

Issue 15 | February 2022

The issue was prepared before the start of the Russian attack on Ukraine and does not take into account the related impact.

Overview

- Moderate recovery of GDP with 3.2% real growth in 2021. In 2022, small increase to 3.3%, if conflict with Russia does not escalate further.
- Growth is driven by private consumption and record harvest, but restricted due to low investment.
- Solid external position and moderate FX development. However, recent tensions with Russia increase volatility.
- Inflation at 10%, way above the target range. Key policy rate was increased to 10% in order to bring inflation back to target until 2023.
- Fiscal policy is back on a consolidation path, with a 3.5% of GDP planned budget deficit.
- Strong recovery of external trade in nominal terms, but exports slightly declined in real terms.

Topics

- **Russia-Ukraine conflict.** So far only limited impact on financial markets. International support is key.
- **IMF programme.** 2nd tranche in Nov-21 after 16 months delay. Structural reforms are essential for further progress.
- **Banking sector.** Sector has shrunk but is resilient. Share of NPLs is decreasing. Future privatisation is a challenge.
- **SME financing.** Financing gap is high but decreasing. 5-7-9 programme is important but needs to be refocused.
- **IT-sector.** Strong growth of the sector and export share but few ties with the rest of the economy.
- **Digital transformation.** Companies see it as an opportunity but investment is needed.
- **Bilateral transport permits.** Shortages in permits impede increasing trade with EU countries.

Basic indicators

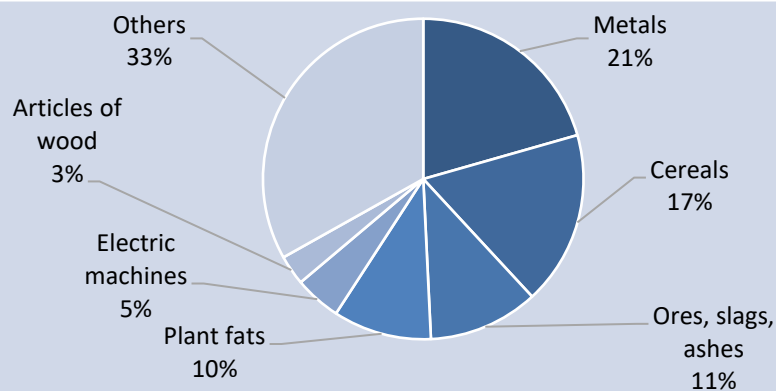
	Belarus	Russia	Ukraine	Moldova	Georgia
GDP, USD bn	68.2	1,647.6	191.9	12.6	17.8
GDP/capita, USD	7,332	11,273	4,646	4,856	4,808
Population, m	9.3	146.2	41.3	2.6	3.7

Sources: National statistics, IMF, GET/IER estimate, note: data for 2021

Trade structure

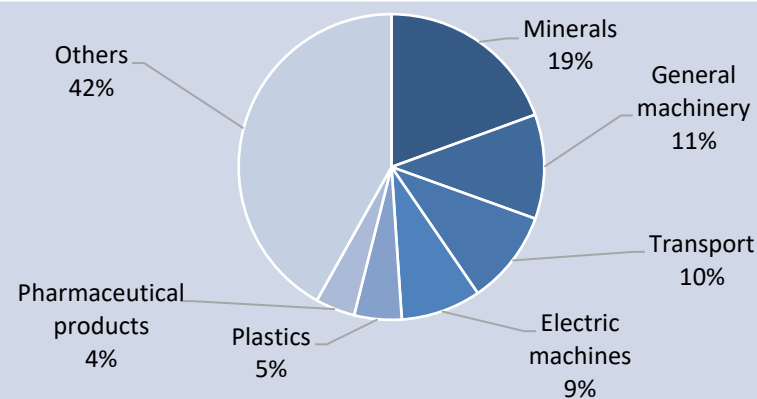
Exports

EU 44% | China 13% | Others 42%



Imports

EU 45% | China 17% | Others 38%



Source: Ukrstat, 11M2021; note: trade in goods

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Economic growth



Sources: Ukrstat, GET/IER, IMF, *preliminary official estimate, **forecast

Regional comparison of real GDP growth, % yoy

	2020	2021	2022	2023
Ukraine	-3.8	3.2	3.3	3.4
Belarus	-0.9	2.3	0.5	1.5
Moldova	-7.0	6.1	4.3	5.1
Georgia	-6.2	10.5	5.5	5.0
Russia	-3.0	4.3	2.3	1.8
EU-27	-6.1	5.0	4.3	2.5
Germany	-4.6	2.7	3.1	4.6

Sources: National statistics, EU-Commission, GET/IER forecasts, IMF forecasts, World Bank

GDP

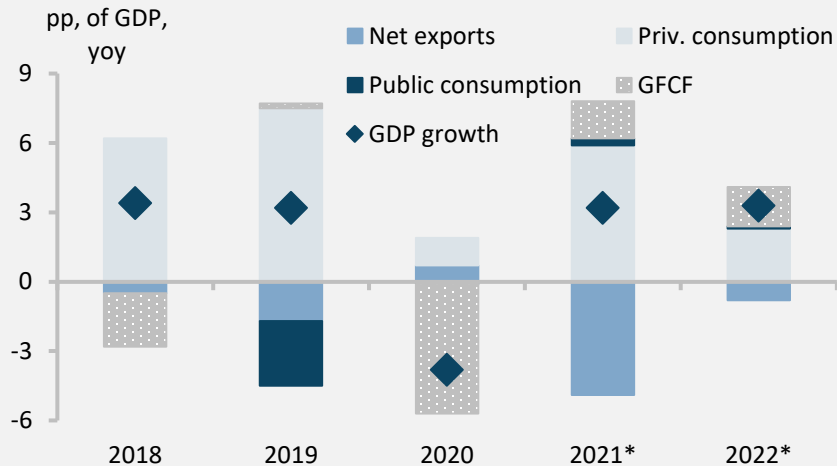
- 2021: Pre-crisis level was not reached
 - Several waves of COVID limited the recovery of investment and increased restrictions on economic activity
 - Pre-crisis level will only be reached in 2022
- 2022/2023: Ukraine moves back towards its pre-crisis growth path
- Key risk: Intensification of current geopolitical tensions

International comparison

- Recovery slower than in peer countries, as many countries reach pre-crisis levels already in 2021
- Ukraine needs economic reforms to converge to its peers
- **Limited recovery in Ukraine, gradual rise towards pre-crisis growth path, if current geopolitical tensions do not escalate**
- **More reforms needed to permanently raise growth potential**

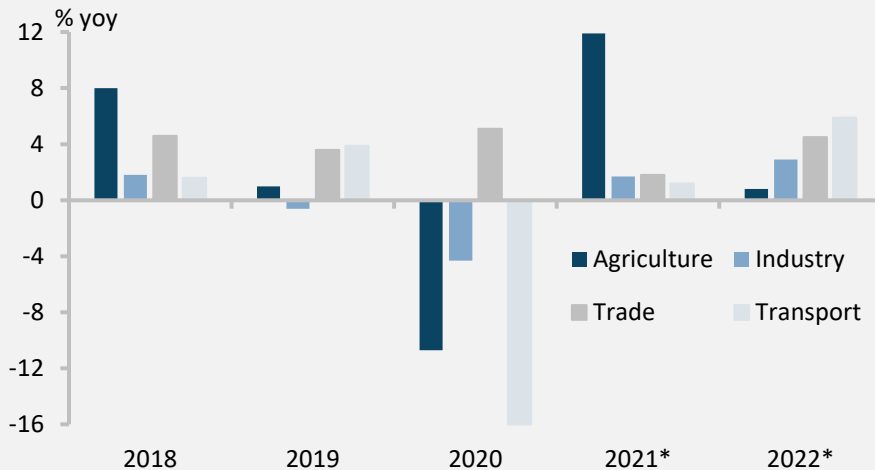
GDP: demand and supply

Contribution to real GDP growth



Sources: Ukrstat, GET/IER, *GET/IER estimate/forecast, preliminary official estimate for 2021 GDP

Sectoral dynamics



Sources: Ukrstat, GET/IER, *GET/IER estimate/forecast

Demand side

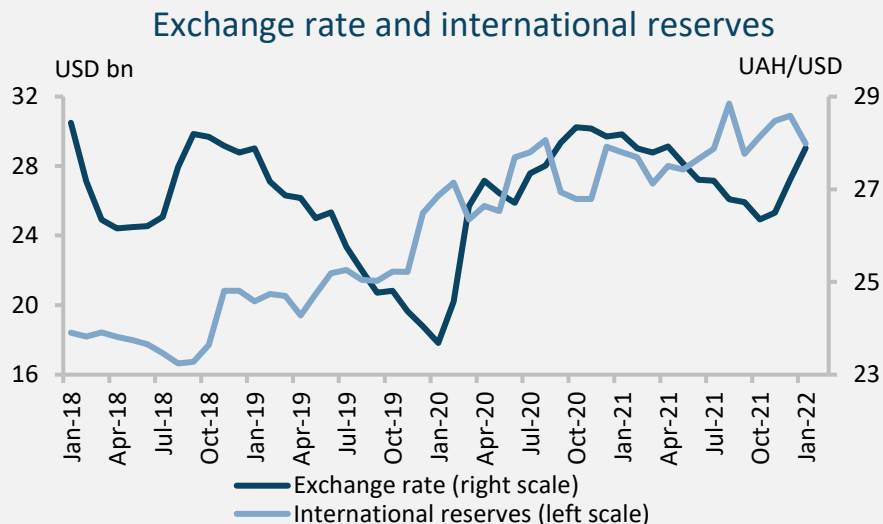
- 2021: Private consumption is the main driver of the recovery
 - Strong negative contribution of net exports
 - Real imports recover, while recovery of real exports is postponed to 2022
- 2022: Growth is driven by private consumption
 - Investment will still remain below pre-crisis level
 - Strong growth of both imports and exports

Supply side

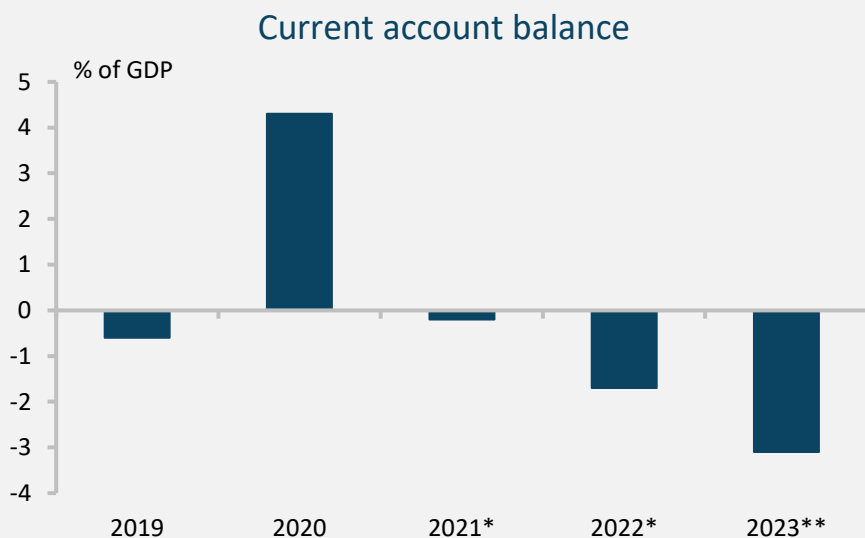
- 2021: Recovery across all sectors, record harvest (81 mt) drives growth in agriculture
- 2022: Industry and transport are expected to remain below pre-crisis levels; agriculture will further grow

- **Private consumption is the main demand-side driver of growth**
- **Economic recovery across all main supply-sectors**
- **But low growth of industry and transport**

Exchange rate and current account



Source: NBU



Sources: NBU, GET/IER, IMF *GET/IER estimate/forecast, **IMF forecast

Exchange rate and international reserves

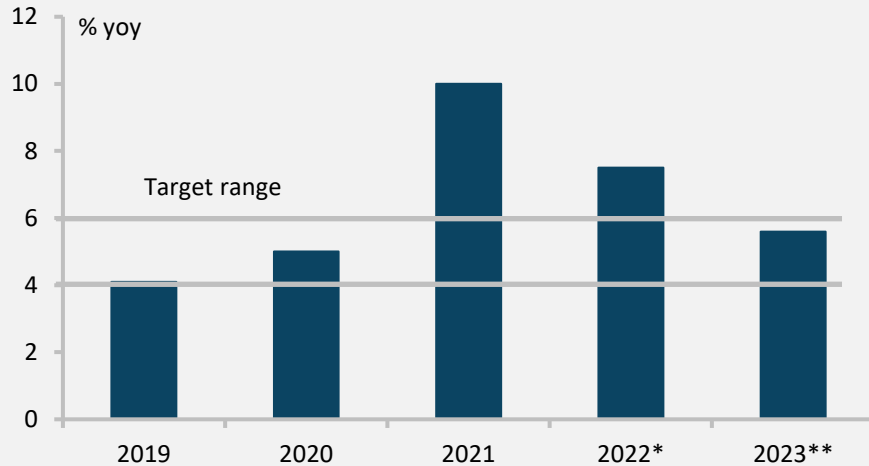
- Despite high inflation, exchange rate remained stable due to tight monetary policy by the NBU
- Slight appreciation during 2021, but 8% depreciation compared to pre-crisis level
- Current tensions with Russia lead to higher FX volatility and increased FX interventions
- Jan-22: International reserves declined to USD 29.3 bn (3.6 months of future imports) due to recent FX interventions by the NBU

Current account

- 2021: Only slight deficit due to favourable terms of trade
- 2022/2023: Return to moderate structural deficit
- **Very solid external position supports recovery**
- **Flexible exchange rate important for shock absorption**
- **Higher FX volatility due to geopolitical tensions**

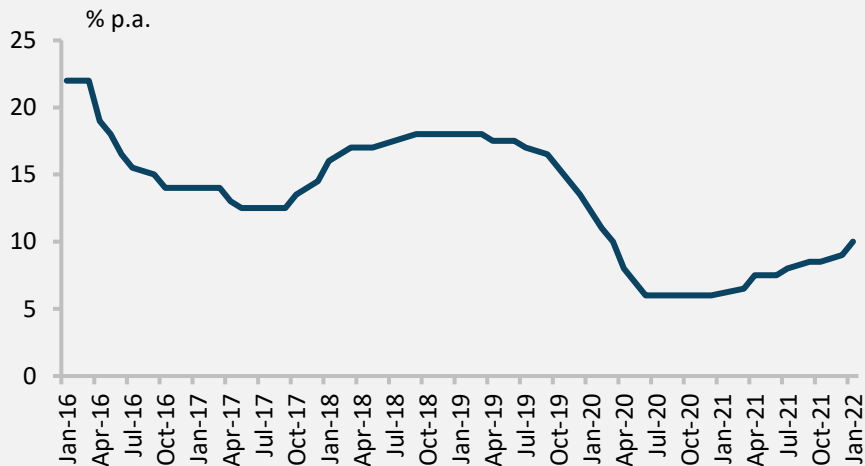
Inflation and monetary policy

Inflation rate



Sources: NBU, GET/IER, IMF, *GET/IER estimate/forecast, **IMF forecast, eop

Policy rate



Source: NBU

Inflation

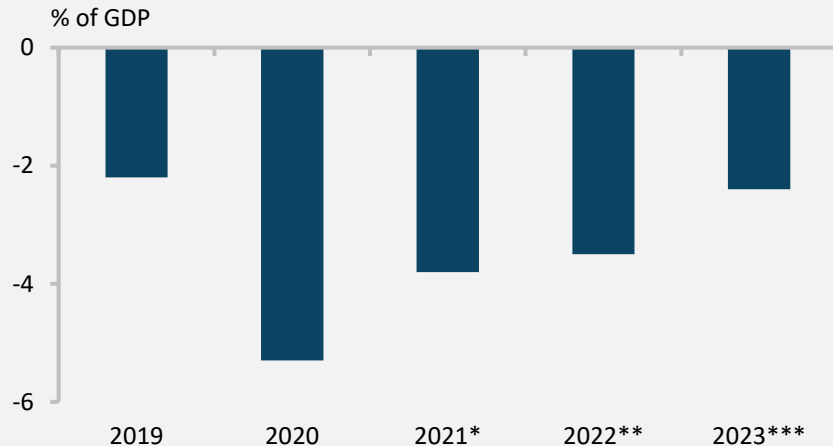
- Dec-2021: Inflation at 10.0%, well above the target, but gradually slowing since Sep-21 (annual average: 9.3%)
- 2022: Inflation expected to slowly decelerate, but to remain above target range during the year, return to target only in 2023

Policy rate

- In response to inflation pressures, NBU increased policy rate stepwise from 6% to 10% in Jan-22
 - Central bank policy is expected to remain tight to bring inflation back to the target
 - This may include further rate hikes also in reaction to the geopolitical situation
- **Inflation is a key macroeconomic challenge, similar to other regional peers**
- **National Bank independence is key to bring inflation back to target**

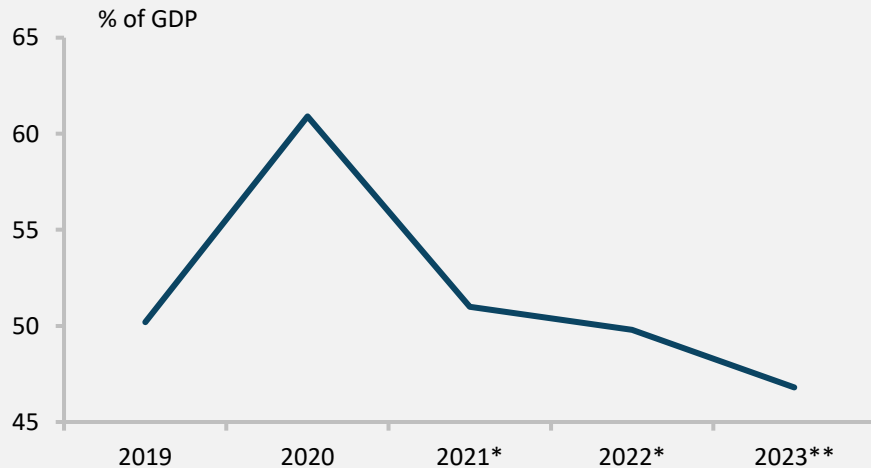
Public finances

Budget balance



Sources: Ministry of Finance, IMF, GET/IER, *GET/IER estimate, **Deficit in budget law, ***IMF forecast

Public debt



Sources: Ministry of Finance, GET/IER, IMF, *GET/IER estimate/forecast, **IMF forecast; note: debt incl. state-guarantees

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Budget

- 2021: 5.5% of GDP deficit planned despite economic recovery but actual deficit expected at 3.8% due to higher revenues (in particular VAT)
- 2022: Deficit of 3.5% planned and agreed with IMF
- Two possible IMF disbursements of USD 2.2 bn (1.2% of GDP) are scheduled for 2022 and are important for financing
- Current geopolitical tensions may impede international market access and increase local borrowing costs

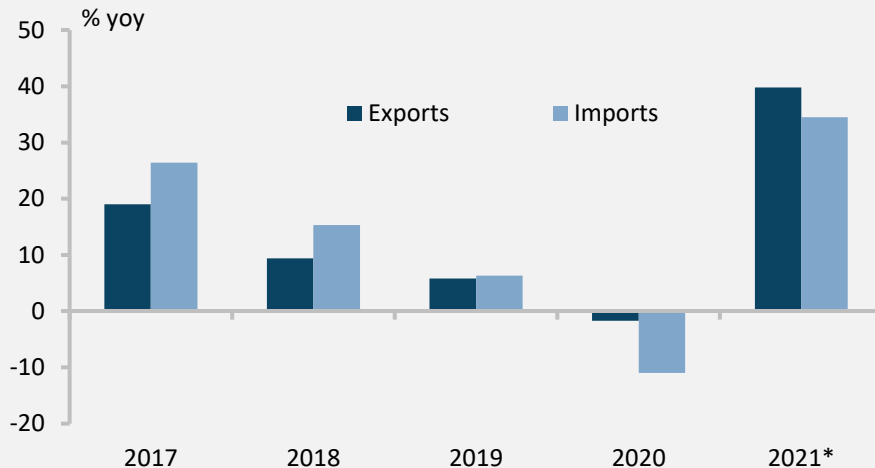
Public debt

- 2021: Debt ratio is declining and only slightly above 2019 level
- 2022: Ratio will fall below 50% as Ukraine is back on the consolidation path

- **Return to steady consolidation path in 2022**
- **IMF-programme remains important, especially under volatile financing conditions**

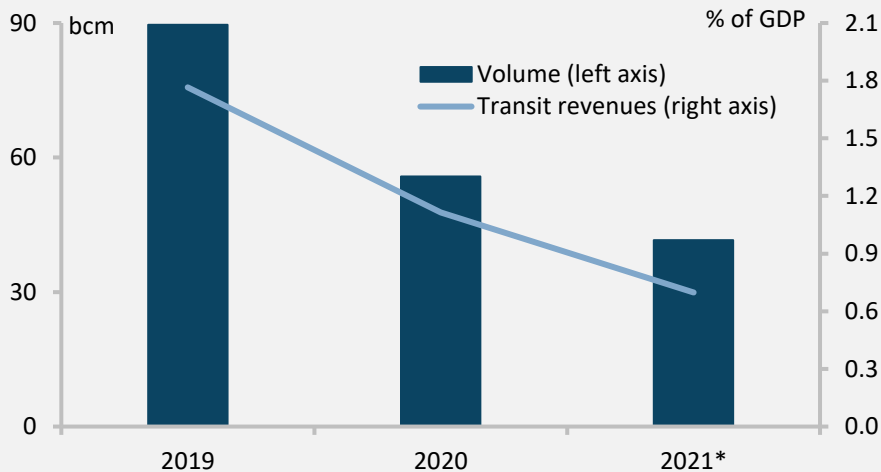
External trade

External trade with goods



Sources: Ukrstat, NBU; note: trade in goods, *preliminary data, nominal growth in USD

Gas transit



Sources: OGTSU, Dragon Capital, Ukrstat, GET/IER, *GET/IER estimate

Exports and imports of goods

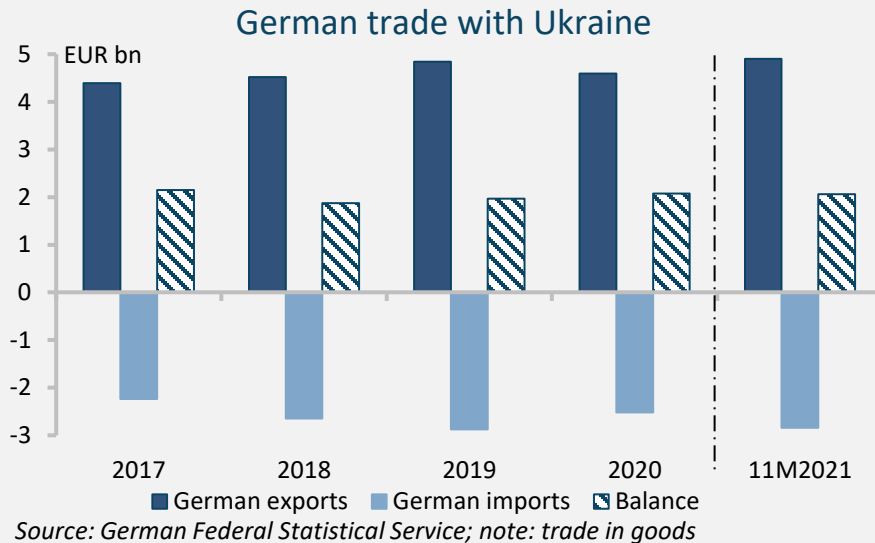
- 2021: Strong recovery of trade (37% yoy)
- Exports: Rebound of 40%, driven by commodity prices, while real exports slightly declined
 - Main contribution: Metals (79% yoy) and minerals (59% yoy)
 - Agriculture exports increased by 25%
- Imports: Recovery of 34% driven by minerals as well as machinery and equipment as part of industry recovery

Gas transit

- Transit volume has significantly declined since 2019, revenues fell to 0.7% of GDP in 2021
- Share in service exports: ICT share (30%) now twice as high as pipe transport services (15%)

- **Strong recovery of both exports and imports in 2021, but real exports slightly declined**
- **Declining economic contribution of gas transit**

Bilateral trade between Germany and Ukraine



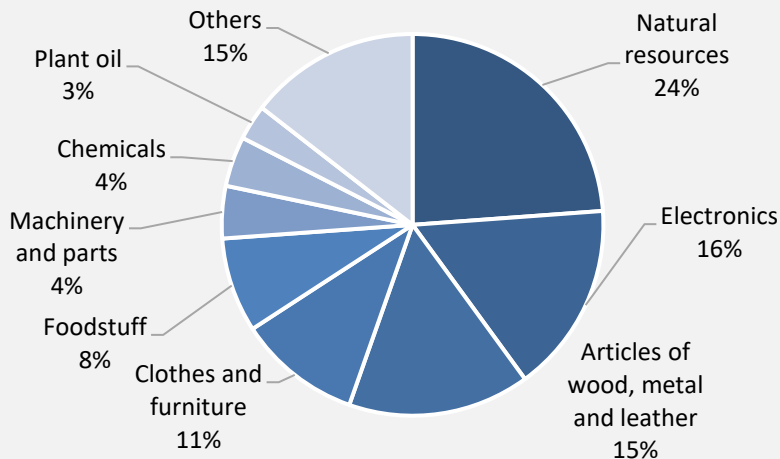
Bilateral trade

- 11M2021: Resumption of bilateral trade growth (19% yoy) which is 9% above 10M2019
- Volume > USD 8 bn is expected for total year

German exports to Ukraine

- 11M2021: Exports increased by 16% yoy
- Traditional export products: Chemicals (23%), machinery (incl. agricultural machines) (20%), motor vehicles and parts (14%)
- For Ukraine, Germany is main import partner within the EU

German imports from Ukraine



Source: German Federal Statistical Service, 11M2021; note: trade in goods

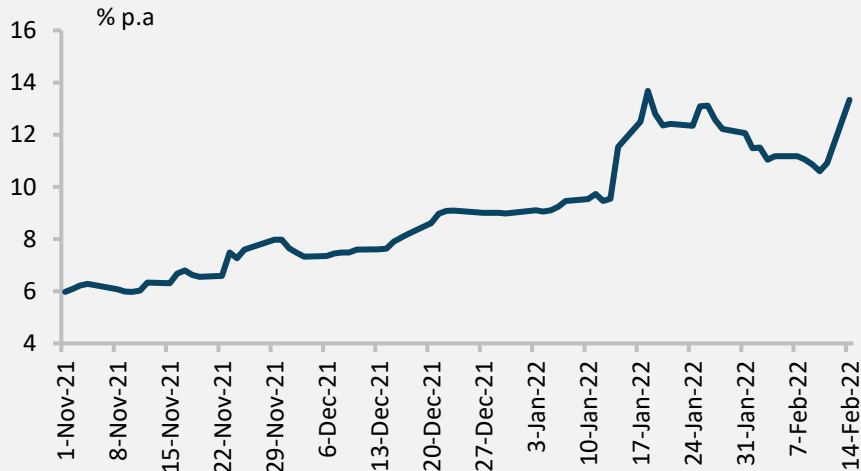
German imports from Ukraine

- 11M2021: Strong growth of imports (25% yoy)
- Increase driven by natural resources (44%) and articles of wood, metal and leather (20%) due to price effects

- **Resumption of bilateral trade growth in 2021**
- **Strong growth of German imports from Ukraine**

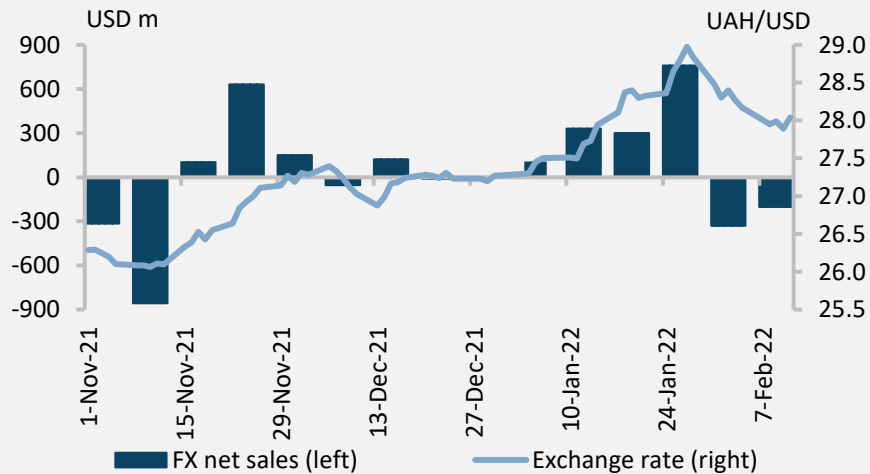
Russia-Ukraine conflict

Ukrainian Sovereign Eurobond yields (YTM)



Source: Frankfurt exchange, note: bond with maturity Sep-26

Exchange rate dynamics and FX interventions



Source: NBU

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Background

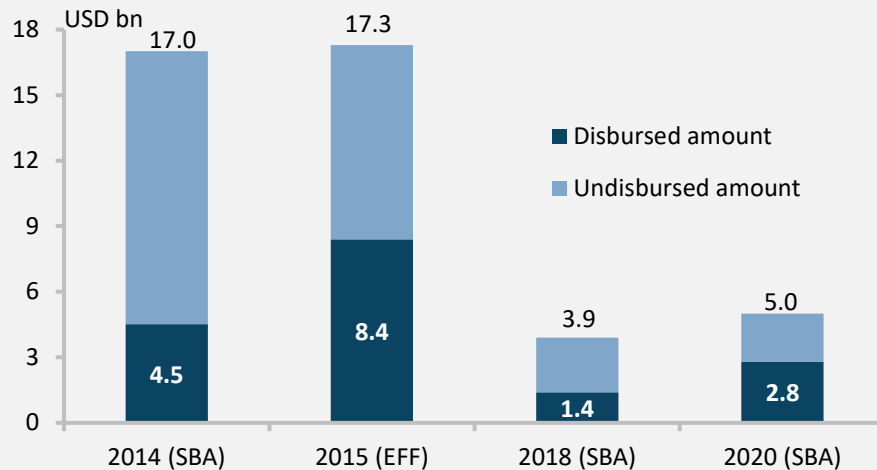
- Since mid Nov-21, increasing geopolitical tensions between Ukraine and Russia
- Impact on economic and financial stability is important to watch

Implications

- So far, visible impact only in high-frequency financial market indicators:
 - Certain depreciation of the Hryvnia, despite NBU FX interventions
 - Substantial increase in Eurobond yields
 - Decreasing share of foreign investors in the local bond market
- As a result, international market access for UKR difficult/expensive
- Support by international partners (IMF, new EU MFA) important to address that risk
- **Access to international markets currently difficult, but strong support by IFIs and EU**
- **Limited impact on the real economy, but this will ultimately depend on duration and intensity of tensions**

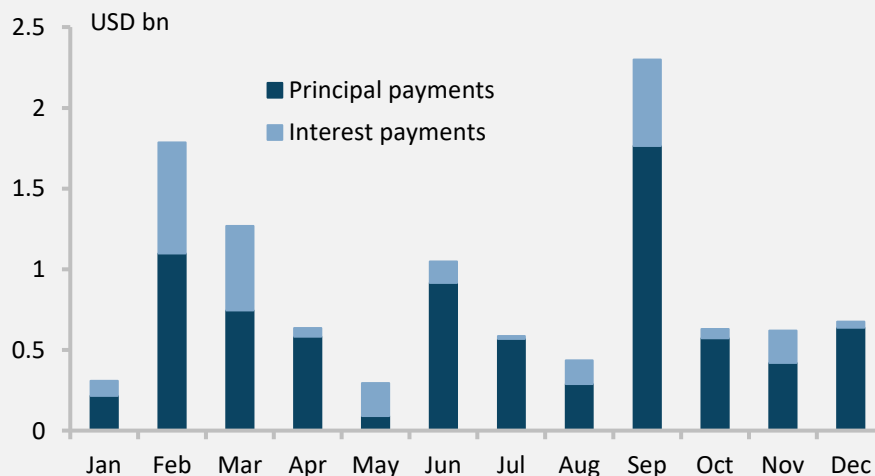
IMF programme

IMF programmes since 2014



Source: IMF

Debt service in FX



Sources: Ministry of Finance, IMF, NBU, own calculation

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Background

- Jun-20: “Stand-by-Arrangement” (SBA) of USD 5 bn including a first tranche of USD 2.1 bn
- Afterwards: 16 months without progress as backtracking of previous reforms was observed
- Nov-21: 1st review successfully completed:
 - Disbursement of USD 700 m
 - Programme extension until mid-2022
- Two additional disbursements totalling USD 2.2 bn in 2022 if conditionalities are met

Importance of the IMF programme

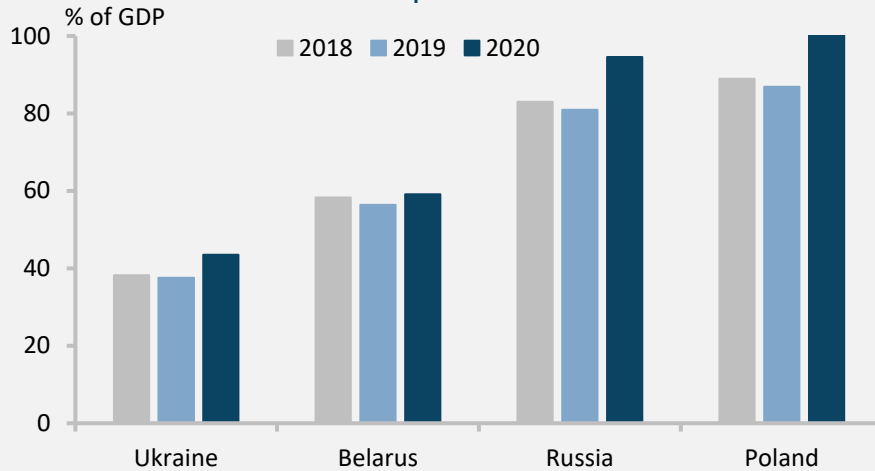
- 2021: Debt service supported by SDR allocation, EU MFA and IMF disbursement in late Nov-21
- 2022: High debt service (USD 10.6 bn), coupled with challenging market conditions

➤ Structural reforms are needed for progress in the programme

- Governance of SOEs
- Privatisation roadmap for state banks
- Addressing quasi-fiscal risks in the energy sector
- NBU capacity building

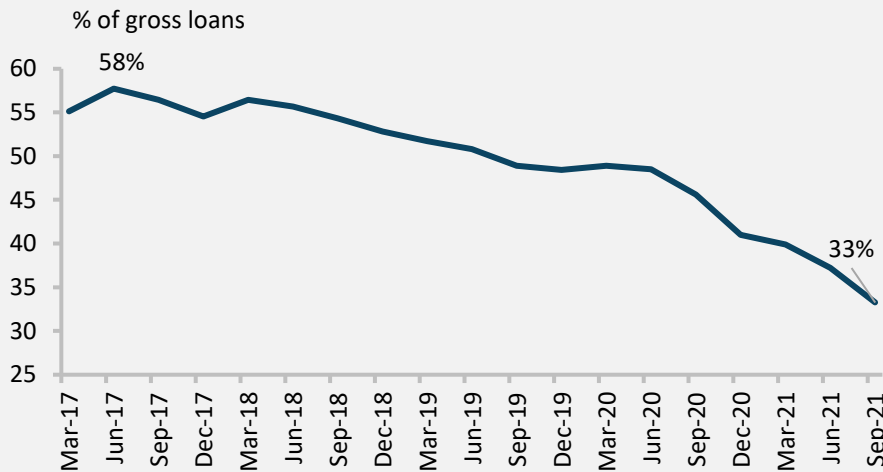
Banking sector

International comparison of bank assets



Sources: NBU, IMF, assets net of provisions

NPLs in Ukraine



Source: NBU

Low banking penetration

- After the clean-up of the banking sector, the sector in Ukraine is much smaller in comparison to peer countries
- No convergence to peers as asset growth had been negative between May-19 and Jul-21, growth only recently turned positive

Some progress on-performing loans (NPLs)

- NPLs still at a high level, but gradual decline
- State-owned banks (SOBs) contributing 80% to the decline
- Privatbank reduced share by 8 pp since Dec-19, but NPLs remain high (70%)
- High capital adequacy ratio (22%) supports resilient and stable sector in Ukraine

- **Overall, resilient and stable banking sector due to past reforms**
- **Some growth of bank assets, but still low penetration and no convergence with peers**
- **Privatisation and governance issues key for state banks**

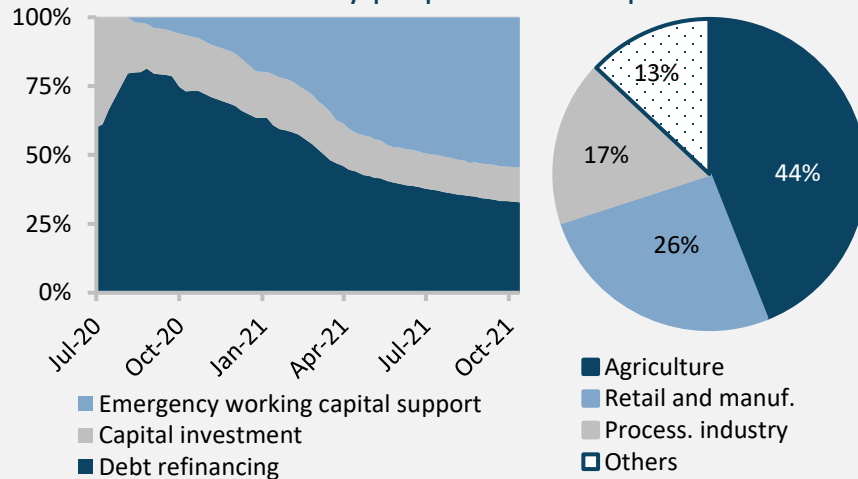
SME finance

SME financing gap – 2016 vs. 2021

Type of finance		Demand, EUR bn	Supply, EUR bn	Gap, EUR bn	Gap, % of GDP	% of demand
2016	Equity	6.7	5.8	0.9	1.0%	13%
	Debt	20.0	11.6	8.4	9.9%	42%
	Total	26.7	17.4	9.3	10.9%	35%
2021	Equity	9.2	6.5	2.8	1.7%	30%
	Debt	22.9	15.3	7.5	4.6%	33%
	Total	32.1	21.8	10.3	6.3%	32%

Source: Own estimation

5-7-9 Loans by purpose and recipients



Sources: Ministry of Finance, Ministry of Economy, as of October 2021

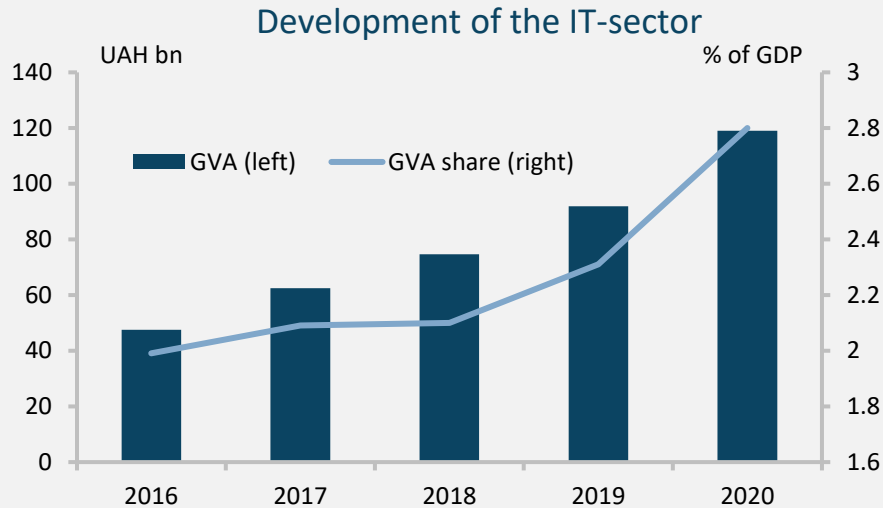
Background

- SMEs are an important element of a dynamic economic structure
- However, one of the typical reported barriers in Ukraine is lack of access to finance

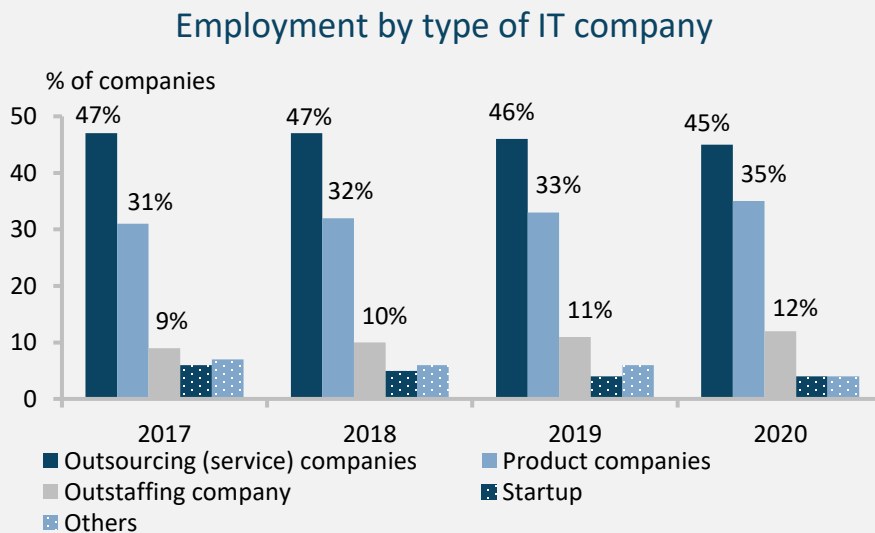
Current developments

- SME financing gap has slightly increased in absolute terms, but declined as share of GDP
- 5-7-9 interest subsidy programme is one of main instruments to address this gap
 - Loans of ca. UAH 84 bn (ca. EUR 2.6 bn) by 40 banks were issued since Jan-20
 - Government plans additional UAH 3 bn support in 2022
- Portfolio guarantee scheme launched during 2021
- Programme supported SMEs during the pandemic, but current recovery should be used to refocus the programme
- Guarantee scheme important instrument

Development of the IT-sector



Source: Ukrstat, own calculations, note: GVA=gross value added



Source: DOU.ua, note: data based on regular survey of IT services professionals

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Economic importance of IT sector

- IT sector includes: IT services, trade and manufacturing, but excludes communications
- Strong growth over past few years, output (GVA) share now approaching 3% of GDP and growing employment
- USD 3 bn of IT services exports in 2020, 5% of Ukraine's total goods and services exports

Growing value added intensity

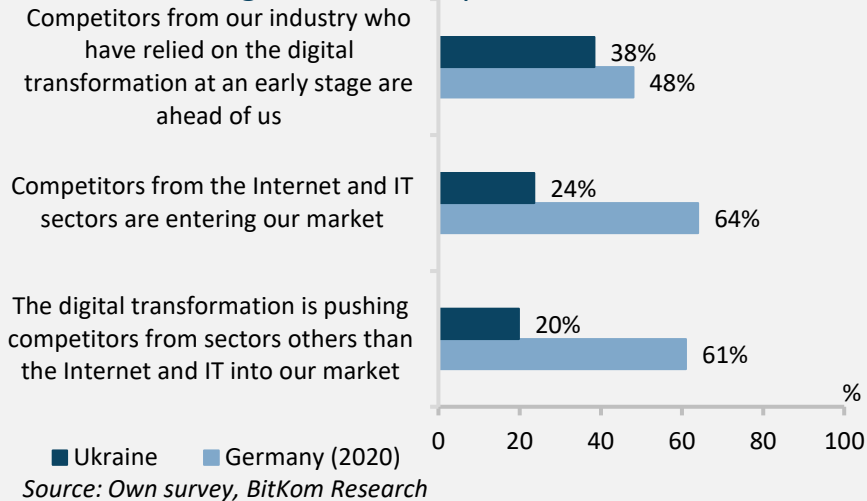
- IT sector has matured from simpler outsourcing to complex products
- High productivity reflected in high wages for specialists (around USD 2,000 per month), but qualified workers are scarce

➤ **Ukraine boasts an internationally competitive strong, dynamic IT sector**

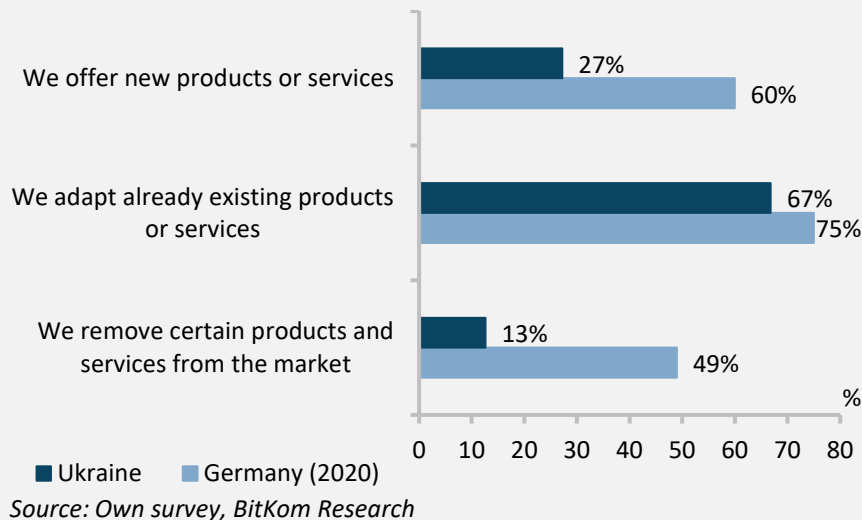
➤ **But few ties exist between the IT sector and the rest of Ukraine's economy**

Digital transformation of Ukrainian companies

Challenges in the competitive environment



State of digital transformation



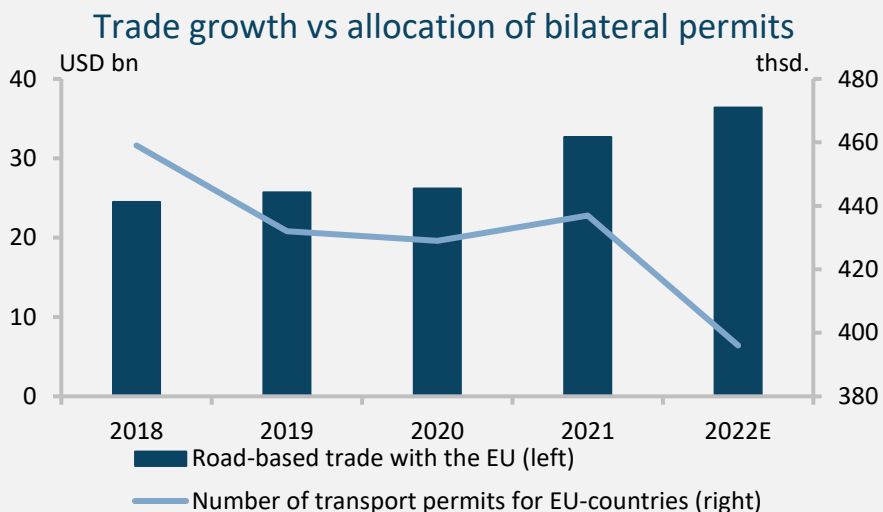
The digitalisation challenge

- Own comprehensive survey reveals that 91% of companies see digital transformation as an opportunity
- But only 17% regard themselves as forerunners in digitalisation
- Still limited competition from IT sector to established companies

Reaction of companies

- > 50% of companies invested in digital transformation in past two years
 - But adoption of advanced digital methods and of new, digital business models remain exception rather than norm
- **Digital transformation pressure will increase**
- **Companies in Ukraine need to invest more in digital transformation of operations and business models**

Shortage of bilateral transport permits



Source: DSBT, Ukraine State Customs Service, own calculations

Negative trade impact of bilateral permit shortages

		2018	2019	2020	2021
Exports	USD m	232	311	66	441
	thsd t	171	229	51	265
Imports	USD m	263	270	119	315
	thsd t	107	102	48	136
Aggregate impact	USD m	495	581	185	756
	thsd t	278	332	98	401

Source: own calculations

Background

- Road shipment dominates EU-Ukraine trade
- To operate abroad, road carriers must have either ECMT licenses or transport permits are agreed bilaterally between two countries
- EU-UKR road-based trade has increased strongly, while number of permits declined
- Shortages occur mainly by Poland (43k) and other transit countries (HU, RO, CZ)

Implications

- Businesses face higher transport prices
- Aggregate trade loss impact USD 756 m in 2021 (=2.4% of road-based trade) and > USD 2 bn over 4 years

➤ **Businesses in EU and Ukraine complain about shortages of permits, as this leads to substantial economic losses**

About the German Economic Team



Financed by the Federal Ministry for Economic Affairs and Climate Action, the German Economic Team (GET) advises the governments of Ukraine, Belarus, Moldova, Kosovo, Armenia, Georgia and Uzbekistan on economic policy matters. Berlin Economics has been commissioned with the implementation of the consultancy.

CONTACT

Garry Poluschkin, Project Manager Ukraine
poluschkin@berlin-economics.com

German Economic Team
c/o BE Berlin Economics GmbH
Schillerstraße 59
10627 Berlin

Tel: +49 30 / 20 61 34 64 0
info@german-economic-team.com
www.german-economic-team.com

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