INSTITUTE FOR ECONOMIC RESEARCH AND POLICY CONSULTING

# Monthly Economic Monitoring of Ukraine

No.217, February 2023

***Resume***

- The decline in production in January 2023 decelerated compared to December 2022 in most sectors of the economy. Important: crop production indicators are not included in January's GDP estimates.
- The electricity shortage in January 2023 slightly decreased due to repairs, electricity import permits, and higher solar power generation.
- Slow inspections by russia have resulted in smaller grain exports through seaports.
- In 2022, the structure of foreign trade in services changed substantially. For the first time, a deficit was recorded due to a sharp increase in imports of travel services.
- In January 2023, Ukraine received the first tranche of a loan from the EU within the framework of macro-financial assistance for EUR 18 bn. For the subsequent tranches, Ukraine will need to do homework.
- Additional costs due to electricity shortages have not yet significantly affected consumer prices. Monthly price increases were less than 1% for three consecutive months, but acceleration is likely in the following months.
- At the end of January 2023, the NBU's international reserves increased to USD 29.9 bn.

Funded by the European Union

*The IER resumed the publication of macroeconomic monitoring of Ukraine with the financial support of the European Union within the framework of the project "Ukraine's economy during the war and support for Ukrainians affected by the war."*

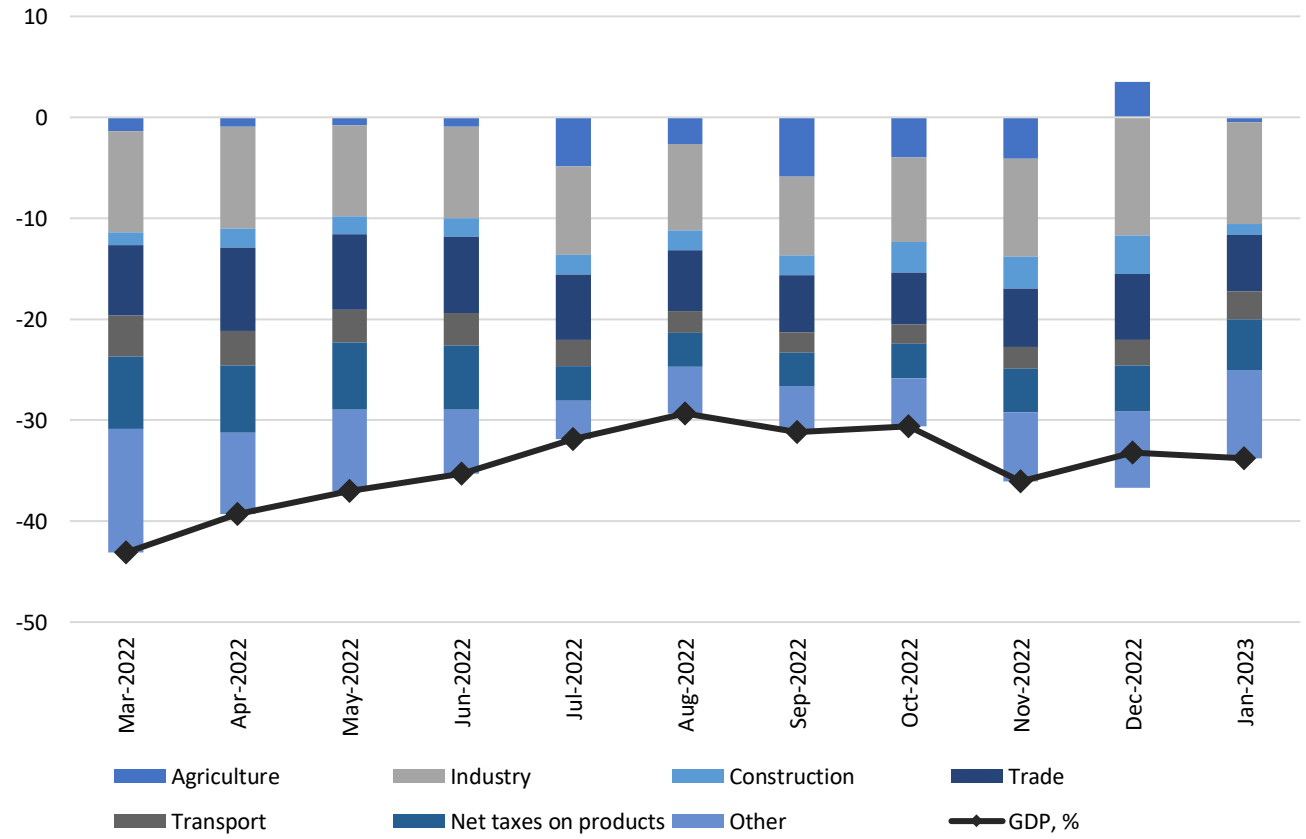
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### *GDP and the real sector: Lower decline in most sectors*

In January, agricultural enterprises collected 4 m tons of corn, while in January 2022 there was likely no harvesting. According to the Ukrstat methodology, the GDP calculation in January-May does not include crop production. Taking this into account, IER experts estimated that the fall in real GDP deepened by 0.6 p.p. to 33.8% yoy in January, as the positive contribution of agriculture due to crop production in December was 3.5 p.p. If we include the corn harvest in the GDP estimate in January, the estimated GDP decline would slow down to approximately 30% yoy.

According to IER estimates, in January the drop in iron ore production decelerated, and its exports increased. Trade and construction also fell slightly less, primarily due to the low statistical base. The seasonal drop in trade turnover and construction volumes in January 2023 compared to December 2022 is estimated to be lower than in January 2022. However, the drop in transport output deepened primarily due to a fall in grain transportation through seaports. The deliberate slowdown in inspections of ships by russian inspectors slowed the passage of cargo through Bosporus.

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




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

The IER monthly business survey indicates improved business expectations and less uncertainty in the short term. This result was facilitated by the smaller destruction of energy infrastructure by russia in January. However, on February 10, due to another missile and drone attack, Ukrenergo reported additional losses, which may affect macroeconomic results in February.

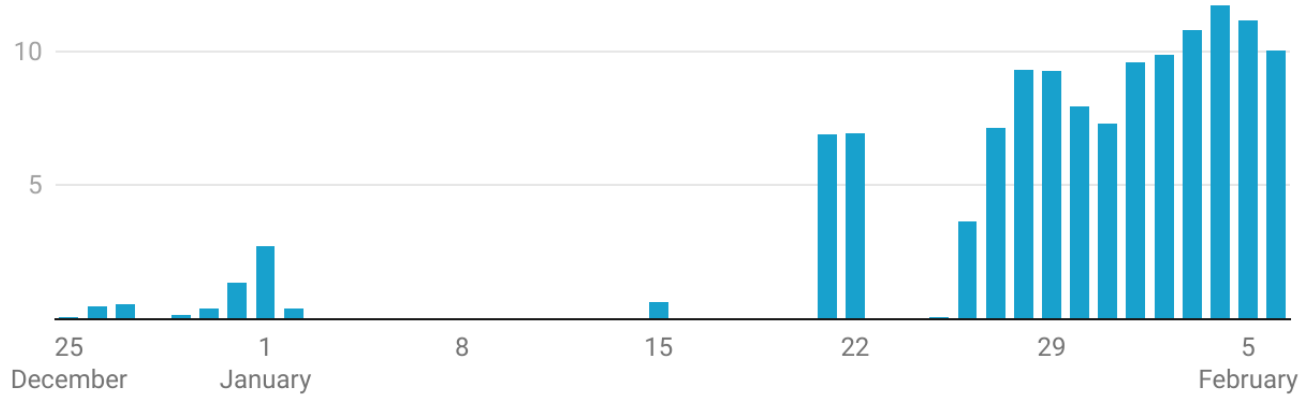
### *Energy: Ukraine started electricity imports from the EU*

In January, the enemy continued shelling the facilities of the Ukrainian energy system, which caused Ukrenergo to apply emergency restrictions. According to DTEK, the electricity shortage during peak hours was up to 5 GW. As of February 2, thanks to repairs, the electricity shortage was reduced to 20%, which made it possible to avoid emergency outages. However, on February 4, two large-scale accidents occurred at the Ukrenergo substation in the Odesa region. As a result, it was necessary not only to return emergency outages but also to import generators to power the critical infrastructure. The results of the next attack, which occurred on February 10, are still being evaluated.

For the smooth operation of enterprises, the Government offered businesses to buy electricity abroad. The government resolution allows avoiding planned outages until April 30 if the volume of

imports is at least at the level of monthly consumption of the relevant enterprise in September. Ukraine began to receive imported electricity starting January 15. The most active importer is D.Trading of DTEK, which imported 60 million kWh of electricity in January. In addition, small amounts were imported by ERU Trading, Nextrade, NAP-Community, Augusta, U. Commodities.

***Figure 2: Electricity imports from Slovakia, m kWh***




*Source: Ex&Pro Consulting*

The Government implemented measures to close the current electricity shortage and made decisions for the sector's development in future years. Thus, the Cabinet of Ministers ordered the construction of two power units at the Khmelnytskyi NPP, with an estimated launch in 2030-2032. However, the timing of the project may be affected by the course of the war. The cost of building one power unit is about USD 5 bn. The construction will be financed by Westinghouse loans and Energoatom's funds.

Another measure to overcome the deficit was the decision of the NERC on January 30 to restore full payment of the "green tariff" to the owners of domestic solar power plants for the generated electricity, which was canceled at the beginning of the full-scale war. This step is designed to encourage owners of domestic SPPs to produce more electricity.

The Norwegian Government has promised to finance the gas purchase for Ukraine by Naftogaz in the amount of up to EUR 188.8 m. Financing will be provided through a grant from the European Bank for Reconstruction and Development (EBRD). Naftogaz announced that there would be enough gas to pass the heating season. According to government reports, on January 25, about 11 bcm of gas was stored in gas storage facilities and almost 1.2 m tons of coal in warehouses.

***Transport: privatized river port***

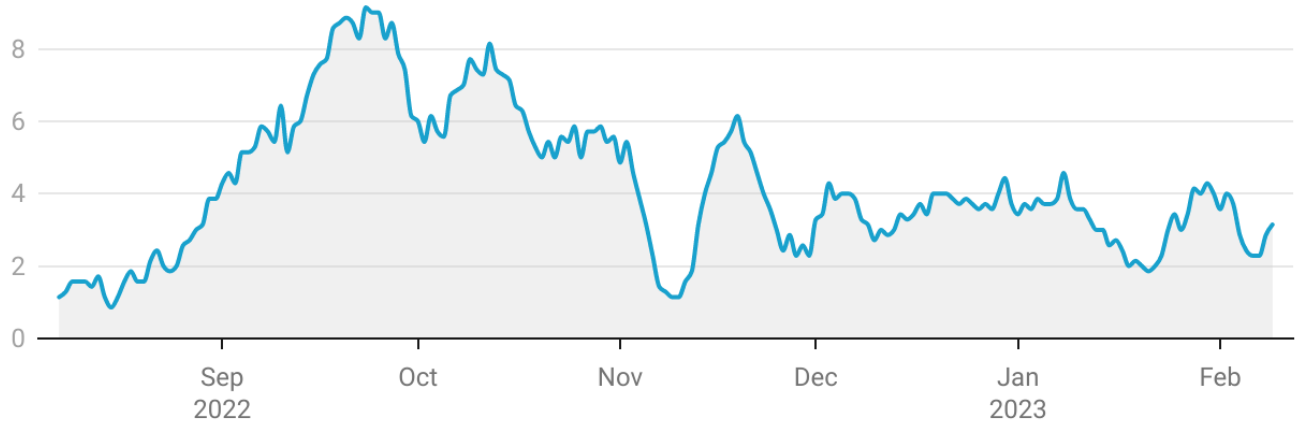
***Sea transport.*** The pace of transportation of Ukrainian grain through the "grain corridor" has decreased as Russia slows down the inspection of ships. During January, on average, 2.5 vessels left Ukrainian ports per day, one of the lowest rates for all months of the "grain initiative." In early February, 117 vessels were in line for inspection, and the average waiting time was from 3 to 5 weeks. This reduction is reflected in export volumes. Only 3 m tons of grain left the grain corridor in January 2023, while in December, Ukraine exported 3.7 m tons.

On January 17, the State Property Fund (SPFU) held an auction to privatize the Ust-Dunaisk sea commercial port. Eight participants competed for the lot. LLC "Elixir Ukraine" from Vinnytsia offered the highest price – UAH 201 m, which is almost 3.5 times more than the starting price of the port of UAH 60 mn. Ust-Dunaisk is the first port privatized through Prozorro.Sale system. The port consists of three assets: the port itself in Vilkovo, Odesa region, the port point of Kiliya in the city of the same name, and the service base for lighter carriers on the island of Shabash. Also, the SPFU plans to put up for privatization Belgorod-Dniester sea commercial port by the end of winter.

In 2022, more than 59 m tons of cargo were handled by Ukrainian ports. In particular, the transshipment of export cargoes amounted to 47.8 m tons, and import cargoes — 6.2 m tons, mostly grain (28.8 m tons) and liquid goods (4.8 m tons). In 2022, the export of agricultural products through the ports of the Danube increased 40 times — the business exported almost 7 m tons of cargo. The seaport of Pivdenny handled 15.28 m tons compared to 53.47 m tons a year

earlier, the port of Chornomorsk handled 11.76 m tons (25.63 m tons in 2021), and the transshipment of the port Odesa amounted to 7.69 m tons compared to 22.56 m tons in 2021.

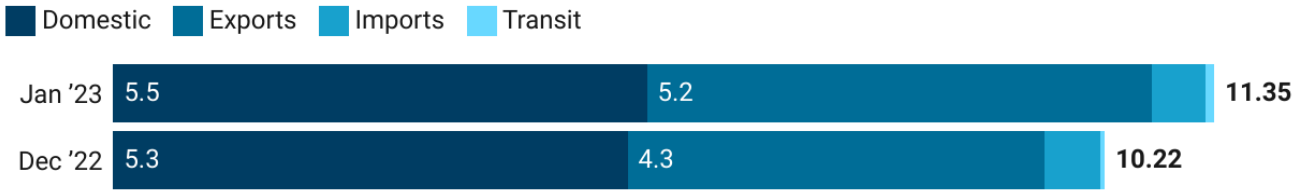
***Figure 3: Number of inspections of vessels passing along the "grain corridor" (moving average for 7 days)***




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

***Railway transport.*** Ukrzaliznytsia increased freight traffic in January by 11% compared to December to 11.3 m tons, of which 5.2 m tons were transported in export traffic. Grain cargoes account for 30% of the total load.

***Figure 4: Volumes of freight rail transportation, m tons***




*Source: Ukrzaliznytsia*

The total queue of wagons on the railway in January decreased by 22% to 16654 cars, and the line of wagons with grain decreased by 32% yom. The most problematic were the border crossing points Batevo, Dyakove, and Chop - Čierna nad Tisou.

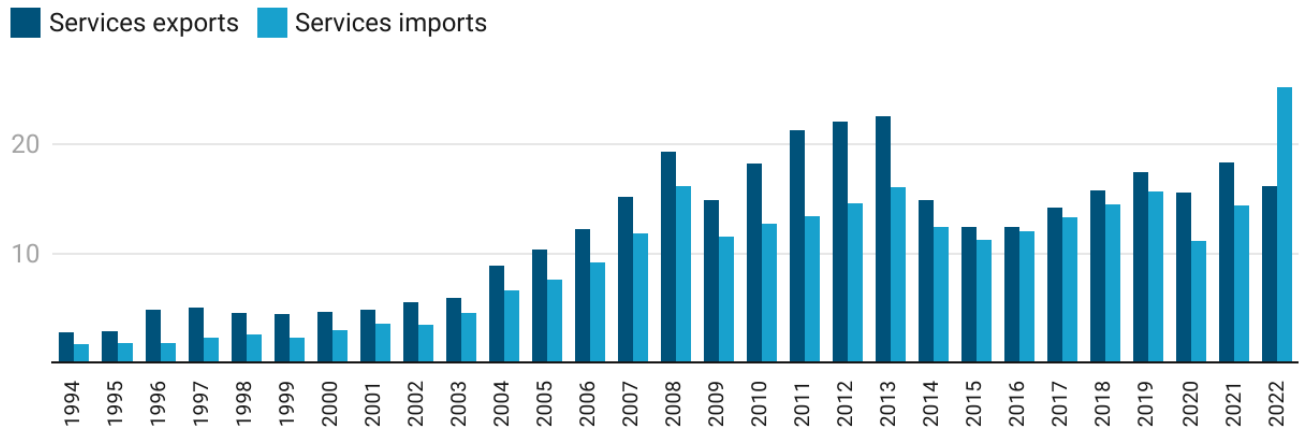
Ukrzaliznytsia's financial plan for 2023 expects a loss of UAH 20.2 bn compared to the expected net loss of UAH 10.8 bn in 2022. In 2022, losses from passenger traffic amounted to UAH 13.3 bn, and the state allocated UAH 10 bn to Ukrzaliznytsia to maintain liquidity and the uninterrupted operation of the industry. Apparently, the same source of damage coverage is planned for 2023.

***Road transport.*** On February 10, a new road checkpoint on the border with Romania was launched – "Dyakivtsi - Rakovets" in the Chernivtsi region, which will unload the Romanian route and reduce the queue of trucks. Thus, as of February 10, the line at the border crossing "Porubne – Siret" was 700 trucks for leaving Ukraine, at "Orlivka – Isaccea," there were 410 trucks for the exit and 220 for entry, and at "Reni – Giurgiulesti" there were 240/30 trucks.

**International Trade: Structural Changes in Trade in Services**

Not only the structure of trade in goods changed in 2022. The full-scale russian military aggression has also provoked significant service trade changes. For the first time since the beginning of observations, the annual balance of trade in services turned negative. The service trade deficit reached USD 9.1 bn. The increase was due to the rapid growth of service imports, which surged by 76% yoy and achieved USD 25.3 bn, setting an all-time high.

***Figure 5: Foreign trade in services of Ukraine, USD bn***

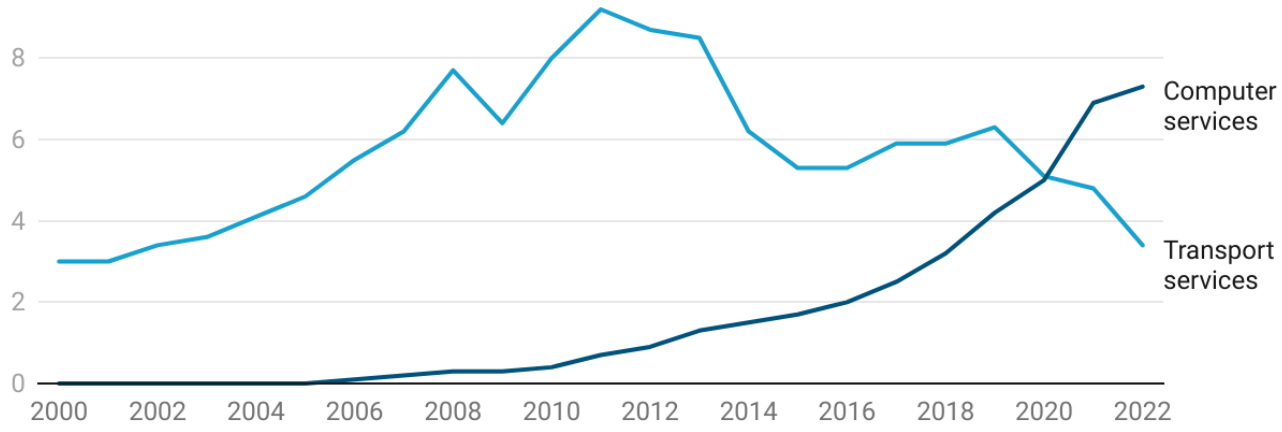



*Sources: World Bank, NBU*

The main reason for the boom in service imports was forced migration of Ukrainians to other countries. According to the balance of payments methodology, the migrants' expenses abroad are counted as service imports. According to the UN, as of the end of 2022, almost 8 m people left Ukraine. As a result, imports of personal travel services grew sixfold from USD 2.5 bn to USD 15.6 bn, while aggregate travel services imports reached USD 20.2 bn, three times higher than the previous year's figure. If before the full-scale war, business travel prevailed among personal travels in imports, in 2022, its share fell from 60% to 23% of the total, although nominal imports increased by 23% yoy. Imports of other services than travel imports fell by 37% in 2022.

In 2022, services exports amounted to USD 16.2 bn, which is only 12% lower than last year. This decrease is much smaller than exports of goods, which fell by more than a third. Such a drop is due to the significant role of computer services exports that continued to grow despite the war. In 2022, exports of these services increased by 5.8% yoy to USD 7.3 bn or 45% of the total. Instead, exports of transport services decreased by 29% yoy to USD 3.4 bn and accounted for only 25% of the total. The most significant reduction was for passenger and related (other) transport services, while export of freight services decreased by only 2% yoy.

***Figure 6: Export of transport and computer services, USD bn***




*Source: NBU*

The trade deficit in services is likely to stay in 2023. Security risks remain high, and most displaced people continue to live abroad while maintaining close family and partly working ties with Ukraine, which leads to continued financing of their expenses from Ukraine. Moreover, the import of other services may be intensified. At the same time, there are no factors for the rapid growth of services exports sufficient to compensate for the gap with imports.

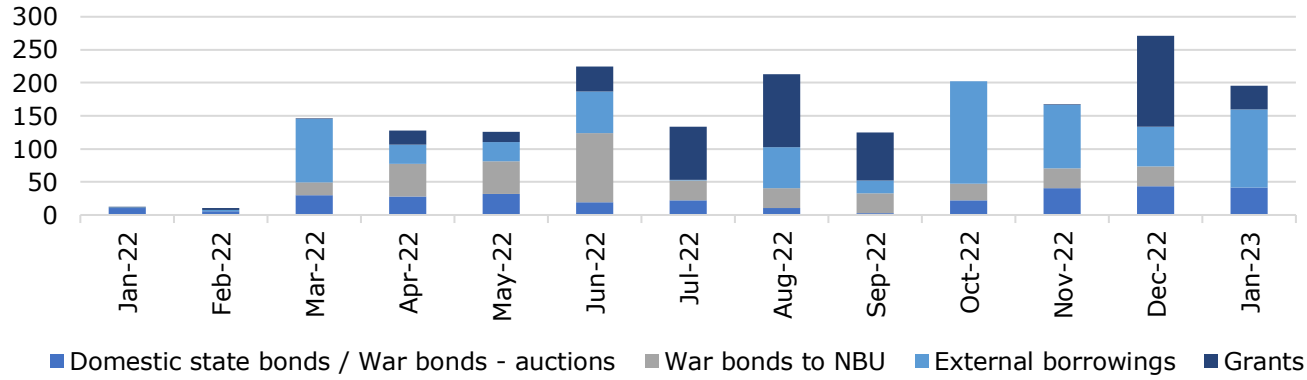
***State Budget: Increasing Demand for Government Bonds in January***

In January, the Ministry of Finance increased the placement of domestic government bonds to UAH 41.4 bn. This increase resulted from a rise in yields and the issuance of benchmark-government

bonds, which the National Bank allowed commercial banks to include in their mandatory reserves. Unlike previous months of the big war, the NBU did not directly buy government bonds since such an issue for 2023 is not yet planned.

At the same time, the Government received USD 1 bn grant from the United States, which was accounted for as part of the State Budget revenues. The first tranche of a loan from the EU within the framework of macro-financial assistance for EUR 3 bn was also received, which was provided immediately after the signing of the memorandum on the EU macro-financial assistance package for 2023 and with very preferential repayment terms. The loan was provided for 35 years with 10-year grace period. Ukraine will not pay interest at least until 2027, provided that reforms continue. To receive the subsequent tranches, Ukraine will have to fulfill several conditions. The measures agreed upon by the Government and the EU include restoring macroeconomic stability, continuing corporate governance reform, reforming customs and public procurement, and developing a plan to restore the energy system. Some of these conditions were also set as structural beacons of the current IMF Program.

***Figure 7: Financing and grants due to the state budget, UAH bn***




*Note: * grants are part of the 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*

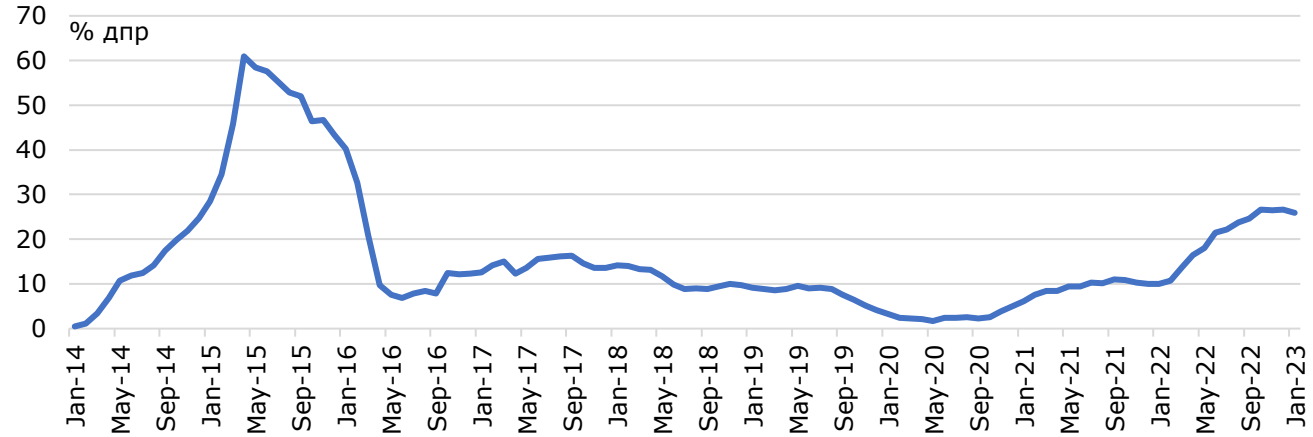
According to preliminary data from the Ministry of Finance, the state budget revenues due to general fund amounted to UAH 104.4 bn, of which UAH 36.6 bn was a grant from the United States. Excluding this grant, general fund revenues decreased by 13.1% primarily due to falling VAT revenues. Thus, the Government reimbursed VAT for a record UAH 19.3 bn (compared to UAH 18.5 bn in January 2022), which is important for improving the financial condition of exporting enterprises, especially agricultural ones. Gross VAT revenues from goods produced in Ukraine decreased by 24.6% yoy, although the revenues increased by 21% compared to December 2022. Revenues from import VAT decreased by 18.7% yoy and 16.9% compared to December. However, the fall in imports was less than expected, and the customs reported an over-fulfillment of the plan of revenues from import VAT and duties by 12.6%.

At the same time, the state budget expenditures amounted to UAH 193.7 bn or 80.6% of the plan. Probably, non-fulfillment of expenditures is associated with planning shortcomings since the deficit of the State Budget's general fund amounted to UAH 78.9 bn (planned UAH 158.6 bn).

***Inflation: Three months of moderate price increases despite electricity shortages***

In January, inflation was 26% year-on-year. Monthly consumer price increases were below 1% for three months in a row. Slowdown in inflation primarily reflected some decrease in devaluation expectations, stabilization of prices for the main import items, particularly for energy sources, and low consumer demand. Other factors contributing to slower inflation include seasonal reductions in the price of clothes and shoes, the gradual normalization of prices in Kherson, and the fixed prices for heating, water and electricity for households. The shortage of electricity did not significantly affect the supply of consumer goods. It also seems that the additional costs associated with using generators and losses due to interruptions in the electricity supply have not yet significantly affected prices. However, inflation expectations remain high, and cost growth in the supply chain of consumer goods and services continues. This indicates inflationary pressures in the coming months.

***Figure 8: Consumer price inflation***



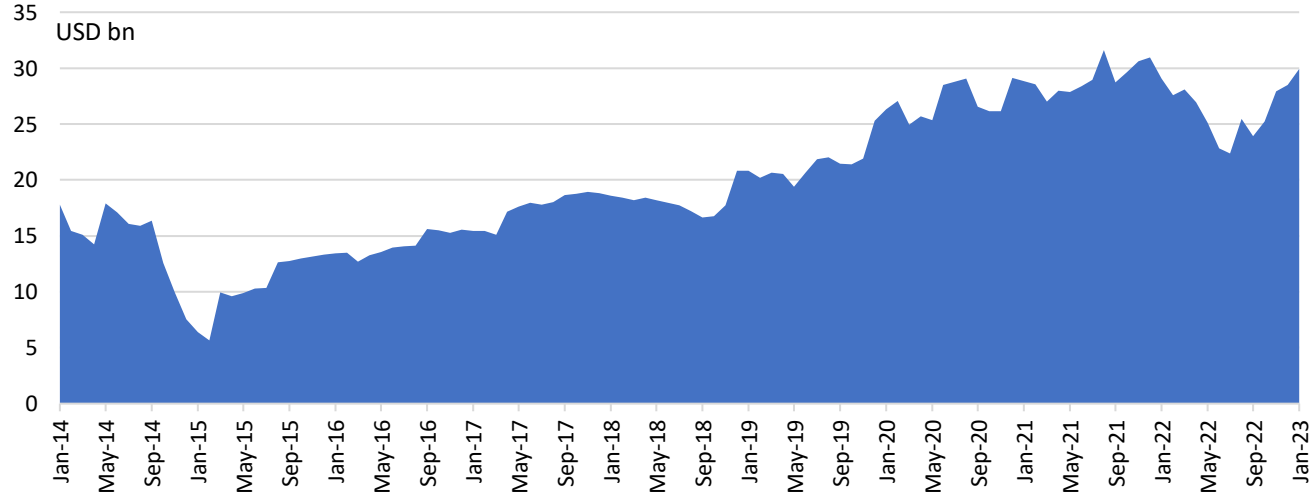

*Source: State Statistics Service*

***Monetary policy: Tighter reserve requirements for current accounts***

At the regular monetary policy meeting, the NBU left the key policy rate unchanged at 25% per annum, and most participants agreed that a reduction in the policy rate this year is unlikely. This decision reflected more stable but still high inflationary pressure and continued inflation risks this year. The NBU also decided to further increase the reserve requirements for on-demand funds such as current accounts and card accounts to encourage banks to raise interest rates on deposits. According to the NBU, this will reduce pressure on the hryvnia exchange rate and contribute to a gradual decrease in inflation.

From February 11, the reserve requirements for on-demand funds were increased by 5 percentage points, namely to 10% for accounts in UAH and 20% for accounts in foreign currency. Also in March, it is planned to increase the reserve requirements for on-demand funds in personal accounts by 10 percentage points. In general, this may increase the mandatory banks reserves kept at the NBU by over UAH 100 bn if banks take the opportunity to invest part of the mandatory reserves in benchmark-government bonds.

***Figure 9: International reserves***




*Source: NBU*

The NBU's international reserves in the end of January 2023 amounted to USD 29.9 bn compared to USD 28.5 bn in the end of December. Reserves increased as the Government's receipts from donor grants and loans exceeded the NBU's spending to maintain the exchange rate. According to the NBU, the Government has attracted in net terms (i.e., net of interest expenses and repayment of public debt in foreign currency) almost USD 4.3 bn to international reserves, primarily thanks to the EUR 3 bn in macro-financial assistance from the EU. At the same time, the NBU spent less than USD 3.1 bn net to support of a fixed exchange rate of the hryvnia. That's slightly less than in December, but NBU sales of the foreign currency were still among the highest since last June. The High FX spending by the NBU probably reflected high volumes of imports in December and January.

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