

ICPS newsletter[®]

New consensus forecast says Ukraine's economy will continue to grow fast

Although economic growth will slow down over 2004, Ukraine's real GDP will continue to grow at a high pace in 2005 and 2006. Government steps to strengthen the hryvnia exchange rate will lower the official exchange rate. Its efforts to curb the inflation brought about by rising social outlays in the Budget will not be enough. These are the key conclusions of the economists who put together the latest consensus forecast

Economic specialists from key organizations in Ukraine who regularly forecast Ukraine's economic growth put together a consensus forecast for 2005–2006 on 25 March 2005. The event had the support of the Ministry of Economy and European Integration and UNDP. Specialists representing government, non-government, international, and commercial organizations all brought their forecasts for Ukraine's key macroeconomic indicators to the table. The resulting average values make it possible to present a picture of upcoming macroeconomic trends in Ukraine.

GDP will grow about 8%

The consensus forecast shows real GDP growing 8% in 2005 and 7.6% in 2006. The key driver will continue to be external demand for Ukrainian exports. Fixed investments will also be a stable growth factor during 2005–2006. Meanwhile, increased social benefits will have a short-term impact on economic growth: private consumption and gross national savings will grow more slowly. In 2005, the average wage is expected to reach UAH 753. In 2006, this indicator will rise to UAH 921.30. Real disposable household incomes will grow 14.2% in 2005 and 11.8% in 2006.

The consensus forecast for development prospects in the economy's real sector is mostly based on two assumptions:

- increased social benefits will lead to higher consumption;
- investment will grow because the political situation has stabilized.

However, the panel of experts was unable to reach consensus as to the impact of stimulated consumer demand on economic development. One group thought this stimulation would lead to an economic upturn, while the rest were convinced that, in an unreformed economy, stimulated

consumer demand would end up hampering economic growth.

According to the specialists, other forecast risks include deteriorating investment appeal if the Government goes ahead with re-privatization and prices for exported fuels increase significantly.

Exports will continue to be strong

The Ukrainian economy continues to be export-oriented. In 2005, the forecast is for exports to make 55.1% of GDP. In 2006, this will slip to 51.6%. Altogether, exports will exceed imports by UAH 626mn in 2005 and by UAH 633mn in 2006. FDI is expected to reach US \$1.780bn in 2005 and US \$2.122bn in 2006.

The group of experts based their consensus forecast for the external sector on the assumption that:

- gaining market economy status will mitigate the negative consequences of anti-dumping probes against Ukraine;
- Ukraine will accede to the WTO in 2006;
- prices for Ukraine's exports will remain high, but slightly slower growth among the country's trading partners will reduce export profits.

One risk to this foreign trade forecast is a sharp drop in world prices for steel and chemical products, which constitute the lion's share of Ukraine's exports.

The deficit will be unusually high

Experts predict a high Budget deficit in 2005—3.72% of GDP. In 2006, the deficit will drop by nearly half, to 2% of GDP. The key cause of the growing Budget deficit will be a significant increase in social outlays, as they are not entirely supported by

revenues. According to participants in the consensus forecast, the Government will use privatization revenues and international and domestic borrowings in equal parts to cover the deficit. Moreover, this will persist throughout both 2005 and 2006.

The panel of forecasters based their projections of Budget indicators for 2005–2006 on the assumption that:

- Budget revenues will grow as the economy gradually comes out of the shadows and privileges and preferential treatment for specific territories, sectors and companies are dropped;
- social outlays will continue to grow in 2006 as well.

The hryvnia will grow stronger

Participants in the consensus forecast expect the USD/UAH exchange rate to change. According to their forecast, the official exchange rate will drop to UAH 5.28/USD 1 by December 2005. By December 2006, the hryvnia will grow slightly stronger again, at UAH 5.25/USD 1. This will be supported by growing NBU reserves, which have been picking up pace again since the political situation stabilized. NBU reserves should reach US \$13.1bn in 2005 and US \$15.7bn in 2006. The average weighted rate on commercial bank loans will remain almost flat at 18.3% in 2005. However, the expert group predicts that it will drop to 16.3% in 2006.

As before, monetary policy will continue to be aimed at supporting stable prices. Still, the expert group expressed pessimism about the Government's ability to curb inflation. The Consumer Price Index will likely grow 11.4% in 2005 and 7.2% in 2006, December-on-December.

The mid-term outlook is optimistic

The organizers of these regular macroeconomic seminars tried to expand the forecast range and asked participants at the March event to provide their macroeconomic forecasts for 2007–2009. However, they did not receive enough data from the participants to produce a

consensus forecast for this longer period. Still, the available data does make it possible to suggest certain general trends in the mid-term expectations of this panel.

Generally speaking, this group of experts is optimistic about the future economic situation in Ukraine. Specifically, they expect that:

- average real economic growth rate will continue at 6% pa;

- domestic factors will gradually replace exports as the main growth driver;
- the deficit will be reduced and inflation will subside;
- tax reform will go through and the shadow economy will move into the official sector. ■

Forecasts were provided by the Institute of Economic Research and Policy Consulting, the

Institute for Economic Forecasting under the National Academy of Sciences, GfK-USM, Alfa and Co., the International Centre for Policy Studies, the Ministry of Economy and European Integration, and the International Monetary Fund and World Bank representative offices in Kyiv.

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Table 1. Average macroeconomic forecast for 2005–2006

Index	2005		2006		Index	2005		2006	
	Consensus forecast	ICPS forecast	Consensus forecast	ICPS forecast		Consensus forecast	ICPS forecast	Consensus forecast	ICPS forecast
Real sector (mn UAH)					Exchange rate, UAH/USD				
Nominal GDP	422,446	418,200	489,773	472,000	average	5.29	5.29	5.25	5.22
Consumption	314,623	326,600	369,319	368,600	year-end	5.28	5.25	5.25	5.20
private	244,514	265,800	287,235	300,000	Public finance (mn UAH)				
public	71,580	60,800	82,842	68,600	Total revenues	122,684	x	133,449	x
Investment	87,029	93,200	106,367	105,200	Total expenditures	138,400	x	143,268	x
Gross accumulation of fixed capital	86,423	92,800	101,105	104,700	Overall balance	-15,716	x	-9,819	x
private	72,901	x	89,414	x	<i>Financing items</i>				
public	13,874	x	15,299	x	Privatization	6,102	x	4,940	x
Net export of goods and non-agency services	23,778	16,200	17,204	5,100	Domestic borrowing	2,474	x	1,477	x
Gross national savings	109,792	x	122,858	x	International borrowing	3,458	x	3,242	x
Real sector (index, year-on-year)					Public finance (% of GDP)				
Real GDP	108.0	107.0	107.6	107.5	Total revenues	29.04	27.0	27.25	28.0
Consumption	109.5	107.3	108.9	108.3	Total expenditures	32.76	30.0	29.25	29.0
private	110.6	108.0	109.6	109.0	Overall balance	-3.72	-3.0	-2.0	-1.0
public	104.3	105.0	104.3	106.0	<i>Financing items</i>				
Investment	112.0	110.0	112.0	112.0	Privatization	1.4	x	1.0	x
Gross national savings	114.4	x	107.8	x	Domestic borrowing	0.6	x	0.3	x
Inflation (index)					Foreign borrowing	0.8	x	0.7	x
GDP Deflator (average annual)	112.9	111.0	107.9	105.0	Money and credit (mn UAH)				
CPI (average annual)	113.8	114.2	108.9	107.0	Monetary base, year-end	66,783	x	82,765	x
Dec. on Dec.	111.4	111.0	107.2	106.0	Dec. on Dec., %	24.2	33.0	23.9	19.0
PPI (average annual)	116.0	117.7	109.7	108.5	Money supply (M3), year-end	170,355	x	221,216	x
Dec. on Dec.	111.2	112.0	107.5	106.0	Dec. on Dec., %	35.4	38.0	29.9	25.0
External Sector (mn USD)					Average weighted interest rate on commercial hryvnia loans, % pa				
FDI	1,780	1,600	2,133	2,000		18.3	18.5	16.7	16.5
Current account balance	5,910	5,350	4,473	3,380	NBU international reserves, mn USD				
Export volumes	44,022	43,840	48,177	46,780		13,113	13,000	15,757	15,100
Import volumes	39,842	40,660	45,571	45,690	Social indicators				
Revenue balance	-626	-520	-633	-500	Population, mn	47.14	47.1	46.83	46.9
Official transfers (net)	2,356	2,700	2,500	2,800	% change over previous year	99.5	x	99.3	x
External Sector (% of GDP)					Average wage, UAH	753.0	x	921.3	x
FDI	2.2	2.0	2.3	2.2	Real disposable household income, annual percentage change	114.2	108.0	111.8	110.0
Current account balance	7.4	6.8	4.8	3.7					
Export volumes	55.1	55.5	51.6	51.7					
Import volumes	49.9	51.4	48.8	50.5					
Revenue balance	-0.8	-0.7	-0.7	-0.6					
Official transfers (net)	3.0	3.4	2.7	3.1					

icps newsletter is a weekly publication of the International Centre for Policy Studies, delivered by electronic mail.

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