CENTRE FOR ECONOMIC STRATEGY

GET German Economic Team

23/02/2023

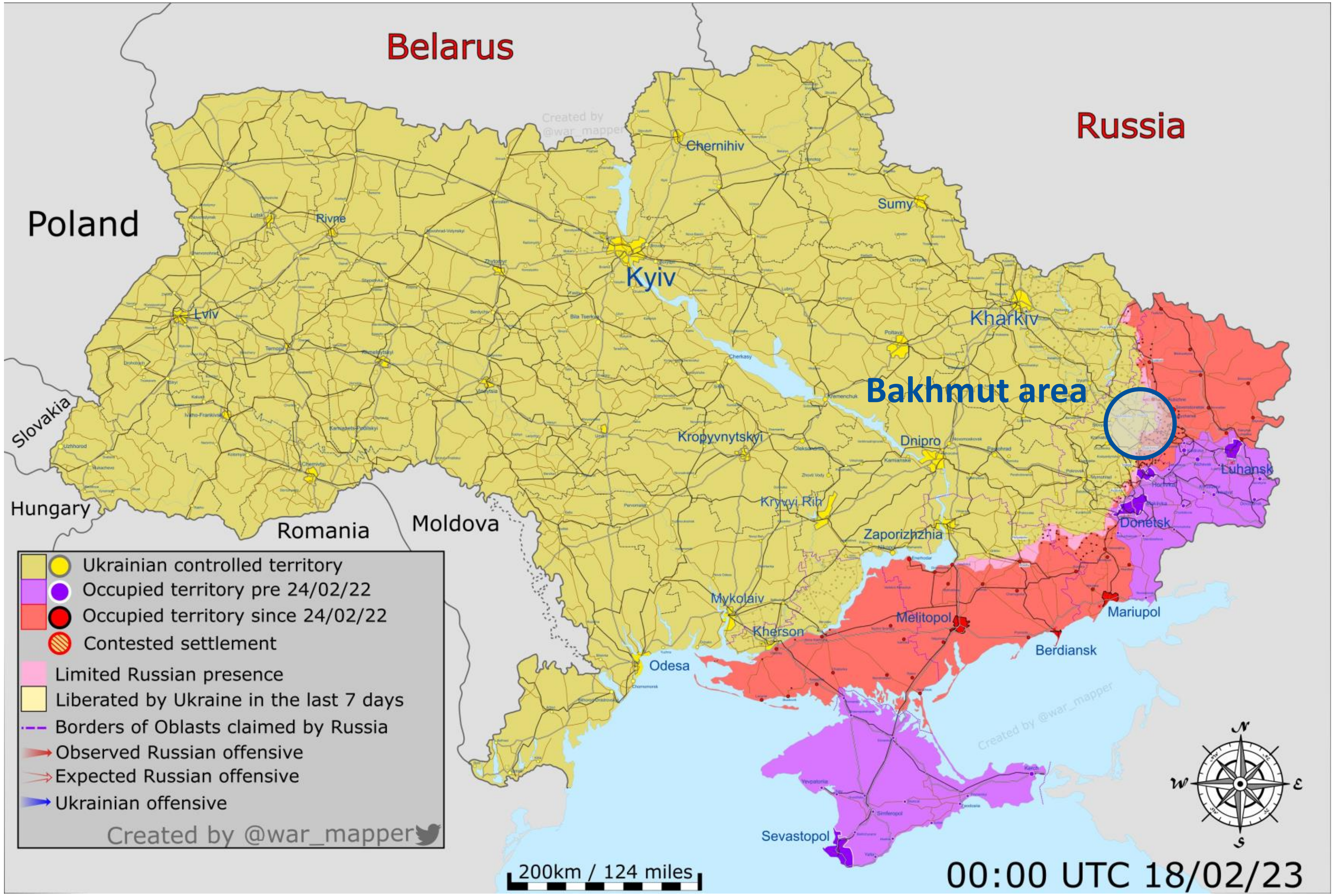
CES Team

FEBRUARY'S ECONOMIC REVIEW: MILITARY NEEDS - ACCOMPLISHMENTS FROM LAST YEAR AND FUTURE PRIORITIES

WAR

WAR UPDATE

CENTRE FOR ECONOMIC STRATEGY



- Heavy fighting is still concentrated in Bakhmut area, where the Russians are exchanging hundreds of their soldiers for mere meters of Ukrainian land.
- In Vuhledar, to the southwest of Donetsk city, Russian 155 Naval Infantry Brigade was nearly destroyed for the third time during this war after previous defeats near Kyiv and Donetsk, after which it was restored.
- Ukrainian soldiers continue their training necessary to operate Western tanks and other armored vehicles.
- On 20 February, US President Joe Biden made a surprise visit to Kyiv. This was the first visit of US President to Ukraine in 15 years.

CENTRE
FOR ECONOMIC
STRATEGY

MACROECONOMIC TRENDS

MACRO

CENTRE FOR ECONOMIC STRATEGY

GDP expected to rise in Q2

- National bank worsens the outlook to 0.3% on assumption of war until the end of the year;
- GDP is expected to fall by 19% in Q1, but to recover 10% in Q2;
- Ministry of economy holds the 3.2% forecast;
- Energy effects estimated as 1.9-3.5% of GDP, according to NBU.

Sources: Ukrstat, NBU

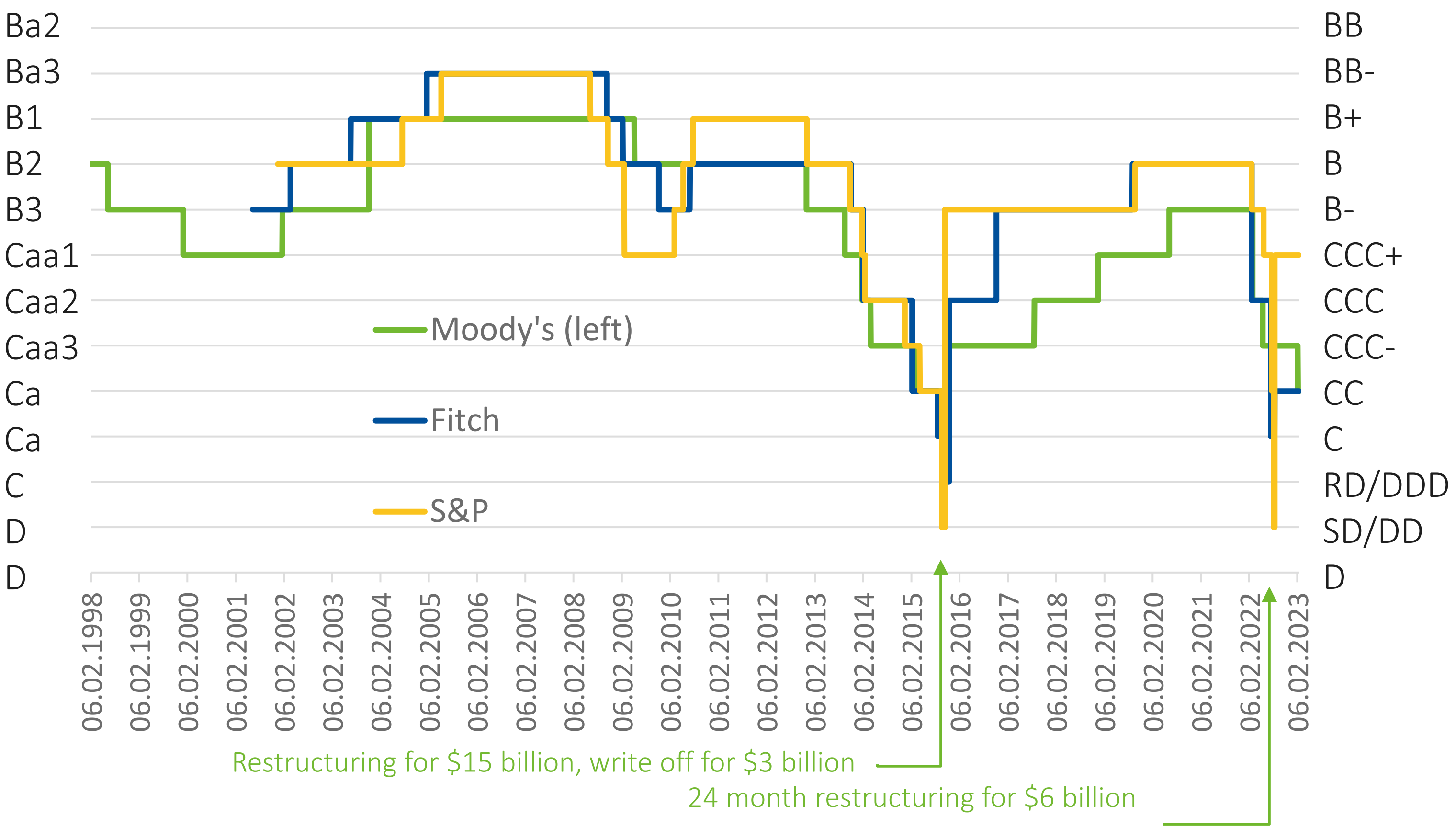
MACRO

CENTRE FOR ECONOMIC STRATEGY

Sovereign credit ratings – the worst passed

- Moody's downgraded Ukraine to Ca, citing long term consequences of war for the economy and for the state budget;
- Fitch holds CC (same as Ca for Moody's), citing possible debt restructuring.

Ukraine's long term credit ratings

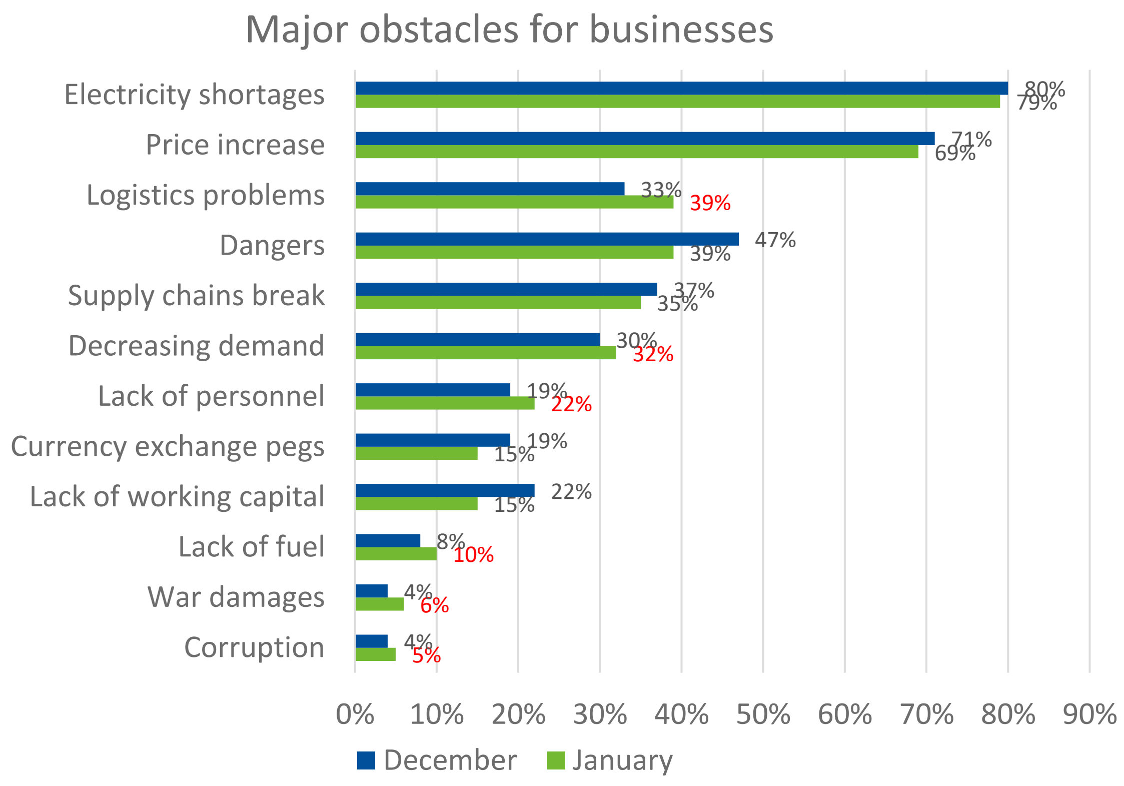


Source: Trading Economics

MACRO

Business suffers from electricity outages

- Interruptions with electricity, heating and water are the fiercest problems;
- Danger issues seem to be less threatening to business operations;
- While the most serious problems subside, some are becoming more frequent, such as logistics problems, decreasing demand and the lack of personnel.



Source: Institute for Economic Research and Policy Consulting

MACRO

CENTRE FOR ECONOMIC STRATEGY

War damages increased by 2.5 billion USD

- Damage assessment increased by 2.5 billion USD during the month;
- Growth is mostly attributed to agriculture and transportation infrastructure;
- Damages for energy infrastructure was not calculated to full extent because of data unavailability.

Asset type	Feb’23	Jan’23	Change
Residential buildings	54.0	54.0	0.0
Transportation infrastructure	36.2	35.6	0.6
Industry	11.1	11.0	0.1
Education	8.8	8.6	0.2
Agriculture and land	7.8	6.6	1.2
Energy infrastructure	7.0	6.8	0.2
Other assets	15.4	15.2	0.2
TOTAL	**140.3**	**137.8**	**2.5**

Sources: KSE, Russia will pay project

CENTRE FOR ECONOMIC STRATEGY

SECTORAL ANALYSIS

SECTORAL

CENTRE FOR ECONOMIC STRATEGY

Metals & Mining are stagnating

Iron ore price

Source: Trading Economics

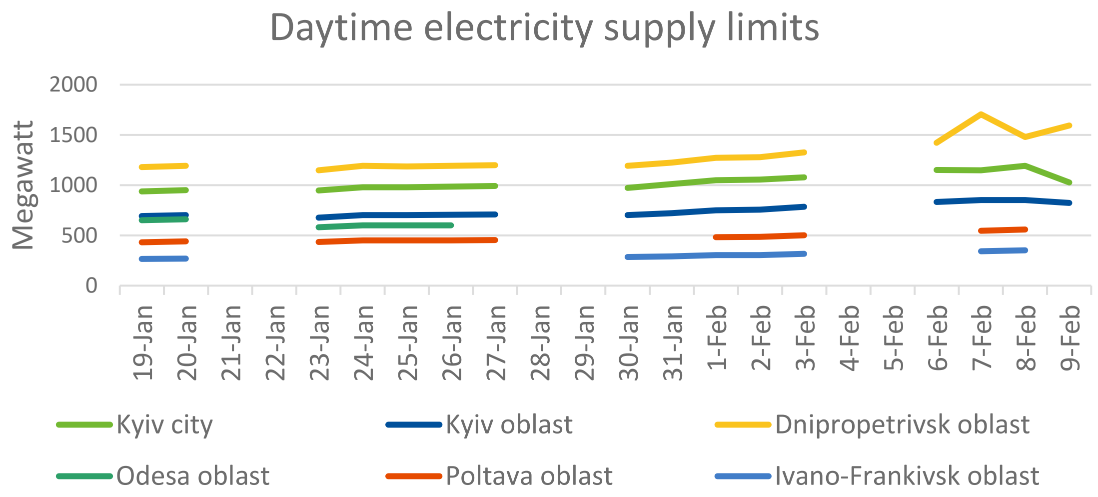
- ArcelorMittal Kryvyi Rih to shutdown one of four sinter plants; expects production growth 5% in 2023;
- Zaporizhstal worked at 50% capacity in 2022, even less in the end of the year;
- Zaporizhzhia ferroalloy plant halted production until spring;
- Centravis Production Ukraine started operations in Uzhgorod subsidiary.

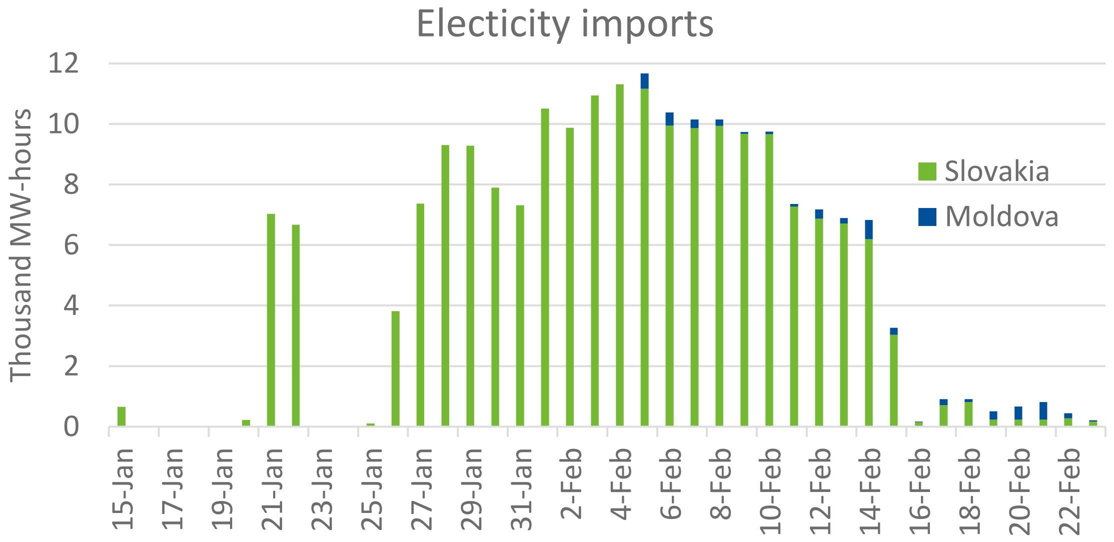
SECTORAL

CENTRE FOR ECONOMIC STRATEGY

Electricity supply increases

- Missile count exceeded 800 in 15 waves of hits on energy infrastructure;
- Despite that, electricity supply limits grew by 30% (on average) before Ukrenergo cancels those limits;
- Electricity imports from Slovakia and Moldova helped to balance the market.



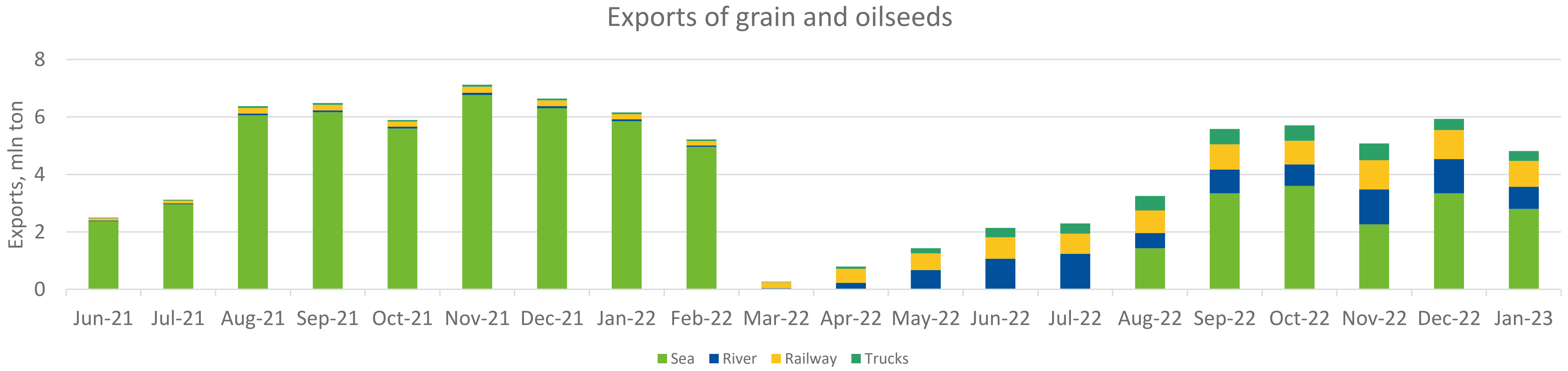


Source: Ukrenergo

SECTORAL

Grain Deal in danger

- Harvest 2022 competed by 97% (and by 93% for corn);
- Russia sabotages grain deal; exports decreased;
- Some traders say they retain land logistics even after ports will be fully available;
- Kernel started to import nitrogen fertilizers for the first time;
- 14 new markets opened for products of animal origin in 2022, new openings underway;
- EU integration conditions met my 51% (+15%).



Sources: State Custom Service, Minagro, UN

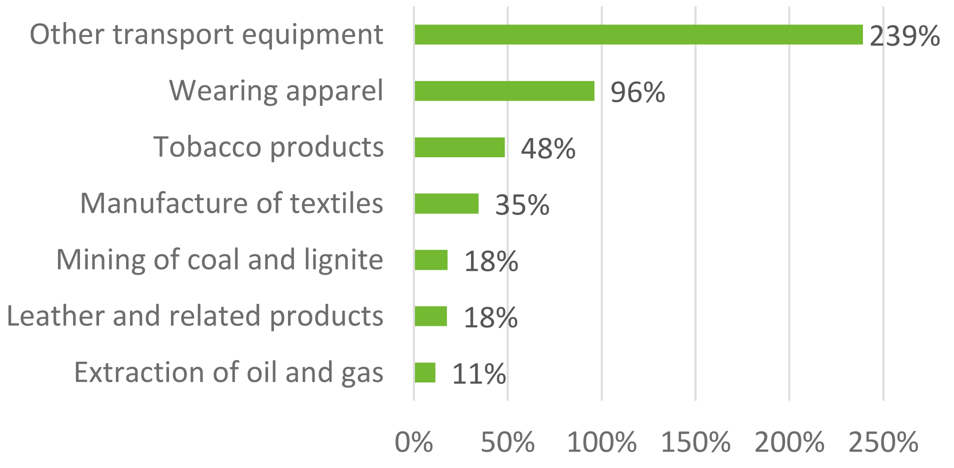
SECTORAL

In the rise

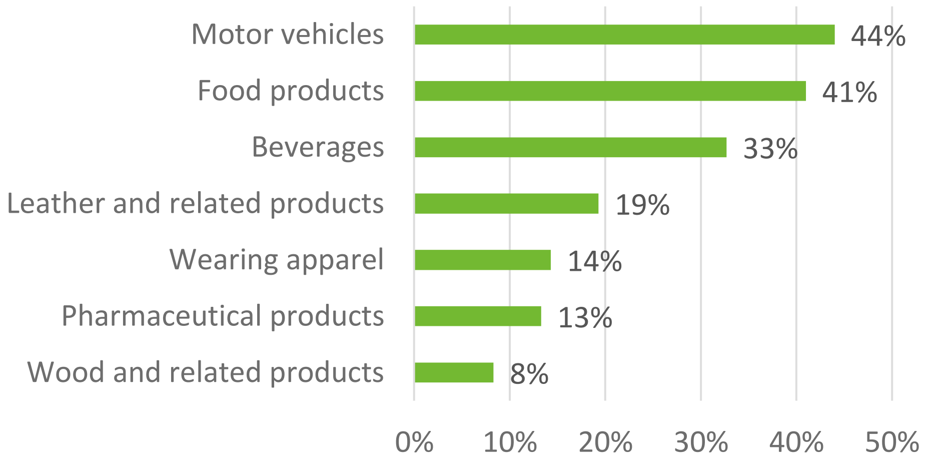
- Military demand boosted some sectors, such as military vehicle production and manufacture of textiles, apparel and footwear;
- Cutoff of Russia and Belarus forced to increase coal mining and oil/gas extraction;

- Currency depreciation boosted exports of certain goods, such as motor vehicles, food and beverages, and, again, apparel.

Internal turnover growth



External turnover growth



Sources: State Statistics Service, August 2022 yoy

CENTRE
FOR ECONOMIC
STRATEGY

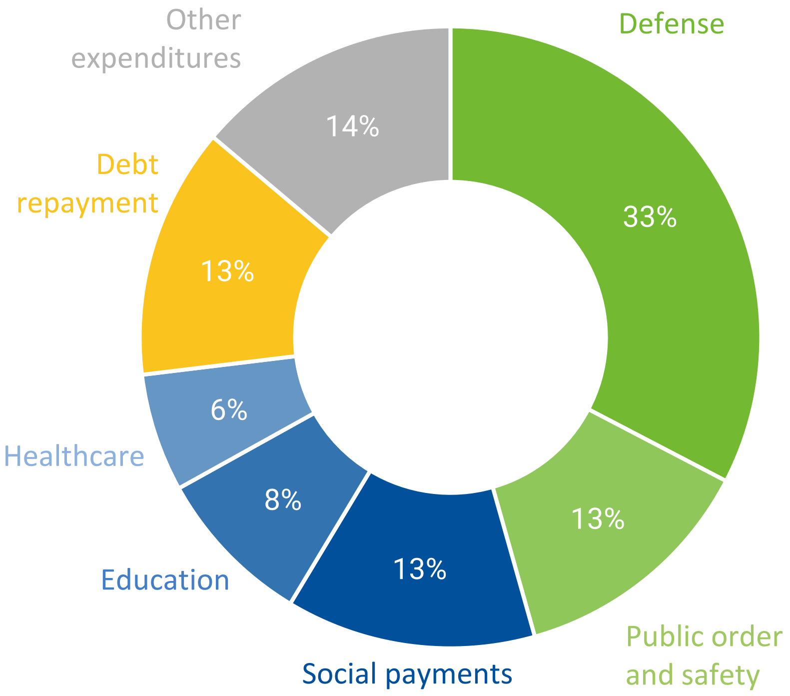
FISCAL SECTOR

FISCAL SECTOR

Defense spending dominated the consolidated budget of 2022

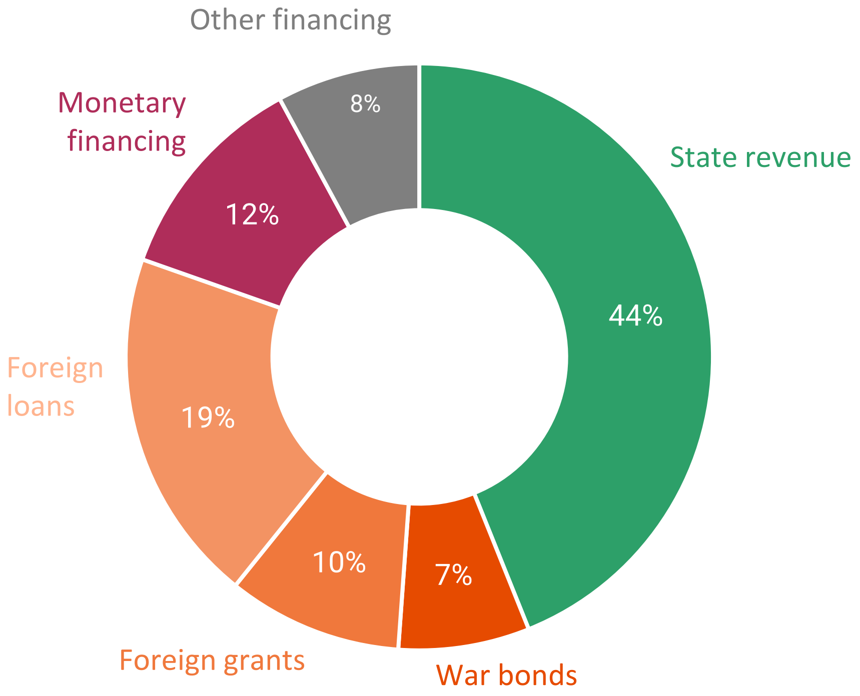
Consolidated budget financing needs, 2022

Consolidated budget spending by state functions and debt repayment, % of total



Source: NBU

Consolidated budget and debt repayment financing sources, % of total



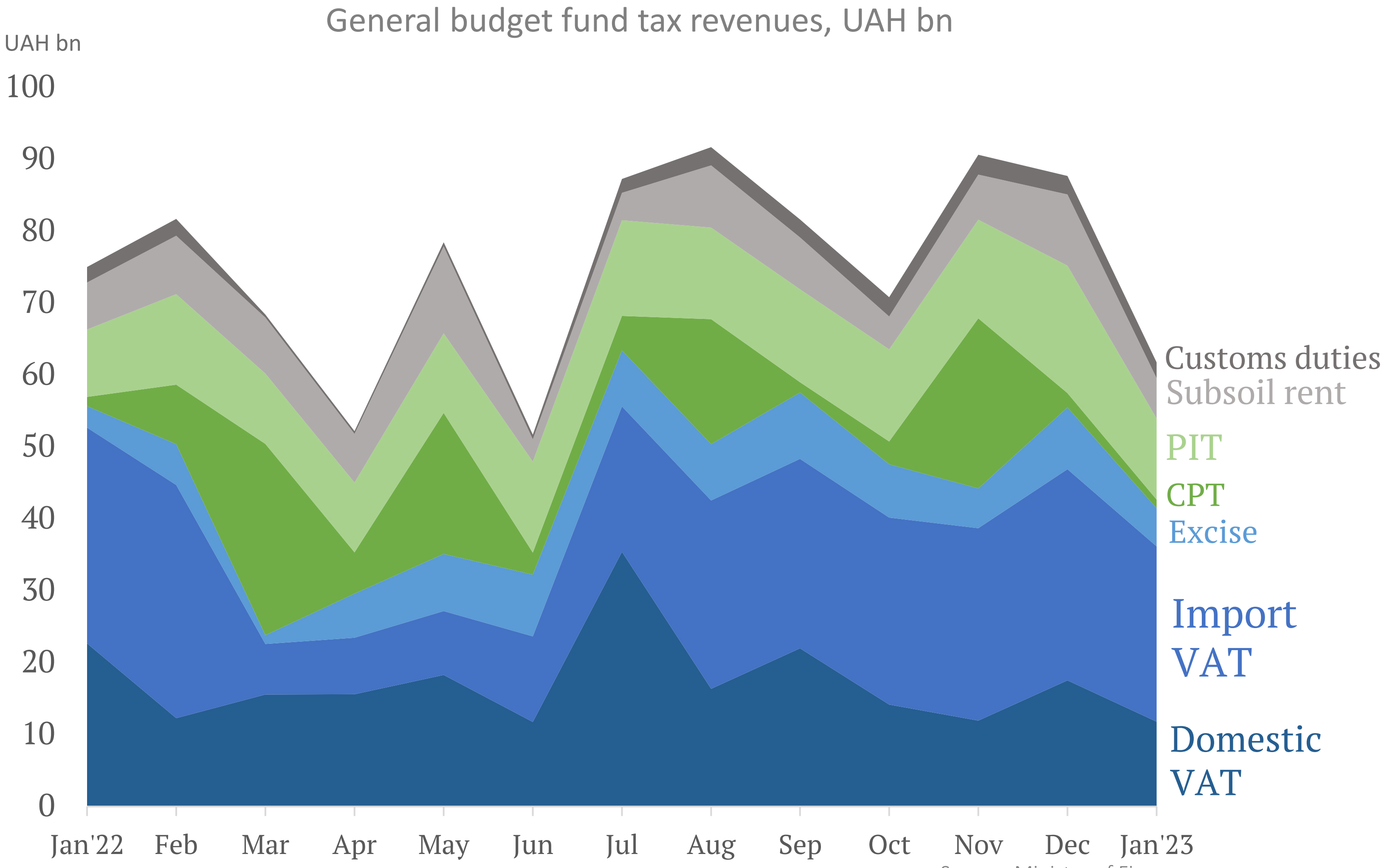
Source: NBU, Ministry of Finance

- More than 40% of the expenditures of the consolidated budget were dedicated to the defense and security sectors in 2022.
- The consolidated budget of 2023 would also be focused on covering the expenditures of the defense and security sectors.
- The European Union, the US and other international partners will play an important role in financing the budget deficit in 2023.

FISCAL SECTOR

CENTRE FOR ECONOMIC STRATEGY

Tax revenues in January undermined by VAT and gas rent payments



Source: Ministry of Finance

- Despite second best monthly result for gross domestic VAT since the beginning of war (UAH 31.1 bln or USD 0.85 bln), the net amount was low due to large VAT refunds (UAH 19.3 bln)
- Imports decrease, traditional for January, led to lower import VAT and customs duties revenues. Still, VAT from imports contributed UAH 24.4 bln to the budget, almost 40% of general fund tax revenues
- Decrease in subsoil rent payments (UAH 5.6 bln), mostly for natural gas extraction, contributed to overall result

FISCAL SECTOR

CENTRE FOR ECONOMIC STRATEGY

VAT refunds increased in January, as government decreased arrears

VAT refunds composition by time between claim and payment

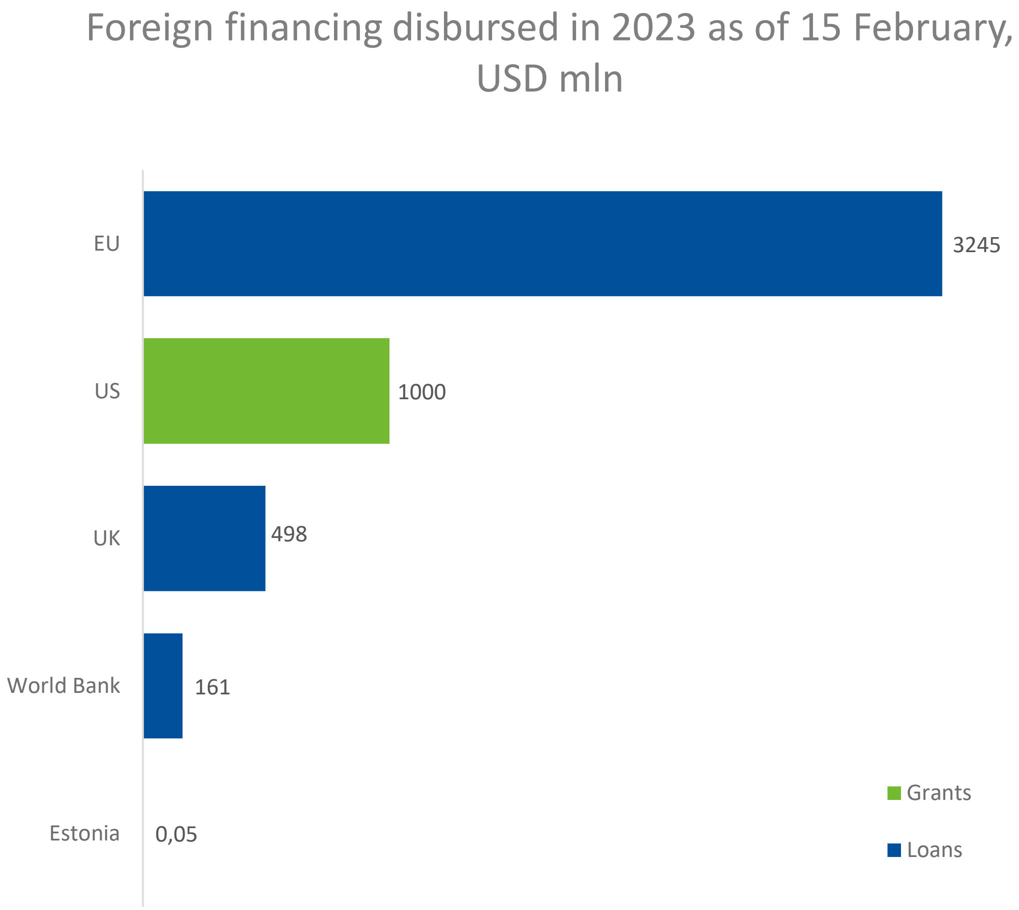
	Days to refund											of which	Total,
	1-10	11-20	21-30	31-40	41-50	51-60	61-70	71-80	81-90	91-100	>100	>60	UAH bln
2018	0%	3%	9%	60%	9%	5%	11%	2%	0%	0%	0%	14%	131,5
2019	1%	3%	5%	43%	10%	8%	23%	3%	1%	0%	1%	29%	151,5
2020	1%	6%	7%	42%	14%	5%	17%	3%	2%	1%	2%	24%	143,1
2021	3%	7%	9%	54%	10%	1%	11%	2%	0%	0%	2%	15%	159,4
2022	0%	5%	2%	25%	6%	4%	7%	2%	1%	6%	41%	57%	84,4
Jan	0%	22%	2%	66%	5%	1%	3%	0%	0%	0%	0%	4%	18,4
Feb	0%	1%	10%	49%	18%	3%	13%	5%	1%	0%	0%	20%	12,1
Mar	0%	0%	0%	6%	85%	0%	0%	7%	0%	0%	3%	9%	0,8
Jun	0%	3%	0%	1%	0%	0%	0%	0%	0%	0%	96%	96%	9,5
Aug	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	100%	100%	9,5
Sep	0%	0%	0%	0%	0%	0%	0%	2%	0%	1%	97%	100%	1,6
Oct	0%	0%	0%	15%	1%	3%	12%	8%	1%	17%	42%	81%	10,9
Nov	0%	0%	0%	11%	10%	0%	16%	1%	0%	20%	41%	79%	13,6
Dec	0%	0%	0%	0%	0%	34%	0%	0%	8%	3%	55%	66%	8,1
2023													
Jan	0%	0%	0%	8%	0%	4%	22%	5%	0%	13%	48%	89%	19,3

- The UAH 19.3 bln is the largest monthly VAT refund in 4 years
- UAH 9.3 bln are refunds, claimed more than 100 days ago, including 1.8 bln to Arcelor and 1.5 bln to Ferrexpo entities
- The decrease of VAT refund arrears was in line with Gov't commitments to IMF
- We expect further decrease of VAT refund delays, as long as the external funding is sufficient. This will have positive impact on business, especially the exporters

Source: Ministry of Finance

FISCAL SECTOR

Foreign financing has unfortunately slowed down



Source: Ministry of Finance

- The disbursements of foreign aid slowed down after a great start in January. So far, Ukraine has received USD 161 mln from the World Bank and USD 498 mln from the UK. Both disbursements were loans.
- According to the new IMF assessment, Ukraine needs USD 40-48 bn of external financing in 2023, as stated by Kristalina Georgieva.
- Japan is aiming to provide Ukraine with USD 5.5 bn of financial aid, according to Japanese PM Fumio Kishida.

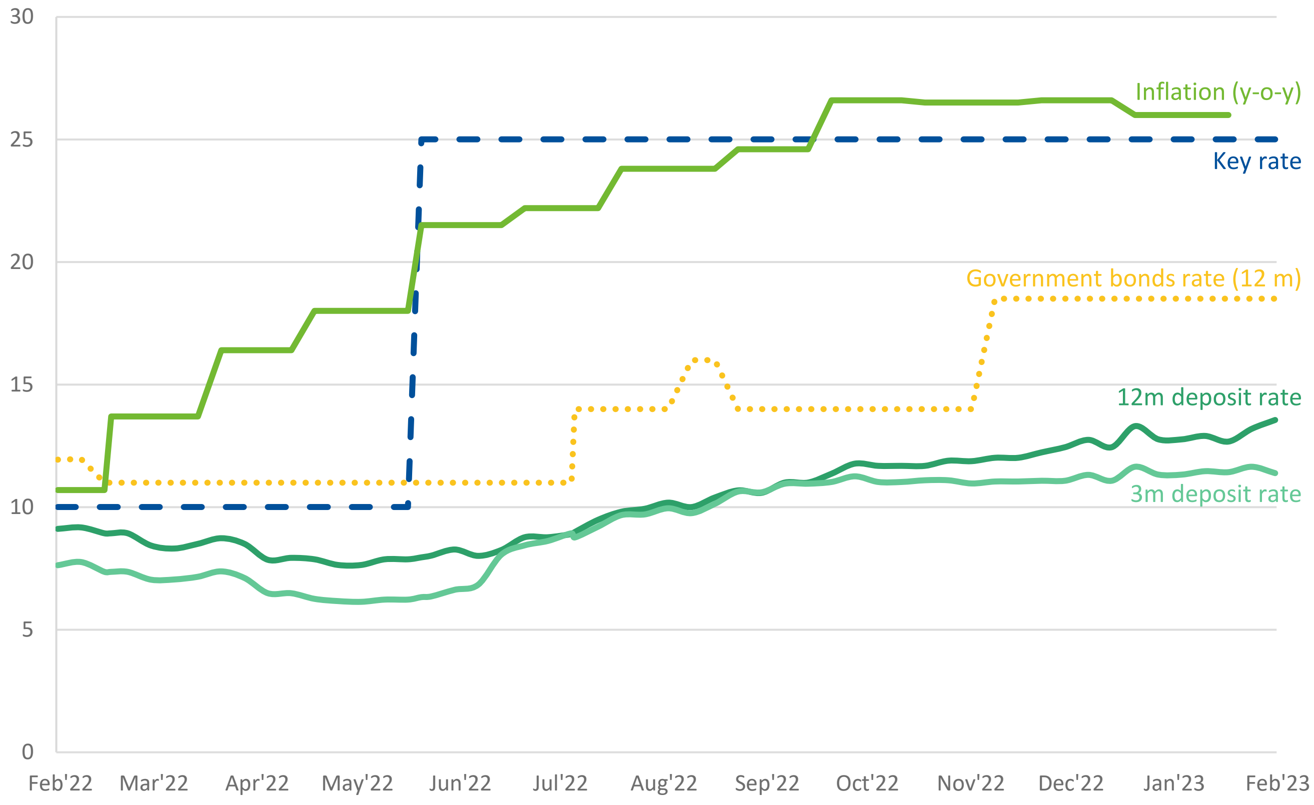
CENTRE
FOR ECONOMIC
STRATEGY

MONETARY AND FX POLICY

MONETARY POLICY

The NBU tightened the mandatory reserves requirements

Inflation (y-o-y), NBU key rate, rates on hryvnia consumer deposits (12- and 3-month), and weighted average level of yield on 1-year hryvnia government bonds, %

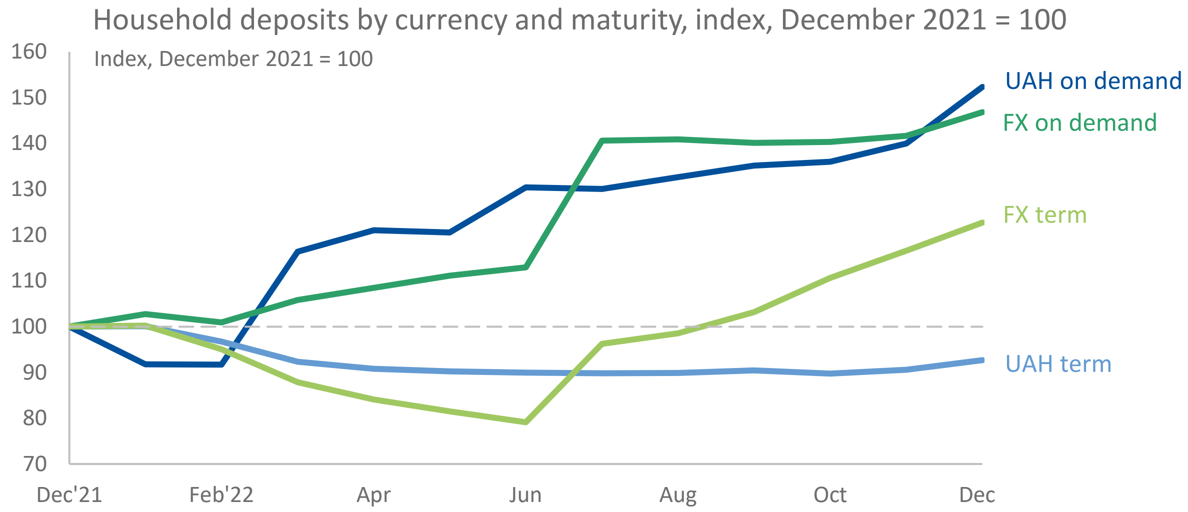


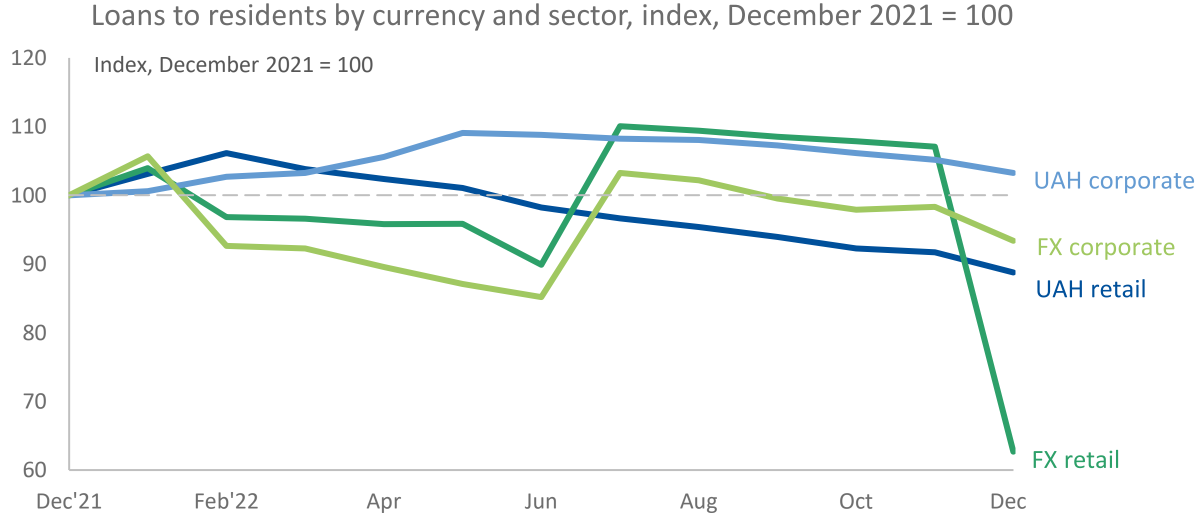
Sources: NBU, State Statistics Service, UIRD

- The key policy rate remains unchanged at 25% p.a.. In his latest interview, Andrii Pyshnyi, the NBU governor, stated that the NBU does not plan to change it for a while to curb inflation.
- The yield of one-year hryvnia military bonds remains at 18.5%.
- Average rates on retail deposits (UIRD) continue to increase slowly. The National Bank changed the requirements for mandatory reserves of banks to strengthen monetary transmission. This should stimulate the banks to increase the deposit rates.

BANKING SECTOR

Deposits are on the rise while loans decrease



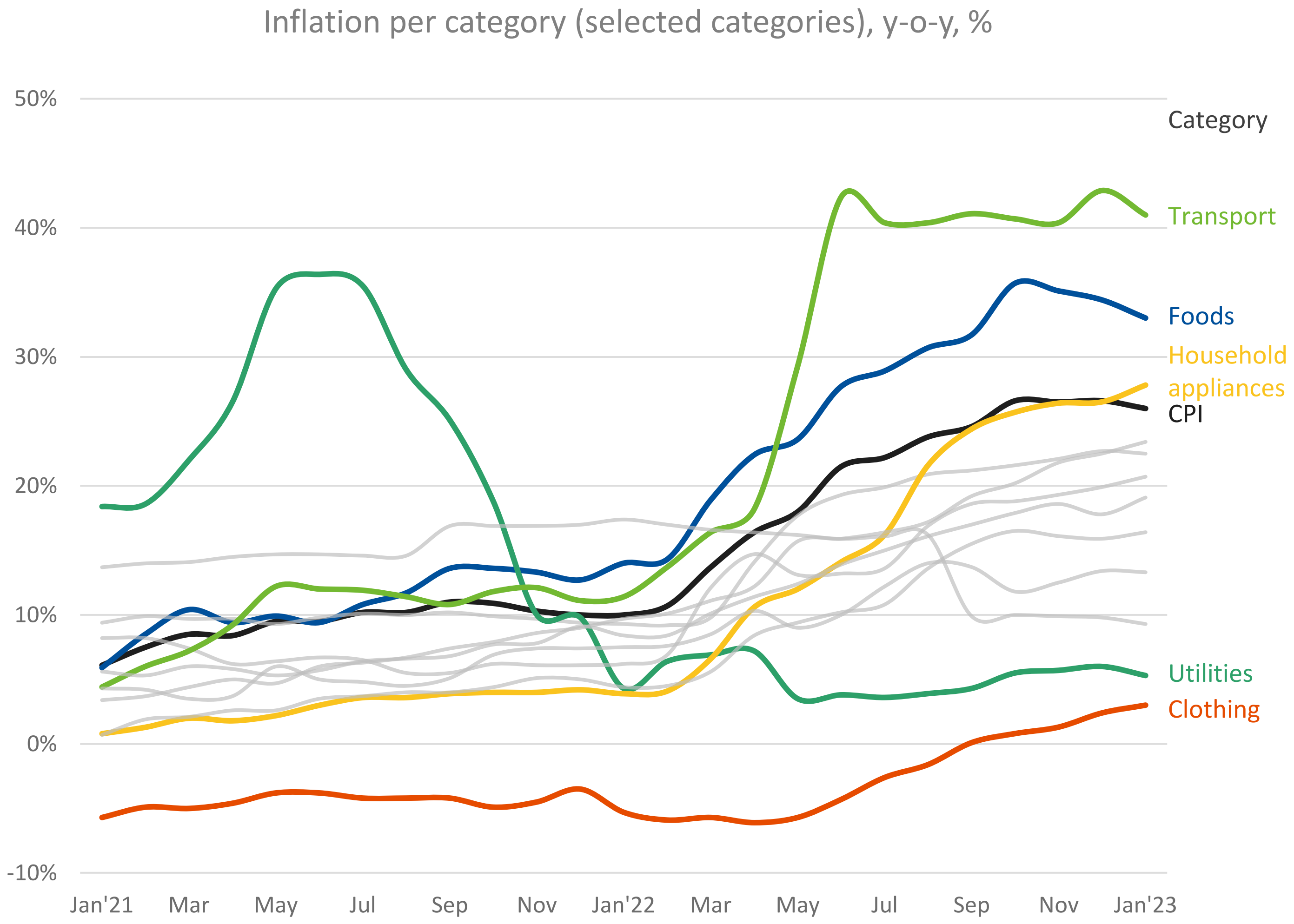


NB: a sharp increase in FX loans and deposits in July is caused by change of official rate. Source: NBU

- According to the NBU, **the volume of hryvnia funds of individuals increased by 8.3% in Q4 2022 (31.2% yoy).** Due to salary projects (including military) and concentration of social payments, the leaders in this indicator were found to be state-owned Oschadbank and Privatbank, with increases of 15% and 8%, respectively. Most of the new fund inflows remain on demand accounts. However, the increase in deposit rates also accelerated the growth of term deposits in hryvnia - up to 2.6% for the quarter (-6% yoy).
- For the quarter, household funds in foreign currency increased by 8.7% (-4.6% yoy). Household term deposits in foreign currency increased by 20.8%. Deposits in institutions with advanced internet banking, particularly Privatbank (+51.4%) and some private banks (+28% for the group), showed the most significant growth. **This was facilitated by the NBU's permission to buy FX online for placement in deposits**.
- **The net loan portfolio of the banks continues to contract**. According to the NBU, in 2022 UAH loans contracted by 1.2%, FX loans – by 32%. FX retail loans declined considerably in December 2022 due to the write-off by one of the state-owned banks.

CPI

Inflation slowed down a bit



Source: State Statistics Service of Ukraine

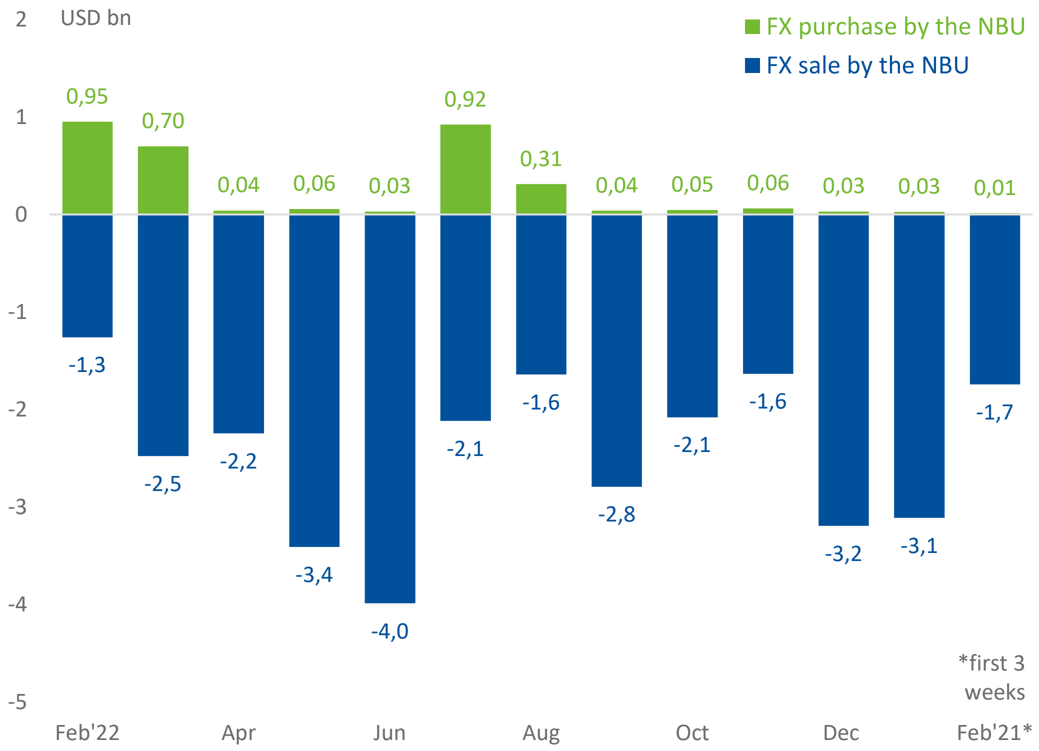
- The annual inflation rate was 26.0% yoy in January. This is less than the NBU forecast due to the larger than anticipated supply of foods.
- In January, prices continued to decrease in Kherson oblast, a large part of which was deoccupied in November (-0.6% m-o-m). Prices in other regions of Ukraine increased.
- Fuel price growth decelerated to 61.8% yoy. Together with the lower demand for electricity generated on-site (as the power grid has been stabilized for now) this should further slow the inflation down in February.

FX POLICY

FX reserves surpassed the pre-war level

There is still a need for large FX sales by the NBU. However, so far, they have been compensated with large amounts of foreign financial aid. **At the end of January, Ukraine's international reserves (USD 29.9 bn) surpassed the pre-war level by 9%.**

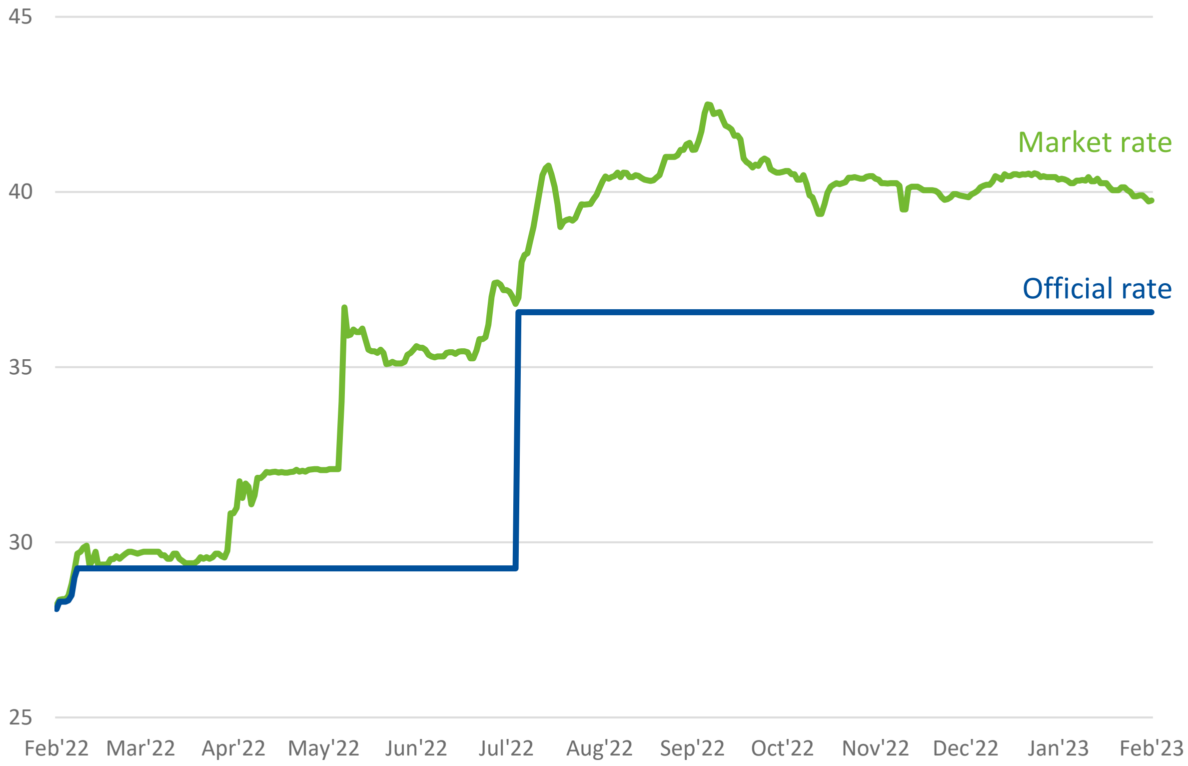
NBU foreign exchange interventions, USD bn



Source: NBU

Official rate remains fixed at 36.57 UAH/USD. The market exchange rates are also quite stable and only changed from 40.35–40.48 UAH/USD on 15 January to 39.60–40.05 UAH/USD on 15 February. Nothing has changed with the capital controls.

Average daily official and market exchange rates UAH/USD



Source: NBU, minfin.com.ua