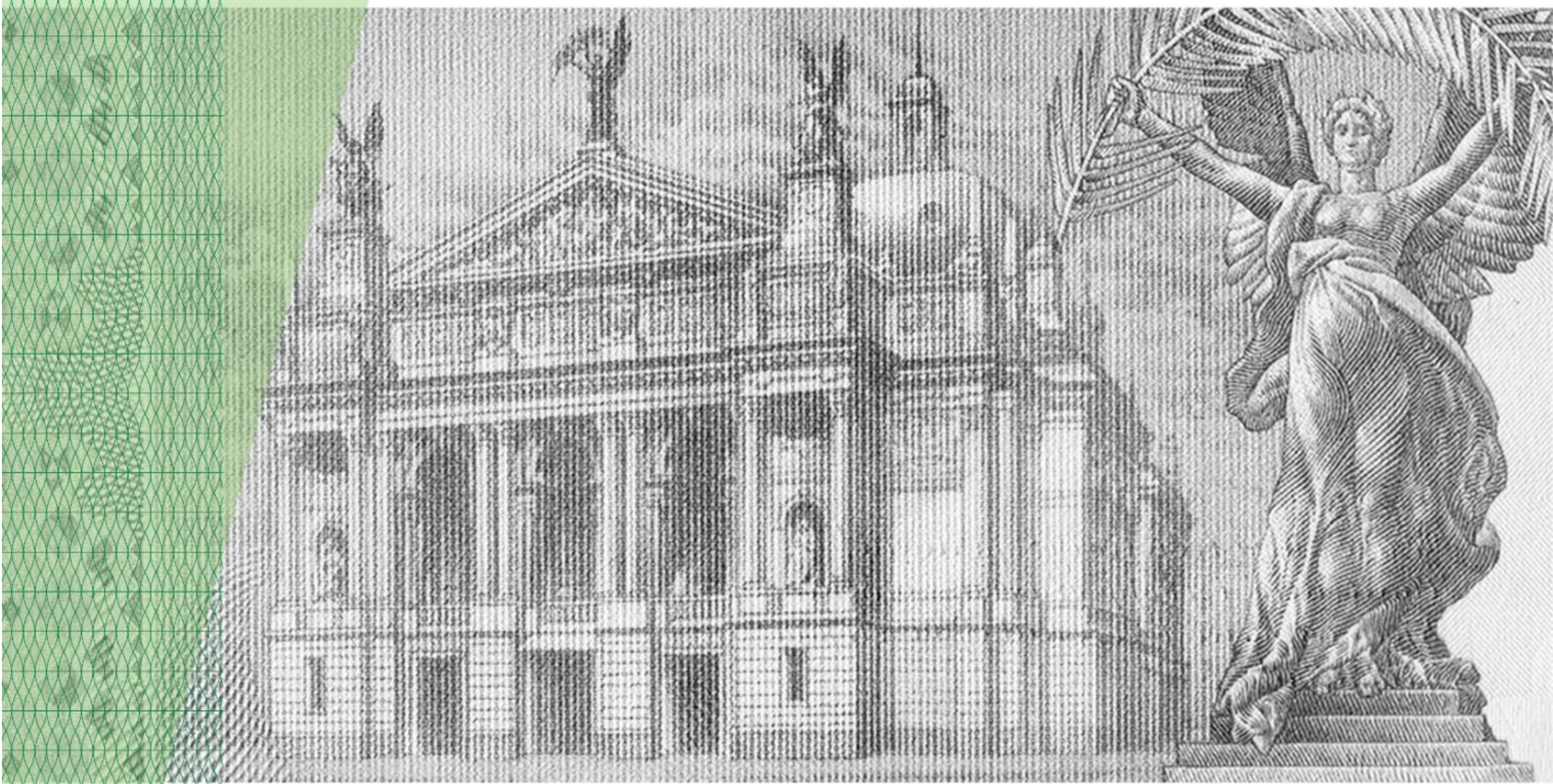
National Bank of Ukraine

Inflation Report

October 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. At the current stage, these goals are being achieved by a coordinated combination of interest-rate-policy and exchange-rate-policy instruments, as well as FX restrictions in accordance with the *Monetary Policy Guidelines for the Medium Term* and the *Strategy for Easing FX Restrictions, Transitioning to Greater Flexibility of the Exchange Rate, and Returning to Inflation Targeting*.

In particular, monetary policy aims to bring inflation, measured by the year-on-year change in the CPI, to its target of 5% over the relevant policy horizon which length does not exceed three years. The flexibility of the current monetary regime allows moderate and relatively short-term deviations of inflation from its quantitative target due to domestic and external factors beyond the effective reach of the NBU's monetary policy. On the one hand, such approach helps the Ukrainian economy adapt to shocks and supports its recovery, and, on the other hand, allows keeping inflation expectations under control.

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 monetary instrument. Changes in the key policy rate and adjustments to the operational framework of interest rate policy take into account significant shifts in the balance of risks, and are primarily aimed at maintaining the sustainability of the FX market and ensuring price and financial stability.

Considering the principles of managed flexibility of the exchange rate, the NBU maintains an active presence in the FX market and compensates for the structural shortage of foreign currency in the private sector to ensure that the exchange rate fluctuates moderately in both directions as market conditions change. Coupled with smoothing out excessive exchange rate volatility, this contributes to keeping inflation and exchange-rate expectations in check, maintaining confidence in the hryvnia, and bringing inflation to the target of 5%. Concurrently, exchange rate flexibility makes it possible to fortify the Ukrainian economy's and the FX market's resilience to domestic and external shocks and reduces the risk of accumulation of external trade imbalances.

Aware of the urgent need to minimize FX market distortions, improve the conditions for doing business in Ukraine and for entry of domestic businesses into new markets, support the economy's recovery, and promote new investment inflows into the country, the NBU is gradually easing the FX restrictions as appropriate prerequisites are met.

The NBU plans to use flexible inflation targeting until the economy's functioning normalizes and inflation targeting is restored to its full format with a floating exchange rate.

The analysis in the current Inflation Report (October 2024) is based on the data available at the date of its preparation. Thus, the time horizon of the analysis may vary for some indicators. For the majority of indicators, the cut-off date for the data in this report is 30 October 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 31 October 2024[1].

The NBU Board makes decisions on the key policy rate and other monetary instruments 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. 392 *On Approval of the Inflation Report* dated 31 October 2024.

Summary

The baseline scenario of the NBU's macroeconomic forecast assumes that Ukraine will continue to conduct prudent monetary and fiscal policies aiming at 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 conditions in which the economy operates will gradually normalize over the forecast horizon. This will take the form of the full unblocking of sea ports, the expansion of opportunities for investment and economic activity, and the gradual return of forced migrants to Ukraine.

As expected, inflation has increased in recent months. However, the pace of the increase was somewhat faster than forecast

In September, inflation accelerated to 8.6% yoy. It rose in October as well, according to the NBU's estimates. The increase in the price pressure in H2 2024 was expected, being reflected in the NBU's previous forecasts (Inflation Reports of January, April, and July 2024). At the same time, the growth in both consumer and core inflation (7.3% yoy in September) was faster than forecast.

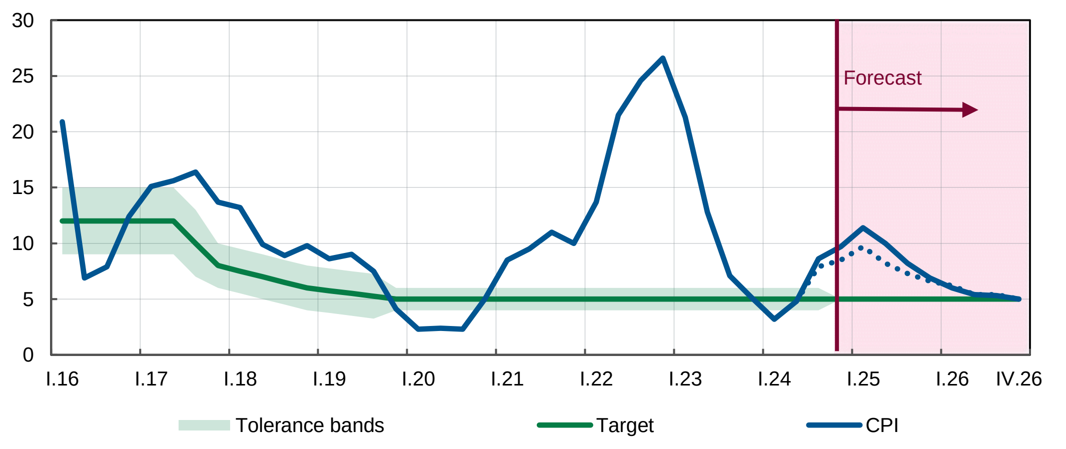
An important contribution to these dynamics came from an increase in food prices on the back of smaller-than-expected harvests of various crops, and from the related growth in the cost of food industry inputs. The rise in inflation was also driven by further increases in production costs, including the costs of electricity and labor, as well as by exchange rate effects from the weakening of the hryvnia in previous periods.

Despite the acceleration of inflation in recent months, economic agents' inflation expectations remained sufficiently stable and manageable, albeit worsening marginally.

The pressure on prices will persist in the coming months, but inflation will start to slow in spring 2025

In the coming months, the pressure on prices will persist due to the further impact of food supply factors, increases in budget expenditures, rapid wage growth, and wider energy shortages during the heating season. As a result, inflation will hit 9.7% at the end of 2024.

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



Source: SSSU, NBU staff estimates.

That said, inflation will start to decline in spring 2025. A deceleration in the price growth next year will be driven by the NBU's prudent monetary policy and weaker external price pressures, as well as by an improvement in the energy sector and an increase in harvests. The NBU forecasts inflation to decline to 6.9% at the end of 2025 and return to the 5% target in 2026.

The economy continues to grow, although the growth remains limited due to the war

The waves of russia's attacks on the energy infrastructure, an increase in migration, and labor shortages slowed the economic recovery. However, real GDP kept growing, in both

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

Q2 and Q3 2024. That said, smaller shortages of electricity and somewhat larger harvests of early grain crops enabled the NBU to revise its forecast for real GDP growth in 2024 upward, to 4%.

Significant budget stimuli, backed by large volumes of international financing, rising household income, growing outputs in crop farming, and sustained external demand will support further growth in the Ukrainian economy, at 4.3%–4.6% in 2025–2026.

The uncertainty about volumes of international assistance decreased. Sufficient inflows of external support will allow the government to continue financing large budget expenditures and enable the NBU to maintain the sustainability of the FX market

In October, the IMF disbursed another tranche to Ukraine in the amount of USD 1.1 billion as a result of the fifth review of the Extended Fund Facility (EFF). Around USD 300 million of concessional financing came from Canada. By the end of the year, Ukraine is expected to receive more than USD 15 billion, of which USD 4.8 billion under the World Bank's SPUR program supported by financing from the United States. In addition, considerable progress was made in confirming future volumes of assistance. International partners came much closer to the disbursement to Ukraine of a non-repayable loan secured by proceeds from frozen russian assets, to the total amount of USD 50 billion as part of the Extraordinary Revenue Acceleration (ERA) Loans.

Therefore, international support for Ukraine will remain significant. Taking into account the expected inflows, the NBU has improved its assumptions about external financial support for 2024–2026. The total amount of international financing is expected to reach USD 41.5 billion this year and USD 38.4 billion next year. The continued external support, together with sufficient volumes of borrowing from the domestic market, will enable the government to keep covering the large budget deficit without resorting to monetary financing.

In order to bring inflation back to its target over the coming years, the NBU is keeping the key policy rate at 13%, while maintaining an active presence on the FX market

Given that inflation has not yet peaked, and that upside risks to inflation have even increased for the coming months, the NBU believes it appropriate to remain cautious while conducting its interest rate policy, and to take prudent measures to safeguard the sustainability of the FX market.

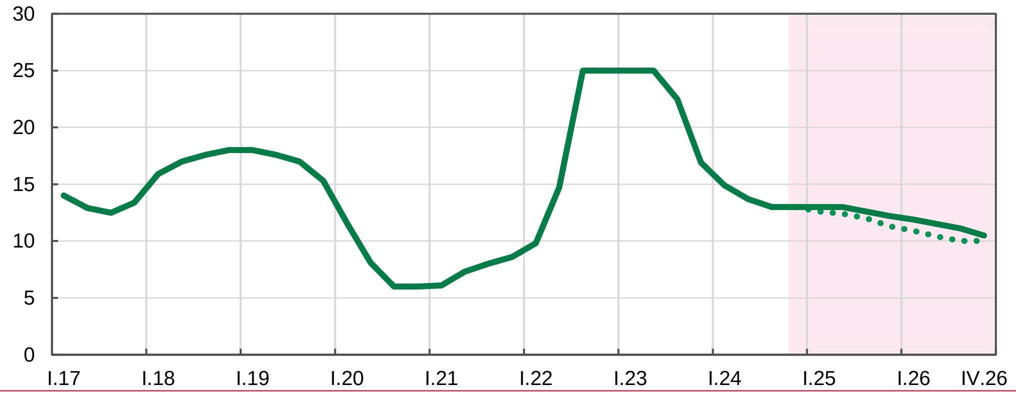
To counteract price pressures, the NBU suspended its easing cycle of interest rate policy starting from July. This has supported interest in hryvnia savings, the interest rates of which currently provide adequate protection against inflationary depreciation. In particular, the inflow of households' hryvnia term deposits resumed in the autumn, and investments in hryvnia-denominated domestic government debt securities continued to grow.

The policy of protecting hryvnia savings from being eroded away by inflation will continue to help limit pressures on the FX market and preserve international reserves. Using the regime of the managed flexibility of the exchange rate, the NBU will compensate for the structural deficit of foreign currency in the private sector and smooth out excessive exchange rate fluctuations. The exchange rate will fluctuate moderately in both directions in response to changing market conditions, which will further strengthen the adaptability of the FX market and the economy. Exchange rate movements will be in line with the NBU's objectives of keeping inflation expectations under control, slowing inflation next year, and returning it to its 5% target over the policy horizon.

If upside risks to inflation continue to materialize, the NBU stands ready to deploy all available monetary policy tools

The revised NBU forecast envisages keeping the key policy rate at 13% for a longer period – at least until the summer of 2025. In the event that price pressures continue to rise above the forecast and threaten to unanchor inflation expectations, the NBU will stand ready to tighten its interest rate policy and apply additional monetary measures.

Figure 2. Key policy rate, quarter average



Source: NBU staff estimates.

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

Due to the war, the risks of a further decline in economic potential remain, in particular due to the loss of people, territories, and production facilities. The speed of the economy's return to normal functioning conditions will depend on the nature and duration of the war.

What is more, russian aggression continues to generate the following risks:

- the emergence of additional budget needs, mainly those to maintain defense capabilities
- the likelihood of an additional hike in taxes, which – depending on its parameters – might drive up pressures on prices
- further damage to infrastructure, especially energy and port infrastructure, which will restrain economic activity and put supply-side pressures on prices
- a deepening of adverse migration trends and a further widening of labor shortages on the domestic labor market.

There is also a risk of increased geopolitical tensions in the world amid the war in the Middle East, the electoral cycles in a number of countries, and russia's attempts to form a coalition of states to confront the democratic world.

At the same time, a number of positive scenarios might materialize, resulting from further acceleration of European integration processes and recovery in the energy sector.

Macroeconomic forecast (October 2024)

Indicators	2021	2022	2023	2024						2025						2026					
				I	II	III	IV	current forecast	forecast 07.2024	I	II	III	IV	current forecast	forecast 07.2024	I	II	III	IV	current forecast	forecast 07.2024
REAL ECONOMY, % yoy, unless otherwise stated																					
Nominal GDP, UAH bn	**5451**	**5239**	**6538**	1609	1706	2088	2226	**7630**	7590	1821	1941	2387	2572	**8720**	8620	2060	2176	2649	2830	**9715**	9625
Real GDP	**3.4**	**-28.8**	**5.3**	6.5	3.7	4.0	2.4	**4.0**	**3.7**	2.3	3.4	4.6	6.3	**4.3**	**4.1**	5.7	5.1	4.4	3.6	**4.6**	**4.8**
GDP Deflator	24.8	34.9	18.5	10.9	12.4	12.8	12.4	12.2	11.9	10.6	10.0	9.4	8.7	9.6	9.1	7.0	6.7	6.3	6.2	6.5	6.5
Consumer prices (period average)	9.4	20.2	12.9	-	-	-	-	6.1	5.8	-	-	-	-	9.5	8.2	-	-	-	-	5.7	5.7
Consumer prices (end of period)	**10.0**	**26.6**	**5.1**	3.2	4.8	8.6	9.7	**9.7**	**8.5**	11.4	10.0	8.2	6.9	**6.9**	**6.6**	6.0	5.4	5.3	5.0	**5.0**	**5.0**
Core inflation (end of period)	7.9	22.6	4.9	4.2	5.0	7.3	9.1	9.1	7.1	9.1	8.4	6.6	5.7	5.7	4.5	5.3	4.6	3.8	3.1	3.1	3.1
Non-core inflation (end of period)	13.5	30.6	5.7	2.4	4.5	10.5	10.4	10.4	10.0	14.4	12.1	10.1	8.2	8.2	9.0	6.9	6.3	7.0	7.3	7.3	7.1
raw foods (end of period)	11.8	41.6	2.2	-4.9	-6.5	7.1	6.7	6.7	5.3	12.9	13.0	9.2	5.9	5.9	4.0	4.5	3.9	3.3	2.8	2.8	2.8
administrative prices (end of period)	13.6	15.3	10.7	9.9	13.3	14.0	14.0	14.0	14.0	14.9	10.6	10.1	10.0	10.0	14.2	9.7	9.2	11.3	12.3	12.3	11.9
Nominal wages (period average)	20.9	6.0	17.4	22.5	22.1	19.4	20.5	21.0	16.1	22.0	17.1	15.1	10.8	16.0	14.6	9.0	9.4	8.7	8.6	8.9	8.7
Real wages (period average)	10.5	-11.4	3.7	17.7	17.6	11.4	10.1	14.0	9.7	10.3	6.2	6.3	3.8	6.5	5.8	2.6	3.3	2.7	3.1	2.9	2.9
Unemployment rate (ILO, period average)	9.8	21.1	18.2	-	-	-	-	14.2	13.9	-	-	-	-	11.6	11.4	-	-	-	-	10.6	10.3
FISCAL SECTOR																					
Consolidated budget balance, UAH bn	**-187**	**-845**	**-1331**	-	-	-	-	**-1347**	**-1241**	-	-	-	-	**-1640**	**-1176**	-	-	-	-	**-1182**	**-853**
% of GDP	-3.4	-16.1	-20.4	-	-	-	-	-17.7	-16.3	-	-	-	-	-18.8	-13.6	-	-	-	-	-12.2	-8.9
excluding grants from revenues, % of GDP	-3.4	-25.3	-27.0	-	-	-	-	-23.3	-22.8	-	-	-	-	-19.6	-17.8	-	-	-	-	-12.4	-10.3
BALANCE OF PAYMENTS (analytical presentation)																					
Current account balance, USD bn	-3.9	8.0	-9.6	-3.4	-6.1	-1.5	-5.3	-16.3	-14.2	-7.2	-6.9	-7.4	-6.4	-27.9	-19.0	-7.0	-7.1	-7.3	-6.9	-28.4	-23.5
Exports of goods and services, USD bn	81.5	57.5	51.3	14.2	13.8	13.3	15.8	57.2	57.0	13.8	13.0	14.2	16.7	57.7	57.3	14.9	14.6	16.3	17.8	63.6	63.4
Imports of goods and services, USD bn	84.2	83.3	89.2	21.1	22.5	23.1	25.4	92.1	91.9	23.4	22.8	24.2	25.2	95.6	93.9	23.6	23.3	24.8	25.6	97.3	95.6
Remittances in Ukraine, USD bn	14.0	12.5	11.3	2.5	2.4	2.4	2.7	9.9	10.6	2.7	2.7	2.8	2.9	11.1	11.6	3.0	3.1	3.1	3.2	12.4	12.8
Financial account, USD bn	-4.4	11.1	-18.9	-6.5	-0.4	-0.6	-7.7	-15.2	-11.4	-5.1	-7.1	-4.1	-8.6	-24.9	-15.5	-5.6	-5.8	-5.8	-5.1	-22.2	-17.6
BOP overall balance, USD bn	**0.5**	**-2.9**	**9.5**	3.2	-5.6	-0.8	2.5	**-0.8**	**-2.6**	-2.0	0.2	-3.2	2.2	**-2.9**	**-3.5**	-1.5	-1.3	-1.6	-1.9	**-6.2**	**-5.9**
Gross reserves, USD bn	**30.9**	**28.5**	**40.5**	43.8	37.9	38.9	43.6	**43.6**	**41.2**	41.5	41.9	38.7	41.0	**41.0**	**37.3**	39.9	38.1	37.1	34.7	**34.7**	**32.0**
Months of future imports	4.5	3.8	5.3	5.6	4.8	4.9	5.5	5.5	5.3	5.2	5.2	4.8	5.1	5.1	4.7	4.9	4.6	4.4	4.1	4.1	3.8
MONETARY ACCOUNTS (cumulative since the beginning of the year)																					
Monetary base, %	**11.2**	**19.6**	**23.3**	3.1	10.5	7.4	13.3	**13.3**	15.5	3.0	5.8	8.1	13.1	**13.1**	12.1	0.7	3.7	5.7	11.4	**11.4**	10.0
Broad money, %	**12.0**	**20.8**	**23.0**	1.7	6.0	6.1	13.3	**13.3**	16.1	0.7	3.6	5.0	11.2	**11.2**	11.4	0.4	2.8	4.8	9.7	**9.7**	9.2
Velocity of broad money (end of year)	**2.6**	**2.1**	**2.1**	-	-	-	-	**2.2**	2.1	-	-	-	-	**2.2**	2.2	-	-	-	-	**2.3**	2.2

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	**9.7**	**6.9**	**5.0**	Higher path-through of production costs to prices, food price increases due to adverse weather conditions, increase in budget expenditures, higher mismatches in the labor market
	1.2	0.3	0.0	
Real GDP growth, %	**4.0**	**4.3**	**4.6**	Higher harvest, reconstruction of energy capacities, higher budget incentives
	0.3	0.2	-0.2	
Nominal GDP, UAH bn	**7630**	**8720**	**9715**	Faster economic recovery and higher inflation
	40	100	90	
Consolidated budget balance (excluding grants from revenues), % of GDP	**-23.3**	**-19.6**	**-12.4**	Higher budget expenditures for defense, social support and reconstruction
	-0.5	-1.8	-2.1	
Current account balance, USD bn	**-16.3**	**-27.9**	**-28.4**	Worse trade balance, lower amounts of official grants (albeit higher amounts of loans)
	-2.1	-8.9	-4.8	
Gross international reserves, USD bn	**43.6**	**41.0**	**34.7**	Higher amounts of official financing
	2.4	3.7	2.7	
Key policy rate (period average), %	**13.6**	**12.7**	**11.2**	Higher inflation pressure
	0	*0.6*	*0.9*	

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	41.5	38.4	25.0
Migration (net, excluding russia and belarus)	m			-0.2	-0.5	-0.2	0.2
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	5.8	3.9	2.7
World prices:**							
Steel price, Steel Billet Exp FOB Ukraine	USD/t	615.0	618.1	539.7	506.6	507.0	494.3
	% yoy	57.9	0.5	-12.7	-6.1	0.1	-2.5
Iron ore price, China import Iron Ore Fines 62% FE	USD/t	161.7	121.4	120.6	107.4	87.6	76.2
	% yoy	48.5	-24.9	-0.7	-10.9	-18.4	-13.0
Steel price, No.1 Hard Red Winter, ordinary protein, Kansas City	USD/t	265.8	360.2	272.3	215.8	232.5	247.3
	% yoy	43.3	35.5	-24.4	-20.7	7.7	6.4
Corn price, Yellow #2 Delivery USA Gulf	USD/t	259.4	318.4	252.7	189.6	213.8	223.3
	% yoy	56.8	22.7	-20.6	-25.0	12.8	4.4
Oil price, Brent	USD/bbl	70.4	99.8	82.6	82.0	74.7	73.1
	% yoy	66.5	41.8	-17.2	-0.7	-8.9	-2.1
Natural gas price, Netherlands TTF	USD/kcm	574.8	1355.9	465.6	370.1	384.7	336.5
	% yoy	399.9	135.9	-65.7	-20.5	3.9	-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	55.2	57.9	61.7
Minimum wage**	UAH	6042	6550	6700	7775	8370	8950

* *Actual data*

** *Annual average.*