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Fiscal Digest – H1 2024

Executive Summary

- **Ukraine's budget stabilized in the second quarter of 2024 after a challenging first three months of the year largely due to the unblocking of international financial assistance and improved domestic tax revenues.** These developments allowed for a significant increase in government spending, particularly on military needs and social welfare, leading to one of the highest expenditure levels since the start of the full-scale war. Continued international financial support remains crucial for covering the non-military budget deficit, as such funds cannot be used for military purposes. However, the risk of insufficient internal financial resources to cover military expenditures in the second half of the year remains significant. This concern arises from the fact that the initial budget plan for defense spending in 2024 was lower than the actual amount spent on similar needs in 2023.
- **The budget deficit** in the first half of the year (H1 2024) amounted to $16 bn, a 9.9% increase compared to $14.6 bn in H1 2023**.** The primary reason for this rise was the significant reduction in grants received in H1 2024: only $1 bn compared to $7.4 bn in H1 2023.
- **Revenues** (excluding grants) increased sharply in H1 2024 compared to H1 2023 – by $4.5 bn or 15.8%. Tax revenues rose by 40.8% on the back of the economy's adjustment to the war, changes to the tax code, and effects from inflation — thereby making the biggest contribution to overall revenue growth. However, the lack of internal resources might negatively influence revenues going forward.
- **Expenditures** in H1 2024 increased by 1.6% compared to the same period last year, reaching $49.6 bn. The most significant growth was observed in the public order, security, and judicial system sectors — +22.6% to $7.4 bn — and in the general government functions sector (mainly due to debt servicing) — +6.3% to $6.6 bn. The social protection sector is the only one that saw reduced funding in nominal terms compared to the same period in 2023 — -10.8% to $5.8 bn.
- **State debt** increased by 20.6% compared to the same period in 2023 to $144.3 bn by the end of the H1 2024. External debt rose significantly, with $23.9 bn in new debt, a 29.9% increase, bringing total external debt to $103.8 bn. Domestic debt grew by $0.7 bn, or 1.8%, reaching $40.5 bn. In contrast, state-guaranteed debt dropped by 14.3% to $7.8 bn, due to minimal new borrowing under state guarantees and ongoing repayments, including $2.5 bn in 2023.

Budget Revenues

In H1 2024, the budget[1] received $32.75 bn in revenues (excluding $1 bn in grants), marking a significant increase of $4.5 bn or 15.8% compared to H1 2023.

Grant funding experienced a significant decline of 85.9%, dropping from $7.4 bn in H1 2023 to $1 bn in H1 2024. This reduction is primarily attributed to the absence of financial support from the United States, which had been the major contributor of grants in previous years. Meanwhile, the European Union continued its support through macro-financial assistance, though delivered in the form of concessional loans rather than direct grants.

Tax revenues continued to rise in H1 2024 — +40.8% to the same period last year — driven by business adaptation and legislative changes (windfall tax for banks, reallocation of part of PIT from local to central budget, etc.). The key sources of the $20.3 bn in tax revenues in H1 2024 were:

- Import VAT: $5.7 bn (28.3% of tax revenues)
- Corporate income tax (CIT): $3.8 bn (18.6%)
- Personal income tax (PIT): $3.7 bn (18.4%)

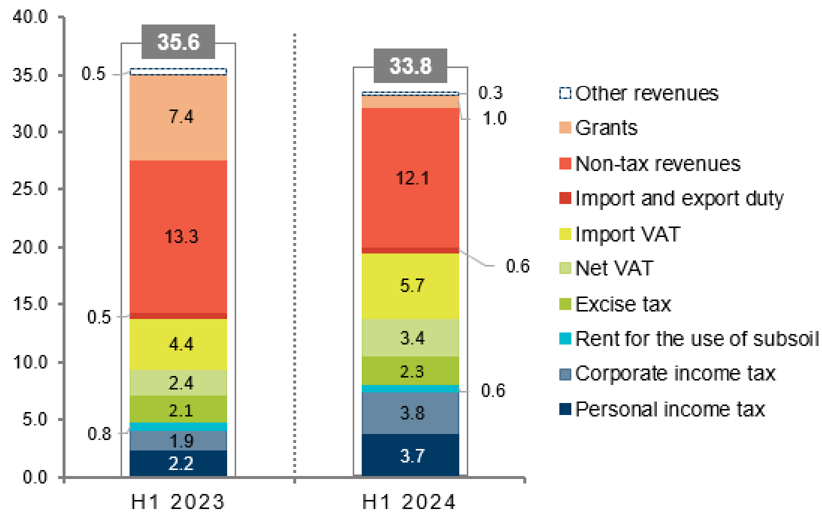
The structure of tax revenues was changed to increase the role of direct taxes: the share of CIT increased from 12.9% in H1 2023 to 18.6% in H1 2024, and PIT increased from 15.2% to 18.4%. Revenues from CIT increased by 103.9% compared to the same period in 2023 due to the high profit of banks ($1.8 bn in H1 2023 and $2 bn in H1 2024), to which a windfall tax was applied. As a result,

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

banks contributed 39.7% of CIT revenues, while state-owned enterprises (SOEs), enterprises created by foreign investors, and other taxpayers accounted for 8.5%, 6.8%, and 37.3%, respectively. Since the economy operates under war conditions, PIT reflects this situation: 47% of PIT was received from the taxation of incomes of military personnel, 31.7% from salaries, and 13.8% from military fees.

As of H1 2024, **all major tax categories, except for rent from the use of subsoil, saw increases**. The rent tax declined by 26.6% due to a drop in natural gas prices, which is the main tax base. Net VAT revenues increased by 40.3% to $3.4 bn and import VAT grew by 29.9%, reflecting the ongoing recovery of the economy and positive consumption expectations.

Figure 1. Structure of budget revenues in H1 2023-2024, $ bn



Source: Ministry of Finance of Ukraine, Openbudget

Budget Expenditures

In H1 2024, defense and security expenditures dominated the budget, accounting for 65.7% ($32.6 bn) of total spending, while socio-economic development received 34.3%. Total budget expenditures increased by 1.6% compared to H1 2023, reaching $49.6 bn. Notably, defense spending remained stable with a minor increase in funding compared to the previous year.

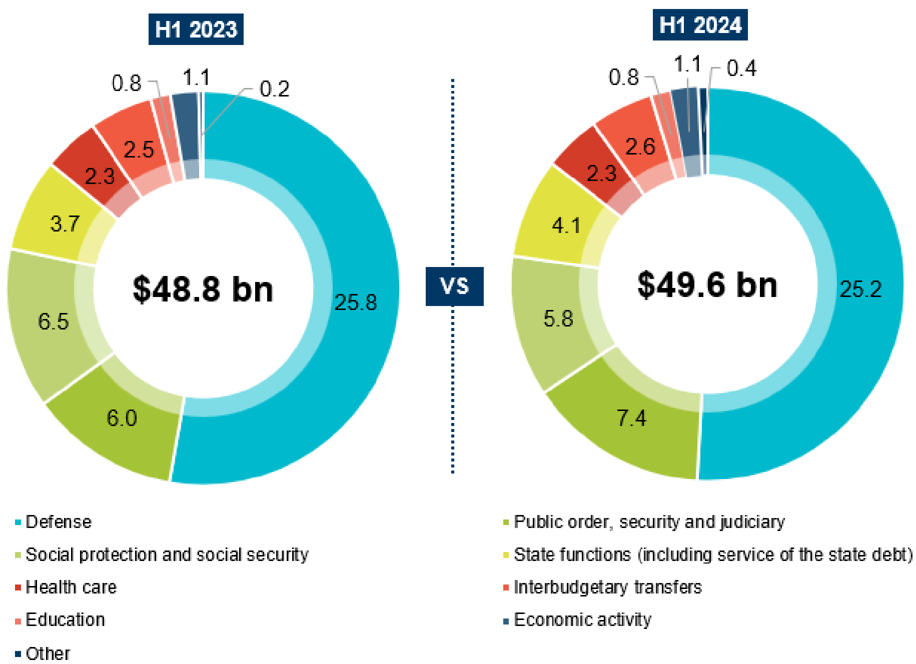
The Ministry of Defense received $24.2 bn, or 48.8% of total expenditures, a slight decrease of 4.8% due to exchange rate fluctuations, though the UAH equivalent rose by 1.5%. Initial challenges in January, driven by uncertainty over international aid, were resolved by the end of the first half of the year. Security funding, mainly managed by the Ministry of Internal Affairs, rose by 22.6% over the same period, reflecting strengthened support for internal security forces.

Despite the stabilization of funding, emerging challenges point to a potential shortfall in defense financing, estimated between $13 bn and $18 bn already this year, which may impact critical military programs starting in October. This shortfall could hinder procurement and provision for the Armed Forces. Preventing this is likely to require tax reforms, including raising rates and broadening the tax base, or a sharp increase in the issuance of domestic government bonds (OVDPs), or cuts in other budget expenditures.

In non-military sectors, social welfare funding saw a 10.8% reduction, dropping from $6.5 bn to $5.8 bn. A large share of this funding continued to support pensions and social payments, marking the only sector with decrease in the hryvnia equivalent compared to the same period in 2023.

In H1 2024, 47% of the annual social protection funding was utilized, totaling $5.8 bn, with 98.4% ($5.7 bn) directed towards social payments. This marked a 10.1% reduction in social payments compared to H1 2023, driven by legislative changes.

Figure 2. Structure of budget expenditures in H1 2023-2024, $bn[2]



Source: Ministry of Finance of Ukraine, Openbudget

Table 1. Actual expenditures on social payments in H1 2023-2024, $bn

Indicator	H1 2023	H1 2024	Change (%)
Pension Fund funding for pension payments & covering deficit	3.72	3.51	-5.56%
Support for vulnerable citizens	1.42	0.99	-30.59%
Support for low-income families	0.80	0.82	2.70%
Support for children & families	0.33	0.30	-9.33%
Support for persons with disabilities	0.03	0.05	53.40%

Source: Ministry of Finance of Ukraine

A significant reduction in spending on support for vulnerable citizens — down 30.6% or $435 mln — was primarily due to adjustments in subsistence allowances for internally displaced persons. From March 1, 2024, only pensioners, children with disabilities, and other vulnerable groups received automatic payment extensions, while other recipients had to meet stricter criteria, including employment requirements (aid was granted based on an application if the family's income did not exceed $242.1 per person). Over 1 million families benefited from this aid.

The Pension Fund's budget support decreased by 5.6%, or $206.8 mln, as higher social security contributions and a lower pension indexation rate (7.96% - 11.7 pp less) reduced the need for state financing. Additionally, the pensioner population declined by 200,000 to 10.3 million compared to H1 2023.

Given budget constraints, the government continues to reform social policy by focusing on support for the most vulnerable groups (veterans, individuals with disabilities, and internally displaced persons) and developing specialized social services. The approach has shifted from merely providing financial aid to those in need to a more comprehensive support system aimed at helping individuals reintegrate into social and labor markets.

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

Budget financing

In H1 2024, Ukraine's budget deficit reached $15.8 bn, a 21.5% increase compared to the same period in 2023, largely due to a significant drop in international grants—only $1 bn in 2024 versus $7.4 bn in H1 2023. The deficit was covered by the following resources: $11 bn of net external borrowings, $1.4 bn of net domestic borrowings, and $3 bn - from treasury funds. Dependence on external financial assistance remains critical, with the budget still heavily reliant on foreign aid to cover the deficit.

Gross external loans amounted to $12.8 bn in H1 2024, down from $15.4 bn in the same period of 2023, with $8.9 bn of that received in March 2024, representing 69.5% of the total. Gross domestic bond issuance also fell, raising $6.2 bn, a 20.5% decline from H1 2023. Debt repayments totaled $6.6 bn, similar to 2023 levels, with $4.8 bn used for domestic debt and $1.8 bn for external debt.

Of total expenditures, 66.1% were covered by domestic revenues (excluding grants), 2.8% by domestic bonds, and 24.2% by external loans and grants. Despite meeting tax revenue targets and regular domestic bond sales, the Ukrainian budget remains vulnerable to potential shortfalls in external financing.

Table 2. Budget funding sources (revenues and gross financing) in H1 2023-2024, $bn

Resources	H1 2023	H1 2024	Change (%)
Internal budget resources	**36.0**	**38.9**	**8.1%**
Domestic government bonds	7.8	6.2	-20.5%
Internal budget revenues (w/o grants)	28.2	32.8	16.0%
Share of internal budget resources	61.2%	73.8%	20.6%
External budget resources	**22.8**	**13.8**	**-39.5%**
External loans	15.4	12.8	-16.9%
Grants	7.4	1.0	-86.5%
Share of external budget resources	38.8%	26.2%	-32.5%

Source: Ministry of Finance of Ukraine, KSE calculations

Table 3. Sources and amounts of external loans to Ukraine in H1 2024

Foreign Loans	Amount, mln
Ukraine Facility (bridge financing)	€7890
IBRD (support development and recovery policies)	$1400
Government of Canada	CA$2000
IMF	$880
IBRD INSPIRE Project	$297
IBRD ARISE Project	$229
IBRD Modernization of the Social Support System of Ukraine Project	$20
IBRD Strengthening the Health System and Saving Lives Project	€3
IBRD Improving Health at the Service of People Project	€3

Source: Ministry of Finance of Ukraine

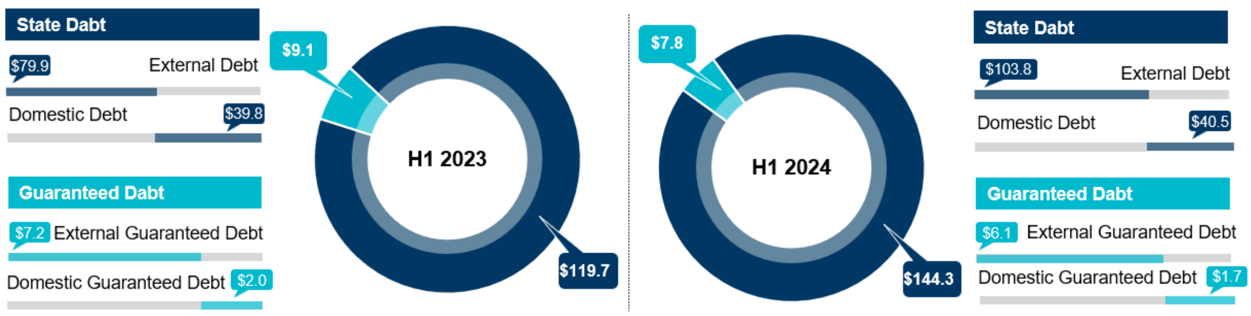
State Debt and State-Guaranteed Debt

As of the end of H1 2024, Ukraine's state debt rose to $144.3 bn, reflecting a 20.6% increase from $119.7 bn in H1 2023. This growth was primarily driven by external debt, which surged by $23.9 bn

(29.9%) to $103.8 bn, largely due to $28.4 bn in international loans received during the period. In contrast, domestic debt saw a modest increase of $0.7 bn, reaching $40.5 bn.

State-guaranteed debt decreased by 14.3% from $9.1 bn to $7.8 bn, with both domestic and external components declining. Domestic guaranteed debt dropped by 15.0% to $1.7 bn, while external guaranteed debt fell by 15.3% to $6.1 bn.

Figure 3. State Debt and State-Guaranteed Debt in H1 2023-2024, $bn



Source: Ministry of Finance of Ukraine, KSE calculations

Key Risks for the H2 2024

In H1 2024, the budget situation remained relatively stable; however, significant risks to fiscal stability will persist for the second half of the year:

- **Continuation of full-scale war.** The ongoing nature and intensity of Russian aggression will continue to significantly impact both the revenue and expenditure sides of the budget.
- **Emergence of additional budgetary needs**. There is a high likelihood of increased budgetary demands, particularly for maintaining defense capabilities, which could strain the budget further.
- **Delay or absence of critical budgetary and tax legislation changes.** The failure to enact necessary budgetary adjustments or tax reforms in a timely manner could result in an inability to meet fiscal needs in the second half of the year.
- **Further infrastructure damage.** Continued damage to critical infrastructure, especially in the energy sector, could lead to a decline in activity, despite the resilience shown by Ukrainian businesses.
- **Worsening migration trends.** Deterioration in security and energy conditions in the second half of the year may exacerbate negative migration trends, further impacting the economy and labor market.

Table 4. Ukrainian budget, $bn

Indicators	H1 2023	H1 2024	Change (%.)
Total revenues	**35.6**	**33.8**	**(5.1%)**
Grants	7.4	1.0	(86.5%)
Non-tax and other revenues	**13.8**	**12.4**	**(10.1%)**
Tax revenues	**14.4**	**20.3**	**41.0%**
PIT	2.2	3.7	70.5%
Corporate income tax	1.9	3.8	103.9%
Rent for the use of subsoil	0.8	0.6	(26.6%)
Excise tax	2.1	2.3	10.4%

Domestic VAT (net)	2.4	3.4	40.3%
Import VAT	4.4	5.7	29.9%
Import and export duty	0.5	0.6	21.0%
Total Expenditures	**48.8**	**49.6**	**1.6%**
Defence	25.8	25.2	(2.3%)
Deficit[3]	**13.0**	**15.8**	**21.5%**
Deficit (net of grants)	**20.4**	**16.8**	**(17.6%)**
Net borrowings	16.6	12.4	(25.3%)
Loans	23.2	19.0	(18.1%)
Repayments	6.6	6.6	0.0%

Source: Ministry of Finance of Ukraine, KSE calculations

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[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