MARKET REVIEW: UKRAINE

A LIMITED RECOVERY

In 2021, Ukraine's economy saw moderate upside. Among key growth drivers, the easing of pandemic restrictions unleashed pent-up domestic demand and global commodity markets supported exports. Amid these broader trends, consumption of the country's steel and iron ore products rose.

MODERATE GROWTH

In 2021, Ukraine's economy saw a reversal of the previous year's negative performance. Overall, real GDP expanded by 3.4% year-on-year after declining by 3.8% in 2020. At the same time, nominal GDP rose to a historic high in dollar terms of US$200 billion, compared with US$157 billion a year ago.

The recovery was driven by improved domestic household demand amid the relaxing of pandemic restrictions. It was also led by record harvests of grain and oilseeds, as well as favourable export markets. In addition, it was aided by the government's sizeable road infrastructure programme. In year-on-year terms, industrial output edged up by 1.9%[1], gross fixed investments increased by 7.5%[1] and the grain harvest rose by 32.5%[1].

Inflation accelerated in 2021, with the annual CPI reaching 9.4% compared with 2.7% a year before. This was above the National Bank of Ukraine (NBU)'s target range of 4-6%, primarily due to food and energy price inflation. This inflationary pressure led the NBU to begin monetary tightening, progressively hiking its key interest rate to 9.0% in December 2021, compared with 6.0% a year earlier.

Though the national currency appreciated throughout most of the year, the trend reversed in November and December 2021. Overall, the average hryvnia rate against the US dollar depreciated by 1.2% year-on-year to 27.29 in 2021, compared with 26.96 in 2020. Coupled with the strong nominal GDP in US dollars, the GDP growth saw the ratio of public debt to GDP drop to 49%, compared with 61%[2] in 2020.

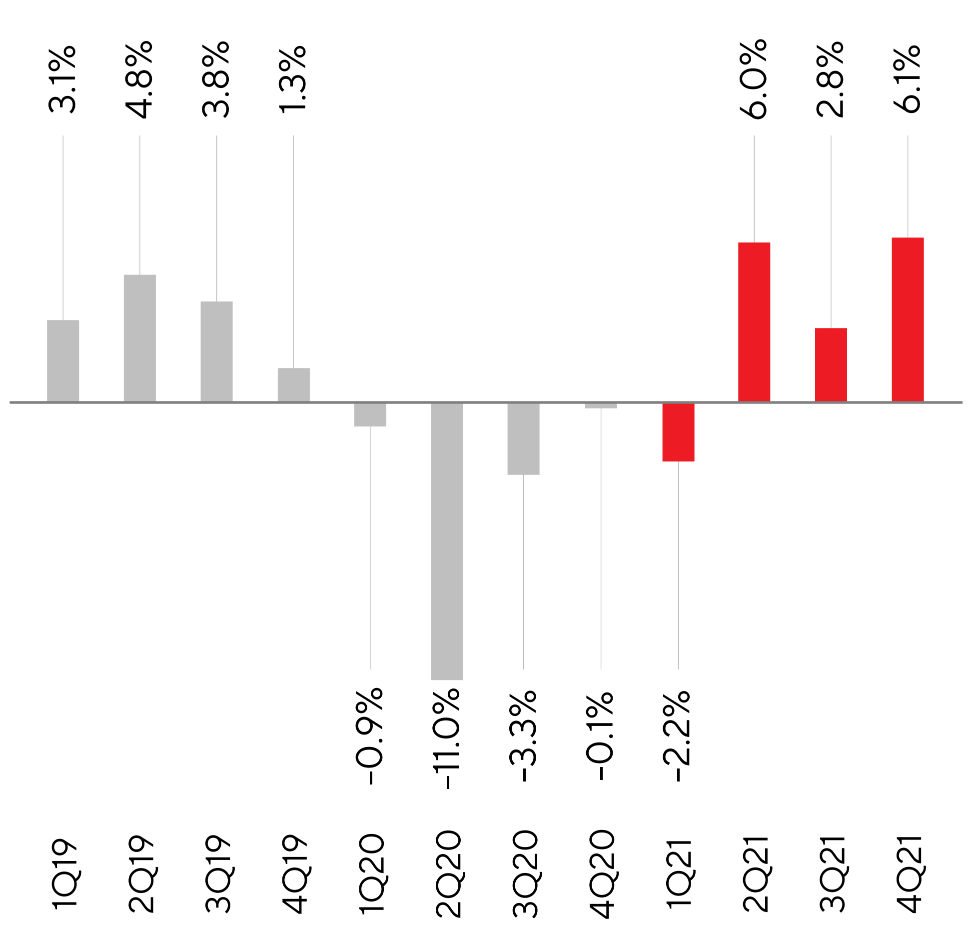
Although Ukraine's budget deficit fell to 3.4%[2] in 2021, down from 5.3%[2] in 2020, amid an increase of 20.7%[2] in budget revenues, external financing remained an important source of support. After a delay of more than a year, the country completed the review of the IMF programme. In November 2021, the IMF released a second, US$0.7 billion tranche under the US$5.0 billion Stand-By Arrangement.

According to the Ministry of Finance of Ukraine, the government's net borrowings in the year amounted to US$4.2 billion domestically and US$3.5 billion internationally. Funding was provided by several international institutions, including the EU, IMF, World Bank, European Investment Bank and European Bank for Reconstruction and Development. Ukraine also used the favourable environment on international debt capital markets in 2021 to issue US$1,250 million (with additional tap issuance of US$500 million on top) in 8.1-year Eurobonds with a coupon of 6.876% per annum. This is the lowest US-dollar denominated coupon achieved by the sovereign in international capital markets since 2011.

Amid prudent monetary policy and debt management, the NBU increased its international reserves by 6.2% year-on-year to US$30.9 billion as of the year-end.

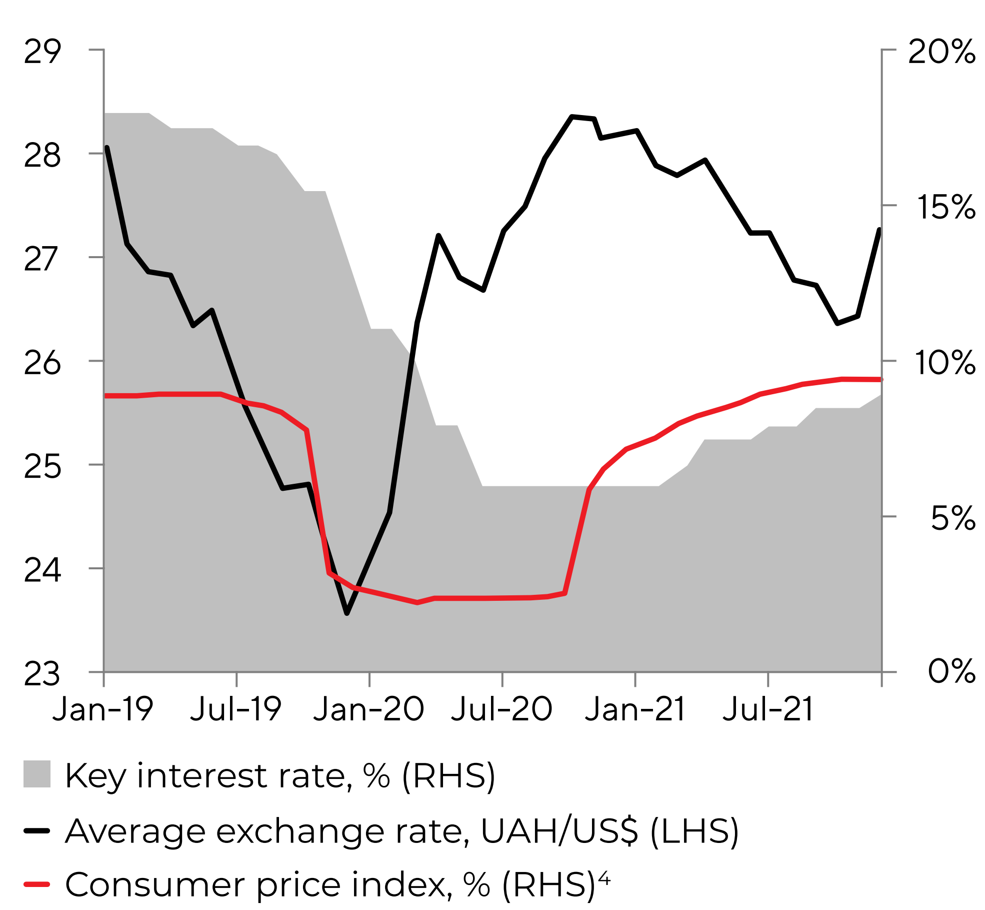
At the end of 2021, Ukraine's sovereign credit ratings from international agencies Fitch and S&P remained aligned at 'B'. Moody's had a rating of 'B3' for the country. The outlook on all three ratings was 'stable'.

Real GDP dynamics[3]



Source: State Statistics Service of Ukraine

Monetary policy



Source: State Statistics Service of Ukraine, NBU

1 State Statistics Service of Ukraine.
2 Ministry of Finance of Ukraine, State Statistics Service of Ukraine.
3 Percent change over the corresponding quarter of the previous year.
4 For CPI, the year-on-year change is for the corresponding cumulative monthly periods since the beginning of the year.

FOLLOWING THE UPWARD TREND

In 2021, Ukraine's traditionally export-oriented steel and iron ore industries followed the global and domestic economic growth trends.

Apparent steel consumption (excluding pipes) in the country climbed by 6.4% year-on-year to 5.7 million tonnes. This was driven by greater construction activity (up 6.8%), machinery output (up 8.5%), pipe production (up 11.3%) and metalware output (up 9.3%). In response to stronger local and export demand, domestic steelmakers increased their crude steel production by 3.6% year-on-year to 21.4 million tonnes.

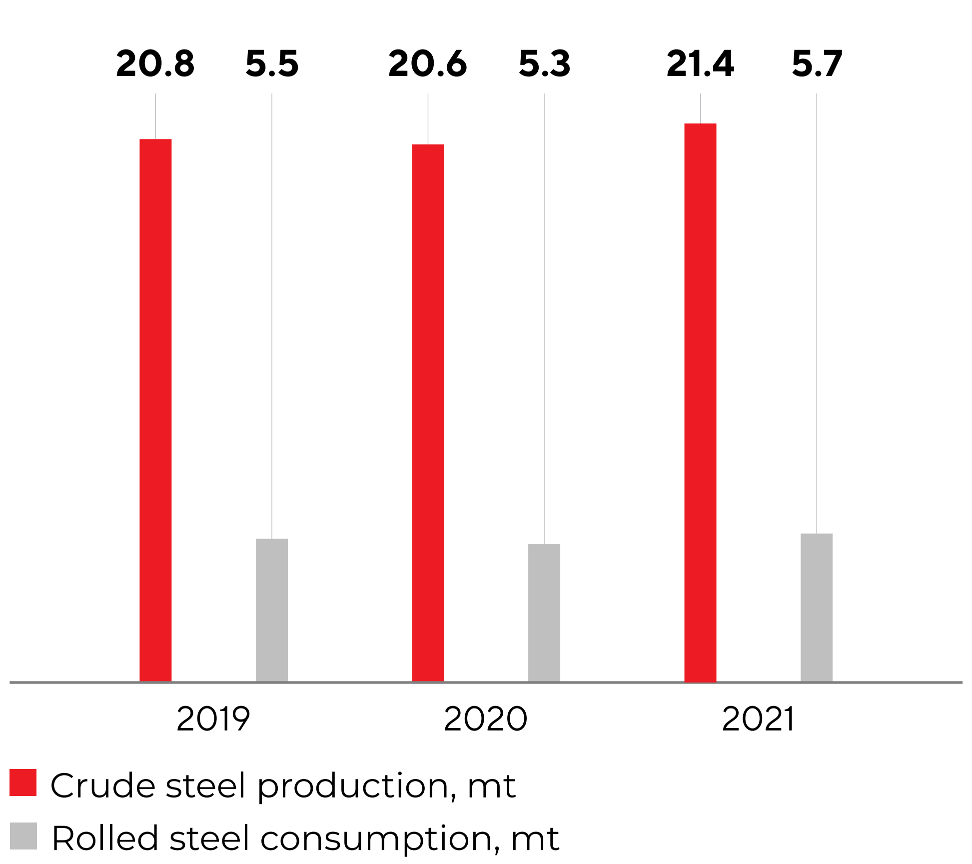
Metinvest followed these trends. It boosted crude steel production by 15.3% year-on-year to 9.5 million tonnes, lifted by the acquisition of new assets in Kamianske and greater output at its steel plants in Mariupol. The Group also increased sales volumes of flat and long products in Ukraine by 6.0% year-on-year.

Greater hot metal output in the country and favourable steel and iron ore export markets spurred the iron ore industry. According to the Group's estimates based on UEX data, Ukraine's merchant iron ore product output and consumption rose by 4.3% and 2.6% year-on-year to 78.8 million tonnes and 33.1 million tonnes, respectively. Metinvest, being the largest iron ore producer in the country, also increased its iron ore concentrate output by 2.8% year-on-year to 31.3 million tonnes.

Ukraine's coking coal production increased by 3.7% year-on-year to 7.2 million tonnes[5]. This was mostly caused by output growth at several state-owned mines, as well as an increase at Metinvest's Pokrovske Coal. As a result, the share of coking coal imports in domestic consumption decreased by one percentage point to 72%[6].

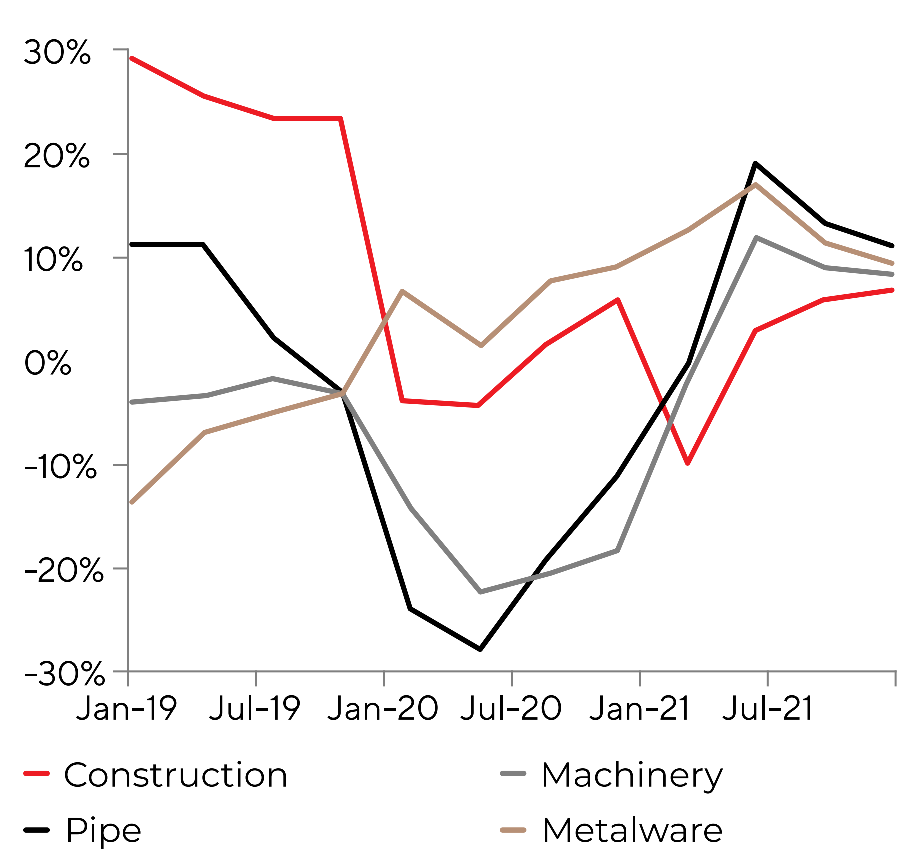
5 Ministry of Energy of Ukraine.
6 Ukrainian Coke Producers' Association.
7 All indexes represent the cumulative index from the beginning of the respective year, year-on-year change.

Steel industry in Ukraine



Source: World Steel Association, Metal Expert

Key steel consuming sectors[7]



Source: State Statistics Service of Ukraine, Metal Expert

WAR IMPACT

The war has fundamentally changed life in Ukraine. While Russian troops initially occupied northern regions of the country and reached the Kyiv suburbs, they were later repelled from there. At the time of writing, active conflict is ongoing, primarily in southern and eastern regions, while some territories remain temporarily occupied. Unfortunately, both civilian and military casualty numbers are likely to continue to rise.

The impact on the people of Ukraine has been profound. Of an average population of roughly 41 million[8] in 2021, about 6.2 million[9] have fled as refugees to other European countries. Ukraine also has more than 6.3 million[9] internally displaced people.

The damage to Ukraine's assets and physical infrastructure has been extensive. Russia has blocked or occupied key seaports, while the limited railway capacity with Western countries has been unable to completely replace seaborne throughput. This has prevented most seaborne imports and exports. The latter include agricultural crops, oils, steel and iron ore, which represent a significant portion of the country's export revenues. In July 2022, the UN brokered an agreement to enable exports of Ukrainian grain and related foods via three Black Sea ports in the Odesa region. It remains to be seen whether such maritime traffic will be sufficient to achieve meaningful export volumes.

In terms of key economic developments, the IMF estimates[10] that real GDP could fall by as much as 35% year-on-year in 2022. The state budget is experiencing a deep deficit amid falling budget revenues and a major increase in military expenses. Ukraine needs significant external financial support to cover its balance of payments and budget needs. To maintain economic resilience, the NBU has imposed several capital control restrictions, including fixing the official hryvnia exchange rate against the US dollar and suspending its inflation targeting regime.

The Ukrainian steel and iron ore mining industries have also been affected materially. Most steel mills halted production in March 2022 to preserve equipment and ensure the safety of personnel. As of August 2022, key mills outside Mariupol have resumed operations, albeit at reduced volumes. Iron ore producers had to scale back operations, mainly because of lower local demand and logistical constraints on exports.

Following the Russian invasion, all three international rating agencies downgraded their sovereign credit ratings for Ukraine. As of 1 August 2022, S&P's rating was 'CC', the outlook 'negative'; Moody's assessment was 'Caa3', the outlook 'negative'; and Fitch's rating stood at 'C'.

This is undeniably the greatest challenge that Ukraine has faced since gaining independence. The situation remains highly unstable and war is inherently unpredictable. The courage of the people of Ukraine and support of the international community are vital to the country's ability to withstand this attack on its sovereignty.

8 State Statistics Service of Ukraine.
9 As at 22-29 July 2022, according to the UN High Commissioner for Refugees.
10 As at April 2022.