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UKRAINE MACROECONOMIC HANDBOOK

July 2025

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Introduction and Assumptions

This forecast covers Ukraine's macroeconomic trajectory for 2025-28 in the context of ongoing Russian aggression, taking into account current and future opportunities for the country once the war comes to an end. Projections rely on the Quarterly Projection Model (QPM) for the majority of the macroeconomic indicators, with accounting-based modeling used for external and fiscal dynamics—accompanied by expert assessments of issues related to current and future policy implementation. The transparent discussion of assumptions allows readers to adjust key forecast indicators based on their own beliefs. Assumptions are a challenge given the extraordinary situation that Ukraine's economy has been facing for more than three years. The assumptions used here are based on expert judgments by the KSE Institute team and are summarized in Table 1 below. **With this publication, we extend our forecast to include the year 2028.**

Table 1. Key assumptions

	2021	2022	2023	2024	2025	2026	2027	2028
War intensity	Low int.			Full-scale			None/low int.	
Financial assistance, $ bn	7.5	32.6	42.4	41.4	58.4	18.4	16.3	1.4
o/w ERA	…	…	…	1.0	39.6	3.0	6.4	0.0
o/w EU Ukraine Facility	…	…	…	17.4	13.5	8.0	1.4	1.4
o/w IMF program	0.7	2.7	4.5	5.3	2.2	2.4	1.1	0.0

For the July forecast, we are changing our core assumption regarding the end of the full-scale war—no longer expecting this to occur during 2025 but rather towards the end of 2026. We believe that the failure of recent diplomatic efforts has clearly demonstrated that Russia is not interested in any ceasefire or peace agreement at this point. In the absence of significantly stepped-up economic pressure on Russia via sanctions, including on its energy exports, as well as increased military aid to Ukraine, we do not expect Russia's assessment of its current situation and incentive structure to fundamentally change. Thus, it is no longer prudent to base our economic projections on the assumption of an end to the war this year—which remains a possibility but is becoming increasingly unlikely. To be able to properly assess Ukraine's macroeconomic situation and vulnerabilities—including in key areas such as the budget and external financing—we now assume that hostilities will continue throughout most of 2026 with some kind of ceasefire before the end of the year. It is worth mentioning that many other institutions, including the IMF, continue to use an end to the war in 2025 as a core assumption behind their forecasting exercises.

For Ukraine's macroeconomic stability, as well as budget and external financing, foreign assistance remains critically important. We assume that Ukraine will receive close to $95 billion in foreign grants and loans over 2025-28, with more than $58 billion expected in 2025. Importantly, the extension of the forecast period to 2028 only adds $1.4 billion to total projected disbursements from multi- and bilateral partners. For the purposes of our analysis, we only consider funding that is either fully committed or extremely likely in our assessment. Thus, while discussions have already started surrounding a new IMF program or additional support from the EU and other G7 partners, we do not incorporate these developments into our baseline forecast. The potential impact of new funding mechanisms is discussed in the section on state debt.

Key risks to the forecast include the future trajectory of the war. While we believe that the assumption of an end to the full-scale war before the end of 2026 is realistic, hostilities may continue in 2027. As noted earlier, much depends on the approach that Ukraine's key allies take towards Russia. An even longer war would add to destruction and recovery needs, weigh on economic activity, prevent Ukraine from reducing defense and security spending or pursuing much needed fiscal consolidation, and reduce foreign capital inflows. As a result, fiscal and external financing gaps could widen substantially—just as they have in this forecast compared to our April publication. We will reassess developments continuously in future editions of the *Ukraine Macroeconomic Handbook*.

Summary of Forecast

The key takeaways from KSE Institute's July 2025 Ukraine Macroeconomic Handbook are:

(1) While Ukraine's economy continues to demonstrate a remarkable resilience, our assumption of the war extending far into 2026 has serious consequences for macroeconomic stability, while also weighing on growth and delaying the recovery (see Special 1). Due to sharply higher defense spending as well as lower interest in Ukrainian government debt, the 2026 budget is underfinanced by $17.7 billion. At the same time, weaker foreign investments, elevated resident outflows, lower remittances, and other war-related distortions to the balance of payments widen the external financing gap to $22.4 billion next year. This will lead to substantial reserve losses and the erosion of important macroeconomic buffers, which have been built up over the last three years.

(2) An additional year of war creates significant challenges for the viability of Ukraine's macroeconomic frameworks, with a growing debt burden potentially crowding out investments in the economy's future. Even without further borrowing or the provision of additional financial assistance, debt as a share of GDP is projected to approach 100% in 2026. Sharply wider fiscal and external financing gaps mean, however, that Ukraine's partners urgently need to consider new support mechanisms, while ensuring the sustainability of the country's debt. One option would be to model them after the ERA, which is repaid using proceeds from frozen Russian assets. For the post-war period, a dedicated funding mechanism for defense needs should be established (see Special 2).

(3) Aside from support mechanisms designed to address Ukraine's fiscal and external financing gaps without causing excessive debt, a stronger recovery of the economy, driven by investments into productivity enhancements, is also critical for debt sustainability. We currently expect Ukraine's real GDP to grow 2.5-3.0% annually during the war and ~2pp higher thereafter. $500 billion in investments into key sectors such as energy, mining, transport, and defense would allow for a faster recovery, taking advantage of their potential to grow ~2-3 times from their current levels. It will be particularly important to fully integrate Ukraine's defense industry into European security initiatives (e.g., ReArm Europe), and to open opportunities for Ukrainian military exports.

Table 2. Forecast for key indicators

	2021	2022	2023	2024	2025f	2026f	2027f	2028f
Real GDP growth, %	3.4	-28.8	5.5	2.9	2.6	3.1	5.0	4.9
Nominal GDP, UAH bn	5,451	5,239	6,627	7,659	8,960	10,107	11,586	13,194
Nominal GDP, $ bn	199.8	162.0	181.2	190.7	212.8	224.8	242.2	265.3
Budget balance, $ bn	-7.6	-28.4	-36.7	-34.0	-30.5	-46.3	-15.7	-15.2
Foreign grants, $ bn	0.9	17.5	14.1	12.4	16.7	0.6	1.7	0.0
Foreign loans, $ bn	2.3	16.6	30.7	28.3	41.7	17.8	14.6	1.4
Budget financing gap, $ bn	…	…	…	…	-13.5	31.2	-0.9	11.1
Headline inflation, % avg	9.4	20.2	12.8	6.5	12.5	7.8	7.6	7.1
Exchange rate (USD), avg	27.3	32.3	36.6	40.2	42.1	45.0	47.8	49.7
Policy rate, % avg	7.5	18.6	22.4	13.7	15.0	13.4	10.0	8.0
Current account, $ bn	-3.9	8.0	-9.6	-13.7	-16.6	-33.0	-30.2	-30.9
External financing gap, $ bn	-2.5	2.3	-11.4	-2.9	-11.3	22.4	-2.9	4.8
Total reserves, $ bn eop	30.6	28.0	38.8	41.7	53.0	30.5	33.4	28.7
Unemployment rate, % avg	9.9	20.6	18.2	13.1	10.1	8.5	9.4	7.6
Nominal wage, UAH avg	13,992	14,863	17,445	21,492	25,016	28,648	32,616	37,679

The longer war dampens Ukraine's economic outlook, with real GDP growth in 2026 revised down from 5.6% to 3.1%. In 2027-28, however, we project it to accelerate to ~5% annually as reconstruction progresses and productivity improves on the back of stronger investment. As government spending on defense gradually declines, investment is expected to become the primary driver of the economy, with private consumption continuing to provide support. The recovery's pace will ultimately depend on sustained investment, particularly in energy, transport, manufacturing, and the growing military-industrial sector. Capital investment, led by private investment in machinery and equipment, is expected to make up roughly one-fourth of GDP by 2028. However, major challenges remain, including growing damages to infrastructure due to Russian attacks—which are now assumed to last until late 2026—energy insecurity, and skilled labor-shortages. Despite the robust recovery, Ukraine's real GDP is projected to stay ~10% below pre-war levels by 2028, underscoring the need for reforms, improved investor confidence, and efficient capital allocation.

Ukraine's trade and current account deficits will widen over 2025-28 from already elevated levels. During the full-scale war, imports recovered much more strongly than exports, resulting in a $30.4 billion trade deficit in 2024 (vs. $6.6 billion in 2021). With an additional year of war weighing on exports while imports remain robust, the deficit is expected to grow to ~$35-37 billion annually over 2025-28. The current account deficit, however, will widen further in 2026 ($33.0 billion vs. $16.6 billion in 2025) and beyond. In addition to the impact of a longer war—lower remittances, higher payments for travel services—Ukraine's current account is fundamentally affected by the decline in foreign assistance (after 2025) and the increasing shift from grants (i.e., part of the secondary income account) to loans (i.e., part of the financial account).

An additional year of war will significantly impact capital flows of both non-residents and residents. *First*, the recovery in foreign direct investment from suppressed levels during the war will now occur one year later than previously expected, i.e., in 2027-28, resulting in $5 billion less in non-resident FDI in 2026 than in the April forecast. *Second*, the longer war will lessen foreign investors' appetite to invest in Ukrainian government or private sector debt, reducing 2026 portfolio inflows by $4.0 billion (vs. April forecast). *Third*, resident capital outflows will remain elevated (+$6.4 billion vs. April forecast) in 2026 as the war continues. Non-resident other investment will be less affected because it currently largely consists of official flows, i.e., loans to the Ukrainian government. Altogether, net capital flows (non-resident inflows minus resident outflows) will drop from a projected $27.9 billion in 2025 to $10.6 billion in 2026—at a time when external financing needs are rising due to a bigger current account deficit. The post-war period, i.e., 2027-28 will see a meaningful rebound in non-resident direct and portfolio investment flows while resident outflows will decline.

Current and financial account dynamics will deplete reserves much more than previously expected. In our April publication, we had projected that Ukraine would be able to accumulate close to $20 billion in reserves over 2025-27, bringing the total to $59.1 billion at the end of 2027, corresponding to a comfortable 6.5 months of imports of goods and services. Now, however, we expect cumulative reserve losses of $13 billion over 2025-28, with the largest external financing gap in 2026 ($22.4 billion vs. $1.8 billion in the April forecast). In this scenario, total reserves will stand at $28.7 billion at the end of 2028 (only 3.2 months of imports). Thus, the longer war's impact on Ukraine's external accounts will force the country to deplete important macroeconomic buffers in order to prevent drastic exchange rate-driven adjustments.

Due to significantly higher defense spending needs, Ukraine's budget is not sufficiently financed. With the full-scale war now expected to continue for most of 2026, Ukraine will not be able to reduce defense and security spending as previously projected. Instead, it will largely remain stable at $73.7 billion, which is a $23.6 billion increase over our April forecast. The budget deficit will, in turn, increase by a similar amount (to $46.3 billion) before beginning to narrow in the post-war period. Over2025-28, the cumulative deficit is now expected to reach $107.7 billion. In April, we had concluded that Ukraine's budget was essentially financed through 2027 due to additional foreign support under the ERA mechanism. This is no longer the case. Higher defense and security spending, less appetite by foreign investors to buy Ukrainian bonds, and an additional forecast year (i.e., 2028) during which most foreign assistance schemes will have run out mean that the total financing gap will be around $27.8 billion. The biggest challenge will be 2026, when a fiscal financing gap of $31.2 billion cannot be filled with money carried over from 2025 ($13.5 billion). Thus, for next year alone, an additional $17.7 billion in funding must be secured.

In our baseline scenario, the increase in state debt due to the longer war is moderate. This is due to the fact that an *unfinanced* budget deficit—i.e., no additional debt issuance or loans from abroad—by definition cannot impact debt levels. We project Ukraine's debt-to-GDP ratio to increase from 84.6% at the end of 2024 to just below 100% at the end of next year, before decreasing moderately to 90.7% in 2028. Total debt will near UAH12 trillion, or $207.9 billion, at the end of the forecast period, with 75% consisting of external debt. If Ukraine's partners were to provide an additional $17.7 billion, however (i.e., enough to finance the budget deficit in 2026)—and if all of this were delivered as loans, the scenario with the greatest impact on debt—then Ukraine's debt-to-GDP ratio would rise to above 107% in 2026 and only fall to just below 100% in 2028. Thus, it is important to set up a funding mechanism that ensures the sustainability of Ukraine's debt while providing the necessary funds to preserve macroeconomic stability.

After reaching a peak of 15.9% y-o-y in May, inflation is expected to decline but remain above the NBU's 5% target during and after the full-scale war. Currently, key inflationary drivers include higher electricity prices (which will be suspended in June 2025), persistent nominal wage growth above 20% y-o-y, surging producer price inflation (up to 29% y-o-y, mostly due to damages in energy-intensive sectors), and agricultural shocks. Inflation is projected to ease gradually, reaching around 7% y-o-y by mid-2027, supported by the NBU's careful monetary policy and base effects. However, a return to the target will likely be delayed to beyond 2028. Upside risks remain during the period of moderating inflation, especially from weather-related shocks. Inflation expectations, while elevated (~10%), remain broadly stable, reflecting the NBU's credibility. Wage pressures and energy costs will continue to shape the inflation trajectory.

The National Bank of Ukraine has maintained a forward-looking policy stance, keeping its key interest rate at 15.5% since March 2025 after cumulative hikes of 250 bps since late 2024. With inflation beyond its peak, the NBU will likely avoid premature easing until disinflationary trends are fully established. In the medium term, the NBU is expected to support Ukraine's post-war recovery by transitioning to a softer monetary policy, provided inflation stays below the critical 10% threshold. This cautious flexibility aims to balance the need for economic revitalization with the imperative of price stability. Additionally, investor behavior has shifted, with household participation in domestic government bonds increasing significantly, signaling growing public trust. Market interest rates remain elevated but are set to decline from 2027, incentivizing investment while gradually reducing returns on Hryvnia-denominated savings instruments.

The Hryvnia will depreciate to ~45 UAH/USD in 2026, as insufficient external financing tied to the prolonged war limits the NBU's ability to intervene. In recent months, Ukraine's currency remained stable at ~41.5 UAH/USD, supported by substantial FX interventions of ~$4 billion per month. However, because the Dollar has weakened, the exchange rate against the Euro has moved to ~49 UAH/EUR. External vulnerabilities are mounting, with reserves—temporarily boosted to ~$58 billion in 2025 by front-loaded foreign assistance—projected to decline significantly in 2026 amid the ongoing war and insufficient financing. Meanwhile, a gradual realignment of Ukraine's foreign exchange reserves toward the Euro is gaining traction, reflecting deepening EU integration and the potential benefits of reducing currency mismatches and volatility amid depreciation of both the Dollar and the Hryvnia relative to the Euro. This shift could strengthen the alignment of FX and monetary policy over the medium term.

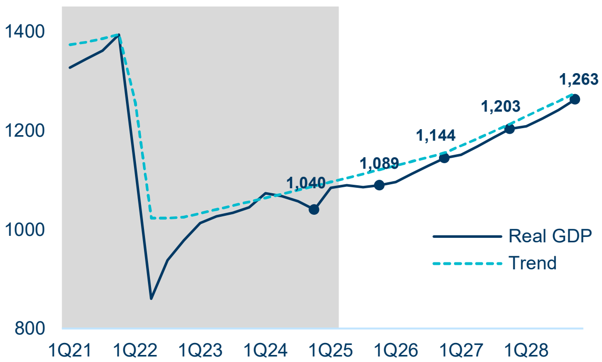
Ukraine's labor market continues to show resilience during the war, though structural challenges persist. The unemployment rate has declined substantially, from ~25% in 2022 to ~10% in mid-2025, but structural skills mismatches are behind companies' ongoing difficulties in finding (qualified) employees, as consistently highlighted in surveys. However, recent data show growing activity in the labor market in terms of both demand and supply, which points to further normalization. For now, labor market conditions continue to put upward pressure on nominal wages, which rose 24.1% y-o-y in Q1 2025.

Differences between our forecast and the projections of other institutions largely stem from differing assumptions about when the war will end. Both the IMF and Ukraine's Ministry of Finance (in its baseline scenario) continue to base their numbers on an end to hostilities in 2025. This has major implications for the budget deficit and Ukraine's external balance. However, other institutions fundamentally align with our view on the economy's gradual recovery, the overall inflation and exchange rate outlook, and wage dynamics. Overall, Ukrainian authorities, the IMF, and KSE Institute all see sustained robust growth, fiscal consolidation, and external support as essential for maintaining macroeconomic stability.

Economic Activity

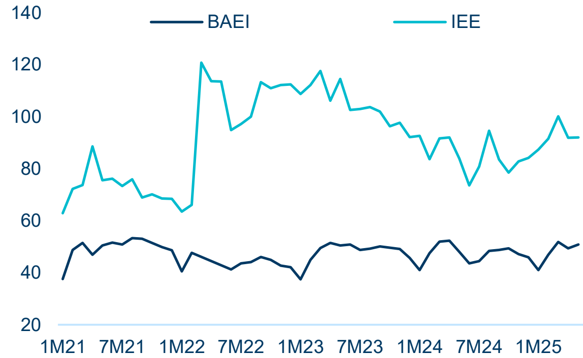
Ukraine's economy will experience a robust recovery after the war due to strong reconstruction investments, but growth will remain constrained in 2025-26. Real GDP growth is expected to reach 2.8% in 2025, slightly less than in the previous year (2.9%) due to Russia's ongoing aggression, which suppresses activity in some key sectors, especially mining. For 2026, we now project growth of 3.1%—a marked downgrade from our April forecast (5.6%) due to the assumption that the war will extend far into next year. In 2027-28, substantial investments into reconstruction will allow for productivity improvements and, along with rising private consumption on the back of robust wage increases, ~5% annual growth (see Figure 1). Despite constrained growth rates in 2024-26 of ~3%, the economy continues to demonstrate remarkable resilience in the face of persistent attacks on critical infrastructure, including energy facilities. The improvement of economic expectations came to a halt in April 2025, however, as peace initiatives failed and Russia continued its large-scale attacks, particularly on Ukraine's largest cities (see Figure 2).

Figure 1: Real GDP and trend, 2021 UAH billion



Source: SSSU, KSE Institute

Figure 2: Economic expectations, indices

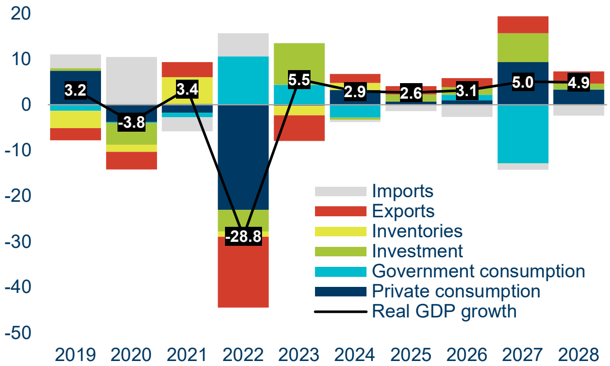


Source: NBU, KSE Institute

Investment-driven productivity gains in key sectors will ensure a robust pace of economic growth. However, sustaining annual growth around 5% in the medium term will require significant scaling up of existing and planned projects, which is achievable through extensive reforms and other policy measures, one of which being the highly anticipated permission to export weapons. Military production in Ukraine reached $10 billion in 2024, with $15 billion expected for 2025—a significant share of GDP (~7%) that is comparable with agriculture. Prospects are much bigger, however, as a large part of production capacity (estimated at $30-35 billion) is currently not used due to insufficient domestic demand; production capacity could increase to $50 billion by 2028 with the realization of potential investment projects, which are not included in the current forecast and therefore represent an upside risk to the baseline scenario.

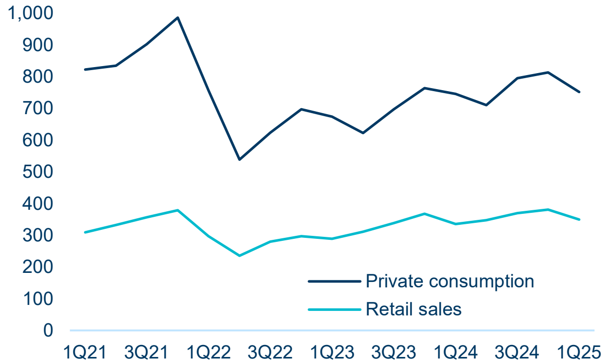
Domestic enterprises, the government, and foreign partners should reorient efforts and funds to capital investments. For the government, this implies a strategic reallocation of expenditures from predominantly social transfers and consumption towards capital spending and targeted support for productive industries. Social support should be reoriented to the reintegration of vulnerable groups, namely veterans, IDPs, and people with disabilities into the labor market. Despite the projected recovery, Ukraine's real GDP will remain ~10% below its 2021 level in 2028, highlighting the urgent need for additional investments.

Figure 3: Real GDP growth by expenditure, in %/pp



Source: SSSU, KSE Institute

Figure 4: Private cons. and retail sales, 2021 UAH billion

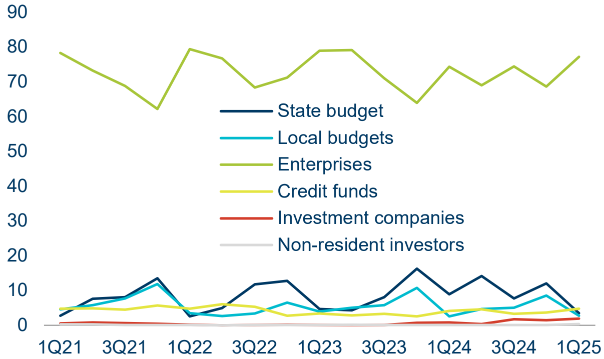


Source: SSSU, KSE Institute

As the full-scale war subsides, the structure of drivers of economic growth will change. *Government consumption* has played a critical role in sustaining aggregate demand during the war—its share of GDP increased from 20% in 2021 to 40% in 2024—and will likely continue to do so in 2025-26. However, afterwards, its share will decline as defense spending is reduced moderately (see Figure 3). The contribution from *private consumption*, after weaking in the winter of 2024-25 along with retail sales due to growing inflationary pressures (see Figure 4), is expected to be broadly neutral during the remainder of the war, but will increase markedly in 2027—fueled by rising wages, labor market normalization, and improved expectations. However, private consumption is projected to account for a smaller share of GDP in the medium term after falling from 70-75% of GDP in 2019-21 to 60-65% during the war. In recent years, this was due to the larger role played by government consumption; looking forward, it will be driven by the stronger influence from investment. *Exports* decreased as a share of GDP by ~10pp in 2024 vs. 2021 when they had accounted for 39%, but a moderate bounce back to ~33% is expected by 2028, partially driven by military exports.

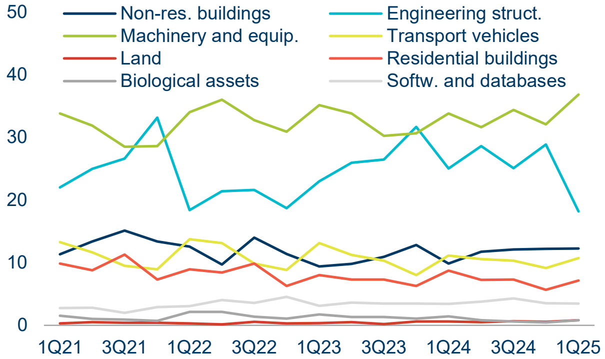
Investment is poised to become one of the key drivers of growth in Ukraine's future economy. We expect its share of GDP to increase from ~18% before the full-scale invasion to 26% in 2028. Foreign direct investment will play a key role and, in turn, catalyze higher capital spending by domestic firms. Investment will, in turn, support private consumption and exports. Capital investments in Ukraine have largely come from private enterprises—roughly 72% of total investment in 2024 (see Figure 5)—with the state budget playing a somewhat bigger role since 2023 (11% in 2024). Investments are skewed toward machinery and equipment and engineering structures (33% and 27% of total investments, respectively, in 2024), with non-residential buildings, transport vehicles, and residential buildings accounting for much smaller shares (see Figure 6). Agricultural companies play a big role in machinery and equipment investments, supported by programs for local farmers. The role of machinery in investments increased in Q1 2025 by 4pp (a ~1.5x increase from UAH 31.5 billion in Q1 2024 to UAH 45.6 billion in Q1 2025) after engineering structures dropped by 10pp; total investments increased by 32.5% y-o-y, significantly outperforming inflation.

Figure 5: Capital investments by source, % total



Source: SSSU, KSE Institute

Figure 6: Capital investments by asset type, % total



Source: SSSU, KSE Institute

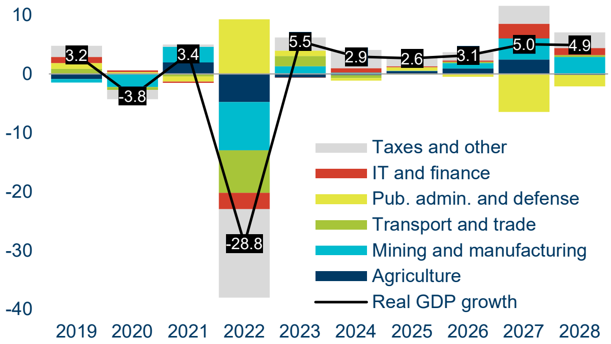
Sectors

Ukraine's economic recovery is advancing unevenly across sectors, shaped by varying levels of war-related damage, reconstruction efforts, and investment needs. The current economic situation is dependent on the implementation of investment and re-investment strategies, with a large focus on the energy and transportation sectors during the war. These areas are crucial to keep the economy running under constant pressure from Russian aggression, but have both been heavily affected by the war.

The post-war recovery will be driven by mining and manufacturing, responsible for 3.6pp and 2.9pp of real GDP growth in 2027-28 respectively, accompanied by growth of the agriculture and IT sectors. Public administration and defense will decrease growth by 6.4pp in 2027 and 1.9pp in 2028 due to the lower military spending. However, they will remain elevated in comparison to the pre-war situation (see Figure 7).

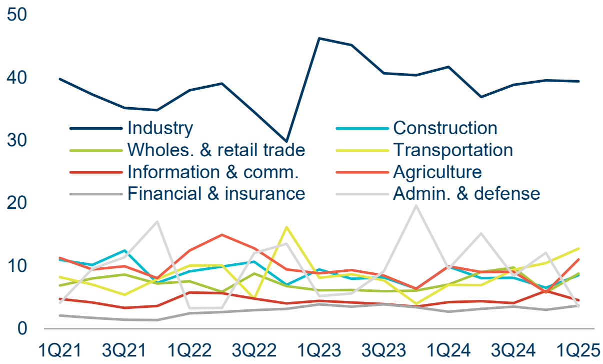
The sectoral breakdown of investment has remained broadly stable (see Figure 8). Currently, industrial investments account for ~40% of the total, while transportation-related investments increased to 10% and administrative and defense have fluctuated around 10%. During the war, we expect an increase in the share of construction investments due to efforts to rebuild critical infrastructure. However, capital spending will shift to machinery and equipment to an even larger extent after the war, as productivity growth will be a key objective to grow the economy and support Ukraine's euro integration path. Agricultural investments will likely stabilize, as agriculture will be supported by government programs following the cancellation of special trade measures with the EU in June 2025.

Figure 7: Real GDP growth by sector, in %/pp



Source: SSSU, KSE Institute

Figure 8: Capital investments by sector, % total



Source: SSSU, KSE Institute

Agriculture remains a key export sector but continues to struggle with productivity challenges stemming from war-related disruptions, including land contamination, transport blockages, and reduced livestock. A gradual recovery is expected to begin in 2025. Despite the broader development and activity of agricultural producers, farmers have faced adverse weather conditions that delayed the sowing campaign and, consequently, may negatively impact the overall crop yield—particularly wheat—and total production in 2025. On the other hand, state grant programs have significantly contributed to the growth of horticulture in Ukraine, especially supporting micro-enterprises within the agricultural sector, which is also reflected in the growing share of agriculture in capital investments. These programs stimulate investment, job creation, and production expansion, which are expected to remain a driver of growth into 2026; stronger growth is also expected in 2027–28, accounting for ~2% of real GDP. The cessation of hostilities will unblock maritime routes—particularly important for grain export costs—and accelerate demining efforts, leading to an expansion of sowing areas. With projected investments of $40 billion in technology, demining, and transport logistics, the productivity gap with European peers is expected to narrow. This will drive a substantial increase in sector productivity from ~$10,000 per capita in 2023-24 to ~$11,500 in 2028.

Ukraine's mining industry continues to face significant challenges due to ongoing military operations, leading to reduced production and a loss of capacity. In 2025, several important coal mines were closed due to Russian attacks as well as the advancing frontline, including in Selidove and Pokrovsk. Mining saw a decline of 16% y-o-y in Q1 2025, while the long-term outlook is underpinned by modernization and investments in energy efficiency and logistics, with the development of critical raw materials offering strategic opportunities tied to Ukraine's EU integration path. This will enable growth from UAH307 billion in 2024 to UAH727 billion in 2028, a ~2.5x expansion in nominal terms. A law significantly simplifying the process of obtaining special permits for subsoil use was adopted in 2023, resulting in record-high budget revenues from fees for these permits. The rights provided by these permits may also contribute to the long-term development of the mining industry. Finally, the recently concluded minerals agreement with the United States may bring additional investment to the sector.

Manufacturing will be a key driver of Ukraine's economic recovery, accounting for the largest GDP share in 2028. The sector will jump from 8% of total GDP to 11%, growing ~2.5x in nominal terms. The defense sector has become a major engine of growth and innovation, with military-industrial production expanding several-fold since the full-scale invasion, reaching $10 billion in 2024 and a projected $15 billion in 2025. Defense manufacturing, drone technology, and R&D-driven startups are reshaping Ukraine's industrial landscape, supported by initiatives such as Brave1. This sector is expected to remain central both for exports and productivity gains in the post-war economy, with technological advancements and investor interest in the area amid global war risks growing and rearmament initiatives (e.g., ReArm Europe) unfolding, which will support the expansion of the Ukrainian defense-tech sector.

Metallurgy will continue to play a significant role in Ukraine's GDP, serving as a key driver of economic growth and industrial development. In 2025, Ukraine's metallurgical industry shows mixed trends, but some stabilization of production is expected. The main challenges remain high transportation and energy costs, a shortage of skilled workers, and unfavorable global market conditions. Post-war development of the metallurgical industry will be based on production modernization, the transition to green metallurgy, and adaptation of products to the requirements of EU markets.

Construction is set to grow from 2% of GDP to 3%, driven by reconstruction needs, while the energy sector will benefit from investments in damaged infrastructure but remains vulnerable to further attacks. National recovery programs will stimulate construction during the forecast period. In particular, the National Program for the Recovery and Modernization of Housing and Regional Infrastructure envisions more than 100 projects by 2032, with a total value of up to $250 billion. The recovery of energy self-sufficiency and the build-up of cross-border electricity trade with the EU will be essential for long-term resilience.

Services sectors show mixed dynamics. Wholesale and retail trade is stabilizing but will likely see slower growth as global trends reach Ukraine, reducing its GDP share from 13% to 10%. Ukraine's IT sector, following temporary setbacks, remains a global leader in outsourcing and is now increasingly oriented toward military-tech and AI development, fueling and supporting the manufacturing sector and opening opportunities for domestic-oriented projects. Financial and professional services are set to benefit from modernization and the return of capital and skilled labor on the tail end of the forecast horizon.

Transport and logistics remain critical bottlenecks. Wartime destruction of seaports and other transport corridors has decreased the share of transport in GDP from 6-7% in 2019-21 to 4% in 2023-24, but has also accelerated the shift to EU-backed inland routes. The restoration and diversification of Ukraine's transport system will be key to sustaining growth in other sectors, including agriculture, manufacturing, and CRM. Significant investments into the transport network are needed to bring its GDP share back up to 5% and facilitate the performance of the overall economy. Ukraine also aims to integrate fully with the EU transport market, having already synchronized its electricity grid and begun preparations for TEN-T membership.

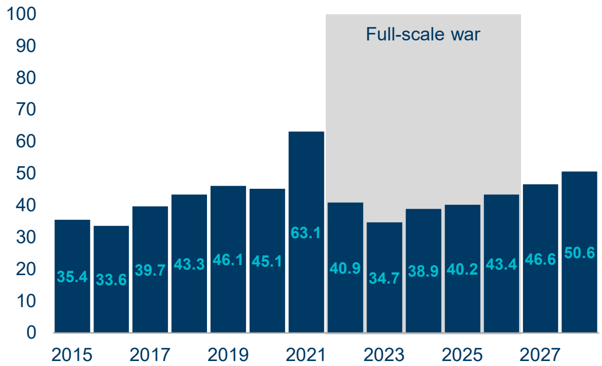
Public sector consolidation will weigh on the GDP contributions of administration, education, and health from 2027 onward, though social sectors will remain larger than pre-war levels in absolute terms. The public sector's GDP share will likely stay elevated around 12-18% (vs. 6-7% in the pre-war period) due to elevated defense spending. Tax revenues are expected to stabilize, with potential declines in military levies from 2027 compensated for by larger taxes on alcohol, tobacco goods, and imported goods. Subsidies will remain broadly unchanged.

Foreign Trade

Export and import dynamics differ fundamentally—with important implications for the trade balance. Compared to the pre-Covid baseline (2019), Ukraine's goods exports were only 11.3% lower in the first year of the war, but continued to decline in 2023 (-24.8% vs. 2019) before recovering somewhat in 2024 (-15.6% vs. 2019). In value terms, 2024 exports were $7.2 billion lower than in 2019. On the other hand, while imports declined to a similar degree in 2022 (-8.0% vs. 2019), they had already surpassed their pre-Covid level in 2023 (+5.7%) and were 14.8% (or $8.9 billion) higher in 2024. As a result, Ukraine's trade deficit has grown substantially during the full-scale war, from $14.7 billion in 2019 to $30.4 billion in 2024.

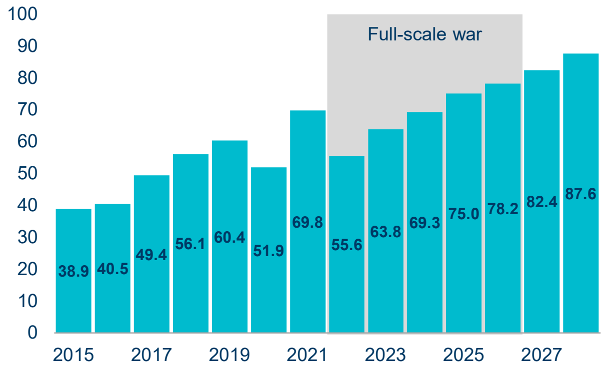
Exports and imports will be weaker due to the longer war. We project Ukrainian goods exports to grow by a cumulative 30.0% in 2025-28, compared to the projected 32.7% over 2025-27 in our April forecast; see Figure 9). In 2025, lower volumes and lower prices both contribute to the change, while weaker volume growth plays the key role in 2026. In absolute terms, exports will be $1.6 billion lower than previously forecast in 2025 and $3.1 billion lower in 2026. We have also lowered import projections. Over 2025-28, goods imports are expected to grow by a cumulative 26.5% (vs. 29.1% over 2025-27 previously; see Figure 10). Lower real GDP growth—and, thus, demand for imports—is the most important factor impacting the number for 2026 (-$2.8 billion vs. April) and 2027 (-$7.0 billion). As a result, Ukraine's trade deficit will grow from $30.4 billion in 2024 to ~$35 billion in 2025-26 and $36-37 billion in 2027-28.

Figure 9: Good exports, USD billion



Source: NBU, KSE Institute

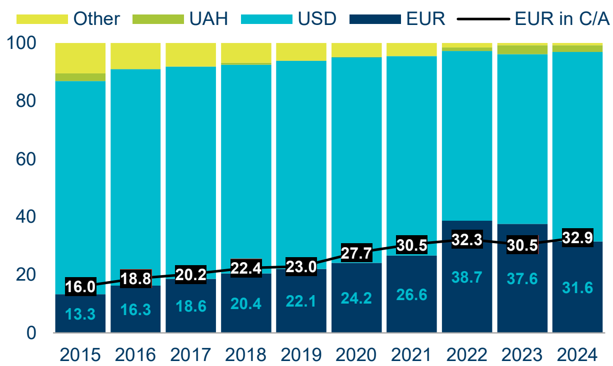
Figure 10: Goods imports, USD billion



Source: NBU, KSE Institute

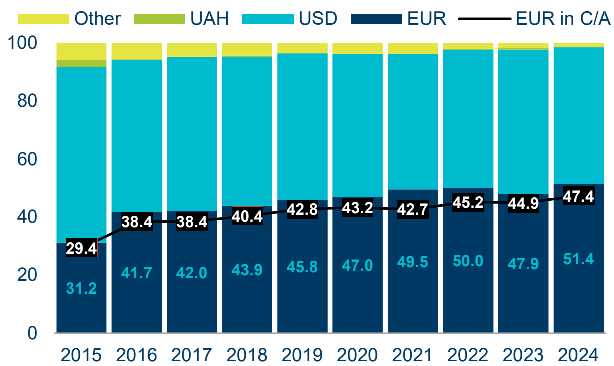
The importance of the Euro in Ukraine's trade relationships is growing. According to NBU data, the Euro's share in receipts for goods exports has grown from 13.3% in 2015 to 26.6% in 2021 and 31.6% in 2024 (see Figure 11); numbers are similar for all current account receipts—i.e., goods, services, income, and transfers. On the imports side, the Euro's share in payments rose from 31.2% in 2015 to 49.5% in 2021, and ticked up to 51.4% in 2024 (see Figure 12), with dynamics broadly the same for all current account payments. The rising Euro share has important implications for macroeconomic policies, including regarding the Hryvnia exchange rate and the NBU's reserve management. Increasing depreciation of the Dollar against the Euro has shown the vulnerability of the Ukrainian economy to UAH/EUR depreciation. There is potential for a further shift towards the Euro as its share in receipts is much lower than the EU's as a destination for Ukrainian exports—31.6% vs. 54.6% in 2024 (see the April edition of the *Ukraine Macroeconomic Handbook*). For imports, a larger share is actually settled in Euro than imported from the EU—51.4% vs. 47.9%.

Figure 11: Currency of export receipts, %



Source: NBU, KSE Institute

Figure T4: Currency of import payments, %



Source: NBU, KSE Institute

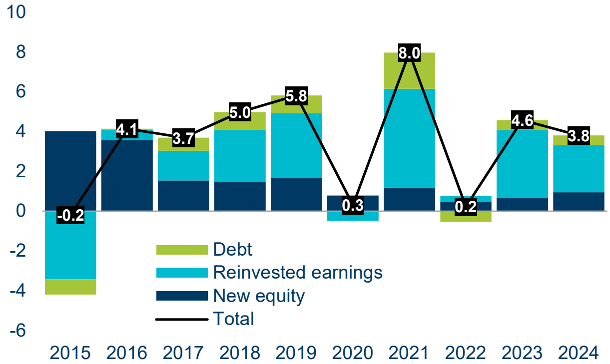
KSE | Institute

Capital Flows

A longer war delays the normalization of capital flows and reduces available financing. During the war, non-resident investments outside of official flows dropped sharply—from $12.0 billion in 2021 to -$3.8 billion in 2022, $5.1 billion in 2023, and $1.4 billion in 2024. However, financial support in the form of loans from Ukraine's international partners allowed for a significant build-up of reserves despite a considerably wider current account deficit, i.e., much higher external financing needs. In 2025, $41.7 billion in foreign loans—largely under the ERA mechanism and the EU's Ukraine Facility—will provide important support at a time when other capital inflows remain subdued due to the war. This situation will change in 2026 due to two simultaneous developments: *One*, disbursements of foreign loans will drop sharply to $17.8 billion, and *two*, the war extending far into 2026 will reduce other capital inflows by an additional $10.7 billion compared to our April forecast. For an analysis of the impact on reserves, please see the *Balance of Payments* section.

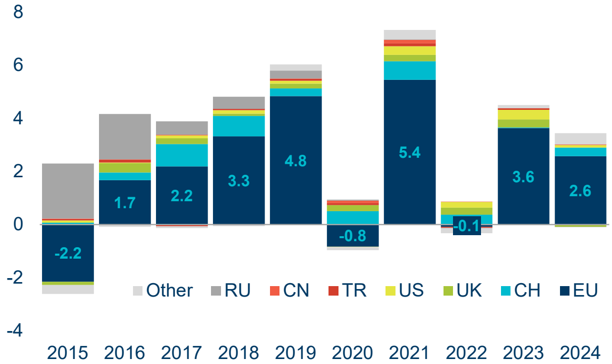
Foreign direct investment will remain suppressed during the war. FDI amounted to $8.0 billion in 2021, collapsed to $220 million in the first year of the full-scale war, and recovered somewhat to $4.6 billion in 2023 and $3.8 billion in 2024 (see Figure 13). Reinvested earnings have accounted for a large share of the total in recent years (close to 70% of the total in 2023-24), with new equity playing a much smaller role (~20%). Foreign direct investment into Ukraine is dominated by EU-based investors (see Figure 14), which were responsible for more than 60% of total inflows in the last ten years (including 73% in 2022-24). Thus, investments from the EU—and, more broadly, Ukraine's EU accession—will be critically important for future flows. In terms of the destinations, five sectors accounted for more than 95% of total inflows in 2022-24 (see Figure 15): trade (~36%), finance & insurance (~31%), information & communications (~16%), manufacturing (~7%), and agriculture (~6%); the only sector registering outflows was mining. We expect a significant rise in FDI after the end of the war as foreign companies invest in Ukraine's economic recovery, with inflows of $10 billion in 2027 and $12 billion in 2028 (see Figure 16). However, the longer war will depress investments in 2026, which are now expected to be $5 billion lower than in our April forecast.

Figure 13: Foreign direct investment by type, USD billion



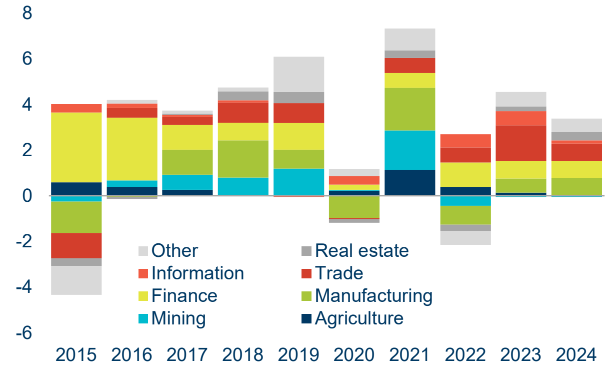
Source: NBU, KSE Institute

Figure 14: Foreign direct investment by country, USD billion



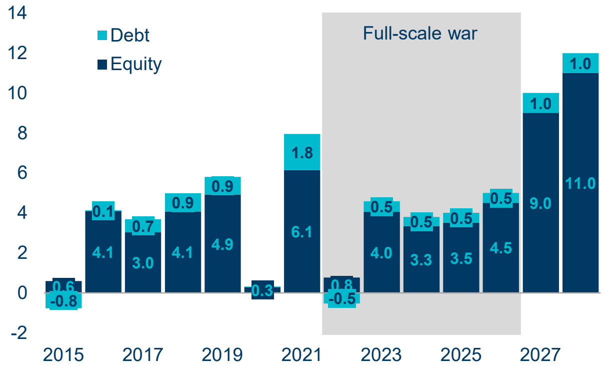
Source: NBU, KSE Institute

Figure I3: Foreign direct investment by country, USD billion



Source: NBU, KSE Institute

Figure I4: Foreign direct investment forecast, USD billion

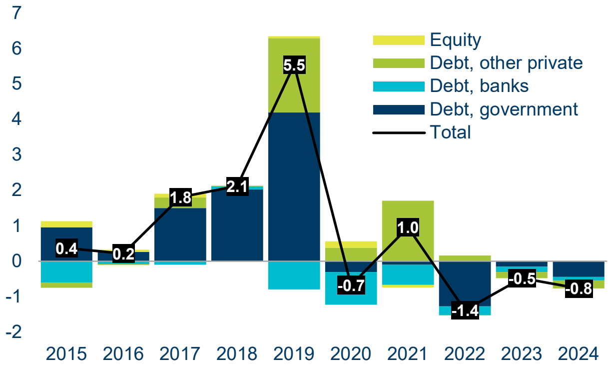


Source: NBU, KSE Institute

Non-resident portfolio investment will rise sharply after the end of the war. Portfolio flows into Ukraine have largely been driven by foreigners' investments in sovereign debt, with smaller contributions from bond issuance and repayments by Ukrainian banks and non-financial corporations (see Figure 17). Foreign asset managers' involvement was dominated by holdings of Eurobonds until 2019, when they bought domestically-issued debt worth $4.2 billion (see Figure 18). At their pre-pandemic peak in mid-February

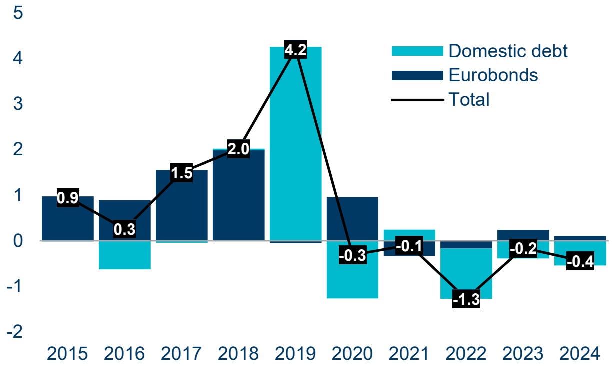
2020, holdings stood at UAH127 trillion ($5.1 billion), which amounted to almost 16% of total outstanding securities. Over 2020-24, investors pulled out $3.1 billion, while Hryvnia depreciation decreased the Dollar value of the remaining holdings. By the end of 2024, they stood at UAH20.8 trillion ($500 million), or 1% of the market. As portfolio investments are generally short term and passive in nature, they are less determined by geographical proximity, with EU-based investors holding 49% and US-based ones 21% (as of end-2023, see Figure 19). We project that portfolio flows will increase sharply in 2027-28 after the end of the full-scale war (see Figure 20), with €6 billion in Eurobond issuance, inflows of foreign capital into domestically-issued sovereign debt of $5 billion, investments in private sector debt of $4 billion, and ~$1.0 billion in equity flows. These equity funds are being set up with support from DFIs and IFIs and are, ultimately, backed by the EU's Ukraine Investment Framework. Additional ~$500 million are expected to turn into FDI) Compared to our April forecast, inflows will be $4 billion lower in 2026 than previously expected due to the longer war.

Figure 17: Foreign portfolio investment by type, USD billion



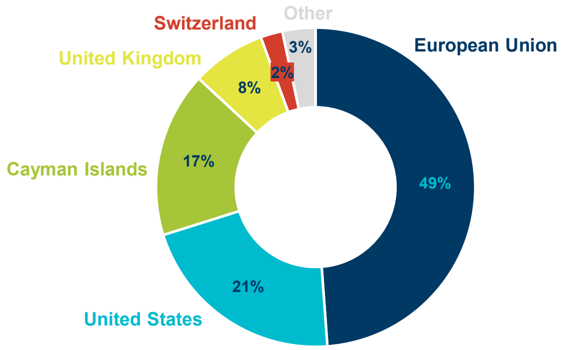
*Source: NBU, KSE Institute *2024 number excludes debt restructuring*

Figure I6: Flows to public sector by instrument, USD billion



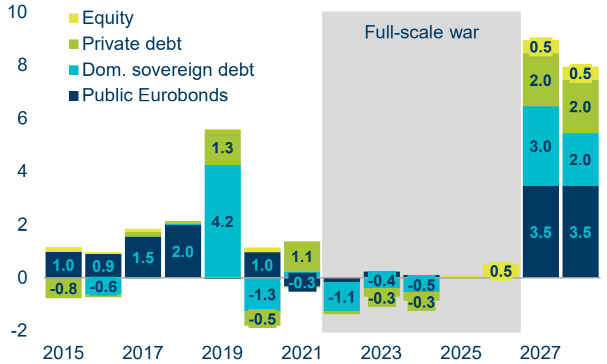
*Source: NBU, KSE Institute *2024 number excludes debt restructuring*

Figure I7: Portfolio holdings by country



Source: IMF, KSE Institute

Figure 20: Foreign portfolio investment forecast, USD billion

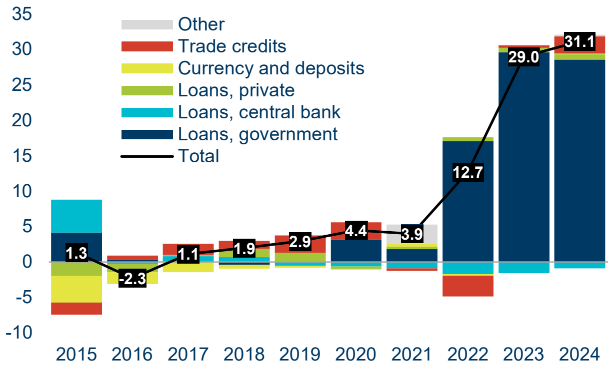


*Source: NBU, KSE Institute *2024 number excludes debt restructuring*

Non-resident other investment is primarily driven by loans from foreign partners. Since the start of the full-scale war, Ukraine's partners have provided $75 billion in net loans to the government (i.e., disbursements minus repayments). This amounts to 103% of total non-resident other investment as other loans, currency and deposits, and trade credits registered net outflows of $2.3 billion (see Figure 21). Disbursement of new loans is projected to rise to a record $41.7 billion this year—including $24.6 billion under the ERA mechanism, $11.8 billion through the EU's Ukraine Facility, and $2.2 billion from the IMF program (see Figure 22). However, as discussed previously, foreign loans will drop sharply in the following years—to $17.8 billion in 2026, $13.2 billion in 2027, and $1.4 billion in 2028—with serious implications for Ukraine's budget and external accounts. Other investment will be supported by loans provided to Ukrainian companies, state-owned enterprises, and municipalities through various schemes, including the Ukraine Investment Framework. We expect new loans of $21 billion over 2025-28 (and ~$13 billion in net inflows after repayments are taken into account). Altogether, non-resident other investment will remain around $18-20 billion in 2026-27 before falling sharply in 2028 as support from partners largely ends (see Figure 23). Compared to our April forecast, 2026 inflows will be around $1.7 billion lower as the longer war weighs on investor sentiment.

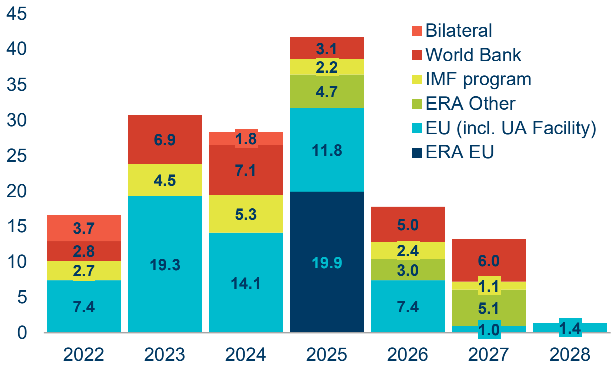
Resident capital outflows will remain elevated until the end of the war. Another key driver of Ukraine's financial account are movements of resident capital. Over 2022-24, residents shifted more than $53 billion out of Ukraine, largely in the form of currency and deposits, i.e., transfers into accounts with foreign banks (see Figure 24). Quarterly data (up to Q1 2025) indicates that this dynamic is unlikely to fundamentally change during the war. Thus, we project outflows to remain elevated in 2025-26 before declining meaningfully in the post-war period. For 2026, we project outflows to be $6.5 billion higher compared to our April forecast.

Figure 21: Foreign other investment by type, USD billion



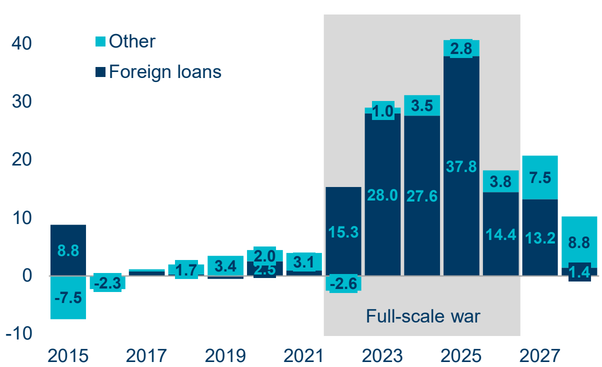
Source: NBU, KSE Institute

Figure I10: Foreign loans disbursements, USD billion



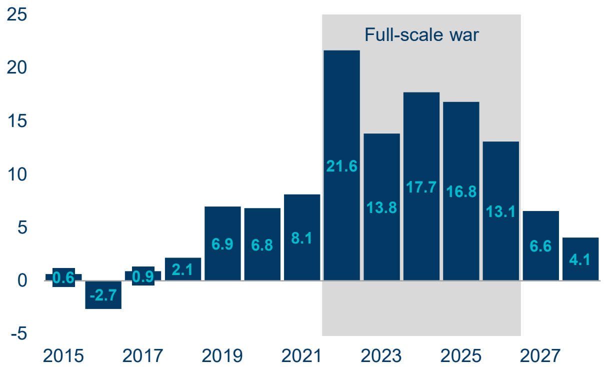
Source: NBU, KSE Institute

Figure 23: Foreign other investment forecast, USD billion



Source: NBU, KSE Institute

Figure I12: Resident capital outflows forecast, USD billion



Source: NBU, KSE Institute

External financing situation will be challenging in 2026. The simultaneous decline in foreign loans and delayed normalization of capital flows dynamics—non-resident inflows and resident capital outflows—will generate a challenging situation in 2026. Total capital inflows are projected to drop from $27.9 billion this year to $10.6 billion in 2026 (see Table 3). The primary driver of the change since our April forecast is the updated assumption regarding war termination (late 2026 vs. late 2025), leading us to project non-resident inflows to be $10.7 billion lower and resident outflows $6.5 billion higher. What distinguishes 2026 from 2023—when net capital inflows were similarly weak—is the scale of foreign grants ($0.6 billion vs. $14.1). This means external financing needs from the current account will be much higher next year than they were in 2023.

Table 3. Capital flows forecast

$ billion	2021	2022	2023	2024	2025f	2026f	2027f	2028f
Total non-resident invest.	12.9	11.5	33.1	29.0	44.7	23.7	39.7	30.2
Direct investment	8.0	0.2	4.6	3.8	4.0	5.0	10.0	12.0
Equity	6.1	0.8	4.0	3.3	3.5	4.5	9.0	11.0
Debt	1.8	-0.5	0.5	0.5	0.5	0.5	1.0	1.0
Portfolio investment	1.0	-1.4	-0.5	-5.9	0.1	0.5	9.0	8.0
Equity	-0.1	-0.0	0.0	0.0	0.1	0.5	0.5	0.5
Debt	1.0	-1.4	-0.5	-5.9*	0.0	0.0	8.5	7.5
Public Eurobonds	-0.3	-0.2	0.2	-5.1*	0.0	0.0	3.5	3.5
Dom. sovereign debt	0.2	-1.1	-0.4	-0.5	0.0	0.0	3.0	2.0
Private sector	1.1	-0.1	-0.3	-0.3	0.0	0.0	2.0	2.0
Other investment	3.9	12.7	29.0	31.1	40.6	18.2	20.7	10.2
Loans	1.2	15.9	28.6	28.4	38.1	15.7	18.2	7.7
Public sector loans	0.9	15.3	28.0	27.6	37.8	14.4	13.2	1.4
Other	0.0	-3.2	0.4	2.8	2.5	2.5	2.5	2.5
Resident invest. (- = outflow)	-8.1	-21.6	-13.8	-17.7	-16.8	-13.1	-6.6	-4.1
Direct investment	-0.4	-0.0	-0.1	-0.3	-0.3	-0.3	-0.3	-0.3
Portfolio investment	0.0	-0.6	-2.3	-0.7	-0.5	-0.3	-0.3	-0.3
Other investment	-7.7	-21.0	-11.4	-16.7	-16.0	-12.5	-6.0	-3.5
Financial derivatives, net	0.2	0.0	0.0	0.1	0.0	0.0	0.0	0.0
Capital inflows, net	4.7	-10.1	19.2	11.3	27.9	10.6	33.1	26.1

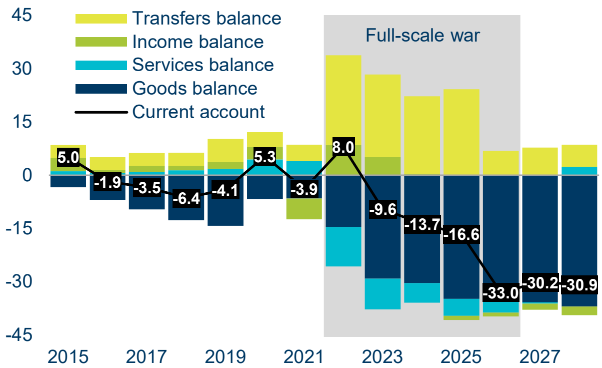
**Numbers include Eurobond restructuring of $5.2 billion, which is also reflected (with inverse sign) in the capital account.*

Balance of Payments

The outlook for Ukraine's external accounts is significantly impacted by the longer war. While $58.4 billion in foreign grants and loans provide critical support in 2025 and allow for a $11.3 billion increase in reserves, the situation will become challenging in 2026. This is due to two simultaneous developments: first, financial assistance from partners is expected to drop sharply (to $18.4 billion); and second, the war continuing for most of next year will weigh on trade, drive up payments for services, reduce remittances, sharply reduce capital inflows from foreign investors, and keep resident outflows elevated. Altogether, we project an external financing gap (i.e., reserve losses) of $22.4 billion—$20.6 billion higher than in our April forecast (see also *Special 1*). With foreign investments projected to pick up after the war, the situation will stabilize in 2027-28, but next year's financing gap will likely require additional foreign funding.

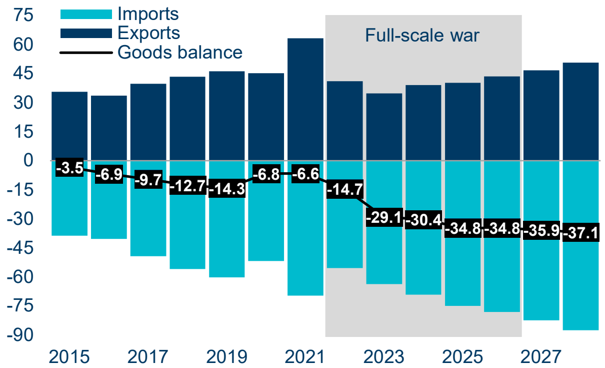
Ukraine's current account deficit is projected to widen markedly after 2025—from $13.7 billion in 2024 and (projected) $16.6 billion in 2025 to $33.0 billion in 2026 and ~$30 billion in 2027-28 (see Figure 25). This dynamic is driven by several key factors: *First*, imports will continue to grow strongly—in 2026 due to the demands of the war and afterwards as a result of the economy's robust recovery. *Second*, foreign grants, which have offset pressure on Ukraine's external accounts, are expected to drop sharply as foreign assistance will decline and increasingly shift to loans. *Third*, dynamics related to the number of Ukrainian refugees abroad—remittances and travel service imports—will take several years to return to pre-war levels. *Fourth*, a strong inflow of foreign investments after the war will increase interest and dividend payments.

Figure E1: Current account and components, USD billion



Source: NBU, KSE Institute

Figure 26: Trade balance and components, USD billion



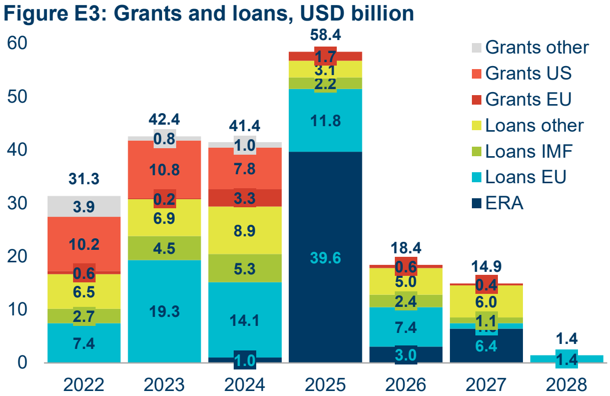
Source: NBU, KSE Institute

The longer war will weigh on the recovery in Ukraine's external trade. We expect goods exports to grow by 3.3% in 2025 (vs. 7.4% in the April forecast, due to lower volumes and prices), while imports are expected to grow by 8.3% (vs. 9.0% previously). As a result, the trade deficit will widen to $34.8 billion (see Figure 26). In 2026, the continuation of the war will significantly weigh on exports (-$3.1 billion vs. April forecast), while lower real GDP growth will drive down imports (-$4.1 billion vs. April forecast), leading to a larger projected trade deficit of $34.8 billion. In 2027, imports will also be weaker than previously expected (-$7.0 billion), largely due to our downward revision of the pace of the economic recovery, but the trade deficit will increase to $35.9 billion. Altogether, we project Ukraine's goods exports to grow by cumulative 30.0% over 2025-28 (previously 32.7% over 2025-27), and goods imports to grow by cumulative 26.5% (previously 29.1%).

Ukraine's services balance is set to improve in the coming years—but significant improvements will not materialize until the end of the war. After a deficit of $5.5 billion in 2024, we project deficits of $4.8 billion and $3.9 billion in 2025-26, respectively, a marginal one in 2027 and a surplus of $2.3 billion in 2028. Payments related to travel services have been a major driver of Ukraine's services balance since 2022 due to the large number of refugees abroad, and are expected to decline to pre-war levels only in 2028, as the return of Ukrainians living abroad will take time and not start in earnest until the end of the war. The longer war impacts our projections for travel services debits in 2026, which are now $2.5 billion higher than in the April forecast. Economic growth will partially offset these dynamics and limit the decrease in total services imports—from a peak of $27.7 billion in 2022 to ~$19 billion in 2027-28. Despite the loss of pipeline transport receipts after the end of the transit agreement with Gazprom, services exports are expected to grow strongly—by 23.5% in 2028 vs. 2024—resulting in an improving services balance.

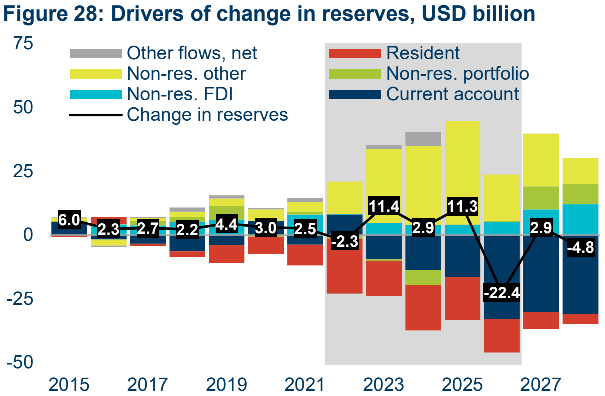
The primary income account is expected to run a deficit throughout the forecast period. After recording large surpluses in 2022-23, driven by sharply reduced payments on foreign investment income, Ukraine's primary income account was roughly balanced in 2024 (+$0.3 billion) on the back of significantly weaker remittances. Compensation paid to Ukrainians abroad declined by ~30% last year to their lowest level since 2016 ($7.8 billion). We do not expect remittances to begin recovering until the war ends, and they are unlikely to return to pre-war levels until the end of the forecast period in 2028. Weaker-than-expected quarterly data led us to reduce our remittances forecast for 2025 by $1 billion, while the continuation of the war through most of 2026 means remittances are projected to be $3 billion below our April forecast for that year. Primary income debits will remain subdued until rising in 2027-28 as a result of strong post-war foreign investments. Meanwhile, **a noticeable decline in foreign grants will result in a much smaller secondary income surplus after 2025.** Following a $21.8 billion surplus in 2024, driven by significant disbursements of foreign assistance (see Figure 27), we expect ERA-related payments to push the surplus up to $24.2 billion this year. Thereafter, the surplus is forecast to fall to $6-8 billion annually over 2026-28 as no major grants are planned, once again making private transfers the key driver.

Figure E3: Grants and loans, USD billion



Source: KSE Institute

Figure 28: Drivers of change in reserves, USD billion



Source: NBU, KSE Institute

Non-resident capital flows are projected to remain subdued until the end of the war. As discussed in the *Foreign Investment* section above, the heavily-frontloaded disbursement schedule of foreign loans, including under the ERA mechanism and the EU's Ukraine Facility, means that non-resident other investment will reach a record-high $40.6 billion this year before dropping to ~$18-21 billion in 2026-27 and ~$10 billion in 2028 (see Table 4). At the same, the recovery of foreign direct and portfolio investment will be further delayed by the war's assumed continuation well into 2026. Altogether, this means that total non-resident flows will fall from projected $44.7 billion in 2025 to $23.7 billion in 2026—significantly below the $34.3 billion forecast in April. The longer war also means that **resident outflows will remain elevated** at $13.1 billion (vs. $6.6 billion projected in April). This coincides with a sharp increase in external financing needs, as much smaller foreign loans contribute to a significantly wider current account deficit. After the war ends (i.e., in 2027-28), non-resident investment will pick up significantly, easing pressure on Ukraine's external accounts. However, 2026 will present a particularly serious challenge (see Figure 28).

Table 4. External sector forecast

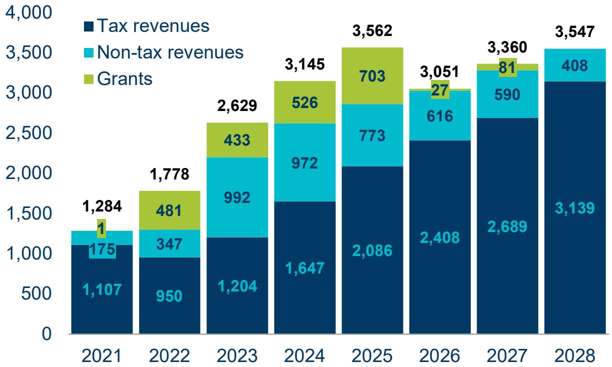
$ billion	2021	2022	2023	2024	2025f	2026f	2027f	2028f
Current account balance	-3.9	8.0	-9.6	-13.7	-16.6	-35.0	-30.2	-30.9
Goods balance	-6.6	-14.7	-29.1	-30.4	-34.8	-34.8	-35.9	-37.1
Exports	63.1	40.9	34.7	38.9	40.2	43.4	46.6	50.6
Imports	69.8	55.6	63.8	69.3	75.0	78.2	82.4	87.6
Services balance	4.0	-11.1	-8.7	-5.5	-4.8	-3.9	-0.3	2.3
Primary income balance	-5.8	8.5	5.1	0.3	-1.2	-1.1	-1.7	-2.4
Secondary income balance	4.6	25.2	23.2	21.8	24.2	6.9	7.7	6.3
Foreign grants	0.9	17.5	14.1	12.4	16.7	0.6	1.7	0.0
Non-resident capital flows	12.9	11.5	33.1	29.0	44.7	23.7	39.7	30.2
o/w direct investment	8.0	0.2	4.6	3.8	4.0	5.0	10.0	12.0
o/w portfolio investment	1.0	-1.4	-0.5	-5.9	0.1	0.5	9.0	8.0
o/w other investment	3.9	12.7	29.0	31.1	40.6	18.2	20.7	10.2
Resident flows (- = outflow)	-8.1	-21.6	-13.8	-17.7	-16.8	-13.1	-6.6	-4.1
Change in reserves	2.5	-2.3	11.4	2.9	11.3	-22.4	2.9	-4.8
Total reserves	30.6	28.0	38.8	41.7	53.0	30.5	33.4	28.7
in months of imports	4.4	4.0	5.2	5.4	6.6	3.7	3.9	3.2

Budget and Financing

The continuation of the full-scale war in 2026 will put a heavy burden on Ukraine's budget, with the projected financing gap over 2025-26 reaching $17.7 billion. Most importantly, it will be necessary to maintain significantly higher defense expenditures next year—UAH2.5 trillion vs. the UAH1.6 trillion expected in the April forecast. Previously, we had concluded that a cumulative budget deficit of ~$72 billion over 2025-27 would largely be financed thanks to financial assistance from partners. Now, we expect the deficit to reach $92.4 billion over 2025-27 (plus $15.2 billion in 2028), while foreign loans are effectively unchanged and non-resident portfolio inflows delayed (see *Capital Flows*). Altogether, this leaves Ukraine's state budget underfinanced by a cumulative $27.8 billion over the forecast period.

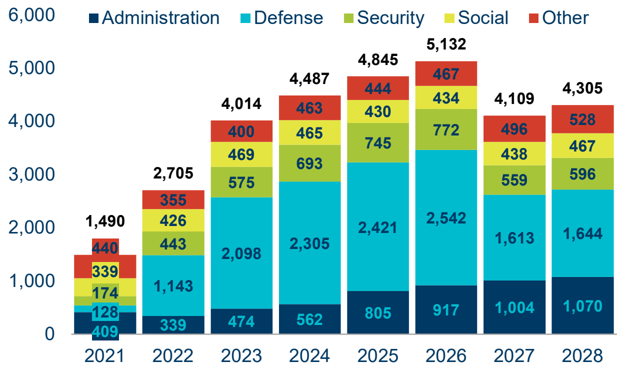
Revenues are expected to grow robustly over 2025-28, underpinned by stronger tax receipts. In 2025, they will reach UAH3.6 trillion (+13.3% vs. 2024), with UAH2.1 trillion coming from taxes (+26.6% vs. 2024), UAH770 billion from non-tax revenues, and over UAH700 billion from official transfers in the form of grants from partners (see Figure 29). Tax revenue growth will be supported by several factors, including: (i) amendments to the tax code adopted in late 2024 (e.g., an increase in the military levy rate and its extension to individual entrepreneurs); (ii) the introduction of a higher corporate income tax rate for financial institutions; (iii) the gradual alignment of excise duties with EU directive levels; and (iv) a recovery of domestic economic activity and rising imports. By 2028, tax revenues are expected to reach UAH3.1 trillion, fueled by strong private consumption after the end of the war, with the structural reforms outlined in the National Revenue Strategy also contributing. These include a shift to progressive personal income taxation, the phaseout of inefficient tax exemptions, a reform of the simplified taxation regime, improved tax compliance through anti-shadow economy measures, and the ongoing digitalization of tax and customs administration. Total revenues in 2028 are projected to reach UAH3.5 trillion, illustrating the much smaller role of foreign grants.

Figure 29: Budget revenues, UAH billion



Source: Ministry of Finance, KSE Institute

Figure 30: Budget expenditures, UAH billion

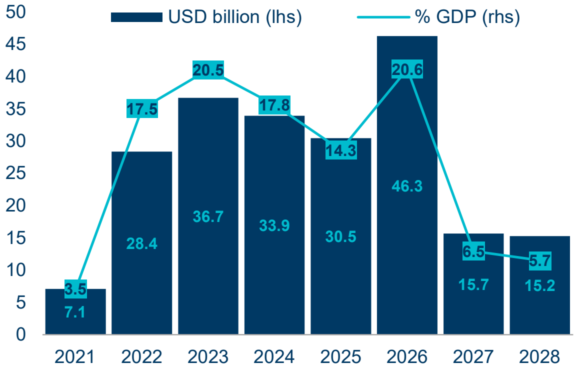


Source: Ministry of Finance, KSE Institute

Budget expenditures are now projected to rise from UAH4.8 trillion in 2025 to UAH5.1 trillion in 2026 after reaching UAH4.5 trillion in 2024. This is due to defense spending remaining elevated next year at UAH2.5 trillion (+5.0% vs. 2025), while the non-defense and security budget is set to rise by 8.3% (see Figure 30). After the war, total expenditures are projected to slide to UAH4.1 trillion and UAH4.3 trillion in 2027-28, respectively. Sharply lower defense spending (UAH1.6 trillion in both years) is a key driver, while security spending is also expected to decline (-14% in 2028 vs. 2024). Even after this decline, the defense budget will account for more than 10% of GDP, well above the levels in NATO countries. Social spending—education, healthcare, housing, and social protection—will remain stable in 2028 vs. 2024, which represents a significant cut in real terms. Nevertheless, the provision of essential services will be maintained. Spending on state functions and economic activity, on the other hand, will rise over the forecast period.

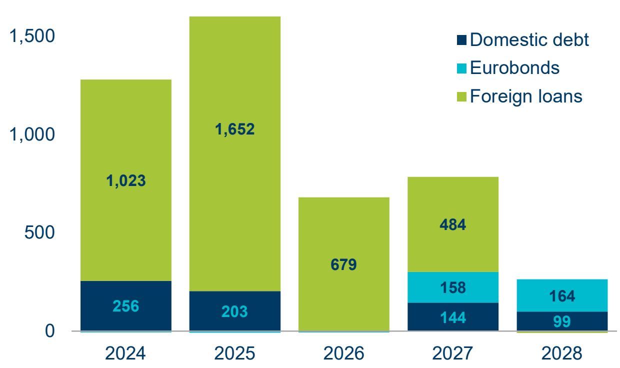
Ukraine's budget deficit will decline marginally as a share of GDP this year. The deficit is projected to reach 14.3% of GDP in 2025, down from 17.5 (see Figure 31). In absolute terms, this amounts to UAH1.3 trillion (or $30.5 billion), which is slightly below our April forecast. For 2026, the revised assumption about the war's end has major implications. Because higher defense spending will need to be maintained, the deficit is now expected to reach UAH2.1 trillion ($46.3 billion), compared to the UAH1.0 trillion ($22.7 billion) previously projected. After the war, gradual fiscal consolidation is expected to reduce the deficit to ~UAH750 billion (~$15-16 billion) in 2027-28. Altogether, financing needs will be significantly larger than anticipated in April, with the cumulative deficit over 2025-28 reaching UAH4.9 trillion ($108 billion).

Figure 31: Budget deficit



Source: Ministry of Finance, KSE Institute

Figure 32: Financing, UAH billion



Source: Ministry of Finance, KSE Institute

External assistance and domestic borrowing ensured budget financing in 2024. Last year, Ukraine received $13.1 billion in grants and $28.3 billion in loans from international partners, a significant share of which ($17.4 billion) was provided under the EU's Ukraine Facility. While grants are recorded as revenues and directly reduce the fiscal deficit, loans contribute to budget financing. In local currency terms, foreign loans amounted to approximately UAH1.3 trillion in 2024. After accounting for repayments of around UAH100 billion, these loans financed ~87% of the state budget deficit (see Figure 32). The remainder was largely covered through domestic debt issuance, i.e., in Hryvnias. The Ministry of Finance issued UAH640 billion in domestic securities, against repayments of UAH380 billion—resulting in a rollover rate of 167%.

Due to the longer war, Ukraine's fiscal financing gap is estimated to reach $27.8 billion over 2025-28. The situation varies considerably within the forecast period. In 2025, the heavily frontloaded disbursement schedule of grants and loans—along with additional domestic debt issuance—means Ukraine will have around $13.5 billion more than needed (see Table 5). However, for 2026, our estimate of the financing gap has risen from $6.1 billion (in April) to $31.2 billion, primarily due to much higher defense and security spending (+$22.6 billion) and lower purchases of domestic debt by foreign investors (-$3.0 billion). Looking ahead, Ukraine's ability to issue Eurobonds and the expected strong foreign inflows into domestically issued bonds after the war suggest that financing will likely be secured in 2027. In 2028, although portfolio flow dynamics should remain supportive, loans from partners are set to drop steeply from $14.6 billion to $1.4 billion. With the situation fundamentally changed from a few months ago, conversations about additional assistance need to start now—and should carefully consider the implications for Ukraine's debt sustainability.

Table 5. Fiscal sector forecast

	2021	2022	2023	2024	2025f	2026f	2027f	2028f
Total revenues, UAH bn	1,284	1,788	2,629	3,145	3,562	3,051	3,360	3,547
in % of GDP	23.6	34.1	40.2	41.1	39.8	30.2	29.0	26.9
Tax revenues, UAH bn	1,107	950	1,204	1,647	2,086	2,408	2,689	3,139
Foreign grants, UAH bn	1	481	433	526	703	27	81	0
Total Expenditures, UAH bn	1,490	2,705	4,014	4,487	4,845	5,132	4,109	4,305
in % of GDP	27.3	51.6	61.4	58.6	54.1	50.8	35.5	33.0
Defense, UAH bn	128	1,143	2,098	2,305	2,421	2,542	1,613	1,644
Overall balance, UAH bn	-193	-918	-1,386	-1,342	-1,282	-2,081	-750	-758
in % of GDP	-3.5	-17.5	-21.2	-17.5	-14.3	-20.6	-6.5	-5.7
Balance excl. grants, UAH bn	-195	-1,399	-1,819	-1.868	-1.986	-2.108	-831	-758
in % of GDP	-3.6	-26.7	-27.8	-24.4	-22.2	-20.9	-7.2	-5.7
Financing, UAH bn								
Domestic bonds				256	203	0	144	99
Issuance				638	700	347	429	244
Amortization				383	497	347	285	145
Eurobonds				-8	-8	-8	158	164
Issuance				606*	0	0	165	172
Amortization				614*	8	8	8	8
Foreign loans				1,023	1,652	679	484	-64
Disbursement				1,136	1,756	800	631	70
Repayments				113	104	121	147	134
Financing gap, $ bn				0.0	-13.5	31.2	-0.9	11.1

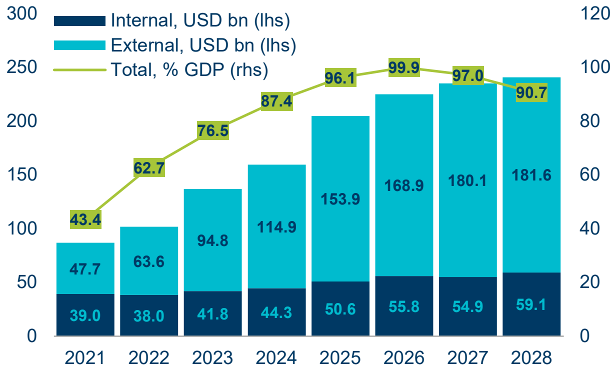
**Numbers do not show actual repayments and issuance but rather reflect debt restructuring.*

State Debt

As of May 2025, Ukraine's total state debt stood at UAH7.2 trillion (~$174.3 billion), with roughly two thirds consisting of external obligations. Since the end of 2021, debt has roughly tripled in UAH terms (from UAH2.4 trillion) and doubled in USD terms (from $86.6 billion). Its composition has also changed—the share of external debt was only 55% then, as large amounts of assistance have since been provided by Ukraine's partners. With a debt-to-GDP ratio of 85% in May and a significant budget financing gap emerging for next year requiring further foreign support, the country's debt burden could rise to unsustainable levels.

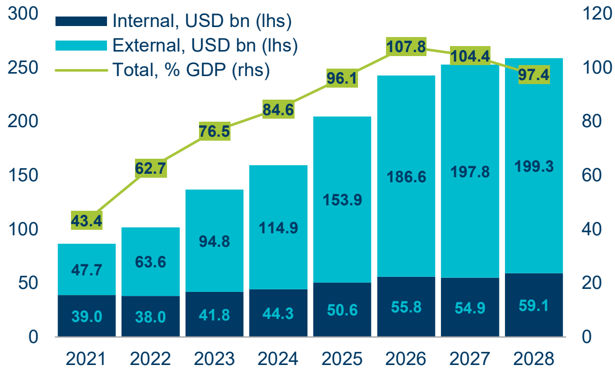
State debt as a share of GDP is expected to rise further in 2025-26, reaching approximately 100%, before declining to ~91% after the war ends (i.e., by the end of 2028). Importantly, this forecast (see Figure 33 and Table 6) reflects our baseline scenario in which the fiscal financing gap in 2026 is *not* closed by additional foreign assistance. These figures are somewhat higher than our previous projection, which anticipated a peak of 94% of GDP. If Ukraine's partners were to provide an additional $17.7 billion—and if all of this were delivered as loans, the scenario with the greatest impact on debt—then Ukraine's debt-to-GDP ratio would rise to above 107% in 2026 and only fall to just below 100% in 2028 (see Figure 34).

Figure 33: Debt dynamics*



*Source: Ministry of Finance, KSE Institute *includes ERA*

Figure 34: Debt dynamics*



*Source: Ministry of Finance, KSE Institute *includes ERA*

This debt forecast includes loans issued under the ERA mechanism, which are collateralized by frozen Russian assets. These obligations are currently contingent and Ukraine is not yet required to make repayments. As a result, the funds allocated through the ERA mechanism—intended to support fiscal sustainability, finance social expenditures, restore critical infrastructure, and to some extent address defense sector needs—do not currently increase Ukraine's debt burden, even though they are nominally included in the total debt numbers. Excluding ERA loans, Ukraine's debt-to-GDP ratio will be 11.6pp lower in 2025 (when the largest disbursements occur), 12.3pp in 2026, 13.5pp in 2027, and 12.3pp in 2028.

Post-war economic growth will play an important role in reducing the debt burden. In all three scenarios—debt without ERA funds, with ERA funds, and with additional foreign support in 2026—the debt-to-GDP ratio is expected to decline after 2026. This is due to two factors: first, reduced budget needs for defense and security once hostilities end; and second, persistently high nominal GDP growth as strong real economic expansion combines with easing inflation. Although the debt-to-GDP ratio will remain well above the fiscal rule threshold of 60%, its downward trajectory signals positive macroeconomic trends.

Table 6. Debt dynamics forecast

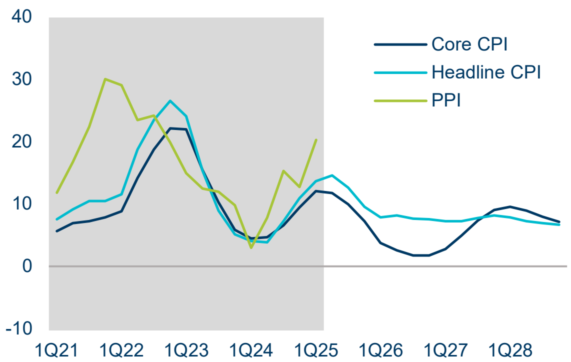
	2021	2022	2023	2024	2025f	2026f	2027f	2028f
Total debt, in UAH billion	2,363	3,715	5,188	6,692	8,612	10,100	11,243	11,967
o/w external	1,300	2,325	3,600	4,829	6,482	7,591	8,616	9,028
o/w domestic	1,063	1,390	1,588	1,863	2,130	2,510	2,627	2,939
Total debt x/ERA	*2,363*	*3,715*	*5,188*	*6,692*	*7,576*	*8,860*	*9,679*	*10,341*
Total debt, in $ billion	86.6	101.6	136.6	159.2	204.5	224.7	235.0	240.6
o/w external	47.7	63.6	94.8	114.9	153.9	168.9	180.1	181.6
o/w domestic	39.0	38.0	41.8	44.3	50.6	55.8	54.9	59.1
Total debt x/ERA	*86.6*	*101.6*	*136.6*	*159.2*	*179.9*	*197.1*	*202.3*	*207.9*
Total debt, in % GDP	43.3	71.6	79.9	84.6	96.1	99.9	97.0	90.7
o/w external	23.9	44.8	55.4	60.2	72.3	75.1	74.4	68.4
o/w domestic	19.5	26.8	24.4	24.3	23.8	24.8	22.7	22.3
Total debt x/ERA	*43.3*	*71.6*	*79.9*	*84.6*	*84.6*	*87.7*	*83.5*	*78.4*

Inflation

Headline inflation accelerated to 15.9% y-o-y in May 2025—the highest level in the past two years. Significant inflationary pressures continue to be driven by elevated electricity prices, persistently high wage growth (24% y-o-y in Q1 2025 in nominal terms), and effects of rising producer prices. Significant concerns regarding the 2025 harvest started with frost in early spring, which impacted vegetables and stone fruits, leading to 33.5% and 35.7% y-o-y inflation for those groups in May 2025. PPI remains high, but with a distinctive downside trend, at 28.9% y-o-y in May after a peak of 51.9% in March. But cost pressures still remain and are ultimately transmitted to consumers, particularly in energy-intensive sectors. Electricity costs rose by 63.6% in June 2024, thus lowering y-o-y growth one year later, and no further increase is expected before October 2025. Additionally, numerous private sector energy resilience projects are underway, which will expand capacities, enhance stability, and moderate cost growth over the medium term. Further energy investments have been endorsed by the government.

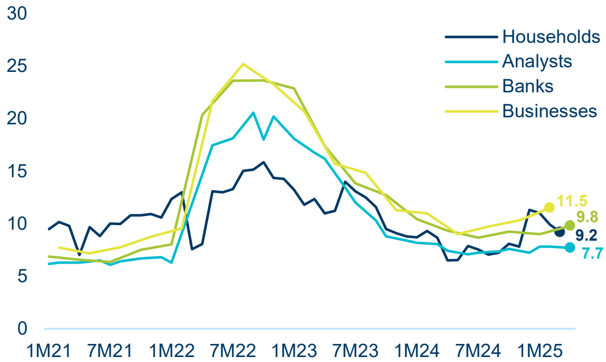
Recent developments point to the beginning of a period of disinflationary trends, but risks remain. The government's decision to postpone a further increase in electricity tariffs is expected to shave roughly 1pp off headline inflation in June 2025. Preliminary data also suggest a decline in egg prices, which could reduce inflation by ~0.2pp, PPI data reinforces the point. However, important upside risks exist, particularly if weather-related shocks to agricultural production continue and affect the broader harvest. As food accounts for more than 40% of household consumption, inflationary pressures could rise in the coming months.

Figure 35: Headline, core inflation and PPI (rhs), % y-o-y



Source: SSSU, NBU, KSE Institute

Figure 36: Inflation expectations, % y-o-y 12M ahead



Source: NBU, KSE Institute

During the post-war period, inflation will increase temporarily due to the economy's rapid recovery. We project headline inflation to decline to around 7% y-o-y in the first half of 2027 before rising somewhat in the second half of the year, driven by robust real GDP growth and strong private consumption (see Figure 35). By the end of the forecast period (i.e., in late 2028), inflation is expected to return to ~7% y-o-y. This differs from our previous forecast (in April), when we had assumed a faster decline toward the NBU's inflation target of 5% by the end of 2027. We believe that the central bank will remain committed to supporting the economy's recovery with a softer monetary policy, while being prepared to respond to price destabilization.

Despite elevated inflation, expectations remain well-anchored due to consistent monetary policy and effective communication by the NBU. Inflation expectations currently lie around 10%—somewhat above our forecast mid-2026—but display stability across household and business surveys (see Figure 36). This stability underscores the credibility of the NBU's inflation-targeting framework and the effectiveness of its proactive policy tightening. We expect a gradual easing of inflationary pressures beginning in the second half of 2025 and supported by both base effects and early signs of price normalization in key categories.

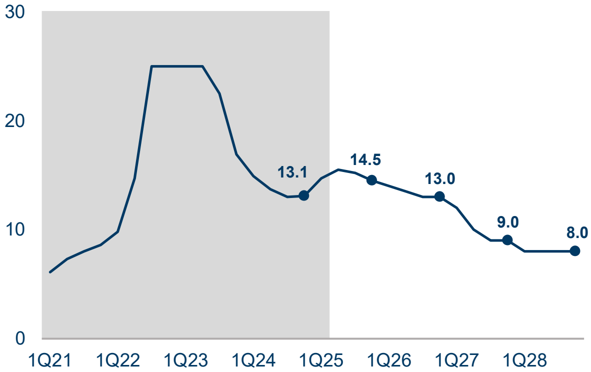
Structural pressures, especially from wage and service-sector inflation, will remain a challenge. As wage growth continues to lie at 24.5% y-o-y, labor-intensive sectors are facing persistent cost increases, which are gradually being passed on to consumers. While these dynamics complicate plans to bring inflation under control in the short term, they are also indicative of a tight labor market and a robust recovery of domestic demand. Going forward, the trajectory of inflation will depend heavily on macroeconomic stability, the further normalization of energy markets, and the NBU's ability to maintain credibility for its monetary policy while navigating significant fiscal and external uncertainties.

Monetary Policy

The NBU remains committed to a prudent and consistent monetary policy stance, emphasizing inflation control as its primary objective in the near term. Following a cumulative tightening of 250 bps since December 2024, the policy rate was held steady at 15.5% during the latest MPC meetings, i.e., since March (see Figure 37). This decision aligns with the NBU's assessment that inflationary pressures have peaked and will begin easing in June. Nevertheless, the central bank has signaled that it will not begin easing until there is clear and sustained evidence of disinflation. The approach remains forward-looking, and any signs of inflation persistence or new shocks will delay monetary loosening.

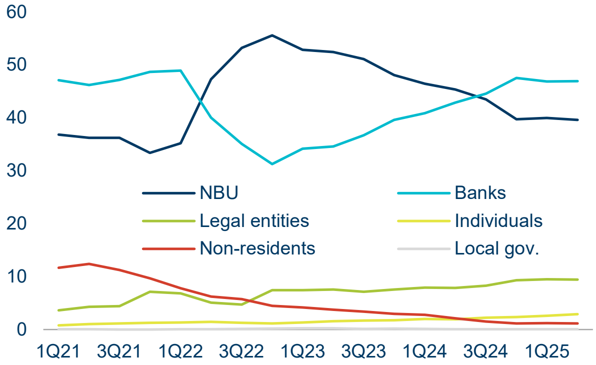
The medium-term outlook assumes a transition toward more accommodative conditions from 2027, once the war ends and the economy enters a more investment-intensive phase of its recovery. In this context, the NBU is expected to support the government's strategic focus on investment-led growth by maintaining relatively low real interest rates, even amid slightly elevated inflation. However, this stance is conditional on inflation remaining below a critical 10% threshold. Should it breach this level, the NBU will stand ready to adjust its stance to preserve macroeconomic stability and anchor inflation expectations. This conditional flexibility reflects the central bank's balancing act between post-war economic revitalization and price stability.

Figure 37: Policy rate, quarterly average, %



Source: NBU, KSE Institute

Figure 38: Domestic bond holdings, % total

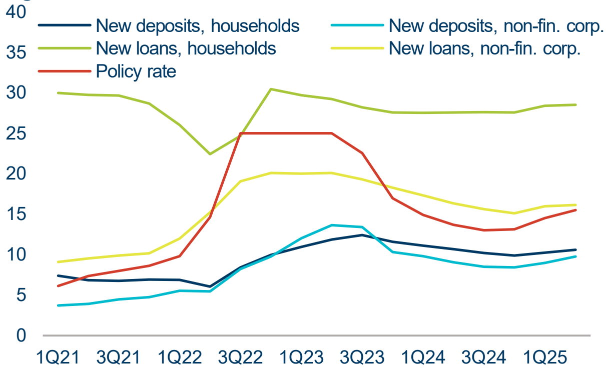


Source: NBU

Recent monetary developments also reflect changes in investor behavior. The multi-year decline in non-resident holdings of domestic government bonds has continued, highlighting persistent investor caution during the war (see Figure 38). Domestic banks, which sharply increased their exposure in 2024 by reallocating reserves into benchmark bonds, supported by regulatory changes, have largely stabilized their holdings. Notably, there has been a marked rise in household participation, with holdings doubling to UAH50 billion over the past two years. This shift indicates improving public trust in domestic financial instruments and a deepening of the local investor base, which may support fiscal financing in the medium term.

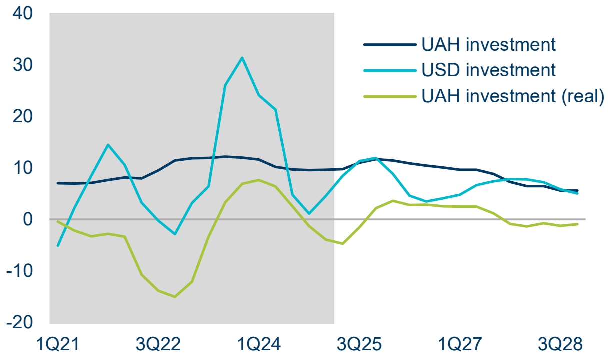
Currently elevated market interest rates are expected to fall in 2027, fueling the post-war recovery and incentivizing investments. The NBU's cautious stance and banks' responsiveness to the policy rate (see Figure 39) has allowed Hryvnia-denominated instruments to offer attractive returns—both compared to foreign currency alternatives and in real terms (see Figure 40). This has helped limit dollarization pressures and sustain savings in UAH. However, beginning in 2027, the NBU's stance—while stimulating spending and bolstering economic activity—will reduce the appeal of domestic savings options.

Figure 39: Interest rates, %



Source: NBU, KSE Institute

Figure 40: Profitability of investments, %



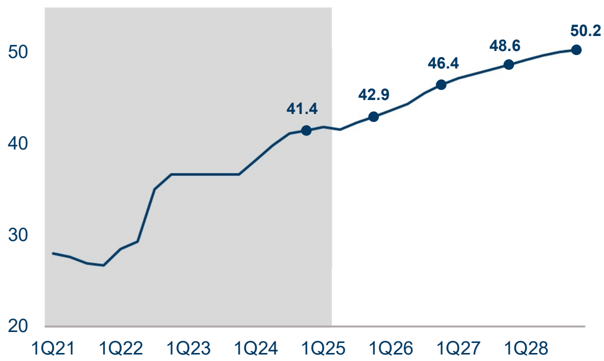
Source: NBU, KSE Institute

Exchange Rate

The Hryvnia has been stable vs. the Dollar while depreciating vs. the Euro in Q2 2025. So far, the NBU has managed to contain volatility through substantial FX interventions. Following a temporary spike to 42.3 UAH/USD in early 2025, the market stabilized around 41.5 during Q2 (see Figure 41), aided by improved exchange rate expectations and the disbursement of significant donor assistance. Interventions reached ~$3 billion per month in Q2 (see Figure 42). As inflation is expected to gradually decline from mid-2025, the NBU will be able to ease the pace of interventions, allowing for moderate depreciation and manageable imported inflation. Expectations, which had deteriorated in early 2025, improved markedly in Q2 (see Figure 43).

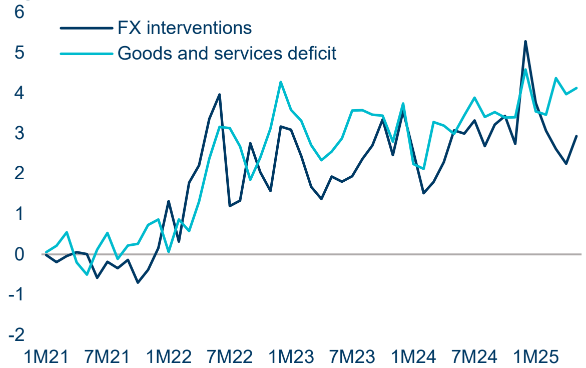
The outlook for the exchange rate in 2026 is becoming increasingly uncertain as the longer war will significantly weigh on market sentiment, external financing conditions, and the NBU's policy space. Despite a temporary rise in gross international reserves to ~$53 billion by the end of 2025, which is driven by front-loaded disbursements of international assistance mechanisms, the lack of sustained external support in 2026 will constrain the NBU's capacity to defend the currency. As a result, reserves are projected to decline sharply throughout 2026 (see *Balance of Payments*). This deterioration will create mounting uncertainty in FX markets and force the NBU to adjust its policy stance regarding the exchange rate.

Figure 41: Exchange rate UAH/USD



Source: NBU, KSE Institute

Figure 42: NBU FX interventions, USD billion

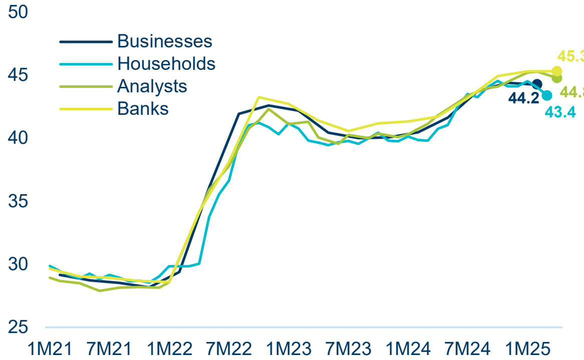


Source: NBU, KSE Institute

The NBU may face a choice between a prolonged, gradual depreciation in 2026, which undermines confidence, or a one-off adjustment that restores clarity in the market in the medium-term. It may ultimately opt for the former to preempt disorderly pressures, minimize prolonged speculative activity, and preserve reserves. This decision would likely coincide with a shift in monetary policy to contain second-round inflationary effects and re-anchor expectations. Although imported inflation may temporarily increase, the overall macroeconomic framework would benefit from a more transparent and credible exchange rate path.

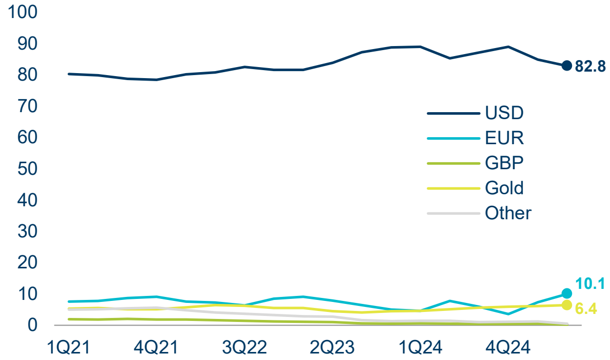
Ukraine's reserves remain heavily skewed towards the Dollar, despite trade and financial integration with the EU. With EU countries now accounting for ~50% of Ukraine's trade, and accession-related alignment continuing, there is increasing debate over the need to rebalance reserves towards the Euro and include it to a larger extent in indicators guiding monetary and FX policies. This would not only reduce volatility vs. the Euro, but also help smooth import price fluctuations. While realignment requires careful calibration, anchoring part of the reserve strategy to the Euro—by increasing the share of Euro holdings (see Figure 44) in line with other European countries—may enhance policy coherence as Ukraine deepens its EU ties.

Figure 43: Exchange rate expectations, 12M ahead



Source: NBU, KSE Institute

Figure 44: Structure of international reserves, %

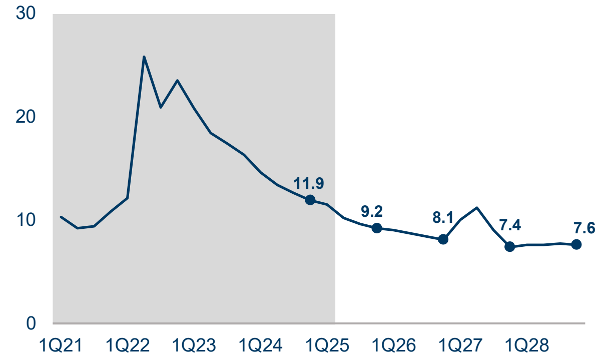


Source: NBU, KSE Institute

Labor Market

Ukraine's labor market continues to show resilience during the war, though structural challenges persist. There are signs of gradual stabilization—with the unemployment rate declining markedly from its Q2 2022 peak of ~25% to ~10% in Q2 2025—demonstrating successful labor market adjustment to the exogenous shocks of war and migration (see Figure 45). Importantly, these dynamics are driven by economic adaptation and demographic shifts rather than purely by an increase in labor demand. Significant demographic pressures and skills mismatches persist, however. The economy's post-war recovery will allow for unemployment to remain at ~7.5%, below its pre-war steady state, despite the return of hundreds of thousands of demobilized soldiers to the labor market. In fact, the demands of reconstruction will require using all available resources, including veterans, IDPs, people with disabilities, and pensioners; the government will likely pursue schemes that incentivize higher labor market participation among these groups.

Figure 45: Unemployment Rate, %



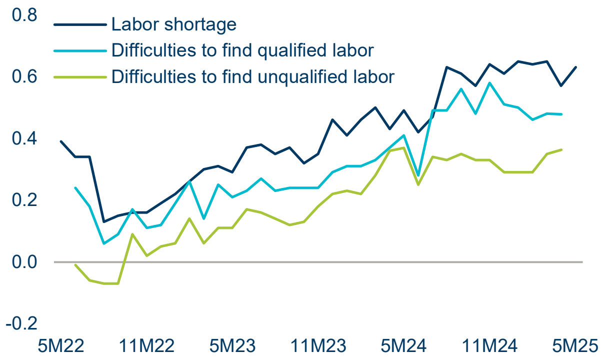
Source: SSSU, Info Sapiens, KSE Institute

Figure 46: Job vacancies and CVs, thousands

Source: SSSU, Info Sapiens, KSE Institute

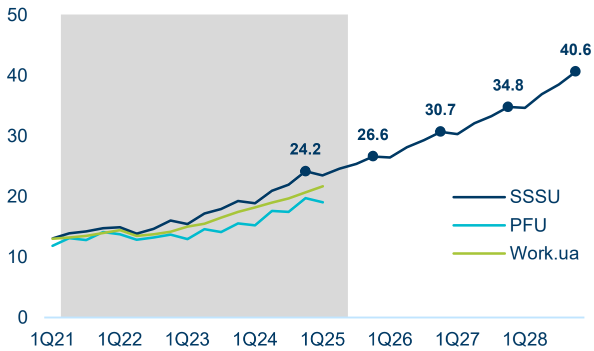
Job vacancy postings and CV submissions both increased in June 2025, with vacancies growing 4% y-o-y and CVs rising 30% y-o-y, thereby widening the once (almost) closed gap again (see Figure 46). This suggests continued labor market dynamism and growing demand from firms that is not backed up by a sufficiently steady supply of workers. Despite the challenges, these developments are rather positive signs—both of economic growth and of companies being more active in the labor market again, with refitted strategies to preserve and attract workers built up in 2022-24. However, **recruitment challenges indices indicate persistent difficulties in finding both qualified and unqualified workers** (see Figure 47). While both indices have been relatively stable throughout 2025, without the significant spikes observed in 2024, they remain elevated and there are growing risks of increases.

Figure 47: Recruitment challenges indices



Source: IER, KSE Institute

Figure 48: Nominal wage, UAH thousands



Source: SSSU, PFU, work.ua, KSE Institute

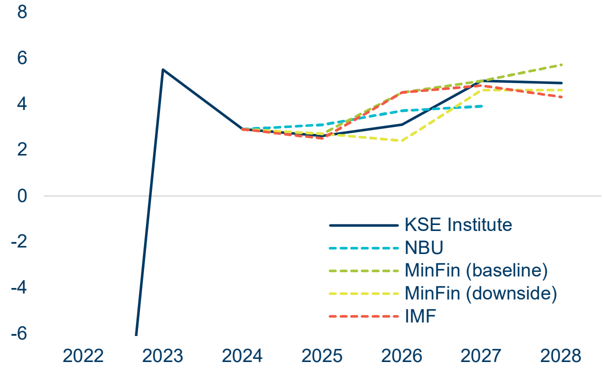
The tight labor market continues to support nominal wage growth, but it is moderating in real terms. Nominal wages continue to rise at a robust pace according to multiple sources, including SSSU, the Pension Fund of Ukraine (PFU), and work.ua (see Figure 48). At the moment, high inflation is weighing on real wage gains, but this situation is expected to change in the coming months. As inflation will likely moderate starting in the second half of 2025 while nominal wages continue to grow at robust rates—reaching ~UAH30,000/month in 2026, and ~UAH40,000/month at the end of the forecast period in 2028—real wage growth will lie around 6-8%. This will allow for strong private consumption, which will support growth.

Forecast Comparison

Growth: assumptions regarding the war's end explain key differences. KSE Institute projects real GDP growth of 2.6% in 2025, 3.1% in 2026, and ~5% annually in 2027-28 as the economy's recovery accelerates after the war (see Figure 49). The NBU, IMF, and MinFin baseline scenarios broadly share our view with regard to the current year and medium-term prospects (although the NBU sees somewhat lower growth in 2027). Forecasts differ considerably, however, for 2026, which we treat as a war year, while the IMF assumes an end to hostilities. The MinFin's downside scenario is the most negative here.

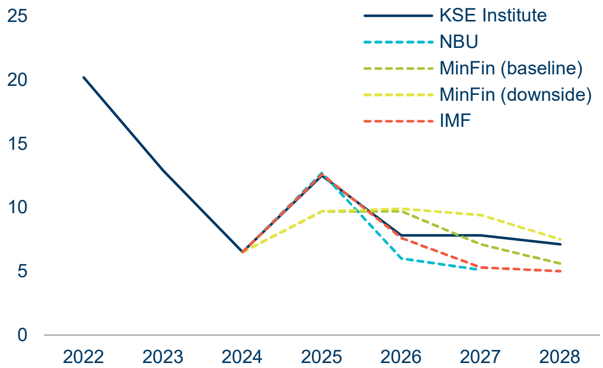
Inflation: there is a consistent expectation of inflation moderating by the mid-2020s. KSE Institute projects higher inflation in 2026-28 than the NBU and in 2027-28 than the IMF; we see significant inflationary pressures during and after the war, and expect the NBU to support the recovery with somewhat looser monetary policy (see Figure 50). The MinFin forecast shows a quicker deceleration of inflation in the 2025 in their baseline scenario and relatively high inflation in 2026-28 in their downside scenario.

Figure 49: Real GDP growth, %



Source: IMF, Ministry of Finance, NBU, KSE Institute

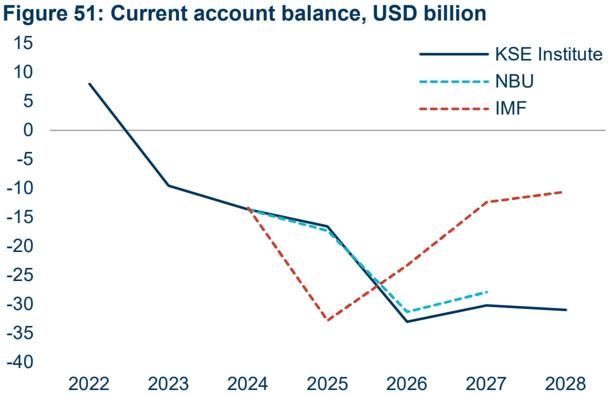
Figure 50: Inflation, % avg



Source: IMF, Ministry of Finance, NBU, KSE Institute

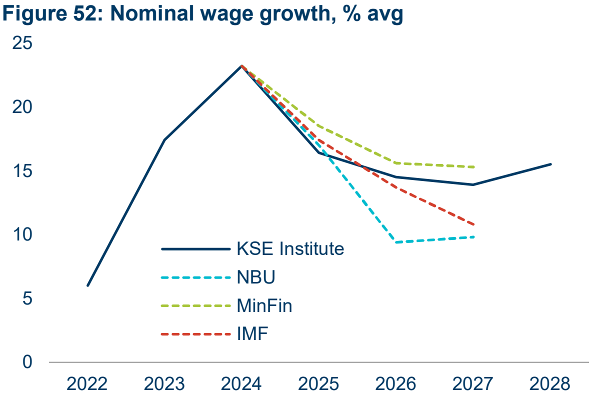
Current account: KSE Institute's forecast consistent with NBU; IMF disagrees. Our projections show a deficit of $17 billion in 2025 (vs. $14 billion last year), followed by a widening to $33 billion annually in 2026-28, which is closely aligned with the NBU's numbers (see Figure 51). The IMF, however, sees a much larger deficit in 2025—likely due to a different assessment of the nature of ERA funds, i.e., grants vs. loans—and a significant narrowing thereafter. While the IMF appears to assume that the war will not extend into 2026, its forecast is fundamentally different for 2027-28, as well. We see the IMF's forecast as overly optimistic, given likely strong demand for imports after the end of the war due to the economy's robust recovery, a sharp drop in foreign grants, as well as other war-related distortions to Ukraine's current account (e.g., lower remittances, higher travel services payments) that will take several years to reverse.

Figure 51: Current account balance, USD billion



Source: IMF, NBU, KSE Institute

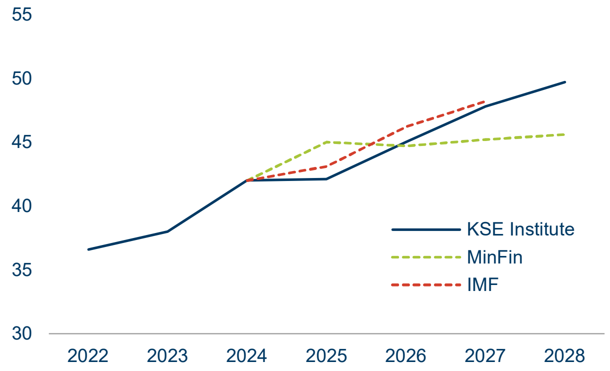
Figure 52: Nominal wage growth, % avg



Source: IMF, Ministry of Finance, NBU, KSE Institute

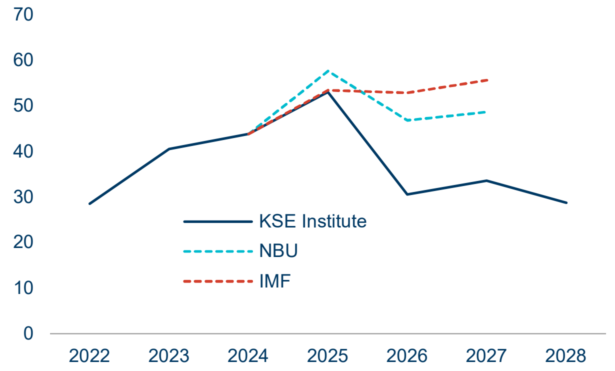
Wage growth: all institutions agree on strong growth due to labor shortages. Firms must pay more to attract workers, and wage growth forecasts for 2025 are within a 16-19% range (see Figure 52). For 2026, KSE Institute, the IMF, and MinFin forecast a moderate slowdown, while the NBU expects a drop to ~10%. The IMF agrees with the NBU regarding 2027, while KSE Institute and MinFin see broadly stable growth. Thereafter, we believe that the economy's robust recovery will put upward pressure on wage growth again.

Figure 53: Exchange rate, UAH/USD



Source: IMF, Ministry of Finance, KSE Institute

Figure 54: Reserves, USD billion eop



Source: IMF, NBU, KSE Institute

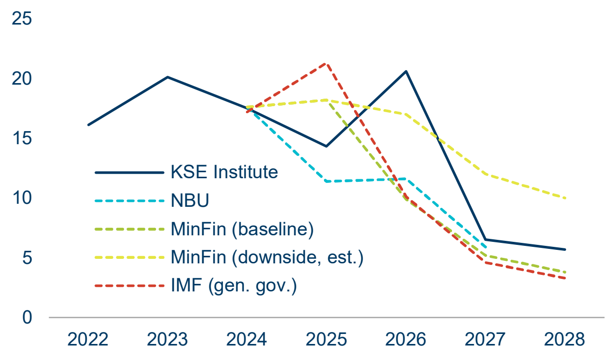
Exchange rate: consensus on moderate depreciation. KSE Institute forecasts the Hryvnia moving from ~42 UAH/USD in 2024 to ~50 in 2028—in line with the IMF's forecast (until 2027) but more pessimistic than MinFin (see Figure 53). The government's budget plans assume a more stable exchange rate of ~45-46 in 2025-28.

Reserves: KSE Institute has a more pessimistic view. Our assessment is driven by the impact of the longer war on the BoP—from goods and services trade to remittances, foreign direct and portfolio investments, and resident capital outflows (see *Special 1*). The resulting external financing gap—if not addressed by additional financial assistance from partners—will weigh heavily on reserves, reducing them to below $30 billion by the end of 2028 (see Figure 54). The IMF and NBU disagree with us, the former due to a different view regarding the war's end. Importantly, the IMF's current forecast is close to our April forecast's numbers, when we assumed the war to come to an end in late 2025. The significant drop in reserves that we project may not ultimately materialize due to further financial support—but no commitments exist as of now.

Fiscal deficit: agreement that budget deficit will remain elevated during the war. Views on the post-war consolidation path are also similar, with the deficit approaching or even falling below 5% of GDP in 2027-28 (see Figure 55). They disagree with us, however, regarding when fiscal consolidation can begin. Based on our assumption that the war will extend deep into 2026, we project a much larger deficit next year (above 20% of GDP) than the NBU, MinFin's baseline scenario, and the IMF (all around 10-12%). MinFin's downside scenario (estimated based on different expenditure numbers and the same revenues as in their baseline) shows much higher deficits during the war and a much slower consolidation path thereafter. Importantly, there are also different projections regarding this year's deficit. As far as the IMF is concerned, this is not surprising as the classification of ERA funds as loans instead of grants (see above) reduces government revenues—and, thus, the deficit—while increasing available financing by the same amount.

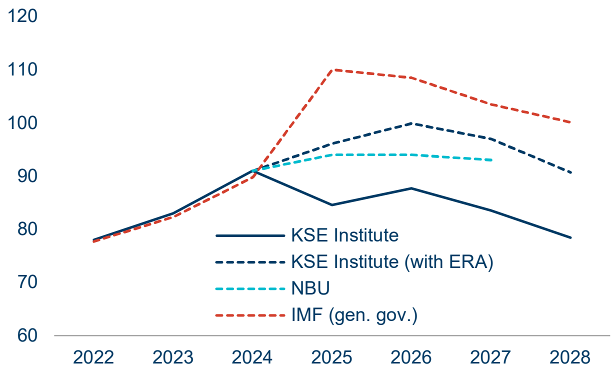
State debt: elevated debt-to-GDP ratios for the foreseeable future. KSE Institute projects state debt to rise to ~100% of GDP in 2026 before declining to around 90% in 2028 (see Figure 56). The IMF's numbers are not fully comparable as they cover general government debt. The NBU sees a somewhat lower debt-to-GDP ratio over the forecast period. All institutions fundamentally agree, however, that the key to debt sustainability will be a combination of robust economic growth, significant fiscal consolidation after the war, and restructuring of existing debt. In addition, the design of future financial support is of critical importance.

Figure 55: Budget deficit, % GDP



Source: IMF, Ministry of Finance, NBU, KSE Institute

Figure 56: State debt, % GDP



Source: IMF, NBU, KSE Institute

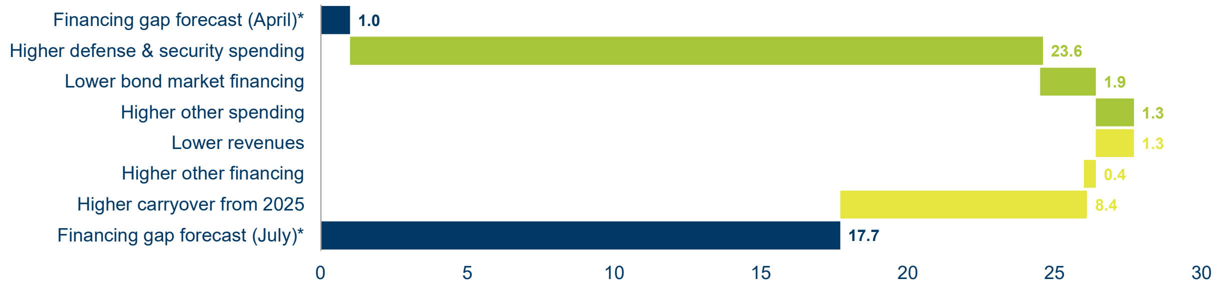
Special 1: Cost of a Longer War

As we discussed in previous chapters, the revised assumption that the war will end in late 2026 rather than late 2025 has major implications for our macroeconomic forecast. This includes lower economic growth, much larger fiscal and external financing gaps, as well as altered trajectories for inflation, the Hryvnia exchange rate, and monetary policy. The forecast revisions are summarized in Table 7. T**he longer war means that currently committed levels of support from partners will not be sufficient to allow Ukraine to continue resisting Russian aggression without jeopardizing macroeconomic stability.**

Real GDP growth in 2026 is expected to be 2.6pp lower than previously forecast (3.1% vs. 5.6%). The additional year of war will impact economic activity in several ways, including by (i) increasing the amount of destruction to infrastructure and productive capacities, (ii) shifting important resources from future-oriented investments to urgent repairs, (iii) weighing on foreign investors' sentiment and capital inflows, (iv) delaying partial demobilization and the return of refugees from abroad, and (v) requiring tighter monetary policy as fiscal deficits remain elevated due to higher defense funding needs.

The fiscal financing gap in 2026 is now projected to reach $17.7 billion (vs. $1.0 billion expected in April). The most important driver is significantly higher defense and security spending to withstand Russian aggression for an additional year (+$23.6 billion), with lower financing from foreign investors (-$1.9 billion) and somewhat higher other expenditures (+$1.3 billion) also playing a role. The gap is reduced by a larger carryover of financing disbursed in 2025 (+$8.4 billion) thanks to higher expected absorption of domestic debt issuance by Ukrainian banks and households. For a summary of contributions, see Figure 57.

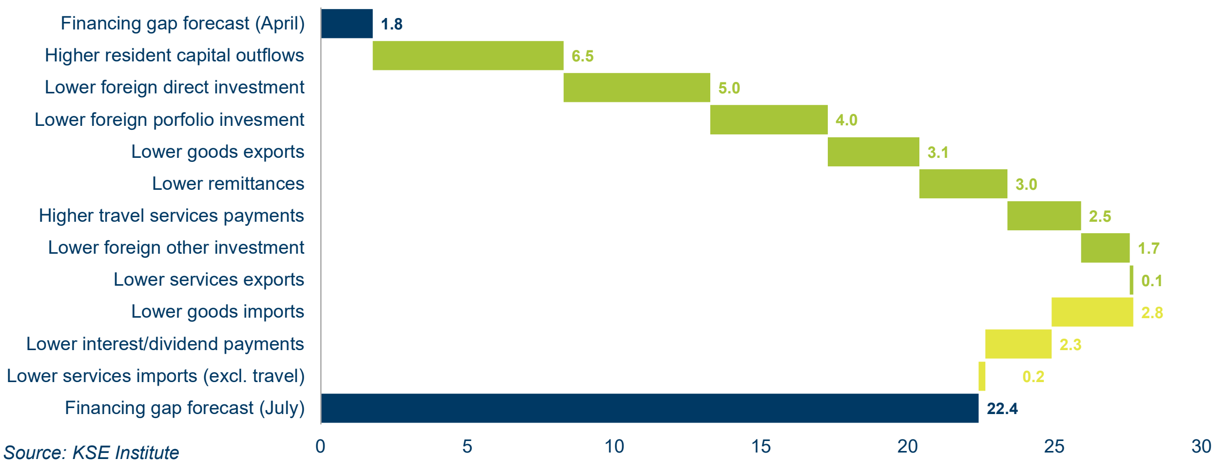
Figure 57: Change in fiscal financing forecast for 2026 (vs. April publication)



*Source: KSE Institute *includes available financing carried over from 2025*

The external financing gap in 2026 is now projected to reach $22.4 billion (vs. $1.8 billion expected in April). Several factors contribute to this change, including lower foreign direct investment (-$5.0 billion), foreign portfolio investment (-$4.0 billion), goods exports (-$3.1 billion), remittances (-$3.0 billion), foreign other investment (-$1.7 billion), and services exports (-$0.1 billion), as well as higher resident capital outflows (+$6.5 billion) and payments for travel services (+$2.5 billion). Lower goods imports (-$2.8 billion), interest and dividends payments (-$2.3 billion), and payments for non-travel services (-$0.2 billion), provide some support to Ukraine's external accounts. For a summary of contributions, see Figure 58.

Figure 58: Change in balance of payments forecast for 2026 (vs. April publication)



Source: KSE Institute

Debt will rise more than previously estimated; however, by definition, there is no impact from an unfinanced budget gap since no additional external or domestic borrowing occurs. We primarily project higher net issuance of domestic sovereign debt in 2025, even without foreign investor demand, due to increased purchases by Ukrainian banks and households. In 2026, less interest from foreign investors due to the ongoing war will, in fact, reduce total debt compared to our previous forecast, as prospects for net issuance are more limited. Regarding the 2026 budget gap, if additional foreign funding is secured and this funding is provided in the form of loans (not grants), debt as a share of GDP would climb to nearly 108% in 2026 before declining modestly to ~97% by the end of the forecast period. Thus, it is critical for Ukraine's partners to set up further support schemes in a way that safeguard debt sustainability.

Another year of war will put additional pressure on the exchange rate due to higher financing needs and elevated risk premia. As the longer war will also accelerate the depletion of international reserves, the NBU will likely be forced to allow some currency depreciation in 2026. **In turn, a weaker Hryvnia will generate inflationary pressures**, further amplified by an additional year of destruction caused by Russian attacks. At the same time, these effects will be partially offset by weaker economic activity, particularly subdued private consumption, weighing on aggregate demand, and a broader disinflationary trend following last year's high base. **This environment will enable the NBU to gradually soften its monetary policy**, though the central bank is likely to remain conservative given the heightened risks.

Table 7. Summary of changes to forecast vs. April publication*

	2024	2025f	2026f	2027f	2028f**
Economic activity					
Real GDP growth, %	2.9 *(-)*	2.6 *(-0.2)*	3.1 *(-2.6)*	5.0 *(-0.6)*	4.9
Nominal GDP, $ bn	*190.7* *(-)*	*212.8* *(+3.5)*	*224.8* *(+2.7)*	*242.2* *(-9.0)*	265.3
Fiscal accounts, $ bn					
Budget revenues	78.3 *(+1.1)*	84.6 *(+5.2)*	67.9 *(+1.3)*	70.2 *(-0.8)*	71.3
Budget expenditures	111.7 *(+2.7)*	115.1 *(+2.2)*	114.2 *(+24.9)*	85.9 *(-1.0)*	86.6
o/w defense & security	74.6 *(+5.3)*	75.2 *(+3.5)*	73.7 *(+23.6)*	45.4 *(-1.7)*	45.0
Budget deficit	33.4 *(+1.6)*	30.5 *(-3.0)*	46.3 *(+23.6)*	15.7 *(-0.3)*	15.3
Fiscal financing gap	0.0 *(-)*	-13.5 *(-8.4)*	31.2 *(+25.1)*	-0.9 *(+0.1)*	11.1
Total state debt, $ bn***	159.2 *(-)*	204.5 *(+9.0)*	224.7 *(+26.5)*	235.0 *(+21.0)*	240.6
Debt, % GDP***	84.6 *(-1.8)*	96.1 *(+2.1)*	99.9 *(+7.6)*	97.0 *(+5.6)*	90.7
Balance of payments, $ bn					
Current account balance	-13.7 *(-)*	-16.6 *(-2.6)*	-33.0 *(-3.5)*	-30.2 *(0.3)*	-30.9
Non-resident capital flows	29.0 *(-)*	44.7 *(-2.1)*	23.7 *(-10.7)*	39.7 *(+1.9)*	30.2
Resident capital outflows	17.7 *(-)*	16.8 *(-)*	13.1 *(+6.5)*	6.6 *(+2.5)*	4.1
External financing gap	-2.9 *(-)*	-11.3 *(+4.7)*	22.4 *(+20.6)*	-2.9 *(+0.3)*	4.8
Total reserves	41.7 *(-)*	53.0 *(-4.7)*	30.5 *(-25.3)*	33.4 *(-25.7)*	28.7
Monetary sector					
Exchange rate, UAH/$ (avg.)	40.2 *(-)*	42.1 *(-0.5)*	45.0 *(-0.9)*	47.8 *(+1.7)*	49.7
Headline inflation, % (avg.)	6.5 *(-)*	12.5 *(+0.7)*	7.8 *(+0.3)*	7.6 *(+2.1)*	7.1
Policy interest rate, % (avg.)	13.7 *(-)*	15.0 *(+0.1)*	13.4 *(-0.3)*	10.0 *(-1.0)*	8.0

**Shown are the revised numbers as well as the change vs. April in parentheses*
***2028 not included in April forecast*
****Includes ERA but only existing/committed assistance mechanisms*

Special 2: Financing Defense

Our baseline scenario illustrates the serious budget financing challenges stemming from higher defense spending during a longer war. But even after a ceasefire, significant funds will be required to put Ukraine in a position to deter and/or confront future Russian attacks. Assuming hostilities subside by the end of 2026, a fundamental restructuring of the financing model will have to take place. In its absence, constrained domestic resources will either leave Ukraine's defense perilously underfunded or lead to an erosion of macroeconomic stability, thereby jeopardizing the post-war recovery. After total defense spending of ~$70 billion per year in 2024-26, we expect total defense needs of $68-105 billion each in 2027-28.

Material and technical assistance from partners will remain a critical pillar of Ukraine's defense financing. However, a significant reduction in allocations from mechanisms such as the PDA (Presidential Drawdown Authority) and USAI (Ukraine Security Assistance Initiative) is anticipated due to shifts in US foreign policy. To partially offset this decline, European partners are expected to increase their contributions by purchasing US-manufactured equipment with their own budgetary and financial instruments. Overall, international military aid is projected to reach ~$21 billion annually during 2025–26. However, the heavily frontloaded disbursement schedules of the EU's Ukraine Facility, the ERA initiative, and the IMF program mean that budgetary support will drop sharply in 2026-27 and almost completely disappear in 2028.

The future financing framework should rely on a three-component model. *First*, direct budgetary funding is projected at $17.5 billion annually, $10 billion of which supporting a standing force of approximately 350,000 personnel, with the remaining $7.5 billion allocated to developing a reserve force and providing logistics, education, and training. *Second*, a new generation of international support mechanisms should be activated—designed to avoid direct budgetary injections and minimize impacts on Ukraine's macroeconomic stability and public debt—with projected annual inflows around $28-35 billion, primarily for military equipment.

The *third* component envisions a forward-looking partnership model in which Ukraine receives full and unconditional access to military equipment stockpiled by partner countries. These assets, while formally held abroad for allied defense readiness, would be made available to Ukraine in the event of renewed aggression. Annual commitments from this mechanism could reach $23-53 billion. Altogether, the proposed structure would provide resources for defense and security of $68-105 billion annually during 2027–28, with $17.5 billion sourced directly from the Ukrainian budget and the remainder through various international support instruments. This model aims to enhance strategic resilience while maintaining macro-fiscal sustainability.

Source of Financing	Type		Amount (USD billion/year)					Description / Role	
	Ceasefire scenario	During the wartime	2024	2025	2026	2027 (ceasefire scenario)	2028	Ceasefire scenario	During the wartime
Ukraine National Budget (expenditure is financed exclusively through domestic revenues of the state budget, without accounting for international financial or military assistance.)	Direct fiscal expenditure	Compensation of Employees (military salary)	24,9	24,9	23,9	10	10	Covers full personnel costs (350,000 people after demobilization) and partial costs for training reservists (up to 2.5 million people of the reservist corps), logistics and veterans	Covers full costs for personnel, procurement of weapons, training and education of recruits, social component, etc.
		Goods and Services (medicine, nutrition, etc.) and other	15,9	15,9	15,3	7,5	7,5		
		Current Transfers (purchasing of military equip.)	9,4	9,4	9,0				
Partner Financing / Special Instruments (international material and technical support provided through the mechanisms of the special fund of the state budget, programs - PDA, USAI, ERA, etc)	Grants, in-kind, concessional loans	Goods and Services (special fund - international assistant)	20,6	21	21	28–35	28–35	Co-financing for reservist training, equipment procurement, logistics, and support	Receipts from international partners of military equipment, equipment, logistical costs, intelligence, etc.
Shared European Weapon Stock	Prepositioned, in-kind access					23–53	23–53	Strategic reserves and stockpiles held by partners, usable by Ukraine during crises	
Total Available Defense Resources	—	—	70,8	71,3	69,3	68–105	68–105	Sum of domestic + external budgetary + in-kind military support	Sum of domestic + external budgetary + in-kind military support

**The total amount of in-kind contributions depends on the valuation of military equipment, and 2024 numbers could be as high as $45 billion. With the increasing depletion of stocks and subsequent shift to newly-produced items, costs per unit will likely increase—and similar amounts buy fewer items*