

Economic reforms aimed at external stabilisation.

A progress assessment

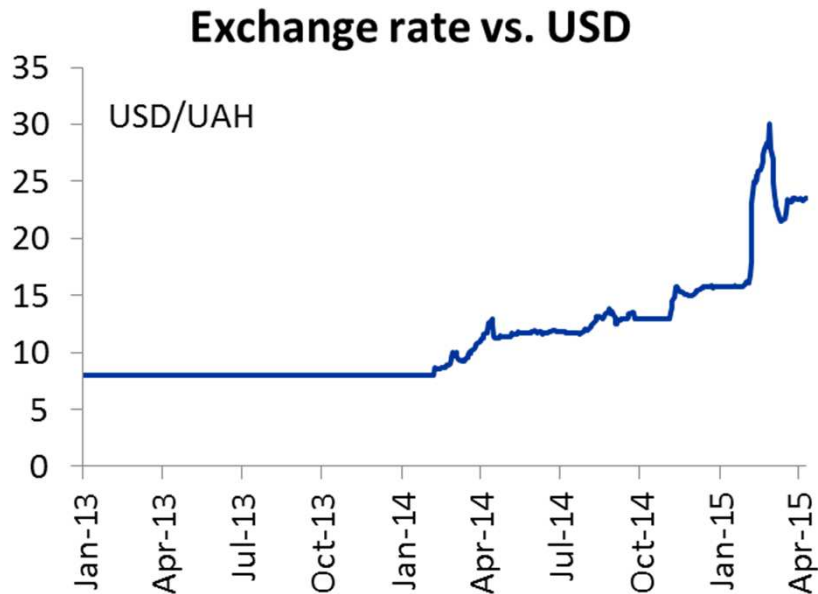
3rd east forum Berlin

(Re)Building Ukraine

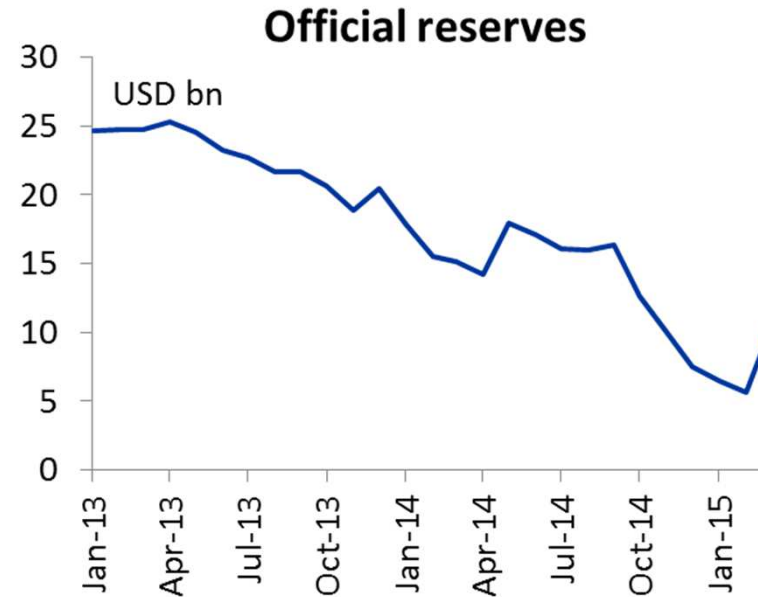
Dr Ricardo Giucci, German Advisory Group Ukraine

Berlin, 22 April 2015

External stabilisation and economic reforms



Source: National Bank of Ukraine



Source: National Bank of Ukraine

- Urgent need for macroeconomic/external stabilisation
- How? Monetary and fiscal policy (i.e. macro) not sufficient, also economic reforms at a micro level are necessary
- Our focus: Economic reforms aimed at external stabilisation

→ **Macro stabilisation and reform policy must go hand in hand**

Five reform areas for external stabilisation

Balance of payments, 2014, selected items

	USD bn	Comment
Exports (change yoy)	- 13.0	Exports to Customs Union: -35%; 2/3 of total drop
Imports (change yoy)	- 24.5	However: Energy imports still 27% of total imports
Internal capital flight	- 2.7	Mainly due to lack of confidence in banking sector
FDI flows (net)	+ 0.3	Insignificant inflows, below potential
Official loans (net)	+ 5.1	However: Project finance far below potential

Source: National Bank of Ukraine, UkrStat

Internal capital flight

2014: Net purchases and withdrawals of foreign currency by population amounted to USD 2.7 bn

Main reason: Lack of confidence in banking sector

Reforms implementation so far:

- Resolution of 46 banks since 2014; almost 20% of system assets
- Legislation introducing unlimited liability of bank owners and managers on losses arising from related-party loans
- Implementation despite strong resistance from vested interests

Progress assessment: Good progress in cleaning up the banking sector, fighting vested interests and re-establishing confidence

Energy and gas imports

2014: Energy imports amounted to USD 16 bn

- Significant drop (-28%) compared to 2013
- Nevertheless: 27% of total imports; main import category
- In particular: Still very high gas imports (USD 5.7 bn)

Reasons: Low tariffs for population and lack of investment

Reform implementation so far: Increase of gas and heating tariffs

	Cost coverage gas	Cost coverage heating
01.04.2015	Ca. 50%	Ca. 50%
01.04.2016	75%	75%
01.04.2017	100%	100%

Progress assessment: Crucial first step; now focus on how to attract investment in order to reduce energy and gas consumption

FDI flows

2014: Net inflows of FDI amounted to USD 0.3 bn (0.2% of GDP)

- Very low inflows; below potential
- 2008: USD 9.9 bn; 2013: USD 4.1 bn

Reasons (beyond military conflict in the east):

- Poor investment climate
- Lack of clear focus for FDI attraction

Reform implementation so far:

- Deregulation in many fields
- But: Business doesn't feel the full impact of deregulation yet

Progress assessment:

- Some progress concerning deregulation
- Missing: Focus of FDI attraction in light industry; much potential due to very competitive labour costs

Export promotion

2014: Exports dropped by USD 13 bn, despite devaluation

- In relative terms: 17% decline of exports
- Gross exports important contributor to external instability

Main reason:

- Massive drop to Customs Union (-35%); 2/3 of total drop
 - Expectation: Situation will not improve in the short term
- Export re-orientation needed → Better product quality needed

Reform implementation so far:

- Implementation of DCFTA shifted to 2016; negative feature
- Still only limited instruments for export promotion

Progress assessment:

- Limited progress, much to be done

Official loans and project finance

2014: Net official loans amounted to USD 5.1 bn

- However: Mostly budget and balance of payments support
- Low inflows of project finance to public sector (e.g. infrastructure loans)

Reason: Project finance in Ukraine very complicated procedure

- Lots of signatures are necessary; very long bureaucratic process
- Requirement for national feasibility study („teo“)
- Resolutions („Postanovas“) 1027 and 153

Reform implementation so far:

- Discussion with donors on simplification of procedures

Progress assessment:

- Little progress so far
- Our view: Relatively simple reform with high expected impact

Conclusions

Focus: Economic reforms aimed at restoring external stability

Assessment of reform progress in five key areas

Reform area	Progress assessment
Stabilising the banking sector	Good progress
Reduction energy imports	Crucial first steps
FDI attraction	Some progress on deregulation
Export promotion	Limited progress so far
Project finance	Still lot to do

→ **Some reform areas need to catch up**

→ **Overall: Reform process is well under way**

Dr Ricardo Giucci

giucci@berlin-economics.com

German Advisory Group

c/o BE Berlin Economics GmbH

Schillerstr. 59, D-10627 Berlin

Tel: +49 30 / 20 61 34 64 0

Fax: +49 30 / 20 61 34 64 9

E-mail: info@beratergruppe-ukraine.de

www.beratergruppe-ukraine.de

Twitter: [@BerlinEconomics](https://twitter.com/BerlinEconomics)

