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## **ANALYSIS OF EXTERNAL SUSTAINABILITY IN UKRAINE: CURRENT ACCOUNT ASPECTS**

The current account balance serves as a reliable tool for determining the effectiveness of macroeconomic policy implemented by any country. This is especially true for emerging economies, where current account deficits may reflect the inflow of resources to finance excessive investment demand that in turn will help to accelerate economic growth in the country. However, on the other hand, these deficits may reflect imbalances that will lead to the accumulation of external debt and the impossibility of its servicing (Roubini, Wachtel, 1998).

The stability of current account deficits is closely linked to the external sustainability of the economy. Given the significant external vulnerability of the national economy, the purpose of this research is to analyze the trends of Ukraine's current account balance and the sources of financing its deficits in the context of the external sustainability of national economy.

The current account is determined as the difference between national savings and investments. Therefore, its deficit is a result of investment growth or a decline in savings (Roubini, Wachtel, 1998).

At the same time, the overall decline in savings may be due to the fall of private and public savings (an increase in budget deficits). The latter cause a deterioration of the situation in terms of external sustainability of the economy (although there are exceptions in economic practice)), causing an increase of the debt burden on the economy.

There are many approaches to the sustainability of current account deficits. As to many researches, the current account deficit is considered sustainable if it is characterized by an excess of investment demand over national savings. N.Roubini and P. Wachtel (Roubini, Wachtel, 1998) distinguish the following criteria for assessing the sustainability of current account deficits:

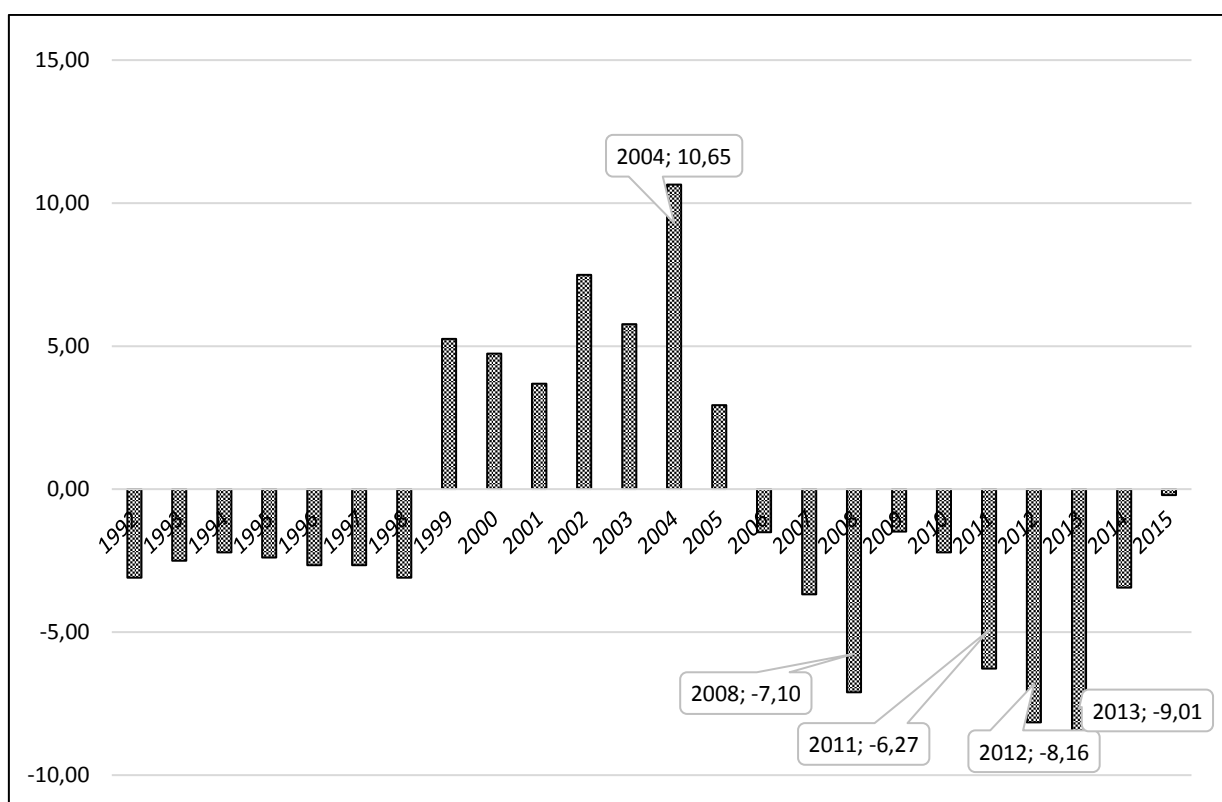
- analysis of the size of the deficit in relation to GDP and its trends,
- defining the causes of deficits (in particular, consumer booms and low national savings indicate imbalances);
- analysis of exchange rate regimes (for example, targeting the real exchange rate will contribute to greater stability of the current account deficit);
- analysis of banking and financial systems development.

However, they also highlight factors contributing to the sustainability of current account deficits, including a small inflow of portfolio investments and a significant amount of accumulated international reserves (Roubini, Wachtel, 1998).

G.M.Milesi-Ferretti and A.Razin consider the sustainability of current account deficits in the context of the ability of countries to pay for their obligations and the desire of creditors to lend to them (G.M. Milesi-Ferretti, A. Razin, October, November 1996). They also formulate sustainability criteria as the size of the deficit, the cause of the deficit (falling rates of savings or increase in investment rates) and the level of saving rates.

Thus, persistent current account deficits provoke also debt crises, to assess the current trends in the sustainability of current account deficits we will consider the dynamics of the current account as a criterion of volatility that leads to the accumulation of external indebtedness.

In Ukraine the current account balance is characterized by recurrent recessions and upsurges. Thus, the largest current account surplus was observed in 2004 at the level of 10.65% of GDP, the largest deficit - in 2013 with 9.01% (Fig.1). During 2014-2015 it declined due to a significant decrease in net exports, and in 2015 it was already 0.21%. Excess of the current account deficit threshold of 5% of GDP was observed in 2008, 2011, 2012, and 2013.



**Fig.1. Dynamics of the current account balance in Ukraine (% of GDP) in 1992-2015.**

**Source:** compiled by the author according to World Development Indicators and (Roubini, Wachtel, 1998)

Analysing the sustainability of the current account balance in Ukraine in terms of investment and savings imbalances, the following periods can be distinguished:

- 1992-1998 (small current account deficits, excess of national savings);
- 1999-2005 (persistent current account surpluses due to the formation of the export model of the economy and stable foreign exchange earnings due to favorable external conjuncture for Ukrainian exports);
- 2006-2015 (persistent and significant current account deficits, especially in 2008 and in 2011-2013, which corresponded to a negative balance of net exports of goods and services (the largest deficits occurred in 2013); investments surplus).

In our opinion, a sharp reduction in the rate of savings in 2013 to 8.73% was a catalyst for a narrowing of the economy. Although in the next two years, it has increased and in 2015 was 14.91%, which led to an increase of investment rates in 2015. From 2014 there was a reduction in the current account deficit from 3.44% of GDP in 2014 to 0.21% in 2015.

In the context of ensuring external sustainability, the sources of financing the current account deficit come to the forefront. This, above all, is due to the flow of financial flows to the country and the accumulation of debts. At the same time, the structure of financial flows entering the country also plays an important role in this aspect.

For example, according to N. Roubini and P. Wachtel (Roubini, Wachtel, 1998), short-term capital flows represent a greater threat to external sustainability than long-term ones. Direct foreign investment contributes to its increase compared to "debt-creating" financial flows. At the same time financing of the current account deficit due to direct foreign investments is more desirable than the inflow of short-term "hot money".

In this context, it is also necessary to indicate the problem of inflow of large volumes of financial flows in countries that may exceed the current account deficit (Roubini, Wachtel, 1998). In the short-term these funds contribute to increased external sustainability, as they are used to finance the current account deficit. By contrast, in the long run they can contribute to external instability. First, this can happen in the event of portfolio investment accumulation. Secondly, they can contribute to the revaluation of the national currency and reduce the competitiveness of domestic goods in foreign markets. In order to prevent this situation, the central bank of the country should intervene and increase the volume of international reserves, which in turn will contribute to greater stability of the current account imbalance.

In Ukraine the sharp fluctuations of capital flows are mainly due to different stages of economic and political instability. Generally during 1994-2015 there was a net outflow of direct investment from Ukraine. Portfolio investment inflowed only in 1999, 2001, 2008, 2009, and 2014. During 1994-2007 the amount of outflow of foreign direct investment exceeded the volume of outflow of portfolio investments from Ukraine. The

exceptions were only in 1997 and 2004. During 2008-2009 and 2014, portfolio investment inflows to Ukraine were observed, which in our opinion is due to the inflow of funds during periods of political instability and the years ahead (2008-2009 were preceded by the 2010 presidential elections ) During 2010-2015, the prevailing trend of outflow of direct portfolio investment continued. However, the exception at this stage was 2013, when the outflow of portfolio investments exceeded direct outflow more than twice and amounted to 8.787 billion US dollars.

During 2000-2006, 2009-2012 and in 2014 there were significant inflows of the "Other investments". In some years these volumes were significantly contrasted with loans to deposit-taking corporations and ones received from the IMF (for example, 2007-2009, 2012 and 2014).

It should be noted that significant loans to deposit corporations during 2006-2007 in the amount of 15.350 billion US dollars exceeded the current account deficit in these years by almost 3 and 2 times, respectively. Generally, in 2006-2008 the country received more than 25 billion US dollars in the form of obligations of deposit-taking corporations. However, since 2009, there has been a reversal of these financial flows, which has worsened the economic situation in the country.

As regards IMF commitments, significant IMF loans to the central government began to come in 2009-2010 and amounted to US \$6.826 billion in this period (in 2014-2015 - \$2.173 billion). At the same time, the IMF has been lending to the National Bank of Ukraine since 1994 (based on the Balance of Payments Statistics data). In particular, during 2008-2010 inflows from IMF amounted to 6.772 billion US dollars, during 2014-2015 - US \$ 3.897 billion.

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