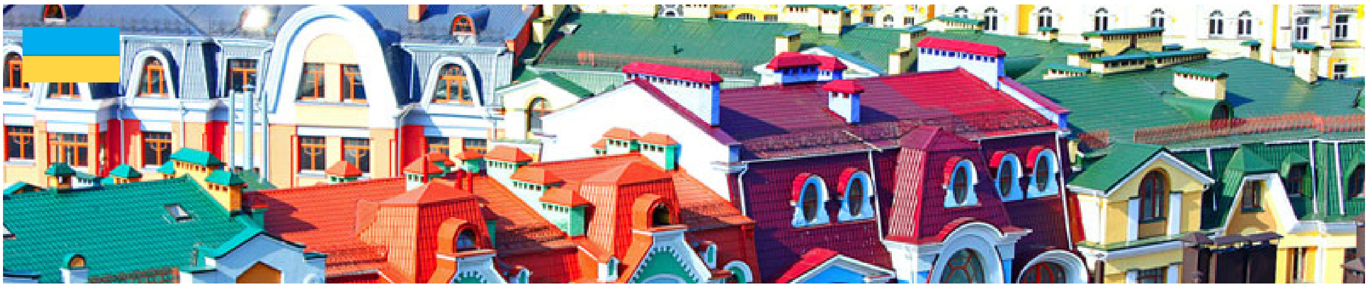

Ukraine

Highlights

- **The economy is being damaged by a new wave of destruction, with the Russian military targeting Ukraine's electricity infrastructure.** The new Black Sea shipping corridor along the coastline has opened up export possibilities for Ukraine's grain, mining and base-metal sectors. However, electricity shortages caused by Russia's renewed heavy bombing of electricity generation and transmission infrastructure have resulted in serious challenges for Ukraine's economic recovery.
- **The external financing required to maintain macroeconomic stability and the functioning of public services has now been received after some delays.** The financing gap for 2024 has eventually been closed, but delays in official foreign financing and associated uncertainty have placed pressure on the foreign-exchange market.
- **The opening of European Union (EU) accession negotiations marks the beginning of a complex process of harmonisation with EU legislation.** The government's Ukraine Plan shows that it is committed to a comprehensive economic recovery and transformation, with an early focus on judicial reform, the fight against corruption, and strengthening institutions and the public administration.

Key priorities for 2025

- **The authorities should use the momentum from the opening of accession negotiations and mobilise all domestic resources to advance reforms.** The Ukraine Plan is a viable roadmap, and strict adherence to it will bring irreversible progress in critical areas such as the rule of law, governance and the fight against corruption.
- **Stronger efforts should be made to bring veterans and women into the labour force.** Businesses face growing skills shortages, with many men engaged in the defence of the country and millions of people – mostly women and children – having been forced to leave Ukraine. Filling labour gaps with retrained veterans and currently inactive women will not only support the war effort through a stronger economy, but also foster inclusion and increase the economy's medium-term growth potential.
- **The authorities should improve energy resilience by enhancing Ukraine's energy generation capabilities (including renewables).** Large legacy thermoelectric plants have suffered heavy war damage, so diversifying supply using numerous low-capacity plants based on a mixture of gas and renewable sources will reduce energy-sector vulnerability and contribute to the green transition.

Main macroeconomic indicators (per cent)

	2020	2021	2022	2023	2024 proj.
GDP growth	-4.0	3.4	-28.8	5.3	3.0
Inflation (average)	2.7	9.4	20.2	12.9	6.4
Government balance/GDP	-5.9	-4.0	-15.6	-19.6	-18.7
Current account balance/GDP	3.3	-1.9	5.0	-5.4	-8.1
Net FDI/GDP [neg. sign = inflows]	0.0	-3.8	-0.1	-2.4	-2.2
External debt/GDP	80.2	64.9	80.8	90.4	na
Gross reserves/GDP	17.7	14.6	15.7	21.1	na
Credit to private sector/GDP	28.2	23.6	23.3	na	na

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Macroeconomic developments and policy response

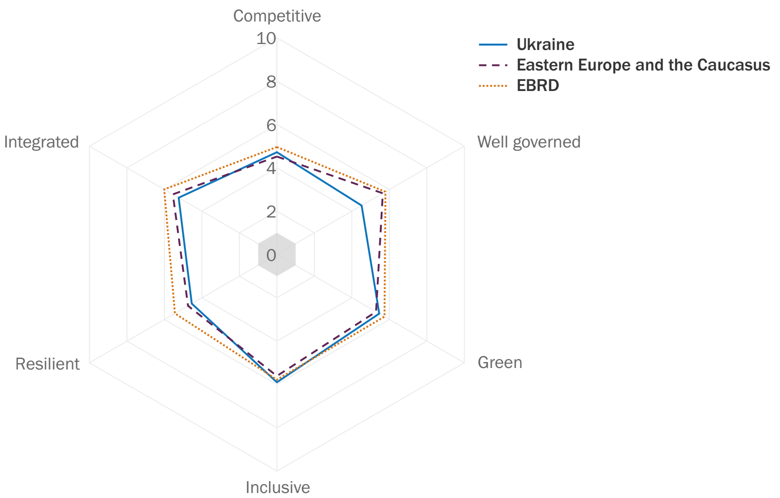
Russia's war of aggression continues to affect the economy. Real gross domestic product (GDP) increased by 6.5 per cent year on year in the first quarter of 2024, driven by a recovery in exports and the expansion of domestic military production. The opening of the new Black Sea export corridor along the coastline has enabled increased exports of grain and a resumption of maritime exports of other bulk goods, such as metals and ores (and even a resumption of container transport). This has boosted the metal and mining industries, which have been among the hardest hit over the last two years. However, Russia's heavy destruction of electricity infrastructure since late March 2024 has wiped out half of Ukraine's pre-war generation capability, causing power shortages and increased dependence on imported electricity at much higher prices. As a result, real GDP growth moderated to 3.7 per cent year on year in the second quarter of 2024.

Monetary policy easing has been paused amid resurfaced inflation. Annual inflation dropped to 3.2 per cent in March and April 2024. The National Bank of Ukraine consequently continued its monetary policy easing, cutting its policy rate by a further 200 basis points in the first half of the year to 13.0 per cent in June 2024. Inflation then rose again to 8.6 per cent in September, leading the central bank to pause further rate cuts. In October 2023 the central bank shifted its exchange-rate policy from a pegged exchange rate to a managed flexible exchange rate, allowing the hryvnia to gradually depreciate by 10 per cent. The resulting pass-through to inflation and the higher production costs caused by electricity shortages have boosted inflationary pressures in the second half of 2024, prompting an increasingly cautious approach to monetary policy.

External financing has supported economic stabilisation and growth. The authorities have performed well under the International Monetary Fund programme, successfully completing the third, fourth and fifth reviews in March, June and September 2024, respectively, and unlocking US$ 4.2 billion (€3.8 billion) in budget financing. Financing from the EU and the United States of America (which had accounted for around 70 per cent of the US$ 73.5 billion [€67 billion] received in the previous two years) was hit by delays at the beginning of 2024. Eventually, the EU's new €50 billion package for 2024-27 was approved in February 2024 (with around €16 billion set to be released in 2024) and the US contribution of around US$ 8 billion (€7.3 billion) was approved in April 2024. It is expected that this external financing, together with inflows from other bilateral and multilateral creditors, will fully cover Ukraine's budget deficit for 2024, which is forecast to stand at US$ 38.6 billion (€35 billion, or 20 per cent of GDP). Heavy reliance on foreign debt financing has increased the country's public debt by more than 60 per cent since the start of the war, to US$ 155 billion (€141 billion, or around 90 per cent of GDP) in August 2024. Bilateral creditors from the G7+ group of countries have extended the grace period for debt repayments to March 2027. Meanwhile, Ukraine has reached a deal on debt restructuring terms with a committee of bondholders for bonds totalling US$ 20.4 billion (€18.5 billion, or 13 per cent of total public debt). It will thus gain significant short-term cash-flow relief totalling US$ 11.4 billion (€10.4 billion) in the next three years.

Short-term growth prospects are highly uncertain. Amid the continuing war of attrition and unrelenting support by Ukraine's partners, GDP growth is expected to remain positive at 3.0 per cent in 2024 and 4.7 per cent in 2025. However, the risks remain exceptionally high and depend on the dynamics of the war.

Assessment of transition qualities (1-10)



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Structural reform developments

The EU has opened accession negotiations with Ukraine. Following the December 2023 decision to open negotiations, the European Council approved the negotiating framework in June 2024, two years after the original decision to grant Ukraine candidate status. Ukraine will now embark on the comprehensive process of incorporating the EU's acquis communautaire into its legal system. Accession negotiations are expected to help drive the reform process, with a focus on judicial reform, the fight against corruption, and strengthening institutions and the public administration.

The Ukraine Plan is the roadmap for the country's recovery and integration into the EU. The plan, which was published in March 2024 in close coordination with the European Commission, is a strategic guidance document detailing the reforms needed to: (i) foster recovery, reconstruction and modernisation; and (ii) support EU accession. It sets out the sequence of comprehensive reforms needed to access the EU's €50 billion Ukraine facility (of which €38.3 billion is budgetary support, €7.0 billion is investment funds in the Ukraine Investment Framework, and €4.7 billion is technical and administrative support, including interest-rate coverage for budgetary support). The plan is expected to drive the reform agenda and set investment priorities in the short to medium term.

Progress is being made on corporate governance reforms for state-owned enterprises (SOEs). In February 2024, the Ukrainian parliament adopted the SOE Corporate Governance Law, establishing the foundations for governance reform in that broad sector. Aside from a few temporary exclusions owing to the war, the law reflects the Organisation for Economic Cooperation and Development's guidelines on corporate governance, seeking to strengthen supervisory board powers, increase transparency, and introduce checks and balances. Members of supervisory boards will be selected using competitive and transparent processes, and boards will have full power to appoint and dismiss SOE executives, as well as to approve strategic plans and budgets. The Ministry of Finance will retain the power to approve key indicators assessing the financial plans of strategic SOEs in order to limit fiscal risks to public finances. Following the adoption of the law, the authorities have started to draft the comprehensive bylaws needed to implement it and establish a policy on state ownership.

New measures have been put in place to fight financial crime. In June 2024 the Ukrainian parliament adopted legislation aimed at reforming the Economic Security Bureau (ESB). Under the auspices of the government, the ESB will get enhanced analytical capacity and will focus on identifying and fighting major financial crimes. Its new management team is to be selected in a robust, competitive and transparent procedure by a committee of experts, half of whom are independent, international specialists with the right to cast the deciding vote. Existing staff will be recertified by the same committee, with international experts again having the deciding vote. The rebooted ESB comes in response to the concerns of Ukrainian businesses.

Ukraine is now fully connected to the European energy system. Now that Ukrenergo has fully complied with the necessary technical requirements, the European Network of Transmission System Operators for Electricity (ENTSO-E) has permanently connected Ukraine to the European energy system. This process was first initiated back in 2017, before being given renewed impetus in February 2022. The capacity limit for electricity trade between continental Europe and Ukraine and Moldova has been raised from 1,200 MW to 1,700 MW. This is vital at a time when Ukraine's electricity generation capabilities are under attack and being destroyed by Russia on a near-daily basis.

The authorities are taking steps to address labour shortages. Nearly three years of full-scale warfare have taken an enormous toll on Ukraine's human capital, with a highly negative impact on the labour market, the economy and social cohesion. With the support of the EBRD and other international partners, the Ukrainian authorities are working to enhance the workforce's capacity to adapt to challenges stemming from the ongoing war, with a focus on reintegrating veterans into work.