Ukraine: Worst Hit by the Financial Crisis

Anders Åslund
Senior Fellow
Peterson Institute for International Economics, Washington, DC

George Washington University
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ANDERS ÅSLUND

UKRAINE

HOW UKRAINE BECAME A MARKET ECONOMY AND DEMOCRACY

PETERTSON INSTITUTE FOR INTERNATIONAL ECONOMICS
Causes of Crisis

1. Fixed exchange rate with USD
2. Messy politics
3. Collapsing steel industry: 42% of exports
4. International finance dried up
1. Financial Causes

- Fixed exchange rate with USD
- Caused excessive currency inflows, which were monetized
- Which caused high inflation &
- Large current account deficit &
- Excessive private foreign debt
Monetary Expansion Constrained
2007: 51%; 2008: 31%; 2009 13%?

Source: Dragon Capital, January 2009
Inflation
Peaked at 31% in May 2008

Source: Dragon Capital, February 2009
Current Account: -6.7% of GDP in 2008 rendered Ukraine vulnerable

Source: Dragon Capital, February 2009
Yet Dynamic Market Economy since 2000

- Critical mass of market reforms
- ...and privatization
- Conservative fiscal policy

7.6% GDP growth a year 2000-7
Extraordinary Economic Growth in USD

- In USD, Ukraine’s GDP grew by 24% a year, 2000-2007
- GDP rose 6 times from $31bn in 2000 to $178bn in 2008, but drops 40% to $106bn in 2009
GDP Growth Reversal

Source: Dragon Capital, February 2009
In 1999, Ukraine’s GDP per capita was 2.9% of the Euro level in current prices.

In 2007, Ukraine’s GDP per capita had tripled to 7.5% of the Euro level.

Economic convergence: Likely to come back and rise soon.
Investments Grow by 13% a Year, but Irregularly

Source: Dragon Capital, Aug 2008
Foreign Direct Investment: Promising: 5.6% of GDP in 2008

Source: Dragon Capital, January 2009
Although the Budget Deficit Remains under Control

Source: Dragon Capital, February 2009
Public Debt Was Minimal
But Now Rises

Source: Dragon Capital, February 2009
International Reserves: Falling But Sufficient

Source: Dragon Capital, February 2009
2. Constitutional Disorder

- Persistent fight over authority leads to stalemate
- Minimum of legislation & reforms
- Enormous political corruption
Political Equilibrium:

Advantages

- All three major parties are center-right parties
- Big businessmen behind all parties
- Uniquely broad consensus on domestic policy
Political Equilibrium: Problems

- Nobody can govern: President regularly vetoes decisions by Prime Minister
- Ukraine has too little legislation and therefore little reform
- Constitutional reform needed
Corruption Declined But Rose Again

Corruption Perception Index (10=highly clean 0=highly corrupt)

Solution: IMF Program

- Approved on November 5, 2008
- Total financing: $16.4 billion
- Conditions
  - Balanced budget
  - Abandoning peg for floating exchange rate
  - Bank restructuring
Economic Outcome

- GDP fell by 20% in January
- Industrial production plummeted by 34% in January (steel, mining & construction)
- Hryvnia depreciation about 50%
- Inflation abated to 22%
Has Ukraine Hit an Early Bottom?

- Highly competitive exchange rate and costs
- Reserves hold: $25bn end 2009?
- Default highly unlikely
- Industrial production might be close to bottom
Economic Growth Tanking

Source: Dragon Capital, February 2009
What to Look for?

- Budget discipline?
- More international financing/size of reserves?
- Social unrest?
What Can the West Do?

1. Provide substantial financing as for Hungary and Latvia!
2. Engage! Set up a Biden-Tymoshenko Commission!
3. Support energy sector reform!
4. European Association Agreement!
5. US Free Trade Agreement!
6. Offer 1,000 student scholarships a year!
Economic Prospects

- Ukraine is likely to weather the financial crisis
- Many economic and social reforms are needed
- Corruption must be controlled
- In the long run: European convergence