NEWSLETTER
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# IMF programme supports stable economic outlook

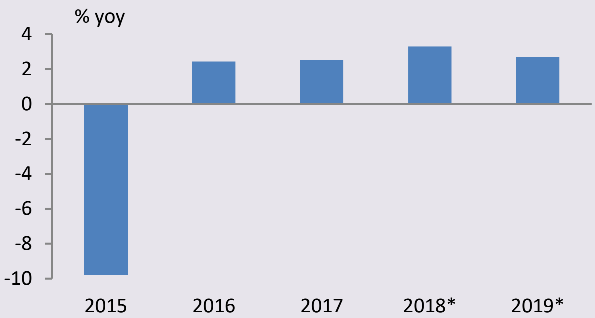
**The cooperation with the IMF, which was resumed at the end of last year, has already borne fruit. Inflation is slowly declining; foreign exchange reserves have reached a multi-year high and public finances continue to consolidate. The macroeconomic and financial situation is therefore stable, which is not a given in the light of the upcoming elections and a rather volatile global environment. Given the high external public debt interest and principal payments schedules for the current and upcoming year (USD 13.3 bn), there is no alternative to the cooperation with the IMF.**

**The real gross domestic product is also developing positively (3.3% in 2018, 2.7% in 2019), but needs to grow much faster. Here, the mixed experiences with structural reforms over the past years are reflected. In order to permanently achieve higher growth rates, new efforts in this area are indispensable.**

### Moderate development of the real economy

Last year, Ukraine's real gross domestic product (GDP) grew by an estimated 3.3%. This represents a slight acceleration compared to 2016 and 2017 when GDP expanded by 2.4% and 2.5%, respectively.

**Real GDP growth**




*Source: IMF, *Estimates/projections*

On the demand side, growth was driven by investments and private consumption. Gross fixed capital formation grew by 14% in real terms in the first three quarters of 2018. Consumption also increased significantly (6.4%) – partly driven by sharply rising incomes. As in previous years, net exports made a negative contribution to growth.

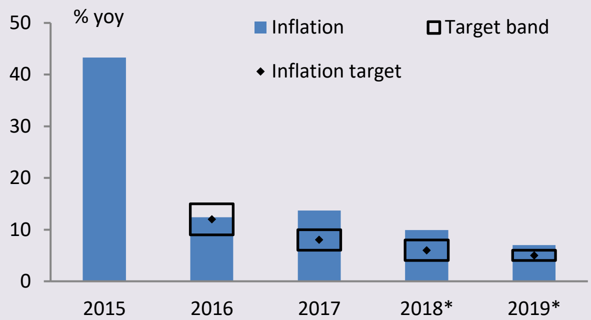
On the supply side, particularly noteworthy is the performance of the agricultural sector, which grew by a total of 7.3%. The main reason behind this is a record harvest of grain, reaching a historic high of 70.1 m t. In addition – according to preliminary calculations – a record harvest was also achieved for oilseeds. Other strongly expanding economic sectors were construction (6.0%) and retail trade (5.1%). The latter reflects the already mentioned growth of income and consumption.

This year, however, GDP growth will slightly slow down to 2.7%. There are both internal and external reasons for this development. Domestically, investment activity will slow down as elections increase the overall uncertainty in the market and the financing environment remains very tight. Moreover, fast-growing wage costs have become a restrictive factor in the firms' investment decisions. On the other hand, there are external factors such as a slow-down of global economic growth and price risks of certain export products (e.g. steel). In the medium term, increasing the annual GDP growth rate to above 3% p.a., which would actually be urgently needed, seems realistic only through additional reforms.

### Gradual decline of inflation continues

With another decline in the previous year, inflation finally reached single-digit figures at the end of 2018 (9.8%) – something that should be positively highlighted. This development will further continue in 2019.

**Inflation (consumer prices)**



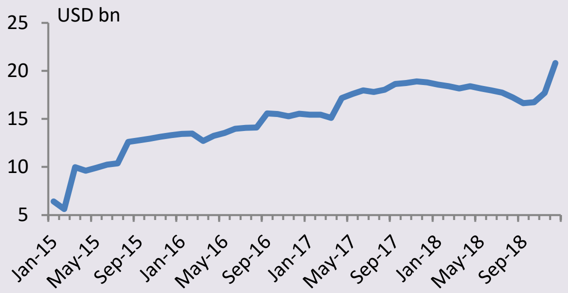

*Source: IMF, *Estimates/projections; Note: end of period*

However, inflation still remains above the National Bank's target corridor and is unlikely to reach its goal until early 2020. As a result, little room remains for a reduction of the main refinancing rate (currently 18% p.a.).

### Stable external economic situation

The exchange rate was relatively stable last year; crises in various emerging economies (such as Turkey and Argentina) also left no negative effects here. A direct consequence of the new IMF programme (see our November newsletter) was a significant increase of the foreign exchange reserves at the end of 2018, which reached a new high since 2013.

**Development of official foreign exchange reserves**



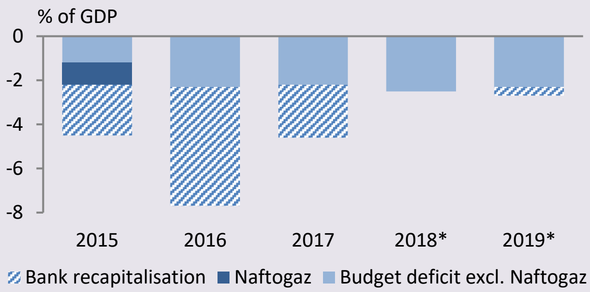

*Source: NBU*

In December 2018, official foreign exchange reserves amounted to USD 20.8 bn, increasing by USD 3.1 bn compared to the previous month. Aside from the first IMF loan tranche of USD 1.4 bn, EU loans and funds backed by a World Bank guarantee also played an important role in this positive development.

### Improvement of public finances

Moderate budget deficits for 2018 (estimated at 2.5% of GDP) and 2019 (planned at 2.3% of GDP) are positive against the background of this year's elections. In addition, Naftogaz no longer poses any fiscal risks and funds planned for bank recapitalisation remain very low.

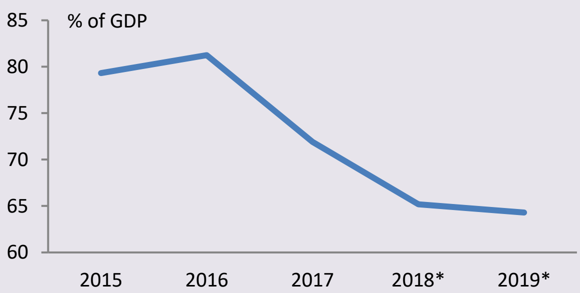
**Budget deficit**




*Source: IMF, *Projections*

As a result of continuous fiscal consolidation against the background of a growing economy, public debt – which sharply increased until 2016 – has been successfully reduced. This development will further continue this year.

**Public debt**




*Source: IMF, *Projections*

### Conclusion

The macroeconomic and financial situation can be described as stable, which can be primarily explained by the renewed cooperation with the IMF. This cooperation remains an important anchor in the election year of 2019 against the background of a very high level of external public debt servicing. This and next year alone, a total of USD 13.3 bn will be due, with principal and interest payments remaining high in the years to come. Their refinancing will hardly be achieved without the IMF, given already difficult conditions on international capital markets. In addition, other financial resources (e.g. from the EU) are conditioned on an IMF programme.

In addition to the continuation of a cooperation with the IMF, faster progress in restructuring and modernising the economy needs to be made. The mentioned moderate growth rates of the economy are a sign that much remains to be done in this regard. This remains the main economic policy task for the coming years.

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