UBN NETWORK

UKRAINE MONTHLY REPORT

February 2024

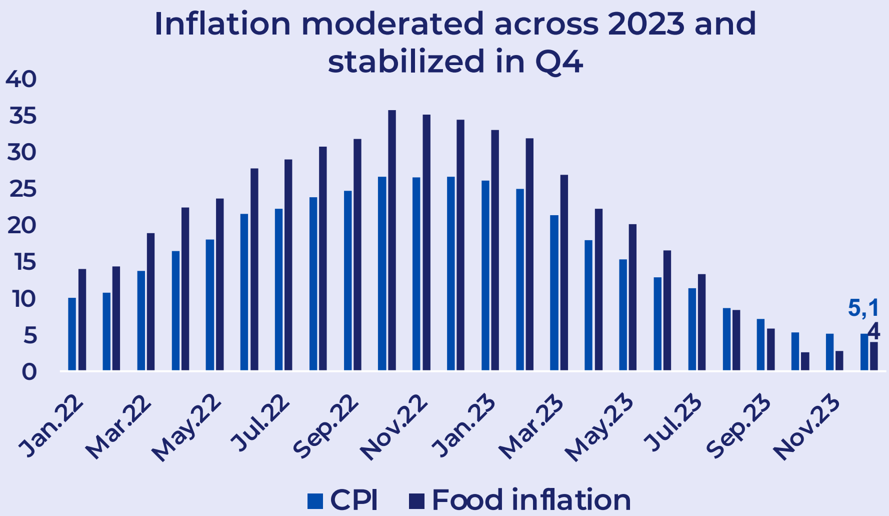
Trump’s unexpected intervention creates new worries over US funding

Powered by Ukraine Business News

Forecast Summary

Forecasts as of February 1, 2024, subject to monthly revision
** Preliminary estimate*

	2021	2022	2023f	2024f	2025f
GDP, %YOY	3.4	-28.2	5.0*	5.4	6.0
Inflation, %YOY	9.4	20.6	13.4	8.0	7.5
Consumer Spending, %YOY	7.6	-16.9	6.0	7.5	6.0
Investment, %YOY	74.4	-34.0	5.0	11.0	16.0
USD:UAH (avg)	27.29	32.70	36.80	40.00	41.00



Forecast Revisions

No forecast revisions were made this month for 2024 or 2025

Ukraine Monthly Report

After a solid 2023, some improvements in the investment environment may drive further growth

BUSINESS & ECONOMIC TRENDS

- Preliminary estimates indicate GDP grew by 5% YOY in 2023 (after falling by 28.8% in 2022). Defense, retail trade, construction, and agriculture drove the growth. While defense and retail trade will continue to grow this year, some moderation in construction and agriculture is likely. In 2023, cafes and restaurants saw sales rise by 30% YOY while car sales rose 60% (and 9% in December compared to November), nearly back to 2021 levels, indicating the resilience of consumers into 2024. Retail traders forecast 10% YOY growth of sales this year, in part driven by stress/escapism. However, agriculture is expected to see a milder harvest in H2, which will sustain relatively high food inflation. Meanwhile, construction will improve from weak levels this winter, though restrained by high interest rates (15%) and lack of war risk insurance.
- Anecdotal evidence, supported by a recent EBA survey, suggests top issues for investors this year relate to capital controls, harmonization of Ukrainian standards/legislation with the EU, and risk insurance/investment guarantees. Positively, two of these issues are seeing some progress. After removing some currency restrictions last year, the National Bank announced the second stage of currency liberalization (easing of trade financing, paying interest on debts). The next stage later this year would involve the return on principal. In addition, the development of nascent war risk insurance schemes in late 2023 look set to come to fruition in H1 2024. In Q2, Ukraine's Export Credit Agency will make its insurance operational, while the World Bank, the US, and several European governments are setting up effectively pilot schemes to drive investment. Ukraine also launched a project to insure ships with top British insurers.
- External trade is seeing some improvements, though pressures continue. While a high trade deficit persists (the value of imports exceeded exports by 76% in 2023), Ukraine exported 99.8 million tons of goods in 2023, slightly above 2022 levels, and exports are expected to rise by 9% YOY this year. In Q4, the trade deficit moderated thanks to higher exports and lower imports from the blockade on the western border, which caused a 6% drop in customs payments to the budget and an economic loss of $1.7 bn. Some improvements are visible as three Polish checkpoints were re-opened, though delays and rising transport costs continue as the required high-level political intervention by the respective governments remains lacking, prolonging the crisis. More positively, sea exports are growing: in 2023, Ukraine exported one million tons more than in 2022 and exports via the Odessa ports in December reached pre-war levels. Since September, insurance costs are down 75% and some 500 ships have used the grain corridor. These exports will add over $3 bn to GDP (~1% of GDP) this year. Progress will continue as Russia is unlikely to attack due to not only the international condemnation but also the increased insurance premiums on its own ships.

WHAT IT MEANS FOR BUSINESS

- Improving exports will be critical towards helping protect the hryvnia this year, which in turn will gradually allow for further liberalization of capital controls, encouraging foreign investment and driving stronger economic demand.
- Risk insurance mechanisms should be monitored closely for effectiveness as they could cause a notable rise in investment starting in H1. Though interest rates will not come down notably this year with inflation still at relatively elevated levels, these programs would provide a critical investment boost to sectors in dire need of financing, namely construction and warehousing/logistics, among others. As the construction has a disproportionate impact on the broader economy, the benefits of hiked investment would spread widely.

Ukraine Monthly Report

After a solid 2023, some improvements in the investment environment may drive further growth

MAJOR DEVELOPMENTS

- Western funding remains unresolved to date. Positively, the EU looks nearly certain to approve its 4-year 50 bn euro funding program on February 1 (or otherwise in the coming weeks), providing Ukraine with assistance at a similar amount as last year, protecting the budget for most the year irrespective of other external funding sources. However, on the US side, pressure from Donald Trump, who seeks to campaign on a platform related to immigration and the Mexican border, has recently derailed a burgeoning agreement between Republicans and Democrats on the border that would have unlocked aid to Ukraine. While we still expect US funding to Ukraine to materialize, this new political hurdle has delayed a deal and increased the possibility of severely reducing funding. In addition, the fact that military support is unable to be sourced elsewhere would have dire consequences for the front lines, with reports already emerging that the ongoing delays are beginning to cause rationing of ammunition and artillery.
- In part inspired by Western fatigue over providing taxpayer funds to Ukraine, significant progress has been evident in confiscating Russia's ~$350 bn foreign exchange reserves and transferring them to Ukraine. The US government will soon pass a law supporting confiscation and transfer to Kyiv, while the UK and other governments have also voiced approval. With Belgium (where most these funds are held), Germany, and France the most (cont'd) hesitant in the EU, given the possible damage done to the euro's credibility as well as Russian nationalization of European assets, confiscation is still likely over time but delayed to later in the year. In the meantime, the EU has agreed to tax the profits of Russia's reserves and provide them to Ukraine. However, these minimal amounts ($3-4 bn/year, or one month of Ukraine's budget needs) is a step in the right direction but entirely inadequate.
- On the war front, little has changed in the past month as Russia's assaults continue across all fronts, though with inconsequential gains. In recognition of its strategic shortcomings, Zelenskiy has publicly supported moving to a more defensive strategy this year, defined by reconstituting Ukraine's forces, mobilizing more manpower, limiting offensives to preserve men and ammunition, and constructing its own Surovikin line of defensive fortifications along the existing front. Such a strategy would preserve Ukraine's fighting capability for the long term while revealing to Putin that his losses will continue with no prospect of advances. Continued air assaults on Crimea and in Russia itself, particularly against oil and gas facilities in recent weeks, will lower Russia's recently-found confidence from late 2023, bringing home to Russia the realities of an endless war in which victory on Putin's terms is not possible.

WHAT IT MEANS FOR BUSINESS

- Firms should create contingency plans for reduced US funding, which would not only weigh on general investor and demand confidence, but more tangibly over time would cause budgetary shortfalls leading to less support to the economy while causing greater hryvnia depreciation and thus inflation.
- In the event of an eventual seizure of Russia's reserves, there would be a range of potential responses by the Kremlin. Retaliation could be extreme (and highly unlikely) – use of a non-conventional weapon (nuclear, chemical, biological) in Ukraine – or more limited (and highly likely) – seizure of Western corporations' assets in Russia.

The UBN Network membership offers

UBN Network membership is available to Ukraine Business News readers

4 LIVE EVENTS IN KYIV / YEAR

- Discussions with panelists from different sectors, with 80-100 attendees
- Macroeconomic, political, and business briefing, including best management practices
- Forum for in-person networking and live benchmarking of issues and expectations

RESEARCH REPORTS AND SURVEYS

- 4 Benchmarking Surveys focused on Budgeting, Talent Management, Channel Management, Digitization, etc...
- 4 quarterly reports on Ukraine's political, economic, and business outlook
- Monthly reports with macroeconomic forecasts for Ukraine, as well as analysis for the broader region and global markets

NETWORK AND INSIGHTS

- Ad hoc webinars and two analyst briefings for your company with our in-house Ukraine expert
- Facilitation of introductions and relationship-building in the Ukraine business community

Please do not hesitate to contact us if you have any questions

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UKRAINE QUARTERLY REPORT

Q4 2023

Manage a long war, while capitalizing on a steady, stable, growing economy in 2024

Powered by Ukraine Business News

Contents

Executive Summary

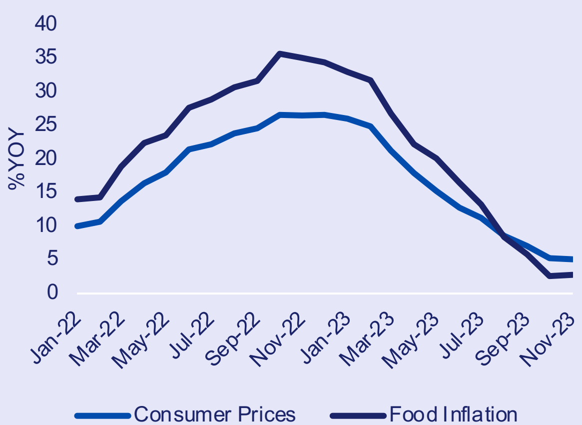
Manage a long war, while capitalizing on a steady, stable, growing economy in 2024

With the 2023 counteroffensive having failed to achieve its aims, the war is now set to last deep into 2025 at a minimum. While delaying an acceleration in growth made possible by an end to hostilities, growth is clearly reviving and is expected to remain consistent through 2024, rising by over 5% YOY this year and next. Slowing inflation, falling interest rates, rising lending, and a stable hryvnia across 2023 encourage optimism for 2024, despite some moderation in some sectors in Q4, largely from worries over Russian air raids this winter. Real incomes are up for most of 2023 and will rise further next year, buttressing consumer demand, which will continue to drive the economic revival. Steady and stable performance will allow foreign firms to consider raising investments in 2024. Meanwhile, concerns over continued Western funding continue to weigh on the market; however, our base expectation remains further support for the year at similar levels as in 2023.

BUSINESS TRENDS

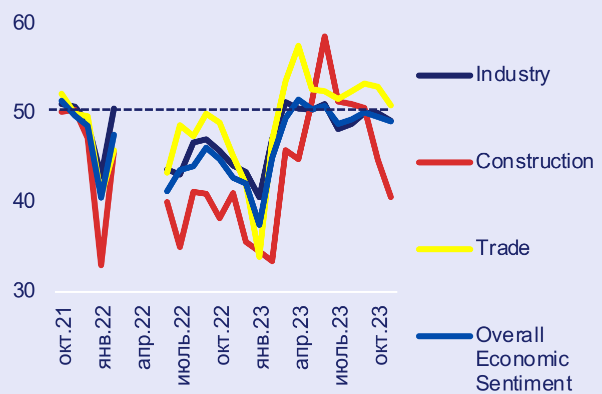
CONSUMERS

Improving drivers of spending build optimism for 2024



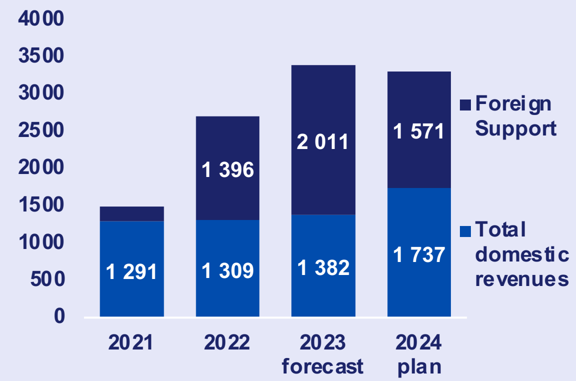
BUSINESSES

Businesses are struggling with logistics and high costs
Business Activity Expectations Index



GOVERNMENT

Western funding is critical, and underestimated in the budget
Budget revenue sources in UAH, billion



Forecast Summary

Forecasts as of December 2023, subject to monthly revision

	2021	2022	2023f	2024f	2025f
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Consumer Spending, %YOY	7.6	-16.9	6.0	7.5	6.0
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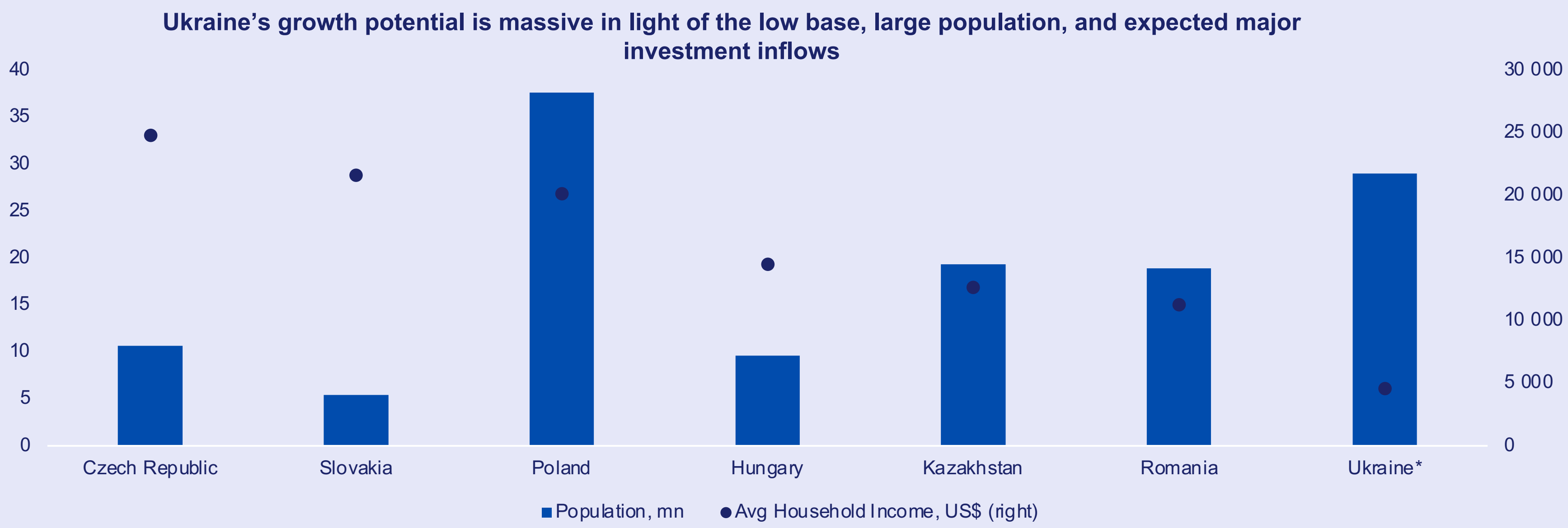
Investment, %YOY	74.4	-34.0	5.0	12.0	16.0
USD:UAH (avg)	27.29	32.70	36.80	40.00	41.00

Ukraine in the CEE portfolio

Ukraine is likely to become the most attractive emerging market in EMEA in the coming years

REGIONAL COMPARISON

- Ukraine's investment appeal is based largely on its long-term attractiveness, which itself is dependent on both a positive outcome for the war and ensuing peace, as well as high levels of Western public investment. These factors will underpin the revival of private investment, both domestic and foreign, helping the country to recover its economic potential.
- Moving into 2024, Ukraine will begin to perform more strongly than the rest of the Central European region, with expected 5+% YOY growth in 2023, 2024, and 2025 (albeit after a drop of 29% YOY in 2022). However, Ukraine's growth could accelerate well beyond these growth rates 1) should the war move in Kyiv's direction, and 2) an agreement is made related to Western security guarantees, ending Russian missile barrages across the country. This scenario becomes increasingly likely only in 2025, based on current expectations.
- With Poland's economic potential solid and consistent for years to come, Ukraine will benefit from being both managed and supplied from this robust market.
- Inflation will remain more elevated than the rest of the region, driven by high producer prices and some expected further hryvnia depreciation in H1 2024.



**Note: Ukraine's population has been revised down notably this year from ~40 million to 29 million on account of the loss of territory and emigration*

Economic Outlook for Ukraine

The economy is set to further stabilize in 2024, providing greater investment predictability

LATEST ECONOMIC TRENDS

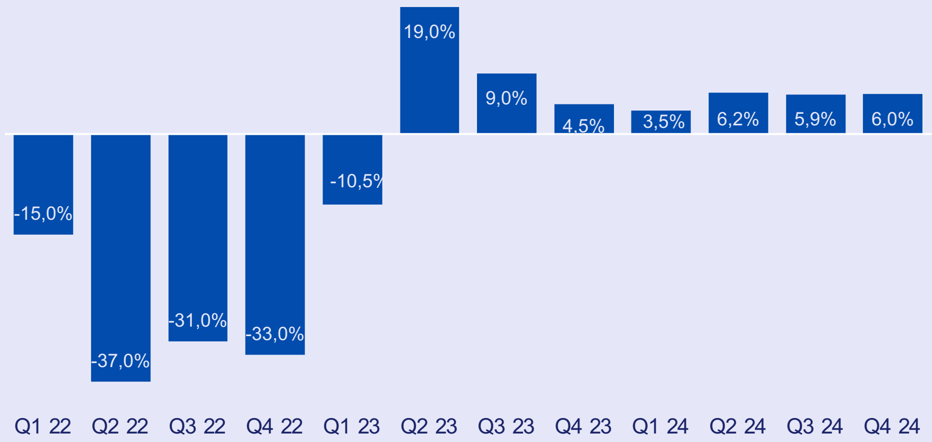
- The economy is clearly reviving – and well beyond expectations, with GDP rising 10.5% YOY in October and improving each month, marking 5.5% YOY growth through October this year. Moderating consumer prices (5.3% YOY in October) and food inflation (2.6%), in part due to the strong performance of the agricultural sector, buttress confidence. As a result, the central bank moved to a managed flexible exchange rate and cut the key rate by 4 p.p. to 16%. Consumers continue to drive the economy; however, after improving confidence across the year, sentiment moderated in October and November, though remained at healthy levels. Consumers express less worry about unemployment, a weaker hryvnia, and rising prices.

2024 OUTLOOK FOR UKRAINE

- Under our base-case expectation, the war with Russia will continue throughout 2024 and well into 2025 at least, with vital international financial and military assistance (amounting to ~US$ 150 billion since February 2022) to continue to cover budget and defense expenditures, albeit possibly delayed into January.
- For 2024, growth should remain on a stable, solid, consistent trajectory, albeit without a major acceleration, supported by consumer spending benefiting from revived real income growth. The hryvnia is expected to fall mildly (~10%) in Q2 2024, while interest rates also fall minimally. This will have only a slight impact on inflation, which will moderate further in 2024.
- Russia is again targeting energy infrastructure this winter, though Ukraine's improved defenses will help avoid the level of destruction and business disruption felt last winter, helping sustain growth and investor sentiment through Q1. Assuming this, domestic and foreign investment should see a boost starting in Q2.
- Pressures on the labor market will impact business costs, given the serious shortages of personnel, which will worsen with an intensifying mobilization drive.

Growth for the next few quarters will remain consistent and solid, albeit rising from a low base

GDP %YOY



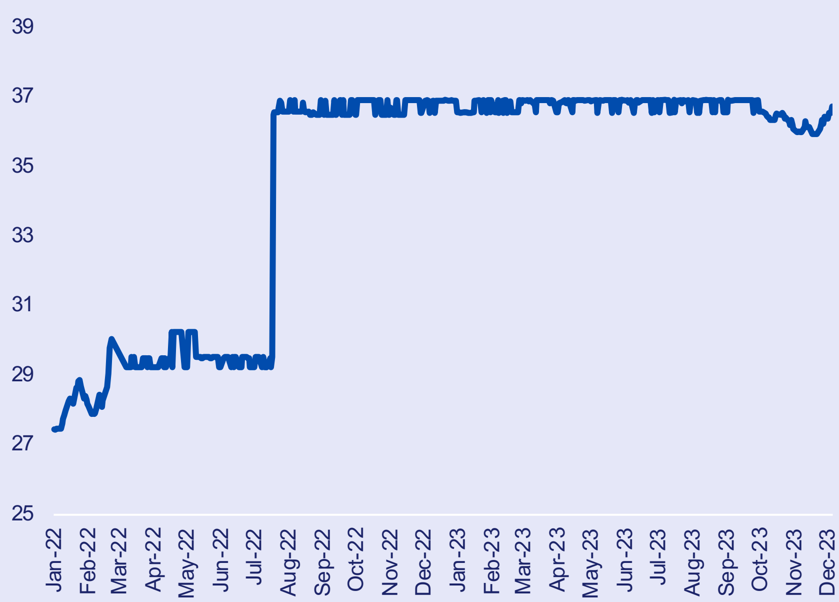
Hryvnia Tracker

Expect another mild devaluation in Q2 2024

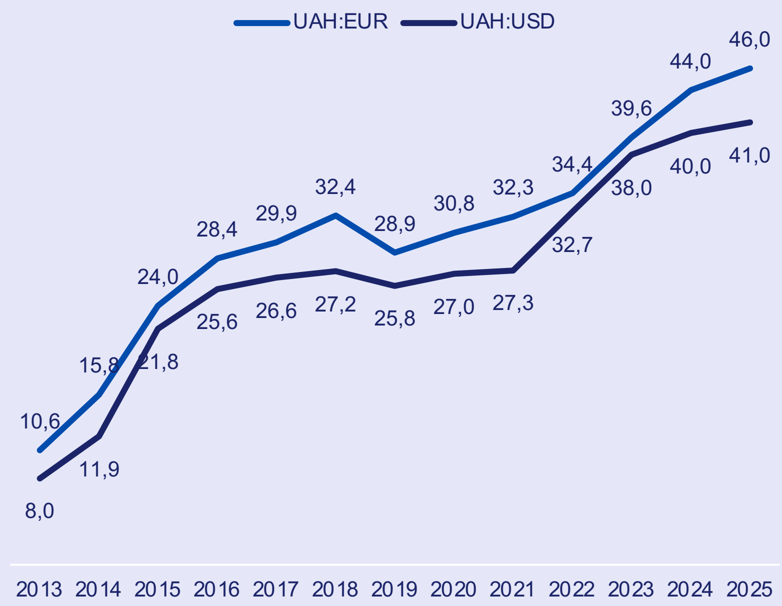
- After a 20% devaluation in July 2022, the hryvnia has remained stable since, in a surprise to markets anticipating far worse depreciation. Sufficient Western financial support has buoyed the currency, allowing for consistency and predictability the last year and a half. With pressure on exports accruing and imports improving, the central bank is likely to devalue the currency once again by ~10% in our estimation after the winter in Q2 2024. Depreciation pressure will remain into 2025.
  - Critical to hryvnia stability is continued Western financial support, which allowed FX reserves to rise to a record high of US$ 41.7 billion in July, protecting the currency. Reserves have since fallen moderately (to US$ 38.8 bn in November) given delayed Western financial aid and moderating exports; however, with Western funding highly likely to persist in 2024, the hryvnia should avoid any further major destabilizing drops.
  - The major risk to the hryvnia's outlook relates to delays and/or reductions in Western aid, which would entail a notably larger depreciation in 2024 as aid would be diverted from currency support to defense expenditures. Meanwhile, the end of the grain export deal is not particularly impactful as Ukraine is able to export its current reduced level of output via alternative routes, protecting the hryvnia.

After freezing the hryvnia the past year, the central bank will likely devalue it again in Q2 2024

USD:UAH



The hryvnia will remain under pressure through 2025



Operational Environment

The operational environment will remain challenging across 2024

OPERATIONAL ENVIRONMENT OUTLOOK

- The operational environment is set to remain challenging in light of elevated costs, labor market pressures, and difficulty in planning and obtaining corporate resources amid the uncertainty of the war. Continued attacks on energy infrastructure this winter will again create logistical hurdles. Under the expectation that Ukraine is unable to make strategic advances in the war in 2024, marked improvements to the investment environment will be delayed into 2025.

DEMAND AND COST PRESSURES

- Stable and steady economic performance across 2023, after steep declines amid a tumultuous 2022, is driving investable opportunities. Confidence is solidifying at an improved level compared to the first year after the war. Moderating inflation is helping push consumers into more of a spending mode, while recovering lending amid falling interest rates will aid demand, potentially driving profitability in 2024. Still, the weaker hryvnia next year, rising labor costs, removal of utilities subsidies, and a weaker harvest in H2 2024 will sustain slightly elevated inflation.

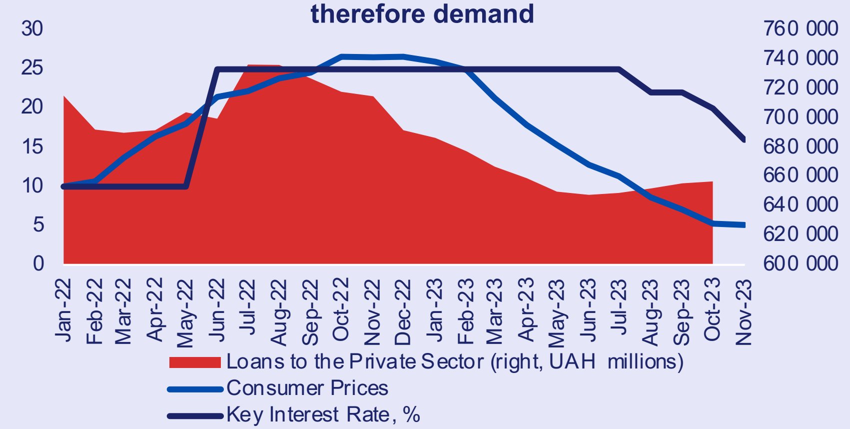
TALENT MANAGEMENT

- The severe population decline from ~40 million to ~29 million from before the war to now on account of emigration abroad and loss of territory has created a lack of white-collar specialists and blue-collar workers. With real incomes now rising again in H2, labor costs are picking up while productivity struggles and critical vacancies remain: just two candidates apply for each vacancy, with shortages for core sectors at ~15-20%. The situation will worsen in H1 amid an intensifying mobilization drive.

INTERNAL MANAGEMENT

- Positively, consistent anecdotal evidence suggests increasing interest in investing in the market from corporate headquarters in Western countries, unlike earlier in the year. Regardless, most firms struggle with making the case for investment given the poor optics of the unpredictable environment amid the war and bombing raids across the nation. Capital controls, while being loosened, still create shortages of hard currency and hinder investor sentiment. Firms able to maintain strong support from headquarters have reported clear improvements in their market position. B2C and healthcare firms in particular have even reported solid sales compared with 2021.

Falling inflation and interest rates is helping revive lending, and therefore demand



Most Western firms have adequate resources but in many cases are still limiting investments

Q4 2023, % of respondents

Demand Outlook

Consumer Demand Outlook

Improving drivers of spending build optimism for 2024, however worries exist for the coming winter months

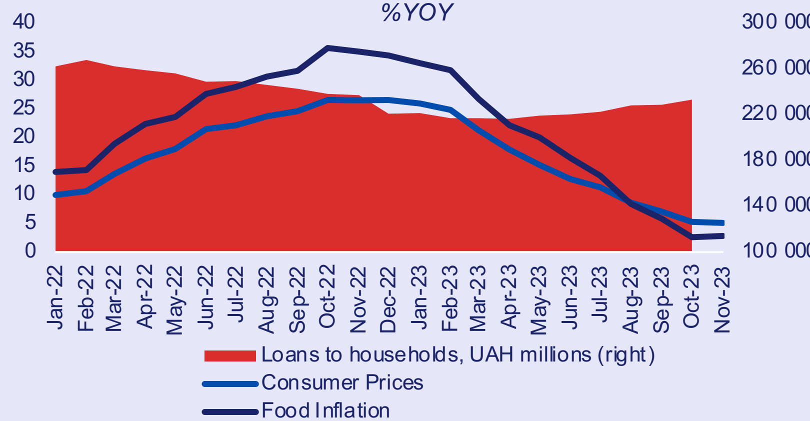
OUTLOOK FOR CONSUMER DEMAND

- Retail sales rose by 7.1% YOY in H1*, albeit after a drastic drop in 2022. As confidence remained stable and businesses report solid sales, H2 2023 saw consistent demand as well (e.g. seen in the 60% YOY growth in new car sales in 2023). Critically, with inflation slowing markedly and businesses fighting for talent, real incomes have been growing solidly since the summer and will continue to rise in 2024. Matched with increased consumer lending and continued budget support to supplement incomes, B2C firms should be optimistic about solid demand across 2024. The main risk relates to Russian air raids this winter and hiked imported prices from hryvnia devaluation in Q2, weighing on investor and consumer sentiment in the coming months.

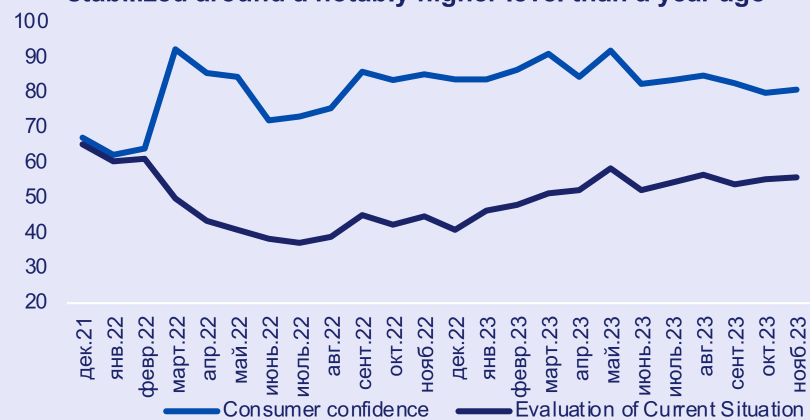
KEY DRIVERS

- **Government support:** Large state bonuses to those in the military have been vital to overall spending, amounting to ~30% of total household consumption. Thus, a 16% YOY budgetary cut to military salaries in 2024 presents a threat to demand; however, private sector wage hikes and a planned 19% rise in the minimum salary in Q1 2024 should be adequate to fill the gap.
- **Labor market:** Calculations by the National Bank of Ukraine indicate that real household incomes have been growing by ~10% YOY since Q2, alongside pensions. An EBA survey indicated 76% of businesses increased wages in 2023 and SMEs also raised their wage payments. The rapid slowdown in inflation dramatically aided real income growth. In 2024, businesses will raise salaries further given the falling supply of workers, driving up disposable incomes and spending.
- **Food inflation:** With discretionary income squeezed and up to 50% of consumer spending devoted to food, the notable slowdown in food prices—at just 2.8% YOY in November, down from 30% YOY in Q1, thanks to the strong harvest—is boosting sentiment and disposable incomes, and will persist into 2024. Firms can look to raise prices to enjoy better margins in certain product categories targeting higher income classes.
- **Consumer credit:** After 10% YOY growth in 2022, consumer credit slowed notably in H1 2023 but has since bounced back (as seen in the chart), falling by just 12% YOY in the January to October period. Falling interest rates in H2 and improved incomes have raised both the demand for and supply of loans, indicating that consumers are again confident to supplement their incomes with loans.

Slowing price growth and falling interest rates are driving confidence and reviving lending



Consumers' evaluation of their current situation has stabilized around a notably higher level than a year ago



Business Demand Outlook

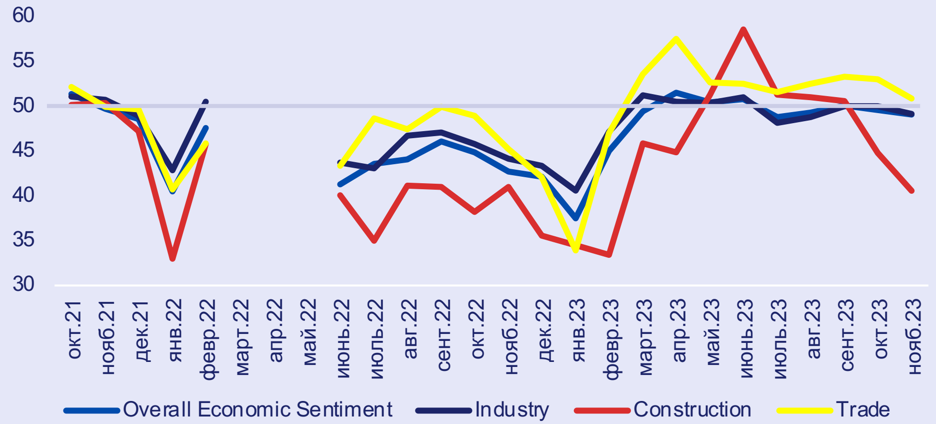
Businesses are struggling with logistics disruptions, elevated costs, and concerns over winter air raids

OUTLOOK FOR BUSINESS DEMAND

- Industrial production—down 2.9% YOY in H1, after a 37% drop in 2022*—is far from recovered from the war and will only rise by 3–5% YOY in 2023. Metallurgy has struggled the most given the loss of assets from the war in the southeast and blockage of seaports, with no prospects for improvement in 2024 or in the years ahead. Food output continues to uphold overall industry performance, thanks to resilient consumer spending and a strong harvest. With consumer demand to rise further in 2024, this segment should continue to improve mildly.
- Ultimately, output will remain restrained by continued hesitant investment given the uncertainty and safety concerns related to the war. Pressure on export routes complicate matters further. The end of the grain export deal with Russia will continue to limit export capacity, despite reviving exports via this route since this summer. Meanwhile, although the border issue with Poland is expected to be resolved in due time with the new government in Warsaw, the matter has dampened investor sentiment.
- Positively, overall business confidence revived notably in H1 2023 and has remained consistent since thanks to rebounding domestic demand amid greater stability in the hryvnia and prices. Thus far in Q4, sentiment has moderated mildly given logistical issues at the Polish border, higher energy costs, worries over Russian air raids this winter, and worker shortages.
- Cost pressures remain elevated overall, as labor costs rise amid wage hikes, the weak hryvnia sustains higher import prices. Firms note their plans to raise prices in order to cover their rising costs.
- Retail firms have become the sole industry with positive expectations for the coming months, thanks to slowing inflation and resilient demand.
- Considering the loss of nearly a third of total harvesting land due to the war, the agriculture sector rebounded well beyond expectations in 2023. Agriculture will rise by as much as 10% YOY in 2023, thanks in part to favorable weather, compared to initial forecasts of 10-15% YOY decline. For 2024, the harvest is expected to normalize while export routes remain constrained, limiting profitability and therefore demand in this sector.

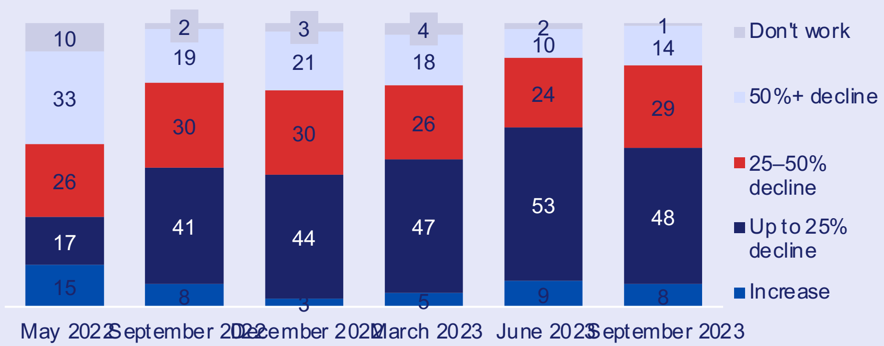
Sentiment has taken a downturn lately, driven by seasonal weakness in construction, worries over winter air raids

Business Activity Expectations Index, above 50 indicates optimism



The number of domestic firms operating near pre-war levels remains well beyond half of all companies

Business output relative to pre-war levels, % of firms



Government Demand Outlook

Western funding is critical, and also underestimated in the budget

OUTLOOK FOR GOVERNMENT REVENUE

- The 2024 budget foresees expenditures at similar levels as in 2023; however, this is based upon borrowing of an estimated US$ 41 billion from external partners, which is not only in question but also likely an underestimate based upon budget performance in 2022 and 2023. In those years, domestic revenues amounted to 48% and 42% of total expenditures, respectively, while in 2024 domestic revenues seek to cover some 51% of spending. In particular, the budget expects a nearly 30% YOY increase in domestic tax revenue, which is likely unrealistic.

- Of the required US$ 41 bn in foreign support: US$ 18bn is expected from the EU (a third in grants); $12bn in grants from the US; $5.4bn from the IMF; and at least $4.0bn from other partners.

- ***This reliance on foreign support is concerning because of the potential change in political moods in the West, and particularly in the US, as discussed on page 18.***

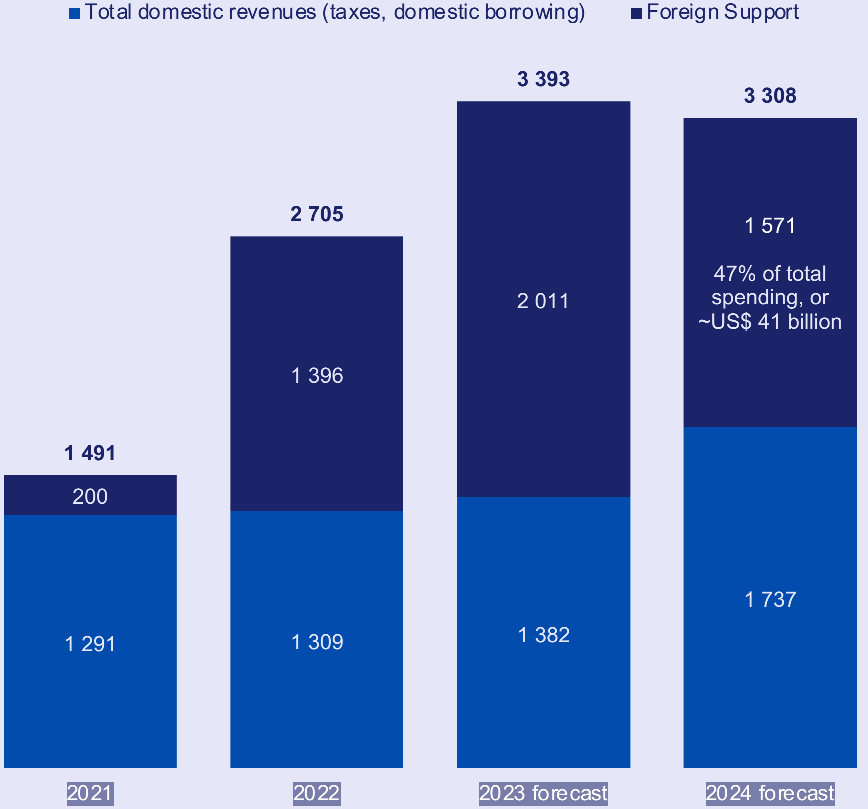
OUTLOOK FOR GOVERNMENT SPENDING

- Total expenditures are set to be cut by nearly 10% YOY in 2024, driven by a 18% YOY cut to national security and defense, which is unrealistic and will require a revision as the 2023 budget did. Most of the remaining budget covers social areas, including indexed pensions, while reduced but still considerable payments to the military will help sustain total consumer spending.

- Debt repayment and service still eat up a substantial amount of spending (almost 20%); however, debt service expenditures are likely to be around a third lower than the plan, which will free up resources. In early 2024, another restructuring of debt to Eurobond holders is expected, which will include a haircut, extension of maturities, and decrease in coupons. Meanwhile, debt-to-GDP levels will rise mildly, to ~90% from 80% end-2023 – less than the IMF's 100% forecast – given the weaker hryvnia.

Domestic revenues are likely overestimated, while foreign support needs are underestimated for 2024, requiring a budget revision in the coming months

Budget revenue sources in UAH, billion



UBN NETWORK

Major Topics

War Tracker (1/2)

The war is still likely to end in Ukraine's favor, though now notably delayed into 2025 or beyond

- Ukraine's counteroffensive failed to achieve even its minimal objectives (advancing to cut off the land link to Crimea via artillery shelling) much less its maximalist objectives (advancing to Crimea by year's end). While severely depleting Russia's manpower and materiel resources, with so little land seized, Ukraine was unable to strategically shift the war in its direction. The war will now settle into an intense war of attrition throughout 2024, with neither side with the offensive capabilities to gain a strategic advantage: Russia limited by inadequate manpower and poor command and control; Ukraine limited by its disadvantage in artillery and ammunition.

- The most recent significant developments relate to Russia's abhorrent losses of manpower and equipment for very mild gains in Avdiivka to date, as well as in Luhansk and Bakhmut to a lesser degree. None of these fronts allow Russia to strategically shift the balance of the war, but rather indicate Moscow's continued intention to try to win the war and make gains ahead of March presidential elections. On the Ukrainian side, mild advances have occurred along the Dnipro, which looks to be an area of focus in early 2024 with the provision of F-16s. Due to terrain and limited supply lines, logistical support is difficult for Russia here, leaving Russia somewhat vulnerable.

- In recognition of the inability to advance, President Zelenskiy has publicly noted a turn in strategy for the coming year that involves Ukraine taking a more defensive posture. This ensures the war is prolonged well into 2025, and likewise raises the likelihood of this evolving into a frozen conflict situation – something akin to an 'Israel' scenario in which Ukraine becomes a permanently militarized state with Western support but no real security guarantees (NATO membership). Assuredly, as casualties mount and no clear gains are made by either side over the course of 2024, international calls for a ceasefire will increase – matched with the realistic potential of a Trump presidency and his spoken interest in a ceasefire.

War Tracker (2/2)

The war is still likely to end in Ukraine's favor, though now notably delayed into 2025 or beyond

- The most likely scenario remains a Ukrainian 'victory', which would resemble something akin to a 'Korea' scenario, or otherwise (far lower likelihood) a full Ukrainian victory with Russian troops out of Ukraine to 1991 borders. In advance of US presidential elections in November, President Biden is highly incentivized to provide greater capabilities (more F-16 jets, longer-range artillery and guided missiles, electronic warfare systems, etc…) to demonstrate the effectiveness of his Ukraine strategy and avoid an electoral loss. Western support could also allow Ukraine to gain the artillery advantage in 2025 and beyond, which in turn would allow Ukraine and the West to negotiate from a position of strength in 2025. As this scenario involves security guarantees for Ukraine (and specifically NATO membership), this can only occur in the event of more Russian losses on the battlefield combined with such economic pressure in Russia that the Kremlin opts to end the war in 2025.

Russia-Ukraine War Scenarios through 2025

End point	Scenario 1: Russian 'victory'	Scenario 2: Ukraine 'wins', Russia ends the war	Scenario 3: Frozen conflict, fighting persists at lower level	Scenario 4: Direct Russia-NATO confrontation
Likelihood	**10%**	**50%**	**35%**	**5%**
Likely timeline	Early 2025	Mid-2025 and beyond	Possible by mid-2024	Through 2024 and beyond
What it looks like	• Western support cut off, likely due to a Trump presidency in the US. • Ukrainian government effectively forced to negotiate for peace. • Russia seizes more territory; Ukraine turns war into an insurgency.	• More military defeats for Russia in multiple offensives over the next two years. • Combined with economic problems at home, Russia is forced to end the war (likely retaining some territory). • West provides Ukraine some form of security guarantees.	• Ukrainian advances end with no realistic potential for future gains. • Western assistance to Ukraine wanes while an interest in negotiations in the West grows. • Kyiv becomes willing to negotiate, while Moscow can declare a "victory." • However, the two sides get bogged down by extended negotiations.	• NATO and Russia are directly involved in a military confrontation, instigated by a Russian attack on a NATO country or tactical nuclear strike in Ukraine. • The West responds with an overwhelming conventional response. • Potential for a Russian nuclear retaliation in the West.

Russia’s 2024 Economic Outlook (1/2)

Short-term resilience in the face of sanctions is now evolving into long-term decay in 2024

- Since the invasion and sanctions, Russia’s economy has been far more resilient than expected, falling by just 2.1% YOY in 2022 and rising by over 2.0% in 2023. The resilience is primarily driven by Russia’s surprising ability to fully transit its oil export volumes to Asian markets, sustaining growth and state spending.

- However, that short-term resilience is now waning amid pressures from sanctions and accelerating budget spending. The 2024 state budget will be the largest in post-Soviet Russia, driven by a nearly 70% YOY rise in defense spending, while budget revenues are notably overestimated, demanding additional taxes.

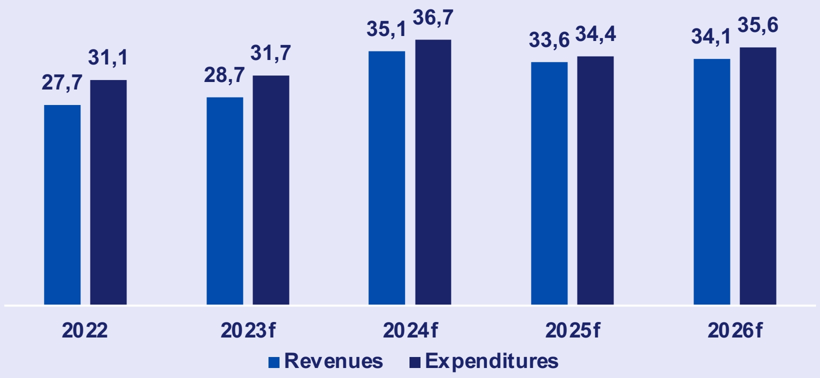
- In short, the government has created too many conflicting policies that must be dealt with in time, though no solution is available as long as the war persists. The government is implementing stop gap measures to avoid pre-election economic problems, namely capital and export controls to address ruble weakness and inflation. On the one hand, defense spending is rising massively though lacks the domestic manufacturing to satisfy this demand, and thus must import heavily to support defense sectors, severely weakening the ruble – all raising inflation. To combat ruble weakness, capital controls have been instituted, while to combat inflation, interest rates have been raised dramatically (to at least 16% in December) and export controls placed on certain products. However, reduced exports reinforce ruble weakness and inflation, while higher interest rates increase the debt burden of businesses, requiring state subsidies to protect defense manufacturing – raising inflation. Meanwhile, the ongoing mobilization (and perhaps a more formal one after March elections) lowers the labor supply and raises wage costs for businesses, lowering investment and raising inflation.

Russia’s 2024 Economic Outlook (2/2)

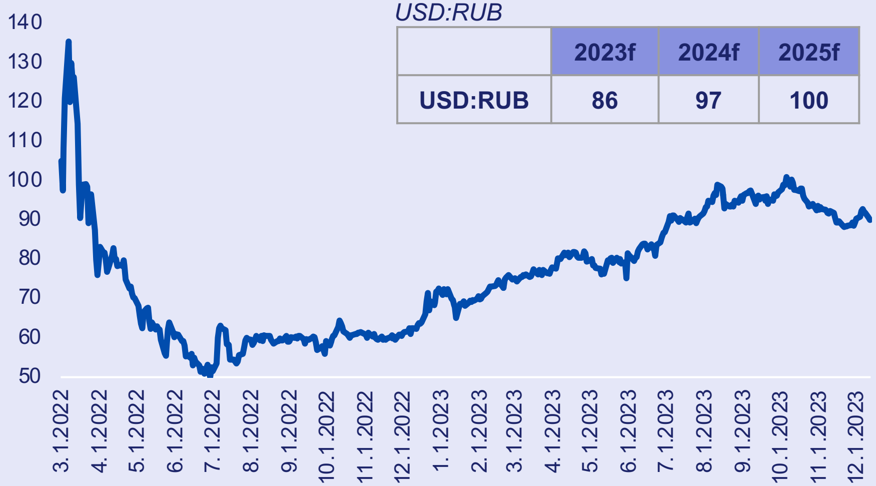
Short-term resilience in the face of sanctions is now evolving into long-term decay in 2024

- Politically, Putin’s regime will anger certain elite factions with its response to these conflicting policies in Q2 after March elections, creating greater pressure within the Kremlin. Ultimately, Moscow is likely to choose a middle ground: remove some capital controls while maintaining high interest rates across 2024 to limit inflation and ruble depreciation, despite the deleterious impact on private investment.

Massive defense spending requires large budget spending hikes, diverting from most other sectors
RUB trillion



The ruble was the world’s worst performing currency in 2023, and will continue to weaken notably across 2024 and 2025
USD:RUB



	2023f	2024f	2025f
USD:RUB	86	97	100

Western Funding (1/2)

Western funding remains the base case scenario, with aid provided in January at the latest

- Despite increasing concern of reduced or otherwise cancelled financial and military support from the US and the EU for 2024, the base case expectation with a high probability remains continued aid at levels similar to 2023. This level of support will be adequate to both finance the budget as well as to provide the necessary defense to – at a minimum – resist further Russian advances.

- Ultimately, holding aside far-right Republicans, strong bi-partisan support for Ukraine exists within the Senate, House of Representatives, Congressional committees, executive branch, and the American public in recognition of the threat Russia poses to the broader Western order. Critically, once a critic of funding to Ukraine, the new Speaker of the House Mike Johnson has since consistently voiced his strong support to continuing to fund Ukraine, importantly linking countering Russia with opposing China, helping focus minds in the US about the collective threat posed by the non-Western world to the American-led order. These dynamics ensure the high likelihood of continued US support for 2024.

- Nonetheless, in a downside scenario, support may not come or otherwise be reduced/delayed well into 2024, giving Russia an even greater advantage over Ukraine and opening up far worse outcomes for Ukraine and the West. Thus, businesses should prepare contingency plans for funding delays/reductions, as tax hikes and sizeable budget cuts to non-defense areas like business support programs and capital expenditures will hurt investment and employment, while the central bank over time would resort to printing money, driving up inflation and weakening the hryvnia.

Western Funding (2/2)

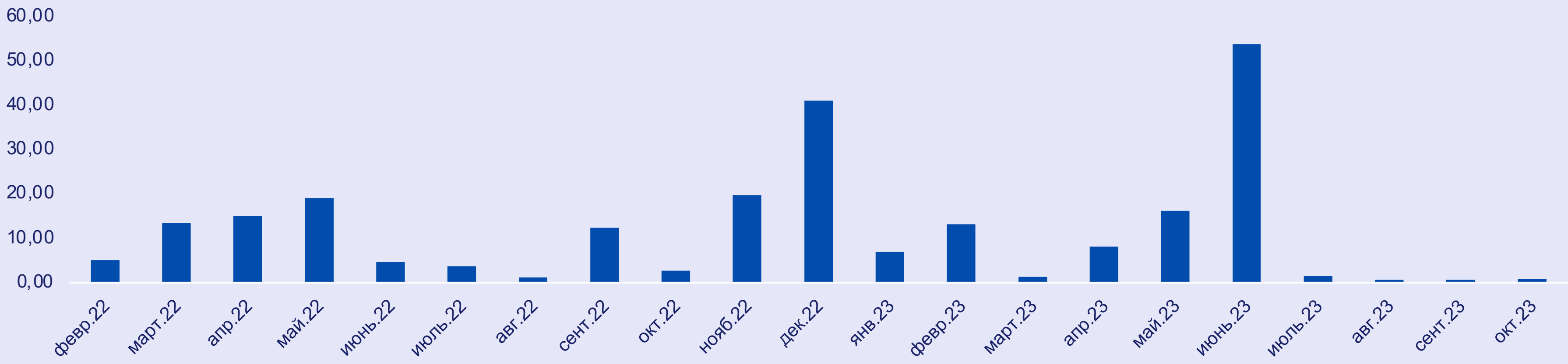
Western funding remains the base case scenario, with aid provided in January at the latest

- In this downside scenario, the EU itself as well as the UK, Eastern European and Nordic nations would fill the funding gap to some degree; however, military assistance would be entirely inadequate given the US's dominance in this area, while longer-term funding would be problematic, leading over time to Western calls for a disadvantageous ceasefire.

- Looking far ahead to US elections in November 2024, questions remain as to the continuation of US funding given the potential for a Trump presidency. Our continued expectation is that core Republican party officials will continue to strongly support backing Ukraine, ensuring bipartisan consensus on the matter, and be able to overturn any Trump veto on Ukrainian support in 2025, should 1) Trump be elected, and 2) he seeks to implement a policy that abandons Ukraine, both of which are unclear currently.

Western funding has dried up since this summer, raising concerns about long-term support

Total financial, humanitarian, military aid, euros billion



Winter Air Raids

Anecdotal evidence suggests businesses are more optimistic about this winter than last, and should be

Based on conversations with businesses and government officials, the consensus belief we share is that Ukraine will pass through this winter in better form than last winter, thanks to greater air raid defense and business preparation, and despite Russia's increased aerial assault capacity.

RUSSIA'S OFFENSIVE CAPABILITIES

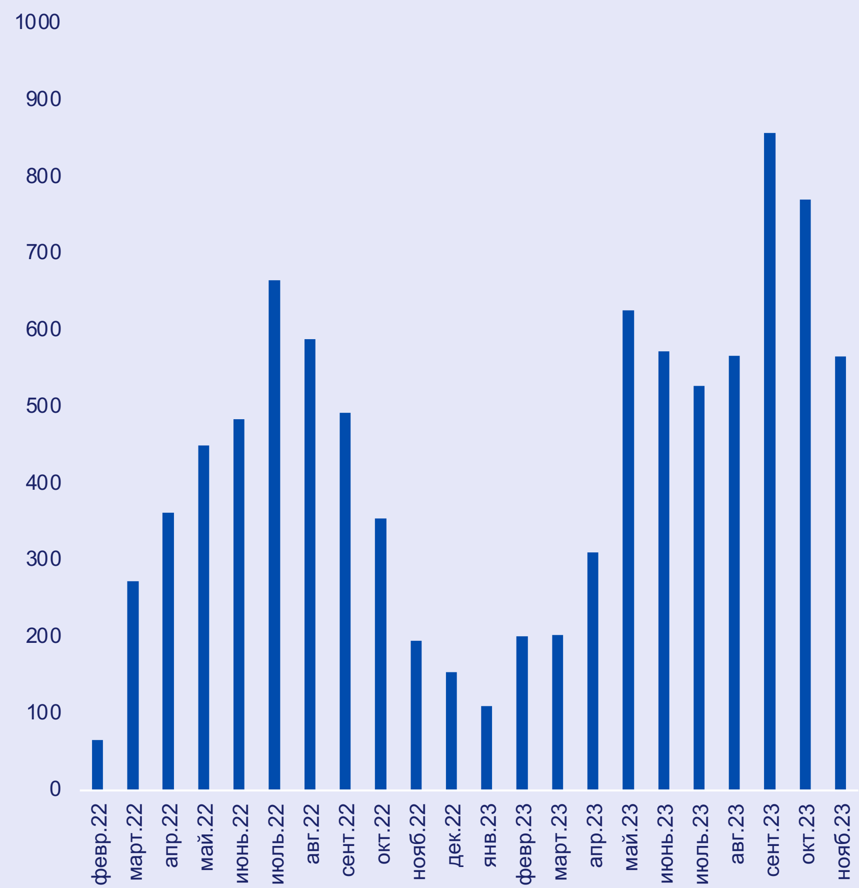
- As seen last winter as well, the strong expectation is that Russia aims to destroy Ukraine's infrastructure (primarily energy) in order to undermine society's morale and deplete Western air defense support as one piece of this broader war of attrition. Last winter, Russia launched some 1,200 missiles at Ukraine's energy infrastructure, damaging to varying degrees most power plants across the nation as well as up to 40% of power distribution lines.
- Businesses should expect even larger-scale attacks and more frequent than last winter. NATO and other sources have indicated that Russia has likely stockpiled drones and missiles for attacks during the coldest weeks of winter. Thanks to imports of sanctioned components for missile and drone production from third countries, Russia has successfully increased production capacity of both drones and missiles. More drone attacks are expected than last winter, as seen in the largest drone strike on Kyiv since the start of the war in late November, when some 75 drones were launched.

UKRAINE'S DEFENSE CAPABILITIES

- As Russia's offensive air capabilities have improved in the past year, as have Ukraine's aid defense capabilities, as well as business and state preparation. Some 40 surface-to-air missile defense systems, with more on the way, around 100 anti-aircraft guns, 15 radars, and promises of more equipment to arrive imminently provide the necessary defense. Also, the energy sector is far better protected: ~80% of power generators and transmission lines have been repaired, around half a million diesel generators have been imported, and connection to the European power grid raises electricity capacity.
- Nonetheless, while Kyiv is highly protected, extensive damage is expected in the rest of the country, which is far less protected, albeit better than last winter.

Drone strikes have seen a massive uptick since May, indicating high production capacity moving into 2024

Total air/drone and missile strikes by Russian forces on Ukraine since the start of the war



The UBN Network membership offering

UBN Network membership is available to Ukraine Business News readers

4 LIVE EVENTS IN KYIV / YEAR

- Discussions with panellists from different sectors, with 80-100 attendees
- Macroeconomic, political, and business briefing, including best management practices
- Forum for in-person networking and live benchmarking of issues and expectations

RESEARCH REPORTS AND SURVEYS

- 4 Benchmarking Surveys focused on Budgeting, Talent Management, Channel Management, Digitization, etc...
- 4 quarterly reports on Ukraine's political, economic, and business outlook
- Monthly reports with macroeconomic forecasts for Ukraine, as well as analysis for the broader region and global markets

NETWORK AND INSIGHTS

- Ad hoc webinars and unlimited analyst briefings for your company with our in-house Ukraine expert
- Facilitation of introductions and relationship-building in the Ukraine business community

Please do not hesitate to contact us if you have any questions

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Sources

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- *Bloomberg*
- *BMB Russia*
- *Carnegie Endowment*
- *Concorde Capital*
- *EBA*
- *ICU*
- *In Moscow's Shadows*
- *InfoSapiens*
- *Institute for Economic Research*
- *Investing.com*
- *Jamestown Foundation*
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- *Ministry of Finance*
- *National Bank of Ukraine*
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- *UkrStat*
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