

Macroeconomic stabilisation in Ukraine

During the last two years Ukraine experienced how difficult life is under the absence of macroeconomic stability. Stable macroeconomic conditions are essential for the wellbeing of the population and at the same time a necessary precondition for economic growth.

Currently all macroeconomic indicators reflect that Ukraine is on the right path. The GDP is growing after two years of severe recession, investment increases, inflation is below 10% and the exchange rate is relatively stable. Also, the budget and current account deficits are decreasing – in 2016 they will amount to 4%, respectively 2% of the GDP.

This successful path could be entered in spite of extremely unfavourable external conditions including the conflict in the Eastern part of the country, the increasingly limited access to the Russian and Central Asian markets and the low prices for the two most important Ukrainian export goods – grain and steel.

Achievements have been made especially in the banking sector and in energy prices, but the speed of reforms in other sectors has to be increased. A sustainable macroeconomic stabilisation can be reached only if the population will profit from it in form of increased incomes.

The importance of macroeconomic stability

One reads much about the importance of macroeconomic stability, but few really understand what macroeconomic instability actually implies. In 2014 and 2015 Ukrainians experienced how difficult life under unstable economic conditions is.

Not only the people but also the economy suffers from its disadvantages. One of the problems is that companies have to invest much time to find a way to cope with capital controls. This makes external trade complicated and costly.

Another problem is the servicing of loans, which becomes increasingly expensive due to the currency devaluation. Additionally, enterprises are no longer granted new loans by the banks. Many banks go bankrupt, which brings about the partial loss of deposits of companies and individual clients.

Also, foreign investors are negatively affected by unstable conditions, if profits cannot be repatriated. This has a negative impact on the investment climate. It is obvious that under such circumstances economic growth is not feasible.

The current state of macroeconomic stabilisation

Currently all relevant indicators reflect the stabilisation of the macroeconomic situation. GDP growth will amount to 1.5% in 2016 and investment increased by 9.6% in the first half of 2016. Inflation decreased from over 60% in April 2015 to less than 10%. The exchange rate is also relatively stable. A stable exchange rate is not to be mistaken for a fixed exchange rate, which had been in place in Ukraine until the beginning of 2014 and was one of the main reasons for the country's macroeconomic destabilisation.

Due to the current trend capital controls can now be gradually reduced. Thus, profits can again be repatriated, which increases Ukraine's attractiveness for investors.

Also, control over the large budget deficit could be regained. It amounted to 10% of the GDP in 2014 and will decrease to approx. 4% in 2016.

Furthermore, the current account deficit decreased significantly: from 9% in 2013 to approx. 2% in 2016. The strong reduction of gas imports has contributed to this development. Altogether the Ukraine is heading in a good direction of economic development.

Stabilisation under difficult conditions

The difficult external conditions under which macroeconomic stabilisation is being achieved, are not often mentioned. The conflict in Donbass led to a massive flight of capital since 2014. Also, it forced Ukraine to increase its military expenditures in spite of the heavy economic crisis (USD 4.4 bn in 2014, respectively approx. 5% of GDP). Last but not least, the 1.7 m registered internally displaced people made additional expenditures necessary.

At the same time access to the Russian market worsened. In 2013 exports to Russia amounted to USD 15 bn, but decreased to USD 4.8 bn in 2015. An end of this trend is not in sight, as exports to Russia continue to decrease. Also export to Central Asia becomes increasingly difficult, as transit through Russia is frequently being hindered.

Additionally, the low commodity prices, which have fallen strongly in the last year, have a negative impact - especially as grain and steel are the country's two most important goods of export. This development - next to decreasing exports to Russia - is one of the main reasons for Ukraine's decrease in exports.

It is a great achievement that the current level of stabilisation could be reached in spite of such negative external conditions.

The long-term impact of stabilisation

It has to be stressed that the achievements made do not reflect a temporary state of stabilization. Instead they are backed by reforms aiming at a long-term impact. The deep structural reforms of the banking sector serve as an example. Before the crisis there were around 180 active banking institutions in Ukraine, many of which operated with a non-transparent business concept, like the “oligarch banks”, which used clients’ deposits to finance own businesses. Currently around 80 of these non-transparent banks are liquidated.

Their closure contributes to diminish long-term risks in the financial sector and the state budget. The National Bank of Ukraine faces harsh criticism after ordering the closures. We argue that this criticism is grounded upon the oligarchs’ interests and should not be taken into account by the National Bank.

Another important example is the increase of energy prices to a cost-covering level. In the past, the subsidization of energy prices has been a heavy burden for the Ukrainian state budget and the current account balance alike. Both get relieved by these measures, which are painful in the short-run, but allow for more efficient energy spending and a decrease in corruption in the future. Thus, the stabilization in Ukraine, which is backed by reforms, is a sustainable trend.

Macroeconomic stabilisation and reform speed

The achieved stability is a positive development for the people in Ukraine, but not yet sufficient. People expect the reform and stabilization efforts to translate into higher incomes and a higher standard of living. In order to reach that, the speed of reforms has to be increased significantly.

If this does not happen, people may lose patience and demagogues may gain influence. The achievements may deteriorate in case the staff of key positions is exchanged or important reforms are cancelled. In this case the IMF programme will be suspended and macroeconomic instability might return.

Sustainable macroeconomic stability is possible only in the case of quick reformation of the country. This has to be understood not only by the government, but also by the parliament and the oligarchs, who still have an influence on politics.

Conclusion

Macroeconomic stability is essential for Ukraine’s further economic development. Ukraine is on a good path in spite of difficult external conditions. The International Monetary Fund is an important partner in this process. It is running a medium-term programme with Ukraine, which aims not only at short-term stabilization, but also at long-term reforms. This includes, first of all, the energy sector, tax policy and the fight against corruption. Without the IMF’s support and pressure many achievements would not have been made, such that it is very important to continue cooperation.

On September 14 the IMF approved the third tranche of USD 1 bn, after Ukraine had proved the successful implementation of further reforms. These payments, which are a condition to further payments by the EU, the USA and other donors, will contribute to further stabilisation of the country.

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