CENTRE FOR ECONOMIC STRATEGY

GET German Economic Team

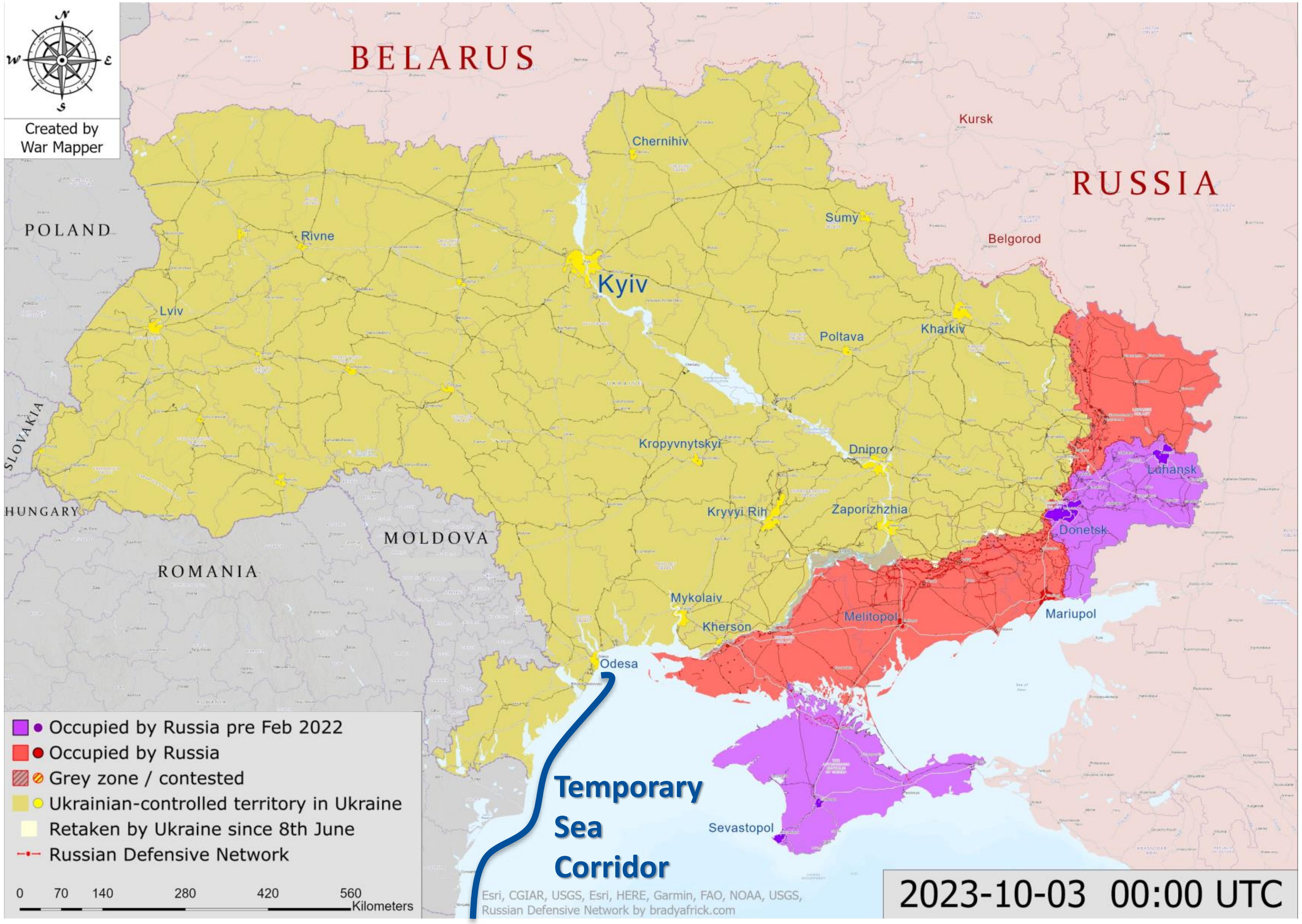
Economy review in October.

Special topic: Ukraine’s state budget 2024

Date: 13/10/2023
Author: CES Team

WAR

WAR UPDATE



- In September, Ukrainian counteroffensive operations continued, with limited progress near Robotyne and Bakhmut.
- On September 21, the Russian army resumed its attacks on Ukraine's energy infrastructure. Ukraine has been preparing for them since last spring.
- The temporary sea corridor, introduced by Ukraine to renew maritime access to Odesa ports, has been used by more and more vessels both arriving to and departing from Ukrainian ports.

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MACROECONOMIC TRENDS

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GDP growth 19.5% y-o-y in Q2 2023

Sources: State Statistics Service of Ukraine, NBU

- In the second quarter of 2023, GDP grew by 19.5% y-o-y — a first increase during the full-scale war.
- While such growth is a consequence of a low base, it is nevertheless a positive indicator of recovery of economic activity.
- GDP growth in Q2 2023 exceeded NBU expectations, which forecasted the growth to be 18.1%.
- Ukraine's GDP is expected to increase by 2.9% in 2023 (NBU forecast).

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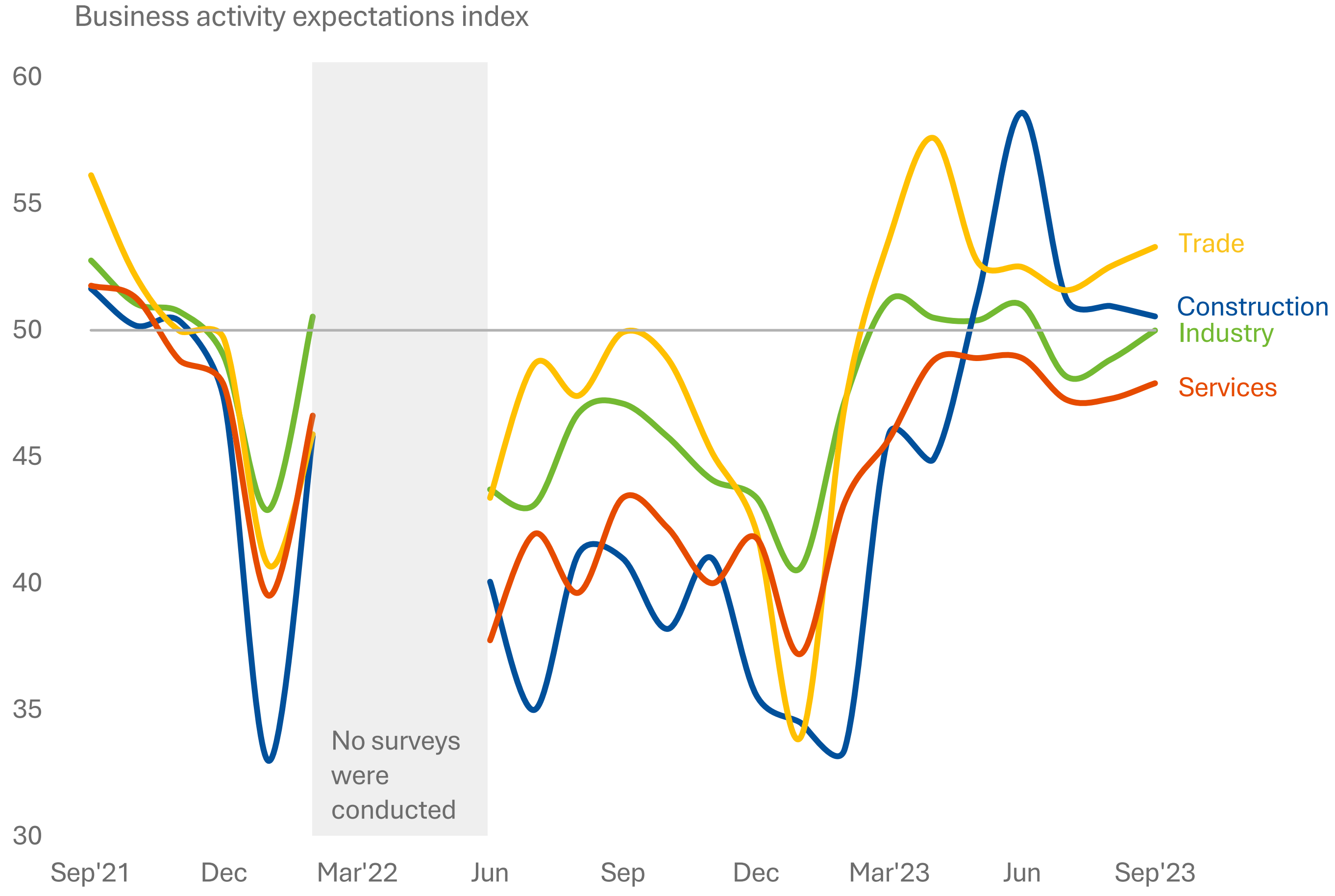
Business expectations were positive in September



Source: NBU

- In September, the NBU's index of business expectations rose to 50.1, up from 49.3 in August, exceeding the neutral level of 50 points.
- Only the expectations of service providers are negative (47.9).
- Construction companies outlook slightly decreased, while trade and industry companies improved their expectations.
- Production rates recovery, new supply chains, decline in costs growth among main factors contributing to the improvement.

SECTORAL ANALYSIS

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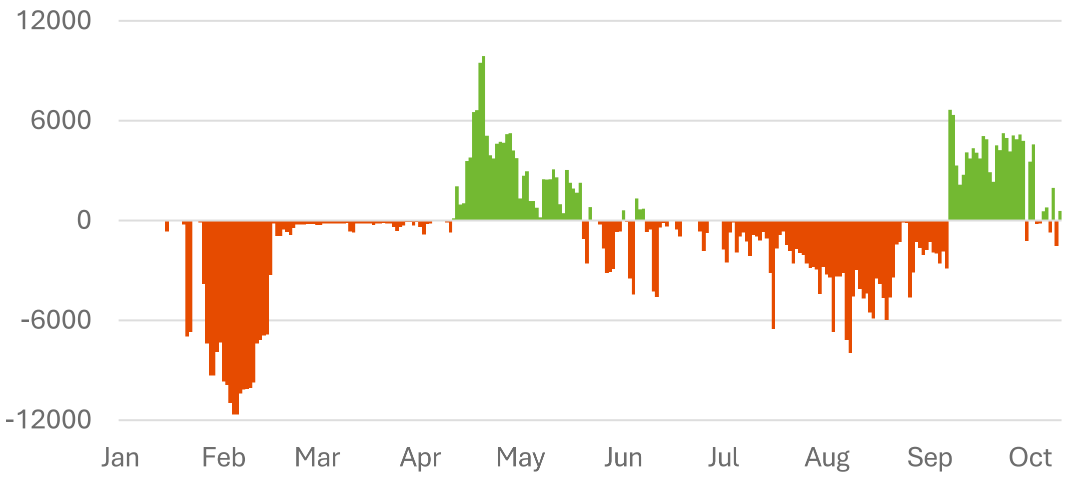
Last preparations for the winter season are underway in the energy sector

- Commercial electricity exports were consistently high in September, with almost 110 thousand MWh exported. Electricity imports amounted to 24 thousand MWh in September
- Exports decreased in October as there is more local need because of the lower temperatures.

Ukraine net electricity commercial exports in 2023, MWh



Source: ENTSO-E

- Winter preparations are underway, with different fuels being accumulated in storages, power plants out of scheduled repairs, and the grid being prepared for the Russian attacks.
- Ukraine has amassed 15.1 bn m^3 of natural gas in its underground storages, which is already more than 14.7 bn that are needed for the winter season.
- However, coal reserves were insufficient as of end-September: out of 1.8 million t needed only 1.3 m t were amassed. Power plants may resort to using more expensive natural gas if there is not enough coal.

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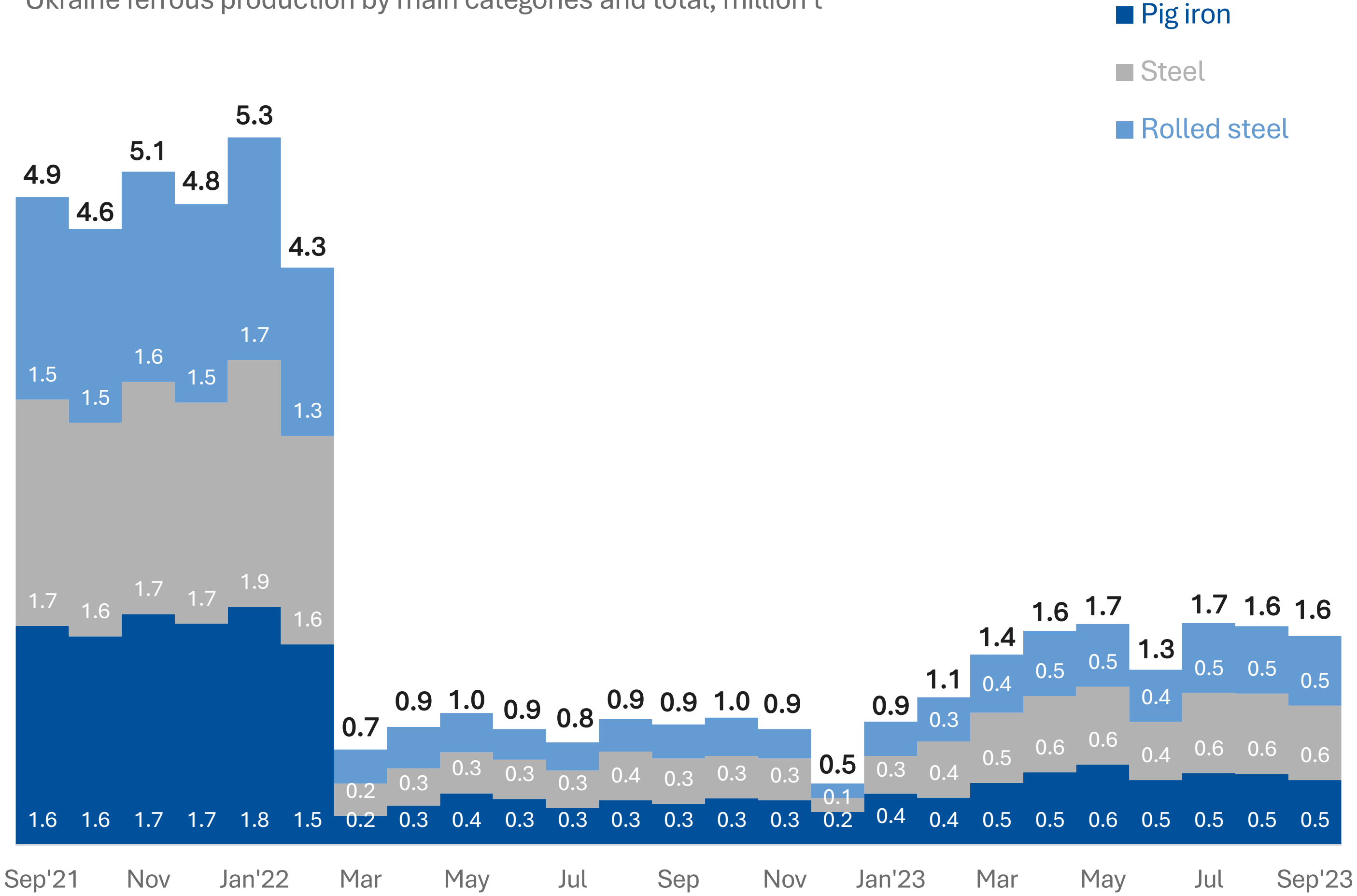
Ferrous production decreased in September

Ukraine ferrous production by main categories and total, million t



Source: Ukrmetalurgprom

- In September, the ferrous production further decreased by 4.5% compared to August.
- The metallurgy enterprises are in desperate need of improved logistics, with open Black Sea ports being the only feasible solution.
- The temporary sea corridor may give the industry a needed boost, but it is not yet clear whether there will be an opportunity for large-scale ferrous exports using it.

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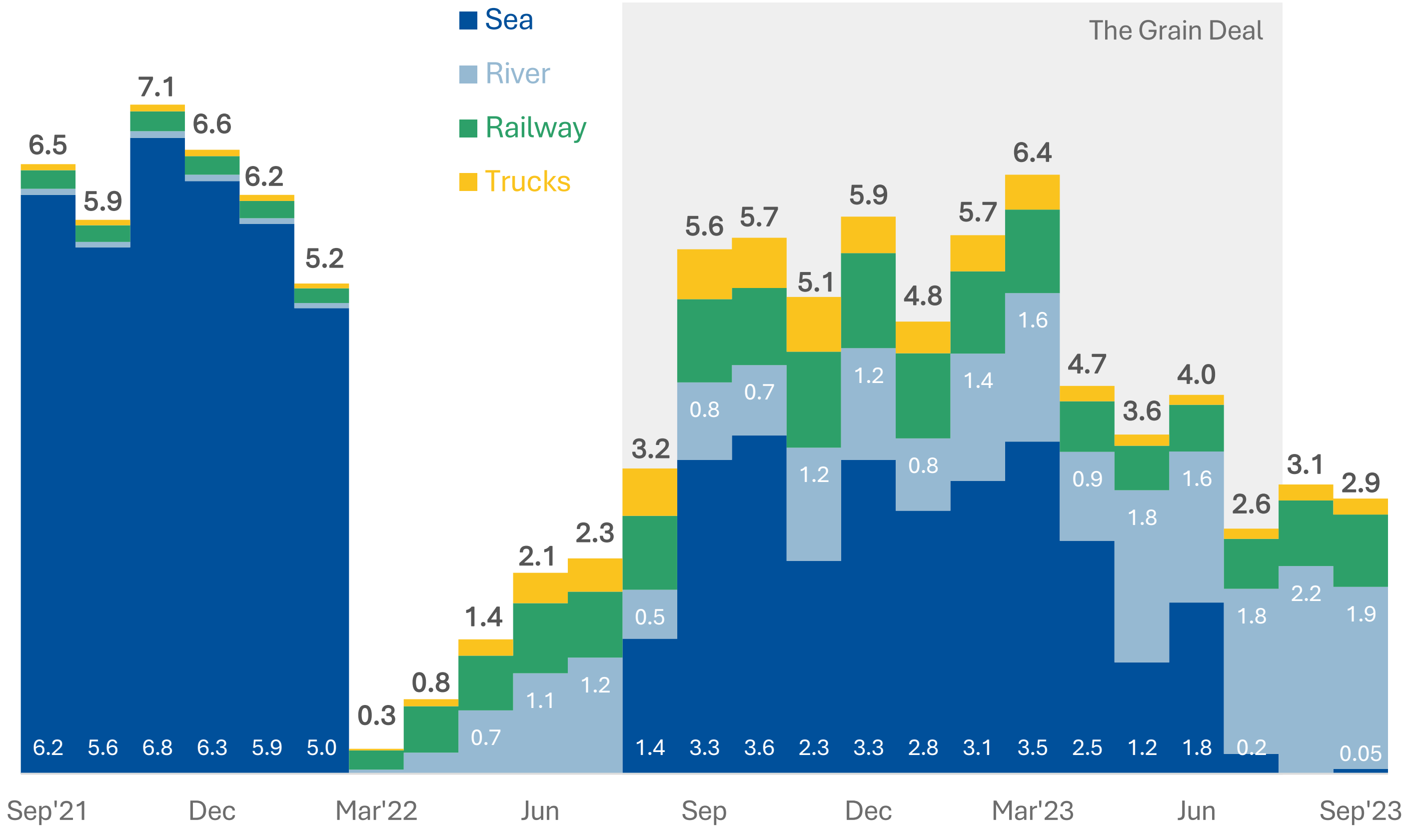
Temporary sea corridor is yet to show its full potential

Exports of grain and oilseeds by transport and total, million t



Sources: Ministry of Infrastructure, Ministry of Agriculture, State Custom Service, UN.
Created with Datawrapper

- The issue of logistics remains crucial for Ukraine's agriculture. The temporary sea corridor to Odesa ports, established without Russia nor the UN, has been successfully used for at least 17 outbound and 19 inbound voyages over the last two months.
- Danube ports are still under constant attacks by the Russian army, which hampers the goal of reaching 5 million t grain exports per month.
- Buckwheat yields are record-breaking this year, already reaching 0.17 million t even though the harvest is not over yet. The previous high was 0.15 m t in 2022.

Sources: Ministry of Agriculture, State Custom Service, UN

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MONETARY AND FX POLICY

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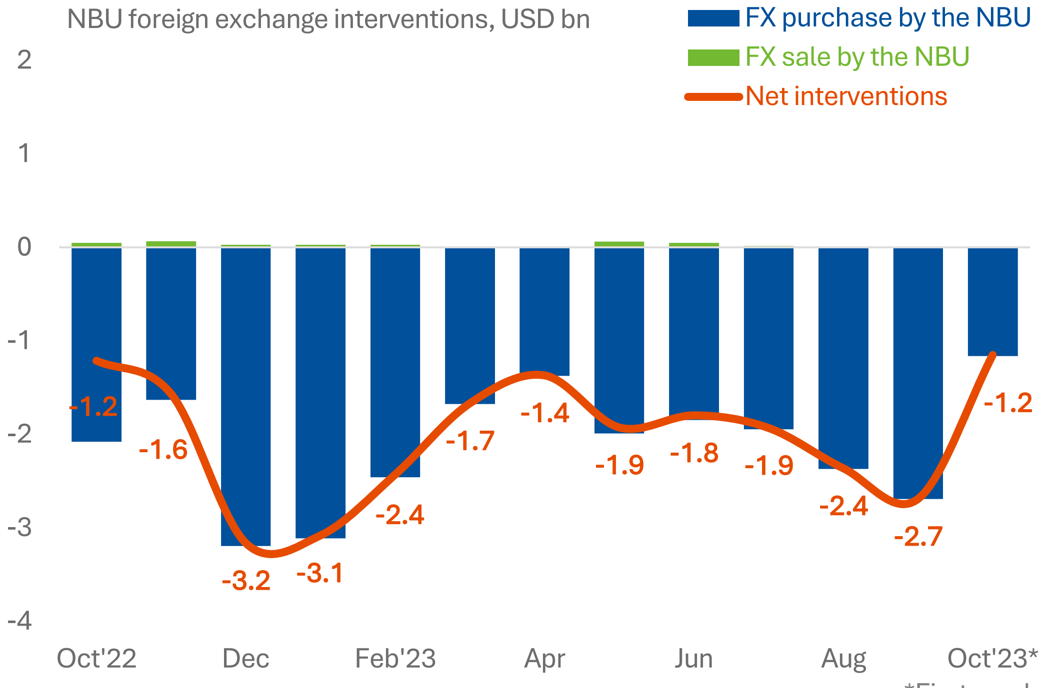
NBU moves to managed flexibility of exchange rate

There is still a need for significant FX sales by the NBU. **Ukraine's international reserves declined by 1.7% m-o-m in September, reaching 39.7 USD bn.** It happened due to the NBU's FX sales to balance Ukraine's FX market, partly compensated by international aid inflows.

The NBU has moved to a regime of managed exchange rate flexibility with the intention of keeping the rate fluctuations minimal. The cash market rate continued to devalue: 37.00–37.65 UAH/USD on August 15 and 37.75-38.40 UAH/USD on September 15.

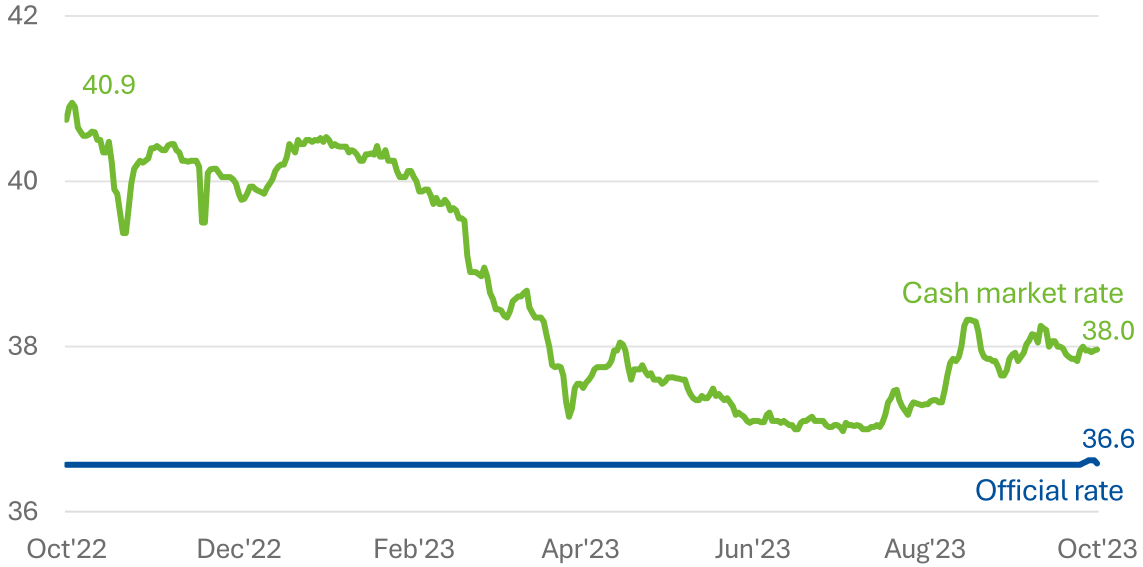
NBU foreign exchange interventions, USD bn



*First week

Source: NBU

Average daily official and market exchange rates UAH/USD



Sources: NBU, Ministry of Finance

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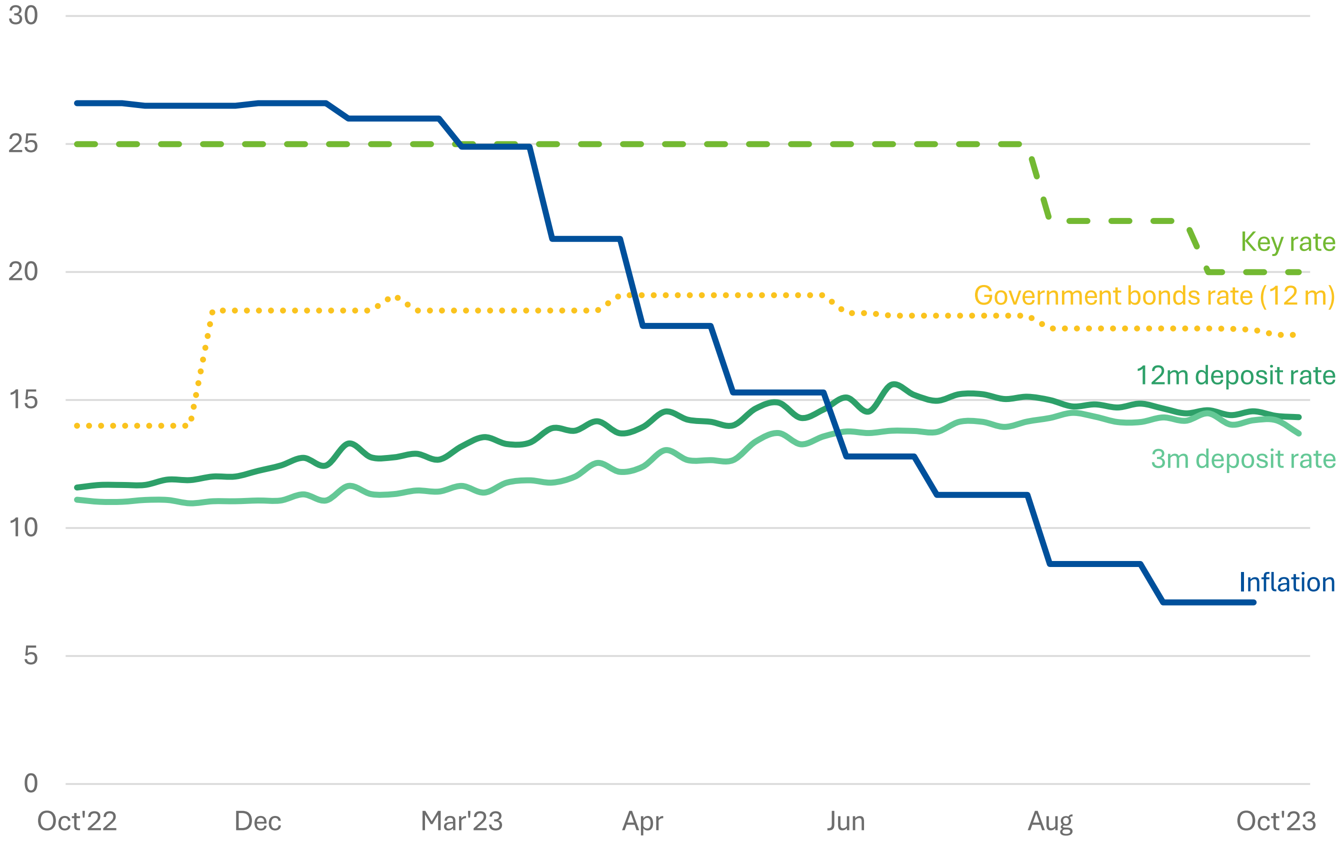
NBU cuts key policy rate to 20%; inflation continues to decelerate

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



Sources: NBU, State Statistics Service, UIRD

- Following the recent monetary policy meeting of the NBU Board, the key policy rate has been reduced to 20%. The further pullback and the NBU's ability to ensure FX market sustainability allowed it to continue the cycle of key policy rate cuts while maintaining sufficient attractiveness of hryvnia savings.

- The yield of one-year hryvnia war bonds gradually declined to 17.6%. At the end of September, average rates on retail remained quite the same for 3-month deposits (14.2%) and 12-month retail deposits (14.4%).

- In September, inflation declined, and the growth in consumer prices decelerated to 7.1% y-o-y. While in monthly terms, prices increased by 0.5%.

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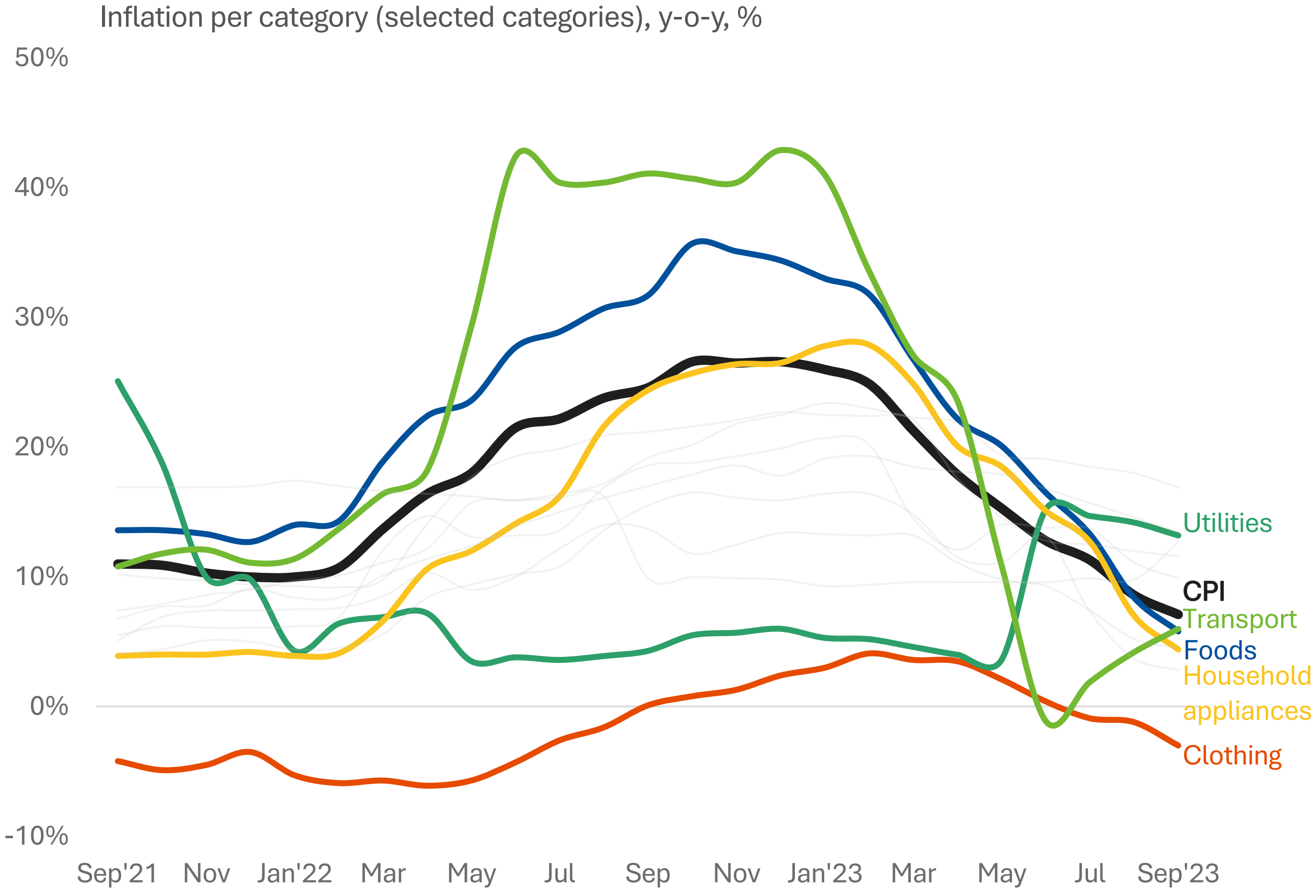
Inflation slows down; CPI 7.1% y-o-y in September



Source: State Statistics Service of Ukraine

- According to the State Statistics Service, inflation in August was +0.5% compared to August. Since the beginning of the year, inflation has amounted to 3%.
- The price of food products fell by 0.5% over the month — primarily due to the decrease in the price of vegetables (-9.7% m-o-m).
- Education (+9.9% m-o-m) and clothing and footwear (+7.8% m-o-m) rose in price the most. However, prices for the last category in September were lower than at the beginning of the year by 0.7%.
- The faster-than-expected slowdown in inflation was primarily due to a higher supply of food products, including fresh vegetables and fruits from the new harvest and better yields of cereals and oilseeds, partly attributed to their quicker harvesting.

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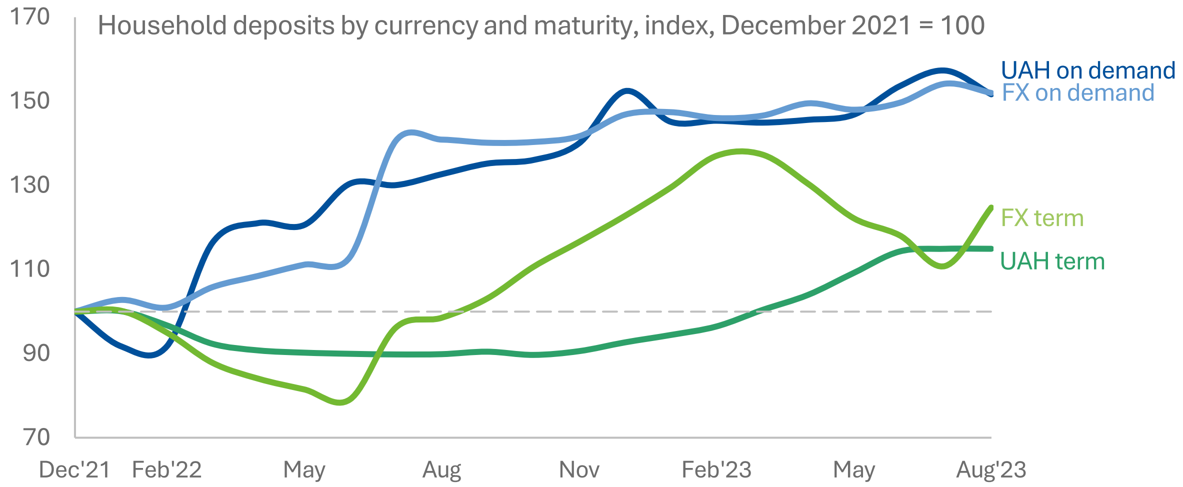
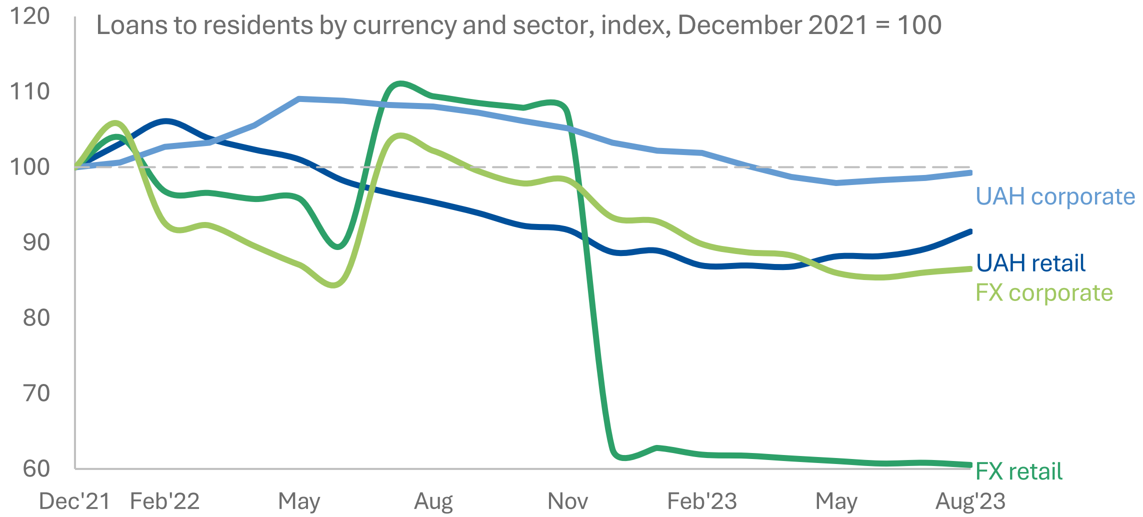
Hryvnia loans and FX-term deposits are on the rise





Source: NBU

- The volume of household deposits has remained the same for UAH term deposits and decreased for on-demand ones. On the other hand, FX term deposits demonstrated growth for the first time since March 2023. Such reorientation might relate to the devaluation of hryvnia in August.
- All types of loans, except FX retail loans, have gradually increased in volume. Most of the lending still occurs under the Affordable Loans 5–7–9% program, primarily in agriculture and trade. Loans granted within this program still compromise 1/3 of the hryvnia corporate loans' performing gross portfolio.
- The share of non-performing loans (NPL) in the banking sector as of September 1, 2023, was 38.5%, 0.8 p.p. lower than on August 1, 2023.

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STRATEGY

FISCAL SECTOR

FISCAL SECTOR

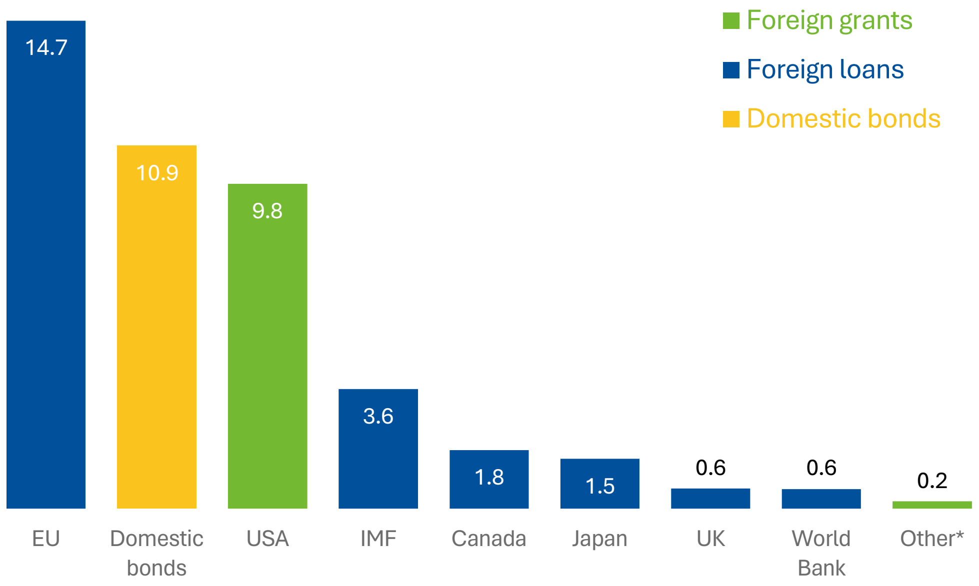
USD 2.9 bn of foreign financing in September

In September, Ukraine received a USD 1.6 bn loan from the EU, a USD 1.25 bn grant from the US, and a USD 100 million loan from the UK (channeled through the World Bank).

9 months 2023:

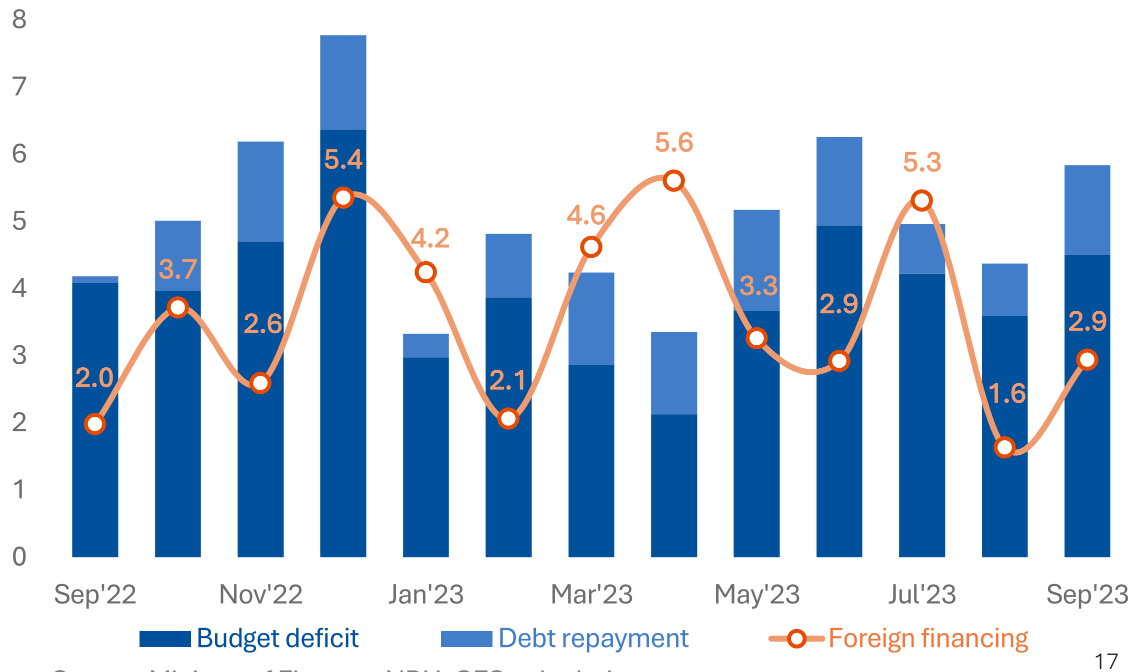
- State budget deficit, debt repayment needs: USD 42.4 bn
- Foreign financing disbursed so far: USD 32.6 bn
- No monetary financing
- Financing gap (pledges - budget needs) stands at USD 6.3 bn and will be covered mostly with additional issues of domestic bonds.

2023 additional financing of Ukraine's state budget as of September 28, USD bn



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

Foreign financing, state budget deficit and debt repayment, USD bn



Source: Ministry of Finance, NBU, CES calculations

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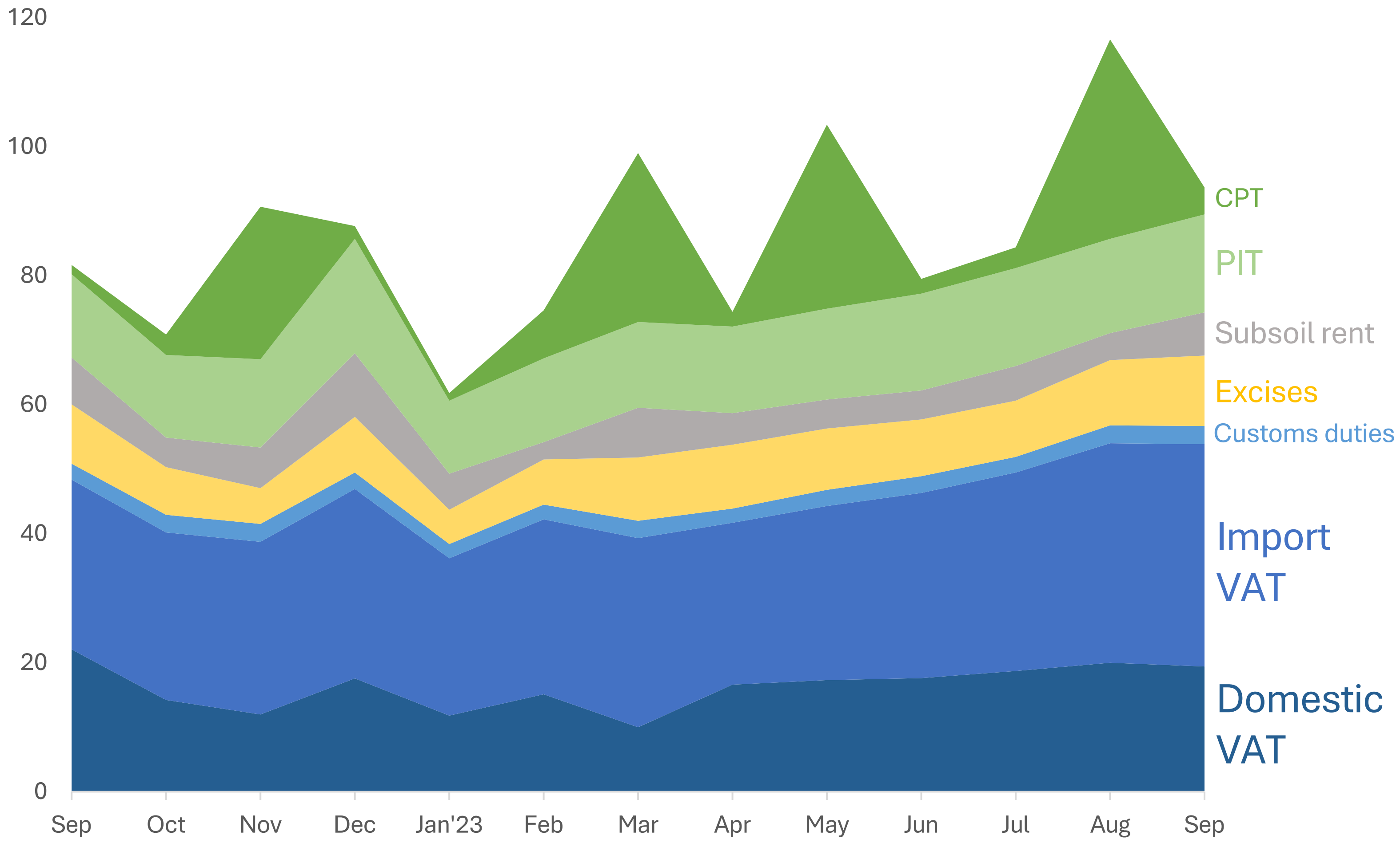
Tax revenues continue steady growth driven by excise, rent and PIT



Source: Ministry of Finance

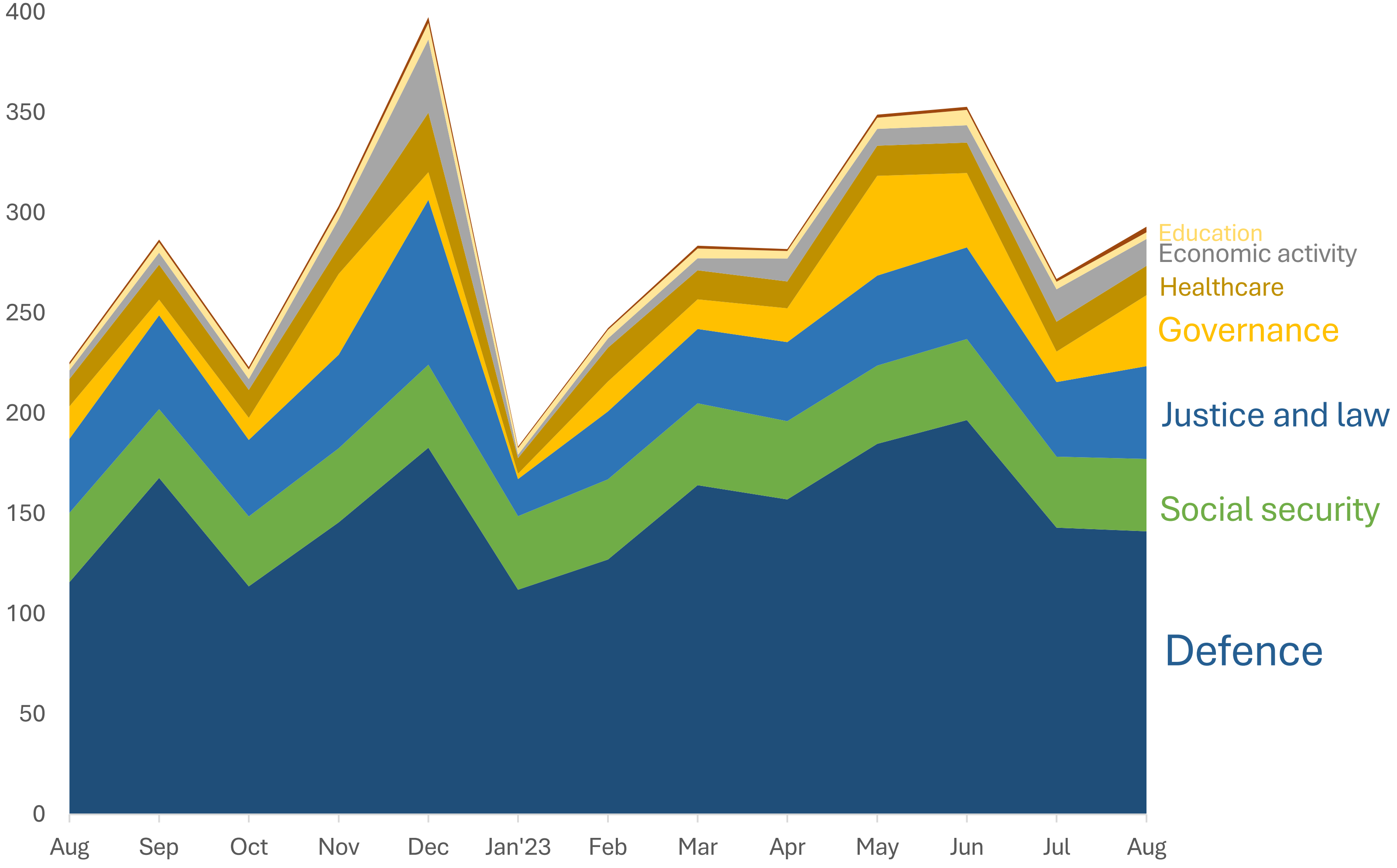
Tax revenues in September brought UAH 93.7 bn

- 14.7% increase vs Sep’22, beating the inflation (7.1% Sep’23 to Sep’22)
- The growth was supported by excise, subsoil rent and PIT revenues

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

FISCAL SECTOR

Defence spending leveled in August



Source: Ministry of Finance

- Monthly defense spending (UAH 141 bn) is less than 50% of total spending first time this year
- Since the beginning of the year defence accounts for 52% of state expenditure, or over a quarter of state GDP (est)
- Governance spending (UAH 52 bn) consisted of UAH 31.6 bn of debt service expenses (20.5 bn – internal, 11.1 bn – external) and UAH 16.6 bn of transfers to the local budgets

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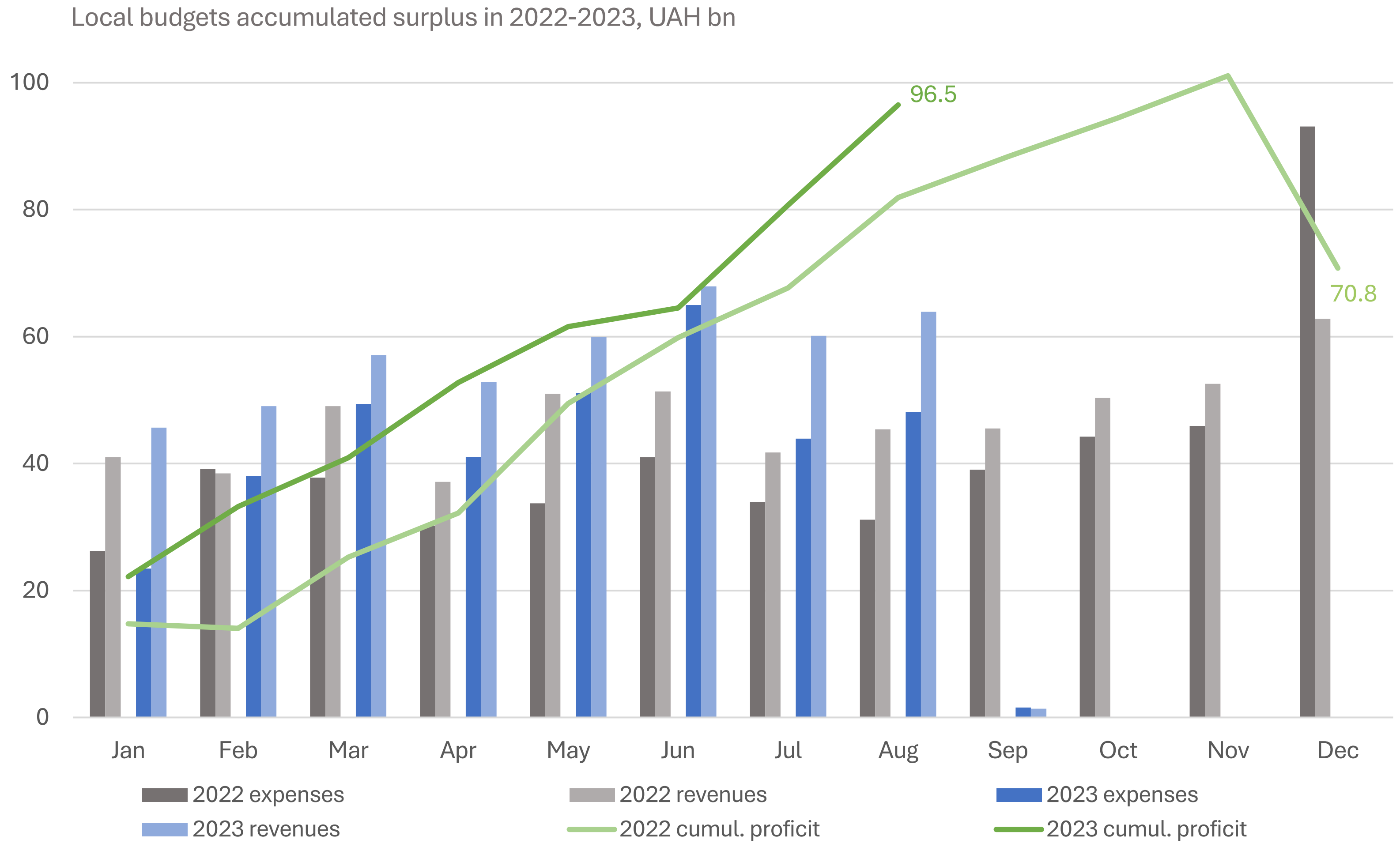
Local budgets surplus continues to be larger than in 2022



Source: Ministry of Finance, CES calculations

- August local budgets **revenues** increased to **UAH 63.9 bn**, 41% more than in Aug 22, of which 29.2 bn – local share of PIT and CPT, 11.6 bn – local taxes and fees, 19.3 bn – transfers from the state budget.
- The increase m-o-m was due to share of corporate tax revenues, paid quarterly (UAH 3.2bn) and higher transfers from the state budget (UAH 19.3 bn)
- **Expenses** reached **UAH 48.1 bn**, 54% more than in 2022.
- This brought the **accumulated surplus** of local budgets in 2023 to **UAH 96.5 bn**.
- Accumulated PIT revenues from military salaries for 8m2023 reached UAH 67.8 bn

STATE BUDGET 2024

STATE BUDGET 2024

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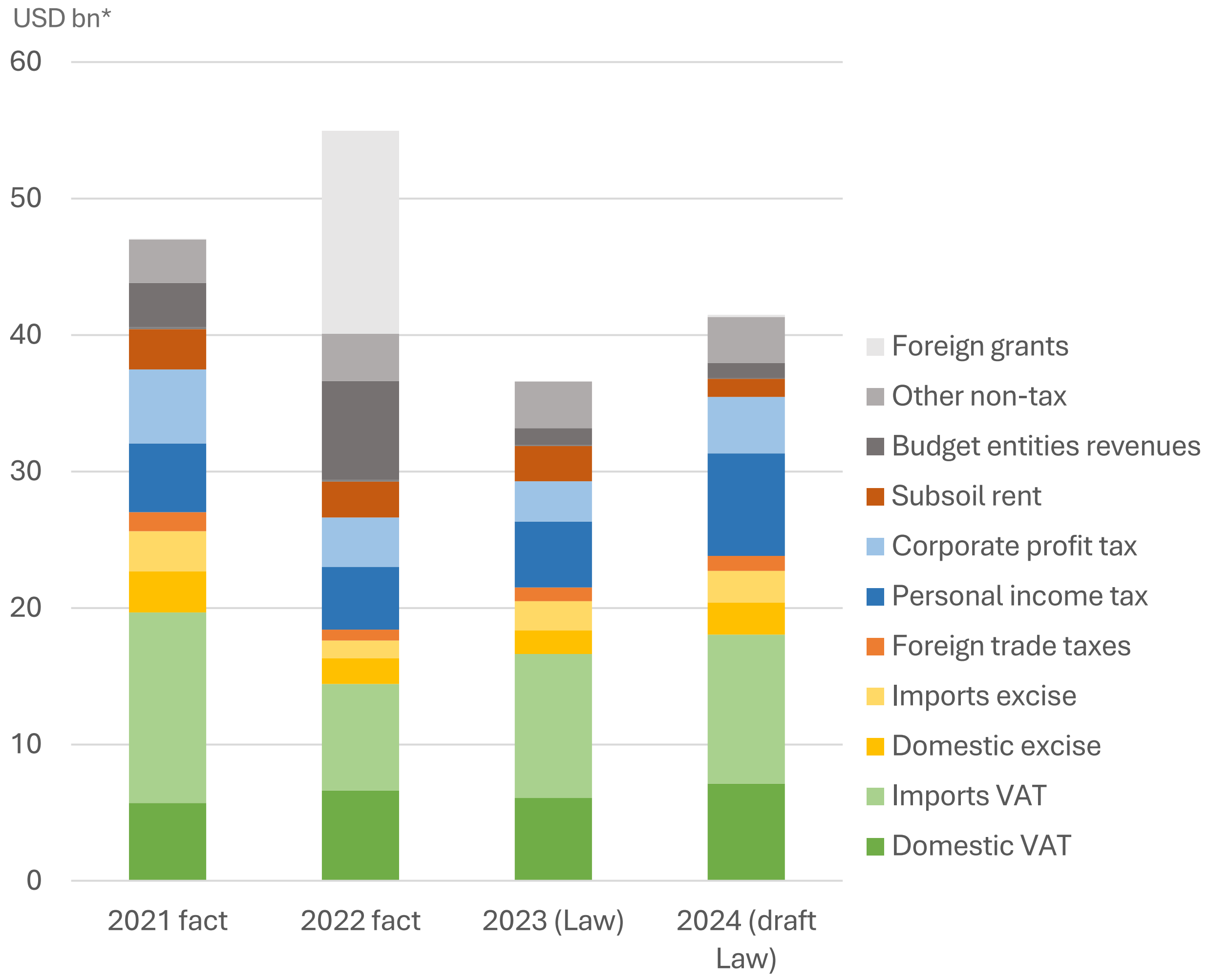
Own revenues expected to increase in real terms



- The 2024 budget revenues are expected to increase by over 26% in nominal terms, with VAT and PIT as main drivers.
- In USD the projected budget remains 12% below 2021 revenues.
- Budget doesn't account for foreign grants and will likely significantly understate the actual budget entities revenues due to defence transfers.

*here and further on in this document at the FX rate as implicitly projected by the IMF under the 1st review
Source: Draft State Budget Law for 2024

STATE BUDGET 2024

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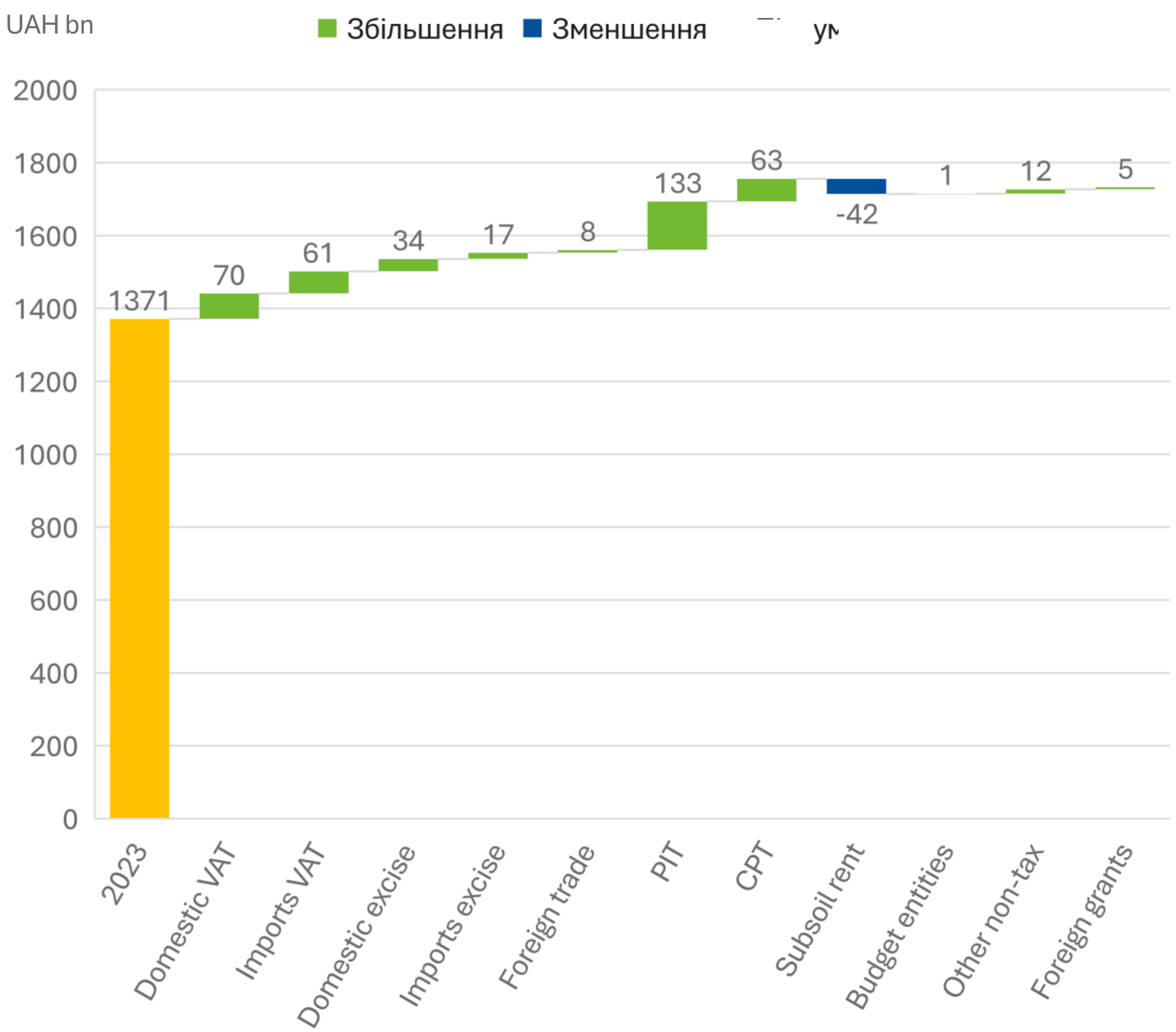
Changes in revenues



	2021 fact	2022 fact	2023 8m fact	2023 (Law)	2024 (draft Law)	Change
Tax revenues	**1 107**	**950**	**743**	**1 196**	**1 538**	**28,6%**
% of GDP	*20,3%*	*18,3%*		*18,4%*	*19,9%*	*8,4%*
Personal income tax	138	148	110	180	313	73,6%
Corporate profit tax	148	117	102	111	174	56,7%
Subsoil rent	81	85	42	97	55	-43,5%
Domestic excise	83	61	58	64	99	53,5%
Imports excise	80	42	49	80	96	20,7%
Domestic VAT	156	214	127	228	298	30,8%
Imports VAT	381	253	226	395	456	15,3%
Foreign trade tax	38	26	26	38	46	20,4%
Other tax	4	3	3	3	2	-19,9%
Budget entities	88	235	413	46	47	3,0%
Other non-tax	87	111	118	128	140	9,4%
Foreign grants	1	481	317	1	6	462,4%
Total	**1 284**	**1 778**	**1 631**	**1 371**	**1 732**	**26,3%**
% of GDP	*23,6%*	*34,3%*		*21,1%*	*22,5%*	

STATE BUDGET 2024

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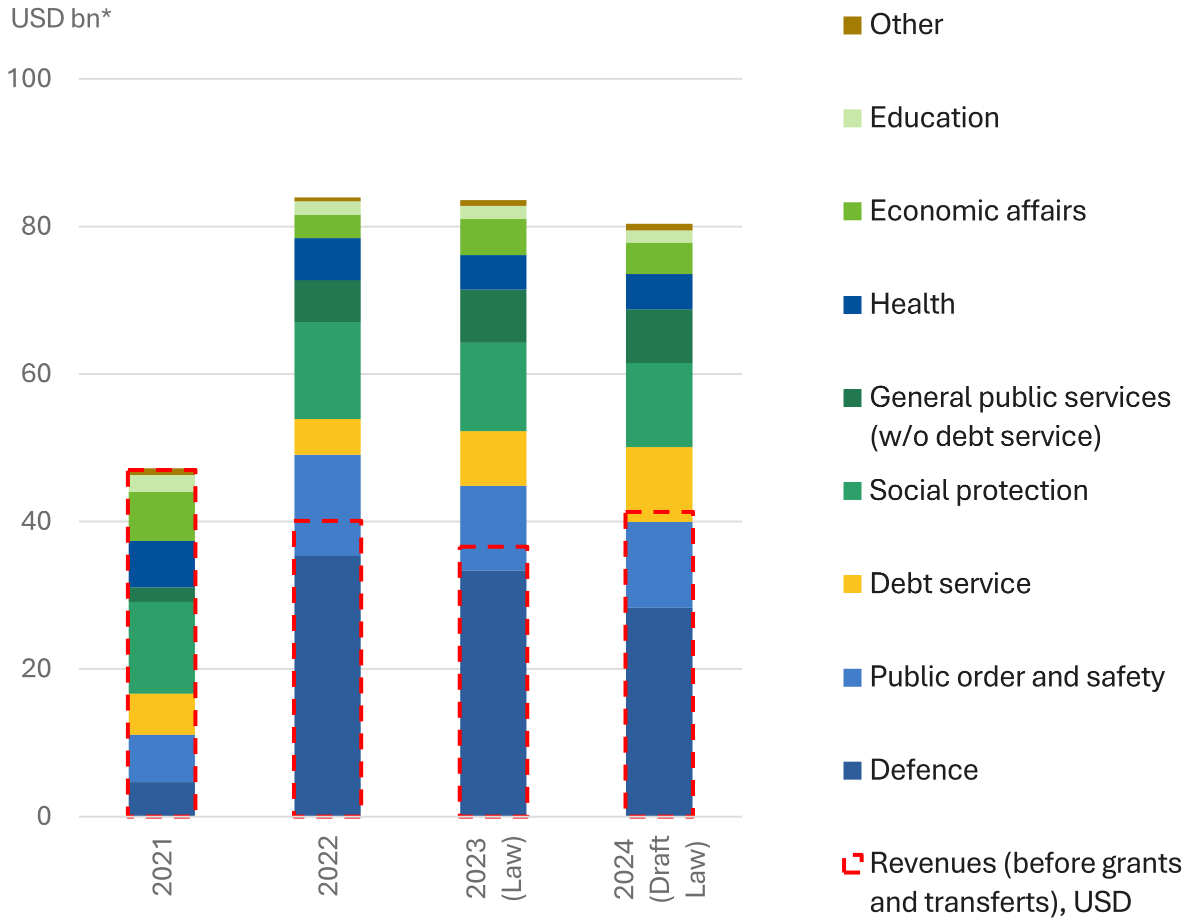
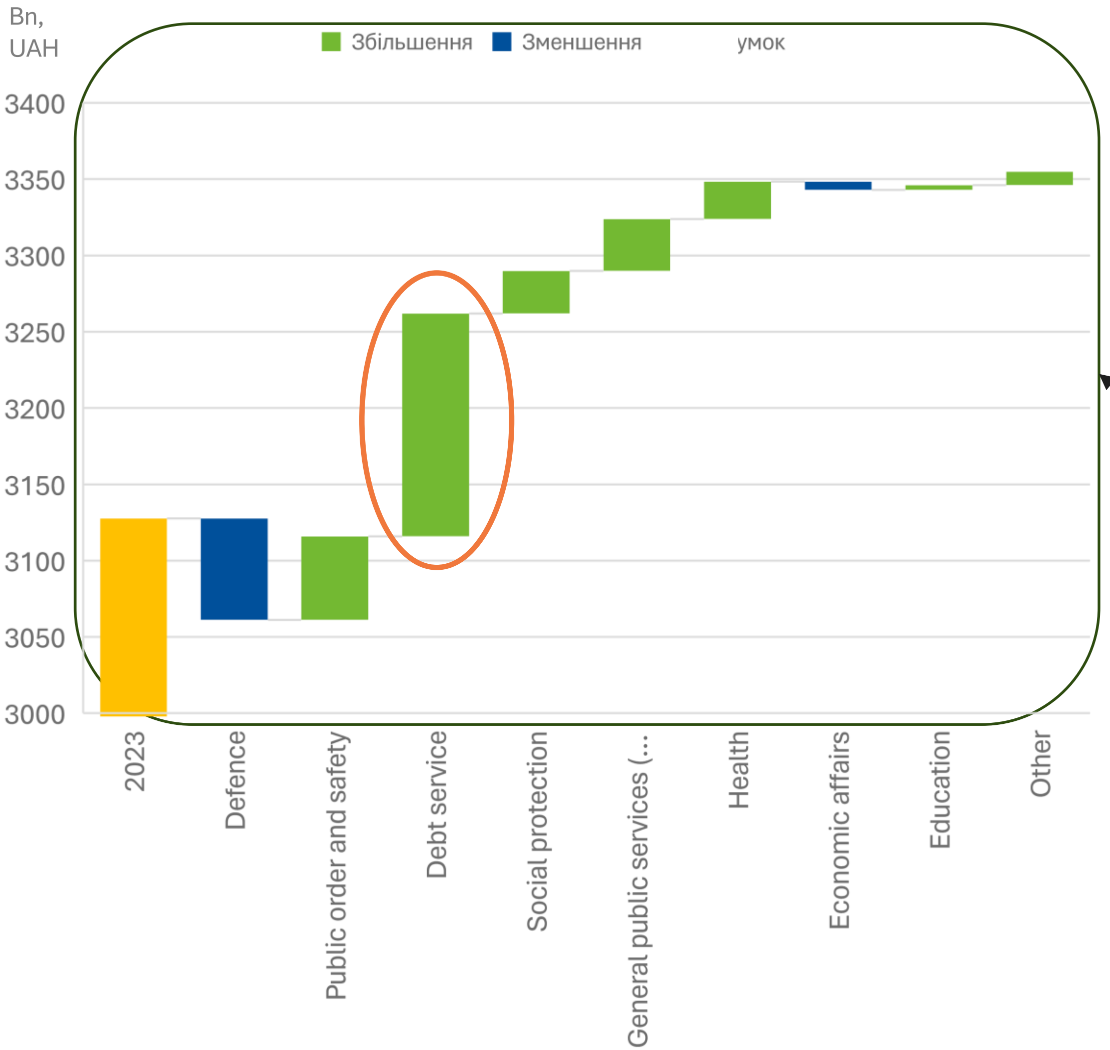
Deficit remains high, budget remains focused on defence



- The 2024 budget is the third consecutive war budget for Ukraine with defence and public order expenditures dominating the state budget breakdown.
- The own revenues (taxes and other revenues) cover only defence and public order expenditures, thus leaving the rest to be covered by the anticipated donors’ aid.

STATE BUDGET 2024

Changes in expenditures



- The expenditures except for the interest payments are virtually frozen.
- Spending on defence category is smaller in 2024 than in 2023, but this may change in further versions of the budget project.
- The increase of expenditures to the 2nd reading and throughout the 2024 is very likely for other categories as well.

FUNDING SOURCES 2024

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The government anticipates borrowing as much as USD 51 bn in 2024

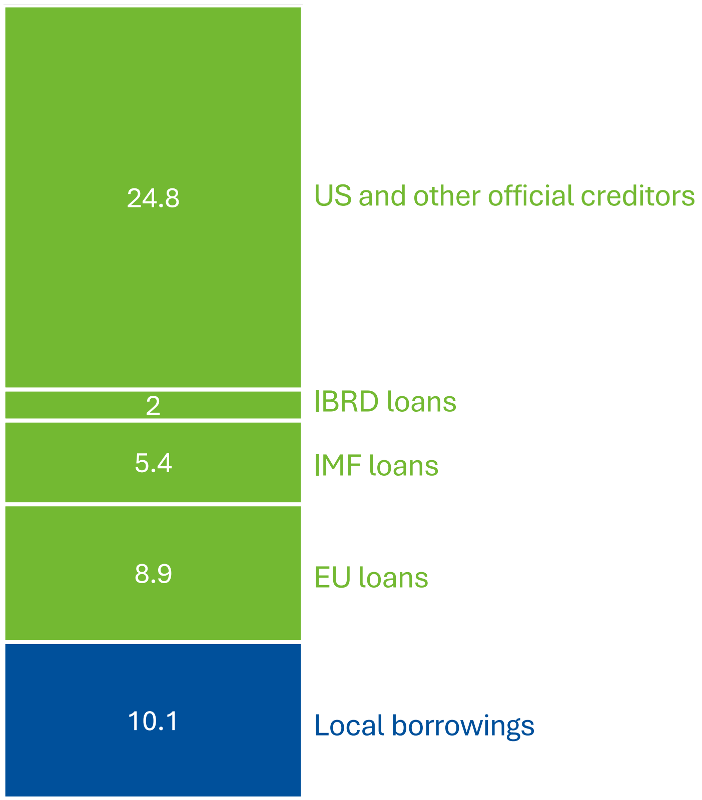
State budget revenues: USD 41.3 bn
State budget expenditures: USD 80.4 bn

Budget gap: USD 38.3 bn (20% GDP)
+ Redemptions (local): USD 10.1 bn
+ Redemptions (ext.): USD 4.4 bn

Total funding needs: USD 52.9 bn

Total expected borrowings: USD 51.1 bn

Funding sources expectations, 2024 state budget proposal, USD bn



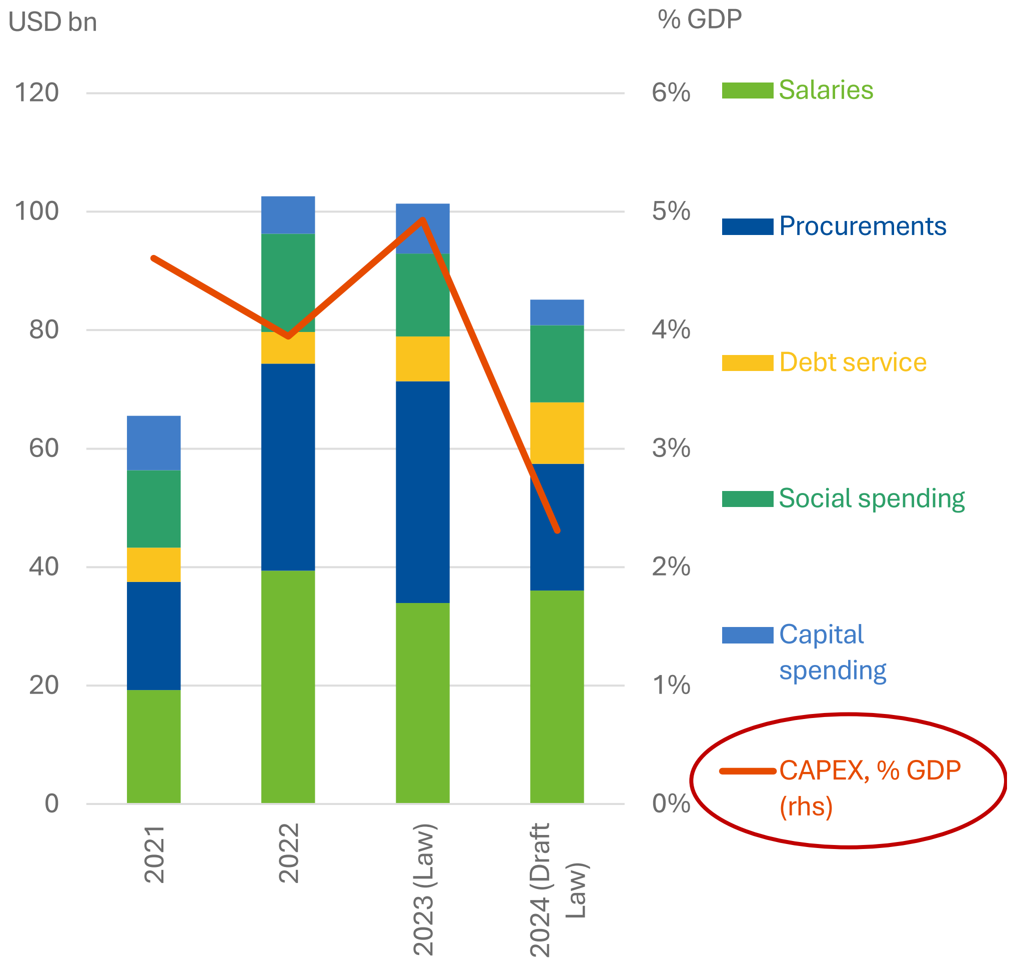
Note: State budget revenues and budget gap are shown without grants. The expected sources of external borrowings are envisaged in the explanatory documents to the Draft State Budge Law for 2024. They are not defined in the Draft. Source: Draft State Budget Law for 2024

- 81% of expected funding sources is to come from external sources, with no guarantees.
- Even the EU's 50 billion facility is currently subject to final approval, and the US appears hesitant to make pledges, as evidenced by the recent 45-day budget vote that did not allocate aid to Ukraine.
- If Ukraine does not receive sufficient support, there may be a need to resort to monetary financing, and if the situation does not improve, there is a tangible risk of a collapse in the current form of the public finance system

CONSOLIDATED BUDGET 2024

CENTRE FOR ECONOMIC STRATEGY

CAPEX was cut by half as % of GDP



Consolidated budget, UAH trillion	2021	2022	2023	2024	Change 2023-24
Current expenditures	**1.7**	**3.5**	**3.6**	**3.5**	**-2%**
% GDP	*31%*	*67%*	*57%*	*45%*	
Salaries	0.5	1.3	1.3	1.5	18%
from which military	*24%*	*59%*	*60%*	*n/a*	
Procurements	0.5	1.1	1.4	0.9	-36%
Debt servicing	0.2	0.2	0.3	0.4	53%
Social expenditures	0.4	0.5	0.5	0.5	4%
Current transfers and other current expenditures	0.1	0.4	0.2	0.2	11%
Capital expenditures	**0.3**	**0.2**	**0.3**	**0.2**	**-42%**
% GDP	*5%*	*4%*	*5%*	*2%*	
Total	**1.9**	**3.7**	**4.0**	**3.8**	**-6%**
% GDP	*36%*	*71%*	*63%*	*48%*	
Nominal GDP	5.5	5.2	6.4	7.8	23%

THANK YOU.

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