

Macro Insight

The fog thickens

The Ukrainian economy is going through the most challenging period since 2022, as Russia's terrorist attacks on industrial facilities as well as national storage and transport infrastructure continue unabated. The outright loss of assets by many businesses is amplified by an unprecedented uncertainty and suspension of critical sea export routes. As much of the damage will be irreparable during the war, the economy is set to contract in 4Q26 and further in 2027. Yet, we expect only a contained decline as the structure of the economy has shifted heavily towards services and the defense sector over the past years. Economic contraction is being accompanied by a pick up in inflation, which has been in double digits since September. We now expect the CPI peak to be close to 12% during the winter, and the yearly tally will only return to single-digit territory in 3Q27. The inflation surprise can be mainly put down to cost pressures due to more expensive logistics and higher fuel prices. With new risks crystalizing, the NBU may choose to deliver another 50bp key policy rate hike to 16.5% and will likely keep the rate at this level through end-1H27. The NBU is facing growing challenges in making transmission work as commercial rates have stayed unresponsive to NBU's move over the past several months. The deficit of external accounts (net of foreign aid) continues to grow. Export shrank as sea transportation routes are effectively closed while import is expanding on purchases of foreign weapons and their components, all being funded with a defense component of US\$. Concessional funding, although much delayed, should remain sufficient for patching the external gap at least until end-2027. This implies the NBU will remain in a strong position to keep the FX market under its full control. We see only moderate hryvnia depreciation in 4Q with the rate reaching UAH45.8/\$ at end-2026 and UAH49.2/\$ at end-2027. On the fiscal front, we see 4Q government liquidity problems as temporary, but 2027 presents a real challenge. The government is yet to secure over US\$25bn in additional funding needed for the next year. Like in previous reports, we assume no major change in the security risks in the medium-term – no peace deal and no major territory gains by the enemy.

Economy adjusting fast to new risks; some damage irreparable for now

Since mid-summer, businesses have faced the grave challenges last seen in 2022 in the immediate aftermath of the full-scale Russian invasion. Massive damage to warehouses, industrial production facilities, and transport infrastructure in the Kyiv vicinity and eastern regions imposed a new type of reality where production chains and logistics need to be rebuilt for thousands of companies. According to a survey by the Kyiv-based Institute of Economic Research, around 90% of companies claim their

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Key macroeconomic data and projections

	2026F	2027F
Real GDP, YoY, %	-0.6	-1.9
Nominal GDP, US\$bn	225	230
Inflation, YoY, %, e.o.p.	12.0	8.2
Key policy rate, %, e.o.p.	16.5	15.5
UAH/USD, e.o.p.	45.8	49.2
C/A balance, % of GDP	-7.7	-8.7
NBU reserves, US\$ bn	59.7	53.2
Budget gap, % of GDP*	-21	-23
Public debt, % of GDP	104	105

* budget balance before official grants
Source: UkrStat, NBU, ICU

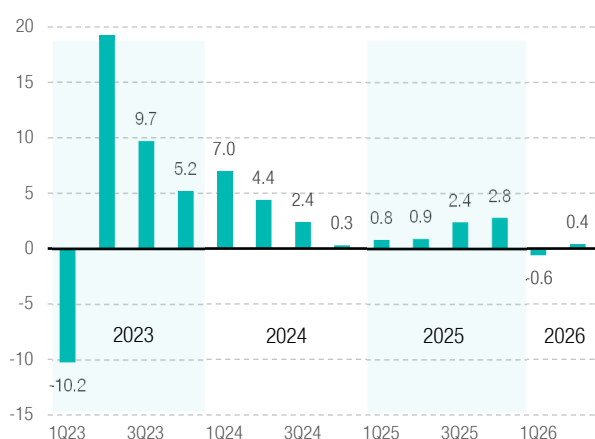
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activities are affected by Russia's attacks on infrastructure, and 7% of businesses claim they have had to bear direct losses. The economic impact is twofold. Firstly, some businesses lost part of production facilities outright and have no plans to carry out repairs until peace is achieved. Some are pausing production due to heightened risks to their workers and/or lack of capacity to deliver production to external markets. Large metal producers and iron ore miners are the notable examples. Secondly, supplies of raw materials have become more expensive and take longer, which is adding pressure on businesses that continue to operate.

There is no doubt that the economy is in contraction. Industrial production was down 6.1% YoY in August and, it is safe to say, shrank even more in September. Construction and transportation are also in decline. The harvesting campaign likely helped maintain 3Q real GDP numbers in positive territory, but 4Q will erase all the modest 9M26 gains. A silver lining is hard to find in such circumstances, but some pillars of strength remain. Private household consumption remained very strong in 1H26, and retail trade data for August show it is likely to remain a positive contributor to economic growth, albeit to a lesser extent. The role of government consumption is becoming more prominent as the state started to make substantial purchases of domestically produced weapons and ammunition funded with the defense component of the Ukraine Support Loan (USL). Against this backdrop, the real GDP decline will likely be contained to 0.5-0.7% in 2026 (vs our earlier projection of 0.8% growth).

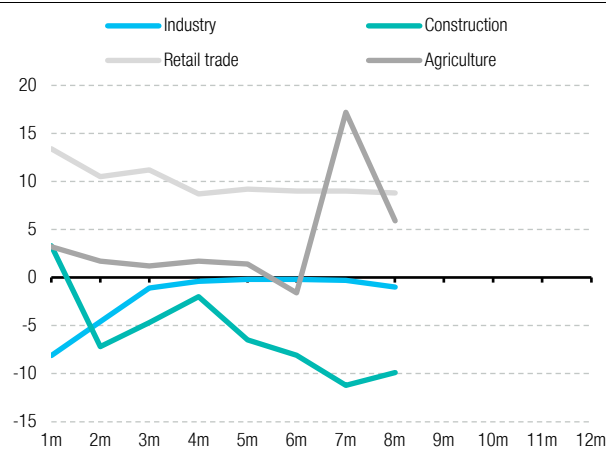
The next year will present more challenges. Large industrial companies, including steel producers, are expected to stay idle for longer periods of time in 2027 compared with 2026. Also, local farmers, faced with limited export opportunities and unfavorable domestic prices (often below breakeven level), will likely be forced to reduce areas under production. On the demand side, investments and private consumption will remain contained due to lingering uncertainty and persistent security risks. We therefore see real GDP contracting by 1-2% in 2027. Yet, any visible improvement in the security situation and resumption of operations of Black Sea ports could fully offset the risk and keep economic output flat.

Chart 1. Real quarterly GDP, change YoY, %



Source: Ukrstat, ICU.

Chart 2. Real output of sectors in 2026, change YoY*, %



* cumulative change from the start of the year

Source: Ukrstat, ICU.

Inflation broad-based; surpasses expectations

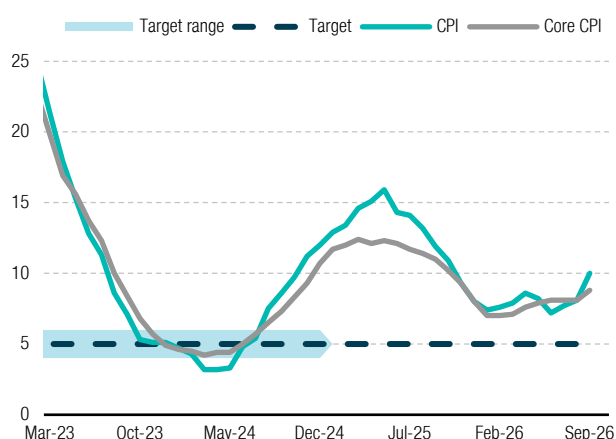
Annual CPI surged to 10.0% in September from 8.1% in August; core inflation was up to 8.8% YoY from 8.1% in August. The monthly inflation stood at 2.1% last month, the highest September reading since 2015, when Ukraine experienced the previous major crisis and period of rapid hryvnia depreciation. Much of monthly inflation is driven by typical seasonal revision of prices, yet this year, the magnitude was much more visible. Annual price growth sped up for nearly all components of the consumer basket. Yet, the largest disappointment was food prices, which accelerated to 8.9% YoY from 5.9% a month before despite the relatively strong harvest of grains, fruits, vegetables, and oilseeds.

September inflation was much higher than we and the market expected, thus underscoring the substantial cost pressures amplified by Russia's attacks on storage and transportation infrastructure over the past two months. By our estimates, that was the most significant contributor that made the CPI trend deviate from broader market expectations. Given September's surprise, we now expect end-2026 CPI to be close to 12%. Although inflation will start to decelerate in 1Q27, it is set to remain in double digits until 3Q27. We don't think there are significant risks of inflation spinning out of control as several disinflationary forces remain in play, including abundant supply of agricultural produce, a relatively stable exchange rate, and growing economic uncertainty that may dampen private consumption.

NBU likely to hike key policy rate by another 50bp

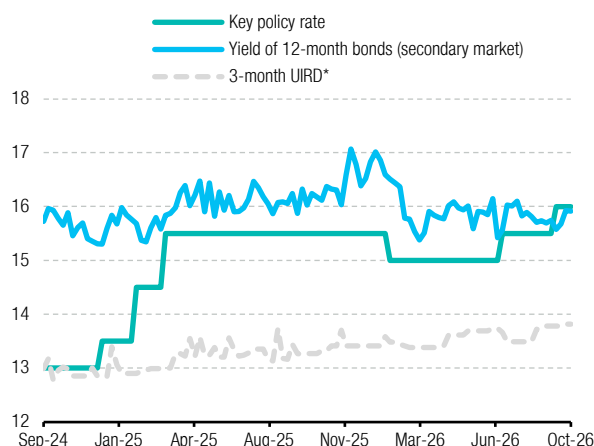
The monetary-policy-committee minutes following the September 50bp key policy rate hike did not reveal the appetite to maintain an upward rate trend. That was before the September inflation surprise. Now that double-digit inflation is clearly a reality for the next couple of quarters, the central bank will need to assess if a tighter policy is warranted. The quick answer is yes – a big negative surprise implies a need for more decisive actions. The counterargument here is that at these levels, the marginal effect of the key-policy-rate increase on commercial rates is close to zero (see below). Higher rates clearly feed into banks' profits via rising yields on CDs while businesses and households don't receive any additional reward on their savings. At this point, we believe the NBU will opt for another 50bp hike to 16.5% in October to signal it is taking the risks seriously and pause thereafter.

Chart 3. CPI, core CPI and inflation target, YoY, %



Source: UkrStat, NBU, ICU.

Chart 4. NBU key policy rate and commercial rates, %



* Ukrainian index of retail deposit rates

Source: NBU, ICU.

Commercial rates show little sensitivity to key policy rate

The two key policy rate hikes of 50bp each since July revealed a major challenge the NBU is facing in 2H26: commercial rates have barely moved since then. The vast majority of banks have kept the cost of deposits unchanged in the past months. Three-month UIRD, the index of retail deposits, was up by 34bp, but the increase was fully driven by decisions of a couple of banks that have an insignificant deposit base. The Ministry of Finance's stance was noticeable as it fully ignored key policy rate hikes and kept yields on UAH debt little changed. MinFin's arguments are crystal clear – to minimize interest rate risks towards the end of the year, they were in a rush to front-load their borrowings. The debt that remains to be sold in 4Q will be easily digested by the market at current yields. With no rate response in the primary market, rates in the secondary market, including those offered to retail investors, also stayed little change. We must note, though, that this strategy of the MinFin of disregarding NBU rate hikes may remain viable only if the government doesn't revise the borrowing plan for 4Q, an event that we believe has low probability despite funding pressures facing the budget.

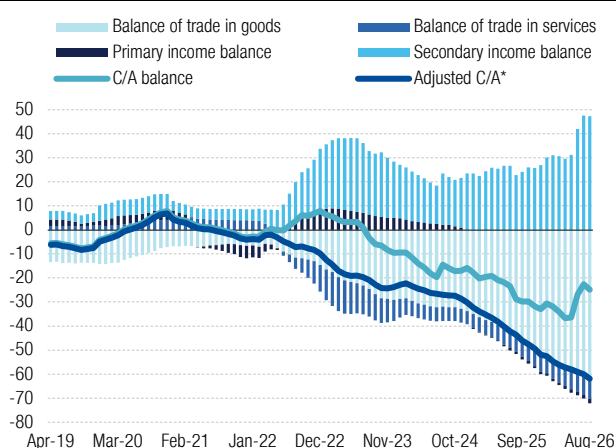
External deficit at its widest since the start of the war

Ukraine's external imbalances keep ballooning. The key culprit is the closure of export sea routes due to Russia's attacks on ports and vessels. In 3Q, Ukraine had to stop nearly all

deliveries of agricultural produce, iron ore, and steel via Black Sea ports. August statistics underscore the gravity of the situation: export was down 19% YoY (8M26 volumes were still at +1% YoY), and the September numbers were likely even worse. Delivery of grains were partly redirected via railways and Danube river ports. Yet, the authorities indicated that September volumes were below half of what is needed to ensure timely sales of agricultural produce abroad. There is no indication the situation may improve materially in the foreseeable future. Moreover, significant damage to steel producing facilities means export will continue to suffer even if logistics hurdles ease.

Import of goods, on the other hand, is surging and was up 23% YoY in August (+27% in 8M26). Yet, one should keep in mind the bulk of the total increase is driven by purchases of foreign weapons and inputs for the local defense industry. In June, the EU started to disburse tranches of the EUR30bn defense component of the Ukraine Support Loan (USL). A significant part of weaponry and munitions that were previously supplied by Ukraine's partners for free is now being purchased by Ukraine with USL money with a direct impact on import statistics. It's not surprise that Ukraine's deficit of foreign trade will continue to widen and may exceed 35% of GDP in 2026. That implies a C/A gap (net of foreign financial aid) close to 30% of GDP. There appears to be very few preconditions for improvements in 2027 unless a 2022-style Black Sea «grain corridor» eases export constraints.

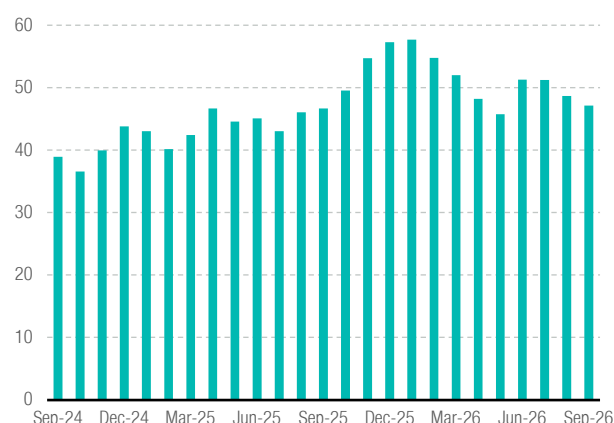
Chart 5. Current account, 12-month trailing, US\$bn



* net of official transfers to the government

Source: NBU, ICU.

Chart 6. NBU gross international reserves, US\$bn



Source: NBU, ICU.

The financial account side of the BoP remains in relatively good shape given the tough capital controls that the NBU is not in a rush to soften. Capital outflows from the private sector are not significant and mainly stem from cash FX purchases by the population. They were at \$4.9bn in 8M26, a level that is not a big concern. Strict restrictions on repayments of external loans and repatriation of FDI are likely to remain in place in 2027, and we, thus, don't expect any negative surprises emerging on the financial account side. The only thing that could go wrong is an upsurge of FX purchases by the population, but we see little risk of this happening as the hryvnia exchange rate is under full control of the central bank.

External funding delayed but inflows picking up in 4Q

Concessional external funding remains a lifeline for the Ukrainian economy. The EU is doing the heavy lifting as its Ukraine Support Loan (both budget and defense components) and Ukraine Facility will make up over ¾ of total external funding. The pace of loans/grants disbursement was disappointing in 9M26 – funding fell substantially short of the foreign trade deficit which dented NBU reserves by 18% to \$47.1bn. That was a wake-up call for the government and the parliament as both are now fast-tracking some of the critical reforms.

With fiscal pressures building, we see a high chance the remaining 2026 financial aid commitments will be unlocked, and Ukraine is set to receive at least \$22bn in budget support in 4Q26. Combined with a defense component of USL, this will likely help bring NBU reserves back close to US\$60bn at the end of 2026. By our estimates, the financial commitments of

Ukraine's partners for 2027 are still insufficient to close the fiscal gap but are high enough to keep the NBU reserves above the \$50bn mark through 2027.

Hryvnia expected to weaken but at a slow pace

The NBU keeps reminding the market that hryvnia exchange rate may move in both directions, but it rarely allows fluctuations wider than 1-1.5% within a month. The central bank is very optimistic (much more than we are) about the future pace of reserve accumulation and see them close to \$70bn at end-2027. With expectations being that high, it is no wonder the NBU is determined to defend the hryvnia and prevent any meaningful depreciation. We remain of the view that the central bank will stick to its (implicit) policy of managed and gradual hryvnia depreciation going forward. Our end-2026 exchange rate forecast is unchanged at UAH45.8/\$ (vs the current rate of UAH45.0/\$), implying US\$ will appreciate by 8% in 2026. We don't see any reason for the NBU to substantially deviate from this rate of depreciation in 2027, and we see end-2027 rate at UAH49.2/\$. Yet, we keep in mind that the NBU's FX policy in 2H27 will be largely shaped by its expectations of foreign aid receipts in 2028. Should risks of underfinancing materialize, the central bank may decide to move faster with exchange rate adjustment.

Fiscal situation challenging; additional funding for 2027 needed

The government's liquidity position strongly deteriorated recently on delayed inflows of foreign concessional funding. MinFin had to pause some non-critical capital expenditures and delay VAT refunds to exporters. The current pressures will likely ease substantially in the coming weeks as the authorities are fast-tracking some of the critical pieces of reform legislation. Despite all the challenges, the chances of closing the 2026 fiscal plan without visible setbacks are high. A good sign is that MinFin does not seem to have plans to update this year's budget law and is not in the mood to step up borrowings in the domestic market.

Yet, all eyes are now on the 2027 fiscal plan, and there are numerous challenges. The current commitments on external budgetary support for 2027 are in the ballpark of \$25bn, well below estimated needs of over \$50bn. The USL defense component of EUR30bn comes on top but is of little help since the projected fiscal gap is shaped by non-military expenditures. With no end to the war in sight, domestic revenues will barely cover defense-related expenditures. With little appetite for new bilateral lending from Ukraine's partners, focus will likely shift towards a new arrangement with the EU that is similar to the USL deal struck in 1H26. We believe the chances of the government being able to secure additional funding are reasonably high, but new funding will come with more economic reform commitments.

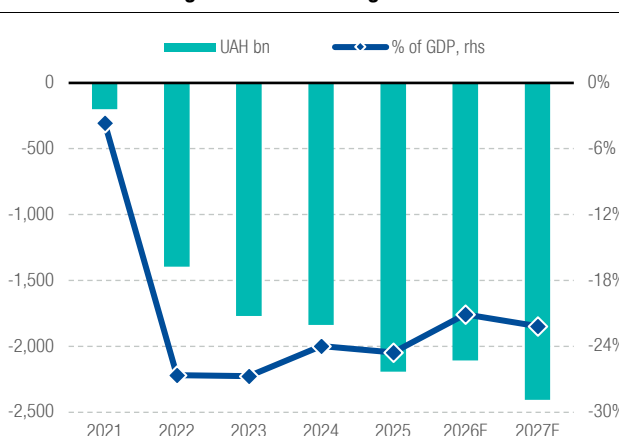
The public debt-to-GDP ratio barely moved and should remain below 106% this year and next. Over two thirds of 2026 external funding is in the form of contingent debt that will only be repaid if Russia makes reparations to cover war-related damages. The high debt burden is not an immediate issue for the economy as the official debt servicing payments will remain insignificant in the coming years.

Table 2. Key parameters of state budget, UAH bn

	2025	2026F	2027F
Total revenues (before grants)	2,332	2,890	3,156
incl. tax revenues	2,016	2,510	2,864
Expenditures	4,526	4,997	5,563
Budget balance (before grants)	-2,194	-2,107	-2,407
Total revenues / GDP	26.1%	28.9%	29.1%
incl. tax revenues / GDP	22.6%	25.1%	26.4%
Expenditures / GDP	50.7%	50.0%	51.2%
Defense expenditures / total expenditures	69.9%	68.2%	67.2%
Budget balance (before grants) / GDP	-24.6%	-21.1%	-22.2%

Source: MFU, ICU.

Chart 7. State budget balance before grants



Source: MFU, ICU.

Yearly forecast 2026-27

	Historical data for 2016–2025										Forecast	
	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Activity												
Real GDP (% , YoY)	2.4	2.4	3.5	3.2	-3.8	3.4	-28.8	5.5	3.2	1.8	-0.6	-1.9
Nominal GDP (UAHbn)	2,385	2,984	3,560	3,977	4,222	5,451	5,239	6,628	7,662	8,931	9,987	10,856
Nominal GDP (US\$bn)	93	112	131	155	155	200	162	181	191	214	225	230
Unemployment (%)	9.3	9.5	8.8	8.2	9.5	9.8	21.1	18.2	13.1	11.3	10.0	9.5
Inflation												
Headline inflation (% , YoY, e.o.p.)	12.4	13.7	9.8	4.1	5.0	10.0	26.6	5.1	12.0	8.0	12.0	8.2
Headline inflation (% , YoY, avg.)	13.9	14.4	10.9	7.9	2.7	9.4	20.2	12.9	6.5	12.7	9.0	10.4
GDP deflator (% , YoY)	17.1	22.1	15.4	8.2	10.3	25.1	34.9	19.9	12.0	14.5	12.5	10.8
Exchange rates												
UAH/USD (e.o.p.)	27.2	28.1	27.7	23.7	28.3	27.3	36.6	38.0	42.0	42.4	45.8	49.2
UAH/USD (avg.)	25.6	26.6	27.2	25.8	27.0	27.3	32.3	36.6	40.2	41.7	44.3	47.1
External balance												
Current account balance (US\$bn)	-1.9	-3.5	-6.4	-4.1	4.8	-4.7	6.3	-10.5	-15.9	-28.8	-17.2	-20.0
Current account balance (% of GDP)	-2.0	-3.1	-4.9	-2.7	3.1	-1.1	3.9	-5.8	-8.3	-13.5	-7.7	-8.7
Trade balance (US\$bn)	-6.5	-8.7	-11.4	-12.5	-2.8	-3.5	-27.6	-38.8	-39.5	-55.8	-87.4	-74.3
Trade balance (% of GDP)	-6.9	-7.8	-8.7	-8.1	-1.8	-1.7	-17.1	-21.4	-20.7	-26.0	-38.8	-32.2
Capital flows (F/A) (US\$bn)	3.1	6.0	9.3	10.1	-2.8	5.2	-9.4	19.8	10.8	41.4	19.8	13.0
FDI (US\$bn)	4.0	3.4	4.9	5.2	-0.6	7.5	1.0	4.4	3.7	1.7	2.0	2.2
FDI (% of GDP)	4.2	3.1	3.7	3.3	-0.4	3.8	0.6	2.4	1.9	0.8	0.9	1.0
NBU reserves (US\$bn)	15.5	18.8	20.8	25.3	29.1	30.9	28.5	40.5	43.8	57.3	59.7	53.2
Interest rates												
NBU's key policy rate (% , e.o.p.)	14.0	14.5	18.0	13.5	6.0	9.0	25.0	15.0	13.5	15.5	16.5	15.5
Fiscal balance												
State budget balance (% of GDP)	-2.9	-1.5	-2.4	-2.1	-5.1	-3.7	-26.6*	-26.7*	-24.0*	-24.6*	-21.2*	-23.0*
Public debt (% of GDP)	80.9	71.8	60.9	50.6	60.8	49.0	77.8	83.3	91.1	101.2	104.1	105.1

* budget balance before official budgetary grants

Source: UkrStat, NBU, MFU, ICU.



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