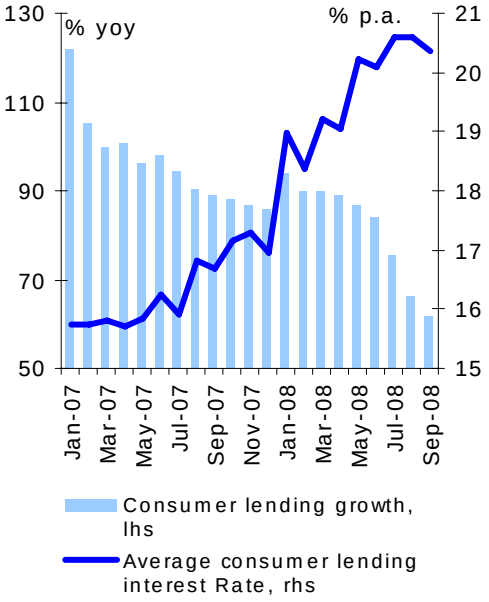
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Global financial crisis: impact on the real sector in Ukraine

The negative impact of the global financial crisis on the Ukrainian economy started to reveal itself since the second quarter of 2008 when private household consumption and investments into fixed capital decelerated partly due to external financing constraints faced by the Ukrainian banks. The real GDP growth was supported by accelerating exports thanks to favorable conditions on the international commodities markets including then increasing metals and chemicals prices, and also accumulation of inventories. These factors preserved real GDP growth unchanged from the first quarter of the year at 6.5% yoy.

The situation changed in the third quarter when following the financial crisis the global economy started cooling down. All over the world limited access to credits has hit investment spending, in particular demand for construction. Consequently metals demand also suffered. As a result, exports of metals have started decreasing since August. Domestically, the hryvnia has sharply devaluated since September against less exports and flight of foreign capital, hurting enterprises that rely on import inputs and making the servicing of foreign currency credits much more expensive than before. Besides consumption and investment demand has further decelerated because of problems with financing. In October, the deepening of these negative tendencies resulted in the serious difficulties in the banking system, when several large banks faced problems with liquidity and were not able to refinance their loans in foreign banks. Thus, there have been two major channels of impact of the global financial crisis on the real economy: through decrease in external demand and through problems in domestic financial sector.

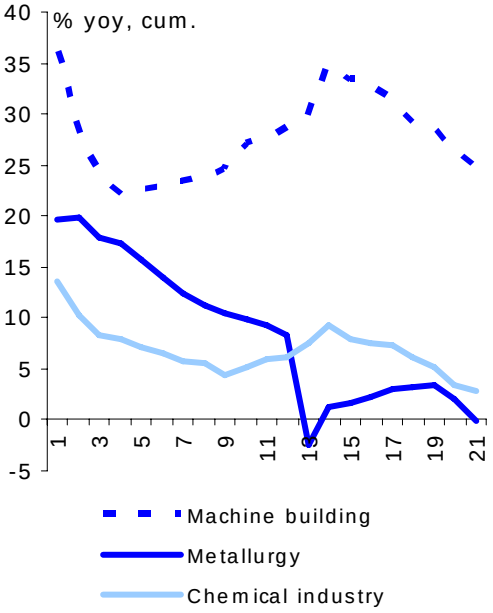
Consumer lending and interest rates



Source: NBU, IER calculations

Decrease in metal exports has forced metallurgy plants and mining companies to reduce their output. Other industries such as machine building and chemical production have been contracting their production because of problems with demand on the domestic market. As a result, industrial output growth slowed down to 5.1% yoy in January-September from 7.5% yoy in the first six months and is expected to decline by the end of the year. The reduction in output and credit crunch forced firms to revise their investment plans. In particular, several metallurgy companies has already announced stopping of modernization programs. Another illustration of this trend is value added in construction that plunged by 10.3% yoy in three quarters of 2008 from 3.9% yoy falls over the first six months. Slowdown in consumer lending, recent devaluation of hryvnya and slowing income growth caused deceleration in household consumption with durables suffering the most. Accordingly, value added in trade slowed down from 14.8% yoy for the first half of 2008 to 9.4% yoy for three quarters of 2008.

Major industries output growth



Source: NBU, IER calculations

All mentioned factors constrain the real GDP growth in the country. Though the growth rate in January-September remained high at 6.9% yoy due to abundant harvest in agriculture, we can expect sharp deceleration in the fourth quarter of 2008. In such circumstances difficulties of the banking sector can only deepen negative tendencies in the real sector. Therefore, Ukraine was forced to adopt anti-crisis legislation to stabilize the banking system and prepare ground for implementation of macroeconomic policy changes and structural reforms in real sector. In particular, the established Stabilization Fund is expected to recapitalize systemic banks in order to guarantee banking stability, while increased flexibility of exchange rate will help absorb external shocks.

The global financial markets are expected to stabilize in the first half of 2009, while the world economy will probably need one or two quarters more time to start recovering. Therefore, without any internal impetuses the situation in the Ukrainian economy will improve only in the second half of the next year. Hopefully, some reforms in the residential construction and state investments in Euro-2012 will hasten this process. Moreover, devaluation of hryvnia against US dollar will facilitate the recovery in Ukraine.

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Quarterly trends

National accounts		Q2 05	Q3 05	Q4 05	Q1 06	Q2 06	Q3 06	Q4 06	Q1 07	Q2 07	Q3 07	Q4 07	Q1 08	Q2 08
GDP	UAH bn	97.5	119.4	123.6	105.4	124.1	150.4	157.7	137.6	165.1	197.4	212.8	186.6	232.5
GDP (real)	% yoy	3.4	1.4	1.7	4.1	6.8	6.9	9.5	8.9	8.6	6.2	7.4	6.5	6.5
Household consumption (real)	% yoy	17.7	17.0	17.1	20.2	18.2	11.8	9.9	14.7	15.5	15.2	19.0	22.0	13.3
State consumption (real)	% yoy	0.0	1.0	4.0	9.6	5.8	5.8	1.0	0.8	6.2	4.4	2.4	1.0	1.5
Gross fixed capital formation (real)	% yoy	-0.5	0.2	0.3	19.9	19.3	17.9	18.3	24.4	23.5	18.9	23.8	14.7	6.3
Exports of goods and services (real)	% yoy	-14.0	-12.7	-15.5	-14.9	-9.6	3.2	1.0	4.9	5.2	0.1	5.6	0.9	8.9
Imports of goods and services (real)	% yoy	3.2	3.9	-0.9	10.7	0.9	8.3	6.4	12.9	19.6	13.7	27.2	20.2	25.6
Agriculture, hunting, forestry (real)*	% yoy	8.3	2.6	-7.2	3.8	2.8	-5.6	8.1	4.8	6.8	-9.3	7.1	0.4	-0.4
Manufacturing industry (real)*	% yoy	1.8	-1.1	2.0	-1.5	6.1	7.3	7.2	15.0	13.2	13.1	4.4	8.7	9.0
Construction (real)*	% yoy	-11.3	-8.5	-7.5	0.1	0.8	1.4	4.2	13.3	8.2	12.7	5.8	-1.5	-6.4
Trade, repair services (real)*	% yoy	-10.7	-11.7	-11.9	6.2	16.4	20.0	21.9	14.3	17.5	25.3	15.0	15.7	10.9
Transport (real)*	% yoy	5.7	2.8	7.8	4.9	7.7	9.4	5.3	7.0	5.6	8.0	10.2	10.1	10.6
Balance of payments														
Current account balance	USD bn	0.6	0.4	-0.1	-0.8	0.0	0.5	-1.4	1.2	-0.8	-0.5	-3.5	-3.6	-2.8
Current account balance	% of GDP	3.2	1.7	-0.4	-3.7	0.0	1.7	-4.3	4.4	-2.4	-1.2	-8.1	-9.6	-7.9
Trade balance in goods	USD m	-236	-1131	-788	-1353	-935	-884	-2022	-1735	-1701	-2684	-4452	-4321	-3562
Trade balance in services	USD m	392	1035	191	219	506	1054	347	103	512	1689	392	261	526
Current transfers	USD m	694	745	780	622	790	851	910	825	968	1099	1183	966	957
Direct investment (FDI)	USD m	365	477	6474	1053	1389	1636	1258	1709	1934	3927	1648	2387	3083
Portfolio investments	USD m	923	90	1347	4	-141	370	3350	1816	1477	517	1844	225	129
Gross international reserves	USD bn	13.1	14.3	19.4	17.3	17.6	19.1	22.3	23.5	25.6	30.6	32.5	33.2	35.5
Exchange rate(market), UAH/USD	aop	5.08	5.00	5.02	5.06	5.02	5.02	5.03	5.04	5.02	5.01	5.04	5.03	4.79
Exchange rate(official), UAH/USD	aop	5.10	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.05	4.96
Fiscal indicators														
Consolidated fiscal revenues	% of GDP	35.1	31.5	31.0	31.2	31.7	31.9	32.8	33.3	32.8	30.8	31.1	32.5	42.7
Personal income tax	% of GDP	4.4	3.9	4.2	4.4	4.6	4.1	4.1	5.1	5.3	4.9	4.8	5.1	6.9
Enterprise profits tax	% of GDP	5.9	5.3	6.3	3.4	4.6	4.3	6.7	3.8	4.1	4.1	6.4	4.1	5.2
Value-added tax	% of GDP	9.2	7.9	7.3	9.2	9.2	9.7	9.3	10.4	9.8	8.7	7.6	10.5	14.9
Excise tax	% of GDP	2.0	2.0	1.7	1.8	1.7	1.5	1.5	1.8	1.7	1.6	1.3	1.5	1.8
Consolidated fiscal expenditures	% of GDP	36.4	28.1	41.7	30.9	32.8	29.4	36.6	28.4	31.0	29.6	36.7	29.5	42.2
Current expenditures	% of GDP	33.6	24.0	34.2	28.9	29.7	24.9	29.2	26.9	28.4	25.9	27.3	28.6	37.3
Capital expenditures	% of GDP	2.7	4.1	7.5	1.9	3.2	4.5	7.4	1.6	2.6	3.7	9.4	0.9	5.0
Consolidated fiscal balance	% of GDP	1.0	-5.0	6.2	-0.4	1.1	-2.4	4.0	4.7	1.7	1.2	-6.2	3.0	0.5
Privatisation receipts	% of GDP	0.6	0.6	16.0	0.1	0.1	0.1	0.1	0.5	0.5	0.3	0.4	0.1	0.1
Labour market														
Average wage (real)	% yoy	19.0	19.6	26.4	23.8	22.6	18.8	11.3	14.7	13.9	14.9	15.7	13.8	7.1
Household income (real)	% yoy	28.0	19.4	18.9	22.1	18.6	20.3	16.3	17.5	17.4	14.9	16.4	19.0	10.1
Unemployment rate (ILO methodology)	% cum	7.1	5.2	7.8	7.9	6.8	6.4	6.8	7.4	6.6	6.2	6.4	7.1	6.2
Banking system														
Monetary aggregate M0	% yoy cum	39.1	31.1	42.2	36.2	25.3	23.7	24.5	22.9	30.4	36.4	48.2	48.4	48.8
Monetary aggregate M2	% yoy cum	37.4	31.3	53.9	39.2	36.6	36.7	34.3	38.6	40.7	47.8	50.8	52.7	48.8
Household deposits in national currency	% yoy cum	31.6	30.4	90.8	54.6	41.1	39.7	37.3	50.7	56.3	64.8	71.9	68.8	68.2
Household deposits in foreign currency	% yoy cum	45.4	46.4	59.1	54.5	66.2	64.3	57.5	52.3	43.8	38.4	32.5	35.2	32.9
Com. bank credits in national currency	% yoy cum	32.6	43.4	58.7	59.8	53.7	49.0	52.3	52.4	57.2	60.7	72.7	81.2	70.7
Com. bank credits in foreign currency	% yoy cum	36.8	47.1	66.3	72.0	82.1	90.4	95.4	98.9	97.4	91.0	75.4	71.3	57.9
Long-term com. bank credits	% yoy cum	53.0	70.1	84.6	87.6	86.7	76.6	79.5	84.1	86.5	87.9	85.7	84.8	67.2
Long-term com. bank credits	% of total	56.1	59.7	61.8	63.1	63.4	63.5	64.9	65.8	67.3	68.2	69.2	69.1	68.6
Average lending rate on national cur. credits	% p.a.	15.4	15.4	16.4	15.8	15.5	14.6	15.1	14.0	13.9	13.7	14.0	14.6	17.3
Average lending rate on foreign cur. credits	% p.a.	11.0	11.3	11.7	11.5	11.3	11.3	11.5	11.5	11.4	11.3	11.1	10.8	11.4

Sources: National Bank of Ukraine, State Committee of Statistics, State Treasury, Ministry of Finance, Reuters, IER estimates

* change in value added

Notes:

yoy year on year change **p.a.** per annum