Center of Public Finance and Governance at Kyiv School of Economics

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Budget Declaration: Analysis and Assessment of Government Forecasts for 2025–2027

Executive Summary

- This year, in response to challenges and obligations to international partners, **Ukraine has resumed medium-term budget planning – the government has prepared a medium-term Budget Declaration for 2025-2027.** This resumption is an important step in strengthening financial discipline and increasing the predictability of state policy.

- **The indicators of the Budget Declaration are based on a macroeconomic forecast, which predicts real** GDP growth of 2.7% in 2025, 7.5% in 2026, and 6.2% in 2027. The trade balance will remain negative, although its size will slightly decrease, and expected inflation will be 9.7% in 2025 and 8.6% in 2027.

- **A key factor – the duration of active hostilities – is anticipated to last at least throughout 2025**. The needs for war-related expenditures will remain high throughout the entire three-year period, as evidenced by the forecasted volume of defense spending, minimization of non-military expenditures, and other indirect indicators. At the same time, in 2026**–**2027, defense expenditures are planned to be reduced by about one-third from the 2025 level, with the freed-up funds directed, in particular, to infrastructure projects such as road construction and repair.

- **The main fiscal risk will remain the duration and intensity of hostilities in Ukraine.** Among other risks are the trade blockade on the western borders and at sea; deterioration of the demographic situation and the outflow of labor resources abroad; acceleration of inflationary processes and a decrease in demand for domestic debt instruments.

- **During 2025–2027, the share of tax revenues in GDP will increase by 3.1 pp. to 21.6% of GDP in 2027.** Tax revenues will grow by an average of 17.3% annually due to the increase in excise tax and its alignment with EU Directives, the reform of the military tax, the continuation of the allocation of military personal income tax to the budget, and the improvement of tax administration efficiency according to the National Revenue Strategy of Ukraine until 2030.

- **Funding for "non-defense" budget sectors will be reduced already in 2025 and will remain at this level during 2026–2027**.

- **The Declaration does not specify the volumes of capital expenditures, as they will only be made for the implementation of public investment projects according to a prioritized list to be approved by the Strategic Investment Council.** The total resource to be allocated for financing public investment projects in 2025–2027 will include:
  - Revenues from foreign states and organizations (USD 1.3 bn in 2025),
  - Pillar II within the Ukraine Facility (EUR 6.97 bn),
  - Funds from the general fund of the state budget (USD 0.6 bn annually).

- **In 2025–2027, a sharp reduction in the budget deficit is forecasted from the actual 20.6% of GDP in 2023 to 6.7% in 2027 (achieving this will be extremely difficult even if active hostilities cease)** through the gradual increase in revenues and reduction of expenditures due to the recovery of the economy. However, the government should avoid "forced" deficit reduction. Accordingly, budget financing through debt operations should decrease from USD 34.7 bn in 2023 to USD 17.0 bn in 2027.

- **The main strategic goal of the government's debt policy will be to reduce the level of state and state-guaranteed debt to 90% of GDP by 2027.** Strategic directions in debt management will remain in cooperation with international partners to attract long-term concessional financing and the development of the domestic government securities market.

- **The financial resources of local budgets will increase and in 2027 will exceed UAH 1 tn for the first time.** At the same time, local budget revenues will grow faster than transfers from the state budget (by 51% and 39%, respectively), indicating the government's expectation that the positive effects of decentralization will continue.

Key Changes in Macroeconomic Indicators

It is expected that nominal GDP will grow from USD 188.1 bn in 2025 to USD 253.9 bn in 2027. This growth will be driven by increasing investment demand (which directly depends on the security situation and support from international partners), associated with the necessity to restore destroyed facilities, as well as growing household demand. Real GDP in 2025 will grow by only 2.7% due to the destruction of the energy infrastructure (previous projection of 6.8% was made by the Ministry of Economy at the end of 2023). However, growth will accelerate thereafter – to 7.5% in 2026 and 6.2% in 2027 – due to reduced security risks, the establishment of full-fledged logistics, and the gradual but steady recovery of the economy.

Inflation will average 8.6% in 2025–2027, which is significantly above the NBU's target range of 5% ±1 percentage point. There is a significant risk of rising inflation linked to the complex security and migration situation, as well as high uncertainty regarding international aid.

The trade balance is expected to remain negative due to the necessity of substantial imports and limited export opportunities for key trade items. However, the government anticipates a significant reduction in the trade deficit – from USD 40.7 bn in 2025 to USD 21.1 bn in 2027.

The macroeconomic forecast assumes that the average annual exchange rate of the hryvnia to the US dollar will gradually depreciate: from 45 UAH/USD in 2025 to 46.4 UAH/USD in 2027.

The increase in tax revenues and the reduction of social payments from the state budget will be slightly affected by the forecasted decrease in the unemployment rate in 2025-2027 by 1.2% to 16.5%. The unemployment rate decreases slowly and remains critically high.

Table 1. Key Forecasted Macroeconomic and Social Indicators of Ukraine for 2024–2027

Indicator	2024*	2025	2026	2027
GDP, nominal, USD bn	184.7	188.1	217.7	253.9
GDP, real change, %, y-o-y	3.6	2.7	7.5	6.2
CPI, %, avg	107.4	109.7	109.9	108
CPI,%, eop	108.5	109.5	110.4	105.9
Trade balance, USD bn	-32.8	-40.7	-27.2	-21.1
Unemployment rate, %	18.2	17.7	17.4	16.5
FX, UAH/USD, evg	40.3	45.0	46.5	46.4
FX, UAH/USD, eop	41.7	45.6	45.9	46.2

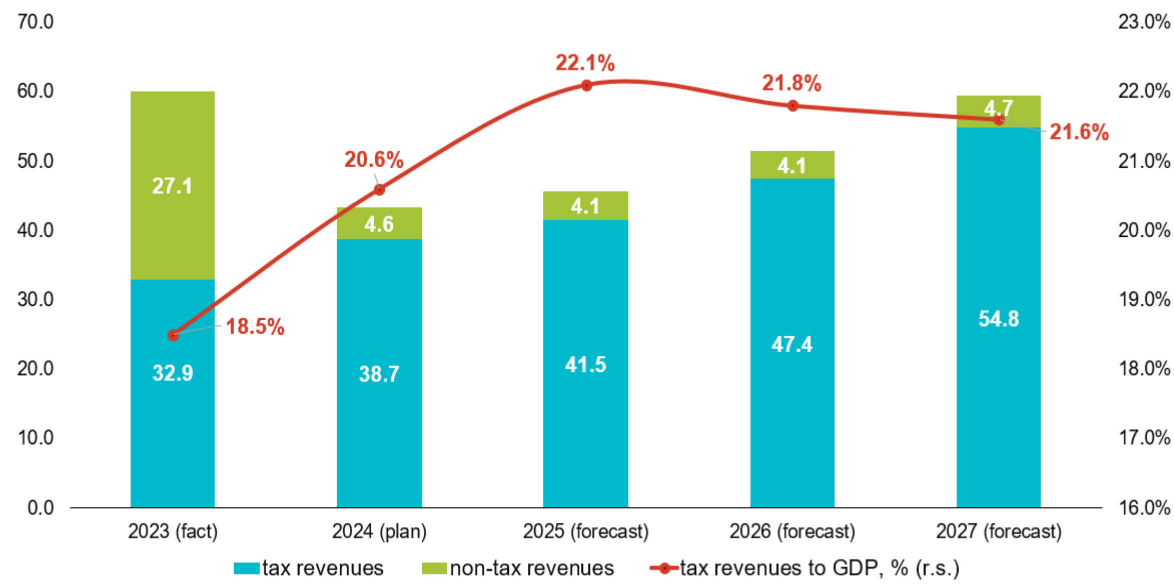
**Data from consensus forecast as of April 2024*
Source: Forecast of the Ministry of Economy of Ukraine

Budget Revenues

During 2025-2027, budget revenues are forecasted to gradually increase in nominal terms – from **USD 43.4 bn** in 2024 to **USD 67.5 bn** in 2027. In 2025, revenues are expected to grow by **23.5%** compared to 2024, and by **10.5% and 13.8%** in 2026 and 2027, respectively.

The main share of budget income will remain from tax revenues, and during 2023-2027, the fiscal role of tax payments will increase. Taxes collected in the state budget will amount to about 22% of GDP in 2025-2027 compared to 18.5% in 2023 and 20.6% in 2024.

Figure 1. Budget Revenues in 2023–2027, USD bn



Source: Budget Declaration for 2025-2027

The increase in the share of taxes in state budget revenues is planned to be achieved through the following measures:

- Gradual increase in excise tax rates on tobacco, alcoholic products, and fuel, bringing them closer to the EU levels.
- Continuing the allocation of military personal income tax (PIT) from local budgets to the special fund of the state budget.
- Restoring the allocation to the state budget of part of the PIT at a rate of 4%, which was temporarily directed to community budgets in 2022-2024.
- Strengthening control over the circulation of alcoholic beverages and tobacco products.
- Introducing an excise tax on sugar-containing beverages.
- Reforming the military tax.

In the Budget Declaration, revenue calculations are made based on the assumption that the rates of the main (largest) taxes – VAT, PIT, and corporate profit tax – will remain unchanged and will be set at the current levels: 18%, 20%, and 18% (25% for bank profits) respectively. However, it is also mentioned that *“to ensure stable and uninterrupted financing of urgent needs in the sphere of state security and defense against armed aggression, it is necessary to develop an additional package of measures for 2025-2027, taking into account the priority tasks of tax policy for the corresponding years, which would provide state finances with resources amounting to about UAH 340 bn [an average of USD 7.4 bn] annually.”* These measures could potentially include an increase in the rates of the main taxes, which are currently not accounted for in the document.

In 2025-2027, it is forecasted to accumulate no more than **USD 4.8 bn** in non-tax revenues. One of the sources will remain the profit transferred by the National Bank of Ukraine, based on its forecasts.

The main fiscal risks that will continue to exert pressure on financial stability in 2025-2027 and may have a negative impact on Ukraine’s socio-economic situation include:

- Uncertainty regarding the duration and intensity of hostilities in Ukraine.
- Trade blockade by western neighbors.
- Situation at sea - blockade of ports and destruction of port infrastructure by Russia.
- Complex demographic situation and outflow of labor resources abroad.
- Decrease in agricultural production yields.
- Acceleration of inflationary processes and decline in demand for domestic internal debt instruments.

Budget Expenditures on Defense and Reconstruction

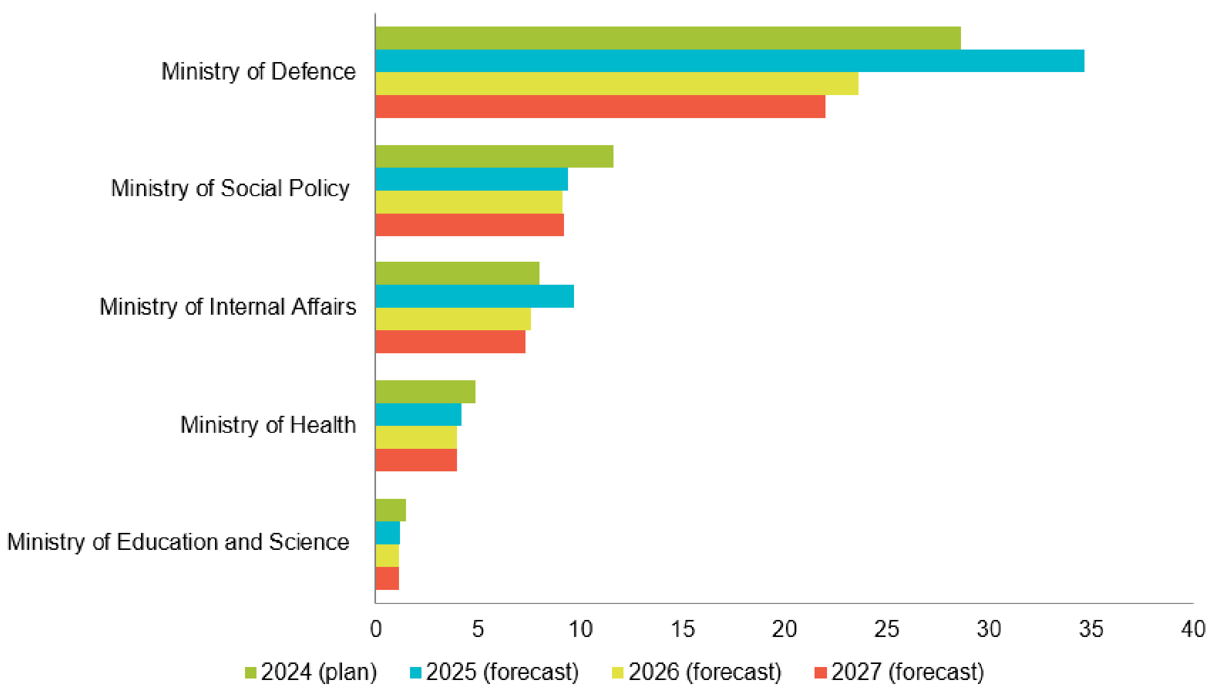
The total level of expenditures in 2025 will increase to nearly USD 87.9 bn from USD 81.3 bn planned for 2024 and will remain at this level during 2026–2027.

The priority sectors remain defense and security (50% of all expenditures on average during 2025-2027), general public services (23.9%, including servicing the national debt 10,9%), and the social sector (12.2%).

In 2025, the main direction of funding will continue to be the defense and security sector – accounting for 57.2% of all expenditures. The expenditure items for the Ministry of Defense are planned to be allocated USD 34.7 bn in 2025, which is 21% more than currently planned in the state budget for 2024 (although this year, expenditures are likely to be higher). The need to increase defense spending is driven by the higher intensity of mobilization (60% of all Ministry of Defense funding goes to military salaries) and potentially more active procurement of military equipment and weapons.

Overall, an increase in funding in 2025 is observed in most defense structures (Figure 2).

Figure 2. Top-5 Ministries by Expenditure Volume in 2024–2027, UAH bn



Source: OpenBudget, Budget Declaration for 2025–2027

Meanwhile, funding for the main non-defense budget administrators remains at the 2025 level. However, there are some exceptions. The State Agency for Reconstruction will receive 59% more in 2026 compared to 2025 - USD 1.8 bn (its funding will also increase in 2025 - by 35%, to USD 1.2 bn) and an additional USD 1.5 bn in 2027, raising total funding to USD 3.3 bn. This may be related to the gradual restoration of funding for the Road Fund. The Ministry of Infrastructure will also receive more funding - an additional USD 19.4 million in 2026 and another USD 21.6 million in 2027, raising the total funding to USD 181 million per year.

The proposed changes for 2026-2027 suggest that the government, assuming the conflict does not conclude by the end of 2025, anticipates a potential de-escalation of hostilities and the commencement of reconstruction efforts after. Concurrently, the government appears to be maintaining flexibility in its fiscal strategy, particularly in terms of infrastructure investments. This approach allows for the rapid reallocation of funds from road expenditures to defense requirements if the situation demands. Such a reallocation would be more complex for social expenditures, especially without support from international partners.

Budget Social Expenditures

In the next three years, the government plans to cut funding for the social protection system, veteran support, education and science, healthcare, youth and sports, and culture. These changes reflect the economic and demographic challenges posed by the war and large-scale migration.

Instead, it is planned to optimize and increase the targeting of social support. Such measures will contribute to a more efficient use of resources and support those who need it most.

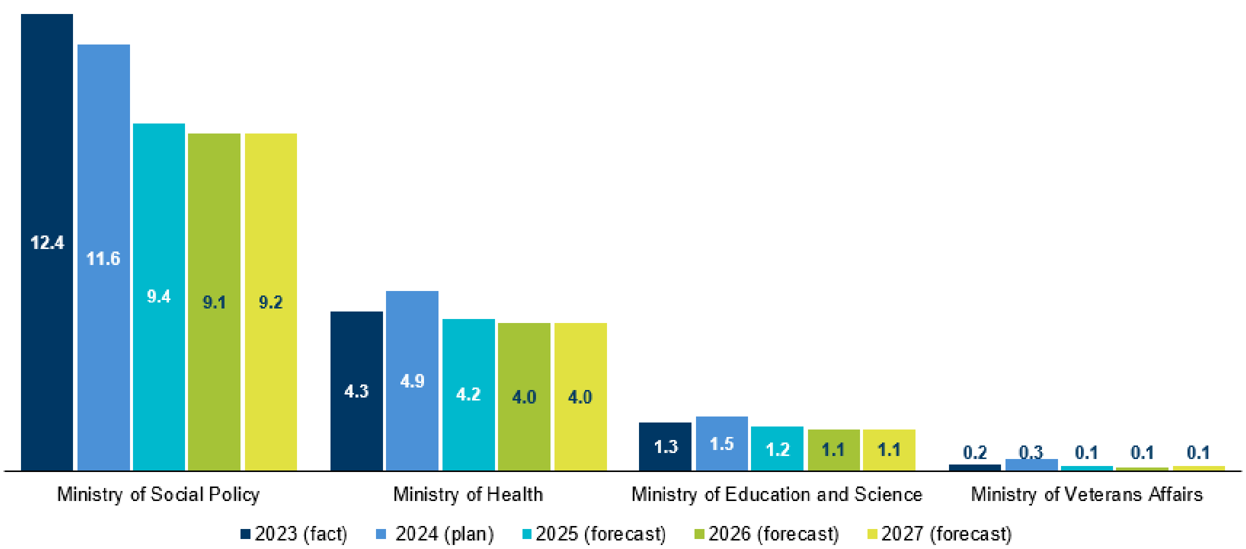
The Cabinet of Ministers plans to reduce expenditures of the Ministry of Social Policy by 18.2% (by USD 2.1 bn) in 2025 compared to 2024, bringing it to USD 9.4 bn. This figure will remain unchanged during 2026-2027.

The Pension Fund will continue to rely on state budget financing, although the government plans to reduce this amount and increase the fund's own revenues. Additionally, a reform is planned to enhance the fairness of pension provision and establish unified principles for calculating pensions.

A fixed subsistence minimum and the minimum pension amount will curb the increase in pension and social benefit expenditures from the budget. The government has not abandoned the annual indexation of pensions, but the increase will be capped at its maximum amount, which will also limit the growth of expenditures. The nominal amount of the maximum pension in hryvnias will not change in 2025-2027, but its real value in US dollars will decrease due to the change in the exchange rate from 9.5% to 12.4% (in 2025 - USD 525, in 2026-2027 - USD 508).

At the same time, the projected decrease in the number of pensioners from 10.5 mn to 10.3 mn people in 2025-2027 will not lead to a significant reduction in expenditures.

Figure 3. Social Expenditures in 2023–2027 by Main Budget Administrators, USD bn



Source: Budget Declaration for 2025–2027

Expenditures of the Ministry of Veterans Affairs of Ukraine will decrease by 61,6% to USD 128 mn in 2025 and remain at this level for 2026-2027. The reduction in expenditures is largely due to the absence of housing purchase compensations.

In 2025, funding for the Ministry of Health of Ukraine will decrease by 15% (by 731 mn), to USD 4.2 bn compared to 2024. In 2026-2027, these expenditures will be at the level of USD 4.0 bn.

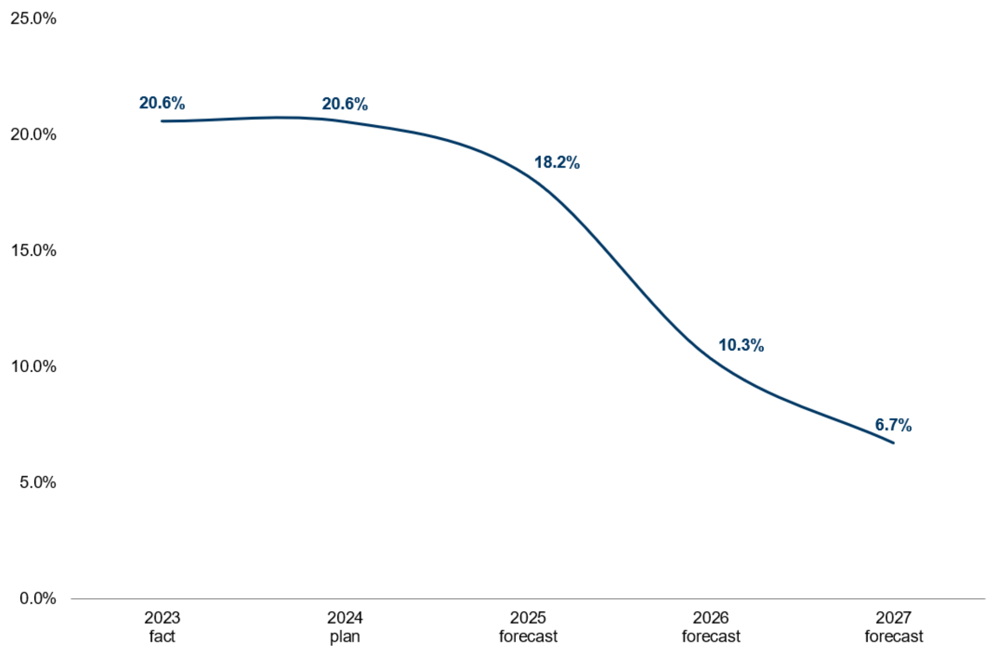
Expenditures on education and science will decrease by 20% (by 298 mn), to USD 1.2 bn in 2025. In 2026-2027, these expenditures will decrease by another 4.1% to USD 1.1 bn. This is due to the expected decrease in the number of children and youth. According to Eurostat, as of April 30, 2024, 1.4 mn children from Ukraine had temporary protection status in the EU.

Expenditures of the Ministry of Culture and Information Policy of Ukraine will decrease by 20%, to USD 211 mn in 2025, and to USD 201-202 mn in 2026-2027.

Budget Deficit Financing

For 2025-2027, due to increased revenues and reduced certain expenditures, the budget deficit is forecasted to gradually decrease both in nominal and relative terms to GDP: to **USD 34.3 bn (18.2% of GDP)** in 2025, **USD 22.5 bn (10.3% of GDP)** in 2026, and in 2027, the deficit should be **USD 17.0** or **6.7% of GDP**. For comparison, in 2023, the actual state budget deficit was **USD 36.6 bn (20.6% of GDP)**, in 2024 it is planned at nearly **USD 38.6 bn**, which will also be **20.6% of GDP**. Reducing the state budget deficit will positively impact Ukraine's financial stability, but it will still be far from the maximum allowable **3% of GDP** declared by the Budget Code.

Figure 4. Budget Deficit to GDP in 2023-2027, %



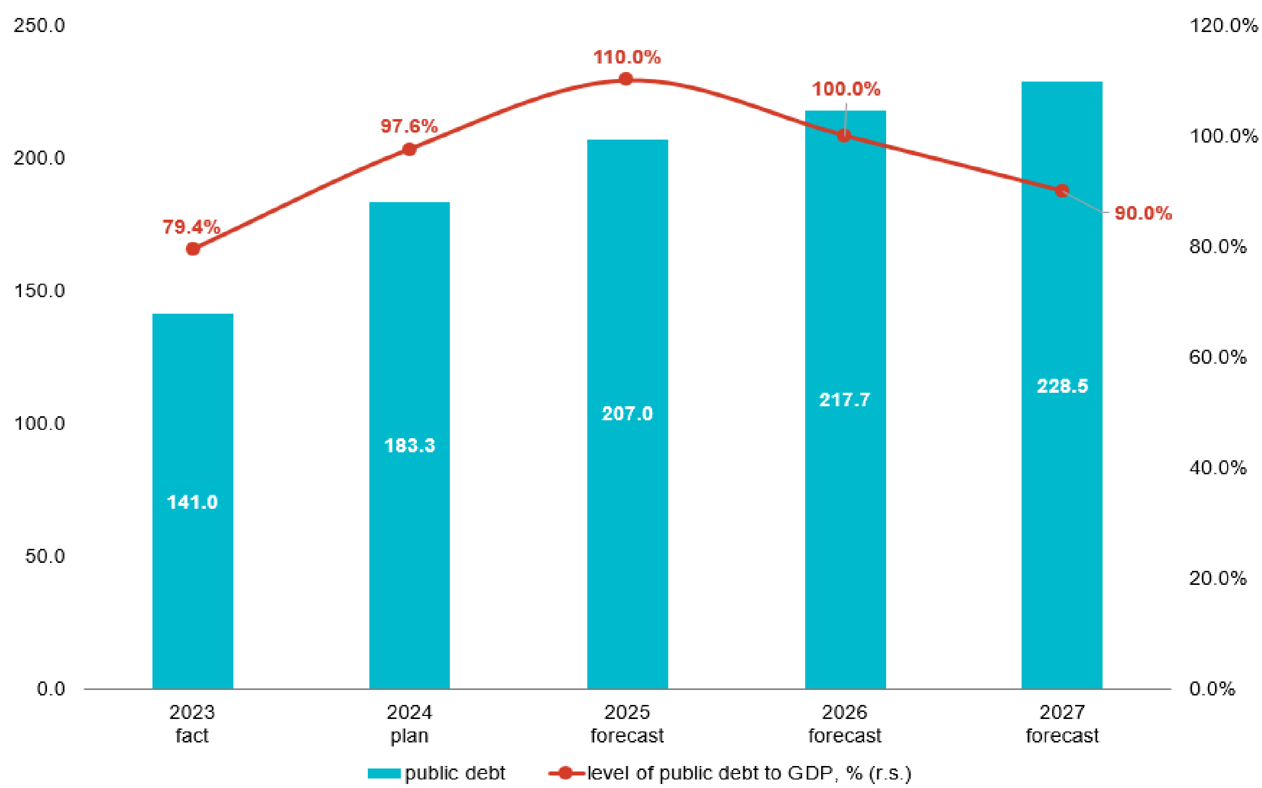
Source: Budget Declaration for 2025–2027

Debt Policy

The main strategic directions in managing public debt in 2025-2027 will remain close cooperation with international partners to attract long-term concessional financing, developing the domestic government securities market, and continuing efforts to secure financing at the lowest possible cost. Therefore, it can be forecasted that in 2025-2027, external borrowings will be primarily sourced from donors within existing programs: the IMF (Extended Fund Facility Program), the World Bank, the EU (Ukraine Facility), and others.

The main benchmark in public debt management policy for 2025-2027 will be reducing the debt-to-GDP ratio. It is expected that the debt-to-GDP ratio will start to decrease in 2026, after reaching 110% in 2025.

Figure 5. State and State-Guaranteed Debt, USD bn

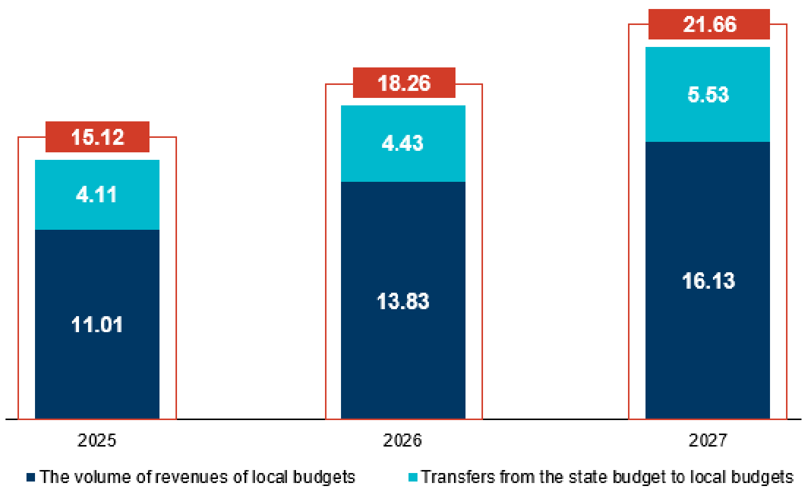


Source: Budget Declaration for 2025–2027

Local Budgets

The total financial resources of local budgets will increase in the coming periods and in 2027 will exceed UAH 1 tn for the first time. At the same time, own revenues will grow faster than transfers from the state budget (by 51% and 39% respectively), indicating the government's expectation that the positive effects of decentralization will continue (in particular, increasing revenues from PIT and local taxes and fees).

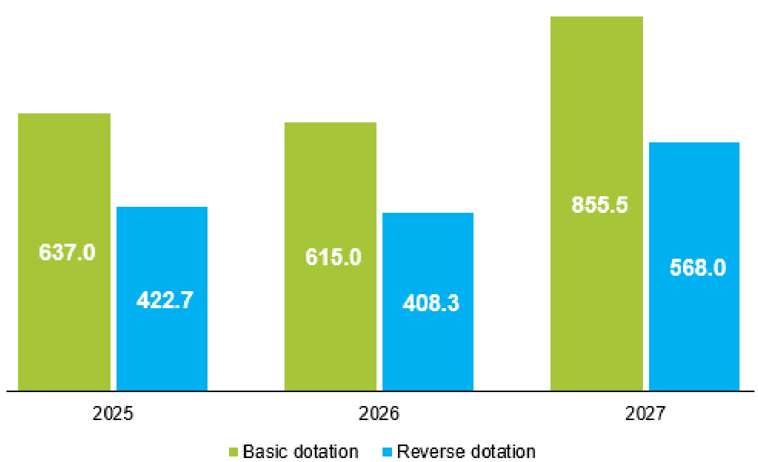
Figure 6. Financial Resources of Local Budgets in 2025–2027, USD bn



Source: Budget Declaration for 2025–2027

Horizontal equalization of fiscal capacity will take place under the same rules that currently exist. However, unlike the current year, the reverse subsidy from local budgets to the state budget will be reinstated (amounting to USD 415 mn in 2025-2026 and USD 587 mn in 2027).

Figure 7. Indicators of Horizontal Equalization of Fiscal Capacity in 2025–2027, USD mn



Source: Budget Declaration for 2025–2027

Conclusions

The implementation of medium-term budget planning in Ukraine is pivotal for maintaining the stability and predictability of the state's financial policy. The COVID-19 pandemic and the full-scale invasion have significantly complicated this process. The resumption of this planning in 2024 aligns with Ukraine's commitments to international partners and represents a crucial step towards bolstering financial discipline and enhancing the predictability of state financial policy.

However, several risks may impact the realization of this forecast. Key among these risks are the security situation, political instability, economic challenges associated with post-war reconstruction, and potential external economic and financial shocks. The government has likely considered these factors and their impact on the key indicators of the Declaration. This consideration is essential for the successful implementation of medium-term budget planning in Ukraine, both currently and in the future. Nonetheless, it is important to acknowledge the ongoing state of maximum uncertainty, necessitating vigilant monitoring and readiness to make new assumptions to adjust the final budget indicators as needed.

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