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Economy review in March.

Special topic: How can the Ukrainian economy
withstand new energy attacks?



EXECUTIVE SUMMARY

EXECUTIVE SUMMARY: UKRAINIAN ECONOMY IN MARCH 2024

- **SPECIAL TOPIC:** Russia intensified attacks on energy infrastructure. The energy system of Ukraine now has a deficit of generation capacity. Ukraine needs nearly \$5 bn to restore capacity of the united energy system.
- **Macroeconomic trends:** GDP increased by 5.3% in 2023, but the growth only partially offset the 28.8% GDP drop in 2022. Business expectations were positive again in March — for the first time in half a year.
- **Sectoral analysis:** Steel production sets new wartime highs, with 611 kt produced in March 2024 — still 3 times lower than in March 2021. Exports of grain and oilseeds decreased as seasonality returns. IT exports remain on two-year low.
- **Monetary, FX, and Banking sector:** Inflation slows down even further to 3.2% in March, and NBU decreased the key rate to 14.5%; NBU keeps the key rate high to support the appeal of hryvnia assets. International reserves increased thanks to large foreign aid, but hryvnia continued to devalue.
- **Fiscal sector:** In March, Ukraine received \$8.9 bn of foreign financing, a highest-ever amount. The large inflows of foreign financing in March somewhat levelled out the negative situation that had been developing in the first quarter of the year.

See our report below for further details.

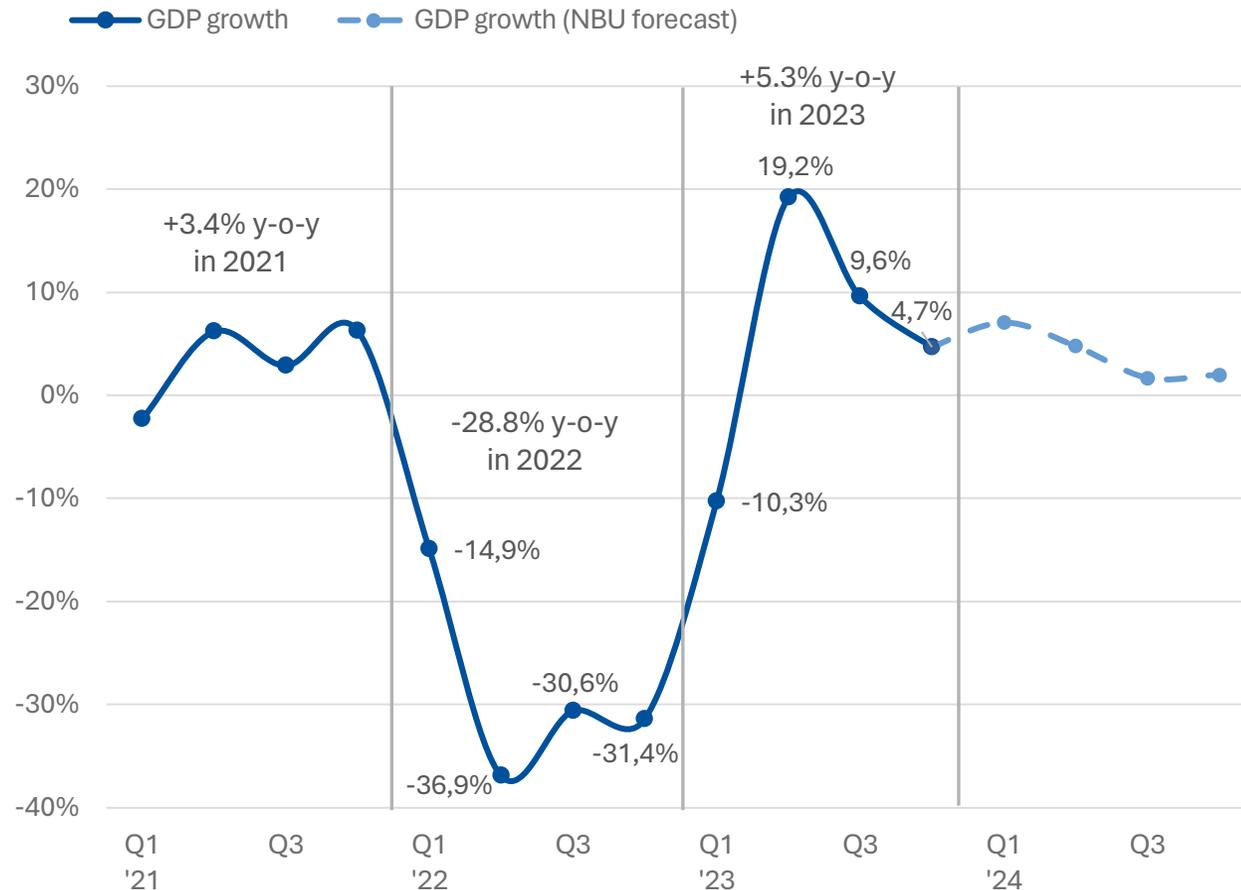


MACROECONOMIC TRENDS

MACROECONOMIC TRENDS

GDP increased by 5.3% in 2023

GDP growth (y-o-y) per quarter, %



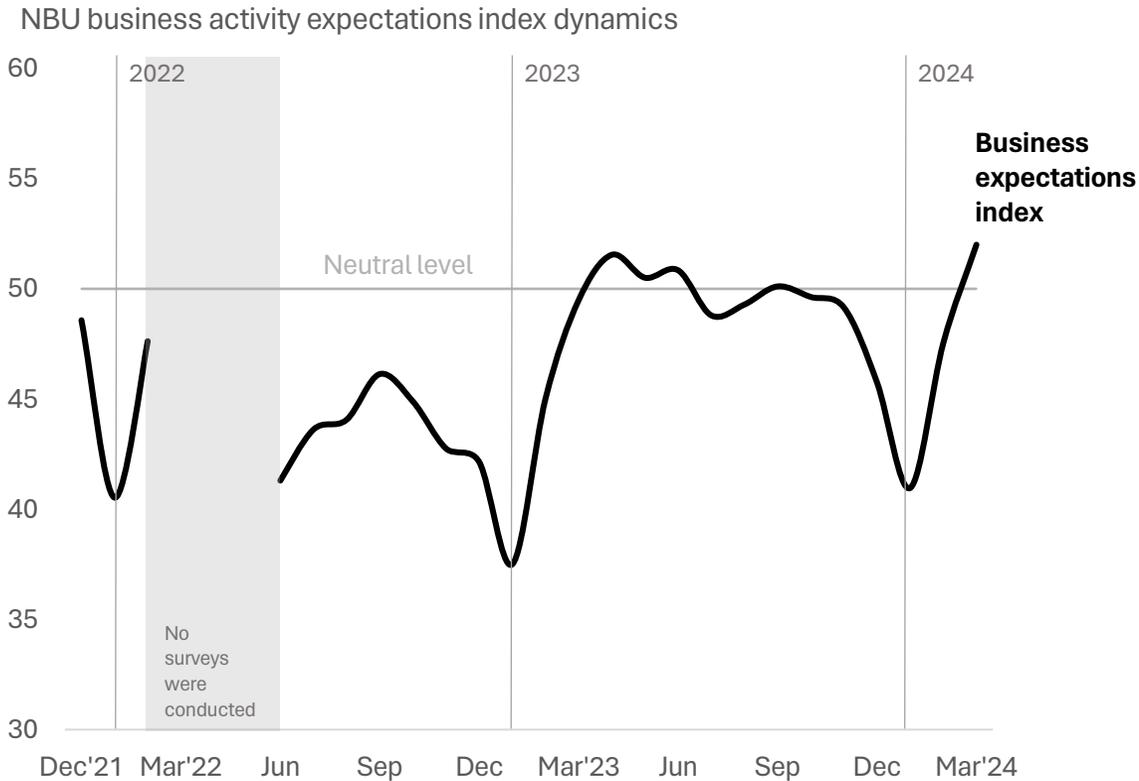
Source: State Statistics Service of Ukraine, NBU

- In 2023, GDP of Ukraine grew by 5.3% according to a figure published by the State Statistics Service.
- This growth only partially offset the 28.8% GDP drop in 2022.
- The Ministry of Economy estimates that GDP increased by 3.6% y-o-y in Jan-Feb 2024.
- GDP remains at approximately 3/4 of 2021 levels and the recovery slows down.

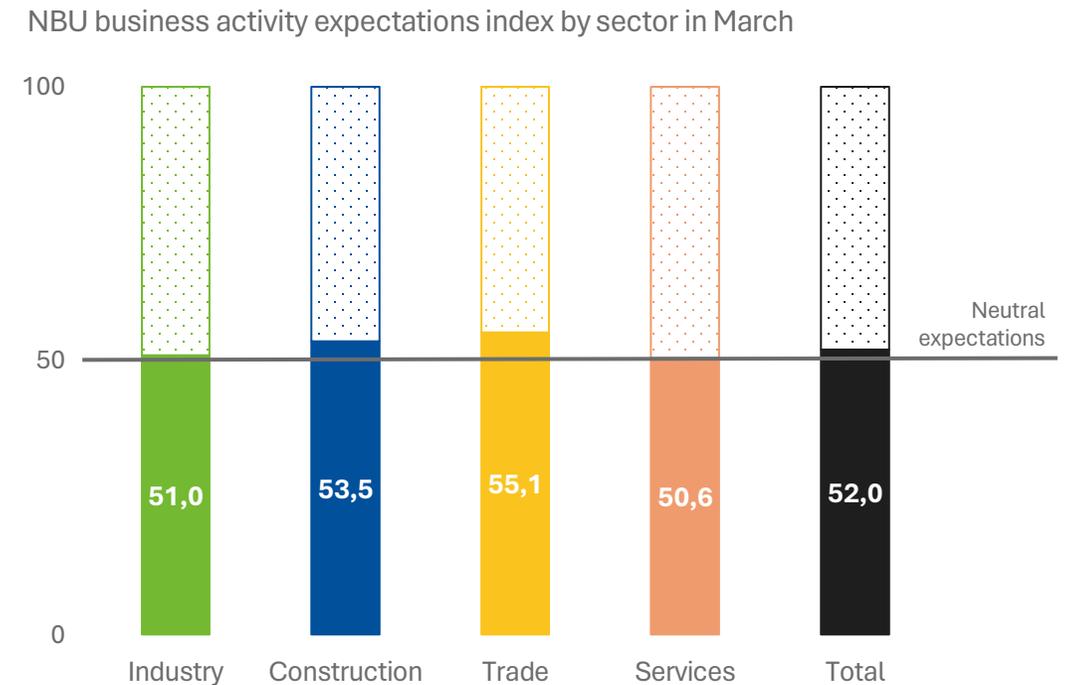
MACROECONOMIC TRENDS

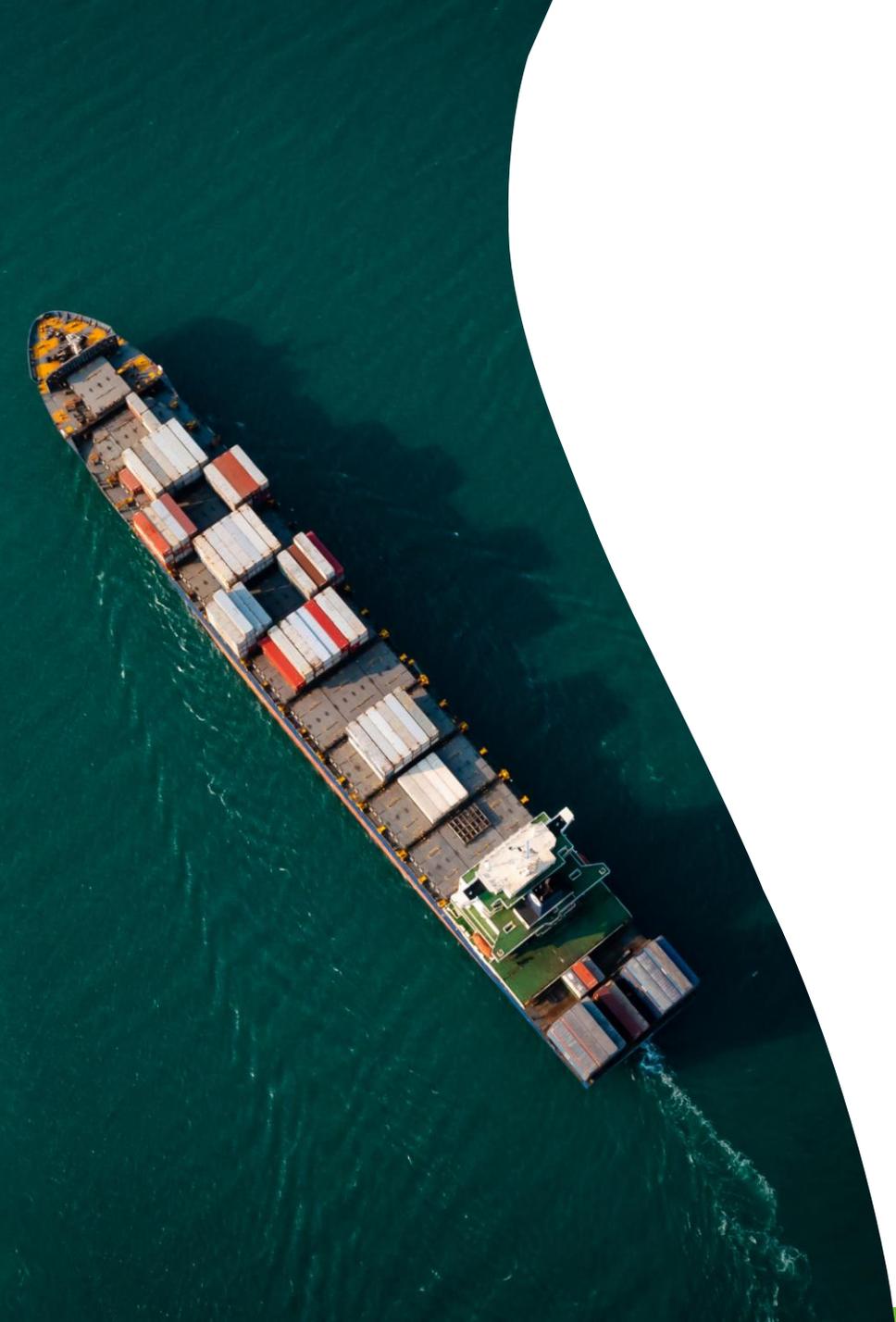
Business expectations are positive in March

- In March, NBU business activity expectations index was 52 — expectations improved and are now at the highest level during the full-scale war. Expectations became positive for the first time in 6 months.
- All sectors except reported positive expectations. Respondents across all sectors were encouraged by an increase in shipping and rail traffic, a stable FX market, low inflation expectations, and a seasonal pickup in business activity.



Source: NBU





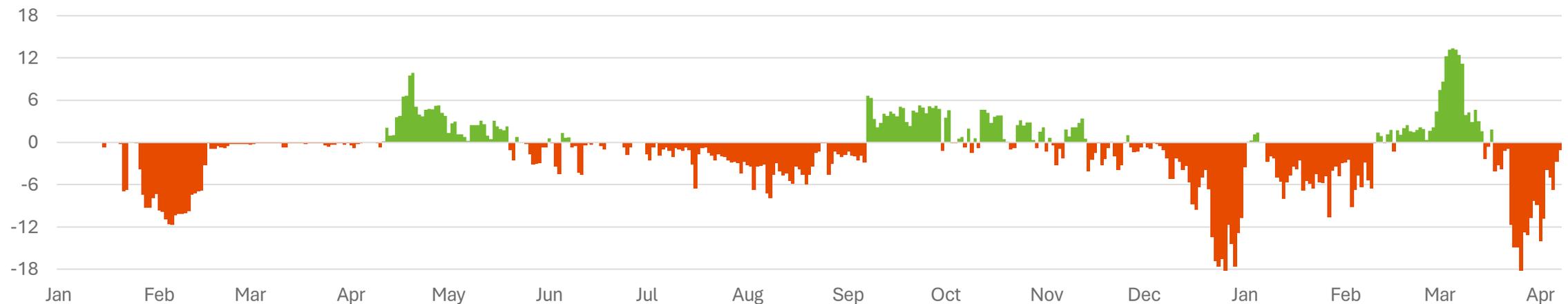
SECTORAL ANALYSIS

SECTORAL ANALYSIS

Russian assaults on power infrastructure compel resumption of energy imports

- After Ukraine restored electricity exports in March, **Russia intensified its attacks on Ukraine's energy facilities.**
- On April 11, Centrenergy announced the loss of 100% of its generating capacity
- After the largest attacks (March 22, 23, 29), 1 million consumers were left without electricity, and emergency blackouts were introduced in 7 regions of the country. As of April 8, 398 settlements in 6 regions are currently without electricity.
- In the first two weeks of March, net electricity exports from Ukraine amounted to 112 GWh, but the second half of the month was determined by Russian shelling of the power system and the need to import significant amounts of electricity (up to 18.7 GWh on March 26). As a result, net imports in March amounted to 17 GWh.
- In the first week of April, net imports amounted to another 44 bn GWh, but **the deficit in the system is gradually decreasing.**

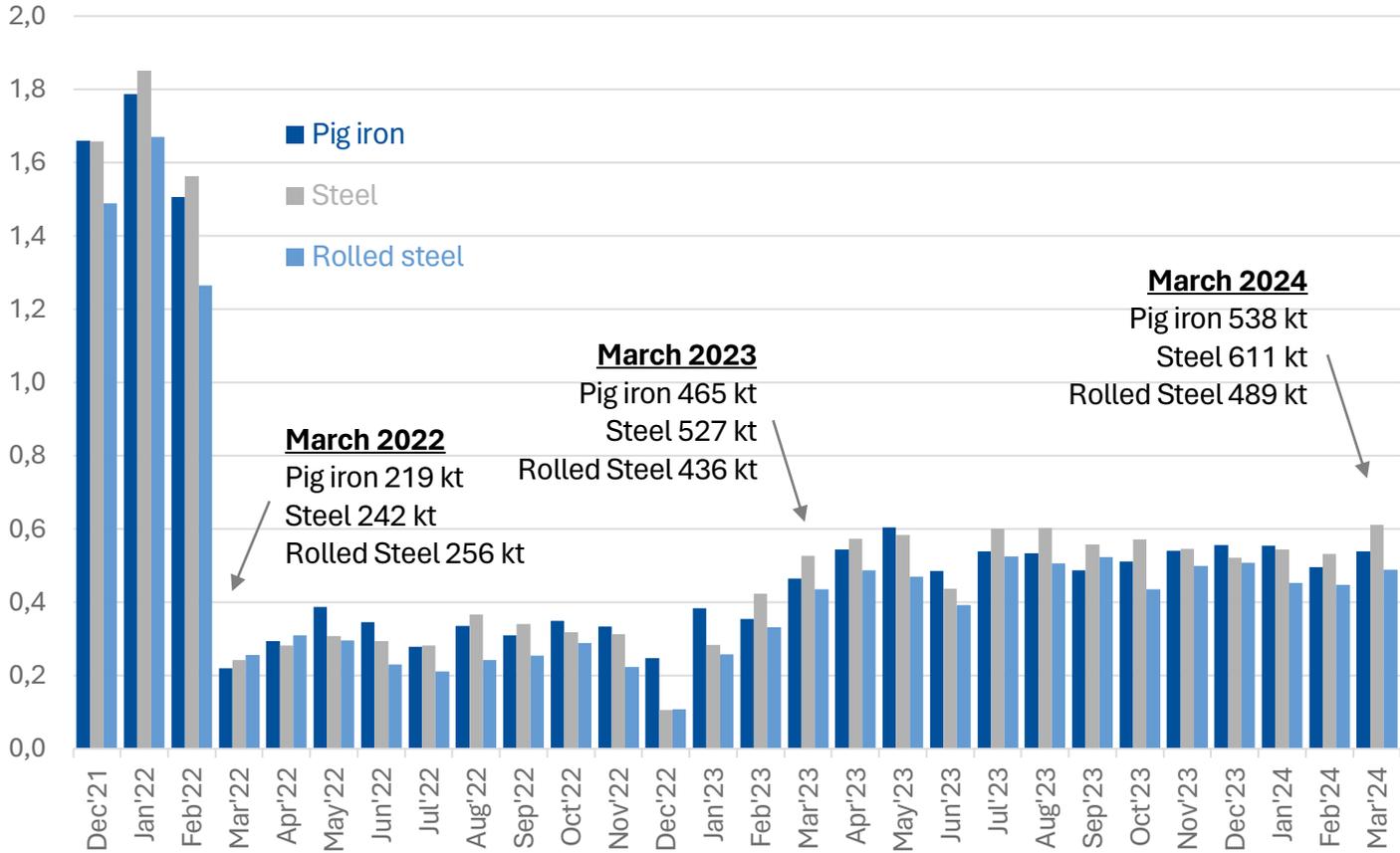
Ukraine net electricity commercial exports in 2023-2024, GWh



SECTORAL ANALYSIS

Steel production sets new wartime highs

Ukraine ferrous production by main categories, mt



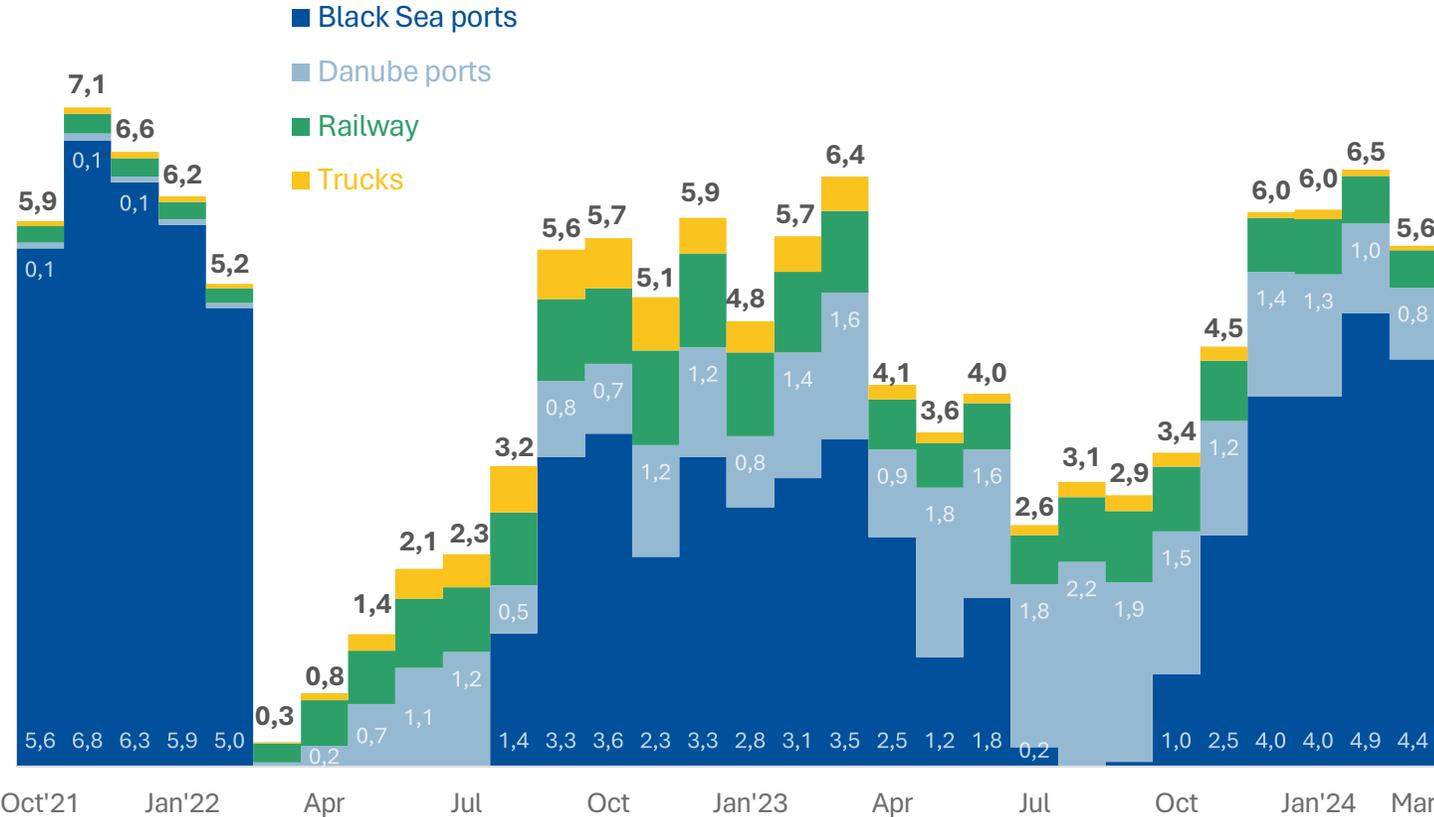
Source: Ukrmetallurgprom

- In March, Ukraine **produced 611kt of steel** (+15% m-o-m, revised). This is the highest figure since the beginning of the Russian invasion, however three times lower than in March 2021. Pig iron production in March amounted to 538 kt (+8%) and rolled products – 489 kt (+9%). Overall, in the first quarter, production of the main types of steel products increased by 32-37%.
- Fitch Ratings has **raised its iron ore price forecast** for 2024-2026 by \$10/t, but continues to expect a gradual decline: in 2024, the price of raw materials is expected to reach \$105/t, in 2025 - \$90/t, and in 2026 - \$85/t.
- Ukrainian metallurgical companies **plan a 10-15% growth** in 2024.
- Metinvest Group has identified the **most pressing problems** for Ukrainian exports during the war: expanding logistics capabilities, currency liberalization and transparent rules for reserving employees from mobilization.
- During 2024-2026, **124 m tons of new steelmaking capacity** will be introduced, according to the WorldSteel Association. Last year global steel production capacity reached a maximum of 2.5 billion tons. In the future, expansion opportunities will gradually narrow due to initiatives to reduce carbon emissions.
- **Metinvest published FY2023 results.** Company’s revenue declined 11% to \$7.4 bn, net loss fell 10 times to \$194 m.
- Ukraine **cannot resume production of ferroalloys** in 2024 due to the proximity of enterprises to the front line. Exports of ferroalloys fell almost 50 times to \$2 m in January-February.

SECTORAL ANALYSIS

Agri exports falls by all types of transportation in March

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

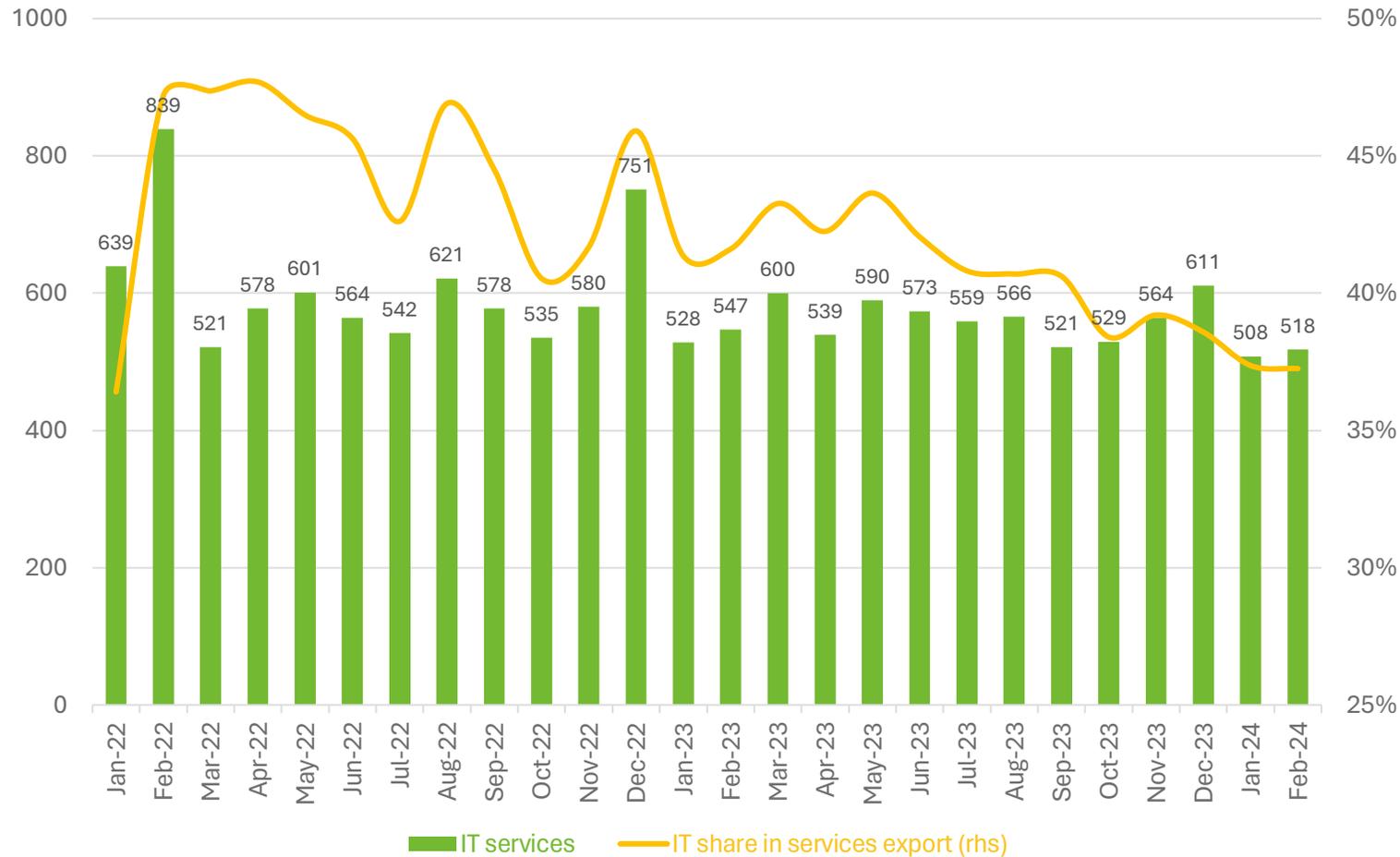


- Agricultural exports fell to a 4-month low in March. Exports decreased by all modes of transportation and amounted to 5.6 mln tons (-13% m/m). Agricultural exports from Black Sea ports decreased to 4.4 million tons, and truck exports fell to a 2-year low of 48 kilotons.
- European Parliament and European Council reached a new provisional agreement on extending temporary trade measures for Ukraine. **Import duties and quotas on Ukrainian agricultural exports to the EU will be suspended for another year, until 5 June 2025, to support Ukraine amidst Russia’s continuing brutal war of aggression.** These unilateral trade liberalisation measures will help stabilise the Ukrainian economy and facilitate the country’s gradual integration into the EU’s internal market. An emergency brake can be triggered for particularly sensitive agricultural products to protect European farmers.

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

SECTORAL ANALYSIS

IT share in services export hits 2-year minimum



- IT exports remain on 2-year low, adding just 2% in February to reach \$518 mln, second-lowest figure during the wartime.
- There are no more IT companies with more than 10,000 employees in Ukraine, according to DOU data as of early 2024. Out of 30 companies with 1000+ employees, 21 remained. In the second half of 2023, all 5 largest companies in the market reduced their staff. EPAM (9986 employees) and SoftServe (7841) remain the largest companies in the industry.
- The share of IT exports in national exports of services in February has updated its lowest level since the beginning of the full-scale invasion, amounting to 37.2%.

Sources: NBU, CES calculations

MONETARY, FX AND BANKING SECTORS

MONETARY AND FX SECTOR

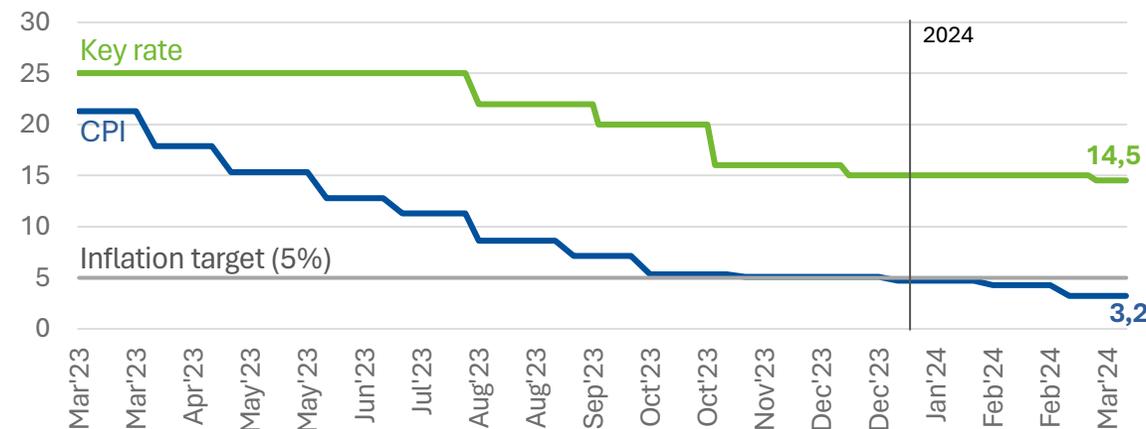
Inflation slows down even further, other key rates are stable

Key rates as of April 2, 2024 (CPI y-o-y in March 2024)

Indicator	Value, %	Change in March
Government bonds rate (12-m)	16.23	-0.57 p.p.
Key rate	14.50	-0.50 p.p.
12-m deposit rate	14.02	-0.15 p.p.
3-m deposit rate	14.39	-0.10 p.p.
Inflation (CPI)	3.20	-1.1 p.p.

Sources: NBU, State Statistics Service, UIRD

Inflation (CPI) y-o-y and NBU key rate, %



Source: State Statistics Service of Ukraine

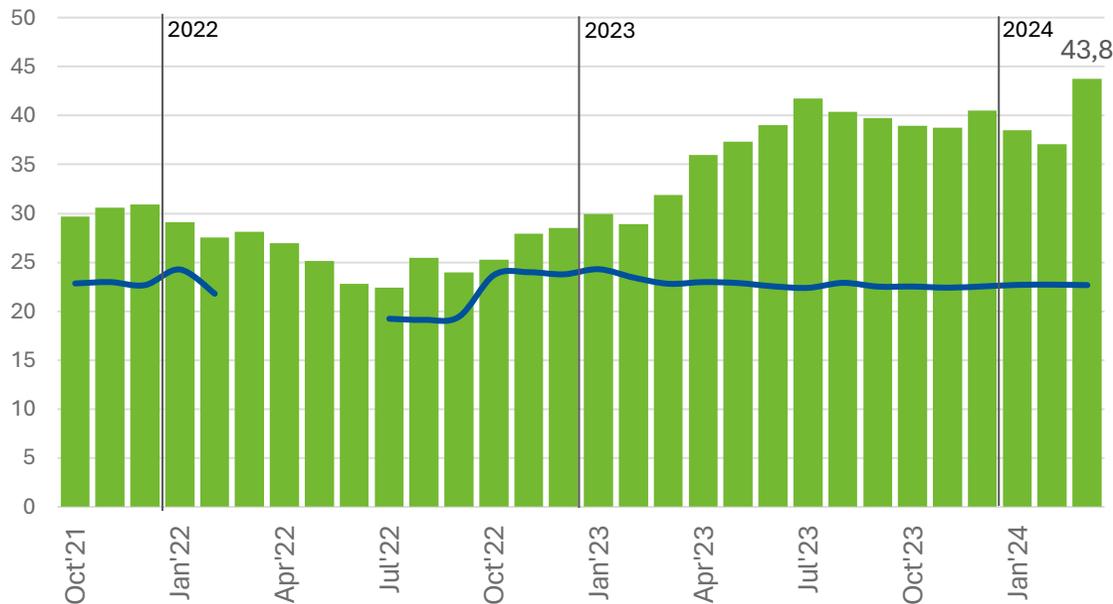
- NBU keeps the key policy rate at 14.5% after its decrease in mid-March. Current interest rates on NBU operations support the appeal of hryvnia assets, ensure exchange rate stability, and control moderate inflation.
- According to NBU, three-month certificate of deposit operations will encourage banks to grow their hryvnia household term deposit portfolios.
- The yield of one-year hryvnia war bonds has declined slightly as a response to the decrease in key policy rate. 3- and 12-month deposits have remained at a relatively the same level as in Feb 2024.
- In March 2024, inflation was recorded at its lowest level since 2020 – **3.2% y-o-y**. Inflation has decreased due to unpredictable raw food price decrease mostly dictated by favourable harvest from last year and blockage on the Western border.

MONETARY AND FX SECTOR

International reserves hit new record high for independent Ukraine

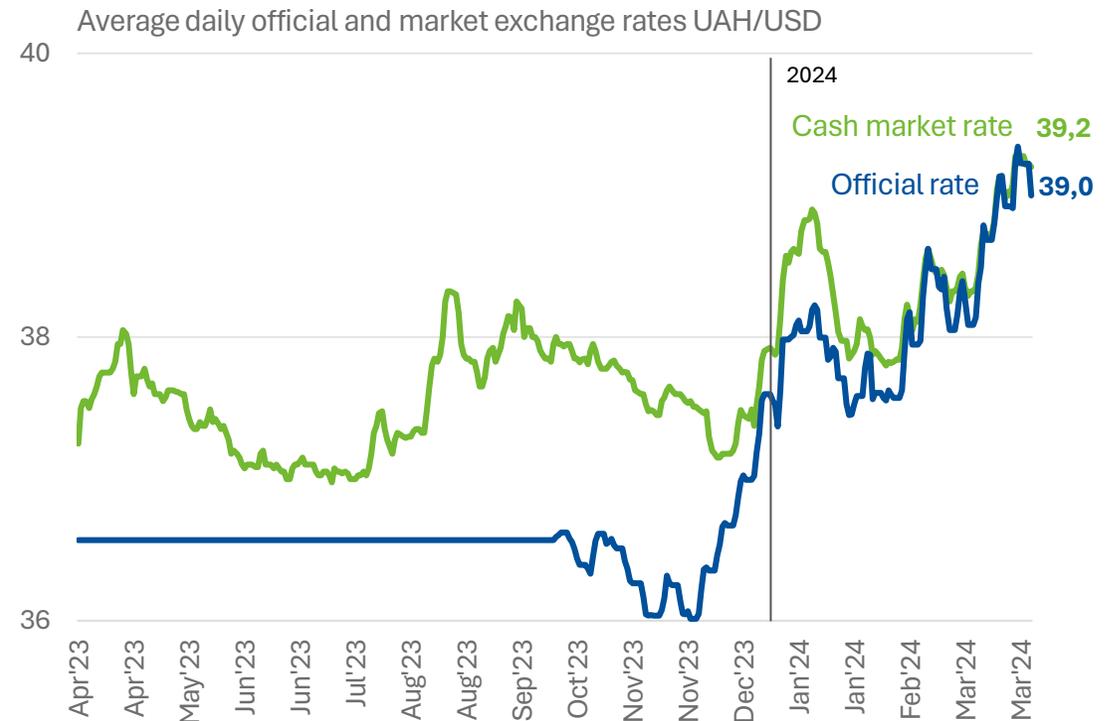
In March, international reserves increased by 18% to record high value - \$43.8 bn (5.8 months of import coverage) due to significant flows from international partners (over \$9 bn), which exceeded the NBU's net FX sales and Ukraine's debt repayments.

Gross international reserves and their amount needed to cover 3 months of future imports, \$ bn



Source: NBU. In March-June 2022, the NBU did not calculate the coverage of future imports due to the unstable situation

The official exchange rate of the hryvnia against the US dollar fluctuated in both directions in March, moderately devaluing at the end of the month because of a certain worsening of the supply and demand balance in the FX market.



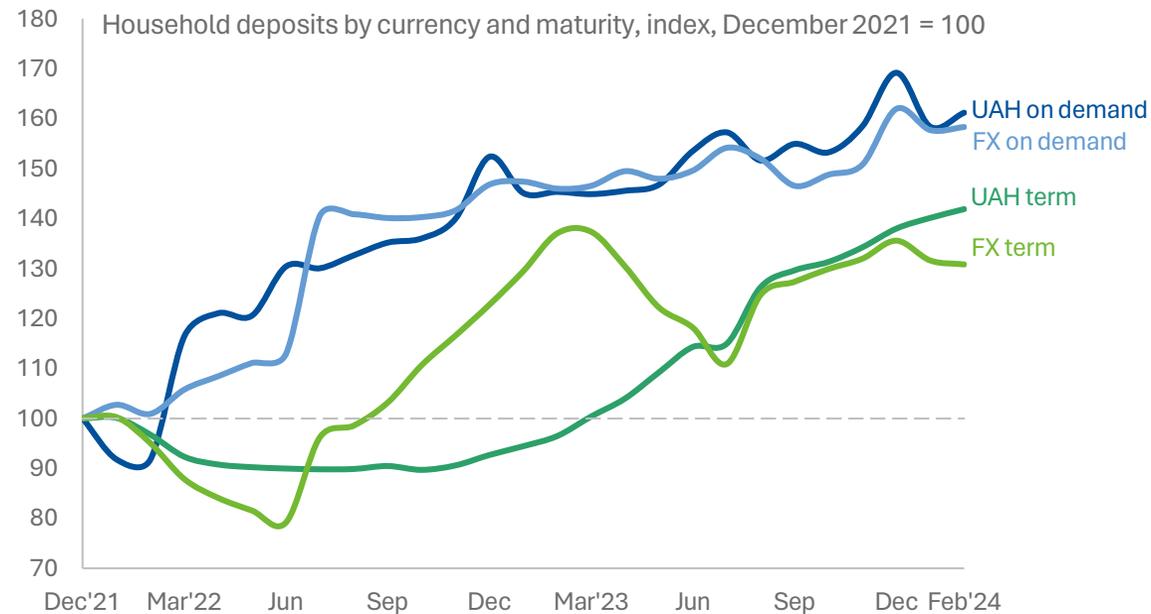
Source: NBU (official rate), index.minfin.com.ua (cash market rate)

BANKING SECTOR

February was marked by bouncing back in deposits growth after seasonal decline

In February, **demand for hryvnia assets** (both UAH term and on-demand ones) **has bounced back in growth after a seasonal decline in January**.

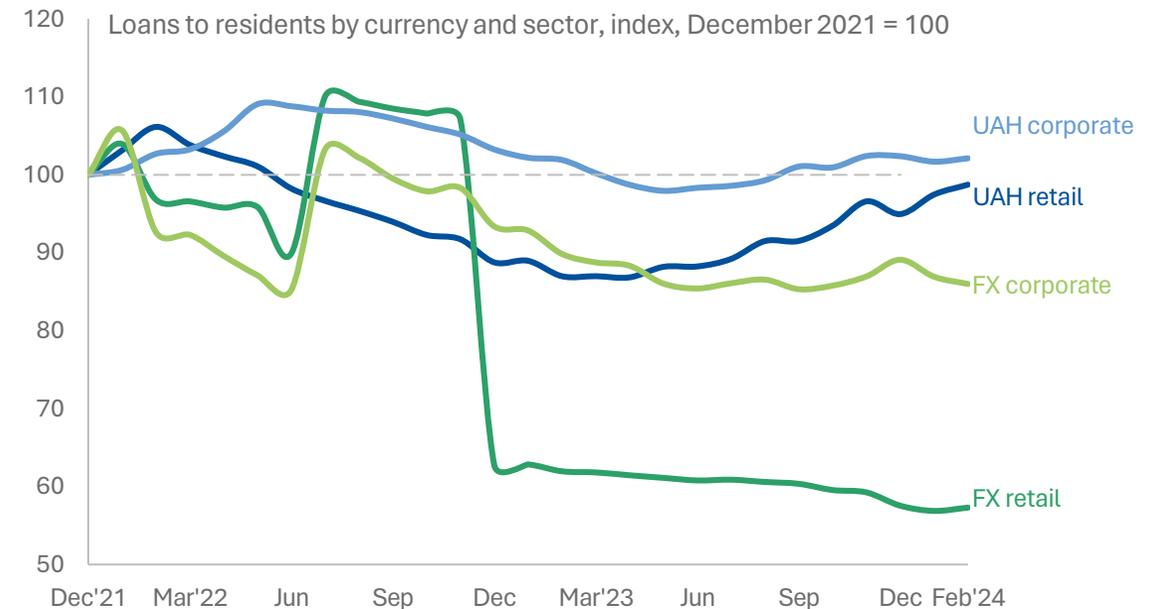
FX on-demand deposits demonstrated slight increase and are quite close to UA on-demand deposits. On the other hand, FX term deposits continued the downward trend.



Source: NBU

All types of loans, except FX corporate loans, have gradually increased in volume. Most of the lending (1/3 of UAH corporate loans' performing gross portfolio) still occurs under the Affordable Loans 5–7–9% program.

Non-performing loans (NPLs) ratio decreased to 36.6% thanks to partial write-offs, debt restructuring, and resumed servicing of problem debts by banks.



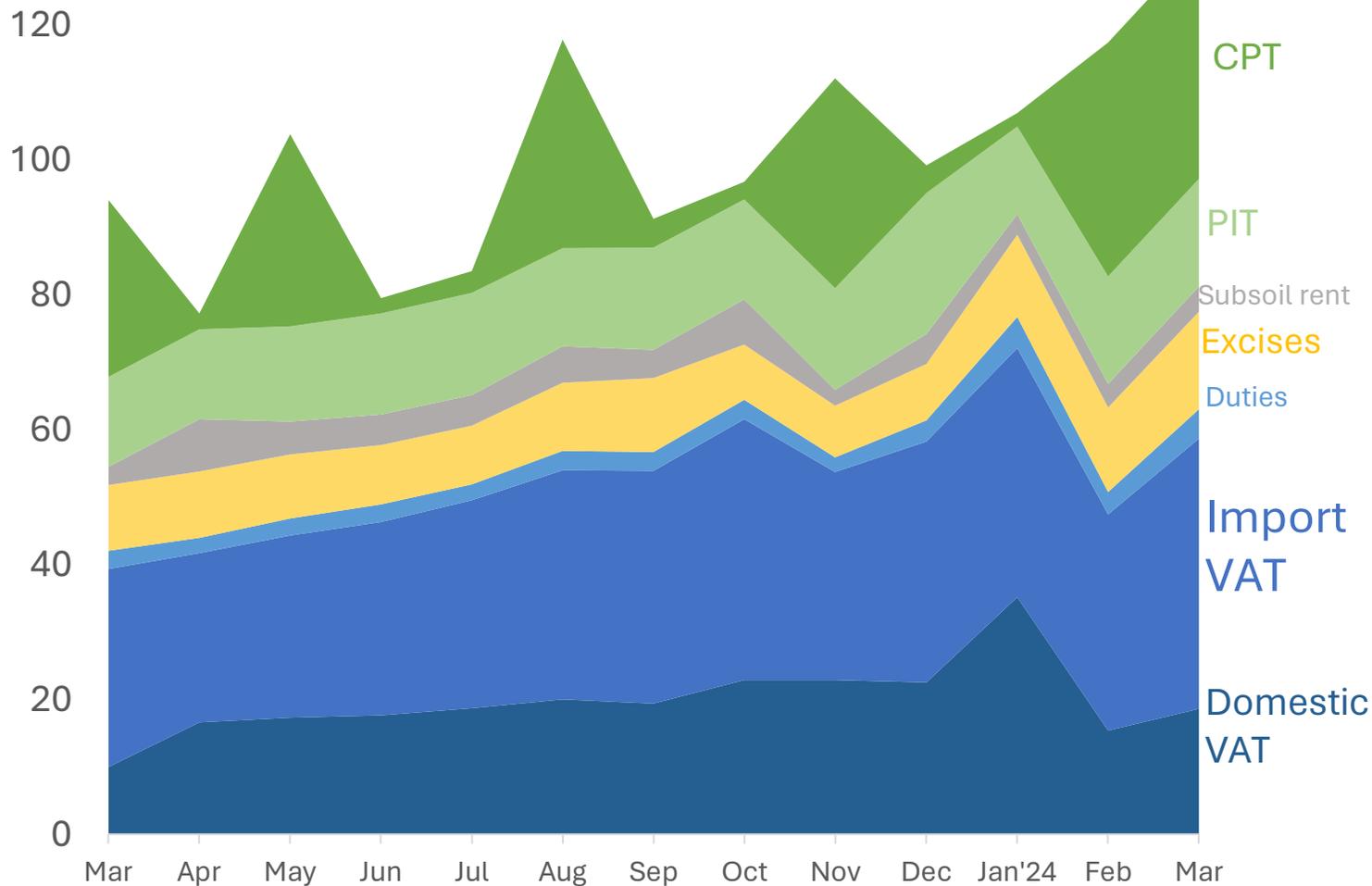


FISCAL SECTOR

FISCAL SECTOR – TAX REVENUES

Record high tax revenues, driven by CPT from banks and consumption

State budget tax revenues, UAH bn



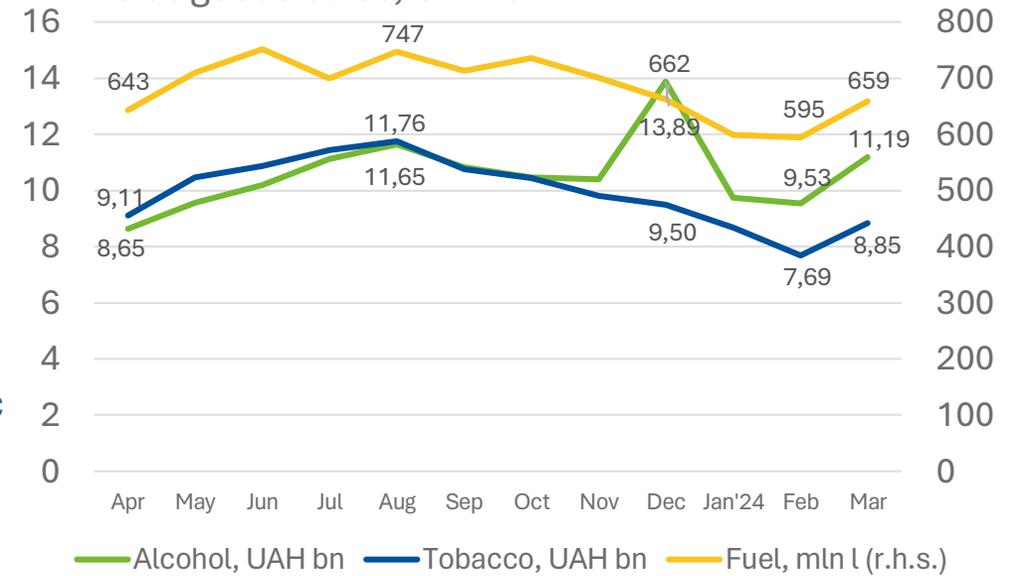
Source: Ministry of Finance

Tax revenues of state budget in March reached UAH 130.4 bn

Record high revenues driven by strong CPT proceeds for a second month in a row (UAH 34.7 bn, of which UAH 23.5 bn – from banks' profits) and VAT (UAH 58.7 bn, above Q4 monthly average and +49% YoY).

Excise revenues reached record high UAH 14.5 bn.

Excise goods sales, UAH bn/mln l

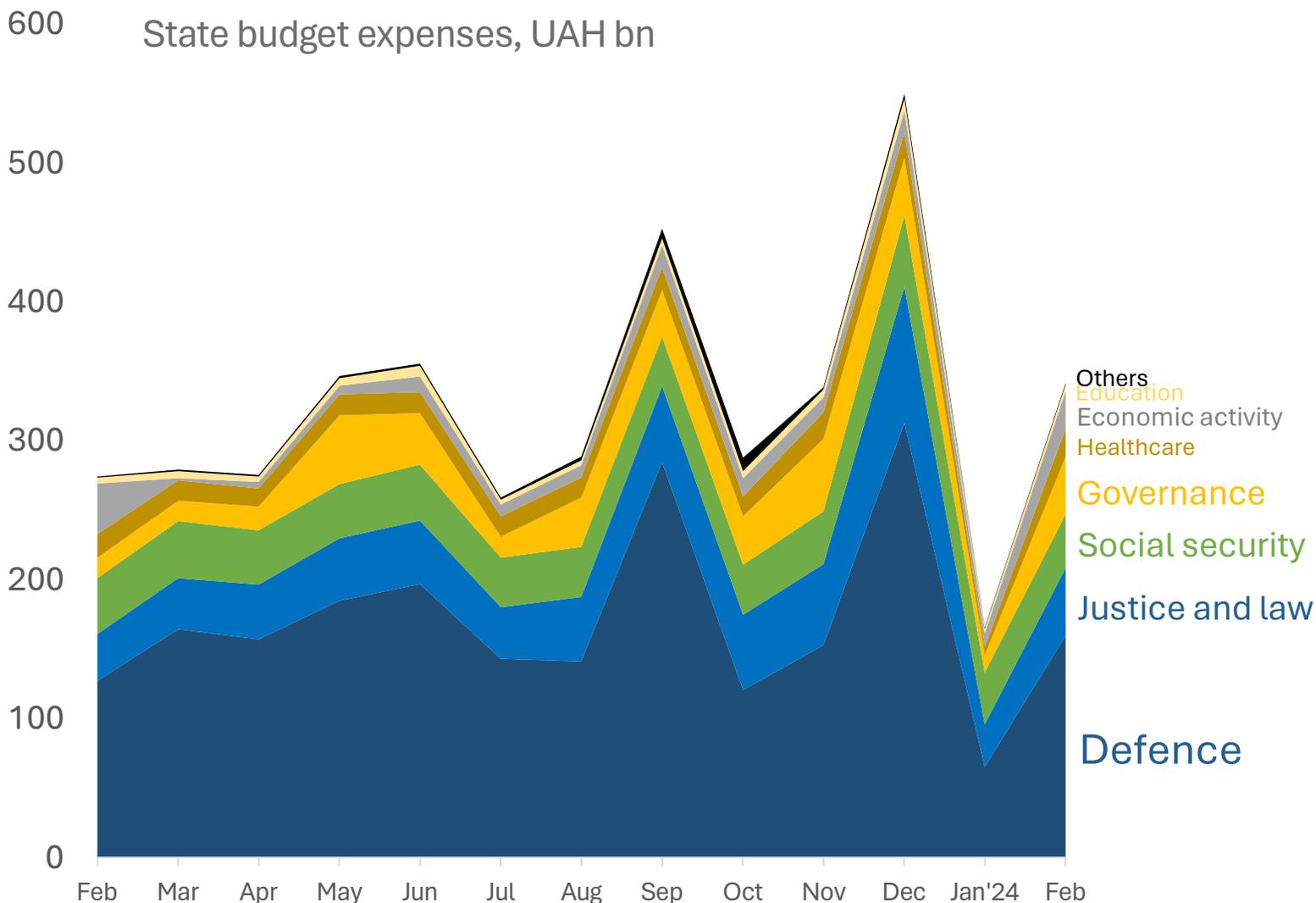


Source: State Tax Service cash registers data

FISCAL SECTOR – EXPENSES

February expenses rebounded, but below average due to weak financing

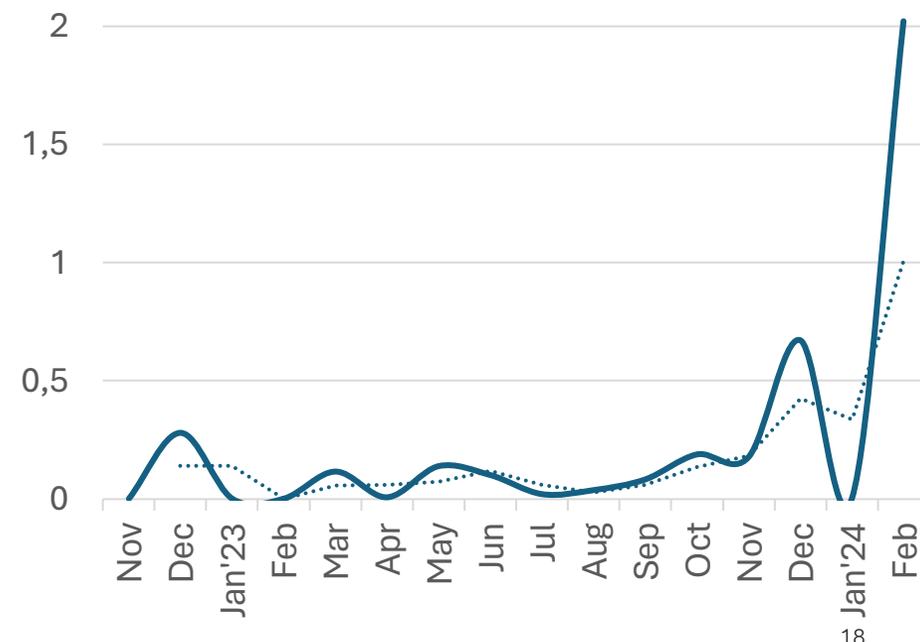
State budget expenses, UAH bn



State budget expenses in February (UAH 323.4 bn) rebounded to Nov'23 levels, but were below monthly average for the 2H2023, limited by absence of external support in February.

Defence spending up to UAH 160 bn, justice and law – UAH 48.7 bn

Fortifications construction expenses, UAH bn



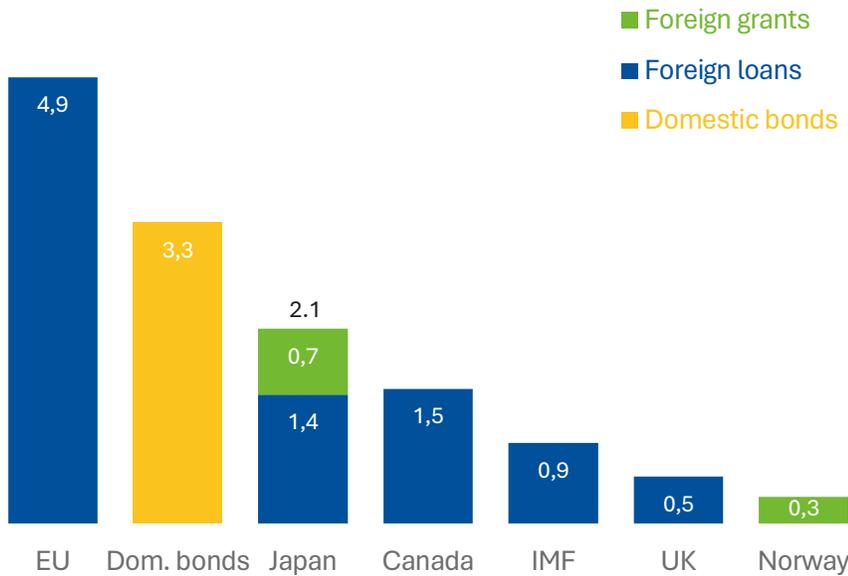
Note: only Feb figures were released as of the presentation date

FISCAL SECTOR

\$8.9 bn of foreign financing in March, but no reason to celebrate

In March, Ukraine received \$8.9 bn of foreign financing, a highest-ever amount. A \$4.9 billion loan from the EU, a \$1.5 billion loan from Canada, a \$1.1 billion loan from Japan, an \$880 million IMF loan tranche, and a \$515 million loan from the UK were disbursed.

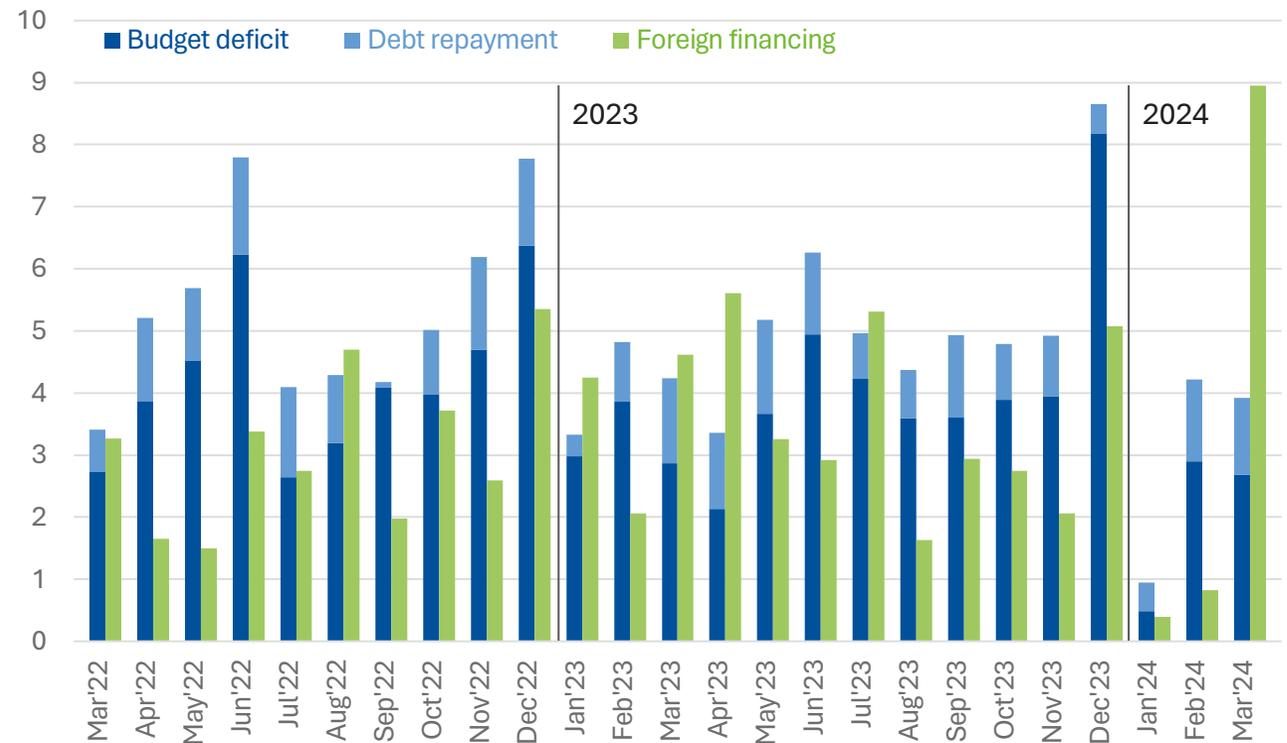
2024 additional financing of Ukraine's state budget as of April 3, \$ bn



Spain — \$3 m. Source: Ministry of Finance

The large inflows of foreign financing in March somewhat levelled out the negative situation that had been developing in the first quarter of the year. However, foreign inflows are expected to decrease in April again, and the situation will remain fragile until the U.S. aid issue is resolved.

Foreign financing, state budget deficit and debt repayment, \$bn



Source: Ministry of Finance, NBU, CES calculations

EXPRESS DAMAGE ASSESSMENT REPORT UNITED ENERGY SYSTEM OF UKRAINE

Decentralization of power generation is the only solution to restore sustainable power supply in the current situation

by Energy Industry Research Center

MARCH 2024 ATTACKS AND IMMEDIATE IMPACTS

Moscow terrorists attack civil infrastructure with focus on energy supply

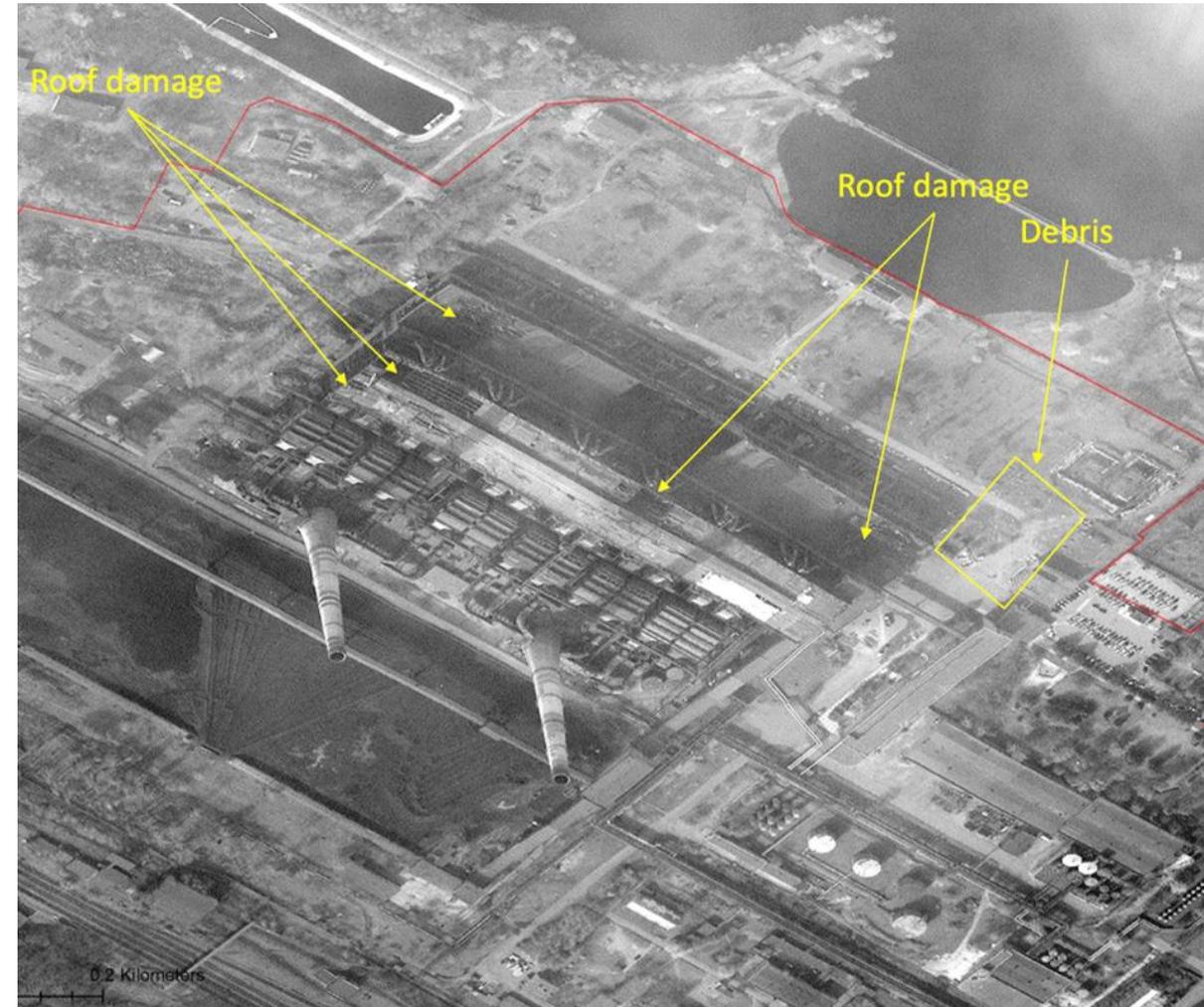
In March 2024, the Ukrainian power system was subjected to two massive missile attacks as well as daily based small scale attacks to separate objects:

- On March 22nd - **Russia used 63 strike drones** (55 drones were destroyed) and 88 missiles (37 missiles were destroyed).
- On March 29th - **Russia used 60 strike drones** (58 drones were destroyed) and **33 missiles** (26 missiles were destroyed).

The attacks were primarily aimed at energy infrastructure objects, as a result of the shelling, various degrees of damage were sustained by:

- 4 large thermal power plants (TPPs)
- 1 large and several small combined heat and power plants (CHPs)
- 4 hydropower stations (HPS)
- 17 main high voltage substations.

Targeted attacks on energy infrastructure objects in various regions continue daily.





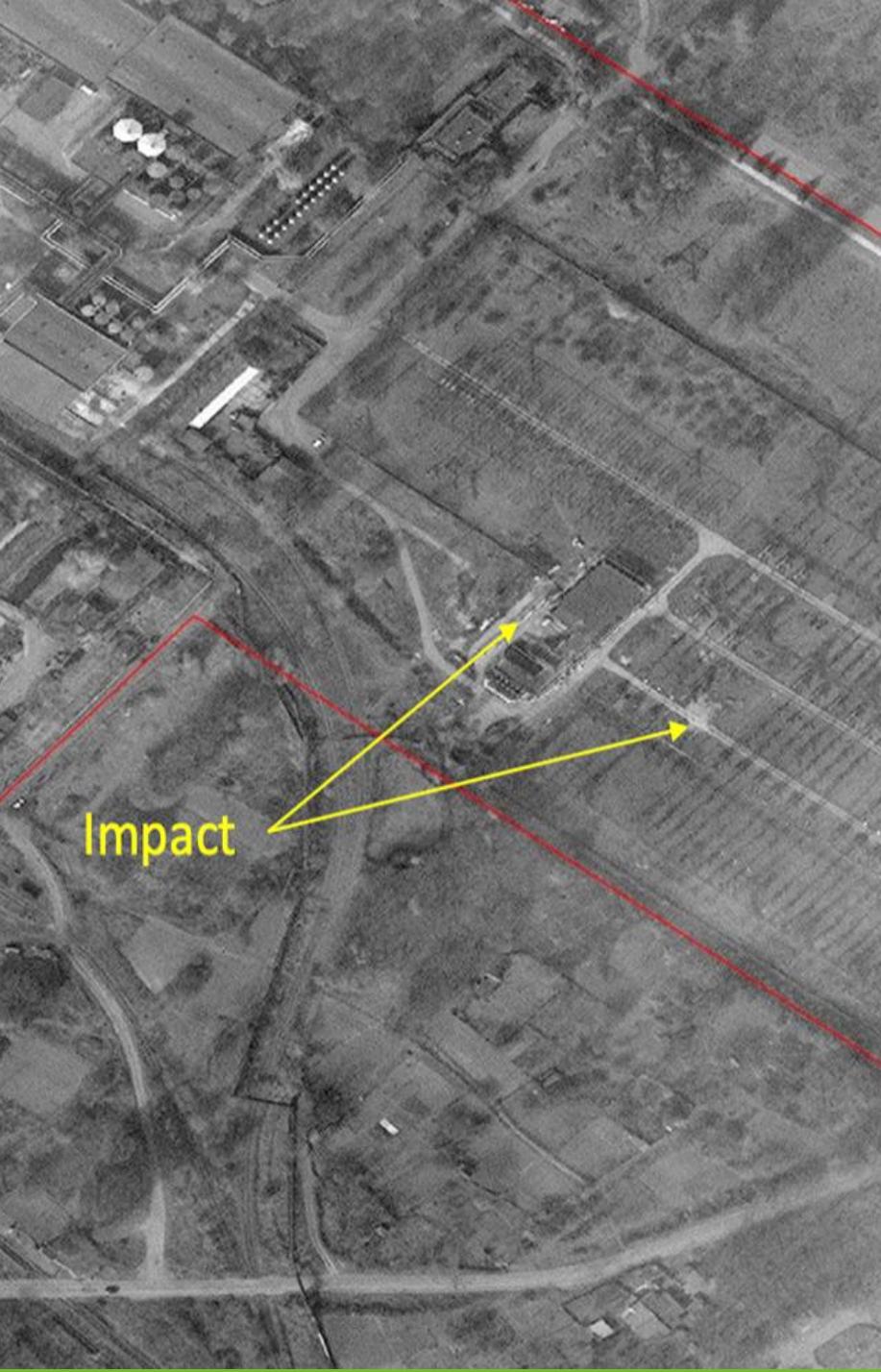
LOSS OF GENERATING CAPACITY

The United Energy System (UES) of Ukraine already has a deficit of generation capacity

Loss of generating capacity because of shelling in March 2024:

- **In thermal generation - 47%** of those operating in the power system at the time of the attack;
- **In hydrogeneration - 34%** of those operating in the power system at the time of the attack;
- **23% - the total loss of generating capacities** of the UES of Ukraine (of those operating in the power system at the time of the attack).

According to preliminary estimates and assuming the restoration of the power transmission system's capacities, it **may be possible to return about 2 GW of thermal generation capacities** in the UES of Ukraine before winter 2024/2025.



OPERATIONAL CAPACITY

Forecast and Recovery Plans

The volume of available generating capacities in the UES of Ukraine as of 31.03.2024 will allow to provide (excluding RES capacities):

- **75% of the forecasted daily maximum consumption** during the heating season 2024/25 without considering the import of electricity
- **87% of the forecasted daily maximum consumption** during the heating season 2024/25 in case of engaging the maximum possible import of electricity
- **98% of the forecasted daily maximum consumption** during the heating season 2024/25 in case of engaging the maximum possible import of electricity and returning to the system 2 GW of thermal generation capacities.

FINANCIAL COSTS OF DAMAGE AND RECOVERY

Ukraine needs nearly \$5 bn to restore capacity of the united energy system in 3-5 years perspective

- The **cost of compensating for the capacities** lost due to missile strikes in thermal and hydrogeneration is preliminarily **estimated at €5.2 billion euros**. The evaluation assumes that hydrogeneration capacities will be restored (within 1.5-3 years), and thermal generation capacities will be replaced by **decentralized gas piston and gas turbine generation**.
- The cost of restoring the **power transmission system** is preliminarily estimated at **€100 million**.





THANK YOU.

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