



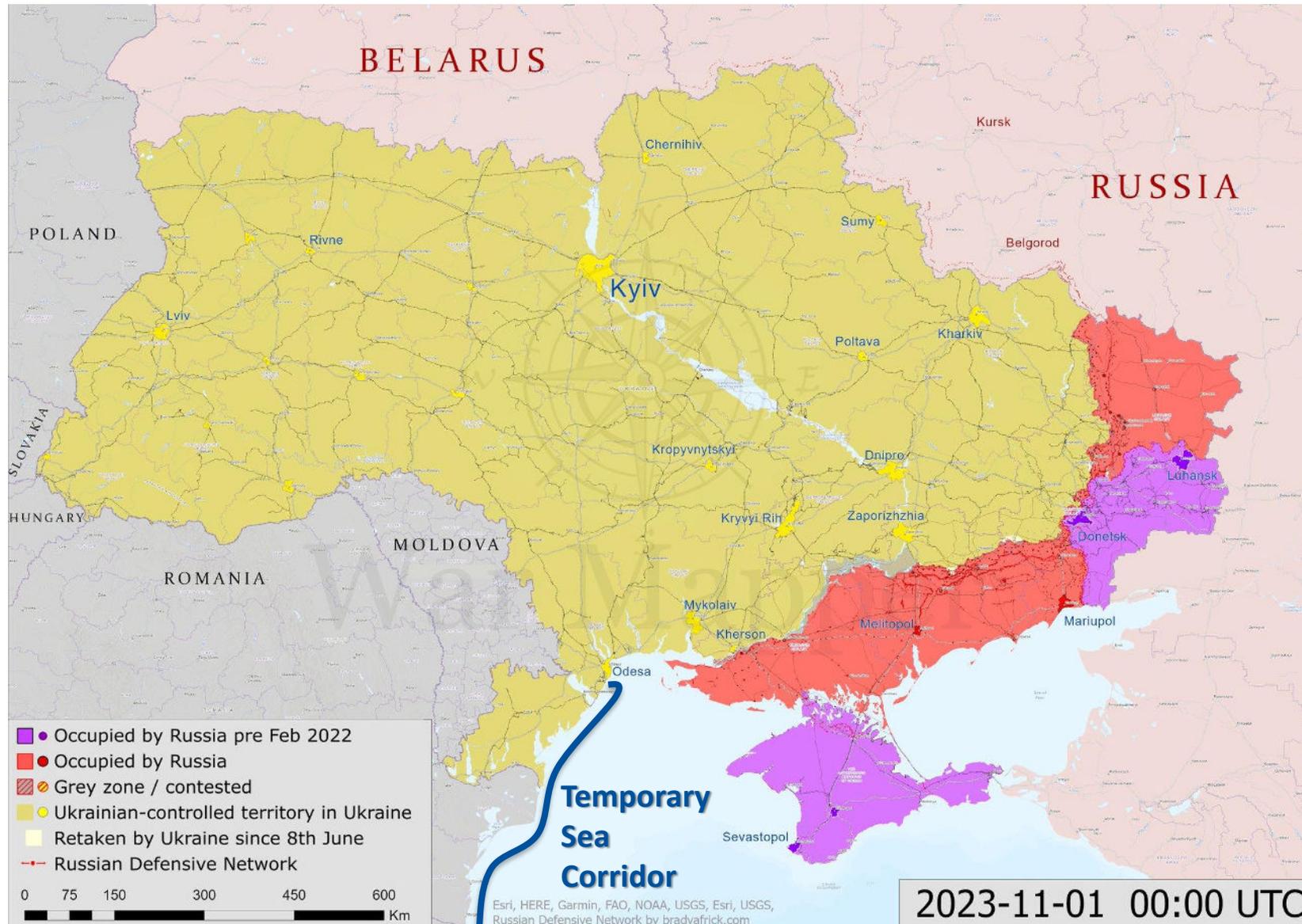
Economy review in October. Special topic: The revival of business loans

Date: 9/11/2023
Author: CES Team



WAR

WAR UPDATE



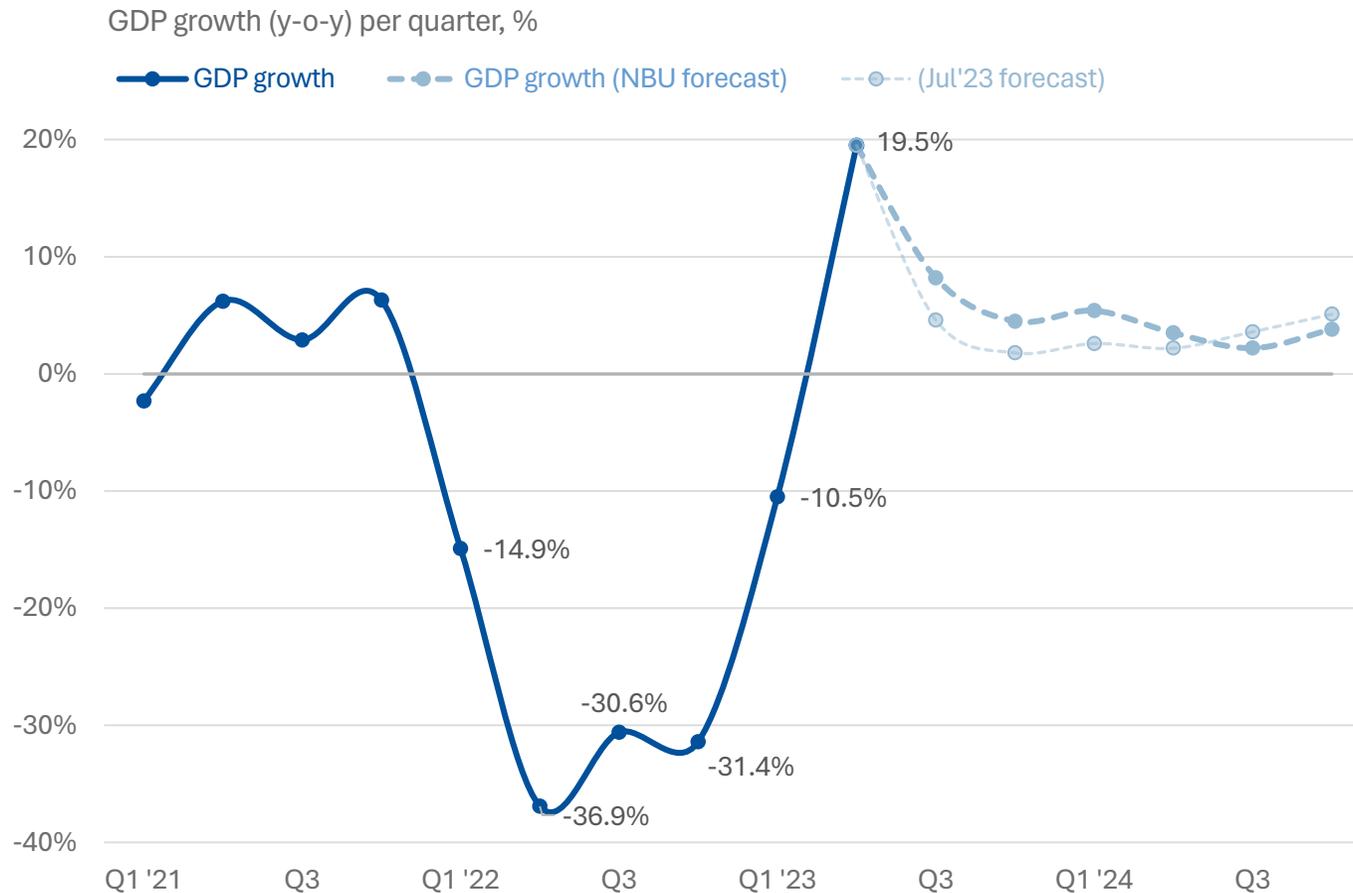
- In October, intense fighting continued at all parts of the front, from Kherson through Robotyne and Avdiivka to Kupiansk.
- No large-scale attacks on the energy infrastructure this month.
- The temporary sea corridor, introduced by Ukraine to renew maritime access to Odesa ports, has been operating, but not at a full capacity. On November 8, Russia attacked one of civilian cargo ships in Odesa region, killing 1.



MACROECONOMIC TRENDS

MACROECONOMIC TRENDS

NBU improved its GDP growth forecast to 4.9% in 2023



Sources: State Statistics Service of Ukraine, NBU

- NBU improved its GDP growth forecast for 2023 to 4.9% from 2.9% in the previous forecast.
- The key reasons for the improvement include further adaptation of businesses and households to the war conditions; good harvests; expansion of alternative export routes; and higher budget spending.
- GDP growth forecast in 2024 was also slightly improved from 3.5% to 3.6%.

MACROECONOMIC TRENDS

Key insights from the NBU Inflation Report

	2023	2024	2025
Real GDP, change, %	4.9 (2.9)	3.6 (3.5)	6.0 (6.8)
Nominal GDP, UAH bn	6 625 (6 525)	7 730 (7 620)	8 900 (8 830)
CPI, y-o-y, % (eop)**	5.8 (10.6)	9.8 (8.5)	6.0 (6.0)
Core CPI, y-o-y, % (eop)**	5.7 (8.7)	8.6 (7.0)	3.1 (2.8)
Current account balance, USD bn	-7.3 (-11.0)	-11.0 (-17.2)	-17.6 (-16.1)
Gross reserves, USD bn	41.8 (38.3)	44.7 (42.6)	45.0 (44.1)

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

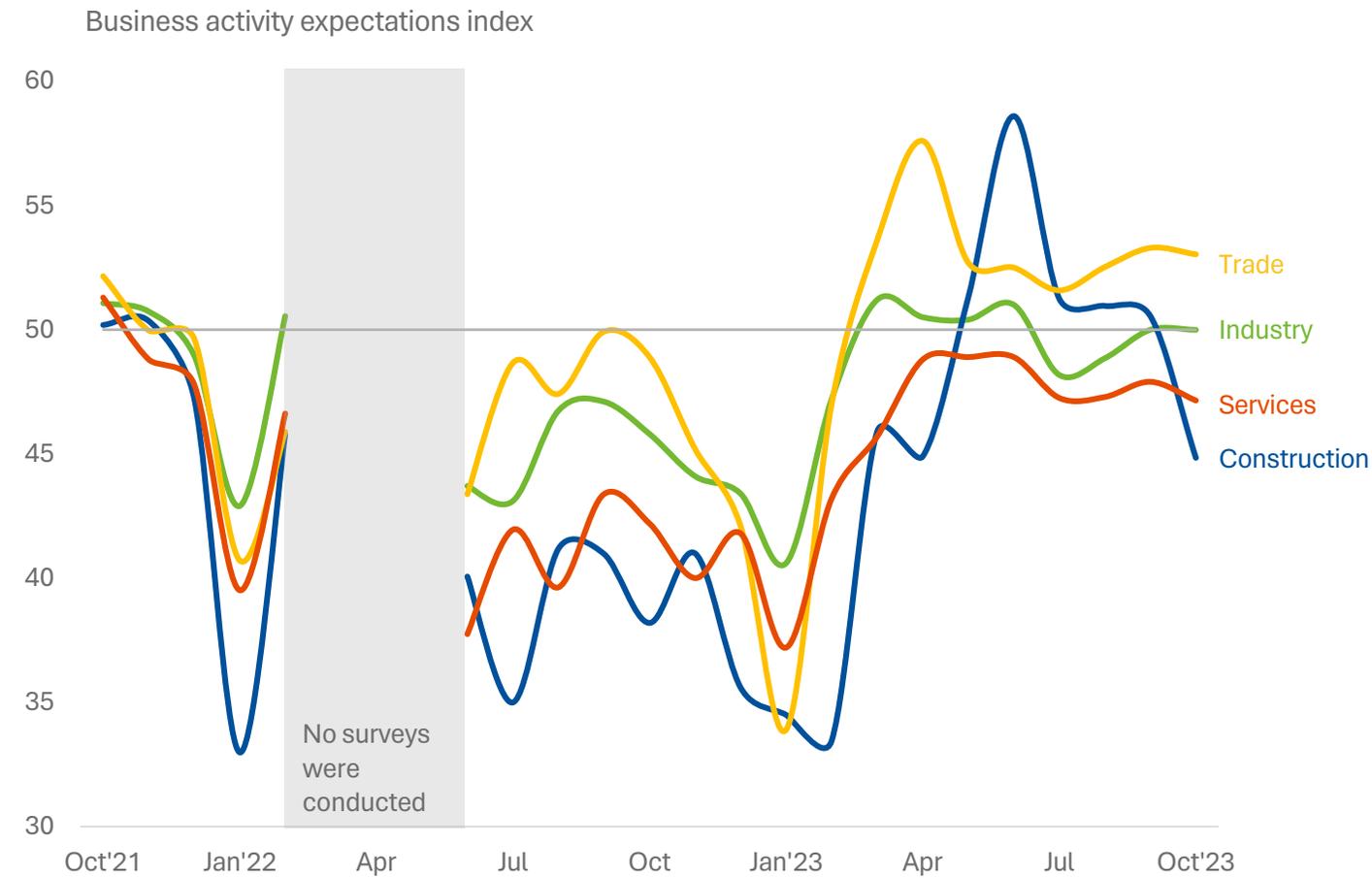
** end of period (December to December of the previous year)

Source: NBU

- The economy will rebound despite the war challenges, but it won't reach its pre-war potential output by the end of 2025 due to the scale of losses.
- Inflation will remain moderate in the coming years. In 2023, it will slow to 5.8% due to increased food supply along with challenges in agricultural exports. However, in 2024, the effect will wane, causing inflation to rise to 9.8%. By 2025, reduced security risks will enable businesses to recover, leading to a slowdown in inflation to 6%.
- Foreign aid will continue to be crucial for financing the budget and current account deficits in 2023-2025. Substantial disbursements of it will lead to a net inflow of foreign currency, bolstering international reserves.

MACROECONOMIC TRENDS

Business expectations worsened in October



Source: NBU

- In October, the NBU's index of business expectations decreased to 49.6 compared to 50.1 in September, falling again below the “neutral” level of 50 points.
- This means that negative expectations prevail among the surveyed businesses.
- According to the NBU, the deterioration in assessments was caused by the persistence of military risks and new destructions, logistical constraints, a narrowing of investment demand, rising fuel prices, and a shortage of labor.



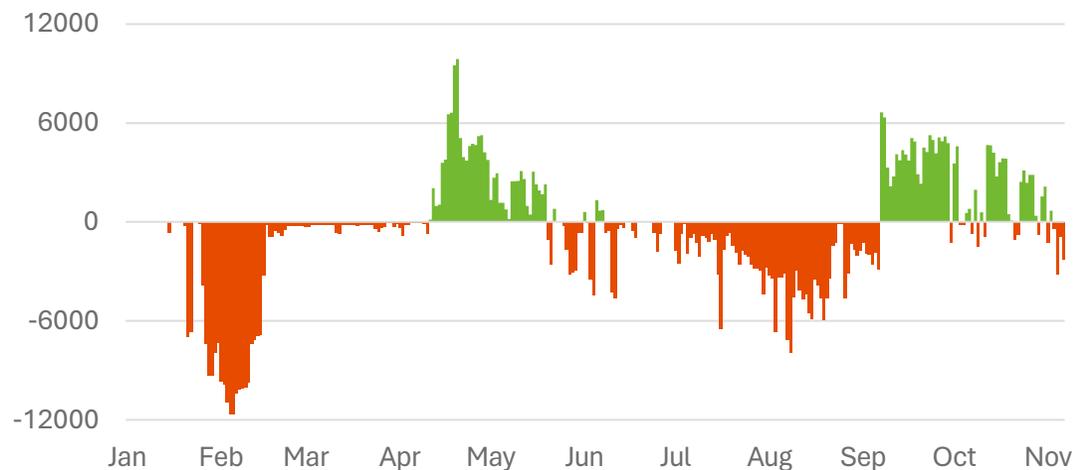
SECTORAL ANALYSIS

SECTORAL ANALYSIS

Energy sector is stable so far

- Commercial electricity exports decreased in October, with almost 69 thousand MWh exported. Electricity imports also decreased to 17 thousand MWh in October.
- For the first time, access to electricity trade was sold under European rules, which unblocks additional cross-border connections.

Ukraine net electricity commercial exports in 2023, MWh



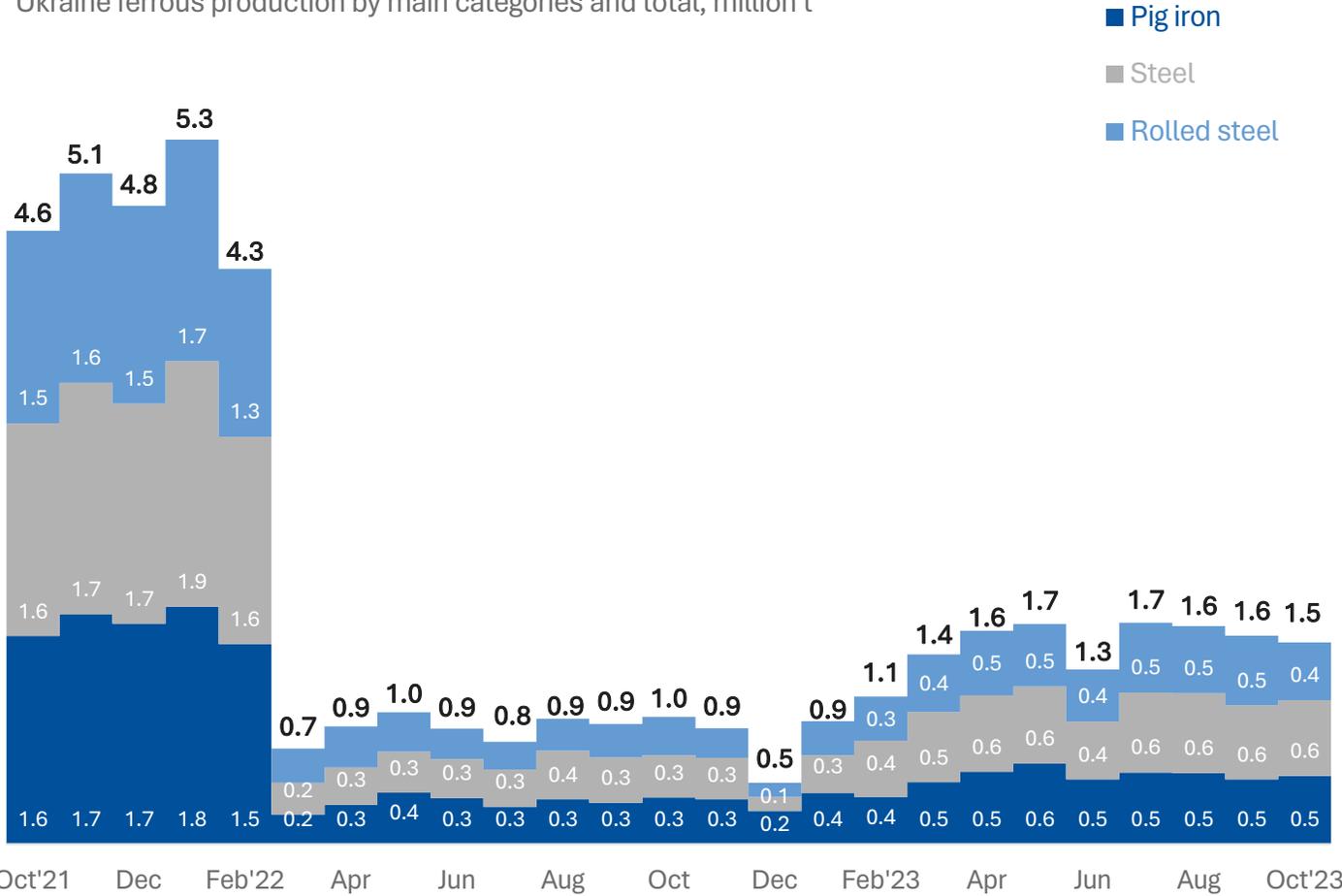
Source: ENTSO-E

- There have been no large-scale attacks on the energy infrastructure this months, which provided valuable time to make the system more resilient.
- Ukraine has amassed more than 16 bn m³ of natural gas in its underground storages. More than 3.2 bn m³ of this volume belongs to the European companies that use Ukrainian storages. It is not clear whether Ukraine has 14.7 bn m³ needed for the winter available in.
- Electricity producers assure that they now have enough coal for the winter. DTEK now has more coal in its reserves that it had in 2021; Centrenergo imported some coal from Poland to meet the future needs.

SECTORAL ANALYSIS

Ferrous production further decreased in October

Ukraine ferrous production by main categories and total, million t



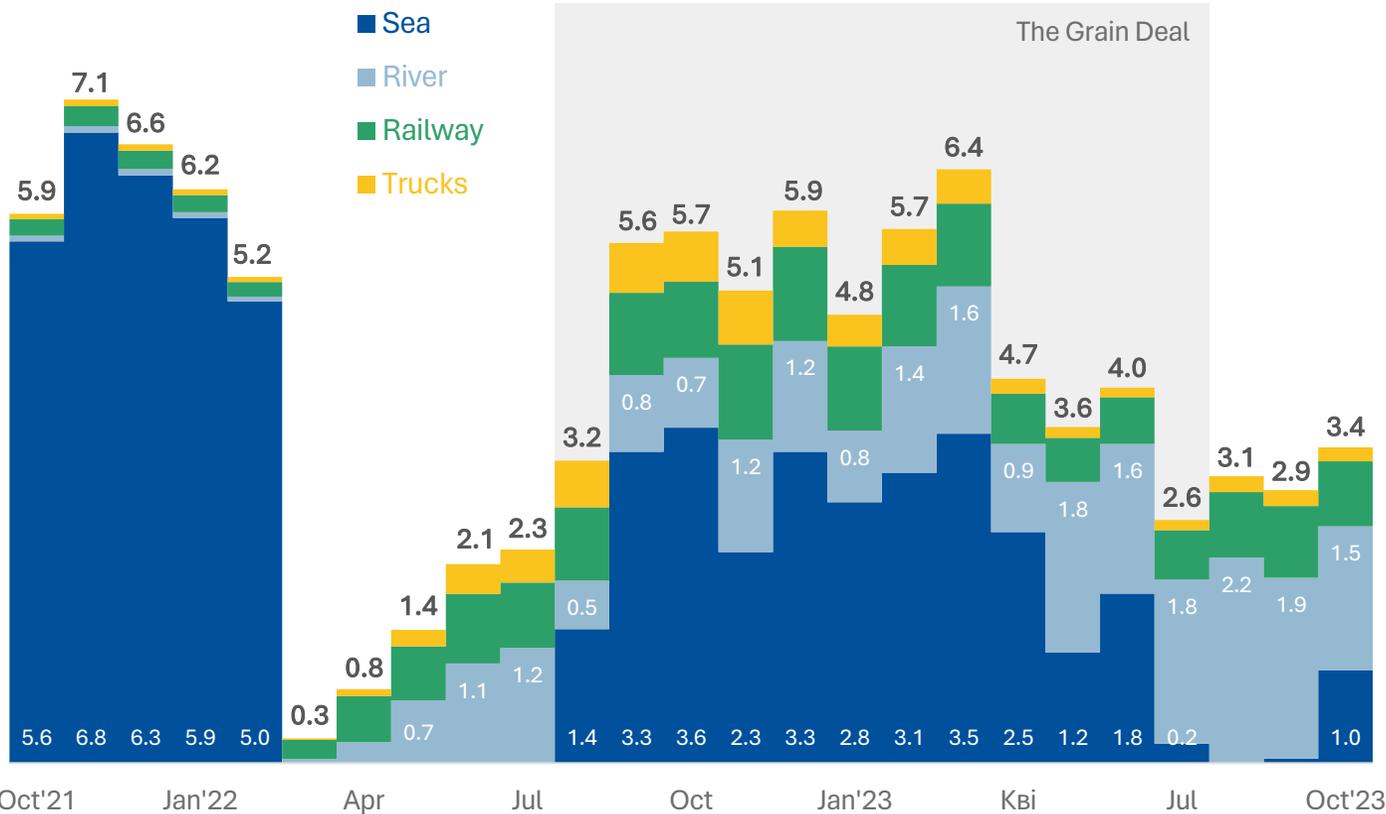
Source: Ukrmetallurgprom

- In October, the ferrous production further decreased by 3.2% compared to September.
- One of the main reasons of the production decrease is the hampered export logistics. Only a smaller part of production can be consumed locally. Out of 3.9 m t of rolled steel produced in 9M 2023, 1.8 m t were consumed in Ukraine (45%).
- The metallurgy sector used to export 4/5 of its production. Improved sea logistics are needed for survival of the industry.

SECTORAL ANALYSIS

Grain exports by sea increased in October

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



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

- The issue of logistics remains crucial for Ukraine’s agriculture. Russia is still fixated on limiting Ukrainian abilities to use the Black Sea and Danube ports.
- More than 116 inbound trips (including several ships with imported goods), 91 outbound using the temporary sea corridor. Most of the outbound ships carried grains and oilseeds.
- Grains and oilseeds yield may reach 79.1 m t (Ministry of Agriculture forecast) or even 81.6 m t (Ukrainian Grain Association forecast). Improved export capacities are urgently required.



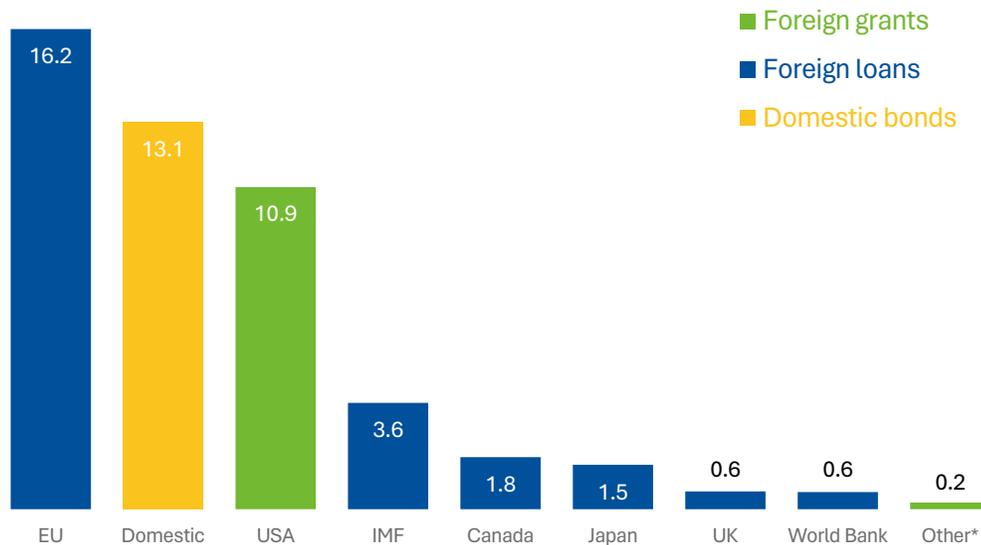
FISCAL SECTOR

FISCAL SECTOR

USD 2.75 bn of foreign financing in October

In October, Ukraine received a USD 1.6 bn loan from the EU and a USD 1.15 bn grant from the US. The grant tranche from the US was the last pledged financing from this country. Congress approval needed for further disbursements.

2023 additional financing of Ukraine's state budget as of November 2, USD bn



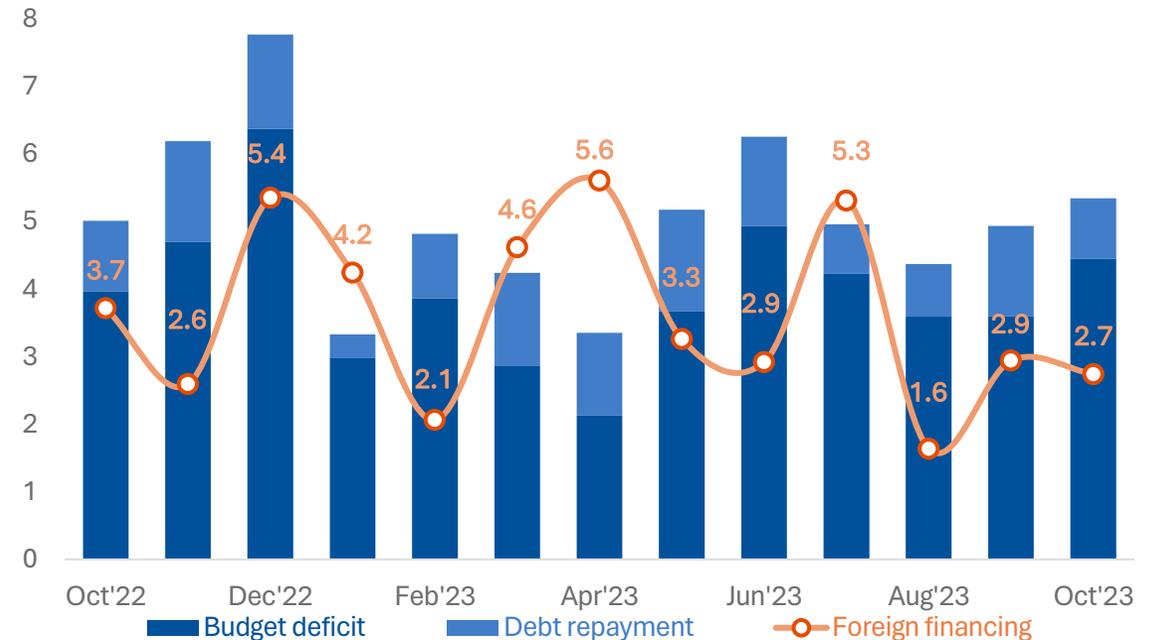
Source: Ministry of Finance

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

10 months 2023:

- State budget deficit, debt repayment needs: USD 46.8 bn
- Foreign financing disbursed so far: USD 35.3 bn
- No monetary financing
- Financing gap (pledges - budget needs) increased to USD 12 bn because of the spending increase in 2023 state budget.

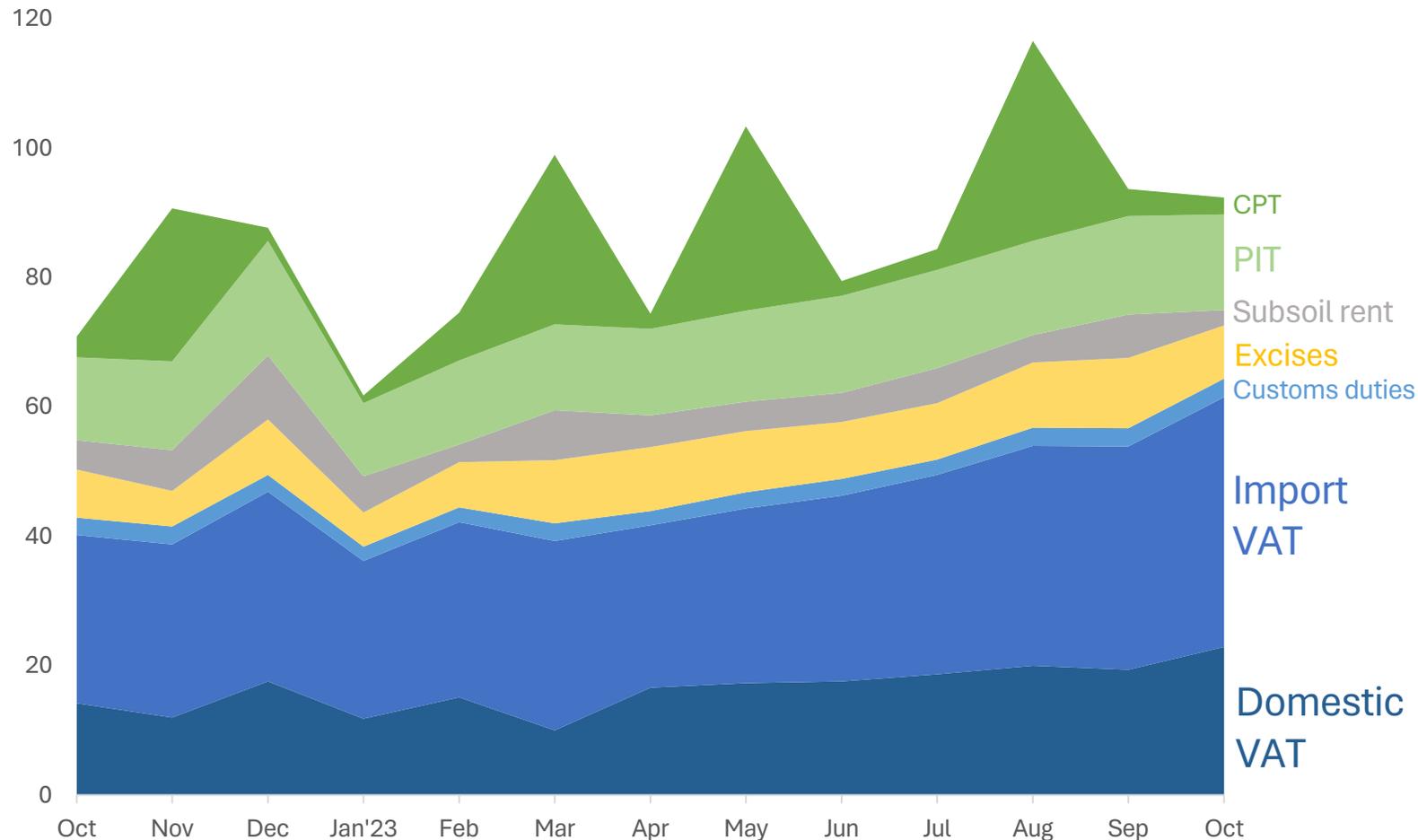
Foreign financing, state budget deficit and debt repayment, USD bn



Source: Ministry of Finance, NBU, CES calculations

FISCAL SECTOR

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



Tax revenues in October brought UAH 92.4 bn

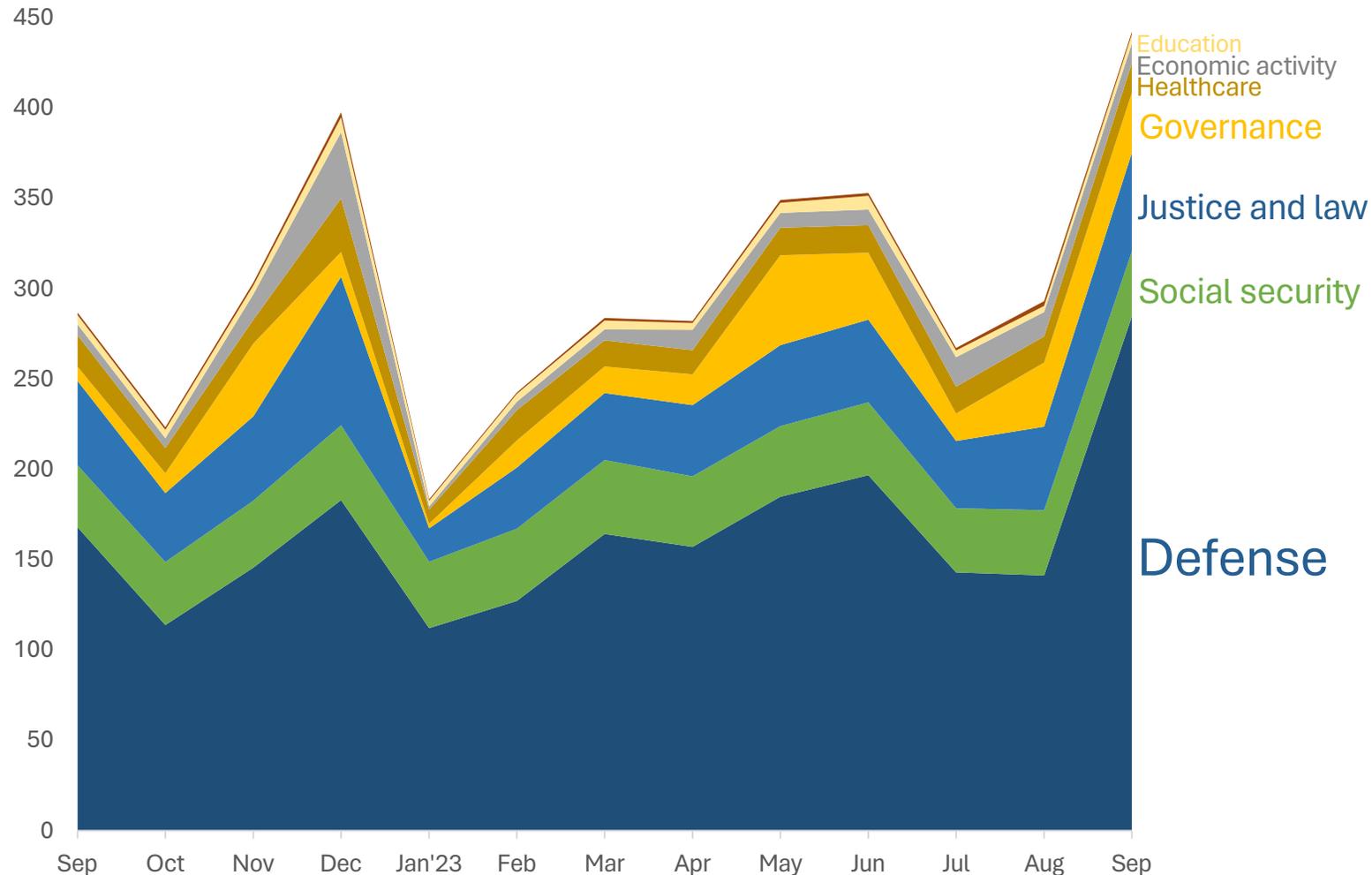
- VAT makes 66% of October revenues (annual average - 52%).
- Weak performance of excise and subsoil rent revenues balanced the revenues from the VAT.

Source: Ministry of Finance

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

FISCAL SECTOR

Defense spending more than doubled in September

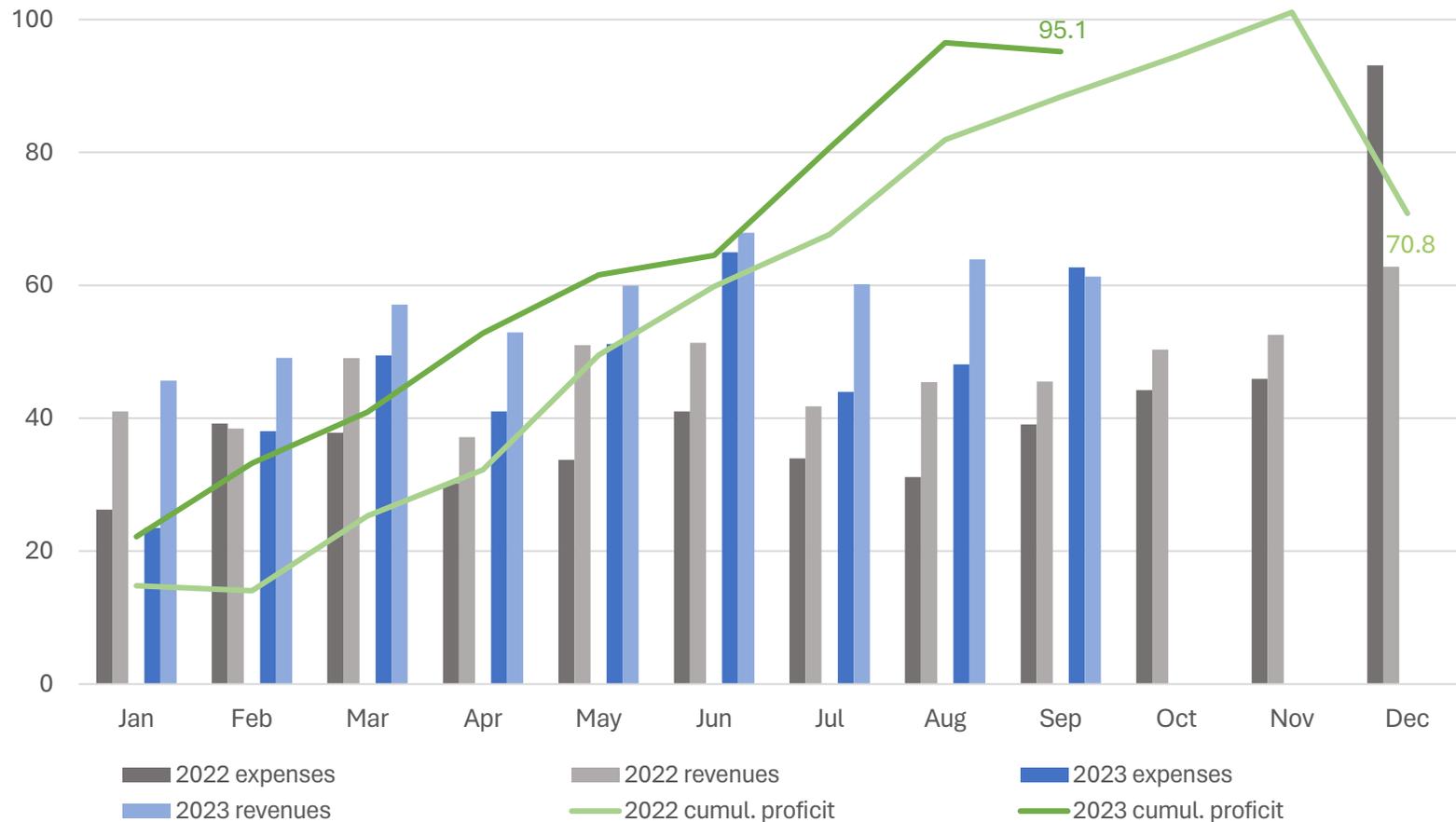


Source: Ministry of Finance

- Monthly defense spending doubled (UAH 285 bn) reaching 64% of total expenses and bringing total spending to UAH 447 bn.
- Spending on weapons and ammo increased by UAH 69 bn, spending on non-lethal supplies and personnel – by UAH 75 bn, details being classified.
- The increase of UAH 8 bn in Justice and Law was spent on the Border Guard and National Guard.
- Another UAH 5 bn was spent without functional assignment on the classified program, for the first time.

Local budgets surplus continues to be larger than in 2022

Local budgets accumulated surplus in 2022-2023, UAH bn



- August local budgets **expenses** jumped to **UAH 62.7 bn**, 60% more than in 2022.
- Key drivers – education, construction and transfers to statutory capital of the communal entities.
- With revenues remaining stable, this led to first monthly aggregate deficit, which decreased the **accumulated surplus** of local budgets in 2023 to **UAH 95.1 bn**.

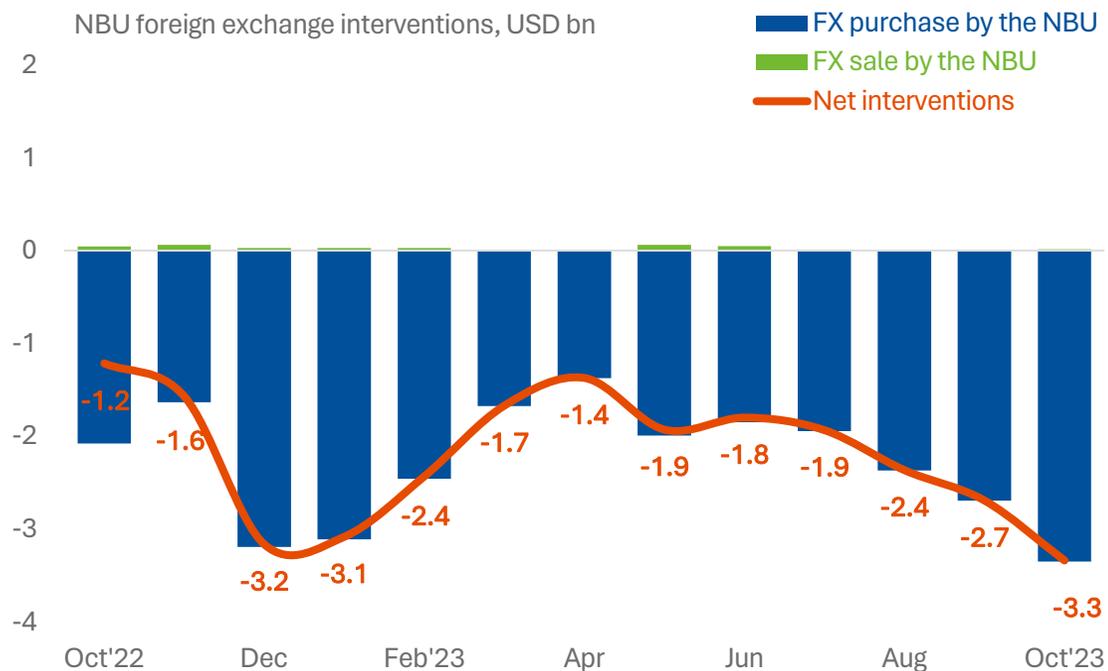
MONETARY AND FX POLICY

MONETARY AND FX POLICY

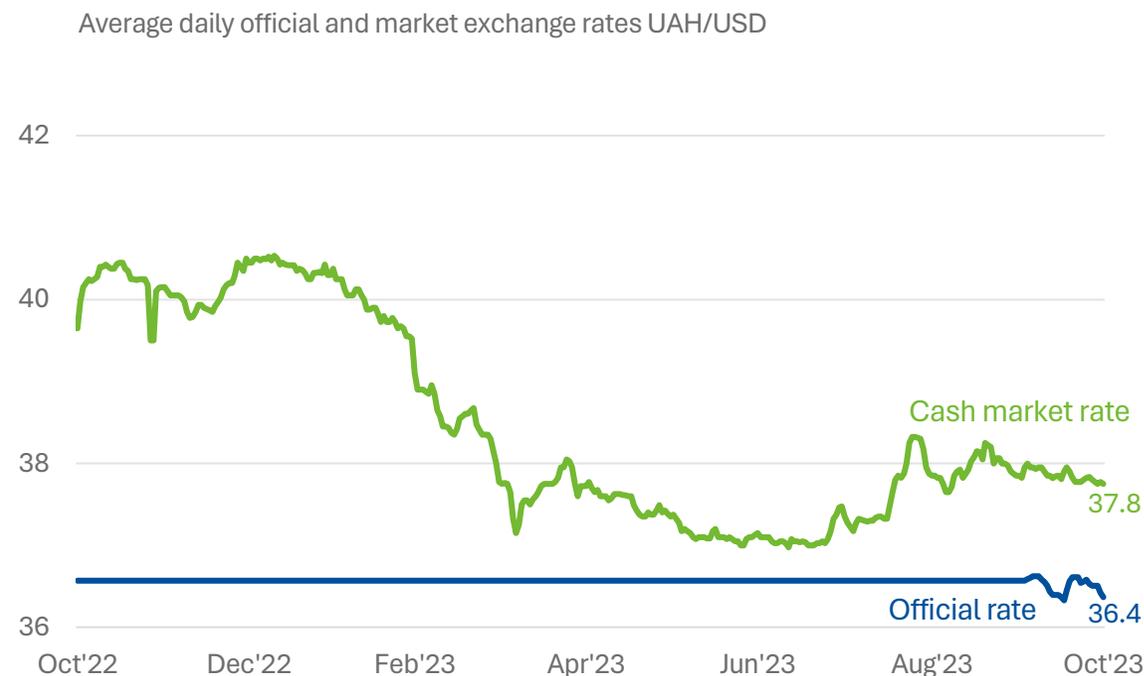
International reserves declined and hryvnia strengthened

There is still a need for significant FX sales by the NBU. In October, Ukraine's international reserves declined by 1.9% m-o-m, reaching 39.0 USD bn: the NBU interventions and FX debt repayments were largely offset by inflows of financial aid.

For more than one month, the NBU has been maintaining the managed exchange rate flexibility regime. The official rate has strengthened to 36.40 UAH/USD, and the cash market rate revalued: 37.75-38.40 UAH/USD on September 15 and 37.50-38.20 on October 15.



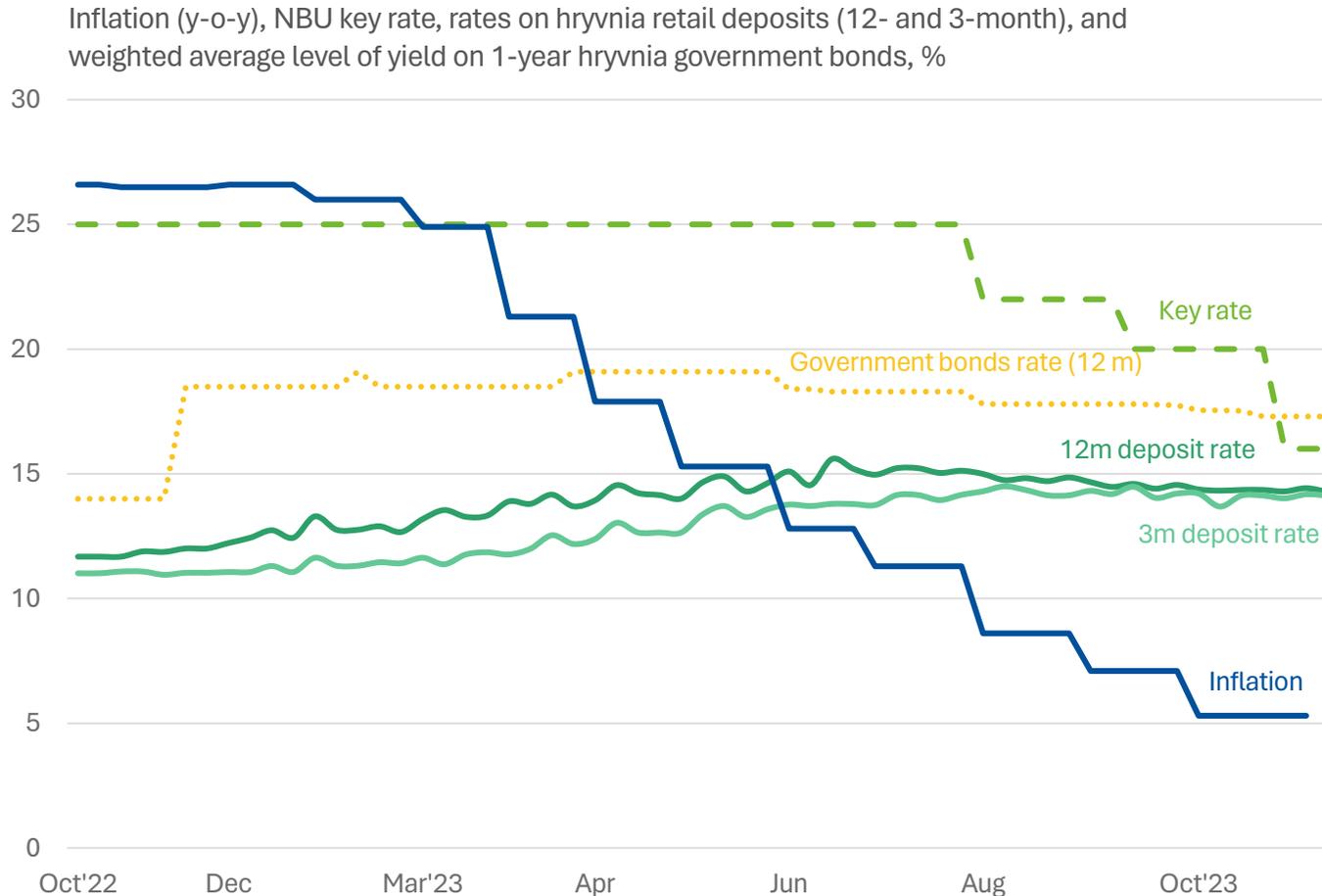
Source: NBU



Sources: NBU, Ministry of Finance

MONETARY AND FX POLICY

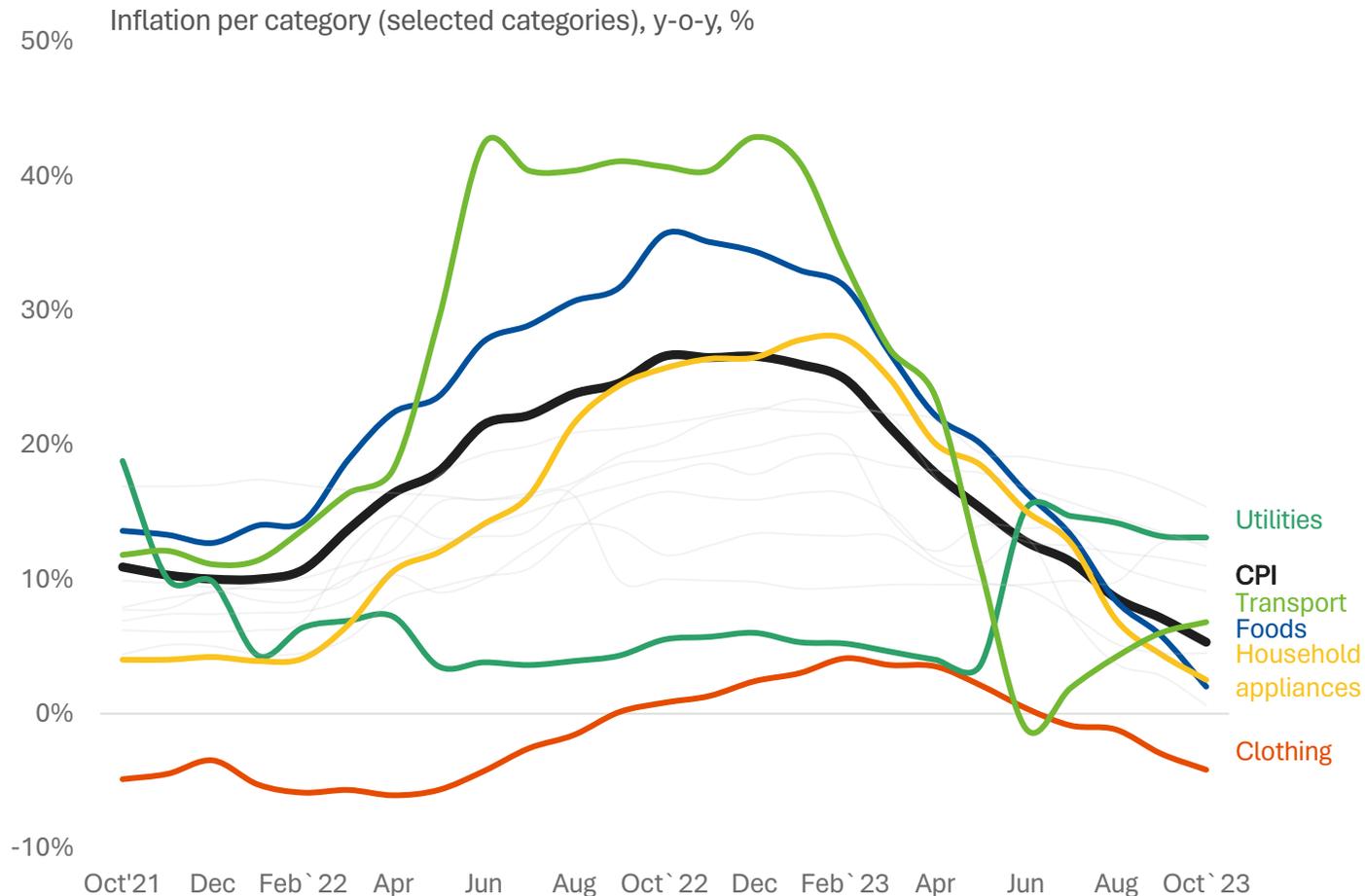
NBU cuts key policy rate to 16%; inflation continues to decelerate



- Following the recent monetary policy meeting of the NBU Board, the key policy rate has been set at 16%. The NBU modernized the operational framework of its monetary policy in line with the lower-bound system to enhance the signaling role of the policy rate amid the structural liquidity surplus.
- The yield of one-year hryvnia war bonds gradually declined to 17.3%. At the end of October, the average rate on retail remained the same for 3-month deposits (14.2%) and 12-month retail deposits (14.4%).
- In October, inflation declined, and the growth in consumer prices decelerated to 5.3% y-o-y, achieving the NBU`s inflation target.

MONETARY AND FX POLICY

Inflation slows down; CPI 5.3% y-o-y in October



Source: State Statistics Service of Ukraine

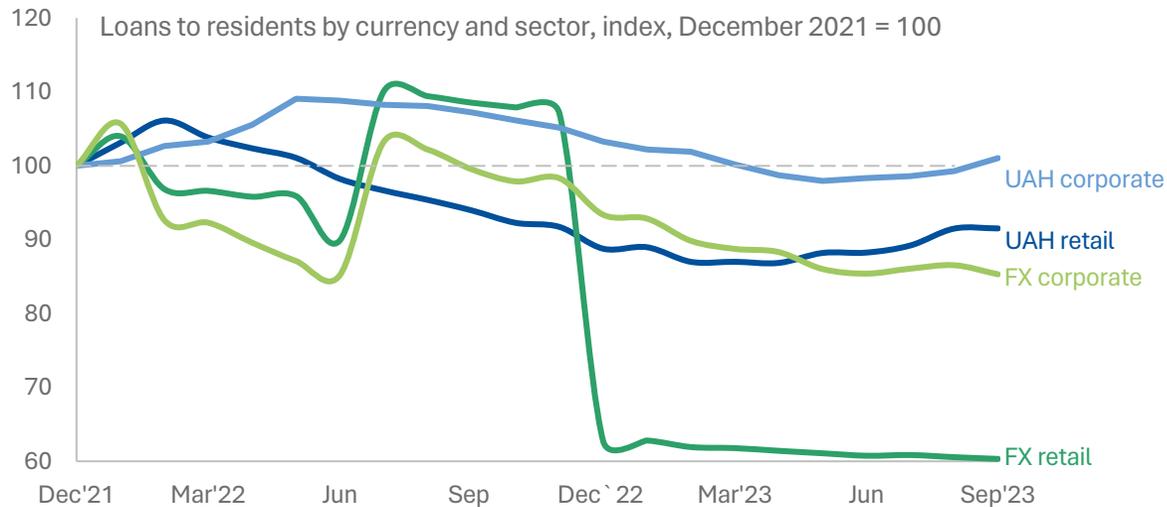
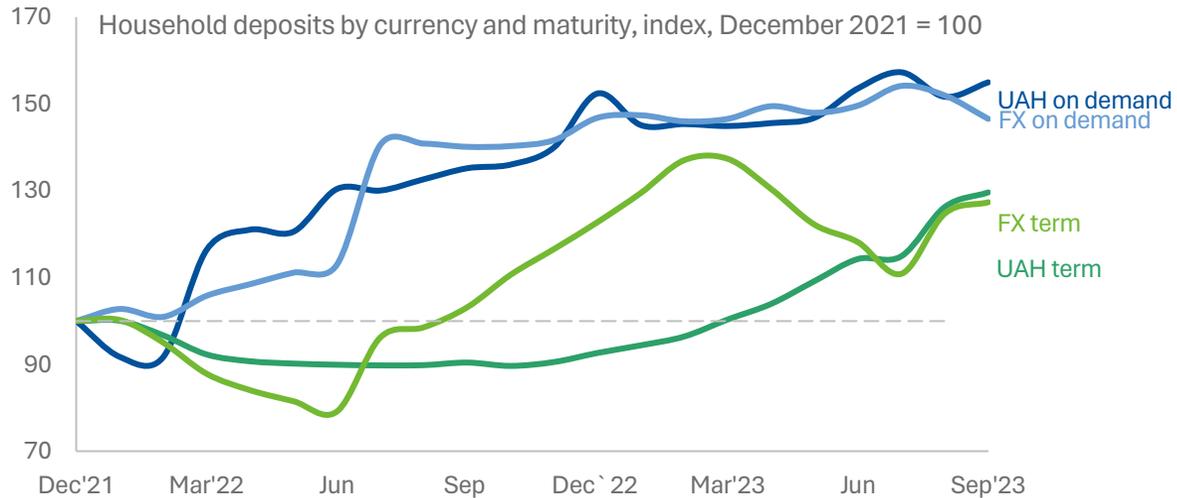
- According to the State Statistics Service, inflation in October was +0.8% compared to September. Since the beginning of the year, inflation has amounted to 3.8%.
- The price of food products increased by 1.0% over the month — vegetables and eggs rose in price the most (+14.0% and +10.1% m-o-m, respectively).
- Prices for transport increased by 1.5% m-o-m, mainly due to an increase in the price of fuel and lubricants. At the same time, fares in railway passenger transport became cheaper by 5.7% m-o-m.
- The inflation slowdown was primarily driven by a greater supply of new harvest foodstuffs, fixed tariffs, and improvements in exchange rates and inflation expectations.

BANKING SECTOR



BANKING SECTOR

Hryvnia loans and FX-term and Hryvnia deposits are on the rise



Source: NBU

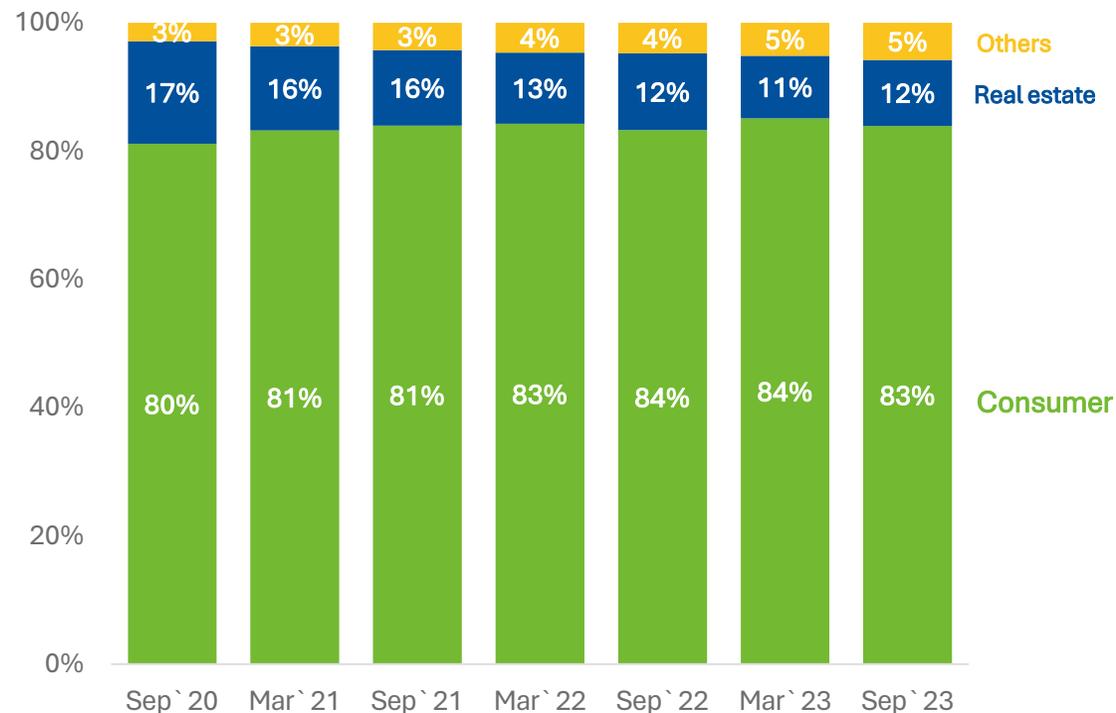
- The volume of household deposits has increased both for UAH term and on-demand ones due to high-interest rates amid inflation.
- FX term deposits continue to rise having reached the same level with the UA term. On the other hand, FX on-demand deposits continued the downward trend.
- Demand for hryvnia corporate loans increased, as did demand for retail loans, with most banks expecting further growth in their corporate and retail loan portfolios over the next 12 months according to the Bank Lending Survey.
- Most of the lending still occurs under the Affordable Loans 5–7–9% program (more details in the following slides).

BANKING SECTOR

Household loans distribution: most of them are for current needs

The majority of loans are disbursed for consumer purchases, and its share slightly increased in the last 3 years, while the share of real estate decreased (-4 p.p. compared to Sep`20) since the beginning of the war.

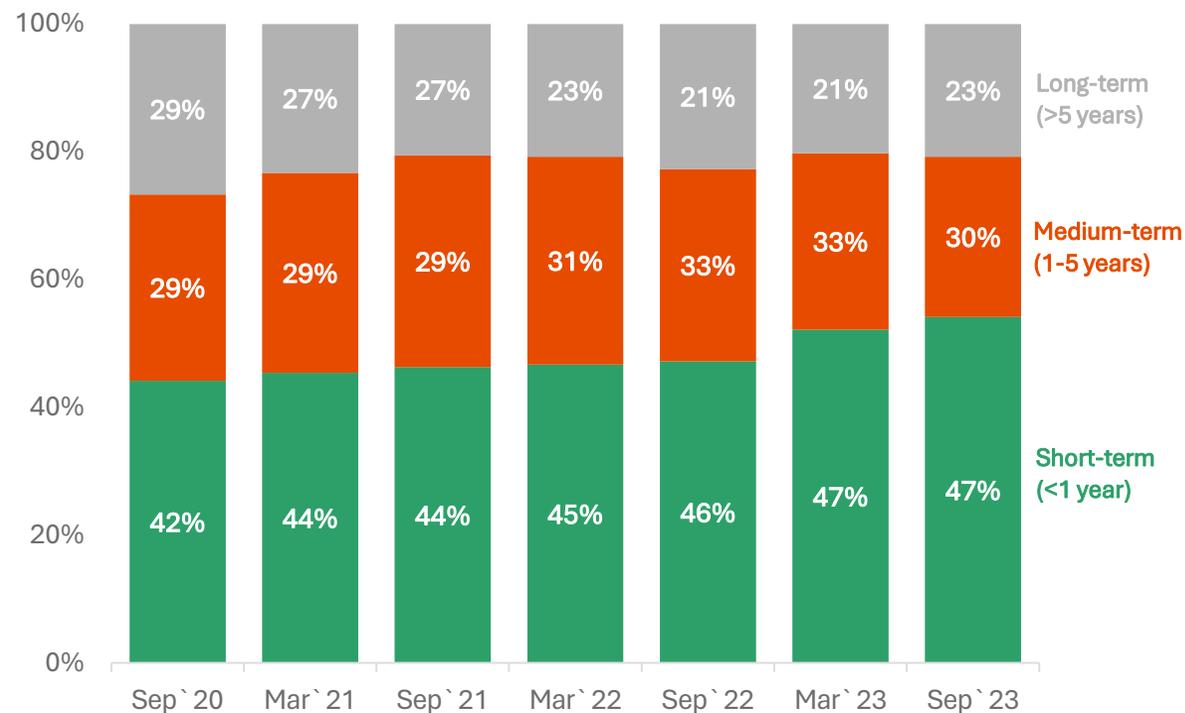
Share of household loans based on its target, %



Source: NBU

In the structure of loans to households, the loans for current needs (up to one year) increased by 5 p.p. at the expense of new loans, while the long-term decreased with the initiation of the full-scale invasion.

Share of household loans based on its maturity, %



Source: NBU

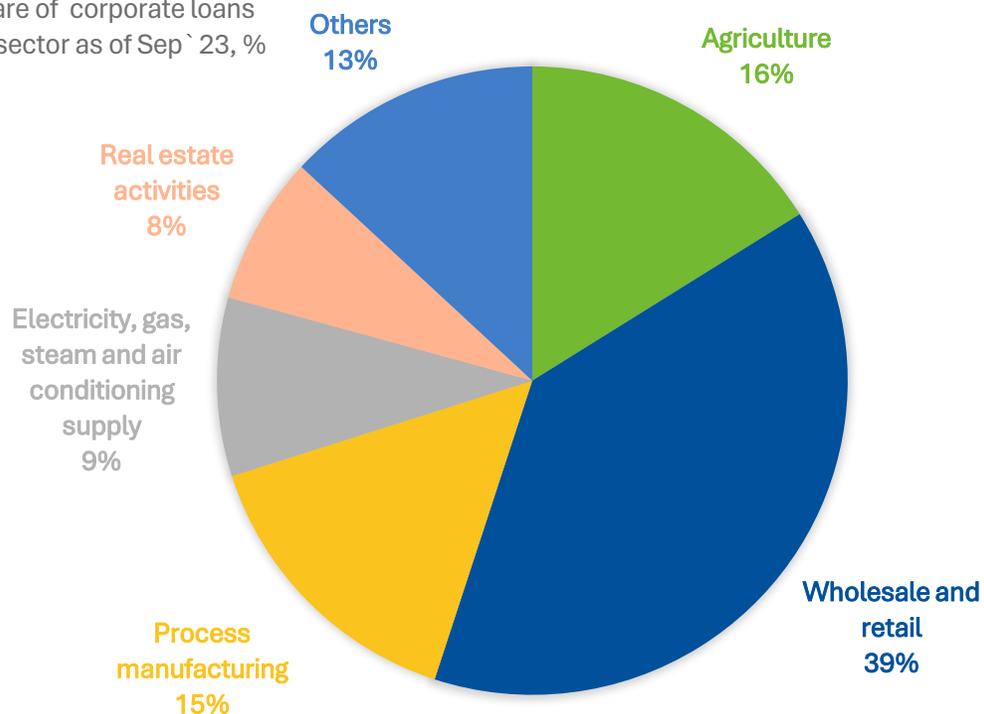
BANKING SECTOR

Corporate loans distribution: most of them are short-term and in wholesale and retail

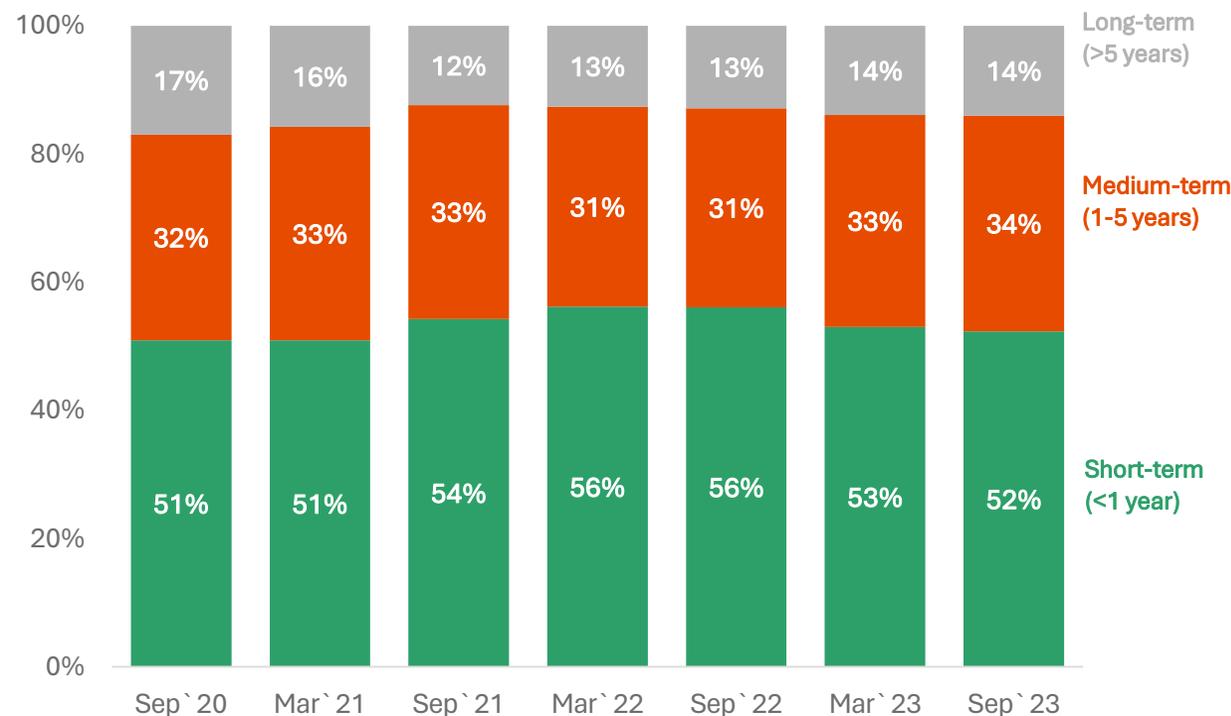
As of September 2023, the majority of loans are disbursed in wholesale and retail trade (39%), agriculture (16%), and process manufacturing (15%). On average, 70% of these loans are in national currency, and the rest – in foreign.

In the structure of corporate loans, the changes were insignificant in the last 3 years. More than half of them are disbursed for current needs (less than 1 year), while 1/3 – for medium-term.

Share of corporate loans by sector as of Sep`23, %



Share of corporate loans based on its maturity, %

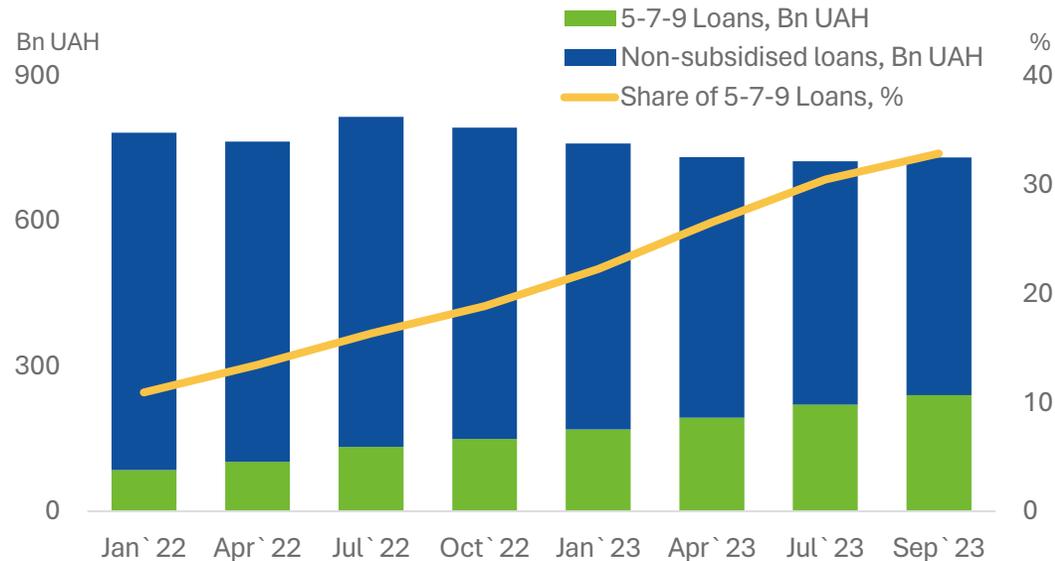


BANKING SECTOR

Affordable Loans 5-7-9% program

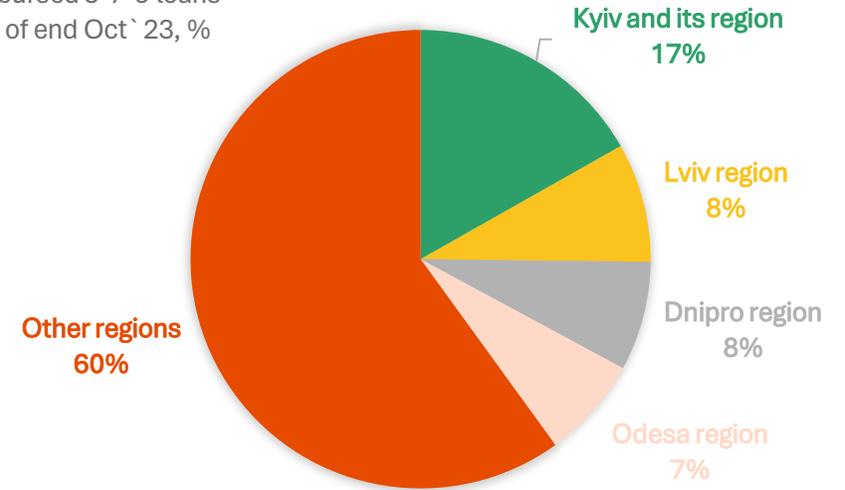
- Most of the lending occurs under the Affordable Loans 5–7–9% program. Loans granted within this program comprise 1/3 of the hryvnia corporate loans.
- The primary users are businesses within agriculture (50%), wholesale (25%), and industry (14%), while most of the loans are disbursed in Kyiv city and its region (17%).

Subsidized and non-subsidized corporate loans, bn UAH, and share of 5-7-9 loans, %

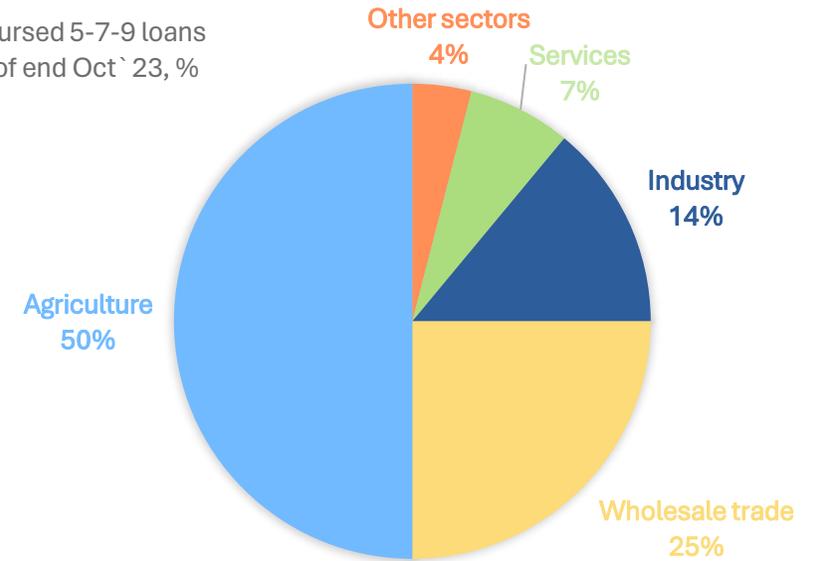


Source: NBU, BDF

Share of disbursed 5-7-9 loans by region, as of end Oct`23, %



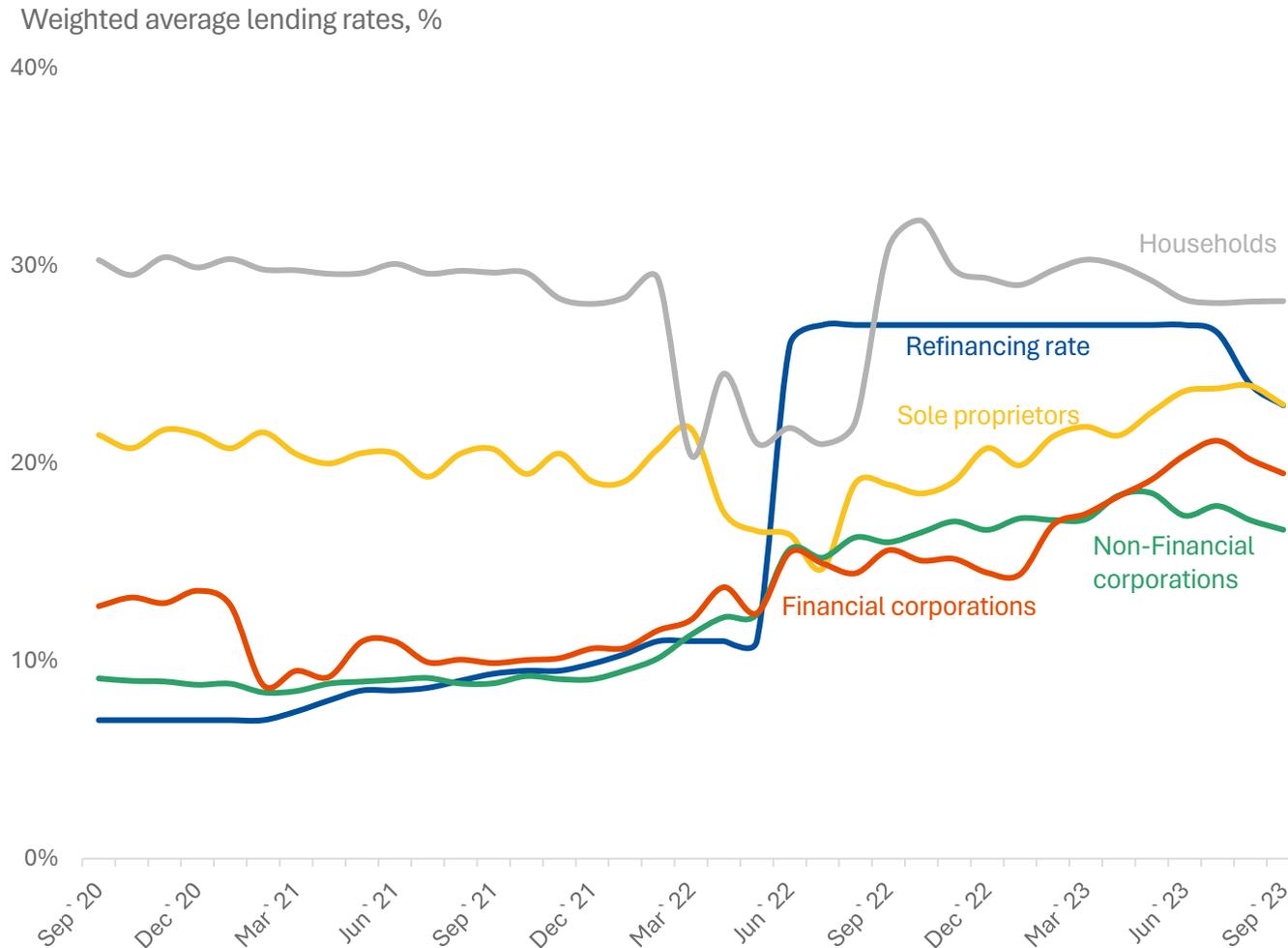
Share of disbursed 5-7-9 loans by sector, as of end Oct`23, %



Source: BDF

BANKING SECTOR

Lending rates demonstrate downward trend



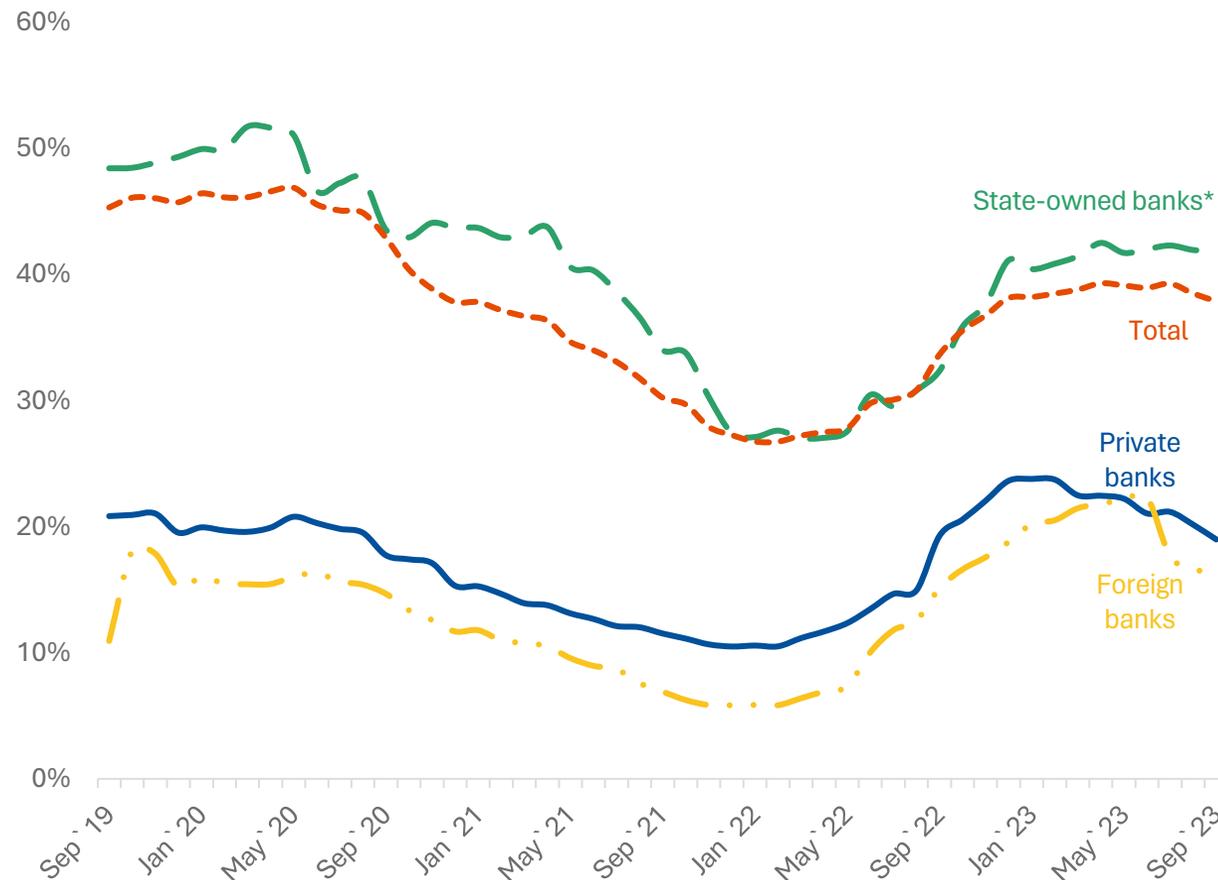
Source: NBU, monthly average

- Based on the NBU`s modernized operational design of its monetary policy, the refinancing rate = the key policy rate + 6 p.p.
- The weighted average lending rates for Financial and Non-Financial corporations and sole proprietors (until Aug`23) have remained lower than the NBU`s refinancing rate during the war. One of the key explanations is the increasing share of preferential loans under the program 5-7-9%.
- Before the decrease of the NBU`s refinancing rate in July`23, banks were keeping the high corporate interest rates to cover acquired deposits and try to offset the repayment of old loans.
- The lending rates for households have remained the highest; last year, they returned to the pre-war level (~30% p.a.).

BANKING SECTOR

Non-performing loans (NPLs) drops in the first nine months of 2023

Non-performing loans by bank ownership, % of total assets



*excluding PrivatBank

Source: NBU

- By October 1, 2023, the banking sector had UAH 422.5 billion in NPLs, down UAH 9.6 billion from January 2023. The NPL ratio also decreased by 0.2 percentage points to 37.9% over this period.
- In 2023, banks have been slower in recognizing credit losses compared to 2022. Since the onset of the full-scale war, they have set aside UAH 107 billion in loan loss provisions, equivalent to nearly 13% of their performing loan portfolio at the end of February 2022.
- The ongoing resilience assessment of banks and the banking system indicates that, overall, banks are appropriately assessing credit risks.
- For reference: before the full-scale invasion, the NPL ratio had been steadily decreasing since 2018 (from 55% to 27% as of March 1, 2022), while the banks' loan portfolio had been growing.



THANK YOU.

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