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UKRAINE MACROECONOMIC HANDBOOK

Q1 2026

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Introduction and Assumptions

This forecast covers Ukraine's macroeconomic trajectory for 2025–28 in the context of ongoing Russian aggression, taking into account current and future opportunities once the war comes to an end. Projections rely on the Quarterly Projection Model (QPM) for the majority of macroeconomic indicators, with accounting-based modeling used for external, fiscal, and real sector dynamics—accompanied by expert assessments of issues related to current and future policy implementation. The transparent discussion of assumptions allows readers to adjust key forecast indicators based on their own beliefs. Assumptions are a major challenge given the extraordinary situation that Ukraine's economy has been facing for almost four years. The assumptions are based on expert judgments by the KSE Institute team and are summarized in Table 1 below.

Table 1. Key assumptions

	2021	2022	2023	2024	2025	2026	2027	2028
War intensity	Low int.	Full-scale					None/low int.	
Financial assistance, $ bn	7.5	31.3	42.4	41.4	50.3	78.8	61.1	18.2
o/w new EU loan	…	…	…	…	…	52.4	52.4	…
Macrofin. support*	…	…	…	…	…	17.5	17.5	…
Funding for defense*	…	…	…	…	…	34.9	34.9	…
o/w ERA	…	…	…	1.0	36.1	8.9	2.0	…
o/w EU Ukraine Facility	…	…	…	17.4	11.8	10.4	1.6	0.2
o/w IMF program	0.7	2.7	4.5	5.3	0.9	4.4	3.1	2.0
o/w future EU support**	…	…	…	…	…	…	…	16.0

**Disbursement schedule to be determined. **€100 billion within 2028–34 EU multiannual financial framework (MFF)*

For the purposes of this forecast, we maintain our assumption that the full-scale war will come to an end in late 2026 as a result of Ukraine's international partners' efforts to develop a comprehensive framework for a lasting peace and their imposing of additional economic and diplomatic pressure on Russia. However, there is a significant risk that other geopolitical developments could divide the coalition of allies, and that other conflicts may absorb substantial time and political capital. With Russia clearly not interested in any ceasefire or peace agreement at this point, these factors could lead to a meaningful prolongation of the full-scale war beyond 2026. Our assumption regarding war termination is in line with those used by other institutions, e.g., the European Union and the IMF, in their respective financial support mechanisms for Ukraine.

For Ukraine's macroeconomic stability, as well as budget and external financing, foreign assistance remains critically important. We assume that Ukraine will receive $158.1 billion in foreign grants and loans over 2026–28. This is a dramatic increase compared to the October forecast of $51.0 billion. The most important drivers are a recently adopted €90 billion loan from the European Union—including €30 billion in macrofinancial assistance and €60 billion for the strengthening of Ukraine's defense-industrial capacity—a new IMF program of ~$8.1 billion, and significant funding from the EU's Multiannual Financing Framework (MFF) for 2028–34. As the disbursement schedule and specific use of these funds is yet to be determined, our forecast is subject to considerable uncertainty; the overall amounts, however, are likely accurate.

The future trajectory of the war remains the key risk to the forecast. While we believe that assuming a conclusion to the full-scale war before the end of 2026 is realistic, hostilities may continue into 2027. As noted earlier, much depends on the approach that Ukraine's key allies take towards Russia. An even longer war would add to destruction and recovery needs, weigh on economic activity, prevent Ukraine from reducing defense and security spending or pursuing much needed fiscal consolidation, and reduce foreign capital inflows. In addition, risks stem from a potential redirection of partners' attention and support away from Ukraine; domestic imbalances, including regulated gas and electricity tariffs that remain below market levels; demographic pressures related to population decline and the non-return of migrants; and debt sustainability concerns that may require continued diplomatic engagement and tailored restructuring solutions. As a result, fiscal and external financing gaps could widen substantially. More immediately, Ukraine faces serious challenges due to the growing destruction of energy infrastructure in recent months.

Summary of Forecast

The key takeaways from KSE Institute's Q1 2026 Ukraine Macroeconomic Handbook are:

(1) Since the publication of the October 2025 forecast, Ukraine has been able to secure significant additional funding from its international partners, primarily through a €90 billion loan from the European Union consisting of macrofinancial assistance and funding for the strengthening of defense-industrial capacities. Additionally, this loan will enable the IMF to start a new multi-year program for Ukraine worth ~$8.1 billion, and further financial support will likely start arriving in 2028 as part of the EU's next Multiannual Financial Framework (MFF). Altogether, we assess that close to $160 billion in foreign grants and loans from partners will be disbursed over 2026–28. Importantly, key funding mechanisms such as the ERA and the new EU loan are set up in a way that limits threats to debt sustainability, which we had flagged in the October edition.

(2) The additional funding will ensure three key things: (i) Ukraine's budget will be financed until 2028, despite persistently high deficits due to large defense and security needs as well as rising social spending to address the considerable social impact of the war. Over 2026–28, we identify a residual fiscal financing gap of only $2.3 billion. (ii) Inflows of foreign assistance will offset large external financing needs stemming from a rapidly widening trade deficit and subdued non-resident investment during the full-scale war. We project that reserves will rise by close to $25 billion by 2028—a dramatic improvement compared to the previously expected large reserve loss. (iii) Defense and security needs will be met with total spending—within the budget and through other channels—totaling more than $130 billion in 2026 and above $100 billion in 2027.

(3) Despite the war and, in particular, serious disruptions to the energy supply, Ukraine's economy continues to demonstrate remarkable resilience, with real GDP growth projected to pick up from 1.9% in 2025 to 3.2% in 2026. Inflation has moderated—to 8.0% y-o-y at the end of last year—due to prudent monetary policy reinforced by the National Bank of Ukraine's credibility, and the exchange rate has been broadly stable vs. the U.S. dollar and depreciated moderately vs. the euro. Renewed attacks on the energy system represent the most immediate downside risk and could lead to significant output losses if they result in extended production and value chain disruptions. At the same time, newly-secured financial support from partners functions as a powerful offset. After the war, the recovery is set to gain momentum with growth averaging ~5% per year, contingent on the ability to attract sufficient foreign and domestic investment.

Table 2. Forecast for key indicators

	2021	2022	2023	2024	2025e	2026f	2027f	2028f
Real GDP growth, %	3.4	-28.8	5.5	2.9	1.9	3.2	4.6	5.3
Nominal GDP, UAH bn	5,451	5,239	6,628	7,659	8,920	10,035	11,468	13,221
Nominal GDP, $ bn	200.6	160.5	181.2	190.2	214.0	231.4	252.9	282.7
Budget balance, $ bn	-7.1	-28.4	-37.9	-33.4	-38.2	-44.7	-39.0	-29.5
Foreign grants, $ bn	0.9	17.5	14.1	14.0	14.3	4.7	0.4	0.0
Foreign loans, $ bn	2.3	16.6	30.7	28.3	42.5	74.8	60.7	18.2
Budget financing gap, $ bn	…	…	…	…	1.3	-4.6	-0.5	6.2
Headline inflation, % avg	9.4	20.2	12.8	6.5	12.8	7.4	7.5	8.2
Exchange rate (USD), avg	27.3	32.3	36.6	40.2	41.7	43.3	45.2	46.8
Policy rate, % avg	7.5	18.6	22.4	13.7	15.3	14.1	10.0	8.0
Current account, $ bn	-5.5	7.3	-9.3	-15.2	-33.8	-58.0	-56.0	-35.1
External financing gap, $ bn	0.2	2.3	-11.4	-2.9	-10.0	-14.0	-13.9	3.3
Total reserves, $ bn eop	30.9	28.5	40.5	43.8	57.3	71.2	85.1	81.8
Unemployment rate, % avg	9.9	20.6	18.2	13.1	10.8	9.0	9.9	7.9
Nominal wage, UAH avg	13,992	14,863	17,442	21,492	26,009	30,401	33,746	38,401

Ukraine's near-term growth outlook reflects a fragile balance between severe wartime disruptions and large-scale, externally financed stimulus. Real GDP growth forecasts for 2025 have been revised down in successive editions of the *Handbook*, and growth is now estimated to have reached 1.9% as intensified Russian strikes on energy infrastructure weighed on production, reduced private consumption, and increased imports. In the short run, renewed attacks on the energy system represent the most acute downside risk to GDP and household demand: if firms manage to adapt, output losses could remain limited (around 0.1–0.2% of GDP), but localized or prolonged energy system failures could result in substantially larger losses (up to 2–3% of GDP) as production becomes intermittent and value chains are disrupted. Private consumption is particularly vulnerable, as households cut discretionary spending, reallocate resources toward energy-related imports, and potentially relocate away from large cities. At the same time, the EU's new €90 billion loan provides a powerful offset through higher investment and the meeting of budget needs. This financing allows for an upward reassessment of growth to 3.2% in 2026. In 2027–28, we expect a structural shift away from exceptionally high government consumption toward investment and reconstruction and, overall, a further acceleration of real GDP growth to ~5% per year in the post-war period.

While Ukraine's trade deficit remains a structural challenge, its effect on external financing needs has been alleviated by new financial support, resulting in a considerable accumulation of reserves. Ukraine's trade deficit rose by 54.6% y-o-y in the first eleven months of 2025—even higher than previously expected—and is estimated to have reached $49.0 billion for the full year. While goods exports are recovering slowly, imports will remain significantly elevated due to new EU financing for defense-industrial capacity building, including weapons purchases. As war-related developments continue to weigh on Ukraine's services balance as well as remittances from abroad and foreign grants are set to fall sharply, the current account deficit is expected to rise $56–58 billion this year and next before narrowing in 2028.

Additional support from international partners significantly improves Ukraine's external financing situation and ensures macroeconomic stability. Non-resident capital inflows outside of foreign loans, i.e., direct and portfolio investment, will not pick up significantly until after the end of the full-scale war. In fact, FDI inflows were extremely low last year. Ukraine's external balance is supported, however, by a faster-than-expected drop in resident capital outflows. Altogether, financing needs will remain extremely high. However, recently secured support from the EU in the form of a new €90 billion loan and money under the 2028–34 budget, as well as a prospective new IMF program (+$6.0 billion vs. remaining disbursements of the old program) ensure that these needs will be met. As a result, we estimate that Ukraine will accumulate close to $25 billion in reserves over 2025–28 with the total reaching close to $82 billion by the end of 2028 This is a dramatic improvement compared to the October edition, when we had projected serious reserve losses.

Ukraine's state budget will be financed through 2028 due to stepped-up support from the country's international partners. Financing needs are expected to remain exceptionally high, with the budget deficit peaking at 19.3% of GDP in 2026 (or $44.7 billion), before gradually narrowing after the end of the full-scale war. Despite robust growth in tax revenues, a sharp decline in non-tax revenues (e.g., in-kind military support) and grants will lead to a ~16% decline in total revenues this year. Budget expenditures will also peak in 2026, as defense and security spending remains high at UAH4.5 trillion (or $102.9 billion). In the post-war period (i.e., 2027–28), total expenditures will decline as defense needs gradually moderate while priorities shift to social spending and reconstruction. Over 2025–28, we estimate a cumulative budget deficit of $151.3 billion, while committed and/or likely financing sources amount to $149.0 billion, resulting in a financing gap of only $2.3 billion. In our view, €30 billion in macrofinancial assistance under the recently-adopted EU loan and €15 billion from funding for the strengthening of Ukraine's defense-industrial capacity will be used for the budget. In addition, a new IMF program and the EU's 2028–34 Multiannual Financial Framework (MFF) will provide important funding, while Ukraine will also benefit from a return to the Eurobond market and non-resident inflows into domestically-issued debt after the war.

Ukraine's state debt has risen considerably during the full-scale war, reaching $197.4 billion in November 2025. Excluding obligations such as the ERA or the newly-adopted €90 billion EU loan, whose repayment is conditional on the (unlikely) receipt of reparations from Russia, debt as a share of GDP will stabilize at ~81% in 2026 before declining toward ~77% by 2028. The stabilization and expected subsequent gradual decline of Ukraine's debt-to-GDP ratio is the result of the country's international partners' decision to set up mechanisms, which provide urgently needed financing while limiting the burden from debt repayments and servicing and, thus, preserve debt sustainability. The headline debt-to-GDP ratio, which includes all obligations, is projected to rise to above 110% in 2027 before slowly moderating.

Headline inflation has continued to ease since its peak of 15.9% in May 2025—reaching 8.0% in December and beating even the most optimistic forecasts. This was primarily driven by supply-side factors—most notably stronger food supply—and supported by a broadly stable exchange rate, the NBU's conservative policy stance, and anchored expectations. Food prices remained the most volatile and policy-relevant component, driving a near-term drop while simultaneously creating upside risks for early 2026. Fuel, administrative, and services prices remained sources of pro-inflationary pressures. Inflation is expected to decline to 7.4% by the end of 2026, which will give the NBU more room to consider a cautious easing of monetary policy. However, there are significant near-term risks due to the destruction of energy infrastructure, which will primarily impact consumer goods and retail prices. We maintain our view that inflation will temporarily and moderately rise in 2027 due to post-war reconstruction and the economy's robust recovery.

The NBU maintained a tight monetary policy in Q4, keeping the key rate at 15.5% to control inflation and stabilize expectations in the context of pro-inflationary war-related risks. Due to the sustained downward trend in inflation, we expect a reduction in the policy rate to 13% by the end of 2026. Elevated lending and deposit rates in late 2025 indicate that monetary policy is transmitted effectively, albeit unevenly across borrowers. Corporate lending conditions improved in late 2025 but are still restrictive, underscoring that future monetary easing will support investment. The expansion of financial corporations' balance sheets in 2025 demonstrates a normalization of liquidity conditions and a recovering capacity of the financial system to provide credit to the economy. After the end of the full-scale war, the NBU is expected to permit a temporary increase in inflation driven by a positive output gap and refrain from tightening monetary policy during the reconstruction phase to support access to funding and the continued growth of businesses in Ukraine.

The hryvnia remained stable at 41.9 UAH/USD in Q4 2025 thanks to the NBU's interventions in the foreign exchange market. The underlying source of depreciation pressure remains Ukraine's increasingly structural trade deficit, which was 48% higher in 2025 than in 2024. We project a gradual depreciation toward ~44 UAH/USD by the end of 2026, as pressure on the hryvnia will continue with the trade deficit expected to grow further on the back of soaring imports. The hryvnia's movements against other major currencies—depreciation against the euro and slight weakening against the yuan—reflected global realignments, including a weakening U.S. dollar in light of uncertainty surrounding future Fed policies. Expectations remained broadly anchored (43.8–45.0 UAH/USD), with a positive outlook for external financing strengthening confidence.

Ukraine's unemployment rate continued to decline throughout the year, reaching 10.1% in Q4 2025, which reflects a tightening labor supply that is especially notable in high-skill segments. Business adaptation and a contracting labor force—due to mobilization and outward migration—have driven the continued downward trend in headline unemployment from a peak of ~26% in Q2 2022. However, the labor market is tighter than these figures suggest due to skills mismatches, and labor shortages remain the most-frequently cited constraint to business activity and growth. This has supported household incomes and reinforced cost pressures for businesses, with real wages growing by 8% in 2025. They are expected to continue rising but at a moderating pace as labor supply constraints gradually ease in the post-war period.

Differences between this forecast and the projections of other institutions largely stem from our inclusion of Ukraine's new external financial support, as well as differing assumptions regarding the strength of the post-war, investment-driven economic recovery. As the only forecast that accounts for new EU and (expected) IMF funding, KSE Institute projects significantly greater reserve accumulation and sharper deterioration in the current account deficit. The rate of post-war growth is also subject to disagreement, with KSE Institute forecasting a stronger recovery driven by investment and reconstruction. All forecasts expect strong nominal wage growth in the near term, further depreciation of the hryvnia (though pace and timing differ), and sustained wartime fiscal deficits as well as debt accumulation.

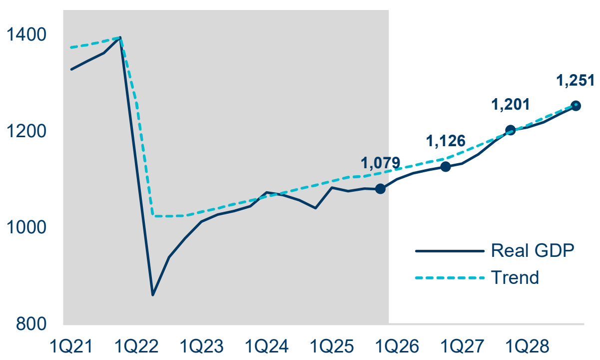
Economic Activity

Ukraine's growth outlook is driven by two key opposing forces: severe wartime disruptions, including to the energy infrastructure, which weigh on economic activity, and large-scale foreign support, which ensures macroeconomic stability and finances government spending. Estimates for real GDP growth in 2025 have been revised down several times, now standing at 1.9%, as intensified Russian strikes weighed on production, reduced private consumption, and increased reconstruction-related imports.

Renewed attacks on the energy system represent the most acute short-term downside risk: if firms manage to adapt through generators and load-shedding, output losses could remain limited (around 0.1–0.2% of GDP), but localized or prolonged energy system failures could result in substantially larger losses (up to 2–3% of GDP) as production becomes intermittent and value chains are disrupted. Private consumption is particularly vulnerable, as households cut discretionary spending, reallocate resources toward energy-related imports such as batteries and generators, and potentially relocate away from large cities.

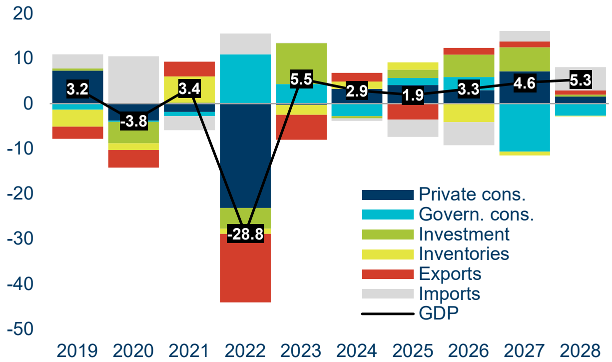
At the same time, the new €90 billion EU financing package provides a powerful offset through higher investment—especially in defense-related manufacturing and infrastructure reconstruction—and indirect support to private consumption via fiscal spending. This financing allows for an upward reassessment of growth to 3.2% in 2026, albeit while keeping extreme energy-related downside risks firmly in mind. A shift of demand away from exceptionally high government consumption toward investment, normalizing private consumption and net exports, will result in growth of ~5% in the post war years (see Figures 1 & 2).

Figure 1: Real GDP and trend, 2021 UAH billion



Source: SSSU, KSE Institute

Figure 2: Real GDP growth and contributions, in %/pp



Source: SSSU, KSE Institute

Private consumption has been the main stabilizing force of economic activity during the full-scale war, cushioning the impact of supply disruptions. In 2025, household spending proved resilient despite high inflation, energy insecurity, and ongoing hostilities—supported by real wage growth and targeted social transfers. As a result, private consumption became the single largest contributor to GDP growth, adding more than 4pp. Government consumption further reinforced this dynamic, with wartime fiscal expansion lifting public spending to around 40% of GDP in 2025, driven by defense expenditures, social support, and the maintenance of critical public services, and largely financed by foreign assistance.

Private consumption is expected to weaken temporarily in 2026 amid renewed attacks on energy infrastructure and elevated uncertainty, making winter-period consumption a key downside risk to the current forecast. In the post-war phase, it is projected to rebound strongly and partially offset a decline in government consumption, as military spending gradually recedes after peaking in 2025–26. Nevertheless, public spending is expected to remain structurally elevated relative to pre-war levels, reflecting persistent security needs and the reorientation of foreign support toward public investment and reconstruction.

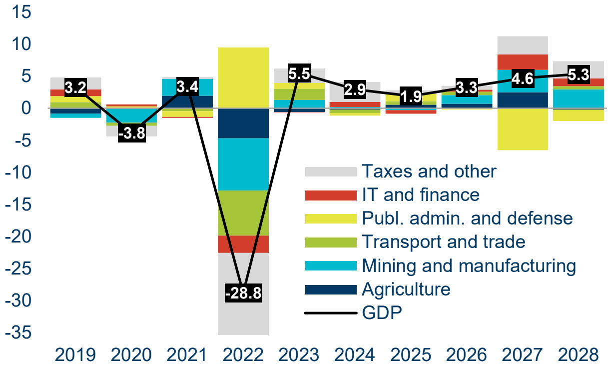
Fixed capital formation is set to become the dominant driver of growth in the post-war period. After a deep collapse at the onset of the full-scale invasion, gross fixed capital formation rebounded strongly in 2025. It was supported by state-funded recovery projects, direct donor financing, and private investment by relocated enterprises. While inventory drawdowns generated a large negative contribution to growth in 2025, reflecting logistics disruptions, energy outages, and security risks, this effect is expected to reverse gradually.

From 2026 onward, investment growth is projected to accelerate as large-scale reconstruction intensifies, underpinned by concessional financing, public-private partnerships, industrial relocation, and reforms in public investment management, war-risk insurance, and FDI policy. By 2028, the investment share of GDP is expected to reach around 29%, well above pre-war levels, anchoring a shift toward an investment-led growth model. The view is largely supported by international stakeholders and partners through numerous formats, including the recently announced “prosperity plan,” which seeks to facilitate international companies’ access to the Ukrainian market for significant investment projects.

External trade continued to weigh heavily on growth in 2025, reflecting elevated import needs and constrained export capacity. Wartime challenges such as damages to infrastructure, high logistics costs, and constrained port capacity reduced exports to about 25% of GDP. At the same time, imports remained close to 50% of GDP, driven by energy, military and other machinery and equipment, and reconstruction inputs. As a result, net exports remained a major drag on growth at around -7pp in 2025. From 2026 onward, trade dynamics are expected to improve gradually. Exports are projected to recover as production capacity is rebuilt and maritime routes remain open, while imports will continue to soar, including due to €60 billion in financing from the EU for defense-industrial capacity. By 2027–28, declining real imports, rather than rapid export expansion, are expected to narrow the trade deficit, allowing net exports to turn from a drag on growth into a modest positive contributor for the first time since the full-scale invasion.

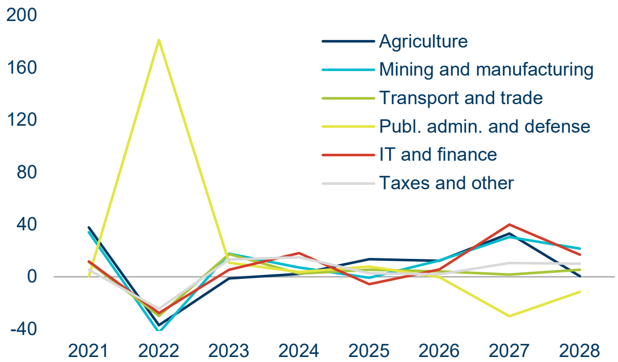
Sectoral developments in 2025 also point to an economy that remains constrained in wartime but is gradually reorienting toward an investment- and reconstruction-led growth model in the post-war period. Agriculture and extractive industries have acted as near-term drags on growth due to weather shocks, labor shortages, security risks, and logistics constraints, but both sectors retain significant rebound potential once demining, export access, and investment conditions (especially into CRM) improve, contributing to growth in 2027–28. Manufacturing has been resilient, but its recovery is expected to remain narrow until war termination brings greater energy reliability and investment acceleration, which will make the manufacturing sector—including an already strong military segment—a key post-war growth engine. For now, defense, metallurgy, and reconstruction-linked industries are expanding while traditional branches of manufacturing have stagnated. Energy and transport continue to function primarily as enabling sectors: while their own real output gains are limited, large-scale investment in power generation, grids, and logistics is critical to unlocking capacity in all industries. Construction, meanwhile, emerged as the strongest cyclical driver in 2025, supported by public and donor financing, and is expected to remain a major multiplier through its linkages with metallurgy, non-metallic minerals, and services. Trade, and consequently consumption, served as primary drivers of economic activity in recent years, but will assume a less prominent role during the investment-led recovery phase (see Figures 3 & 4).

Figure 3: Real GDP growth and contributions, %/pp



Source: SSSU, KSE Institute

Figure 4: Real growth of key GDP sectors, % y-o-y



Source: SSSU, KSE Institute

Agriculture remained a key pillar of Ukraine’s economy, but output weakened as weather shocks and wartime labor constraints offset an earlier recovery. Total agricultural production declined by 6.6% in January–November, reversing part of the rebound seen in 2023–24 and underscoring the sector’s continued exposure to supply-side risks. The decline was driven mainly by crop losses linked to adverse weather, delayed harvesting, and mobilization-related labor shortages. Oilseeds and industrial crops were most affected, with soybean and sunflower output falling by 26.9% and 15.8%, respectively. These losses were partly offset by a ~3% increase in grain output that was supported by relatively favorable cereal yields and the partial normalization of farming activity in previously affected regions. Livestock production proved more resilient, reflecting stable domestic demand and adaptive farm practices.

Policy support and producer adjustment helped limit the contraction in agricultural activity. Government measures, such as subsidies for small farmers, expanded crop insurance, and prioritized reconstruction of irrigation provided targeted relief, while producers invested in storage capacity and mobile grain dryers. Structural constraints continue to weigh on the recovery, however. Elevated fuel and fertilizer costs, labor shortages, limited access to credit, and constrained export logistics remain binding. A durable recovery will depend less on short-term policy support and more on faster demining of agricultural land, sustained logistics and port access improvements, and deeper integration into global markets. We expect a strong rebound, with a +2.5% impact on real growth from agriculture in 2027, compared with ~0% during the 2023–26 period.

Extractive industries remained under heavy pressure in 2025, continuing a wartime contraction shaped by both structural weaknesses and direct security shocks. Total mining output fell by 10.6% y-o-y in January–November 2025, reflecting sustained declines in coal mining, iron ore extraction, and hydrocarbons. Iron ore production dropped by 6.7% as logistics bottlenecks and constrained export routes limited output and discouraged investment. Coal mining also remained depressed, particularly in Donetsk and Luhansk regions, where many mines are occupied, damaged, or destroyed—though some western mines marginally increased production to support domestic power generation. Energy extraction faced additional setbacks. In 2025, Russia attacked Ukraine's gas production infrastructure with missile strikes for the first time, directly disrupting gas and oil output. Meanwhile, the effective cessation of Russian gas transit through Ukraine's pipeline system in 2024 removed a key source of revenue and sharply reduced pipeline-related activity in 2025, further weakening incentives for gas extraction and transport operations.

A partial counterweight came from non-metallic mineral extraction: quarrying of construction materials such as limestone, sand, and gravel remained broadly at the previous year's level, supported by strong domestic demand linked to reconstruction and housing activity. Nevertheless, overall sectoral recovery remained limited. Ongoing security risks, repeated attacks on energy and transport infrastructure, electricity shortages, high equipment replacement costs, and a shortage of skilled labor weighed on operations. The loss of Black Sea export routes continued to suppress iron ore and metals exports, while volatile global commodity prices and weak investor confidence limited capital inflows for maintenance or expansion. As a result, mining in 2025 showed only early signs of stabilization. The sector has significant room for improvement during the post-war period—including CRM projects—adding an additional 1.2–1.3% to total growth in 2027–28.

Manufacturing remained broadly stagnant in 2025, highlighting a highly uneven recovery in which wartime demand and reconstruction needs benefited a narrow set of industries while traditional branches stayed under pressure. Output rose by just 0.5% in January–November, though this masks strong divergence across subsectors. Defense-related manufacturing was the main growth engine, as firms expanded production of ammunition, drones, electronics, and military equipment for government procurement. Metallurgy recorded a moderate recovery, with steel and finished metal output up 8.3%, supported by a more stable power supply and improved export routes to the EU. Light industries such as furniture, wood processing, and parts of the textile sector achieved higher capacity utilization, in some cases nearing full capacity. Machinery and equipment production showed modest resilience with 1.9% growth, though it is still constrained by dependence on imported components, logistics bottlenecks, and energy risks.

In contrast, several traditional industries continued to contract: food and beverage production declined by 5.4% due to raw-material constraints and export disruptions, while oil-and-fat processing and parts of the chemical sector were hit by refinery downtime, high input costs, and logistics problems. Weak domestic demand, labor shortages, high energy prices, and intermittent outages further weighed on consumer-oriented manufacturing, particularly in eastern and southern regions exposed to security risks. Government support ("5-7-9%" program, defense procurement, and "Made in Ukraine" grants) helped stabilize activity and supported recovery in selected branches such as pharmaceuticals and construction materials. As a whole, the manufacturing sector has demonstrated adaptability under wartime conditions and will bring the strongest impact on post-war growth—1.6–2.3%—as investment and recovery gain steam.

The energy utility sector remained highly fragile in 2025, with temporary stabilization masking deep structural vulnerability. Output of electricity, gas, steam, and air-conditioning supply declined marginally (-0.8% in January–November), ending the wartime collapse. Electricity generation increased by 0.7%, supported by rapid repairs, grid fortification, international assistance, and reliable nuclear and hydropower output, allowing Ukraine to meet domestic demand and briefly resume limited power exports in the summer. Industrial electricity demand recovered alongside economic activity, while household consumption remained broadly stable, and fewer blackouts during the winter of 2024/25 pointed to improved short-term resilience, aided by air defense, emergency mobile generation, and milder weather. At the same time, electricity distribution fell by 2.4%, reflecting persistent infrastructure losses and the disappearance of industrial consumers in war-affected regions, while gas supply remained structurally constrained as attacks on production sites and the end of Russian transit sharply reduced pipeline utilization, partly offset by EU imports and storage injections. This relative stability proved short-lived: from late 2025, renewed large-scale missile and drone attacks on power plants, substations, and gas infrastructure reversed earlier gains, leading to renewed outages, higher operating costs, and deteriorating reliability. In the coming years, the sector will be a key enabler of the growth in other sectors and we expect significant investments, even if its own real output impact will not be particularly noticeable as it will grow in line with the broader economy.

Construction emerged as one of the main engines of economic recovery in 2025, driven by state- and donor-financed reconstruction. The construction production index rose by 12.2% in January–November, led by non-residential construction, which expanded by nearly 30% as repairs and new projects in commercial buildings, logistics facilities, and public infrastructure accelerated. Residential construction also increased (13.1%), supported by government mortgage programs and the rebuilding of war-damaged housing, while civil engineering works such as roads, bridges, and utilities recorded more moderate growth (3.2%) as priority infrastructure projects advanced. This expansion was underpinned by higher public capital spending, targeted grants for home repairs, subsidized mortgages, and externally financed projects to rebuild hospitals, schools, and transport links; business relocation to safer regions further boosted demand for commercial real estate and domestic production of construction materials. At the same time, growth remained uneven and fragile: security risks continued to disrupt activity in frontline regions, labor shortages due to mobilization and migration persisted, and higher material and wage costs squeezed margins, while supply-chain bottlenecks and investor uncertainty limited purely private developments. The sector will remain heavily dependent on public and donor financing. Like the energy sector, it will act as a key multiplier for related industries—notably metallurgy and non-metallic mineral production—even when it will contribute just ~0.5% real output growth.

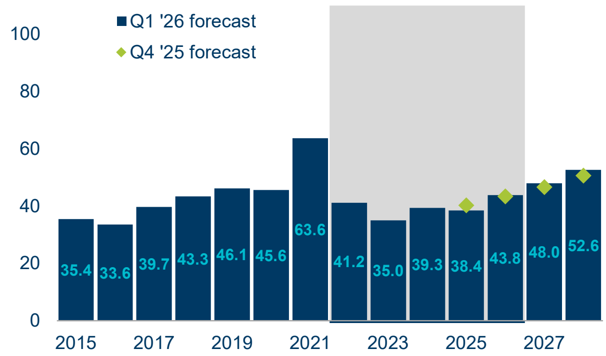
The trade sector became an important source of economic resilience in 2025, driven primarily by recovering household demand. Retail trade was the main growth engine: in January–November, retail turnover increased by about 7.2% in real terms, with a sharp acceleration toward year-end, including a surge of more than 14% in November. Rising incomes, improving consumer sentiment, and strong seasonal spending supported demand across both food and non-food categories, with particularly strong sales of clothing, electronics, and home goods as households replaced items lost or worn during displacement. Rapid growth of e-commerce and delivery services helped retailers mitigate physical risks and expand their reach nationwide, while both large chains and small businesses adapted by relocating to safer regions. Wholesale trade dynamics were more uneven, benefiting in some segments from inventory restocking, humanitarian flows, and military-related demand, while exporters of agricultural goods and commodities remained constrained by logistics bottlenecks linked to restricted Black Sea access. At the same time, inflation, regional disparities, and security risks continued to limit growth, as higher prices eroded purchasing power for lower-income households, hryvnia depreciation raised import costs, and supply bottlenecks persisted for import-dependent goods. Trade dynamics are strongly tied to consumption levels, and both are expected to make neutral contributions to growth during the investment-led post-war recovery period as they rise on par with the overall economy.

Transport and logistics remained one of the most constrained sectors of the economy in 2025, reflecting the permanent loss of transit capacity and ongoing wartime disruptions. Freight activity continued to contract, with total volumes down 9.5% and freight turnover falling even more sharply (-13.6% in January–November), pointing to shorter transport distances and the disappearance of long-haul transit flows, driven above all by the collapse of pipeline transport after the end of Russian gas transit and the continued contraction of water transport amid the blockade of major seaports. Rail and road transport carried the bulk of cargo, supporting exports via EU land corridors and Danube ports, as well as domestic distribution for reconstruction and humanitarian needs. Railways transported 148.6 million tonnes, though volumes remained 7.7% below 2024, while road transport proved slightly more resilient at 113.4 million tonnes (4.8% lower), supported by domestic trucking and EU-oriented logistics. By contrast, water transport remained the most severely affected segment, with volumes collapsing to just 0.9 million tonnes and freight turnover nearly 30% lower, underscoring the continued disruption of maritime and river routes. Passenger mobility improved modestly but stayed far below pre-war levels, with slightly higher journeys and longer average trips, while urban public transport and intercity rail played a central role in wartime mobility. Within the sector, warehousing, postal, and courier services provided a key stabilizing effect, as growth in e-commerce, humanitarian logistics, and military supply chains sustained demand for storage and parcel delivery, supported by expanded warehouse capacity near western borders and new logistics hubs linked to Danube ports and border crossings. As another enabling sector, the growth of the sector is tightly linked to that of overall output amid significant investment activity.

Balance of Payments

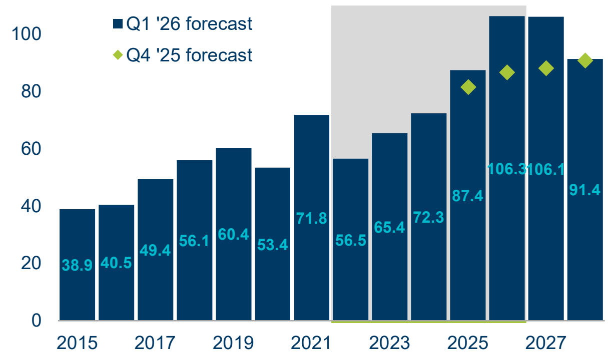
Higher-than-expected imports led to a faster deterioration of Ukraine's trade balance and new EU funding for defense will keep them elevated in 2026–27. Over January–November 2025, goods imports rose 22.3% y-o-y, with a notable acceleration from $6.5 billion per month in Q1 to $8.1 billion in October–November. This was driven to a significant extent by imports of electrical machinery (+40.0% y-o-y in Q1–Q3), transport equipment (+26.2%), mineral products (+11.8%), and chemical products (+10.4%). Exports, on the other hand, performed in line with expectations, declining 3.5% y-o-y in January–November 2025 on the back of a drop in exports of plant products (-23.3% y-o-y in Q1-Q3) and minerals (-8.4%), while those of metals were flat (-0.1%) and those of other agricultural goods and food performed well. As a result, Ukraine's trade deficit reached $44.6 billion in January–November—a 54.6% increase y-o-y ($28.9 billion in 2024). For context, KSE Institute projected a full-year trade deficit of $35.3 billion in its January 2025 forecast.

Figure 5: Goods exports, USD billion



Source: NBU, KSE Institute

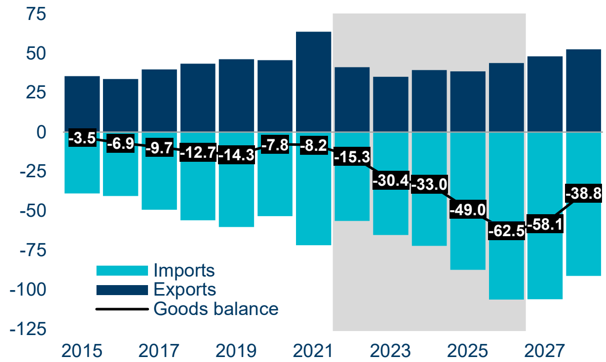
Figure 6: Goods imports, USD billion



Source: NBU, KSE Institute

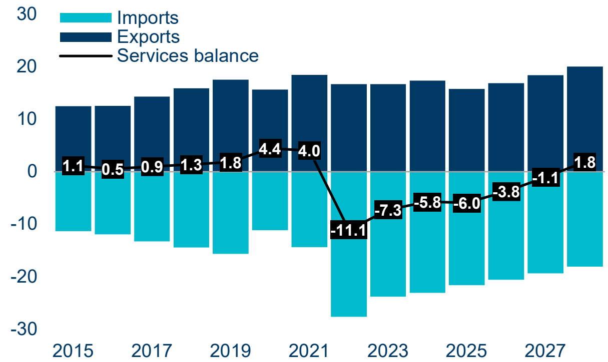
We have increased our forecast for goods imports in 2025 from $81.4 billion (in October) to $87.4 billion (see Figure 5). Recently secured funding of €60 billion from the EU for defense in 2026–27 (see "Introduction and Assumptions"), specifically weapons purchases, will lead to a sharp increase in imports, which has led us to increase our forecast to ~$106 billion annually for the two years. Here, we assume that around 25% ($17.4 billion) of the total amount will be needed to finance already-planned defense spending in the budget (see "Budget and Financing") and, thus, not result in additional imports, while the remaining $52.4 billion will be used in equal amounts for the procurement of weapons from abroad and from domestic producers, with the latter having a share of imported components of 40%. There is a considerable amount of uncertainty surrounding the specific allocation of the funds as well as the timeline of their execution. As our forecast for exports is broadly unchanged from the October edition (see Figure 6), we project a much wider trade deficit in 2026 ($62.5 billion vs. $41.3 billion) and 2027 ($58.1 billion vs. $43.2 billion) (see Figure 7). While this creates significant pressure on Ukraine's external balance, it is important to emphasize that the resulting financing needs are being met by commitments from international partners.

Figure 7: Trade balance and components, USD billion



Source: NBU, KSE Institute

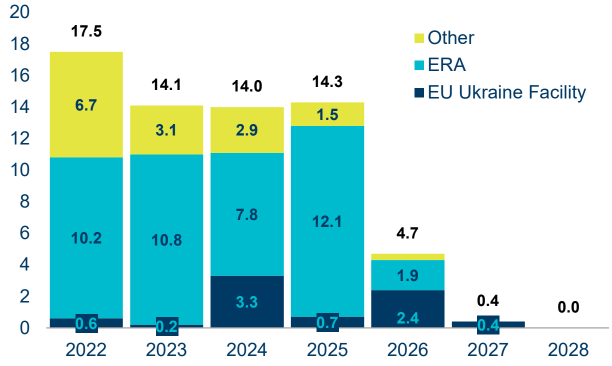
Figure 8: Services balance and components, USD billion



Source: NBU, KSE Institute

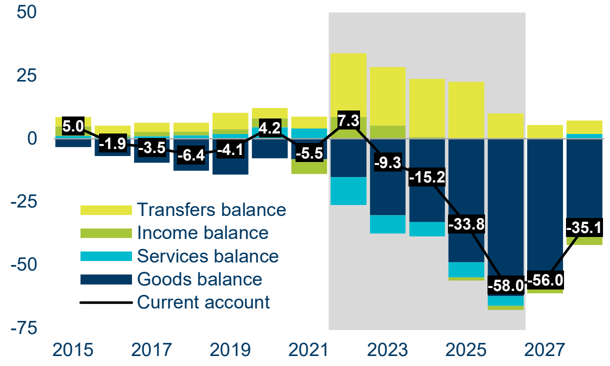
Ukraine's services balance is expected to improve in the coming years. Significant improvements will not materialize until the end of the war, however. After a (revised) deficit of $5.8 billion in 2024, we project gradually narrowing deficits of $6.0 billion in 2025 ($5.5 billion over January–November), $3.8 billion in 2026, and $1.1 billion in 2027, before the balance will turn into a surplus of $1.8 billion in 2028 (see Figure 8). Payments related to travel services have been a major driver of Ukraine's services balance since 2022 due to the large number of refugees abroad, and are expected to decline to pre-war levels only in 2028, as the return of Ukrainians living abroad will take time and not start in earnest until the end of the war. Economic growth will partially offset these dynamics and limit the decrease in total services imports—from a peak of $27.7 billion in 2022 to $18–19 billion in 2027–28. Services exports are expected to grow robustly—by 15.3% in 2028 vs. 2024. However, based on the January–November 2025 outturn (-8.6% y-o-y), we have revised downward our projections for services exports for the entire period of 2025–28.

Figure 9: Foreign grants, USD billion



Source: KSE Institute

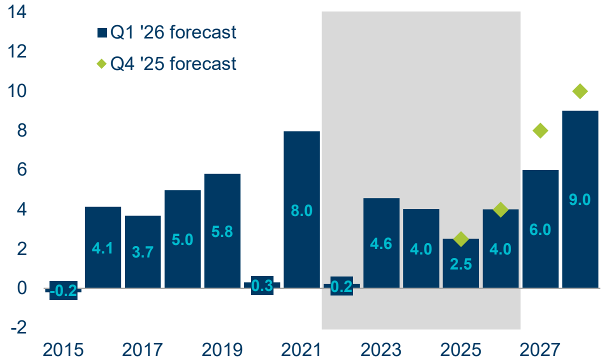
Figure 10: Current account and components, USD billion



Source: NBU, KSE Institute

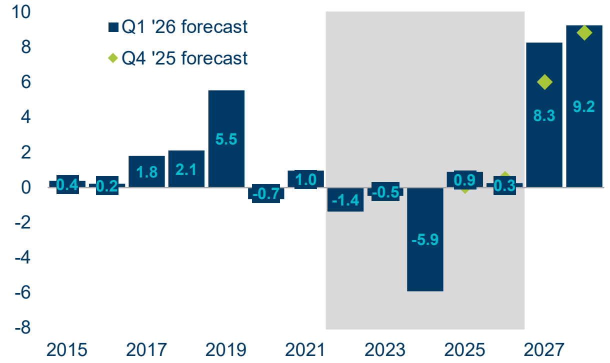
The current account deficit will widen considerably due to higher imports and lower foreign grants. In addition to the aforementioned dynamics in the goods and services trade, Ukraine's current account is heavily influenced by foreign grants, i.e., secondary income credits. They increased from less than $1.0 billion in 2021 to $17.5 billion in 2022 and remained at ~$14 billion in 2023–24, thereby limiting the war's impact on the current account. For 2025, we expect total foreign grants to have reached $14.3 billion—significantly higher than in the October forecast ($7.4 billion) as more information on specific arrangements under the ERA has emerged—followed by $4.7 billion in 2026 and $0.4 billion in 2027 (see Figure 9). Thus, the shift from grants to loans leads to a dramatic decline of the secondary income balance, which will, in turn, widen the current account deficit. While a shift from grants to loans is immaterial for overall external financing needs, it moves money from the current account to the financial account. Overall, we expect Ukraine's current account deficit to grow from an estimated $33.8 billion in 2025 ($30.6 billion over January–November) to $56–58 billion in 2026–27, respectively, before narrowing to ~$35 billion in 2028 (see Figure 10).

Figure 11: Non-resident direct investment, USD billion



Source: NBU, KSE Institute

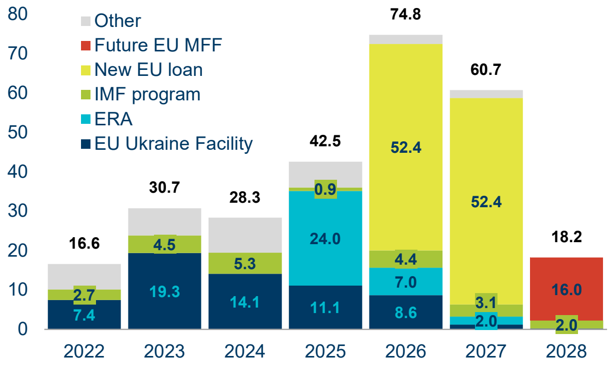
Figure 12: Non-resident portfolio investment, USD billion



Source: NBU, KSE Institute

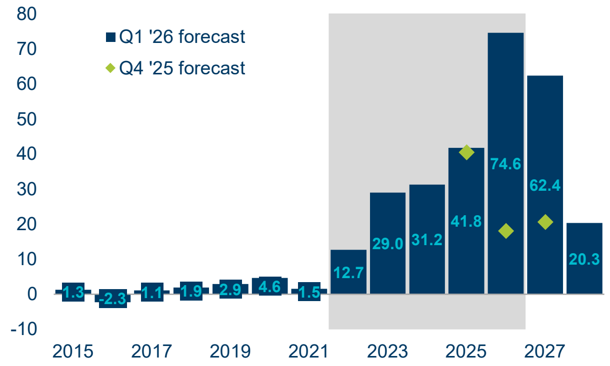
Capital flows are largely driven by official inflows, while direct and portfolio investment remain weak. Over January–November, FDI was significantly lower y-o-y at $2.0 billion (-48.5%). We maintain our forecast of $2.5 billion in 2025 and a noticeable pickup to $4.0 billion in 2026, although there is a downside risk. We also take a somewhat less optimistic view for 2027–28 (see Figure 11). Portfolio inflows have largely been absent during the full-scale war—the numbers in 2024–25 reflect debt restructuring—but we now assume a more forceful return to the market to finance the budget in 2027–28, with total issuance of €6.0 billion (see Figure 12). As for non-resident other investment, estimated inflows of $41.8 billion in 2025 will be in line with the previous forecast. Most importantly, the EU's recently adopted support mechanism, which will provide €90 billion in loans over 2026–27 for macro-financial stability and defense needs, as well as a new IMF program led to a dramatic revision to $74.6 billion in 2026 and $62.4 billion in 2027 (see Figures 13 & 14). For 2028–34, we also expect support under the new EU MFF. Ukraine's financial account also benefits from a faster drop in resident outflows ($2.7 billion over January–November 2025), though we do project a partial rebound of such flows as capital controls are loosened in the coming years (see Figure 15).

Figure 13: Foreign loans, USD billion



Source: KSE Institute

Figure 14: Non-resident other investment, USD billion



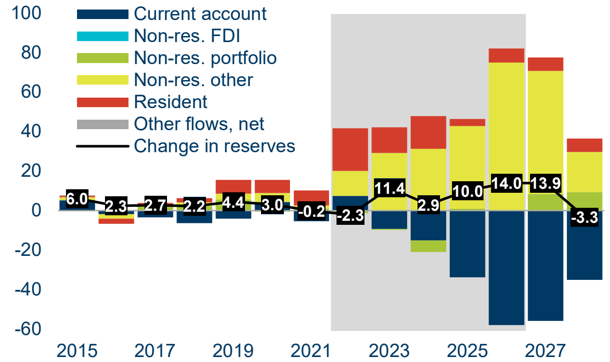
Source: NBU, KSE Institute

Newly secured support from the EU and IMF will allow for substantial reserve accumulation. On the back of disbursements of grants and loans—and due to a revaluation of existing assets driven by higher gold prices and a weaker dollar—Ukraine's international reserves increased to $57.3 billion at the end of 2025 (+$13.5 billion vs. end-2024). We project further accumulation of $24.5 billion over the forecast period of 2026–28 (see Figure 16) and, thus, a level of $81.8 billion (leaving aside future valuation effects). This is a major revision of our October forecast, when we expected reserves to fall by $28.5 billion over this period. Additional foreign support through the EU loan adopted in December (€90 billion), a new IMF program (+$6.0 billion), and the next EU budget framework (~€14 billion per year over 2028–34) fundamentally changes the outlook for Ukraine's balance of payments and will ensure macroeconomic stability over the forecast period.

Figure 15: Resident capital outflows, USD billion

Source: NBU, KSE Institute

Figure 16: Drivers of change in reserves, USD billion



Source: NBU, KSE Institute

Table 4. External sector forecast

$ billion	2021	2022	2023	2024	2025e	2026f	2027f	2028f
Current account balance	-5.5	7.3	-9.3	-15.2	-33.8	-58.0	-56.0	-35.1
Goods balance	-8.2	-15.3	-30.4	-33.0	-49.0	-62.5	-58.1	-38.8
Exports	63.6	41.2	35.0	39.3	38.4	43.8	48.0	52.6
Imports	71.8	56.5	65.4	72.3	87.4	106.3	106.1	91.4
Services balance	4.0	-11.1	-7.3	-5.8	-6.0	-3.8	-1.1	1.8
Primary income balance	-5.8	8.5	5.1	0.8	-1.3	-1.6	-2.2	-3.4
Secondary income balance	4.6	25.2	23.2	23.1	22.5	9.9	5.4	5.3
Foreign grants	0.9	17.5	14.1	14.0	14.3	4.7	0.4	0.0
Non-resident capital flows	10.4	11.5	33.1	29.3	45.2	78.8	76.6	38.5
Direct investment	8.0	0.2	4.6	4.0	2.5	4.0	6.0	9.0
Portfolio investment	1.0	-1.4	-0.5	-5.9	0.9	0.3	8.3	9.2
o/w public Eurobonds	0.8	-0.3	-0.1	-5.3*	0.9*	0.0	3.5	3.5
o/w domestic gov. debt	0.2	-1.1	-0.4	-0.5	0.0	0.0	2.2	3.2
Other investment	1.5	12.7	29.0	31.2	41.8	74.6	62.4	20.3
o/w public loans	0.9	15.3	28.0	27.6	38.5	71.3	57.4	15.3
Resident flows (- = outflow)	-7.7	-21.5	-13.1	-16.5	-3.7	-7.1	-6.8	-6.8
Change in reserves	-0.2	-2.3	11.4	2.9	10.0	14.0	13.9	-3.3
Total reserves	30.9	28.5	40.5	43.8	57.3	71.2	85.1	81.8
in months of imports	4.3	4.1	5.4	5.5	6.3	6.7	8.1	9.0

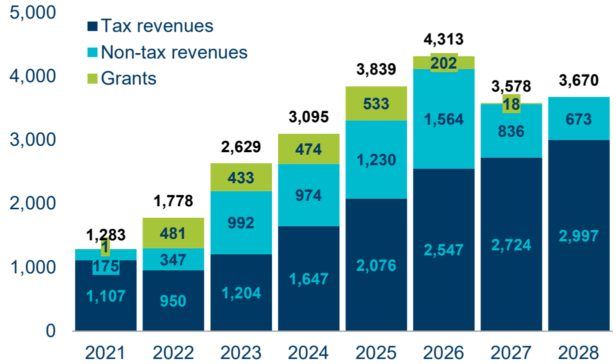
**Reflects debt restructuring*

State Budget and Financing

State budget revenues are projected to grow strongly this year, driven primarily by improved tax administration. Total revenues are estimated to reach UAH4.3 trillion (+12.3% y-o-y) in 2026, with tax revenues amounting to UAH2.5 trillion, non-tax revenues to UAH1.6 trillion, and grants of ~UAH200 billion (see Figure 17). The decline in grants (-62.2%) reflects a shift in foreign support toward concessional lending and a greater mobilization of domestic resources. In 2027–28, we expect a decline of revenues to UAH3.6–3.7 trillion, largely due to a sharp drop in non-tax revenues, which include in-kind military support, though tax revenues are set to grow at a robust pace (7.0% in 2027 and 10.0% in 2028). This will be underpinned by tax reforms, including a potential excise tax on sweetened beverages, taxation of digital income, and mandatory VAT payments for small and micro businesses, as well as strengthened efforts to reduce the shadow economy, improved revenue administration, and record profit transfers from the NBU.

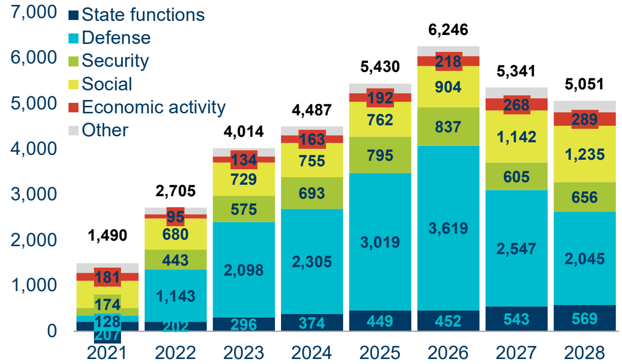
Over the medium term, we expect a transition toward a more sustainable public finance framework. Following a peak in non-tax revenues in 2026, the fiscal system is expected to gradually shift toward greater reliance on stable tax revenues. This transition will be supported by structural reforms outlined in the National Revenue Strategy, including the introduction of a progressive personal income tax, the elimination of inefficient tax exemptions, reform of the simplified taxation regime, measures to reduce the shadow economy, and large-scale digitalization of tax administration. Overall, this marks a shift from wartime fiscal flexibility toward the restoration of financial stability based on a broader and more sustainable tax base.

Figure 17: State budget revenues, UAH billion



Source: Ministry of Finance, KSE Institute

Figure 18: State budget expenditures, UAH billion

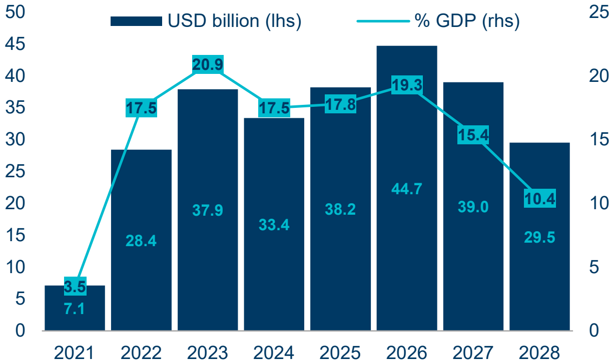


Source: Ministry of Finance, KSE Institute

State budget expenditures are projected to reach UAH6.2 trillion in 2026, up 15.0% from last year and 39.2% higher than in 2024 (see Figure 18). The increase is primarily driven by persistently high defense and security spending, expected to amount to UAH4.5 trillion ($102.9 billion) in 2026, up from UAH3.8 trillion ($91.5 billion) in 2025 and UAH3.0 trillion ($74.6 billion) in 2024. Non-defense spending is also set to rise by 10.8% y-o-y this year, reflecting new government initiatives in education, healthcare, and social protection. Following the end of the full-scale war, total expenditures are expected to gradually decline to UAH5.3 trillion in 2027 and UAH5.1 trillion in 2028, mainly due to lower defense and security spending, projected at UAH3.2 trillion ($69.7 billion) and UAH2.7 trillion ($57.8 billion), respectively. However, we assess that this reduction will be more gradual than previously expected, as Ukraine will need to maintain deterrence against future Russian aggression and replenish military stockpiles, partly supported by international financial and in-kind military assistance. As a result, defense and security spending will remain well above NATO averages, at 27.5% of GDP and 20.4% of GDP in 2027–28. Non-defense expenditures, including social protection, housing, and economic activity, are expected to grow moderately after the war, with a focus on support for IDPs, veterans, and infrastructure recovery.

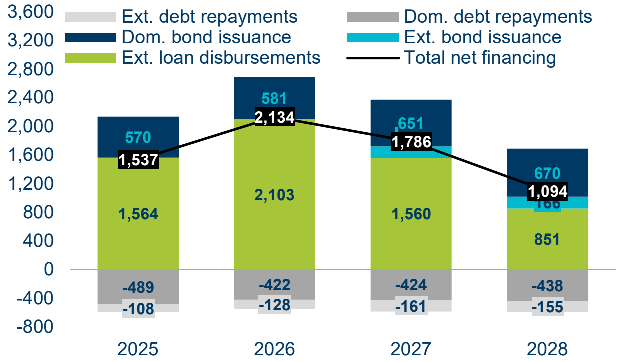
Ukraine's state budget deficit is expected to remain exceptionally high throughout the full-scale war. In 2026, the budget deficit is projected to reach UAH1.9 trillion ($44.7 billion or 19.3% of GDP), up from UAH1.6 trillion ($38.2 billion or 17.8% of GDP) in 2025 and the highest since the full-scale invasion. In the post-war period, the deficit is forecast to gradually narrow, declining to UAH1.8 trillion ($39.0 billion or 15.4% of GDP) in 2027 and to UAH1.4 trillion ($29.5 billion or 10.4% of GDP) in 2028 (see Figure 19). Despite meaningful consolidation, pressure on public finances will persist well beyond the end of the full-scale war, as defense and security expenditures remain elevated, vulnerable populations continue to require significant social support, and reconstruction efforts rely in part on public investment. Under these conditions, sustained and predictable financial assistance from Ukraine's international partners will remain critical.

Figure 19: State budget deficit



Source: Ministry of Finance, KSE Institute

Figure 20: State budget financing, UAH billion



Source: NBU, KSE Institute

Budget financing over the forecast horizon is expected to remain heavily reliant on international financial assistance. In 2025, the main sources of financing were funds disbursed under the EU's Ukraine Facility ($11.1 billion in loans) and the ERA mechanism ($24.0 billion in loans). These will also remain key funding channels in 2026, while additional support will be received under the new €90 billion EU loan and a new ~$8.1 billion IMF program (see Figure 20 & Table 5). We assess that €30 billion will be provided by the EU as macro-financial assistance over 2026–27 and €15 billion of the funds aimed at strengthening Ukraine's defense-industrial capacity will be used within the budget, while the remaining €45 billion will be managed outside of it. In addition, we expect Ukraine to receive ~€100 billion under the EU's Multiannual Financial Framework (MFF) for 2028–34, with a first tranche of ~€14 billion made available in 2028. Budget financing will also be available through a return to the Eurobond market (~€6 billion) as well as substantial inflows (~$5 billion) of non-resident investment into domestically-issued sovereign debt in 2027–28.

Altogether, we assess that the recently adopted EU loan, a new IMF program, and future funding within the EU's MFF will ensure that Ukraine's budgetary needs are met until 2028. Over 2025–28, we assess that financing needs amount to around UAH6.7 trillion or $151.3 billion ($169.3 billion without grants). For the same period, we identify committed or likely financing of UAH6.5 trillion or $149.0 billion, which overwhelmingly (~90%) stems from external sources. This means that, over the forecast period, only a minor financing gap of $2.3 billion remains. It should be emphasized that the exact disbursement schedules for the new EU loan and IMF program are yet to be determined, meaning that there could be shifts between years.

Table 5. State budget forecast

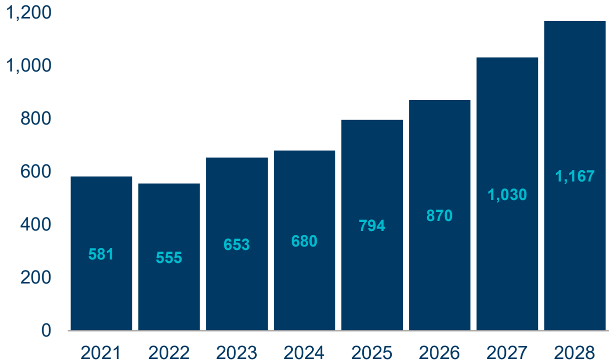
	2021	2022	2023	2024	2025e	2026f	2027f	2028f
State budget								
Total revenues, UAH bn	1,297	1,788	2,629	3,145	3,838	4,313	3,578	3,670
in % of GDP	23.8	34.1	39.7	41.1	43.0	43.0	31.2	27.8
Tax revenues, UAH bn	1,107	950	1,204	1,647	2,076	2,547	2,724	2,997
Foreign grants, UAH bn	1	481	433	474	533	202	18	0
Total expenditures, UAH bn	1,490	2,705	4,014	4,487	5,430	6,246	5,341	5,051
in % of GDP	27.3	51.6	60.6	58.6	60.9	62.2	46.6	38.2
Defense & sec., UAH bn	302	1,586	2,672	2,997	3,814	4,456	3,152	2,701
Overall balance, UAH bn	-193	-918	-1,386	-1,341	-1,590	-1,933	-1,763	-1,381
in % of GDP	-3.5	-17.5	-20.9	-17.5	-17.8	-19.3	-15.4	-10.4
Balance excl. grants, UAH bn	-195	-1,399	-1,819	-1.815	-2,123	-2,135	-1,781	-1,381
in % of GDP	-3.6	-26.7	-27.4	-23.7	-23.8	-21.3	-15.5	-10.4
Financing, UAH bn								
Domestic financing					81	158	227	232
Debt issuance					570	581	651	670
Repayments					489	422	424	438
External financing					1,455	1,975	1,559	861
Debt issuance					0	0	160	166
Loan disbursements					1,564	2,103	1,560	851
Repayments					108	128	161	155
Financing, $ bn								
Needs					38.2	44.7	39.0	29.5
Sources					36.9	49.3	39.5	23.4
Gap					1.3	-4.6	-0.5	6.2

Local and Consolidated Budgets

The continuation of the full-scale war through 2026 will keep pressure on local public finances, delaying the recovery of development spending and reinforcing dependence on own revenues and transfers from the state budget. Local budget revenues are projected to increase steadily from UAH0.9 trillion in 2026 to UAH1.2 trillion in 2028, driven mainly by personal income tax, gradual normalization of economic activity, and higher intergovernmental transfers (see Figure 21 & Table 6). Personal income taxes remain the core revenue source and account for more than two-thirds of local revenues outside of intergovernmental transfers. The medium-term forecast assumes a stable transfer policy, no major tax reforms before 2028, and a gradual expansion of the local tax base as reconstruction accelerates.

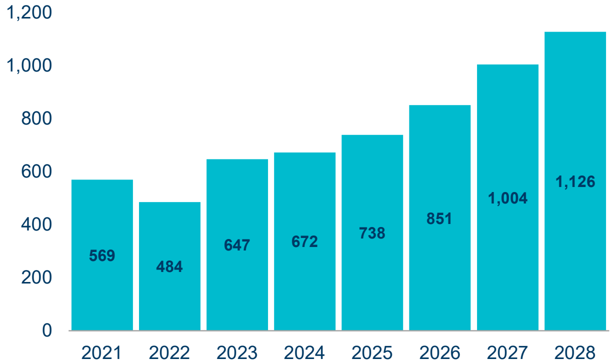
Local budget expenditures will remain constrained in 2026 at around UAH0.9 trillion, before expanding to UAH1.0 trillion in 2027 and UAH1.2 trillion in 2028 as municipalities shift from emergency stabilization to recovery and reconstruction (see Figure 22). Education will absorb an increasing share of expenditures due to higher teacher salaries financed through the education subsidy, while spending on housing and utilities will rise as post-war repairs intensify. Compared with the previous forecast, expenditures on social services are expected to increase, reflecting the late-2025 regulatory recommendation for municipalities to raise compensation to social workers. By contrast, wartime defense-related spending will decline after 2026, while cultural and community services gradually resume as facilities reopen and population needs normalize. Figures 23 & 24 as well as Table 6 show consolidated budget revenues and expenditures.

Figure 21: Consolidated budget revenues, UAH billion



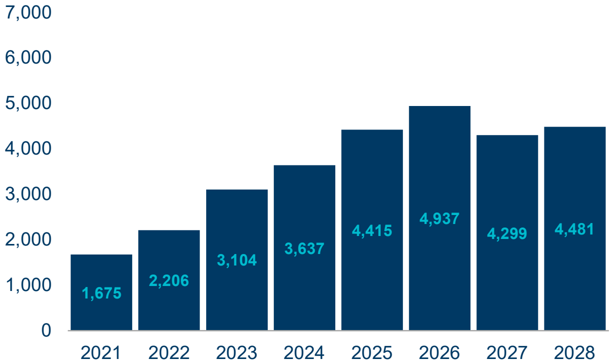
Source: Ministry of Finance, KSE Institute

Figure 22: Consolidated budget expenditures, UAH billion



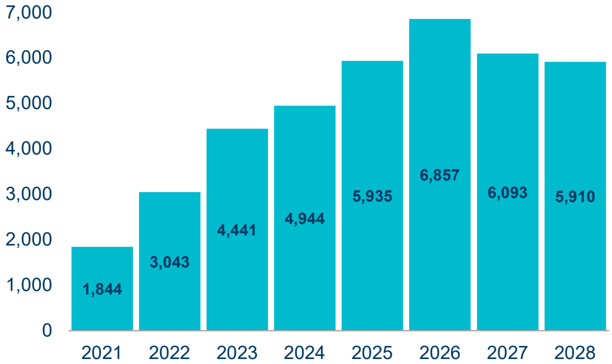
Source: Ministry of Finance, KSE Institute

Figure 23: Consolidated budget revenues, UAH billion



Source: Ministry of Finance, KSE Institute

Figure 24: Consolidated budget expenditures, UAH billion



Source: Ministry of Finance, KSE Institute

Table 6. Local and consolidated budget forecast

UAH billion	2021	2022	2023	2024	2025e	2026f	2027f	2028f
Local budgets								
Revenues	581	555	653	680	794	870	1,030	1,167
Expenditures	569	484	647	672	738	851	1,004	1,126
Balance	11	71	6	7	57	20	26	41
Consolidated budget								
Revenues	1,675	2,206	3,104	3,637	4,415	4,937	4,299	4,481
Expenditures	1,844	3,043	4,441	4,944	5,935	6,857	6,093	5,910
Balance	-170	-837	-1,337	-1,308	-1,520	-1,920	-1,793	-1,430

State Debt

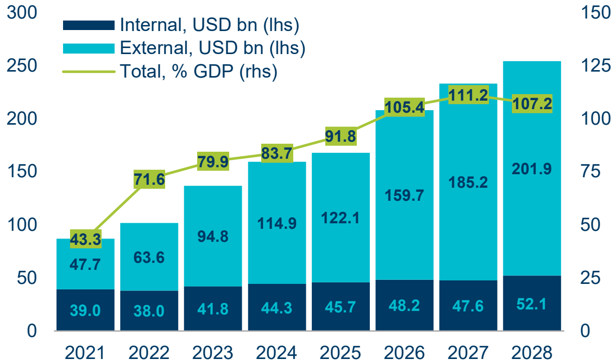
Ukraine's state debt has risen considerably since the start of the full-scale invasion, reaching UAH8.3 trillion (or $197.4 billion) by November 2025. Persistently high reliance on external borrowing has contributed to a shift in the composition of debt. On the one hand, the majority of external loans currently being extended to Ukraine (e.g., ERA and new EU loan) are provided with favorable concessional terms, making them very advantageous and imposing minimal additional debt service burden. On the other hand, the growing share of external debt introduces additional risks related to exchange rate depreciation.

In the baseline scenario, debt as a share of GDP will stabilize at ~81% through 2025–26 before falling toward 77% by 2028 (see Figure 25 & Table 7). These projections exclude obligations under the ERA loan mechanism as repayments are conditional on the (unlikely) receipt of reparations from Russia. The €90 billion to be disbursed by the EU for macrofinancial assistance and defense-industrial capacity building over 2026–27 will also only be repaid in the case of reparations payments. Moreover, the EU loan is non-interest bearing, which reduces the potential debt service burden considerably, while windfall profits from immobilized Russian sovereign assets abroad are being used for ERA-related interest payments.

The setup of new funding mechanisms is the main reason for the stabilization and subsequent decline in the debt-to-GDP ratio, with Ukraine receiving a large amount of foreign financial support in a manner that effectively does not increase its debt burden. Ukraine's international partners, thus, opted for the approach suggested in the October edition of the *Handbook*. This is also critical for the successful adoption of a new IMF program, as debt sustainability must be ensured. Including the ERA and new EU loan, debt will climb to above 111% of GDP by 2027 before moderately easing when less foreign support is received and GDP growth accelerates after the end of the war (see Figure 26 & Table 7).

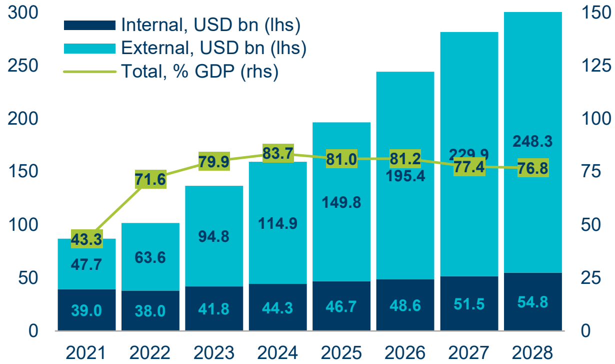
Any future funding mechanisms must take debt sustainability concerns into account. In addition, despite the favorable design of the ERA mechanism and new EU loan, Ukraine will face a considerable debt repayment burden for the foreseeable future due to loans already received since the start of the full-scale war. Its management, and the refinancing of amortizing loans, will become major topics of conversation after the end of the war; repayments will require refinancing, which will largely come from commercial sources.

Figure 25: Debt dynamics, excluding conditional loans



Source: Ministry of Finance, KSE Institute

Figure 26: Debt dynamics, including conditional loans



Source: Ministry of Finance, KSE Institute

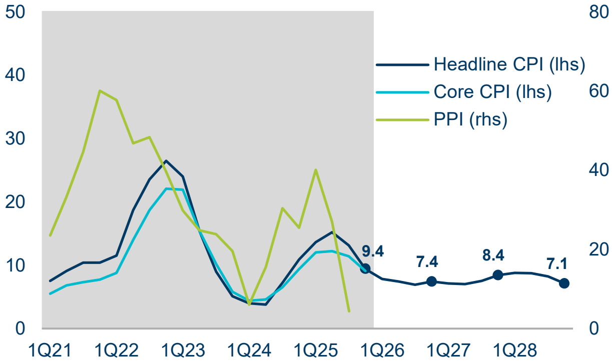
Table 7. Debt dynamics forecast

	2021	2022	2023	2024	2025e	2026f	2027f	2028f
Total debt, UAH bn	2,363	3,715	5,188	6,692	7,229	8,132	8,853	10,149
o/w external	1,300	2,325	3,600	4,829	5,285	6,029	6,525	7,588
o/w domestic	1,063	1,390	1,588	1,863	1,944	2,102	2,329	2,560
Including ERA, EU loan	*2,363*	*3,715*	*5,188*	*6,692*	*8,187*	*10,564*	*12,730*	*14,170*
Total debt, $ bn	86.6	101.6	136.6	159.2	173.5	187.8	195.7	217.1
o/w external	47.7	63.6	94.8	114.9	126.8	139.3	144.2	162.3
o/w domestic	39.0	38.0	41.8	44.3	46.7	48.6	51.5	54.8
Including ERA, EU loan	*86.6*	*101.6*	*136.6*	*159.2*	*196.5*	*244.0*	*281.4*	*303.1*
Total debt, % GDP	43.3	71.6	79.9	83.7	81.0	81.2	77.4	76.8
o/w external	23.9	44.8	55.4	60.4	59.2	60.2	57.0	57.4
o/w domestic	19.5	26.8	24.4	23.3	21.8	21.0	20.4	19.4
Including ERA, EU loan	*43.3*	*71.6*	*79.9*	*83.7*	*91.8*	*105.4*	*111.2*	*107.2*

Inflation

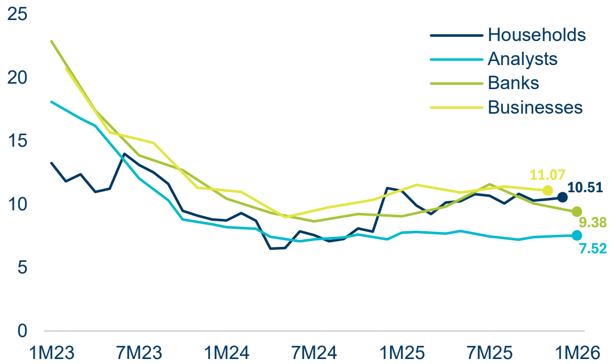
Inflation slowed in late 2025 and will continue to do so going forward, giving the NBU more room to consider cautious easing while taking into account significant risks to price stability. Annual inflation fell to 8.0% in December, down from 11.9% in September and the peak of 15.9% in May (see Figure 27). The slowdown was driven primarily by supply-side factors, most notably stronger food supply, and supported by a broadly stable exchange rate and the NBU's conservative policy stance to slow consumption. Altogether, inflation ended the year below even the most optimistic forecasts, as the prolonged impact of strong harvests on raw food prices more than offset higher business costs related to alternative energy sources. The downward dynamics will be supported by improving expectations, which sit at ~10% for most respondent categories (see Figure 28). However, near-term risks from destruction of the energy system will have a pro-inflationary effect that may not be fully offset by broader trends. We expect additional pressure of 1–2pp due to Russian attacks, mainly affecting consumer goods and retail prices. Later, inflation is set to decline to 7.4% by the end of 2026, followed by a moderate increase as the output gap will turn positive and trigger a demand-side shock in 2027 due to Ukraine's post-war reconstruction and economic recovery.

Figure 27: Inflation, % y-o-y



Source: NBU, KSE Institute

Figure 28: Inflation rate expectations (12M ahead), %



Source: NBU, KSE Institute

Food prices remained the most volatile and policy-relevant component of headline inflation, driving near-term disinflation while simultaneously creating upside risks for early 2026. In November, food and non-alcoholic beverage prices grew by 10.2% y-o-y, despite a sharp 29.8% y-o-y decline in vegetable prices thanks to favorable weather conditions and expanded planting. This supply-driven disinflation, however, is partially temporary. A substantial share of the harvest faces storage constraints due to damaged energy infrastructure and high costs of diesel-powered storage, raising the risk of a rebound in food prices as domestic supply diminishes in early 2026. Cost pressures were also evident in the processed food segment: bread prices increased by 13.5% y-o-y as bakeries faced elevated energy costs, while the livestock sector continued to experience supply constraints, pushing meat product and egg prices up (10.8%) this year.

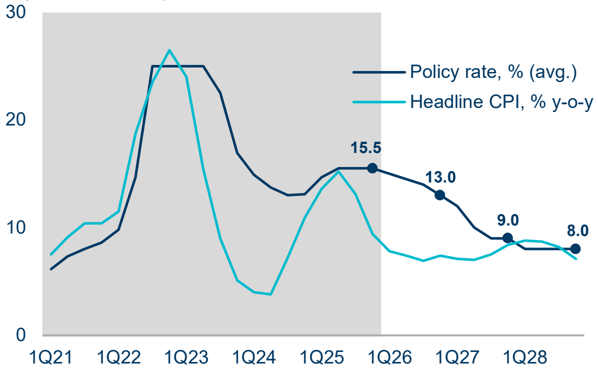
Fuel and administrative prices remained a secondary but persistent source of inflation, driven largely by regulatory and tax changes. Fuel price dynamics were broadly stable in Q4 2025, rising 6.4%, but the outlook for early 2026 is shaped by regulatory adjustments. In line with EU harmonization, higher excise rates came into effect on January 1, 2026. While retail prices for gasoline and diesel are expected to remain relatively stable, supported by declining global oil prices and sufficient domestic stocks, gas prices are more exposed and likely to rise. Administrative prices increased by 9.7% in 2025, driven primarily by tobacco excise hikes, with annual price increases for tobacco products reaching up to 27.7%, underscoring the ongoing policy-driven nature of inflation that will persist in the coming years. The pressure from international organizations and analysts to adjust administratively-regulated utility prices to market levels—closing the quasi-fiscal gap that exists—will remain a highly anticipated pro-inflationary risk.

Service prices remained a persistent component of core inflation, reflecting cost pressures that are only weakly responsive to monetary tightening. Although overall services inflation slowed to 12.3%, elevated price growth persisted in education (14.4%) and restaurants (13.5%). These dynamics were driven primarily by energy-related costs, as service providers relied on diesel and petrol-powered generators to maintain uninterrupted operations amid the ongoing energy deficit. Service prices also relate to continuous salary growth and decisions determining businesses' access to labor, e.g., mobilization laws that allowed 18–22-year-old men to leave Ukraine. These major pro-inflationary risks that exist in 2026 will subsequently be replaced by consumption and network effects during the post-war recovery.

Monetary Policy

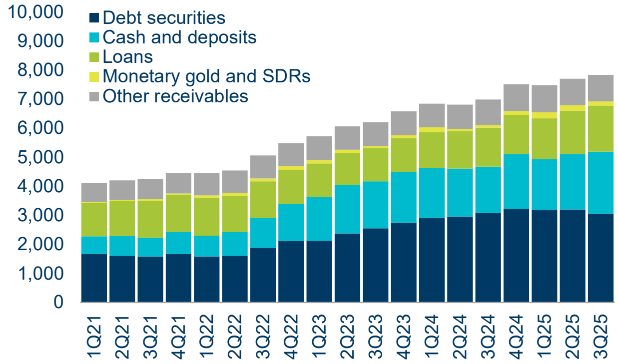
An improved macroeconomic environment with significant committed foreign financial support opens the door to policy easing even amid inflationary energy system destruction and blackout risks. As inflation expectations remained elevated and pro-inflationary war-related risks materialized, the NBU kept the policy rate at 15.5% on December 12, 2025. However, inflation dropped faster than expected to 8% in December, signaling a continuation of its downward trajectory. By the end of 2026, we expect a reduction in the policy rate to 13% as inflation is projected to ease further to ~7% (see Figure 29). After the end of the full-scale war, i.e., 2027 in our assumption, the NBU is expected to permit a temporary increase in inflation driven by a positive output gap and refrain from tightening monetary policy during the reconstruction phase to support access to funding and the continued growth of businesses in Ukraine.

Figure 29: Policy rate and inflation



Source: SSSU, NBU, KSE Institute

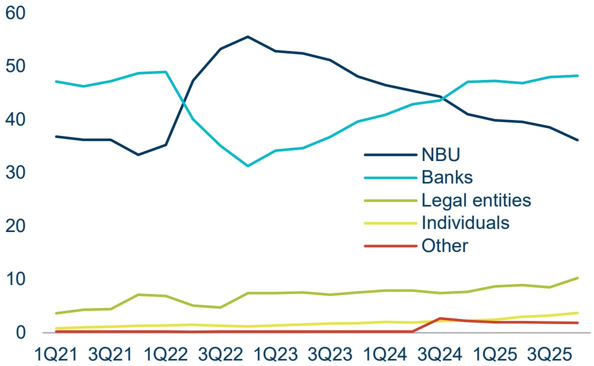
Figure 30: Financial assets of fin. corporations, UAH billion



Source: NBU, KSE Institute

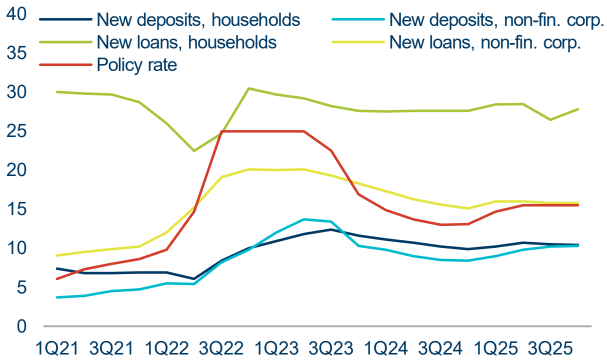
The expansion of financial corporations' balance sheets in 2025 indicates a normalization of liquidity conditions and a recovering capacity of the financial system to transmit monetary policy, which is set to continue in 2026–28. Financial assets grew by 13% to UAH7.8 trillion in Q3 2025 (see Figure 30). Debt securities remained the largest asset category, accounting for 39% of total assets (UAH3.1 trillion), reflecting continued demand for low-risk instruments amid elevated uncertainty. Cash and deposits, serving as liquidity buffers, accounted for 27% of assets (UAH2.1 trillion) and grew by 34%, pointing to improved confidence and deposit inflows. At the same time, loans increased by 18% to UAH1.6 trillion, indicating that credit activity is expanding both nominally and in real terms despite tight monetary conditions. The sharp rise in monetary gold assets (+68%) mainly reflects valuation effects from higher global gold prices.

Figure 31: Domestic bond holdings, % total



Source: NBU, KSE Institute

Figure 32: Interest rates, %



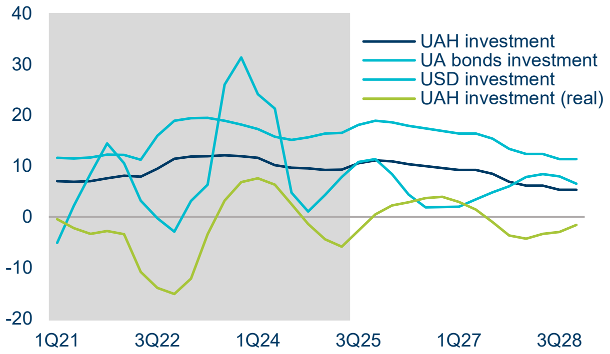
Source: NBU, KSE Institute

The structure of government bond holdings in 2025 points to a gradual normalization and reduced reliance on NBU support, signifying a healthier domestic bond market. Total holdings reached UAH1.8 trillion in Q4, up 11% in nominal terms but down marginally in real terms (see Figure 31). Banks, which continued to hold the largest share (48%), increased their holdings by 14% (above inflation), reflecting stable demand for sovereign debt amid elevated uncertainty. Individual investors recorded the fastest growth, with holdings rising by 83%, indicating a continued shift of household savings toward domestic currency instruments in line with the NBU's strategy. At the same time, the NBU's share of outstanding domestic bonds declined further to 36%, signaling the absence of monetary financing.

Elevated lending and deposit rates in late 2025 indicate that monetary policy is transmitted effectively, albeit unevenly across borrowers. In Q4 2025, interest rates for new household loans remained high at 27.8%

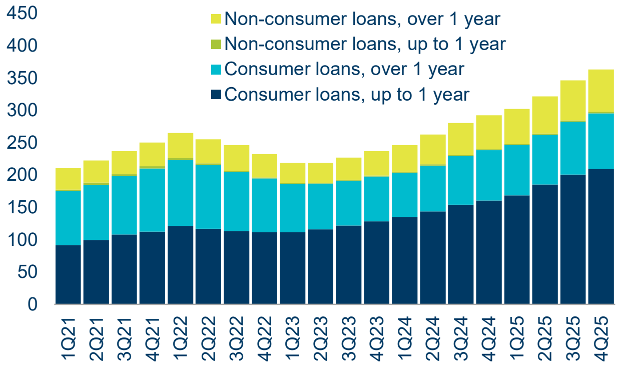
and significantly above those for non-financial corporations (15.8%), reflecting elevated credit risk and shorter maturities in retail lending (see Figure 32). For corporates, borrowing costs in 2026 are expected to broadly follow the policy rate, with an anticipated spread of around 2–3pp, suggesting a relatively stable pass-through and opening the door to cheaper funding. Deposit rates for households and non-financial corporations fluctuated moderately in 2025 in line with the policy rate, reaching 10.4% and 10.3%, respectively, in Q4, thereby continuing to support hryvnia-denominated savings (albeit to a much lesser extent than government bonds) and indicating an abundance of liquidity for banks. However, real profitability of investments (deposits and bonds) will only be positive in the near future, fading as policy easing and recovery gain steam (see Figure 33).

Figure 33: Profitability of investments, %



Source: NBU, KSE Institute

Figure 34: Loans to households, UAH billion

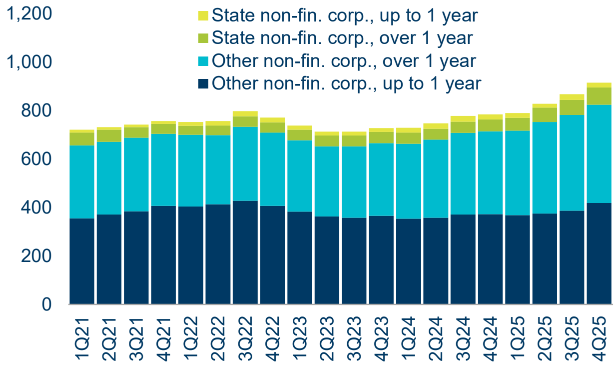


Source: NBU, KSE Institute

Continued household lending growth in late 2025 reflects short-term consumption spikes, in line with salary increases and optimistic income expectations. Despite a 27.8% interest rate for new household loans, their stock increased to UAH357 billion in Q4, up 24.1%. Consumer loans dominated, accounting for 81.3% of total household lending and remaining largely short-term (see Figure 34). Non-consumer loans accounted for 18.7%, with a relatively balanced maturity structure between short-term (54%) and long-term (45%) loans. The fastest growth was observed in short-term consumer and non-consumer lending, where nominal growth rates exceeded inflation at 30.6% and 48.6%, respectively. Thus, credit expansion is concentrated in short-maturity segments with limited implications for investment or medium-term inflation.

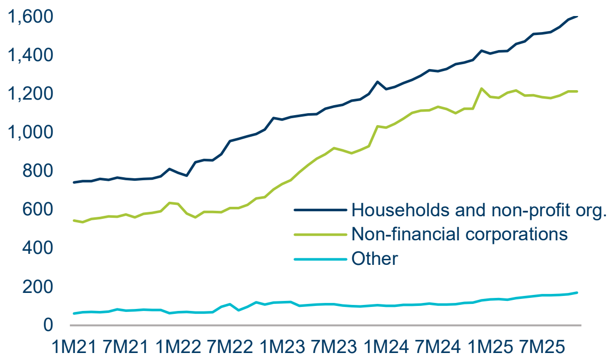
Corporate lending conditions improved in late 2025 but are still restrictive, underscoring that future monetary easing will support investment. Total loans to non-financial corporations reached UAH916 billion in Q4, remaining below pre-war levels in real terms (see Figure 35). Elevated borrowing costs—15.8% on new corporate loans in Q4—continued to weigh on credit demand and limited investment activity. Credit growth was concentrated in short-term lending, with loans of up to one year to non-financial SOEs expanding most rapidly (+46.5%), followed by those to other businesses (+23%). Overall, lending is still predominantly market-based, with private non-financial corporations accounting for around 90% of total corporate credit.

Figure 35: Loans to non-financial corporations, UAH billion



Source: NBU, KSE Institute

Figure 36: Resident deposits, UAH billion



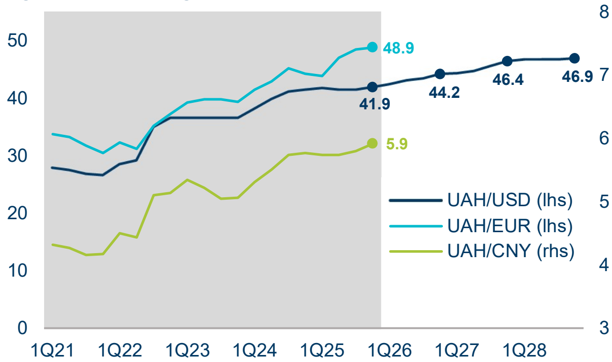
Source: NBU, KSE Institute

Deposit dynamics in late 2025 point to sustained confidence in the banking system and continued effectiveness of monetary policy in supporting hryvnia-denominated savings, even amid growing attractiveness of government bonds. Household and non-profit organization deposits grew at the fastest pace, increasing by 16.6% in November 2025—above the inflation rate—while non-financial corporation deposits expanded at a moderate pace of 8%. As a result, the share of business deposits declined slightly to 40.6% from 42.9% a year earlier (see Figure 36), while the share of household deposits continued to rise, reaching 53.6% (vs. 52.5% in November 2024. Overall, resident deposits amounted to UAH3 trillion in November 2025, reflecting 10% growth and reinforcing the banking sector's domestic funding base.

Exchange Rate

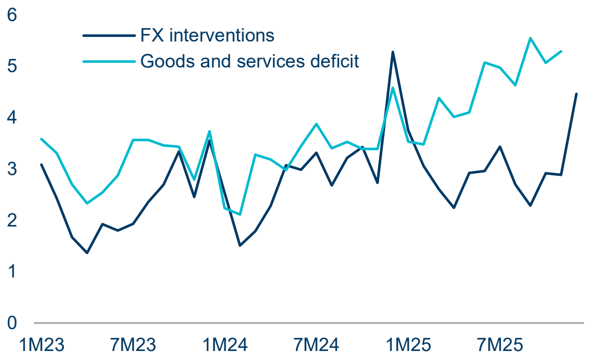
Hryvnia stability in 2025 was maintained through foreign exchange interventions by the NBU, which were supported by external financing. The ability to intervene going forward is ensured by additional assistance. The hryvnia remained broadly stable against the U.S. dollar at an average exchange rate of 41.5 UAH/USD in 2025 (see Figure 37). In Q4 2025, the NBU intervened heavily in the foreign exchange market, selling $3–4.5 billion per month to sustain stability and offset a negative goods and services balance of roughly $5 billion per month (see Figure 38). An increasingly structural trade deficit, which grew to an estimated $49.0 billion in 2025 (+48% vs. 2024), is the main underlying source of depreciation pressure. As the deficit is expected to increase further in 2026–27 due to soaring imports, including of weaponry, the hryvnia will remain under pressure. By end-2026, we project a gradual depreciation toward ~44 UAH/USD.

Figure 37: Exchange rates



Source: NBU, KSE Institute

Figure 38: NBU FX interventions, USD billion

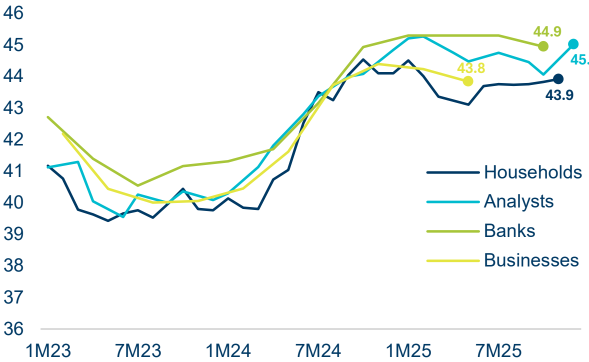


Source: NBU, KSE Institute

Movements of the hryvnia against other major currencies in late 2025 reflected global realignments. In Q4 2025, the hryvnia depreciated against the euro to 48.9 UAH/EUR and slightly weakened against the yuan to 5.9 UAH/CNY (see Figure 37). The former was largely driven by external factors, including a relatively strong euro amid signs of U.S. dollar overvaluation in real effective terms and shifting global expectations regarding U.S. monetary policy. By contrast, weakening against the yuan partly reflected the yuan's global appreciation and further deteriorated the bilateral trade balance with China. Taken together, these cross-currency dynamics marginally increased pressure on the exchange rate and underscore the importance of complementary structural measures, such as supporting export-oriented sectors and addressing distortive incentives in small-parcel imports, to mitigate external imbalances beyond the scope of monetary policy.

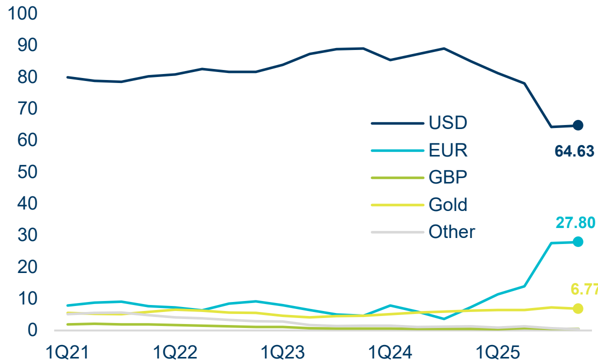
Expectations remained broadly anchored in late 2025 but are increasingly conditional on the outlook for external financing. One-year-ahead expectations converged in the range of 43.9–45.0 UAH/USD in Q4 2025, with financial analysts revising their forecasts upward, while household expectations remained relatively stable (see Figure 39). This divergence suggests that professional forecasters increasingly internalize medium-term BoP pressures, while households continue to focus on the prevailing exchange-rate regime. At the same time, expectations remain highly sensitive to the continuity and predictability of international support; thus, improved visibility of key developments in this area, including significant reserve gains, should further strengthen confidence. In parallel, the ongoing diversification of reserves, with the share of dollar-denominated assets declining to 64.2% and euro-denominated assets rising to 27.8% by end-Q4 2025, supports closer alignment with Ukraine's main trading partner and helps reduce cross-currency volatility (see Figure 40).

Figure 39: Exchange rate expectations (12M ahead), UAH/USD



Source: NBU, KSE Institute

Figure 40: Structure of international reserves, %

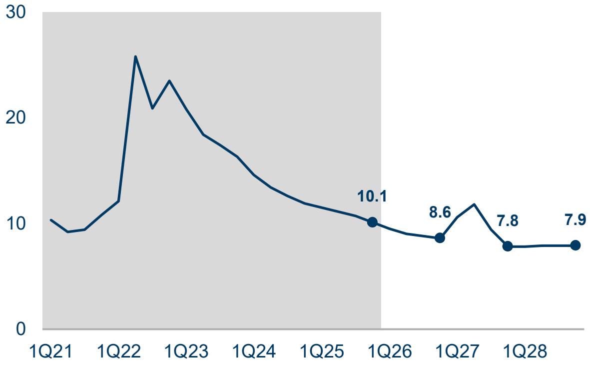


Source: NBU, KSE Institute

Labor Market

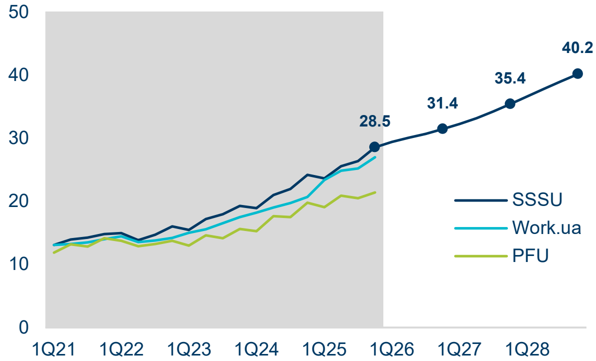
Ukraine's declining unemployment reflects tightening labor supply, signaling that labor availability is already a constraint on economic growth. The unemployment rate fell from 11.9% in Q4 2024 to 10.1% in Q4 2025 (see Figure 41), continuing the downward trend observed since the peak of ~26% in Q2 2022, driven primarily by business adaptation and a contraction of the labor force due to mobilization and outward migration. As a result, headline unemployment increasingly understates underlying labor market tightness, especially in skill-intensive segments of the economy. Unemployment is projected to decline further to around 8.6% by Q4 2026, before temporarily rising in H1 2027 when demobilization expands the labor supply and falling again when the excess labor is absorbed by reconstruction activity and investment-driven growth.

Figure 41: Unemployment rate, %



Source: SSSU, Info Sapiens, KSE Institute

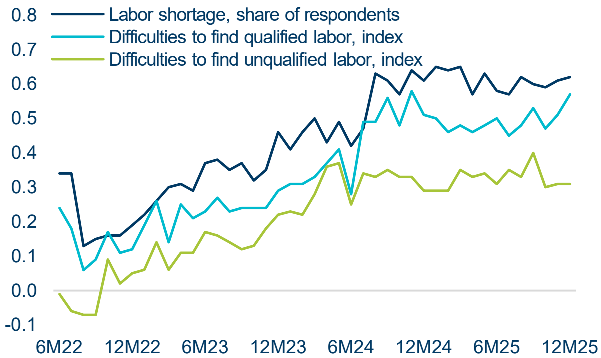
Figure 42: Nominal wage, UAH thousands



Source: SSSU, work.ua, PFU, KSE Institute

Strong nominal wage growth in 2025 further reflects acute labor shortages and continues to support household incomes, while also reinforcing cost pressures and competitiveness risks for businesses. Average nominal wages increased from UAH24,153 in Q4 2024 to UAH28,541 in Q4 2025—a 21% nominal and 8% real increase (see Figure 42). This dynamic is observed across data sources, including PFU (UAH21,421 vs. UAH19,741) and Work.ua (UAH27,000 vs. UAH20,660), underscoring the consistency of wage pressures across formal employment and vacancy postings. Looking ahead, real wages are projected to rise at a moderating pace, especially during the post-war period, as labor supply constraints gradually ease following demobilization and the return of displaced workers, while inflation continues to trend downward.

Figure 43: Recruitment challenges



Source: IER, KSE Institute

Figure 44: New job vacancies and CVs, thousands

Source: Work.ua, KSE Institute

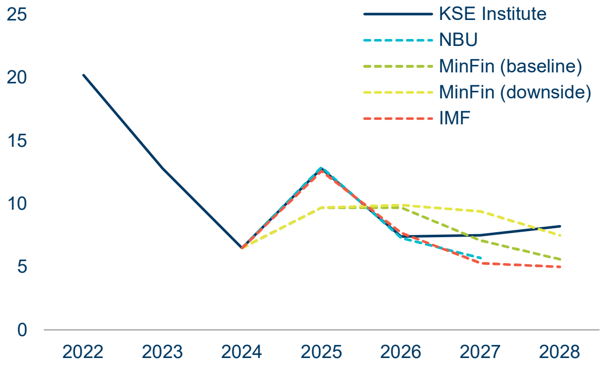
Labor shortages remain the most-frequently cited constraint to business activity and growth. In December 2025, 62% of firms reported labor shortages (see Figure 43). Rather than easing, labor market tightness has plateaued at an elevated level. Recruitment difficulties intensified markedly for qualified workers, reflecting seasonal demand and the continued outflow of skilled labor. In contrast, recruitment challenges for unqualified workers remained broadly stable. Labor constraints are concentrated in higher-skilled occupations, limiting firms' ability to scale output, delaying investment, and sustaining upward pressure on labor costs. The number of vacancies dropped and the gap with CVs grew by year-end, signaling a seasonal slowdown in the labor market, but this is expected to be reversed in January (see Figure 44).

The August 2025 decision allowing men aged 18–22 to cross the border has not yet had a measurable impact on labor market tightness. Labor market indicators through December 2025 show no sustained deterioration, likely due to this cohort's small share in the active labor force and its significant heterogeneity, skewed toward students and service-sector employment. Lagged effects may materialize in 2026, however.

Forecast Comparison

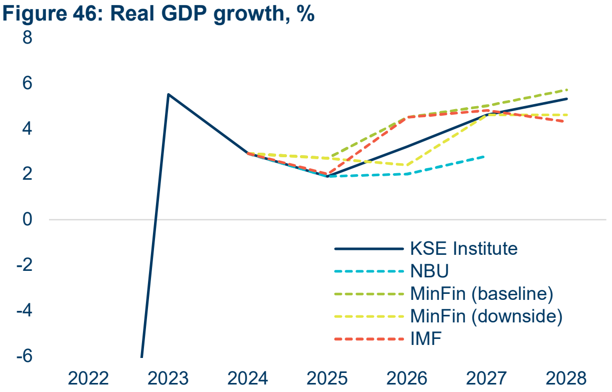
The comparison includes key institutions that provide regular forecasts for Ukraine: National Bank of Ukraine[1] (NBU), Government of Ukraine[2] (GoU), and International Monetary Fund[3] (IMF). Over the last three months, there have been no updates to the government's forecast, while the new IMF program announced in November 2025 is still in the preparation phase. Thus, this section focuses more on the difference between KSE and NBU forecasts, while IMF and GoU forecast details are covered in the October *Handbook*.

Figure 45: Inflation, % avg



Source: IMF, Ministry of Finance, NBU, KSE Institute

Figure 46: Real GDP growth, %



Source: IMF, Ministry of Finance, NBU, KSE Institute

Differences in inflation forecasts primarily reflect divergent assumptions about the strength of the post-war recovery and the persistence of labor-driven price pressures. KSE projects a gradual decline to roughly 7–8% over 2026–28, with a spike in 2027. By contrast, NBU projects faster disinflation, with average CPI falling to 7.3% in 2026 and 5.7% in 2027 (see Figure 45). The NBU attributes this outcome to a strong agricultural supply outlook, a monetary stance that sustains demand for hryvnia instruments and limits FX pass-through, and a gradual easing of labor-market mismatches that should moderate wage pressures; it acknowledges, however, that administered price increases, energy shocks, and second-round effects may slow the decline in core inflation. KSE Institute incorporates the same policy transmission channels but takes a more cautious view on their strength, particularly regarding labor-related inflation dynamics.

Growth projections reflect divergent assumptions about wartime constraints, military production, and the strength of reconstruction-driven investment. KSE projects stronger near-term growth of 3.2% in 2026, 4.6% in 2027, and 5.3% in 2028, driven by faster investment and reconstruction. The NBU adopts a more conservative baseline, revising 2025 growth down to 1.9% and assuming only a gradual acceleration to 2.0% in 2026 and 2.8% in 2027, despite support from larger harvests and increased reconstruction and defense spending (see Figure 46). The bank points to energy shortages, labor mismatches, and continued attacks on infrastructure as binding constraints, while KSE's more optimistic path reflects expectations of stronger investment and productivity effects from EU-backed financing of defense production.

All forecasters expect strong nominal wage growth in the near term, reflecting labor shortages and fiscal support. The updated KSE projection shows a gradual slowdown after substantial wage increases in 2024–25. The NBU shows a similar forecast path, with a return to low double digits, though at a faster pace of normalization. Its reasoning ties persistent services inflation and elevated wage growth over 2024–25 to wartime labor mismatches and warns that wages will remain an important core inflation driver until labor market imbalances ease. It also reflects an estimation of businesses' capacity to increase wages.

KSE projects a substantially sharper deterioration in the current account deficit over the medium term than the NBU. The NBU stresses that the deficit is driven by investment-style imports (defense and reconstruction) rather than booming consumption. Importantly, the NBU argues that these deficits are financed by stable international assistance and concessional lending so that Ukraine's external financing

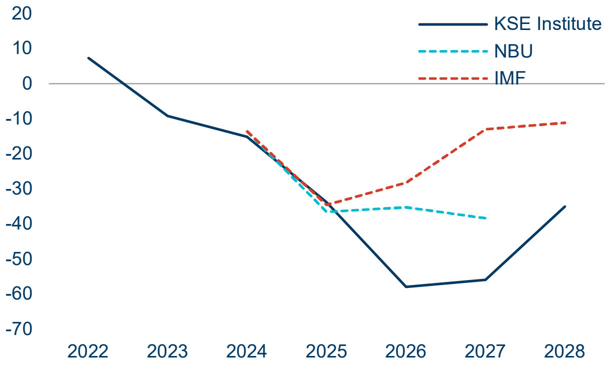
[1] The NBU forecast is prepared on a quarterly basis, with the last edition published on October 30th, 2025, making it the most up-to-date among the institutional forecasts. Its war assumption is undisclosed.

[2] The government forecast is partially outdated as it was prepared for the Budget Declaration and published on June 27th, 2025. Consequently, only the downside scenario of the government forecast is retained in this comparison, as its baseline scenario has already proven to be unrealizable.

[3] The IMF forecast used in the charts is taken from the 8th Review of the Extended Fund Facility published on June 30th, 2025, which is rather outdated as it reflected a more favorable short-term dynamic. We compare our forecast with the downside scenario, which is the IMF's only scenario that projects the war's continuation into 2026 (with a mid-2026 termination). The delay on the next review marks the transition toward a new IMF program, which will include revised assumptions on the duration of hostilities, financing composition, and structural reforms. For available indicators, the WEO published on October 14th was used.

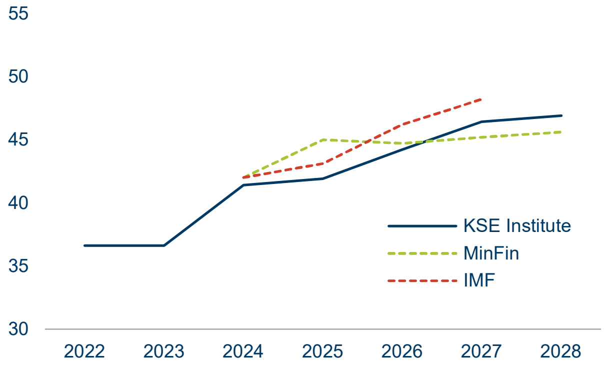
needs are met. KSE's logic is similar, but we see a stronger effect from defense-related imports supported by the new EU loan, which the NBU's forecast does not take into account yet. KSE's projected path is a deficit of around $56–58 billion in 2026–27, with a return to current levels in 2028 (see Figure 47).

Figure 47: Current account balance, USD billion



Source: IMF, NBU, KSE Institute

Figure 48: Exchange rate, UAH/USD

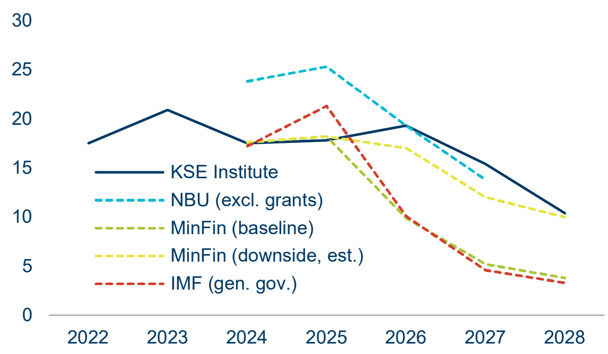


Source: IMF, Ministry of Finance, KSE Institute

Reserve projections differ primarily due to assumptions about the scale and timing of external financing. The NBU assumes that continued international support, including ERA and other reparations-linked flows, will keep reserves at adequate levels and allow renewed accumulation by end-2026, with reserves remaining in the $50–60 billion range over 2025–27. KSE projects a stronger reserve buildup, reflecting newly secured and prospective external financing that materially improves the balance-of-payments outlook, with reserves rising to $80–85 billion in 2027–28. Again, the NBU's October forecast did not yet incorporate several financing commitments agreed upon toward the end of 2025.

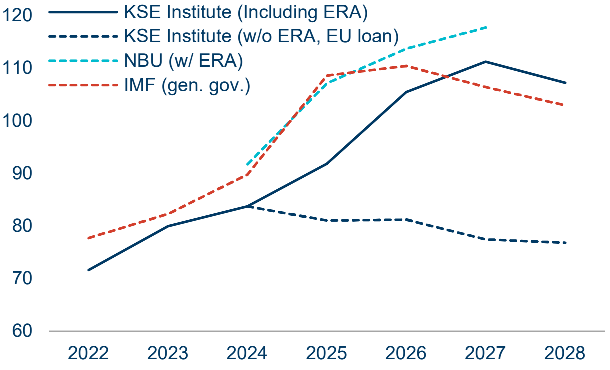
All forecasts envisage further depreciation of the hryvnia over the forecast horizon but differ in pace and timing. The KSE Institute's path takes the hryvnia from roughly 42 UAH/USD in 2025 to about 46.9 by 2028, with notable depreciation pressure in the second half of 2026. The IMF and GoU projections differ modestly in levels and timing; differences across institutions stem from varying assumptions about the exchange-rate regime (i.e., the degree of NBU intervention), the pace of capital inflows, and the structure of external financing (see Figure 48). As the situation with regard to the latter has changed dramatically in recent months, older forecasts, naturally, do not take this into account.

Figure 49: Budget deficit, % GDP



Source: IMF, Ministry of Finance, NBU, KSE Institute

Figure 50: State debt, % GDP



Source: IMF, NBU, KSE Institute

There is broad agreement that wartime deficits will remain elevated. The NBU does not publish an overall consolidated deficit series in its new inflation report; the NBU's consolidated-excluding-grants series is now the central fiscal comparator in its statistics. KSE projects a headline deficit of 19.3% of GDP in 2026 with gradual improvement afterwards. The NBU's series shows a slightly faster recovery (see Figure 49).

Differences in debt projections are largely driven by how ERA and other reparations-linked financing instruments are treated. The NBU now publishes debt paths both including and excluding ERA-related and other contingent financing, as these instruments materially affect headline debt-to-GDP ratios. For the former, public and publicly guaranteed debt rises well above 110% of GDP, while the forecast excluding such contingent liabilities shows a substantially lower debt burden of around 80% of GDP by 2027. KSE has made a similar distinction in past *Handbooks*. In this forecast, we project public debt to peak at 111% of GDP in 2027 when ERA and the new EU loan are included, followed by gradual easing thereafter (see Figure 50). Without these instruments, we expect that debt would stabilize at ~80% of GDP before declining.

Special 1: New Foreign Support

At the European Council meeting in December, European leaders agreed to a new €90 billion support package for Ukraine to address critical financing needs 2026–27. The approach ultimately chosen is fundamentally different from the "reparations loan" originally proposed by the European Commission, which would have provided up to €210 billion in funding over a five-year period (i.e., 2026–30) and been backed by immobilized Russian sovereign assets. While the EU had removed a key obstacle to this scheme by effectively indefinitely freezing these assets with qualified majority, member states could not agree on how to provide guarantees to Belgium with regard to potential legal risks related to the funds held at Euroclear.

To provide urgently needed resources to Ukraine, European leaders decided instead to fund the loan through borrowing on the capital markets backed by the EU's budget headroom. Importantly, the loan is non-interest bearing and will only have to be repaid by Ukraine once Russia pays it reparations for the damage caused by its war of aggression—the same properties that the reparations loan would have had. The difference is that now it is European countries that provide the funds and carry the interest cost of borrowing on the market themselves, rather than relying on immobilized Russian assets.

In January, the EU specified that €30 billion of the loan's total amount will be provided as macrofinancial assistance, i.e., budget financing, while the remaining €60 billion are geared towards the strengthening of Ukraine's defense-industrial base. In our assessment, part of the latter (~€15 billion) will be used to fund weapons purchases within the regular state budget, while €45 billion will be employed through other channels outside of it. Details about the specific use as well as the disbursement schedule are yet to be determined. For our analysis, we assume that the funds will be split evenly between 2026 and 2027.

We believe that the new EU loan fundamentally addresses the financing gap identified by the IMF during its fall visit to Ukraine—and will, thus, allow the Fund to approve a new multi-year program. A new Extended Fund Facility (EFF) will likely provide ~$8.1 billion in financing over 2026–29 and function as a cornerstone of Ukraine's macro-financial framework for 2026–29. As this replaces an existing program, which had some disbursements outstanding, we assess that $6.0 billion in additional funds will be received by Ukraine. IMF staff and Ukrainian authorities reached a staff-level agreement in November 2025 on a set of fiscal, monetary, and structural policies to anchor the arrangement, whose core objectives are to support macroeconomic stability amid the ongoing war, restore debt and external sustainability, and enhance governance and anti-corruption frameworks external. The package is conditional on Ukraine completing a set of prior actions (see below) before the IMF Executive Board considers approval. With the €90 billion in new financial assistance from the EU secured at the end of 2025, the Board may do so in a matter of weeks.

The structural prior actions specified by the IMF include both revenue-enhancing measures and governance commitments. Key elements include broadening the tax base with legislation to tax income earned through digital platforms, closing customs loopholes that permit undervalued or exempted imports, abolishing VAT registration exemptions, and strengthening the capacity of tax and customs administrations to reduce evasion and avoidance. Measures to combat the shadow economy, increase competition and transparency in public procurement, and address loopholes in current labor legislation are also highlighted as part of the overall reform effort. Ukrainian authorities have already adopted the 2026 state budget consistent with the parameters and continue work on related legislative steps, including public financial management and improvements in tax administration, while maintaining commitments to independent anti-corruption institutions and continued reforms of state-owned enterprises. The ongoing, widely debated issue of broadening the VAT program for private entrepreneurs, announced by the Ministry of Finance as part of prior actions for the IMF in mid-December, could become a key issue that is not acceptable to the population and may further complicate the dialogue between Ukraine and the IMF.

Finally, discussions have begun concerning €100 billion in further budgetary support for Ukraine as part of the European Union's 2028–34 Multiannual Financial Framework (MFF). Under the assumption of an even distribution throughout the seven-year budget period, around €14.2 billion could be expected to come to Ukraine in 2028, the final year of our forecast.

Special 2: New Labor Code

The new Labor Code marks a structural break from Ukraine's Soviet-era labor framework and will materially affect both labor market functions and macro-fiscal dynamics. Ukraine has been working for several years to replace the 1971 Labor Code with a modern regime aligned with contemporary employment practices and European standards. The reform process began in 2019, when the government launched a comprehensive overhaul aimed at clarifying employment relationships and reducing regulatory rigidities, amid persistent tensions between employers and trade unions. During the full-scale war, labor regulation was temporarily reshaped by the 2022 wartime law on labor relations, which adjusted rules on probation, working hours, transfers, and rest periods and has remained in force throughout martial law. In 2024–25, the reform gained momentum through extensive consultations led by the Ministry of Economy with employers, trade unions, and international partners, focusing on flexible and atypical work arrangements, overtime regulation, labor inspection powers, and compliance with EU and ILO standards.

Finalizing a new Labor Code by end-2025 was explicitly included in the Government Action Plan adopted in August 2025. On 7 January 2026, the Cabinet of Ministers approved and submitted the new draft Labor Code to Parliament (registered as draft law No. 14386). If adopted, it will replace the 1971 Code and introduce several key innovations: (i) clear legal criteria for defining labor relations to combat informality, (ii) an expanded set of employment contracts including remote and flexible work, (iii) full digitalization of employment documentation, (iv) updated leave and family-friendly provisions, (v) reformed labor inspection, and (vi) a transparent mechanism for setting the minimum wage linked to average wage benchmarks in line with European practice. The draft is currently under consideration by the Verkhovna Rada and is expected to enter into force roughly six months after the end of martial law.

A central macro-critical element of the new Labor Code is the redefinition of the minimum wage, which introduces meaningful policy discretion and requires explicit assumptions for scenario analysis. The draft introduces the concept of a minimum wage linked to the average wage, as practiced in EU countries, with the percentage to be set by the Cabinet of Ministers. Also, it explicitly limits the practice of using the minimum wage as a universal "calculation base" for some pay items (a technical but important change for budget indexation and compliance incentives). To conduct the scenario analysis exercise in this Special, we assume that the minimum wage will be set at 40% of the previous year's average wage reported by SSSU. The number reflects data from numerous EU countries and the approach to the 50% ratio suggested in Directive (EU) 2022/2041 on minimum wage. At the same time, the transmission of a higher minimum wage to public-sector pay is likely to be weaker than in the private sector, or to be accompanied by rapid headcount and compensation optimization, as a full mechanical pass-through would imply a substantial and costly increase in budget expenditures.

The macroeconomic impact of the new Code would be sizable and require adjustment by both firms and policymakers. The first-round macro effect is a redistribution of business profits toward low-wage households and an increase in government wage expenditures. The total increase in the wage bill will be partially offset by cost-cutting and automation in low-productivity roles. The new Labor Code will also attract labor to the official market, leading to an estimated 9.4% increase in nominal wages compared to the baseline scenario, or an additional UAH3,684 of average monthly salary. However, companies will, in turn, be pushed to redistribute wage pressure between profits and prices, driving up inflation (+2.8% annual average, +4.7% end-of-year) and leading to a smaller increase in real wages. Higher wages will also restrict business' capacity for reinvestment for the next few years.

As the new Labor Code will take effect after the end of the war, it may significantly influence the capacity for an investment-led recovery. Altogether, we estimate a net positive effect on real growth, with significantly higher real private consumption growth of 6pp coming at the expense of capital investment growth. As overall employment rises and productivity grows, domestically produced goods will partially replace imports, alongside lower capital imports. Monetary policy would need to respond with a modestly tighter stance, with the NBU policy rate path higher by around 0.8pp on average, sufficient to dampen inflationary pressures without materially worsening credit conditions and further undermining investment choices. The effect on the exchange rate will be rather neutral. Volatility and uncertain base effects make projections beyond a timeframe of one year less reliable.

Revenue collection will improve but the net budgetary effect is likely to be limited by higher expenditures. Additional tax revenues from the state and local budgets amount to around UAH191 billion.

Revenues from the single social contribution will also increase by UAH85 billion. The main revenue gains stem from personal income taxes, which generates roughly UAH98 billion as a direct consequence of higher wages and improved formalization (i.e., the de-shadowing effect). Stronger private consumption boosts both domestic and imported VAT revenues by an estimated UAH43 billion, while excise tax revenues increase by around UAH26 billion amid higher nominal spending. By contrast, corporate income taxes contribute only modestly, about UAH13 billion, reflecting compressed profit margins following the redistribution of income toward labor. On the expenditure side, however, higher wage floors translate into substantial pressure on public-sector compensation, absorbing a large share, and potentially most, of the additional revenues. This effect is amplified by unresolved distributional and political issues surrounding military pay, as even in the post-war period the size of the armed forces is expected to remain well above pre-war levels due to persistent security risks from Russia. As a result, the reform strengthens overall fiscal flows and compliance but delivers only limited net budgetary space unless accompanied by fiscal consolidation.

Beyond wages, the draft Labor Code promotes the de-shadowing of the labor market and expands employment opportunities for individuals who previously faced barriers to accessing work. As part of de-shadowing efforts, the Code introduces precise definitions of what constitutes working time and rest, explicitly covering preparatory and concluding activities, special breaks, and travel time for mobile work, and systematizes legally recognized regimes for standard, shift-based, and flexible working hours. These clarifications are complemented by the formal recognition and regulation of non-standard forms of employment, including remote, home-based, unfixed-hour, and apprenticeship contracts, which historically operated in legal gray areas and were often misclassified as civil contracts.

Strengthened requirements for time recording and employment documentation, together with clearer employer obligations, materially reduce the scope for informal arrangements and improve enforceability. Consequently, the Code reinforces worker protections, such as equal pay, non-discrimination, and safeguards against harassment, without restricting firms' operational flexibility, providing businesses with more predictable scheduling tools and compliance certainty. In macroeconomic terms, this shift toward clearer, codified labor regimes is expected to support higher formal employment, broaden the tax base, and raise measured productivity by reallocating labor from informal and low-productivity arrangements toward formally contracted jobs, aligning labor market practices more closely with EU standards.

Special 3: Ukraine vs. Russia

Ukraine and Russia are on fundamentally different trajectories four years into the full-scale war. While Ukraine has secured crucial new financing to ensure macroeconomic stability and meet defense and security needs, Russia's economy is stalling and its budget is showing serious cracks.

Economic activity: Despite four years of Russia' war of aggression, Ukraine's economy has displayed remarkable resilience and continues to grow, even amid stepped-up attacks on civilian infrastructure that weigh heavily on economic activity. Over 2026–28, we project real GDP to grow by a cumulative 14% and 2028 GDP to come within 10% of the pre-war (i.e., 2021) level. Russia, on the other hand, has had the advantage of fighting its war largely outside of its own territory. After a 1.4% drop in real GDP in 2022 (trailing all oil exporting peers), it experienced a boom in 2023–24—with 4.1% and 4.3% real growth, respectively—driven by a massive war-related fiscal stimulus, high energy prices, and a dramatic private sector credit expansion. This boom, however, has come to an end. Growth has steadily declined, and most forecasters project minimal growth (~1% annually) in the medium term. Prospects are particularly grim for non-military-related sectors, which have entered a prolonged recession. After years of neglecting the civilian sector in favor of the military-industrial complex, Russia's economy will struggle to adjust to a post-war reality when critical fiscal stimulus is withdrawn. Ukraine, meanwhile, is forecasted to experience a post-war boom.

Budget and financing: While Ukraine has been facing extraordinarily high budget deficits since 2022—and will continue to do so even after the end of the full-scale war—financing needs are being fulfilled through large receipts of financial assistance from international partners. Over 2025–28, we identify only a $2.3 billion budget financing gap, which can be filled through additional domestic borrowing or further assistance from abroad. At the same time, Russia's budget deficit is quickly widening as sanctions weigh on oil and gas revenues, the stalling economy slows down non-O&G revenue growth, and expenditures continue to rise. In 2025, Russia reported the largest deficit on record—5.6 trillion rubles, ~$68 billion, or 2.6% of GDP—and there is reason to believe that it achieved this result only by delaying expenditures into the new year. In addition, the situation with regard to financing is fundamentally different from Ukraine's: Russia no longer has meaningful access to external funding sources due to sanctions, and can only rely on its sovereign wealth fund (NWF) and domestic borrowing to fulfill budgetary needs. To preserve the NWF, the Ministry of Finance opted to issue a record-high amount of domestic debt (i.e., OFZ) in 2025—7 trillion rubles—for which only Russian banks remain as a buyer following the exit of foreign investors. To increase their absorption capacity, the Russian central bank now regularly provides large amounts of liquidity to the banking system through repo operations, which are pro-inflationary once they become permanent.

Macroeconomic buffers: We assess that new financial support for Ukraine will allow for significant reserves accumulation over 2026–28, with their total amount reaching $80 billion or nine months of imports in 2028. As a current account surplus country, Russia generally does not struggle with reserve levels; however, a significant share of its assets—$350 billion or more—remain frozen in sanctions coalition countries. Moreover, in December the EU effectively immobilized the assets under its jurisdiction through a qualified majority procedure, making it unlikely that they will be returned anytime soon (i.e., until Russia pays reparations to Ukraine). As a result of the asset freeze, the CBR is left with a constrained policy space and only increasingly unorthodox measures to maintain macroeconomic stability while supporting the war effort. What is more, the missions of the central bank and the government are increasingly at odds. Ukrainian authorities, on the other hand, possess the ability to intervene in the foreign currency market to keep the exchange rate on a sustainable path in the face of war-related imbalances, including a soaring trade balance.

Inflation and monetary policy: Considering that Ukraine is involved in a war on its own territory, the NBU has been able to normalize its monetary policy stance to a surprising degree. While some extraordinary measures such as capital controls remain in place, the NBU seems to be on track to lower interest rates in the coming months (and years) as inflationary pressures are gradually subsiding despite the challenging energy situation, thereby supporting investment and economic activity. Russia, on the other hand, which does not face any immediate war destruction and physical disruption of economic activity, has necessitated an extended period of extremely tight monetary policy. Over 2023–24, the CBR increased its policy rate by a cumulative 1,350 basis points in order to control inflation. While this policy was ultimately successful and the central bank was able to loosen monetary conditions in H2 2025, it has been extremely costly for the economy: domestic credit growth has dropped sharply, and many businesses continue to face an unfavorable interest rate environment. Even now, real interest rates in Russia are in double-digit territory.