

# MEMU Supplement No.5-2006

## Deceleration of economic growth in 2005: what statistics tell us

According to revised information disseminated by the Derzhkomstat in April, in 2005 the real GDP growth decelerated to 2.6%, being the lowest after the start of economic recovery in Ukraine in 2000. Although the growth of households' final consumption reached historical maximum of 16.6%, it was not able to fully compensate for negative changes in external demand. In addition, growth of investments essentially stopped in 2005.

The slow real GDP growth is mostly explained to a sharp reduction of real exports, which was an engine for Ukraine's economic recovery in 2000-2004. After several years of strong growth, in 2005 real exports of goods and services declined by 11.2% due to reduction in commodity trade. There were three major product categories, exports of which declined: energy products, machinery and equipment, and metals.

The reduction of metal exports was the most painful, as it constituted approximately a third of total exports. The decline is explained by two key factors. First, world prices for metal products reduced. Second, one of the key consumers of Ukrainian metal – China – considerably expanded its metal products. As a result, China has not only cut back on a demand for metals from Ukraine, but also started to compete with Ukraine for other markets.

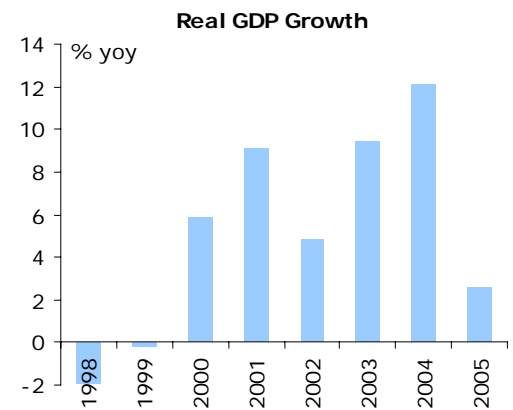
Also, the year 2005 has been the first year of negative gross fixed capital accumulation since 1996. Real gross fixed capital accumulation reduced by 0.3% in 2005, while during the previous five years its average annual growth rate was above 10%. Investments in fixed capital – the major component of gross fixed capital accumulation – increased by very modest 1.9% compared to 28.0% rise in 2004. In addition to statistical base effect, the sharp deceleration of investment activity in 2005 was attributed to several groups of factors.

First, there was elimination of selected decisions of previous governments. The most striking was a revision of earlier privatisation settlements that created an ambiguity concerning property rights. Also, sudden changes in tax legislation, in particular elimination of special economic zones, became a negative shock for investors. Also, there was a period 'between elections' when a lot of investment decisions were postponed until high political uncertainty would be resolved.

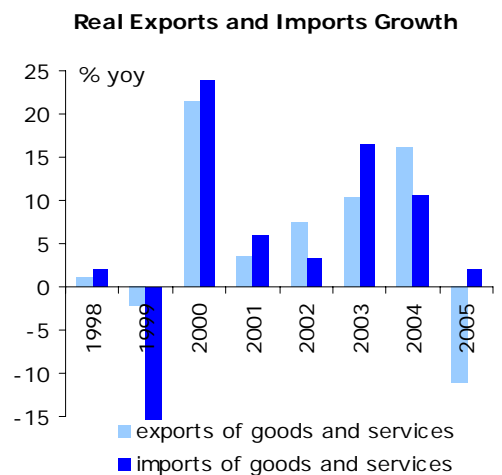
In addition, an expansionary wage and social policies resulted in change of value added distribution in the economy. In particular, in 2005 the share of wage bills in the GDP was 47.0%, a 1.4 percentage point above the 2004 figure, while the share of net taxes increased by 3.3 percentage points to 13.5%. These changes happened at the expense of the share of gross operational surplus/mixed income that dropped by same 4.7 percentage points to 39.5%. The lower share of profits signals about reduced capacity to invest from own funds of enterprises, so far the key source of investment financing in the country.

The positive growth rate of GDP was ensured by stable development of private consumption. In other words, the economic growth in Ukraine was used to compensate for the long-lasting downturn in households' well-being. In 2005 the households' consumption increase was mainly attributed to higher demand for non-food products and services, in particular telecommunication, recreational activities and health care. The increased incomes plus rapid development of consumption micro-crediting created the financial foundation for such expansion.

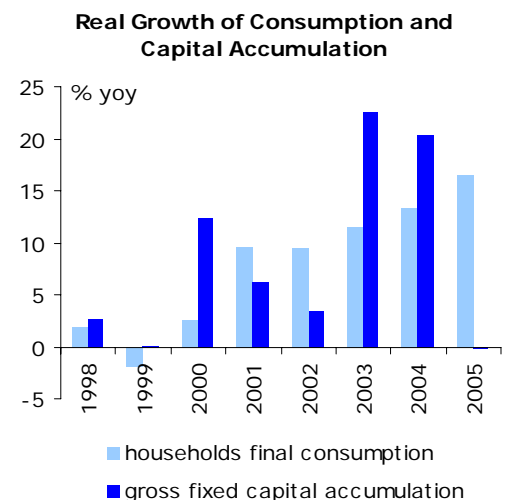
The GDP deceleration in 2005 further accentuated two problems of Ukraine's economic development. The first is a low diversification of exports that makes the country extremely vulnerable to single-market external shocks. The second is a leading growth of private consumption at the expense of investments. If these two problems are not solved, no sustainable growth in Ukraine can be expected.



Source: Derzhkomstat



Source: Derzhkomstat



Source: Derzhkomstat

Author:  
Veronika Movchan  
Institute for Economic Research and  
Policy Consulting



## Quarterly Trends

National accounts **		Q3 03	Q4 03	Q1 04	Q2 04	Q3 04	Q4 04	Q1 05	Q2 05	Q3 05	Q4 05
GDP	UAH bn	75.6	77.1	64.7	79.0	100.5	100.6	84.3	97.5	119.4	123.6
GDP (real)	% yoy	6.8	12.1	12.7	13.7	14.0	8.5	4.9	3.4	1.4	1.7
Households consumption (real)	% yoy	11.2	13.6	14.6	16.8	13.1	16.2	14.3	17.7	17.0	17.1
State consumption (real)	% yoy	19.2	9.0	3.3	1.0	5.0	10.1	6.1	0.0	1.0	4.0
Gross fixed capital formation (real)	% yoy	24.3	9.0	18.4	6.5	4.6	12.9	-2.3	-0.5	0.2	0.3
Exports of goods and services (real)	% yoy	9.8	11.6	18.1	19.9	10.5	8.6	-0.6	-14.0	-12.7	-15.5
Imports of goods and services (real)	% yoy	17.4	17.7	13.8	7.3	6.7	7.8	2.8	3.2	3.9	-0.9
Agriculture, hunting, forestry (real)*	% yoy	-22.5	6.7	-4.4	0.9	35.7	9.9	5.8	8.3	2.6	-7.4
Manufacturing industry (real)*	% yoy	23.0	20.1	23.9	16.3	12.5	9.4	7.0	1.8	-1.1	2.0
Construction (real)*	% yoy	30.9	16.9	29.9	30.6	16.4	3.9	-8.4	-11.3	-8.5	-7.5
Trade, repair services (real)*	% yoy	22.6	29.6	23.6	35.0	2.7	13.7	-2.1	-10.7	-11.7	-11.9
Transport (real)*	% yoy	15.9	11.7	10.1	8.0	12.3	10.5	6.6	5.7	2.8	7.8
<b>Balance of payments</b>											
Current account balance	USD bn	0.7	0.4	1.4	2.3	2.1	1.1	1.6	0.6	0.4	-0.1
Current account balance	% of GDP	5.0	3.0	11.1	15.7	10.9	5.7	10.1	6.3	4.5	3.0
Trade balance in goods	USD m	-155	-381	933	1552	774	482	1020	-236	-1131	-788
Trade balance in services	USD m	362	409	133	198	749	157	188	392	1035	191
Current transfers	USD m	574	584	475	758	720	623	626	694	745	780
Direct investment (FDI)	USD m	390	329	333	614	420	344	247	365	477	6474
Portfolio investments	USD m	-444	-293	449	149	1313	156	397	923	90	1347
Gross international reserves	USD bn	6.7	6.9	7.9	9.6	12.1	9.5	12.0	13.1	14.3	19.4
<b>Fiscal indicators</b>											
Consolidated fiscal revenues	% of GDP	30.1	28.6	27.2	26.9	26.3	25.9	32.1	35.1	31.5	31.0
Personal income tax	% of GDP	5.3	5.1	4.4	4.1	3.8	3.8	4.3	4.4	3.9	4.2
Enterprise profits tax	% of GDP	4.8	5.0	3.9	4.0	4.1	6.1	4.8	5.9	5.3	6.3
Value-added tax	% of GDP	5.8	4.8	6.2	5.7	5.1	4.1	8.6	9.2	7.9	7.3
Excise tax	% of GDP	2.1	2.0	2.1	2.1	2.0	1.8	2.0	2.0	2.0	1.7
Consolidated fiscal expenditures	% of GDP	27.9	28.8	25.3	26.5	26.8	35.2	28.3	36.4	28.1	41.7
Current expenditures	% of GDP	24.2	24.3	22.4	22.7	21.7	27.2	26.5	33.6	24.0	34.2
Capital expenditures	% of GDP	3.7	4.4	2.9	3.8	5.1	8.0	1.8	2.7	4.1	7.5
Consolidated fiscal balance	% of GDP	2.2	-0.2	1.9	0.4	-0.5	-9.3	3.7	1.0	-5.0	6.2
Privatisation receipts	% of GDP	1.0	0.8	1.5	3.7	3.5	1.0	0.2	0.6	0.6	16.0
<b>Labour market</b>											
Average wage (real)	% yoy	19.9	14.9	19.9	18.6	14.7	15.4	15.0	19.0	19.6	26.4
Household income (real)	% yoy	10.0	8.7	11.7	16.3	11.3	16.6	24.0	28.0	19.4	18.9
Unemployment rate (ILO methodology)	%	9.2	9.0	9.3	8.3	8.1	8.7	8.7	7.0	5.2	7.8
<b>Banking system</b>											
Monetary aggregate M0	% yoy cum	30.5	25.3	29.1	25.6	37.1	27.9	28.2	39.1	31.1	42.2
Monetary aggregate M2	% yoy cum	49.9	47.6	45.4	44.8	51.5	32.3	38.9	37.4	31.3	53.9
Household deposits in national currency	% yoy cum	65.0	66.1	69.4	67.3	67.9	26.2	28.3	31.6	30.4	90.8
Household deposits in foreign currency	% yoy cum	70.4	77.5	67.0	61.7	55.2	54.3	51.8	45.4	46.4	59.1
Com. bank credits in national currency	% yoy cum	73.0	61.7	56.8	52.1	44.3	29.4	28.3	32.6	43.4	58.7
Com. bank credits in foreign currency	% yoy cum	57.7	60.9	63.6	56.2	43.5	32.2	33.1	36.8	47.1	66.3
Long-term com. bank credits	% yoy cum	164.0	157.9	141.7	102.7	82.7	57.1	49.5	53.0	70.1	84.6
Long-term com. bank credits	% of total	40.1	45.0	47.4	49.3	50.9	54.2	54.4	56.1	59.7	61.8
Average lending rate on national cur. credits	% p.a.	17.2	17.7	17.2	16.6	17.0	17.6	17.0	15.4	15.4	16.4
Average lending rate on foreign cur. credits	% p.a.	11.7	10.9	12.2	12.1	12.6	12.2	12.1	11.0	11.3	11.7

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

\* change in value added

\*\* preliminary

## Notes:

yoy year on year change

p.a. per annum