

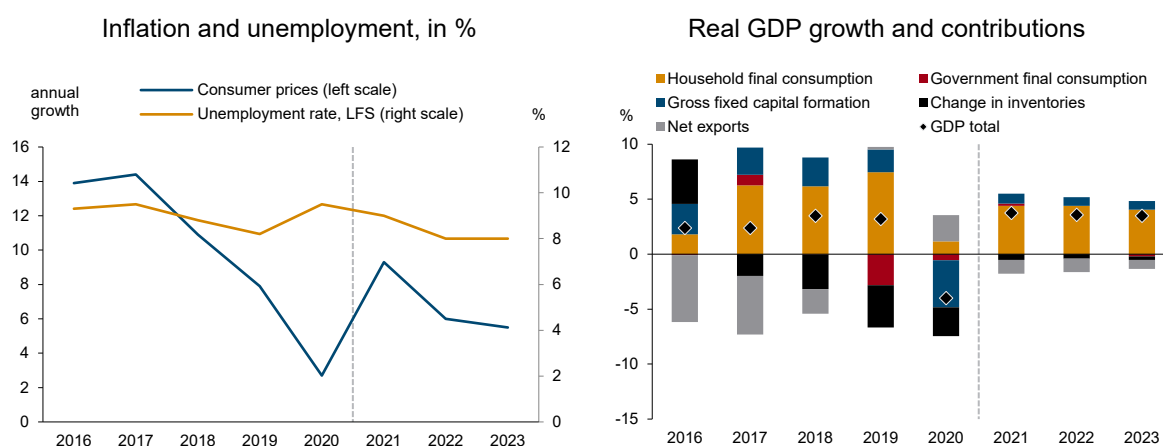


## UKRAINE: Underwhelming recovery against background of mounting risks

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Economic recovery in 2021 will be slower than expected, with GDP growing by 3.8% in annual terms. Private consumption will remain the main driver of growth throughout the forecast period. The recent acceleration in inflation is only temporary: it will slow down in 2022-2023. Any further delays to IMF funding disbursements would constitute a major risk to growth.

Figure 4.23 / Ukraine: Main macroeconomic indicators



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

**At 5.4% year on year, Ukraine's GDP growth in Q2 2021 was lower than expected.** Sluggish investment and falling export volumes lay behind this unexpectedly slow recovery. Private consumption has continued to be the main driver of growth, increasing in Q2 2021 by 17.4% in annual terms. It has been supported both by a double-digit rise in real wages and by increased remittances; however, inflation – which has soared to over 10% year on year in recent months – is acting as a drag on real wages.

**We expect GDP growth to increase slightly in the second half of 2021, on the back of a better harvest than last year.** That will allow a rise in the volume of exports. Consequently, annual GDP growth in 2021 is forecast to be 3.8%. In 2022-2023, the stabilisation of external demand for major export commodities and the lack of any great improvement in the investment climate will cause the economy to grow rather sluggishly (by about 3.5% per year), still largely on the back of private consumption.

**Attempts to improve the investment climate in the country have met with mixed success.** To curb the influence of business tycoons on the country's politics, Ukraine's parliament has passed a law defining the term 'oligarch' and establishing a register of individuals who meet the definition. They are

required to disclose their assets and will be banned from funding political parties. However, the lack of judicial reform remains one of the main barriers to eradicating corruption; moreover, according to a study by the American Chamber of Commerce and Citi Ukraine, the courts create the biggest obstacles to business.<sup>33</sup> Judicial reform has stalled: on 13 September 2021, the Ukrainian Council of Judges failed to nominate members to the Ethics Council, a key body for judicial reform.

**To combat the high inflation, the National Bank of Ukraine raised its policy rate to 8.5% on 7 September 2021.** In addition, the bank took the decision to phase out its anti-crisis monetary measures (long-term refinancing tenders and interest rate swap auctions) at the beginning of Q4 2021. Higher base effects in the second half of this year, plus an increased supply of food on the back of a better harvest, will reduce the rate of year-on-year inflation by the end of 2021. As commodity and energy prices are expected to stabilise in the near future, annual inflation will slow from 9.3% in 2021 to 5.5% in 2023.

**The USD 2.7bn that Ukraine is due to receive as part of a Special Drawing Rights (SDR) allocation by the International Monetary Fund (IMF) will help finance its short-term budget needs this year,** including external debt repayments.<sup>34</sup> The next IMF mission was due in September 2021: if it makes a positive assessment of the government's progress in implementing reforms to fulfil the conditions of the stand-by agreement, Ukraine is likely to receive about USD 700m in the next tranche before the end of 2021. The government borrowing plan for 2022, submitted to parliament along with the draft budget, envisages an issue of Eurobonds, with a maturity of 5–15 years, for the equivalent of USD 1.5bn; it also plans to raise an additional USD 2.9bn from the IMF. Given the country's hefty external financing needs, maintaining cooperation with the IMF is crucial for Ukraine's macro-financial stability. Any failure to do so would present a major risk to the growth forecast.

**The recent spike in gas prices in Europe renders it increasingly likely that the Nord Stream 2 pipeline from Russia to Germany across the Baltic Sea will soon start operating.** As a consequence, we expect Ukraine to lose a proportion of its gas transit revenues as early as 2022; that will increase its current account deficit. However, this is not likely to have a major effect on the exchange rate dynamics, as pipeline transport accounts for only 4% of total exports.

**The fourth wave of COVID-19 could pose an additional risk to growth.** Since late August, the number of confirmed COVID-19 cases and hospitalisations has been growing rapidly in Ukraine. Moreover, the country has the lowest vaccination rate in the CESEE region – as of the end of September, about 13% of the population were fully vaccinated. If the situation deteriorates, stricter quarantine rules could be introduced, with a knock-on effect on economic activity. However, the pandemic will not have such a strong impact on the economy as last year, partly because the economy has adapted and partly because governments in CESEE are tending to prioritise the economy over public health.

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<sup>33</sup> <https://www.kyivpost.com/ukraine-politics/survey-ukraines-businesses-financially-recovering-from-covid-19-pandemic.html>

<sup>34</sup> The first tranche (USD 1.9bn) landed in the government's account on 23 August 2021. Ukraine has also received EUR 600m assistance from the EU.

**Table 4.23 / Ukraine: Selected economic indicators**

	2018	2019	2020 <sup>1)</sup>	2020	2021	2021	2022	2023
				January-June			Forecast	
Population, th pers., average	42,270	42,028	41,745	.	.	41,370	41,080	40,790
Gross domestic product, UAH bn, nom.	3,560	3,977	4,192	1,728	2,178	4,800	5,300	5,800
annual change in % (real)	3.5	3.2	-4.0	-6.8	2.0	3.8	3.6	3.5
GDP/capita (EUR at PPP)	8,570	8,990	8,820	.	.	.	.	.
Consumption of households, UAH bn, nom.	2,439	2,918	3,079	1,380	1,705	.	.	.
annual change in % (real)	9.3	10.9	1.6	-1.8	11.1	6.0	6.0	5.5
Gross fixed capital form., UAH bn, nom.	628	701	547	214	247	.	.	.
annual change in % (real)	16.6	11.7	-24.4	-22.1	5.0	7.0	6.0	6.0
Gross industrial production								
annual change in % (real)	3.0	-0.5	-4.5	-7.6	2.1	2.0	3.0	3.0
Gross agricultural production								
annual change in % (real)	8.2	1.4	-11.5	.	.	.	.	.
Construction output								
annual change in % (real)	8.6	23.6	5.6	-4.3	0.2	.	.	.
Employed persons, LFS, th, average	16,361	16,578	15,915	16,056	15,589	16,200	16,500	16,600
annual change in %	1.3	1.3	-4.0	-2.6	-2.9	1.8	1.9	0.6
Unemployed persons, LFS, th, average	1,579	1,488	1,674	1,631	1,713	1,600	1,430	1,440
Unemployment rate, LFS, in %, average	8.8	8.2	9.5	9.3	9.9	9.0	8.0	8.0
Reg. unemployment rate, in %, eop <sup>2)</sup>	1.3	1.3	1.7	.	.	.	.	.
Average monthly gross wages, UAH <sup>3)</sup>	8,865	10,497	11,591	10,928	13,309	13,600	15,300	17,300
annual change in % (real, gross)	13.2	9.7	7.4	6.4	12.5	7.0	6.0	7.0
Consumer prices, % p.a.	10.9	7.9	2.7	2.4	8.3	9.3	6.0	5.5
Producer prices in industry, % p.a.	17.4	4.1	-1.6	-5.0	28.5	25.0	3.0	4.0
General governm.budget, nat.def., % of GDP								
Revenues	33.3	32.4	32.8	37.8	34.7	32.0	33.5	33.0
Expenditures	35.2	34.6	38.2	38.0	35.4	37.0	36.5	35.0
Deficit (-) / surplus (+)	-1.9	-2.2	-5.4	-0.2	-0.7	-5.0	-3.0	-2.0
General gov.gross debt, nat.def., % of GDP	60.9	50.2	60.9	52.9	54.1	58.0	56.0	54.0
Stock of loans of non-fin.private sector, % p.a.	5.6	-9.8	-2.8	-3.3	-2.1	.	.	.
Non-performing loans (NPL), in %, eop	52.8	48.4	41.0	48.5	37.2	.	.	.
Central bank policy rate, % p.a., eop <sup>4)</sup>	18.00	13.50	6.00	6.00	7.50	8.5	7.5	6.5
Current account, EUR m <sup>5)</sup>	-5,443	-3,682	4,612	3,673	-542	-1,400	-3,800	-4,900
Current account, % of GDP	-4.9	-2.7	3.4	6.1	-0.8	-0.9	-2.4	-3.0
Exports of goods, BOP, EUR m <sup>5)</sup>	36,677	41,146	39,527	19,167	22,772	43,900	44,900	46,200
annual change in %	4.2	12.2	-3.9	-3.6	18.8	11.1	2.3	2.9
Imports of goods, BOP, EUR m <sup>5)</sup>	47,436	53,877	45,462	21,263	24,592	50,500	53,700	56,300
annual change in %	8.4	13.6	-15.6	-14.0	15.7	11.1	6.3	4.8
Exports of services, BOP, EUR m <sup>5)</sup>	13,401	15,591	13,628	6,712	6,662	14,100	12,000	12,200
annual change in %	6.1	16.3	-12.6	-7.2	-0.7	3.5	-14.9	1.7
Imports of services, BOP, EUR m <sup>5)</sup>	12,270	14,029	9,775	4,924	5,156	10,400	11,200	12,100
annual change in %	3.9	14.3	-30.3	-25.6	4.7	6.4	7.7	8.0
FDI liabilities, EUR m <sup>5)</sup>	3,872	5,207	215	-156	2,788	3,400	.	.
FDI assets, EUR m <sup>5)</sup>	98	554	317	124	470	400	.	.
Gross reserves of CB excl. gold, EUR m <sup>5)</sup>	15,955	21,590	22,422	24,139	22,593	.	.	.
Gross external debt, EUR m <sup>5)</sup>	92,352	109,134	102,293	108,907	105,402	110,000	113,000	114,000
Gross external debt, % of GDP	83.4	79.4	75.1	80.0	71.4	74.0	72.0	70.0
Average exchange rate UAH/EUR	32.14	28.95	30.79	28.60	33.49	32.5	33.6	35.4

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. - 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.