

Ukraine's economy plunges into recession

Arkadiusz Sarna, Gospodarka Ukrainy pogrąża się w recesji

Statistics published over the last few days have confirmed the persistence of the economic recession in Ukraine which began in mid-2012. In the first quarter of this year, the value of industrial production decreased by about 5%, and that of construction by 16.8%; only agriculture bucked this trend, rising by 5.8%. Foreign trade dynamics remain weak. Although exports rose (over the first two months of this year) by 1.9%, to US\$10.5 billion (even though metallurgy exports are still falling), imports fell by up to 6.3%, to US\$11.4 billion (mainly due to a decrease in gas imports of over 23%). It has not yet been announced, but another likely quarterly decline in GDP means that hopes of a rapid recovery from the recession and meeting the government's target of GDP growth of 3.4% are not realistic. The prolonged recession has also caused a further reduction of Ukraine's GDP growth forecast in 2013; the World Bank has reduced its forecast from 3.5% to 1%, and the International Monetary Fund from 3.5% to 0%. In its April 2013 World Economic Outlook, the IMF predicts that this year Ukraine will post the worst result of all the CIS countries.

Commentary

- The ongoing recession is mainly related to the slump in overseas markets, which are the key customers of Ukrainian exports (export-oriented sectors generate up to 60% of Ukraine's GDP). Other countries in the region have also achieved weaker results, including Kyiv's economic partners (including Russia and the CIS, the euro area and Central Europe), and forecasts by international financial institutions do not foresee a speedy improvement in these markets.
- Kyiv is trying to counter the recession by stimulating domestic demand, in order to maintain a positive growth in real income for the population, and by announcing support for domestic industry. However this will be very difficult, in conditions of a budget deficit (a lower GDP translates to lower than planned revenues and higher budget deficits) and the large financial demands this year connected to foreign debt (about US\$10 billion). The main source for financing the deficit is the issuing of new debt: in the first quarter, the Ministry of Finance borrowed about 43 billion hryvnia (over US\$5 billion), while paying off only 14.8 billion hryvnia during that time (including only part of the foreign debt). This has caused public debt to rise (although so far it is still at a safe level: under 40% of GDP).

- Ukraine could be assisted by the start of a new IMF loan worth about US\$15 billion. However, this would require a number of reforms (including increases in domestic gas prices), which would cost the government politically in the context of the presidential elections planned for 2015. Kyiv's position in its negotiations with the IMF, which have been ongoing for some months, is also influenced by the possibility of agreement with Russia (and a reduction in the price of imported gas), but this would require costly decisions of a non-economic nature: the creation of a gas consortium on Moscow's conditions, or membership in the Customs Union. This is why Kyiv will put off taking any strategic decisions – as long as the market situation allows (that is, as long as the budget deficit can be financed by the sale of bonds on the domestic and foreign markets).