CENTRE FOR ECONOMIC STRATEGY

GET German Economic Team

APRIL ECONOMIC OVERVIEW. HOW WILL THE IMF PROGRAM IMPACT THE BUDGET, TAXES, AND STABILITY IN UKRAINE?

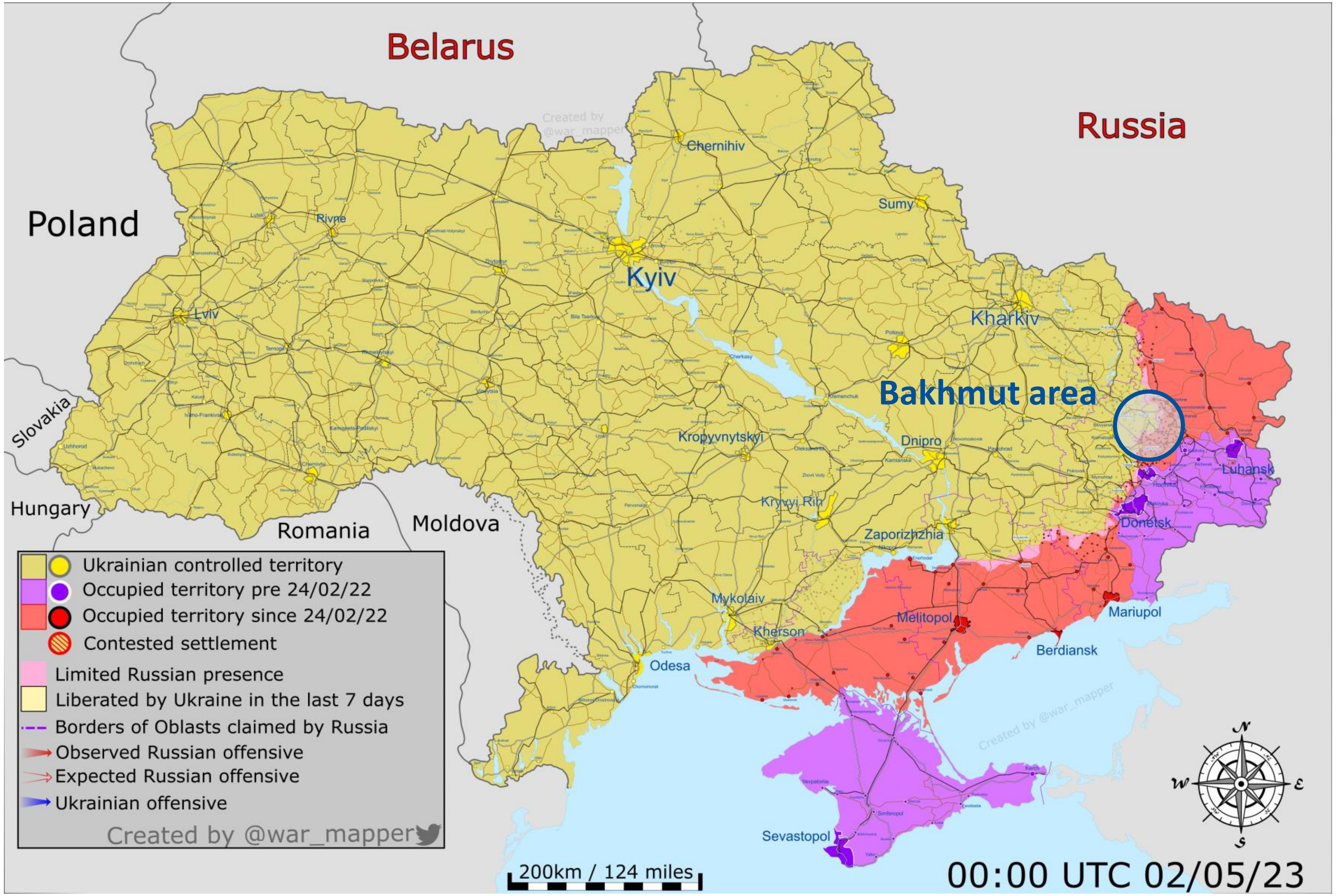
03/05/2023

CES Team

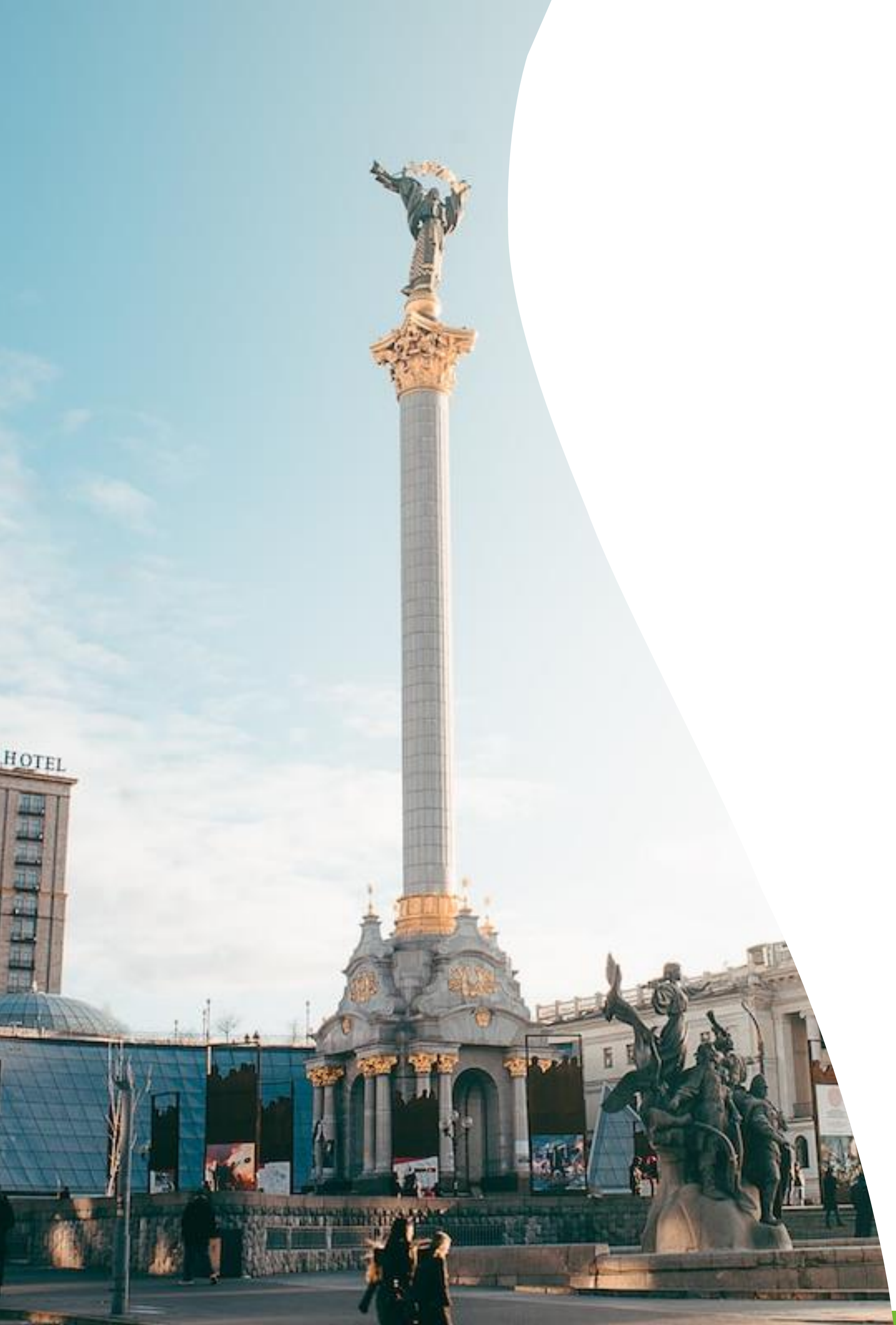
WAR

WAR UPDATE

CENTRE FOR ECONOMIC STRATEGY



- The Russian forces have captured parts of Bakhmut, but the battle is far from over. The Ukrainian troops are holding the western parts of the city.
- Other parts of the frontline have mostly been stable. The fighting is going on all over the front but is most intense in the Bakhmut area.
- According to Secretary General of NATO Jens Stoltenberg, Ukraine has received 98% of promised combat vehicles.
- Russia has increased its use of guided bombs to strike Ukrainian towns and cities along the border and the frontline. Two bombs were dropped by the Russian air force on the Russian city of Belgorod on 21 April.
- On 3 May, an unknown UAV struck the Kremlin, damaging the roof of the Senate Palace.

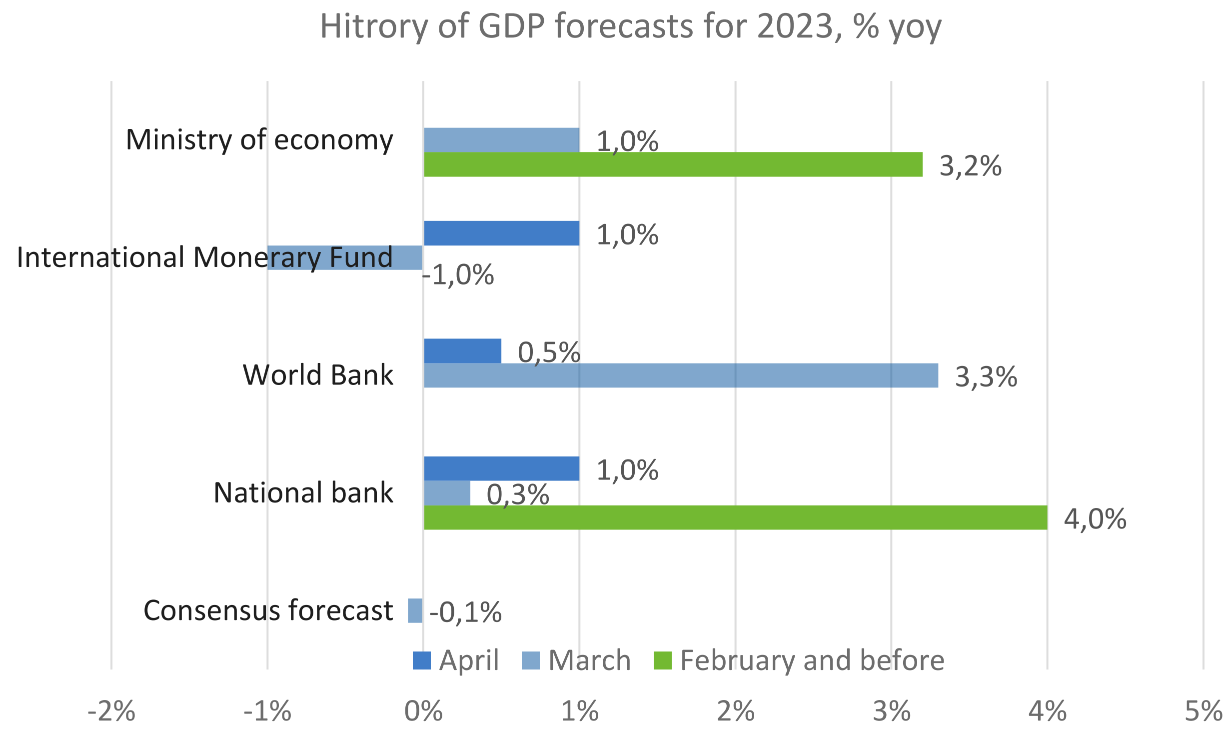


MACROECONOMIC TRENDS

MACRO

Another wave of forecast revision

- The National Bank of Ukraine improved the forecast of GDP growth in 2023 from 0.3% to 1%;
- The World Bank worsened the forecast from 3.3% to 0.5%;
- The International Monetary Fund narrowed the forecast from a range of -3% to 1% in 2023 to 1% p.a.



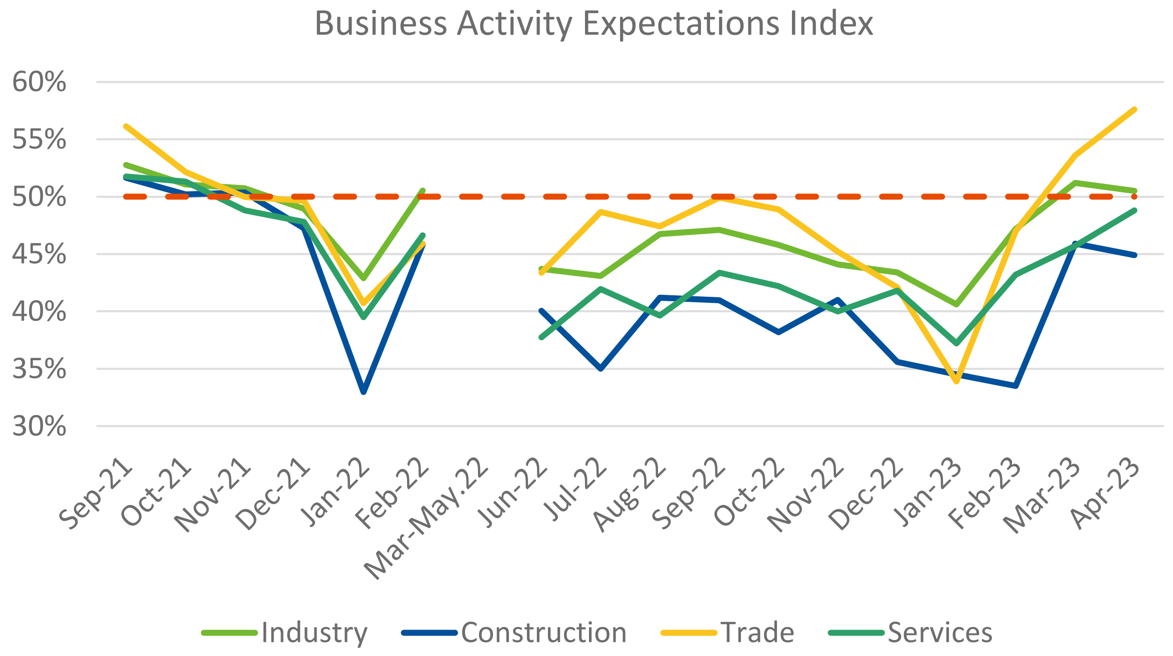
Sources: Ministry of Economy, NBU, CES,
IMF (for the previous forecast, this is the average of the range)

MACRO

CENTRE FOR ECONOMIC STRATEGY

Business confidence reached pre-war level

- In April, the Business confidence index went up to 51.1, on a three-month rise after four months of decrease;
- Composite index is now above neutral level for the first time in 18 months;
- Primary reasons for optimism are electricity supply stabilization, improving inflation and FX expectations, and better consumer confidence.



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

MACRO

War damage estimates increased by 2.5 billion USD

CENTRE FOR ECONOMIC STRATEGY

- Damage assessment increased by 2.5 billion USD during the month;
- Growth is mostly attributed to housing and agriculture damages.

Asset type	Apr’23	Mar’23	Change
Residential buildings	54.4	53.8	0.6
Transportation infrastructure	36.2	36.2	0.0
Industry	11.4	11.3	0.1
Education	9.1	8.9	0.2
Agriculture and land	9.1	8.7	0.4
Energy infrastructure	8.3	8.1	0.2
Other assets	17.8	16.8	1.0
TOTAL	**146.3**	**143.8**	**2.5**

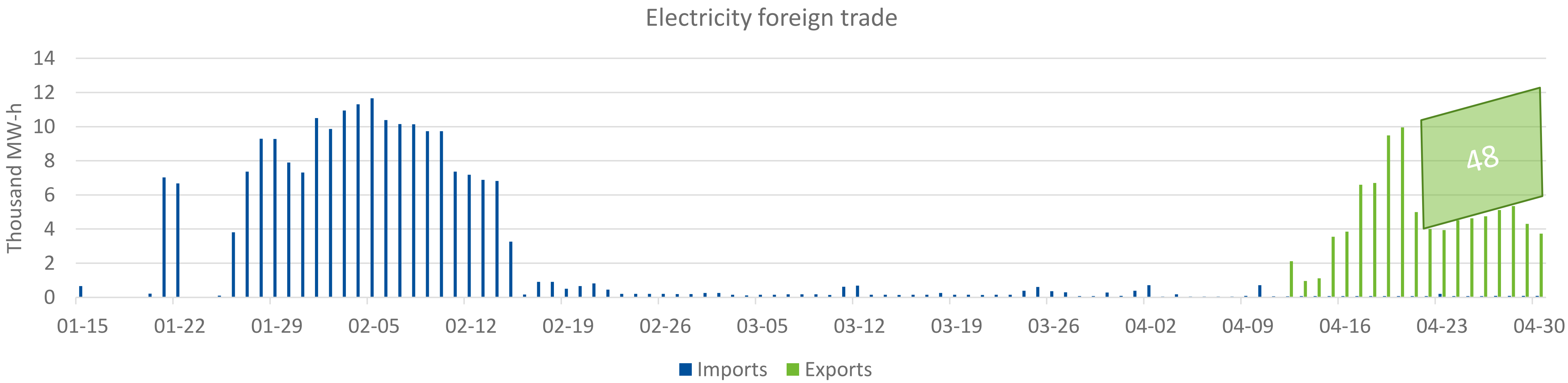
Sources: KSE, Russia will pay project

SECTORAL ANALYSIS

SECTORAL

Energy: Deficit turned to surplus

- Heating season is finished, supply stabilized;
- Stockpiling for the next season has begun;
- Electricity export restored;
- Discussion started on exports of gas and coal;
- Tariff rise for households is being discussed;
- Deficit may arise in summer due to repairs.

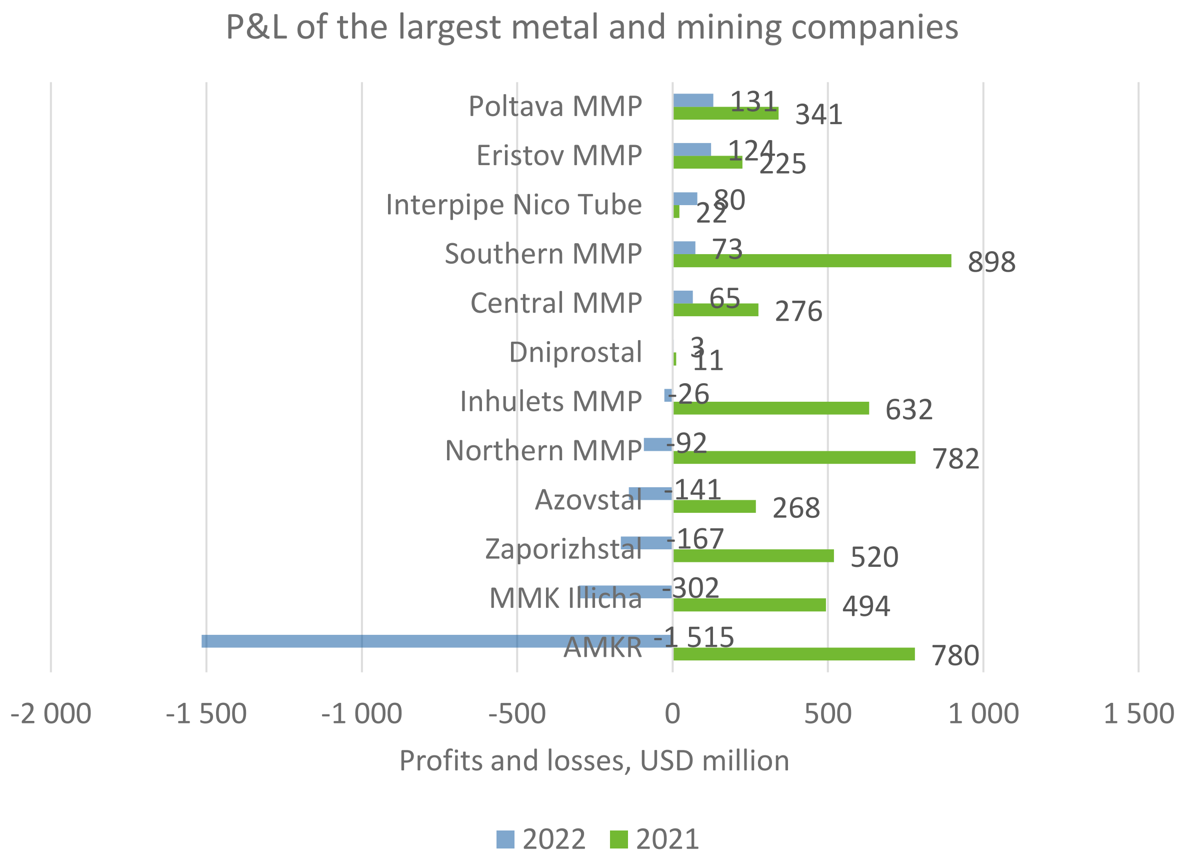


Source: Ukrenergo

SECTORAL

CENTRE FOR ECONOMIC STRATEGY

Metals: Huge losses in 2022 revealed



Source: State Statistics Service

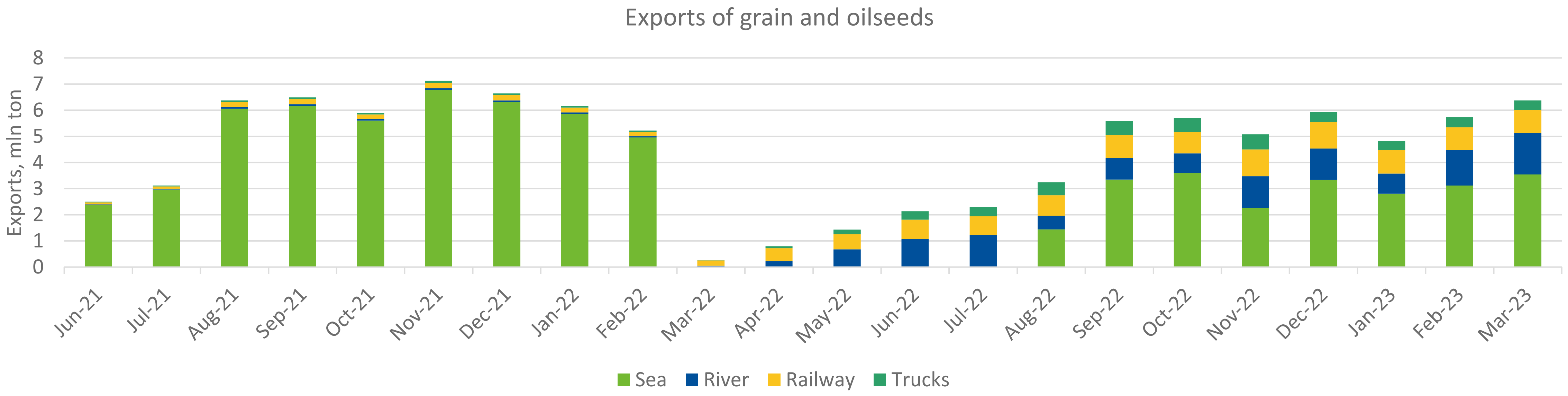
- In 2022, ore mining fell by 68% (in dollar terms), metal production by 64%;
- Only some plants remained profitable;
- Metinvest got USD 2.2 bn net losses in 2022, compared to USD 4.8 billion profit in 2021;
- ArcelorMittal Kryvyi Rig got USD 1.5 bn net losses compared to USD 0.9 billion profit;
- Kametstal modernizes coke production; DMZ resumes production of coke for steelmaking

SECTORAL

Agriculture: EU banned some Ukrainian grains

CENTRE FOR ECONOMIC STRATEGY

- The "grain corridor" deal is sabotaged again;
- EU banned exports of some grains and oilseeds from Ukraine to five neighboring countries;
- Both logistical bottlenecks and EU restrictions may force businesses to invest in processing;
- This year, grain yields will fall, while oilseeds and sugar beets will grow;
- You can now book conscripted workers to participate in the sowing campaign.



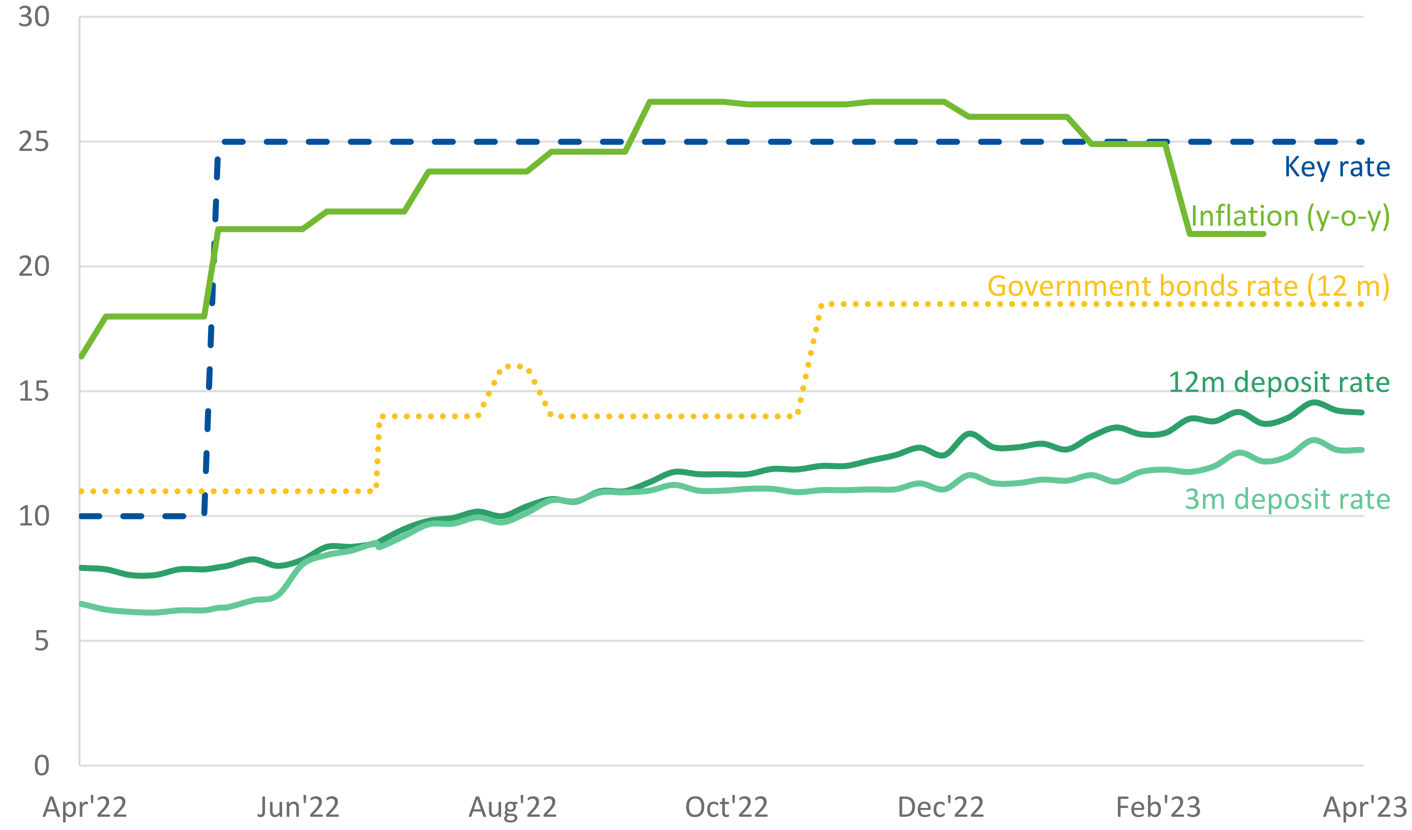
Sources: State Custom Service, Minagro, UN

MONETARY AND FX POLICY

MONETARY POLICY

The rates are stable; inflation continues to decelerate

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, %

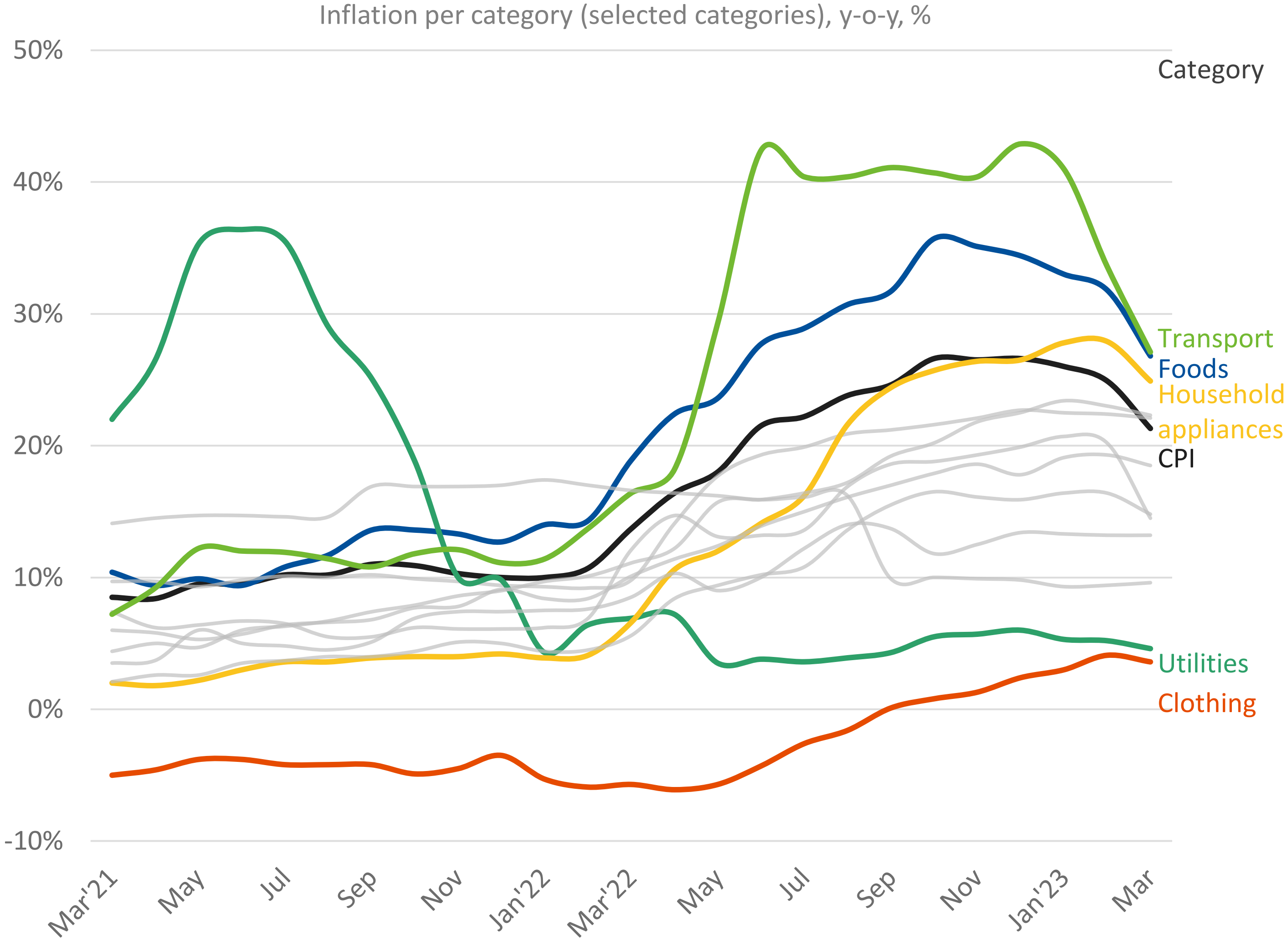


Sources: NBU, State Statistics Service, UIRD

- The key policy rate remains unchanged at 25% to reinforce the impact of prior NBU's measures and enable increased investment appeal to hryvnia's savings. However, the NBU stated that they will begin to lower the key rate in Q4 2023, which is earlier than expected earlier (Q2 2024).
- The yield of one-year hryvnia military bonds remains at 18.5% p.a. At the end of April, average rates on retail deposits (UIRD) remained quite the same level as in March.
- In March, inflation has been declining faster than expected, and the growth in consumer prices decelerated to 21.3% y-o-y. The updated NBU`s forecast indicates that inflation will slow to 14.8% in 2023 and return to single digits in the coming years.

CPI

Inflation slows down; CPI 21.3% y-o-y in March



Source: State Statistics Service of Ukraine

- The decline in inflation is attributed to ample supplies of food and fuel, a more favorable energy sector, improved inflation expectations, and favorable conditions in the cash segment of the FX market.

- Core inflation decreased to 19.8% y-o-y in March, while growth in administered prices slowed to 13.5% y-o-y, thanks to weaker demand, sufficient import supply, and a stronger hryvnia. The moratorium on increasing household utility prices also helped.

- Improved inflation and exchange rate expectations have also contributed to easing inflationary pressures. However, the ongoing war creates significant uncertainty and inflation risks.

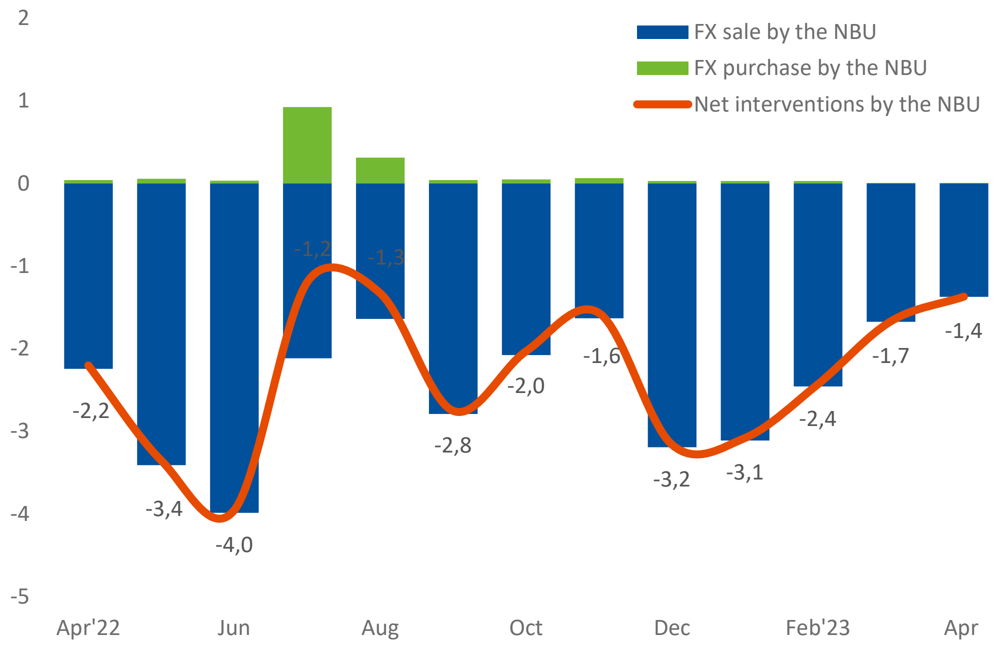
FX POLICY

UAH has strengthened; international reserves rose to 11-year high

There is still a need for significant FX sales by the NBU. **Ukraine's international reserves increased by 10% in March, reaching 31.9 USD bn – the highest level in the past 11 years.** They rose primarily due to inflows from foreign aid amid a decreased volume of net FX sales by the NBU and moderate external debt repayments by the state.

The official rate remains fixed at 36.57 UAH/USD. Hryvnia has strengthened from 38.20–38.65 UAH/USD on 15 March to 37.50–38.00 UAH/USD on 15 April. On 21 April, the NBU increased banks' ability to sell foreign currency to households and enabled the launch of the e-residency project to boost cash FX market trends.

NBU foreign exchange interventions, USD bn



Source: NBU

Average daily official and market exchange rates UAH/USD

Source: NBU, Ministry of Finance

MONETARY POLICY

CENTRE FOR ECONOMIC STRATEGY

IMF`s primary monetary policy conditionalities

- The **sustaining of the financial autonomy of the NBU** and abstaining from the monetary financing of the state budget.

- **Preparation** of a conditions-based strategy **for the move to a more flexible exchange rate**, ease of FX restrictions, and return to an inflation-targeting framework.

- **The resume of scheduled onsite supervision** inspections for both bank and non-bank financial institutions and unwind all emergency prudential measures by end-March 2024 if conditions allow.

- Implementation of measures to **strengthen bank regulation** and supervision and movement to the application of a risk-based approach in banking supervision.

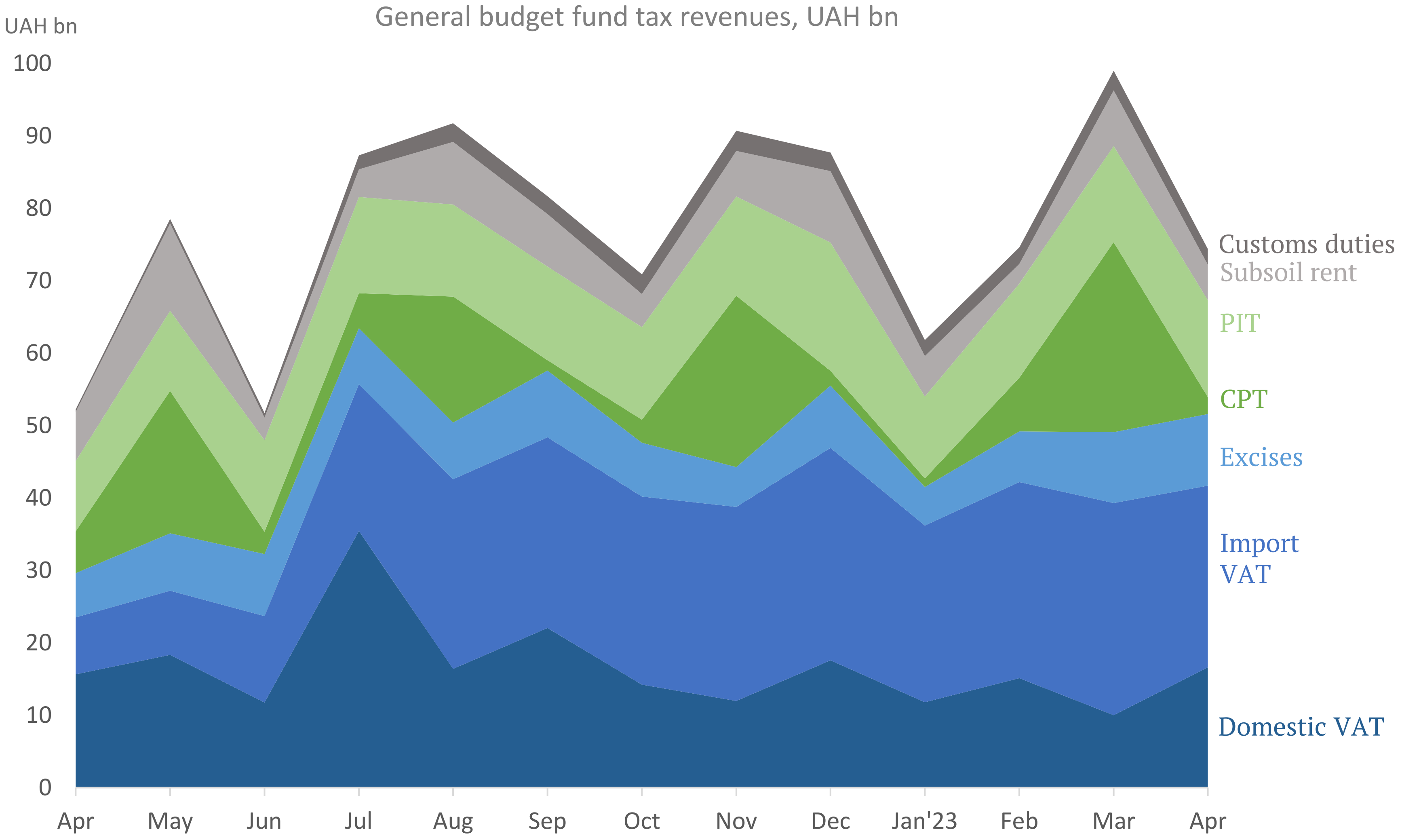
- Any decisions that have the potential to increase state ownership in the banking sector should be taken in consultation with IMF staff.

FISCAL SECTOR

FISCAL SECTOR

CENTRE FOR ECONOMIC STRATEGY

Tax revenues remain within expectations



Source: Ministry of Finance

Imports in April declined in line with the NBU's quarterly forecast, which resulted in a 15% yoy decline in related taxes (import VAT and customs duties) to **UAH 27.3 bn**.

Gross **domestic VAT** brought in **UAH 16.6 billion** due to an increase in gross VAT paid and a decrease in VAT refunds.

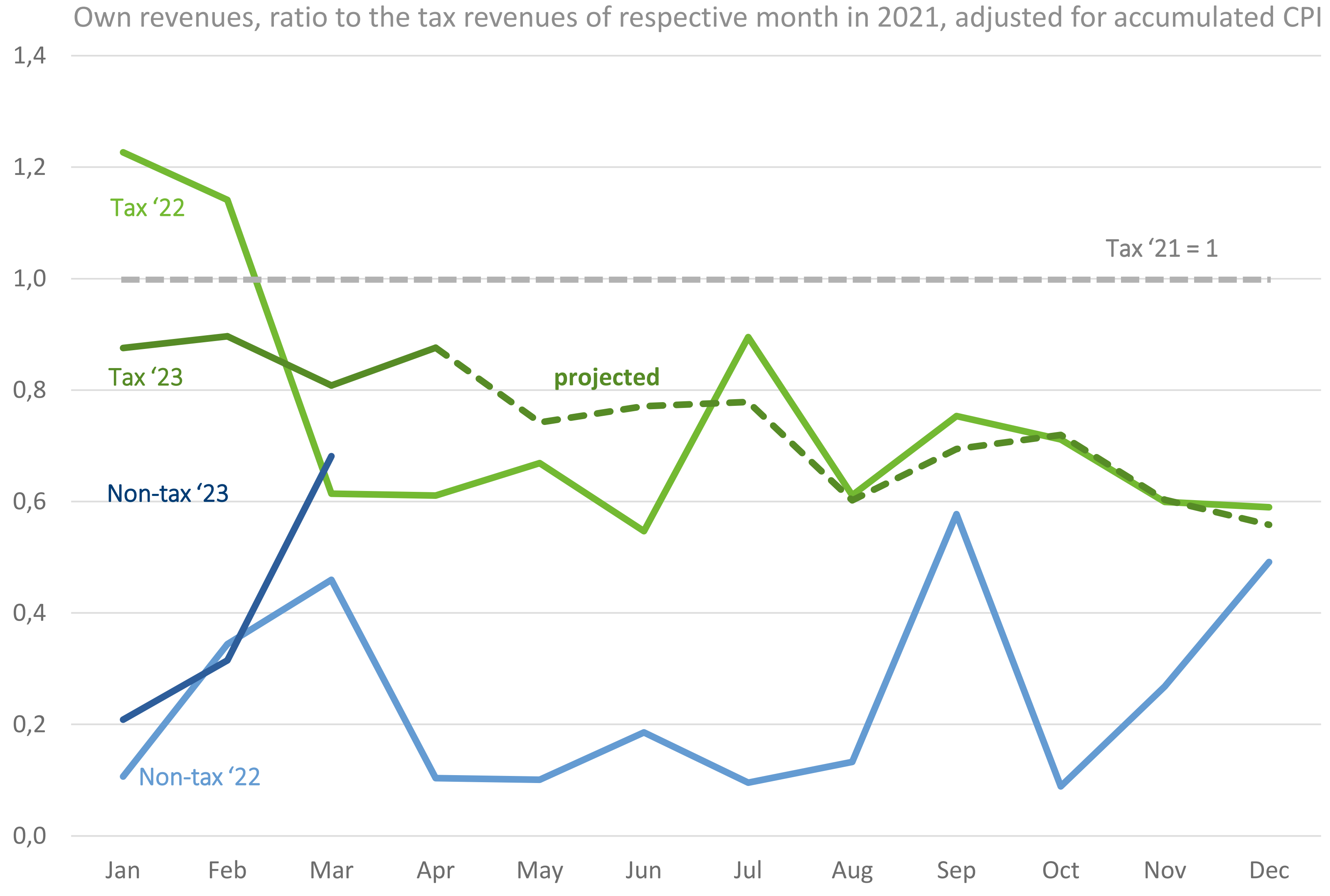
The excise revenues brought UAH 9.9 bn, growing for the 3rd consecutive month

The **rent fee for subsoil use** amounted to **UAH 4.9 billion**.

Note: the detailed breakdown by sources is not available as only preliminary Apr figures and aggregate items for Mar were released as of the current date

FISCAL SECTOR

Tax revenues will remain stable, own non-tax growing significantly



Sources: NBU, CES projections

Ukraine's own **non-tax revenues*** are gaining ground and already **exceed the annual budgeted amount of UAH 184.8 billion,** may include military support.

131.8 bn received in 1Q 2023, UAH 71.8 bn of NBU revenues transferred in April.

Tax revenue forecasts may be revised upward after the expected return to pre-war taxation in July 2023:

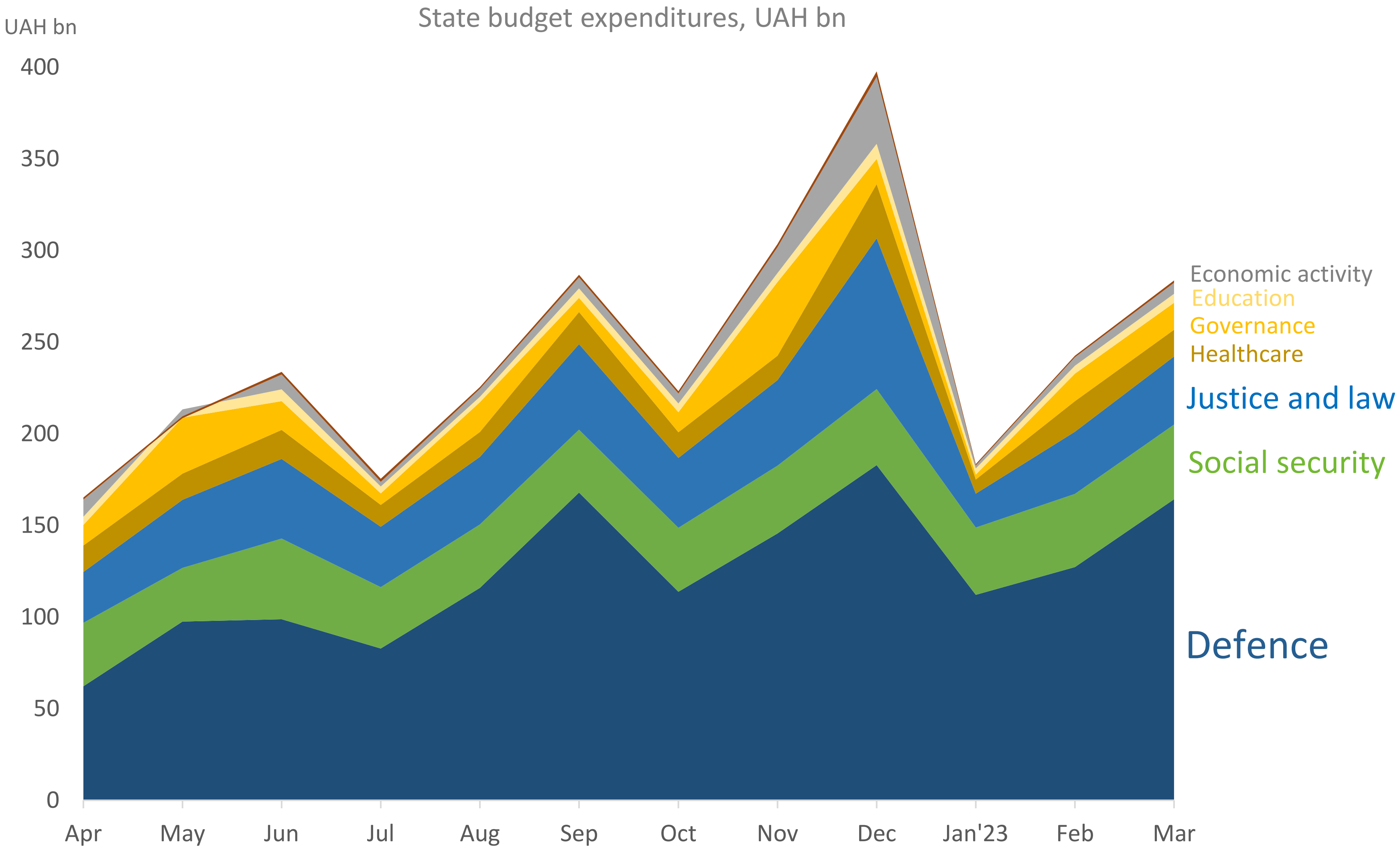
- limited simplified tax system,
- 20% VAT and pre-war excise rates for the fuel).

*excluding grants

FISCAL SECTOR

CENTRE FOR ECONOMIC STRATEGY

Defence and security comprise over 2/3 of the state expenditures



Source: Ministry of Finance

Defence expenses for 1Q2023 amounted to UAH 403 bn, 57% of total expenses, with UAH 89 bn spent on **Justice and law** (13%).

The largest "civil" spending item, **social security**, reached UAH 118 bn.

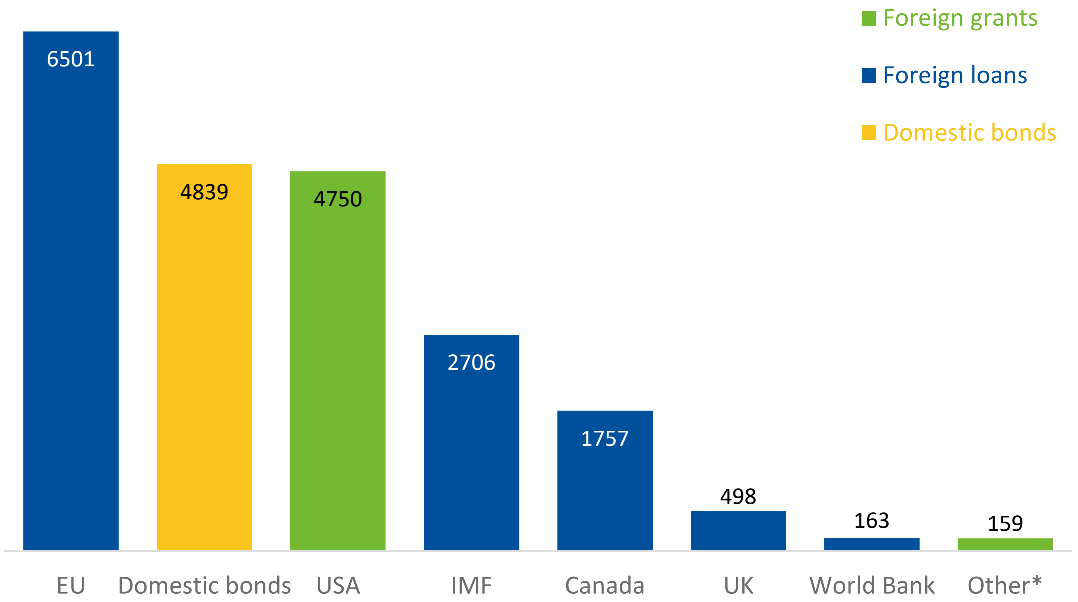
Other 1Q2023 expenses, including Healthcare, Governance and Education, comprised only 14% of expenditures, or UAH 99 bn, remaining on par with 2022 monthly spending in nominal terms.

FISCAL SECTOR

Highest ever foreign financing in April

In April, Ukraine received a USD 1.65 bn loan from the EU and a USD 1.25 bn grant from the US. Additionally, a first loan tranche of USD 2.7 bn was disbursed by the IMF. Two more IMF disbursements are planned for 2023.

2023 additional financing of Ukraine's state budget as of 28 April, USD mln

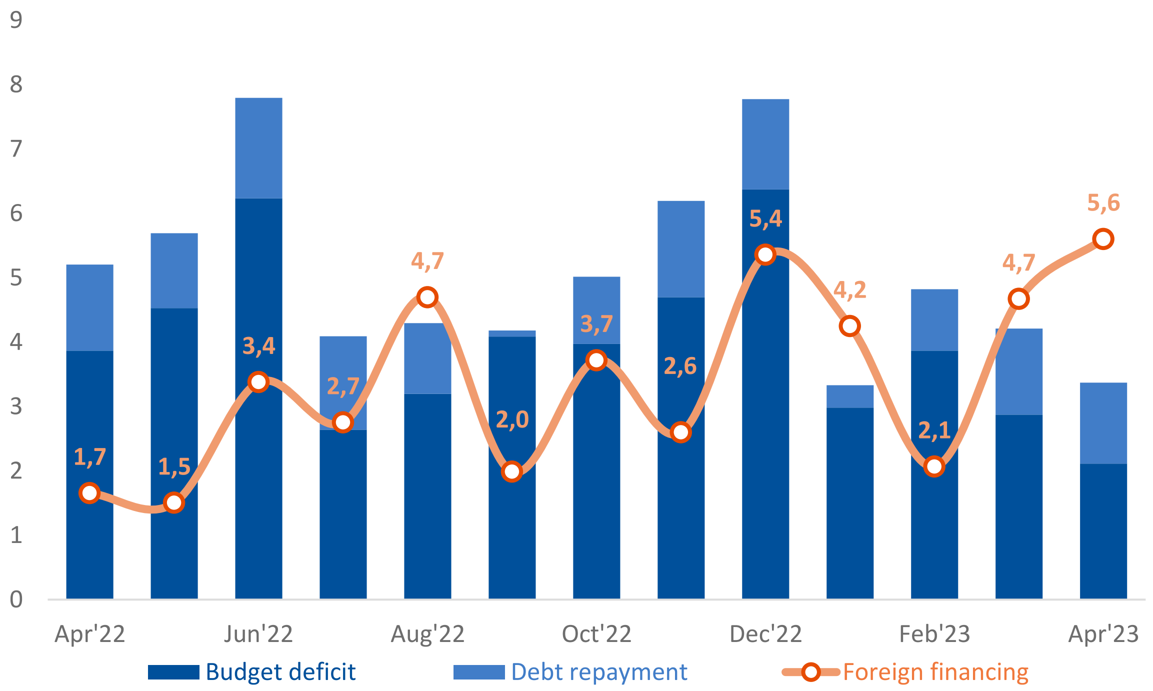


Germany, Spain, Finland, Ireland, Switzerland, Belgium, Iceland, Estonia*

Source: Ministry of Finance

Foreign financing in April reached USD 5.6 bn, the highest monthly amount since the beginning of the international financial support of Ukraine. Stable disbursements of foreign financing in 2023 allow for some predictability in budget implementation.

Foreign financing, budget deficit and debt repayment in 2022-23, USD bn

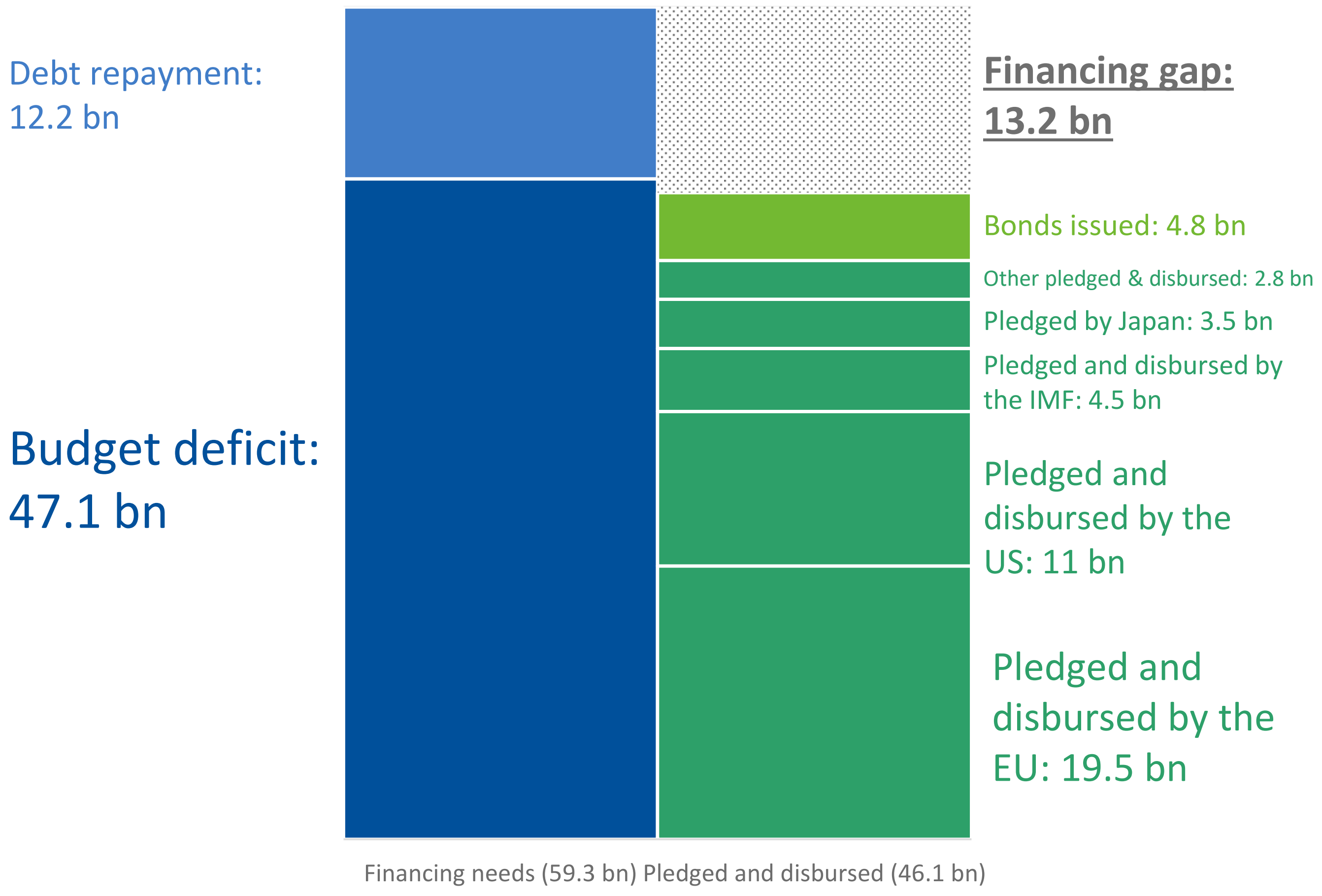


Source: Ministry of Finance, NBU, CES calculations

FISCAL SECTOR

Will there be enough foreign financing in 2023?

Financing gap estimate of Ukraine's state budget in 2023 as of 28 April, USD bn



Sources: Verkhovna Rada, Ministry of Finance, CES research

- With March increase in budget spending, Ukraine's 2023 budget deficit grew to USD 47.1 bn, and debt repayment increased to USD 12.2 bn. This was approved by the IMF.
- However, disbursed and publicly pledged foreign financing, and issued domestic bonds amount only to USD 46.1 bn, which leaves a **financing gap of USD 13.2 bn.**
- More financing may be coming which is currently publicly unannounced.
- Ukraine has stopped the monetary financing since the beginning of 2023. However, if the foreign disbursements are insufficient and other sources of internal financing mobilization (such as local bonds) fail, Ukraine may be forced to print money again.

FISCAL POLICY

CENTRE FOR ECONOMIC STRATEGY

IMF`s primary fiscal policy conditionalities

- Preparing and adopting the **National Revenue Strategy:**
  - key principles and objectives of tax policy for short-term and post-war
  - strengthening customs and tax services
  - revision of the simplified taxation system
  - aligning VAT and excises with EU acquis

- Return to **mid-term budgeting**

- **Strengthening the institutional capacity of ESBU**, improving analytical component, subordinating to MoF

- Strengthening **public investment management** ahead of post-war reconstruction

- Improving fiscal transparency: targets for State Budget and social funds arrears, control over the issuance of public guarantees, restoring regular reporting by SOEs and improving transparency of special funds and accounts

- Debt sustainability and increase of domestic financing

CENTRE FOR ECONOMIC STRATEGY

GET German Economic Team

THANK YOU.

This text reflects the opinion of the authors and does not necessarily represent the views of the German Economic Team.