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UKRAINE QUARTERLY REPORT Q1 2025

Despite lower chances of a ceasefire and continued uncertainty, Ukraine's outlook remains positive

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Executive Summary

Despite lower chances of a ceasefire and continued uncertainty, Ukraine's outlook remains positive

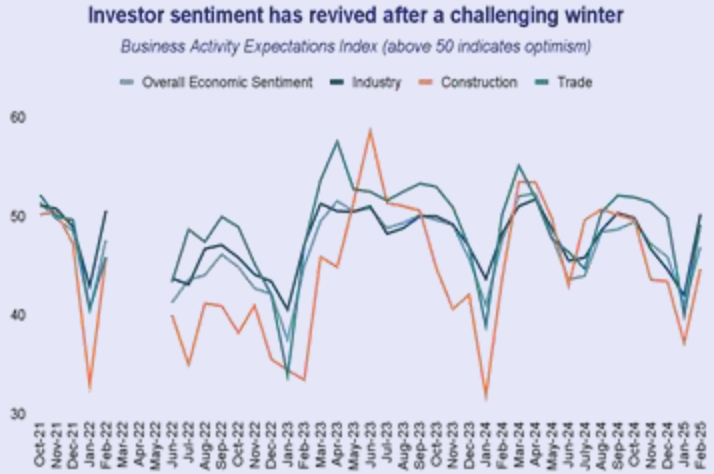
The likelihood of a ceasefire this year has fallen; however, a land-for-peace deal over the longer term remains the most likely scenario, given our confidence in Europe stepping up to replace US aid and provide for both Ukraine and its own security and defense. The upcoming weeks and months will be determinant for the war's outlook and ultimately Ukraine's future. Investors should monitor not only US policy towards Russia amid negotiations, but also future US aid support. If lacking, the US will lose leverage in talks, transferring any future negotiations to the Europeans. Likewise, investors should monitor further steps by European nations to support Ukraine, including extending sanctions in June, ensuring Russia's FX reserves do not revert back to Russian control. Regarding the economy, growth is gradually reviving after a slow winter of power outages and high inflation. As business costs and consumer prices stay higher-for-longer, and the labor market remains a challenge, demand will further revive but remain restrained.

BUSINESS TRENDS

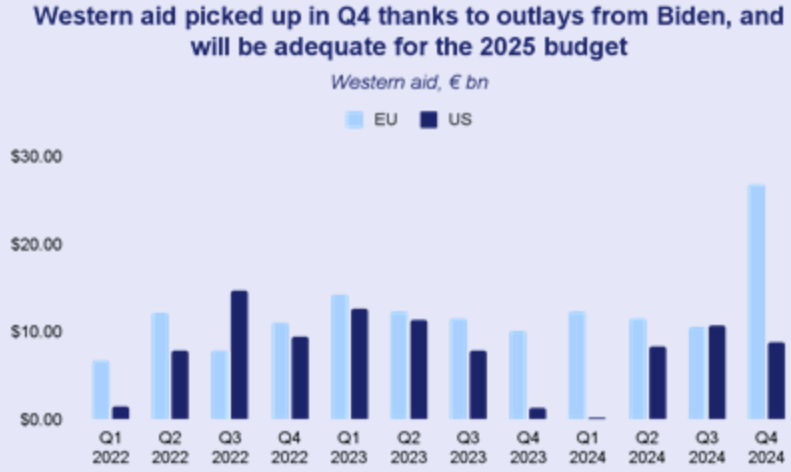
CONSUMERS



BUSINESSES



GOVERNMENT



Forecast Summary

Forecasts as of March 20, 2025, subject to monthly revision

	2023	2024e	2025f	2026f
GDP, %YOY	5.3	3.6	3.9	5.4
Inflation, %YOY	12.9	6.5	11.9	7.4
Consumer Spending, %YOY	6.1	5.0	5.2	6.1
Investment, %YOY	52.9	9.0	12.0	17.5
USD:UAH (avg)	36.80	40.11	43.70	47.0

Economic Outlook for Ukraine

Growth looks steady this year, though with high uncertainty and higher-for-longer inflation restraining sentiment

LATEST ECONOMIC TRENDS

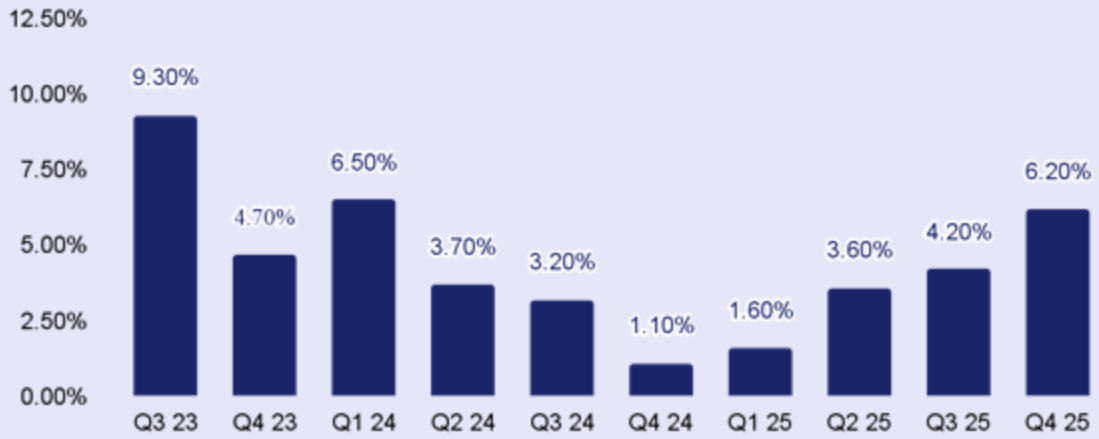
- While the economy progressed through a difficult winter as best as possible, GDP growth still moderated in Q1 - rising by just 0.5% YOY in February - on account of greater geopolitical uncertainty and Russian shelling of infrastructure. In particular, damage to ports in Odessa caused the transport sector to fall by 5% YOY in February, while the gas and distribution networks in Kharkiv and Poltava also suffered, weighing on the sector. Overall manufacturing also slowed from power outages.. Elevated prices remain problematic for businesses: price growth hit 13.4% YOY in March, driven by high energy and food prices. In turn, the key interest rate was raised to 15.5%. Still, business sentiment overall picked back up moderately in February, after seasonal lows in January.

2025 OUTLOOK FOR UKRAINE

- Businesses should still expect a land-for-peace deal over the long term; however, the likelihood of a durable ceasefire in the coming months has fallen. Trump has shown a growing disinterest in achieving a real ceasefire and a willingness to detach the US from the war and let the fighting continue. Investors can take comfort in Europe's rapid reaction to support Ukraine following US disengagement.
- External financial support looks solid for Ukraine for the entirety of 2025, thanks to European support to fill the expected gap in US funding, Though a lack of US military support is problematic, a combination of Ukrainian domestic production and an expected rapid increase in European support will be adequate to protect Ukraine and resist Russian air and land aggression.
- The economy will pick up moderately in Q2, albeit restrained by weak sentiment from high prices and uncertainty. Inflation is accelerating and will only moderate in Q3. The hryvnia will depreciate in Q2, adding to the price pressure. Consumer demand will remain the backbone of growth thanks to solid income growth.
- The major risk to the outlook relates to Kyiv's reduced ability to deter long-range strikes from possible removal of US air defense. Meanwhile, the very tight labor market will continue to drive up business costs and worsen staff shortages.

The economy has gone through its worst moments, and should revive more in Q2 2025

GDP %YOY



Hryvnia Tracker

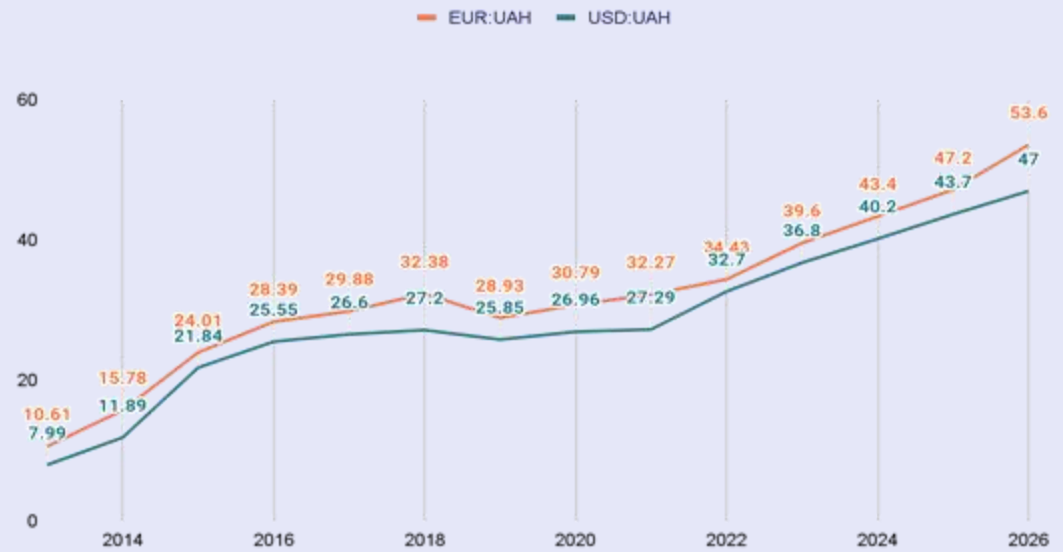
The hryvnia will continue to weaken in 2025, starting in Q2

- Following considerable devaluation in H1 2024, the hryvnia has been stronger and more stable into the start of the year thanks to large outlays of Western support. Though questions now remain related to US support specifically, European and aid from other nations remains set to fill that gap. As a result, the central bank felt confident to support the currency strongly in Q1. However, a worsening current account balance in Q1 from rising imports and falling exports demands a devaluation in April that is set to continue the rest of 2025, limited by adequate reserves provided by the West. Businesses should factor in their business plans and contracts with suppliers a consistently weakening hryvnia the rest of the year.
- Critical to hryvnia stability is continued Western financial support, which allowed reserves to revive to ~$44 bn in December, to then drop to $40bn in February from elevated currency interventions. Reserves are likely to remain stable through 2025 as Western outlays continue and interventions moderate.
- Positively, the major risk to the hryvnia's outlook – cuts in Western aid – is not a significant concern this year given Europe's determination to provide funding to Ukraine at either the bilateral or EU-wide level. Should we see a cut in US funding, Europe will fill the necessary financing gap.

The central bank will protect the hryvnia less going forward, allowing for further devaluation



The hryvnia will weaken further next year, though with limited impact on inflation



Operational Environment

Prepare for a wide range of scenarios amid a prolonged war and uncertainty

OPERATIONAL ENVIRONMENT OUTLOOK

The optimism of a potential ceasefire facilitate by a Trump presidency has faded, leaving continued uncertainty and a prolongation of the war through 2025 as the base case scenario. As a result, the operational environment will remain challenging in 2025. The labor market pressures are likely to only further intensify while the energy network has been damaged and continues to be attacked. Matched with uncertainty related to a Trump presidency and sustained intense attacks along the front, investor sentiment at headquarters is weak, delaying investment. Meanwhile, questions will soon arise regarding duty-free trade with the EU, which expires in June.

LOWER LIKELIHOOD OF CEASEFIRE THIS YEAR

- To date, the lack of pressure on Moscow from the Trump administration indicates a lower chance of reaching a ceasefire in the coming months. Trump's seemingly greater interest in improved ties with Russia than achieving a ceasefire (which could upset those ties) raises the likelihood of the war continuing into 2026.
- Investor optimism related to the end of the war has moderated as well. Polling at our UBN Network event in March showed that 74% of attendees believe the war will only end in 2026 or later. Only 21% believe Trump will provide Ukraine "overwhelming support", which would be required to stop Russia and achieve a ceasefire. Anecdotal evidence also suggests executives moderated their optimism towards a ceasefire. *For more on this, see the MAJOR TOPICS section below.*

TALENT MANAGEMENT

- HR issues continue to dominate internal decision-making, as has been the case since the start of the year. Tens of thousands more soldiers are needed and urgently, indicating that this pressure on talent is set to escalate in the near future and across 2025. The vast majority of firms struggle from staff shortages. Work.ua data indicates companies are looking for more workers after the holiday slowdown, and job seekers are posting more resumes than in previous months; however, labor market activity remains notably lower than in 2021.

ROLLING POWER OUTAGES

- While Ukraine proceeded through the winter in a far better position than initial expectations, severe damage to energy infrastructure from Russian shelling has had a notable impact on power generation and therefore manufacturing the last few months. Though power outages have been problematic, anecdotal evidence from businesses indicates that the market has been adequately supplied with electricity via the main power grid as well as individually procured alternative energy sources. The worst is now over and output and sentiment should pick up as warmer weather sets in and less power is required.

POSSIBLE WORSENED TRADE CONDITIONS

- Poland, Hungary, and other countries are again indicating opposition towards extending Ukraine's duty-free trade deal with the EU, which expires in early June. Given worries over US aid to Ukraine, such worsened trade activity would incur considerable macroeconomic damage while disrupting businesses' trade plans. While still likely to be extended, the end of the trade regime would harm about 10% of Ukraine's total exports.

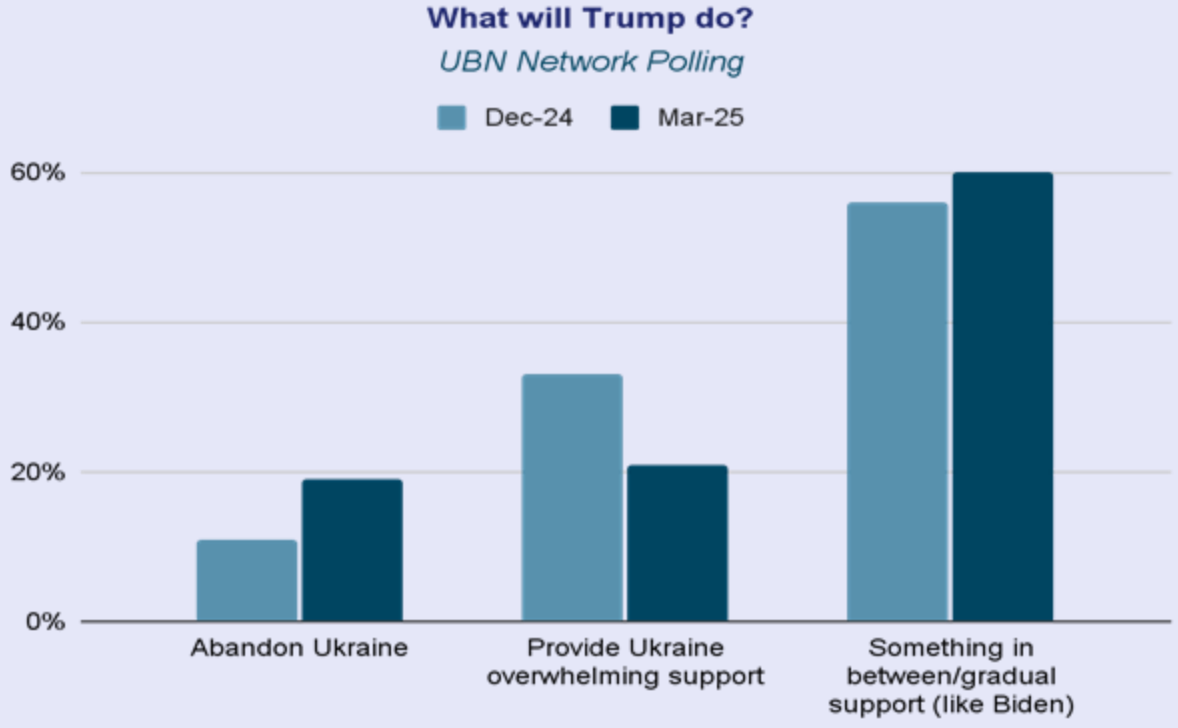
Operational Environment

Prepare for a wide range of scenarios amid a prolonged war and uncertainty

DEMAND AND COST PRESSURES

- Rapid rises in inflation are clearly weighing on sentiment and overall demand for B2C and B2B firms. Rolling power outages, higher food prices, higher taxes, and rising labor costs have driven up costs faster than expected and will remain elevated through Q2. Margin pressures for businesses are rising, pushing firms to raise prices on their customers more frequently now. Advances in inflation have also caused multiple hikes in the key interest rate, from 13% in November 2024 to 15.5% in March, which is minimally limiting the earlier lending growth.





DEMAND OUTLOOK

Consumer Demand Outlook

Solid income growth will continue to drive spending in 2025, despite rising inflation

OUTLOOK FOR CONSUMER DEMAND

- Consumer spending remains the primary driver of economic growth, thanks to high wages; however, faster-than-expected price growth is dampening spending. Retail sales rose by 12% YOY in 2024, though slowing to 5% in Q4 on account of the power outages and accelerating inflation. Consumer confidence began to revive though in February, hitting its highest level since last summer. Further income growth from the exceedingly tight labor market will continue to sustain the spending growth in H1. B2C firms can plan for continued demand growth in 2025, though likely without an acceleration.

KEY DRIVERS

Labor Market:

- Job-seeking and job vacancies have picked up lately primarily for seasonal reasons. Encouragingly, job-seeking saw a notable rise in February, to its highest level in a year, though is not expected to rise considerably looking ahead. Unemployment, at around 17% currently, rose minimally over the winter but is expected to decline further over the course of the year, further tightening the labor market and sustaining wage growth. While positive to sustain consumer spending, consumer-oriented industries are facing some of the toughest challenges in the war for talent, impacting profitability amid rising labor (and other) costs.

Incomes:

- Real wages (after inflation) rose by ~16% YOY in 2024, with 15% growth in Q4. Wage growth assuredly continued to grow solidly into 2025, though likely to moderate in H2 only due to the high base of 2024 and high inflation. Surveys and anecdotal evidence suggest the vast majority of Western firms are raising salaries above inflation projections, as they did in 2024 given the war for talent. High incomes support confidence: consumer confidence has picked up consistently since October 2024, reaching the highest level in February since last summer.

Consumer Prices:

- Consumer prices accelerated rapidly in Q4 2024 and Q1 2025, hitting 13.4% YOY in February. The worst of the price growth appears over: after prices rose by nearly 2% in month-on-month (MOM) terms in late 2024, each month prices rose by only 1% MOM at the start of 2025. Still, high food prices, at 15.3% YOY in February, remains the main driver of inflation due to a slightly weaker harvest and power outages which impact food processing. Businesses are also increasingly forced to pass on their high producer prices, which again accelerated over the winter, hitting 37% YOY in February, driving up consumer prices. Higher electricity tariffs, high costs of alternative energy supplies, elevated labor costs, and higher import prices on account of a weak hryvnia have contributed to the price growth. Inflation should start to moderate by H2 due primarily to the high base effect of 2024.

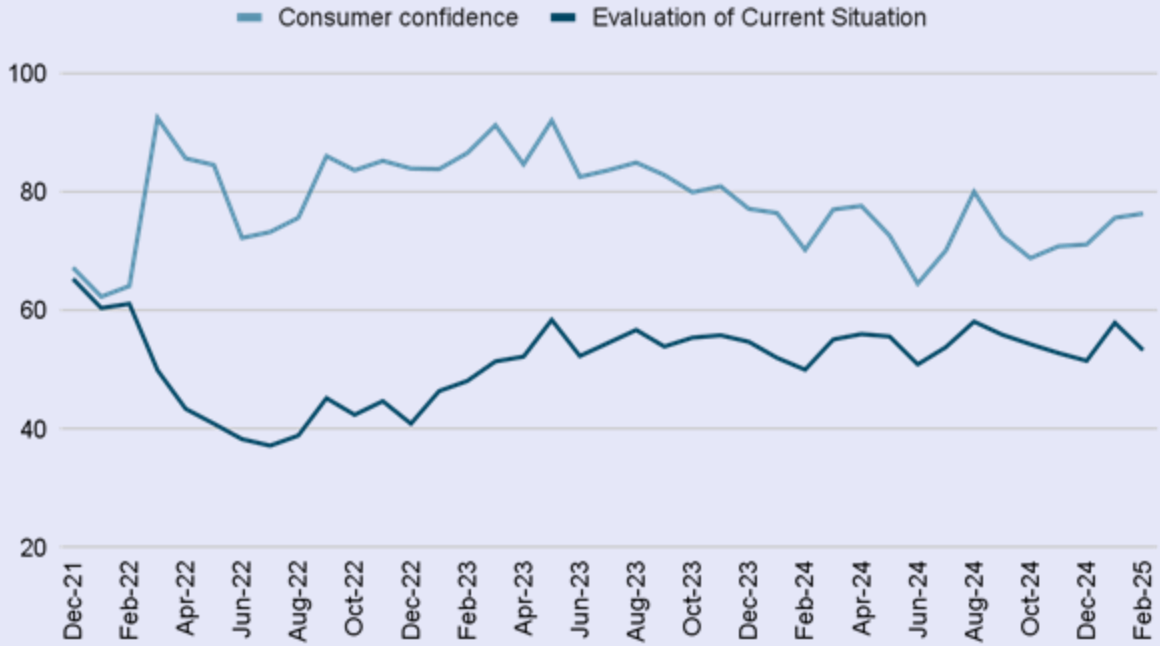
Consumer Demand Outlook

Solid income growth will continue to drive spending in 2025, despite rising inflation

Strong income growth will outpace inflation and drive spending again in 2025



Confidence has revived thanks to seasonal factors and despite inflation



Business Demand Outlook

Operations and demand will remain under pressure in the months ahead

OUTLOOK FOR BUSINESS DEMAND

- The primary issues impacting demand and operations relate to elevated costs (energy, labor, food) and talent management, both of which will continue to dominate business planning across 2025. The prolonged nature of the war and ongoing uncertainty further weigh on sentiment. B2B firms will see demand continue, albeit without a notable uptick until there is greater clarity around a possible ceasefire perhaps later in 2025. Costs will weigh on margins despite more firms seeking to pass costs onto customers.

KEY DRIVERS

Recent Performance:

- Business sentiment saw a notable upturn in February, as expected. Primarily driven by reviving domestic demand for seasonal reasons, the National Bank's sentiment index reached 46.9, still below the 50 neutral level but up from 41 in January. This figure is only slightly below February 2024, indicating rough parity with last winter-spring conditions. Industrial firms were the most optimistic, citing increased output and rebounding domestic demand. Retail also saw a major improvement thanks to strong levels of supply and consistent demand.

Segmentation by Sectors:

- Positively, industrial production rose by 4% YOY in 2024, after 7% growth in 2023. Food/drink sector continues to drive overall industrial output, rising by 11% YOY. The sector on average since the start of the full-scale invasion has been the most resilient, enjoying both output and investment growth. Coal, rubber/plastics, construction (public projects), textiles, and the agriculture sectors are also relatively more resilient in terms of industrial production and investment on average. In 2024 specifically, production in the rubber/plastic (5%) and pharma (5%) sectors have rebounded relatively well. Metals (26%) have also seen notable output increases this year, albeit from a very low base.

(cont'd) Export-related sectors (e.g. agriculture, raw materials) will remain consistent thanks to improved trade conditions. In 2024, the agriculture sector achieved its pre-war volume of exports, totaling $24.5 bn, despite output falling by 6% from 2023's record levels. Agriculture output is expected to rise by 3% in 2025, aiding exports even further..

Cost Pressures:

- Businesses are under notable cost and margin pressure, with producer prices rising once again. After mildly moderating from high levels in H2 2024, producer prices have accelerated again and hit their highest level in two years, averaging 35% YOY in Jan-Feb 2025. High wages, food prices, electricity tariffs, and taxes are raising costs, which have to be passed onto customers. Such inflation facing businesses is unlikely to subside notably until late in 2025..

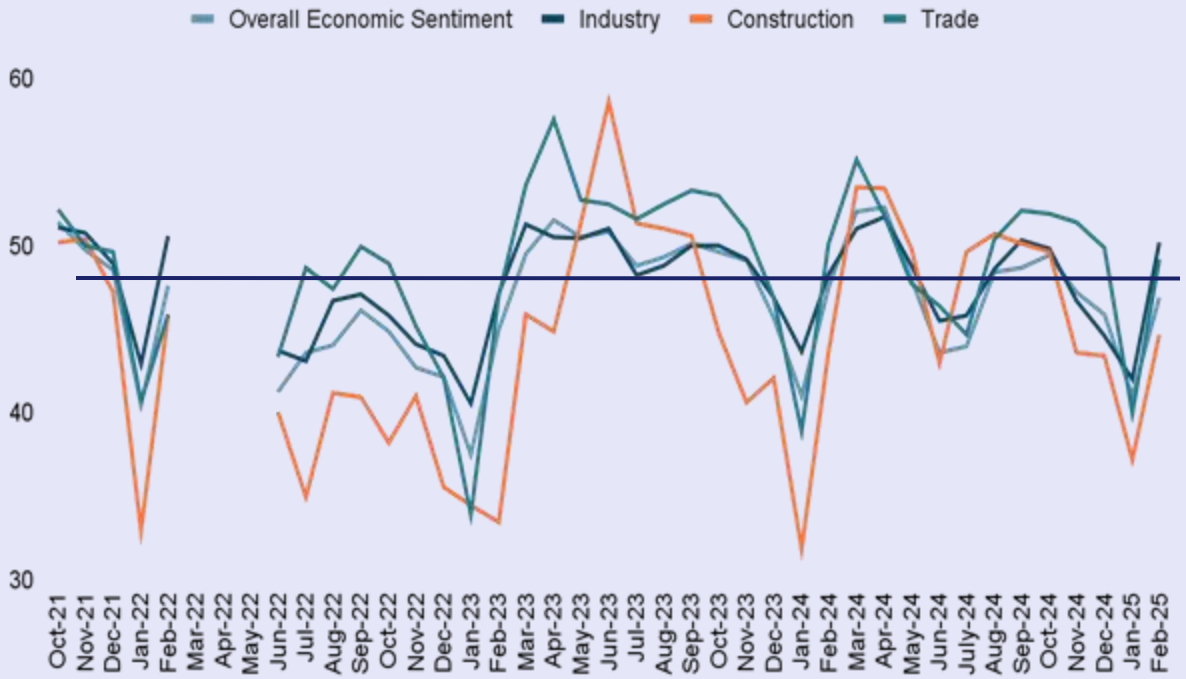
- Multiple hikes in the key rate (to 15.5% in March) is restraining some corporate lending through H1 as the central bank is unlikely to cut the rate again for a few quarters at least. Corporate lending had been growing solidly through Q3 and accelerating each month. However, a real interest rate of only about 2% amid elevated inflation currently protects borrowers.

Business Demand Outlook

Operations and demand will remain under pressure in the months ahead

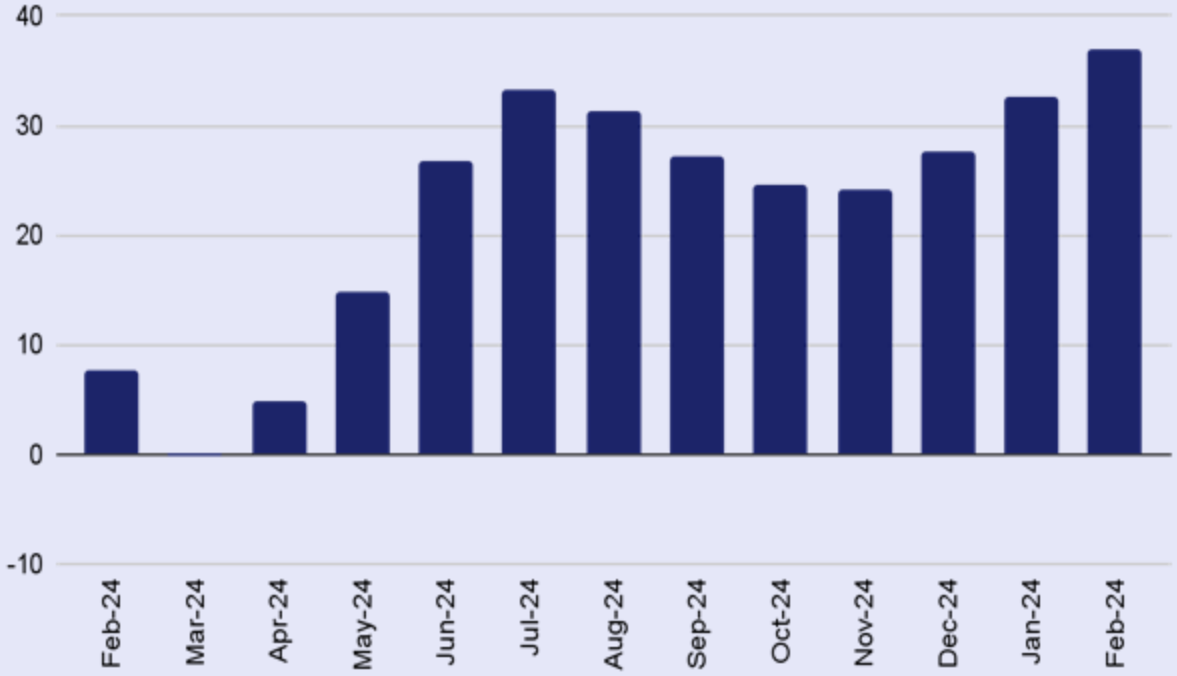
Investor sentiment has revived after a challenging winter

Business Activity Expectations Index (above 50 indicates optimism)



Already high costs for businesses are accelerating once again

Producer Prices, %YOY



Government Demand Outlook

Budget funding looks solid for 2025, despite questions over US support

OUTLOOK FOR GOVERNMENT REVENUE

- The US's brief suspension of aid in Q1 has naturally raised concerns about Ukraine's fiscal future. Positively, prior to this, the Biden administration fast-tracked much-delayed aid prior to Trump's inauguration, while in response to Trump cutting off aid European countries have stepped up with far greater financial and military support pledges. Critically, the German government removed its debt brake and has passed a major defense and infrastructure bill, with far greater funds promised to Ukraine.
- These recent developments occur in the backdrop of strong promises of Western support that had ensured Ukraine's fiscal outlook for 2025 and even for most of 2026. In particular, promised rising allocations thanks to the G7's $50 bn Extraordinary Revenue Acceleration (ERA) facility ensures Ukraine's macroeconomic stability this year. More structurally, Ukraine's main European partners have recognized the need to support Ukraine as a matter of European security in light of the unreliability of the US.
- Domestic tax revenues are set to be an increasing share of total spending, exceeding 50% in 2025, up from 45% in 2024. Domestic VAT receipts were up 40% YOY through February, thanks to stricter tax collection. Assuming the trend continues, the share of external support to fulfill budget spending plans may be lower than planned.
- Longer term, we remain optimistic the West will seize Russia's frozen fx reserves amounting to over $300 bn. Europe's recognition of its need to provide for Ukraine as well as its own security needs under a Trump presidency will compel the EU to seize the funds. In this case, Ukraine's budgetary and military needs would be financed for years.

OUTLOOK FOR GOVERNMENT SPENDING

- In 2024, total state budget expenditures reached UAH 4.5 trillion, up 12% compared to 2023, though was flat when accounting for inflation. Defense and security spending surprisingly remained relatively under control for most the year. In December, however, defense spending rose notably, though was covered by increased budget revenues in Q4. Ultimately, the controlled consolidation of defense expenditures helped restrain overall budget expenditures and, matched with hiked external support, protected the budget and covered the deficit.
- In 2025, budget spending will again be dominated by defense and national security spending, approaching some 60-65% of total spending as in 2024. Total spending is roughly stagnating in real terms, though as a percent of GDP is in fact falling from roughly 50% to 45%. With strong revenues thanks to the ERA facility and planned controlled expenditures, the deficit is set to fall in 2025 to 19% of GDP from 24% in 2024.
- For 2025, defense/security spending is rising by more than 2% YOY (UAH 2.22tr, from UAH 2.18tr). Non-defense areas (healthcare, education, social spending, etc.) are seeing consistent outlays in 2025 as in 2024 and will be funded by additional taxation and coming Western aid.
- Even in the event of a ceasefire late in 2025, there will be no major revisions to defense spending. Defense spending needs will be elevated for the long-term as a large standing army and high military spending will be required to protect against future Russian aggression.

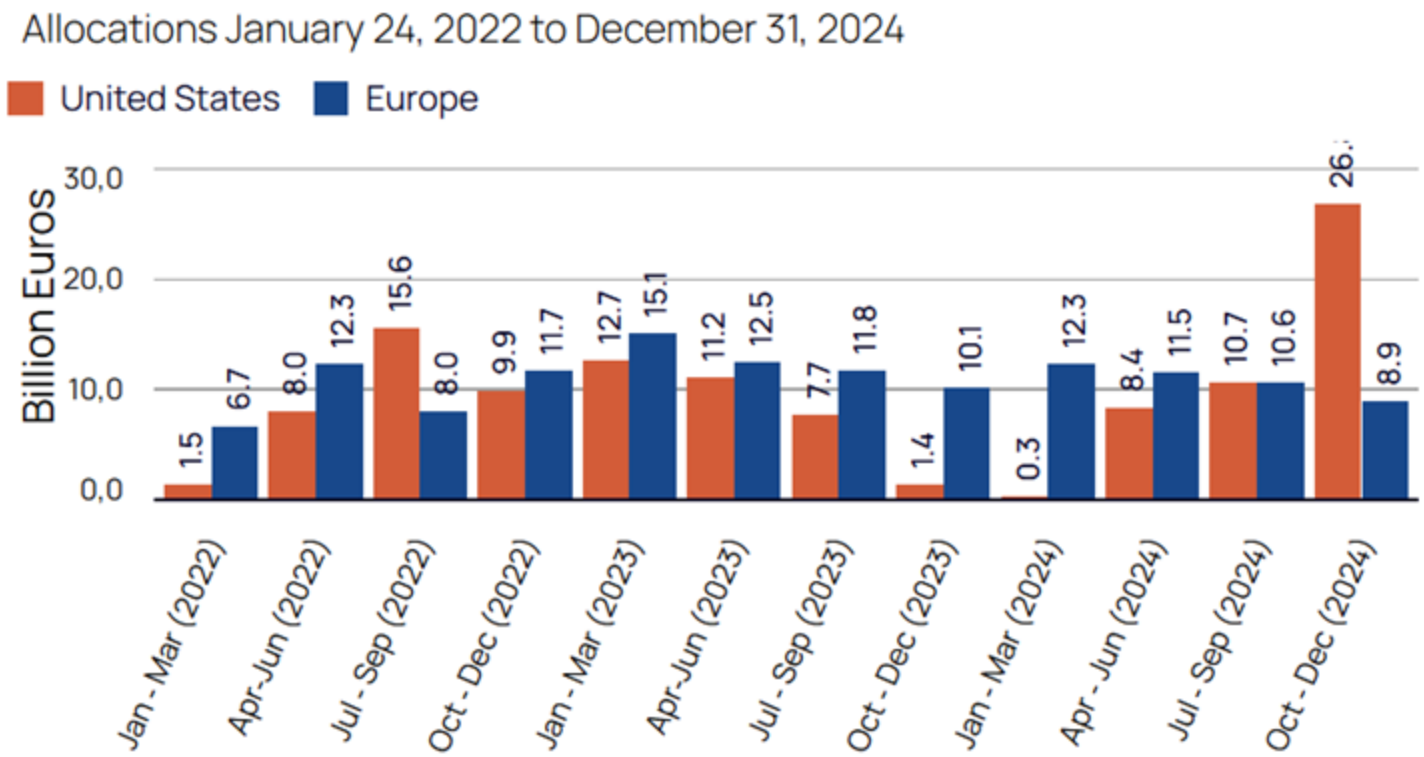
Government Demand Outlook

Budget funding looks solid for 2025, despite questions over US support

Western aid picked up in Q4 thanks to outlays from Biden, and will be adequate for the 2025 budget

Western funding, € bn

Kiel Institute for the World Economy



MAJOR TOPICS

Trump’s Policy and Ceasefire Talks

Trump’s team to date is showing greater interest in re-establishing relations with Russia than aiding Ukraine

We remain cautiously optimistic Trump will not abandon Kyiv, and some aid will continue. Trump’s extreme pressure on the Ukrainians, including the suspension of aid, matched with concessions to the Kremlin, are concerning. However, since then, the US and Ukraine came to an agreement on a ceasefire and now “the ball is in Russia’s court”, as US Secretary of State Rubio noted. Soon, the US side will have to make a decision related to supporting/abandoning Ukraine as talks are bound to fail. In addition, should Trump end aid to Kyiv, he would sacrifice all US leverage over Ukraine/Europe and against Russia in negotiations.

- **Problematic for Kyiv is that Trump has shown greater interest to date in re-establishing relations with Russia than in supporting Ukraine’s independence**. However, we should still at this point continue to interpret Trump’s moves as pre-negotiating tactics to bring Russia to the table. While deeply concerning, and permanently eroding US’ credibility, these concessions to Russia do not equate to an abandonment of Ukraine to Russia, which Trump cannot do anyhow. Assuming Trump’s underlying motivation of winning the Nobel Prize, he needs Ukraine and Europe’s compliance.
- **As of this writing, little progress towards a ceasefire has been made.** In addition, Trump’s tight deadline for a ceasefire (by late April) adds an intensity to the talks that is unlikely to end in a bona fide ceasefire. Predictably, Russia’s tactic remains to deny US overtures for a ceasefire, delay decisions, drown negotiators in details, and offer no genuine concessions to work towards a ceasefire and ultimately peace. Once Putin’s disinterest in peace inevitably becomes clear to Trump’s team, the US will have a decision to make: continue to support Ukraine, potentially even “arming Ukraine to the teeth” as Trump had earlier warned, or otherwise abandon Ukraine and leave Kyiv’s security to Europe, as Trump has also warned.
- **Trump will fail to achieve a larger deal with Russia**, in an attempt to divide Russia and China. When this policy inevitably fails due to Putin and Xi’s strong personal relationship, shared hostility to the US, and robust economic and political partnership, Trump will be forced to make a decision on abandoning/supporting Ukraine.

From the Oval Office Fight to Improved US-Ukraine Relations in Jeddah





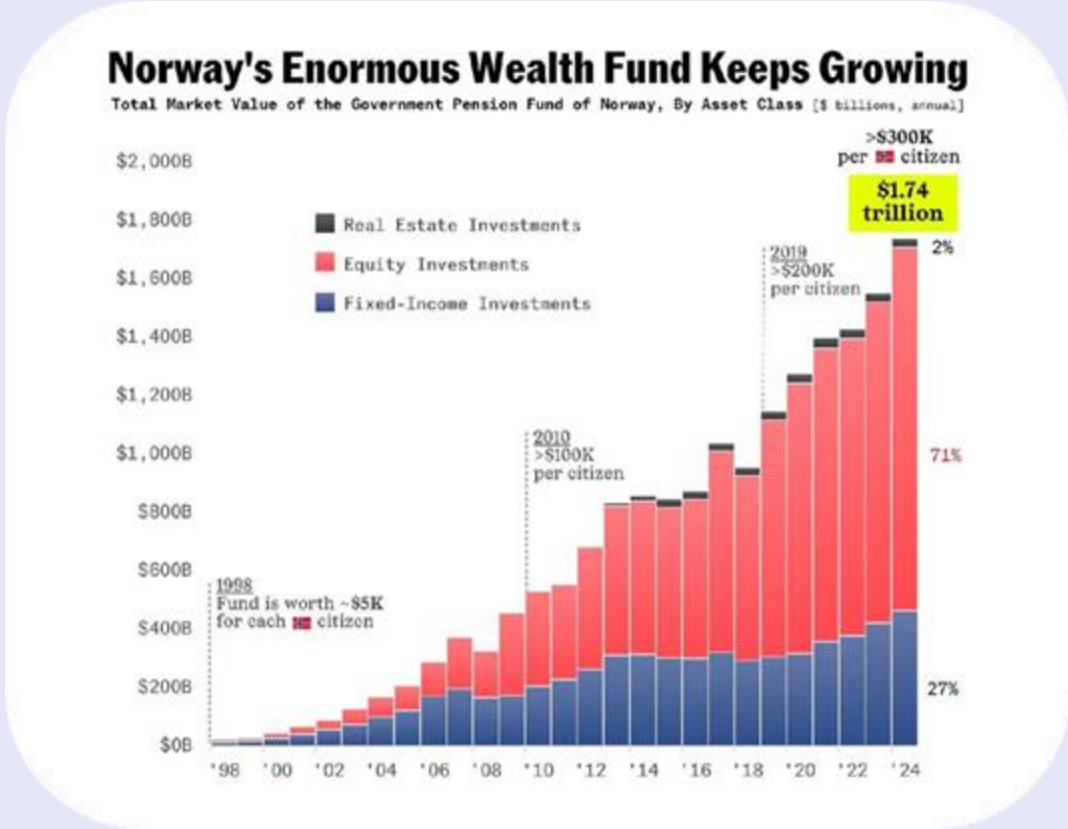
Europe and Ukraine

Europe must take care of its own (and Ukraine's) security for the first time in 80 years

We feel confident Europe will step up and fill any gap in US support to Ukraine. Based on both political rhetoric as well as financial actions, Europe understands it must take care of its own security - as well as Ukraine's - for the first time in 80 years. Europe has the financial capacity to provide for its own defense, and now just requires the political will. Concerns exist related to dissension within the EU naturally; however, we believe the primal fear over national security will trump any concerns and the EU will "do whatever it takes" to support Ukraine, in the words of incoming German Chancellor Merz.

- **GDP differential** - The total GDP of the EU (~$20 trn) is 10 times Russia's ($2 trn), allowing for far greater fiscal space for defense spending. Even at purchasing power parity, in which Europe's GDP is only ~4 times larger than Russia's, Europe's capacity remains incomparably greater when accounting for Russia's lower costs of production. Likewise, Europe's ability to tap international capital markets, unlike Russia, provides another major advantage.
- **EU's €800 bn defense spending package** - The EU announced this package after the Oval Office spat. While most of the funding simply allows for hikes in defense spending, funds made available from the COVID recovery and defense loans will drive this.
- **Germany's end of the debt brake** - Critically, Germany – the core of European political and economic power – is squarely leading the defense initiative. In a historic move of exempting defense spending from its fiscal debt brake, Germany is unleashing hundreds of billions of euros towards defense and nearly doubling its aid to Ukraine this year.
- **Norway's Sovereign Wealth Fund** - Major rises in both export volumes and prices of gas to Europe since 2022 has driven Norway's SWF towards $1.8 trn, earning ~$80 bn just in interest in Q3 2024. Pressure is rising both in Norway and the EU for Oslo to tap these funds.

Concerns remain. The EU failed recently to pass a €40 bn defense package for Ukraine, and then a €5 bn package. A package will be approved; however, hesitance from countries to raise their own deficits is clear. In addition, pro-Russian actors in Hungary and Slovakia create obstacles towards unified support to Kyiv. Specifically, a worrying deadline in June is approaching related to the extension of EU sanctions against Russia, including Russia's frozen FX reserves.



War Tracker

Uncertainty and a prolongation of the war become more likely as ceasefire hopes fade

- **We are less hopeful for a ceasefire in the coming months,** based primarily on the little progress to date as well as the demonstrated incompetence and misunderstanding of the conflict of the US negotiators. To date, the lack of pressure on Moscow from the Trump administration, and Moscow's known disinterest in peace, indicate a lower chance of reaching a ceasefire. Trump's seemingly greater interest in improved ties with Russia than achieving a stop to the fighting (which could upset those ties) raises the likelihood of the war continuing into 2026. Despite earlier promises to end the fighting and raising the political stakes to do so, Trump has since shown a growing disinterest in achieving a real ceasefire and a willingness to detach the US from the war and let the fighting continue. As a result, we have raised the likelihood for a "Frozen Conflict" scenario (*next page)* once again back near the levels it was prior to Trump's election.
- **The EU is likely to provide the required security guarantees to Ukraine in order to bring about peace in the future.** A policy of containment is required to repel Russian aggression, and while until the very recent past the US was that security guarantor, the responsibility for upholding Ukraine's sovereignty as well as Europe's security is now Europe itself. In the event of a full US abandonment of both Ukraine and Europe, the impact will be notable and unfortunate, but not critical or immediate. The vast majority of Kyiv's military needs are either domestically produced or provided by Europe. Core areas of drones, artillery, ammunition, and mines can be adequately requisitioned to avoid a collapse. However, long-range precision strikes and long-range air defense capabilities will be impacted (cont'd) in the coming months. While the EU can purchase from the US what is needed, a very unlikely and extreme downside scenario becomes plausible: the US sides with Russia and refrains from selling defense systems to Europe, imposing a punishing settlement on Ukraine.
- **The battlefield has been dynamic lately**, with both positive and negative developments for Kyiv. While Ukrainian forces have been all but pushed out of Kursk, most of the front has been stabilized, Russia is advancing on only a few fronts, and Ukraine has taken back the initiative in several areas. Related to ongoing talks, a more stable front and even areas of Ukrainian advantage would provide Ukraine, Europe, and the US greater negotiating power.

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- **A strong upside is possible for Ukraine.** As we expect with mild confidence that some US aid will continue, Ukraine's outlook would be much improved, reinforcing our belief in a land-for-peace deal. In this nightmare scenario for Moscow, a robust Ukraine backed by a revitalized Europe and supportive US would ensure the defeat of Russia in the long run.
- **In summary, the most likely scenario remains a land-for-peace deal.** Russia's victory in Ukraine remains unlikely despite Trump's policy as this scenario is tantamount to a collapse of the Western order, threatening the viability of the EU, NATO, UN, and other Western-created institutions. To stop this, Europe will have to provide the security for itself and for Ukraine, which is entirely feasible financially and militarily, and now necessary politically. With a lower chance of a ceasefire due to the minimal pressure on Russia to date, a prolongation of fighting becomes more likely now.

War Tracker

Trump's ineffective diplomacy results in continued fighting, while maintaining the base case of a Ukrainian "victory"

Russia-Ukraine War Scenarios into 2026

End point	Scenario 1: Russian 'victory' (Collapse of Western Order)	Scenario 2: Ukraine 'wins', Land-for-Peace Deal	Scenario 3: Frozen conflict, fighting persists at lower level	Scenario 4: Direct Russia-NATO confrontation
Likelihood	**20%** (was 20%)	**50%** (was 50%)	**25%** (was 15%)	**5%** (was 15%)
Timeline	Mid 2025	Mid-2025 at earliest	Late-2025	Through 2025 and beyond
What it looks like	• Trump cuts off US support • Europe cannot provide adequate support • Kyiv forced to negotiate a bad peace • Russia seizes more territory • **Ukraine turns war into an insurgency**	• Neither side can shift the line of contact decisively • Russia seeks a ceasefire to pause the war • Zelenskyi offers land-for-peace • **West provides more aid and security guarantees**	• Neither side can strategically shift the war in its favor • Western aid to Ukraine moderates • Kyiv is forced to negotiate, while Moscow declares a "victory" • **The two sides get stuck in extended negotiations and fighting persists**	• NATO-Russian War 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 Russian nuclear retaliation in the West**

Russia’s 2025 Economic Outlook

The Kremlin will likely seek to pause or slow the war by late 2025 to avoid an economic crisis

- **Pressure on the Russian economy remains high and will continue to worsen.** GDP performed well across 2024, though slowing in Q3 and Q4 to ~3% YOY, and is expected to grow by around 1% this year. The economy has effectively not grown since late 2023, but rather has simply risen in year-on-year terms for most of 2024 (stagnating in month-on-month terms). In the event of a downside of oil prices - e.g. around $60/bbl, a 40% likelihood - GDP would see a notable contraction amid sharp ruble depreciation, accelerating inflation, and debilitatingly high interest rates.

- **The corporate sector has seen problems arise, impacting investment potential.** A sharp rise in preferential lending to defense firms caused a 71% increase in corporate borrowing since mid-2022, amounting to a level of 19% of GDP ($415 bn). Repayment of these loans will be costly and demand state support. Compounding matters, energy exporters saw declining revenue across the winter and will likely face greater pressure in the coming months.

- **Meanwhile, oil prices have moderated notably in recent months** and will face further pressure amid a supply surplus from rising OPEC and US output as well as lower demand from a weakening US economy. Brent crude oil prices are forecast to average $67/bbl. in 2025, though weaker-than-expected US and global growth and higher-than-expected US oil output - both very possible - could drive prices down much further.

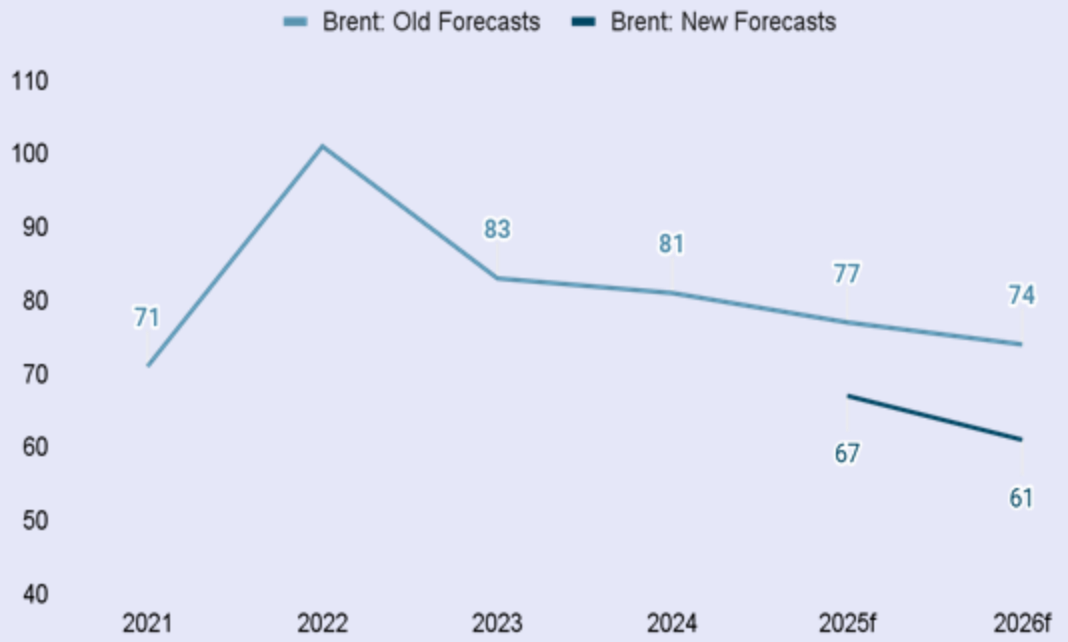
- **Financial problems are quickly accruing amid potential drops in the oil revenues.** The 2024 deficit was 1.7%, double initial plans, and 2025 does not look any better. Russia sells its oil ~$10 less than the Brent crude price, but the budget is based on an oil selling price of $70, meaning Russia will be selling oil in the high-$50s in a base case scenario and low-$50s in a downside scenario. As long as the war continues, extreme defense spending and imports to sustain defense manufacturing will continue, demanding budgetary cuts to non-defense sectors while sustaining high inflation and interest rates across 2025. Wages - averaging 18% in 2024 - will continue to accelerate given the severe shortages of labor resulting from military recruitment, further driving up inflation (10% in February) and interest rates (21% currently, with no expectations of cuts in 2025). Investment is set for a marked slowdown in 2025, particularly amid the rise in the corporate tax rate.

- **By H2 2025, the Kremlin will become increasingly interested in establishing a ceasefire/operational pause** due to rising pressures. On the one hand, pressure on the population via the higher cost of living and debt payments from high interest rates create a feedback loop attracting more contract soldiers, allowing Russia to attract ~30,000 contract soldiers each month recently. However, with losses above 40,000, recruitment is inadequate. Also, later in the year, macroeconomic stability will be in jeopardy, threatening Moscow’s ability to continue to prosecute the war. High interest rates hurt the domestic bond market, creating problems in funding a rising budget deficit.

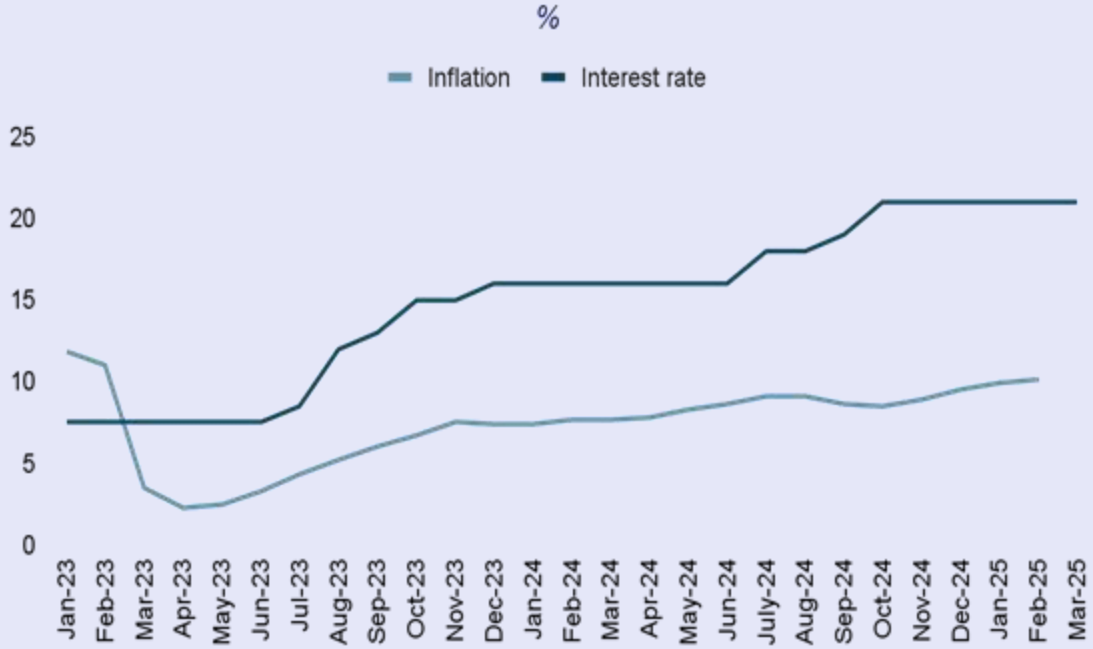
Russia’s 2025 Economic Outlook

The Kremlin will likely need to pause the war by late 2025 to avoid an economic crisis

Oil prices have been revised down notably, with risks to the downside for lower prices



High labor costs and food prices ensure high inflation and interest rates in 2025, creating the conditions for a crisis



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