Institute for Economic Research and Policy Consulting

Monthly Economic Monitoring of Ukraine

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Resume

- **The EU has decided to open accession talks with Ukraine.**
- The State Statistics Service estimated real GDP growth in the third quarter of 2023 at 9.3% yoy. That is slightly higher than the IER estimate, according to which the growth rate was close to 8% yoy.
- According to the IER, real GDP growth slowed from 6.4% in October to 3.6% in November.
- The strike of Polish carriers since November 6 has hindered Ukraine's foreign trade.
- The deficit in trade in goods narrowed in November amid increased maritime exports and reduced imports amid the blockade of selected road border crossing points.
- The state budget deficit exceeded one trillion hryvnias. It was financed mainly by soft loans.
- Ukraine has received a tranche from the IMF and continues heated negotiations with the EU and the US on further support.
- In November, consumer inflation remained close to 5% yoy as competition for limited consumer demand intensified.
- Fluctuations in the hryvnia exchange rate prompted banks to trade more foreign currency among themselves, but NBU remained the leading player on the market. The hryvnia depreciated slightly in the first half of December.

Фінансується Європейським Союзом

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Breaking news

On December 14, the European Council approved the decision to open negotiations on Ukraine's accession to the EU. Now, Ukraine and the EU can start the official screening of legislation for compliance with the EU acquis. The initial and final requirements for six clusters, divided into 35 negotiation sections, will be determined based on the screening results. There is already an estimate that it will be necessary to harmonise 3000 norms of European legislation. Therefore, the coming years will be full of difficult work. And based on its results, becoming a member of the EU may be realistic for Ukraine as early as 2030.

GDP and Real Sector: Real GDP Growth Decelerated in November

The Ukrstat estimated real GDP growth in the third quarter of 2023 at 9.3% yoy. That is slightly higher than the IER estimate, according to which the growth was close to 8% yoy. The difference is moderate given the limited data published on Ukraine's economy during the war. Overall, GDP growth reflects this year's higher harvest, the economy's adjustment to new working conditions, the gradual recovery of consumer spending, and spending on the priority restoration of destroyed infrastructure. However, real GDP remained almost 25% lower than in the third quarter of 2021.

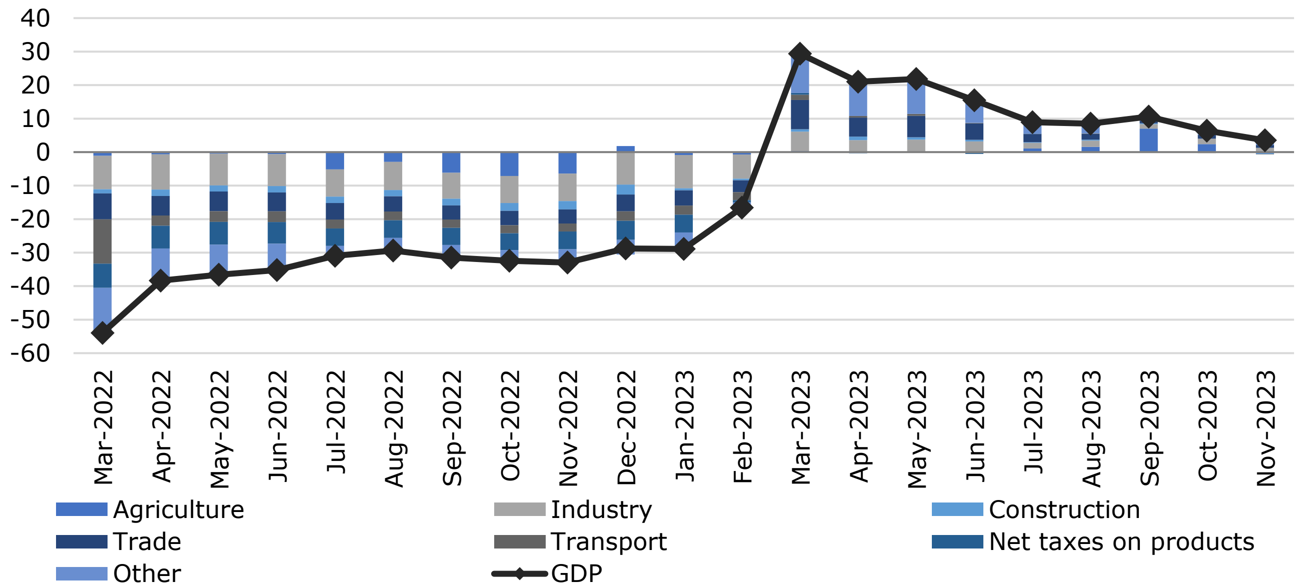
According to the IER estimate, real GDP growth slowed from 6.4% yoy in October to 3.6% yoy in November. That is primarily due to decreased real gross value added (GVA) in agriculture and transport. Both were harmed by the blockade of the border by Polish carriers. According to our estimates, real GDP in November 2023 was more than 30% lower than in November 2021.

The decline in real GVA in construction is estimated to remain almost unchanged as compared to October; however, it decreased more compared to 2021 because of less funding for infrastructure projects. The growth of real GVA in the energy sector accelerated, in particular, due to the effect of the statistical base: in November 2022, there were problems with access to electricity, and in the last days of the month, there was a blackout. Also, this year, electricity consumption by the population and industry increased.

The growth rate in manufacturing decelerated slightly, but still exceeded 14% yoy, reflecting the continued gradual economic recovery and the low base last year. The stable situation in machine building contrasted with the difficulties in metallurgy. In fact, in November, ferroalloy plants stopped.

Businesses faced greater problems with logistics, as evidenced by the IER survey. That was due to the blocking of the border by the Polish truck drivers (see Transport). Overall, we estimate that real GVA in transport decreased by 4.0% yoy. At the same time, trade indicators grew.

Figure 1: Contributions to real GDP, percentage points



Source: IER assessment supported by the USAID Competitive Economy Program in Ukraine

According to the IER, after the rapid growth of real GVA in agriculture in September and October, agricultural production fell by about 4% yoy in November. This was attributed to the faster harvest in 2023 compared to 2022. This year, many more late crops were harvested in September and

October, while last year, farmers were forced to harvest more crops in November. That applies to oilseeds as well as corn and beets. At the same time, smaller sown areas were compensated by higher yields for several crops. According to estimates, some livestock subsectors slightly reduced production compared to the previous year, although the decline was generally not rapid. As a result, the estimated real GVA in agriculture was about 30% lower than in 2021.

The IMF has improved its forecast for Ukraine's economic growth for 2023. According to the baseline scenario, real GDP, according to the IMF, will grow by 4.5% this year. At the same time, the forecast includes uncertainty for 2024, when real GDP will increase by 3-4%. The IMF has also developed a pessimistic scenario in which the active stage of the war will last until the end of 2025, leading to a 5.0% drop in GDP in 2024.

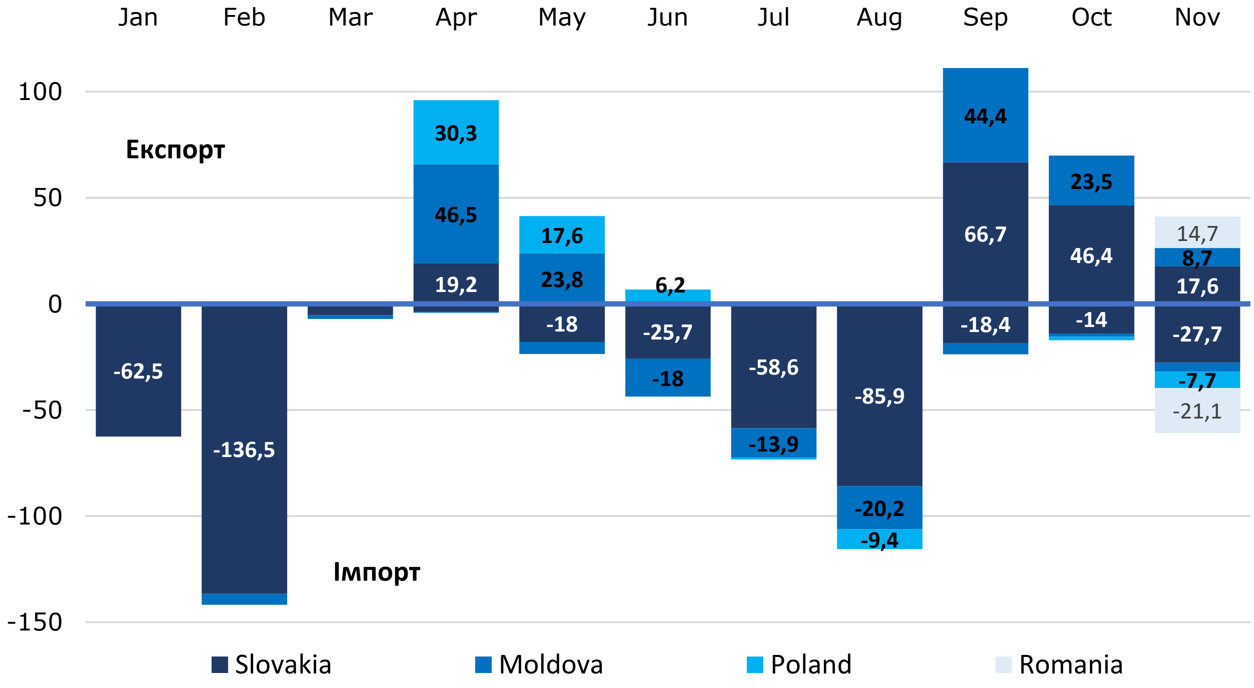
Energy: there is a shortage of electricity production in Ukraine

Electricity. In Ukraine, in the second half of November and the first half of December, there was a shortage of electricity due to low temperatures and Russian shelling of energy infrastructure. The Starobeshevo TPP was shelled, and units at other TPPs and CHPs were shut down for emergency repairs. A missile strike was also carried out on one of the mines of the Toretsk Coal State Enterprise. In addition, solar power plants did not generate a sufficient amount of electricity due to cloudy weather. Therefore, the generation volume was insufficient against the background of high consumption. Thus, the excess of consumption over production by 2.2% is equivalent to the operation of at least two additional units of thermal power plants. Prime Minister Denys Shmyhal appealed to Ukrainians and businesses to save electricity due to the power shortage in the energy system.

To cover the energy system deficit, emergency assistance was attracted from Romania, Slovakia, and Poland, as well as imports from Slovakia, Romania, and Moldova. From December 1, the technical capacity of imports from Europe to Ukraine and Moldova is 1700 MW. In November, Ukraine increased electricity imports by 3.5 times compared to October – up to 61.1 thousand MWh. At the same time, electricity exports decreased by 41% to 40.9 thousand MWh.

Ukraine's State Nuclear Regulatory Inspectorate has extended the license to operate power unit No. 1 of the South Ukraine NPP until December 2, 2033. The extension took place without a lengthy shutdown of the unit, which made it possible to generate additional electricity for the power system.

Figure 2: Electricity exports and imports in 2023, thousand MWh



Source: DixiGroup

Energoatom promises to fulfil its obligations to provide affordable electricity to the population (PSO) for the entire year. It has already paid more than UAH 113 bn out of the required UAH 121 bn. The payment of financial PSO by Energoatom and Ukrhydroenergo covers the difference between the market price and the tariff for the population at the level of UAH 2.64/kWh, which is much lower.

The National Energy and Utilities Regulatory Commission increased tariffs for NPC Ukrenergo's services for 2024 by 9%. The new tariff for electricity transmission is UAH 528.57/kWh, and the dispatch control service is UAH 104.57/kWh.

Gas. Daily natural gas production in Ukraine is decreasing. Specifically, production on December 2 amounted to 51.4 m m^3 of gas, which is 3% less than November 30. That is the lowest output since mid-August 2023. The decrease in production volumes is primarily due to the suspension of production by Ukrnaftoburinnya at the Sakhalin field in the Kharkiv region from December 1. The company stopped production in pursuance of the court's decision to revoke the special permit.

The "actual gas selling price" to calculate the rent in Ukraine for November was UAH 14,381 per 1 thousand cubic meters, which is 5.4% less than in October. Because gas has not been traded on trading floors since September, this indicator was calculated based on two indicative prices for the Ukrainian market (in the Argus European Natural Gas reports and ICIS European Spot Gas Market). Gas prices have fallen after rising for four consecutive months. Over the past year, the price has halved. The average gas price is calculated according to the formula for the Ukraine Tax Code regarding the collection of rent for subsoil use.

The Naftogaz Group completed the integration of the main gas distribution companies, which began in November 2022 after the resolution of the Cabinet of Ministers of Ukraine on the transfer of state gas distribution networks to Gas Distribution Networks of Ukraine LLC in the structure of Naftogaz. By the end of the year, it is planned to add three small companies (Korostyshivgaz, Tysmenytsiagaz, and Luhanskgaz), after which there will be 26. Naftogaz declares that integrating regional gas companies is a wartime step to ensure gas supply and control and prevent unauthorised withdrawal.

Transport: vehicles were blocked on the border with Poland for more than a month

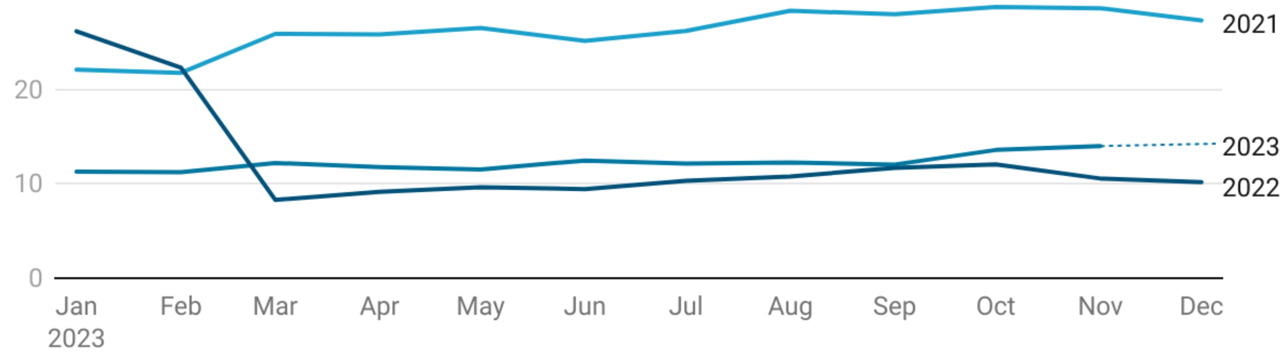
Maritime transport. The volume of sea and river transport exports increased by 70.7% in November to 5.9 m tons, and imports by sea and river transport increased by 8.2% mom last month, to 495.2 thousand tons. In November, about 620 thousand tons of iron ore and 140 thous. tons of metal products were exported from the ports of Odesa and Pivdennyi. Also, 2.8 m tons of agricultural products were exported by deep-water ports.

The enemy continues to attack the port infrastructure of Ukraine. On December 7, the Izmail district of Odesa oblast was hit: the driver of one of the trucks was killed, and warehouses, an elevator, and trucks were damaged.

Rail transport. Ukrzaliznytsia transported 14 m tons of cargo in November, which is 33.8% more than in the same period in 2022 and 4% more than in October 2023. Imports by rail increased by 10.6% mom, to 561.3 thousand tons. Exports decreased by 17.9% mom, to 2.535 m tons. In the volume of transportation in the direction of western border crossings and ports, the first place is occupied by grain cargoes (40%). Iron and manganese ore are in second place (38%), and ferrous metals are in third place (7%). The volume of grain transportation in this direction increased by 40.4% to 2.43 m tons, primarily due to a 1.7-fold increase in the volume of grain transportation in the direction of ports – up to 1.7 m tons.

Within the structure of Ukrzaliznytsia, a branch called "Operator of Port Stations" was created, which included port stations of key seaports - Odesa-Port, Chornomorsk-Port, Poromna, Beregova, Izmail, Mykolaiv-Gruzhny, Zhovtneva and Kherson. The branch is tasked with ensuring efficient railway logistics in ports. Ukrzaliznytsia and the Kryukov Carriage Works signed a contract to supply 22 passenger cars for UAH 980 m.

Figure 3: Transportation of goods by rail, m tons



Source: Ukrzaliznytsia

Road transport. The mayor of the Dorohusk community, Wojciech Sawa, revoked his consent to the protest of carriers on the Polish-Ukrainian border, which allowed traffic to be unblocked on December 11. The European Commission welcomed the unblocking of the Yahodyn-Dorohusk checkpoint on the Ukraine and Poland border and called for the resumption of traffic at the remaining checkpoints. In total, about 3300 trucks stand in queues on the Polish-Ukrainian border. The most significant number of trucks is observed in front of the Shehyni checkpoint – 1200 units and "Rava-Ruska" – about 850.

At the same time, Slovakia has blocked the movement of trucks through the Vyšné-Nemecké checkpoint on the border with Ukraine since December 11. Protesters have restricted the movement of trucks heading from Ukraine towards Slovakia. At the exit from Slovakia, the movement of trucks is not blocked. Also, on December 11, there was a demonstration of Hungarian carriers at the Záhony-Tisza checkpoint, demanding the abolition of the "transport visa-free regime" for Ukraine.

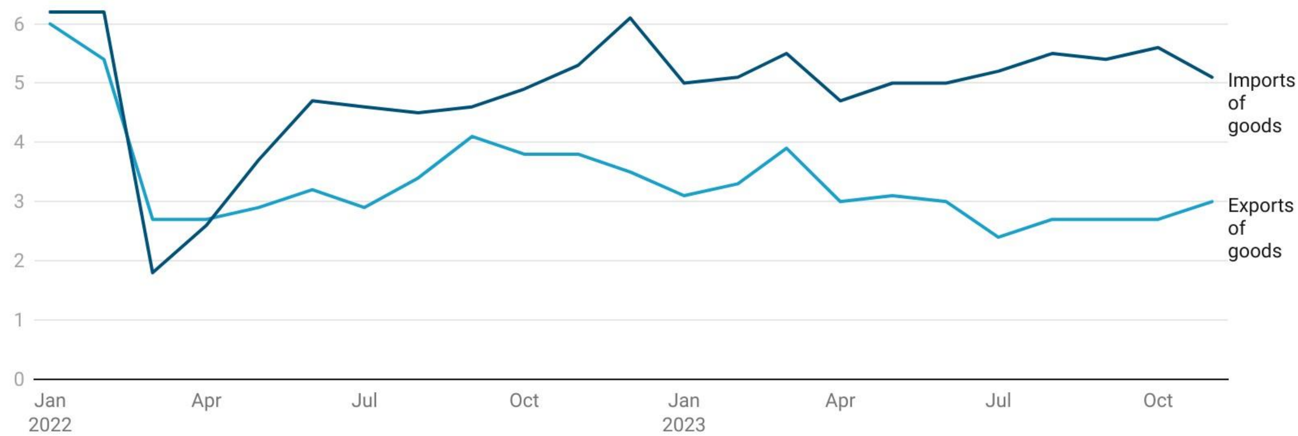
Exports by road due to the blockade on the Ukrainian-Polish border in November this year fell by 26.7% compared to October – to 783 thousand tons, and imports decreased by 23.5% mom, to 967 thousand tons.

During the year-long existence of the eCherha service, more than 615 thousand trucks and more than 28 thousand buses were registered to cross the border there. Most often, the service was used by Ukrainian (81.2%), Polish (6.7%), and Turkish (4.3%) carriers. The most popular checkpoint was Yahodyn-Dorogusk, where the service was launched in the first place – it accounted for 25% of all registrations. In total, 100 thousand consumers are registered in the system, 20% of them are foreigners.

Foreign Trade: Logistics continues to determine trends in goods foreign trade

In November 2023, according to preliminary estimates of the State Customs Service of Ukraine, exports of goods reached USD 3.0 bn, 10% more than a month ago. The revival was mainly due to the intensification of the sea corridor, which Ukraine and the EU countries created after the termination of the Black Sea Grain Initiative in July 2023. That made it possible to increase the supply of grain, primarily corn, the export of which increased from 1.1 m tons in October to 2.5 m tons in November. The physical volumes of exports of soybeans, sunflower oil and iron ore also increased. It is difficult to overestimate the importance of the resumption of maritime exports, as trade relations between Ukraine and neighbouring countries remain tense. In addition to the bans on importing certain agricultural goods from Ukraine, which have been in force in Poland, Slovakia and Hungary since May, since November 6, Polish carriers have blocked several road border crossing points with Ukraine. In December, they were joined by carriers from Slovakia and Hungary (see Transport).

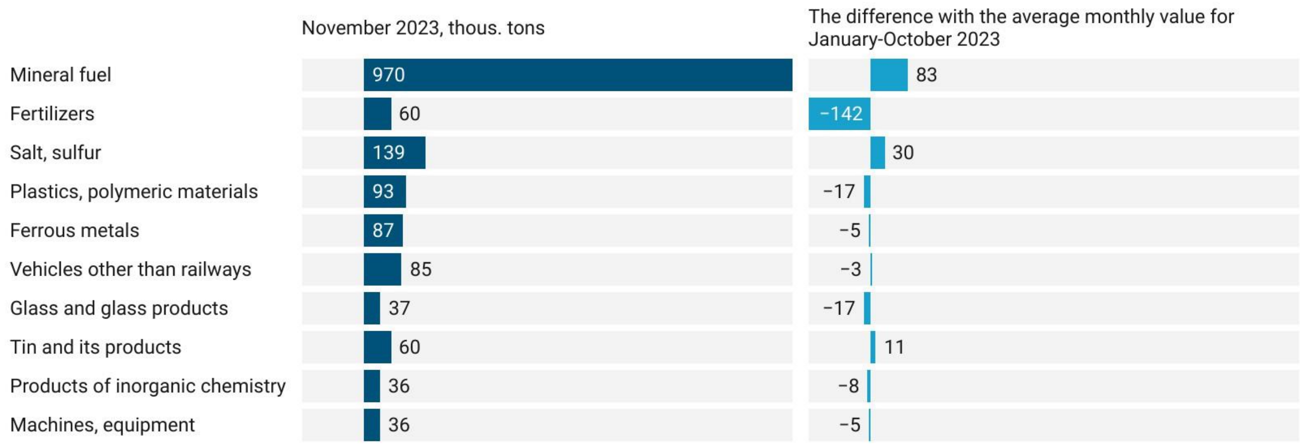
Figure 4: Ukraine's foreign trade in goods, 2022-2023, USD bn



Source: UN ComTrade, SCSU

The blockade of border crossing points had a much more significant impact on imports of goods than on exports since the share of road transport in imports is much higher, accounting for about ¾ of the total monthly value of supplies. Commodity imports in November amounted to USD 5.1 bn, 9% lower than in October. The physical volume of imports decreased for most groups of the commodity nomenclature, particularly for imports of fertilisers, where the drop was 61% of the mom. At the same time, the physical volume of imports of petroleum products (HS 27) increased by 12% mom.

Figure 5: Trends in the physical volume of imports



Source: SCSU. The top 10 product groups are defined by their physical volume for the first 11 months of 2023

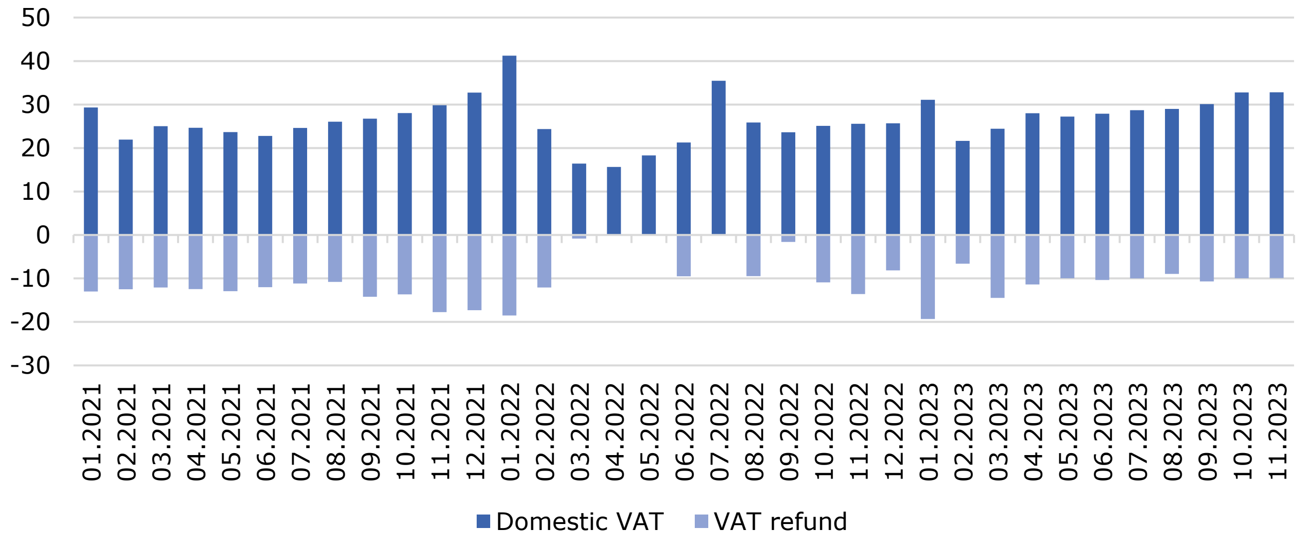
Changes in export and import trends led to a narrowing of the monthly goods trade deficit to USD 2.2 bn.

State Budget: Fiscal situation remains challenging

According to Minfin, in November, the revenues of the State Budget amounted to UAH 194 bn, including the general fund revenues of UAH 122 bn. The special fund revenues increased partially due to the inclusion of the "military" personal income tax (*more details below*). Compared to October, corporate income tax (CPT) revenues almost compensated for the lack of a grant from the United States. Thus, revenues from the CIT amounted to UAH 31.1 bn, a record level during the full-scale war but 13% lower than in November 2021. Commercial banks had the highest profits. That is why the government proposed and the Parliament decided to introduce a 50% CPT rate for taxing bank profits for 2023 and 25% in the future compared to the standard rate of 18%. That is expected to bring an additional UAH 25 bn to the state budget in 2024 and UAH 5 bn based on the results of the banks' work in 2024.

Gross VAT revenues from goods and services produced in Ukraine increased by 28% yoy, indicating higher consumption. At the same time, the amount of VAT refunds remained at the October level of about UAH 9.9 bn. VAT revenues on imports decreased by 20.3% compared to October, which resulted from the border blockade by Polish truck drivers. At the same time, they were 15% higher than in November 2022.

Figure 6: Domestic VAT, UAH bn

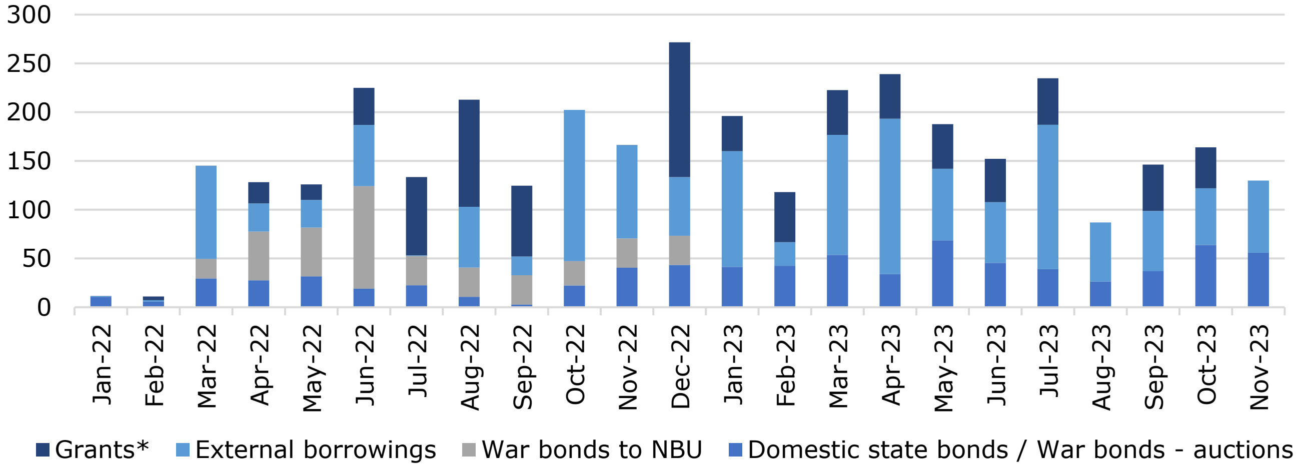


Source: Ministry of Finance, openbudget.gov.ua

Personal income tax revenues increased by only 10.0% yoy, which may indicate a slowed military provision growth and a halted stabilisation of the labour market situation. At the end of November, local authorities had to return to the State Budget the funds paid as personal income tax on the amount of military support in October. That resulted from the Parliament's decision to channel all personal income tax from the military (paid from the State Budget) to the State Budget: previously, it was split between the state and local budgets as personal income tax on regular salaries.

In November, the government did not receive a grant from the United States. At the same time, a loan from the EU was received. A loan guaranteed by the UK was also received from the World Bank. In total, external borrowings in November were equivalent to UAH 73.8 bn. Also, this month, UAH 56 bn was raised from domestic government bonds, of which the equivalent of UAH 10 bn was received from bonds denominated in foreign currency.

Figure 7: Funding and grants received by the state budget, UAH bn



*Note: * Grants are part of budget revenues, which are accounted for under the code 42000000 "From the European Union, foreign governments, international organizations, donor institutions".*
Source: Ministry of Finance, openbudget.gov.ua

In 11 months of 2023, the State Budget deficit amounted to UAH 1045 bn. At the same time, expenditures were financed in the amount of UAH 3452 bn. Spending of the general fund of the State Budget amounted to UAH 2632 bn and was fulfilled by 93% of the plan.

International Support: IMF Executive Board approves second program review

IMF: On December 11, the IMF Executive Board approved the second review of the IMF program, and on December 14, Ukraine received the third tranche under the program of almost USD 900 m. At the same time, Ukraine did not fulfil some of the structural benchmarks on time and did not fulfil one at all – the revision of the Affordable Loans 5-7-9% program was postponed to the end of March 2024.

Other twelve structural benchmarks were added to the memorandum. These are, first of all, measures designed to ensure additional internal budget revenues, a return to medium-term budget planning, effective management of state property (both enterprises and banks) and acceleration of privatisation (of both companies and banks). The next review under the optimistic scenario may occur at the end of March 2024 if the government quickly and efficiently fulfils the benchmarks planned by the end of this year. In particular, this includes the adoption of the National Revenue Strategy.

Overall, revenues from the IMF program are not much higher than the amount of interest and principal on previous loans received from the IMF. The average interest rate on debts to the IMF currently exceeds 7% per annum due to the increase in the SDR interest rate, the premium for the long duration of the debt, and its high level. At the same time, the IMF decision opens the door to broader support. In particular, the EU mainly provides support to Ukraine only if there is an active IMF program.

EU: So far, the European Union is delaying the adoption of a new support mechanism for Ukraine, the so-called Ukraine Facility, which provides EUR 50 bn for five years. According to the European Commission, of these, EUR 39 bn will be budget support through EUR 33 bn in concessional loans and EUR 6 bn in grants: it will be provided based on the European Commission's analysis of the fulfilment of clearly defined obligations. Another EUR 8 bn are investment guarantees: their format is hotly debated today by various stakeholders. The rest is the repayment of the interest rate on loans under this support instrument and previous macro-financial assistance programs, as well as the provision of international technical assistance (ITA). At the same time, there is a risk that due to the increase in borrowing rates for the EU, this third component of the instrument will leave almost no money for the ITA.

The EU delay in providing assistance (as the procedural issues of approval will take at least until the end of January) creates fiscal risks, especially against the lack of a US decision to support Ukraine. At the same time, during the delay in funding from the EU and the United States, Ukraine may receive support from other donors, such as Japan, Norway, and Canada, which can help Ukraine finance its expenditures during January.

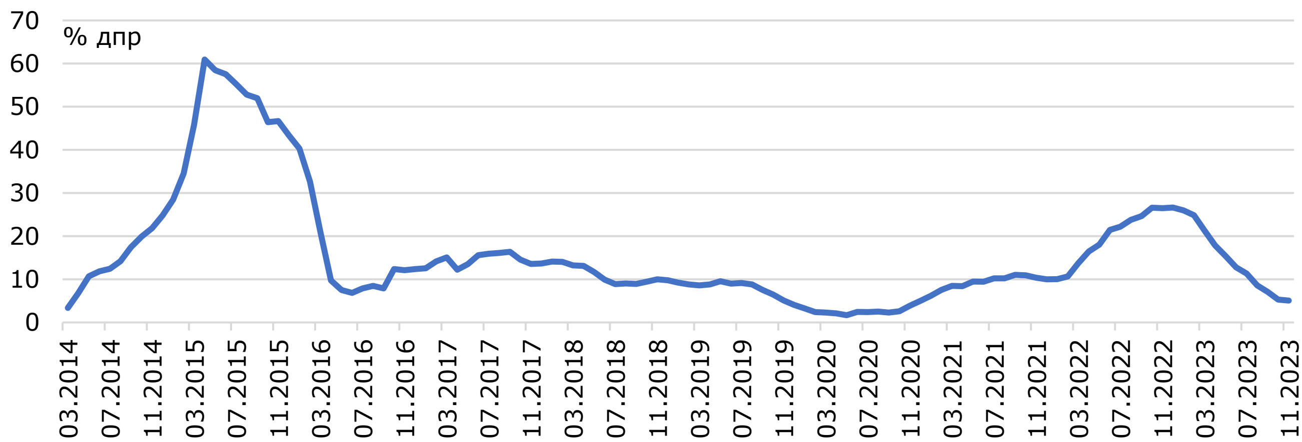
Also, on December 14-15, the EU failed to adopt changes to its budget, which would increase funding for Ukraine in the amount of EUR 50 bn. Twenty-six member states supported the proposed changes, but they have so far been blocked by Hungary.

Inflation: Again, close to the NBU's target

In November, consumer inflation remained close to 5% and reached 5.1% yoy. Before the full-scale war, the NBU set an inflation target of 5±1%. The main drivers of low inflation remained unchanged. The hryvnia exchange rate was close to fixed, which limited the growth in prices for imported goods and the cost of imported raw materials. A good harvest this year contained price increases for most food products and reduced prices for cereals and vegetables compared to the previous year. Prices for clothing, footwear and household appliances also declined, while prices for many other goods rose moderately due to moderate consumer demand and rebuilt cheaper supply chains. However, prices for several services and goods (restaurant services, consumer services, education, communications, bread, meat, dairy products, medicines, and others) grew faster than by 5%. Factors explaining this growth include rising energy costs, labour shortages, higher labour costs for certain occupations, and limited supplies of some goods due to the war.

In November, monthly inflation was again less than 1% and amounted to 0.5% mom. Seasonal increases in prices for vegetables and dairy products continued (although prices were, on average, lower than in 2022), as well as a seasonal decline in prices for clothing and footwear. The State Statistics Service recorded decreased prices for household appliances, smartphones and furniture as end-year sales were in full swing (although temporary discounts should not be considered when calculating inflation, permanent discounts can be recorded). Due to the blockade of the border with Poland, prices for natural gas used as car fuel rose sharply, and prices for gasoline and diesel fuel did not fall against the background of lower oil prices in Europe.

Figure 8: Consumer price inflation



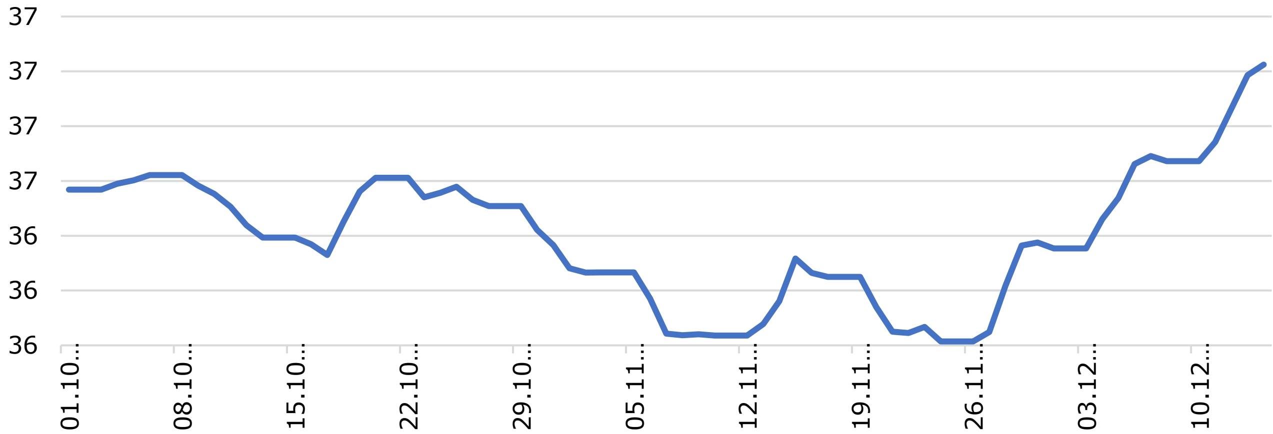
Source: State Statistics Service of Ukraine

Exchange rate policy: NBU keeps hryvnia exchange rate fluctuating

In November, the hryvnia remained in a narrow UAH 36-36.4 per USD corridor. A decrease in imports due to the blockade of trucks on the western border of Ukraine and a reduction in the budget's capital expenditures may have helped keep FX demand in check. In November, the NBU spent USD 2.45 bn to support the hryvnia exchange rate. That is less than in October (USD 3.34 bn) but more than the average for January-September 2023 (USD 2.16 bn). The increase in exchange rate flexibility prompted banks to intensify their operations in the interbank market: their volume increased to USD 2.09 bn in November vs USD 0.86 bn on average in January-September. Still, the volumes remained significantly lower than before the war (USD 9.8 bn on average for the month of 2021).

In the first weeks of December, the hryvnia weakened somewhat and on December 14, the official exchange rate exceeded UAH 37 per dollar for the first time. The change in the hryvnia exchange rate in the first half of December may reflect a seasonal increase in demand for foreign currency. The NBU generally left its interventions in December at the level of previous weeks.

Figure 9: Official exchange rate of the hryvnia to the US dollar, UAH per USD



Note: The exchange rate values in the figure start at UAH 36 per USD.
Source: NBU

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