Ukraine

Ukraine’s investment shortage puts rebound at risk

Affordable financing is hard to come by as banks hesitate to give new loans

Vladimir Lempert is struggling to get the funds he needs to expand his factory, which produces parts for carmakers including Land Rover, BMW and VW

Roman Olearchyk in Dnipropetrovsk region and Neil Buckley in London 4 HOURS AGO

Vladimir Lempert, founder of a factory in the industrial city of Kamianske in east-central Ukraine, strolls proudly along production lines churning out plastic parts used by carmakers including Land Rover, BMW and VW. Elsewhere, imported robotic machinery shapes plastic pellets into containers for food, construction materials and the medical industry.

Yet something is spoiling this rare Ukrainian business success story. The factory’s output and profits are getting back to their levels before 2014 when Russia annexed Crimea and fomented a separatist war in far eastern regions — 300km east of Kamianske — causing a sharp economic contraction. But Mr Lempert is struggling to get the funds he needs to expand.

“We could have doubled production but we’ve had to turn away orders,” he says. “We need to double capacity by building a new production line facility.”

Mr Lempert's expansion plans are stuck for the same reasons Ukraine's economy grew only 2 per cent last year: domestic financing is hard to come by, and foreign investment is scarce.

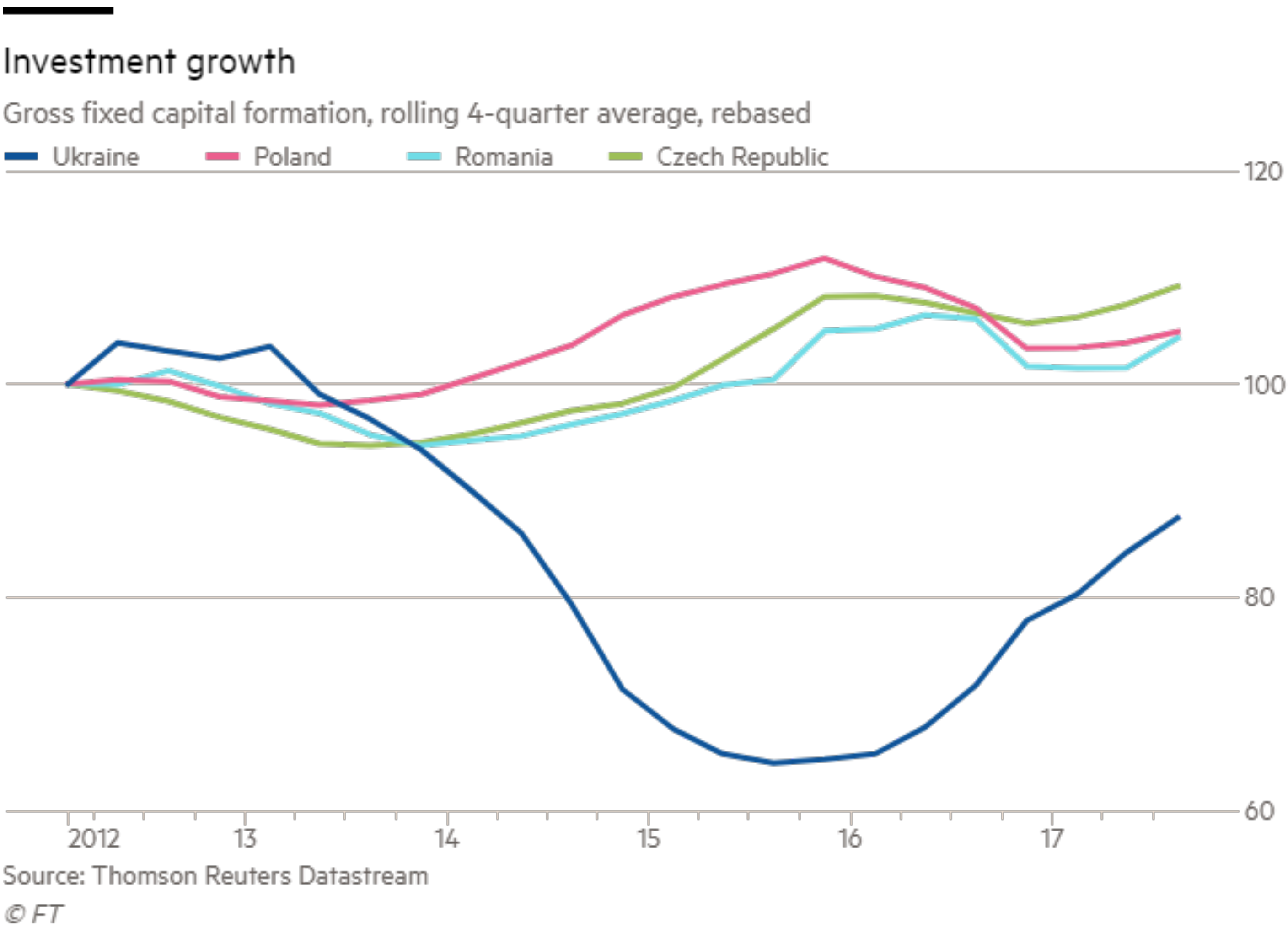
The growth rate represents a feeble bounceback after the 17 per cent cumulative economic collapse in 2014-2015. It is slower than EU and global growth — and far less than needed to put the country firmly back on the road to recovery. Anders Aslund, an economist at the Atlantic Council, warns that Ukraine risks slipping behind Moldova to become Europe's poorest country in per capita terms.

Disappointing 2017 growth — after a 4.8 per cent year-on-year increase in the final quarter of 2016 — resulted partly from a trade blockade imposed in March last year on separatist-controlled eastern regions, which contributed to a 0.1 per cent decline in industrial output.

But low investment is the main underlying reason. The still-smouldering eastern conflict is one cause — but so, too, are issues with the banking system and concerns over the government's pace of reforms and efforts to strengthen the rule of law.

Ivan Miklos, a former Slovak finance minister advising Kiev's government, says direct investment is running at only 15 per cent of Ukrainian gross domestic product. For the country to reach its potential growth of 6 per cent to 7 per cent a year, it should be about 25 per cent.

"There are three main sources of investment: public finance, loans, and the most important . . . is foreign direct investment," Mr Miklos told the Financial Times. "[Progress on] this is linked to the rule of law, privatisation."



Ukraine's central bank has conducted a vigorous banking reform, reducing the number from 180 in 2014 to 86 now. But the restructured banks, some of which still have very high rates of non-performing loans, are hesitant to give new loans, and even then only at double-digit interest rates.

With Ukraine's currency, the hryvnia, recently weakening again following its deep plunge in 2014, banks are extra cautious towards clients who import machinery and raw materials.

A surprise central bank decision last month to hoist its core lending rate from 14.5 per cent to 16 per cent to curb unexpectedly high inflation has further darkened the mood among businesses the FT visited recently in the industrial Dnipropetrovsk region.

"All of industry is in debt. Banks are hesitant to lend more, let alone at affordable rates," says Mr Lempert. "The war has not been the main problem since the end of 2015. Corruption is not felt as it was before," he adds. "Problem number one" is affordable financing.

Ukraine's relatively few foreign investors, which do have access to cheaper financing, are doing better than domestically-owned enterprises.

A two-hour drive south west of Mr Lempert's factory, ArcelorMittal, the global steelmaker that paid nearly $5bn for Ukraine's largest steel plant, Kryvorizhstal, in 2005, is building production lines and boosting energy efficiency through renewable technologies. Paramjit Kahlon, chief executive of ArcelorMittal's Ukrainian operations, says the business has invested $9bn in Ukraine.

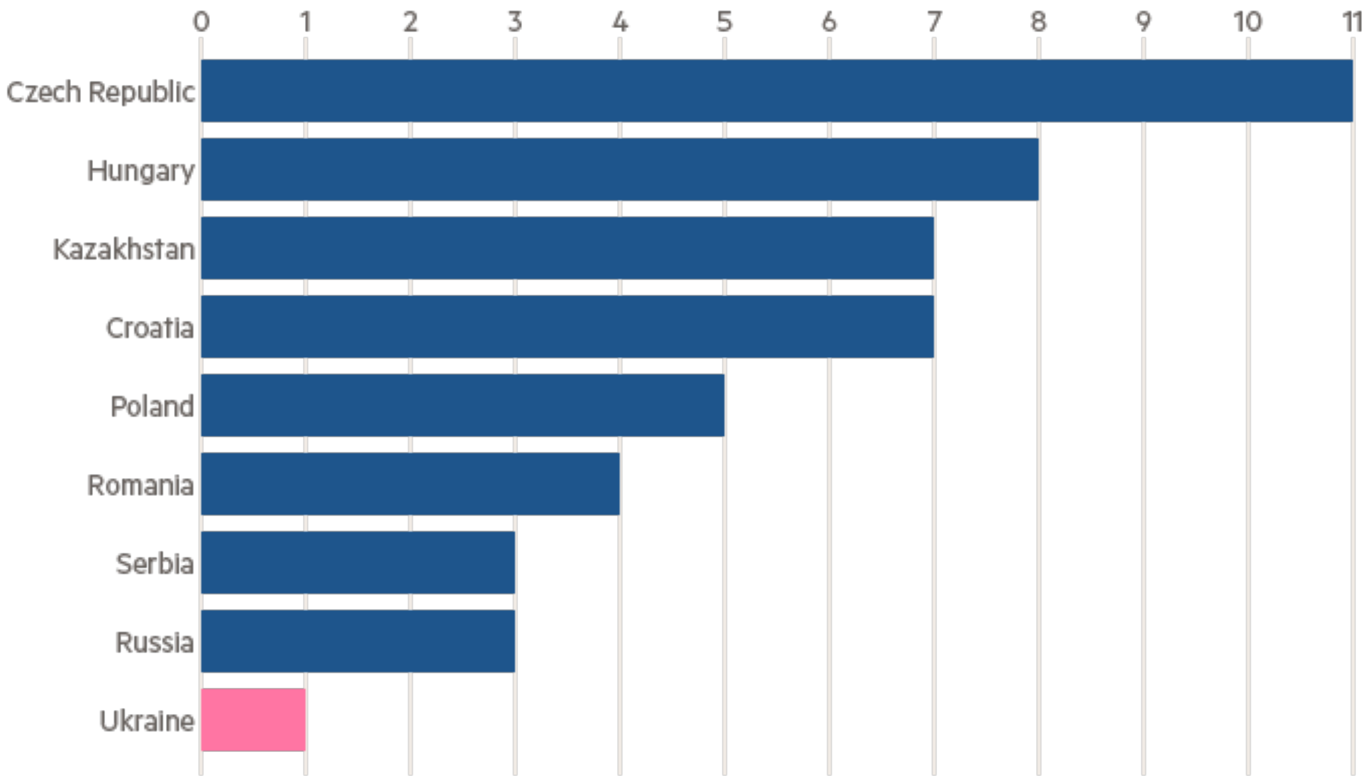
But he says oligarch-owned competitors and regional officials — sometimes in league with one another — still harass the company "using all sorts of tools", including non-governmental groups or trade unions, or even organising protest marches. Construction permits are blocked, or ArcelorMittal finds itself unfairly accused of pollution, he complains.

"They create trouble for us, and then a messenger [comes] through the back doors saying you have to agree to this or that," says Mr Kahlon. "Even after making such a big investment, we are not getting respect."

He adds that the courts system needs to be reformed so disputes can be fairly settled, and high-level corruption has to be curbed.

Foreign direct investment

Developing Europe, stock per capita in m$, 2016



Source: Unctad

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There are bright spots. Further south in Nikopol, Canada's Refraction Asset Management has built a €10.5m solar power plant in what city officials say is the first real foreign investment there since Tsarist times. Michael Yurkovich, Refraction's president, says larger projects are planned.

Yet such investments are tiny compared with what is needed to drive growth; Ukraine's total stock of foreign direct investment is $71bn, less than one-third of the $236bn that has poured into neighbouring Poland.

"It's hard to lure in foreign investment if they see things are so hard for local business," says Mr Lempert. Competitors have offered to buy his business at a fire sale price, but he has refused. "Why should I sell what I've toiled to build over 30 years?"