

May 2019

Oleg Ustenko, Julia Segura, Valentyn Povrozhnyuk
 Edilberto L. Segura

Executive Summary

- ❖ Volodymyr Zelensky, a TV and movie actor without any political experience won 73% of all votes in the second round of the Presidential elections of April 21st. His victory was attributed to disillusioning of the Ukrainian people with slow economic growth, increased poverty, widespread corruption, and stalemate in the military conflict with Russian-backed separatists in the East. Rada elections are scheduled for later this year.
- ❖ Following four months of declines, in March 2019 industrial production recovered growing by 2.1% yoy, with manufacturing increasing by 5% yoy. Agricultural production also recovered in March, increasing by 3.5% yoy. Similarly, during the month, construction activities continued to grow at a fast rate of 28.9% yoy (10.8% yoy for building construction and 54.1% yoy for civil engineering). Ukrainian retail and wholesale trade also continued to perform well with retail trade expanding by 8.9% yoy and wholesale trade growing by 9.5% yoy. Finally, passenger and freight transportation increased by 3.9% yoy and 2.2% yoy, respectively.
- ❖ The consolidated fiscal budget had a deficit of about 4.5% of period GDP in March. During 2019-Q1, the cumulative consolidated budget balance from the beginning of the year turned negative at UAH 9.0 billion (1% of period GDP).
- ❖ Consumer inflation further decelerated in March. The all items index edged down by 0.2 percentage points to 8.6% yoy. Similarly, core inflation dropped 0.2 percentage points to 7.6% yoy.
- ❖ Although still growing at a reasonable rate, the situation with banking deposits slightly deteriorated in March. Growth of total national currency deposits decelerated to 9.7% yoy on the back of slower expansion of corporate sector deposits. Growth of household deposits remained stable at 15.1% yoy.
- ❖ Apart from some fluctuation during the first couple of days at the beginning of the month and at the final trading session of the month, the UAH/USD exchange rate was relatively stable during most of April. Overall, the exchange rate appreciated by 3.1% during the month to 26.4 UAH/USD.
- ❖ In March 2019, the current account of the balance of payments had a deficit of USD 650 million, compared to a deficit of USD 712 million in March 2018. Financial inflows of USD 1,310 million fully covered this deficit, with international reserves increasing to USD 21 billion.

Main Macroeconomic Indicators	2013	2014	2015	2016	2017	2018	2019f
<i>GDP, USD billion</i>	180	130	87	93.4	113	125	135
<i>Real GDP Growth, % yoy</i>	0.0	-6.6	-9.9	2.4	2.5	3.3	2.8
<i>Fiscal Balance (incl. Naftogaz/Pension Fund), % of GDP</i>	-6.5	-11.7	-2.1	-2.3	-1.4	-1.9	-2.3
<i>Public Debt, External and Domestic, % of GDP</i>	40.4	69.4	79.1	80.9	71.8	62.6	64.5
<i>Consumer Inflation, eop, % yoy</i>	0.5	24.9	43.3	12.4	13.7	9.8	8.0
<i>NBU Key Policy Interest Rate, % eop</i>	6.5	14.0	22.0	14.0	14.5	18.0	16.0
<i>Hryvnia Exchange Rate per USD, eop</i>	8.2	15.8	24.0	27.1	28.1	27.7	30.0
<i>Current Account Balance, % of GDP</i>	-9.2	-3.5	1.8	-1.5	-2.2	-3.7	-3.0
<i>Merchandise Exports, USD billions</i>	59	51	35	34	40	43	46
<i>Merchandise Imports, USD billions</i>	81	58	39	40	49	56	58
<i>FDI, Net Annual Inflow, USD billion</i>	4.5	0.4	3.0	3.3	2.3	2.4	2.0
<i>International Reserves, USD billion</i>	20.4	7.5	13.3	15.5	18.8	20.8	18.0
<i>Public External Debt, USD billion</i>	31.7	34.9	42.6	42.5	47.0	49.9	50.0
<i>Private External Debt, USD billion</i>	110.3	91.2	76.0	69.9	70.0	71.0	72.0

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Political and Reform Developments

Volodymyr Zelensky, a TV and movie actor without any political experience won 73% of all votes in the second round of the Presidential elections of April 21st. His victory was attributed to disillusioning of the Ukrainian people with slow economic growth, increased poverty, widespread corruption, and stalemate in the military conflict with Russian-backed separatists in the East. President-elect Zelensky offered the hope that rapid positive changes will take place in all these areas. Indeed, he has now a clear mandate to act in these areas and improve the quality of life of Ukrainians. Nevertheless, there are political uncertainties as the Rada elections are scheduled for later this year. Therefore, many investors are waiting for the President-elect to disclose his reform agenda, including relationships with the IMF. An IMF mission will be visiting Kyiv on May 21st for a stay of two weeks.

In the meantime, current President Poroshenko has been quite busy appointing judges to the Supreme Court and other senior positions such as the high command of the Army. He also promoted to the rank of General more than 20 officers. These actions have been criticized by the President-elect team as unwelcome pre-emptive actions.

Economic Growth

Following four months of declines, in March 2019 industrial production recovered, growing by 2.1% yoy, and with manufacturing increasing by 5% yoy.

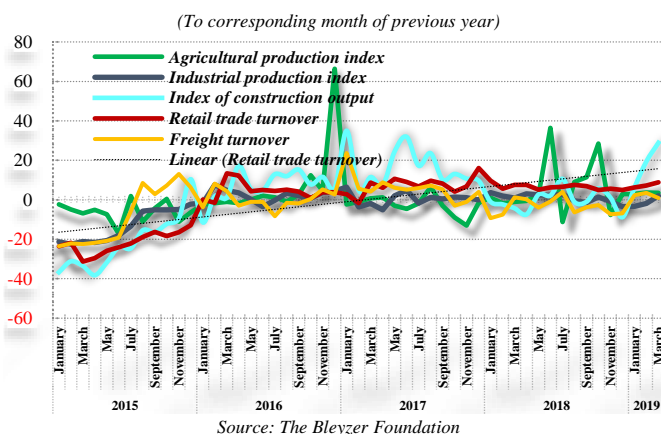
Agricultural production also recovered in March, increasing by 3.5% yoy. Similarly, during the month, construction activities continued to grow at a fast rate of 28.9% yoy (10.8% yoy for building construction and 54.1% yoy for civil engineering). Ukrainian retail and wholesale trade also continued to perform well with retail trade expanding by 8.9% yoy and wholesale trade growing by 9.5% yoy. Finally, passenger and freight transportation increased by 3.9% yoy and 2.2% yoy, respectively.

These performances were supported by increases in real monthly wages of 12.5% yoy in March, a stronger Hryvnia, and by further deceleration of inflation.

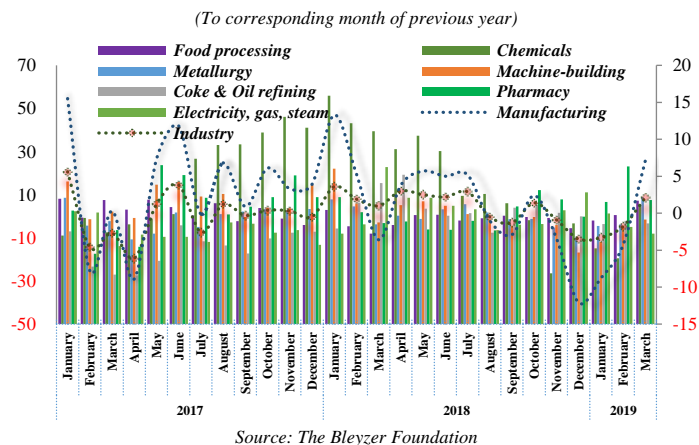
Within manufacturing, the fastest growth rates in March took place in repair and installation of machinery and equipment (17.1% yoy); followed by manufacturing of furniture (12.9% yoy); manufacturing of rubber and plastic products (12.4% yoy); metallurgy (8.9% yoy); manufacturing of pharmaceutical products (7.6% yoy); production of foodstuffs (7.3% yoy); and manufacturing of chemicals (5.2% yoy).

On the other hand, negative growth rates were experienced in manufacturing and distribution of natural gas (-31.1% yoy); manufacturing of textiles

Ukraine Economic Performance by Sector, % yoy



Industrial Production by Sectors, % yoy



Headquarters
123 N. Post Oak Ln., Suite 410
Houston, TX 77024 USA
Tel: +1 (713) 621-3111
Fax: +1 (713) 621-4666
Email: sbleyzer@sigmableyzer.com

Kyiv Office, Ukraine
4A, Baseyna Street, «Mandarin Plaza», 8th floor
Kyiv 01004, Ukraine
Tel: +38 (044) 284-1289
Fax: +38 (044) 284-1283
Email: kiev.office@sigmableyzer.com.ua

Kharkiv Office, Ukraine
Meytin House, 49 Sumska Street, Office 4
Kharkiv 61022, Ukraine
Tel: +38 (057) 714-1180
Fax: +38 (057) 714-1188
Email: kharkov.office@sigmableyzer.com.ua

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(-10.3% yoy); manufacturing of wood and paper products (-3.7% yoy); and manufacturing of machinery and equipment (-1.5% yoy). Some of these sectors were negatively affected by Russia's imposition of import restrictions.

From a regional viewpoint, the oblast with the highest growth rates of industrial production in March included Rivne (26.2% yoy); Vinnytsya (18.5% yoy); Mikolayiv (12.2% yoy); Luhansk (11.0% yoy); Dnipro (9.3% yoy); Kirovohrad (9.0% yoy); and Kherson (5.1% yoy).

Negative growth in industrial output occurred in Khmelnytskyi (-18.4% yoy); Zhytomyr (-9.5% yoy); Kyiv Oblast (-5.6% yoy); and Zaporizhzhya (-5.5% yoy).

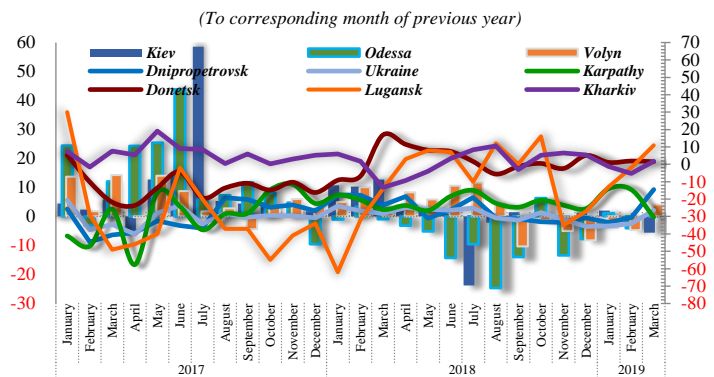
Fiscal Policy

The consolidated fiscal budget had a deficit of about 4.5% of period GDP in March. The central state budget was executed with a deficit of UAH 12.5 billion which was accompanied by a UAH 1.2 billion deficit in local budgets. The government borrowed heavily to finance the deficit in March. In fact, borrowings were more than two times higher than repayments in the month with net borrowings totalling UAH 31.6 billion. At the same time, the government used all its instruments to curtail liquidity during the month. In particular, it substracted UAH 20.4 billion of cash out of the economy. During 2019-Q1, the cumulative consolidated budget balance from the beginning of the year turned negative at UAH 9.0 billion (1% of period GDP).

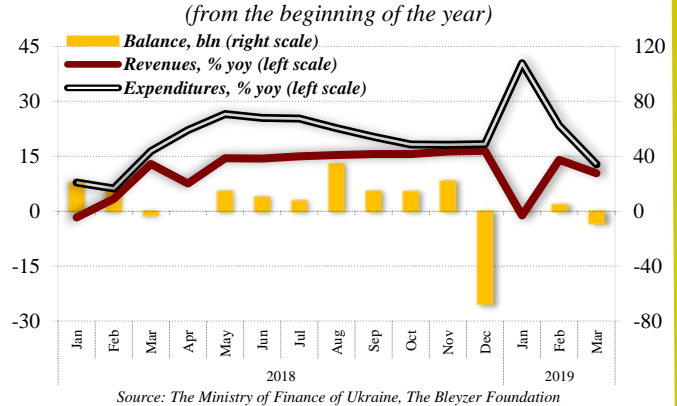
Consolidated budget revenues continued to expand but at significantly lower pace in March. Their growth rate decreased by more than four times to 5.3% yoy. Tax revenues expanded at slower rate of 6.7% yoy, while nontax revenues declined at almost identical rate of 6.6% yoy. Deceleration in growth of the former was driven by lower receipts from both domestic taxes and taxes on imported goods. Furthermore, corporate profit tax receipts, which were among those with the highest growth rates in 2018, declined by 1.3% yoy. Receipts from personal income tax, in contrast, continued to grow at high rate of 22.1% yoy. Cumulative consolidated budget revenues grew by 10.4% yoy in the first quarter of the year.

Growth of consolidated budget expenditures continued to decelerate in March. Their growth dropped to just 1.2% yoy due in part to a decline of 0.4% yoy of current expenditures, and in particular because of drop in social security expenditures (27.4% yoy). Current transfers, payroll expenditures, and expenditures on goods and services grew at fast pace ranging from 87.5% yoy to 13.2% yoy. Capital expenditures grew at accelerated rate again in the reporting month (41.2% yoy). Cumulative consolidated budget expenditures from the beginning of the year expanded by 12.8% yoy in January-March.

Industrial Production by Region, % yoy



Dynamics of Consolidated Budget Components



Headquarters
123 N. Post Oak Ln., Suite 410
Houston, TX 77024 USA
Tel: +1 (713) 621-3111
Fax: +1 (713) 621-4666
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Kyiv Office, Ukraine
4A, Baseyna Street, «Mandarin Plaza», 8th floor
Kyiv 01004, Ukraine
Tel: +38 (044) 284-1289
Fax: +38 (044) 284-1283
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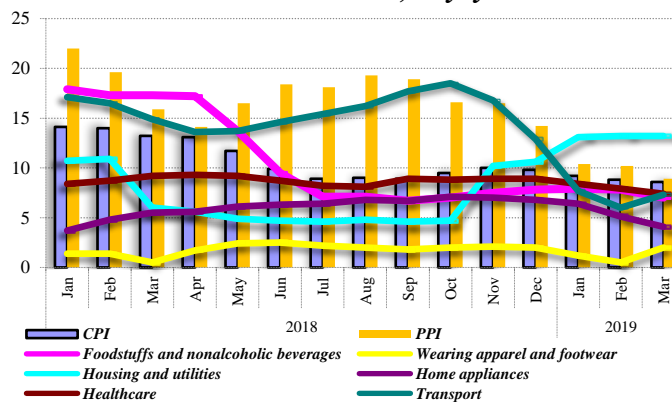
In March, principal and servicing payments on state and guaranteed debt denominated in foreign currency were lower than in the previous month. They totaled USD 866 million equivalent. USD 706 million equivalent was directed at servicing and repayment of domestic and external sovereign bonds and at other liabilities denominated in foreign currency. Also, the government and the NBU paid USD 159 million equivalent to the IMF.

Monetary Policy

Inflation. Consumer inflation further decelerated in March. The all items index edged down by 0.2 percentage points to 8.6% yoy. Similarly, core inflation dropped 0.2 percentage points to 7.6% yoy.

Several important groups of goods and services saw notable change in price dynamics. In particular, growth of prices decelerated for home appliances (by 1.0 percentage point to 4.1% yoy), recreation and culture (by 0.9 percentage points to 3.1% yoy), and foodstuffs and non-alcoholic beverages (by 0.8% percentage points to 7.0% yoy). On the other hand, significantly faster growth of prices was observed for communication (by 1.8 percentage points to 17.5% yoy), wearing apparel and footwear (by 1.5 percentage points to 2.0% yoy), and transport (by 1.3 percentage points to 7.3% yoy). Changes in growth of prices of other groups of goods and services did not exceed 0.5 percentage points in March.

CPI, PPI, and Growth of Prices for Select Goods and Services, % yoy



Source: State Statistical Service of Ukraine, The Bleyzer Foundation

Observing the dynamics of consumer inflation, the NBU decided to lower the policy rate by 0.5 percentage points to 17.5% starting on April 26th. The major reasoning was the steady tendency for inflation to approach the target band of 5%±1 percentage point and expectation for inflation at end of year to be at 5.0% yoy. We think that the NBU is rather overoptimistic about the inflation rate at the end of the year and expect it to be around 8.0% yoy.

Banking Sector. Although still growing at a reasonable rate, the situation with banking deposits slightly deteriorated in March. Growth of total national currency deposits decelerated to 9.7% yoy on the back of slower expansion of corporate sector deposits (grew at 7.0% yoy, which is 3.6 percentage points slower than in February). Growth of household deposits remained stable at 15.1% yoy. Foreign currency deposits denominated in USD saw little changes in their dynamics, decreasing by 1.0% yoy. Once again, corporate sector was the one responsible for the deterioration with its 3.9% yoy decline in deposits, while household foreign currency deposits denominated in USD edged up by 1.1% yoy.

Bank lending activities gradually improved in March. National currency loans increased by 4.5% yoy on the back of a 28.7% yoy growth of household loans. Corporate loans continued to decline dropping 1.6% yoy. The situation with foreign currency loans denominated in USD continued to deteriorate due to declines in both corporate and household sectors. Business loans edged down by 1.6% yoy, while household loans decreased faster at 10.8% yoy.

Although monetary base saw little changes in monthly terms (inched up by 0.1%), its over-year growth almost doubled to 7.8% yoy. Growth of the money supply remained almost unchanged at 7.2% yoy.

Headquarters
 123 N. Post Oak Ln., Suite 410
 Houston, TX 77024 USA
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Hryvnia Exchange Rate. Apart from some fluctuation during the first couple of days at the beginning of the month and at the final trading session of the month, the UAH/USD exchange rate was relatively stable in April. As in the previous month, appreciation of the exchange rate during the first week of the month was the result of low demand for dollars by those non-residents, who usually purchase dollar for dividends repatriation purposes. There was also an increase in the supply of dollar by those non-residents, who participated in auctions of domestic sovereign bonds denominated in UAH. Appreciation of dollar during the last trading session of the month happened because of upcoming Orthodox Easter and Labor Day celebrations leading to lower activities of importers and, therefore, lower demand for dollar. Overall, the exchange rate appreciated by 3.1% to 26.4 UAH/USD.

Official UAH/USD Exchange Rate (based on the Average Weighted Rate at the Interbank Forex Market)

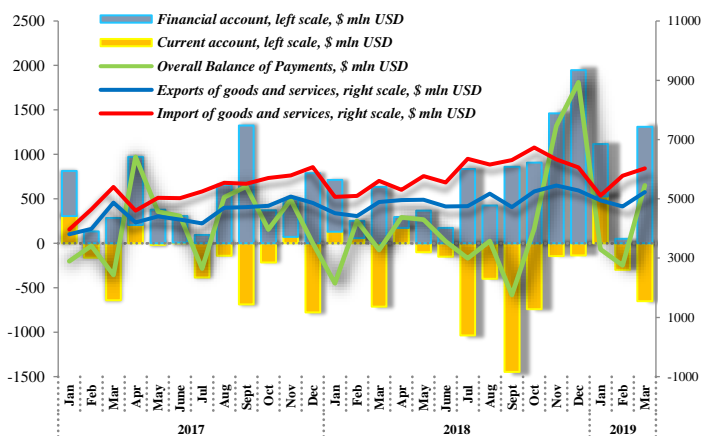


Source: The NBU, The Bleyzer Foundation

International Trade and Capital

In March 2019, the current account of the balance of payments had a deficit of USD 650 million, compared to a deficit of USD 712 million in March 2018. The lower current account deficit was due to a higher growth in exports of goods (7.1% yoy to USD 4.0 billion), than in goods imports, which increased by 6.7% yoy (to USD 4.8 billion). The primary income account (employees' compensation and investment income) had a deficit of USD 111 million in March. The secondary income account (principally foreign personal transfers) had a surplus of USD 266 million in the month.

Ukraine's External Balance of Payments



Source: NBU, the Bleyzer Foundation

Agricultural products continue to be the largest export category, with exports of USD 1,882 million in March (representing 48% of total exports and with a growth rate of 20% yoy).

Metallurgical exports represent the second largest export group (about USD 867 million in March), but had 13% yoy decline compared to March 2018. Exports of mineral products amounted to USD 393 million in March, showing a growth rate of 19% yoy. Moreover, exports of machinery and equipment reached USD 238 million, with a growth rate of 36% yoy.

From a geographical point-of-view, in January-March 2019 Ukraine exports to Russia fell by 84% yoy and amounted to USD 595 million. They now represent 5.3% of total exports. Exports to Asia increased by 12.3% yoy in 2019Q1, representing 31.5% of the total Ukrainian exports. Exports to Europe increased by 6.7% yoy and now account for 39.4% of exports. In addition, exports to the US increased by 27% yoy, but are still small at 2.4% of total exports.

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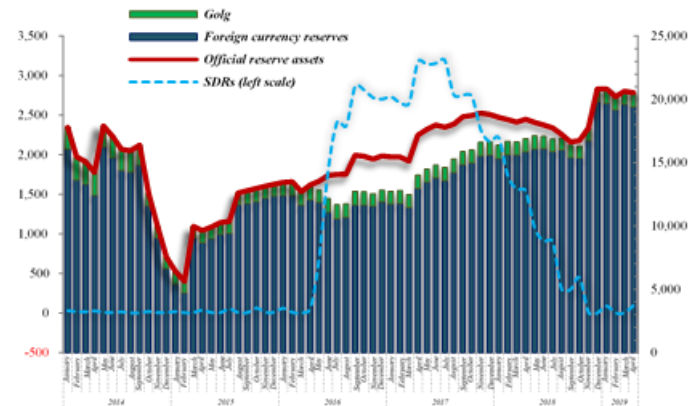
With regard to merchandise imports, in March 2019, machinery and equipment accounted for the major share (29% of the total import amount, or USD 1,383 million). The second largest imports category was chemical products, which accounted for 23% of the total imports (USD 1,111 million), increasing by 18% yoy. Imports of mineral products (including energy) are the third largest import category, amounting to USD 881 million. At the same time, agricultural imports represent the fourth largest import group (with 10.7% of the total at USD 512 million) and increased by 5.23% yoy in March.

Geographically, Europe is the largest supplier of goods to Ukraine, with a 41% share of January-March imports. It was followed by Asia with a 24.3% share. Furthermore, the share of Russia in Ukrainian imports has been reduced to 13% of the total, compared to 15.3% in January-March 2018.

In March 2019, the financial account had net inflows of USD 1,310 million. The largest inflows came from foreign loans to the government and the corporate sector (USD 1,103 million) as well as direct foreign investments, which reached USD 263 million in March.

The inflows in the financial account (USD 1,310 million) fully covered the current account deficit of USD 650 million. Consequently, the overall balance of payments had a surplus of USD 652 million in March, increasing international reserves to about USD 21 billion as of the beginning of April.

Ukraine's International Reserves, mln USD



Headquarters

123 N. Post Oak Ln., Suite 410
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Email: kharkov.office@sigmableyzer.com.ua