



Economy review in July.

Special topic: What should be funded with public money in war times aside from the military?



WAR

WAR UPDATE



- In July, Ukrainian counteroffensive operations continued, with heavy fighting on the eastern and southern fronts.
- Ukrainian forces are doing their best to try to break through the Russian minefields using limited equipment available to them.
- Ukraine has also been disrupting the Russian logistics with missile strikes on various ammunition hubs as well as Chonhar and Kerch bridges.
- On July 17, Russia withdrew from the Grain deal and intensified its attacks on civilian ports in Odesa region, including the ports on Danube, hindering Ukrainian grain exports.

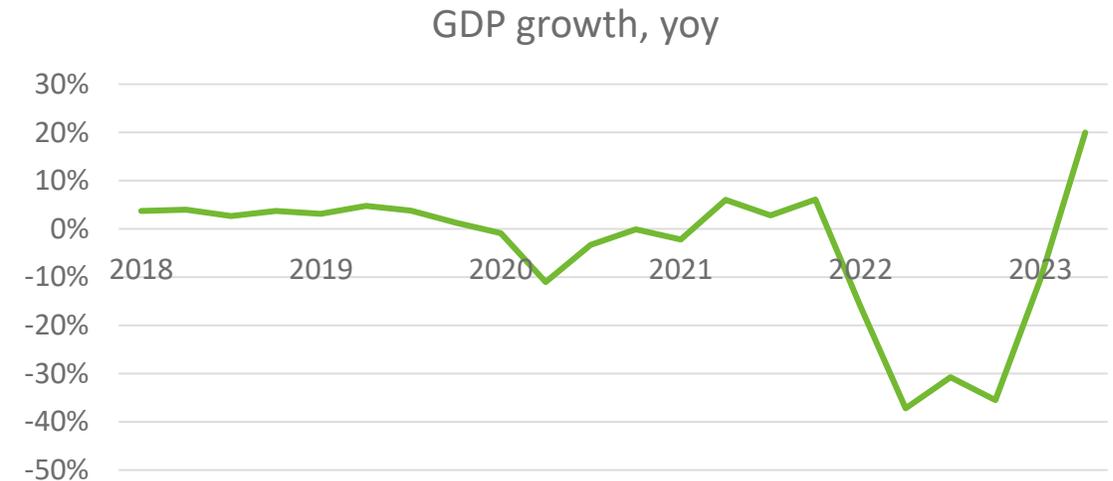


MACROECONOMIC TRENDS

MACRO

GDP up by 20% yoy in Q2

- In the second quarter, GDP increased by 20-21% yoy, according to estimate of IER, the first increase after the beginning of the full-scale invasion;
- The National Bank improved 2023 forecast from 2% to 2.9%; ICU expects even 5.8%;
- At the same time, NBU worsened 2024 outlook from 4.3% to 3.5% because of expectations that active phase of the invasion will end in the middle of 2024, not at the beginning.

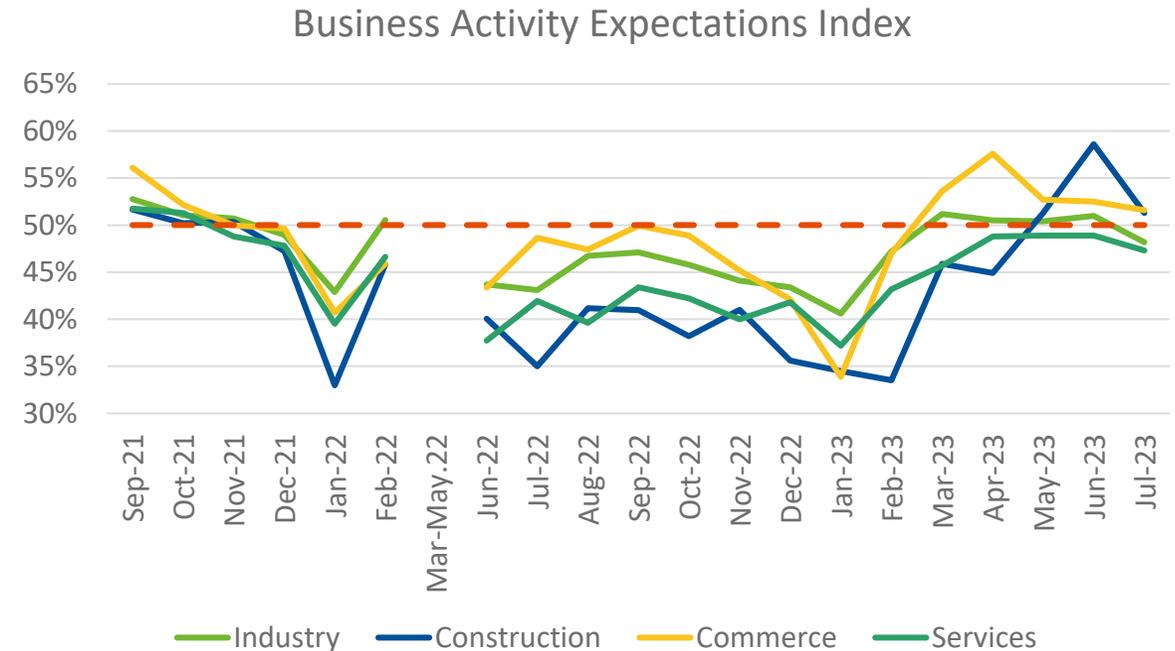


Sources: Ukrstat, IER

MACRO

Business confidence: More pessimism after 3 month of optimism

- In July, the Business confidence index was 48.8, a decrease comparing to June;
- Composite index is below neutral level now, after third month of growth; two subindices are too (industry and services);
- All sectors worsened expectations because of electricity tariffs and fuel taxes increases, the end of the Grain Deal and more missile attacks.



Source: National bank.

50% is neutral level (number of optimists equals the number of pessimists)

MACRO

War damage estimates increased by USD 2.8 billion

- Damage assessment exceeded USD 150 billion; increased by USD 2.8 billion during July, the largest increase this year;
- Mostly increase is related to the inclusion of estimates of Kakhovka HPP's destruction (USD 2 billion);
- The largest other contribution is the cumulative update on housing estimates, which is already the largest article. The issue is already being addressed (see "Construction").

Asset type	Jul'23	Jun'23	Change
Residential buildings	55.9	54.1	1.8
Transportation infrastructure	36.6	36.2	0.4
Industry	11.4	11.4	0.0
Education	9.7	9.7	0.0
Agriculture and land	8.7	8.7	0.0
Energy infrastructure	8.8	8.3	0.5
Other assets	19.4	18.9	0.5
TOTAL	150.5	147.7	2.8

Source: KSE, Russia will pay project



SECTORAL ANALYSIS

SECTORAL

Energy: Winter is coming

- Zaporizhzhia NPP's terrorism risks are estimated as lower by the Army, but the fourth reactor is in hot stop mode now;
- Electricity imports increased by 68% in July, no exports;
- The recovery of energy infrastructure is at 60%, more capacity to be restored before cold;
- Reserves are growing; gas 12.4 billion sq m of natural gas (out of 14.7) and 1.4 million tons of coal (out of 1.8);
- Full-scale taxation of fuels did not kick in to the full extent yet. In July, fuels' price increased by 7.3%, more to come in August.

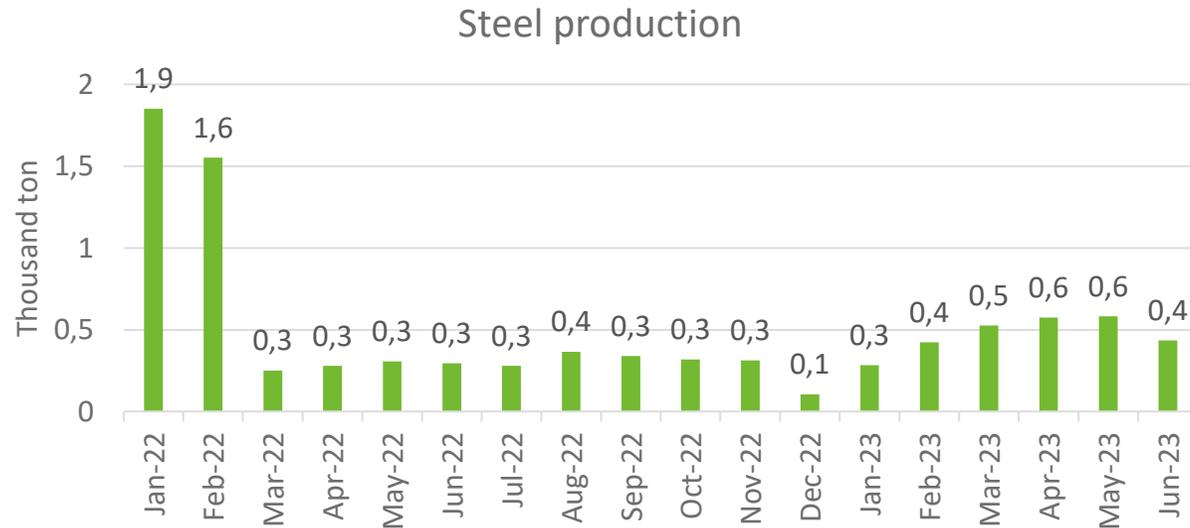
Electricity foreign trade



Sources: Ukrenergo / ENTSOE

SECTORAL

Metals: Steel production decreased after Kakhovka HPP's destruction



Source: Worldsteel

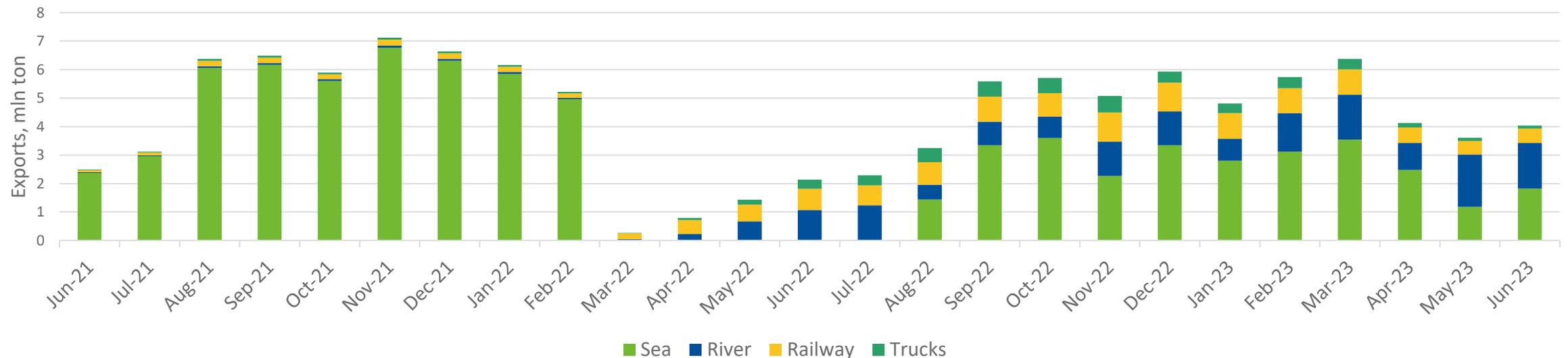
- In June, steel production decreased by 25% comparing to May, still almost 50% higher than in June 2022;
- ArcelorMittal Kryvyi Rig and Nikopol ferroalloy plant restored water supply;
- The end of the Grain Deal increases competition for overland routes;
- Metinvest was not allowed to buy Dunafer plant in Hungary, considers building a facility in Italy.

SECTORAL

Agriculture: Grain Deal ended

- Grain Deal ended; it allowed to export 32.8 million ton;
- In 2023, harvest of grains and oilseeds should reach 69 million ton;
- Danube route could cater 30-35 million ton per year;
- Extension of overland capacity is also being discussed;
- 96% of agricultural regulations could be abolished or modified.

Exports of grain and oilseeds

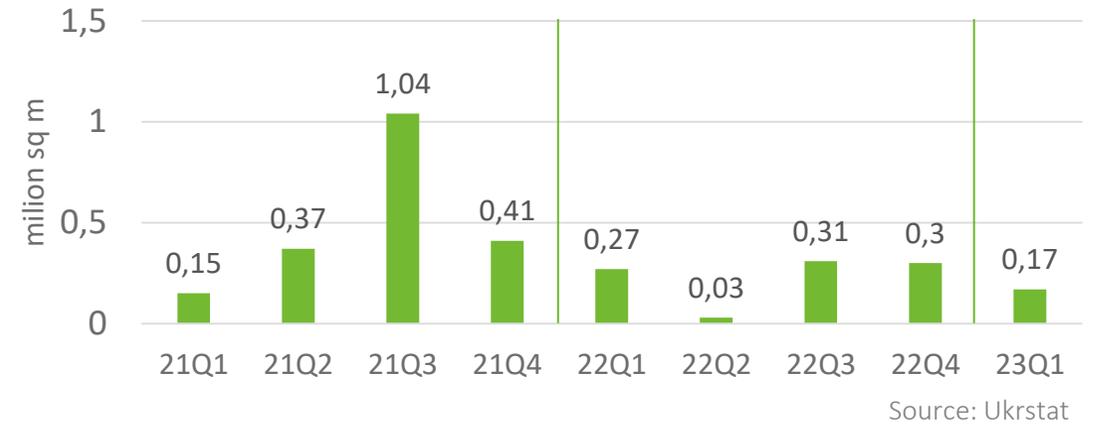


SECTORAL

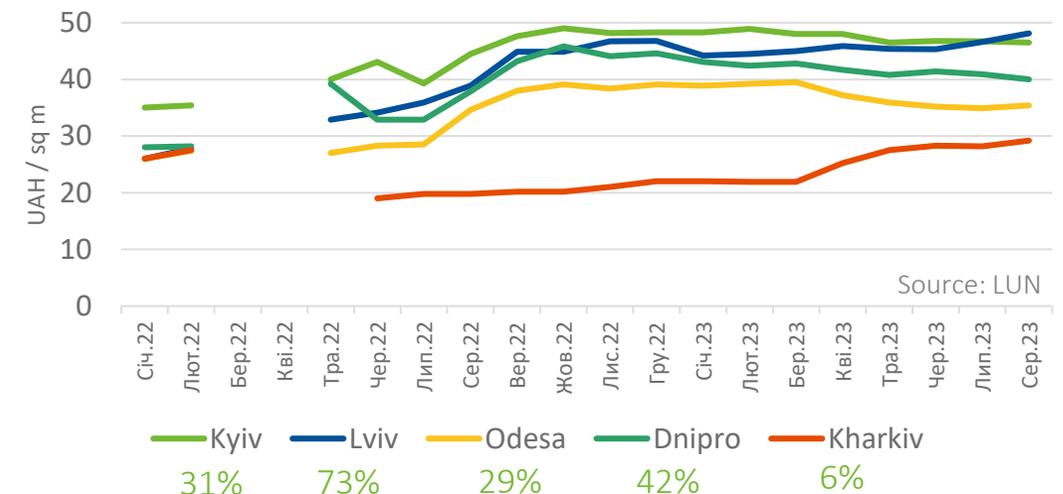
Construction: Reconstruction money started to flow

- In June, index of business activity expectations in construction was the fastest growing among sectors;
- Reconstruction money started to flow, from budget, private sources and foreign donors;
- The budget started to paid compensations on damaged housing;
- More mortgages, mostly state-subsidized;
- 75% housing projects resume construction, 189 new projects started;
- Rent rates and occupancy are rising in all segments (housing, office, commerce).

New residential construction



New housing price

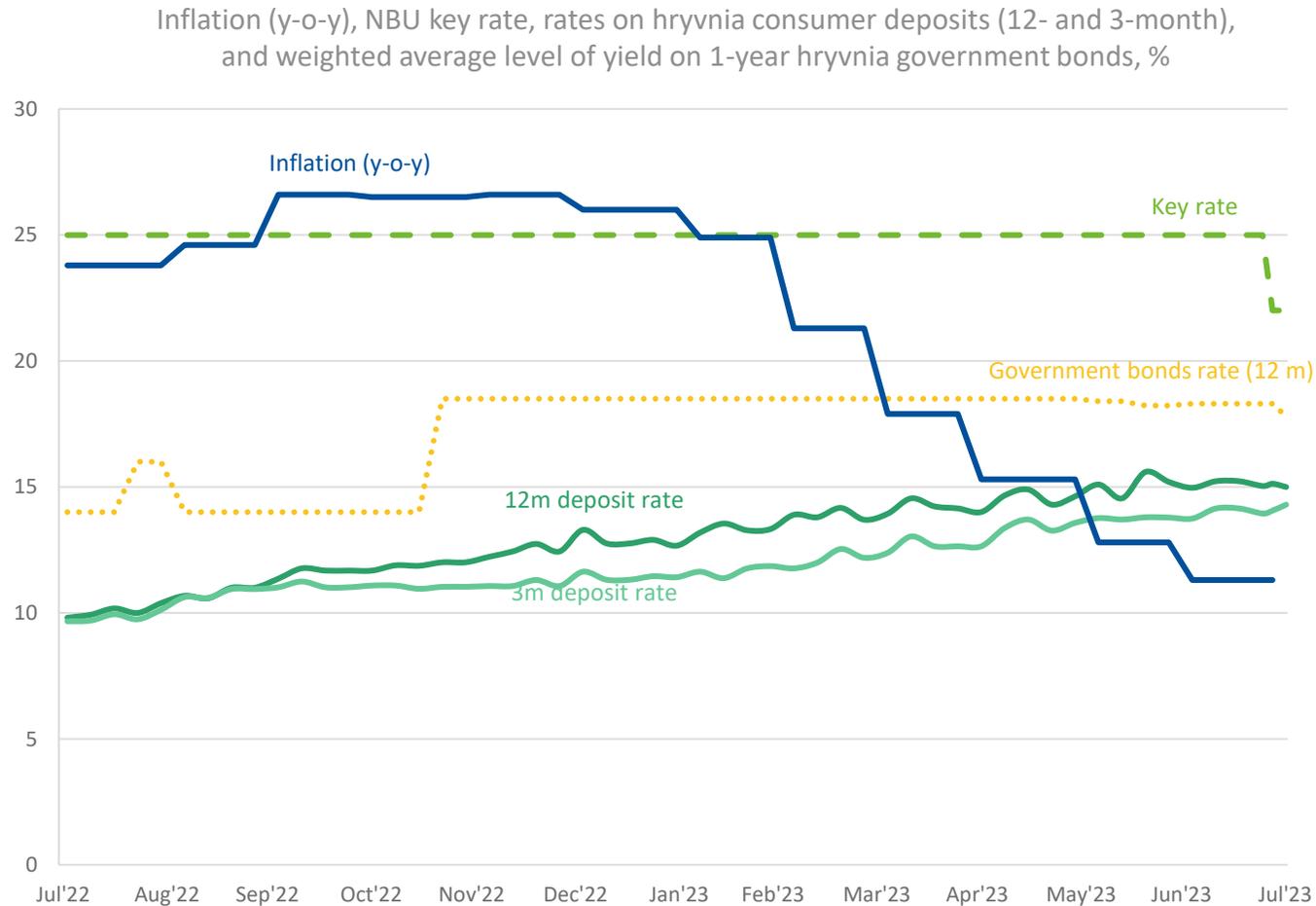


MONETARY AND FX POLICY



MONETARY POLICY

The NBU cuts the key policy rate to 22%; inflation continues to decelerate

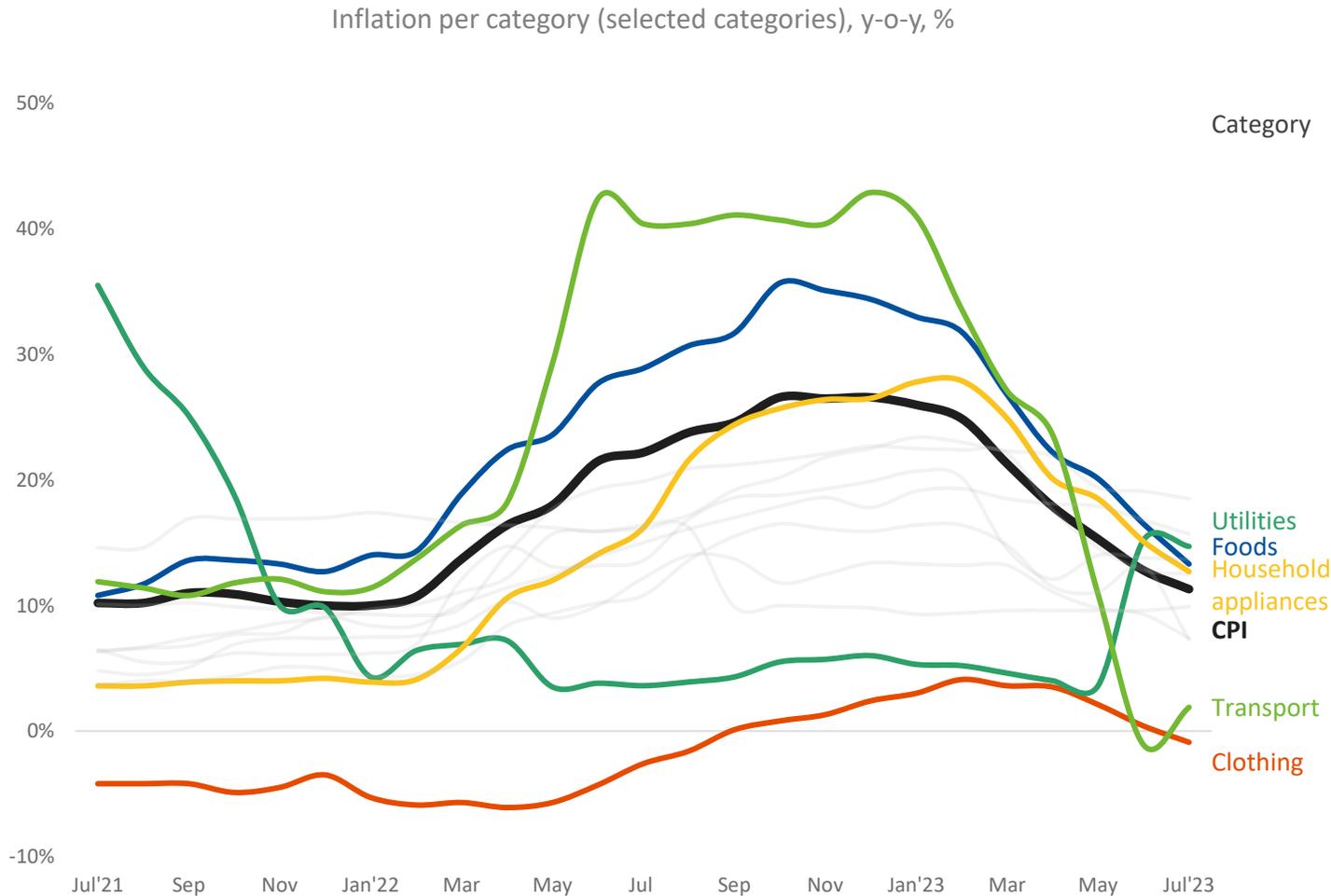


Sources: NBU, State Statistics Service, UIRD

- The NBU cut the key policy rate from 25% to 22% p.a. Rapid disinflation and sustained FX market conditions enabled the central bank to initiate the cycle of key policy rate cuts. The reduction of the rate amid stable macro-financial conditions will support economic recovery.
- The yield of one-year hryvnia military bonds decreased to 17.8% p.a. At the end of July, average rates on retail deposits (UIRD) continued to rise slowly for 3-month deposits – up to 14.3% p.a., while the interest rates on 12-month retail deposits decreased to 15% p.a.
- In July, inflation has been declined, and the growth in consumer prices decelerated to 11.3% y-o-y. In monthly terms, prices decreased by 0.6%.

CPI

Inflation slows down; CPI 11.3% y-o-y in July

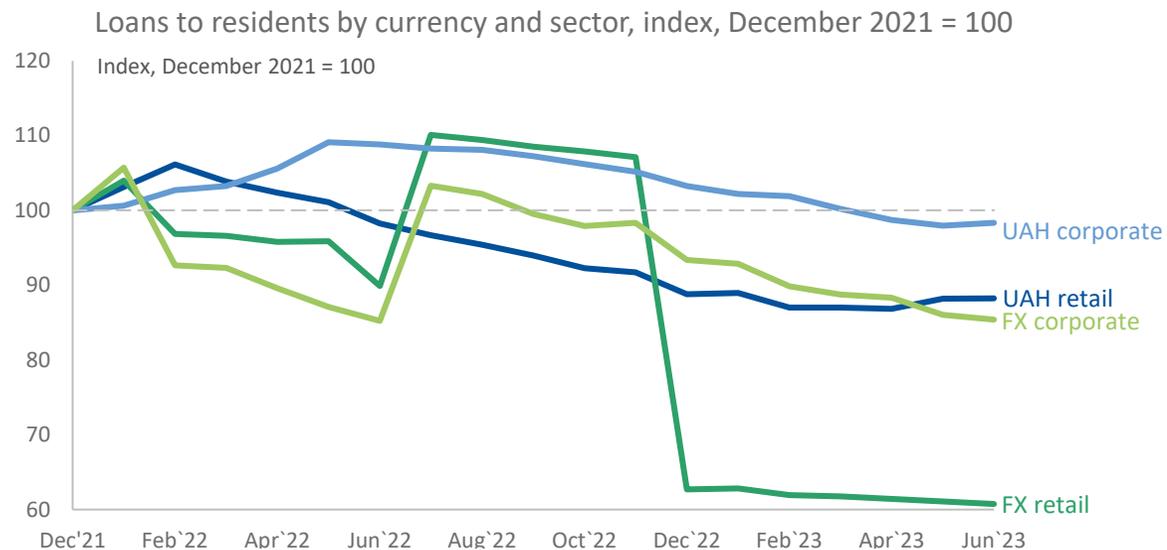
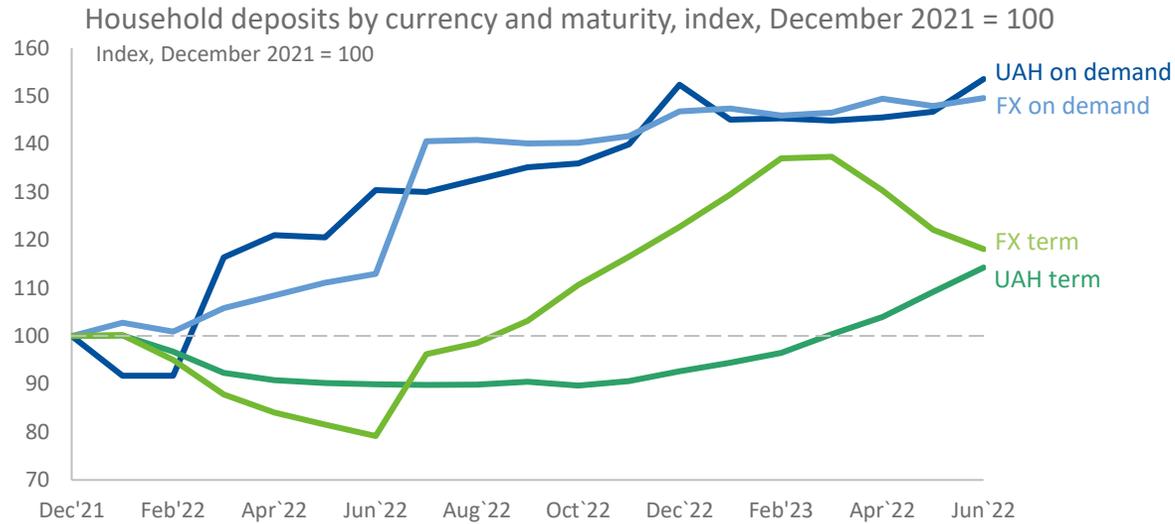


Source: State Statistics Service of Ukraine

- According to the State Statistics Service, inflation in July was -0.6% m-o-m, meaning prices decreased compared to June. Since the beginning of the year, inflation has amounted to 4.0%.
- Food prices fell by 1.9% over the month. Prices for vegetables decreased the most (-18.2% m-o-m) and for eggs (-7.6% m-o-m).
- Transport prices rose the most over the month - by 2.7% — mostly due to the increase in fuel prices (7.3% m-o-m).
- Although inflation continues to slow down, the risk of pro-inflationary pressure is high in wartime conditions, in particular, due to the destruction of infrastructure.

BANKING SECTOR

Hryvnia loans and deposits are on the rise



- The volume of household deposits continues to increase, both for term and on-demand ones in hryvnia, due to the increase in interest rates.
- However, FX term deposits continue to decline due to hryvnia's strengthening, the spread narrowing between exchange rates, and the allocation of funds into hryvnia deposits.
- In June's Bank Lending Survey, banks noted increased demand for hryvnia retail loans and approved more hryvnia corporate loan applications, particularly for SMEs, a first since the war began.
- The main driver for lending is the Affordable Loans 5-7-9% program – the main recipients are agriculture and wholesale enterprises. It is 30% of the corporate loan portfolio.
- In mid-July, SENSE BANK JCS, a systematically important bank, was nationalized to stabilize the Ukrainian financial system and safeguard depositors' and creditors' interests. NBU also liquidated non-systemic JSCB CONCORD JSC for violating anti-financial crime laws.

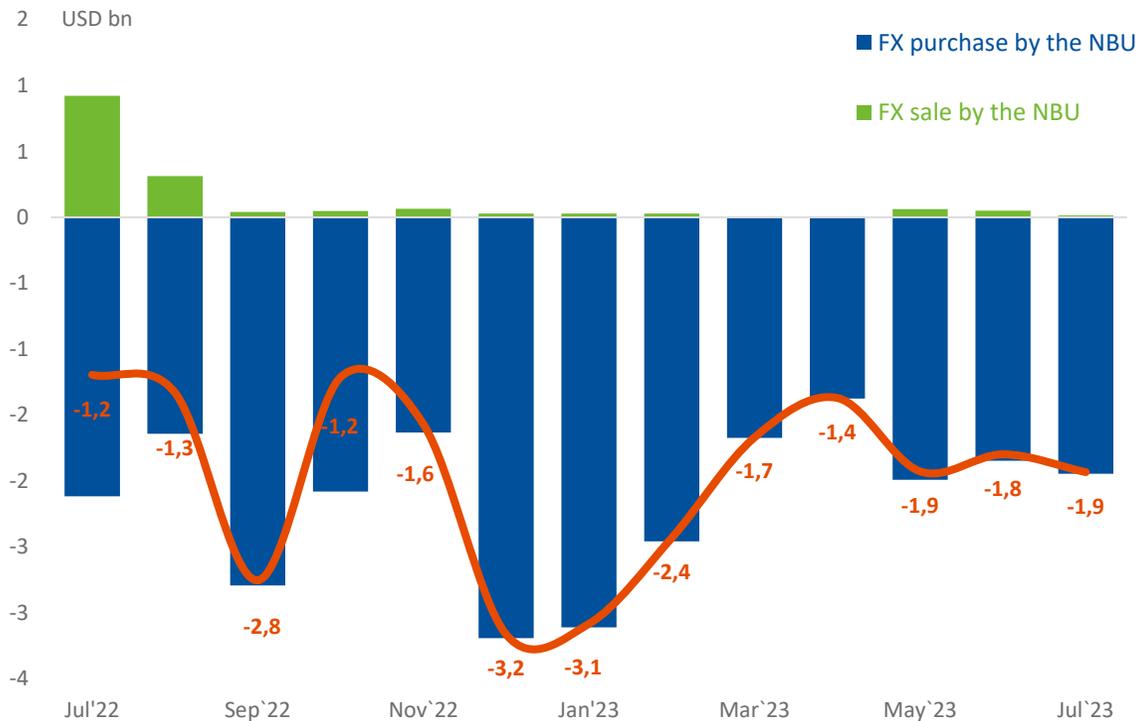
FX POLICY

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

There is still a need for significant FX sales by the NBU. **Ukraine's international reserves increased by 6,9% in July, reaching 41.7 USD bn – the highest level since Ukraine's independence.** They rose primarily due to sustainable and regular inflows from international partners, surpassing the NBU's net FX sales and Ukraine's FX debt repayments.

The official rate remains fixed at 36.57 UAH/USD. Cash market rate has been stable; 37.30–37.35 UAH/USD on June 15, 37.20–37.20 UAH/USD on July 15. The NBU has prepared the Strategy to gradually ease FX restrictions and return to inflation targeting with floating exchange regime. In the long-run, it will ensure the financial stability, as well as sustainable economic growth.

NBU foreign exchange interventions, USD bn



Source: NBU

Average daily official and market exchange rates UAH/USD



Source: NBU, Ministry of Finance

KEY MACROECONOMIC INDICATORS

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

	2023	2024	2025
Real GDP, change, %	2.9 (2.0)	3.5 (4.3)	6.8 (6.4)
Nominal GDP, UAH bn	6 525 (6 510)	7 620 (7 700)	8 830 (8 910)
CPI, y-o-y, % (eop)**	10.6 (14.8)	8.5 (9.6)	6.0 (6.0)
Core CPI, y-o-y, % (eop)**	8.7 (12.5)	7.0 (7.2)	2.8 (3.1)
Current account balance, USD bn	-11.0 (-13.5)	-17.2 (-10.6)	-16.1 (-7.7)
Gross reserves, USD bn	38.3 (34.5)	42.6 (36.1)	44.1 (37.1)

* in brackets – previous forecast (inflation report, April 2023)

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

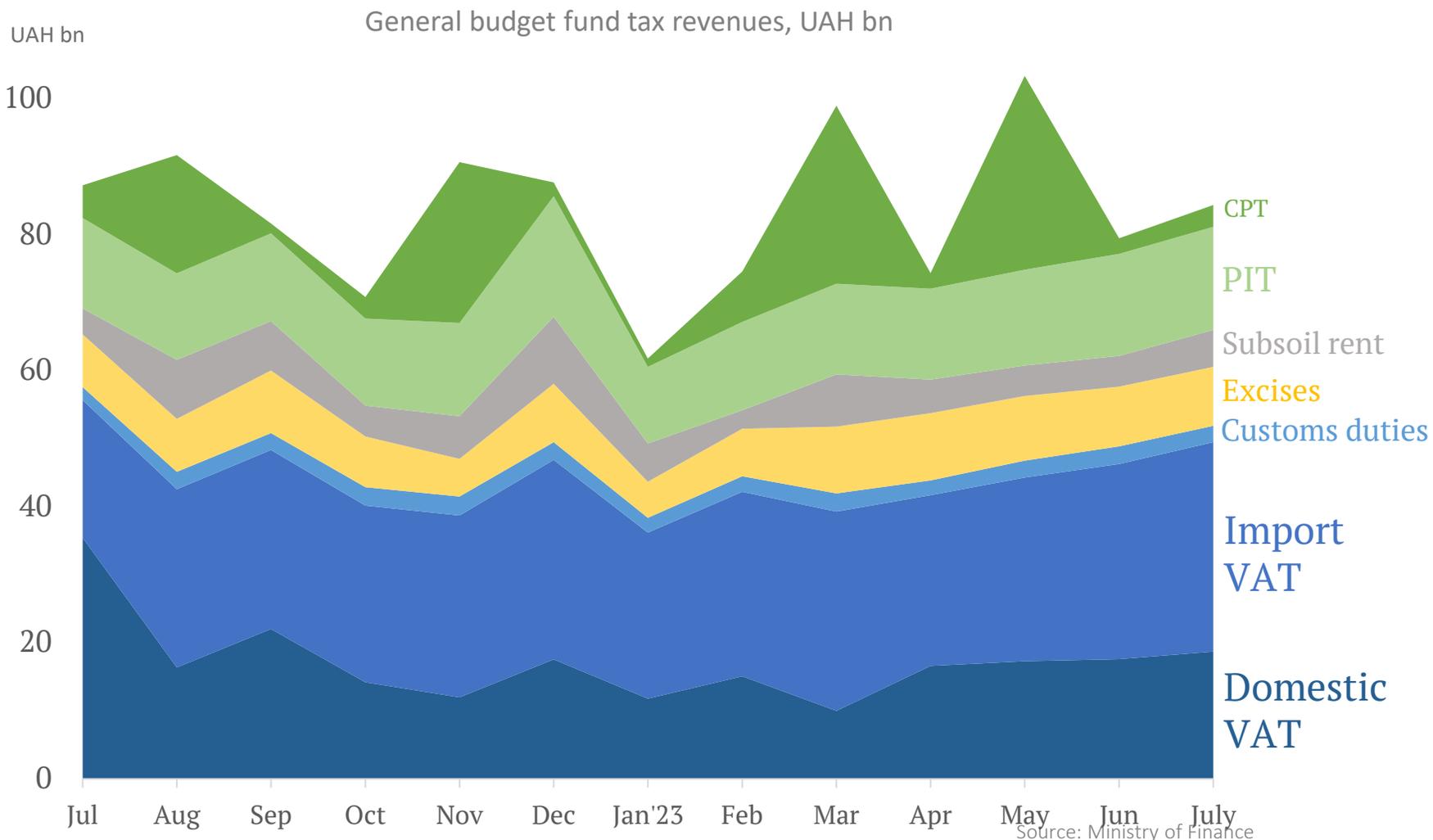
- Economic recovery will continue despite the challenges of the war. However, the economy will stay below its potential due to gradual labor market recovery, production capacity revival, and exporters' slow return to lost markets.
- Inflation will decline in the following years. In 2023, it will slow to 10.6% due to NBU's measures, frozen tariffs, and global price decline, though hindered by Kakhovka HPP destruction effects and fuel taxation changes. In 2024-2025, inflation will slow down due to better logistics and production recovery after security risks ease.
- External assistance will make it possible to finance large budget needs and maintain international reserves at a high level in 2023-2025.
- The NBU will continue reducing its key policy rate gradually to keep hryvnia instruments attractive. At the same time, monetary conditions will remain tight for a long time.



FISCAL SECTOR

FISCAL SECTOR

Tax revenues continue steady growth for another month, driven by VAT



Tax revenues in July brought UAH 84.4 bn.

That's a 6.2% MoM increase, driven by VAT, both domestic (+ UAH 1.1 bn) and imports (+ UAH 2.1 bn).

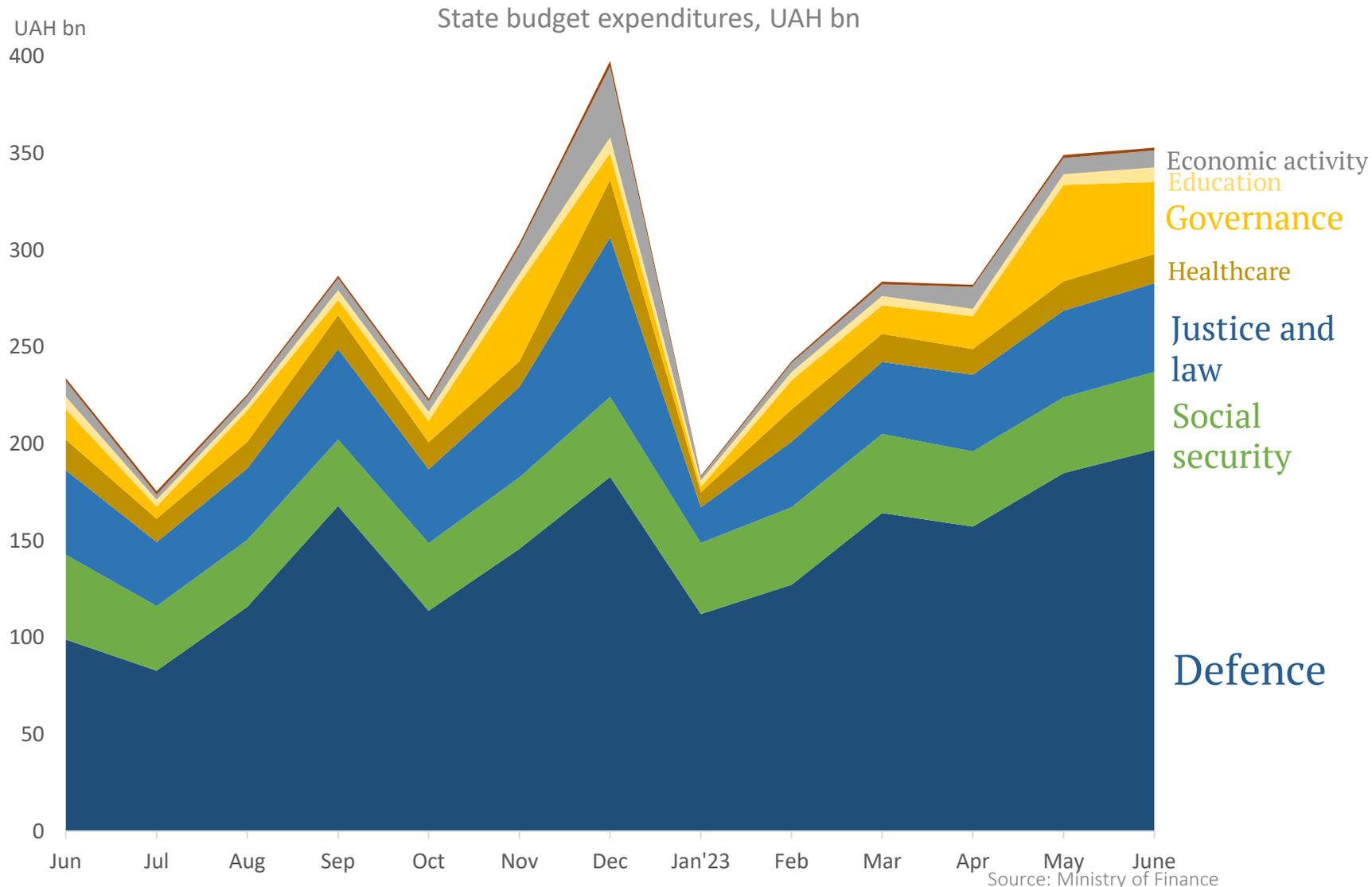
All indirect taxes (VAT+excises+duties) brought UAH 60.6 bn, the highest monthly figure this year, amounting for almost ¾ of all tax revenue.

For the 7 months of 2023 the State Tax Service has slightly outperformed the planned revenues (+2.8%), while Customs have collected 1.6% less than expected.

Note: the detailed breakdown by sources is not available as only preliminary June figures were released as of the current date

FISCAL SECTOR

State budget expenses stay level, while defense spending is record high



Monthly state budget expenses in June reached UAH 353 bn – the second largest monthly spending after Dec'22 (+1.1% MoM and +51% YoY).

Defence expenses in June exceeded UAH 197 bn, the largest nominal monthly expenditure in Ukrainian history.

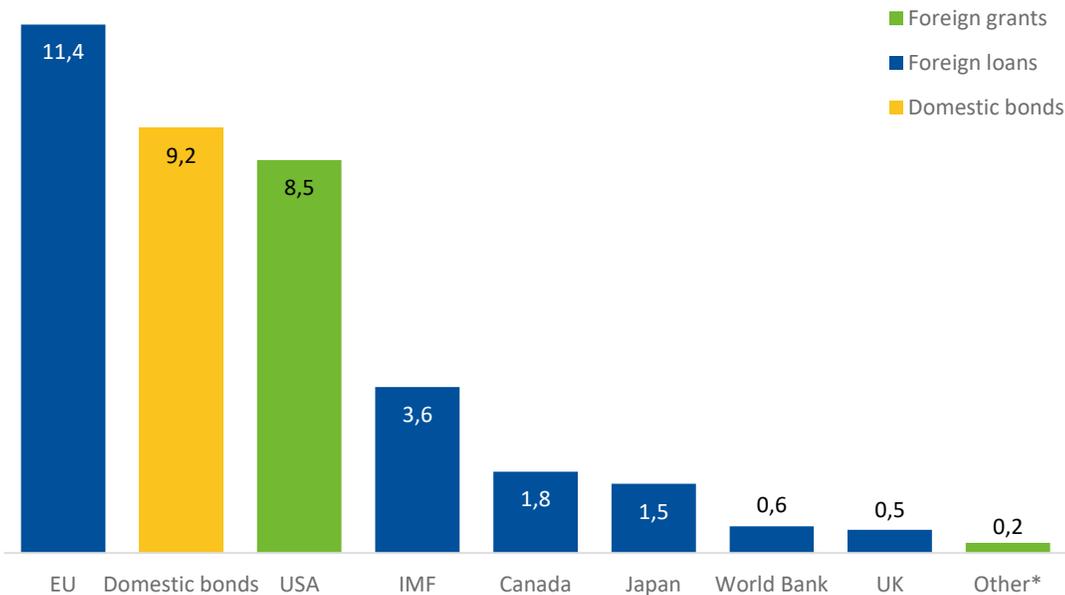
Spending on Governance decreased to UAH 37 bn, in line with debt service expenses. Other spending articles remained mainly on par.

FISCAL SECTOR

USD 5.3 bn of foreign financing in July

In July, Ukraine received a USD 1.67 bn loan from the EU and a USD 1.25 bn grant from the US. Additionally, Japan disbursed a USD 1.5 bn loan (USD 2 bn more to be disbursed). The IMF disbursed a second tranche of its loan of USD 890 m under the current EFF.

2023 additional financing of Ukraine's state budget as of August 7, USD bn



Germany, Spain, Finland, Ireland, Switzerland, Belgium, Iceland, Estonia*
Source: Ministry of Finance

In the first 7 months of 2023, Ukraine's state budget deficit and debt repayment needs amounted to USD 32.1 bn while the foreign financing amounted to USD 29 bn. There has been no monetary financing. The financing gap (the difference between pledges and budget needs) now stands at USD 8 bn and should be covered mostly with additional issues of domestic bonds.

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

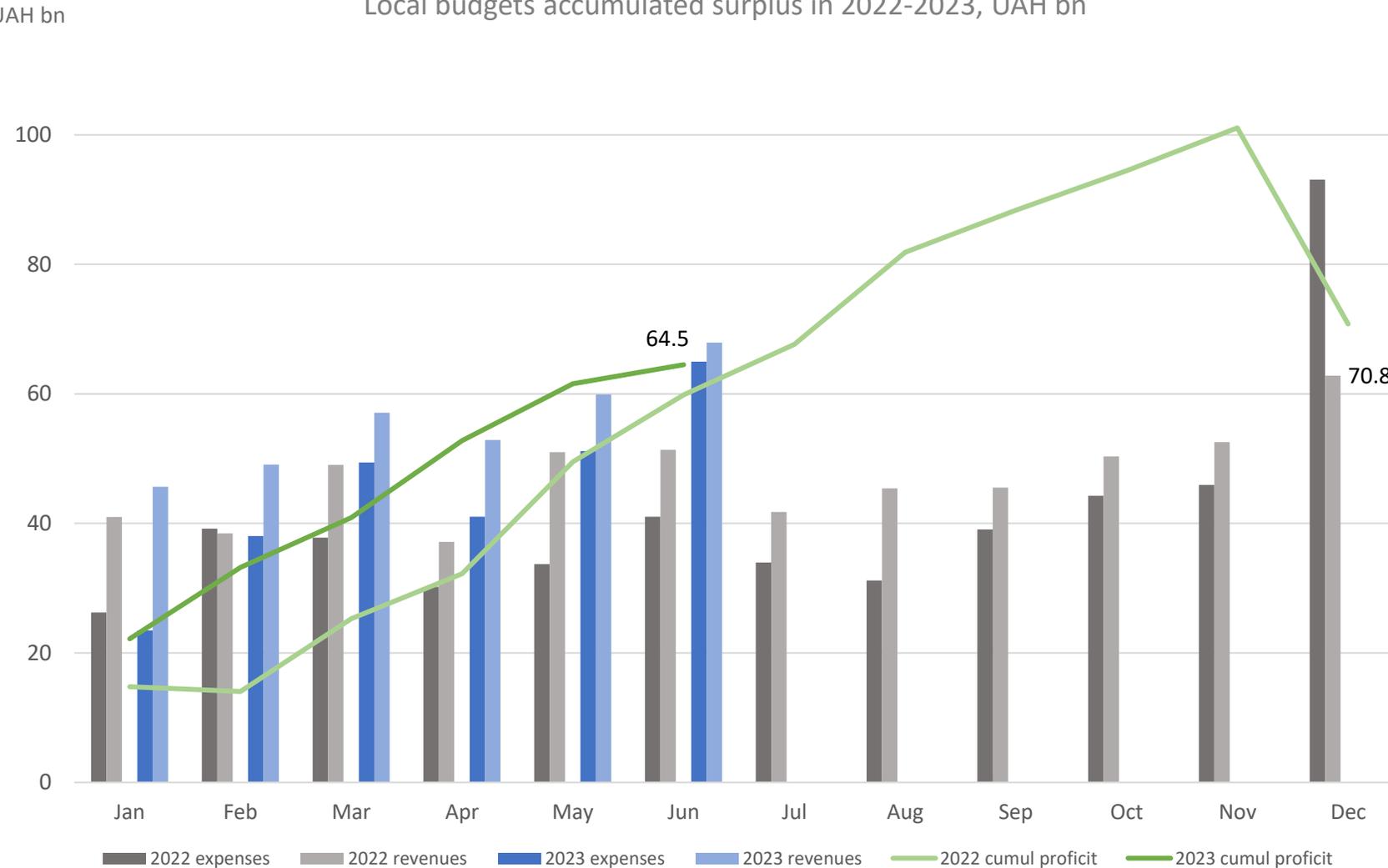


Source: Ministry of Finance, NBU, CES calculations 22

FISCAL SECTOR

Local budget surplus exceeds 2022, slowed in June

Local budgets accumulated surplus in 2022-2023, UAH bn

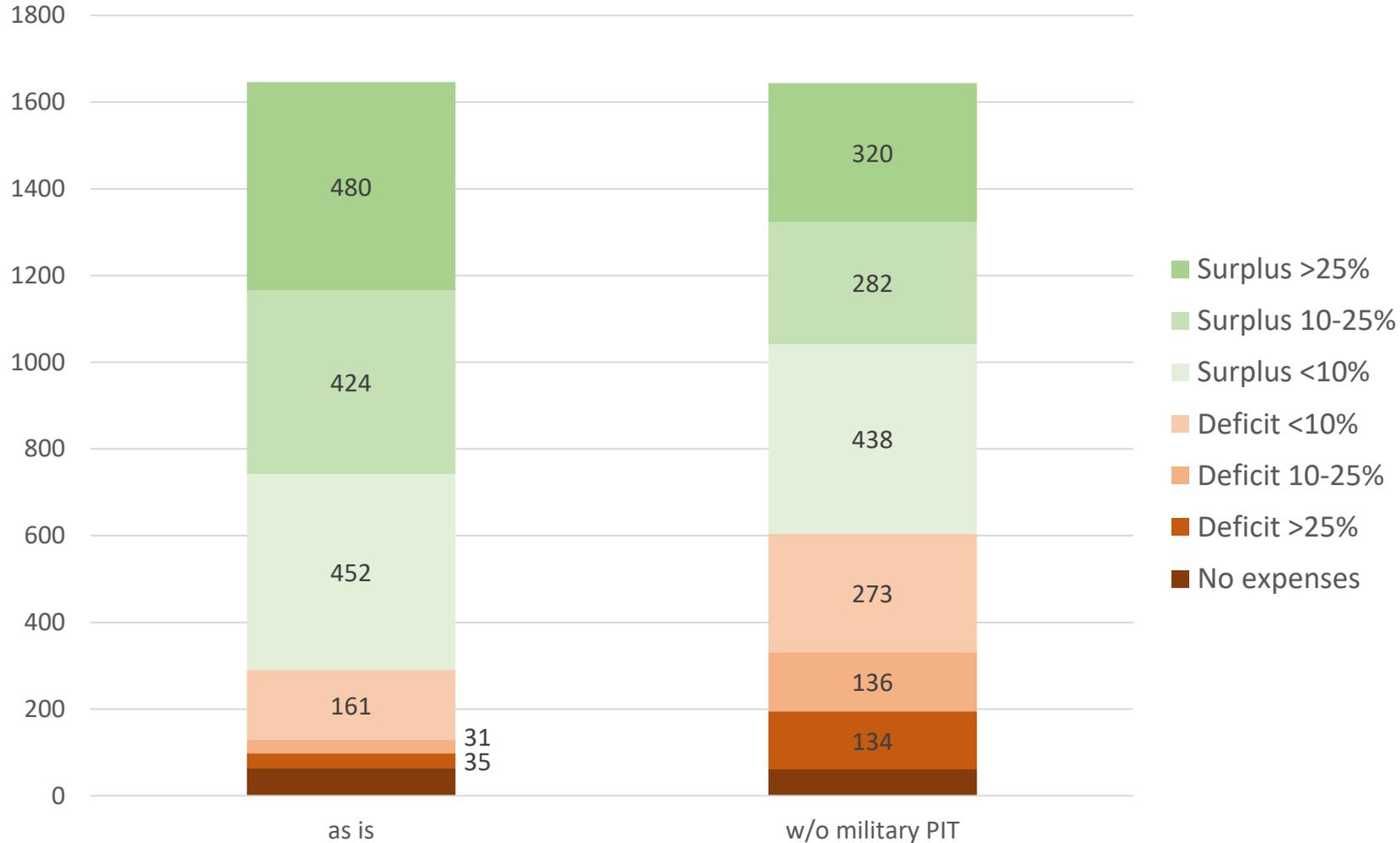


The local budgets surplus was growing fast in first 5 months of 2023, but slowed due to sharp increase in expenses in June

FISCAL SECTOR

1356 out of 1646 local budgets are in surplus

Number of local budgets with surplus/deficit, 6m 2023



The balance of budgets differs significantly across the country.

As does their dependence on “military” PIT, which contributed over UAH 50 bn on 6m 2023.

In scenario where the local budgets do not receive the “military” PIT, number of budgets in deficit would increase from 227 to 543, including 270 with the deficit of more than 10%.

FISCAL SECTOR

Top 10 local budgets by surplus

Top 10 local budgets by surplus, 6m 2023, UAH mln

	Revenues	Expenses	Surplus	Balance w/o mil PIT
Kyiv city	39 621	26 192	13 429	10 558
Kharkiv city	8 517	6 701	1 816	-146
Mariupol' city	2 080	375	1 705	1 349
Odesa city	6 698	5 095	1 603	924
Dnipro city	10 871	9 576	1 295	-207
Lviv City	7 811	6 588	1 223	335
Odesa oblast'	3 071	1 923	1 147	563
Kharkiv oblast'	3 571	2 589	982	381
Donets'k oblast'	2 425	1 494	931	282
Mykolayiv city	3 131	2 254	877	-364

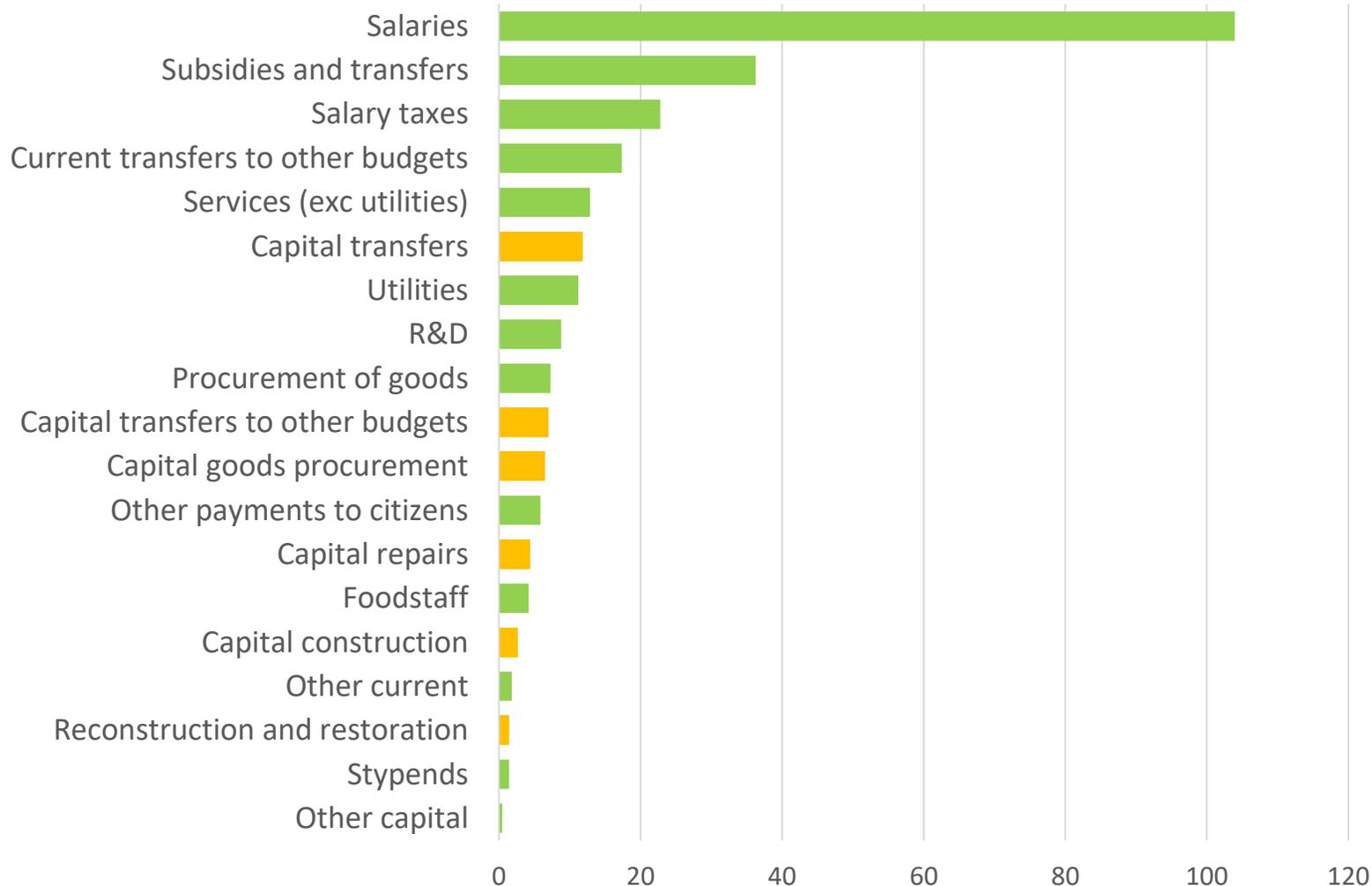
Top 10 surplus budgets account for almost 39% of total accumulated surplus for 6m 2023.

Three of them would become deficit budgets without the “military” PIT.

FISCAL SECTOR

Less than 13% of local budget expenses are capital

Expense structure by type, 6m 2023, UAH bn

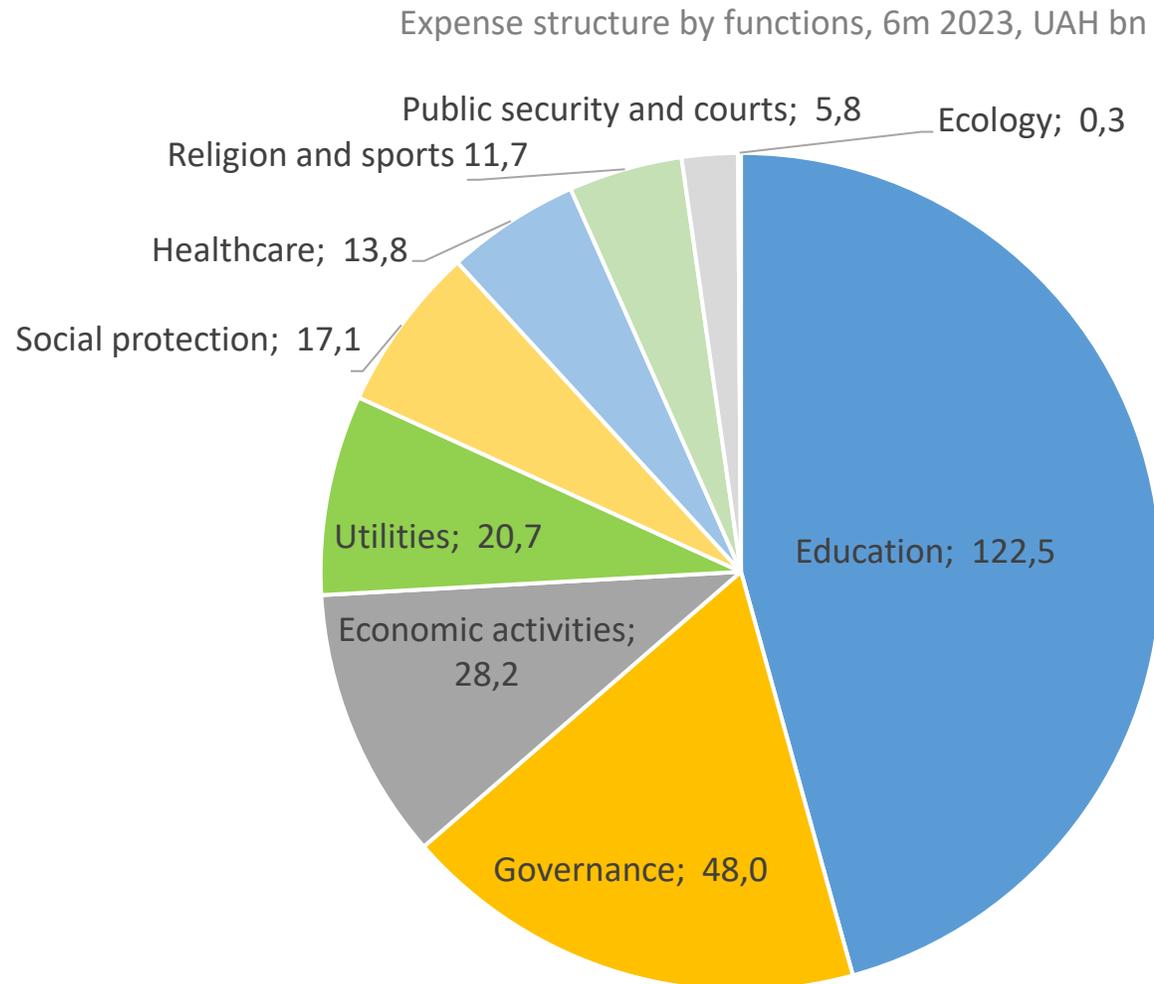


Less than 13% of local budget expenditure is capital.

Most expenses go to salaries, subsidies, utilities and services procurement.

FISCAL SECTOR

45.5% of local budgets is spent on education





THANK YOU.

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