Macro Insight

A Race to Secure More Budget Funding for 2026

16 JULY 2025

Economic growth to remain slow as the economy will struggle to increase the stock of available resources, capital and labor, in the near future. The recovery will be supported by private consumption on the back of surging incomes in the private sector. Meanwhile, government consumption will remain a drag due to a gradual fiscal consolidation. Additionally, lower-than-expected harvest prompts a downgrade in our 2025 GDP growth forecast to 2.5%. The key near-term challenge for the government is to secure an additional US$10-15bn in funding for 2026 on top of the existing commitments of the foreign partners. We expect the IMF will substantially revise its unrealistic baseline scenario for the BoP and budget during the next review in December 2025 and will use much more conservative assumptions admitting the need for more external funding. Inflation sharply reversed the trend since June, and we expect it will keep decelerating robustly in the coming months. The NBU will remain very cautious in its shift to monetary-policy loosening, partly due to sustained huge imbalances in the FX market. We now expect only two key policy rate cuts for a combined 100bp through end-2025. We don't expect the CPI to return to the NBU target next year or in the foreseeable future due to rapid growth in the prices for services against the backdrop of a tight labor market. We upgrade our projection of end-2025 exchange rate to UAH42.6/US$ from 43.5 previously. We have seen little appetite from the NBU over the past year to weaken the hryvnia. If the government finds US$10bn of additional funding for 2026, the NBU will have all the necessary resources to keep the hryvnia strong through end-2026. We, thus, expect insignificant hryvnia depreciation in 2026 as well. The NBU reserves will spike to above US$55bn this year, but will take a U-turn back to the US$40-45bn range in 2026. Our analysis assumes no major breakthrough in terms of a ceasefire in the near future. Even if a peace agreement is signed, that is unlikely to bring credible relief leading to a sustained improvement in business sentiment. This implies the revised baseline scenario in the IMF program in December 2025 will be close to the current downside scenario.

Economic growth to remain sluggish

The sluggishness of economic growth has been a reality since 3Q24, one that will be extremely difficult to escape in the coming years, even if safety risks subside considerably. Bottlenecks are getting narrower on both the demand and production side. From the production capacity angle, the economy is unlikely to increase the stock of resources, labor and capital, any time soon and will need to rely on the existing stock. On the demand side, headwinds mainly stem from the need to pursue fiscal consolidation as foreign aid (relative to the size of the economy) will decline.

Key macroeconomic data and projections

	2025F	2026F
Real GDP, YoY, %	2.5	2.8
Nominal GDP, US$bn	214	235
Inflation, YoY, %, e.o.p.	8.2	7.0
Key policy rate, %, e.o.p.	14.5	13.5
UAH/USD, e.o.p.	42.6	44.9
C/A balance, % of GDP	(12.8)	(15.3)
NBU reserves, US$bn	56.8	40.5
Budget gap, % of GDP*	(21)	(18)
Public debt, % of GDP	105	110

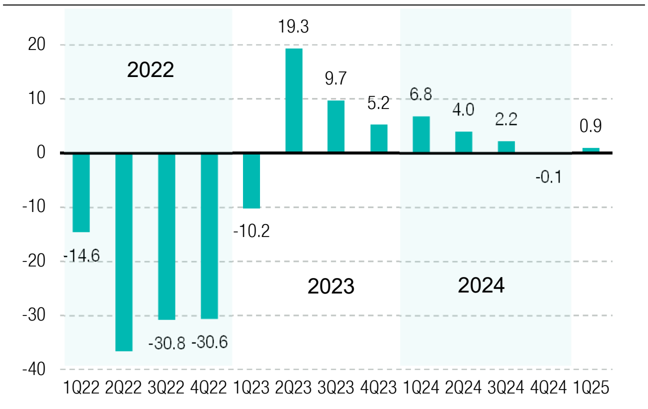
* budget balance before official grants to the government
Source: UkrStat, NBU, ICU

The economy rose 0.9% YoY in 1Q25 and the low growth was broadly expected for that quarter due to the high comparison base. GDP was boosted by government military expenditures in 1Q24 and reached 82% of pre-war levels. In subsequent quarters—2Q-3Q24—the economy moderated and was at 78-79% of the pre-war level before slumping to 73% in 4Q24. Given last year's base pattern, the broad expectation is that this year the growth will mainly materialize in 2H25. The economy will gain pace in the coming months, but expectations for the full-year result are now more cautious. We downgrade our 2025 GDP growth forecast to 2.5% from our previous estimate of 3.0%

The primary reason for the downgrade is declining prospects for a rebound in the harvest as this year's weather also presents a risk to the yields of grains and oilseeds. The combined harvest of grains and oilseeds is likely to be only marginally above last year's numbers, while the beginning-of-the-year expectations were for a 10-15% YoY increase. Unimpressive agricultural output will also have secondary effects by preventing an uptick in food processing and cargo transportation.

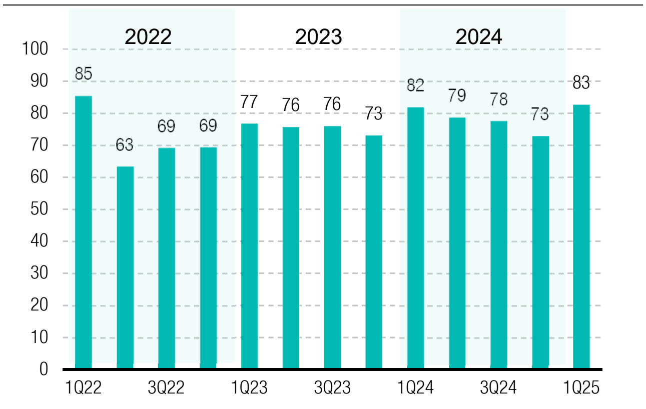
Agriculture aside, growth remains sluggish across the board. Industrial production slipped into negative territory since last December, construction tanked since March, while retail trade decelerated to 5-6%, a still healthy level, but well below 10%+ growth seen until 3Q24. Private domestic demand likely remains the only sustainable driver of economic growth as the strength of other components waned completely. Investment demand is constrained by safety concerns of local businesses, especially given that russia significantly upscaled its drone/missile attacks on regions far behind the frontline. Commodity export likely has nearly reached its potential given global commodity prices and expensive export logistics for Ukrainian businesses. Yet, the key drag on economic activity is ongoing fiscal consolidation, as the budget deficit is on a path to decline by 2-3% of GDP annually, implying negative contribution of the state consumption to growth. On a positive note, household consumption continues to grow robustly driven by rising salaries in the private sector (average nominal salary up 24% YoY in 1Q25), even though it decelerated considerably to 1.6% YoY in 1Q25. Businesses also benefited from the smooth supply of electricity over the past two quarters.

Chart 1. Real quarterly GDP, change, YoY



Source: UkrStat, ICU.

Chart 2. Real quarterly GDP, respective quarter of 2021 = 100%



Source: UkrStat, ICU.

The economy is likely to continue to recover slowly over the next two years, and we expect growth below 3% to persist in 2026. The economy will need to rely on the already available resources only, and they are getting more and more scarce. Over 60% of local businesses are currently working at full or close to full capacity, according to a business survey of IER, a local think tank. The deficit of labor remains the key impediment for the conduct of business, shifting the safety risks to a second place. With the unemployment rate likely returning close to the pre-war level of 10-11%, which is relatively low, this problem is likely to remain relevant going forward. Net emigration from Ukraine is still positive and the conscription campaign will remain a reality in the coming years even if a ceasefire agreement is reached. Economic growth is bound to remain marginally positive in the foreseeable future.

Inflation on a firm decelerating trend since June

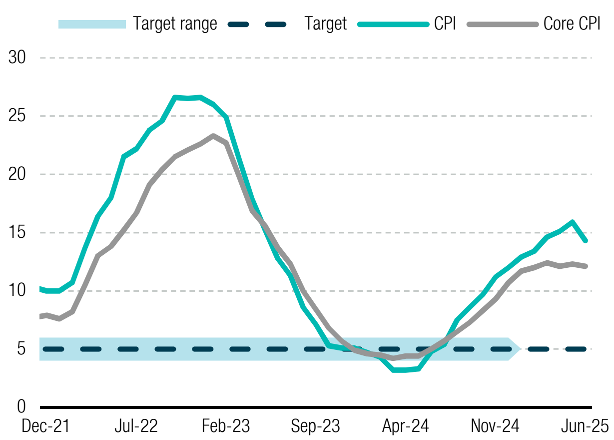
The inflation trend reversed sharply in June as annual inflation slowed to 14.3% YoY from 15.9% YoY in May. This change in trend was not a surprise and resulted from last year's high comparison base. Yet, the key conclusion at this point is that the slowdown will most likely continue, and we'll likely see three consecutive quarters when annual CPI will decline in every single month. Yet, we now anticipate this decline in headline inflation is going to be somewhat slower than we expected, and we downgrade our end-2025 CPI forecast to 8.2% YoY from the previous 7.6% YoY.

Food prices have remained the key inflation driver over the past year. They kept growing rapidly in June and were up 23.2% YoY. As they make up 38% of the consumer basket, their contribution to annual CPI stood at 8.8pp out of 14.3%. Growth in food prices was driven by a number of factors, including surging energy and labor costs. Yet, there is no doubt the key root cause was a dismal harvest of vegetables, fruits, grains, and oilseeds in 2024. This year, weather conditions proved to be far from perfect as well. The harvest of the majority of crops is going to be below what was expected and hoped for at the beginning of the year, but still above last year's numbers. Our downgrade of end-year CPI projection is entirely related to the worsening expectations of food price dynamics.

Looking across the board, the change in the price trend seems to be wide-encompassing with annual price growth for nearly all components either stabilizing or starting to decline. Core inflation well captures this underlying trend as it has also stabilized in the 12.0-12.5% range since February. Utilities were a clear outlier with tariff growth rate dropping to just 2.4% YoY from 20.1% in May. This happened as the June 2024 electricity price hike for households was removed from the 12-month trailing series. We expect muted growth of utility tariffs, as the authorities are determined to keep them heavily subsidized during the war.

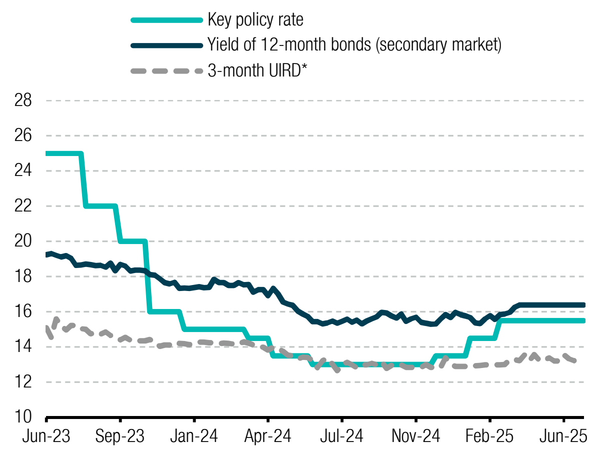
Looking ahead, we expect inflation to slip into high single-digit territory in Oct-Nov and stay there at least for the next two years. One of the strong supporting factors is the relative stability of the effective nominal exchange rate despite the recent weakening of the dollar. Other tailwinds include uninterrupted supply of electricity and deceleration in nominal incomes in the public sector. Despite this, we don't expect inflation will return close to the NBU target of 5% in 2026 due to the continued growth of prices for services.

Chart 3. CPI, core CPI and inflation target, YoY, %



Source: UkrStat, NBU, ICU.

Chart 4. NBU key policy rate and commercial rates, %



* Ukrainian index of retail deposit rates

Source: NBU, ICU.

Key policy rate to be cut only marginally in 2H25

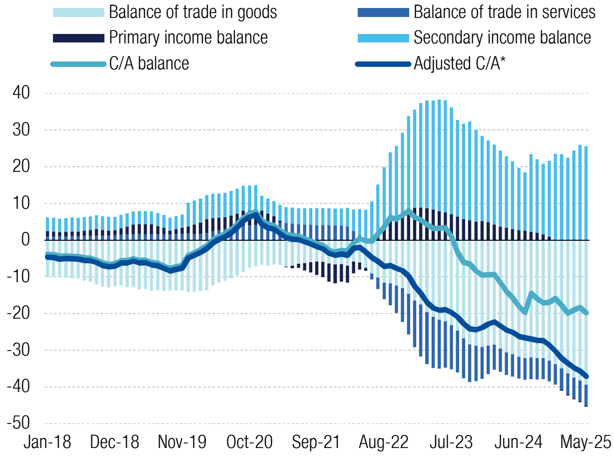
The NBU tightened its monetary policy stance starting in December 2024 by hiking the key policy rate by a cumulative 250bp to 15.5% and then paused since March. Commercial interest rates proved to be quite unresponsive to the changes in the central bank rates. Rates on retail hryvnia deposits were up by only 20-40bp YTD, depending on maturity, despite interest on three-month CDs rising by 350bps over the same time. Yields on bonds offered by MinFin on the primary market were up by 125bp, half of the cumulative increase of the key policy rate. However, the increase was less significant in the secondary market, at less than 60bp. Moreover, secondary market yields on short-term hryvnia bonds were up by less than 50bp (paper due sooner than one year are not offered in the primary market). Hikes in the key policy rates clearly played to the benefit of banks much more significantly then to the benefit of their clients.

Regardless of previous NBU actions, its further steps are likely to be extremely cautious for two reasons: 1. lack of clarity as to what extent this year's harvest will provide relief to food prices, and 2. the risks of FX demand raising again in the retail segment by the end of the year. In the current framework, where the NBU claims its monetary policy transmission mechanism is effective (we are not convinced it is) that would be fully reasonable to maintain a very cautious stance on rates. We now expect the NBU will cut the key policy rate only twice this year, each time by 50bp for an end-2025 key policy rate of 14.5%. With regard to commercial rates, we expect the cuts will have an immediate effect on deposit rates as banks will not waste their time to reduce cost of funds further. Yet, the story about bond yields is likely to be less straightforward. Given large government borrowing needs for this year (as stipulated in the draft budget amendments), the MinFin may not follow suit and reduce the yields on the primary auctions.

Trade deficit remains at record high

The trade deficit continues to deteriorate in money terms, and it has stabilized close to 20-21% of GDP, a whoppingly high number by any metric. These statistics exclude weapons that are supplied for free and also the majority of weapons purchased by Ukraine from its allies. Given that the hryvnia remains strong, there is no a realistic scenario under which this gap narrows even partly in the foreseeable future (in an optimistic scenario of a sustainable ceasefire the gap will be driven by import for reconstruction). In 5M25, export of goods was at just 48% of import. This ratio may improve on larger export of the harvest in the 2025/26 marketing year and lower gas imports if Ukraine manages to repair the capacities damaged by russia. The balance of foreign trade in services is also negative due to sizeable expenditures of Ukrainians abroad (they are classified as import of tourism in the balance of payments statistics). The balance of primary income has stabilized close to zero in recent months as income of Ukrainians abroad is fully offset with incomes of non-residents on their investments and loans given to Ukrainian entities. We expect the C/A deficit to widen close to 13% of GDP in 2025, up from 8.4% in 2024, as the surplus of secondary incomes shrinks on lower budgetary grants to Ukraine. Excluding budgetary grants, the C/A deficit is going to be at 15-16% of GDP, which implies about a 1.0-1.5pp increase from 2024.

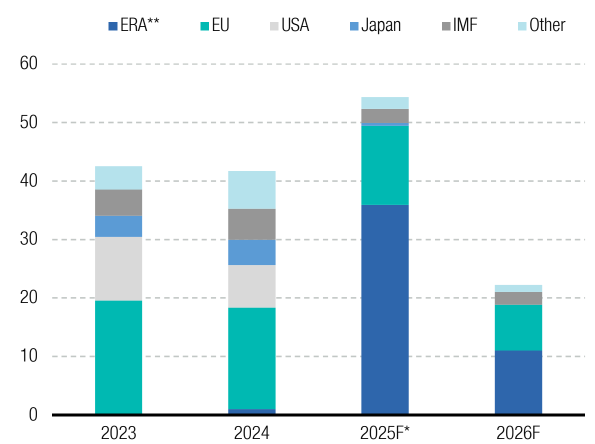
Chart 5. Current account, 12-month trailing, US$bn



* net of official transfers to the government

Source: NBU, ICU.

Chart 6. Foreign financial aid to Ukraine, US$bn



* Funding in 2025 includes US$12.2bn budget pre-financing for 2026. ** ERA stands for Extraordinary Revenue Acceleration Facility and is provided by G7 countries.

Source: IMF, ICU.

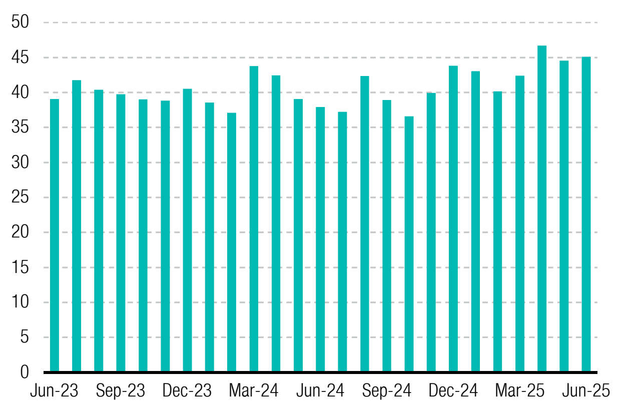
On the financial account side, the current pattern is also likely to persist over the next 12-18 months. We believe room for further NBU measures to loosen capital controls is extremely limited. The central bank might take only symbolic steps that are unlikely to change the existing restrictions significantly. To put it straight, the NBU will not open the way to repatriation of FDI and repayment of loans until the hryvnia gets much weaker, and a much weaker hryvnia is definitely not a baseline scenario for the next 18 months. Outflows of FX cash from the banking system (to meet the demand of households and shadow business) will remain the key drag on the financial account. One of the most positive developments on the financial account side is the robust reduction in the stock of trade credits as Ukrainian businesses likely accelerated return of export FX proceeds to the country.

Foreign aid package for Ukraine increased further

As usual, the IMF memos provide useful insights about how much aid Ukraine's foreign allies plan to provide over the horizon of the EFF program. The June memo reveals the total package of financial aid to Ukraine is increased by US$4.1bn over the remaining lifetime of the program. This implies total gross external financing from the IMF and other donors of US$54.3bn in 2025 (including pre-financing of US$12.2bn for 2026), US$22.2bn for 2026 (including US$11.1bn buffer for downside scenario), and US$3.0bn for 1Q27 (US$1.3bn for downside scenario).

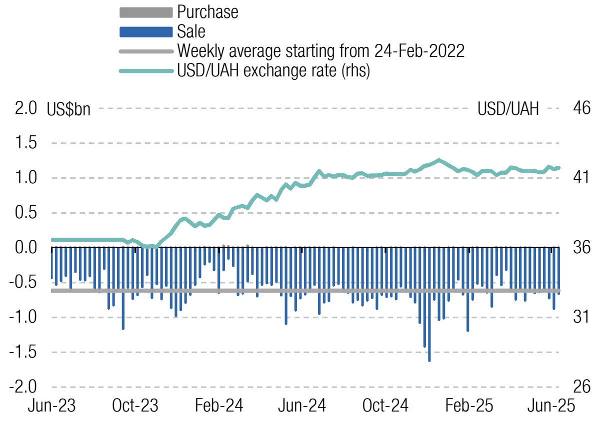
The size of these financial commitments is impressive, yet it still falls short of the budget financing needs in the two-year period. Government will likely need to find another US$10-15bn of additional funding for 2026 (see the next page for more details), primarily from external sources. We, thus, believe the current commitment represents a floor to external funding, and they may be topped by the time of the ninth IMF program review in December 2025. Given the frontloaded nature of the expected disbursement of the financial aid, we forecast a spike in NBU reserves to above US$55bn by the end of 2025 followed by a sharp contraction in 2026 to a range of US$40-45bn in 2026.

Chart 7. NBU gross international reserves, US$bn



Source: NBU, ICU.

Chart 8. UAH/US$ rate and NBU weekly interventions



Source: NBU, Bloomberg, ICU.

The NBU will remain committed to strong hryvnia policy

There is no doubt the NBU is encouraged by the recent upgrade of the financial aid package and potential upside surprises of more aid in the future. The central bank has had little appetite to weaken the local currency so far and now that the effective nominal exchange rate of the hryvnia weakened somewhat on a global slide of the dollar, its appetite will be even smaller. The NBU needs to spend about US$72-78bn over 2025-26 to fully cover the deficit in the FX market, and this money will most likely be available to the central bank. There is little doubt it will be willing and will be able to keep the hryvnia strong, close to the current level over the next 12 months. Importantly, the IMF seems to be fully comfortable with the existing setup of the FX policy. In view of this, we revise our end-2025 UAH/US$ exchange rate projection to 42.6 from 43.5 previously. We also expect relatively moderate depreciation of less than 7% over 2026.

A funding gap of US$10-15bn in 2026 is still to be closed

Even though Ukraine's fiscal gap has kept narrowing in relation to GDP, it has been robustly high in money terms and exceeded US$45bn in both 2023 and 2024. This year will be not different as the upcoming revisions to the budget add US$6bn to an already hefty planned deficit of US$39bn. Budget expenditures continue to be dominated by national security and defense needs, as they account for close to 60% of all central budget outlays. They remain at close to 30% of GDP, but if in-kind military aid provided by the allies is added, the numbers reach 40% of GDP. That excludes official underreported bilateral aid or indirect assistance, i.e. via intelligence sharing (sometimes significant).

The current baseline scenario of the IMF program (unrealistically) assumes the budget deficit will halve next year to 10.1% of GDP. For this reason, the programmed external assistance stands at US$22bn (including a buffer for a downside scenario). Needless to say, the chances of the budget deficit narrowing significantly from the current US$45bn is null. In fact, we expect it's going to stay close to US$45bn next year. We, thus, expect the IMF will substantially revise its fiscal (and BoP) numbers for the baseline scenario during the next program review in December. Fortunately, Ukraine can count on US$12.2bn of pre-financing to be disbursed this year with a view of being used in 2026. All in, Ukraine now expects that US$34bn should be available next year as per current commitments. This is unlikely to be sufficient to patch the next year's fiscal gap, and we expect the government will target securing an additional US$10-15bn of funding for 2026. The capacity of the local market is not sufficient to provide funding of that size. At this point, the potential sources for additional funding remain unclear and closing the gap in 2026 will be the key challenge within the current IMF program. Needless to say, additional borrowings on top of the existing plan are a new risk factor for IMF debt sustainability analysis.

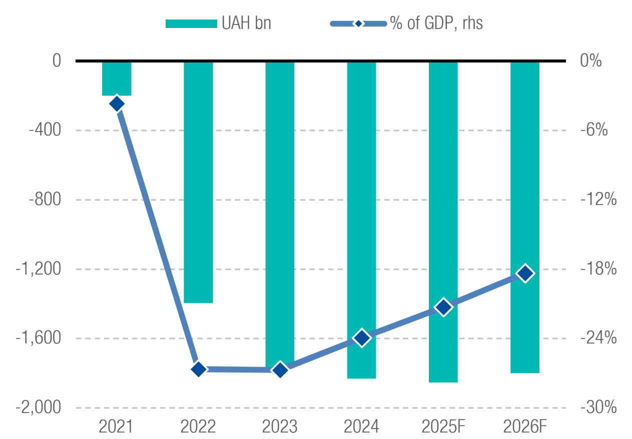
Table 1. Key parameters of state budget, UAHbn

	2024*	2025*	2025* revision
Total revenues (before grants)**	1,904	2,327	2,475
incl. tax revenues	1,647	1,995	2,083
Expenditures	3,742	3,929	4,330
inlc. defence and security	2,252	2,225	2,637
Budget balance (before grants)	-1,832	-1,641	-1,891
Total revenues / GDP	24.9%	26.0%	27.6%
incl. tax revenues / GDP	21.5%	22.2%	23.2%
Expenditures / GDP**	48.9%	43.8%	48.3%
Budget balance (before grants) / GDP	-23.9%	-18.3%	-21.1%
Total revenues / expenditures	50.9%	59.2%	57.2%
Tax revenues / expenditures	44.0%	50.8%	48.1%
Defence, security / total expenditures	60.2%	56.6%	60.9%

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

Source: MinFin, ICU.

Chart 9. State budget balance before grants



Source: MinFin, ICU.

Meanwhile, for this year, the government seems to be in a relatively comfortable position. Even though the deficit is set to increase by about 2.5% of GDP, the MinFin expects it will be ready to borrow this money in the local market. Government debt now makes up about a quarter of banks' net assets, and the net borrowing plan of the government, if approved, will be equivalent to 7-8% of the banking-sector assets. This is a challenging task and the only way to make ends meet is for the NBU to adopt new regulatory incentives for banks to lend more to the government. While this is a realistic task for this year, the room for further investment in 2026 will be extremely limited if available at all.

We expect Ukraine's public debt to reach 105% of GDP by the end of 2025. Yet, if ERA is excluded from public debt statistics, we'll see a debt-to-GDP ratio of around 87%, implying a decline vs. 2024.

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	2.5	2.8
Nominal GDP (UAHbn)	1,989	2,385	2,984	3,561	3,978	4,194	5,460	5,191	6,628	7,659	8,965	10,091
Nominal GDP (US$bn)	90	93	112	131	155	155	200	161	181	191	214	235
Unemployment (%)	9.1	9.3	9.5	8.8	8.2	9.5	9.8	28.0	18.2	13.1	11.0	10.0
Inflation												
Headline inflation (%, YoY, e.o.p)	43.3	12.4	13.7	9.8	4.1	5.0	10.0	26.6	5.1	12.0	8.2	7.0
Headline inflation (%, YoY, avg.)	48.7	13.9	14.4	10.9	7.9	2.7	9.4	20.2	12.9	6.5	12.6	6.9
GDP deflator (%, YoY)	38.9	17.1	22.1	15.4	8.3	9.8	25.1	34.3	19.9	12.3	14.2	9.5
Exchange rates												
UAH/USD (e.o.p.)	24.0	27.3	28.1	27.7	23.8	28.3	27.3	36.6	38.0	42.0	42.6	44.9
UAH/USD (avg.)	21.9	25.6	26.6	27.2	25.8	27.0	27.3	32.3	36.6	40.2	41.9	42.9
External balance												
Current account balance (US$bn)	5.0	(1.9)	(3.5)	(6.4)	(4.1)	5.3	(3.2)	7.9	(9.6)	(15.9)	(27.4)	(36.0)
Current account balance (% of GDP)	5.6	(2.0)	(3.1)	(4.9)	(2.7)	3.4	(1.1)	4.9	(5.3)	(8.4)	(12.8)	(15.3)
Trade balance (US$bn)	(2.4)	(6.5)	(8.7)	(11.4)	(12.5)	(2.4)	(2.7)	(25.7)	(37.9)	(39.4)	(43.4)	(45.6)
Trade balance (% of GDP)	(2.6)	(6.9)	(7.8)	(8.7)	(8.1)	(1.5)	(1.5)	(16.0)	(20.9)	(20.7)	(20.3)	(19.4)
Capital flows (F/A) (US$bn)	(4.6)	3.1	6.0	9.3	10.1	(3.3)	3.7	(10.9)	18.9	10.8	40.4	19.7
FDI (US$bn)	(0.4)	3.8	3.7	4.5	5.2	0.1	6.9	0.3	4.6	4.0	2.2	3.1
FDI (% of GDP)	(0.5)	4.1	3.3	3.4	3.4	0.1	3.4	0.2	2.5	2.1	1.0	1.3
NBU reserves (US$bn)	13.3	15.5	18.8	20.8	25.3	29.1	30.9	28.5	40.5	43.8	56.8	40.5
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	14.5	13.5
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)*	(20.7)*	(17.8)*
Public debt (% of GDP)	79.0	80.9	71.8	60.9	50.6	60.8	49.7	78.5	83.3	91.2	104.9	110.1

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

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