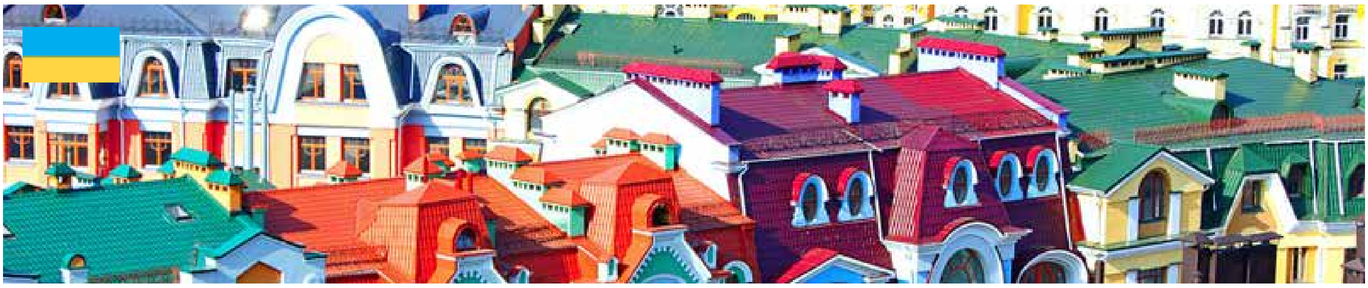


Ukraine

Highlights

- **The economy has stabilised in 2023, but economic conditions remain very difficult.** After an economic collapse in 2022, the situation has improved slightly in 2023 as businesses adapt to wartime conditions. Gross domestic product (GDP) growth is slightly positive once again, and inflation has declined to single-digit levels.
- **Timely external financing and the new International Monetary Fund (IMF) programme have helped to restore macroeconomic stability.** Foreign reserves have increased to a historical high, while surpluses on the foreign-exchange market have brought down the market exchange rate close to the official level and prompted a shift from a pegged to a managed flexible exchange rate.
- **The prospect of European Union (EU) accession and the IMF programme are powerful drivers of reform.** The authorities are coordinating a reform agenda with international partners and, despite the exceptionally difficult circumstances, are making steady progress, including on seven priority areas identified by the European Commission on Ukraine's application for membership. As a result, in November 2023 the Commission recommended that the European Council open accession negotiations with Ukraine once all priorities have been completed.

Key priorities for 2024

- **Reforms to strengthen governance and transparency and tackle corruption need to proceed without delay.** Progress in these areas is essential, not only to build a fair and prosperous society, but also to convince foreign investors that there is a level playing field in Ukraine and to assure donors that their resources will be well spent. These reforms are also critical to progress towards EU accession.
- **An asset quality review of systemically important banks is needed.** This exercise should reveal if banks' assets are valued appropriately and whether banks have adequate capital to absorb current and future losses on delinquent assets. Meanwhile, ongoing bank profits need to be fully added to capital reserves.
- **Fiscal policy should focus on systemic measures rather than short-term fixes.** Proposals for short-term tax breaks and, in the medium term, tax havens should be avoided. Budget needs will remain high long after the war ends, and long-term, quality investors will be attracted by a sound business environment rather than by tax incentives.

Main macroeconomic indicators (per cent)

	2019	2020	2021	2022	2023 proj.
GDP growth	3.2	-3.8	3.4	-29.1	1.0
Inflation (average)	7.9	2.7	9.4	20.2	17.7
Government balance/GDP	-2.2	-5.3	-3.4	-16.3	-19.1
Current account balance/GDP	-2.7	3.4	-1.6	5.0	-5.7
Net FDI/GDP [neg. sign = inflows]	-3.4	0.0	-3.8	-0.1	-0.4
External debt/GDP	79.1	80.3	64.9	81.6	n.a.
Gross reserves/GDP	16.4	18.6	15.5	17.8	n.a.
Credit to private sector/GDP	24.3	22.2	18.7	18.9	n.a.

Macroeconomic developments and policy response

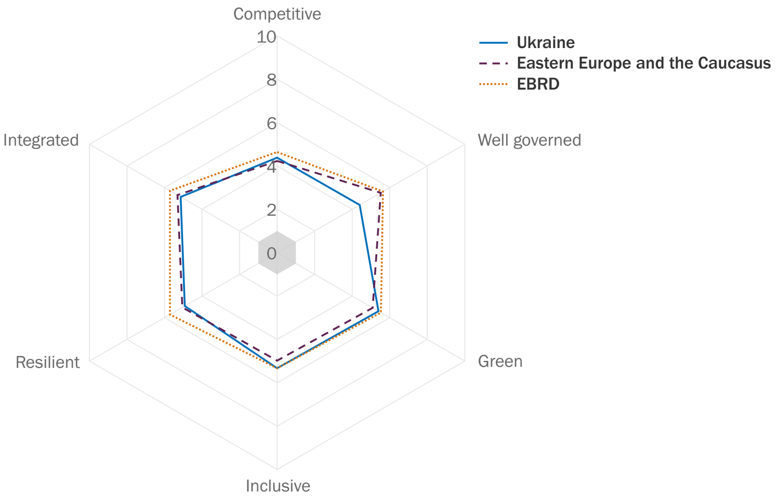
The economy has stabilised at around 70 per cent of pre-war real output levels. GDP collapsed by around 30 per cent in 2022 following Russia's invasion of the country. Signs of a modest recovery are now apparent, but domestic demand remains depressed due to the displacement of more than 8 million people abroad and the weak purchasing power of those remaining in Ukraine. According to a Transparency International survey, the war negatively affected the finances of 83 per cent of businesses, with 20 per cent suffering very significant losses. Encouragingly, businesses have adapted to the difficult conditions, and many have cited an optimistic outlook since the beginning of 2023. In the first half of the year, annual GDP increased by around 4.5 per cent, with the second quarter recording growth of 19.5 per cent compared to the second quarter of 2022, the first upturn since the start of the war. The grain and oilseed harvest in 2023 is forecast to be almost 10 per cent higher than last year, helped by favourable weather conditions. However, grain and oilseed exports are expected to fall to 49 million tonnes in the 2023-24 season (July to June) from 58 million tonnes in 2022-23.

External financing is supporting the recovery. In March 2023 the IMF approved a 48-month extended arrangement under the Extended Fund Facility (EFF) for an amount of SDR 11.6 billion (US$ 15.6 billion [€14.6 billion], and 577 per cent of the quota). The main goal of the programme is to sustain macroeconomic and financial stability under extreme uncertainty and promote reforms that support Ukraine's recovery on the post-war path to EU accession. The authorities met all applicable quantitative performance criteria and structural benchmarks in the first review in May 2023. Probably the most difficult measure was restoring pre-war tax rates on fuel and on the self-employed and small businesses, which were reduced or abolished in March 2022. This move will strengthen budget revenues in the second half of 2023. Meanwhile, external financing has become more timely, stable and predictable. As of 20 October 2023, Ukraine had received US$ 33.8 billion (€31.3 billion) from donors and international organisations out of the expected US$ 42.2 billion (€39 billion) for the whole year. This lifted official foreign reserves to US$ 39.7 billion (€37.3 billion) as at the end of September 2023, close to the highest level since Ukraine's independence. It also narrowed the exchange-rate spread between the cash market and the official exchange rate to less than 2 per cent (as of late August 2023) compared with 17 per cent in September 2022. These developments enabled a policy shift from a pegged to a managed flexible exchange rate at the beginning of October 2023.

Monetary policy is being eased amid falling inflation. The inflation rate peaked at 26.6 per cent in December 2022, but dropped thereafter to 7.1 per cent in September 2023. On the back of this positive development, the National Bank of Ukraine started easing monetary policy in July 2023 by reducing the policy rate from 25 per cent to 22 per cent, followed by a further cut to 20 per cent in September 2023. Increased foreign debt financing has lifted public debt by one-third since the start of the war, to US$ 133.9 billion (€122.7 billion) as of August 2023, or more than 80 per cent of GDP. Bilateral creditors from the G7+ group of countries have extended the grace period for debt repayments to March 2027. Meanwhile, the Ukrainian authorities are trying to reach an agreement with bond holders on a debt operation under comparable terms to bilateral creditors, with the aim of finalising it by the end of August 2024.

With the ongoing war, uncertainty remains high. Despite the optimism and mild recovery so far in 2023, the recent non-extension of the grain export corridor and the wave of destruction on grain port infrastructure add to the uncertainty surrounding the short-term outlook. On the assumption that the war continues at its current level of intensity, we forecast GDP growth of 1 per cent in 2023 and 3 per cent in 2024.

Assessment of transition qualities (1-10)



Structural reform developments

Reforms are moving ahead, despite the war, guided by the EU accession process and the IMF programme. The current environment is obviously not conducive to structural reforms, but the authorities are still taking important steps to implement reforms in line with the seven priority areas set out in the European Commission's opinion on Ukraine's membership application and with commitments under the IMF programme. In November 2023 the Commission noted Ukraine's progress on addressing the seven priorities and recommended that the European Council open negotiations on membership once all priorities have been completed.

Judicial reform has advanced. In December 2022 the parliament amended the procedure for selecting constitutional court judges in a competitive process. Under the new rules, an advisory group, comprising an equal number of Ukrainian and international experts, will check the integrity and professional competence of candidates. To address concerns about potential impasses in the decision-making process, the Venice Commission suggested adding one more international expert to the advisory group. The European Commission expects the Venice Commission's recommendations to be implemented in full in order to avoid political interference in the selection of Constitutional Court judges. In addition, the High Council of Justice resumed its work in early 2023 and in June 2023 appointed all 16 members of the High Qualification Commission of Judges, a judicial body that vets and nominates candidates for judicial jobs. This is a significant milestone in fundamental judicial reform. The two judicial governing bodies will have to appoint more than 2,000 judges and complete the process of building a professional and independent judicial system.

Anti-corruption reforms are continuing. The authorities have moved ahead with the appointment of heads of the High Anti-Corruption Court (HACC) and National Anti-Corruption Bureau (NABU). The new head of the HACC was named in February 2023 and in March the government appointed a new director of the NABU from the three candidates shortlisted by a selection commission consisting of three Ukrainians and three international experts. These steps complete the triad of a fully formed and functioning anti-corruption infrastructure. Progress on anti-corruption was acknowledged by the Council of Europe Group of States against Corruption (GRECO), which concluded in March 2023 that Ukraine had implemented or satisfactorily dealt with 15 out of 31 recommendations contained in the previous report, and partly implemented nine other recommendations. As a result, Ukraine is no longer deemed to be "globally unsatisfactory", and the special reporting procedure was discontinued.

Significant progress was achieved in regulating the media in accordance with EU standards. The new media law, adopted in December 2022, harmonises media-sector regulation with the EU audiovisual media services directive. It also gives the independent media regulator the power to ensure the smooth functioning of the media market. In May 2023 the parliament adopted the provisions of the EU acquis in the field of audiovisual advertising.

A law on de-oligarchisation was adopted, but further refinements may be necessary. The Venice Commission classifies the new law as a "personal approach", which seeks to identify persons as oligarchs through specific criteria, such as wealth, ownership of a business monopoly, media ownership and political engagement, and subjects them to a series of limitations. Contrary to this, the common approach in most countries is to prevent undue influence through the concentration of economic and political power by pursuing a multi-sectoral and systemic approach.