scarce: Ukrstat still does not publish all relevant data, while published data comes with a delay

## Demand side:

- Real wage grew strongly due to economic growth, lack of qualified labour and minimum wage increase. In 2023, real wages were just 5pp below pre-war level supporting private consumption
- Domestic demand growth remained strong, driven by gross fixed capital formation and private consumption
- Government consumption remained strong, but according to the IER estimate it did not grow much to budget constraints in 1Q
- Even though net real exports negatively contributed to the economic growth, exports still increased thanks to the operation of Ukraine Sea Corridor.

## Supply side:

- The positive export development supports not only agrarian companies, but also producers of iron ore and steel
- Starting end of Mar-24, businesses and population faced difficulties with access to electricity and rolling blackouts. Ukraine lost 9 GW of electricity generation capacity, affecting all key economic sectors (Ukrenergo, 2024)
- So, these losses will affect the economic development in the current and in the upcoming quarters

# Review of inflation and current account

## Inflation:

» Inflation continued decelerating in the first several months of 2024 and stabilized at around 3% yoy in March to May. In June it shot up to 4.8% yoy, as the government increased electricity tariffs
  - Good harvest contributed while logistics improvements reduced supply chain disruptions
  - The Government kept all utility tariffs except for electricity for households fixed, Electricity price **increased by 70% in June 2023 and 64% in June 2024 to reduce subsidy costs and generate more cashflow for rebuilding generation capacities**

## Current account:

» Imports recover faster than exports

» Ukraine increased also imports of electricity to reduce shortages

» International transfers and remittances were not enough to offset the increased trade deficit

» Service trade deficit reflects spending of Ukrainians abroad

→ CA deficit remains high

# Review of economic policies

## Government:

- The Government is on track with the implementation of the Ukraine Plan and the IMF programme
- In the end of 2023, the Government introduced windfall tax of 50% on profits of commercial banks in 2023 and 25% for profits in 2024. However, it has not yet approved the decision to increase rates of other major taxes
- Electricity tariffs were increased in June, but other tariffs are kept in place

→ Overall, financial support is expected as planned in volume but with delays possible during the year

## NBU:

- Key policy rate was gradually reduced from 15% p.a. in Dec-23 to 13% p.a. in Jun-24 as inflation was lower than forecast
- Managed floating exchange rate regime still in place
  - Exchange rate reached UAH/USD 41 in Jul-24 with 6% depreciation since Jan-24
  - Current account deficit remains significant
  - The NBU introduced several steps towards FX liberalization
  - The NBU intervention on FX marker remains substantial

→ FX liberalization steps depend on regular stable inflow of FX assistance from international partners

# 3. Assumptions underlying the forecast (1/2)

## War assumptions

- Ukraine will not lose further territories
- War intensity will not reduce in 2024, but from mid-2025 onwards
- More Ukrainians will return than leave: net inflow of people

## Fiscal policy assumptions

- Recovery and reconstruction spending will be limited to emergency needs in 2024 and in 2025, recovery spending will be largely financed by IFIs loans and other donor assistance.
- The US, the EU, and other international partners will deliver on their commitments to provide the financial and military support needed
- The current IMF programme will remain on track in 2024 and 2025
- Ukraine and commercial investors will conclude on a debt restructuring agreement
- No substantial changes in tax policy in 2024 but tax rate increases might be introduced in 2025

# 3. Assumptions underlying the forecast (2/2)

## Trade policy assumptions

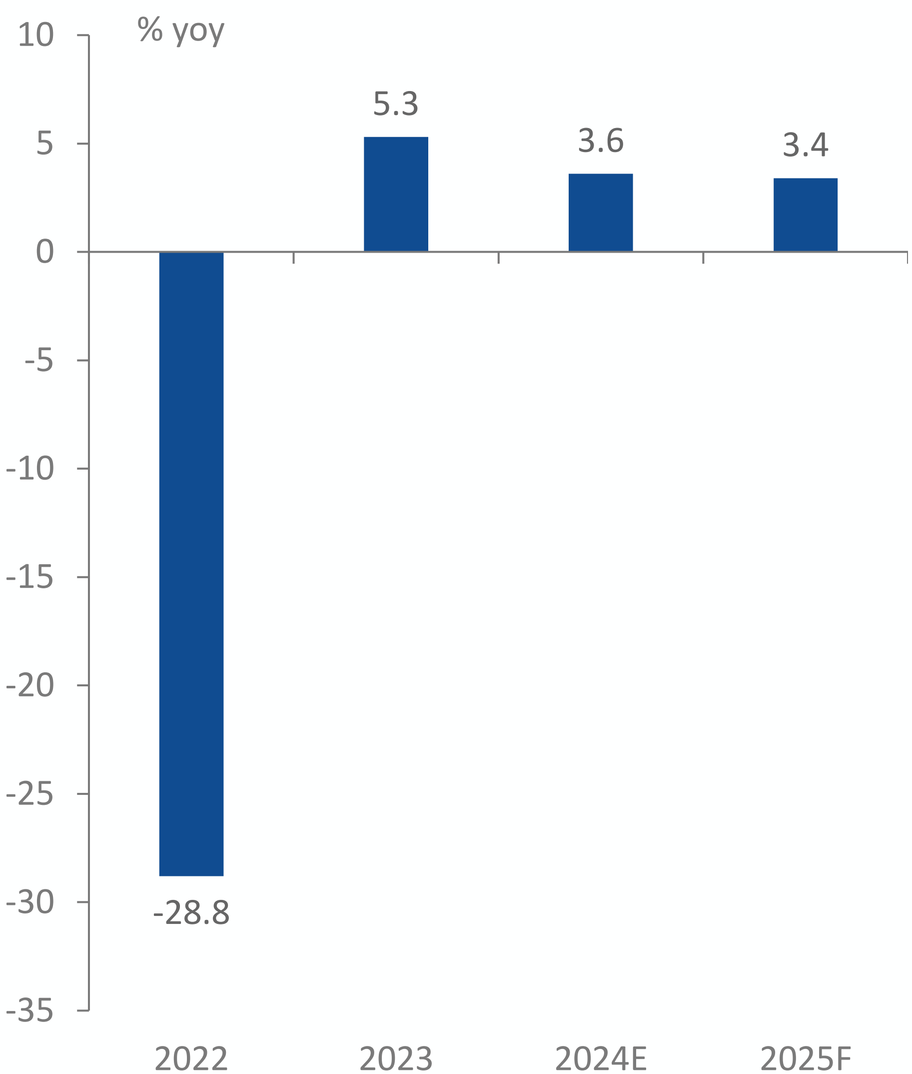
- Ukrainian Sea Corridor will be effective within forecasting period with extended possibilities for both exports and imports
- Western border of Ukraine will operate mostly unobstructed for trade in 2024 and 2025

## Financial and monetary policy assumptions

- Financial sector will remain stable within forecasting period and the NBU will maintain current monetary policy approach
- Capital controls will be gradually relaxed in line with the approved strategy
- Ukraine will be able to install some electricity generating capacities, increase imports, but the electricity deficit will remain in 2024 and 2025
- Gas and heating prices will remain unchanged in 2024
- The Government will gradually increase utility tariffs (e.g. heating and gas in 2025)

# 4. Key forecast indicators for 2024 and 2025

**Ukraine's real GDP change**




*Source: Ukrstat, own forecast for 2024 and 2025*

## Key GDP parameters:

- GDP growth: **3.6% yoy in 2024, 3.4% yoy in 2025, 20% below pre-war in real terms**
- Nominal GDP:
  - 2024: UAH 7.296 bn (USD 184 bn)
  - 2025: UAH 8.363 bn (USD 199 bn) close to pre-war GDP in USD

## Key driving forces:

- Increased GVA in manufacturing, trade, and transport
- Domestic demand will increase gradually
- Fixed capital accumulation will grow: investment into defence and essential repair and rebuilding efforts
- Net exports improve significantly due to the new sea corridor but import‘s growth stronger than export‘s one
- **Recovery is limited by ongoing war**

# GDP forecast: demand side

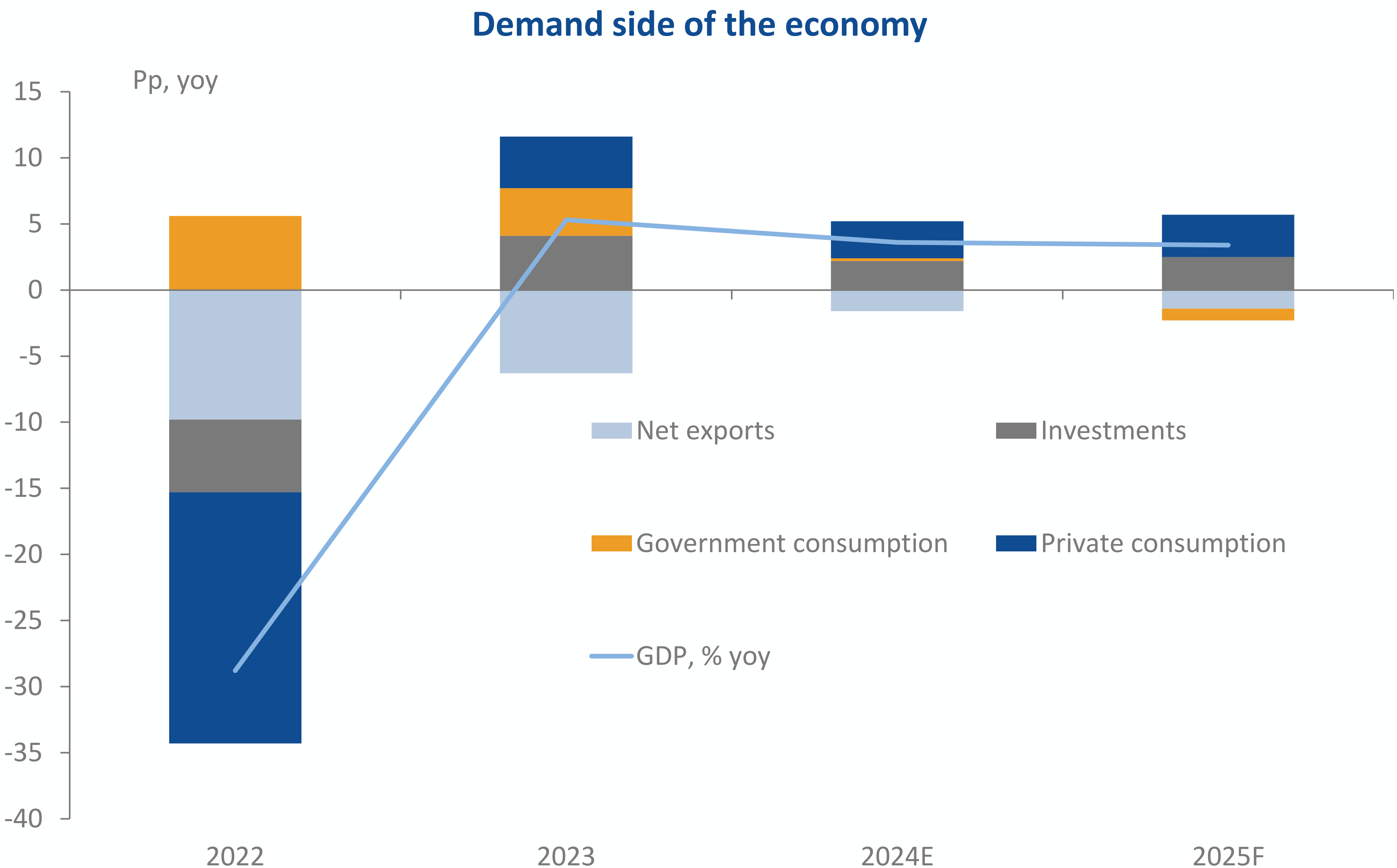
**Real GDP forecast: demand side (change in % yoy)**

| | 2022 | 2023 | 2024E | 2025F |
|---|---|---|---|---|
| GDP | -28.8 | 5.3 | 3.6 | 3.4 |
| Including: | | | | |
| Private consumption | -28.7 | 6.3 | 4.4 | 5.1 |
| Government consumption | 31.4 | 9.0 | 0.4 | -2.4 |
| Fixed capital accumulation | -33.9 | 52.9 | 18.0 | 8.8 |
| Exports | -42.0 | -5.4 | 5.2 | 0.3 |
| Imports | -17.4 | 8.5 | 6.2 | 2.8 |

*Source: Ukrstat, own forecast for 2024 and 2025*

- **Private consumption**: Growth due to real wage recovery, indexation of pension, and use of savings
- **Investments**: Growth is attributed to investments into defence as well as emergency reconstruction and repair needs, i.a. in the energy sector.
- **Real exports**: Ukrainian Sea Corridor ensures increase in exports
- **Real imports**: Increase in response to higher demand
- Import’s growth stronger than export’s one → widening trade deficit in both 2024 and 2025

# Contributions to real GDP growth: demand side




*Source: Ukrstat, own forecast for 2024 and 2025, Investments include gross fixed capital accumulation and inventories.*

# GDP forecast: supply side

**Real GDP forecast: supply side (change in % yoy)**

| | 2022 | 2023 | 2024E | 2025F |
|---|---|---|---|---|
| GDP | **-28.8** | **5.3** | **3.6** | **3.4** |
| Including: | | | | |
| Agriculture | -25.2 | 7.6 | 2.1 | 3.4 |
| Industry | -37.7 | 5.4 | 4.1 | 5.1 |
| Trade | -32.2 | 6.6 | 5.3 | 5.7 |
| Transport | -40.5 | 5.6 | 12.5 | 7.6 |

*Source: Ukrstat. own forecast for 2024 and 2025*

» Agriculture: Major crop harvest is expected to be slightly lower than in 2023 but expected to be offset by gradual recovery in other subsectors of agriculture.

» Industry: Increase in export capacity, gradual recovery of domestic demand and sustained defence contracts are projected to support growth in 2024 and 2025 despite electricity supply constraints.

» Energy:

- On the one hand, in contrast with the winter 2022/2023, businesses are more prepared, and supply limits are more predictable. Electricity imports can be an option for some businesses.
- On the other hand, damage to electricity generation is more entrenched and difficult to repair than it was before. Capacity deficit is high especially in times of peak demand.

» Trade and transport:

- Increase in external trade capacity thanks to reopening of Odesa ports.
- Transport is additionally supported by growing passenger flows including temporary returns of displaced population as well as rising e-commerce orders.

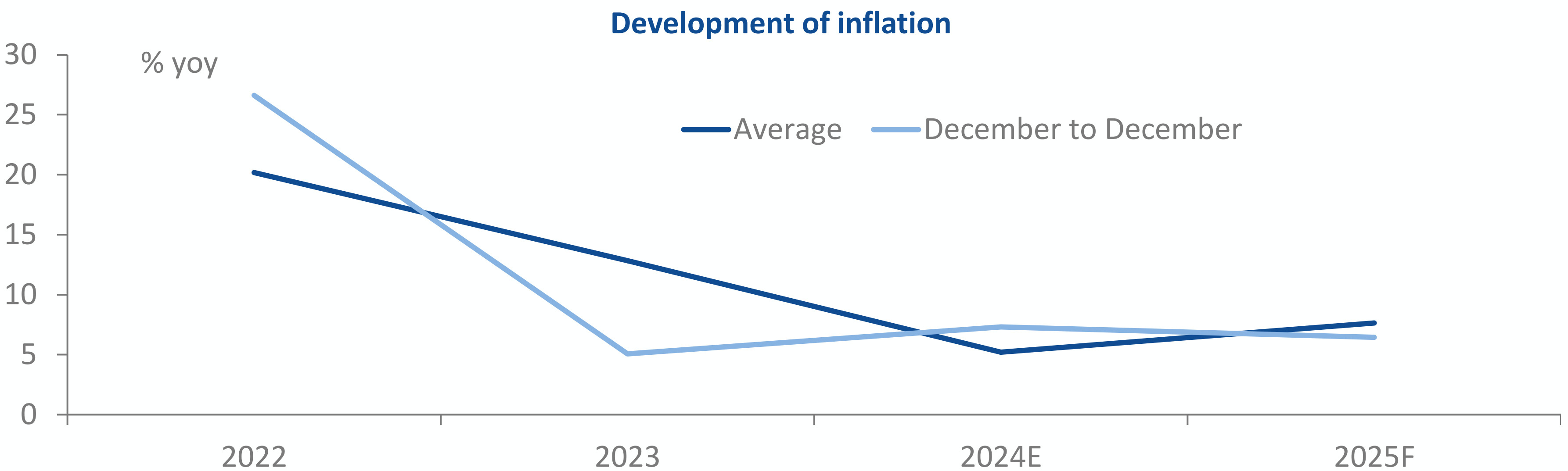
# Current account forecast

| | | Current account | | | |
|---|---|---|---|---|---|
| | | 2022 | 2023 | 2024E | 2025F |
| Current account balance | USD bn | 8.0 | -9.2 | -18.9 | -25.5 |
| Current account balance | % of GDP | 4.9 | -5.2 | -10.3 | -12.9 |
| Exports of goods | USD bn | 40.9 | 34.7 | 35.7 | 37.0 |
| Imports of goods | USD bn | -55.6 | -63.5 | -70.1 | -75.8 |
| Balance of services | USD bn | -11.1 | -8.6 | -7.3 | -6.2 |
| Transfers and remittances* | USD bn | 38.1 | 34.2 | 28.2 | 25.4 |

*Source: NBU, own forecast for 2024 and 2025*

- Goods exports:
  - In 2024, we observe an easing of logistics constraints that added to export capacity.
  - However agricultural export prices – the main export sector – remain lower than previous year. We also expect lower harvest and electricity supply disruption to limit export potential.
- Goods imports: Gradual recovery in domestic demand leads to increase.
- Service trade: Deficit is driven by the refugee spending abroad but gradually declines as some of the long-term migrants are classified as non-residents. Spending of non-residents is not counted as imports of services in contrast to residents temporarily abroad.
- (*)Transfers and remittances: refers to sum of net wage income and secondary transfers and include grants to the state budget at USD 7.5 bn in 2024 and USD 4.0 bn in 2025

# Inflation forecast




*Source: Ukrstat, own forecast for 2024 and 2025*

- 2024: Inflation projection at **5.2% aop and 7.3% eop**: inflation is expected to accelerate in the second half of the year
  - Weaker exchange rate, higher wage costs, as well as lower harvest for some food items (i.e. buckwheat, fruit and vegetables) are expected to add to inflation in the second half of 2024. Still recovery from supply chain disruptions, lower global prices for energy and some commodities and relatively tight monetary conditions are expected to cap inflation increase
  - Increase in electricity tariff by 64% in June added over 1.5 p.p. to inflation in 2024.
- 2025: Inflation projection at **7.6% aop and 6.5% eop**:
  - Increases in tariffs, some decompression of margins as consumer demand continues to recover are expected to keep inflation higher than 5% target

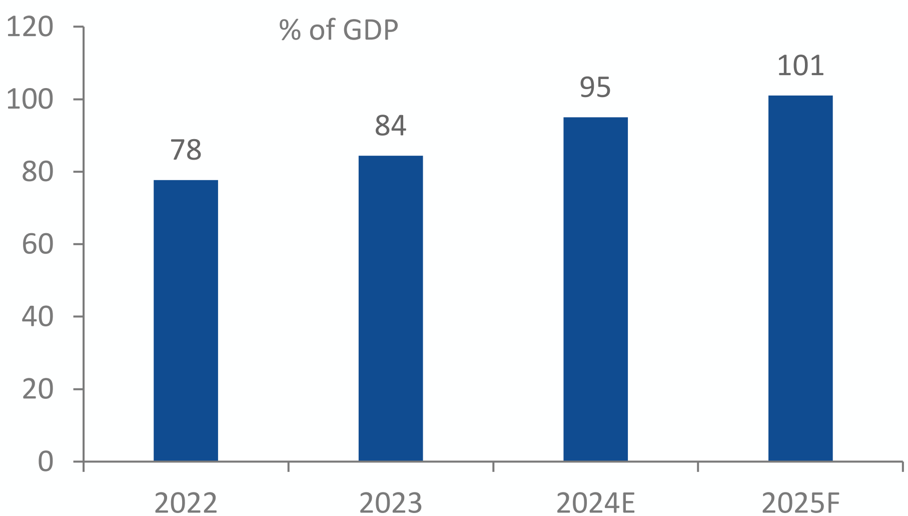
# Fiscal forecast

### Summary of fiscal indicators

| | 2024E | 2025F |
|---|---|---|
| Consolidated fiscal deficit (grants <u>not</u> accounted as revenues), USD bn | 43.4 | 40.7 |
| Consolidated fiscal deficit (grants <u>not</u> accounted as revenues), % GDP | 23.5 | 20.3 |
| Financing needs, incl. domestic debt refinancing USD bn | 50.0 | 54.0 |
| Assumed international aid (grants and loans), USD bn | 37.5 | 32.0 |

*Source MinFin, own forecast for 2024 and 2025*

### State and guaranteed by state debt




*Source MinFin, own forecast for 2024 and 2025*

- Expected financing needs higher than expected international aid
- In 2024, financing is secure if:
  - The US timely disburses USD 7.8 bn
  - Ukraine fulfils timely and in full all conditionalities under the IMF programme and facility by the EU
  - The Government is expected to conclude an external commercial debt restructuring before August 2024
- In 2025, financing is secure if:
  - Loan of USD 50 bn backed by Russian asset proceeds is disbursed – part of can be distributed to upcoming years
  - Further disbursements under IMF programme and facility by the EU
  - Further aid programme by the US
- The IMF, the EU, and most other bilateral assistance **will be provided as concessional loans, which will add to debt burden**
- Public debt (incl. guarantees) is expected at **95% of GDP in 2024 and 101% of GDP in 2025**

# 5. Key risks for the forecast

## Downside risks:

» Worsening of security situation and further occupation of territories

» Increasing infrastructure and energy destruction all over Ukraine

» Delays/change in financial assistance from IFIs and bilateral donors

» Damage to  grain export facilities as well as disruption of seaborne exports

## Upside risks:

» De-occupation of Ukrainian territory, improved security situation

» Faster than expected recovery of seaborne exports

» Larger than expected donor inflows, i.e. for reconstruction or from frozen assets

# 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

| | | 2022 | 2023 | 2024E | 2025F |
|---|---|---|---|---|---|
| **Real Economy** | | | | | |
| Nominal GDP | UAH bn | 5,239 | 6,538 | 7,296 | 8,363 |
| Nominal GDP | USD bn | 162.0 | 178.8 | 183.8 | 198.7 |
| Real GDP | % yoy | -28.8 | 5.3 | 3.6 | 3.4 |
| Consumer price index | aop, % yoy | 20.2 | 12.8 | 5.2 | 7.6 |
| Consumer price index | eop, % yoy | 26.6 | 5.1 | 7.3 | 6.5 |
| **Balance of Payments** | | | | | |
| Current account balance | USD bn | 7.9 | -9.2 | -18.9 | -25.5 |
| Current account balance | % of GDP | 4.9 | -5.2 | -10.3 | -12.9 |
| Exports of goods | USD bn | 40.9 | 34.7 | 35.7 | 37.0 |
| Imports of goods | USD bn | 55.6 | 63.5 | 70.1 | 75.8 |
| Balance of services | USD bn | -11.0 | -8.6 | -7.3 | -6.2 |
| **Exchange rate (official)** | aop, UAH/USD | 32.34 | 36.57 | 39.70 | 42.09 |
| **State and state-guaranteed debt** | % of GDP | 77.7 | 84.4 | 95.0 | 101.0 |

*Source: Ukrstat, NBU, own forecast*

# 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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