

# Latest developments in Ukraine

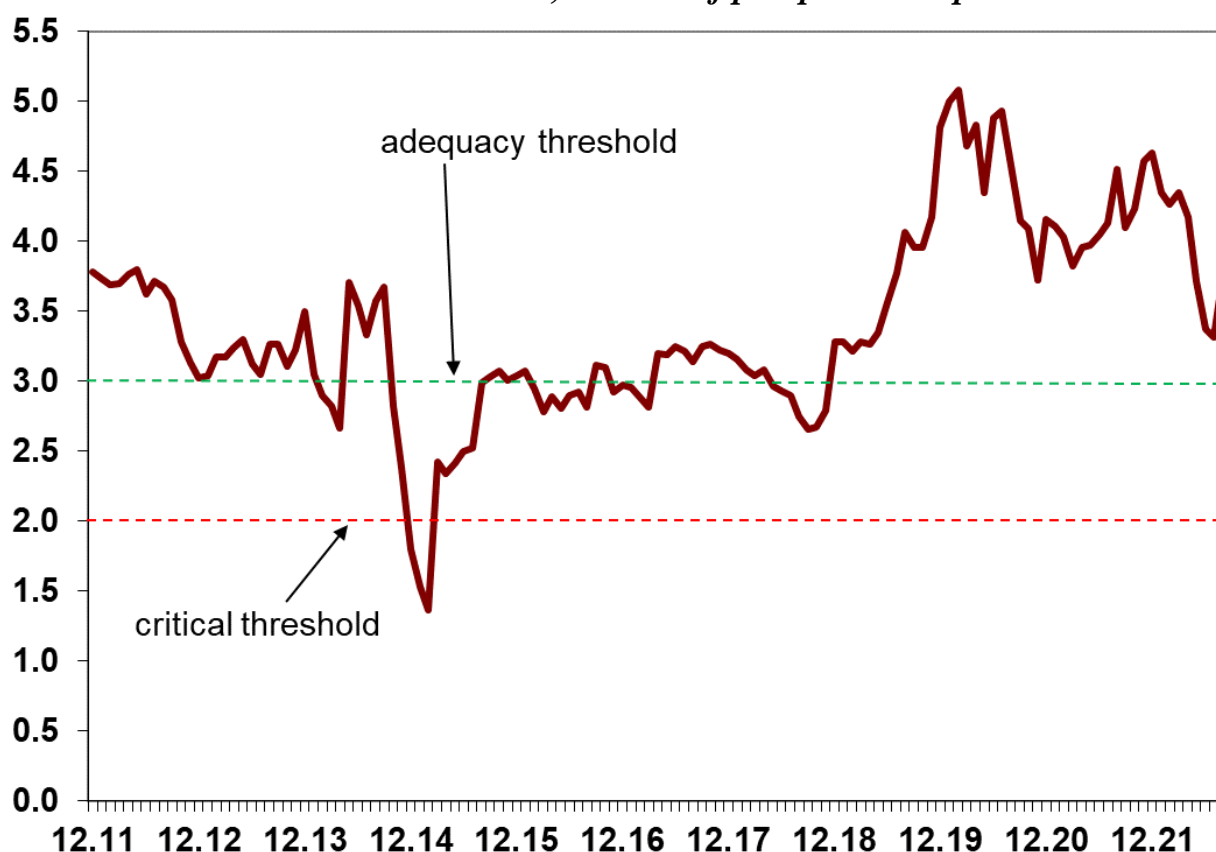
Oleksiy Blinov, Head of Research

26 September 2022



**Increased foreign financing boosts FX reserves.** In August, international reserves of the National Bank of Ukraine grew USD 3.05 bln (13.6% MoM) to USD 25.4 bln. This was due to USD 4.7 bln inflow on external fiscal financing (including USD 3 bln from the USA and EUR 1 bln from the EU). According to our estimates, FX reserves increased to 3.8 months of prospective imports.

## *International reserves in 2011-2022, months of prospective imports*



Sources: NBU, Alfa-Bank Ukraine

Soon, Ukraine is expected to receive another EUR 5 bln loan from the EU. This installment should expand international reserves to over USD 29 bln, which corresponds to their pre-war level (or 4.4 months of prospective imports). This should reinforce the central bank's ability to maintain stable exchange rate till the end of 2022.

**About 7.5% of pre-war GDP deactivated by invasion.** In a [recent research](#), we have attempted to evaluate losses in GDP production function incurred by war-related damage or occupation. We have evaluated this loss at 7.5% (*see table overleaf*), with most of respective assets potentially recoverable by liberation of occupied territories and damage repairs.

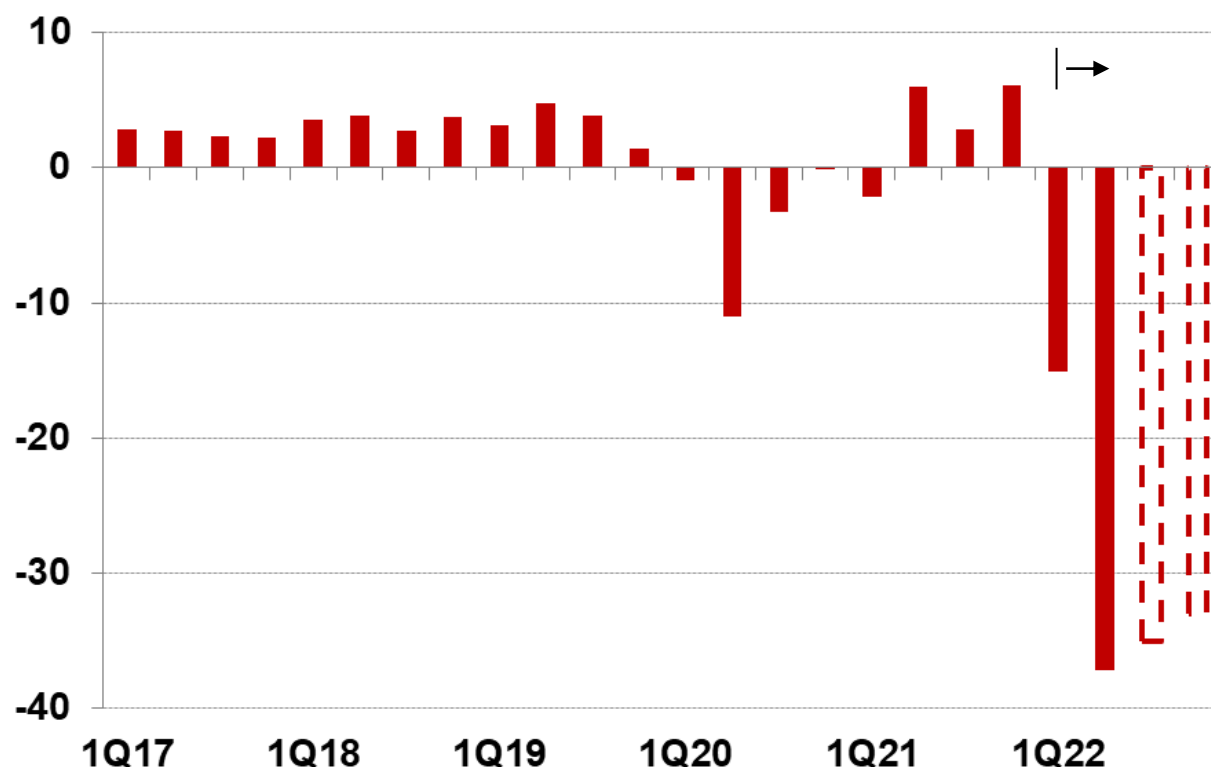
**Contributions to production function loss in 2022, p.p.**

Sectors	Recoverable	Damaged, recoverable	Non-recoverable	Total
<b>Primary sectors</b>				
Agriculture	2.0	0.2	—	<b>2.2</b>
Extraction industries	0.3	—	0.0	<b>0.3</b>
<b>Secondary sectors</b>				
Food processing	0.2	0.1	0.0	<b>0.3</b>
Steel production	—	0.6	0.6	<b>1.2</b>
Other manufacturing	0.2	0.3	0.1	<b>0.6</b>
Power sector	1.1	0.0	—	<b>1.1</b>
<b>Tertiary sectors</b>				
Construction	0.1	0.0	0.0	<b>0.1</b>
Trade	0.4	0.2	0.1	<b>0.7</b>
Transportation	0.3	0.1	0.1	<b>0.5</b>
Other services	0.2	0.0	0.0	<b>0.3</b>
<b>Total</b>	<b>4.8</b>	<b>1.6</b>	<b>1.1</b>	<b>7.5</b>

Source: Blinov, Djankov “Assessment of damages to Ukraine’s productive capacity”

**The economy plunged 37% YoY in the second quarter.** That was very likely the deepest point, judging by many indicators. However, one should not expect a steep recovery in the second half of 2022, especially when record-high harvest in agriculture of 2021 is the baseline. We maintain our forecast for a 33% decrease in 2022.

**Ukraine’s GDP in 2017-2022, % real change YoY**



Sources: State Statistics Service, Alfa-Bank Ukraine

**Baseline forecast for 2023: economic recovery at 6%, slower inflation, possibility for interest rate reversal.** In this report, we introduce macroeconomic forecast for 2023 (see table at the end). We pencil real GDP growth of 6% next year. While that might seem somewhat optimistic, it is not. The forecasts rests on the assumption that

war would drag on into the next year. Growth of 6% after a decline of 33% would in the end still constitute a 29% plunge to 2021.

We expect a slight slowdown in CPI next year: from average annual of 20.4% in 2022 to 18% in 2023. This might allow the central bank to start cautiously decreasing its prime rate in the second half of 2023.

**The government submit 2023 State Budget (in fact, more of its idea than rigid finance) to the parliament.** Before analyzing the document, it is worth stressing that the budget was drafted under unprecedented uncertainty. It is still hard to predict where key parameters of the 2022 State Budget would end up, not to speak about the next year. Thus, MinFin has placed a good deal of leeway into its fiscal framework for the next year.

The macroeconomic forecast accompanying the draft law includes 4.6% real GDP growth in 2023, inflation at another 30% and end-2023 exchange rate of USD/UAH 50 (with average annual rate of USD/UAH 42.20). All these parameters are debatable, but hardly shocking. Nominal GDP growth of 36.7% projected by the government is the key reference for comparing revenue and expenditure.

#### ***Key State Budget features, UAH bln***

	<b>2022 pre-war</b>	<b>2022 current law</b>	<b>2023 draft law</b>	<b>Change in 2023</b>
<b>Revenue, including:</b>	1,322	1,553	1,279	-17.6%
VAT on imports	405	429	368	-14.3%
Corporate profit tax	158	170	132	-22.4%
Profits from state-owned companies	49	113	7	-93.5%
International transfers, grants	1	131	0	-99.8%
<b>Expenditure, including:</b>	1,498	2,648	2,514	-5.1%
Defense	136	633	870	+37.5%
Pension Fund financing transfer	201	253	233	-7.9%
State debt servicing	181	184	326	+76.9%
Reserve Fund	2	204	17	-91.5%
<b>Balance, covered by:</b>	-189	-1,108	-1,280	+15.5%
External borrowing	151	695	1,596	+129.8%
Local borrowing	420	796	91	-88.6%
<b><i>Memorandum:</i></b>				
Average annual minimal wage, UAH	6,550	6,550	6,700	+2.3%
Average annual minimal pension, UAH	1,986	1,986	2,093	+5.4%

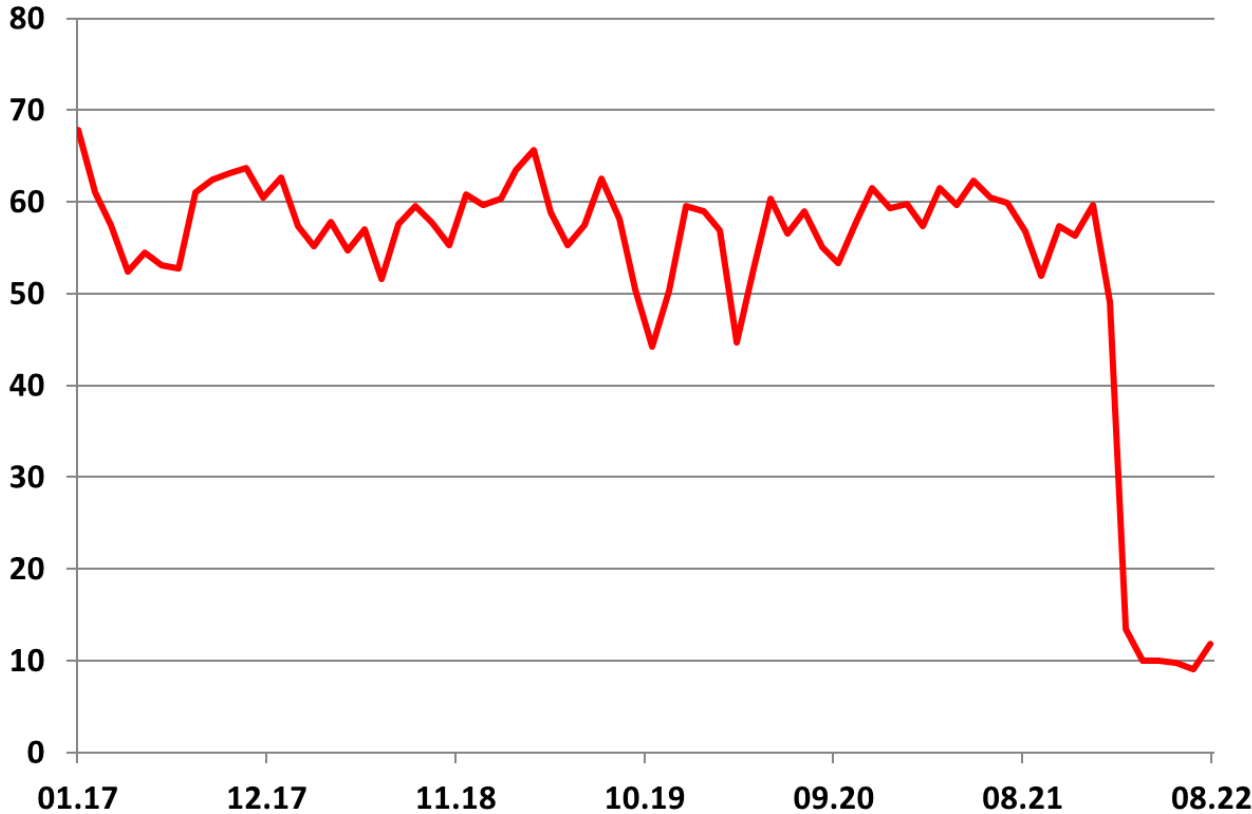
*Sources: legislation, draft law on State Budget for 2023, Alfa-Bank Ukraine*

It is important to stress that actual 2022 fiscal indicators are likely to deviate significantly from the current law, meaning many 2023/2022 comparisons in the *table below* are rather tentative. There are two key ideas behind the draft budget. First, the war remains of utmost importance. Security and defense expenditures (including Police and National Guard) are planned at over UAH 1 trln, and multiple hidden reserves in the Budget (like bloated debt service costs, a usual trick by MinFin) are to serve that cause.

Second, drafters of the State Budget for 2023 were obviously tasked with maximizing the external financing check, sending it to USD 38 bln. Out of that, according to MinFin, the US should cover USD 18 bln, the IMF another USD 15 bln, while the others (including the EU) are expected to come up with the remaining USD 5 bln. We expect the actual deficit to be lower, but the official request should have been sent, and the budget law is the best for such kind of message.

**Steel output rebounds in August, but still only 20% of 2021.** According to a flash estimate by UkrMetalurgProm, total average daily steel output increased to 11,800 tonnes (an increase of 30% MoM, decrease of 80% YoY).

*Average daily steel output in 2017-2022, '000 tonnes*



*Sources: UkrMetalurgProm, Alfa-Bank Ukraine*

**Inflation accelerates further.** The Consumer Price Index (CPI) added 1.1% MoM in August, accelerating annual CPI growth further to 23.8% YoY. We maintain our end-2022 CPI growth forecast at 28%.

## *Inflation in August 2022*

Goods and services	MoM price growth, %	MoM contrib. to CPI growth, p.p.	YoY price growth, %	YoY contrib. to CPI growth, p.p.	Recent trend*	Share in CPI basket, %
Foodstuffs, including:	0.7	0.3	30.7	13.3	↑	43.6
bread and grain products	1.1	0.1	37.9	<b>2.9</b>	↑	7.6
meat and products	3.0	<b>0.3</b>	20.3	<b>2.2</b>	↑	10.7
fish and products	3.7	0.1	37.0	1.0	↑	2.8
eggs	15.4	0.1	5.8	0.0	↑↑	0.8
sunflower oil	-0.3	-0.0	8.9	0.1	→	1.1
fruit	4.8	0.1	28.4	0.9	↑	3.1
vegetables	-13.9	<b>-0.5</b>	112.4	<b>4.0</b>	↑↑	3.5
sugar	6.4	0.0	22.3	0.2	↑	0.7
Tobacco and alcohol	1.2	0.1	20.9	<b>1.7</b>	↑	8.2
Clothes and footwear	-2.0	-0.1	-1.6	-0.1	↑	5.0
Utilities, including:	0.8	0.1	3.9	0.3	→	8.4
electricity	0.0	0.0	-7.4	-0.1	→	1.6
natural gas	0.0	0.0	3.7	0.1	↓	2.3
Household items	5.0	0.2	21.6	1.0	↑↑	4.5
Healthcare	2.9	0.2	16.9	1.2	↑	7.2
Transportation, incl.:	0.8	0.1	40.4	3.7	↑	9.3
gasoline	-3.9	-0.1	68.1	<b>1.9</b>	↑	2.8
Other	—	0.2	—	2.7	—	13.8
<b>CPI</b>	<b>1.1</b>	<b>1.1</b>	<b>23.8</b>	<b>23.8</b>	↑↑	<b>100.0</b>
<b>Core CPI</b>	<b>2.1</b>	—	<b>19.1</b>	—	↑↑	—

\* arrow up means acceleration in YoY terms over the last 3 months,  
 arrow down means deceleration

Sources: State Statistics Service, Alfa-Bank Ukraine

**Recent sovereign debt operations and upcoming payments schedule**

	New debt	Payments	
		Amortization	Interest
15 August	EUR 200 mln	—	—
16 August	UAH 72.1 mln	—	—
17 August	—	—	UAH 932 mln
18 August	CAD 450 mln	—	—
19 August	UAH 5,000 mln*	—	—
22 August	UAH 25,000 mln*	—	—
23 August	UAH 292 mln	—	—
24 August	—	—	UAH 1,567 mln
26 August	—	UAH 15,722 mln	UAH 877 mln
30 August	UAH 327 mln + USD 48.3 mln + EUR 50 mln	—	—
31 August	—	—	UAH 3,379 mln
02 September	—	—	UAH 135 mln
05 September	UAH 15,000 mln*	—	—
06 September	UAH 47.6 mln	—	—
07 September	—	UAH 1,715 mln	UAH 707 mln
12 September	UAH 15,000 mln*	—	—
13 September	UAH 188 mln + EUR 33.8 mln	SDR 295.5 mln**	—
14 September	—	—	UAH 272 mln
16 September	—	SDR 59.7 mln***	—
20 September	UAH 281 mln + USD 12.3 mln	SDR 125 mln***	—
21 September	—	—	UAH 1,063 mln
26 September	—	—	UAH 313 mln
27 September	<i>placement</i>	—	—
28 September	—	—	UAH 1,042 mln
29 September	—	—	USD 2.1 mln
04 October	<i>placement</i>	—	—
05 October	—	SDR 61.2 mln***	UAH 383 mln
06 October	—	—	USD 6.5 mln
11 October	<i>placement</i>	—	—
12 October	—	UAH 14,994 mln	UAH 1,642 mln
13 October	—	USD 142 mln	—

\* NBU purchase of war bonds

\*\* debt to the IMF: MinFin pays 54%, NBU the remaining 46%

\*\*\* debt to the IMF, paid fully by the NBU

Sources: Ministry of Finance, IMF, Alfa-Bank Ukraine

***Economy-related legislation voted in Verkhovna Rada over last 4 weeks***

<b>Draft Law No.</b>	<b>Content</b>	<b>Status</b>
0165	EEC/EFTA Convention on the Simplification of Formalities in Trade in Goods	Ratified
0166	EEC/EFTA Convention on a Common Transit Procedure	Ratified
3663	Consolidates administration of social security funds	Approved
5322	Amendments to regulations of the energy market	1st reading passed
5616	On protection of geographical indications in food&agriculture	Approved
5795	Eases employment of foreigners and people with no citizenship	Approved
6067	Provides stimulus for employers to hire long-term unemployed	Approved
6120	Increases frequency for payroll reports from quarterly to monthly	1st reading passed
6245-d	Amendments to legislation on audit	Approved
6320	Streamlines rules on provision of ultimate beneficial owner data to state company registers	Approved
6458	On facilitating reconstruction of old housing	1st reading passed
7532	Amendments to legislation on agricultural land circulation	1st reading passed
7559	Allows for additional sources of financing international aviation commitments of Ukraine	1st
7588	Reforms state-owned companies that have 100 hectares of land and more into limited-liability companies	1st reading passed
7616	Amendments to regulations on fisheries and aquaculture	1st reading passed
7632	Exempts war-zone real estate from taxation	1st reading passed
7636	Restores pre-war settings for agricultural land registers	1st reading passed
7649	Widens options for voluntary pension contributions	1st reading passed
7655	Changes corporate profit tax rules for foreign currency cash exchange business (introduces monthly advance payment per outlet linked to minimum wage)	1st reading passed
7668-d	Restores excise taxes for fuel (EUR 100 per 1,000 liters for gasoline and diesel fuel, EUR 52 per 1,000 liters for LPG)	Approved
7669	Amendments to the State Budget for 2022 (restores clause that allows for road construction spending)	Approved
7681	Amendments to the State Budget for 2022 (expenditures increased by another UAH 12.7 bln to finance natural gas purchases)	Approved
7683	Amends taxation rules for the construction sector	Approved
7685	Delays ban for placement of advertising at historical sites till 1 January 2023	Approved
7732	Changes to taxation base for natural gas extraction rent	Approved

*Sources: Verkhovna Rada, Alfa-Bank Ukraine*

### ***Ukraine: key macroeconomic indicators***

	<b>2020</b>	<b>2021</b>	<b>2022f</b>	<b>2023f</b>
GDP, UAH bln	4,222	5,460	4,682	6,204
GDP, USD bln	155.8	200.9	144.6	152.6
GDP, % real change	-3.8	3.4	-33.0	6.0
Industrial output, % real change	-4.5	1.9	-37.0	8.0
CPI, % average annual change	2.7	9.4	20.4	18.0
CPI, % change Dec/Dec	5.0	10.0	28.0	16.5
Average wage, USD	430	514	490	452
Average wage, % real change	7.4	10.5	-6.6	-0.5
Consolidated Budget balance, % of GDP	-5.3	-3.4	-21.0	-14.5
Public debt (incl. guarantees), % of GDP	60.4	48.9	91.2	88.6
Net FDI inflow, USD bln	-0.1	6.9	1.8	4.5
Current account balance, % of GDP	3.4	-1.6	3.7	0.9
FX reserves, USD bln at year-end	29.1	30.9	26.4	23.0
USD/UAH rate, annual average	26.96	27.29	32.28	40.65
NBU key policy rate, % (annual average)	7.9	7.5	18.7	23.2

*Sources: State Statistics Service, National Bank of Ukraine, Ministry of Finance, forecast by Alfa-Bank Ukraine*

*This report was prepared and issued by Alfa-Bank. Any information in this report is based on data obtained from public sources considered to be reliable, but no representations or guarantees are made by Alfa-Bank with regard to the accuracy, completeness or fairness and such information has not been independently audited and verified. The opinions and estimates contained herein constitute our best judgment as of the date of this report, and are subject to change without notice. This report is for information purposes only; it is not intended to be and should not be construed as a business offer or solicitation. Alfa-Bank, all its offices, employees of shareholders disclaim all responsibility or liability whatsoever for any expense, loss or damages incurred directly or indirectly out of, or in any way connected with, the use of all or any part of this report.*