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- In March 2023, according to the IER, real GDP grew by 28% year-on-year (yoy). However, it should be noted that since March, annual figures are compared to the period of russia's full-scale war against Ukraine. Therefore, compared to March 2021, the current GDP decline would be 31%.
- The State Statistics Service has released GDP data for 2022: real GDP contracted by 29%, while nominal GDP decreased only by 5%.
- Efforts by energy companies to increase their own gas and coal production are growing, which is expected to contribute to Ukraine's energy independence.
- The Grain Initiative has been extended for 120 days, although russia continues to claim that it has agreed only to 60-days extension.
- The foreign trade deficit in goods and services remained significant in the first two months of 2023 but was financed by international assistance inflows.
- Changes in IMF policies have allowed Ukraine to receive a full EFF program of USD 15.6 bn, which is part of a USD 115 bn assistance package.
- Inflation continued to slow down and reached 21.3% yoy in March. This trend is expected to continue for at least until June.
- The NBU continued to adjust its policy on reserve requirements for banks to encourage them to increase interest rates on bank deposits.

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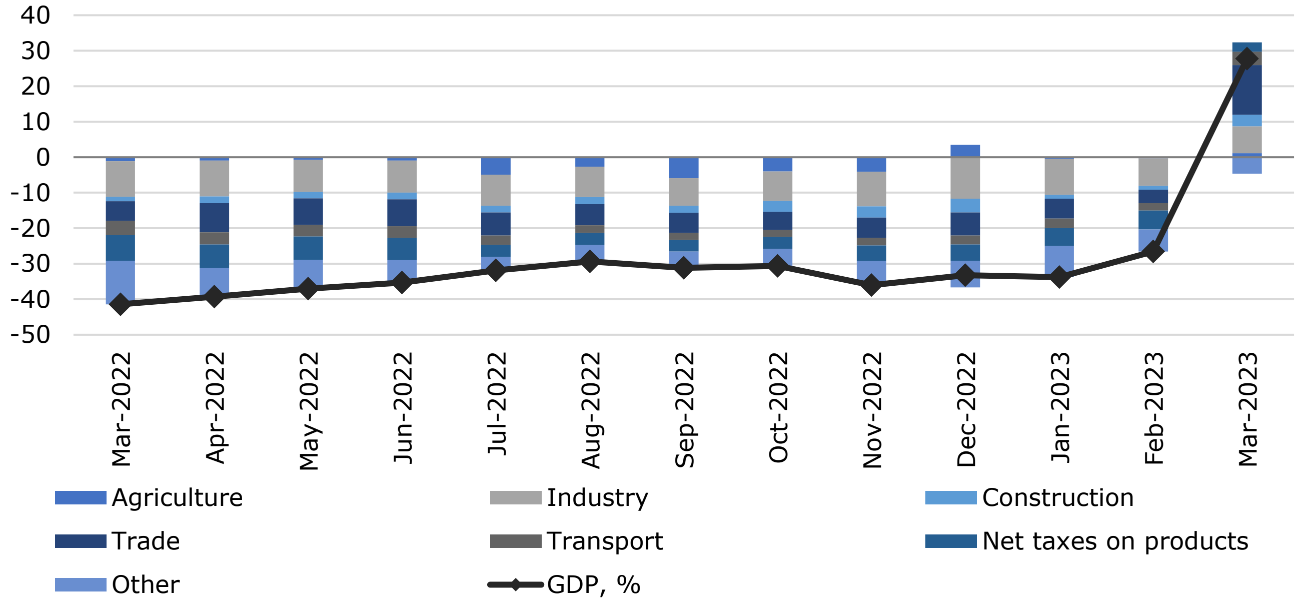
GDP and the Real Sector: Sharp Recovery in March, But Not Really

In March 2023, economic indicators are compared with the period of full-scale war, when the largest decline in Ukraine's economy was recorded. According to the estimates of IER experts, real GDP in March 2022 fell by 46% yoy (compared to the previous year) as shelling occurred throughout Ukraine, a large territory was temporarily occupied, supply chains were disrupted, and uncertainty was exceptionally high.

According to IER estimates, in March 2023, real GDP grew by almost 28% yoy. However, it remained 31% lower than in March 2021. The situation varied by sector of the economy. For example, the real value added in education and healthcare decreased compared to the previous year. The performance of the energy sector was also worse than last year due to the occupation of the Zaporizhzhia Nuclear Power Plant and the destruction of facilities, particularly in solar and wind power generation. Value added in mining was also somewhat lower, as some enterprises in the sector were still trying to operate in March 2022.

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



Source: IER assessment made with the support of the USAID Competitive Economy Program

Real GVA in the livestock sector, which comprises agricultural indicators in March, increased by almost 40% yoy due to recovery in poultry and pig farming. Additionally, indicators of the processing industry grew by an estimated 80% yoy, although compared to March 2021, the decrease was about 40%. Trade almost doubled compared to March 2022, when it suffered from the destruction of wholesale warehouses, worsening logistics, and declining demand. Transportation also showed an increase of over 50% yoy, primarily due to automobile permit-free delivery and unblocking of three seaports.

In the coming months, real GDP will continue to grow, but at a slower pace, as since April 2022, businesses have started to restore economic activity and adapt to new working conditions.

Year 2022. The State Statistics Service published data on national accounts for 2022. Real GDP contracted by 29.1%, which is close to our estimate of 30.2%. Nominal GDP amounted to UAH 5,191 bn, which is only 4.8% lower than the nominal GDP of the previous year due to a deflator of 34.3%. Dollar-denominated GDP decreased by 21% to USD 159 bn due to the devaluation of the hryvnia.

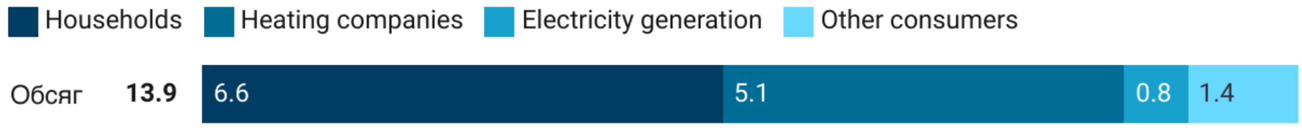
On the demand side, real final private consumption decreased by 26.7% due to a decline in household disposable income. Meanwhile, government consumption increased by 18% due to higher spending on defense and security, including increased funding for military equipment and arms purchases. Gross accumulation of fixed capital fell by 34.3% due to the temporary occupation of territories, the poorer financial performance of enterprises, and increased uncertainty and destruction of enterprises by the Russian army. These reasons, along with complex logistics and very limited access to seaports (and almost entirely for grain), led to a 42.4% decline in real exports of goods and services. Imports of goods and services decreased by 18.5% in real terms. A comparatively moderate decline in imports reflects the growth of travel imports (spending of

Ukrainians abroad). According to the State Statistics Service estimate, the fall in imports of goods was greater than the fall in physical volumes of exports (44.7% compared to 40.1%). Imports were also supported by higher volumes of fuel and equipment imports in the last months of the year, which helped to overcome the period of energy shortage for both businesses and the population.

Energy: Power System is Recovering, Electricity Export Has Started

The Naftogaz of Ukraine reported that gas consumption for the 2022/23 heating season is estimated at 13.9 bcm. This volume of gas was sourced from: production by UkrGazVydobuvannya – 7.6 bcm, gas storage withdrawals – 5.3 bcm, and imports - 1 bcm. Naftogaz had planned to import 2.9 bcm, but due to the mild winter, only 1 bcm was needed.

Figure 2: Natural gas consumption in the heating season 2022/2023, bcm



Source: Naftogaz

UkrGazVydobuvannya (UGV) seeks to increase gas production, therefore investing in developing new wells and restarting old ones. In March, the company drilled a new well with a depth of 5950 m, which yields 340 thousand m^3 of natural gas per day. The well was drilled in a field that has been in operation for 45 years and is depleted by 85%. Still, experts, using a 3D model of the field, were able to identify a prospective area of the productive layer of the field that has not been developed yet. UGV launched another powerful well at the end of March.

In March, the Ukrainian energy system recovered to the extent that Ukrenergo lifted consumption limits in some regions. Ukrainian hydroelectric power stations provided a portion of electricity generation, accounting for over 10% of the total, similar to pre-war times. This was facilitated by the flooding that started in February and continued into the spring. All reservoirs of the Dnieper cascade (except for Kakhovka, which Ukraine does not currently control) and the Dniester reservoir are almost filled to the level needed for the summer-autumn period to ensure Ukraine's water supply for electricity generation.

If Ukraine faces an electricity shortage, Ukrenergo will be able to urgently import electricity from 15 EU countries (members of the ENTSO-E association), as stipulated in the agreement signed on March 29. However, for the past two months, the Ukrainian energy system has been operating with a surplus, so on April 7, the Ministry of Energy started resuming electricity exports. On April 10, the first auction for the allocation of transmission capacity of interstate networks for electricity export to Moldova took place. As a result of the auction, 51% (330 out of 650 MW) of the total available transmission capacity in this direction was allocated among four participants: EKU, Ukrhydroenergo, D. Trading, and Artlex-Energy.

Recovery of coal mining is also ongoing. Since the beginning of the year, DTEK Energy has started production on six new coal horizons: two in January, three in February, and one in March. Last year, the company's coal mining enterprises launched 28 new coal horizons.

Transportation: "Grain Deal" Stalls, Queues at the Borders

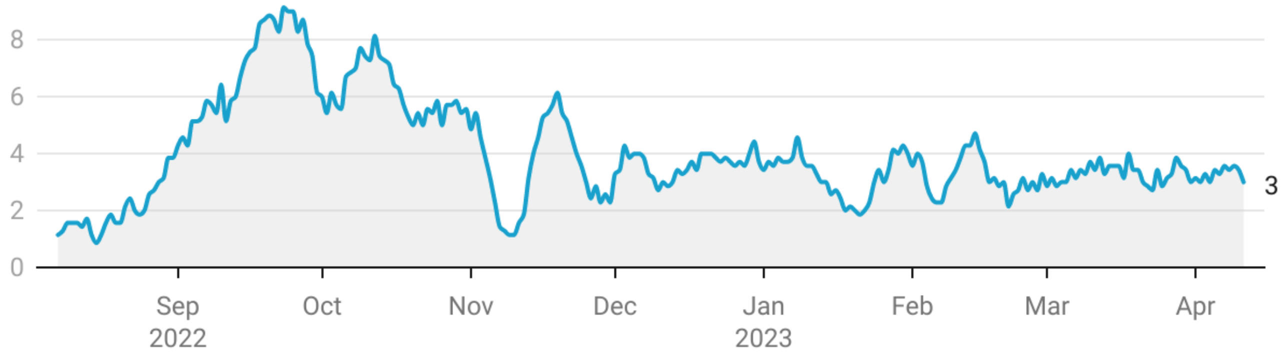
Maritime transport. On March 13, an auction for the sale of the Bilhorod-Dnistrovskyi port took place on the Prozorro.Sales platform. The winner was LLC Ukrdoninvest, which bought the port for UAH 220 m. The starting price was UAH 93.8 m.

The Grain Initiative for exporting Ukrainian grain through three seaports near Odesa has been extended for another 120 days. However, Russia claims to have agreed to extend the agreement for only 60 days.

Transportation volumes of Ukrainian grain through the "grain corridor" slightly increased in March compared to February but remained low due to slow vessel inspections. According to the Ministry of Infrastructure, there are about 90 vessels in line for entry and exit from the ports of Odesa. In March, the parties to the Joint Coordination Center approved 303 vessel inspections in the Bosporus Strait, but only 168 took place. The Ministry reports that as a result, the loading capacity of Ukrainian ports has dropped to 30-35%, with almost 15 m tons of food cargo remaining unexported.

Since August 1, 2022, Ukraine has exported 27.4 m tons of Ukrainian food through three ports in Odesa.

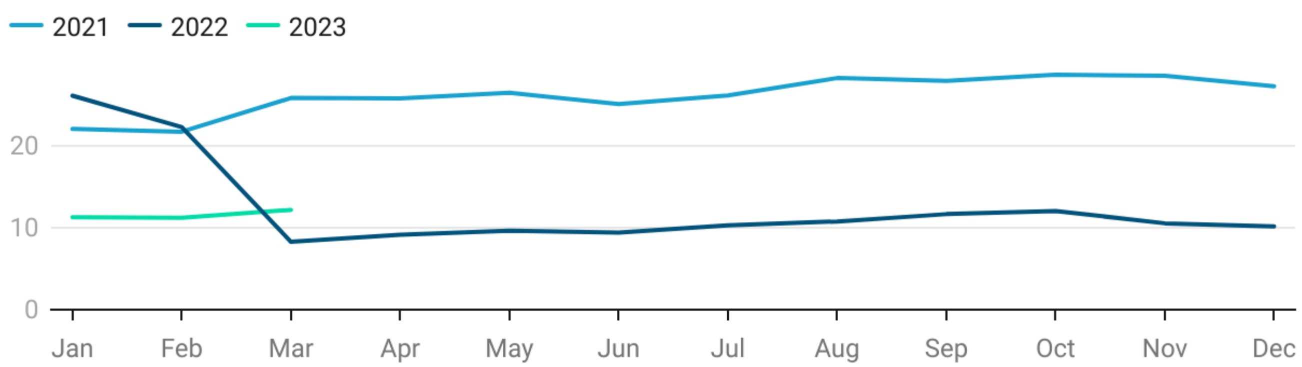
Figure 3: Number of inspections of vessels passing through the "grain corridor" (7 days moving average)



Source: Black Sea Grain Initiative Vessel Movements https://data.humdata.org/dataset/black-sea-grain-initiative-vessel-movements

Railway transportation. The Government of Moldova has simplified the transit of railway cargo between Moldova and Ukraine. The interstate agreement on railway transportation provides for the elimination of operations of double and, in some sections, triple customs and border control operations. Simplifying the transit of goods by rail through the territory of Ukraine and Moldova will increase the volume of cargo turnover.

Figure 4: Rail freight volumes, m tons



Source: Ukrzaliznytsia

The total queue of wagons as of March 31 was 16,501 wagons. The longest queues are observed at the stations Chop, Uzhgorod, Batyovo, and Izov. On average, 1,987 wagons were handled daily in March.

Road transportation. The opening of traffic on the bridge over the Desna River in the Chernihiv region has allowed for the restoration of the direct connection between Chernihiv and Kyiv.

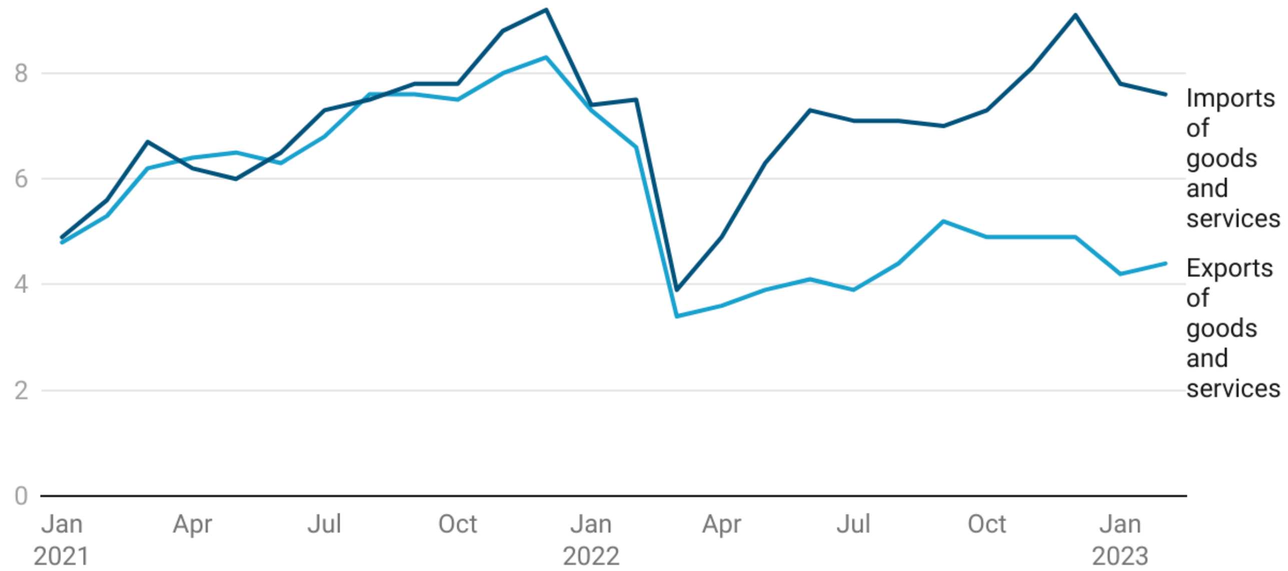
Queues of trucks are still present at the border checkpoints. Businesses report that the queues have stretched for a dozen kilometers, and trucks have to wait for about a week. The Government is negotiating with neighbouring countries to simplify cargo control procedures to reduce the queues.

International trade: Large Trade Deficit in Goods and Services Persists

The large trade deficit in goods and services, which emerged in mid-2022, persists in the first months of 2023. According to the NBU data, in January-February 2023, exports of goods and services amounted to USD 8.7 bn (-38% yoy), while imports reached USD 15.3 bn (+3% yoy). As a result, the negative trade balance in goods and services for the first two months of the year amounted to USD 6.7 bn, compared to USD 1.0 bn a year ago before the full-scale Russian aggression. The expansion of the deficit occurred due to both an increase in the traditional deficit in goods trade and the emergence of a deficit in service trade as the high spending of Ukrainian migrants is included in the services import under the "travel" category, according to the NBU methodology.

International grants inflow was the primary source for deficit coverage. Private remittances from abroad also remained important for counterbalancing the deficit, although their inflow gradually slowed after February 2022. In January-February 2023, Ukraine received USD 1.9 bn in private remittances, 16% less than a year ago.

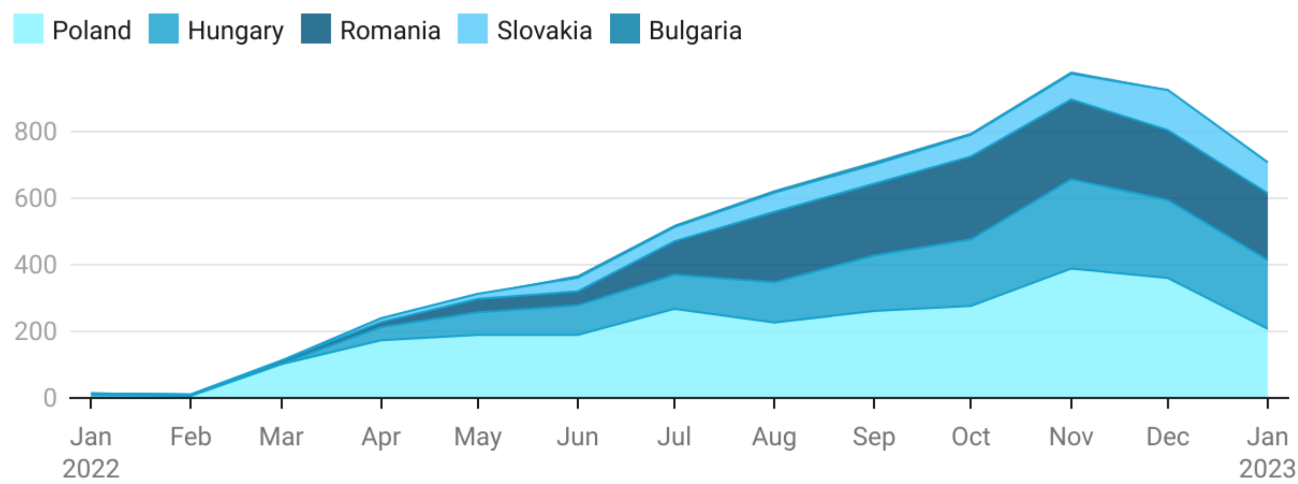
Figure 5: Ukraine's foreign trade in goods and services, 2021-2023, USD bn



Sources: NBU

Exports of grain and other food products remain a crucial topic in foreign trade. In March 2023, the "grain deal" was extended. However, the situation with grain trade with neighbouring EU countries has become more complicated. Polish farmers have been protesting for several months against the excess agricultural production from Ukraine. Recently, Romanian and Bulgarian farmers have also joined the protests. In early April, the European Commission allocated EUR 56 m in subsidies to farmers who suffered losses due to increased competition from Ukrainian grains. However, the leaders of Poland, Romania, Slovakia, Hungary, and Bulgaria are calling for a broader range of actions, including the purchase of excess grain in the EU market for humanitarian purposes, the development of storage and transit infrastructure, the introduction of automatic compensation for farmers, and the possibility of rapid implementation of protective trade measures.

Figure 6: Imports of Ukrainian grain (HS 10) by individual EU countries, thousand tons



Source: Eurostat

At the beginning of April, the situation remained tense. On April 7, Ukraine and Poland agreed to temporarily suspend the import of Ukrainian wheat, rapeseed, corn, and sunflower to Poland until the new season. The parties also announced the development of new transit rules for crops. On

April 10, Hungary announced that it would introduce new measures and stricter control over grain coming from Ukraine.

According to Eurostat data, the physical volumes of EU imports of Ukrainian cereals (HS code 10) doubled in 2022, increasing from 7.9 to 16.0 m tons. Two-thirds of the overall growth (5.5 m tons) went to imports by Poland, Romania, Hungary, Bulgaria, and Slovakia, with Poland importing the largest share (+2.4 m tons in 2022 compared to the previous year), followed by Romania and Hungary (+1.3 m tons each). As a result, the share of these five countries in Ukrainian grain imports among EU countries increased from 1% to 35%. Thus, objectively, these countries did absorb a significant portion of the additional grain flow that Ukraine used to sell to other countries worldwide through seaports. However, the impact of this additional grain influx on neighbouring countries' markets is not apparent. Such excess product supply would be expected to lead to a price drop in the domestic market, but research by the European Commission showed that prices did not decrease; instead, inflation was observed.

State budget: New IMF Program - Part of a USD 115 bn Support Package

IMF: In March 2023, the IMF approved a four-year USD 15.6 bn program for Ukraine. To make this possible, the Fund changed its rules for providing financing, simplifying the issuance of loans to countries in a situation of great uncertainty, including in the case of war. This rule will now apply to all countries, but Ukraine is a pioneer in this new approach.

The program is divided into two stages. Policy measures and 19 structural benchmarks are identified only for the first stage of 2023-2024. Subsequent measures and benchmarks will be determined based on the Program review results. The program aims to ensure fiscal, external, price, and financial stability, supporting Ukraine's economic recovery. The Government has committed to implementing prudent fiscal policies, restoring medium-term budget planning, adopting medium-term strategies for managing public debt and national revenue, strengthening banking supervision, and continuing corporate governance and anti-corruption reforms.

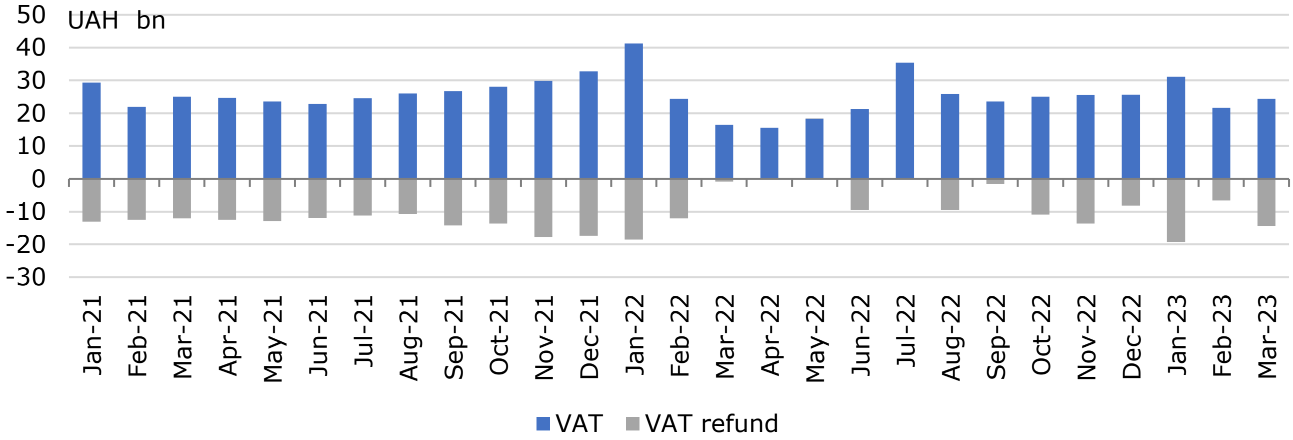
Notably, the IMF program is expected to be part of Ukraine's overall international financial support package for the next four years, totalling USD 115 bn. In addition to assistance from the EU, the US, other countries, and IFIs, this amount includes a deferral of payments on Ukraine's external public debt during the IMF program. The total amount of support corresponds to Ukraine's forecast of the external financial gap, which anticipates only moderate growth in capital investments. It, therefore, does not include expenditures for large-scale recovery. The estimated financial gap from Q2 2023 to Q1 2024 is USD 37.9 bn. Of this amount, USD 14.5 bn is expected to come in the form of concessional loans from the EU and USD 7.4 bn in grants from the US. The IMF is expected to provide USD 5.6 bn, of which USD 2.7 bn was already disbursed in early April. Japan is expected to provide Ukraine with USD 5.5 bn in various forms of assistance. The remaining funds will come from other partners.

The mentioned funding needs do not include financing already received in Q1 2023, including a USD 1.8 bn loan from Canada provided on March 31 for 10 years at an interest rate of 1.5% per annum. Additionally, in the first quarter, Ukraine received USD 4.9 bn in concessional loans from the EU and USD 3.5 bn in grants from the US.

Budget execution: According to the preliminary data from the Ministry of Finance, in March 2023, the revenues of the State Budget amounted to UAH 241 bn, which is twice as much as in the previous year. In particular, revenues from most taxes increased. Revenues from personal income tax increased by 35.8% yoy primarily due to the higher number of military personnel and their increased remuneration. Revenues from import VAT increased by 3.9 times, as in March of the previous year, imports were practically absent due to disrupted supply chains and high uncertainty caused by the full-scale war. However, despite devaluation and high inflation, nominal revenues from import VAT were lower than the March 2021 figure, according to the estimates of the customs service. This reflected legislative changes that reduced budget revenues and decreased physical volumes of imports.

Net domestic VAT decreased compared to the previous year when VAT refunds were almost absent. In March 2023, VAT refunds amounted to UAH 14.4 bn after some decrease in February. Meanwhile, gross revenues from domestic VAT increased by 48.6% yoy due to higher consumption and inflation. Revenues from excise tax also increased rapidly.

Figure 7: Domestic VAT



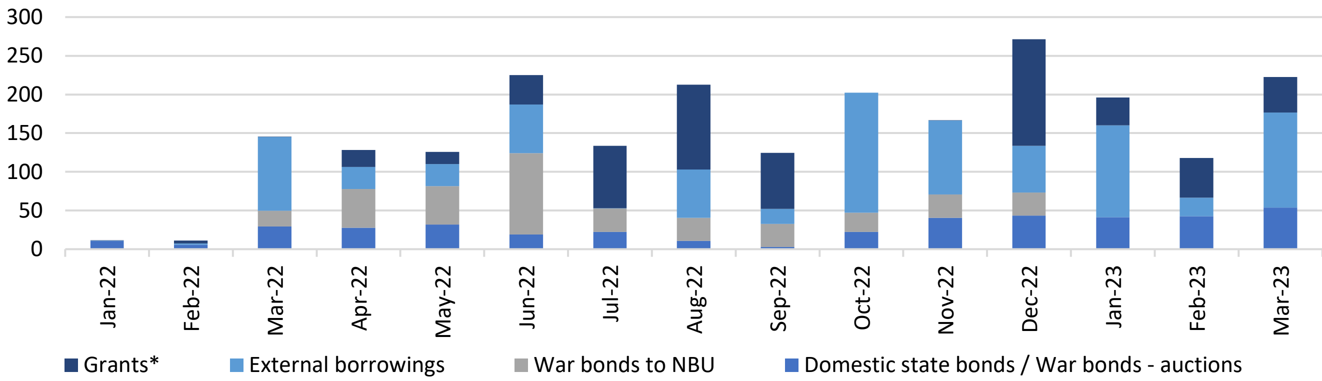
Source: Ministry of Finance, openbudget.gov.ua

Income from corporate profit tax (CPT) was almost at the level of March 2022, although for the first quarter, it decreased by 3.6% yoy. This is quite an unexpected result considering the decrease in revenues of many companies due to military actions. However, some companies reported profits and paid CPT to the budget. According to published financial statements, the most profitable companies were in the energy sector and fuel sales. Still, among the leaders in terms of profits was the agricultural holding "Kernel".

In March, Ukraine received a traditional grant from the USA equivalent to UAH 45.8 bn, which was accounted as part of budget revenues. This contributed to a reduction in the actual deficit of the state budget compared to the planned level. In addition, the deficit was lower due to the under-execution of planned expenditures. According to the Ministry of Finance, cash expenditures of the state budget in the 1st quarter amounted to 88.7% of the planned amount for this period. As a result of these two factors, the state budget deficit for the first quarter amounted to UAH 220 bn or 47% of the planned level.

The deficit was financed primarily through borrowings from the EU, Canada, and domestic government bonds (OVDP) placements. The coordination of policies between the NBU and the Ministry of Finance contributed to the raising of funds in the domestic market of almost UAH 138 bn: the NBU allowed commercial banks to include up to 50% of benchmark domestic government bonds in mandatory reserves and the Ministry of Finance places such papers among other issuances.

Figure 8: Funding and grants received due to the state budget, UAH bn



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

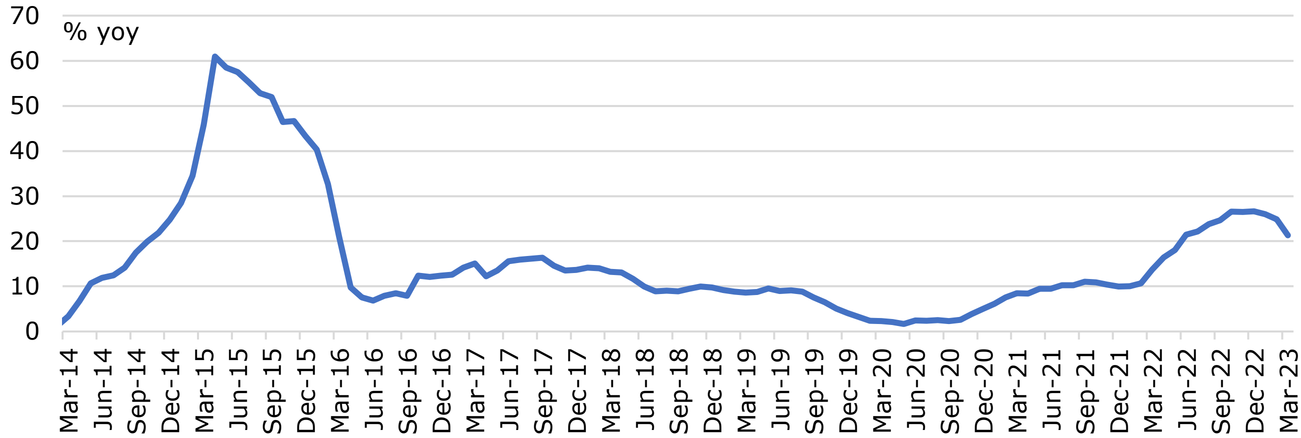
Pensions. In March, the Government indexed pensions using an indexing coefficient of 1.197. The recalculation of pensions affected 10.5 m people and was carried out under several pension laws. The average increase in pensions was UAH 579, and the average pension after indexing reached UAH 5220 per month. The increase in pensions will be financed by the approved transfer from the State Budget and revenues from the Single Social Contribution. The Government currently does not plan to increase the transfer to the Pension Fund this year.

Inflation: Inflation will slow down until at least June

In March, inflation slowed down to 21.3% yoy compared to 24.9% yoy in February. Year-on-year inflation is likely to slow down at least until June due to high price growth in the early months of the full-scale war in 2022. At that time, prices increased primarily due to disruptions in regular supply chains and increased costs for alternative routes. Over time, these months will not be considered in calculating consumer price growth for the last 12 months.

Monthly consumer price growth compared to the previous month (mom) exceeded 1% for the first time since last October and reached 1.5% mom. However, this was due to seasonal price increases for clothing and footwear. Since March, the State Statistics Service has begun to include spring clothing and footwear in the consumer price index instead of recording falling prices for winter models during the winter season. Excluding these fluctuations, monthly inflation would remain within 1%. As before, low consumer demand and the absence of external price pressure restrained price growth. At the same time, costs for producers and sellers of consumer goods remained high and were not fully reflected in consumer prices.

Figure 9: Consumer price inflation



Source: State Statistics Service

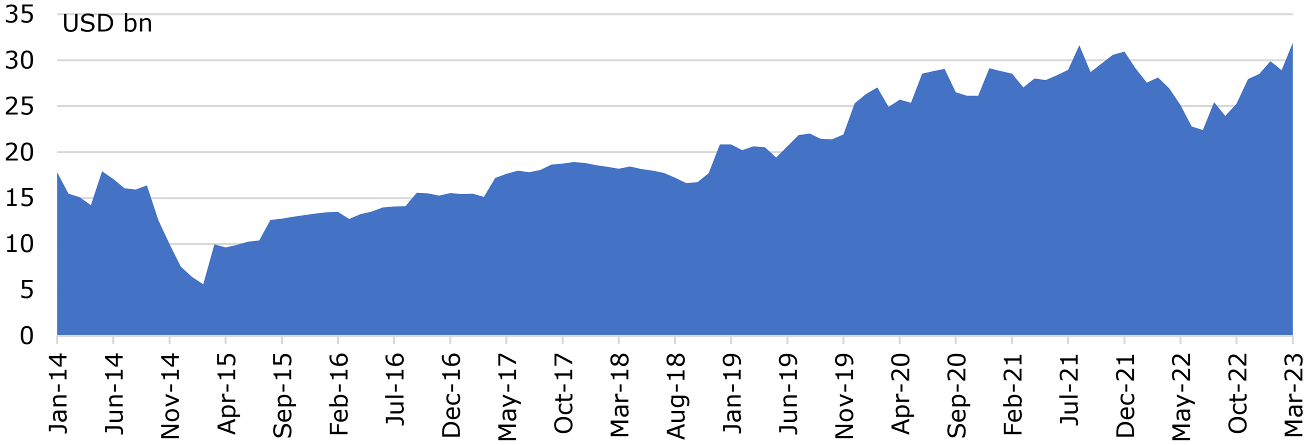
In March, vegetable prices continued to rise (increased by 42% over the first three months of 2023) due to insufficient long-term storage facilities. At the same time, fuel prices remained low due to significant stocks at gas stations (down 10% compared to December 2022). However, in July, fuel prices will likely increase after the planned restoration of pre-war excise and VAT rates.

Monetary policy: The NBU continued its efforts to raise deposit rates.

At the March meeting on monetary policy, the NBU kept the key policy rate at 25% but announced further changes regarding reserve requirements for banks and changed its approach to operations with deposit certificates. The NBU is seeking new approaches, as there remains a significant gap between the key policy rate and deposit rates. The average rate for new household deposits in February was 6% per annum, reflecting both a high share of demand and short-term deposits and low rates for longer-term deposits (11% p.a. for deposits of one year or more and 8-9% for deposits of 3 months to 1 year).

As a result, starting from May 11, reserve requirements for time deposits will cover only deposits with a term of 91 days or more, and short-term deposits will be subject to reserve requirements at the same level as demand deposits. In addition, as of April 7, the NBU lowered the overnight deposit rate from 23% p.a. to 20% p.ac. In addition to "sticks," the NBU also applied "carrots" to increase banks' deposit rates, this time by resuming the placement of three-month deposit certificates at the key policy rate of 25% per annum. The sum that banks can place at a more favourable rate is tied to the amount of deposits attracted for a term of 91 days or more and the growth rates of such deposits in banks' portfolios. In the first tender on April 7, 45 banks placed UAH 51 bn for 91 days. At the same time, banks continue to place over UAH 300 bn in overnight NBU deposits, and the growth of the Ukrainian index of retail deposit rates remains moderate. However, revising the deposit policy in response to NBU novelties may require time, so that we may see changes in the coming months.

Figure 10: International reserves



Source: NBU

The NBU's international reserves reached USD 31.9 bn at the end of March, compared to USD 28.9 bn at the end of February. This reflected the largest inflows from donors in recent months. According to the NBU data, the Government attracted USD 3.91 bn in net terms to the international reserves. In March, funds were received from Canada, the EU, and the United States, and payments were made for loans from the World Bank and the IMF. Interventions to support the fixed exchange rate of the hryvnia decreased to USD 1.67 bn in March, which is one of the lowest levels since the start of the full-scale war, likely reflecting the narrowing gap between the cash and non-cash exchange rates of the hryvnia and higher export revenues in March.

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