

The first effects of the war on Ukraine's economy

Sławomir Matuszak

As the war rages on, it is extremely difficult to estimate its effects on the Ukrainian economy, but losses are likely to run into hundreds of millions of dollars a day. A considerable number of enterprises and industrial plants have suspended or limited their operations, but for the time being at least some of them are still paying salaries to their employees. Russia has blockaded Ukrainian ports – a key route for the export of essential commodities (steel and steel products, and above all cereals and food) – which has already caused a significant rise in world prices. A fuel deficit can be expected in the coming weeks, which will further aggravate the economic situation, and may also lead to the delay of the sowing campaign and a reduction in its scope. The likely continuation of military operations in the coming weeks will hamper the country's economic situation, and the expected crisis will have long-lasting consequences.

The business and financial sector

Business activity in Ukraine can only be assessed on the basis of indirect data. Electricity consumption almost doubled after the start of the war (from 24 to about 13.5 GW at peak hours). This suggests that most industrial plants and other enterprises are not operating. According to the President's Office, 50% of companies have stopped their operations, and the rest are working at the limit of their capacity. Some of the largest metallurgical combined collectives – two in the surrounded city of Mariupol, but also the plants in Kryvyi Rih and Zaporizhzhia near the front line – have stopped production, also because most of their output was intended for exports, which is now impossible due to the blockade of ports.

Enterprises in a large part of the country are being prevented from functioning normally by military operations and regular anti-aircraft alerts in cities further from the front line. This also applies to important industrial centres of left-bank Ukraine, such as Kharkiv and Dnipro. The economy ministry has said it would give a preliminary estimate of GDP after the first month of the war. The International Monetary Fund estimates that Ukraine's GDP will shrink by 10%, provided the conflict ends soon; if it continues, the recession could reach 25-35%. According to the Minister of Finance, [Serhiy Marchenko](#), the war has caused a significant drop in budget revenues, especially customs duties: the state is currently receiving only 15% of such revenue compared to peacetime.

Economic activity has further been paralysed by the huge number of refugees. More than 2.7 million people have left Ukraine. The number of internally displaced persons is unknown, but it amounts to several million (from Kyiv alone about 2 million people left, i.e. half of the population, have left, and more than 600,000 have left Kharkiv). A gradual resumption of economic activity can only be observed in those regions less affected by the war (in the

western and central oblasts): apart from grocery shops, pharmacies and even restaurants have started to operate. Since 14 March, school education has been restored in fourteen regions. The authorities and opposition politicians are appealing to small and medium-sized businesses to return to work if their circumstances permit. The supply of food and medicine, but also the regular transport of goods by road, is complicated by the numerous so-called block-posts which have been set up throughout the country at the entrances and exits of towns and at intersections on routes. The checks are significantly lengthening delivery times and causing disruption to logistics chains, with a consequent partial paralysis of internal trade. The authorities are aware of this problem, and have announced a plan to optimise the number of checkpoints.

The country's financial system is still stable. On 25 February, the National Bank of Ukraine (NBU) froze the exchange rate of the local currency at ₴29.25 per dollar. Despite the state of war, it did not decide to increase the base interest rate, which remains at 10%. At the end of February, foreign exchange reserves stood at US\$27.5 billion. To finance its budgetary needs, the government decided to issue war bonds for ₴20 billion (US\$685 million), which were purchased by the NBU on 8 March. About half of the country's banking branches remain open. To avoid a shortage of cash at ATMs, a limit of ₴6000 (just under US\$200) per single withdrawal has been introduced, and some retail chains are offering cash withdrawals at their shops. It seems that in the short term such a step may help solve the problem of access to money. Both the NBU and the President's Office are calling for maximum use of cashless transactions due to difficulties in getting funds to some regions. On 27 February, the NBU decided to move its systems (including electronic payments) to western Ukraine, where employees are not at risk of losing their lives on a daily basis.

Problems with exports

The Russian aggression has led to the blockade of Ukrainian ports on the Black Sea and the Sea of Azov, through which nearly 70% of exports moved. It means losses for Kyiv of around US\$180 million a day, as well as the suspension of supplies of important commodities (mainly heating coal, oil, petrol and diesel). Furthermore, Ukraine is a major global exporter of foodstuffs (mainly oilseeds and cereals), which are primarily exported by sea. Agricultural produce is sent to countries in the Middle East, India and China, among others. The war has already caused a surge in cereal prices on world markets.

The fuel deficit will worsen in the coming weeks. Ukraine alone supplies around 50% of its own petrol needs, 15% of diesel and 20% of LPG. About two-thirds of its petrol and diesel imports came from Belarus and Russia; these supplies are currently halted. In addition, it is not possible to import by sea. The authorities have not said for how many days the stocks will suffice, whether alternative sources of supply have been found in EU neighbouring countries, or to what extent such sources will secure the country's needs. The Russians have so far destroyed only one large fuel depot (in Vasylkovo near Kyiv); the refinery in Kremenchuk is also operational, but the aggressor troops are continuing their advance towards the city. In order to reduce fuel prices, the Ukrainian parliament is proceeding with a draft amendment to the tax legislation, which would abolish excise duty and reduce the VAT rate from 20 to 7%.

The fuel deficit will cause problems during the sowing campaign, which should start in two to three weeks. The Russians have not yet occupied the areas responsible for most

agricultural production, located in the central and eastern parts of the country. Due to the export blockade, some industrial enterprises and individual farmers no longer have sufficient resources to start sowing. To help them, the government has introduced compensation for interest on loans intended for agricultural activities: the maximum support for a company is US\$1.7 million. The Ministry of Agriculture estimates that operators in this sector have most of the products needed to start sowing: seeds (78% of requirements), fertilisers (84%) and crop protection products (55%).

If the country's full sowing programme is not carried out, this could deepen the food crisis on global markets (especially in Egypt, Tunisia and Turkey). Ukraine is the world's largest exporter of sunflower oil, and ranks among the top five for wheat, maize and rapeseed. Agri-food production is a key category of its exports: it brought in US\$27.8bn in 2021, accounting for 44% of foreign goods sales. Failure to export within a few months will significantly increase Ukraine's economic problems. At the same time, however, not even a significant reduction in the available sowing area should lead to food shortages in the country. The Ministry of Agriculture estimates that Ukraine has stocks of 6 million tonnes of wheat (consumption of 8 million tonnes per year) and 15 million tonnes of corn (consumption is 7 million tonnes per year).

Infrastructure losses

On 7 March, the Ministry of Infrastructure estimated losses related to the destruction of the transport network (roads, bridges, railways, airports) at US\$10 billion. During the first two weeks of the war, 63 hospitals and more than 200 schools were destroyed or damaged, and this number is rising every day. On 10 March, the presidential adviser on economic affairs, Oleh Ustenko, estimated the total losses associated with Russian aggression at US\$100 billion, and on 14 March, the Ministry of Economy announced that this figure had already reached US\$119 billion. At present, however, it is not possible to verify these figures even approximately.

The military action is leading to increasing problems in the energy sector, but so far the Ukrainian gas system and electricity grids have not been paralysed. It is estimated that around 240,000 people have been left without gas, and close to a million without electricity, but these figures are constantly changing due to Russian military activity and the repairs carried out by Ukrainian repair teams. There is no information on the size of coal stocks for thermal power plants, but in the current situation (i.e. the drastic fall in energy consumption) domestic mining should yield sufficient quantities to continue operation.

There are also no reports on how rail freight is functioning under wartime conditions. Gas transit is proceeding unhindered, although there is fighting in the Kharkiv and Sumy oblasts, through which gas pipelines carrying crude to Western Europe pass, and these may be damaged. On 10 March, OGTSU (the gas pipeline operator) reported that Russian soldiers had seized one of the compressor stations in the Kharkiv region, which could threaten stable transmission, but so far no such disruptions have occurred.

Prospects

The scale of the crisis for the Ukrainian economy will depend on how the military situation develops in the coming weeks, but if the current trend continues, the collapse will only get worse (especially if Kyiv and the eastern cities are blockaded). So far, the authorities have been able to pay salaries, pensions and other social benefits. However, the significant fall-

off in trade and the fact that a large part of enterprises cannot pay taxes may lead to further economic destabilisation, and create social discontent. Consequently, the functioning of Ukraine's financial system will be directly dependent on prompt and flexible assistance from the West. Currently, according to the estimates of the head of the parliamentary committee on finance, Danylo Hetmantsev, the amount of support received and announced in the form of loans and direct grants is about US\$25 billion. However, it is difficult to say for how long this will be sufficient.