

Ukraine experiencing growing economic difficulties

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The Ukrainian statistical office has announced that Ukraine's gross domestic product fell by 1.5% between September and July, marking a fifth consecutive quarter of declining GDP. The poor economic performance is translating into budget revenues much lower than had originally been planned, and into a larger budget deficit. This is also causing rising tensions over the necessity to make cuts in a number of public spending categories. On 1 November, after the government had repaid the penultimate instalment of its IMF loan for 2013, only 410 million hryvnia (around US\$ 50 million) of unallocated funds remained in the state treasury account; this is the lowest amount recorded in the last ten years. In order to stop the budget revenue from declining further, the government is considering reversing the CIT and VAT tax rate reductions as of 2014, which had originally been planned in the Tax Code.

Commentary

- The negative economic growth is due to the fact that the situation in foreign markets remains unfavourable, including the problems with Ukraine's constantly deteriorating access to the Russian market, as well as dwindling investments and internal demand, a trend that reflects the unfavourable investment climate in Ukraine. With the current economic indicators, the government will not be able to achieve its macroeconomic targets for 2013 (including GDP growth of 3.4%), and in practice there will be no chance of even minimal economic growth this year. The poor macroeconomic performance has also made cuts necessary to a number of public spending categories (mostly investments and transfers to local governments, but in the last several months, also some fixed spending items such as public sector salaries).
- Given Ukraine's deteriorating credit rating and the fact that it is less and less able to borrow from the international markets, the contracting budget revenues will limit the government's capacity to implement any crisis management measures. This has already caused a problem with paying the bill for August gas deliveries from Russia (more than US\$ 880 million); Gazprom has agreed to postpone the payment deadline until the end of October, but as of 4 November it had confirmed the receipt of only a small portion of the total amount, i.e. around US\$ 70 million. Even though state-owned Naftogaz is formally responsible for the gas settlements, its disastrous financial situation means they often have to be covered by the state budget (through provision of extra capital to the company in the form of additional issues of government bonds, guarantees of Naftogaz's loans, etc.).

- The Ukrainian government is currently negotiating a new IMF loan of around US\$ 15 billion and has signalled that they might be prepared to implement some of the Fund's recommendations (such as a reduction in budget expenditure by limiting tax privileges and public administration costs, or a more flexible hryvnia exchange rate). However, they have been postponing the IMF-recommended gas price increase for domestic consumers in the hope that the economic situation will improve, and because they fear an escalation of negative public sentiment (the Ukrainian government has suggested that the increased prices would apply only to a narrow group of the richest citizens who consume more than 3.5 thousand m³ a year). Kyiv's games with the main potential creditors, i.e. Russia and the West, are being played over the coming Eastern Partnership summit in Vilnius and may suggest that the ultimate decisions of the Ukrainian government concerning the issues to be determined in Vilnius will depend on the progress made with regard to the financial support, which, given the current macroeconomic situation, seems to be Ukraine's only hope for avoiding a collapse of public finances.