CENTRE FOR ECONOMIC STRATEGY

German Economic Team

Economy review in July

Special topic: How much money does Ukraine lack? Budget deficit, partner assistance, and prospects for 2025

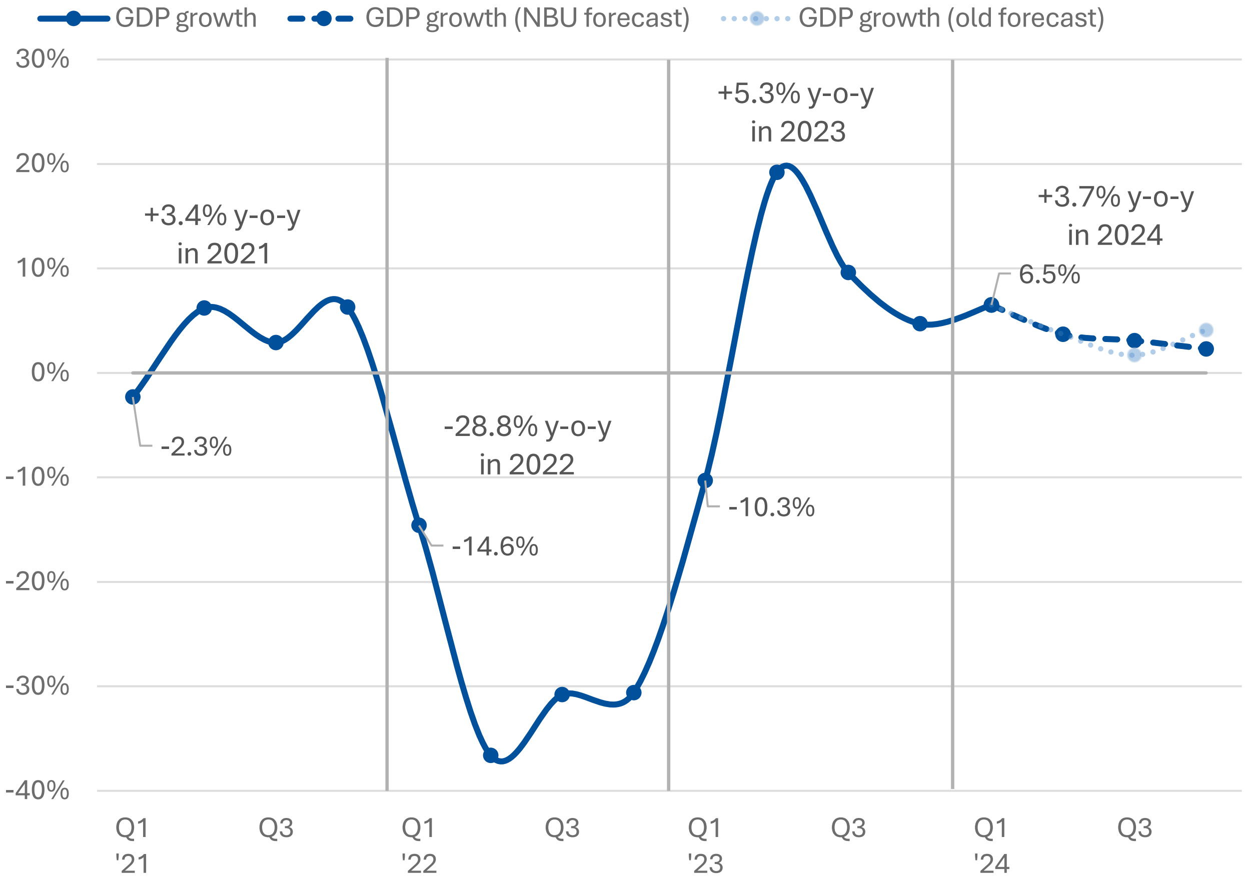
Date: 20.07.2024

Author: CES Team

MACROECONOMIC TRENDS

CENTRE FOR ECONOMIC STRATEGY

NBU forecasts GDP growth by 3.7% in 2024



Source: State Statistics Service of Ukraine, NBU

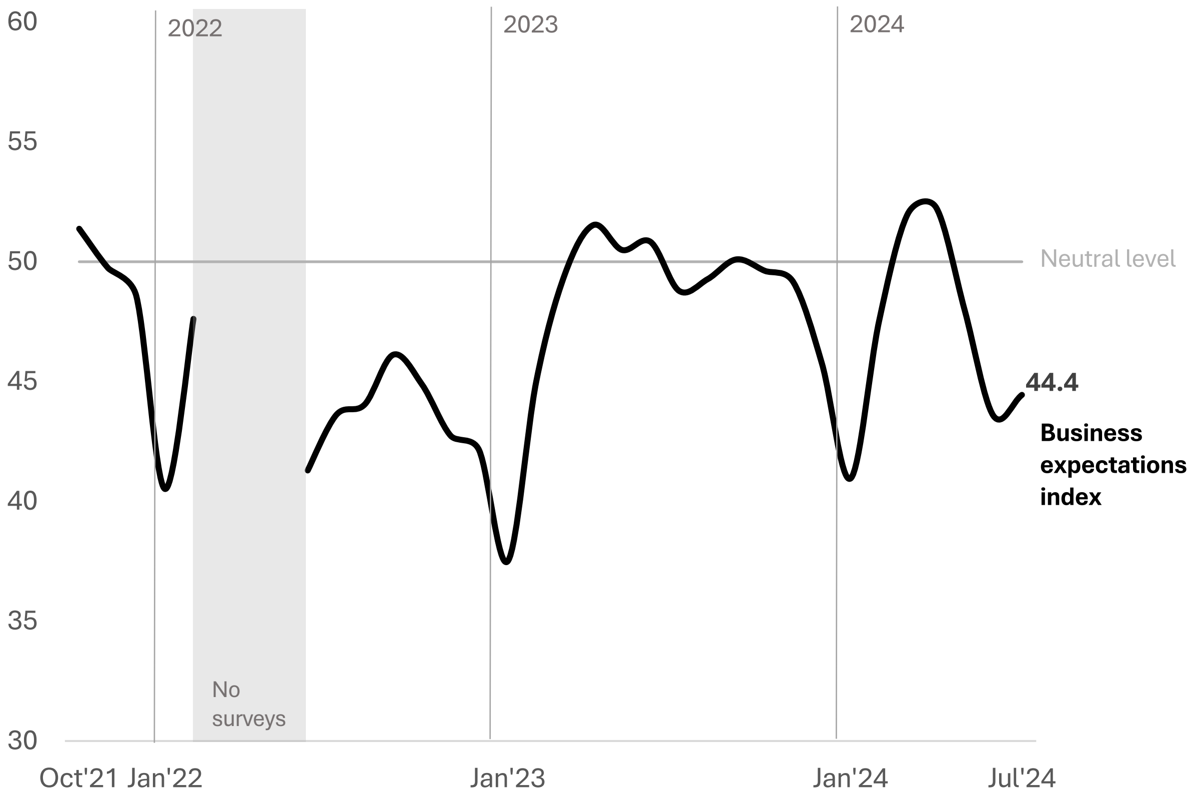
- Ukraine's GDP grew by 4.1% in 1H2024 compared to 1H2023, according to the Ministry of Economy.
- The economy is recovering more slowly than expected due to electricity shortages.
- According to IER estimates, GDP grew by 4.4% in July due to a faster harvest than last year.
- In its latest forecast, the NBU upgraded its forecast for GDP growth in 2024 to 3.7%. This was primarily due to better results in the first quarter of 2024 and higher crop estimates.

CENTRE FOR ECONOMIC STRATEGY

Business expectations slightly improved in July

- **In July, the NBU's business activity expectations index improved to 44.4**, up from 43.6 in June, but remained below the "neutral" level of 50 points.

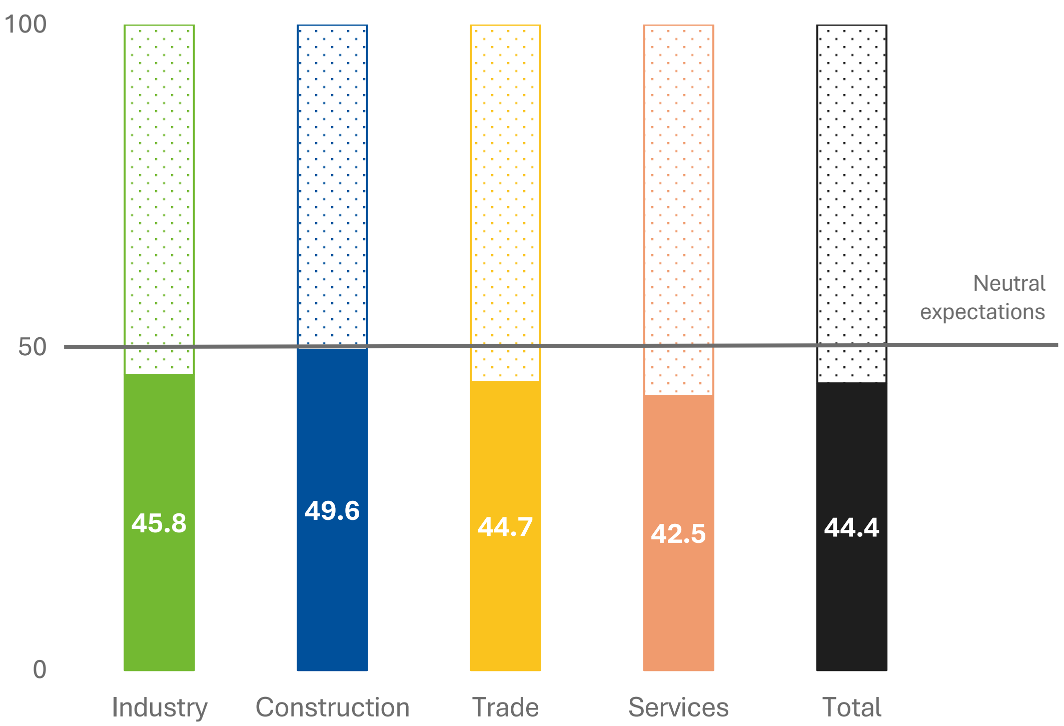
NBU business activity expectations index dynamics



Source: NBU

- **Expectations slightly improved, but negativity still prevailed among businesses in all sectors surveyed.** Power outages remained a challenge for all industries, but businesses are gradually adapting to the situation.

NBU business activity expectations index by sector in July

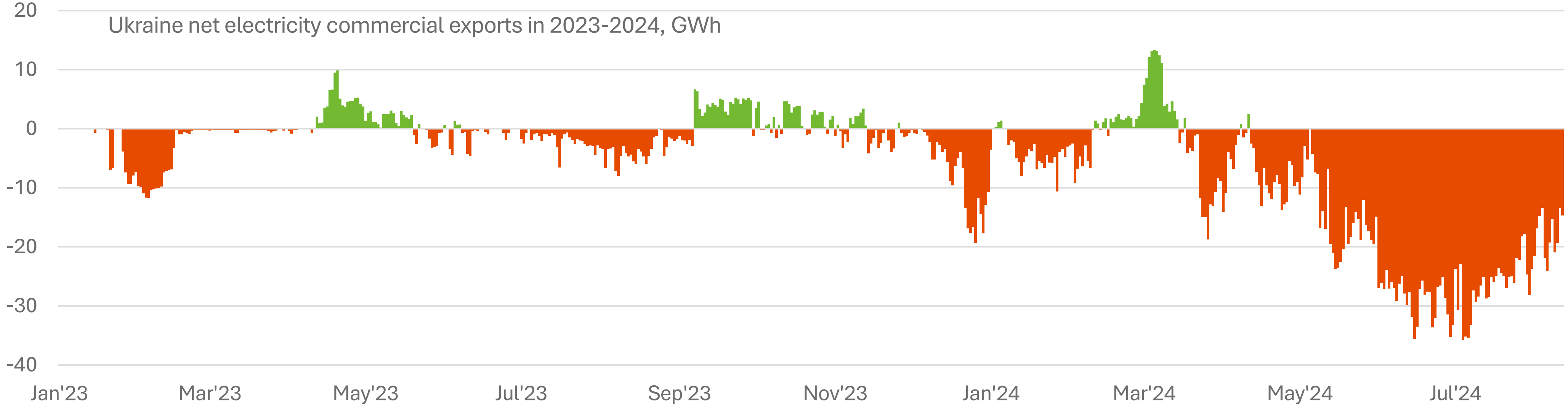


SECTORAL ANALYSIS

CENTRE FOR ECONOMIC STRATEGY

Electricity deficit remained high in July, may ease in August

- Electricity imports in July amounted to 819 GWh, down 4% from June, but much higher than in all previous months of the full-scale invasion.
- The maximum daily imports were recorded on July 4 - 35.7 GWh, and by mid-August, daily imports decreased to 13-14 GWh.
- The relative reduction of the deficit in the power system allowed not to apply the scheduled outage schedules from July 30 till August 18.
- Commercial electricity exports have not been carried out since April 11
- On August 15, Ukrenergo held the first long-term special auction for the purchase of frequency maintenance reserves for 5 years to ensure stable operation of the power system. The entire amount of 99 MW required for this type of reserves was purchased. The auction was attended by 39 participants who made 230 offers. The winners were 12 companies that offered the lowest prices for the service: UAH 589-1001/MW. The weighted average price was less than UAH 700. The auction terms provide for the commissioning of new generating capacities by September 2025. The contract with the winners will be concluded for 5 years at a rate pegged to the euro.

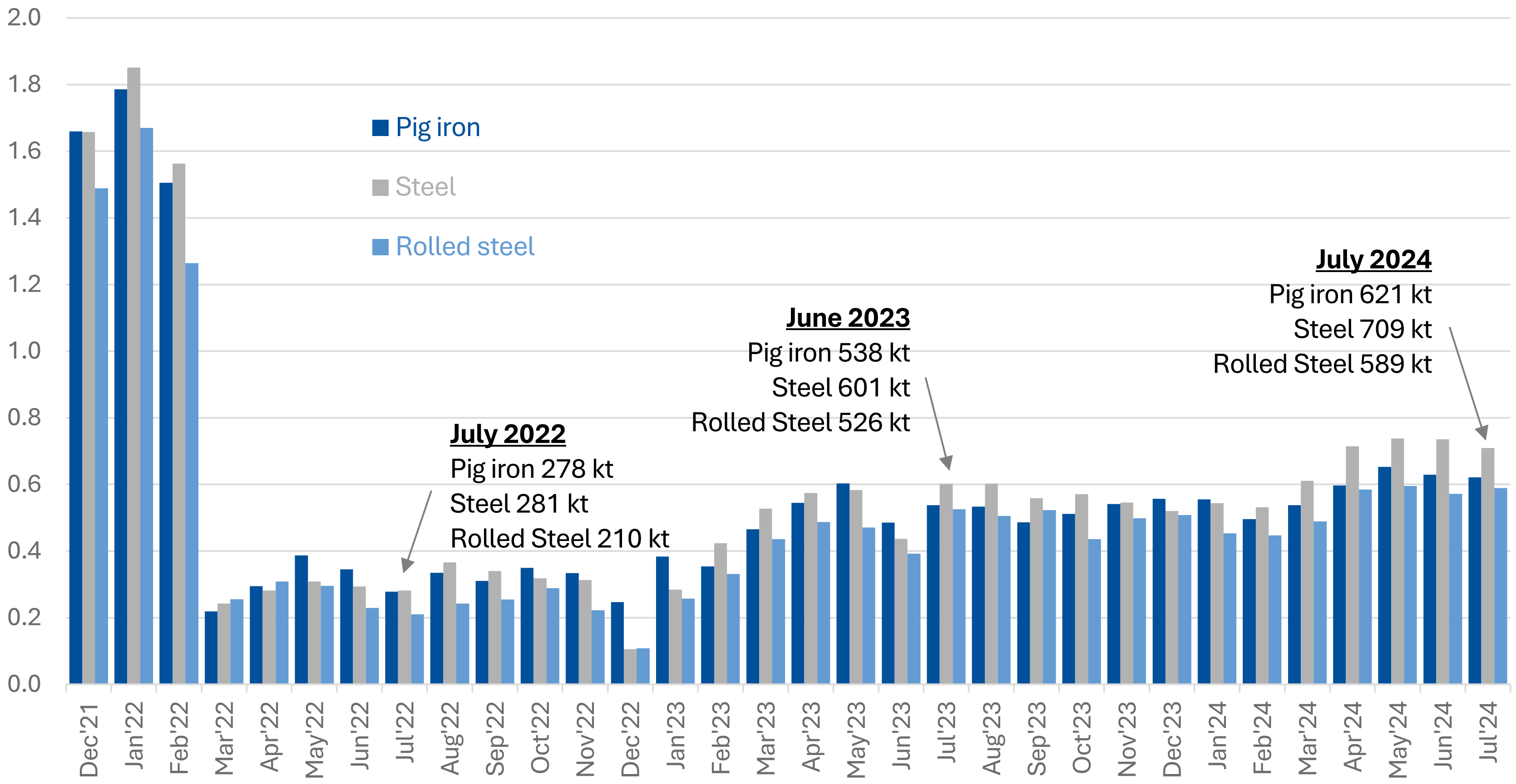


Source: ENTSO-E

CENTRE FOR ECONOMIC STRATEGY

Iron&steel production moderately declines for the second month in a row

Ukraine ferrous production by main categories, mt



Source: Ukrmetalurgprom

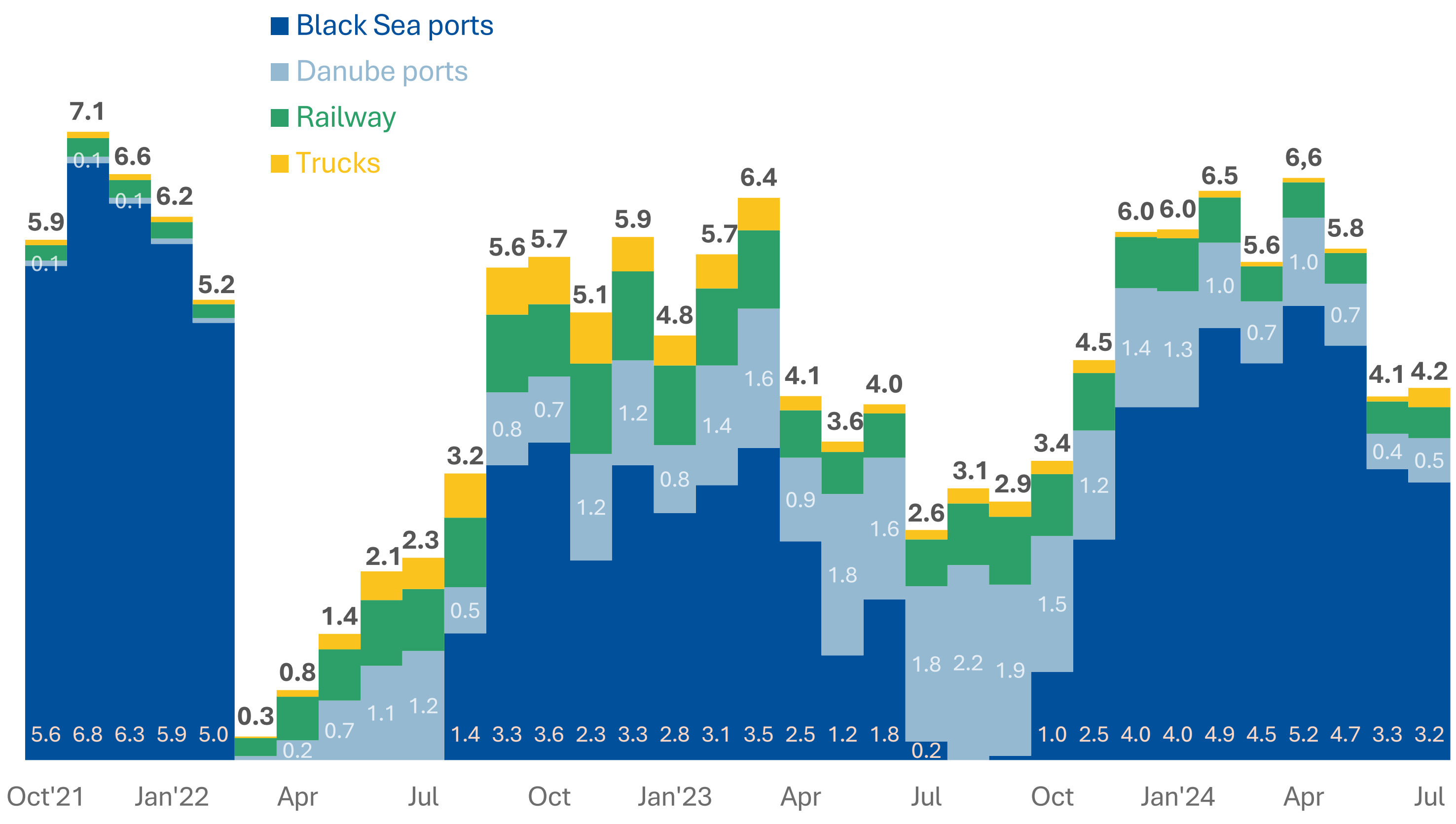
- In July, **Ukraine produced** 621 kt of pig iron (-1% m-o-m), **709 kt of steel (-4%)** and 589 kt of rolled products (+11%). In total for 7m2024, production of the main types of steel products increased by 21-34%.
- In July, Ukraine's **iron ore exports fell** for the fourth consecutive month to 2.5 mt. At the same time, in 7m2024, ore exports increased 2.15 times y-o-y to 20.8 mt.
- Ukraine **increases exports of ferrous metals by 3.6%** to $1.46 bln in 1H2024
- **Consumption of steel products in Ukraine increased by 7.7%** to 1.74 mt in 1H2024.
- **Global steel prices have halved since their peak in October 2021 to $395/t.** Lower demand from China's construction industry is putting pressure on steel prices.
- **Ferrexpo increased its pellet production by 76%** y-o-y to 3.3 mt in 1H2024. This was driven by the resumption of exports and the launch of previously suspended production facilities.

SECTORAL ANALYSIS

CENTRE FOR ECONOMIC STRATEGY

Agri exports slightly over 4 mt in June and July

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



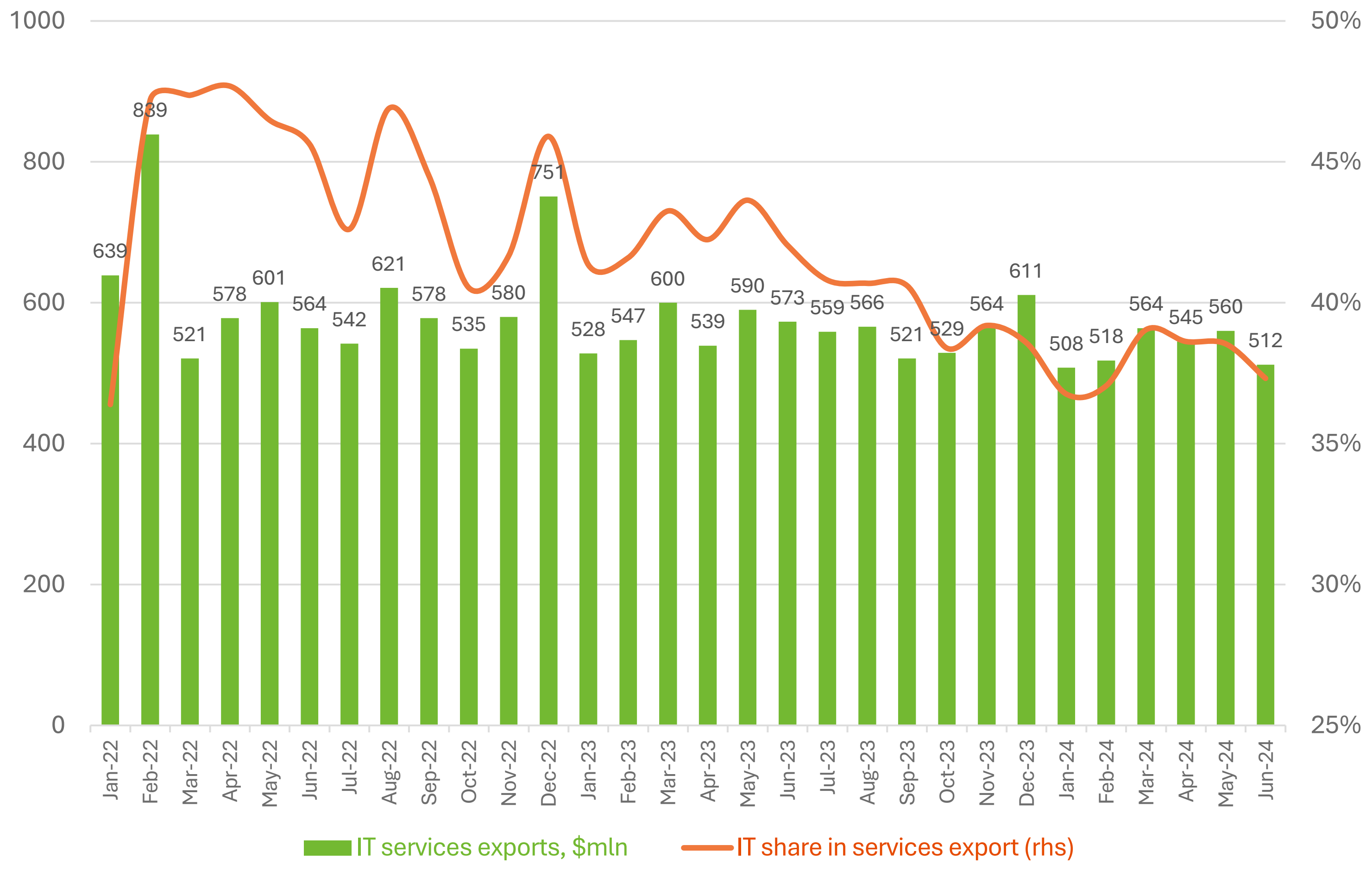
Sources: Ministry of Infrastructure, Ministry of Agriculture, State Custom Service, UN, Dragon Capital estimate.

- In July, **agricultural exports grew by 2%** to 4.2 mt. This was due to a higher number of days in July.
- **The share of the Black Sea ports in agricultural exports decreased to 75%**, a six-month low. At the same time, the share of road transportation reached 220 kt, the highest in the last year.
- **Hot weather has worsened the outlook for crop harvests in Ukraine.** According to forecasts, the corn harvest will decline by 21% y-o-y to 23.4 mt, wheat - by 10% to 19.8 mt, sunflower - by 10% to 12.8 mt, barley - by 15% to 4.95 mt. The forecast of rapeseed harvest is in line with the actual result of the previous year - 4.3 mt.

SECTORAL ANALYSIS

CENTRE FOR ECONOMIC STRATEGY

IT industry slowly deflates amid global cooling in the sector



Sources: NBU, CES calculations

- In 1H2024, the 50 largest IT companies in Ukraine laid off 2,400 employees, which is 2.9% of the total.
- Layoffs continue in outsourcing companies, while product companies continue to hire people and increase their share of the IT market.
- Exports of IT services in June decreased by 9% to $512 mln. This is second lowest monthly volume for last 3 years. In 1H2024, IT exports decreased by 5% to $3.2 bln.
- IT services share in services exports declined to 37,3%.

CENTRE
FOR ECONOMIC
STRATEGY

MONETARY, FX AND BANKING SECTORS

CENTRE FOR ECONOMIC STRATEGY

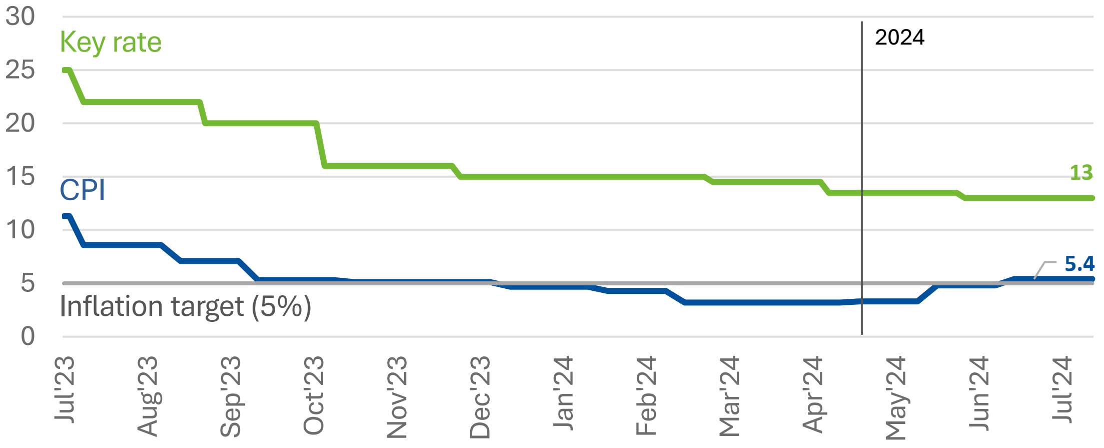
Inflation accelerates to 5.4%, and key rate policy remains the same – 13%

Key rates as of July 31, 2024 (CPI y-o-y in July 2024)

Indicator	Value, %	Change in July
Government bonds rate (12-m)	14.65	-0.06 p.p.
Key rate	13.00	0.00 p.p.
12-m deposit rate	13.01	0.19 p.p.
3-m deposit rate	13.08	-0.11 p.p.
Inflation (CPI)	5.40	1.4 p.p.

Sources: NBU, State Statistics Service, UIRD

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



Source: NBU, State Statistics Service

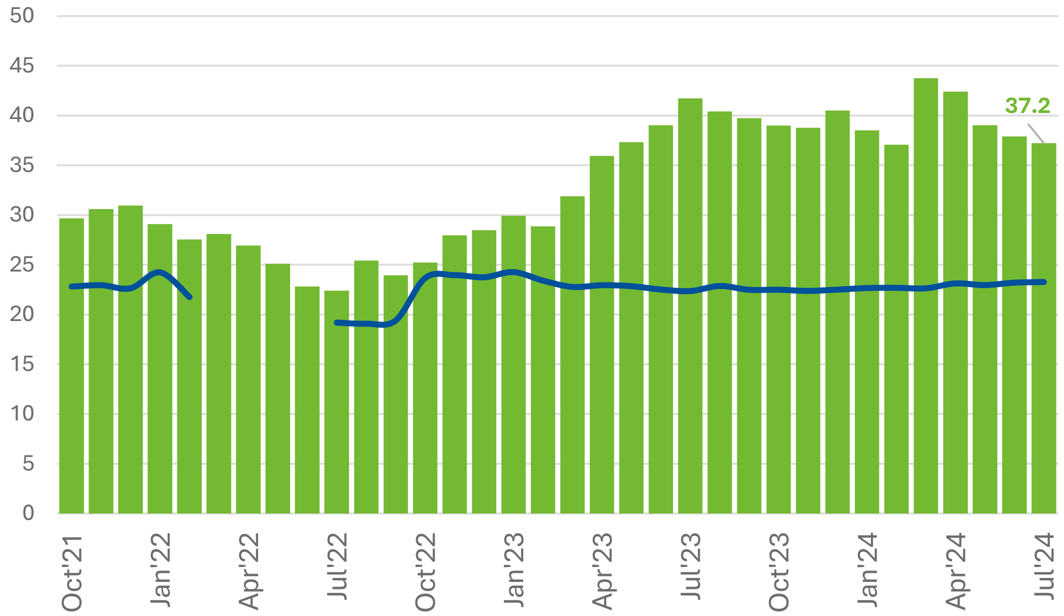
- At the end of July 2024, the NBU kept the key policy rate unchanged **at 13%,** aiming **to ensure the FX market's sustainability, protect households' hryvnia savings, and bring inflation closer to its 5% target** within the forecast horizon.
- Currently, the NBU assumes that it **will return to a key policy rate easing cycle in early 2025.**
- The yield of one-year hryvnia war bonds, along with the 3-month deposit rate, **continued to slightly decline** in response to recent reductions in the key policy rate over the past several months.
- In July 2024, **inflation accelerated to 5.4% year-over-year**, driven by a faster rise in processed food prices due to higher energy, storage, and wage costs, as well as the pass-through effects of hryvnia depreciation.

International reserves declined, and hryvnia set a new anti-record of its value to USD

In July, **international reserves fell by 1.8% to $37.2 bn** (4.8 months of import coverage) due to NBU's currency interventions to cover market deficits and manage exchange rate fluctuations, along with debt payments, partially offset by international aid and bond placements.

In July, **situational and psychological factors caused net currency demand to exceed the structural deficit**, contributing to the noticeable weakening of the hryvnia exchange rate, **setting new anti-record value - 41.7 UAH per 1 USD.**

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

Average daily official and market exchange rates UAH/USD

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

BANKING SECTOR

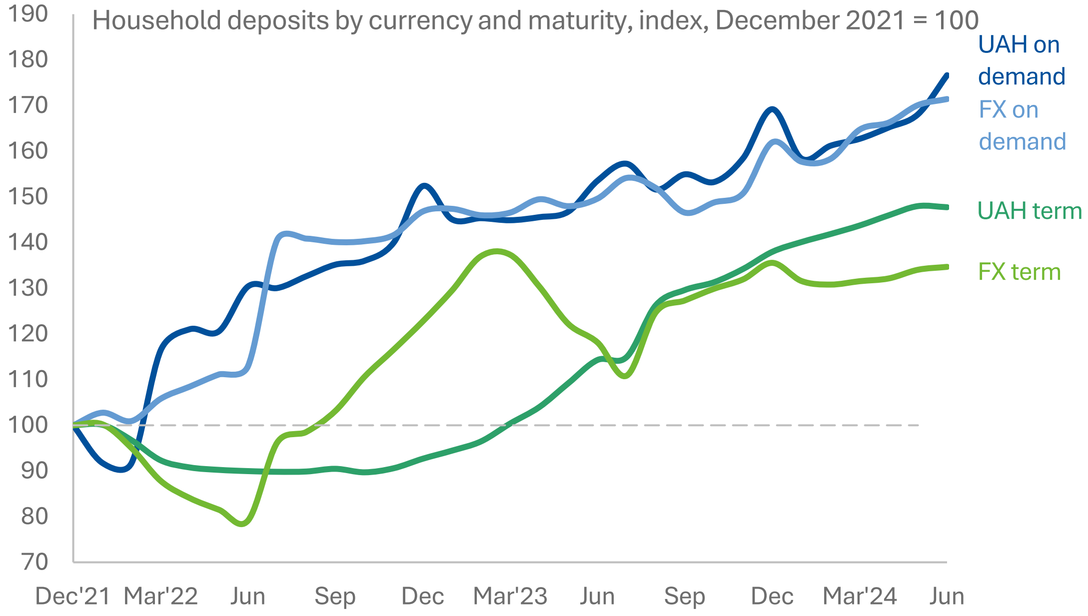
Household deposits on demand continue to rise alongside UAH corporate and retail loans

In June, **hryvnia and foreign currency demand deposits continued to grow**, with UAH deposits leading the race.

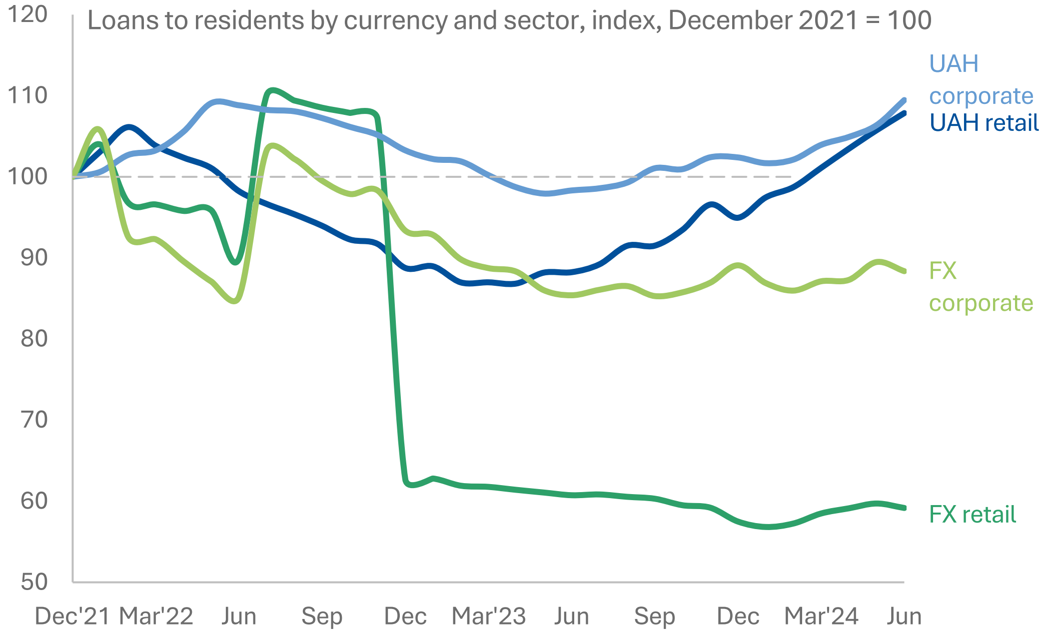
In the coming months, **banks expect a further decrease in deposit rates while their volume continues to grow.** The term length of deposits will also decrease further.

UAH corporate and retail lending continues to recover modestly, while lending in foreign currencies has decreased.

Banks expect higher demand for all loans and increased loan volumes over the next 12 months. SME loan demand is growing due to capital investment needs, lower interest rates, and debt restructuring.



Source: NBU



Source: NBU

CENTRE FOR ECONOMIC STRATEGY

Next steps in bringing regulation closer to EU standards

1

The new requirements for the capital adequacy of banking groups focus on the calculation of the capital of the credit and investment subgroup (KIP) under a new three-level structure.

The updated requirements will be phased in according to National Bank Board Resolution No. 65 (June 7, 2024), with a schedule to reach a 10% regulatory capital sufficiency norm by July 1, 2025.

Transitional provisions permit including level 1 KIP in fixed and additional capital until mid-2025 to support the banking system's economic potential.

2

The new leverage ratio measure for level 1 capital adequacy will be phased in as follows:

- Banks develop provisions by March 31, 2025, and conduct test calculations from April 1 to July 1, 2025, reporting to the NBU;
- Banking groups develop documents by June 30, 2025, and conduct test calculations from July 1, 2025, to January 1, 2026.

The National Bank will set the minimum ratio based on test results, with new requirements starting in mid-2025 for banks and April 2026 for banking groups, aligning with Basel III reforms.

3

The introduction of requirements for the organization of the ILAAP process ensures banks maintain sufficient liquidity to meet obligations, comply with National Bank standards, and plan for future needs.

The ILAAP process assesses liquidity sufficiency, aligns with the bank's business model, and is part of risk management.

Annual reports are due by May 31 for banks and June 30 for banking groups, starting in 2025. Banks have until December 31, 2024, to prepare necessary documentation.

Source: NBU

KEY MACROECONOMIC INDICATORS

CENTRE FOR ECONOMIC STRATEGY

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

Key macroeconomic indicators

Indicators	2024	2025	2026
Real GDP, change, %	3.7 (3.0)	4.1 (5.3)	4.8 (4.5)
Nominal GDP, UAH bn	7 590 (7 590)	8 620 (8 705)	9 625 (9 685)
CPI, y-o-y, % (eop)**	8.5 (8.2)	6.6 (6.0)	5.0 (5.0)
Current account balance, $bn	-14.2 (-20.2)	-19.0 (-18.2)	-23.5 (-23.1)
Gross reserves, $bn	41.2 (43.4)	37.3 (44.3)	32.0 (39.3)

* in brackets – previous forecast (inflation report, April 2024)
** end of period (December to December of the previous year)

Source: NBU

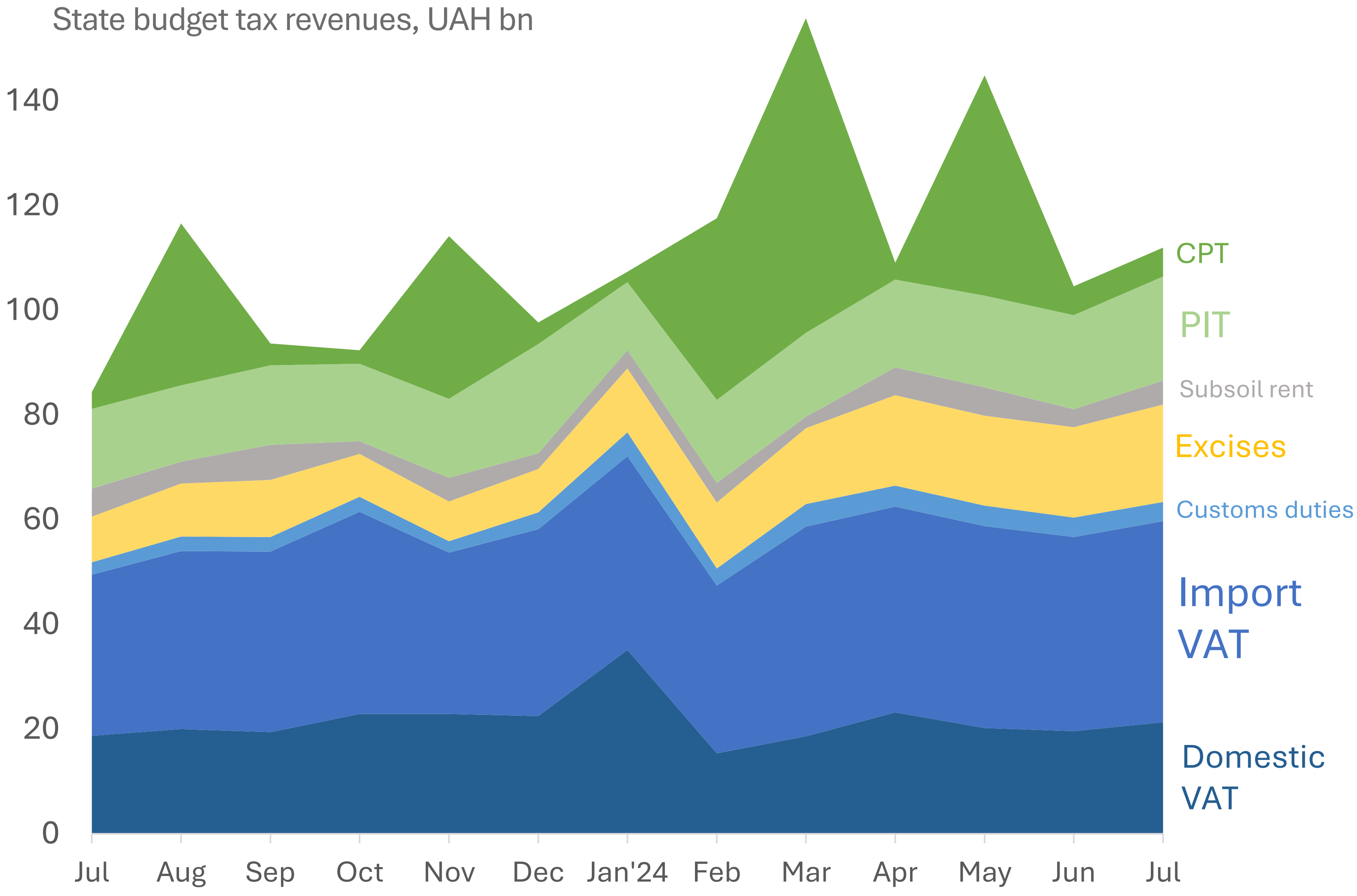
- **Economic growth slowed** recently due to energy attacks, but businesses adapted, and the sea corridor remained stable. **The NBU upgraded its 2024 growth forecast to 3.7%.** GDP growth is expected to reach **4%-5% in 2025-2026** with economic normalization and better export routes.
- In 2024, **inflation will rise** due to higher costs, taxes, and lower crop yields but **is forecasted at 8.5% by year-end** due to NBU measures and a utility tariff moratorium. It will **slow to 6.6% by 2025 and 5% by 2026** as the economy and energy situation improve.
- Ukraine will receive **USD 38 bn in external financing in 2024** and **at least USD 31 bn in 2025**. These funds, along with increased domestic borrowing, will **cover budget deficits of 23% of GDP in 2024 and 18% in 2025**. The NBU will maintain reserves for FX market stability and moderate inflation.

FISCAL SECTOR

FISCAL SECTOR – TAX REVENUES

Taxes on consumption rebound after 2 month's decrease

CENTRE FOR ECONOMIC STRATEGY



Source: Ministry of Finance. *Note: based on the preliminary budget performance data, released by the MoF*

Tax revenues of the state budget in July were UAH 112 bn, adding 7% MoM and 33% YoY, driven by growth in domestic VAT, excises and PIT.

Net domestic VAT revenues **(UAH 21.3 bn)** added 9% MoM and 14% YoY despite the VAT refund of UAH 13.5 bn (largest in 1.5 years).

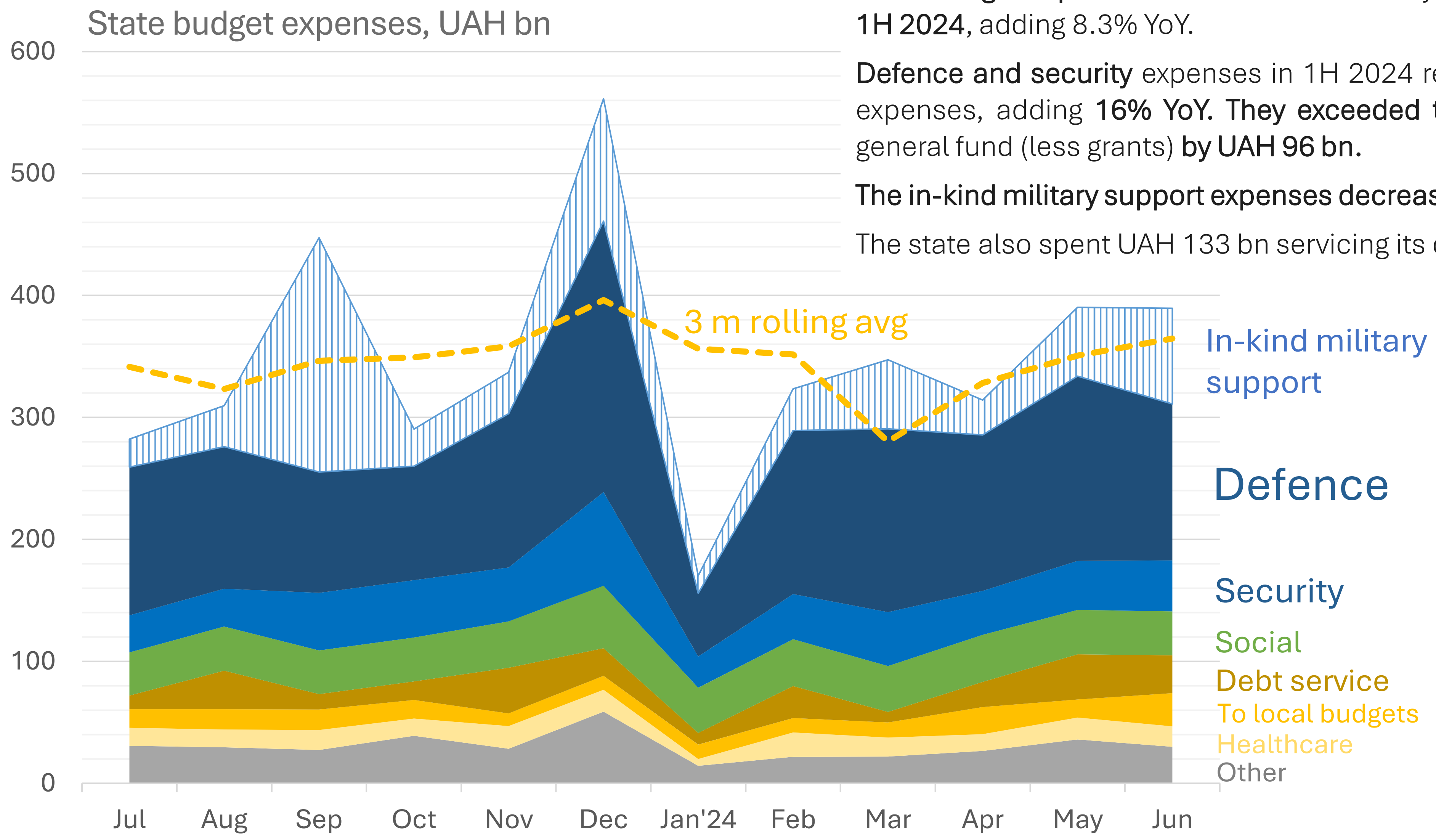
Excise revenues **(UAH 18.6 bn)** added 7.5% MoM and **more than doubled YoY**, reflecting excise rates' increases and stricter administration of fuel and tobacco markets.

Nevertheless, the VAT underperformed vs budgeted amounts, mostly due to lower imports and larger VAT refund.

The budget plan was exceeded by 0.9% due to overperformance of the PIT, CPT and excise revenues.

FISCAL SECTOR – STATE BUDGET EXPENSES

Defence spending in 1H2024 limited by own revenues, military support decreased



State budget expenses net of in-kind military support reached **UAH 1,935 bn in 1H 2024**, adding 8.3% YoY.

Defence and security expenses in 1H 2024 reached **UAH 969 bn**, half of all the expenses, adding **16% YoY. They exceeded the own revenues** to state budget general fund (less grants) **by UAH 96 bn.**

The in-kind military support expenses decreased by 9.3% YoY, to UAH 269 bn.

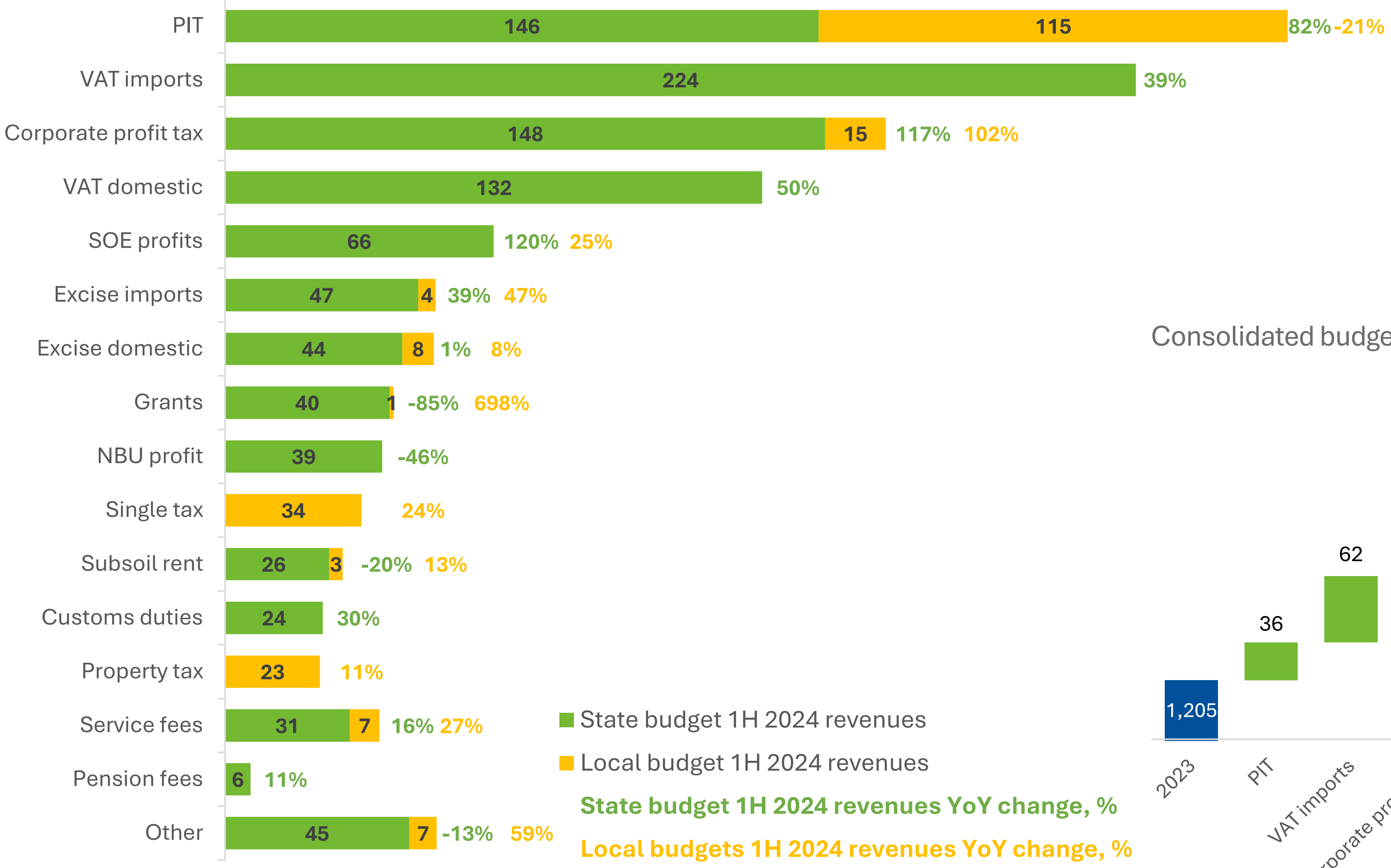
The state also spent UAH 133 bn servicing its debts, +13.6% YoY.

Source: Ministry of Finance. *Note: only June figures were released as of the presentation date*

FISCAL SECTOR – REVENUE COMPOSITION

The revenue structure changed, direct taxation weight growing

Consolidated budget 1H 2024 revenues, UAH bn

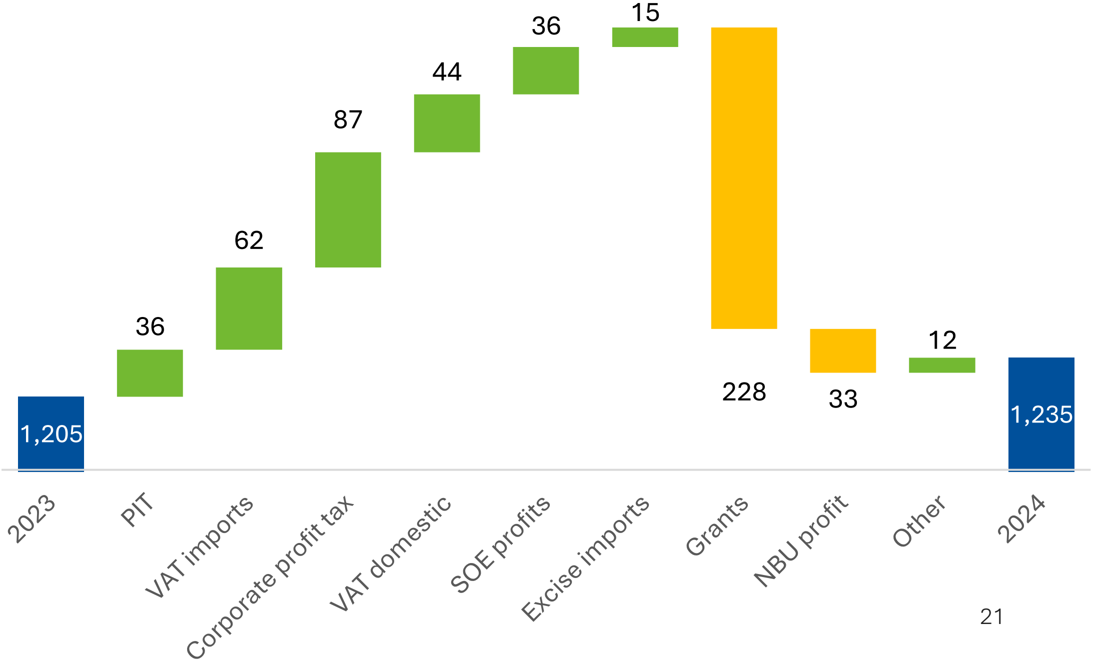


Local budgets lost 21% of their PIT revenues vs 1H 2023 due to transfer of the military PIT to the state budget.

Corporate profit taxes soared due to the windfall tax on bank profits.

Indirect taxes revenues continue solid performance.

Consolidated budget 1H 2024 revenue changes, UAH bn



Source: Ministry of Finance

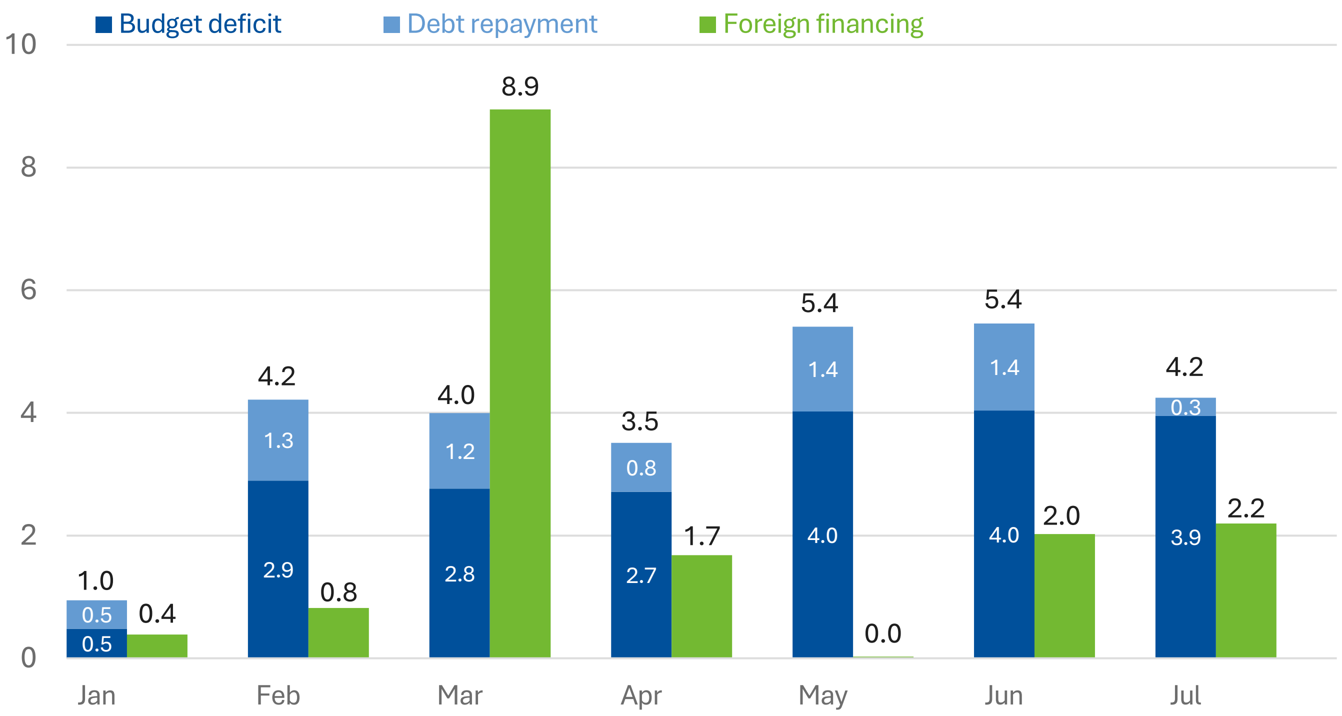
FISCAL SECTOR

Foreign aid less regular in 2024, covers fewer needs

Ukraine received $20 bn in foreign budget financing in 7 months of 2024, but disbursements were often delayed and irregular. In August, Ukraine has received another $8.5 bn. The need for foreign financing to cover civilian budget expenditures is $37 bn. According to the NBU's forecast, Ukraine will be able to raise USD $38 bn. However, **one of the key problems for this year's budget is the untimely provision of military aid**, which has added to the challenges for this year's expenditure financing.

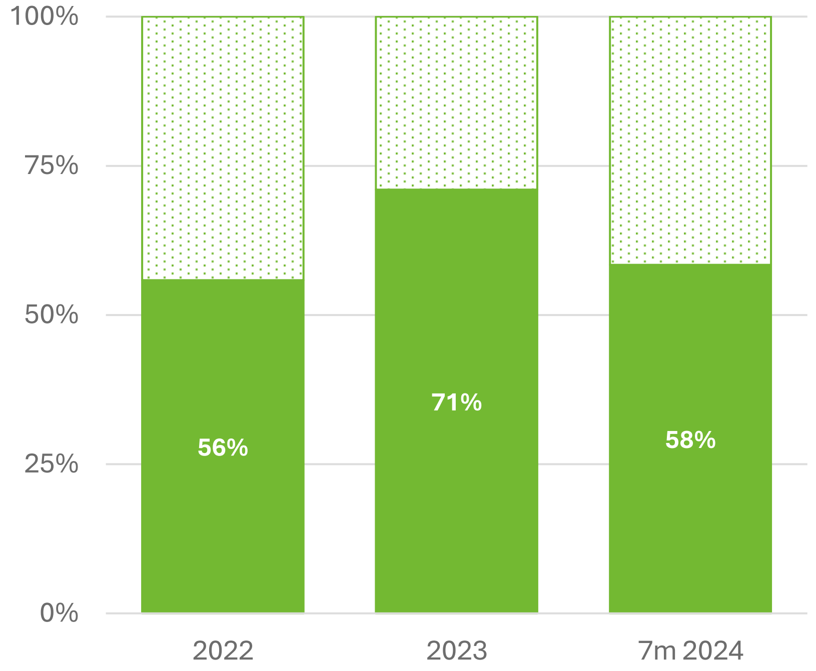
Foreign aid covered 58% of the additional needs of the state budget in 7 months of 2024, which is less than in 2023. In August, this figure will be significantly better (~77%) due to significant disbursements but will continue to decline later.

Foreign financing, state budget deficit and debt repayment in 2024, $bn



Sources: Ministry of Finance, NBU, CES calculations

State budget financial needs coverage by foreign financing, %



FISCAL SECTOR

Foreign financial assistance for 2025 is uncertain

- Ukraine needs a minimum of $32 bn in foreign financing in 2025, according to the Ministry of Finance.
- However, only $15 bn are currently pledged: €12.5 from the European Union (Ukraine Facility) and $1.8 bn from the IMF.
- Ukraine currently lacks at least $17 bn to finance civilian expenditures in 2025.

- A potential solution to the problem is the transfer of $50bn of frozen Russian assets to Ukraine.
- The best option for Ukraine: an unconditional grant, which could also be used for military purposes.
- No final decision yet. G7 countries have not reached an agreement. There are proposals to partially replace military support from partner countries with this money.

2025 announced foreign financing need vs. pledged amounts, $ bn

Source: Ministry of Finance

CENTRE FOR ECONOMIC STRATEGY

GET German Economic Team

THANK YOU.

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