

Ukraine and the IMF program

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A short comment on...

- Exchange rate policy:

Is flexible exchange rate appropriate for Ukraine?

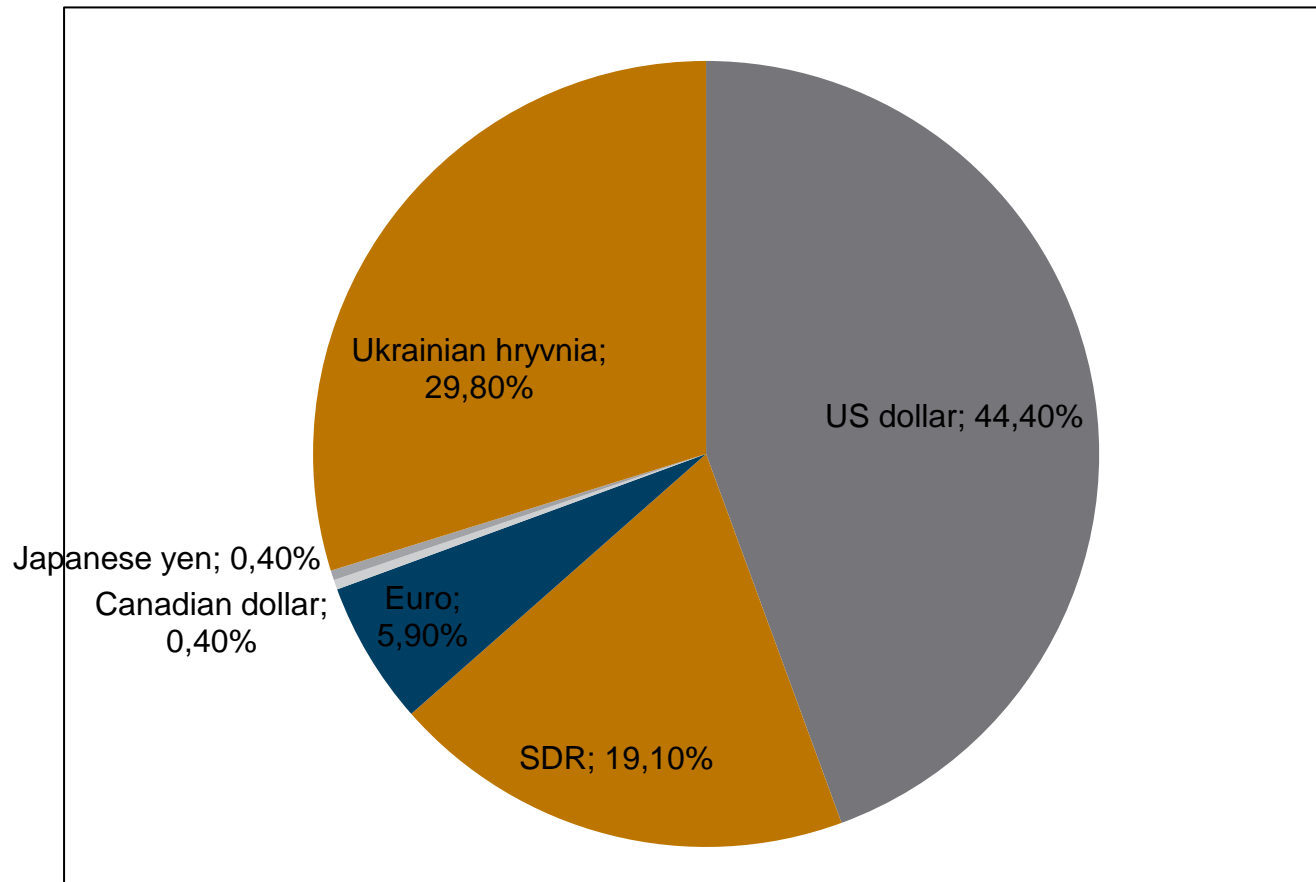
- Fiscal policy:

Is economic recession a right time to pursue fiscal austerity?

Why exchange rate matters

- ‘Small open economy’
 - exports & imports of goods & services = 114% of GDP
- Direct impact on banking sector stability...
 - more than half of all loans denominated in foreign currency
- ... and the burden of public debt
 - 70% of public debt denominated in foreign currency

Currency composition of public debt end of 2015

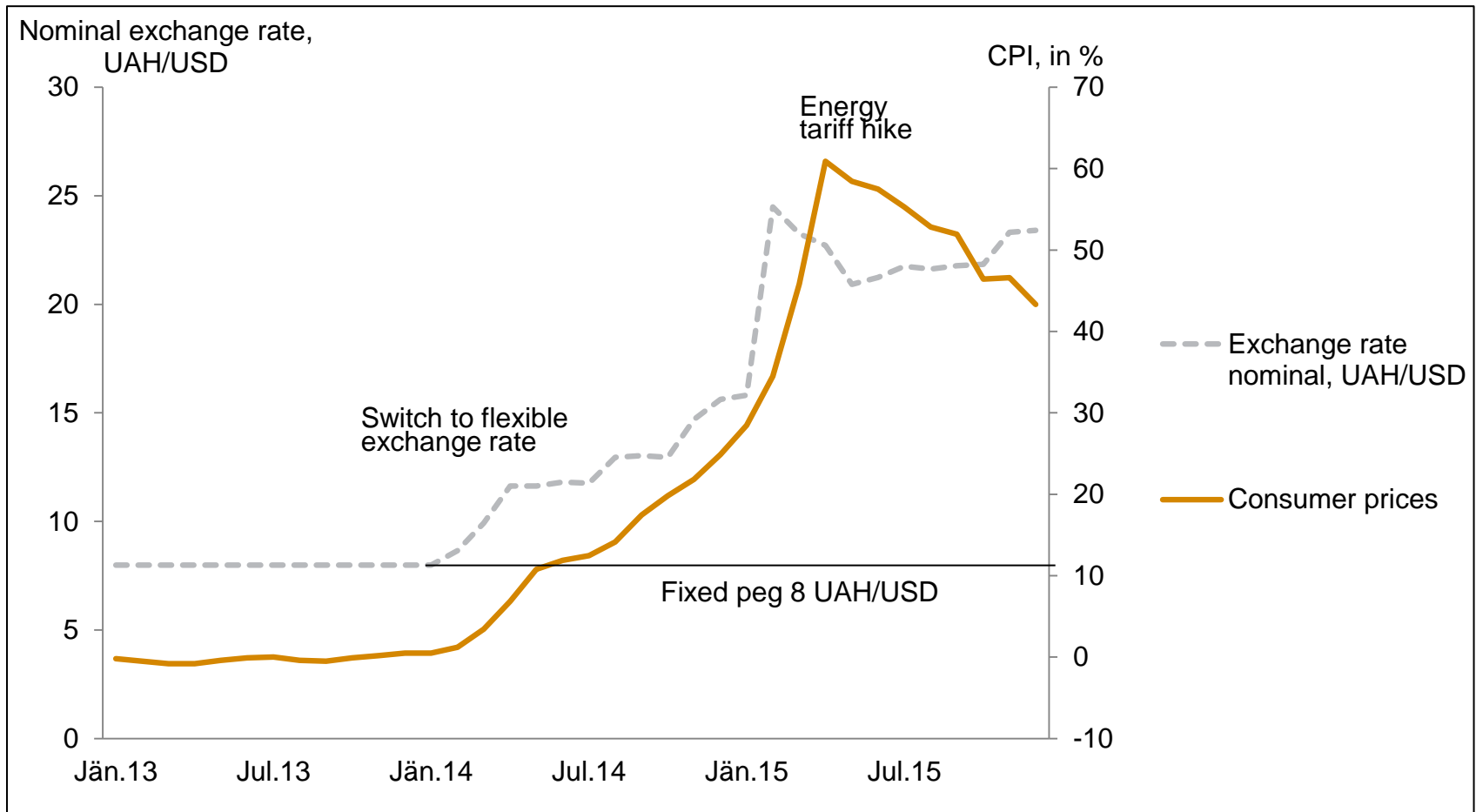


Source: Ministry of Finance.

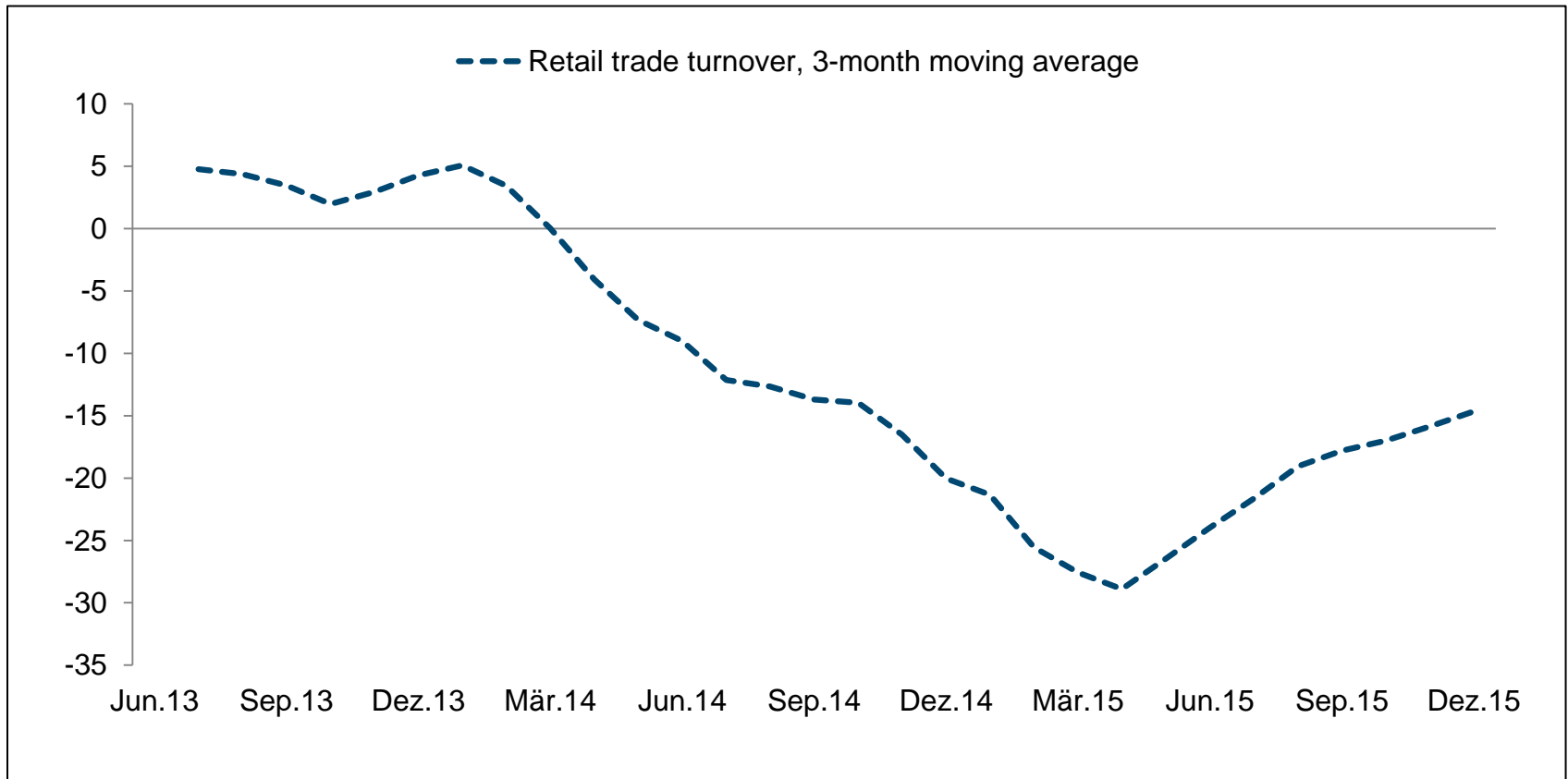
Conditions for flexible exchange rate/inflation targeting

	Present in Ukraine?
'Deep' and liquid market for foreign exchange	No
Effectiveness of 'classical' monetary policy tools: interest rates and open market operations	No
Alternative 'monetary anchor'	No
Reasonable (and credible!) inflation target	No

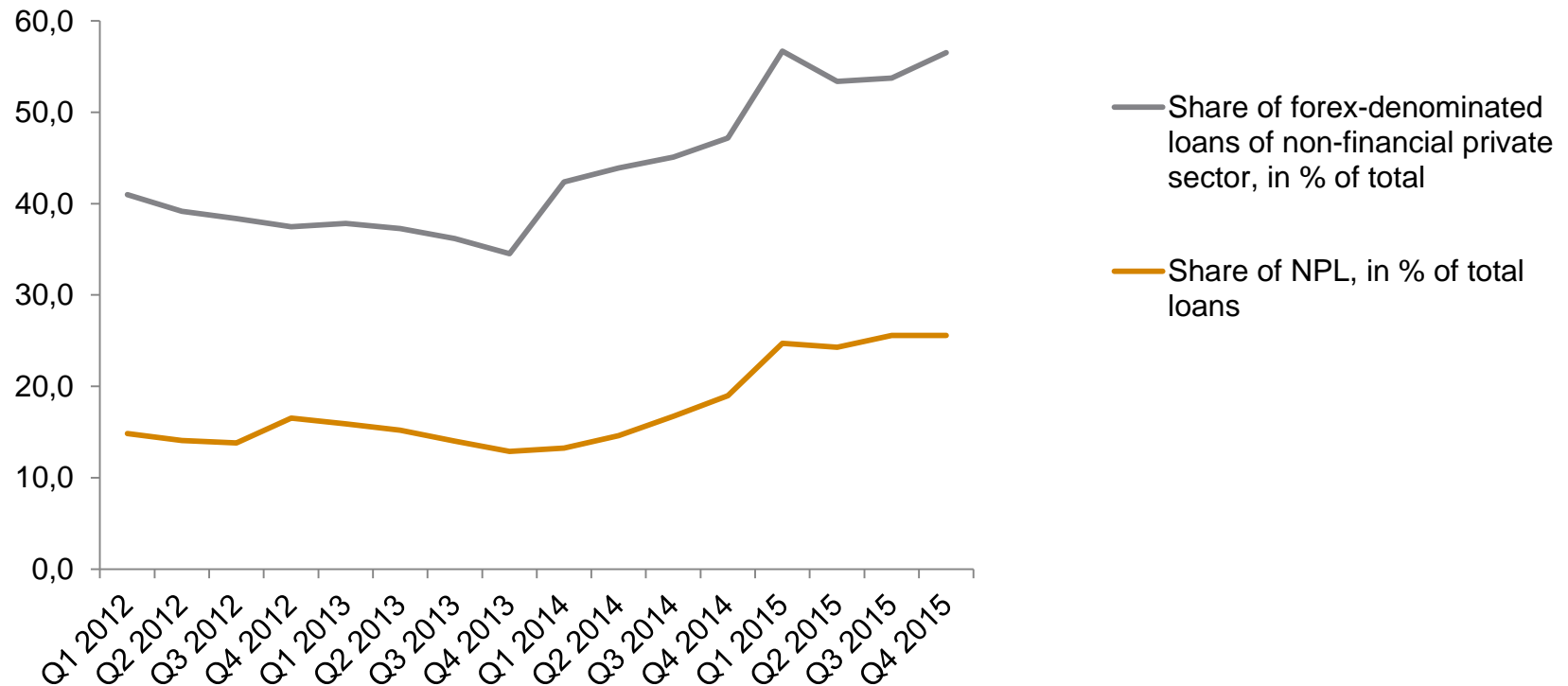
Currency depreciation fuelled inflation ...



... which eroded purchasing power of households



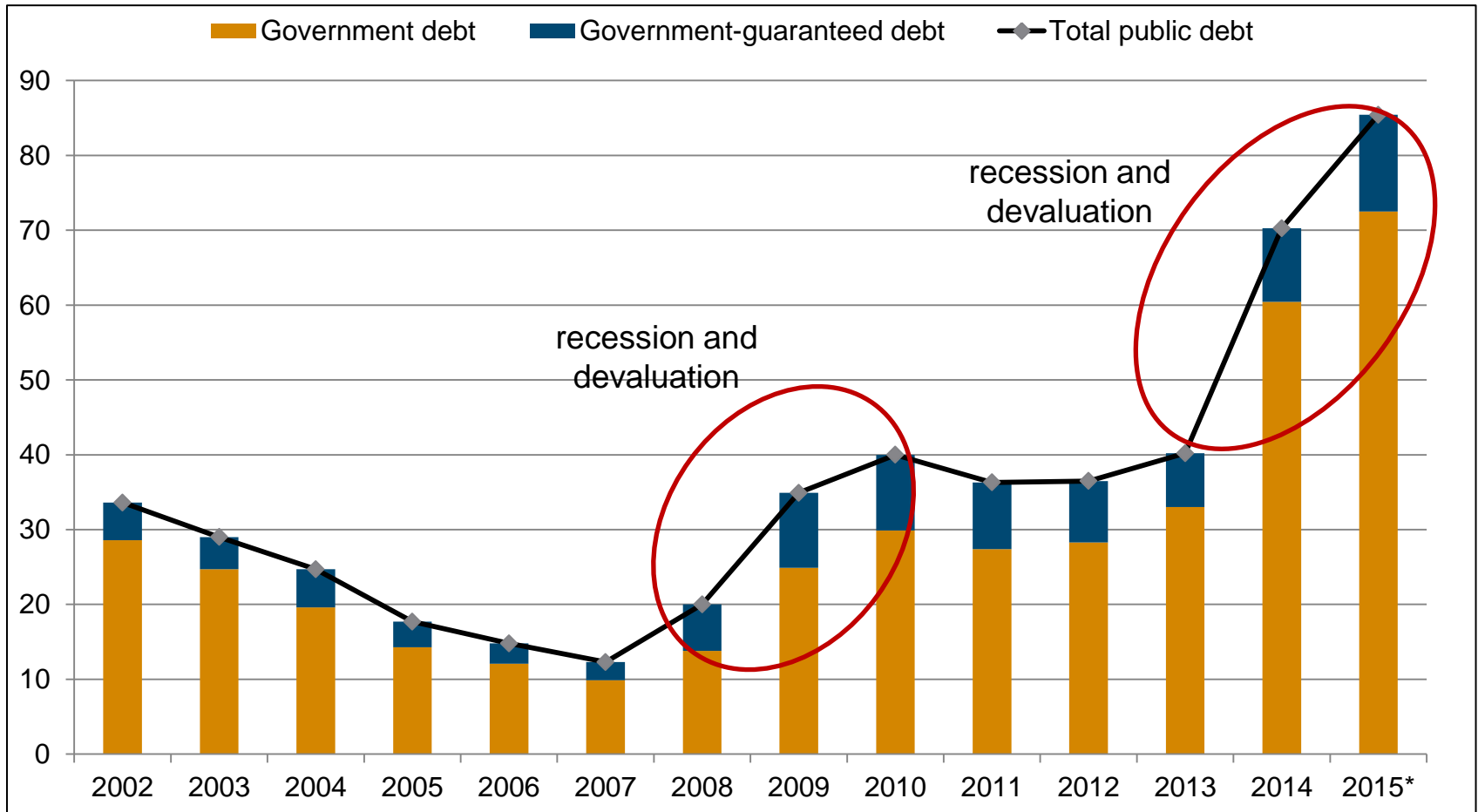
Share of forex-denominated loans vs. non-performing loans



Source: National Bank of Ukraine.

Public debt, 2002-2015

as % of GDP



* Estimate

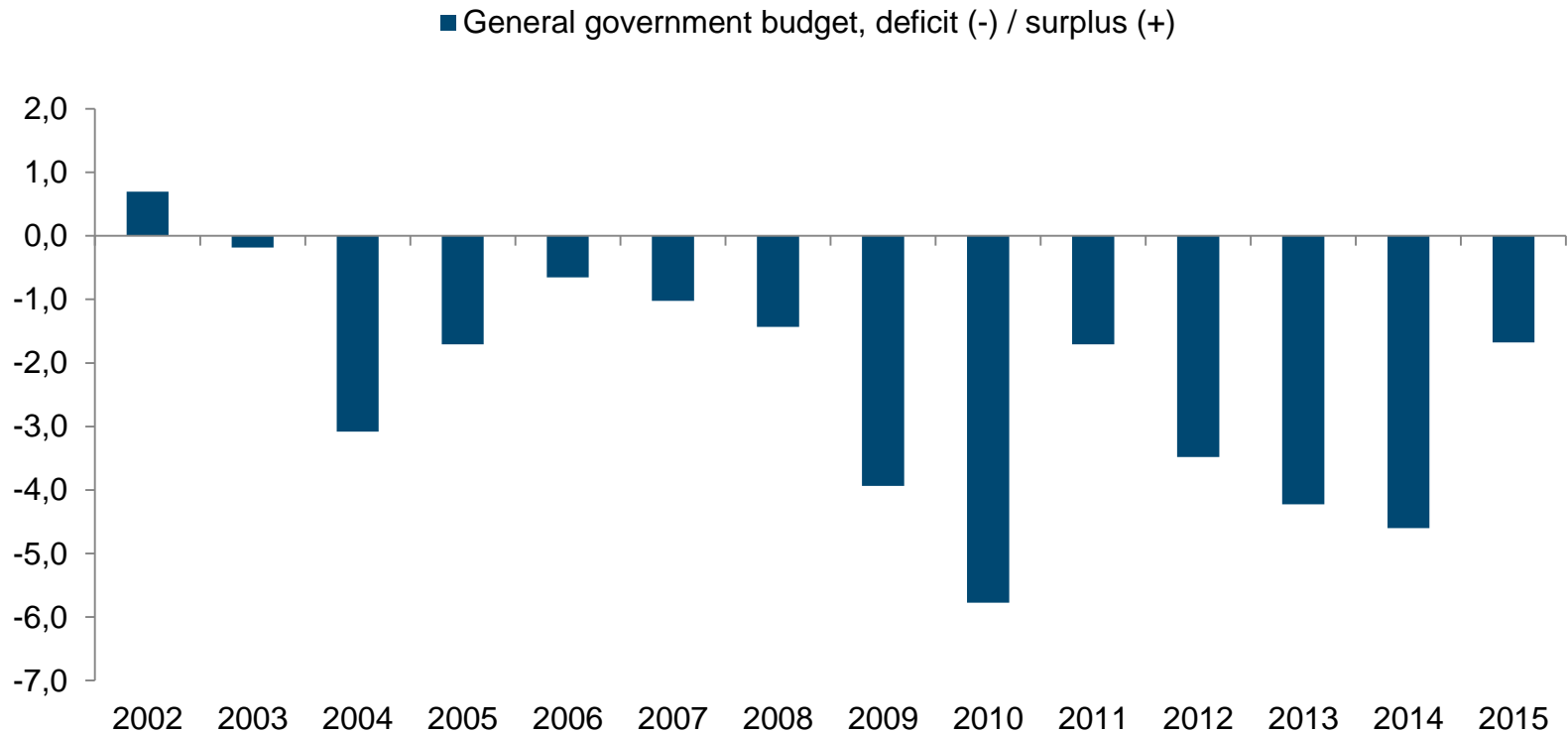
Source: Ministry of Finance.

Some conclusions

- Fixed exchange rate at 8 UAH/USD under Yanukovych was not sustainable
- Downward adjustment was needed
- But: flexible exchange rate led to excessive depreciation and ultimately extensive capital controls
- A better alternative would be some degree of ER fixation
- For that: substantial forex reserves are needed!

Budget deficit, 2002-2015

% of GDP



2015: estimate

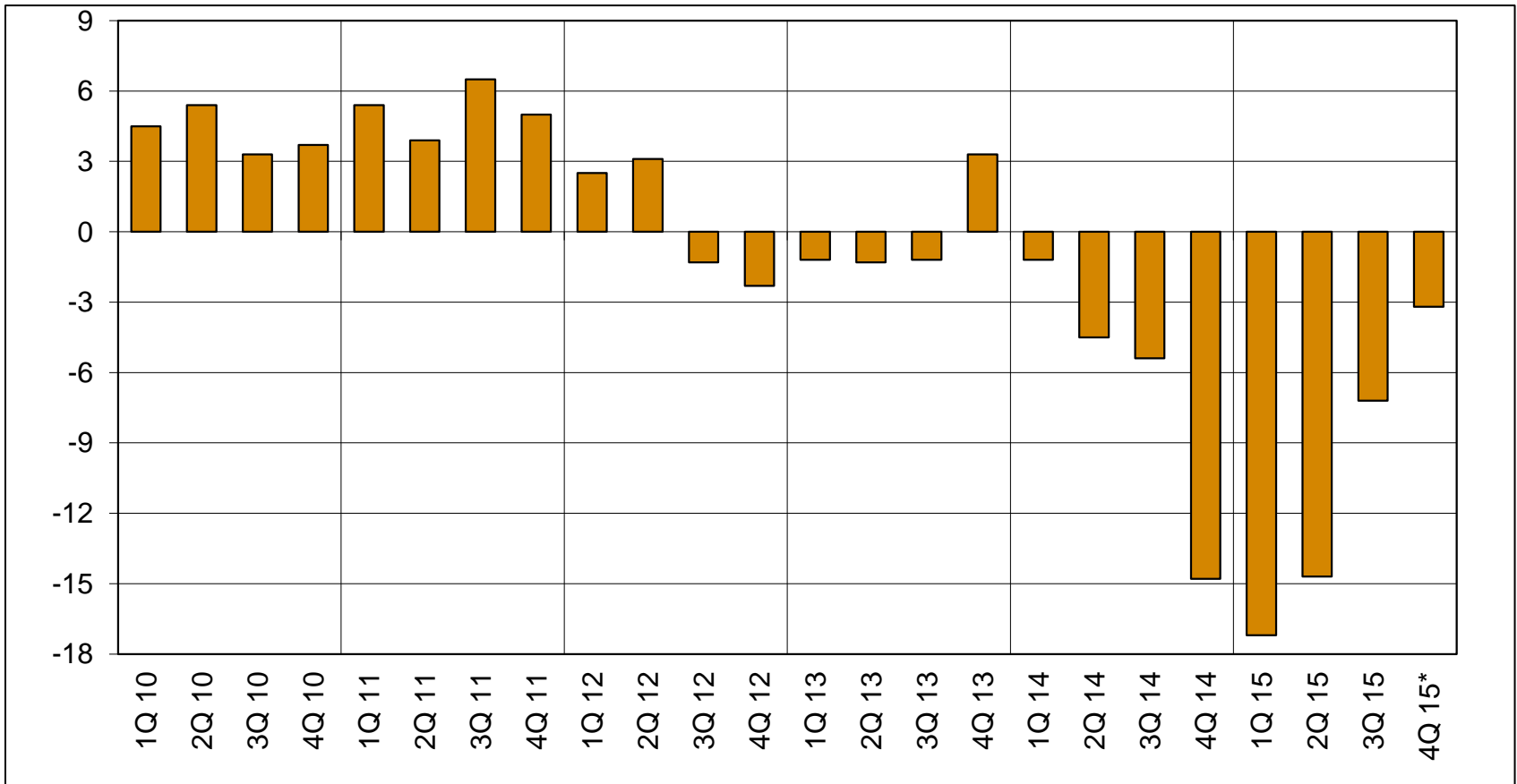
Source: wiiw Annual Database incorporating national statistics.

IMF-imposed fiscal austerity

- 2014: even keeping budget deficit constant at 4% of GDP required a sizeable consolidation effort because of recession (automatic stabilizers!)
- 2015: budget deficit was *reduced* by 3 pp of GDP in spite of even deeper recession
 - public sector wages and pensions largely frozen despite 43% inflation
- Plus: cuts in energy subsidies (some 3 pp of GDP in 2015)

Real GDP growth

year-on-year change in %

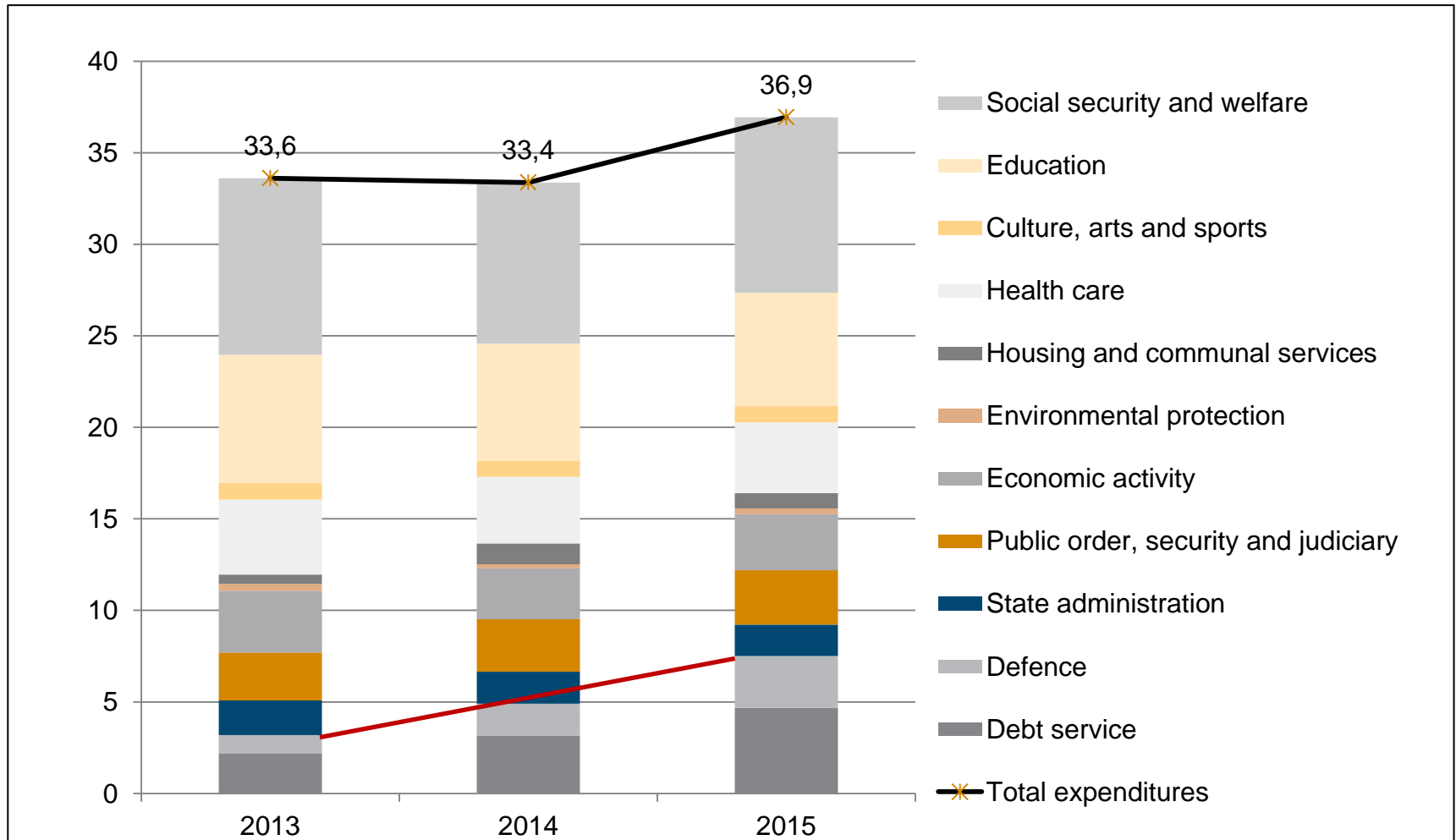


* preliminary

Note: From 2014 without Crimea and from 2015 without Crimea and parts of Donbass.

Source: State Statistics Service of Ukraine.

Budget expenditures, as % of GDP



Some conclusions

- Fiscal imbalances are **not** at the root of the current crisis (unlike e.g. in Greece)
- Public debt as a share of GDP has risen dramatically, but for other reasons
- Nevertheless: IMF demands pro-cyclical fiscal policy
- Main victims are health, education, pensioners...
- This will likely erode public reform support
- Alternatives: less austerity / change expenditures structure (e.g. more ambitious debt restructuring)

Thanks for your attention !!!

Tipp:

**„How to Stabilize the Economy of Ukraine“,
Background study prepared by wiiw, April 2015**

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www.wiiw.ac.at