Ukrainian macroeconomic forecast for 2018

Credit Agricole CEO in Ukraine Jean-Paul Piotrowski says the Ukrainian economy is recovering but attracting investments remains a great challenge and key economic driver for the coming years

About the interviewee: ***Jean-Paul Piotrowski*** *is the CEO of Credit Agricole in Ukraine*

On 18 October, Credit Agricole Ukraine organized its annual "Macroeconomic Review: Summary and Trends" event, inviting its top corporate and premium customers to an official presentation. This traditional autumn conference aims to share the bank's vision and forecasts, providing analysis of the current global and Ukrainian economic situations while also looking ahead to the coming year.

The macroeconomic review presented during the event offers a number of reasons for guarded optimism, with Ukraine's key economic indicators pointing towards a continued recovery following the lows of 2014-15. However, significant challenges remain as the country seeks to attract much-needed international investment while maintaining strategically crucial cooperation with international financial institutions and taking into account the upcoming elections. Credit Agricole CEO in Ukraine Jean-Paul Piotrowski shared his perspective on what to expect in 2018 with Business Ukraine magazine.

What are the key current trends in the Ukrainian economy identified during Credit Agricole's annual macroeconomic review event?

The Ukrainian economy is currently recovering on the back of a range of fundamental factors such as GDP growth and rising consumer demand. According to the recent NBU forecast, GDP growth is set to reach 2.2% this year, with further acceleration to 3.2% expected in 2018, climbing to above 4% in 2019. The country has managed to maintain this recovery trajectory despite a number of economic shocks over the past years including the trade blockage of the Donbas conflict zone. This recovery process comes in tandem with tight cooperation between Ukraine and international financial organizations. The Ukrainian government continues to follow the path of reforms prescribed by the IMF, although this process is not always as rapid as might be anticipated. In any case, the government is trying to create a more favorable investment climate in order to attract investments from abroad. I see the recent USD

3 billion Eurobond issue and upgrade of the country's sovereign rating by Moody's as supporting our view. The growing integration of Ukraine's foreign trade activity into the Eurozone is one of the visible and important trends in this process, and is clear in recent figures. Inflation targeting by Ukraine's Central Bank (NBU) is another key pillar for continued smooth but stable GDP growth. This year's annual inflation rate is likely to be over 12%, which is higher than the 9% target but still below 2016 levels and a significant improvement on 2015.

Based on the results of Credit Agricole's research, what do you anticipate as the key macroeconomic issues facing Ukraine in 2018?

The stability of the relationship with the IMF and World Bank will remain a necessary factor for the country's development during 2018. The Consumer Price Index (CPI) will also be key, with the government facing considerable challenges to reduce inflation and contain a number of inflationary factors including rising salaries and utilities tariffs. Positive Foreign Direct Investment (FDI) dynamics will depend on the development of favourable investment conditions. The country needs to show progress on judicial sector reform as well as the anticorruption fight, since both are likely to hamper the attraction of FDI in greater volumes. With a fresh election cycle already looming increasingly large on the horizon, reform momentum may slow, making it potentially more difficult to pass legislation aimed at improving the business climate. Targeted GDP growth of 3.2% will remain a challenge. It is worth bearing in mind that for countries in Ukraine's current position, GDP growth of above 6% would be closer to the norm. If Ukraine seeks to secure further ratings agency upgrades, 4% GDP growth must be the minimum objective.

How do you see developments in the broader Ukrainian economy affecting the country's banking sector in 2018?

Investment will remain the key driver for the domestic economy over the coming year. The monetary easing policies of the NBU witnessed in 2017 have already initiated a recovery in lending activity in the banking sector. As this trend develops, we can expect limitations and challenges emerging in this area over the coming year due to banking capital requirements. In order to support further growth, multinational companies will need to increase cross-border funding. Private consumption will remain the second most important factor fueling the Ukrainian economic recovery in 2018, with increased banking sector lending to this segment capable of supporting this dynamic. In terms of domestic financing, 2018 could see a significant focus on the retail segment.

What are the key challenges facing the Ukrainian banking industry in 2018?

We have already witnessed much-needed steps to improve the quality of the Ukrainian banking sector, resulting in the cleanup of the sector and a reduction in the number of banks from 180 to 88. These actions have brought about a deep structural transformation of the banking sector but challenges remain. In order to boost confidence in the Ukrainian banking sector, we need additional measures. The share of state-owned banks has risen to 55% of total banking assets. An important part of the challenge would be a step-by-step re-privatization of state banks to decrease the share of state banks progressively. Western banks now make up 19% of the market, with the share of Russian and private banks visibly decreasing. The ratio of Nonperforming Loans (NPLs) remains extremely high and is presently 57% on average for the Ukrainian banking sector as a whole. This calls for enhanced NPL resolution mechanisms. Greater protection of creditor's rights is required as this issue currently prevents banks from lending more. The domestic banking system will likely remain focused on the quality of its assets while working to follow regulatory requirements (including those related to capital) and improving liquidity and risk policies. Other key challenges include the implementation of IFRS 9 (International Financial Reporting Standards) alongside harmonization with Basel recommendations and EU directives. We can also expect to see attention focus on the NBU's new supervision model, together with further consolidation of the banking sector as a whole.

How might global economic trends shape the development of the Ukrainian banking sector in 2018?

We should not expect to see any specific or direct impact on the banking system in Ukraine as long as the domestic banking sector remains isolated from global markets by regulatory measures. Banks in Ukraine are mostly limited to servicing the foreign trade activity of their customers. However, the situation on global commodities markets could result in a number of indirect impacts. This is particularly the case in terms of grain traders, together with global demand for steel and developments in the energy sector. Current trends in these areas are broadly positive for Ukraine and we can expect to see higher demand in 2018 for different types of financing including trade finance, together with more appetite for investment services.

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