BLOG

Economic resilience key in Ukraine’s three-year fight for survival

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AUTHOR

Sinikka Parviainen
Senior Economist

We are now entering the fourth year of Russia’s full-on military invasion of Ukraine, yet the aggressor Russia, despite its vast military advantage, has failed to subdue Ukraine. Moreover, the pessimistic predictions that the Ukrainian economy would succumb to hyperinflation, fiscal crisis or some other common affliction of wartime economies have failed to materialise. A prolonged war necessarily depletes economic resources, but preliminary estimates show the Ukrainian economy last year grew by 3.4 % y-o-y . All this in spite of Russia’s bombing of half of the country’s energy production capacity and a worsening shortage of labour.

Price stability a valuable achievement under wartime conditions

The war-induced flare-up in inflation peaked at over 26 % in autumn 2022. This situation was quickly brought under control, however, thanks to international economic support and good harvests in Ukraine. Credit also goes to the government’s timely imposition of measures such as capital and currency controls that a necessary stabilisation instrument in times of severe crisis. Runaway inflation would have been intolerable in a country already experiencing a significant rise in poverty. The UN’s International Organization for Migration estimates that nearly 14 million Ukrainians are dependent on humanitarian aid. Moreover, rampant inflation would complicate military procurements further. Inflation accelerated somewhat last year due to below-average harvests, rising wage costs and incessant destruction of energy infrastructure. The National Bank of Ukraine raised its discount rate by 100 basis points to 14.5 % in January 2025. Even so, this key rate remains well below its over-20 % level at the start of the war in spring 2022.

Ukraine’s external financing position better now than a year ago

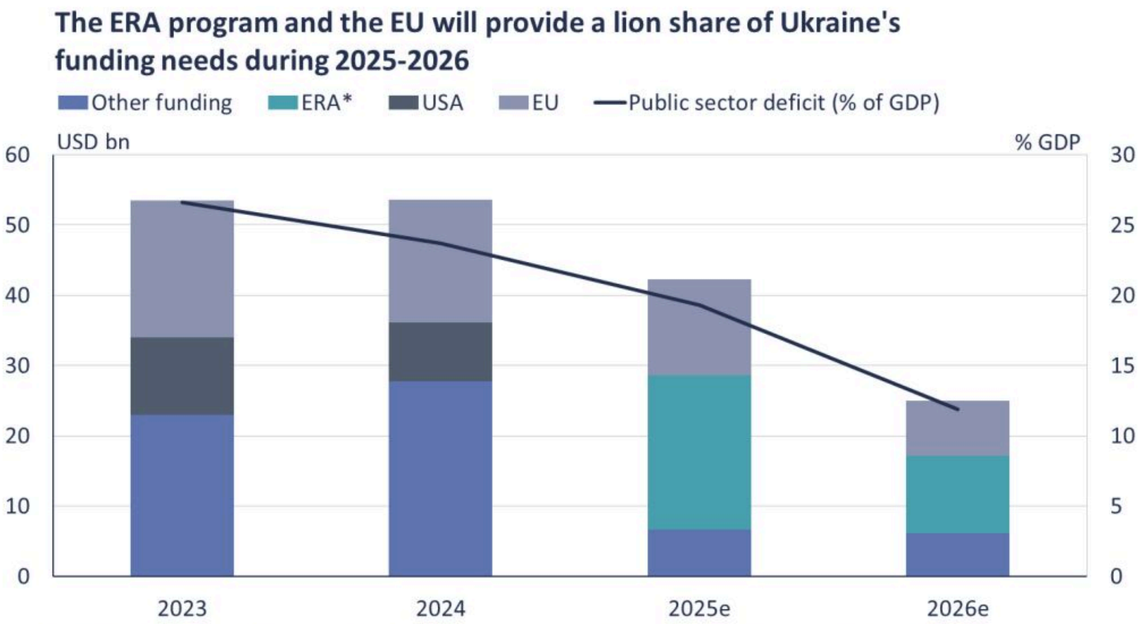
Financing from abroad has been essential in sustaining Ukraine’s ability to survive. Ukraine’s 2024 public sector deficit (excluding grants) rose to a record 1.832 trillion hryvnia, or nearly 24 % of GDP. Over 60 % of spending went to defence and domestic security without compromising on social spending thanks to higher taxation and (especially) foreign aid. Ukraine’s foreign partners last year provided roughly $42 billion in direct budget support, of which a large chunk ($17.5 billion) was support provided via the EU’s Ukraine Facility.

In 2025, Ukraine’s financing situation looks brighter compared to the start of last year, when the EU’s 50-billion-euro Ukraine Facility and America’s over-60-million-dollar Ukraine aid package were stuck due to legislative intransigence. The consolidated budget deficit is expected to shrink to around 20 % of GDP, so substantial external financing is still needed (about $38 billion). The current budget plan assumes that the war will continue through the end of 2025.

Proceeds from frozen Russian assets to cover a vast share of the 2025 budget deficit

The structure of 2025 deficit financing represents a big change from last year as a substantial part of the deficit will be covered out of the yield on Russia’s frozen assets. Last summer, G7 leaders agreed on an Extraordinary Revenue Acceleration (ERA) arrangement allowing for the use of €183 billion of frozen Russian assets (end-2024) in the EU area to help Ukraine. The ERA programme does not draw on the Russian assets directly but uses its proceeds to finance payments and costs of a $50 billion loan. ERA disbursements allocated to Ukraine will come to nearly $22 billion this year and $11 billion next year. The new US presidential administration has yet to withdraw from the ERA programme, even if substantial cuts have already been made in e.g. USAID financing to Ukraine. The US to date remains the ERA programme’s largest backer, accounting for a total disbursement commitment of $20 billion.

Chart 1.



*ERA-Extraordinary Revenue Acceleration is a loan program that uses the profits from Russian frozen funds in the EU to service the loans. For Ukraine ERA-funds are grants. e=estimate.
Sources: National Bank of Ukraine, Ministry of Finance of Ukraine and BOFIT.

Labour supply worries in war and peace

2025 started with loud promises from the incoming US Trump administration for a quick resolution to the war. Newsfeeds were full of speculation about the nature and character of peace talks. Even if some sort of resolution to the war is reached and reconstruction in earnest becomes possible, Ukraine's economy is unlikely to return to its former size and structure. One of the main changes determining Ukraine's future is the loss of population and workforce. The National Bank of Ukraine reports that Ukraine has lost about a quarter of its labour force since February 24, 2022.

According to the UN's refugee agency, about 6.4 million Ukrainians live outside the country's borders and over 3 million Ukrainians are considered internally displaced. All of the Ukrainians fleeing the war abroad, a significant portion of which are children and highly skilled women, are unlikely to return to Ukraine. A survey from December 2024, for example, found that only 43 % of Ukrainian refugees abroad plan to return home. Unfortunately, the war has also produced large numbers of dead and wounded.

The changes in Ukrainian labour markets over the past three years have not all been for the worse. The participation of women in traditionally male-dominated branches has increased and considerable emphasis is now placed on training for new skills and careers.

The adjustment of Ukraine's economy to wartime conditions and growth since 2022 provides evidence for cautious optimism. At the outset, a cessation in hostilities may result in a period of fairly rapid economic growth as resources are redeployed from defence to civilian sectors. Before that Ukraine needs an enduring and credible peace agreement.

Key words

economy, reconstruction, Ukraine, war