Taking stock of Ukraine’s macroeconomic situation and prospects

Oleg Churiy, CFA
former Deputy Governor National Bank of Ukraine

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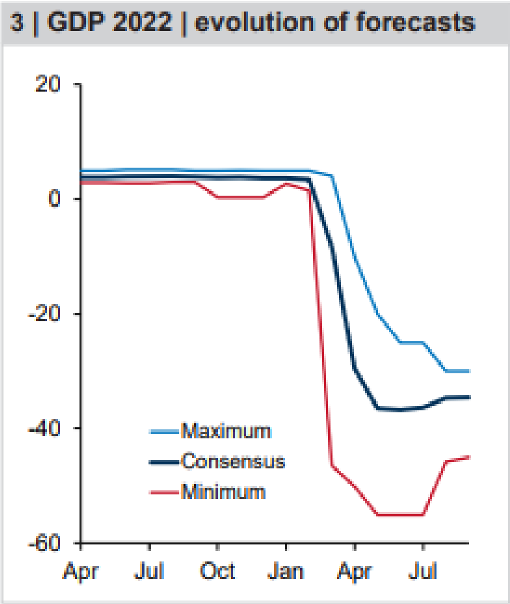
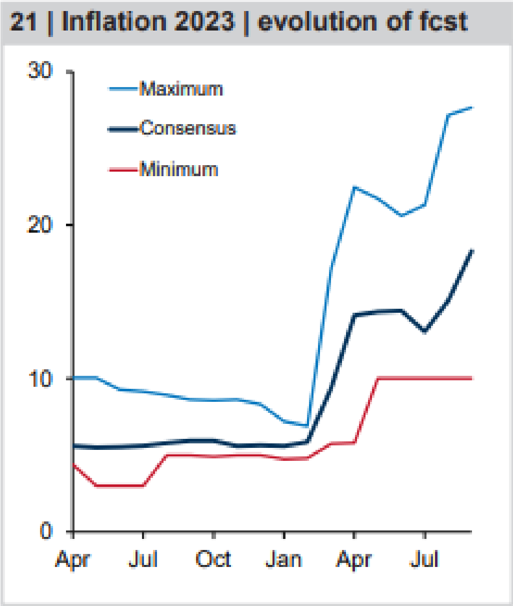
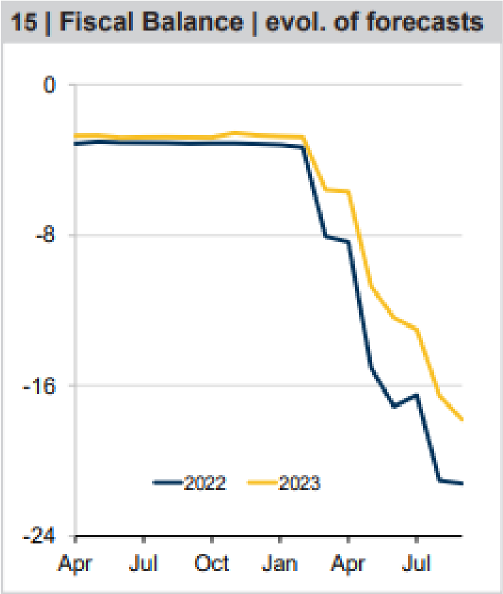
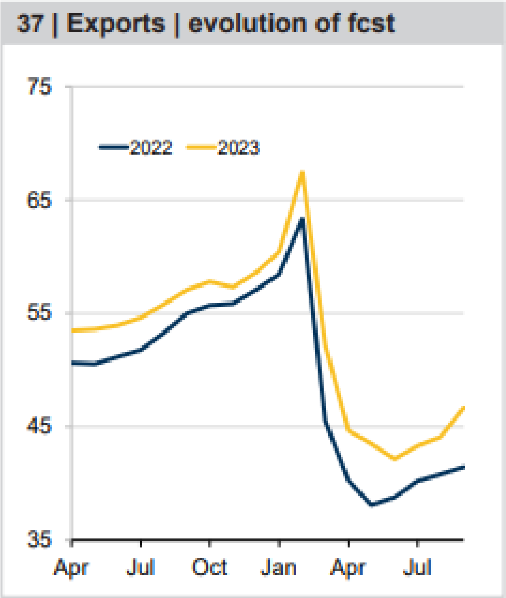
Impact of War on Ukrainian economy

- Physical destruction of production capacity and infrastructure
- Blocking export via seaports
- Internal and external refugees
- Ukraine lost access to international debt market
- As a result: drastic GDP decline, collapse of government revenues, inflation spike, FX reserve depletion









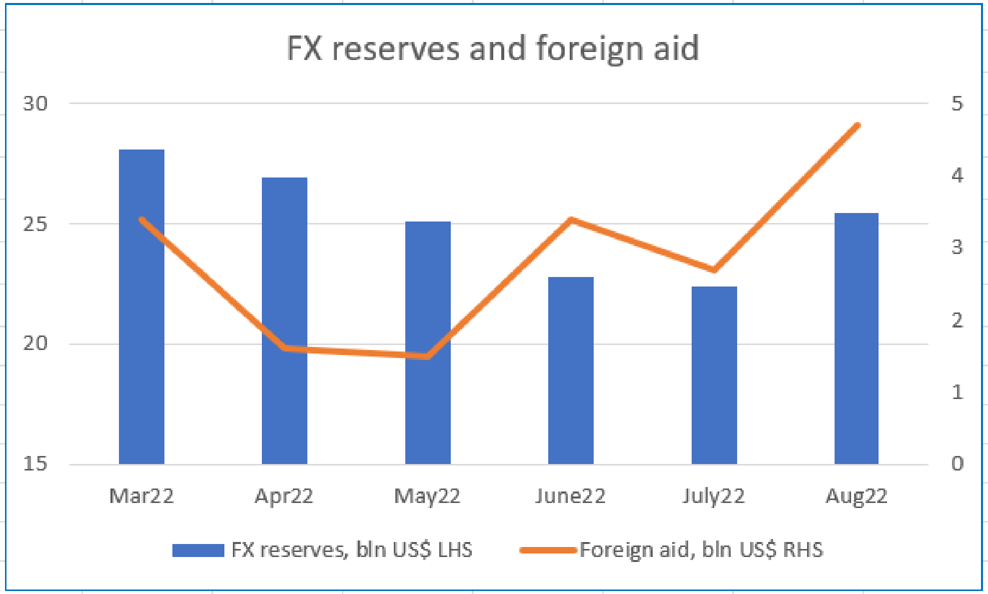
Source: Focus Economics

Policy response- initial steps

- Ensuring banks remain operational and liquid
- Suspending inflation targeting regime
- Fixing ER at 29,3 UAH per 1US$
- FX interventions to support the peg
- Capital controls measures
- Sequestering of non-essential budget spending
- Limited support to business and internally displaced people
- Temporary tax breaks, including import duties
- Monetization of budget deficit
- Request for financial support from foreign partners
- Government & SOEs continued paying external debt

Policy response- later steps

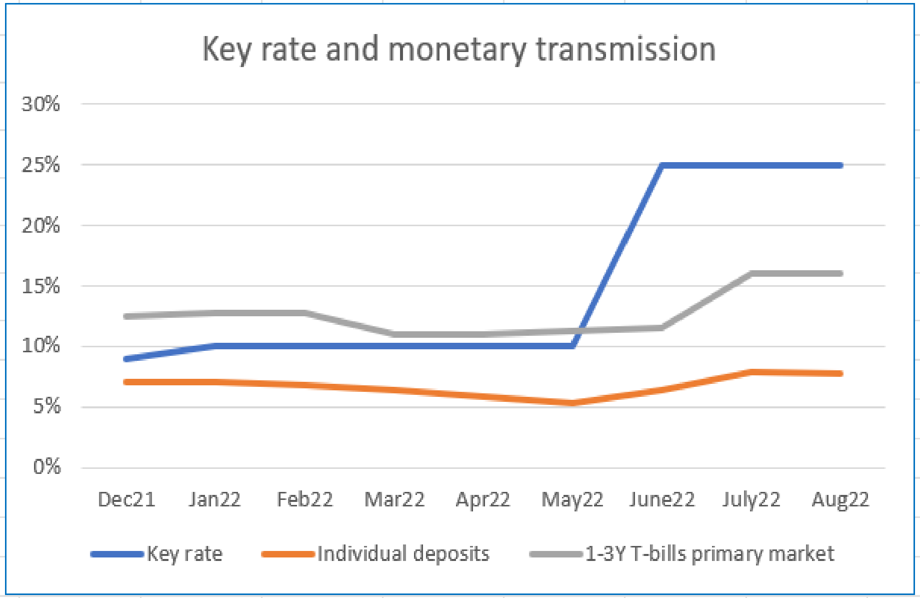
- Hiking key rate from 10% to 25% in June
- Refixing exchange rate at new level of 36.6 UAH per 1US$ or devaluing by 20% in July
- Further tightening and fine-tuning of capital controls
- Reinstatement of import duties but refusal to increase taxes
- Reprofiling of external sovereign & selected SOEs debt held by private creditors
- Relying heavily on budget deficit monetization
- Minfin pays little attention to local debt market

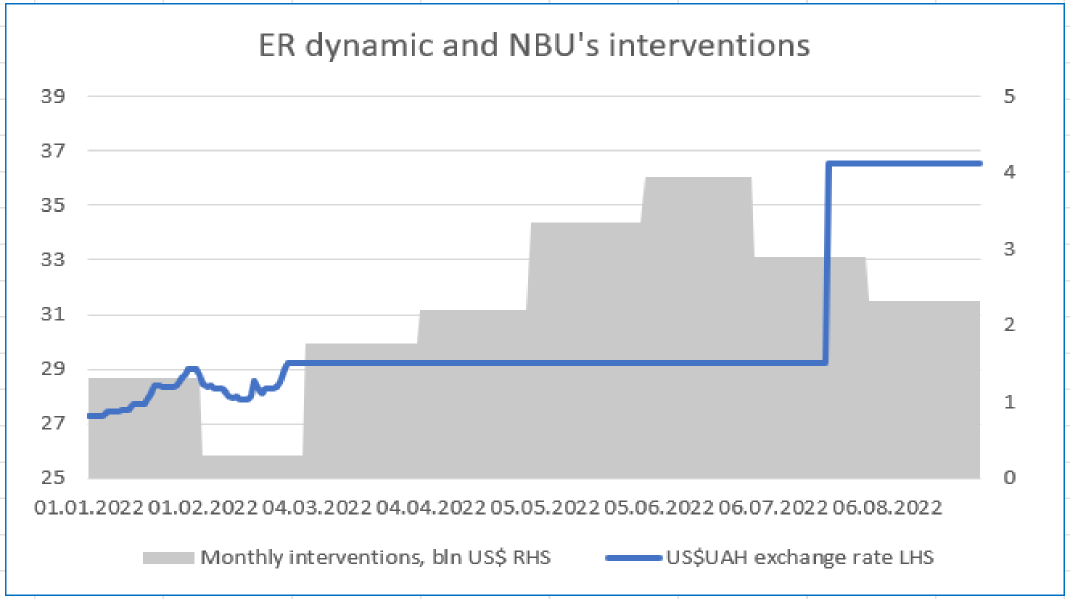


Source: Ukraine MOF, NBU

How effective is policy response?

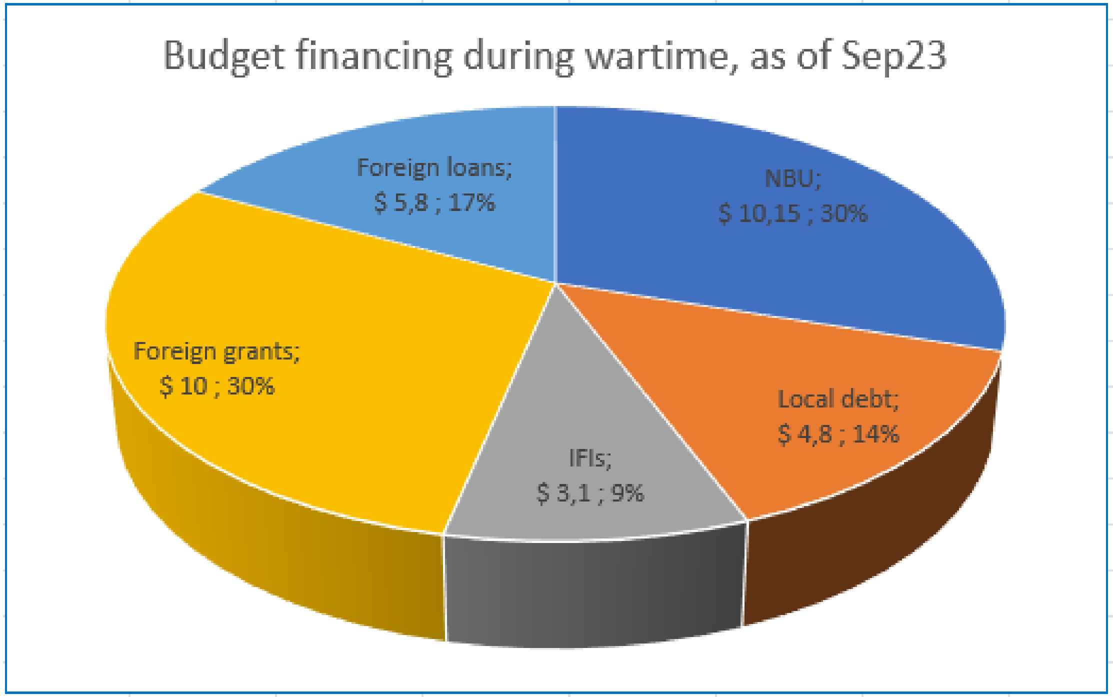
- Financial system is stable (liquid, operations uninterrupted in government-controlled territories)
- Ukraine managed to finance its war budget
- Fixed exchange rate provides nominal anchor although imperfect
- With monetary financing NBU has limited ability to fulfill its mandate for price stability
- Real rates are deeply negative –stimulate capital flight
- July devaluation and increased foreign support helped to reverse FX reserves depletion



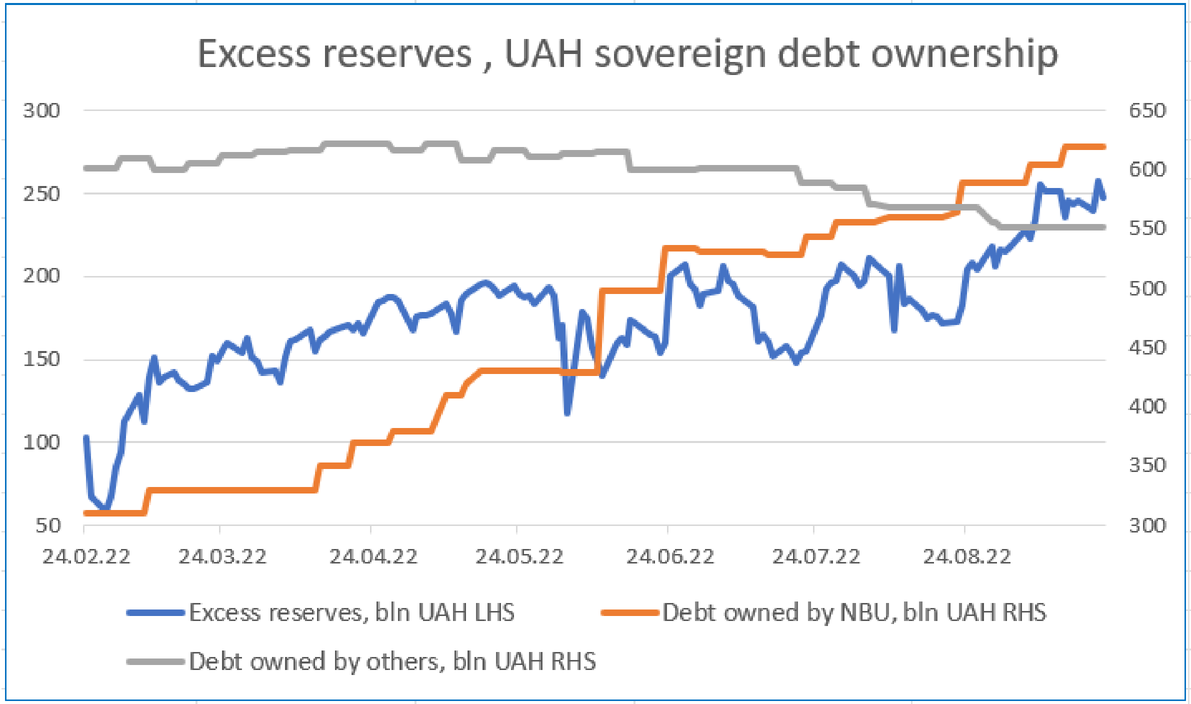


Source: NBU

Financing sources in 2022



Source: Ukraine MOF



Source: NBU

- Minfin relies heavily on foreign support and NBU monetization
- Local market is neglected (55% rollover rate YTD) regardless of all-time high liquidity
- Minfin expects to receive additionally US$ 10-15 bln of foreign financing this year

Draft budget 2023

	UAH, trn	US$, bln*	% of GDP**
Budget revenue	1,28	30	20%
Budget expenditure	2,57	61	40%
Gross financial needs:	1,69	40	26%
Public sector deficit	1,27	30	20%
Amortization :	0,41	10	6%
-external	0,1	2	2%
-domestic	0,31	7	5%
Gross financial sources:	1,69	40	26%
-external	1,59	38	25%
-domestic	0,09	2	1%

* Budget exchange rate 42,2 UAH per 1 US$

** Based on GDP of UAH 6,4 trn (US$ 151 bln)

- Financing from foreign partners would cover 95% of funding needs and amount US$ 38 bln or US$ 3,2 bln per month
- Rollover for domestic debt is less than 30%
- Most probably any shortfall from foreign financing would be covered from domestic sources (NBU +local debt market)
- Sovereign external debt reprofiling allowed to save about US$3 bln of principal and interest next year

Main takeaways

- Foreign financing is critical for budget financing and macro stability
- Grants are preferrable
- Fiscal consolidation is necessary but mainly via revenue enhancement
- Monetary financing must be minimized (only in case other sources are used up)
- Don’t forget about local market!
- Real rates must go up, but NBU must find the way to sterilize liquidity
- Next ER resetting is inevitable, but reserve depletion would be the main trigger
- Is it time to move to more flexible ER (managed float) ?