German Advisory Group Ukraine

NEWSLETTER

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Positive economic outlook

The successfully held presidential and parliamentary elections in Ukraine have clearly dominated public attention with their surprising outcomes.

In this context, less attention was paid to the economic performance of the country, although a quite positive development can be noted. The economy is growing at a stable rate of 3% p.a. and the overall macroeconomic situation seems stable.

This should support the newly elected decision-makers and provide the economic basis to implement the reforms mandated by the electorate.

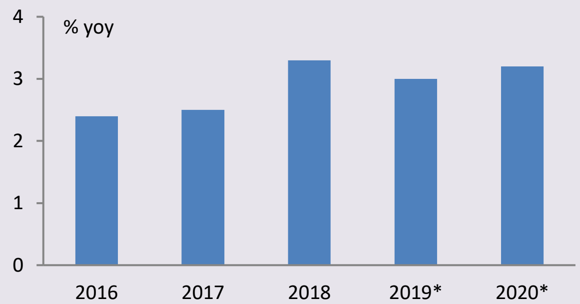
A fast agreement with the IMF about a new long-term programme would be an important signal to all other international stakeholders against the background of a more uncertain development of the world economy.

Stable economic growth

In the first half of this year, the economy grew surprisingly strong at 3.7%. Increasing private consumption and investment where the main growth drivers on the demand side. The two elections did not dampen the investment behaviour of private firms, contrary to the predictions of some observers.

The forecasts for this and the upcoming year are at similar levels: 3.0% (2019) and 3.2% (2020). Although there are some upward risks due to the strong performance in the first half, there are at least equally strong downward risks due to the slowdown of the world economy and the developments of some commodity prices.

Real GDP growth

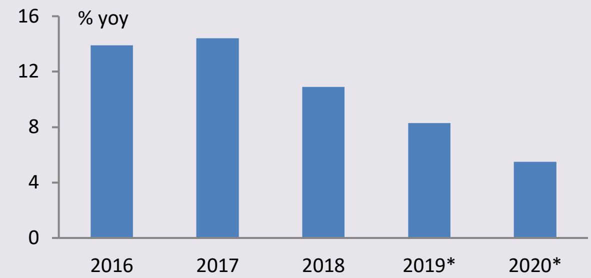


*Source: National Bank of Ukraine, *forecast*

Gradual decline of inflation

Current inflation of 9% is still above the target range of the National Bank. However, as the graphic below illustrates, inflation has been decreasing since quite some time.

Inflation



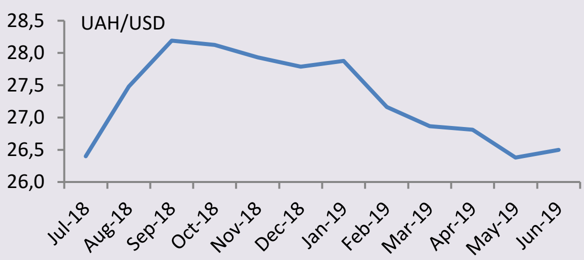
*Source: National Bank of Ukraine, *forecast; Notice: yearly average of the Consumer Price Index (CPI)*

The National Bank is confident that the decrease in inflation will continue and the target of 5% will be reached in 2020. On the basis of this development, the National Bank decided to lower the key interest rate to currently 17%. Further rate cuts can be expected. As an important step towards more transparency, the National Bank also began (as only the eighth bank worldwide) to publish its own forecasts of the development of Ukraine's key interest rate.

External position continues to be positive

The exchange rate is broadly stable, while some appreciation tendencies were visible in the last 12 months. The National Bank took advantage of this situation and increased foreign currency reserves. The stock of reserves is currently at USD 21.8 bn, corresponding to 3.6 months of import coverage.

Development of the exchange rate



Source: National Bank of Ukraine

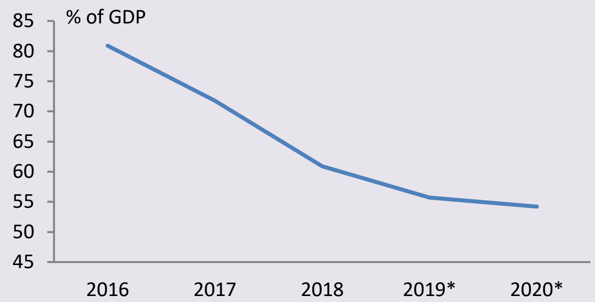
The current account deficit will amount to 2.9% of GDP in 2020, a slight increase compared to this year (2.6%), German Advisory Group Ukraine

which is due to an expected decrease in revenues of gas transits, among others.

Solid public finances

Since 2016, the budget deficit has been stable at around 2.3% of GDP p. a., pointing towards conservative public finance policies. Furthermore, since 2018 there are no additional deficits due to Naftogaz or to the recapitalisation of banks. In combination with the improved economic performance, this led to an overall decrease of public debt in terms of GDP. This positive trend is expected to continue in 2020, reaching a level of 54% of GDP.

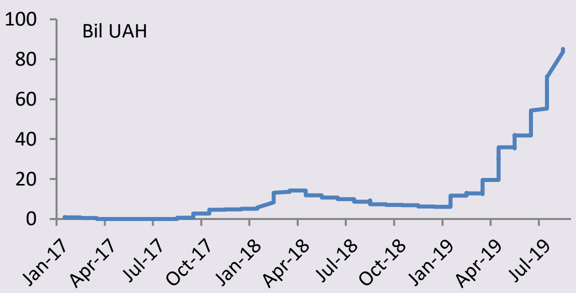
Public debt



*Source: National Bank of Ukraine; *forecast*

Concerning the liabilities to private creditors, some structural shifts are observable. Foreign investors demonstrate increasing interest in Ukraine's Hryvnia government bonds that offer high returns. The stock of local currency government bonds held by foreigners literally exploded since the beginning of this year and is currently at UAH 83 bn, corresponding to 11% of market share. The beforehand mentioned currency appreciation tendencies can partly be explained by this development.

Local government bonds held by foreigners



Source: National Bank of Ukraine

Of course, the improved macroeconomic sentiment explains part of the reason why Ukraine has become more attractive to foreign bond investors. A second and important reason is the connection of the Ukrainian market to the international clearing organization Clearstream, which was opened this year. This new connection to international financial markets decreased transaction costs for foreign investors significantly. Nevertheless, when considering the experiences of other developing countries, there is even more potential regarding the market share of foreign investors.

Conclusion

Since last year, Ukraine's economy has been growing at a stable rate of about 3%. This development is expected to continue next year. Moreover, other macroeconomic indicators point towards the right direction. This situation provides the newly elected decision-makers with a stable background for conducting ambitious economic reforms, aiming at accelerating economic growth. In this light, the plans to negotiate with the IMF about a new long-term programme are very positive. The importance of this potential programme does not only come from the fact that more money would be available, but rather from the possibility to anchor the reform agenda which is of high importance to international stakeholders (international and private financial institutions). Although external financing is functioning very smoothly so far, the slow-down of the world economy demands for forward-looking policies.

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The group advises the Government of Ukraine on economic policy issues since 1994. It is funded by the German Federal Ministry for Economic Affairs and Energy and implemented by the consulting firm Berlin Economics.

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