INSTITUTE
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Executive Summary

- According to the IER, real GDP growth accelerated to 4.4% yoy in July from 3.1% yoy in June due to a faster harvest than last year.
- In July, problems with the access to electricity were among the biggest impediments to business activity. The power outages were temporarily suspended at the end of July.
- Cargo transportation by Ukrzaliznytsia decreased slightly in July compared to June.
- Exports in July, according to Customs, partially recovered after a decline in June. This was facilitated by the relatively rapid harvesting of early grains.
- Imports in July increased primarily due to higher imports of electricity, as well as higher volumes of imports of engineering products related to access to electricity.
- The need to increase state budget expenditures on defense and security prompted the government to initiate changes in tax legislation.
- Inflows of international aid helped the government finance higher spending in July.
- Ukraine announced an exchange offer and consent solicitation for its existing Sovereign Eurobonds and Ukravtodor Guaranteed Eurobonds.
- In July, according to the Ukrstat, inflation reached 5.4% yoy.
- In recent weeks, hryvnia has suspended its gradual but steady decline against the US dollar and fluctuated in the range of UAH 41.0-41.5 per dollar.
- In July, the NBU unanimously left the key policy rate at 13% per annum and pointed to the low likelihood of further rate cuts this year.

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GDP and the Real Sector: Early harvest supports GDP growth

According to the IER, real GDP growth accelerated to 4.4% yoy (year-on-year) in July from 3.1% yoy in June due to a faster harvest than last year. Flash data of the Ministry of Agrarian Policy indicate that the grain harvest has grown rapidly, but at the same time the yield has slightly decreased.

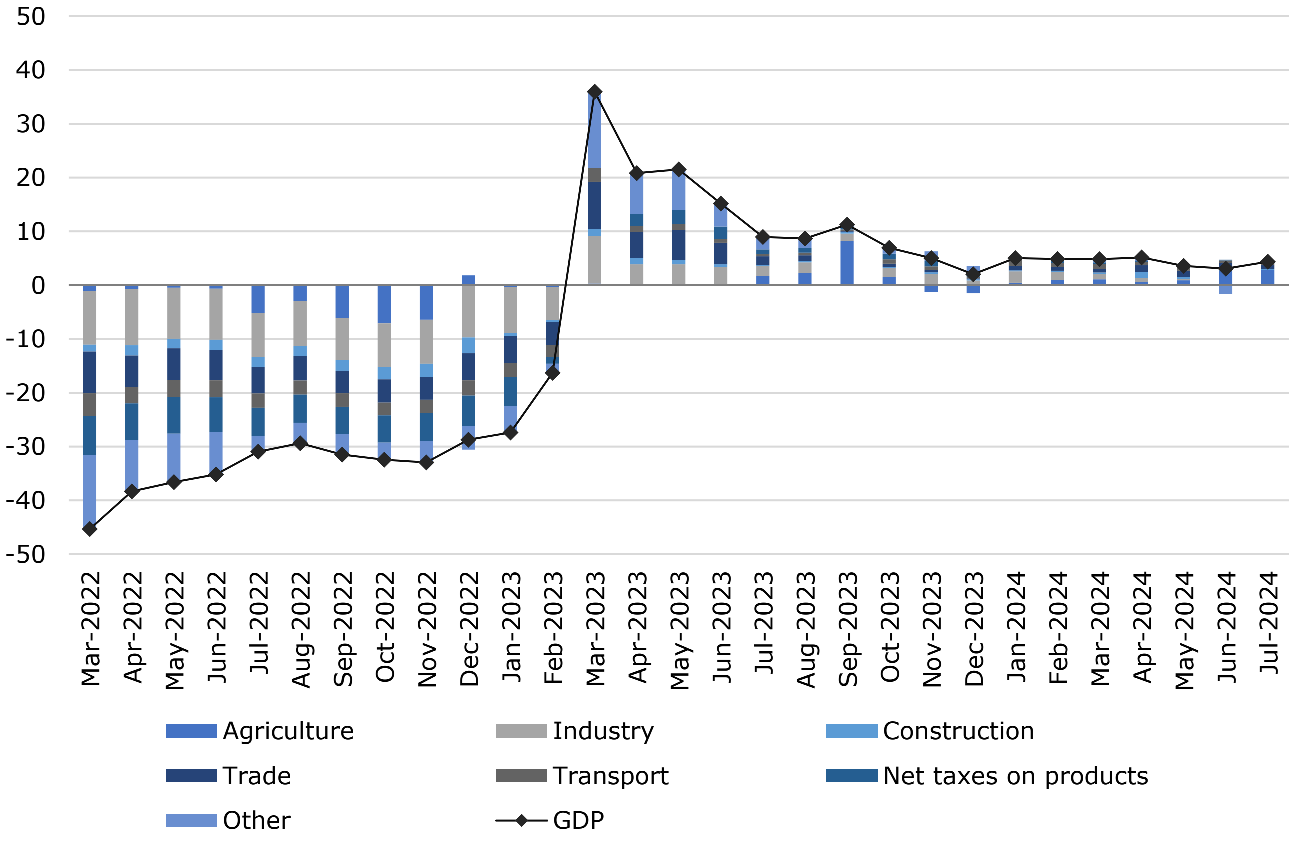
Thus, according to the data of the Ministry of Agriculture, the volume of the grain harvest was one and a half times higher than last year, primarily due to the rapid harvesting of wheat. Overall, real gross value added (GVA) in agriculture is estimated to have increased by 27% yoy in July. At the same time, the total grain harvest is likely to be smaller this year due to lower yields.

In livestock, the growth rate of real GVA was estimated to be close to zero, as a slight decrease in the number of cattle and milk yield was offset by a moderate increase in poultry and pig breeding.

According to the Ukrstat, in the first quarter of 2024 retail trade turnover of enterprises increased by about 20% yoy, which is higher than we estimated earlier. Therefore, we rebalanced the growth rate by sector in the first quarter and revised upwards our estimates for trade growth in the second quarter. According to our estimates, real GVA in trade increased by almost 7% yoy in July, as higher retail trade figures are somewhat offset by a slow recovery in wholesale trade.

Real GVA in the energy sector (primarily, electricity production and distribution) is estimated to have decreased by almost 9% yoy due to the destruction of thermal power plants and power grids as well as scheduled repairs of blocks at nuclear power plants. Scheduled power outages increased in July due to heat and increased demand during the month. In general, in July, the biggest impediment to business activity was problems with access to electricity, as evidenced by a business survey conducted by the IER. Big business continued to overcome the problems with the access to electricity by buying imported electricity. Nevertheless, according to our estimates, real GVA in the manufacturing slowed down to 3.4% yoy, while the growth of metallurgy slowed down in July. Also, GVA in the extractive industry grew by less than 1%.

Figure 1: Contributions to real GDP, n.p.



Source: Ukrstat, IER estimates

In July, the growth of Ukrzaliznytsia's freight transportation slowed down slightly. At the same time, the Ukrainian Sea Corridor continued to play an important role in the export of iron ore and metallurgy. The growth rate in road transport slowed down slightly. Overall, according to our estimates, the real GVA in transport increased by more than 8% yoy.

Energy: The situation with electricity has improved

Electricity. The shortage of electricity depends on the weather and on the pace of equipment repair at nuclear power plants. In late July and early August, power outages were canceled due to the finished repairs of two units of nuclear power plants and a drop in temperature, and so far there were no power outages except for a few hours on August 8. However, Energoatom plans to repair two more power units this year.

According to the government's decision, power outage schedules will not apply to consumers who cover at least 80% of their electricity usage by own production. Earlier, a similar decision was made regarding imports. In this way, the state stimulates the energy autonomy of business. There are already such cases – in mid-July, two Kyiv shopping malls, Gulliver and Respublika, began generating electricity.

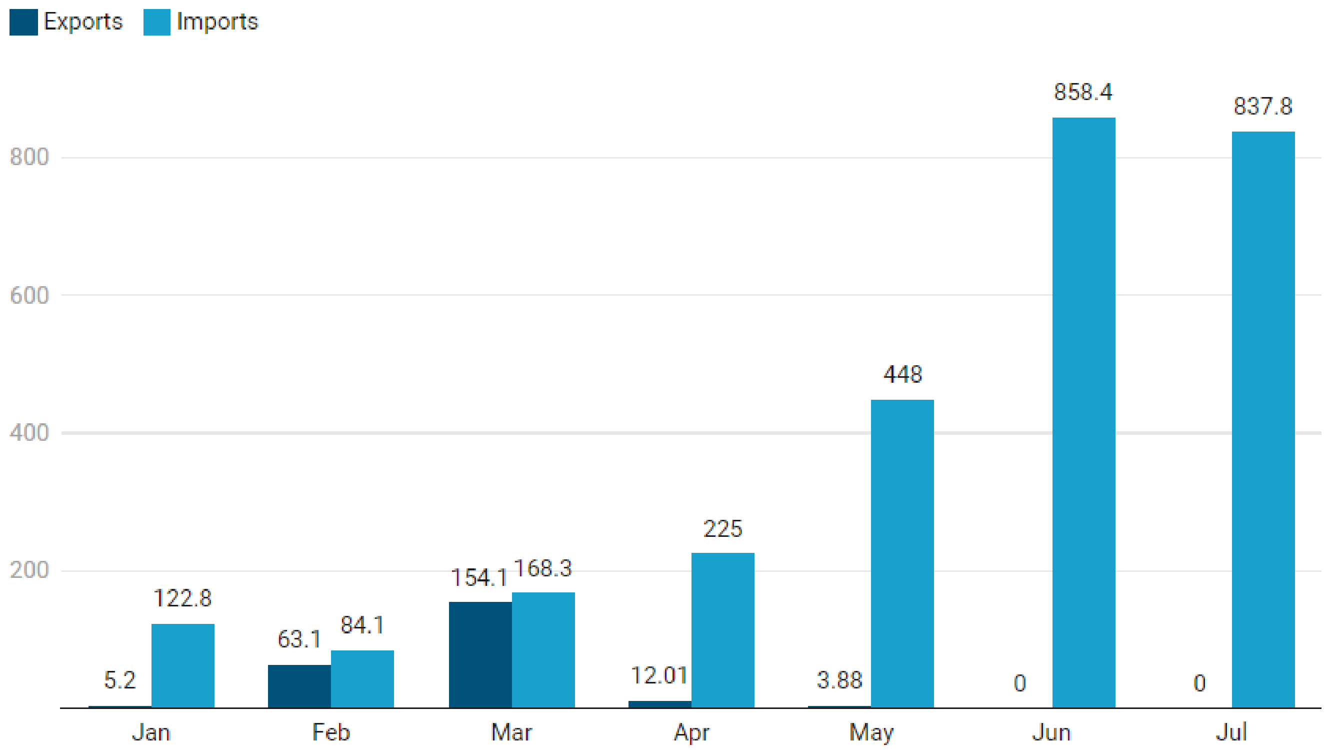
According to ExPro Consulting estimates, electricity production in the first half of 2024 decreased by 1.1% yoy to 52 m MWh. Electricity production at thermal power plants and hydroelectric power plants decreased the most, which is a consequence of Russia's strikes on energy infrastructure in March 2024. Electricity consumption for this period increased by 3% yoy to 54 m MWh.

In July, Ukraine reduced electricity imports by 2% mom to 838 thousand MWh, there were no electricity exports. The largest share in electricity imports belongs to Hungary – 45%, second is Poland (19%), third – Romania (18%), the rest – Slovakia and Moldova.

Ukrenergo announced the first long-term auctions for the purchase of ancillary services for balancing the power system – on August 15 and 22 to encourage investment in new capacities. Contracts with the winners of the auctions, guaranteeing the flow of funds after the construction of balancing facilities, will be concluded for five years with a delay in the provision of services up to one year. In total, Ukrenergo expects 1099 MW of additional capacity.

Energoatom plans to finish 2024 with a profit. The company expects an improvement in financial results after the government raised electricity tariffs for the population by 64% in June. The company ended the first quarter of 2024 with a loss of UAH 5.5 bn.

Figure 2: Electricity exports and imports in 2024, thousand MWh



Source: DixiGroup

Gas. For seven months of 2024, Naftogaz Group enterprises produced 8.6 bn m^3 (bcm) of gas, an increase of 7% yoy. According to ExPro Consulting, in the first half of 2024, natural gas consumption decreased by 1.1% yoy to 11.5 bcm. The largest share is consumed by the population - 35%. Gross production during this period amounted to 9.4 bcm.

Transport: due to the stable operation of the Ukrainian Sea Corridor, cargo turnover in the Danube ports is falling

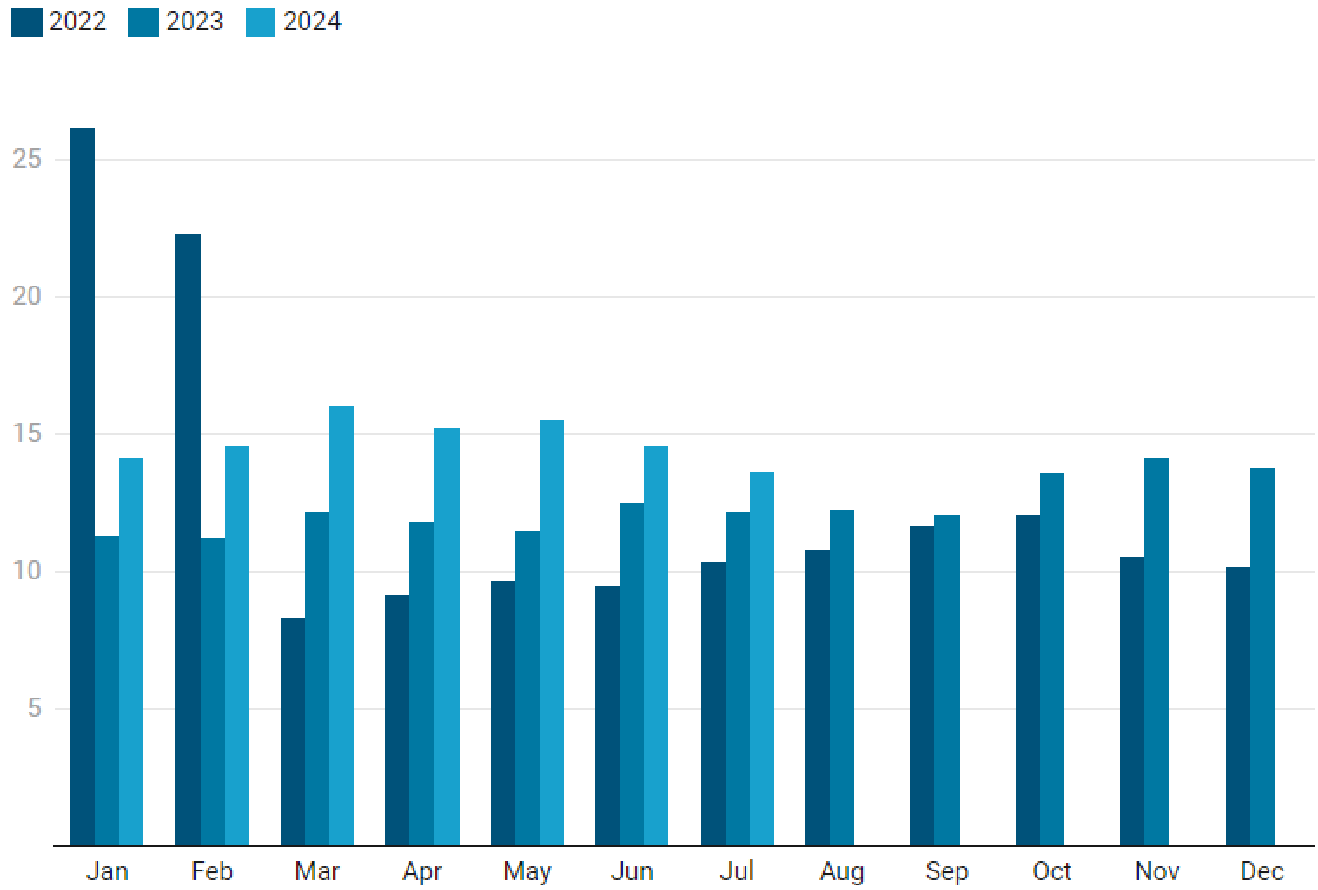
Maritime transport. During the 11 months of operation of the Ukrainian Sea Corridor (since August 2023), 60 m tons of cargo were transported, of which 40.6 m tons were grain.

The Ukrainian Danube Shipping Company (UDP) reported that it was forced to take anti-crisis measures to preserve the export direction due to the reorientation of agricultural cargo to the ports of Odesa. The UDP is forced to cut costs: stop some investment projects, reduce staff. It also plans to write off and sell for scrap metal ships that have been in lay-up for years. In July, 276 employees were laid off in the UDP.

Rail transport. Ukrzaliznytsia (UZ) transported 13.6 m tons of cargo in July, which is 7% less than in June and 12% more than in July 2023. The volume of cargo transportation by rail is decreasing for the second month in a row. UZ transported mostly ore (3.6 m tons), construction materials (2.7 m tons) and grain cargo (2.5 m tons).

In the first half of 2024, UZ made a profit of UAH 3.1 bn. Total freight revenues increased by UAH 6.5 bn yoy to UAH 43 bn. At the same time, profit fell by UAH 1.7 bn to UAH 3.1 bn due to higher operating expenses.

Figure 3: Railway fright transportation, m tons



Source: Ukrzaliznytsia

Road transport. The government allowed foreign companies to obtain permits for construction activities during martial law. The adoption of this decision will allow representative offices of Polish companies in Ukraine to set up checkpoints on the Ukrainian-Polish border, among other things.

On August 5, Poland began repairing the road at the border crossing in Dorohusk (Yahodyn checkpoint on the Ukrainian side). Thus, significant traffic difficulties and longer waiting times to enter Poland are expected. The expected date of completion of the reconstruction is November 14 this year.

Ukraine and the Czech Republic have simplified the opening of international bus routes between the countries. The requirement for a parity partner from a neighboring country was abolished, and the period for approving routes was reduced to four months. This will improve transport accessibility and increase passenger traffic. In addition, Ukraine and the Czech Republic have verified the network of bus routes between the countries. The Czech Republic is the first country with which Ukraine ensured full compliance of regular bus routes.

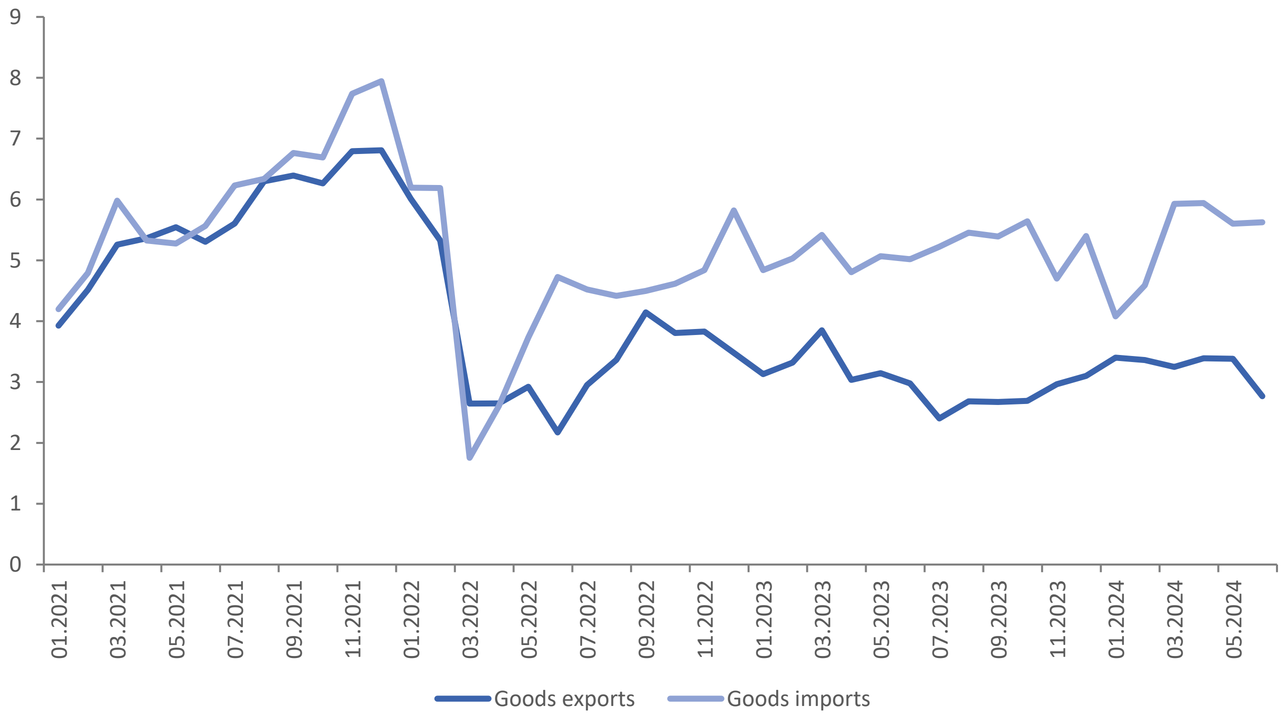
Foreign trade: Exports and imports increased in July

Exports in July, according to customs, partially recovered after a decline in June. This was facilitated by the relatively fast harvesting of early grain crops. The growth in wheat exports and the return to exports of barley and rapeseed, probably from this year's crop, more than offset drop in corn exports due to low stocks. In total, exports of agricultural products increased to USD 1.76 bn from USD 1.60 bn in June but were still significantly lower than USD 2.16 bn on average in January-May. The recovery of exports in dollar terms was also facilitated by a gradual increase in the declared export prices for wheat, sunflower oil, barley and rapeseed.

Exports of steel products reached USD 397 m in July, the highest level since the beginning of the year, compared to USD 355 m in June. This included significant jump in exports of semi-finished steel products increased. The physical volume of iron ore exports continued to fall, but the declared price increased. This may reflect exports with a lower volume of transactions, but at prices closer to world prices. Exports of other products increased slightly, although the electricity deficit was greater in July.

Imports in July increased to USD 5.93 bn, according to customs, from USD 5.63 bn. in June. Against the backdrop of rising demand for electricity due to high temperatures and the widening ment gas and equip related to ensuring uninterrupted access to electricity (batteries, generators, solar panels, transformers). The total volume of imports for these items in July reached USD 400 m including USD 217 m. in the equipment. In June this figure was USD 273 m, and the average for the first quarter was USD 162 m. Imports of medicines and fertilizers also increased, while imports for defense purchases remained high at $638 m, albeit lower than in June

Figure 4: Trade in goods of Ukraine, 2021-2024, USD bn



Source: State Customs Service of Ukraine

Fiscal Policy: The Need to Increase Defence Spending Leads to Initiatives to Raise Taxes

Changes: At the beginning of the year, military assistance from international partners was significantly lower than expected, which prompted the government to approximate spending on the purchase of military equipment and equipment from the second half of the year to the first months. Besides, the assumptions on which the indicators of the State Budget were based, as well as the IMF program, on the reduction of the intensity of hostilities in mid-2024 turned out to be wrong. This is another reason for the need to increase defense spending in the second half in 2024. Thus, for six months of 2024, defense spending amounted to 65% of the annual plan.

That is why the government submitted to the parliament a draft law on amendments to the State Budget for 2024, which provides for an increase in net expenditures by UAH 435 bn, with defense and security spending increasing by UAH 495 bn, while other expenditures will be reduced by UAH 66 bn. The spending cuts apply in particular to lower expenditures on public debt servicing, primarily due to state debt restructuring (see below).

Additional expenditures are planned to be financed by increasing planned revenues by UAH 215 bn and larger domestic borrowings by UAH 220 bn. At the same time, higher revenues are the result of taking into account the already existing overperformance of certain sources of income: this is primarily UAH 40 bn of higher revenues from CIT due to payment of increased tax rate for banks (50% of profits in 2023 and 25% of profits in 2024) and UAH 21 bn from a larger transfer of profits by the NBU. UAH 140 bn of additional revenues should be provided by amendments to the Tax Code, which will still need to be adopted by the parliament (see below). At the same time, additional revenues from the placement of domestic government bonds in the amount of UAH 220 bn mean that the Ministry of Finance will need to significantly increase borrowing, which is difficult to do without raising the yields on domestic government bonds or changes in the NBU's policy.

Tax changes. To finance additional expenditures on defense and security (international financial assistance cannot be spent on these expenditures), the government submitted to the parliament a draft law on amendments to the Tax Code. These changes, according to the government, will be able to provide additional revenues to the state budget in the amount of UAH 140 bn in the last four months of 2024 and UAH 340 bn in 2025. As a reminder, in the adopted Budget Declaration for 2025-2027, an "additional package of measures" was spelled out in the revenue indicators, which should provide UAH 340 bn annually.

Among the main changes in tax rates is an increase in the rate of military fee on employees from 1.5% to 5%, which has caused criticism from business and a number of experts due to the possible further shadowing of wages. It is also planned to introduce a military fee for entrepreneurs operating under the simplified taxation system: 1.5% for the third group and 5% of the minimum wage for other groups – which looks like a reasonable step. Finally, it was proposed to introduce a military fee for legal entities at the level of 1% of gross income. This would de facto become a turnover tax, which is harmful to the economy. Therefore, due to widespread criticism, the government and the parliament are considering replacing this tax with an increase in the VAT rate (today the regular VAT rate is 20%, while in Poland it is 23%, and in some other EU countries it is 25%). The military tax is also planned to be introduced from the first registration of cars, the sale of real estate, the sale of jewelry by legal entities, which is an expedient step.

The government of Ukraine initiated the introduction of an excise tax on drinks containing sugar taking as an example a number of countries that have already introduced such a tax, such as Poland and France. However, the challenge of rapid implementation of its administration remains in question. Another change that may create problems due to the heavy burden on the customs authorities is the proposed reduction in the customs value of goods that are sent in parcels from abroad and are not subject to VAT and customs duties from EUR 150 to EUR 45.

Debt restructuring: After lengthy negotiations with creditors, Ukraine announced an exchange offer and consent solicitation for its existing Sovereign Eurobonds (USD 19 bn) and Ukravtodor Guaranteed Eurobonds (USD 0.7 bn). The principal parameters of such an exchange were determined on July 22 within the agreement-in-principle reached with the bondholders' Ad Hoc Committee. Bondholders have time until August 28, 2024, to submit exchange applications.

According to the agreement, the existing Eurobonds will be replaced by new securities with a 37% haircut, with the possibility of recover 12% of the value in 2028 if GDP is higher than the current IMF forecast.

Instead of the existing securities, new Eurobonds will be issued: four series of Bonds A maturing in 2029, 2034, 2035 and 2036 and four series of Bonds B maturing in 2030, 2034, 2035 and 2036. Coupon payments of the A Bonds will increase gradually: 1.75% in 2024-2025, 4.5% in 2026 and the first half of 2027, 6% in the second half of 2027 and 2028-2033, and 7.75% from 2034 onwards. Coupon payments of B bonds will be set as follows: absent until the second half of 2027, then 3% from the second half of 2027 to 2033, and increase to 7.75% from 2034 onwards.

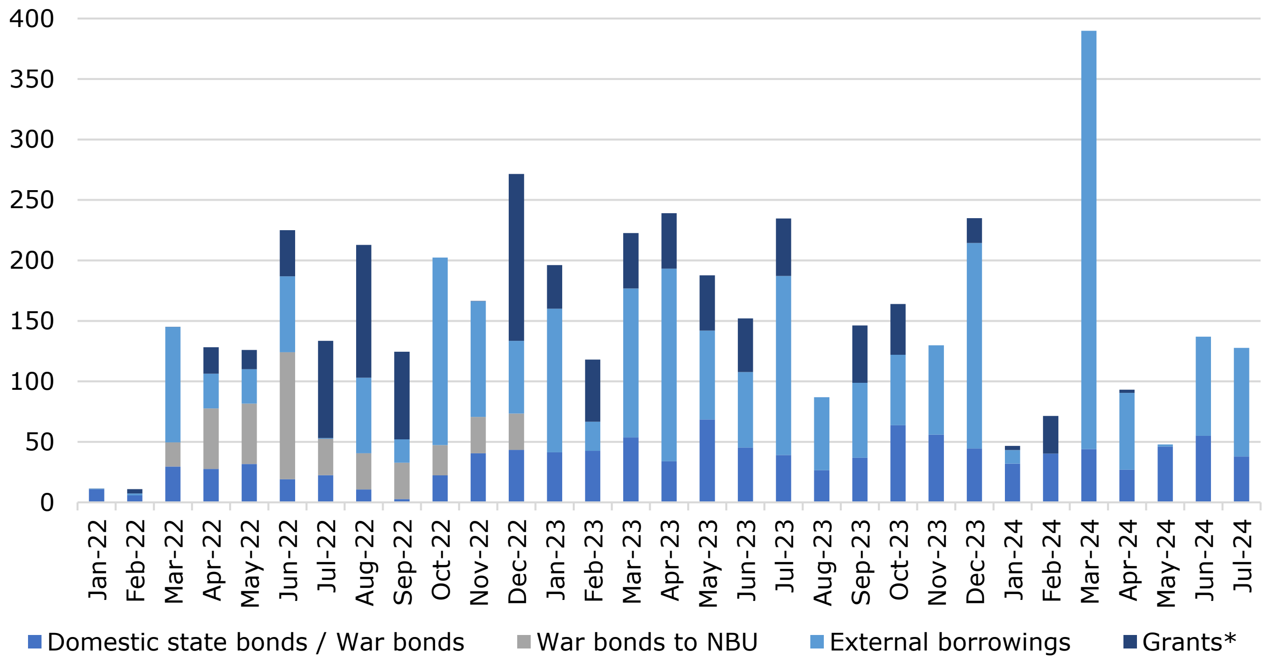
Overall, a successful debt restructuring will allow Ukraine to reduce its state debt by USD 8.67 bn. and save USD 22.75 bn on debt payments by 2033. To complete the state debt restructuring, the consent of 2/3 of the securities holders is required.

Budget execution: According to preliminary data from the Ministry of Finance, state budget revenues in 2024 amounted to UAH 169 bn in July compared to UAH 242 bn in June. At the same time, the revenues of the general fund of the state budget amounted to UAH 118 bn in July and UAH 139 bn in June, as the budget received UAH 29 bn in dividends in June. Meanwhile, the revenues of the special fund of the state budget were also lower (a large share of special fund ervenues since September 2022 has been military aid, which is put on the balance sheets of military units and other defense institutions).

Revenues were also lower than in July 2023, when the budget received UAH 48 bn (in equivalent) in the form of the US grants. At the same time, gross revenues from domestic and import VAT increased by over 20% yoy. However, VAT refunds were also higher (by 35% yoy), which is deducted from the amount of gross VAT revenues

In general, revenues administered by the State Tax Service (STS) exceeded by 6.7% of the plan in July. At the same time, the State Customs Service (SCS) reports that taxable imports have decreased, and therefore the actual revenues administered by the SCU were 5.7% lower than planned. This likely reflected a larger share of preferential imports, including energy equipment.

Figure 5: 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 "Official transfers from the EU, foreign governments, international organizations, donor institutions".
Source: Ministry of Finance, openbudget.gov.ua

In July, a tranche of USD 2.2 bn was received from the IMF. This, together with EUR 1.9 bn of transition financing from the EU under the Ukraine Facility, received at the end of June, allowed the government to finance record expenditures: UAH 312 bn, which was close to the July plan. In particular, the government was able to catch up with expenditures that were delayed in June, when actual expenditures were almost 13% lower than planned due to a delay in external financing, which was expected earlier.

In August, the government's liquidity improved due to the receipt of budget support from the United States in the amount of USD 3.9 bn (out of the total approved aid in the amount of USD 7.8 bn). The government hoped to receive these funds earlier this year. Also, Ukraine has already received EUR 4.2 bn in budget support from the EU under the Ukraine Facility due to the successful implementation of all indicators of the Ukraine Plan in the second quarter of 2024. At the same time, the time of receipt of the next tranche from the United States is not yet known, while funds from the EU are expected to arrive no earlier than November.

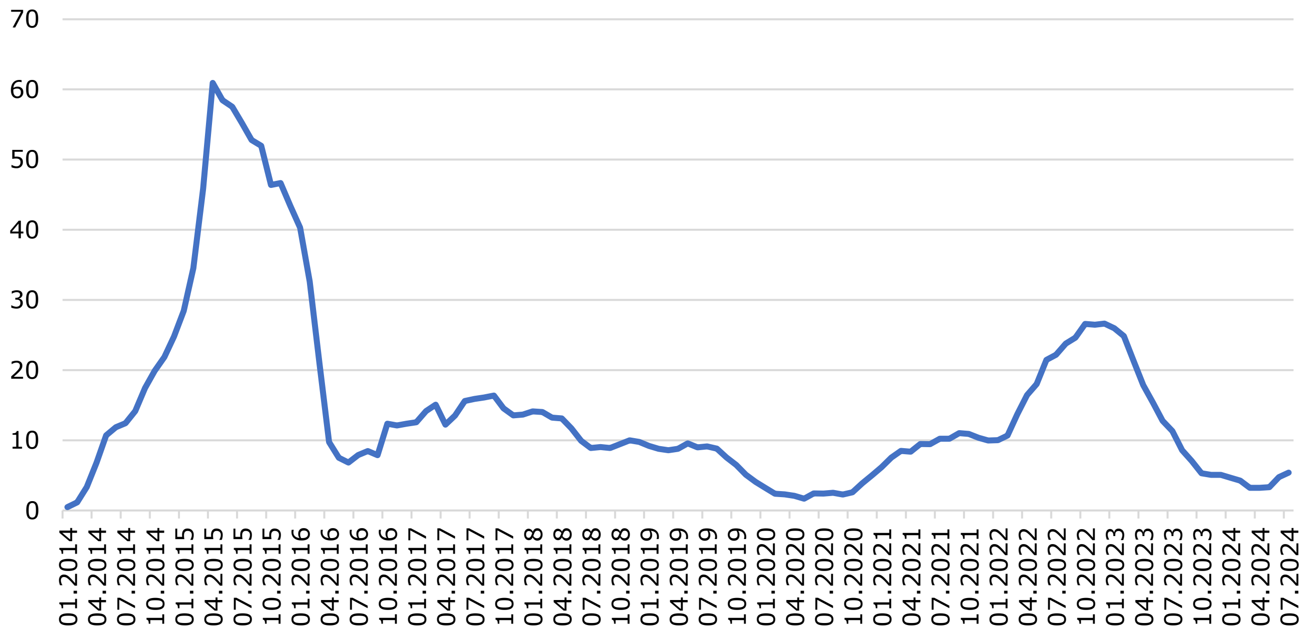
Also in September, Ukraine expects the fifth revision of the IMF Program, which will be difficult, although Ukraine has already fulfilled the only structural benchmark for this revision: the law on rebooting the Bureau of Economic Security. At the same time, the IMF will change its macroeconomic forecast, as the main assumption of a lower intensity of hostilities has not been realized in mid-2024. This will lead to the need to provide for higher amounts of need for additional external financing to IMF funds, while so far there is a lack of corresponding amounts for 2025: out of a need of more than USD 32 bn of funding only EUR 12.5 bn from the EU and USD 1.8 bn from the IMF are confirmed, but subject to the timely fulfillment of commitments by Ukraine.

Inflation: Consumer inflation accelerated to 5.4% yoy in July

In July, according to the State Statistics Service, inflation reached 5.4% yoy (y-o-y). This reflected accelerating price growth for some goods, such as bread, groceries, sugar, and mobile communications. Here, the increase in the costs of producers and trade enterprises probably played a significant role. Import costs increased due to the weakening of the hryvnia. As a result of the shortage of workers in several occupations, wages increased (average wages increased by 22.5% yoy in the first quarter, in particular in trade by 28% yoy). Costs for alternative sources of electricity, which are much more expensive than grid electricity, have also increased.

In monthly terms, prices remained unchanged on average in July despite the seasonal decline in prices for vegetables (by almost 20% mom) and clothing (3.7% mom), which often allows to record price declines in July and August. As we mentioned above, producers' costs have increased in recent months. However, the impact on consumer prices is still quite moderate.

Figure 6: Consumer price inflation, % yoy



Source: State Statistics Service of Ukraine

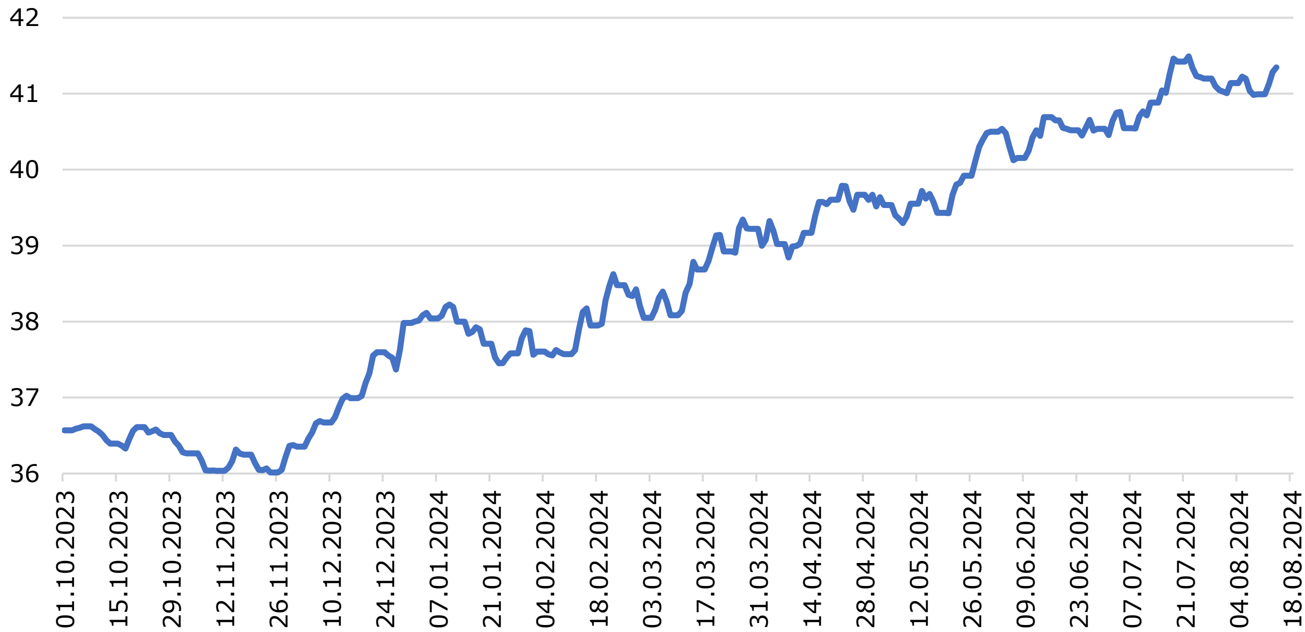
Exchange rate and monetary policy: Hryvnia is still stable

Exchange rate. In recent weeks, the hryvnia has suspended its gradual but steady decline against the US dollar and fluctuated in the range of 41.0-41.5 UAH per dollar. However, to keep the hryvnia at this level, the NBU's expenses to support the exchange rate remain significant. During the four working weeks ending August 9, the NBU's interventions amounted to more than USD 3 bn. This happened against the backdrop of high net demand for cash foreign currency, which again exceeded USD 1 bn. in July. The international trade deficit remained consistently high.

The NBU's international reserves fell again in July to USD 37.2 bn from USD 37.9 bn at the end of June and USD 43.8 bn in March. The government's borrowings (in July primarily from the IMF and foreign currency domestic government debt securities) were lower than the cost of debt service (to official creditors and government bonds) and the cost of NBU interventions. According to the NBU, reserves now cover 4.8 months of imports against 5.8 months in March.

Monetary policy. In July, the NBU unanimously left the key policy rate at 13% per annum and indicated a low probability of further rate cuts this year. This decision was expected against the backdrop of rising inflationary pressures. In the updated macroeconomic forecast, the NBU still expects inflation above 8% yoy in December. The NBU maintained its estimate of GDP growth in the second half of the year, but downgraded its growth forecast for 2025 to 4.1% from 5.3% in April as it now assumes longer active hostilities.

Figure 7: Official exchange rate of the hryvnia to the US dollar (UAH per USD)



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

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