

Issue 12 | June 2020

Overview

- GDP: Due to COVID-19, the Ukrainian economy is forecast to decline by 7.0% in 2020, followed by a small growth of 1.1% in 2021
- The significant decline of GDP is a combination of domestic lockdown measures as well as a deterioration in the global environment
- Due to significant progress with macroeconomic stability during recent years, Ukraine faces this global crisis much better prepared than in the past
- A flexible exchange rate acts as a shock absorber and protects international reserves (Jun-20: USD 25.4 bn)
- The current account will almost be balanced in 2020 (-0.3% of GDP), as imports shrink faster than exports
- Low inflation (May-20: 1.7%) allowed the NBU to decrease the policy rate, supporting the economy
- Public finances: after years of moderate deficits, the budget deficit is set to rise to 7.5% of GDP in 2020 as a result of the crisis

Topics

- **Economic impact of COVID-19.** Detailed analysis of the impact of COVID-19 under different scenarios
- **IMF programme.** New SBA is important for budget financing and obtaining further international support
- **Land market.** New law is a small step in the right direction, but short-term economic impact very small
- **Banking law.** New legislation prevents the return of insolvent “zombie” banks to the market
- **COVID-19.** Development of cases, lockdown measures, policy response, international financial support

Basic indicators

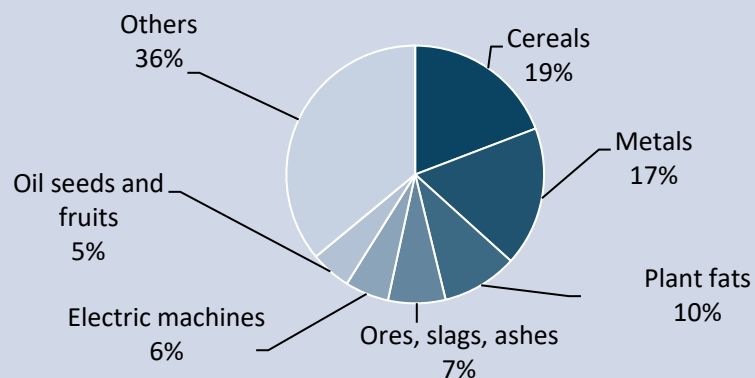
	Ukraine	Belarus	Moldova	Georgia	Russia
GDP, USD bn	153.8	63.1	12.0	17.6	1,699.9
GDP/capita, USD	3,648	6,658	4,476	4,763	11,587
Population, m	42.1	9.5	2.7	3.7	146.7

Sources: Countries' statistical services, 2019,

Trade structure

Exports

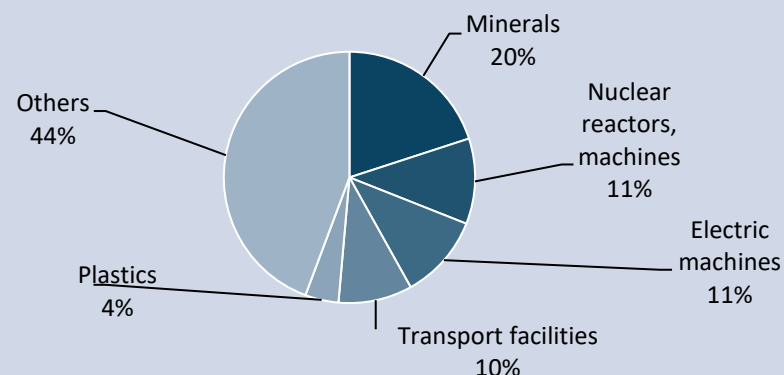
EU 43% | China 7% | Other 51%



Source: Ukrstat, data for 2019; Note: trade in goods

Imports

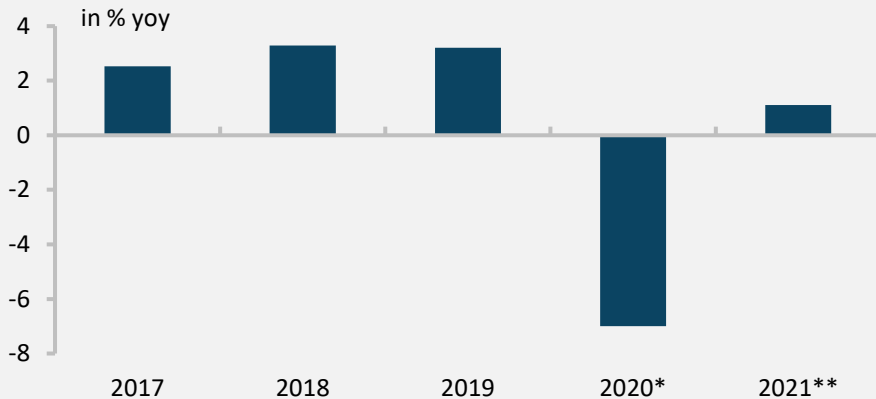
EU 42% | China 15% | Other 43%



Source: Ukrstat, data for 2019; Note: trade in goods

Economic growth

Real GDP growth

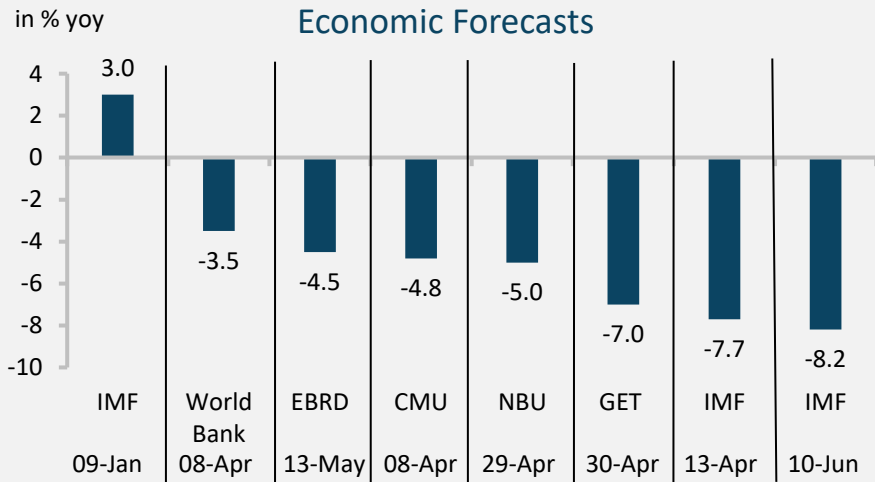


Sources: Ukrstat, IMF, German Economic Team; *GET forecast, **IMF forecast

GDP

- 2019: GDP grew by 3.2%, similar to 2018 (3.3%)
- 2020: forecasts show strong decline (-7.0%)
 - Impact of COVID-19 domestic lockdown measures
 - Impact of COVID-19 crisis in partner countries
 - Lower agricultural harvest forecast due to bad weather
- 2021: GDP will only marginally grow (+1.1%), no V-shaped recovery

Economic Forecasts



Sources: IMF, World Bank, EBRD, CMU, NBU, German Economic Team

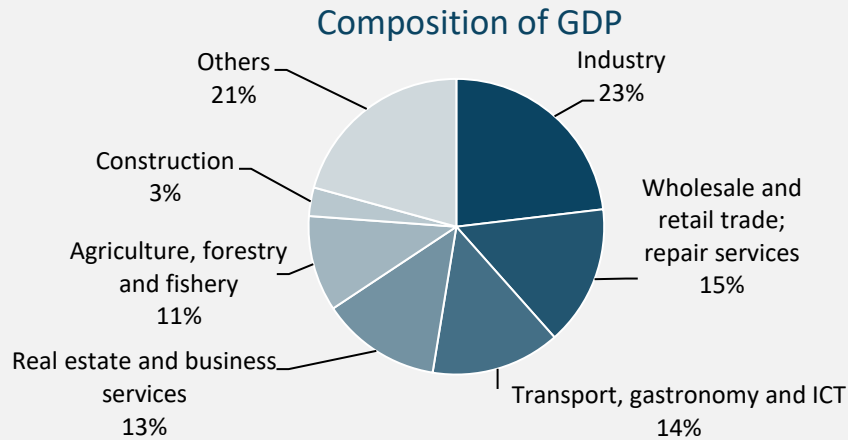
High uncertainty

- Current forecasts reflect high uncertainty
 - Length and depth of domestic lockdown measures
 - The external environment
 - Fiscal and monetary policy support
 - Possible future changes to consumer and investor behaviour

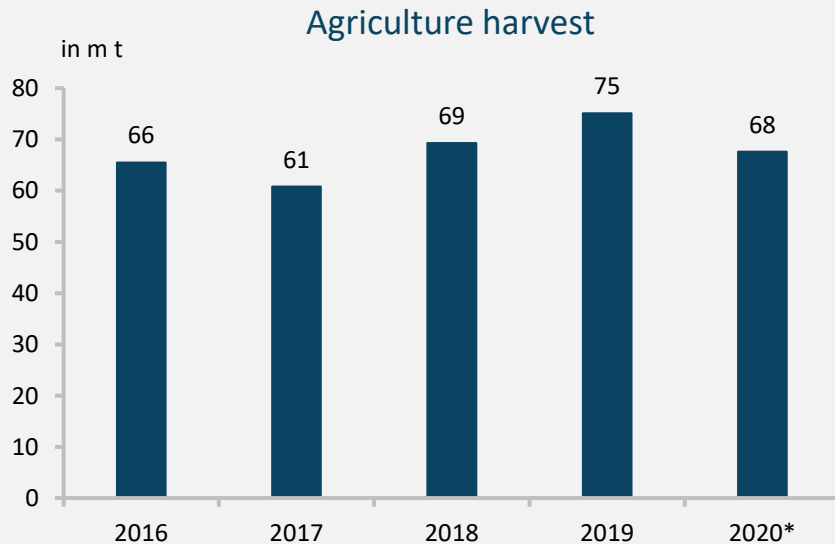
Conclusion

- Strong GDP decline, but extent is uncertain

Sectoral perspective



Source: Ukrstat, 2019



Sources: FAO, German Economic Team; *GET forecast

Sectoral structure

- Most important sector on the supply side is industry (23%) even though production declined over the course of 2019 (-1.8%)
- COVID-19-exposed service sectors follow in importance:
 - Retail trade and repair services (15%)
 - Transport, gastronomy and ICT (14%)
 - Real estate and business services (13%)

Outlook 2020

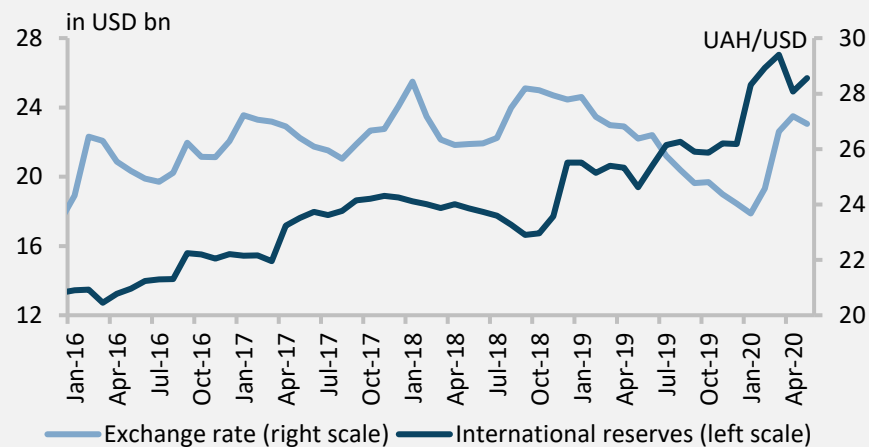
- Transport and trade services decline strongly due to lockdown measures
- Decline in agriculture mainly caused by dry weather conditions

Conclusion

- Both COVID-19 and bad weather negatively affect the supply side and have a sizeable impact

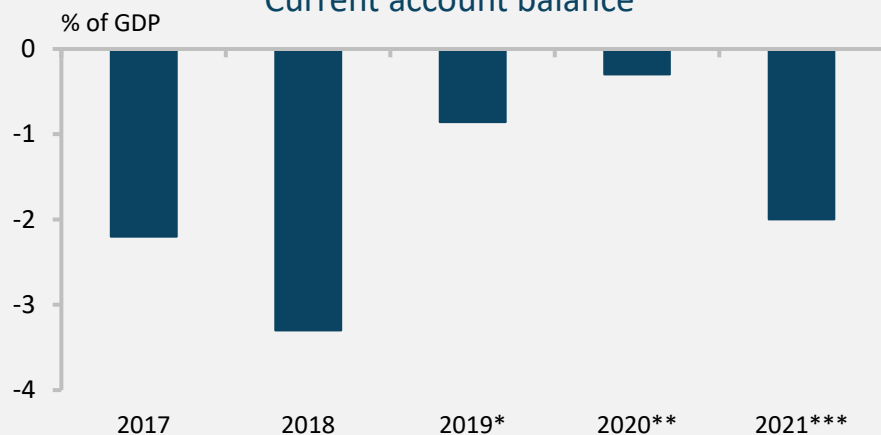
Exchange rate and current account

Exchange rate and international reserves



Source: NBU

Current account balance



Sources: IMF, German Economic Team; *Gazprom payment included, **GET forecast, ***IMF forecast

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Exchange rate

- 2019: strong appreciation against USD (+16.2%)
- Mar-20: UAH faced depreciation pressures during the crisis, but quick recovery afterwards

International reserves

- Mar-20: Sale of reserves to support UAH, but since April, old trend of reserve accumulation continues
- Jun-20: USD 25.4 bn; import coverage: 4.5 months

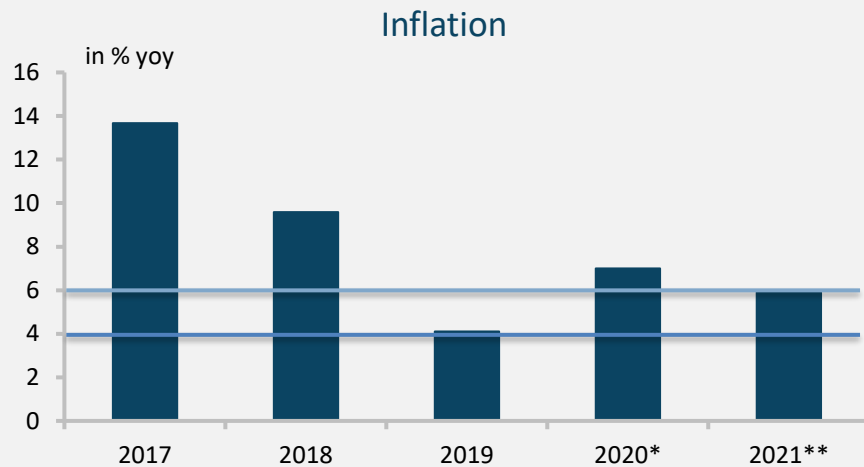
Current account

- 2019: current account deficit below 1% of GDP (incl. Gazprom payment to Naftogaz in late December)
- Crisis and low energy prices will decrease the deficit further, as imports contract faster than exports; some deterioration in 2021 (-2.0% of GDP)

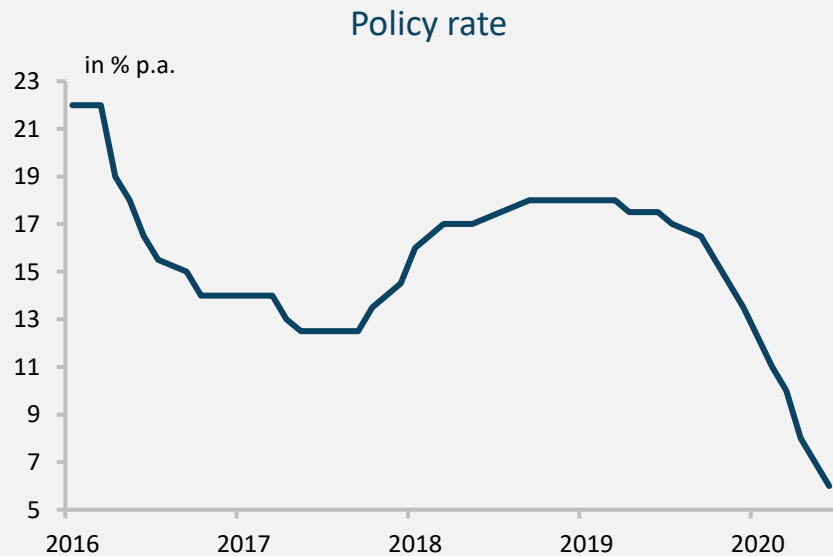
Conclusion

- Stable external position despite the crisis
- Flexible exchange rate important shock absorber

Inflation and monetary policy



Sources: Ukrstat, IMF, German Economic Team; Note: EoP, *GET forecast, **IMF forecast



Source: NBU

Inflation

- Strong decline of inflation since 2017
- Currently 1.7% (May-20), below the National Bank's target range (4-6%)
- Inflation is expected to increase slightly, but overall moderate in 2020-2021

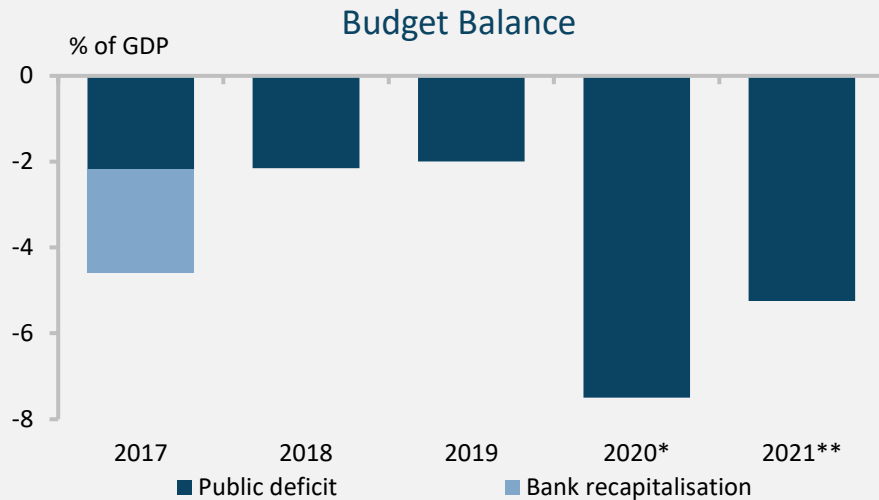
Policy rate

- Declining inflation and exchange rate stability allowed the NBU to decrease the policy rate in response to COVID-19 to currently 6%, a historic low
- Further policy rate reduction dependent on future inflation developments

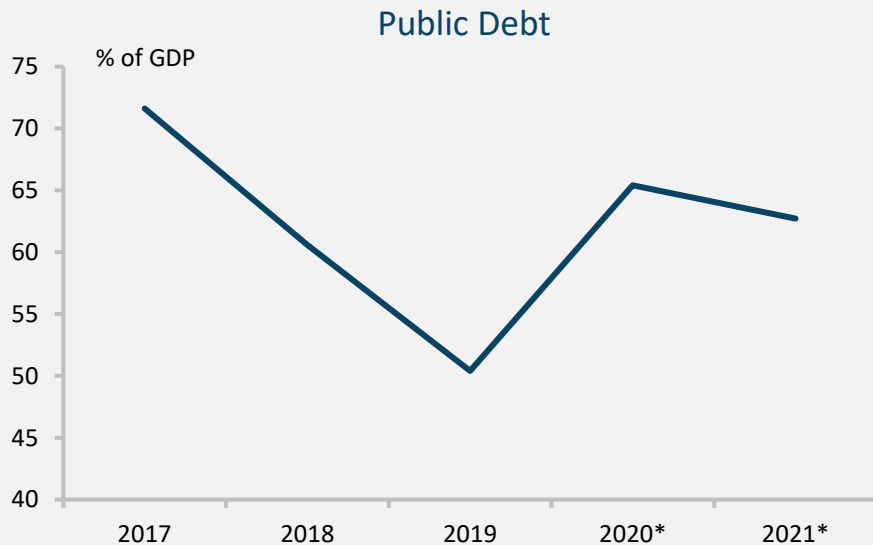
Conclusion

- Positive inflation developments allowed monetary policy to deliver rate cuts during the crisis

Public finances



Sources: IMF, *Ministry of Finance, **IMF forecast



Source: IMF; *forecast

Government budget

- Moderate deficit of 2.0% of GDP in 2019
- Similar level originally planned for 2020, but massive budget deficit increase to 7.5% in budget amendment for 2020 to fight the crisis
- IMF programme key for unlocking financing

Public debt

- Significant reduction of Debt-to-GDP ratio due to strong growth of nominal GDP and appreciation of the Hryvnia in 2017-2019
- Now, temporary increase in public debt to finance measures against COVID-19

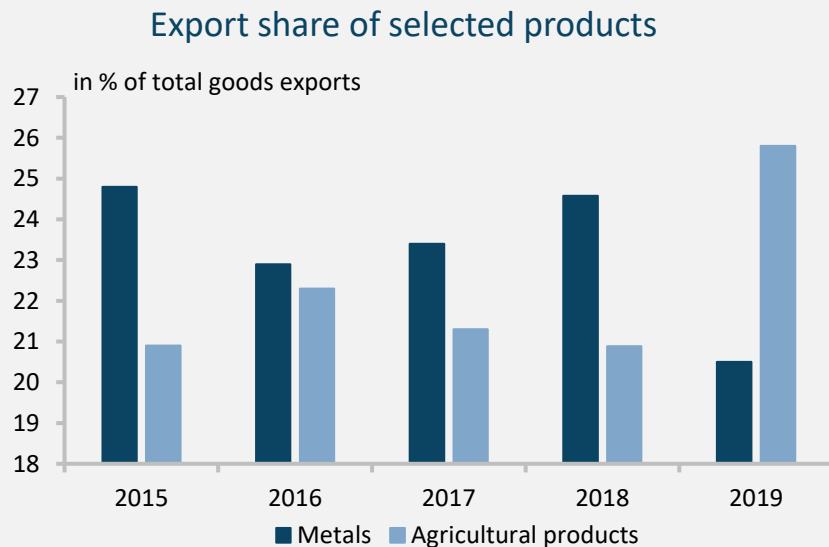
Conclusion

- Conservative fiscal policy supports resilience against crisis
- For deficit financing, IMF-programme important
- Reduction of public debt priority after the crisis

External trade



Source: Ukrstat; Note: trade in goods



Source: Ukrstat; Note: trade in goods

Exports and imports

- Exports and imports increased at almost the same rate in 2019 (around 6%)
- In 3M2020, trade growth came to a halt; expectation of shrinking exports and imports during the crisis

Export development of selected products

- Structural change observable in key export products
- Metals and agricultural goods make up almost 50% of total exports, but changed their relative importance over time

Conclusion

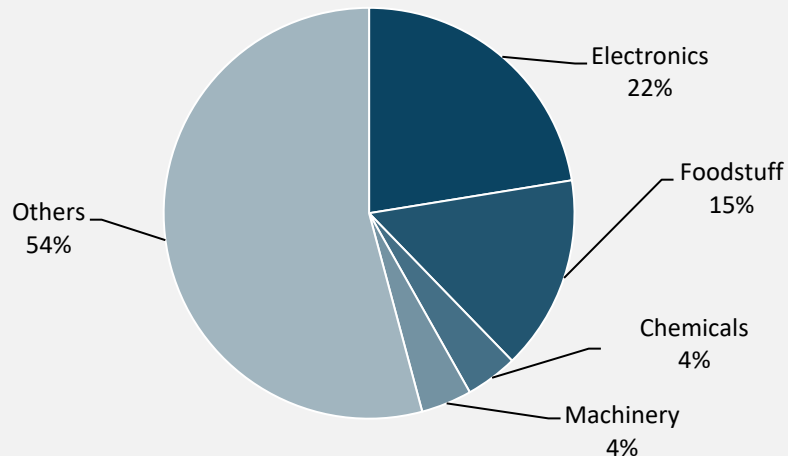
- Positive development in external trade during 2019 came to a stop; for 2020 a shrinking of trade is forecast
- Agricultural exports take the lead from metals; stabilizing factor during the crisis

Bilateral trade between Germany and Ukraine



Source: Federal Statistical Service of Germany

Structure of German imports



Source: Federal Statistical Service of Germany, 2019; Note: trade in goods

Bilateral trade

- Increase of 8.3% in 2019, after 9.1% in 2018
- Bilateral trade increased by further 1.9% in 3M2020

German exports to Ukraine

- Increase of 8.9% in 2019, mainly due to robust domestic demand in Ukraine
- In 3M2020, similar rate of increase of (8%)
- Traditional export products:
 - Chemicals (22%)
 - Machinery (incl. agricultural machines) (22%)
 - Motor vehicles (incl. parts) (14%)

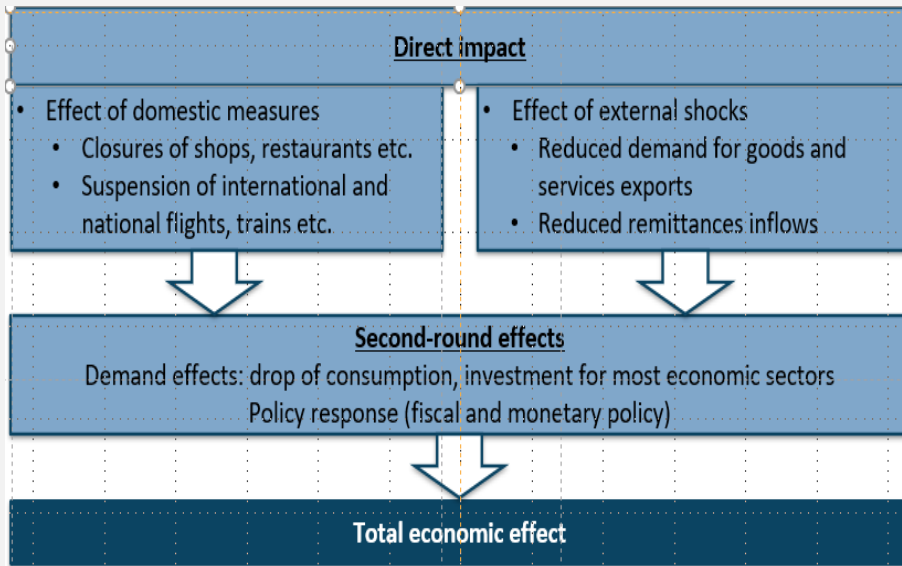
German imports from Ukraine

- Robust increase of 7.4% in 2019
- In 3M2020, a decrease of 7.8%
- Most important sectors: electronics (22%), foodstuffs (15%) chemicals (4%) and machinery (4%)

Conclusion

- Positive development so far, but subject to the same risks as overall trade due to the crisis

Economic impact of COVID-19 (1)



Source: GET illustration

Direct impact

	Sector	Optimistic	Baseline	Pessimistic
Domestic sectors	% of annual GVA	-1.4%	-1.6%	-2.3%
Goods exports	% of GDP	-0.9%	-1.7%	-2.4%
Services exports	% of GDP	-2.2%	-2.6%	-3.2%
Remittances	% of GDP	-1.6%	-2.3%	-3.0%

Source: GET/IER calculation

Background

- Strict lockdown measures introduced in Ukraine and globally due to COVID-19 spread

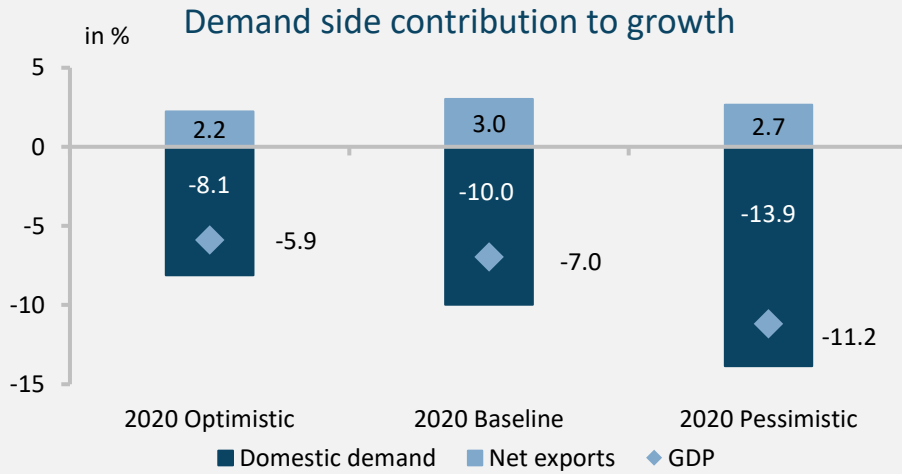
Assumptions

- GET/IER forecast of economic effect in two steps:
 - Direct effect of domestic measures and external shocks
 - Second-round effects
- Three different scenarios are assumed:
 - Domestic: different duration of lockdown
 - External: difference between current and last IMF forecast $\pm 30\%$

Results

- “Shutdown” of domestic sectors causes domestic sector output declines between -1.4% and -2.3%
- Estimated total reduction of external goods trade between 0.9% and 2.4% of GDP
- Reduction of service trade is even stronger, as drop in goods trade influences service sectors and international transport is strongly declining

Economic impact of COVID-19 (2)



Source: GET/IER calculation



Source: GET/IER calculation

Results

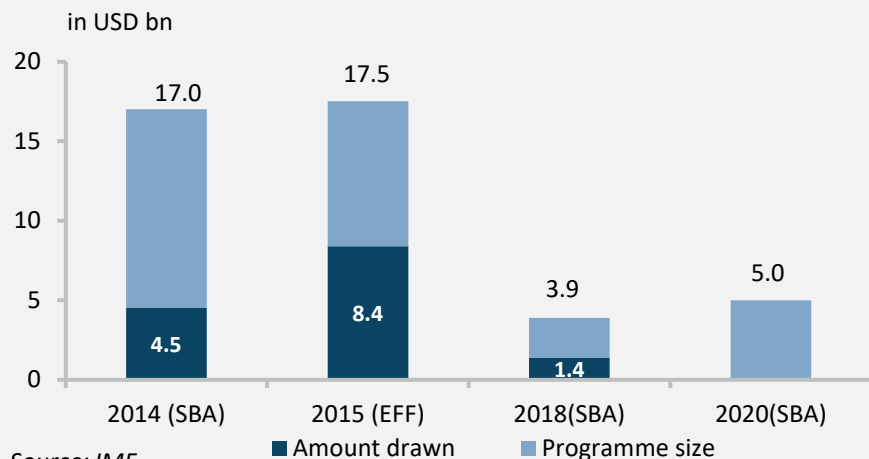
- Baseline forecast of 7% real GDP decline in 2020, with domestic demand (investment and private consumption) driving the decline
- Net exports deliver positive impulse, as imports shrink faster than exports and some import substitution is expected
- On the supply side, transport and trade sectors suffer from the crisis, while the decline in agriculture is explained by dry weather
- Current account deficit very moderate in baseline/optimistic scenario, and in surplus in pessimistic scenario

Conclusion

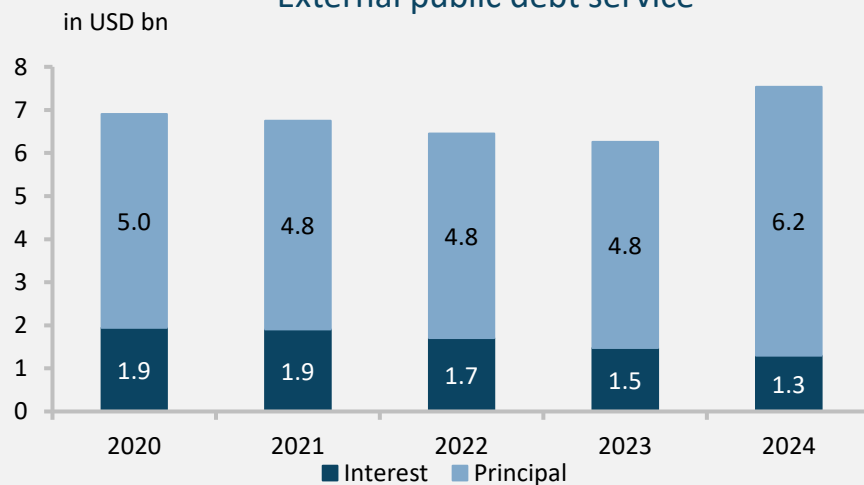
- Forecast broadly in line with other institutions
- Additional adverse effect of dry weather affects GDP in 2020

New IMF programme

IMF programmes



External public debt service



Background

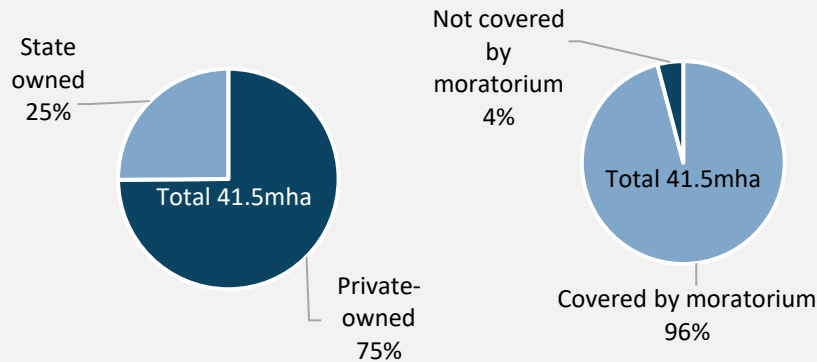
- Three previous agreements with IMF with overall amount of USD 14.5 bn paid out since 2014
- After long discussions lasting since 2019, COVID-19 and related financing pressures led quickly to new “Stand-by-Arrangement” (SBA):
 - IMF Board approval date: 9 June
 - Duration: 18 months; Size: USD 5 bn
 - First tranche released: USD 2.1 bn
- Main prior actions fulfilled:
 - Land market liberalisation
 - Banking Law
- Programme will unlock further support from other IFIs and donors, such as EU (macro-financial assistance of EUR 1.7 bn) and the World Bank

Conclusion

- Agreement on a new programme helps to finance budget deficit, eases servicing of external public debt and unlocks further bilateral and multilateral support

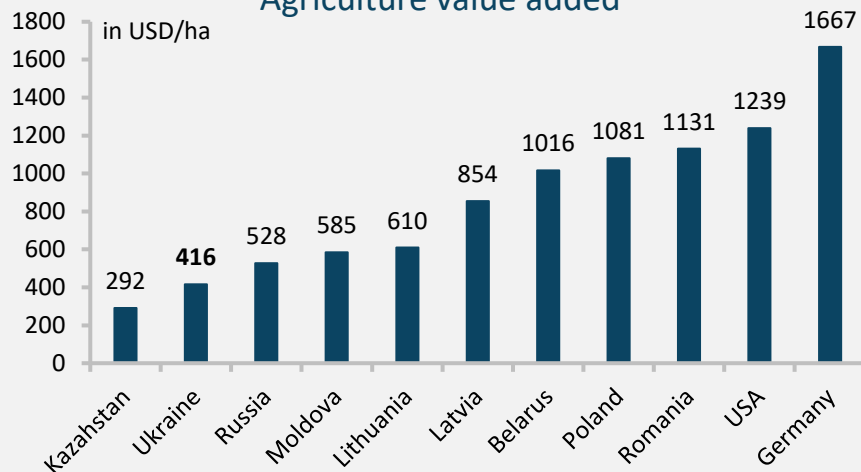
Liberalisation of land market

Structure of agricultural land



Source: Dragon Capital

Agriculture value added



Sources: World Bank, Dragon Capital, 2016

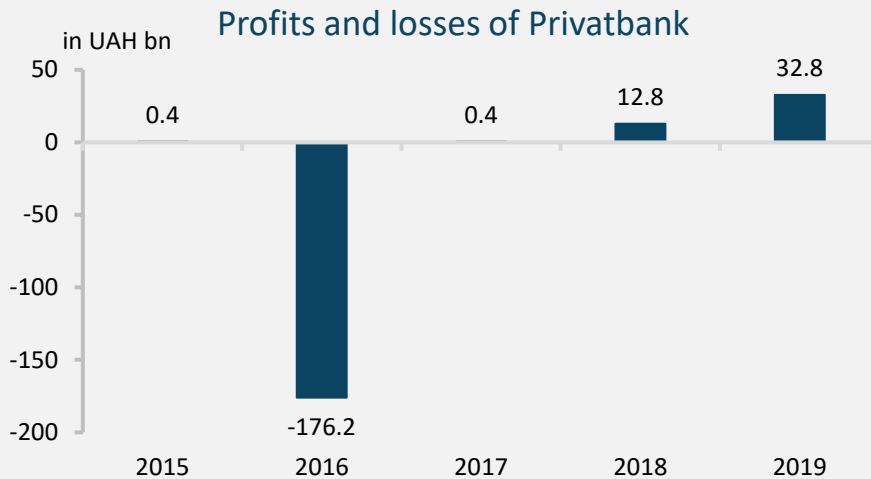
Background

- Ukraine has with 41.5 mha the second largest stock of agricultural land in Europe (32.5 mha of that is arable land)
- Until now, a memorandum did not allow for selling/buying agricultural land, which is one reason for low sectoral productivity
- On 30 March, the “Law on land market” was finally adopted, but in a very restrictive form:
 - From 01 July, 2021 onwards, only individuals will be allowed to purchase land of up to 100 ha
 - Legal persons can acquire up to 10,000 ha from 2024 onwards
 - The participation of foreigners will be decided in a future referendum

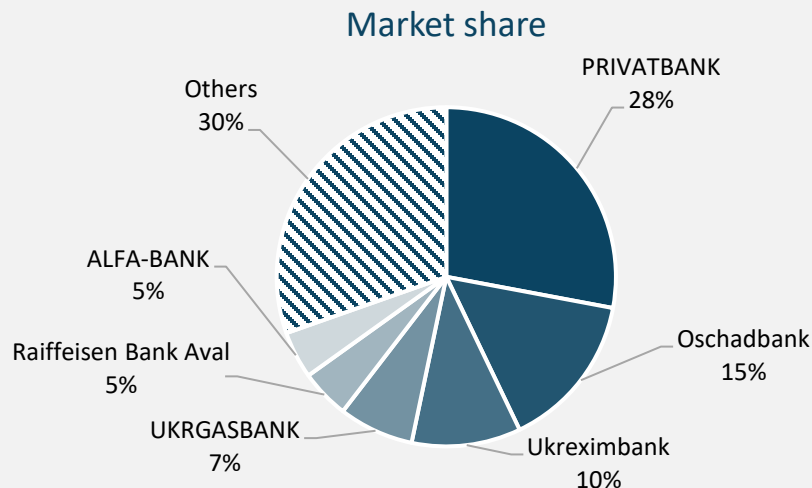
Conclusion:

- Although the short-term economic impact of this reform will be very low, it is an important step in the right direction

Banking law



Source: PrivatBank annual reports



Source: NBU, May, 2020

Background

- Since 2014, the National Bank as regulator removed more than 100 banks from the market
- Many previous owners of insolvent banks use decisions by the court system to get their banks back
- One case is Privatbank, Ukraine's biggest bank, nationalised in late 2016 after huge losses
- On 13 May, adoption of law to prevent such a reversion
 - It guarantees the irreversibility of insolvency and continuation of asset sales (conformity with most European countries)
 - It defines conditions and procedure of compensation for former owners
 - It provides further procedural rights to NBU to detect problematic banks at earlier stages

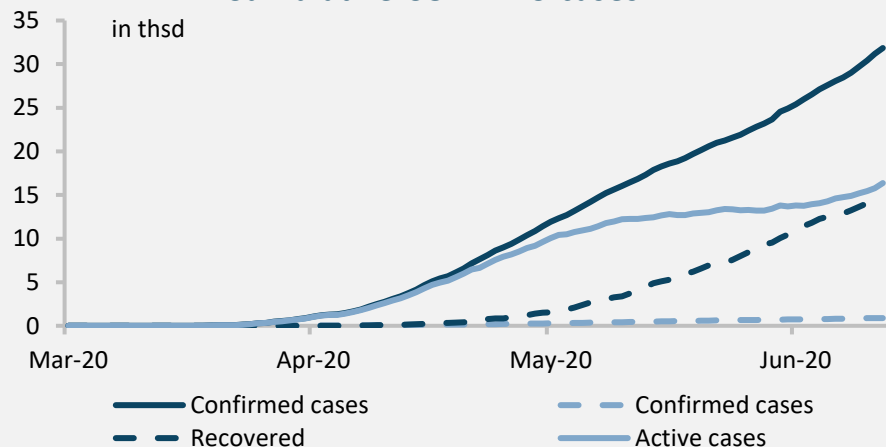
- The adoption was the last prior action for approval of the IMF SBA programme

Conclusion

- Important step to protect gains of the banking reform, safeguard taxpayers' money and unlock IMF support

COVID-19: overview of cases

Cumulative COVID-19 cases



Source: Johns Hopkins University

Domestic perspective

- Since April: moderate increase in number of cases
- Since May: situation seemed under control, with active cases flattening out
- Since June: number of active cases is again on a rising path, vigilance warranted

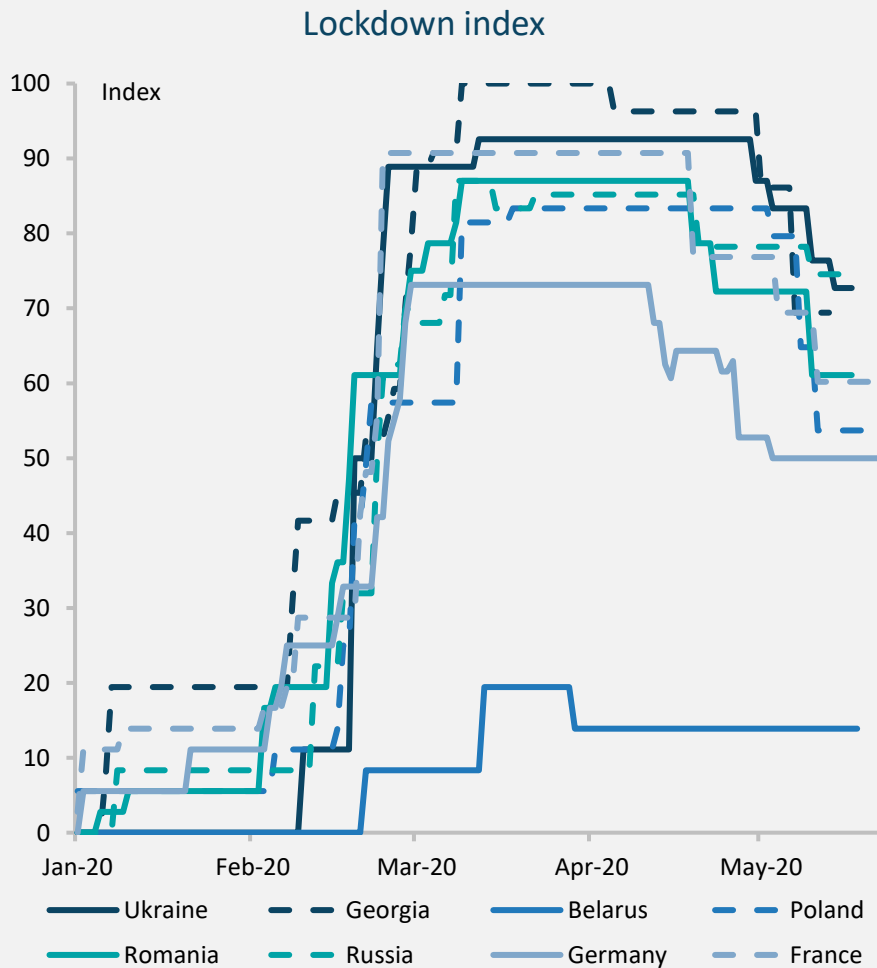
International perspective

- Relatively good performance by any measure, low number of deaths
- However, low level of conducted tests limits the validity of numbers

	Absolute numbers				Per 1 m population			
	Total Cases	Deaths	Recovered	Active	Total Cases	Deaths	Active	Tests
Ukraine	31,154	889	14,082	16,183	712	20	370	11,186
Georgia	864	14	703	147	217	4	37	19,030
Belarus	53,973	308	30,103	23,562	5,712	33	2,493	77,654
Poland	29,392	1,247	14,226	13,919	777	33	368	31,408
Romania	21,999	1,410	15,719	4,870	1,143	73	253	29,133
Russia	528,964	6,948	280,050	241,966	3,625	48	1,658	101,967
Germany	187,671	8,870	172,200	6,601	2,240	106	79	56,034
France	157,220	29,407	72,859	54,954	2,409	451	842	21,215

Source: Worldometer, data as of 14 June 2020; Note: latest available data; Data for tests are updated infrequently

COVID-19: containment measures and lifting



Source: Oxford COVID-19 Government Response Tracker

Note: the stringency index aggregates policy responses related to containment, closure and public information campaigns on a scale from 0 (lowest) to 100 (highest)

Domestic perspective

- Measures taken:
 - Announcement of emergency situation in major cities
 - All flights and train connections cancelled
 - Closure of borders
 - Closure of public transport in large cities
 - Closure of parks, salons, cultural events
 - Restaurants only for delivery
 - Closure of retail outlets (except for food, fuel, hygiene and medical products)
- Relaxation:
 - Since 11 May: reopening of parks, museums, beauty salons
 - Since 25 May: reopening of subway in large cities, resumption of some national and international railway connections

International perspective

- Compared to development of cases, relatively early and strict response
- Relaxation timing comparable to neighbours

COVID-19: support by the government

Households	Business	
<ul style="list-style-type: none"> • Deadline for filing annual income and asset declarations extended to July 1 • Introduction of a top-up of 300% of the salary for medical personnel working with COVID-19 patients • Allowance of households to deduct the expense of COVID-19 medicine from the calculation of personal income tax • Introduction of a one-off pension increase to low-income pensioners of UAH 1,000 and a regular monthly UAH 500 pension top-up for retirees aged 80 years or more • Increase of unemployment benefits • Introduction of partial unemployment scheme • Cancelled penalties for violation of tax legislation 	<ul style="list-style-type: none"> • Exemption from import duties and VAT on medicines/medical devices against COVID-19 (mandatory reporting in Prozorro System) • Deadline for filing annual income and asset declarations extended to July 1 • Full suspension of land tax and rent for publicly owned land for land used in economic activity for March • Cut of key policy rate by NBU to 6% 	
	SMEs	Large companies/banks
	<ul style="list-style-type: none"> • Introduction of partial unemployment scheme for SMEs • Extension of 5%-7%-9% subsidized loan programme 	<ul style="list-style-type: none"> • Suspension of the introduction of capital buffer and modification of regulation of reserve requirement calculation for banks • Postponement of bank inspections and tests

Sources: IMF, CMU Note: selection, measures as of 15 June 2020

COVID-19: international support

International assistance by IFIs/donors

Organisation	Amount of support	Status
IMF	<ul style="list-style-type: none"> • USD 5bn (SBA programme) 	<ul style="list-style-type: none"> • Approved
EU Commission	<ul style="list-style-type: none"> • EUR 500m (macro-financial assistance, loan (old MFA programme)) • EUR 1.2bn (macro-financial assistance, loan (new programme)) • EUR 190m (Health-related support package) 	<ul style="list-style-type: none"> • Approved
World Bank Group	<ul style="list-style-type: none"> • USD 135m (Mitigate health and social impacts of the pandemic) • USD 350m (Aid program of World Bank) • USD 700m (Development Policy Loan) 	<ul style="list-style-type: none"> • Approved • Approved • in discussion
UN	<ul style="list-style-type: none"> • EUR 140m (Global Humanitarian Response Plan) 	<ul style="list-style-type: none"> • Approved
KfW	<ul style="list-style-type: none"> • EUR 150m (Financial loan program of Federal Government) 	<ul style="list-style-type: none"> • Approved

Sources: Different sources; Note: table reflects information available as of 15 June

- Ukraine announced a deficit of 7.5% of GDP in the revised budget: international assistance needed for financing
- Key support comes from IMF programme, but EU and other institutions are also very active
- International support/aid is equivalent to around 5% of GDP (2020)

About the German Economic Team



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. As part of the project we also work in other countries on selected topics.

In a continuous dialogue with high-level decision makers of the project countries, we identify current problems in economic policy and then provide concrete policy recommendations based on independent analysis.

In addition, GET supports German institutions in the political, administrative and business sectors with its know-how and detailed knowledge of the region's economies.

The German Economic Team is financed by the Federal Ministry of Economics and Energy (BMWi). The consulting firm Berlin Economics has been commissioned with the implementation of the project.

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