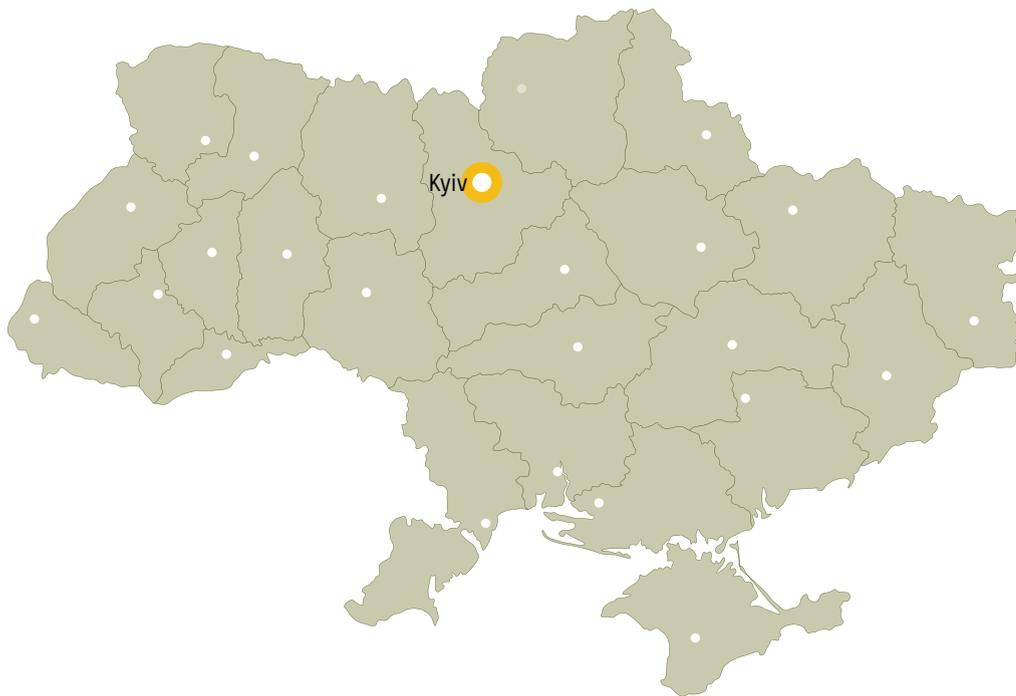


SOCIO-ECONOMIC VULNERABILITY AND RISK ASSESSMENT



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 analysis is intended to serve as an internal document to support UN and UNDP contingency planning and evidence-based programming in Ukraine.



OVERVIEW

September-October saw a further deepening of Ukraine's socio-economic crisis, with growing declines in output, accelerating inflation rates, and renewed exchange-rate instability. Despite "de-escalation", the security situation remained volatile, while political life was dominated by Parliamentary elections, which resulted in a victory for pro-European forces.

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ELECTIONS, SECURITY CHALLENGES, AND ECONOMIC COLLAPSE IN DONBASS

The parliamentary elections that were conducted on 26 October 2014 were recognized as democratic and representative by international community, despite some concerns about security and access to voting in conflict-affected territories. The Committee of Ukrainian Voters informed that “administrative resources” (the unfair use of budget resources and opportunities in favour of the ruling party) were not used in party list voting; such practices were only noted in some majoritarian electoral districts.

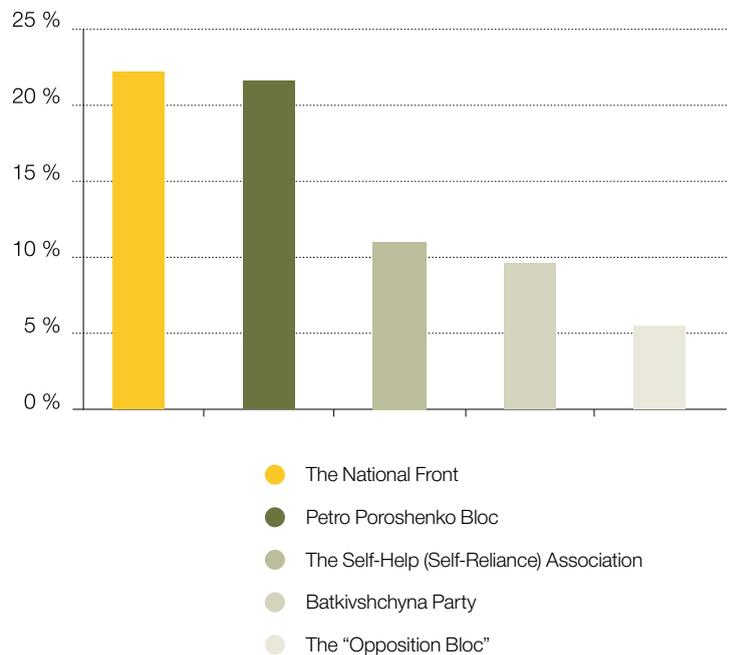
Preliminary elections results of the party list voting suggest a dominant role for pro-European, pro-Western parties in the future parliament. The National Front led by Prime Minister Arseniy Yatseniuk received 22.14% of these votes, while the Petro Poroshenko Bloc received 21.81%. The Self-Help (Self-Reliance) Association led by mayor of Lviv Andriy Sadoviy received 10.97%, while the Batkivshchyna Party of former PM Yulia Tymoshenko received 5.68%. The “Opposition Bloc”, which united allies of deposed President Viktor Yankovych, got 9.42%.

When added to the outcome of the voting from majoritarian districts, these results suggest that the Petro Poroshenko Bloc will have the largest faction in the parliament, with the National Front a close second. Two biggest parties have announced their intention to create a coalition government able to quickly introduce much needed reforms. The prevalence of pro-European parties in the Parliament is likewise hopeful in this respect. Already under the previous Parliament, President Poroshenko signed a package of four anti-corruption laws which, among other things, established the National Anti-Corruption Bureau.

The President on 9 October also signed into law lustration legislation – which subsequently resulted in the removal of dozens of officials who served during the Yanukovych presidency. These included 39 high level officials working in the Council of Ministers; the dismissal of another ten is expected shortly. In total, the general prosecutor’s office has announced the dismissal of 132 officials; another 450 dismissals are in process.

The security situation in Ukraine remained volatile, despite “de-escalation” in areas of armed conflict. Regular battles took place for the Donetsk airport, and several hotspots in Debaltsevo, Uglegorsk, Avdeevka, and Granitnoye. Following the Minsk agreements, and the passage of legislation on the special regime for local governments, another meeting of the Ukrainian and Russian Presidents was held in Milan. However, the approach of the local elections to be held in areas not controlled by the government has worsened overall prospects for a sustainable peace in the region.

Preliminary elections results



880.000

PEOPLE
HAVE LEFT THE
DONBASS AND CRIMEA

• **450.000**

*have left for other countries
(mainly Russia)*

• **430.000**

*moved to other parts
of Ukraine*



According to UNHCR, some 880,000 people have left the Donbass and Crimea. Around 430,000 have moved to other parts of Ukraine, while some 450,000 have left for other countries (mainly Russia). Many are living in difficult conditions. IDPs pose serious challenges for Ukraine both in the short term (in terms of ensuring shelter during the winter) and in the long run (in terms of securing their successful return or integration into new host communities). The provision of social services for IDPs, as well as including them in economic recovery efforts, will be important dimensions of initiatives to recover from the conflict in the East.

SOCIO-ECONOMIC CRISIS: STILL LOOKING FOR THE BOTTOM

The negative consequences of the conflict in the Donbass and Ukraine's overall unfavourable economic conditions further deepened in September. The volume of industrial and construction activities were down some 17% (compared to September 2013); a 12% decline in retail sales (a proxy for household spending and incomes) was reported (Figure 1).

In some respects, these trends represent the continuation of multi-year production declines: industrial output was reported down by 4.9% in 2013 and 3.9% in 2012; while construction dropped by 13.2% in 2013, and 2.1% in 2012. As such, they reflect deep structural problems in the Ukrainian economy as a whole, which require similarly deep structural reforms.

In other respects, however, these production declines are reflections of the conflict in the Donbass. This is most apparent in coal production, which reported horrific declines in August and September (Figure 2). Since coal is a key fuel for Ukraine's power sector, knock-on effects on electricity generation are apparent. Likewise for industrial production: an 85% year-on-year decline in industrial output was reported for Lughansk oblast in September; while Donetsk oblast reported a 59% decline in industrial production.¹ Expert assessments indicate that Donbass has lost 80% of its industrial potential: 19 out of 23 "enterprises of systemic importance" in Lughansk have been closed; while the share of such enterprise closures in Donetsk oblast is estimated at 50%.²

These production declines also reflect Ukraine's on-going external economic adjustment: due to external financing constraints, imports during the first eight months of 2014 were 25% below year-earlier levels. Ukraine's exports reported a more moderate (8%) drop during this time. While exports to Russia and other CIS countries were down 26%, exports to non-CIS countries actually increased by 2% during this time – showing the on-going east-to-west geographic reorientation of Ukraine's trade. Thanks to this sharp import compression, a \$1.16 billion surplus was reported on the merchandise trade balance for the first eight months of the year. Ukraine is on track in 2014 to report a trade surplus for the first time 2004.

Figure 1. Trends in the volume of industrial, construction, and retail trade activities (2014)

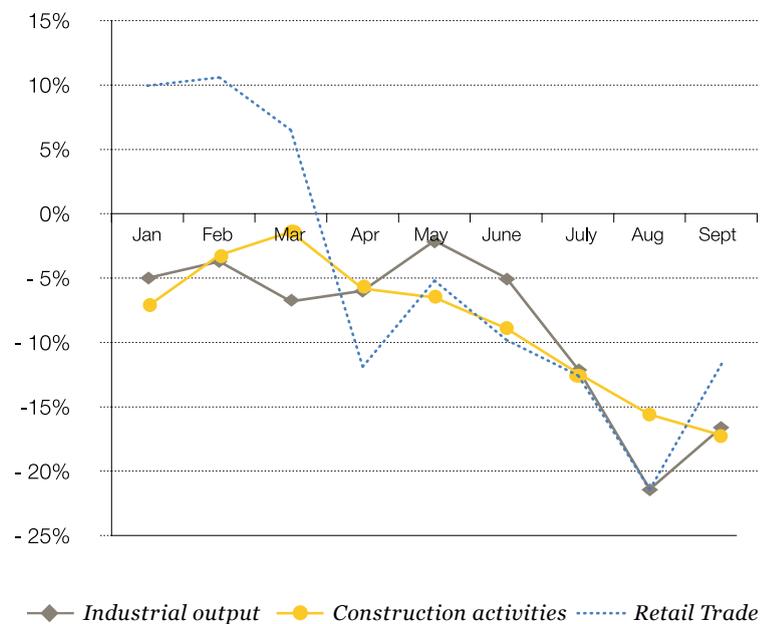
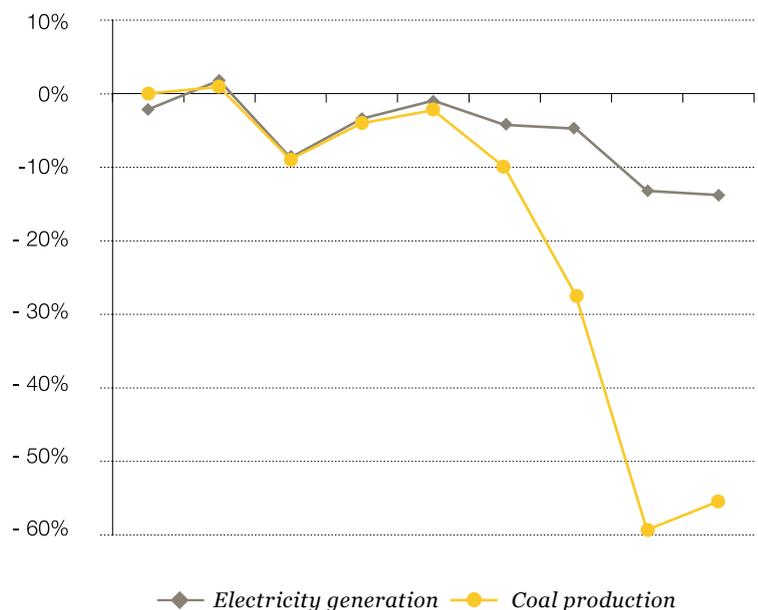


Figure 2. Trends in coal production, electricity generation (2014)



One positive development was the signing of the gas agreement between Ukraine and the Russian Federation, under the brokerage of the European Union. Under this agreement (if it holds), Ukraine would buy gas on a pre-paid basis at a price of \$378/thousand cubic metres - on the condition that Ukraine pays \$3.1 billion of its \$5.3 billion gas debt. An International Monetary Fund mission is to take place in late November, to assess the progress of reforms and decide about the disbursement of the third and fourth tranches of funding under Ukraine's Standby Facility by the end of 2014.

¹ Information on the official site of the Lughansk Statistics Committee is not available. Data for Lughansk comes from the official press-release of the State Statistics Service: http://delo.ua/ukraine/padenie-promproizvodstva-v-luganskoj-oblasti-sostavljaet-okolo-8-280949/?updated_new=1414573037

² <http://economics.unian.ua/industry/993306-donbas-vtrativ-80-svogo-ekonomichnogo-potentsialu.html>

SOCIAL IMPACT OF THE CRISIS: INFLATION AND FALLING REAL INCOMES

Inflation rates continue to accelerate (Figure 3): year-on-year increases in consumer prices and foodstuffs rose above 17% in September; while household communal service tariffs (energy, water sewage, etc.) were up some 24%. The most noticeable year-on-year inflation rates were registered for gas (63%), water supply (47%), and sewage (69%). Sharper increases in inflation rates were limited by the effects of a good harvest in 2014, and by the closure of the Russian market for some exports – which were then redirected to the domestic market.

On the other hand, the sharp decline in the value of the Ukrainian hryvnia (Figure 4) continues to introduce inflationary impulses into the Ukrainian economy – driving up the prices and costs of imports, goods produced with imported components, and goods that compete with imports. Meanwhile, industrial producer price inflation in September rose to 27% (compared to year-earlier levels), suggesting that pricing pressures in Ukraine continues to gather momentum.

Ukraine's accelerating inflation rates are 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. Moreover, the real value of public spending on health, education, and social insurance and assistance through August had dropped by 15%, 12%, and 6%, respectively (compared to the same period in 2013). These trends underscore how the deepening socio-economic crisis concerns Ukraine as a whole, not just the Donbass.

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

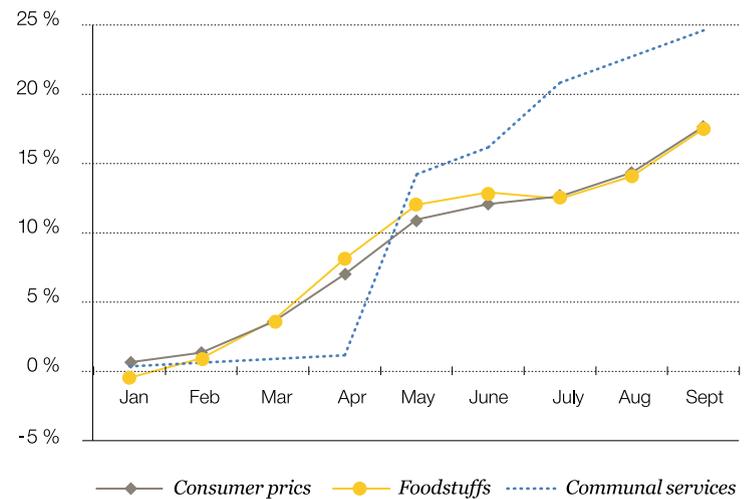
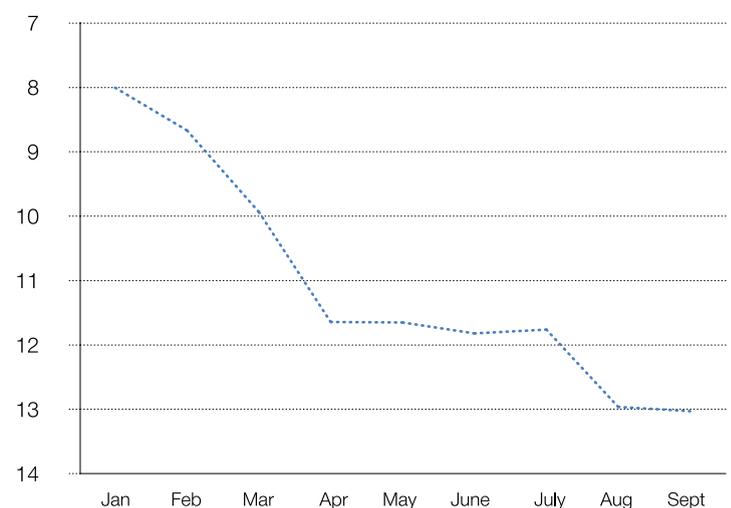
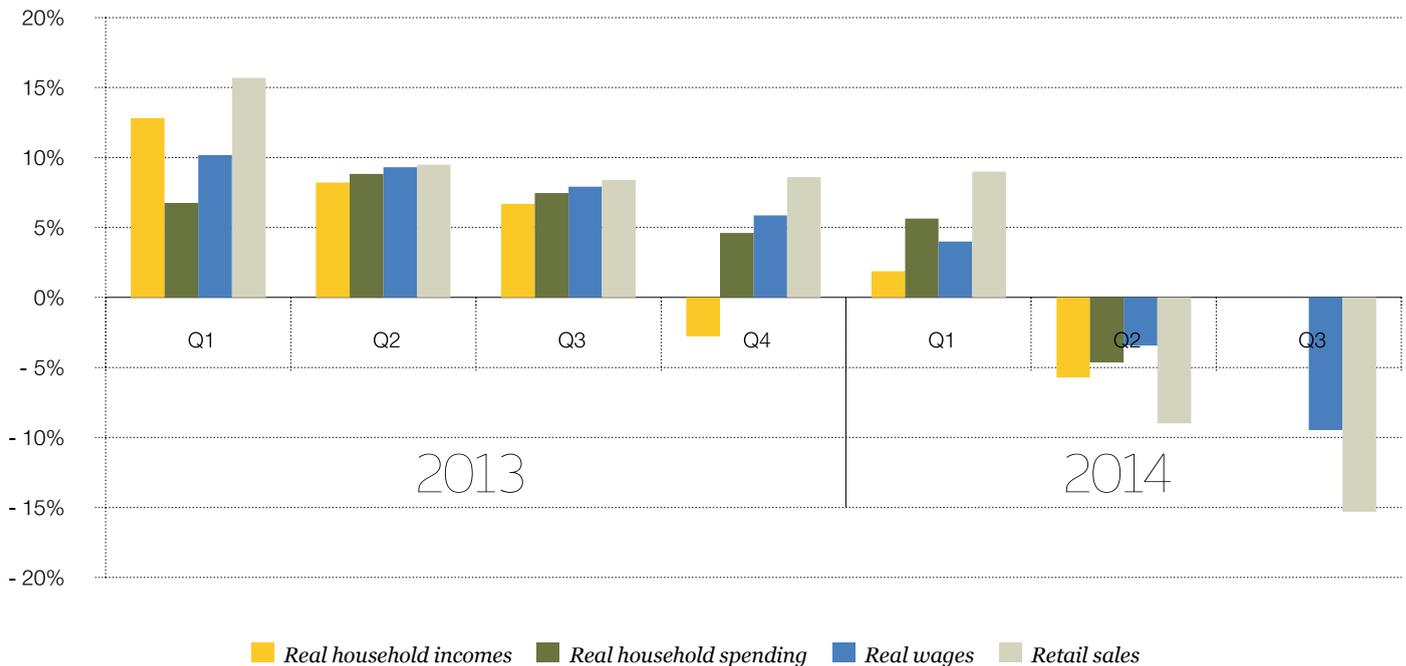


Figure 4. Official exchange rate trends (Hryvnia/\$, 2014)



THE SHARP DECLINE IN THE VALUE OF THE UKRAINIAN HRYVANIA CONTINUES TO INTRODUCE INFLATIONARY IMPULSES INTO THE UKRAINIAN ECONOMY

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



DILEMMAS FACING THE NATIONAL BANK OF UKRAINE

The exchange rate remains a hot topic in Ukrainian media. Lines in front of currency exchanges, public debates about the exchange rate, are evident almost everywhere. The National Bank of Ukraine has taken strong administrative measures to support the hryvnia by preventing sales of foreign exchange at rates in excess of 12.95 hryvnia/\$. It is also selling dollars (often from 50 to 200 million per day), in order to provide banks with foreign exchange liquidity and ease the “dollar hunger” in cash desks. As a result, official exchange rates have held at around 12.95 hryvnia/\$. However, many experts doubt that these measures can be sustained over time – particularly in light of Ukraine’s accelerating inflation rates. Meanwhile, as of 3 November the black market exchange rate was above 14 hryvnia/\$. Ukraine continues to face the spectre of a self-reinforcing devaluation/inflation spiral.

12.95
HRYVNIYA / \$

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