

Issue 13 | January 2021

## Overview

- Due to COVID-19, GDP declined by 4.6% in 2020: a moderate decline in international comparison. In 2021, growth of 4.3% is expected
- Stability of the external sector during the crisis: current account surplus (2020: 4.7% of GDP), moderate exchange rate dynamics, international reserves reached their highest level since 2012 (USD 29 bn)
- Inflation is currently at the 5% target of the central bank, policy rates were decreased to a historic low of 6% to support economic recovery
- During the crisis, the budget deficit considerably increased (2020 estimate: 5.6% of GDP), and will decrease only slightly in 2021, public debt meanwhile increased to 65.7% of GDP
- International trade declined by 9.1% after 11M2020: stronger decrease of imports (-12.9%) than exports (-3.5%)

## Topics

- **IMF programme.** IMF-support remains vital, reinforced reform effort is necessary
- **Banking sector.** Stability during crisis proves importance of reforms in previous years
- **Coal transition.** Phase-out of coal mining will be supported by Germany
- **Electricity market.** Still a long way to go to a fully liberalised market
- **COVID-19.** Development of case numbers, domestic measures, economic support

# Basic indicators

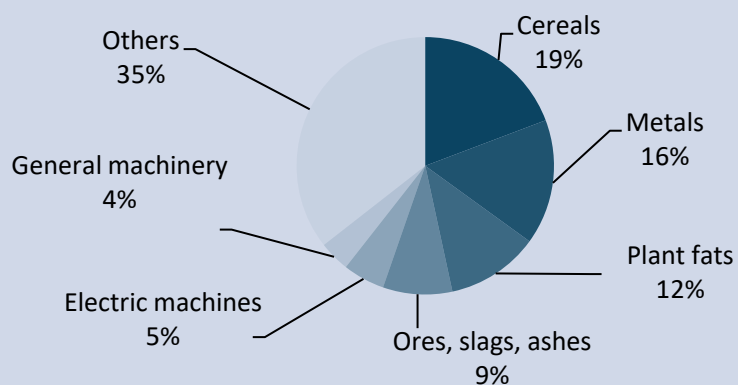
	Belarus	Russia	Ukraine	Moldova	Georgia
GDP, USD bn	57.7	1,464.1	154.7	11.4	16.3
GDP/capita, USD	6,134	9,973	3,717	4,318	4,763
Population, m	9.4	146.8	41.6	2.6	3.7

Sources: IMF, GET, National statistical offices, 2020, estimate

## Trade structure

### Exports

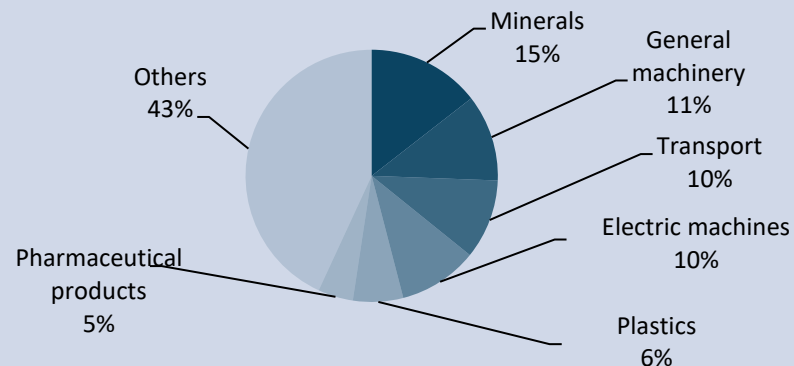
EU 38% | China 14% | Others 48%



Source: Ukrstat, 11M2020; Note: trade in goods

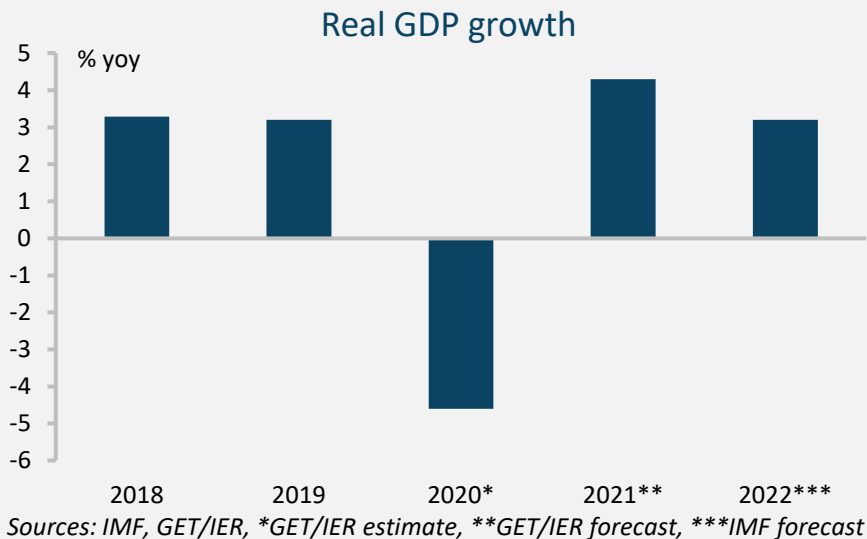
### Imports

EU 43% | China 15% | Others 42%



Source: Ukrstat, 11M2020; Note: trade in goods

# Economic growth



## GDP

- 2020: GDP declined by 4.6% due to COVID-19 crisis
- 2021: Recovery expected with 4.3% growth, but pandemic-related uncertainty remains
- From 2022: Return to pre-crisis growth rates

## International comparison

- Decline in Ukraine around average of benchmark countries
- Counter-cyclical monetary and fiscal policy and international support limited economic impact of the crisis

## Changes of the GDP forecast 2020

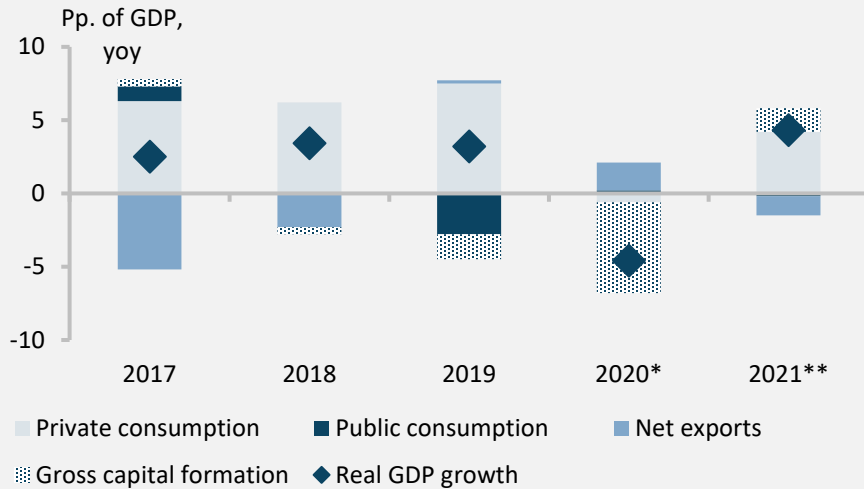
	GDP forecast (% yoy)		Changes (Pp.)
	January 2020	Latest estimate	
Ukraine	3.0	-4.6	-7.6
Belarus	0.9	-0.9	-1.8
Moldova	3.8	-6.7	-10.5
Georgia	4.3	-5.0	-9.3
Russia	1.9	-4.1	-6.0
Germany	1.1	-5.0	-6.1
EU	1.4	-7.4	-8.8

- **Ukraine is on a recovery path, yet no fast compensation of the GDP decline**
- **Good macroeconomic policy during the past years was very helpful for fighting the crisis**

Sources: World Bank, IMF, GET/IER, European Commission

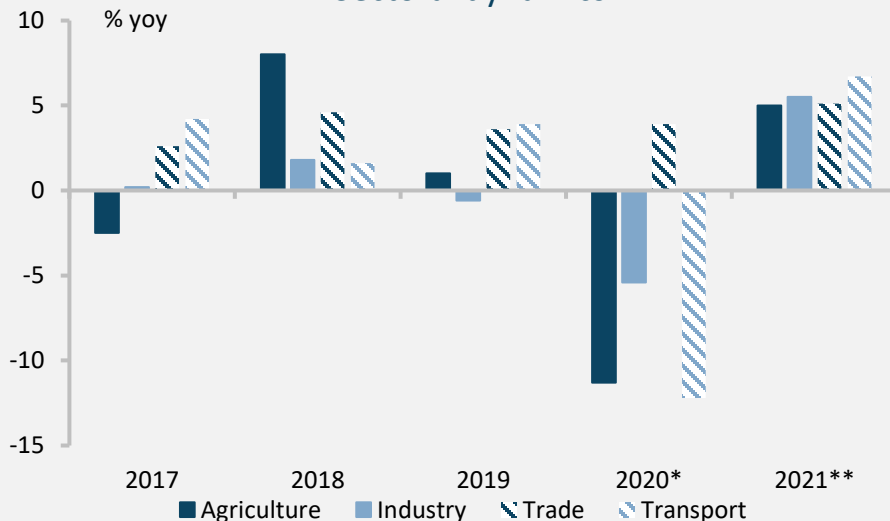
# Sectoral perspective

## Contribution to real economic growth



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

## Sectoral dynamics



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

## Demand side

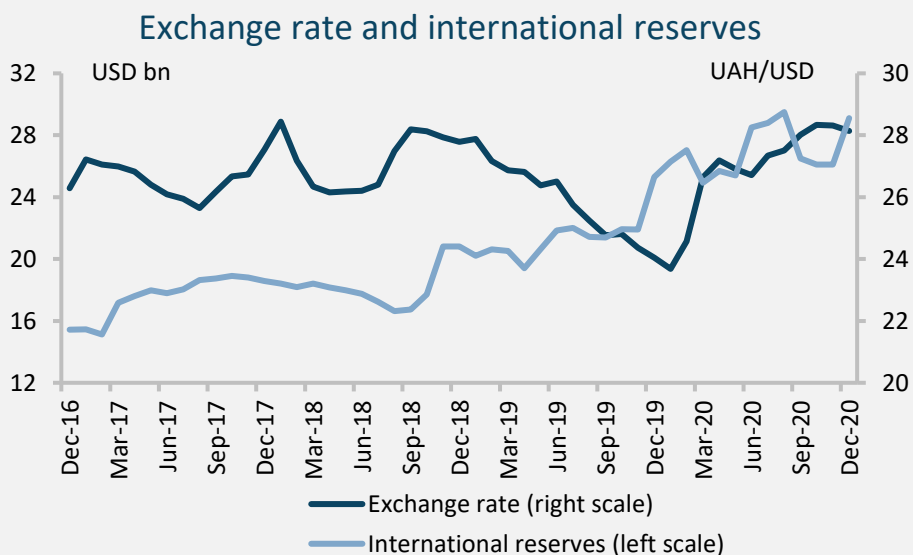
- 2020: Investment and private consumption were main reasons for the GDP decline:
  - Investment: -6.2 pp.
  - Private consumption: -0.6 pp., main driver of growth in the past
  - Positive contribution of net exports (+1.9 pp.), as imports declined faster than exports (-7.1% vs. -3.8%)
- 2021: Investment and private consumption support economic recovery

## Supply side

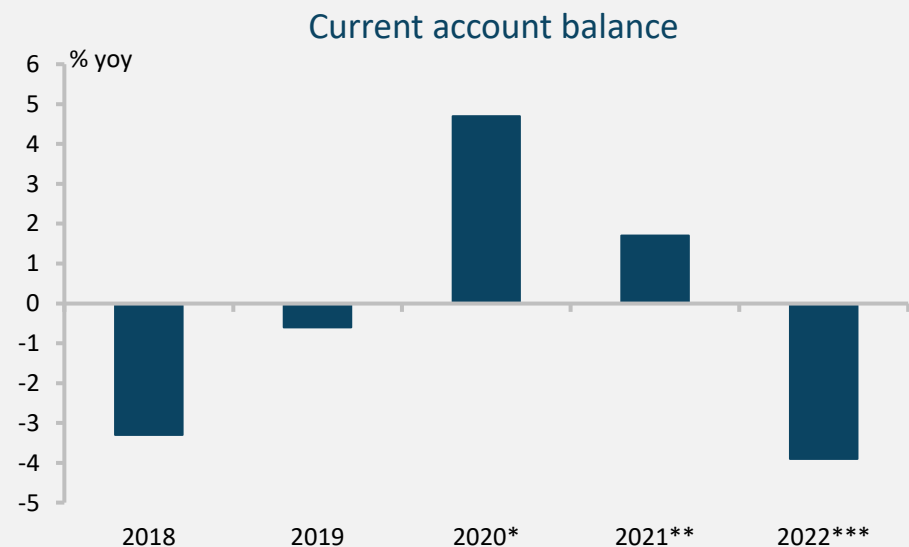
- 2020: Several reasons for decline in sectors:
  - Industry and transport: COVID-19 (global demand decline, lockdown, international travel restrictions)
  - Agricultural sector: Low harvest yield
- 2021: Recovery expected across all sectors

- **Investment and private consumption will resume role as drivers of growth in 2021**
- **Economic recovery across all main sectors**

# Exchange rate and current account



Source: NBU



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

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## Exchange rate

- 2020: Moderate depreciation during the crisis, Hryvnia remained under USD/UAH 30

## International reserves

- 2020: Gradual accumulation despite crisis
- Dec-20: USD 29.1 bn, highest value since 2012; import coverage: ca. 4.8 months

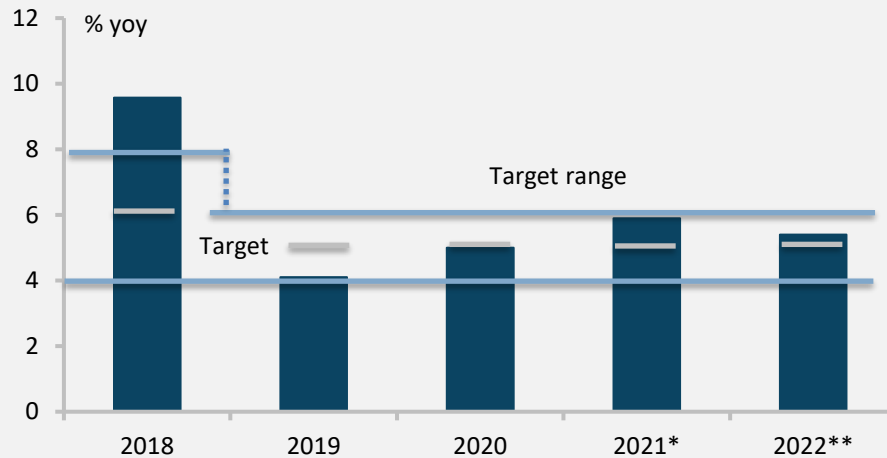
## Current account

- 2020: Substantial surplus during the crisis
- Reason: Imports decreased stronger than exports, low energy prices
- 2021: Slight surplus, then gradual return to a moderate structural current account deficit

- **Very solid external position despite crisis**
- **Flexible exchange rate is important for shock absorption**

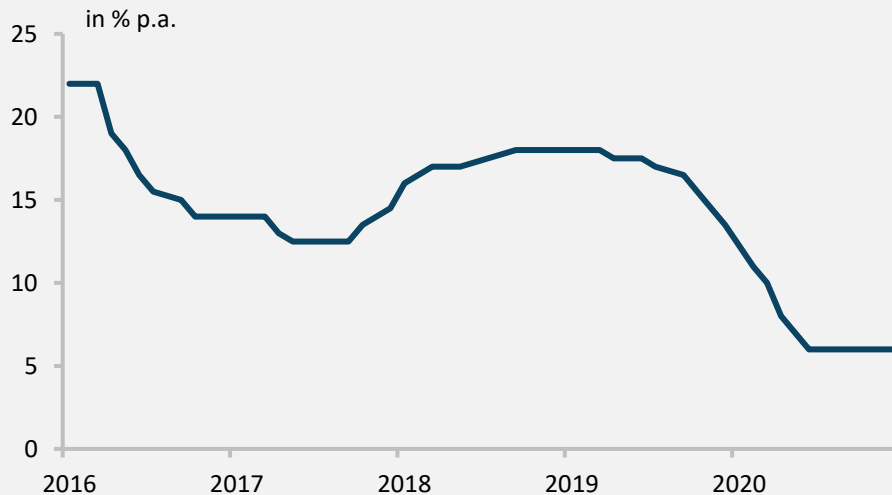
# Inflation and monetary policy

## Inflation rate



Sources: NBU, GET/IER, IMF, \*GET/IER forecast, \*\*IMF forecast, EoP

## Policy rate



Source: NBU

## Inflation

- Inflation currently at 5%, exactly in the middle of the NBU's target range (4-6%)
- Subsequent years: Inflation expected to remain within the target range
- However: Expansionary fiscal policy (e.g. stepwise increase of minimum wage) implies risks of inflationary pressure

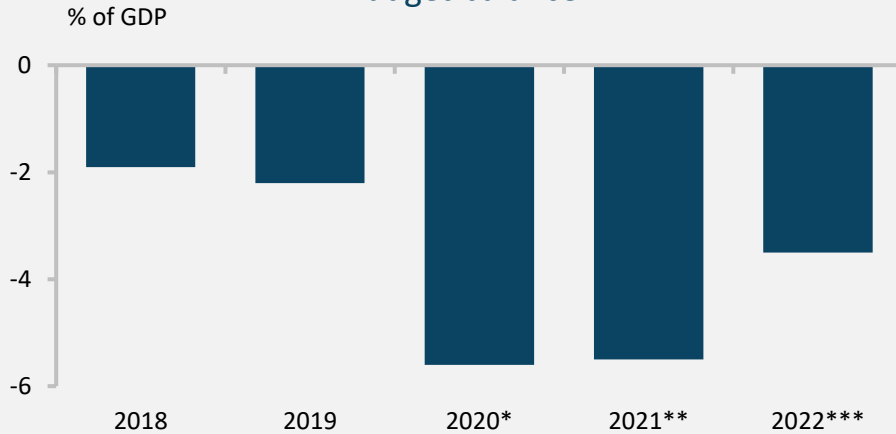
## Policy rate

- Policy rate was reduced to 6% during Corona crisis, a historic low
- In the medium-term, higher policy rates to be expected if inflation considerably exceeds the target range

- **Monetary policy support contributes to successful stabilisation**
- **Independence of the central bank remains essential to keep inflation within the target range**

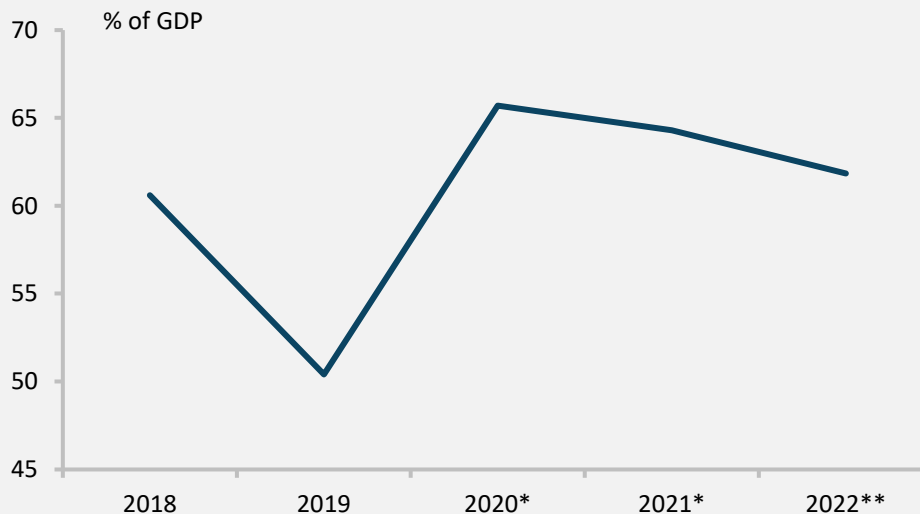
# Public finances

## Budget balance



Sources: NBU, Ministry of Finance, GET/IER, IMF, \*GET/IER estimate, \*\*Deficit in the state budget plan, \*\*\*IMF forecast

## Public debt



Source: IMF; \*estimate, \*\*forecast

## Budget

- 2020: Deficit planned at 7.5% of GDP
- However: Actual deficit considerably lower (ca. 5.6%), as expenditure target could not be financed
- 2021: Little fiscal consolidation planned despite economic recovery
- As in past years, actual deficit will likely be lower than planned (ca. 4.5%)

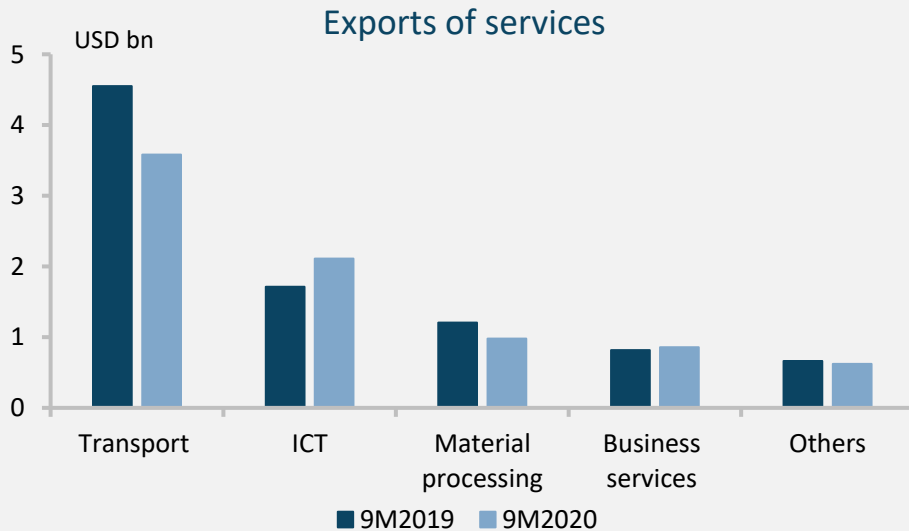
## Public debt

- 2020: Considerable increase of debt ratio
  - From 2021: Gradual decrease, dependent on consolidation and economic recovery
- 
- **Pre-crisis consolidation enabled fiscal support during the crisis**
  - **IMF-programme important for financing of the deficit; gradual return to consolidation should occur in the near future**

# External trade



Source: Ukrstat; note: trade in goods



Source: Ukrstat

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## Exports and imports of goods

- 11M2020: Sharp decrease of the trade volume (-9.1%)
- Imports decreased faster than exports (-12.9% vs. -3.5%)
- Decline of agricultural exports (24% of goods exports) by 7.9% caused by bad harvest
- Decline of metal exports (16% of goods exports) by 15.1%

## Exports of services

- Service exports (19% of total exports) declined by 12% to USD 8.2 bn (9M2020)
- Most important category: Transport (e.g. pipelines) accounting for 44% of service exports
- Share of ICT increased from 19% to 26% (9M2020)

➤ **COVID-19 crisis caused decline in the goods and services trade**

➤ **Growth of ICT-exports continues**

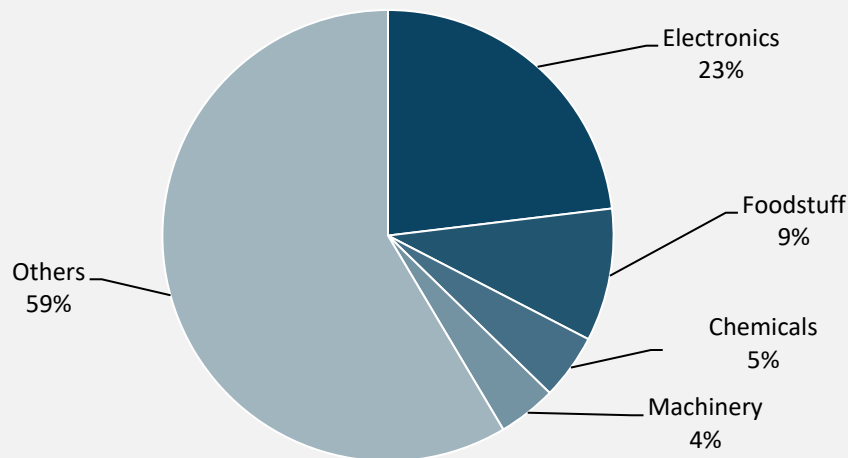


# Bilateral trade between Germany and Ukraine



Source: Federal Statistic Service, 11M2020; note: trade in goods

## Structure of German imports



Source: Federal Statistic Service, 11M2020; note: trade in goods

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## Bilateral trade

- Considerable decline by 8.8% (11M2020)

## German exports to Ukraine

- 11M2020: Moderate decrease by 6.0%
- Traditional export products:
  - Chemicals (22%)
  - Machinery (incl. agricultural machines) (22%)
  - Motor vehicles (incl. parts) (14%)

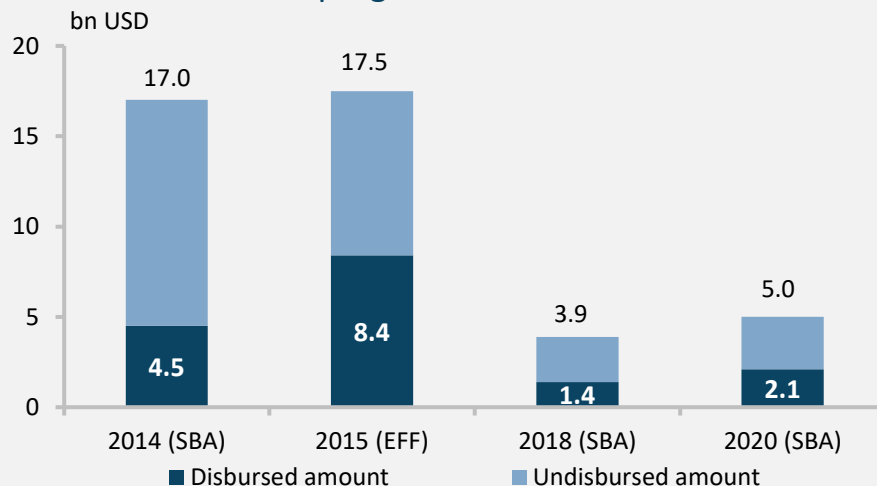
## German imports from Ukraine

- Sharp fall by 13.7% (11M2020)
- Decline of electronics (-13% yoy) presumably due to production stop of the automotive industry in March
- Sharp decrease of plant product imports (-46%) due to bad harvest

- **German exports stable despite COVID-19**
- **Considerable decline of imports caused by bad harvest and reduced production in the automotive sector**

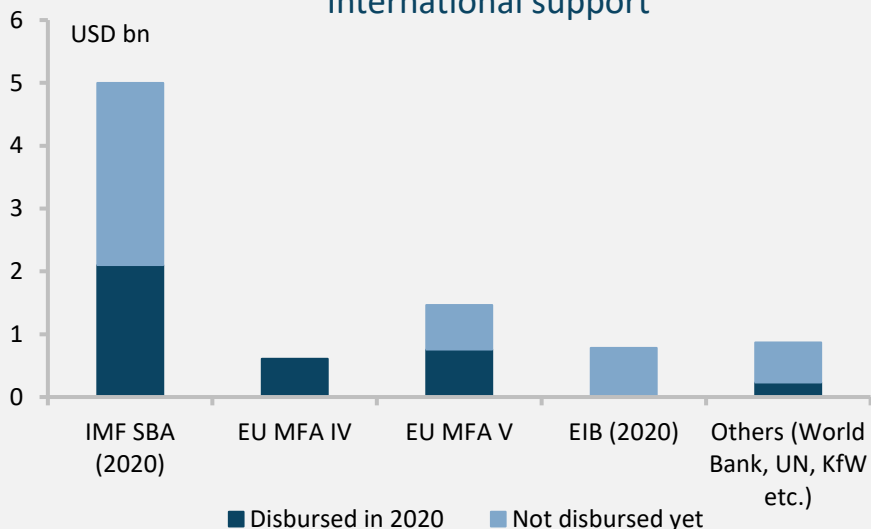
# Current IMF programme

IMF programmes since 2014



Source: IMF

International support



Sources: Ministry of Finance, IMF, EU

## Background

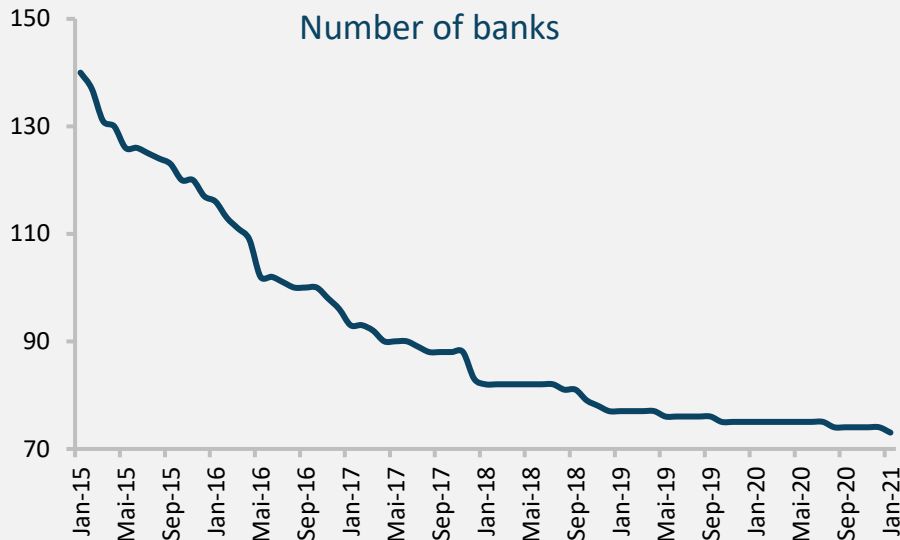
- COVID-19 led to a new “Stand-by-Arrangement” (SBA) in June:
  - Duration: 18 months; Volume: USD 5 bn
  - USD 2.1 bn disbursed in June 2020
- No further disbursements yet due to lack of reform progress and some setbacks;
- Dec-20: IMF mission started review

## Importance of the IMF-programme

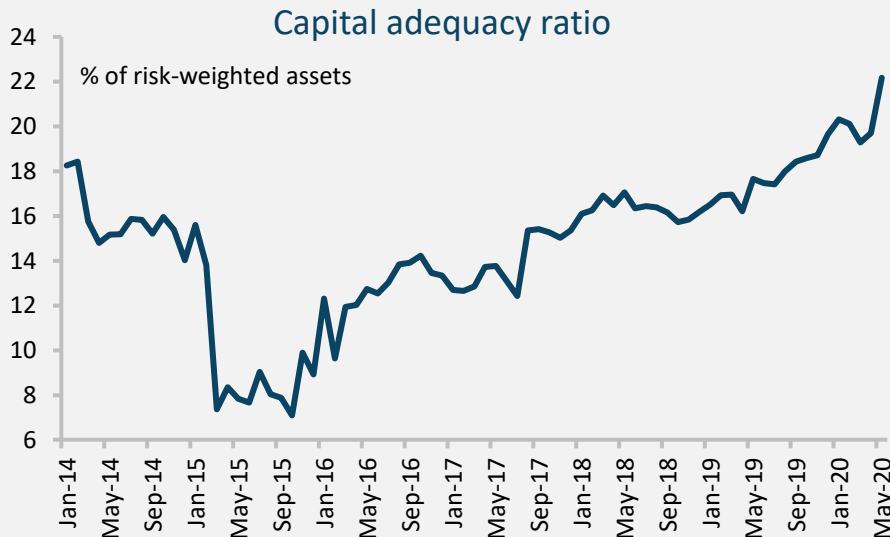
- IMF programme remains vital, also due to IMF conditionality of other donors’ programmes
- End of 2020: Financing of the deficit became difficult as second IMF tranche not yet disbursed
- December: EUR 623 m in EU EU macro financial assistance (MFA V), despite delayed IMF programme

➤ **Positive steps towards anti-corruption, ensuring the independence of the national bank & energy tariffs essential for further cooperation with the IMF**

# Banking sector



Source: NBU



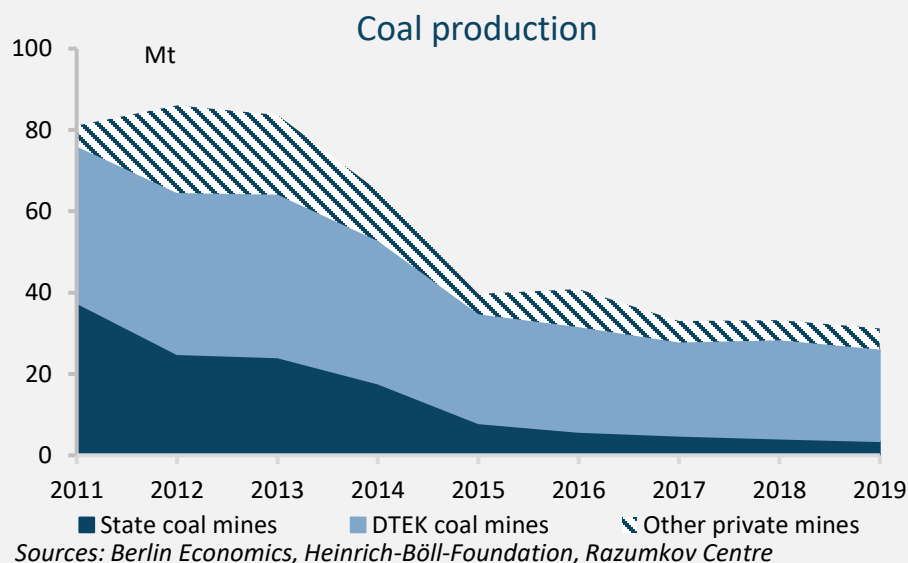
Source: NBU

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## Background

- Since 2014, the National Bank took more than 100 banks off the market; currently stabilisation
  - Four state-owned banks now dominate the sector (Nov-20: 53% market share)
  - Banks' capital adequacy ratio (CAR) was increased considerably since 2015
  - Banking reforms and increase of the CAR supported the resilience of the sector, thus no panic dynamics were observed during the crisis
  - Large share of non-performing loans (Nov-20: 42%) remains an important challenge
- **Reforms in the banking sector have paid off during the COVID-19 crisis**
- **In the future, the banking sector should focus on loan provision to the real economy**

# Challenges in the coal mining sector



## Production and employment in coal mining

	Private mines	State mines
Number	17	27
Production volume in Mt	27.7	3.8
Share	87.94%	12.06%
Employment in thsd.	47.6	37.9
Share	55.67%	44.33%

Sources: Energy Ministry of Ukraine, Berlin Economics, 2019

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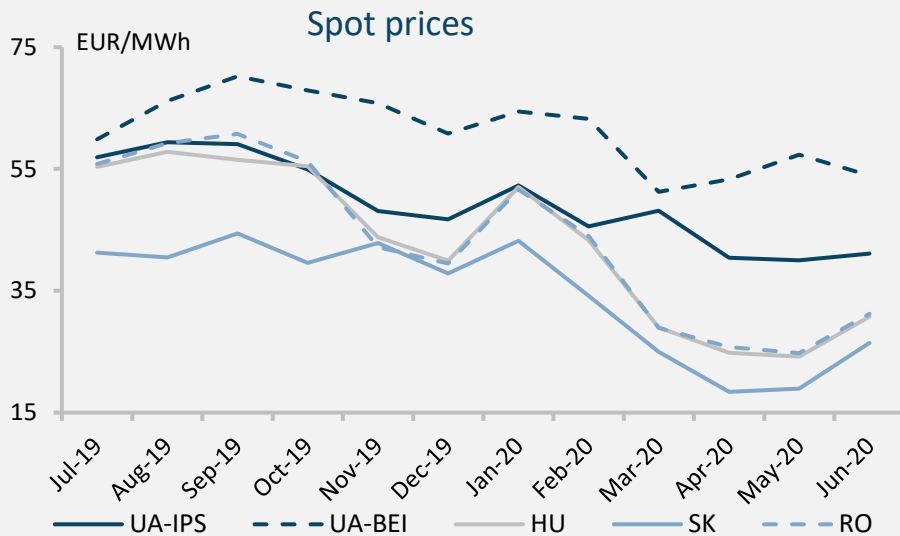
## Background

- Coal production has declined for many years
  - Loss of many mines in the Donbass
  - Lack of profitability of mines
- Germany supports the coal transition through the energy partnership, two mines selected as pilot projects for closures

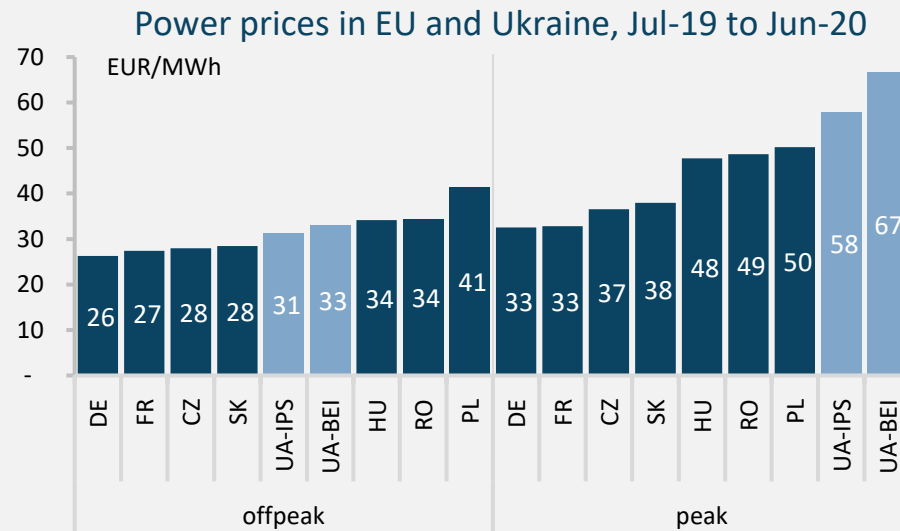
## Lack of profitability of state mines

- Lack of profitability mainly because of geological conditions
  - The most profitable mines were privatised (DTEK)
  - Little production, but high employment in remaining state mines
  - Considerable subsidies: UAH 12 bn (2019)
- **Phase-out of state coal mining will support budget, but has only a small ecological impact**
- **Private coal production is probably also not really profitable, phase-out can be expected in the medium-term**

# Electricity market



Sources: UA Market Operator, Entso-E transparency platform



Sources: Berlin Economics, UA Market Operator, Entso-E transparency platform

## Background:

- July 1st, 2019: Liberalisation of the electricity market
- Shifting from a regulated single-buyer model to a competitive wholesale market

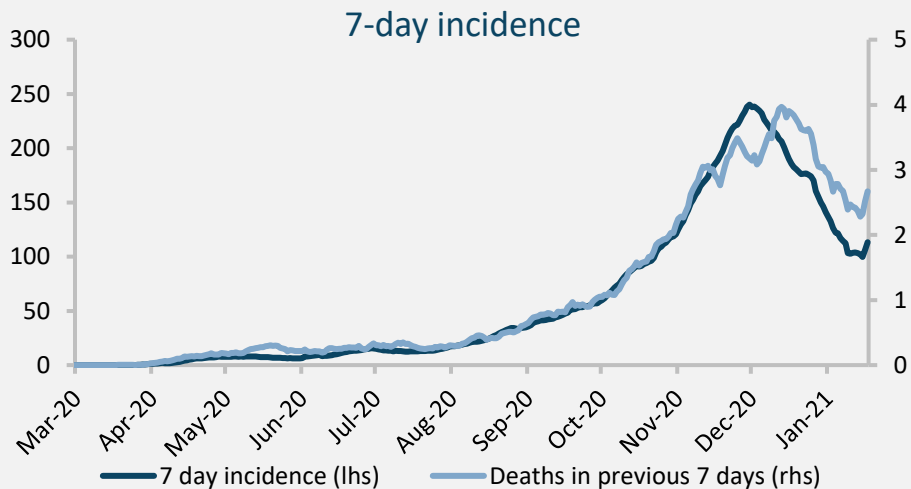
## Market development:

- High market concentration: 3 state generators + private DTEK account for 85% of the electricity production
- State generators face high level of regulation
- Import restrictions impede competition
- Price caps prevent excessive prices, but reduce investment incentives

➤ **Fundamental problem of missing competition must be tackled**

➤ **Still a long way to go to a fully liberalised market**

# COVID-19: overview of cases



Sources: Johns Hopkins University, Worldometer, Figures per 100,000 people.

## 7-Tage incidence in international comparison

	7-day incidence	Deaths in previous 7 days
<b>Ukraine</b>	<b>116</b>	<b>2.7</b>
Romania	117	3.0
Poland	132	5.7
Belarus	140	0.7
Georgia	231	4.3
Russia	112	2.5
Germany	145	7.2
EU	223	5.6

Sources: Johns Hopkins University, Worldometer, Figures per 100,000 people, Data as of January, 17, 2021.

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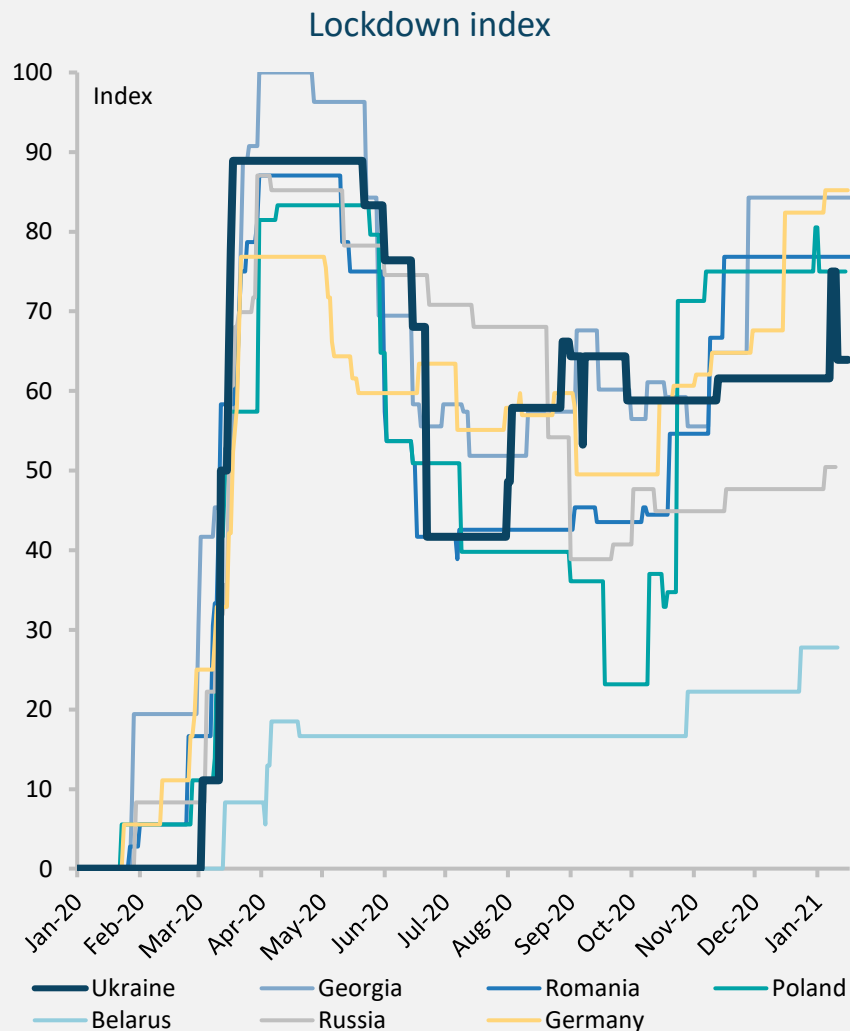
## Domestic perspective

- March-May: Moderate increase of cases
- Since July: 7-day incidence and number of deaths increased and reached their peak in autumn/winter, thereafter decline
- Since January 2021: Strict lockdown
- 0.7 m vaccine doses by Sinovac (China) are expected at the end of February

## International perspective

- 7-day incidence is low in international comparison
  - However, EU and Russia have already begun with mass vaccination
- **Peaks of the case incidences in autumn and winter, however moderate in international comparison**
- **Ukraine has to wait for vaccine doses till February, while EU and Russia have started vaccination**

# COVID-19: Containment measures



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

- March/April: First lockdown
- May-August: Loosening of measures
- August-December: Partial lockdown
- Since January 2021: Second strict lockdown
  - Closure of education institutions
  - Closure of parks and cultural events
  - Restaurants: delivery only
  - Closure of retail outlets (except for food, fuel, hygiene and medical products)

## International perspective

- Compared to development of cases, relatively early and strict response
- Timing of loosening comparable to neighbours
- Second lockdown was introduced later than in neighbouring countries

# COVID-19: support by the government

Households	Businesses	
<ul style="list-style-type: none"> <li>• 300% top-up of of medical staff salaries</li> <li>• Personal income tax allowance for medical expenses</li> <li>• UAH 1,000 one-off pensions increase for low-income pensioners, monthly UAH 500 top-up for pensioners <math>\leq 80</math> years</li> <li>• Increased unemployment benefits</li> <li>• UAH 8,000 one-off payment to employees in case of company closure during lockdown</li> <li>• Cancellation of tax debts of max UAH 3,600, deferred tax payments up to UAH 6,800</li> <li>• Extended possibilities to apply for tax exemption</li> </ul>	<ul style="list-style-type: none"> <li>• Exemption from import duties and VAT of medicines/medical devices against COVID-19</li> <li>• Suspension of fines for violation of tax code (March to May)</li> <li>• Full suspension of land tax and rent for publicly-owned land in March</li> <li>• One-off payment to avoid mass job cuts (max. UAH 8.000 per employee)</li> <li>• One-off payment of social contributions costs (average of previous 10 months)</li> </ul>	
	SMEs	Banks
	<ul style="list-style-type: none"> <li>• Extension of partial unemployment scheme for SMEs</li> <li>• Extension of 5%-7%-9% subsidized loan programme</li> </ul>	<ul style="list-style-type: none"> <li>• Modifications of reserve and capital buffer requirements</li> <li>• Only one instead of two bank stress tests</li> <li>• Introduction of long-term refinancing instruments</li> <li>• Extension of deadlines for annual financial results, strategies against non-performing loans</li> </ul>

Sources: Ministry of Finance, NBU, Cabinet of Ministers Note: selection measures as of December 2020



# About the German Economic Team



Financed by the Federal Ministry for Economic Affairs and Energy, the German Economic Team (GET) advises the governments of Moldova, Georgia, Ukraine, Belarus and Uzbekistan on economic policy matters. Furthermore, GET covers specific topics in other countries, such as Armenia. Berlin Economics has been commissioned with the implementation of the consultancy.

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