Monthly Economic Monitoring of Ukraine

No.230, March 2024

Resume

- According to the IER, real GDP growth accelerated to 5.6% yoy (year-on-year) in February 2024 from 3.1% yoy in January, partly due to the calendar effect.
- The power system survived the winter: the use of coal from thermal power plants and nuclear reactors increased. During this heating season, Ukraine used only gas of its own production for the first time in its history.
- Sea and rail transport had record performance against the backdrop of the blockade of the Polish border for trucks: 8 million tons and 14.6 million tons, respectively.
- According to preliminary customs estimates, trade in goods in February remained at the level of January 2024.
- State Budget revenues increased in February due to advance payment of dividends by state-owned banks and enterprises.
- In February, international financial assistance remained low, but we expect EUR 4.5 bn of bridge financing from the EU under the Ukraine Facility in March.
- Consumer inflation decelerated further to 4.3% yoy in February due to moderate growth in consumer demand and lower global commodity prices.
- Hryvnia remained stable for most of the first quarter of 2024, likely due to lower demand for foreign currency, including cash.

Funded by
the European Union

The IER is preparing the publication of the Macroeconomic Monitoring of Ukraine with the financial support of the European Union within the framework of the project "Ukraine's economy during the war and support for Ukrainians affected by the war".

Authors: Oleksandra Betliy, Iryna Kosse, Vitaliy Kravchuk, Veronika Movchan

IER. Kyiv

@IER_Kyiv

GDP: The Calendar Effect Is Important

According to the IER estimates, real GDP growth accelerated to 5.6% yoy (year-on-year) in February 2024 compared to 3.1% yoy in January. An important reason for this change is the calendar effect – an additional day in February this year. That is also due to further recovery in industry and transport through better sea logistics.

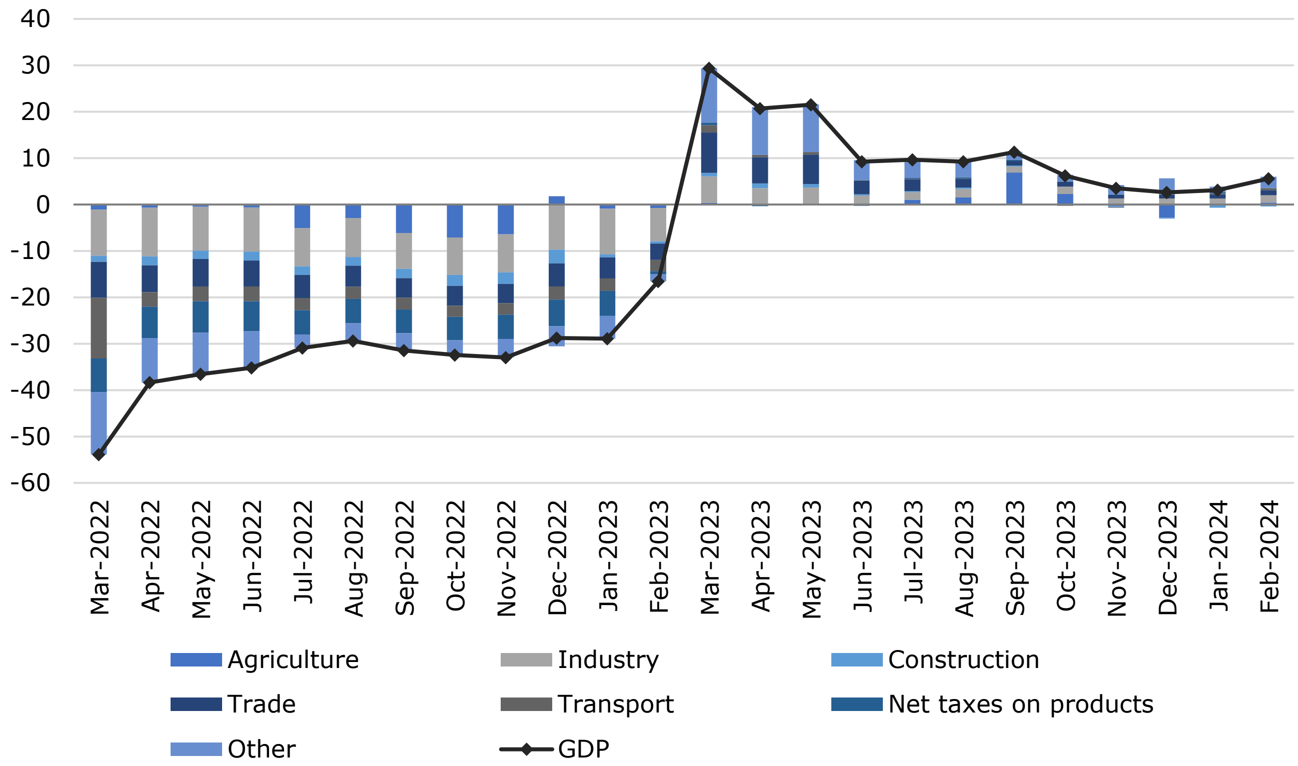
If we consider the calendar effect, then the performance of agriculture remained at the level of last year (but it is worth remembering that in February, it reflects only the livestock sector). The problematic situation in the budget was one of the reasons for the decline in construction, which decreased by more than 20% yoy.

The extracting industry's real gross value added (GVA) accelerated to almost 7% yoy in February due to higher ore and coal mining. In the future, further recovery is expected against the launch of new capacities to extract these minerals. The 2023/2024 heating season must be expected to be the first that Ukraine will pass only on gas of its own production.

Fewer problems with access to electricity and greater accessibility of seaport logistics have contributed to growth in metallurgy. The machine building and light industry also grew. Overall, we estimate the growth of real GVA in the industry to be 13% in February.

The growth of electricity consumption by industry and the population contributed to the increase in electricity production. Real GVA in the energy sector is estimated to have increased by 9% yoy. Sector developments were limited by further shelling of energy infrastructure by russia.

Figure 1: Contributions to real GDP, pp



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

Real GVA in transport also increased due to the successful operation of the Ukrainian Sea Corridor and the high rates of cargo transportation by Ukrzaliznytsia to ports and other destinations. Polish farmers' strikes continued to restrain road transport and create fiscal risks, as Ukraine received lower revenues from imports VAT. Still, real GVA in transport is estimated to increase by 13.6% yoy.

The increase in consumption contributed to the growth of real GVA in trade by 9.6% yoy. An enterprise survey also indicates higher sales volumes. In general, the business remains quite optimistic, although the level of uncertainty is very high.

Energy: The Power System Withstood The Winter

Electricity. Although the heating season is just ending, power engineers and experts are already summarising the results of the autumn-winter period of 2023-2024. Due to the high need for balancing in the event of an electricity shortage, the power units of thermal power plants (TPPs) and combined heat power plants (CHPs) worked more hours than in previous years. Accordingly, the use of coal increased, especially in December-January, but its supply was timely. Therefore, despite the loss of coal generation, as of the end of February 2024, more than 1 million tons of coal remained in warehouses, which is 236 thousand tons more than envisaged by the schedule of the Cabinet of Ministers.

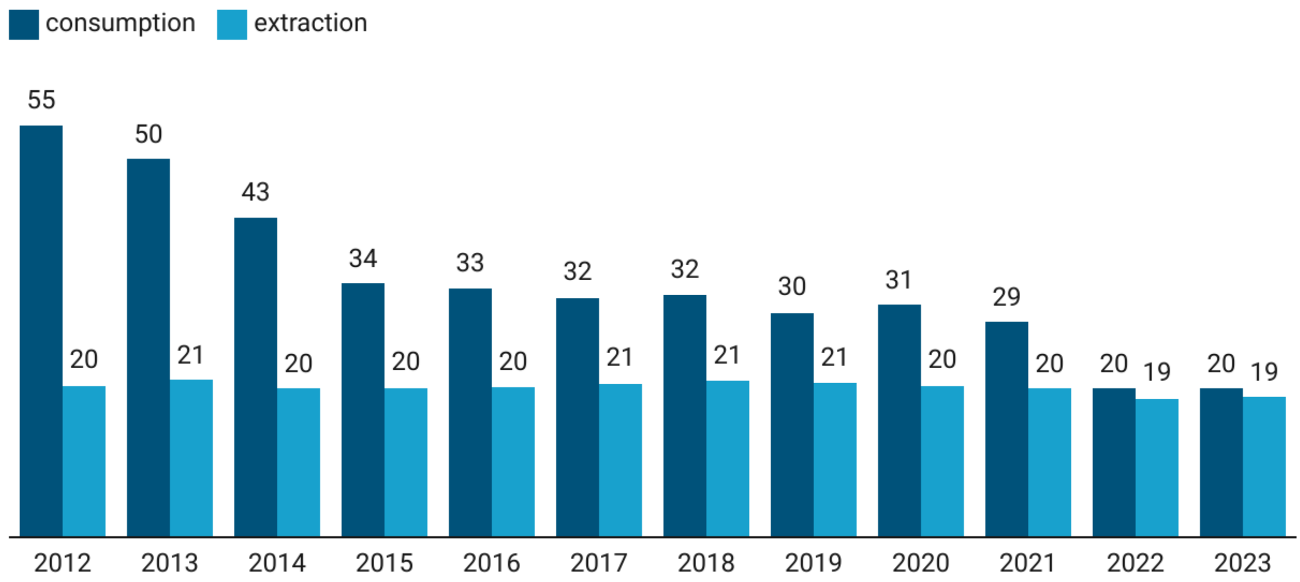
Nuclear generation remains the most stable component of the energy system, with nine power units operating throughout the winter in the territory controlled by Ukraine. According to Energoatom, during the current heating season, the utilization rate of the installed capacity of nuclear units reached 100% compared to 82% in 2022/23 and 76% in 2021/22. At the beginning of March, there was an excess of electricity production in the power system, due to which the load on nuclear power units was reduced. This load reduction made it possible for Energoatom to start preparing for maintenance. As of March 7, Ukrainian nuclear power plants generated 6950 MW of electricity.

Despite repairs in the electricity transmission system, its losses from russian attacks have not yet been compensated. According to DiXi Group's rough estimates, the capacity of transformers in the electricity transmission system is about 65% of the capacity before the start of russian attacks on energy facilities. This capacity is sufficient for current needs but reduces reserves in case of damage or increased demand.

Since the beginning of February, Ukraine has increased its electricity exports. In February, more than 84 thousand MWh were imported, and more than 63 thousand MWh were exported. More than 60% of electricity exports are to Romania and Moldova. An important prerequisite for developing foreign electricity trade was the launch of joint auctions to distribute transmission capacity. In particular, at the end of February, auctions for the supply of electricity to Hungary were resumed.

Gas. Ukraine went through the winter of 2023-2024 almost entirely using gas of its own production. The main reason for the minimum import is a significant reduction in consumption. In 2023, gas consumption fell by 30% compared to 2021. The main volume, about 4.8 bn cubic meters or 60%, was lost by industry. The reasons for this reduction are the occupation of the territory, the destruction of industry, and the departure of the population abroad.

Figure 2: Gas consumption and production in Ukraine, bcm



Source: ExPro Consulting

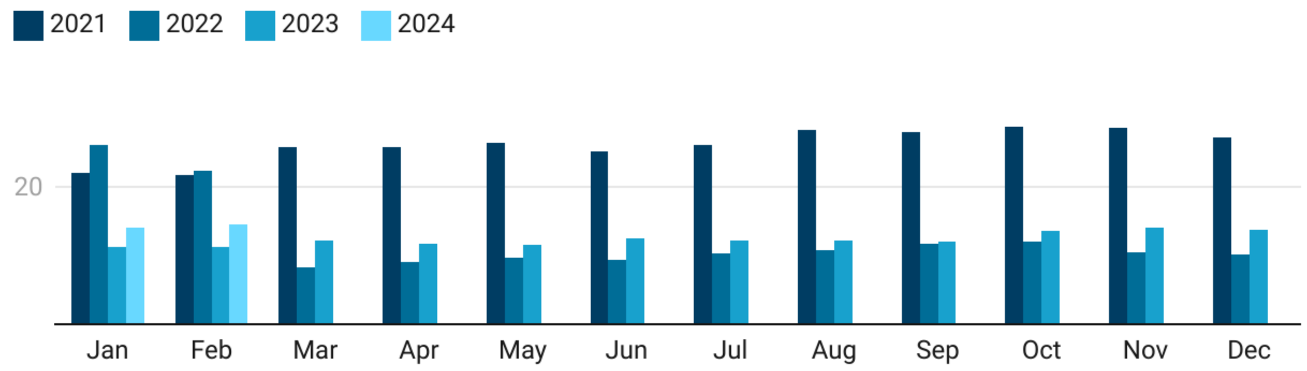
Transport: Sea And Rail Modes Of Transport Break Traffic Records

Maritime transport. The cargo turnover of the ports of Greater Odesa in February amounted to 8 m tons, of which 5.2 m tons were products of Ukrainian farmers. These are record export figures through the Ukrainian sea corridor and during the full-scale invasion.

The Unity Facility grain transportation insurance mechanism through the Ukrainian Sea Corridor, which has been in effect since November 2023, has been expanded from February 2024 to ships carrying not only grain but also any other cargo. The Unity Facility was created using a public-private partnership, in which the Government of Ukraine provided funds for reimbursement of USD 20 m. This amount allows Ukraine to insure about a thousand vessels annually (which can export about 30 m tons of grain) with a maximum insurance value of USD 50 m per vessel.

Rail transport. Ukrzaliznytsia transported 14.6 m tons of cargo in February, 3% more than in January and 30% more than in February 2023. The volume of transportation in the direction of the western border and ports increased by 3.5% mom to 7.8 m tons (3.0 m tons to the border and 4.8 m tons to ports). Of these, 3.3 m tons were grains, and 3.3 m tons were iron and manganese ores.

Figure 3: Transportation of goods by rail, million tons



Source: Ukrzaliznytsia

Road transport. The Polish farmers continue to block Ukraine's border with Poland. The Krakowiec-Korczowa checkpoint was temporarily unblocked on March 9-13. As of March 9, 2300 trucks were queuing at all checkpoints on the Polish border. The most challenging situation is observed at the checkpoints "Dorohusk - Yahodyn" and "Shehyni - Medyka," where farmers do not allow Ukrainian trucks to enter Poland.

The European Commission has proposed to extend the road transport agreement with Ukraine, but subject to amendments. The Commission proposes to make it mandatory to have documents confirming the license of an international carrier and a transit operation if a truck travels without cargo and to strengthen control over the fulfilment of agreement obligations by road carriers. In addition, it is proposed to enhance the fight against fraud and forgery of driving documents, as well as offences related to road safety, and to provide for the possibility of suspending the agreement in a particular geographical region in the event of a significant violation of the agreement.

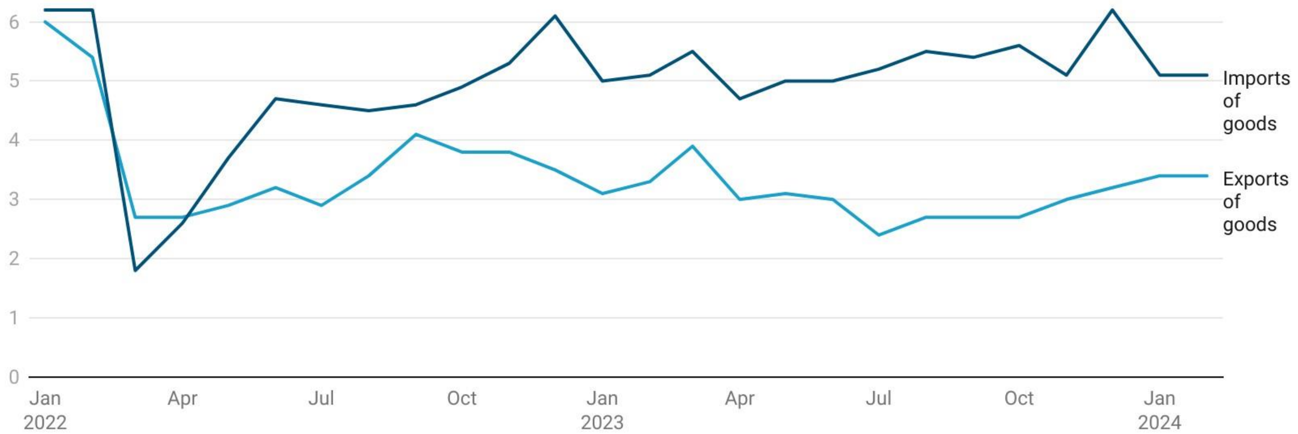
Foreign trade: February's Overall Goods Trade Indicators Did Not Differ From January's

According to preliminary data from the State Customs Service, in the first two months of 2024, exports of goods amounted to USD 6.8 bn, 5% higher than in 2023. Imports of goods for two months amounted to USD 10.0 bn, unchanged from last year.

Interestingly, according to customs estimates, exports and imports of goods in February were equal to January figures despite several positive and negative shocks that trade experienced throughout the month. Among the positive shocks, it is worth noting the rapid growth of agricultural exports, primarily due to the work of the Ukrainian Sea Corridor. According to the Ministry of Agrarian Policy, in February 2024, exports of the main types of agricultural products by sea increased by 0.9 million tons (tons) compared to January and reached 6.4 million tons, an absolute record since the full-scale invasion. The export of these products by all modes of transport amounted to 7.3 million tons, which is the second best figure since March 2022. The basis of agricultural exports were corn (more than 2.9 million tons in February) and wheat, the export of which increased to 2.5 million tons. Also, in February, according to Ukrzaliznytsia, the export of iron ore intensified: rail transportation increased to 3.3 million tons compared to 3.0 million tons in January. Among the negative factors influencing foreign trade in February, the decisive ones were the blockade of road transport in

Poland, which restrained exports and imports, and the continued decline in prices for agricultural products.

Figure 4: Trade in goods of Ukraine, 2022-2024, USD million United States



Source: State Customs Service of Ukraine, UN ComTrade

Poland has remained a key trading partner of Ukraine despite enduring unilateral trade restrictions on grain and other agricultural products and border blockades for road freight transport. According to Ukrainian customs, in the first two months, exports to Poland amounted to USD USD 0.65 bn. United States. That makes Poland the largest destination for Ukrainian exports among the EU countries (Spain was second with USD 0.62 bn) and globally. Poland is also the second source of commodity imports after China and the first among the EU countries, pushing out Germany. The corresponding figures for Poland are USD 1.1 bn, Germany USD 0.8 bn, and China USD 2 bn. However, protracted trade disputes may lead Poland to lose its leadership position. In particular, exports to Poland have gradually decreased since mid-2022 against the backdrop of increased sea supplies to other EU countries.

Figure 5: Trade in goods with Poland, 2021-2024

Source: State Customs Service of Ukraine, UN ComTrade

State Budget: Lack of International Aid Leads to Steps to Use Domestic Reserves

In February 2024, international aid remained low, although higher than in January. Japan and Norway provided grants equivalent to UAH 31 bn, and Spain borrowed the equivalent of UAH 0.1 bn. Lower international inflows forced the government to approve the decision on advance dividend payments by state-owned banks and enterprises. As a result, the budget received UAH 66.8 bn from corporate profit tax (CPT) and dividends in February, compared to UAH 7.5 bn in February last year. The government also announced plans for a possible increase in taxes in 2024. According to available information, they will likely include introducing a 1.5% military fee for entrepreneurs on a simplified taxation system, a new excise on some goods (including jewelry) and increasing excise on fuel.

In February, VAT revenues decreased compared to January. Domestic gross VAT revenues fell to UAH 27 bn (compared to UAH 44 bn in January) due to a seasonal decline in demand compared to the end of last year. Revenues from import VAT also decreased to UAH 32 bn due to strikes by Polish farmers who blocked the border. According to the Ministry of Finance, in February, the budget did not receive UAH 8 bn in import revenues due to this reason.

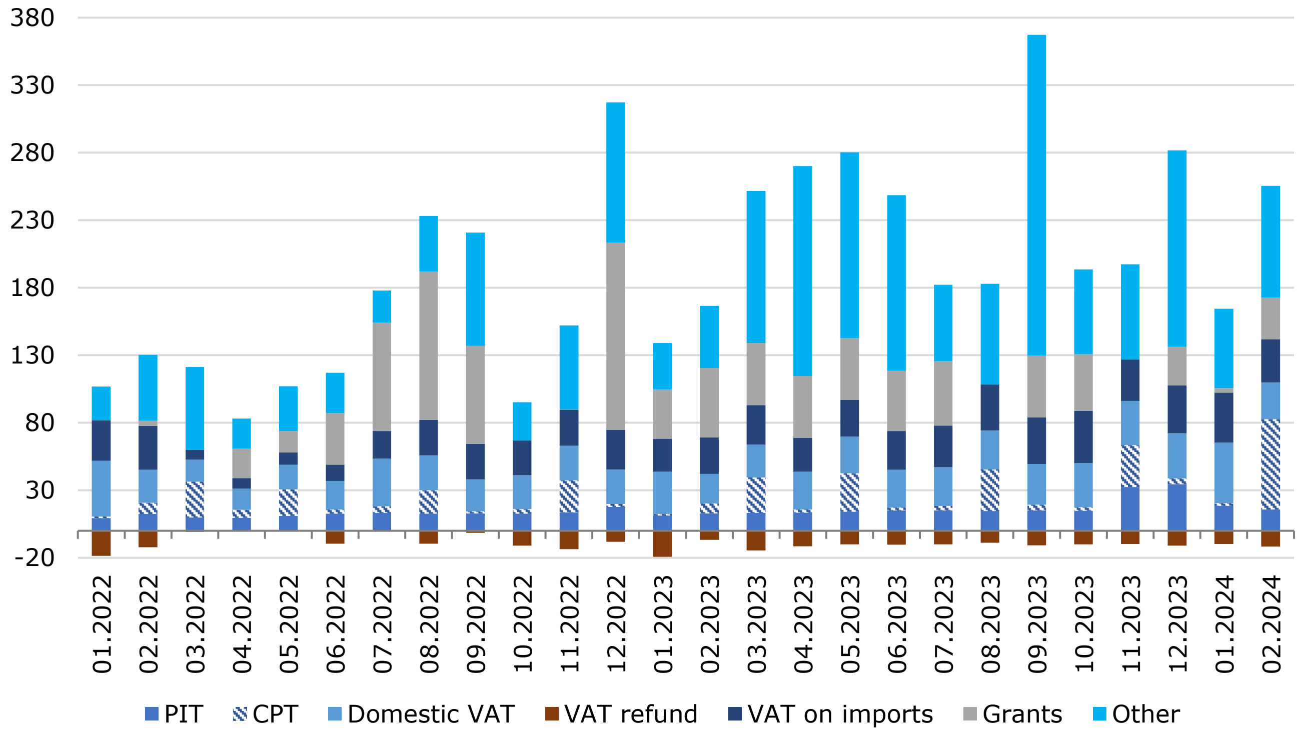
In February, VAT refunds increased to UAH 11.7 bn, higher than the annual average 2023. At the same time, the news shows that several billion hryvnias of VAT were refunded on the last day, which could result from a lack of liquidity for the government during the month.

In general, according to preliminary information from the Ministry of Finance, the revenues of the State Budget in February amounted to UAH 244 bn (of which the revenues of the general fund amounted to UAH 189 bn) compared to UAH 155 bn in January.

Higher revenues contributed to higher financing of state budget expenditures in February after the drop in January. According to preliminary information, expenditures of the state budget's general fund grew by 20.7% yoy to UAH 274 bn in February 2024 compared to UAH 150 bn in January 2024. Most likely, spending on defense and security increased.

In February, the government also decided to conduct an indexation of pensions of 7.9% from March 2024. That is somewhat less than initially planned, primarily due to significantly lower inflation in 2023 than expected when the budget was formed. According to the Ministry of Social Policy, indexation will mean an increase in pensions for 10 million pensioners by an average of UAH 322. It is expected that the average size of pensions, as a result, will increase by 6% to 5717 UAH.

Figure 6: State Budget revenues, UAH bn

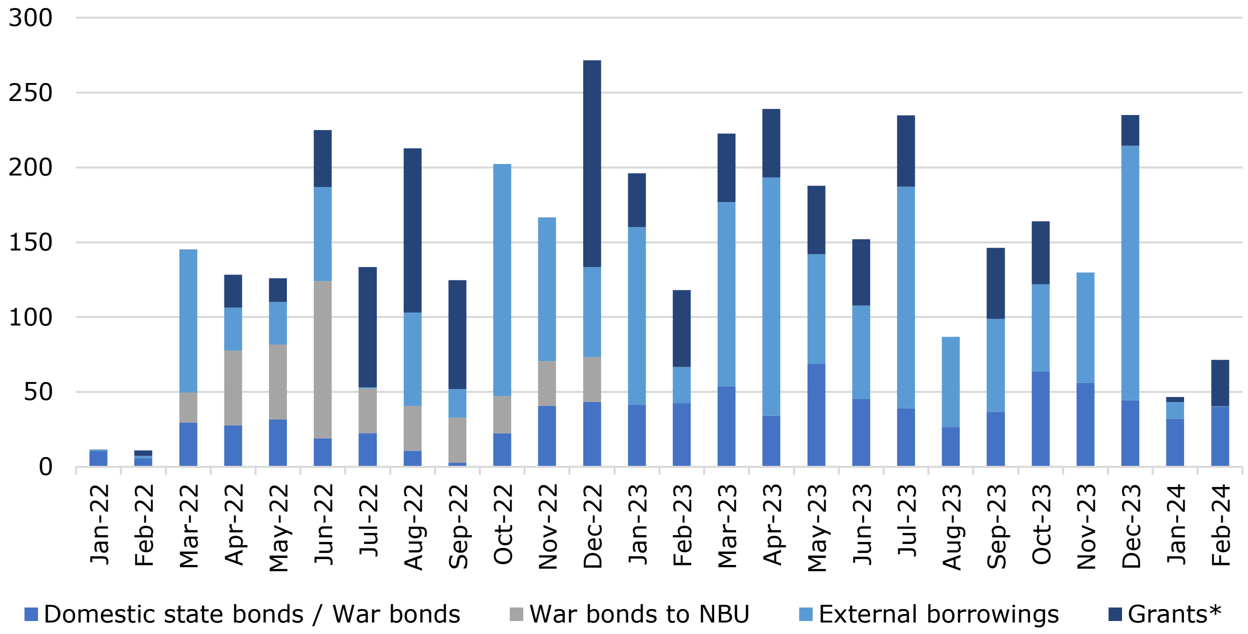


Note: preliminary data for February 2024, in which CPT revenues also include dividends.
Source: Ministry of Finance, openbudget.gov.ua

Domestic borrowing amounted to UAH 40 bn in February, compared to UAH 32 bn in January. At the same time, almost half of the funds were raised from placing FX-denominated domestic government bonds. Yields remained unchanged at a level above the NBU discount rate. Thus, at the beginning of March, the yields for hryvnia-denominated bonds were 16.8% for one-year bonds, 17.6% for two-year bonds, and 18.5% for bonds with a maturity of 3.4 years. The government was able to raise more funds than it spent on interest payments and redemption of domestic debt.

Although the government still has a standstill on all payments on private external debt (Eurobonds) and official external debt, it continues to service loans from IFIs, including the IMF and the World Bank, on time and in full. Already in the summer, the government should agree on debt restructuring with the Eurobonds holders. Expectations of a successful restructuring contributed to a certain increase in the yields.

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

International support: Positive News At Last

IMF. In February, a staff-level agreement was reached on the successful third review of the IMF Program for Ukraine. In the second half of March, the IMF Executive Board is expected to approve the third review, resulting in Ukraine receiving a loan of USD 880 m. At the same time, along with the money, the government will also receive a new set of structural benchmarks, which it has pledged to fulfil to receive the subsequent tranches of payments.

EU. The EU Council and the European Parliament have adopted an agreed version of the EU Regulation on the Ukraine Facility, which provides support to Ukraine in the amount of up to EUR 50 bn over the next four years. The Regulation entered into force on March 1, 2024.

Assistance under this Facility will be provided under three pillars: 1) budget support (EUR 33 bn in loans and EUR 5.27 bn in grants), 2) investment component (almost EUR 7 bn) and 3) interest rate subsidies and technical assistance (EUR 4.76 bn). The draft amendments to the EU budget 2024 provide for EUR 3 bn in grants, EUR 155 m in technical assistance commitments, and EUR 527 m in commitments to support investments in Ukraine.

The exact amount of loans for budget support to Ukraine in 2024 is unknown. Still, budget support is expected to amount to EUR 16-18 bn (in 2023, Ukraine received EUR 18 bn from the EU under the macro-financial assistance program). Thus, EUR 4.5 bn is already expected in March as bridge financing. In April, bridge financing could amount to EUR 1.5 bn if Ukraine fulfils two commitments that have not yet been fulfilled under the signed memorandum (three out of five commitments have already been fulfilled). In particular, the government should adopt the procedure for financing industrial parks to attract investment to the de-occupied territories and ensure the exchange of data between the State Land Cadastre and the Register of Property Rights. The government is now elaborating on both decisions.

Another tranche is expected after the approval and coordination of the Ukraine Plan with the European Commission. Further tranches of the loan within the framework of budget support under the Ukraine Facility will be provided after the European Commission assesses Ukraine's fulfilment of a specific list of indicators and obligations. They will be determined no later than April based on the Ukraine Plan developed by the Government of Ukraine and must be agreed upon by the European Commission. The relevant tranches will decrease if Ukraine does not fulfill its obligations on time. Therefore, timely and full implementation of the Ukraine Plan is crucial for the macroeconomic stability of the state.

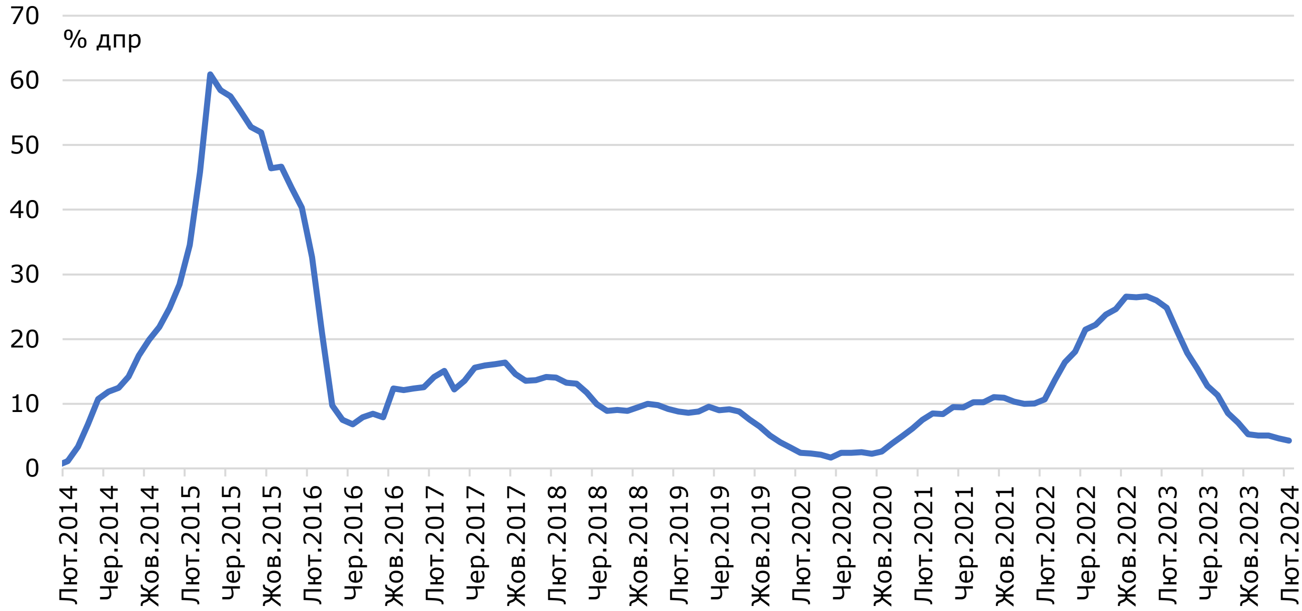
USA. The hot debates and discussions on both military and financial support for Ukraine continue in the USA. Under the IMF program, Ukraine was expected to receive USD 8.5 bn from the United States for the budget this year. United States.

Inflation: Consumer Inflation Decelerates Again

In February, consumer inflation decelerated again to 4.3% yoy. The main factors helping contain inflation have not changed in recent months: the recovery of consumer demand continues gradually, the hryvnia remains relatively stable against the dollar, and the government keeps utility tariffs mostly fixed. Also, global commodity prices are generally not rising, while prices for some commodities continue to decline.

Consumer prices increased by only 0.3% mom compared to the previous month. Low export prices limited the growth in prices for several food products including meat, sugar, cereals and sunflower oil. Also, as usual, winter clothing and footwear prices fell in February, and dairy products became more expensive. On average, prices for other goods and services increased slightly compared to January.

Figure 8: Consumer price inflation



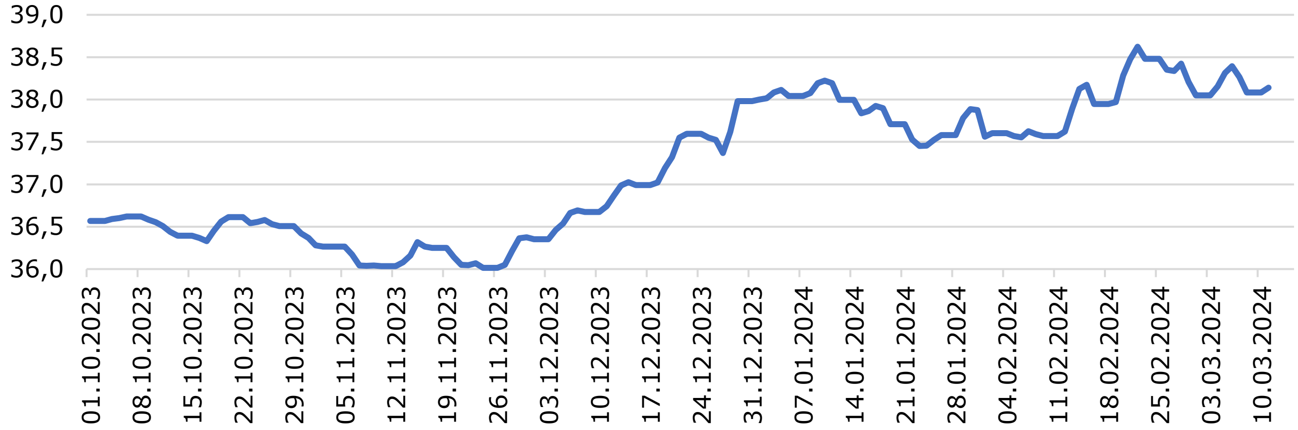
Source: State Statistics Service of Ukraine

Exchange Rate Policy: Exchange Rate Remained Stable

In the first quarter (as of mid-March), the hryvnia exchange rate remained fairly stable, with the hryvnia hovering around UAH 38 per USD. Demand for cash FX declined in February, while the foreign trade deficit eased slightly compared to the previous quarter.

As demand for foreign currency decreased and external aid inflows were uncertaain, the NBU seems to have decided to reduce sums spent to support the hryvnia rather than encourage the hryvnia to appreciat. Thus NBU interventions in the foreign exchange market became much lower: in the eight weeks of 2024 ending March 9, net interventions amounted to USD 2.77 bn. For comparison, in the last three weeks of 2023, the NBU spent USD 2.73 bn to support hryvnia.

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

Contacts:

Institute for Economic Research
and Policy Consulting
st. Reitarska 8/5-A, 01030 Kyiv
Tel. (+38044) 278-6342
E-mail: institute@ier.kyiv.ua
http://www.ier.com.ua

Disclaimer