

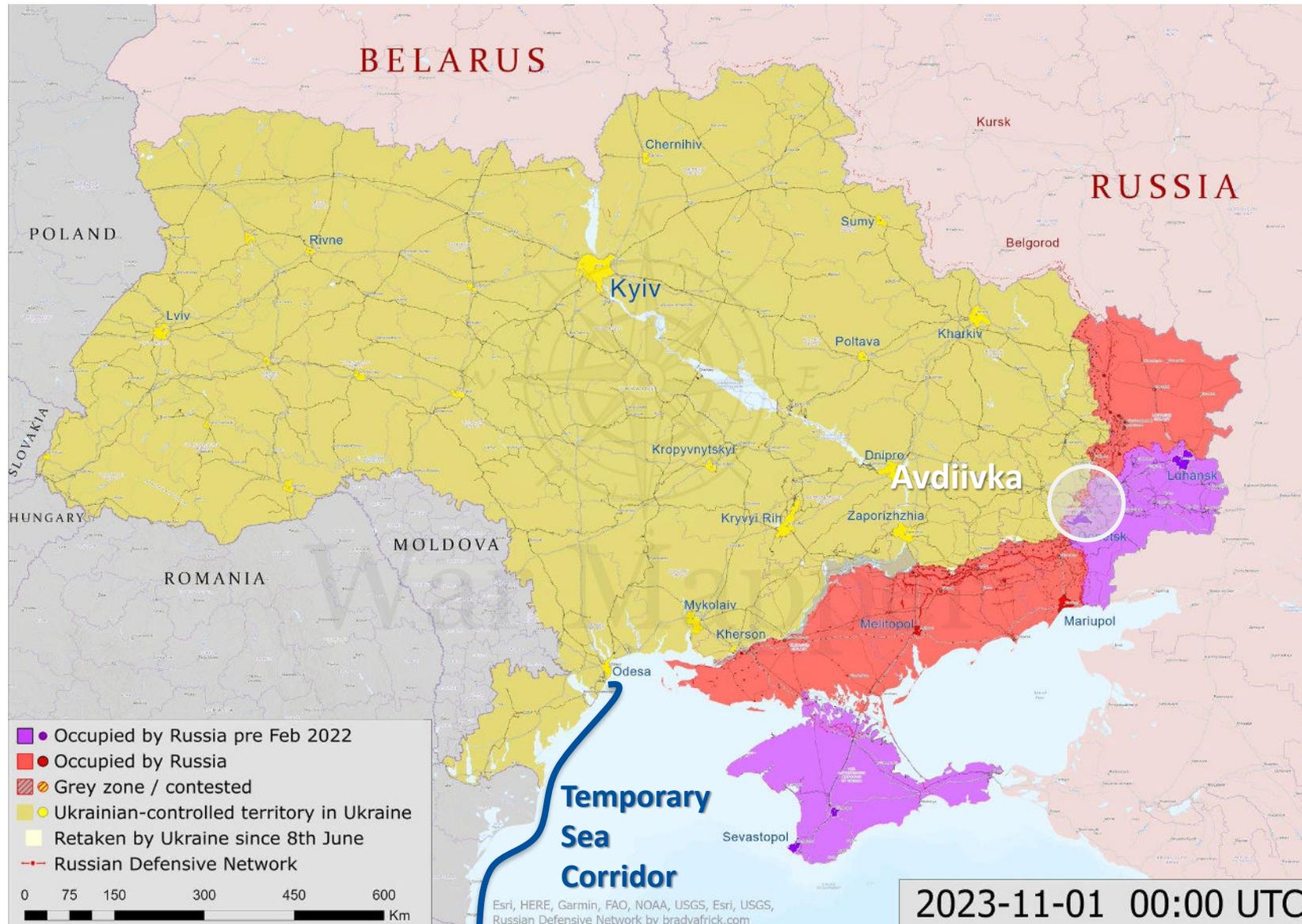


Economy review in December.
Special topic: EU Accession Negotiations: Is
the Ukrainian Economy Ready?



WAR

WAR UPDATE



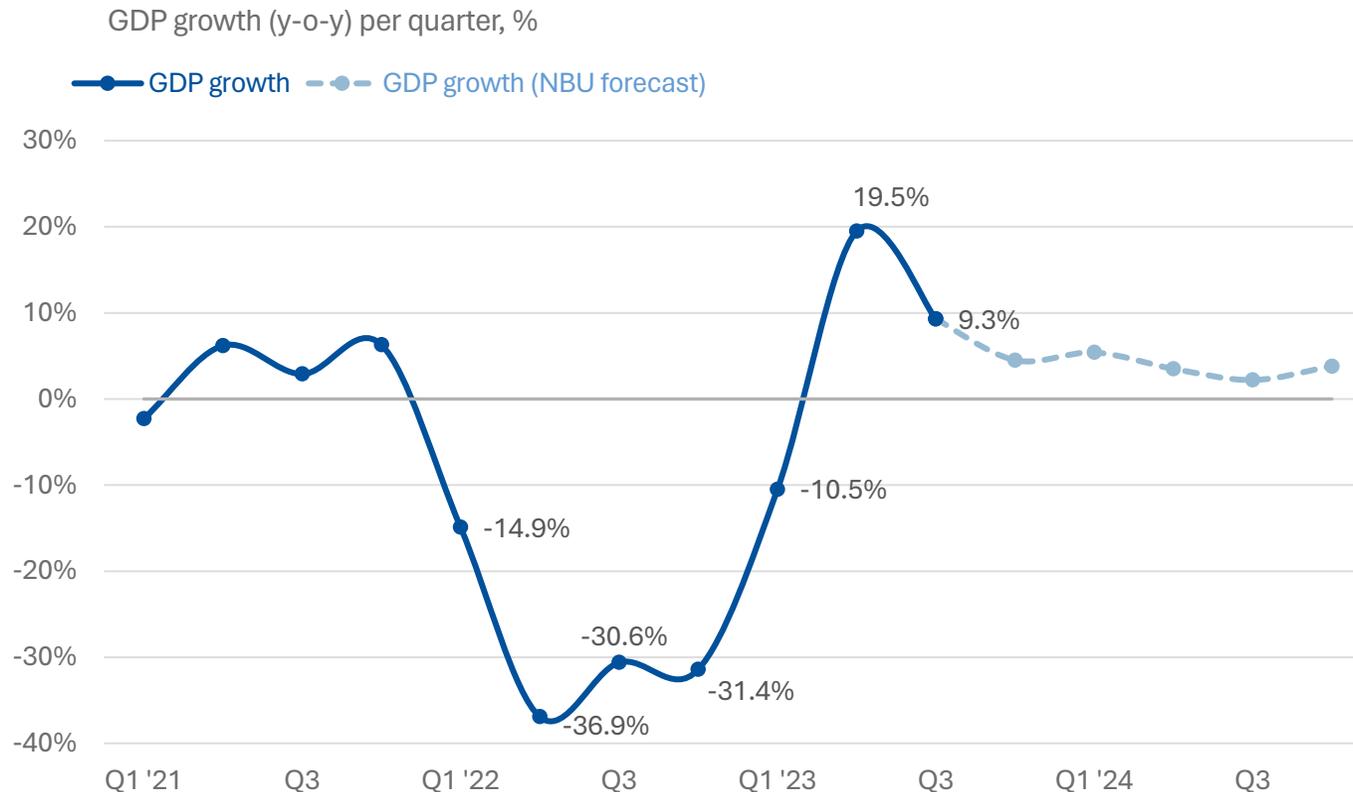
- In November, Ukrainian forces mostly switched to defensive mode, with Russian army eager to capture Avdiivka near Donetsk.
- Russia has been probing Ukrainian air defense, probably preparing for large-scale attacks on the energy sector.
- The temporary sea corridor, introduced by Ukraine to renew maritime access to Odesa ports, has been operating, with amount of agriculture exports reaching the Grain Deal levels.
- On December 12, the Kyivstar telecom provider — one of 3 largest in Ukraine — was attacked by the Russian hackers. All provider's services were down for more than a day.



MACROECONOMIC TRENDS

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GDP increased by 9.3% in Q3 2023 — more than expected



Sources: State Statistics Service of Ukraine, NBU

- Ukraine's GDP increased by 9.3% y-o-y in Q3 2023.
- The increase is larger than was forecasted by the NBU, which assumed that GDP would increase by 8.2% in Q3 2023.
- NBU forecasts the GDP to increase by 4.9% y-o-y in 2023, Dragon Capital — by 5.2% y-o-y.
- In 2024, the GDP is forecasted to increase by 3-4% (IMF), or by 3.6% (NBU).

MACROECONOMIC TRENDS

Business expectations slightly worsened in November



Source: NBU

- In November, the NBU's index of business expectations decreased to 49.1 compared to 49.6 in October, remaining 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 ongoing hostilities, increased security risks, disruption of logistics chains a certain limitation of electricity supply and its rise in price for businesses, tax changes, a narrowing of investment demand, and a shortage of skilled workers.

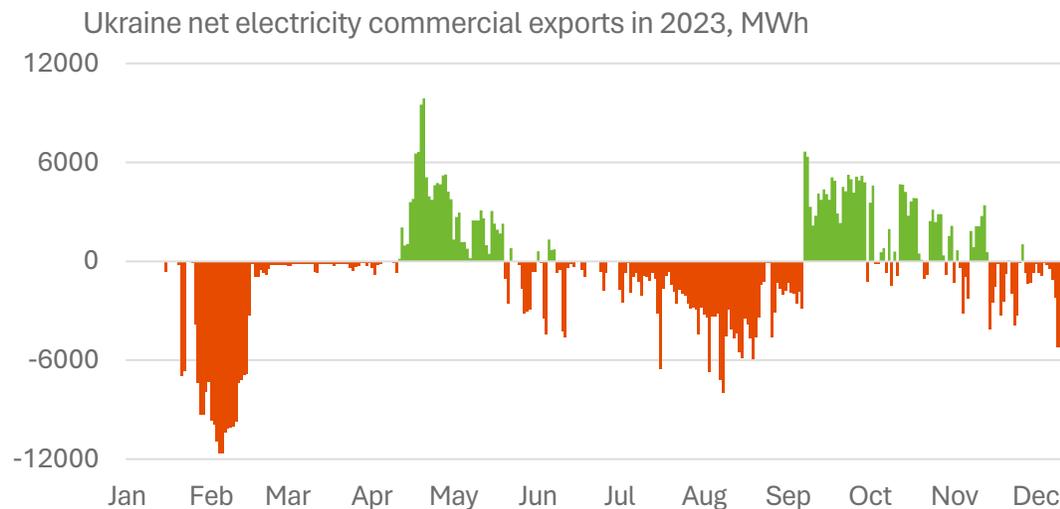


SECTORAL ANALYSIS

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Winter energy season: no blackouts yet

- Commercial electricity exports further decreased in November, with almost 40 000 MWh exported. However, electricity exports stopped in the end of the month, and more than 60 000 MWh were imported in November.
- With increased consumption due to cold weather, net electricity exports are negative.



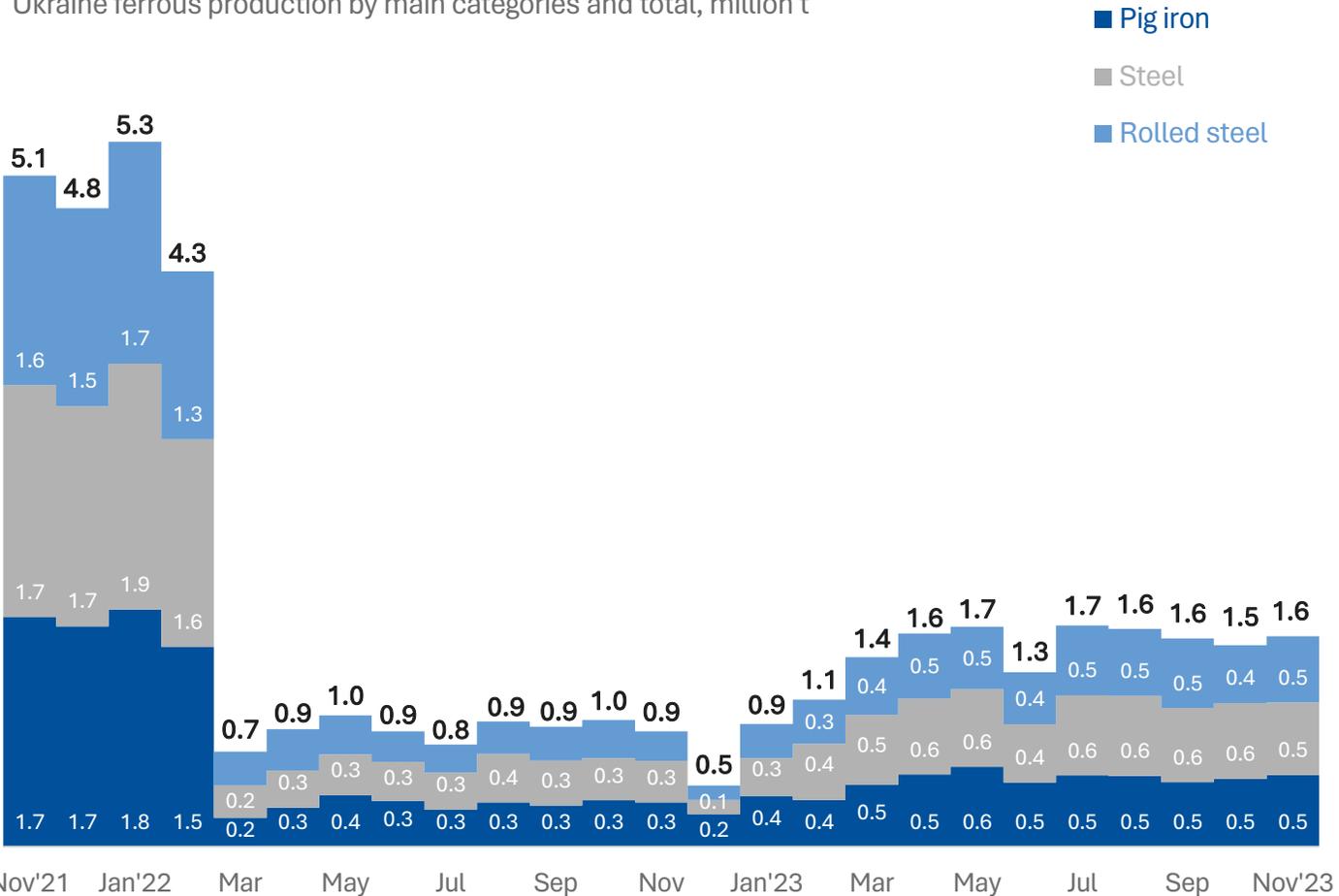
Source: ENTSO-E

- Russia has made several attempts to attack Ukrainian energy infrastructure without success.
- Ukraine lacks enough coal to pass through the winter without resorting to burning natural gas. Natural gas is more expensive but there is enough of it in the storages.
- Ukraine fulfilled all the conditions necessary to become a full member of the ENTSO-E. As a full member with voting rights, Ukraine will be one of the largest and most important members of the organization.

SECTORAL ANALYSIS

Ferrous production slightly increased in November

Ukraine ferrous production by main categories and total, million t



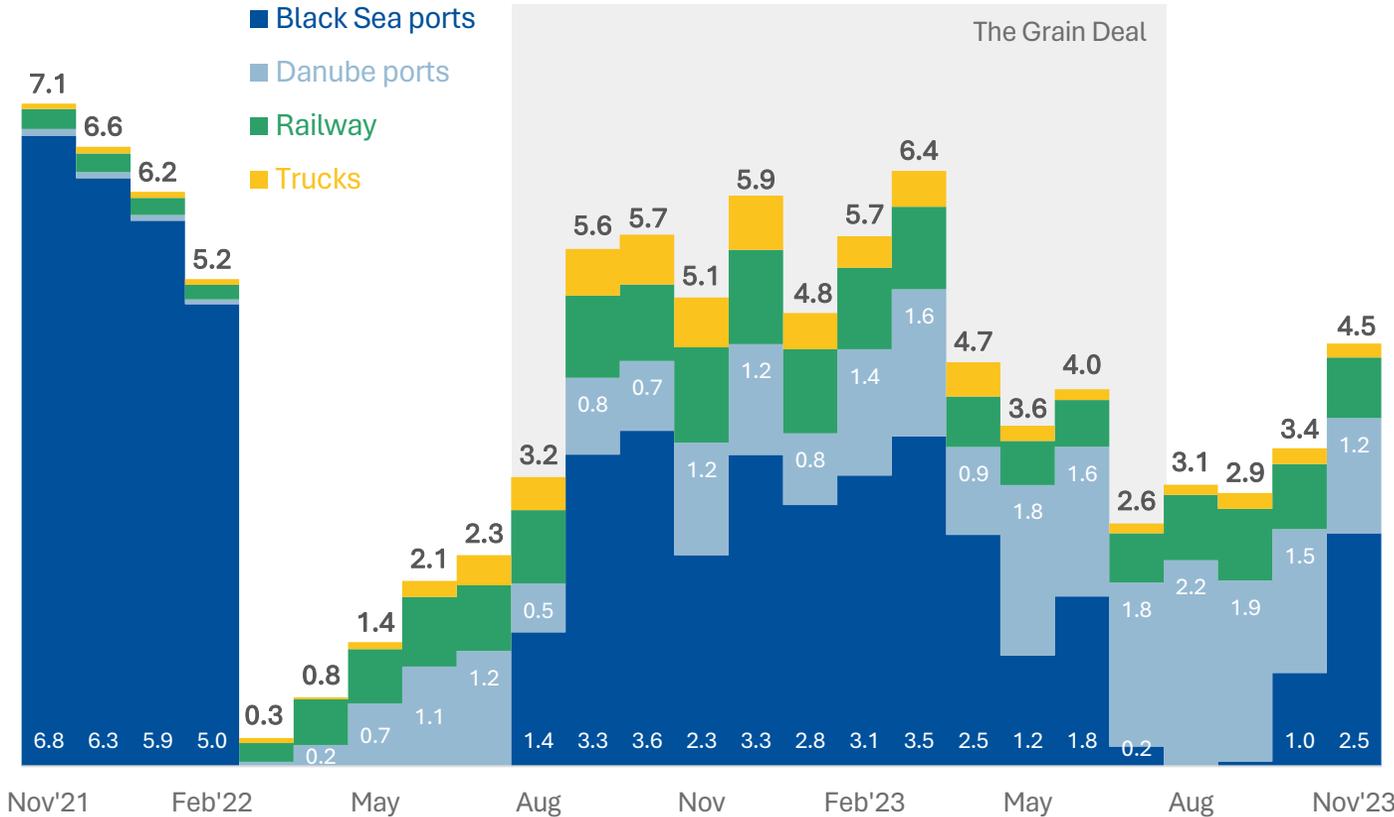
Source: Ukrmetallurgprom

- In November, the ferrous production increased by 4.4% compared to October.
- 14 ships which carried 0.62 m t of iron ore and 0.14 m t of metallurgical products departed the Black Sea ports in November. This is a 5.5% increase compared to October.
- Vessel escorts and greater mine-safety measures can increase cargo handling and make maritime exports safer

SECTORAL ANALYSIS

Grain exports by sea are on the rise

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



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

- The temporary sea corridor is working. According to the Ministry for Restoration, between August 8 and December 4, more than 7 million tonnes of cargo have been exported through the corridor from the ports of Pivdennyi, Odesa and Chornomorsk, including almost 5 million tonnes of Ukrainian farm products. In total, more than 200 vessels have already sailed through the Temporary sea corridor to Ukrainian ports and 226 vessels departed the ports.
- Production increased in almost all sectors of agriculture this year. It is imperative that Ukraine manages to increase sea exports.

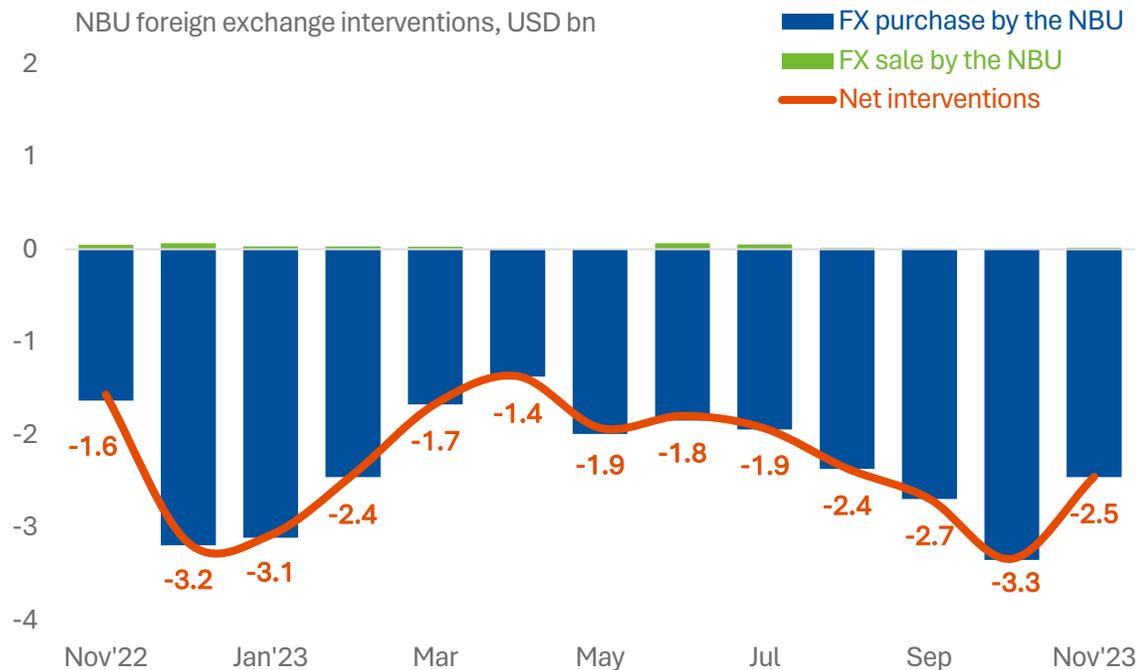
MONETARY AND FX POLICY

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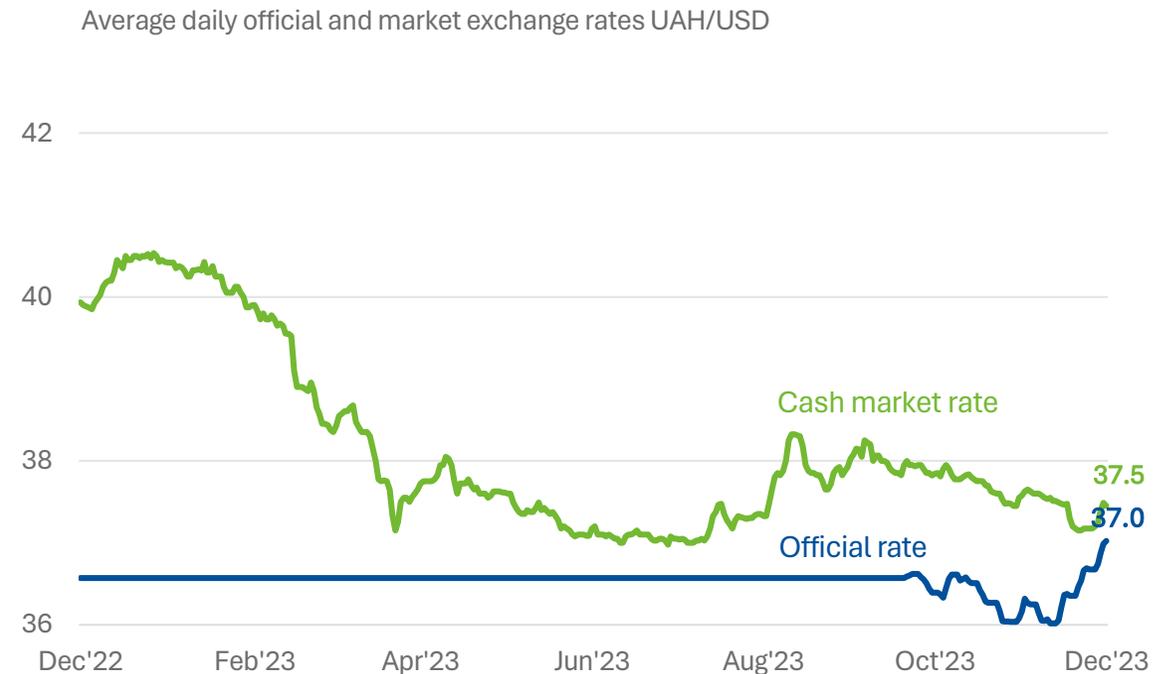
International reserves declined and hryvnia strengthened

There is still a need for significant FX sales by the NBU. In November, Ukraine's international reserves declined by 0.5% m-o-m, reaching 38.8 USD bn: the NBU interventions and FX debt repayments were largely offset by inflows of financial aid.

For more than two months already, the NBU has been adhering to the managed exchange rate flexibility regime. The official hryvnia rate strengthened at first, but then started going up along with the cash rate. Official hryvnia rate reached 37.0 on December 14, a new historic low.



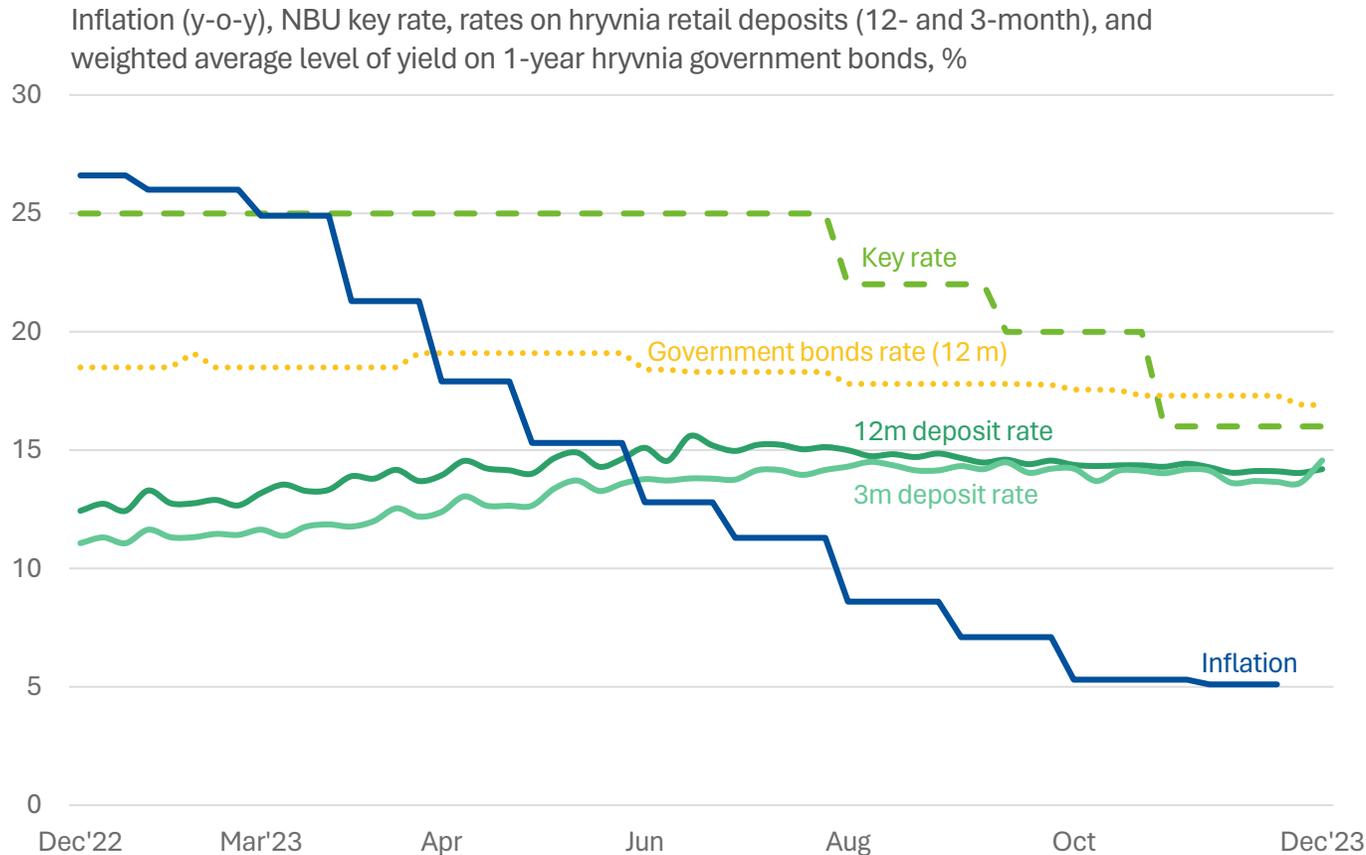
Source: NBU



Sources: NBU, Ministry of Finance

MONETARY AND FX POLICY

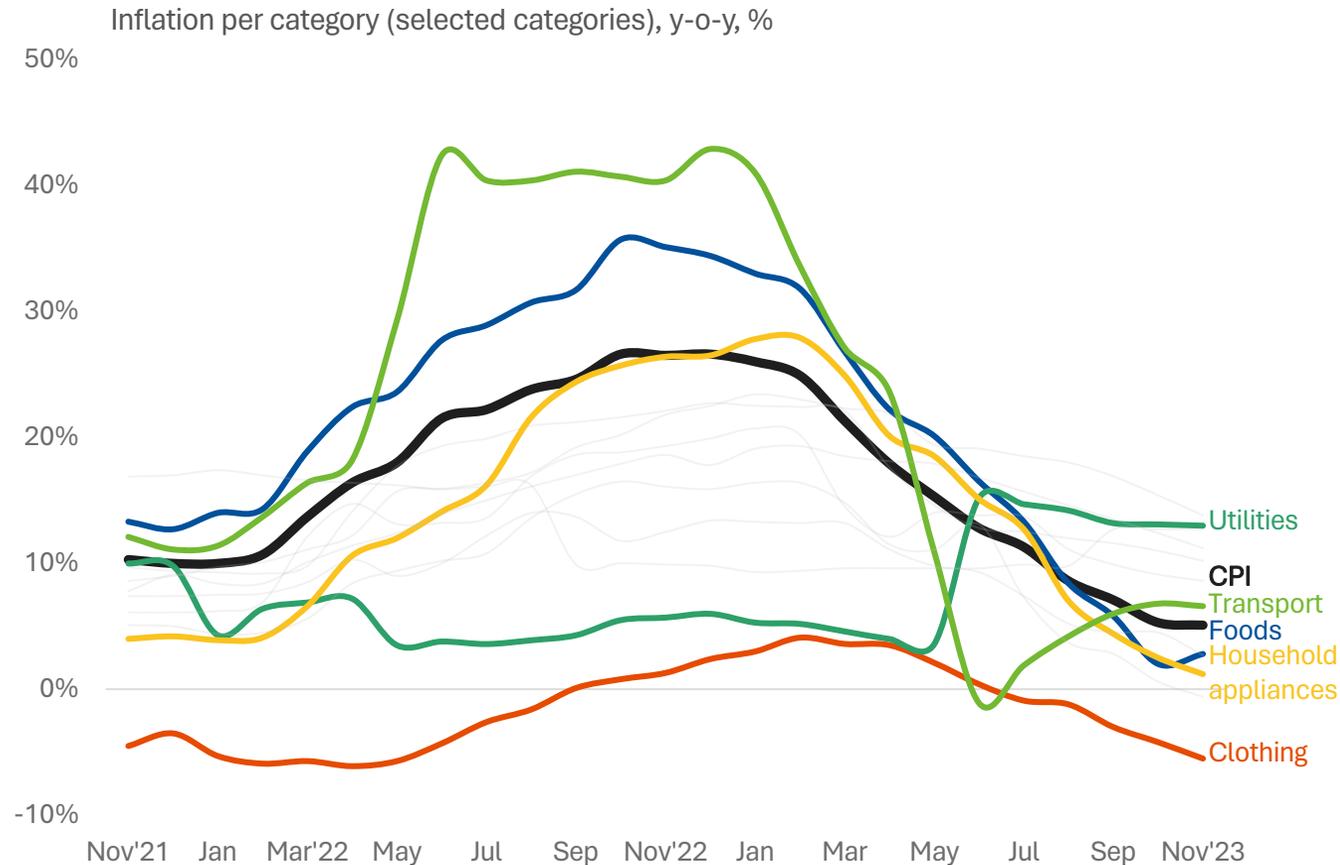
Key rate down to 15% as inflation decreased



- The key policy rate was cut from 16% to 15% effective December 15
- This choice coincides with a reduction in inflation and a positive shift in inflation expectations, enhancing the enduring appeal of hryvnia savings instruments.
- The yield of one-year hryvnia war bonds declined to 16.9%. At the end of November, the average rate on retail deposits decreased slightly for 3-month (13.7%) and 12-month deposits (14.1%).
- In November, inflation declined, and the growth in consumer prices decelerated to 5.1% y-o-y, almost achieving the NBU's inflation target.

MONETARY AND FX POLICY

Inflation slows down; CPI 5.1% y-o-y in November

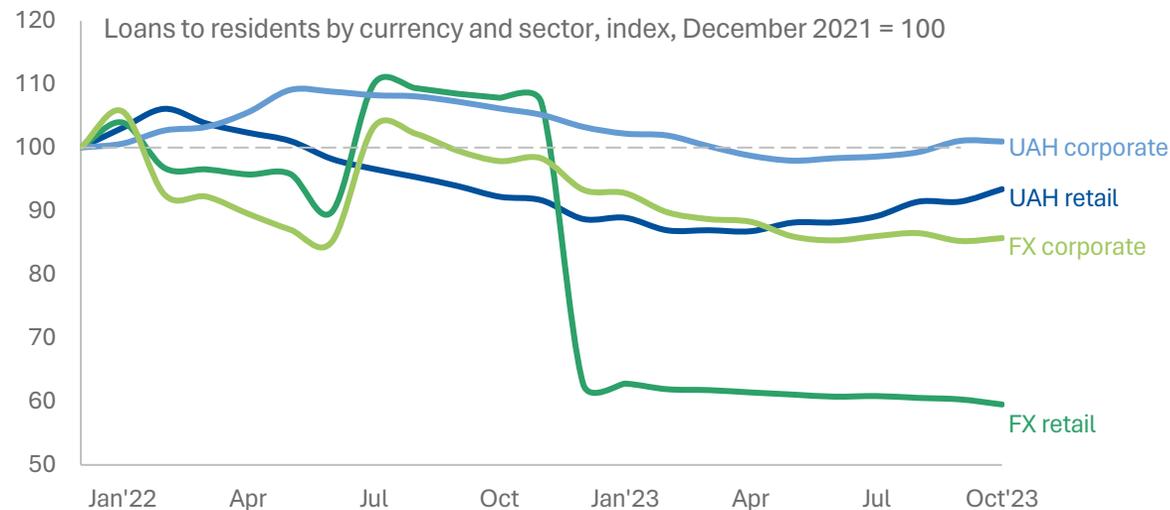
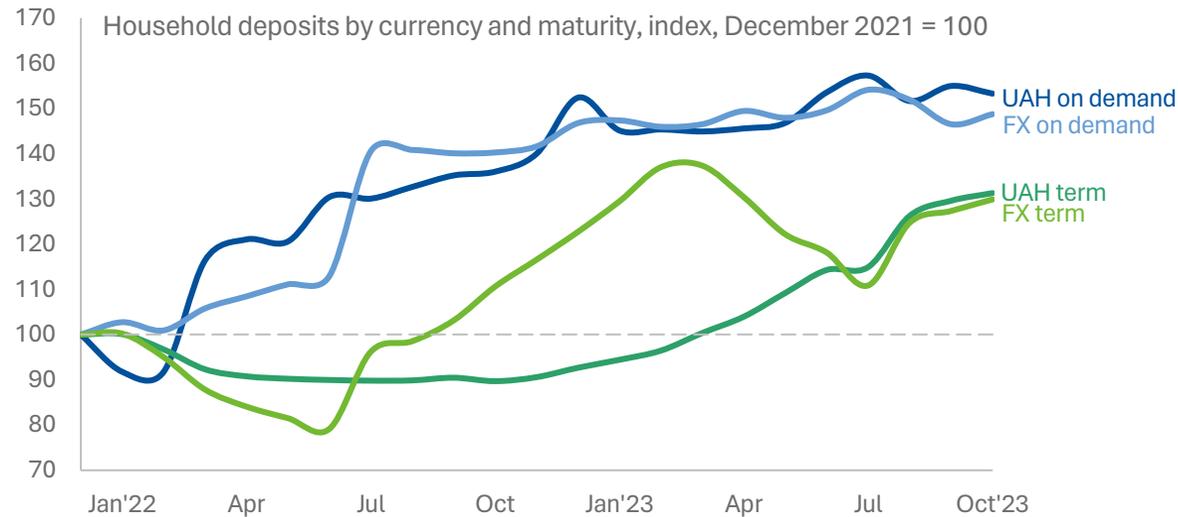


Source: State Statistics Service of Ukraine

- According to the State Statistics Service, inflation in November was +0.5% compared to September. Since the beginning of the year, inflation has amounted to 4.4%.
- The price of food products and non-alcoholic beverages creased by 0.8% over the month — vegetables rose in price the most (+13.2% m-o-m).
- Prices for transport increased by 0.9% m-o-m, mainly due to an increase in the price of fuel and lubricants and travel in road passenger transport by 1.8% m-o-m.
- Inflation moderated with increased food supply, including a robust harvest, while core inflation eased due to improved exchange rate expectations and reduced business costs.

BANKING SECTOR

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



Source: NBU

- In October, the volume of household deposits has increased both for UAH and FX term and FX on-demand, while the volume of UAH on-demand decreased slightly in comparison to September.
- The volume of corporate and retail loans continue to increase. PrivatBank and Ukrainian private banks saw the largest increases in hryvnia corporate loans, while two retail in terms of retail portfolios generated 3/4 of this increase.
- Most of the lending still occurs under the Affordable Loans 5–7–9% program with a focus on agriculture and whole trade enterprises. Loans within this program make up more than 40% of the operating gross portfolio of business hryvnia loans.
- As of November 1, 2023, NPLs were 37.7%, down 0.2 p.p. from October 1, with NPL volume increasing by UAH 2.8 billion and bank-provided loans growing by UAH 12.3 billion during the month.



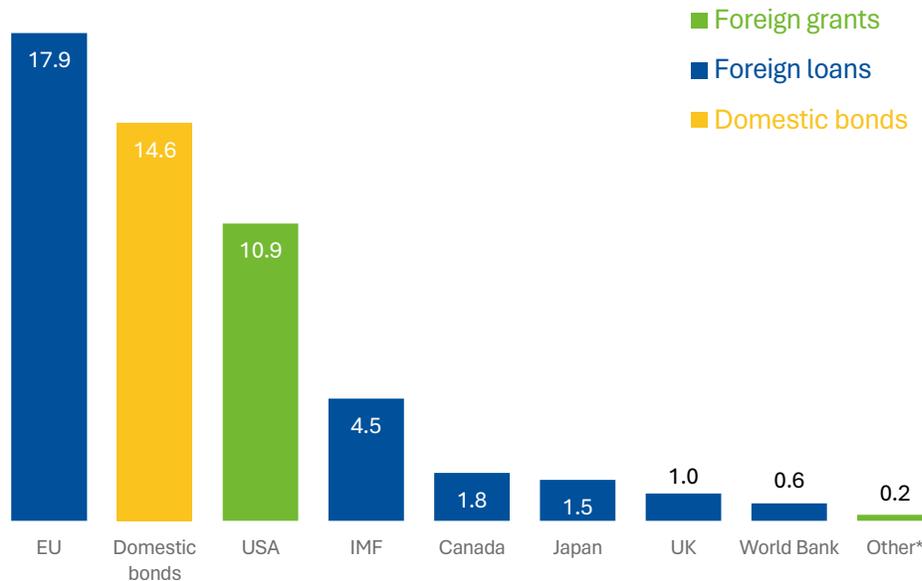
FISCAL SECTOR

FISCAL SECTOR

USD 2.1 bn of foreign financing in November

In November, Ukraine received a USD 1.6 bn loan from the EU, a USD 400 m loan from the World Bank (under the UK guarantee), and another USD 5 m loan from the World Bank. Ukraine did not receive grant funding from the US, as it has not yet been approved by the Congress.

2023 additional financing of Ukraine's state budget as of December 14, USD bn



Source: Ministry of Finance

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

11 months 2023:

- State budget deficit, debt repayment needs: USD 51.2 bn
- Foreign financing disbursed so far: USD 37.4 bn
- No monetary financing

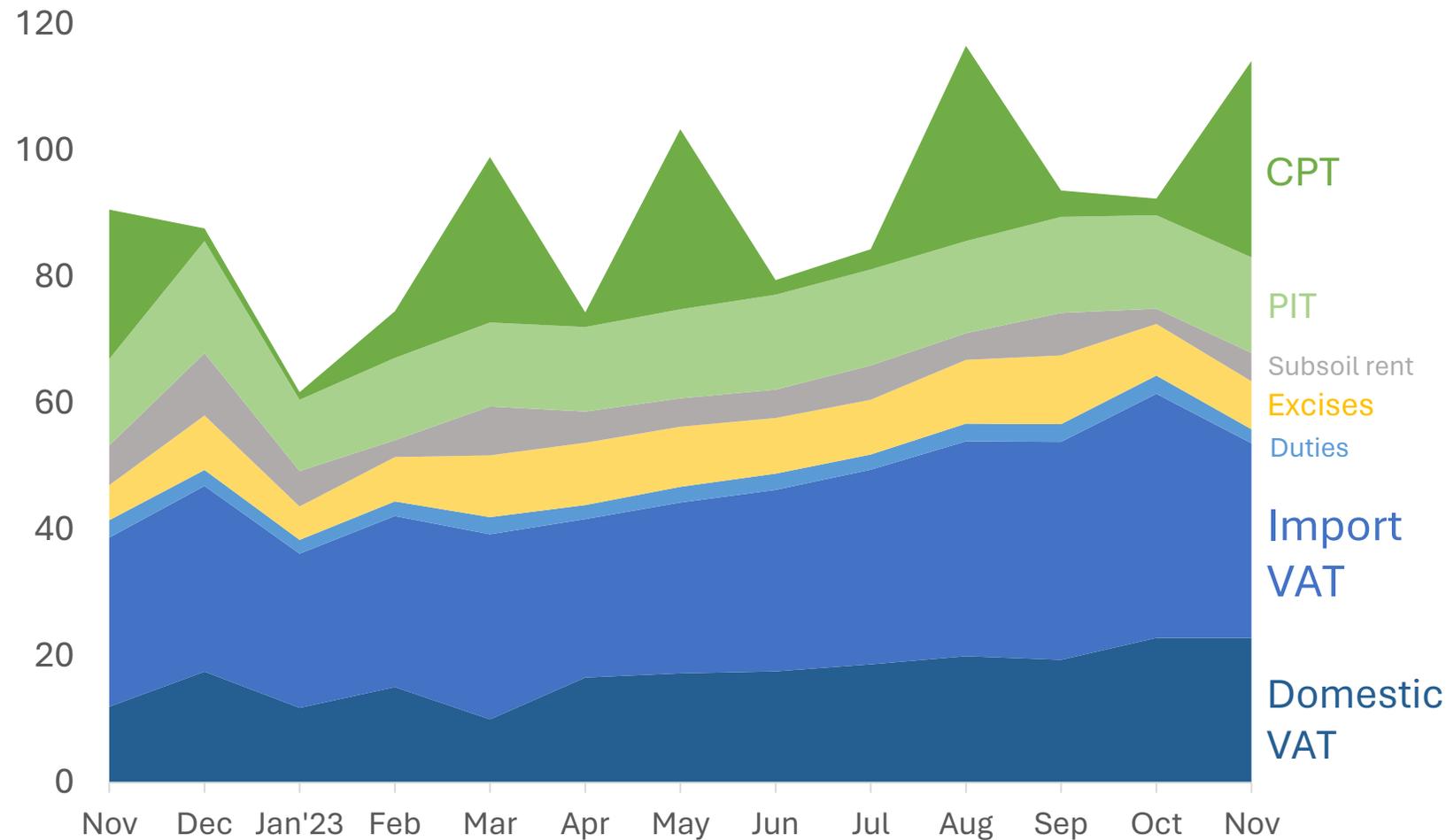
Foreign financing, state budget deficit and debt repayment, USD bn



Source: Ministry of Finance, NBU, CES calculations

FISCAL SECTOR

Tax revenues from imports slump, balanced by strong corporate profits



Source: Ministry of Finance

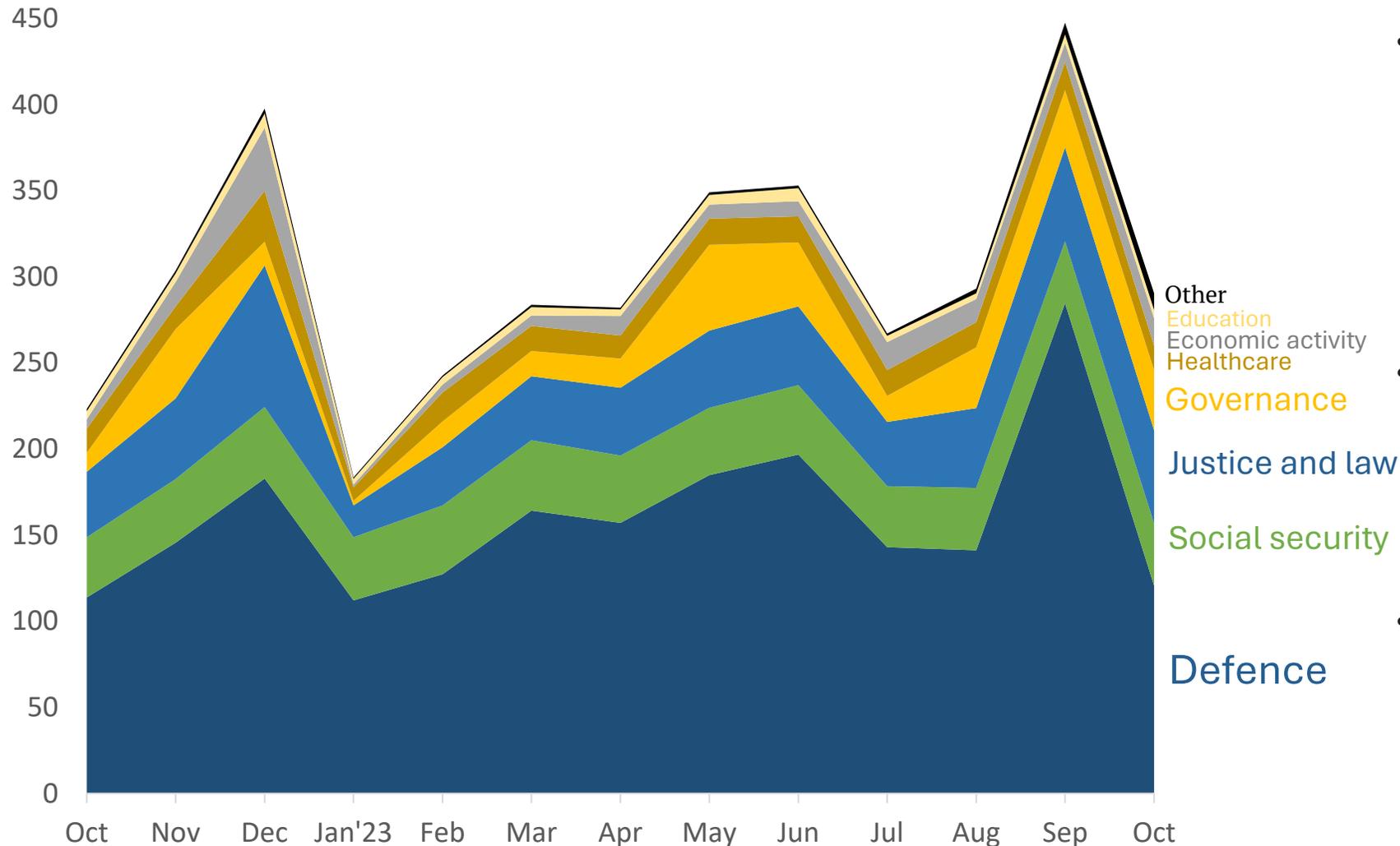
Tax revenues in November hit UAH 114.2 bn

- Decline of import VAT (-20% MoM), duties and excises due to blockade of boarder crossings with EU countries, mostly – Poland
- Domestic VAT revenues maintained at UAH 22.9 bn, refunds steady
- CPT compensated for loss of indirect tax revenues from imports

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 down to the lowest since January

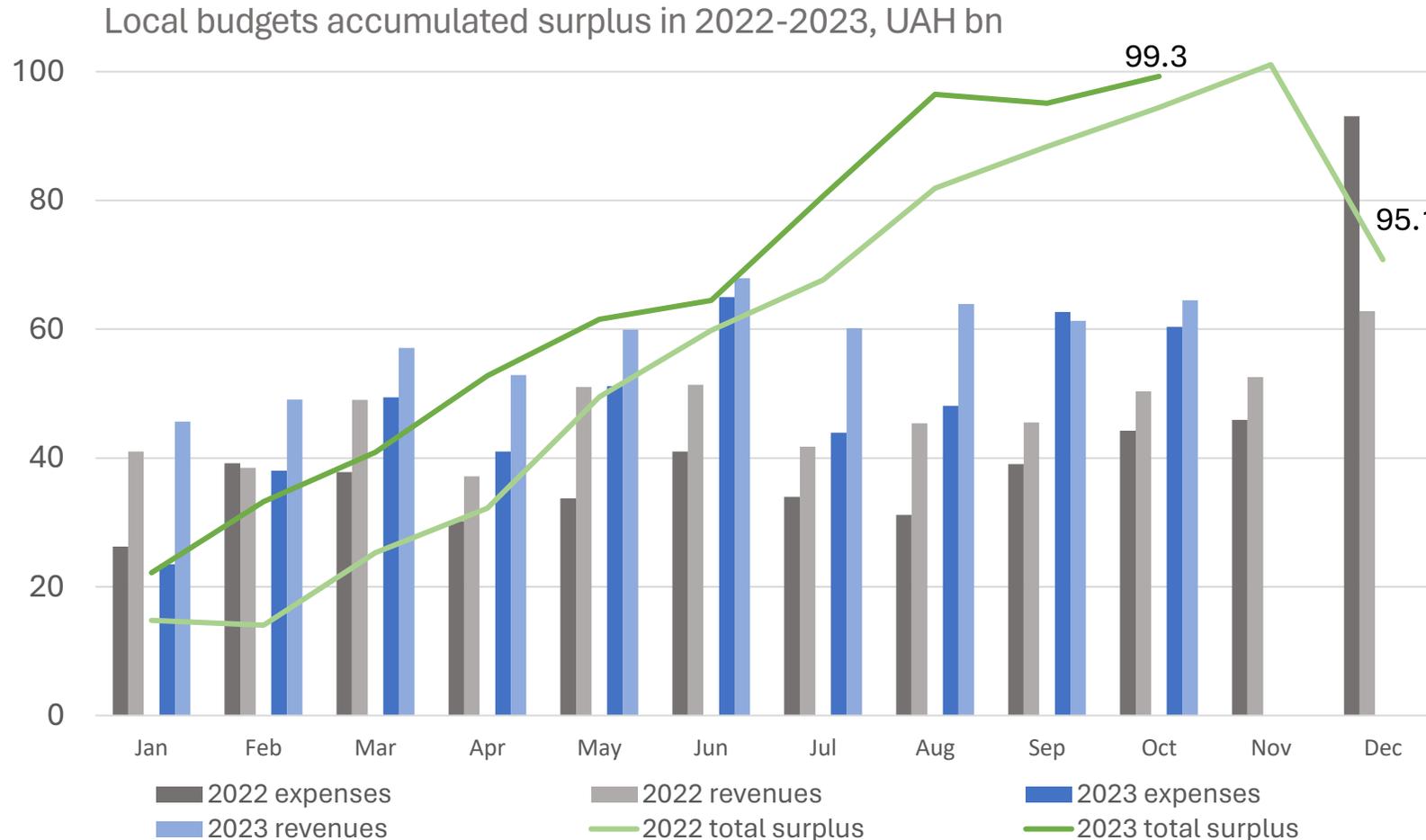


Source: Ministry of Finance

- Monthly defense spending declined to UAH 121 bn, the lowest monthly spending since January. Major driver – decrease of weapons and ammo procurement by UAH 92 bn vs September.
- The economic activity expenses increased MoM by UAH 5 bn, driven by expenses on protection of critical infrastructure.
- UAH 6 bln were allocated under Utilities function on construction of water pipe system

FISCAL SECTOR

Local budgets total surplus hits new high



- October local budgets **expenses** slightly decreased to **UAH 60.3 bn**.
- Growth in monthly **revenues** to **UAH 64.5 bn** contributed to increase of **accumulated surplus** of local budgets in 2023 to **UAH 99.3 bn**.

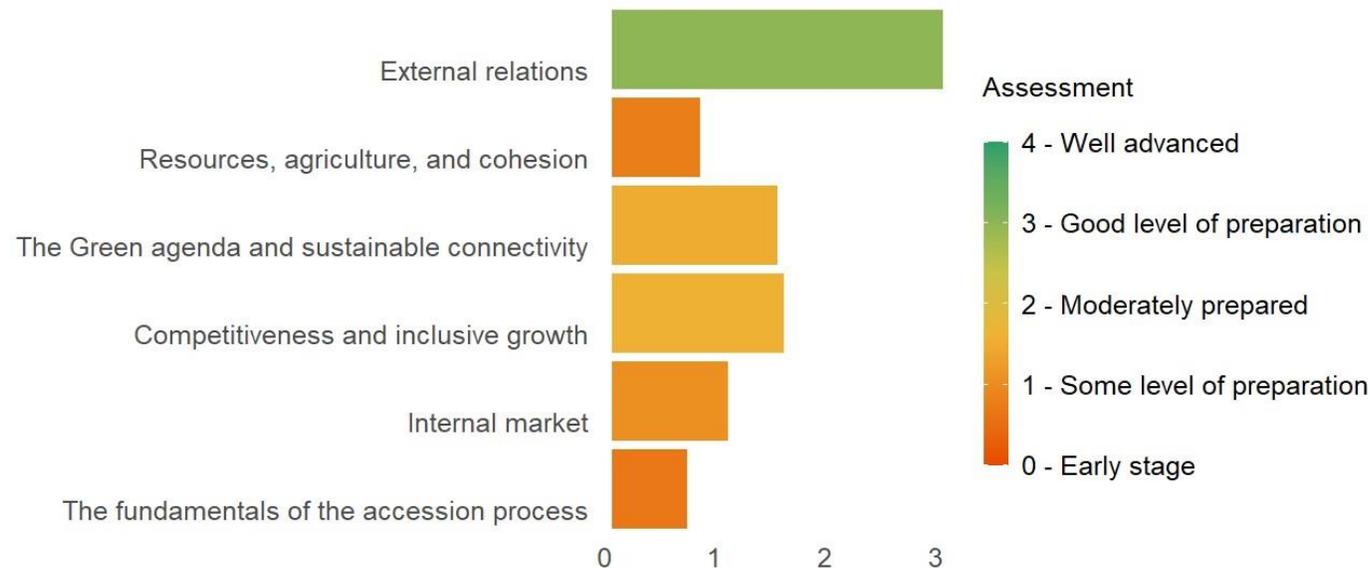
Source: Ministry of Finance, CES calculations



PERSPECTIVES OF THE EUROPEAN UNION ACCESSION

UKRAINIAN ECONOMY AT A GLANCE

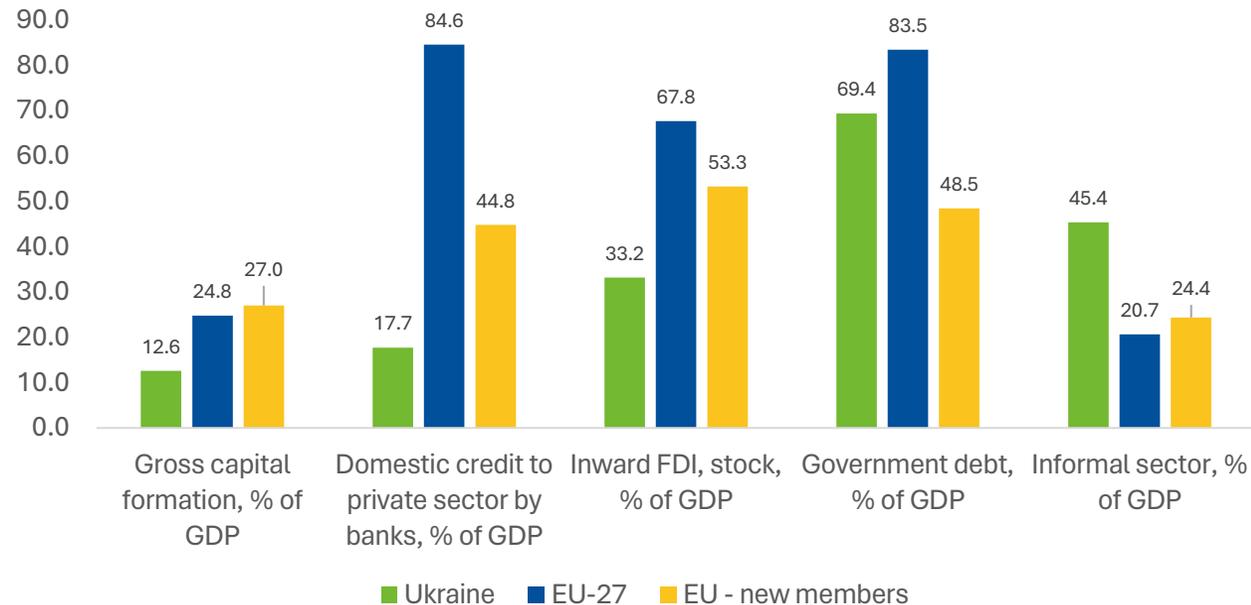
In the most recent European Commission report issued in November, Ukraine was assessed based on 33 chapters classified by 6 clusters.



- The fundamentals of the accession process chapters were assigned a score between «early stage» and «some level of preparation». **Resources, agriculture, and cohesion cluster** performed slightly better.
- **Internal market, Competitiveness and inclusive growth, The Green agenda and sustainable connectivity** criteria got scored between «early stage» and «good level of preparation».
- The greatest progress was achieved in the field of **Foreign relations** («good level of preparation»).

THE EXISTENCE OF FUNCTIONING MARKET ECONOMY

The adequate policy response facilitated macroeconomic stability during the war. However, the government footprint is increasing, and there are some persistent structural problems.



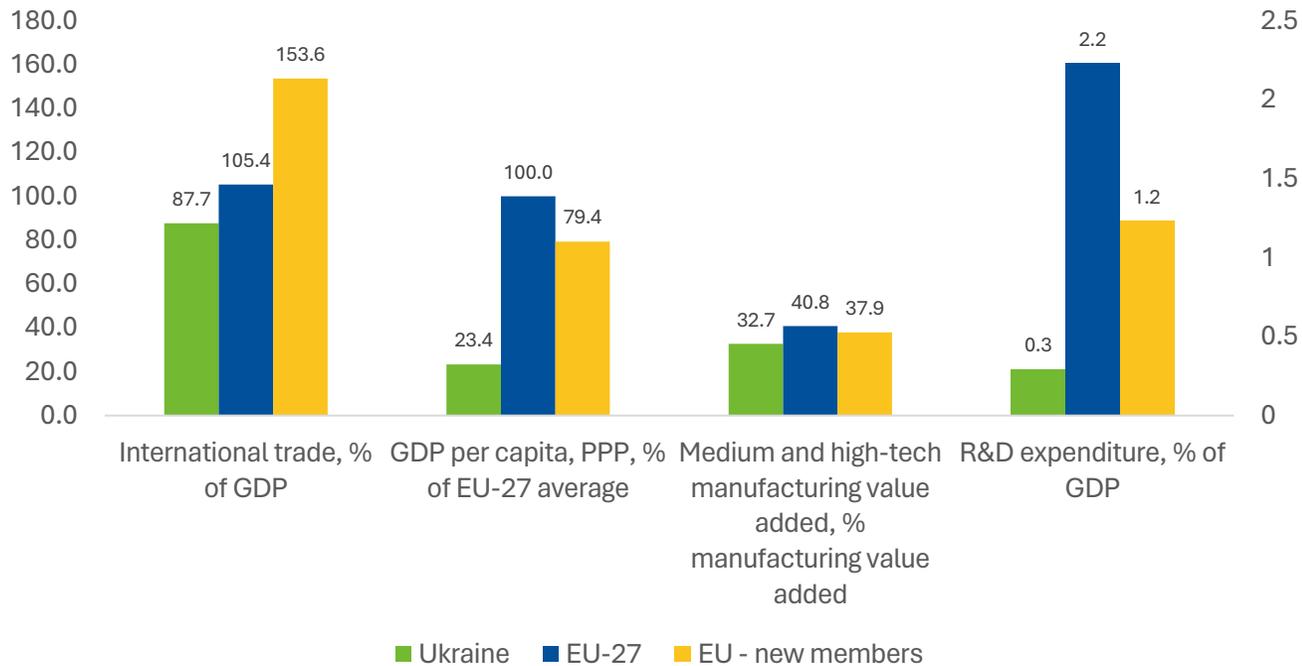
Note: based on the most recent data. When computing average inward FDI figures for the EU, tax havens were excluded. The list of the EU new members includes CEE countries, which joined EU in 2004 and later (Bulgaria, Croatia, Czechia, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia).

Sources: ECB, Eurostat, Ministry of Finance of Ukraine, NBU, UNCTAD, the World Bank.

- Ukrainian economy is between **an early stage and some level of preparation** towards establishing a functioning market economy.
- Key recommendations:
 1. **Regarding economic governance:** continue to implement prudent policies maintaining macroeconomic stability. Ensure adequate financing for core state functions, at the same time improving public finance transparency. Safeguard financial sector stability.
 2. **Regarding private sector:** improve business environment. Reduce regulatory and administrative burden, address the problem of corruption and enhance the anti-monopoly framework. Foster effective management of state-owned enterprises and intensify privatization.
 3. **Regarding labour market:** take measures to reintegrate internally displaced persons to the labor market. Address structural labor market issues and the informal employment problem.

THE CAPACITY TO COPE WITH COMPETITIVE PRESSURE AND MARKET FORCES WITHIN THE UNION

Ukrainian economy had been demonstrating little progress before the full-scale invasion. Current substantial international financing should be utilized for modernisation purposes.



Note: Note: based on the most recent data. The list of the EU new members includes CEE countries, which joined EU in 2004 and later (Bulgaria, Croatia, Czechia, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia).

Sources: Eurostat, the World Bank.

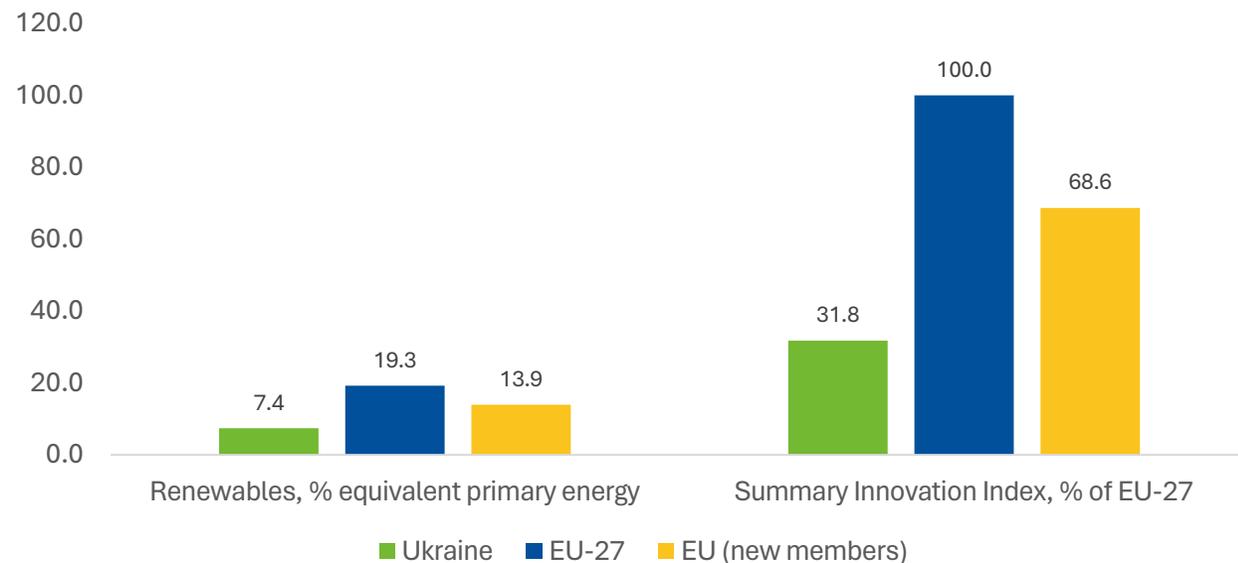
- Ukraine is at an **early stage of preparation** in terms of its capacity to cope with the competitive pressure and market forces within the EU.

Key recommendations:

- Regarding infrastructure:** keep renewal and rehabilitation of infrastructure, in particular, transport and energy infrastructure, schools, and healthcare facilities.
- Regarding investment:** facilitate investment, in particular, by improving public procurement and developing administrative capacities.
- Regarding human capital:** improve education and training, modernise education in accordance with the labour market and reconstruction needs. Ensure that education system can re-integrate Ukrainians returning from abroad.

ABILITY TO ASSUME THE OBLIGATIONS OF MEMBERSHIP

During the upcoming year, Ukraine must become closer to adopting the European *acquis communautaire* in numerous areas.



Note: based on the most recent data. The list of the EU new members includes CEE countries, which joined EU in 2004 and later (Bulgaria, Croatia, Czechia, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia).

Sources: Energy Institute Statistical Review of World Energy, European Innovation Scoreboard.

- For instance, the production of **renewable energy** should be increased substantially.
- The list of recommendations also includes adoption of the **strategy for scientific and technological development**.
- There is a need to align **VAT, direct taxes, and excise duties** with the EU legislation.
- In the upcoming year, some progress is required in the field of **social policy and employment**.
- In total, there are **27 chapters**, for which Ukraine has not reached the stage of “moderate preparation” yet.



ECONOMIC AND MONETARY POLICY RECOMMENDATIONS

ECONOMIC AND MONETARY POLICY RECOMMENDATIONS

Economic and monetary policies: conclusion and recommendations

Ukraine is **moderately prepared** in the area of economic and monetary policy. As the Russian full-scale invasion demanded extraordinary economic policy measures, **no progress could be made in the policy areas**. In times of war, the Ukrainian authorities have implemented extensive measures to preserve macroeconomic and financial stability, deviating from conventional practices when necessary. This policy approach has successfully ensured stability.

In the coming year, Ukraine should in particular:

- prepare to **return to inflation targeting and flexible exchange rate regime**;
- **limit monetary financing** of the state budget;
- prepare to return to **medium-term budgetary planning** in 2024.



Monetary policy: key points from the EU Commission

- The legislative framework ensures the NBU's functional, institutional, personal, and financial independence, while also prohibiting both direct and indirect monetary financing of the public sector.
- Recent legislation has boosted the Central Bank's independence, emphasizing operational autonomy, including supervision functions. The law mandates the NBU to carry out tasks without external or public interference.
- However, this legislation, adopted in 2021, still provides a degree of interaction with the authorities through mutual consultations between the NBU and the government.
- The legal framework allows the President of Ukraine or the Rada to unilaterally remove a governing body member, reducing safeguards against arbitrary dismissals by eliminating judicial review.
- There is **still room for refining eligibility criteria and experience requirements for appointments to the Council and Executive Board.**

ECONOMIC AND MONETARY POLICY RECOMMENDATIONS

Economic policy: key points from the EU Commission

- Medium-term budget planning has become **difficult due to the war**.
- **Transparency has suffered a setback**, as there has been a significant reduction in the publication of comprehensive budgetary information.
- Ukraine has continued to forecast economic and social developments, although it has become very challenging in view of the many uncertainties.
- Forecasting capacities need **to be stronger**.
- **Lack of independent fiscal institutions** for evaluating forecasts, scrutinizing the budgetary assumptions, or evaluating previous forecasts' performance.
- **The Ukrainian government has initiated a return to medium-term budget planning starting with the 2024 budget**, and tentative steps have been taken to reform the accounting framework.
- **Economic Security Strategy (2021-2025)** approved by Presidential decree in August 2021, includes a transparent system with **34 indicators aligned with the EU framework** for continuous monitoring of economic stability.
- **Ukraine does not report general government sector data in line with ESA 2010**, as they are based on the IMF's GFS Manual 2014, which differs substantially.



THANK YOU.

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