

# SOCIO-ECONOMIC VULNERABILITY AND RISK ASSESSMENT



This note provides a short analysis of current socio-economic trends in Ukraine, on the basis of high-frequency official data. It focuses on data that can serve as leading indicators in the context of Ukraine's gathering socio-economic crisis, as well as helping to monitor the impact of this crisis on vulnerable households. This is an internal document intended to support UN and UNDP contingency planning and evidence-based programming in Ukraine.

## DEEPENING CRISIS

### TABLE OF CONTENTS

- 2 Political context

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- 2 The fall in output deepens

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- 3 The sliding hryvnia is boosting inflation, squeezing living standards and the financial system

### OVERVIEW

The new government that was formed at the end of November is facing difficult, and worsening, socio-economic conditions. Output/turnover indicators in industry, construction and retail sales in October showed double-digit declines (in year-on-year terms), while inflation rates headed towards 20% and budget spending on social protection and services dropped

sharply (in real terms). These trends suggest that large declines in employment and household incomes (as well as GDP) are likely to be reported for the second half of 2014. Although some progress has been noted in arresting the hryvnia's slide against the dollar, foreign exchange reserves remain at critically low levels, and household, bank, and state finances seem to be very stressed.

## POLITICAL CONTEXT



### RULING COALITION IN THE NEW UKRAINIAN PARLIAMENT \*

*Petro Poroshenko  
Block*

**145**  
seats

*National Front  
Party*

**83**  
seats

*Samopomich  
(Self-Help)*

**32**  
seats

*Radical Party  
of Oleh Lyashko*

**22**  
seats

*Batkivschiyna*

**19**  
seats

\*as of 1 December 2014

Ukraine's new parliament met for the first time on 27 November. Five parties – the Petro Poroshenko Block (with 145 seats), the National Front Party (83 seats), Samopomich (Self-Help) (32 seats), the Radical Party of Oleh Lyashko (22 seats), and Batkivschiyna (19 seats) – established a ruling coalition with a constitutional majority (301 seats in total). The coalition agreement signed by these parties<sup>1</sup> calls for the implementation of major constitutional, electoral, decentralization, deregulation, energy and judicial (as well as other) reforms. Under this agreement Arseniy Yatsenyuk will continue as Ukraine's prime minister.

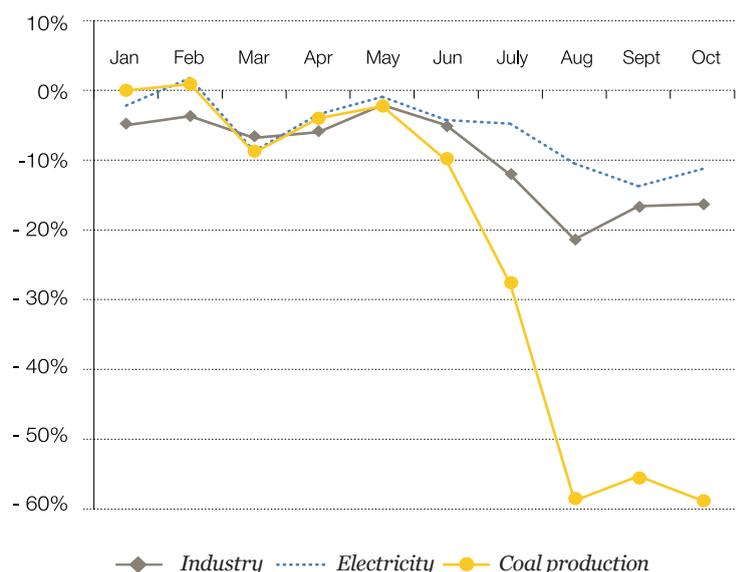
The coalition agreement was followed by the issuance of a presidential decree ordering the withdrawal of state institutions

from, and the cessation of state payments (salaries, pensions, social assistance) in, the territories controlled by anti-government forces. All budget programmes are being closed, banks are to leave, and treasury bank accounts are to be suspended by the National Bank of Ukraine. On paper, all citizens of Ukraine continue to have access to state-provided benefits and services. In order to receive them, however, they will need to be physically located in areas under government control. This decision could result in further reductions in living standards (if not a humanitarian crisis) in affected areas on both sides of the "line of separation".

## THE FALL IN OUTPUT DEEPENS

The most recent official data point to a deepening of Ukraine's socio-economic crisis. A 16.3% year-on-year reduction in industrial output was reported in October 2014, while an 18.6% decline in the volume of construction activities was reported for January-October (relative to the same period of 2013). The 23% decline in coal production recorded for this time (Figure 1) is particularly worrisome, in light of the sector's importance for employment (especially in the Donbas) and as a fuel source for power generation. Coal imports also fell steeply during the first three quarters of 2014, putting Ukraine on course for a second consecutive year of sharp decline in apparent coal consumption (production plus imports, minus exports – Figure 2). As gas and

**Figure 1.** Year-on-year changes in industrial production, coal, electricity output (2014)



<sup>1</sup> [http://samopomich.ua/wp-content/uploads/2014/11/Koalicyjna\\_uhoda\\_parafovana\\_20.11.pdf](http://samopomich.ua/wp-content/uploads/2014/11/Koalicyjna_uhoda_parafovana_20.11.pdf)

coal account for more than half of Ukraine's electricity generation, the risks of winter electricity (as well as heating) shortages are growing.

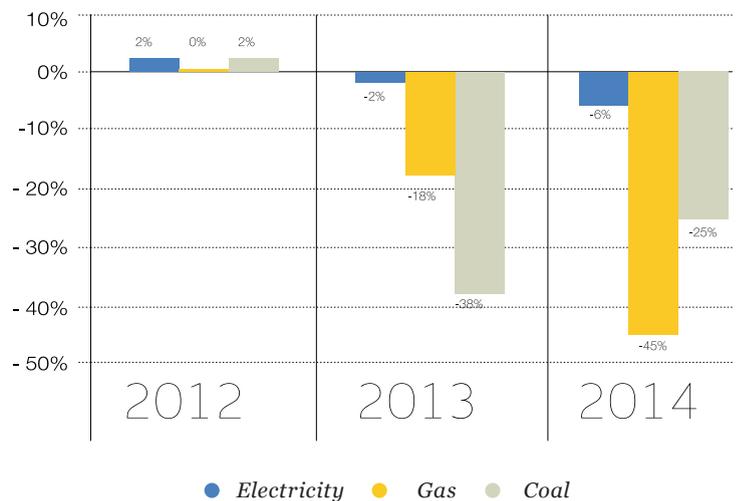
It is easy to blame these sharp output declines on the collapse of economic activity in the Donbas, sanctions/supply chain disruptions in trade with the Russian Federation, and stresses in Ukraine's financial system. However, Ukraine has reported declines in the volume of construction activities for six years out of the past seven; industrial output has fallen in five out of the last eight years. The continuation and deepening of these trends in 2014 can therefore be seen as evidence of the Ukrainian economy's deep structural crisis – as well as of the need for significant reforms and modernization.

## THE SLIDING HRYVNIA IS BOOSTING INFLATION, SQUEEZING LIVING STANDARDS AND THE FINANCIAL SYSTEM

Inflation rates continue to rise (Figure 3), reducing household purchasing power and increasing the burdens on Ukrainian financial institutions and other borrowers with debts that are denominated in foreign currencies. Prices for consumer goods in general, and for foodstuffs in particular, in October were nearly 20% above year-earlier levels. Communal service tariffs rose 27% during this time; household tariff increases for sewage and gas were above 60%.

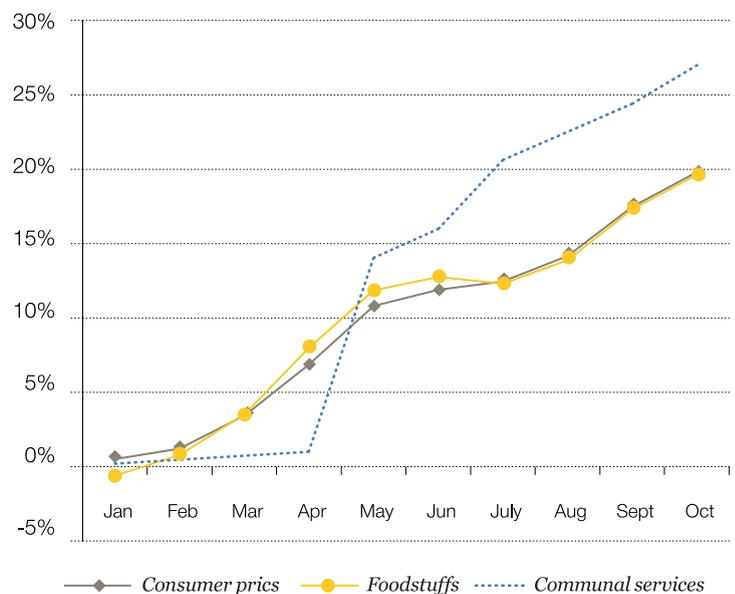
Although the official exchange rate stabilized during August-October (Figure 4), it slid again in November, following the National Bank of Ukraine's decision to let the hryvnia float against the dollar. This decision may have reflected the paltry state of Ukraine's official foreign exchange reserves: as of October 2014, the NBU's reserves were reported down to \$12.6 billion – the lowest level recorded since 2006. The decision to float the hryvnia may also have reflected concerns that Ukraine is unlikely to receive any more funds from the IMF (which sent a mission to Kyiv in November) in 2014. In any case, the Ukrainian currency is on course to experience a 50% (or greater) depreciation (in nominal terms) against the dollar over the course of the year. This is despite NBU requirements that exporters sell off 75% of their foreign exchange earnings, as well as daily limits on the purchase of foreign exchange by individuals.

**Figure 2. Changes in apparent consumption\* of electricity, gas, coal (2012-2014)**



\* Production plus imports minus exports. Data for 2012-2013 are annual changes; 2014 data are for the first three quarters of the year (compared to the same period of 2013).

**Figure 3. Year-on-year inflation rates (2014)**



**Figure 4. Official average monthly exchange rates (hryvnia per \$1)**



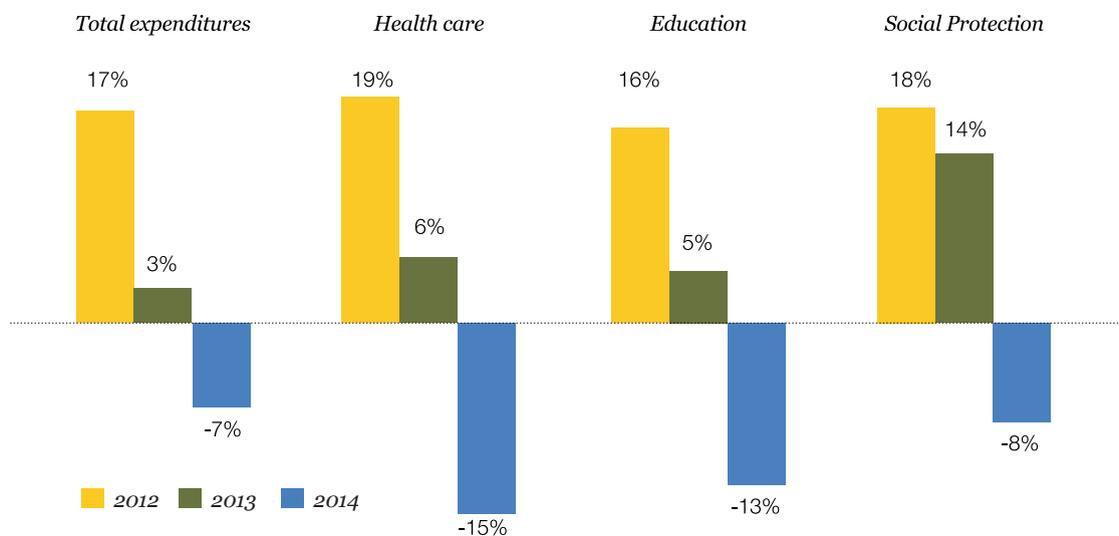
**Figure 5. Real household income and spending trends (quarterly data, 2013-2014)**



Ukraine’s accelerating inflation rates are also squeezing living standards. While increases in household incomes and spending continued during the first quarter of 2014, this growth was reversed during the second quarter (Figure 5). Since real wages

and retail sales (which correlate closely with household incomes and spending) dropped sharply during the third quarter of 2014, it is likely that household living standards (and employment) fell sharply during July-September as well.

**Figure 6. Changes in the real values of consolidated budget spending during 2012-2014\***



\* Changes in nominal spending levels, divided by changes in the consumer price index. The 2014 data are for the first three quarters (relative to the same period of 2013).

Moreover, the costs of the fighting in the Donbas and rising official debt-service obligations (due in part to the weak hryvnia) are squeezing the state budget. The real value of public spending on health, education, and social insurance and assistance during the first three quarters of 2014 had dropped by 15%, 13%, and 8%, respectively, compared to

the same period in 2013 (Figure 6). These trends suggest that – in addition to falling incomes – many Ukrainian households are facing declines in access to/quality of social services and social protection. They also underscore how the deepening socio-economic crisis and growing human insecurity concern Ukraine as a whole, not just the Donbas.