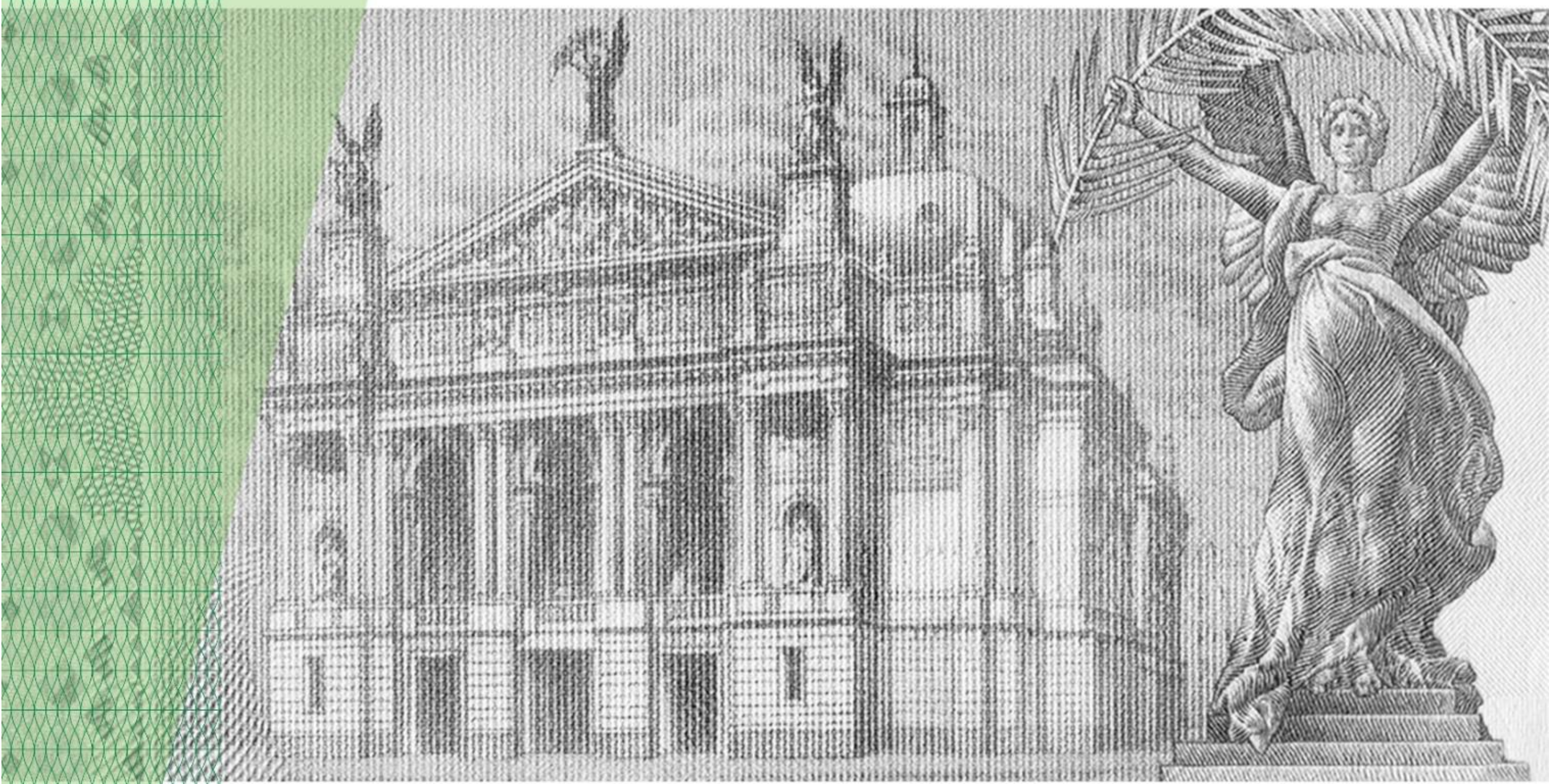
National Bank of Ukraine

Inflation Report

July 2024

Summary



Despite the full-scale war's challenges, the NBU remains committed to its mandate to ensure price and financial stability – the key to achieving sustainable economic recovery. These goals are being achieved by a coordinated combination of interest rate policy and exchange rate policy tools, as well as FX restrictions in accordance with Monetary Policy Guidelines for the Duration of Martial Law and the Strategy for Easing FX Restrictions, Transitioning to Greater Flexibility of the Exchange Rate, and Returning to Inflation Targeting (hereinafter referred to as the "Strategy").

In particular, monetary policy aims to bring inflation, as measured by the year-over-year change in the CPI, to its target of 5% within a forecast horizon that spans the current and the next two years. In some periods, inflation may deviate from its quantitative target due to domestic and external factors beyond the effective reach of the NBU's monetary policy. However, the central bank is focused on avoiding an unanchoring of inflation expectations and on returning inflation to its target within the forecast horizon.

The NBU is taking steps to strengthen the effectiveness of monetary transmission channels and to continue to revive the key policy rate's performance as the core monetary instrument. Decisions to change the key policy rate or adjust the operational design of interest rate policy are informed by significant shifts in the balance of risks and primarily aimed at maintaining the sustainability of the FX market and price and financial stability.

In keeping with the principles of managed flexibility of the exchange rate, the NBU maintains an active presence in the FX market and makes up for structural deficits of foreign currency to ensure that the exchange rate fluctuates moderately in either direction as market conditions change. Coupled with smoothing out excessive exchange rate volatility, this contributes to keeping inflation expectations and exchange rate expectations in check, maintaining confidence in the hryvnia, and ensuring favorable inflation developments. Concurrently, exchange rate flexibility makes it possible to fortify the Ukrainian economy's and the FX market's resilience against domestic and external shocks and reduces the risk of accumulation of foreign-trade imbalances.

Aware of the need to minimize FX market distortions, improve conditions for doing business in Ukraine, enable Ukrainian companies to tap into new markets, and support economic recovery, the NBU has been easing its FX restrictions. The loosening of the FX controls is guided by the availability of macroeconomic prerequisites, rather than by specific deadlines.

The analyses laid out in the current (July 2024) Inflation Report are based on cutoff dates for the data, meaning that the time horizons of the analyses may differ for some indicators. The cutoff date for most indicators in this report is 24 July 2024. The Inflation Report presents a forecast for the country's economic development in 2024–2026 that was prepared by the Monetary Policy and Economic Analysis Department and approved by the NBU Board at its monetary policy meeting on 25 July 2024.[1]

The NBU Board makes decisions on the key policy rate and other monetary tools in line with the schedule published in advance. The decisions the NBU Board makes in January, April, July, and October are based on a new macroeconomic forecast. At the remaining four meetings (in March, June, September, and December), the NBU Board makes its decisions based on assessments of risks and uncertainty that take into account the economic developments in Ukraine and abroad since the latest forecast. The decisions are announced at a press briefing held at 2 p.m., after the NBU Board's monetary policy meeting. A press release that reflects the NBU Board's consensus perspective on its decisions is published at the same time. The summary of the discussion at the Monetary Policy Committee is published on the 11th day after the decision is taken. The summary shows the depersonalized opinions of all MPC members on the optimal monetary policy decisions to be made. It includes differences of opinion and the reasoning behind them.

Previous issues and presentations of the Inflation Report, the forecast of the main macroeconomic indicators, and data in tables and figures are available here.

[1] NBU Board decision No. 271–D *On Approval of the Inflation Report* dated 25 July 2024.

Summary

The baseline scenario of the NBU's macroeconomic forecast assumes that Ukraine will continue to conduct prudent monetary and fiscal policies focusing on maintaining macrofinancial stability and will consistently meet its commitments under programs with international partners, which will keep providing sufficient financial support. The NBU assumes that security risks will subside and that economic conditions will normalize within the forecast horizon, resulting in the full unblocking of sea ports, the expansion of opportunities for investment and economic activity, and the gradual return of forced migrants to Ukraine.

Inflation has expectedly accelerated and approached 5% in recent months

After a long period of decreases, inflation returned to growth in May and picked up to 4.8% yoy in June. This inflation trajectory came out only slightly below the NBU's forecast published in the April 2024 Inflation Report. The lower-than-expected gain in food prices made up for a more significant increase in household electricity tariffs.

At the same time, core inflation (at 5% yoy in June) was in line with the NBU's forecast. Underlying price pressures intensified as businesses incurred greater costs of labor and electricity. In addition, developments in some of the core CPI's components reflected a weakening of the hryvnia's exchange rate.

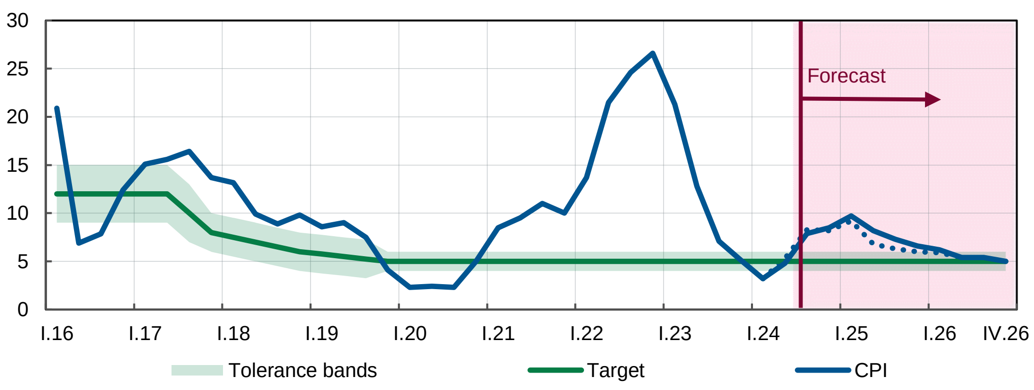
Inflation will pick up going forward, but will begin to ease next year already and will head to the NBU's 5% target

Price pressures will persist in the coming months, fueled by further increases in business costs, higher excise taxes, the fading effects of last year's large harvests, and the adverse impact of a summer drought on this year's crop yields. Early estimates of inflation in July confirm that it is trending higher.

However, inflation will remain moderate, at 8.5% at the end of the year, the updated forecast shows. This will be facilitated by the NBU's measures to safeguard households' hryvnia incomes and savings from inflation and ensure the sustainability of the FX market. The extension of the moratorium on increases in utility tariffs for natural gas, heating, and hot water supply will also have a restraining effect on prices.

The NBU's balanced interest rate and exchange rate policies and the weakening of external inflationary pressures will make it possible to slow inflation to 6.6% as soon as 2025. In 2026, inflation will return to its 5% target as the economy gradually normalizes and the energy situation continues to improve.

Figure 1.[2] **CPI change (end of period, % yoy) and inflation targets**



Source: SSSU, NBU staff estimates.

Economic recovery will carry on, but will be restrained by the war's impact, including extensive damage to the energy system

Economic growth continued in H1 2024, but has decelerated in recent months, impeded by russia's massive attacks on energy infrastructure. However, businesses have partially

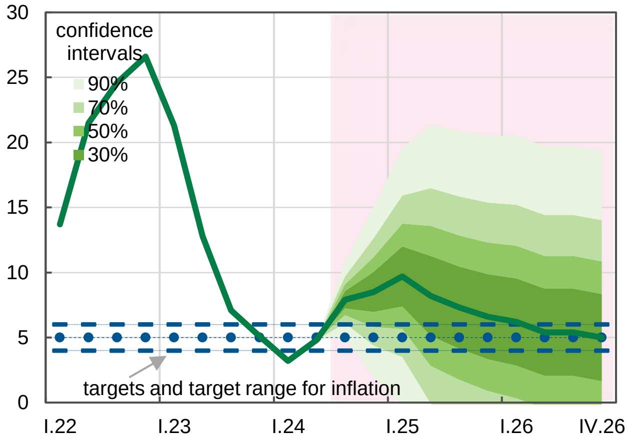
[2] Unless specified otherwise, a dashed line in the figures indicates the previous forecast.

adapted to regular power outages. The smooth operation of the sea corridor has also significantly bolstered economic activity.

Despite power shortages and smaller harvests compared to a year ago, the NBU has even slightly upgraded its economic growth forecast for this year, to 3.7%. This was made possible by better Q1 results and an anticipated expansion of budget stimuli, as well as by the development of distributed power generation, including thanks to support from large-scale lending programs.

The gradual normalization of economic activity and the fiscal policy's remaining loose, combined with the development of export routes and the revival of external demand, will help speed up real GDP growth to 4%–5% in 2025–2026.

Figure 2. CPI growth forecast and inflation targets, % yoy

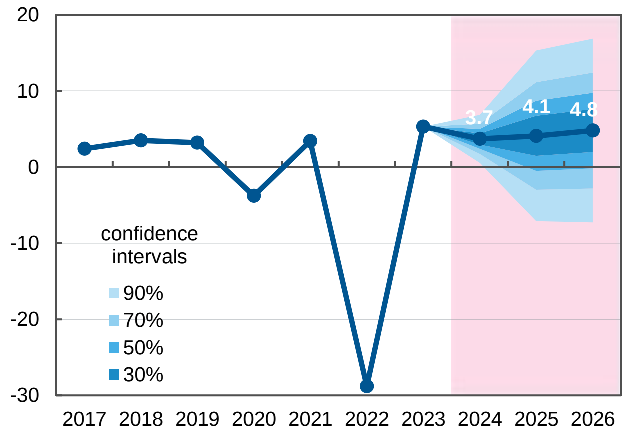


Source: NBU staff estimates.

The continuation of international financial support will enable the government to finance the budget deficit, and the NBU to maintain a comfortable level of reserves

Under the forecast's baseline scenario, Ukraine will keep receiving substantial external financing inflows, though they will slowly decline as the country builds up its capacity to use domestic resources to finance budget expenditures. According to our assumptions, international partners will provide about USD 38 billion in soft loans and grants to Ukraine this year, and no less than USD 31 billion next year.

Figure 3. Real GDP growth forecast, % yoy



Source: NBU staff estimates.

Such volumes of aid, coupled with growing domestic borrowing, will make it possible to cover a significant budget deficit of about 23% of GDP in 2024 and 18% in 2025. The NBU, for its part, will be able to maintain a sufficient level of international reserves to make sure that the FX market remains sustainable and inflation moderates.

Given the need to ensure the sustainability of the FX market and to bring inflation closer to its 5% target within the forecast horizon, the NBU kept the key policy rate unchanged at 13%

Despite a gradual decline in hryvnia deposit rates and in interest rates on domestic government debt securities, the yields on these instruments currently protect households' hryvnia savings from being eroded by inflation. In particular, interest rates on these instruments exceed both the NBU's inflation forecast and households' inflation expectations.

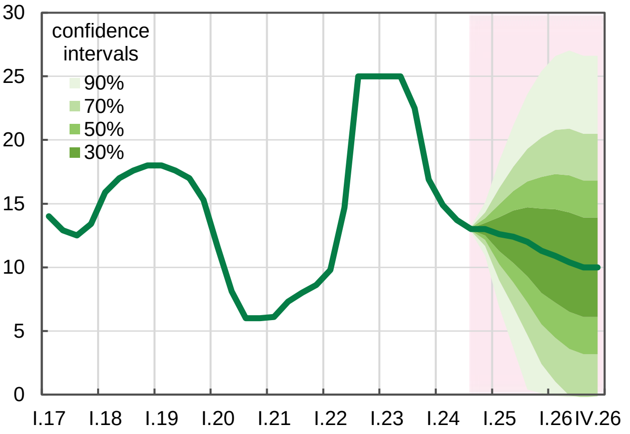
However, the growth in hryvnia retail term deposits halted in June. Considering that a further acceleration of inflation could worsen expectations and decrease the real yields on hryvnia instruments, it is viable to keep the key policy rate at 13%.

The NBU will also maintain an active presence on the FX market to cover the structural deficit of foreign currency, support two-way fluctuations in the exchange rate, and smooth out excessive volatility. The NBU aims to ensure that the FX market is in such a state that the central bank will be able to control inflation expectations and achieve its inflation target within the forecast horizon.

Although the forecast's baseline scenario assumes that the NBU will return to its easing cycle of the key policy rate no earlier than 2025, the NBU will respond flexibly to changes in the balance of risks to inflation and the FX market

If the risks to inflation and the FX market abate, in particular as a result of Ukraine receiving more financial support, the NBU will consider resuming the easing cycle of the key policy rate earlier. At the same time, the NBU will be ready to tighten its monetary policy in the event of a significant increase in price pressures and risks of expectations becoming unanchored.

Figure 4. **Key policy rate, quarter average, %**



Source: NBU staff estimates.

The course of the full-scale war continues to be the key risk to inflation and economic developments

The duration and nature of russia's aggression will continue to have a notable impact on Ukraine's inflation and economic development. A protracted high-intensity war will make it impossible for the economy to return to normal, and difficult for the NBU to bring inflation to its target.

There are other risks, most of which are also directly or indirectly related to the war, including:

- the emergence of additional budget needs, mainly those to maintain defense capabilities
- the pass-through to prices of certain new business taxes whose introduction is currently being discussed at the state level
- further damage to infrastructure, especially the energy grid and ports, which will curb economic activity and put supply-side pressures on prices, and
- more adverse changes in migration flows.

There is also a risk that international partners will reduce their support for Ukraine more significantly, in particular due to the effects of the election cycles in many countries.

At the same time, a number of positive scenarios are also likely to materialize. These scenarios are related to the further expansion of export opportunities, the acceleration of European integration processes, the implementation of a large-scale recovery program, and a faster pace of repairs in the energy sector.

In addition, the practical implementation of the Extraordinary Revenue Acceleration Loans (ERA) mechanism, secured by future revenues from immobilized russian assets, could provide Ukraine with additional financial resources starting in 2025. This will reduce risks to the timely and regular inflows of international financing.

Macroeconomic forecast (July 2024)

Indicators	2020	2021	2022	2023	2024 I	2024 II	2024 III	2024 IV	2024 current forecast	2024 forecast 04.2024
REAL ECONOMY, % yoy, unless otherwise stated										
Nominal GDP, UAH bn	**4222**	**5451**	**5239**	**6538**	1609	1696	2067	2217	**7590**	7590
Real GDP	**-3.8**	**3.4**	**-28.8**	**5.3**	6.5	3.7	3.1	2.3	**3.7**	**3.0**
GDP Deflator	10.3	24.8	34.9	18.5	10.9	11.7	12.7	12.2	11.9	12.7
Consumer prices (period average)	2.7	9.4	20.2	12.9	-	-	-	-	5.8	6.2
Consumer prices (end of period)	**5.0**	**10.0**	**26.6**	**5.1**	3.2	4.8	7.9	8.5	**8.5**	**8.2**
Core inflation (end of period)	4.5	7.9	22.6	4.9	4.2	5.0	6.1	7.1	7.1	6.7
Non-core inflation (end of period)	5.9	13.5	30.6	5.7	2.4	4.5	10.1	10.0	10.0	10.1
raw foods (end of period)	4.1	11.8	41.6	2.2	-4.9	-6.5	6.3	5.3	5.3	4.9
administrative prices (end of period)	9.9	13.6	15.3	10.7	9.9	13.3	13.6	14.0	14.0	14.7
Nominal wages (period average)	10.4	20.9	6.0	17.4	22.5	15.6	13.0	14.2	16.1	14.8
Real wages (period average)	7.4	10.5	-11.4	3.7	17.7	11.4	5.7	5.4	9.7	8.1
Unemployment rate (ILO, period average)	9.5	9.8	21.1	18.2	-	-	-	-	13.9	14.2
FISCAL SECTOR										
Consolidated budget balance, UAH bn	**-224**	**-187**	**-845**	**-1328**	-	-	-	-	**-1241**	-1395
% of GDP	-5.3	-3.4	-16.1	-20.3	-	-	-	-	-16.3	-18.4
excluding grants from revenues, % of GDP	-5.3	-3.4	-25.3	-26.9	-	-	-	-	-22.8	-20.7
BALANCE OF PAYMENTS (analytical presentation)										
Current account balance, USD bn	5.3	-3.9	8.0	-9.7	-3.2	-5.4	-0.5	-5.0	-14.2	-20.2
Exports of goods and services, USD bn	60.7	81.5	57.5	51.1	14.2	13.7	13.6	15.4	57.0	57.1
Imports of goods and services, USD bn	63.1	84.2	83.3	88.8	21.2	22.3	23.6	24.8	91.9	90.3
Remittances in Ukraine, USD bn	12.0	14.0	12.5	11.3	2.6	2.4	2.7	2.9	10.6	11.3
Financial account, USD bn	3.3	-4.4	11.1	-19.0	-6.4	0.3	-2.1	-3.2	-11.4	-19.8
BOP overall balance, USD bn	**2.0**	**0.5**	**-2.9**	**9.5**	3.2	-5.6	1.6	-1.9	**-2.6**	**-0.3**
Gross reserves, USD bn	**29.1**	**30.9**	**28.5**	**40.5**	43.8	37.9	42.3	41.2	**41.2**	**43.4**
Months of future imports	4.2	4.5	3.8	5.3	5.6	4.9	5.4	5.3	5.3	5.6
MONETARY ACCOUNTS (cumulative since the beginning of the year)										
Monetary base, %	**24.8**	**11.2**	**19.6**	**23.3**	3.1	10.5	9.0	15.5	**15.5**	14.4
Broad money, %	**28.6**	**12.0**	**20.8**	**23.0**	1.7	6.0	9.1	16.1	**16.1**	14.1
Velocity of broad money (end of year)	**2.3**	**2.6**	**2.1**	**2.1**	-	-	-	-	**2.1**	2.2

Indicators	2025 I	2025 II	2025 III	2025 IV	2025 current forecast	2025 forecast 04.2024	2026 I	2026 II	2026 III	2026 IV	2026 current forecast	2026 forecast 04.2024
REAL ECONOMY, % yoy, unless otherwise stated												
Nominal GDP, UAH bn	1808	1915	2360	2537	**8620**	8705	2047	2150	2624	2805	**9625**	9685
Real GDP	1.8	2.8	5.1	5.9	**4.1**	**5.3**	5.8	5.2	4.4	4.1	**4.8**	**4.5**
GDP Deflator	10.4	9.8	8.7	8.0	9.1	8.9	7.0	6.7	6.4	6.2	6.5	6.5
Consumer prices (period average)	-	-	-	-	8.2	7.3	-	-	-	-	5.7	5.5
Consumer prices (end of period)	9.7	8.2	7.3	6.6	**6.6**	**6.0**	6.2	5.4	5.4	5.0	**5.0**	**5.0**
Core inflation (end of period)	6.9	5.8	4.8	4.5	4.5	3.6	4.2	3.9	3.6	3.1	3.1	3.0
Non-core inflation (end of period)	13.1	10.9	10.2	9.0	9.0	8.9	8.5	7.1	7.3	7.1	7.1	7.4
raw foods (end of period)	9.9	9.4	6.3	4.0	4.0	3.2	4.0	3.6	3.2	2.8	2.8	3.0
administrative prices (end of period)	15.0	11.8	13.6	14.2	14.2	15.5	13.8	11.1	11.8	11.9	11.9	12.1
Nominal wages (period average)	15.5	17.1	15.2	10.9	14.6	14.2	9.2	9.5	8.6	7.8	8.7	8.6
Real wages (period average)	5.6	7.1	6.9	3.7	5.8	6.5	2.6	3.5	3.0	2.5	2.9	3.0
Unemployment rate (ILO, period average)	-	-	-	-	11.4	11.9	-	-	-	-	10.3	10.6
FISCAL SECTOR												
Consolidated budget balance, UAH bn	-	-	-	-	**-1176**	-941	-	-	-	-	**-853**	-703
% of GDP	-	-	-	-	-13.6	-10.8	-	-	-	-	-8.9	-7.3
excluding grants from revenues, % of GDP	-	-	-	-	-17.8	-13.5	-	-	-	-	-10.3	-7.5
BALANCE OF PAYMENTS (analytical presentation)												
Current account balance, USD bn	-4.7	-5.7	-4.8	-3.8	-19.0	-18.2	-5.9	-5.8	-6.2	-5.7	-23.5	-23.1
Exports of goods and services, USD bn	13.6	12.9	14.2	16.6	57.3	60.8	14.9	14.6	16.2	17.8	63.4	65.6
Imports of goods and services, USD bn	22.9	22.4	23.8	24.8	93.9	92.3	23.1	22.8	24.5	25.2	95.6	95.3
Remittances in Ukraine, USD bn	2.8	2.8	2.9	3.1	11.6	12.7	3.1	3.2	3.2	3.3	12.8	13.7
Financial account, USD bn	-2.1	-6.0	-4.3	-3.1	-15.5	-19.6	-4.6	-4.4	-5.1	-3.5	-17.6	-17.6
BOP overall balance, USD bn	-2.6	0.3	-0.5	-0.7	**-3.5**	**1.4**	-1.2	-1.4	-1.1	-2.2	**-5.9**	**-5.6**
Gross reserves, USD bn	38.6	38.3	38.3	37.3	**37.3**	**44.3**	36.2	34.9	34.0	32.0	**32.0**	**39.3**
Months of future imports	4.9	4.9	4.8	4.7	4.7	5.6	4.5	4.3	4.1	3.8	3.8	5.8
MONETARY ACCOUNTS (cumulative since the beginning of the year)												
Monetary base, %	2.5	5.7	7.0	12.1	**12.1**	13.0	0.3	3.6	4.5	10.0	**10.0**	8.4
Broad money, %	1.6	3.9	5.0	11.4	**11.4**	12.5	1.4	2.6	4.3	9.2	**9.2**	7.6
Velocity of broad money (end of year)	-	-	-	-	**2.2**	2.2	-	-	-	-	**2.2**	2.3

Comments on the dynamics of the main indicators in the macro forecast and factors behind their revision

Indicators	2024	2025	2026	Factors behind the revision
Inflation, %, eop	**8.5**	**6.6**	**5.0**	In 2024, effects of July drought and higher excise tax hikes; in 2025, fiscal expansion impact
	0.3	*0.6*	*0*	
Real GDP growth, %	**3.7**	**4.1**	**4.8**	In 2024, actual data for the Q1 and an increase in the budget deficit; in 2025, a higher energy deficit due to the attacks on energy sector, a slower normalization of conditions in which the Ukrainian economy operates
	0.7	*-1.2*	*0.3*	
Nominal GDP, UAH bn	**7590**	**8620**	**9625**	Lower rates of real economic growth in 2025
	0	*-85*	*-60*	
Consolidated budget balance (excluding grants from revenues), % of GDP	**-22.8**	**-17.8**	**-10.3**	Higher budget expenditures for defense, social support and reconstruction
	-2.1	*-4.3*	*-2.8*	
Current account balance, USD bn	**-14.2**	**-19**	**-23.5**	In 2024, redistribution of official financing towards grants; in 2025-26, worse situation in energy sector, more migrants abroad, lower harvests due to slower recovery of cultivated areas
	6	*-0.8*	*-0.4*	
Gross international reserves, USD bn	**41.2**	**37.3**	**32**	Larger interventions due to higher electricity deficit (which will limit exports and stimulate additional imports), longer stay of forced migrants abroad and increased demand for FX due to a slower normalization of conditions in which the Ukrainian economy operates
	-2.2	*-7.0*	*-7.3*	
Key policy rate (period average), %	**13.6**	**12.1**	**10.3**	Response to expected higher inflationary pressures in 2024–2025
	0	*0.2*	*-0.1*	

The indicator has been revised downwards (pp)

The indicator has been revised upwards (pp)

Forecast assumptions

Indicators		2021*	2022*	2023*	2024	2025	2026
Official financing	USD bn		32.2	42.9	38.0	31.4	21.1
Migration (net, excluding russia and belarus)	m			-0.2	-0.4	-0.3	0.4
Real GDP of Ukraine's MTP (UAwGDP)	% yoy	6.9	3.6	1.5	2.3	2.8	2.7
Consumer inflation in Ukraine's MTP (UAwCPI)	% yoy	6.4	13.8	7.6	5.6	3.9	2.7
World prices:**							
Steel price, Steel Billet Exp FOB Ukraine	USD/t	615.0	618.1	539.7	517.1	508.1	494.3
	% yoy	57.9	0.5	-12.7	-4.2	-1.7	-2.7
Iron ore price, China import Iron Ore Fines 62% FE	USD/t	161.7	121.4	120.6	109.7	87.6	76.2
	% yoy	48.5	-24.9	-0.7	-9.0	-20.1	-13.0
Steel price, No.1 Hard Red Winter, ordinary protein, Kansas City	USD/t	265.8	360.2	272.3	225.2	242.5	247.3
	% yoy	43.3	35.5	-24.4	-17.3	7.7	2.0
Corn price, Yellow #2 Delivery USA Gulf	USD/t	259.4	318.4	252.7	198.8	215.3	223.3
	% yoy	56.8	22.7	-20.6	-21.3	8.3	3.7
Oil price, Brent	USD/bbl	70.4	99.8	82.6	84.1	74.7	73.1
	% yoy	66.5	41.8	-17.2	1.8	-11.2	-2.1
Natural gas price, Netherlands TTF	USD/kcm	574.8	1355.9	465.6	354.6	384.7	336.5
	% yoy	399.9	135.9	-65.7	-23.8	8.5	-12.5
Volumes of gas transit	bcm	41.6	20.6	14.6	15.0	0.0	0.0
Harvest of grain and leguminous crops	t m	86.0	53.9	59.8	53.7	57.9	61.7
Minimum wage**	UAH	6042	6550	6700	7775	8370	8950

** Actual data*

*** Annual average.*