

Ukraine



Ukraine is an emerging democracy, where power is divided between the president and the parliament. The Orange Revolution of 2004 triggered significant investments into Ukraine from European countries, although the current political environment is uncertain. The pre-term parliamentary elections in 2007 established some short-term stability, but inconsistent decision-making broke down the governing coalition and was a key reason behind the country's failure to gain access to the Membership Action Plan for entering NATO. Tension between pro-Russian and pro-Western factions is a feature of Ukraine's political and economic landscape.

Ukraine's population of approximately 46 million is ageing, with the population of the 0-14 year-old declining by over 19% since 2000. There are currently 32 million people in the economically active section of the population (15-64). The country has a highly skilled and well-educated labour force, with a 98% literacy rate, and nearly 30% of population has higher education. Until recently, the Ukrainian economy could be counted among Europe's best performers, resulting in the rapid improvement of living standards, with real wages and personal disposable income increasing at a rapid rate.

Ukraine became a member of the WTO at the beginning of 2008; a move which is set to have a positive long-term impact on the country's economy. In addition, the country's historically strong economy has encouraged a substantial increase in the volume of FDIs since 2000 to USD 12 billion at the end of 2008, as foreign investors gained confidence in the country.

As a result, foreign currency reserves grew rapidly in the face of strong current-payment outflows.

In late 2008, however, the global economic crisis began to affect the Ukrainian economy, and has continued to do so into 2009. However, the adverse external environment was not the only reason for Ukraine's emerging economic problems. Historically, the Ukrainian economy has been highly dependent on industrial production. In 2008, over a quarter of the country's GDP was linked to metals' production, which accounted for 80% of the country's total exports. The recent collapse in the global demand for metals has clearly exposed a significant economic imbalance, which has existed since the 1990s. The situation has been aggravated by the banking crisis. The GDP growth slowed in 2008 to 2.1% following a rapid growth in 2005-2007 on average by 6% per year.



A sharp decline in exports in the fourth quarter, driven by reduced prices and a fall in external demand for metals and chemical products together with weakening of domestic currency resulted in 8.2% drop in the whole 2008.

The Ukrainian currency, the Hryvnia (UAH), has been pegged in a relatively tight band to the US Dollar since 2000. The National Bank of Ukraine (NBU) revalued the Hryvnia in April 2005 by 5%. Since then it has been pegged at UAH 5-5.05 to the Dollar. Following the collapse of global steel prices in late 2008, Ukraine's US Dollar-denominated income from metal exports contracted by almost 50%. Coupled as it was with the capital flight it contributed to a significant contraction in the balance of payments. The majority of external borrowings in the Ukrainian financial sector were denominated in US Dollars, and were therefore difficult to refinance amid the global liquidity crisis, triggering a US Dollar deficit in the financial system. As a result, in October 2008 the Hryvnia depreciated significantly to the Dollar and the Euro (respectively by 55% and 50%). The sharp devaluation of the Hryvnia forced the NBU to support it with forex interventions. As a result, Ukraine's gold and currency reserves decreased by almost USD 6 billion from September to December 2008.

The impact of the credit crunch on banking system growth intensified in the final quarter of 2008, as a result of liquidity, financing and refinancing problems at most Ukrainian banks. The depreciating currency exacerbated the problem, and lost confidence in the system saw worried depositors withdraw their money en masse. As a result, refinancing much of the external debt repayments faced by the Ukrainian banking sector became difficult. In October, the NBU prohibited the pre-term withdrawal of deposits. It also placed those banks most affected by the crisis under temporary administration and injected substantial liquidity via long-term refinancing. Also, it enlisted international auditors to carry out diagnostic 'stress tests' on the banking sector to determine whether any further capital injections were required.

In November 2008, the IMF approved a USD 16.4 billion, 24-month stand-by arrangement, to help Ukraine stabilise the impact of the crisis. An initial tranche, amounting to USD 4.5 billion, was drawn down soon afterwards, and a second tranche worth USD 2.8 billion was received in May 2009. The third tranche of USD 3.3 billion was granted in late July 2009. The IMF set strict conditions, including a tightening of fiscal and monetary policy and

a significant reform of exchange-rate policy. This includes the introduction of a flexible exchange rate.

The Ukrainian parliament has also adopted an anti-crisis law, designed to stabilise the banking system and the real estate sector. Other sectors of the economy (metals and chemical producers, construction companies, agriculture and the food industry) are also expected to receive government assistance.

Despite the fact that the economic crisis has exposed many structural weaknesses, the underlying fundamentals remain stable. Ukraine has traditionally maintained a fairly tight fiscal policy, flexible government budget and current account surplus. Ukraine enjoys a relatively low amount of public debt. The total amount of Ukraine's sovereign and quasi-sovereign debt repayment for 2009 is USD 3 billion, a figure that is manageable, given the country's foreign currency reserves of USD 26.5 billion as at 1 March 2009.

Despite strong growth in recent years, Ukraine's GDP per capita is still significantly below most other Central European countries. This is advantageous, however, in that it leaves sufficient room for long-term, above average economic growth following emergence from the crisis, as living standards continue to converge with European averages.

The country also enjoys great natural resource wealth, particularly in terms of its rich agricultural land and large iron ore deposits. Formerly known as the 'bread basket' of the Soviet Union, Ukraine accounted for about a quarter of Soviet grain production, one fifth of its meat and dairy output, and more than half of its sugar beet production. The country also boasts about 20% of global iron ore reserves, nearly 25% of the world's black-soil, and over 30% of the world's manganese ore reserves, and is counted among the world's top 10 steel producing countries.

The structure of GDP did not change significantly, with major movements in agriculture (which increased from 7.4% to 8.6% of total GDP) and construction (which decreased from 4.4% to 3.7%). Manufacturing showed growth during the past year, but a sharp decrease in the fourth quarter affected the year-on-year indicator, resulting in a total decrease of 3.1%. The chemical manufacturing, engineering industry and mining and smelting sector decreased the most in the fourth quarter 2008 by some 29-45%, in comparison with fourth quarter 2007.

The banking sector, which represents the most developed and advanced part of the country's financial system, increased its total lending by 71.9%, with a simultaneous increase in deposits by 27.7%. Agriculture became the leading sector in 2008, with a 17.5% growth in real volume. Difficulty in obtaining credit caused a 16% year-on-year decrease in all types of construction work in comparison with 2007.

The EURO 2012 Football Championship finals are to be held in Ukraine and Poland. A massive direct impact on the Ukrainian economy is expected, with preparation set to cost some USD 25 billion in Ukraine alone. The Ukrainian government expects 75% of this to be covered by private investment in sport infrastructure and transport connections, including the construction and development of seven airports, railways and motorways, across the country, alongside the development of modern public transport systems (metro, trams, trolleybuses, and buses) in all host cities.

Ukraine	2005/2007 Average Values	2007-2008	2008
	Change (%)	Change (%)	
Population (mil.)	-0.7	-0.7	46.0
Average monthly gross wage (EUR)	32.8	-10.8	163.3
EUR Exchange rate vis-à-vis	1.7	49.9	11.1
USD Exchange rate vis-à-vis	-1.6	54.6	7.8
	Real change (%)	Real change (%)	EUR mil.
GDP	6.0	2.1	85,882
Private consumption	15.8	6.4	62,843
Public consumption	2.0	0.3	5,716
Gross fixed capital investments	18.9	-24.8	24,773
Exports (goods and services)	-3.3	-10.4	40,222
Imports (goods and services)	12.7	-4.2	47,149
	Nominal change (EUR mil.)	Nominal change (EUR mil.)	EUR mil.
Trade balance	-3,505	-5,258	-13,070
Current account balance	-3,042	-5,074	-9,121
General government balance	218	-202	-1,028
General government gross debt	66	5,096	17,126
External debt	599	255	10,290
Foreign currency reserves	4,920	-20	21,716
	Percentage point change	Percentage point change	%
Economic activity rate	0.7	0.8	68.3
Unemployment rate	-0.4	0.7	3.0
CPI rate (previous year = 100%)	5.5	5.7	22.3
Central bank interest rate	-0.3	4.0	12.0
1-year yield on Treasury Bill	n/a	n/a	n/a
10-year yield on Treasury Bond	n/a	n/a	n/a

Sources used: Reuters EcoWin Pro

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