CENTRE FOR ECONOMIC STRATEGY

GET German Economic Team

MAY ECONOMIC OVERVIEW. A YEAR OF UKRAINIAN BUSINESS RECOVERY

07/06/2023

CES Team

WAR

WAR UPDATE

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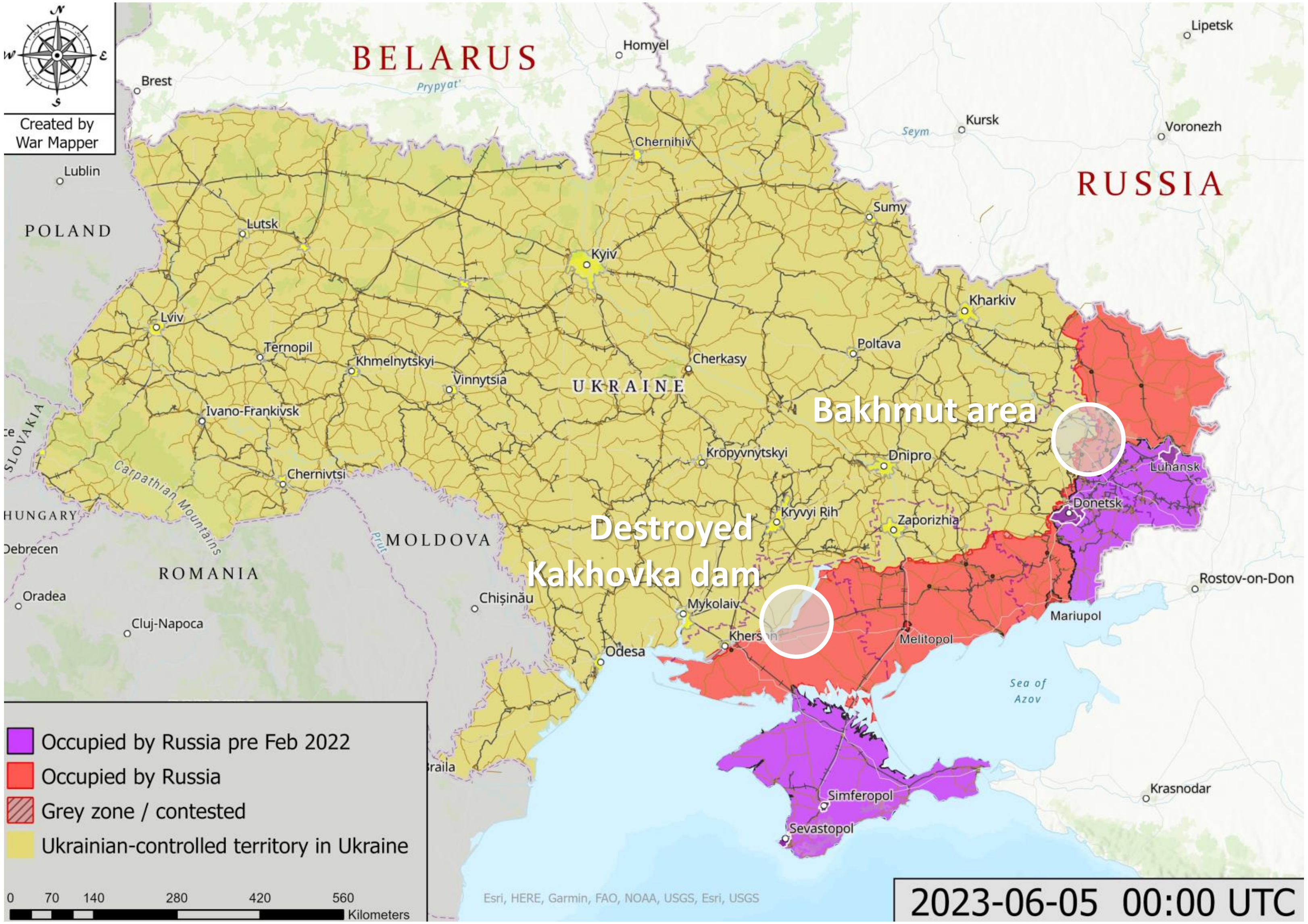

- Russia destroyed Kakhovka dam on June 6 – an unprecedented catastrophe, full extent of which is yet to be determined.
- On May 20, Russia announced the capture of Bakhmut. The Ukrainian forces mostly left the city but are pushing forward on the flanks. The battle of Bakhmut continues.
- Ukrainian anti-air defense managed to shoot down a Russian Kinzhal missile over Kyiv on May 4. This was made possible by Patriot anti-air systems supplied by the U.S., Germany, and The Netherlands. After that, a new wave of Russian missile attacks on Kyiv began; most missiles have been intercepted.
- Ukrainian-backed Russian rebel groups have been conducting raids into Russia, distracting Russian attention from the occupied Ukrainian territories.

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MACROECONOMIC TRENDS

MACRO

GDP down by 13.5% in Q1

- GDP decrease slowed down to 13.5% yoy in Q1;
- The government improved the forecast of GDP growth in 2023 from 1% to 3.2%;
- The World Bank worsened the forecast from 3.3% to 2%.

Sources: National Bank

MACRO

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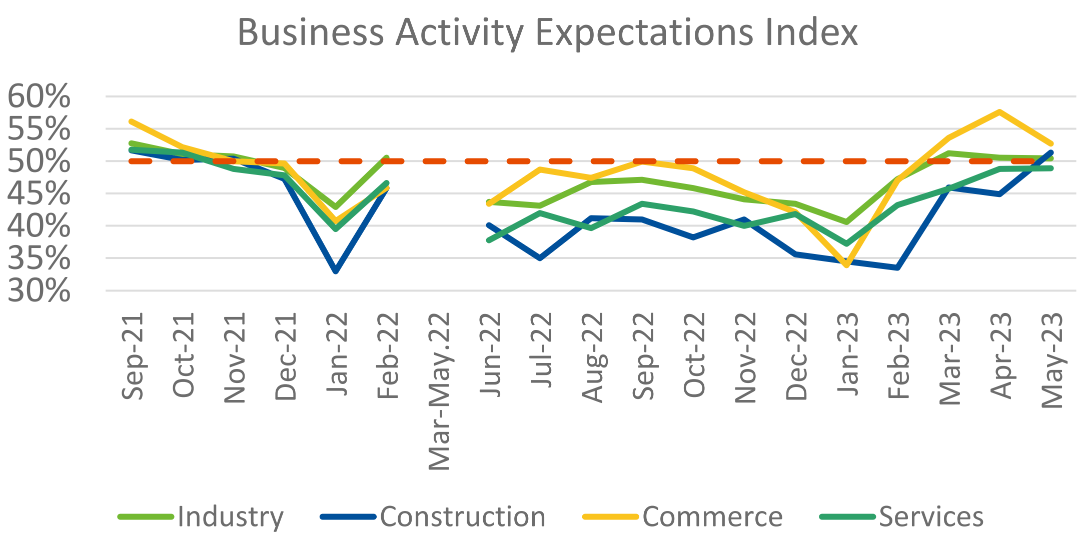
Business confidence: Most sectors are optimistic

- In May, the Business confidence index was 50.5, a small decrease comparing to April;
- Composite index is above neutral level for the second month; subindices are too, except for services;
- All sectors improved expectations except commerce;
- The largest improvement was in construction, which is a sigh that investment demand recovers.



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

MACRO

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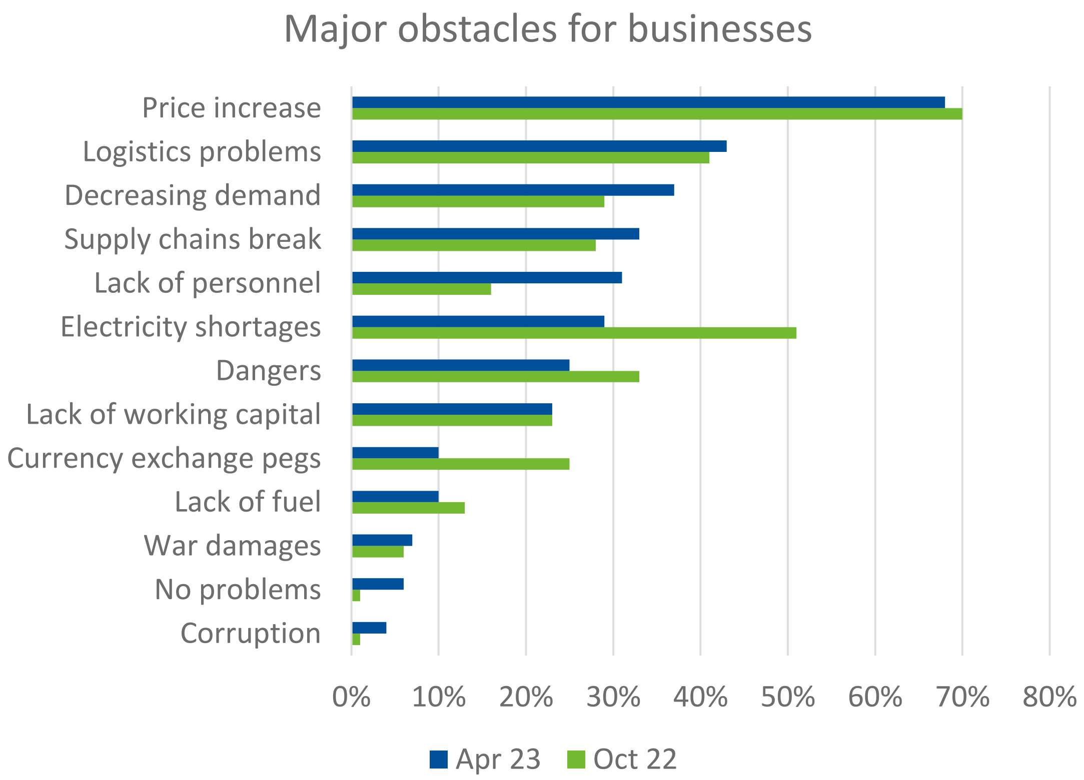
Prices and logistics are the most frequently cited problems

- Input price increases and logistical issues remains the most acute problems of entrepreneurs during the latest months;
- Electricity shortages, wartime dangers and currency peg are less important issues compared to six month ago;
- The most important arising problem is the lack of personnel.



Source: Institute for Economic Research and Policy Consulting

MACRO

War damage estimates increased by USD 0.5 billion

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- Damage assessment increased by USD 0.5 billion during the month, the smallest increase this year;
- Estimates for housing and agriculture were downgraded;
- Growth is mostly attributed to education;
- Damages from Kakhovka HPP’s destruction are to be determined.

Asset type	May’23	Apr’23	Change
Residential buildings	54.1	54.4	-0.3
Transportation infrastructure	36.2	36.2	0
Industry	11.4	11.4	0
Education	9.7	9.1	0.6
Agriculture and land	8.9	9.1	-0.2
Energy infrastructure	8.3	8.3	0
Other assets	19.4	19.0	0.4
TOTAL	**148.0**	**147.5**	**0.5**

Source: KSE, Russia will pay project

MACRO

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Economic Consequences and Assessments of the Dams' Destruction at the Kakhovka Hydroelectric Power Station.

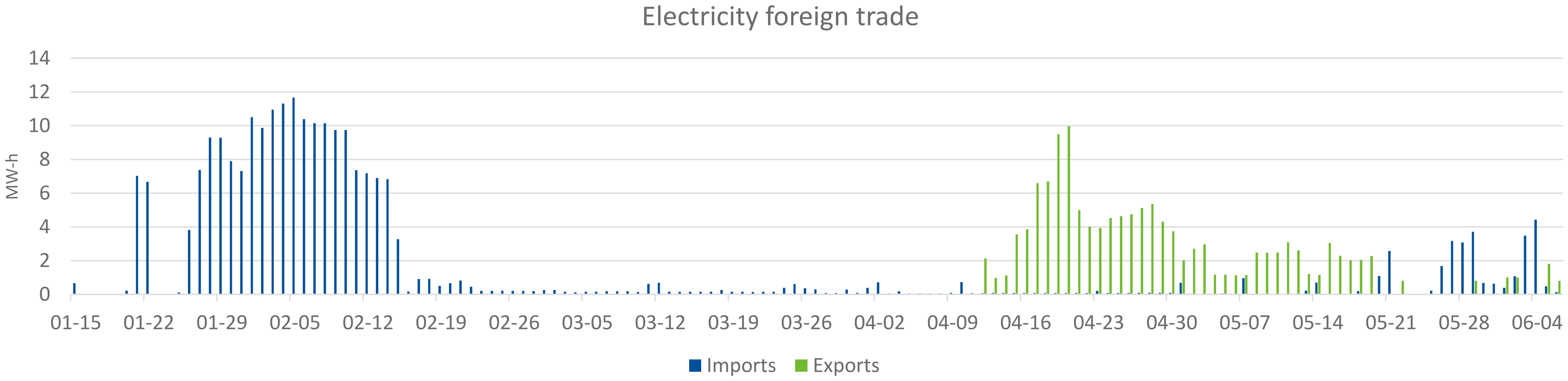
- The destruction of the Kakhovka HPP means the loss of 335 MW of renewable energy capacity. It is 5% of Ukraine's total hydroelectric power plants (7530 MW);
- $800 million to $1 billion is needed to build a new station. The duration of construction may reach five years;
- The undermining of the dam led to the flooding of the Kherson TPS pumping station. 129 transformer substations were flooded and damaged in the city. Also, two solar power plants were flooded in the Mykolaiv Oblast.
- Almost 20,000 consumers were left without electricity in Kherson and neighboring settlements (as of 11 a.m., June 7).
- The Ministry of Agrarian Policy and Food of Ukraine predicts flooding approximately 10,000 hectares of agricultural land on the right bank in the Kherson region. And several times more on the left bank, which is currently under occupation.
- A disaster will stop the water supply of 31 field irrigation systems in the Dnipropetrovsk, Kherson, and Zaporizhzhia regions. In 2021, these systems provided irrigation for 584,000 hectares, from which Ukraine collected about 4 million tons of grain and oil crops worth about 1.5 billion dollars.
- According to preliminary calculations, losses from the death of all biological resources will amount to UAH 10.5 billion.

SECTORAL ANALYSIS

SECTORAL

Energy: Electricity surplus ended

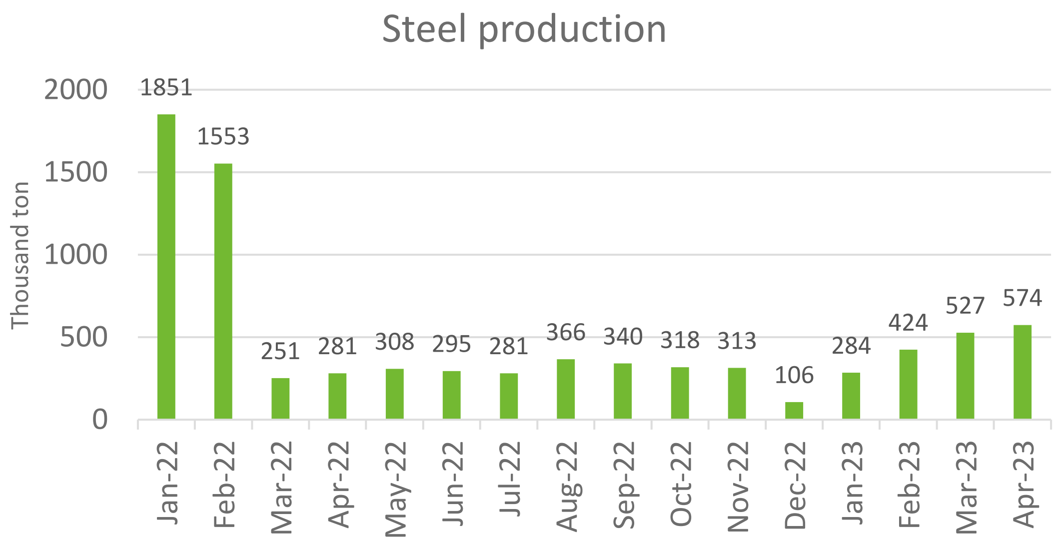
- Hydro and renewable energy compensate for repairs on nuclear and thermal power stations;
- Also, exports decreased and imports increased to compensate for lower supply;
- Still, some temporary interruptions occurred; additional interruptions caused by massive missile attacks in May;
- Electricity tariff for households increased.



Sources: Ukrenergo / ENTSOE

SECTORAL

Metals: Steel production set wartime record



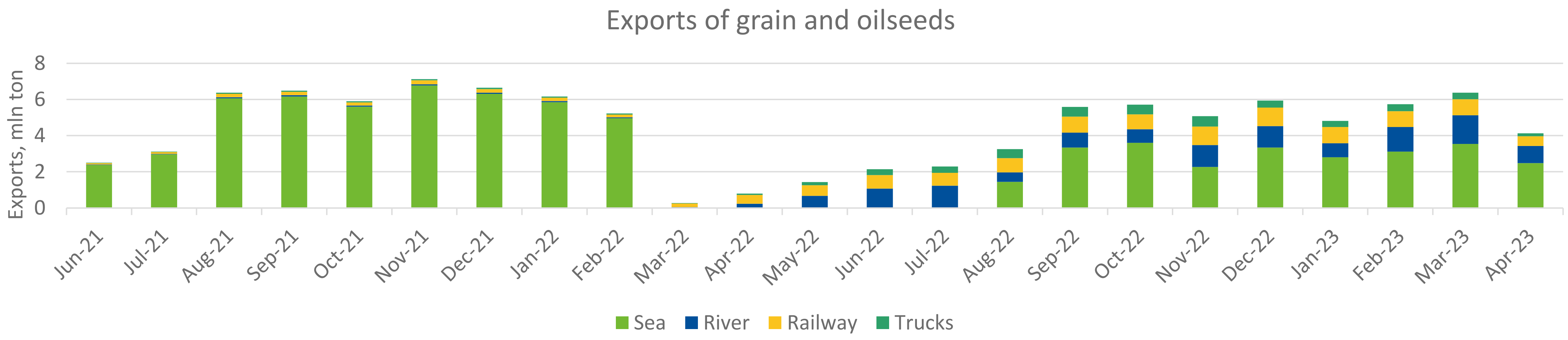
Source: Worldsteel

- Starting from February, steel production began to exceed 2022 post-invasion levels, thanks to European market;
- However, the destruction of Kakhovka HPP decrease water supply, which already caused nearby facilities to scale down operations;
- The two largest players, Metinvest and ArcelorMittal, declared readiness to join EU's Green Deal, which implies investment in direct reduction and electric furnaces.

SECTORAL

Agriculture: EU extended ban until autumn

- Sowing campaign finished; harvest expected at 68 million ton (down by 8,5% from 2022);
- EU's ban on exports of some grains and oilseeds from Ukraine to five neighboring countries extended to September 15;
- Similar threat from Moldova was diverted;
- There is a risk of re-establishment of EU's tariff quotas for poultry, eggs and frozen fruits;
- The Grain Deal is sabotaged again; losses exceed USD1 billion;
- 300-600 thousand hectares of arable land flooded as a result of Kakhovka HPP's destruction.



Sources: State Custom Service, Minagro, UN

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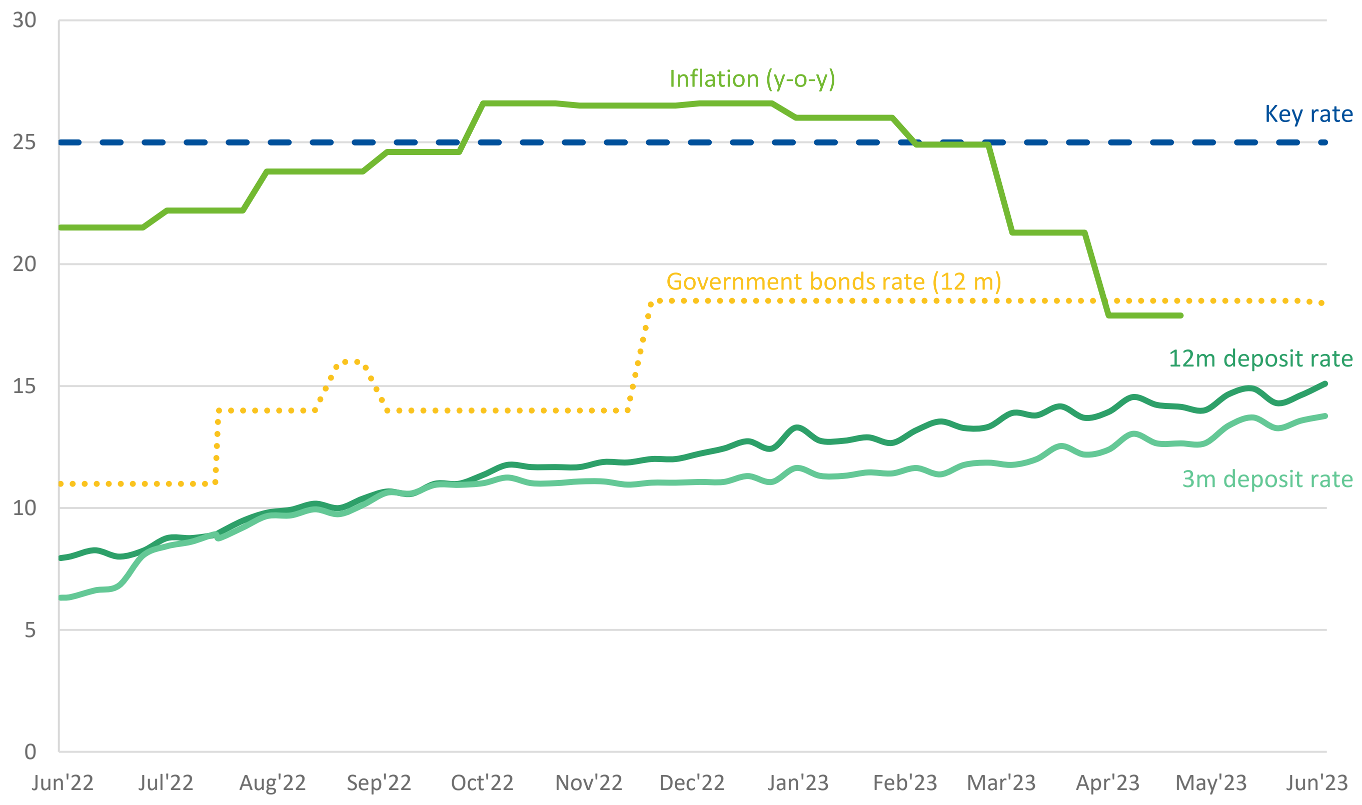
MONETARY AND FX POLICY

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, %

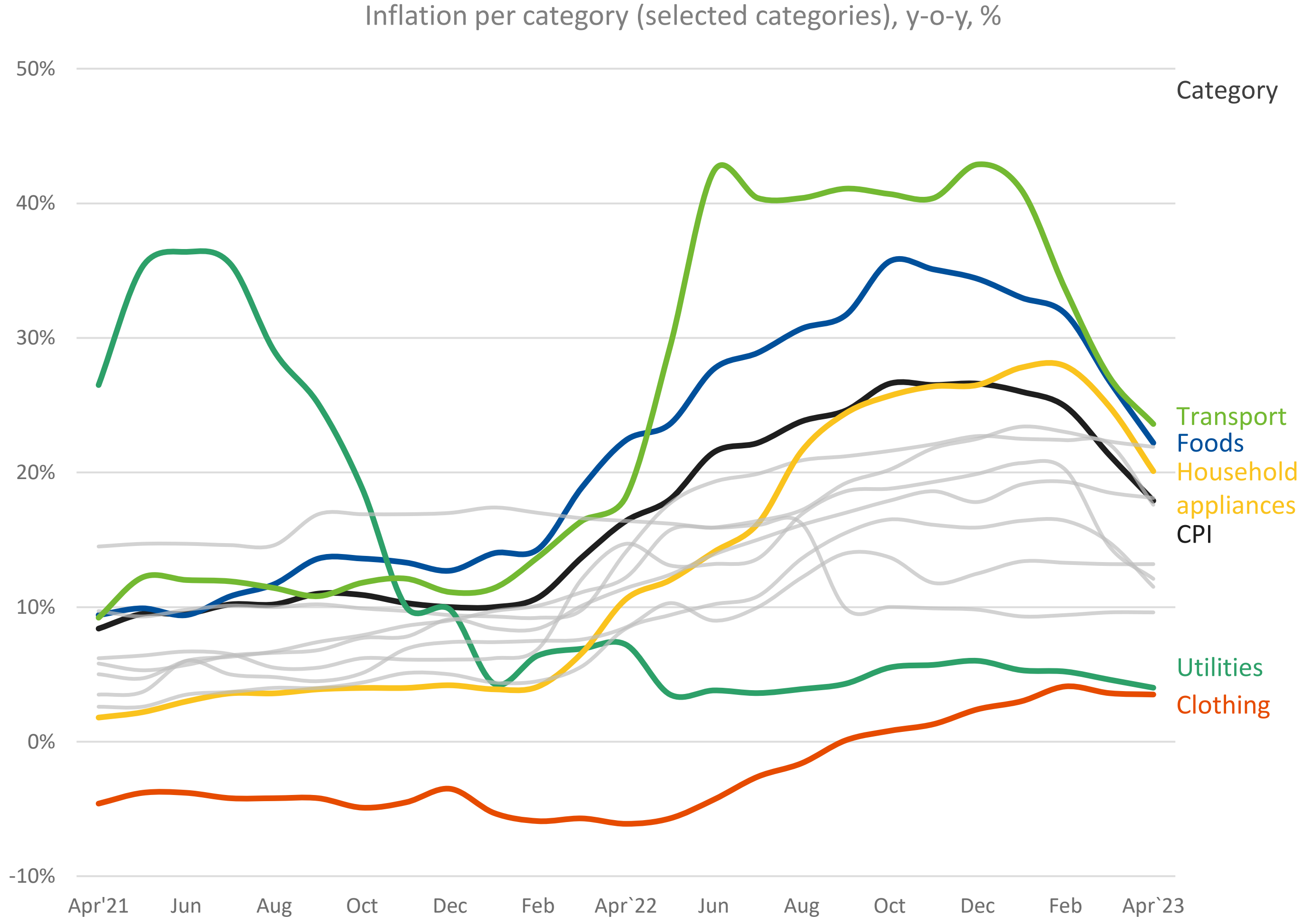


- The key policy rate remains unchanged at 25% to enhance the appeal of hryvnia assets, sustain the stability of the FX market, and create favorable conditions for ongoing disinflation and the easing of burdensome foreign exchange restrictions.
- The yield of one-year hryvnia military bonds remains at 18.5% p.a. At the end of April, average rates on retail deposits (UIRD) continued to rise slowly. Interest rates on 12-month retail deposits rose to 14.6% p.a., and rates on 3-month deposits increased to 13.6% p.a.
- In April, inflation has been declining faster than expected, and the growth in consumer prices decelerated to 17.9% y-o-y. In monthly terms, prices grew by 0.2%.

Sources: NBU, State Statistics Service, UIRD

CPI

Inflation slows down; CPI 17.9% y-o-y in April



- The decline in inflation is attributed to abundant food and fuel supplies, strengthening of hryvnia, improved inflation expectations, and the influence of base effects from the previous year's rapid acceleration.

- Core inflation decreased to 16.9% y-o-y in March, while growth in administered prices slowed to 10.9% y-o-y, primarily due to last year`s base effects and stabilization of fuel prices. The moratorium on raising utility prices for households also restrained the increase in administrated prices.

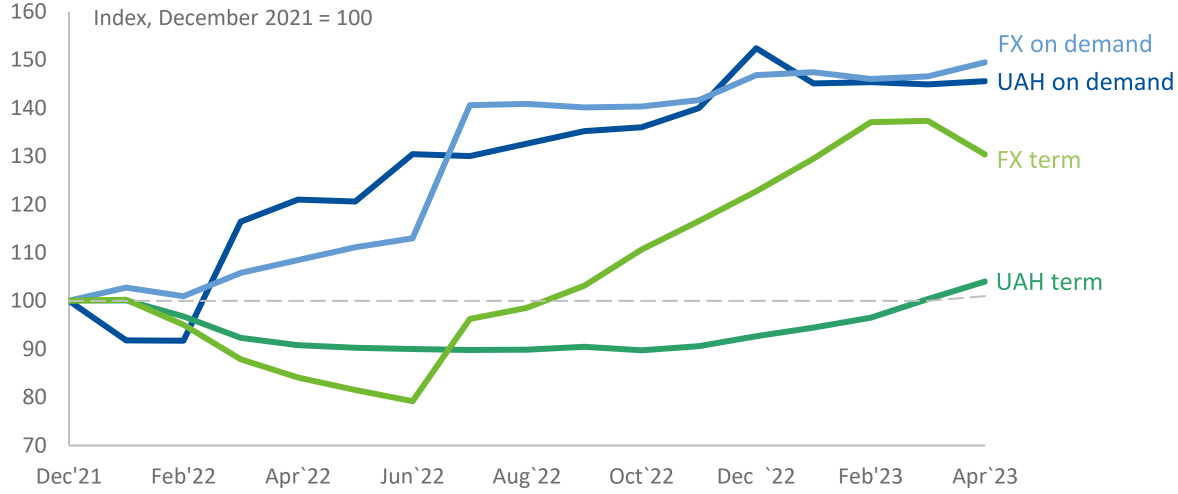
- Nevertheless, the war generates substantial uncertainty and poses risks to inflation.

Source: State Statistics Service of Ukraine

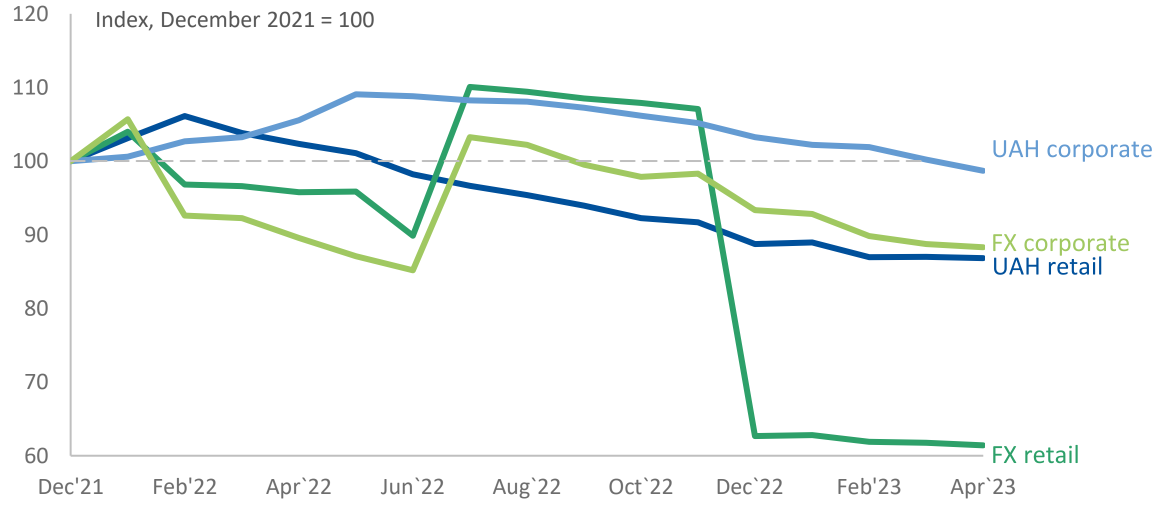
BANKING SECTOR

Loans continue to decrease; term deposits in hryvnia on the rise

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



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



NB: a sharp increase in FX loans and deposits in July 2022 is caused by change of official rate. Source: NBU

- The volume of household deposits continues to increase, primarily the term ones across all groups of banks, except for PrivatBank. The term deposits in hryvnia increased a little bit more than on-demand due to higher interest rates compared to short-term deposits.
- However, the dynamics of FX retail deposits have been different. The term ones reversed growth in April compared to previous months, while the deposits on demands continue growing slowly.
- Loans to residents continue to decrease both for hryvnia and foreign currency loans. Demand for loans remained low, with lending primarily focused on the redesigned Affordable Loans 5-7-9% in March 2023.
- Banks continue to recognize loan losses. NPL grew to 39.3% at the beginning of May, which is 12.6 p.p. higher than in February 2022.

FX POLICY

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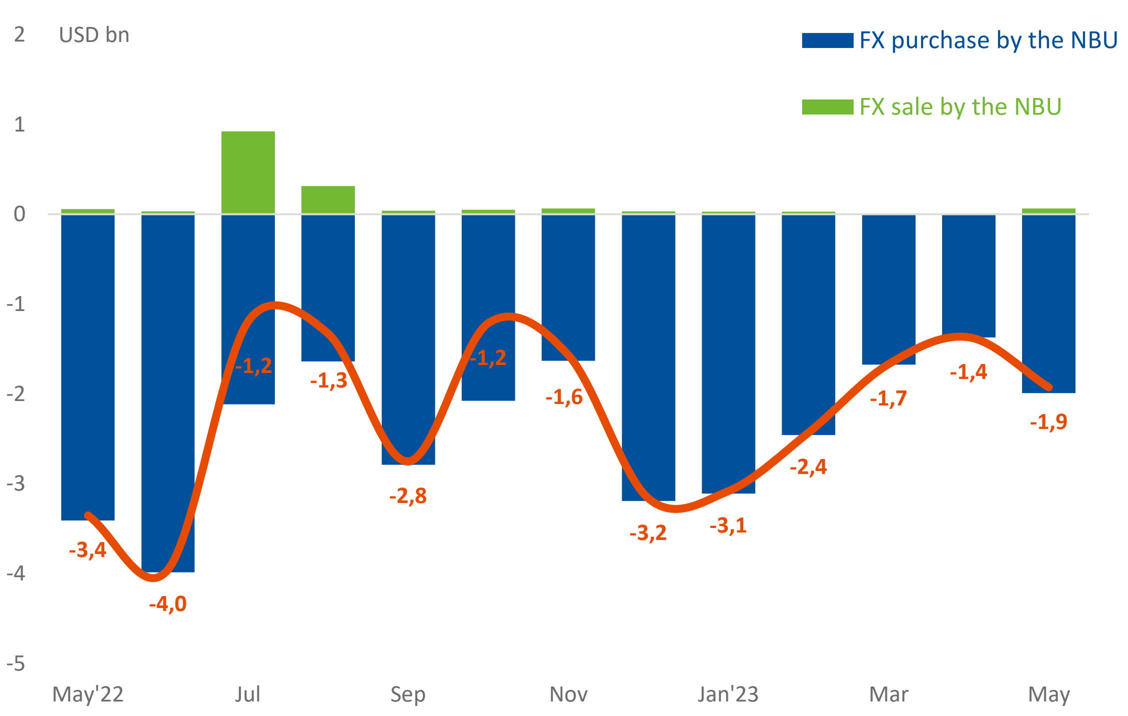
UAH has strengthened; international reserves rose to a record high value in 11 years

There is still a need for significant FX sales by the NBU. **Ukraine's international reserves increased by 4% in May, reaching 37.3 USD bn – the second highest level to August 2011.** They rose primarily due to sustainable and regular inflows from international partners, surpassing the NBU`s net FX sales and Ukraine`s debt repayments.

The official rate remains fixed at 36.57 UAH/USD. Hryvnia has strengthened from 37.50–38.00 UAH/USD on April 15 to 37.40–37.80 UAH/USD on May 15. The NBU continued to ease FX restrictions in the insurance sector and clarified on repatriation process for interest on domestic government debt securities by foreign investors.

NBU foreign exchange interventions, USD bn



Source: NBU

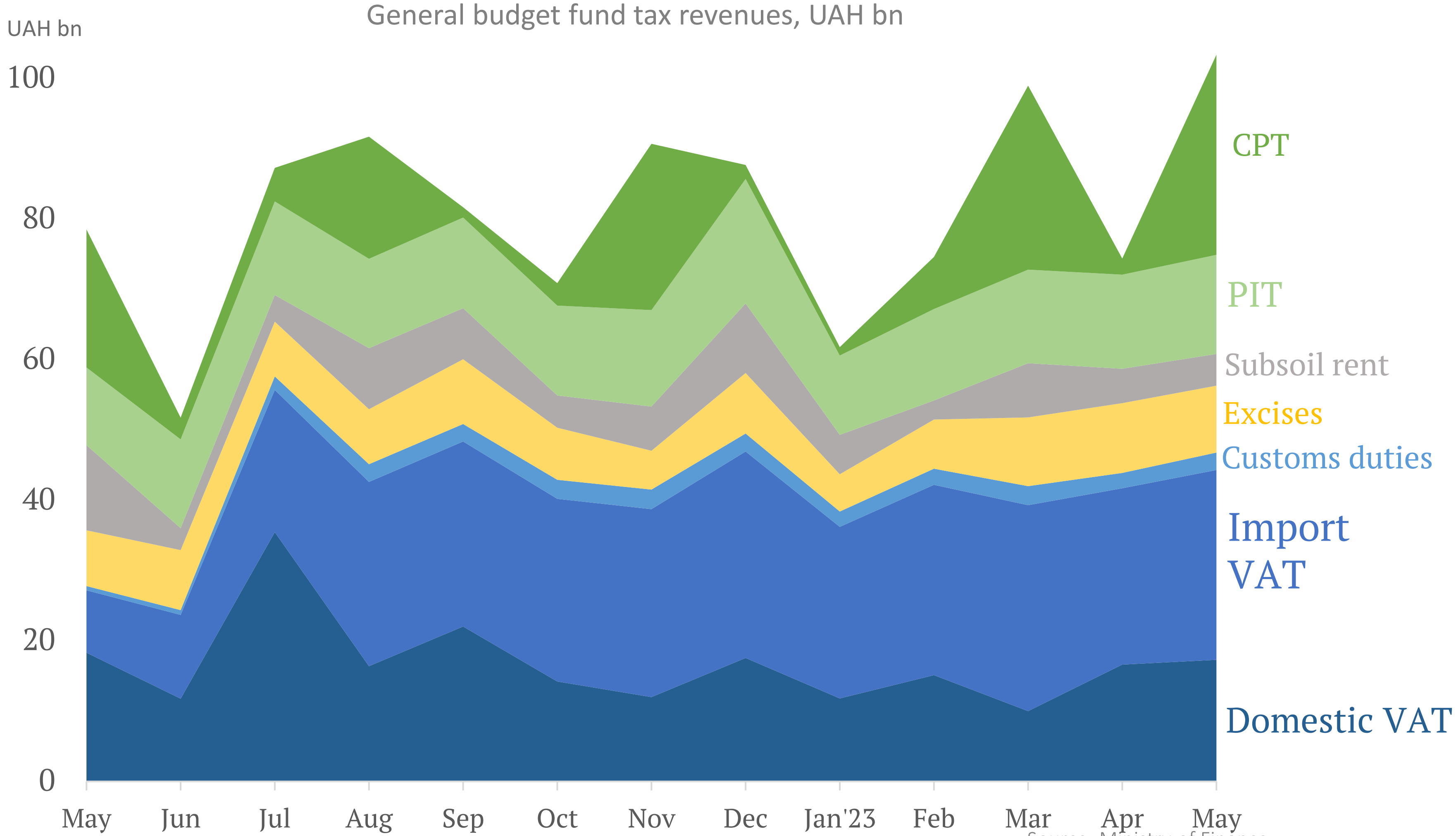
Average daily official and market exchange rates UAH/USD

Source: NBU, Ministry of Finance

FISCAL SECTOR

FISCAL SECTOR

Tax revenues slightly exceed expectations



Source: Ministry of Finance

Tax revenues in May hit a record high **UAH 103.4 bn,** as **Corporate Profit Tax** became the largest revenue source, bringing **UAH 28.5 bn.**

Imports VAT and duties together contributed **UAH 29.5 bn** – roughly the same nominal level for the last 10 months.

Net **domestic VAT** brought in **UAH 17.3 bn –** marginal increase, as VAT refund decreased.

Excises and subsoil **rent** decreased by 4% and 8% over the month.

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

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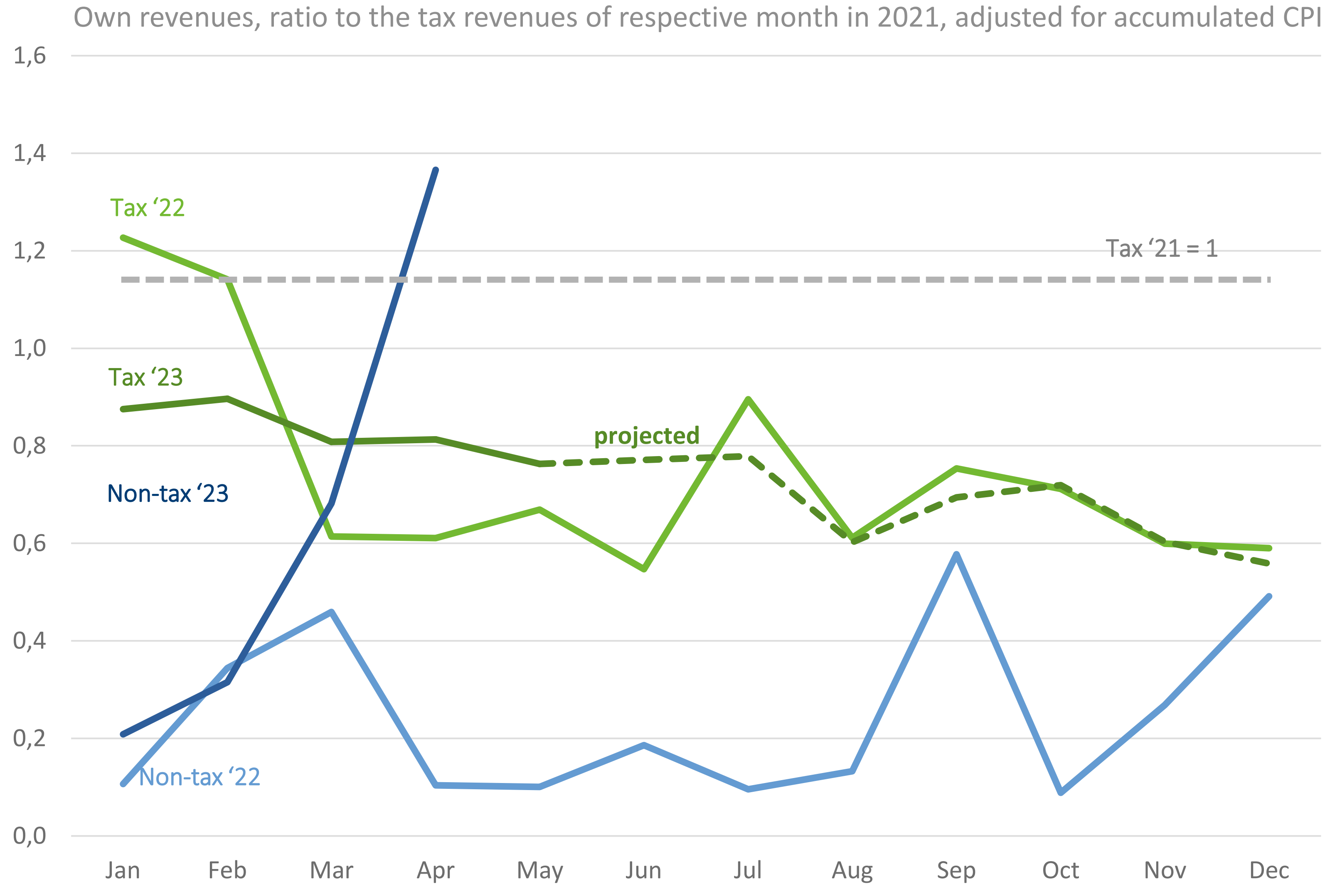
Tax revenues will remain stable, own non-tax growing significantly



Sources: NBU, CES projections

Ukraine reported UAH 133.5 bn of **non-tax revenues*** in April – that exceeds the total for 1Q2023, most likely due to accounting for received military aid, which is not the liquid budget funding.

May tax revenues slightly exceeded our projections, mostly due to better CPT revenues.

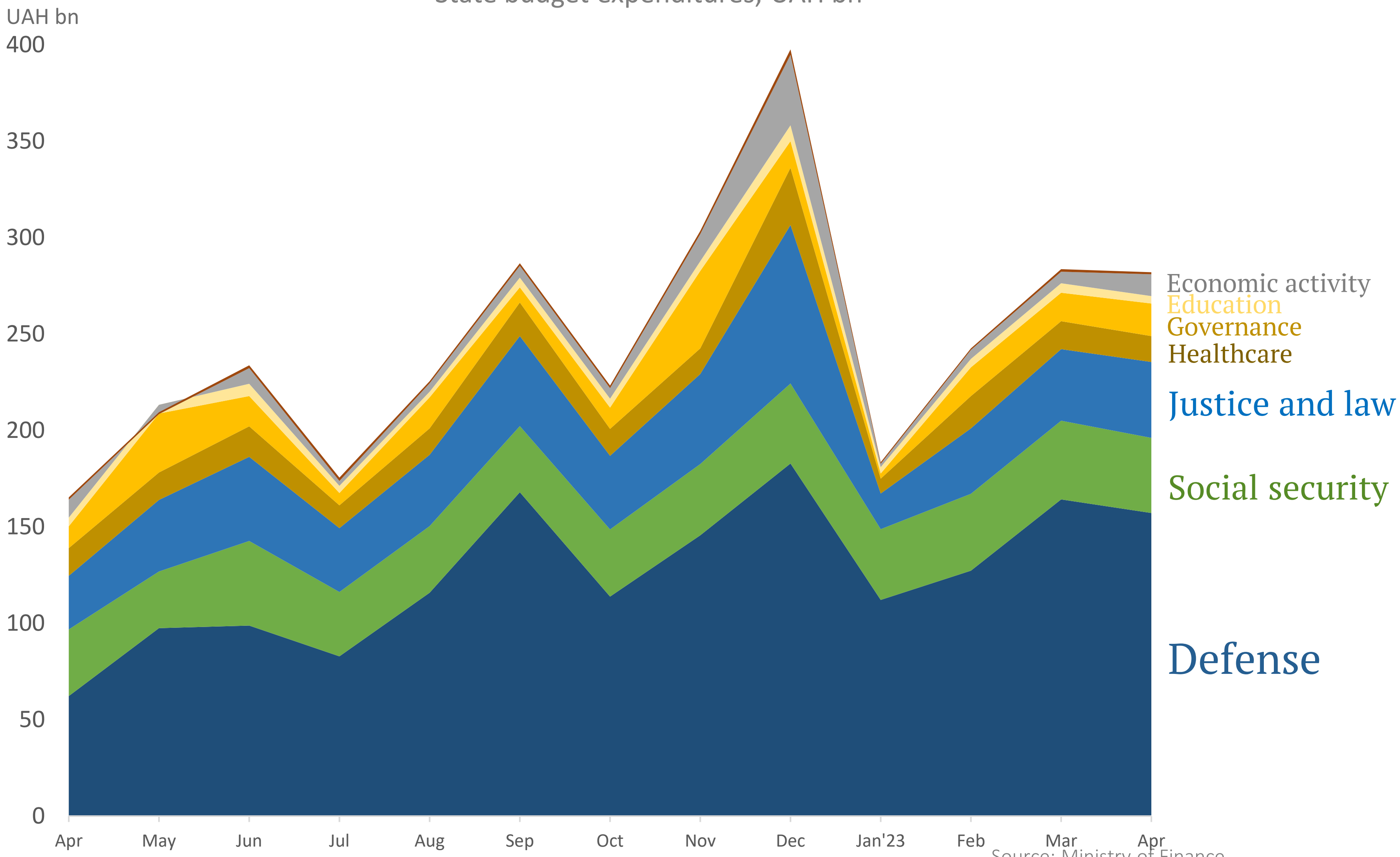
Tax revenue forecasts may be further revised upward after the expected return to pre-war taxation in July 2023:
- limited simplified tax system,
- 20% VAT and pre-war excise rates for the fuel).

*excluding grants

FISCAL SECTOR

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

State budget expenditures, UAH bn



Source: Ministry of Finance

Monthly state budget expenses stabilized in April after fast growth in Feb and Mar.

Defence expenses for 4m2023 amounted to UAH 561 bn, 57% of total expenses, with UAH 129 bn spent on **Justice and law** (13%).

The largest "civil" spending item, **social security**, reached UAH 157 bn.

Other 4m2023 expenses, including Healthcare, Governance and Education, comprised 15% of expenditures, or UAH 146 bn, remaining on par with 2022 monthly spending in nominal terms.

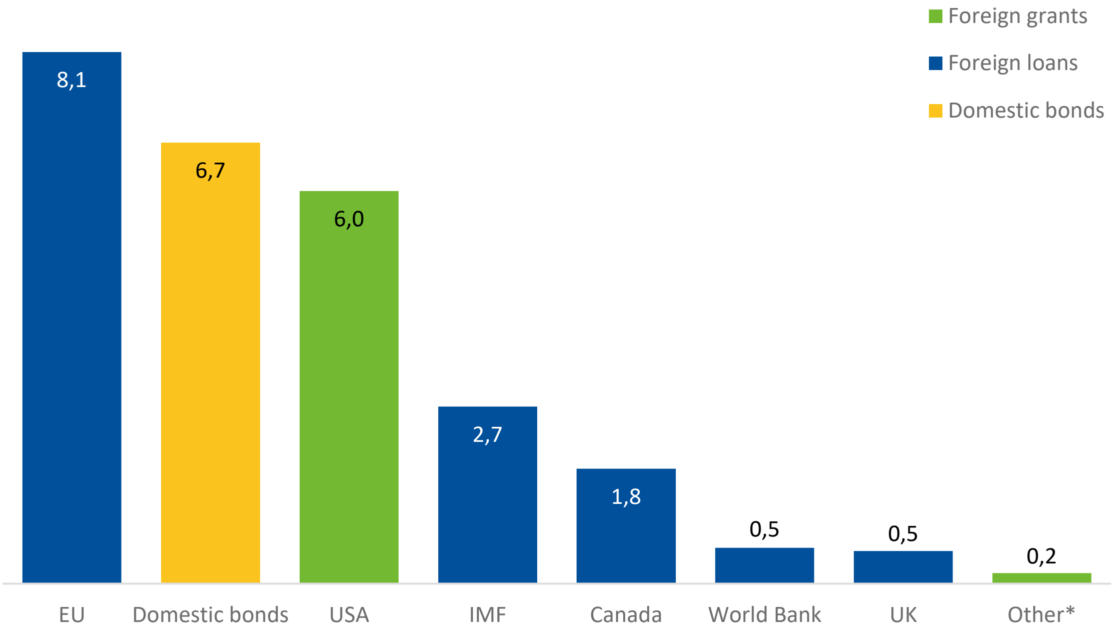
FISCAL SECTOR

USD 3.3 bn of foreign financing in May

In May, Ukraine received a USD 1.62 bn loan from the EU and a USD 1.25 bn grant from the US. Additionally, the World Bank disbursed USD 0.384 bn of loans. After successful completion of the first review of the IMF program, Ukraine will receive USD 0.9 bn from the Fund in June.

Over the first 5 months of 2023, budget deficit and debt repayment needs amounted to USD 20.9 bn, while the disbursed foreign financing amounted to USD 19.8 bn. Looking at the big picture, the foreign financing is more stable and predictable than in 2022. However, it is still not clear whether the financing gap will be covered in full.

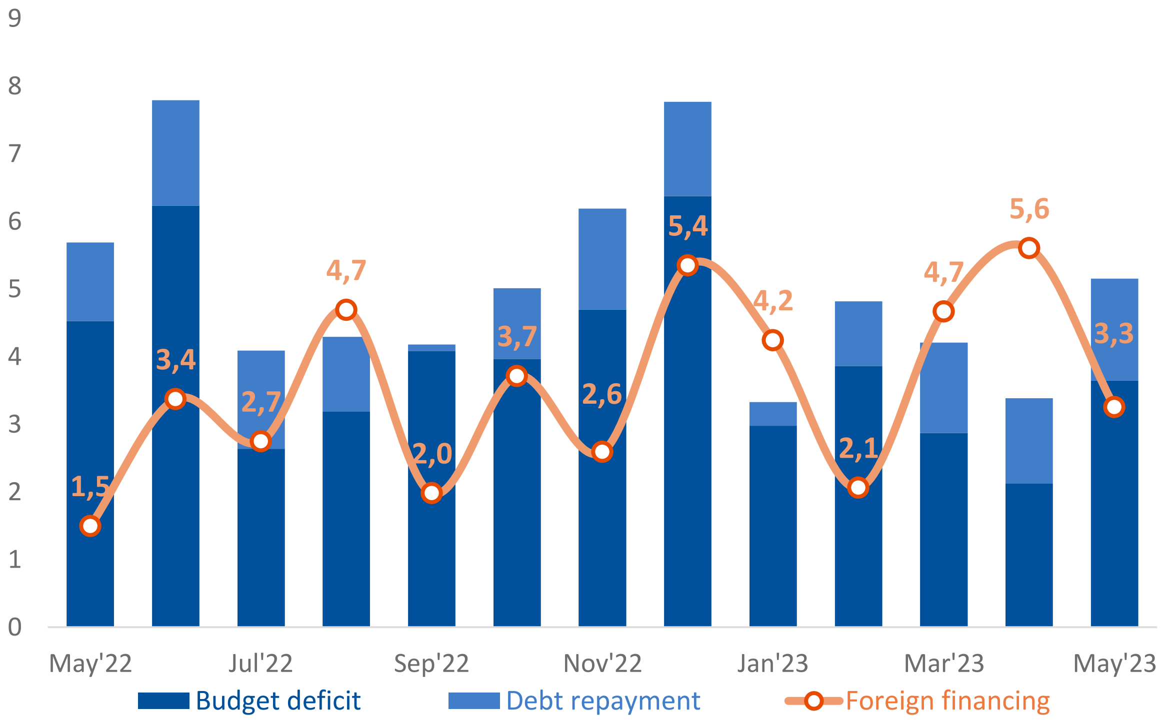
2023 additional financing of Ukraine's state budget as of June 5, USD bn



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

Source: Ministry of Finance

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



Source: Ministry of Finance, NBU, CES calculations

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THANK YOU.

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