INSTITUTE FOR ECONOMIC RESEARCH AND POLICY CONSULTING

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Summary

- Businesses faced problems with access to electricity due to the russian shelling of energy facilities. This restrained GDP growth.
- Transportation by railway and through the Ukrainian Sea Corridor is growing, contributing to the development of several sectors of the economy.
- The value of goods exports declined sharply in March on a year-on-year basis amid continued decline in grain and iron ore prices.
- In March, a record external financing of USD 9 bn was received. Half the funds came from the EU as bridge financing under the Facility for Ukraine.
- The Government approved the Ukraine Plan, which defines priority steps and measures, the implementation of which should become the basis for the EU budget support.
- State fiscal revenues continued to grow, partly due to the windfall taxation of banks' profits.
- Inflation slowed to 3.2% yoy in March. Inflation was last at this level in the COVID year of 2020 and before the start of the russian aggression in 2014.
- The NBU lowered the policy rate to 14.5% p.a. in response to the low inflation and the resumption of aid from donors to Ukraine. However, the NBU moved cautiously as the Ukrainian economy faces serious risks.
- The hryvnia weakened to UAH 39 per USD as the NBU paced its support.

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GDP and Real Sector: The Slowdown is Expected

2023. The Ukrstat released most of the 2023 economic data: quarterly data for national accounts and monthly data for the performance of industry, construction, retail, and transport. Accordingly, the IER experts slightly revised their estimates of changes in real gross value added (GVA) by sectors of the economy in 2023. Still, the annual real GDP growth rate released by the Ukrstat was close to the IER estimate: 5.3% (Ukrstat) compared to 5.2% (IER).

Previous estimates of the IER were too pessimistic for the manufacturing, electricity generation, construction, and transport. At the same time, the growth rate of real GVA in the extractive industry, trade, and the "other" sector, which in the IER estimate includes public administration, the defence sector and other services, was worse than our estimates.

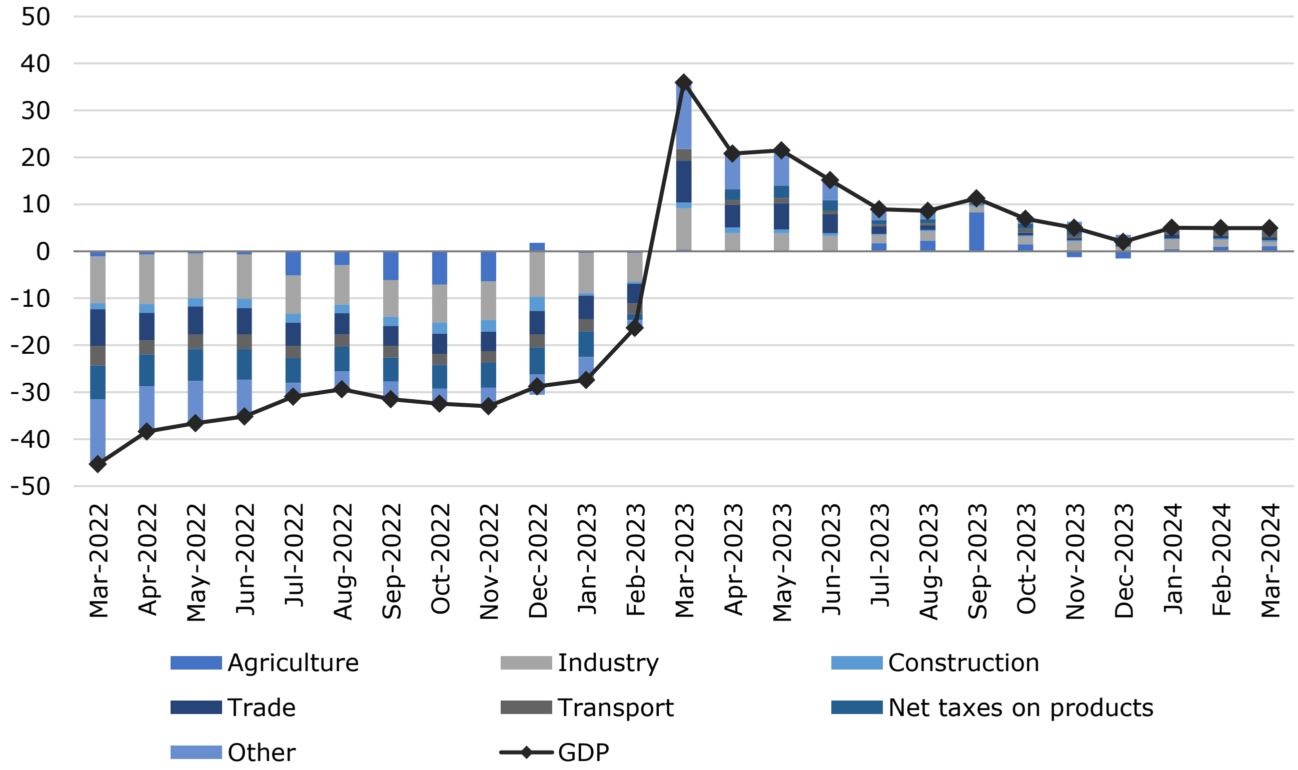
2024: New data prompted revising of the IER estimates for January-February 2024. According to our estimates, real GDP grew by 5.2% yoy in January and 5.0% yoy in February.

According to our estimates, the growth of real GVA in the manufacturing industry slowed to almost 11% yoy in March compared to 17% yoy in January. The IER survey indicates the increased importance of the "access to electricity" impediment to enterprises’ activities. That is due to the russian shelling of thermal and other electricity-generating plants: most occurred in the last week of the month. According to estimates, real GVA in electricity generation decreased by 2% yoy and a larger decline is expected in April.

Real GVA in transport continued to grow by over 20% yoy, while trade growth slowed to 4.6% yoy. Construction continued to grow, particularly due to the construction of budget-financed fortifications.

Overall, real GDP was estimated to have decelerated to 4.9% yoy in March. In April, we expect a further slowdown in growth because of problems with access to electricity due to the massive destruction of generation.

Figure 1: Contributions to real GDP, pp



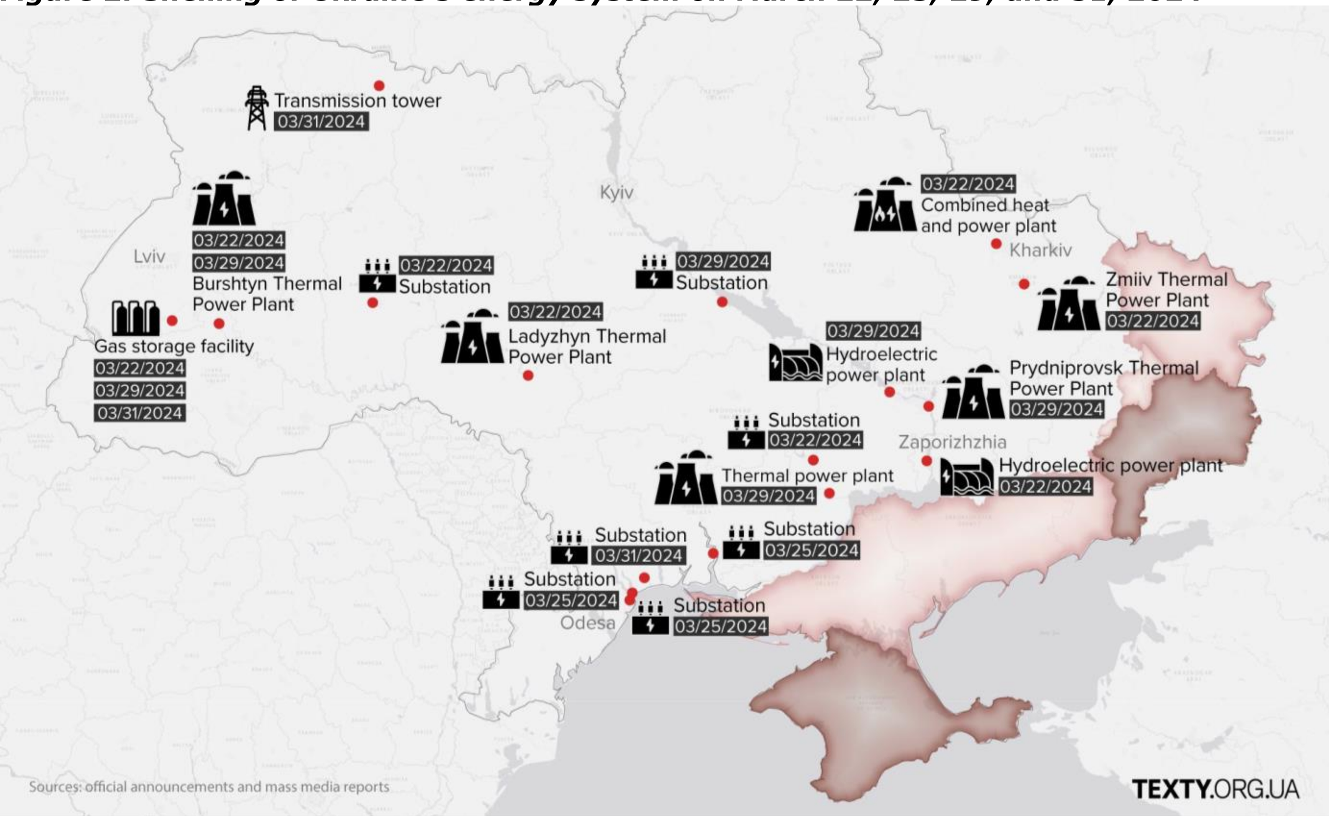
Source: IER estimates conducted under the support of the USAID Competitive Economy Program in Ukraine

Energy: russia has Destroyed a Large Share of Ukraine's Maneuvering Capacities

Electricity. In the second half of March and early April, russia massively attacked Ukrainian thermal and hydroelectric power plants. Shunting power generation in Ukraine suffered significant losses; more than 6 GW of capacity was damaged or destroyed. According to DTEK Executive Director

Dmytro Sakharuk, up to 80% of the company's facilities were damaged or destroyed. Due to these losses, Ukrenergo had to impose restrictions on the supply of electricity in Dnipropetrovsk, Donetsk, Zaporizhzhia, Kirovohrad, Kharkiv, Odesa, Khmelnytsky, Poltava and Sumy regions. There were also emergency shutdowns. The balance in the energy system is maintained by emergency assistance from neighbouring countries and electricity imports. However, during some hours of lower demand, there is an excess of capacity in the system, necessitating restrictions on the operation of renewable energy facilities.

Figure 2: Shelling of Ukraine's energy system on March 22, 25, 29, and 31, 2024



Source: [*texty.org.ua*](texty.org.ua)

Given the shortage of electricity and an unusually warm spring, many Ukrainian cities have decided to end the heating season ahead of schedule. Some cities have also stopped operating electric transport. Two weeks before schedule, one of the Khmelnytskyi NPP units was connected to the grid after the repair. However, the lost power generation capacity will not be fully restored during the summer repair campaign, and reconstruction will require significant funds, equipment, and time. Ukrenergo urges enterprises to invest in electricity generation to insure against outages.

Gas. On April 1, Naftogaz started the season of pumping gas into underground storage facilities. During the 2023/2024 heating season, 6.7 bn cubic meters of natural gas were withdrawn from UGS facilities for Ukrainian consumers, and in total, the gas withdrawal season lasted 145 days.

At the end of March, russia struck several times near the city of Stryi in the Lviv region, where a large gas storage facility is located. According to official reports, significant gas storage and transmission system damage was avoided.

Coal. Despite war risks, shelling, blackouts, and staff shortages, since the beginning of the year, coal production at state-owned mines in Ukraine increased by 24% in March compared to January, when it increased to 221 thousand tons. The increase in coal production made it possible to accumulate almost 1,208 thousand tons of coal in the warehouses of thermal power plants at the end of March, which is 508 thousand tons more than envisaged by the plan of the Cabinet of Ministers.

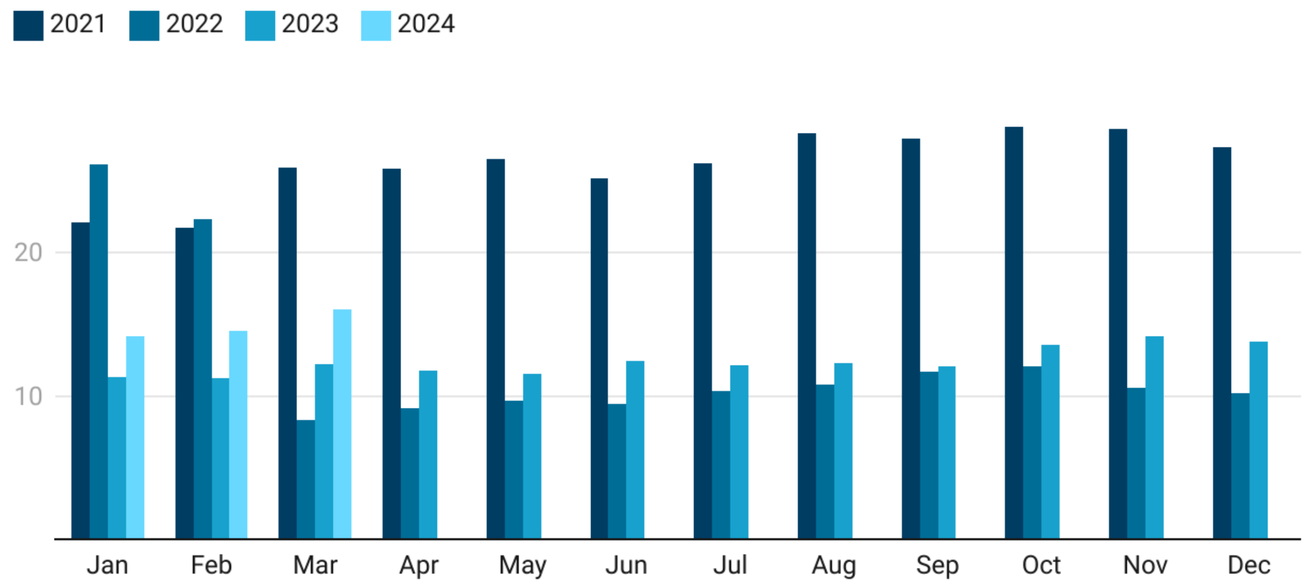
Transport: Ukrainian Sea Corridor Increases Volumes Despite Shelling Of Port Infrastructure

Maritime transport. On March 1-28, 6.3 m tons of cargo were exported through the Ukrainian sea corridor, including 4.2 m tons of agricultural cargo. For comparison, in March 2023, 3.9 m tons of freight (agricultural products) were exported through the "grain corridor." In total, during the operation of the corridor, 33.8 m tons of cargo were exported, of which most of the cargo was handled by the operators of the port of Pivdennyi (14.3 m tons), 11.4 m tons of freight were transshipped in the port of Chornomorsk, and 8.1 m tons in the port of Odesa.

At the beginning of April, the first since the start of the war, a container ship entered the port of Odesa. The pioneer was the Panama-flagged ship "T Mare": on April 4, it returned to the Romanian port of Constanta. Previously, small volumes of bulk cargo, such as technical salt and fertilizers, were imported through the ports of Odesa. We can expect a gradual resumption of imports to Odesa ports, although threats to the safety of navigation remain. On April 6, the port infrastructure of Odesa was shelled by a ballistic missile. The russians are also shelling the ports of the Danube region.

Rail transport. Ukrzaliznytsia transported 16 m tons of cargo in March, 10% more than in February and 31% more than in March 2023. The volume of transportation in the direction of the western border and ports amounted to 8.7 m tons (3.4 m tons to the border and 5.3 m tons to the ports). In domestic traffic, 7 m tons were transported, 11% more than in March 2023. Import traffic increased by 65% yoy and amounted to 808.3 thousand tons. Transportation volumes could have been higher if it weren't for the russian shelling. Due to air raids in the Odesa region and power outages, Ukrzaliznytsia's port stations were forced to stand idle for about five days. In addition, interruptions in the operation of the ports of Greater Odesa led to an increase in the accumulation of wagons at these stations to 8772 units as of March 29.

Figure 3: Transportation of goods by rail, million tons



Source: Ukrzaliznytsia

Road transport. Polish protesters continue to block the movement of trucks at the Rava-Ruska, Uhryniv, and Yahodyn border crossing points (BCPs). Polish farmers do not allow trucks to enter Poland in all these BCPs. Several trucks per hour are permitted to pass towards Ukraine. As of April 4, more than 400 trucks are queuing in these areas. The blockade of the Uhryniv checkpoint was temporarily suspended from March 28 to April 2.

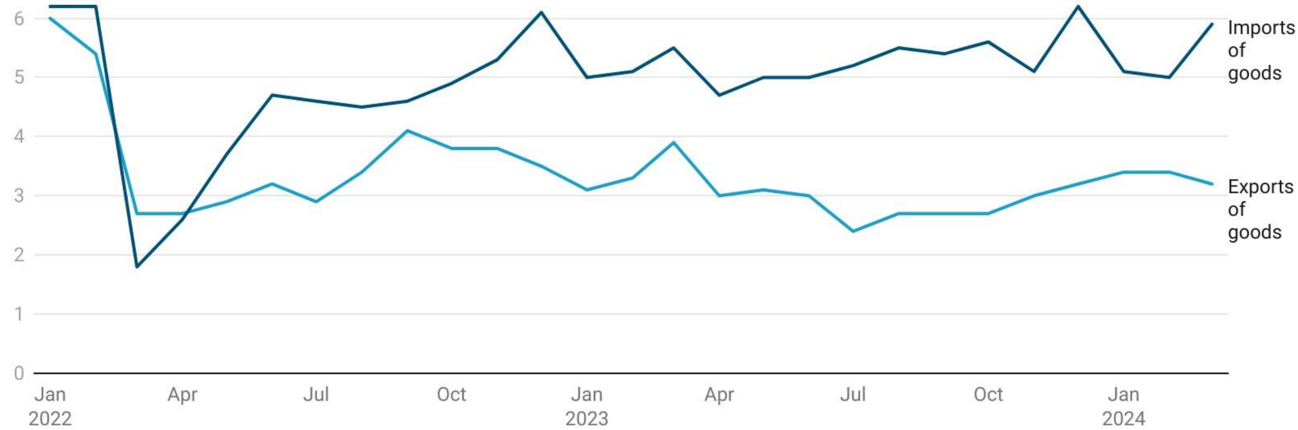
Queues were also observed at the BCPs, unblocked on March 20. As of the morning of April 4, there were about 550 trucks in the queue at the Krakivets BCP and 450 vehicles in the direction of Shehyni BCP.

At the beginning of April, Ukraine and Hungary agreed to open the Velika Palad – Nagyhodos checkpoint for passenger vehicles and the possibility of moving empty trucks weighing more than 7.5 tons at the Luzhanka – Beregsuranyi checkpoint. In addition, a new Ukrainian-Romanian checkpoint is planned to open, "Bila Tserkva – Sighetu Marmatiei."

Foreign trade: Low Prices Led to a Drop in Exports

In March 2024, the goods trade deficit began to grow again. According to preliminary data from the State Customs Service, in March, exports of goods were USD 3.2 bn, declining by 16% year-on-year, while imports grew by 7% yoy to USD 5.9 bn. That led to a deficit of USD 2.7 bn, close to the 2023 peak figures. In general, in the first quarter, exports of goods amounted to USD 10.0 bn (-2% yoy), and imports were USD 16.0 bn USD (+3% yoy), which means the trade deficit amounted to USD 6.0 bn.

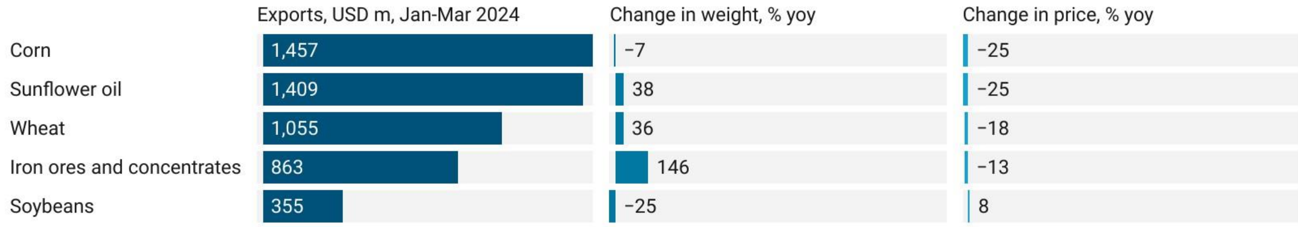
Figure 4: Trade in goods of Ukraine, 2022-2024, USD m



Source: State Customs Service of Ukraine, UN ComTrade

An essential factor for the drop in exports was the continued export price decline, which overshadowed the effect of the recovery in maritime transportation (including for non-food products), which contributed to the 31% yoy growth in the physical volume of exports in the first quarter. In particular, prices for four of the five primary Ukrainian export products, which accounted for 51% of the total in the first quarter, decreased significantly compared to the previous year. The export price of corn decreased by 25% yoy; the same decline was observed for the price of sunflower oil, and the price of wheat fell by 18%. The continuation of the partial border blockade by Poland remained another negative factor affecting both exports and imports.

Figure 5: Structure of exports of goods of Ukraine, top 5 goods



Source: State Customs Service of Ukraine, UN ComTrade. Note: a price change is a change in the average cost per ton of exports

State Budget: A Record Amount of International Aid was Received in March

Financing. After two months of low external funding, the State Budget received almost USD 9 bn from international partners in March. The largest funding of EUR 4.5 bn came from the EU as bridge financing under the Ukraine Facility, which provided total assistance of EUR 50 bn for four years. The Mechanism consists of three components: EUR 38.3 bn in budget support (for priority non-defence expenditures), almost EUR 7 bn for the investment fund (guarantees, investments), nearly EUR 4.8 bn for technical and administrative support, which also includes an interest subsidy on EU loans to Ukraine. In 2024, it is planned to receive EUR 16 bn in budget support. In April, EUR 1.5 bn is expected to be received, for which Ukraine must fulfil five obligations (three have already been fulfilled). In May, it is expected that the EU will provide another EUR 1.9 bn for the approval of the Ukraine Plan by the European Commission and the EU Council.

In March, the Government approved the Ukraine Plan, which should become the basis for providing budget support under the Ukraine Facility. It defines a list of reforms and measures, the implementation of which will be assessed by the European Commission and the EU Council. In case of a positive assessment, Ukraine will receive a predetermined amount of funding for each indicator met. At the same time, the Facility is quite flexible. In case of failure to implement the measure within the initial period, the Government will have an additional year to implement it, making it possible not to lose funds. In total, the Ukraine Plan provides for 135 general indicators in 69 areas of reforms and 16 investment indicators designed to strengthen Ukraine's macro-financial stability, modernize the economy, approach the EU membership, and increase the growth potential. At the same time, this plan is not a comprehensive government program but a list of priority steps.

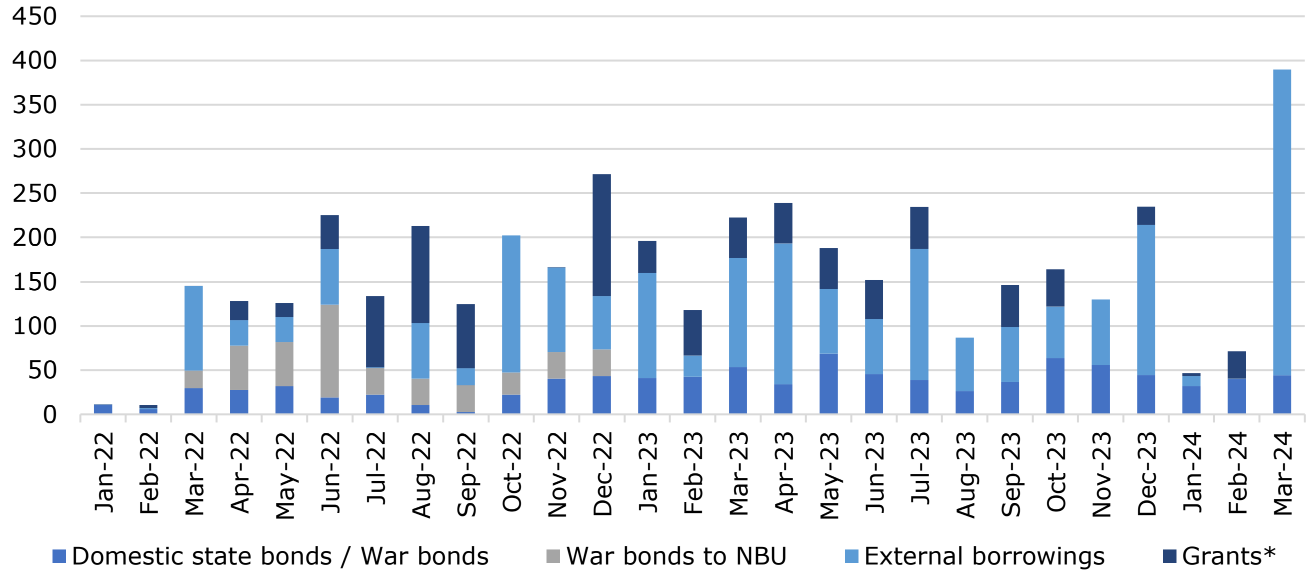
Also, in March, the World Bank provided Ukraine with a loan of USD 1.4 bn under the guarantees of Japan and Great Britain (USD 0.9 bn and USD 0.5 bn, respectively). The funds were provided as the DPL. That was preceded by the adoption of three laws regarding corporate reform, capital market reform, and electronic agrarian notes.

Also, in March, USD 880 m was received from the IMF, thanks to the decision of the IMF Board to approve the third review of the program. At the same time, no new structural beacons were added to the program, but several of the existing ones were postponed. Among the near future beacons, adopting the law to reboot the Economic Security Bureau will be the most difficult.

Canada provided USD 1.5 bn in the form of SDRs. So far, it is the only state that uses SDRs to assist Ukraine through a special IMF account.

At the same time, in March, Ukraine did not receive grants because the USA had not yet approved assistance to Ukraine, which it had previously provided as grants. However, Ukraine was able to increase borrowing from the placement of domestic government bonds. In March, UAH 44 bn was raised in the domestic market. In total, in the first quarter of 2024, the rollover of domestic government bonds amounted to 129%. Yield rates remained high, and some government bonds were denominated in foreign currency.

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



Note: * Grants are part of budget revenues, accounting under the code 42000000 "Official transfers from the EU, foreign governments, international organizations, donor institutions".
Source: Ministry of Finance, openbudget.gov.ua

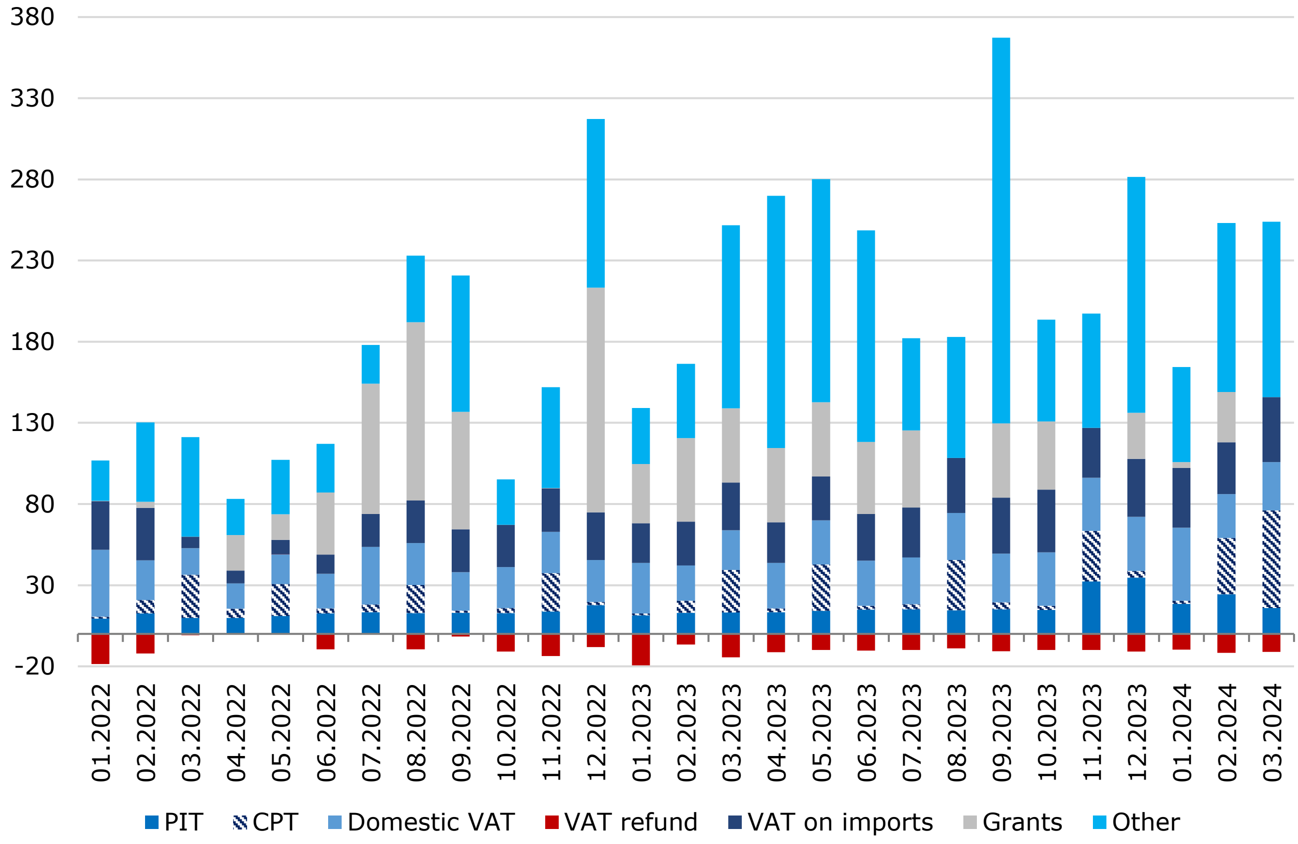
Revenues. The State Budget revenues in March amounted to UAH 243 bn (according to preliminary estimates), of which UAH 164 bn were the general fund revenues. The lack of grants led to a drop in revenues compared to February.

At the same time, corporate profit tax (CPT) revenues were record high. They amounted to UAH 60.1 bn, of which UAH 23.5 bn came from higher taxation of banks' excess profits. At the end of 2023, the parliament agreed with the Government's initiative to tax excess banks' profits: 50% of profits in 2023 and 25% in 2024 and subsequent years (the usual CIT rate is 18%).

More robust demand contributed to an increase in gross revenues from domestic VAT by 12% yoy. At the same time, VAT refunds remained at the level of previous months, although they were less than in March 2023, when the Government repaid the debt.

Import VAT reached a record (nominal) level of UAH 40.1 bn, 36.9% higher than in March 2023. That was facilitated by increased imports by rail, imports by sea, and comparatively less stringent border blockades by Polish farmers.

Figure 6: State Budget revenues, UAH bn



Note: preliminary data for March 2024
Source: Ministry of Finance, openbudget.gov.ua

In general, actual revenues administered by the State Tax Service were higher than planned by UAH 9.8 bn or 10% in March or by 13.4% (UAH 33 bn) in the first quarter. Revenues administered by the State Customs Service were close to the plan in March, but in the first quarter, they exceeded the plan by 6.3% (or UAH 8.1 bn). Customs revenues could be even higher if Polish businesses did not block the border.

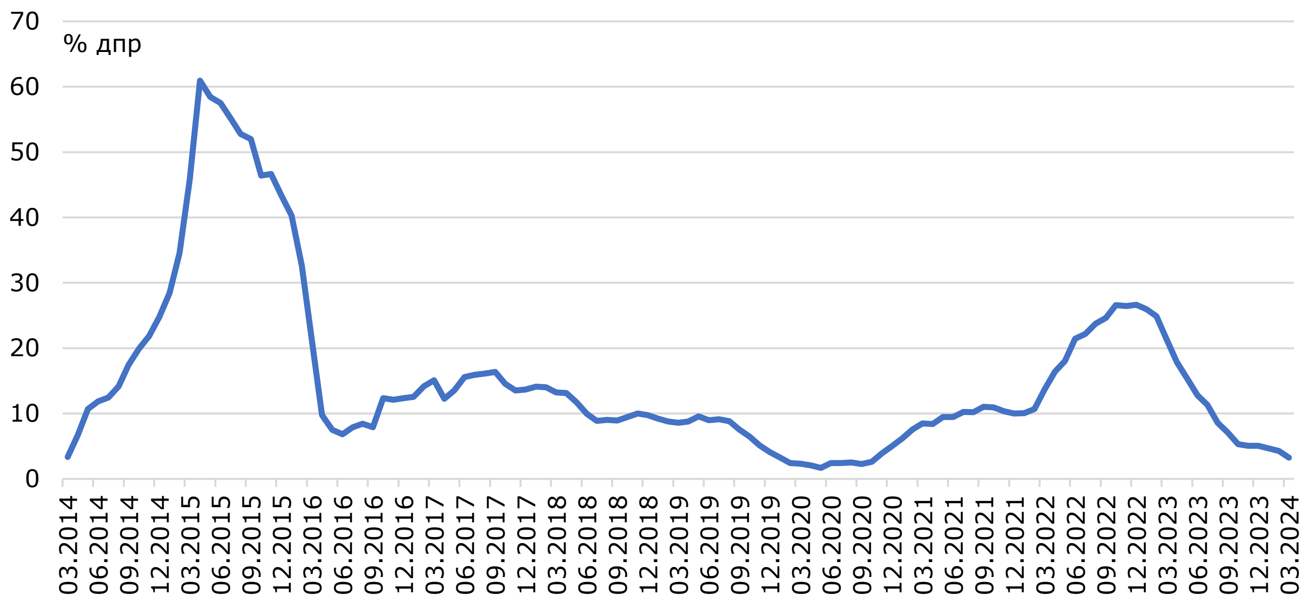
Expenditures. Expenditures of the general fund of the State Budget increased by 19% yoy in March. At the same time, they were lower than the average of March-November 2023 and lower than the figure of February 2024. The situation with international funding, namely the lack of regularity and predictability of aid flows, complicates the Government's expenditure planning. Despite this, the Government is currently working on the preparation of the Budget Declaration for 2025-2027, in which it should determine the priorities of funding. The Government should consider the Budget Declaration and the medium-term macroeconomic forecast by mid-May 2024.

Inflation: Consumer inflation approached 3% yoy

In March, consumer inflation was at 3.2% yoy. Inflation was at this level in 2020 and before the start of Russian aggression in February 2014. Unusually low inflation reflects falling prices for several goods, stable prices for others, and mostly moderate price growth for the rest. According to the State Statistics Service, oil, vegetables, sugar, and eggs fell in price compared to the previous March, reflecting a better harvest and low export prices. As for non-food products, the State Statistics Service recorded lower prices for clothes and footwear, household and other personal appliances, and cars. That likely reflected competition for limited demand for discretionary consumption goods and lower transportation costs for imports. That offset the weakening of the hryvnia against the dollar. The government also kept prices fixed for most utilities and rail transportation. However, prices for necessities and goods with a large share of labour costs have mainly increased (e.g. bread, meat, medicines, household services, hotel and restaurant services, medical services). Also, over the past 12 months, the Government has increased electricity tariffs and excise taxes on tobacco and gasoline.

Consumer prices increased by only 0.5% mom compared to the previous month. That reflected the "technical" increase in prices for clothing and footwear (in March, the State Statistics Service begins to take into account the prices of the new season, which are higher than at the end of the previous one), higher fuel prices, higher oil prices and lower egg prices due to increased supply in the spring. Excluding these factors, the price increase would be about 0.2% mom.

Figure 8: Consumer price inflation



Source: State Statistics Service of Ukraine

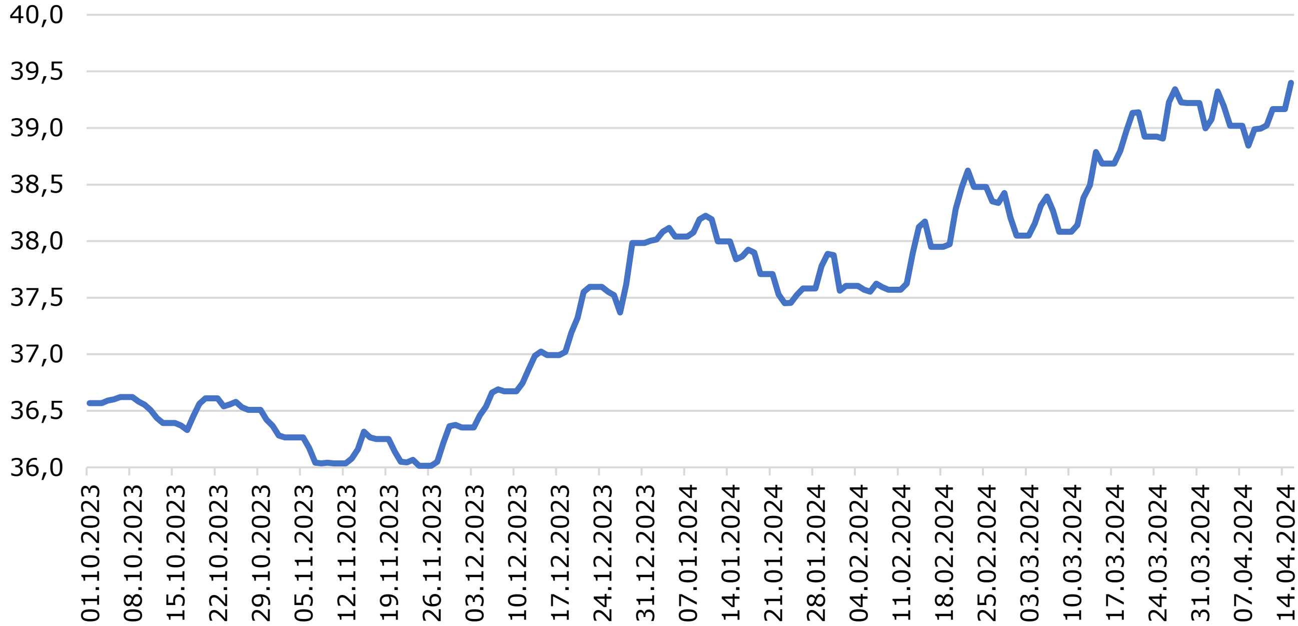
Monetary policy and exchange rate: the NBU lowered the rate, and the hryvnia weakened slightly against the dollar

Monetary policy. At its March monetary policy meeting, the NBU cut the key policy rate and the overnight deposit rate from 15% to 14.5% per annum. At the same time, the NBU slightly narrowed the interest rate corridor: the refinancing rate of the NBU and on three-month certificates of deposit decreased by 1.5 percentage points to 19.5% and 17.5%, respectively. This decision did not align with the NBU's previous signals to keep rates unchanged for several months. The opinions of the Monetary Policy Committee members diverge, and a compromise decision was made. Some participants advocated a larger rate cut due to low inflation and unblocking part of the external aid for Ukraine. Other participants emphasized that risks to Ukraine's economy remain high.

Exchange rate. In the second half of March, the hryvnia exchange rate exceeded UAH 39 per USD and stabilized in early April. Net demand for cash foreign currency declined significantly in March, but demand for foreign currency for foreign trade increased due to a slowdown in exports and an acceleration in imports.

The NBU's interventions in the FX market remained moderate compared to the end of last year, although they increased slightly in the second half of March. That may reflect the persistence of risks to Ukraine's external financing despite receiving significant funds to reserves in March. Overall, in the first quarter of 2024, the NBU's reserves increased from USD 40.5 bn to almost USD 43.8 bn.

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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