Center of Public Finance and Governance
at Kyiv School of Economics

KSE | Institute

# Fiscal Digest Q1 2025

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## *Executive Summary*

Ukraine's fiscal position in Q1 2025 remained stable but under pressure. Despite ongoing war-related expenditures, the government maintained budgetary resilience through strong tax performance, renewed donor support, and access to external financing. The deficit widened slightly y-o-y but remained manageable, and state debt growth – while notable – was driven largely by contingent liabilities tied to EU disbursements under the Ukraine Facility.

- **Tax revenues grew steadily, supported by recent policy changes and inflation dynamics.** Total tax collections reached $11.8 bn, exceeding the quarterly target by 14.3% and marking an 11.1% increase y-o-y. The sharpest gains came from personal income tax and the military levy, which rose by 43.7% to $2.5 bn following the end-2024 tax reform. VAT also remained a key source of revenue, contributing 21.6% of total receipts.
- **Non-tax revenues played an important role in the budget[1] structure**. In Q1 2025, non-tax revenues increased by 52.3% to $7.7 bn, increasing their share in total revenues to 34.7%. The main source of such revenues was military aid – $6.6 bn (86% of all non-tax budget revenues).
- **Defense expenditures dominated the spending structure, reflecting the ongoing full-scale war.** Total expenditures grew to $27.9 bn (+26.8% y-o-y), of which $20.8 bn (74.6%) was allocated to war-related needs. The Ministry of Defense alone accounted for $16.4 bn – 55% more than in Q1 2024 – boosted by international military aid funneled through the special fund.
- **Social expenditures declined due to policy adjustments and reduced transfers.** Spending on social support fell by 15.6% to $2.5 bn, with pension fund transfers down 26% following the shift of special pension categories to the general system. Assistance to vulnerable groups, including IDPs, dropped by over 30% due to stricter eligibility requirements, despite the launch of a new rental subsidy scheme for IDPs.
- **The budget deficit widened moderately, while financing remained balanced.** The overall deficit reached $5.7 bn (up 9.6% y-o-y), or $8 bn excluding grants. Net financing amounted to $5 bn, supported by domestic bond placements ($2.3 bn total) and external borrowing. The deficit remains manageable but highlights the need for continued funding diversification.
- **Donor funding showed signs of recovery, easing fiscal pressure.** Ukraine secured $2.3 bn in grants in Q1 2025–up 130% from the previous year – making up 11.6% of total revenues. Major loan disbursements included €3.5 bn from the EU under the Ukraine Facility, CA$2.5 bn from Canada, and $2.4 bn from the EBRD. However, overall external financing declined by 19%, making domestic instruments more critical.
- **State debt increased, mainly due to external liabilities tied to EU funding.** Total public and state-guaranteed debt rose to $171.7 bn (+13.6% y-o-y), driven by new EU commitments and currency revaluation. Most of this increase reflects contingent liabilities under the ERA mechanism, which are not serviced from the budget but linked to future proceeds from immobilized Russian assets.

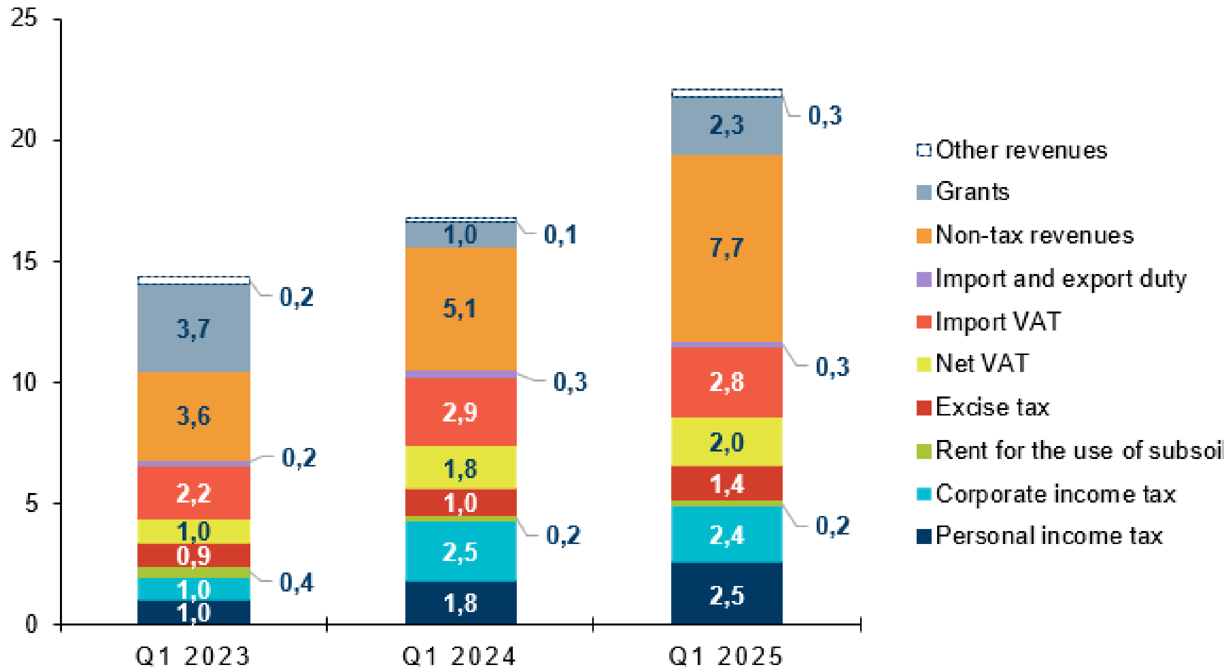
Ukraine's public finance system demonstrated continued adaptability under wartime conditions, aided by fiscal reforms, partners' engagement, and diversified financing tools. However, growing defense needs, the expiration of trade preferences, and unresolved debt restructuring issues pose significant risks for the second half of 2025. Careful mid-year adjustment and sustained partner support will be essential to maintain macro-fiscal stability.

[1] *"Budget" refers to the central (state) level budget*

## Budget Revenues

**Taxes remain the cornerstone of budget revenues in Ukraine, providing funding for the country's defense and security needs.** Despite the ongoing war and economic challenges, taxpayers continue to fulfill their obligations, which leads to sustainability in revenue collection. In Q1 2025, tax revenues exceeded the target by 14.3%, amounting to $11.8 bn vs $10.3 bn planned. Total tax revenues in the Q1 2025 increased by 11.1% compared to the same period in 2024 – from $10.6 bn to $11.8 bn.

**Figure 1. Structure of budget revenues in 2023-2025, $bn**




*Source: Ministry of Finance of Ukraine, Openbudget*

**Ukraine's Value Added Tax (VAT) remained the largest source of budget revenue in the first quarter of 2025, contributing 21.6% of total revenues, followed by personal income tax (PIT) and the military levy, which together accounted for 11.3%.** These two payments also demonstrated the strongest year-on-year growth, with collections rising by 43.7% compared to the same period in 2024 ($2.5 bn in Q1 2025 vs $1.8 bn in Q1 2024), largely as a result of tax policy changes adopted at the end of 2024. Specifically, the rate of the military levy was increased from 1.5% to 5%, and its scope was expanded to include individual entrepreneurs under the simplified taxation system. In addition to these legislative measures, higher VAT and PIT revenues were also supported by macroeconomic factors: annual inflation accelerated to 13.4% in February 2025, while the average monthly salary rose from $539 in December 2024 to $591 in March 2025.

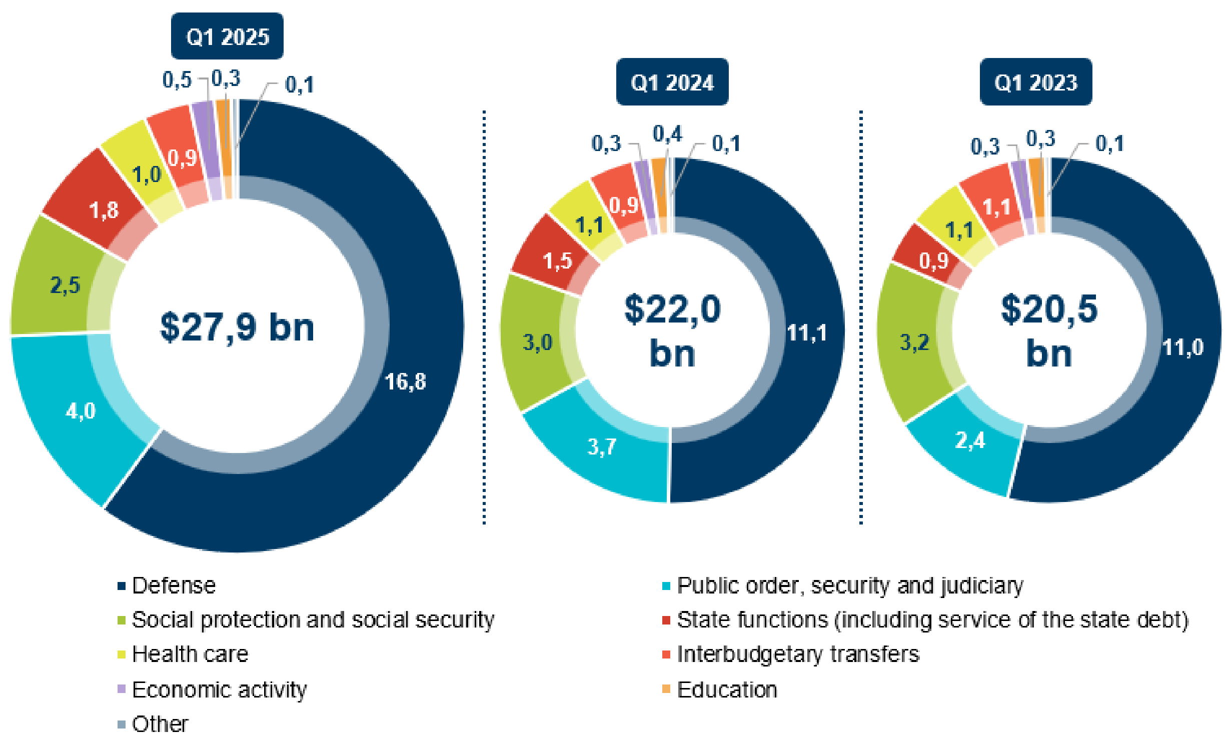
**In Q1 2025, the budget received 52.3% more non-tax revenues than in the same period of 2024 ($7.7 bn vs $5.1 bn)**. They accounted for 34.7% of all budget revenues in Q1 2025. Non-tax revenues in Q1 2025 were mainly generated by military aid, which amounted to $6.6 bn, or 86% of all non-tax revenues in the period. Of this total, Ukraine received about $1 bn (£752 mn) in financial assistance directed toward military purposes from the United Kingdom. These funds were received under the ERA program, which are guaranteed by the proceeds of frozen Russian assets.

**In the first quarter of 2025, the Ukrainian government secured $2.3 bn in grants – an increase of 138.7% y-o-y – demonstrating the continued importance of non-repayable external assistance.** Grants accounted for 11.6% of total budget revenues during this period, underscoring the critical role of donor support in maintaining fiscal stability. More than three years into the full-scale war, the consistent flow of grant funding remains a cornerstone of Ukraine's budgetary resilience, helping to finance priority expenditures without increasing state debt**.**

## *Budget Expenditures*

**In Q1 2025, budget expenditures rose to over $27.9 bn, marking a 26.6% increase y-o-y**. The main areas included war-related expenditures, social spending, and debt servicing.

**Figure 2. Structure of budget expenditures in 2023-2025, $bn**[2]




*Source: Ministry of Finance of Ukraine, Openbudget*

**War-related expenditures remained the dominant budget item, accounting for 74.6% of total spending, or $20.8 bn.** Of this amount, $16.4 bn was allocated to the Ministry of Defense, representing 58.9% of all budget expenditures and marking a 55% increase compared to the previous year. This growth stems from substantial inflows of military aid from international partners: through the special fund that channels this assistance, the Ministry of Defense disbursed $5.8 bn in Q1 2025, compared to only $2.7 bn during the same period in 2024. In addition, spending on the security sector increased to approximately $4 bn, a 9% rise y-o-y. This increase is linked to the absence of disruptions in the delivery of military-technical assistance at the beginning of the year, unlike in early 2024. Meanwhile, 25.4% of expenditures, or $7.1 bn, were directed toward socio-economic development, compared to 33%, or $7.3 bn, in the first quarter of 2024.

**The government reduced social expenditures across major categories, primarily due to legislative changes and a reallocation of pension obligations.** Social expenditures, amounting to $2.5 bn (-15.6% y-o-y) in the Q1 2025, primarily consisted of pension payments, social protection for individuals in difficult life circumstances (including internally displaced

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

persons, or IDPs), support for low-income families, and social protection for children, families, and people with disabilities. This reflects a broader trend of fiscal tightening, with cuts focused on less critical areas while core support for the most vulnerable is maintained.

**This decline reflects a broader trend of reduced social expenditures across key categories.** The largest cut was in budget transfers to the Pension Fund, which decreased by 26% (from $1.7 bn in Q1 2024 to $1.3 bn in Q1 2025) due to the shift as of January 2025. This was mainly due to a policy change starting in January 2025, when certain pension payments previously funded directly from the budget – including those for civil servants, academics, judges, prosecutors, and Chornobyl-affected individuals – were reassigned to the general pension system, funded by social security contributions. Expenditures on support for vulnerable groups, including IDPs, fell by 30.7% (-$173 mn), primarily due to legislative changes that reduced the number of eligible beneficiaries. A similar trend was observed for low-income families, where spending declined by 9.6% (-$47 mn) following the introduction of stricter financial and property-based eligibility requirements for housing and utility subsidies.

**In January 2025, an experimental project was launched to provide rental subsidies for IDPs, introducing for the first time state co-financing of housing costs to support vulnerable groups.** The support is available to IDPs who have relocated from areas where hostilities are ongoing or have previously taken place, do not own housing in government-controlled areas, have signed a formal rental agreement, and do not receive other housing-related benefits. The subsidy is granted for six months (or three months for non-working individuals) and is calculated based on household income, region, and the social housing norm (13.65 m² per person, with a minimum of 35.22 m² per household). The government also reimburses landlords for the personal income tax, military levy, and single tax (for entrepreneurs) on income earned from renting housing to IDPs. In 2025, about $215 mn is provided for in the budget to finance both the rental subsidy program and the tax compensation for landlords.

**Table 1. Actual expenditures on social payments in Q1 2023-2025, $bn**

| Indicator | Q1 2023 | Q1 2024 | Q1 2025 | Change (%, q-o-q, 2025 vs 2024) |
|---|---|---|---|---|
| Pension Fund funding for pension payments & covering deficit | 1.9 | 1.7 | 1.3 | (26.0) |
| Support for vulnerable citizens | 0.7 | 0.6 | 0.4 | (30.7) |
| Support for low-income families (including housing and utility subsidies) | 0.5 | 0.5 | 0.4 | (9.6) |
| Support for children & families | 0.2 | 0.2 | 0.1 | (16.8) |
| Support for persons with disabilities | 0.01 | 0.02 | 0.01 | (12.5) |

*Source: Ministry of Finance of Ukraine*

## *Budget Financing*

**In Q1 2025, Ukraine's budget deficit expanded due to a significant rise in expenditures that outpaced revenue growth.** The total deficit, including $2.3 bn in grants, reached $5.7 bn, marking a 9.6% y-o-y increase. Excluding grants, the deficit stood at $8 bn, reflecting a 29% y-o-y growth.

**The net total amount for budget financing in Q1 2025 amounted to $5.4 bn, which is down 38.6% y-o-y ($8.8 bn).** The financing of the budget deficit, as in previous periods, is based on a combination of domestic resources (government bonds, privatization) and external financial support. These instruments have continued to secure Ukraine's financial stability in 2025. However, domestic borrowing did not play a crucial role in financing during the Q1 2025. Gross domestic bond issuance declined from $3.1 bn in Q1 2024 to $2.4 bn in Q1 2025 because redemptions exceeded the amount of new bonds issued.

### Table 2. Budget funding sources (revenues and gross financing) in 2023-2025, $bn

| Resources | Q1 2023 | Q1 2024 | Q1 2025 | Change (%, q-o-q, 2025 vs 2024) |
|---|---|---|---|---|
| **Internal budget resources** | **10.7** | **13.7** | **14.2** | **3.6** |
| Domestic government bonds | 3.8 | 3.1 | 2.4 | (22.6) |
| Own budget revenues (without grants) | 6.9 | 10.6 | 11.8 | 11.3 |
| Share of internal budget resources | 49.3% | 56.4% | 62.3% | x |
| **External budget resources** | **11.0** | **10.6** | **8.6** | **(18.9)** |
| External loans | 7.3 | 9.6 | 6.3 | (34.4) |
| Grants | 3.7 | 1.0 | 2.3 | 130.0 |
| Share of external budget resources | 50.7% | 43.6% | 37.7% | x |

*Source: Ministry of Finance of Ukraine, KSE calculations*

**Despite their decline, international financial support and borrowing continue to play a crucial role in budget financing in 2025.** For 1Q 2025, gross external loans amounted to $6.3 bn (compared to $9.6 bn for the Q1 2024). The majority of external loans for the budget – $4.2 bn – were received through the ERA Initiative, which is backed by future revenues from frozen Russian assets. Canada provided an additional $1.7 bn, while the IMF disbursed $400 mn in the eighth tranche of its four-year Extended Fund Facility (EFF) program.

### Table 3. Sources and amounts of external loans to Ukraine in 2025

| Foreign loans received in 2025 | $ bn |
|---|---|
| **ERA** | **5.9** |
| *European Union* | *4.2* |
| *Canada* | *1.7* |
| **IMF** | **0.4** |

*Source: Ministry of Finance of Ukraine*

## *State Debt and State-Guaranteed Debt*

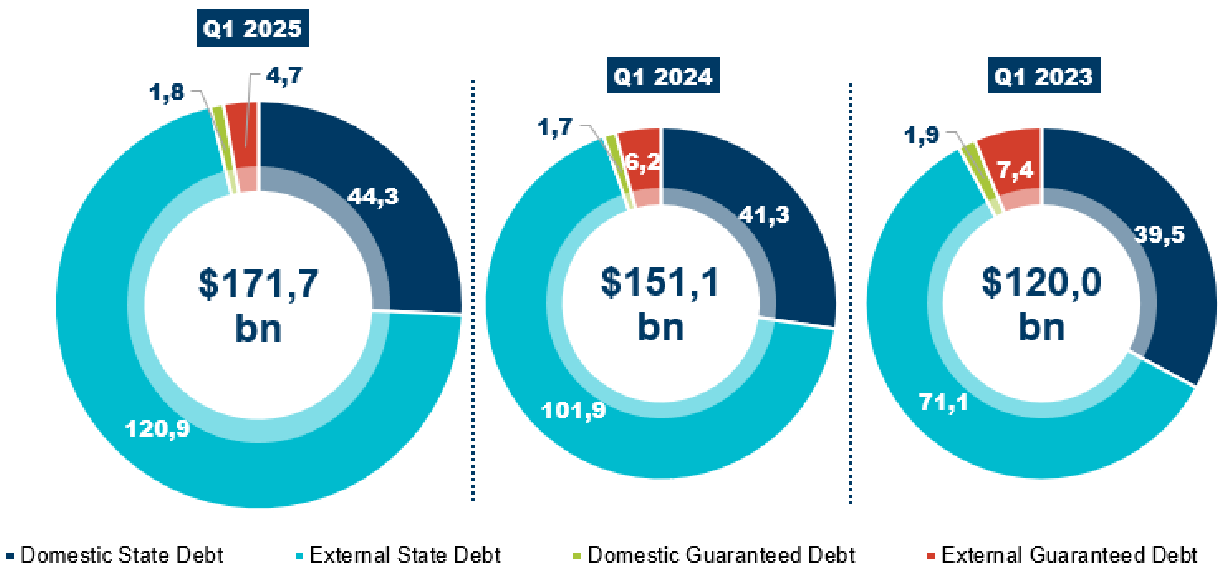
**Ukraine's state debt grew substantially in early 2025, driven by heightened borrowing needs due to budgetary deficits and the reliance on international financial support.** By the end of Q1 2025, total state and state-guaranteed debt reached $171.7 bn, marking a 13.6% rise compared to the end of Q1 2024.

**Ukraine's external state debt increased by 18.6%** compared to the end of Q1 2024, reaching $120.9 bn, which accounts for 70.4% of total state debt. Apart from new borrowings, the currency effect caused by the appreciation of the euro against the U.S. dollar in Q1 2025, was one of the key drivers behind this growth. Since a significant portion of Ukraine's debt to the EU is denominated in euros, its dollar-equivalent value rose even without additional borrowing.

**Ukraine's domestic state debt increased by 7.2%** compared to the end of Q1 2024 to $44.3 bn, accounting for 26.3% of total state debt. Notably, in February 2025, domestic debt significantly decreased due to the repayment of government domestic bonds. This indicates active debt portfolio management of the Ministry of Finance aimed at optimizing the debt structure and reducing servicing costs.

**State-guaranteed debt for the period from the end of Q1 2024 to the end of Q1 2025 decreased by 18.8% from \$8 bn to \$6.5 bn**. However, state-guaranteed domestic debt increased by 5.9%, from \$1.7 bn to \$1.8 bn, while state-guaranteed external debt decreased by 24%, from \$6.2 bn to \$4.7 bn.

**Figure 3. State Debt and State-Guaranteed Debt in 2023-2025, \$bn**




*Source: Ministry of Finance of Ukraine, KSE calculations*

## *Key Risks for 2025*

While no major fiscal risks are expected for 2025 due to strong commitments from international partners and sufficient external support (primarily via G7-backed conditional loans tied to future proceeds from frozen Russian assets and the implementation of the Ukraine Facility), several risks may emerge in the second half of the year and beyond:

- **Uncertainty around the duration and intensity of hostilities creates the need for potential mid-year budget adjustments.** As in 2024, the government frontloaded defense spending, which may require significant increases in the second half of the year if fighting continues. This pressure is compounded by the potential reduction or suspension of external (notably U.S.) military aid. To bridge the financing gap, the government may need to resort to further domestic borrowing, tax hikes (e.g., VAT), fiscal consolidation, and structural reforms aimed at reducing shadow economy revenues (*high risk*).
- **Failure to finalize the restructuring of GDP warrants (\$2.6 bn) by the end of May**, when a \$600 mn payment is due, may result in unexpected fiscal outflows or worsen future borrowing conditions, even if a default is avoided (*medium risk*).
- **The expiration of the EU's trade liberalization regime ("economic visa-free") on 5 June, without a favorable and timely replacement, may lead to an export decline of \$1.5–2 bn (up to 6% of total exports) and suppress GDP growth by 2.5%.** The risk is heightened by limited time for negotiating new terms, which range from reverting to pre-war arrangements to selective restrictions on key exports (*high risk*).

**Table 4. Ukrainian budget, $bn**

| Indicators | Q1 2023 | Q1 2024 | Q1 2025 | Change (%, q-o-q, 2025 vs 2024) |
|---|---|---|---|---|
| **Total revenues** | **14.4** | **16.8** | **22.2** | **32.1** |
| Grants | 3.7 | 1.0 | 2.3 | **130.0** |
| **Non-tax and other revenues** | **3.6** | **5.1** | **7.7** | **51.0** |
| **Tax revenues** | **6.9** | **10.6** | **11.8** | **11.3** |
| PIT | 1.0 | 1.8 | 2.5 | **38.9** |
| Corporate income tax | 1.0 | 2.5 | 2.4 | **(4.0)** |
| Rent for the use of subsoil | 0.4 | 0.2 | 0.2 | **0.0** |
| Excise tax | 0.9 | 1.0 | 1.4 | **40.0** |
| Domestic VAT (net) | 1.0 | 1.8 | 2.0 | **11.1** |
| Import VAT | 2.2 | 2.9 | 2.8 | **(3.4)** |
| Import and export duty | 0.2 | 0.3 | 0.3 | **0.0** |
| **Total Expenditures** | **20.5** | **22.0** | **27.9** | **26.8** |
| Defence | 11.0 | 11.1 | 16.8 | **51.4** |
| **Deficit** | **(6.1)** | **(5.2)** | **(5.7)** | **9.6** |
| **Deficit (net of grants)** | **(9.8)** | **(6.2)** | **(8.0)** | **29.0** |
| Net borrowings | 8.4 | 9.6 | 4.9 | **(49.0)** |
| Loans | 11.1 | 12.6 | 8.7 | **(31.0)** |
| Repayments | (2.7) | (3.0) | (3.8) | **26.7** |

*Source: Ministry of Finance of Ukraine, KSE calculations*

*Prepared by the Center of Public Finance and Governance at the Kyiv School of Economics*