Macro Insight

Larger Financial Aid Buys More Time for Economy to Adjust

17 APRIL 2025

Ukraine's economy has been in a sluggish recovery mode since 3Q24, and chances for a significant near-term acceleration are slim. The need to cut the fiscal deficit and budget expenditures will significantly restrain GDP growth going forward. We see economic growth close to 3% this year and next, supported by recovery in household consumption and higher agricultural output. Inflation is set to start decelerating rapidly from June on last year's high base and larger supply of agricultural harvest. We see good chances of consumer prices slowing to 7-8% at the end of 2025, supported by weaker growth in domestic demand, a relatively stable exchange rate, and cheaper food products. The NBU will keep its tight monetary policy stance unchanged until September and will likely deliver three 50bp cuts thereafter to end the year reaching 14%. The revised schedule of foreign aid commitments revealed by the IMF is a huge positive surprise for Ukraine. The aid package has been increased by US$15bn vs. the December plan, and the supply of loans/grants became much more frontloaded. Ukraine should receive over US$50bn in 2025, implying a spike in NBU reserves and strengthened central bank firepower to keep the hryvnia strong. We upgrade our end-2025 exchange rate projection to UAH43.5/US$. A larger financial aid package implies the economy now has more time to tackle its surging imbalances of external accounts. Should inflows of financial aid subside substantially beyond 2025, the pressures in the FX market will rise and the NBU will likely need to resort to relatively significant hryvnia devaluation. The state budget financing looks to be fully secured for 2025, even though some increase in expenditure targets is likely in 3Q. Yet, the visibility for 2026 in terms of deficit financing is very low at this point. Our projections assume no significant changes in the balance of safety risks over the 12-month horizon. We believe that even if a ceasefire agreement is reached soon, the hostilities on the frontline and russian attacks on civil infrastructure all over Ukraine will not subside completely. Ukrainian businesses and households will continue to operate under great uncertainty that will weigh on their sentiment and activities.

Economy slows dramatically since 3Q24

After a relatively upbeat recovery in 2H23–1H24, the Ukrainian economy switched to sluggish growth since 3Q24. Economic growth even turned marginally negative at 0.1% YoY in 4Q24, ending full 2024 with a 2.9% increase (preliminary UkrStat estimate that may be adjusted by end-2025). Agriculture, hit by last year's unprecedented draught, was apparently the key drag on economic growth. Two other sectors that saw contraction were (surprisingly) trade and (expectedly) power generation affected by russia's destruction of production and distribution capacities.

Key macroeconomic data and projections

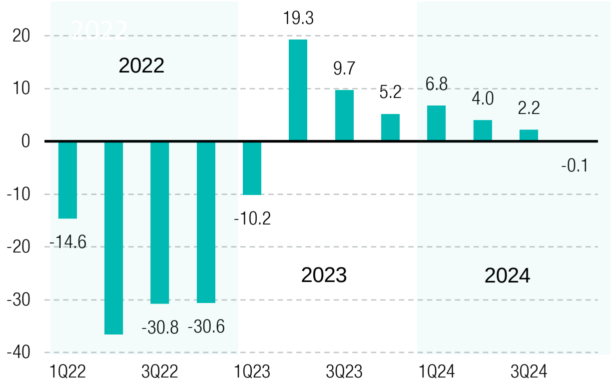
	2025F	2026F
Real GDP, YoY, %	3.0	3.0
Nominal GDP, US$bn	205	213
Inflation, YoY, %, e.o.p.	7.6	8.0
Key policy rate, %, e.o.p.	14.0	12.5
UAH/USD, e.o.p.	43.5	47.9
C/A balance, % of GDP	(13.0)	(12.5)
NBU reserves, US$bn	56.2	32.8
Budget gap, % of GDP*	(20)*	(15)*
Public debt, % of GDP	110	112

* budget balance before official grants to government
Source: NBU, UkrStat, ICU

On the demand side, the only significant contributor to last year's economic growth was the private consumption of households that surged 6.8% YoY (even though it slowed to 4.2% YoY in 4Q) supported by increases in salaries in the private sector. Gross fixed capital formation also had a positive but far less significant contribution. Meanwhile, government consumption and net exports weighed on economic growth and their contribution to real GDP was negative. The 2024 data show that Ukraine's war economy remains reliant on the government sector whose share in total consumption stood at 38%, far above the 18% in 2021. On the production side, state governance, including defense, contributed about 20% to GDP, up from 6% in 2021.

The preconditions for near and mid-term economic growth are not particularly encouraging, providing no major improvement in the safety situation takes place. The key problem facing the economy over the next three years is the need for the government to reduce the fiscal deficit and, subsequently, consumption. Fiscal consolidation is inevitable as the size of foreign financial aid (relative to GDP) to Ukraine is going down and an extremely large fiscal gap cannot be sustained. The state budget deficit (before grants) will decrease from 24% of GDP in 2024 to likely 19-20% in 2025 and further to 14-15% in 2026. A significant related reduction in government consumption (primarily on defense) will be difficult to compensate.

Chart 1. Real quarterly GDP, change, YoY



Source: UkrStat, ICU.

Table 1. Structure of GDP by demand-side components

GDP component	Real change in 2024	Share in nominal GDP* 2024	2021
Household consumption	6.8%	60.6%	68.2%
Government consumption	-4.5%	37.9%	17.7%
Gross fixed capital formation	3.5%	18.9%	13.2%
Exports	10.3%	29.4%	40.7%
Imports	7.7%	-48.3%	-42.0%
GDP	**2.9%**		

* shares may not add up to 100% due to omitted other minor components.
Source: UkrStat, ICU.

Private consumption of households will be the key driver of economic growth in the coming years. It is set to slow from last year's 6.8% rate, but will remain quite strong supported by robust growth of wages in the private sector. Tightness of the labor market will not lessen any time soon, and the demand for labor will far exceed the supply. Yet, a related offsetting effect of a stronger domestic demand on economic growth will come from a surge in imports. We expect imports will continue to outpace exports in the coming years, implying a negative contribution of foreign trade to economic growth. We don't expect a rapid and significant increase in exports even if the safety situation improves markedly. Export-oriented companies don't face binding logistics problems at the moment. The key constraints are on the production and/or demand side (tariff / non-tariff barriers of trading partners also play a role), so lower safety risks won't boost exports if other constraints remain in place.

We downgrade our 2025 GDP growth projection to 3.0% from 3.4% previously. Agriculture will likely be the key growth engine this year if we don't see a repetition of extremely unfavorable weather conditions. In our baseline scenario, we also see the same rate of growth over 2026. A ceasefire agreement and a related reduction in safety risks may bring about a number of positive effects: better consumer and business confidence, partial return of refugees, and a launch of large-scale infrastructure projects. Yet, this scenario also likely implies more fiscal consolidation efforts. A positive safety scenario may add another 1.5–2.0pp to economic growth in 2026, but very unlikely more than that.

All in, we think chances of principal increase conditions for Series B Eurobonds is very unlikely to be met as the chances of Ukraine's GDP crossing the threshold in 2028 are nominal.

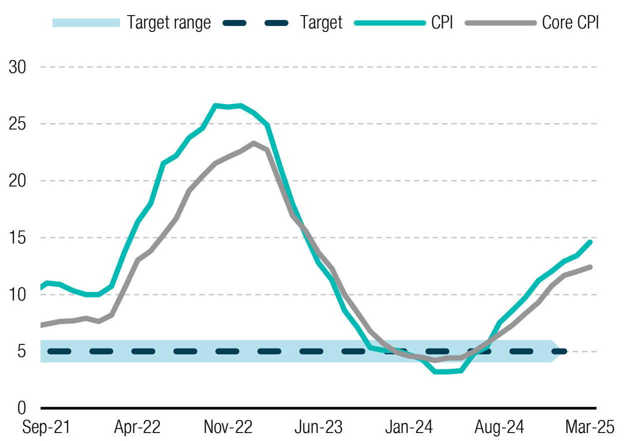
Price growth to decelerate notably from June

Inflation keeps delivering negative surprises as consumer price growth accelerated to 14.6% YoY in March. Undoubtedly, last year's poor harvest of fruits, vegetables, grains, and oilseeds is the main culprit of high inflation. Food and non-alcoholic beverages contributed about 7pp to annual inflation. Yet, over the past 12 months we've seen a series of many other unfavorable factors that also helped fuel inflation. Administrative hike in electricity tariffs last June contributed 1.0pp to the current inflation. Stricter administrative controls and upcoming excise tax hikes pushed the prices of alcohol and tobacco much higher, with their combined contribution to inflation at 1.3pp. More pressures came from the decision of mobile operators to revise tariffs well above what was a usual rate of increase over the past years (partly due to the need to secure uninterrupted operations during blackouts) and from a hike in motor third-party liability insurance due to administrative requirements. The factors behind a spike in inflation are diverse, and they stem from many sources. Yet, many of them have some commonalities like production cost pressures, including those originating from higher energy and labor costs, and relatively strong consumer demand.

Despite a significant acceleration in inflation it's safe to say that price trends are not spinning out of the control, and there are many bright spots: prices for cloths and foot wear are down in YoY terms, prices of white goods and electronics are only marginally up, and motor fuels prices are only 10% higher YoY despite a significant rise in excise tax. Reasonable price changes for the above goods are supported by a relatively stable exchange rate of hryvnia.

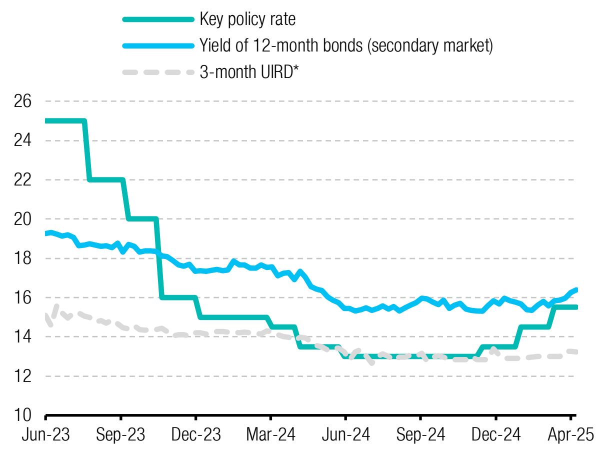
We expect a significant deceleration of inflation starting from June on high base effects if government doesn't choose to deliver another hike in electricity or gas tariffs and weather conditions are supportive for the harvest. Inflation is likely to peak close to 15% in 2Q before embarking on a fast decelerating trend. Other supporting factors will include a slowdown in household incomes, a strong hryvnia and still weak consumer confidence. Yet, given higher-than-expected inflation in 1Q, we revise end-2025 projection to 7.6% from a previous 7.0%.

Chart 2. CPI, core CPI and inflation target, YoY, %



Source: NBU, ICU.

Chart 3. NBU key policy rate and commercial rates, %



* Ukrainian Index of Retail Deposit Rates

Source: NBU, ICU.

Monetary policy focus will shift from price to exchange rate stability by end-2025

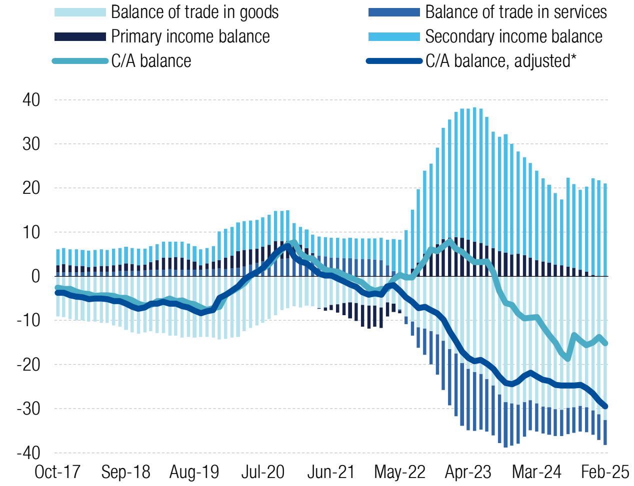
The NBU's decision to hike the key policy rate by a cumulative 250bp since Dec. 2024 to 15.5% was a delayed reaction to inflation risks that have by now nearly fully materialized. Despite very high chances of inflation slowing rapidly from June, we now don't expect the NBU to move fast to change its monetary policy stance. It'll take months for the monetary policy decisions of the NBU (including a key policy rate hike and a broader utilization of three-months CDs) to have a visible effect on deposit rates of banks. Some of Ukraine's largest banks plan to revise rates from May and smaller banks may follow with their responses in subsequent weeks. Technically, such a lagged response of the banking sector makes any reversal of monetary policy stance in June or July simply impossible. That would create a lot of confusion and inconsistency of messages for banks. We thus expect the NBU will switch to a loosening stance in September. Our current baseline scenario envisages three 50bp cuts to 14.0% by the end of the year. We think the probability of bigger cuts is very low despite an expected slowdown in inflation. The NBU will likely want to keep the key policy rate relatively high to counter possible higher pressures in the FX market from 1Q26. The central bank remains clearly reluctant to weaken the hryvnia now (and it now has ample firepower to protect the hryvnia), but it will likely have to deal with higher pressures beyond 2025.

The transmission of hikes in the key policy rate to commercial rates has been muted so far. Banks increased their three-month deposit rates by 30-40bp since December vs a cumulative key policy rate hike of 250bp, but more is to come in May. The Ministry of Finance has been more responsive and revised yields on bonds in the primary auction by exactly half of the increase in NBU rate (excluding yields on reserve bonds that are detached from the policy rates). While yields on normal and military bonds were up by 125bp in the primary market (though placements have remained insignificant so far), the transmission to the secondary market was weaker, at 60–80bp, and even smaller to the retail segment. Banks increased yields on bonds offered to individuals by about 50–75bp. We expect the MinFin will maintain its pattern of response to the changes in the key policy rate. This implies a possible decline in bond yields in the primary auctions by about 75bp in 2H25, implying only insignificant changes in the retail segment.

Imbalances of external accounts will remain huge in the coming years

Imbalances of Ukraine's external accounts remain unprecedented and will pose a major risk for Ukraine's economy if foreign financial aid is reduced substantially in the future. In 2024, the country's export of goods was 38% below the pre-war level of 2021. The smooth functioning of sea cargo routes is definitely a big facilitator of export, but the volumes are now restricted by supply and/or demand factors rather than by logistical constraints. Meanwhile, 2024 import returned exactly to the 2021 level and, importantly, official import statistics includes only a small part of military equipment supplied by Ukraine's allies. The balance of foreign trade in services is also a concern as imports are up 58% vs 2021, primarily due to expenditures of Ukrainian refugees abroad (recorded as import of tourism). Trade in services turned to a huge deficit of 7% of GDP in 2022 (first year of full-fledged war) and then more than halved in 2024, but the narrowing of the deficit largely came on the back of tighter capital controls / AML rules imposed by the NBU. Trends of primary income are also concerning as remittances are shrinking rapidly (-43% in 2024 vs 2021), likely reflecting weakening ties of migrants with Ukraine.

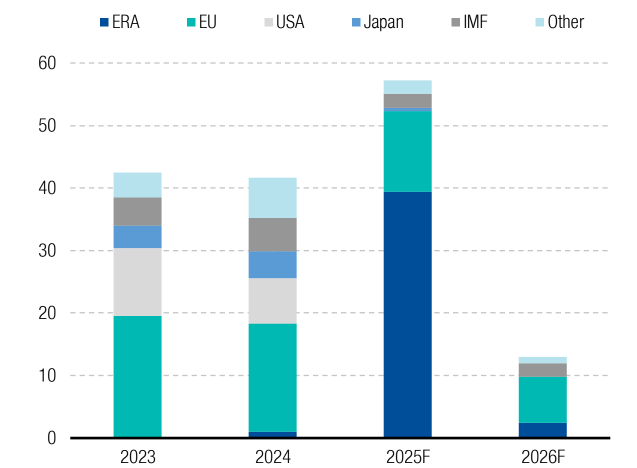
Chart 4. Current account, 12-month trailing, US$bn



* net of official transfers to the government

Source: NBU, ICU.

Chart 5. Foreign financial aid to Ukraine, US$bn



* ERA stands for Extraordinary Revenue Acceleration Facility and is provided by G7 countries.

Source: IMF, ICU.

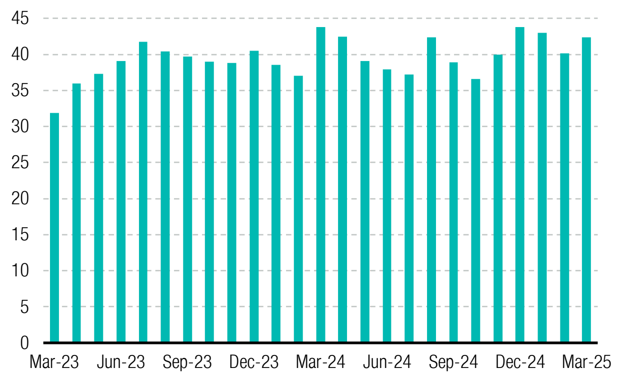
Given the above, Ukraine's current account deficit widened to above 11.5% of GDP in 2023-24, excluding budgetary grants provided by foreign partners (recorded as secondary income inflows). This is way above an average of 3% over the decade preceding russia's full-scale invasion. We see the C/A deficit remaining in the range of 12–13% of GDP this year and next. With the ERA facility being classified as loans by the NBU and MinFin, foreign aid will not technically reduce the C/A shortfall (contrary to our earlier expectations). A possible reduction of safety risks is very unlikely to bring any significant relief for the current account. Any return of refugees and lower consumption abroad (lower import of services) will likely be offset with higher commodity imports on the back of strengthening consumer confidence and demand.

On the financial account side, FX cash outflows from the banking sector remain the key drag (8.6% of GDP in 2024). This represents household and shadow business demand for hard currency, and it remained at an elevated level over the past years. Excluding cash outflow from banks and foreign concessional loans to the government, the net balance of other financial-account components was close to zero in 2024. This results from tight capital controls imposed by the NBU that effectively prohibit repayments of the vast majority of private credit. Trapped credit will pose another major risk for the economy when the NBU decides to gradually unwind the restrictions. All in, the persistently high C/A deficit, significant FX cash outflows from banks and significant accumulated overdue debt of the private sector will need to be tackled in the coming years.

Foreign aid package for Ukraine increased substantially

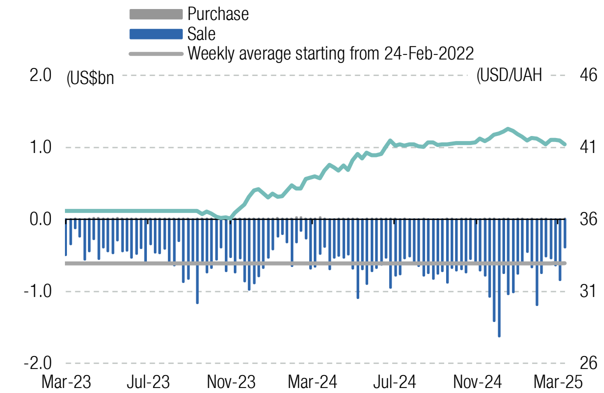
The revised IMF memorandum released upon completion of the 7th EFF program review shows a substantial increase in financial aid commitments to Ukraine. The total ERA packaged destined as direct budget aid is revised up by US$11bn vs. the December version to US$44.1bn. Additionally, the document mentions new potential contingent financing of US$4bn. Another noticeable change is that a larger part of foreign financing will be frontloaded and disbursed in 2025. Overall, US$57.2bn in direct budget support is scheduled to arrive to government coffers until the end of the year (US$10.1bn of that amount cannot be spent in 2025 and must be kept as government liquidity reserve for future periods). An expansion of the foreign financing aid has major implications for NBU reserves and the NBU's behavior in the FX market in the next 12–18 months. With a significant boost to financial aid coming from allies, we now expect NBU gross international reserves to reach US$56bn at the end of 2025 that will, in turn, provide a boost in the NBU confidence that it is fully able and should maintain the hryvnia exchange rate at a relatively high level.

Chart 6. NBU gross international reserves, US$bn



Source: NBU, ICU.

Chart 7. UAH/US$ rate and NBU weekly interventions



Source: NBU, Bloomberg, ICU.

Near-term outlook for hryvnia exchange rate improves; FX risks pushed back to 2026

The NBU has clearly been reluctant to pursue gradual, managed hryvnia depreciation since July 2024. This stance can be partly explained by its intention to use (quite reasonably) the exchange rate instrument to moderate CPI growth. Yet, based on central bank messages and actions, we see very little or no appetite for a weaker hryvnia despite surging external imbalances (net of foreign aid). The recent increase in the foreign aid package will only enhance the central bank's firepower and intention to keep the hryvnia exchange rate close to the current level. Given this, we upgrade our end-2025 projection of the hryvnia exchange rate to UAH43.5/US$ from our previous projection of UAH45.7/US$. While this definitely bodes well for inflation, the flipside is persistence and a likely further increase in external imbalances. The key question today is what the future of foreign financial aid beyond 2025 is. The IMF program envisages a significant decline in concessional loans / grants in 2026, and the prospects for a further substantial increase in commitments from allies is limited, in our view. Beyond 2026, the key hope is progress with regard to confiscation of russian assets. If a substantial reduction in foreign aid becomes a reality beyond 2025, the central bank will have no choice but to switch to a much faster weakening of hryvnia in anticipation of growing pressures on the FX market. We thus believe that the deficit in the FX market and hryvnia stability concerns will increase substantially by the end of 2025 and in 2026.

Fiscal consolidation continues at a gradual pace

Declining foreign financial aid (in relation to GDP) leaves no other option for the government but to pursue a gradual fiscal consolidation. The state budget deficit contracted to 24% of GDP in 2024 from 27% in 2023. The plan for 2025 is even more ambitious, and we see a deficit of 20% (slightly above the government target of 19%). The contraction in government expenditures is going to be less substantial than the contraction in the deficit as lower foreign aid (and fiscal deficit) will be partly compensated for with higher tax and non-tax collections. Yet, the expected slump in foreign aid in 2026 will present new challenges. We don't see how the IMF assumption of state budget deficit being halved to about 10% of GDP in 2026 can become a reality.

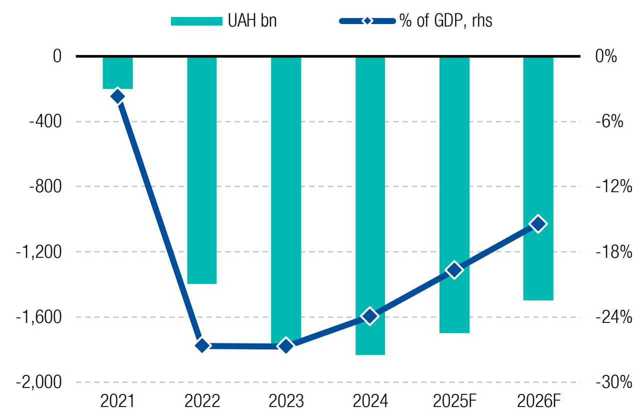
Table 2. Key parameters of state budget, UAHbn

	2024*	2025*
Total revenues (before grants)**	1,904	2,327
incl. tax revenues	1,647	1,995
Expenditures	3,742	3,929
inlc. defence and security	2,252	2,225
Budget balance (before grants)	-1,832	-1,641
Total revenues / GDP	24.9%	26.9%
incl. tax revenues / GDP	21.5%	23.1%
Expenditures / GDP**	48.9%	45.5%
Budget balance (before grants) / GDP	-23.9%	-19.0%
Total revenues / expenditures	50.9%	59.2%
Tax revenues / expenditures	44.0%	50.8%
Defence, security / total expenditure	60.2%	56.6%

* actual data for 2024 and budget law targets for 2025 (may differ from ICU projections). ** excludes foreign military aid in kind

Source: MFU, ICU.

Chart 8. State budget balance before grants



Source: NBU, ICU.

We expect foreign concessional grants and loans will be sufficient to cover over 90% of the 2025 budget deficit, with the remainder being covered with domestic borrowings. The next year remains a big question mark and lack of foreign financial aid will force the MinFin to increasingly rely on domestic borrowings.

Ukraine's public debt is set to spike close to 110% of GDP this year from 91% at the end of 2024. This will come on the back of borrowings via the ERA facility from G7 countries (so far it is classified as loans even though it will be rapid with income on russia's frozen assets) and the Ukraine Facility from the EU. Yet, if ERA is excluded from public debt statistics, we'll see an increase of the debt-to-GDP ratio to around 94%, implying only a marginal uptick from 2024. High indebtedness does not pose any major liquidity risk for Ukraine in the near future. Yet, high debt ratios will definitely need to be addressed once the safety situation improves and Ukraine is able to slash military expenditures.

Yearly forecast 2025-26

	Historical data for 2015–2024										Forecast	
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Activity												
Real GDP (%, YoY)	(9.8)	2.4	2.5	3.4	3.2	(4.0)	3.4	(29.1)	5.5	2.9	3.0	3.0
Nominal GDP (UAHbn)	1,989	2,385	2,984	3,561	3,978	4,194	5,460	5,191	6,628	7,659	8,638	9,742
Nominal GDP (US$bn)	90	93	112	131	155	155	200	161	181	191	205	213
Unemployment (%)	9.1	9.3	9.5	8.8	8.2	9.5	9.8	28.0	18.2	15.0	12.0	10.0
Inflation												
Headline inflation (%, YoY, e.o.p)	43.3	12.4	13.7	9.8	4.1	5.0	10.0	26.6	5.1	12.0	7.6	8.0
Headline inflation (%, YoY, avg.)	48.7	13.9	14.4	10.9	7.9	2.7	9.4	20.2	12.9	6.5	12.0	7.8
GDP deflator (%, YoY)	38.9	17.1	22.1	15.4	8.3	9.8	25.1	34.3	19.9	12.3	9.5	9.5
Exchange rates												
UAH/USD (e.o.p.)	24.0	27.3	28.1	27.7	23.8	28.3	27.3	36.6	38.0	42.0	43.5	47.9
UAH/USD (avg.)	21.9	25.6	26.6	27.2	25.8	27.0	27.3	32.3	36.6	40.2	42.2	45.7
External balance												
Current account balance (US$bn)	5.0	(1.9)	(3.5)	(6.4)	(4.1)	5.3	(3.2)	7.9	(9.6)	(13.7)	(26.5)	(26.6)
Current account balance (% of GDP)	5.6	(2.0)	(3.1)	(4.9)	(2.7)	3.4	(1.1)	4.9	(5.3)	(7.2)	(13.0)	(12.5)
Trade balance (US$bn)	(2.4)	(6.5)	(8.7)	(11.4)	(12.5)	(2.4)	(2.7)	(25.7)	(37.9)	(35.9)	(40.9)	(38.4)
Trade balance (% of GDP)	(2.6)	(6.9)	(7.8)	(8.7)	(8.1)	(1.5)	(1.5)	(16.0)	(20.9)	(18.8)	(20.0)	(18.0)
Capital flows (F/A) (US$bn)	(4.6)	3.1	6.0	9.3	10.1	(3.3)	3.7	(10.9)	18.9	8.6	38.9	3.3
FDI (US$bn)	(0.4)	3.8	3.7	4.5	5.2	0.1	6.9	0.3	4.6	3.8	2.5	4.0
FDI (% of GDP)	(0.5)	4.1	3.3	3.4	3.4	0.1	3.4	0.2	2.5	2.0	1.2	1.9
NBU reserves (US$bn)	13.3	15.5	18.8	20.8	25.3	29.1	30.9	28.5	40.5	43.8	56.2	32.8
Interest rates												
NBU's key policy rate (%, e.o.p.)	22.0	14.0	14.5	18.0	13.5	6.0	9.0	25.0	15.0	13.5	14.0	12.5
Fiscal balance												
Budget balance (% of GDP)	(2.3)	(2.9)	(1.5)	(2.4)	(2.1)	(5.1)	(2.4)	(26.9)*	(26.7)*	(23.9)*	(19.7)*	(15.4)*
Public debt (% of GDP)	79.0	80.9	71.8	60.9	50.6	60.8	49.7	78.5	83.3	91.2	110.2	112.3

* budget balance before official budgetary grants
Source: Ukrstat, NBU, MoF, ICU.

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