

# ICPS newsletter<sup>®</sup>

## Economic forecast from ICPS

**The latest issue of "Quarterly Predictions" is out in print, with ICPS's updated political and economic forecast for Ukraine for the next three years. According to the Centre's research, Ukraine's economy will grow at a moderate pace. ICPS economists expect real GDP to grow 6.5% in 2007, 5.5% in 2008 and 6.5% in 2009**

### Government policy: emphasis on investment

According to ICPS analysts, the Government will not implement any large-scale economic reforms during the forecast period. The failure to complete political reform and the lack of consensus on the country's political system will lead to a situation where political competition will be focused primarily around the issues related to the political structure and powers of various institutions. Meanwhile, economic policy will remain in the background.

The Government will try to resolve current problems and implement initiatives that were prepared but not completed in previous years. It will also invest actively, but inefficiently, as

the Government has neither clear-cut priorities regarding the distribution of public funds nor a vision of its own role in the economy.

Despite the Government's announced intentions to reduce the tax burden, the share of GDP re-distributed through the Budget will remain higher. ICPS economists expect Consolidated Budget revenues to constitute 33.5% of GDP in 2007, 33.3% of GDP in 2008 and 34.3% of GDP in 2009.

The lengthy period between elections will make it possible to increase the share of capital spending in the State Budget. However, in 2009, the Budget's orientation towards capital investment will lessen as the 2009 presidential election approaches and presidential

hopefuls begin to focus more on social spending.

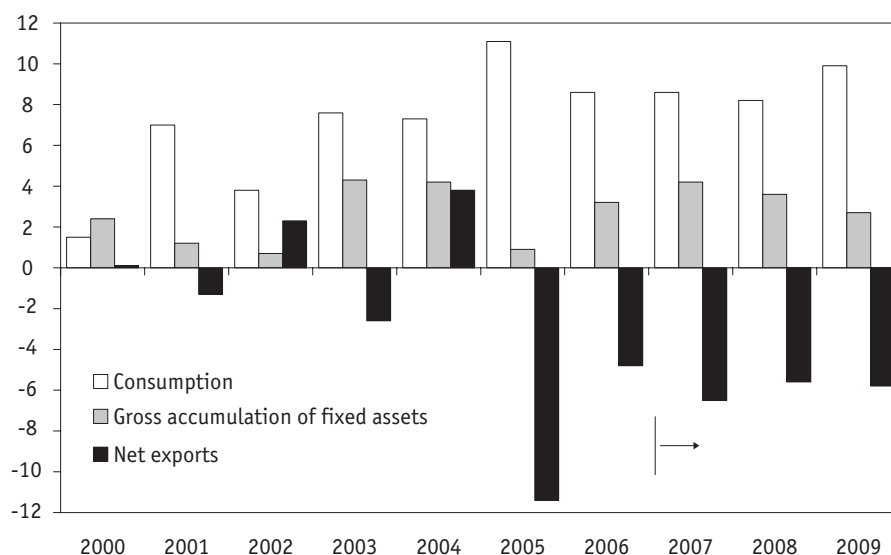
### Structure of growth

As in the previous years, consumption will be the main driver of growth. The propensity to consume will continue to be high throughout the forecast period. As in 2006, private consumption will be encouraged by bank loans to private individuals, in addition to growing wages and social benefits. Still, ICPS economists expect consumption to slow down over 2007–2008, as personal incomes grow more slowly. Specifically, ICPS economists expect social benefits to remain nearly flat in real terms over this period. The ICPS forecast is for household consumption to grow 13% in 2007 and 12% in 2008 in real terms. In 2009, private consumption will accelerate to 14% as social outlays grow in advance of the presidential election.

Rapid growth of consumption will stimulate growth in consumer-oriented sectors of the domestic economy. The need to expand production capacities in sectors oriented on the consumer market will continue to be one of main drivers of investment. Now that it has been operating successfully for some years, the financial sector has been actively expanding and overall risks in the economy have gone down, business will have easier access to credit.

Ukraine's industry will grow at a moderate pace, with output growing 5% in 2007, 4.5% in 2008 and 5% in 2009. "Traditional" industrial sectors, such as metals and chemicals, will lose their price-related competitive edge as world prices for these commodities stop growing in 2007 and energy becomes more expensive. Over the forecast period, these industries will not complete the restructuring that they need in order to

### Contribution of GDP components to real growth, pp



Source: Derzhkomstat; calculations and forecast by *quarterly predictions*

gain a new competitive advantage, that is, a quality improvement in the range of products. This means that these sectors will grow slowly. High demand for capital in Ukraine and in CIS countries will spur rapid expansion in machine-building.

The investment component of GDP will grow steadily. ICPS economists expect gross accumulation of fixed assets to grow 18% in 2007, 14% in 2008 and 10% in 2009. Slower growth over the period will be the result of a gradual saturation of the economy with capital investment. This saturation will largely be the result of lack of reform that might provide new investment opportunities, such as the formation of a full-fledged land market and such public-private partnership mechanisms as concessions.

During the forecast period, the contribution of foreign trade to GDP will be negative and the trade deficit will grow. ICPS economists

expect exports to accelerate gradually, from 8% in 2007, to 10% in 2008 and 12% in 2009. This increase in exports will be driven by the situation on external metal and chemical markets. Over 2008–2009, the conditions for foreign trade should improve as Ukraine accedes to the WTO.

Imports will grow 15% in 2007, 13% in 2008 and 11% in 2009. Imports of investment goods will remain high. Accession to the WTO will not have a major impact on volumes of imported goods, as liberalization in this area largely took place over 2005–2006.

### Financial situation

Despite a deteriorating trade balance, the NBU has enough gold and foreign currency reserves to support the hryvnia exchange rate at current levels. These reserves continue to grow with the inflow of FDI and the active accumulation of public and private foreign debt. ICPS economists

expect the central bank to allow a slight depreciation of the hryvnia only in 2008 and to support the exchange rate at a new level, UAH 5.30/USD, in 2009.

ICPS economists expect the rate of inflation to subside throughout the forecast period. Slower growth of producer prices and stable prices in regulated sectors should lead to slower growth in the CPI over 2008–2009, with consumer prices growing 9.5% in 2007, 8% in 2008 and 6% in 2009.

### Forecast risks

The risks to the ICPS forecast are:

- an exacerbation of political competition to the point where investors and consumers have to change their plans and their behavior;
- serious fluctuations in world prices for steel and chemical products;
- price rises in imported gas to above US \$130 per 1,000 cu m over 2008–2009;
- a transition to targeting inflation over the forecast period;
- price controls on competitive markets;
- shrinking tax revenues because of exemptions or benefits and/or a revival of shadow operations among investment projects in SEZs and TPDs. ■

*ICPS economists have been providing regular forecasts for the economic development of Ukraine since 1997. These forecasts are updated quarterly and published in **quarterly predictions**. If you are interested in receiving this publication on a regular basis, you can subscribe today by contacting Andriy Starynskiy at (380-44) 484-4410 or at [marketing@icps.kiev.ua](mailto:marketing@icps.kiev.ua).*

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## Key macroeconomic indicators

Years	2005	2006	2007	2008	2009
Indicator	estimate		forecast		
GDP, mn. UAH	441.5	535.9	651.6	765.8	880.2
GDP, apc, %*	2.7	7.1	6.5	5.5	6.5
Real industrial output, apc, %	3.1	6.2	5.0	4.5	5.0
Real agricultural output, acc, %	-0.1	0.4	6.0	3.0	3.0
Gross investment, % of GDP	22.0	23.6	25.5	27.0	27.8
Real gross fixed investment, apc, %	3.9	14.7	18.0	14.0	10.0
Real consumption, apc, %	15.7	11.2	11.0	10.5	12.4
Net FDI, mn USD	7,533	5,336	5,500	5,700	6,000
Real disposable household income, apc, %	23.9	16.1	13.0	12.5	15.5
Real retail trade, apc, %	23.4	25.3	18.0	13.5	15.0
Consumer price index, apc, %	10.3	11.6	9.5	8.0	6.0
Producer price index, apc, %	9.5	14.1	11.5	9.0	7.5
Population, mn	47.3	46.9	46.6	46.3	46.1
Average monthly real wages, apc, %	20.3	18.3	14.0	14.0	16.0
Unemployment rate (ILO methodology), %	7.2	6.7	6.4	6.2	6.1
Exports of goods and services, apc, %	7.5	13.2	8.4	10.2	12.0
Imports of goods and services, apc, %	20.4	22.0	15.5	13.4	11.2
Current account balance, % of GDP	2.9	-1.5	-4.4	-5.6	-5.4
Consolidated Budget balance, % of GDP	-1.8	-0.7	-2.6	-1.4	-1.6
Official exchange rate (average annual), UAH/USD	5.12	5.05	5.05	5.12	5.30

\*apc = annual percentage change

Sources: Derzhkomstat (State Statistics Committee), National Bank of Ukraine, Ministry of Finance; calculations and forecast by **quarterly predictions**

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