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Executive summary

- According to the IER estimates, in June GDP growth continued to decelerate: from 3.2% yoy in May to 2.7% yoy in June - due to problems with access to electricity, which are the result of damage to electricity generation by russian drones and missiles.
- The shortage of electricity remains very acute. Due to the uneven consumption during the day peak hours, the deficit can reach 25-30%. Electricity imports have reached their maximum capacity.
- Ukraine and the EU have extended the "transport visa-free regime" until 2025. In June, cargo handling by seaports increased by 30% yoy to 6.7 m tons.
- Exports in June, according to customs, decreased significantly compared to previous months, while imports remained almost unchanged compared to May.
- Expenditure performance deteriorated in June, most likely due to minimal external borrowing in May and lower than expected external borrowing in June.
- In May, the Government received EUR 1.9 bn from the EU under the Ukraine Facility, but the money from the IMF did not arrive until July.
- Ukraine fulfilled timely all the indicators of the Ukraine Plan, which were to be implemented by the end of the 2nd quarter of 2024. Accordingly, the next tranche of the loan from the EU should arrive in August.
- In June, inflation accelerated to 4.8% yoy due to higher electricity tariffs.
- The NBU is considering further key policy rate cuts in the second half of 2024.
- The hryvnia exchange rate exceeded UAH 41 per USD on the back of a high trade deficit and high demand for cash currency.

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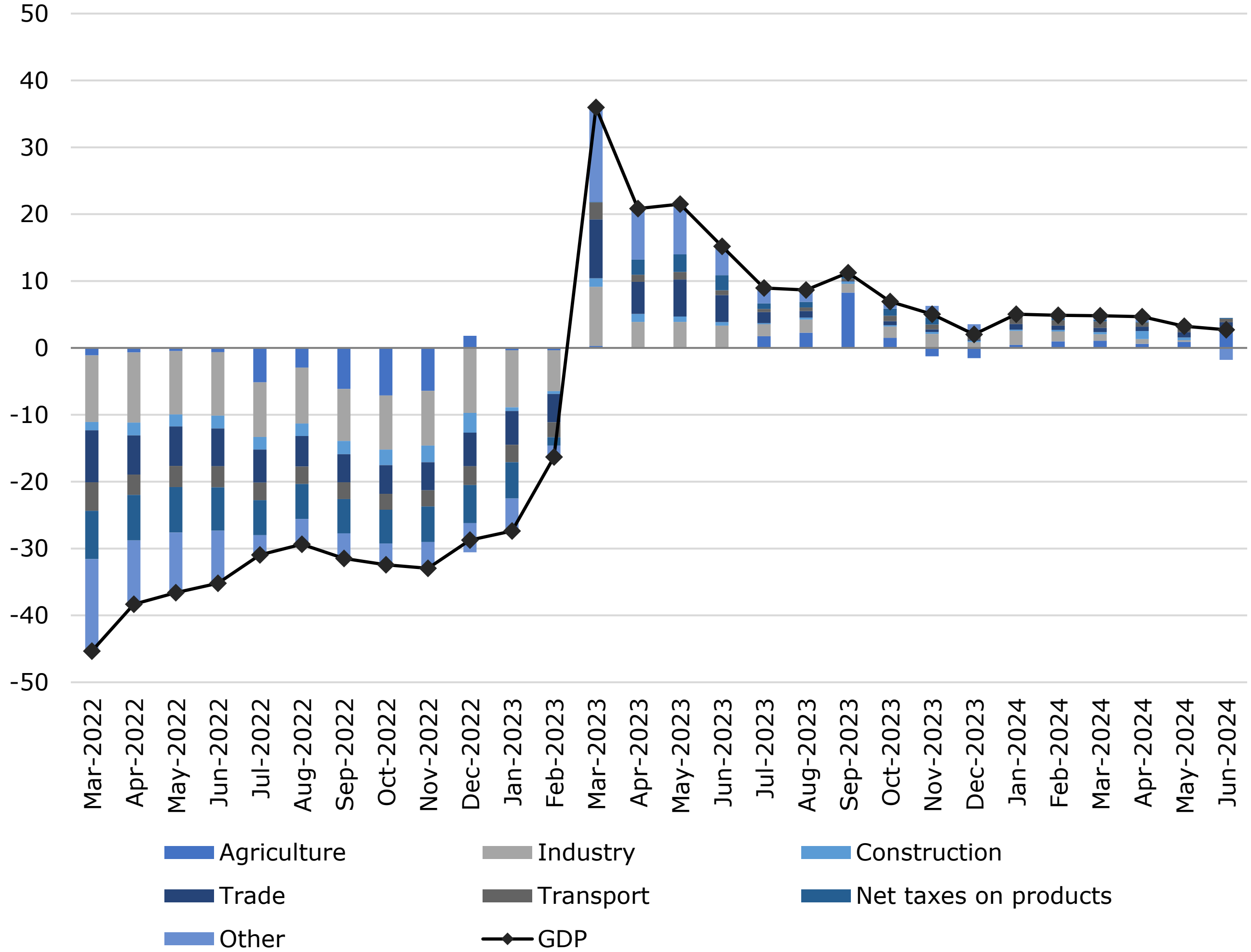
GDP and Real Sector: Problems with Access to Electricity Threaten Growth

According to the IER estimates, in June GDP growth continued to decelerate in June: from 3.2% yoy in May to 2.7% yoy in June. As before, the main reason for the economic slowdown was problems with access to electricity. This was due to the destruction and damage to electricity generation as a result of russian shelling and the planned shutdown of units at nuclear power plants for repair. Thus, according to our estimates, real GDP growth was 3.5% yoy in the second quarter, while according to the State Statistics Service's preliminary data it grew by 6.5% yoy in the first quarter.

Real gross value added (GVA) in manufacturing is estimated to have increased by 4.1% yoy in June compared to 5% yoy in May, primarily due to problems with access to electricity and a higher statistical base. According to the IER survey in June, it was the lack of electricity that businesses most often mentioned as an obstacle to work, while the second was the danger of working. Overall, production and sales indices deteriorated, but remained positive, as did businesses' expectations for future production. At the same time, for the second month in a row, metallurgy companies report high growth rates, which may be due to the possibility of direct contracts for electricity imports. At the same time, from June 1, they must import 80% of their consumption for this purpose, and metallurgy enterprises appealed to the Government to reduce this limit to 50%, justifying this by the unprofitability of production under the current norm.

Overall, according to the IER, the real GVA in the energy sector decreased by 9.9% yoy. In June, there were schedules of planned power outages as russian missiles and drones destroyed more than half of the generation. Nuclear power plant units were also taken out for repair as planned. The situation was partly helped by the generation of electricity by solar and wind power plants. An important task now is the development of decentralized electricity generation.

Figure 1: Contributions to real GDP, pp



Source: IER assessment

Ukrzaliznytsia reported a slowdown in the growth rate of freight traffic in June. Also, slightly smaller volumes of cargo were transported by sea. According to the IER estimates, real GVA in transport increased by 9% yoy in June compared to 15% yoy in May.

Trade was estimated to decelerate growth to 4% yoy, although it was further supported by purchases of devices and appliances that can ensure household resilience during power outages.

In June, agricultural indicators finally reflect not only livestock, but also crop production. This month, earlier than last year, the grain harvest began. Also, according to flash data, the situation in the cultivation of vegetables, fruits and berries developed positively. Part of the livestock sectors also grew. According to the IER estimate, the real GVA in the agriculture increased by 5.6% yoy.

Energy: Ukraine is critically short of electricity

Electricity. The shortage of electricity remains very acute. Due to the uneven daily consumption, 67% of non-critical consumption is turned off during peak hours. Stabilization shutdowns of industry and the population occur daily in all regions of Ukraine. This situation is caused by damage and destruction of power plants, Russian shelling, increased consumption in Ukraine and Europe due to high air temperatures, and repairs of power units at nuclear power plants.

In particular, DTEK reported that the enemy has carried out seven massive attacks on the company's thermal power plants over the past three months. As a result of the shelling, about 90% of thermal generation capacities were destroyed or damaged. Thus, the Burshtyn TPP in the Ivano-Frankivsk region was attacked more than 12 times and cannot be restored. This year, the company plans to invest about UAH 3.9 bn of its own funds in repairing and restoring DTEK's thermal power plants.

A Rakuten Viber survey showed that 85% of Ukrainians have reduced their energy consumption to support the energy system. They try to use less air conditioning, lighting, and kitchen appliances and unplug unused devices.

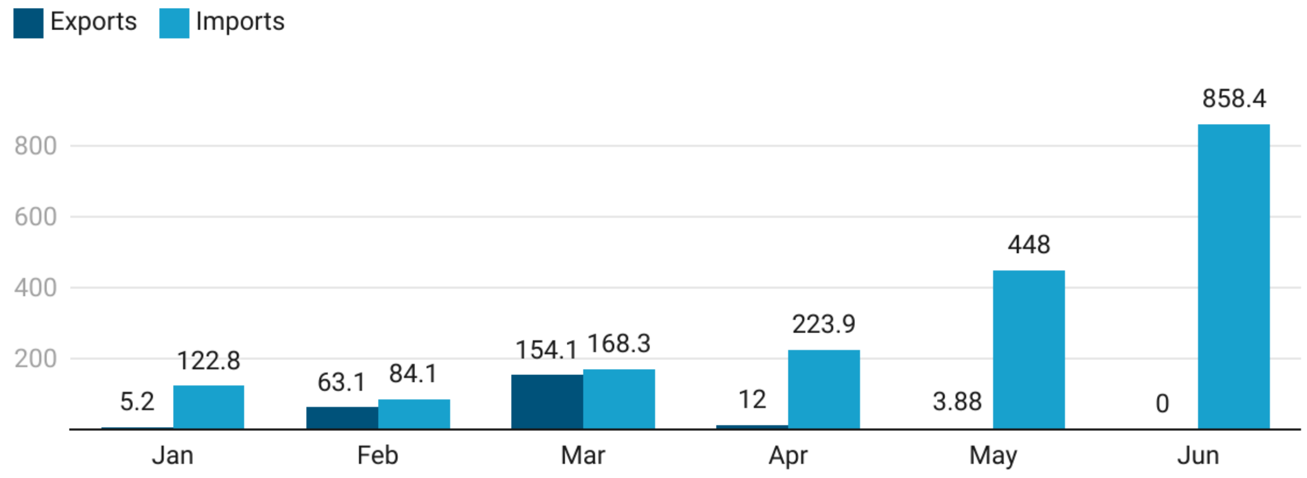
Electricity imports continue to grow – in June, Ukraine imported 859 m kWh, 91% more than in May. The largest share of imports comes from Hungary (42%). At the beginning of June, the Velke-Kapušany-Mukachevo line, which connects Ukraine and Slovakia, was being repaired, so supplies in this direction were limited for some time. There were no electricity exports in June.

Cities and businesses are adapting to power outages. Here are some examples. In Lutsk, the city authority began to install solar panels at traffic lights for their autonomous operation during the day. Also, 33 traffic lights in Khmelnytskyi have backup power, and their number is constantly increasing. A similar practice is used in other cities. In Konotop, from June 26, the movement of electric transport was stopped indefinitely. Ukrzaliznytsia plans to build gas power plants with a total capacity of up to 250 MW in different regions of Ukraine, for which it created the UZ Energo company. Kryvyi Rih Cement, one of the largest cement producers in Ukraine, has also unveiled plans to build its power plant. Several dozen gas piston stations are also being installed.

The Government has expanded the 5-7-9 program to distributed generation projects: loans can now be obtained for constructing gas turbines, gas reciprocating and biogas plants. The maximum amount of a concessional loan for the relevant purposes is up to UAH 150 m, and the loan term is up to 10 years.

On June 25, Ukraine approved the National Energy and Climate Plan (NPEC), which provides for a 65% reduction in greenhouse gas emissions compared to 1990 levels, achieving a 27% share of renewable energy sources in total final energy consumption, deepening the diversification of energy sources and supply routes and other goals. The creation of the NPEC is an important part of Ukraine's European integration process and was one of the indicators in Ukraine's Plan. In the future, the Green Transition Office, an independent advisory body under the Ministry of Economy of Ukraine, which plans to develop and present an approach to the implementation of the NPEC and monitor the implementation of the document's objectives, will help coordinate the implementation of the NPEC.

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



Source: DixiGroup

Gas. As of July 1, natural gas reserves in Ukrainian underground gas storage facilities exceeded 9.5 bn cubic meters (bcm). At the beginning of the heating season 2024-2025, it is planned to accumulate at least 13 bcm of natural gas in storage facilities. According to Oleksii Chernyshov, Chairman of the Board of Naftogaz Group, this gas should be enough for the heating season.

According to ExPro estimates, more than 0.71 bcm of natural gas was pumped into Ukrainian UGS facilities in June, 17% less than in June last year.

For six months of 2024, Ukrgasvydobuvannya and Ukrnafta produced 7.3 bcm of commercial gas, which is 8% more than in the same period last year. This result was achieved thanks to the launch of 41 wells, of which 14 are high-rate and give more than 100 thousand cubic meters of gas daily.

Transport: Ukraine and the EU have extended the "transport visa-free regime" until 2025

Maritime transport. On July 4, Russia struck the port of Chornomorsk: there were human losses, and port facilities were damaged. At the same time, the port continues to operate.

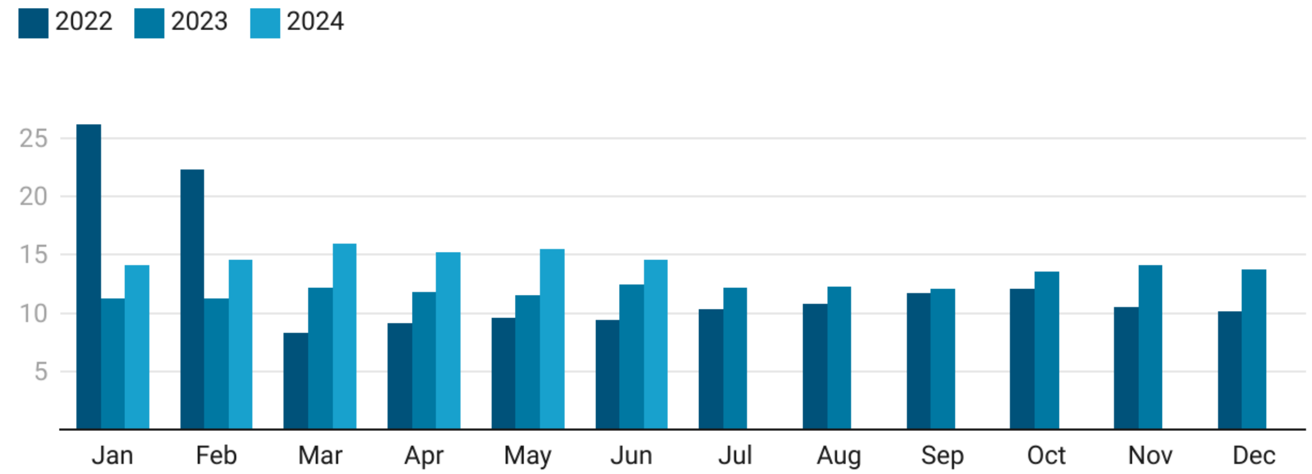
In the first half of 2024, six Ukrainian ports handled a total of 52.7 m tons of cargo, 68% more than in the same period in 2023. The vast majority of these cargoes (64%) are agricultural products. In June 2024, cargo handling by seaports increased by 30% yoy to 6.7 m tons, of which 4.1 m tons were agricultural products. Other commodities are mainly iron ore and metals. At the same time, imports have already begun to be transported through the sea corridor.

Since the beginning of 2024, Ukraine has expanded the capacity of the Ukrainian Sea Corridor and eliminated the possibility of remote mining of the sea from aircraft. These measures made it possible to increase the stability of the corridor's operation. However, the danger of using missile weapons and kamikaze drones remains. At the beginning of July, Türkiye, Romania, and Bulgaria began demining in the Black Sea to help exports from Ukraine and ensure the overall safety of maritime transport in the Black Sea. The Türkiye-led initiative is the first major joint operation by Black Sea countries since Russia's invasion and aims to clear mines drifting in some regions of the sea as a result of the war.

Rail transport. Ukrzaliznytsia transported 14.6 m tons of cargo in June, 6% less than in May and 17% more than in June 2023. More than 90 m tons of freight were transported in the first half of 2024, an increase of 28% yoy. Of these, 40 m tons were transported domestically, 45 m tons in the direction of the western border and ports, and 5 m tons for import. Mostly, it was ore (22.9 m tons), grain (22.5 m tons), coal (12.5 m tons) and construction materials (13.7 m tons).

Passenger traffic in June increased by 18% yoy to 2.5 m passengers. For rail passenger traffic, summer is the peak season. Accordingly, Ukrzaliznytsia launched new routes, redistributed rolling stock, and organized transfer routes to strengthen international connections (such as Lviv – Rava-Ruska – Warsaw and the development of Chop station as a hub for travel from Ukraine to Budapest and Vienna).

Figure 3: Transportation of goods by rail, million tons



Source: Ukrzaliznytsia

Road transport. Ukraine and the EU have updated the Agreement on the Liberalization of Road Transport text and extended it until June 2025 with the possibility of automatic extension until the end of 2025. Ukrainian trucks must have the appropriate sticker, a license copy in English, and cargo documents for empty trucks. Although, according to the Agreement, the amendments shall apply from the date of signing on June 20, they were officially made public only on July 2. Because of this, on July 1, the Polish customs service did not allow Ukrainian trucks to cross the border without bilateral international permits or permits for transportation under the ECMT Agreement. The situation was resolved only on the evening of July 1.

The Government has allocated over UAH 2.38 bn from the reserve fund of the state budget for the restoration of roads in eight border and frontline regions (Dnipropetrovsk, Donetsk, Zaporizhzhia, Mykolaiv, Sumy, Kharkiv, Kherson, and Chernihiv regions). The funds can be spent exclusively on restoring destroyed roads used for transporting military and humanitarian goods and as evacuation routes.

The Ministry of Infrastructure abolished the simplified procedure for issuing licenses for transporting passengers and goods, which was in effect during martial law, and introduced mandatory vocational training and obtaining a certificate of professional competence for drivers (these changes will come into force one year after adoption). The need for vocational training is defined by European standards, particularly the relevant EU Directive.

External trade: Exports in June decreased compared to previous months

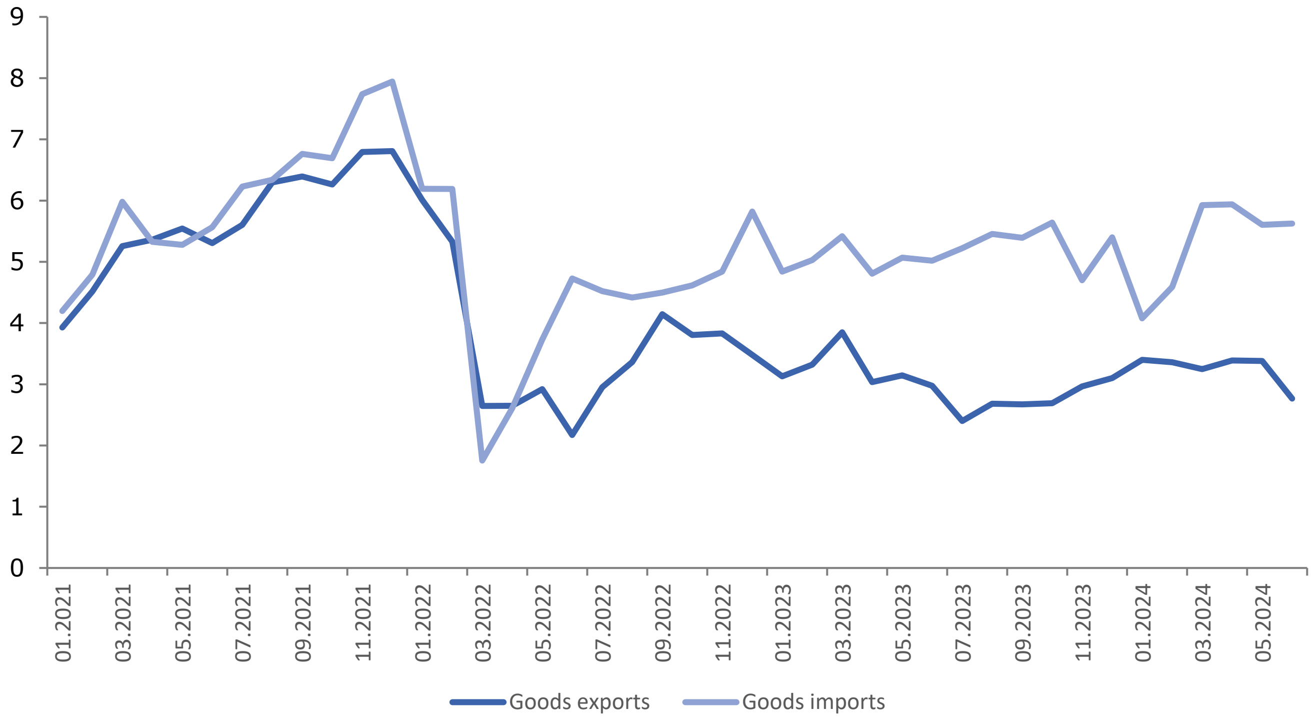
Customs data show that merchandise exports decreased significantly in June as compared to previous months at USD 2.77 bn. United States. This is the lowest figure since the beginning of the year: in January-May, exports ranged from USD 3.25 bn to USD 3.40 bn, according to the customs reports. Exports of agricultural products fell sharply due to the depletion of last year's harvest stocks ($1.60 bn in June compared to $2.11 bn in May). In dollar terms, exports of oil and wheat fell by more than a third compared to May, and corn exports by 17%.

Exports of steel products at USD 355 m decreased slightly compared to May, but remained higher than in January-April. This likely reflected higher electricity import costs following an increase in the share of imported electricity by businesses needed for uninterrupted supply at 80% in June. Exports of mineral products, primarily ore, remained almost unchanged in dollar terms compared to May and amounted to USD 284 million. The increase in the price of iron ore offset the decrease in export volumes to 2.77 million tonnes in June from 3.13 million tonnes in May. The share of electricity costs for producers of iron ore and iron ore concentrate is one of the highest in the industry. However, due to the resumption of exports from Odesa ports, iron ore exports in tons were still 87% higher than in June 2023. Exports of other types of products also decreased slightly. Here, too, the shortage of electricity probably influenced the outcome.

Imports in June were almost unchanged compared to May, but increased by 10% compared to June 2023 and amounted to USD 5.63 bn. In June, imports of machinery and equipment decreased (although imports of generators and batteries increased), as well as imports of chemical and food products decreased seasonally. However, this decrease offset the growth in imports of "other goods" (primarily goods purchased for the needs of the Armed Forces of Ukraine). Imports of "other goods" reached USD 752 m from about USD 400 m in the previous months of the year.

The shortage of electricity led to an increase in imports of electricity (to USD 78 m in June, compared to USD 35 m in May and USD 21 m in April) and batteries (to USD 68 million in June compared to USD 49 million in May and USD 29 million on average in January-March). These two positions, as a result, took the 7th and 8th positions among the groups of goods in terms of dollar import volumes after "other goods", petroleum products, cars, medicines for retail sale, drones and mobile phones. However, battery was still lower than in winter 2023. Petrol imports increased compared to previous months, but it looks like a seasonal phenomenon: imports volume increased by only 2% yoy. This indicates that generators' gasoline needs have so far had a limited impact on the overall demand.

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



Source: State Customs Service of Ukraine

State Budget: Problems with Financing Expenditures Due to Lower International Aid

According to the preliminary information of the Ministry of Finance, the revenues of the State Budget in June amounted to UAH 241 bn, of which the revenues due to general fund were UAH 138 bn, while in May they amounted to UAH 229 bn and UAH 152 bn, respectively. Thus, in June, the revenues of the special budget fund were higher – these are, first of all, the own revenues of budgetary institutions, mainly the registration of military assistance (received from allies) by military units.

Lower general fund revenues were due to the fact that in May there is a quarterly payment of corporate profit tax (CPT): in May, the corresponding revenues amounted to UAH 42.1 bn. In June, such income was only partially offset by dividends in the amount of UAH 29.1 bn.

Gross VAT revenues on goods and services produced in Ukraine also decreased slightly compared to May: by UAH 0.5 bn to UAH 32.4 bn, which may mean lower consumption. According to the State Customs Service, road transportation across the border was lower, which affected imports and, accordingly, VAT revenues from imports decreased by UAH 1.5 bn to UAH 37.1 bn. At the same time, the growth rate remained high compared to the previous year: 16.2% yoy for domestic VAT revenues and 29.3% yoy for import VAT. VAT refunds increased to UAH 12.8 bn. Accordingly, total VAT revenues decreased from UAH 58.8 bn in May to UAH 56.7 bn in June.

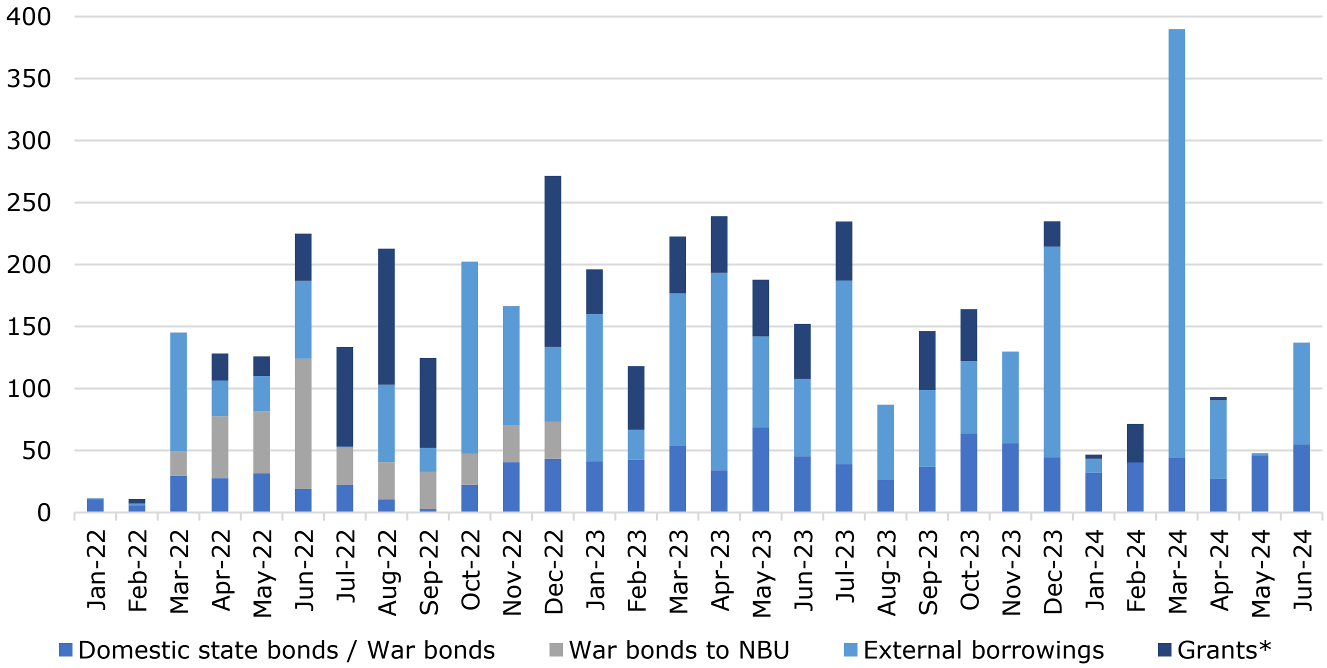
Also in June, income from rent payments was lower than in May. At the same time, the growth of wages contributed to a certain increase in personal income tax revenues paid to the general fund of state budget.

In general, the implementation of the monthly revenue plan, administered by the State Tax Service, amounted to 112.1% (due to dividends and part of the net profit, the payment of which is administered by the State Tax Service), and by the State Customs Service – 99.2%.

Although the revenues were higher than planned, the implementation of the State Budget expenditures deteriorated. In nominal terms, the expenditures of the general fund of the state budget amounted to UAH 287 bn, which is 8% less than in May. There were also signs of delays in certain payments during the month. This is likely due to lower than expected amounts of international aid. The disbursement of loan under the IMF program was made only in the first days of July, although it was originally expected in June. Still, after receiving only USD 20 m in May, the Government received in June almost EUR 1.9 bn from the EU under the Ukraine Facility. This is transitional financing that Ukraine received after the approval of Ukraine plan and the ratification of the Financial Agreement on Budget Support under the Ukraine Facility.

Accordingly, the state budget deficit was less than planned. It was partially financed by domestic borrowing. The placement of domestic government bonds brought UAH 55 bn to the budget, of which USD 407 m (equivalent to UAH 16.6 bn) was received from foreign currency domestic government bonds.

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

IMF: On June 28, the IMF Executive Board approved the fourth review of the Program, as a result of which almost USD 2.2 bn was received from the Fund by Ukraine on July 3. The IMF has not revised the macroeconomic forecast laid down in the program, although its assumptions are already outdated. In particular, it is said that the activity of the war is not decreasing, and therefore Ukraine's financial needs are greater in 2024 and 2025, than provided for in the Program. Most likely, during the fifth review of the IMF Program, the macroeconomic forecast will be revised, which will require an additional round of negotiations with the largest countries on the need to increase support for Ukraine. Perhaps this will contribute to a faster decision on the procedures and amounts for providing an aid package to Ukraine in the amount of USD 50 bn, which should be secured by frozen Russian assets: the initial decision of the G7 countries was made in June.

The implementation of three structural benchmarks has been postponed, while two new benchmarks were added. In general, Ukraine implements the program on time.

EU. Ukraine has fulfilled all the indicators provided for in the Plan of Ukraine for the second quarter of 2024 on time. Now the European Commission and then the EU Council have to assess the implementation of the indicators. A successful assessment will mean that Ukraine will be able to receive EUR 4.2 bn in budget support in August, of which EUR 1.5 bn will come as grants.

Budget declaration. The resumption of medium-term budget planning was among the important issues in the IMF Program: several structural benchmarks are devoted to it. That is why the Government was expected to approve the Budget Declaration for 2025-2027, the submission of which to the parliament is defined as an indicator in the Ukraine Pla for the 2nd quarter.

The indicators of the Budget Declaration are based on the macroeconomic forecast updated by the Ministry of Economy: real GDP in 2025 will grow by 2.7% (for comparison, according to the current IMF forecast, GDP will grow by 5.5% next year). The forecast of state budget revenues envisages revenues from an additional package of measures in the amount of UAH 340 bn. It is likely that there is an increase in taxes behind these figures: in particular, an increase in VAT and military tax rates was discussed. However, so far there is no relevant draft law in the parliament. The already prescribed estimates of tax revenues do not provide for significant changes, except for the planned gradual increase in excise tax rates to the level of EU countries. At the same time, the changes will affect the distribution of taxes: the financing of the State Road Fund will be gradually resumed, to which the excise tax on fuel will be partially directed. This year, such an excise tax goes to a special budget fund to finance defense procurements. Also, local budgets will not receive an additional 4% of personal income tax, which they receive now.

Table 1: Macroeconomic indicators behind the Budget Declaration

	2025	2026	2027
GDP: nominal, UAH bn	8 466.3	10 123.2	11 782.8
real change, % yoy	2.7	7.5	6.2
Consumer Price Index:			
average, % yoy	9.7	9.9	8.0
end of year, % yoy	9.5	10.4	5.9
Producer price index of industrial products:			
end of year, % yoy	11.1	112.4	107.8
Balance of trade determined by the balance of payments methodology, USD m	-40 675	-27 324	-21 058
Export of goods and services:			
USD m	57 229	67 311	80 273
% yoy	7.0	17.6	19.3
Import of goods and services:			
USD m	97 904	94 635	101 331
% yoy	3.7	-3.3	7.1

Source: Budget Declaration for 2025-2027

Against the background of limited external funding, which is now included in the Budget Declaration, the Government plans to reduce most expenditures in 2025. Defence spending will increase in 2025, but will gradually decline in in 2026-2027. The size of the subsistence minimum and the minimum wage will be frozen at the current level. At the same time, the central fiscal deficit is projected to gradually decrease from 20% of GDP now to 6.7% of GDP in 2027. Such a reduction is unrealistic given the current parameters of the Declaration, if Ukraine is not provided with a significant amount of grants from international partners. So far, grants are also absent from the Declaration.

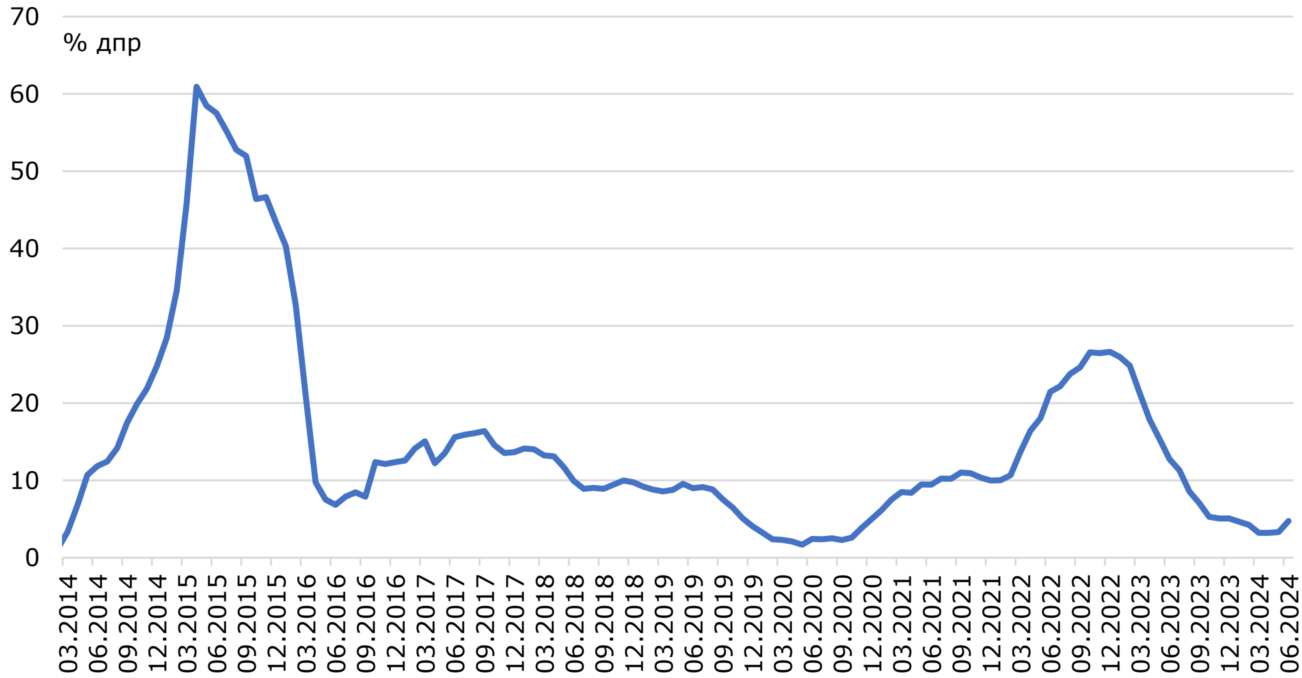
Inflation: Consumer inflation accelerated to 4.8% yoy in June

In June, according to the State Statistics Service, inflation accelerated sharply to 2.2% mom (compared to the previous month) and 4.8% yoy (compared to the previous year). This is the highest monthly inflation rate since October 2022 and primarily reflects an increase in electricity tariffs of almost 64%. However, the published inflation rate turned out to be unexpectedly high: in June 2023, the electricity tariff was increased by almost 70%, and inflation was only 0.8% dpm.

This difference is partly due to the fact that other prices have been rising this year (by an average of more than 0.5%), and last year they were almost unchanged. Also, last year's tariff increase means that this year the share of electricity in the consumer basket has become higher. However, so far we have not been able to fully explain this difference between the monthly inflation rates in June 2024 and June 2023.

In addition to the increase in electricity tariffs, the seasonal decline in prices for clothing and footwear continued in June. Egg prices have risen since the collapse in the spring. Excluding these one-time and seasonal changes, prices in June increased by an average of 0.5-0.6% mom (6-7% in annual terms). This is significantly faster than in previous months, when a similar growth was 0.2-0.4% mom (3-5% in annual terms). This acceleration reflected an increase in the costs of manufacturers and retail chains for imports, wages, and energy (in particular, gasoline for generators). However, price growth continued to be restrained by significant competition for limited demand, lower global prices for some commodities, and a significant supply of a number of food products.

Figure 6: Consumer price inflation



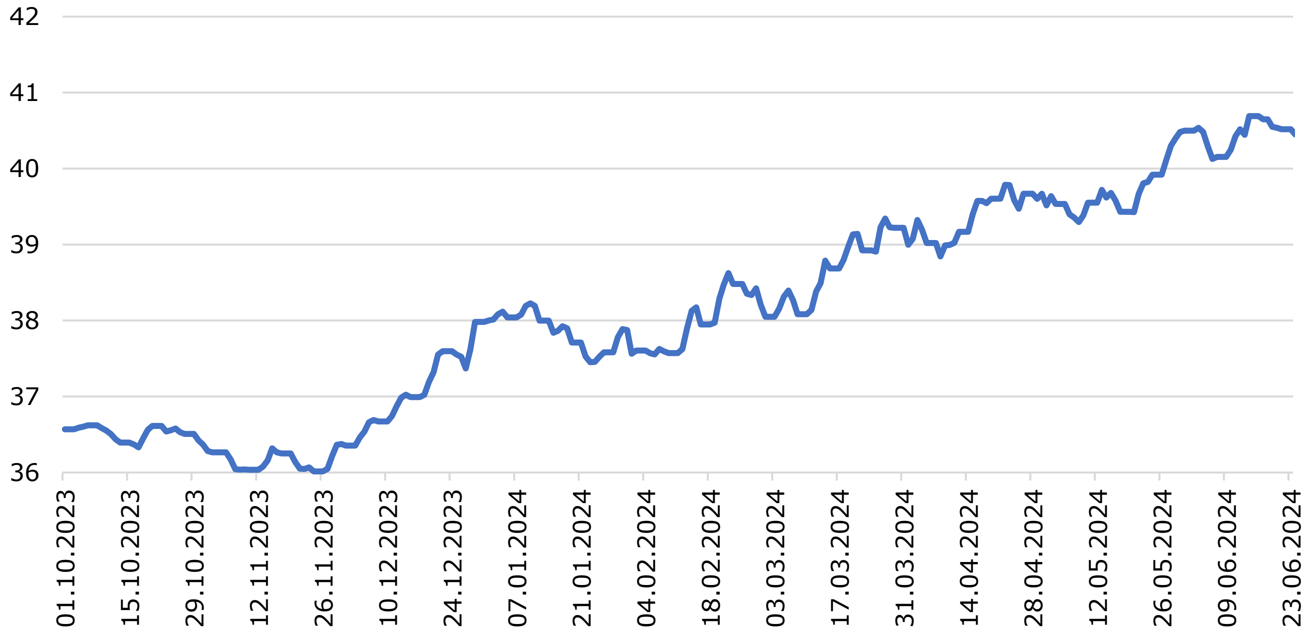
Source: State Statistics Service of Ukraine

Exchange rate and monetary policy: Hryvnia continues to depreciate against the dollar

Exchange rate. Over the past four weeks, the hryvnia has been gradually weakening against the US dollar, and on July 12, the exchange rate for the first time passed the mark of UAH 41 per dollar (the official exchange rate as of July 15, based on the average exchange rate on the interbank market on July 12). Although the depreciation of the hryvnia is gradual, it creates expectations of further weakening of the hryvnia. This, in turn, reduces supply and increases demand in the market and, correspondingly, it increases pressure on the NBU's reserves and pushes up inflationary pressures. Net sales of cash foreign currency by banks reached almost USD 4.7 bn in the first half of 2024. However, the NBU's room for manoeuvre is limited: even with the gradual weakening of the hryvnia, it spends significant amounts of international reserves to support the exchange rate. In the four working weeks ending July 12, the NBU's interventions amounted to almost USD 2.6 bn. For comparison, as of July 1, the NBU's international reserves amounted to USD 37.9 bn.

Monetary policy. The published results of the discussion of the NBU Monetary Policy Committee on June 14 indicate that 9 out of 11 participants supported the decision to cut the key policy rate to 13% per annum. Also, the majority of 7 members of the committee expected further cuts in the key policy rate in the second half of the year, despite increased inflationary pressures and likely already formed expectations of hryvnia depreciation. They seem to be optimistic about the risks to inflation this year and assume that Ukraine will receive sufficient external financing in this year and the next one.

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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