

Macro Insight

Reparation Loan is a Likely Game Changer for Economy

The lingering war and heightened safety risks imply Ukraine will remain critically dependent on foreign financial aid for its defense efforts and macroeconomic stability. A new IMF program would be of little help if not funded properly. Fortunately, the EU started serious discussions about an EUR140bn reparation loan for Ukraine linked to Russian frozen assets. The Ukrainian authorities believe the loan approval is highly likely and only the timeline is uncertain. Should the loan be stamped, Ukraine will receive much-needed reassurance that its fiscal needs are fully covered even in a pessimistic scenario of a prolonged war. Also, the NBU would be fully equipped to keep the FX market and hryvnia exchange rate under its full control for many years. The flipside is that Russian frozen assets were supposed to cover Ukraine reconstruction needs after the war, but the lack of alternative funding leaves no other choice for Ukraine and the EU but to start tapping them now. Economic growth is set to remain sluggish in the near future unless safety risks subside considerably. Inflation is decelerating at a good pace, exceeding NBU expectations. Price growth for nearly all consumer-basket components is slowing, indicating the disinflationary process is robust. However, we think that the NBU's inflation target of 5% will remain out of reach in the coming years. All in, we believe preconditions are now in place for the central bank to switch to a gradual monetary-policy loosening cycle next week. We see the end-2025 key policy rate at 14.5%. In 2026, rate cutting will gain pace if a reparation loan is eventually approved. The ample current-account deficit will remain a major long-term challenge, but it should be safely covered with foreign aid in the mid-term. Given this, we take a more constructive view on the exchange rate and see the end-2025 level at UAH42.4/US\$ and end-2026 level at UAH44.5/US\$. Our conviction is that growing external imbalances (net of foreign financial aid) will force the NBU to change its de-facto fixed exchange-rate policy and start a managed gradual hryvnia depreciation policy. On the fiscal side, we see few risks as long as reparation loan approval is a realistic scenario. Importantly, this loan will not affect Ukraine's debt sustainability metrics.

Economy stagnant with no growth impulse in sight

Ukraine's GDP inched up 0.7% YoY in 2Q25, implying it was at just 79% of the pre-invasion (2021) level. Monthly data clearly indicate weakness was pervasive across key sectors, even though economic activity started to improve towards the end of the quarter. Industrial production narrowed the decline from -6.1% in 1Q25 to -3.9% in 1H25. Cargo transportation turnover also narrowed the decline from -15.1% in 1Q25 to -12.7% in 1H25. Meanwhile, retail trade grew at above 6% in YoY terms in 2Q vs sub-6% growth in 1Q25. The key drag on 2Q growth was the agricultural sector, as

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Key macroeconomic data and projections

	2025F	2026F
Real GDP, YoY, %	2.5	2.7
Nominal GDP, US\$bn	215	235
Inflation, YoY, %, e.o.p.	8.5	7.0
Key policy rate, %, e.o.p.	14.5	12.5
UAH/USD, e.o.p.	42.4	44.5
C/A balance, % of GDP	(14.2)	(15.3)
NBU reserves, US\$bn	51.5	51.4
Budget gap, % of GDP*	(23)	(20)
Public debt, % of GDP	104	113

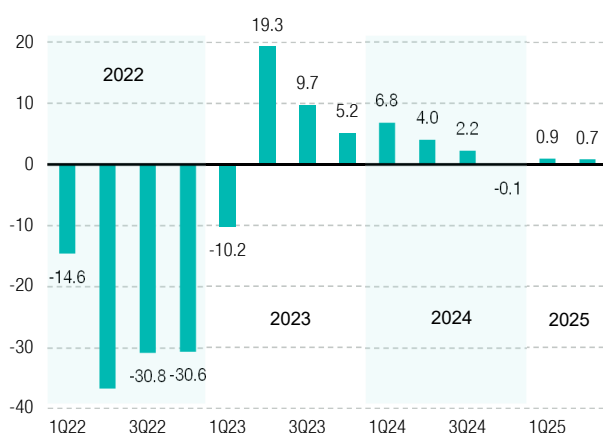
* budget balance before official grants to the government
Source: UkrStat, NBU, ICU

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the harvesting campaign started later than in 2024 due to weather conditions. We expect growth to pick up significantly in both 3Q and 4Q as agriculture gains pace and supports related sectors, including food processing and cargo transportation. We maintain our full 2025 GDP growth projection of 2.5% YoY in anticipation of a temporary boost from agriculture.

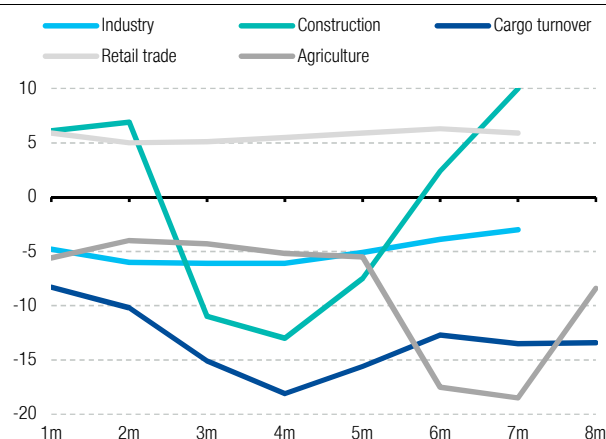
At this point, it is fair to say that the economy completely ran out of steam, and there is little hope growth will pick up meaningfully without a significant reduction of safety risks. The weakness is seen across all demand-side components. Export is constrained by lackluster agricultural harvest and a lack of new investments into sectors that are competitive abroad. Government consumption was a powerful growth pillar back in 2022-23, but now that the fiscal deficit started to narrow, its contribution is likely to be negative. Investments are mainly supported by capex into the military segment and construction of fortification along the front line. Domestic household consumption is the only positive contributor on the back of surging salaries. Yet, even so, household incomes and private consumption are going to be less dynamic than in the previous years as social payments and salaries in the public sector are lagging behind salaries in the private sector. Overall, we see economic growth remaining below 3% in the coming periods unless we see a significant improvement in safety risks. The recent resumption of massive strikes on Ukraine's energy infrastructure by Russia leaves no space for optimism with regard to trends in the economy.

Chart 1. Real quarterly GDP, change YoY, %



Source: Ukrstat, ICU.

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



* cumulative from the start of the year

Source: Ukrstat, ICU.

Inflation remains below NBU forecast

Annual CPI slowed to 11.9% in September vs 13.2% in August and a peak of 15.9% in May. The end-September tally came in below the NBU forecast of 13.1%. Core inflation was down to 11.1% YoY in September from the peak of 12.4% in March. The deceleration in prices was seen across the vast majority of consumer basket groups with the notable exceptions being education and hotels and restaurants. The largest relief came from the deceleration in food prices (+17.2% vs the peak of 23.2% in May) on the back of ample harvest of fruits and vegetables.

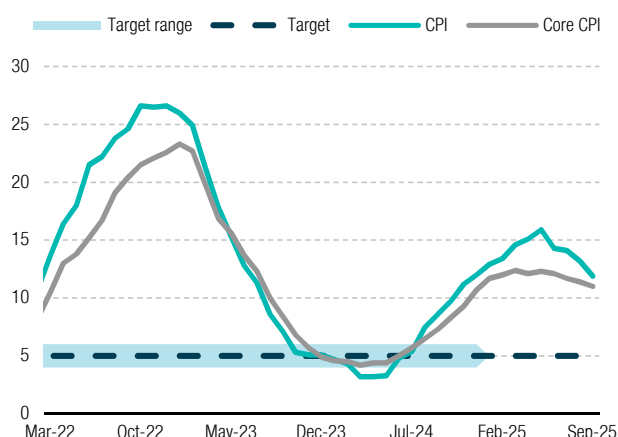
Looking forward, we see no significant risks that may derail disinflation. Household incomes are slowing in both nominal and real terms due to weak growth in social payments and salaries in the public sector. Administrative tariffs for gas and electricity for households are likely to remain fixed at least for the next 12 months. The harvest was not perfect this year, but should be more than sufficient to keep the food market fully saturated. On the other hand, we see little chance of inflation returning to the NBU target of 5% either in 2026 or 2027. A tight labor market implies that salaries will continue to drive production costs, especially in the service sector. Unemployment rate is already close to the pre-2022 level, which implies employees will maintain their salary bargaining power going forward. Yet, the most significant pressure will likely come from growth in energy (natural gas and electricity) prices for industrial producers as Ukraine will increasingly rely on more expensive imported energy

since Russia renewed massive strikes on Ukraine's energy infrastructure. For 2025, we see the CPI slipping to single digits in November and landing at 8.5% at end-2025.

NBU left with no arguments for not reducing key rate

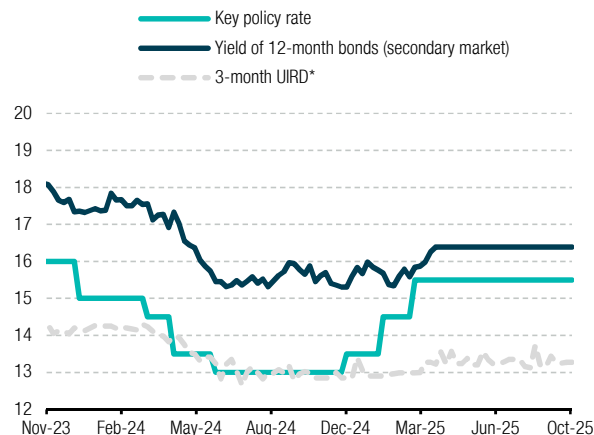
The NBU monetary policy is effectively getting tighter as the key policy rate remains flat while inflation trends down, and it does so much faster than the central bank expected. The outlook for inflation also remains broadly favorable with the annual CPI likely to decline in every single month at least until March 2026. Judging by the current inflation and mid-term inflation outlook, the start of the monetary policy easing cycle is becoming overdue. Yet, the FX market and exchange-rate considerations also remain critical components of monetary policy decision-making. However, at this point, it's safe to say that the FX market is not showing any concerning trends as NBU reserves remain ample and the central bank uses them without limits to defend the hryvnia exchange rate. With more external funding (via an EU reparation loan) coming in 2026 and beyond, the FX market should not pose any visible threats that need to be addressed via a high key policy rate. Based on central bank previous actions and messaging, we assume it will want to ensure that hryvnia assets (term deposits and government hryvnia bonds) continue to offer a premium over yields on FX assets (so that in FX terms hryvnia assets generate higher earnings), but this is possible with lower rates.

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.

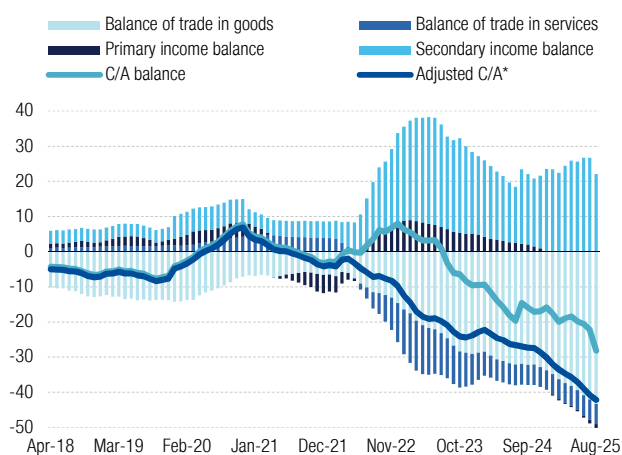
The NBU has kept the key policy rate at 15.5% since March, and we maintain our projections of two 50bp cuts in October and December. If a new reparation loan is fully approved by the EU and the NBU gets the much-needed resources to control the FX market in the coming several years, the pace of rate cuts next year may be faster and an end-2026 key policy rate of 12.5% may become a reality.

Short-term commercial rates have become detached from the NBU key policy rate over the past couple of months. Yields on government hryvnia bonds with remaining maturities of six months or below offered in the retail segment decreased by 100-150bps in Aug-Sep due to scarce supply. However, the rates on longer-term government bonds in both the primary and secondary markets have remained broadly unchanged since April. We don't expect the government will be in a rush to reduce rates on primary auctions following cuts in the NBU key policy rate. MinFin is very likely to face temporary liquidity pressures at the end of 2025 and also in 1Q26 and will maintain an extremely cautious stance on securities pricing so that demand for bonds from banks remains robust.

External imbalances are a major long-term concern

The ample current account (C/A) has become an essential feature of the war economy. In 2025, the C/A deficit is likely to exceed 14% of GDP. Yet, net of budgetary transfers from Ukraine's allies (recorded in the secondary income component of BoP), the deficit of the C/A is going to be above 20%, a number never seen in the country's history. Surging deficit of trade in goods remains the key problem as import of goods is likely to be close to 38% of GDP in 2025 (broadly in line with the pre-2022 number) while export is set to stand at 19-20% (vs. above 30% pre-2022). Import is sizeable due to both purchases of defense-related goods and hefty supplies of consumer goods. Strong hryvnia (real effective rate was up by 5.4% in 12 months to August 2025) definitely bodes well for the strength of import flows.

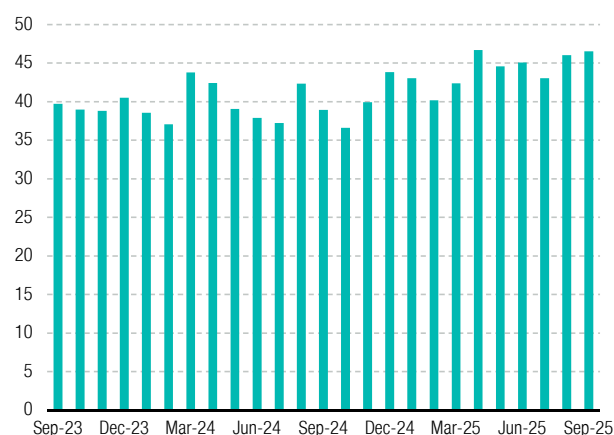
Chart 5. Current account, 12-month trailing, US\$bn



* net of official transfers to the government

Source: NBU, ICU.

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



Source: NBU, ICU.

A seemingly surprising fact is that the FX market deficit and the NBU interventions subsided recently despite a record-high foreign trade gap. The explanation for this is that household demand for FX cash hit its lowest level since the start of the full-fledged war. The relative hryvnia stability has discouraged households from converting their savings into dollars and euros at any price. The de-facto fixed exchange rate (with only minor fluctuations) of hryvnia vs US\$ that prevailed over the past 15 months reduced incentives for short-term hedges by households. On the corporate side, that stability of the hryvnia encourages companies to reduce the stock of foreign trade credits. The economy sees a net inflow of funds YTD as exporters transfer their sale proceeds from abroad with no delays. Thus, the financial account (net of official concessional loans) improved considerably and the NBU interventions declined to US\$2.3bn in September from a monthly average of US\$3.0bn in summer.

Reparation loan is the key to long-term macro-stability

The record-high C/A gap would be a major problem and detrimental for macroeconomic stability, if not for foreign financial aid that Ukraine received since February 2022 in the form of grants and loans. Foreign financial aid is critical for macroeconomic stability going forward. Ukraine needs at least US\$40bn annually to cover the imbalances of external accounts that are primarily driven by the trade deficit and demand for FX cash within the country. Commitments of Ukraine's allies under the current IMF program imply the NBU will have reserves of just above US\$50bn at the end of 2025, and Ukraine will receive another US\$25bn in 2026-1Q27 (after which the current IMF program ends). Overall, this implies the external accounts gap will be fully covered in 2026 (with reserves and new inflows), but large questions loom in periods beyond 2026. Without new sizeable funding (that is needed even in a favorable scenario of subsiding safety risks) Ukraine would be facing unprecedented challenges.

The new IMF program that is currently being shaped addresses this concern. The critical component of the program is the funding that is expected to be provided by the EU in the form of reparation loans linked to Russian frozen assets. While a long approval process lies

ahead, there is a high level of confidence the loan of EUR140bn is going to be stamped. That implies Ukraine will be in safe territory and be able to cover its budgetary needs and the deficit of external accounts at least for the next four years ending 2029.

While the use of russian foreign assets is very much welcome, it creates/reveals another significant longer-term problem. The russian assets were supposed to cover Ukraine's reconstruction needs after the war, while the baseline scenario now is that the money will be used to fund the war efforts of Ukraine. This implies that inflows of foreign financial aid will shrink and the economy is likely to see a cliff effect in terms of foreign funding in the mid-term. While this now seems to be a distant perspective, economic policy decisions should definitely take account of this fact.

NBU has unprecedented flexibility over choice of FX policy

Over the past 15 months, the NBU has clearly demonstrated it has zero appetite for managed hryvnia depreciation. With a sizeable reparation loan coming in on the horizon, the central bank will have all the resources it needs to maintain unlimited interventions in the FX market in the years to come. Yet, we think the exchange rate policy stance may be adjusted going forward. The surging external imbalances cannot be left unnoticed for years, and we expect the NBU will have no reasonable choice but to gradually address this concern. We bet on an NBU move towards a managed hryvnia weakening with a pace that will be comfortable both for households and businesses. We thus see an end-2025 rate of UAH42.4/US\$ and end-2026 rate of UAH44.5/US\$.

Reparation loan set to close fiscal funding gap

The draft 2026 budget targets a deficit of UAH1.9trn, an equivalent of US\$46bn at the current exchange rate, or 19% of GDP. Gross external financing needs are estimated at UAH2.1trn, an equivalent of US\$52bn at the current exchange rate. The government sends a clear signal that Ukraine's reliance on foreign financial aid will remain critical in 2026 and beyond. Apparently, at this point it is too early to assume any de-escalation of the war and a reduction of the war-related budget expenditures. Moreover, the proposed revisions to the 2025 budget boost the outlays on the national security and defense by another US\$8bn that are expected to be funded with ERA facility from the EU (a part that was supposed to be a pre-financing for 2026).

Apparently, the 2025/26 fiscal financing needs make the existing IMF program fully irrelevant. Ukrainian authorities express a high level of confidence the reparation loan will be eventually approved by the EU, implying the state budget deficit will remain to be safely covered in the coming years without affecting the debt sustainability metrics of the country.

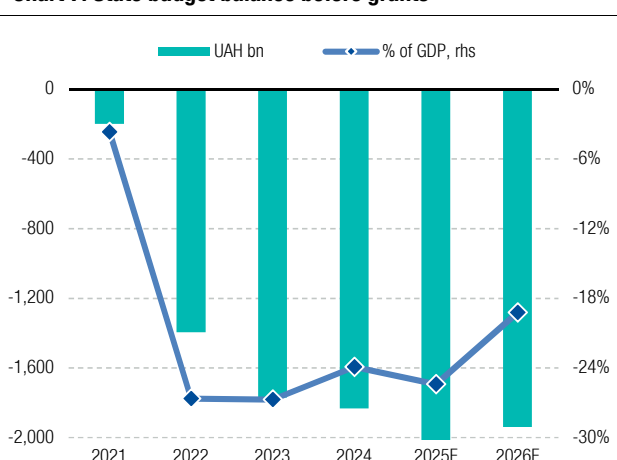
Table 1. Key parameters of state budget*, UAH bn

	2024	2025	2026
Total revenues (before grants)**	1,904	2,414	2,847
incl. tax revenues	1,647	2,111	2,468
Expenditures	3,742	4,654	4,752
incl. defence and security	2,252	2,961	2,806
Budget balance (before grants)	-1,832	-2,276	-1,939
Total revenues / GDP	24.9%	26.9%	28.2%
incl. tax revenues / GDP	21.5%	23.5%	24.5%
Expenditures / GDP**	48.9%	51.9%	47.1%
Budget balance (before grants) / GDP	-23.9%	-25.4%	-19.2%
Total revenues / expenditures	50.9%	51.9%	59.9%
Tax revenues / expenditures	44.0%	45.4%	51.9%
Defence, security / total expenditures**	60.2%	63.6%	59.0%

* actual data for 2024, proposed revision of 2025 budget, draft 2026 budget (may differ from ICU projections). ** excludes foreign military aid in kind

Source: MinFin, ICU.

Chart 7. State budget balance before grants



Source: MinFin, ICU.

Yearly forecast 2025-26

	Historical data for 2015–2024										Forecast	
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Activity												
Real GDP (% , YoY)	(9.8)	2.4	2.5	3.4	3.2	(4.0)	3.4	(29.1)	5.5	2.9	2.5	2.7
Nominal GDP (UAHbn)	1,989	2,385	2,984	3,561	3,978	4,194	5,460	5,191	6,628	7,659	8,965	10,082
Nominal GDP (US\$bn)	90	93	112	131	155	155	200	161	181	191	215	235
Unemployment (%)	9.1	9.3	9.5	8.8	8.2	9.5	9.8	28.0	18.2	13.1	11.0	10.0
Inflation												
Headline inflation (% , YoY, e.o.p)	43.3	12.4	13.7	9.8	4.1	5.0	10.0	26.6	5.1	12.0	8.5	7.0
Headline inflation (% , YoY, avg.)	48.7	13.9	14.4	10.9	7.9	2.7	9.4	20.2	12.9	6.5	12.8	7.0
GDP deflator (% , YoY)	38.9	17.1	22.1	15.4	8.3	9.8	25.1	34.3	19.9	12.3	14.2	9.5
Exchange rates												
UAH/USD (e.o.p.)	24.0	27.3	28.1	27.7	23.8	28.3	27.3	36.6	38.0	42.0	42.4	44.5
UAH/USD (avg.)	21.9	25.6	26.6	27.2	25.8	27.0	27.3	32.3	36.6	40.2	41.6	42.9
External balance												
Current account balance (US\$bn)	5.0	(1.9)	(3.5)	(6.4)	(4.1)	5.3	(3.2)	7.9	(9.6)	(15.1)	(30.5)	(36.0)
Current account balance (% of GDP)	5.6	(2.0)	(3.1)	(4.9)	(2.7)	3.4	(1.1)	4.9	(5.3)	(7.9)	(14.2)	(15.3)
Trade balance (US\$bn)	(2.4)	(6.5)	(8.7)	(11.4)	(12.5)	(2.4)	(2.7)	(25.7)	(37.9)	(39.4)	(50.8)	(45.6)
Trade balance (% of GDP)	(2.6)	(6.9)	(7.8)	(8.7)	(8.1)	(1.5)	(1.5)	(16.0)	(20.9)	(20.7)	(23.6)	(19.4)
Capital flows (F/A) (US\$bn)	(4.6)	3.1	6.0	9.3	10.1	(3.3)	3.7	(10.9)	18.9	10.0	38.2	36.0
FDI (US\$bn)	(0.4)	3.8	3.7	4.5	5.2	0.1	6.9	0.3	4.6	4.0	2.2	2.6
FDI (% of GDP)	(0.5)	4.1	3.3	3.4	3.4	0.1	3.4	0.2	2.5	2.1	1.0	1.1
NBU reserves (US\$bn)	13.3	15.5	18.8	20.8	25.3	29.1	30.9	28.5	40.5	43.8	51.5	51.4
Interest rates												
NBU's key policy rate (% , e.o.p.)	22.0	14.0	14.5	18.0	13.5	6.0	9.0	25.0	15.0	13.5	14.5	12.5
Fiscal balance												
Budget balance (% of GDP)	(2.3)	(2.9)	(1.5)	(2.4)	(2.1)	(5.1)	(2.4)	(26.9)*	(26.7)*	(23.9)*	(23.0)*	(19.8)*
Public debt (% of GDP)	79.0	80.9	71.8	60.9	50.6	60.8	49.7	78.5	83.3	91.2	103.7	113.4

* budget balance before official budgetary grants

Source: UkrStat, NBU, MoF, ICU.



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