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NEWSLETTER

German Economic Team

UKRAINE

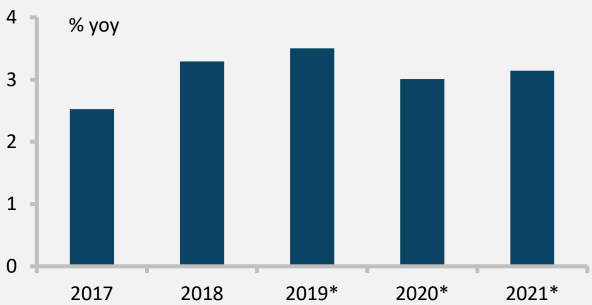
Ukraine's economy in good shape

Ukraine emerges from 2019 in a stable economic shape. GDP growth was at 3.5%, driven by strong domestic demand, despite two elections being held in 2019. Due to strong inflow of foreign capital to the domestic bond market, the Hryvnia appreciated by 16% against the US dollar. Inflation was at 4.1% and thus for the first time within the National Bank's target range, allowing a gradual reduction of the policy rate. Both the current account and budget deficits are under control at ca. 3% and 2% of GDP, respectively.
For Ukraine, these are good values of the key macroeconomic indicators, especially in the context of recent years. The task for economic policy will now be to maintain this stability and to confirm the new trust of investors in the Ukrainian economy. Maintaining a good relationship with the IMF plays a key role in this regard. Going forward, it is necessary to sustainably increase the stable but low growth by carrying through the announced structural reforms.

Stable economic growth continues

The economy of Ukraine grew by 3.5% in 2019, the highest growth rate within the last 8 years. The main driver of growth was strong domestic demand. Both private consumption and private investment expanded due to higher real incomes. The double elections in 2019 had no negative impact on growth, whilst the staff-level agreement with the IMF and the conclusion of a gas transit deal with Russia reinforced the confidence of investors.

Real GDP growth



*Source: IMF, German Economic Team; * Estimate/Forecast*

GDP growth forecasts for 2020 and 2021 are currently 3.0% and 3.1%, respectively. Risks remain in external shocks such as a weakening of the global economy or drops in world market prices for key export goods such as steel or grain.

Development of sectors and foreign trade

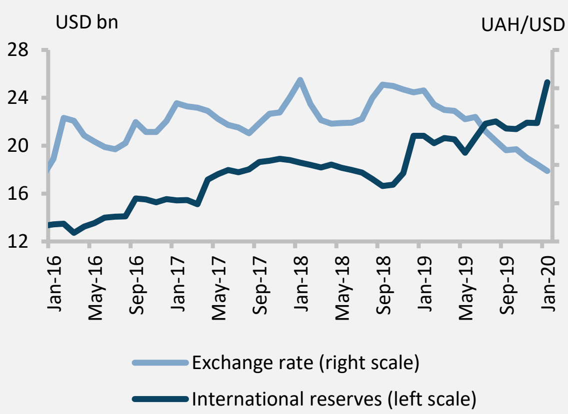
Industrial production decreased by 1.8% in 2019, in large part due to the fall in steel prices. Manufacturing remains the most important sector on the supply side at 21% of GDP, followed by steadily growing service sectors. A positive factor was the record grain harvest of more than 74 m tonnes (7.5% higher than in the previous year), which highlights increasing productivity. The agri-food sector (including manufacturing of food products) now accounts for 15.6% of GDP.

Foreign trade continued to expand in 2019. Exports and imports both increased by ca. 7% in the first ten months of 2019. Given the uncertain context of international trade, the growth of exports was a positive development. Agricultural exports to the EU continued on their upward trend. With exports worth more than USD 5.2 bn in the first three quarters of 2019, Ukraine ranked third among agricultural exporters to EU, behind the US and Brazil. Ukraine's current account deficit will probably have remained below 3% of GDP in 2019 and is expected to remain below 4% of GDP in the coming years.

Appreciation of the Hryvnia

The Hryvnia appreciated against the US dollar by 16% and against the Euro by even more than 18% during 2019. The main reason for this development was the inflow of capital into the domestic bond market. Foreign investors now hold more than USD 5 bn in Hryvnia-denominated bonds, a market share of ca. 16%. Investors were of course attracted by high interest rates for Ukraine bonds, but this strong inflow also reflects trust in the stability of Ukrainian economy and currency.

Exchange rate und international reserves



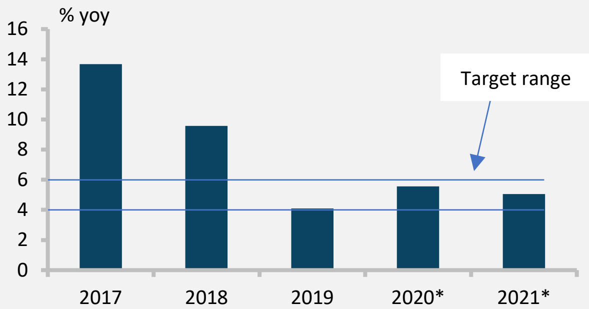
Source: National Bank of Ukraine

At the end of January 2020, international reserves reached their highest level since October 2012 at close to USD 26.3 bn, equivalent to almost 4 months of import coverage. This increase was supported by the appreciation of the Hryvnia as well as the payment of USD 2.9 bn by Gazprom as part of the gas deal.

Inflation: target range of National Bank was reached

Inflation decreased sharply during 2019, reaching 4.1% by the end of the year, which is not only within but even the lower bound of the NBU's target range between 4% and 6%. Inflation is expected to remain within the target range in the coming years.

Inflation rates



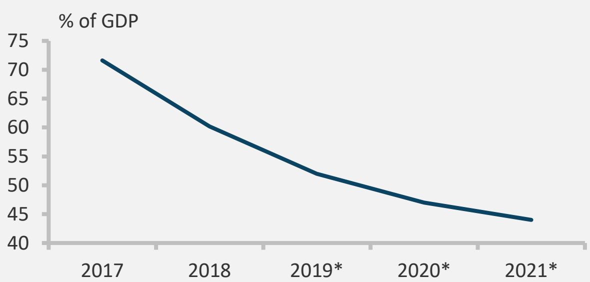
*Source: IMF, Ukrstat; Note: eop * Estimate/Forecast*

Reaching the inflation target range for the first time is a very important achievement and permits the National Bank to gradually reduce the policy rate, strengthening domestic demand and reducing further appreciation pressure. During 2019, the National Bank reduced the policy rate in five steps. After a further reduction in February 2020, the policy rate is now at 11%, the lowest rate since July 2014.

Reduction of public debt

The government's budget deficit was at a solid 2% of GDP at the end of 2019. The debt-to-GDP ratio decreased, reaching 52% of GDP at the end of 2019.

Public debt



*Source: IMF, Ministry of Finance Ukraine; *Estimate/Forecast*

This development can be explained by the steady growth of nominal GDP and the appreciation of the Hryvnia, which reduced the share of foreign currency debt. It is expected that the public deficit will remain under control and the debt-to-GDP ratio will continue to decrease throughout 2020 and 2021. A further positive aspect is that the inflow of foreign capital into Hryvnia-denominated bonds reduces exchange rate risks as well as reducing the costs of debt service.

Conclusion

The good values in basically all macroeconomic indicators in 2019 are a considerable achievement for Ukraine, which has not been in such a stable situation for a long time. It shows that sound fiscal and monetary policies eventually pay out. For the future, it is now crucial to retain and reinforce the confidence of investors in the Ukrainian economy. Maintaining a good relationship with the IMF through sound fiscal policy and a clear stance regarding the banking sector will remain crucial in this regard.

Nevertheless, a substantial increase of growth rates remains indispensable in order to eventually reduce the prosperity differential with Western neighbours. To achieve this, structural reforms such as the announced land market reform, a new labour code and privatisation of state-owned enterprises will have to be successfully completed.

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The German Economic Team (GET) advises the governments of Ukraine, Belarus, Moldova, Georgia and Uzbekistan regarding the design of economic policy reform processes and a sustainable development of the economic framework. It is funded by the Federal Ministry of Economics and Energy and implemented by the consulting firm Berlin Economics.