

Ukraine's Economy in 2018-2019: Slow Recovery and Build-up of Risks

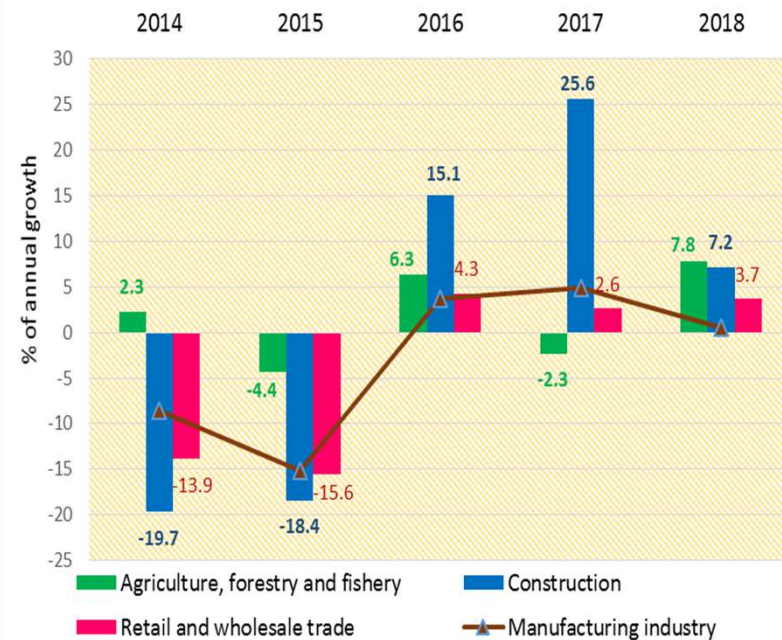


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Ukraine's real GDP growth rates: production side

	2014	2015	2016	2017	2018	2018 as compared to 2013	2018 as compared to 2015
Manufacturing industry	-8.6	-15.2	3.7	4.9	0.6	-15.2	9.4
Mining industry	-15.4	-13.8	-0.5	-6.1	1.9	-30.6	-4.8
Supply of electricity, gas and steam	-8.5	-12	1.1	-6.8	2.2	-22.5	-3.7
Agriculture, forestry and fishery	2.3	-4.4	6.3	-2.3	7.8	9.5	12.0
Construction	-19.7	-18.4	15.1	25.6	7.2	1.5	55.0
Retail and wholesale trade	-13.9	-15.6	4.3	2.6	3.7	-19.4	11.0
Transport, logistics, posts	-10	-2.5	3.1	4.2	1.1	-4.7	8.6
Education	-2.9	-3.1	-4.5	1.1	-1.1	-10.2	-4.5
Health care and social assistance	-5.2	-0.7	-3.1	-0.1	-1.7	-10.4	-4.8
Total GDP	-6.6	-9.8	2.4	2.5	3.3	-8.7	8.4

Annual growth rates of selected sectors of Ukraine's economy



* On a GDP production side the most **dynamic sectors** of economy are construction, agriculture and trade. Real GDP of agriculture in 2018 was 9,5% higher than in 2013; and GDP of construction - 1,5% higher.

* After a sharp fall in 2014-2015 (by almost 30%) **manufacturing industry** bottomed out in 2017-2019.

* **A total GDP** of 2018 is still lower by 8,7% as compared to 2013.

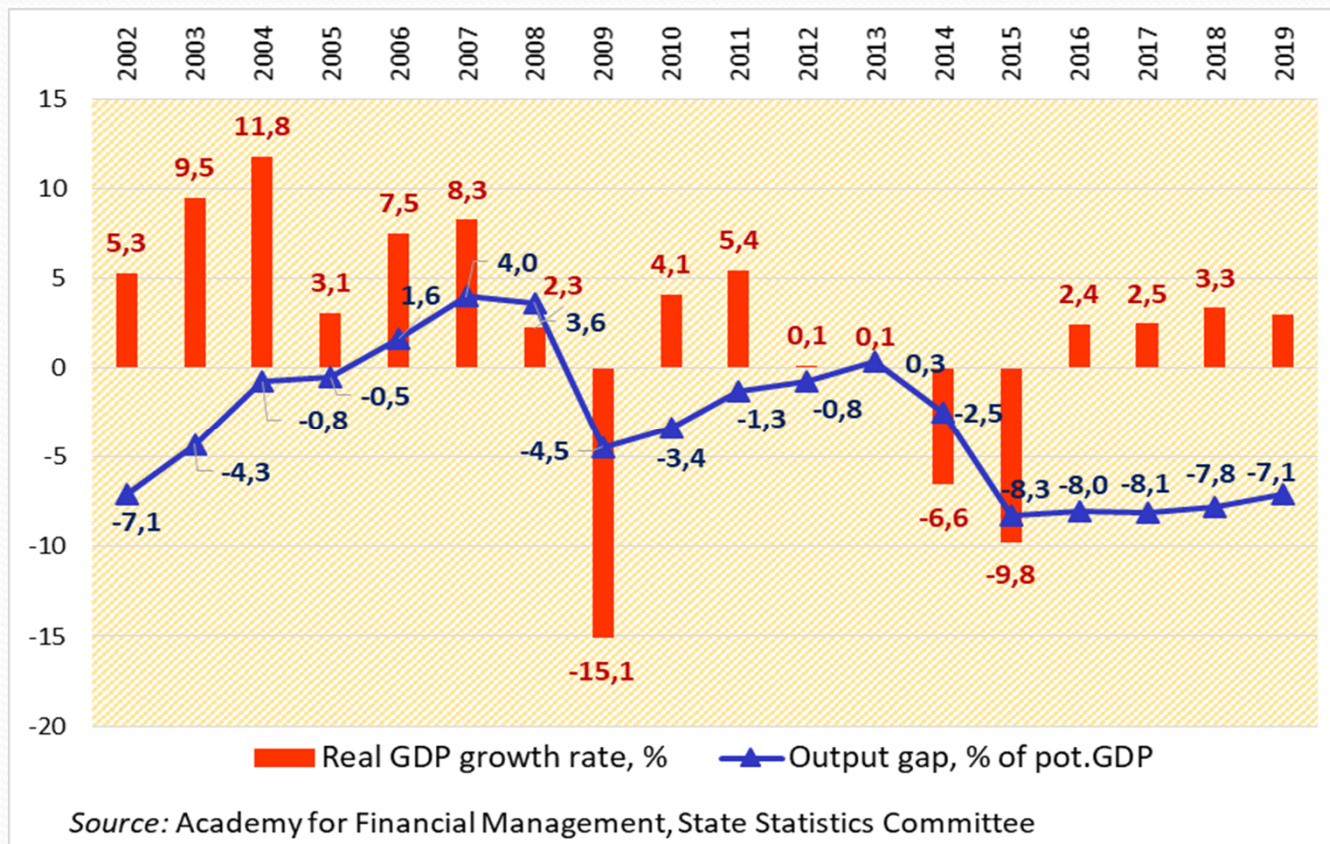
Ukraine's real GDP growth rates: demand side

	2014	2015	2016	2017	2018	2018 as compare d to 2013	2018 as compare d to 2015
Household consumption expenditure	-8.3	-19.8	2.7	9.5	8.9	-9.9	22.5
General government consumption expenditure	1.1	1.7	-0.5	5.2	0.3	7.9	5.0
<i>of which: collective con- sumption expenditure</i>	17	10.8	1	2.7	0.3	34.9	4.0
Gross capital formation	-34.5	12	42.8	2.4	-0.3	7.0	45.8
Exports of goods and serv	-14.2	-13.2	-1.8	3.8	-1.6	-25.3	0.3
Total GDP	-6.6	-9.8	2.4	2.5	3.3	-8.7	8.4

* Main drivers of the GDP growth are **household consumption** expenditure and **gross capital formation**.

* Although household consumption of 2018 is still lower than in 2013 by 9,9%

Output gaps and actual GDP growth rates in Ukraine



Ukraine's GDP lags far behind its potential: -7.8% output gap in 2018 (estimated by I.Bogdan on the basis of Kalman filter)

Low Growth and Deindustrialization of Ukraine's Economy resulted from

deficient **public fundamentals** + weak **private fundamentals** for investments and innovations, *among which*:

- inadequate **infrastructure** for industries,
- lack of long-term and accessible **funding** needed for risky investments,
- “brain drain” and insufficient **human capital** to produce high-tech products,
- decline of national **R&D** sector and lack of targeted incentives for **innovations**,
- poor **investment climate** and inability to attract foreign capital and new technologies in manufacturing.

Labour Market Indicators in Ukraine and Role of Remittances

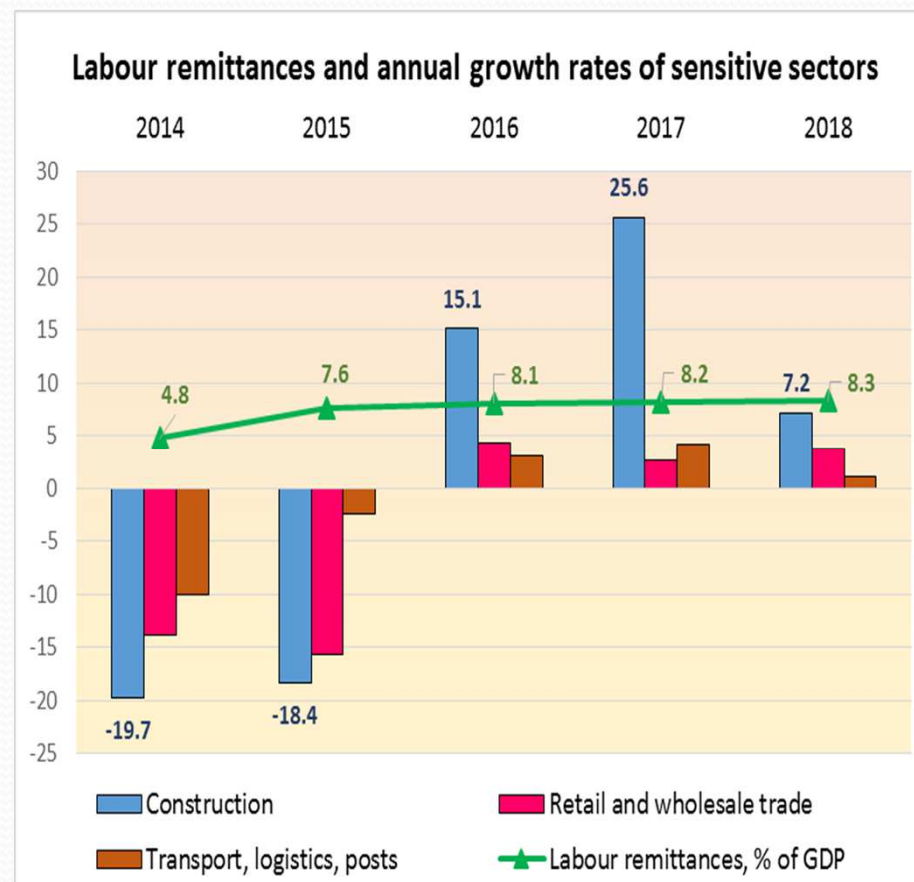
Indicators	2013	2014	2015	2016	2017	2018
Unemployment, % of working age population	7.8	9.7	9.5	9.7	9.9	9.1
Employment, % of working age population	67.3	64.5	64.7	64.2	64.5	66.1
Real wage index, as a % to December of a previous year	106.7	86.4	90.1	111.6	118.9	109.7
Real wage index, as a % to December of 2013	100	86.4	77.8	86.9	103.3	113.3
Labour remittances, mln USD	8537	6489	6959	7535	9264	10888
Labour remittances, % of GDP	4.5	4.8	7.6	8.1	8.2	8.3

- Labour Remittances don't have a noticeable effect on official indicators of **employment** and **unemployment**;
- However, since 2016 real **wages** has shot up and labour migration seems to have a sizeable effect. In Dec. 2018 real wage approached 113.3% of Dec. 2013.

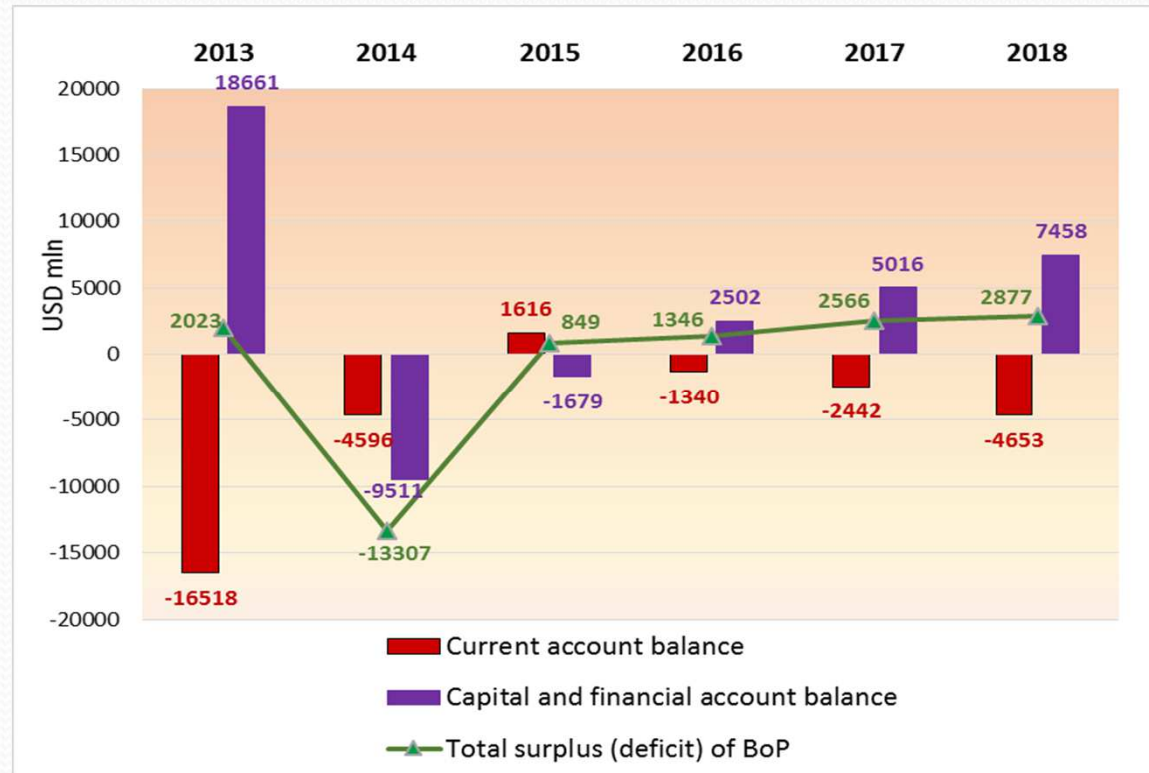
Labour Remittances and Dynamics of Non-Tradable Service Sector

The IMF (*Are Remittances Good for Labor Markets in LICs, MICs and Fragile States?*) suggests that huge remittances promote growth of non-tradable service sector.

In Ukraine this effect is evident in case of **construction** (55% of real growth over 2016-2018) and less evident in case of **transport, trade** and **tourism** where shares of shadow economy are high.

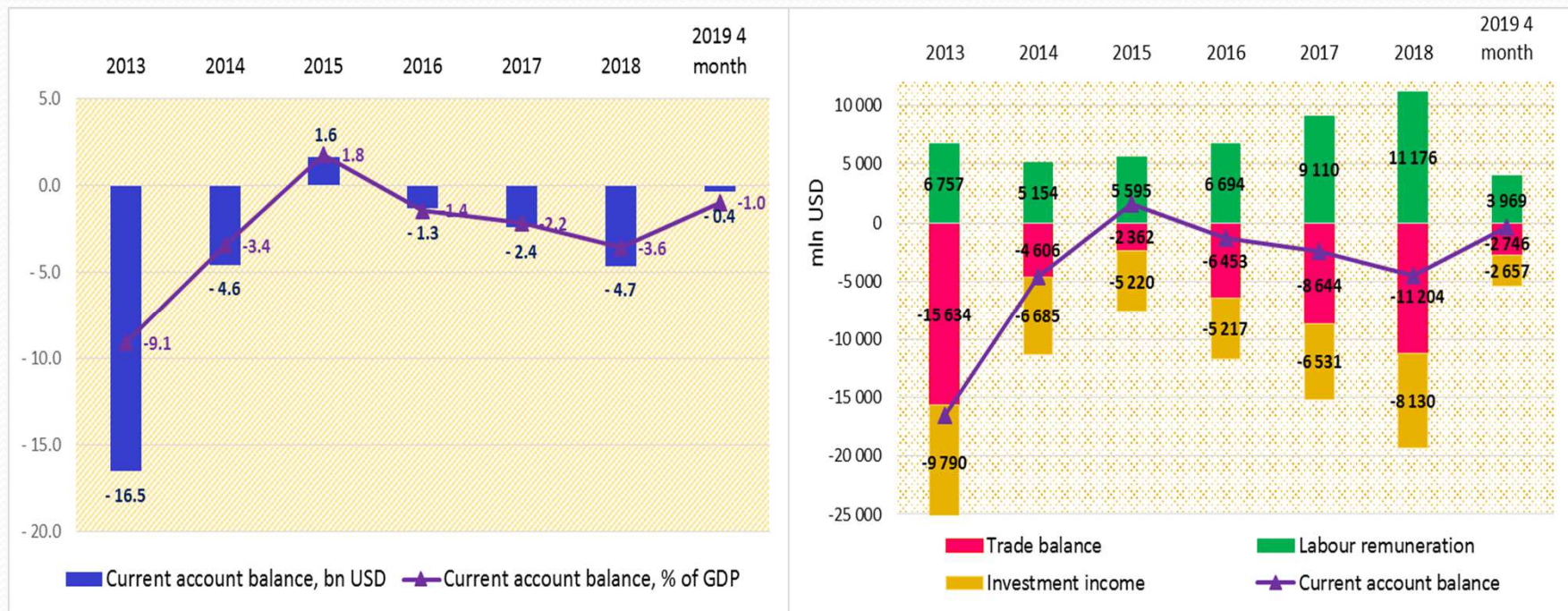


Ukraine's Balance of Payments Aggregates



Current account balance has deteriorated since 2016, although total balance is in surplus (due to official financing and small inflow of FDI and portfolio investments)

Current Account Balance and its Components



A magnitude of **current account deficit** is getting dangerous (3.6% of GDP in 2018).
Huge **trade deficits** and **investment income** outflows are smoothed by **labour remittances**.

Ukraine's External Sustainability Assessment

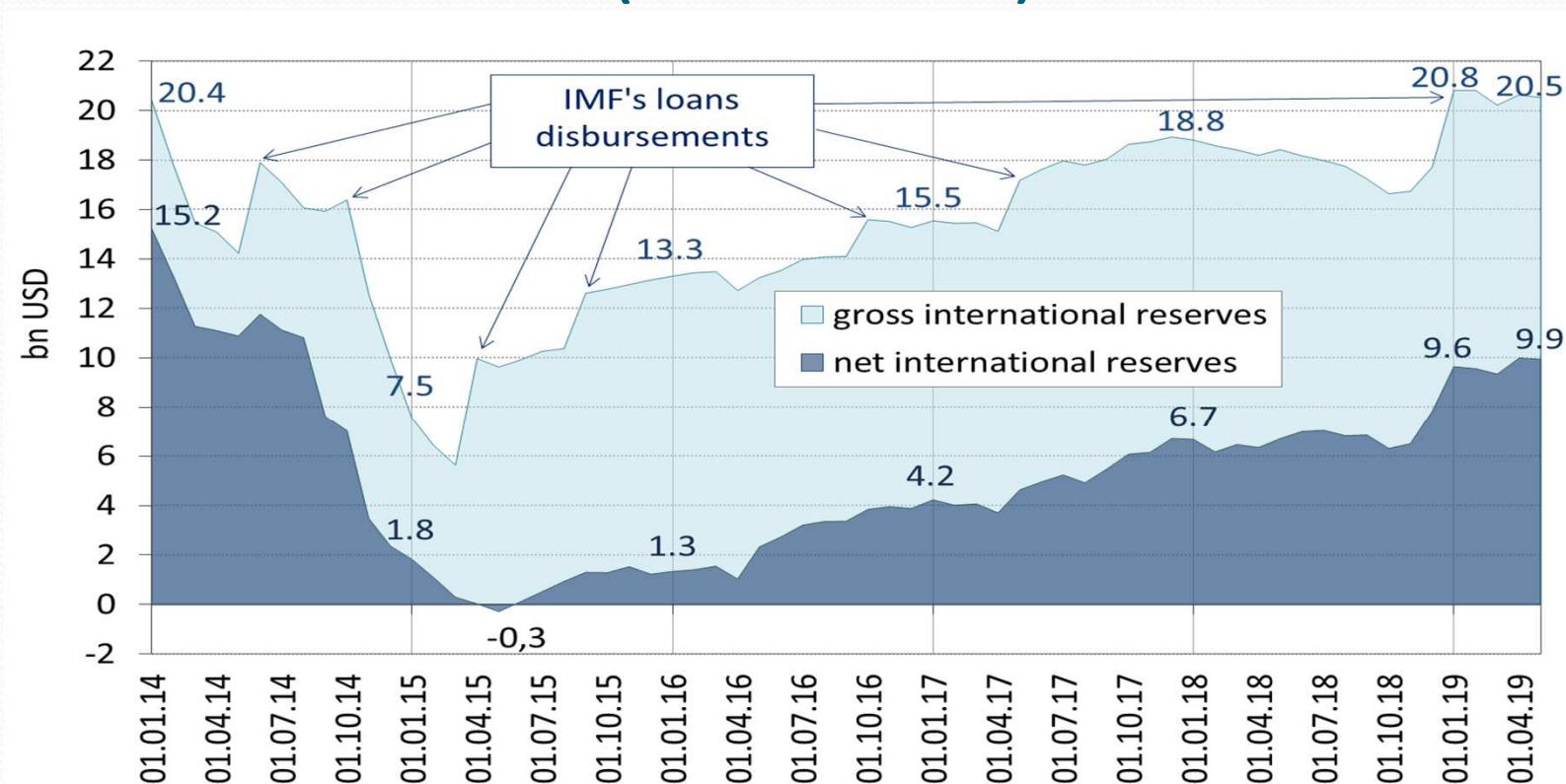
	Indicators	2013	2014	2015	2016	2017	2018	Threshold values
1	Gross External Debt, % of Exports	173.9	193.0	248.0	246.9	216.8	194.4	200
2	Gross External Debt, % of GDP	78.1	94.6	130.4	121.8	102.9	89.9	60
3	Short-Term External Debt, % to total Debt	41.7	44.8	43.3	41.6	40.2	39.9	20
4	Short-Term External Debt, % of Exports	72.6	86.5	107.3	101.9	86.2	77.5	40
5	External Debt Payments, % of Exports	42.4	27.8	58.3	*	65.0	56.7	25
6	International Reserves, % of ST External Debt	34.4	13.3	25.9	33.2	40.6	45.5	100
7	International Reserves, % of IMF Metrics	*	*	45.2	56.1	66.1	71.2	100
8	International Reserves, % of Imports	2.5	1.3	3.2	3.6	3.6	3.5	3.8
9	International Reserves, % of Broad Money	18.0	12.4	32.1	38.3	43.7	45.4	20
10	Current Account Balance, % of GDP	-9.1	-3.4	1.8	-1.4	-2.2	-3.6	-2.3
11	Net International Invest. Position, % of GDP	-36.8	-40.1	-41.7	-37.1	-24.1	-16.8	-35

Out of 11 standard indicators of external sustainability only 2 indicators - ***International Investment Position*** and ***FX Reserves*** as a ratio to M3 - signal the low risks of external distress (**green colour**).

Gross External Debt as a ratio to Exp. indicates the moderate risks (**yellow colour**)

While **8 indicators** signal the high degree of external vulnerability (**red colour**).

Gross and Net International Reserves (in USD bn)

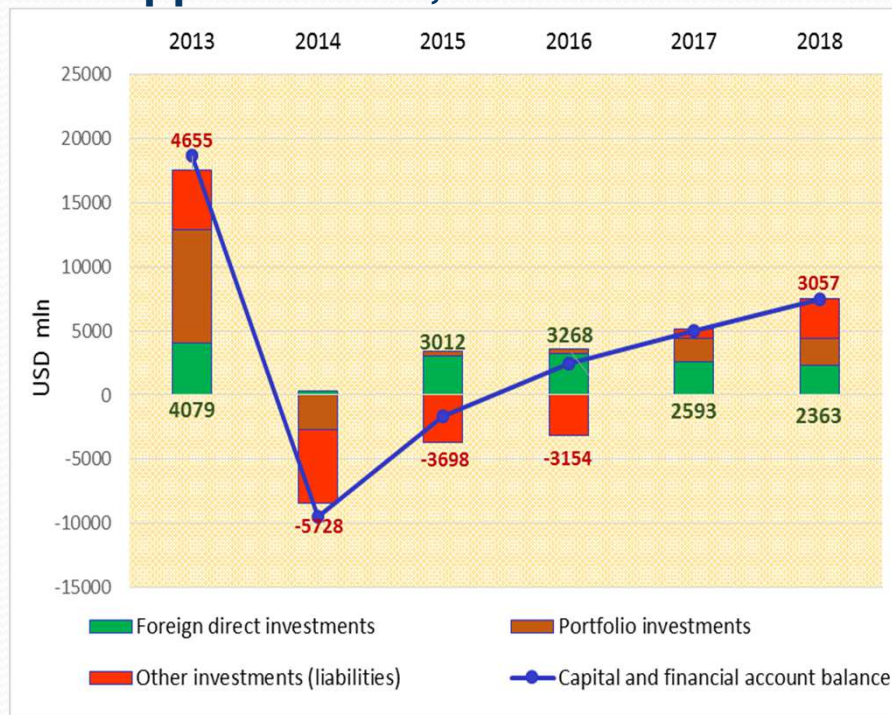


Source: M.Dzhus presentation on the basis of NBU data.

At the end of 2018 International Reserves volume constituted only **45.5%** of ST external debt and **71.2%** of composite IMF criterion.

Financial Account Balance and its Components

Private capital inflows (FDI and portfolio invest.) are small. However, other investments balance is growing and approached 3,1 bn USD in 2018.

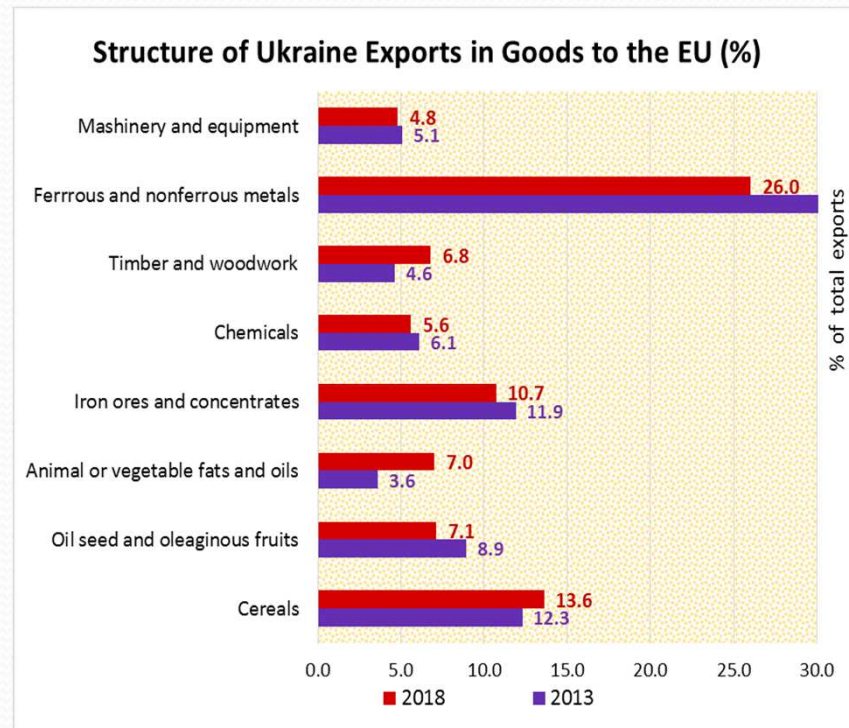
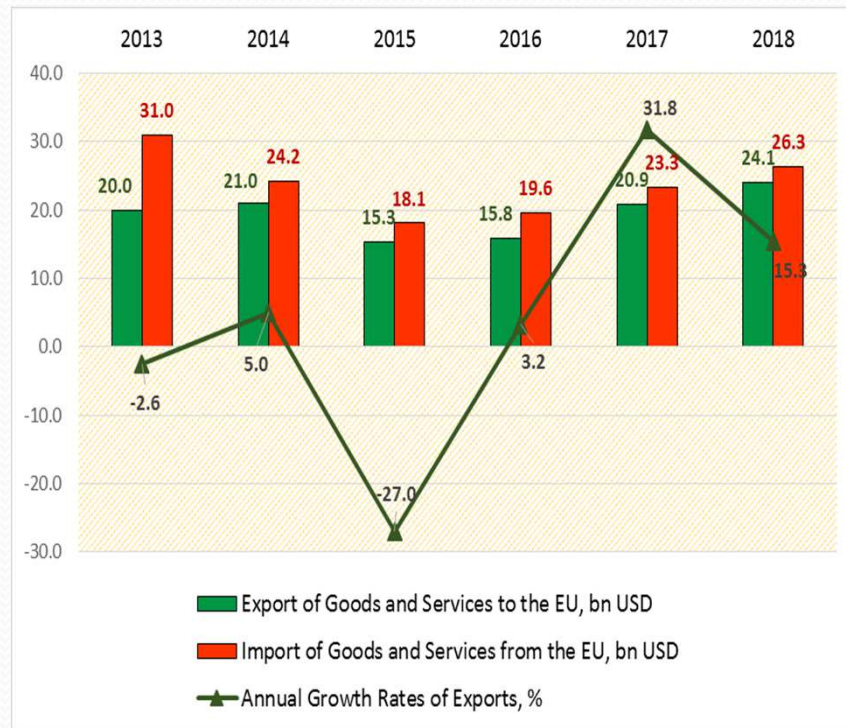


Global and country-specific factors of minor capital inflows to Ukraine
(T. Bogdan's Empirical Estimation)

- global risk sentiment (VIX index)
- commodity price changes (UNCTAD commodity price index),
- real GDP growth in Ukraine,
- exports of goods and services growth,
- foreign exchange reserves volumes,
- public debt increase in Ukraine.

Source: Bogdan T. Determinants of Capital Flows to Emerging Market Economy: A Case of Ukraine // Transformations in Business & Economics, 2016, Vol. 15, No 1(37), pp.127-146.

Ukraine's Foreign Trade with the EU



Growth rates of Ukraine's exports to the EU are impressive (31.8% in 2017 and 15.3% in 2018).

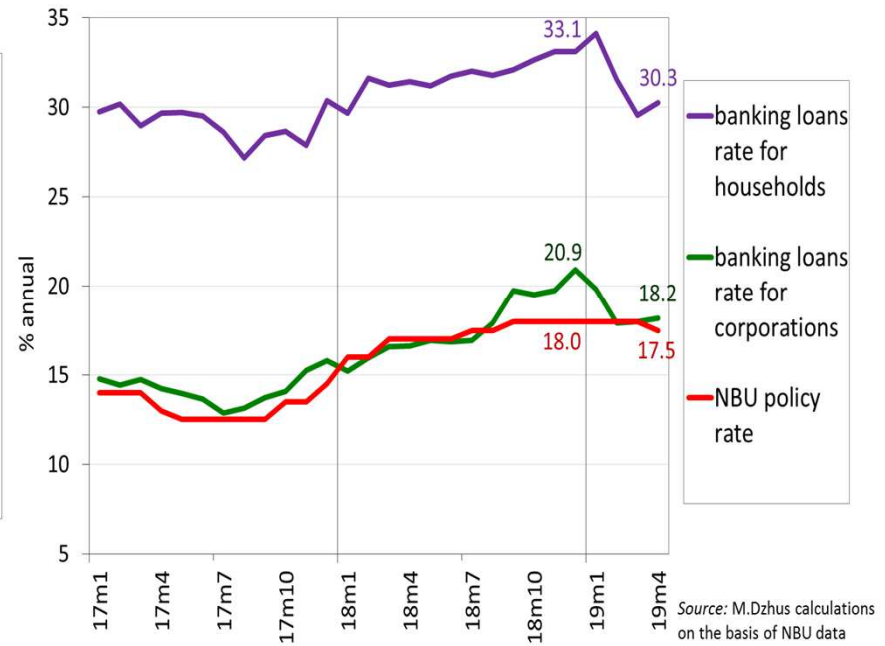
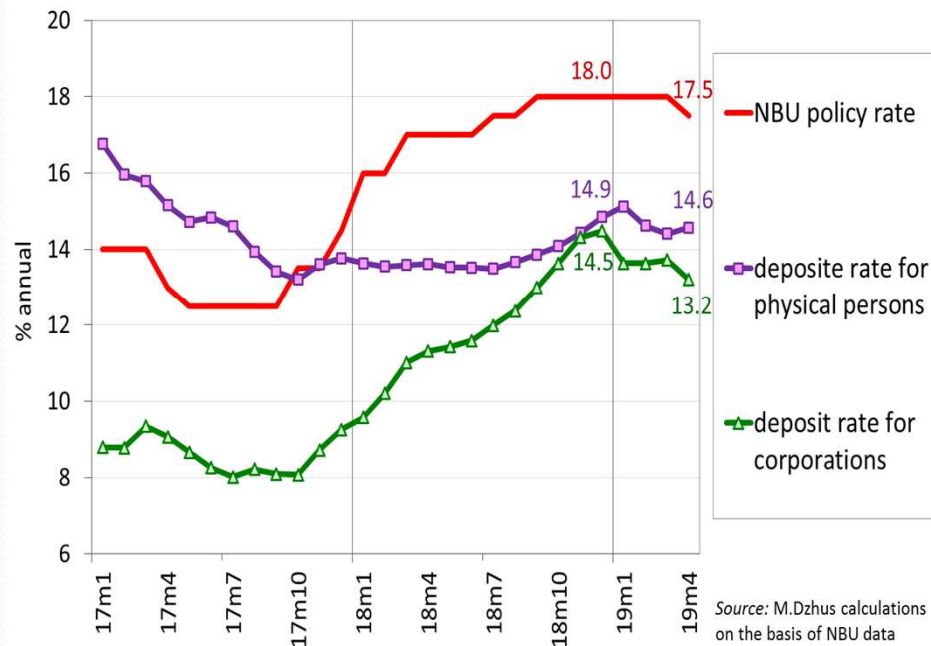
Although primary commodities dominate the **export structure**, which are ferrous metals, iron ores, cereals, oil seed, veget. fats, timber.

Progress in Implementation of the EU-Ukraine Association Agreement (AA)

- “Plan of actions for implementation of the EU-Ukraine AA” was approved in March 2018. 1943 actions encompassing 27 areas make up this Plan.
- Progress in implementations: 41% of the planned tasks were fulfilled in 2017 and 52% in 2018.

Successful areas of AA's implementation	% of execution	Failed areas of AA's implementation	% of execution
Entrepreneurship	89%	Education, training and youth policy	13%
Agriculture	86%	Transport, infrastructure and posts	15%
Technical barriers in trade	70%	State procurements	16%
Social policy and labour relations	70%	Environment and civil protection	22%
Financial sector	67%	Statistics and data exchange	33%

Monetary Policy is Extremely Tight



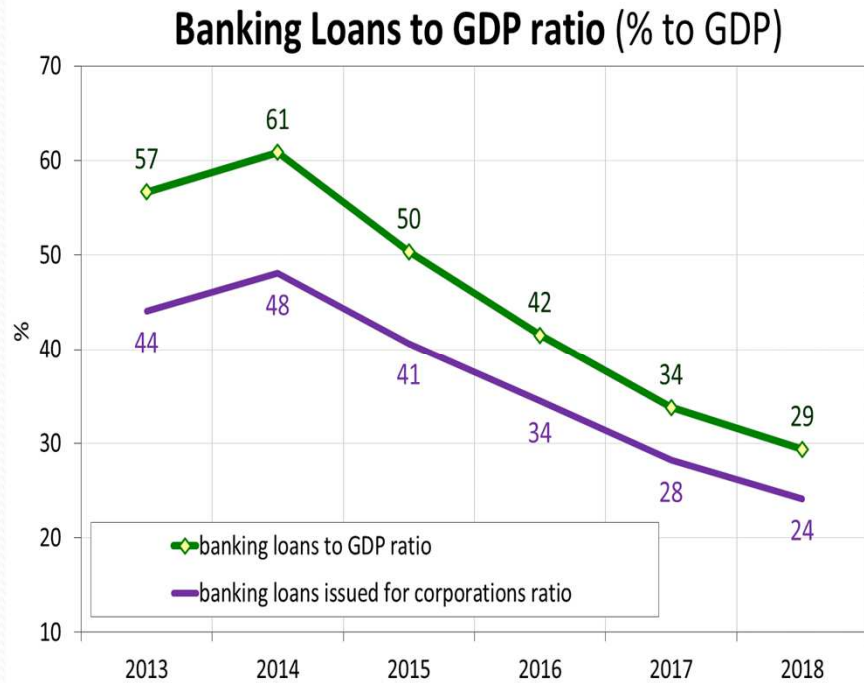
NBU's **policy rate** (17,5% in nominal and 10% in real terms) is one of the highest in the world.

Market **deposit rates** (13.2,14.6%) are lower than NBU's discount rate (17,5%).

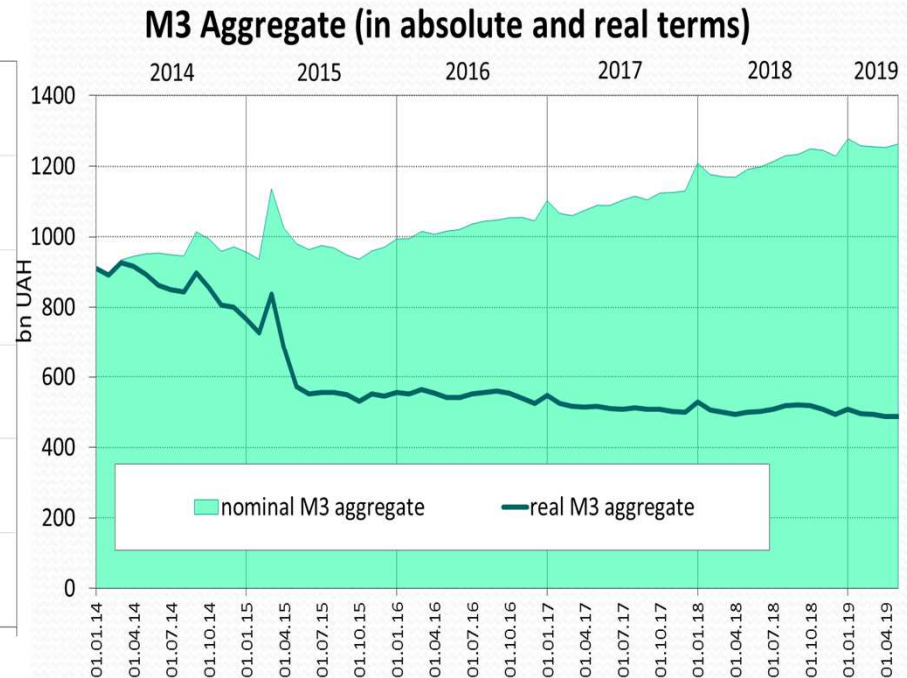
Banking loan rates for households are very high (30.3%).

Starting from February 2019 all interest rates **are declining slightly**.

Credit Crunch and Economy's Demonetization



Source: M.Dzhus calculations on the basis of NBU and State Statistics data



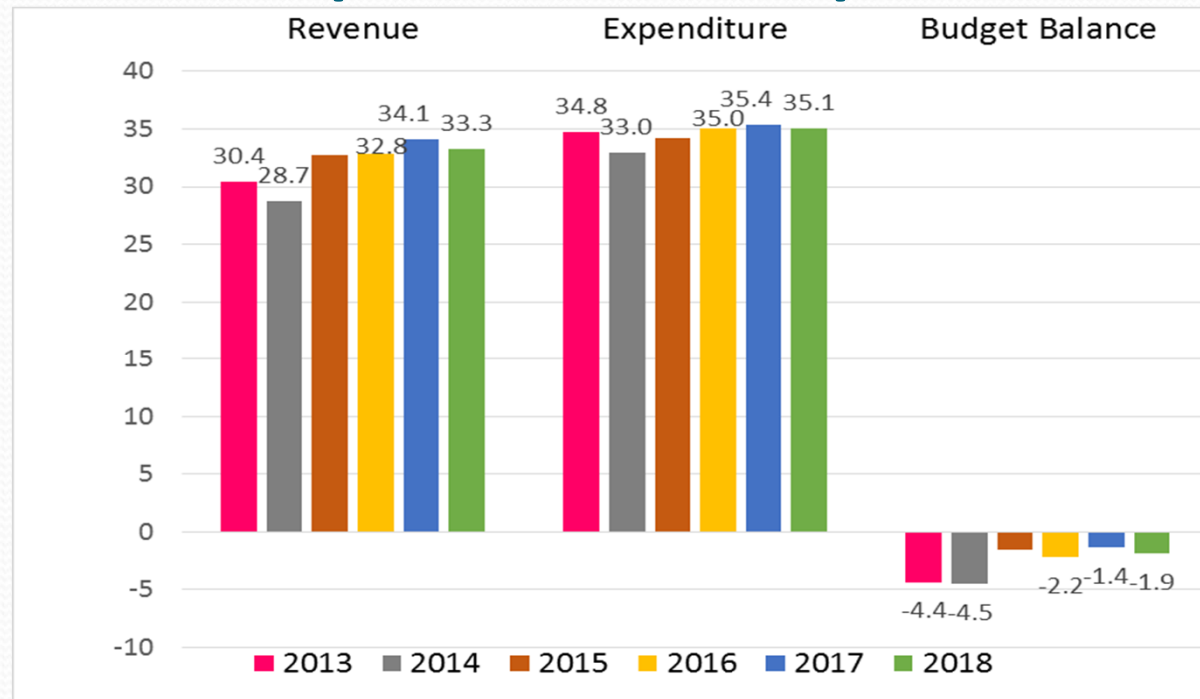
Source: M. Dzhus calculations on the basis of NBU and State Statistics Committee.

Banking loans to GDP ratio decreased by two-folds over 2014-2018 and now stands at 29% of GDP (of which 15% of GDP are NPLs).

Banking loans to corporations are even lower – 24% of GDP.

M3 aggregate declined by 46.5% in real terms since 2014 and demonetization goes on in 2019: M3 reduction by 4.4% over 4 month.

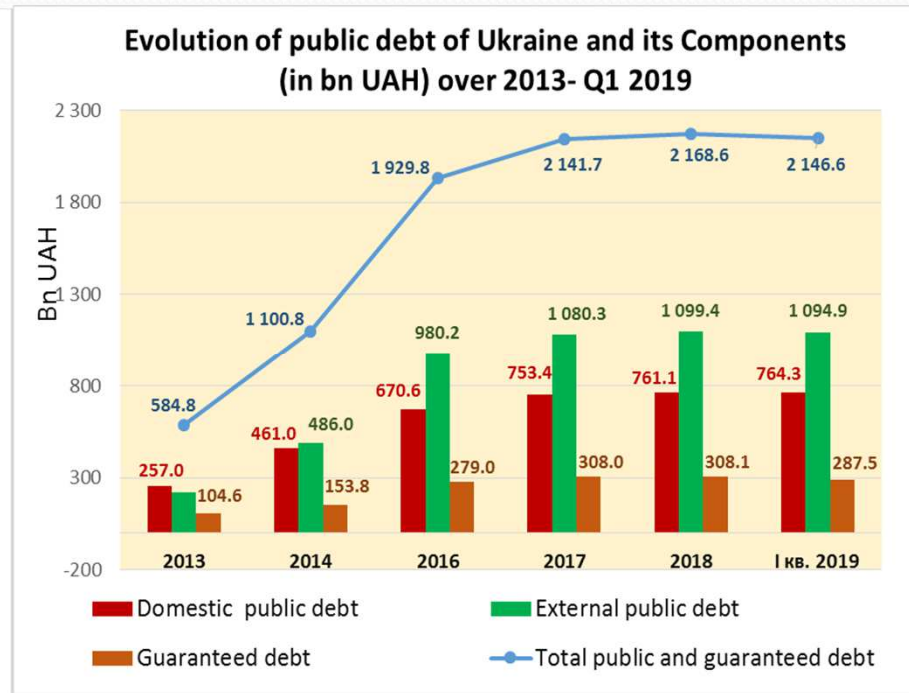
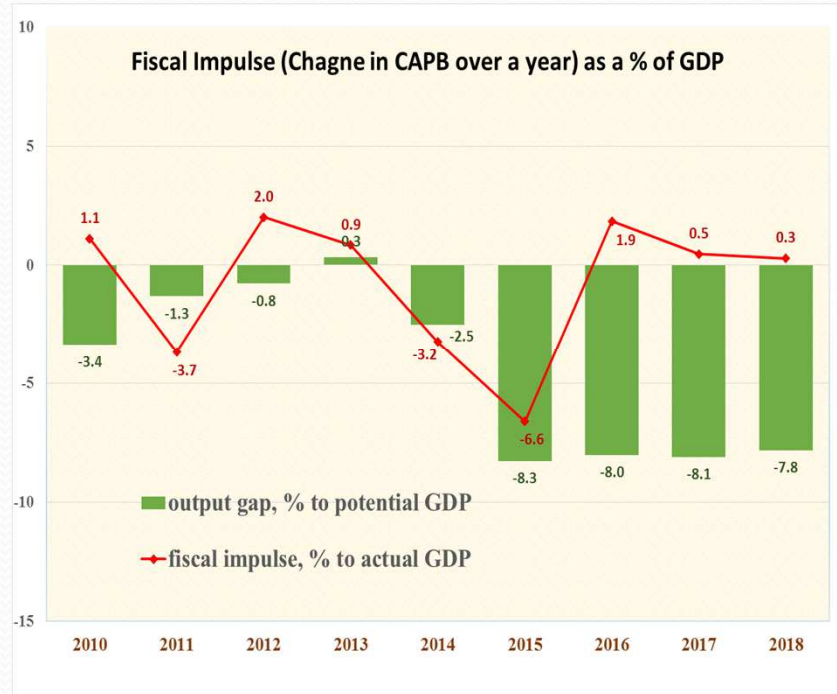
Consolidated Budget Revenue, Expenditure and Balance in 2013-2018 (as a % of GDP)



Budget revenue and expenditure were on upward trend over 2014-2017 (relative to GDP) and declined slightly in 2018-2019.

Budget deficit is in a range of 1.4 – 2.2% of GDP.

Fiscal Impulse and Public Debt Level

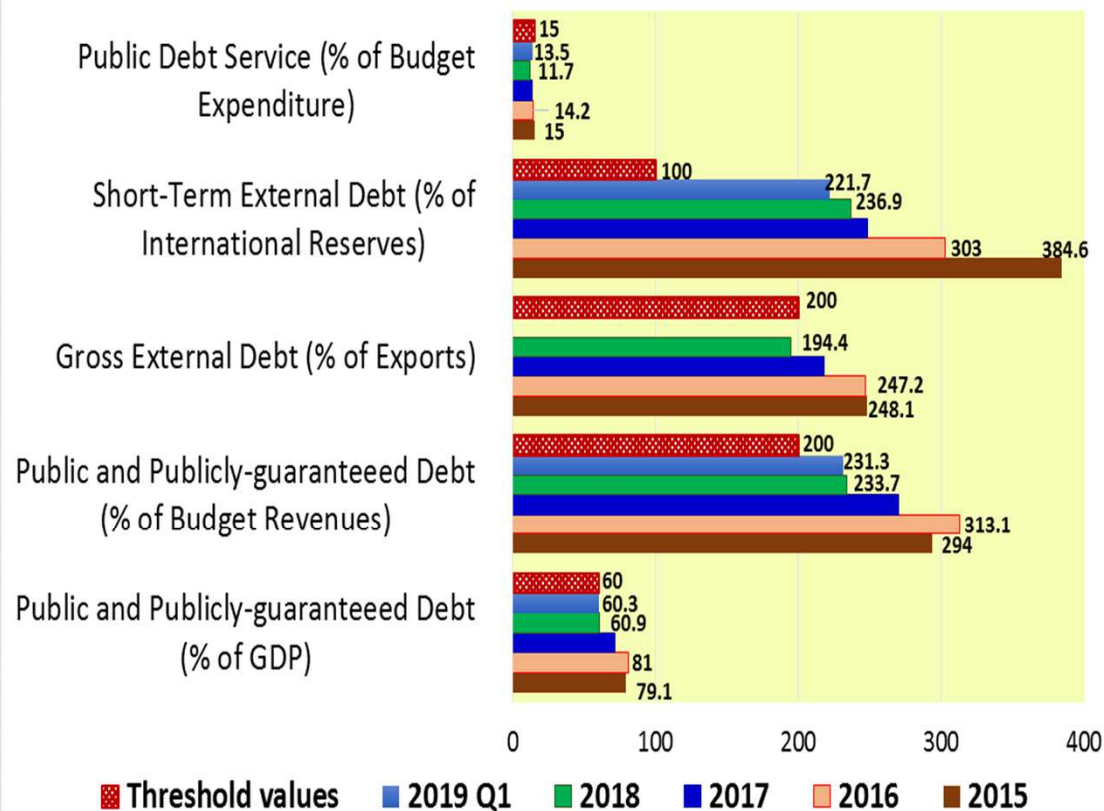


Fiscal impulse is slightly positive through 2017-2019.

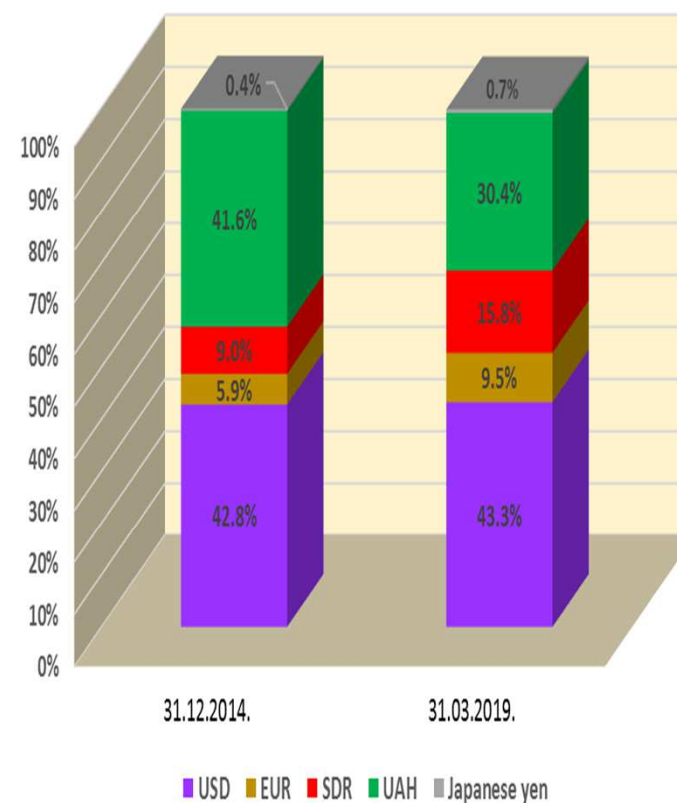
Public debt is stable in nominal terms, although debt sustainability issues are still on the agenda.

Debt-Related Risks are still high, although declining

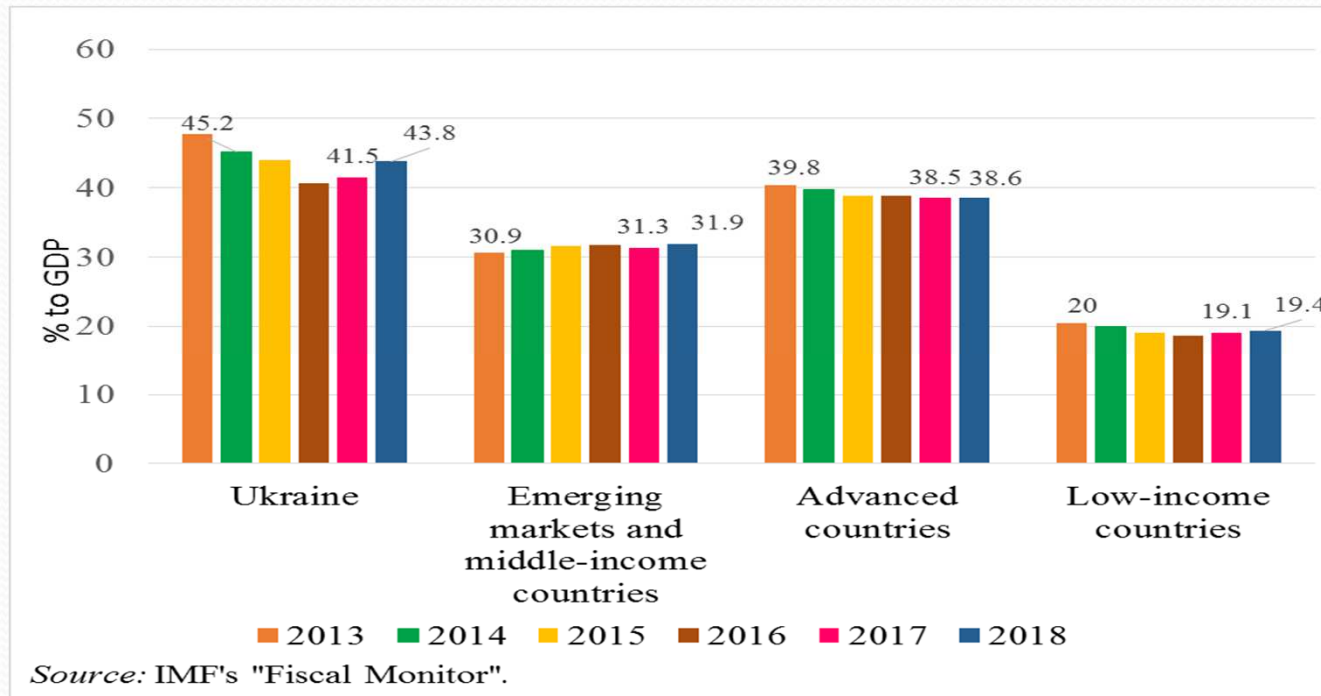
Debt Sustainability Indicators through 2015- Q1 2019 and Their Threshold Values



Public Debt Structure by the Currency Type



General government expenditure in Ukraine versus expenditure in different country groups



Public expenditure in Ukraine are high as compared to other emerging and MI countries: 41-44% versus 31-32% of GDP. Along with a high public debt level, that indicates a necessity of further fiscal adjustment.

Fiscal Policy Actions for Restoration of Fiscal Sustainability and Improving Efficiency

I. Reduction of unproductive public expenditure:

- Cut of direct subsidies to traditional economic sectors;
- Rationalization of expenditure on state governance and police;
- Consolidation of numerous social benefits programs, extending the scope of the means testing,
- Equalization of Pension Fund revenues and expenses.

II. Proper design and enforcement of fiscal rules:

- imposing an expenditure limit on the general government,
- extension of the coverage in debt rule beyond the central government,
- introducing an automatic correction mechanism for fiscal policy in case of approaching a debt limit.

III. **Strengthening fiscal institutions** related to the **medium-term budgetary planning, performance budgeting** and **fiscal risks management.**

Public Policy Challenges for Long-Term Growth and Structural Transformation:

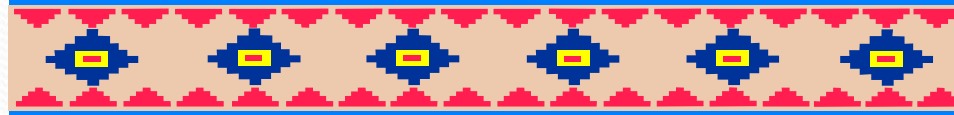
I. Pursue the standard growth policy actions: improving **physical infrastructure**, enhancing **business climate** and attracting **FDIs**.

II. Provide incentives/ tools for businesses and individuals to invest in **skill upgrading** and **innovations**, *in particular*:

- implement the guidelines from the EU Communication (2014/C 198/01) on **state aid for R&D** and **innovation** (to the extent possible);
- to activate **Export Credit Agency** and initiate special **loan programs for R&D** and innovation within state-owned banks (targeted at SMEs, predominantly).

III. Elaborate **Technology and Innovation Policy for Ukraine** (*in line with Cherif D. and Hasanov F. (2019) proposals*):

- Steering the factors of production into **technologically sophisticated industries**; building domestic capabilities in these industries;
- Focus on **export orientation** with a use of signals from external markets;
- Fostering intense **competition** and strict **accountability** of businesses benefiting from state interventions.



Thank you for attention!

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