UKRAINE

Table 1	2020
Population, million	44.0
GDP, current US$ billion	137.3
GDP per capita, current US$	3118.4
International poverty rate ($1.9)[a]	0.0
Lower middle-income poverty rate ($3.2)[a]	0.2
Upper middle-income poverty rate ($5.5)[a]	2.5
Gini index[a]	26.6
School enrollment, primary (% gross)[b]	99.0
Life expectancy at birth, years[b]	71.6

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2019), 2011 PPPs.
(b) Most recent WDI value (2018).

With an estimated contraction of 4.5 percent, the economic impact of COVID-19 has been smaller than in most other countries, nevertheless the pandemic has caused a heavy toll on households and weakened the commitment by the government to undertake critical reforms. Only a partial recovery in GDP growth of 3.8 percent is expected in 2021, given high uncertainty regarding the rollout of the vaccine and the slow pace of structural reforms to address bottlenecks to investment and to safeguard macroeconomic sustainability.

Key conditions and challenges

Even prior to the COVID-19 outbreak, Ukraine faced structurally weak growth due to low levels of domestic savings and fixed investment. Until 2020, savings represented up to 5 percent of GDP and gross capital formation was above 10 percent over the last five years. While the pandemic and associated recession has temporarily reversed this trend, savings estimated at 11.3 percent of GDP in 2020 and investment at around 7 percent are well below comparator countries with similar development and infrastructure needs. Reforms that address structural weaknesses in the financial sector; reduce market distortions, including due to still dominant role of SOEs in select sectors; and address macroeconomic vulnerabilities are paramount to increase investment. In addition, while household incomes have grown rapidly in recent years, this has increasingly been driven by transfers rather than labor incomes, a pattern that is unsustainable for effective poverty reduction.

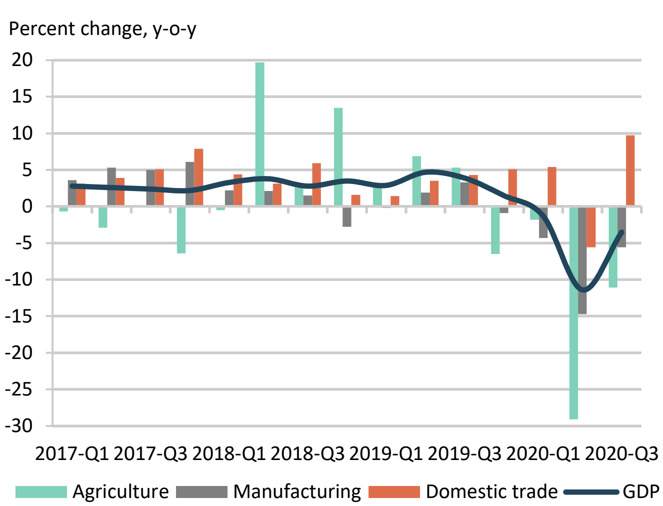
The COVID-19 outbreak redirected government policy from structural reforms towards ad-hoc reactive measures. As a result, macro-fiscal risks have increased. Public sector financial needs are expected to grow due to increases in minimum wages and social transfers, limiting space for public investment, and fueling inflationary pressures in a supply-constrained economy. Additionally, large government domestic borrowings are crowding out much needed private investment. Holdings of government securities already represent close to 30 percent of total assets of the state-owned banks while corporate lending continues to stagnate. Stronger fiscal discipline is needed to reduce risks for medium-term growth prospects.

Recent developments

Although the economic impact from the COVID-19 outbreak appears to be less severe than initially anticipated – GDP declined by estimated 4.5 percent in 2020 (vs 6.5 percent decline 1H2020) – the pandemic has exacted a heavy toll in terms of health and mortality impacts; and undermined the government's commitment to undertake critical reforms. Recent anti-corruption reforms have also suffered setbacks due to adverse court rulings in late 2020.

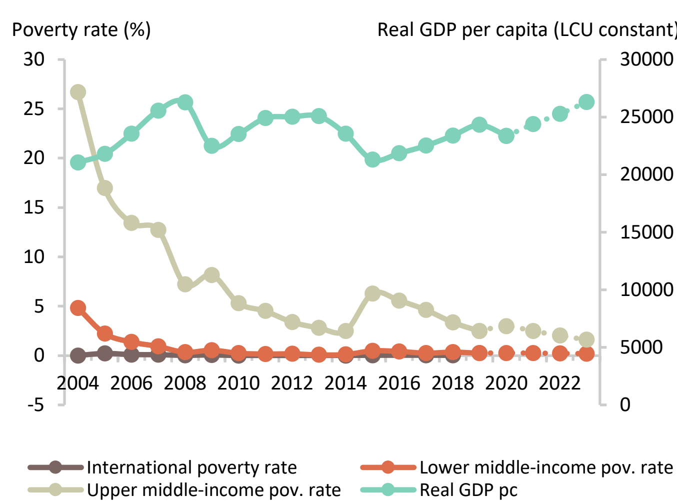
Economic activity recovered in H2 2020 supported by a number of measures to mitigate the impact of COVID-19. Moreover, the full-scale lockdown has been replaced by an adaptive quarantine in June 2020 that enabled many services to return to normal functioning. Domestic demand was boosted by over 10 percent YoY real wage growth due to increase in minimum wages and gradual recovery in economic activity. Thus, on the supply side, retail and wholesale trade grew 7.9 percent YoY in 2020 and made a significant positive contribution to GDP growth. The financial sector has weathered the downturn with its capital adequacy still strong. At the

FIGURE 1 Ukraine / GDP and sectoral growth



Source: State Statistics Service of Ukraine.

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



Source: State Statistics Service of Ukraine.

same time, agriculture output fell almost 12 percent due to drought and a poor harvest.

On the external side, lower energy and higher iron and grain commodity prices resulted in the most favorable terms of trade for Ukraine for the last decade. Combined with import compression, this resulted in a CA surplus of 4.4 percent in 2020. Remittances were relatively resilient, down only 5.3 percent YoY in 2020, while private capital inflows also recovered in 2H2020. Thus, international reserves reached US$29.1bn at end-December, equal to 4.7 months of next year's imports.

Following the smaller-than-expected economic decline, fiscal revenue also performed better than anticipated. On the expenditure side, COVID-19 related outlays were less than budgeted, and a portion of the pandemic special fund was redirected to capital expenditures and to support a public sector wage and pension increase. The fiscal deficit amounted to 6.2 percent of GDP vs. the initial plan of 7.6 percent.

After two years of tight monetary policy, the National Bank of Ukraine gradually cut its key policy rate to 6 percent in June 2020, a level it has since maintained However, a more accommodative fiscal policy stance resulted in an increase in inflation expectations from 6.7 percent in August to 8 percent at year-end. The inflation rate grew from 2.5 percent on average in Q1-Q3 2020 to 6.1 percent in January 2021 that is slightly above the NBU's target of 5+/-1 percent. This triggered the key rate increase to 6.5 percent in March 2021.

While the COVID-19 relief measures were welcome, attention once again needs to turn towards structural reforms that are needed to raise the medium-term growth prospects. Slower reform momentum has undermined investors' confidence and delayed IFI financing; as a result, significant public financing needs in 2020 have been met mostly by domestic borrowing that amounted to 10.5 percent GDP (gross). The composition of external financing was shifted towards more expensive commercial borrowings and Eurobonds comprising 4.3 percent of GDP in total.

The poverty effects of COVID-19 are expected to be relatively muted, with the poverty rate based on US$5.5 a day projected to have increased by 0.5 pp to 3 percent in 2020, as increase of pensions and wages helped to partially offset decline in employment.

Outlook

Ukraine's economic recovery in 2021 is expected to be mild given high uncertainty associated with the vaccine rollout and the direction of economic policies to address bottlenecks to investment and safeguard macroeconomic sustainability. The GDP growth projection of 3.8 percent is underpinned by positive base effects in agriculture and processing industry and takes into account that further temporary lockdowns are possible in the first half of 2021 due to the delays in vaccinations.

The 2021 budget targets a 5.4 percent deficit. Together with 10.5 percent of GDP debt amortization and 1.3 percent of GDP of arrears to private sector, this will increase total fiscal financing needs to 17.2 percent of GDP (vs 15 percent of GDP in 2020). The increase in minimum wages will push the public wage bill to over 11 percent of GDP and create additional pressures on current account imbalances and inflation. Prudent fiscal policy is needed to address inflationary pressures in the medium term.

The poverty rate based on the US$5.5 a day threshold is expected to decrease to 2.5 percent in 2021, similar to the level in 2019. Accelerating the reform momentum is key to achieve faster economic growth and poverty reduction in 2022 and 2023.

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

	2018	2019	2020 e	2021 f	2022 f	2023 f
Real GDP growth, at constant market prices	3.3	3.4	-4.5	3.8	3.0	3.5
Private Consumption	8.9	11.9	-3.0	4.6	3.8	3.5
Government Consumption	0.1	-5.0	1.8	1.5	0.0	0.0
Gross Fixed Capital Investment	14.3	15.0	-27.4	9.7	8.4	7.5
Exports, Goods and Services	-1.6	6.7	-7.4	3.4	2.0	4.4
Imports, Goods and Services	3.2	6.3	-11.5	6.8	5.0	4.8
Real GDP growth, at constant factor prices	3.3	3.4	-4.6	3.9	2.9	3.5
Agriculture	7.8	1.3	-7.0	5.0	4.5	5.0
Industry	2.0	-2.0	-4.0	2.0	3.0	4.5
Services	3.0	5.7	-4.4	4.4	2.6	2.9
Inflation (Consumer Price Index)	9.8	4.1	4.8	5.0	5.0	5.8
Current Account Balance (% of GDP)	-3.2	-0.9	4.4	-1.3	-2.8	-3.3
Net Foreign Direct Investment (% of GDP)	1.9	2.1	2.2	2.4	2.6	6.2
Fiscal Balance (% of GDP)	-2.0	-2.0	-6.1	-5.4	-4.0	-2.5
Debt (% of GDP)	60.6	50.4	63.2	62.4	59.7	57.8
Primary Balance (% of GDP)	1.4	1.1	-2.4	-0.9	0.1	1.8
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	0.4	0.2	0.3	0.2	0.2	0.2
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	3.4	2.5	3.0	2.5	2.0	1.6

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate. f = forecast.
(a) Calculations based on ECAPOV harmonization, using 2019-HLCS. Actual data: 2019. Nowcast: 2020. Forecast are from 2021 to 2023.
(b) Projection using neutral distribution (2019) with pass-through = 0.87 based on GDP per capita in constant LCU.