

Issue 11 | January 2020

## Overview

- 2019: GDP grew by around 3.5%, the highest rate in eight years. Domestic demand (consumption and investment) were main drivers of growth, no negative effect of the elections was experienced. Projections for growth in 2020 and 2021: 3.0-3.1%
- International reserves are at a peak since 2013 (USD 25.3 bn). Hryvnia has appreciated relative to USD by 16% in 2019, in large part due to strong capital inflows into the domestic bond market. Current account deficit is moderate (2019: 2.8% of GDP). Agreement on the continuation of gas transit decreased risks.
- Inflation at 4.1% within the target range of the National Bank. The easing of monetary policy (current policy rate: 13.5%) will probably be continued in 2020
- Budget deficit of 2% of GDP in 2019 and will remain close to this level in 2020-2021. Public debt has fallen to 52% of GDP in 2019 and will continue to decrease

## Topics

- **Labour migration.** Increasing migration supports growth in real wages.
- **Reform agenda of the government.** Ambitious economic policy goals require comprehensive reforms
- **IMF programme.** New agreement is a positive signal and supports the reform agenda
- **Reform proposals of German business in Ukraine.** Update of our study shows progress in improving the investment climate
- **Gas transit deal.** Agreement between Naftogaz and Gazprom on gas transit is a positive development

# Basic indicators

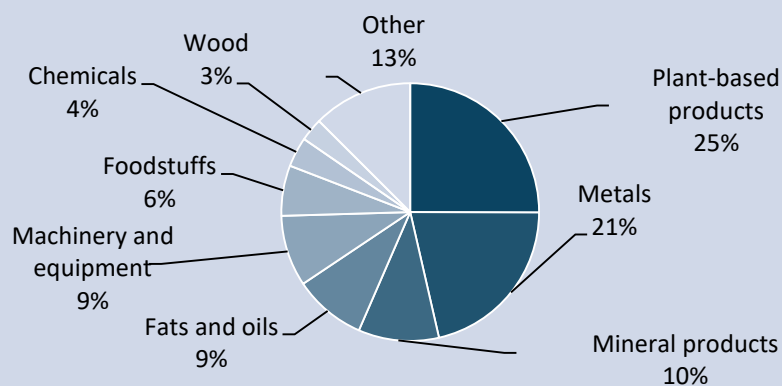
	Belarus	Russia	Ukraine	Moldova	Georgia
GDP, USD bn	63.1	1,637.9	150.4	11.7	16.1
GDP/capita, USD	6,659	11,163	3,592	3,300	4,380
Population, m	9.5	146.7	41.9	3.5	3.7

Source: IMF, Belstat, Geostat, German Economic Team; Estimate for 2019

## Trade structure

### Exports

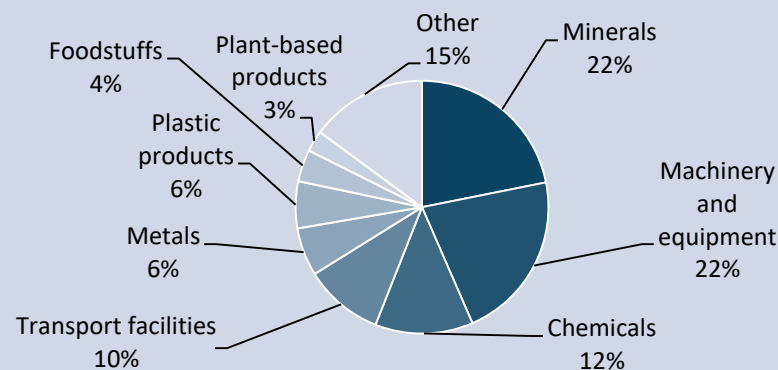
EU 42% | Russia 7% | Other 52%



Source: Ukrstat, data for 10M2019; Note: Trade in goods

### Imports

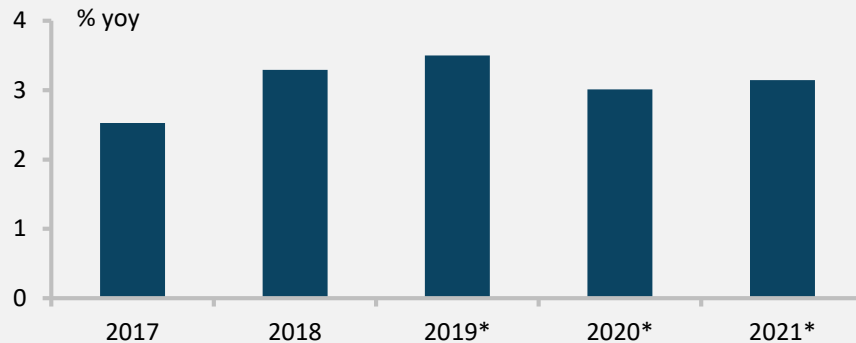
EU 41% | Russia 12% | Other 47%



Source: Ukrstat, data for 10M2019; Note: Trade in goods

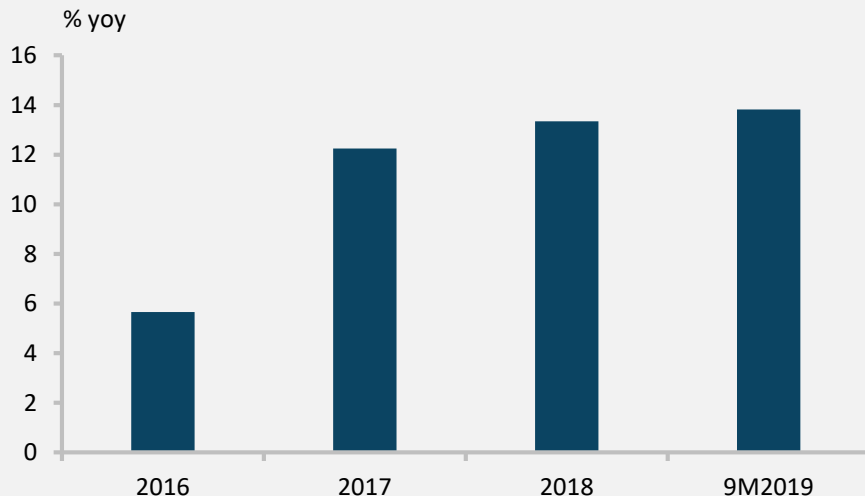
# Economic growth

## Real GDP growth



Source: IMF, German Economic Team; \*Estimate/Forecast

## Private consumption



Source: Ukrstat

## GDP

- 2019 GDP grew by around 3.5%, up from 3.3% in 2018:
  - Highest value in 8 years
- For 2020-21 expected growth 3.0-3.1%
  - IMF agreement strengthens investor confidence
  - New gas transit deal with Russia has positive effects

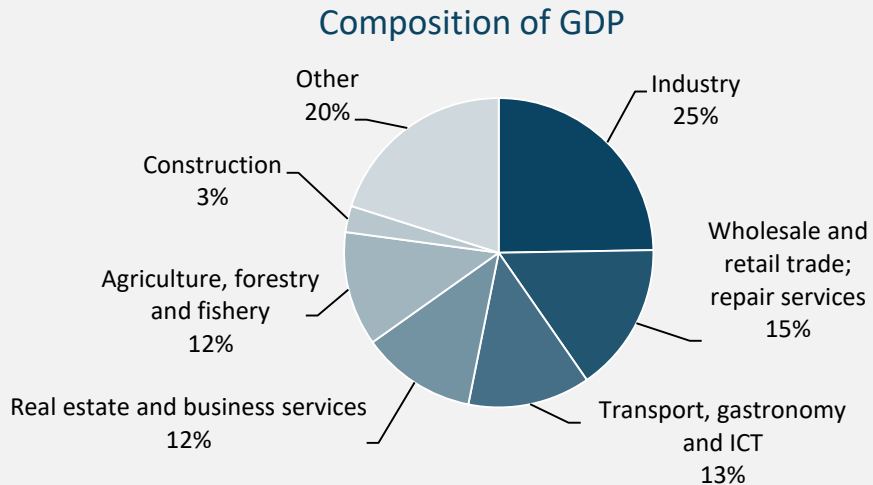
## Domestic demand spurs growth

- Private consumption further expands (+13.8% in 9M2019), mainly due to rising incomes
- Two elections in 2019 had no adverse effects on investment (+7.2% in 9M2019)

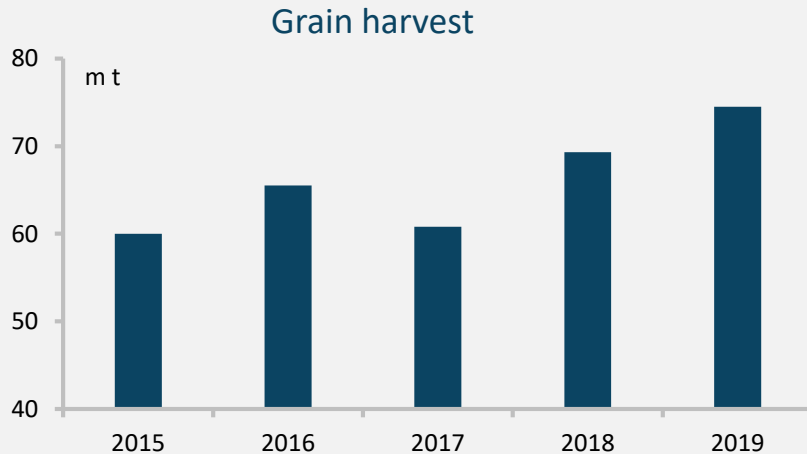
## Conclusion

- Growth unaffected by elections in 2019
- But: Importance of economic reforms to accelerate growth remains high

# Sectoral perspective



Source: Ukrstat, 2018



Source: FAO/UN, 2019

## Sectoral structure

- Most important sector on the supply side is industry (25%) even though production declined over the course of 2019 (-1.8%)
- Service sectors follow in importance:
  - Retail trade and repair services (16%)
  - Transport, gastronomy and ICT (13%)
  - Real estate and business services (12%)

## Agriculture

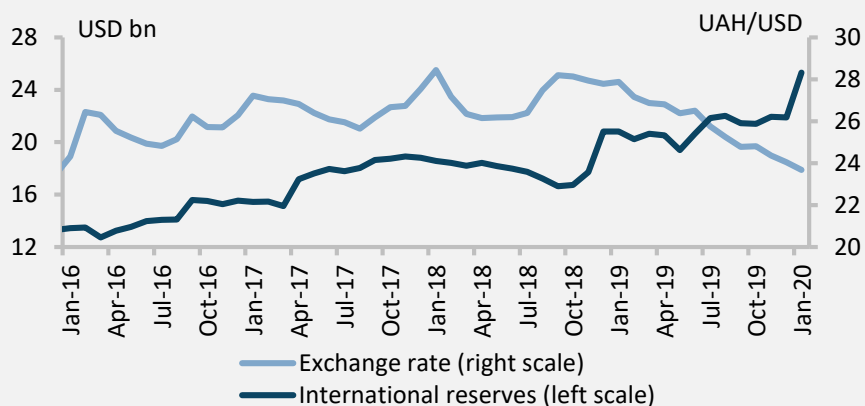
- New record grains harvest in 2019: 7.5% increase from 2018
- Agriculture (combined with food production) contribute 15.6% to GDP

## Conclusion

- Agricultural sector develops positively, while industry is declining

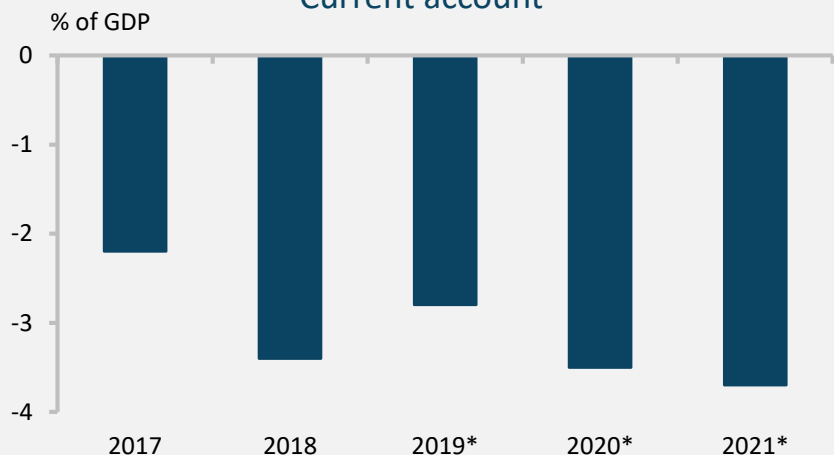
# Exchange rate and current account

Exchange rate and international reserves



Source: National Bank of Ukraine

Current account



Source: IMF; \*Estimate/Forecast

## Exchange rate

- 2019 strong appreciation against USD (+16.2%) and EUR (+18.5%)
- High capital inflows (into UAH-denominated government bonds) due to high interest rate

## International reserves

- Jan-20: USD 25.3 bn, highest level since 2013
- Strong increase caused by transfer of USD 2.9 bn by Gazprom in Dec-19
- Import coverage: Around 4 months

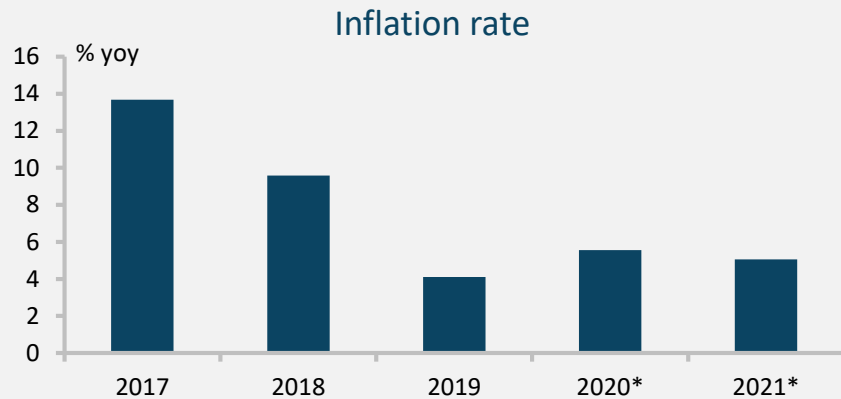
## Current account

- Since 2017, the current account deficit has been relatively stable between 2% and 4% of GDP

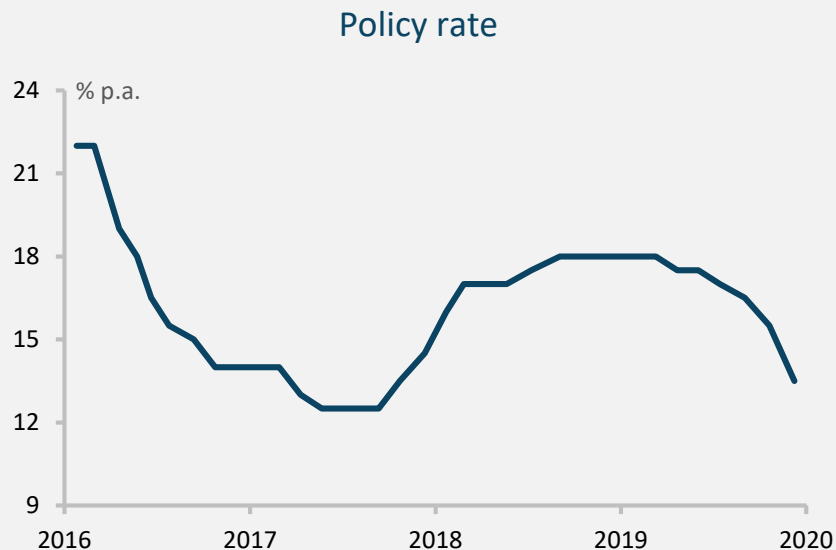
## Conclusion

- Stable external position

# Inflation and monetary policy



Source: IMF, Ukrstat; Note: EOP, \*Estimate/Forecast



Source: National Bank of Ukraine

## Inflation

- Strong decline of inflation (Dec-19: 4.1%), now at the lower boundary of the National Bank's target range (4-6%)
- Inflation is expected to remain within target range in 2020-2021

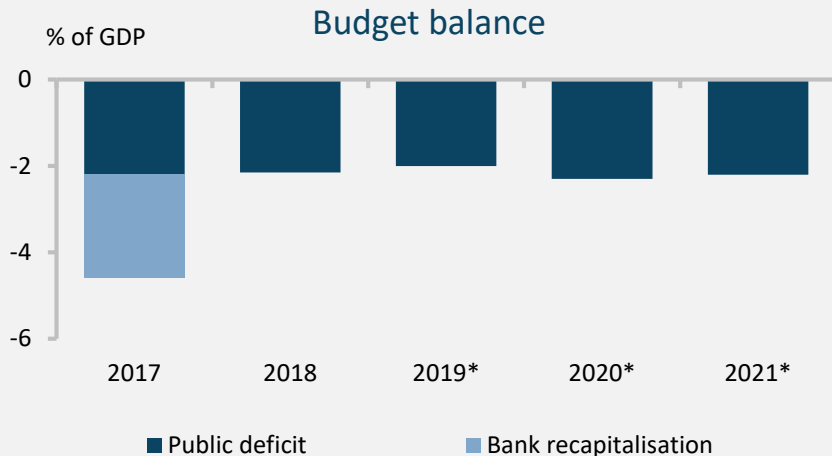
## Policy rate

- Five policy rate reductions in 2019
- Policy rate remains high (Jan-20: 13.5%), strong decline in inflation creates space for further decrease in 2020

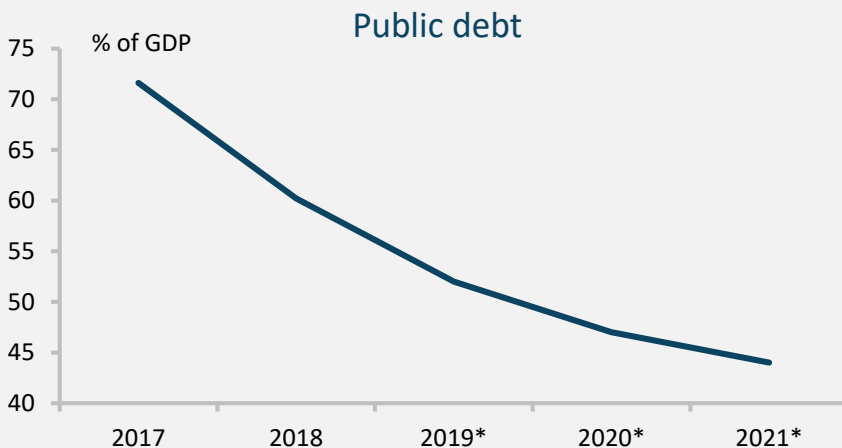
## Conclusion

- Reaching the inflation is a very positive development and leaves space for further easing of monetary policy
- Upcoming rate reductions should support domestic demand and curb appreciation pressures

# Public finances and government debt



Source: IMF, Ministry of Finance of Ukraine; \*Estimate/Forecast



Source: Ministry of Finance of Ukraine, IMF; \*Estimate/Forecast

## Government budget

- Small deficit of 2.0% in 2019, according to preliminary information
- Similarly small deficits to be expected for 2020 - 2021

## Public debt

- Significant reduction of debt-to-GDP ratio continues (due to strong growth of nominal GDP and appreciation of the Hryvnia)
- Continuous interest of foreign investors in the local bond market:
  - Foreign investors are currently holding 116.7 bn in UAH bonds (USD 4.8 bn, 10.01.20)
  - Corresponds to 24% market share (w/o NBU)

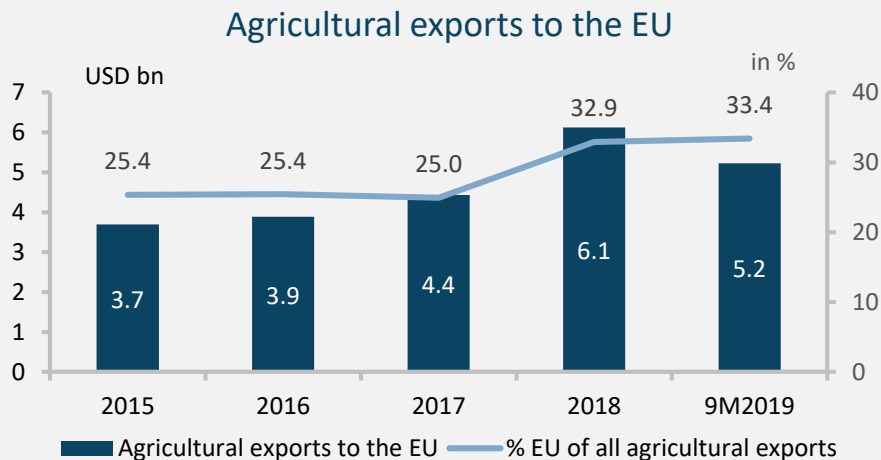
## Conclusion

- Conservative fiscal policy supports stability
- High share of foreign investors in the local bond market clearly demonstrates this

# External trade



Source: Ukrstat; Note: Trade in goods



Source: European Commission, Ukrstat; Note: Trade in goods

## Export

- Continuous increase in exports in 10M2019 (7.4%), but at a slower pace than in the previous year (10.3%)
- Agricultural exports to EU are continuously rising: Ukraine now No. 3 of sources for the EU in this category (behind USA and Brazil)

## Import

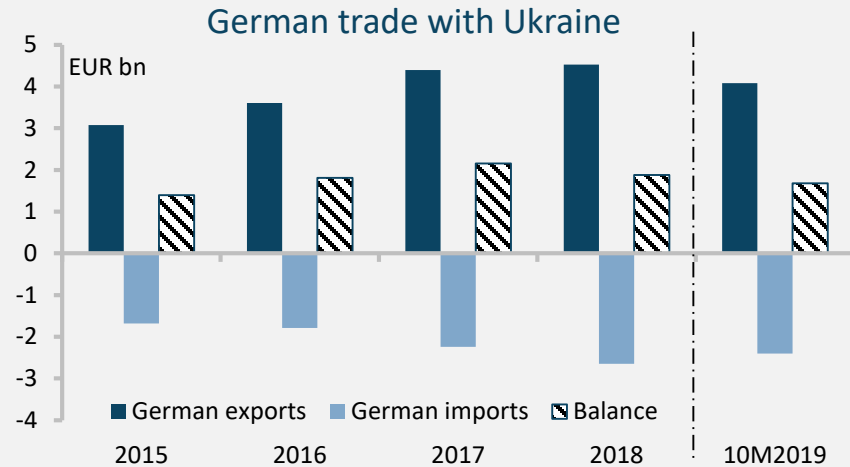
- Increase in imports also continues in 10M2019 (7.1%), but also slightly weaker than in the previous year (7.4%)

## Conclusion

- Positive development in external trade continues in 2019, but with declining dynamic
- Good development given various global uncertainties
- Significant increase in agricultural exports to the EU

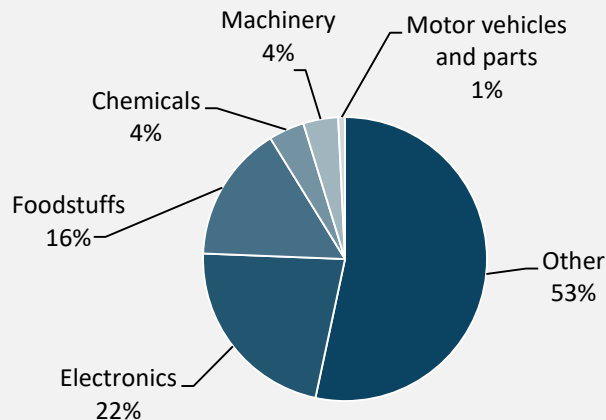


# Bilateral trade between Germany and Ukraine



Source: German Federal Statistics Office

## Structure of German imports



Source: German Federal Statistics Office, 10M2019; Note: Trade in goods

## Bilateral trade volume

- Positive: Increase of 9.6% over 10M2019 in relation to previous-year period

## German exports to Ukraine

- Moderate increase of 7.8% in 10M2019 compared to prior year, mainly due to robust domestic demand in Ukraine
- Traditional export products: Machinery (incl. agricultural machines) (23%), chemicals (22%) and motor vehicles (incl. parts) (14%) make up almost 60%

## German imports from Ukraine

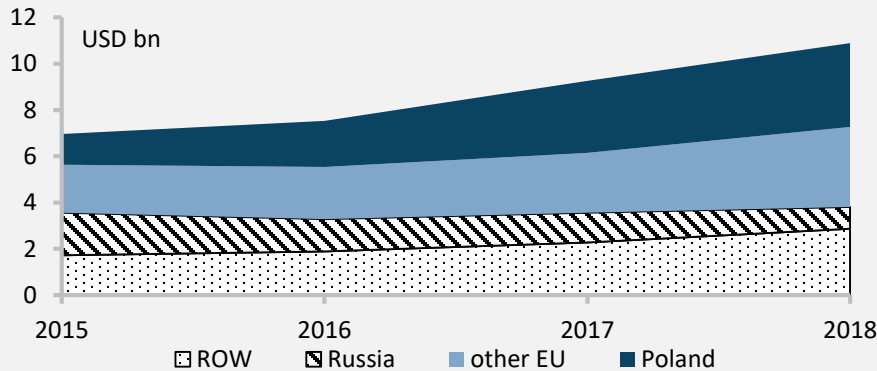
- Large increase of 12.6% over 10M2019 yoy
- Most important sectors: Electronics (22%), foodstuffs (16%) und machinery (4%)

## Conclusion

- Continued positive development of bilateral trade despite global uncertainties

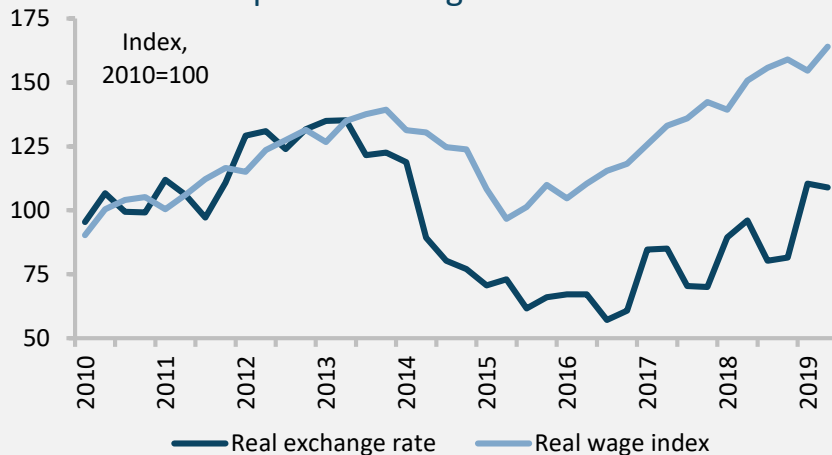
# Labour migration

Remittances to Ukraine



Source: National Bank of Ukraine

Development of wages and unit labour costs



Source: Ukrstat, LFS 2017, Eurostat, German Economic Team;

Note: Real exchange rate on the basis of unit labour costs; Ukraine/Eurozone, Index based on 2010 annual average over four quarters.

## Background

- Since 2014 reports about large migrant streams from Ukraine to EU, mainly Poland

## Analysis

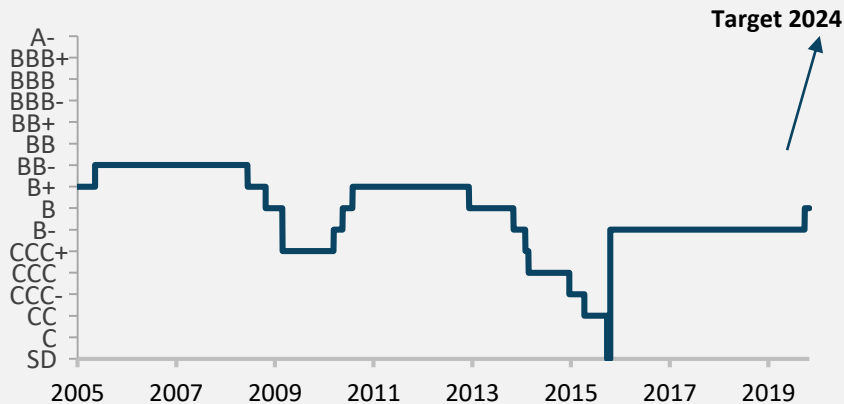
- Conservative estimate of total numbers of migrant workers from Ukraine
  - 2012: 1.6 m
  - 2017: 2.0 m
- Shift of primary destination of migrants: Previously the East (Russia), now West (Poland)
- Further immigration of Ukrainian migrant workers to Poland of 200,000 p.a. in 2017/2018
- Labour migration has contributed to the recovery of real wages after the crisis
- Competitiveness not threatened so far: Real exchange rate now at the same level as 2010

## Conclusion

- Currently no negative economic effects of the significant increase of labour migration towards the EU
- Risk for competitiveness and investment in the long run

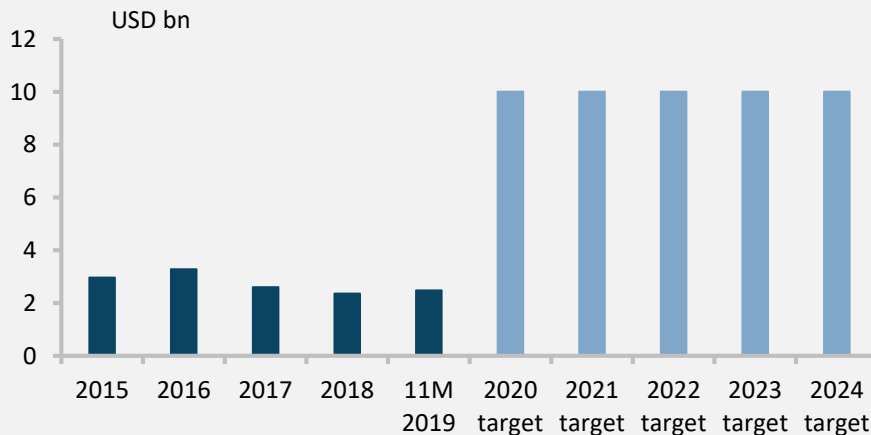
# Reform agenda of the government

Country rating Ukraine (S&P)



Source: S&P

FDI inflows



Source: National Bank of Ukraine

## Background

- Autumn 2019: Presentation of economic and social target values as part of a reform agenda of the Cabinet of Ministers of Ukraine
- Target values for 2020-2024 include:
  - Attracting USD 50 bn in FDI
  - Ukraine receives country rating of A-

## Analysis

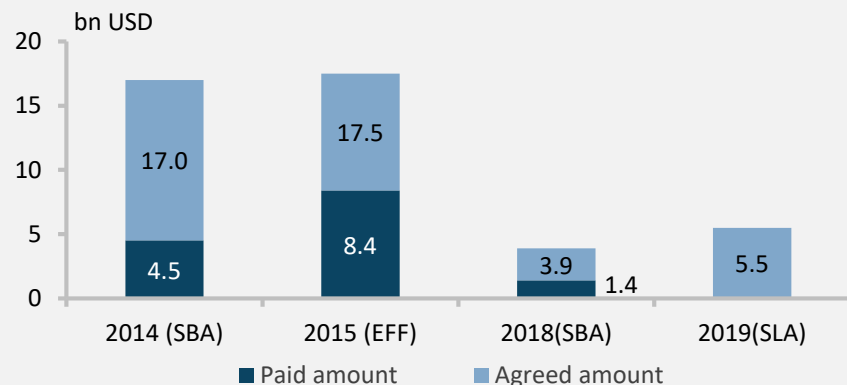
- Current rating: B (S&P)
- Quick rise to A- (e.g. Poland) unrealistic
- FDI inflows currently around USD 2-3 bn p.a.
- Increase to USD 10 bn p.a. from 2020 not likely

## Conclusion

- Challenging, target values partly too ambitious
- Ultimately, quickly implementing reforms aimed towards these goals is crucial. Even only partially achieving the goals would constitute good progress

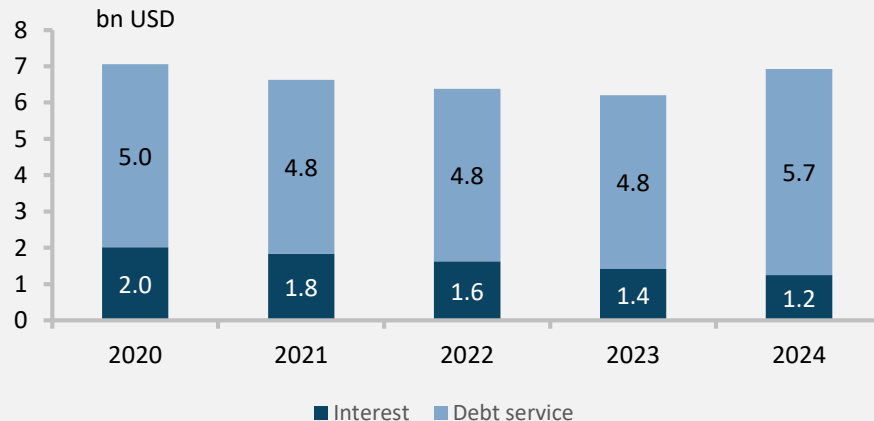
# New IMF programme

IMF programmes since 2014



Source: IMF

Public debt repayment



Source: Ministry of Finance of Ukraine, IMF, German Economic Team

## Background

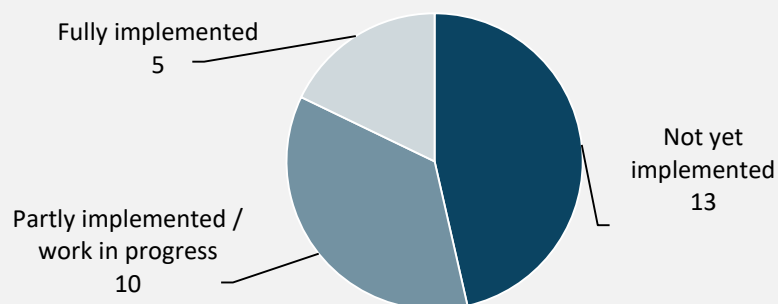
- 3 agreements with IMF with an overall amount of USD 14.5 bn paid out since 2014
- Another agreement („Staff Level Agreement“) was reached late 2019, payments of USD 5.5 bn over the next three years
- Programme has to be confirmed by IMF leadership (likely in Q1 2020), after Ukraine has fulfilled a number of prior actions
- Agreement can unlock further loans / guarantees from third parties, such as EU or World Bank

## Conclusion

- Agreement on a new programme eases servicing of external public debt
- Also functions as an „anchor“ for economic policy reforms

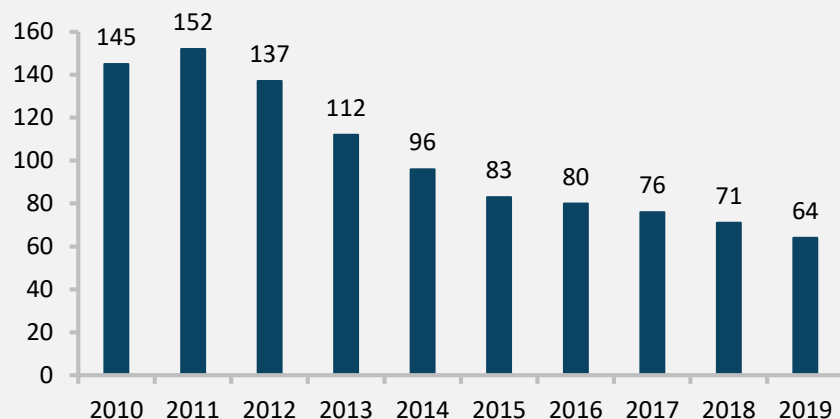
# Reform proposals of German business in Ukraine

Implementation status of 28 proposals (Dec-19)



Source: German Economic Team

Rank of Ukraine in "Doing Business"



Source: World Bank

## Background

- Joint study with the German-Ukrainian Chamber of Industry and Commerce in 2018
- Reform proposals of German companies to improve investment climate in Ukraine
- Update presented late 2019:
  - Monitoring of implementation status
  - Bringing non-implemented proposals to the attention of the new government

## Results

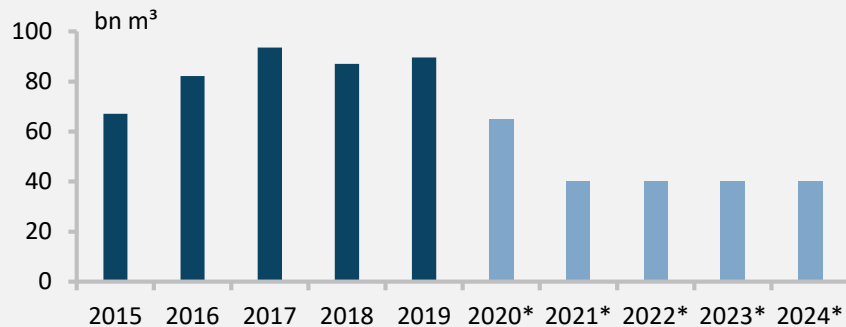
- More than half of the 28 proposals were implemented, at least in part
- Work remains to be done on 23 proposals
- For example:
  - Improving energy connection of companies
  - Simplification of documentation requirements for transport and tax
  - Acceptance of EU invoice prices

## Conclusion

- Implementation of the proposals would support the reform agenda of the government and the improvement of the business climate

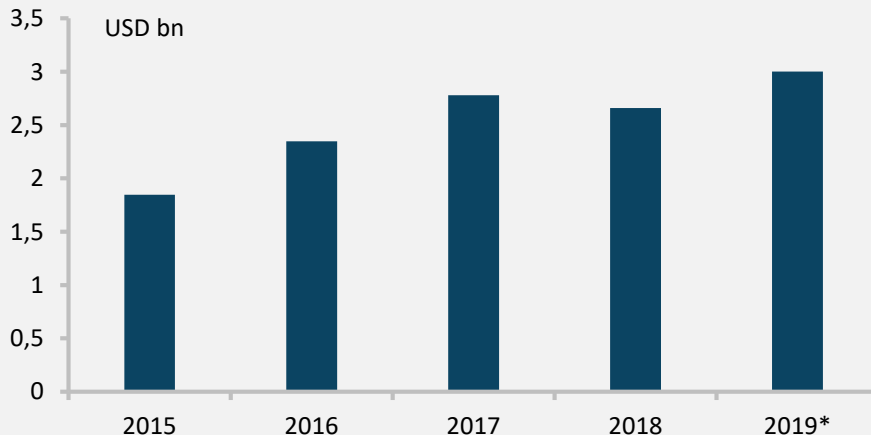
# Gas transit deal

## Gas transit and minimum transit volume



Source: German Economic Team, S&P Global, Ukrinform; \*Future minimum volume

## Gas transit revenue for Naftogaz



Source: Naftogaz, German Economic Team; \*Forecast

## Background

- Transit contract between Naftogaz and Gazprom expires at the end of 2019
- New situation with regard to gas transit, particularly due to Nord Stream 2 project and related US sanctions

## Key points of the agreement

- Naftogaz and Gazprom agree on future gas transit for at least 5 years and on compensation claims
- Agreement on minimum transit volume of 65 bn m<sup>3</sup> in 2020 and 40 bn m<sup>3</sup> p.a. 2021-2024;
- Support of Germany/EU important
- Gazprom pays USD 2.9 bn to Naftogaz as a result of the Stockholm Arbitration (in return, substantial claims have been dropped)

## Conclusion

- Agreement on future transit 2020-2024 is a positive development

# 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.

The German Economic Team is financed by the Federal Ministry of Economic Affairs and Energy (BMWi). The consulting firm Berlin Economics has been commissioned with the implementation of the project.

## CONTACT

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](mailto:info@german-economic-team.com)  
[www.german-economic-team.com](http://www.german-economic-team.com)  
Twitter: @BerlinEconomics  
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