



# ECONOMIC REVIEW IN JANUARY. HOW DOES MONETARY POLICY AFFECT ECONOMIC GROWTH?



WAR

# WAR UPDATE



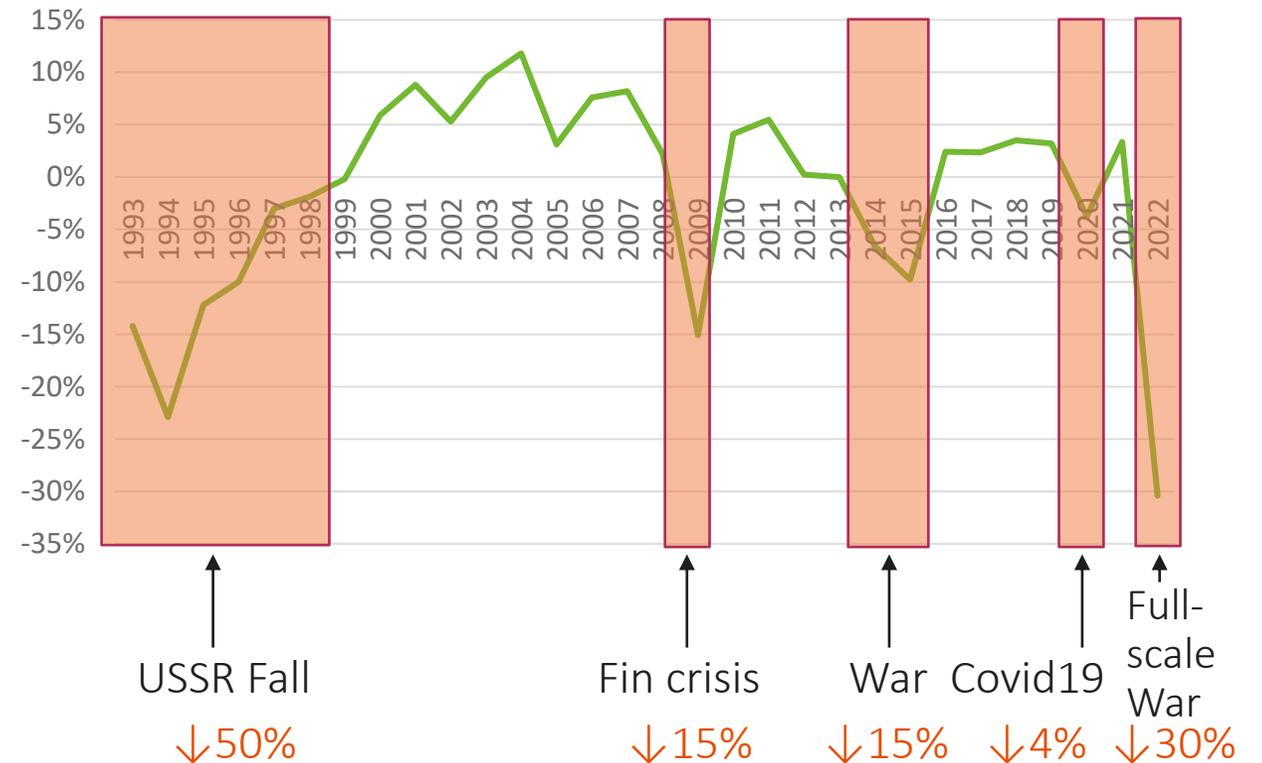
- The fighting is concentrated in the Bakhmut area. Capture of this city is politically important for Russia after long months of heavy battles.
- Ukraine is set to receive first tanks and armored fighting vehicles from an international coalition.
- Russia continues its campaign of terror bombing of civilian targets. In response, the US and Germany pledged to provide Patriot air defense systems to Ukraine.
- The Ministry of Internal Affairs leadership was killed in a helicopter crash in Brovary on 19 January 2023.

# MACROECONOMIC TRENDS



## GDP contracted less than expected – positive surprise

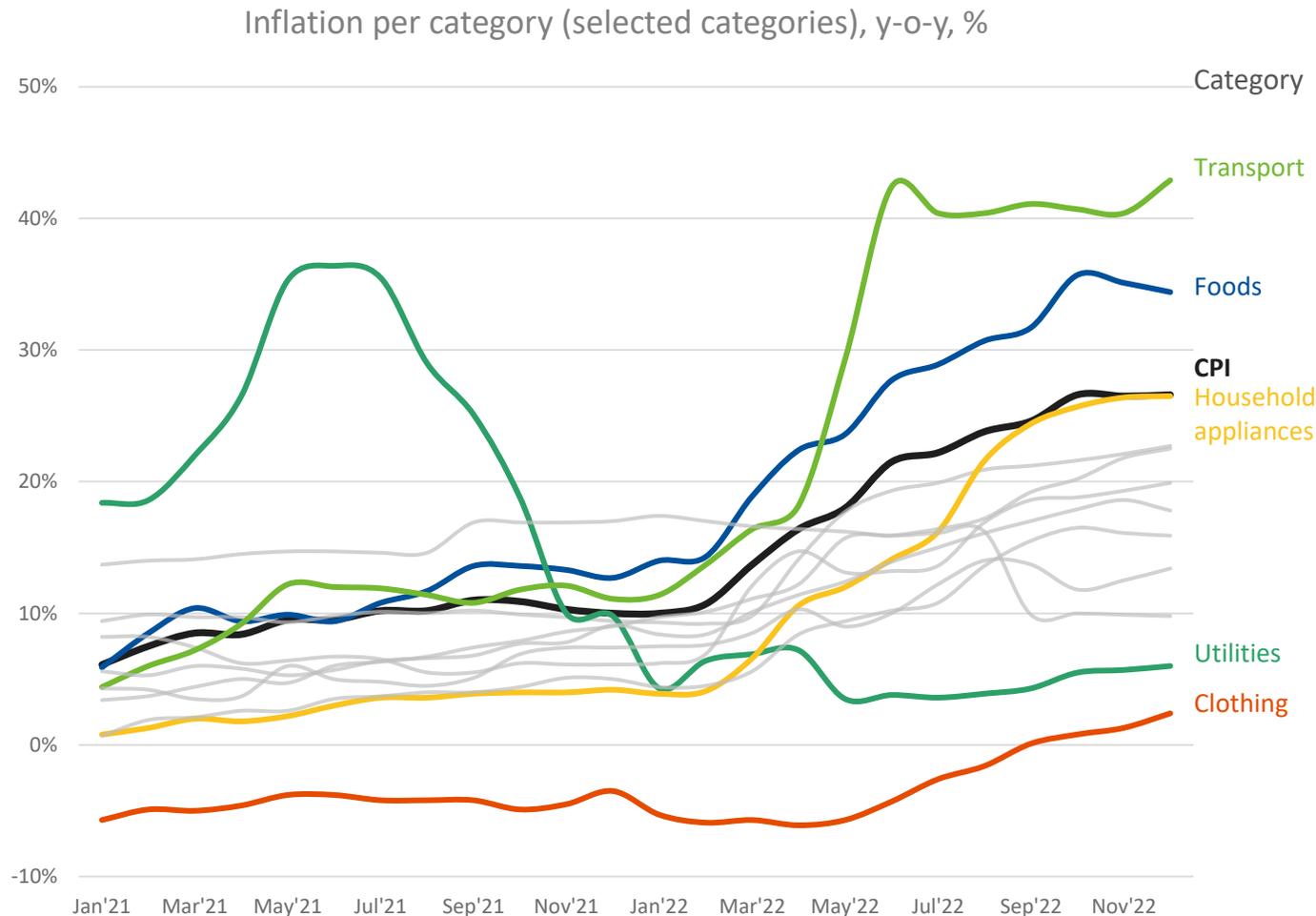
- GDP down by 30.3% in 2022, the worst drop in the history of independent Ukraine.
- But it still turned out better than expected (32-45% decline in different forecasts)
- Q2 was the worst, but the Q4 has almost beat it because of electricity disruptions
- In 2023, the government expects 3.2% growth, some institutions share this view, others expect a slight decline
- Energy disruptions may worsen the forecast by 3-9 p.p., according to the Ministry of Economy



Sources: Ukrstat, NBU

# MACRO

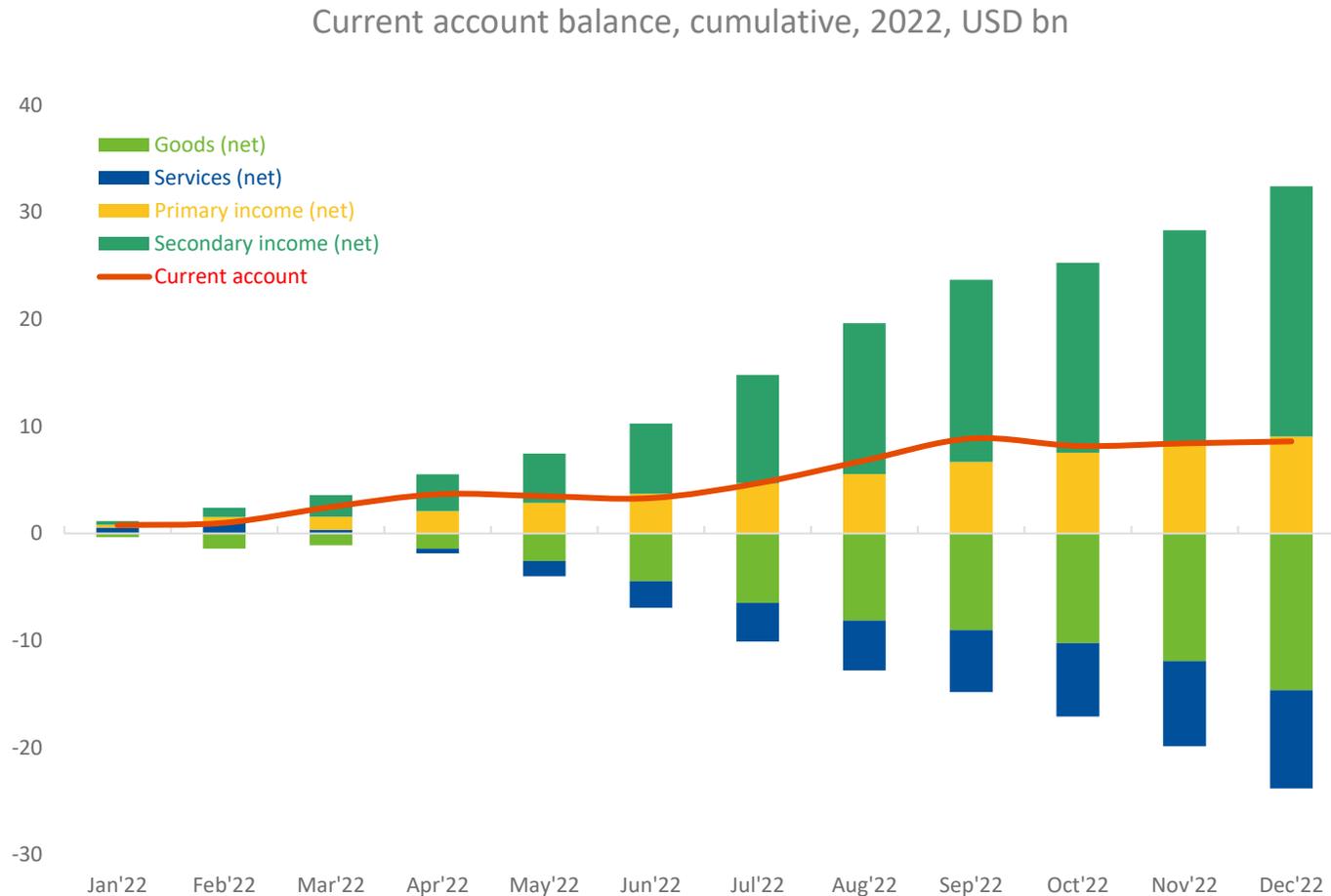
## Inflation in 2022 was lower than expected



Source: State Statistics Service of Ukraine

- The annual inflation rate was 26.6% yoy in December, which is less than 30% that were anticipated earlier.
- In December, prices decreased in Kherson oblast, a large part of which was deoccupied in November (-4% m-o-m). Vinnytsia, Sumy and Khmelnytskyi are the oblasts where prices increased the most in December (+1.5%, +1.5%, and +1.3% m-o-m respectively).
- The inflationary pressure may ease when the winter is over. With warmer temperatures, the need for heating will lessen, and cheaper energy produced by power plants will become more available.

## Positive current account in 2022

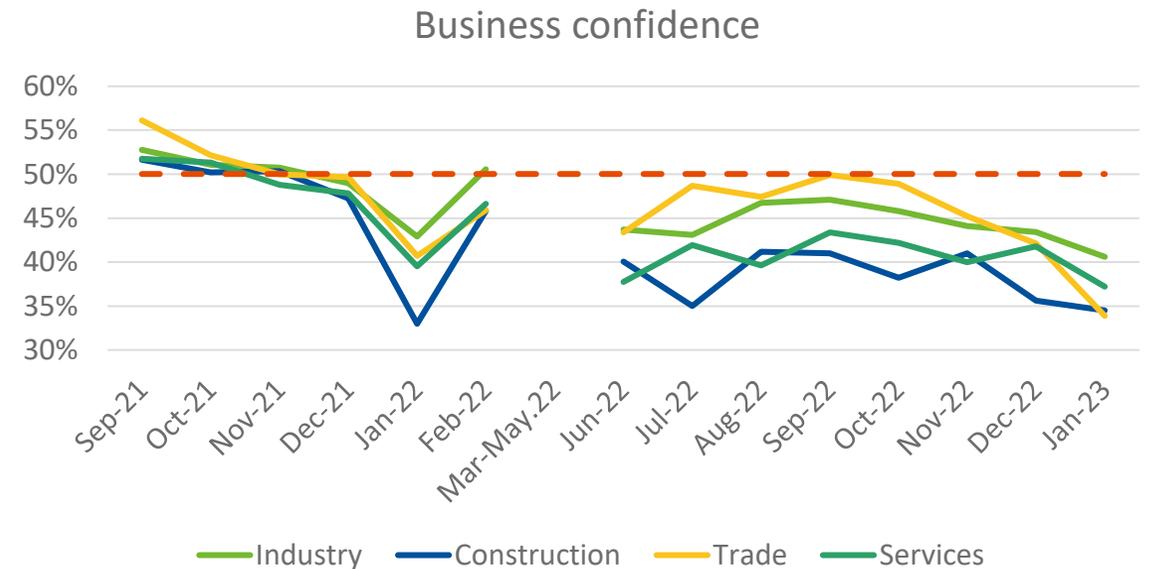


Source: NBU

- Current account was positive (USD 2.9 bn) in 2022.
- Large deficit of net goods (USD -14,6 bn.) and net services (USD -9,1 bn) was compensated by positive net primary and secondary income (USD 9 and 23,4 bn respectively), largely thanks to the foreign aid. Current account balance in 2022 has a surplus of USD 8.6 bn.
- Overall, in 2022 the NBU sold USD 25 bn of FX. Payments on servicing and repaying Ukraine's FX public debt amounted to USD 9.1 bn. This was largely compensated by USD 31.1 bn of foreign grants and loans that Ukraine received in 2022.

## Business confidence keeps falling

- In December, the Business confidence index down to 37,5% comparing to 42,1% in December and 46,1% in September
- Construction has the worst outlook (investment demand is effectively absent), now trade joined the club
- Services show some optimism in December (probably they have the lowest dependence on electricity) but their index fell in January



Source: National bank.  
50% is neutral level (number of optimists equals the number of pessimists)

## Damages increased by more almost 2 billion USD

- Damage assessment increased by 1.9 billion USD during the month
- Growth is attributed to housing, transportation infrastructure, and education
- Damages for energy infrastructure was not calculated to full extent because of data unavailability

Asset type	Jan'23	Dec'22	Change
Residential buildings	54.0	52.5	1.5
Transportation infrastructure	35.6	35.6	0.0
Industry	13.0	13.0	0.0
Education	8.6	8.2	0.4
Agriculture and land	6.6	6.6	0.0
Energy infrastructure	6.8	6.8	0.0
Other assets	13.2	13.2	0.0
<b>TOTAL</b>	<b>137.8</b>	<b>135.9</b>	<b>1.9</b>

Sources: KSE, Russia will pay project

# SECTORAL ANALYSIS



# SECTORAL

Metals & Mining is down by almost 3/4



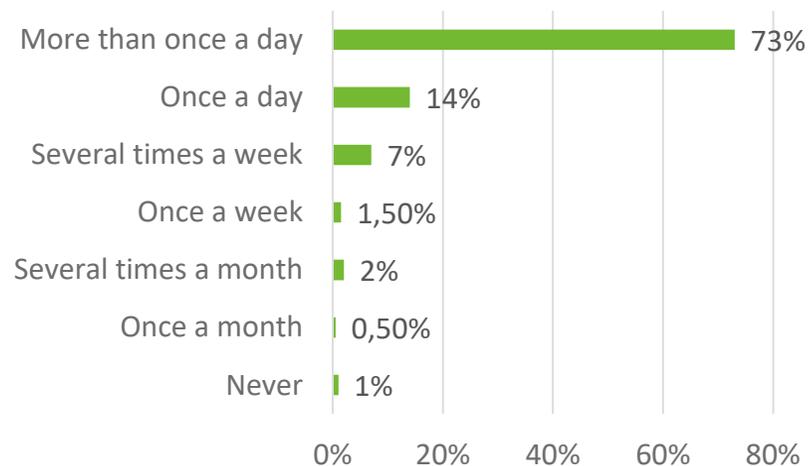
- Base metal production down by 72% in 2022
- Metal product export down by 67.5%, iron ore export by 58% in 2022
- Destroyed Azovstal and MMK Illich are officially bankrupt
- Current capacity utilization is at 15-20%, according to Ukrmetalurgprom
- Extraction rent set to zero, ore price are rising

Source: Trading Economics

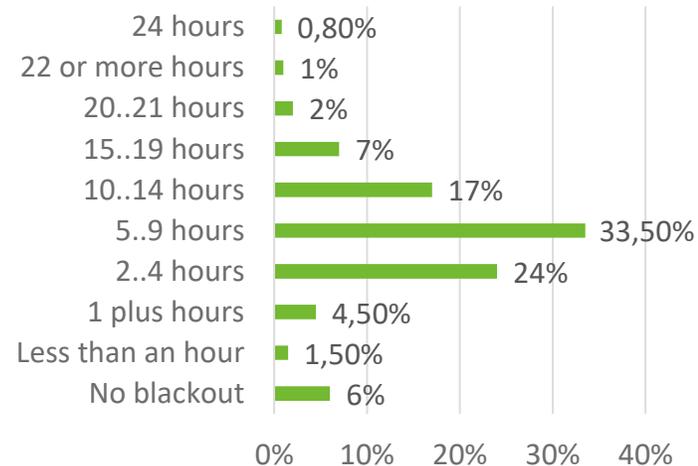
## Energy infrastructure severely damaged

- Missile hits are less frequent, but previous destructions and increased demand do the job of making electricity scarce
- At the same time, no more full blackouts are expected
- More businesses become self-sufficient in terms of electricity supply – small distributed generation is developing
- Companies can now import electricity and avoid power outage per day

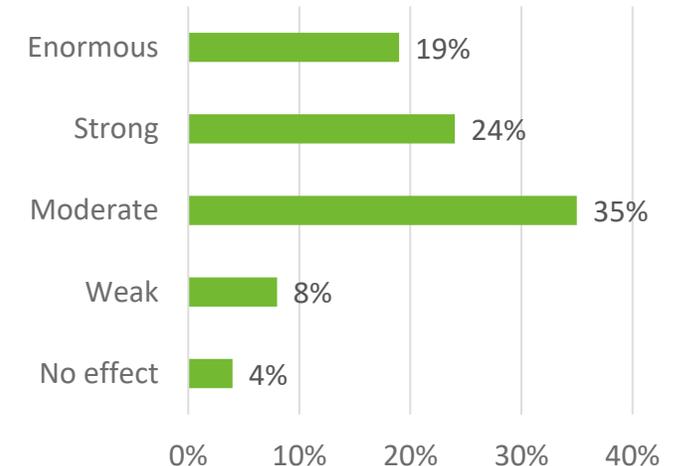
Frequency of power outage per day



Power outage duration per day



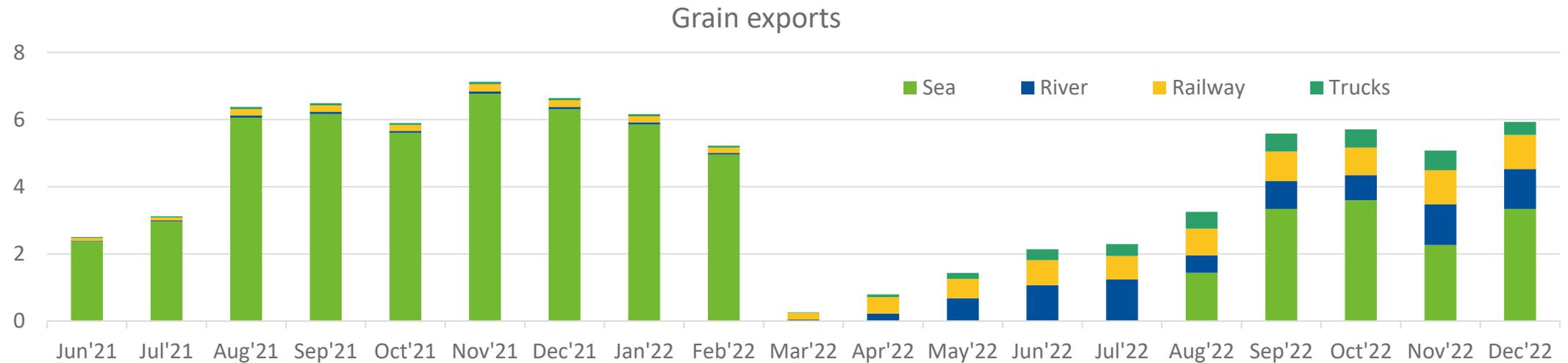
Effect on people



Source: Razumkov Center, household survey

## Agriculture saved by Grain Deal

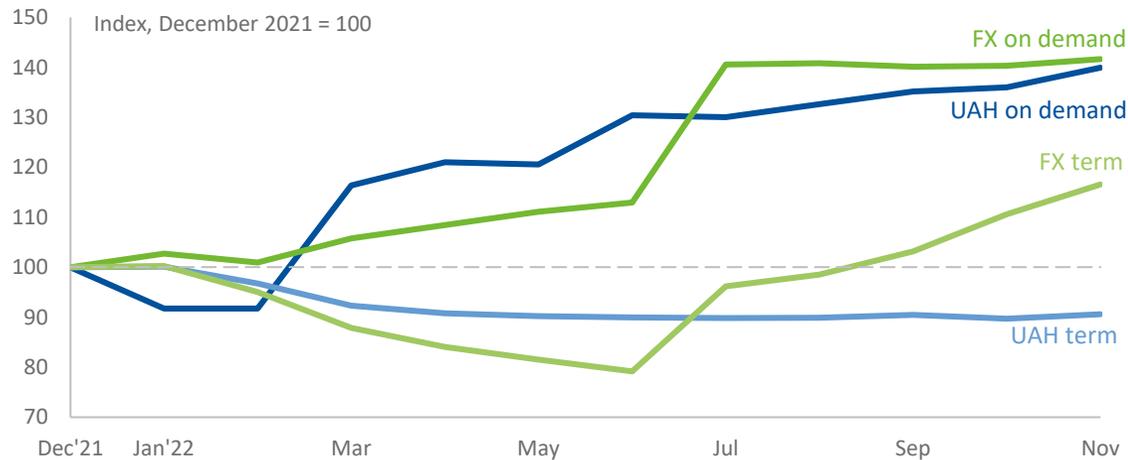
- Some agricultural infrastructure may become critical (to secure electricity supply)
- Project of building an edible oil pipeline to Poland is under development
- Vegetables, fruits and eggs set record prices; supply expected to increase in 2023 after several regions liberation
- Winter crops sewn 40% less than a year before
- In 2023, harvest expected to be at 70-75% of the year 2022
- Grain initiative prospects are unclear so far



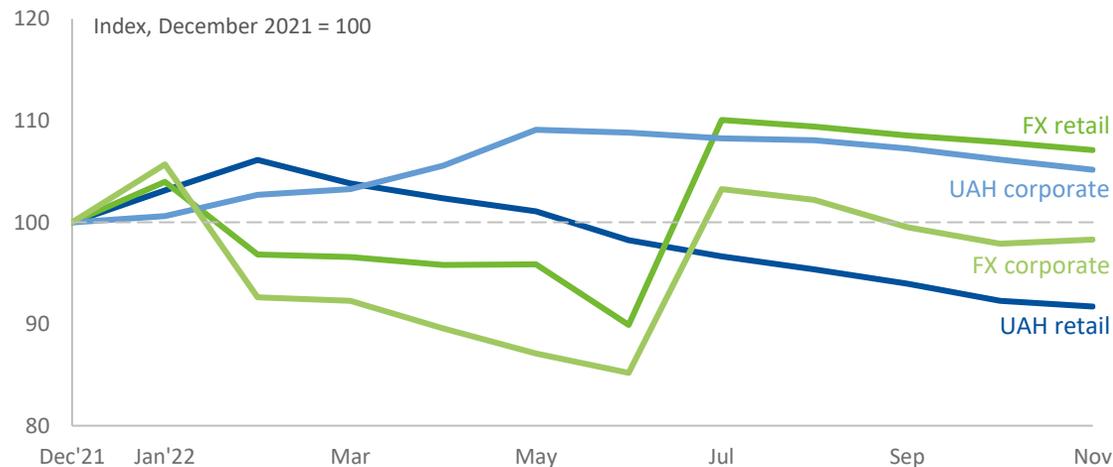
# SECTORAL

## The banking sector is stable and continues to operate normally

Household deposits by currency and maturity, index, December 2021 = 100



Loans to residents by currency and sector, index, December 2021 = 100



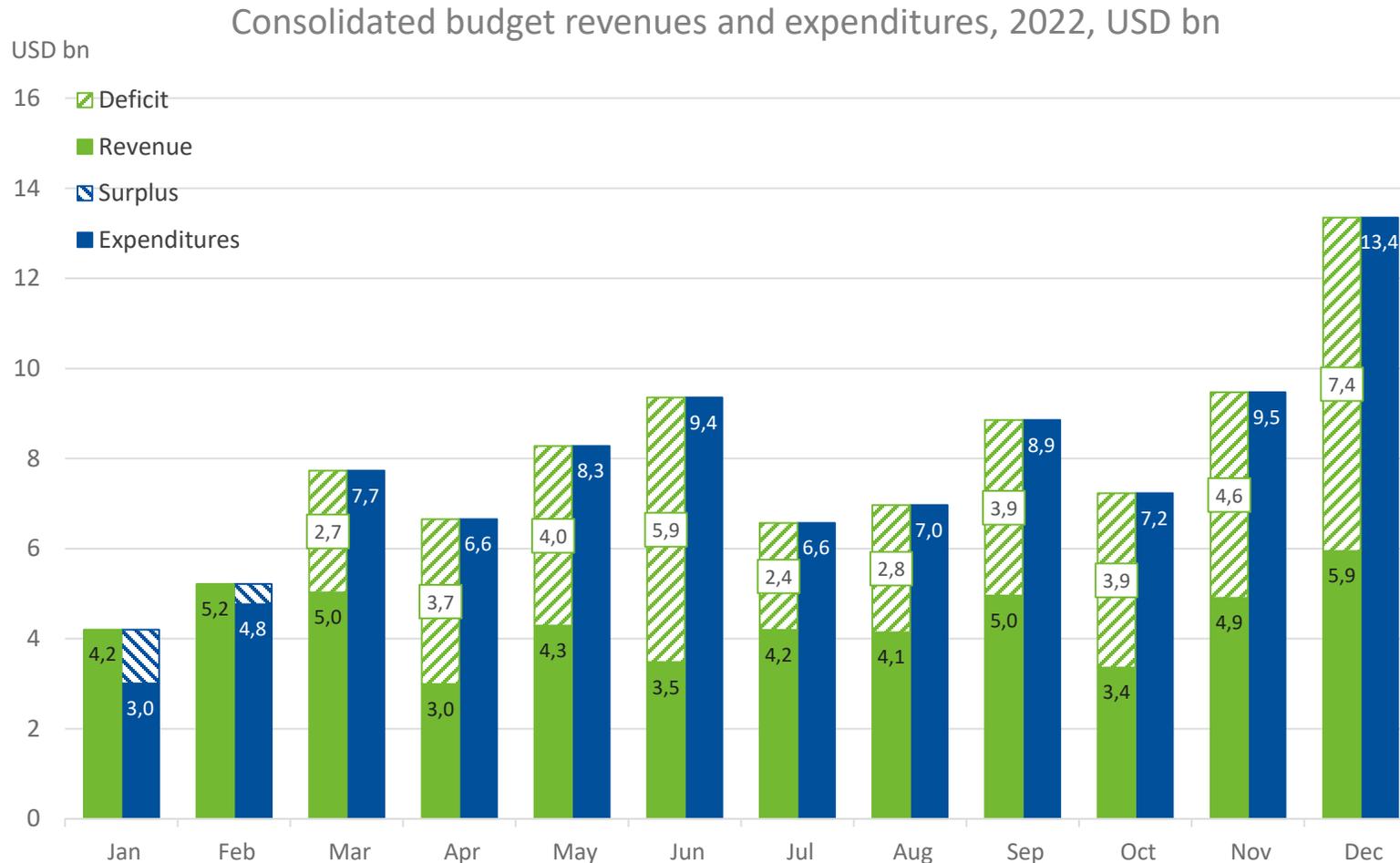
- The banking sector remains trustworthy. Demand deposits are rising with military salaries as an important growth factor. However, UAH term deposits are stagnant. This is caused by low deposit rates and poses some danger for the banks as there is a possibility of withdrawal of on-demand deposits.
- As reported by the NBU, the net loan portfolio of the banks is contracting – gradually for corporate loans (with 5-7-9 government loan program slowing the decline down) and sharply in the retail segment. Around 9% of the bank loan portfolio has turned into NPLs, other 21% are in a risk zone.
- The NBU together with the systematically important banks continues to enlarge its Power Banking network. The goal is to ensure that core banking services are available even in an event of a full blackout.



# FISCAL SECTOR

# FISCAL SECTOR

## The Consolidated budget of 2022 has become the war budget



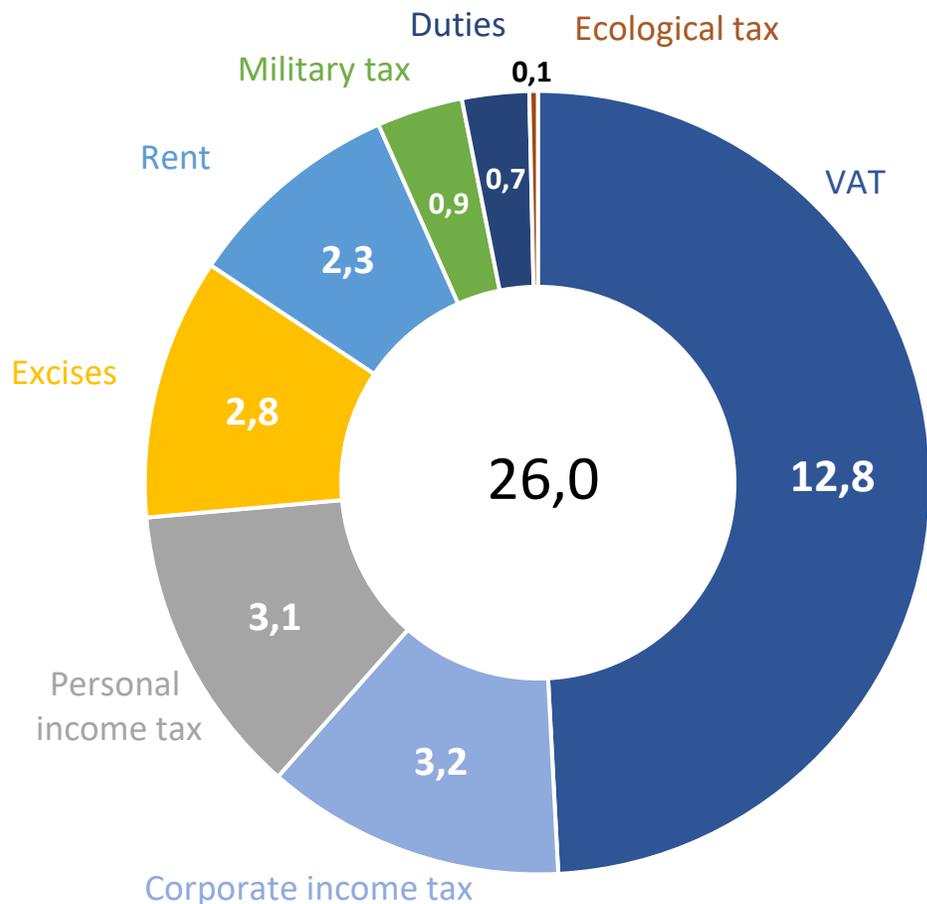
NB: Revenues do not include foreign grants, which are included here in the deficit for the sake of clarity. Source: NBU

- The revenues received in 2022 were not large enough to cover all expenditures.
- The deficit of the consolidated budget was mostly financed by foreign grants and foreign loans, NBU monetary financing and war bonds.

# FISCAL SECTOR

## State budget tax revenues slightly underperformed vs economy

State budget tax revenues by source,  
12m 2022, USD bn



Aside from the war, revenues were affected by temporary tax reliefs, introduced in the spring of `22. Excise and import duty revenues suffered the most.

VAT revenue drop caused by reliefs was compensated by tight administration.

PIT surged due to increased army salaries,

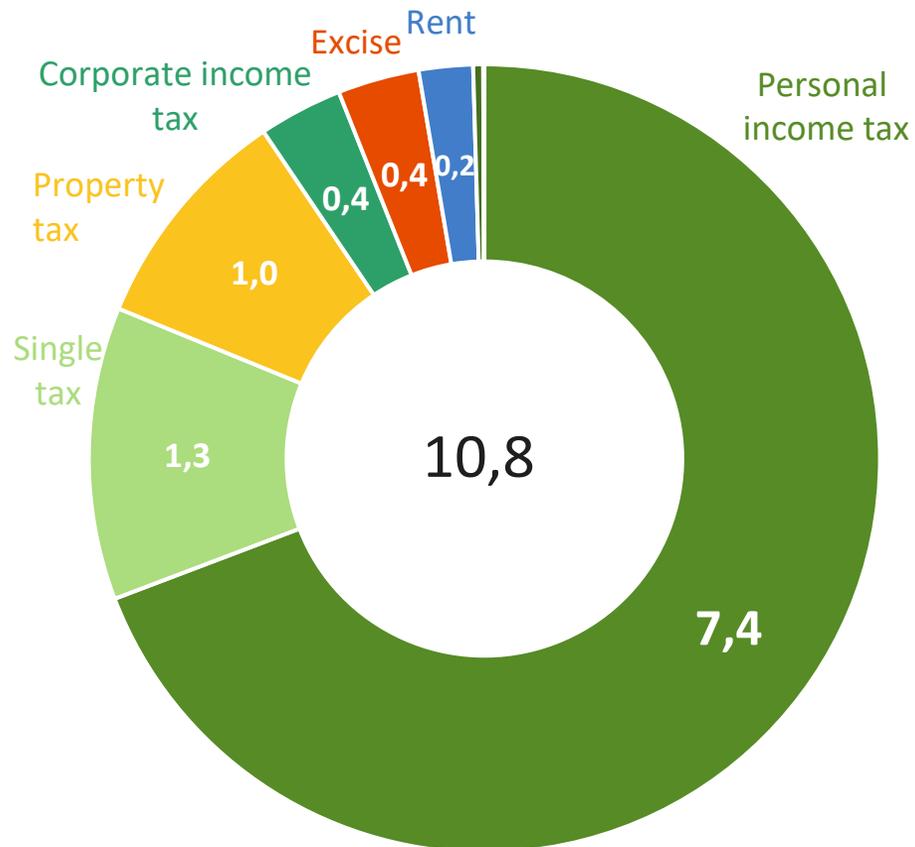
Subsoil rent increased due to changes in tax base and rates.

Revenue source	2022 vs 2021, % inflation adjusted	Performance vs economy (GDP YoY)
Value Added Tax	68.7	●
Corporate Income Tax	62.5	●
Personal Income Tax	85.2	●
Excise	49.7	●
Rent (incl. subsoil)	83.5	●
Import duties	54.2	●
<b>Total</b>	<b>67.8</b>	●

# FISCAL SECTOR

## Local budgets overperformed due to army salaries (PIT) and move to simplified taxation

Local budgets tax revenues by source,  
12m 2022, USD bn



PIT was driven by a large increase in army salaries

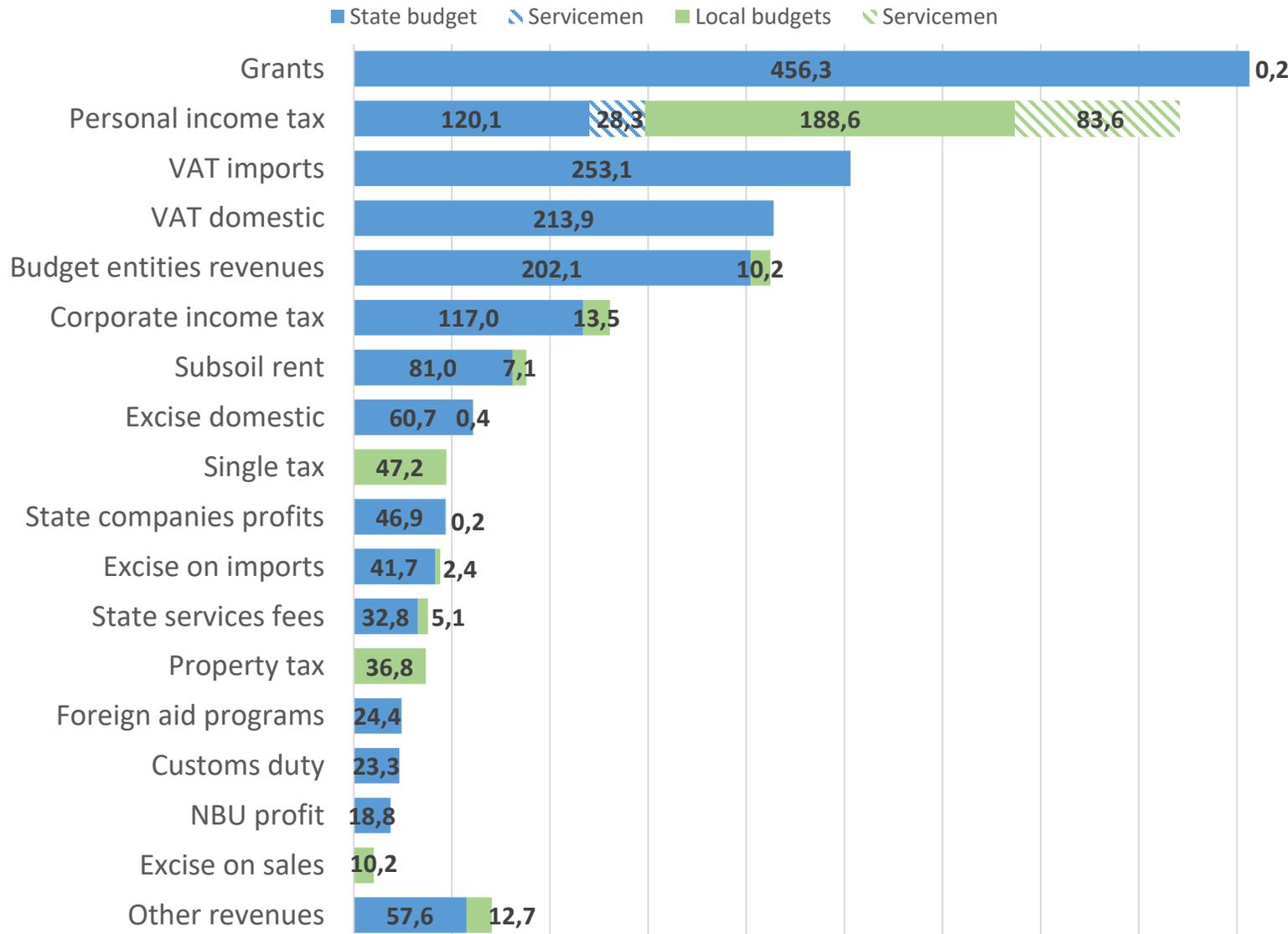
Single tax increased as businesses moved to a simplified taxation system, pushed by introduced tax reliefs and removed STS eligibility criteria.

Excises dropped due to tax reliefs, namely – for oil products, and a decrease in sales of alcohol and tobacco (curfew limitations and counterfeit sales)

Revenue source	2022 vs 2021, % inflation adjusted	Performance vs economy
Personal Income Tax	101.3	●
Single Tax	80.5	●
Property Tax	67.3	●
Corporate Income Tax	66.2	●
Excise	58.1	●
Rent	91.6	●
<b>Total</b>	<b>89.6</b>	●

# FISCAL SECTOR

## Consolidated budget: PIT, grants and VAT were the largest sources of revenues



Consolidated budget revenue sources, excluding internal transfers, 12m 2022, UAH bn

In December Grants overtook the PIT as the largest source of revenue for the consolidated budget.

PIT(including military tax) was the largest source of revenue for local budgets.

However, **UAH 111,9 bn** of PIT were accrued for military salaries, which are paid from the state budget.

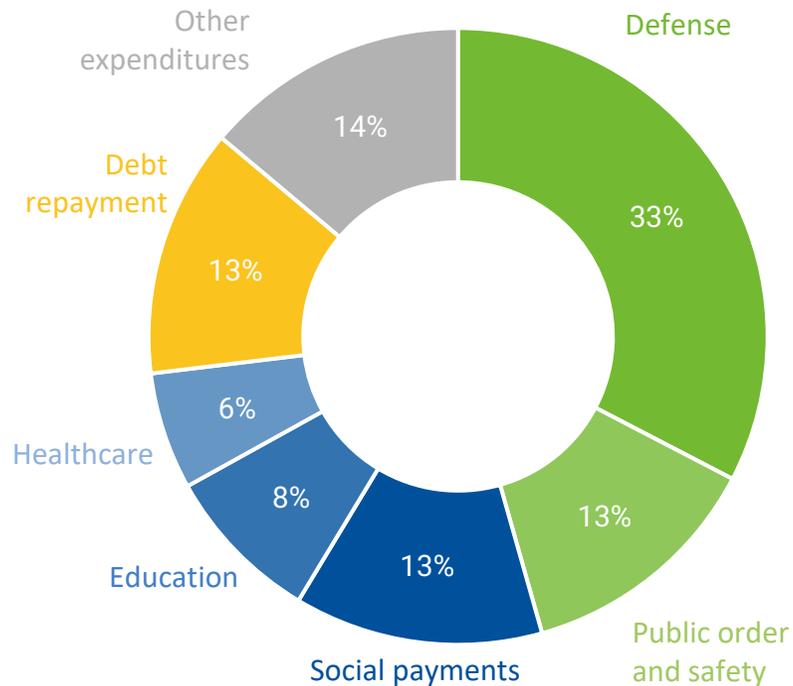
**UAH 83,6 bn** out of these 111,9 bn were received by local budgets and are de-facto transfer from the state budget to local budgets via compensation of servicemen PIT

# FISCAL SECTOR

## Defense spending dominated the consolidated budget of 2022

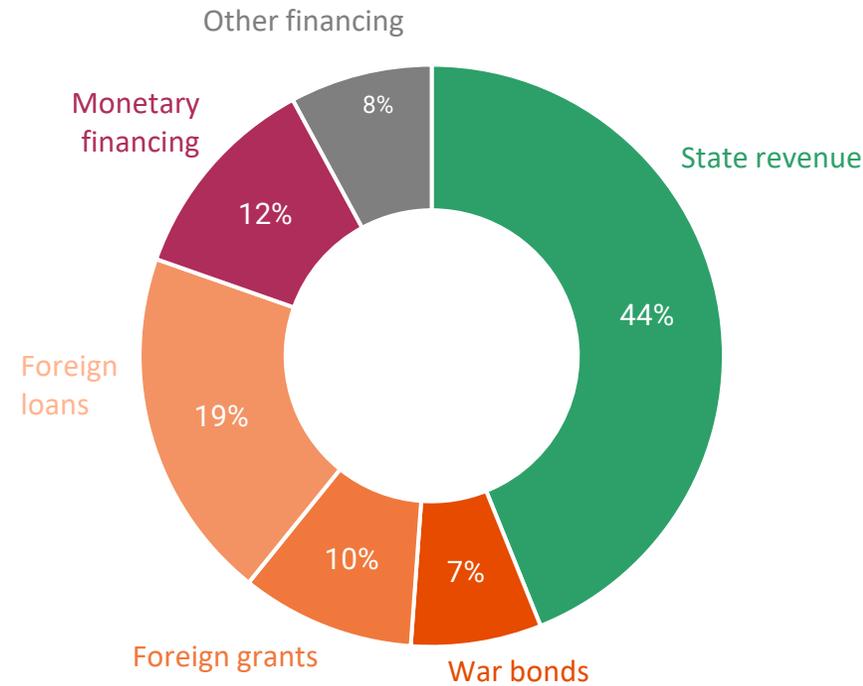
Consolidated budget financing needs, 2022

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

## Great start of foreign financing in 2023

Foreign financing and state budget financing needs, 2022, USD bn



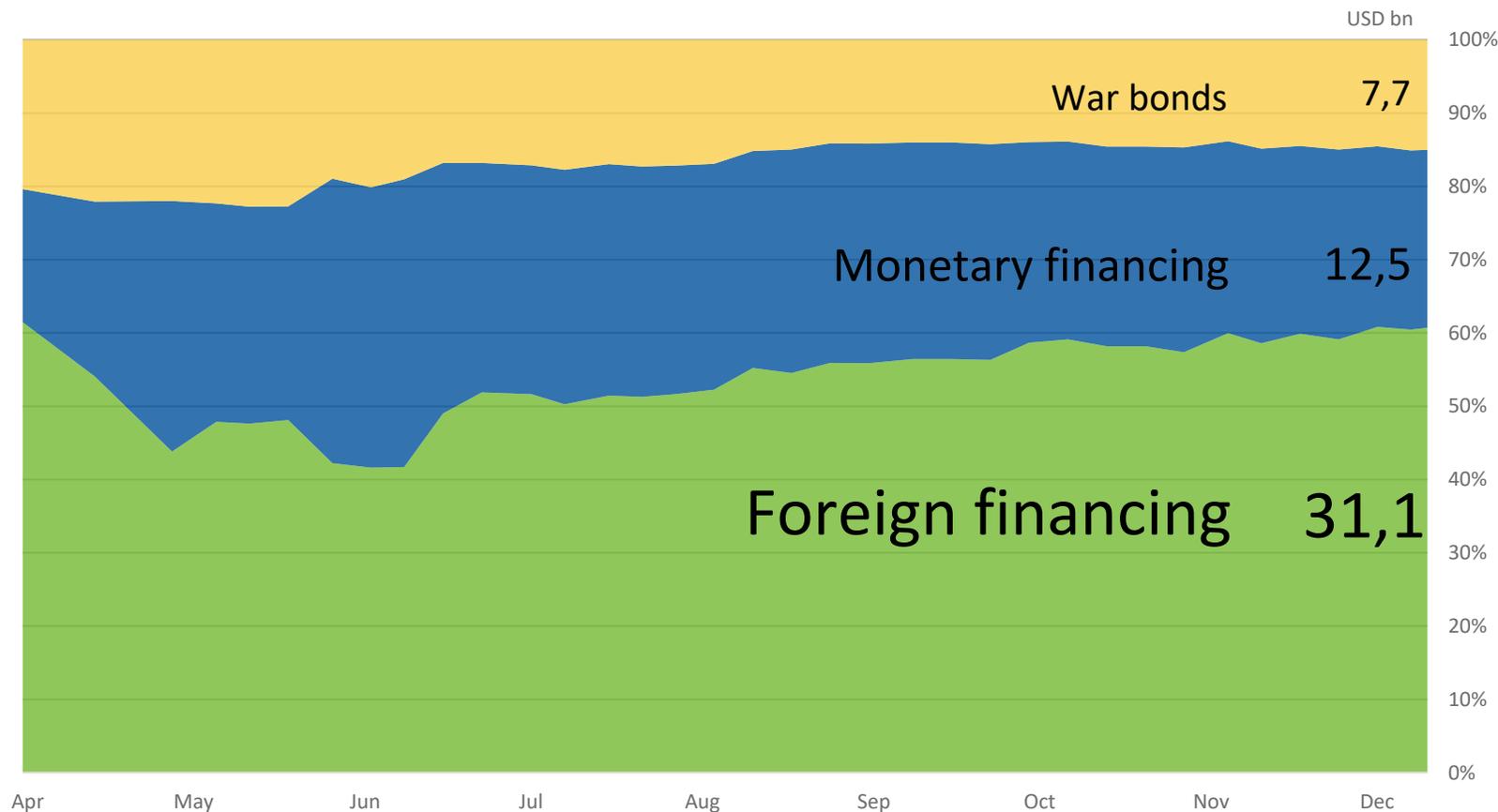
Source: NBU, Ministry of Finance, CES research

- Ukraine received USD 31.1 bn of foreign grants and loans in 2022, an average of 3.1 bn per month of war.
- However, the disbursements were not stable nor regular, with some months of exceptionally high and low amounts of financing.
- Irregular disbursements hurt the budget implementation. Both the US and the EU state that one of their priorities is to disburse their financial aid to Ukraine in 2023 in timely and steady payments.
- The foreign financing in January 2023 serves as a testament to the seriousness of this intent. Ukraine received USD 4.2 bn of foreign disbursements, which was enough to cover the state budget deficit and debt repayment needs.

# FISCAL SECTOR

## Foreign financing has dominated the sources of additional budget financing

Sources of additional financing of the state budget of Ukraine during the war, cumulative, 2022, % of total



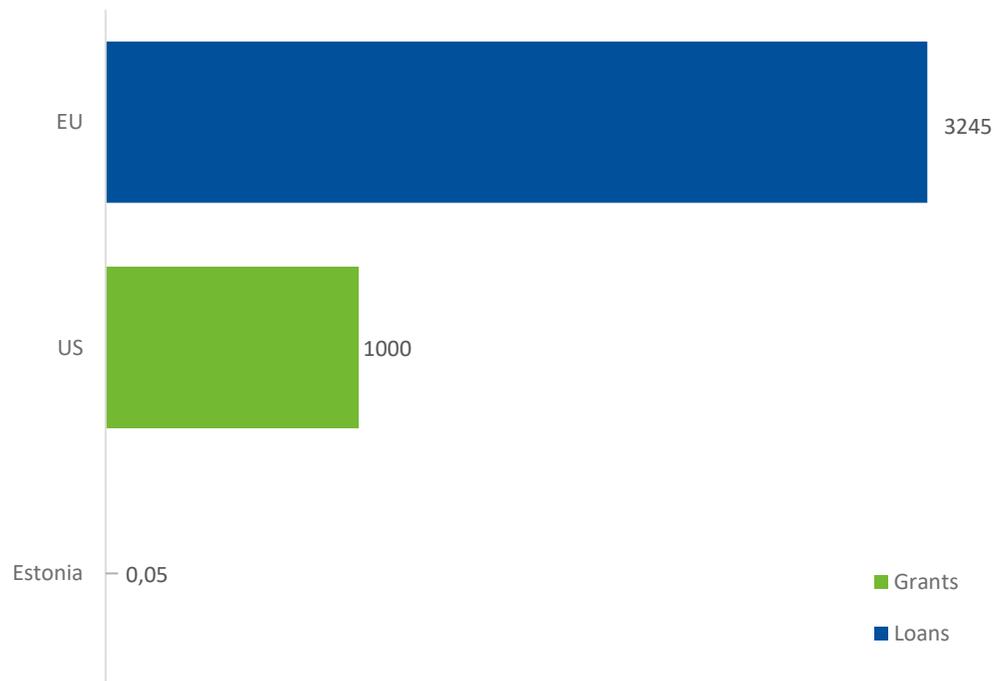
Source: Ministry of Finance

- Foreign financing accounted for more than 60% of additional financing of the state budget of Ukraine.
- With insufficient disbursements of aid in the spring and in the first half of June the share of monetary financing dangerously increased.
- Thankfully, the monetary financing was confined to its pre-determined amounts – UAH 400 bn, or USD 12.5 bn, in 2022.
- January 2023 was the first month of the full-scale war with no monetary financing of the budget.

# FISCAL SECTOR

## Foreign financing has already exceeded USD 4 bn in January 2023

Foreign financing disbursed in 2023 as of 2 February,  
USD mln



Source: Ministry of Finance

- Ukraine has already received EUR 3 bn from the EU, USD 1 bn from the United States and USD 0.05 mln from Estonia in January 2023.
- EUR 3 bn from the EU is a part of a EUR 18 bn package planned for 2023. However, this tranche is a leftover from 2022 EUR 9 bn aid package, of which only 6 bn were disbursed. Further disbursements are expected to be conditional and connected to Ukraine's progress in reforms.
- The US finished the disbursements pledged in 2022. Additional USD 13 bn of grants for Ukraine are included in the US state budget for fiscal year 2023.
- The IMF assessments of amounts of financial aid that Ukraine would need in 2023 range from USD 39.5 bn to USD 57 bn. In October 2022, Ukrainian government officials stated that Ukraine would need to receive USD 38 bn in 2023; however, this was before the Russian terror bombing campaign started.

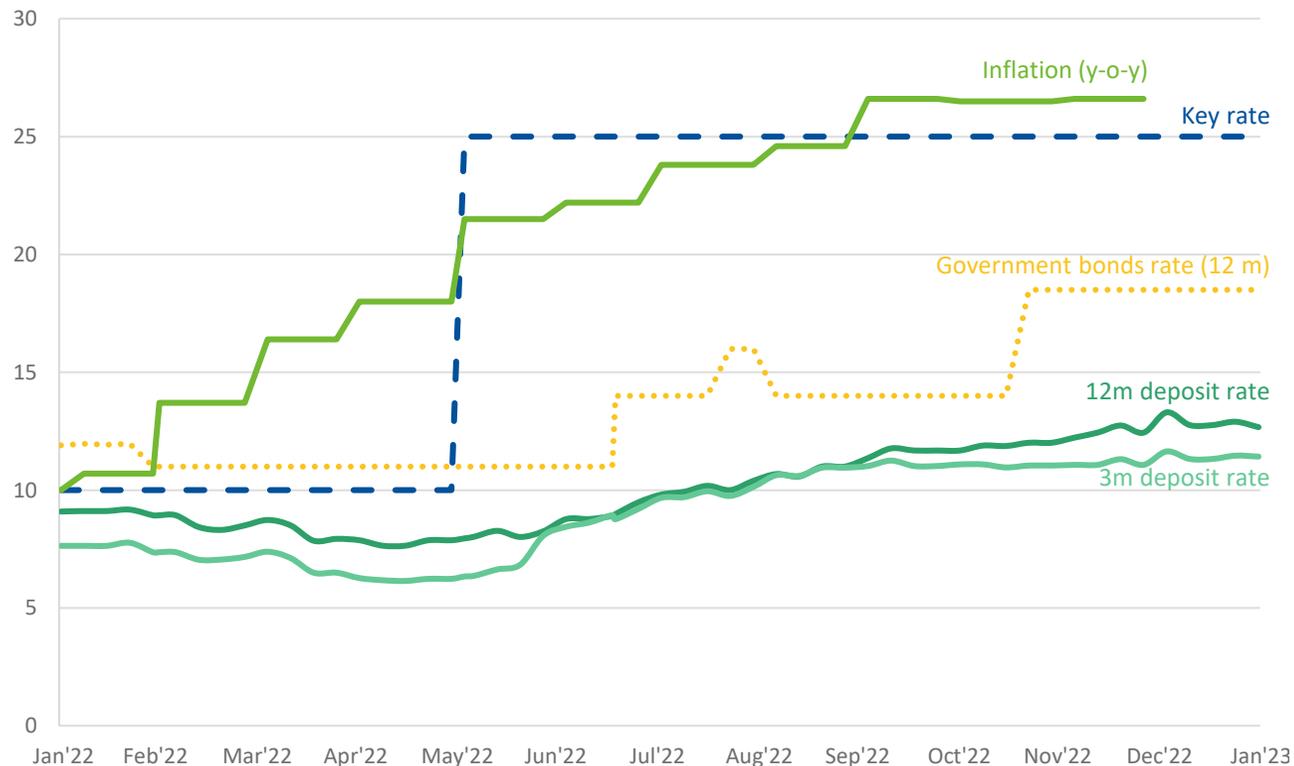


# MONETARY AND FX POLICY

# MONETARY POLICY

## Rates are stable

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

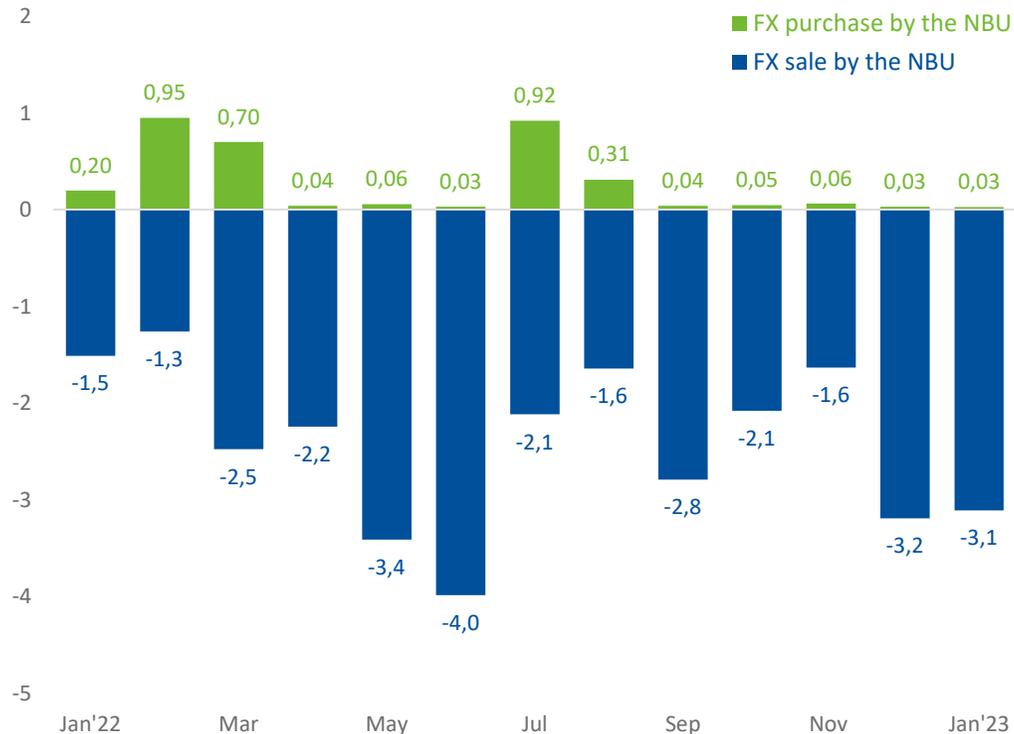
- In December and January, the key policy rate remained unchanged at 25% and the yield of one-year hryvnia military bonds remained at 18.5%.
- Average rates on retail deposits (UIRD) continue to increase slowly.
- As time goes by, the transmissional mechanism of key rate should kick in soon and show first tangible effect on inflation. The key rate performance should then be evaluated as it is sometimes argued that the key rate is now too low for curbing inflation and too high for stimulating economic growth.

# FX POLICY

## Exchange rate remains fixed

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. In 2022, Ukraine’s international reserves decreased only by 7.9% to USD 28.5 bn.

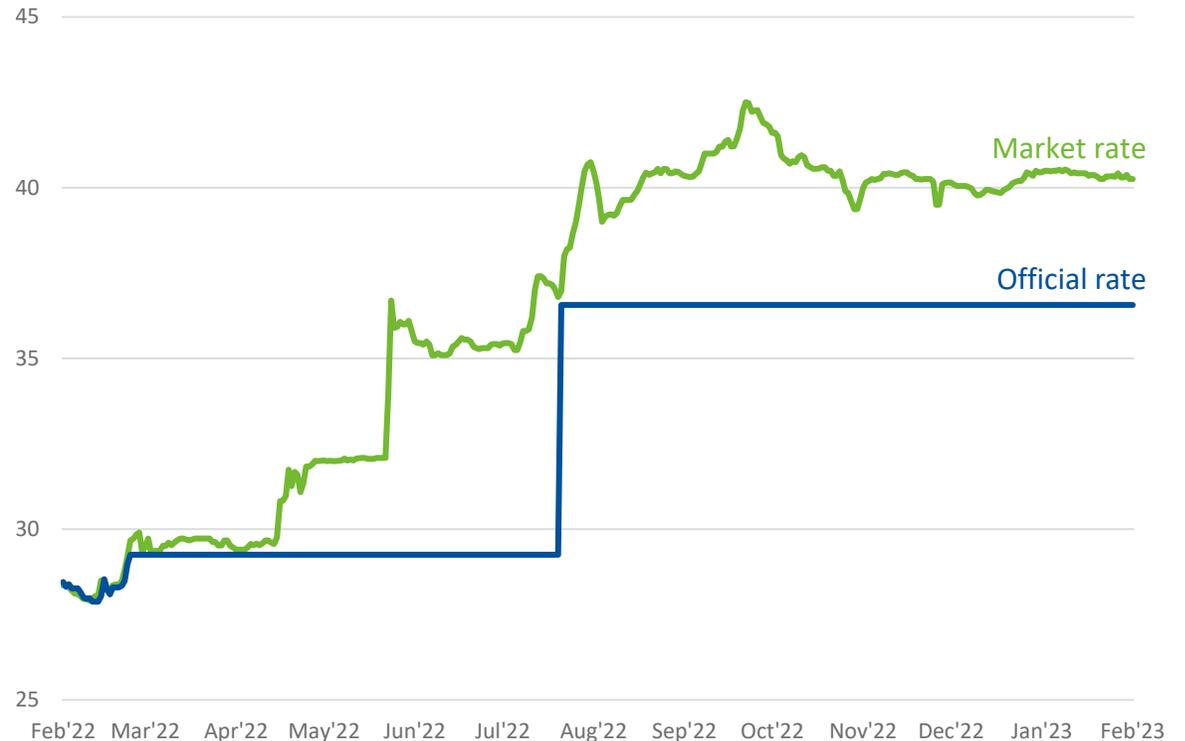
NBU foreign exchange interventions, USD bn



Source: NBU

Official rate remains fixed at 36.57 UAH/USD. The market exchange rates are also quite stable and only changed from 39.92–40.10 UAH/USD on 15 December to 40.35–40.48 UAH/USD on 15 January 2023. Nothing has changed with the capital controls.

Average daily official and market exchange rates UAH/USD



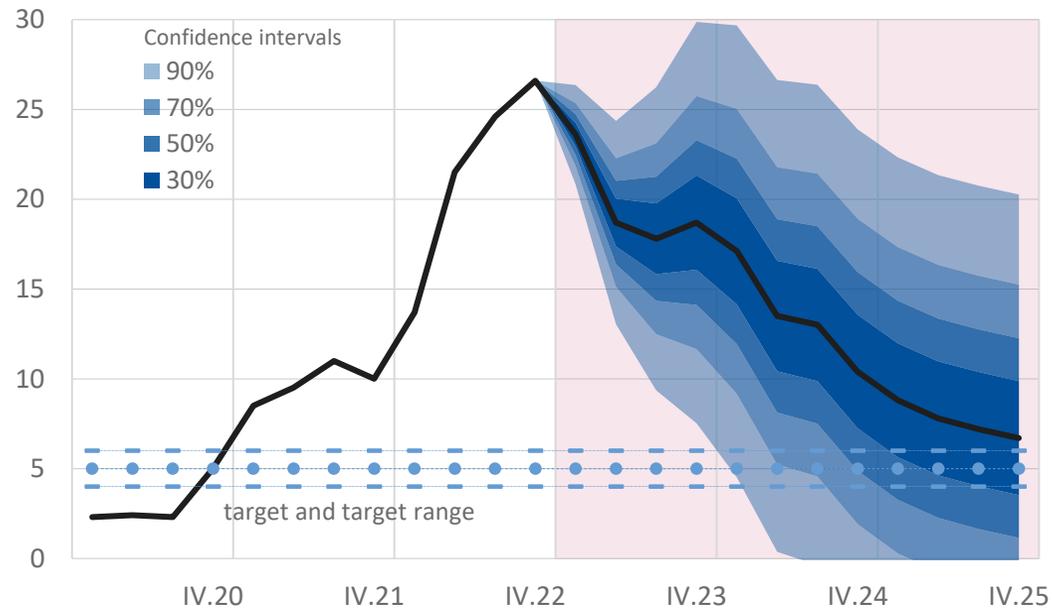
Source: NBU, minfin.com.ua

# MONETARY POLICY DECISIONS

## NBU'S RECENT DECISIONS AND FORECAST OF CPI AND IR

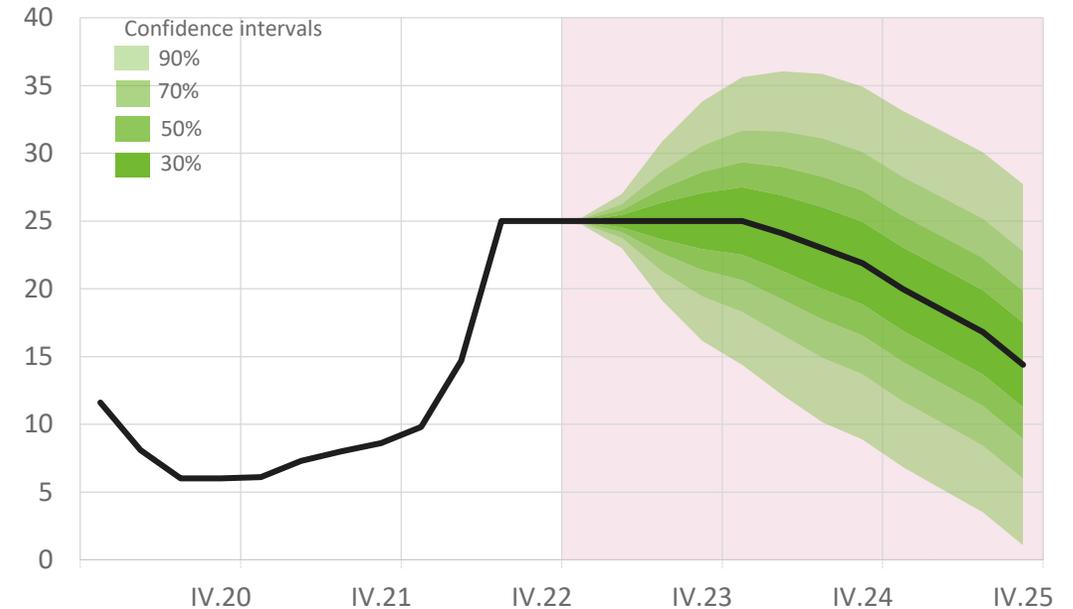
- The Board of the National Bank of Ukraine has decided to leave its key policy rate unchanged at 25% per annum with the aim of bringing the inflation back to the steady decline trajectory, as well as maintaining exchange rate and macro-financial stability in conditions of a high-level of uncertainty.
- Additionally, the NBU has raised reserve requirements for banks to decrease the liquidity surplus in the banking system and increase competition for hryvnia term deposits by pushing up interest rates on hryvnia assets. Moreover, it has decided to allow banks using a wider list of government bonds eligible to cover up to 50% of their total required reserves to revive the domestic debt market.

Forecast of Inflation (y-o-y), %



Source: NBU

Forecast of Key policy rate, %



Source: NBU

# KEY MACROECONOMIC INDICATORS

What will be with our main indicators in the coming years?

	2022	2023	2024	2025
<b>Real GDP, change, %</b>	-30.3 (-31.5)	0.3 (4.0)	4.1 (5.2)	6.4
<b>Nominal GDP, UAH bn</b>	4 825 (4 750)	5 985 (6 175)	7 085 (7 350)	8 175
<b>CPI, y-o-y, % (eop)**</b>	26.6 (30.0)	18.7 (20.8)	10.4 (9.4)	6.7
<b>Core CPI, y-o-y, % (eop)**</b>	22.6 (24.5)	15.8 (13.3)	8.7 (3.0)	3.0
<b>Current account balance, USD bn</b>	8.6 (6.8)	-20.4 (-8.0)	-8.4 (-5.1)	-5.5
<b>Gross reserves, USD bn</b>	28.5 (26.0)	27.0 (21.7)	31.0 (27.4)	34.6

\* in brackets – previous forecast (inflation report, October 2022)

\*\* end of period (December to December of previous year)

Source: NBU

- As a result of the full-scale invasion and Russian's energy terror, the real GDP declined to 30.3%. The NBU expects its growth to be weak in 2023, but the economy will resume growing in 2024-2025 due to decline in security risks, economy recovery, a pick up in domestic demand etc.
- At the end of 2022, Inflation has stabilized but is still high. The NBU forecasts inflation to slow in 2023 due to tight monetary conditions, global inflation decline, and decrease of consumer demand. In the next years, it will decelerate more rapidly.
- As of the end of 2022, the current account recorded a surplus, but the limited exports, a large number of displaced people abroad, and the economy's large needs for imports to carry out reconstruction will cause its deficit to be high in the coming years.
- The international reserves will be maintained at a sufficient level due to international aid, coupled with the cooperation with the IMF.