INSTITUTE FOR ECONOMIC RESEARCH AND POLICY CONSULTING

Monthly Economic Monitoring of Ukraine

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Summary

- According to the IER, real GDP growth in August remained close to 8% yoy (year-on-year), but real GDP was still more than 20% below the 2021 level.
- Thanks to favourable weather, grain yields increased, and the pace of harvesting was higher than last year.
- Numerous repairs of power units of nuclear and thermal power plants against the high consumption background led to emergency electricity imports.
- The shutdown of seaports caused the accumulation of wagons at the railway stations of Reni and Izmail.
- The termination of the Black Sea Grain Initiative has again increased the EU's share of Ukrainian goods exports to 73%, despite the current trade restrictions.
- Lower-than-expected inflation and stronger than assumed during the state budget preparation hryvnia challenge the state budget revenues implementation.
- There was no usual grant from the United States, but the EU provided a regular loan tranche in August.
- In August, consumer inflation slowed down to 8.6% yoy and returned to single digits for the first time in more than two years, primarily due to a record drop in vegetable prices.
- The NBU's international reserves declined slightly but remained high after receiving a concessional loan from the EU.

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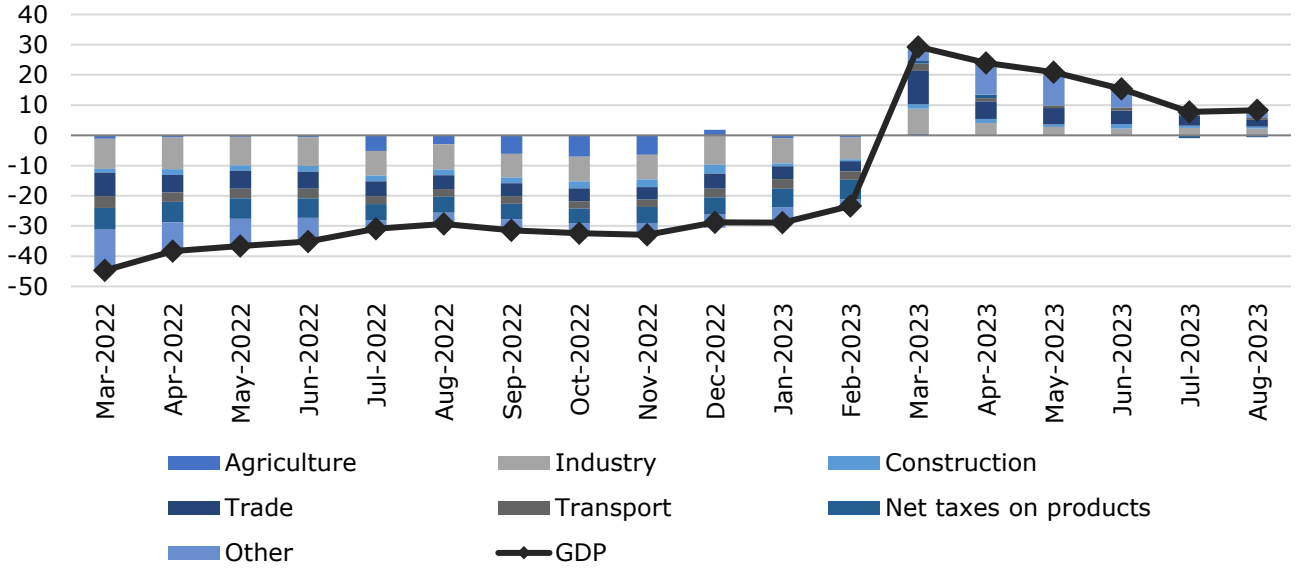
GDP and Real Sector: Limited Ports Operations Are Holding Back Recovery

In August, Russia continued to block seaports and fired drones and missiles at the Danube ports of Izmail, Reni, and Ust-Dunaisk. These attacks slowed down exports and partially displaced non-grain products from transportation. Probably, that is why more agricultural products, especially grain, were transported through ports and railways in August than in July. Nevertheless, according to the IER, the indicators of transport recovery have slowed down. At the same time, according to estimates, the decline in the energy sector accelerated slightly due to active repairs at nuclear and thermal power plant units. The manufacturing sectors' recovery varied, as evidenced by the monthly survey of enterprises conducted by the IER.

At the same time, August was marked by positive news about the results of agriculture. A significant share of early grains and oilseeds were harvested in August, and yields increased. Based on the data of the Ministry of Agrarian Policy and Food of Ukraine, the growth rate of grain harvested in August can be estimated at 37% yoy (year-on-year). According to the IER, the real GVA in manufacturing increased by 11% yoy.

As a result, according to the IER, real GDP growth in August remained close to 8% yoy (8.2% yoy in August compared to 7.7% yoy in July). However, real GDP remained almost 24% lower than in 2021. The only sector with an estimated gross value added exceeding the 2021 level is the public administration and defence sector, which is included in the "Other" category in Figure 1.

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



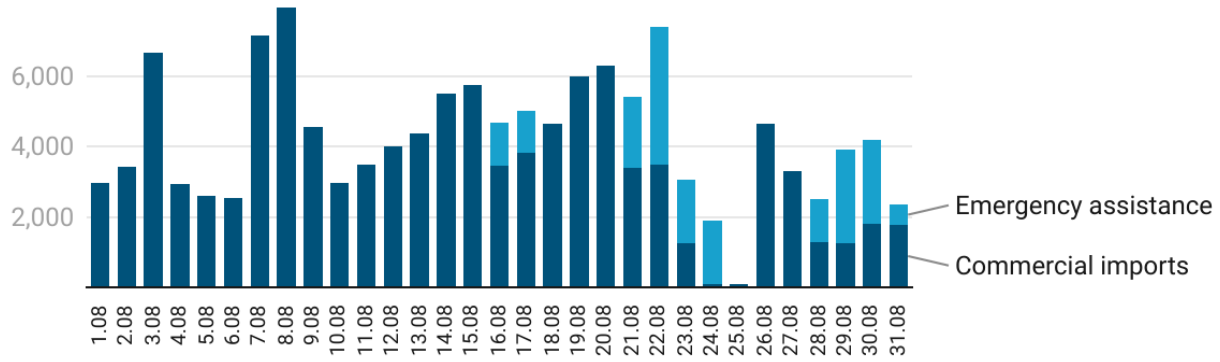
Source: IER assessment supported by the USAID Competitive Economy Program in Ukraine

Overall, the pace of recovery is slightly higher than we expected. According to the current forecast of the IER, prepared under the support of *Berlin Economics*, real GDP will grow by 4.1% in 2023. For 2024, the recovery rate is expected at 5.5%, assuming active hostilities will cease in the middle of the year, international financial assistance will continue, and seaports will resume operation.

Energy: Domestically Produced Electricity Is Not Enough

Electricity. Thermal and nuclear power plant repairs, both planned and emergency, continue. Reduced electricity production due to russian attacks, repairs, and increasing consumption due to hot weather forced Ukraine to ask for emergency assistance from neighbouring countries – Romania, Poland, and Moldova. However, the National Energy and Utilities Regulatory Commission (NERC) expressed concern that Ukrenergo did not use thermal power plants to cover the deficit. TPPs produced 13% in the summer, or almost 940 thousand MWh less than planned in the Forecast Balance Sheet. According to Forbes estimates, in August, Ukrenergo spent EUR 3.9 m on emergency imports.

Figure 2: Electricity imports in August, MWh



Source: ExPro Consulting

As of the end of August, repairs of 70% of nuclear generation capacities controlled by Ukraine have been completed. These are six units with a more than 5.4 thousand MW total capacity. According to data for seven months of 2023, nuclear power plants generated 48% of all electricity in the country, thermal power plants 28%, and hydroelectric power plants 14%; renewable energy sources produced the remaining 10%.

In August, electricity imports (commercial and emergency assistance) increased by 57.6% to 115.6 thousand MWh. At the same time, exports remained minimal. The end of the heat wave in early September allowed Ukraine to resume electricity exports during surplus hours.

The total debt to RES entities is more than UAH 32 bn. In 2021, the debt was UAH 0.6 bn; in 2022, it grew to UAH 17.1 bn, and this year, the debt is already UAH 14.3 bn. Most likely, this problem will be solved after the victory in the war. At the same time, it has already been officially stated that Ukraine will not return to the practice of setting a high green tariff.

Gas. About 13 billion cubic meters (bcm) of gas have been accumulated in Ukraine's gas storage facilities. Considering the risks of russian shelling of electricity generation facilities and the likelihood of using gas for electricity production, the Cabinet of Ministers plans to accumulate 14.7 bcm in storage facilities. Naftogaz believes that 13 bcm is enough to pass the heating season and does not plan further gas imports yet. However, Naftogaz has a EUR 300 m EBRD credit line, which, if necessary, is designed to create gas reserves for electricity production.

The Ukrnafta was able to bring oil and gas production closer to the level of 2021. For seven months of 2023, oil with condensate production amounted to 828 thousand tons, gas 628 m cubic meters. In 2021, the corresponding figures were 867 thousand tons and 639 m cubic meters.

In August 2023, Ukraine received almost 1.1 bcm of gas from the EU and Moldova, of which 66% was stored in the "customs warehouse" mode and 34% under the short-haul service to pump into the "customs warehouse." At the same time, natural gas imports have practically stopped since June. Since the beginning of the year, more than 1.884 bcm of natural gas has been imported to Ukraine without customs clearance from EU countries and Moldova. July-August 2023 was marked by particularly high demand among foreign traders for the services of Ukrainian GTS and UGS facilities for seasonal gas storage.

Transport: Queues Of Wagons At The Moldovan And Romanian Borders Have Increased

Maritime transport. In August, there was no trade through seaports, although Ukraine managed to withdraw four ships from the ports that had been blocked since the beginning of russia's full-scale invasion. In August, Ukraine exported 2.4 m tons of cargo through river ports, 14% more than in July.

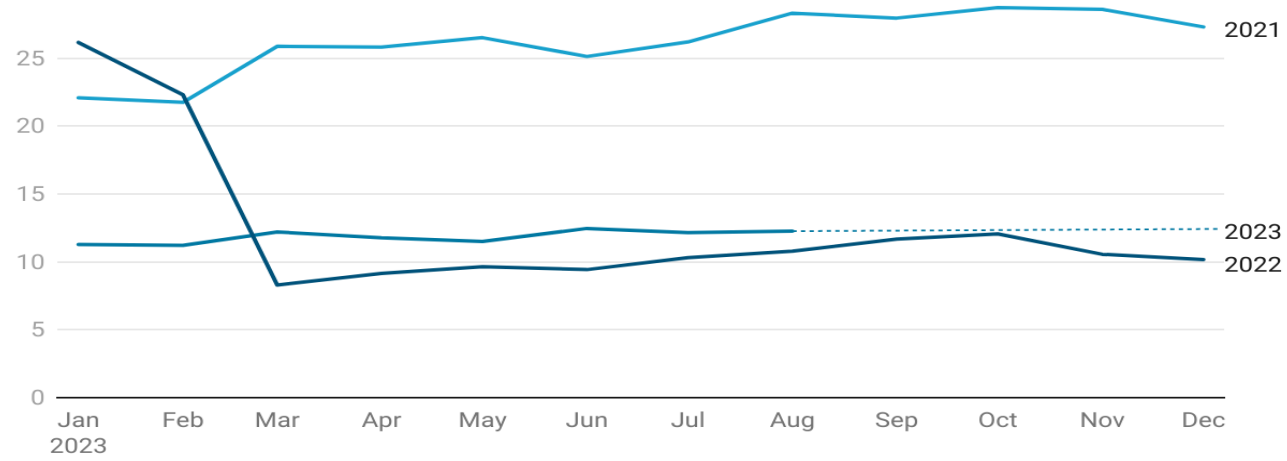
Since the end of August, British Air Force aircraft have patrolled the Black Sea to deter the russians from striking civilian ships carrying grain from Ukraine.

Rail transport. In August, 12.3 m tons of cargo were transported by rail. This volume is 14% more than in August 2022 and corresponds to the July 2023 figure. The leaders in terms of transportation in August were construction materials (3.2 m tons), coal (2.3 m tons), iron and manganese ore (2 m tons), and grain (1.7 m tons). Transportation of goods for export (including transportation to ports) decreased to 3.3 m tons. In particular, grain transportation in August fell by 45% mom (to 875.8 thousand tons).

In August 2023, the queues of wagons at the western border crossings increased to 10,309 units, 17% more than in June. The lion's share of the queue growth is wagons with grain. Most of the wagons with grain accumulated at two crossings - Vadul-Siret - Dornesti (Romania) - 699 wagons, Serpneve-1 - Basarabeasca (Moldova) - 446 wagons. These are border crossings through which grain is transported to Moldovan and Romanian ports.

A critical situation with the accumulation of wagons has developed at Reni station. There are already 878 wagons there (as of September 5); 358 of them are waiting to be sent to the Romanian port of Galați through the territory of Moldova. The slow transfer of wagons across the border decelerates rail traffic and threatens to stop Reni station. In total, 758 wagons are heading to the Serpneve-1-Basarabeasca junction, 600 of them for the port of Galați. The situation also remains difficult at the Izmail station, where Ukrzaliznytsia has restricted cargo transportation.

Figure 3: Transportation of goods by rail, million tons



Source: Ukrzaliznytsia

Road transport. On September 1, a simplified regime of freight transportation with Norway came into force - transportation permits were cancelled. However, this regime will apply to trucks of the Euro-5 standard and above. The carrier must have a certificate confirming the truck's environmental class to take advantage of the simplification. The regime applies to both two-way and transit traffic. Permits remain for vehicles of a lower environmental class.

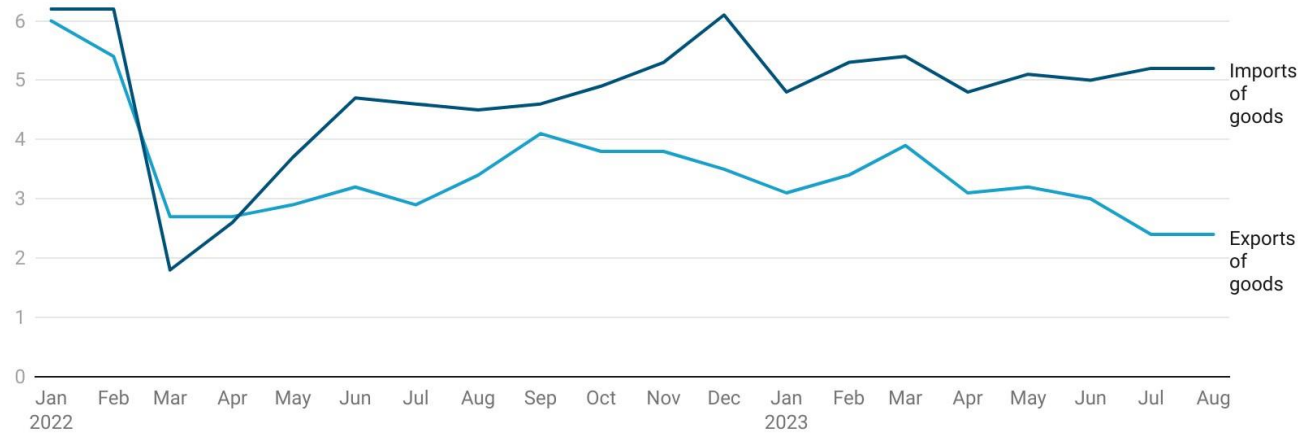
Norway became the 35th country with which Ukraine signed the so-called "transport visa-free regime" - permit-free passage of trucks. The liberalization of freight transportation will be valid at least until June 30, 2024.

International trade: EU's Share Began To Grow Again Amid The Termination Of The "Grain Deal"

In August, Ukrainian goods exports amounted to USD 2.7 bn, an increase of USD 0.3 bn compared to July, when the Black Sea Grain Initiative (the "grain deal") formally ceased to operate. The recovery in exports was due to the intensification of trade in food products, while exports of non-food products remained at the level of USD 1.1 bn. At the same time, August exports were still noticeably lower than the monthly average of the last twelve months (USD 3.3 bn), not to mention the indicators before the full-scale russian military aggression. In general, in the first eight months of 2023, Ukraine's exports of goods amounted to USD 24.5 bn, which is 15% less than in January-August 2022.

On the other hand, import trends remain stable. In August, Ukraine imported goods worth USD 5.5 bn, while in the first eight months of the year, imports amounted to USD 41.1 bn (+19% yoy). The deficit of trade in goods reached USD 16.6 bn.

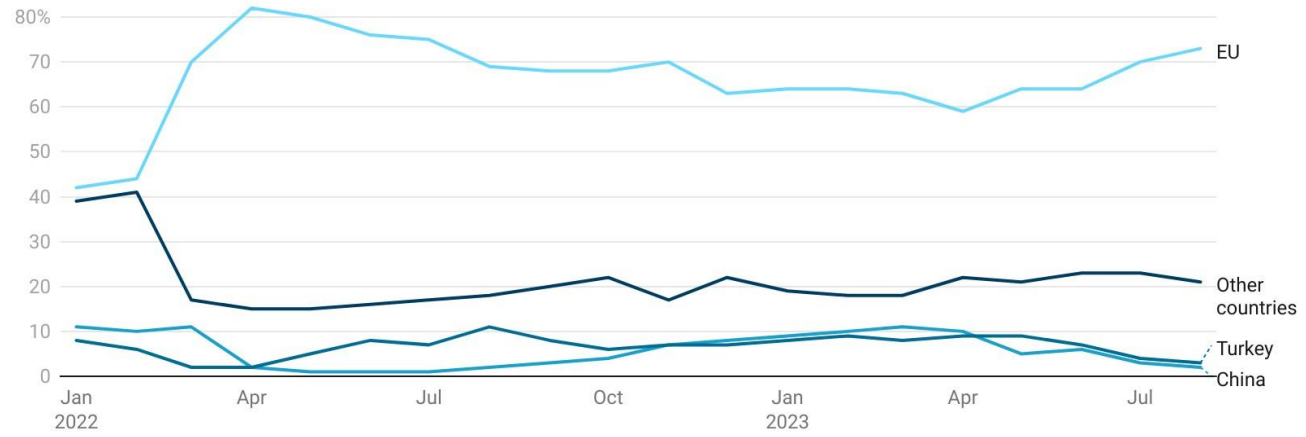
Figure 4: Ukraine's foreign trade in goods, USD bn



Sources: UN ComTrade, SCSU

Against the background of the "grain deal" termination, the geography of Ukrainian goods exports began to change again. After the launch of full-scale russian aggression, the role of the EU has multiplied due to changes in logistics routes, additional trade preferences, and migration. The maximum was achieved in April 2022, when the EU's share reached 82%, after which the gradual rebalancing of export flows began, and the EU's share decreased to 59% in April 2023. However, the slowdown, and since July, the complete termination of the "grain deal" has changed this trend. In August, the EU's share reached 73%, actually returning to the level of early summer 2022, while exports to Turkey, China, and other countries requiring maritime logistics decreased sharply. At the same time, it should be noted that the value of exports to the EU remains lower than last year's figures due to the restrictions on imports of Ukrainian agricultural goods by five neighbouring countries. In August 2023, Ukraine exported goods worth USD 2.0 bn to the EU compared to the USD 2.2 bn average over the past twelve months.

Figure 5: Geography of Ukraine's goods exports, % of total



Source: SCSU

State budget: INTERNATIONAL AID IS VITAL TO FINANCE COMMITMENTS

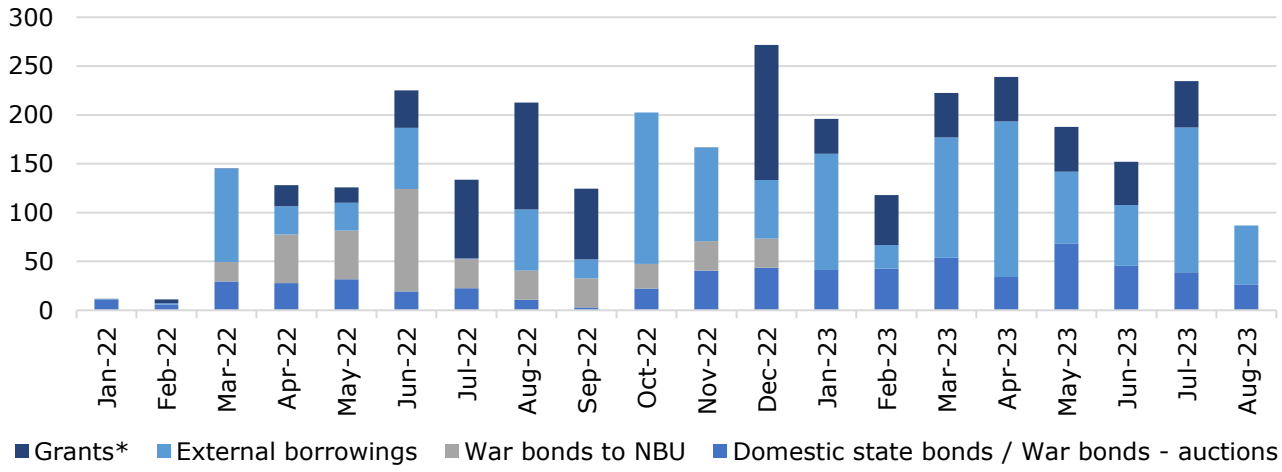
Budget-2023. In August, according to the preliminary data of the State Treasury Service of Ukraine, the plan of tax revenues administered by the State Tax Service (STS) was fulfilled by 100.3%, while revenues from taxes and payments administered by the State Customs Service – by 95.3% yoy. The difference between planned and actual revenues is primarily due to the difference in the situation with the assumptions included in the budget. The active war, assumed to end in mid-2023, continues. At the same time, the hryvnia remains stronger than forecasted, which outweighs the effect of the growth of dollar imports and leads to lower revenues from import payments (VAT, excise duty, customs duties). Lower inflation, in particular, leads to smaller than possible revenues from domestic VAT. At the same time, VAT refunds are likely to be lower than expected due to a slowdown in exports.

The revenues due to general fund of state budget totaled UAH 124.7 bn in August compared to UAH 137 bn in July. It is important that in August, the budget did not receive grants from international partners (primarily from the United States), which amounted to UAH 47.6 bn in July. Still, the United States provided the grant in the first days of September. However, August saw the quarterly peak of corporate income tax (CPT) revenues, which amounted to UAH 30.9 bn, the most considerable monthly amount since the beginning of the full-scale war of russia against Ukraine. Gross revenues from domestic VAT amounted to UAH 29.0 bn, 12.2% more than in August 2022. Import VAT revenues increased by 29.7% yoy to UAH 34 bn due to the hryvnia devaluation and resumption of imports. Higher payments to the military (in particular, due to increased military personnel) and some recovery in the labour market resulted in an increase of personal income tax revenues by 14.6% yoy. At the same time, in August, the budget did not receive grants from international partners (which is classified as a part of revenues), which amounted to UAH 47.6 bn in July.

The state budget deficit in August was financed primarily by external borrowing. In August, the EU provided a regular tranche of EUR 1.5 bn as part of macro-financial assistance. The Ministry of Finance also raised UAH 26.5 bn on the domestic market, which at the same time mostly covered the repayment and servicing of domestic debt. During the month, the Ministry of Finance was able to slightly reduce the yields on domestic government debt securities due to the reduction of the discount rate by the National Bank. At the same time, another issue of domestic government bonds was launched, which the NBU added to the list of benchmark domestic government debt securities that commercial banks can include in their compulsory reserves.

According to preliminary data, cash expenditures of the state budget in January-August amounted to UAH 2,377 bn or 93% of the plan. As before, more than 50% of expenditures are spent on defense and security. The deficit for eight months reached UAH 715 bn.

Figure 6: Funding and grants received by the state budget, UAH bn



*Note: * Grants are part of budget revenues, which are accounted for under the code 42000000 "From the European Union, foreign governments, international organizations, donor institutions."*
Source: Ministry of Finance, openbudget.gov.ua

Budget 2024: By September 15, the government must submit a law on the State Budget 2024 to the parliament. The available information shows that the minimum wage will be increased from UAH 6700 to UAH 7100 from January and to UAH 8000 from July 2024. At the same time, the government will not submit the so-called "resource" draft law on tax changes. Defence and security will remain the main priority of budget expenditures. There is still a high level of uncertainty about budget financing. According to the estimate announced in August by the Minister of Finance Sergii Marchenko, the need for international funding is USD 42 bn in 2024. Today, such amounts are not provided for in the commitments already undertaken by international partners. The European Commission has initiated the provision of EUR 50 bn by the EU over four years, of which only 78% (according to the amendments of the European Parliament, probably 75%) will be directed to the budget. At the same time, the US budget laws for the new budget year (October 2023-September 2024) and, accordingly, funding for Ukraine are currently far from being adopted. Also, in 2024, Ukraine will face complex negotiations over the settlement of external public debt, which was previously frozen until September 2024. These negotiations could result in a further freeze on payments or (more likely) a debt restructuring.

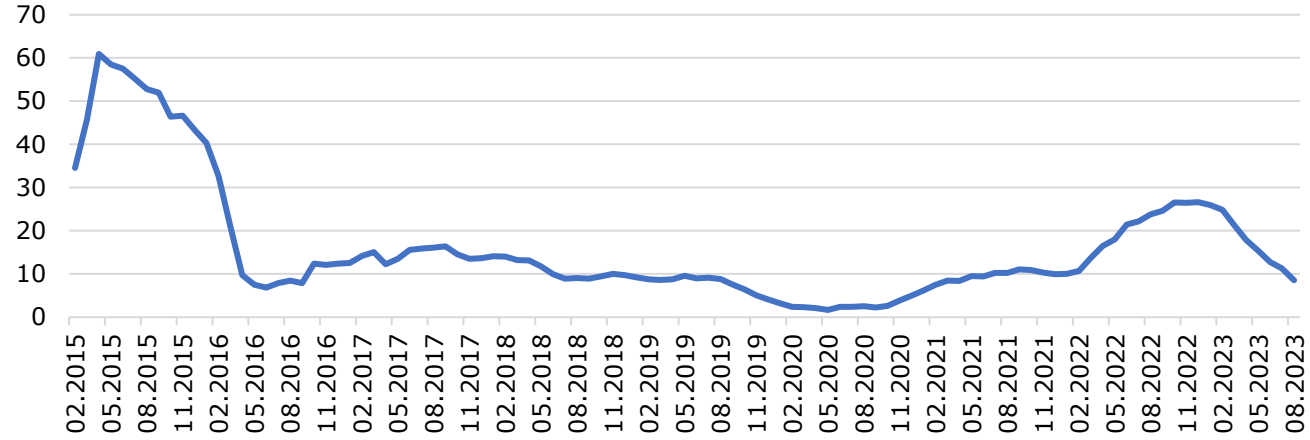
Inflation: Record decline in CPI due to collapse in vegetable prices

In August, consumer inflation slowed down to 8.6% yoy returned to a single-digit level for the first time in more than two years and amounted to. The usual suspects of recent months have played a role here: still moderate consumer demand despite its gradual recovery, billions of dollars spent by the NBU to maintain a fixed hryvnia exchange rate, and favourable world prices for main goods in Ukraine's international trade.

However, large drop in vegetable prices in August by 37.6% mom (compared to July) also played a crucial role in the inflation slowdown. As a result, vegetable prices fell by more than a quarter on average compared to August 2022. Although a decrease in vegetable prices in the summer is frequent, the collapse of vegetable prices in a month on this scale did not happen before. A 15-25% drop in prices was more common. The sharp drop in vegetable prices was probably due to a good harvest of vegetables and high prices for vegetables in the previous months, which persisted after supply disruptions in the summer of 2022. So far, limited vegetable storage capacity does not allow vegetable producers to regulate the supply of goods in the event of a high harvest.

As a result, in August, a record monthly drop in consumer prices since 2002 was observed at 1.4% mom, after a decrease in prices by 0.6% mom in July. The price decline could have been even higher, but the restoration of the pre-war rate of excise duty and VAT on fuel from July 1, fuel prices in August to increase by more than 15% compared to June. Excluding changes in fuel and vegetable prices, consumer prices were, on average, close to the July level: seasonal declines in prices for clothing, footwear, fruits, and milk products offset the rise in prices for other goods, including meat.

Figure 7: Consumer price inflation, % yoy



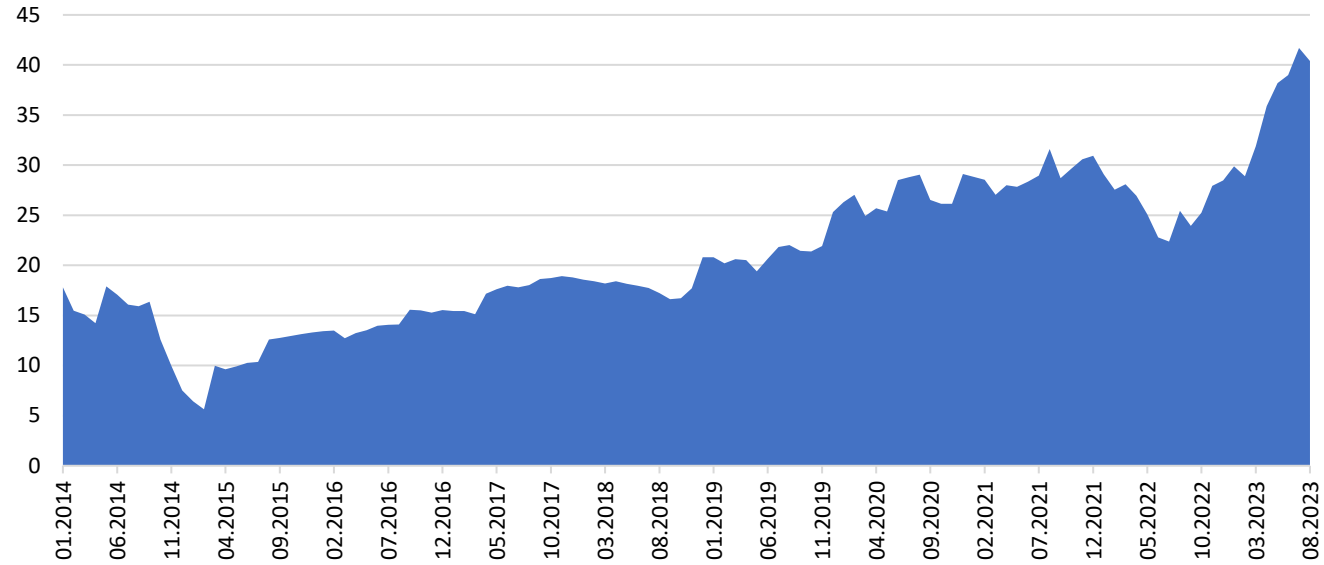
Source: State Statistics Service of Ukraine

Monetary policy: NBU's international reserves declined for the second time in the last 12 months

In August, the NBU international reserves reduced slightly to USD 40.4 bn. However, reserves have remained at historically high level and can fund more than five months of imports. In August, Ukraine received only monthly inflow from the EU for EUR 1.5 bn (USD 1.63 bn). After payments to creditors, net FX inflows from donors amounted to USD 1.02 bn. This amount was insufficient to cover cost of maintaining a fixed exchange rate at USD 2.45 bn that increased compared to previous months.

In the end of August, the NBU expanded the opportunities for individuals to purchase non-cash currency. This move happened against the backdrop of a larger gap between the official dollar exchange rate and the value of cash dollars, as well the recently announced strategy of the National Bank to gradually ease capital controls and FX regulations. These changes have not yet forced the NBU to increase interventions in the foreign exchange market.

Figure 8: International reserves, USD bn



Source: NBU

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