

Atradius Country Report

Ukraine – March 2009



Overview

General information

Capital:	Kiev
Government type:	Republic
Currency:	Hryvnia (UAH)
Population:	45.9 million
Status:	Lower middle income country (GDP/capita: US-\$ 3,853 in 2008)

Most important sectors (% of GDP, 2008)

Services:	58 %
Industry:	32 %
Agriculture:	10 %

Main import sources (2007)

Russia:	28 %
Germany:	12 %
Poland:	8 %
China:	7 %

Main export markets (2007)

Russia:	21 %
Turkey:	7 %
Italy:	6 %
USA:	4 %

Important import products

Oil and gas (31 %), machinery and equipment (30 %)

Important export products

Steel/metals (43 %), machinery and equipment (18 %), agricultural products (10 %)

Key Indicators

	2005	2006	2007	2008*	2009**
GDP (US-\$ million)	86,151	107,762	141,168	177,704	97,311
Real GDP growth (%)	2.6	7.1	7.6	2.1	-12.0
GDP per capita (US-\$)	1,836	2,314	3,055	3,853	2,122
Inflation p.a. (%)	13.5	9.1	12.8	25.2	16.3
Fiscal balance (% of GDP)	-1.8	-0.7	-1.1	-1.2	-1.0
Total foreign debt (US-\$ million)	33,297	49,887	68,788	73,222	64,173
Foreign debt/GDP (%)	39	46	49	41	66
Foreign debt/XGS (%)	74	97	102	86	99
Short-term debt/inter. reserves (%)	61	72	68	66	60
Debt service ratio (%)	13	18	24	25	32
Current account balance (US-\$ m.)	2,531	-1,617	-5,272	-11,048	-2,033
Current account/GDP (%)	2.9	-1.5	-3.7	-6.2	-2.1
Nom. exchange rate to US-\$ (average)	5.12	5.05	5.05	5.27	9.41
International reserves (US-\$ million)	19,666	21,407	30,838	28,500	20,030
In months of merchandise imports	6.5	5.7	6.1	3.8	4.4

* estimated ** forecast

Source: Economist Intelligence Unit (EIU)

Political situation: Very unstable

Head of state:	President Viktor Yushchenko (since January 2005)
Head of government:	Prime Minister Yulya Tymoshenko (since December 2007)
Form of government:	“Orange” coalition of the YTB of prime minister Tymoshenko and the pro-Yushchenko Our Ukraine (OU).

Internal situation

Since the “Orange Revolution” in 2004 Ukrainian, politics has fallen victim to instability due to a permanent power struggle between the former communist Party of Regions (PoR) and the Orange-parties OU and YTP, headed by president Yushchenko and prime minister Tymoshenko respectively. The oppositional PoR favours good relations with Russia and strong ties with the very powerful business tycoons in the eastern part of the country, whereas the Orangists opt for market reform and tighter relations with the west. This political borderline is also dividing the main regions of the country: the western part mainly supports the Orangists, while the eastern regions back the PoR.

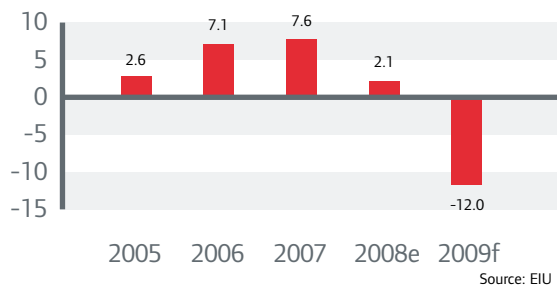
At the same time, the Orange-bloc itself is strongly divided because of a deep personal rivalry between prime minister Tymoshenko and president Yushchenko, who are constantly at odds with each other, thereby hampering any effective ruling and decision-making. The fact that the Ukrainian constitution does not provide a clear division of power and delineation of roles between president and prime minister has also fuelled this power struggle. After the collapse of the government in September 2008, three months of uncertainty and lack of effective ruling, the Orange-coalition was rebuilt, but since then the same tensions as before have lingered on, making governing extremely difficult. Another premature collapse of the coalition therefore seems very likely.

International relations

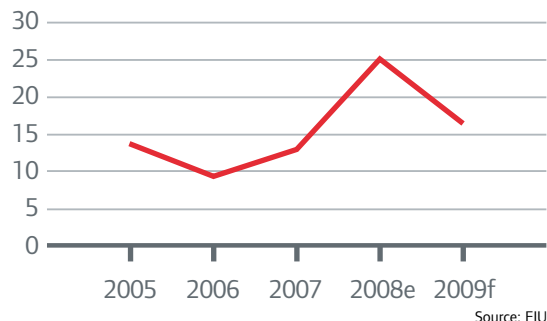
Relations with Russia are difficult, especially after the Orange coalition returned to power. The relationship deteriorated in recent months after Russia’s invasion of Georgia in August 2008 and the bitter dispute with Moscow over gas prices in January 2009. Accession efforts to EU and NATO have been scaled back.

Internal economic situation: Very bad: deep recession

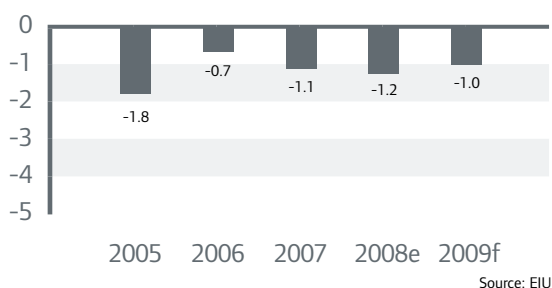
Real GDP growth (%)



Inflation p.a. (%)



Fiscal balance (% of GDP)



General situation

After years of high GDP-growth (>7 % p.a.) propelled by high exports and by household consumption financed by foreign currency loans, the economy has fallen into recession since the fourth quarter of 2008. The Ukrainian economy is currently in a virtual state of collapse: exports have dropped sharply, commodity prices have plunged and the financial system is frozen due to global credit crisis. Illiquidity and wage arrears are dragging real economic activities even further down. Economic figures are deeply worrying: real GDP contracted by 13 % in the last quarter of 2008, and industrial output shrank by 34 % year-on-year in January 2009. The projection for a real GDP-contraction of more than 10 % in 2009 may even be too optimistic. Inflation has come down from its peak in mid-2008 (31 %) and reached 22 % end of 2008.

This downfall is aggravating the already high credit risk of the private and state sectors - with their high foreign currency debts denominated in euro and US-\$ - and of banks, with rapidly accumulating bad loans. Many households and corporates already struggle to service their debts; most at risk is the heavily indebted state-owned energy firm Naftogaz. This struggle will become even more difficult the further the economy contracts and the exchange rate of the hryvnia falls. With insufficient reserves to defend the exchange rate peg, the authorities have had to allow the hryvnia to depreciate against the US-\$ in mid-2008. Since then the hryvnia has lost over 40 % of its value, raising the costs of servicing foreign currency denominated debt. It is to be expected that many households and corporates will not be able to honour their payment obligations in 2009 and beyond and will end up in default.

Such a scenario would further exacerbate the financial problems in the already stressed banking sector. To date, deposit losses have hit the sector hard. Banks are very vulnerable to a drop in the hryvnia and a further rise of the already high share of non-performing loans (15 %) in addition to the obligations to honour their own debts. So far seven banks had to be nationalised, including Prominvest and Nadra. In view of the international illiquidity it is to be expected that even more banks will have to take recourse to public sector support.

Economic policy

In late October 2008 the International Monetary Fund (IMF) and Ukraine agreed on a US-\$ 16.4 billion loan to stabilise the economy, but the vexed political situation has made it almost impossible to comply with the IMF conditions of strict budgetary policy: Prime Minister Tymoshenko is resisting IMF pressure to balance the 2009 budget, as cutting the deficit would force her to cancel some social spending she had promised to voters. This would put her popularity to the test and probably hamper her chances in the presidential elections next year. Instead she has turned to other countries for support, including Russia. President Yushchenko in turn has demanded that Tymoshenko should strictly abide by the IMF-conditions, as he wants to weaken her political position ahead of the election. As a consequence of Tymoshenko's 2009 budget plan with a deficit of 3% of GDP, the IMF has cancelled the disbursement of the loan's second tranche for the time being. This stalemate is rapidly weakening the fiscal position of the government and putting additional pressure on the currency.

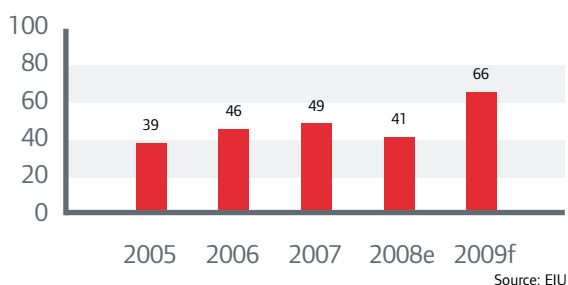
The central Bank has pumped liquidity into the banking sector in order to counter the meltdown in the financial markets. But the monetary policy is essentially ineffective because of a high dollarization and Ukrainian banks' heavily borrowing abroad.

Energy situation

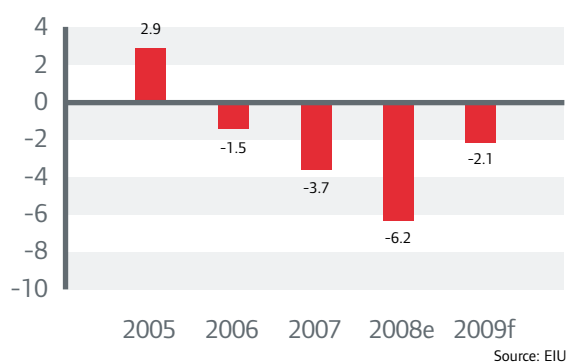
Abundant coal reserves, but only minor oil and gas deposits.

External economic situation: Very bad: on the brink of default

Foreign debt/GDP (%)



Current account/GDP (%)



Foreign debt

- Level: Strongly risen to US-\$ 73 billion by the end of 2008 (41 % of GDP and 86 % of exports of goods and services). Mainly private-sector debt accumulation
- Structure: Not favourable: high short-term-share (about one-third)
- Debt service ratio: Risen to more than 25 %. Including the short-term obligations climbing to > 50 % in 2009

Remarks:

After a selective default in 1999 (non-resident treasury bills and bonds) Ukraine concluded debt-restructuring deals with commercial creditors, Russia (including Gazprom) and the Paris Club. Since the outbreak of the credit crisis in mid-2008 ratings have been downgraded again. In November 2008 Ukraine received a two-year IMF-standby (US-\$16.4 billion, of which US-\$4.5 billion were immediately disbursed). Although public debt levels are low, contingent liabilities from the banking sector are building up very rapidly.

Balance of payments

Trade balance:	Improving from a record deficit in 2008
Current account:	Improving after a record deficit of 6.2 % of GDP in 2008
Capital account:	Less positive. Negative in the second half of 2008
Total account:	Negative in 2008

Remarks:

Market-based financing of the current account deficit is virtually impossible, and roll-over of existing debt obligations is increasingly difficult. In the absence of IMF-support, Ukraine's government would have to tap the central bank's foreign reserves, or seek a loan deal from another government. This would risk further depreciation of the currency and a possible run on the highly dollarized banking system.

International reserves

In months of imports (cif):	Reserves have fallen from US-\$37.5 billion in September 2008 to US-\$ 28 billion in January 2009. Net foreign assets have become negative.
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Outlook: Very precarious

Internal political situation

The political situation will remain unstable until the next presidential elections in 2010. The lack of consensus between the parties and personal rivalries between the key politicians will continue to negatively affect the economic performance.

External political situation

Ukraine will continue to balance its ties with Russia (favoured by the powerful PoR-clans, fact of energy dependency) and closer relationship with the West (favoured by Orangists, EU and NATO integration as a long-term goal).

Internal economic situation

Domestic consumption is under severe pressure. Forecasts assume a contraction in consumer spending of as much as 20% in 2009. Household finances are being constrained by the depreciation of the currency which is at once raising the costs of servicing foreign currency denominated debt and pushing up the price of imported goods. Energy price adjustments and rising unemployment are exacerbating the situation. Non-performing loans and payment arrears will sharply increase due to the economic meltdown and the falling hryvnia exchange rate. The government lacks the liquidity needed to bail out the troubled corporate/banking sector and overcome the crisis, contributing to a wave of defaults and bankruptcies. The IMF-conditions require a flexible exchange rate, banking sector recapitalisation, a balanced public sector budget in 2009 and more reforms (land reform, privatisations).

External economic situation

Very bad: even taking into account the huge financial funding (IMF, bilateral support) Ukraine will not be able to fully honour its debt service by corporates and banks, risking a free fall of the hryvnia.