



# Ukraine's Economy in the Volatile Global Context

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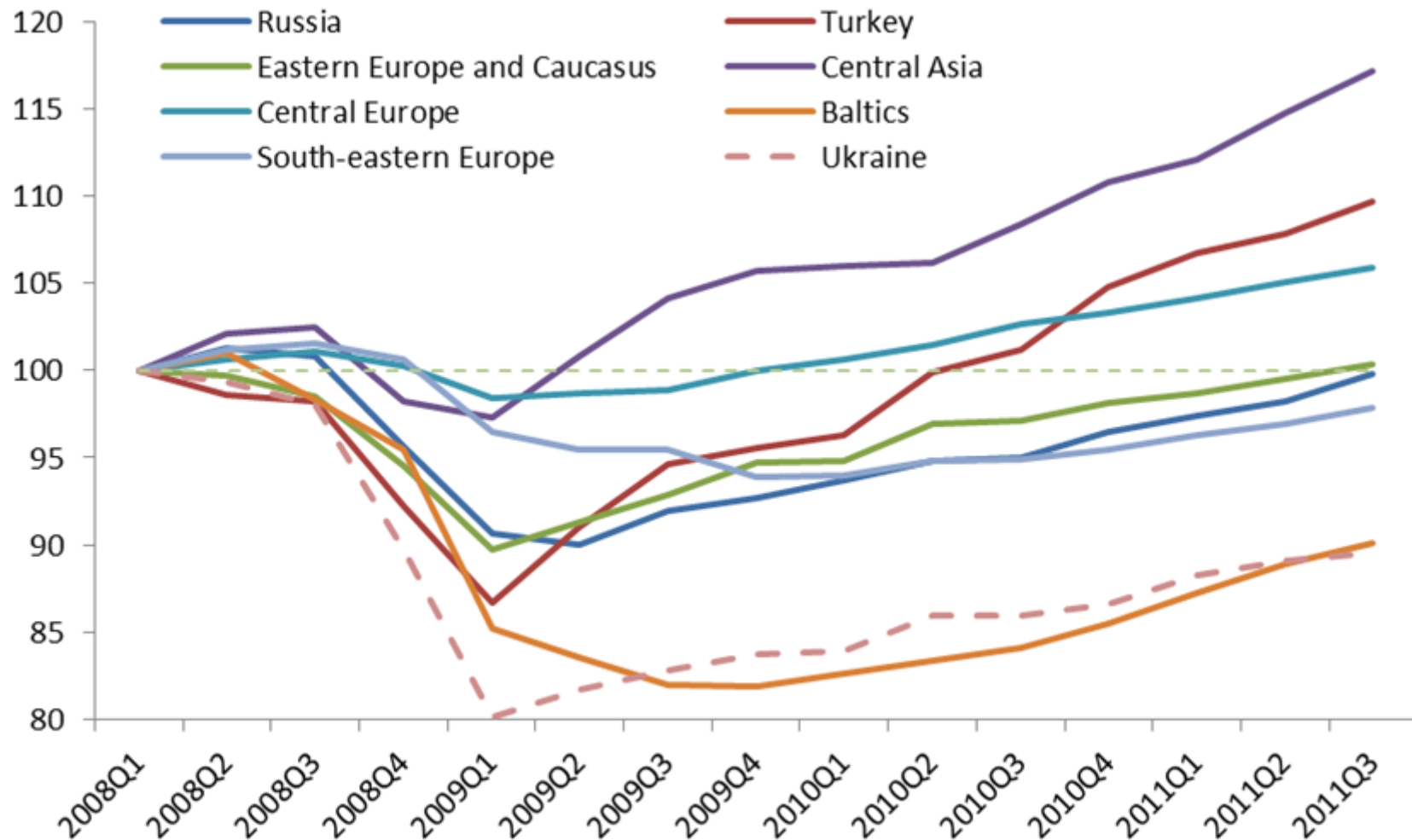
21 February 2012

1. The impact of the 2008-09 crisis on households (based on 2011 Transition Report)
  - Role of social safety nets, access to finance *in* the crisis
  - Mortgage borrowing *before* the crisis (FX vs. local currency)
2. A new crisis? Emerging Europe under threat from the Eurozone
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# The region's economies were hit hard by the crisis...



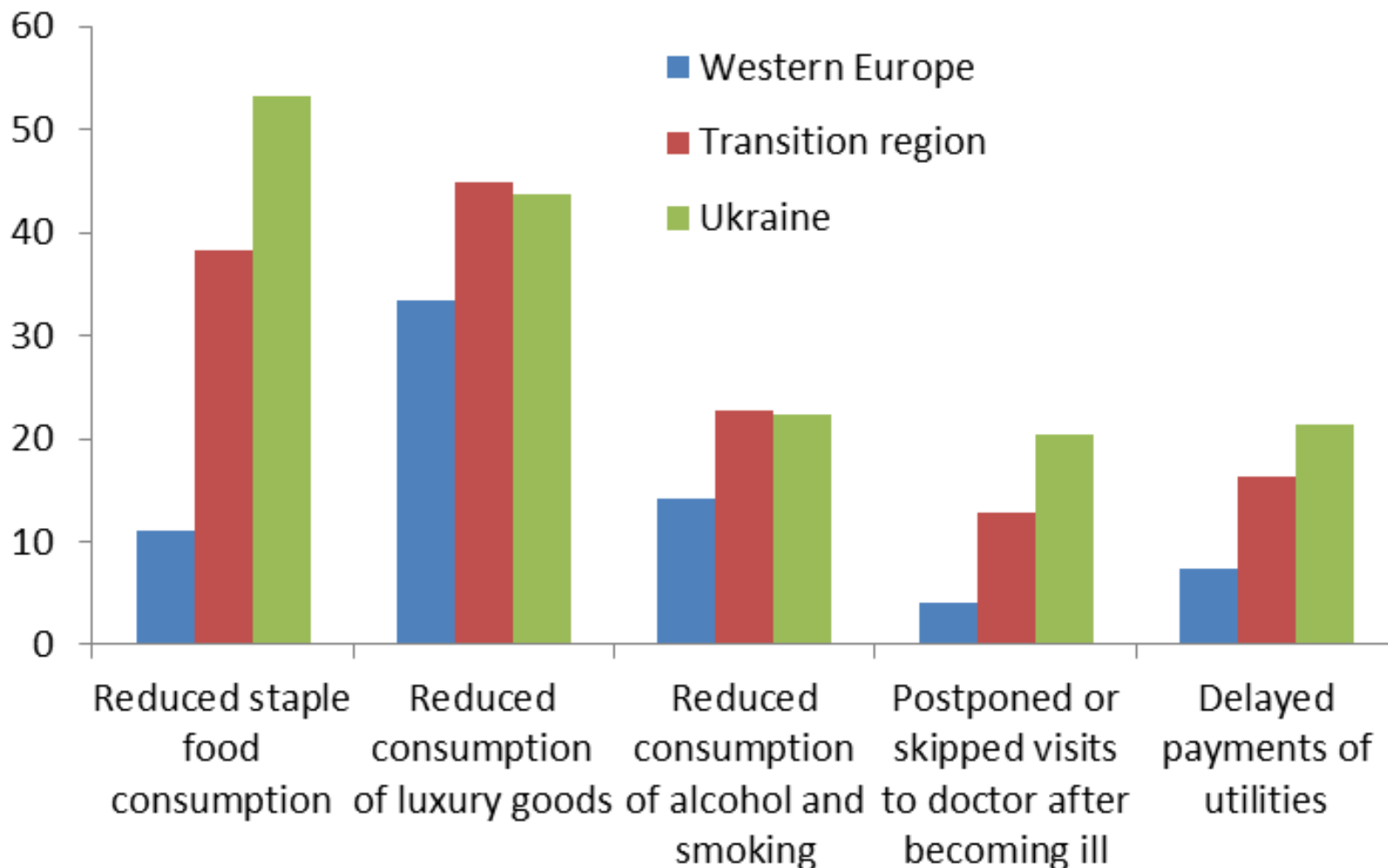
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# Consumption falls bigger across all categories, with Ukrainians hit hard



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# What explains why households hurt so much?



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## 3 drivers of crisis-induced consumption fall

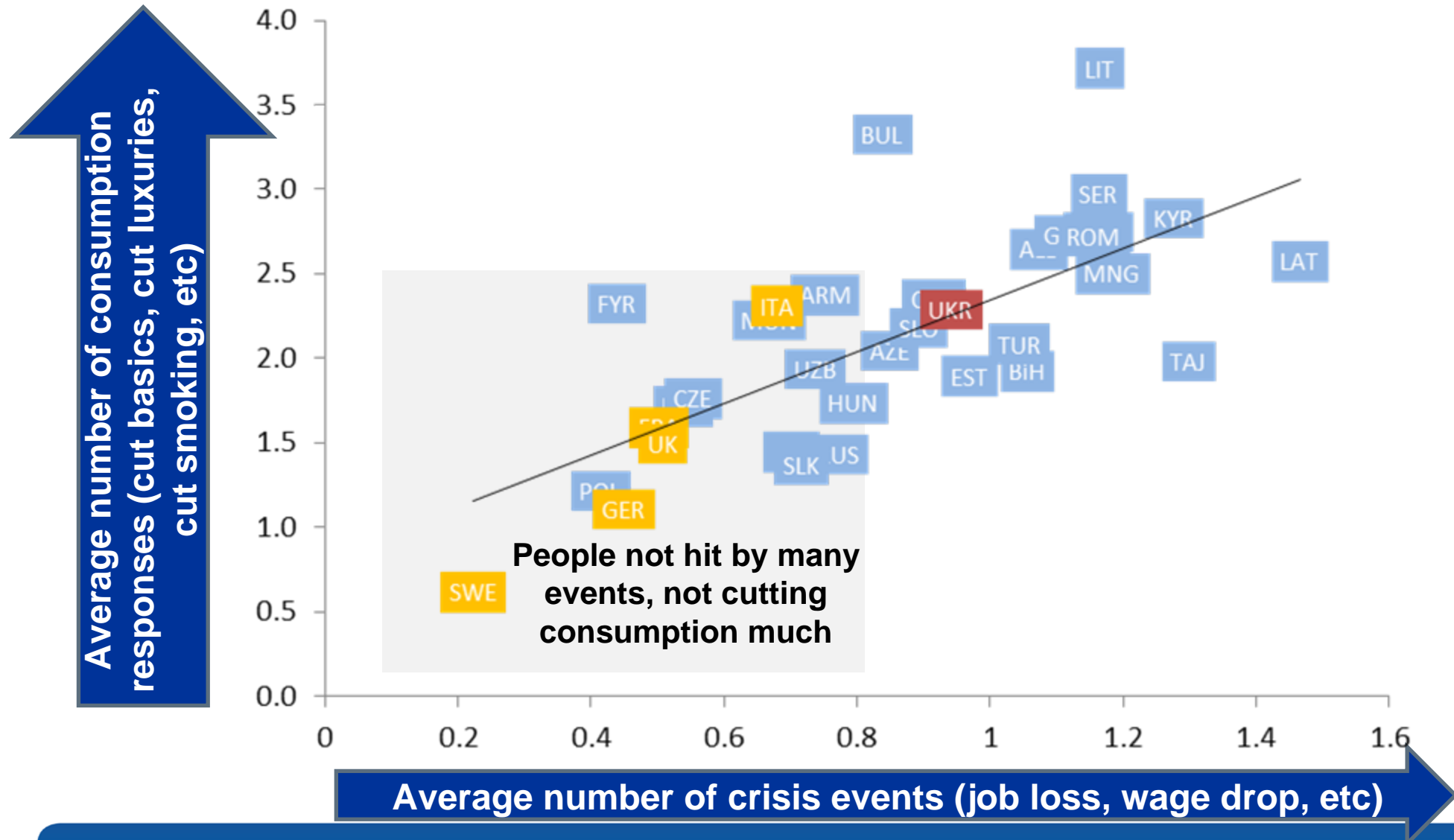
- 1 Large actual crisis shocks (job losses, bankruptcies, wage reductions ...)
- 2 Formal safety nets (state, borrowing) not widely used and not very effective
- 3 FX borrowing exacerbated the impact in crisis-hit countries

# Crisis-induced consumption response driven by “crisis events”



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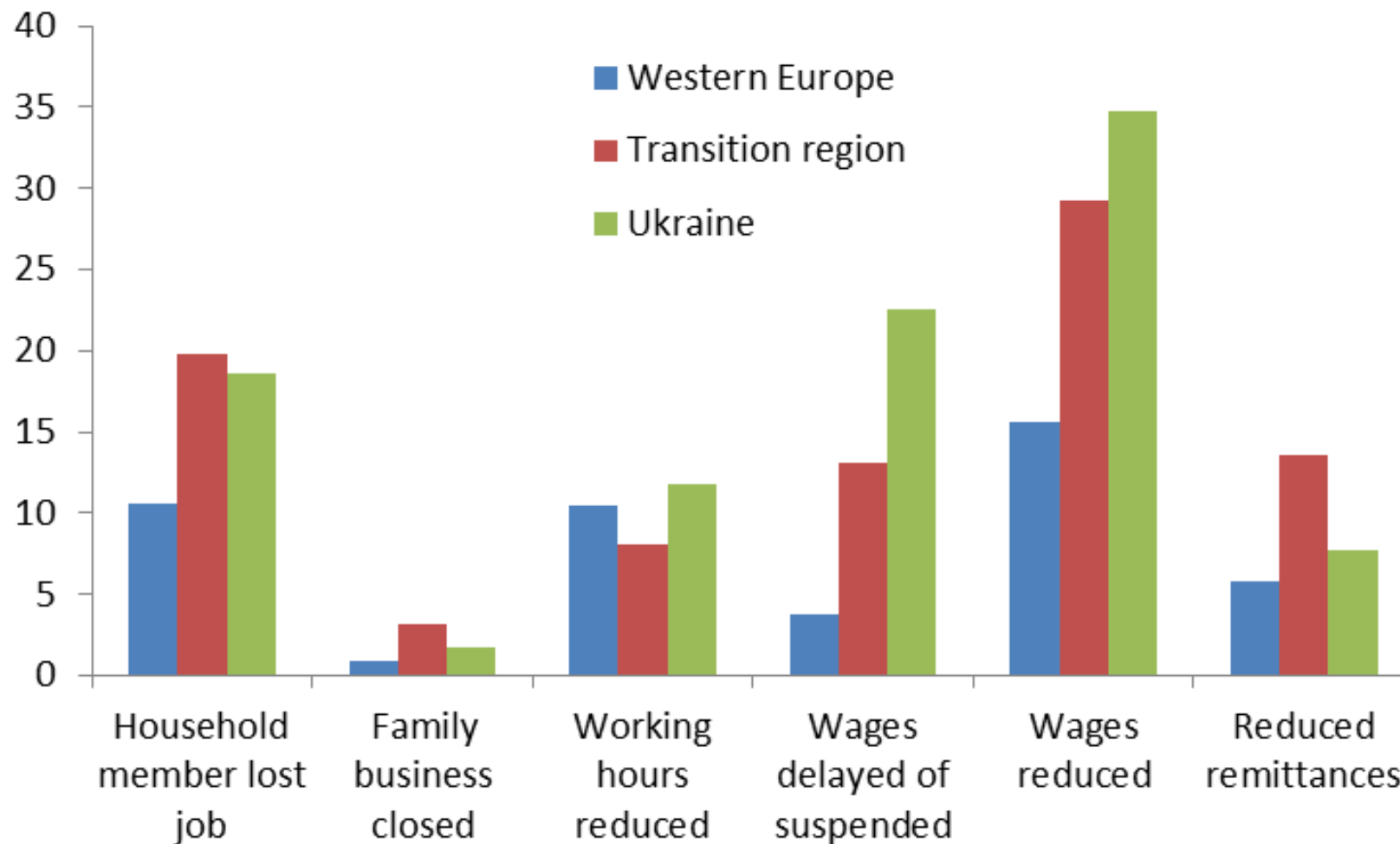


# Many Ukrainians report wage reductions...



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# ...which had a high impact on consumption



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Dependent variable: base consumption response (index)

Country sample	Transition region		Western Europe	
	[1]	[2]	[3]	[4]
Crisis event impact	0.349*** (0.014)		0.291*** (0.043)	
<i>Job loss</i>		0.487*** (0.028)		0.399*** (0.081)
<i>Close business</i>		0.243*** (0.044)		0.413** (0.186)
<i>Less wage income</i>		0.446*** (0.030)		0.319*** (0.072)
<i>Less remittances</i>		0.335*** (0.032)		0.197*** (0.034)
<i>Reduced hours</i>		0.276*** (0.036)		0.225*** (0.072)
Observations	30,469	30,469	5,278	5,278
R-squared	0.217	0.213	0.242	0.239

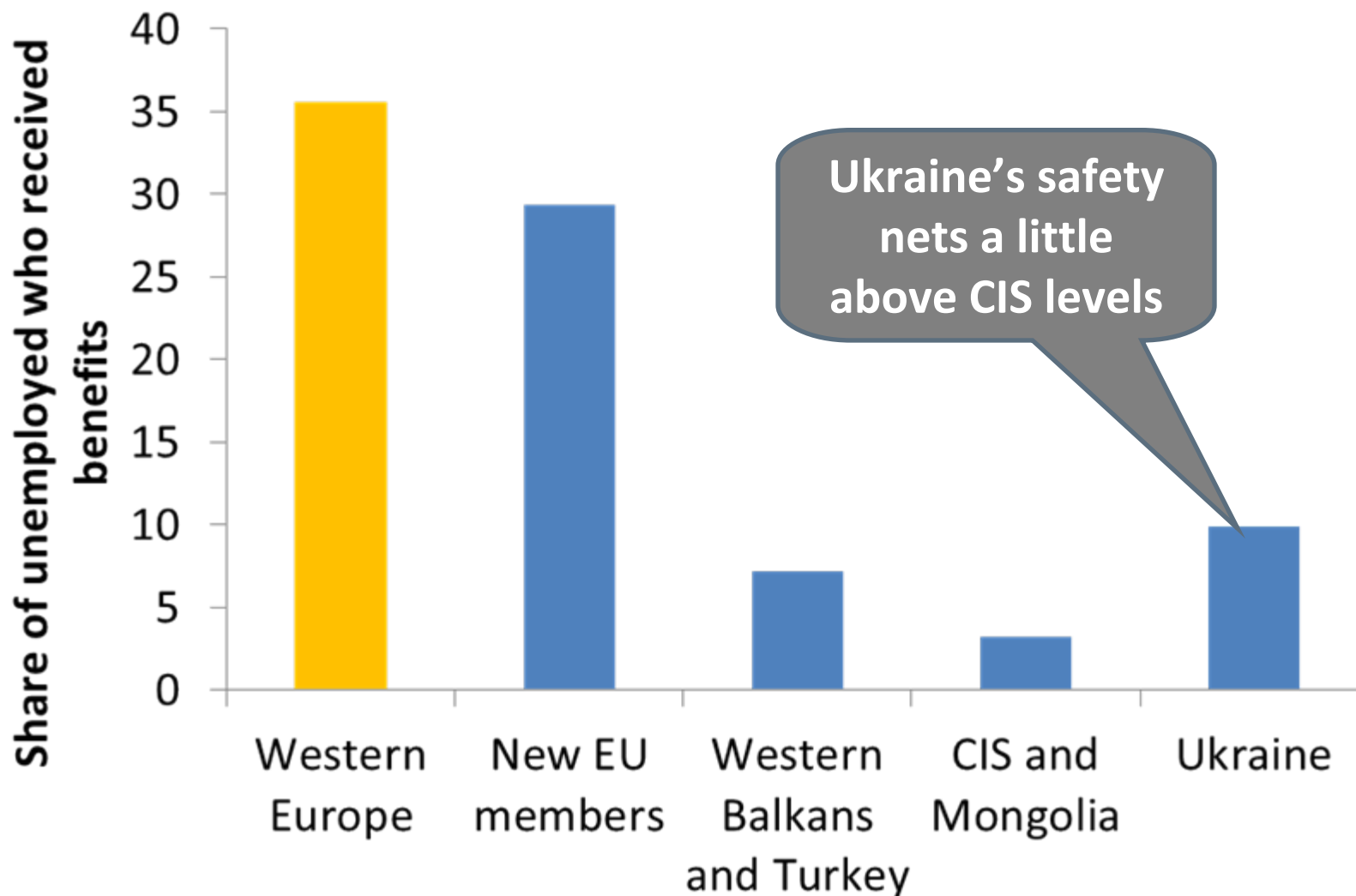
Socio-economic controls and country fixed-effects included.



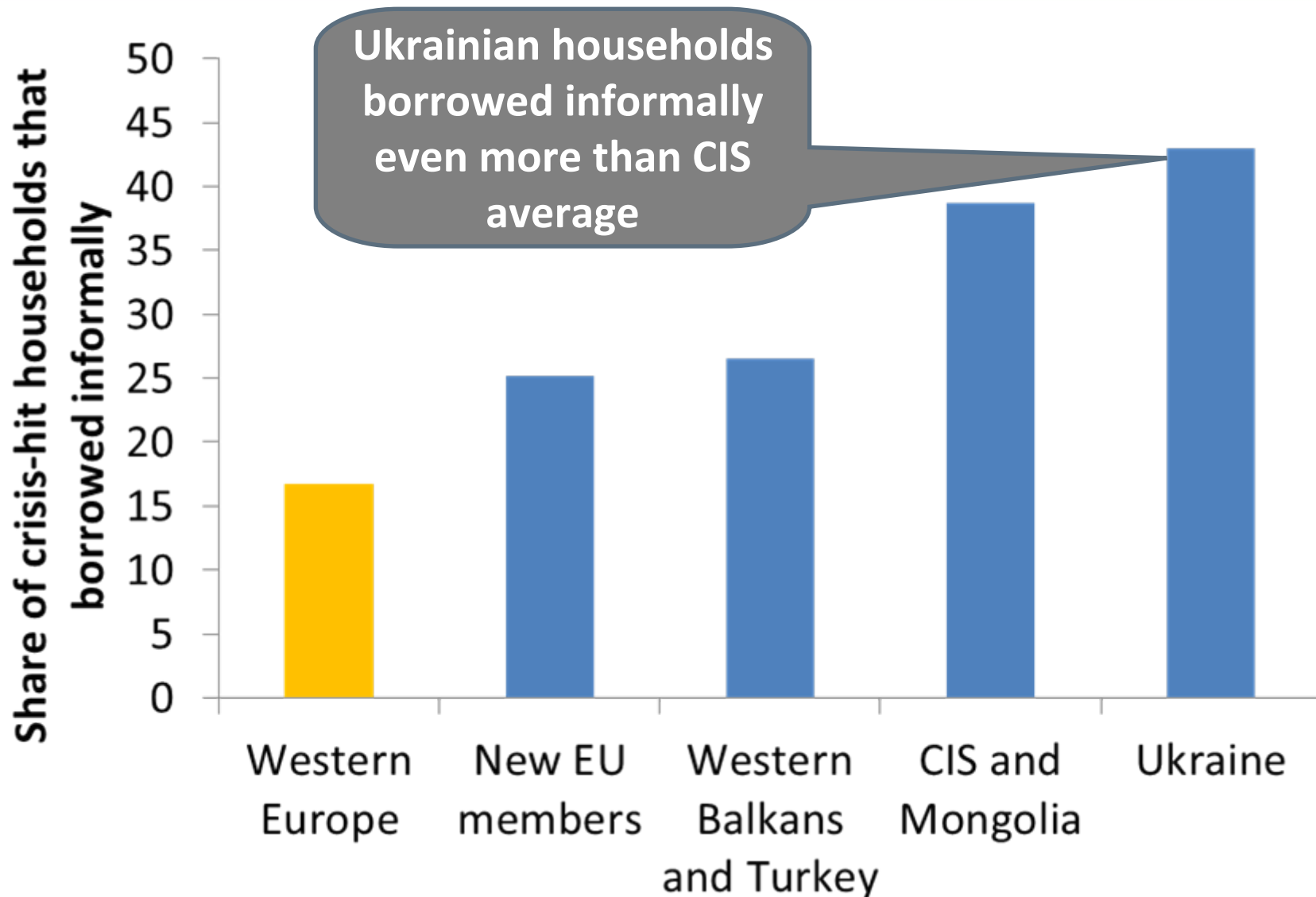
# Official social safety nets were used less than in the West...



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# ...and informal, rather than formal, borrowing was used more...



# Furthermore, official aid and informal borrowing were not very effective



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Dependent variable: base consumption response (index)

Country sample	Transition region		Western Europe	
	[1]	[2]	[3]	[4]
Succeeded <b>formal</b> borrowing	-0.365*** (0.086)	-0.365*** (0.088)	-0.620*** (0.202)	-0.616*** (0.205)
Succeeded <b>informal</b> borrowing	-0.183* (0.104)	-0.183* (0.104)	-0.133 (0.235)	-0.132 (0.221)
Received housing support	0.079 (0.119)	0.070 (0.123)	-0.272** (0.121)	-0.279** (0.119)
Received unemployment benefit	-0.011 (0.098)	-0.038 (0.097)	-0.460*** (0.159)	-0.457*** (0.163)
Observations	30,469	30,469	5,278	5,278
R-squared	0.217	0.213	0.242	0.239

Socio-economic controls and country fixed-effects included.

# Pre-crisis access to mortgage finance: help or hindrance during the crisis?



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*Positive* side: home ownership implies countries may have collateral which facilitates access to credit

- households may withdraw equity from their home

*Negative* side: households may have become over-indebted before the crisis

- credit constrained in the crisis.

*Type of credit may matter: LC versus FX debt*

# FX mortgage holders were hit harder in transition countries



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Dependent variable: base consumption response (index)

Country sample	Transition region			West
	[1]	[2]	[3]	[4]
Mortgage	0.128** (0.053)			-0.116*** (0.026)
<i>Local currency mortgage</i>		0.085 (0.054)	0.103 (0.097)	
<i>FX mortgage</i>		0.203** (0.084)	0.007 (0.107)	
Bank account	-0.081*** (0.026)	-0.081*** (0.026)	-0.081** (0.034)	-0.145*** (0.055)
Crisis event impact	0.348*** (0.014)	0.348*** (0.014)	0.342*** (0.017)	0.290*** (0.041)
Crisis event impact * Local currency mortgage			-0.016 (0.075)	
Crisis event impact * Foreign currency mortgage			0.149** (0.063)	
Observations	30,465	30,465	30,465	5,278
R-squared	0.22	0.22	0.22	0.25

Controls for socio-economic, social assistance and borrowing variable and country fixed-effects

# This effect is driven by FX mortgage holders in high depreciation countries



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Dependent variable: base consumption response (index);  
regression based on sample of mortgage holders

Exchange rate development	No/Small depreciation		Large depreciation	
	[1]	[2]	[3]	[4]
FX mortgage	0.045 (0.171)	-0.118 (0.188)	0.240*** (0.061)	-0.340*** (0.093)
Debt-service burden	0.309 (0.455)	0.620 (0.492)	0.266 (0.410)	-1.227 (0.952)
Crisis event impact	0.522*** (0.076)	0.548*** (0.150)	0.260* (0.134)	-0.342*** (0.053)
<i>Crisis event impact * FX mortgage</i>		0.123 (0.090)		0.422*** (0.048)
<i>Crisis event impact * Debt service burden</i>		-0.230 (0.372)		1.154*** (0.430)
Observations	702	702	174	174
R-squared	0.237	0.238	0.225	0.262

Large depreciation countries are Hungary, Poland, and Ukraine

# However, FX mortgage holders continued to repay



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Dependent variable: dummy variable indicating mortgage arrears;  
regression based on sample of mortgage holders

	All countries		No/Small depreciation		Large depreciation	
	[1]	[2]	[3]	[4]	[5]	[6]
FX mortgage	-0.094*** (0.037)	-0.105** (0.049)	-0.122** (0.053)	-0.129* (0.069)	-0.037 (0.065)	0.032 (0.033)
Debt-service burden	0.077 (0.090)	0.113 (0.092)	0.004 (0.081)	0.080 (0.096)	0.185 (0.182)	0.036 (0.085)
Crisis event impact	0.035** (0.014)	0.040** (0.017)	0.022* (0.011)	0.039** (0.019)	0.076*** (0.012)	0.071*** (0.020)
<i>Crisis event impact * FX</i>		0.008 (0.020)		0.005 (0.023)		-0.065** (0.026)
<i>Crisis event impact * Debt</i>		-0.030 (0.032)		-0.060** (0.029)		0.155*** (0.038)
Observations	864	864	691	691	173	173
R-squared	0.136	0.135	0.147	0.146	0.110	0.109

Large depreciation countries are Hungary, Poland, and Ukraine

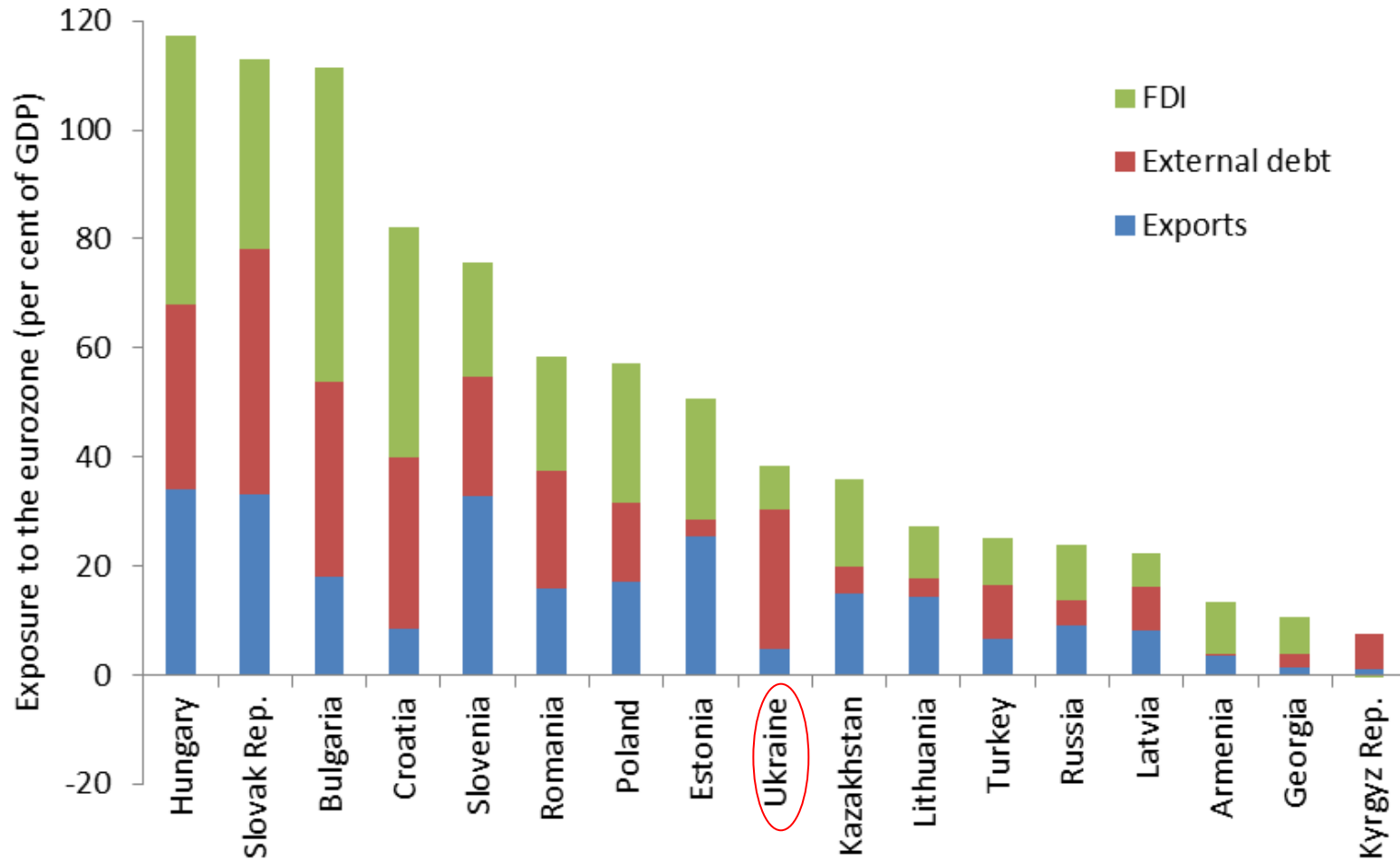
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# Key vulnerability: exposure to eurozone...



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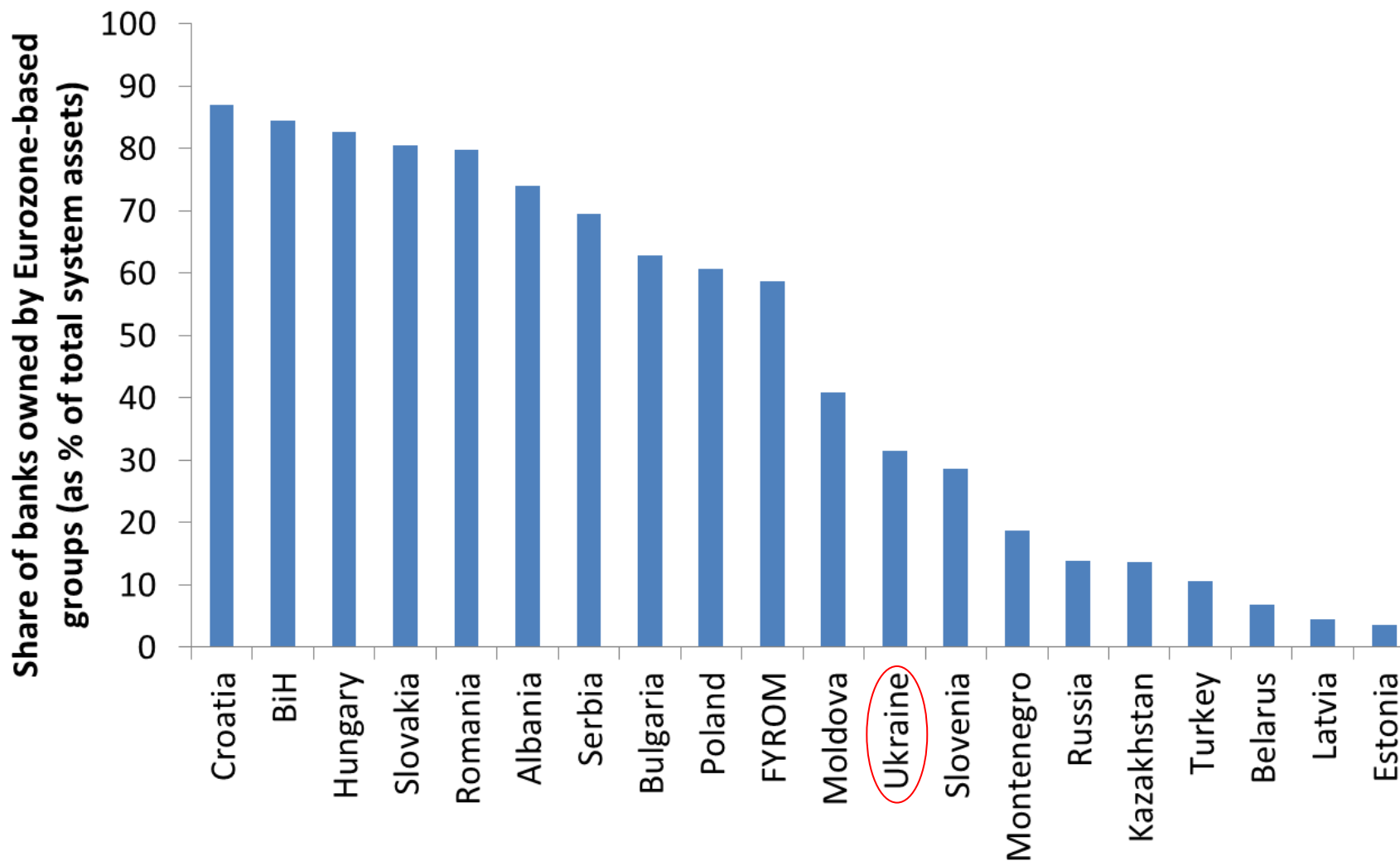


Note: The index is calculated as the sum of the share of eurozone countries in exports weighted by the share of exports in GDP, the share of eurozone in cross-border claims on the EBRD country GDP weighted by the short term external debt as a share of GDP, the share of eurozone countries in FDI weighted by the share of FDI in GDP .

# ...and high dependence on eurozone banks



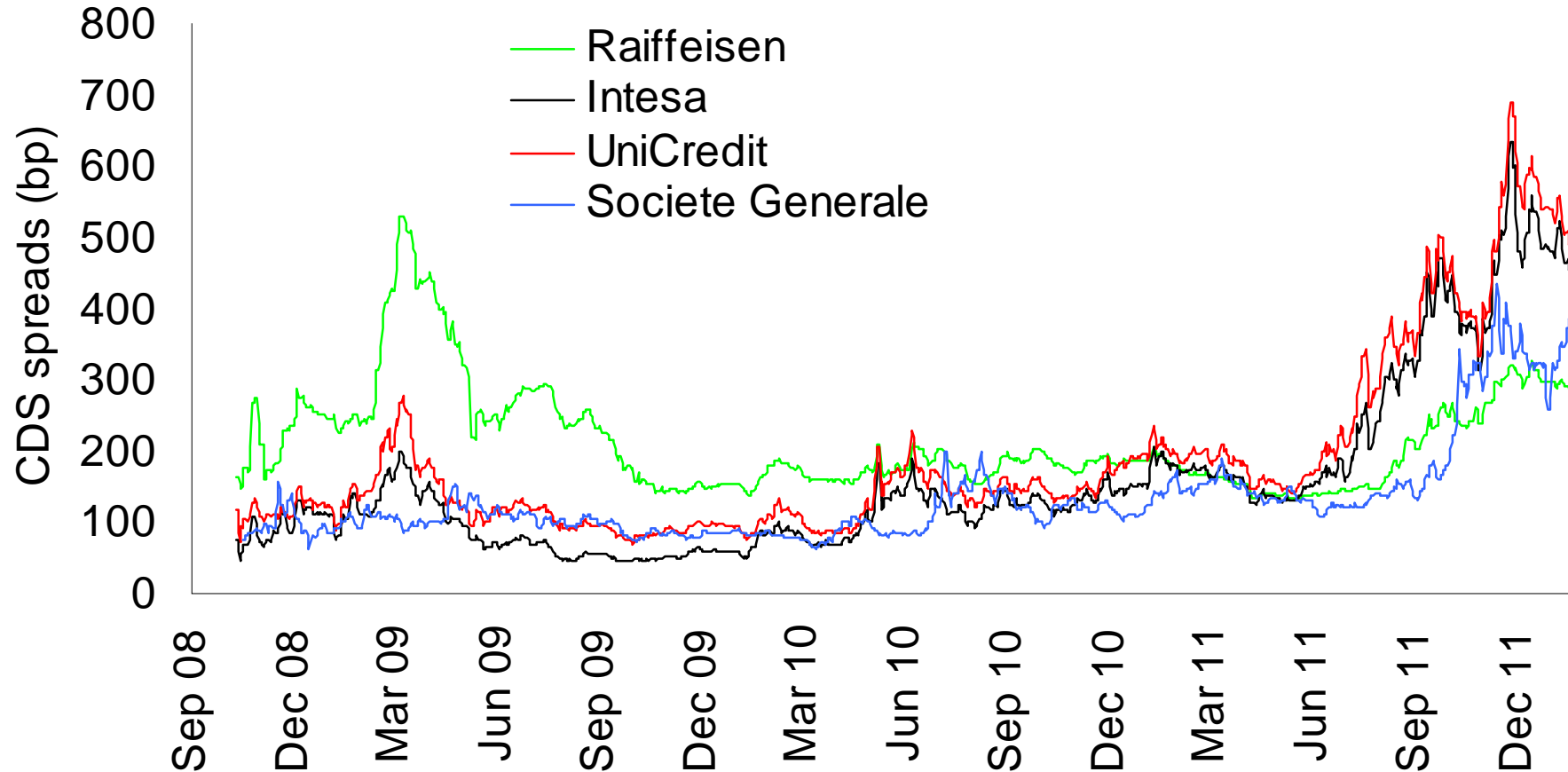
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# ...which are now at bigger risk than in the last crisis



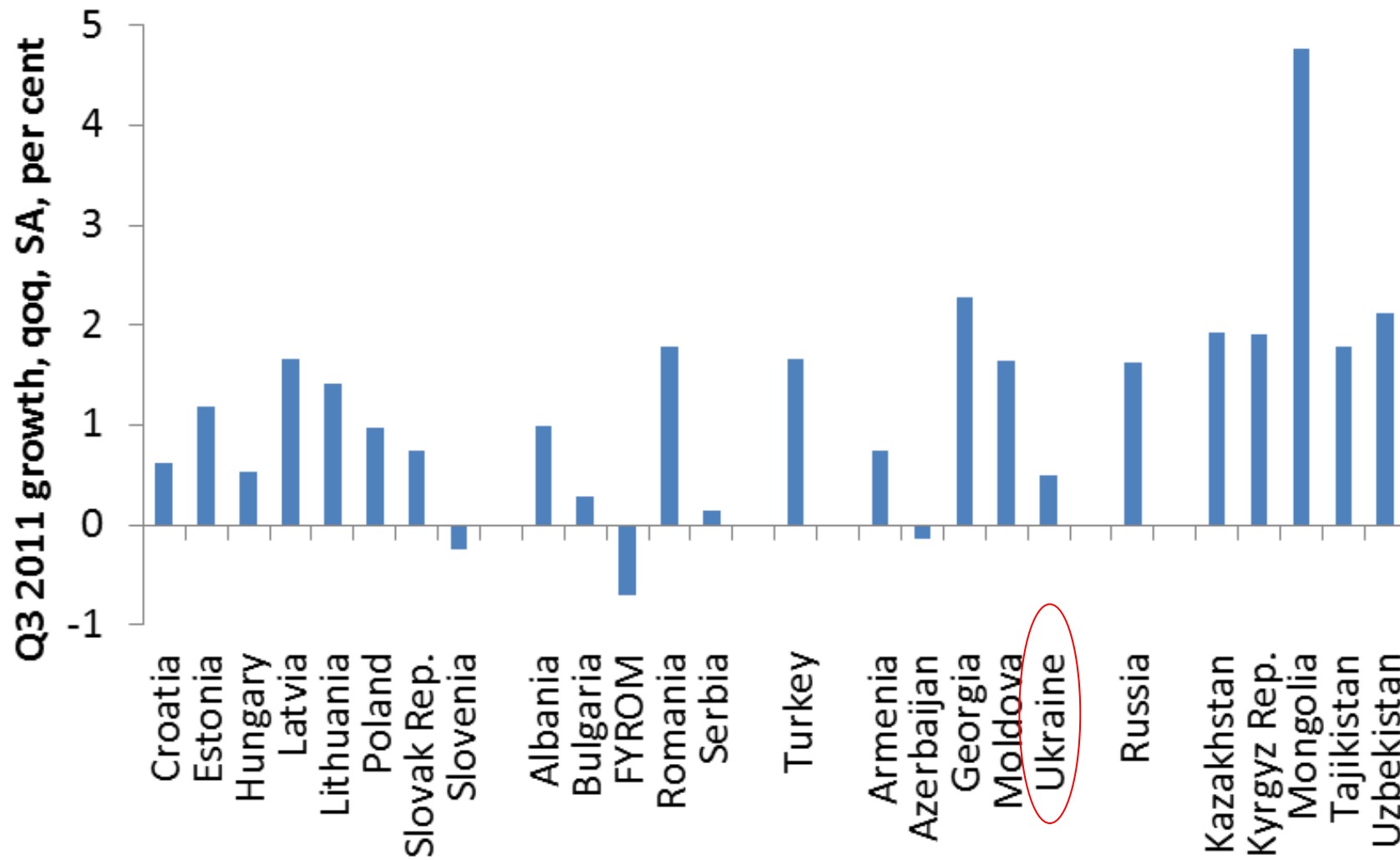
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# So far, growth continues ...



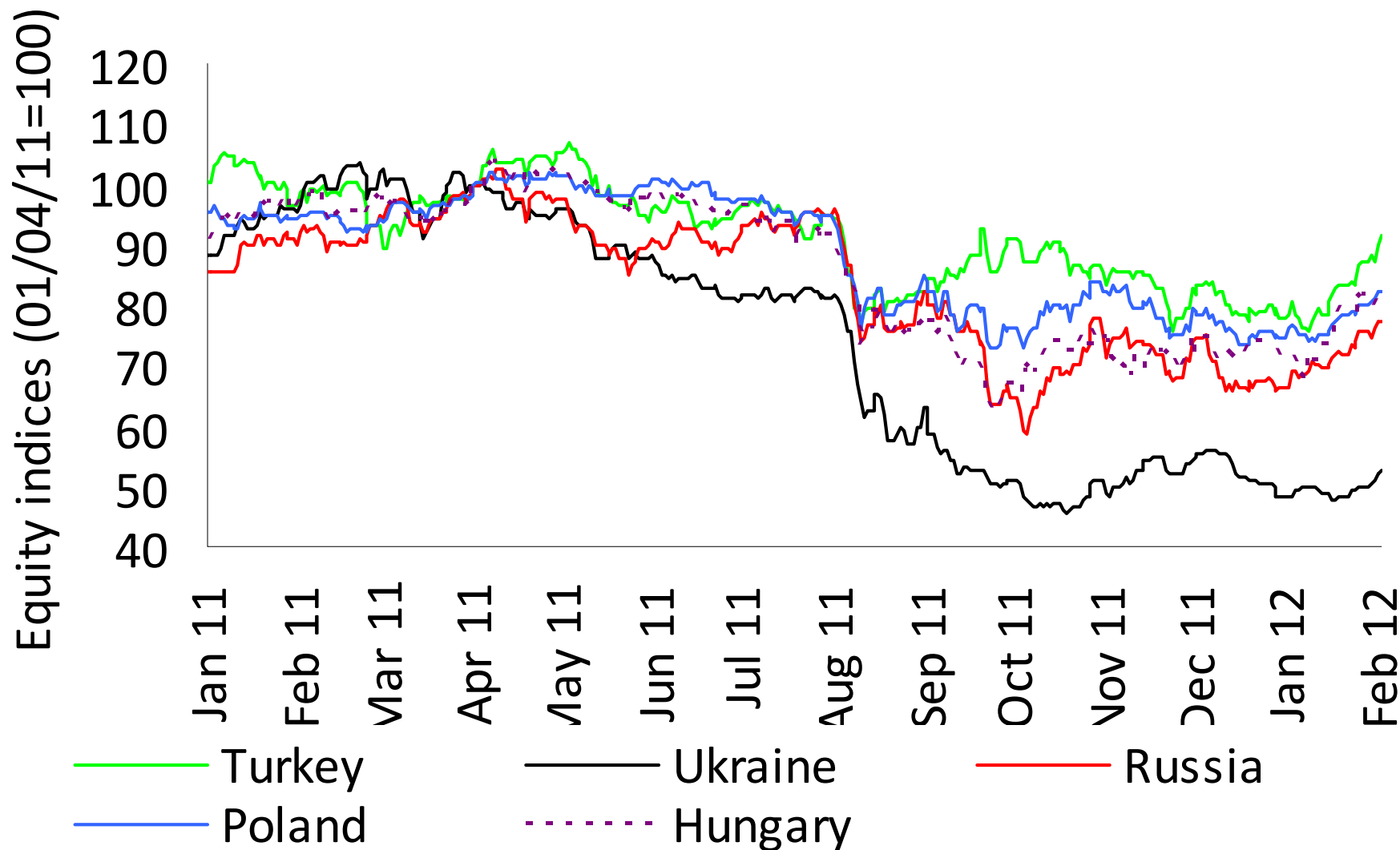
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# However, stock markets have dropped...



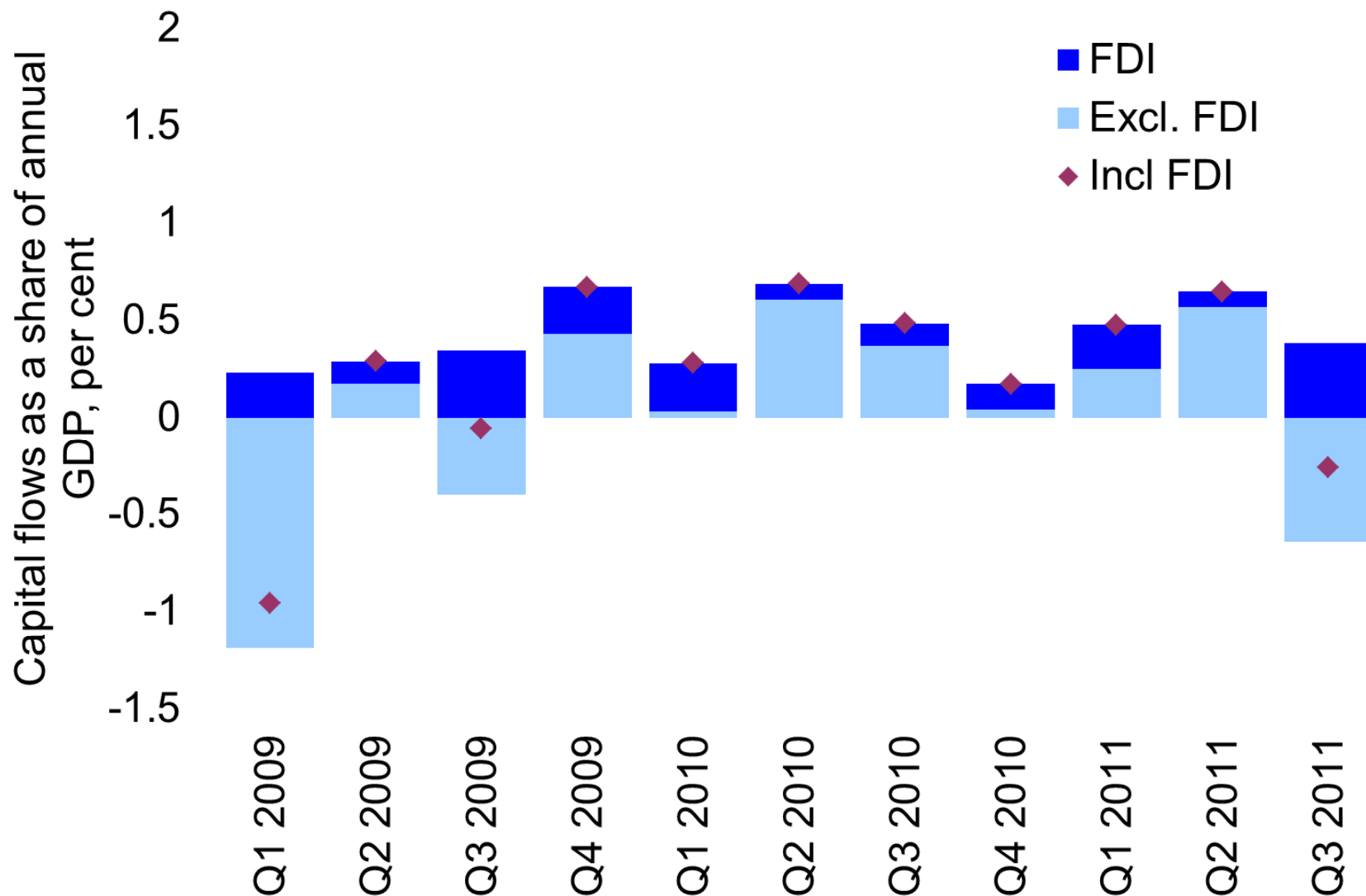
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# ...capital flows have reversed ...



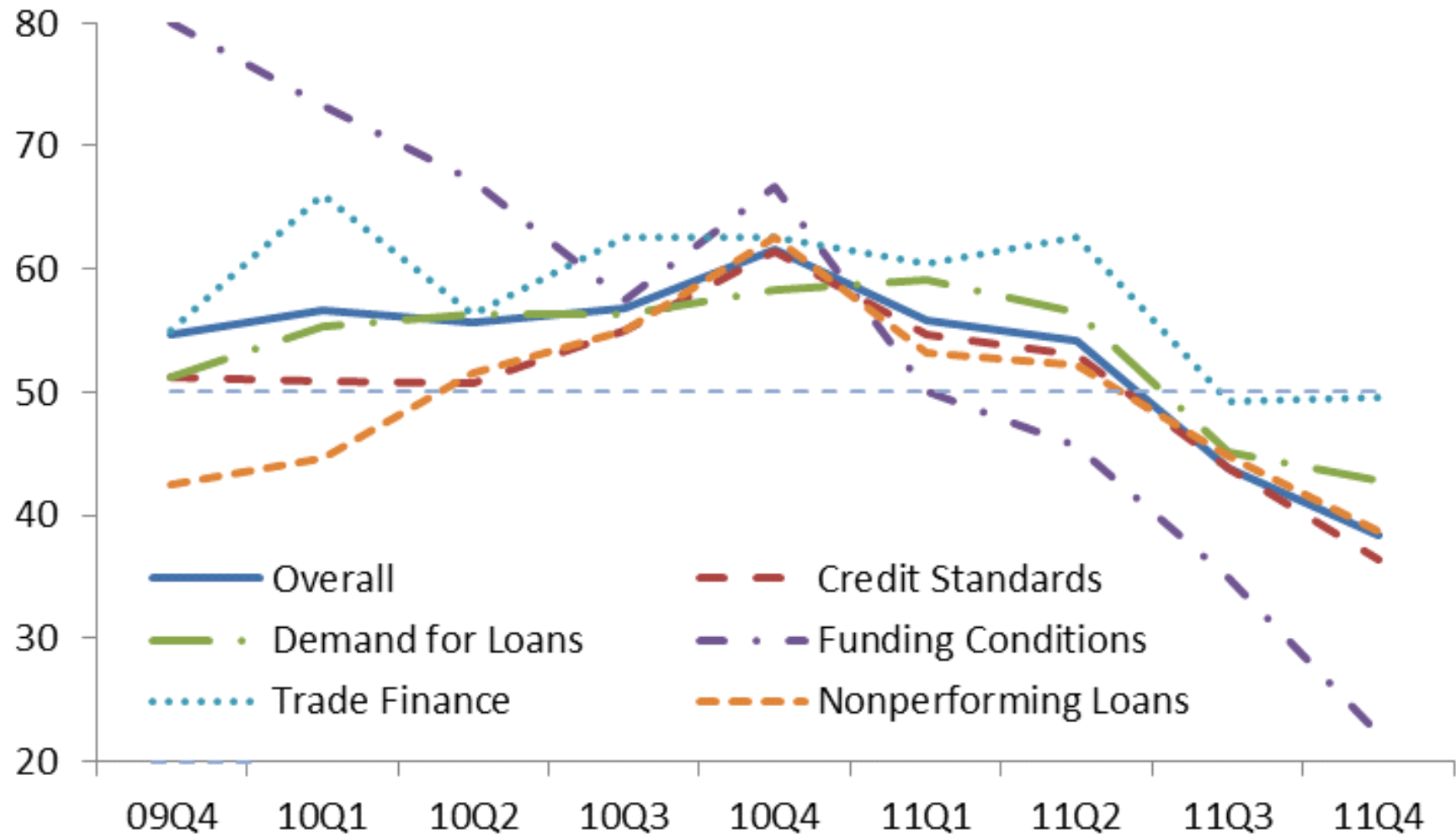
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# ... and credit conditions are tightening



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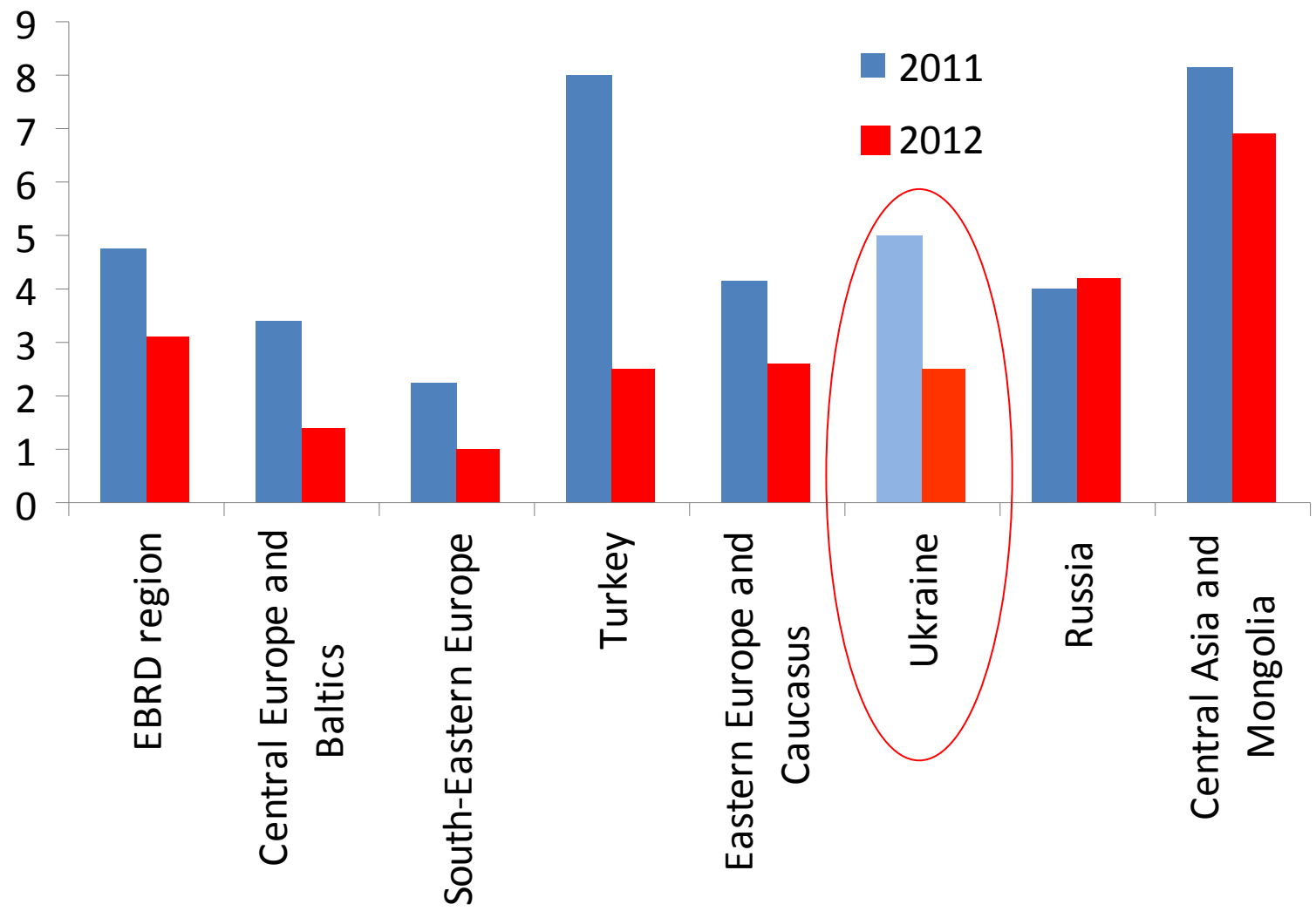


# Significant slowdown projected



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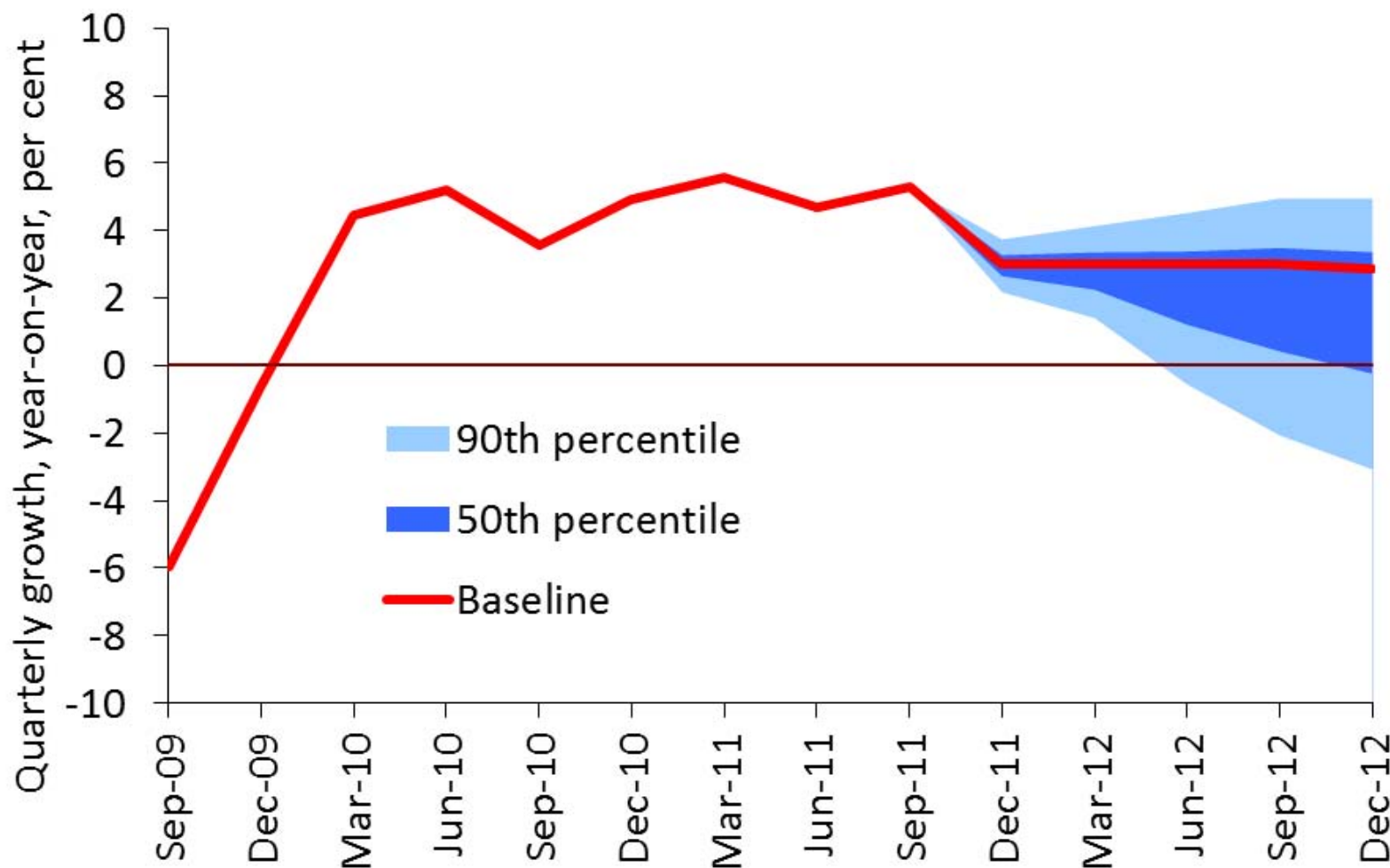
Annual real GDP growth projections, as of January 2012, per cent



# ... with large downside risks to the regional outlook



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# Main short-term challenge in Ukraine: avoiding a new crisis



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- **Expected output growth:** 2011: 5%; 2012: 2.5%.
- **Macroeconomic risk: medium to high**
  - High levels of external private sector debt (foreign currency denominated and much of it short-term);
  - Pegged exchange rate;
  - Large fiscal rollover requirements;
  - Poorly capitalized and highly dollarized financial system;
  - Loss-making energy sector.