

Economics in Brief



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Ukraine – Small economy, major problems

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The current crisis continues to weaken the ailing Ukrainian economy, which is already beset with structural problems. On the one hand, solutions are needed for the present problems, primarily that of securing the solvency of the state with international assistance. On the other hand, economic reforms addressing fundamental structural issues have also to take place, as the willingness to reforms was previously not apparent in economic policy. If the reforms are successful, Ukraine's economic strength – which at present corresponds to 5% of Germany's nominal GDP – should grow over the long term.

Return to recession inevitable

The economic recovery following the economic crisis of 2009 has proved very short-lived. After positive rates of growth in 2010 and 2011, changes in real GDP against the same quarter of the previous year are now once again negative. The zero growth reported for 2013 as a whole is solely attributable to a strong fourth quarter, which was the result of a good harvest and an accompanying increase in value added in agriculture. However, the outlook is gloomy at present, and a recession is inevitable. The

further decline in industrial output at the start of the year and the fall in consumer confidence are just the first signs of that.

Ukraine has experienced several periods of very high inflation. The most recent was in 2008, when rates reached just over 30%. After a spell of virtually stable prices, the inflation rate climbed to 3.7% in March. Raising the key interest rate by three percentage points certainly helps in the fight against further currency devaluation (the hryvnia dropped around 27% against the US dollar between 1st January 2014 and 21st April 2014). It also helps fighting inflation. However, this will probably not prevent a marked rise in inflation over the coming months due to the weakness of the hryvnia and rising gas prices.

Foreign trade in deficit

The current account balance has been negative since 2006, and it has deteriorated further since the economic crisis of 2009 (around -10% of GDP in the fourth quarter of 2013).

The exchange rate fix on the dollar had to be removed. The Ukrainian central bank had been unable to defend the exchange

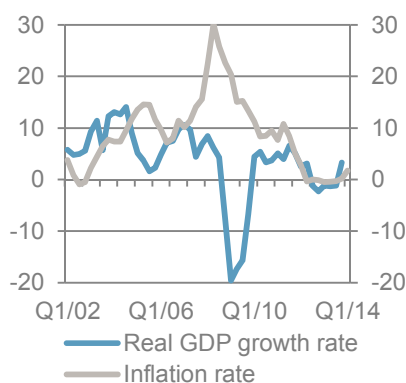
rate on another occasion in 2008, when the currency depreciated significantly. It could also not tolerate the recent downward pressure on the currency. On 15th April, one hryvnia could be exchanged officially for US 8 cents, whereas up until January it had been 12 cents. Defending the exchange rate cost a substantial portion of the currency reserves. These are almost depleted by now, having fallen around 61% since their previous peak in April 2011. A return to a fixed exchange rate is therefore not expected in the foreseeable future.

There has also been a marked devaluation against the rouble, with a fall of around 20% between 1st January 2014 and 21st April 2014. But little impetus for foreign trade is expected from Ukraine's main trading partner Russia due to the weakness of the Russian economy.

Significant growth in government debt

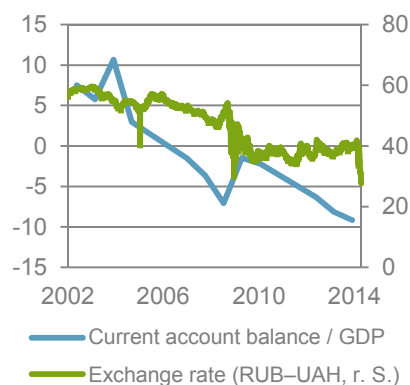
Government debt has risen steeply since 2008, climbing from around 21 to 41% of GDP. The budget deficit currently stands at 4.5% of GDP (excluding the Naftogaz energy group). The scope for fiscal policy is extremely limited. The IMF support package is therefore conditioned on budget stabilization and reform in the energy sector among others. Without this, the deficit would grow to over 10% of GDP in 2014, according to IMF estimates. ■

Figure 1: Growth and inflation
[year-on-year change]



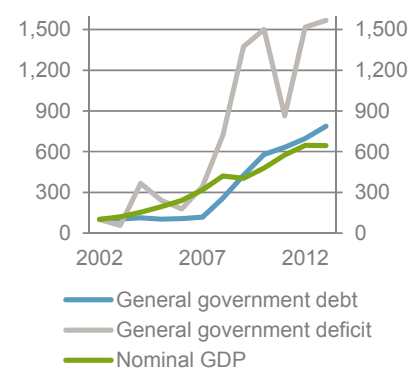
Sources: State Statistics Service of Ukraine, author's calcs.

Figure 2: Current account balance
[as percentage]



Sources: World Bank, NBU.

Figure 3: Government debt
[UAH, Index 2002=100]



Sources: IMF, NBU, author's calcs.