UKRAINE COUNTRY REPORT: FORECAST OF THE MAIN DEVELOPMENT MACROINDICATORS OF UKRAINE'S ECONOMY FOR 2012–2013

Project LINK Fall Meeting, New York, October 24-26, 2011

Valeriy Heyets, Maria Skrypnychenko
Institute for Economics and Forecasting, Ukrainian National Academy of Sciences

I. Recent Trends

In 2011, the post-crisis development and recovery of Ukraine's economy is going on with the increase in foreign trade turnover and against the background of favorable external conjuncture, a 8.6% increase in gross fixed investments in II quarter (as compared to 4.5% in I quarter of 2011), and, at the same time, a considerable reduction of investment activities as an aftermath of the crisis. The uncertain market environment, low credit activities of the credit banks, their improper financial condition and lack of financial resources for economic agents all are hindering further expansion of investment-purpose output for the domestic market, as well as modernization and mastering of new products. Under such conditions, the demand for investment items will be satisfied mainly at the expense of imports. And no massive import substitution will take place in the near future. In the forecasted period, the main impetus of investment activities is the preparation for the UEFA Euro 2012.

By preliminary estimates, during I quarter of 2011, Ukraine's real GDP grew by 5.3%, and in the 2nd quarter, as compared to similar period of 2010, its growth rate somewhat decreased (3.8%). The increase in gross value added in I and II quarters of 2011 as compared to similar periods of previous year, took place in manufacturing (by 12.9% and 8.7% respectively), trade (by 9.7% and 1.6%), construction (by 7.8% and 21.7%), generation and distribution of electricity, gas and water (by 6.0% and 10.1%), agriculture (by 5.8% and 1.1%), financial activities (by 5.2% and 11.9%), mining (by 5.2% and 5.8%), and transports and communications (by 4.4% and 5.8%). At the same time, a reduction of value added generation took place in the education (by 4.7% and 4.6%), state management (by 1.0% and 0.8%), and health care social welfare (by 0.1% and 1.7%).

In January-July 2011, industrial output, as compared to similar period of previous year, increased by 8.7%. Manufacturing output increased by 9.8%, mining output - by 5.9%, and generation and distribution of electricity, gas and water – by 7.3%.

Output expansion took place in machine building (20.5%), metallurgy (by 11.4%), chemical and petrochemical industries (by 19.1%), and light industry (by 11.4%). At the same time, output decreased in the production of food products, beverages and tobacco products (by 3.2%), and wholesale and retail trade (by 0.8%).

In January-July 2011, consumer price index amounted to 104.6% (in similar period of previous year it was 103.1%), and industrial producers' price index to 115.7% (114.1%).

During the 1st half of 2011, real revenues of the Consolidated Budget, as compared to similar period of 2010, increased by 12.1%, and those of the State Budget – by 13.8%.

In the structure of revenues of the Consolidated Budget, the greatest share was accounted for by tax revenues (86.4%, in similar period of previous year – 77.3%). The share of value added tax is 33.5% (32.0%), that of income tax – 15.6% (15.9%) and that of corporate tax – 14.4% (11.8%).

Official exchange rate of the hryvnia to USD, as of 1 August 2011, was 7.9712 Hrn per one USD. Since early 2011, the hryvnia has depreciated against the USDby 0.12%. Official exchange rate of the hryvnia to euro, as of 1 August 2011, was 11.3669 Hrn per one euro (depreciation by 7.5%).

During January-July 2011, monetary base increased by 9.9% (in previous year – by 13.1%), money supply - by 4.5% (in previous year - by 14.8%), cash in circulation – by 6.0% (in previous year - by 11.5%). The share of cash in circulation in total money supply, as of end of July 2011, amounted to 29.5% as compared to 30.6% in late 2010, and its share in total monetary base was 82.3% as compared to 82.3% by late 2010. The level of monetization of the national economy, by late July 2011, amounted to 48.6%.

During January-July 2011, agricultural output in all categories of enterprises increased by 9.1% relative to similar period of previous year. It increased both in the agricultural companies (by 12.2%), and in the people's farms (by 6.2%). During January-July 2011, average prices for farm produce sold by agricultural companies rose by 25% as compared to similar period of previous year. In particular, for crop production, the prices grew by 48% and those for livestock products grew by 5%.

In the 1st half year of 2011, the volume of investments in fixed capital by Ukrainian institutions and organizations increased, as compared to similar period of 2010, by 15.9%. A considerable share of all investments was directed to the development of industrial enterprises (38.9% of total). Investments in the industry increased by 13.5%, including in manufacturing by 0.5%, in mining by 28.3%, and in the generation of electricity, gas and water by 44.8%. In the social sphere, capital investments in education enterprises increased by 46.7%, in those engaged in health care and social protection by 34.5% and in those providing individual and communal services and engaged in culture and sports by 75.9%. However, capital investments in house construction were lower than in the 1st half of 2010 by 27.2%.

In the 1st half of 2011, the volume of exports of goods and services was 39397.9 mln USD, and imports – 41199.0 mln USD. As compared to the 1st half of 2010, exports of goods and services have grown by 38.5% and imports by 48.1%. The negative foreign balance amounted to 1801.1 mln USD (in previous year, it was positive in the amount of 633.7 mln).

In the 1st half of 2011, exports of goods amounted to 32843.3 mln USD (increase by 42.5% as compared to similar period of 2010), and imports to 38352.9 mln USD (increase by 50.8%). The negative foreign balance amounted to 5509.6 mln USD (in 2010, it was negative too in the amount of 2371.6 mln). In January-June 2011, the ratio of commodity export coverage amounted to 0.86, while in 2009 it was 0.91.

Ukraine carried out foreign commodity transactions with partners from 210 countries. The biggest volumes of exports were delivered to the Russian Federation (28.2% of total exports), to Turkey (6.1%), Italy (5.4%), Poland (4.3%), Belarus (2.9%), and to China and India (2.8% each). The biggest shares of Ukraine's imports are accounted for by the Russian Federation (39.3% of total), Germany (7.9%), China (7.1%), Belarus (4.4%), Poland (3.7%), USA (3.3%), and Italy (2.2%).

In the 1st half of 2011, foreign direct investments in Ukraine's economy amounted to 2788.2 mln. USD. 82.0% of total FDI came from EU countries and 3.0% from CIS countries. At the same time, non-residents took away a 447.0 mln of capital. Total FDI in Ukraine, since early this year, has grown by 5.5%, and, as 1 July 2011, amounts to 47205.7 mln. USD, which equals to 1033.2 USD per one Ukrainian citizen.

In the 1st half of 2011, investments came from 127 countries. The top ten investor countries which account for over 83% of total direct investments include Cyprus (24.6% of total), Germany (15.6%), The Netherlands (10.1%), The Russian Federation (7.2%), Austria (6.0%), France (5.1%), The United Kingdom (5.0%), Sweden (3.7%), British Virginian Islands (3.2%), and USA (2.3%). Of considerable interest for the investors are the companies engaged in financial activities, were 32.5% of total investments are accumulated.

During January-July 2011, as compared to similar period of previous year, real wages grew by 7.6%.

The number of available population of Ukraine, as of 1 July 2011, was 45675 ths persons. During the 1st half of 2010, the population number decreased by 103.6 ths persons.

The overall reduction of the population number took place exclusively due to natural decrease (112.1 ths persons), while migration was positive in the amount of 8.5 ths persons.

The rate of registered unemployment, as of 1 August 2011, was 1.7% of able bodied population.

II. National Policy Assumption and International Environment

The forecast of key macroindicators for 2012-1013 (the probable intensive scenario) is based on the assumption that proper economic preconditions will be created to speed up Ukraine's economic development (by preventing risky price and exchange rate situations, overcoming stagflation and recession with the use of anti-crisis policy and stabilization and improvement of economic performance, as well as creating basic legal foundations to promote economic development based on real assessment of available resources and possibilities.

External preconditions for the development of Ukraine's economy The world economy, after the quite robust growth rates registered in the beginning of the post-crisis period (with the rate of world GDP reaching 5.1% in 2010 and 4.3% in I quarter of 2011), has slowed down recently. According to IMF forecasts, that indicator will be at 4% in 2011, as well as in the following year.

The post-crisis development of the world economy is very uneven with rather unstable conditions for further growth. Stability is hampered by the retention of credit restrictions, excessive debts of the leading financial institutions, dependence of the recovery process on massive financial injections by many governments, remaining complex conditions for international trade and financial flows, in particular, due to the uncompleted negotiations on the WTO Doha Round, unclear prospects of the reconstruction of the world exchange and financial system etc.).

Under such conditions, in most developed countries, due to the sharp appreciation of basic commodities and the outburst of debt crisis in the euro area, there is a tendency towards lower growth rates. In USA, beginning with II quarter of 2011, GDP growth rate considerably decreased (to 1% in annual terms) as a result of the considerable decline in industrial production under the aggravating domestic financial instability and lower deliveries from Japan suffering from the aftermath of the ruinous earthquake and tsunami.

In the euro area, in II quarter of 2011, economic growth slowed down too (to 1.6% in annual terms). In the EU, with the aggravated debt problems in some Southern countries and weaker euro, against the background of the North African hostilities, there are signs of further aggravation of the financial crisis towards its second phase. At the same time, in the emerging markets, the rates of economic development remain high. In China, in I half of 2011, the GDP growth is estimated at 9.5%. In Russia, despite a certain decline due to lower industrial rates, the overall GDP growth stays at a moderate 3.8%. With the increased instability, the global inflation rate has an upward trend: According to IMF, it will be 4% as compared to 3.5% in IV quarter of 2010.

A negative factor for Ukraine may be further growth of oil prices, Which, according to an IMF forecast, is expected at 9.5% in 2012 (in average annual terms). During 2012-2013, the prices for Russian natural gas, with stronger instability on the world markets, will have an upward trend (following the trend of the oil prices). By expert estimates, in 2012-2013, average oil prices (Brent) will be, respectively, 102–108 USD and 105–110 USD per barrel [2]. At the same time, the level of average price for natural gas will depend on the agreements between the leaders of Ukraine and Russia. One can expect their rise, in the medium run, to 410-420 USD per one cubic m.

For Ukraine, which has suffered from the crisis most of the European countries, the main factor of renewal of the domestic demand should is not so much the consumer demand (as was the case during the past period against the background of political instability and social populism) as the revival, first of all, of the demand for investments and resumption of the development of this country's real sector.

III. Forecast Summary

Main medium-term indicators of Ukraine's socio-economic development With Ukraine's successful progress to overcome the recession and other consequences of the financial and economic crisis, we expect a gradual recovery of this country's economy with a GDP growth rate at 4.6% [table 1]. In the second half of 2011, the growth dynamics will somewhat worsen with the reduced external demand and corresponding decline in the world prices for metal due to slower economic growth in the developer partner countries.

The main factor of economic activities, until the year end, will remain the growth of investments, (to a great extent, the government ones), which will be directed, first of all, to the development of the transport infrastructure and energy generation. The high level of the government spending is testified by statistical surveys. Thus, in the first half of 2011, the capital expenditures of Ukraine's Consolidated Budget grew 2.2 times as compared to the corresponding period of previous year.

Table 1.

The main macro-indicators of Ukrainian economy for 1995–2013

Macro-indicators										***Forecast***				
	1995	**2000**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	***2011***	***2012***		***2013***	
										Estimate	***Basic scenario***	***Pessimistic scenario***	***Basic scenario***	***Pessimistic scenario***
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Change in real macro-indicators:														
GDP, %	-12,1	5,9	12,1	2,7	7,3	7,9	2,1	-15,1	4,2	4,6	4,4–5,5	3,0–3,5	5,6–6,8	3,6–4,2
Final consumption expenditure, %:														
- government consumption	-7,9	1,9	1,8	2,9	2,7	2,5	0,4	-5,6	2,7	1,3	1,7–2,1	1,3–2,0	2,3–2,7	2,1–2,4
- private consumption	-1,6	2,5	13,1	20,6	15,9	17,2	11,8	-14,2	7,0	9,5	6,7–8,8	5,2–6,4	7,0–7,8	5,2–6,4
Gross fixed investment, %	-19,5	12,4	20,5	3,9	21,2	23,9	1,6	-46,2	4,9	6,5	6,7–7,4	3,8–4,8	8,1–9,2	4,8–5,8
Prices and exchange rate:														
Consumer price index, year average, %	–	28,2	9,1	13,5	9,1	12,8	25,2	15,9	9,4	9,2	7,5–8,3	9,5–10,7	6,1–6,8	9,0–10,0
December to December, %	281,7	25,8	12,3	10,3	11,6	16,6	22,3	12,3	9,2	10,7	8,2–9,4	10,2–12,5	6,2–7,1	9,2–11,5
Producers' price index, year average, %	–	20,9	20,4	16,8	9,6	19,5	35,5	6,7	20,9	20,1	14,4–15,3	17,4–18,4	10,4–11,3	12,4–14,4
December to December, %	272,1	20,8	24,1	9,5	14,1	23,3	23,0	14,4	18,7	21,2	13,3–14,2	16,4–19,7	11,3–12,2	13,4–15,7
Exchange rate, average for period, Hrn/$	1,87	5,44	5,31	5,12	5,05	5,05	5,27	7,8	7,94	8,0	8,2–8,5	9 - 10	8,2–8,5	9 - 10

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Money aggregates: (**in previous year **), %														
Monetary base, %	54,2	54,2	34,2	54,2	18,1	46,3	31,5	4,4	15,8	6-10	17,0–19,0	14,0–15,0	15,0–17,0	12,0–13,0
Money supply (*M3*), %	35,1	54,3	32,1	54,3	35,2	52,4	29,9	-5,4	22,7	14 - 17	25,0–28,0	20,0–25,0	24,0–26,0	18,0–20,0
Budget:														
Total revenues, % to GDP	37,1	28,9	26,5	30,4	31,6	30,5	31,4	29,9	28,7	29 -30	28,0–28,5	27,5–29,0	29 -30	28,0–28,5
Total expenditures, % to GDP	41,9	28,3	29,7	32,2	32,3	31,6	32,9	34,0	34,5	32,4 - 35	30,6–31,6	32,3–34,6	32,4 - 35	30,6–31,6
Balance, % to GDP	-4,8	0,6	-3,2	-1,8	-0,7	-1,1	-1,5	-4,1	-5,8	-3,4- -5	-2,6– (-3,1)	-4,8– (-5,6)	-3,4- -5	-2,6– (-3,1)
Social indicators:														
Real average monthly wages, %	-10,6	-0,9	23,8	20,3	18,3	12,5	6,3	-9,2	10,2	8 - 9	7,7–8,8	4,8–5,2	6,5–6,8	3,8–4,2
Real unemployment rate (ILO), %	–	11,6	8,6	7,2	6,8	6,4	6,4	9,0	8,1*	7,6–8,1	7,2–7,7	7,8–8,0	6,7–7,2	7,5–8,0
Foreign trade:														
Exports of goods and services, bill $US	–	18,178	41,290	44,378	50,239	64,001	85,612	54,174	69,26	85,95	93,6–95,2	89,2–92,8	102,7–105,2	97,2–99,8
Exports of goods			33,432	35,024	38,949	49,840	67,717	40,411	52,19	66,54	71,9–74,0	68,4–70,2	80,1–84,0	77,4–79,2
Imports of goods and services, bill $US	–	15,107	36,310	43,707	53,307	72,153	100,13	56,896	73,24	90,72	98,6–101,3	96,3–101,4	106,7–110,3	105,4–109,5
Imports of goods			29,691	36,159	44,144	60,413	84,65	45,740	60,58	76,25	81,3–84,6	85,5–83,8	88,5–94,0	90,7–94,0
Balance of foreign trade bill $US	–	3,071	4,980	0,671	-3,068	-8,152	-14,52	-2,722	-3,98	-4,77	-5,0– (-6,1)	-7,1– (-8,6)	-4,0– (-5,1)	-8,2– (-9,7)
Balance of goods			3,740	-1,132	-5,194	-10,57	-16,93	-5,329	-8,39	-9,71	-9,4– (-10,6)	-12,3– (-13,6)	-8,4– (-10,0)	-13,3– (-14,8)

For 2012-2013, in the probable intensive scenario, we predict a GDP growth at 4.4-5.5 and 5.6-6.7% respectively, and, in the pessimistic scenario, at 3.0-3.5 and 3.6-4.2% (see Table 1). In 2012, expected fluctuations of external demand and slow increase in the prices for metal (with retained high prices for imported natural gas) will restrict economic growth. At the same time, we expect the revival of investment activities to considerably offset the pressure of the external factors. We expect further revival of investment activities at the expense of increased public spending and greater investment orientation of the companies' funds with further improvement of the financial results of their activities.

Beginning with 2012, we predict the rate of gross capital generation at 6.7-7.4% due to better conditions for a revival of innovation and investment oriented development of Ukraine. Such a development should be instrumental in the transition to dynamic economic growth based on domestic investments and innovations and oriented to structural and technological modernization of this country's economy.

Increased domestic demand for investments will promote, in the medium run, a speed up of industrial and construction output. With overall growth rate of industrial output in 2012 at 7.5-8.8%, the growth rate of machine building (16-18% in annual terms) will exceed the industrial average. Such an increase will be based on a revival of domestic demand, including on the part of the construction, against the background of a weaker demand from the developed countries.

The expected moderate increase in the foreign demand and fluctuations of the prices for raw materials (in 2011) will determine the unstable dynamics of Ukrainian metallurgy and chemical production. At the same time, in the medium run, we project a gradual recovery of external demand for domestic investment produce from the CIS countries, which will become an important factor of the growth of Ukraine's processing sector.

Estimated inflation rate, as of late 2011, will be 10.7% or 9.2% in monthly terms. The increase in the current inflation is due, *first,* to the increase in the world prices for cereals and food items (In January-March 2011, the index of world prices for agrarian produce was the highest since 1990 amounting, according to FAO data, to 233 points). *Secondly,* due to the increase in the world prices for oil and domestic ones for gasoline, transport services have been growing. The revival of inflation is also associated with the increase in the households' effective demand due to increased rates of people's incomes this year (during the 1st half of 2011, real monthly wages grew by 8.1% (while during the same period of previous year – only by 4.9), as well as the increase in electricity for the population (by 15% in April and 26% in October 2011 p.) And gas tariffs for the population (by 30% in October 2011 p.) and higher residential rentals (by 27% in October 2011p.). In the 1st half of 2011, the prices for fuel grew by 14.4% due to the protracted increase in the oil price. However, recently, because of the end of this tendency on the world markets, the growth rate of fuel price has been reduced.

Inflation forecasts for 2012 and 2013 show its gradual decline in 2012 p. (to 8.2-9.4 in the probable intensive scenario (December to December), and to 10.2–12.5% in the pessimistic one) and its retention within 5–6% in 2013–2014. The main factors of growth of the consumer prices will remain the appreciation of fuel and raw food commodities. Thus, the increase in the prices for imported natural gas in 2012 will cause an increase in tariffs for public utilities electricity and gas. We expect a gradual rise of the gas tariffs for the population: by 10% each half year during 2012-

2013 until the complete cancellation of subsidies. Similarly (by 10% each half year), the tariffs for electricity for the households will grow during the same period.

A big probability of the shortage of skilled personnel remains on the **labor market**, which may become a serious restriction to the innovation based economic reform. On the whole, in the medium run, we project a considerable change in the balance of labor flows, as well as a considerable reduction of the unemployment (by ILO methodology – from 7.9% in 2011 to 6.7–7.5% in 2012-2013).

During the forecasted period, we expect a growth of the services market, which corresponds to the expected increase in the households' effective demand that will be proportional to the change in the households' real incomes.

We project a retention of the trend towards higher households' expenses on public utilities due to higher energy prices, providing the government abandons subsidizing the natural gas supplies for the households and public utilities, as well as cross-subsidizing, and brings all tariffs to the economically grounded level. We forecast further regulation and optimization of the system for subsidizing the households' expenses on public utilities by was of introducing targeted subsidies.

As regards monetary policy, The NBU plans to implement a flexible medium-term policy oriented to the following objectives: increase in the money supply in order to promote economic dynamics and provide the economy (first of all, the real sector) with the means of payment; curbing inflation/deflation through the regulation of cash level; supporting the stability of the financial system (and solution of the budget problems) through issue and mobilization of funds on the credit and exchange markets; and increase in the monetization of the economy. As a result of the planned monetary measures directed to the post-crisis recovery and growth, the monetary base, in 2012, will grow by 17.0–19.0% by late December, and the money supply, by the same date, by 25.0–28.0%. . The banks will gradually lower the rates on credit, against the background of the decrease in the deposit rates and the NBU discount rate. The integral credit rate will decrease, in 2012, by 1.5-2.0%. In 2011-2012, the dynamics of the hryvnia exchange rate will reflect the NBU policy directed to suppressing (leveling) excessive fluctuations of the exchange rate and stabilizing the exchange market.

In 2012, in the **budget sphere**, increase in social benefits should be achieved, first of all, through the reduction of expenditures on state management, reduction of privileges, and optimization of expenditures on budget-funded agencies and government purpose-oriented programs. In 2012–2013, budget policy will be focused on balancing public finances with a moderate deficit of the Consolidated Budget at 2.1-2.8%, with a gradual easing of the tax and debt burdens.

In the years to come, increase in real average annual wages will be realized through raising minimum social standards (minimum wage, subsistence minimum) and more vigorous business activities. With increased GDP rates, In 2011-2012, the rates of final consumer expenses will gradually lag behind those of GDP (with much higher rates of gross capital generation), and, correspondingly, the growth rates of the households' effective demand will be lower than those of GDP with a lag of 6-9 months.

III. Policy Issues and Uncertainties

Risks and threats

However, there exist **risks and threats**, which may enable the pessimistic scenario with hardly forecastable and ruinous consequences for Ukraine's economy.

Considerable ***external risks*** are associated with the possibility of failure of the world economic recovery. They are as follows:

– Despite a series of successful measures to encourage economic activities, which have been taken in many countries, the considerable increase in the budget deficit and public debt (in 2010, the total public debt in the developed countries exceeded 100% of GDP) may cause another recession, which would require a corresponding adjustment towards financial consolidation.

– A new aggravation of global misbalances, against the background of considerable debts accumulated in the EU Southern countries and USA may cause a loss of confidence in the main international currencies. And the enormous amount of the recent financial injections may create new financial bubbles and a new expansion of unstable financial flows to the new market economies leading to new financial misbalances similar to those, which provoked the recent crisis.

– Possible second wave of bankruptcies in the developed or developing countries;

– Expansion of import-substituting policy in Ukraine's partner countries with the loss of considerable segments of this country's international outlets including in the greatest consumer of Ukrainian goods, the Russian Federation, where protectionist measures are not limited by the WTO restrictions, as the Russian Federation is not its member country;

– The openness of Ukraine's economy remains excessive, which determines this country's high vulnerability to external shocks. Due to the retention of problematic situation in the euro area, reduced investment demand and difficulties with debt repayment in many countries, one can expect a global slowdown in the second half of 2011. Further aggravation of the crisis phenomena in the euro area and expected delay with overcoming the crisis in several European countries (Greece, Spain, Portugal, Italy etc.) will worsen the situation on the world markets, including in some Ukraine's trade partner countries, which would hamper the recovery in Ukraine's export oriented sectors and decrease this country's budget revenues.

– Instability and possible increase in interest rates on the international financial markets reduce the availability of external financial for Ukraine and decrease the risk propensity of international investors.

Among the main domestic risks and threats of the forecast period, one should mention the following:

Risks associated with the real sector:

First, during 2012, one can expect a decline in the global economic activities due to the retention of crisis phenomena in the euro area, narrowing investment demand and aggravated public debt in many countries against the background of the expansion of hot money in the global economy, and greater financial instability and political risks, in particular, due to the hostilities in North Africa. Such developments could worsen the situation on the world markets, in particular, on the markets of Ukraine's trade partners, which would hamper the recovery in this country's export oriented sectors and negatively impact the rates of economic growth and budget replenishment.

Secondly, a considerable threat to Ukraine's economy is the degradation of the industrial potential, in particular, in the machine building branch that has taken place during the period of market oriented reforms. Ukraine got into the crisis of 2008-2009 with degraded productive stock characterized by a high wear and tear (up to 57.0–65.0% in many sectors including processing, mining, transports and communications). Those negative trends emerged against the background of the low level of stock renewal, which never exceeded 2% annual average during the recent years.

According to data obtained from statistical surveys, the increase of fixed funds was accounted for mostly by the construction of new trade and office facilities and offices, and this country's economic development was characterized by a shift of economic activities from production to turnover. Further massive injections of liquidity in the economy as a whole and, in particular, in the banking sector, may provoke a speed up of inflation, which may aggravate the existing economic distortions and weaken the incentives for efficient economic activities.

Thirdly, among the risks of the forecasted period is a possible increase of consumer inflation up to 10% (as annual average), which is caused by a number of factors:

– increased growth of producers' prices, first of all, those for food processing items (with a lag of about 4 months) under the expected increased effect from imported food inflation; rapid growth of the global prices for agricultural products, which began in summer 2010 due to unfavorable weather conditions (heat, fires in Russia and other countries) and lower yield forecasts in other regions. As a result, in 2010, agricultural prices on the world markets grew by 44.5%. Against that background, in Ukraine, in 2010, index of industrial producers' prices reached, in average monthly terms, 20.9%, i.e. was twice as high as consumer inflation. That tendency holds in 2011. That is why the lagged effect of the above mentioned factor will contribute to the inflationary pressure on this country's economy in the forecasted period;

– Parliamentary or regional elections, especially the election to Ukraine's Verkhovna Rada in 2012, may cause populist increases of wages, pensions and other social payments, when, despite the considerable lag of productivity rate behind that of wages, the public funds will be directed, first of all, on consumption rather than support of the credits for the real sector. Doing so would create conditions for higher inflation and corresponding reduction of the households' consumption.

– *Fourthly*, one of the contradictions of Ukraine's model of economic growth remains the lack of correspondence between the structure of supply and that of demand. It is necessary to raise domestic demand for the produce of domestic producers (both from the public and private sectors). So far, the anti-crisis measures in Ukraine have been oriented mainly to support demand in selected sectors, in particular, in the raw-material and export ones. However, to properly support the domestic demand, special attention should be given to house construction and provision of the households with affordable dwelling, and durables of domestic make, and implement a program, which would become an important source of domestic demand. Simultaneously with raising the demand, it is necessary to ensure the availability of supply, in particular, to create favorable conditions for the reduction of interest rates and more available credits for physical persons and companies (first of all for those, who implement programs of technological re-equipment, supply innovative products to the market, and carry out restructuring and reduction of operational costs.

– *Fifthly,* further delay with reforming Ukraine's agriculture and low rates of the modernization of agro-industrial production may lead to resumed substitution of Ukrainian produce with that originated from Poland, Lithuania and other EU and Customs Union countries, which would have a strong negative impact on Ukraine's economic recovery.

Risks associated with the labor market:

– Further aggravation of the demographic situation due to rapid depopulation and ageing, which lowers the quantitative and qualitative properties of this country's labor potential and endangers the necessary reforms and innovation based economic recovery;

– Probable shortage of highly qualified personnel due to the migration of skilled Ukrainian labor to the countries with higher living standards. That latter phenomenon may become an important restriction to economic reforms and modernization in this country, and, may create a need in special public retraining programs;

– Decreased incomes and aggravation of social tensions due to excessive rise in the tariffs for housing and public utilities, which should be compensated with a proper public support for the socially vulnerable strata.

Risks associated with the budget sphere:

– Lack of the sources of external borrowing to finance the budget deficit and service the previous debts at acceptable cost and terms, with the worsening situation on the world financial markets may aggravate the debt problems; retention of the practice of accumulating considerable borrowings of the public sector on domestic market, which may provoke crowding out of the funds from the real sector, and hence increased costs of financial resources for business development'

– Further accumulation of foreign debt without adequate use of resources for economic modernization and retention of the practice of spending the revenues on the repayment of past loans; hampering the transition to economically grounded prices for gas and tariffs for public utilities and railway transportation.

Risks associated with the monetary sphere:

– a high inflation with its sources and mechanisms of action lying beyond the direct impact of the NBU's monetary tools and the strengthening of devaluation trends on the exchange market;

– weaker financial regulation and control by the NBU, destabilization in the banking sector due to non-payment of credits, and low credit activities of the commercial banks;

– Reduction of the domestic sources to finance the real budget deficit, and the volatile dynamics of the speculative short-term capital.

Risks associated with the social sphere:

– In the social sphere is a probability that the increase in the households' effective demand will be hindered by a number of strong factors, such as: Low rates of the households' real incomes and expenses, limited access of the households to consumer and mortgage credits and their high costs; Inflationary expectations, together with negative and low positive rates of real monthly wages and available incomes will reduce the households' propensity to savings, which will be followed by risks as to the satisfaction of the needs of durables, services, affordable dwelling and may result in a poor structure of the households' expenses.

– During all years of the pre-crisis period, the gap between the cumulative rates of average monthly wages and those of productivity Taking into account the fact that, in 2009, labor productivity was 80% of the 1990 amount, and average monthly wage exceeded the 1990 level by 12%, one can make a conclusion that: If, in 2012-2013, no correspondence between the above mentioned indicators is achieved, then there remains a considerable risk of imbalance between the households' effective demand and supply of goods on domestic consumer market, which would strengthen inflation and hence reduce the people's welfare.

The probability of the above mentioned risks, which may materialize in the medium run, will decrease with successful implementation of anti-crisis measures, structural reforms and economic modernization. The prospects of overcoming the consequences of the global crisis and creation of the foundations of stable economic growth will depend on the rates of recovery of domestic and external demand and efficiency of the government policy involving anti-crisis measures and consistent implementation of systemic reforms in order to carry out successful economic modernization supported by the recovery and efficient functioning of the global financial system.