Key macroeconomic developments in Ukraine:

	2021	2022	2023f	2024f	2025f
Real GDP (% yoy)	3.4	-28.8	5.3	3.4	6.5
Private consumption (% yoy)	6.9	-26.7	6.3	6.7	8.0
Gross fixed capital formation (% yoy)	9.3	-33.9	52.9	10.0	7.8
Unemployment (avg, %)	9.1	18.0	15.0	12.0	9.0
Current account balance (% of GDP)	-1.9	4.9	-5.5	-7.4	-7.6
EUR/UAH (eop)	31.0	39.2	42.2	44.4	47.6
CPI inflation (avg, % yoy)	9.4	20.2	12.9	6.1	7.8
Policy rate (% eop)	9.00	25.00	15.00	12.50	10.00
Budget balance (% of GDP)	-3.4	-16.1	-19.4	-14.3	-8.6

GDP recovery: Upside surprises coming along with downside risks

After a drastic GDP drop during the first quarters of the war, the economy is gradually recovering. In 2022, real GDP fell by 28.8%, and in 2023 it increased by 5.3%. For 2024 we are currently expecting a GDP expansion well fbove 3% yoy. In the first quarter of 2024 GDP results surprised on the upside posting a growth rate of 6.4% vs forecasts of 4.6%. This upbeat performance seems to be tied to optimistic views of the business sector on the current year's prospects and a rather mild winter, which keeps business activity high and lowered the risk of electricity cut-offs then. However, the overall recovery potential is limited currently, while we see non-negligible risks of deterioration in the coming months.

Overall, we still see solid internal investments of business (which was strengthened recently by investments into energy independence) and rather strong private demand (boosted by increasing real income of households). Key risk factors are mostly linked to security risks, e.g. occupation of additional territory by aggressor), energy risks (interruptions with electricity supply, continuation of energy terror) and risk of workforce deficit (mobilization, emigration).

Rising inflation to limit rate cuts

On a positive note, a decent decline in inflation allowed for rather bold and forward-looking monetary easing in 2023, i.e. the key rate was cut from 25 % to 15%. Compared to 2023 additional monetary easing in 2024 might be more limited. As of recently annual inflation even inched below the NBU target range of 4-6% (3.3% yoy in May). This trend allowed the National Bank of Ukraine (NBU) to start its monetary easing earlier than the regulator expected before. Hence, the NBU policy rate has dropped from 15% to 13% currently. However, in our view, pro-inflationary risks are likely to be present in the second half of this year due to further adjustment in public utility tariffs, growing prices of imported goods (due to recent surprising UAH devaluation) and stronger demand. Hence, we expect inflation to increase gradually to 7.5% by the end of this year. Pro-inflationary risks as well as decreasing attractiveness of investments in local currency (instruments) shall prevent further active monetary easing by the NBU in the course of 2024. Hence, we expect only a 50 bp cut in NBU policy rate to 12.5% in 2024, followed by a pause until the end of the year.

2024 financing secured but risks dominate the long-term outlook

Shortfalls of external financing are no longer a pressing near-term problem for 2024 amid approvals of bold external financing on both sides of the Atlantic (i.e. by the US and EU) and compliance of Ukraine with IMF conditionalities and/or conditionalities by other donors like the EU. After the G7 decision on providing a USD 50 bn loan to Ukraine (under collateral of frozen assets of the country-aggressor), there is also some certainty to plan the budget even for 2025, which raises the steadiness of budget planning and financing for the coming two years. Ukraine reached a preliminary agreement with holders of commercial Eurobonds worth over USD 20 bn to restructure with new issues. Conditions of the deal consider 32% haircuts and rather small interest rate in the coming two years and redemptions over 2029-36. The deal would save USD 11.4 bn for debt servicing in the coming three years.

FX liberalisation in gradual steps

In addition, financial market players have already had to digest some untelegraphed adjustment steps this year. Contrary to expectations and previous statements by the NBU, it pursued a rather active hryvnia devaluation path over May-June, which increased USD/UAH exchange rate by 8% to the range of 40.70-41.20. Therefore, in year-on-year terms the local currency devaluation already exceeded 12%, which is a critical measure for the NBU, because it may induce local investors to withdraw their holdings from hryvnia and invest them into foreign currency, thus even increasing devaluation. Therefore, we expect year-end USD/UAH value near 41.10-42.00. Moreover, in May the NBU kicked-off a bold exchange market liberalisation (since the war started). It allowed foreign currency purchases for paying services' imports, part of interest for intercompany loans and dividends earned in 2024. This seriously raised foreign currency demand in May-June. Overall, we do not expect any near-term recovery of the UAH. However, disregarding current demand pressure on FX market, the NBU is still well equipped with instruments to stabilize the market and smooth volatility., Despite some drops recently, the NBU reserves stay at USD 38 bn (as of the end of June), covering around 5 months of imports. Furthermore, we expect additional inflows of foreign currency into NBU reserves due to more active foreign aid in the coming month or two.

Banking sector resilient in war conditions

The Ukrainian banking sector adopted fully to current circumstances, because it was well prepared to high risks just before the war started. Well-crafted NBU policies (i.e. limitation on certain operations, introductions of credit holidays, relaxation of some normative criteria, provision of additional financing to banks etc) saved the sector from collapse at the beginning of the war. The quality of banks' portfolio has worsened moderately (but not dramatically) in the first year of the war, with the non-performing loan ratio increasing from 27% to 39%. Currently, this ratio shows a gradually declining pattern in 2024 to 35.0% as of June. Capital adequacy ratio stays excessively high, thus providing a bold cushion to the banking sector. Moreover, banks actively made loan-loss provisions in 2022-2023, which sometimes were excessive ahead of actual worsening of portfolio quality. However, Ukrainian banks are not actively growing their business activity and portfolios as the recovery of the economy remains capped, while loan demand decreased on the back of still high key rate levels. Preferential loans under program 5-7-9% (with partial interest payments' compensation from the government) still save the economy and banking sector from a more rapid decline of bank financing. Not to forget that banks remain well prepared for potential electricity cut-offs this winter, which should not worsen their operating activity in winter season.

No foreign retreat from the Ukrainian banking sector

The astonishing resilience of the local banking sector under wartime conditions has also enabled foreign banks still operating in Ukraine to maintain or stabilize their exposure to the country. International (Western) banks currently report Ukraine exposure levels of around USD 10 billion. At the end of 2021, these were slightly higher at just under USD 11 billion, but slightly lower at USD 8 billion at the end of 2022. Nevertheless, the resilience of the exposures is a noteworthy development given the situation in Ukraine and past exposure reductions in (financial market) crisis phases at an international level or locally in Ukraine. Exposure reductions of 15 to 30% have repeatedly been observed here. Not to forget - even if driven by sanctions - the exposures of Western foreign banks towards Russia are now 50-60% below pre-war levels. With regards to Ukraine exposures, the countries of Austria, France and US are currently representing around 80% of international banking exposures towards the war-ravaged country according to year-end 2023 data (more or less the same levels as year-end 2021, where this ratio stood at 77%). The Austrian banking sector (mainly via the local subsidiary of Raiffeisen Bank International) represents 37% of international banking exposures, being flat since 2021. French banks (mainly via the local subsidiary of BNP Paribas) represent 27% of international banks' Ukraine exposures (with a slight decrease since 2021), while US banks represent 18% (with a slight increase since 2021).

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