INSTITUTE FOR ECONOMIC RESEARCH AND POLICY CONSULTING

Monthly Economic Monitoring of Ukraine

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Resume

- The IER estimates that real GDP grew by 22% in April 2023 compared to the low base of April 2022.
- In April, there were no limits on electricity consumption, and Ukraine returned to its exports.
- To prepare for power outages due to the repair of energy units, Ukrenergo and ENTSO-E are constantly increasing technical capacity for importing electricity to Ukraine.
- The Cabinet of Ministers has not yet raised energy tariffs for the population.
- The Energy Strategy until 2050 was adopted, but its text was classified.
- Last month was difficult for exports due to further problems with the Black Sea Grain Initiative, bans on agricultural imports by Poland and several other neighbouring countries, and transit problems.
- In April, Ukraine received a record amount of international financial support, which helped the National Bank to reach a new high in international reserves.
- Inflation has fallen below 20% yoy for the first time since June 2022.

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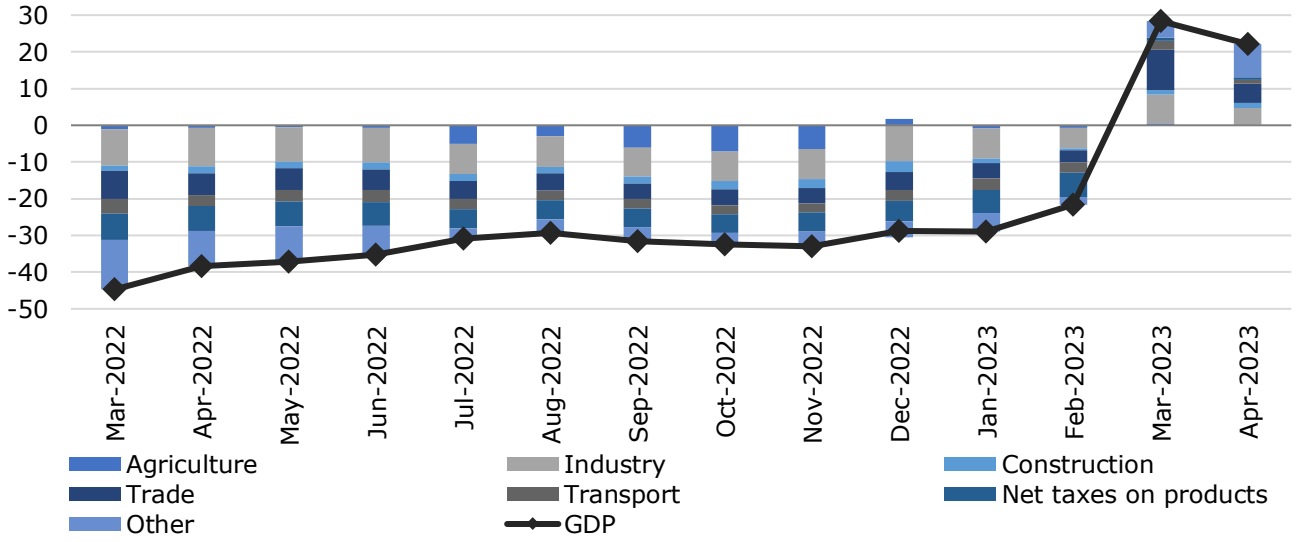
GDP And The Real Sector: The Situation Continues To Improve

In April 2023, the situation in some sectors improved compared to the previous month, helped by the absence of electricity shortages. At the same time, in April last year, economic activity partially resumed compared to the collapse in March 2022. The IER estimates that real GDP grew by about 22% yoy in April 2023 compared to 28% yoy in March.

Real gross value added (GVA) in agriculture is estimated to have increased by almost 5% yoy but remained 20% below 2021. It is worth remembering that in April, agriculture statistics further reflect only livestock indicators. The sowing campaign was slower due to weather conditions and high uncertainty caused by limited access of Ukrainian grain to the markets of five countries of Central and Eastern Europe – Ukraine's neighbours. Data for mid-May indicate a change in the structure of crops with a decrease in the role of corn in favour of sunflower and soybeans.

The situation improved in iron ore mining, as well as in metallurgy and machine building. According to our estimates, real GVA increased by about 4% yoy in the mining industry and by 42% yoy in processing (but remained significantly lower than in 2021 in both sectors).

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



Source: IER assessment made with the support of the USAID Competitive Economy Program

Real GDP will likely remain higher than last year in the coming months but will grow slower. Its pace of growth will be influenced primarily by the military situation, the availability of electricity, the trade policy of the main trading partners, and the work of the Grain Corridor. According to the IER forecast, real GDP will grow by about 3% in 2023.

Energy Sector: The Heating Season Is Over

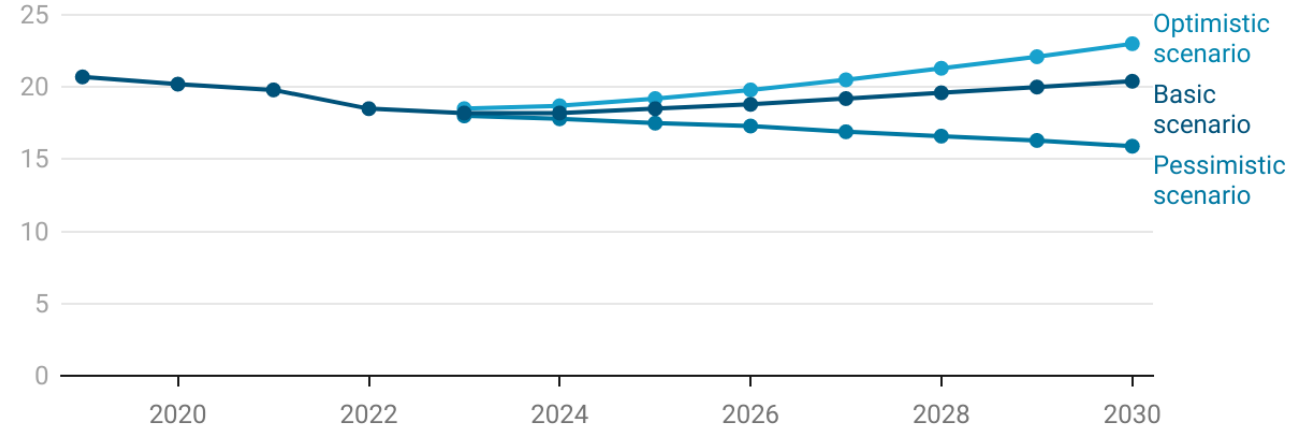
Electricity. Ukrenergo summed up the last heating season. As a result of Russian attacks on key energy facilities, 43% of the main electricity networks have been damaged, and all thermal and hydroelectric power plants have suffered varying degrees of damage. European partners came to the rescue: Ukrenergo has already received almost 500 pieces of equipment, and even more, units are being manufactured and are going to Ukraine. Thanks to the joint efforts, 80% of the damaged backbone network has been partially or wholly returned to operation. In addition, Ukraine passed this heating season without purchasing coal abroad, fully meeting the needs of thermal generation with domestically produced coal. At the end of the heating season, coal reserves in the warehouses of TPPs and CHPPs amounted to 1.2 m tons.

In the summer, Energoatom plans to put half of the power units of nuclear power plants under repair and modernization for more than two months. According to the Center for Energy Research estimates, Ukraine will have to fully use the available technical capabilities to import 1050 MW of electricity during the summer peak of consumption and launch additional units of thermal power plants operating on gas. If additional gas capacities are used, it will be more challenging to accumulate enough gas for the next heating period. Moreover, extra gas units may not be available due to the destruction of the energy infrastructure. Therefore, Ukrenergo and ENTSO-E constantly increase their technical capacies for importing electricity to Ukraine. In April, import capacities from the Continental Europe zone to the Ukraine/Moldova bloc were increased by 200 MW to 1050 MW.

At the same time, electricity imports in April remained insignificant and decreased by almost half to 3.9 thousand MWh. At the same time, in April, Ukraine exported 89.7 thousand MWh of electricity. Most electricity was exported to Moldova – more than 40 thousand MWh. Another 30.4 thousand MWh went to Poland and 19.2 thousand MWh – to Slovakia.

Gas. According to estimates in a recent IMF report on Ukraine, under the baseline scenario, about 2 bn cubic meters of gas imports may be needed for the next heating season. On April 17, Ukrtransgaz began pumping gas into underground storage facilities to accumulate at least 15 bn cubic meters in storage facilities by the following season. As of April 18, more than 9 bn cubic meters (bcm) of gas were stored in UGS facilities. Since the beginning of the withdrawal season on October 7, 2022, 5.572 bn cubic meters of gas have been withdrawn from UGS facilities.

Figure 2: Forecast of natural gas production in Ukraine, million m³



Source: ExPro Consulting

Tariffs. The Cabinet of Ministers has extended the fixed electricity tariff for the population for another month - until the end of May. The price of electricity for the households until June will be UAH 1.44/kWh and UAH 1.68/kWh, depending on consumption (up to 250 kWh and more than 250 kWh, respectively). In addition, Naftogaz reported that the annual gas tariff until May 1, 2024, will remain at UAH 7.96 per cubic meter (including VAT). Naftogaz's clients as of April are 12.4 m Ukrainian households, making the company the country's largest gas supplier. Current annual gas tariffs for the population were set in 2021.

Energy strategy. The government adopted the Energy Strategy until 2050, although the document's text was not made public. Some information was given in a press release by the Ministry of Energy. The Strategy, in particular, states that in 2022 Ukraine consumed 19.5 bcm of gas and produced 18.5 bcm. The largest consumers are power plants and CHPs that provide heating for the population. The document stipulates that Ukraine will consume 2% more gas this year, in 2024 - 4% more. At the same time, over the next ten years, consumption will increase by 18% - up to 23 bcm of gas. According to the baseline scenario of the Strategy, Ukraine will increase gas production to 20 bcm (by 8%) in 2024 and 2025 and in subsequent years — by 7.5%, to 21 bcm. According to the Strategy, Ukraine should achieve carbon neutrality in the energy sector by 2050.

Transport: Queues At The Borders Due To The Blockade Of The "Grain Deal" And Import Restrictions By Neighbouring Countries

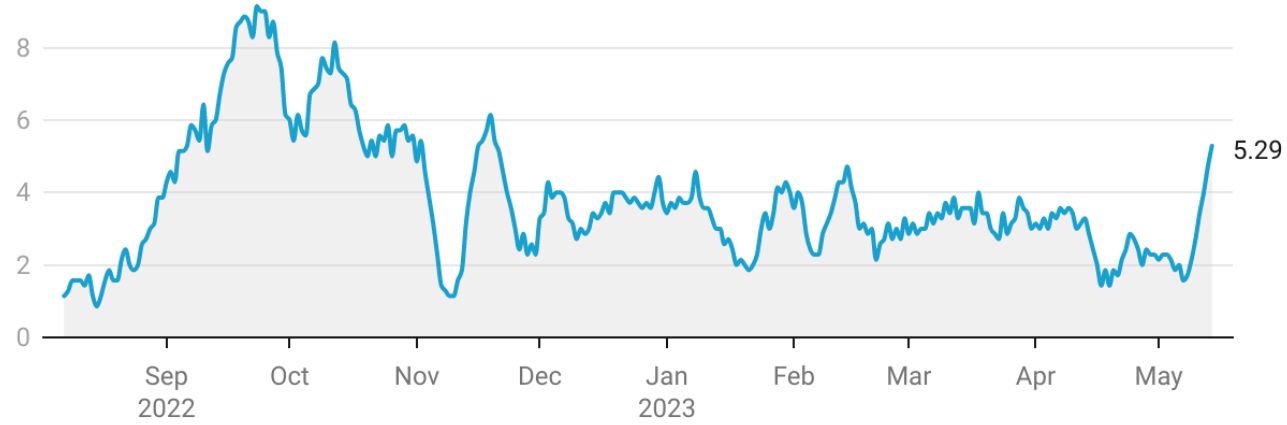
Maritime transport. In April, Russian representatives continued to disrupt the Black Sea Grain Initiative – there were no ship inspections for several days. According to the Ministry of Recovery, the Russian inspectors wanted to approve the list of vessels for inspection single-handedly. The situation was resolved by agreeing that the lists of ships for examination would be formed 50/50, one part by the Ukrainian side and the second by a joint commission.

On May 10, Deputy Foreign Ministers of the parties to the Black Sea Grain Initiative and UN representatives met in Istanbul to discuss the continuation of sea exports of agricultural products from Ukraine. After the meeting, Turkish Foreign Minister Mevlüt Cavusoglu said the grain deal could be extended for two months. Deputy Prime Minister for Recovery of Ukraine Oleksandr Kubrakov added that further consultations on unblocking the Grain Initiative to be continued online.

In April, Ukrainian ports received almost half as many fleets under load. The volume of the fleet that the Russians let pass to the port of Pivdenny has halved. In January 2023, Pivdenny accepted 30 ship calls; in April, there were only 15. At the same time, Danube ports are increasing traffic

volumes. In May, the port of Izmail fulfilled its annual plan for cargo handling in the amount of 6.2 m tons. This pace of implementation of yearly indicators is a record in the port's history.

Figure 3: Number of inspections of ships passing through the "grain corridor" (moving average for seven days)



Source: Black Sea Grain Initiative Vessel Movements https://data.humdata.org/dataset/black-sea-grain-initiative-vessel-movements

Railway transport. Due to delays in the work of the Grain initiative and the ban on the import of agricultural products by Poland, Bulgaria, Hungary, and Slovakia, queues formed at the border. At the beginning of May, more than 2100 wagons with agricultural products were in line near the Polish border and the transit zone, 1138 cars on the border with Hungary, and 73 cars with Slovakia.

In April, Ukrzaliznytsia transported 4.903 m tons of cargo for export, which is 7.5% less compared to the previous month and 25.6% more compared to the same period in 2022. Grain export shipments in April amounted to 2.13 m tons or 43% of the total volume of such transportation. Grain cargoes ranked first in terms of traffic volume in April. In second place is iron ore, and in the third is ferrous metals. Transportation of iron ore decreased by 4% compared to the previous month – to 1,665 m tons.

Road transport. The Ministry of Recovery has launched eQueue (eCherha) at another 15 cargo checkpoints. The online booking system for freight carriers of border crossing points (eQueue) will operate at 16 checkpoints with the EU countries and Moldova. Before that, the system worked at the Yagodyn-Dorohusk checkpoint. Until the end of May, eQueue will work in test mode.

The blockade of the "grain corridor" and import restrictions of neighbouring countries also formed queues at road checkpoints. At the end of April, the transit of agricultural products was unblocked. Still, in early May, like last September, Polish carriers blocked the Yagodyn-Dorohusk crossing again, demanding to cancel permits for Polish drivers to transport goods to Ukraine from third EU countries. As a result of negotiations between the Ministry of Recovery of Ukraine, the Ministry of Infrastructure and Development of Poland, and the leadership of the Lublin Voivodeship, traffic at the Yagodyn-Dorohusk checkpoint was unblocked from May 15. Ukraine has temporarily stopped requiring permits from Polish carriers transporting to Ukraine from any country in the European Union.

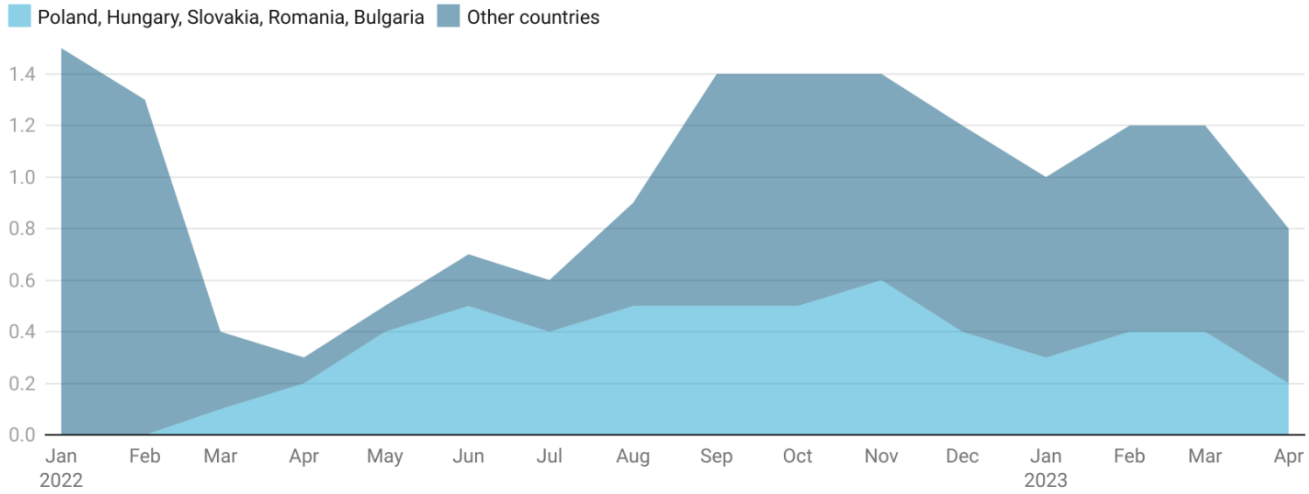
International Trade: Unexpected Import Bans By Ukraine's Neighbours

The key April event in international trade was Poland's ban on imports and transit of Ukrainian grain and other agricultural and food products announced on April 15. Over the next few days, Hungary, Slovakia, and Bulgaria decided to ban imports (but not transit!), while Romania announced that it was exploring the ban possibility. The countries claimed the threat to local producers due to high imports of Ukrainian goods against the background of lower prices as the official reason for the prohibition. Transit through Poland formally resumed on April 21 but with additional restrictions in the format of convoys and the use of GPS trackers. However, according to carriers, delays in transit traffic remained.

Despite the inconsistency of restrictions with the obligations of the EU-Ukraine Association Agreement, the EU internal market principles and WTO rules, five countries have achieved their goal. On May 2, two weeks after the bans came into effect, the EU announced that individual restrictions would be replaced by exceptional temporary preventive measures, namely a ban on imports of four Ukrainian goods (wheat, corn, rape and sunflower seeds) to Poland, Hungary,

Slovakia, Bulgaria, and Romania until June 5, 2023. Import to other EU countries remains unlimited. To this end, the beneficiary countries abolished individual restrictions imposed on goods from the list and other Ukrainian agricultural products. Also part of the agreement was the European Commission's proposal to allocate an additional EUR 100 m of EU subsidies to these five countries to support farmers who grow grains and oilseeds.

Figure 4: Ukraine's exports of wheat, corn, rapeseed, and sunflower seeds, 2022-2023, USD m

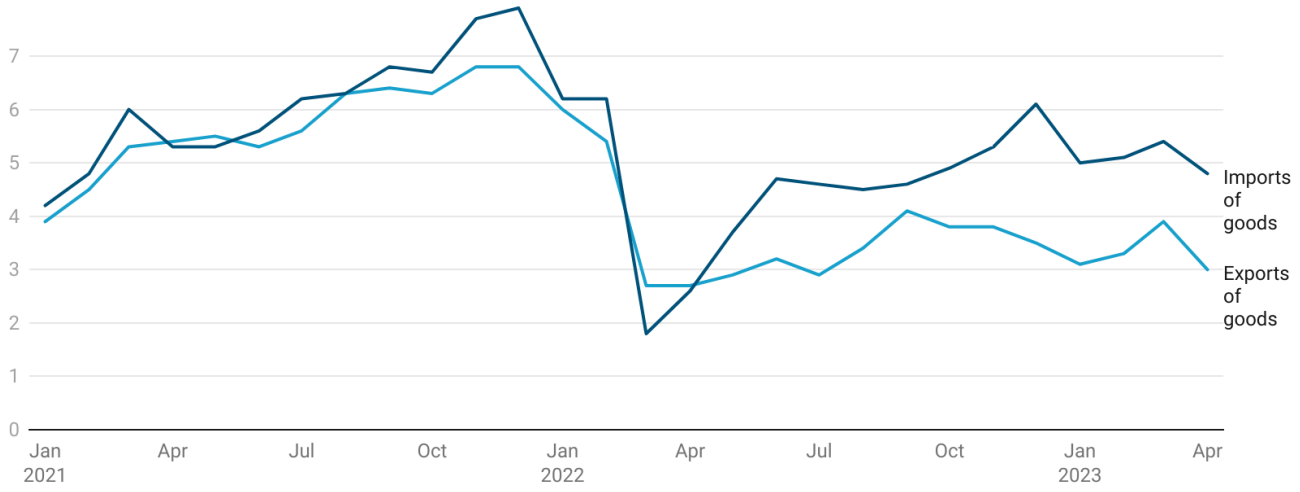


Source: TradeMap, State Customs Services of Ukraine

This decision is probably "the best of the worst" for Ukraine. On the one hand, this decision retains access to the rest of the EU market, whereas, typically, safeguard measures would apply to all member states. It also once again emphasizes free transit through the territory of five neighbours of Ukraine. In January-March 2023, other countries, besides the five neighbours, accounted for two-thirds of total exports of wheat, corn, rapeseed, and sunflower seeds. And these goods account for about a third of Ukraine's total exports in the first quarter of 2023. Also, formally, the decision is temporary, although there are already demands to extend it until the end of the year and expand the list of products covered by the ban.

On the other hand, the decision requires a significant reorientation of agricultural exports to other markets, which means costs in addition to those incurred by exporters during the weeks of unilateral bans. But worst of all, concessions in response to rule violations mean that other EU countries may also want to protect their producers from increased competition from Ukraine. This situation creates uncertainty and, therefore, additional losses for Ukrainian exporters.

Figure 5: Ukraine's foreign trade in goods, 2021-2023, USD bn



Sources: State Statistics Service, UN Comtrade, State Customs Services of Ukraine

Half a month of import restrictions by neighbouring countries and the deterioration of the Black Sea Grain Initiative ("grain deal") were the main factors in the decline in Ukrainian goods exports in

April 2023 compared to March. Exports fell by USD 0.8 bn, returning to USD 3.0 bn. That is the lowest figure since August 2022, when the "grain deal" came into force. Although exports increased by 14% yoy compared to April 2022, total exports of goods over the past twelve months were 38% lower than a year ago.

In April 2023, Ukraine imported goods worth USD 4.8 bn, which is USD 0.6 bn less than a month ago. However, total imports over the past twelve months were only 15% lower than a year ago, and April imports exceeded last year's figure by 84%. The main imported products in April were mineral fuels (18% of the total), means of land transport (10%), and electric machines (9%).

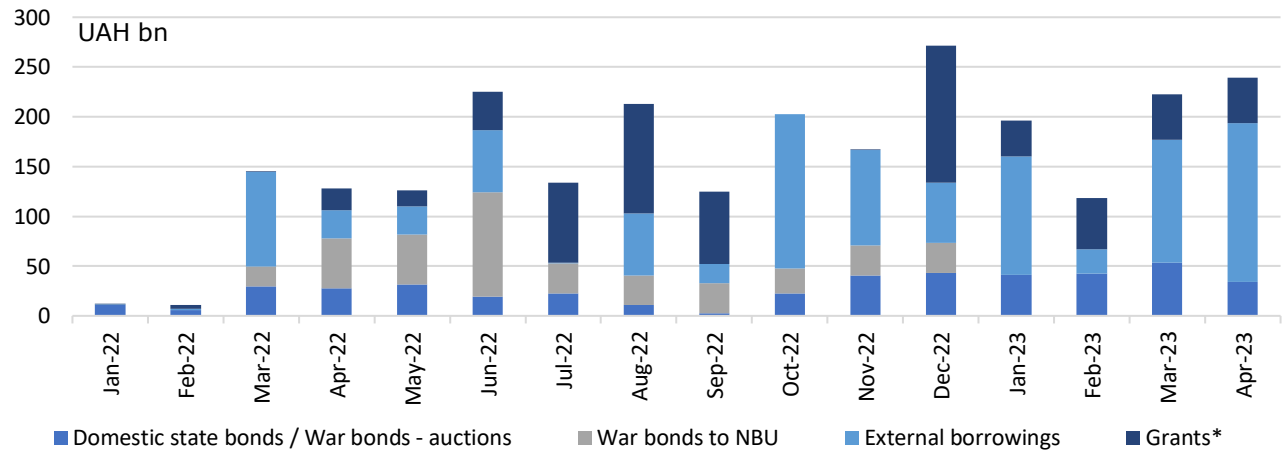
State Budget: A Record Amount Of International Financial Support In April

In April, Ukraine received a record amount of international financial support, equivalent to USD 5.6 bn. USD 1.2 bn came from the U.S. in the form of a grant. The concessional loan from the EU under the macro-financial assistance program amounted to EUR 1.6 bn. In the first days of April, Ukraine received USD 2.7 bn loan from the IMF provided under the new EFF Program. Funding comes in 2023 more predictably and regularly than in 2022. That allows the government to plan monthly expenditures better since international funding is directed primarily to pay salaries and social benefits.

At the same time, the government continues to finance defence and security from domestic sources and does not yet need direct funding from the NBU, which is not planned for this year and amounted to UAH 400 bn in 2022. Thus, in the first quarter of 2023, state budget expenditures on defence (without security) amounted to UAH 403 bn, and state budget revenues, excluding grants, amounted to UAH 383 bn. Another source of financing for the relevant expenditures is the funds raised from placing government bonds. In January-March 2023, defence spending accounted for 53.9% of state budget expenditures and another 12.0% for security.

In the four months of 2023, the government attracted UAH 172 bn from the domestic government bonds, of which UAH 41 bn was denominated in foreign currency. The increase in demand for bonds is ensured by coordination of the policy of the government and the NBU: commercial banks can include benchmark government bonds in their mandatory reserves (up to 50%).

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



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

In April, the revenues of the State Budget were supported by the transfer of NBU profits to the budget at UAH 71.9 bn. This amount was distributed differently than traditionally when the entire amount was directed to the general budget fund. This year, 50% of the received amount was allocated to a special budget fund to finance the budget program "Fund for the Elimination of the Consequences of Armed Aggression," namely for the compensation to the population for destroyed or damaged housing. According to the latest information from the Ministry of Finance, the state budget revenues in April amounted to UAH 261.7 bn, of which UAH 45.7 bn came in the form of grants. General fund revenues without the U.S. grant increased by 10% yoy. Personal income tax revenues were 38% higher than last year due to a low base and more funding for military remuneration. Also, due to the low base, inflation, and some recovery in consumption, gross revenues from domestic VAT and VAT on imported goods have skyrocketed. At the same time, net

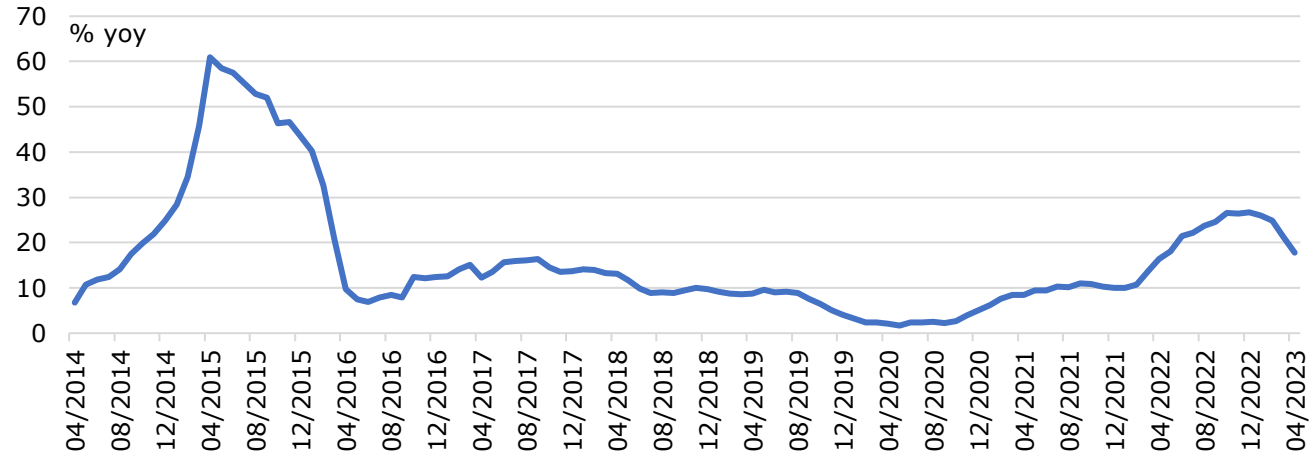
revenues from domestic VAT decreased as the government refunded VAT for UAH 14.5 bn, while last year, there was no refund due to a lack of funds in the budget.

From July, according to the obligations in the IMF program, Ukraine must restore the tax system that existed before the full-scale invasion. This includes the abolition of the 2% unified tax, the restoration of full fuel taxation, and the resumption of tax inspections. These measures are expected to contribute to budget revenues.

Inflation: Inflation slowed more than expected in April

In April, inflation slowed to 17.9% yoy against 21.3% yoy in March. Inflation has fallen below 20% for the first time since June 2022. This figure reflects a sharp slowdown in the price increases over the recent months. Over the past six months (in April 2023 compared to October 2022), consumer prices have increased by 4.7%, while in the previous six months (in October compared to April 2022), prices have increased by 12.6%. This change reflected a gradual decline in inflation expectations, still restrained consumer demand, and lower prices for the critical positions of Ukraine's international trade than last year.

Figure 7: Consumer price inflation



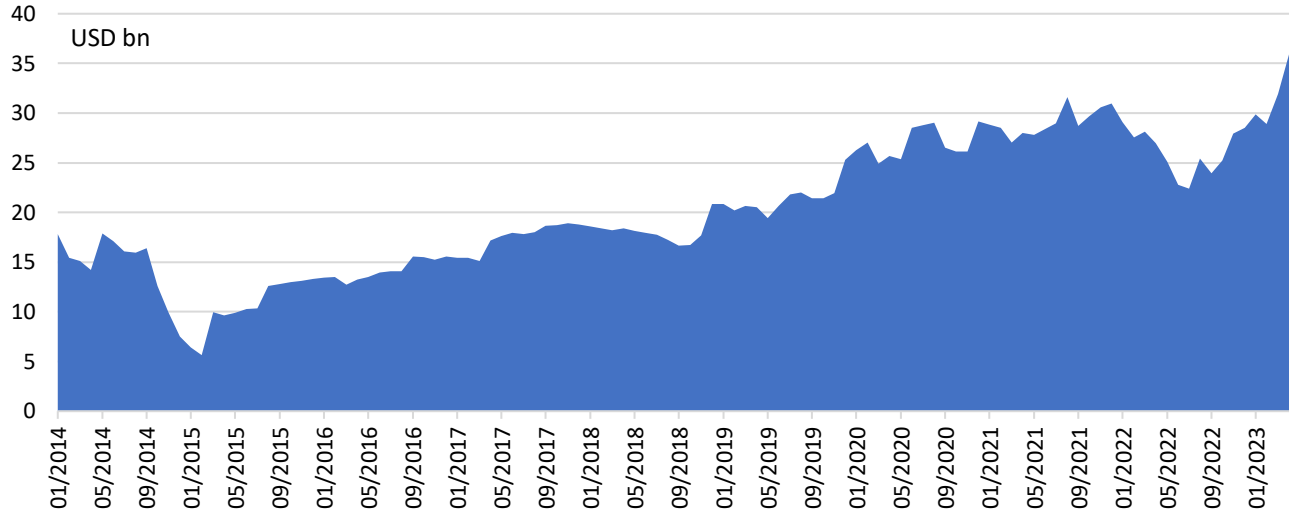
Source: State Statistics Service

The increase in consumer prices compared to the previous month was the smallest since August 2021 and amounted to 0.2% mom. That resulted from a fundamental decline in inflationary pressure and fluctuations in prices for certain goods due to seasonal and other temporary factors. For example, fuel prices continued to decline in April since fuel demand for sowing operations was lower than expected.

Monetary policy: The NBU is considering a rate cut this year.

As at the previous six monetary policy meetings, the NBU kept the key policy rate at 25% per annum at its April meeting as well. The NBU has not announced changes in reserve requirements for banks. The NBU noted that previous efforts to increase maturity and deposit interest rates had borne fruit. However, in response to a significant slowdown in inflation and inflationary expectations, the NBU now forecasts a moderate reduction in the discount rate in October this year and a policy rate of 21% p.a. at the end of the year. Previous forecasts projected a flat rate this year and a rate cut only in 2024.

Figure 8: International reserves



Source: NBU

At the end of April, the NBU's international reserves updated their maximum in recent years and reached USD 35.9 bn. This increase reflected the largest inflows from donors in recent months. According to the NBU, the government attracted USD 5.34 bn in net inflows to international reserves. In April, Ukraine received aid from the EU and the United States and the first tranche under the IMF program. In April, NBU spent USD 1.37 bn on maintaining a hryvnia peg to the US dollar. That is the lowest figure since the beginning of the full-scale war, and it happened despite a significant decline in exports of goods in April.

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