INSTITUTE FOR ECONOMIC RESEARCH AND POLICY CONSULTING

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Resume

- According to the IER, the real GDP growth rate was 3.1% yoy in January 2024.
- The power system remains balanced despite russian shelling. Due to the cold weather, industry and the population increased electricity consumption.
- The Ukrainian Sea Corridor is working well, but trucks at the border are blocked again. Exports by sea in January amounted to 8.7 m tons, and another 2.7 m tons were transported by rail.
- The strike of Polish farmers hinders Ukraine's foreign trade. Since February 12, they have blocked five border crossing points on the Ukrainian-Polish border.
- The current account deficit in 2023 was 5.5% of GDP. The key factors are sharply increased goods trade deficit against reduced grants and expanded investment payments.
- In January 2024, a minimal amount of external financial assistance was received. Expenditures were significantly lower than planned.
- The EU almost approved aid to Ukraine, while a heated debate continues in the United States.
- At the beginning of 2024, consumer inflation decelerated to 4.7% yoy. It was below 5% for the first time since 2020.
- The hryvnia stabilized in 2024 due to a better balance between exports and imports.
- The NBU left the key policy rate at 15% per annum in January and confirmed that there are currently no plans to reduce the rate significantly in 2024.

Фінансується Європейським Союзом

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2023: Challenges were immense, but macroeconomic resilience was maintained

2023 was not a year of victory in the war; active military operations continued throughout the year. However, thanks to the support of international partners, Ukraine maintained its macroeconomic stability, although this stability is fragile and requires ongoing assistance, both militarily and financially.

- On December 14, the European Council approved initiating negotiations on Ukraine's accession to the EU. The next step, the "negotiation framework" approval, is expected in March 2024.
- According to the IER estimate, the real GDP grew by 5.2% in 2023, remaining 25% lower than in 2021. Growth occurred in the agricultural sector, where the grain harvest exceeded all initial estimates, and in the processing industry.
- Demand-side GDP growth was based on a 7% increase in private consumption due to the timely and full payment of the public sector's wages, pensions, and social benefits and the use of savings. Defence procurement contributed to investment growth.
- Expenditures of the consolidated budget on defence and security amounted to 47.2% and 13.3% of the total, respectively. Ukraine's internal resources covered these expenditures. All other State Budget expenditures were funded through international assistance.
- In 2023, grants and loans received by the state budget amounted to USD 42.5 bn (2022: USD 31.1 bn). The consolidated budget deficit reached nearly 22% of GDP.
- One of the anchors of macroeconomic stability was low inflation, which slowed to 5.1% yoy in December 2023 from 26.6% yoy in December 2022. A stable exchange rate, a good harvest, and fixed tariffs for utilities (except electricity) and passenger rail transport contributed to that.
- At the same time, the inflation slowdown allowed the National Bank of Ukraine (NBU) to reduce the discount rate from 25% per annum to 15% during the year. The NBU also eased currency restrictions and allowed moderate fluctuations in the exchange rate while continuing to sell billions of dollars to stabilize the exchange rate.
- In 2023, the deficit of trade in goods, according to customs, reached a record USD 27 bn or 16% of GDP. Imports grew by 15% to USD 64 bn against high military needs and economic recovery. At the same time, exports decreased by 19% to USD 36 bn, primarily due to problems with logistics and the introduction of quantitative restrictions on Ukrainian grain in Poland and other EU neighbouring countries.
- After Russia abandoned the Black Sea Grain Initiative, Ukraine launched the Ukrainian Sea Corridor in August 2023, which, by the end of the year, allowed increasing exports not only of grain but also of ores and metals.
- The blockade of the Ukrainian border, first by farmers and then by carriers, primarily in Poland, challenged international freight traffic during the year, especially in November and December.
- Russia's destruction of infrastructure continued. In June, the Russians destroyed the Kakhovka Hydroelectric Power Plant (HPP) and its dam, causing flooding in the southern regions of Kherson, Zaporizhzhia, and Mykolaiv.
- Total electricity consumption in 2023 decreased by 5% yoy and production by 7% yoy. Production at nuclear power plants decreased the most due to the loss of the Zaporizhzhya NPP. At the same time, electricity production from renewable energy sources in 2023 increased by 9% yoy despite the loss of Kakhovka HPP. In 2023, about 10% of electricity was generated by wind and solar power plants; the share of renewable energy sources, including HPPs, was 20.3%.
- In 2023, the Centralized Spent Fuel Storage Facility was launched in Ukraine. This facility eliminated dependence on Russia for storing used nuclear fuel and is crucial for the country's energy security and independence.

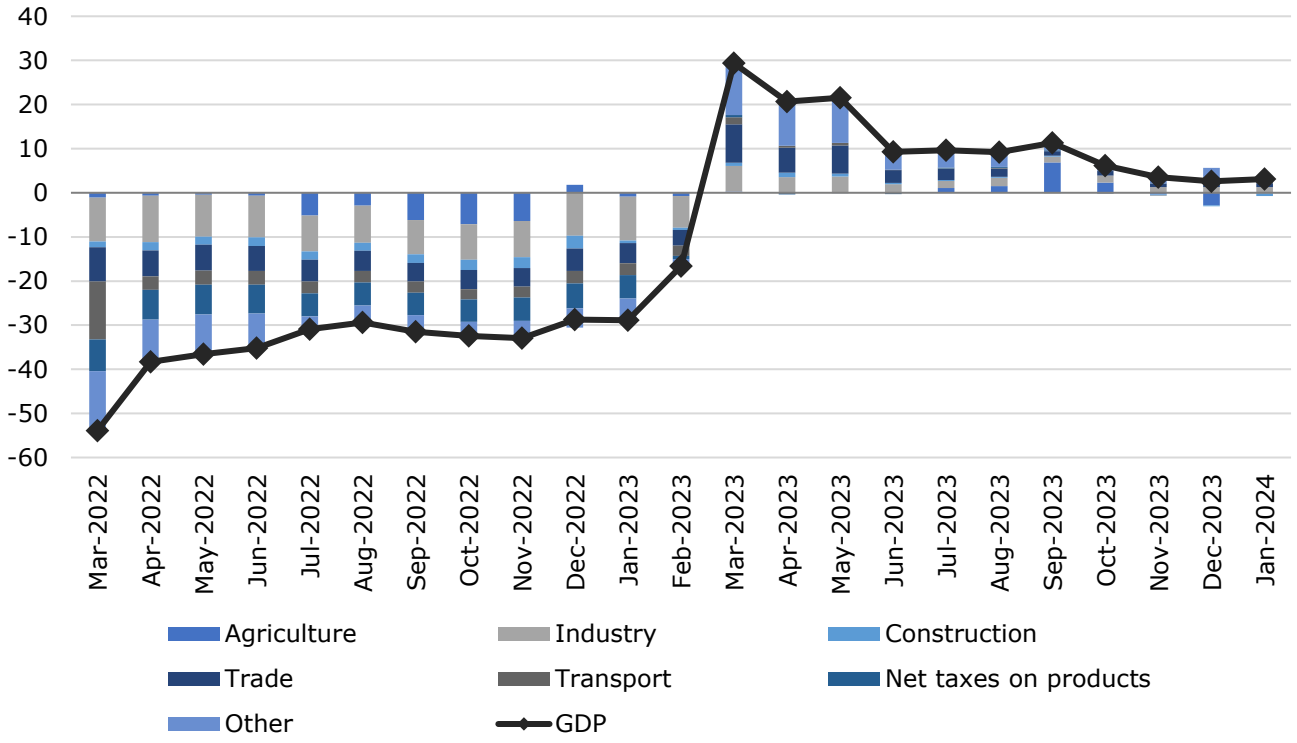
GDP: Real GDP grew by 3.1% yoy in January

According to the IER, real GDP growth accelerated from 2.6% yoy in December 2023 to 3.1% yoy in January 2024. That is primarily because the January indicator, unlike the December one, stopped accounting for the decline in crop production. According to the State Statistics Service methodology, only livestock is accounted for in GDP from January to May. January's tax revenues suggest that trade in December 2023 likely grew faster than we previously estimated. But we have so far refrained from revising the December estimates.

The growth rate in the extractive industry is estimated to have slowed slightly from 8% yoy in December 2023 to 6% yoy in January 2024, primarily due to the statistical base effect. While ore production probably increased due to opening opportunities for sea exports, the extraction of construction materials declined.

Growth in the manufacturing decelerated from 18% yoy in December 2023 to 12% yoy in January 2024, also primarily due to the statistical base effect. In January last year, companies mostly already adapted to power outages, which became predictable and smaller than in December 2022. Military orders further facilitated the development of mechanical engineering. Metallurgy showed good results due to the simplification of export logistics. The IER survey shows that production growth slowed down but remained positive.

Figure 1: Contributions to real GDP, p.p.



Source: IER assessment supported by the USAID Competitive Economy Program in Ukraine

The successful operation of the Ukrainian corridor significantly increased sea exports from Odesa ports. Also, the transportation volume by Ukrzaliznytsia increased rapidly (by 25% yoy). According to the Ministry of Economy, that contributed to the growth of exports to a record 12 m tons. The situation with road transport remained difficult, although it improved somewhat. They are further hampered by road blockades by protesters in neighbouring states. According to the IER, the real GVA in transport increased by almost 7% yoy.

The acceleration of foreign trade, both exports and imports, contributed to the growth rate in the trade sector. Retail trade grew due to the continued payment of pensions, salaries and social benefits. Real GVA in trade is estimated to have increased by 8% yoy.

In construction, the situation has deteriorated, according to estimates, due to lower budget funding for reconstruction and recovery projects. GVA in the energy sector also grew slower than in December, as the situation in the sector was somewhat better in January last year.

Energy: The power system remains balanced despite russian shelling

Electricity. In January, Ukrainian nuclear power plants generated 5.88 bn kWh of electricity, which is 20% more than in January 2023. Thanks to a large-scale repair campaign carried out in the summer and autumn of last year, in winter, Energoatom was able to operate all nine power units located in the territory controlled by Ukraine. In January, DTEK's thermal power plants produced almost 1.5 bn kWh of electricity, 12% more than in January 2023 and equivalent to an average monthly energy consumption of about six million families.

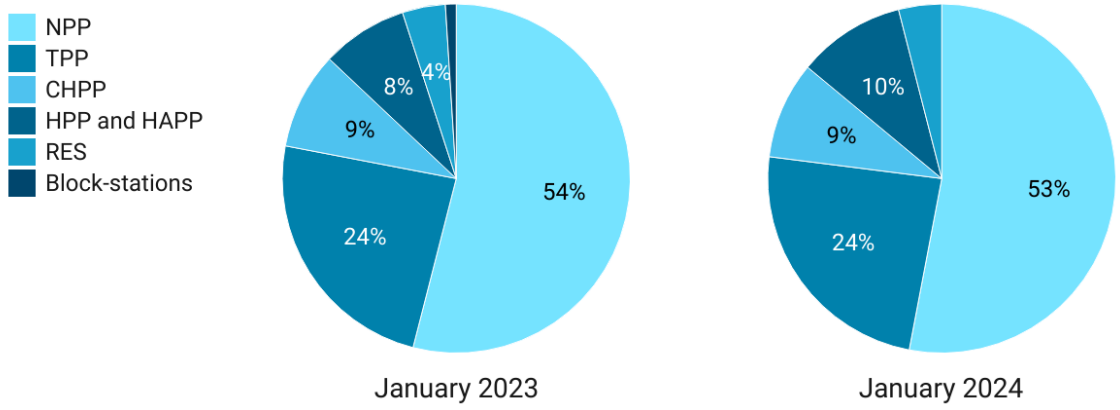
In winter, electricity consumption has increased significantly. In November 2023, industrial enterprises increased consumption by more than 25.7% yoy, and in December – by 37.6% yoy. The volume of electricity consumption by the population also grew. In December 2023, Ukrainians consumed 11% more electricity than in the same period in 2022.

Centrenergo announced that it accumulated 30% more coal than planned. The company reported an increase in the production capacity of state-owned combined heat and power plants (CHPPs) by almost three times compared to the last heating season due to equipment repairs. According to experts, the total coal reserves at thermal power plants (TPPs) and CHPPs are about 800 thousand tons. According to the Ministry of Energy, this is enough to complete the heating season.

As a result of the shelling of the energy infrastructure, TPP units are periodically taken out for short-term emergency repairs, but the balance of the power system is maintained.

The government has transformed SE Guaranteed Buyer into a joint-stock company to strengthen the transparency of the company's work. 100% of the shares in the authorized capital of the SOE belong to the state and are not subject to privatization. Guaranteed Buyer buys electricity from renewable energy sources for state support of the industry and ensures the availability of electricity for the population. At the end of January, the company repaid the debt for renewable energy sources (RES) for UAH 5.8 bn, and it remains to pay another UAH 31.8 bn. The level of settlements with RES in 2023 is 71%.

Figure 2: Share in electricity production, %



Source: ExPro Consulting

Gas. There are about 10 bn cubic meters (bcm) of gas in Ukrainian storage facilities. For the first time in history, Ukraine is going through the heating season using exclusively domestic gas and hopes to reach a zero gas balance in 2024. In January, Ukrgasvydobuvannya launched a new exploration well for 0.25 bcm of gas per day.

The Cabinet of Ministers approved a new charter of Naftogaz, which provides for changes in the company's activities. Oil and gas production is no longer Naftogaz's main activity. Now, its primary activity is ensuring energy supply to Ukrainian consumers.

The gas network also suffers from Russian shelling. As a result of the enemy shelling of Kharkiv on January 23, the medium-pressure gas pipeline in the city was significantly damaged.

Transport: The Ukrainian sea corridor is working well, but trucks are blocked again

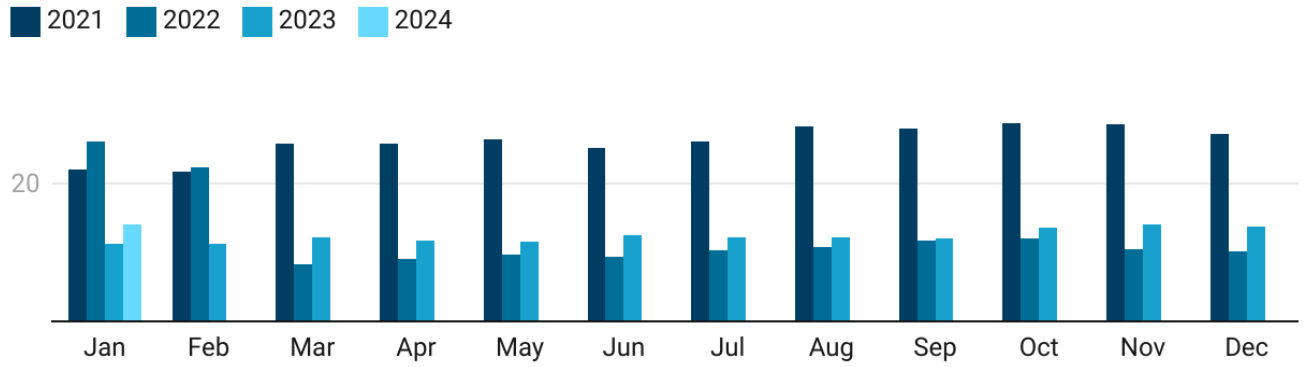
Maritime transport. In January 2024, 6.3 m tons of cargo were exported through the Ukrainian Sea Corridor, 7% less than in December 2023. In total, 8.7 m tons were exported by sea, and more

than 700 vessels with more than 22 m tons of cargo have already passed through the new sea corridor since the beginning of its operation in August 2023.

Rail transport. Ukrzaliznytsia transported 14.1 m tons of cargo in January 2024, 2.5% more than in December 2023. The volume of transportation in the direction of the western border and ports almost tripled compared to December, reaching a record 7.5 m tons (2.7 m tons to the border and 4.8 m tons to the ports). Of these, the railway transported 3.4 m tons of grain and 3 m tons of iron and manganese ore. Such results were achieved thanks to the effective operation of the Ukrainian sea corridor.

In January 2024, 5.6 m tons were transported within the country, and 921 thousand tons were imported.

Figure 3: Transportation of goods by rail, million tons



Source: Ukrzaliznytsia

In suburban traffic, Ukrzaliznytsia carried more than 40 m passengers in 2023, 13% more than in 2022. Suburban trains run in all regions except Luhansk.

Road transport. After the unblocking of the Polish border on January 15, the movement of freight road transport did not fully resume. According to the Ministry for Communities, Territories and Infrastructure Development, the Krakovets-Korczowa and Rava-Ruska-Hrebenne checkpoints operated in early February at 35% of the agreed rates and the Yahodyn-Dorohusk checkpoints at 60%.

Due to the protests of Polish farmers on February 9, the movement of trucks through the checkpoints Hrebenne-Rava-Ruska, Shehyni-Medyka, and Dorohusk-Yahodyn was hampered since February 12, the checkpoints Zosin-Ustyluh and Uhryniv-Dolhobyczow were added to them. Formally, the reason for the blocking was the proposal of the European Commission to extend the complete opening of the EU market for Ukrainian agricultural products for another year.

In January, Ukrtransbezpeka revoked 223 licenses of road carriers that had stopped paying taxes. Their owners ceased their economic activities, but contrary to the legal requirements, they did not apply for the cancellation of permits. Identification of unscrupulous carriers became possible due to the integration of the Unified Complex of Information Systems (SHLYAH) with the Unified State Register of Legal Entities, Individual Entrepreneurs, and Public Organizations. In 2023, there were 1882 such revoked licenses.

The Ministry for Communities, Territories and Infrastructure Development extends the electronic queue service for crossing the border by buses to all checkpoints with EU countries and Moldova. From February 12, buses will be able to cross the border at all 29 checkpoints only after an appointment in the eCherha system. This registration will make it possible to verify the implementation of bus routes and analyze the load on the border.

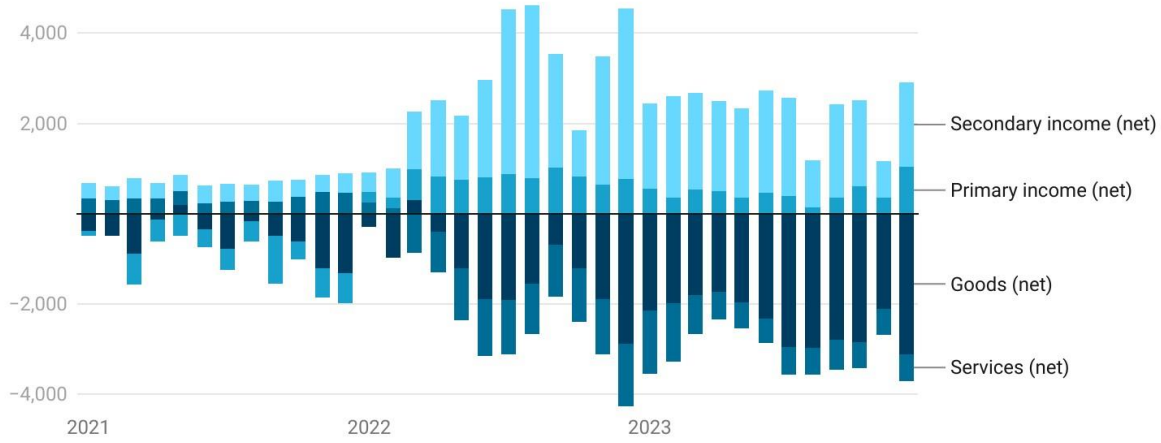
Foreign trade: In 2023, the current account deficit was 5.5% of GDP, a striking change from the 2022 surplus

According to NBU estimates, in 2023 the current account deficit was about USD 9.8 bn (5.5% of GDP) compared to last year's surplus of USD 8.0 bn (5% of GDP). A critical factor in this dramatic change was the widening merchandise trade deficit. The negative balance reached USD 28.8 bn compared to USD 14.7 bn a year ago, as exports declined and imports increased.

In 2023, exports continued to fall, due not so much to the blowing up of the Kakhovka Hydroelectric Power Plant, the consequences of bombing or occupation, but to the introduction of quantitative restrictions on Ukrainian goods in five EU countries, problems with maritime and land logistics, and a decrease in international commodity prices. At the same time, economic recovery and high military needs stimulated the growth of goods imports. The negative balance of trade in services was also preserved in 2023. However, the imports of travel services decreased by USD 2.0 bn and contributed to the narrowing of the deficit from USD 11.0 bn to USD 8.9 bn.

The deficit in trade in goods and services was partially offset by a positive balance of primary and secondary income, but these items were lower in 2023. The primary income balance was USD 5.5 bn, down by nearly USD 3.0 bn from a year ago due to the expansion of investment income payments. Also, in 2023, Ukraine received USD 2.8 bn less grant aid from international partners and 0.9 bn less humanitarian assistance, narrowing the positive balance of secondary income to USD 22.5 bn.

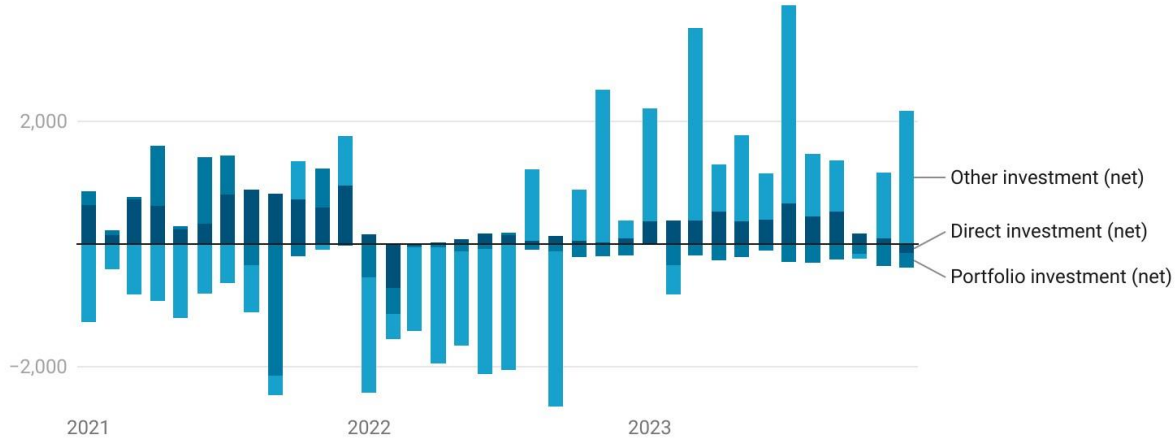
Figure 4: The current account of the balance of payments, USD m



Source: NBU

The current account deficit was balanced by net borrowings from the outside world, which amounted to USD 9.6 bn in 2023. That was USD 1.4 bn more than last year. Most striking was the change in the balance of other investments (including loans, unregistered securities, trade credits, and changes in deposits and cash), with net borrowings reaching USD 15.7 bn compared to USD 8.9 bn in net outflows a year ago. That is explained by the intensification of government borrowing, which in 2023 increased by UAH 11.2 bn compared to 2022 and reached USD 25.9 bn. Net foreign direct investment inflows increased to USD 4.2 bn, mainly due to reinvested earnings.

Figure 5: The financial account of the balance of payments*, USD m



*Source: NBU, * mirror data: (+) means net borrowing, (-) net lending*

State budget: Minimum international aid in January

2023. In December 2023, the State Budget expenditures increased rapidly and amounted to UAH 561 bn compared to UAH 326 bn on average in February-November 2023. Higher defence and

security funding accounted for almost 90% of these figures' differences. In particular, these are expenditures were military procurements, which is important for the state's defence capability. Part of the increase in spending in December was due to premiums paid in the public sector.

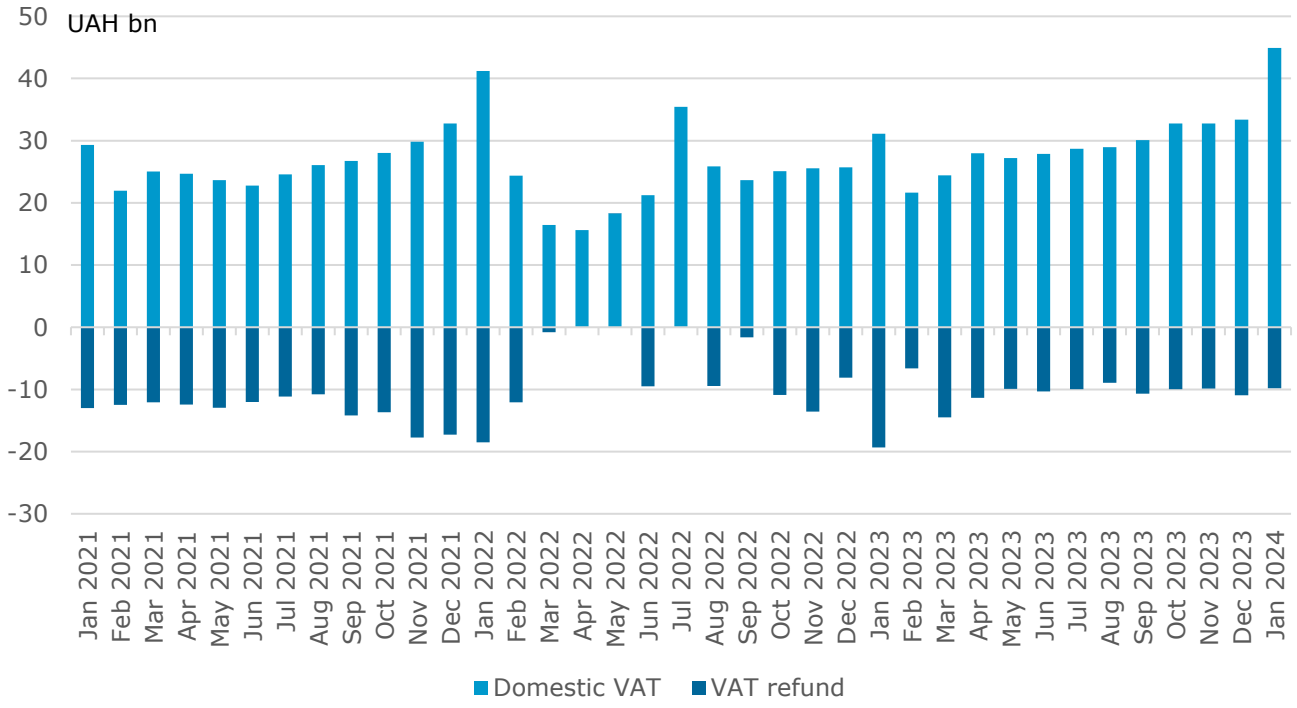
The consolidated budget deficit reached 22% of GDP in 2023. It was primarily financed by external borrowing. EUR 18 bn of macro-financial assistance (under the MFA+ program) was received from the EU as a concessional long-term loan, under which the EU currently provides interest subsidy. According to our estimates, public and state-guaranteed debt increased to almost 90% of GDP.

In 2023, fiscal revenues were supported by grants from the USA of about USD 11 bn. The in-kind (non-monetary) military aid from international partners and volunteers was also included in the budget revenues.

2024. In January 2024, the revenues of the State Budget amounted to UAH 147 bn, of which UAH 116 bn due to general fund of the budget (for comparison, in December, revenues due to the general fund were at UAH 127 bn). The budget received only UAH 3.4 bn in the form of grants.

As a result of high government consumption and higher private consumption in December 2023, gross VAT revenues on goods produced in Ukraine skyrocketed in January 2024. They amounted to UAH 44.9 bn, which is more than in January 2022 in nominal terms (however, in real terms, revenues fell significantly). Although exports have recovered slightly, the amount of VAT refunds has not increased and amounted to UAH 9.8 bn in January. A certain revival of taxed imports due to the easing of the border blockade contributed to an increase in VAT on imports to UAH 37 bn, which is more than in November and December 2023 but still less than in October 2023.

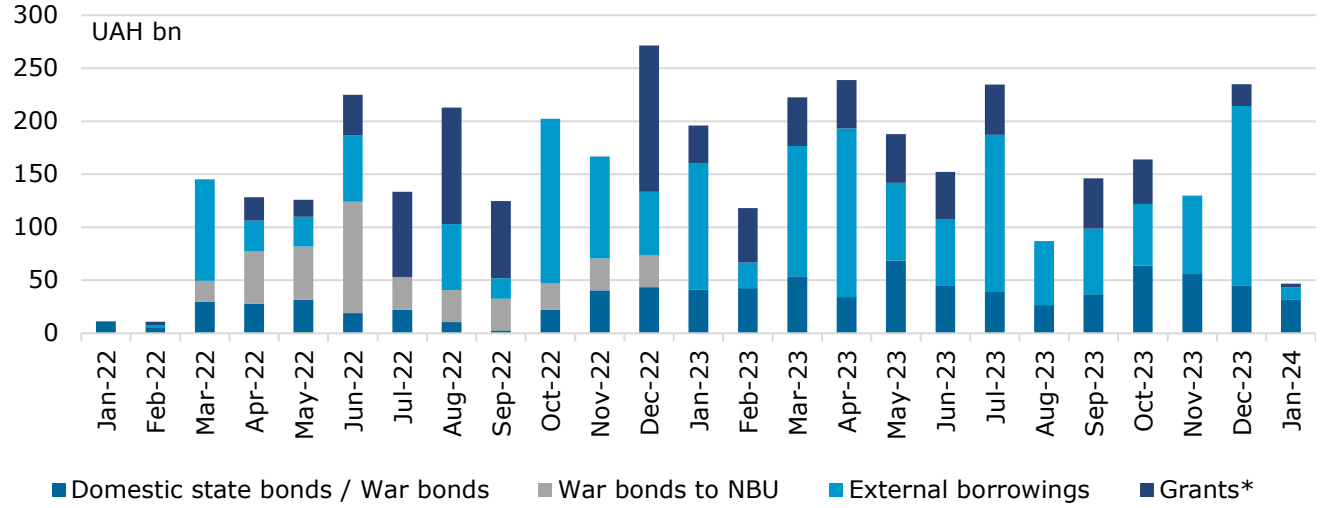
Figure 6: Domestic VAT, UAH bn



Source: Ministry of Finance, openbudget.gov.ua

In January, external borrowings amounted to only UAH 11 bn: the funds came from the World Bank under Japan's guarantees. The placement of domestic government bonds attracted an equivalent of UAH 32 bn to the budget: 60% of domestic government bonds were denominated in foreign currency. Yields haven't changed much. For hryvnia securities, they were higher than the key policy rate (16.8% for one-year securities, 17.6% for 1.7-year securities, and 18.5% for three-year securities). At the same time, in January, the government allocated UAH 17.5 bn for debt repayment and UAH 9.5 bn for servicing (payment of interest). In fact, the government continues to make all payments on domestic debt and debt to IFIs, primarily the IMF. At the same time, there is a standstill on payments on private external debt until September 2024 and on official external debt until 2027. In 2024, the government should agree on restructuring with the Ukrainian Eurobonds holders.

Figure 7: Funding and grants received by the state budget, UAH bn



Note: * Grants are part of budget revenues, accounting under the code 42000000 "Official transfers from the EU, foreign governments, international organizations, donor institutions".
Source: Ministry of Finance, openbudget.gov.ua

Actual borrowings in January amounted to only 34.6% of the plan. Low external financing and uncertainty about future support likely explain the failure to execute the plan for fiscal expenditures. Expenditures of the state budget totalled UAH 169 bn, including the general fund expendures of almost UAH 150 bn, while general fund expenditures in January 2023 amounted to UAH 184 bn.

International support: EU almost approves aid, discussions continue in US

On February 1, 2024, the EU members' leaders provided political support for the Ukraine Facility mechanism at a meeting of the EU Council. After that, on February 5, the European Parliament and the EU Council reached a preliminary agreement on the text of the relevant regulation (but the text is still being finalized). The document is expected to be fully approved by the end of February, and in March, Ukraine will be able to receive a bridge loan. The amount of this loan will depend on the time of approval of the Ukraine Plan, but the March tranche is expected to amount to EUR 4.5 bn. Also, according to preliminary plans, Ukraine should receive EUR 18 bn in concessional loans from the EU in 2024. Still, the final amount will depend on the agreements and the timely fulfilment of Ukraine's commitments. The subsequent loan tranches will also be received depending on the fulfilment of Ukraine's comittments. It is expected that quarterly assessments of the program's implementation will take place. Commitments should be based on the Ukraine Plan, developed (but not yet approved) by Ukraine's Government, which is still also to be approved by the EU Council.

At the same time, the USA continue a heated debate about support for Ukraine. A USD 60 bn support program is currently being considered. About USD 10 bn should come as financial assistance to Ukraine, the rest is primarily defence assistance and funds for the rearmament of the US Armed Forces after previous tranches of assistance to Ukraine.

Since February 13, an IMF mission has been operating in Kyiv, launching the third review of the Extended Fund Facility at the technical level. In general, Ukraine has fulfilled the three structural benchmarks that were due by the end of 2023, and, most likely, has complied with the indicative indicators. Progress is also being made in the implementation of the subsequent structural benchmarks. At the same time, the lack of certainty about financial aid from the USA poses challenges for assessing Ukraine's debt sustainability and financing plan in 2024. Therefore, it is likely that a third review will be approved by the IMF Board either when it is certain that the United States is assisting or if the government provides a plan to cover the gap that arises from its absence, which is extremely difficult.

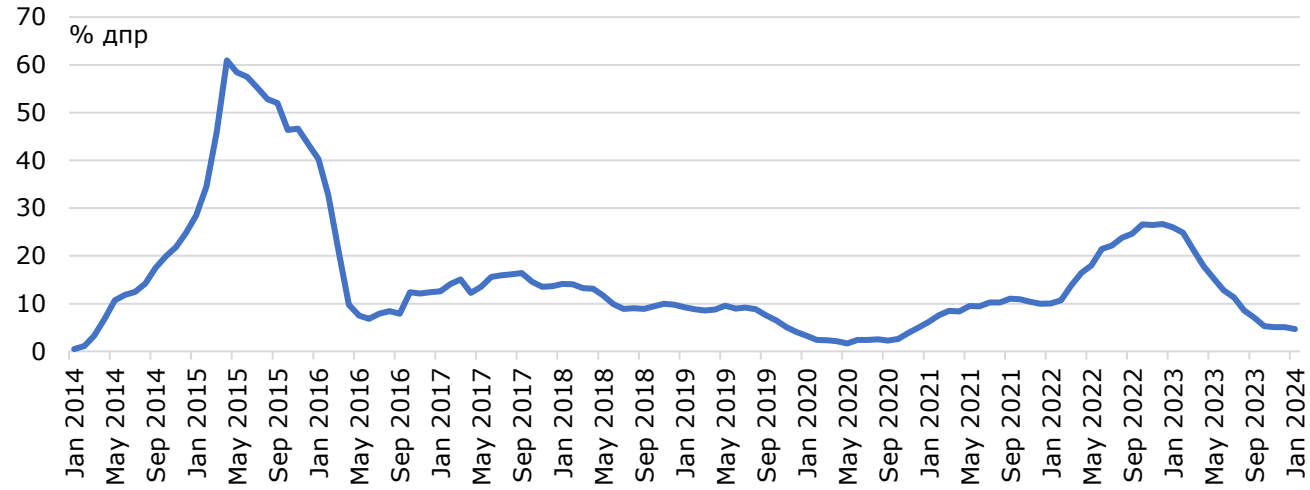
Inflation: Consumer inflation declined below 5% yoy

In January, consumer inflation decelerated to 4.7% yoy. As in previous months, prices for services increased the most: for example, the prices of dining and hotel accomoddation and for outpatient services (dentistry, laboratory tests, etc.) increased by 12% yoy each. The increase in service prices likely reflected rising labour, energy and other incidental costs. At the same time, prices for non-

food products, according to the State Statistics Service, did not increase significantly or even fell compared to January 2023. The stability of prices for non-food products that include large share of imports is likely explained by limited fluctuations in the hryvnia exchange rate, lower logistics costs, and lower commodity prices. Food prices were impacted by the decline in agricultural prices on the world market, which largely offset the increase in other expenses of producers and traders.

Consumer prices in January increased by only 0.4% mom compared to December. Vegetable prices increased again by almost 16% mom and 72% compared to September 2023, when prices collapsed due to a good harvest. This reflected higher import prices and seasonally limited domestic supply. Prices for winter clothing and footwear fell amid limited demand, fuel prices gell as well. On average, prices for other goods and services remained unchanged compared to December.

Figure 8: Consumer price inflation



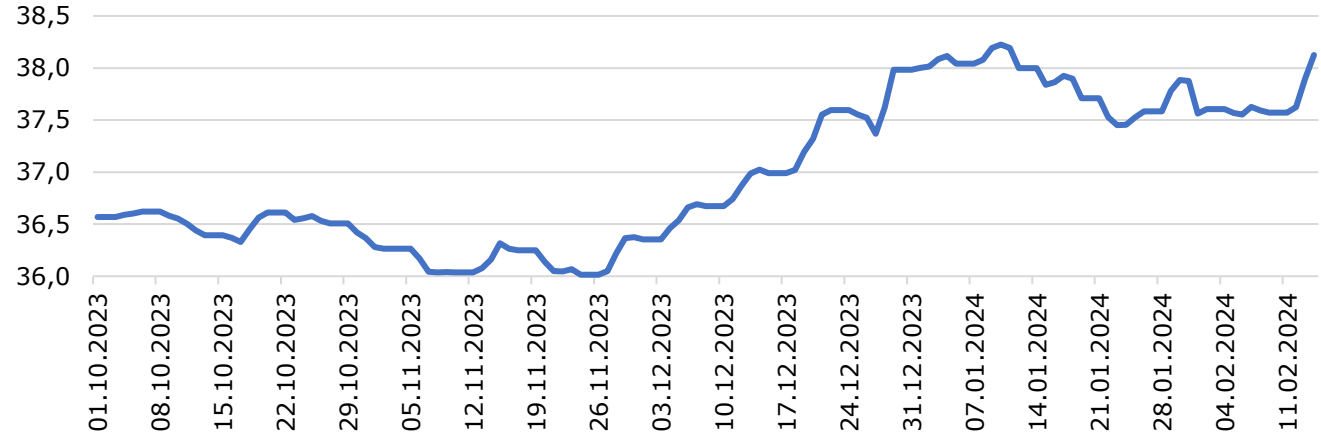
Source: State Statistics Service of Ukraine

Monetary and exchange rate policy: The exchange rate stabilized in early 2024

Exchange rate. In January and February, the hryvnia exchange rate remained relatively stable: the hryvnia remained in the range of 37.4-38.2 UAH per USD. After the seasonal peak in December, the demand for non-cash currency decreased. That happened against a narrowing deficit in goods trade in January. However, the demand for cash foreign currency remained high.

The decrease in demand for foreign currency allowed the NBU to spend less on supporting the hryvnia exchange rate. In the four weeks ending February 9, net interventions amounted to USD 1.38 bn. The last time such an amount was sufficient for the NBU to maintain the exchange rate was in the spring of last year.

Figure 9: Official exchange rate of the hryvnia to the US dollar (UAH per USD)



Note: The exchange rate values in the figure start at UAH 36 per USD. United States
Source: NBU

Monetary policy. In January, the NBU left its key policy rate at 15% per annum, and further decisions to cut the key interest rate are expected in the second half of the year. The NBU reiterated that the policy interest rate will depend on the receipt of external aid and, according to the baseline scenario, any rate reductions will not exceed 1-2 percentage points by the end of the year. However, the NBU's monetary committee noted increased risks, which may force the NBU to reconsider its plans.

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