

Ukraine: Worst Hit by the Financial Crisis

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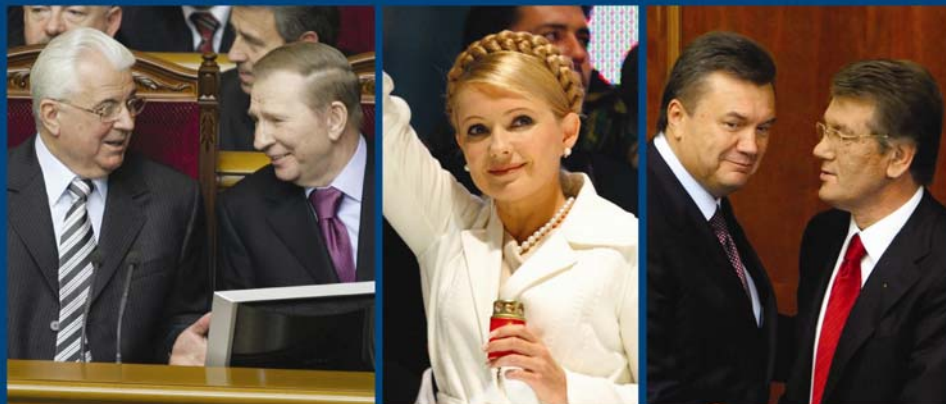
George Washington University

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UKRAINE

HOW UKRAINE BECAME A MARKET ECONOMY AND DEMOCRACY



PETERSON 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

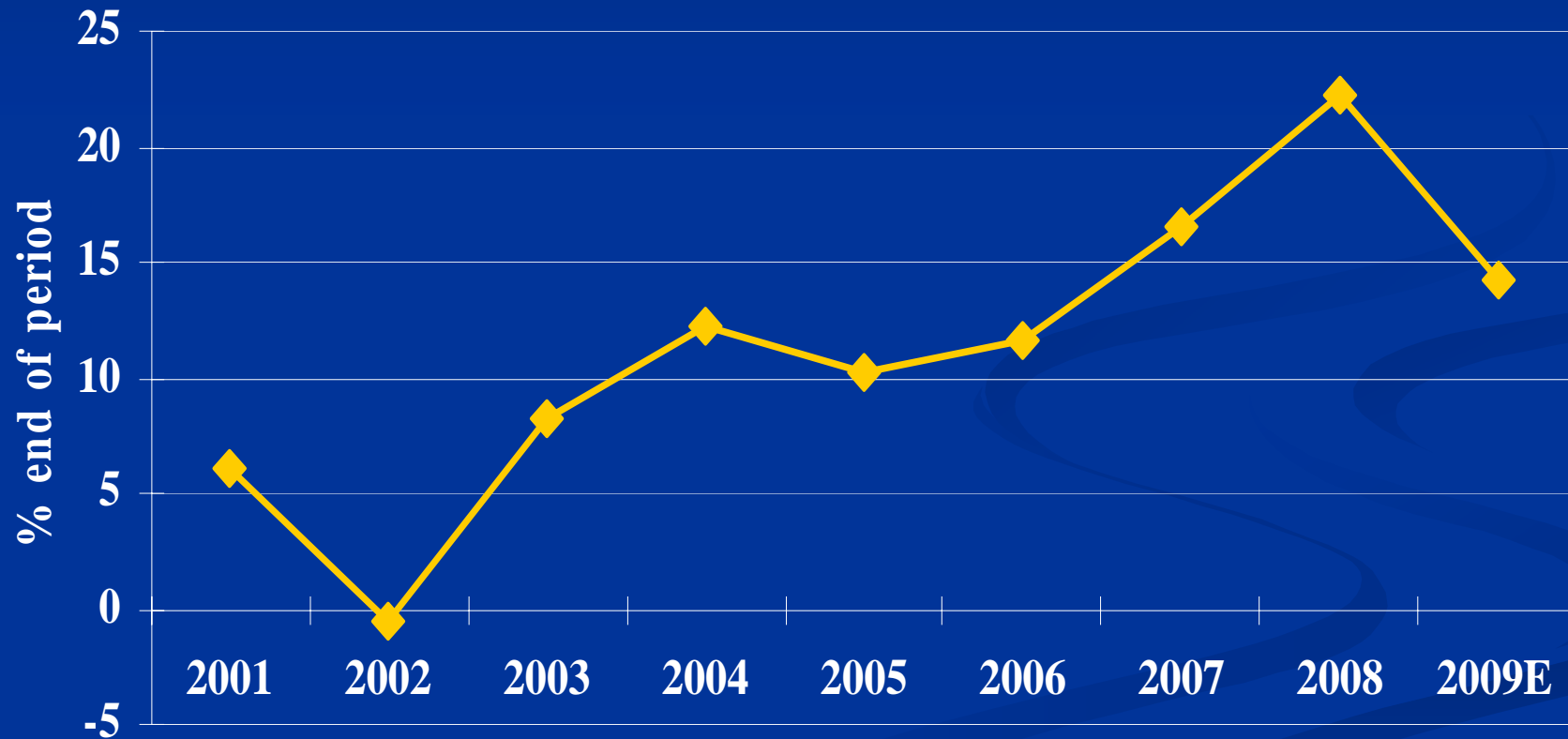
2007: 51%; 2008: 31%; 2009 13%?



Source: Dragon Capital, January 2009

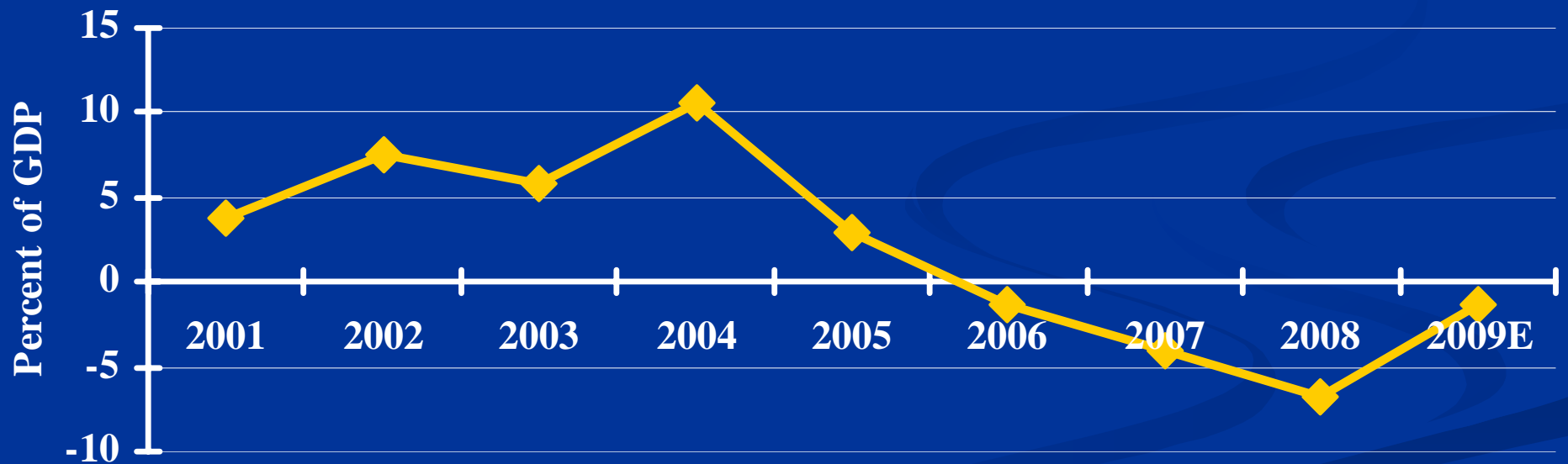
Inflation

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

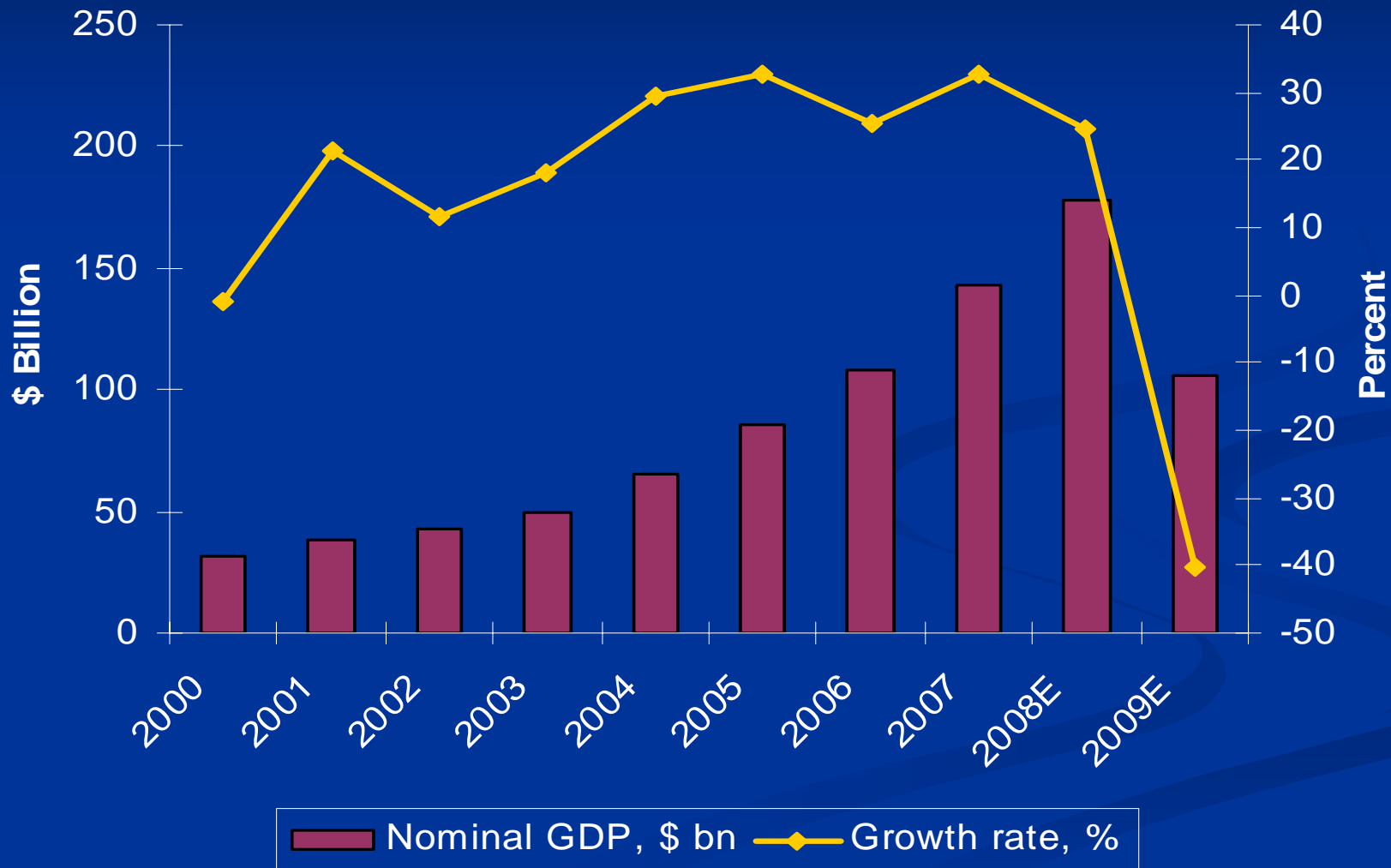
- Critical mass of market reforms
- ...and privatization
- Conservative fiscal policy

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

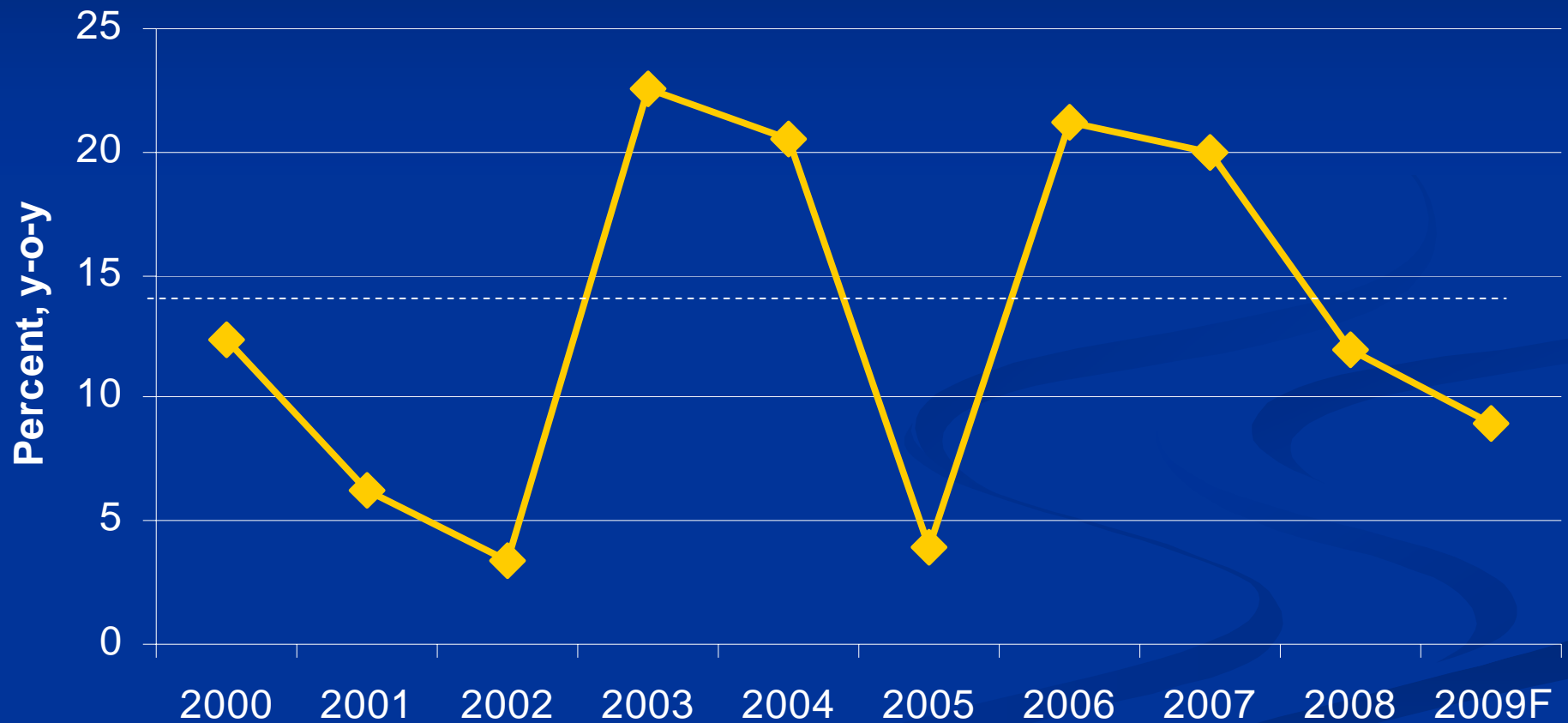


Source: Dragon Capital, February 2009

Ukraine Versus Euroland

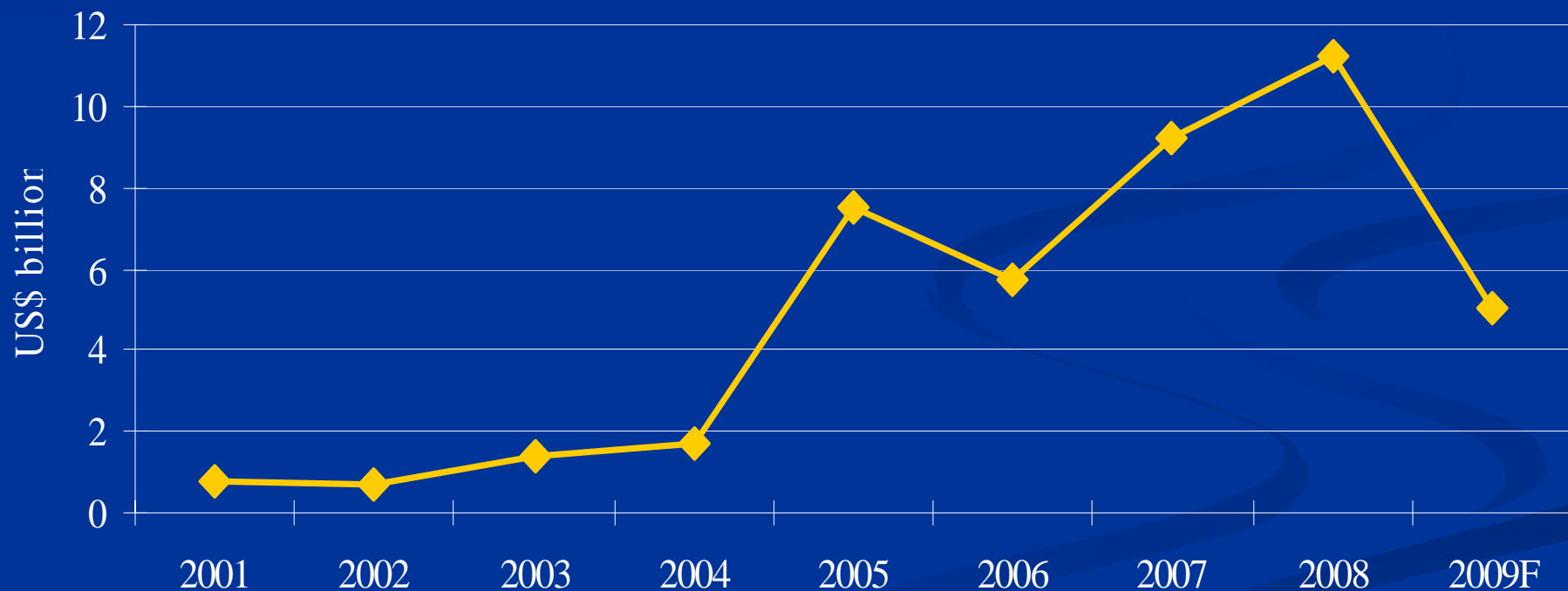
- In 1999, Ukraine's GDP per capita was 2.9% of the Euro level in current prices
- In 2007, Ukraine's GDP per capita had tripled to 7.5 % of the Euro level
- Economic convergence: Likely to come back and rise soon

Investments Grow by 13% a Year, but Irregularly



Source: Dragon Capital, Aug 2008

Foreign Direct Investment: Promising: 5.6% of GDP in 2008



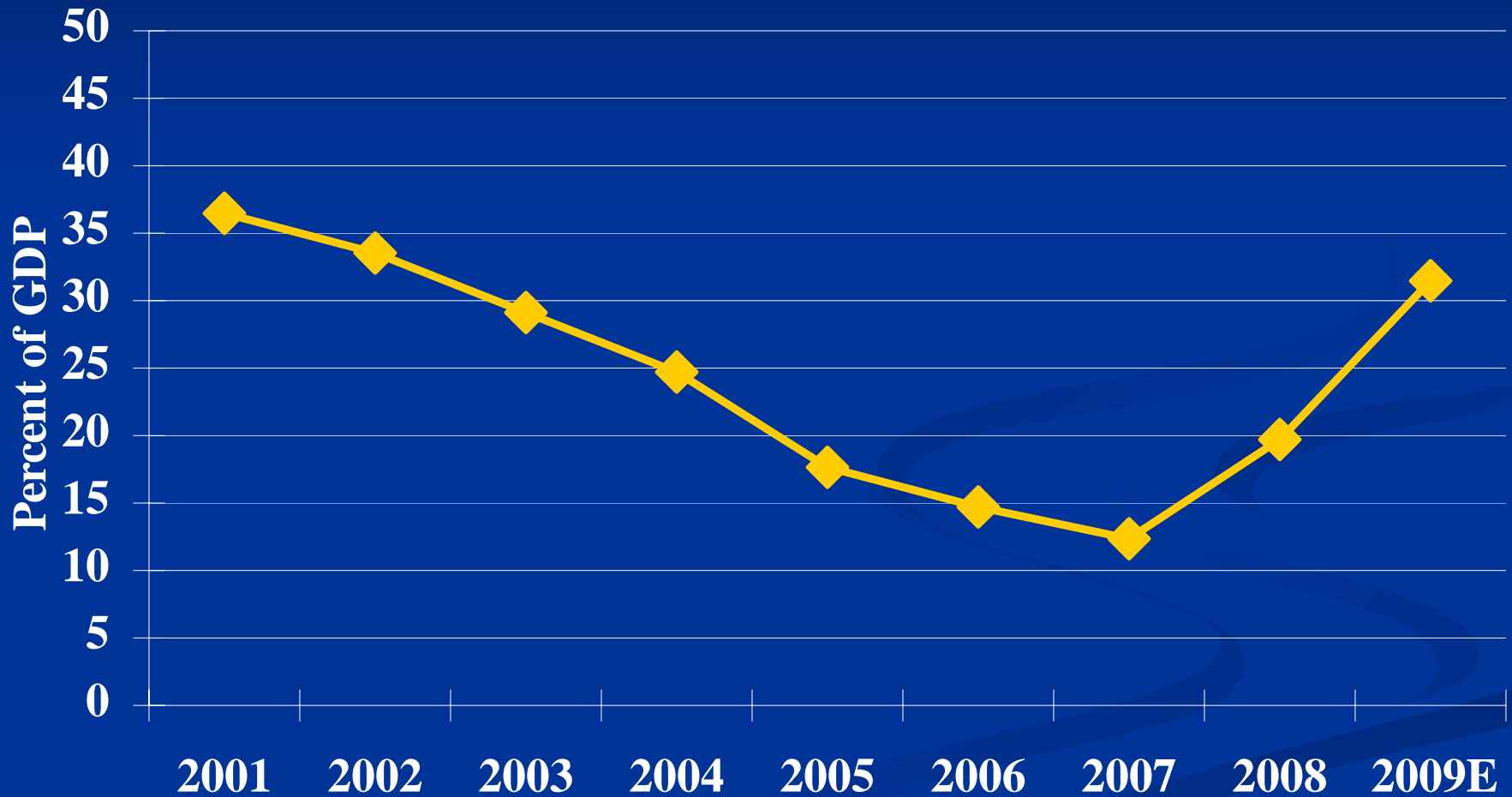
Source: Dragon Capital, January 2009

Although the Budget Deficit Remains under Control



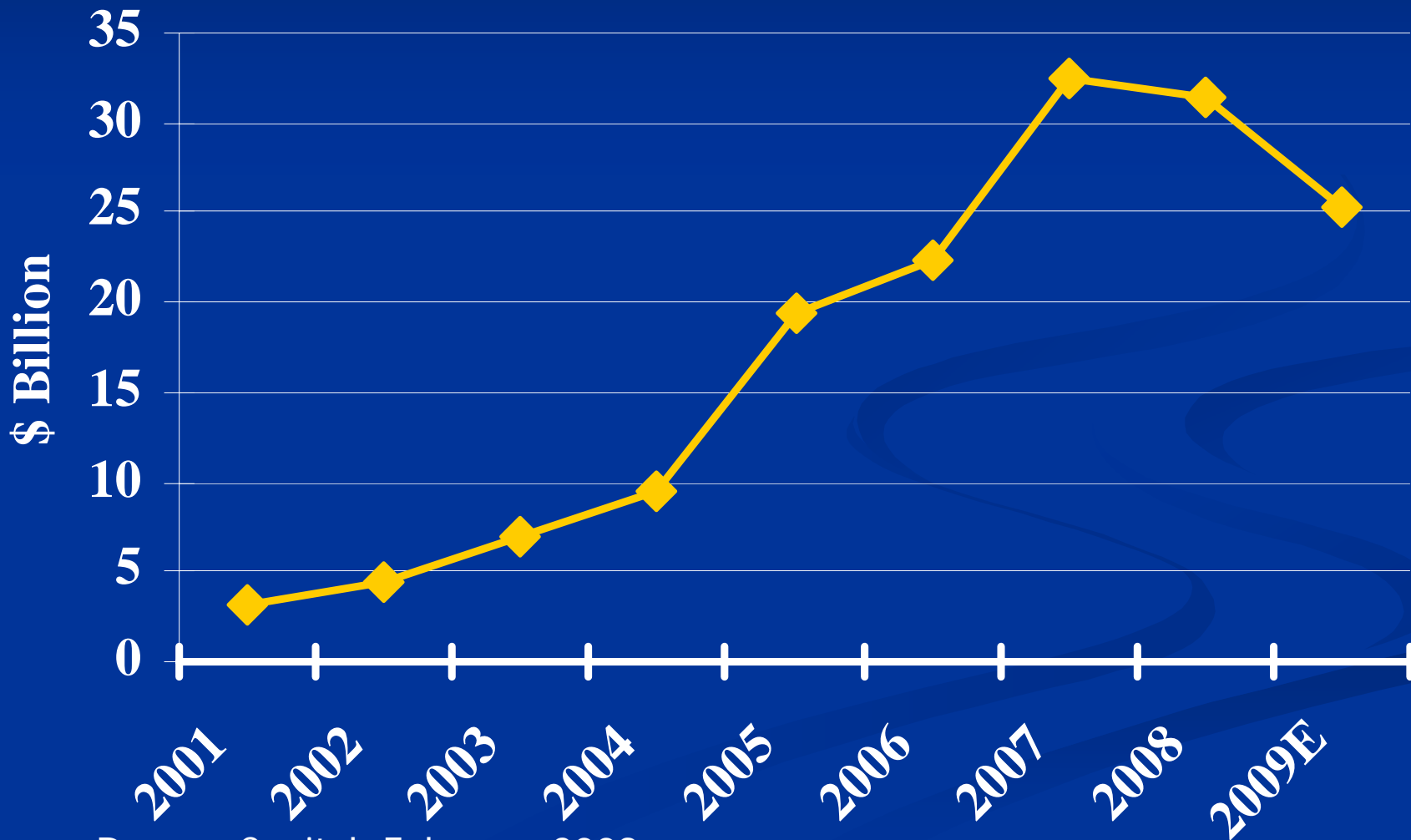
Source: Dragon Capital, February 2009

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

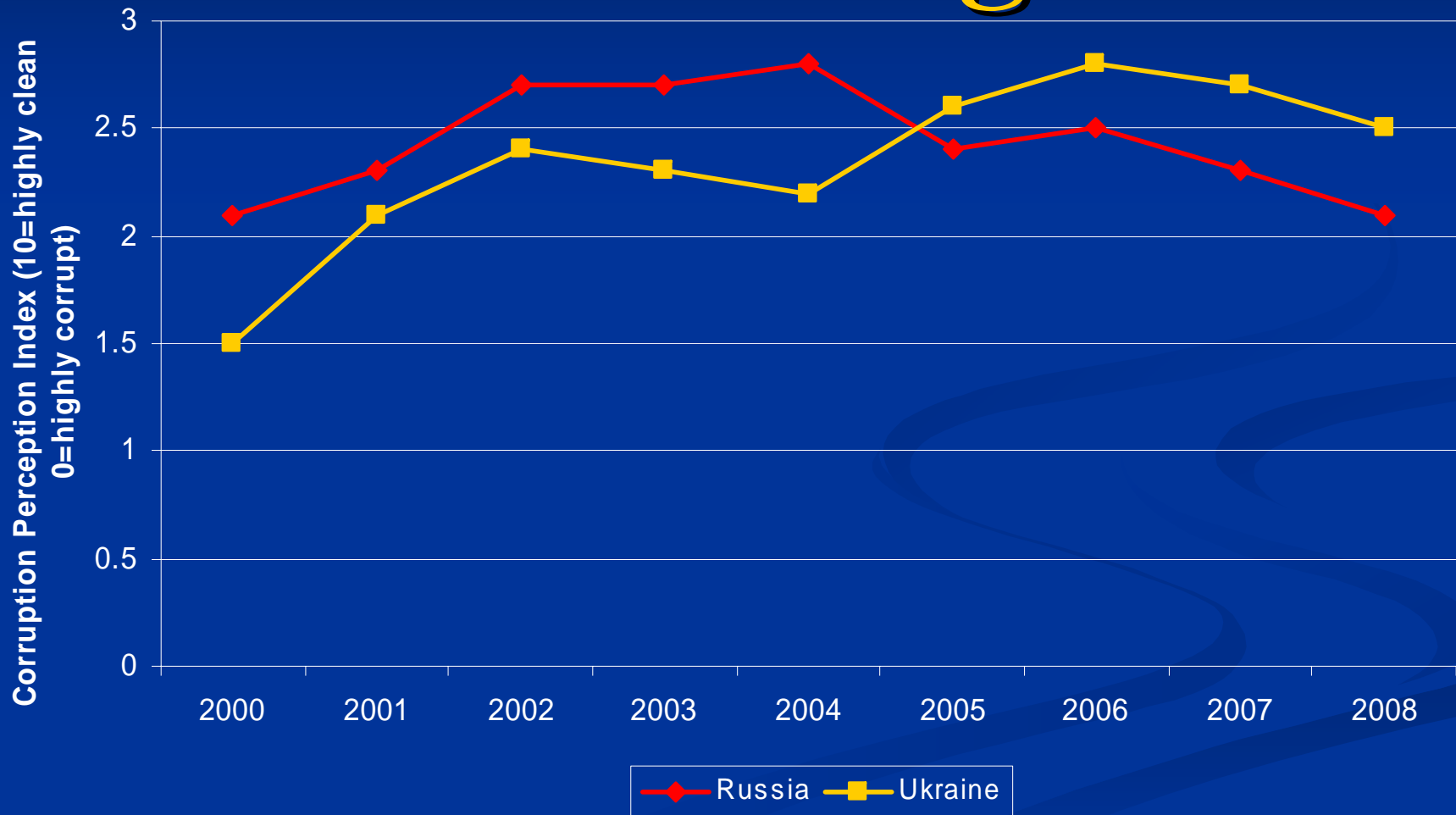
- All three major parties are center-right parties
- Big businessmen behind all parties
- Uniquely broad consensus on domestic policy

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



Source: Transparency International. Accessed February 2, 2009

Solution: IMF Program

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

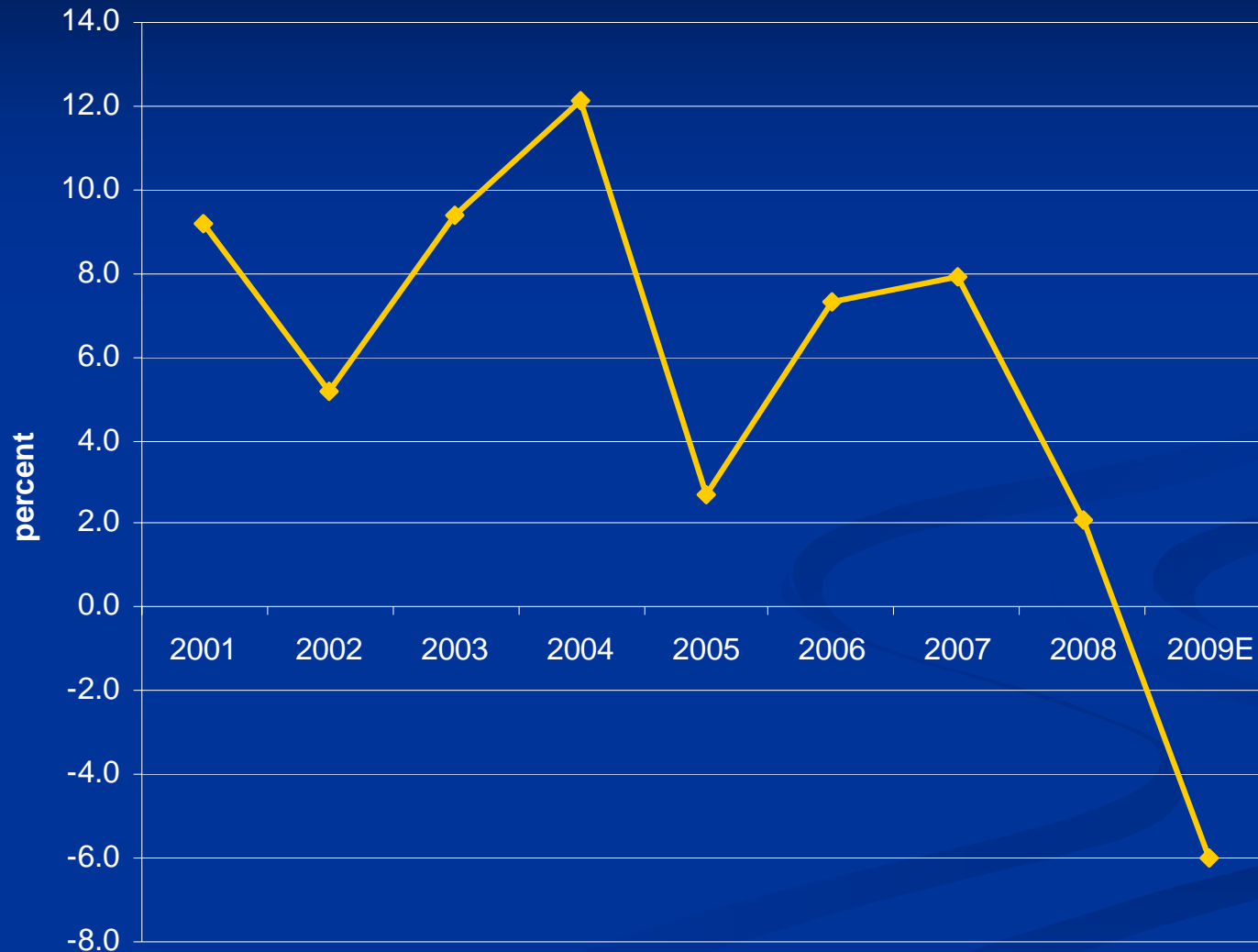
Economic Outcome

- 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-Tymnoshenko Commission!
3. Support energy sector reform!
4. European Association Agreement!
5. US Free Trade Agreement!
6. Offer 1,000 student scholarships a year!

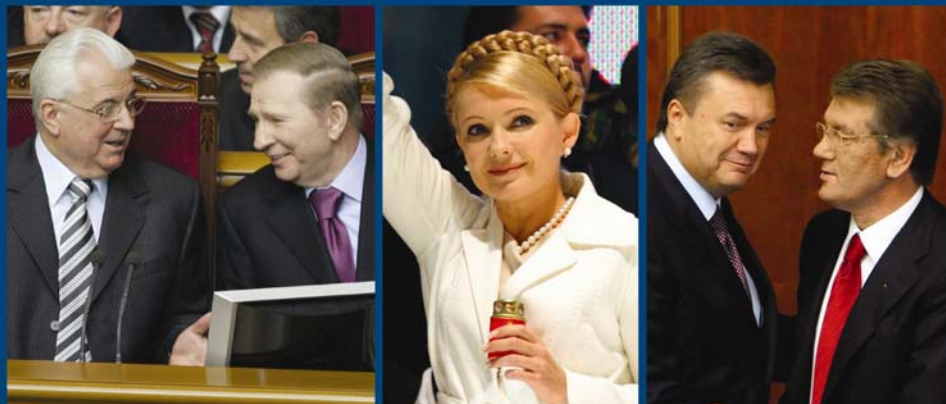
Economic Prospects

- 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

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