

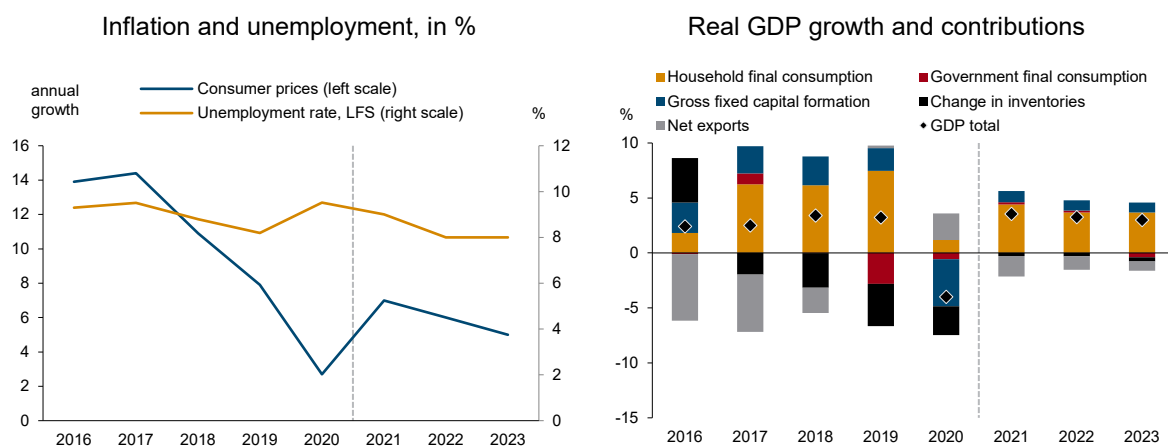


UKRAINE: Good luck can get you only so far

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Ukraine's GDP contracted in 2020 by only 4%, largely because of favourable conditions in key export markets and resilient household incomes. In 2021 the economy will return to growth, supported by a rebound in private consumption and a revival in investment. Negative risks to the forecast have been growing, due to the suspension of the IMF loan programme and a slow vaccine roll-out.

Figure 4.23 / Ukraine: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

The Ukrainian economy contracted in 2020 by 4% – more moderately than had been expected at the beginning of the COVID-19 pandemic. In Q4 2020 GDP shrank only by 0.5% year on year, despite the second wave of the pandemic. Luck was on the country's side as Ukrainian exporters could benefit from high global prices of corn, other grains, and metals, while prices of imported energy were, until recently, relatively low. Owing to the asymmetric effects of the pandemic on foreign trade in 2020, exports of goods and services decreased by only 4.6% year on year, while imports of goods and services fell by 18.1% year on year. As a result, the current account posted a surplus of USD 6.6bn (more than 4% of GDP), compared with a USD 4.1bn deficit (2.7% of GDP) in 2019.

The resumption of household income growth and easing of quarantine restrictions in the second half of the year stimulated private consumption. Ukraine was one of only a few countries in the CESEE region where private consumption increased in real terms in 2020, regardless of the lack of sufficient fiscal stimulus. In 2020 real household consumption was estimated to have increased by about 2% year on year, while real government final consumption contracted by 3% – the steepest decline in the region. Private consumption was supported by strong real wage growth (7.4% year on year on

average in 2020) and decreasing saving propensity (1.0% in Q3 2020, down by 0.7 percentage points from Q2). A recent survey of households³¹ showed that food accounts for about 45% of total household expenditure, with utilities and other mandatory payments accounting for a further 15% – reflecting a low level of income for the majority of the population, which makes saving hardly possible.

The key driver of the fall in GDP was the reduction in investment, which was the steepest in the region. High uncertainty about the future and lack of access to affordable funding sources made businesses postpone their investment projects; as a result, gross fixed capital formation decreased in 2020 by about 24% year on year. Notable growth in capital investment was registered only in postal and courier activities as delivery services and online trade experienced a boom.

After reaching a markedly low level of 2.7% in annual average terms in 2020, inflation picked up significantly in January-February 2021. Inflation reached 7.5% year on year in February, well outside the 4-6% target range set by the National Bank of Ukraine (NBU). Acceleration was driven mostly by rising food and fuel prices, as well as by hikes in administered prices for a number of goods and services. In order to combat inflationary pressures, the NBU has abandoned its accommodative monetary stance; it raised its policy rate by 50 basis points to 6.5% on 5 March 2021. In light of elevated inflation expectations, further increases in the policy rate are likely; we expect it to reach 7.5% by the end of 2021. We expect inflation to slow in the second half of the year, when a new harvest arrives, and forecast average annual inflation of 7% this year. In 2022-2023 inflation is forecast to return to the target range, and depreciation pressure is likely to remain contained during the forecast period.

Government securities accounted for the lion's share of growth in banks' net assets in 2020, while the stock of loans to the real sector of the economy declined. Domestic government debt securities, which accounted for two thirds of the growth in banks' net assets in 2020, were seen as a relatively safe haven. After a slump in H1 2020, newly issued household loans started to grow again in H2, with mortgage lending picking up the fastest – issuance of new loans almost doubled from its H1 level. New corporate loans also resumed growth in H2 2020, although the stock of loans was decreasing as banks actively wrote off non-performing loans (NPLs). Credit risk remains high, owing to pandemic-related threats to the solvency of households and companies. Despite the radical loosening of monetary policy, interest rates for new household loans have remained in double digits in both the consumer and mortgage loan segments (30.5% and 14.2% per year respectively in February 2021), raising questions about sustainability and a possible future increase in NPLs.

The third wave of the coronavirus pandemic has begun to have a significant impact on the economy. A lack of meaningful quarantine restrictions in the second half of 2020 has led to a recent rapid increase of coronavirus cases. COVID-19 deaths exceeded 300 per day at the end of March 2021. The National Academy of Sciences of Ukraine believes that the third wave is going to last until mid-May and be the deadliest yet; it expects 40,000 infections and 1,000 deaths each day. Several regions of Ukraine already face a lack of capacity in the healthcare sector to deal with a surge of patients. Ukraine remains in adaptive quarantine, where each oblast is assigned one of four epidemiological levels, depending on the COVID-19 situation there. New lockdowns have been introduced in the worst-affected regions; it is likely that a country-wide lockdown will soon be introduced.

³¹ <https://www2.deloitte.com/content/dam/Deloitte/ua/Documents/Press-release/RWD%202020%20UA.pdf>.

A slow vaccine roll-out is aggravating the situation and reduces the chances of restoring a normal level of activity in 2021. By the end of March Ukraine had vaccinated fewer than 200,000 people (less than 0.5% of the total population). There are issues both with supply of vaccines and the willingness of people to be vaccinated. Ukraine received a fresh supply of 215,000 doses of Sinovac, a Chinese-made vaccine, on 25 March. However, the anticipated delivery of 1.5m doses of the AstraZeneca/Covishield vaccine from India is at risk. India has announced that it will halt exports until the local producer satisfies the country's own demand for vaccines. Meanwhile, according to recent surveys, more than 40% of Ukraine's population are not willing to be vaccinated.³²

Lack of progress in anti-corruption reforms puts at risk Ukraine's access to external finance. After completing an unusually long virtual mission to Ukraine, which lasted for almost two months, the IMF has frozen a USD 5bn 18-month stand-by programme approved in June 2020. Ukraine had received only the first tranche of USD 2.1bn on 12 June. According to the IMF's statement, the country must show more progress on reforms (in particular, judicial reform) to be eligible for a new tranche. The Constitutional Court has been the focus of criticism for issuing a ruling in October 2020 that effectively destroyed Ukraine's entire asset declaration system for state officials (as well as for a ruling in August 2020 that undermined the authority of the national anti-corruption bureau, NABU). The IMF also voiced concern over the recent government's decision to regulate household gas prices. The new US administration is leaning on the Ukrainian government to prosecute those responsible for the fraud relating to the nationalised PrivatBank. In March 2021 the US imposed a visa ban on the bank's former owner, Ihor Kolomoisky, and his family over his involvement in significant corruption in 2014-2015. Under external pressure, the president, Volodymyr Zelensky, has started to take the first steps against oligarchs. In March 2021 he ousted two Constitutional Court judges for being threats to national security, a potentially unconstitutional move that was deemed necessary to break an impasse that had lasted for months. Additionally, NABU has charged three former senior executives at PrivatBank with embezzlement, the first criminal proceedings since its nationalisation. In the absence of an active IMF programme, loose external monetary conditions may not be sufficient for the resumption of capital inflows into the country and the government could face the risk of default.³³

In 2021 Ukraine's economy is projected to grow by 3.5%, supported by a rebound in private consumption and an investment revival. The forecast assumes that Ukraine will satisfy the requirements of the IMF and receive the next tranches of loans from it, as well as from the EU and the World Bank, and that vaccine roll-out speeds up enough to avoid prolonged lockdowns. The current account will return to deficit as economic activity recovers and import demand grows. In 2022-2023 we forecast that the economy will grow by about 3% per year, primarily on the back of household final consumption; the contribution of net exports will become negative as imports demand recovers.

³² http://ratinggroup.ua/research/ukraine/vakcinaciya_v_ukraine_barery_i_vozmozhnosti_18-19_marta_2021.html?fbclid=IwAR2q4_iRqT9chUJMqKwGGkGLIa8Uaccc7F3Z16WmbYzsxh3SR17q0zZA8-o.

³³ In 2021 Ukraine's loan repayment and servicing costs will be more than USD 15.5bn (or about 10% of 2020 GDP).

Table 4.23 / Ukraine: Selected economic indicators

	2017	2018	2019	2020 ¹⁾	2021	2022	2023
					Forecast		
Population, th pers., average	42,485	42,270	42,028	41,750	41,460	41,250	41,040
Gross domestic product, UAH bn, nom.	2,984	3,561	3,978	4,194	4,600	5,000	5,400
annual change in % (real)	2.5	3.4	3.2	-4.0	3.5	3.2	3.0
GDP/capita (EUR at PPP)	8,130	8,310	8,730	8,570	.	.	.
Consumption of households, UAH bn, nom.	1,978	2,439	2,918	3,079	.	.	.
annual change in % (real)	9.5	9.3	10.9	1.6	6.0	5.0	5.0
Gross fixed capital form., UAH bn, nom.	470	628	701	547	.	.	.
annual change in % (real)	16.1	16.6	11.7	-24.4	8.0	7.0	7.0
Gross industrial production							
annual change in % (real)	1.1	3.0	-0.5	-4.5	2.0	3.0	3.0
Gross agricultural production							
annual change in % (real)	-2.2	8.2	1.4	-11.5	.	.	.
Construction output							
annual change in % (real)	26.4	8.6	23.6	4.0	.	.	.
Employed persons, LFS, th, average	16,156	16,361	16,578	15,915	16,200	16,500	16,600
annual change in %	-0.7	1.3	1.3	-4.0	1.8	1.9	0.6
Unemployed persons, LFS, th, average	1,698	1,579	1,488	1,674	1,600	1,430	1,440
Unemployment rate, LFS, in %, average	9.5	8.8	8.2	9.5	9.0	8.0	8.0
Reg. unemployment rate, in %, eop ²⁾	1.4	1.3	1.3	1.7	.	.	.
Average monthly gross wages, UAH ³⁾	7,104	8,865	10,497	11,591	13,300	15,200	17,200
annual change in % (real, gross)	18.5	13.2	9.7	7.4	7.0	8.0	8.0
Consumer prices, % p.a.	14.4	10.9	7.9	2.7	7.0	6.0	5.0
Producer prices in industry, % p.a.	26.4	17.4	4.1	-1.6	10.0	3.0	4.0
General governm.budget, nat.def., % of GDP							
Revenues	34.1	33.3	32.4	32.8	32.0	33.5	33.0
Expenditures	35.5	35.2	34.6	38.2	37.0	36.5	35.0
Deficit (-) / surplus (+)	-1.4	-1.9	-2.2	-5.3	-5.0	-3.0	-2.0
General gov.gross debt, nat.def., % of GDP	71.8	60.9	50.2	60.8	62.0	57.0	55.0
Stock of loans of non-fin.private sector, % p.a.	1.9	5.6	-9.8	-2.8	.	.	.
Non-performing loans (NPL), in %, eop	54.5	52.8	48.4	41.0	.	.	.
Central bank policy rate, % p.a., eop ⁴⁾	14.50	18.00	13.50	6.00	7.5	7.0	6.5
Current account, EUR m ⁵⁾	-3,079	-5,443	-3,682	5,648	2,800	900	-300
Current account, % of GDP	-3.1	-4.9	-2.7	4.1	2.0	0.6	-0.2
Exports of goods, BOP, EUR m ⁵⁾	35,192	36,677	41,146	39,544	41,200	42,500	43,700
annual change in %	16.1	4.2	12.2	-3.9	4.2	3.2	2.8
Imports of goods, BOP, EUR m ⁵⁾	43,758	47,436	53,877	45,192	48,400	51,400	53,900
annual change in %	19.6	8.4	13.6	-16.1	7.1	6.2	4.9
Exports of services, BOP, EUR m ⁵⁾	12,625	13,401	15,591	13,517	14,100	15,200	16,400
annual change in %	12.3	6.1	16.3	-13.3	4.3	7.8	7.9
Imports of services, BOP, EUR m ⁵⁾	11,811	12,270	14,029	9,457	9,800	10,800	11,900
annual change in %	9.4	3.9	14.3	-32.6	3.6	10.2	10.2
FDI liabilities, EUR m ⁵⁾	3,473	3,872	5,207	-97	.	.	.
FDI assets, EUR m ⁵⁾	207	98	554	282	.	.	.
Gross reserves of CB excl. gold, EUR m ⁵⁾	14,872	15,955	21,590	22,422	.	.	.
Gross external debt, EUR m ⁵⁾	96,741	92,352	109,134	102,299	113,000	116,000	117,000
Gross external debt, % of GDP	97.3	83.4	79.4	75.1	82.0	80.0	78.0
Average exchange rate UAH/EUR	30.00	32.14	28.95	30.79	33.4	34.5	35.7

Note: Excluding the occupied territories of Crimea and Sevastopol and, with the exception of the population, excluding the temporarily occupied territories in the Donetsk and Luhansk regions.

1) Preliminary and wiiw estimates. - 2) In % of working age population. From 2019 wiiw estimate. - 3) Enterprises with 10 and more employees. - 4) Discount rate of CB. - 5) Converted from USD.

Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.