

Economic forecast for 2021: Rebound despite uncertainty

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Executive Summary

- The global Covid-19 shock significantly affected the Ukrainian economy during 2020
- However, due to past economic reforms, as well as structural features of Ukraine's economy, the country faced this crisis much better prepared than in the past
- As a result, we estimate a 4.6% GDP decline for 2020, which is better than in many peer countries
- The decline was caused by domestic lockdown measures as well as the global recession impacting trading partners

Forecast for 2021:

- We expect private consumption on the demand side and transport and industry on the supply side to boost the recovery
- Recovery in partner countries and increasing trade flows will support this tendency
- **Overall, we forecast 4.3% GDP growth for 2021, without reaching the pre-crisis real GDP level of 2019**

Structure

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2. Review: Real GDP in 2020
3. Assumptions for 2021
4. Forecast for 2021:
 - Real GDP
 - GDP demand and production sides
 - Inflation
 - Current account
5. Key risks of the forecast

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Annex

1. Motivation

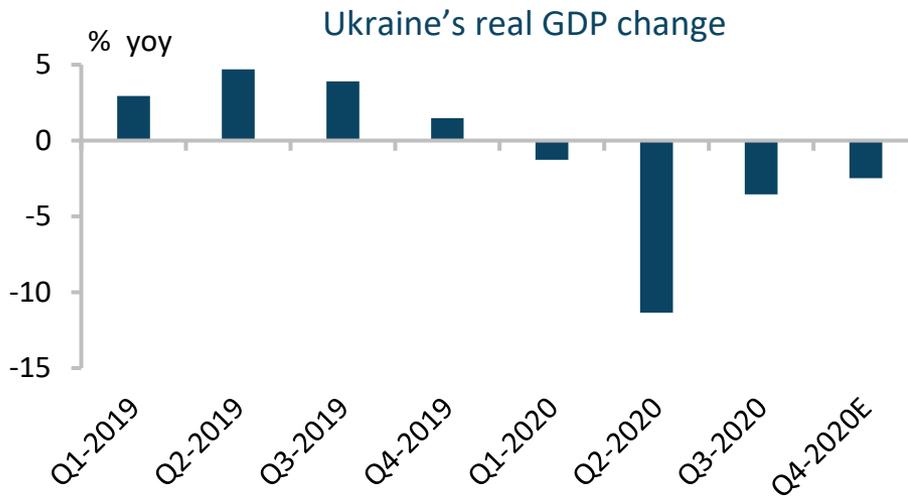
Background:

- Ukraine's economy was hit hard by the COVID-19 pandemic
- But the country's economic resilience appeared quite strong with the real GDP decline hampering significantly already in Q3-2020
- In 2021, the economy is set to rebound but the strength of the recovery will strongly depend on:
 - Severity of pandemic economic costs in winter season 2020/2021 both in Ukraine and globally
 - Ukraine's access to international financial assistance

Purposes of this Policy Briefing

- Assess Ukraine's economic performance in 2020 amid COVID-19 pandemic
- Present the forecast of key macroeconomic parameters for 2021
- Discuss main risks of the forecast and related scenarios for real GDP development

2. Real GDP in 2020: quarterly trends



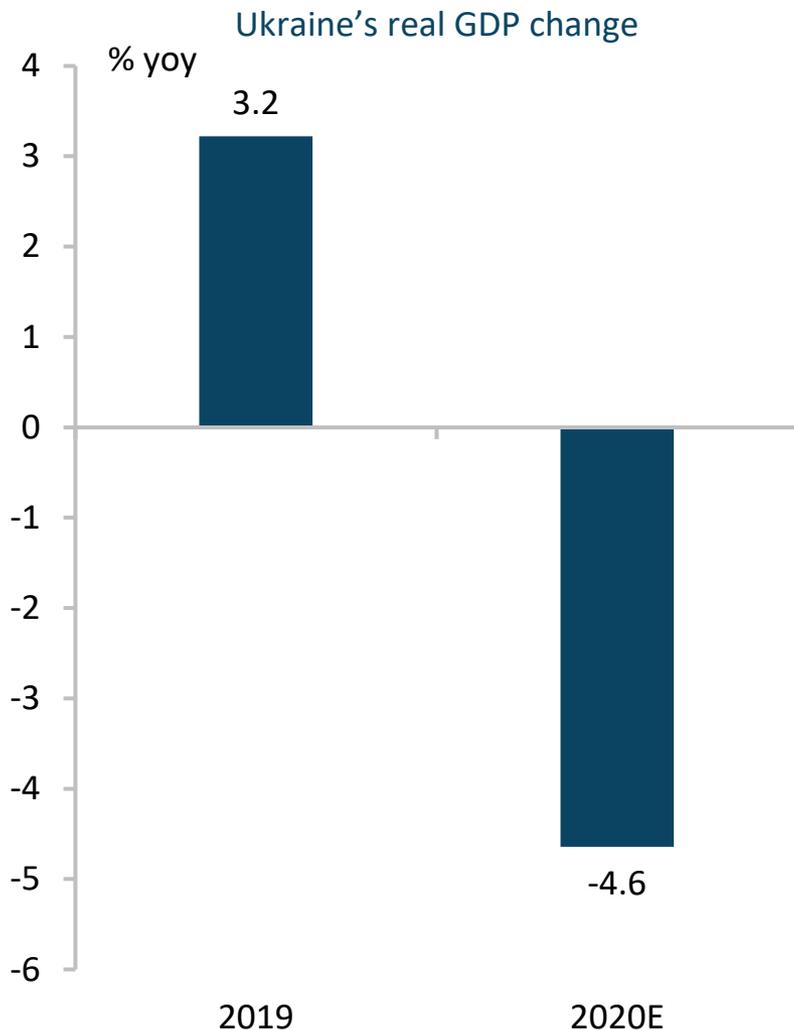
Source: for 2019-q3-2020: Ukrstat; for q4-2020: IER estimate



Source: Johns Hopkins University

- The strict lockdown introduced in March 2020 lasted until mid-May only, replaced by adaptive quarantine with safety rules (masks, social distancing)
- The softening of quarantine measures occurred also in partner countries
- As a result, in Q3-2020, Ukraine's real GDP decline slowed to -3.5% yoy compared to -11.4% yoy drop in Q2-2020
- However, in Q4-2020, the rebound slowed due to intensified spread of COVID-19 cases and aggravated internal political and fiscal imbalances

Real GDP in 2020: aggregate



Real GDP change, 2020:

- Jan-21 estimate: -4.6%
- Apr-20 estimate: -5.9% up to -11.2% depending on scenario (see PS/01/2020)

➤ **Higher economic resilience than expected**

Why higher resilience:

- Robust household consumption
- Decline of imports is stronger than of exports leading to an estimated current account surplus in 2020

Source: Ukrstat for 2019, own estimates for 2020

3. Assumptions for 2021: domestic

- **Quarantine restrictions** in some form will continue through spring
- **Cooperation with IMF and other development partners unfrozen** in response to progress in key areas including rule of law, anti-corruption institutions, public finance management, NBU governance, public administration
- The **disbursements from IMF** Stand-by Arrangement (SBA) are expected in Q2 2021 and in the second half of 2021
- **Access to global financial markets** will be maintained
- The **NBU will pursue accommodative policy** allowing inflation to exceed target range slightly for a short time
- **Financial sector will remain stable** in 2021 with some expansion of lending
- **Minimum wage increases** to UAH 6,500 in December as planned after increase to UAH 6,000 in January
- **Pension indexation** occurs in mid-2021
- **Tax rates** remain unchanged
- **Intensive fighting in Donbas does not restart** within the forecasting period

Assumptions for 2021: external

GDP growth of trade partners, % yoy

| | 2020 | 2021 |
|----------|------|------|
| USA | -4.0 | 3.7 |
| EUR area | -7.6 | 4.8 |
| China | 2.0 | 7.9 |
| Russia | -4.3 | 3.1 |
| Egypt | 3.5 | 2.8 |
| Turkey | -5.0 | 5.0 |
| India | -9.3 | 9.2 |

Source: FocusEconomics consensus forecast, December 2020 edition; IMF World Economic Outlook

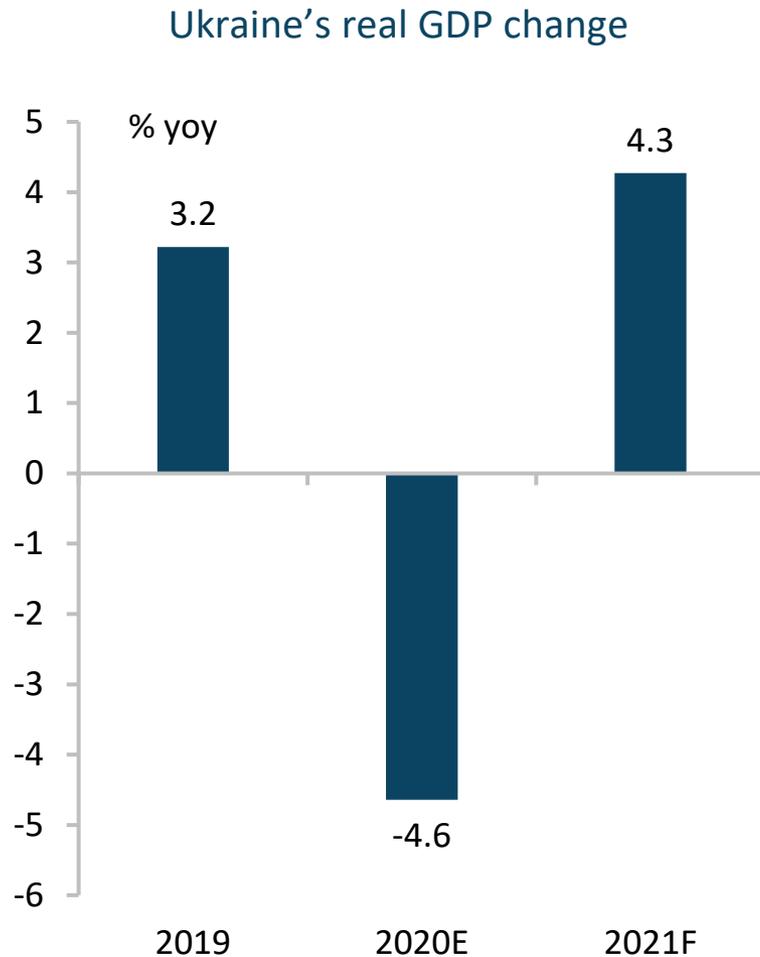
2020/2021 key commodity prices

| | 2020 | 2021 |
|-------------------------|------|------|
| Wheat (USD/100 bushels) | 535 | 510 |
| Corn (USD/100 bushels) | 360 | 370 |
| Steel (USD/tonne) | 560 | 600 |
| Iron ore (USD/tonne) | 100 | 120 |
| Crude oil (USD/barrel) | 43 | 48 |

Source: Fitch (formerly BMI)

- Pandemics will be contained in 2021 enabling global economic recovery
- Travel flows are expected to increase in the second half of 2021
- Real GDP growth assumptions for key trading partners:
 - USA: +3.7%
 - Euro area: +4.8%
 - BRIC +7.5%
- Prices for key commodities in Ukraine's international trade are expected to be fairly close to 2020 averages

4. Forecast for 2021: real GDP



Source: Ukrstat for 2019, own estimates for 2020 and forecast for 2021

GDP parameters, 2021:

- Real growth: +4.3%
- Nominal:
 - UAH 4,690 bn
 - USD 165 bn
- **Rebound compared to 2020**
- **But, still below 2019 level**

Key driving forces:

- Demand side: revival of private consumption stimulated by growing minimum wages and social payments
- Supply side: broad-base production recovery

Forecast for 2021: demand side

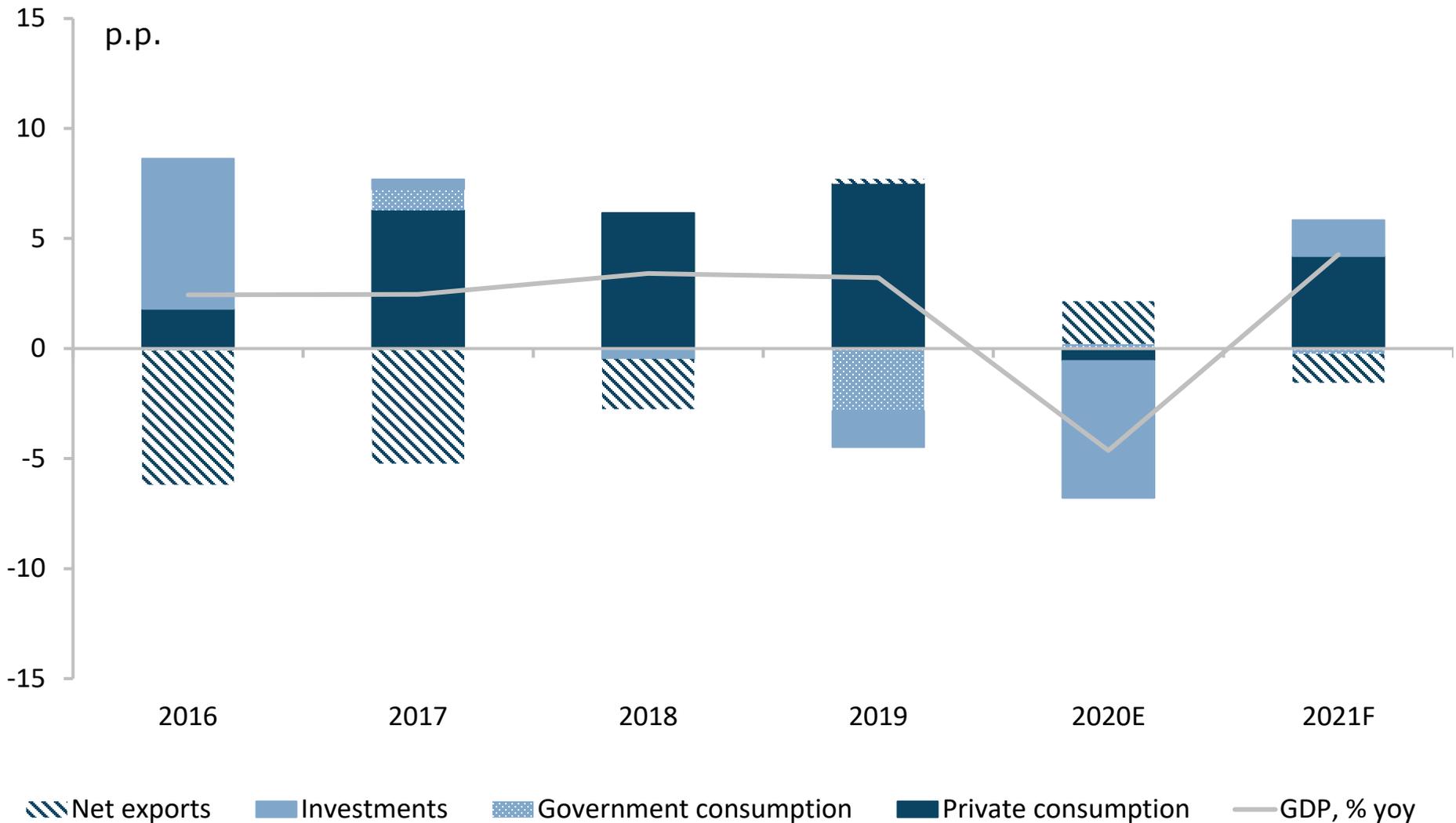
Real GDP forecast: demand side (change in %)

| | 2019 | 2020E | 2021F |
|----------------------------|-------|-------|-------|
| GDP | 3.2 | -4.6 | 4.3 |
| <i>Including</i> | | | |
| Private consumption | 10.9 | -0.8 | 5.9 |
| Government consumption | -13.6 | 1.1 | -1.2 |
| Fixed capital accumulation | 11.7 | -14.2 | 8.9 |
| Exports | 7.3 | -3.8 | 8.0 |
| Imports | 5.7 | -7.1 | 11.0 |

Source: Ukrstat, own calculations

- Private consumption is expected to drive economic recovery in 2021, while the government consumption is likely to decline
- Both exports and imports will recover after drop in 2021. Contribution of net real exports will become negative due to higher import growth

Forecast for 2021: contributions to real GDP growth



Source: own calculations; note: E – Estimate, F - forecast

Forecast for 2021: production side

Real GDP forecast: supply side (change in %)

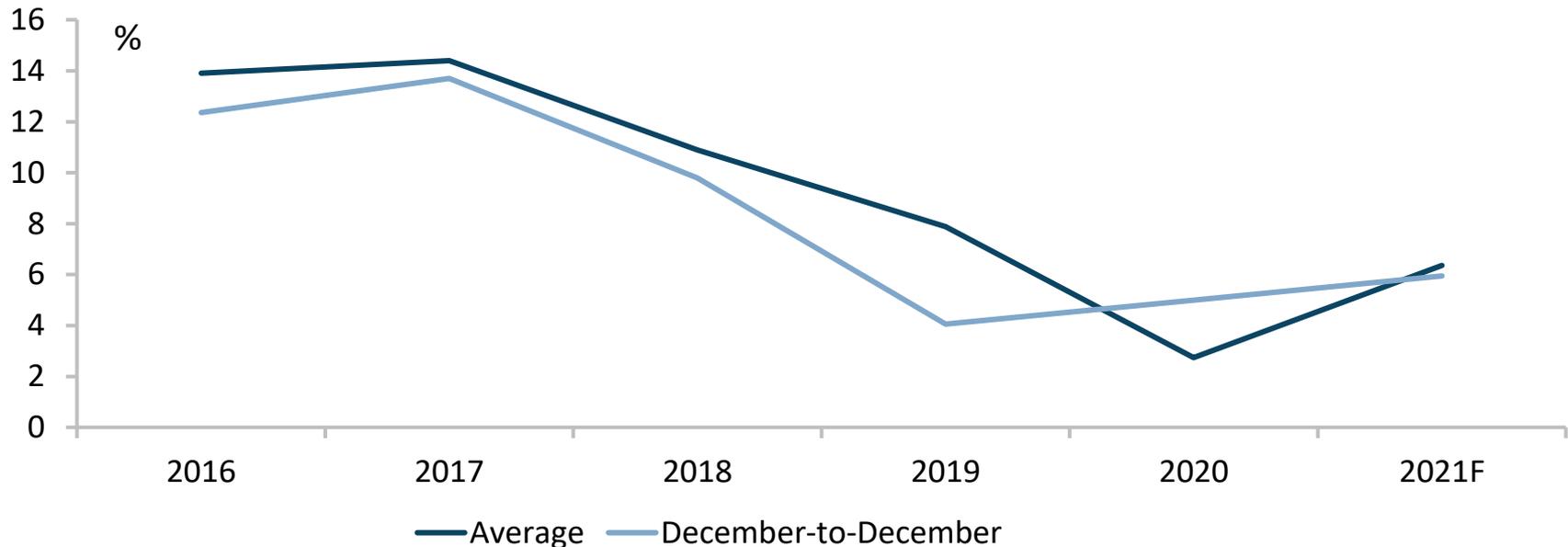
| | 2019 | 2020E | 2021F |
|--------------------|------------|-------------|------------|
| GDP | 3.2 | -4.6 | 4.3 |
| <i>including</i> | | | |
| Agriculture | 1.0 | -11.3 | 5.0 |
| Industry | -0.6 | -5.4 | 5.5 |
| Trade | 3.6 | 3.9 | 5.1 |
| Transport | 3.9 | -12.2 | 6.7 |

Source: Ukrstat, own calculations

- Agriculture recovers after bad harvest in 2020
- Recovery in industry and trade is supported by stronger external and domestic demand
- Economic activity in transport is projected to remain far lower than in 2019
- Uneven recovery in services and construction

Forecast for 2021: inflation

Consumer price inflation



Source: Ukrstat, own calculations

- Import prices increased as commodity price increased from low levels observed in the spring 2020
- Domestic demand started to recover in the second half of 2020 and will continue growing in 2021
- Inflation expectations are expected to remain anchored in 2021

Forecast for 2021: current account balance

Current account balance

| | | 2019 | 2020E | 2021F |
|----------------------------------|----------|-------|-------|-------|
| Current account balance | USD bn | -4.1 | 7.2 | 3.3 |
| Current account balance | % of GDP | -2.7 | 4.7 | 2.0 |
| Exports of goods | USD bn | 46.1 | 44.9 | 51.0 |
| Imports of goods | USD bn | -60.4 | -51.3 | -58.7 |
| Balance of services | USD bn | 1.8 | 4.6 | 4.2 |
| Transfers and remittances | USD bn | 19.2 | 15.7 | 16.7 |

Source: NBU, own calculations

- Recovery in international trade is expected in 2021
 - Services recovered faster after deeper drop in 2020
 - Trade balance in goods and services close to 2020 level
- Expected increase in investment income transfers explains lower projected current account surplus in 2021

5. Key risks of the forecast

Downside risks:

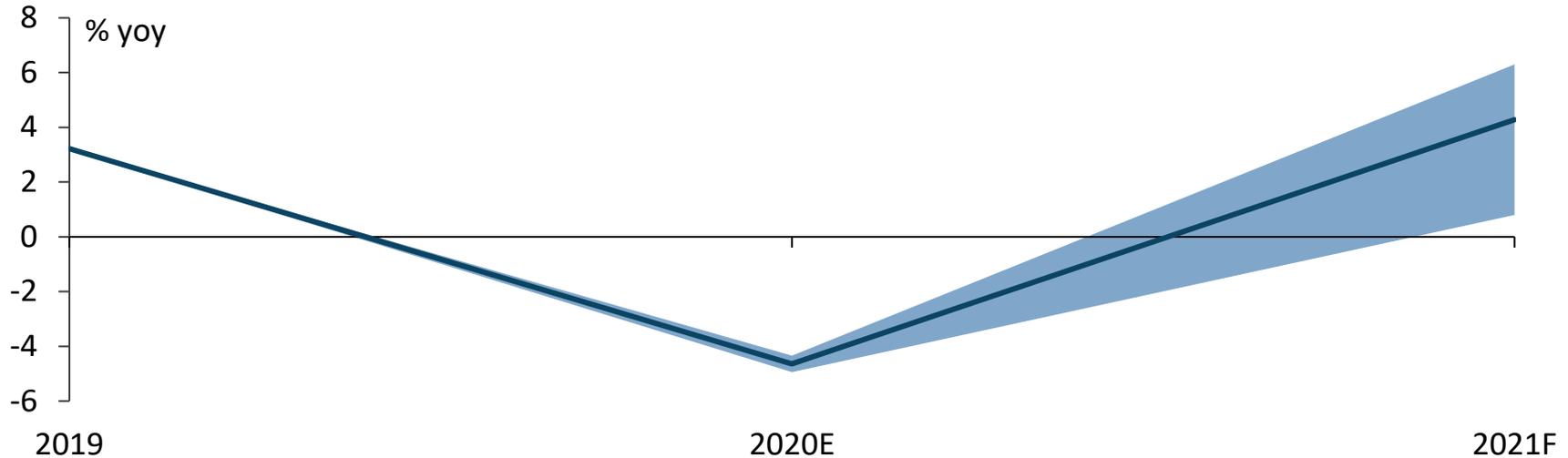
- **Multiple, more severe or longer lockdowns in Ukraine** will likely result in lower real private final consumption negatively affecting retail and services sectors. If the lockdowns include restrictions on public transportation, it will negatively impact industry
- The **cooperation with the IMF being inactive** as a result of absence of robust policy steps will restrict the possibilities for the Government to attract concessional lending and limit the fiscal space
- **Continuation of pandemic due to delayed vaccination** will result in higher uncertainty and vulnerabilities globally negatively impacting Ukraine's economy
- **Political crisis in Ukraine** resulting in preliminary Parliamentary elections will result in higher uncertainty in the country and likely new wave of populism

Upside risks:

- **Better consumer sentiment** in Ukraine amid slowdown of pandemic
- **Exporters make full use of the opportunities** provided by the global recovery

Key risks for the forecast: illustration

Real GDP growth for 2021



Source: Ukrstat for 2019; own estimates for 2020-2021

- Given the global economic recovery and the effect of statistical base in 2020, Ukraine will see the real GDP growth in 2021
- However, the strength of the recovery will strongly depend on Ukraine's determination in reforming the country in line with its international commitments

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.

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Annex: Technical note on modelling

- Forecast was produced using the IER short-term macroeconomic forecasting model. Model is based on iterative-analytical techniques, grounded in the system of national accounts
- Model looks at GDP and GDP components based on production and expenditures. The final result of the GDP forecast is based on forecasts for each component.
- The forecast for each component are produced using scenario assumptions and historical relationships. The forecast is built on a system of built-in proportions, which are expected to stay fairly constant
- Components of the GDPs by production and by expenditures are interconnected.
- The real GDP growth is determined by summation of the contributions of each component. If the two sides of the GDP accounting equation are not balanced, then another iteration begins. The iterations continue until the two methods of GDP produce balanced results.