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Fiscal Digest – 9M 2024

Executive Summary

- **In the third quarter of 2024, the government aimed to sustain fiscal stability despite a mixed performance in tax revenue collection and fluctuations in international financial assistance**. In September 2024, Ukraine announced the successful completion of the restructuring of state and state-guaranteed debt amounting to $20.5 bn, a move expected to save $11.4 bn over the next three years and a total of $22.8 bn by 2033. Certain domestic taxes exceeded projections — corporate income tax (CIT) collection rose significantly, driven by strong banking sector profits. However, revenues from import-related taxes underperformed due to lower physical import volumes and tax exemptions introduced by Parliament to support households in achieving energy resilience. Meanwhile, international financial aid continued to play a crucial role for Ukraine's budget. Notably, in August, after months of stagnation, Ukraine secured $5.5 bn in foreign grants — the highest monthly grant inflow since the beginning of the full-scale invasion. As a result, grants accounted for over half of the budget's[1] total revenues that month, providing critical relief.
- **The need for increased defense expenditures became more pressing in the third quarter, as the initial budget underestimated the intensity of combat operations later in the year.** In response, Parliament approved the first budget amendment of 2024, allocating an additional $12.5 bn for the armed forces of Ukraine. To finance these expenses and bolster domestic fiscal capacity for the following year, a landmark tax reform bill — the largest in Ukraine's modern history — was passed. However, the bill remained unsigned for an extended period of time, causing uncertainties in funding critical defense and budgetary priorities. The president ultimately signed it in the final days of November.
- **The financing of expenditures in the third quarter generally follows the trend of the first half of 2024.** The defense and security sectors remain the primary focus of funding and accounted for 65.3% of total expenditures in the first nine months of 2024. However, funding for the defense sector decreased by 8.5% in dollar terms compared to the same period in 2023, while in hryvnia the reduction was only 0.7%, thus exchange rate fluctuations remain one of the key factors in expenditure financing. Socio-economic sectors continue to receive funding at levels consistent with previous quarters.
- **Financing from international partners shifted from grants to loans**, primarily due to a change in US policy, which provided Ukraine with $11 bn in grants in 2023 but only $5.2 bn as of November 19 of this year.This reduction in grants led to a 1% decrease in revenues in the first 9 months of 2024, which was partially offset by an increase in loans, of which $18 bn was received in the first 9 months of 2024.
- **The budget deficit for 9M 2024 totaled $20.2 bn compared to $21.9 bn in the same period of 2023.** However, in local currency terms, the deficit remained nearly unchanged, underscoring that the reduction in dollar terms was primarily driven by a 7.9% devaluation of the hryvnia during this period.
- **Debt trends remain unchanged and public debt continues to grow due to the attraction of significant amounts of external financial assistance, mainly in the form of loans.** State debt increased by 19.2% over the past twelve months – to $148.7 bn at the end of September 2024 (external debt +26.7% to $106.7 bn, domestic debt +3.7% to $42.0 bn). State-guaranteed debt, on the other hand, decreased by 21.3% to $7.0 bn due to minimal new borrowings under state guarantees and constant repayments of such debt.

Budget Revenues

Taxes remain the main source of budget revenues and taxpayers continue fulfilling their obligations despite a full-scale war, safety concerns, and energy limitations. However, actual tax

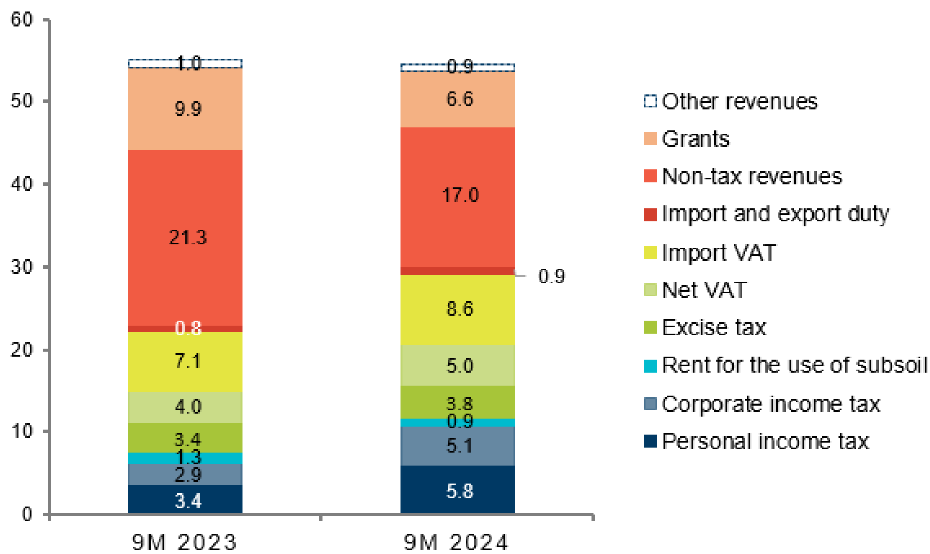
[1] *Here and after term "budget" is used for the central (state) level budget*

collection lagged behind projections, achieving only 71.6% of the full-year target in Q1-Q3, which indicates a slight underperformance in tax execution as well as a slightly optimistic forecast. Own budget revenues (without grants) increased by 5.6% to $47.7 bn, with tax revenues growing to $30.2 bn (+30.8%) in 9M 2024 vs 9M 2023 and non-tax and other revenues decreasing to $17.5 bn (-20.8%).

While the most important tax remains VAT, direct taxes showed higher growth. Both import VAT and net VAT increased substantially (+20.7% and +24.2% respectively) due to growth in consumption and are responsible for a quarter of all revenues in 9M 2024, but direct taxes (PIT and CIT) have shown even higher growth (+69.7% and +74.3% respectively). One third of CIT was paid by banks. Notably, accrued tax by banks amounted to $0.9 bn and the banks' return on equity was 45.8% in 9M 2024. As far as the structure of PIT is concerned, the main sources of revenues are taxes paid by military personnel (on wages and military fees), which are responsible for 91.3% of PIT. Revenues from the rent for the use of subsoil decreased by 25.7% due to lower prices of natural gas and a reduction of production of some products.

Weakened financial support in the form of grants amounted to 30.9%. Primarily, this was driven by a shift in US policy with grants decreasing from $11 bn in 2023 ($9.8 bn over 9M 2023 to $5.2 bn as of 19 November 2024.

Figure 1. Structure of budget revenues in 9M 2023-2024, $ bn



Source: Ministry of Finance of Ukraine, Openbudget

Budget Expenditures

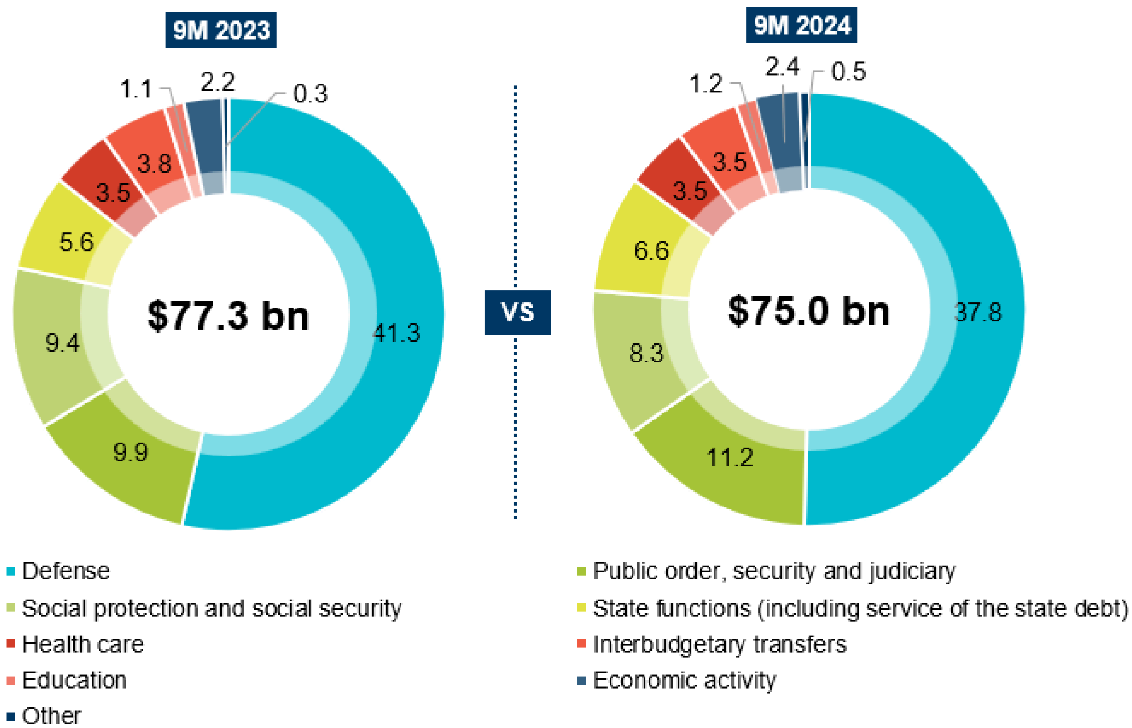
In 9M 2024, defense and security expenditures dominated the budget again, accounting for 65.3% ($49 bn) of total spending, while socio-economic development accounted for 34.7%. Overall budget expenditures decreased by 3% compared to the first half of 2023 to $75 bn, primarily due to a significant reduction in financing for the defense sector.

The Ministry of Defense was allocated $25.4 bn, or 48.6% of total expenditures – a reduction of 10.7% driven primarily by a 3% drop in financing in hryvnia terms as well as currency fluctuations. There are several reasons for these developments. Firstly, the adoption of the 2024 budget, in which the overall level of defense sector funding did not meet the urgent needs for 2024, leaving a shortfall of approximately $13 bn. Secondly, the uncertainty regarding international aid at the beginning of the year led to funds reserved for the year's end being spent earlier than planned. Thirdly, the delayed decision to raise tax rates, which was intended to ensure adequate funding for the defense sectors from the start of the year, further exacerbated the issue.

As a result, annual targets would have meant a substantial funding shortfall in Q4. Consequently, the Ukrainian government had to urgently adopt the first budget amendments of 2024, which provided an additional $12.5 bn for the defense and security sectors. This additional funding will help maintain the average annual funding level for military sectors through the end of the year. However, this requires ensuring the implementation of revenue improvements outlined in the plan, which includes tax increases and a significant boost in domestic borrowing.

Funding for the Ministry of Internal Affairs, which represents the security sector, increased by 7% y-o-y, reflecting continued support for internal security forces, even taking account of currency fluctuations.

Figure 2. Structure of budget expenditures in 9M 2023-2024, $bn[2]



Source: Ministry of Finance of Ukraine, Openbudget

Table 1. Actual expenditures on social payments in 9M 2023-2024, $bn

Indicator	9M 2023	9M2024	Change (%. y-o-y)
Pension Fund funding for pension payments & covering deficit	5.58	5.15	(7.7)
Support for vulnerable citizens	2.11	1.38	(34.7)
Support for low-income families	0.94	0.99	5.2
Support for children & families	0.50	0.44	(11.5)
Support for persons with disabilities	0.05	0.08	45.2

Source: Ministry of Finance of Ukraine

Over the first 9 months, there is a clear trend of reducing social expenditures, driven by a decrease in the number of recipients of payments, particularly due to changes in the criteria for granting subsistence allowances to internally displaced persons (IDPs) and other social programs. This is evident in the fact that total expenditures on social payments for the first 9 months of 2024 decreased by $1.2 bn (12.5%) compared to the same period in 2023, amounting to $8 bn. The largest reduction was in support for vulnerable citizens, with expenditures falling by $734 mln (34.7%) due to changes in the rules for granting subsistence allowances for IDPs, which were implemented in

[2] *The state functions sector includes the public debt servicing*

March 2024. Budgetary support for the Pension Fund dropped by $427 mln (7.7%) as revenues from social contributions increased, and this year's lower pension indexation (7.96%, down by 11.7 percentage points) reduced the need for state funding.

In addition, in September 2024, amendments to the budget resulted in a $216.7 mln (1.8%) reduction in expenditures by the Ministry of Social Policy of Ukraine, bringing total expenditures to $11.6 bn. Funding for social support for children and families decreased by $58.2 mln (8.4%), support for low-income families was reduced by $57.8 mln (11.4%), and expenditures on housing subsidies and benefits fell by $100.7 mln (8%). These reductions were primarily due to a decrease in the average monthly number of beneficiaries in these programs.

Budget Financing

Financing the budget deficit still critically depends on external assistance. In particular, the deficit for 9M 2024 of $20.2 bn was mainly covered by external and domestic borrowings: $15.5 bn of net external loans (76.7% of all resources used to cover the deficit), $3.3 bn of net domestic loans (16.3%), and another $1 bn (5%) from treasury funds. The remaining 2% of funding are proceeds from the privatization of state property. Of total expenditures, 63.6% were covered by domestic revenues (excluding grants), 4.4% by domestic bonds, and 29.4% by external loans and grants.

For 9M 2024, gross external loans amounted to$18.0 bn (compared to $22.8 bn for the 9M 2023), of which $8.9 bn was received in March 2024 (49.4% of the total amount). This is a record amount of loans in a single month since the beginning of the full-scale invasion. During 9M 2024, Ukraine received external loans from:

- €10.6 bn from the EU (Ukraine Facility);
- $3.1 bn from the IMF (EFF);
- CA$2 bn from the Government of Canada;
- $1.9 bn from the World Bank.

The majority of these loans were provided on concessional terms, featuring exceptionally low interest rates and extended repayment schedules. However, their disbursement is contingent upon Ukraine fulfilling specific conditions, including implementing reforms, enacting necessary legislation, and ensuring the efficient functioning of state institutions.

Gross domestic bond issuance declined during 9M 2024, with $9.5 bn raised — a 10.4% decrease compared to the same period in 2023. Debt repayments totaled $8.7 bn ($0.7 bn less than in 2023) with $6.2 bn allocated to domestic debt and $2.5 bn to external debt. Notably, 71.2% of total state debt repayments were directed toward domestic debt, down from 75.5% in 2023. This shift highlights the limited efficiency of domestic loans as a source of budget financing; during the 9M 2024 only 34.7% of domestic loans were utilized to finance budget expenditures.

Table 2. Budget funding sources (revenues and gross financing) in 9M 2023-2024, $bn

Resources	9M 2023	9M 2024	Change (%. y-o-y)
Internal budget resources	**55.8**	**57.5**	**3.0%**
Domestic government bonds	10.6	9.5	(10.4%)
Own budget revenues (without grant)	45.2	47.7	5.6%
Share of internal budget resources	63.1%	70.0%	11.1%
External budget resources	**32.7**	**24.6**	**(24.8%)**
External loans	22.8	18.0	(21.1%)
Grants	9.9	6.6	(33.5%)
Share of external budget resources	36.9%	30.0%	(18.9%)

Source: Ministry of Finance of Ukraine, KSE calculations

Table 3. Sources and amounts of external loans to Ukraine in 9M 2024

Foreign loans received in 2024	mln
Ukraine Facility	€10590
Government of Canada	CA$2000
IBRD (support development and recovery policies)	$1400
IMF	$3080
IBRD INSPIRE Project	$297
IBRD ARISE Project	$229.4
IBRD Modernization of the Social Support System of Ukraine Project	$20
IBRD Strengthening the Health System and Saving Lives Project	€13
IBRD Improving Health at the Service of People Project	€3

Source: Ministry of Finance of Ukraine

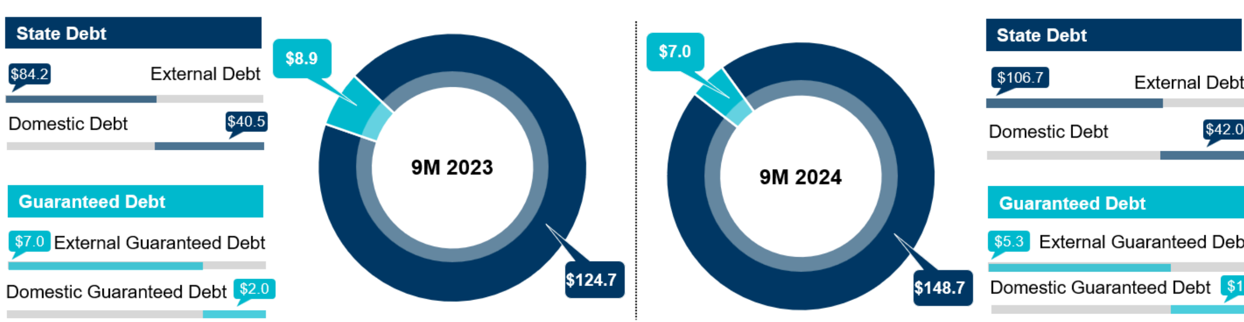
State Debt and State-Guaranteed Debt

In September 2024, Ukraine announced the successful restructuring of $20.5 bn in state and state-guaranteed debt. This included the re-issuance of $15.2 bn in sovereign bonds to address $14.7 bn of external state debt and $0.5 bn in bonds of the State Agency for the Restoration and Development of Infrastructure. This restructuring is projected to save $11.4 bn over the next three years and $22.8 bn by 2033, significantly easing the debt burden.

As of the end of September 2024, Ukraine's state debt increased to $148.7 bn, a 19.2% rise compared to $124.7 bn at the end of September 2023. This growth was primarily driven by external debt, which rose by $22.5 bn (26.7%) to $106.7 bn. From October 2023 to September 2024, Ukraine secured $26.2 bn in international loans, while $2.9 bn was allocated to external debt repayments.

Domestic debt grew modestly by $1.5 bn, reaching $42 bn. Over the same period, $14 bn was raised through domestic borrowing, and $8.1 bn was spent on repayments. In contrast, state-guaranteed debt declined by 21.3%, falling from $8.9 bn to $7 bn. Both domestic and external components decreased, with domestic guaranteed debt dropping 20% to $1.6 bn and external guaranteed debt declining 24.3% to $5.3 bn. This reduction reflects the near absence of new guaranteed borrowings and ongoing repayments, with $2 bn allocated for state-guaranteed debt repayment in 2024.

Figure 3. State Debt and State-Guaranteed Debt in 9M 2023-2024, $bn



Source: Ministry of Finance of Ukraine, KSE calculations

Key Risks for the 2024

- **Intensification of the full-scale war and increased political uncertainty.** The continuation and potential intensification of the war remain significant risks. This could arise from a sharp escalation in hostilities due to shifts in political dynamics, particularly stemming from increased uncertainty related to a change in U.S. leadership following the 2024 elections. Such developments could affect

Ukraine's ability to secure timely international support, placing additional strain on budgetary resources while further destabilizing the domestic economic environment.

- **Significant underfunding of expenditures.** A medium-to-high risk exists due to delays in implementing critical tax reforms aimed at increasing revenues. The late adoption of legislation to raise taxes would leave insufficient time for its provisions to take effect, creating a funding gap for planned expenditures. This delay would impede the government's ability to meet financial obligations, particularly in areas critical to national defense and social welfare.
- **Overuse of limited budgetary resources for popular spending initiatives.** In response to deteriorating public sentiment amid mounting hardships on the frontlines, there is a growing risk of excessive allocation of scarce budgetary resources toward politically popular spending initiatives. While these measures might temporarily ease public discontent, they would further strain fiscal capacity, diverting funds from critical priorities such as defense and the long-term economic recovery.
- **Reduced options for deficit financing.** A medium risk arises from declining demand for domestic government bonds, driven by reduced liquidity in the banking system. This limits the government's ability to secure financing through domestic borrowing, further constraining options for covering the fiscal deficit. Without robust domestic or international alternatives, reliance on short-term solutions may grow, increasing fiscal vulnerability.

Table 4. Ukrainian budget, $bn

Indicators	9M 2023	9M 2024	Change (%. y-o-y)
Total revenues	**55.1**	**54.3**	**(1.4%)**
Grants	9.9	6.6	(33.5%)
Non-tax and other revenues	**22.1**	**17.5**	**(20.8%)**
Tax revenues	**23.1**	**30.2**	**30.8%**
PIT	3.4	5.8	69.7%
Corporate income tax	2.9	5.1	74.3%
Rent for the use of subsoil	1.3	0.9	(27.5%)
Excise tax	3.4	3.8	11.3%
Domestic VAT (net)	4.0	5.0	24.2%
Import VAT	7.1	8.6	20.7%
Import and export duty	0.8	0.9	11.7%
Total Expenditures	**77.3**	**75.0**	**3.0%**
Defence	41.3	37.8	(8.5%)
Deficit[3]	**21.9**	**20.2**	**(7.8%)**
Deficit (net of grants)	**31.8**	**26.8**	**(15.7%)**
Net borrowings	24.0	18.8	(21.7%)
Loans	33.4	27.5	(17.7%)
Repayments	9.4	8.7	(7.4%)

Source: Ministry of Finance of Ukraine, KSE calculations

Authors:

[3] *The size of the deficit is not equal to the arithmetic difference between revenues and expenditures since the size of the deficit is additionally affected by the volume of loans from the budget and their repayment*

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