UKRAINE

Highlights

- **The economy started to recover in the second quarter of 2021.** The prolonged lockdown caused economic growth to decline by 2.2 per cent year-on-year in the first quarter of 2021 but the gradual lifting of containment measures and high commodity prices supported a growth of 5.7 per cent year-on-year in the second quarter.
- **The authorities renewed Covid-19 crisis response measures throughout the first half of 2021.** In December 2020 parliament adopted a new set of fiscal measures to support the economy during the prolonged Covid-19 pandemic. The central bank has extended some prudential measures in 2021 and kept crisis liquidity instruments until the middle of the year.
- **After a long delay, parliament approved a series of key reform bills.** These include reinstating criminal liability for inaccurate asset declarations of public officials, strengthening the independence and regulatory power of the central bank and taking steps to reform the judiciary.

Key priorities for 2022

- **It is important to preserve reform achievements in the area of macro-financial stability and intensify reform efforts in the judiciary, anti-corruption and corporate governance.** An independent and professional central bank proved to be a great asset during the Covid-19 economic shock. Building an independent and professional judicial system, efficient anti-corruption bodies and good corporate governance in state-owned enterprises (SOEs) will lift the growth potential of the economy.
- **Post-Covid-19 recovery policies should focus on climate change and digitalisation.** A green-tilted recovery is necessary to reduce dependence on fossil fuels and to maintain the country's competitiveness on external markets, which increasingly take climate change into account. A systemic upgrade of digital infrastructure and skills, targeting all groups of society, could also boost competitiveness.
- **Preparations should be made to benefit from the expected reshuffle of global value chains.** As one of the largest economies in the European Union (EU) neighbourhood, Ukraine could play a significant role in the expected nearshoring efforts of companies in the EU.

Main macroeconomic indicators %

	2017	2018	2019	2020	2021 proj.
GDP growth	2.5	3.4	3.2	-4.0	3.5
Inflation (average)	14.4	10.9	7.9	2.7	9.5
Government balance/GDP	-2.2	-2.1	-2.2	-5.8	-4.5
Current account balance/GDP	-3.1	-4.9	-2.7	3.4	-0.7
Net FDI/GDP [neg. sign = inflows]	-3.3	-3.4	-3.4	0.1	-1.7
External debt/GDP	102.9	87.6	79.1	80.8	n.a.
Gross reserves/GDP	16.8	15.9	16.4	18.7	n.a.
Credit to private sector/GDP	34.1	30.1	24.4	22.6	n.a.

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Covid-19: macroeconomic implications

After a contraction in 2020 and the first quarter of 2021, the economy has returned to growth in the second quarter of 2021. In 2020 gross domestic product (GDP) declined by 4.0 per cent as a result of reduced foreign demand and Covid-19 pandemic containment measures. Private consumption remained slightly in positive growth territory, driven by a strong demand for goods, but investments in fixed assets fell by almost a quarter despite strong government stimulus in the roads sector. Exports and imports declined by 5.6 and 9.5 per cent respectively. A prolonged lockdown in early 2021 caused the economy to shrink by 2.2 per cent year-on-year in the first quarter of 2021, before returning to a growth of 5.7 per cent year-on-year in the second quarter of 2021, supported by higher commodity prices.

The Covid-19 pandemic caused a reversal of previous trends in public finances and the external sector. After several years of prudent fiscal policies, the government deficit deepened to 5.8 per cent of GDP in 2020 due to increased spending to finance the Covid-19 response. On top of that, the fall of output and currency depreciation led to an increase in public debt from 50.3 per cent in 2019 to 60.8 per cent in 2020. The current account deficit turned into a strong surplus of 3.4 per cent of GDP in 2020, supported by low prices of imported hydrocarbons, reduced spending on travel abroad and an increase in the primary income surplus. As a result, foreign reserves rose from US$ 25.3 billion in December 2019 to US$ 29.1 billion in December 2020, equal to 4.8 months of future import coverage. Reserves were boosted further in September 2021 by the new International Monetary Fund Special Drawing Rights allocation of US$ 2.7 billion, which fully compensated for the undisbursed remaining part of the Stand-By Arrangement (SBA) programme.

Inflation is rising, prompting the central bank to raise the policy rate. Driven by rising prices of utilities, food and transport, inflation accelerated in the first half of 2021 and reached 11.0 per cent in September 2021, prompting the National Bank of Ukraine (NBU) to raise the key policy rate four consecutive times since the beginning of the year to 8.5 per cent in September 2021.

A moderate recovery in 2021 is likely amid rising global commodity prices and erratic reform progress. The growth recovery which took hold in the second quarter of 2021 is expected to gain further traction in the second half of the year. We expect an economic growth of 3.5 per cent both in 2021 and 2022. Major downside risks remain, however, including the slow speed of vaccinations, the possibility of new variants emerging, and the slow progress of reforms.

Policy response to Covid-19

In December 2020 parliament adopted a new set of fiscal measures to support the economy during the prolonged Covid-19 pandemic. To help businesses during the strict lockdown in January 2021, a one-off payment of UAH 8,000 (US$ 280) was made to more than 400,000 employees and sole entrepreneurs who lost their income. Those entrepreneurs most affected by the Covid-19 pandemic were exempted from paying income tax and social security distribution tax in the period December 2020 to May 2021, and tax debts not exceeding UAH 3,060 (US$ 110) were written off. The subsidised loans programme, which was expanded at the beginning of the Covid-19 crisis, continued in 2021. In addition, parliament approved state guarantees amounting to US$ 180 million for business loans granted by banks.

The central bank has extended some prudential measures in 2021 and kept crisis liquidity instruments until the middle of the year. Banks were recommended to restructure loans of borrowers facing financial difficulties from the Covid-19 pandemic and refrain from credit risk revision until the end of April 2021. As the economy returned to a steady growth and financial markets stabilised, the NBU decided in June 2021 to gradually phase out anti-crisis monetary measures such as long-term refinancing and interest rate swaps.

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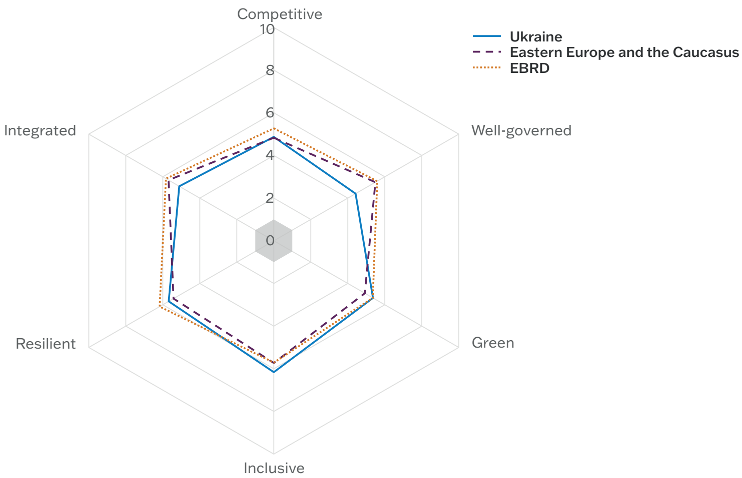
Assessment of transition qualities (1-10)



Structural reform developments

Insufficient progress on reforms led to a pause in further disbursements of the IMF programme. To help sustain the external finances during the Covid-19 crisis, the authorities entered an 18-month IMF SBA of US$ 5.0 billion in June 2020. The lack of meaningful progress in the fight against corruption, in particular related to several rulings of the Constitutional Court undoing previous reform efforts, impeded the completion of several programme reviews. Additional concerns arose from the decision of the Cabinet of Ministers to temporarily reintroduce a regulated price for natural gas for households in January 2021 until the end of the heating season, which went against Ukraine's commitment to the IMF to apply a market-based pricing scheme.

Concerns regarding corporate governance standards and their application resurfaced. In April 2021 the Cabinet of Ministers dismissed the supervisory board of Naftogaz, the country's largest national oil and gas company, and subsequently dismissed the management board and appointed a new one. Immediately afterwards, the government reappointed the same supervisory board for another six months. This bypassing of the supervisory board to appoint a new Chief Executive Officer undermines the corporate governance principles of SOEs.

After initial setbacks, reform momentum gathered pace at the end of June 2021. A new bill, signed into law in July 2021, fully introduced criminal liability for civil servants for errors in asset declarations, significantly increasing the punishment for false or omitted reporting. The independence of the central bank and its regulatory powers regarding corporate governance and licensing in commercial banks were enhanced. Parliament approved in first reading the law to restructure the debt of the Deposit Guarantee Fund and for Oschadbank to join the Fund. The law also improves procedures for liquidating failed banks.

Parliament approved key judiciary reform bills. In July 2021 parliament approved a bill that relaunches an independent panel, the High Qualification Commission of Judges, to appoint judges and ensure they qualify for the job. The bill also includes a provision that gives international experts a decisive voice in selecting the nominees. Appointments of members of the High Council of Justice (HCJ), the key judicial governance body responsible for ensuring judicial independence and accountability of judges, are regulated by another regulation put in place in July 2021. The commission to select members of the HCJ, the Ethics Council, will include six members, of which Ukraine's Western partners will appoint three. The Ethics Council will also perform an integrity check of existing members of the HCJ.

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Efforts to improve the investment climate are ongoing. In March 2021 the president signed a law establishing the Bureau of Economic Security, which will take over the functions of investigating economic crimes from the Security Service of Ukraine, State Fiscal Service and State Bureau of Investigations. Efforts to make Ukraine more attractive for large investors have been increased in the past year. Investors can get state support of up to 30 per cent of their investment if it exceeds €20 million. State support can come in the form of tax benefits and special conditions for the rent of land or infrastructure construction around the project.

The authorities made significant pledges to contribute to the global efforts to fight climate change. Ukraine submitted its updated nationally determined contributions in July 2021. By 2030 greenhouse gas (GHG) emissions should not exceed 35 per cent of 1990 levels, which is a significant improvement on the 60 per cent target envisaged in 2016. In March 2021 the government approved the National Economic Strategy until 2030, through which climate neutrality is to be achieved no later than 2060. Ukraine also plans to set up a national GHG emissions trading system and to introduce carbon taxes in 2025. As a first step, in January 2021 the law implementing a system to monitor, report and verify GHG emissions came into force.

Digital services are expanding. The number of government services available via the “Diia” app is expanding. In March 2021 Ukraine gave e-passports the same legal status for domestic use as traditional paper documents.