National Bank of Ukraine

Inflation Report (January 2025)

4 Feb 2025

Key takeaways

- **In December 2024, inflation accelerated to 12% yoy, exceeding the NBU's previous forecast** and price pressures will persist in early 2025
- **Inflation is expected to decelerate to 8.4% at the end of 2025** and to reach the 5% target in 2026. The NBU's interest rate and exchange rate policy measures, as well as stronger harvests, improved energy supply, a narrower fiscal deficit, and moderate external price pressures will contribute to the slowing of inflation
- **Economic recovery will continue, although it will be limited due to the consequences of the war.** The pace of economic growth is expected to accelerate moderately in 2026–2027, to around 4%
- **International support will be sufficient to finance the budget deficit without resorting to monetary financing**, and to maintain the sustainability in the FX market. The volume of international reserves will fluctuate at a relatively stable level – about USD 40 billion in 2025–2027
- **The key policy rate hikes** (by 0.5 pp in December and 1 pp in January) are intended to ensure that hryvnia savings are adequately protected from inflation, and to maintain public interest in hryvnia assets
- **The NBU's updated macroeconomic forecast envisages further key policy rate hikes to curb inflationary pressures**

Macroeconomic forecast*

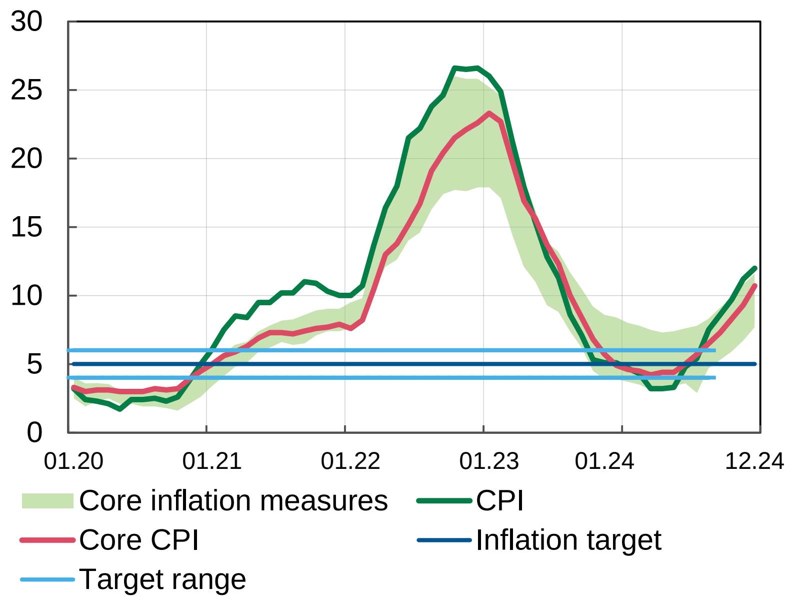
Forecast	2024**	2025	2026	2027
Real GDP, change, %	3.4 (4.0)	3.6 (4.3)	4.0 (4.6)	4.2
CPI, % yoy (eop)	12.0 (9.7)	8.4 (6.9)	5.0 (5.0)	5.0
Current account balance, USD bn	-14.6 (-16.3)	2.6 (-27.9)	-28.3 (-28.4)	-27.9
International reserves, USD bn	43.8 (43.6)	40.5 (41.0)	38.5 (34.7)	40.2
Consolidated budget deficit, % GDP ***	23.7 (23.3)	19.3 (19.6)	11.9 (12.4)	7.0

Assumptions	2024**	2025	2026	2027
Official financing, USD bn	41.9 (41.5)	38.4 (38.4)	25 (25.0)	15
Harvest of cereals and legumes, million tons	55.2 (55.2)	60.1 (57.9)	62.3 (61.7)	64.9
Migration (net), million persons	-0.5 (-0.5)	-0.2 (-0.2)	0.2 (0.2)	0.5
Real GDP of Ukraine's MTPs, %	1.9 (2.3)	2.5 (2.8)	2.6 (2.7)	2.7
CPI of Ukraine's MTPs, %	5.1 (5.8)	3.4 (3.9)	2.7 (2.7)	2.5

* in brackets – previous forecast (Inflation report, October 2024), decrease/increase marked by color
** actual/estimate
*** excluding grants

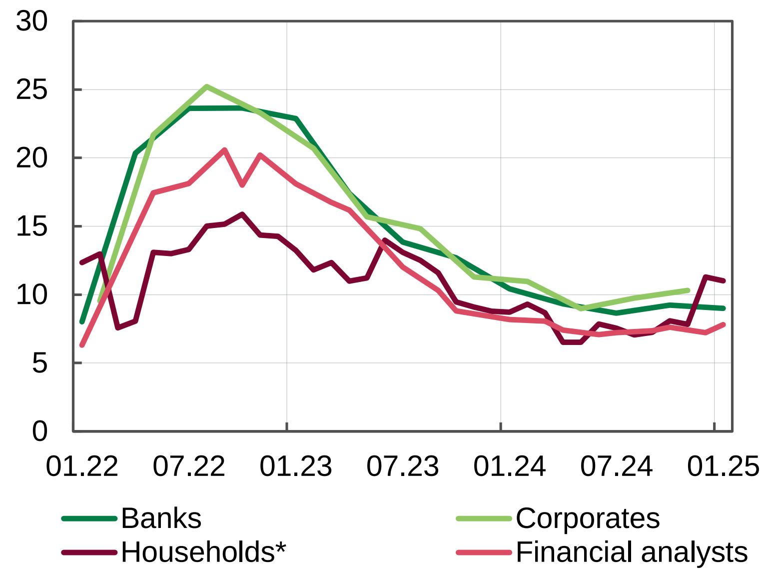
In 2024, inflation accelerated to 12%, exceeding the previous forecast (9.7% in October 2024)

Inflation and inflation target, % yoy



Source: SSSU, NBU staff estimates.

Inflation expectations for the next 12 months, %

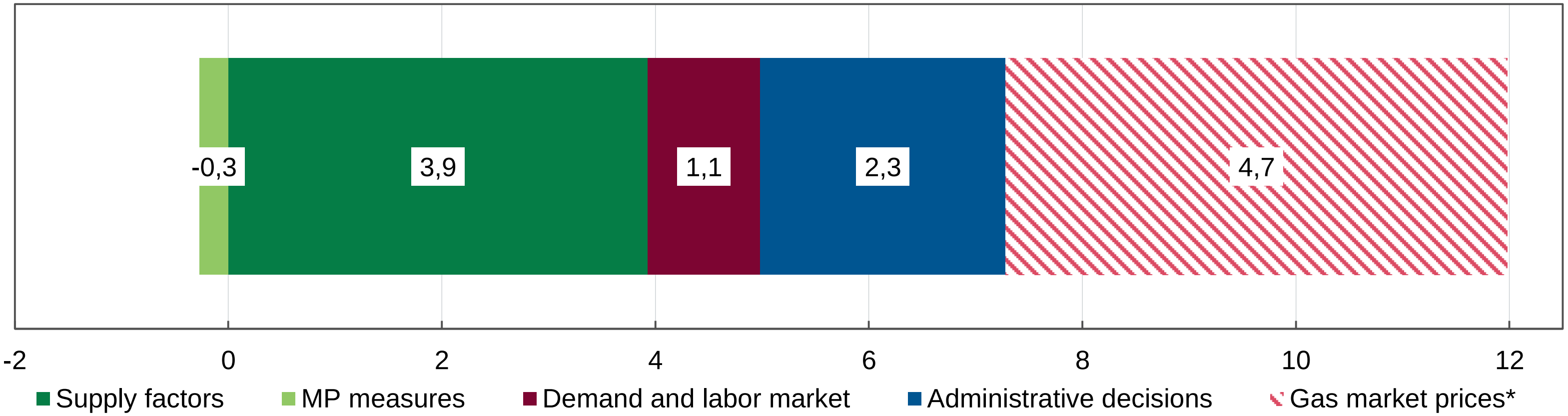


* In March 2022, the survey method was changed from face-to-face to telephone interviews.
Source: NBU, Info Sapiens.

- **The rapid growth in consumer prices was to a large extent driven by temporary factors** (primarily the effects of last year's lower harvests)
- **Meanwhile, underlying price pressures also intensified.** This is evidenced by a further acceleration in core inflation (amid higher business costs for raw inputs, materials, and electricity, an increase in wages, and exchange rate effects from the hryvnia's depreciation against the US dollar in previous periods)
- **Inflation reaching double digits is negatively affecting inflation expectations** of households and businesses

Box. Factors that Determined the Deviation of Inflation From the Target in 2024

Decomposition of inflation deviation from the target in December 2024, pp



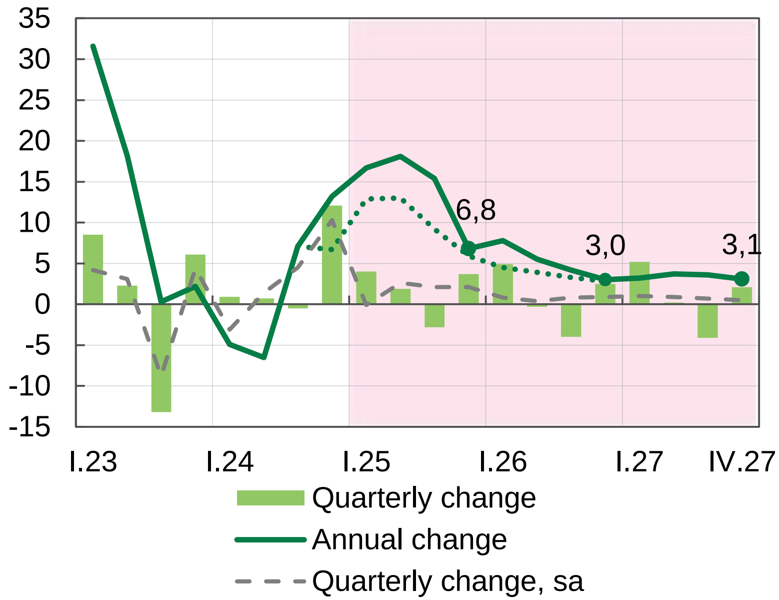
* The difference between market-justified natural gas prices and tariffs for households was compensated for by a moratorium on raising utility tariffs. This factor was not realized, the figure shows estimates of potential effects.

Source: SSSU, NBU staff estimates.

- **Supply shocks**. Decrease in crop yields, the convergence of internal and world food prices due to the improvements in export logistics, expenses of enterprises for the development of autonomous energy supply, and electricity imports
- **Demand and labor market**. Aggregate demand increase was fostered by loose fiscal policy while labor market disproportions determined fast growth of wages
- **Administrative decisions**. Increase in the electricity tariffs for the households and excise taxes on fuel. Tobacco products became more expensive due to the measures against shadow-market supply and exchange rate depreciation in previous periods
- Monetary policy measures remained **disinflationary** factor

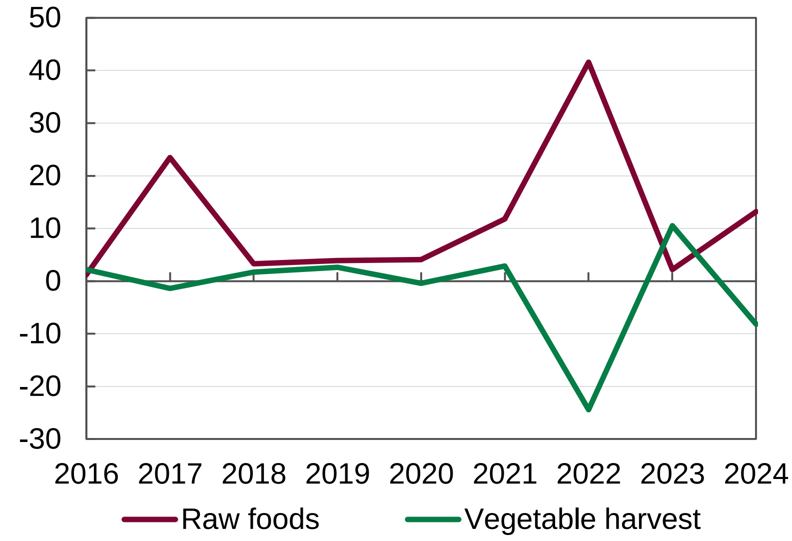
Food inflation will slow significantly in the second half of the year due to anticipated harvest increases

Raw foods inflation, end of period, %



Source: SSSU, NBU staff estimates.

Vegetable harvest* and raw food prices at the end of period, % yoy

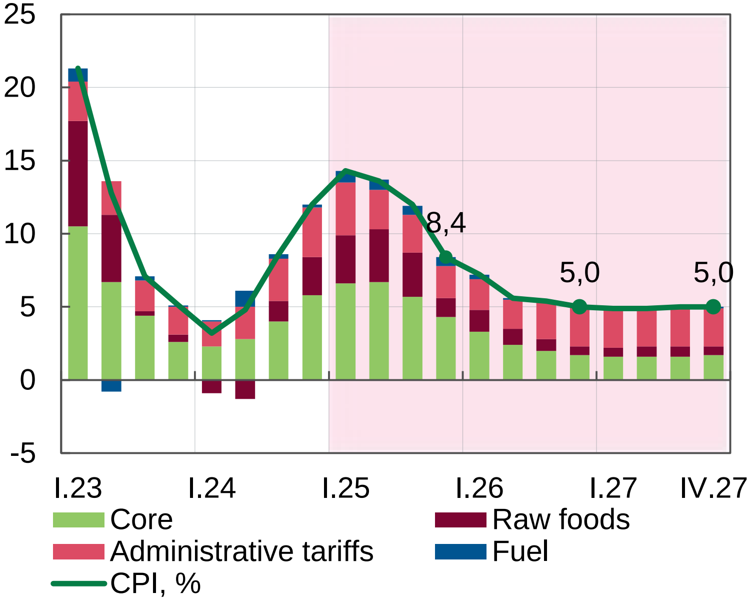


* Harvest in 2024 according to the NBU's estimates.
Source: SSSU, NBU staff estimates.

- **The 2024 harvest of ground vegetables and potatoes has been lower** than both last year's and the NBU's forecasts, largely due to unfavorable weather conditions
- **Food inflation surged in Q4 of 2024**
- **With the new harvests arriving in the summer, inflation for raw foods will slow down considerably**

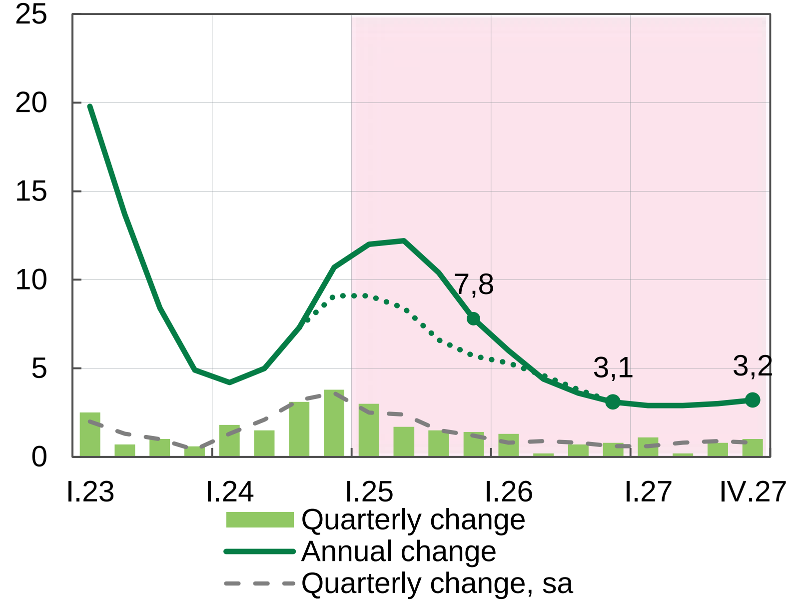
CPI will slow to 8.4% in 2025 and reach the target in 2026, driven by the fading of temporary factors and the impact of NBU policy

Contributions to annual CPI growth by main components at the end of period, pp



Source: SSSU, NBU staff estimates.

Core CPI, % yoy

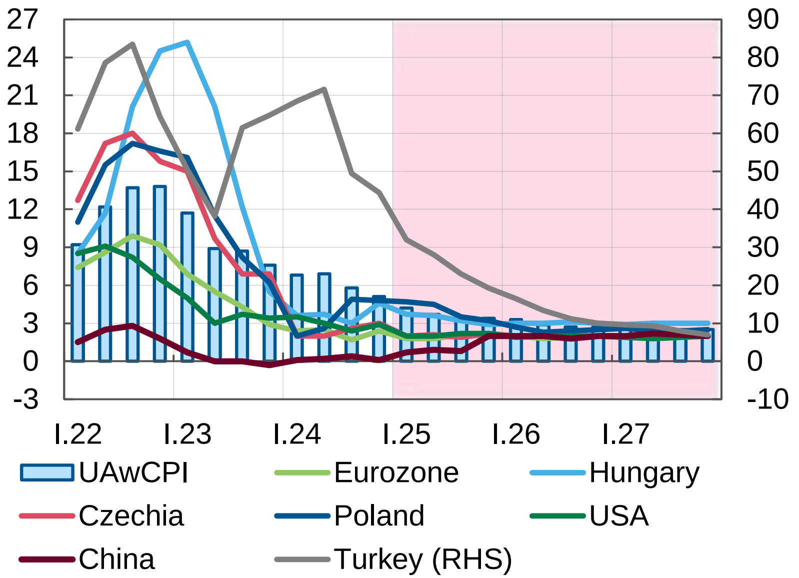


Source: SSSU, NBU staff estimates.

- **In the first months of 2025, inflation will continue to rise** influenced by both temporary factors (such as the effects of last year's lower harvests) and fundamental factors, particularly pressure from business production costs
- **By the end of 2025, inflation will decelerate to 8.4%, with a further decline to 5% in 2026**, supported by NBU policy measures, higher agricultural yields, improved energy supply, a reduced fiscal deficit, and moderate external price pressures
- **Core inflation will also decrease**, primarily due to the impact of monetary policy measures

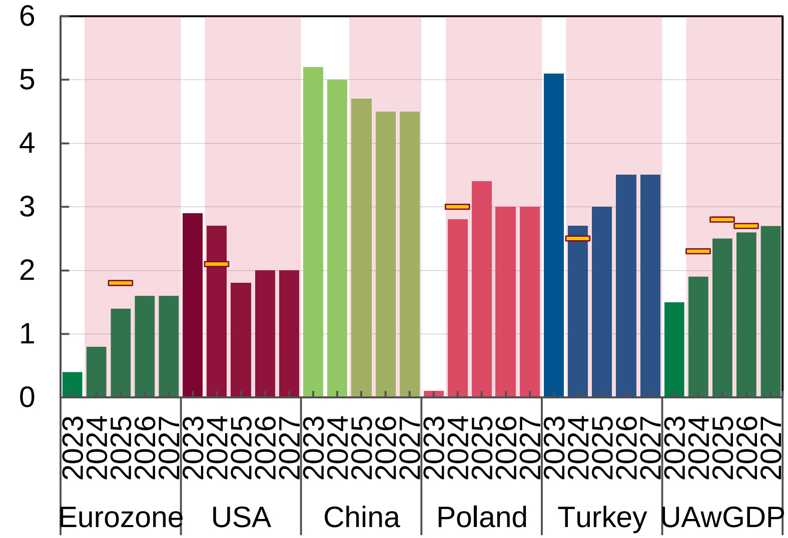
Inflation in the MTPs will remain moderate, which will limit domestic price pressures

Consumer inflation in selected countries – Ukraine's MTPs (eop) and UAwCPI, % yoy



Source: National statistical agencies, NBU staff estimates.

Real GDP in selected countries – Ukraine's MTPs and UAwGDP, % yoy

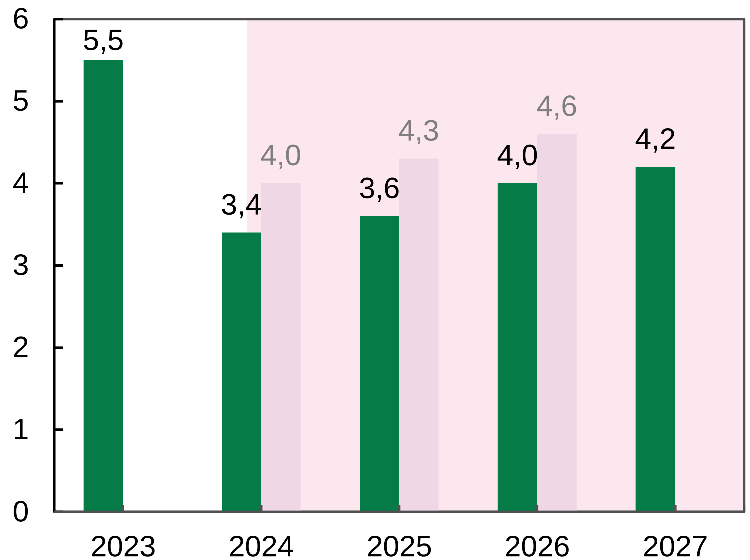


Source: National statistical agencies, NBU staff estimates.

- **Inflationary pressures will remain moderate:** on the one hand, consumer demand will continue to recover gradually, and on the other hand, the effects of most supply shocks will wear off
- **The Ukrainian economy will be supported by a further recovery in external demand,** although the impetus from it will be smaller than expected
- **Ukraine's terms of trade will improve,** although there are growing risks of increased geopolitical polarization and, consequently, fragmentation of global trade, which will limit external demand for Ukrainian products

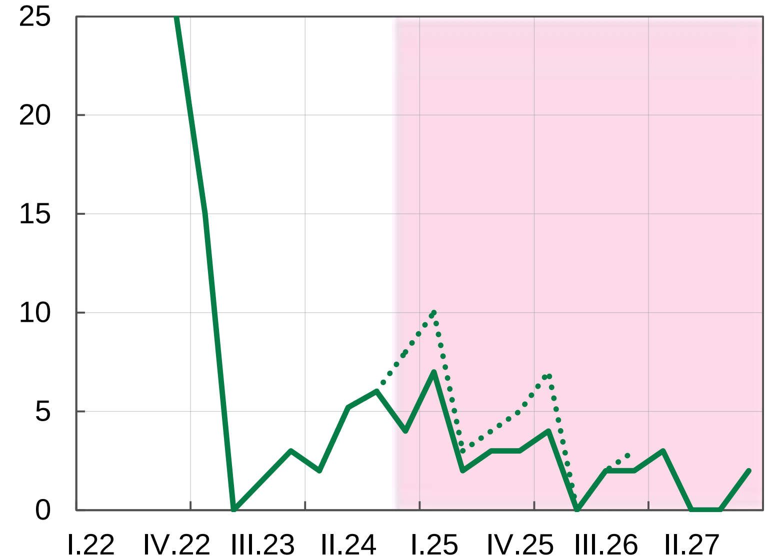
Economic recovery will continue, although it will be limited due to the consequences of the war

Real GDP, %



gray bars – previous forecast
Source: NBU staff estimates.

Electricity deficit, %

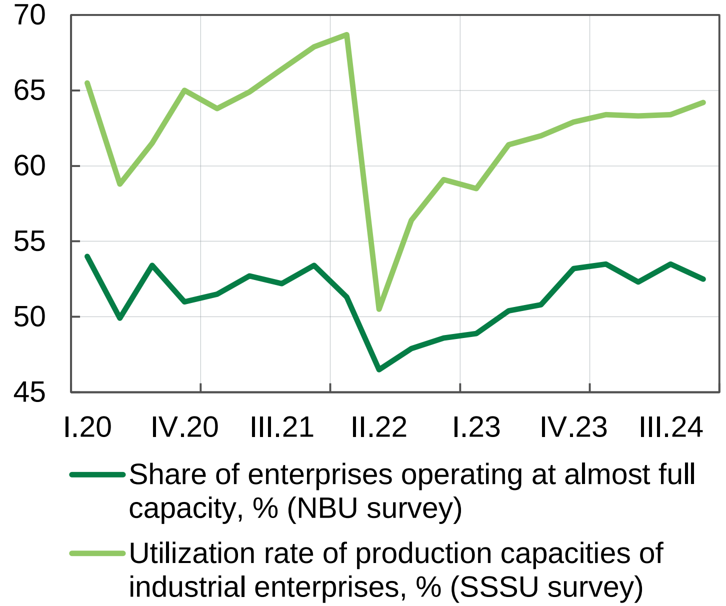


Source: NBU staff estimates.

- Considering security risks and the challenging situation in the labor market, the **NBU has revised its real GDP growth projection for 2025 downward** to 3.6%
- **The pace of economic growth is expected to accelerate moderately in 2026–2027, to around 4%.** Investment being made into energy and production capacity, fiscal policy remaining rather loose, and private consumption rising on the back of an increase in household income will all contribute to recovery
- **The electricity deficit will persist** due to significant damage to the power system

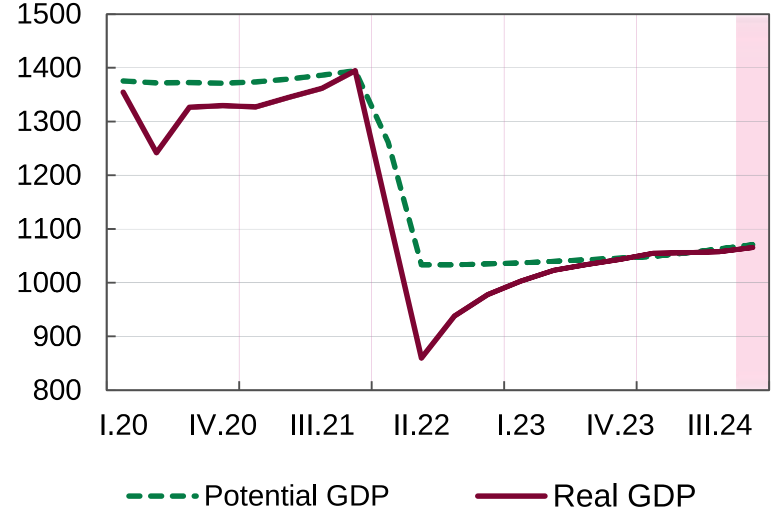
Updated estimates show a slight GDP gap in 2024, which is no longer a disinflationary factor

Indicators of production capacity utilization



Source: SSSU, NBU.

Real and potential GDP, sa, at 2021 constant prices (UAH billions)

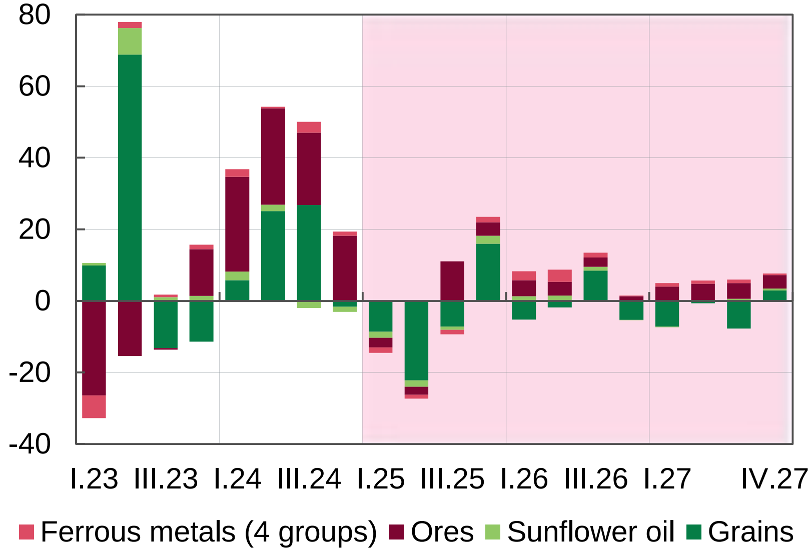


Source: SSSU, NBU staff estimates.

- **Business surveys indicate high capacity utilization** starting from the end of 2023
- **According to updated QPM estimates, GDP is close to its potential level** (zero GDP gap). Previous estimates (October 2024) suggested GDP was below potential (negative gap)
- **Projected GDP growth rates will be close to potential**, constrained by labor shortages and limited investment in productive capital

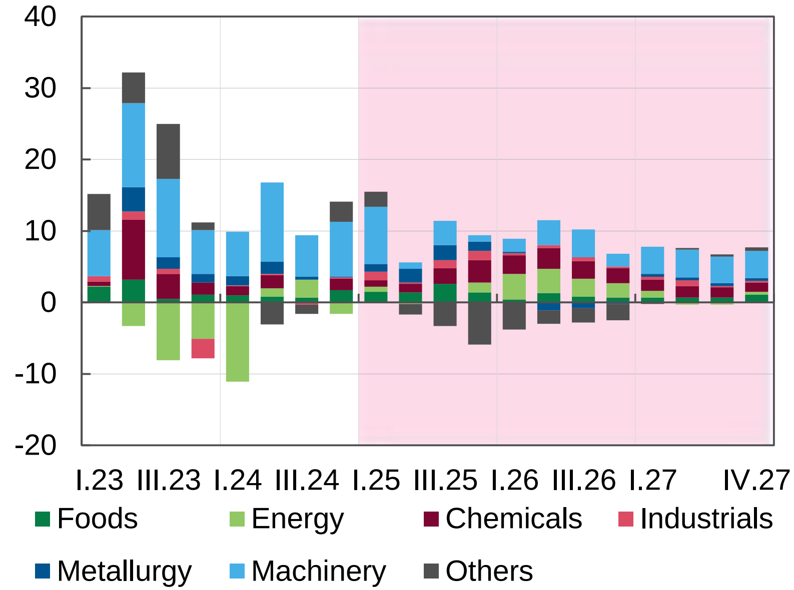
Exports will be constrained by limited production capacity and a recovery in domestic consumption

Contributions of selected commodities to the annual change in exports volumes, pp



Source: SCSU, NBU staff estimates.

Contributions to the annual change in imports, pp

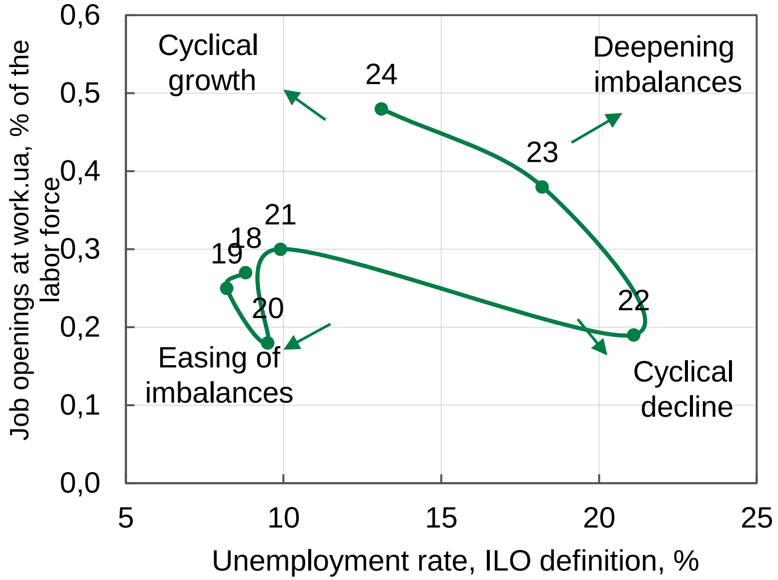


Source: SSSU, NBU staff estimates.

- **In 2025, export volumes are expected to decline (nominal exports will grow due to prices)** as a result of low stocks of last year's corn and sunflower harvests and the suspension of mines in Pokrovsk. Starting in 2026, a gradual improvement in economic activity in Europe will contribute to an increase in volumes of exports of goods
- **Demand for imports will remain high** amid significant needs in the defense sector, as well as further restoration of infrastructure and production capacity. Large budget expenditures will support growth in consumer imports

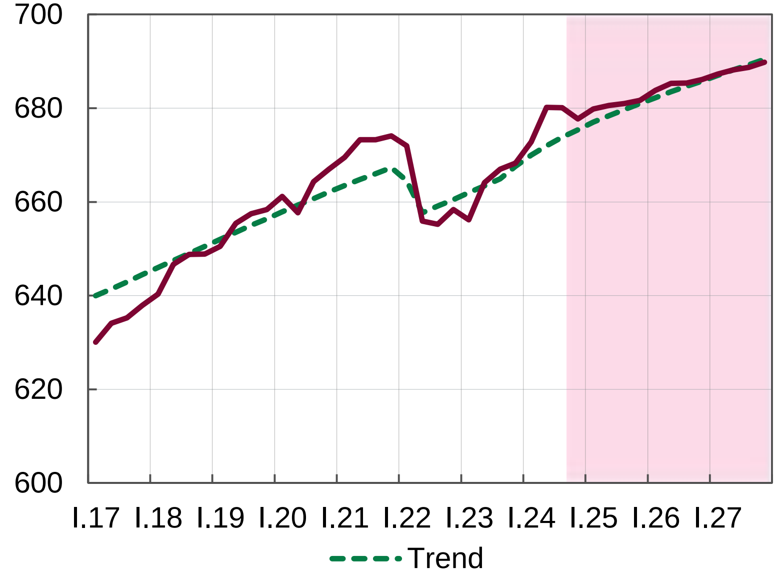
Labor shortages will remain significant and limit economic recovery

The Beveridge curve



Source: SSSU, work.ua, NBU staff estimates.

Real wages, level (logs)

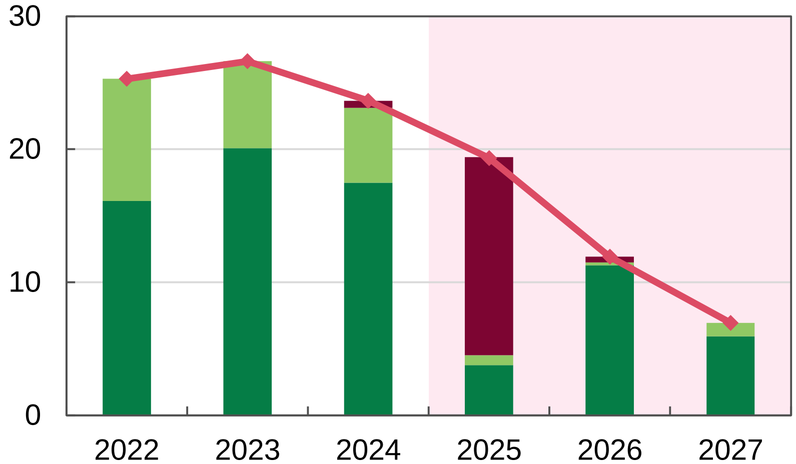


Source: SSSU, NBU staff estimates.

- **The shortage of personnel stimulated further wage growth.** In Q3 2024, real wages exceeded pre-war levels in most types of economic activity. The demand for qualified workers will remain high, which will determine further wage growth in the private sector
- **Due to increase in demand for labor, unemployment will gradually decrease**, but will still remain higher than the level before the full-scale invasion. Disproportions in the labor market will persist primarily due to the limited supply of labor with appropriate qualifications

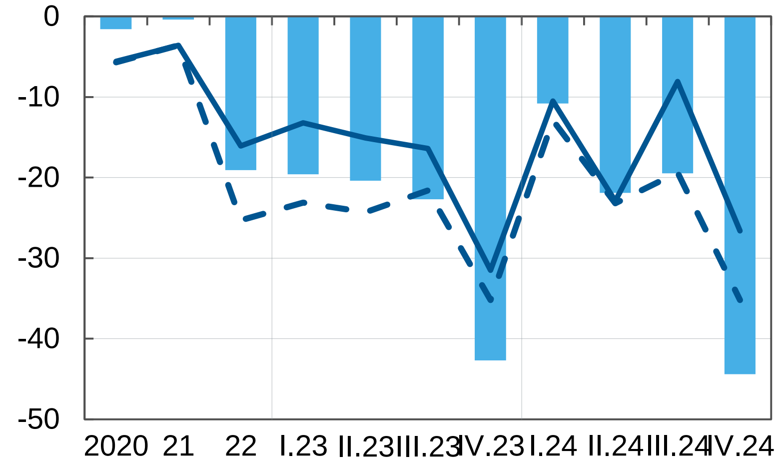
The budget deficit will gradually decrease (from 19.3% of GDP in 2025 to 7% of GDP in 2027)

Consolidated budget deficit, % of GDP



Source: STSU, SSSU, NBU staff estimates..

General government fiscal balance*

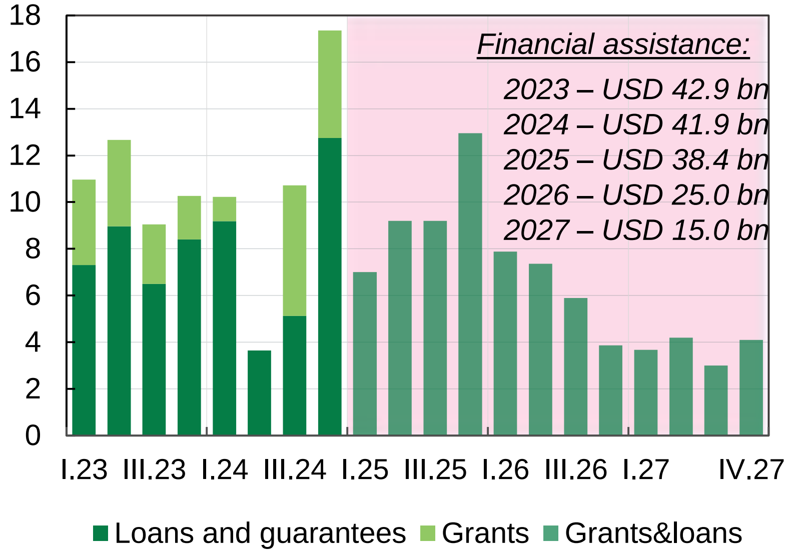


* Overall balance is the consolidated budget balance, taking into account loans to the PFU from the STA. A negative value indicates expansionary fiscal policy.
Source: STSU, SSSU, NBU staff estimates.

- **The expansionary fiscal policy significantly boosted aggregate demand.** Increased expenditures were supported by efforts to mobilize budget revenues and actively attract resources from the domestic debt market
- **International support will be adequate** to finance the budget deficit **without resorting to monetary financing**
- **The gradual reduction of fiscal stimulus will be offset by the growing contribution of the private sector** to economic growth

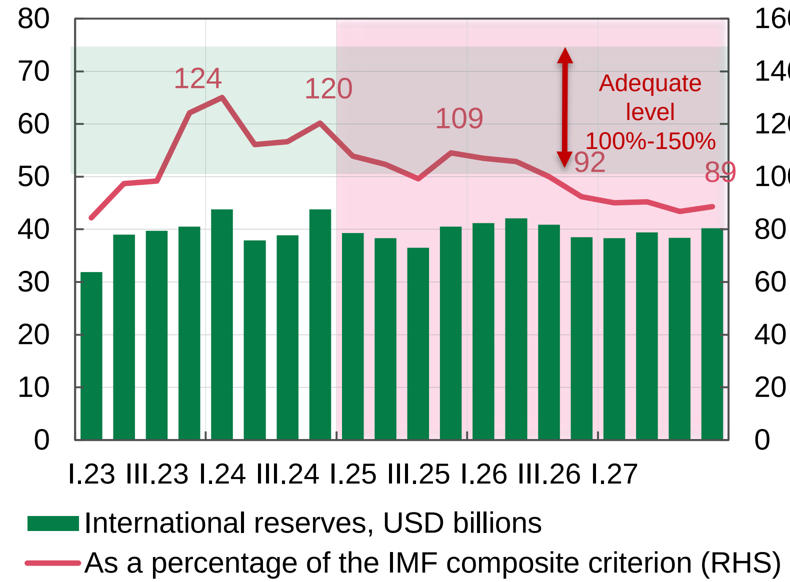
Significant international assistance and a high level of reserves will help ensure the sustainability in the FX market

International financial assistance, USD billions



Source: NBU, MFU, data from open sources, NBU assumptions.

Gross international reserves

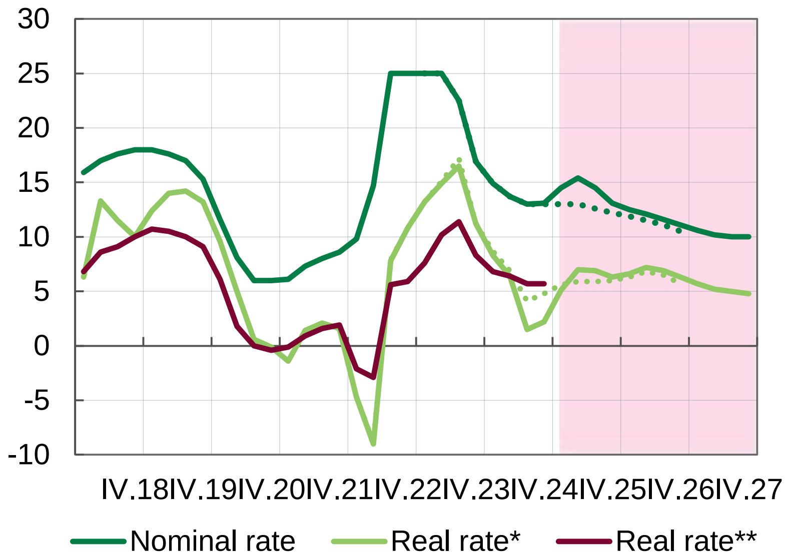


Source: NBU staff estimates.

- **Given the expected volumes of international financial assistance, the NBU will be able to compensate for the structural FX deficit in the private sector** and smooth out excessive exchange rate fluctuations
- **The need for the NBU's interventions will gradually decline.** However, amid fiscal consolidation, international financial assistance will also decline, while external debt repayments will increase. As a result of these factors, international reserves will fluctuate at a relatively stable level, at around USD 40 bn in 2025-2027

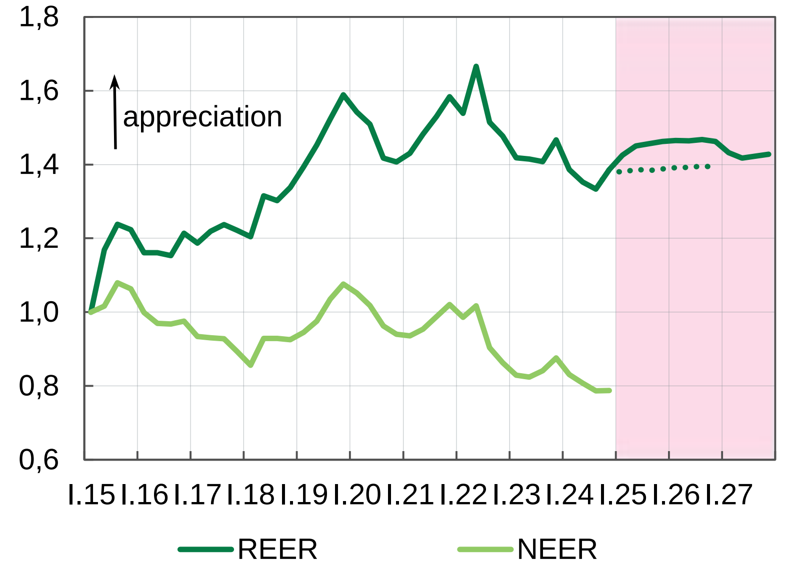
The updated macro forecast of the NBU foresees a further increase in the key policy rate to curb inflation

Key policy rate, %



* Deflated by model expectations (QPM).
** Deflated by the expectations of financial analysts.
Source: NBU staff estimates.

REER and NEER indices, Q1 2015 = 1



Source: IMF, national statistical offices, NBU staff estimates.

- **An increase in the real rate will contribute to improving expectations**, as well as the redistribution of financial flows from consumption and FX purchases in favor of hryvnia savings, which will reduce pressure on the ER and international reserves
- **The key rate will remain positive (5-7%) in real terms** (the neutral level of the real rate in 2016−2019 was estimated at 3-4%), which is not excessive in the current conditions (high risks)
- **The hryvnia REER will remain relatively strong** (strong hryvnia ER against the euro), which will ensure the maintenance of fairly tight real monetary conditions

Risks

Degree of impact on the baseline scenario		Probability of Risk Occurrence: Low <15%	Average 15%–25%	High 25%–50%
	Weak			
	Moderate	Rapid restoration of damaged energy infrastructure Accelerating European Integration Processes	Increased negative migration trends Raising taxes	Greater geopolitical polarization and the corresponding fragmentation of global trade
	Strong	Rapid implementation of the large-scale plan for the reconstruction of Ukraine A faster end to active hostilities	Less regular international assistance Strengthening financial support from partners	Escalation of hostilities, further destruction of production facilities Higher electricity deficit due to further damage to the energy infrastructure Additional budgetary needs