UKRAINE

Table 1	2018
Population, million	44.5
GDP, current US$ billion	124.6
GDP per capita, current US$	2799
International poverty rate ($1.9)[a]	0.1
Lower middle-income poverty rate ($3.2)[a]	0.5
Upper middle-income poverty rate ($5.5)[a]	6.4
Gini index[a]	25.0
Life expectancy at birth, years[b]	71.5

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2016), 2011 PPPs.
(b) Most recent WDI value (2016)

In 2018 GDP growth accelerated to 3.3 percent, but macroeconomic vulnerabilities remain. Growth was supported by a record harvest, services, and favorable domestic demand conditions. Consumption continued to grow due to higher public spending, real wages, and remittances. Investment is held back by uneven reform progress, election related uncertainties, and low domestic savings. The growth outlook depends on accelerating reforms and mobilizing adequate financing as Ukraine faces formidable financing needs to repay its public debt in 2019-2021.

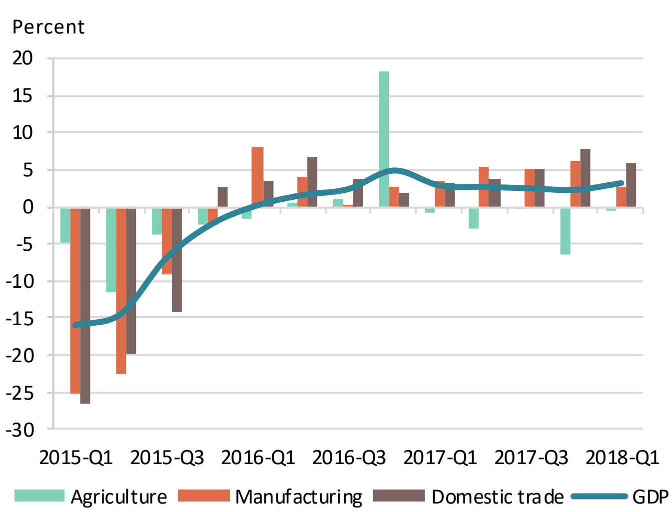
Recent developments

In 2018, GDP grew by 3.3 percent (after 2.3 and 2.5 percent in 2016 and 2017 respectively). The pickup in growth was driven by a good agricultural harvest, and sectors dependent on domestic demand—domestic trade and construction (which both grew by over 5 percent). Household consumption continued to grow rapidly in 2018 on the back of (i) significant hikes in public sector wages and pensions; (ii) sizable remittance inflows due to labor migration to EU countries; and (iii) resumption of consumer lending. At the same time, investment growth decelerated to around 9 percent (vs 18 percent in 2017) due to reform delays, election and conflict-related uncertainties, and continued low domestic savings. Structural weaknesses remain in the banking system and the real sector. The debt overhang and legacy nonperforming loans in the corporate sector still remain high. FDI inflows remained low (just 2 percent of GDP) for the third consecutive year.

Higher consumption helped reduce poverty but pressures on the current account have intensified. Real wages continued to grow in 2018 due to further increases in minimum wages and pressures from outward labor migration. After four consecutive years of decline, pensions increased by 22.2 percent in real terms in 2018. As a result, poverty (consumption per capita below 5.5 USD/ day in 2011 PPP) declined to 4.0 percent in 2018 from 4.9 percent in 2017 and 6.4 percent in 2016. Strong domestic demand, together with real exchange rate appreciation, contributed to a pick-up in imports and a widening of the current account deficit to 3.7 percent of GDP in 2018 (vs 1.9 percent in 2017). Remittances reached 9 percent of GDP in 2018, but they were not sufficient to cover the growing trade deficit.

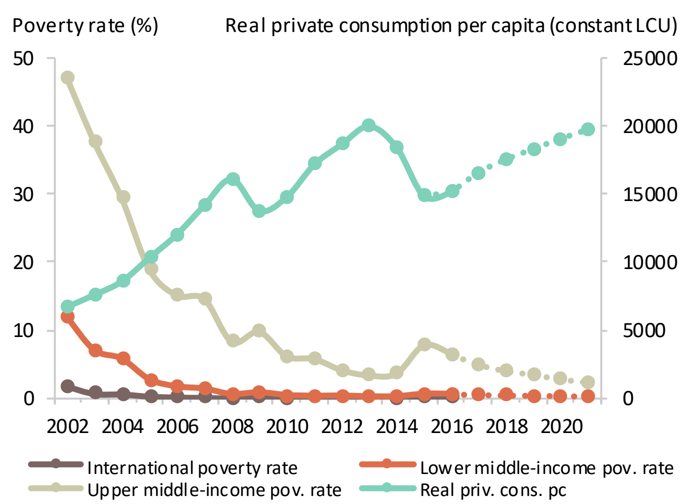
Monetary policy helped to maintain a macroeconomic stability. Fiscal deficit amounted to 2.1 percent of GDP (vs 2.3 percent in 2017) that helped to reduce PPG to 63 percent of GDP in 2018. At the same time, significant hikes in minimum wages and additional sectoral top-ups resulted in the wage bill to grow up to 11 percent of GDP (vs 9 percent in 2016). Social assistance spending remained high at 4 percent of GDP. To deal with the outcomes of higher current expenditures the National bank increased the policy rate sharply over 2018 to 18.5 percent, although this has raised the cost of funds and dampened investment. With limited access to external funds, domestic public borrowings have increased in 2018 crowding out the private sector investment. This limited the supply responses to the growing demand pressures. As a result, the external trade deficit has widened significantly in 2018. Ukraine's renewed cooperation with the IMF, EU and WB helped to cover the current account deficit and to rebuild international reserves that reached $20.8bn (or equivalent of 3.5 month of import cover).

FIGURE 1 Ukraine / GDP growth by sectors



Sources: UKRSTAT, World Bank.

FIGURE 2 Ukraine / Actual and projected poverty rates and real private consumption per capita



Source: World Bank. Notes: see table 2.

Outlook

The growth outlook depends critically on sustaining the reform momentum to support investment and mobilizing adequate financing. In 2019, growth is projected at 2.7 percent as investment remains constrained by difficult external conditions, election-related uncertainties, and the resulting high cost of external borrowing. In addition, Ukraine's terms of trade are projected to soften and limit traditional exports. Growth in 2019 will thus continue to be supported by the services sectors and consumption. The continued growth of consumption is expected to help continue to mildly reduce poverty.

Going forward, if the reform momentum is sustained, growth can recover to 4 percent in the medium term after election related uncertainties abate. This will require progress in the following areas: (i) attracting private investment into tradable sectors by improving the business environment and privatizing large state-owned enterprises, developing a market for agricultural land, and tackling corruption; (ii) ensuring fiscal sustainability through affordable implementation of the health and education reform, rationalizing social assistance, and a more equitable and growth-friendly tax system; (iii) further reducing inflation and rebuilding reserves; and (iv) reviving sound bank lending to the enterprise sector. If reforms do not progress and adequate financing is not mobilized, growth could fall below 2 percent as investor confidence deteriorates, macroeconomic vulnerabilities intensify, and financing difficulties force a compression in domestic demand.

Risks and challenges

Ukraine faces formidable financing needs in the next three years, which will require mobilizing sizable international financing and meeting the fiscal target of a deficit of 2.5 percent of GDP to maintain macroeconomic stability. Ukraine needs about $11 billion per year (8 percent of GDP per year) to repay public debt and finance the fiscal deficit in 2019, 2020, and 2021. To raise the necessary financing, it is critical to maintain the reform momentum and stay on track with completion of IMF reviews. Ukraine will continue to need an IMF program after the SBA runs out in March 2020.

Ukraine remain highly vulnerable to external shocks and commodity price cycles due unfinished structural transformation of the economy. To increase resilience to external shocks Ukraine will need higher and more sustainable economic growth, supported by tradable and higher value-added sectors. This will require significant capital investments and deeper integration into global value chains. To facilitate investments, it is critical to maintain the reform momentum, reduce macroeconomic risks and insure repayment of public external obligations.

TABLE 2 Ukraine / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016	2017	2018 e	2019 f	2020 f	2021 f
Real GDP growth, at constant market prices	2.3	2.5	3.3	2.7	3.4	3.7
Private Consumption	1.8	8.4	8.9	3.8	3.5	3.0
Government Consumption	0.0	3.3	0.1	0.5	1.0	1.5
Gross Fixed Capital Investment	20.1	18.4	14.3	6.6	9.3	9.6
Exports, Goods and Services	-1.6	3.6	-1.6	0.5	2.0	4.5
Imports, Goods and Services	8.4	12.8	3.2	3.8	4.2	5.0
Real GDP growth, at constant factor prices	2.4	2.6	3.3	2.5	3.4	3.7
Agriculture	6.0	-2.5	7.8	1.5	2.5	4.5
Industry	3.3	2.1	2.0	3.0	4.5	6.0
Services	1.4	3.7	3.0	2.4	3.2	2.7
Inflation (Consumer Price Index)	13.9	13.7	9.5	6.8	6.0	5.4
Current Account Balance (% of GDP)	-3.7	-2.1	-2.9	-3.0	-3.5	-3.7
Net Foreign Direct Investment (% of GDP)	0.2	2.1	1.9	2.2	2.4	2.5
Fiscal Balance (% of GDP)	-2.3	-2.3	-2.0	-2.1	-2.2	-2.4
Debt (% of GDP)	81.2	72.3	63.2	60.1	57.9	55.7
Primary Balance (% of GDP)	2.0	1.5	1.9	2.3	1.9	2.3
International poverty rate ($1.9 in 2011 PPP)[a,b]	0.1	..	..	..	..	..
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	0.5	0.4	0.3	0.3	0.2	0.2
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	6.4	4.9	4.0	3.4	2.8	2.3

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2016-HLCS. Actual data: 2016. Nowcast: 2017-2018. Forecast are from 2019 to 2021.
(b) Projection using neutral distribution (2016) with pass-through = 0.87 based on private consumption per capita in constant LCU.